Recent economic data is consistent with a rapidly slowing economy. Rising interest rates and higher prices are resulting in a very grumpy consumer. Confidence is at low levels not seen since the early '80s. In addition, the S&P 500 is trading near bear market territory. In fact, the U.S. economy may already be in the midst of a technical[1], yet mild, recession. On the heels of the first quarter's negative GDP growth, the Atlanta Fed's GDPNow indicator is pointing to a second quarter contraction. If we are or soon will be in a recession, it would be occurring with several strong data points that do not typically accompany a recession, including a very strong labor market, a healthy banking system, and resilient corporate profits. The trend of corporate commentary still points to strong demand accompanied by very acute supply issues.

Investors are understandably nervous, and it is natural to extrapolate recent market declines into future declines. However, we are optimistic that stock prices have mostly, and accurately, discounted the economic environment. That is not to say prices won't overshoot to the downside, or discount the same news twice, on a frenzy of negative news. But we do believe that many stocks representing companies that make real things, earn actual profits, can return capital to shareholders, and trade at reasonable valuations offer attractive entry points to long-term investors.

Humbly hoping not to jinx it, this could be the first garden variety U.S. recession in nearly 30 years. By 'garden variety', we mean a slowdown not accompanied by a cataclysmic crash of the financial system like in 2008, or a stock market implosion and terrorist attack aka 2000-2001. As the economy slows and inflationary pressures abate, it is possible the Federal Reserve will begin talking down interest rate expectations. While the Fed Funds Rate is set to increase to 3.5% by year-end, it is possible that shortly thereafter expectations begin to ebb.

It has been more than 40 years since the Federal Reserve has had to combat rampant inflation, and the 40-year downtrend in U.S. Treasury yields will likely morph into a trading range above the floor produced by massive Fed stimulus. When the history of Chairman Powell's tenure at the Fed is written, the reversal in U.S. Treasury yields may very well be described as its defining moment. There are several other trends worth watching in this environment that will likely be the difference between recession (either mild or deep) and soft-landing.

1 A textbook recession is characterized as back-to-back quarters of negative real GDP growth.

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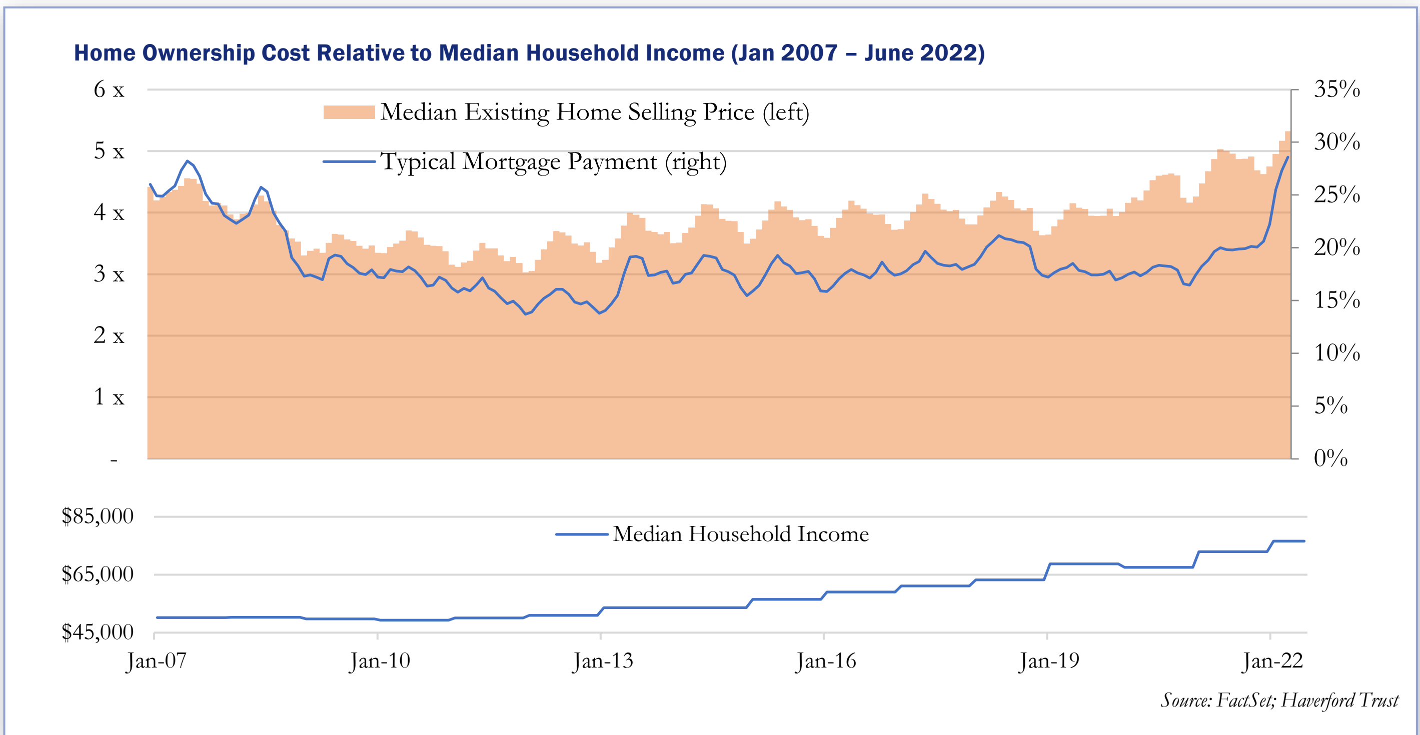
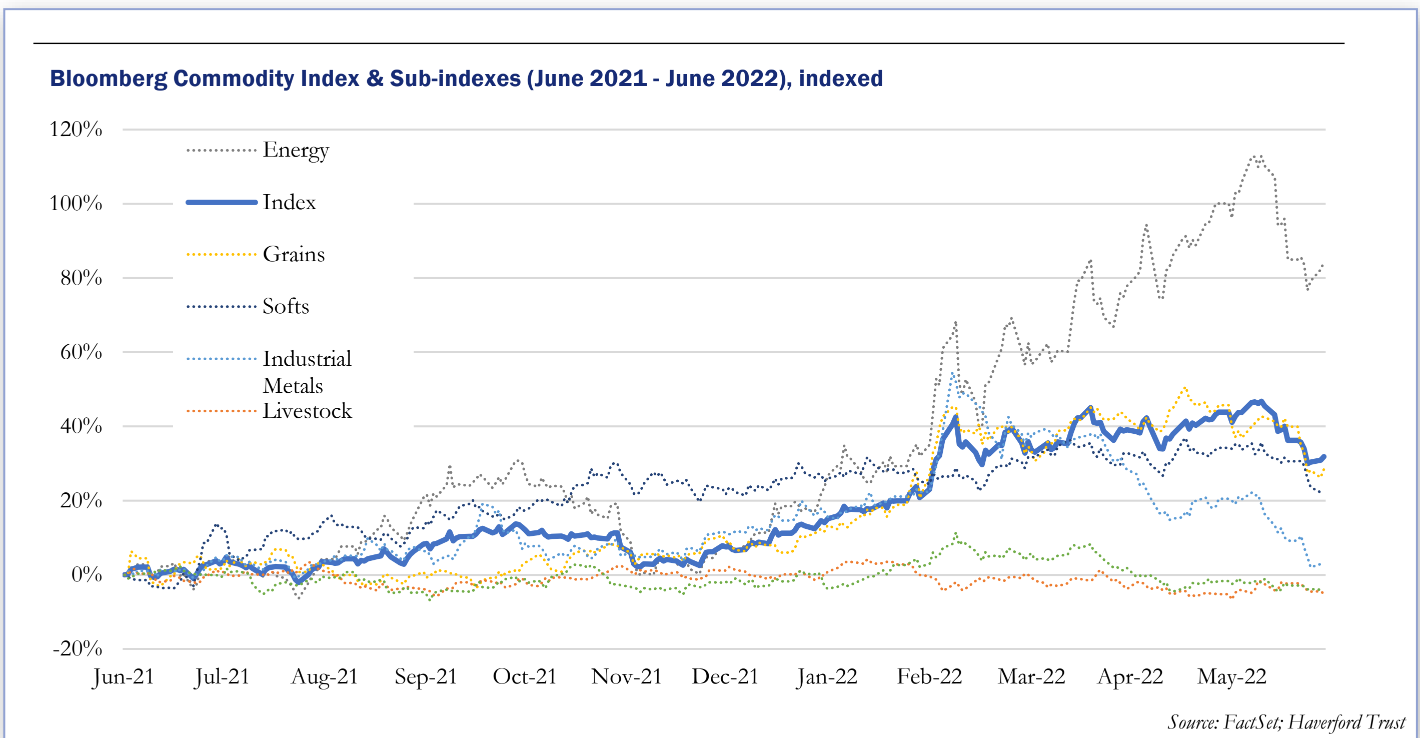
No one expects home prices to continue to rise at their current pace; however, will they move sideways for a period or fall from these levels? The cost of purchasing a home has risen significantly, and while rising values benefits consumer sentiment, higher interest rates are increasingly putting home ownership out of reach for many Americans.

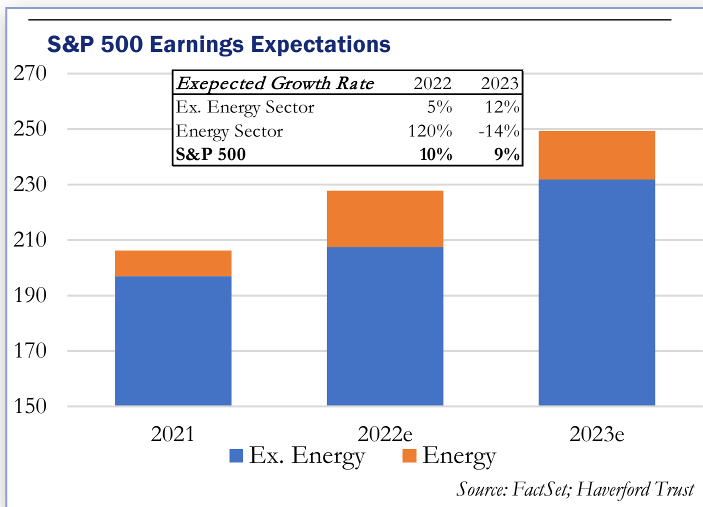


The Bloomberg Commodity Index has increased 31% over the past year but traded in a more modest range since early March. Of the five subindexes that comprise the index, only energy is higher than its March levels. Industrial Metals and Grains are down 33% and 15%, respectively. While the decline in metals prices is coincident with weakening economic expectations, the overall index offers a glimmer of hope that inflationary forces are ebbing.



S&P 500 earnings expectations continue to defy a recession scenario. Typically, double digit earnings declines accompany economic recessions. However analysts, guided by corporate management, have remained optimistic on earnings. Declines in earnings expectations for consumer discretionary and media companies have been more than offset by a 70%+ increase in energy expectations. Excluding the energy sector, earnings expectations are only down slightly year-to-date, and remain up close to 10% on a year-over-year basis. We believe this optimism will begin to wane in the coming months as many management teams will have to reduce forward expectations. The U.S. Dollar's strength alone will likely take several points of earnings growth off multinational corporations.

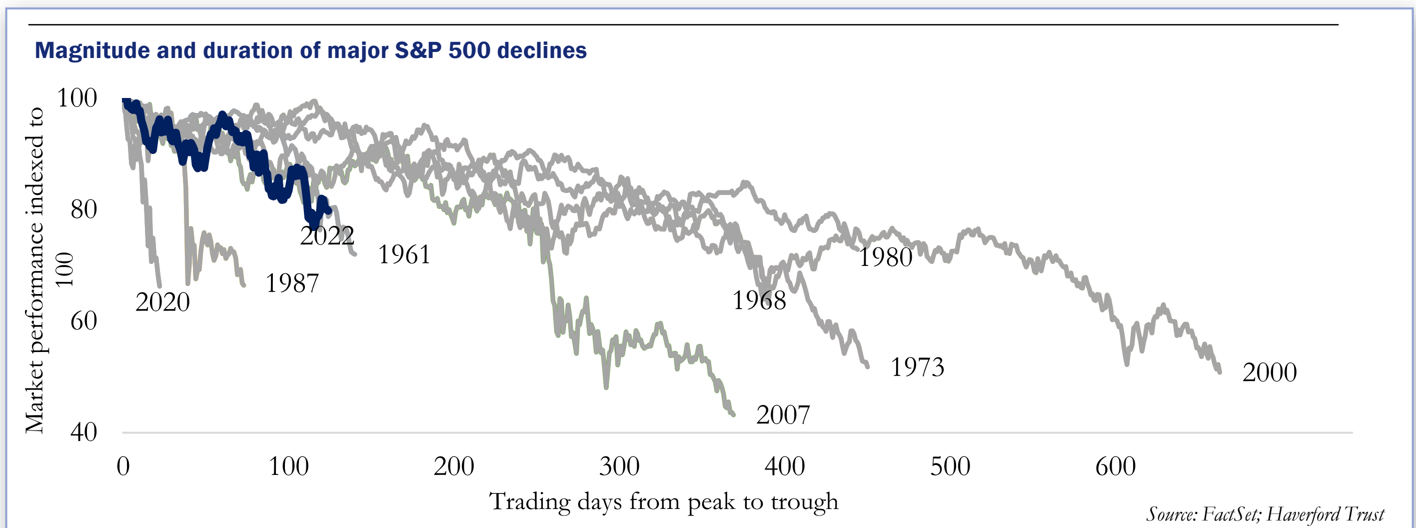
Earnings expectations may be underestimating economic risks, but asset prices are not. Stock prices have pulled in significantly, and nearly half of the largest 1,000 companies in the U.S. now trade at pre-pandemic levels. The S&P 500 is down close to 20% year-to-date, while multiples have contracted by 25%. The bear market in stocks means that some portion of negative news to come, including higher interest rates and a weaker economy, is already priced in.



Exepected Growth Rate	2022	2023
Ex. Energy Sector	5%	12%
Energy Sector	120%	-14%
S&P 500	**10%**	**9%**

Source: FactSet; Haverford Trust

Only with hindsight will we know how accurately stocks are pricing in the near-term economic risks. If history is any guide, stocks will find a bottom before the economy bottoms. It is also worth noting that stock prices are much more volatile than economies, and an equity bear market does not guarantee an economic recession; over the past 70 years, there have been six bear markets without economic recessions. Typical bear markets last about 340 days with declines close to 30%, which, on average, theoretically means we could be almost halfway done in terms of duration and two-thirds of the way in intensity. Also, 12 months following markets being in bear market territory, stocks tend to be higher, up 13% on average.



Source: FactSet; Haverford Trust

Regardless of short-term hurdles, the odds have always favored the long-term investor, a fact we believe remains true today. Our expectations for future returns are higher today than they were to begin the year. Lower prices today increase the probability of more upside tomorrow. It may take more time before stocks put in a bottom for this cycle, but every bear market in history has been followed by a bull market. Looking forward, we are confident that Haverford's *Quality Investing* philosophy will help protect investors' principal throughout down markets and provide a strong foundation for future growth.