Russia's invasion of Ukraine and the world's response continued to dominate the news in March. U.S. sanctions and the mass exodus of Western companies from Russia reverberated throughout the world. Global energy and commodity prices surged with crude oil rising above $120 a barrel.[1] During March, inflation statistics for Germany and France rose to record highs, while Spain's inflation rate climbed to levels not seen in almost four decades. At month-end, however, crude oil prices eased as the U.S. announced the release of more crude oil from its strategic reserves. In addition, there was some hope that diplomatic talks between Russia and Ukraine might lead to a lessening of hostilities, which could further temper energy and commodity prices.

The U.S. Federal Reserve (Fed) raised its benchmark interest rate 0.25% in March, the first hike since 2018.[2] The Fed said that it anticipated six additional hikes over the rest of the year. Global bond markets plunged and the Bloomberg Global Aggregate Bond Index, a benchmark for government and corporate debt total returns, was down -3.04% in March.[1] This index recorded a negative -6.16% return for the first quarter, the largest quarterly decline in decades.[1] The 10-year U.S. Treasury Note yield rose to its highest level in two and a half years, reaching 2.50% before settling back to end the month at 2.32%.[3]

On the positive side, the number of Americans applying for unemployment benefits fell to its lowest level in 52 years as the U.S. job market continued to show strength despite rising costs and an ongoing coronavirus pandemic.[4] The U.S. unemployment rate fell to 3.6%, its lowest level since 1969.[4] Reflecting these economic and geopolitical crosscurrents, stock prices swung back and forth during March, but most stocks were able to record gains. Technology stocks were strong with the NASDAQ-100 Index rebounding 4.28% in March, although the index was still down -8.91% since the beginning of the year.[1] The S&P 500 Index gained 3.71% and the Dow Jones Industrial Average rose 2.49% for the month but both were still lower for the year by -4.60% and -4.10%, respectively.[1] Small cap stocks showed less strength as the Russell 2000 Index added only 1.24% for the month and was down -7.53% since the beginning of 2022.[1]

Equity valuations declined due to good earnings comparisons but remained in overvalued territory. Valuations adjusted for inflation also remained high. Investor sentiment was the bright spot in the team's work during March because bearish sentiment increased, which is positive from a contrary point of view. Nonetheless, the team's rate-of-change models for interest rates — for both Treasurys and corporates — were still in negative territory.

The 10-year to 2-year yield curve flattened and briefly inverted during the month. However, the short end of the curve versus longer maturities has not inverted and credit spreads have so far not widened significantly. At this point, while a tightening monetary policy is negative for financial assets, the team's models do not yet indicate definitive signs that a recession is on the horizon. In addition, we must remember that an inversion of the yield curve can precede a recession by several months to several years. And historically there have been instances of the yield curve inverting without a recession. Nonetheless, the team is carefully monitoring the monetary picture for any widening of credit spreads or further yield curve inversion.

The team's short- and intermediate-term volume and breadth momentum models strengthened during March. The team raised exposure modestly during the month and the portfolio was invested in large cap value and technology stocks. With that said, the portfolio still has a robust cash cushion to help weather any future market volatility. The team would raise market exposure further if momentum continued to improve, interest rates stabilized, credit spreads remained narrow and investor sentiment remained pessimistic. The team would lower exposure once again if interest rates rose, credit spreads widened or if the team's short-, intermediate- and long-term volume and breadth momentum models deteriorated.

Continued next page
Disclosure next page

Our assessment of the four pillars of our investment process is as follows:

Valuation: Valuations have improved but remain in overvalued territory. Price-earnings (P/E) multiples have declined from their high of 33.9x in early 2021 to 24.1x as of the end of February 2022, still above the 58-year median P/E ratio of 17.4x.[5] The team's measure of valuations adjusted for inflation remain high. This measure could decline if inflation abates, but continued inflationary pressures and a rise in interest rates would be negative for this valuation measure.

Monetary factors and credit conditions: The 10-year U.S. Treasury Note closed the month with a 2.32% yield, up from 1.83% at the beginning of the month. This increase kept the team's 26-week rate-of-change models for both 3-year U.S. Treasury Notes and corporate bonds in negative territory. Further rises in interest rates would be negative for the team's rate-of-change models. However, a stabilization of interest rates might suggest that the peak upward rates of change had been reached, which would be a positive development.

Credit spreads are still narrow although they have risen somewhat in recent months.[6] The spread between Treasurys and high yield corporate bonds was 369 basis points at the end of March. A rise above 500 basis points would be a negative development. The team will be watching credit spreads closely as the Fed moves to hike interest rates, as a widening of spreads would be indicative of a deterioration in credit conditions.

The yield curve flattened with the rise in interest rates. The U.S. Treasury 10-year to 2-year briefly inverted during March and was positive by only 4 basis points at the end of the month. The U.S. Treasury 30-year to 2-year curve was positive by only 16 basis points.[6] Historically, yield curve inversions are usually caused by a scramble for short-term funds by less credit-worthy companies and financing disruptions at these lesser credit levels. This scramble for short-term financing pushes up short rates above long rates. During this cycle, however, we have not yet seen the very short end of the curve rise as much as the middle of the curve. For example, the spread between the 10-year U.S. Treasury Note and the federal funds rate is still a positive 190 basis points [6] — and this curve has actually steepened recently. This may be evidence that the Fed is late in tightening or "behind the curve," as many market commentators have noted. But the failure of the very short end to invert, as well as the continued narrowness of credit spreads, may suggest that while a recession may be somewhere down the road, it may be further down the road than some pundits believe. Yield curve inversions can happen anywhere from several months to several years before a recession. It is the totality of the team's four-pillar process that will determine future market exposure and asset allocation.

Sentiment: Investor sentiment remained bearish throughout most of March (positive from a contrary point of view), although this measure became more neutral toward the end of the month. Ned Davis Research's measure of daily sentiment showed the most bearishness in early March since the pandemic low in early 2020. This is a positive development from a contrary point of view. [6]

While this bearish investor sentiment is positive for the near-term outlook, some longer-term measures of investor sentiment are still worrisome. Margin debt continues to be higher than it was at the 2000 and 2008 market highs. Stocks as a percentage of household financial assets (adjusted for pension funds) remains at its highest leave in history.[6]

Continued next page
Disclosure next page

And finally, money market fund assets as a percentage of total market value (as calculated by Ned Davis Research) shows continued low cash balances.[5] Low cash indicates that investors are heavily invested in equities, which often occurs at or near market peaks.

Momentum: The team's intermediate-term volume and breadth momentum models strengthened in March. In addition, several short-term thrust indicators were triggered. These thrust indicators measure the strength of market rallies in terms of both volume and breadth. Confirmation of these thrust signals would be given by the triggering of the team's longer-term thrust models and longer-term volume and breadth momentum models.

1 *Source: Bloombergy. March 31, 2022*
2 *Source: U.S. Federal Reserve. March 16, 2022*
3 *Source: U.S. Department of Treasury. March 31, 2022*
4 *Source: The New York Times. April 1, 2022*
5 *Source: Ned Davis Research. February 28, 2022*
6 *Source: Ned Davis Research. March 31, 2022*