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CIO CORNER

May 2022

A WORD FROM
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After a choppy and volatile start to the year, the month of May provides investors an opportunity for equity markets to stabilize. The Federal Reserve is expected to raise interest rates 50 basis points and global investors will be closely monitoring for any additional insight on its plans for further tightening of monetary policy to combat the current and persistent inflation.

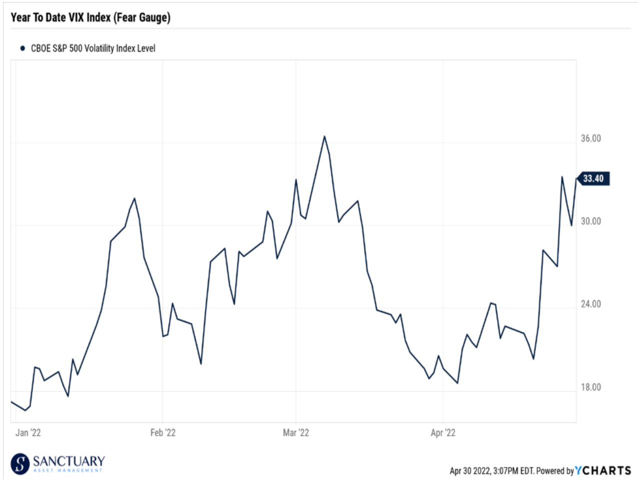
April Showers, bring May flowers. "Adversity is followed by good fortune" The saying can be traced back to England from the 1500s poet Thomas Tusser. Back then, he wrote "Sweet April showers do spring May Flowers."

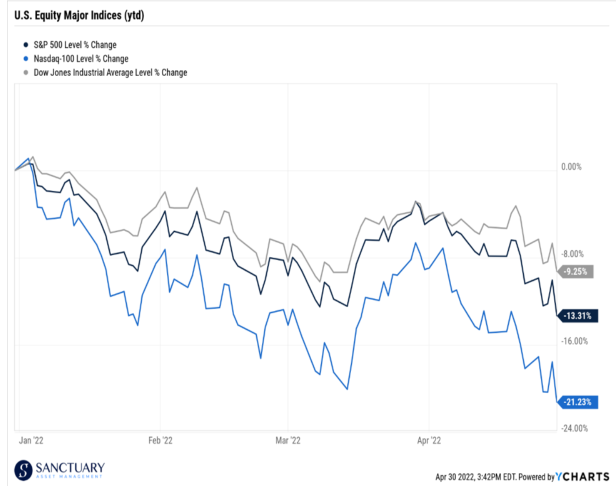
To be clear, the stock market proverbially rained a lot last month as the lower end of the S&P 500 range (4200) has been tested. April was the worst month for stocks since the pandemic hit in March of 2020 and the worst April on record since 1970. Also, it was only the second April with losses in the last 17 years. However, I remain cautiously optimistic for the remaining two months of Q2, and I look forward to having the Fed's highly anticipated May meeting finally in the rear-view mirror during this tumultuous mid-term election year. This continued elevation of volatility and recent downdraft in equities may quiet the recent hawkish tune that Chairman Powell has been whistling.

In April, the VIX surged back above 30 as equity sellers fiercely emerged to close out the month on a dismal note as the tech-heavy Nasdaq 100 skid to a new low for 2022, the S&P 500 unfortunately did as well. The S&P 500, which is the most favored U.S. equity benchmark, took out its previous low for the year established back in early March.

Stocks endured another challenging month as investors continue to contend with a plethora of problems, from the Federal Reserve's hawkish pivot to tightening monetary policy, rapidly rising rates, persistent inflation, Covid case spikes (and lockdowns) in China and the ongoing war inside of Ukraine. The Nasdaq fell roughly 13% in April, its worst monthly performance since October 2008 in the heart of the financial crisis. The S&P 500 dropped 8.8%, its worst month since March 2020 at the onset of the Covid pandemic. The blue-chip laden Dow Jones Industrial Average was down only 4.9% on the month.

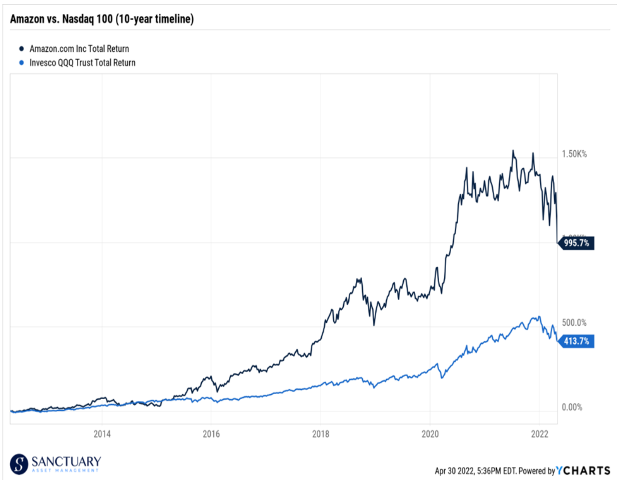
There were a few bright spots inside of this very tough macro landscape. One bright spot has been earnings season. As the S&P 500 Index recently slid into correction territory, down more than 10% from the previous peak, the dislocation between earnings beats and misses has been greatly amplified. During this type of elevated volatility, it can be difficult for investors to focus on anything beyond the short-term, but at times like this, studying market history for reminders of the benefits of long-term investing can be quite helpful. In addition, it is important to remember that we are in a mid-term election year that historically has been littered with volatile potholes along the road for the first three quarters of any voting year.



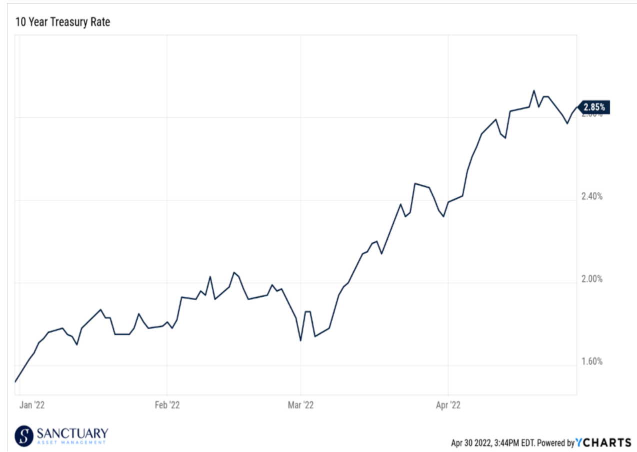


Tech: The broad sell-off in tech has erased trillions of dollars in market value, with investors repositioning and profit-taking on shares of everything from software and semiconductor companies to social media giants. Technology stocks have been the epicenter of the April sell-off, as dramatically higher interest rates hurt valuations and supply chain issues stemming from Covid and the war in Ukraine disrupt business. The Nasdaq Composite sits in bear market territory, 23.9% below its intraday high.

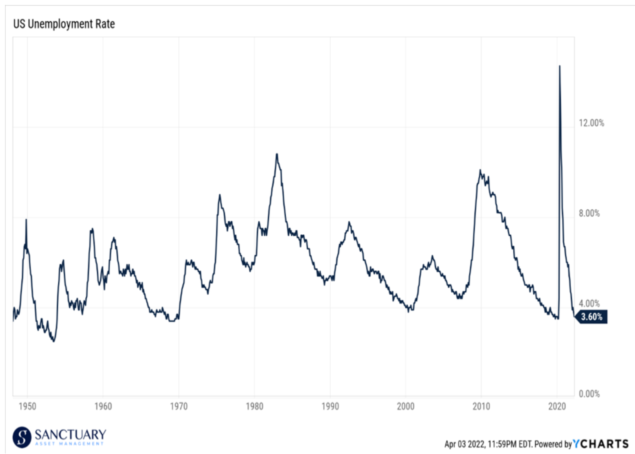
Amazon -- A Nasdaq darling and Essential 40 holding on Friday sunk about 14% — its biggest drop since 2006 — after the e-commerce giant reported a surprise loss and issued weak revenue guidance for the second quarter. The company said that Q1 profits were off by $6B from supply chain inefficiencies and general inflation. AMZN sales increased 7% in the quarter, compared to a 44% rise in the same period last year, marking the company's slowest growth rate in more than two decades. Despite the post-earnings plunge in Amazon's stock, investor confidence is staying largely upbeat on a view that the company's fundamentals will sharply improve later this year and into 2023. A myopic view measuring just one quarter can be misleading for investors with a longer investment timeline. For example, on a ten-year perspective (per below chart), Amazon has more than doubled the performance of the sensational rise of the Nasdaq 100 as tracked via the ETF, QQQ.



Fed: The Federal Reserve is widely expected to raise its policy rate by 50 basis points in May, as 8%+ inflation and a tight labor market trump the surprise Q1 GDP contraction, which was attributed to temporary trade and inventory challenges. On the other hand, the weakness in GDP may allow for a path for the Fed to revert to a slightly more dovish stance (short-term) and most likely give a stiff arm to the aggressive 75bp rate hike suggestions (floating around on financial news) at the June or July FOMC meetings. This hawkish course of action has been suggested by the one and only, boisterous St. Louis Fed President James Bullard. According to the CME FedWatch Tool, the probability is now better than 97% that the Fed raises rates by 50 basis points in May.



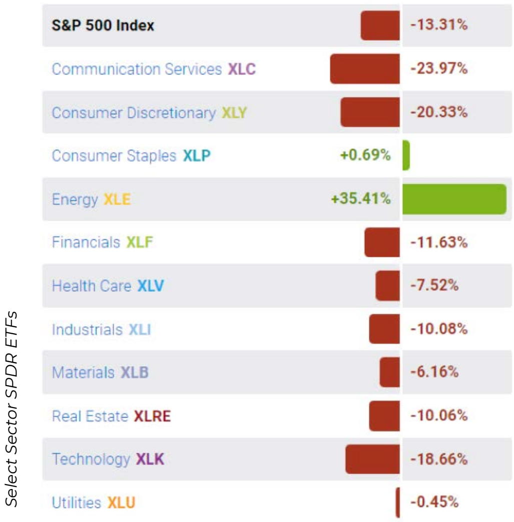
Jobs Jobs Jobs: Economists forecast a gain of 375,000 jobs in nonfarm payrolls, compared with an increase of 431,000 in March. The unemployment rate is expected to remain unchanged at 3.6%, near historical lows. The labor market remains tight, as job openings continues to outpace job seekers.



U.S. Treasuries: The 10-year note yield logged its biggest monthly increase in more than a decade in April as the expectations of a more hawkish Fed were indeed solidified in commentary by Fed Chairman Powell when participating in a panel for the IMF, International Monetary Fund. The yield on the 10-year note has popped like a pogo stick, nearly doubling its beginning 2022 yield of 1.53% to roughly 3%. And after a high velocity four-month recalibration, I see 3% as resistance in the surging yield of the 10-year, as this investment now offers global investors more than a 2% difference to other instruments, such as the German 10-year Bund currently offered at 0.93%

Earnings Season: At the close of April and according to FactSet, the percentage of S&P 500 companies beating EPS estimates is above the five-year average, but the magnitude of these positive surprises is below the five-year average. Overall, 55% of the companies in the S&P 500 have reported actual results for Q1 2022 to date. Of these companies, 80% have reported actual EPS above estimates, which is above the five-year average of 77%. Looking ahead, analysts expect earnings growth of 5.5% for Q2 2022, 10.9% for Q3 2022, and 10.5% for Q4 2022. Sector rotation and sector exposure continues to be a paramount theme for investors in 2022.

Putin Pain: Global investors remain bothered about developments in the Russia-Ukraine war. Russia's President Vladimir Putin warned the West of a "lightning fast" response to any country intervening in the Ukraine war.



Warren's Wallet: Warren Buffett gave Berkshire Hathaway investors a few details recently about how he spent more than $50 billion thus far in 2022, and again reassured them that the company he built will endure long after the 91-year-old billionaire is gone. His firm's mountain of cash shrank to $106 billion in the first quarter from $147 billion at the beginning of the year, as Buffett invested $51 billion in stocks and repurchased $3.2 billion of its own shares. (BRK.B is an Essential 40 holding.)

Elon: Elon Musk met with Twitter executives and shareholders, and in short order, he had a $44 billion take-private deal. This is the second largest buyout ever. Mr. Musk is financing the takeover with $13B in bank loans, plus $12.5B in loans against his stock in Tesla. He has pledged $21B in cash to buy the rest of Twitter's equity. Tesla shares fell 12% on the news. Musk sold some $8.5B in Tesla shares, then tweeted that he wouldn't unload more. Despite its daily user base of 229 million people, Twitter (ticker: TWTR) has yet to turn a profit in its nearly nine years as a public company. Q1 2022 earnings just released showed an operating loss of $128 million in the period.

POSITIONING FOR MAY

After a tough month for equity investors in April, May is kicking off with a host of major market events that will certainly keep volatility heightened across risk assets. However, May will serve as a critical month for investors still grinding along inside of a much-needed price discovery period. The resolve of the Federal Reserve's increasingly hawkish stance will also be tested, as its day-trading mentality should not abate and I expect it to remain inherently dovish once it can put out the blazing fire of inflation, which the Fed designed btw.

Choppy markets are unequivocally hard to stomach and can be quite challenging, but inside of turmoil there is opportunity. The opportunity to rebalance portfolios, tax loss harvest where appropriate, or simply talk through your portfolio exposure can be timely. I remain cautiously optimistic and, as reiterated in previous notes, embrace the range in the S&P 500. Please reach out if you would like to discuss further.

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