Asset Strategy Consultants

MARKET REVIEW

First Quarter 2022

We are pleased to present *Market Review,* featuring a discussion of the Capital Markets during the First Quarter 2022 and a summary of historical performance for the major asset style passive indices for the period ending March 31, 2022. We hope you find the information useful and helpful in your investment considerations.

We welcome your comments.

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Founded in 1991, Asset Strategy Consultants provides investment consulting services to institutional clients representing $8 billion under advisement. Headquartered in Baltimore, Asset Strategy Consultants has offices throughout the East Coast.

THE MACROECONOMIC ENVIRONMENT

A Bleak Beginning to the Year

Grim geopolitical events and broadly negative investment returns were hallmarks of 1Q22. The heart-wrenching invasion of Ukraine weighed heavily on our minds while COVID worries faded into the background. Markets were volatile throughout the quarter, and broad global stock and bond indices fell as inflation worries fueled interest rate increases and portended global central bank tightening cycles. Commodities were beneficiaries in this environment.

The Fed faces a daunting challenge in coming months to curb inflation without tilting the economy into a recession. The heightened market volatility during the quarter reflected fluctuations in risk sentiment amid a dizzying array of tail risks around inflation, the human toll of war and the effects of sanctions, and the impact of tighter Fed policy.

The U.S. bond market faced its worst quarterly loss since 1980, and the yield curve flattened meaningfully as yields on shorter maturities rose more than those on longer maturities. As of quarter-end, a portion of the curve was inverted. Yield curve inversions, while not perfect predictors, have often presaged recessions. And the S&P 500 sank 12% by mid-March (officially entering correction territory) but rallied into quarter-end to close down 4.6%. Growth stocks, more sensitive to rising rates than their value counterparts, bore the brunt of the pain. Overseas results were similar; the MSCI ACWI ex-US Index fell 5.4% and the MSCI Emerging Markets Index lost 7.0%. Currencies were mixed with the Brazilian real (+18%) up strongly vs. the U.S. dollar and the Japanese yen (-5%), the pound (-3%), and the euro (-3%) declining.

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Fourth quarter GDP was revised downward slightly to 6.9% (annualized) but 1Q is expected to be much lower. Notably, inventory rebuilding accounted for 5.3% of that gain—but now inventory is close to pre-pandemic levels so that boost is unlikely to be repeated. A survey of 36 forecasters by the Federal Reserve Bank of Philadelphia revealed a prediction of 1.8% (annualized) real growth in 1Q. The bite of inflation, waning fiscal stimulus, and the spread of Omicron early in the year is expected to take a toll on growth.

Inflation, as measured by the Consumer Price Index, hit a 40-year high in February, rising 7.9% year-over-year (less food and energy: +6.4%). Energy rose nearly 26% YOY, food prices were up 8%, and gains were also seen in new and used vehicles, shelter, and restaurants/hotels. The Fed's favored measure, the Personal Consumption Expenditures Index, rose 6.4% (less food and energy: +5.4%), well above the Fed's 2% target and the highest since 1982. WTI Crude Oil soared more than 30% and closed the quarter at just over $100/barrel. The Biden administration announced that the U.S. would be releasing an unprecedented 1 million barrels per day from its strategic petroleum reserves, beginning in May and extending for six months, to help offset the supply constraints imposed by the sanctions on Russia.

As expected, the Fed raised rates at its March meeting, bringing the Fed Funds rate up to 0.25% - 0.50%. Prior to the invasion in February, some had expected a 50 bps hike would be announced. The median projection for the Fed Funds rate is 1.90% at the end of 2022, rising to 2.80% in 2023. However, the range of projections (1.4% to 3.2% by year-end) from Federal Open Market Committee members reflects a high degree of uncertainty. As of quarter-end, the market was anticipating nine rate hikes in 2022, three more than expected by the Fed. The Fed's median projection for the Core PCE Index (less food and energy) is now 4.1% in 2022, up from a 2.7% projection in December 2021. The forecast for real GDP in 2022 was lowered to 2.8% from 4.0%.

The labor market remains a source of strength for the economy with unemployment falling to 3.6% in March. And according to the U.S. Job Openings and Labor Turnover Survey (JOLTS), there were 11.3 million job openings, a record number, at the end of February. As of March, roughly 90% of the 22 million jobs lost during the pandemic had been recovered. The YOY gain in average hourly earnings (private, non-farm jobs) was 5.6%, a meaningful uptick but shy of inflation. Consumers are faring well by some measures; they have high savings relative to history, household wealth is up (thanks to house and stock market gains), and debt is at relatively low levels. At the same time, a survey of more than 2,600 people by the LendingClub revealed that the number of consumers living paycheck to paycheck was 64% in January 2022, including 48% of those earning more than $100,000 per year. While a small sample, it illustrates the level of income inequality in the U.S. and may help to explain the degree of polarization witnessed in recent years.

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Housing prices continued to climb and home inventory remains lean. The Corelogic Case-Shiller National Home Price Index rose 19.2% YOY in January, the fourth highest reading in 35 years. The National Association of Realtors (NAR) reported that total housing inventory at the end of the year was down 14% from the year prior, to the lowest level since it began to gather data in 1999. The report further stated that the national median existing home price was up nearly 16% in March from one year prior, and the March increase marked the 118th consecutive month of YOY gains. According to data from the St. Louis Fed, the average rate for a 30-year fixed-rate home loan was 4.7% as of quarter-end, up from 3.2% one year prior. It remains to be seen if higher mortgage rates will put a dent in housing prices.

Outside the U.S.

The economic effects of the Russian invasion of Ukraine have been especially painful in Europe, which relies heavily on Russia for its energy needs. Europe gets more than 40% of its natural gas and nearly 30% of its crude oil from Russia. Natural gas prices in Europe are more than five times higher than one year ago. Consumer sentiment has suffered and euro zone inflation hit 7.5% in March, a record high and exceeding expectations. Elevated energy prices are weighing on both the economy and inflation, posing the same challenges for the European Central Bank as we face in the U.S.

China has struggled with a resurgence in COVID cases and re-imposed lockdowns in several major cities while it combats slowing growth. The government set a GDP growth target of 5.5% for 2022, below 6% for the first time in 30 years.

Russia has been hurt by the wide array of sanctions imposed in response to its invasion of Ukraine. It saw the ruble drop from 75/U.S. dollar to more than 135 before recovering to around 90 at quarter-end. Russia jacked rates to 20% (from 9.5%) to combat the fall in its currency. A Bloomberg survey projected that Russia's economy would contract by nearly 10% in 2022 and inflation would hit 20%. ■

GLOBAL EQUITIES

The S&P 500 Index fell 4.6% in 1Q, but was down more than 12% early in March before staging a rally into quarter-end. Value stocks sharply outpaced growth across capitalizations, with the spread exceeding 10% in both mid and small caps and just over 8% in large caps. Not surprisingly, Energy (+39%) was the best-performing sector given a 33% spike in WTI crude oil prices. The Utilities sector (+5%), which typically does well in a rising rate environment, also posted a positive result. Communication Services (-12%), Consumer Discretionary (-9%), and Information Technology (-8%) were the worst-performing sectors.

Global ex-U.S. equity (MSCI ACWI ex US: -5.4%) saw mixed performance from its constituents around the globe. Canada (+5%), Australia (+7%), and Norway (+10%) were helped by soaring commodity prices while Japan (-7%) and Europe ex-U.K. (-10%) posted declines. As in the U.S., value outperformed growth by a wide margin (EAFE Value: +0.3%; EAFE Growth: -11.9%). Emerging markets (MSCI EM: -7.0%) also posted mixed results, with Latin America (+27%) faring well on the back of rising oil prices and Emerging Europe (-71%) plunging, reflecting Russia's -100% return before it was removed from the Index. As elsewhere, value outperformed growth (EM Value: -3.4%; EM Growth: -10.3%). ■

GLOBAL FIXED INCOME

The Bloomberg US Aggregate Bond Index sank 5.9% in 1Q, the third-worst quarter since the index's inception in 1976 (the other two being in 1980). Rates rose sharply on worries over inflation and expectations for Fed rate hikes. The 10-year U.S. Treasury closed the quarter at 2.32%, up from 1.52% at year-end, and reached 2.48% just a week before the quarter closed. Notably, the yield flattened meaningfully and as of quarter-end the relationship between the 5-year yield (2.42%) and the 10-year yield (2.32%) was inverted. Yield curve inversions have historically been a reasonably good predictor of a coming recession, and this recent inversion has thus garnered much attention. Spread sectors broadly underperformed U.S. Treasuries, but the bulk of the negative return was attributable to rising rates. Ten-year breakeven spreads, a measure of expected inflation, widened to 2.84% as of quarter-end, up from 2.56% as of year-end. High yield corporates (Bloomberg High Yield: -4.8%) fared a bit better given less sensitivity to interest rates and a relatively high energy sector weighting. Rates were also up overseas while the dollar strengthened vs. most developed market currencies; the Bloomberg Global Aggregate ex-US Bond Index fell 6.1% unhedged and 4.1% hedged. Emerging market debt was not immune to rising rates in the U.S.; the JPM EMBI Global Diversified Index fell 10.0% over the quarter. Local debt indices performed

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better but with a high degree of dispersion across constituents (JPM GBI-EM Global Diversified: -6.5%). Russia was removed from all emerging market debt indices at a price of $0 (-100% return).

REAL ASSETS

Commodities were a rare bright spot given their inflation-protection properties as well as war-induced supply concerns. The Bloomberg Commodity TR Index soared 25.5% and the energy-heavy S&P GSCI climbed 33.1%. Gold (S&P Gold Spot Price Index: +6.9%) and listed infrastructure (DJB Global Infrastructure: +3.2%) outperformed global stocks and bonds. TIPS (Bloomberg TIPS: -3.0%) fell but outpaced nominal U.S. Treasuries.

CLOSING THOUGHTS

Myriad challenges face the world as it unites against Russia's aggression. Maintaining strict sanctions on Russia while attempting to tame inflation via rate hikes—without extinguishing the economic recovery—is top of mind. Keeping a careful eye on COVID also merits mentioning. Clearly, 2022 has not started in a manner one could have imagined a year ago. We remain mindful of the high degree of uncertainty and expect that volatility may be an underpinning theme in 2022. As such, ASC continues to advise adherence to a disciplined investment process that includes a well-defined long-term asset allocation policy.

Source: Asset Strategy Consultants and Callan Associates

PRELIMINARY RETURNS FOR VARIOUS PERIODS: 1Q22

		January	February	March	Last Quarter	Year to Date	Last Year	Last 3 Years	Last 5 Years	Last 10 Years	Last 15 Years
	1 Russell:3000 Index	(5.88)	(2.52)	3.24	(5.28)	11.92	11.92	18.24	15.40	14.28	10.10
	2 Russell:1000 Index	(5.64)	(2.74)	3.37	(5.13)	13.27	13.27	18.71	15.82	14.53	10.26
	3 Russell:1000 Growth	(8.58)	(4.25)	3.91	(9.04)	14.98	14.98	23.60	20.88	17.04	12.92
	4 Russell:1000 Value	(2.33)	(1.16)	2.82	(0.74)	11.67	11.67	13.02	10.29	11.70	7.36
	5 Russell:Midcap Index	(7.37)	(0.72)	2.56	(5.68)	6.92	6.92	14.89	12.62	12.85	9.48
	6 Russell:Midcap Growth	(12.90)	(1.21)	1.61	(12.58)	(0.89)	(0.89)	14.81	15.10	13.52	10.41
	7 Russell:Midcap Value	(4.27)	(0.47)	3.04	(1.82)	11.45	11.45	13.69	9.99	12.01	8.31
	8 Russell:2500 Index	(8.32)	1.13	1.59	(5.82)	0.34	0.34	13.79	11.57	12.09	8.98
	9 Russell:2500 Growth	(13.19)	0.30	0.72	(12.30)	(10.12)	(10.12)	12.99	13.22	12.69	10.03
EQUITY	10 Russell:2500 Value	(5.08)	1.63	2.11	(1.50)	7.73	7.73	12.98	9.19	11.04	7.59
	11 Russell:2000 Index	(9.63)	1.07	1.24	(7.53)	(5.79)	(5.79)	11.74	9.74	11.04	7.99
	12 Russell:2000 Growth	(13.40)	0.44	0.46	(12.63)	(14.33)	(14.33)	9.88	10.33	11.21	8.81
	13 Russell:2000 Value	(5.83)	1.65	1.96	(2.40)	3.32	3.32	12.73	8.57	10.54	6.91
	14 S&P:500	(5.17)	(2.99)	3.71	(4.60)	15.65	15.65	18.92	15.99	14.64	10.26
	15 S&P:400 Mid Cap	(7.21)	1.11	1.38	(4.88)	4.59	4.59	14.14	11.10	12.20	9.67
	16 S&P:600 Small Cap	(7.27)	1.40	0.37	(5.62)	1.23	1.23	13.58	10.89	12.56	9.50
	17 MSCI:ACWI ex US	(3.69)	(1.98)	0.16	(5.44)	(1.48)	(1.48)	7.51	6.76	5.55	3.13
	18 MSCI:EAFE	(4.83)	(1.77)	0.64	(5.91)	1.16	1.16	7.78	6.72	6.27	2.91
	19 MSCI:EM	(1.89)	(2.99)	(2.26)	(6.97)	(11.37)	(11.37)	4.94	5.98	3.36	3.79
	20 MSCI:ACWI	(4.91)	(2.58)	2.17	(5.36)	7.28	7.28	13.75	11.64	10.00	6.49
	21 Blmbg:Aggregate	(2.15)	(1.12)	(2.78)	(5.93)	(4.15)	(4.15)	1.69	2.14	2.24	3.56
	22 Blmbg:Gov/Credit	(2.44)	(1.17)	(2.85)	(6.33)	(3.85)	(3.85)	2.12	2.44	2.45	3.71
	23 Blmbg:Credit	(3.21)	(1.89)	(2.51)	(7.42)	(4.16)	(4.16)	2.81	3.18	3.44	4.58
	24 Blmbg:Corporate High Yld	(2.73)	(1.03)	(1.15)	(4.84)	(0.66)	(0.66)	4.58	4.69	5.75	6.53
FIXED INCOME	25 Blmbg:Municipal Bond	(2.74)	(0.36)	(3.24)	(6.23)	(4.47)	(4.47)	1.53	2.52	2.88	3.72
	26 Blmbg:US TIPS	(2.02)	0.85	(1.86)	(3.02)	4.29	4.29	6.22	4.43	2.69	4.30
	27 Blmbg:Glob Agg ex USD	(1.96)	(1.11)	(3.20)	(6.15)	(7.89)	(7.89)	(0.19)	1.27	0.06	2.14
	28 S&P:LSTA Levg Loan	0.36	(0.51)	0.05	(0.10)	3.25	3.25	4.22	4.01	4.30	4.37
	29 ML:US Treasuries 1-3 Yrs	(0.65)	(0.37)	(1.33)	(2.34)	(2.84)	(2.84)	0.88	1.08	0.86	1.69
	30 LIBOR - 3 Month	0.03	0.04	–	–	–	–	–	–	–	–
	31 3 Month T-Bill	0.00	0.01	0.03	0.04	0.06	0.06	0.81	1.13	0.63	0.83
	32 S&P GSCI	11.63	8.77	9.63	33.13	64.55	64.55	13.40	9.98	(3.31)	(3.10)
	33 MSCI:US REIT Index	(6.93)	(3.19)	6.49	(4.06)	26.20	26.20	11.14	9.65	9.74	6.33
	34 Alerian:MLP Index	11.07	4.82	2.05	18.81	36.56	36.56	2.70	(0.07)	1.28	4.69
	35 DJB:Glbl Infrastructure	(2.93)	(0.40)	6.74	3.20	17.45	17.45	8.57	8.01	8.56	7.26
	36 US DOL:CPI All Urban Cons	0.84	0.91	–	–	–	–	–	–	–	–

Source: Callan Associates