Ameriprise Financial

Committee Perspectives

An Ameriprise Global Asset Allocation Committee publication

June 13, 2022
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Weathering Volatility

Understandably, investors may feel uncertain about their investment portfolio against the backdrop of elevated stock and bond volatility, steep year-to-date losses, and a macroeconomic environment that remains highly uncertain. The Global Asset Allocation Committee is rigorously and continuously monitoring market events and reviewing current conditions in relation to its allocation advice. Below is a brief update on our current thinking regarding market/economic dynamics, specific equity and fixed income considerations, and our overall allocation advice to help you weather this challenging period in the market.

Market Brief — What might cut the volatility?

Major U.S. stock averages are currently trading well off their 52-week highs, with several indices trading deep into a bear market (defined by a decline of 20% or more from a recent high). The sharp rise in interest rates, record-high inflation pressures, and central bankers around the world removing monetary accommodation have sent both stocks and bond prices sliding lower this year. In addition, an unexpected war in Ukraine, causing a surge in energy and food prices, along with growing recession odds, have increased fears consumers will retrench their spending, causing corporate profits to slow more than expected.

More recently, equity pressure has included a broader array of areas, such as mega-cap technology stocks and retailers that had benefited during the pandemic. However, wider selling pressure across some of the market's last strongholds is often a hallmark of bear markets. As uncomfortable as the drawdown is to endure, stock selling has been orderly and, in our view, helping clear out the excessive optimism that had washed through stock prices following the pandemic bottom.

But calling a market bottom is a fool's errand. Often during more prolonged bear markets, stock prices can rally substantially for a period, only to fall to lower lows. But history is very clear on bear markets. Once the bottom is reached, stock returns tend to be strong over the next six

Key Points

- Stocks are struggling with higher interest rates, tightening monetary policies, high inflation, a war in Ukraine, growing recession fears, and concerns corporate profitability could slow more considerably.
- Stabilizing interest rates and more clarity on when the Fed may slow rate hikes could reduce market volatility over time.
- Elevated energy prices are the most significant risk to our economic assessment. However, U.S. economic conditions support a still positive view of growth.
- Ways to mitigate volatility in a portfolio include asset diversification, incorporating quality attributes across investments, and utilizing Alternative Strategies.
- Maintaining discipline, utilizing a systematic dollar-cost averaging approach, and incorporating intelligent drawdown strategies can help investors navigate stock drawdowns.

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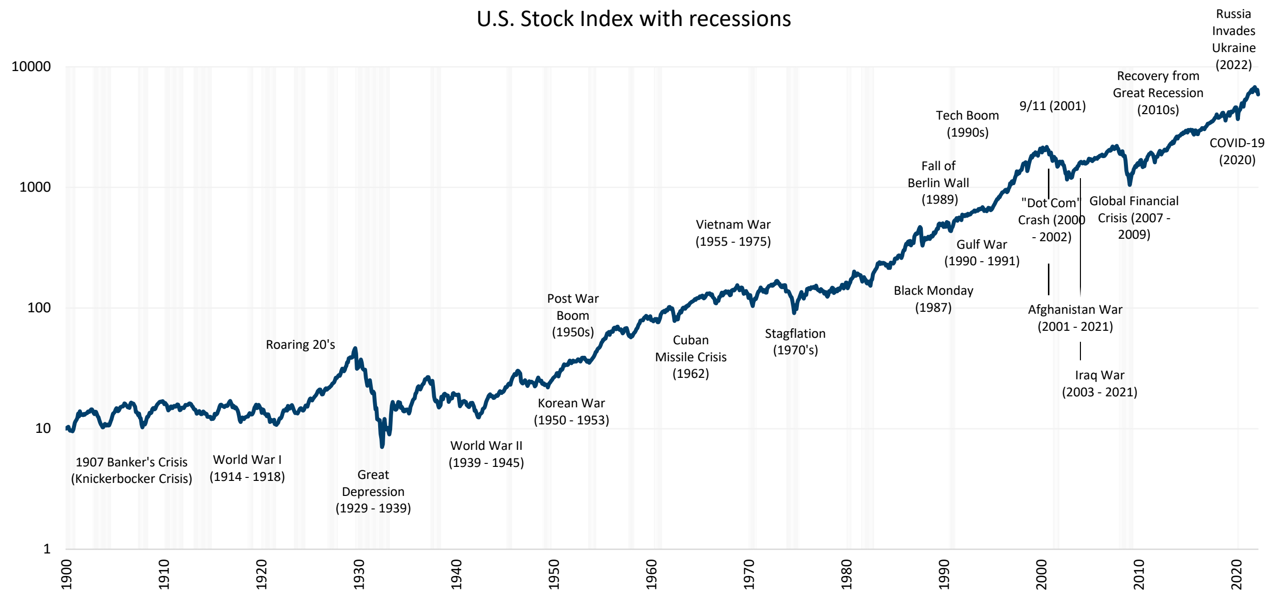
and twelve months, with positive returns over the next one, three, and five years. In our view, investors should be thinking less about how much further stock prices could fall and more about properly weathering the volatility today so they can be in a position to benefit from the eventual rebound.



Source: NBER, Bloomberg, American Enterprise Investment Services, Inc.
Data shown is based on the following: 1900 - 1917, Cowles Commission Index as converted by the Standard & Poors Corporation and available through the National Bureau of Economic Research (NBER). 1918 - 1956, monthly average of the weekly Standard and Poor's weekly composite price index based on Wednesday's close and as available by the NBER. 1957 through current, monthly closing price of the Standard and Poor's 500 Price Index. Recessions are as defined by NBER and highlighted by the vertical gray bars.
Data presented in log scale.

Through wars, depressions, recessions, and pandemics, the *Ameriprise S&P 500 mountain chart* above helps illustrate that throughout history, the setbacks of the day have never ended the stock market's climb higher. Given all the current uncertainties, we believe a longer-term perspective can help recenter your focus.

The following could help reduce market volatility over time:

- In our view, inflation is in the process of peaking. Further economic and corporate evidence of this point over the coming months could reduce investors' worst fears that the Federal Reserve over tightens monetary policy and causes a recession.
- Stock prices may continue to face challenges as long as the level of interest rates remains a moving target. Nearly all assets are priced against a risk-free rate, such as the 10-year U.S. Treasury yield. Once yields find a more stable range, investors can value other assets, like stocks, more accurately.
- Stock volatility could come down when the Federal Reserve and other central banks start to signal they have hiked rates and/or removed enough monetary accommodation to tame inflation. While we are likely a ways off from a less hawkish Fed, the market will look to anticipate the shift ahead of any such announcement, and we suspect stock prices could react positively.
- Simply, when all the bad news has finally been fully priced into stocks. Over the coming weeks and months, we expect analysts to reduce earnings estimates, an increasing number of companies to issue negative profit guidance for Q2, and make mention of higher costs eating into profit margins. Market bottoms are often formed once the deck chairs are reset, and stocks stop reacting negatively to bad news.
- Importantly, the demand environment remains strong. The economy is likely to grow this year, consumers are on solid footing, the job market is tight, and a lot of pain has already occurred in the stock market. Therefore, this is the time to double down on your well-diversified strategy, concentrate on what's working, and make plans for being proactive in capturing the opportunities created during market downdrafts.

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Economic Brief — Fundamentals remain strong.

We believe U.S. economic fundamentals currently offer a strong base for the market to stand on. Still, high inflation and rising interest rates are powerful forces that should be expected to weaken the pace of growth. It remains to be seen if these influences will strengthen enough to send the economy into recession.

Presently, we believe a recession can be avoided. Additionally, whether or not we meet the technical definition of a recession may be inconsequential as financial markets seem to be already pricing in such a downturn. Further, if the economy does face a more material downturn in activity, we believe it would likely be relatively short and shallow given the strong financial position of consumers and businesses.

Currently, we view elevated energy prices as the most significant risk to our outlook. This is because global crude oil production was not keeping up with the demand recovery prior to Russia's invasion of Ukraine. Unfortunately, the war has worsened the situation, given that Russia is the world's third-largest oil producer and second-largest exporter, according to the International Energy Agency. And while global production is expanding, the pace is slow and could continue at a rate that may not be able to fully offset the loss of some Russian output on the global market.

Aside from inflation and geopolitical risks, the U.S. economy's underlying fundamentals remain sound, in our view. Consumer finances appear strong with a high savings rate, low debt burdens, and strong property values. We believe aggregate business balance sheets are also in solid health. Under normal circumstances, the conversation would end there, leaving an encouraging landscape for growth. However, elevated inflation pressures and ongoing supply risks related to the Ukraine situation and global COVID-19 developments (primarily in China) remain significant risks for investors. These dynamics could pressure the pace of economic expansion this year and act to keep market volatility elevated over the intermediate term.

Forecast:	Full-year				Quarterly						
	Actual	Actual	Est.	Est.	Actual	Actual	Actual	Actual	Est.	Est.	Est.
	2020	2021	2022	2023	Q2-2021	Q3-2021	Q4-2021	Q1-2022	Q2-2022	Q3-2022	Q4-2022
Real GDP (annualized)	-3.4%	5.7%	2.0%	2.2%	6.7%	2.3%	6.9%	-1.5%	1.5%	1.8%	2.5%
Unemployment Rate	6.7%	3.9%	3.3%	3.4%	5.9%	4.8%	3.9%	3.6%	3.5%	3.3%	3.3%
CPI (YoY)	1.4%	7.0%	6.4%	3.0%	5.4%	5.4%	7.0%	8.5%	8.1%	7.8%	6.4%
Core PCE (YoY)	1.5%	4.9%	4.0%	2.8%	3.6%	3.7%	4.9%	5.2%	4.8%	4.7%	4.0%

Sources: Historical data via FactSet. Estimates (Est.) via American Enterprise Investment Services Inc.

YoY = Year-over-year, Unemployment numbers are period ending. GDP: Gross Domestic Product; CPI: Consumer Price Index

PCE: Personal Consumption Expenditures Price Index. Core excludes food and energy.

All estimates other than GDP are period ending.

Last Updated: June 10, 2022

Equity Perspectives — 2H Playbook

We attribute much of the year's stock volatility to a more hawkish Fed, uncertainty on the pace of rate hikes and balance sheet unwinding, and the overall pace of inflation. This outsized volatility manifested itself in significant selling pressure for growth-oriented stocks with high valuations and little or no earnings (or cash flow), including companies in the semiconductor, electric vehicle, and software-as-a-service markets, as well as former pandemic winners. The shift in sentiment drove a more than 30% decline in the Tech-heavy NASDAQ Composite from its late-November high-water mark to its intra-day low on 5/20/22. And the selling pressure was not relegated to the Technology sector as the Communication Services and Consumer Discretionary sectors, which include high-valuation, higher-growth companies, are two of the worst-performing sectors YTD, down 24% and 25%, respectively, as of 6/6/22.

In contrast to the turmoil for Growth investors, what has worked on a YTD basis is the return to a more traditional investing style with investors focused on companies with quality attributes (i.e., consistent earnings, profitability, limited leverage, etc.), stable or rising dividends, and reasonable valuation levels. Many of these companies fall into the Value camp and serve the more traditional areas of the economy such as Health Care, Financials, and Industrials. For example, the YTD (through 6/6/22) divergence in Value and Growth is reflected in the S&P 500 Growth Index posting a total return of -21.2%, while the

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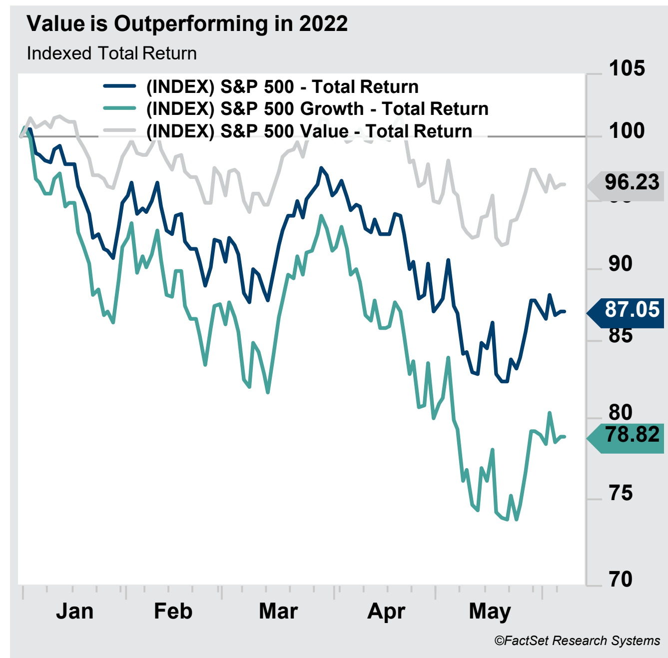
S&P 500 Value Index posted a modest -3.8% total return, a performance premium of over 1,700 basis points (bp) for Value investors (see chart).



In our view, the "2H Playbook" for domestic stock investors could be summed up with the old adage, "*if it's not broken, don't fix it*." Specifically, we believe what has worked well in 1H'22 can serve as a foundational roadmap for the remainder of the year. Moreover, this focus on quality, dividends, and valuation means resisting the temptation to try and '*find the bottom*' in some of the more beaten-up high-valuation companies. While this quality/dividend/valuation strategy will require a fair amount of investor resolve and determination, we also believe it is a solid recipe for relative outperformance with lower volatility for the remainder of the year.

Fixed Income Perspectives

The swift rise in U.S. Treasury yields from January through April reset market expectations for the aggressive Fed policy retreat. The move priced in aggressive Fed hikes this year and resulted in the worst four-month U.S. Aggregate total return performance in 40 years. Diminishing fixed income liquidity also served as a factor with anticipation of approximately half a trillion dollars rolling off the Fed's balance sheet and returning to investors' hands in the year's second half.

At lower prices and higher yields, we view fixed income as more attractive for long-term investors today. Therefore, we suggest investors who follow our tactical (6-12 month time horizon) prepare to rebuild Treasury positions over time. In the near term, maintain a small position in short-term TIPS. Though the performance of short-TIPS already prices in likely Fed rate hikes, more stubborn inflation is a risk for bond markets. Thus, a small holding of short-TIPS is a nod to that possibility.

In the year's first half, we favored investment-grade corporates over high-yield to navigate a potential repricing of risk assets from higher Treasury yields. We guide investors to be selective when choosing corporate bond exposure as the rising tide of Fed policy support aided companies across the board recedes, leaving companies to stand on their own merits. Key challenges include weathering inflation pressures and evolving demand. We believe narrowing bond market liquidity suggests companies with strong cash flow and superior market positioning likely benefit to the most significant degree. Conversely, companies with vulnerable cash flows or market positions may face rating downgrades. The best could rise to the top, outperforming, while the poorly positioned underperform.

We believe investors should favor companies with strong cash flow that remains durable through evolving demand and inflation dynamics. For example, this cash flow could be used to pay down debt or fund strategic opportunities. In this environment, credit selection remains key, favoring active management over passive.

Though intermediate and long-term bond markets already reflect Fed rate hikes, we anticipate investments on the front end of the curve could still benefit from Fed hikes as yields inside two years ratchet higher. Accordingly, we favor investment grade floating rate debt and short-term bond strategies such as ultra-short and short-term bond funds over the next year. Bottom line: Yield likely returns to bond investments that can help support emergency fund or capital preservation goals, in our view.

Asset Allocation — What's working

As noted above, performance has been challenging this year on many fronts, with stocks and bonds at one point down more than 10% on the year (for the first time since our data series began in 1926). Only rarely are stocks and bonds down in the same year. Despite this unusual occurrence, bonds still added value in this downturn relative to an all-equity portfolio (e.g., -10.0% for the Bloomberg US Universal Bond Index through 6/6/22 vs. -13.0% for the S&P 500 Index). While diversification between these two primary asset classes hasn't worked to the degree that most have grown accustomed to, it has provided some small benefits.

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Coming into the year, we recommended investors look beyond stocks and bonds and increase allocations to Alternatives (sourcing from Fixed Income) to strengthen diversification and manage potential downside in a portfolio. This "third leg" of the investment stool can help stabilize in times of market stress. Many of this year's leading investments, including Commodities (+37.8% for the Bloomberg Commodity Index), Managed Futures (+17.5% for Morningstar's Systematic Trend category), and Global Macro (+10.4% for Wilshire Liquid Alternatives Global Macro Index), come from this category. In addition, other bellwethers, including Nontraditional Bond Funds (-4.4% for the Morningstar Nontraditional Bond Fund category) and Hedged Equity (-3.4% Wilshire Liquid Alternatives Equity Hedge Index), cushioned the downside compared to their traditional counterparts.

Bottom line: A properly diversified portfolio of stocks, bonds, cash, and alternatives has mitigated the effects of volatility this year and should continue to do so in the second half if volatility remains elevated. Particularly in the Alternatives space, strategies that mitigate equity and/or fixed income risk could continue to play an essential role in helping investors navigate the second half. Notably, maintaining discipline, utilizing a systematic dollar-cost averaging approach, and incorporating intelligent drawdown strategies can help investors navigate market drawdowns.

Additional Resources

For a concise look at the investment themes shaping today's market and economic landscape, please refer to *Committee Perspectives: Tactical guidance for today's environment*. The report summarizes economic themes the Global Asset Allocation Committee is closely watching and believes are impactful for tactically managed portfolios. It also includes a checklist of actions to consider including in well-diversified portfolios. Since economic themes are often connected and impacted by one another, we recommend using the listed guidance holistically.

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Global Asset Allocation Committee

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