Lynx Capital Group Ltd

Disciplined Strategic Investment Management

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Market outlook as of April 2022

"No matter what political reasons are given for war, the underlying reason is always economic."

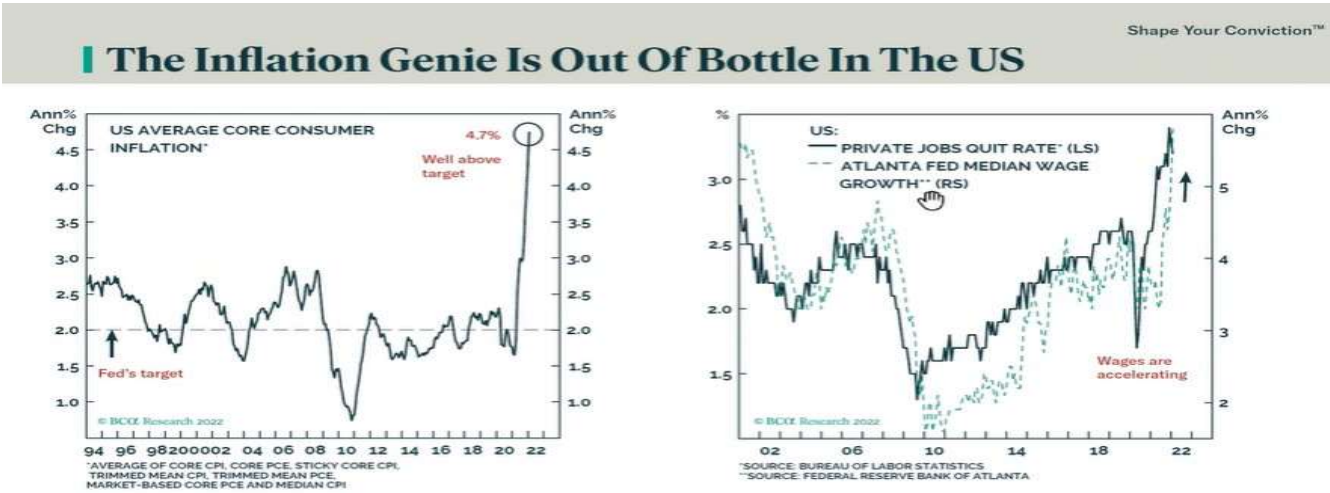
Alan John Percivale Taylor FBA (25 March 1906 – 7 September 1990) was a British historian who specialized in 19th- and 20th-century European diplomacy. Both a journalist and a broadcaster, he became well known to millions through his television lectures. In a 2011 poll by History Today magazine, he was named the fourth most important historian of the previous 60 years.

While we were constructive in our last Market Outlook, suffice to say, a lot has taken place during the last quarter! Rising inflation, supply-chain issues and the uneven COVID recovery were already collaborating at the year end to slow global economies in 2022. The Ukraine invasion exacerbated everything, from the uncertainty of war to commodity price shocks especially gas at the pump. This forced analysts to recalibrate their GDP estimates as it took its toll on household budgets especially amongst the middle to lower classes. They were already struggling due to higher energy, food, used car and rental increases. Crude could also go a lot higher in the summer due to vacation driving. As the U.S. is a consumer driven economy accounting for around 70% of GDP they are a key indicator of future economic health.

As we mentioned in our last outlook, we were concerned about certain valuations and manias mainly in the technology area. The technology index dropped over 9% for the first quarter as investors recalculated valuations due to expected higher interest rates. The speculative manias have fared a lot worse with ARK Innovation ETF the poster child of the manias being down over 60% since February 2021 and down around 30% for the quarter.

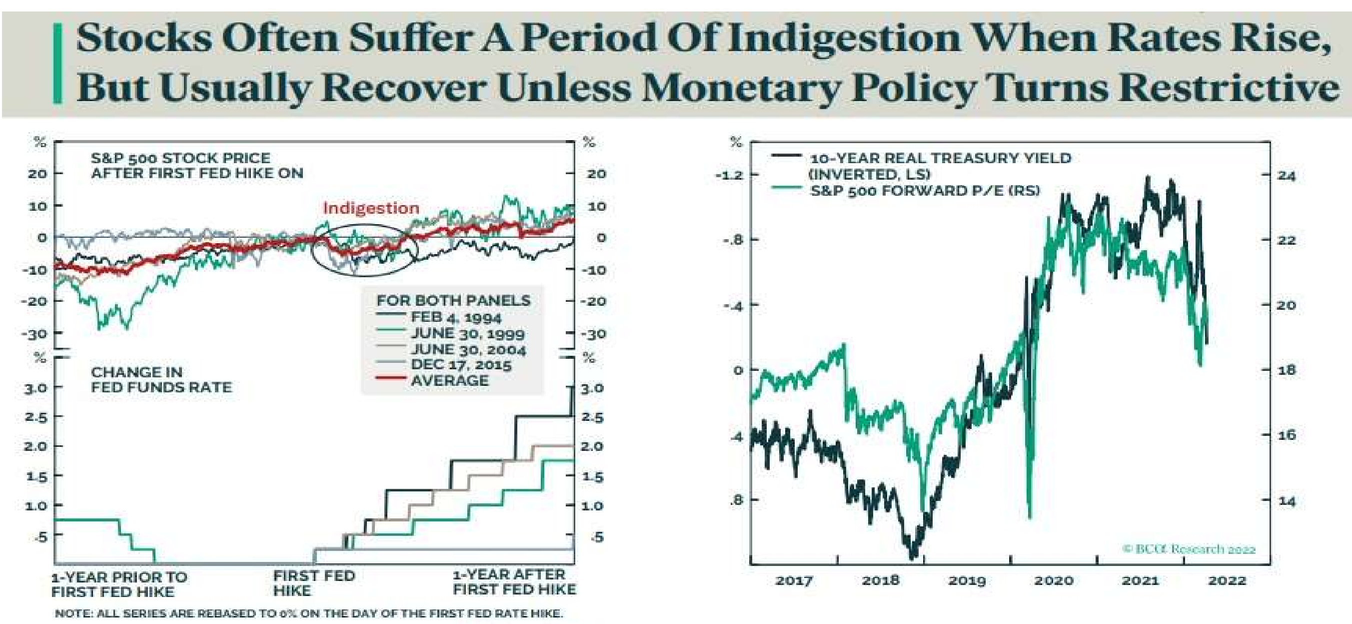
Consumer price inflation in the US reached an annualized rate of 8.5% in March, a 40-year high. As we have stated previously, even when it cools, we think it is highly likely to remain much higher than we are accustomed to for many years. Investors need to employ a more strategic view into their investment portfolios by actively seeking out those type of investments that will hold up in an inflationary environment, while shunning those that will bear the brunt of inflation. This involves an understanding of the relationship between inflation, earnings and returns and focusing more on companies that have "pricing power", an important indicator of a quality business, even more so when inflationary forces are running rampant.

As households pay more for gas, they will have to spend less on other goods and services. Expenditures were already set to weaken this year in the absence of Federal stimulus, particularly for middle to lowerincome households that have already spent much of the savings they accumulated in 2020 and the beginning of 2021. On the bright side, energy costs account for a smaller share than they did during the 1970's oil crisis, meaning a price spike does not have as an pronounced effect.

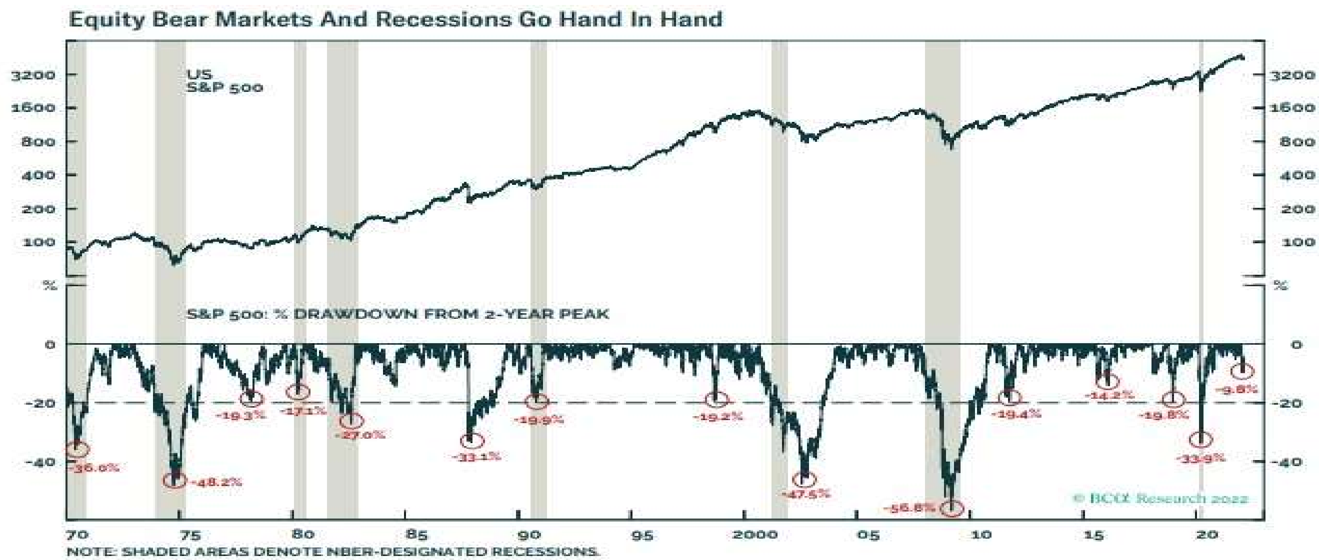


Markets are currently pricing in about seven 25-basis-point (0.25%) rate increases in 2022. The Fed is increasingly concerned about inflation becoming unmanageable, and its latest projections indicate it may move rates above its estimated long-term neutral rate of 2.4% by next year. The neutral rate is a theoretical federal funds rate at which monetary policy is considered neither accommodative nor restrictive.

The Fed faces tough choices. If the Fed remains passive, allowing inflation to run higher, food and energy prices would be amongst the most likely to accelerate even further. If they tighten aggressively, they will not only stymy growth, but could cause a recession raising unemployment and curtailing wage growth as well.



While there is plenty of things to be concerned about, we do not think a bear market (overall market decline of 20% or more) is likely this year as bear markets are closely correlated to economic recessions. (see chart below) We also think it is unlikely that we will see stagflation (inflation with no growth). The Fed still expects decent economic growth approaching 3% in 2022, mainly due to the post Covid economy recovering such as travel and entertainment and supply chain bottlenecks being alleviated. The release of the Strategic Petroleum Reserve lowers risk of recession in the near term.

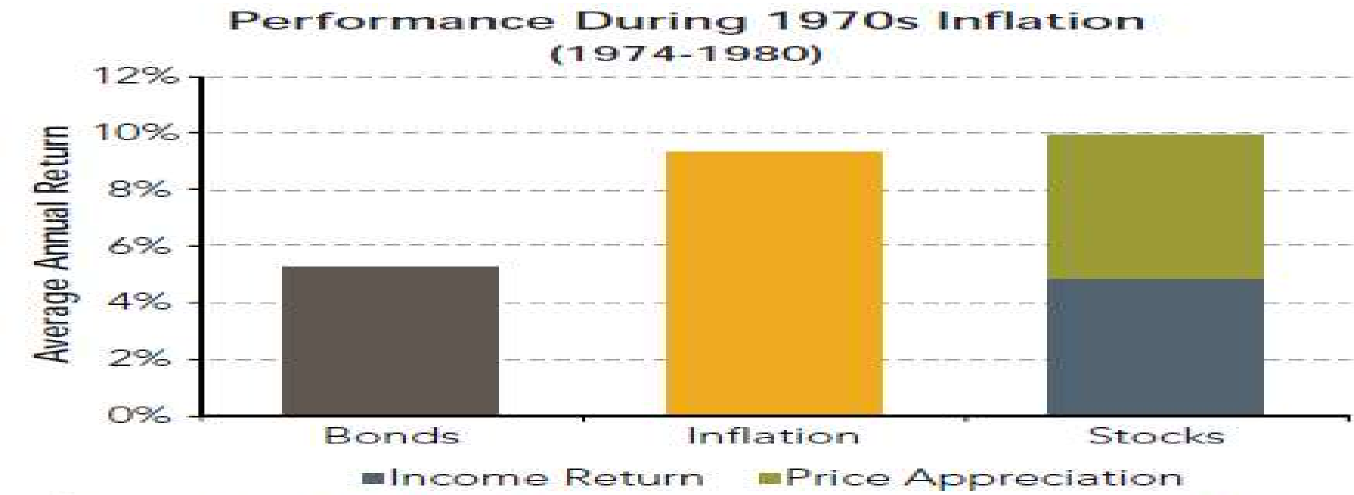


Portfolio thoughts going forward.

Towards the end of the quarter, markets stabilized from the Ukraine invasion shock, but risks still abound, from a Russian debt default to Covid lock downs in China. We expect more volatility ahead as the Fed wrestles with raining in inflation vs maintaining economic growth and unemployment without pushing the economy into a recession. The market is currently not fully pricing in weaker economic growth. Corporate earnings, are also so far, holding up well, should we start getting a lot of downward revisions expect more downward pressure on the market.

It is important to keep in mind, that while the market has become more volatile, there is still no large-scale alternative to equities. Cash and bonds are offering <u>negative</u> returns in relation to inflation. There has been a distinct outflow from Bonds (as they dropped around 10%!) this year looking for a better home. Consumers savings are in good shape and anyone who wants to work has employment. We as always, favor blue chip dividend growth stocks (with a value bias), especially now that bond returns are harder to come buy when the Fed is raising rates.

During the 1970s, dividends helped stocks outpace a historically high rate of inflation, while total returns for bonds lagged.



Inflation is the annualized percentage change in the Consumer Price Index. Source: Morningstar EnCorr, FMRCo. (MARE) as of 9/30/10. Past performance is no guarantee of future results.

As stated previously, we still feel very optimistic as quality, dividend paying stocks hold up well during modestly inflationary periods. While inflation tends to be bad for speculative stocks, dividend paying companies have tended to payout rates higher than inflation. They also tend to be growing their payouts faster than inflation. Many dividend stocks in sectors such as healthcare, financials, and consumer staples can successfully increase prices when commodity prices increase. Those companies are then able to increase payments with the additional cash flow.

It is always advisable to review one's individual circumstances and tolerance for risk. If any of your financial circumstances have changed, or you want to adjust your portfolios risk profile <u>we always encourage you to contact us should you want to make any changes to your portfolio allocation.</u>

As always, please feel free to contact us with any questions or concerns.

Brian Chait

President, April 13th, 2022

Each year Lynx Capital Group files a <u>Form ADV Part 2A.</u> The Form ADV Part 2A defines our business, key personnel and business relationships. If you wish to receive our Form ADV Part 2A and or a copy of our <u>Privacy Policy</u>, please contact us and we will gladly mail or email you a copy.