Portfolio Update

January 21, 2022

We have taken the step of reducing stock market risk across our portfolios as January has settled into a series of drawdowns exhibiting disquieting patterns. Maybe most notable is that even a positive move early in a trading session is dissipating and being overrun by sellers that have caused a pattern of disappointing closes to start the year. Technology in particular has been hit hard, breaking through prior support in July and October and looking to test the March and May lows. Across our ETF portfolios, we reduced equity investment through a basket of small and mid cap US stock ETFs and in select portfolios convertible securities as well. For our ESG strategies, we reduced equity through a broad US market ESG ETF and selectively lowered equity-linked bond risk by reducing a US corporate ESG bond ETF.

Time frame is everything. We are concerned about near-term threats to equity prices, from ongoing supply chain issues to pandemic-related labor shortages to broadening inflation and expected Fed action, all of which we have been writing about steadily for months. Looking at three weeks in January in isolation one sees an ugly picture being drawn.

Take a couple healthy steps back though, and these stresses and the market's reaction have much better context. Equities have been on a rocket ship. Looking at stock prices without looking at headlines and it would be difficult to find any signals we have been operating in a crisis environment. 5% annualized returns for US equities are satisfying and reasonable. 10% is an exceedingly good year. Depending on the index for measurement, US equity investors saw returns of more than 20%, or 25%, or even touching 30% in 2021. Just because we turned a page on a calendar does not mean everything resets to zero. We are standing on the peak of a run-up that has continued with small and brief pauses since March of 2020, or really since March of 2009. From a purely technical standpoint, a little consolidation following a massive run is not only reasonable and expected, it is healthy.

Markets have whipped through a series of paradigm shifts in a short period of time thanks to the pandemic. As we have written about extensively, the economy and markets were met with extraordinary legislative, fiscal and monetary action to address the crisis. This injection of liquidity inevitably drove up asset prices, but that could not continue indefinitely. Spending and consumption patterns abruptly changed as well as people in developed economies cocooned and shifted from spending in person to spending online and for items and services delivered to and in the home, from streaming to home food delivery to exercise, heavily benefiting hardware, service, and content delivery tech companies. Again, this could not continue indefinitely as the situation normalizes and people return to work, to travel, and to their communities. We also saw the acceleration and intensification of suburban flight as people left the urban core to flee the consequences of the pandemic. This was underway to a degree already as Millennials with young families considered cost and quality of life and access to education, open spaces, etc. prior to the pandemic. We may have seen several years of relocations and retirements packed into a year., and again the upward pressure on real estate markets could not continue forever.

Despite exceptional expansion of wealth, high employment and low rates, inflation has been historically low as well. As much as we would all like it, this cannot continue indefinitely either. Even with prices lurching forward by 7% in the last year and forgetting about the low base effect from the pandemic period, we are still below historical trend if inflation had been continuing each year prior at a more "normal" level. Each of these regimes is winding down, but to the irritation of the markets, all at the same time. We have reduced our equity risk and increased cash levels while the market consolidates and figures out what is next.

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