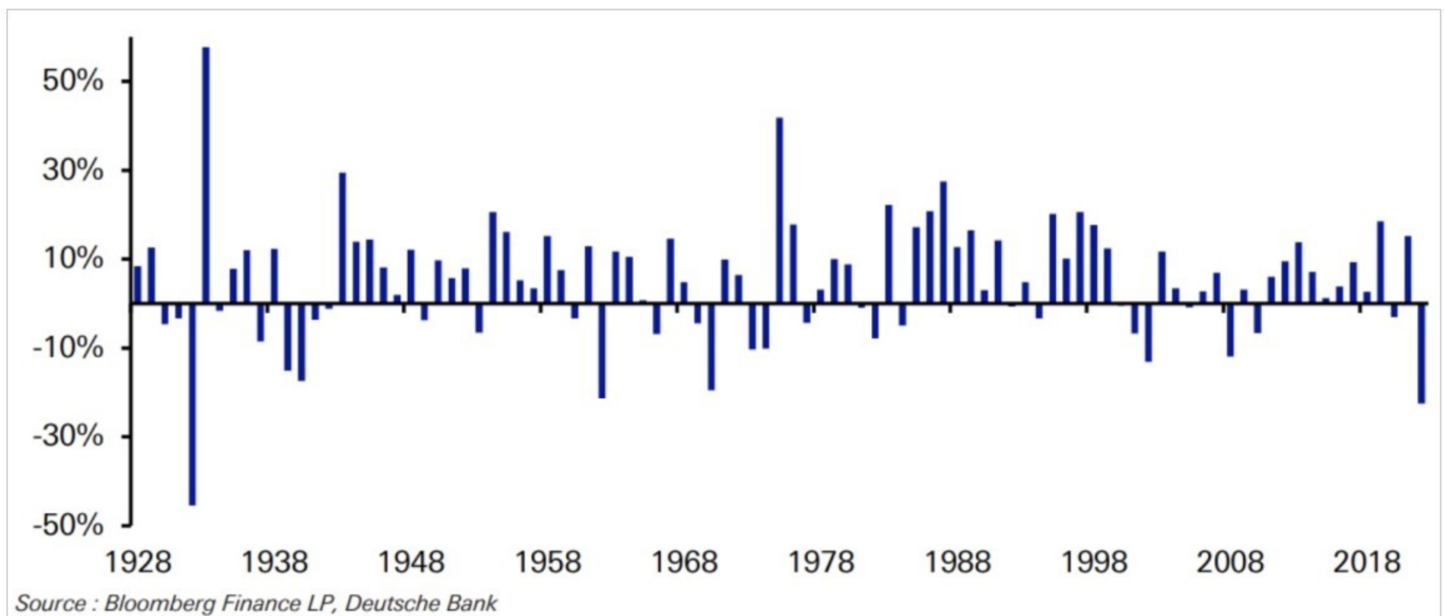
Chart of the Month

June 2022

S&P 500 First Half Performance
1928-2022



Stocks and bonds are on pace to suffer their worst first half in more than 50 years. Through Tuesday, June 28, the S&P 500 and the Bloomberg U.S. Aggregate Bond Index were down approximately 20% and 11%, respectively, since the start of the year. If the markets remain flat to down the rest of the week, it would mark the first time that stocks and bonds have both declined more than 10% in the opening six months of the year. In fact, this combination is so unusual that the last eight times the S&P 500 was *down* in a calendar year, the Bloomberg Index finished *up*, cushioning the blow for balanced portfolios.

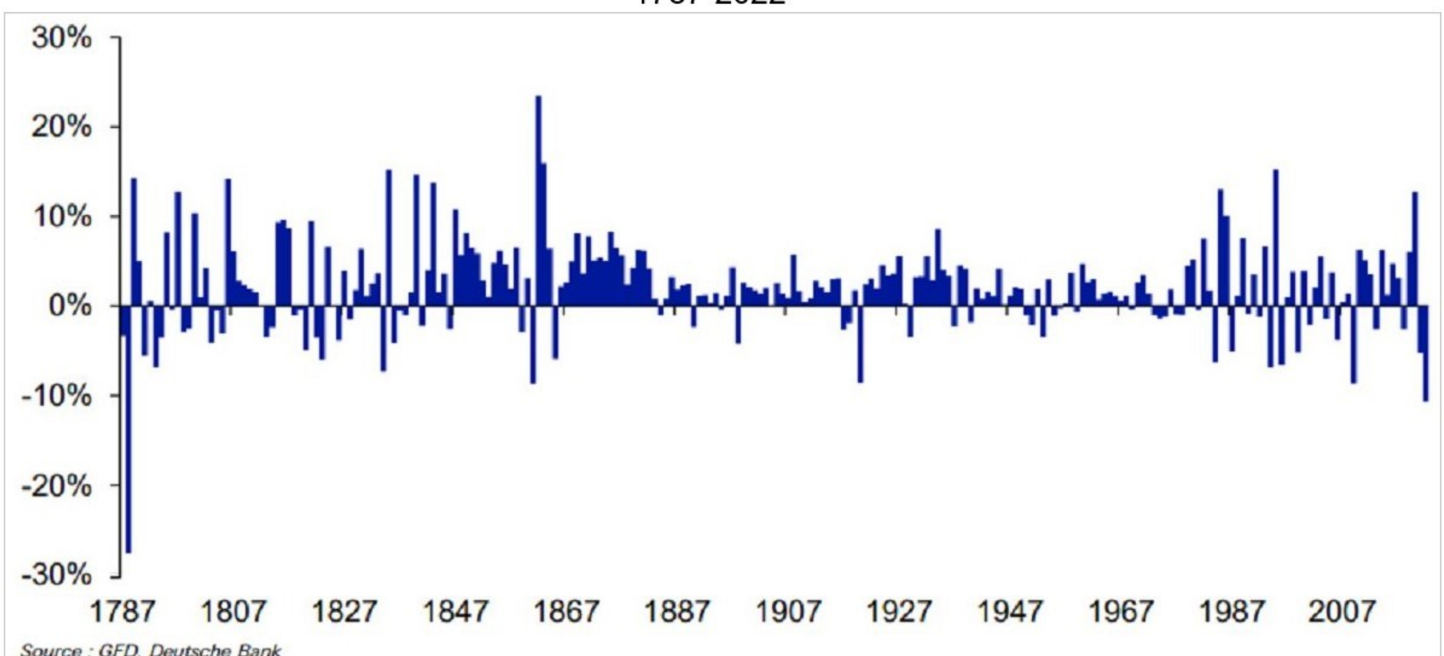
The S&P fell into a bear market (defined as a drop of more than 20% from its recent high) on June 13 and was off more than 23% at its low on June 16. After back-to-back weekly contractions of 5% (for only the eighth time since World War II), the index climbed 6.5% last week, reversing three straight weeks of losses.

Meanwhile, as shown below, U.S. Treasury bonds (and their proxies) have experienced their worst first half since 1788, the year before the founding of the Treasury. Most recently, the yield on the 10-year U.S. Treasury has ballooned from 1.63% to its current level of 3.21%, roughly doubling in six months. The yield spiked to 3.48% on June 13 in response to the higher-than-expected consumer inflation report on June 10, which precipitated a 0.75% hike in the fed funds rate on June 15, the largest increase since 1994. The yield on the two-year Treasury, which is more sensitive to changing monetary policy than longer-dated bonds, jumped 60 basis points (0.60%) in the two sessions following the CPI report to a high of 3.45%, before settling back to 3.11%.

The fed funds futures market is pricing in an 87% probability that the central bank will raise the rate another 0.75% at the July 27 Fed meeting and a 66% likelihood of a 0.50% hike at the September meeting. The expectations of the magnitude of increases have actually dropped over the past week with the mid-point of the year-end target rate now at 3.50%, well above what the Fed deems to be its "neutral" rate of 2.00-3.00%. The move from a highly accommodative policy through early 2022 to a more restrictive position should negatively impact economic growth while heightening the possibility of a recession within the next year.

The good news is that stocks have historically rebounded strongly from such oversold conditions over the following 6-12 months. The bad news is that virtually all recoveries from bear markets have occurred with the Federal Reserve *lowering* rather than *raising* interest rates. As a result, rallies will probably be limited in duration and size until the inflation rate rolls over and the Fed backs off its aggressive rate hikes.

U.S. 10-Year Treasury First Half Performance
1787-2022



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