File # 211130

AndCo's Monthly Market Update

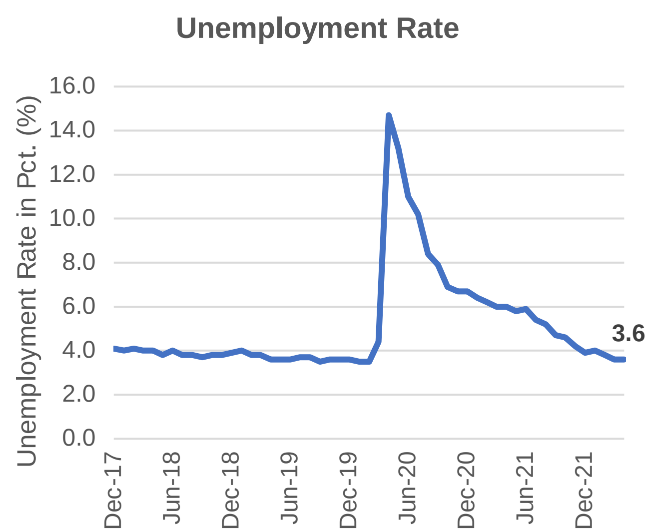
May 2022

THE ECONOMY

"The problem with the race to the bottom is that you might win" – Seth Godin

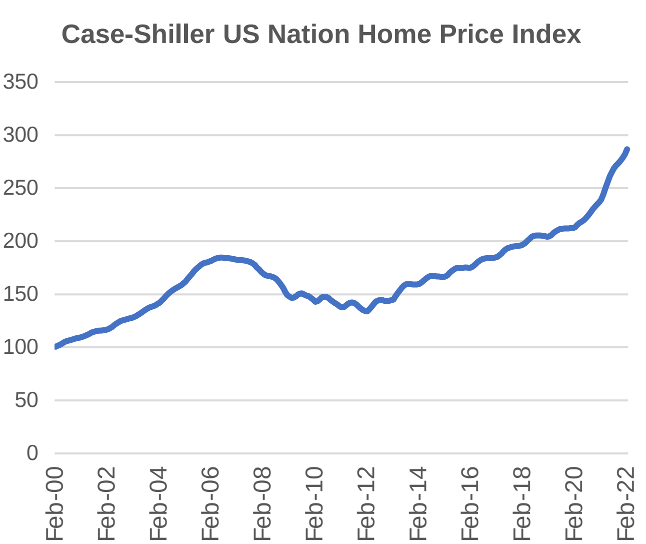
After a very disappointing first quarter, the month of April was no relief to investors as most broad markets showing continued declines. The primary drivers of the market in April continue to be concerns related to Ukraine, rising inflation, and slowing economic growth. Little progress was made during the month to end the violence in Ukraine. Importantly, additional sanctions of Russian energy are being considered by Western Europe, which could further contribute to higher energy prices in the event additional supplies are not developed. Global inflation remains well above expectations as supply chain disruptions, coupled with rising energy and food prices, continue to drive inflation. As is normally the case, global economic growth appears to be slowing under the combined weight of these factors. The initial estimate for first quarter US gross domestic product (GDP) showed that the economy contracted during the period by -1.4%.[1] This decline in activity followed the previous quarter's robust 6.4% in growth, making the decline all the more impactful.[2] While the growth contraction is worrisome, we do not feel the reading tells the full story with regard to what is happening in the economy.

The data points we monitor have been giving conflicting information regarding the overall health of the economy. Labor markets have largely recovered following the dramatic rise in unemployment resulting from the pandemic. The jobs report for April was stronger than expected with the non-farm payroll growing by 428,000, which was above the market's consensus forecast of 380,000 new jobs.[3] Importantly, job growth appears to be healthy across each of the sectors including hospitality (78,000), education (59,000), manufacturing (55,000), and transportation (52,000).[4] The unemployment rate remained steady at 3.6% for the month.[5] Unfortunately, wage growth has shown signs that it is beginning to slow with average hourly earnings rising by only 0.3% in April, down from 0.5% in March.[6] While it is encouraging to see the unemployment rate continue to fall, the fact that real average hourly earnings are failing to keep pace with inflation means workers may have difficulty maintaining their lifestyles as prices of goods and services continue to increase.



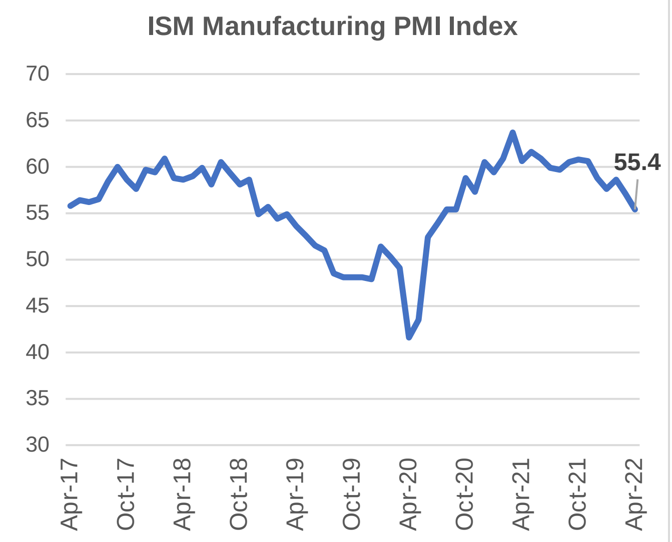
Source: Bloomberg as of May 6th, 2022

The housing market has been a beacon of strength in recent years with a significant increase in property values as evidenced by the Case-Shiller Index, which reported the median price of homes closed at another all-time high in February.[7] Further confirmation was seen in the national median listing price of homes, which rose by double-digits in April despite the fact that mortgage rates are significantly higher than a year ago.[8] Rising property values have historically been a positive catalyst for consumer sentiment. However, the average 30-year fixed rate mortgage climbed to 5.1% in April compared to 3.2% a year earlier.[9] While the rise in mortgage rates was broadly expected given recent action by the Fed, historically, rising interest rates have served to slow the price appreciation of real estate. Moving forward, our concern is that home prices could potentially begin to decline as mortgage rates increase. While any price declines



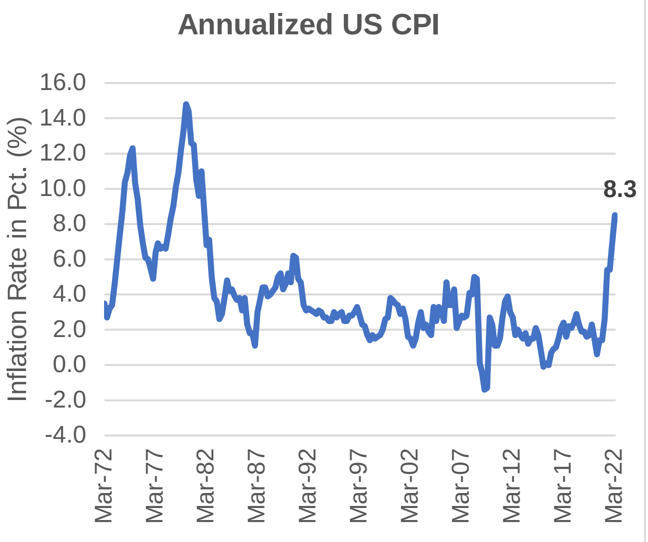
Source: Bloomberg, as of April 28th, 2022 may be welcome by potential buyers, the rise in mortgage rates could act as a negative offset, keeping home affordability challenging for many Americans.

Manufacturing and industrial production in the US have shown conflicting signs in recent months. For the month of April, the ISM Manufacturing Index declined to 55.4, down from 57.6 in March.[10] While the index remains above the neutral level of 50, the data suggests the trajectory of manufacturing activity is likely lower after peaking in the first quarter of 2021. Conversely, US industrial production increased at an annualized rate of 5.4% in the first quarter.[11] An important indicator of activity, and the productivity of factories, is capacity utilization, which rose to 78.7%, the highest reading since 2007.[12] While it is encouraging to see new orders increasing, concerns related to supply chains and the ability to source materials as costs increase could put a damper on growth moving forward.



Source: Bloomberg, as of April 30th, 2022

US inflation moderated slightly in April with the Consumer Price Index (CPI) reporting 8.3%, down from 8.5% in March.[13] Despite the drop, inflation remains near a four-decade high. The consensus forecast was for the CPI to fall to 8.1%, which could have taken some of the pressure off the Fed to continue with aggressive rate hikes. Following the announcement, the market is now pricing in eight rate hikes with an implied Fed Funds rate close to 3.0%, a level not seen since prior to the Great Financial Crisis in 2007.[14] Unfortunately for consumers, there appears to be little relief on the horizon as the price of goods and services continue to rise. There are several factors contributing to higher-than-expected inflation including snarled supply chains, food supply issues, a lack of affordable housing, and declining fuel stocks. As a result, certain parts of the economy, like housing, food, and energy, will likely continue to see elevated inflationary pressures. So, what does this mean?



Source: Bloomberg as of May11th, 2022

The Fed will most likely continue raising interest rates in the coming months to cool the economy with the goal of moderating inflation. However, given the factors listed above, inflation is likely to remain well above the Fed's target for some time. Importantly, rising interest rates have historically been a significant headwind to corporate earnings, which could lead to lower forecasted economic growth and potentially job losses.

EQUITIES

Equity markets were broadly lower in April as investors faced a combination of challenges related to the conflict in Ukraine, rising inflation, and tighter monetary conditions. The Fed's decision to continue raising interest rates played a significant role in the market's decline. Not surprisingly, technology stocks led the market lower given their sensitivity to rising interest rates. For the month, the S&P 500 Index was down -8.72%.[15] Looking across the equity markets, small cap stocks underperformed large caps for the month, while growth companies significantly underperformed value-oriented companies.[16] From a sector perspective, consumer staples was the only sector that contributed positive absolute performance during the month, rising 2.56%.[17] The worst performing sectors were communication services and consumer discretionary which declined by -15.62% and -13.00%, respectively.[18]

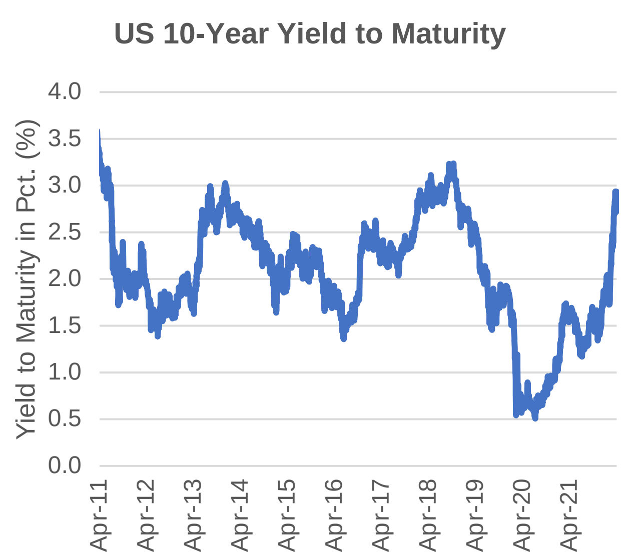
Overseas markets fared somewhat better relative to their domestic counterparts during April. Developed market stocks fell by -6.47% while emerging market stocks declined by -5.56%.[19] Growth in Europe likely continued to slow as the conflict in Ukraine remained active. Rising fuel costs, particularly in Germany, were a persistent headwind. With inflation rising, the European Central Bank will likely begin the process of raising interest rates sooner rather than later. In the UK, the Bank of England raised interest rates by 0.25% as expected.[20] Consensus estimates are for two additional rate hikes later this year. In Japan, core inflation continued to strengthen in April due primarily to rising energy and food costs. The Bank of Japan has stated that it does not intend to follow the Fed and raise interest rates, keeping its target rate for the 10-Year bond at 0.25%. Not surprisingly, the Yen has continued to fall against most major currencies. The story in emerging markets continues to be China's decision to restrict movement in Shanghai, the world's largest port, as a result of rising Covid-19 infections. While information out of China is interment and subject to revision, estimates are that the Chinese economy may have fallen into recession because of the continued lockdown. This lack of economic activity, both in the manufacturing and shipping of goods, likely means that global supply chains will remain under pressure for the foreseeable future.

	Index Returns			
Index	April	Year-to-Date	3-Years	5-Years
S&P 500 Total Return Index	-8.72%	-12.92%	13.88%	13.66%
Russell 1000 Index	-8.91%	-13.59%	13.60%	13.44%
Russell Mid Cap Index	-7.70%	-12.91%	10.60%	10.66%
Russell 2000 Small Cap Index	-9.91%	-16.69%	6.57%	7.24%
MSCI EAFE Index	-6.47%	-12.00%	4.54%	4.77%
MSCI Emerging Market Index	-5.56%	-12.15%	2.13%	4.32%

Source: Morningstar, April 30th, 2022

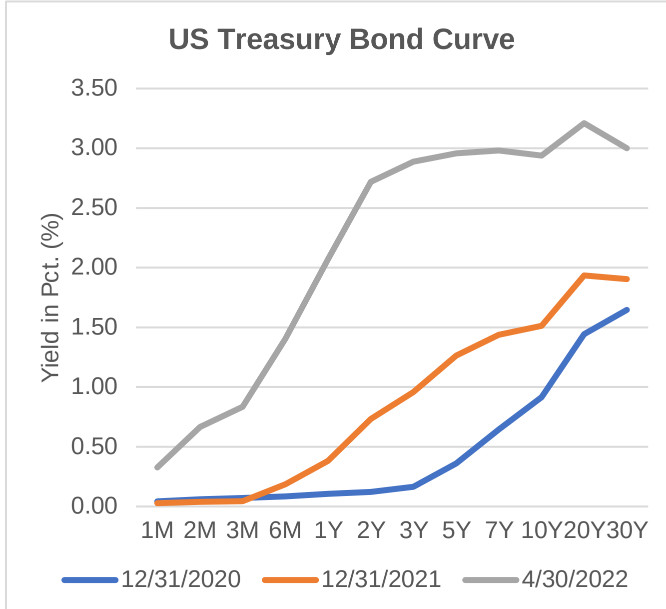
FIXED INCOME

Fixed income markets remained under pressure in April as tighter monetary policy and rising inflation weighed on returns. The benchmark 10-Year US Treasury bond tested the key long-term resistance level of 3.0% closing the month at 2.94%.[21] For the month, the yield on the 10-Year US Treasury rose by roughly 95 basis points.[22] A large factor in rise was the release of the Fed's March FOMC minutes, which discussed the potential for more aggressive rate hikes in the future if inflation remained above the target. As a result of the move higher in yields, performance was broadly negative with the Bloomberg US Aggregate Bond Index declining by -3.79% during the month.[23]



Source: Bloomberg, April 30th, 2022

While the performance of the bond market has been disappointing, one positive sign is the yield curve has steepened dramatically since the beginning of the year. Why is this important? Historically, a sustained yield curve inversion (short-term rates are higher than long-term rates) has been a reliable predicator of a recession within 6-24 months. The chart to the right illustrates the yield curve is now fairly steep between short-term and long-term rates. However, should the Fed continue to raise interest rates while economic indicators suggest growth is slowing, the yield curve could begin to flatten as investors' concerns about a potential recession increase. This could result in longer-term rates actually declining as short-term rates are rising, resulting in an inverted yield curve.



Outside of Treasury bonds, spreads were wider across the credit spectrum during the month. In April, investment grade spreads widened by roughly 20 basis points, while high yield bond spreads widened by more than 50 basis points.[24] Not surprisingly, as borrowing costs increased, companies issued less debt month-over-month.[25] While there does not appear to be any current stress in credit markets, we are monitoring readings for an uptick in defaults in lower quality bonds as an indicator of potential stress in the market.

APPENDIX

1. Bloomberg, April 30th, 2022
2. Bloomberg, April 30th, 2022
3. Bloomberg, May 6th, 2022
4. Bloomberg, May 6th, 2022
5. Bloomberg, May 6th, 2022
6. Bloomberg, April 30th, 2022
7. Bloomberg, April 30th, 2022
8. https://www.forbes.com/advisor/mortgages/will-housing-market-crash/
9. https://fred.stlouisfed.org/series/MORTGAGE30US
10. Bloomberg, April 30th, 2022
11. Bloomberg, April 30th, 2022
12. Bloomberg, April 30th, 2022
13. Bloomberg, May 13th, 2022
14. Bloomberg, May 13th, 2022
15. Morningstar, April 30th, 2022
16. Morningstar, April 30th, 2022
17. Bloomberg, April 30th, 2022
18. Bloomberg, April 30th, 2022
19. Morningstar, April 30th, 2022
20. Bloomberg, April 30th, 2022
21. Bloomberg, April 30th, 2022
22. Bloomberg, April 30th, 2022
23. Morningstar, April 30th, 2022
24. Bloomberg, April 30th, 2022
25. https://www.bloomberg.com/news/articles/2022-05-09/firms-pay-biggest-premiums-on-new-bond-deals-since-covid-peak

Important Disclosure Information

This document is being provided solely for informational and educational purposes and should not be regarded as investment advice or as a recommendation regarding any particular course of action and additionally is not intended to provide, and should not be relied upon, for legal, tax, or accounting advice.

Any securities cited are for illustrative purposes only. References herein do not constitute a recommendation to buy, sell or hold such securities.

The material provided herein is valid as of the date of distribution and not as of any future date, and will not be updated or otherwise revised to reflect information that subsequently becomes available, or circumstances existing or changes occurring after such date. This document may contain opinions, observations, projections or forward-looking statements which are subject to various uncertainties whereby the actual outcomes or results could differ from those indicated.

Certain information is based on sources and data believed to be reliable, but AndCo cannot guarantee the accuracy, adequacy, or completeness of the information. The source for all data, charts and graphs is AndCo Consulting unless otherwise stated.

AndCo Consulting is an investment adviser registered with the U.S. Securities and Exchange Commission ("SEC"). Registration as an investment adviser does not constitute an endorsement for the firm by securities regulators nor does it indicate that the adviser has attained a particular level of skill or ability.