Capital Investment Advisors

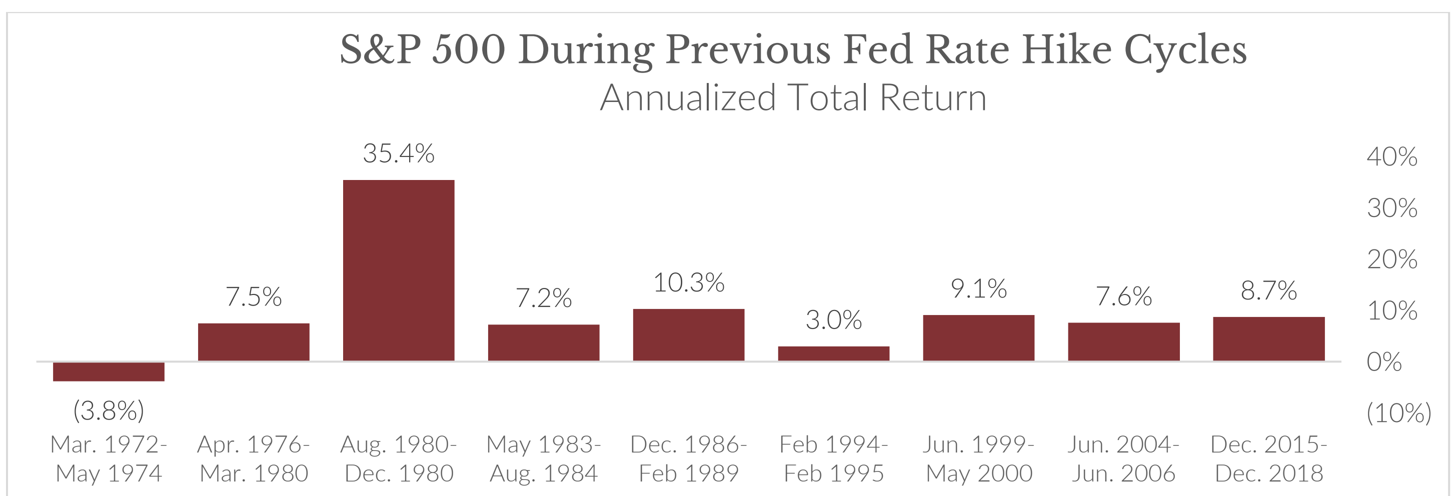
A Painful Start to 2022. Is There Any Relief in Sight?

2022 has proven to be a difficult year thus far. If it feels like it's been a volatile year for stocks, it's because it has been. Nearly 90% of all trading days in 2022 have seen markets move at least 1% or more in either direction. For some context, in 2017 this occurred in less than 10% of days. All this adds to stocks suffering their worst start to a year since the 1930s. Adding insult to injury, bonds are also struggling due to inflation and rising interest rates. Given the current market gyrations, we want to take a moment and provide you with our current thoughts.

We think it's prudent to first remind ourselves about the headwinds we knew we were facing headed into 2022 - higher inflation, higher interest rates, and contending with a mid-term election year. Couple these known issues with a brand-new war between Russia and Ukraine, and many of these headwinds have been exacerbated. Inflation went from bad to worse and combating this higher inflation required the Fed to eye a more aggressive interest rate hiking cycle.

Don't Fed interest rate hikes hurt stocks?

Yes, higher interest rate hikes can slow the economy and in turn take a toll on stocks in the short run. However, when looking at the past 12 rate hike cycles in the US, stocks were decidedly positive over the duration of rate hikes. See the chart below.



Source: Bloomberg

How are dividend stocks doing?

Due to the likelihood of higher rates in 2022, we have expected dividend-paying, more value-oriented stocks to fare better than their growth and technology counterparts. This trend has played out in this young year.

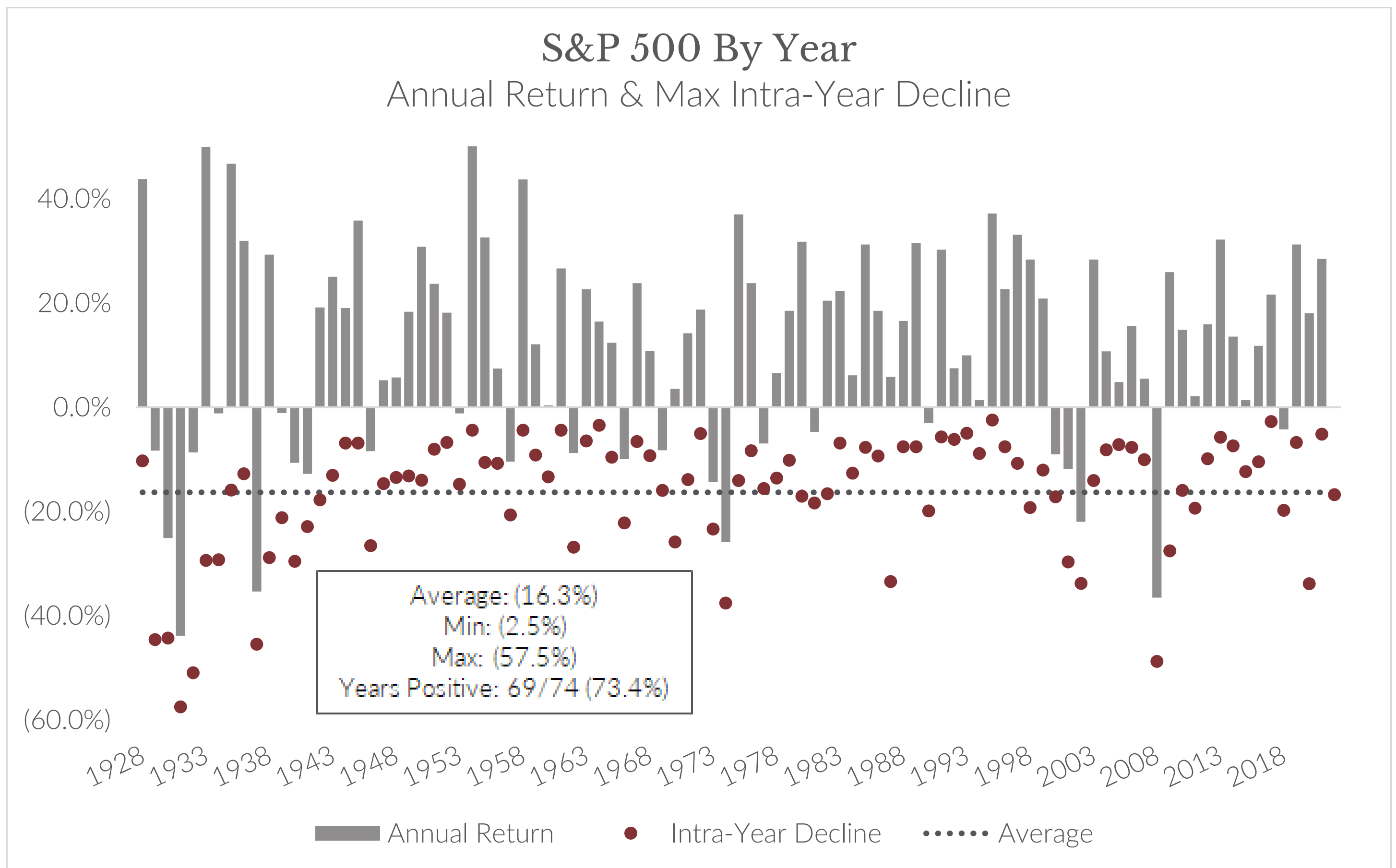
As a measure, the Russell 1000 Value index is down -9.8%, while the Russell 1000 growth index is down a much more significant -24.7%.

Source: YCharts

This exercise is not meant to sugarcoat a rough 2022. Every industry sector is in the red for 2022 except for the energy sector. But, in large part, investing for dividends and income in 2022 has been a bright spot. Is this something that we should change course on now? For us, this is a resounding “No”. The past few years saw excesses develop in the many corners of the market which are now being unwound (think unprofitable “stay at home” tech companies trading at 100 times sales). Now many of these areas have come back down to earth, falling more than 80% in price. The unwinding of these COVID excesses has caused the overall market very real consternation. That said, we continue to believe companies with reasonable valuations and strong balance sheets that pay and grow their dividends are the best option for the families we serve.

Additionally, while drawdowns like we are experiencing can be painful in the moment, it’s worth remembering this is a normal part of investing. Going back to the late 1920s, the average annual drawdown in the S&P 500 is -16.3%, or about exactly in line with this year’s pullback. Perhaps more

amazing is despite this level of average drawdown, 69 of the past 94 years have seen positive annual returns. Said another way, *the S&P 500 has registered gains in almost 75% of the past 94 years despite experiencing an average decline of -16.3% each year*. Investing will always have its ups and downs, but we continue to believe that a collection of high-quality, dividend-paying stocks and income producing bonds will withstand all environments over time.



Source: Bloomberg; NYU Stern Database

A rough start to the year typically leads to a much better 2nd half.

As you can see from the table below, the worst starts to any given calendar year typically give way to higher returns throughout the remainder of the year. 2022 ranks as the third worst start to a year going back to the Great Depression. When looking at the other 9 worst starts to a calendar year, stocks finish the rest of the year on average up 10%. Essentially, bad starts generally signal that much of the damage is done.

2022 Is One Of The Worst Starts Ever For Stocks

10 Worst S&P 500 Index Returns YTD By The End Of April

	S&P 500 Index Return	
Year	YTD Return End Of April	Rest Of Year Return
1932	-28.2%	18.7%
1939	-16.8%	14.0%
2022	-13.3%	?
1941	-12.0%	-6.7%
1942	-11.9%	27.5%
1970	-11.4%	12.9%
2020	-9.9%	29.0%
1973	-9.4%	-8.8%
1960	-9.2%	6.9%
1962	-8.8%	-3.3%
	Average	10.0%
	Median	12.9%
	% Positive	66.7%

Source: LPL Research; FactSet 4/29/2022

What about Bonds/Fixed Income – Aren't these areas suffering as well?

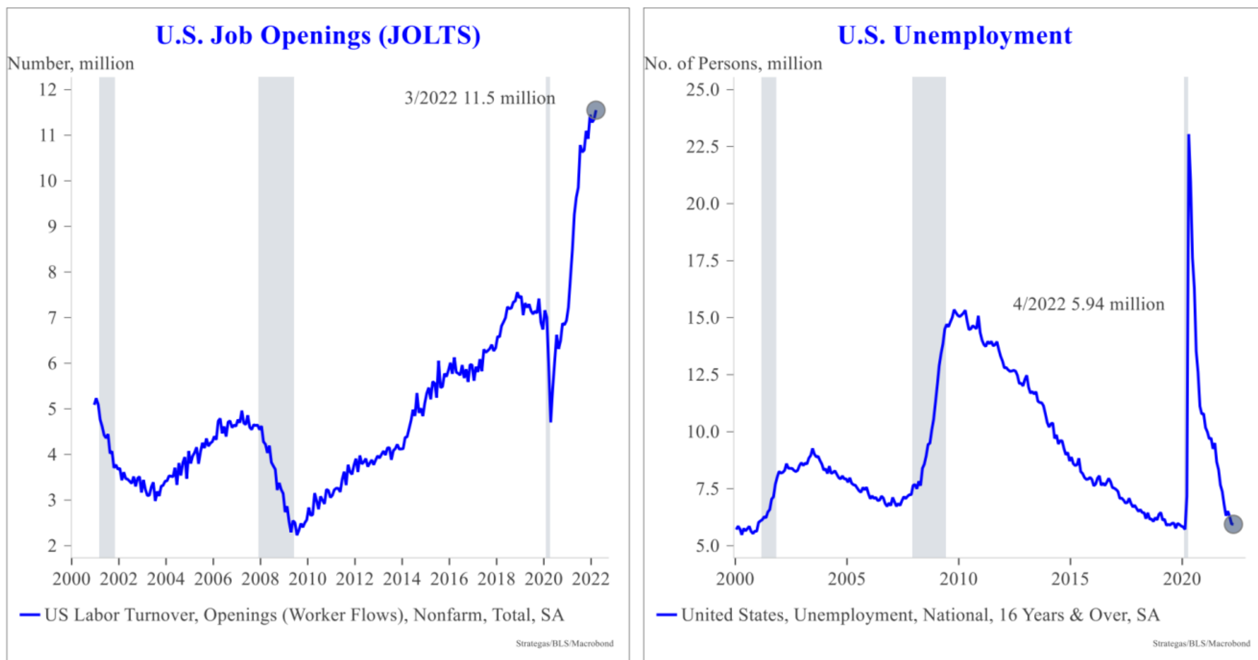
Yes. Anytime interest rates rise in a significant way it creates indigestion for bonds. A way to combat this is to focus our bond allocation on shorter maturities, a hallmark of our current fixed-income allocations. More importantly, long-term bond returns are highly correlated to starting interest rate levels. Since the 10-year US Treasury bond has gone from near 0% during COVID to over 3% recently, the outlook for receiving higher interest payments and better-fixed income returns has improved dramatically.

Furthermore, since interest rates have moved higher in such short order and inflation is showing signs of peaking, we believe the outlook for fixed income over the coming year to be much improved.

Will the US go into recession in 2022?

Even with recession fears mounting, we believe 2022 will stay relatively strong from an economic perspective. Despite a slightly negative GDP print in Q1 2022 (-1.4%), the Fed is doing everything it can to engineer tamer inflation, without a large economic contraction. This will be a tricky needle to thread as raising interest rates to slow inflation will also tap the breaks on the US economy. **That said, the US labor market is so strong, that it may be the parachute the Fed needs to engineer a soft landing or keep a US recession in the mild camp.**

There are currently 11.5 million job openings in the US and less than 6 million people unemployed. Said another way there are more than 5.5 million more job openings in the US than people to fill them. Even with higher interest rates, the sheer strength of the labor market will go a long way in maintaining economic stability in the coming year.



Source: Strategas/BLS/Macrobond

Bottom Line

Despite a year of cross currents hurting most financial assets (stocks, bonds, REITs, etc.) **the latter half of 2022 may provide some relief.** As we outlined in our annual outlook, midterm election years are generally difficult for stocks, until the election season takes shape. Stocks generally perform best in midterm elections years once we hit the 4th quarter. Patience continues to be a virtue as investors, and we still believe that well balanced, multi-asset income producing portfolios are a cornerstone to helping our families work towards their retirement goals.

As always, we are here to help at any time.

- *Capital Investment Advisors' Investment Committee*

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