



Northport Investment Management, LLC
A Registered Investment Adviser

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Market Commentary – 1st Quarter 2022

It was a difficult quarter for stocks, with all three of the major stock indices suffering their first quarterly losses in two years. In the first quarter, stocks were buffeted by a trifecta of bad news, as inflation hit new highs, a war erupted, and the Federal Reserve started to raise interest rates. The Dow lost 4.6% for the first three months of 2022, while the S&P 500 fell 5.0% (-4.6% with dividends). The tech-heavy NASDAQ Composite was worse, declining 9.1% in Q1. Nine of the eleven S&P 500 sectors were negative for the quarter. Energy (+37.7%) and Utilities (+4.0%) were the best sectors. Communication Services (-12.1%) and Consumer Discretionary (-9.2%) were the worst sectors. Mid-cap, small-cap, international, and emerging market equity categories, all lagged the S&P 500 for Q1.

U.S. bonds had their worst quarter in over forty years, as interest rates kept rising. Our taxable bond benchmark, the Bloomberg U.S. Aggregate Bond Index, logged its worst quarter since 1980, returning -6% in Q1. Tax-exempt municipal bonds fared slightly less poorly. The benchmark ten-year Treasury note yield closed the quarter at 2.33%, up from the 1.52% yield at year-end, and from its record low yield of .52% early in the pandemic.

During the first quarter, a widely watched signal in the bond market gave a warning sign that an economic recession may lie ahead. Yields on two-year Treasuries surpassed yields on ten-year Treasury notes for the first time since 2019. When the shorter-dated bond yield rises above that of the longer-dated bonds, it is known as a yield curve inversion. The bond market could be signaling that inflation is too high, that the Federal Reserve has been well behind the curve with its slow pace of interest rate increases to date, and that the Fed risks pushing the economy into recession as it tries to catch up. I am a believer in an inverted yield curve's very successful track record of forecasting recessions, however there is a great variability in terms of lead time. It could take twelve or eighteen months, or longer, to see a recession after a yield curve inversion. A recession is unlikely in 2022. It could very well happen in 2023, and it will be an issue of ongoing concern. For now, the investment choice favors equities, which have pricing power and a reasonably strong earnings trend, versus bonds which have substantially negative real yields.

Every first quarter of a new calendar year, I always remember March 9, 2009. This was the date that the stock market bottomed, coming out of the "Great Recession" of 2008-2009. I had just started Northport Investment Management; my first clients having joined me in February of 2009. Since then, it has been a spectacular thirteen years of cumulative stock market returns,



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especially the past three calendar years, and this past year. With this experienced perspective, I view Q1 2022 as a minor negative blip in a long-term uptrend. Short-term volatility is the price equity investors pay for attractive long-term returns and comes with the territory. If 2022 delivered one or two 10%+ corrections throughout the year, this outcome would be considered normal in a historical context. Corporate earnings prospects for 2022 are solid, a good reason to remain patient, even if the stock market re-enters correction territory from here. History shows significant rallies come after stock market setbacks run the course. One can only participate in these rallies if they remain invested at the bottom, which means participating in the negative volatility leading up to it.

Uncertainty abounds, and elevated market volatility is expected in 2022. A choppy stock market seems likely with no clear answers on when inflation peaks, and the aggressiveness of Fed tightening. The Fed's plan to raise interest rates removes a historic wave of stimulus that had driven the stock market to dozens of records and fueled a rush into some of the most speculative investments. The markets are used to "free" money. After this extraordinary speculative period, it may be hard to achieve a soft landing. Controlling inflation causes collateral damage, in growth projections and stock prices. We are still dealing with supply chain disruptions and a war, which may, or may not, deescalate. It's not going to be smooth or pain free, but one should take solace remembering that corrections and periods of consolidation are healthy for the market. Markets need to reset valuations and investor expectations from time to time.

The stock market has faced many corrections, and bear markets, over the decades, and has managed to recover from even the most severe ones. While it may take months or even years for the market to fully rebound, it has always bounced back. Stocks should be owned based upon expectations for their long-term business performance, and not viewed as vehicles for timely market moves. One shouldn't try to game the market. One can't predict what a virus, or Putin, or an election, may, or may not, do. Liquidity, cash flow, diversification, and patience are governing factors in terms of how to respond to the uncertainty that this current environment has created.

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