LADENBURG
AN ADVISOR GROUP COMPANY

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MARKET VIEW QUARTERLY

Ladenburg Asset Management

During the first quarter of 2022, investors were on edge due to a more hawkish Federal Reserve Bank, 40-year highs in inflation, and a war between Russia and Ukraine. The confluence of these factors led to volatility, causing markets to significantly pull back from all-time highs. While market volatility is unsettling, it is historically not unusual; on average, since 1980, markets have experienced four 5% pullbacks each year and at least one market correction of 14%.[1] Thus, it is important to remember that corrections are a normal part of investing and more importantly are much different than bear markets. The bear market ended just over two years ago, and the subsequent bull market has clearly been an amazing ride. For some context, it was the fastest bull market to double ever, at just under 18 months, but with strong consumer and resilient corporate earnings, there are still plenty of reasons to believe that stocks and economic growth could push higher from here.[2]

DOMESTIC EQUITIES

On January 3rd, 2022, stocks hit a new record high, potentially signaling to investors that the gains experienced in 2021 were going to be carried forward to 2022. However, the next day stocks reversed, and a very volatile first quarter ensued. The volatility was twofold; to begin the year, markets attempted to digest a Fed that became more focused on fighting inflation by raising interest rates and reducing the size of its balance sheet. For two years, the stock market had largely been able to deal with the economic impact of the pandemic, as underlying policies (i.e., low interest rates) provided support. Although the economy showed improving fundamentals, markets took the withdrawal of this support as a negative signal. Volatility stemming from the actions of the Fed were exaggerated as the armed conflict between Russia and Ukraine escalated. Ultimately, the unpredictability of the geopolitical event sent the NASDAQ and the S&P 500 index into correction territory, which means a decrease of at least 10% from their previous highs. However, after falling for the first two months of the year, US stocks notched their first monthly gain in March as markets seemed to fully price in multiple rate hikes this year while peace talks between Russia and Ukraine were showing progress. While the rally in March helped indexes recoup a majority of the losses suffered in the first two months of the year, it was not enough to turn indexes positive as the S&P 500 index ended the quarter down -4.60%.[2] During the first quarter, large cap value stocks led the way. A major reason why value stocks are beating growth rivals this year is that the longer-dated cash flows of many growth companies become less appealing as rates rise. Rising rates coupled with increasing commodity prices have befitted cyclical areas of the market. In fact, the Russell 1000 Value index returned -0.74%, despite a major sell off experienced during the first quarter. On the other hand, growth stocks were squarely negative, with the Russell 1000 Growth Index returning -9.04%. The Russell 1000 Index returned -5.13%.[2] The Russell Mid-Cap Index returned -5.68%[2] and the Russell 2000 Index returned -7.53%.[2] Overall, we expect stocks to continue to grind higher in 2022. From an economic growth perspective, there is sufficient strength for consumers and businesses to absorb higher rates. Last week's initial jobless claims report provided further evidence of strength in the labor market, with new claims falling to the lowest level since 19691. In addition, job openings are still exceptionally high, which is a good sign that businesses are expecting ongoing demand. Add to this the more than $2 trillion in accumulated household savings and we think consumer spending (70% of U.S. GDP) will be able to grow despite higher borrowing costs. [2]

INTERNATIONAL EQUITIES

International developed equities and emerging market (EM) equities returned -5.91% and -6.97% for the first quarter[2], respectively, both lagging the S&P 500. For the first two months of the year, international and emerging market stocks outperformed domestic equities. The developed international equity market (mainly Europe and Japan) is much more value-focused than the U.S. market, based on the MSCI EAFE Index and the S&P 500 Index. With the threat of rising rates, money poured out of the growth oriented domestic arena and into the cyclically oriented international space. The emerging market complex was extremely oversold coming into the year, as it was the only major equity index that was negative during 2021; Therefore, it appeared an upward reversion to the mean was much overdue. International and EM leadership was short lived, however, as the Ukraine situation dominated headlines and wreaked havoc on the market, causing a knee-jerk reaction to the geopolitical event. International and EM equities could remain under more pressure than domestic stocks as the conflict between Russia and Ukraine persists.

FIXED INCOME

Despite tepid bond returns in 2021, this year is shaping up to be an even more challenging period for fixed income. The fixed income market, as measured by the Bloomberg US Aggregate Bond Index, returned -5.93% for the first quarter. [2] Inflation is currently the highest it's been since 1981 and is most notably impacting consumers through elevated energy and food prices, however, we're beginning to see the negative effects of high inflation broaden out and affect other sectors of the economy as well. Pandemic-related supply chain bottlenecks, the initial catalyst spurring inflation early last year, have persisted and have been exacerbated by the Russian invasion of Ukraine. This added fuel to the inflationary fire as sanctions were imposed, certain Russian exports were banned, and prices of commodities produced in the resource-rich nation scorched higher. For the past two years we have had the most supportive fiscal and monetary policy in history. M2, a measure of the money supply in the U.S., is 40% higher than it was pre-pandemic, and this expansion can be seen as the root cause of the inflationary pressures we're experiencing today3. A particularly tight labor market, coupled with high inflation, has prompted the Fed to act, and earlier this month the FOMC moved to end Quantitative Easing (QE) and hike interest rates a quarter point. Further, hawkish comments from Chairman Jerome Powell opened the door to possible half a percent point hikes at upcoming meetings. Markets are currently pricing in 7-8 quarter point hikes through the end of the year and as a result, the 10- year U.S. Treasury yield ended the first quarter at 2.34%, up 0.83% from the beginning of the year2. Raising rates while the economy is slowing rightfully has market participants worried, and these fears are already being reflected through the yield curve, which has flattened substantially; the short end of the curve has pushed up in response to the anticipation of rate hikes, while the long end of the curve has remained relatively anchored on increasing growth concerns and a stable, long-term inflation outlook of roughly 3.0%. As a result, we expect short-term rates to continue to climb higher, in lockstep with Fed rate increases, and long-term rates to remain relatively range bound. This could lead to a yield curve inversion, as the current 2-year and 10-year yields are nearly equal, and the 5-year and 10-year spread has already inverted.2 Thus, we believe that fixed income securities will continue to be challenged throughout 2022.

ALTERNATIVES

Alternative assets have continued to rise in 2022, led mainly by increasing commodity prices. WTI Crude reached new highs as many nations placed sanctions on the Russian economy due to the country's invasion of Ukraine. WTI crude oil prices started the quarter at $75.21 per barrel and hit a high of $123.70 (a level not reached in over a decade), before eventually retreating down to $100.28 per barrel to end the quarter.[3] Additionally, the price of wheat, a major export of Ukraine has also risen tremendously, as a result of the war with Russia. Furthermore, hedge fund-like alternatives moved slightly lower on the quarter, down -0.30%[3], as measured by the Morningstar Diversified Alternative index.

REAL ESTATE

Interest rates have finally moved higher, with the Fed beginning its hiking cycle in early March, and while home prices and home constructions are still high, there are signs of this turning around. According to the St. Louis Fed, the median price for a new home sold dropped to $408,100, and while this number is still historically elevated, it was the first drop in median sales prices in over five quarters.[4] Over the past year, single-family starts are up +13.7% while multi-unit starts are up +46.6%. In addition, compared to last year, permits for single-family units are up +5.4% while permits for multi-family homes are up +12.2%.[2] These vast differences are evidence of how difficult it has become for many individuals, and especially first-time buyers, to afford a home. As such, those would-be first-time buyers are extending their rents, and creating a bifurcation in multi-family and single-family starts.

CONCLUSION

The United States, Europe, Canada, Britain, Japan, and other countries have responded to the Ukraine invasion by immediately imposing unprecedented sanctions against Russia. While we acknowledge that this will not immediately stop the war, the hope is that these sanctions dramatically raise the cost of the conflict and ultimately persuade Putin that the economic impact will be too severe if he continues his actions against Ukraine. While we hope the conflict between Russia and Ukraine subsides, the potential for faster than expected rate hikes by the Fed remains. However, current economic data is solid and earnings growth, while lower, should remain resilient. Fed rate hikes by themselves do not mean the bull market is approaching an end. In fact, in reviewing the last eight hiking cycles, the S&P 500 was higher a year after the first rate hike in every cycle. While some of those returns were muted, by no means were they considered bear market events for investors. In closing, 2021 marked only the 10th time the S&P 500 has generated 3 straight years of positive double-digit returns in the last +90 years. The S&P was up 31.20% in 2019, 18.40% in 2020 and 28.71% in 2021.[3] Due to increased market volatility, we may not get a fourth year of double digit returns for the S&P 500, however, we believe that equities will continue to push modestly higher.

Economic Definitions

GDP: Gross domestic product (GDP) measures the final market value of all goods and services produced within a country. It is the most frequently used indicator of economic activity. The GDP by expenditure approach measures total final expenditures (at purchasers' prices), including exports less imports. This concept is adjusted for inflation.

Unemployment Rate: The unemployment rate tracks the number of unemployed persons as a percentage of the labor force (the total number of employed plus unemployed). These figures generally come from a household labor force survey.

CPI (headline and core): Consumer prices (CPI) are a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.

Housing Starts: Housing (or building) starts track the number of new housing units (or buildings) that have been started during the reference period.

Index Definitions

S&P 500: The S&P 500® is widely regarded as the best single gauge of large-cap U.S. equities and serves as the foundation for a wide range of investment products. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Russell 1000 Value: Russell 1000 Value Index measures the performance of those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.
Russell 1000 Growth: Russell 1000 Growth Index measures the performance of those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The index was developed with a base value of 200 as of August 31, 1992.

Russell Mid-Cap: Russell Midcap Index measures the performance of the 800 smallest companies in the Russell 1000 Index, which represent approximately 25% of the total market capitalization of the Russell 1000 Index.

Russell 2000: The Russell 2000 Index is comprised of the smallest 2000 companies in the Russell 3000 Index, representing approximately 8% of the Russell 3000 total market capitalization. The real-time value is calculated with a base value of 135.00 as of December 31, 1986. The end-of-day value is calculated with a base value of 100.00 as of December 29, 1978.

MSCI EAFE: The MSCI EAFE Index is a free-float weighted equity index. The index was developed with a base value of 100 as of December 31, 1969. The MSCI EAFE region covers DM countries in Europe, Australasia, Israel, and the Far East.

MSCI EM: The MSCI EM (Emerging Markets) Index is a free-float weighted equity index that captures large and mid cap representation across Emerging Markets (EM) countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

Bloomberg Barclays US Agg Bond: The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate pass-throughs), ABS and CMBS (agency and non-agency).

Bloomberg Barclays High Yield Corp: The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below. Bonds from issuers with an emerging markets country of risk, based on Barclays EM country definition, are excluded.

Morningstar® Diversified Alternative Index: The Morningstar® Diversified Alternatives Index is designed to provide diversified exposure to alternative asset classes in order to attempt to enhance risk-adjusted portfolio returns when combined with a range of traditional investments. The index consists of a diversified set of ProShares alternative exchange traded funds that employ alternative and nontraditional strategies such as long/short, market neutral, managed futures, hedge fund replication, private equity, infrastructure, or inflation-related investments

Disclosures

Index performance does not reflect the deduction of any fees and expenses, and if deducted, performance would be reduced. Indexes are unmanaged and investors are not able to invest directly into any index. Past performance cannot guarantee future results.

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[1] https://www.chase.com/personal/investments/learning-and-insights/article/tmt-january-twenty-one-twenty-two

[2] Bloomberg as of 3/31/2022

[3] Morningstar as of 3/31/2022

[4] https://fred.stlouisfed.org/series/MSPUS