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Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

March 2022

The Russian Invasion of Ukraine

On February 23, Russia launched a series of coordinated attacks on key military targets in Ukraine, including ground and air assaults. In more recent days, as the Russian army faces obstacles to its military objectives, it has significantly increased attacks on the civilian population and infrastructure. Russia has claimed, officially, that its goal behind these attacks is to protect Russian citizens in the self-proclaimed republics of Luhansk and Donetsk, who claimed independence when Russia invaded the Ukraine in 2014. However, the roots of the conflict run much deeper as Ukraine was an important component of the Soviet Union during the Cold War and the second most populous of its fifteen republics. Analysts believe a desire to return to those days are a large driver behind the invasion.

As with everyone, our thoughts are first and foremost on the human tragedy and suffering. To date, 2.8 million people have fled the battle zone, and the United Nations fears more than four million will eventually leave, which would represent approximately 8% of Ukraine's population. There are currently as many unknowns as there are hard facts. How long will the conflict last, will it spread outside of Russia/Ukraine, what is Putin's ultimate goal with this act of war, how will the West respond if the situation deteriorates further, and will alliances be strained and new ones forged are some of the key questions.

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Initially, global equities – for the most part – sold off. Traditional "safe havens" such as gold and Treasuries rallied, and energy prices jumped – a common occurrence when geopolitical events happen. As ever tougher sanctions have been applied, markets have become more discerning as investors begin to look for sectors and locales that will be more resilient in the face of the ongoing conflict. The good news is that Russia (as an emerging market) is a relatively small weight in the global stock and bond market indices, and in a diversified portfolio, it typically represents a small allocation. For example, the most aggressive BFE Asset Allocation model (Aggressive Growth) suggests an 8% portfolio allocation to the emerging markets asset class. If an everyday investor had an 8% allocation to the MSCI Emerging Markets Index, their exposure to Russia would be less than two-tenths of one percent. It is important to remember that any international or global equity index is a collection of heterogeneous countries, and other energy exporters – such as Canada, Mexico, and Brazil – have seen their equity markets outperform broader international indices such as the MSCI EAFE or MSCI EM indices year to date.

One of the questions many investors are asking is: does the Russia/Ukraine conflict (and the resulting effects) impact the Federal Reserve's decision on interest rates? Global central banks are in a difficult position with inflation running very hot across the globe, and the desire to not negatively impact global growth. With CPI at the highest level in four decades (7.9%), and more fuel to the inflation fire in the form of higher energy prices because of Russia's actions, the consensus is that the Fed will raise rates multiple times beginning this month. Prior to the invasion, the conversation had centered on the size of the first increase (25 or 50 basis points). The current crisis provides the Fed the cover to increase at a more modest 25 basis points amid the ongoing geopolitical uncertainty.

There is a tremendous amount of uncertainty in the world and, investor anxiety is justifiably heightened. In these situations, we find it helpful to remember some of the key lessons of previous downturns and tenets of successful investors.

- **Market downturns happen more frequently than you think** – Looking at the history of the S&P 500, the average peak to trough drawdown in a given year since 1928 is approximately 13%. This calendar year, the peak to trough drawdown (to date) is approximately 13%. While this "feels" worse than that, it is relatively normal.

- **Be resistant to panic and euphoria** – It is very difficult to do in the moment, but being clear on your goals, risk tolerance, and time horizon can help one maintain some calm in a difficult market environment. It is also important to have a plan, in terms of rebalancing or raising or deploying cash. That plan should be consistent across market environments.

- **History provides valuable lessons but can't be counted on to repeat itself** – "Past performance is no guarantee of future results" is a common refrain in terms of investing. History can provide valuable context, but markets and events unfold in different manners and at different speeds, and phrases such as 'guarantee' and 'with certainty' are seldom – if ever – correct and should be viewed with a critical eye.

- **Corrections and bear markets are buying opportunities** – Declines in asset prices increase the prospects for forward returns by providing more attractive entry points.

- **Trying to time entry and exit points in a volatile market is difficult at best** – Moving to the sidelines in a declining market, with the hopes of getting

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back in at an opportune time, involves two correct decisions: when to get out and when to get back in. In our experience, getting back in often is the more difficult decision with the best time typically corresponding with when the news "feels" the worst since markets are forward looking. It is also important to note that some of the strongest positive days occur in bear markets, making these timing decisions even more difficult.

"Markets climb a wall of worry" is an old saying and might better be interpreted as there always being something to worry about. On any given day, equities have a slight bias towards being positive, but over longer periods, they have proven to be one of the best ways to build wealth. The average annualized return since adopting 500 stocks into the S&P 500 in 1957 through December 31, 2021, is 10.67%. However, for an investor to earn that return they would have needed to stay invested and would have suffered through eight bear markets (declines of 20% or greater). To earn the benefits of equity returns, one must be willing to accept the accompanying volatility and discomfort it can cause.

We will close with two final thoughts: first is that the worst bear markets typically occur in recessions. And while a recession is a possibility, the unemployment rate remains very low (3.8%), and according to the JOLTS data (Job Openings and Labor Turnover Survey), job openings remain plentiful. And with the Fed ready to increase rates being one of the biggest fears for investors, we would point out that over the last eight tightening cycles, equities have been higher each time one year after the first interest rate increase. We have also had a very recent period that is a perfect example of how difficult timing the market can be. We had the shortest bear market on record in the forced recession of early 2020, followed by the quickest stock market double on record, and a prolonged period of new stock market highs.

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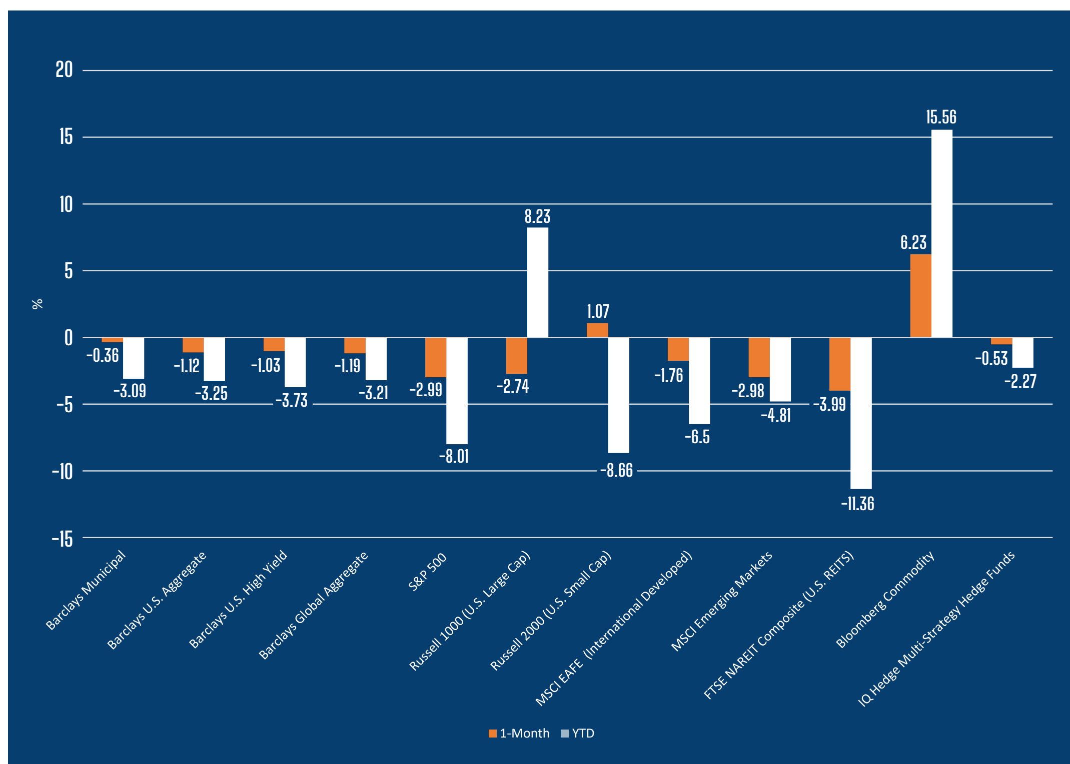
Asset Class Returns as of February 28, 2022
Comparing Recent Month and Year-to-Date Total Returns



Source: Morningstar

Fixed Income

- Treasury and sovereign bond yields across the globe continued to move higher in February leading to losses in core fixed income and municipals.
- Credit spreads widened last month across the board.
- Floating rate loans were not spared as they experienced negative returns and wider spreads.

Equities

- U.S. equities were mixed versus non-U.S. equities in February.
- Large cap stocks lagged small cap stocks for the first time in a while.
- Value continued to outperform growth with energy being the best performing sector.
- Non-U.S. equities generally outperformed the U.S. last month excluding small cap stocks.
- Similar to the U.S., value beat growth, and small cap outperformed large cap.
- Emerging markets fell 3% in February led by extreme weakness in Russia/Eastern Europe.
- U.S. dollar strength hurt international developed and emerging market returns last month.

Real Assets

- Commodities were very strong as inflation fears ramped up and energy prices continued to climb.
- REITS had another poor month and were hurt by weak equity and weak fixed income markets.

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February 28, 2022	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.01%	0.01%	0.01%	0.04%	0.80%	1.07%	0.59%
Barclays Municipal	-0.36%	-3.09%	-3.09%	-0.66%	3.19%	3.24%	3.15%
BBgBarc U.S. Govt/Credit Intermediate	-0.44%	-1.15%	-1.15%	-1.62%	1.70%	1.55%	1.23%
Barclays U.S. Aggregate	-1.12%	-3.25%	-3.25%	-2.64%	3.30%	2.71%	2.47%
Barclays U.S. High Yield	-1.03%	-3.73%	-3.73%	0.64%	5.31%	4.88%	5.86%
S&P/LSTA Leveraged Loan	-0.51%	-0.15%	-0.15%	3.20%	4.15%	4.02%	4.37%
Barclays Global Aggregate	-1.19%	-3.21%	-3.21%	-5.32%	2.15%	2.36%	1.28%
JPM GBI EM Global Diversified	-5.00%	-5.01%	-5.01%	-9.96%	-1.06%	0.95%	-0.77%
U.S. Equity Indices							
DJ Industrial Average	-3.29%	-6.43%	-6.43%	11.59%	11.72%	12.71%	12.74%
S&P 500	-2.99%	-8.01%	-8.01%	16.39%	18.24%	15.17%	14.59%
NASDAQ Composite (Price)	-3.43%	-12.10%	-12.10%	4.24%	22.22%	18.74%	16.57%
Russell 1000	-2.74%	-8.23%	-8.23%	13.72%	18.08%	15.07%	14.51%
Russell 1000 Growth	-4.25%	-12.47%	-12.47%	12.55%	23.18%	20.24%	16.97%
Russell 1000 Value	-1.16%	-3.46%	-3.46%	14.99%	12.22%	9.45%	11.71%
Russell Mid Cap	-0.72%	-8.03%	-8.03%	7.07%	14.25%	12.02%	12.82%
Russell 2500	1.13%	-7.29%	-7.29%	0.40%	12.88%	11.21%	12.15%
Russell 2000	1.07%	-8.66%	-8.66%	-6.01%	10.50%	9.50%	11.18%
Russell 2000 Growth	0.44%	-13.03%	-13.03%	-17.40%	9.22%	10.49%	11.38%
Russell 2000 Value	1.65%	-4.27%	-4.27%	6.63%	10.91%	7.97%	10.66%
Non-U.S. Equity Indices							
MSCI World	-2.50%	-7.64%	-7.64%	11.22%	15.01%	12.64%	11.33%
MSCI ACWI	-2.55%	-7.32%	-7.32%	8.26%	13.96%	11.99%	10.41%
MSCI ACWI Ex-U.S.	-1.97%	-5.57%	-5.57%	0.03%	8.16%	7.76%	5.87%
MSCI EAFE	-1.76%	-6.50%	-6.50%	3.30%	8.29%	7.67%	6.65%
MSCI EAFE Growth	-2.21%	-12.48%	-12.48%	-0.65%	10.56%	9.78%	7.80%
MSCI EAFE Value	-1.34%	-0.30%	-0.30%	6.98%	5.46%	5.24%	5.28%
MSCI Europe	-2.81%	-7.25%	-7.25%	7.43%	9.11%	8.43%	6.84%
MSCI Japan	-1.11%	-6.13%	-6.13%	-4.70%	7.60%	6.50%	6.98%
MSCI AC Asia	-1.90%	-5.64%	-5.64%	-10.95%	7.29%	7.53%	6.49%
MSCI EAFE Small Cap	-1.25%	-8.48%	-8.48%	-1.14%	8.99%	8.25%	8.70%
MSCI ACWI Ex-U.S. Small Cap	-1.28%	-7.44%	-7.44%	1.42%	10.34%	8.53%	7.43%
MSCI Emerging Markets	-2.98%	-4.81%	-4.81%	-10.40%	6.40%	7.37%	3.61%
MSCI EM Asia	-2.34%	-5.74%	-5.74%	-14.81%	8.21%	8.90%	6.10%
MSCI China	-3.90%	-6.73%	-6.73%	-31.22%	0.66%	5.85%	4.88%
MSCI EM Eastern Europe	-42.76%	-46.55%	-46.55%	-36.21%	-11.06%	-2.42%	-3.42%
MSCI EM Latin America	4.84%	12.58%	12.58%	14.77%	-1.48%	2.03%	-2.36%
MSCI EM Small Cap	-2.47%	-6.78%	-6.78%	4.85%	11.75%	8.21%	5.04%
MSCI Frontier Markets	-4.40%	-7.77%	-7.77%	10.18%	8.06%	6.81%	6.51%
Hedge Fund Indices							
IQ Hedge Long/Short	-1.58%	-4.64%	-4.64%	2.46%	7.83%	5.62%	--
IQ Hedge Multi-Strategy	-0.53%	-2.27%	-2.27%	-2.72%	3.14%	3.03%	2.95%
Real Assets Indices							
FTSE NAREIT Composite	-3.99%	-11.36%	-11.36%	20.72%	10.16%	8.52%	9.97%
Alerian MLP	4.82%	16.42%	16.42%	43.06%	3.16%	-0.73%	0.66%
Bloomberg Commodity	6.23%	15.56%	15.56%	34.43%	12.89%	6.63%	-1.94%
S&P Global Infrastructure	2.51%	1.49%	1.49%	15.08%	6.87%	7.19%	7.19%
Other							
Oil Price Brent Crude	10.72%	29.84%	29.84%	52.71%	15.22%	12.68%	-1.83%
CBOE Market Volitility (VIX)	-0.25%	60.22%	60.22%	-1.29%	23.13%	16.39%	4.12%

Source: Morningstar

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