POST OAK PRIVATE WEALTH ADVISORS
ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

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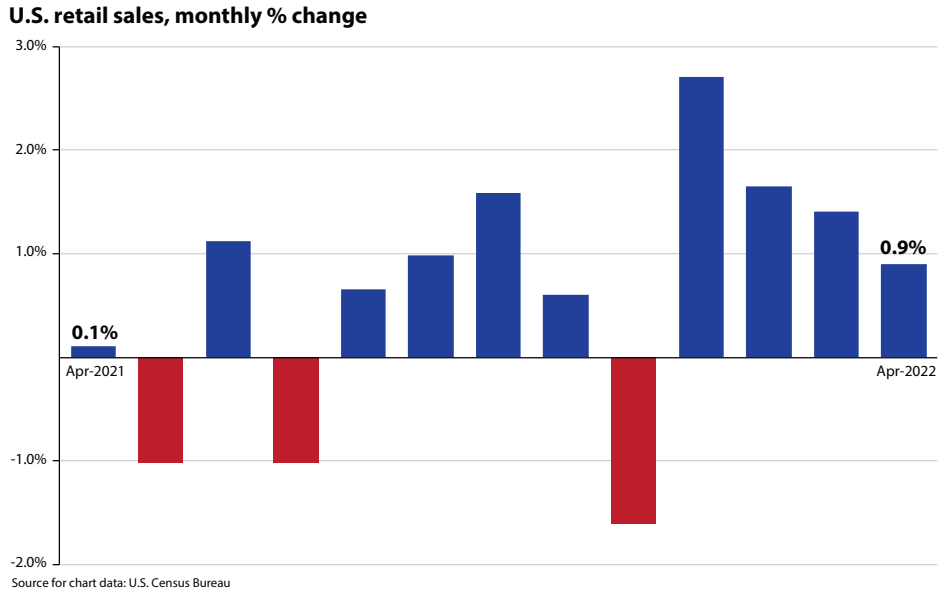
Monthly Market Commentary

by Robert M. Wyrick, Jr., Managing Member/CIO
Post Oak Private Wealth Advisors

Stocks have been on a brutal run over the last two months that brought the major equity market indices close to bear market territory in May. The Dow Jones Industrial Average recently suffered a string of eight consecutive weekly losses, a streak that snapped only after the last full week of trading in the month (May 23-27). Both the S&P 500 Index and the Nasdaq Composite endured seven straight weekly losses until rallying during the final week of May. The S&P 500 ended the month on the positive side with a 0.2% return for the month. Declines in the technology and consumer discretionary sectors contributed to the Nasdaq's 2.1% loss for the month.

Inflation remains top of mind for most investors, but they're also focused on the almost-certainty of Federal Reserve rate hikes to fight rising prices and the knock-on effects of a likely recession. This past month, investors zeroed in on the retail sector, where many big names posted disappointing Q1 earnings and issued warnings of difficult paths ahead. Walmart and Target saw their share prices fall in their largest single-day declines since 1987; both retailers cited the pressures of rising food costs and labor costs as constraints on their profitability.

Even as retailers felt the squeeze of inflation on their profit margins, retail spending has remained robust. Inflation has yet to deter consumers as retail sales (which includes spending at stores, restaurants and e-commerce) rose 0.9% in April over the previous month. That marks the fourth straight month of consumer spending growth. Retailers and the consumer discretionary sector are important barometers of economic growth as consumer spending makes up approximately two-



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thirds of the U.S. economy. But continued spending also helps to sustain inflation, which puts both the Fed and the U.S. economy in a bind.

It's hard to imagine inflation getting under control without a decrease in spending or a drop in consumer demand. The highest inflation rates in 40 years have yet to deter the American consumer. The strong job market and trends in wage growth have something to do with that, but so does higher asset prices. Rising values for stocks and houses create a "wealth effect" where people feel richer when looking at their investment statements and neighborhood home listing. As a result, they feel more confident about their finances and spending money on goods and services.

For the first time, the Fed appears to be using its economic pulpit to talk down asset prices, hoping that a drop in asset values will have a "reverse wealth effect", where investors and homeowners feel less rich and therefore cut back on their spending. There's only so much the Fed can do with rate hikes and monetary policy actions, so central bankers have turned to speeches and public announcements to try to ease consumer spending and relieve some of the pressure on inflation.

In a sense, the markets are doing the work for the Fed by taking some of the air out of elevated stock values. Signs in the housing market also point to a potential cooling; sales of new houses were down over 16% in April from the previous month, with the steep rise in mortgage rates deterring some borrowers. However, home prices have yet to come down from record levels, which could mean the reverse wealth effect has a way to go before elevated house prices catch up with rising inventories of unsold homes. So the Federal Reserve finds itself in a bind, trying to tap the brakes on the biggest driver of economic growth – consumer spending, fueled by the wealth effect -- while also avoiding a crash into a recession.

There are some early signs of a possible peak in inflation, with easing pressures on some drivers of consumer spending. For one, the Fed's preferred gauge of inflation, the personal consumption expenditures index (PCE), rose at a slower pace in April of 4.9% from a year earlier, down from 5.2% in March. Different measures of consumer sentiment from both the Conference Board and the University of Michigan also showed declines over the last several months. Moreover, the hot job market may be starting to cool; the number of job openings seem to have hit a plateau, although still high at 11.4 million open positions in May according to Indeed.

Higher energy and gas prices may also help halt spending in other areas, especially as the summer travel season swings into gear. West Texas Intermediate crude oil climbed steadily in May, peaking for the month at $115 per barrel. The Memorial Day weekend saw national gas price averages reach $4.62 per gallon according to AAA. Yardeni Research also reported spending on gasoline has nearly doubled from a year ago for the average U.S. household, which adds more pressure on consumers' discretionary spending. The rise in oil prices helped firms in the Energy sector strongly outperform all other sectors for the month with a return of 15.8%. Stocks of Consumer Staples and Consumer Discretionary companies were among the monthly laggards, although Real Estate was the worst-performing sector for the month, falling 5.0%. (See sector performance table on the next page.)

With so much uncertainty in the economy right now, it's likely we'll see continued volatility for the near term until investors have a better sense of how the economy will weather a potential recession. Even if we do enter a recession later this year, it won't be the end of the world; since 1945, the average recession has lasted 11 months according to data from the National Bureau of Economic Research. The same holds true for bear markets, although bear markets for stocks don't necessarily have to coincide with economic recessions. Since World War II, the average bear market has lasted 13 months (market peak to trough). So, if we are in bear market right now, we may be almost two-thirds of the way through it.

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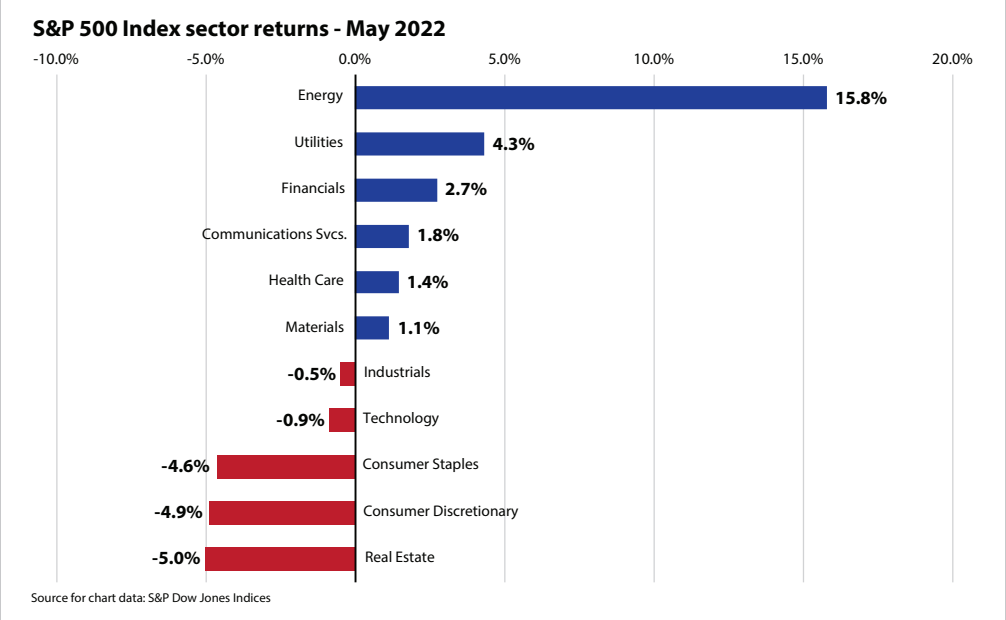

As an investor, you shouldn't pay too much attention to what happens in the market in the short term. Tracking the daily ups and downs can contribute to feelings of fear and anxiety that could lead to emotionally charged investment decisions. Many investors have tried to time market swings in the past, with little success of getting their moves right either at the peak or the bottom. Your best course of action is to invest with strategy that can see you through these bouts of market volatility and stay the course with that strategy through thick and thin.

The current market correction appears to be lingering, but keep in mind that corrections happen all the time. They are not unusual, nor long-lasting. In most cases, individual stocks are likely to follow the direction of the broader market, either up or down. Our strategy is all about protecting your portfolio from catastrophic broad market declines, while allowing the individual portfolio components to experience their own volatility. It is more cost-effective for us to protect your investment from these cyclical downturns rather than hedging individual stocks. We use prudent stock selection to help manage the risks of holding these positions.

Market downturns also provide opportunities for investors to buy good companies at potentially exceptional prices. At present, what we may be seeing in the stock market is a resetting of valuations after a surge of upside momentum. Price multiples (e.g., price/earnings ratios) for a stock are based on where investors in general believe that company's earnings will be going forward. Given the existing pressures on earnings from inflation, labor and supply chain factors, plus uncertainty about where the economy will be in the near future, we are seeing stock valuations reset to levels where stock prices are more reasonably priced. Still, it's important to follow a long-term approach to stock ownership, seeking out quality companies with solid fundamentals and business models that are designed to deliver returns through different economic cycles.

As we enter the first official days of summer, I wish you and your family a happy and safe summer season. We look forward to continuing to serve your wealth management needs and speaking with you in the months to come.

700 Louisiana, Suite 3950 | Houston, Texas 77002 281.580.2100 Ext. 1 | 877.359.2081 toll free
info@postoakprivatewealth.com | www.postoakprivatewealth.com