MONTHLY MARKET UPDATE
February 2022

OPAL WEALTH ADVISORS

February followed up a challenging January with one of the most volatile months since 2008 across both stock and bond markets driven by a surge in geopolitical risks and continued angst surrounding the inflation/monetary policy debate. The month began with a series of highly publicized anti-public health mandate protests and ended with massive government sanctions against Russia as the U.S. and most other global economies resorted to financial and economic weaponry in lieu of military combat. The Russia invasion of Ukraine on February 24th resulted in surging commodity markets and a spike in volatility across equity markets, interest rates, and currencies. Meanwhile, the Federal Reserve remained steadfast on its policy position that inflation fighting is the prerogative with an end to crisis era levels of interest rates and balance sheet reduction as the primary tools.

Fourth quarter U.S. corporate earnings, reported during February, were very strong with year over year growth coming in over 30% while overall economic conditions remained very healthy. Most economic survey data (services and manufacturing activity) were beginning to slow slightly toward month end but remained very much at expansionary levels. A robust labor market recovery left U.S. unemployment at 3.8% in February, just above the pre-pandemic record low, and Europe at 6.8%, an all-time low reading. The economic recovery is pressing forward in large part due to continued favorable trends in Covid-19 data, emboldening a normalization across both public health policy and consumer behaviors.

Global equity markets generated mixed results with the S&P 500 -3%, U.S. small caps +1%, developed international -1.8%, and emerging markets -2.4%. Growth stocks again underperformed value stocks with heavier underlying exposure in U.S. markets to technology (-5%), consumer (-4%), and communications (-7%) explaining a good deal of U.S. underperformance in February and year to date relative to international markets. January and February have stacked up as one of the worst starts for growth stocks on record. Of course, energy stocks were the only sector to finish February with gains thanks to geopolitical stresses and their impact on end market supply.

The bond market continued to endure headwinds of rising interest rates with 10-year yields (+4bps) moving slightly higher but 2 year yields (+26bps) surging on increasing Fed rate hike expectations. The Bloomberg Global Aggregate Index (-3.2% YTD) posted a seventh consecutive monthly loss which is the longest such streak on record dating back to 1990. Commodity markets enjoyed broad based gains with WTI crude +8.6%, gasoline +9.5%, grains +8.9%, industrial metals +6.4%, and gold +5.8% while the USD ended the month with a slight gain.

Market Anecdotes

- It has been a pretty volatile start to 2022 with an average intraday S&P 500 trading range of +/- 2%, the widest since 2009 and before that, 2008. It's been the second worst start to the year since 1983, trailing only the GFC in 2009.
- Fourth quarter earnings season marched on with blended S&P 500 top and bottom-line growth of 15.3% and 30.3% respectively. Forward guidance has been a key focus of markets this quarter with the majority of companies guiding downward looking into 2022.
- Russia and Ukraine account for 29% of global wheat exports and the former for over 10% of global crude oil production and while high commodity prices by themselves don't make a recession inevitable, large price surges have preceded three prior recessions.
- The monthly OPEC meeting, which lasted only ten minutes, resulted in no announced changes to production quotas leaving only a small output rise of 400,000bpd scheduled for April while the IEA announced a 60-million-barrel release, 30mm of which will come from U.S. reserves.
- Tightening financial conditions, dramatic commodity price increases, and the associated economic risks have policy makers on edge. However, the BoC moved forward with their 25bps

hike and markets still anticipate 25bps from the FOMC in March.

- BCA (and ample economic research) make a compelling argument that, given the material change in the Fed's reaction function, the 3m/10yr is a far better predictor of recession.
- Strategas notes that in times of extreme policy uncertainty, forward looking returns in the 3mo, 6mo, and 1yr that follow are, on average, 6.9%, 12.6%, and 23.1%, respectively.
- While rental and housing prices have garnered a lot of attention in the inflation debate, energy has been the biggest contributor to inflation every month since February 2021 and last month it added 1.71% to the 7.50% YoY rise in CPI with the geopolitical unrest set to add to the trend.
- After the acute phase of the Covid pan-demic, Car rental companies who aggressively liquidated inventory following the initial surge of Covid-19, have rebuilt fleets to a normal operating level, likely resulting in a diminishing tailwind for used car prices.
- Charlie Bilello notes the MSCI Russia ETF experienced a 16-sigma event when it fell 33% in one day. According to probability laws, this should not have happened even once in the history of the universe!

Economic Release Highlights

- The February jobs report was beyond the highest estimate and nearly doubled the consensus (678k v 390k) which dropped the unemployment rate to 3.8%. Average hourly earnings were flat MoM in February and at a 5.1% AR which fell short of the 5.8% expectation.
- Eurozone unemployment is at record lows with January's 6.8% reading logging the first sub 7% reading with data going back to 1998. Core EU inflation rose 2.2% annualized pace in February.
- The February UofM Consumer Sentiment declined much further than consensus expectations, falling to 61.7 from the prior month and February consensus of 67.2 and 67.5 respectively.
- February's Consumer Confidence survey registered 110.5, relatively in line with the consensus forecast of 110.0.
- February ISM Manufacturing and Service index readings showed mixed results with Manufacturing beating expectations (58.6 v 58.0) but Services lagging by a wide margin (56.5 v 60.9).
- Final Markit PMI data readings (C,M,S) for February across the U.S. (55.9, 57.3, 56.5), EU (55.5, 58.2, 55.5), and global (53.4, 53.6, 54.9) were all largely in line with expectations.
- The Personal Income and Outlays report showed strong Personal Consumption Expenditures of 1.5% real growth, well exceeding expectations and back in line with long term trend growth.
- Headline and core PCE inflation came in at 6.1% and 5.21%, respectively.
- New Homes Sales were in line with consensus, registering at an 801k annual rate versus 804k expected and the Case-Shiller Home Price Index registered a 1.1% MoM increase bringing the YTD appreciation to 18.6%, both within consensus range.

Positioning

While we continue to believe inflation data and corresponding central bank policy will be the primary drivers of global financial markets, the Russian invasion and associated commodity market impact carries material potential short-term economic implications. The situation remains fluid and highly uncertain but assuming things stay limited to Ukraine and the Black Sea area, we look to history as a guide to navigating geopolitical volatility and to the constructive global economic backdrop, leading us to conclude this is a buy the dip opportunity once markets draw closer to capitulation. With commodities, the cure for high prices is high prices and supply responses will come. Russia-UE energy flows are a key risk to monitor with further deterioration likely but ultimately a recovery will ensue.

Monetary policy is expected to stay the course with rate hikes, albeit at a slightly slower pace than markets anticipated in early February and both real and nominal rates are expected to remain highly accommodative for the foreseeable future. Financial market volatility implicitly tightens overall financial conditions creating some space to avert a hawkish policy mistake.

Encouraging corporate earnings, a fading global pandemic and healthy economic growth have us maintaining a moderately constructive twelve-month outlook on equity markets, relative to bond markets. Across equity markets we are favoring developed international, U.S. small cap, and value-oriented exposures with a sector/industry emphasis in financials, materials, and semiconductors. We expect rate sensitive (utilities, REITs) and high valuation pockets (select tech and shadow tech) to continue to face headwinds. Fixed income investors should maintain a modestly short duration and remain overweight credit sectors.

Equity	**Level**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
Dow Jones	33893	(2.16)	(2.38)	(6.43)	11.59	11.72
NASDAQ	13751	(0.05)	(11.09)	(12.01)	4.92	23.25
S&P 500	4374	(1.16)	(4.45)	(8.01)	16.39	18.24
Russell 1000 Growth		(1.37)	(10.39)	(12.47)	12.55	23.18
Russell 1000 Value		(0.02)	0.59	(3.46)	14.99	12.22
Russell 2000		4.15	(8.55)	(8.66)	(6.01)	10.50
Russell 3000		(0.42)	(5.48)	(8.25)	12.29	17.56
MSCI EAFE		(0.83)	(3.14)	(6.50)	3.30	8.29
MSCI Emg Mkts		(1.58)	(3.82)	(4.81)	(10.40)	6.40
Fixed Income	**Δ Yield**	**1 Mo**	**3 Mo**	**YTD**	**1 Yr**	**3 Yr**
US Aggregate	1.80	(0.00)	(0.00)	0.03	(0.35)	(0.92)
High Yield	4.43	0.04	0.00	0.16	(0.67)	(1.14)
Municipal	1.75	(0.01)	(0.01)	0.04	(0.18)	(0.49)

Commodities	**2/28/22**	**12/31/21**	**9/30/21**	**6/30/21**
Oil (WTI)	119.26	75.33	75.22	73.52
Gold	1909.90	1805.90	1742.80	1763.20
Currencies	**2/28/22**	**12/31/21**	**9/30/21**	**6/30/21**
USD/Euro ($/€)	1.12	1.13	1.16	1.19
USD/GBP ($/£)	1.34	1.35	1.35	1.38
Yen/USD (¥/$)	115.11	115.17	111.50	111.05
Treasury Rates	**2/28/22**	**12/31/21**	**9/30/21**	**6/30/21**
3 Month	0.35	0.05	0.04	0.05
2 Year	1.44	0.73	0.28	0.25
5 Year	1.71	1.26	0.98	0.87
10 Year	1.83	1.52	1.52	1.45
30 Year	2.17	1.90	2.08	2.06

Style Returns

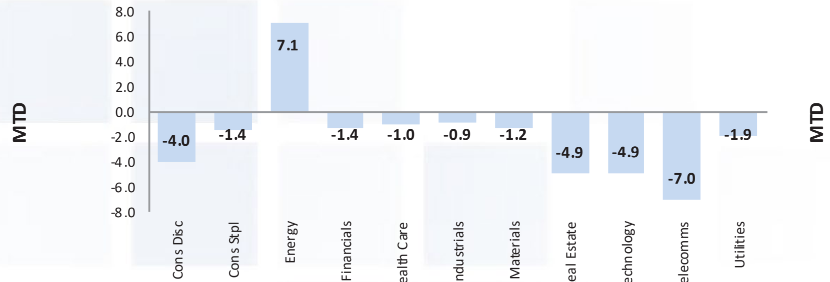
MTD

	V	B	G
L	-1.16	-2.74	-4.25
M	-0.47	-0.72	-1.21
S	1.65	1.07	0.44

YTD

	V	B	G
L	-3.46	-8.23	-12.47
M	-4.72	-8.03	-13.96
S	-4.27	-8.66	-13.03

S&P 500 Sector Returns



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