MARKET REVIEW & OUTLOOK

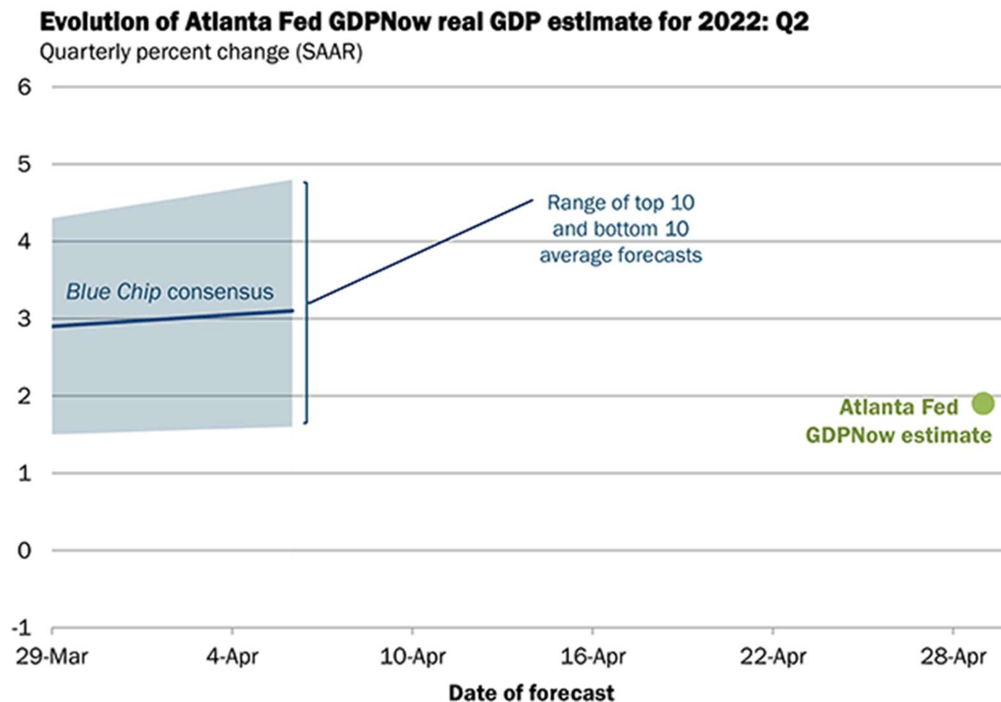
April 2022

KEY TAKEAWAYS

- The sharp rally the second half of March, couldn't be sustained. The last 10 days of April got downright ugly with equities closing at the lows of the month. The NASDAQ, i.e., Growth, had the worst monthly decline since 2008, down over 13%.
- Interest rates continued their march higher during, the first half of the month. However, interest rates started showing signs of stabilization as the equity markets started taking heavier losses to end the month. The next Fed announcement is May 4th, the Fed has telegraphed a 50-basis point increase in Fed fund interest rates.
- The Russia/Ukraine conflict doesn't have any signs of an end in sight. However, oil was surprisingly stable, hugging the $100 level.

The U.S. Economy

The first release of 1st quarter GDP was expected to be much weaker than the 4th quarter, but the negative print, -1.4%, was shocking. The big driver of the decline was the big driver of the 4th quarter advance, Inventories. Inventories showed a decline of -0.8% in the 1st quarter vs. +5.3% in the 4th quarter. The 1st quarter GDP growth was impacted by the lockdowns in Shanghai that are expanding to Beijing. The question now, does that leave us with a 2nd quarter surprise as the forecast again is in the +2 - 3% range, please see the chart below.



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates continued marching higher through the middle of April as inflation prints continued to rise. The continued increase in inflation, has got the Fed heads nearing a panic. Even Fed chairman Powell came out in favor of a 50-bps increase in May. The Fed funds rate market is even starting to price in an additional 75 bps raise in June, which would be the first hike of that size since 1994. Though after mid-April, the longer maturity Treasury rates started to stabilize as Equity markets started selling off harder. So, while year to date returns for both Equites and Fixed Income are bad, maybe the Treasury market is finally starting to reach an equilibrium point. The result for High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, still finished the month with another big loss at -3.81%. The U.S. 10-year Treasury bond yield ended the month near the levels hit mid-month, at 2.89%, up significantly from March's close of 2.33%.

The Dow Jones Industrial Average fell -4.91%, the S&P 500 dropped -8.80%, and the small cap Russell 2000 plunged -9.95%. The international markets traded in similar fashion of the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index dumped -8.41%, and the MSCI Emerging Markets iShares Core ETF Index fell -6.68%.

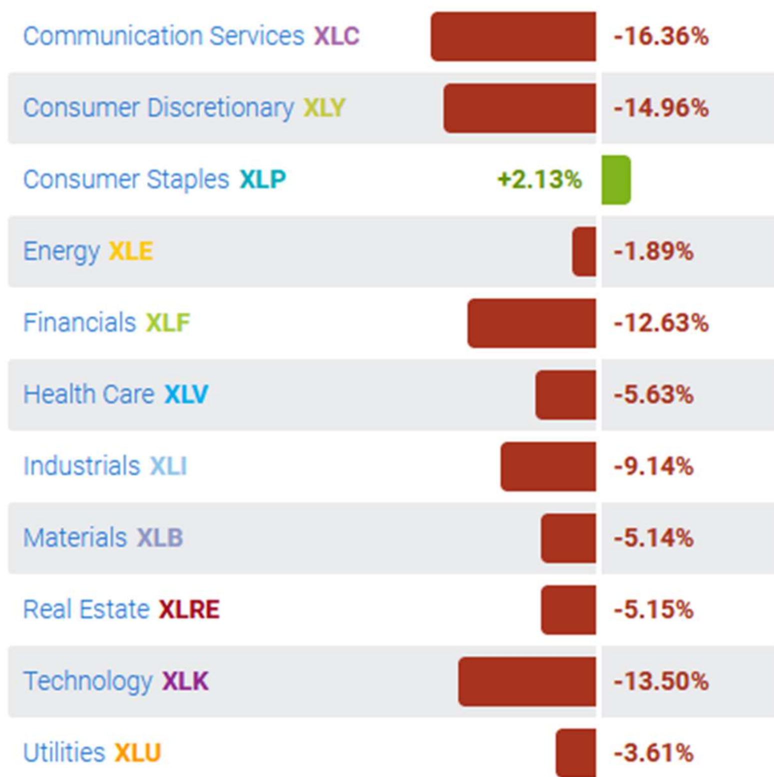
In April, we generally had varying shades of red, light and very dark!

The best performers were…

- Consumer Staples: +2.13%
- Energy: -1.89%
- Utilities: -3.61%

The lagging performers were…

- Communication Services: -16.36%
- Consumer Discretionary: -14.96%
- Technology: -13.50%



Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The oil market was relatively stable for the month, hugging the $100 level. The back and forth of sanctions on Russian energy, counterbalanced with demand destruction from the expanding lockdowns in China lead to the tug of war. China speaks of easing their Zero Covid policy, but then turns around and locks down more areas. Meanwhile, the West still seems completely disinterested in a peaceful resolution of the Russian/Ukraine conflict. In fact, it seems that NATO is creeping closer to having an outright proxy war with Russia as more countries offer up supplies to Ukraine. The current NYMEX WTI Crude Oil futures settled at $104.13 and posted a gain of almost 4% from the prior month close of $100.28 a barrel. The strength in oil also drove prices higher for RBOB gasoline, with a gain of almost 9% vs March's close as the emergency release of the SPR had limited effects on reducing prices. The end of May marks the beginning of the summer driving season. Again, I think we have a tug of war on our hands, one side wants to break free after two years of lockdowns, versus $5 or $6 dollars a gallon to fill up. I suspect price wins out by a nose.

The Rest of the Data

The March ISM Manufacturing Index decreased 1.5 points to 57.1 from February's reading of 58.6. Conversely, the ISM Services Index increased to 58.3 in March from February's print of 56.5. The prices paid component jumped for the Manufacturing survey and held steady for the Services survey, both at very elevated levels. Any reading above 50 generally indicates improving conditions. Consumer confidence was relatively steady at 107.3 in April, which compares to an upwardly revised figure of 107.6 in March. The unemployment rate declined again, coming in at 3.6% and the economy added a solid 431,000 jobs in March, though missed expectations of 490,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) was up +1.2% in March, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased to +8.5% on a non-seasonally adjusted basis, the highest since December 1981. The CPI ex Food and Energy, increased to 6.5% from last month's 6.4%. The GDP report was weak, but the other economy data is good, employment continues to be solid, but wages are increasing, and inflation is all around us. The Fed has their chance to show us how tough they will be on inflation with a soft equity market. A 50-bps rate hike in May seems a given. Will they really do it again in June? The equity market is starting to react poorly to either inflation or the prospect of a hawkish Fed. Now the question is, how will inflation and the economy react? Further, will the weaker equity markets keep the Fed from initiating Quantitative Tightening sooner than expected as was thought at the end of March. We will continue to closely monitor economic and geopolitical activity to see how long and hard the Fed needs to raise rates.

Summary

Last month, we thought GDP growth was weak, but still positive, though the actual report was negative. Inflation continues to show strength with only small glimpses of less robust rate of change. The bond market has priced in 11 rate hikes (2.75%) before year end. The equity market, either through concerns about the Fed meaningfully increasing rates or the slowing in the rate of earnings growth, seems to be finally taking a bite out of equity prices as we have been discussing for a few months. The dreaded "stagflation" has been getting more airtime of late and the last few days reports certainly didn't quell

those concerns. The chart below shows that inflation expectations are the highest since the early 1980's, which was the reduction of expectations after Fed Volker raised Fed fund rates substantially to bring inflation under control. The current Fed is still in a tough spot; the last few years the Fed seemed to cave to declines in equity prices. This time though, they don't have the background of very low inflation to support their efforts. The Fixed Income market is showing initial signs of stabilization on the longer maturities. Perhaps the Fixed Income markets are satisfied that the Fed is going to continue to raise rates to bring inflation back under control. The first test of this thesis will be Wednesday May 4th. We think the one safe bet, is that volatility is likely to be with us for a while.

Source : https://www.zerohedge.com/markets/inflation-expectations-hit-41-year-highs-umich-survey-hope-fades-during-month

However, as bad as that all sounds, we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to decline, we will reallocate the overweight that occurs in Fixed Income back into equities. The decline in equity markets has triggered the rules-based defense mechanisms to reduce the risk of the portfolio via the dynamic investment vehicles that have been deployed. Further, if the equity markets get too extended on the downside, some of the vehicles will reallocate some capital back into their respective equity exposures.

These dynamic tools have been engaged, a couple of times during the increase in volatility. At month end a portion of equity has shifted to Treasury Bills for U.S. Large and Mid-Cap, as well as Developed International.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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