IRONWOOD
Investment Counsel, LLC

Ironwood Investment Counsel, LLC constructs and manages customized investment and wealth management programs designed to meet our clients' unique goals and objectives. Our distinctive process maximizes performance through return enhancement, risk reduction, tax efficiency, and cost containment.

Your Ironwood Team
14646 North Kierland Boulevard
Suite 135
Scottsdale, Arizona 85254
480-609-4700
Fax 480-609-4725
www.ironwoodic.com

Second Quarter 2022 Market Commentary

Similar to the first quarter of 2022, the second quarter was characterized by generally supportive economic indicators but declining equity and fixed income prices. There were few places for investors to seek refuge as broad stock and bond indices reached new lows for the year. The S&P 500 fell by -16.11% over the three-month period ending June 30th. Smaller, publicly traded domestic companies declined similarly as the Russell 2500 fell -16.99%. The Nasdaq Composite index, which has a greater weight to technology companies relative to the S&P 500 and Dow Industrial Average, shed -22.44%. Though returns were similarly negative, international equities outperformed returns in the United States as the MSCI EAFE lost -14.32% for the quarter. With such declines, most Ironwood equity holdings and holdings in funds used by Ironwood in client portfolios are trading at prices below fair value based on future cash flows.

At least for the first six months of 2022, fixed income did not provide the typical safety net it has historically offered when stock prices decline. While bonds outperformed stocks, the Bloomberg U.S. Aggregate Bond Index or broad bond benchmark declined by -4.69% over the three-month period. Notwithstanding that roughly 90% of a bond's total return is derived from income, there is an inverse relationship between interest rates and bond prices. The 10-year Treasury Note has significantly increased from the depths of COVID which has recently weighed on the prices of bonds. On July 1st, 2020, the rate was 0.67% and is now 2.75% at the time of this writing (July 24th). Although the increasing interest rate environment is challenging, conservative investors should ultimately benefit as their fixed income portfolios offer higher yields, going forward. Further, new bond and preferred securities purchases will offer superior returns relative to years past.

Harry Truman once famously requested a one-handed economist because he was tired of hearing economists say, "On the one hand, this" and "On the other hand, that". The current environment feels like a two-handed economy with divergent and opposing datapoints across many indicators pointing to a wide range of possible outcomes. This has caused increased anxiety among investors which have coalesced around two camps: those who believe we are already in a recession (or are headed for one), and those who believe declining stock and bond prices to be at odds with many positive economic fundamentals. One can find both positive and negative aspects of key economic indicators regarding growth, inflation, consumer behavior, employment and recent actions by the Federal Reserve. We outline these aspects of the various indicators below:

Growth
Economic growth, as measured by the US Gross Domestic Product, declined by -1.6% in the first quarter and looks to be negative in the second quarter as well. Many pundits will point to the classic definition of two consecutive quarters of negative GDP growth as proof of a recession. A closer look at some specific data, however, provides a more nuanced message. The overall negative reading was caused by a -0.5% decline in government spending and very strong US imports which dragged down growth by -3.2%. Further, both consumer spending and business investment were actually positive in the first quarter, growing at nearly 2.2%.

Inflation
The Labor Department recently reported that the Consumer Price Index climbed 9.1% from June of last year. The ascent was the fastest pace since 1981. A 60% surge in gas prices from a year earlier was the largest contributor to the latest CPI figure (up 11% from May alone). Up to this point, strong consumer demand for goods, supply chain issues, and commodity disruptions related to the ongoing war in Ukraine contributed to the persistent inflationary problem. Despite the rapid ascent of inflation over the last few quarters, there have been signs of price moderation in July. As of the time of this writing, the CRB Commodity Index, which tracks a broad basket of commodity prices, is down nearly 15% from its high in mid-May. Any further improvement in supply chains and progress towards an agricultural shipping resolution in Ukraine, known as the "bread basket of Europe", would also likely put downward pressure on inflation.

Consumers
Consumer sentiment recorded the lowest level on record dating back to 1952. Based on recent polls, the alarming level of consumer pessimism has largely been a function of inflation pressure through the escalation of prices across many important consumer spending categories. While recent data does not suggest this, lower sentiment could translate to lower spending in due time which would adversely affect the US economy. Contrary to this latest sentiment polling are retail sales and consumer balance sheets. Discretionary dollars continue to make their way into the economy as the Commerce Department indicated that consumers drove retail sales higher by another 1% in June. Further, home equity touched an all-time high at the end of the first quarter.

Employment
Carl Tannenbaum, the Chief Economist at Northern Trust indicates "that every recession has featured substantial job losses". There are still 524,000 fewer jobs than there were in February 2020 before the onset of the pandemic. Additionally, labor force participation is also below levels seen in early 2020. Relative to Tannenbaum's point on job loss, the antithesis has transpired in 2022. The Labor Department recently reported that there were 11.3 million job openings at the end of May. Further, they reported that 372,000 jobs were added in June, besting expectations. As such, the unemployment rate stayed at 3.6% putting it at a 50-year low.

Federal Reserve
To respond to recent inflation trends and hot labor markets, the Federal Reserve raised the key benchmark rate in June by 0.75%, their largest rate hike since 1994. With a similar hike planned at month end, the target rate would reside between 2.25%-2.50%. Such aggressive monetary policy is focused on slowing demand; however, much of the inflation pressure is about supply side problems. Princeton Professor Alan Blinder indicated that, "Fed Chairman Jerome Powell and his colleagues would love to unclog supply chains, alleviate food shortages, and lower oil prices, but they can't do these things. What they can do is raise short-term interest rates. That will help, but don't expect miracles".

Despite relatively late Fed action, wage gains appear to be moderating as they slid from 5.8% for much of the first quarter to 5.5% in April. In the short term, inflation eclipsed these wage gains (8.3% compared to 5.5%). While neither figure is overly positive, this relationship is important given the magnitude of potential wage pressure on earnings. Thankfully, wage pressure has primarily been associated with lower hourly positions thus far.

We do not know if the numerous economic indicators mentioned above will ultimately improve or deteriorate. Nor do we know if the Federal Reserve can raise the benchmark rate enough to slow demand but avert a recession. Only time will tell. Regardless of the direction of the economy or Federal Reserve policy action, we are committed to our investing philosophy of selecting and owning high quality fixed income and equity holdings with consistent and growing earnings and long-term competitive advantages. Often, uncertain economic times, like current conditions, present the optimal opportunities to acquire quality assets at prices not often found when the consensus forecast is for blue skies ahead.

We are grateful for the continued confidence you have placed in us. As always, please let us know if you would like to set up a time to review your financial objectives and portfolio structure.

Ironwood Investment Counsel, LLC