ECONOMIC & INVESTMENT PERSPECTIVES

APRIL: STOCKS & BONDS MELT DOWN

NEGATIVE REAL GDP GROWTH DUE TO HIGH INFLATION

Figure 1: 4/30/2022 Returns (source: Bloomberg)

Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-3.8%	-9.4%	-8.6%	-11.9%	0.2%
Investment Grade Corp Bonds	LQD	-6.7%	-14.5%	-12.2%	-17.7%	0.2%
U.S. Treasury Bonds	GOVT	-3.0%	-9.2%	-7.4%	-10.7%	0.4%
20+ Year Treasury Bonds	TLT	-9.4%	-19.0%	-12.5%	-23.0%	0.7%
Muni Bonds	MUB	-2.5%	-7.8%	-7.0%	-9.6%	0.1%
High Yield	HYG	-4.2%	-8.7%	-6.4%	-10.9%	0.1%
Non-US Corp Bonds	IBND	-7.7%	-14.9%	-19.5%	-23.5%	0.2%
Emerging Markets Bond LC	EMLC	-5.7%	-10.2%	-14.7%	-21.5%	0.9%
Global Equity						
ACWI Global Equity	ACWI	-8.1%	-13.3%	-5.9%	-14.6%	0.2%
United States	VTI	-9.1%	-14.0%	-3.5%	-15.2%	0.1%
International Developed	EFA	-6.7%	-12.8%	-9.2%	-16.6%	3.2%
Emerging Markets	EEM	-6.1%	-13.2%	-20.0%	-24.6%	3.9%
Global Equity by Region						
United States	VTI	-9.1%	-14.0%	-3.5%	-15.2%	0.1%
Europe	IEUR	-6.4%	-14.1%	-9.1%	-16.9%	6.4%
Asia ex-Japan	AAXJ	-5.5%	-14.2%	-22.7%	-26.4%	4.3%
China	MCHI	-4.6%	-19.6%	-37.9%	-40.1%	15.8%
Japan	BBJP	-8.1%	-15.3%	-14.3%	-24.6%	1.0%
Latin America	ILF	-14.1%	11.2%	-0.5%	-19.7%	15.6%
US Equity						
US S&P 500	IVV	-8.9%	-13.0%	0.0%	-14.2%	1.8%
NASDAQ 100 QQQ	QQQ	-13.6%	-21.2%	-6.9%	-23.4%	0.2%
US Large Growth	IWF	-12.2%	-20.1%	-5.6%	-21.9%	0.2%
US Large Value	IWD	-5.7%	-6.4%	1.0%	-8.7%	2.0%
US Eqwt S&P 500	RSP	-6.5%	-9.0%	0.8%	-10.6%	1.3%
US Mid Cap	IJH	-7.1%	-11.7%	-7.1%	-14.6%	0.6%
US Small Cap	VTWO	-9.8%	-16.7%	-16.8%	-24.4%	0.3%

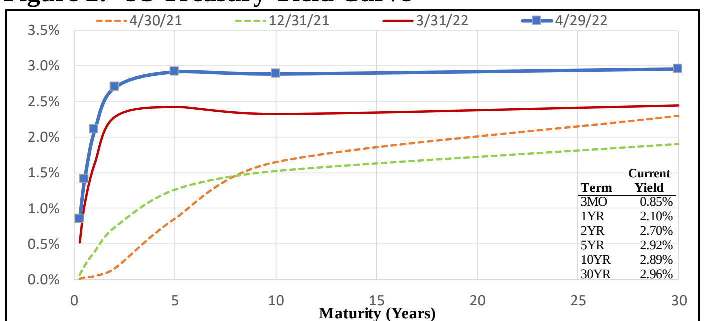
Stocks and bonds tumbled in April amid rising interest rates and global economic concerns as war in Europe and COVID lockdowns in China exacerbated trade and supply disruptions and elevated commodity prices (oil, metals, agriculture), resulting in the highest inflation in decades (+8.6% as of March). Performance highlights for the month and year-to-date (YTD) follow.

- Bonds: The U.S. Aggregate index (AGG) fell 3.8% (-9.4% YTD) as interest rates rose. Corporate bonds (LQD) were down 6.7% (-14.5% YTD), and high yield bonds (HYG) fell 4.2% (-8.7% YTD) as credit spreads widened. Non-US bonds (IBND and EMLC) were weaker as the dollar gained 4.5%.
- Global equity (ACWI): -8.1% in April (-13.3% YTD).
- U.S. Equity: The broad market (VTI) fell 9.1% (-14.0% YTD), and the S&P 500 (IVV) lost 8.9% (-13.0% YTD). Large growth stocks (QQQ and IWF) fell 12-14% and are more than 20% below previous highs as rising interest rates erode the present value of future earnings. Small stocks (VTWO) fell 9.8% (-16.7% YTD) and are 24% below 52-week highs. All sectors were down for the month except Consumer Staples (defensive).
- Non-U.S. Equity: Developed markets (EFA) were down 6.7% (-12.8% YTD), with weakness in Europe and Japan. Emerging markets (EEM) fell 6.1% (-13.2% YTD); Latin America stocks erased YTD gains (ILF -14.1%, -0.5% YTD); while China surged into month-end to cut losses (MCHI -4.6%, -19.6% YTD) despite the negative impact of COVID lockdowns.

Interest Rates and the Economy

The US yield curve (Figure 2) plots the yields (Y-axis) for various maturities (X-axis) of U.S. Treasuries. Yields rose across the term structure in April as the Fed signaled a willingness to aggressively raise interest rates to remove monetary accommodation and combat inflation. The yield curve remains flat at longer maturities and is partially inverted (short-term rates higher than long-term yields), increasing recession concerns. The benchmark 10-year bond yield ended the month at 2.89%.

Figure 2: US Treasury Yield Curve

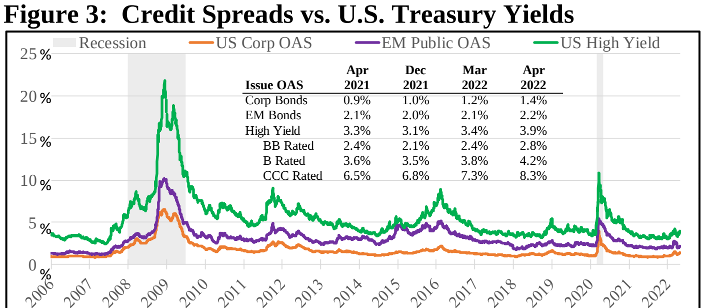


Source: Board of Governors of the Federal Reserve System via FRED

For bonds other than U.S. Treasuries, we track the option-adjusted yield spread (OAS) versus Treasuries of comparable maturities. Low or narrowing spreads signal optimism while high or rising spreads signal fear. Spreads widened in April and YTD, confirming the "risk-off" tone of global markets.

- Investment grade corporate bond spreads rose to +1.4% this month but remain higher than +1.0% spreads at year-end.
- High yield (non-investment grade) spreads widened to +3.9% but are nowhere near panic levels. The riskiest bonds (rated CCC & below) yield +8.3% over Treasuries, higher this month and well above 2021 year-end and year-ago levels.
- Emerging market bond spreads rose slightly to +2.2% after spiking to +2.6% in February with geopolitical tensions; these spreads had been stable, but emerging market debt has underperformed due to the strength of the U.S. dollar.

Figure 3: Credit Spreads vs. U.S. Treasury Yields

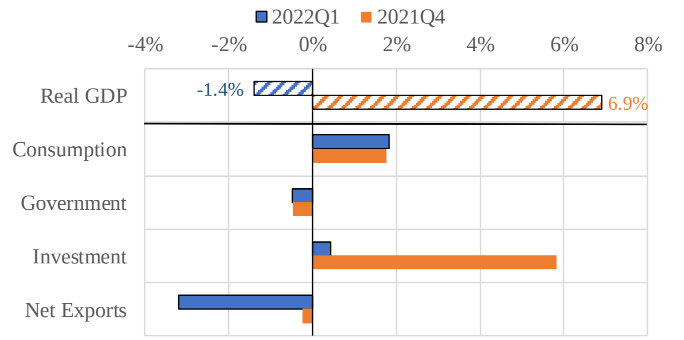


Source: Ice Data Indices, LLC via FRED

Growth & Inflation

The U.S. Bureau of Economic Analysis (BEA) reported that real GDP contracted at an annualized pace of -1.4% in the first quarter (Q1), a significant deterioration from the reported growth rate of nearly 7% in the prior quarter. (Note: Real GDP stands for Gross Domestic Product, the value of all final goods and services produced in the U.S., adjusted for inflation.) The COVID resurgence and the Russia-Ukraine conflict dramatically impacted economic activity. Figure 4 illustrates the real growth contributions of the four primary sub-components of GDP in the last two quarters.

Figure 4: U.S. Real GDP Growth Contribution



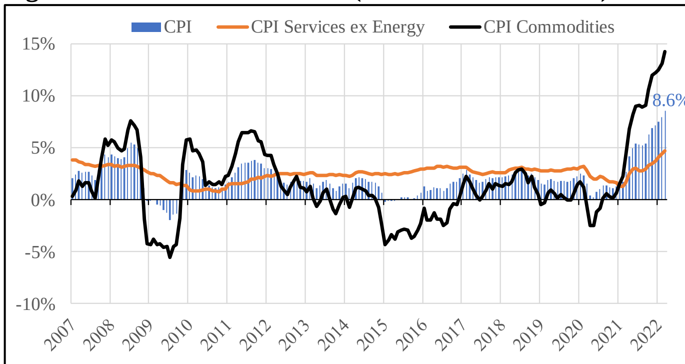
Source: U.S, Bureau of Economic Analysis via FRED

Analyzing the contributions to growth in this manner highlights two key differences between the quarters: Q4 growth (orange bars above) was significantly boosted by business spending (inventory rebuild), and Q1 growth was severely dampened by weaker net exports, causing aggregate real growth to turn negative. A discussion of the sources of growth is instructive.

- **Personal Consumption:** 69% of the U.S. economy is powered by the aggregate expenditures of individual consumers. Personal consumption continues to be a key driver of growth, increasing slightly from 2021Q4 to 2022Q1, net of inflation.
- **Government expenditures:** 17% of GDP is driven by direct consumption of goods and services by federal, state and local governments. Decreasing government spending continues to have a small, negative impact on overall GDP growth.
- **Private Investment:** 19% of the economic output comes from the expenditures and investment activity of businesses, including construction, equipment, manufacturing and inventories. A build in inventories was the primary driver of growth in Q4; inventories shrank in Q1, but overall business spending was a small, positive contribution to real GDP growth.
- **Net Exports:** A trade deficit (the net value of U.S. exports minus imports) subtracts from economic growth, currently -5% of GDP. That drag increased in Q1, largely due to higher prices paid for energy imports (oil > $100 per barrel).

The primary concern facing markets and investors is real growth. It is worth noting that nominal GDP growth (not adjusted for inflation) in Q1 was actually +6.5% annualized; however real GDP growth of -1.4% implies an inflation impact of roughly -8%. This inflation is primarily caused by spiking oil prices and supply chain disruptions due to the staggered restart of the global economy in the wake of the pandemic, exacerbated by the disruption of energy, materials and food markets caused by the Russia-Ukraine conflict. The latest Consumer Price Index (CPI) inflation reading came in at +8.6% for March versus a year ago; data for April is due out next week and is expected to be similarly high. Figure 5 breaks CPI down into two major sub-components: commodities (raw materials: oil, gas, materials, agriculture, etc.) and non-energy services (housing, medical, transportation excluding gas, education, etc.). It is clear that the current inflation surge is driven by rising commodity prices (primarily oil and gas), while the cost of services (which comprises more than half of the CPI calculation) is rising modestly but has remained below 5%.

Figure 5: Inflation Year/Year (source: St. Louis Fed)



Source: U.S. Bureau of Labor Statistics via FRED

To bring inflation back down toward their target of 2%, the Fed is likely to accelerate the pace and/or the magnitude of rate hikes in the coming months. Bond markets are pricing in multiple 0.5% increases, beginning with the Fed's meeting this week.

Bottom Line

The flat, partially inverted yield curve suggests a moderation of economic growth ahead (lower long-term yields) and expectations of multiple rate hikes to combat inflation (rising short-term yields). Though the U.S. real GDP contracted in the first quarter, it does not appear that the economy has fallen into recession. Employment remains strong, but the probability of recession in the next 12-18 months is rising. It is important to note that this is a global phenomenon; inflation is elevated in most economies, and many sovereign yield curves around the world are similarly flat. Markets are weak, anticipating slowing growth and rising recession risks. Figure 6 (below) lists various equity markets and indices that are already in a bear market, defined as a decline of 20% from previous highs. Markets are likely to remain volatile as economic activity, inflation and interest rates seek equilibrium, but that will likely only occur with continued progress against the pandemic (an end to lockdowns in China) and some resolution of the war in Europe, which would reduce or reverse the inflationary pressures caused by spiking commodity prices. Though bonds have been weak as well as equities in this rising rate environment, portfolio diversification remains critical.

Figure 6: Bear Market ETF Returns (source: Bloomberg)

Symbol	ETF Name	MTD	YTD	vs. 52wk High
MCHI	iShares MSCI China ETF	-4.6%	-19.6%	-40%
EWY	iShares MSCI South Korea ETF	-6.4%	-14.4%	-30%
BBJP	JPMorgan BetaBuilders Japan ETF	-8.1%	-15.3%	-25%
EEM	iShares MSCI Emerging Markets ETF	-6.1%	-13.2%	-25%
VTWO	Vanguard Russell 2000 Index Fund	-9.8%	-16.7%	-24%
QQQ	Invesco QQQ Trust	-13.6%	-21.2%	-23%
EZU	iShares MSCI Eurozone ETF	-7.3%	-18.2%	-22%
EWZ	iShares MSCI Brazil ETF	-13.3%	16.7%	-22%
IWF	iShares Russell 1000 Growth ETF	-12.2%	-20.1%	-22%

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