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Last week's S&P 500 Index: -4.7%

Take a deep breath

Key takeaways

- We believe the financial markets are pricing in much of the bad news we expect to hear in coming months.
- Seek to take advantage of this correction and any further downside that may occur by incrementally putting cash to work.

It's easier said than done. We know the stock market doesn't just go up in a straight line. We also know the nearly 40-year downtrend in long-term interest rates, as measured by U.S. Treasury yields, had to come to an end at some point. As investors attempt to digest what have been meaningful negative returns for both stocks and bonds this year, it is helpful to look at history and realize that at some point inflation will ease, financial markets will stabilize, and the Federal Reserve will be finished hiking interest rates. While those things won't likely happen tomorrow or next week, we believe the markets are pricing in much of the bad news we expect to hear in coming months.

That's not to say stocks have found an ultimate bottom or interest rates won't go higher, but our view is that price moves over the past six or seven months have been in anticipation of what we believe is likely to occur. After all, the stock market tends to be an anticipatory mechanism. Should the economy slow and eventually fall into recession and inflation stays higher for longer, we believe financial asset prices have adjusted to reflect this likely reality. But, eventually, brighter skies will be on the horizon.

We have been positioned more defensively since March of this year. We are comfortable that we have noticeably reduced much of the cyclical, or sensitivity to the ebb and flow of the economy, in portfolio allocations. We have moved allocations from equities into short-term fixed income. Our strategy conversations of late have largely been focused on when it might be time to get more positive on stocks and bonds rather than how to move portfolios into an even more defensive posture.

However, based on our work, the U.S. economy is likely to fall into recession late this year. We expect the recession to last into the middle portion of 2023. Historically, looking back at every U.S. economic contraction since 1948, the S&P 500 Index has bottomed out, on average, four months before the end of the recession. That means we need to anticipate where the economy is headed and, optimally, begin to adjust allocations to reflect potential improved conditions in advance.

So our recommendation to be patient remains intact. We want to take advantage of this correction and any further downside that may occur by incrementally stepping into the market with sidelined funds. For now, we are focused on U.S. over international exposure and larger (and mid) cap equities over small caps. A quality bias means buying companies with good balance sheets, easy access to credit, and attractive cash flow.

Our advice to investors is to take a deep breath and have confidence in your well-thought-out investment plan. We know that financial asset prices are susceptible to periodic corrections due to a variety of uncertainties. The current period is one of those times. We continue to believe that one of the best ways to benefit from the future growth potential of the global economy is by owning stocks. Stay invested.

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