

April Market Update 2022 – Progress and Direction into Q3 & Q4 of 2022

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Transcript:

This is Tom Hulick I'm the CEO of strategy asset managers and I'm joined here today with Alexander Hagstrom CFA and also portfolio manager and Joe Traba our other senior portfolio manager we're here today to talk to you about the markets and where we're headed going into the the second half of the year the direction that we've seen so far has been obviously very volatile we've got a lot of headwinds and Joe is going to talk about that i'm just going to turn it right over to Joe Joe thank you Tom and what we'll do is first start off just a quick first quarter recap and as we're in April heading into hopefully warmer months just go over what we've seen and as Tom mentioned we had unprecedented volatility and it wasn't just with the equity market we saw it in the fixed income market and we saw in the commodity markets we had oil and interest rates explode higher and for bond accounts there was one of the worst performances in over 40 years in the first quarter so we saw bond prices go down for the first time in a really long time along with the equity market and then obviously the commodity markets led by oil surged overall we ended up seeing the s p down about five percent for the first quarter and nasdaq was down about 10 just under that in the international markets down about five so we did see a number of negative developments including the war in Ukraine obviously covid there's quite a bit of recession worries interest rates inflation and what does this mean for a slower growth outlook now those are all the negative headlines and it's quite a few but we like to remind people there are also some positives that are going on right now and one thing the markets were down and we've held this support even with today we did see one of the strongest rallies in march after the markets were down so when we go through what we look at we first start off with the economy now the u.s economy yes we have our bumps and lumps but it is still growing now our markets are much more insulated than it but Joe it's not growing as fast though so so let's let's talk about that a little bit um you know as before we go on to the the key points so with the economy the us economy i'm just talking about the united states we've had a lot of discussions about energy and agriculture products those two are huge when we look at the rest of the world and

just being a little bit more insulated from obviously the higher prices in oil and than in Europe so those are two big tailwinds for us but you also have to look at the labor market anyone that's trying to hire you have a very tight labor market you have unemployment at the lowest not seen since 1969 so jobless claims continue to go lower wages are going higher this is helping our economy um go through this choppiness is exactly what Tom said it's not necessarily going to be going straight up but again we are seeing strength in the economy as it relates to wages and we'll go into a few more when we look at the consumer what kind of shape they're in but yes we can look at the US economy and the leading indicators and this is just going forward it's still healthy it's not going to be growing at the GDP that we saw last year and we knew that it was going to kind of be a reset down and that's what we saw there's a big building inventories and some discussion about that but we are seeing again as the lockdown that affected the rest of the world and especially now with china going back down to lockdowns that does have you know negative short-term effects and we've seen that the last couple years but if we do take a step forward and we look at the world as it awakens from covid you are going to see and we are seeing this it's an explosion of people wanting experience and and we'll get into the consumer in a little bit but when we were talking about the economy the big for us positive is the u.s dollar the u.s dollar continues to be the standout for currencies across the world and we've seen the dollar surge and continue to make highs relative to the euro the japanese yen in china and obviously when we get into to Russia everything everyone would prefer to get paid in u.s dollars that attracts money flowing into our markets not just the stock market but the bond market as well that's a really big positive now Joe talk about the strength of the us dollar also in kind of the quiet way of being able to pay off debt so a lot has been made and Alex can go into this as well a lot has been talked about the us dollar not being strong and this has been for a number of years where we would start seeing it decrease relative to other currencies but it's been in fact the complete opposite and just being in us dollars you're up seven eight percent even higher i guess versus other currencies so that helps us not only pay off our debt but it gives us a little bit more buying power and you can kind of think when you travel overseas the us dollar remains strong you're able to buy more product and and that's what we're seeing not just with our companies but it's also again as people are traveling so it helps our government out it helps our corporations and it helps us more importantly good thanks Joe now the next point as we were mentioning the dollar we have to look at interest rates now the impact of higher rates and and we've said this quite some time we are still at historic lows and when you look back at our history now we did see an unprecedented move in the first quarter and i'll reference the 10-year u.s treasury we did see that jump from 1.5 percent all the way up to where it's at now about 2.9 again that's as enormous move in a move we have not seen in quite

some time so what does that do does two things one it means borrowing costs are going up and you can see that with mortgage rates but it's also seeing that in your savings account you're you're gonna get a few more pennies um and again that's a positive for savers you now can get a three percent yield and we can go out just a few years so these are ramifications that we are seeing a lot of talk is that potentially raising rates too fast well we look at what the market's done the market's done the job for the federal reserve they've only had to raise rates one time 25 basis points and the market's already moved up to 3 percent on the 10-year so we're factoring in more interest rates potentially a 50 basis point rate hike next month um so we'll see if in fact we get the six to seven originally or potentially the 10 25 basis point hikes that is now kind of expected so this is causing a lot of volatility because what you see when higher interest rates go up it typically affects more of the growth year names potentially companies that are don't have strong cash flow and that's what we saw in the first quarter with the higher multiple stocks really take a big correction relative to the rest of the market that has lower multiples so that was one big impact that we continue to see in the month of April as we're ending today now we're going to briefly talk about the Ukraine war and we had a call on this a couple weeks ago and we are cognizant of the real consequences that it's having and we did see an increase in obviously the price of energy and other commodities like wheat and and seeds that are produced in Ukraine but when we look at the us and a lot of talk has been are we us energy independent just meaning do we export more than we import and we potentially can do that um so that does help us yes we've still seen the price of gas go up to you know some prices over seven dollars it's kind of settled down this five dollar range um but it's again in Europe it's double that amount and especially natural gas so when we do the shale drilling that's a byproduct is natural gas and that could be a really large exporter for us to Europe so that that's another positive for the u.s so and it looks like Alex will probably cover the you know the the net positive on exporting so correct is that right Alex and we're going to get into that Alex if you want to hop in Alex somehow i can't hear you in the recording would you oh sorry about that um in general there's been a lot of worry and panic about the spikes and interest rates and oil prices just because of the speed at which they've happened but when you take a step back and look at longer time frames you can really see that the levels we're at today are not anything that's been disastrous in the past you know for example oil prices right now around a hundred dollars a barrel are very high relative to the past five years however oil was at this level or higher for the entire time period from 2000 through 2014 it was actually that shale technology in 2014 2015 which pushed prices down to the low levels that we've had for the last few years and this technology still exists the shale ceos say that their break even to drill new wells is 50 to 70 a barrel so while the war has been incredibly disruptive to

energy markets and anything can happen in the short term because politics are involved not economics we're going to be okay in the long run eventually prices will probably revert back down closer to that 60 to 70 level and then you know life will go on plus even oil at 100 has not been catastrophic for the u.s economy we had many good years of very strong growth during the 2000s and early 2010s probably many of you remember that and during those years oil prices were at these levels or much higher interest rates are actually kind of the same story the rapidity of the spike is really scaring people but rates are at the same levels that they were in 2018 and rates are much lower than they've been basically through the entirety of American history so you know we don't expect the world to end just because interest rates are near three percent they're usually much higher than that and you know the economy still grows it's kind of echoes what we said with Covid eventually these fears um they will pass one way or another and you know the u.s economy will continue to move forward just as it always does Alex talk a little bit about real and nominal interest rates as well it's i think it's a good point to bring up absolutely so when we reference real interest rates what we do is we take the yield on a treasury bond and we subtract inflation either the actual rate of inflation or expected inflation and as you probably know inflation right now is much higher than interest rates right you get you know two to three percent on your bonds and inflation is eight percent so real bond yields are negative six right they're they're extremely low um and that's you know sort of a stealth way to 2d leverage right that favors borrowers over lenders and that really reflects itself in our portfolio right where we seek out companies that are able to borrow money for basically negative real interest rates invest that and you know grow at nominal rates of of eight to ten percent in spite of borrowing at two so that can be very very positive for certain corporations you know the market's been trading in a range for quite some time we've seen a rotation um once again this is Tom Hulick the CEO we've seen a rotation from growth over to core then to value Joe talk a little bit about that rotation shift and why strategy asset managers and the separately managed account portfolios have been performing so well this year so one of the things that we did at the end of last year we did anticipate higher inflation and that's an area that we did load up in because stocks can do well with inflation you want to own hard assets and that's kind of like materials and energy those are two areas we were underweighted financials we just didn't like the setup for that and those are two big areas that that's really helped us this year whether the storm a little bit better than well a lot better than the overall markets but what we saw again in the first quarter and what we're seeing now it is these higher growth higher multiple stocks when you get a raise in interest rates for discounted cash flow it just doesn't make them as appealing as they are but we also we talked about experience and i think this is really critical is we are seeing the kind of at-home stocks and i do like to

mention like Netflix was at over 750 in November and it this year has really had a huge correction down to just a little over 200 and what we're seeing is people getting out of their home and going out and one of the things that we really are positive in on is consumer demand and what I mean by this you are seeing people travel not just with airline travel and you listen to the number of the CEOs that are out there they're all expected to be back at pre-2019 levels so you've seen a recovery in airline travel you've seen recovery and some with traffic and another way we look at that is with some of the car companies um people getting in accidents and tune-ups and those auxiliary plays that is all back to pre-level so we are seeing people going out and about we are seeing for us is looking listening to some of the credit card companies these are the large banks and what you're seeing is credit card debt and their spending and it's over two trillion in savings and you kind of think about the last few years and we've talked about this before your accounts have done well your house has gone up in price but people haven't really been going out and spending so we're seeing this wave of spending coming out and it really started in the U.S we're seeing a little bit in Europe and I think as more people get comfortable with going out and again it's this wave and very similar to what we saw with the Spanish flu 1918 and then you had two years just like we had two years to the date and people were done with being locked down even though the virus is still out so that's what we're expecting to continue to happen consumer credit growth is strong you have the consumer in good shape just like the businesses are in pretty good shape a lot of cash on the sidelines a lot of cash on the sidelines that's a big when we look at money flows um obviously money has been going into equities we've seen a little bit push now money coming out of bonds and now with the higher rates that's seeing a little bit of a plus there but a lot has gone into cash so we think the markets when Tom was talking earlier about where we're seeing with with equities you know you're getting this reset and kind of a pause with an expectation of higher rates higher inflation and people just pulled money out of the markets when we look at what the consumers doing spending is very healthy but for us the key is earnings and this this week was one of the busiest weeks for earnings and you have heard from all the bellwethers out there but earnings is coming in better than expected and now this is typical with companies what they do they set the bar low than they beat but we have to remember last year we had 40 percent 40 percent growth so we're not growing at that level we're probably around eight to nine percent right now and again but that's still growing it's not growing at that 40 we didn't think it would be from the pandemic lows to the highs but again we're still seeing companies making money have very strong cash flow and their balance sheets are good now with this correction that we're in right now you are getting a forward P/E that's 10 to 15 percent lower than when we started the year what is the P/E right now Joe well this is interesting so the

pe like is it 15 and a half percent 16 and a half percent because forward was 27 right when we look at the top if you take the top five companies out that have multiples of in the high 20s that's like the apple and amazon right right you get a multiple that's closer to like Tom said 15 and a half to 16 and a half but the overall market is down probably around 18 and a half so that's a that's historically that's a little high but you take off those top companies we're right in range there and that's kind of a step so it's kind of a stock pickers market at this point um and and will probably continue for several years to come you know we had you know passive strategies do very well you can put your money in any index fund and and and be very happy but this year if you had that that investment acumen you're you're down considerably and the active management has has outperformed um i appreciate you talking about the consumer being strong i would um and and also the growth in earnings and the expectations out there Joe it's you know that's a counterbalance to all these headwinds that were we're talking about um i think the next big question that everybody has been asking is a recession likely in 2010 2022 and that's a good question we think we'll see you know more of the kinks in Europe before we see it in the u.s obviously we know growth has slowed globally but we do think the us is more resilient and like we mentioned economy corporate earnings they're very supportive even though we have higher inflation and higher borrowing costs we also think Ukraine that's going to persist for some time and that's just going to have these uncertainties as we kind of play out the recovery but we do think the u.s economy strong consumers are spending so so no recession in 2022 and even even into 2023 correct i mean this is going out six months and you you're gonna have from the first quarter you know you had a seven for six percent growth but it's gonna even out and and one thing i do want to mention and this is just a little bit on the technical side um this is sentiment for retail investors it's at extreme bearish lows and for us that typically it's again when people are throwing out you know everything and selling everything that's that's when you kind of get these reversals back so you know we're not seeing it today but

again I think that's where the market's trying to to find a botTom here and we saw that yesterday and we saw that in march in march we had three four of the strongest days and that usually leads to again having support with the markets and then you look out three months to one year later and the markets you know historically are higher so that gives us some technicals what we're looking at i don't want to get stuck with the negative narratives that people keep pounding there are some positives that are happening and again that's the tug of war that the market's doing and that's why you're seeing the volatility and we saw again three phenomenal years with the stock market and typically every two years you do get a 10 pullback and that's what we got right now but to say that the markets are going

to be down 30 40 percent we just don't see it because again people are working and people are spending and historically that leads to markets doing all right right resetting the expectations and and doing some um asset allocation shifting from growth lightening up on the growth maybe and and shifting it over into you know more of a value approach this year has proved very well you don't want to abandon you don't want to abandon growth technology is not slowing down it's it's it's actually just amazing us on a daily basis but for the time being in the short term the the sector rotation over to more value-centric or demonstrated leaders has proved very very well for portfolios Joe why don't you why don't you sum things up for us so again i don't want to get with all the volatility we did expect it coming into this year obviously not to this magnitude it's come across the equity fixed income commodity markets and when when you have this much indecisiveness you know that's where you get people heading to the cash flow heading into cash the sidelines but we are going to get some decisions on a lot of these talking points on the negative side but as long as the u.s is resilient and we continue to see the spending going through that's going to help corporate earnings and that's going to help our economic data and our economic outlook as well so there are obviously headwinds out there and some of them are going to persist a little bit longer than others but we do think the us is in good shape not just because of the strong us dollar we have energy independence and we have a consumer that wants to go out and spend and i just think ahead and look out a little bit longer when the rest of the world feels safe and and what kind of traveling are we going to see and people just from being locked down for a couple years just wanting to get out and and that gets us really positive and we like hearing people doing that and i think that's going to be the tsunami that you kind of saw with the roaring 20s and like Tom mentioned technology goes forward it does not go backwards and that's another positive for our markets good good rapid fire last last minute Joe and Alex we haven't done this before but i'm gonna ask Alex and you a question and you'll just say yes or no are we gonna have a recession Alex in 2022 i mean those are you know tough tough predictions to make but um i mean yes or no i mean i i i don't know i mean at this point i think you know you come on i'm putting you on the spot yes or no i say no no i mean it just what gets what gets interesting if you did have an and we saw this again with Covid a shutdown and and then the market can move ahead on it so am i concerned with that i'm more concerned with the consumer spending and seeing the slowdown so we're not seeing um you know sustainable long-term turnaround with negative growth we do think it's going to be choppy but again unless something changes our outlook is positive and that's what we're seeing that was a great yes or no answer Joe thank you any time all right we we although we have a lot of headwinds down there out there as we've we've discussed Joe explained clearly that you know at strategy asset managers we're we're not looking for a recession in the 2022 and

possibly not into 2023 we've got to keep our eyes focused on what the consumer is doing yes rates are very high inflation is very high the supply chain is starting to adjust and we're already seeing signs that inflation may be lightening up a little bit what does that mean for the second half of the year you definitely want to be in in an active managed portfolio of stocks the earnings season has started out strong um and that also helped move the markets back from this very bearish outlook that we we had over the last several weeks Joe Alex and i will be back again next month for another update our commentary was just sent out a couple of days ago it is available up on the strategy asset manager's website and the link for the market replay will be up shortly at this time we're going to conclude the call it's Friday April 29th 11 29 we wish everybody a wonderful weekend and we'll look forward to hearing from you if you have any questions obviously feel free to to call Joe myself or Alex or anybody and we'll be happy to talk with you take care everybody and stay safe. Bye!