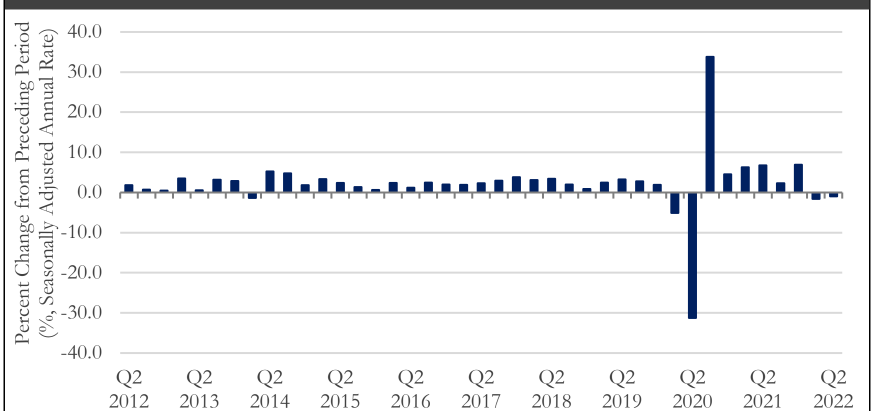
Economic Commentary & Capital Market Update

Recap

The U.S. economy contracted at a 0.9% annualized rate in the second quarter of 2022. A slower pace of inventory building had an outsized effect and accounted for much of the decline. This was the second straight quarterly decline. Based on the available data, back-to-back quarters of negative GDP growth were not consistent with a contraction that was typically thought of as a recession. However, it is undeniable that the economy was cooling.

Real GDP Growth: U.S.



Source: U.S. Bureau of Economic Analysis

Signals of a slowdown have started to flash across sectors. Business and consumer sentiment has faltered, real consumer spending has weakened, housing activity has stalled, and business investment has downshifted in response. The retail sales report offered further evidence of fading consumer purchasing power. Consumers have spent more and gotten less across the board. Manufacturers have also felt the pressure of higher costs. Industrial production unexpectedly declined 0.2% in June. Manufacturing activity declined for the second consecutive month and downward revisions to past data would suggest a slower pace of production. Moderation in the factory sector has been traditionally consistent with a broader moderation in demand, and June's weaker-than-expected outcome likely signaled to the Fed that tighter policy has had the intended effect on activity.

That said, robust employment growth and solid gross domestic income would suggest the economy is not in the hole just yet. Output should grow modestly throughout this year before beginning to contract in Q1-2023. The reason economic growth should slip into negative territory

New York (HQ)
400 Park Avenue 6th Floor
New York, NY 10022

Chicago
311 W. Monroe Street,
Suite 304
Chicago, IL 60606

Palm Beach
515 N. Flagler Drive
Suite P-300
West Palm Beach, FL 33401

Los Angeles
10250 Constellation Blvd
Los Angeles, CA 90067

Newport Beach
4041 MacArthur Blvd
Suite 400
Newport Beach, CA 92660

212.254.4876
info@matrixpcg.com
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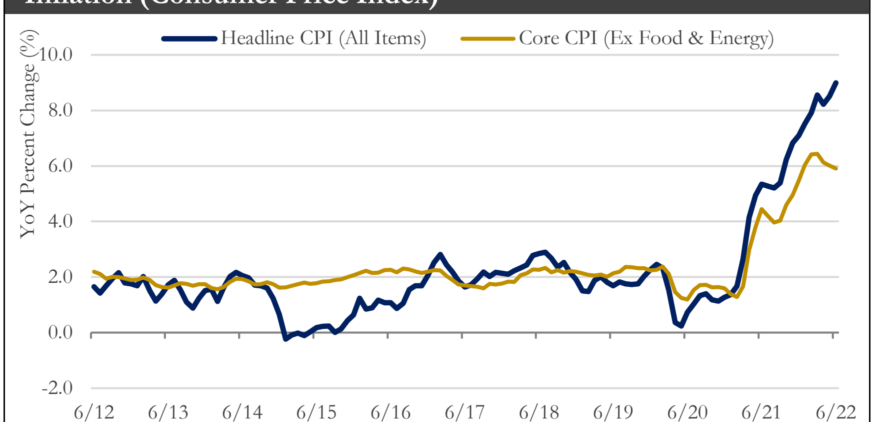
next year is that the Fed has turned even more hawkish in the face of persistently high inflation due to past economic stimulus, ongoing supply-side constraints, and intensifying food and energy prices resulting from the Ukraine crisis. In recent weeks, the headline Consumer Price Index and measures of consumer long-term inflation expectations have risen faster than anticipated.

The FOMC will likely follow up the 225 bps of hikes implemented so far this year with an additional 200 bps of hikes over the next three quarters. This aggressive pace of monetary policy tightening has been designed to achieve a soft landing, where growth slows to the point that the unemployment rate stops falling or even rises modestly. Given the current high pace of inflation, the Fed will not only have to achieve a soft landing but also maintain it for a year or more to slow inflation in a meaningful and lasting way. Unfortunately, the Fed's record in achieving soft landings has been spotty at best and has had even less success at maintaining a soft landing for beyond a few quarters.

Inflation

U.S. consumer inflation rose to a new four-decade high at an annual rate of 9.1% in June, extending a year and a half stretch of persistently higher prices. Costs were up broadly across the economy, with gasoline far outpacing other categories at an 11.2% gain over the prior month. Shelter and food price increases were also major contributors to inflation.

Inflation (Consumer Price Index)



Source: U.S Bureau of Labor Statistics

Even more troubling, the drivers behind the price increase were broad-based and mostly in the core components. Core CPI inflation rose 0.7% in June. Price gains for goods such as apparel and vehicles showed no signs

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Chicago
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Palm Beach
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info@matrixpcg.com
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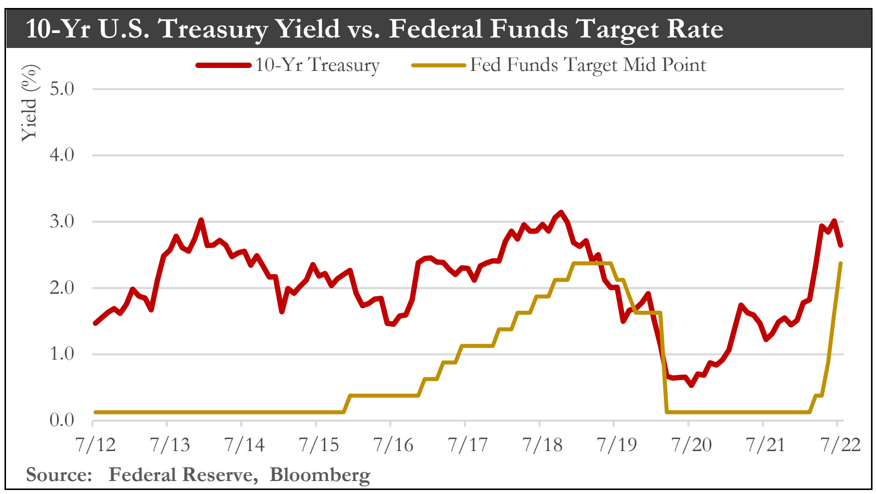
of easing, while inflation for services such as shelter, and medical care continued to escalate.

The resilient upward pressure on core goods prices over the past two months has been an unwelcome development for the Federal Reserve. Core goods inflation has risen at a torrid 6.8% annualized pace over the past three months which would suggest the year-over-year rate of core CPI peak has not been seen yet.

Monetary Policy

The Federal Open Market Committee (FOMC) raised its target range for the federal funds rate by 75 bps in July, bringing the top end of the range to 2.50%. The FOMC is expected to increase the federal funds rate by 75 bps in September, 50 bps in November, and 25 bps in December. This would put the peak in the federal fund's target range at 4.00%-4.25%.



If a recession begins in the United States in Q1-2023 as expected, then the end of the Federal Reserve's tightening cycle likely will occur around the same time. Accordingly, the final rate hike is expected in December, followed by a pause as the FOMC grapples with a deteriorating economy, but inflation that is still above target.

New York (HQ)
400 Park Avenue 6th Floor
New York, NY 10022

Chicago
311 W. Monroe Street,
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Chicago, IL 60606

Palm Beach
515 N. Flagler Drive
Suite P-300
West Palm Beach, FL 33401

Los Angeles
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Newport Beach
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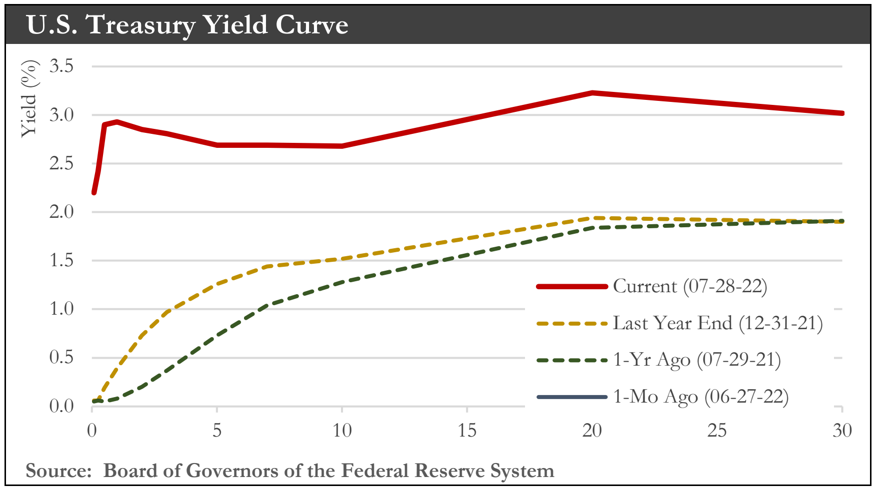

As time passes, inflation will cool further as the economy weakens, and as a result rate cuts could begin in Q3-2023. In the near term, Fed tightening should push Treasury yields up across the entire curve, with yields on shorter-dated securities rising more than longer-dated ones. Once the FOMC is done tightening, however, the Treasury curve should start steepening again as rate cuts come more sharply into view.

Labor Market

The near-term momentum in the labor market has remained intact. Nonfarm payrolls put up another robust gain in June, increasing by 372,000, and employment growth was once again broad-based across industries. However, beneath the surface, there have been some tentative signs that the labor market is cooling.

Wage growth has slowed, initial jobless claims have ticked higher, and job openings have peaked. With employment levels finally catching up with demand, hiring could slow steadily over the second half of the year. An outright decline in employment is expected to begin in late Q1 early Q2 of 2023 as the economy slips into a mild recession.

Housing Market

Housing activity has also continued to pull back under the weight of higher mortgage rates and stretched household budgets. This year's sharp rise in mortgage rates has affected home buying. Despite May's upside surprise in new home sales, sales have slowed markedly compared to the blazing

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Chicago
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212.254.4876
info@matrixpcg.com
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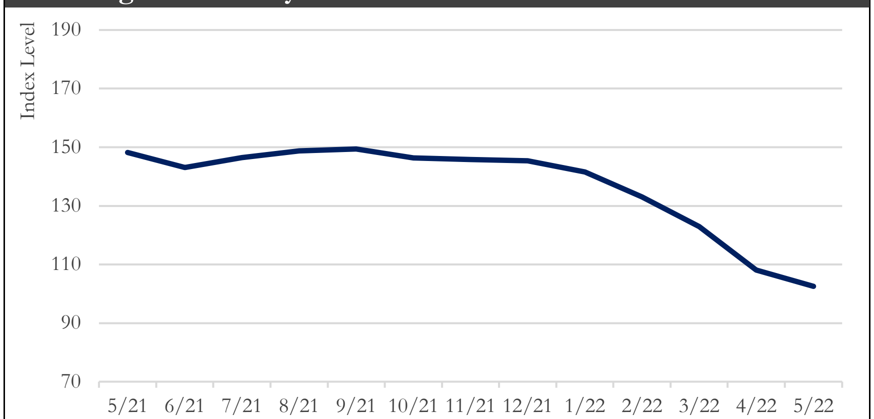
hot pace seen over the past two years. The same trend has been evident in existing home sales, which recently fell to the slowest pace since the pandemic brought home buying to a virtual stand-still in early 2020. The sharp increase in financing costs has significantly reduced affordability. Builder confidence has fallen amid the rise in rates, as buyer traffic slims, and cancellation rates rise.

Housing Affordability Index



Source: National Association of Realtors

But the prospects for new residential construction have remained profitable. While builders are likely to scale back, lower lumber prices will allow for the development of more affordable single-family units. There is still a structural shortfall of existing single-family homes, even if inventories increase as demand slows. Apartment vacancy rates should remain well below long-term averages, which will bolster the strong pace of multifamily development.

Global Economy

The global economic outlook has continued to move in the direction of slower growth and faster inflation. A recession in the United States will likely lead to slower growth (or recessions) in some key foreign economies as well. Global GDP growth of 2.5% in 2022 and slower growth in 2023 are now expected. Meanwhile, global CPI inflation is expected to rise to 7.5% this year.

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Outlook

Aggressive monetary policy tightening and reduced consumer purchasing power are weighing on economic activity, raising the probability of recession in many major economies. Going forward, the prospects for global growth have dwindled as central bank rate hikes and elevated inflation disrupt economies around the world. Sharp declines in key sectors have raised the prospects of a stalled economic recovery and possibly a recession.

A mild recession is expected for next year starting in early 2023. A recession next year is not necessarily assured, however, and the Fed may still be able to pull off an economic soft landing. But prospects of a soft landing are looking increasingly less credible, and a recession next year is more likely than not.

This U.S. recession is expected to be short-lived. European countries and emerging market nations with strong trade linkages to the U.S. are also at risk of falling into recession. Zero growth out of the U.S. economy, by itself, will keep the prospects for global growth quite dim next year; however, contagion is likely to spread to many of the major economies and push global growth even lower in 2023 relative to 2022.

With a mild U.S. recession in early to mid-2023, the Federal Reserve could eventually look to unwind monetary tightening. The Fed's terminal rate is now expected to reach 4.50% in early 2023 and the FOMC will look to lower its Fed funds rate by a cumulative 50 bps by the end of next year to cushion the economic downturn.

Sources: Department of Commerce, Department of Labor, National Federation of Independent Business, Morningstar, Bloomberg, Institute for Supply Management

New York (HQ)
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Chicago
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Palm Beach
515 N. Flagler Drive
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Los Angeles
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New York (HQ)
400 Park Avenue 6th Floor
New York, NY 10022

Chicago
311 W. Monroe Street,
Suite 304
Chicago, IL 60606

Palm Beach
515 N. Flagler Drive
Suite P-300
West Palm Beach, FL 33401

Los Angeles
10250 Constellation Blvd
Los Angeles, CA 90067

Newport Beach
4041 MacArthur Blvd
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Newport Beach, CA 92660

212.254.4876
info@matrixpcg.com
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Index Performance as of: 7/31/2022

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Russell									
3000 Value	3.45	6.81	6.81	-0.70	-7.23	-1.65	8.90	8.15	11.03
3000	4.21	9.38	9.38	0.10	-13.70	-7.36	12.55	12.18	13.48
3000 Growth	4.95	11.95	11.95	0.83	-19.56	-12.66	15.30	15.66	15.59
1000 Value	3.39	6.63	6.63	-0.79	-7.08	-1.43	8.88	8.27	11.10
1000	4.20	9.31	9.31	0.01	-13.58	-6.87	12.91	12.56	13.69
1000 Growth	4.99	12.00	12.00	0.73	-19.44	-11.93	16.05	16.30	15.95
Mid Cap Value	4.14	8.61	8.61	-1.48	-9.02	-2.85	9.38	7.76	11.47
Mid Cap	4.35	9.87	9.87	-1.02	-13.83	-9.83	9.47	9.70	12.32
Mid Cap Growth	4.74	12.24	12.24	-0.17	-22.56	-21.77	7.51	11.06	12.81
2000 Value	4.36	9.68	9.68	0.74	-9.30	-4.77	9.44	6.71	10.18
2000	4.35	10.44	10.44	1.51	-15.43	-14.30	7.51	7.12	10.60
2000 Growth	4.33	11.20	11.20	2.34	-21.55	-23.19	4.71	6.87	10.66
Standard & Poors									
S&P 500	4.28	9.22	9.22	0.39	-12.58	-4.64	13.36	12.83	13.80
Consumer Disc	5.55	18.94	18.94	0.95	-20.10	-10.30	11.29	13.21	15.54
Consumer Staples	1.65	3.30	3.30	-3.94	-2.47	7.44	11.15	9.37	10.73
Energy	10.37	9.72	9.72	5.68	44.66	67.50	14.29	8.47	4.83
Financials	2.99	7.21	7.21	-1.87	-12.86	-5.98	8.36	8.36	13.25
Health Care	2.00	3.32	3.32	2.02	-5.29	1.82	15.47	12.72	15.23
Industrials	5.71	9.50	9.50	0.92	-8.88	-6.03	9.07	8.72	12.29
Information Technology	5.09	13.54	13.54	2.07	-17.01	-5.51	22.49	22.27	20.09
Materials	4.10	6.14	6.14	-7.51	-12.85	-5.06	12.61	9.71	10.70
Real Estate	4.88	8.54	8.54	-4.02	-13.20	-1.64	9.34	10.03	9.76
Communication Services	2.49	3.71	3.71	-2.55	-27.57	-28.98	5.47	5.61	5.71
Utilities	6.51	5.50	5.50	4.58	4.92	15.59	11.07	10.43	10.79
Other U.S. Equity									
Dow Jones Industrial Avg.	2.97	6.82	6.82	0.13	-8.60	-4.14	9.22	10.86	12.31
Wilshire 5000 (Full Cap)	4.21	9.58	9.58	-0.12	-14.41	-8.72	12.07	11.87	13.25
International Equity - Broad Market									
MSCI EAFE	2.11	4.98	4.98	-4.04	-15.56	-14.33	3.16	2.62	5.79
MSCI EM	0.41	-0.25	-0.25	-6.46	-17.83	-20.10	0.90	0.95	2.84
MSCI Frontier Markets	1.15	1.24	1.24	-10.27	-19.60	-16.04	0.15	1.48	5.09
MSCI ACWI	3.27	6.98	6.98	-1.92	-14.61	-10.49	8.52	7.86	9.35
MSCI ACWI Ex USA	1.76	3.42	3.42	-4.80	-15.63	-15.27	2.91	2.45	5.04
MSCI AC Asia Ex Japan	-0.20	-1.21	-1.21	-5.21	-17.29	-19.95	2.30	1.78	5.10
International Equity - Country Region									
MSCI Brazil	9.73	5.53	5.53	-7.55	8.43	-13.78	-8.31	-0.20	-1.61
MSCI BRIC	-0.61	-3.58	-3.58	-3.33	-20.00	-25.32	-3.11	-0.16	2.57
MSCI China	-3.69	-9.50	-9.50	-2.42	-19.69	-28.36	-3.65	-1.57	4.29
MSCI Europe	2.61	4.95	4.95	-4.78	-16.87	-15.11	3.55	2.55	5.83
MSCI India	3.37	9.32	9.32	-3.99	-7.35	3.19	12.51	7.57	9.15
MSCI Japan	0.93	5.70	5.70	-1.05	-15.72	-14.29	2.85	2.49	6.43
MSCI EM Latin America	7.02	4.26	4.26	-6.39	3.67	-8.80	-5.07	-1.33	-1.90
Fixed Income									
Barclays U.S. Aggregate	0.64	2.44	2.44	1.49	-8.16	-9.12	-0.21	1.28	1.65
ICE BofAML US 3M Trsy Bill	0.03	0.05	0.05	0.14	0.20	0.21	0.58	1.10	0.64
Barclays U.S. Gov't	0.29	1.58	1.58	0.88	-7.60	-8.61	-0.29	1.04	1.09
Barclays U.S. Credit	0.52	3.04	3.04	1.24	-11.19	-12.16	-0.18	1.70	2.48
Barclays High Yield Corp.	1.53	5.90	5.90	-0.98	-9.12	-8.02	1.95	3.06	4.87
Barclays Municipal	0.92	2.64	2.64	2.46	-6.58	-6.93	0.43	1.88	2.49
Barclays TIPS	2.08	4.35	4.35	0.05	-4.96	-3.58	4.39	4.00	1.97
Barclays Gbl Agg Ex USD	1.57	1.92	1.92	-2.66	-14.88	-18.47	-4.24	-1.90	-0.97
Barclays Global Aggregate	1.15	2.13	2.13	-0.88	-12.08	-14.59	-2.44	-0.47	0.20
JPM EMBI Global Div	2.43	2.89	2.89	-3.48	-18.01	-19.29	-4.70	-0.79	2.13
Alternative Investments									
Alerian MLP	8.10	12.49	12.49	4.27	23.78	25.28	4.14	1.83	1.43
Bloomberg Commodity	4.60	4.26	4.26	-5.55	23.49	27.25	16.20	8.82	-1.03
FTSE NAREIT Equity REIT	5.00	9.06	9.06	-5.32	-12.97	-2.48	6.60	6.89	8.12
S&P Global Natural Res.	6.93	3.52	3.52	-8.60	2.10	6.95	10.75	8.42	4.93
S&P N. Amer Natural Res.	8.64	7.44	7.44	-0.62	24.49	38.61	14.02	7.57	3.81

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