August 11, 2022

Quarterly Commentary

Asset prices are off to a rough start in 2022 as markets grappled with high inflation, slowing economic momentum, and less accommodative monetary policy.

High and rising inflation expectations during the second quarter proved challenging for almost all major asset categories. Bonds suffered significant losses as projections for higher rates rose. Global stock prices experienced a bear market. Commodity prices also slumped after a massive rally as demand waned.

Bear Market

Every month, our investment committee holds a meeting to discuss the most important issues driving the macroeconomy and financial markets. This month's meeting was especially pertinent as it comes on the heels of a substantial decline in global equities. The S&P 500 has shed over 20% from its top, officially entering a bear market. (Chart 1) Therefore, is now a good time to buy the dip? Warren Buffett, after all, advises investors to be "fearful when others are greedy, and greedy when others are fearful", and right now US sentiment surveys show most market participants to be scared.

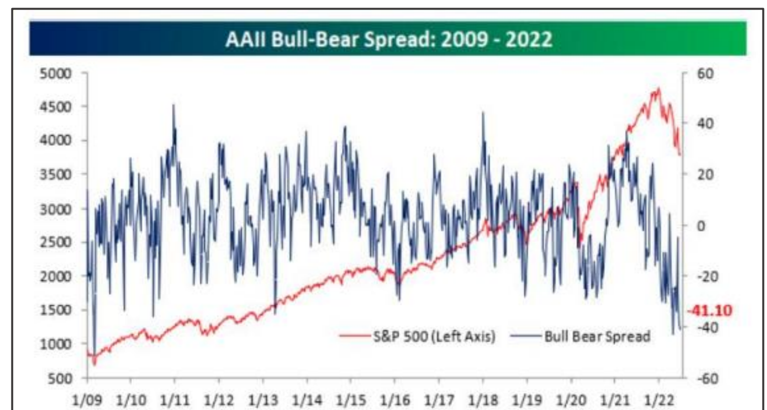

Chart 1

15%+ Quarterly Drops for the S&P 500: Post WW2

Quarter	Quarterly Drop (%)	Next Quarter (%)	Next Half (%)	Next Year (%)
Sep-46	-18.83	2.27	1.40	1.00
Jun-62	-21.28	2.78	15.25	26.70
Jun-70	-18.87	15.80	26.72	37.10
Sep-74	-26.12	7.90	31.19	32.00
Dec-87	-23.23	4.78	10.69	12.40
Sep-02	-17.63	7.92	4.04	22.16
Dec-08	-22.56	-11.67	1.78	23.45
Mar-20	-20.00	19.95	30.12	53.71
Jun-22	-19.06	?	?	?
	Average	**6.22**	**15.15**	**26.07**
	Median	**6.34**	**12.97**	**25.08**

Chart 2

Of course, price affects sentiment and it's been a quarter to forget for equities. As shown to the right, the S&P 500 is on pace to experience its 9th quarterly decline of 15%+ in the post-WW2 market era. Following the prior 8 quarterly drops of 15%+, the S&P averaged a gain of 6.22% the following quarter, a gain of 15.15% over the next two quarters, and a gain of 26% over the next year. Over both the next half year and year, the index was higher every single time. (Chart 2)

However, a typical bear market drawdown for the S&P 500 is 34% and last 431 calendar days. Currently, the S&P 500 is in a 24% drawdown and 165 days since an all-time high. This would imply further downside, which our current technical analysis reiterates. The key issue that we are grappling with is whether the Fed can achieve a proverbial soft landing or whether the US and the rest of the global economy were spiraling towards recession (if it wasn't already there).

A July Rally, But Not out of the Woods Yet

Major stock indices crossed some key technical thresholds, and interest rates and commodities pulled back sharply as economic concerns really start to pile up ahead of a hawkish Federal Reserve. It's rare you see the Fed tighten monetary policy into an economic backdrop that's clearly weakening, but that's where we stand. It's hard to get too bullish about

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the prospects for the economy or the market from these levels, but as sentiment surveys and positioning clearly indicate, the negative view is as crowded as Times Square on New Year's Eve. The markets can always see further over the horizon than any of us, which makes it hard to ignore the moves higher we've seen over the last month. We're still not out of the woods but let's evaluate where we stand and how were positioning around that.

Inflation

Market participants hoping for some relief on the inflation front were disappointed once again this month. The US headline CPI rose 1.32% month-over-month in June, above the consensus of 1.1%. Core inflation increased to 0.71%, surpassing consensus estimates of 0.5%.

The key question is how much of June's report is "water under the bridge" and how much is a harbinger of things to come.

Since the CPI data for June was collected, oil prices have dropped to below $100/ bbl. Nationwide gasoline prices have fallen for four straight weeks, with the futures market pointing to further declines in the months ahead. Wage growth has slowed to about 4% from around 6.5% in the second half of last year. All this suggests that inflation may be peaking. (Chart 3).

The TIPS market certainly agrees. It is discounting a rapid decline in US inflation over the next few years. This week's inflation report did little to change that fact.

Projected Path of CPI Inflation

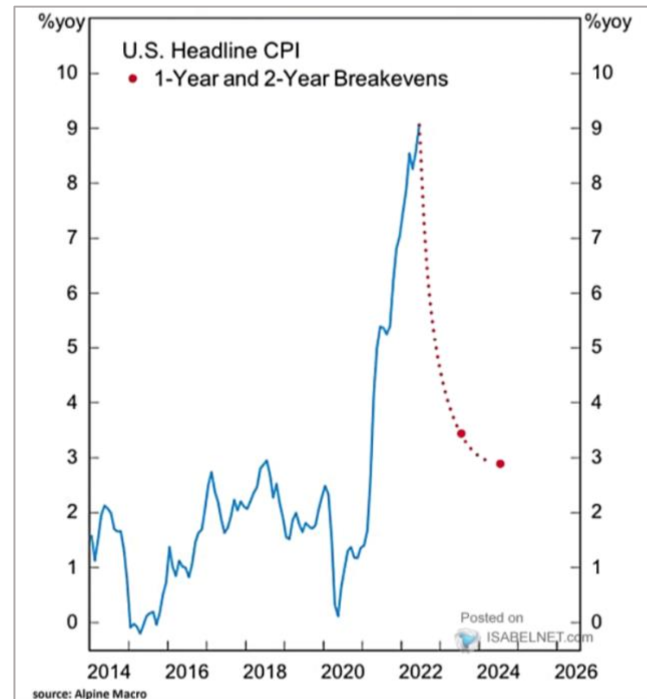

Chart 3

Growth

Just about every macroeconomic metric has been showing weaker momentum lately, led by housing and manufacturing rolling over. The US has now seen two straight quarters of contracting GDP growth.

While growth metrics are losing momentum, key metrics are still holding up at absolute levels, specifically employment.

Many investors now see recession as baked into the cake. According to Bank of America, the majority of fund managers saw a recession as likely in this month's survey. (Chart 4) Additionally, global growth optimism and equity positioning are at all-time lows. (Chart 5)

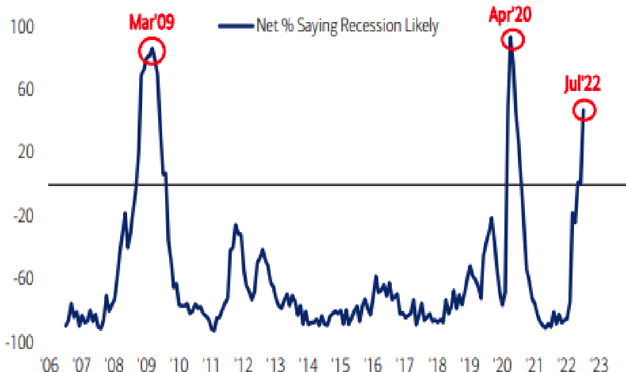

Chart 4

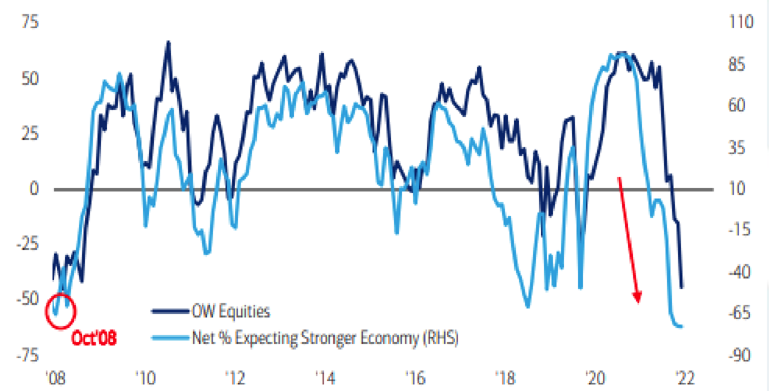

Chart 5

See important disclosures on the final page.

Technicals/Trends

It's been an important last few weeks for market technicals as Bulls have made some key progress but aren't out of the woods yet. The S&P 500 broke above its 50-DMA for the first time in 60 trading days (its longest streak since 2008), but is still firmly below its 200-DMA, failing to break through its long-term downtrend. (Chart 6) We will be monitoring these trends closely, as technicals help identify important market turning points.

Chart 6

Conclusions

Markets are at an inflection point. We experienced a shallow technical recession (2 quarters of negative real GDP growth), but much of that scenario is largely baked into prices. For us, the real question is are we going to experience a deep recession where unemployment significantly rises. Then asset prices could face much steeper drawdowns. Right now, we are in the former camp, and are aggressively monitoring the latter. We aim to protect against capital destroying downside and believe the odds of that scenario have increased.

Stocks lack an immediate macro driver to move higher. We think that driver could come in the form of lower inflation prints, which we just saw for the first time this month. This should allow the Fed to dial back hawkishness. However, we also want to position against rising risks of recession.

Donoghue Forlines Portfolios

In today's environment, the 60/40 retirement rule is stuck in the past. Advisors are challenged to rethink foundational portfolio elements of investor portfolios – which means seeking out strategies that bolster the "core" going forward. With no cheap assets, tactical and unconstrained management is now more important than ever.

We continue to focus on the need to help craft easy-to-understand, longer-term narratives for Advisors and their Clients. Panicking and abandoning diversified investment strategies during volatility and market crashes/surges is a time-tested losing proposition.

Donoghue Forlines solutions are designed to be client-centric and deliver strong risk-adjusted return streams through both our rules-based, tactical strategies as well as our global macro, fundamentally driven tactical solutions. We aim to capture the majority of the upside but more importantly to avoid the majority of the downside.

We have continued to carefully assess exposure across all our portfolios over the past quarter, as per our risk management process. Our positioning is outlined in more depth below. We have made moves to protect against

downside in current markets.

We will stay vigilant with our goal of seeking strong risk-adjusted returns. Please visit our website at www.donoghueforlines.com for our latest information including Fact Sheets for the entire suite of products. Thank you for your confidence in Donoghue Forlines. Please let us know if you have any questions. We will stay vigilant with our goal of seeking strong risk-adjusted returns. Thank you for your confidence in Donoghue Forlines. Please let us know if you have any questions.

Regards,

Jeffrey R. Thompson
Chief Executive Officer
Portfolio Manager

The following reflects Donoghue Forlines' portfolios positioning as of June 30, 2022.

Donoghue Forlines Dividend Portfolio

Positioning: 50% allocated to large and mid-sized high yielding stocks with a diversified sector exposure and quality orientation. 50% invested in short-term treasury ETFs.

During the quarter, we received one tactical signal. On June 17th, we sold 50% of our equity exposure and moved into short term treasuries. On June 9th, the portfolio was reconstituted and rebalanced.

Donoghue Forlines Momentum Portfolio

Positioning: 50% invested in large and mid-sized stocks exhibiting strong short-term momentum with a diversified sector exposure. 50% invested in short-term treasury ETFs.

During the quarter, there no technical signals. On June 9th, the portfolio was reconstituted and rebalanced.

Donoghue Forlines Treasury Portfolio

Positioning: 100% invested in intermediate-term U.S. Treasury bonds via ETF exposure.

During the quarter, the portfolio did not receive a technical trigger and remained 100% invested in intermediate-term U.S. Treasury bonds.

BLENDED SOLUTIONS

The blended solutions combine the best ideas from our rules-based and global macro solutions into long-term investment solutions.

Donoghue Forlines Income Portfolio

The DF Income Portfolio's asset allocation at the quarter end is as follows: 57% in cash, 29% in fixed income, 7% in equities, and 7% in alternatives.

Target Allocations: *(55%) in Donoghue Forlines Tactical Income Fund; (31%) in Donoghue Forlines Risk Managed Allocation Fund; (12%) in Trim Tabs Donoghue Forlines Tactical High Yield ETF; and 2% Cash.

Donoghue Forlines Dividend & Yield Portfolio

The DF Dividend and Yield Portfolio's allocations at quarter end are as follows: 42% in cash, 22% in fixed income, 25% in equities, 10% in alternatives.

Target Allocations: Donoghue Forlines Tactical Income Fund (44%); Donoghue Forlines Tactical Allocation Fund (24%); Donoghue Forlines Risk Managed Income Fund (15%); Donoghue Forlines Dividend Fund (12%); Donoghue Forlines Momentum Fund (3%); and 2% Cash.

Donoghue Forlines Growth & Income Portfolio

The DF Growth and Income Portfolio's allocations at quarter end are as follows: 24% in cash, 25% in fixed income, 41% in equities, and 10% in alternatives.

Target Allocations: Donoghue Forlines Tactical Allocation Fund (15%); Donoghue Forlines Momentum Fund (21%); Donoghue Forlines Risk Managed Income Fund (5%); Donoghue Forlines Tactical Income Fund (15%); Donoghue Forlines Dividend Fund (15%); and 2% Cash.

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The Russell 2000 Index refers is a stock market index that measures the performance of the 2,000 smaller companies included in the Russell 3000 Index. The Russell 2000 is is widely regarded as a bellwether of the U.S. economy because of its focus on smaller companies that focus on the U.S. market.

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