

**FLIPPIN, BRUCE & PORTER**  
A BUSINESS OF CANTOR FITZGERALD INVESTMENT ADVISORS

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Equity markets in the US and around the world followed first quarter weakness with even steeper losses in the second quarter. The S&P 500 experienced its worst start to a year since 1970, down 20% for the first six months of 2022. International equity markets tumbled, and, with rising interest rates, fixed income markets were also weak. Investment-grade bonds fell 11% for the first half, their worst start to a year on record. Large cap value stocks, as measured by the Russell 1000 Value index, continued to outperform during the quarter, but still booked double-digit percentage losses for the three- and six-month periods.

During the second quarter, pockets of strength in the market were few and far between as global economic policy makers stepped up their efforts to combat the worst spell of inflation seen in more than 40 years. A combination of factors is to blame for the predicament in which we find ourselves. Strong consumer demand coming out of the pandemic, supply chain challenges, elevated government spending, and limited oil and gas supplies, exacerbated by Western sanctions on Russian commodities, all played a role in the spiking inflation rates. The Federal Open Market Committee hiked the fed funds rate 75 basis points in June, more than had been expected, following news that the CPI had risen to 8.6% in May. The FOMC is projecting further boosts to the fed funds rate as we move through 2022 and into next year. It will be a challenge for the committee to facilitate a soft landing whereby inflation slows but economic growth persists. Oftentimes in the past, the Fed's attempts to tamp down inflation have led to recessions. We believe that a soft landing is possible, but recession odds have certainly increased in the last few months. A recent Wall Street Journal survey of economists put the odds of recession in the next twelve months at 44%, up from only 18% in January. The odds are likely to rise from 44% as we move into the back half of the year.

Rising interest rates tend to bring about lower valuations, particularly compression in the price/earnings multiple. This has been most pronounced in the higher valuation segment of the market such as the Nasdaq. For the S&P 500, the P/E multiple has fallen from over 20 times to around 15 times this year as investors digest higher rates and attempt to discount the heightened risk of recession. Corporate earnings have generally held up well so far in 2022, but this may be temporary. Rising inflation typically impacts corporate margins as companies are not always able to pass through cost increases to consumers. Moreover, consumer spending itself usually falls as discretionary income gets eaten up by higher gasoline prices, higher rent payments and other non-discretionary costs. Relatively strong consumer balance sheets may offset some of these pressures. There is one significant bright spot in the outlook: the jobs situation remains quite strong with unemployment at 3.6% and nonfarm payrolls surprising to the upside in June. It will be important to keep an eye on the labor statistics, as rising unemployment could be a signal of forthcoming economic weakness.

While the economic outlook is uncertain and may be deteriorating, that doesn't guarantee the rough patch for stocks will continue. According to Dow Jones Market Data,

the S&P has fallen more than 15% to start a year on six different occasions. The average return for the second half of those years was +24%. This brings to mind the quote by economist Paul Samuelson that “the stock market has predicted nine of the last five recessions.” Investors always attempt to price into the market today what is expected to happen in the future, and they are not always correct. If the Fed engineers a soft landing, the market could see a significant rebound from current levels. It may be that the markets are discounting a mild recession already, which could also lead to higher stock prices from here. The worst-case scenario of a deep recession is probably not priced into the market today. Bear market returns of -30% or more are not uncommon throughout history during severe recessions. We do not believe this is the most likely outcome, but it is a risk of which we are cognizant. Therefore, with a significant drop already experienced in many securities, a major portion of the pullback has most likely occurred.

While our Equity & Dividend Plus strategy fell during the quarter, it outperformed both the S&P 500 and the Russell 1000 Value. Year to date results are significantly better than the benchmarks as well. Longer-term total returns also compare favorably to the indices, particularly the Value index. Sector weights, lower valuations and higher dividend yields were the positive factors helping portfolio performance. Activity in the quarter included new purchases of Comcast, Skyworks and Target, as well as sales of Compass Minerals, Warner Brothers Discovery and Amdocs. Cash flow generation from dividends and call option premiums remains strong, ahead of pace for our annual goals.

We encourage you to contact us with any questions you may have. For additional firm wide information please visit our website at [www.fbpinc.com](http://www.fbpinc.com) or call us at 1-800-851-3804. As always, we appreciate your continued interest in our firm.

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