MARKET UPDATE

February 23, 2022

RECENT VOLATILITY

What is Driving Volatility?

- **A Change in Federal Reserve Policy** – For much of the last 10 years, investors have become accustomed to a Federal Reserve that would step in to support the economy, and by extension the investment markets (the “Fed Put”). With inflationary concerns mounting and the economy appearing to be on stable footing, the Federal Reserve can no longer be relied on in the same fashion. Without the Fed Put, investors are reassessing both their appetite for risk and the price they willing to pay for assets.

- **The Russia-Ukraine Conflict** – Tensions between Russia and the Ukraine have both immediate and long-term implications. NATO and its allies are focused on protecting Ukraine’s fledgling democracy and its importance as a buffer nation between NATO’s eastern most countries and the Russian Federation. While Ukraine is not a member of NATO, it has aligned itself with the West. The potential for economic sanctions combined with Europe’s dependence on Russian oil (at a time when there is already an oil supply-demand imbalance) could drive prices higher and exacerbate inflationary concerns.

- **Equity Earnings** – Early in this earnings season there were a few notable earnings misses and cautionary forward guidance, which added to the overall level of concern in the markets. As earnings season has progressed, the earnings outlook has improved. According to FactSet, earnings have exceeded estimates for 77% of the S&P 500 companies that have reported earnings thus far. However, future earnings growth rates remain an unknown, which has investors on edge.

- **Equity Valuations** – Equity valuations, especially in some areas of the market, are extended. With the concerns about future earnings growth discussed above and the threat of interest rates rising faster than anticipated, investors are re-evaluating the price they are willing to pay for stocks. Growth stocks, the biggest benefactors of lower interest rates, have borne the brunt of the market decline year-to-date. Through Friday, large-cap growth stocks have declined 13.5%, while large-cap value stocks have only declined 3.1%. With the Fed slowing its support and uncertainty surrounding valuations, we expect this period of price discovery, and the associated volatility, to continue.

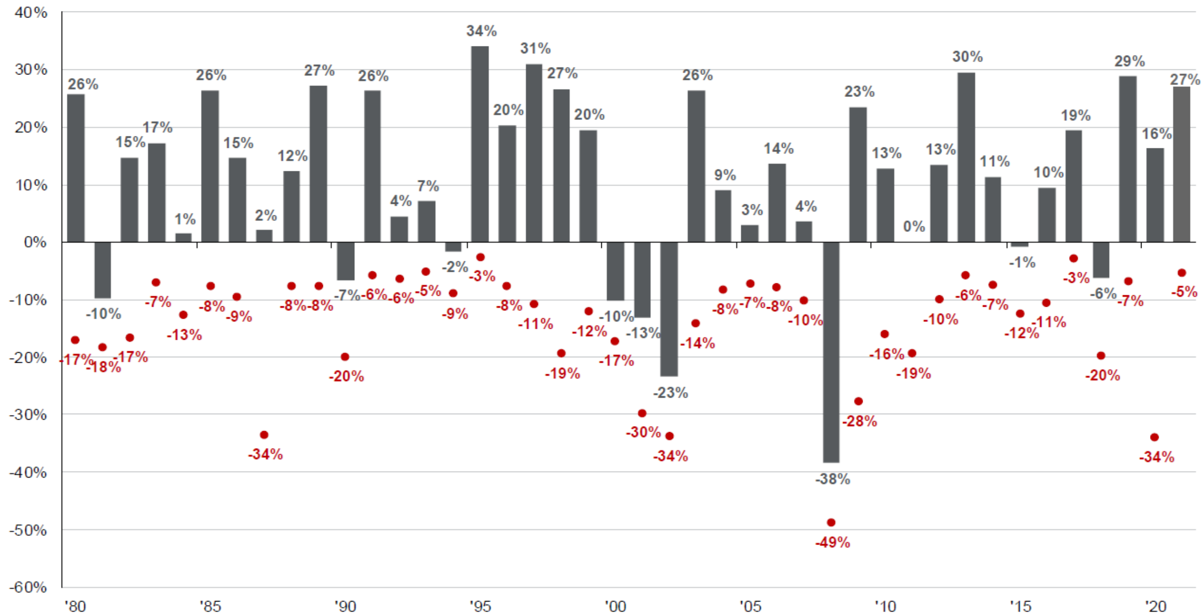
Things To Consider

- Investor sentiment has turned decidedly negative. According to the American Association for Individual Investors, the percentage of respondents to their sentiment survey, who classified as “bullish”, is among the lowest level since the survey started in 1987. Such an extremely pessimistic reading has historically been followed by favorable equity returns in the ensuing 12-months.

- Investor anxiety, induced by extended or severe market volatility, is always acute during the volatility, but it quickly fades as markets recover. In contrast, the real negative impact of making emotionally driven adjustments in response to that anxiety, can last for decades.
- Rising interest rates do not automatically signal that a recession will occur. Over the last 15 periods of tightening monetary policy, a recession resulted 60% of the time (9). However, even in those instances, the equity market peak occurred, on average, nearly 2 years after the first interest rate hike which is yet to occur in the current cycle.
- Intra-year market declines are common. In the last 42 years:
  - The S&P 500 has experienced a 5% or greater intra-year decline in 90% of the years.
  - The S&P 500 has experienced a 10% or greater intra-year decline in 50% of the years.
  - Despite that level of intra-year volatility, the S&P experienced only 7 annual declines of more than 5% (16% of the time) and only 5 annual declines of 10% or greater (12% of the time).

S&P intra-year declines vs. calendar year returns

Despite average intra-year drops of 14.0%, annual returns were positive in 32 of 42 years



How We Are Approaching the Current Volatility

We are not making any significant adjustments to portfolio strategy currently. Since the beginning of last year, we have been gradually tilting the portfolio allocations towards value-oriented strategies which stood to benefit from a re-opening economy. This has proved beneficial during the first two months of this year. While we intend on maintaining that tilt, we see an opportunity to acquire quality growth stocks that have been excessively repriced. Where possible, we will also be using the volatility to enhance the tax efficiency of the portfolio through loss harvesting strategies.

We thank you for your continued trust and confidence. Please call us if you would like to discuss this further.

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