

QUARTERLY MARKET GUIDE: Q3 2022

Our View of What's Most Relevant Now

July 15, 2022



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Please see important disclosures at the end of this report.

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Data in Focus: Yield Curve

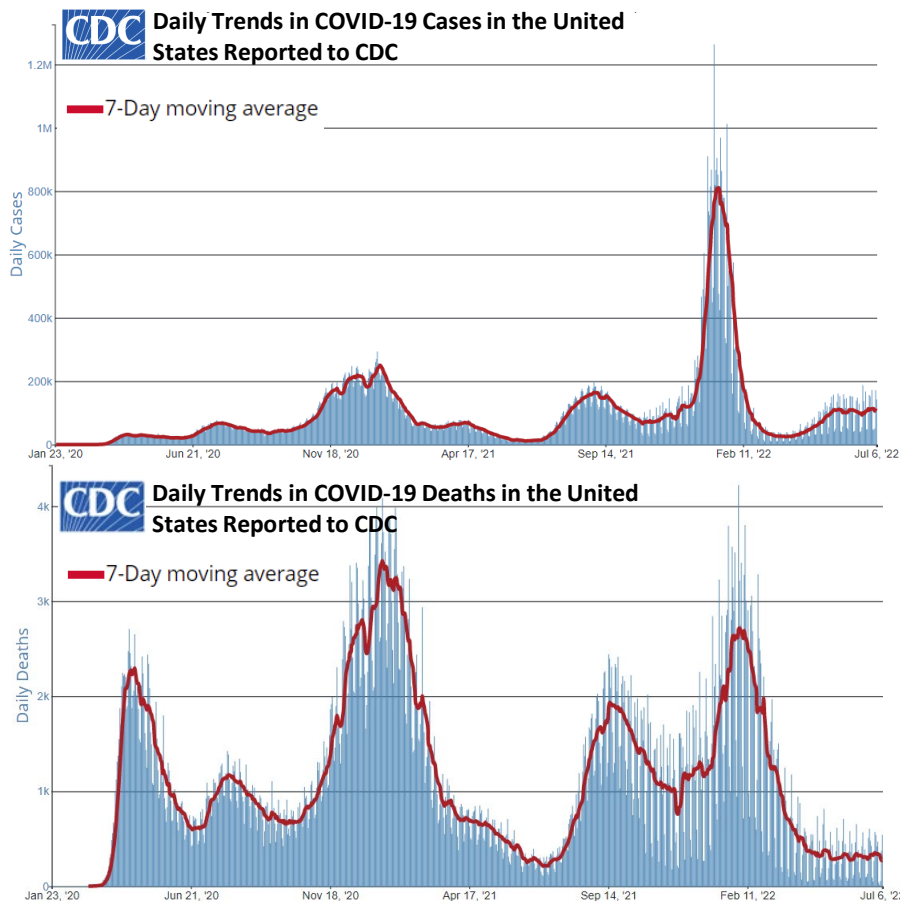


While the relevance of the yield curve inversion in April 2022 was arguable, the current inversion presents unequivocal concern about our current economic condition. *(More on pgs.14 & 15.)*

Source: U.S. Bureau of Labor Statistics

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COVID-19



Source: Centers for Disease Control and Prevention

CDC data reflects some increased infection rates since the spring. However, other reports regarding the spread of the highly transmissible Omicron subvariants BA.5 and BA.4 appear to indicate that many positive self-test results are not being reported/counted in the national numbers.

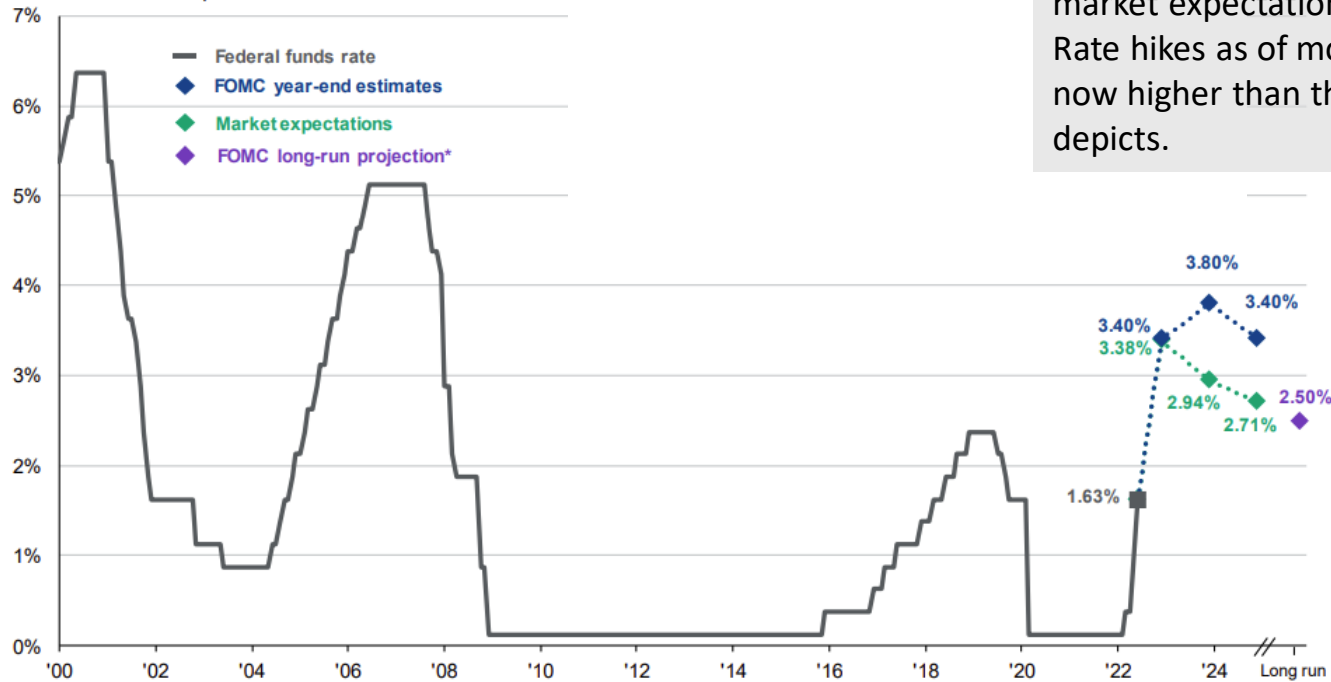
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Economy

Federal Funds Rate

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



The new cycle high just reported for CPI (see p. 5) was not reflected in the market expectations for Fed Fund Rate hikes as of month end. These are now higher than the adjacent chart depicts.

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management.

Market expectations are based off of the respective Federal Funds Futures contracts for December expiry. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

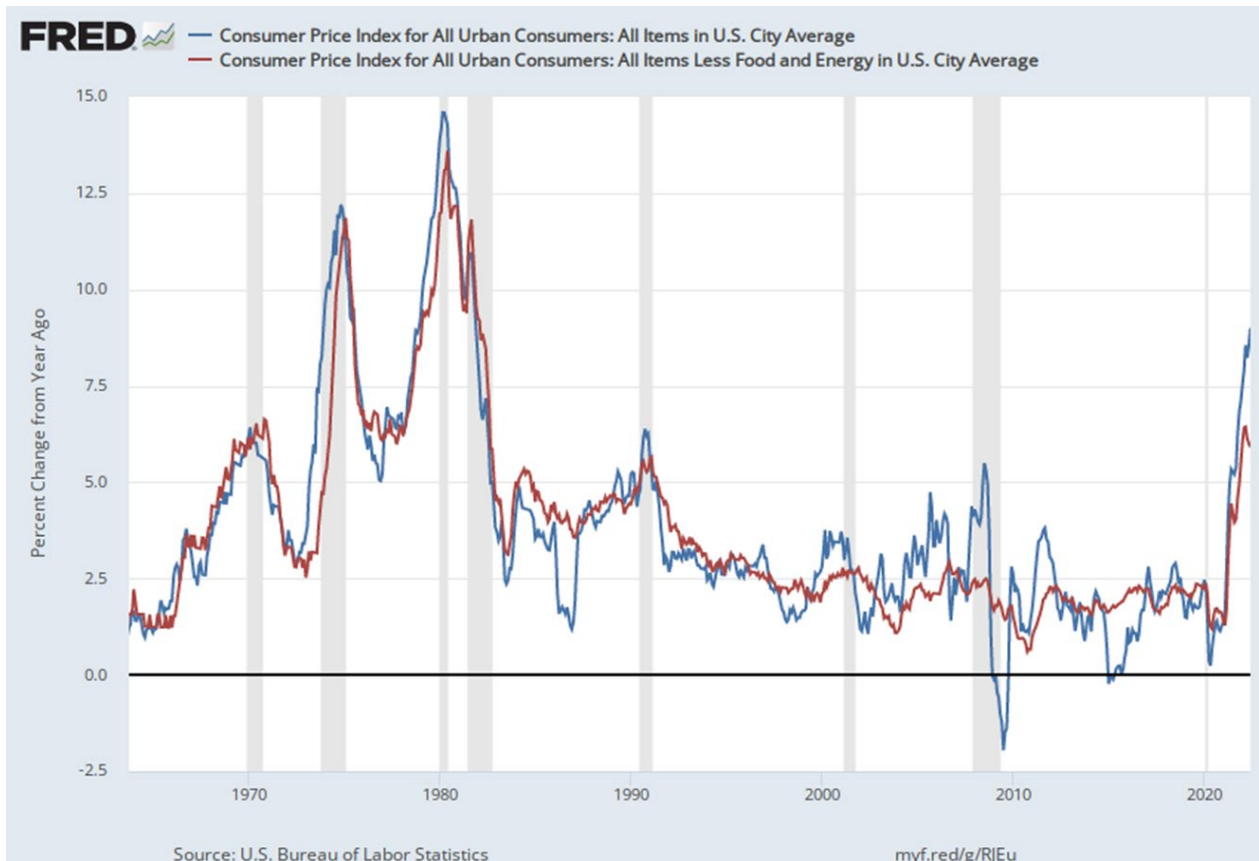
Guide to the Markets – U.S. Data as of June 30, 2022.

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Economy

Inflation

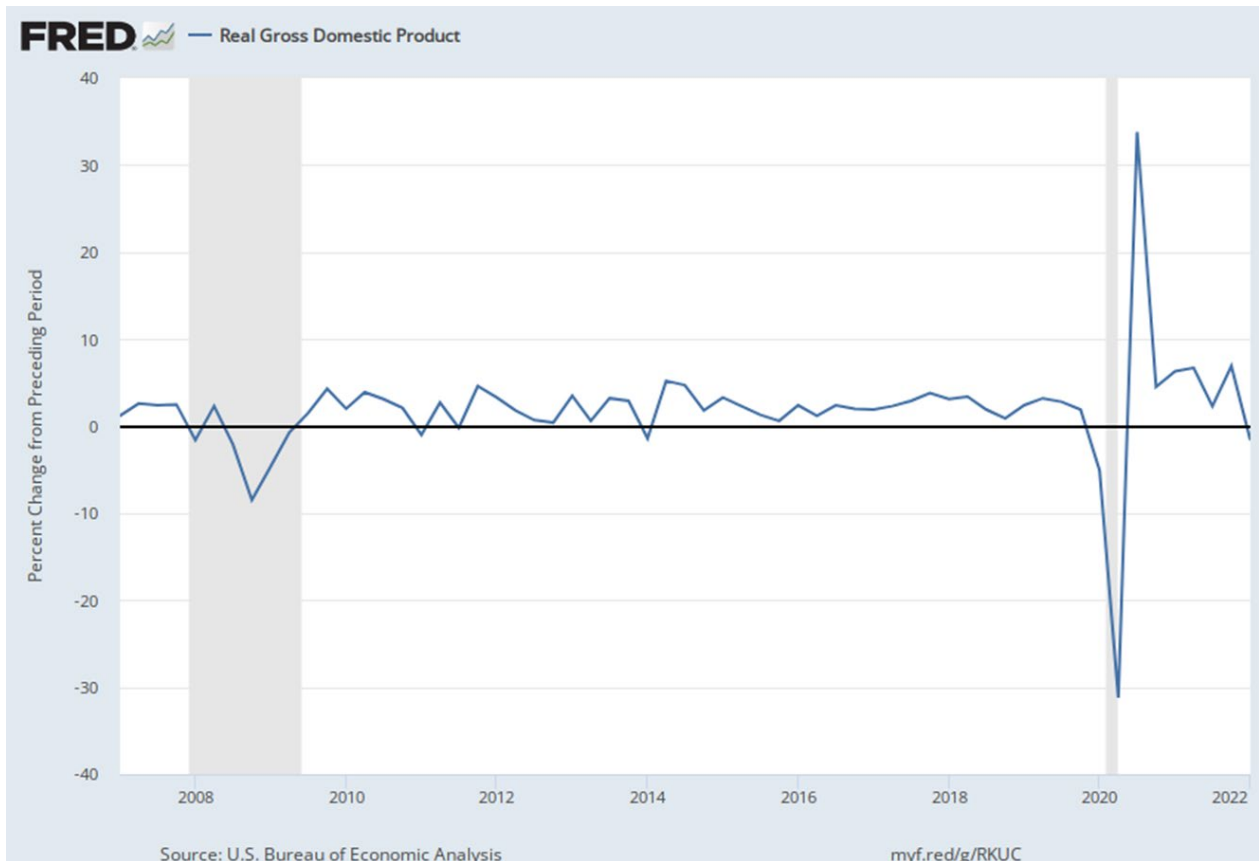


The inflation rate just reported for June 2022 was 9.1%, surprising expectations. While some upward pressures for key components have moderated since June (e.g., energy), other key measures have continued to push higher (e.g., food).

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Economy

Real GDP

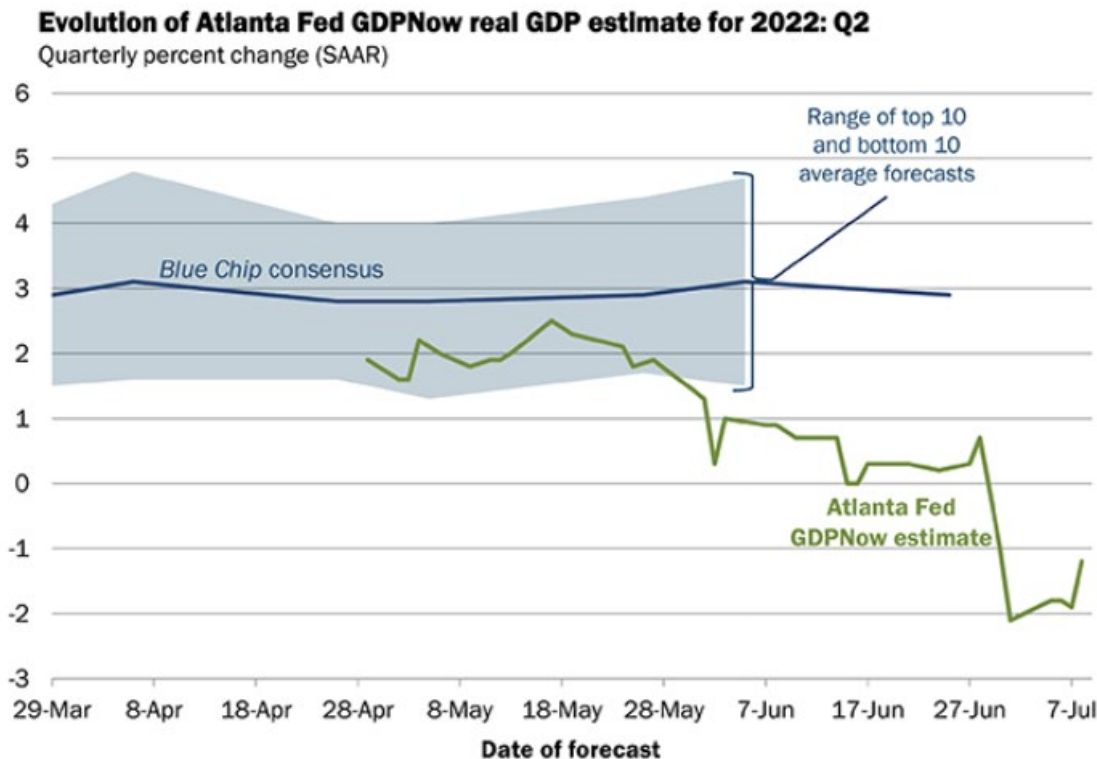


When real GDP levels are considered as a percent change from the preceding quarter, Q1 2022 decreased at an annual rate of 1.6%, a notable decline from the 6.9% increase in Q4 2021.

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Economy

Real GDP Estimate – Atlanta Fed GDPNow



Sources: Blue Chip Economic Indicators and Blue Chip Financial Forecasts

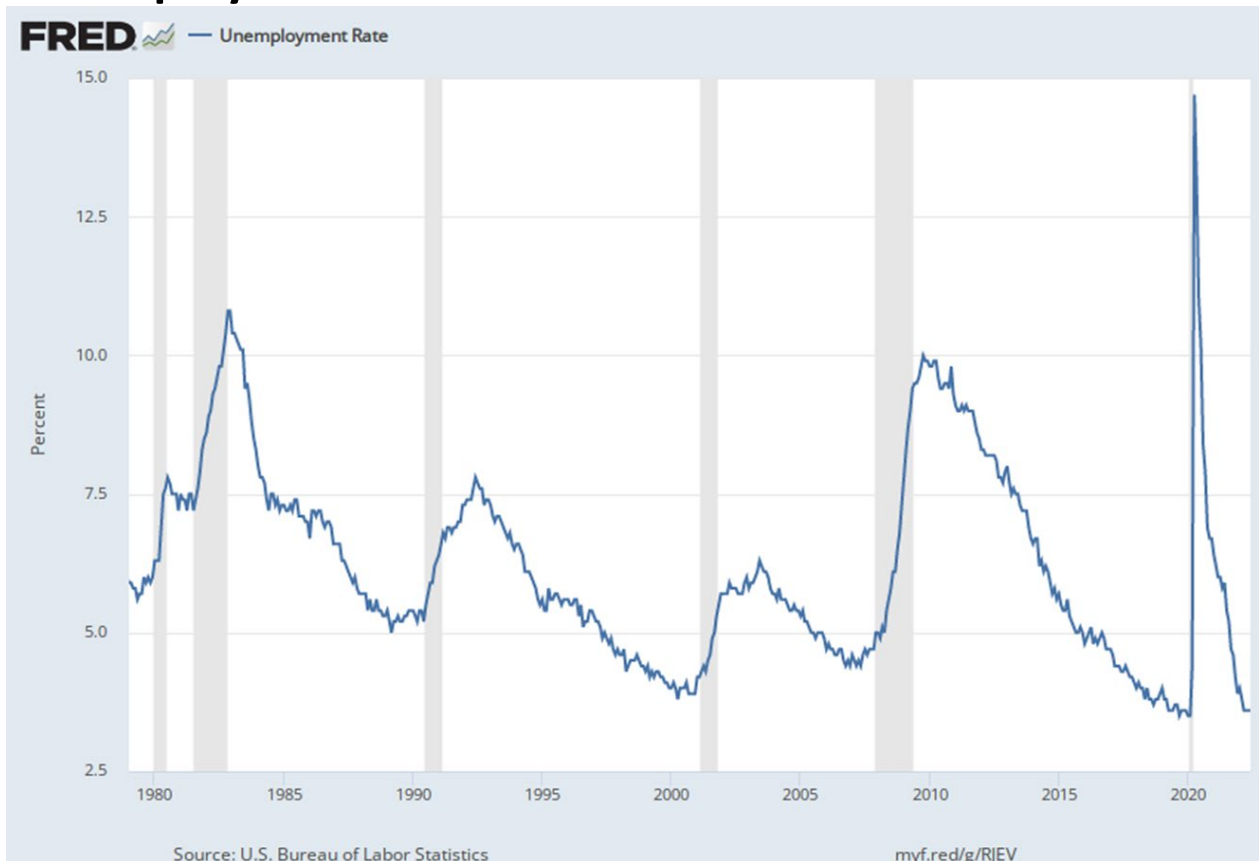
Note: The top (bottom) 10 average forecast is an average of the highest (lowest) 10 forecasts in the Blue Chip survey.

A confluence of economic headwinds became increasingly apparent as Q2 2022 unfolded. The risks to real GDP growth have been conveyed in real time by the GDP estimate offered by the Atlanta Fed.

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Economy

Unemployment Rate

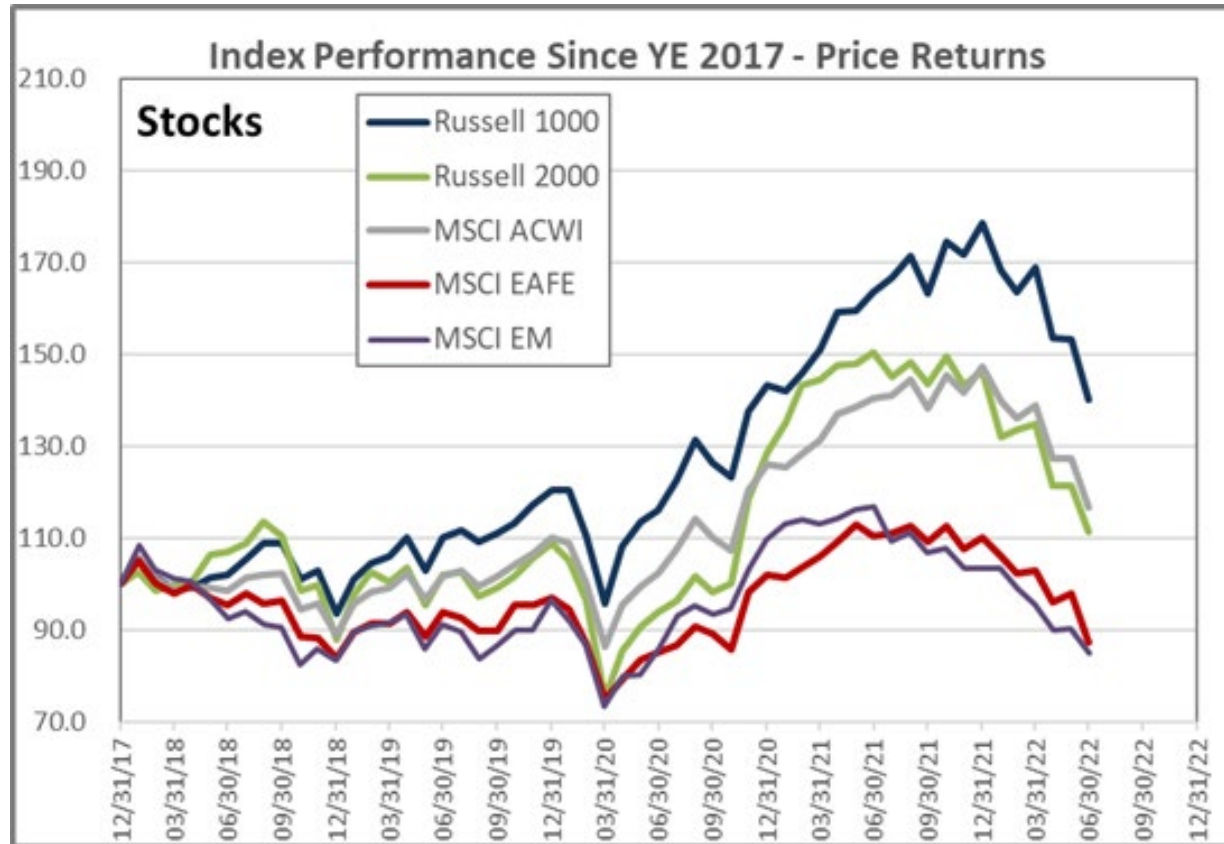


Despite the clouds of concerns about an economic slowdown, the unemployment rate remains an important silver-lining.

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Equities

Sub-Asset Class Relative Performance



Source: Bloomberg and Yahoo Finance monthly index data, with analysis by Villagran Investments LLC

Differentiation is often subordinated in bear markets. Such appears to be the case across major equity indexes year-to-date (YTD).

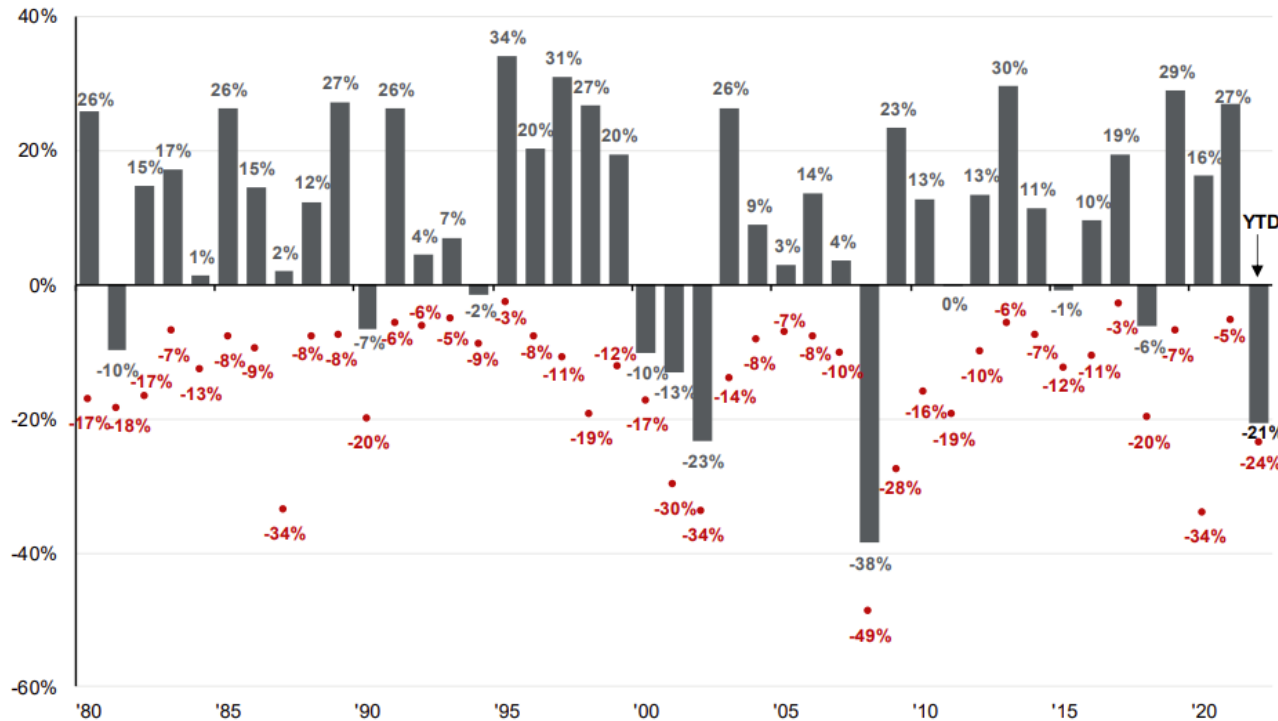
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Equities

S&P 500 Annual Returns & Intra-Year Declines

S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.0%, annual returns were positive in 32 of 42 years



Don't blame the messenger, but were a recession to be confirmed, based on prior cycles the drawdown could be materially greater than the YTD.

Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2021, over which time period the average annual return was 9.4%.
Guide to the Markets – U.S. Data are as of June 30, 2022.

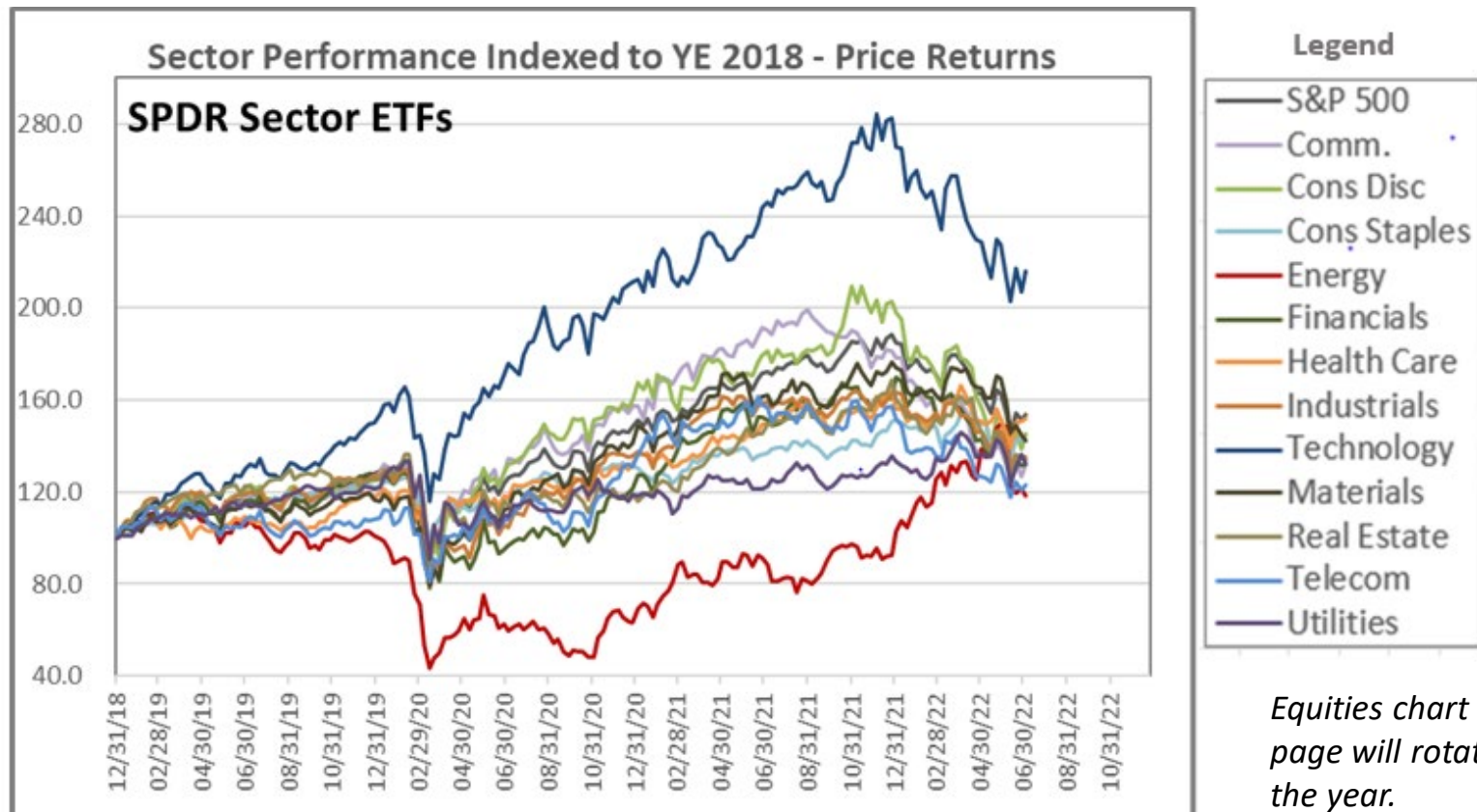
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Equities

S&P 500 Sectors Relative Performance

The relative performance of this cycle's outliers, Tech and Energy, have recently been notable by their reversions toward the mean.



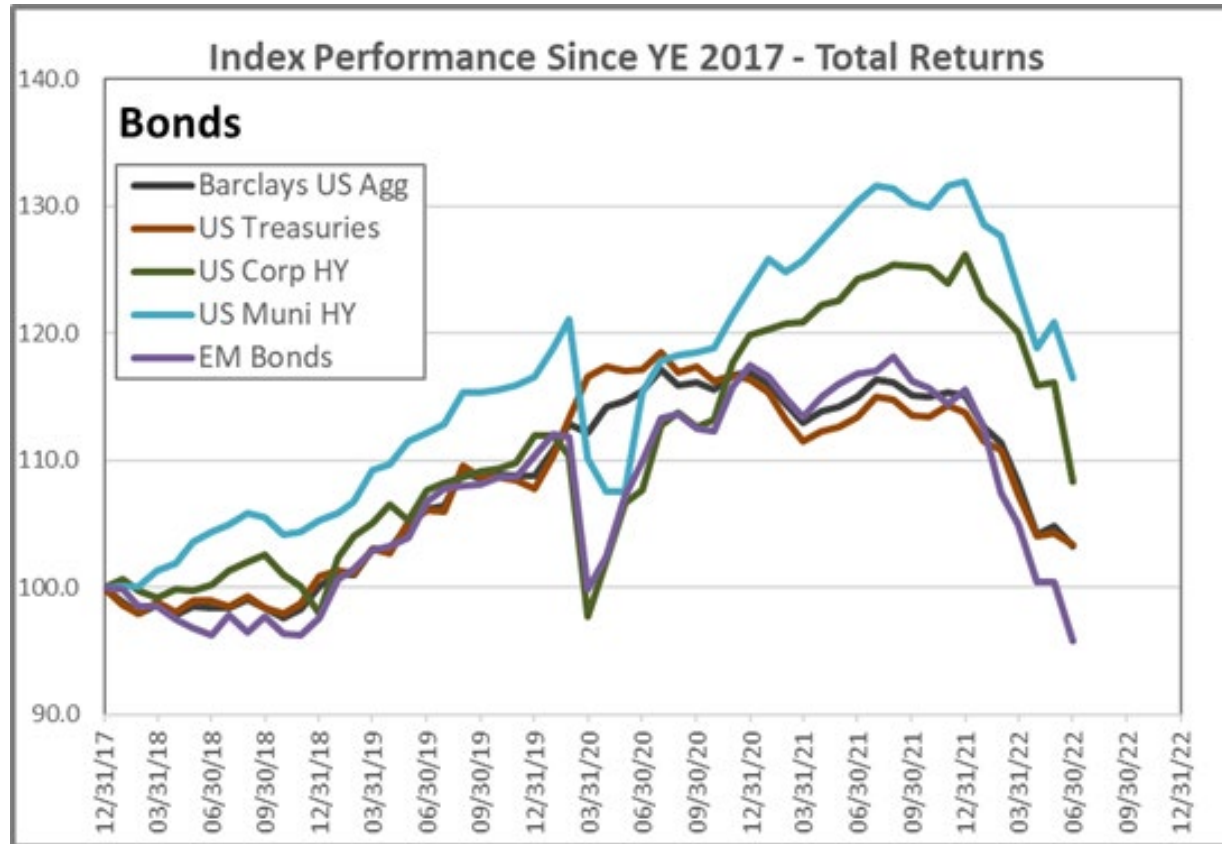
Equities chart on this page will rotate thru the year.

Source: Bloomberg and Yahoo Finance monthly index data, with analysis by Villagran Investments LLC

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Fixed Income

Sub-Asset Class Relative Performance



Source: Bloomberg monthly index data, with analysis by Villagran Investments LLC

While the YTD performance for all bond categories has been poor, we highlight the recent accelerated declines for the higher risk categories of U.S. Corp. High Yield and Emerging Market bonds.

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Fixed Income

Market Yield - U.S. Treasury 10-Year Bond

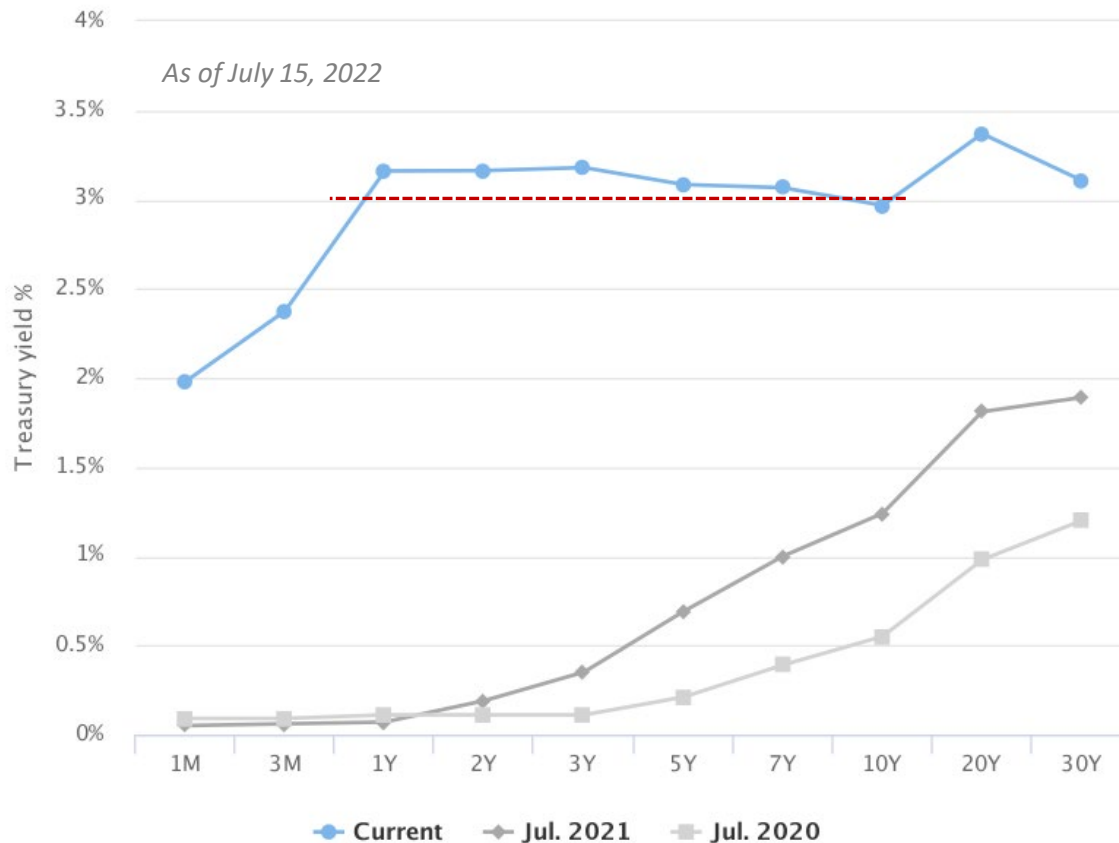


Since the recent pop higher for market rates, 10-year Treasury rates have been hovering around the anticipated terminal rate for the current Fed Funds tightening cycle.

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Economy

Treasury Yield Curve



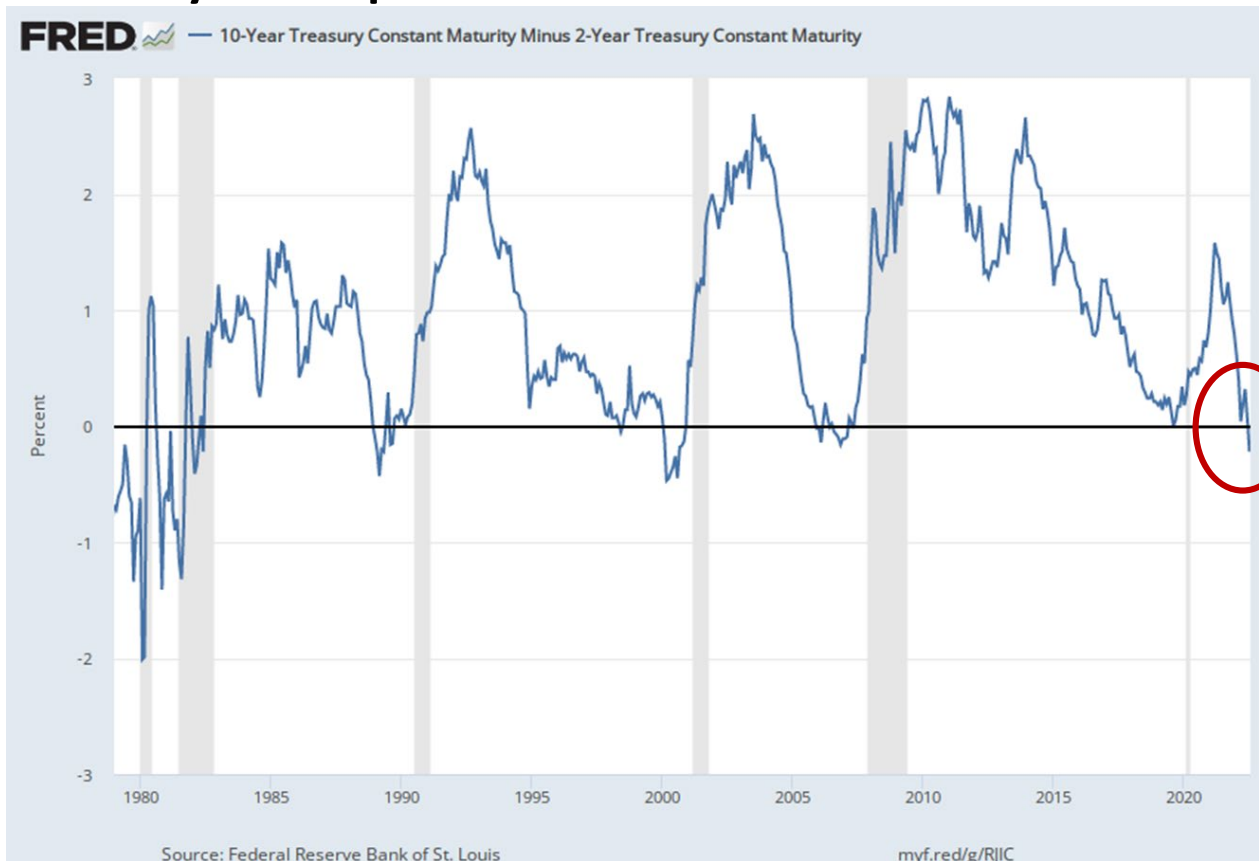
Relative to the 10-year, Treasury rates stand inverted from 1-year up and across the yield curve.

Source: GuruFocus.com

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Economy

Treasury Yield Spreads – 10-Year vs. 2-Year



Again, don't blame the messenger, but yield curve inversions have consistently foretold recessions. Seems the question among bond investors is moving away from "if" to rather "how long and/or how severe"?

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Economy

Credit Spreads – U.S. Corp High Yield vs U.S. Treasuries



The recent move in high yield spreads should serve as a reminder that High Yield bonds are often not best utilized as strategic allocations held through market cycles, particularly if the investment is pulled from investment grade bonds.

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Rafael A. Villagran, the author of this report, is a Portfolio Manager, Head of the Asset Management Department, and investment advisor representative of NWAM, LLC dba Northwest Asset Management and RIA Innovations, an SEC registered investment advisor. This publication is in no way a solicitation or offer to sell securities or investment advisory services. Statistical information, quotes, charts, references to articles or quoted statement or statements regarding market or other financial information is obtained from sources which we believe reliable, but we do not warrant or guarantee the timeliness or accuracy of this information.

Sources Include:

Centers for Disease Control and Prevention – COVID-19 Data Tracker <https://www.cdc.gov/coronavirus/2019-ncov/covid-data/covidview/index.html>

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Reference to market index information is included for illustrative purposes only, as it is not possible to directly invest in an index. Indexes are unmanaged, hypothetical vehicles that serve as market indicators. Index total return performance data reflects the assumptions of the reinvestment of interest and dividends but does not include the deduction of fees or transaction costs which otherwise reduce performance of an actual portfolio. Any blended indexes are shown for informational purposes only and are not representative of any particular investment or plan.

Definitions of Indexes Referenced

Russell 3000 – Index comprised of 3,000 largest U.S. stocks by market capitalization.

Russell 1000 – Index comprised of 1,000 largest U.S. stocks by market capitalization.

Russell 2000 – Index comprised of 2,000 smaller U.S. stocks by market capitalization within the Russell 3000.

S&P 500 – Compilation of 500 major U.S. stocks meeting certain criteria; market capitalization and float-weighted.

MSCI All Country World (ACWI) – Global equity index across market capitalizations with about 2,800 constituents, representing about 85% of the free float-adjusted market capitalization across 23 developed and 27 emerging markets.

MSCI All Country World ex USA – Global equity index across market capitalizations, which excludes the U.S., with about 2,300 constituents which represents free float-adjusted market capitalization across 22 developed and 27 emerging markets.

MSCI Europe, Asia & Far East (EAFE) – International equity index across market capitalizations, which excludes North America, with about 840 constituents which represents free float-adjusted market capitalization across 21 developed markets.

MSCI Emerging Markets (EM) – International equity index across market capitalizations with about 1,400 constituents which represents free float-adjusted market capitalization across 27 emerging markets.

Bloomberg Barclays U.S. Aggregate Bond – Widely followed bond benchmark comprised of investment grade, U.S. dollar denominated, fixed rate taxable bonds including Treasuries, government-related, corporate, mortgage-backed, and agency.

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IMPORTANT DISCLOSURES (Continued)

Definitions of Indexes Referenced (Continued)

Bloomberg Barclays U.S. Treasuries – U.S. bond index comprised of U.S. dollar denominated, fixed rate nominal bonds issued by the U.S. Treasury, and excludes T-Bills and STRIPS.

Bloomberg Barclays U.S. Corporate High Yield Bond – Fixed rate U.S. dollar denominated index of corporate bonds rated BB+ or below by Fitch and S&P.

S&P Municipal High Yield Bond – U.S. index of municipal bonds that are either not rated or rated below investment grade.

Bloomberg Barclays Emerging Market Bond – International bond index comprised of U.S. dollar denominated bonds hard currency debt from sovereign, quasi-sovereign and corporate issuers in Emerging Markets.

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