

Stegent Equity Advisors, Inc. Investment Letter

Market Review

April 2022

Uncertainty among investors has clearly been the main theme over the last few quarters. The events of Q1 2022 are starting to give us a clearer picture on what is to come and the image is still not pretty. This quarter saw the FED hike interest rates, inflation continue to rise, yield curve inversion warnings and most notably the start of the Russia-Ukraine conflict. These events lead us to believe that market volatility will likely get worse before it gets better.

Q1 2022 saw negative returns across the board. The U.S. Stock Market dropped 5.3%. International Developed Stocks were down 4.8%. Emerging Markets fell even lower, losing 7%. Global Real Estate was down 3.8%. And finally, U.S. Bonds were down 5.9% with International Bonds falling by 4%.

Early in Q1 2022, we added exposure to dividend paying stocks as well as increased our exposure to energy and natural resources as a play on gas and metals shortages. Due to these shortages, we believed traditional energy prices would continue to rise. And rise they did. Per NASDAQ.com, investors saw the Bloomberg Commodity Index up 25.6%, the United States Oil Fund LP (USO) increase by 36.4%, and the Energy Select SPDR Fund (XLE) rise 39%. Additionally, we think investors may see “clean energy” benefit from expedited deployment and the move away from fossil fuels.

On March 16th, the Federal Reserve raised short-term interest rates by a quarter of a percentage point, their first since December of 2018. They have also indicated that there would be additional hikes at each of the six remaining meetings in 2022. According to HEDGEYE analyst Josh Steiner, “the FED’s tightening cycles have historically averaged 28 months in the previous 5 inflation shocks. This time they’re on pace to get most everything done in less than half that time because they’re late and playing catch-up. That swiftness of acceleration in policy is likely to break things harder than the economy or the market is prepared for.”

In mid-April, the National Federation of Independent Business released its March Small Business Economic Trends survey. When asked about their expectations for the economy to improve in the next 6 months, Small Business Owners reported a 14-point M/M decrease to a -49 reading. That’s the lowest reading in the history of a series that dates back 48 years. It is rather remarkable that when one considers some of the larger economic environments over the past half-century including the Great Financial Crisis and 1980’s almost 15% inflation, Small Business Owners are currently saying they feel worse about their business’ future than at any point previously.

Interestingly, the same survey found that the net percent of owners raising average selling prices in March increased 4 points to 72%, seasonally adjusted. This also marks the highest reading in the 48-year history of the series. For context, the next highest reading, 67%, occurred in the Q4 1974. Inflation in December 1974 was 12.1% Y/Y and 1 year later it was 7.1% Y/Y. Two years later it dropped down to 5.1%. Growth during 1974 stalled and the economy was in recession that entire year. The S&P 500 in 1974 was down 31% in absolute terms and down 43% in real terms when you adjust for the 12% inflation.

Now let's add the Russia-Ukraine conflict to the mix. In anticipation of the impending invasion, market volatility increased, seemingly to price in the conflict. This volatility continued throughout the start of the conflict but has since changed course, with the S&P 500 recovering from the hit it took mid quarter. However, the possibility of a recession remains a large concern for Europe due to their economic ties to the two countries involved. Additionally, the U.S. Treasury yield curve inverted for a few days in Q1 2022. Traditionally, this has been known to indicate a coming recession.

The War in Ukraine triggered a further energy rally that pushed out the peak in inflation to March/April, but the outlook for the rest of the year is disinflationary. We expect disinflation, fueled initially by energy costs and used vehicle prices, to begin in Q2. It will begin somewhat slowly – as many phase transitions do – as there will be lagged, residual lifts from shipping costs and shelter inflation offsetting it to an extent in Q2, but the second half of 2022 is when disinflation will gather momentum.

Taking into consideration the events that took place this quarter, and what the FED is telling us they plan to do to short term interest rates in the coming quarters, we expect an extremely difficult market environment. We will continue to play defense, rather than offense, with our portfolio positioning.

As always, we are grateful for the opportunity to continue to serve as your trusted advisor. Please reach out to us with any questions or concerns,



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