Inflation, the Fed, Correction; Oh My!

February 2022

Market Recap

2022 started with a thud and plenty of market moving headlines. Omicron, inflation and the Federal Reserve, among other topics, weighed on the minds of investors. Most major indexes sold off with some crossing into a technical correction. Additionally, fixed income markets pulled back over the period as investors weighed new information from the Fed. Value stocks took a strong lead ahead of their growth counterparts to start the year. Such a pullback is not uncommon in equity markets. Since 1980, the median intra year draw down in the S&P 500 is 9.3 percent, yet the median annual return is 13.6 percent.

Index	YTD Return (%)	Return from Recent High	2021 Return (%)	5 Year Return (% annualized)
S&P 500	-5.2%	-5.9%	28.7%	16.8%
NASDAQ	-9.0%	-11.3%	22.2%	21.6%
Russell 1000 Value	-2.3%	-3.9%	25.2%	10.5%
Russell 1000 Growth	-8.6%	-9.8%	27.6%	22.3%
Russell 2000 Value	-5.8%	-11.3%	28.3%	7.9%
Russell 2000	-9.6%	-17.0%	14.8%	9.7%
Russell 2000 Growth	-13.4%	-24.5%	2.8%	10.9%
MSCI EAFE Value	2.3%	-4.5%	18.7%	5.3%
MSCI EAFE	-3.6%	-7.6%	19.2%	8.0%
MSCI EAFE Growth	-9.3%	-12.9%	19.4%	10.5%
MSCI EM Value	-0.6%	-9.5%	7.1%	7.4%
MSCI EM	-1.8%	-16.4%	0.1%	9.6%
MSCI EM Growth	-2.8%	-23.4%	-6.1%	11.7%

Source: FactSet as of January 31, 2022

Since 1980 the median intra year draw down on the S&P 500 is 9.3 percent[2]. What we have observed in January of 2022 is not atypical and is in line with our expectations of rising volatility and historical norms seen in markets.

Inflation is on the minds of many investors, which came to the forefront as the Consumer Price Index (CPI) rose 7.1 percent over 2021, the strongest growth since the 1980s.[1] The index was materially influenced by energy prices. Energy as a whole rose by nearly 30 percent and motor fuel was a primary contributor, up nearly 50 percent during the same time.[2] In periods of rising inflation, capital intensive businesses with real (not accounting) assets on the balance sheet tend to perform better than businesses with intangible assets. The January pullback in intangible and technology-oriented companies fits this historical pattern as investors look to reconcile both higher valuations and rising inflation.

[1] *WSJ: Where Inflation Rose in 2021 in Seven Charts*
[2] *U.S. Bureau of Labor Statistics*

See page 5 for full list of disclosures.

CPI Reaching Levels Not Seen Since the 1980s

Sources: U.S. Bureau of Labor Statistics, Federal Reserve

Sector	Weight in S&P 500	January Return (%)	3 Month Return(%)
Information Technology	28.3%	-6.9%	0.5%
Health Care	12.8%	-6.8%	-1.4%
Consumer Discretionary	12.6%	-9.7%	-8.1%
Financials	10.9%	0.1%	-2.5%
Communication Services	10.2%	-6.2%	-8.8%
Industrials	7.8%	-4.7%	-3.2%
Consumer Staples	6.6%	-1.4%	7.6%
Energy	3.3%	19.1%	16.5%
Real Estate	2.6%	-8.5%	0.0%
Materials	2.5%	-6.8%	-0.3%
Utilities	2.4%	-3.3%	4.3%

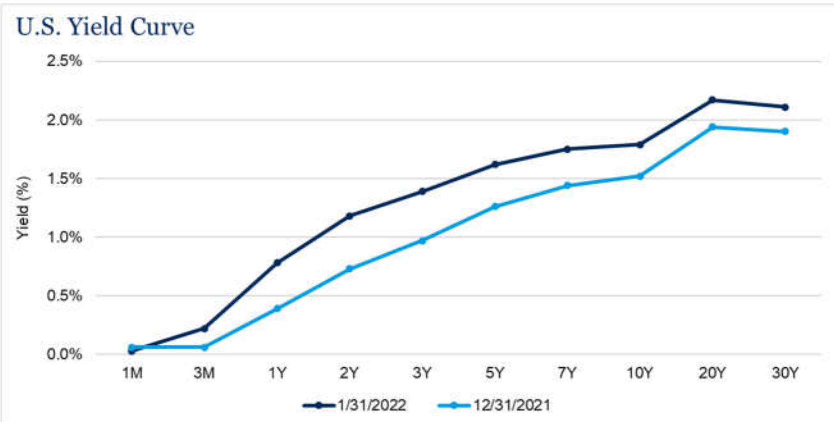
Source: FactSet as of January 31, 2022

As a result of higher inflation, the Fed has been under pressure to stabilize prices. On January 26, the Federal Open Markets Committee (FOMC) announced they will hold interest rates at their current level (0 - 0.25 percent) but signaled it would "soon" look to increase rates to combat higher prices. Many Fed watchers interpret "soon" as March 2022. The Fed will continue to reduce its bond buying program and indicated it will seek to shrink its balance sheet (quantitative tightening, the opposite of quantitative easing better known as QE) only after it has begun to increase the Fed Funds rate. Fed Chair Jerome Powell noted "…I think there's quite a bit of room to raise interest rates without threatening the labor market."[3]

Indices cannot be invested in directly. Index performance is reported gross of fees and expenses and assumes the reinvestment of dividends and capital gains. Past performance does not indicate future performance and there is a possibility of a loss. See disclosure page for indices representing each asset class.

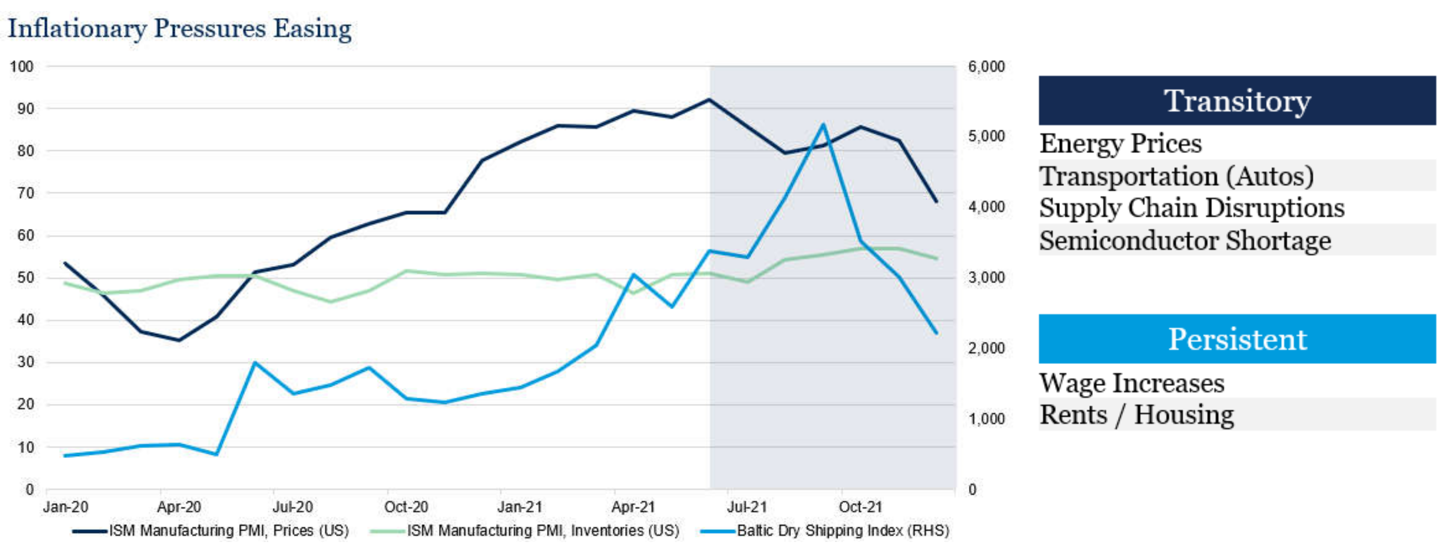
[3] *Fortune*

Fixed income investors took note of the Federal Reserve's recent actions. As a result, interest rates moved higher during the month. The U.S. yield curve flattened as the U.S. 10-Year Treasury Yield ended the month at 1.79 percent, 27 basis points higher. Credit spreads widened in January as well, with investment grade and high yield credit spreads gaining 14 and 59 basis points, respectively. The higher move in interest rates, coupled with widening credit spreads, pushed bond prices lower. The broad fixed income market, as measured by the Bloomberg U.S. Aggregate Bond Index, returned -2.2 percent in January – the worst start to a calendar year since 1980.



Source: FactSet as of January 31, 2022

Inflation – While CPI figures in January were eyebrow-raising and may persist longer than some would prefer we believe they are unsustainable. A combination of cooling in the red-hot energy market, easing shortages of semiconductors and used car prices and unkinking of the global supply chain can help moderate headline figures. Early signs of easing can be seen below in the ISM manufacturing data and the Baltic Dry Shipping Index, which moderated from highs in 2021. With that said, we do not anticipate inflation dropping to the one to two percent range we have seen over the past two decades. We fully anticipate a more robust inflation environment in the coming years at three percent plus and believe portfolios should be positioned accordingly.



Source: FactSet as of January 31, 2022

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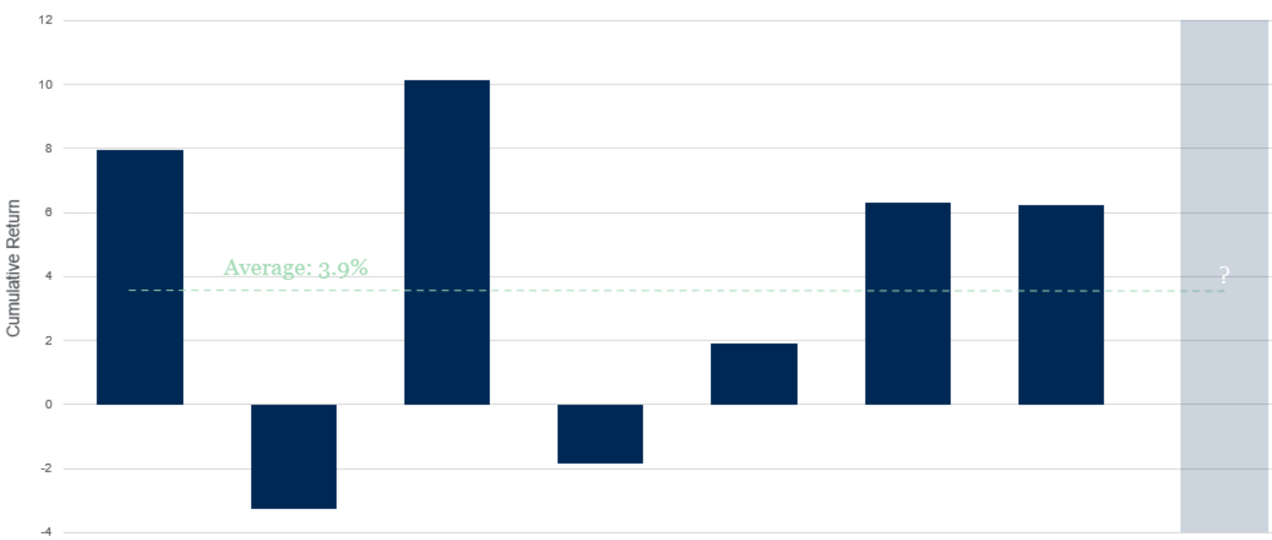
The Fed & Interest Rates – As depicted in the chart below, the Federal Reserve initiated seven cycles of rate increases since April 1983 and the average return of the Bloomberg U.S. Aggregate Index over those time periods was 3.9 percent. However, the average starting yield to worst (YTW) of the index across those periods was 6.7 percent. As of January 31, 2022, the Bloomberg Barclays Aggregate YTW was 2.1 percent.[4]

This indicates two things:

1. We believe the death of bonds is likely overstated. They can still play a critical role in portfolio diversification to control volatility.
2. Investors should consider their current exposures carefully. Extended interest rate risk, low current yields and less accommodative monetary policies may reveal risks that were previously nascent or perhaps unknown within fixed income.

Bloomberg U.S. Aggregate During Rate Hiking Cycles

On average bonds have weathered previous rate cycles with positive performance. However, previous rate cycles had the benefit of much higher starting yields.



	4/1/83 – 7/31/84	1/1/87 – 9/30/87	4/1/88 – 5/31/89	2/4/94 – 2/1/95	6/30/99 – 5/16/00	6/30/04 – 6/29/06	12/16/15 – 12/20/18	?
Increase in the Federal Funds Rate (%)	3.00	1.44	3.31	3.00	1.75	4.25	2.25	?
Starting Yield-to-Worst (%)	10.88	7.75	8.76	5.62	6.55	4.64	2.59	?

Sources: Capital Group, Bloomberg Index Services Ltd., Morningstar, as of October 31, 2021. Daily results for the index are not available prior to 1994. For those earlier periods, returns were calculated from the closest month-end to the day of the first hike through the closest month-end day of the final hike. Starting Yield to Worst sourced from FactSet and is taken from the start of the month in period displayed.

For more information, please reach out to any of the professionals at MPS LORIA Financial Planners, LLC.

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[4] *FactSet, as of January 31, 2022*

Comparisons to any indices referenced herein are for illustrative purposes only and are not meant to imply that actual returns or volatility will be similar to the indices. Indices cannot be invested in directly. Unmanaged index returns assume reinvestment of any and all distributions and do not reflect our fees or expenses.

- ***Consumer Price Index*** *is a measure of prices paid by consumers for a market basket of consumer goods and services. The yearly (or monthly) growth rates represent the inflation rate.*
- ***Bloomberg U.S. Aggregate Index*** *covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities.*
- ***The S&P 500*** *is a capitalization-weighted index designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.*
- ***The NASDAQ*** *is a broad-based capitalization-weighted index of stocks in all three NASDAQ tiers: Global Select, Global Market and Capital Market.*
- ***Russell 1000 Growth*** *measures the performance of those Russell 1000 companies with higher P/B ratios and higher forecasted growth values.*
- ***Russell 1000 Value*** *measures the performance of those Russell 1000 companies with lower P/B ratios and lower forecasted growth values.*
- ***Russell 2000*** *consists of the 2,000 smallest U.S. companies in the Russell 3000 index.*
- ***Russell 2000 Growth*** *measures the performance of the Russell 2000 companies with higher P/B ratios and higher forecasted growth values.*
- ***Russell 2000 Value*** *measures the performance of those Russell 2000 companies with lower P/B ratios and lower forecasted growth values.*
- ***MSCI EAFE*** *is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the U.S. and Canada. The index covers approximately 85% of the free float-adjusted market capitalization in each country.*
- ***MSCI EAFE Value*** *captures large and mid-cap securities exhibiting overall value style characteristics across Developed Markets countries around the world, excluding the U.S. and Canada. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI EAFE Index.*
- ***MSCI EAFE Growth*** *captures large and mid-cap securities exhibiting overall growth style characteristics across Developed Markets countries around the world, excluding the U.S. and Canada. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI EAFE Index.*
- ***MSCI Emerging Markets*** *captures large and mid-cap representation across Emerging Markets countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country.*
- ***MSCI Emerging Markets Value*** *captures large and mid-cap representation across Emerging Markets countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country. The value investment style characteristics for index construction are defined using three variables: book value to price, 12-month forward earnings to price and dividend yield. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI Emerging Markets Index.*
- ***MSCI Emerging Markets Growth*** *captures large and mid-cap representation across Emerging Markets countries. The index covers approximately 85% of the free-float adjusted market capitalization in each country. The growth investment style characteristics for index construction are defined using five variables: long-term forward EPS growth rate, short-term forward EPS growth rate, current internal growth rate and long-term historical EPS growth trend and long-term historical sales per share growth trend. The index targets 50% coverage of the free float-adjusted market capitalization of the MSCI Emerging Markets Index.*
- ***Institute for Supply Management (ISM) Manufacturing Purchasing Managers' Index (PMI)*** *is a monthly measure of US economic activity based on surveys from US manufacturing firms; it is a composite index with equal weights to sub-indexes, including new orders, production, employment, supplier delivers and inventories.*
- ***Baltic Dry Shipping Index*** *measures the cost to ship various dry raw materials used in manufacturing, such as coal, iron ore and grains, based on average prices paid for various shipping routes.*