BULL & BEAR BULLETIN

June 2022

Bear is Out From Hibernation

As of mid-June, the S&P 500 was down over 20%. This is a widely held mark to record a bear market regime. For the next twelve months, the S&P 500 index, which is at a level near 3,700 at the time of this writing, is expected to see the combined companies in the index produce $236 of forward earnings. If investors hypothetically buy the index at this level, they in effect are buying the combined earnings of all the companies at a yield of 6.3%. This is a different concept than the dividend yield which is actual distributions that may be paid to investors who hold company shares.

A significant inflationary episode is like throwing a giant curveball. In other words, the $236 of earnings and the 6.3% earnings yield begin to be treated as subject to a host of uncertain variables that become for a time much more difficult to predict. What is playing out now in terms of policy and in the environment around us is reasserting monetary policies that are restraining which is believed will bring back more certainty with regards to the stability of prices. This is a needed action that should bring about better conditions for all businesses and consumers alike.

What are some of the most important concepts and features in and around the policy, risk and business operating backdrops in this current environment? In order to make an attempt to provide some clarity from a market operator view, we can put forth a few things. *First*, sustained periods of higher inflation have not been seen since the 1970s and, while some of the current period's inflation dynamic such as the rising energy costs, is similar to that era it is also distinctly different. For example, the 1960 through 1980 period saw the working age population growing at a more rapid pace versus today, as the baby boomers came online in their peak consumptive years. *Second*, from a policy standpoint, it has generally been considered appropriate to run a proactively restraining monetary policy well in advance of it arriving, else the price instability can compound even further as consumer attitudes and therefore behaviors about expected future inflation solidifies, not in a good way. *Third*, the amount of total credit system debt including corporate, household and government aggregate levels is historically very high. *Lastly*, monetary policymakers are saying that more supply of things like food and energy are not easily brought forth with the levers that they have control of but rather, what they can accomplish is to tamp down demand for goods and services to a degree which will lessen the upward force on prices.

In future months and quarters, incoming data will reveal where the economic and corporate health conditions are. The Federal Reserve is now proactively engaged to bring monetary restraint forward. While the bears have begun to win out more recently, what is up for debate at present is the level of weakness that may persist and on what timeline will inflationary pressures abate.

Bulls would argue that while an economic slowing is upon us, the intensity will likely be shallow and not necessarily automatically recessionary. Mid-growth cycle slowing does often occur and an engaged Federal Reserve attacking inflation pressures can quickly deflate some of the hotter parts of the economy, thereby reducing some of the headwinds to growth. This stability would then allow corporate and business America to re-engage with consumers to deliver goods and services in an equilibrium environment as opposed to one that is out of whack.

Bears are arguing that growth will slow down more aggressively. This may be due to the idea that the tightening and restraining process was not conducted soon enough and now policymakers may have to be more aggressive to bring inflation under control. This process will necessitate more of a growth and corporate earnings adjustment than is currently widely thought.

VALICENTI ADVISORY SERVICES, INC.

400 East Water Street
Elmira, NY 14901
607-734-2665
Fax: 607-734-6845

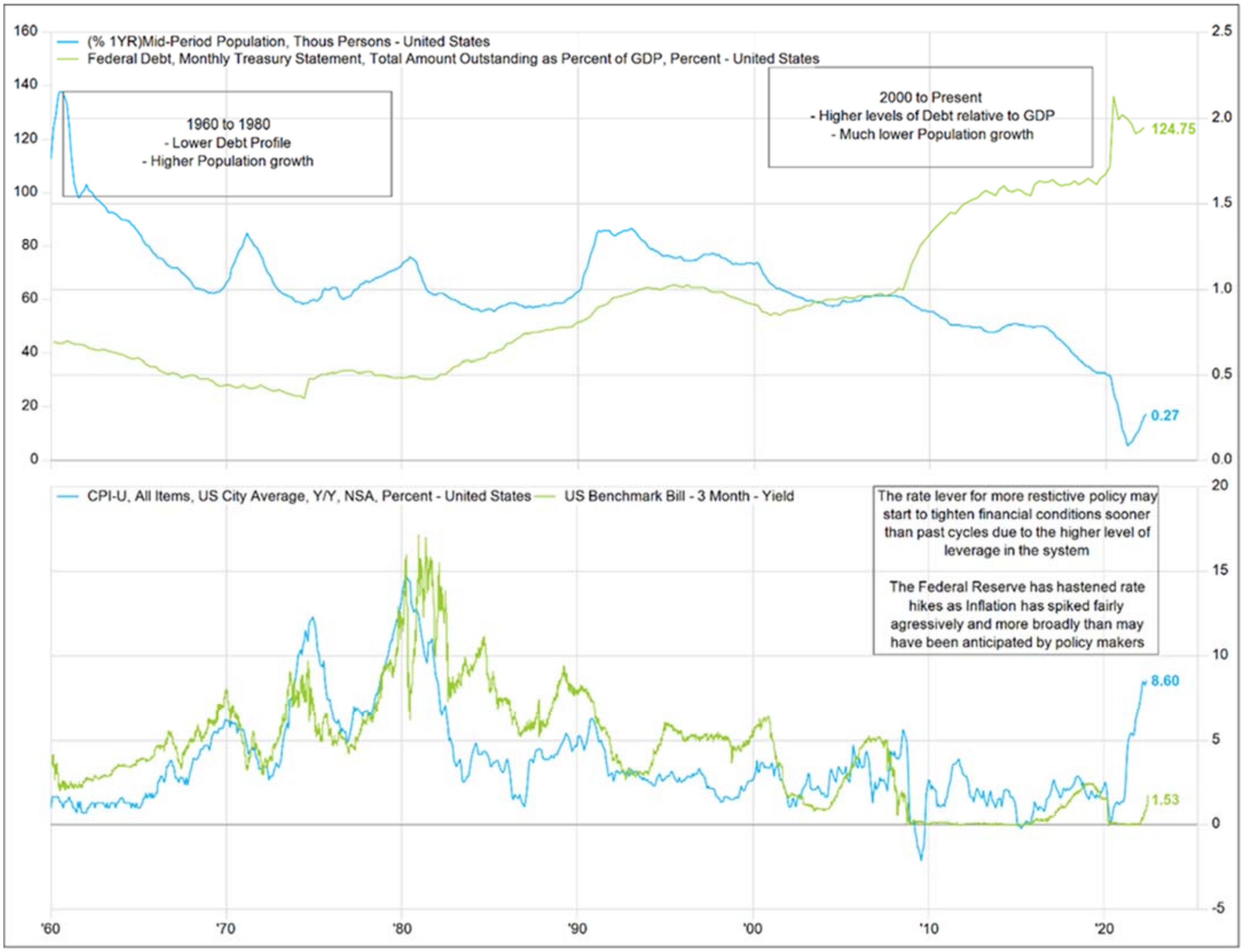
447 East Water Street
Elmira, NY 14901
607-733-9022
Fax: 607-734-6157

24 West Market Street
Corning, NY 14830
607-936-1203
Fax: 607-936-0213

www.valicenti.com

An on-line publication by The Investment Committee

It does not appear that either argument at present is winning a majority of adherents and the balance of participants is still patiently, though anxiously, awaiting more data and understanding of the uncertainty of the fluid moment. Market participants have in some cases increased assessments of recession risk as viewed in survey results and anecdotally. On the brighter side, longer term (5 to 10 years) expectations for inflation are still relatively subdued in the vicinity of 3% to 3.3% based on survey and market indicators. This, of course, is much lower than what we are currently observing in the trailing inflation figures, so expectations are considered "anchored" out into the future. This is a strong vote that there is a high level of confidence in the overall system's ability to fight effectively against the current price instability. While it is not the most comforting thing for consumers and investors to hear living through this moment, the poignant observation may be that the necessary act of tightening financial conditions further may be needed in order to bring about a lower inflationary growth environment sooner.



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