April 2022

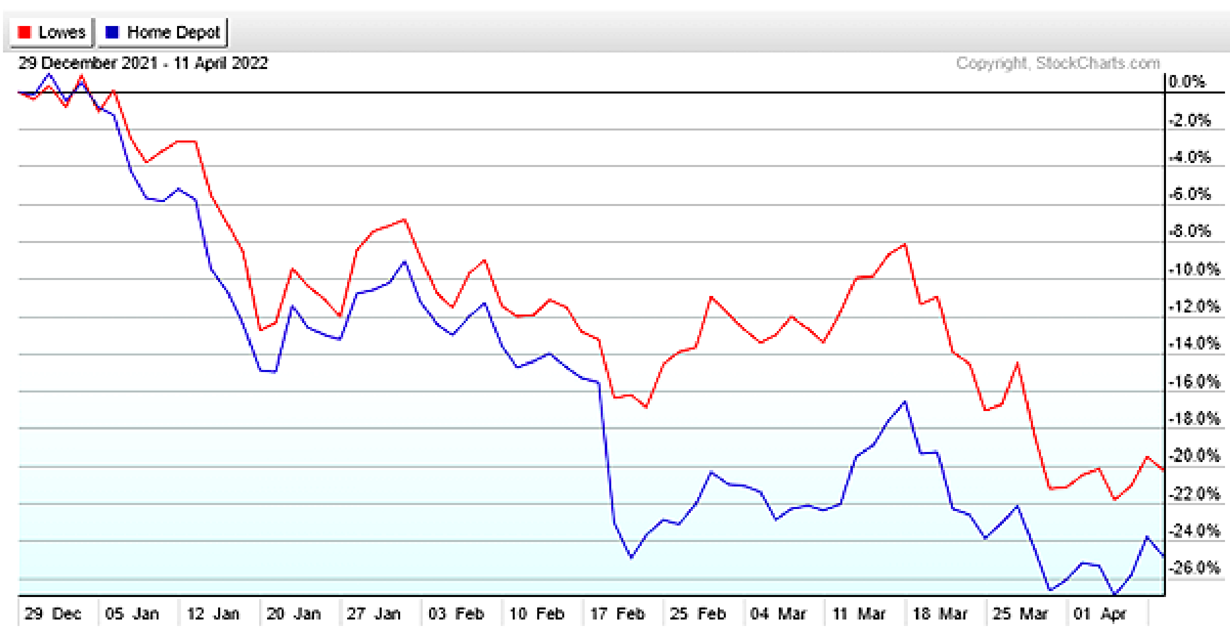
Dear Clients and Friends,

What an amazing and volatile quarter for the markets! Stocks managed to fall AND rise over 10% during the quarter; while bonds, depending on which bonds you look at, had their worst start of the year in 4 decades (when Reagan was president!). First quarter bond returns are boxed in blue in the table below.

Fixed income market dynamics

	Yield		Return			
U.S. Treasuries	03/31/2022	12/31/2021	2022 YTD	Avg. Maturity	Correlation to 10-year	Correlation to S&P 500
2-Year	2.28%	0.73%	-2.54%	2 years	0.68	-0.37
5-Year	2.42%	1.26%	-5.16%	5	0.92	-0.34
TIPS	-0.52%	-1.04%	-3.02%	10	0.58	0.21
10-Year	2.32%	1.52%	-6.86%	10	1.00	-0.31
30-Year	2.44%	1.90%	-11.41%	30	0.93	-0.30
Sector						
U.S. Aggregate	2.92%	1.75%	-5.93%	8.8	0.85	0.04
IG Corps	3.60%	2.33%	-7.69%	11.9	0.44	0.39
Convertibles	4.44%	3.66%	-5.42%	-	-0.26	0.87
U.S. HY	6.01%	4.21%	-4.84%	6.2	-0.23	0.73
Municipals	2.60%	1.11%	-6.23%	12.9	0.40	0.10
MBS	2.99%	1.98%	-4.97%	7.1	0.81	-0.13
ABS	3.45%	1.96%	-2.11%	2.4	-0.42	0.62
Leveraged Loans	5.41%	4.60%	-0.01%	2.7	0.16	0.13

Company valuations had been running near historic highs last year as the Fed used all the tools at their disposal to reinvigorate the economy after COVID containment policies ravaged consumption the year prior. The obvious problem, which the Fed has not formally acknowledged, is that they have always been aggressive at cutting interest rates, but much slower to bring interest rates back to "normal". In 2021, with the economy opening back up, consumers and commercial customers opened up the spigots in an environment of artificially low interest rates and massive pent-up demand. Housing prices in many areas of the country witnessed price growth not seen since post-WWII while inflation jumped to shockingly high levels. At first, the Fed was timid saying that inflation was "transitory," maybe a 2-3 quarter phenomenon that would adjust as supply chain shortages recovered. But here we are in the spring of 2022 and inflation is still running around ~8% depending on what government measure you look at -- for some consumers the reality is likely much higher. As a result, the Fed is in a position where they must hike rates aggressively to quell inflation. It's now clear that stock and bond investors alike have become very wary of this path. Will the economy be able to withstand these aggressive rate hikes? It's not at all clear. One of the bond market's preferred barometers for the future health of the economy, the yield curve, is signaling a forthcoming recession in 6-18 months. While home sales have held up so far (we are very early in the Fed's proposed cycle of rate hikes), companies that benefit from home sales such as Lowes (LOW) and Home Depot (HD) have seen their share prices get slammed in the most recent quarter (see below) – this certainly is not what you'd expect in a booming economy.



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Notice that we haven't even mentioned the war in Ukraine yet. The war in Ukraine contributed to market volatility, pushing oil prices up dramatically, while causing additional concerns about the potential of food shortages and further supply chain disruptions. Russia is a significant supplier of oil, gas, and other petrochemicals as well as mining and metals. Sanctions against Russia are already having far-reaching implications for manufacturers, and for the world's largest banks as they hold Russian government and corporate bonds, which are now in a precarious position. The full implications of Russia's financial situation likely won't be apparent for several months if not years. But for investors, the potential for secondary and tertiary effects will continue to make them uneasy.

We'd be remiss if we failed to look explicitly at interest rates, which have shot dramatically higher in anticipation of Federal Reserve rate hikes. From the chart below you can see the yield on the 10yr treasury note has risen over 80% in little more than 3 months while the NASDAQ 100 stock market index has fallen about 14% in the same time frame.

Rate increases will reach every corner of the economy, most obviously cooling down the housing market as well as car sales, and eventually even credit card purchases. As one prominent pundit recently put it (paraphrasing here) "the Fed wants you to suddenly feel poor. This will lead you to spend less, causing prices to fall and easing inflation." Ouch.

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With earnings season just getting underway, S&P500 1Q22 earnings are set to rise, but that rise is expected to be all due to the rebound in oil prices – leaving S&P500 earnings ex-energy to be slightly negative, something no one anticipated only a few months ago. There's no question that it's challenging to feel bullish in this environment making us glad to have strategies to navigate the choppiness. In the next few weeks, earnings calls will provide outlooks on the coming quarters that could set the stage for significant market moves. No matter the direction, our strategies remain well equipped for the volatility.

To future profits,

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