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# Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

May 2022


## Market Corrections are Inevitable

There is an old saying, "A recession is when your neighbor loses their job, and a depression is when you lose yours." It feels like a similar sentiment can be applied to the stock market. While the S&P 500 hasn't met the classic definition of a bear market (20% peak-to-trough decline), one look at the financial news or one's stock portfolio and it certainly feels like a bear market. And in fact, some of the indices such as the NASDAQ and Russell 2000 are currently in bear market territory, down more than 20%. While it might be a correction for your neighbor, it feels like a bear market personally. Noted financial journalist Alan Abelson put it more succinctly, "In a correction, other people's stocks go down; in a bear market, your stocks go down."

By now we have all heard the litany of reasons that stocks are under pressure: heightened inflation, stretched valuations, higher Fed funds rate (and bond yields), and recession fears. While these are all legitimate concerns, they have been faced by investors and the markets previously and both have survived and thrived. And while it is important to focus on what the markets are doing, it is equally as important to focus on what you are doing, particularly in a stressed market environment.

With that in mind, here are a few thoughts and lessons we have gleaned over the years:

- **Bear markets and corrections happen** – Looking at the S&P 500's performance since 1928, the index has returned 10% annualized with an average intra-year drawdown of 16.3%. The drawdown this year (to date) has been 16.8%, in line with history (see chart). There have also been 21 bear markets in the S&P 500 since 1928. To realize the higher potential returns of equities, investors must be willing to accept the greater volatility and periodic corrections/bear markets.

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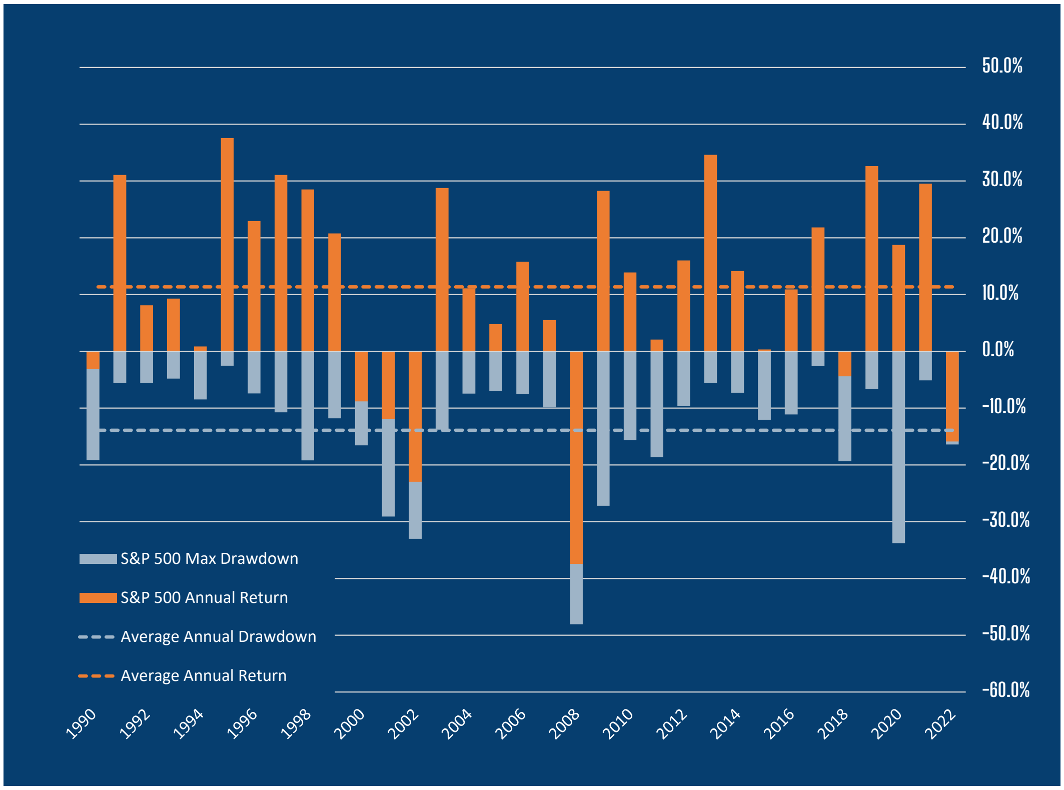
- **Being resistant to panic and euphoria is one of the biggest determinants of investor performance** – Maintaining discipline to your investment style and risk tolerances is key to long term success. Not panicking in periods of heightened volatility and selling out, and not chasing the latest hot stock or hot manager, will have a large part in determining your personal investment outcome.
- **How you react to a bear market has a large impact on your financial journey** – Declines in asset prices increase the prospects for forward returns (put another way, price matters). Deploying cash or rebalancing are ways to take advantage of declines in asset prices, as are systematic investment programs.
- **Be honest with yourself about risk tolerance** – If a correction or bear market causes too much anxiety, it means a reevaluation is in order.
- **Disciplined rebalancing and asset allocation are risk management tools that work.**
- **Market timing is hard** – Many people will indicate they are long-term investors until the markets turn down and then they begin to think more tactically. Timing market corrections involves multiple decisions about when to get out and back in, and the tendency for large up and down days to be clustered together can result in missing some sharp rebounds. Last week's activity in the NASDAQ was a classic example, with a 3+% gain followed by a 4+% loss.
- **Stocks have proven through time to be one of the best ways to create wealth.**

### S&P 500 Max Drawdown and Yearly Returns




*Source: Morningstar, Benjamin F. Edwards*

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We would make two additional observations about recent market weakness. The first is that as markets have marched higher through time, there is a base effect in the sense that large nominal point swings have less of an impact on a percentage basis. The largest single day point loss for the Dow Jones Industrial Average was in March of 2020 at 2,997 points (12.96%). However, the largest single percentage day was October 1987 when a 22.6% loss was "only" 508 points. The other point we would make is that technology has made information immediately accessible and trading much simpler. That has had the effect of shortening market cycles/reactions.

The recent activity has been gut wrenching, and no one knows when it will end. Despite the aforementioned negative factors, reasons to not panic are present. First quarter earnings have generally come in stronger than expected, the jobs market remains robust, and our work suggests that valuations outside of large cap are now below longer-term averages. We also believe that there is good chance that inflation is peaking/has peaked, based on year-over-year comparisons. If that is the case, the Federal Reserve might not need to be as aggressive as previously thought. Financial conditions have already tightened, doing some of the Fed's work for them. Fed funds futures currently indicate a terminal rate for this cycle in the 3% to 3.25% range, while the Fed in its latest projection materials centered in a neutral rate in the 2.25% to 2.5% area. In closing, for investors with longer-term horizons we would be looking to deploy cash into the markets, not pull back.

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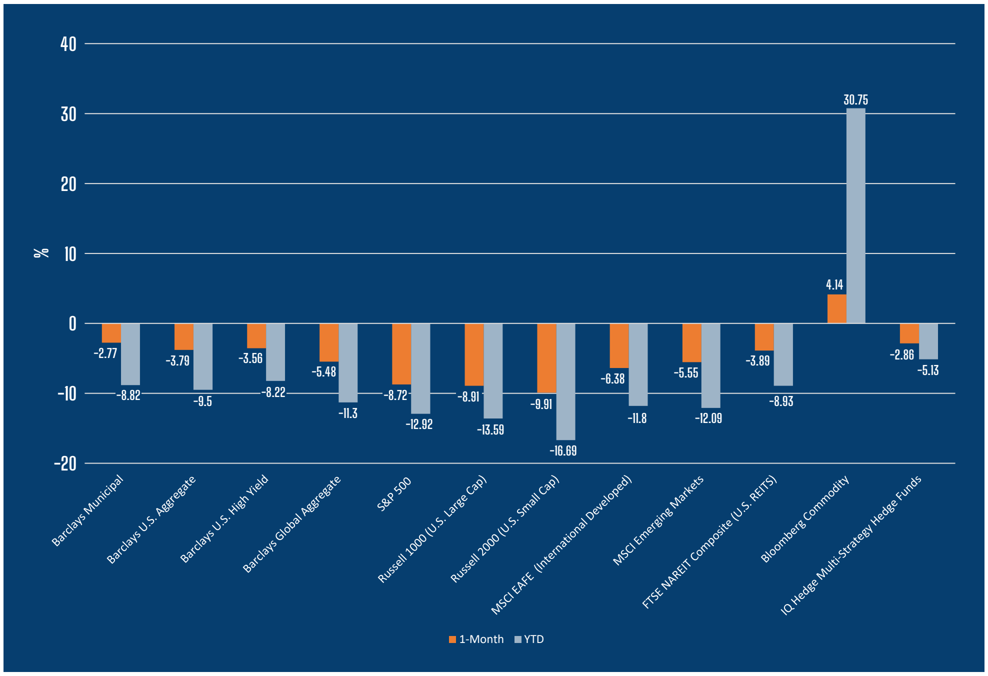
**Asset Class Returns as of April 29, 2022**
*Comparing Recent Month and Year-to-Date Total Returns*




*Source: Morningstar*

## Fixed Income

- It was another rough month for fixed income with Treasury/sovereign debt yields moving higher across the board.
- Credit spreads widened in April as investors looked to de-risk portfolios. Investment grade and high yield were hit hard while floating rate loans eked out a small gain.
- Bonds outside the U.S. were also hit by the stronger U.S. dollar.

## Equities

- U.S. equities fell sharply in April led by the NASDAQ/tech/growth. Consumer Staples was the only sector that generated positive performance.
- Value trounced growth, and the Russell 2000 (small cap) lagged the Russell 1000 (large cap).
- The NASDAQ is down 21.2% YTD.

## 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.
- Non-U.S. equities outperformed their U.S. counterparts in April. EAFE markets in particular tend to be value focused so the outperformance is not surprising.
- Outside the U.S., value led growth and large caps slightly beat small caps.
- Emerging markets provided some relative outperformance led by strength in China after months of weakness.
- The strong U.S. dollar cost investors more than 500 basis points in EAFE (international developed) returns and more than 200 bps in emerging market returns.

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| April 29, 2022 | MTD | QTD | YTD | 1-Year | 3-Year | 5-Year | 10-Year |
|---|---|---|---|---|---|---|---|
| **Fixed Income Indices** | | | | | | | |
| Barclays U.S. Treasury Bill 1-3 Month | 0.02% | 0.02% | 0.05% | 0.08% | 0.68% | 1.06% | 0.59% |
| Barclays Municipal | -2.77% | -2.77% | -8.82% | -7.88% | 0.46% | 1.80% | 2.48% |
| BBgBarc U.S. Govt/Credit Intermediate | -0.54% | -0.54% | -3.01% | -3.50% | 0.76% | 1.11% | 1.02% |
| Barclays U.S. Aggregate | -3.79% | -3.79% | -9.50% | -8.51% | 0.38% | 1.20% | 1.73% |
| Barclays U.S. High Yield | -3.56% | -3.56% | -8.22% | -5.22% | 2.84% | 3.69% | 5.26% |
| S&P/LSTA Leveraged Loan | 0.01% | 0.23% | 0.12% | 2.95% | 3.73% | 3.97% | 4.23% |
| Barclays Global Aggregate | -5.48% | -5.48% | -11.30% | -12.63% | -1.09% | 0.33% | 0.35% |
| JPM GBI EM Global Diversified | -6.03% | -6.03% | -12.10% | -15.95% | -3.10% | -1.28% | -1.43% |
| **U.S. Equity Indices** | | | | | | | |
| DJ Industrial Average | -4.82% | -4.82% | -8.73% | -0.82% | 9.77% | 11.96% | 12.20% |
| S&P 500 | -8.72% | -8.72% | -12.92% | 0.21% | 13.85% | 13.66% | 13.67% |
| NASDAQ Composite (Price) | -13.26% | -13.26% | -21.16% | -11.66% | 15.07% | 15.32% | 15.01% |
| Russell 1000 | -8.91% | -8.91% | -13.59% | -2.10% | 13.57% | 13.44% | 13.53% |
| Russell 1000 Growth | -12.08% | -12.08% | -20.03% | -5.35% | 16.68% | 17.28% | 15.56% |
| Russell 1000 Value | -5.64% | -5.64% | -6.34% | 1.32% | 9.58% | 9.06% | 11.17% |
| Russell Mid Cap | -7.70% | -7.70% | -12.94% | -6.10% | 10.48% | 10.66% | 11.99% |
| Russell 2500 | -8.52% | -8.52% | -13.84% | -11.73% | 9.20% | 9.44% | 11.17% |
| Russell 2000 | -9.91% | -9.91% | -16.69% | -16.87% | 6.73% | 7.24% | 10.06% |
| Russell 2000 Growth | -12.27% | -12.27% | -23.35% | -26.44% | 4.14% | 7.08% | 9.95% |
| Russell 2000 Value | -7.76% | -7.76% | -9.97% | -6.59% | 8.38% | 6.75% | 9.81% |
| **Non-U.S. Equity Indices** | | | | | | | |
| MSCI World | -8.27% | -8.27% | -12.89% | -3.10% | 10.95% | 10.74% | 10.65% |
| MSCI ACWI | -7.97% | -7.97% | -12.81% | -5.04% | 9.93% | 10.00% | 9.78% |
| MSCI ACWI Ex-U.S. | -6.22% | -6.22% | -11.22% | -9.90% | 4.78% | 5.43% | 5.52% |
| MSCI EAFE | -6.38% | -6.38% | -11.80% | -7.70% | 4.93% | 5.27% | 6.27% |
| MSCI EAFE Growth | -7.93% | -7.93% | -18.85% | -12.76% | 5.97% | 6.88% | 7.05% |
| MSCI EAFE Value | -4.96% | -4.96% | -4.48% | -2.88% | 3.27% | 3.30% | 5.25% |
| MSCI Europe | -5.62% | -5.62% | -12.45% | -6.12% | 5.49% | 5.56% | 6.51% |
| MSCI Japan | -8.80% | -8.80% | -14.68% | -13.08% | 3.50% | 4.32% | 6.16% |
| MSCI AC Asia | -6.47% | -6.47% | -13.41% | -18.13% | 3.22% | 5.00% | 5.85% |
| MSCI EAFE Small Cap | -6.79% | -6.79% | -14.65% | -13.38% | 5.33% | 5.41% | 7.97% |
| MSCI ACWI Ex-U.S. Small Cap | -6.40% | -6.40% | -12.41% | -10.15% | 7.44% | 6.24% | 7.06% |
| MSCI Emerging Markets | -5.55% | -5.55% | -12.09% | -18.06% | 2.60% | 4.69% | 3.26% |
| MSCI EM Asia | -5.08% | -5.08% | -13.29% | -21.15% | 3.98% | 5.94% | 5.57% |
| MSCI China | -4.08% | -4.08% | -17.69% | -36.12% | -4.92% | 2.27% | 3.96% |
| MSCI EM Eastern Europe | -15.36% | -15.36% | -81.65% | -79.12% | -38.37% | -21.91% | -12.52% |
| MSCI EM Latin America | -12.94% | -12.94% | 10.85% | 4.10% | -1.30% | 1.59% | -1.82% |
| MSCI EM Small Cap | -4.98% | -4.98% | -9.03% | -5.01% | 10.41% | 6.88% | 5.33% |
| MSCI Frontier Markets | -2.70% | -2.70% | -10.31% | -0.10% | 6.53% | 5.41% | 6.05% |
| **Hedge Fund Indices** | | | | | | | |
| IQ Hedge Long/Short | -4.51% | -4.51% | -8.43% | -5.55% | 5.32% | 4.47% | -- |
| IQ Hedge Multi-Strategy | -2.86% | -2.86% | -5.13% | -6.13% | 1.69% | 2.34% | 2.71% |
| **Real Assets Indices** | | | | | | | |
| FTSE NAREIT Composite | -3.89% | -3.89% | -8.93% | 8.88% | 9.65% | 9.26% | 9.49% |
| Alerian MLP | -0.09% | -0.09% | 18.71% | 27.34% | 3.13% | 0.17% | 1.04% |
| Bloomberg Commodity | 4.14% | 4.14% | 30.75% | 43.53% | 17.87% | 10.22% | -0.26% |
| S&P Global Infrastructure | -3.27% | -3.27% | 3.96% | 9.05% | 6.43% | 6.63% | 7.42% |
| **Other** | | | | | | | |
| Oil Price Brent Crude | -0.30% | -0.30% | 38.33% | 59.94% | 14.25% | 15.77% | -1.03% |
| CBOE Market Volitility (VIX) | 62.45% | 62.45% | 93.96% | 79.47% | 36.54% | 25.29% | 6.89% |

*Source: Morningstar*

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