PETERSON FINANCIAL SERVICES
Limited Liability Company ♦ Registered Investment Advisory Firm

FINANCIAL FOCUS

First Quarter 2022

April 1, 2022 – no foolin'

JUST AS ECONOMIC FORCES DRIVING MARKET ACTION GOT PRICED IN, PUTIN INVADES UKRAINE.

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- Quarterly Market Recap
- Markets at this point are working on pricing in war, inflation and interest rates – it's a lot to take in all at once.

QUARTERLY MARKET RECAP

Volatility was the hallmark of 2022's first quarter as virtually all indexes reached the "correction" threshold and some dipped into bear market territory. But recovery started toward the end of the quarter and a new confirmed uptrend is underway.

Last quarter, the DJIA lost 4.57%, the S&P 500 shed 4.95%, the NASDAQ bled off 9.11%, and the small-cap Russell 2000 drifted to a 7.80% decline. Foreign equities retreated 5.53%. Many sectors did even worse. Many leading tech companies were really beaten up, as forward earnings are what they're all about, making them very inflation sensitive.

Reversal in those themes may be at play, but it's too early to tell. With clarity on interest rate policy, the Barclay's Aggregate Bond Index plunged by 6.05%. Last quarter we cautioned to expect fixed-income losses in 2022, and we are sticking to that.

Markets started declining in the latter months of last year as inflation and interest rate concerns dominated. Two attempted rallies died early last quarter but investors seem to be coming to terms with normalizing interest rates. Then, the Russians attacked Ukraine and immediate reaction to that proved negative. But as Ukraine has shown some success in defending itself, markets have stabilized.

THE LAST MONTH HAS SHOWN THAT GEOPOLITICAL EVENTS STILL HAVE SIGNIFICANT MARKET IMPACT

The domestic American economy is still sporting strong fundamentals. While inflation, and the necessary higher interest rates required to fight it, weigh on the economy, we still enjoy strong GDP growth, a fantastic employment situation, and resilient corporate earnings. Supply chain issues linger, and were starting to loosen some before Putin's war, but are back to complicating things. The massive spending and confiscatory taxes proposed under the Build Back Better plan, had receded into the rearview mirror, allaying concerns for a recession, but have just been resurrected in Biden's proposed budget. So, a mixed bag.

But Russia's attack on Ukraine has doubled down on inflation pressures as energy costs have skyrocketed, with a barrel of oil trading around $100. That's down from a near-term intra-day peak of over $130, but it's not yet stable, as it's been gyrating for weeks.

At this point, the war is edging out inflation and interest rates for dominance in moving markets day-to-day. That's only because a strategy has been announced regarding the latter and there isn't anything new to report about it daily. We'll just have to see how the scheduled rate increases affect the inflation rate and that will take months to reveal.

But the war creates new news daily and at this writing, it appears Russia is bogged down, the Ukrainians are putting up an unexpectedly robust fight, western alliances are strengthened, China may be rethinking its linkage to Putin, and the early initial fears of the war's fallout are receding. The most significant risk is that Putin's miscalculation is so embarrassing for him that he does something desperate. But just a few days ago his government announced they will not go nuclear, which would have forced a response from us. This all seems to be calming the markets to some degree.

There are other positives to this terrible war, which include America getting serious about energy policy and national defense imperatives. For too long we've moved toward unrealistic policy prescriptions that endanger our long-term security in these areas, and perhaps now we can work toward a more nuanced and reasonable set of achievable goals that will protect our standards of living and economy in a more lasting fashion.

Diving deeper into the analysis of the market action of the last quarter reveals a lopsided distribution of performance among sectors.

Growth stocks outperform value stocks in twelve of thirteen years on average, so that's the place for concentration in the vast number of years. But recently that's been flipped. However, it's too early to tell if this will last. When the market has significant relief rallies, the growth stocks take center stage again.

This environment has occurred because many growth stocks – specifically technology companies – are more inflation sensitive than other, more capital-intensive firms. This is because their stocks are valued based entirely on future earnings, and inflation erodes the value of a dollar of earnings, so the share prices must be adjusted to reflect those new expectations. But eschewing this asset class is short sighted, as our economy has transitioned from industrial to information based and tech companies will continue to dominate. As well, innovation and productivity have a way of overcoming these obstacles. For these reasons we are sticking with a long-term strategy that incorporates these themes and see signs that patience will be rewarded. For example, on strong gaining days, our positions rise more than the market. This will soon pay dividends.

Similarly, international positions have been more affected by both inflation/interest rate increases and the war fallout. While we do not have overweighting in these areas, we always have representation in foreign positions for diversification and opportunity reasons. As long as the economy is global – and it very definitely is – participation in many markets will make sense. Even so, international positions represent a slightly smaller proportion of our portfolios than was the case a year ago.

On the fixed-income side, bond values move inverse to interest rates. We have just begun a season of incremental rate increases that the Federal Reserve has suggested will span more than a year, and perhaps as much as two. Further, their schedule includes bringing the Fed Funds rate up to the 1.75% - 2.00% range. Until this last month, that target was held since 2018 at 0% - 0.25%, so this is significant. The first increase occurred a few weeks ago. Prior to the war, the futures markets were pricing in a half-point initial move, but Russia's invasion into Ukraine led to a more cautious quarter-point movement. However, the underlying reason for a bolder move – which is containing a more-aggressive level of inflation than the Fed initially supposed – is still the real condition. This suggests that the next movement, or perhaps the next couple movements, will be in the half-point range. For this reason, we have spent the last few months completely divesting of all bond positions and holding those allocations in cash until the rate cycle is complete. This will prevent known losses over the coming quarters.

The markets have perked up recently, but broad indexes somewhat conceal the breadth of health because many widely-held companies have not had the recovery of the overall indexes. Still, as of a couple weeks ago, the market is in a technical uptrend, and this one appears it may hold.

"It's not whether you get knocked down; it's whether you get up!"

- Vince Lombardi

Pursuant to SEC Rule 204-3 (C) of the Investment Advisors Act of 1940, we hereby offer, without cost, a copy of our "Disclosure Statement", Form ADV Part II, which is the document attached to your copy of our Service Agreement. Please e-mail us, or mail us, a written request if you'd like another copy and we'll send it in February after we update our annual filing. Also, in conformance with Regulation S-P of the Gramm-Leach-Bliley Act, we are required to provide annual notice of our Privacy Policy. Our policy is posted to our website, and is mailed to each client.

ABOUT PETERSON FINANCIAL SERVICES, LLC

As an aside, we wish to remind our clients of our various services. While we specialize in portfolio management, we continue to provide financial planning and insurance services. Longtime clients may have forgotten this, and newer clients may not be aware of this. Additionally, we build our business through referrals, and much appreciate them. Please keep us in mind as you come across friends, family and colleagues who might benefit from our financial services. We appreciate your business.

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