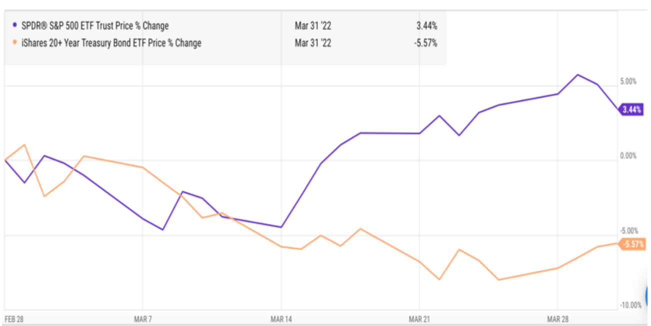
April 4, 2022

Overview

Volatility and divergence were the two themes of the month of March for investors. If US equities managed to progress overall, volatility was high and reversals numerous. Meanwhile, as US equities advanced, fixed-income markets suffered some of the largest losses ever seen in such a short amount of time. The chart below illustrates this dichotomy.



The purple line represents the S&Ps' 500. It ended up rising about **3.44%** in March. The orange line represents the progression of TLT, the long-term US bond ETF (Exchange Traded Fund). This investment vehicle lost a whopping **5.57%** in March.

Overall, the S&Ps' 500 gained **3.71%** last month.
The Nasdaq Composite rose **3.48%** and the Russell 2000 (small caps) **2.56%.** Internationally, developed markets were flat, with the S&P Epac BMI progressing **.01%** and emerging markets dropping **2.26%** (MSCI Emerging Markets Index).

In the US fixed income markets the damage caused by fears of inflation and of a broader and longer interest rate tightening cycle by the Federal Reserve brought about steep losses in most sectors. The US Long-term bond was down **5.34%.** Medium-term US corporate bonds were down **2.52%** and the municipal bond Index was down **2.85%.**

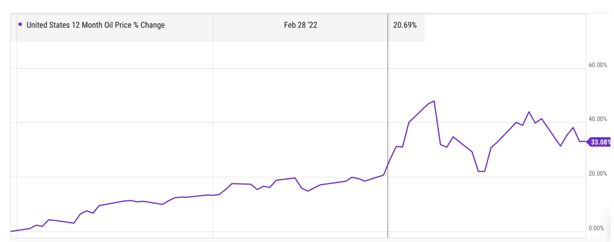
In March, the performance of our clients' portfolios ranged between losses of **.51%** and gains of **1.04%.** Over the same period, a portfolio consisting of 50% ACWI (All Country World Index) and 50% AGG (US Bond Aggregate) declined **.44%.** On a YTD basis, our losses range from **5.85%** to **8.35%** vs. a **5.76%** loss for our index.

As a reminder, the equity allocation in our clients' portfolios varies currently from 45% to 70%, depending on risk profiles.

Market developments

Throughout the month of March strong US economic releases, particularly for employment and consumption, alternated with stubbornly elevated levels of inflation and a gradually more hawkish tone from the Federal Reserve. The effect of these contradictory forces for balanced portfolios was to neutralize performance. What was earned on equities was often lost on fixed income securities, as illustrated in the previous chart.

One of the biggest factors that caused market volatility was the price of oil. Its significant rise in March continued to exacerbate fears of sustained levels of inflation.
Below is the YTD (year-to-date) graph for USL, the ETF that tracks the price of the 12-month futures oil contract. While not a perfect proxy for oil price on the cash market, it is still telling the story.



The vertical line marks the beginning of March. That contract has gained 33% since January 1. Although it went up and down several times in March as the prospects for peace in the Ukraine-Russia conflict waxed and waned, the contract still gained 13% this past month. The price of oil as well as that of other industrial and agricultural commodities keeps on feeding inflation together with the supply and demand imbalances caused by the pandemic.

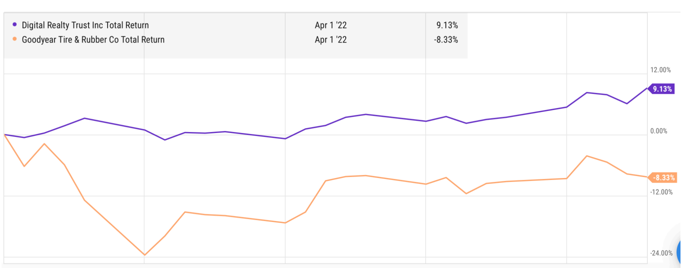
With the risk of persistent inflation increasing, the Federal Reserve has gradually become more hawkish; and on occasion, more hawkish than the market expected. Specifically, Chairman Powell indicated in mid-March that several .50% increases in the Fed funds rate were quite possible should data (read "inflation data") justify it. That surprised market participants who expected a series of .25% rate increases between now and the end of 2022. While equities have more that recovered since then thanks to subsequently strong economic data releases, it was not so for the bond market. Long-term fixed income securities have since suffered from a quasi-constant wave of heavy selling.

Tilts and Allocations

March was a difficult month. In the first two weeks, equities continued their dive into negative territory and, in some sectors, entered briefly bear territory, in the US and worldwide.
Concerns over the war in Ukraine and the persistence of inflationary pressures in the global economy seemed to overwhelm market participants.

In this context, I sold all our remaining European equities, except for our investment in Air Liquide. My rationale for this move was, and still is, that Europe will suffer from its reliance on Russian gas and that its ability to substitute for it will not bear fruit for a long while. Until then, its economy will likely grow at reduced speed. Air Liquide, however, is a global producer of liquid gases that could very well benefit from this state of affair given their manufacturing and distribution know-how in the space. This stock went up 4.5% in March.

Elsewhere in our portfolio DLR, our Reit, performed well after a difficult beginning of the year. This helped us offset continued losses on our investment in Goodyear Tires (GT). The chart below illustrates the performance of each of these investments during the month of March.



Additionally, in order to get back closer to our long-term equity allocation, I started buying SPY (S&P's 500 ETF) again shortly after selling our European equities. This has proven to be a positive move so far. Overall, I have increased our net equity allocation by about 5% across most portfolios since the end of February after reducing it in the prior two months.

Finally, while I am not a fan of gold investments for inflation hedging purpose, a stronger case can be made for its mitigating effect in situations of increased geopolitical tensions. Those tensions increase the risk of equity corrections and buying gold to offset a high-beta stock (such as GT), made some sense. With this in mind, I bought a bit of IAU (a gold ETF) for most portfolios.

Conclusion

2022 continues to be a difficult year for investors. The rising interest rates environment in the US and in other developed economies almost guarantees more volatile times ahead. This is because, all things equal otherwise, higher interest rates reduce the value of all assets and cause the market to "re-calibrate" every time an interest rate surprise occurs. One element that can mitigate this negative pressure is a strong economy. We continue to benefit from this key component in the US.

US equities, sustained by a still strong economic rebound, remain a reasonable alternative for investors. Higher bond yields have not yet reached a level that would make them competitive with equities, on an inflation-adjusted basis.

Until they do, meaningful allocations to equities remain justified, albeit at a lower level than in years past.

Thank you for your continued trust.

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