MARKET INSIGHT

Second Quarter 2022

NEWS & VIEWS FROM LPL RESEARCH

The economic forecasts set forth in the presentation may not develop as predicted. Please note: all return figures are as of June 30, 2022, unless otherwise stated. This information is not intended as authoritative guidance or tax or legal advice. You should consult with your attorney or tax advisor for guidance on your specific situation.

LPL Research

About us

LPL Financial Retirement Partners is the retirement-focused division of LPL Financial LLC dedicated solely to supporting financial professionals who service the retirement plan market. Our promise is to create services and resources so that financial professionals may deliver employers and employees exceptional experiences and high-quality programs by providing services that help save time, reduce exposure to fiduciary liability, and address both Internal Revenue Service and Department of Labor requirements. Our comprehensive analysis of retirement plans and plan design features establishes a strong foundation, and our structured service and employee communication model strives to ensure ongoing excellence.

LPL Financial Retirement Partners provides professional human capital gained through decades of experience working for, and with, some of the top defined contribution, defined benefit, and deferred compensation service providers in the industry. Our independent perspective has been utilized by thousands of companies nationwide, with billions in retirement plan assets. The economies derived from our scale and national presence enable us to give financial professionals outstanding resources to help plan sponsors evaluate, design, and negotiate high-quality retirement programs. For more information regarding our firm, please visit our website: www.lpl.com.

Second Quarter 2022

MARKET INSIGHT QUARTERLY

Q2 2022 at a Glance

Sector	Q2 2022
Gross Domestic Product*	3.0%
S&P 500 Index	-16.1%
Bloomberg Aggregate Bond Index	-4.7%
Bloomberg Commodity Index	-5.7%

Source: LPL Research, Bloomberg, FactSet, 6/30/2022

* Bloomberg consensus as of 6/30/2022

Figures for S&P 500 Index, Bloomberg Barclays Aggregate Bond Index, and Bloomberg Commodities Index are total returns from 4/01/2022 - 6/30/2022 (Q2)

All indexes are unmanaged and cannot be invested into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment.

Stocks Continued To Struggle With High Inflation and Rising Interest Rates

The S&P 500 Index's woes deepened during the second quarter, losing another 16.1% on the tail of a 4.6% decline in the previous quarter (including dividends) that sent the index into a bear market. The Nasdaq fared even worse, with a 22.3% decline amid persistent weakness in growth-style stocks, while the Dow Jones Industrials held up a bit better, losing only 10.8% for the quarter.

Troubles that have plagued markets since November 2021 steepened in Q2, most notably concerns about persistent inflation, which pushed the Federal Reserve (Fed) to lean further into accelerated rate hikes, marked by a 75 basis point hike on June 15, 2022. In addition to inflation, Russia's military aggression in Ukraine, elevated energy prices, supply chain disruptions, labor shortages, and consumer sentiment declining to levels similar to that of the Great Recession, all weighed on markets for the quarter.

As we progress through 2022, it is clear that inflation and corresponding Fed policy to curb price pressures will remain the major themes for the rest of the year. Given the present significant inflation challenges, along with the Fed's response to price pressures, many market participants are anticipating that an economic contraction could be in the cards. We believe that this is unlikely, at least for 2022. Improving COVID-19 conditions in China should help improve the global supply chain landscape and thus help ease supply-side driven inflation.

A Difficult Quarter Across the Cap Spectrum

Large cap stocks and their small cap counterparts both faced a challenging period during the second quarter, following a quarter where large caps soundly outperformed small caps based on the Russell market cap indexes. At a high level, small caps tend to underperform their large cap counterparts in down markets and periods of economic stress, but with the 10-year Treasury rate nearly hitting 3.5% during the quarter, valuation multiples compressed across the board. Defensive sectors led in both large and small caps, with consumer staples and utilities both posting stand-out quarters.

Value Outperformance Persists, Tech Weakened by Rising Rates

Value-style stocks continued their outperformance in the second quarter, outpacing growth-style stocks as lower-multiple stocks and cash flow-positive businesses were favored by markets. The Russell 1000 Value Index lost 12.2% during the second quarter, compared to the 20.9% decline in the Russell 1000 Growth Index. At a macro level, high inflation and rising interest rates generally creates a more favorable environment for value-style stocks. At the sector and industry level, value-style outperformance was driven relative strength in energy and defensives while weakness in consumer discretionary and technology weighed heavily on the growth side.

Russian Energy Dependence Weighs on Europe

The U.S. outperformance witnessed in 2021 and the first quarter of 2022 partially reversed during the second quarter, as both developed international (MSCI EAFE Index) and emerging markets (MSCI EM Index) outperformed the S&P 500 Index during the quarter despite a strong U.S. dollar. The MSCI EAFE Index lost 14.5% during the quarter, while the MSCI Emerging Markets Index slipped 11.4%. Markets in Hong Kong, the U.K., and Switzerland held up relatively well, while Australian and German markets lagged during the quarter.

The relative outperformance in EM was driven primarily by strength in China, which benefited from signs of reopening following COVID-19 lockdowns as well as easing regulatory pressures and prospects for fiscal stimulus. Gains in China offset weakness in Taiwan and Korea. Russia, after being removed from the index during the first quarter, had no direct impact on second quarter performance for EM.

Negative Core Bond Returns to Start the Year

Bond market returns were deeply negative again in the second quarter as the Bloomberg Aggregate Bond Index lost 4.7%, the fourth worst quarter since inception of the index (1976). For the year, the index was down over 10%, which marks the worst start to the year ever for the index.

Bond markets were lower due to expectations of a more aggressive Fed response to still elevated consumer price increases. U.S. Treasury securities and U.S. mortgage-backed securities (MBS) outperformed the index during the quarter but were still down around 4%. Due to the expectation of a very committed Fed, inflation expectations came down during the quarter, which hurt Treasury Inflation-Protected securities (TIPS) as that sector was down over 6% for the quarter.

No Place to Hide in Corporate Credit Markets

While we think fundamentals remain generally solid for corporate credit, investment-grade corporates, high-yield bonds, and bank loans all generated negative returns during the quarter. Due to the concerns of slowing economic growth globally, the global high yield market was down over 11% with the U.S. high yield market down nearly 10%.

U.S. Treasuries may be considered “safe haven” investments but do carry some degree of risk including interest rate, credit, and market risk. They are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value.

Please see our annual Outlook 2022: Passing the Baton publication for additional descriptions and disclosures.

Mostly Negative Returns for Non-U.S. Fixed Income

Yields on the debt of many developed and emerging countries rose during the quarter, albeit to varying degrees, as the prospects of reduced monetary support weighed on bond prices and pushed yields higher. Moreover, a number of emerging market central banks have started aggressively increasing interest rates to help reduce inflationary pressures. Japan and China were the exceptions as those central banks continue to provide support to their respective economies.

No Reprieve for Munis

Despite much improved credit fundamentals, municipal bonds were also negative for the quarter, albeit less negative than many taxable markets. Supply/demand conditions that helped keep the asset class well bid last year have reversed and are adding to the interest rate pressures seen in other markets. By some accounts, at least 5% of the market has been redeemed through investor redemptions. The high-yield muni market was down 5.6% during the quarter as tobacco and hospital related credits weighed on index returns.

Commodities Pulled Back After Big First Quarter Gain

Commodities followed up a huge 25.5% gain in the first quarter with a 5.7% decline in the second based on the Bloomberg Commodity Index. Commodity prices rose from the beginning of the second quarter through June 8, before reversing lower in the final three weeks of the month to end the quarter lower. The decline in the broad commodities index, just the second down quarter since Q2 2020, was similar in magnitude to the gain in the U.S. dollar. The greenback benefited from a flight to safety during the quarter and provided a headwind for the entire global commodities space.

Weakness in commodities was driven mostly by declines in industrial metals (-26.4%), the steepest quarterly drop since 2008 amid recession fears. Precious metals lost 10.5% during the quarter, while the agriculture and natural gas indexes both fell about 6%. West Texas Intermediate Crude had its ups and downs but was a rare second quarter winner, finishing 9% higher amid Russian supply disruptions. Signs of a reopening Chinese economy also provided some support.

All commodities performance is based on Bloomberg commodity indexes.
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Please see our Midyear Outlook 2022: Navigating Turbulence publication for additional descriptions and disclosures.

A LOOK AHEAD

Economy. LPL Research expects the domestic economy to grow in 2022, but slower than expected six months ago. Other than the anomaly of negative first quarter gross domestic product (GDP) print, we think the economy has sufficient momentum to offset the inflationary pressures. The economy will likely avoid recession, in our view, as growth is expected to notch just above 2% in 2022 with another downshift to under 2% in 2023. These are annual figures so intra-year economic activity could be quite volatile as the Fed tightens further.

Inflation. Inflation will mostly likely be significantly above the Fed's long-run target of 2%. Inflation rates will likely cool throughout this year, but the cool down period will be long and slow. Some inflation pressures should subside as China adjusts its COVID-19 policy and supply chains improve. A slowing housing market could also eventually ease inflationary pressures later this year and into 2023.

Stocks. Stocks will face a number of headwinds in the second half of the year, but the amount of volatility will likely depend on the pace at which inflation falls. Volatility may persist, but an improved macroeconomic environment may set the stage for higher valuations, further earnings growth, and solid gains for stocks over the rest of the year. The challenge comes from predicting how fast inflation will come down. Our year-end fair value target for the S&P 500 is 4,300–4,400, based on a price-to-earnings ratio of 18–19 and our 2023 S&P 500 earnings per share forecast of $235.

Bonds. The value proposition for core bonds is that they tend to provide liquidity, diversification, and positive total returns. Unfortunately, none of those values are certain all the time. Like all markets, fixed income investing involved risks and, at times, negative returns. However, despite the historically poor start to the year, the value proposition for core bonds has actually improved recently. With the big jump in yields that has already taken place this year, LPL Research believes that core bonds look as good as they have in quite some time. As rate hikes work their way through the economy and slower growth starts to get priced in, we could see the 10-year Treasury yield end the year between 2.75–3.25%.

Forecasts set forth may not develop as predicted and are subject to change. Please note: All return figures are as of June 30, 2022, unless otherwise stated.

Past performance is not indicative of future results. The economic forecasts set forth in the presentation may not develop as predicted.

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SECOND QUARTER DATA

Consumer Staples Tops Sector Rankings as Consumer Discretionary Struggles

S&P 500 sector performance, ranked by second quarter returns*

Sector	Q2 2022
Consumer Staples	-4.6%
Utilities	-5.1%
Energy	-5.2%
Healthcare	-5.9%
Real Estate	-14.6%
Industrials	-14.8%
Materials	-15.9%
S&P 500	-16.1%
Financials	-17.5%
Technology	-20.2%
Communication Services	-20.7%
Consumer Discretionary	-26.2%

Growth Stocks Lag, Emerging Markets and Large Value Lead in Q2

Domestic and international asset class performance, ranked by second quarter returns**

Asset Class	Q2 2022
Emerging Markets	-11.3%
Large Value	-12.2%
Large Foreign	-14.3%
Mid Value	-14.7%
Small Value	-15.3%
S&P 500	-16.1%
Russell 3000	-16.7%
Small Growth	-19.3%
Large Growth	-20.9%
Mid Growth	-21.1%

Munis Led in Q2 as EM Debt and Unhedged Foreign Bonds Lag and as Dollar Strengthens

Bond market performance, ranked by second quarter returns**

Sector	Q2 2022
Munis	-2.9%
U.S. Treasuries	-3.7%
MBS	-4.0%
Bloomberg Barclays U.S. Agg	-4.7%
Foreign Bonds (Hedged)	-5.1%
Bank Loans	-5.3%
High-Yield Munis	-5.6%
TIPS	-6.1%
Investment-Grade Corporates	-6.9%
Preferred Stocks	-8.0%
High-Yield Corporates	-9.8%
EM Debt	-10.5%
Foreign Bonds (Unhedged)	-12.5%

**Sources: LPL Research, Bloomberg, FactSet as of 6/30/2022

*Sources: LPL Research, FactSet as of 6/30/2022

All data as of 6/30/2022

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The sectors are represented by the 11 S&P 500 Global Industry Classification Standard (GICS) indexes.

Asset classes are based on Russell 1000, Russell 3000 Growth and Value, Russell 2000, Russell Midcap, MSCI EAFE, and MSCI Emerging Markets indexes.

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

Bond Market Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Preferred Securities – Merrill Lynch Preferred Stock Hybrid Securities Index; Treasury – Bloomberg Barclays U.S. Treasury Index; Mortgage-Backed Securities – Bloomberg Barclays U.S. MBS Index; Investment-Grade Corporate – Bloomberg Barclays U.S. Corporate Bond Index; Municipal – Bloomberg Barclays Municipal Bond Index; Municipal High-Yield – Bloomberg Barclays Municipal High Yield Index; TIPS – Bloomberg Barclays Treasury Inflation-Protected Securities Index; Bank Loans – Bloomberg Barclays U.S. High Yield Loan Index; High-Yield – Bloomberg Barclays U.S. Corporate High Yield Index; Emerging Market Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

IMPORTANT DISCLOSURES

Investing involves risks including possible loss of principal. No investment strategy or risk management technique can guarantee return or eliminate risk in all market environments.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual security. To determine which investment(s) may be appropriate for you, consult your financial professional prior to investing. The economic forecasts set forth in this material may not develop as predicted. All performance referenced is historical and is no guarantee of future results.

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All company names noted herein are for educational purposes only and not an indication of trading intent or a solicitation of their products or services. LPL Financial doesn't provide research on individual equities.

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Yield is the income return on an investment. This refers to the interest or dividends received from a security and are usually expressed annually as a percentage based on the investment's cost its current market value or its face value.

Earnings per share (EPS) is the portion of a company's profit allocated to each outstanding share of common stock. EPS serves as an indicator of a company's profitability. Earnings per share is generally considered to be the single most important variable in determining a share's price. It is also a major component used to calculate the price-to-earnings valuation ratio.

Small cap is a term used to classify companies with a relatively small market capitalization. The definition of small cap can vary, but it is generally a company with a market capitalization of between $300 million and $2 billion. The prices of small cap stocks are generally more volatile than large cap stocks.

The S&P 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

For a list of descriptions of the indexes referenced in this publication, please visit our website at lplresearch.com/definitions.

The Bloomberg Global Aggregate Index measures the performance of global investment grade debt. The index includes treasury, corporate, and securitized fixed-rate bonds.