Morris Capital Advisors, LLC

Investment Commentary
March 31, 2022

The "My Cousin Vinny" Market

My Cousin Vinny is a movie that our family can watch any time, starting any point in the film. In one of the classic scenes, Vinnie (Joe Pesci) and Lisa (Marisa Tomei) are at a cabin in the woods when Lisa launches a rant about her concerns, and her (stomp, stomp, stomp) biological clock. Vinnie reacts by listing his problems: a judge who wants to throw him in jail, an idiot that wants to fight him, loud whistles, slaughtered pigs, and her (stomp, stomp, stomp) biological clock. Lisa responds with "Maybe it was a bad time to bring it up."

The financial markets must feel a lot like Vinny. They are dealing with a lot of problems, as well: spiking energy prices, supply chain issues, chip shortages, consumer inflation, and the possibility of a global slowdown triggered by a resurgence of COVID in China, and the Russian invasion of Ukraine. Add to that, the impending policy shift by the Fed. I guess it's not a good time.

I think that we all knew that 2022 had a tough act to follow after an impressive performance in 2021. Stocks, as measured by the S&P 500 index, rose steadily throughout 2021, ending the year at record highs. The results were driven by very low interest rates, Fed liquidity injections through the purchase of US Treasury and Agency securities (quantitative easing), and massive fiscal stimulus programs. The abundant cash fueled consumer spending and, ultimately, the stock market. The bond market, however, began to show signs of strain as concerns about rising inflation and a potential withdrawal of Fed accommodation pushed yields higher.

As 2022 began, inflation surged to 40-year highs and the Fed began to message that they would move faster to raise rates and withdrawal liquidity. Market participants began to focus on the risks that this potential shift posed to the economy and that the Fed would need to move aggressively, triggering an economic recession and pressuring corporate profits in what many saw as an overvalued market. The S&P 500 ended January with the worst monthly return since the pandemic decline of March 2020. Stocks weakened further as the threat of a major military conflict in Europe led to concerns about a global slowdown. When Russia invaded Ukraine commodity prices surged higher, adding to the inflation concerns and pushing stocks lower. The S&P 500 fell more than 12% while several high profile tech names reported disappointing results pushing the Russell Large-Cap growth index down almost 20%

Stocks staged a strong rebound towards the end of March sparked by the Fed decision to raise short-term interest rates by 25 basis points, a move widely expected by the markets. The rebound in stocks was driven by many of the beaten down large-cap growth names that led the market lower early in the quarter. The strength of the sudden rally surprised many analysts and raised concerns that this was simply a "relief rally" in a declining market, and would prove to be short-lived.

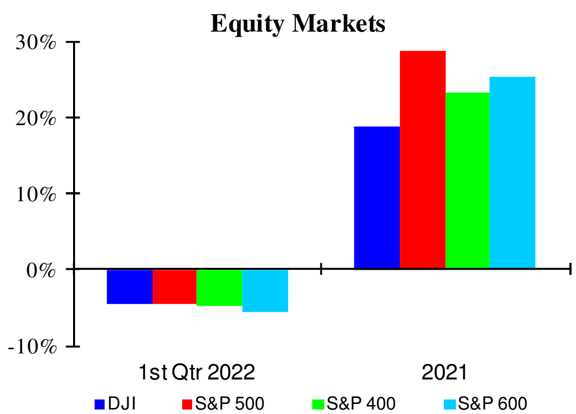
It is obvious the economic and policy issues facing the markets are raising uncertainty among market participants. That uncertainty can lead to wide market swings in both directions as investors shift their focus from past winners to new leadership. Fed policy is clearly shifting from an overly accommodative stance of low interest rates and continuous liquidity injections to a monetary stance that is less accommodative, or possibly restrictive. At the same time, massive governmental spending programs, another powerful driver of economic activity recently, are meeting concerted resistance as concerns about ballooning deficits and structural distortions in the economy become more widespread. The combined impact of the withdrawal of Fed accommodation, spending constraint in Washington, and global slowdowns could result in a more pronounced slowdown in our economy. If that happens, the Fed may be forced to scale back their efforts contributing to further volatility.

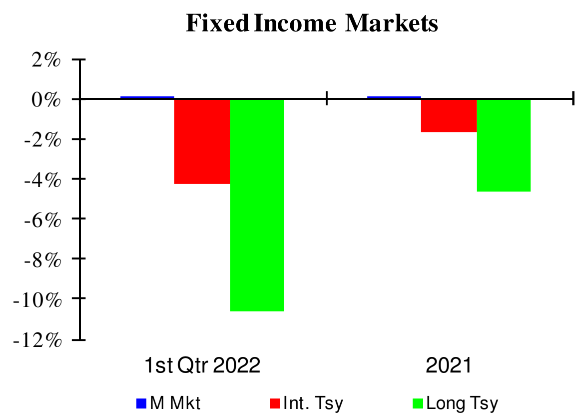
The stock market may have already started to adjust to the new reality. We have observed a shift in market leadership as more conservatively valued names are starting to outperform the "high duration" (high valuation) growth stocks that led the market since the Great Financial Crises of 2008. Those high-growth names were the primary beneficiaries of the Fed policy that pushed interest rates to historically low levels. The withdrawal of external fiscal and monetary stimulus could continue to shift market leadership away from that small group of large-cap, high-growth stocks that dominated the market over the past several years. In this uncertain market we believe that our focus on high quality companies trading at reasonable valuations will provide the best opportunity to generate consistent returns. We will manage our portfolios with a combination of large-cap growth names and those steady performers that served us well over the years. We believe that our approach will give us the best opportunity to produce consistent returns while dealing with the many problems that currently confront our markets. Vinny may have won his case with a single knockout testimony from Lisa, but we know that it is not so easy outside of a Hollywood courtroom.

Sincerely,
Daniel A. Morris

Market summaries on reverse page

Market Summary
March 31, 2022





The stock market declined steadily throughout most of the 1st Quarter of 2022 until a late "relief rally" trimmed the losses. All four major stock indices posted negative returns and Large-Cap stocks outperformed Small-Cap stocks. A number of factors contributed to the declines, chief among them expectations of a shift in Fed policy. Public statements by the Fed clearly messaged their intention to raise interest rates in an effort to combat inflation. The S&P 500 index suffered its worst decline in January since 2009, and the worst quarter since the pandemic decline of March 2020. Growth stocks led the decline as many of the recent market leaders faltered, while previously out-of-favor value names moved to the forefront. Energy names performed well while defensive sectors such as utility and consumer staples also provided stability. Small-Cap stocks were hit the hardest, especially stocks in the cyclical consumer discretionary and technology sectors.

The bond market suffered its first significant decline since 2017 during the 1st Quarter of 2022, as mounting concerns about consumer inflation and the prospect of a change in Fed policy pushed bonds lower. At the start of the year the markets were pricing in three 25 bps rate hikes for all of 2022, but by the end of the quarter expectations rose to eight or nine 25bps hikes over the same period. Some commentators also raised the possibility of 50bps hikes as some meetings. As a consequence, short-term rates, a proxy for Fed policy rates, rose sharply, accompanied by a rise in yields across the maturity spectrum. The spike in short-term rates resulted in an "inverted" yield curve where short-term rates move above longer-term rates. This inverted yield curve often precedes an economic recession.