What is a recession?

The technical definition of a recession is two consecutive quarters of decline in output as measured by Gross Domestic Product (GDP). GDP is the sum total of all goods and services produced by a country for the given period.

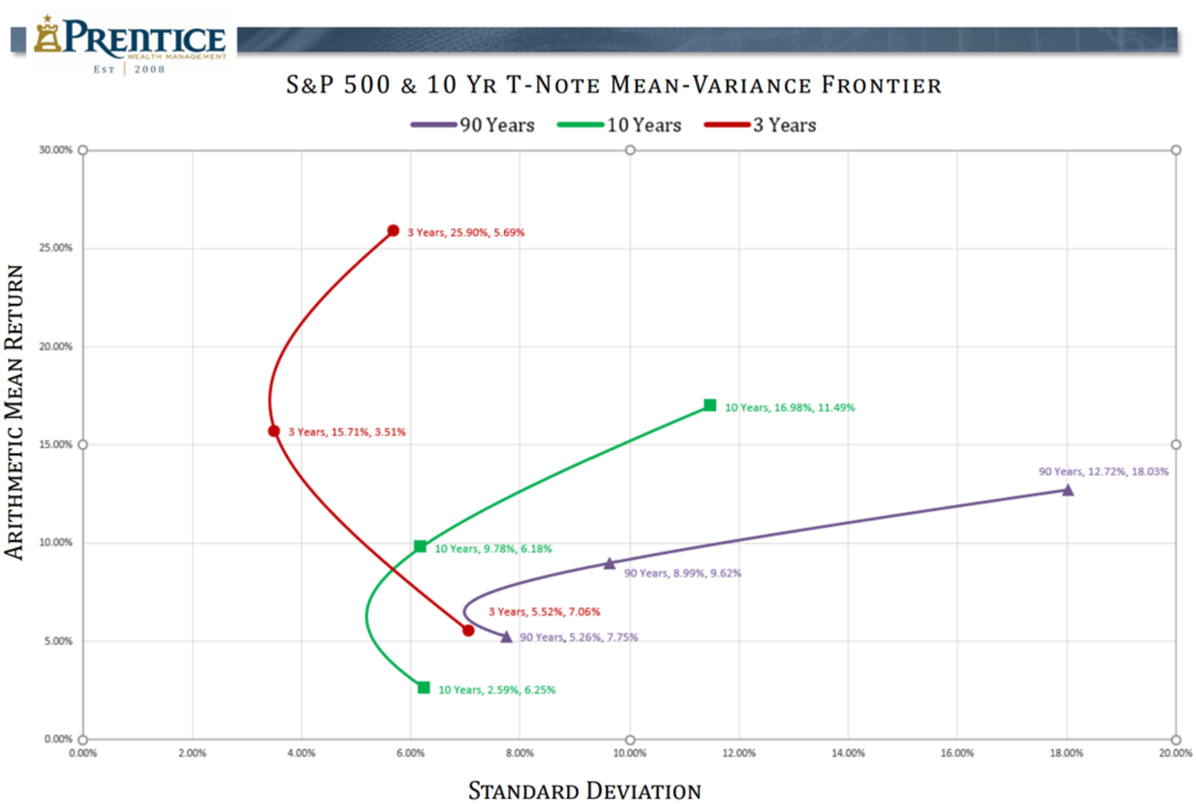
The recently released advance estimate for Q1 GDP output in the United States came in at -1.4% (Gross Domestic Product, First Quarter 2022 (Advance Estimate) | U.S. Bureau of Economic Analysis (BEA)). Although the number is less than ideal, it is important to understand it in context as the number was significantly impacted by decreases in inventory and exports. Consumption represents approximately 70% of GDP and continued to remain strong verifying the foundation of our economy remain sound (Consumer Spending | U.S. Bureau of Economic Analysis (BEA). This spending was driven by a combination of an increase in discretionary incomes and reduced savings rates (United States Consumer Spending - 2022 Data - 2023 Forecast - 1950-2021 Historical (tradingeconomics.com)), as consumers returned to a savings rate similar to pre-pandemic levels.

Exhibit 1 – US Consumer Savings Rate

Should I be concerned about volatility?

Volatility is a natural part of investing and understanding volatility is critical to investment success. The past several years have distorted investor perception of what normal market behavior and volatility looks like. This period has been supported by both monetary and fiscal policy that is now receding. As interest rates increase and these support mechanisms decline, markets will likely return to volatility similar to what has been experienced historically.

Exhibit 2 – Efficient Frontier (numbers through the end of 2021):



The time frame for the 90 year data is from 1932 - 2021.
Past performance is no guarantee of future results. Risk and return are measured by standard deviation and arithmetic mean, respectively. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index.
Securities and Advisory Services offered through Cadaret, Grant & Co., Inc. a Registered Investment Advisor, and Member FINRA/SIPC. Additional Advisory Services offered through Prentice Wealth Management, LLC, a SEC Registered Investment Advisor. Prentice Wealth Management and Cadaret, Grant & Co. are separate entities.

As illustrated in the graphic, equity markets have yielded a sustained period of extremely high returns in combination with extraordinarily low volatility. A period of elevated volatility following such a period is normal as markets recalibrate and prepare for the next phase of an economic cycle. We expect this environment to continue for a period of several months and potentially longer.

Summary Points:

Volatility:

- Volatility in equity markets (S&P 500) for the past 3 years has been nearly 70% less than the 90-year average; shockingly low by any standard.
- Volatility in equity markets (S&P 500) for the past 10 years has been nearly 40% less than the 90-year average; extraordinarily low for a time period of that length.
- Volatility in fixed income has been approximately 9% lower for the past 3 years and approximately 20% lower for the past 10 years.

Investment Returns:

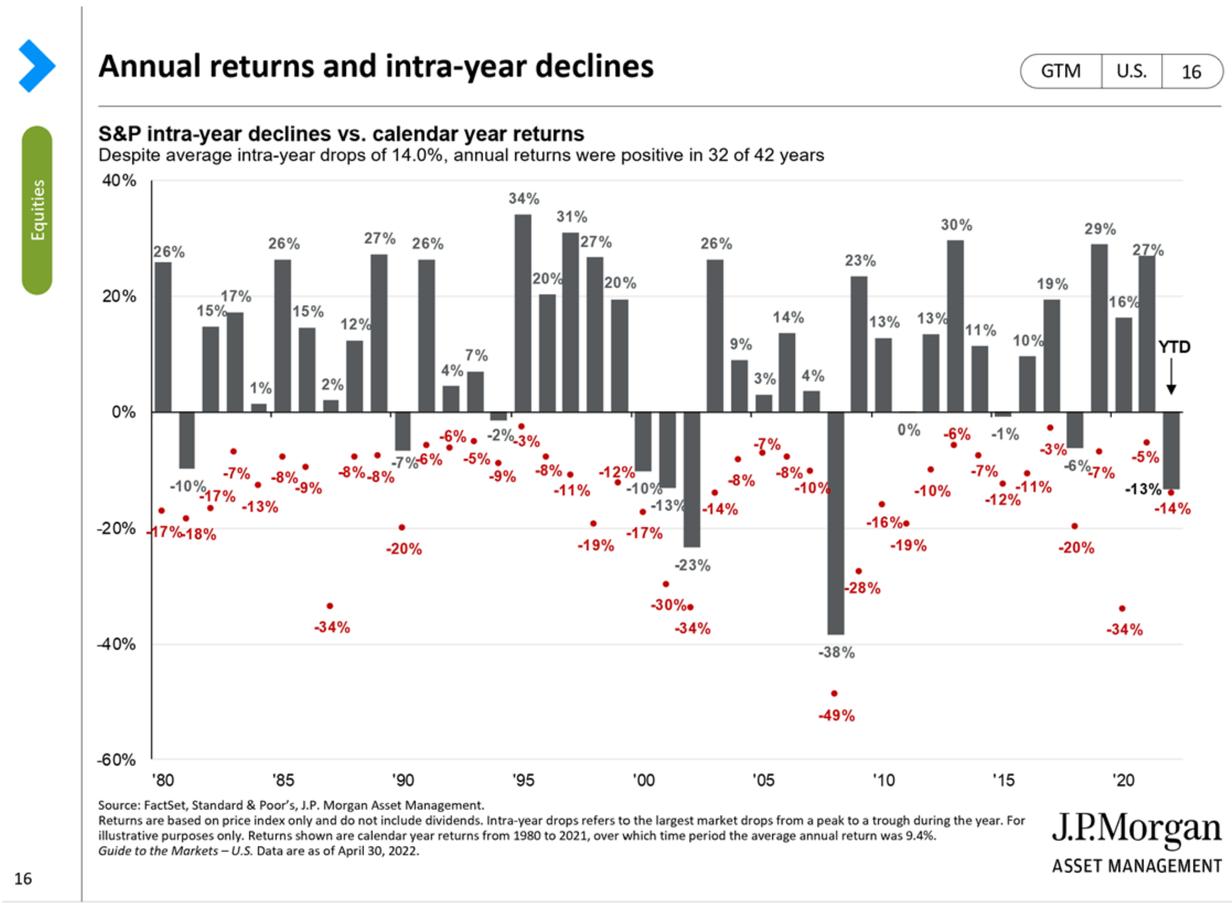
Equity Returns - for both the 3-year and 10-year timeframe have been extraordinarily elevated with the 3-year output bordering on absurd.

- 3-year return output was more than double the 90-year average
- 10-year return output was over 33% greater than the 90-year average
    - These numbers are extraordinary, not only on the surface, but also for the duration of the sustained period and in doing so in combination with the extraordinarily low volatility statistics that were also logged.

Fixed Income Returns - for both the 3-year and 10-year timeframe have been within ranges that are considered historically normal.

- Given the historically low and unprecedented interest rate environment over the past decade, we do not expect these returns to continue as the Federal Reserve Board endeavors to normalize both their balance sheet and their interest rate policy.

Exhibit 3 – S&P 500 Intra-year declines:



Central Point:

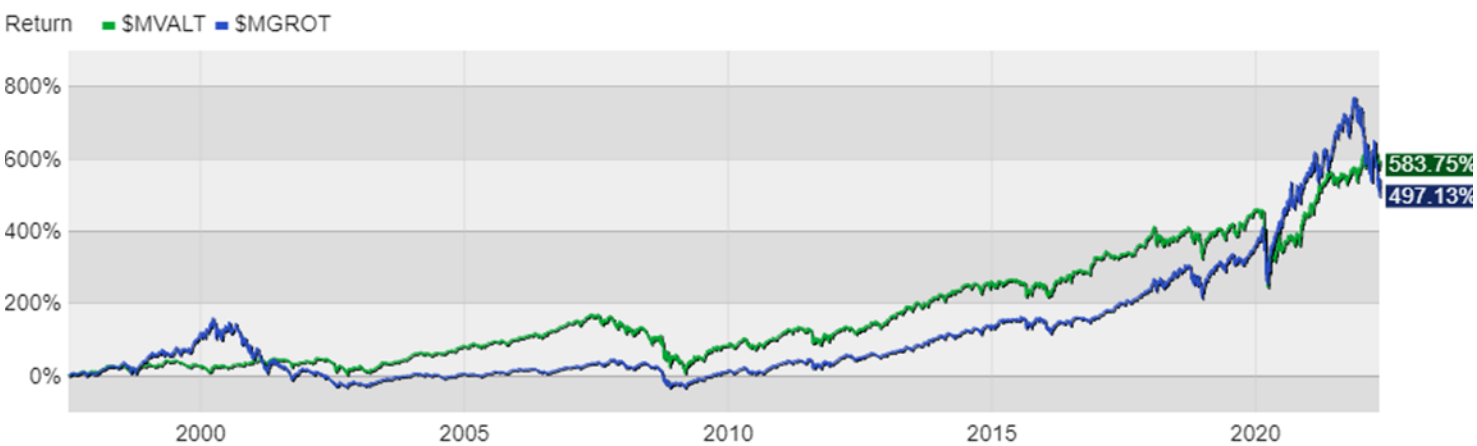
- Since 1980, the average intra-year decline has been 14% and in 32 of 42 years the annual return for the period was positive. A batting average over 76% punctuating that volatility does not necessarily equal negative outcomes.

Exhibit 4 – Growth versus Value trailing 10 years data):

Data as of 5/6/2022	Morningstar US_Value Index ($MVALT)	Morningstar US_Growth Index ($MGROT)
Ytd	-0.26	-27.93
1 year	4.22	-14.27
3y annualized	10.45	12.69
5y annualized	9.59	15.19
10y annualized	11.48	14.50

Exhibit 5 – Growth vs Value Graph – Trailing 25 years (period ending May 6, 2022)

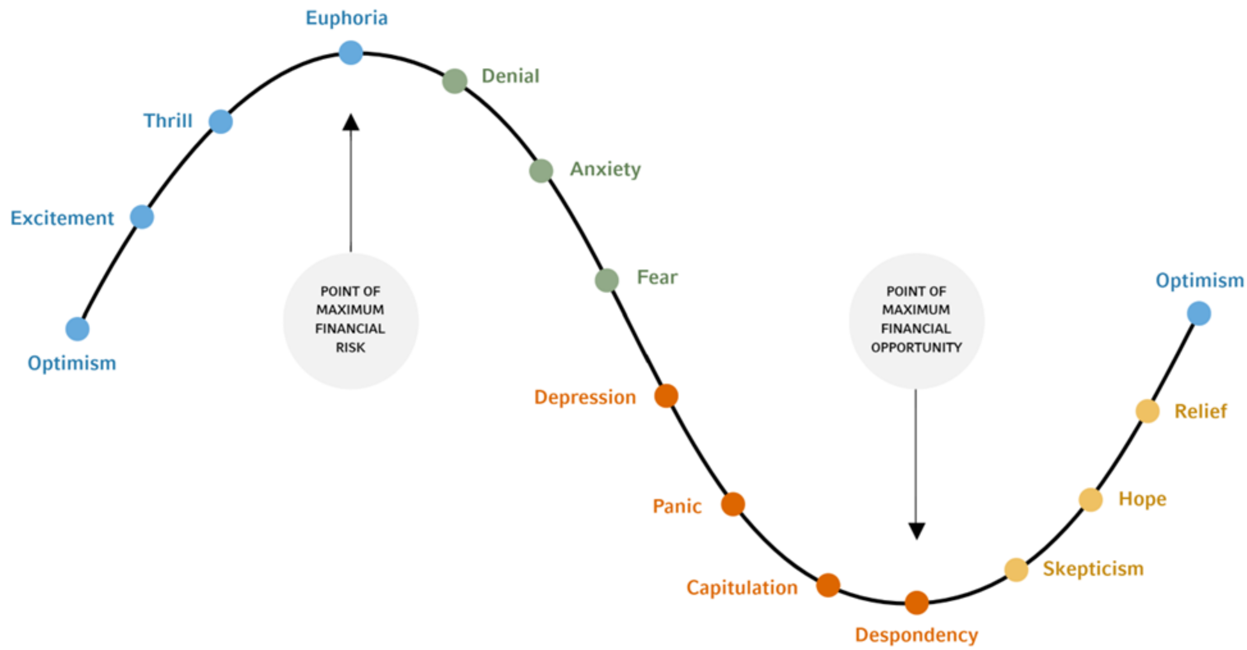
- Morningstar US Value Index ($MVALT) = Blue Line
- Morningstar US Growth Index ($MGROT) = Green Line



Central Point:

- Growth and Value rotate in and out of favor. Growth stocks have been in favor for the past decade; that did not hold in 2022 as Value stocks demonstrating resiliency and Growth stocks shed much of their outperformance over the past three years.
  - Growth and Value rotate in and out of favor, growth has dominated of late however, it is essential to have both styles in a properly diversified portfolio.

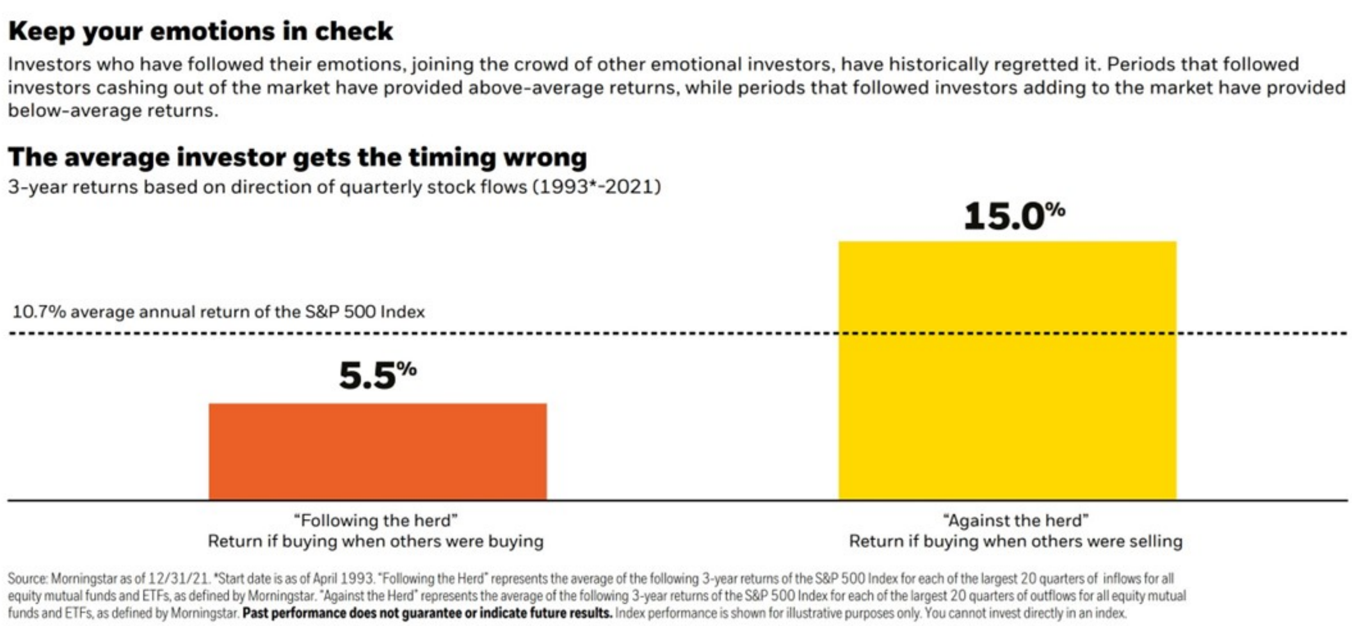
Exhibit 6 – [Cycle of Investor Emotions | Russell Investments]:



Central Point:

- Reacting emotionally is natural, however, acting on those emotions can be harmful. Numerous studies have been done highlighting and quantifying the destructive nature of emotional investment decisions. Markets are very difficult to time and making decisions after markets have declined is rarely a rational decision.

Exhibit 7 – It pays to keep your emotions in check:



Central Point:

- Opportunity exists when others are pessimistic – it may feel good to listen to the noise and simply follow the crowd, but it may not be the best financial decision.

Exhibit 8 – Vanguard Capital market assumptions[1]:

Equities	Return projection	Median volatility
U.S. value stocks	**2.8%–4.8%**	19.00%
U.S. growth stocks	**–1.2%–0.8%**	17.50%
U.S. large-cap stocks	**1.9%–3.9%**	16.30%
U.S. small-cap stocks	**2.3%–4.3%**	22.20%
U.S. real estate investment trusts	**1.8%–3.8%**	19.20%
Foreign developed markets stocks (unhedged)	**5.1%–7.1%**	16.30%
Emerging markets stocks (unhedged)	**4.3%–6.3%**	26.80%

Fixed income	Return projection	Median volatility
U.S. aggregate bonds*	**1.9%–2.9%**	4.6%
U.S. Treasury bonds*	**1.6%–2.6%**	4.8%
Foreign bonds ex-U.S. (hedged)*	**1.8%–2.8%**	3.9%
U.S. high-yield corporate bonds	**2.3%–3.3%**	10.30%
U.S. Treasury Inflation-Protected Securities	**1.2%–2.2%**	4.6%
Emerging markets sovereign	**2.5%–3.5%**	10.50%

Central Point:

- Capital Markets are likely to be more volatile going forward versus the past decade and perhaps historically in general.

What action should I be considering?

Focus on the controllable. Review your financial plan. A well-constructed financial plan considers the impacts of recession and the potential outcomes. Consider stress testing your financial plan with your advisory team.

- How does your plan hold up under a protracted period of higher inflation?
- How do lower investment returns impact the desired outcome?
- What is the impact of higher taxes?

All these questions can be answered inside the context of your financial plan with your advisory team. They can help you see the present clearly and make good decisions that will benefit your financial position when volatility abates. Additional points you may want to consider with your team:

- How are my current cash flows and spending levels?
- Is my debt level appropriate?
- Are my debt structures optimal?
- Should I be Dollar-Cost-Averaging into markets with excess cash reserves?
- Should I increase equity exposure on systematic savings plans (i.e., 401k, 403b)?

Summary Points

The future is likely to look more like the past, just not the immediate past. Markets are prone to return to historical levels of volatility as fiscal and monetary policy accommodation ends. It is important to remember that volatility does not mean the future will be uninvestable or that financial goals will be unattainable. Volatility is the naturally occurring feature of a market economy that has historically occurred regularly. As illustrated in Exhibit 9, domestic equity markets have been in a period of extremely low volatility for well over a decade with the 15 years prior demonstrating significantly more volatility.

Exhibit 9 – Drawdowns on the S&P 500 – trailing 25 years ending May 6, 2022.

- Drawdown defined: a peak-to-trough (high-to-low) decline in value of an investment, investment vehicle or portfolio

It is important that drawdowns do not portend the permanent loss of capital. As illustrated in Exhibit 10, drawdowns have historically been temporary in nature with the length of recovery being related to the severity of the decline.

Exhibit 10 – Drawdowns by size and frequency (thresholds analyzed independently) *

Drawdown Threshold*	Historical Frequency	Typical Occurrences per Year	Typical Recovery Time
20%	Once per Market Cycle	0	20 Months
10%	Once per Year	1	8 Months
5%	Once per Quarter	4	2 to 3 Months
3%	Once per Month	11	2 to 6 Weeks
2%	Often	18	1 to 4 Weeks

Source: Investing with composure in volatile markets by James C. Liu, CFA

Markets can and have demonstrated periods of significant volatility and through it all they continue to grow as illustrated in Exhibit 11. The S&P 500 grew nearly 400% in the last 25 years. 400%! Will the future look like the past? No, most certainly not but there is reason for optimism. It is important to remember the market is the aggregate of our actions. Our collective spending habits lead to economic activity. We all go through periods of high and low spending, loose and tight budgets but so long as our populations continue to grow and people still consume goods and services there is reason to be optimistic. We are our future, and we all need a plan that focuses our efforts on what matters most, on what we can control so we can stay on track and achieve meaningful outcomes for ourselves and our families. Remember, businesses without a business plan rarely flourish and personal finances are no different.

Exhibit 11 – S&P 500 Total Return – trailing 25 years ending May 6, 2022

Footnote 1:

- Source: Vanguard Investment Strategy Group.
- [Market perspectives May 2022 (vanguard.com)]
- These probabilistic return assumptions depend on current market conditions and, as such, may change over time. The data represents Vanguard Investment Strategy Group's 10-year, annualized, nominal return projections. The categories marked with an asterisk (*) reflect a February 28, 2022, running of the Vanguard Capital Markets Model® (VCMM) for broad equity and fixed income asset classes only. Outlooks for the remaining sub-asset classes reflect a December 31, 2021, running of the VCMM. Please note that the figures are based on a 1.0-point range around the rounded 50th percentile of the distribution of return outcomes for equities and a 0.5-point range around the rounded 50th percentile for fixed income.

- **IMPORTANT: The projections or other information generated by the Vanguard Capital Markets Model® regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results, and are not guarantees of future results. Distribution of return outcomes from the VCMM are derived from 10,000 simulations for each modeled asset class. Simulations are as of February 28, 2022, and December 31, 2021. Results from the model may vary with each use and over time. For more information, see the Notes section.**

knightbridge CAPITAL