INTELLIGENT INVESTMENT

First Quarter Newsletter, 2022

S&P 500 YTD (-4.95 %)[4] *MSCI ALL WORLD ex US YTD (-5.49%)[4]*

"And I'm lookin' for a complication
Lookin' cause I'm tired of tryin'
Make my way back home when I learn to fly high"[1]

The markets certainly received their fair share of complications this quarter. If the anticipated reduction of accommodative monetary policy wasn't enough to digest, an incredible once in 40 year inflationary spike coupled with the start of a very tragic war in the Ukraine which may bring the potential for far reaching, long lasting implications most certainly threw a "Monkey Wrench"[1] into the works. Moreover, the loss of Taylor Hawkins, the incredibly talented drummer of the Foo Fighters made this quarter particularly unpleasant. Taylor, thank you for giving us "The Best of You"[1] for so many years. You will be missed "Everlong"[1].

How will equity prices behave in this more uncertain environment? Should markets be more concerned with aggressions in the Ukraine or rising interest rates and high inflation? Are these risks to the markets transitory or will they have staying power? Let's take a look at the challenges stocks contended with during the first quarter and see if they can "Learn to Fly"[1] on their own, without help from the Fed.

The S&P 500 was the "Breakout"[1] star providing a total return of 28.71% in 2021, outpacing the Dow, Nasdaq and MSCI Global indices coming in at 20.94%, 22.18% and 19.88% respectively[6]. However, toward the end of 2021 rumblings of inflation and removal of monetary accommodation began to percolate. In his November 30th testimony to congress Chair Powell articulated "We tend to use [the word transitory] to mean that it won't leave a permanent mark in the form of higher inflation. "I think it's probably a good time to retire that word and try to explain more clearly what we mean." "This is a Call"[1] from the steward of the economy that inflation is here and far higher than had been anticipated. The Fed appeared to be signaling of not only higher interest rates but there may be "No Way Back" from significantly higher prices for many goods and services Americans utilize on a daily basis.

Will rising interest rates and high inflation cause a recession bringing a "Long Road to Ruin"[1] for equity markets? Will Russian aggression in the Ukraine spoil 2022's potential? I think not as the inflation that we are seeing may be shorter lived than many anticipate and Russia is economically irrelevant with a GDP smaller than many companies listed on the S&P 500. From Fundstrat "Our base case is that inflationary pressures are not as durable as market expectations seem to be pricing. Brian Rauscher, Fundstrat's Global Head of Portfolio Strategy, explains it best when he describes inflation issues as "episodic" as 1. first wave was supply chain shortages, 2. second wave was "revenge spend" fueled demand, 3. third wave is commodity parabolic surge further fueled by Ukraine war. This should see inflationary pressures apex. That is, inflationary pressures should begin to cool. Leading indicators like Cass Freight Index, or port delays are rolling over, labor markets are still tight, so this needs to ease, employed to population ratio is only 59% historically this is a recession low, not a sign of a tight market, greatest risk is that consumer expectations are anchored at higher inflation requiring Fed to be super aggressive"[2]. It would seem as if there are head winds to the continuing inflation narrative and it may not "Stick Around"[1] as long as some believe it could.

If inflation begins to ameliorate, why would we need to be concerned about or in need of higher interest rates? One word… Demand… demand is very strong as the millennial population is beginning their peak income and spending years. Historically when a generation breaks into these years it is very good secularly for our economy and markets. Although the Fed may be reducing accommodation through reduction of bond purchases along with increasing the Fed Funds rate over the next several meetings, markets may very likely see past the window dressing of the "what" and focus on the "why" … Demand… The Fed is well aware of the level of demand for goods and services in the US economy and the staying power of that demand due in large part to the millennial populations long term needs. This long-term secular demand story may likely be the purpose of the more hawkish approach to monetary policy for the foreseeable future.

In "Times Like These"[1] can the Fed be careful with necessary tightening measures while not "Making A Fire"[1] in the equity and fixed income markets? The answer very likely is yes. From Bloomberg "Here's a look at how the U.S. stock market has fared historically when the Fed begins tightening rates. History indicates that 2022 is likely to end on a better foot than it started. U.S. stocks have historically performed well during periods when the Fed raised rates, as a growing economy tends to support corporate profit growth and the stock market. In fact, stocks have risen at an average annualized rate of 9% during the 12 Fed rate hike cycles since the 1950s and delivered positive returns in 11 of those instances, according to Keith Lerner, Truist's co-chief investment officer. The one exception was during the 1972-1974 period, which coincided with the 1973-1975 recession."[3]

Although we anticipated the first half of this year to "Rock and Roll"[1] we believe the second half will have "Wheels"[1]. Spring has sprung but it's still a "Cold Day in the Sun"[1] for many parts of the country. At least we can look forward to warmer, sunnier days ahead for both the weather and stocks! Let's hope market lows for 2022 are in and we are "On the Mend"[1]. Whether we are "Waiting On a War"[1] or a "Miracle" [1] ARPG will continue to practice our approach to value investing, "Intelligent Investment is Investment on Value"[5]. This is what sets ARPG apart from the rest. As always, we thank you for your confidence and are humbled by your trust. Please feel free to contact us at any time.

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Sincerely,
Matthew D. Dahl
Chief Investment Officer

1. Foo Fighters
2. Fundstrat
3. Bloomberg
4. ARPG / Stockcharts.com
5. Matthew Dahl
6. Factset