PRIO WEALTH

Investment Newsletter

First Quarter 2022

Stock market performance globally was weak for the quarter. The S&P 500 Index declined -4.7% and the MSCI All-Country World ex-U.S. Index declined -5.4%. This weakness reflected a number of concerns: persistent inflation, leading to higher interest rates and potentially weaker economic growth; further escalation in the Russia-Ukraine war, which could heighten global geopolitical tensions and pressure European economic growth; disruption from COVID-19 on Asian manufacturing; and a high stock market valuation after a strong run over the past three years, with the S&P 500 Index advancing almost +60% cumulatively.

For fixed income, it was also a difficult quarter for performance as interest rates rose in response to rising inflation, and as the Federal Reserve expressed its determination to raise interest rates. Total returns were negative across nearly all maturities, with only the 3-Month U.S. Treasury Bill posting a positive return. The Bloomberg U.S. Intermediate/Government Index declined -4.5%, and the Bloomberg Municipal Bond Blend 1-5 Year Index declined -3.6%.

With interest rates currently at such a low level, even a small increase in yields results in a negative total return when rates rise. Long-maturity bonds were impacted particularly hard, with the 30-Year U.S. Treasury Bill declining -11.4% during the quarter. High-quality bonds outperformed low-quality bonds as investors rewarded safety.

After a long stretch of significant outperformance, municipal bonds were negatively impacted by sharp outflows from mutual funds. From a credit perspective, municipalities are in extremely strong shape and they continue to benefit from being one of the few tax-exempt investment options available to wealthy investors. We expect both of these factors to continue to benefit municipal bonds; however, in the near term, we expect increased volatility driven by increased fund outflows and slightly higher supply. We view these periods of weakness as buying opportunities.

While no one is comfortable with negative returns from a bond portfolio, it is important to reiterate why we believe in investing in individual bond securities rather than in bond mutual funds or bond ETFs. The benefit of investing in individual securities is that the bonds will mature at par. In contrast, a bond mutual fund or bond ETF consists of a large pool of bonds with various maturities that are continuously reinvested as bonds mature, so it essentially has an infinite maturity. If sold, the investor would get the current market price, not a guaranteed return of principal at a known future date.

Given the Federal Reserve's clearly articulated intent to raise interest rates, we remain very cautious and defensively positioned. We continue to target high-quality, liquid and short-to-intermediate maturity individual bonds in both taxable and tax-exempt portfolios. This has been our strategy for the past couple of years given that yields had declined to historically low, and potentially unsustainable levels, thereby increasing the risk of negative total returns.

Coming into the new year, investors were mostly concerned with persistent inflation, the potential trajectory of interest rate increases, decelerating economic and corporate earnings growth, and the high valuation of the stock market. Since that time, multiple events have transpired to further complicate and challenge the investment environment, including the following:

- In response to persistent inflation, the Federal Reserve announced a plan to raise interest rates more aggressively than expected. Consequently, investors are now expecting a Federal Funds Rate above 2.0% by the end of 2022 versus the current 0.25-0.50% today. In addition, the Federal Reserve will start to reduce the size of its balance sheet at a rapid pace as soon as its May meeting. Investors are increasingly concerned that these rate hikes will eventually spark a recession.

- Russia's invasion of Ukraine resulted in the ban of Russian oil by multiple countries, which pushed already-inflated commodity prices higher. It also led to unprecedented globally coordinated financial sanctions, which lowered economic growth in Europe, inflamed geopolitical tensions, caused a reversal in globalization as countries sought to onshore production of goods essential for national security, and galvanized NATO, resulting in a new commitment to higher defense spending in Europe.

  In addition to the price of oil being up +40% on a year-to-date basis, agricultural commodities such as wheat and corn have also risen significantly. Higher commodity prices increase the manufacturing costs for businesses and ultimately result in higher prices for consumer goods. Food prices are spiking in many countries around the world.

  As a reminder, we analyzed how 13 geopolitical/military events effected the stock market going back to Pearl Harbor in 1941. Despite higher initial volatility over the one- and three-month periods after such events, the S&P 500 Index performed well 12 months after all but three of these events, averaging a total return of +13.0%. Additionally, it is worth noting that the three events that produced negative returns after 12 months were accompanied by recessions.

- Reacceleration of new COVID-19 infections in Europe and China based on the new BA.2 variant, which has led to recent lockdowns in Shanghai, China's largest city, and has affected manufacturing plants in China and other Asian countries, further exacerbating supply chain issues.

Despite these new worries, the overall U.S. economic outlook is still encouraging. U.S. unemployment remains low, projected 2022 corporate earnings growth of +9.3% is solid, government tax revenue growth is strong, and consumer net worth is historically high. Most importantly, the global economy continues to reopen as the COVID-19 pandemic recedes. Global new COVID-19 infections last week were down -58% from the peak.

As the Federal Reserve aggressively tightens its monetary policy to fight inflation against the backdrop of an expensive stock market that has performed well for more than a decade, and as the Russian-Ukrainian war persists, clients should continue to expect elevated levels of stock market volatility.

In this highly uncertain environment, we remain committed to executing our investment strategy with prudence, patience and discipline as we seek to maximize long-term performance by investing in well-managed companies aligned with the most compelling secular growth trends.

This document has been prepared by Prio Wealth LP ("Prio Wealth") for informational and educational purposes only and not as investment, legal or tax advice. This document reflects the opinions of Prio Wealth and it is based on information that we believe to be reliable at the time of publication. However, Prio Wealth does not guarantee the accuracy and completeness of any sourced data. Opinions expressed herein are not intended to provide personal advice and do not take into account the unique investment objectives and financial situation of the reader. This document is not an offer to sell or a solicitation of an offer to buy any security and does not constitute a representation as to the suitability or appropriateness of any security or financial product. Prio Wealth cautions the reader that investments in securities involve risks and that past results are not indicative of any future performance.

Sources: Johns Hopkins, Strategas, Bloomberg and FactSet