TD&Co.

THOMPSON DAVIS ASSET MANAGEMENT

THE INVESTOR INSIGHT

JULY 2022

INSIDE:
Handling Bear Markets

CELEBRATING 20 YEARS AS AN INDEPENDENT RIA

Midyear Commentary

As the second quarter came to an end, we witnessed one of the worst periods in investing history. Below are some of the unpleasant facts about the first six months of 2022:

- The S&P 500 had its worst six months in 52 years
- The NASDAQ had its worst six months in its history
- The Russell 2000 also had its worst six months since the index was started in 1984
- Bonds also had one of their worst periods as well, declining double digits
- Inflation registered the highest rates since the early 1980s

Needless to say, there was no place to hide during the first half of 2022. Markets faced ongoing COVID shutdowns, which continued to impact supply chains globally; a very aggressive Federal Reserve, which in June raised rates by 75 basis points (a hike not seen since 1994); and a war that has sent energy prices spiking. Investors found themselves grappling with the most aggressive tightening of monetary policy by the world's central banks since the 1980s. With hopes for peak inflation dashed by hotter-than-expected readings in U.S. consumer prices, trepidation over an economic recession is increasing.

As of the writing of this quarterly update, many of the inflationary inputs are starting to roll over—a silver lining in a period where good news is hard to find. Pricing for oil and other commodities—all of which have been impacted by a lengthy pandemic, war in Eastern Europe, and supply chain disruptions—has started to moderate. Some of this moderation is due to consumers slowing their spending. Retail sales plummeted as the Fed aggressively raised rates, sending some blue-chip stocks such as Walmart down intra-day greater than they did during the Crash of 1987. The Consumer Confidence Index, as seen in the chart below, has reached levels not seen since the Great Recession of 2008 and the early 1980s. And the heavy selling was not limited to retail stocks: many stocks in various industries (from large-caps to small-caps), have corrected by 50% to 80% during the first six months of 2022.

One of the biggest factors impacting stocks is the Fed's rate increases and reducing its massive balance sheet. The Fed is clearly on a mission to tamp down inflation. Its mid-June 75-basis-point rate hike was larger than what Chairman Jerome Powell had projected in May, and he has hinted at another 75-basis-point increase this month. The Fed's plan is to "front-load" bigger rate hikes, in hopes that moving big and fast will solve the inflation problem sooner

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Handling Bear Markets

The point is not to predict every bear market or crash, but to psychologically prepare for them in advance. Anyone who tells you they can correctly time the market on a consistent basis is either lying or senile. Knowing that a market correction can and will occur is half the battle and therefore must be taken into consideration when it comes to your investments.

Bear markets don't feel good, but it is a necessary path the stock market must travel. Between the COVID correction and rebound, and the currently bearish environment the market has been on a crazy ride the past couple years. The S&P 500 fell 16.1% from the beginning of April through the end of June, good enough for the 16th worst quarterly return in the U.S. stock market since 1926.

Here's a look at the 20 worst quarterly returns since 1926, along with the ensuing one-, three-, five- and ten-year returns:

The Worst S&P 500 Quarterly Returns: 1926-2022

Quarter Ending	Performance	+1 Year	+3 Years	+5 Years	+10 Years
6/30/1932	-37.7%	162.9%	170.5%	344.8%	90.5%
9/30/1931	-33.6%	-9.6%	13.1%	118.2%	86.5%
12/31/1929	-27.8%	-24.9%	-60.9%	-40.7%	-16.4%
9/30/1974	-25.2%	38.1%	72.7%	117.5%	296.2%
12/31/1987	-22.6%	16.8%	48.8%	109.0%	465.9%
12/31/2008	-21.9%	26.5%	48.6%	128.2%	338.1%
12/31/1937	-21.4%	31.1%	17.8%	25.4%	207.1%
6/30/1962	-20.6%	31.2%	69.2%	94.8%	171.7%
3/31/2020	-19.6%	56.4%	???	???	???
3/31/1938	-18.6%	35.2%	38.2%	84.5%	149.8%
9/30/1946	-18.0%	6.4%	24.5%	115.4%	442.6%
6/30/1970	-18.0%	41.9%	57.4%	56.3%	127.0%
6/30/1930	-17.7%	-23.4%	-34.7%	-32.8%	-0.4%
9/30/2002	-17.3%	24.4%	59.0%	105.1%	98.6%
6/30/1940	-16.9%	5.7%	51.1%	102.3%	228.6%
6/30/2022	-16.1%	???	???	???	???
3/31/1939	-16.1%	17.6%	-11.5%	49.3%	130.4%
12/31/1930	-15.8%	-43.3%	-19.9%	16.5%	4.1%
9/30/2001	-14.7%	-20.5%	12.6%	40.1%	33.4%
3/31/1933	-14.1%	92.0%	192.1%	84.8%	95.4%
Averages		**18.6%**	**39.8%**	**65.1%**	**134.6%**

Take a look at the average returns following a steep decline in a short period of time. Past performance is not indicative of future returns, of course, but looking at history can provide some perspective.

There is a great quote from Ben Carlson that I believe nicely sums up the feeling investors have during periods of market corrections and bear markets:

> *"Over decade-long time horizons, your investment performance will mainly be derived from how you handle corrections, bear markets, and market crashes. During every single bear market there will be times when you wonder if the losses will ever stop. You will always wonder how much lower the market can go. The economic news will be terrible. Other investors around you will be depressed. Pessimism becomes pervasive."*
>
> *– Ben Carlson*

In the end, bear markets and corrections don't last forever. Stick to your plan and investment goals. Remind yourself of your investment time horizon. Do I need this money in the next 1, 3 or 5 years? Thinking through these questions can help you to stomach current market conditions, and a long-term time horizon can be the great equalizer when making investment decisions.

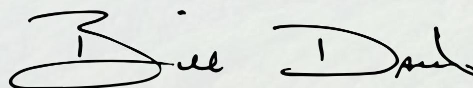
— Brant Jones, CFP®

rather than later. But I am not convinced this plan is going to work. My reasoning here is that inflation today is primarily a supply issue, and the Fed has no control over supply. I have often pointed out that bear markets, like the one we find ourselves in now, often are caused by policy errors, related to either fiscal (government) or monetary (the Fed) policy. In the current environment, I feel the Fed is making a policy error by using a blunt instrument to fight supply chain–related inflation. The Fed is also raising rates into a slowing economy, as evidenced by the –1.6% GDP print in Q1'22. Q2'22 is not looking much better: the Atlanta Fed GDP tracker currently shows Q2 coming in at –2.1%, making it the classic definition of a recession (two consecutive quarters of negative GDP).

While there are currently plenty of negative factors impacting the economy, the markets are pricing in these factors, usually six months ahead of time. Most all markets peaked last November with significant declines already priced in, thus we may be much closer to a bottom than the headlines suggest. History has shown that stock market declines and bear markets are a natural part of investing, but these declines can fill investors with dread and panic, resulting in imprudent behavior. We have seen a lot of that so far in 2022, but one must keep in mind that declines are inevitable, and they don't last forever. Unknowable factors—such as the timeline of both the pandemic and the war in Ukraine—can (and have) contributed greatly to the size and duration of the current market correction. Remember that downturns are temporary and should be used to buy attractively priced companies at discounted prices. As Warren Buffett so famously said: "The market is the most efficient mechanism anywhere in the world for transferring wealth from impatient people to patient people." Given that, I believe the Fed has been a major cause of the downside we have experienced thus far, and that it will likely reverse course (similar to what it did in 2018) as it realizes it is slowing the economy too much. In my view, the current bear market could be stopped in its tracks if the Fed were to signal even a pause in its aggressive rate-hiking campaign.

This month marks our firm's 20th year in business! I want to thank everyone involved in our success – from our stellar employees for their hard work and dedication, to our clients for their trust in us through the ups and downs of the markets. Here's to many more decades!

Kind regards,



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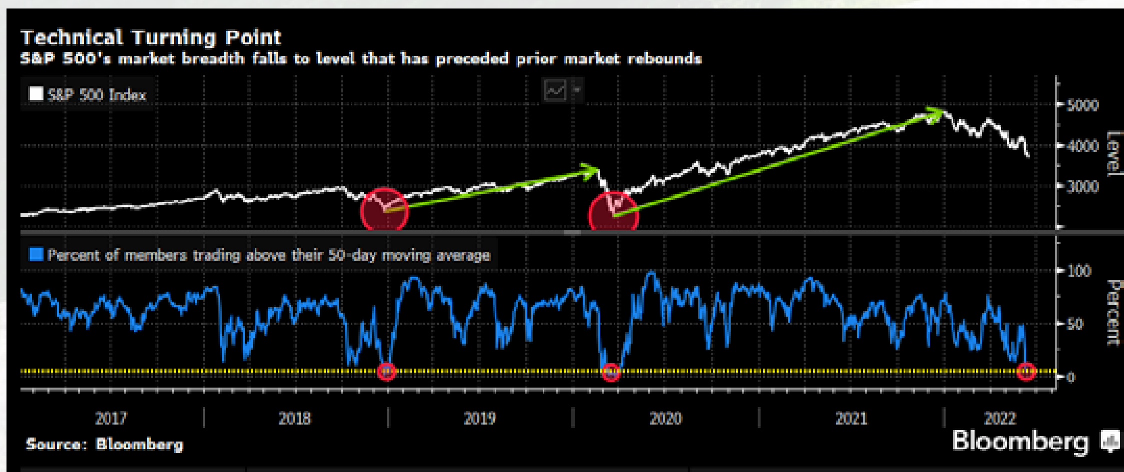

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