Fundamentum
2022 Q1 Market Commentary

After a strong run in 2021, volatility and downside momentum returned in the 1st Quarter of 2022. Rising rates, inflation, and stagflation worries overshadowed any positive news from the economy and corporate earnings. In addition, Russia's invasion of Ukraine further destabilizes the financial markets by reinforcing negative economic trends already in place (rising inflation, slowing growth, and a dysfunctional supply chain). Returns across the board were negative – even Fixed Income with its historical defensiveness was pressured by the continued rise of inflation. During the quarter, the U.S. Treasury two-year yield rose the most since 1981 and the U.S 10-year yield gained the most since 1994. Overall, the Bloomberg/Barclay Aggregate Bond index fell approximately -6%, the biggest quarterly loss since 1980.[1] Only cash and speculative commodities led by energy and food delivered positive returns during the quarter. However, there were significant relative performance differences, especially in investment styles and sectors.

Q1 Total Returns by Asset Class[2]

Russell 1000 Value Index	-0.74%
Dow Jones Industrials Index	-4.10%
S&P 500 Index	-4.60%
MSCI EAFE Index	-5.77%
MSCI EM Index	-6.99%
Russell 2000 Index	-7.53%
NASDAQ Composite	-8.94%
Russell 1000 Growth Index	-9.04%
Bloomberg/Barclay US Bond AGG	-5.93%

The Russian economy makes up only 2% of global GDP and only 1% of the revenues and profits of companies in the S&P 500 Index. Although tragic, the Russian invasion of Ukraine should not threaten the overall MACRO environment of the United States and the global economy. But this "ugly" war will impact various commodities traded across the globe. Russia is the world's largest exporter of natural gas, the third-largest oil producer, and a major producer of nickel, lithium, and other vital minerals.[3]

Even before the war, inflation surprised investors and economists with its strength and longevity. The war's impact on energy & food prices along with numerous supply chains pushed inflation fears even higher. For February, inflation measured by the personal consumption expenditures (PCE) was 6.4%. Core (x–energy & food) PCE inflation, the Federal Reserve preferred inflation gauge, came in at 5.4% the highest level in nearly 40 years.[4]

As expected, the Federal Reserve began to unwind its unprecedented monetary support during the 1st quarter. The Fed approved its first interest rate hike in more than three years and announced its intention to reduce its balance sheet sooner rather than later. During the quarter, a more hawkish Federal Reserve led to a dramatic repricing of interest rate and balance sheet runoff expectations. These expectations now have the Federal Reserve increasing interest rates at each of the six remaining meetings this year, plus another three in 2023.[5] As a result, the yield on the U.S. 10-year Treasury rose to 2.38% from 1.51%.[6]

Inflation and the Ukraine conflict had a major influence on the relative performance of investment styles and sectors. The higher dividend-paying Russell 1000 Value index with its greater exposure to the economy and commodities significantly outperformed the Russell 1000 Growth index (-0.74% vs -9.04%).

Meanwhile, only two sectors had a positive performance during the quarter – commodities-based Energy jumped +37.7% and the defensive Utility sector followed with a +4.0% return. Three sectors led the markets lower: Communications Services (-12.1%), Consumer Discretionary (-9.2%), and Technology (-8.6%).[7]

While much of the news during the quarter was negative there were still numerous bullish talking points: rising income levels and job openings due to the tight labor markets, the consumers' strong balance sheets, supportive corporate earnings, and economic normalization as the Covid impact continues to lessen. During the quarter, the pandemic's impact on the economy continued to fade. The Omicron variant wave did little economic damage as the economy continued to reopen and economic indicators rebounded. The number of U.S. job openings is at a two-decade high while the U.S. economy has added 3.5 million jobs over the last six months.[8] In March, the U.S. economy added 431,000 jobs, below estimates, but it was the 11th month in a row that payroll gains exceeded 400,000 – the longest stretch on record. The unemployment rate improved more than expected falling to 3.6% - nearly back to the 50-year low in late 2019 and early 2020.[9]

One last piece of good news, equities in general have risen during periods of rising interest rates because this is normally paired with strong economic conditions and earnings growth. The S&P 500 has returned an average 7.7% in the first year - the Fed raises rates, according to a Deutsche Bank study of 13 hiking cycles since 1955.[10]

Reflecting the Fundamentum Investment Committee's outlook on inflation and its impact on the economy, interest rates, and the financial markets we looked to diversify our strategies and portfolios away from traditional bonds and low-yielding cash but still maintain some of the same "defensive" characteristics these asset classes historically possess. During February, Fundamentum began to introduce selected Alternative investment funds into our strategies and portfolios. The risk-reward profile of Fundamentum's alternative sleeve should allow for continued upside participation in the markets with improved downside protection given increased volatility due to elevated inflation expectations and rising interest rates.

As we stated in our 2021 Investment Review and 2022 Outlook, we still see positive but slowing economic growth with high-single-digit, normalization of earnings growth. With continued growth in the economy and earnings, we expect positive, single-digit equity performance, but the combination of inflation and monetary tightening will lead to flat to negative bond returns in 2022.

Given slowing growth, rising inflation, increasing interest rates, and high valuation levels; Fundamentum strongly believes future, long-term investment returns will be below historical norms. Therefore, we continue to encourage Advisors to build diversified portfolios with lower capital market returns into their client's long-term financial plans and expectations.

Fundamentum Investment Committee:

John Nichol, CFA® - Chief Investment Officer
Trevor Forbes - Investment Committee
Robert Armagno, CFA® - Investment Committee

Sources:

1. Dow Jones, March 31, 2022
2. Bloomberg Business News, March 31, 2022
3. Manole Capital Management, April 1, 2022
4. John Hancock – Weekly Market Recap, April 1, 2022
5. Manole Capital Management, April 1, 2022
6. John Hancock – Weekly Market Recap, April 1, 2022
7. FactSet, March 31, 2022
8. Manole Capital Management, April 1, 2022
9. John Hancock – Weekly Market Recap, April 1, 2022
10. Reuters Business, March 16th, 2022

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio. Diversification does not protect against market risk.

The Russell 1000 Index consists of the 1,000 largest securities in the Russell 3000 Index, which represents approximately 90% of the total market capitalization of the Russell 3000 Index. It is a large-cap, market-oriented index and is highly correlated with the S&P 500 Index.

The Dow Jones Industrial Average is comprised of 30 stocks that are major factors in their industries and widely held by individuals and institutional investors.

The Standard & Poor's 500 Index is a capitalization weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

The MSCI EAFE Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. The MSCI EAFE Index consists of the following developed country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the UK.

The MSCI EM (Emerging Markets) Index is a free float-adjusted market capitalization weighted index that is designed to measure the equity market performance of the emerging market countries of the Americas, Europe, the Middle East, Africa and Asia. The MSCI EM Index consists of the following emerging market country indices: Brazil, Chile, Colombia, Mexico, Peru, Czech Republic, Egypt, Greece, Hungary, Poland, Qatar, Russia, South Africa.Turkey, United Arab Emirates, China, India, Indonesia, Korea, Malaysia, Philippines, Taiwan, and Thailand.

The Russell 2000 Index is an unmanaged index generally representative of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 10% of the total market capitalization of the Russell 3000 Index.

The NASDAQ Composite Index measures all NASDAQ domestic and non-U.S. based common stocks listed on The NASDAQ Stock Market. The market value, the last sale price multiplied by total shares outstanding, is calculated throughout the trading day, and is related to the total value of the Index.

The Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values.

The Bloomberg Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds.