NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

May 2022

VOLATILITY

Keep Calm And Carry-On

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Talking Points

DEFINITIONS

INSIGHTS AND OBSERVATIONS

CONSIDERATIONS

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CONSIDERATIONS

Some Definitions

vol·a·til·i·ty

/ˌväləˈtilədē/

noun

1. liability to change rapidly and unpredictably, especially for the worse.
   "the succession of new rulers contributed to the volatility of the situation"
2. tendency of a substance to evaporate at normal temperatures.
   "the volatility of chemicals in an indoor environment"

Finance | Volatility is a statistical measure of the dispersion of returns for a given security or market index. In most cases, the higher the volatility, the **riskier the security**. Volatility is often measured as either the **standard deviation** or **variance** between returns from that same security or market index.

VIX | The **VIX** is the ticker symbol for the Chicago Board Options Exchange (CBOE) Market Volatility Index. This index measures the "**implied volatility**" or the **market's forecast of a likely movement** in a security's price. In this case, a basket of S&P Index Options.

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INSIGHTS AND OBSERVATIONS

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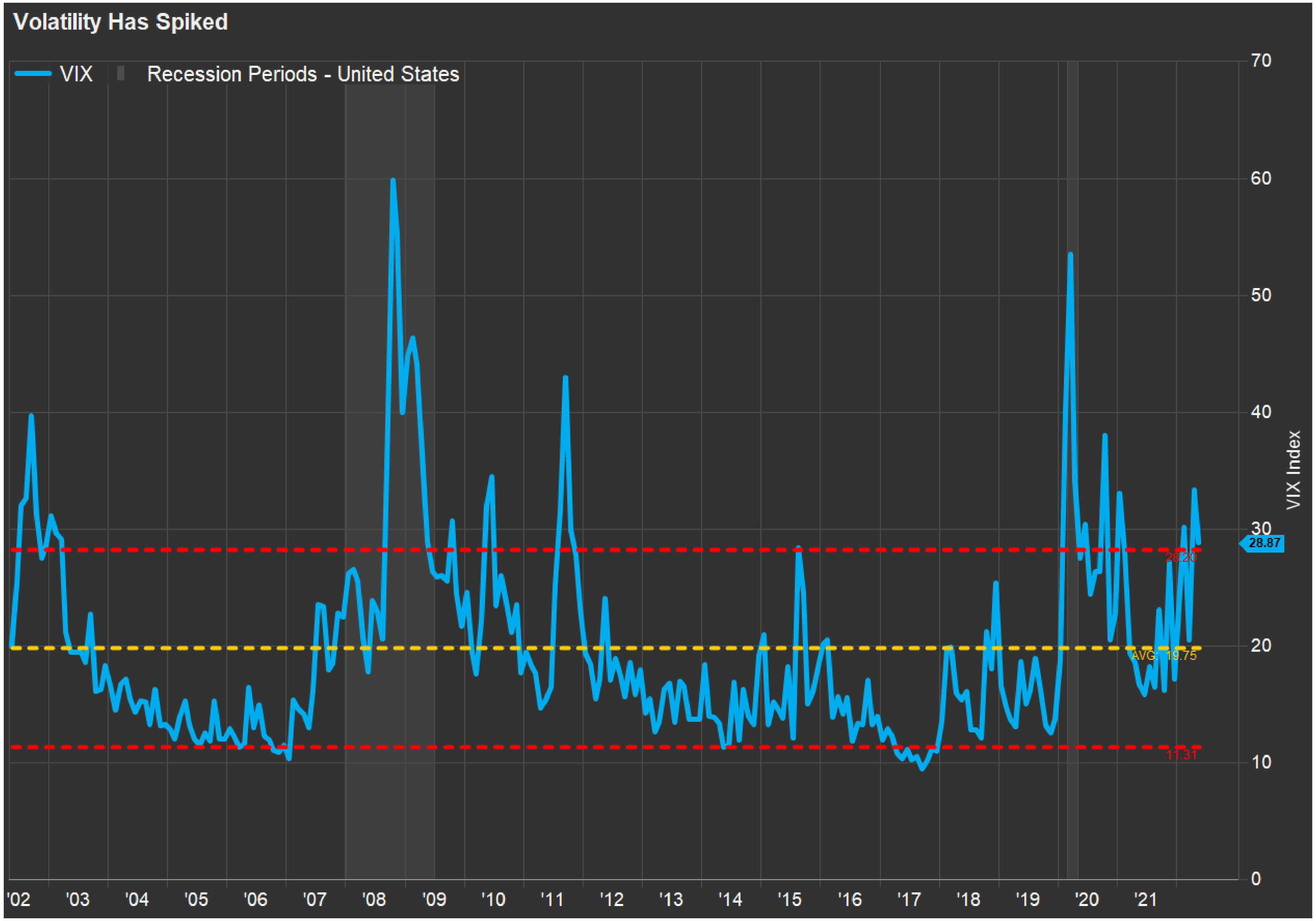
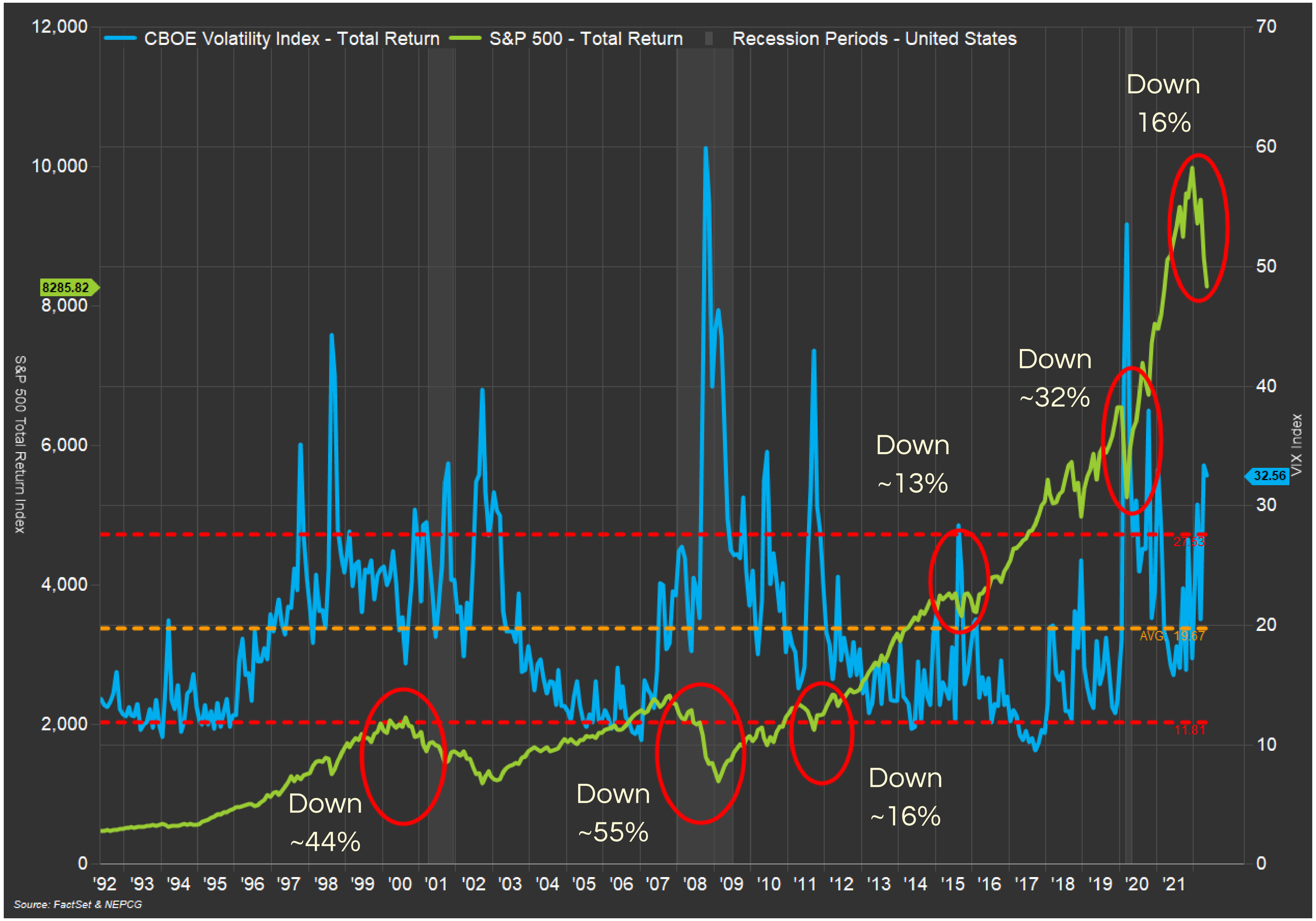
Volatility Insights

Volatility Spikes Are Typically Risk Off Trades | Keep Calm and Carry-On



Volatility Insights

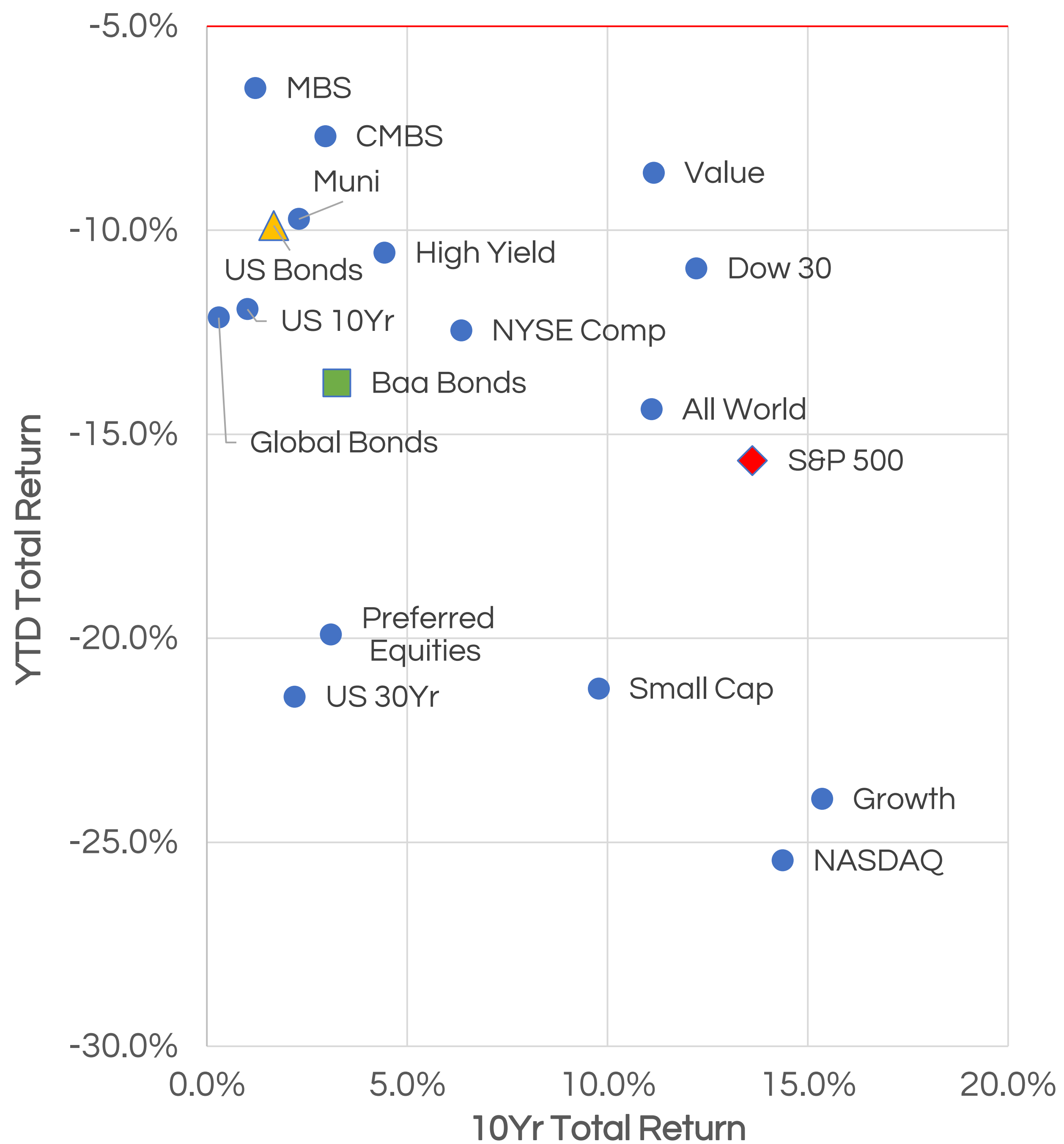
Volatility Spikes Are Typically Viewed As Risk Off Trades | Keep Calm and Carry-On



Performance Review

Nobody told me there'd be days like these...

- As of May 13, 2022, the S&P closed at $4,024, representing a year-to-date (YTD) total return of negative 15.0%.
- Inflation concerns have tightened financial conditions, with the U.S. capital markets bearing much of the brunt.
- Top-performing asset classes thus far through 2022 include Mortgage-Backed Securities, down only 6.5%, followed by Commercial Mortgage-Backed Securities (-7.7%) and Value oriented equities (-8.6%). Lagging returns were provided by the technology laden NASDAQ (-25.6%)
- The top-performing sectors thus far in 2022 were Energy (+47.3%), followed by Staples (-0.2%), and Utilities(-0.3%).



Source: FactSet

Economic Review

COVID Accelerated the US Into A New Economic Cycle With New Challenges

- COVID 19 and the ensuing global recession ended the 129th consecutive month of economic expansion here in the U.S. and the 132nd month of an equity bull market. Few anticipated the ensuing challenges ahead for global supply chains.

While COVID continues to disrupt a classic economic life cycle, we still believe the U.S. economy remains below peak levels and is somewhere just shy of halfway to its peak. However, the exact location on the economic life-cycle curve is unknown given both the idiosyncratic nature of a global pandemic and the unprecedented fiscal and monetary response from international central bankers.

Peak

* Top-line revenue begins to decelerate
* Financial conditions (credit) begin to tighten
* Earnings growth slows as margins are squeezed
* Confidence/consumer comfort peaks
* Inflation registers highest level in the cycle
* Credit spreads trough and start to hook up

Expansion

* Job growth begins to meaningfully expand
* Credit/lending growth begins to slow
* Profit margins expanding driven by lower costs
* Interest rates begin to increase more rapidly
* Confidence is rebounding in a material way
* Inflation begins to percolate, but not out of control

Decline

* Housing demand falling
* Federal Reserve turning dovish
* Inflation is MIA
* Corporate earnings/profits decline
* Overall business activity is falling
* Job growth tops out and turns negative
* Consumer confidence declining

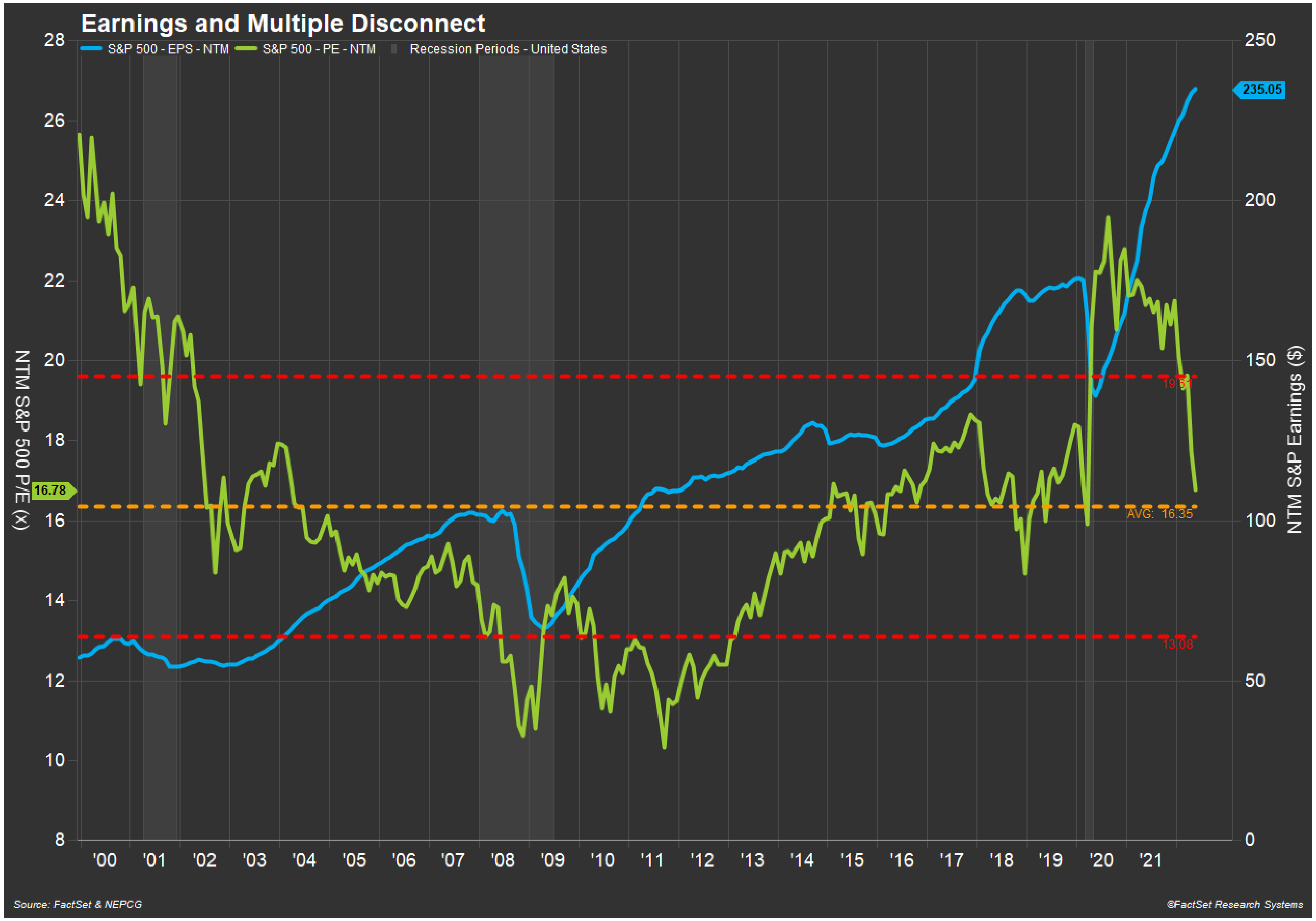
Trough

* Activity rebounds
* Credit begins grow
* Profit growth resumes
* Interest rates low/falling
* Confidence bottoms
* Inflation MIA

Source: NEPCG

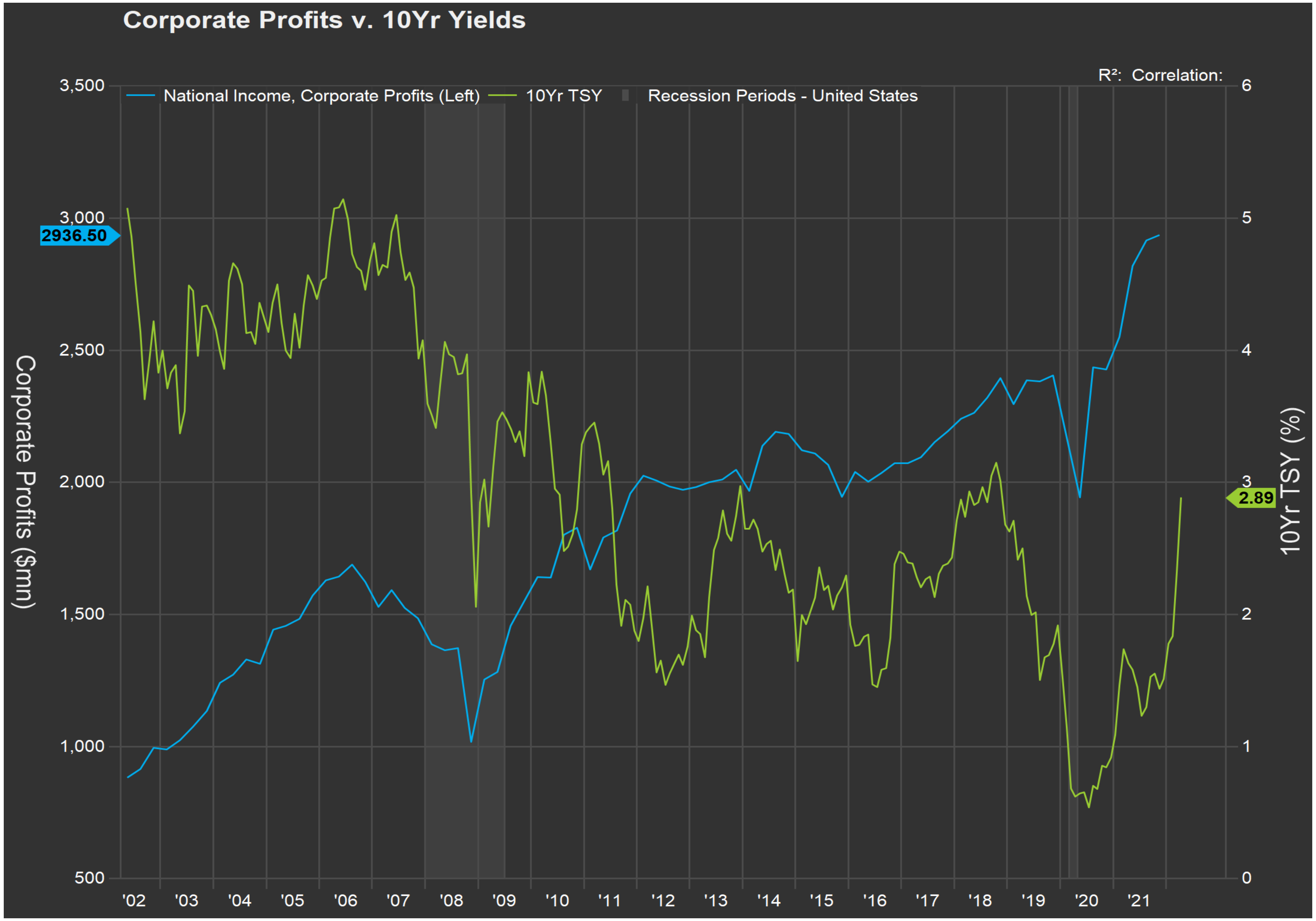
Earnings v. Valuations

Multiples have contracted while S&P earnings continue



Corporate Profits v. Yields

When Rates Are Rising For The Right Reasons

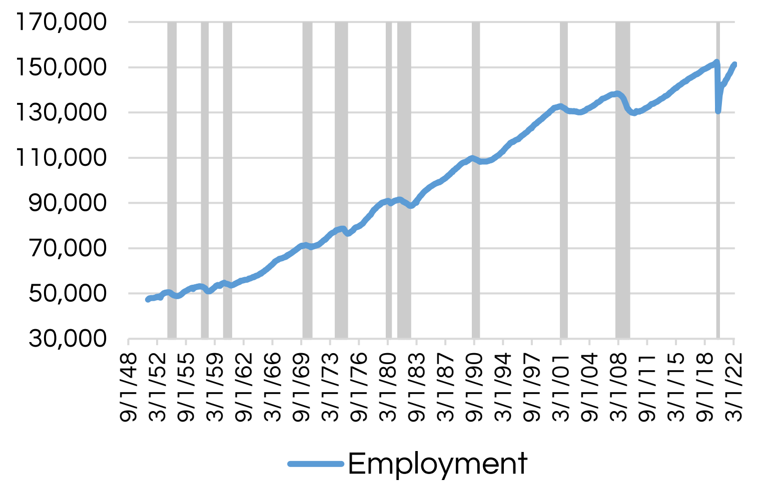


Economic Review

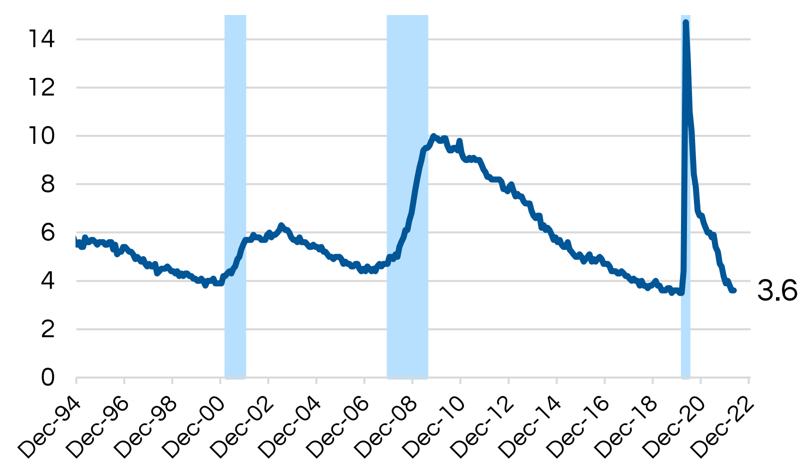
Jobs Are Plentiful | Keep Calm and Carry-On

- We believe the level of disruption caused by COVID and the ensuing global monetary bail-out was, and remains, unprecedented, forcing economies to adapt rapidly.
- <u>**Jobs are the back-bone of any economy.**</u>

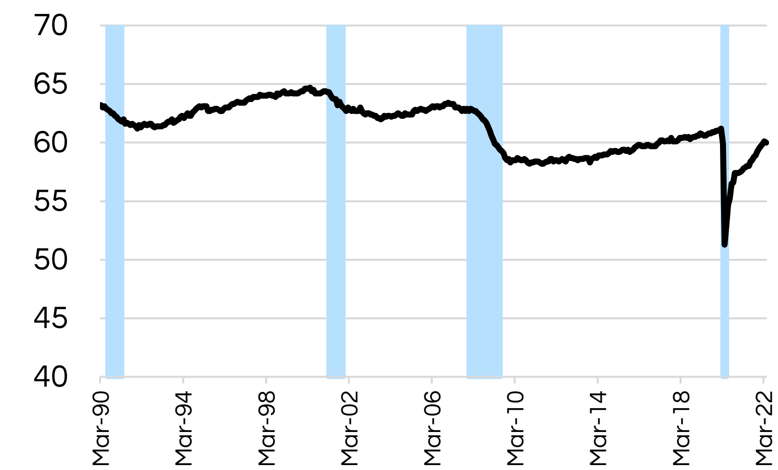
Job Market Trends



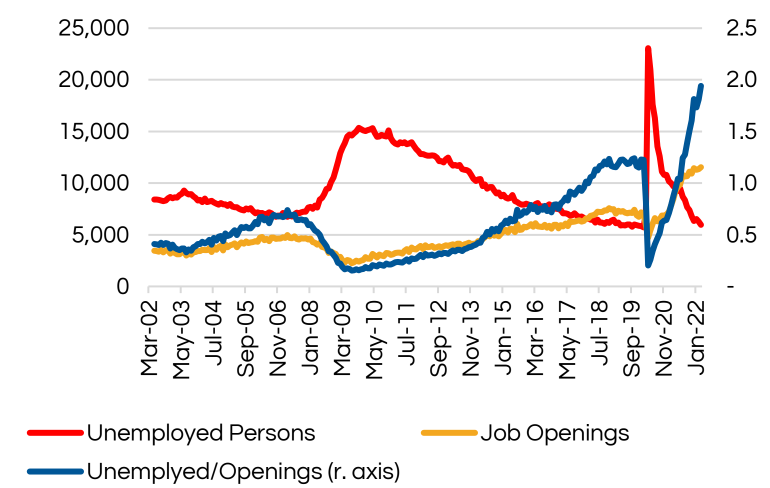
Unemployment Rate



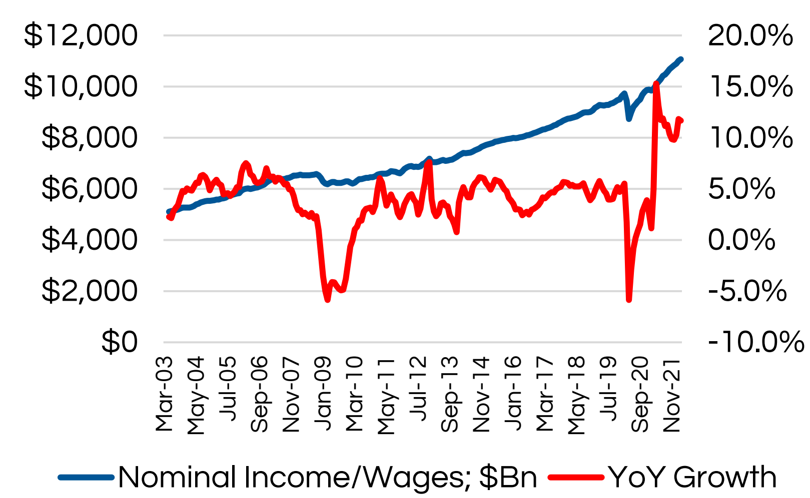
Employment/Population



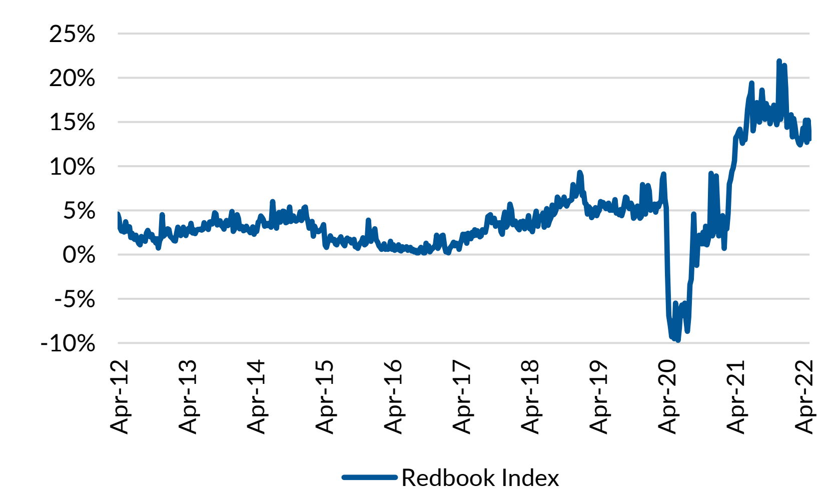
Openings To Unemployed



Nominal Income/Wages

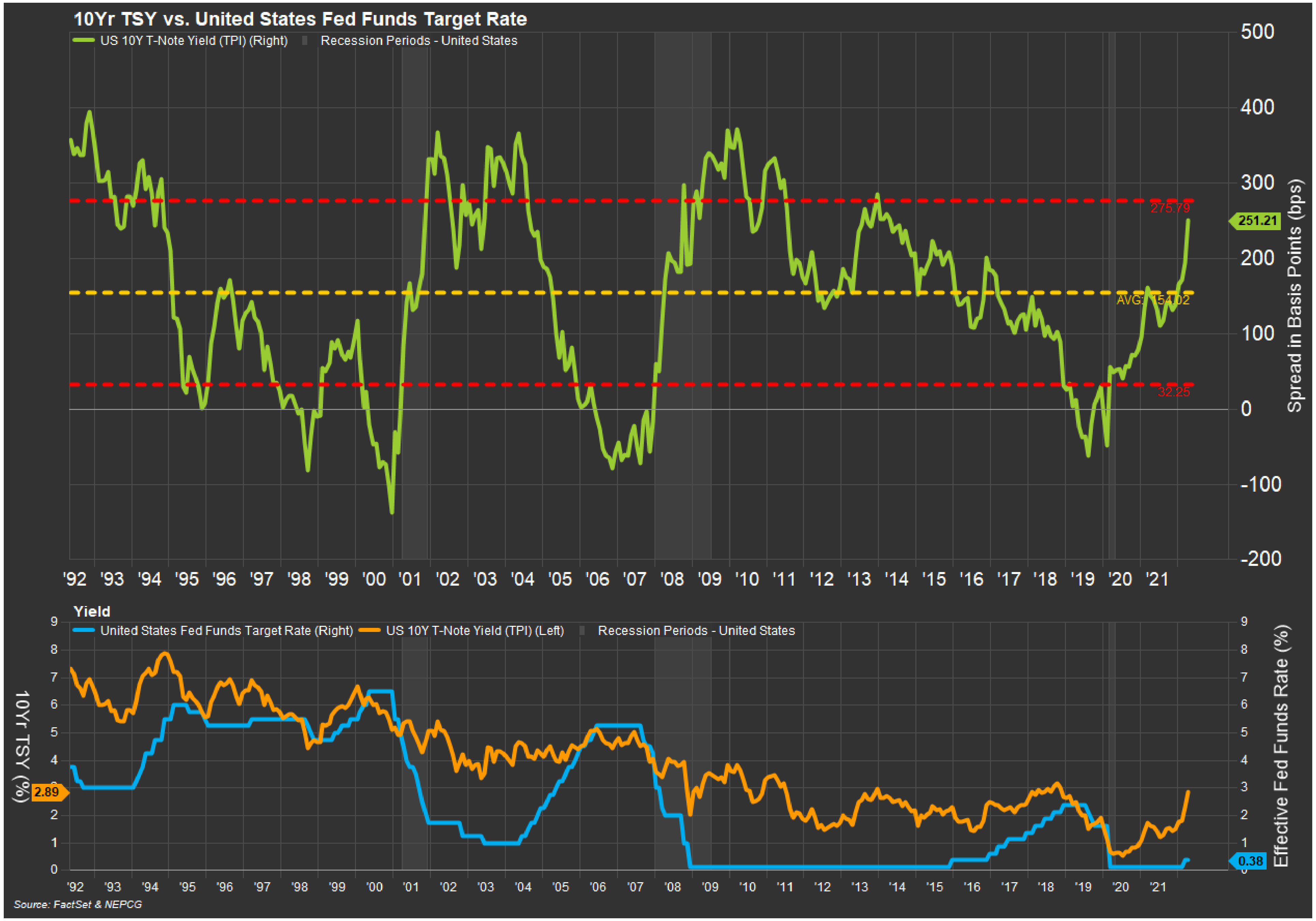


Retail Sales YoY Growth



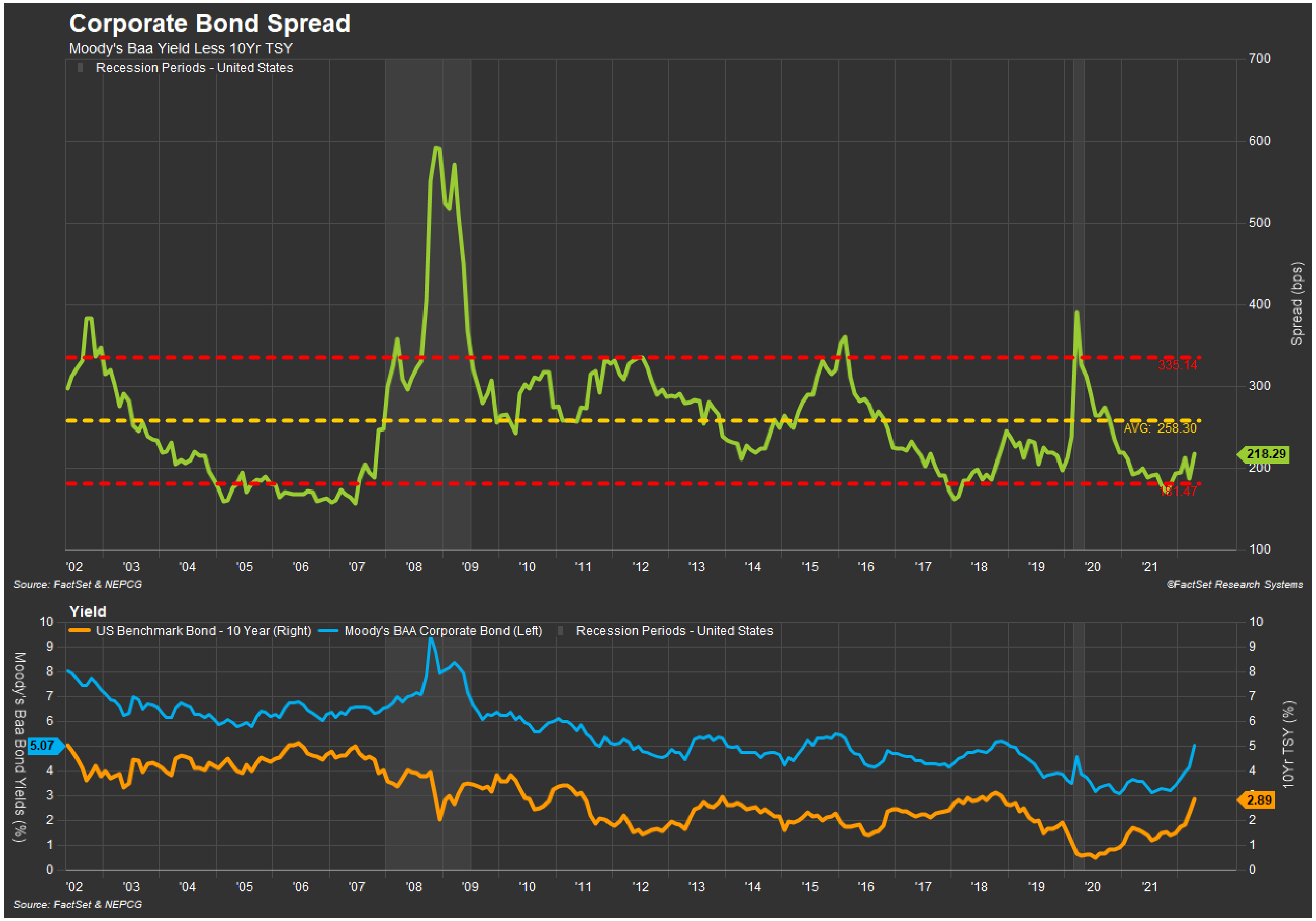
Economic Review

Recession Watch | 10Yr minus Effective Fed Funds NOT inverting = HISTORICALLY NO RECESSION



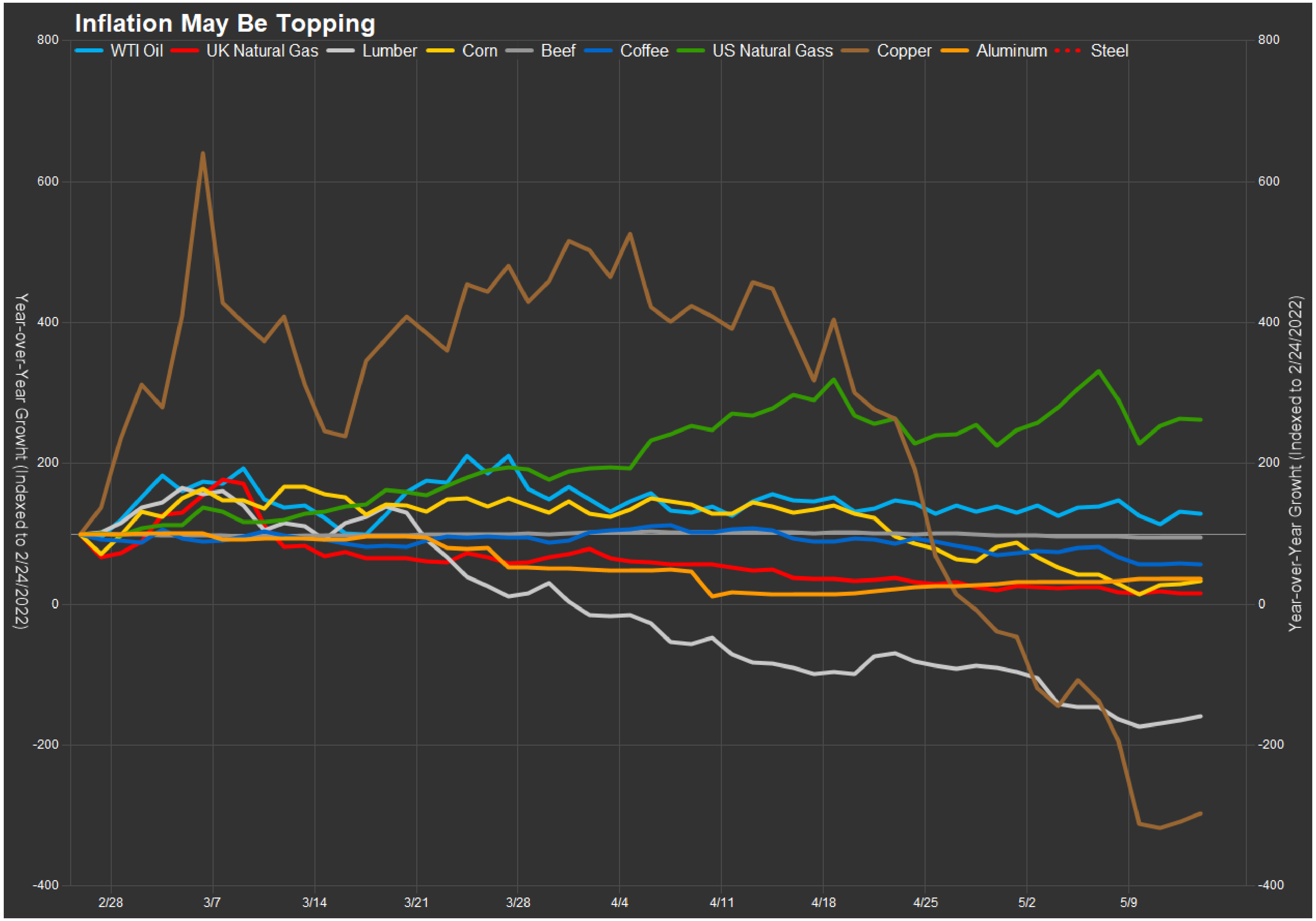
Economic Review

Recession Watch | Credit Spreads Are NOT Blowing Out = HISTORICALLY NO RECESSION



Economic Review

Inflation Watch | “Try To” Keep Calm And Carry-One



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Dislocation Events

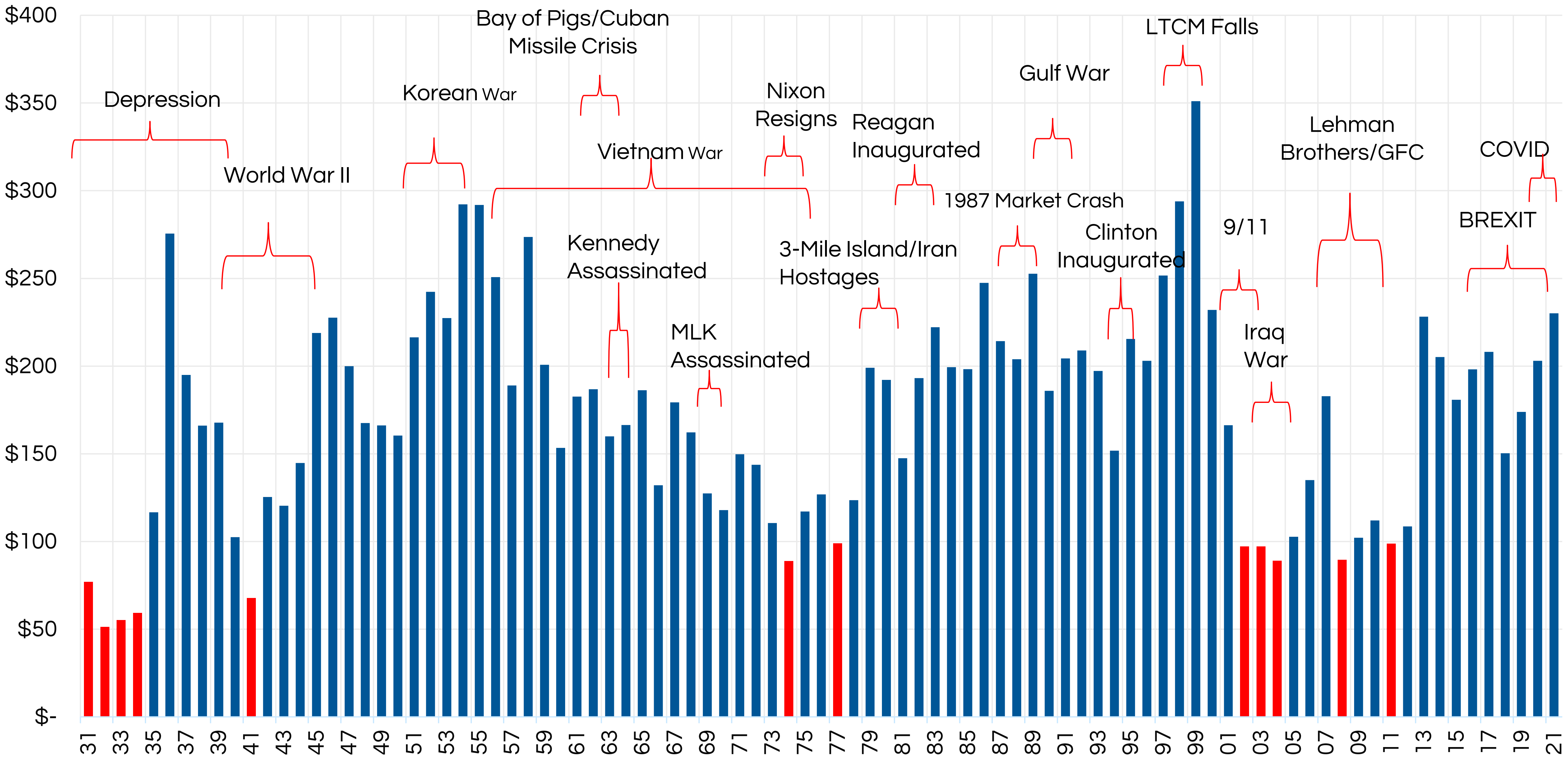
This Too Shall Pass | Keep Calm and Carry-On

				Percentage Change in S&P 500				
Dislocation Event	Start	End	Days	During	+1M	+1Y	+5Y	+10Y
Fall of France	5/9/40	6/22/40	44	-18.2%	3.1%	5.2%	15.9%	13.2%
Attack on Pearl Harbor	12/6/41	12/10/41	4	-6.9%	4.5%	16.0%	18.1%	17.1%
Outbreak of Korean War	6/26/50	7/13/50	17	-11.1%	9.5%	42.0%	27.6%	18.4%
Cuban Missile Crisis	8/23/62	10/23/62	61	-9.9%	15.5%	41.1%	15.8%	11.0%
Kennedy Assassination	11/21/63	11/22/63	1	-2.8%	7.0%	27.8%	12.4%	7.0%
US attacks Cambodia	4/29/70	5/26/70	27	-15.0%	6.4%	49.0%	9.3%	9.3%
Nixon resigns	8/9/74	8/29/74	20	-13.4%	-6.8%	30.6%	14.6%	14.6%
1987 market crash	10/2/87	10/19/87	17	-31.5%	7.1%	27.9%	17.0%	18.9%
Gulf War	12/17/90	1/16/91	30	-2.8%	17.2%	36.6%	17.3%	14.3%
Gorbachev coup	8/16/91	8/19/91	3	-2.3%	3.2%	14.5%	15.2%	14.3%
Collapse of LTCM/Russian Debt	8/17/98	11/15/98	90	-2.0%	-2.0%	25.5%	1.8%	-0.9%
September 11 terrorist attacks	9/11/01	9/21/01	10	-11.6%	11.3%	-11.1%	8.3%	3.9%
US invades Iraq	3/1/03	3/31/03	30	-2.1%	8.2%	35.1%	11.3%	8.5%
Collapse of Lehman Brothers	9/5/08	11/20/08	76	-39.1%	18.3%	48.8%	21.5%	15.8%
US debt downgraded by S&P	8/5/11	10/3/11	59	-8.0%	14.9%	35.0%	17.0%	17.1%
2016 BREXIT (2020 inacted)	6/23/16	6/27/16	4	-5.3%	8.5%	23.5%	16.4%	NA
COVID Pandemic	2/20/20	3/20/20	29	-31.7%	-31.7%	15.8%	NA	NA
Russian/Ukraine War	2/22/22				5.0%			
Average	**Ave Days**		**31**	**-11.4%**	**5.5%**	**27.3%**	**15.0%**	**12.2%**

Source: NEPCG, FactSet and Putnam

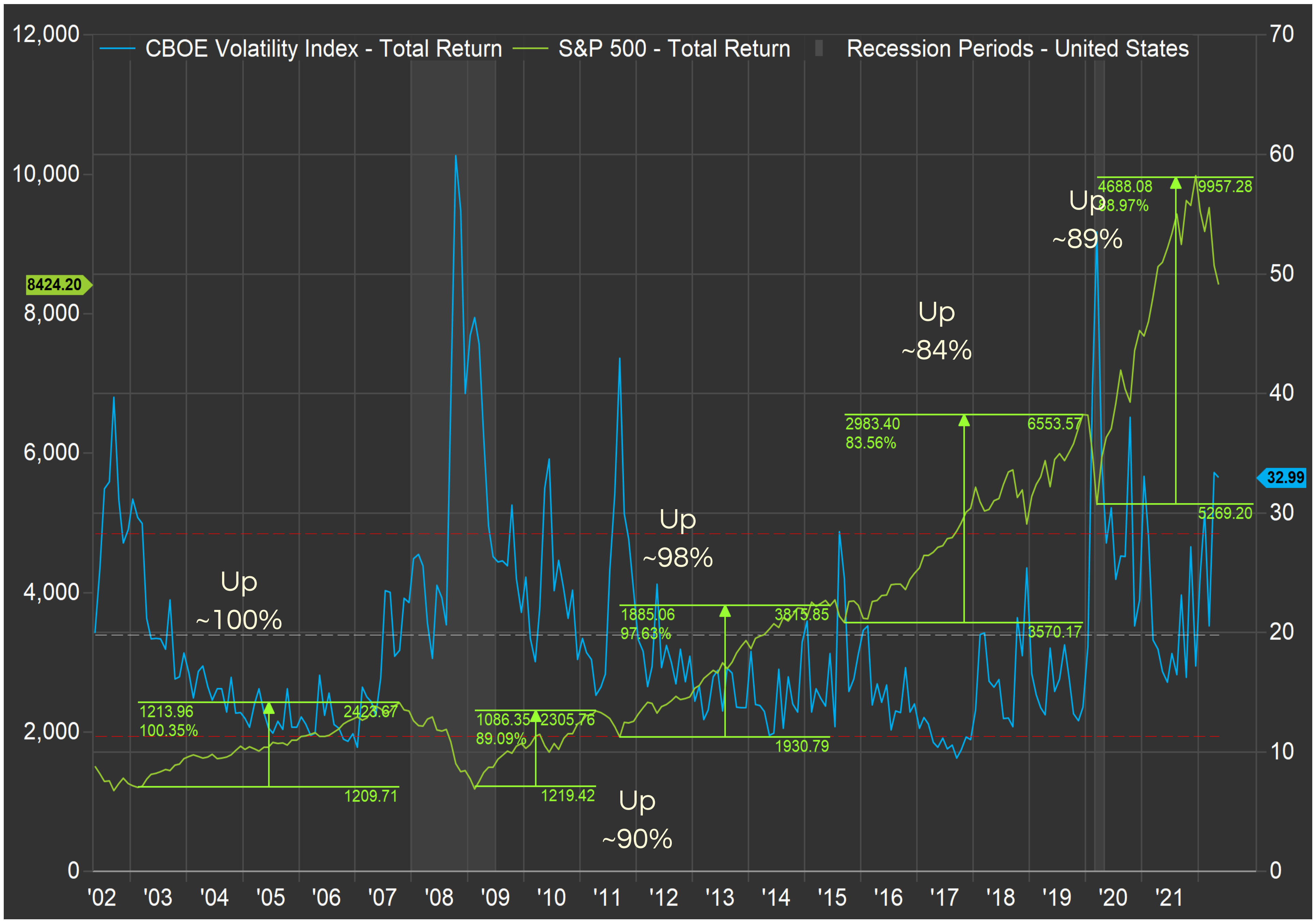
5-Year Look Back Given a $100 Investment

Investors Were Generally Rewarded | Keep Calm and Carry-On



Volatility Insights

Volatility Cuts Both Ways | Keep Calm and Carry-On



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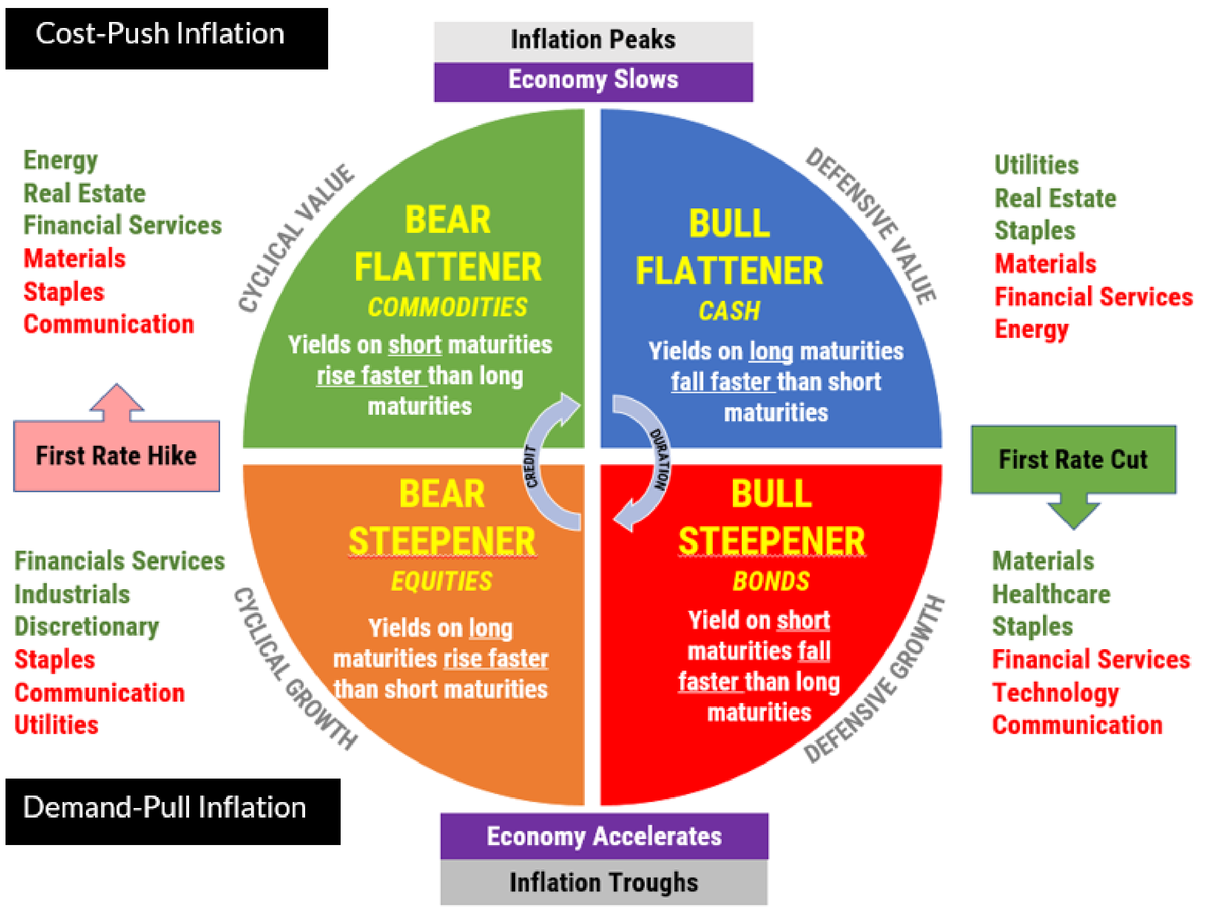
Second Half Play Book

Interest Rate Regime Rotation

- We introduced our Interest Rate Regime framework in our 2020 Outlook report entitled "What Goes Up."
- We intended to help investors triangulate the impact of monetary policy, yield curve dynamics, and equity sector returns.
- At the time, we suggested the U.S. capital market was somewhere between the end of a Bull Steepener (red shaded area) and the beginning of a Bear Steepener (orange shaded area) regime, following a series of Fed rate cuts and commensurate with an economy showing signs of topping.
- In our 2021 Outlook entitled, "Hope Over Despair," we suggested the U.S. capital market was firmly within a Bear Steepener regime. But we also introduced a notion that given the disruptive nature of COVID, certain historical yield curve/sector relationships may be dislocated. Still, we surmised that Value-oriented sectors, beneficiaries of an economic re-boot, would outperform.
- We now believe investors should brace for continued volatility up and through the Midterms, resulting in capital markets shifting between a Bear Flattener and Bull Flattener environment. We prefer Defensive Value sectors/styles for risk-off positioning and expect additional re-opening trends to fuel certain Cyclical Value sectors/styles.



Source: NEPCG and FactSet

The disruptive nature of COVID dislocated historical style/sector relationships. Extraordinarily low interest rates and a consistent bid for mortgage-backed securities (aka Quantitative Easing, "QE") by the FOMC helped drive housing prices. Combined with a re-boot of the global economy, we can now fully rationalize the outperformance of typically Bear Flattener sectors and styles such as Energy, Real Estate, and Commodities. But we believe Commodities and certain Bear Flattener sector/styles are rolling over

Second Half Play Book

It Is Different This Time Because There Was No Last Time

- **We are becoming increasing optimistic that the FOMC could orchestrate a "soft-landing" for the economy, despite occurring only 30% of the time, historically.**
- In our 2021 Outlook, we suggested to investors to "Flip The Script And Buy The Dip," suggesting that despite seeming over-valued from a multiple perspective, the S&P 500 was undervalued from an earnings-yield perspective, given how low interest rates were. Remember, the earnings yield of any stock or equity index is nothing more than the reciprocal of its P/E multiple.
- Then in our 2022 Outlook, we suggested that "…not all dips are created equal," and investors should view with caution the typical "buy-the-dip" mentality.
- Still, are lowering our near-term S&P 500 expectation (relative to our 2022 Outlook) driven by our earnings-yield framework in combination with our P/E construct, to the 4,350-4,500 range.

Key assumptions that drive this expectations are:

- ❑ The 10-Year Treasury Note trades range-bound, averaging 3.25% during 2022
- ❑ EOY 2023 earnings per share (EPS) for the S&P from $265
- ❑ A forward P/E multiple assumption of 17.0, compared to the long-term average of 16.5-17.0x

How Do We Get There?

Earnings Yield Approach

(A)	S&P 2023 Earnings (E)	$	265
(B)	10yr Assumption		3.25%
(C)	Historical Spread		2.85%
(D)=(B)+(C)	S&P Earnings Yield Imputed		6.10%
(E)=1/(D)	Implied "Spread" Multiple		16.39
(F)=(A)x(E)	Forward S&P Price Target		4,344
(G) Price On	5/13/2022		4,024
	% Upside		8.0%

Multiple Approach

(A)	S&P 2023 Earnings (E)	$	265
(B)	Forward P/E Assumption		17.0x
(C)=(A)x(B)	Forward S&P Price Target		4,505
	% Upside		12.0%

Source: NEPCG and FactSet

Second Half Play Book

Risks Remain…Nobody told me there'd be days like these

- Despite our relatively positive outlook for the U.S. economy and market expectations, our forecasts have several risks. Here are just a few.

  - ❑ The FOMC seems steadfast in increasing rates and restoring credibility. To this end, our assumptions for Fed Funds and the 10Yr TSY may prove to be too low.
  - ❑ A resurgence in COVID cases globally, and spikes in new variants, could temper economic growth and corporate earnings.
  - ❑ Geopolitical uncertainty could escalate commensurate with a prolonged war in the Ukraine and emboldened confidence of economic and military rivals of the United States.
  - ❑ Some investors are concerned about slowing economic growth and erosion of run-away inflation, despite continued re-openings across the globe.
  - ❑ Excessive spending proposals leading into Midterms could require an increase in corporate and/or individual taxes.
  - ❑ "Sell in May[(a)]" and Go Away mentality may take hold as many investors, managers and traders maybe looking forward to the first "real" summer holiday in several years.

(a) "Sell in May and go away" is an adage referring to the historically weaker performance of stocks from May to October compared with the other half of the year. Since 1990, the S&P 500 has averaged a return of about 2% annually from May to October, versus about 7% from November to April. -- Investopedia

Wealth Management Process

We Are There, Even When We Aren’t There.

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