Daniel Wildermuth's
MARKET COMMENTARY

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Rough January and Likely More to Come

The S&P 500 rose the last day of January but the increase failed to raise markets enough to avoid their worst monthly performance since the COVID induced crash of 2020. The US Federal Reserve's threat to increase interest rates, sooner and higher than originally expected, is the primary factor weighing on stocks. Throw in some geopolitical risk, particularly Russia and Ukraine, and the market's nervousness is fairly predictable.

European markets have also struggled although not as much as the US while emerging markets are barely in the red for the year. Different market performance likely results from different expectations of policy of the world's central banks.

The Federal Reserve said it would begin steadily raising rates in mid-March and raised the possibility of raising rates in consecutive policy meetings which are held roughly every six weeks. Bank of America predicts seven rate hikes this year. The Fed's actions contrast with the Bank of Japan which will likely keep its policy exceptionally loose for years. China is actually expanding its stimulus. We could see very different performance of global stock markets in 2022.

Declines are not due to recent economic growth. The U.S. economy grew rapidly in the fourth quarter of last year, advancing at a 6.9% annual rate, capping the strongest year of growth in nearly four decades as the country rebounded quickly from the pandemic-induced recession.

But new obstacles could lead to much more modest growth this year. While growth was triple third quarter's, much of the increase was early in the quarter and resulted from companies replenishing depleted inventories. Valuations, despite the recent decline in stocks, also remain high.

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Another headwind remains inflation. Wall Street's summer forecast calls for $100 for a barrel of oil, a price not seen since the summer of 2014, before OPEC launched a price war with U.S. shale producers. After a dismal 2020, oil prices gained 50% last year and are up nearly 20% this year, sitting at over $91 a barrel. Of course, the price of oil is normally a significant inflation contributor.

It appears that fear of higher rates and inflation is causing investors to reprice risk. The Nasdaq CTA Internet Index, which is filled with companies aiming to deliver sharp profit growth in the future, has fallen 18% from Sept. 30 through mid-January. The Nasdaq Composite, heavy in tech, gained 0.4% for the same time frame, while the S&P 500 added 6.3%. Moonshot stocks are coming back to Earth.

While the market remains expensive, opportunities appear to exist. Value shares overall are 50% cheaper than growth peers, double the discount seen before past rate rises. European markets are currently priced at about a 27% discount to Wall Street which compares quite favorably to an average 15% discount before the previous three Fed cycles. Europe is also delivering more positive economic data surprises and upward earnings revisions than the US.

The combination of ongoing inflation, tight labor markets, and a tighter money supply all pose headwinds for companies. The market could bounce back quickly and continue forward as in the past, however today's challenges suggest more of a lasting shift. It is likely that investors may need to brace themselves for more turbulent times ahead.

At Asteria, we remain steadfast in our valuation discipline and have avoided the high-flying stocks that trade at inflated valuations, which have been experiencing steep declines in recent weeks as tighter policy expectations bring a renewed focus on fundamental discounted cash flow analysis/valuation. We anticipate that higher volatility, as compared to the past several years, will create opportunities for active strategies to outperform passive benchmarks via active sector/industry exposure weights and security selection.