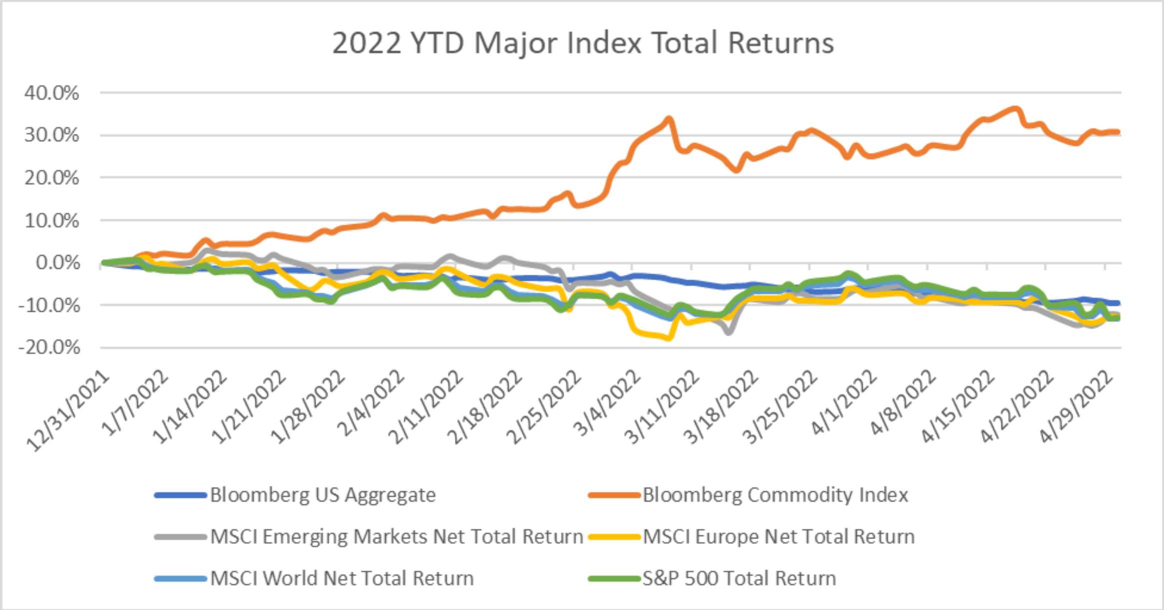
ENCORE INVESTMENT ADVISORS

APRIL 2022 MARKET REVIEW

Market Recap: April brewed up a perfect storm of macroeconomic factors, which pushed both equity and bond prices lower once again; so, forgive us if we have sounded like a broken record over the past several months, as this trend continues. The broad based S&P 500 index fell almost 9%, while European equities fared better, but still fell over 5%. Interest rates continued to march higher, with the 10 year US treasury ending the month at 2.89%, a full 140 basis points higher than at year end. On a year-to-date basis, global equities have fallen between 12% and 13%, while US bonds have fallen 9.5%. Even the most conservative bond portfolios have seen years of yield wiped away by the loss of capital through April 2022. Multi-asset diversification has only exacerbated losses, and while the idea is to hold assets that are driven by different economic factors and therefore have return streams that are uncorrelated, the issue so far in 2022, is that the correlation between stocks and bonds has increased significantly; when equities fall, so do bonds, and vice versa, negating the theoretical benefit of diversification.

When traditional markets are struggling, it can be helpful to take a step back and reassess the factors driving the downturn. The three factors that we anticipate will be most impactful moving forward are also all uniquely intertwined: tighter financial conditions, the Ukraine/Russia conflict, and further Covid induced lockdowns in China. The market is a discounting mechanism, so any small change to the expected outcome of the above factors has a major impact on current prices. After a 50 basis point hike in the fed-funds rate in early May, the bond market is currently expecting significant rate hikes in June and July, followed by smaller hikes later in the year. The Fed, and other central banks, are fighting record inflation caused by both supply and demand side factors stemming from the war, as well as shifting consumer behavior post Covid. In China, the data seems to show a recent downtick in infections which could lead to an improvement in global supply chains and consumption. However, the wildcard is the Ukraine/Russia conflict, where the likelihood of a longer lasting conflict is increasing daily, bringing about the potential for a military mistake that could bring another nation directly into the fight. This has a direct effect on commodity markets, and therefore, indirectly affects the rate of inflation.

How does this impact our perspective? While cross-asset correlations increasing during times of stress is unsurprising, the inclusion of certain assets such as commodities, or international equities and bonds, and cash within a portfolio can help reduce downside risks. From the below chart, it is easy to see the narrow range of outcomes so far on a year-to-date basis across fixed income, US equities, and international equities; commodity assets are the obvious outliers, as supply-side shocks have pushed prices higher. Our expectation is that there will be a divergence in returns across equities and bonds, as the above factors play out. Equities are currently caught between conflicting forces; higher interest rates put downward pressure on valuations while corporate earnings continue to expand. We obviously cannot predict the future, however, investors who continue to hold equities after a market correction are more likely than not to be rewarded over the ensuing 24 months. We expect fixed income markets to continue to struggle as interest rates trend higher, leading us to maintain our underweight stance to the asset class, however we are not abandoning the asset class entirely.



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