CETERA® INVESTMENT MANAGEMENT

COMMENTARY

April 26, 2022

Volatility Persists, but Fundamentals Haven't Faltered

- Volatility is rising again after a pause in late March.
- Headwinds for markets include Fed uncertainty, slowing earnings, and the lockdown in China.
- Despite these risks, we view the downside as limited from current levels.

Stocks are struggling again this month following a late March rally. There is a convergence of headwinds for markets right now. The Federal Reserve (Fed) is in the early stages of a rate hike cycle, there are concerns about slowing earnings growth, and the latest lockdown in China is adding to worries about a slowing global economy. We acknowledge these risks. In particular, there is a high degree of policy risk from the Fed. The economic situation could worsen if the Fed raises rates too aggressively, pushing up the chances of a recession. On the other hand, there are risks if the Fed raises rates too slowly because inflation is at a 40-year high. Surging inflation is negatively impacting consumer spending and the economy is slowing as a result. Markets are already feeling the sting. The S&P 500 is back in correction territory, which is a decline of more than 10%. The Nasdaq and Russell 2000 have both returned to bear market territory (decline of 20% or more).

Although market volatility is on the rise, there are reasons to be cautiously optimistic that the downside is limited from these levels. The underlying economic fundamentals are strong. We feel the economy can withstand less stimulus, which propped consumer spending in the initial stage of the expansion. Consumer balance sheets are healthy because consumer debt servicing costs are low and wages are rising at a fast pace relative to pre-pandemic levels. Additionally, business investment remains strong. Today's durable goods report from the U.S. Census Bureau showed a 1% rise in core capital goods spending last month and a 10% increase compared to a year ago. Firms are increasing this capex spending for anticipated growth and to improve productivity. The 2-10 yield curve briefly inverted earlier this month adding to concerns about a potential near-term recession, but other key data points aren't raising red flags at the moment. The ISM Manufacturing and Services PMI readings remain firmly in expansionary territory, although they have slowed from very high levels reached last year. Labor market data is very strong – the unemployment rate is just 3.6%, continuing claims for unemployment benefits are at the lowest level since 1970, and there is a record 5 million more job openings than unemployed individuals seeking employment. Historically, the Leading Economic Index (LEI) trends lower and declines year-over-year ahead of a recession, but the most recent reading in March rose to a new high and is up more than 6% versus a year ago.

Market momentum has shifted in 2022. The S&P 500 closed at a record-high 70 times last year and stocks have trended lower since reaching the lone S&P 500 record high this year on January 3. The good news is valuations have adjusted lower because of the correction in stock prices. The price-to-earnings ratio for the S&P 500 based on projected earnings declined from above 21 in December to 18 as of yesterday's close. Mid and small cap indices are trading at an even steeper discount relative to projected earnings and their historical average. About a quarter of S&P 500 companies have reported Q1 earnings. While earnings growth has slowed to 7%, more than 80% of firms beat earnings expectations and, earnings growth is expected to exceed 10% for 2022 according to the latest FactSet projections.

Despite the confluence of market headwinds, a prolonged bear market is unlikely in our view. To have a prolonged bear market, you need a sharp selloff and a recession. We are not expecting a recession this year and the S&P 500's correction is close to the average intra-year max drawdown of 14% since 1980.

Despite the selloff and spike in the CBOE Volatility Index (VIX), high yield bond spreads have not increased sharply. Nevertheless, we are in uncertain times and markets are facing less confidence as market headwinds have appeared. It is important to work with your financial advisor to help navigate through periods of volatility. We continue to recommend a diversified allocation to help dampen volatility risk.

This report is created by Cetera Investment Management LLC. For more insights and information from the team, follow @CeteraIM on Twitter.

About Cetera® Investment Management
Cetera Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. Cetera Investment Management provides market perspectives, portfolio guidance, model management, and other investment advice to its affiliated broker-dealers, dually registered broker-dealers and registered investment advisers.

About Cetera Financial Group
"Cetera Financial Group" refers to the network of independent retail firms encompassing, among others, Cetera Advisors LLC, Cetera Advisor Networks LLC, Cetera Investment Services LLC (marketed as Cetera Financial Institutions or Cetera Investors), Cetera Financial Specialists LLC, and First Allied Securities, Inc. All firms are members FINRA / SIPC. Located at 655 W. Broadway, 11th Floor, San Diego, CA 92101.

Disclosures
Individuals affiliated with Cetera firms are either Registered Representatives who offer only brokerage services and receive transaction-based compensation (commissions), Investment Adviser Representatives who offer only investment advisory services and receive fees based on assets, or both Registered Representatives and Investment Adviser Representatives, who can offer both types of services.

The material contained in this document was authored by and is the property of Cetera Investment Management LLC. Cetera Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Cetera Investment Management and did not take part in the creation of this material. He or she may not be able to offer Cetera Investment Management portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Cetera Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about Cetera Investment Management, please reference the Cetera Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are not actively managed. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

A diversified portfolio does not assure a profit or protect against loss in a declining market.

The Russell 2000 index is comprised of 2000 small-capitalization companies. It is made up of the bottom two-thirds in company size of the Russell 3000 index.

The Chicago Board Options Exchange (CBOE) Volatility Index, commonly known by its ticker symbol VIX, is a measure of the stock market's expectation of volatility implied by S&P 500 index options.