

Due to the wide range of risk tolerances of our clients, some topics or asset classes may have more, less, or no importance to your portfolio. For a detailed analysis, give us a call, or request a detailed performance review.

Big Picture

On the Fridge

Floating Rate Bonds

Floating rate bonds were the only sub-asset class (that we track) that posted a positive return in the quarter, rising 0.2%.

Energy Sector

The Energy sector exploded with a 39% gain in the first quarter, while Utilities (+4.8%) was the only other sector to post a positive return.

US stocks suffered their first quarterly loss since Q1 2020, when the COVID-19 pandemic began. Pandemic concerns took a backseat to inflation, Fed overstep, and Russian invasion fears. Energy, Metals, and commodities continued to surge, while a dramatic rise in the short end of the yield curve led to an inversion in the 2s10s and 5s30s spreads. Recession fears are high and the market appears to already be pricing that scenario in, but after a quarter like this I think it is important to provide some perspective. From peak-to-trough, we have seen a -13% drawdown in 2022. The average intra-year peak-to-trough drawdown since 1980 is -14% (-11% median). Over that 42yr timeframe we have seen drawdowns greater than ten percent 57% of the time. Of the years with a drawdown greater than ten percent, the average annual return is +5%. The market has finished with a positive return 58% of the time, while the market finished up ten percent or greater 46% of the time. So, while the first quarter was very painful, and market sentiment is as negative as it has been in recent memory, the statistics show that this is far from abnormal market behavior and even suggests room for optimism.

Looking Ahead

In the Dog House

Corporate Bonds

With interest rates and recession fears rising, corporate bonds fell -7.7%, good for last place among asset classes we track. The poor performance is especially painful given that bonds are often viewed as the safe haven when stocks are falling.

Communication Services

For the second straight quarter, the communication services sector came up dead last falling -12% to start the year. However, it is important to remember that Meta (FB), and Alphabet (GOOG, GOOGL) represent over 40% of the entire sector, so this may say more about those two companies than it does about the economic sector.

This spring/summer will mark the first time in two years that US consumers will be back to business as usual, and the consumer is strong. Consumer balance sheets are healthy with debt levels still low. The Personal Savings Rate has fallen from stimulus-driven highs but currently sits at a comfortable 6.3%. The unemployment rate has plummeted since the initial COVID-19 spike and currently sits at 3.6%, near historic lows. Notably, the falling employment coincided with a steep increase in the labor participation rate which has nearly fully recovered to pre-pandemic levels. Initial jobless claims echo the strength in the labor market as they fell to just 166,000 by the end of Q1, the lowest read since the 1960s. Businesses are seeing the strength as well, free cash flow margins are 15%, corporate profits recovered quickly and are well above pre-pandemic levels. If we ignored inflation, it would be hard to argue that the economy and market outlook were anything but strong. Unfortunately, inflation cannot be ignored. It is currently running at levels not seen since the 1980s, and it is pervasive across nearly every sector of the economy. CPI ended Q1 up 8.5% y/y, which is likely a peak, while core PCE (the Fed's preferred measure) registered at 5.4%. Rising rates have caused strong multiple contraction, and I believe multiple expansion is unlikely unless the market is convinced that inflation can be controlled with far less Fed intervention than is currently expected. I suspect the market's focus on fundamentals rather than top line growth, will remain for at least the next six months. Consumer spending should remain strong as the labor market is tight, wages are rising, and consumer balance sheets are healthy. Additionally, the inventory-to-sales ratio suggests there is plenty of room for business to invest in inventory, especially given the supply chain issues they have faced in the last two years, some of which are likely to continue. The short-term is in the Fed's hands now, let's hope they're delicate.

Links and Articles

The Weakness of the Despot

Russia and Putin expert, Stephen Kotkin conducts an enlightening Q&A with the New Yorker.

The Perpetual Gamma Squeeze

Dror Poleg explains the mechanics and psychology behind the "meme" stock mania.

The Cognitive Bias Codex

An interactive chart of the cognitive biases that often lead to suboptimal investment decisions.

Deep Learning is Hitting a Wall

A sobering critique of the current and future state of artificial intelligent by Gary Marcus.

Performance

Bonds lost -6.2% while stocks fell -5.3% in the toughest quarter since the outbreak of COVID-19. Energy and Utilities were the only sectors to produce a positive return with the Energy sector soaring 39% and Utilities returning 4.8%. The “growthiest” sectors were hurt the worse as Communications Services fell -11.9%, Consumer Discretionary -9%, and Tech -8.4%. Any portfolio that was underweight Energy and overweight Growth severely underperformed in the quarter as multiples shrank. Floating rate treasuries were the only asset class (that we track) that didn’t produce a negative return, eking out just 20bps of positive performance.

	Benchmark Index	2022 Q1	YTD	LTM	3yr	5yr	10yr
Cash	Bloomberg US Treasury Bill 1-3 M TR USD	0.0%	0.0%	0.1%	0.0%	1.1%	0.6%
Fixed Income	Bloomberg Global Aggregate TR USD	-6.2%	-6.2%	-6.4%	0.7%	1.7%	1.0%
Fixed Income Blend	Bloomberg Global Aggregate TR USD	-6.2%	-6.2%	-6.4%	0.7%	1.7%	1.0%
Government	Bloomberg US Government TR USD	-5.5%	-5.5%	-3.7%	1.4%	1.8%	1.7%
Inflation Protected	Bloomberg US Treasury US TIPS TR USD	-3.0%	-3.0%	4.3%	6.2%	4.4%	2.7%
Municipal	Bloomberg Municipal TR USD	-6.2%	-6.2%	-4.5%	1.5%	2.5%	2.9%
Floating Rate	Bloomberg US Trsy Floating Rate TR USD	0.2%	0.2%	0.2%	0.8%	1.2%	0.0%
Corporate	Bloomberg US Corp Bond TR USD	-7.7%	-7.7%	-4.2%	3.0%	3.3%	3.6%
High Yield	Bloomberg US Corporate High Yield TR USD	-4.8%	-4.8%	-0.7%	4.6%	4.7%	5.7%
International Bond	Bloomberg Gbl Agg Ex USD TR USD	-6.1%	-6.1%	-7.9%	-0.2%	1.3%	0.1%
Equity	MSCI ACWI GR USD	-5.3%	-5.3%	7.7%	14.3%	12.2%	10.6%
Equity Blend	MSCI ACWI GR USD	-5.3%	-5.3%	7.7%	14.3%	12.2%	10.6%
US Equity	MSCI USA GR USD	-5.2%	-5.2%	14.1%	19.1%	16.1%	14.6%
Developed Markets	MSCI World ex USA GR USD	-4.7%	-4.7%	3.6%	9.1%	7.7%	6.8%
Emerging/Frontier	MSCI EM GR USD	-6.9%	-6.9%	-11.1%	5.3%	6.4%	3.7%
Alternatives	Wilshire Liquid Alternative TR USD	-1.9%	-1.9%	0.6%	3.1%	2.3%	2.0%
Alternatives Blend	Wilshire Liquid Alternative TR USD	-1.9%	-1.9%	0.6%	3.1%	2.3%	2.0%

Sector	2022 Q1	6mo	YTD	1yr	3yr	5yr	10yr
Information Technology	-8.4%	6.9%	-8.4%	20.9%	30.5%	26.8%	20.6%
Financials	-1.5%	3.0%	-1.5%	14.7%	16.8%	12.4%	13.9%
Health Care	-2.6%	8.3%	-2.6%	19.1%	16.5%	15.1%	15.9%
Consumer Discretionary	-9.0%	2.7%	-9.0%	9.8%	18.6%	17.2%	16.7%
Consumer Staples	-1.0%	12.2%	-1.0%	16.1%	14.0%	10.2%	11.5%
Industrials	-2.4%	6.1%	-2.4%	6.1%	13.2%	11.3%	12.7%
Energy	39.0%	50.1%	39.0%	64.4%	11.0%	6.7%	4.2%
Utilities	4.8%	18.3%	4.8%	19.9%	12.2%	11.4%	11.8%
Materials	-2.4%	12.5%	-2.4%	13.9%	19.2%	13.3%	11.4%
Communication Services	-11.9%	-11.9%	-11.9%	-0.9%	15.5%	9.6%	9.9%
Real Estate	-6.2%	10.2%	-6.2%	25.8%	13.8%	12.6%	11.3%

Source: Morningstar; The 1,3,5, and 10 year performance is

Q4 earnings actually came in strong, rising 16.22% versus the 11.8% rate that was expected at the beginning of the quarter. While Q1 earnings expectations held up fairly well throughout the quarter. As of April 18th, Q1 earnings are expected to come in at 10.93%, about 1.3% ahead of expectations at the beginning of the year. This brought the forward P/E of the S&P 500 down to a low of 18.22x on March 14th, the lowest it has been since the pandemic began and very near the 19.29x pre-pandemic multiple on February 20th 2020.

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Asset Class	Benchmark	Description
Cash	Bloomberg US Treasury Bill 1-3 M TR USD	Measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.
Fixed Income	Bloomberg Global Aggregate TR USD	The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers.
Government Bonds	Bloomberg US Government TR USD	The Bloomberg US Government Bond Index comprises the US Treasury and US Agency indices. The index includes US Dollar-denominated, fixed-rate, nominal US Treasuries and US agency debentures (securities issued by US government owned or government sponsored entities, and debt explicitly guaranteed by the US government).
Inflation Protected	Bloomberg US Treasury US TIPS TR USD	The Bloomberg US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.
Municipal	Bloomberg Municipal TR USD	The Bloomberg U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.
Floating Rate	Bloomberg US Trsy Floating Rate TR USD	The Bloomberg US Treasury Floating Rate Index measures the performance of floating rate bonds issued by the US Treasury.
Corporate Bonds	Bloomberg US Corp Bond TR USD	The Bloomberg US Corporate Bond index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
High Yield Bonds	Bloomberg US Corporate High Yield TR USD	The Bloomberg US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.
International Bonds	Bloomberg Gbl Agg Ex USD TR USD	The Bloomberg Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers. This version excludes USD-denominated debt.
Equity	MSCI ACWI GR USD	The MSCI ACWI captures large and mid cap representation across 23 Developed Markets and 23 Emerging Markets countries. With 2,477 constituents, the index covers approximately 85% of the global investable equity opportunity set.
US Equity	MSCI USA GR USD	Captures broad US equity coverage. The index includes 3,108 constituents across large, mid, small, and micro capitalizations, representing about 99% of the US equity universe.
Developed Market Equity	MSCI World ex USA GR USD	Captures large and mid cap representation across 22 of 23 Developed Market countries, excluding the United States. With 1,023 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Emerging Market Equity	MSCI EM GR USD	The MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 829 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Alternatives	Wilshire Liquid Alternatives TR USD	Measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe, including the Wilshire Liquid Alternative Equity Hedge, Global Macro, Relative Value, Multi-Strategy, and Event Driven indices. This index is meant to provide a representative baseline for how the liquid alternative investment category performed as a whole. Constituents comprised of '40 Act mutual funds.
US Large Cap Equity	S&P 500	Widely regarded as the best gauge of large-cap US Equities. The S&P 500 is a market-weighted index that includes 500 leading companies and captures approximately 80% coverage of available market capitalization.