WAYPOINT ADVISORS

A CARY STREET PARTNERS COMPANY

Equities Give Back Some of Their 3 Year Double-Digit Returns **First Quarter 2022**

Equities Get Repriced

The Federal Reserve's (the Fed) messaging and actions had dramatic impacts on both the equity and bond markets in the US. The technology sector was hit particularly hard. Shopify, Carvana, Netflix, and Meta Platforms (Facebook) all plummeted more than 30% this past quarter. This might seem surprising, but when the Fed intimated in January that interest rate hikes would start earlier than expected and could possibly rise more rapidly than expected, equity markets repriced stocks using higher discount rates. Consequently, we saw many stocks drop more than 25% in the first three months of 2022.[1] It was not all doom and gloom as Russian sanctions outweighed any impact the Fed may have had on energy stocks. Energy stocks comprised 10 of the top 15 highest returning stocks for the quarter with the top returner, Occidental Petroleum, nearly doubling in price.[2]

While technology stocks plunged the broader US equity market also had a difficult quarter. Growth stocks returned -9.3% drastically underperforming the -0.85% return of value stocks for the quarter as energy stocks buoyed value indices.[3] International equities also faced significant headwinds with the conflict in Ukraine weighing heavily on European markets and the region's growth estimates being cut significantly. Growth stocks again were the biggest losers returning -11.9% while value stocks were slightly positive.[4] Additionally, Chinese markets suffered, as local governments continued to impose COVID-19 lockdowns and defaults hit the property sector. There were few investment havens this quarter.

Anticipated Rate Hikes Lead to Bond Market Decline

Yields on the 2-, 3-, and 5-year Treasury notes jumped more than 1% in the first quarter in anticipation of rate hikes and inflation fears. This resulted in a decline in value of these notes ranging from 2.5% to 5.2%. Longer duration notes declined further with the 10-year and 30-year Treasury notes dropping 6.9% and 11.4% respectively.[5] In fact, the Bloomberg US Aggregate Bond index, a proxy for the US bond market, dropped 5.9%, a quarterly decline not seen since September of 1980.[6] The silver lining on this dark cloud is that investors who have been sitting in cash or cash equivalents now have an opportunity to earn interest on these types of assets.

Generally, interest rate hikes lead to a stronger US dollar. This can be a boon for US investors who want to increase their overseas investments as it makes those investments cheaper. It is a bane for those who have already allocated internationally because those investment returns are in foreign currencies which now buy fewer US dollars.

Alternatives were a bright spot

As both equities and bonds went through a repricing, "alternatives" generally provided a safe haven. Some merger arbitrage, equity long/short and commodity strategies were able to capitalize on this market environment. We believe alternatives to be better diversifiers than bonds during this period of rising interest rates and particularly when inflation is elevated.

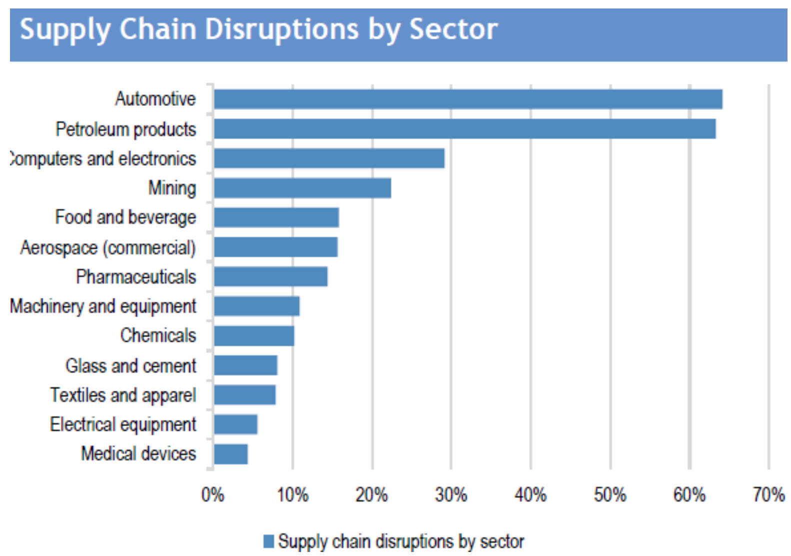
While markets struggle, the economy continues strong growth

Coming into the first quarter, many economists expected above average growth and declining inflation globally as COVID's economic impact faded.[7] A return to pre-pandemic levels of economic activity was anticipated. Supply chain issues would ease. People would spend more time traveling and eating out. Unemployment would continue to decline. While much of this has occurred, this rosy picture faded with the Russian invasion of Ukraine and the subsequent sanctions and continued supply chain disruptions. Nonetheless, economists continue to expect above trend economic growth, though growth projections have been reduced. JP Morgan economists reduced Eurozone real GDP estimates for 2022 from 2.9% to 1.7% and US real GDP estimates from 4.6% to 3.5%.[8]

Persistent elevated inflation

Supply Chains Still Choked

While inflation was thought to be transitory 9 months ago, it continued to climb as COVID variants and their associated restrictions came and went. Suppliers have been unable to meet the pent-up demand created by the record level of savings that US households accumulated from mid-2020 through September 2021. As shown to the right[9] supply chain issues created during the trade frictions with China in 2019 and exacerbated during the waves of COVID have yet to fully recover as worker shortages have been aggravated by immigration policies and the exodus of baby boomers from the labor market.

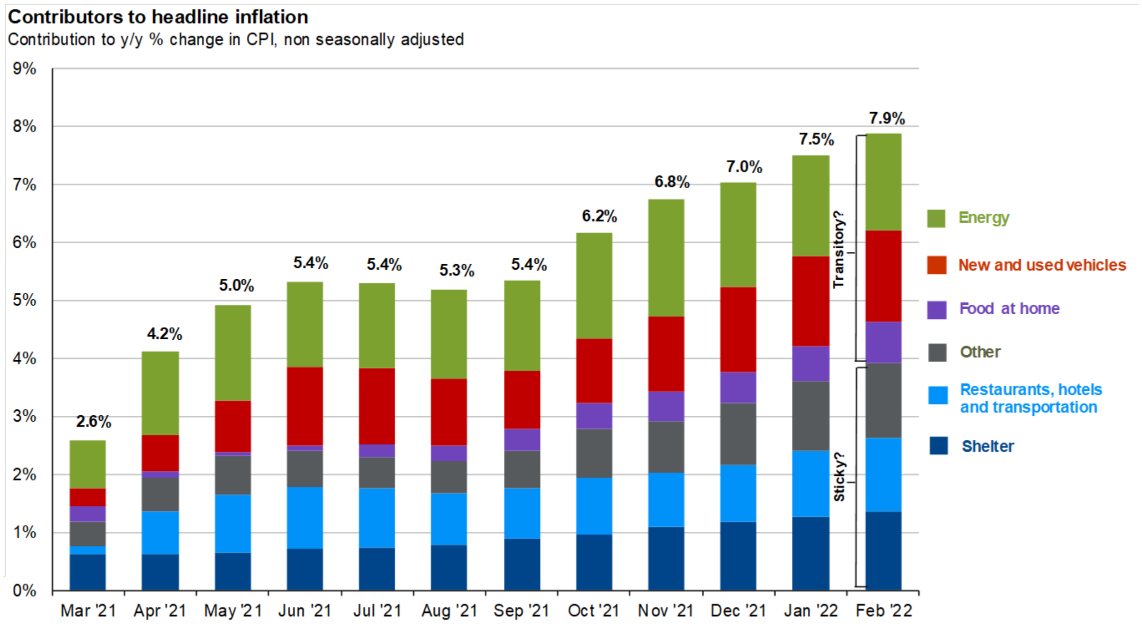


Wage Growth Accelerated, Unemployment Fell

The 6.7% annual wage growth reported by the Bureau of Labor Statistics on April 1 is 117% higher than the average wage growth of the past 30 years.[10] The last time the US experienced this type of growth prior to the COVID pandemic was in February of 1982.[11] Labor intensive industries such as leisure/hospitality and transportation/warehousing have experienced even higher levels of wage growth – 14.9% and 11.1% respectively. With unemployment falling to 3.6% and job openings exceeding available workers by 5.3 million, we can expect wage growth to remain elevated in the near term.[12]

Housing Costs Increased

The growth in the cost of shelter is 71% higher than its 30-year average of 2.8%.[13] A lack of housing supply as well as increased materials and labor costs are fueling this jump in prices and rents. Wages and housing represent categories whose cost tend to be sticky, meaning they are less likely to decline over time. Unfortunately, this portends higher inflation for longer. Non-sticky categories such as food, energy and vehicles are also experiencing significant price increases caused by supply chain problems and Russian oil sanctions. As you see in the chart below[14], sticky categories account for approximately half of the Consumer Price Index.



The Federal Reserve to the rescue?

Fed interest rate hikes and the cessation of quantitative easing have rattled markets causing significant daily market volatility. The Federal Reserve is now the central player in both US equity and bond markets. Having achieved its low unemployment mandate, it is urgently attempting to address its price stability mandate. The yearlong climb from 2.6% to 8.5%[15] headline inflation has created a formidable problem for the Federal Reserve that has a Congressional mandate to promote stable prices. In most inflationary environments we believe equities do well.[16] Unfortunately we are in a period of rising rates accompanied by high inflation. This is a daunting problem until supply chain issues are resolved and the Fed gets rates under control. On the positive side, the Fed has shown it is willing to change course in short order. Also, we are in a period of strong economic growth, low unemployment and high levels of household savings, factors which can see us through this difficult period.

[1]Morningstar. Interest rate hikes increase the discount rate used to value investments which in turn decreases the current value of all investments. For example, if you believe that in 10 years investment Z will be worth $10,000, its present value (what you would pay for it today) assuming you could lend money at 3% would be $7,441. When the Federal Reserve raises the cost of overnight borrowing (the Fed funds rate), this also increases the rate at which you can lend money. So, if you can lend money at 6%, the present value of the investment Z would drop 25% to $5,584.

[2] Think Advisor, Morningstar, https://www.thinkadvisor.com/2022/04/08/15-best-performing-stocks-in-q1-morningstar/

[3] Morningstar data, 1/1-3/31/2022, Russell 3000 Value, Russell 3000 Growth, S&P 500 Energy sector.

[4] Morningstar data, 1/1-3/31/2022, MSCI EAFE Value, MSCI EAFE Growth.

[5] Federal Reserve of St. Louis.

[6] Morningstar, Waypoint Advisors.

[7]Reuters, https://www.reuters.com/world/us/us-economy-likely-regained-steam-q4-2021-growth-seen-best-37-years-2022-01-27/

[8]JP Morgan Economic and Policy Research department, Global GDP Nowcaster.
[9]JP Morgan, *Global Equity Strategy, April 4th, 2022;* Statista.
[10]Source: Waypoint Advisors, Bureau of Labor Statistics, data series CES0500000008. Data as of 3/2022.
[11]See endnote 8.
[12]BLS, Job Openings and Labor Turnover Survey 3/9/2022, Employment Situation news release 4/1/2022.
[13]Source: Waypoint Advisors, Bureau of Labor Statistics, data series CUSR0000SAH1. Data as of 2/2022.
[14]Source: BLS, J.P. Morgan Asset Management. Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owners' equivalent rent and rent of primary residence. "Other" primarily reflects household furnishings, apparel, and medical care services. Guide to the Markets – U.S. Data are as of March 31, 2022
[15]Bureau of Labor Statistics (BLS), through March 2022.
[16]Source: FS Investments, *Playbook for a Fed rate hike cycle*., page 20.