



Canandaigua
National
Trust Company

QUARTERLY
PERSPECTIVE
SUMMER 2022

Midyear Perspective 2022

The first half of 2022 proved to be a reminder to investors of the unpredictable nature of investing. While markets weathered the COVID pandemic and its economic and humanitarian damage with surprising resiliency, they seem less able to adapt to the current issues around inflation. Investors certainly knew coming into the year that interest rates would be on the rise in an effort to quell higher prices, but no one anticipated how aggressive the Fed would become after sitting on its hands through 2021. In the Fed's defense, China's zero-tolerance policy on COVID has caused continued supply chain issues, and Russia's invasion of Ukraine sent energy and other commodity prices skyrocketing, both giving inflation an unexpected tailwind. Either way, markets, both equity and fixed income, have not reacted kindly to the new stance and the Fed's three increases totaling 1.5%. This puts rates well ahead of what was the original year-end estimate, with more rate hikes to come. So where do we go from here?

Inflation and the Fed

In its simplest definition, inflation occurs when too much money chases too few goods and services. During the pandemic, government stimulus programs significantly increased the money available to consumers, while economic shutdowns shuttered factories both here and abroad. While the stimulus spending had the desired effect, and the global economy survived, it also led to the first meaningful uptick in inflation that we've seen in decades. The Fed, deeming inflation as transitory due to the underlying causes, left rates unchanged. After all, stimulus payments had ended, and factories were reopening, which would lead to lower consumer spending on one side and increased output of goods on the other. So, what changed? For one, China's government has remained committed to its zero-tolerance COVID policy, which has continued to include large-scale shutdowns and quarantines. This has complicated and prolonged supply chain issues that might have otherwise been resolved by now.

Second, the war in Ukraine. Few believed Russia would invade and incur the wrath of global sanctions, but on February 24th they did just that. This has led to a substantial increase in oil, natural gas, and other commodity prices, all of which have exacerbated inflationary pressures.

Finally, we're confronted with a very tight labor market. While the unemployment rate has dropped to 3.6%, we still have roughly 11 million unfilled jobs. This is good for workers but puts businesses in the position of having to significantly increase wages to both attract and retain employees. If wage growth continues, it will put upward pressure on prices of goods and services as companies try to maintain margins.

This leaves the Fed in the uncomfortable position of having to raise rates both faster and higher than anticipated. While higher rates won't alleviate supply chain issues, they will likely moderate demand for goods as the costs of borrowing increase, thereby bringing the supply/demand dynamic back into alignment, as has happened in the past. The balancing act comes as they attempt to slow demand, but not so much as to create a recession. If inflation does begin to ease through the summer, and there are some recent indications it may, then the Fed may hold off on increases until later in the year. For now,



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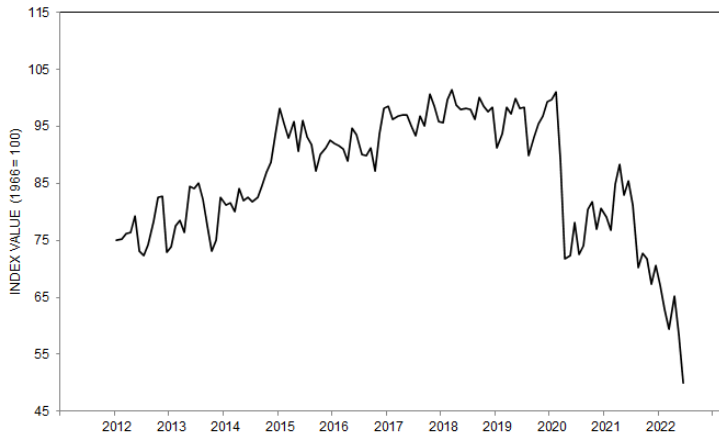
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however, the Fed will likely continue to publicly maintain its tough stance as the negative sentiment it creates may be useful in cutting demand on its own.

The threat of additional rate increases and the potential for a recession will likely keep volatility elevated, but there are positives. From a valuation standpoint, both bonds and stocks look much more attractive than they did coming into the year. Bonds, which yielded very little, now offer reasonable income for conservative investors. Similarly, equity valuations* have gone from very high at over 21x forward earnings to now 15.9x, which is below their 25-year average. This can be an indicator of better returns moving forward, as well as to serve as a possible entry point for investors looking to deploy cash.

University of Michigan Consumer Sentiment Index



Source: University of Michigan

Markets

For investors it's been an especially trying start to the year. While most equity investors understand that volatility is part of the game, and in the end the reason why they're compensated with higher returns over long time periods, bond holders are not generally used to such swings. With both asset classes down so dramatically at the same time, it creates very unnerving times. As of June 30th, the S&P 500 Index was down -19.96%, and the Bloomberg Aggregate U.S. Bond Index was down -10.35%. While some areas like value, dividend payers and short-term bonds were down less than others, there were few if any positive asset classes outside of commodities and cash.

It's also important to note that markets are forward looking, and today's prices have built in expectations for future events. While rates will likely continue to rise, much of it may already be factored into bond prices. And while a recession may take place between now and the end of 2023, equities have already entered bear market territory. As it is, first quarter GDP was negative, and forecasts for second quarter continue to fall, prompting some economists to note that we may already be in a recession. Whatever the timing may be, a recession is likely to be relatively mild given we have not built up some of the excesses typically seen prior to an economic downturn. Additionally, consumer demand remains strong and unemployment remains exceptionally low at only 3.6%, both of which support continued economic growth.

**(based on S&P 500 Index, as of June 30th. Source Standard & Poor's)*

Conclusion

It's disconcerting to see investment values drop, especially when it encompasses all asset classes and styles; equity and bond, U.S. and international, growth and value, small and large. But in the end investors are rewarded for patience through short-term downturns. In times like these the key to focus on is not the return of a particular investment, but rather your overall financial plan, and whether it meets its goals over longer periods. Emotional, knee-jerk reactions to temporary economic distresses are counterproductive. That's why your advisor can help you by making fact-based decisions to meet longer-term objectives by helping you review your financial plan to ensure you are on track or provide insights on how to better manage during this volatility.

Index Returns as of 6/30/22	Q2 2022	YTD
S&P 500	-16.10%	-19.96%
Russell 1000 Growth	-20.92%	-28.07%
Russell 1000 Value	-12.21%	-12.86%
Russell 2000 Value	-15.28%	-17.31%
Dow Jones US Real Estate	-14.46%	-20.02%
MSCI EAFE (net)	-14.51%	-19.57%
MSCI Emerging Markets (net)	-11.45%	-17.63%
Bloomberg US Aggregate Bond	-4.69%	-10.35%
Bloomberg Municipal Bond	-2.94%	-8.98%
Bloomberg High Yield Bond	-9.83%	-14.19%

Data from Morningstar

Data as of 06/30/2022. This material is provided for general information purposes only. Canandaigua National Trust Company of Florida is an affiliate of Canandaigua National Bank & Trust. Investments are not FDIC insured, not bank deposits, are not obligations of, or guaranteed by, Canandaigua National Bank & Trust or any of its affiliates, including Canandaigua National Trust Company of Florida. Investments are subject to investment risks, including possible loss of principal amount invested. Past performance is not indicative of future investment results. Before making any investment decision, please contact your legal, tax or financial advisor. Investments and services may be offered through affiliate companies.