"Don't Oversteer!"

When Covid 19 first broke out in 2020, no one could have imagined what transpired over the next two and a half years.

Initially, the economy shut down. Then, trillions of dollars were created and injected into the financial system. Rather than fortifying the economy, as was originally intended, the stimulus created asset bubbles, which would later become problematic. The productive economy, on the other hand, failed to gain assistance from the stimulus measures and the supply chain seized. This contributed to inflation accelerating. Then came the war in Ukraine, which aggravated all of these issues

Over the past 18 months the asset bubbles popped sequentially; meme stocks, SPACs, Cathie Wood's ARKK Innovation, concept stocks like EVs, and cryptocurrencies. The latest casualties have been the fan favorite, large technology stocks, like Amazon, Apple, and Microsoft. As a result, the stock market is having its worst first half since 1970! To make matters worse, the bond market, with interest rates sharply rising, is having its worst first half in history.

In response to inflation, the Federal Reserve is now forced to tighten at a rapid pace to counteract the inflation it itself, sparked. Now, the economy is on the brink of recession. Last week, the Federal Reserve of Atlanta predicted -2.1% GDP for the second quarter, which would produce two quarters in a row of negative GDP growth.

In retrospect, it is apparent the government and the Fed provided excessive assistance at the outset of the pandemic and is now on the brink of going too far to ameliorate their past miscalculation. It's a reminder of an ever present warning. "Don't oversteer". Otherwise, you can make things worse.

The Return to Normality

Stocks are now mired in a bear market. How will it end?

A narrative that would accompany a recovery, could be that *the economy would finally return to normality.* Just as a patient requires rehabilitation after a serious injury, the process takes time and is uncomfortable, but ultimately, healing happens. The same could be true for our economy.

It just needs to regain normality.

This means free from Covid restrictions, government money printing, broken supply chains, labor shortages, spiraling inflation, and war.

Despite policy blunders and adverse conditions, there are green shoots emerging that signal relief from what ails our economy and the markets.

First of all, we know the virus restrictions have been lifted and money printing is substantially being terminated.

Secondly, the supply chain is mending. This is supported by various commerce data. Formerly crowded ports are opening up and many product delays are lessening. Recent announcements by Target and Walmart actually revealed a glut of goods instead of a shortages. There are even hints of excess inventory in vaunted semiconductor land.

The troubling labor shortage might also be easing. Prominent companies like Amazon, Meta, and Tesla announced layoffs. Growing layoffs across many industries could follow particularly during apparent economic weakness.

Meanwhile, wholesale gas prices peaked in early June at $4.22 and amidst almost no fanfare, has now fallen to $3.40, a sizeable decline. Copper, lumber, and other commodities appear to have topped. Amazingly, wheat is 30% below its price preceding the Russian invasion of Ukraine. Commodities falling will help the inflation outlook.

Lastly, the 10 year treasury rate peaked at 3.50% in June and has now fallen back down below 3.00%. Now, maybe mortgage rates will start to inch lower from their peak. Relief from sharply rising rates would cast a completely different light on the economy and markets.

After nearly two and a half years of disruption and consequent reaction, economic normality can be the medicine that ends the bear market. Hopefully, these recent developments are evidence these improvements are underway.

We never know the stock market has made a bottom until after the fact, but the stage would be set if normality became more definitive.

Peregrine Strategy

Following consecutive negative quarters, we don't want three in a row! Every measure, within reason, must be taken to protect against this from happening, even if circumstatnces worsen. We expect improved trading results in Q3 but conceed, for now, that stock market rallies might be short lived.

A conservative investment approach with a reduced equity weighting and defensive stock holdings is our favored approach.

We will capitalize on higher interest rates to improve the return on safe cash holdings. Short term securities , like T-Blls, are projected to offer 2.5% after the July 15th Fed meeting and 3.25% after the September meeting. For managed accounts, we will be constructing a ladder of these securities, so that safe balances will earn a steady retun, while retaining liquidity.

During Q2, we slashed equity weightings for client accounts due to the pronounced downtrend in so many areas of the stock market. Until something changes more resolutely, we should prepare for the market to probe lower during the third quarter.

We recently invested in apartment real estate stocks. Many of these stocks have dropped sharply on fears of higher interest rates, which may not be justified. Stocks like **Avalon Bay** and **Essex Properties** may be in a position to recover quickly, since their business is highly predictable, recession resistent, and strong.

Consumer staples continue to be a cornerstone for managed client accounts. While these stocks are not immune to broad market selloffs, they have been more resilient compared to the overall market.

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