A View from the Bevy – 1Q22

Market Overview

It was a rough quarter for stocks, with the Dow and the S&P 500 losing 4.6% and 4.1%, respectively, and the NASDAQ losing 9.1%. It was the worst month for all these indices since the first quarter of 2020, when the Covid pandemic began, and ends an impressive rally from those lows two years ago. Bonds had an even more difficult start to the year, as interest rates rose, driving bond prices down. The table below shows the performance of major stock and bond indexes for the 1st quarter.

On the bright side, March was a good month overall, as stocks rallied during the second half of the month; the S&P 500 and NASDAQ each rose by more than 3% during the month. This relief rally resulted from several factors, including growing optimism of a ceasefire in Ukraine and clarity around how central banks are going to act moving forward as they raise rates in the face of persistent inflation. We also saw some technical buying during the month as markets ultimately fell too far too fast to start the year.

Stock Market Indices	1st Quarter 2022
S&P 500	-4.60%
S&P 500 (Equal-Weight)	-2.72%
Bloomberg US Aggregate Bond Index	-5.93%
Dow Jones Industrial Average (DJIA)	-4.10%
NASDAQ Composite	-9.10%
Russell 2000	-7.53%
MSCI World	-5.15%
MSCI World ex U.S.	-4.81%
Bloomberg Global Aggregate Bond Index	-6.16%
MSCI Emerging Markets	-6.97%

Source: AJO. Data supplied by FactSet Research Systems.

Inflation concerns drove the markets in early 2022, as the realization set-in among many market participants that inflation was going to be higher, and last longer, than previously believed. Headlines abounded regarding the rising cost of food, gas, vehicles and building materials, comments from many U.S. Federal Reserve (Fed) Governors, and the Chairman himself, compounded the situation as they indicated that interest rate hikes would begin sooner than expected. The Fed signaled the start of rate hikes in March instead of their projected timeline of mid-year, while also indicating that there would be more interest rate increases in 2022 than formerly assumed.

The current expectation is that there will be at least six more interest rate hikes this year, and the possibility exists that some of them might even be 50 basis points, rather than 25 basis points like the one in March. These interest rate increases along with rising inflation expectations have created a difficult environment for bond investors. The Bloomberg US Aggregate Bond Index has even underperformed the S&P 500 stock index so far in 2022, which is atypical when stock returns are negative.

The bad news compounded for the markets when Russia invaded Ukraine in late February. It had been the consensus that Putin was bluffing and would not invade. This situation has obviously been a humanitarian crisis, but on the positive side, the invasion has not gone nearly as well as Putin expected. The West and NATO have been more unified in their opposition to the invasion than many believed would be the case. While the situation within Ukraine remains bleak, there is a ray of hope that a ceasefire is not too far away, and that NATO will not be drawn into the war.

Notably, what didn't dominate the headlines as the quarter progressed? Covid. Cases, hospitalizations, and deaths dropped dramatically during the quarter, and most Covid restrictions were lifted across the country (and the world). While Covid is not gone, and global hotspots remain, there is a consensus that Covid is now something that we can live with and control. Restaurants and entertainment venues have re-opened, and many people have gone back to the office. It appears that the new normal has arrived (finally).

Outlook

We are cautiously optimistic about the markets as the second quarter begins, but there are still many headwinds that we are watching closely; we think market volatility is likely to continue. While economic growth is expected to be above the long-term average this year, it is expected to slow from last year's historic pace. Interest rates are rising while inflation remains stubbornly high. Meanwhile, the situation in Ukraine remains a wildcard from a market perspective. The mix of these positive and negative factors will likely result in a volatile year for both stocks and bonds.

Global supply chains should right themselves, especially as Covid continues to recede, but nobody is sure exactly when this will happen. In addition, nobody is quite sure exactly how the Fed's interest rate increases will affect the economy. And there is always the possibility of another Covid outbreak. While it is highly unlikely the country will go back into lockdown, there could be some disruptions to the economy, particularly to the recovery of the global supply chain.

But as we have pointed out in the past – the market always faces headwinds – they just aren't always the same ones. It is always helpful to remember that it really is a market of stocks rather than a stock market. Companies and industries will be impacted differently – some positively and some negatively – depending on what occurs in the macro environment.

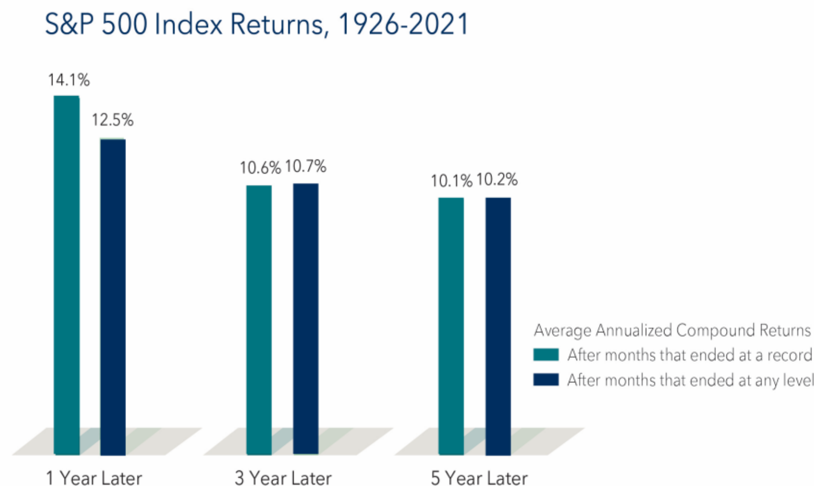
Also, as we have also discussed before, you can't time the market – what's more important is time in the market. Rather than focus on the day-to-day fluctuations in the market, which can be hard to stomach, remember that it is our job at Cygnus to find the companies that we believe are in the best position to weather any storm.

The best way to succeed in investing is to have a long-term plan, one that is personalized to your goals and objectives, and is structured with an asset allocation designed to help you meet these goals. Just like we review plans with clients on a regular basis to ensure that they remain appropriate, we constantly review the stocks in client portfolios, and we will make changes as appropriate to respond to changing circumstances.

Of Interest: Markets and Volatility

The mood of the markets so far this year contrasts sharply with the previous 20 months, when stocks staged a dramatic recovery from the shutdowns caused by Covid-19 and continued to reach new highs even as the pandemic continued. Remember the headlines touting that the S&P 500 Index closed at a market high 70 times during 2021?

Some investors may think that a market high is a signal that stocks are overvalued or have reached a ceiling. However, as illustrated in the chart below, the average returns one-, three- and five- years after a new month-end market high are similar to the average returns over any one-, three- or five-year period.



In looking at all monthly closing levels between 1926 and 2021 for the S&P 500 Index, 30% of the monthly observations were new highs. After those highs, the average annualized compound returns ranged from over 14% one year later to more than 10% over the next five years. Those results were close to average returns over any given period of the same length. Therefore, we can see that reaching a new high tells us very little about the direction of future returns. Similarly, it is difficult to glean anything about valuation from market levels alone.

Given the increase in volatility we have seen this year so far, as persistent inflation and the Russian invasion of Ukraine have spooked investors, we want to reiterate the importance of maintaining a long-term perspective and avoiding any overreactions to short-term volatility.

Since 1926, the U.S. stock market has rewarded investors with an average annual return of about 10%. Yet it is important to remember that returns in any given year may be sky-high, extremely poor, or somewhere in between.

Annual returns came within two percentage points of the market's long-term average of 10% in just 7 of the past 96 years. Yearly returns have ranged as high as up 54% and as low as down 43%. And since 1926, annual returns have been positive 71 times and negative 25 times.

Understanding the range of potential outcomes can help you stick with a plan and ride out the inevitable ups and downs. Please let us know if you experience any life events that impact your overall financial position so that we may help you make any necessary adjustments to keep your investment portfolio on track. As always, we are here to answer any questions.

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