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MARKET MINUTE

FEBRUARY REVIEW 2022

This month's Market Minute reflects the views of our Investment Office and was composed by
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OVERVIEW

February continued January's theme of volatility with a general 'risk-off' tone. The month was capped by Russia's invasion of Ukraine, setting off additional volatility throughout global capital markets. By the end of February, the S&P 500 had suffered its worst two month stretch, declining -8.0%, since March of 2020 and its 6th worst two-month start to a year since 1928.[1] Meanwhile, the combination of low interest rates with the specter for multiple interest rate increases by the Federal Reserve weighed on bond market returns, which saw the Bloomberg Aggregate Bond index suffer its 2nd worst two-month start to a year ever — after declining -3.3% from January through February.[1] More importantly, as it relates to fundamentals, the Q4 earnings season was naturally overshadowed by the geopolitical noise. While earnings expectations for 2022 are projected to be lower than 2021, corporate America is still expected to generate earnings growth of over 8.0% on a year-over-year basis.[2]

DOMESTIC EQUITY *As of February 28, 2022*

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	-3.3%	-6.4%	-6.4%	11.6%
S&P 500	-3.0%	-8.0%	-8.0%	16.4%
Russell 2000	1.1%	-8.7%	-8.7%	-6.0%
Russell 1000 Growth	-4.2%	-12.5%	-12.5%	12.5%
Russell 1000 Value	-1.2%	-3.5%	-3.5%	15.0%

U.S. equity markets gradually traded lower throughout the month while volatility accelerated meaningfully in the final week of the month as Russia moved to invade Ukraine. The S&P 500 ended the month down -3.0%.[1] However, U.S. small caps stocks (Russell 2000)—with generally more exposure to the U.S. domestic economy than their more global large cap peers—gained about +1.1% for the month.[1] Across the cap-spectrum, more inexpensive "value" stocks outperformed their more expensive growth peer (Russell 1000 Value -1.2% vs Russell 1000 Growth -4.3%, Russell 2000 Value +1.7% vs Russell 2000 Growth +0.4%).[1] Risk aversion increased in the final days of February as the U.S. dollar rallied against most EM currencies as well as many developed market currencies.

INTERNATIONAL EQUITY *As of February 28, 2022*

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	-2.0%	-5.6%	-5.6%	-0.4%
MSCI EAFE	-1.8%	-6.5%	-6.5%	2.8%
MSCI Emerging Markets	-3.0%	-4.8%	-4.8%	-10.7%
MSCI EAFE Small Cap	-1.3%	-8.5%	-8.5%	-1.5%

Non-U.S. equity markets were also down in February. Emerging markets, overall, were down on par with US markets (MSCI EM Index -3.0%) for the month, but this masks a great deal of dispersion between individual markets.[1] Russian equities ended the month down over -50% and the Moscow stock exchange was abruptly closed in the final days of February.[1] Chinese and Indian stocks were down approximately 4% during the month while most Latin American equities generated positive returns (MSCI EM Latin America +4.8%) during the month.[1]

International developed market equities (MSCI EAFE -1.8%) also lost ground in February but did the best on a relative basis compared to U.S. or emerging market equities (MSCI Emerging Markets).[1] In both developed and emerging markets, value stocks outperformed growth stocks on a relative basis and small cap stocks declined less than their large cap peers (MSCI ACWI ex US -2.0% vs ACWI ex US Small Cap -1.3%, MSCI ACWI ex US Value -1.8% vs MSCI ACWI ex US Growth -2.8%).[1]

FIXED INCOME *As of February 28, 2022*

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	-1.1%	-3.2%	-3.2%	-2.6%
BarCap Global Aggregate	-1.2%	-3.2%	-3.2%	-5.3%
BarCap US High Yield	-1.0%	-3.7%	-3.7%	0.6%
JPM Emerging Market Bond	-5.5%	-8.2%	-8.2%	-6.1%
BarCap Muni	-0.4%	-3.1%	-3.1%	-0.7%

For 27 days, February's fixed income markets behaved in a similar fashion to January's. Interest rates continued their march higher, and the curve continue to flatten with 2-year U.S. Treasury rates up 39 basis points to 1.57% and 10-year U.S. Treasury rates up 18 basis points to 1.96%.[1] The market's focus was on inflation and how much the Federal Reserve would tighten monetary policy at their March meeting to stem inflation's rise.

Over the final weekend of February, the United States and Europe strongly responded to the Russian invasion of Ukraine and fixed income investors unloaded their risky assets (e.g., emerging market debt spreads widened from 379 to 411 basis points) on the 28th and sought the safety of U.S. Treasury securities (10-year Treasury yields declined from 1.96% on the 25th to 1.83% on the 28th).[1] Although the inflation fear remains and has possibly risen further with oil spiking over $100/barrel, the classic rush to safety has overwhelmed the economic fundamentals.[1]

The bond market's month-end rally could not reverse what, in general, was a difficult month for fixed income investors. The Bloomberg Aggregate index was down -1.12%, led by losses in investment grade corporate securities (Bloomberg Investment Grade Corporate index down -2.00%).[1] One should not be surprised that emerging market debt suffered the worst (JPMorgan EMBI Global index -5.50%) as Russian bonds, which represent 3% of the index, have seen prices severely decline in the wake of Ukraine invasion.[1]

CLOSING

After a remarkably resilient stretch for global equity markets, for U.S. markets in particular, investors find themselves contemplating the stark shift in sentiment that we have observed in the first two months of this year. We have been referring to this amongst ourselves as a "great normalization" which is likely to be emblematic of what the future holds. So, what does that mean for investors? A period of lower return expectations in public equity and fixed income markets with the potential of heightened volatility, at least compared to years past. By now, we sound like a broken record on this point, but we continue to make the case. That said, the remedy is not to run away from investing; rather, it is to reduce expectations towards a more realistic range of outcomes.

Periods of high returns, such as that experienced in the last 10 years (2011-2021) where the S&P 500 gained 16.5% on an annualized basis, tend to be followed by periods of lower returns.[1] February reinforced that asset prices are inherently more volatile than their underlying fundamentals, so volatility is not something to necessarily run away from. We continue to think equity markets can deliver positive returns for 2022 given the still positive corporate earnings backdrop while fixed income continues to be plagued by the low interest rate environment.

SOURCES:

1 Bloomberg LP, as of 28-Feb-22

2 Factset Earnings insight, as of 25-Feb-22