WEALTH ADVISORS

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Market Monitor

First Quarter 2022 Performance Report

Key Observations

- The first quarter certainly lived into our 2022 Outlook, Navigating Moderation, in which we discussed volatility ahead. Even before notable geopolitical events in Europe, both fixed income and equities had pulled back as investors adjusted to the Federal Reserve's new tone of higher rates and less accommodative policies.
- On February 24th, Russia invaded Ukraine, marking the first time a country has tried to forcibly change its borders in Europe since World War II. "The West" responded with unity and forcefulness by imposing sanctions on Russia of a magnitude not seen since previous global conflicts.
- Given Russia's importance in global commodity markets, including energy and agriculture, markets reacted to sanctions with concerns around global supply shortages. This pushed prices higher across many commodities including oil, gas, metals, and agriculture. In many instances these prices retreated in March as circumstances became clearer but remained higher from the start of the year.
- Inflation continued to show persistence through the first quarter ending March with prices rising 8.5 percent year-over-year. That is the largest annual increase in the Consumer Price Index in over 40 years.

Fixed Income

The Bloomberg Aggregate produced its third worst quarterly return since 1976 ending down -5.9% percent.

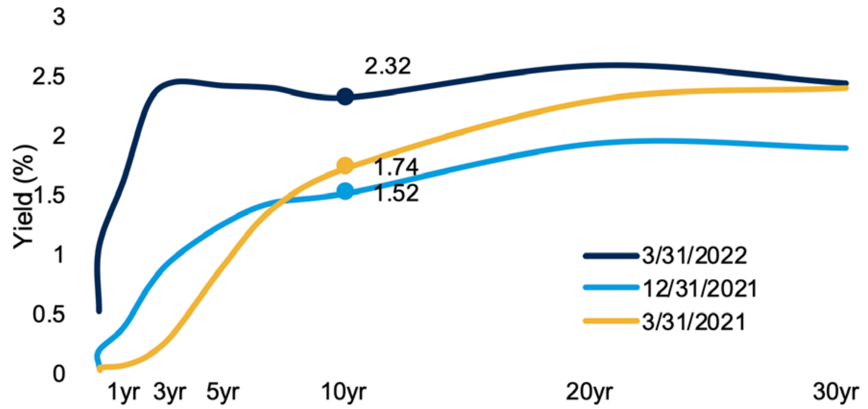
The Federal Reserve (Fed) began efforts to bring about greater price stability and raised the Federal Funds rate 0.25 percent at their March meeting to a target of 0.25 - 0.50 percent. Markets moved ahead of the Fed by selling bonds which pushed the yield on the 10-year Treasury up by 0.8 percent.

This impacted all types of bonds, especially those with longer duration (interest rate sensitivity) profiles.

During the quarter, the heavily watched 2-year vs 10-year spread turned negative briefly. This Farmers' Almanac-like indicator has sounded its warning ahead of every recession since 1976. However, this indicator should come with its own warning label. In the last six instances this has occurred it has done so, on average, nearly two years ahead of a recession.

U.S. Treasury Yield Curve

The U.S. yield curve flattened and the 2-10 spread narrowed to its lowest level since 2019, as the Federal Reserve raised its target rate by 25 basis points. The 10-year ended the quarter 80 basis points higher.



Sources: FactSet. As of March 31, 2022.

Globally, the circumstances are less clear around central bank policies than they are in the U.S. China, the world's second largest economy, has been easing on the back of poor equity market returns and a slowing economy while Europe is bracing for the follow-on impact from Russia's actions. Should E.U. economies slow, the European Central Bank may not be as motivated as the Fed to increase policy interest rates.

Equity

In the U.S., the quarter began with equity investors re-running their math on highly priced businesses amid a regime of rising interest rates. This created heavy dispersion between the haves and the have nots with expensive securities selling off and less expensive securities rallying. This created a nearly 51 percent difference between the best returning equity sector (Energy: +39.0 percent) and the worst (Communication Services: -11.9 percent). While the start of the quarter began with the largest names in the S&P 500 selling off, it ended with a strong rally in March pulling markets off their quarterly lows. In fact, four of the five largest names in the U.S. outperformed the index broadly. However, equity markets were still negative for the quarter, with the S&P 500 returning -4.6 percent.

March did not prove as fruitful for international and emerging markets which started the quarter ahead of the S&P 500 but succumbed to geopolitical volatility and a strengthening dollar. The U.S. dollar index rose 2.2 percent for the quarter as the Fed increased interest rates at a faster pace than peer countries. The MSCI EAFE closed the quarter down -5.9 percent and MSCI Emerging down -7.0 percent.

Real Assets

The bright spot in a dreary quarter, real assets broadly performed well, with commodities in particular moving ahead. Both Russia and Ukraine are important suppliers of energy commodities, metals and agricultural products, such as wheat and fertilizer, to global markets. Conflict between the two led to great concerns of supply issues and complicated demand dynamics with sanctions. These events, coupled with tight supply chains and production issues globally, propelled prices higher.

Real estate performance mimicked broader equities with higher valuation segments like data centers and towers selling off (-14 percent and -12 percent respectively) and defensive segments like health care and lodging showing better results (5 percent and 7 percent respectively).

Lastly, infrastructure and natural resource equities were buoyed by higher costs to the products they sell and performed better than the broad market.

While it has been a busy quarter our outlook remains similar to how we entered the year. One of increased volatility, expectations for persistent, but ultimately slowing inflation, and the realistic struggles fixed income may face to produce positive real returns in the coming years. Due to these circumstances and the uncertainty of events ahead, we remain committed to a thoughtfully diversified portfolio built with resiliency in mind.

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