WestStar Wealth Management | Wealth Watch

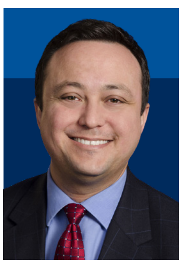
For Managed Portfolios

2022 Q1 Review & Q2 Outlook

2022 is off to a tumultuous start. The breakout of the largest ground war in Europe since World War II compounded a number of challenges already facing the global economy, including surging inflation, soaring oil prices, spiking interest rates, and swinging volatility. In urgent need of less stressful subjects, one looks to America's favorite pastime, ponders what "inning" we may be in, and recalls the immortal quips of Yogi Berra.

"Déjà Vu All Over Again?"

When contemplating these factors, investors wonder if history will repeat itself. Are we facing a circa 1970's hyperinflationary environment? Is oil headed toward the near $150/bbl level as it did in 2008? What is the Fed doing with interest rates and will they ignite a recession as has happened in the past? Finally, what steps can we take amid the volatility we expect to persist? In the spirit of the advent of baseball season, Mr. Berra's simple yet thought-provoking "Yogi-isms" will set the stage.



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Your wealth, well managed.

What You Need To Know:

- All major investment categories were negative with the exception of commodities in the first quarter
- WestStar's tactical strategy currently emphasizing defensive areas
- Volatility is normal and intra-year declines do not presage a negative calendar year
- While some components of inflation may be peaking, others suggest prolonged elevated levels
- Global central banks are tightening, which may suggest a relatively flat near term stock market
- Expectations for longer-term returns are lower and volatility higher relative to recent years
- Adhere to your long-term strategy

Asset Class Index Performance* First Quarter 2022

STRONGEST

Commodities
25.55%

Money Market (Cash)
0.05%

Alternative Investments
-1.85%

Real Estate
-3.79%

US Large Cap Stocks
-4.6%

High Yield Bonds
-4.84%

International Developed Market Stocks
-5.91%

US Investment-Grade Bonds
-5.93%

International Bonds
-6.15%

International Emerging Market Stocks
-6.98%

US Small Cap Stocks
-7.53%

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Performance: *"You Can Observe A Lot Just By Watching"*

Last quarter's Wealth Watch spoke of the "tale of two markets," noting the dichotomous comparison of stock vs. bond performance in 2021. We observed a continuation of this concept in the first quarter of 2022 to some degree. While commodities experienced their best quarter on record, nearly everything else was negative. Indeed, excluding commodities, Q1 was the worst quarter across all asset categories in 40 years. Even bonds which are often misconstrued as being "safe" were crushed amid the 10-year Treasury yield jumping over 80 basis points; the Aggregate Bond Index posting its worst quarter since 1980.

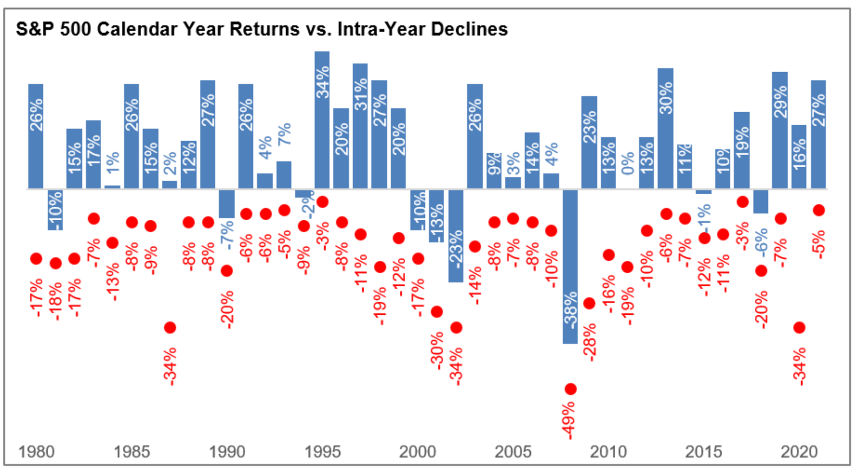
In terms of economic sectors, Energy was no doubt the leader in Q1 with roaring oil prices arising from the war in Ukraine. Conversely, rising rates were a headwind for growth-oriented industries, with Information Technology being the worst sector.

Tactical Strategy: *"The Future Ain't What It Used to Be"*

We had maintained a "maximum overweight" to stocks and a "maximum underweight" to bonds over the past year; however, the aforementioned market-affecting factors warranted a proactive adjustment in the first quarter. Given our expectations for persistent volatility we reduced our equity allocation to "neutral." Because we expect inflation to remain elevated and interest rates to continue to rise, we remain "underweight" fixed income but not to the degree we were last year given enhanced income opportunities in 2022. Our strongest emphasis is now on the two defensive areas of our strategies, with an "overweight" in both Real Assets (inflation defense) and Alternative Investments (volatility defense).

Volatility: *"When You Come to a Fork in the Road, Take It"*

There is no doubt that markets were broadly dismal in the first quarter. When faced with such a scenario, some may wonder if such volatility portends a longer-term trend and may even question whether to remain invested or exit markets entirely. We would strongly advise against liquidating but, as discussed above, we do engage in proactive tactical repositioning. Furthermore, as indicated by the chart below, intra-year declines do not necessarily mean the full year will follow suit. In fact, thirty two of the past forty two calendar years have posted positive returns despite being negative at some point during said year. The moral of the story is that volatility is to be expected and a well-structured investment strategy should take it into consideration. This is true even during sobering global events such as war.



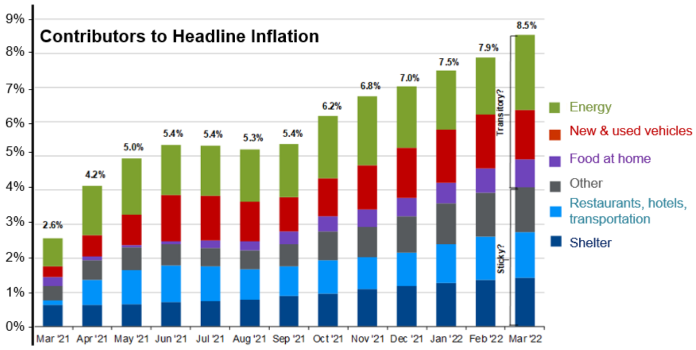
Source: JP Morgan Asset Mgmt; FactSet, Standard & Poor's

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets Index; Core Bond: Bloomberg Aggregate Index; Int'l Bond: Bloomberg Global Aggregate ex-USD Index; High Yield: Bloomberg US Corporate High Yield Index; Cash: BofA Merrill Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity Index; Alternatives: Wilshire Liquid Alternatives Index

Renowned independent investment research firm Ned Davis Research analyzed market reaction to every war event since WWI and found that the Dow Jones Industrial Average is actually positive 1-month, 3-months and 6-months after they commenced on average. While neither diminishing the severity of the situation in Ukraine nor being callous about the ongoing tragedy, the market amid the current conflict has been similar to historical averages so far, with the Index up 4.99% between February 24th and March 24th. War, in and of itself, is not necessarily a catalyst for a market downturn, though it has been a contributing factor to the rampant inflation affecting global economies.

Inflation: *"A Nickel Ain't Worth a Dime Today"*

Inflation has been a topic of concern for over a year now, driven by pent-up consumer demand following the COVID shutdown, supply chain issues, rising wages, and surging commodities prices. Past predictions of inflation being purely "transitory" have proven incorrect, compounded by the war and sanctions relating thereto. There is no indication, however, that we are facing '70's-style hyperinflation. As a net exporter of oil, the US is now much less vulnerable to oil shocks. Furthermore, evidence of inflation peaking remains, with factors such as used vehicle prices now declining.

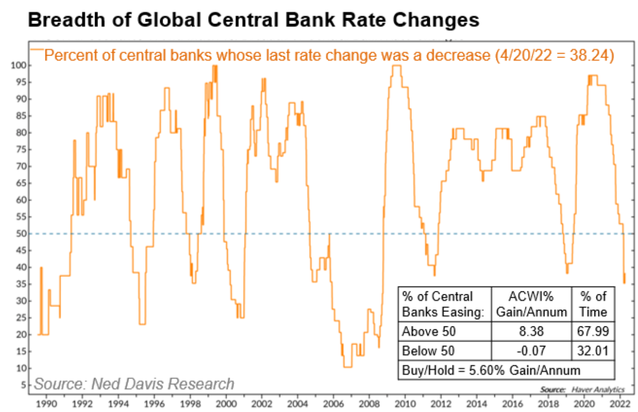


Source: JP Morgan Asset Mgmt., BLS

The chart at left reflects the underlying elements of inflation, some of which are "transitory" (used and new vehicle prices, energy, food) and some "sticky" (rent, services). The transitory elements will recede as supply chain issues continue to resolve. The "sticky" ones, however, become embedded in expectations and are likely to persist. For calendar year 2022 we anticipate inflation running in the 4%-4.5% range. The fact that even "sticky" inflation is currently running above the Fed's 2% preferred level suggests they will maintain a tightening policy.

Interest Rates: *"I Want to Thank Everyone Who Made This Night Necessary"*

In the previous edition of the Wealth Watch we illustrated that historically the US stock market has been volatile but flat from beginning to end over a 24 month period when the Fed is hiking rates at a fast pace (i.e. at least once per meeting). We do anticipate this cycle will be similar but, given the global nature of our equity strategies, wanted to expand the analysis to the worldwide environment. We find on the chart at right that more than half of central banks around the world are now tightening and under such circumstances the All Country World Index of stocks has been flat in years since 1989. It is with this in mind, the fact that we have experienced three consecutive calendar years of double-digit stock returns in the US, and the aforementioned economic factors that we have reduced our equity exposure to "neutral" from "maximum overweight."



Investment Strategy: *"If You Don't Know Where You're Going, You'll End Up Somewhere Else"*

We may be in the later "innings" of an economic cycle, and though growth is slowing we do not expect a recession in 2022. We must, however, consider what may happen beyond. Every year investment advisors and consultants worth their salt evaluate the current and forward-looking economic environment, examine relationships between various asset classes amid this outlook, develop risk, return and correlation projections, and from these projections design longer-term asset allocation strategies. While typically year-to-year projection changes may be subtle and therefore strategic asset allocation modifications may not be necessary, the 2022 outlook is markedly different. Forecasts for volatility are expected to be higher while forecasts for returns are expected to be lower in relation to recent years. Accordingly, restructuring strategic asset allocation strategies was warranted in the first quarter. Additionally, tactical repositioning wherein particular areas are emphasized and deemphasized within the parameters of this new strategic paradigm remain important. While we currently are overweight the most defensive areas of our strategies we remain committed to proactive adjustments as developments arise.

The team you can trust.

As true fiduciaries, our focus isn't on selling products to our clients. Instead, we focus on providing personalized service and real financial solutions.

Our team of wealth management professionals has the valuable depth of expertise you need to navigate life's events.

From retirement planning and investment management to trust services and estate settlement, we can help you devise the most effective plan to meet your financial goals.

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