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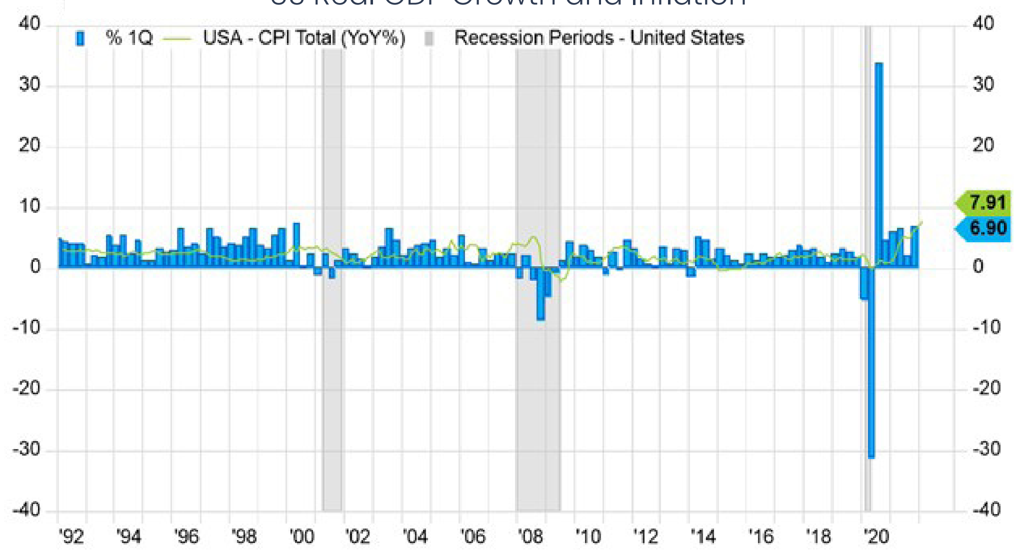
Trajectory Change and Action Plan

Investment Outlook
Spring 2022

First Quarter Review, Second Quarter Outlook:

The winter 2022 edition of this publication produced in early January laid out the case for a double-digit correction to occur in 2022 that would produce a buying opportunity within an ongoing long-term bull market. This was before any experts predicted Russia would invade Ukraine. No words can do justice the tragedy of war. Having said that, the goal of this quarterly is to remain objective in the review of markets, and what you can expect from an investment standpoint. The invasion has shifted market dynamics and increased uncertainty. However, history shows us crises alone do not derail bull markets.

US Real GDP Growth and Inflation



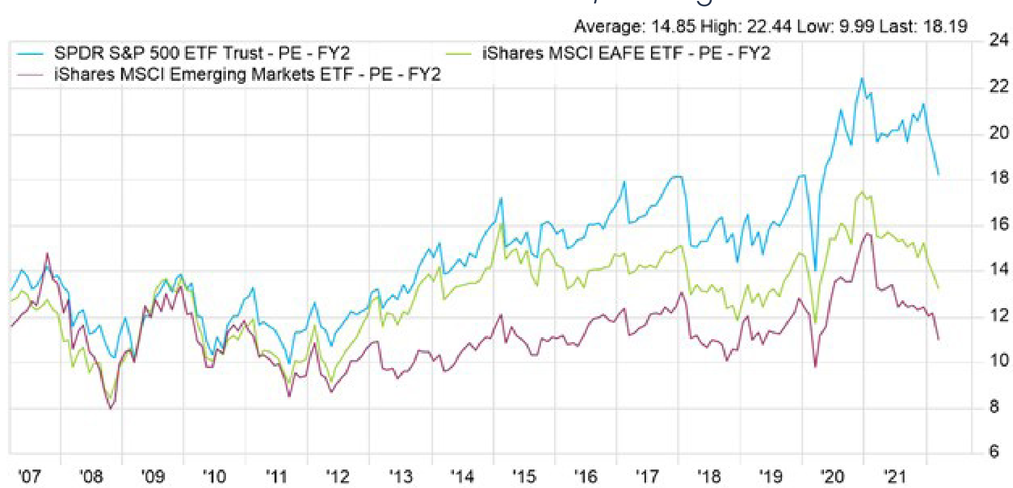
Source: Factset, Argent Wealth Management, LLC © 2022

Market Dynamic Prior to Invasion

There were a few reasons why our winter 2022 edition predicted an imminent double-digit correction. First, the S&P 500 had gone over 420 days without one. This is longer than the average of 330 days according to Ned Davis Research. Second, there were inflation pressures due to global supply chain bottlenecks as international manufacturing plants shut down at various times during the COVID-19 pandemic. (Note that before Russia invaded Ukraine, many supply chain issues were starting to ease). In addition, fiscal and monetary stimuli enacted during the COVID-19 pandemic spurred economic growth more than expected. This can be seen in GDP which is running at 6.9% annualized.

Third, the Federal Reserve has a mandate to ensure price stability and maximum employment. The unemployment rate was and is below 4%, and inflation was and is higher than it has been in 30 years. The Fed is meeting its mandate on employment, but not price stability. So it is no surprise investors predicted the Fed would raise the Federal Funds rate at least 6 times in 2022 to combat inflation and slow the economy. That means a .5% increase at least once in 2022, something the Fed has not done since before the Global Financial Crisis of 2008. The Fed started with a .25% increase in March.

Global Index Forward Price/Earning Ratios



Source: Factset, Argent Wealth Management, LLC © 2022

When the Fed raises interest rates, it slows the economy by increasing the cost of borrowing. As a result, the cost of doing business in general increases as well. In addition, it increases the rate at which investors discount predicted future company cash flows, lowering company valuations. Stock valuations were high to start this year, but have come down to more reasonable levels since.

For the above reasons it was not surprising that the double-digit correction occurred, with the S&P 500 dropping from its peak on January 3rd, 2022, to an intraday low just over 10% on January 27th.

The prediction for the bull market to continue was made for three reasons. First, economic indicators were strong. For example, leading economic indicators were and remain near 20-year highs. Second, the outlook for public companies, despite higher-than-average valuations, was and remains positive. Debt of nonfinancial corporates relative to cash flow (EBITDA) was and is near a 50-year low. In addition, earnings estimates continue to increase. Third, historically the economy does not enter a recession until the Federal Funds rate is in the 3-4% range. It only stands at .25% today. History shows us that calendar year equity returns are usually positive when there is no recession.

Russia Invades Ukraine

The Russia Ukraine war (the war) increases tail risk uncertainty. In a worst-case scenario, Putin could feel like a "wounded bear" backed into a corner. In this case, his actions are unpredictable. In a best-case scenario, there is de-escalation of conflict through negotiations. Russia's military proved to be weaker than many thought. Ukraine's resistance proved to be stronger than many thought. No major world power, including China, is showing outright support for Putin. But no world power is threatening to invade or oust him. Therefore, it is more likely than not peace talks will continue. However, it could take months for this acute conflict to be fully resolved.

DJIA Percentage Gain After Reaction Dates (1907-today)

	Reaction Date Period % Gain/Loss	One Month	Three Months	Six Months	Twelve Months
Mean	-7.1%	4.2%	6%	9.7%	15.3%
Median	-3.0%	4.7%	6.2%	9.7%	17.4%

Source: Ned Davis Research Inc. © 2022
For a full breakdown of crises events and returns, see our March Market View (www.argentwm.com/blog.html)

A history of crises indicates investors should use equity sell-offs as opportunities.

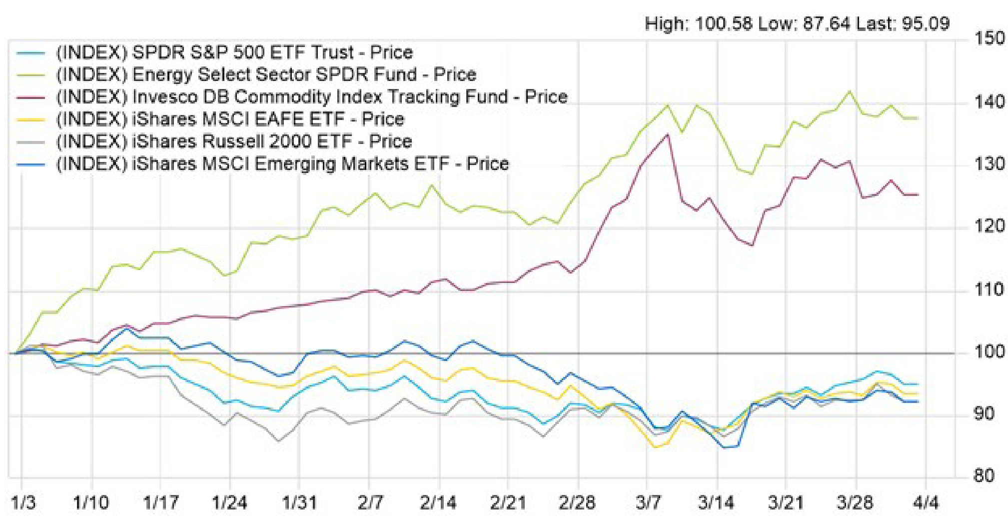
More specifically, when war outbreaks, the market usually reacts negatively for about 3-5 weeks before recovering. The Russia Ukraine war, so far, has followed this pattern with stock markets recovering from their lows.

Oil and Commodities

Energy (ticker XLE) is the best performing sector year-to-date. It is up close to 40%. One major reason for this is that ~10.5% of the world's oil is produced by Russia. Sanctions cast doubt about their ability to export oil. Moreover, Russia accounts for ~25% of the imports of crude oil in Europe; it is only ~5% in the U.S. Ned Davis estimates a $20 per barrel increase in oil translates to a -.4% impact on U.S. GDP. It would have a larger impact on Europe if they banned imports from Russia. So far, Europe has not called for a ban on imports of oil from Russia as they are too reliant.

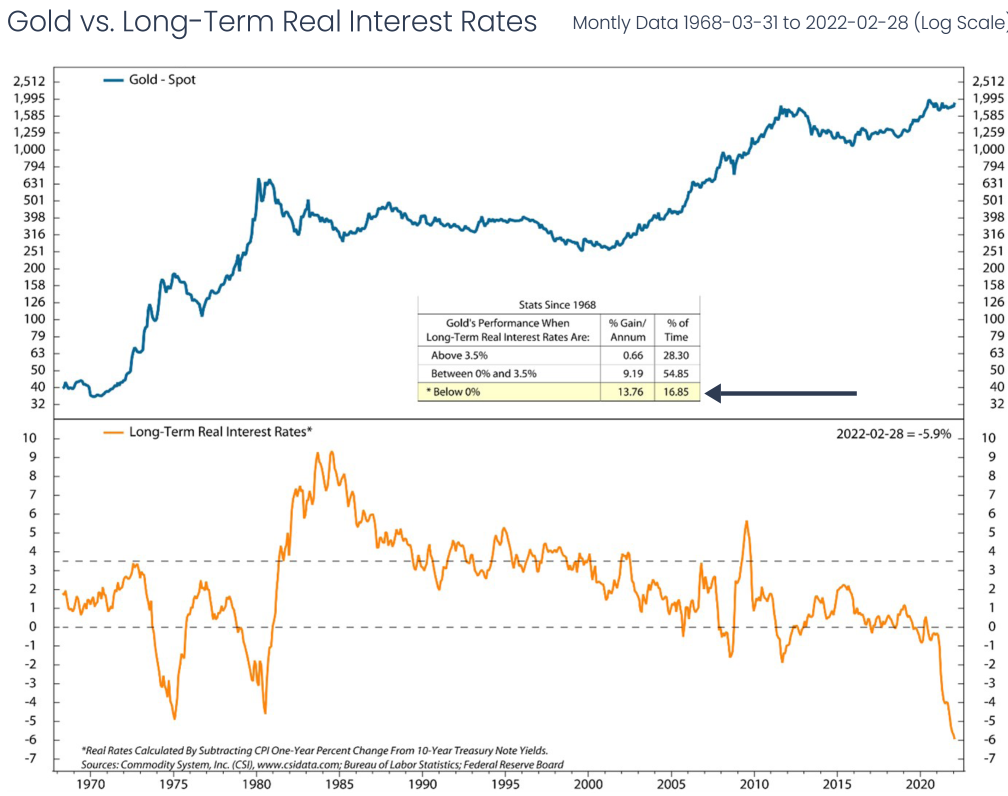
The war has reminded politicians and investors about the importance of energy independence and renewable energy. Renewable energy is an area Argent's investment team believes will outperform fossil fuels in the long run. Since the day Russia invaded Ukraine, renewable energy stocks (ticker ACES) have outperformed traditional energy stocks (ticker XLE) by over 5 percentage points.

Stock Index Returns Year-to-Date



Source: Factset, Argent Wealth Management, LLC © 2022

The war has also increased the cost of commodities. A basket of these is up about 25% year-to-date. Russia and Ukraine are major exporters of wheat, a key ingredient to food for much of the world. The increased cost of oil and commodities has increased, not surprisingly, inflation expectations. When increased inflation expectations come from supply constraints on inelastic or necessary goods like oil and food it forces consumers to spend less on discretionary items. This is negative for economic growth. Therefore, the risk of stagflation (when economic growth slows as prices for goods increase) has increased.



Source: Ned Davis Research Inc. © 2022

Gold is a good hedge in a stagflation environment and/or when real interest rates are negative. According to Ned Davis Research, gold is up on average 13.76% a year when a 10-year treasury note minus inflation is negative, and right now that equation equals -5.9%, the lowest it has been since 1975.

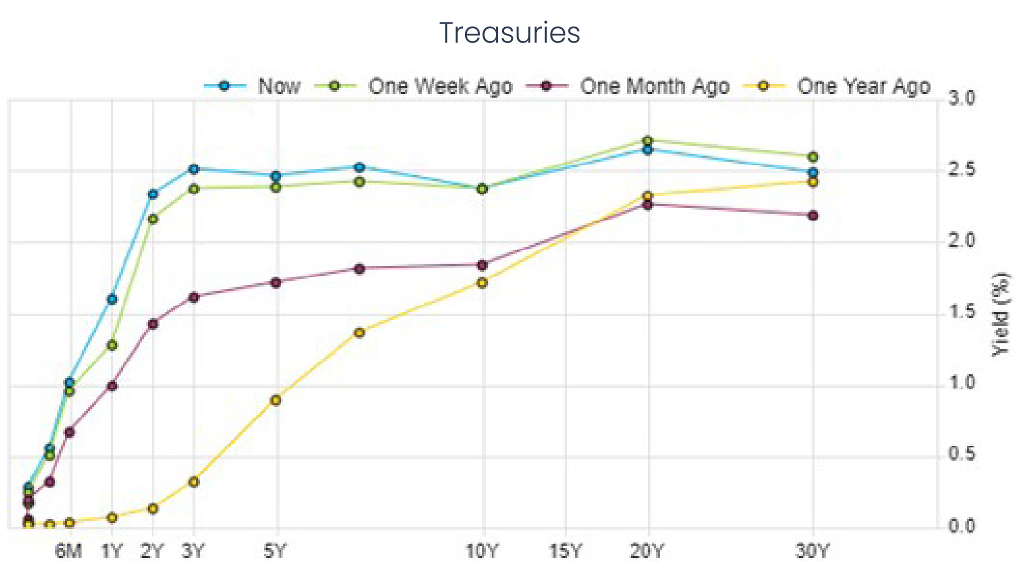
However, investors should not expect an environment like the 1970s. In 1973, when an oil embargo was proclaimed by what was essentially OPEC, 83% of U.S. oil imports came from the Middle East. Today, EIA.gov (Energy Information Agency) estimates that about 11% of imports come from OPEC countries, while the U.S. imports a total of 8.47 million barrels a day (mbd) from 73 countries.

In 2020, according to EIA.gov, the U.S. was the number one world producer of oil at 18.61 million barrels per day (mbd), or about 20% of the world's total. Saudi Arabia was the number two world producer of oil at 10.81 mbd. Russia was the number three world producer of oil at 10.5 mbd, or about 11% of the world's total.

The U.S. has the capacity to produce more, and on March 31 Biden announced the U.S. would release more from its strategic reserves. The U.S. could also import more from Canada, especially if the XL pipeline is engaged. In this instance, the U.S. could import approximately the same number of barrels from Canada as the U.S. does from Russia right now. Any of the above actions could lower the price of oil globally.

The Fed's Reaction and Interest Rates

Due to increased supply constraints due to the war, inflation expectations have increased. In turn, investors have increased their expectations for the Fed to increase the Federal funds rate this year to eight or more (this would get the Federal Funds rate to at least 2%). Members of the Fed remain hawkish as they want investors to know they aim to bring inflation down. To do this they must slow the economy to better match aggregate demand with aggregate supply.



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In reaction to this, interest rates in the U.S. increased. The yield curve has inverted. This almost always precedes a recession.

The message from the yield curve is to expect inflation and economic growth today but less inflation and growth in the future (and potentially a recession). This makes sense. When the Fed hikes rates it takes 6-9 months for it to trickle into the economy and slow it down. Typically, an inversion occurs 1-2 years before a recession begins.

Action Plan

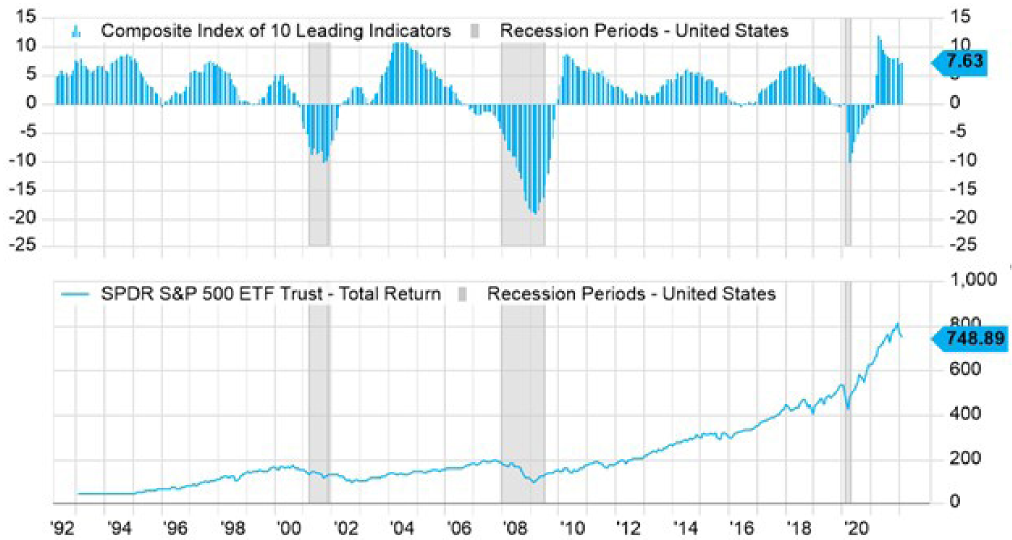
Importantly, the stock market has historically done well after an inversion before a recession begins. The economy tends to grow, along with earnings, until the rate hikes fully impact the economy and slow it down. During this period stocks tend to do well. Stocks tends to react swiftly and negatively once it is clearer that a recession is imminent, and the timing of this is more closely associated with the month over month trend in Leading Economic Indicators (LEIs).

For this reason, investors should maintain their allocation to stocks. If LEIs start to trend down meaningfully, investors should get incrementally more defensive within their risk tolerance ranges and long-term asset allocation plan. In the meantime, own some gold in your defensive allocation as a hedge to stagflation. Within bonds, as LEIs trend down, move towards treasury bonds from corporate bonds. For now, own bonds with maturities in the 2–5-year range as you get a similar yield as a 10-year bond with less risk.

Gold and Bond Index Returns Year-to-Date

Source: Factset, Argent Wealth Management, LLC © 2022

US Index of Leading Indicators



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