GITTERMAN
ASSET MANAGEMENT

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

You Don't Have to Go Home, But You Can't Stay Here

Say what you will about the Federal Reserve, but Chairman Jerome Powell has thrown one heck of a party in the two-plus years since the Covid pandemic began. Since the last financial crisis in 2008, the Fed has been no stranger to spiking the punch bowl in the form of quantitative easing and keeping rates near zero. But the 2020 response dwarfed all efforts that came before it. The Fed doubled their balance sheet from $4 trillion to $8 trillion, purchased corporate bonds for the first time, lent out $800 billion in PPP loans and kept rates ultra-low long after inflation began flashing red warning signs.

Since inflation began to rise and the high-flyers of the Covid rally began breaking down under the surface of the equity indices in mid-2021, we have been warning about last call. Now, midway through 2022, the Fed has removed the punchbowl, shut off the music and turned up the lights. Rate hikes have accelerated from 25 bp earlier in the year to 75 or 100 bp expected at upcoming meetings. Quantitative tightening has begun at a faster pace than ever attempted previously. The party is over, and markets must now deal with the hangover.

Economic Update

We've all been hearing the word "unprecedented" a lot in the last two and a half years. First there was the unprecedented global spread of a novel coronavirus, then unprecedented lockdowns followed by unprecedented stimulus from central banks and governments. The economic shocks resulting from the actions taken back in 2020 have put the economy into truly uncharted waters today and have forced the Federal Reserve to walk a tightrope balancing inflation and growth concerns simultaneously.

For the first two months of the quarter, the market narrative was that inflation had peaked after falling from 8.5% in March to 8.3% in April. The stock and bond markets stabilized as traders priced in a more dovish Fed. Hopes of an inflation peak were dashed in May when CPI rose again to a new cycle high of 8.6%, followed by another unexpectedly high reading of 9.1% in June. Combined with a University of Michigan survey showing consumer expectations of inflation had risen more than expected, the market abruptly began pricing in more aggressive rate hikes and risk assets resumed their downward trend. When the Fed met for its June meeting, Chairman Jerome Powell did not disappoint. He delivered a 75 bp rate hike and indicated another move of that scale was likely at the July meeting.

This level of inflation alone is unprecedented on a personal level for most of us who work in the financial industry. Inflation is now higher than any time since 1982, a time period longer than most Wall Street careers and even the lifetime of many financial professionals. But inflation was significantly higher in the 1970s and early 1980s, hitting a high of almost 15% in 1980. So why is this situation truly unprecedented?

The difference between the market environment today and what we experienced in the 1970s and 1980s is the level of interest rates in the background of this high inflation. The fed funds rate, set by the Fed, ranged from 5-10% in the 1970s and went as high as 20% when Chairman Volcker aggressively hiked rates to combat stagflation. Today, the fed funds rate is still only 1.75% and remained effectively at 0% until March of this year. Real interest rates, which subtract inflation from the nominal interest rate, are near their most negative levels in history.

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

Extremely low starting rates have complicated the Fed's attempts to rein in inflation and have amplified the pain in the bond market as they have increased rates. Mortgage rates, for example, have nearly doubled from 3.3% at the start of 2022 to 5.8% at the end of Q2. This presents a much larger hit to affordability than a 2.5% increase in mortgage rates would have if starting rates were 10%. The increase has pushed the average mortgage payment as a percentage of household income to almost 30%, above the high in 2006 ahead of the 2008 financial crisis.

The tightening of financial conditions caused by the Fed's rate increases and quantitative tightening, along with the complete removal of Covid-related stimulus and dramatic price increases for necessities like food and housing, have begun to impact American consumers. Saving rates, which were well above average during the pandemic, have plummeted to the lowest levels since 2009. While spending growth of 11% YoY in June is still outpacing inflation, forward looking indicators are more pessimistic. The June University of Michigan Consumer Sentiment reading came in at just 50, the lowest on record, and consumer revolving credit increased by 17.8% YoY in April, a worrying sign that consumers are relying on credit cards to make ends meet. More pain may be ahead. A recent Census Bureau survey indicated that 3.5 million households say it is at least somewhat likely that they will be evicted in the next 2 months as a result of skyrocketing rents.

The one bright spot for consumers is the labor market, which is at historically tight levels due to a (there's that word again) unprecedented labor shortage. The ratio of job openings to unemployed people is nearly 2-to-1. The reasons for this shortage have been covered extensively in our commentaries and the broader media but the jury is still out. Given that Covid stimulus ended a year ago, we don't believe those payments are a major driver of the current situation. The worker shortage may be more structural than the Fed has acknowledged, if the main drivers are demographics, reduced immigration, and the impact of Covid death and disability. The labor market is so strong that one of Chairman Powell's stated goals is to slow the economy enough to weaken the labor market and prevent wage-price inflation from spiraling out of control, which may require more significant rate hiking than the market expects.

Overall economic growth has been slowing in recent quarters. The economy contracted 1.6% in the first quarter and, as of July 8th, the Atlanta Fed is projecting another 1.2% contraction in Q2, which would mean the economy is in a technical recession. Ordinarily, the Fed would back off its hawkish tone and cut rates in response to such a slowdown. This time is different. Inflation is the Fed's top concern and the labor market does not need their help.

We expect the Fed to continue hiking rates aggressively and that they will accept the consequences to the stock market, economic growth and corporate profit margins until there is a clear peak in inflation followed by several months of declining CPI and/or a return to equilibrium in the labor market followed by a rise in unemployment. Their rationale for hiking rates so aggressively now by increasing 75 bp in June and potentially again in July and September might be to build up ammunition to respond next year if the economic damage is bad enough to warrant it.

While there's a lot about this market environment that is unfamiliar, we believe the old adage that one should not "fight the Fed" will remain true. Fed decisions and messaging will be key drivers of our asset allocation decisions, particularly how much exposure to risk assets we maintain. As long as the labor market remains strong and inflation remains elevated, the Fed will be forced to continue tightening regardless of the impact on the stock market.

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

GITTERMAN
ASSET MANAGEMENT

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

Market Update

Heading into midyear, stocks entered their second bear market in just over two years, with year-to-date global stock market losses of around 20%. The last time investors saw back-to-back negative quarters for stocks and bonds was in 2008, and before that, 1981. With the unusual combination of losses in both markets, the only safe havens for investors have been cash, commodities-focused strategies, and, to a lesser extent, value stocks and real assets.

Name	QTD	YTD
MSCI ACWI NR USD	-15.66%	-20.18%
S&P 500 TR USD	-16.10%	-19.96%
Russell 1000 Value TR USD	-12.21%	-12.86%
Russell 1000 Growth TR USD	-20.92%	-28.07%
Russell Mid Cap Growth TR USD	-21.07%	-31.00%
Russell Mid Cap Value TR USD	-14.68%	-16.23%
Russell 2000 Growth TR USD	-19.25%	-29.45%
Russell 2000 Value TR USD	-15.28%	-17.31%
MSCI EAFE NR USD	-14.51%	-19.57%
MSCI EM NR USD	-11.45%	-17.63%
MSCI China NR USD	3.41%	-11.26%
Bloomberg US Agg Bond TR USD	-4.69%	-10.35%
Bloomberg US Credit TR USD	-6.90%	-13.81%
Bloomberg US Government TR USD	-3.71%	-9.04%
Bloomberg Municipal TR USD	-2.94%	-8.98%

Source: Morningstar Direct

With most regions and styles of equities down double-digits year-to-date, investors haven't found relief in the fixed income markets either. Higher quality bonds with longer duration, which are typically a hedge against equity declines, have faltered as rates rose. The Barclays Aggregate Index is down about 10% year-to-date. These correlated selloffs have resulted in a loss of about 15% year-to-date for a typical balanced portfolio with global diversification and US Agg-like fixed income. For now, bonds have stabilized as rates remain caught in a tug of war between rising in response to higher inflation and falling in response to slowing growth. If growth fears begin to dominate inflation fears, high quality bonds will likely behave more like a hedge than they have been. [1]

At the heart of this year's stock market slump is the increasingly hawkish monetary policy employed by the Fed and other central banks. Without the "Fed put" propping up markets and flushing the system with liquidity, inflated asset prices fell across global markets.

How did the Fed fall so far behind the inflation curve? The Fed misjudged the effects of pandemic supply constraints and fiscal stimulus pushing up consumer demand at a time when inventories were at historic lows. OPEC has also been

[1] Morningstar Direct. Access date 7.10.22

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

ramping up energy production very slowly, given a general global energy shortage which helped bolster rising energy prices. All these factors led to a larger than expected inflation surge.

The U.S. isn't the only country under fire from its central bank. Broadly speaking, central banks around the world are confronting high inflation by increasing rates. The Bank of England has already increased rates four times, and they seem set to increase rates some more. The European Central Bank has not raised rates yet, but they look likely to increase rates in July. Japan and China are the only major economies not currently on a path to raise interest rates and instead are offering more accommodative policies.

U.S. Equity Markets

Equities have traded expensively in recent years, driven by accommodative monetary policy which kept discount rates extremely low, which in turn increases the value of future cash flows. Investors have also enjoyed lower capital gains tax rates, enhanced global integration, and declining real bond yields. The S&P 500's forward P/E ratio is now down about 27% year-to-date[2]. On the surface, the S&P 500 now looks cheap relative to its history with the current P/E at 15.9x compared to the 25-year average at 16.9x[3]. Practically all of the drawdown that we've seen so far year-to-date has been a function of changes in the valuation multiple (P/E ratio), rather than downward pressure on earnings. Are earnings the next shoe to drop?

According to Bloomberg as of July 13th, earnings are expected to grow more than 19% over the next 12 months, which would require companies to defend margins despite rising costs and a growing inventory glut due to slowing consumer demand. Analysts have not begun to price in slowing in corporate earnings growth so far. A disappointing earnings season would be a major red flashing sign for markets and any downward revisions to future earnings forecasts would result in higher forward P/E ratios, putting the equity market back into expensive territory.

Higher interest rates and mean reversion after years of outperformance have clobbered growth stocks year-to-date. The Morningstar US Large Value Index outperformed the US Large Growth Index by more than 20 percentage points this quarter, the largest gap in favor of value since 2000[4]. The Morningstar US Growth Index lost 25.3% in the quarter, its worst performance since the financial crisis in 2008[5]. High-growth market sectors, including consumer cyclical and technology, took the hardest hits as former market leaders including Amazon and Tesla each lost over 35%[6].

At the sector level, defensive areas of the market lived up to their reputation and held up best during the downdraft. Sectors like healthcare, utilities, and consumer defensive provide services that are required in both good and bad times. Generally, stocks in these categories are considered less volatile and less affected by the ups and downs of long-term market cycles.

[2] Morningstar Direct. Access date 7.10.22
[3] Morningstar Direct. Access date 7.10.22
[4] Morningstar Direct. Access date 7.10.22
[5] Morningstar Direct. Access date 7.10.22
[6] Morningstar Direct. Access date 7.10.22

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

International Equity Markets

The situation for international markets is more tenuous. The price of European natural gas climbed more than 50% after Russia cut flows on Nordstream 1. There are growing worries that rationing of natural gas could take place in Europe this winter, which would force businesses to cut energy usage. In this disastrous scenario, many companies would be forced to stop or reduce production, almost certainly leading to a recession in Europe.

Other commodities were lower in June as market participants priced in a decelerating economy. This led to losses in many of the large commodity-producing emerging economies, which had performed relatively well in the first five months of 2022.

The lone winner has been China, whose stocks benefitted from more accommodative monetary policy by the PBOC and the relaxing of Covid restrictions. Chinese stocks had fallen by half since February 2021 through their low in March of this year. The Morningstar China Index ended the quarter up 8.5%, which followed a decline of 13% in the first quarter. Despite the recent bounce and stimulus announcement, China's economy still faces significant threats from their property bubble and commitment to maintaining a zero-Covid policy for years to come. [7]

For US investors investing internationally, international equities outperformed their US counterparts in local currency terms, but a strong dollar negated almost all of that advantage. In nominal terms, the dollar is at its highest level since 2002. In real terms, it's at its highest level since the mid-1980s.

Fixed Income

The reality is that the bond market today is much more interesting than at the start of this year. Yields have risen to the high end of their 10-year range and a lot of the conversations in fixed income have turned to the idea of adding back some duration. So far, credit spreads have held up well and investors in high yield debt have not been punished for holding more credit risk. Most of the bond selloff has been driven by rising rates, leading to a paradoxical situation where lower credit quality bonds have outperformed higher quality despite a deterioration in the stock market. If the earnings and growth outlooks worsen, we would expect to see this trend reverse.

Yields rose across the bond market. The U.S. Treasury 10-year note climbed to a high of just shy of 3.5% in mid-June and finished the quarter at 3.2%, up from 2.3% at the start of the quarter and 1.5% at the end of 2021. Meanwhile, the yield on the U.S. Treasury 2-year note finished within shouting distance of the 10-year at 3.1%, up from 2.28% at the end of March and 0.73% at the end of December. Long-term bonds took a heavy punch thanks to their vulnerability to rising interest rates. The Morningstar US 10+ Year Core Bond Index fell 12.1% and the Morningstar US 10+ Year Treasury Bond index lost 11.6% QTD. [8]

[7] Morningstar Direct. Access date 7.10.22
[8] Morningstar Direct. Access date 7.10.22

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

Portfolio Positioning

We are currently underweight equities and overweight fixed income and cash, a positioning we have been working into since last summer as our outlook turned bearish. In keeping with our philosophy of not fighting the Fed, we don't anticipate adding risk to the portfolio in any meaningful way in the short term, but we are looking for opportunities to reposition into areas of the market that may provide more upside potential and/or downside protection. Small and mid-cap equities, which have underperformed large caps for years in both rallies and selloffs, are one such area. The U.S. dollar is also well above its long-term fair value, hitting parity with the Euro for the first time ever in July. Any reversion to the mean would be a tailwind for international equities.

On the fixed income side, duration exposure has become much more attractive in the past six months. Coupons have risen alongside interest rates, which mean both higher income and an improved cushion against price declines if rates rise further. Our overweight to high quality fixed income is intended to ballast the portfolio in the event of worsening economic data that could push equities, credit and rates lower simultaneously. We remain wary of adding credit exposure to the portfolio until spreads begin to price in the elevated default risk resulting from monetary tightening and a potential recession.

Climate and ESG Update

U.S. Supreme Court Ruling Limits EPA's Authority In Regulating Greenhouse Gases:

West Virginia vs. EPA was the largest and most important climate change case to come before the Supreme Court in over a decade. Fundamentally, the case is about a group of Republican attorney generals, mostly from fossil fuel producing states — West Virginia, Kentucky, Texas — who are suing the Environmental Protection Agency over its authority to regulate greenhouse emissions from power plants without passing legislation in Congress. This case started with the Obama administration's 2014 Clean Power Plan to curb power plant emissions using an executive order. The order was based legally on the 1970 Clean Air Act, which was signed into law in 1970 by Richard Nixon and gave the EPA authority to clean up the nation's air and water. Obama, and later Biden, relied upon precedent from *Chevron vs NRDC,* in which the Supreme Court ruled that federal agencies have "deference", or the ability to interpret unclear laws and act based upon their interpretation. In the *West Virginia vs EPA*, the Supreme Court decided in a 6-3 ruling that the EPA did not have the broad authority to require states to decarbonize their electricity sectors. This decision dramatically affects the ability of the executive branch to enact climate rules and puts the burden back on Congress and the individual state public utilities commissions who have not taken significant steps on climate historically.

What will this mean for U.S. climate policy? When signing the Paris Agreement, the U.S. pledged itself to cutting 50% of emissions by 2030. There are three basic tools needed to meet that pledge. One of them is the reconciliation bill that has been stuck in Congress since last year. The other two pieces are this regulation on power plants and sweeping regulation on vehicles to phase out internal combustion engine cars in favor of electric vehicles. If any one of those three pieces are taken off the table, it becomes mathematically very difficult for the U.S. to meet its climate goals.

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov

379 Thornall Street | 6th Floor | Edison, NJ 08837
www.gittermanasset.com | Fax: 888-476-1314

Although the EPA's rules on power plant emissions might have been the fastest and most effective way to align the U.S. with its Paris pledge, there are other regulatory agencies who can step up to fill this role, including the Federal Energy Regulatory Commission (FERC), which regulates the interstate transmission of electricity, natural gas, and oil, local Public Utility Commissions, which regulate the generation and transmission of energy within state boarders, and entities like the Department of Labor (DOL) and the U.S. Securities and Exchange Commission (SEC), which has recently released ESG and Climate disclosure rules for investors.

Gitterman Wealth Management, LLC dba Gitterman Asset Management. Services provided by Gitterman Asset Management are provided by Gitterman Wealth Management, LLC. All investment advisory services are offered solely through Gitterman Wealth Management, LLC an independent investment advisory firm registered with the SEC (CRD 153062). Associated persons of Gitterman Wealth Management, LLC are licensed with and offer securities through Vanderbilt Securities, LLC, member FINRA/SIPC, registered with MSRB (CRD 5953). Gitterman Wealth Management, LLC and Vanderbilt Securities, LLC are separate and distinct federally regulated entities. For more information see www.adviserinfo.sec.gov