Convergence Commentary

April 2022 Market Recap

To our clients and friends,

Our investment and research team is constantly monitoring the market and global news so that we can make informed and careful decisions for our clients and their portfolios. Below is our inaugural monthly market commentary. We hope it brings you new insight and ideas.

Market-Moving Highlights

- The Consumer Price Index (CPI), an inflation metric that tracks consumer prices, was up 1.2% in March and 8.56% year over year. This was the highest inflation has been since 1981. The large increase in March was driven by increases in prices for gasoline, shelter, and food. The significant increases in prices for food and energy are related to the war in Ukraine and the subsequent sanctions on Russia that limit the exports of oil and gas from the country, while Ukraine is a major producer of wheat. Meanwhile, the Producer Price Index (PPI), a measure of inflation in terms of costs to suppliers, increased 1.4% in March and was up 11.2% year over year, the highest reading since the 1 Year Data was calculated by the Bureau of Labor Statistics. (BLS)

- The University of Michigan's Consumer Sentiment Index hit its lowest levels since August of 2011. There have only been four occasions since 1970 where consumer sentiment has been lower. (Fred)

- Netflix reported below expectation earnings on April 19th and subsequently fell 35% the next day. The negative performance of Netflix weighed down on the communications sector and the Nasdaq during the day the shares plunged due to the size of the company. This was the second significant drop of Netflix shares following their earnings report so far this year.

- The U.S. 10 Year Treasury hit its highest level since late 2018 topping out at 2.95%. Since, it has decreased. A rising 10 Year Treasury reflects expectations that the Fed will continue to increase interest rates.

- On March 31st, the yield curve inverted for the first time since 2019. The 2-Year and 10-Year yield inverted, which historically, has been a signal that a recession is coming. Since the 1950s, a yield curve inversion has preceded every recession. However, there has been a wide range of time between the curve's inversion and historical recessions, ranging from 6 months to almost 3 years, and an average of 18 months (GS). For more information on the yield curve, check out our recent blog: https://convergence-co.com/https-convergence-co-com-financial-yield-curve/

Index Performance

Index	1 Month	YTD	1 Year	5 Year
S&P 500	(9.84%)	(12.92%)	0.21%	13.66%
Nasdaq 100	(15.20%)	(21.06%)	(6.61%)	19.27%
Russell 2000	(9.98%)	(16.69%)	(16.87%)	7.24%
MSCI ACWI ex US	(8.14%)	(11.38%)	(10.31%)	4.94%
S&P US Aggregate Bond	(3.41%)	(8.78%)	(7.85%)	1.22%

The indexes were down significantly in April after a strong rebound in March. In fact, the S&P 500 had its worst month since March 2020 and the Nasdaq had its worst since October of 2008. The Nasdaq is now considered in a bear market, which happens when an index or stock is down 20% or more from its high, while the S&P 500 is still in correction territory. However, over half of the S&P 500 components are down more than 20% (Markets Insider). After the market low on March 14th, the Nasdaq and S&P surged 16.66% and 12.7%, respectively, to a relative high on March 29th. However, the major indices peaked on this date and hit new lows at the end of the trading day on April 29th. The war in Ukraine as well as some stronger Fed commentary contributed to the poor performance in April, as the Fed reaffirmed that they would continue to increase interest rates to combat inflation. Increasing interest rates is a hindrance to economic growth, which in turn, affects equity valuation, especially in unprofitable growth companies. While stocks have responded negatively to the rising interest rates, it appears that increasing rates have been mostly priced in, barring any surprises. However, if the Fed increases their hawkish tone or unexpectedly increases rates by more than the market anticipates when they meet in early May, further declines can be expected. The market has also responded to increasing concerns about a potential recession caused by a combination of increasing rates slowing the economy down too much and inflation remaining high. Slow growth with high inflation is referred to as stagflation.

S&P 500 Sector Highlights & Commentary

Best Performing Sectors		Worst Performing Sectors	
Consumer Staples	6.32%	Communication Services	(13.46%)
Real Estate	3.70%	Financials	(9.71%)
Utilities	0.87%	Information Technology	(7.22%)

- Since the start of April, investors have become more defensive, favoring sectors like utilities and consumer staples, while continuing to move out of growth and into value. Companies in these two sectors tend to be less volatile and pay a strong dividend, so they tend to be the preferred part of the market for investors during uncertain times. Consumers are less likely to change their consumption of goods and services produced by consumer staple and utility companies even when consumer sentiment is down. Real estate tends to be a more cyclical sector but did well in April.

- Information technology and communication services have been the worst-performing sectors in 2022 so far due to the rotation out of growth stocks and into value stocks. This rotation has occurred largely because of rising interest rates that cause the valuation of companies in these sectors to fall. The communication services sector was especially hard hit after Netflix's earnings reports were released. The stock price plummeted and caused a ripple effect throughout the sector with other streaming and social media stocks trailing behind. These two sectors make up most of the NASDAQ, but the largest components of the index like Apple, Microsoft, Google, Amazon, and Facebook are set to report and should provide more clarity one way or the other.

- Financials have struggled since hitting all-time highs in early January. Going into early January, the sector was expected to perform well because of a steadily rising interest rate environment. However, due to the Fed's move to being increasingly aggressive and moving ahead with a strong tightening cycle, financials have struggled. The sector tends to struggle when the Fed is tightening, and the yield curve is flattening.

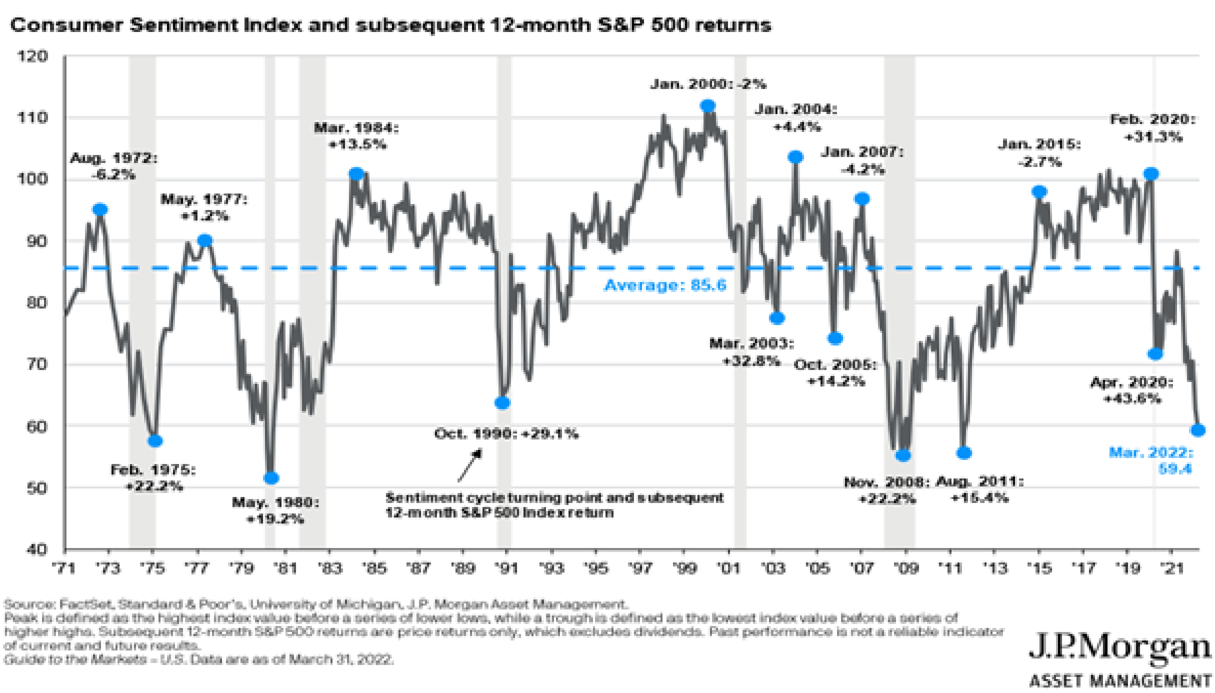
What to Watch in May

- Russia celebrates its victory in World War II on May 9th, which the markets will be watching closely, as it is possible that Russia will officially declare war on Ukraine on this date.

- On May 11, CPI data will be released for the month of April and could give investors an idea of the direction inflation is going.

In Summary...

Markets across the globe have struggled to produce any returns so far this year. Outside of energy and materials, nearly everything is in the red year to date and given the current financial, geopolitical, and economic conditions, more turbulence ahead would not come as a surprise. However, there is good news.



In the graph above, the returns from the lows of consumer sentiment are displayed. While there is no guarantee that sentiment will increase, we certainly are in the range of a consumer sentiment bottom based on historical readings (JPM). Additionally, stocks tend to perform well in the months following a yield curve inversion. The chart below suggests that there could be more returns ahead. (LPL)

Yield Curve Inversions Can Be Bullish For Stocks

2 Year/10 Year Yield Curve Inversions

Date of Inversion	Bull Market Peak Date	S&P 500 Index Return	Months Till Bull Market Peak
12/13/1988	7/16/1990	33.2%	19.1
5/26/1998	3/24/2000	39.6%	22.0
12/27/2005	10/9/2007	24.6%	21.4
8/27/2019	2/19/2020	18.0%	5.8
	Average	28.8%	17.7
	Median	28.9%	20.2

Finally, there are some indicators that inflation could be near its peak. Used car prices, which have been a major driver of increased inflation, have started to come down from their highest levels a few months ago. The backlogs at major ports on the coasts have also started to clear, which could help ease inflation as supply can normalize to meet demand (LPL). It is also important to maintain a long-term mindset even in times of volatility. As investors, it can be hard to look at the markets and stay positive, but over long periods of time, the stock market tends to rise, meaning times like this can provide good opportunities to buy.

Sources

Consumer Price Index-March 2022 (bls.gov)

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