ALTA
CAPITAL MANAGEMENT
A member of Guardian Capital Group Limited

MARKET LETTER

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Volatility in the Face of Tragedy

The S&P 500 declined nearly 5% in the first quarter with growth equity benchmarks down close to 10%. Coming into 2022, the S&P 500 had delivered a greater than 90% return since March of 2020. Investors began the year optimistic that an end to the pandemic and a return to some level of normalcy was within sight. However, Q1 was anything but normal. Inflation concerns, rising interest rates, and the Russian invasion of Ukraine drove volatility higher. Bonds, usually a source of stability during times of heightened volatility, didn't perform much better as Fed speak drove the 10-year treasury yield up more than 100bps during the quarter to nearly 2.5%. After a sustained period of strength, equity markets were due for a correction. Over the last 70 years, a 10% correction has occurred, on average, every 1.6 years. Corrections are common and in general offer opportunities for amplified future returns.

Rising inflation, including more recent energy price increases, coupled with higher interest rates have led consumer confidence measures lower and brought into question the strength of the economy in 2022. The underlying fundamentals, however, appear to be holding up. The consumer remains strong, with balance sheets well ahead of pre-pandemic levels and plenty of employment opportunities. Recent wage increases have been significant and could drive nominal economic growth higher in the face of significant inflation. Growth in equity portfolios and home equity along with improved savings trends in recent years have dramatically improved the financial health of consumers. The economy and the consumer are in a fundamentally better place than just a decade ago during the great recession.

Inflation is currently a major concern for many consumers and businesses. The recent CPI print of 7.9% was well ahead of the Feds inflation target rate of 2%. Nearly $10T in pandemic fiscal and monetary stimulus had the effect intended, padding consumer pockets and quickly returning the economy to full employment. But, the stimulus may have been too strong for too long. Given the strong inflation numbers, the Fed has recently signaled a significantly more hawkish stance on monetary policy, forecasting regular rate hikes and a shrinking of its balance sheet. It raised rates for the first time this cycle in March and the market is currently forecasting an additional 2.25% of rate hikes this year. It is our expectation that while the Fed Funds rate will rise further this year, inflation could diminish in the coming periods. The move in interest rates has already done some of the heavy lifting required to drive down inflationary pressures. The absence of further fiscal stimulus and higher energy costs will temper growth and inflation in the coming periods, helping alleviate some of the work the Fed would do with rate increases and quantitative tightening.

Also encouraging, the decline in markets has not been accompanied by weaker earnings expectations thus far. Through the first quarter 2022, earnings expectations continued to rise. The market selloff brought down the market price to earnings multiple from a lofty 22x to a closer to normal 19.6x. The most expensive parts of the market took a bigger hit than value shares during the quarter. Our focus on growing businesses that trade at reasonable valuations helped us avoid some of the bigger declines and the correction increased opportunities to improve growth and quality in the portfolio.

Geopolitically, we find ourselves in an incredibly uncertain position. Just as Covid related supply chain concerns were starting to alleviate, Russia's action in Ukraine has brought concern of potential disruption to global food supply and energy markets. Ukraine is considered the bread basket of Europe with roughly 40% of European grain production coming from the country. This year's harvest is expected to be down at least 30%. This could potentially lead to higher food prices globally. European countries are moving quickly to alleviate their dependence on Russian oil, but moving away from Russia's energy supplies will take decades. It is difficult to forecast the impact a despot can have on markets, but our hope is for a quick end to the conflict.

Investing always comes with risks, but at times, those risks are more prevalent. It is during elevated risk environments when some of the best opportunities for future returns are found. While recent market moves have been driven by macro trends and concerns, over the cycle, investing in company fundamentals has proven to benefit shareholders. Buying quality businesses on sale is a proven principal of success. The Alta Quality Growth style lends itself well to outperformance during periods of uncertainty. We focus on intrinsic fundamentals such as profitability, free cash flow growth, and sustainable revenue models. Our focus is on finding and investing in companies that will benefit from secular economic growth but that have the financial flexibility to weather periods of weaker growth or recessionary environments. Great quality companies benefit from secular growth trends while also maintaining adequate balance sheets to protect against periods of economic uncertainty.

6440 South Wasatch Boulevard, Suite 260, Salt Lake City, Utah 84121 801.274.6010 Fax 801.274.8061

A Registered Investment Advisor