TC Wealth Partners

Trust Company of Illinois

BUILDING YOUR FUTURE

QUARTERLY MARKET COMMENTARY
SUMMER 2022

Exclusively for Retirement Plan Participants

FROM THE DESKS OF

William M. Giffin
CEO

Kevin Rice
Senior Investment Strategist

At the end of the second quarter the S&P 500 was down over 20%, its worst first six months of any year since 1970. The most aggressive central bank tightening in 30 years, concerns around inflation and the effect of these two factors on growth, have led to a rapid adjustment in interest rates, valuations, and sentiment. As we enter the second half of the year, most of the first half's significant headwinds are still in place: high levels of inflation, slowing growth, rising rates, Fed policy uncertainty and fallout from Russia's war on Ukraine. We offer the following perspective on how the economy, stocks and bonds are shaping up at the midyear point and what could be in store for the second half of 2022.

The economy

FIRST-HALF REVIEW:

After growing by 5.7% in 2021 the U.S. economy entered the year from a position of strength. A positive outlook was supported by pent-up consumer demand, a robust labor market and strong corporate and household finances. Yet, persistently high inflation started to take a bite out of personal disposable income and forced the Fed to signal an aggressive rate-hike path.

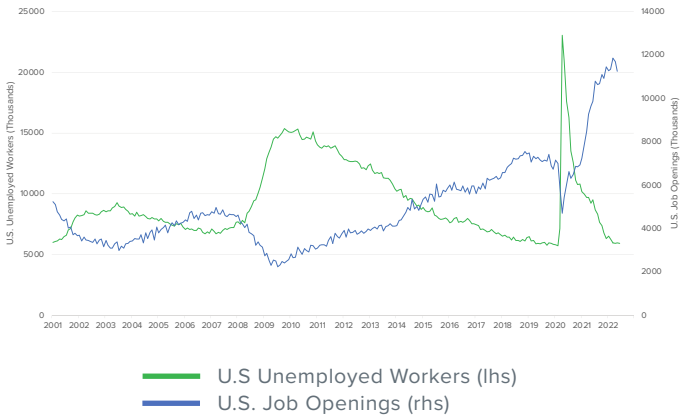
First-quarter GDP unexpectedly contracted, driven by a drag from exports and a decline in inventory spending, but consumer spending continued to grow at a solid pace. As of July 1, a real-time estimate of second-quarter GDP from the Atlanta Fed is showing a decline of -2.1%. While there is risk of another quarter of negative growth that would meet the definition of a "technical" recession (two consecutive quarters of negative GDP growth), an "official" recession, as designated by the National Bureau of Economic Research (NBER), is not expected to have occurred in the first half. The NBER relies most heavily on real personal income and nonfarm payrolls to determine when a recession starts and ends and the employment picture remained strong during the first half, while real personal income growth started to slow.

SECOND-HALF OUTLOOK:

As we move into the second half of the year, we believe that demand will likely decelerate further as consumers and businesses react to the sharp rise in borrowing costs. Typically, changes in Fed policy impact the broader economy with a lag, but the interest-rate-sensitive sectors, such as housing and autos, are already slowing.

The labor market will continue to be a bright spot in an otherwise gloomy environment. We believe the labor market will remain tight, which, along with household savings, will continue to support growth. However, initial jobless claims have been slowly rising over the past two months as companies are taking a more cautious approach to hiring. Job openings are still twice the number of unemployed workers, and we believe it will probably take a while to clear the imbalance between labor supply and demand for unemployment to rise meaningfully. We are hopeful that the Fed can engineer a soft landing. Slower growth and an aggressive Fed increases the odds of a potential recession in 2023.

U.S. JOB OPENINGS & U.S UNEMPLOYED WORKERS



Source: Bloomberg

Inflation has broadened and proven stickier, which means that the Fed's foot will remain firmly on the brakes for the economy this year. While a lot of the factors driving inflation are outside of the Fed's control, the sharp rise in rates will have an impact on demand, economic activity and eventually inflation.

Equity markets

FIRST-HALF REVIEW:

The first half of the year contained an all-time high for stocks early on, then the longest losing streak since 2001 followed, and now we are seeing an ensuing bear market, the second 20%+ drawdown in three years. With oil prices up 40% this year the energy sector was the only sector to post gains. Utilities and consumer staples outperformed as investors sought the safety of companies that are less sensitive to the business cycle. On the other hand, growth-style investments lagged the most as bond yields rose, with technology, communication services, and consumer discretionary sectors all down more than 25%. Internationally, foreign markets declined as the Russia-Ukraine war continued with no signs of a ceasefire in sight. Emerging markets outperformed developed markets thanks to high commodity prices despite rising global recession fears.

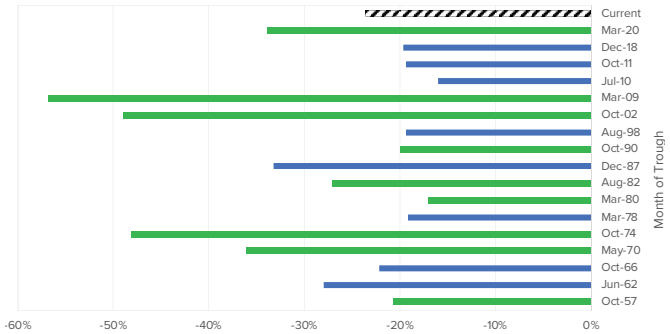
SECOND-HALF OUTLOOK:

We expect more market volatility because inflation remains far too high for the Federal Reserve's liking. As GDP growth slows and likely falls below 2% this year and next, we believe earnings expectations will move lower. Currently, analysts expect S&P 500 earnings to grow 8% this year and 6% in 2023. The kickoff of the second-quarter earnings season in the coming weeks will provide some clarity on how resilient the outlook for corporate profits is. Our belief is that current estimates will be reduced, but this year's earnings will still be able to rise from last year.

Without the benefit of Fed support, the bottoming process will likely be bumpy and prolonged.
We believe that it will require several months of moderating inflation for stocks to stage a rebound. Given the unpredictable nature of geopolitical events that affect commodity prices, we believe that the range of inflation outcomes is wide. The markets have already fallen further than in some of the past recessions, and we believe that the pullback in equities has created compelling opportunities for those with a longer time horizon.

S&P 500 PEAK-TO-TROUGH DRAWDOWNS OF >15% SINCE 1950

GREEN BARS INDICATE OVERLAP WITH RECESSIONS



Source: Bloomberg

Over the past 80 years the average bear market (11 instances including those that were triggered by deep recessions like in '07-'08) saw equities decline 35% from their peak over the course of a little over a year. Considering that stocks are currently down about 20%, and that the average bull market has lasted almost five years with stocks rising 177% on average, we believe the benefits for staying invested appear to offset the risks.

Fixed-income markets

FIRST-HALF REVIEW:

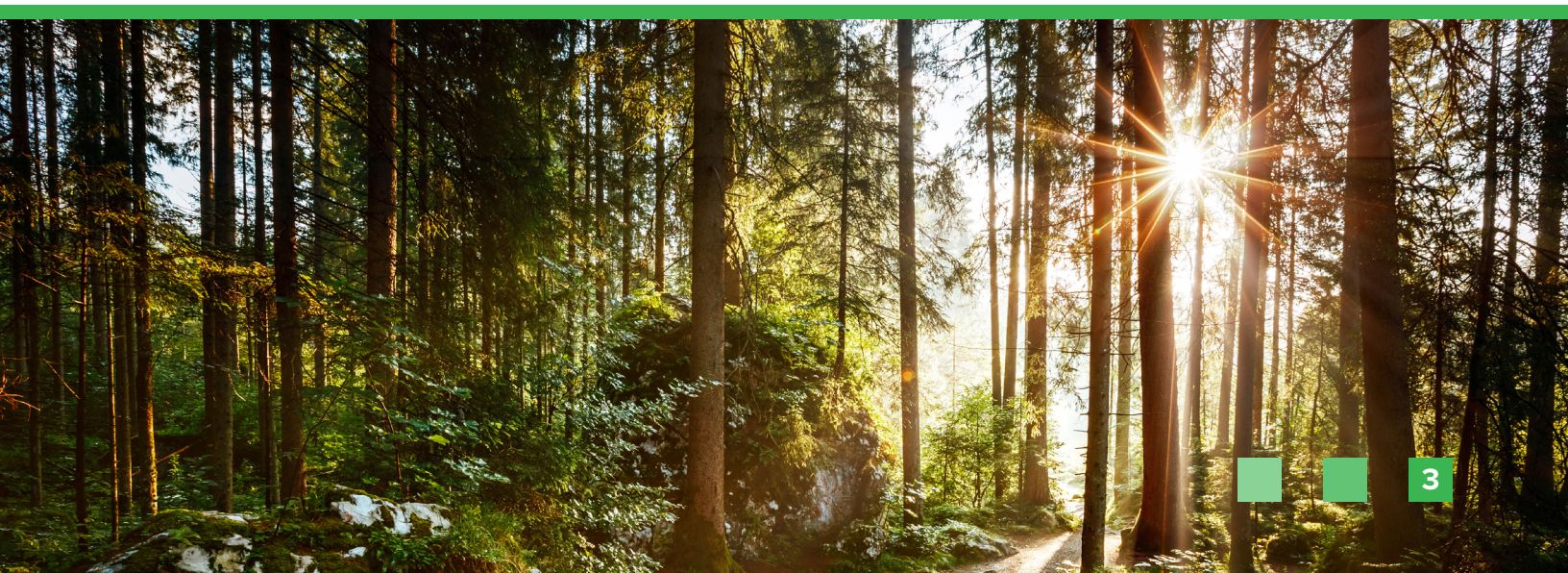
A key reason why performance for balanced portfolios (50% equities/50% fixed income) has suffered more this year than past equity market pullbacks of this magnitude is that bonds have not provided their typical diversification benefit. During this pullback bonds sold off along with stocks, as the Fed's signaling of an aggressive tightening policy triggered a major increase in yields. The 10-year Treasury yield doubled to 3.5% in six months and hit its highest level since November 2018.

The bond market priced in the fastest hiking cycle since the 1990s, with the Fed funds rate expected to settle in the 3.50% - 3.75%% range by the end of the year from 1.75% currently, indicating a mildly restrictive policy.

SECOND-HALF OUTLOOK:

We believe that the 10-year around 3.5% or slightly higher is consistent with the market pricing and the Fed's projection of what the peak policy rate will be. Historically, the 10-year has peaked about two months before the last Fed hike, on average. In our view, we are still a year away from that point, markets have front-run the Fed faster than in the past and are already pricing in an aggressive rate-hiking cycle.

Amid growth worries and recession anxiety, we think that bonds can once again show their value by helping buffer against ongoing equity-market volatility. We believe that fixed income investors are now getting paid an adequate return suggesting that bonds will be better able to help provide portfolio protection.



A WEALTH OF INFORMATION

How to Read a Mutual Fund Prospectus

With more than 7,400 mutual funds to consider in the United States alone, some investors may feel overwhelmed by the thought of deciding which ones to select for their portfolios. At the same time, most mutual fund-owning households base their purchase decisions on these measures: historical performance (94%), investment objectives and risk potential (91%), and fees and expenses (90%).[1]

Fortunately, reading a mutual fund prospectus is an essential way to learn important details about your investment options while learning more about how they may help you pursue your financial goals.

What's in a Prospectus

A prospectus is a document containing specific details about the fund's unique characteristics, designed to help investors better understand their options and make well-informed decisions. The Securities and Exchange Commission requires investment companies to provide prospective investors with a free, up-to-date prospectus for each fund they offer. Although the exact content of each prospectus varies from fund to fund, all prospectuses must include the same general information. (A shorter version, called a summary prospectus, contains much of the same information discussed here in an abbreviated format.)

Here's an overview of what you'll find in a fund prospectus — and why you should care.

Investment Objective, Strategies, and Risks

A fund's investment objective describes the financial goal it targets on behalf of shareholders. For example, the objective could be capital appreciation (i.e., providing asset growth), income (providing interest or dividend payments), or a combination of the two.

The section of a prospectus highlighting a fund's investment strategies, on the other hand, explains how the fund will invest its holdings to attempt to pursue its objectives. It typically identifies the geographic regions, industries, and types of securities the fund focuses on. It also lets you know whether the fund is actively managed or passively tracks the performance of a market index.

Types of Mutual Fund Risk

Business or issuer risk: The risk that a company in which a fund invests will do out of business or suffer another significant financial setback.

Concentration risk: The risk that a fund's holdings may not be well diversified.

Credit risk: The risk that a debt investment's issuer will not be able to make interest payments or repay the principal.

Inflation risk: The risk that the value of investments will not increase in step with rising prices.

Interest-rate risk: The risk that a fund's holdings will lose value if interest rates rise.

Market risk: The risk of loss arising from overall price declines in the broader market.

In addition, a prospectus lists the types of risk a particular fund or group of funds may entail, such as market risk, credit risk, inflation risk, and business or issuer risk. (See table for definitions.)

This information clarifies exactly what types of risk you may encounter by adding a fund to your portfolio. All investments are subject to market fluctuations, risk, and loss of principal. Investments, when sold, may be worth more or less than their original cost. Investments seeking to achieve higher yields also involve a higher degree of risk.

Fees, Performance, and Management

The fees you pay to invest in mutual funds, such as sales charges and operating expenses, can have a direct impact on your net investment returns. To offer insight into how they may influence your portfolio's bottom-line performance, a fund's prospectus specifies the types and amount of fees the fund charges. Each prospectus must include a table illustrating the effect of those fees on a hypothetical investment over different time periods. You can also find details about a fund's management team, rules for buying and selling shares, dividend payment policies, and other helpful information.

A prospectus is required to disclose the fund's performance during the past 10 years (or since inception) and to compare its performance with that of a relevant market index. Keep in mind, however, that the performance of an index is not indicative of the performance of any particular investment, individuals cannot invest directly in an index, and past performance is not a guarantee of future results.

Please consider the investment objectives, risks, charges, and expenses carefully before investing. The prospectus, which contains this and other information about the investment company, can be obtained from your financial professional.

[1]Investment Company Institute, 2021-2022

TC Wealth Partners℠

Trust Company℠
of Illinois

1901 BUTTERFIELD ROAD, SUITE 1000
DOWNERS GROVE, IL 60515
TCWEALTHPARTNERS.COM
TOLL-FREE (888) 545-2200