MARKET COMMENTARY

Redlight/Greenlight—What Are the Risk On and Risk Off Strategies You Should Be Considering Right Now?

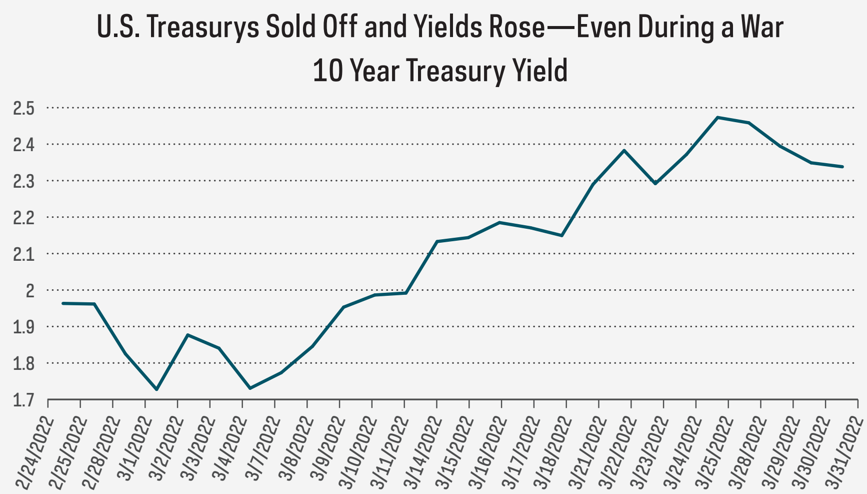
APRIL 2022

from Simeon Hyman, CFA
Global Investment Strategist

KEY OBSERVATIONS

What trades are risk on, and what's risk off in the current climate? With the war in Ukraine continuing, an extremely brief flight-to-safety Treasury rally was followed in March by a month of stocks solidly in the green and bonds in the red.

Chart of the Month:



Source: Bloomberg. Data from 2/24/22-3/31/22.

Some people seem to believe that the past month's stock rally has been driven by just how unattractive bonds have been. Inflation, rate hikes and quantitative tightening all point to a period of rising interest rates. And the direct relationship between rising yields and falling prices for bonds may be moving investors toward stocks, where at least the outcome is more ambiguous.

Other people have seen stocks as attractive in their own right, with ample earnings, cash flow and dividend growth to overcome current inflation and rising interest rates.

The choice doesn't have to be binary:

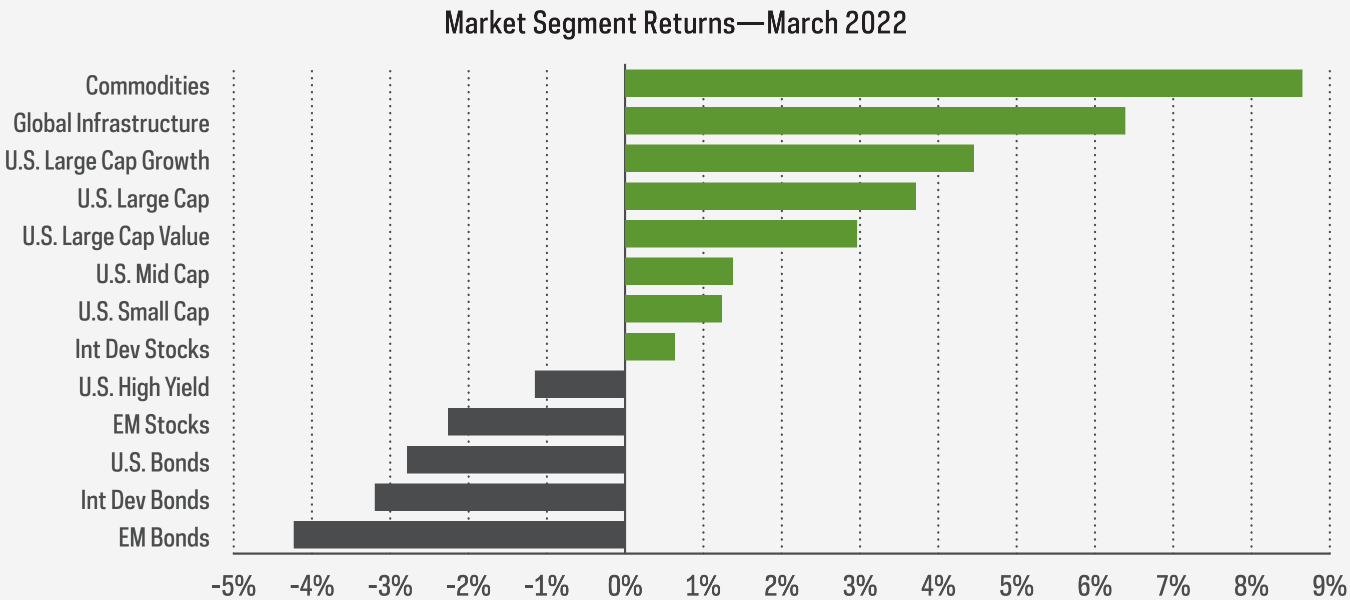
- **Considering bonds:** A range of indicators suggest that corporate credit is comparatively strong (see our fixed income section below). Bond strategies that focus on credit while considering opportunities to mitigate Treasury rate risk may be effective ways to maintain bond exposure, even in a rising interest rate environment.

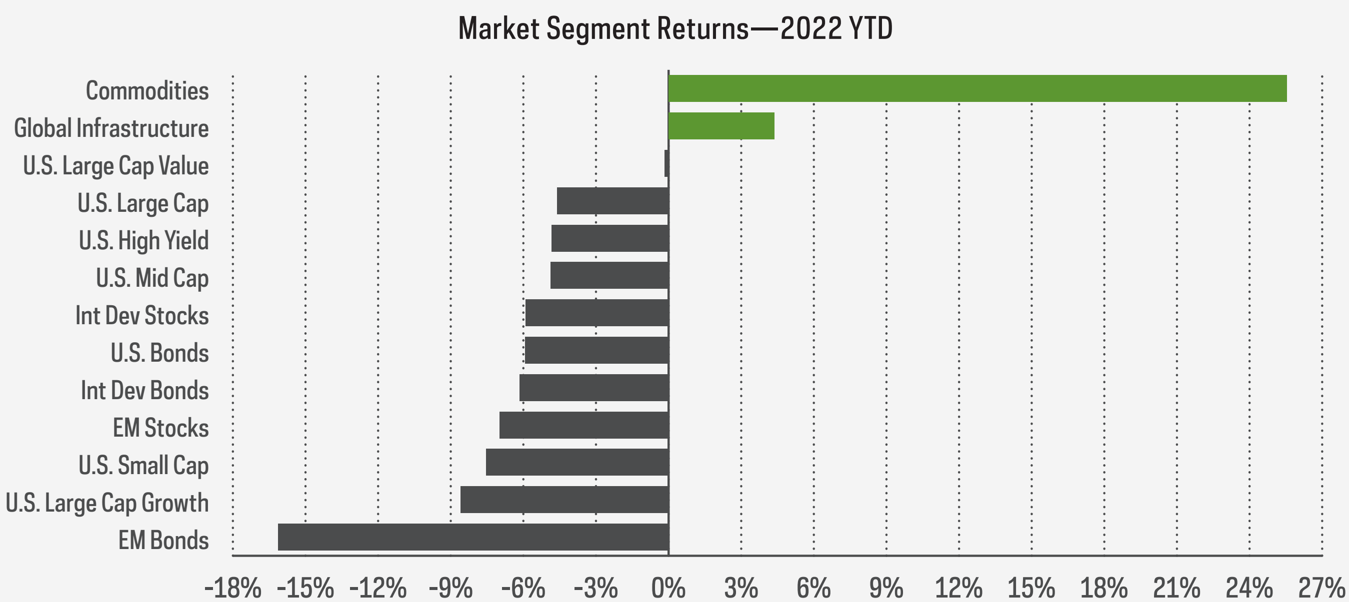
- **Considering stocks:** A well-constructed core allocation that delivers consistent earnings, cash flow and, particularly, dividend growth is never a bad idea. It is particularly important in a rising rate environment. However, there are opportunities to "lean into" it. You might consider sectors like financials, energy and basic materials that can have a leg up in a rising rate environment. You might also look to a real-asset-adjacent strategy like infrastructure (see our equity section below), where attractive yields and pricing power can come into play.

We'll leave the discussion of the "death of the 60/40 portfolio" for another day, but in the meantime, being extra clever about what's in the 60% and what's in the 40% makes a lot of sense.

PERFORMANCE RECAP

Returns of Various Common Market Segments



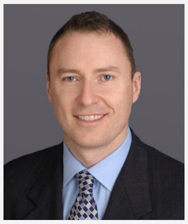


Source: Bloomberg. March returns 3/1/22–3/31/22, 2022 YTD year returns 1/1/21–3/31/21. Performance quoted represents past performance and does not guarantee future results.

ECONOMIC CALENDAR

Here's a list of upcoming key economic releases, which can serve as a guide to potential market indicators.

Date Time	Event	Prior
04/12/2022 08:30	CPI MoM	0.80%
04/12/2022 08:30	CPI Ex Food and Energy MoM	0.50%
04/12/2022 08:30	CPI YoY	7.90%
04/12/2022 08:30	CPI Ex Food and Energy YoY	6.40%
04/13/2022 08:30	PPI Final Demand MoM	0.80%
04/13/2022 08:30	PPI Ex Food and Energy MoM	0.20%
04/13/2022 08:30	PPI Final Demand YoY	10.00%
04/13/2022 08:30	PPI Ex Food and Energy YoY	8.40%
04/14/2022 08:30	Retail Sales Advance MoM	0.30%
04/14/2022 08:30	Retail Sales Ex Auto MoM	0.20%
04/14/2022 10:00	U. of Mich. Sentiment	59.4
04/15/2022 09:15	Capacity Utilization	77.60%
04/19/2022 08:30	Housing Starts MoM	6.80%
04/20/2022 10:00	Existing Home Sales MoM	-7.20%
04/26/2022 10:00	Conf. Board Consumer Confidence	107.2
04/26/2022 10:00	New Home Sales MoM	-2.00%
04/28/2022 08:30	Initial Jobless Claims	—
04/29/2022 08:30	PCE Deflator MoM	0.60%
04/29/2022 08:30	PCE Deflator YoY	6.40%
05/02/2022 10:00	ISM Manufacturing	57.1
05/04/2022 10:00	ISM Services Index	—
05/04/2022 14:00	FOMC Rate Decision (Lower Bound)	0.25%
05/04/2022 14:00	FOMC Rate Decision (Upper Bound)	0.50%
05/06/2022 08:30	Change in Nonfarm Payrolls	431k



By Kieran Kirwan, CAIA
Senior Investment Strategist

EQUITY PERSPECTIVES

Taking Measured Equity Risk

Positive equity performance returned in March after a difficult start to the year. First quarter returns for equities and bonds remain mostly in the red, however, indicating we're not out of the woods just yet.

Indeed, the "timeless" 60% equity/40% bond allocation (based on 60% S&P 500/40% Bloomberg U.S. Aggregate Bond Index) remains down over 5% through March. Over the past few years, that classic framework has attracted scrutiny in terms of its worthiness as the gold standard for asset allocation. Given the prospect of rising rates, most of the attention recently has been focused on what to do with the 40%—the fixed income allocation. That's fair, given the market conditions, but what to do with equities remains an equally valid question.

Taking thoughtful and measured equity risks is perhaps more relevant than ever, particularly when the market remains susceptible to large swings (given the macro risks the market is facing). Higher-risk equity strategies seem to have become fashionable again in some pockets of the market in March, based on a cursory look at flows. However, steady positive returns can be realized without taking undue risks.

A Real Return Strategy for Days Like This

We speak often about the appeal of dividend growth strategies based on the Dividend Aristocrats®—high-quality companies with the longest track records of consistent dividend growth within their given indexes—forming the core of a well-built portfolio.

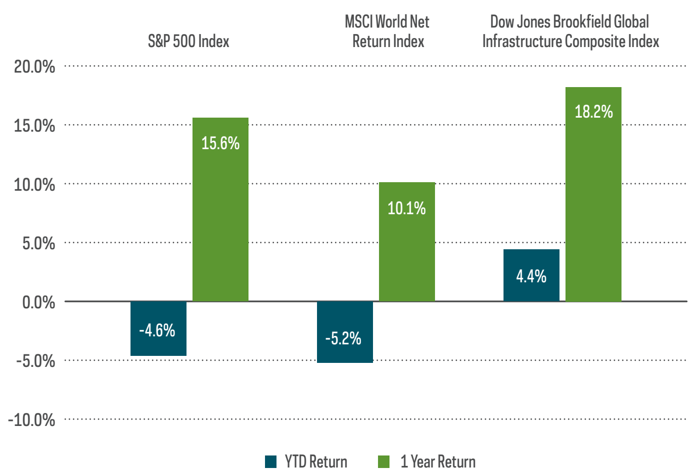
- Companies that grow dividends, regardless of the macro-economic circumstances, send a powerful signal to the market that they have confidence in their underlying businesses.
- Dividend Aristocrats typically have qualities like stable earnings and resilient cash flows that are used to pay income streams that grow at attractive rates—a timeless strategy indeed.

A global infrastructure strategy can also be appealing, serving as a potentially powerful and diversifying equity component during periods of high inflation.

- Owners and operators of transportation, energy, communication, and water assets (like toll roads pipelines, and cell towers) provide the essential things that we use in our lives every day.
- These companies have unique investment characteristics typically producing stable and predictable cash flows that can translate to attractive levels of yield. Often, infrastructure companies can raise their revenues at rates commensurate with inflation, making them an especially timely strategy.

The Dow Jones Brookfield Global Infrastructure Composite Index tracks companies that generate the majority of their cash flows from the ownership and operation of infrastructure assets. The index has delivered attractive rates of return over time and outperformed domestic stocks and global stocks over both year-to-date and one-year periods, as measured by the S&P 500 and the MSCI World Index, respectively.

A Potential Equity Strategy for Today's Market



Source: Morningstar. Data through 3/31/2022. Performance quoted represents past performance and does not guarantee future results.

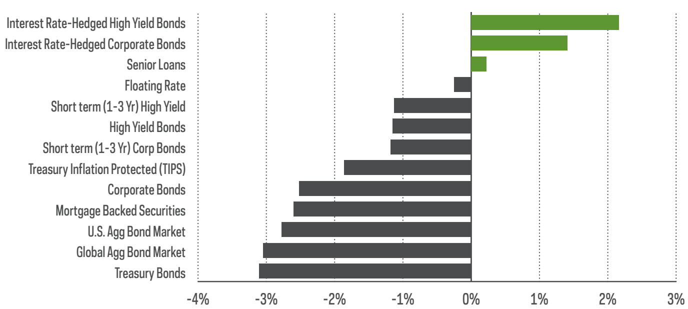
By Daniel Bush, CFA
Senior Investment Strategy Analyst

FIXED INCOME PERSPECTIVES

Rising Rates a Continued Threat

It was another tough month for bonds. In fact it was the bond market's worst monthly performance so far this year when looking at the Bloomberg U.S. Aggregate Bond Index, which dropped 2.8% in March. Rising Treasury yields continued to hurt the prices of bonds with extended durations, while tightening credit spreads helped offset the impact for bonds entailing credit risk. Strategies that pinpoint credit risk as a source of potential return came out on top.

Fixed Income Returns for March



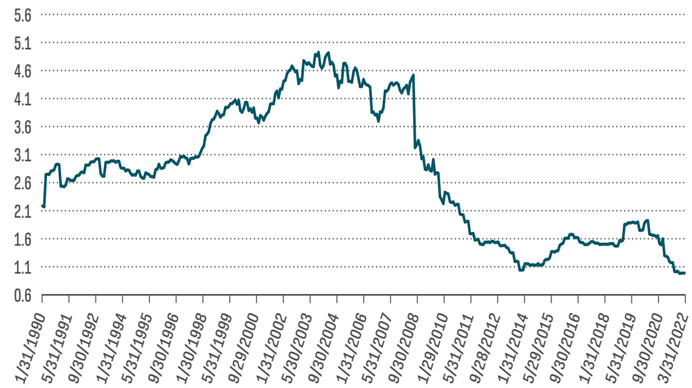
Source: Bloomberg. Data from 3/1/22-3/31/22. Performance quoted represents past performance and does not guarantee future results.

Treasury yields rose across the curve during the month, following the first rate hike from the Federal Reserve (the "Fed"). Interest rate sensitive bonds have been beaten down since August of 2020, and their outlook continues to look bleak. The Fed's latest dot plot indicates six more rate hikes this year, with officials expecting the Fed Funds Rate to end the year around 1.9%. Is it time for investors to cut their losses and reduce fixed income exposure?

Corporate Leverage and Credit Ratings Actions Indicate a Favorable Outlook for Credit

While interest rate risk is likely to detract from fixed income returns, the outlook for credit risk is a bit better. Corporate leverage is at historic lows when looking at Net Debt/EBITDA ratios, indicating that in the aggregate, companies in the United States may be in a strong financial position to pay off debt.

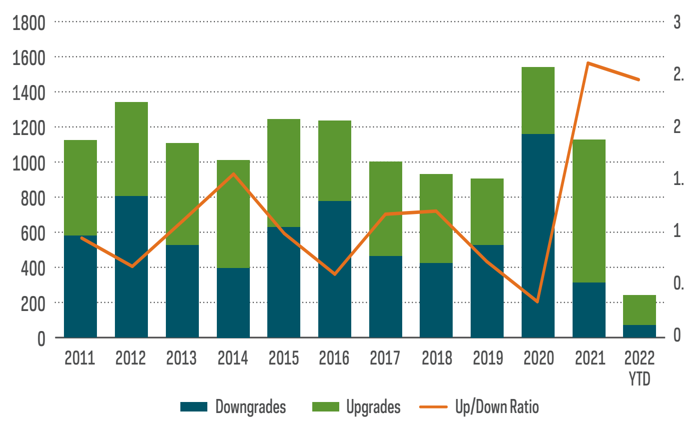
S&P 500 Net Debt/EBITDA



Source: Bloomberg. Data from 12/31/1989-3/31/2022. Net Debt/EBITDA measures a company's ability to pay off its debt by utilizing earnings before interest, taxes, depreciation and amortization (EBITDA).

Additionally, credit rating changes over the past year have been favorable from a historical perspective, with upgrades strongly outpacing downgrades. While credit spreads tightened a bit during investors' risk-on approach in March, they remain higher than any point in 2021, despite the economy and job market showing fairly robust gains. While uncertainty still lies ahead, credit may be the way to go for bond investors, given the outlook for interest rates.

Credit Rating Changes Over Time



Source: Bloomberg. Data as of 3/31/22.

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Important Information

Sources for data and statistics: Bloomberg, Morningstar, and ProShares.

The different market segments represented in the performance recap charts use the following indexes: U.S. Large Cap: S&P 500 TR; U.S. Large Cap Growth: S&P 500 Growth TR; U.S. Large Cap Value: S&P 500 Value TR; U.S. Mid Cap: S&P Mid Cap TR; U.S. Small Cap: Russell 2000 TR; International Developed Stocks: MSCI Daily TR NET EAFE; Emerging Markets Stocks: MSCI Daily TR Net Emerging Markets; Global Infrastructure: Dow Jones Brookfield Global Infrastructure Composite; Commodities: Bloomberg Commodity TR; U.S. Bonds: Bloomberg U.S. Aggregate; U.S. High Yield: Bloomberg Corporate High Yield; International Developed Bonds: Bloomberg Global Agg ex-USD; Emerging Market Bonds: DBIQ Emerging Markets USD Liquid Balanced.

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Bonds will decrease in value as interest rates rise. International investments may also involve risks from geographic concentration, differences in valuation and valuation times, unfavorable fluctuations instability. In emerging markets, many risks are heightened, and lower trading volumes may occur. Small- and mid-cap companies may lack the financial and personnel resources to handle economic or industry-wide setbacks, and, as a result, such setbacks could have a greater effect on small- and mid-cap security prices.