5956 Sherry Ln # 1600
Dallas, TX 75225
(214) 361-5383
www.ackermancapital.com

ACM QUARTERLY MARKET COMMENTARY – SECOND QUARTER 2022

Capital Markets

The second quarter was difficult for investors. Global stocks declined 15% and are now down 20% year-to-date, which is the worst first half start since 1970. Aggregate and municipal bonds were also down in the quarter, bringing their year-to-date losses to about 10% and 8%, respectively. For bonds, that represents the worst first half on record. Therefore, it should come as no surprise that balanced portfolios with both stocks and bonds suffered their largest first half loss since 1932, a time near the depths of the Great Depression. In addition, the Great Depression was accompanied by significant deflation whereas today we are experiencing high inflation. In terms of the real purchasing power of balanced portfolios, the first half of this year represents the largest decline on record.

The first half of 2022 also represents the first time since the 1981 inception of the dataset of seven asset classes (U.S large cap stocks, U.S, small cap stocks, international stocks, emerging market stocks, U.S. Treasury bonds, U.S. Corporate bonds, and real estate investment trusts) that all of them were down 7% or more from the start of the year. Gold and cash were the only two asset classes that avoided significant losses and commodity indices were the only asset class to deliver solid gains.

Within asset classes, the themes of the first quarter continued into the second quarter. Growth stocks were down much more than value stocks. U.S. stocks fared better than international stocks, though emerging markets stocks enjoyed a bit of a second quarter comeback. In fixed income, longer maturities and and bonds with lower credit ratings experienced larger losses.

From an economic perspective, this is certainly not 1932, a year in which unemployment was nearly 25% and shanty towns were pervasive across all major U.S. cities. Presently, GDP growth has turned slightly negative over the last two quarters, but unemployment remains low at 3.6% highlighting the resilience of the labor market. We do face one notable problem, which is stubbornly high inflation, as the most recent CPI reading exceeded 9%. This inflation is primarily a result of the dramatic expansion of the U.S. monetary base that helped the U.S. avoid a recession in 2020 and 2021 as a result of the Covid pandemic. Current inflation has been exacerbated by supply chain disruptions, a workforce that has been slow to re-engage, and the Russian invasion of Ukraine, among other factors. The Fed underestimated this inflationary wave, but has recently taken aggressive action with back to back 0.75% Fed Funds rate increases in June and July. Most signs now point to inflation pressures that will ease in the second half of the year. The question is by what magnitude and whether the inflation fire can be snuffed out without the U.S. economy falling into a recession.

Portfolio Update

It should come as no surprise that our portfolios, which are predominately comprised of stocks and bonds, have experienced losses this year. It has truly been a diffcult stretch. However, on a relative basis,our portfolios have held up well thanks to our combined value/momentum approach. Most importantly, as a result of this discipline, we have been emphasizing U.S. value stocks over plummeting U.S. growth stocks since the beginning of the year. In bonds, we have been correctly leaning toward shorter maturities and higher credit quality. Albeit modest allocations to gold and commodities at the expense of bonds have also been marginally helpful. In our tax-advantaged portfolios, small allocations to certain Alternative funds have delivered gains in aggragate. At the margin, most of our tactical moves and positioning this year have been timely and directionally correct. The one glaring error was the purchase of a Bitcoin futures fund earlier this year, but that was only for tax-advantaged portfolios and was sized at a mere 1%.

In tax-managed portfolios we have also been actively and aggressively harvesting tax losses all year. In fact, this has accounted for more than 80% of our trading activity this year. Tax harvesting involves the sale of a fund with a meaningful and often short-term unrealized loss paired with a corresponding and nearly simultaneous purchase of a similar fund. These transactions incur no commissions and are nearly frictionless due to the tight bid-ask spreads of the highly liquid ETFs that we prefer to own. By engaging in such activity, we book losses that can later be used to offset future realized gains, maximizing the tax-efficiency of our investment gains over time. Few hands-on, active portfolio managers put the time and energy that we do into this important but often underappreciated practice.

Looking Forward

Our long-term outlook for the global equity markets remains positive with a *nominal* expected annual return estimate of 8.4%. The long-term outlook for bonds continues to improve as interest rates rise with *nominal* expected returns of 3.8%. Therefore, given the current inflation backdrop, real return expectations for even the most equity-heavy balanced portfolios remains negative in the short-term. We are of the belief that underlying inflation pressures have already peaked, and that the economy is quickly losing steam as consumers' wallets have already been penalized by these persistently high prices. As a result, the Fed's delayed and now aggressive response to inlflation will likely keep our economy weak for the remainder of the year. This may not be the worst outcome, as it may be what is required to completely put out the inflationary fire. However, it also suggests the stock market decline may have another downleg left in it, but the bond market mayhem is probably behind us. As such, we are inclined to use the stock market rally that we have enjoyed in recent weeks to move to a more defensive posture by trimming equity exposure and adding to bonds.

ACKERMAN
CAPITAL MANAGEMENT

5956 Sherry Ln # 1600
Dallas, TX 75225
(214) 361-5383
www.ackermancapital.com

Legal Disclosure

The commentary included in this quarterly review ("Content") is for illustrative and informational purposes and is not intended to provide investment advice and should not be relied upon in that regard. The Content herein is not intended as a recommendation to invest in any particular asset class, product, security, derivative, commodity, currency, or strategy or as a promise of future performance. Reference to future or expected returns are not promises or even estimates of actual returns a client portfolio may achieve. Any assumptions, opinions, and estimates are provided for illustrative purposes only and not a guarantee of future performance. Forward-looking statements should not be relied upon as actual results may differ materially from those anticipated.

The Content herein (quantitative or qualitative) is subject to numerous assumptions, risks, and uncertainties, which can change over time. This material represents an assessment of the market and economic environment at a specific point in time and is not intended to be a forecast of future events or a guarantee of future results. Forward-looking statements are subject to certain risks and uncertainties. Actual results, performance, or achievements may differ materially from those expressed or implied. Information is based on data gathered from what we believe are reliable sources. It is not guaranteed as to the accuracy, does not purport to be complete and is not intended to be used as a primary basis for investment decisions. It should also not be construed as advice meeting the particular investment needs of any investor.

Neither Asset Allocation nor Diversification guarantees a profit or protects against a loss in a declining market. They are methods used to help manage investment risk. This report does not constitute an offer to sell or a solicitation of an offer to subscribe to ACM portfolio management. Portfolio holdings entail risks and are subject to change without notice. All data, unless stated otherwise, is as of the latest quarter-end. Past performance is not a guarantee of future results.

Investment advisory services offered through Ackerman Capital Management, L.P., a registered investment adviser.