STONEBRIDGE
Capital Advisors

The Stonebridge Market Update
March 2022

Commentary provided by
Robert Kincade, President & Portfolio Manager

Market Correction

A little over a month has passed since Russia invaded Ukraine. Naturally, we've received several calls regarding inflation, geopolitical events (the Ukrainian war), Federal Reserve policy, and COVID. Before I discuss where we are and where we are going, it might be helpful to take a historical perspective on market cycles. During December 2021 and early January 2022, we were fortunate to receive many new accounts funded with cash and many clients sending us additional cash to invest. Investors looked back at the equity market's performance of 2021 and what a great year of performance it was, wanting to participate in it more. Their requests were to "get cash invested as fast as possible." Our portfolio management team reviews the stock and bond markets and closely follows individual companies. We found the bond market overpriced, with income yields at or near historic lows. The companies we own stock in were at or near historical highs. The markets were telling us it was not a good time to buy. So, cash in client portfolios was moved very slowly into the market or, in some instances, raised more cash. By late February, investors became concerned with the drop in the equity markets with requests to stop buying or possibly selling some holdings. We had entered a "corrective phase" of the equity markets.

What is a corrective phase or a correction? The general definition is a drop of 10% or more from recent highs. You will also hear that different markets are at different stages of the corrective phase through the media. The Dow Jones (DJIA) is down -9.3%, year to date not quite in correction. The S&P 500 Index (SPX) is down -12%, year to date just entering a correction phase. The NASDAQ is down -17.9% year to date. Corrections are not unusual. According to JP Morgan analysis,

- Over the past 40 years, there have been 33 corrections.
- The average correction is -18%.
- The average annual return in the first year of recovery from the bottom of a correction is +24%. Most of which occurs in the first two months of recovery. If you are not invested, it is hard to catch the recovery.
- Historically, professional investment managers have been unable to properly time the sale at the top or the buy at the bottom of the market.

We are in a corrective phase of the equity markets, exacerbated by the Russian invasion of Ukraine. Corrections may last for one to three months. Geopolitical situations typically last a month or two. This war in Ukraine is different than other geopolitical situations as it involves Russia, a world power, invading a country on the borders of NATO members. It has also exacerbated inflation, particularly on energy, commodities, materials (all of which seemed to have peaked earlier this past week).

Now What?

The U.S. economy remains strong, and GDP is growing at approximately 4%. Consumers and companies have plenty of cash. They have been participating in re-opening from the constraints of COVID, assuming further complications do not arise. Inflation is a concern initially caused by supply issues. Since this is an issue that can be resolved by private industry, not the federal government, it will be much more efficiently resolved. The Federal Reserve will raise interest rates and taper their buying program. Much of the inflation issue could be resolved by the 4th quarter. Ukraine's war inflation effect could impact certain aspects of inflation longer. You may want to see Dr. Laufenberg's Economic Outlook for more on this topic, which was recently sent out.

Our process during any economic or market condition is consistent. We focus on client investment objectives and asset allocation. We make adjustments to meet clients' needs and attain long-term goals. We look for companies with solid business plans, strong management teams, and growing revenues and earnings. Below is a breakdown of the other aspects we consider and investment facts we know based on each investment type (stocks/bonds).

Equities (stocks)

- Focus on companies with growth in revenues, earnings, cash flow and have a positive forward outlook.
- Focus on sectors that perform well with rising interest rates and have pricing power with their products and services.
- Many sectors and companies have not fully recovered from the pandemic-led recession and will thrive during recovery.
- During the past 2 months, many growth stock companies have been down 25% - 50%.
- Some dividend income companies pay healthy dividends and announce increases in dividend payouts.

Fixed Income (bonds)

- The Fed will raise interest rates.
- Utilize U.S. corporate or government bonds.
- Remain focused on investment-grade bonds.
- Invest in individual bonds or bond ETFs with stated maturity dates.
- Keep maturities within 1-5 Years: The yield spread on a 2-year bond to a 10-year bond is .3% - .4%; there is little value in investing out 10 years or more.
- Sell long-term bond mutual funds and high yield (junk) bond funds.

The markets always offer opportunities and risks. We will continue to sell securities that may be overpriced or where fundamentals have changed. We will also continue to buy securities during this correction if we see significant long-term value at the current prices.

Please contact us at 651-251-1000 if you would like to discuss your needs or objectives.

Thank you,

Bob Kincade
President & Portfolio Manager

Sources: Data sourced through Charles Schwab and J.P. Morgan as of 2/28/22
https://intelligent.schwab.com/article/stock-market-corrections-not-uncommon
https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/?slideId=introduction/gtm-cover
Disclosure: The views expressed here reflect those of the writers as of the date noted however completeness cannot be guaranteed. They may change as economic fundamentals and market conditions change. This commentary is provided as a general source of information only and is not intended to provide investment advice for individual investor circumstances. Past performance does not guarantee future results.