



## POST OAK PRIVATE WEALTH ADVISORS

ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

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### Monthly Market Commentary

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This past April was a cruel month for stocks as investors grew more concerned about increasing likelihood of an economic slowdown. The ongoing Russian war in Ukraine and a surge of COVID cases in China also weighed heavily on the market, but most of the worry remained focused on inflation, interest rates and upcoming action by the Federal Reserve to rein in loose monetary policy. The S&P 500 Index dropped 8.7% during the month, the worst monthly performance for the benchmark stock index since March 2020. Year-to-date through April 30, the S&P 500 has fallen nearly 13%, marking the worst calendar-year start for the benchmark stock index since 1939. Technology and growth stocks bore much more of the damage, with the Nasdaq Composite Index falling over 13% in April, its worst month since October 2008, and is now down over 20% for the year-to-date (officially in a bear market, barring a rebound in early May.)

Stock returns are ultimately driven by company earnings, and analysts have been forecasting for earnings to slow during the first half of 2022. So it shouldn't be surprising to see stocks pull back in these first few months of the year; company executives have for some time warned investors about the probable impact of inflation on their quarterly results, and current earnings numbers are coming off of last year's strong performance during the pandemic rebound.

Q1 earnings so far have been a mixed bag for investors, but a few notable misses have made headlines and upped the level of concern. At the end of April, just over half (53%) of the companies in the S&P 500 had reported Q1 earnings. Around three-quarters of those firms (77%) have beat analyst estimates, according to FSI Insight. That's definitely good news, but there is a flip side; those companies that are beating earnings estimates are doing so at lower rates than recent averages. According to FactSet, Q1 earnings beats are 3.4% above analyst expectations (as of April 29), but that's well below the 1-year average of 14.1%, the 5-year average of 8.9% and the 10-year average of 6.5%.

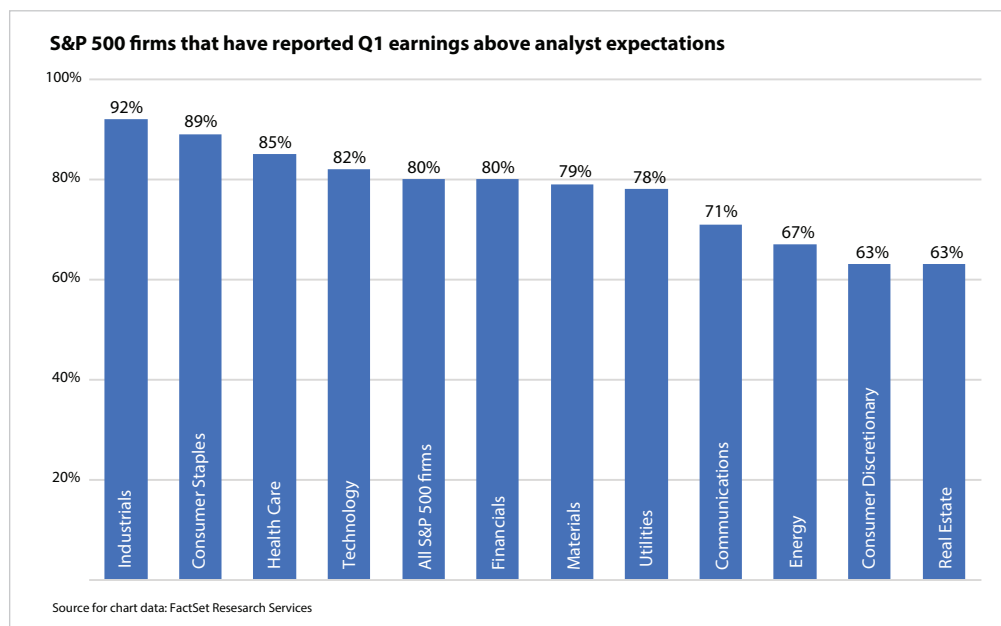
Some firms such as Twitter and Tesla posted upside earnings surprises for Q1, but the bad news was widespread among other high-flying growth names. Amazon posted a drop in earnings for Q1, its first quarterly loss in seven years. Netflix announced 200,000 subscribers had left the streaming service in Q1, and the firm is expecting an even steeper drop in the current quarter. Alphabet, the parent company of Google and YouTube, reported slower sales growth. Apple had one of its best quarters ever in terms of revenue and earnings growth, but warned investors of anticipated problems in its supply chain due to the resurgence of COVID cases in China.

Stock investors punished both the good and the bad reports from these firms and the losses in equity value in these growth names certainly raised eyebrows, if not blood pressure. Amazon declined nearly 24% for the month, including a 14% drop on April 29th, its largest one-day loss in nearly 16 years. Alphabet was down nearly 18% in April, while Netflix lost almost half of its value over the course of the month. Good results couldn't keep Tesla in the black, as CEO Elon Musk watched his firm shed 19% in the month (although his bid to buy Twitter helped its stock rise over 26% in April.)

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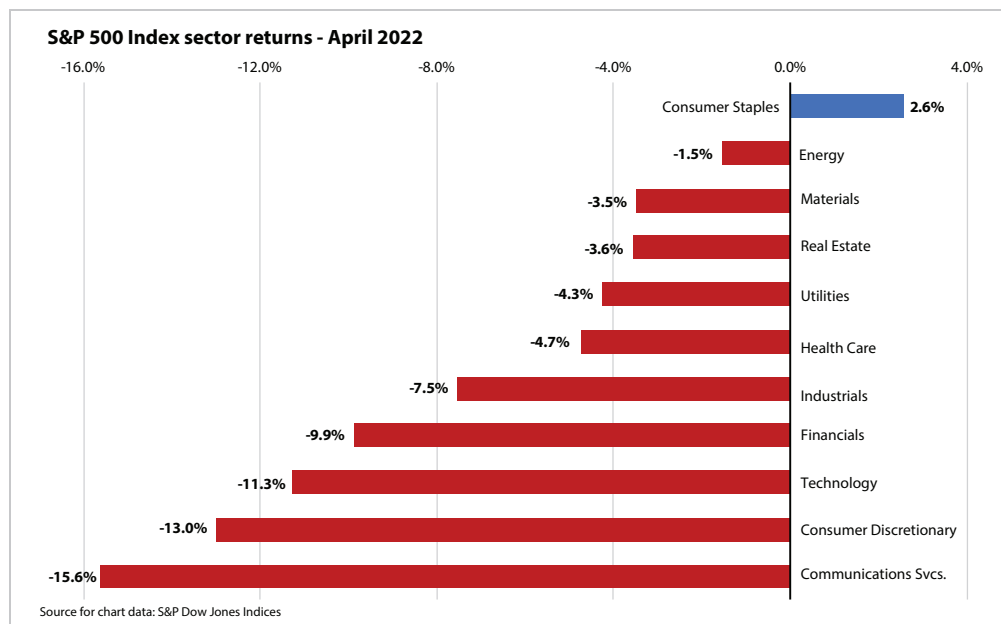
So far in this earnings season, energy firms have posted the strongest year-over-year earnings growth, benefiting primarily from the rise in oil prices over the past quarter. Higher commodity prices also boosted firms in the materials and industrials sector with strong earnings (although nowhere near the results energy firms have reported.) Firms in the financial and consumer discretionary sectors have overall reported earnings declines for Q1 when measured on a year-over-year basis.



But sometimes, positive or even good news on corporate earnings does not translate into favorable stock price momentum. A sour mood in the market can often lead to broad sell-offs, especially in a time when index funds and algorithmic trading dominate so much market activity. That may help explain why nearly all S&P 500 sectors suffered losses in April. Only consumer staples stocks produced a positive return for the month of 2.5%. Despite strong reported earnings, the energy sector lost ground with a 1.5% slide in April, although energy remains the best performing sector by far for the year-to-date. Declines were heaviest in the communications, consumer discretionary and technology sectors, all of which saw double-digit drops in April.

Another explanation for the rough month for stocks is forward expectations for economic growth. Gross Domestic Product (GDP) growth contracted in Q1 at a 1.4% annual rate, a big swing in economic momentum from the 6.9% annual pace of expansion in Q4 of last year. The GDP could be seen as a surprise, as the consensus of economic analysts had expected a positive growth rate of just around 1%, which still represented a significant slowdown from the previous quarter. Inflation, supply chain constraints and labor shortages continue to hamper many businesses that are seeing robust demand but still struggle to keep up with free-spending consumers. Workers continue to benefit from the tight employment market, which is helping to prop up demand and boost retail spending. Employment costs borne by businesses and governments jumped 4.5% in Q1 compared with the previous quarter, the biggest increase in the past 20 years. Compensation costs were a big part of this increase, rising 1.4% in Q1 following a 1.0% increase in the 4th Quarter.

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Into this push-pull mix of job growth, rising wages, higher inflation and supply shortages comes the Federal Reserve. Despite the quarterly drop in GDP, the Fed remains on track to raise its target interest rate again when the Federal Open Market Committee (FOMC) gathers on May 4th. Federal Reserve chair Jerome Powell all but locked in a half-point hike in a recent public appearance by proclaiming “It is appropriate in my view to be moving a little more quickly [on interest rate hikes].” The Fed funds futures market is nearly unanimous in its expectations of not just one but three half-point jumps in the target rate at the next three FOMC meetings. If those expectations are realized, that would put the Fed’s target rate at a range of 2.0-2.5% by the end of summer.

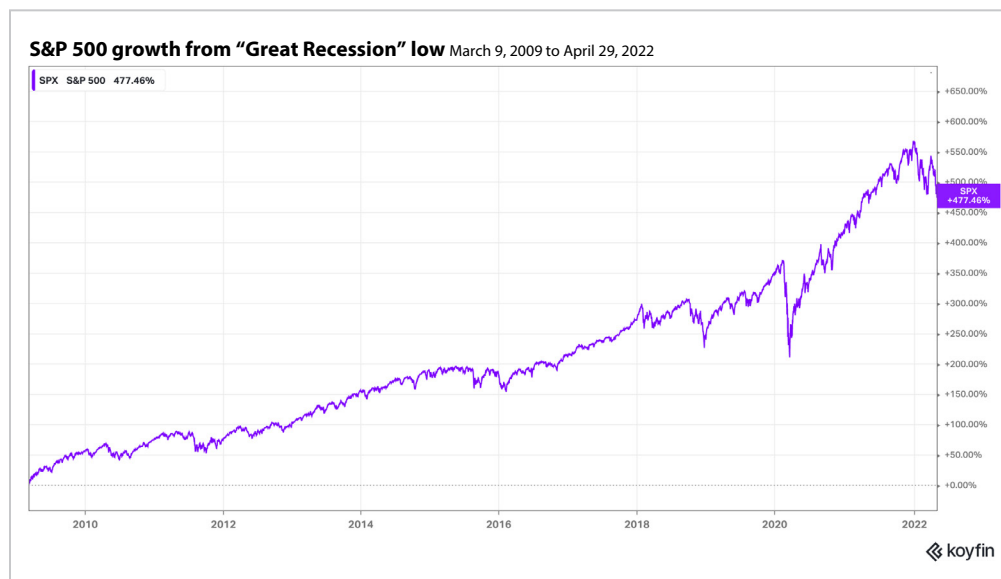
Rapid tightening of Federal Reserve monetary policy is late, at least according to the consensus view of investors. It’s also not surprising, given how quickly inflation has risen and how persistent it has proven to be. Many investors may be wondering if we are at or near the peak of the current round of inflation, especially with consumer prices still rising at a rate not seen in four decades. Some barometers of future inflation expectations have shown signs of moderation. From a consumer perspective, the New York Fed’s Survey of Consumer Expectations showed an expected consumer inflation rate of 6.6% over the next year and 3.7% over the next three years. From a market standpoint, the 5-year breakeven inflation rate, which measures where bond investors expect inflation to be in the next five years, is down from a peak of 3.6% at the end of March to 3.3% on April 29. Those inflation levels seem like cold comfort when reminiscing over the last 10 years and inflation rates that only occasionally broke above 2%.

It’s hard to imagine how the U.S. economy could avoid a recession with the Fed on a path toward tighter monetary policy, taking the Fed funds target rate from near zero to the 2.0-2.5% range in just three quarters. Already, the economy is seeing some immediate effects from FOMC tightening, with mortgage rates rising rapidly to around 5.2% for a conventional 30-year fixed home loan (compared to 3.2% one year ago and 3.4% at the start of this year.) The rise in borrowing costs has led to a 12% drop in new home sales since the beginning of the year (through March) and an 11% fall in existing home sales from their peak in January.

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The Fed's challenge is to temper the recent spike in inflation with a smooth transition to a slower growth, higher rate environment. There will undoubtedly be more bumps along the way, setting the stage for continued volatility in the stock market over the coming months. Short-term spells of volatility happen from time to time, but it's important for investors to continue to invest with conviction and a focus on long-term goals. In times like these, I am often reminded of a quote from Warren Buffet: "The stock market is a device that transfers money from the impatient to the patient." Patience is a valuable trait for investors to possess, but when coupled with a strategy consisting of cash or hedged positions it opens up opportunities to buy good quality companies, potentially at lower prices.



The last two significant short-term downturns (during the Great Recession in 2007-09 and the COVID recession of 2020) demonstrated the value of maintaining a long-term perspective through short-term volatility. Investors who had exited the stock market at the bottom placed themselves in an unenviable position of playing catch-up once the rebound started. For example, since the market low in 2009, the S&P 500 has appreciated 429%, not counting dividends. (See chart above.) Investors who remained patient and prudent during the decline were able to participate in the market's subsequent gains.

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