Liberty Private Client Q1 2022 Market Commentary

After a phenomenal year for domestic equity markets in 2021, the new year kicked off with more of a whimper than a bang. U.S. equity markets had their first quarterly decline since the start of the COVID-19 pandemic two years ago in the first quarter of 2020. All major domestic indices finished in the red with the growth-heavy NASDAQ posting the biggest quarterly decline of 9%. The S&P 500 finished down 5% while the Dow Jones Industrial Average (DJIA) closed with a loss of 4%. Although investors obviously weren't thrilled with those returns, they were certainly pleased to see stocks rebound significantly from the lows as the quarter rolled to a close. At their lows the NASDAQ was down over 20%, the S&P over 14% and the DJIA more than 11%. Nine of the eleven sectors finished in the red with only the Energy and Utilities sectors closing positive for the quarter. With oil & gas prices skyrocketing, Energy had its best quarter in over 30 years, closing with a massive gain of 38%. Consumer Discretionary, Communications, and Technology were the worst performers. Value stocks strongly outperformed their Growth counterparts across all market-caps, leading by an average of about 8 percentage points as investors shifted towards lower risk assets.

By the 4th Quarter of 2021 inflation rates had already reached 40-year highs, with the November CPI at 6.8%. Unfortunately, the colder winter temperatures did not cool rising prices as inflation continued to climb with the most recent reading in February at a staggering 7.9%. The Russian invasion of Ukraine towards the end of February further exacerbated inflation concerns as disruptions of Ukrainian exports, such as wheat, are expected to be significant. Additionally, the economic sanctions imposed on Russia could further limit supply of commodities already facing high demand.

U.S. interest rates have surged higher since the start of the year, especially at the shorter end of the yield curve. The yield on the 2-Year U.S. Treasury, which is viewed by many as a gauge of the Federal Reserve's interest rate policy, jumped from a little over 0.75% at the start of 2022 to nearly 2.50% at the end of March. As the new year began, markets were expecting the Fed to hike rates 25 basis points three to four times in 2022. Those expectations have changed dramatically with markets now pricing in eight to nine rate increases of 25 basis points. Perhaps even more concerning is that we are seeing inversions in the yield curve at multiple levels with the 2-Year and 5-Year Treasuries yielding more than the 10-Year and 30-Year. Inversions in the Yield Curve can often signal a coming recession, although it may not occur for some time. There is often a significant lag between market tops and a recession. Data shows that the previous 7 recessions had almost a year between inversion and a peak in equities. Equities posted an average gain of roughly 14% during that lag.

These concerns have investors asking just how much the U.S. economy, consumers, and markets can handle. While of course only time will reveal the answer to that question, there has also been positive news to consider as well.

Current data shows relatively solid economic growth, a strong jobs market, healthy consumer spending, and positive corporate earnings. With the unemployment rate falling to 3.6% and wage growth accelerating to 5.6%, the labor market continues to be strong and keeping consumer confidence and spending high. Thus far that spending has helped the economy and corporate earnings moving in a positive direction.

The majority of companies reporting earnings in the first quarter exceeded expectations and earnings projections for 2022 are, on average, in the 8-12% range. That potential for continued solid growth coupled with strong corporate balance sheets provide hope for additional market expansion.

Reported cases of COVID-19, along with hospitalizations, and deaths have declined dramatically. With this decline, restrictions on both a federal and state level are being lifted. Fewer illnesses and restrictions should help reduce many of the supply chain issues we've faced over the last two years, further boosting economic activity and possibly helping on the inflation front.

Although challenges are always present, our outlook currently remains cautiously optimistic for the next few quarters. Strong U.S. consumer spending should keep earnings on a positive trajectory for at least the next quarter or two and while equities may not be considered "cheap" right now, valuations are significantly lower than they were 3-4 months ago. For now inflation and rising interest rates seem to be priced in so the biggest wild card is the Russia/Ukraine conflict.

While our near term outlook is more positive it is important to note that we are more than 12 years in to the current bull market. That tenure, along with decades high inflation, rising interest rates and a yield curve inversion in March, make this an important time to think about when this bull market ends. They all do, the question most people ask is, "when?". Of course we don't have the exact answer to the "when" we do feel the potential for a recession and bear market to occur sometime in the next 9-24 months is there. It is paramount to every investors success to have a plan in place that is consistent with your risk-level, goals, and time frame. While there is never a bad time to review your investment plan to ensure it remains consistent with your goals and risk level, I would venture to say now is a perfect time to do so.

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