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Schultz Collins 1st Quarter 2022 Market Review and Commentary

All major stock indices fell in the 1st quarter of 2022. The market volatility stems primarily from the Russian invasion of Ukraine, continued concerns of COVID and the new Omicron variant and related global supply chain issues, persistent inflation, and the effect of rising interest rates. Despite lower deaths and overall COVID case numbers in the USA, Europe saw increased woes in both human devastation and a war, and disease related illness caused by a highly contagious variant. Emerging markets had a difficult quarter, and are down, both for the quarter and the year. Additionally, Russian stocks are no longer trading due to the invasion and global sanctions.

The aggregate global stock market, as measured by the MSCI All Country World Index, fell 5.26% over the quarter and ended the year up 7.74%. Much of the gains can be attributed to the performance of the US stock market, which now represents over 60% of the All Country World Index.

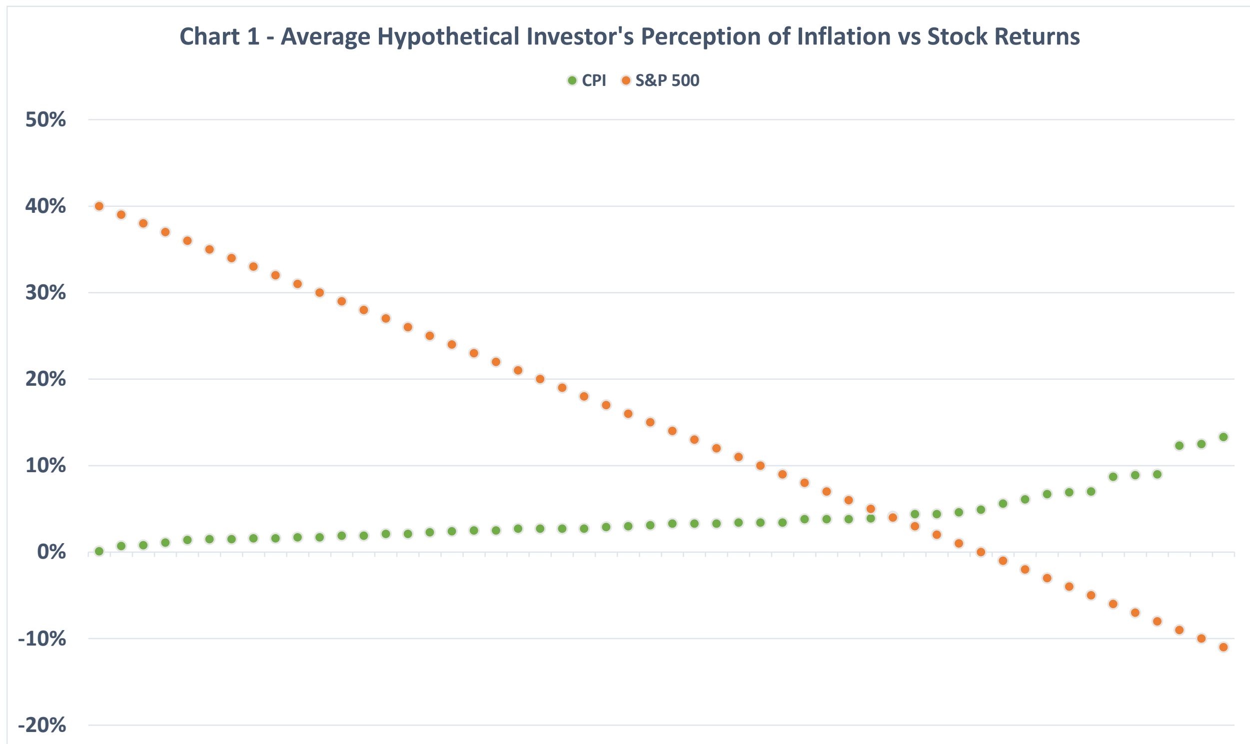
US large cap stocks, as proxied by the S&P 500 index, finished the 1st quarter with a return of negative 4.6%. However, the index is up 15.66% over the past 12 months. The Russell 2000 index of small US companies underperformed large companies, and fell 7.53%, and is down 5.79% over the past 12 months. US real estate, as benchmarked by the Dow Jones US Select Real Estate Investment Trust index, was down 3.71% for the quarter, and yet had a positive 27.75% return over 12 months.

International stock markets continued to lag US markets. The MSCI Europe, Australasia and Far East index of international developed stock markets is down 5.79% for the 1st quarter but up 1.65% for the trailing 12 months. International emerging markets, however, are down 6.92% for the quarter and down 11.08% for the last 12 months.

The first quarter of 2022 was a difficult one for bond holders. The Fed raised interest rates by 0.25% in mid-March and signaled it may do so again in the coming 2022 meetings. The aggregate of US government and corporate bonds was down 5.93% quarter and down 4.15% for the trailing 12 months. The intermediate-term corporate portion of the US bond market was down 5.25% for the quarter and down 4.1% for the year. Global bonds were also down; The FTSE World Government Bond Index ended the quarter down 6.46% and down 7.75% for the year. The yield on the 10-year treasury rose 80 basis points from year-end to 2.32%.

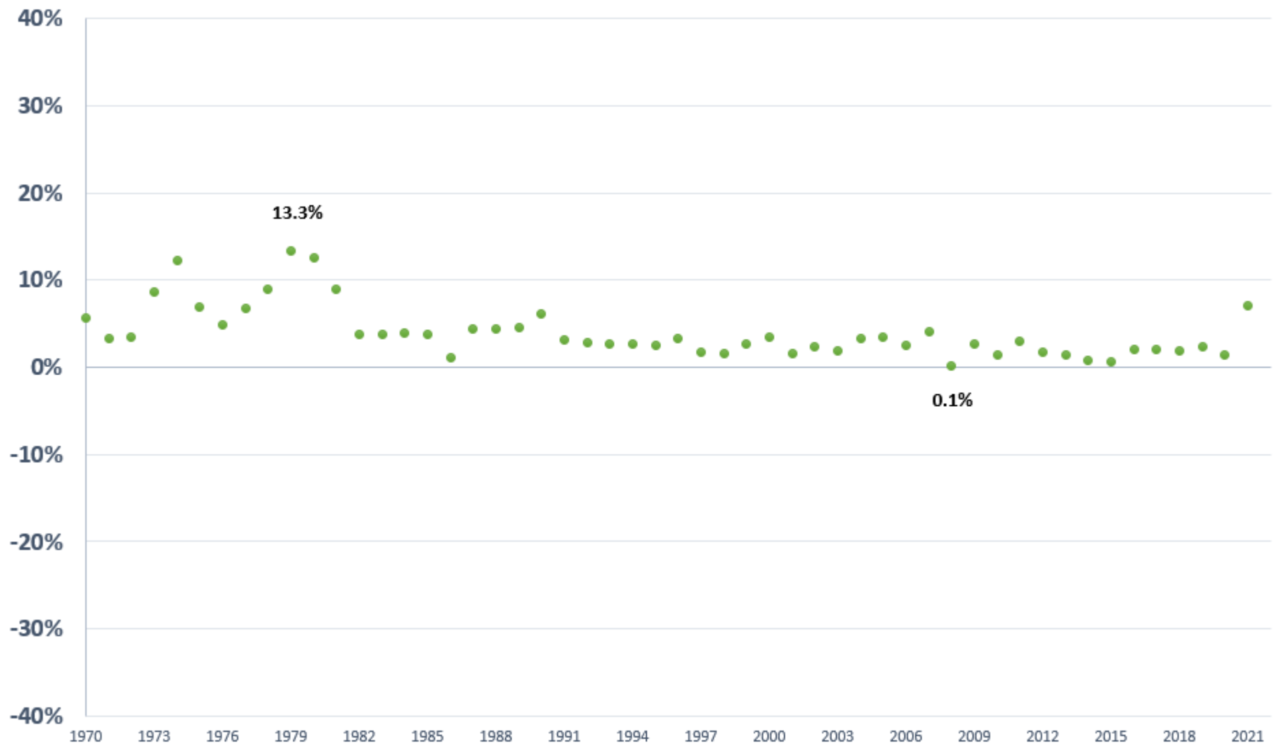
Over the last year, the signs of inflation have gradually surrounded us. Consumer concerns have become elevated as it’s more difficult to purchase the same amount of goods with the same dollar. It is only natural for investors to extend those concerns to their investments in the stock market.

Chart 1



As seen in Chart 1, some investors fear that rising rates of inflation correlate to gradually lower or negative stock returns. But what does the historical data tell us? Will higher inflation necessarily translate to lower stock returns?

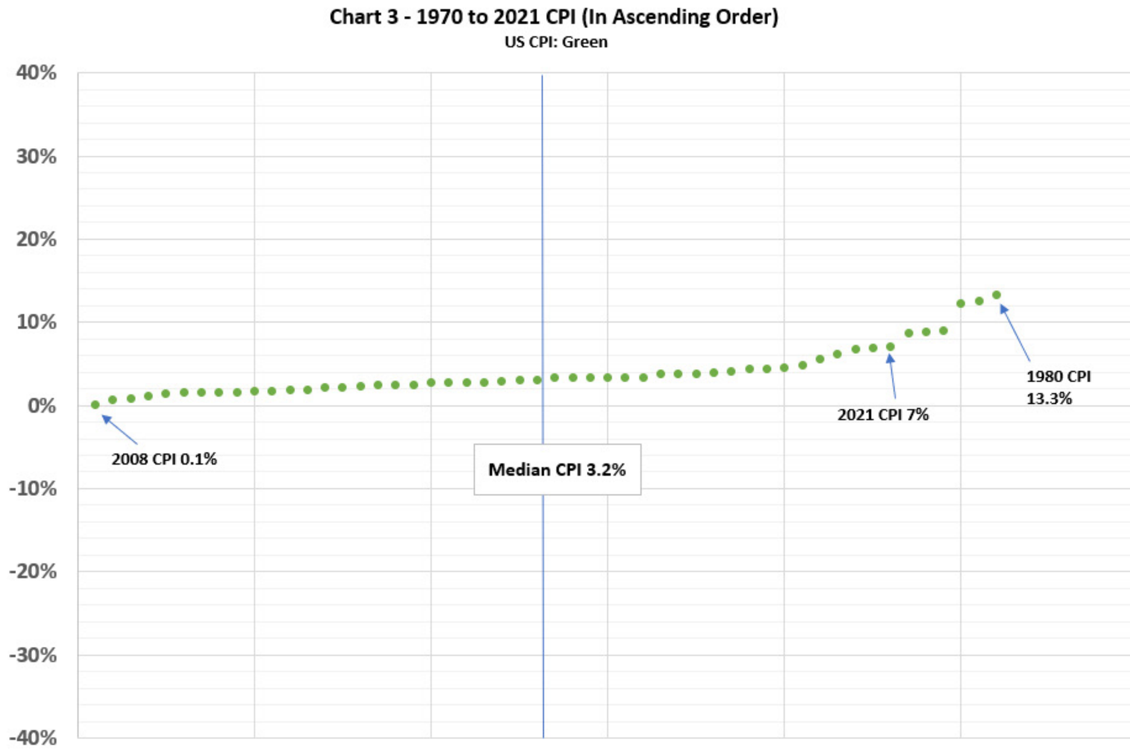
Chart 2[1]



In Chart 2, we see the rate of inflation from 1970 to 2021. During this period, inflation was as high as 13.3% in 1979 and almost 0% during the financial crisis in 2008. If stock returns have a negative correlation to inflation, then we should see a pattern of gradually lower stock returns as inflation increases.

[1] Source: Bureau of Labor Statistics

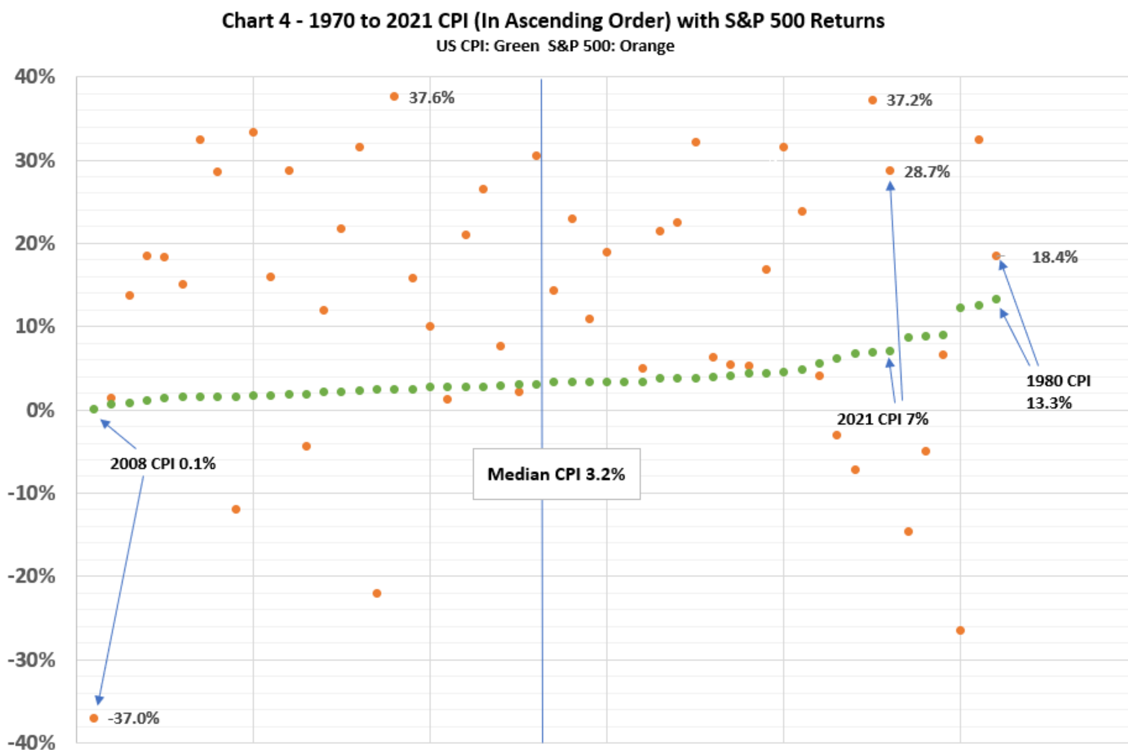
Chart 3[2]



In Chart 3, we have reorganized the inflation data from the lowest inflation rate in 2008 on the left, to the highest rate of inflation in 1979 on the right.

[2] Source: Bureau of Labor Statistics

Chart 4[3]



In Chart 4, we have inserted the yearly nominal return for the S&P 500. Again, if stocks respond negatively to rising rates of inflation, then we should be able to identify a pattern of gradually *decreasing* stock returns as the rate of inflation increases.

Do you see that pattern? Did you notice that the two best performing years occurred when inflation was below *and* above the median rate of inflation? Our interpretation of the data is that there is no obvious connection between stock returns and inflation. More specifically, we don't see any obvious trend in stock returns as inflation rates increase or decrease. This is a somewhat simple analysis, but the conclusion expressed here is consistent with recent research on the subject and we are happy to provide that to you, upon request. [4]

Conclusion: Yes, inflation causes an increase in our costs, thereby stressing our budgets; however, we have some good news: Inflation isn't necessarily bad news for stocks.
Data on nominal stock returns and inflation does not appear to show a reliable relationship.

As always, if you have questions about this information or any other subjects, please feel free to contact us at 415-291-3000.

[3] Source: CPI data from Bureau of Labor Statistics; S&P 500 returns from DFA Advisors Web 2.0
4 *Inflation and Global Asset Returns* by Wei Dai and Mamdouh Medhat-July 2021

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