

Investment and Economic Update First Quarter 2022



There's no sugar-coating the news: the U.S. and global markets took a hit in the first three months of 2022, offering investors an experience that they haven't been accustomed to during the long bull market. The only bright spot is commodities—but it's doubtful that anyone with recent experience at the pump is cheering the turmoil in global oil prices.

Just about every investment declined in value in the first quarter. The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—lost 6.18% since January 1. The Russell 1000 large-cap index finished the quarter with a similar 5.13% decline, while the widely quoted S&P 500 index of large company stocks is down 4.95% so far this year.

Meanwhile, the Russell Midcap Index gave back 5.68% of its value in the first three months of 2022. The comparable Russell 2000 Small-Cap Index is down 7.53% in the year's first three months. The technology-heavy Nasdaq Composite Index is down 9.10% for the year, as tech stocks are, for the first time in a while, underperforming the market as a whole.

International investors were full participants in the downturn. The broad-based EAFE index of companies in developed foreign economies lost 6.61% in the first quarter. In aggregate, European stocks, whose companies are close to the action in Ukraine, are down 11.34% so far this year, while EAFE's Far East Index has lost 6.68%. Emerging market stocks of less-developed countries, as represented by the EAFE EM index, also joined in the global decline, falling 7.32% in dollar terms in the first quarter.

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted 1.25% loss during the year's first quarter. The S&P GSCI index, which measures commodities returns, shone brightly in diversified portfolios, gaining 29.05% in the first quarter, largely driven (as you might expect) by rising oil prices, and also a price rise due to a global wheat shortage.

In the bond markets, yields are going up, albeit incrementally. Coupon rates on 10-year Treasury bonds rose to a 2.36% rate, compared with 1.67% at this time last year. Three month, 6-month and 12-month bonds are now offering real, tangible returns of .525% and 1.075% respectively. Five-year municipal bonds are yielding, on average, 2.03%, up from 0.50% at this time last year. 30-year municipal bonds are yielding 2.60% on average.

These market declines are always a bit nerve-rattling, but if you look at the graph from the start of the year to the end of the quarter, the picture becomes a bit more positive. The first two months of the year saw the S&P 500 index of large companies drop from 4770 down to 4173, more than meeting the technical definition of a market correction. And then, in the second half of March, the graph made up a lot of ground to reach back up to the 4630 level. Nobody, of course, knows what's going to happen next, but if you simply looked at the markets at the end of December and then checked back in on April 1, the one-quarter downturn would have looked like an insignificant blip in a generally positive 13-year upturn.

That said, there are enough clouds on the horizon to raise the possibility that we'll have to endure further declines before the markets again touch new highs. The most obvious one is the uncertainty that comes with a continuing, grinding war in Ukraine, and the sanctions and oil/grain supply disruptions associated with it.

Another is the possibility that the U.S. economy is approaching a recession. Saying the word 'recession' aloud today is a bit like shouting 'fire!' in a crowded theater; a recession is defined as several months of economic decline, and there is no evidence that we are experiencing that at this time. But some might find it worrisome that, in a recent survey of economists, most of them were backing off of the robust growth projections that they were making late last year. Their consensus now is that, when we finally measure the first quarter's GDP growth sometime next month, it will come in around 1.8%—far below the 3.9% prediction in the previous survey. The new forecast probably reflects the fact that there was 0% GDP growth in both December and January.

Meanwhile, there's another recession indicator that will probably get more press coverage than it deserves. The bond markets have recently shifted to what is known in the trade as an inverted yield curve, which is a fancy way of saying that short-term bonds are offering higher rates than longer-term ones. Right now, the yield on 2-year Treasury notes (2.337%) is very slightly more generous than the yield on 10-year issues (2.331%), which makes no sense to a rational investor (why take more risk on longer-term bonds when you can get a higher return for taking less risk on shorter-term ones?), but the fact that the two are yielding something similar might signal that lending institutions might believe that demand for credit is in danger of drying up. Credit demand dries up during recessions.

The problem, of course, is that this 'signal' has not exactly been a perfect predictor of recessions in the past, and even when it has, the time frame could be one year or five. Moreover, it might be a stretch to call this a signal at all, since the yield spread between, say, one-year and 30-year Treasuries is still pretty robust. One might better describe the 2/10-year inversion as a small kink in the yield curve rather than an inversion.

More optimistically, it is not easy to ignore the fact that the U.S. economy added 431,000 new jobs in March, after a gain of 678,000 in February. Oil prices are once again below \$100 a barrel despite all the dire predictions of global shortages, and U.S.-based corporations experienced their most profitable year since 1950 in calendar 2021. People who see the glass half-empty certainly have some data on their side, but so too do the optimists among us—and what's interesting is that this has always been true. In retrospect, we will see who was right, but in the moment, as we look at the future, there tend to be good, compelling clues that lead us to expect very different possible outlooks.

If the markets continue their choppy course, you will see a lot of pundits, soothsayers and (even less reliable) market economists telling us with confidence what's going to happen next. Some of them, by the law of averages, will be right, and will trade on that credibility through several false predictions to come.

And so, we wait, perhaps impatiently, for the next time the markets test new highs. Even if we don't know when that will happen, history offers encouraging evidence that it will, and all the anxiety and excitement that the markets produce in the meantime will have been, depending on your temperament, wasted energy or pure entertainment.

Below, we've summarized some of the widely quoted indexes for your reference. As a reminder the challenge is, the DJIA is not the same as the S&P 500, which is not the same as the NASDAQ – and none of these indexes perfectly match your own distinct mix of assets and their expected returns, especially if you own a globally diversified portfolio with exposure to stocks and bonds, large and small companies, value and growth companies, and U.S. and non-U.S. based companies. The following returns are year-to-date and the rolling 1-year; respectively:

S&P 500: -4.95%, 11.57%

Dow Jones: -4.79%, 4.40%

NASDAQ Composite: -9.10%, 5.21%

Russell 2000 (Small-Cap): -7.53%, -8.88%

MSCI EAFE (International): -6.61%, -1.21%

Barclay's Capital US Aggregate Bond: -6.31%, -4.72%

Please remember that past performance is not indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product made reference to directly or indirectly in this economic update, will be profitable, equal any corresponding indicated historical performance level(s), or be suitable for your portfolio. Due to various factors, including changing market conditions, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this update serves as the receipt of, or as a substitute for, personalized investment advice from Allos Investment Advisors®, LLC. To the extent that a reader is not a client of Allos Investment Advisors®, LLC and has questions regarding the applicability of any specific issue discussed above to his/her individual situation, he/she is encouraged to consult with the professional advisor of his/her choosing. For our clients, please remember to contact Allos Investment Advisors®, LLC if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing/evaluating/revising our previous recommendations and/or services. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.