VWG WEALTH MANAGEMENT
A Hightower Company

VWG Wealth Management 2022 1st Quarter Review

Executive Summary

- The Russian invasion of Ukraine has upset the complex interconnected system between interest rates, commodities, currencies, and equities. This system was already searching for equilibrium in the wake of the COVID-19 pandemic before the aggression erupted. Even if the conflict can somehow be reasonably resolved, it is unlikely that the global economy, inflationary pressures, and the interplay of stock, bond, and commodity asset classes, will fully stabilize anytime soon.
- The outbreak of war led to swift, harsh sanctions and restrictions upon Russia who is a major exporter of energy, wheat, fertilizer, and other essential raw materials. Fears of supply shortages pushed already rising crude oil prices higher, hitting $130/barrel on March 7. The Eurozone's heavy reliance upon essential Russian supplies fanned fears, lifting natural gas prices 58%. The Chicago SRW Wheat continuous futures price spiked 30%.
- These events sparked further fears for persistently high inflation by central banks, economists and investors. The Federal Reserve ended its pandemic bond purchasing program, announced its first 0.25% Federal Funds rate increase, and signaled a future series of increases

and liquidity trimming measures. The Bloomberg Aggregate Bond Index lost 5.8%. Global short-term bond rates rose sharply.

- Equities also exhibited strains from spiking rates and war-related fears, but were relatively resilient considering the moves in bonds and commodities. The S&P 500 index suffered an 11% correction through March 14 but rebounded, trimming its quarterly loss to 4.6%.
- With the amount of uncertainty facing geopolitics and markets, VWG advises our clients to focus on the things we together can control: financial planning focusing on projected short-term and longer-term needs, widening the 'focus' on our long-term investment strategies and manager deployments, and maintaining appropriate levels of cash and safe liquid instruments to provide for unexpected emergencies.
- VWG's long-term investment recommended positioning remains unchanged. Equities continue to be a favored asset class. Also favored are select allocations (for appropriate clients) to private and idiosyncratic managers focusing on durable cash flows and capital appreciation. We maintain the underweight stance to conventional, longer-term bonds which we have held for most of the past 11 years.

Review of the Markets

It is mind boggling to try to grasp all that occurred in the world and key financial markets during the past quarter. The complex interplay between global stocks, bonds, and commodities – heavily influenced by financial conditions, future economic prospects, currencies, liquidity, and politics – was already searching for equilibrium in the wake of the COVID pandemic. The Russian invasion of the Ukraine then stunningly upset the mix.

Commodity markets displayed extreme stresses, which spread to bonds and stocks. Heightened fears of a conflict, along with projections of greater demand as the pandemic receded, pushed crude oil 22% higher in advance of the February 24 invasion. The outbreak of war, and potential for supply

restrictions, caused prices to spike further, hitting $130/barrel on March 7. Russia exports approximately 5% of the world's oil supply, more than half of which goes to Europe. For the quarter the NYMEX West Texas Intermediate Crude Oil continuous futures contract increased 33%.

Natural gas fared worse. Russia is the largest natural gas-exporting country in the world, with approximately 74% going to Europe. Despite Russia's assurances that supplies would not be interrupted, the NYMEX Henry Hub Natural Gas continuous futures contract rose 58% in the quarter.

Prices of grains and other agriculture-related commodities were severely shaken. Russia accounts for 19% of the global wheat export market. Ukraine accounts for 9%. The Chicago SRW Wheat continuous futures contract surged 30% higher in the quarter. Inflation stress and unsettled currency markets also led to gold buying. The NYMEX Gold continuous contract broke out to a 12-month high, rising 6.9% for the quarter.

Inflation fears had already been fanning the markets before the February 23 invasion of Ukraine. The energy spike, along with massive financial and trade sanctions imposed on Russia, pushed these fears into a full-blown bond market rout. For the quarter the yield of the 10-year U.S. Treasury note rose 0.81%, closing at 2.32%. The yield of the 2-year Treasury note spiked 1.56% to 2.29%. The Bloomberg Aggregate Bond Index fell 2.9% in March alone, its second worst monthly loss since December 1981. High yield and municipal bonds also suffered significant losses due to rising rates and widened credit spreads.

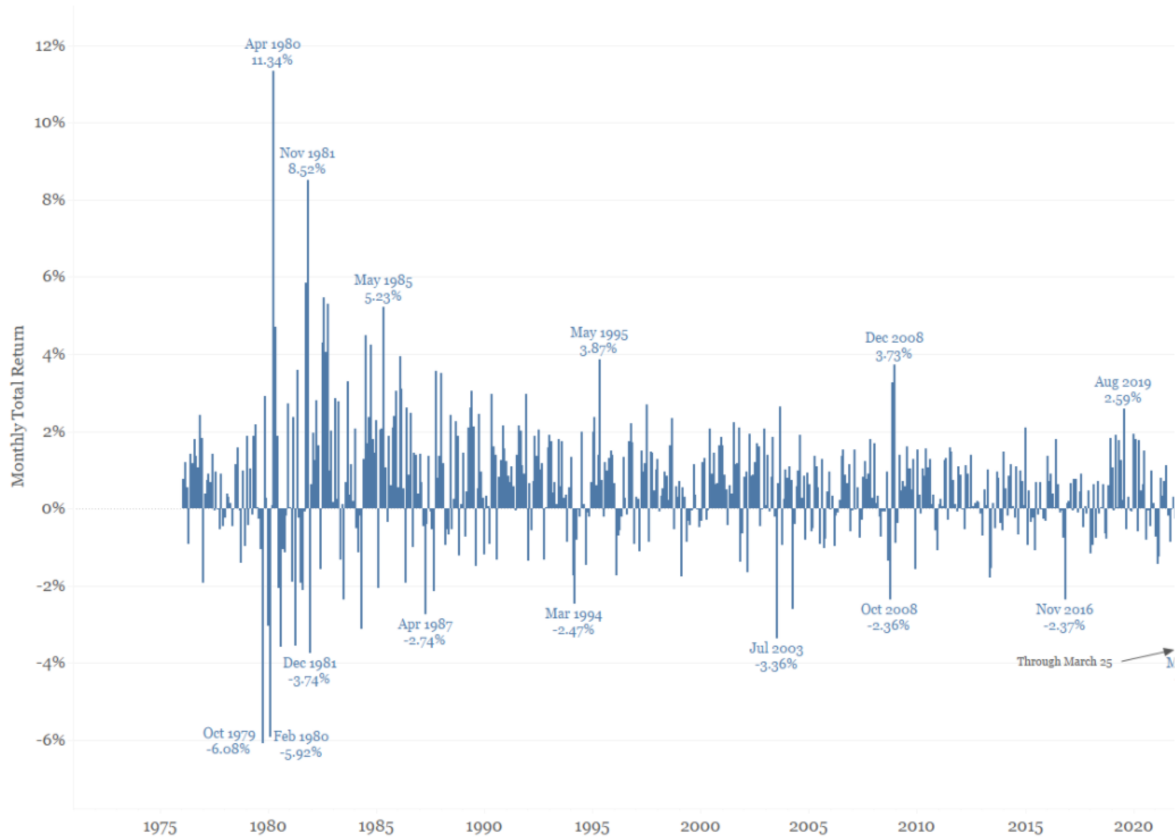


__Chart courtesy of Bianco Research, LLC__

U.S. bonds were not alone in the fixed income selloff. One-year global bond rates jumped 0.82% in the quarter, easily the largest ever recorded. Astoundingly, the total amount of global negative yielding debt plummeted to approximately $3 trillion. It had reached a record high of $18 trillion in December 2020.

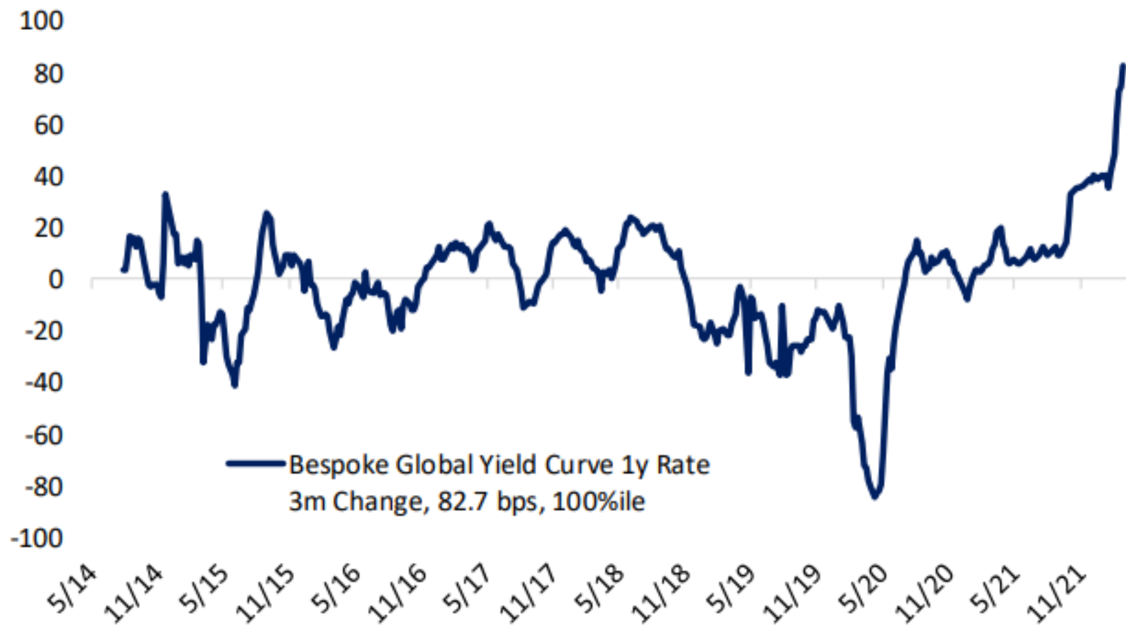


Chart courtesy of Bespoke Investment Group, LLC

Chart courtesy of Strategas Research Partners

In comparison to the fireworks seen in oil, grain and interest rate markets, equities were resilient. This was quite remarkable given the overall 'risk off' tone of the market, and the often-discussed relation of interest rates to equity multiples. The S&P 500 Index touched an all-time high on January 4, then quickly declined, correcting 11% by March 14. For the quarter, the U.S. large capitalization stock benchmark lost 4.6%. Small U.S. stocks fared worse, with the Russell 2000 Index falling 7.5%.

The MSCI EAFE Index, a benchmark for developed markets equities, declined 6.4%. Chinese stocks were one of the worst performing global equity regions, as the China Shenzhen A share index fell 16%. Attributed to these losses were a serious COVID-19 spikes and lockdowns in certain regions of the country, SEC compliance issues with U.S.-listed depositary receipts of certain Chinese companies, geopolitical concerns, and slowing economic growth as more actions were signaled to reign in large debt imbalances.

Challenging Economic and Market Crosscurrents

At the beginning of the year, most economists expected the U.S. and global economies to slow in the second half of the year. Concerns were growing that some levels of inflation might be structural and would not quickly fade away with the pandemic. Goldman Sachs and Piper Sandler commodity specialists, among a handful of others, projected structural tightness in energy markets that would lead to an increased trading band of crude oil in the $80-$100/barrel range.

This was all before geopolitical chaos ensued.

Russia's invasion of Ukraine has added immediate fuel to these concerns and created numerous others. Supplies of critical commodities, oil and natural gas are threatened. The importance of longer-term sovereign energy and food security has come into sharper focus. A swift series of sanctions, asset freezes and exclusions, threaten to significantly distance Russia from the global economy, with uncertain second- and third-order effects. The risks of a possible Eurozone recession have increased. Gavekal's Anatole Kaletsy reminds us that "all wars are inflationary. This war is uniquely dangerous because its inflationary impact has hit when the world economy is exiting the COVID pandemic, with inflationary pressures already at a generational high."

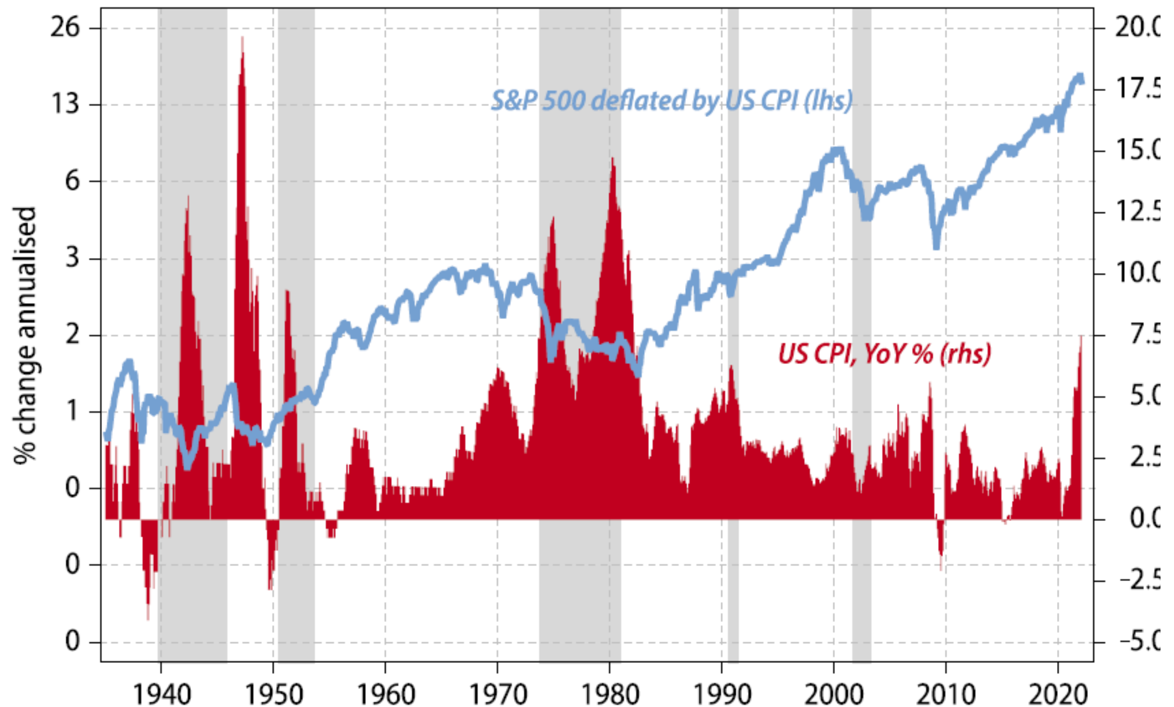


Chart courtesy of Gavekal Research

The Federal Reserve's actions to reduce liquidity are complicating the situation. As the bond purchase program ended in March, the Fed made its first Federal Funds rate increase since the onset of the pandemic.   They signaled six more 0.25% tightenings in 2022 and a further increase 2023. The Fed stated that they would be "open to raising rates faster if needed." In stark contrast, collective global central banks have already made 128 rate increases in the past 15 months. Great conjecture surrounds how massive Fed liquidity may have accentuated sharp price rises in goods, services and housing. It is questioned whether increased rates and other tightening measures will be able to quell supply-driven inflation. Chief Economist of MKM Partners Michael Darda states in a recent interview:

“We are concerned that it will be difficult for the Federal Reserve to pull off a fabled ‘soft landing’ because they’ve fallen so far behind the curve. The Fed has some real challenges ahead of it, and not just to get to neutral. They will need to get into a restrictive posture if they want to get inflation rates back down closer to targets. This will have business cycle implications, but not a 2022 event in my view.”

Piper Sandler’s Nancy Lazar poses an alternative view, with her research showing that global short-term interest rates are much more influential in driving U.S. economic activity than the Federal Funds rate. She believes that the already in-place steep backups in global short rates (see the preceding chart) should slow U.S. growth significantly, and along with higher oil prices help cool inflation. Because all interest rate swings have a 6 to 12 month lagged impact, it is possible that the Fed may not be as far ‘behind the curve’ as feared.

Portfolio Strategy and Asset Positioning

As difficult as it is to comprehend all that has occurred in the past three months, and the past two years, navigating the future appears truly daunting. The global economy and its geopolitics face an astounding set of challenges and changing interrelationships. ‘Normalcy’ feels like it could be an alien concept.

Many conflicting issues are certain to be in focus over the coming months and quarters, even if the Russia/Ukraine conflict is somehow resolved with some degree of clarity. The securing of essential supplies and commodities, and the supply chains that move them around the globe, have been disrupted. China’s recent COVID-19 spike and rolling lockdowns could add to this stress. Shortages in food and shelter could harm many people. Liquidity is being swiftly withdrawn from the monetary system by the Federal Reserve and other central banks. Global corporate profits and forward guidance will be

uneven. Linkages between assets, markets, currencies, and counterparties are under pressure. Unintended consequences are a real possibility.

In this demanding and unchartered environment, we are forced to focus on our core tenants:

- Planning to address our clients' short-term and long-term needs and goals must come first.
- Maintain a long-term investment focus, allocating to tenured managers and strategies focused on durable cash flows and long-term appreciation.
- Seek portfolio diversification within asset classes, strategies, liquidity, and perceived risks.
- Maintain an appropriate level of cash and short-term quality liquid bonds, providing for unexpected needs.

Within our portfolios, VWG is not changing our recommended positioning. Equities remain a favored asset class, and bonds remain underweighted. Investment returns and asset flows support this. We also remain steadfast in our commitment to seeking out and placing differentiated private strategies and structures.

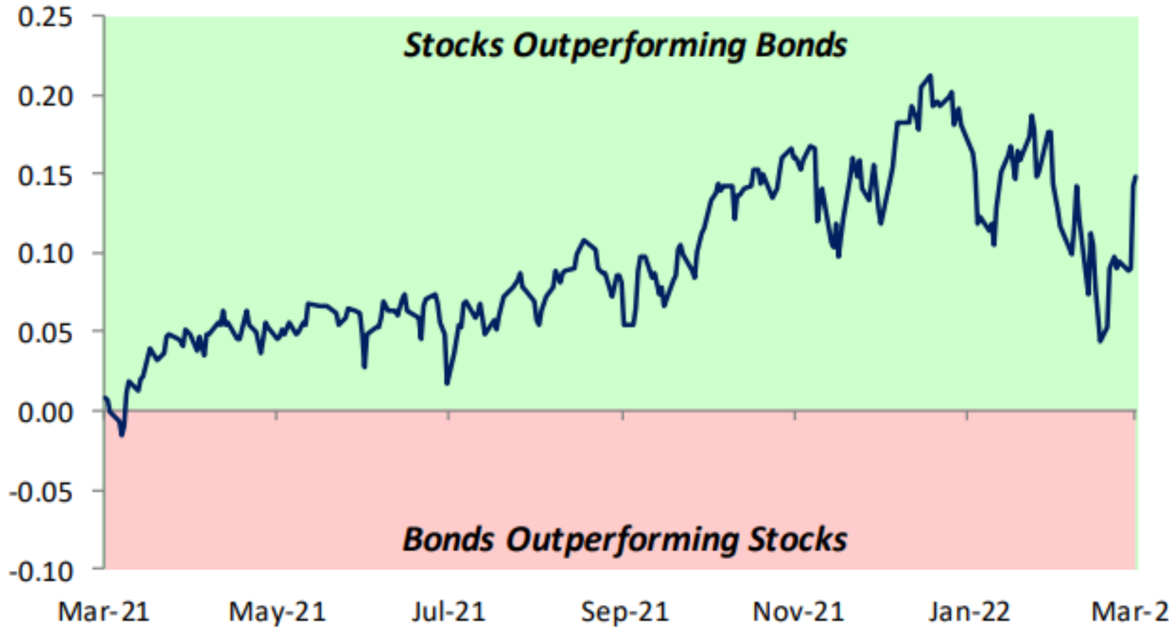
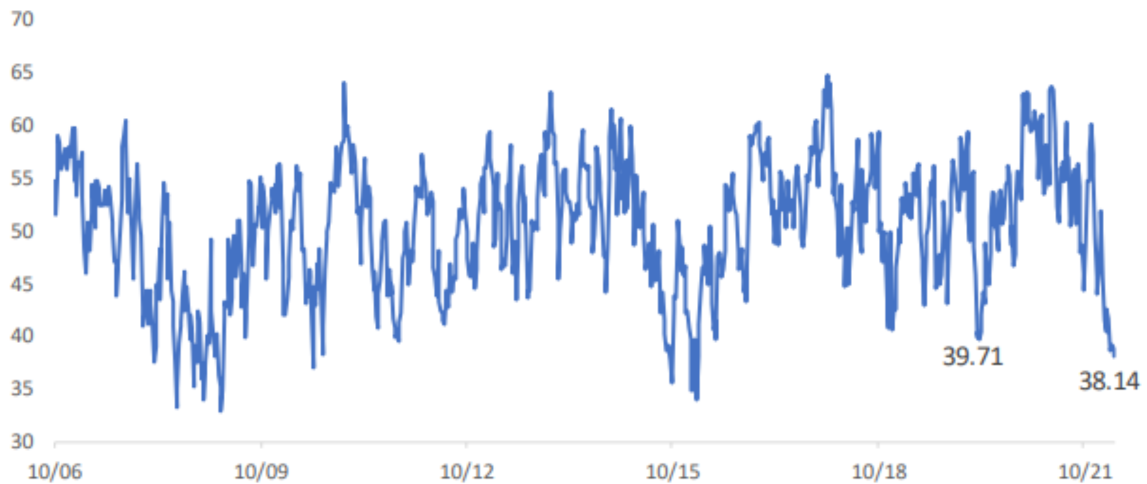


Chart courtesy of Bespoke Investment Group, LLC

Equities will surely face challenges on individual, sector, and geographic levels. But we firmly believe that many businesses and entrepreneurial operators will be able to manage through and even capitalize on an uncertain and quickly changing environment. No further proof of this is needed beyond U.S. industry's nimble response to the colossal COVID-19 pandemic shutdowns and disruptions experienced two years ago. Although expected to slow later this year, the U.S. economy is strong, and it has been resilient. The job market is extremely tight. Longer-term reshoring of mission-critical U.S. manufacturing will ultimately boost productivity.

We are further reminded to watch investor sentiment. February sentiment toward equities, shown in the chart below, reached one of its most negative readings observed in the past 15 years. It is obvious that this helped to fuel the S&P 500's quick 8% bounce from March 14 to the end of the quarter.

Net Bullish Sentiment: Last 15 Years*



*Composite of sentiment from AAII, II, and NAAIM surveys.

Chart courtesy of Bespoke Investment Group, LLC

VWG has held little appetite for longer-term bonds for most of the past 10 years, as central banks bounced in and out of quantitative easing and 'near-zero' rate policies. That was before the inflation in the prices of goods and services emerged. The global negative yielding debt chart depicts that it is possible that the asset 'bubble' so many have been looking for has been in bonds.

At opportune moments, some investors may choose to increase holdings of cash. Maintaining focus on one's individual financial plan, and their commitment to long-term investments, is critical for success. VWG will communicate to you if our outlook changes, and if any actions are necessary. Please reach out to us with your questions. We need to know if anything significant in your financial situation has changed or is expected to change soon.

The VWG team joins our clients in heavy hearts and prayers sent out to so many individuals and families suffering from the despair, pain and loss caused by the Ukraine war. We encourage all to take actions to help with relief efforts. This could be in the form of writing a note of support to an affected

family, or by making a contribution to an organization working for humanitarian relief and recovery.

As spring and warmer weather arrives, we hope you will be spending fun times with friends and family, and perhaps picking up some neglected travel plans. We look forward to speaking with you soon!

Regards,

VWG Wealth Management

Suzanne, Ashley, Rashmi, Kay, Brandi, Lynette, Ona, Michelle, Ryan B., Ryan T., Ryan V., Susan, Marnie, Justin, Elana, Patricia, John, Rick and Jeff

Who we are

Please reach out to us if you have any questions or comments.

VWG Wealth Management

(571) 406-4700
vwg@hightoweradvisors.com

** Index Data and Charts Sourced from FactSet Research, Morningstar, CBC News, Bloomberg, Strategas Research Partners, Federal Reserve Bank of St.Louis.*

Disclosures

VWG Wealth Management, A Hightower Company is a team of investment professionals registered with Hightower Securities, LLC, member FINRA and SIPC & Hightower Advisors, LLC a registered investment advisor with the SEC. All securities are offered through Hightower Securities, LLC and advisory services are offered through Hightower Advisors, LLC. This is not an offer to buy or sell securities. No investment process is free of risk and there is no guarantee that the investment process described herein will be profitable. Investors may lose all of their investments. Past performance is not indicative of current or future performance and is not a guarantee. In preparing these materials, we have relied upon and assumed without independent verification, the accuracy and completeness of all information available from public and internal sources. Hightower shall not in any way be liable for claims and make no expressed or implied representations or warranties as to their accuracy or completeness or for

statements or errors contained in or omissions from them. This document was created for informational purposes only; the opinions expressed are solely those of the author, and do not represent those of Hightower Advisors, LLC or any of its affiliates. Third-party links and references are provided solely to share social, cultural and educational information. Any reference in this post to any person, or organization, or activities, products, or services related to such person or organization, or any linkages from this post to the web site of another party, do not constitute or imply the endorsement, recommendation, or favoring of VWG Wealth Management, A Hightower Company or Hightower Advisors, LLC, or any of its affiliates, employees or contractors acting on its behalf. Hightower Advisors, LLC, does not guarantee the accuracy or safety of any linked site. Hightower Advisors do not provide tax or legal advice. This material was not intended or written to be used or presented to any entity as tax advice or tax information. Tax laws vary based on the client's individual circumstances and can change at any time without notice. Clients are urged to consult their tax or legal advisor for related questions.

VWG Wealth Management, A Hightower Company

1919 Gallows Road, Suite 330, Vienna, VA 22182
(571) 406-4700
Visit Our Website

© 2020 Hightower. All rights reserved.

Legal & Privacy | Unsubscribe