Eideard Group
GUARDIANS OF PROSPERITY

Market Commentary

1Q 2022

Market Movement Highlights

These early months of 2022 have given witness to the stark reminder of how an abrupt shift in Federal Reserve policy (a wake-up call so to speak) can so quickly reset financial market pricing and so rudely awaken investor fears. This after over fifteen years (but for a few sporadic months) of zero interest rate policies, a stock market that has long benefited from a low rate environment and a bond market that has been dancing with bears!

We all dearly recognize the underlying cause to be an inflation rate that has soared almost overnight to its current +8.5% level, a rate that is now (4) times greater than the Fed's target and is said to have now topped a 40 year high! The "old news" is that spiraling prices, at least initially, were the result of the post CV-19's re-opening trade underscored by unprecedented government spending, hyper consumer demand and global supply chain disruptions. This striking impact was materially amplified months later by Russia's invasion of the Ukraine and its further effect on global energy, precious grade minerals and agricultural resources. The latter of these, is likely not yet fully absorbed since we know that, in the aggregate, these warring countries supply some 24% of the world's agricultural demands with a growing season that has not yet begun if it does at all. One might characterize the immediate period before us as a horrendous vortex of human and financial misfortune with no certainty as to how it will play out since the Fed is only now embarking in earnest on its rate hike regime; what some might more politely call its "inflation containment efforts", while others more cynical might label it nothing less than "demand destruction". Something akin to General Sherman's 1864 March to the Sea!

We suspect those who've read our commentaries may well recall our prognosis in 2Q21, where-in we outlined three potential paths for Fed action at a time when the debate was raging as to whether price pressures were transient or more permanent; (a) the bank could pay lip service to rising rates on the notion that incipient inflation would somehow subside on its own. (b) It might act too slowly, placing it firmly behind the curve as inflation took root or (c) it might act too quickly and aggressively to snuff out price pressures, but in doing so also endanger economic growth and perhaps even set the conditions for a recession. It's now pretty clear that the Fed miscalculated the early inflationary warnings which have since been compounded by the Ukrainian war. Talk of (25bps) rake hikes have now risen to 50 even 75bps hikes, with a projected frequency almost double what was originally telegraphed. Add to this, the rapid pace with which the Fed intends to offload its $9Trillion in balance sheet bonds is informative of just how serious the Fed now believes inflation is.

Amazingly, global stock markets illustrated remarkable resiliency all things above considered. US large cap stocks (S&P 500 Index) dropped only (4.6%), small cap stocks (Russell 2000 Index) relinquished (7.5%), developed international stocks (MSCI EAFE Index) contracted by (5.8%), while emerging market stocks (MSCI EM Index) fell (6.9%) over 1Q. Not surprisingly, soaring yields have been crippling long-duration growth stocks, as large cap value stocks outperformed growth by +8%. Small cap value stocks outperformed their growth counterparts by +10%. This rotation in style was probably long overdue given growth's remarkable outperformance over the last five years.

What was troubling on "paper" (no pun intended) was the performance of the bond markets! An unusual double whammy has been underway since January. With no perceivable deterioration in credit quality and backed by all manner of government support, including a strong economy, bond markets have also re-trenched over increasing yields. The high quality Bloomberg US Agg Index fell by a historic (5.9%), a 40-year worst in one quarter. Municipal bonds followed suit declining by (6.2%) another 40-year worst in 1Q. One reasonable explanation is that bond markets, which had correctly anticipated that short yields would

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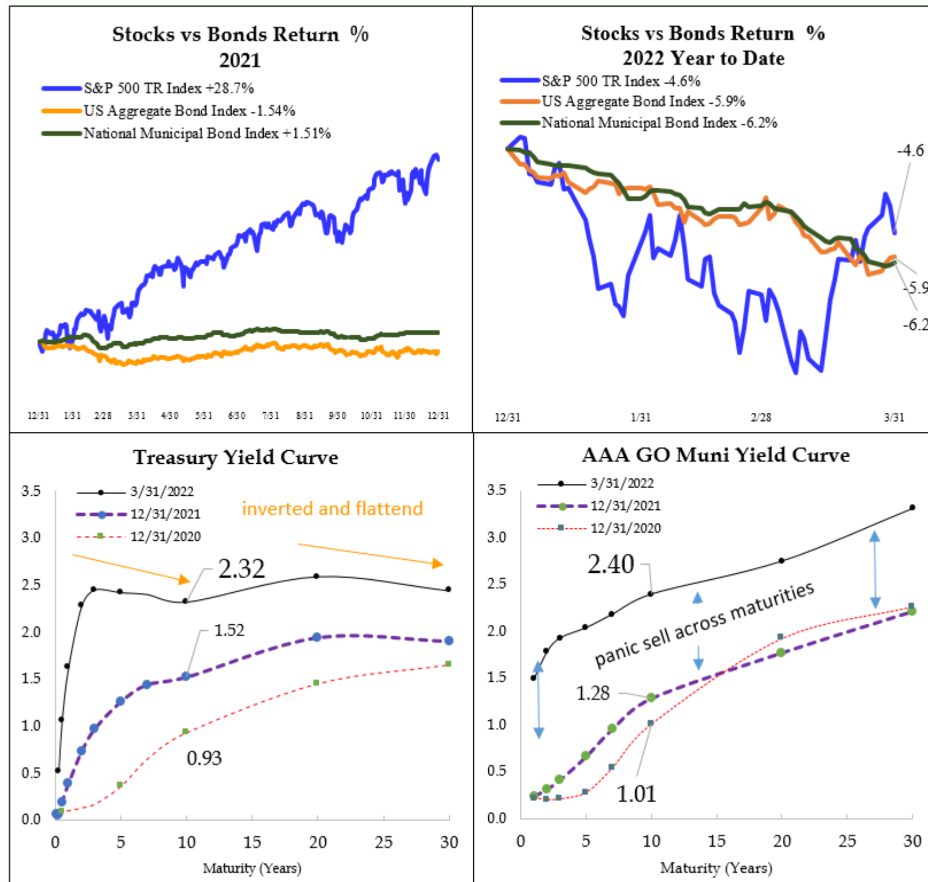
continue to rise, were perplexed that the longer end of the curve was not proportionally steepening. In fact comparatively speaking, the short to intermediate end of the curve experienced modest but brief yield inversions; a phenomenon that quickly catches the attention of economists, but also the bears who see this as a recessionary omen.



Has U.S. Inflation Peaked?

With the consumer price index up +8.5% and the (PPI) producer price index (wholesale prices) up even higher at +11.2%, overall price pressure is unlikely to ease anytime soon especially since PPI's impact tends to lag. Notwithstanding, prices for some durable goods that have been at the core of inflationary pressures, like used cars and consumer electronics, have most recently either retreated or risen less than expected, a modest sign that supply disruptions might be easing.

On the flipside, however, in what has for some time been a very tight labor market caused by nonparticipation or outright retirements, an ensuing wage-price spiral leaves employers with little choice but to pass these labor costs along to consumers. Paying $15-18/hour for counter help must eventually show up in the price of a morning coffee!

Then of course we have the unknown global macro effects of the continuing Omicron variant in China, now some 5 weeks old, which re-threatens global supply chains along with, what is more likely than not to be, a protracted land war in the Ukraine. In our view these outlier events will continue to fuel inflationary pressure for longer than most of us, perhaps even the Fed, thinks as it seeks to drive up its overnight funds rate to its perceived neutral rate of between 2.25-2.75% by year end.

Looking Forward

It's clearly too early to tell whether a recession may be in the offing. But whether it happens or not rests predominantly on what the Fed does. For sure, the bank has no choice but to harness inflation, but doing so will require that it walk a tightrope. It's their hope and ours that the monetary medicine about to be dispensed will help foster a soft economic landing, but for the present the jury is out!

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Market Commentary

In the meantime, how might investors consider re-positioning their portfolios? Unfortunately, our crystal ball is missing but we can still offer with reasonable conviction the following thoughts:

- Our bias is to prefer larger than normal weightings in US markets and, in particular, large cap stocks at some expense to small cap allocations. A much more balanced portfolio weighting between growth and value style investing, along with a focus on opportunities in the more inflation resilient sectors such as energy, financials, healthcare, utilities and consumer staples should be considered. Despite the pain already inflicted, one we cannot abandon the technology sector since in so many ways these stocks pioneer the future. But owning them presently will require conviction and likely enduring more pain. In all cases however one must be sure to invest in companies that have healthy balance sheets, strong free cash flow and "pricing power".
- As for bond portfolios, don't be hasty to redeem like so many bond mutual fund and ETFs investors have been doing since January. These vehicles are much more problematic based largely on transparency of holdings and the need for fund managers to sell off to meet redemption demands. Individual actively managed portfolios with high credit quality positions and shorter portfolio durations will do their part to dampen price consolidation as interest rates rise. Meanwhile coupon payments, and hence income streams, remain largely unaffected.
- Regarding liquidity, one must be sure there is sufficient cash on hand to meet operating and consumption needs for at least six months. Raising cash during periods of marked volatility is both inefficient and foolhardy. It is best to plan for cash needs and stick to the plan!
- At least for the immediate present, daily market volatility across the financial markets is a certainty we must endure. And so in times like these it's always best to avoid fixating on daily financial headlines, market moves and pundit speculation, itself often changing over a seven hour trading day. Better to pick up those good books you've been meaning to read and simply wait for portfolio performance to right itself with time.

Despite that this commentary portends at least a near-term bearish outlook, we also feel the need to inject a bit of optimism. We should not lose sight of the many positives embedded in the larger picture. We have a resilient US economy underscored by a low unemployment rate and a consuming public eager and willing to spend on goods and services irrespective of reasonable price increases.

From the central bank's perspective, shifts in monetary policy for better or for worse typically incur market reactions, but they are finite. And so while the markets are presently consumed by a now hawkish Fed, at the end of the day interest rates are still more likely than not to remain well below the lower-end of previous inflationary periods. It's all just a matter of markets and investors becoming acclimated to less "free money", which in the end strengthens the long-term economy!

In closing, please feel free to reach out to us if you have any questions or concerns regarding your portfolio or the financial markets at-large. With that we leave you with this simple thought: It is time, not timing that rewards the long term investor who seeks portfolio performance.

All Best Regards,

Eideard Group

April 15, 2022

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Major Market Indexes Total Returns YTD (04/15) and past three years

Market Indexes	**YTD**	**2021**	**2020**	**2019**
NASDAQ Composite	*-14.5%*	22.2%	44.9%	36.7%
Dow Jones Industrial Average	*-4.7%*	18.7%	9.7%	25.3%
S&P 500 (US large cap)	*-7.5%*	28.7%	18.4%	31.5%
Russell 2000 (US small cap)	*-8.0%*	14.8%	20.0%	25.5%
MSCI EAFE (Developed Intl.)	*-10.4%*	11.8%	8.3%	22.7%
MSCI Emerging Markets	*-8.5%*	-2.2%	18.7%	18.9%
Bloomberg National Municipal Bond	*-7.5%*	1.5%	5.2%	7.5%
Bloomberg US Treasury Bond	*-7.9%*	-2.3%	8.0%	6.9%
Bloomberg US Aggregate Bond	*-8.5%*	-1.5%	7.5%	8.7%
Bloomberg US Corporate Bond	*-11.1%*	-1.0%	9.9%	14.5%
Bloomberg US Corporate High Yield	*-6.6%*	5.3%	7.1%	14.3%
Alerian MLP Index	*24.3%*	40.2%	-28.7%	6.6%
WTI Crude Oil ETF (OIL)	*45.4%*	66.2%	-25.7%	31.3%
Gold ETF (GLD)	*7.7%*	-4.2%	24.8%	17.9%

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