Public

This Month in the Markets

April 2022

Equity Commentary

April is the Cruelest Month

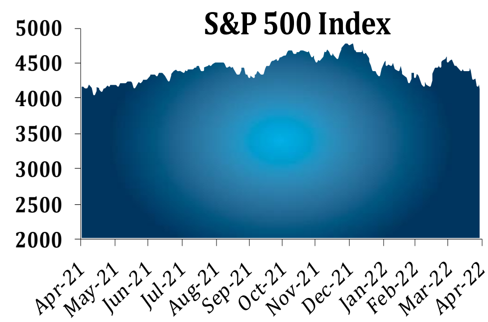
April was indeed a cruel month for the equity market, especially for growth stocks. The MSCI World Value Index fell 5% compared to a 12% decline in the MSCI World Growth Index. The MSCI ACWI Net Total Return Index ended lower with a -8% return in April. The S&P 500 fell 8.7%, while the MSCI EAFE Net Total Return Index declined 6.5%. A rotation into defensive sectors was evident in the month. The ACWI Consumer Staples Sector index was the top performer, climbing 0.6% and the MSCI ACWI Communications Services Sector was the under-performer with a 12.4% loss due to the sell-off of larger internet names like Netflix. The NASDAQ, a tech-heavy composite, fell 13.2% for the month.

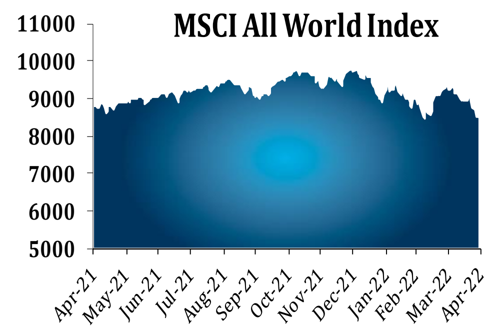
A great deal of this cruelty was dealt on "pandemic stocks" that received a massive boost from the covid acceleration of some trends. Much of the rather euphoric forecasts for future growth have now been dialed back considerably. A stock like Teladoc Health Inc., for example, is down about 90% from its high, as rather grand expectations are reset. The service sector is out-performing discretionary goods companies as we move further along a complete reopening in society and a move further towards "normal" in terms of service usage and social interaction. On the fundamental front, the news is not as dire. In a recent article in Bloomberg that quotes Barclays Research on the quarter so far, year-over-year sales growth for those companies who have reported is about 12% in the STOXX Europe 600 Index and about 11% in the S&P 500. EPS growth is more muted but still positive at about 8% and 4% respectively.* Sentiment is also very depressed. April's last survey by the American Association of Individual Investors showed a dramatic fall in people who were bullish. The bullish readings minus the bearish readings had collapsed to levels not seen since the financial crisis. Such readings are often seen as a contrarian indicator and can signal a bottoming process for markets which in turn could lead to some near-term stability.

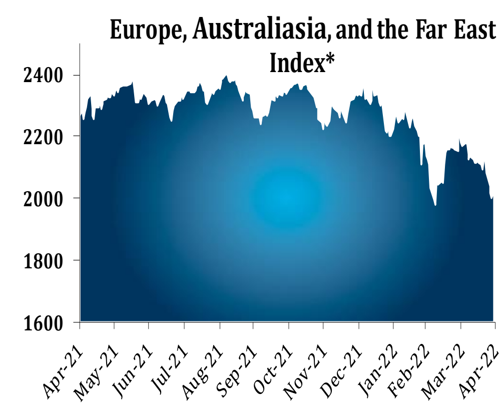
Amazon was the largest detractor in the portfolio for the month, with a decrease of ~24% after reporting disappointing profit guidance. The top performer in the month was Target Corp. which had received a series of positive analyst commentary featuring the resilience of its business model in the face of any potential slowdown and solid foot traffic trends.

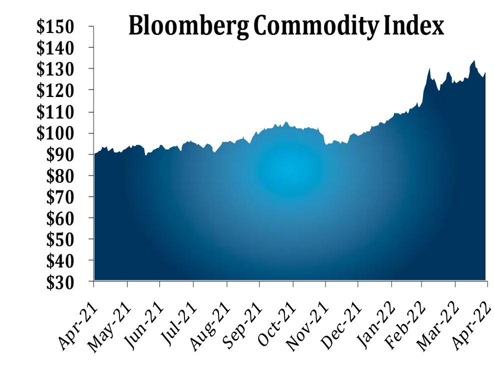
During the month, we exited Brunswick Corp. ("BC"). Our disposal was related to our reassessment of the post-pandemic trajectory of recreational boating sales and the potential supply chain issues that may affect margins and sales for a prolonged period.

We bought one new position in April: Royalty Pharma PLC ("RPRX"). RPRX is the leading acquirer of pharmaceutical royalties and has assembled an impressive royalty portfolio comprising ~40 approved and development-staged products, with 16 of them reaching blockbuster status. RPRX doesn't spend money on R&D or S&M expenses to develop or promote these drugs and as a result possesses a capital-efficient business model with 100% gross margins, 90% EBITDA margins, and 80% profit margins. We believe the company can see a greater volume of deals than consensus expectations given 1) depressed biotech valuations; 2) estimated $100bn+ in financing required for the biotech industry over the next 3 years 3) >$1tn in operating expenses spending from unprofitable biopharma companies over the next decade.









* "Tipping Point Looms for Risk-Adverse Equity Markets: Taking Stock" by Jan-Patrick Barnert and Michael Msika, May 2, 2022

*MSCI EAFE Index

Fixed Income Commentary

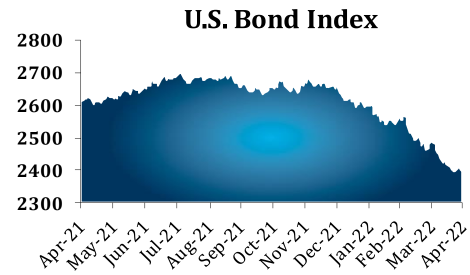
Financial Conditions are Tightening

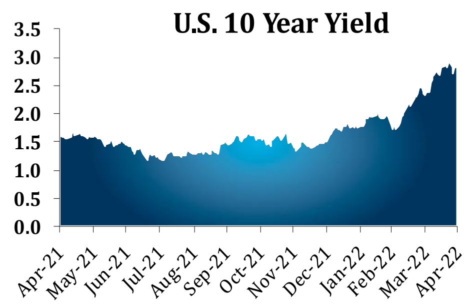
April was another difficult month for bond investors. Treasury rates continued their relentless push upwards on the back of large inflation prints (consumer price index +8.5% YoY) and rising fed fund rate hike expectations. The 10-year treasury rate rose +0.60% in April to end the month at 2.93%. Rates also rose in Europe. At the end of April, there was (only) USD-equivalent $2.8 trillion of negative-yielding debt globally, compared to $11.3 trillion at year-end 2021. At the time of writing, fed fund futures are pricing in just over six 0.25% hikes over the next 3 Federal Open Market Committee (FOMC) meetings. These are likely to come in the form of three 0.50% hikes, the first of which is expected to come at the May 5th meeting. This would be the first 0.50% rate hike since May 2000. There is even speculation of a 0.75% hike in the June meeting. We expect to get more color in the May FOMC meeting about future rate hikes and the pace of balance sheet run-off, which will occur concurrently with rate hikes.

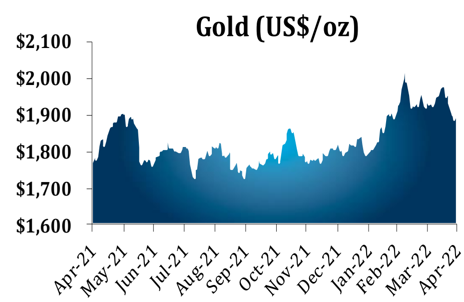
Although the Fed has only delivered one 0.25% rate hike thus far, financial conditions have tightened considerably year-to-date due to fed rhetoric and market expectations. After all, markets are forward-looking. For example, mortgage rates have moved aggressively higher. The bankrate.com US Home Mortgage 30 Year Fixed National Average index has risen +2.41% this year to 5.41% (+80%!). Real rates (adjusted for inflation) have also risen aggressively. The 10-year treasury inflation-protected security (TIPS) yield has risen from -1.10% to -0.001% at April end. These are big moves in a short period of time, especially given the importance of credit to the economy. Another notable tightening variable (globally) has been USD strength. The Deutsche Bank USD Trade Weighted Index has risen 7.3% driven by widening USD interest rate differentials given the hawkish Fed and/or more favorable economic growth. The euro (-6.7%) and the Japanese yen (-12.7%) are notable underperformers versus the USD this year. The euro area has been negatively impacted by Russia's invasion of Ukraine, resulting in soaring energy prices. The Bank of Japan is the only major central bank still employing yield curve control (pegging the 10-year yield to 0.25%).

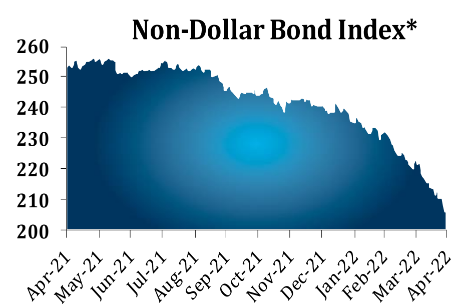
After declining in March, credit spreads widened in April (widening is negative for corporate bond prices) across all rating tiers, led by the riskiest ratings. While spreads have widened the pace of deterioration has been well contained, despite the heightened equity market volatility, treasury rate volatility, and FX volatility. Relative to long-term levels, investment-grade credit spreads are near to their long-term average, while high yield credit spreads are still approximately one standard deviation below the long-term average. Looking at intra-rating credit spreads within high yield, the difference between the highest risk (CCC-rated) and lowest risk (BB-rated) ratings remains almost one standard deviation below the long-term average. While credit spreads have thus far been well contained, we continue to hold a conservative view towards corporate credit going forward.

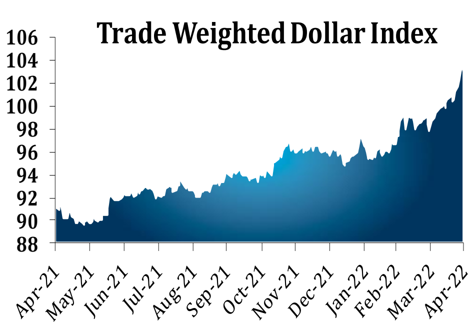
Financial conditions have already tightened notably. The Fed is expected to raise rates rapidly (while reducing its balance sheet) to tackle inflation. Essentially, the Fed will attempt to walk the tight rope of reigning in inflation without causing a recession (and the associated rise in unemployment and negative stock/credit market dynamics); otherwise known as a "soft landing." While the U.S. consumer has held up well thus far, the Fed could be undertaking this historic monetary tightening while U.S. economic growth could also be slowing or even contracting. This would make the Fed's tight rope walk even more difficult.











*Merrill Lynch Global Broad Market, Ex US Dollar Index

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