SAWGRASS ASSET MANAGEMENT LLC

Financial Review & Outlook

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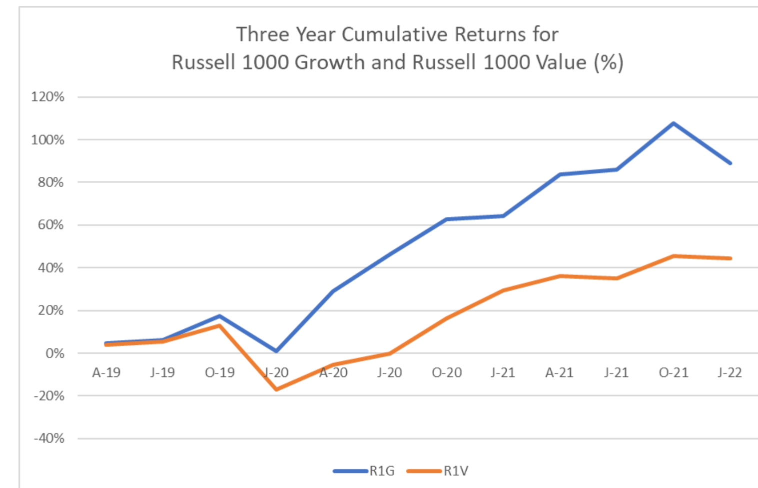
Equity Market

- The equity markets endured their first significant quarterly loss in over two years as the combined risks of inflation, higher interest rates, prospects of significant Federal Reserve tightening, and geopolitical risks from the Russian invasion of Ukraine finally took their toll on investor bullishness. Large growth led the way down while large cap value bucked much of the weakness thanks to the strength in energy stocks.
- After starting the quarter on a sour note, the markets attempted a rally toward the end of January that eventually failed and briefly sent the major indices to lower lows. However, a strong late quarter rally over the last couple of weeks of March brought the indices back to single digit percentage losses in the value and core portions with growth still lagging. An outsized performance in the energy sector due to supply uncertainties was a big contributor to performance depending on the index and manager positioning.
- Factor performance favored more attractive valuation, lower volatility, and more consistent financial characteristics. Large cap and value outpaced small cap and growth with relative sector strength in energy, utilities, and staples and relative sector weakness in communications, discretionary, and technology.
- The large growth index is still as concentrated as it has ever been with greater risk in future index returns as there has been in many years. What has been such a boost to the index during this unusual environment of risk seeking and concentration will likely cause just as much if not more damage to the large growth universe once this trend reverses. The current backdrop favors broader participation with the reversal of this dramatic crowding effect likely to make the environment for active managers as favorable as it has been in years.
- The Federal Reserve has been very willing to add liquidity, keep rates low, and support asset prices since the Financial Crisis of 2008-2009. However, the change in the inflation picture is likely forcing less accommodative conditions going forward and even small changes in this stance are likely to continue to roil markets as the follow through is fully registered in all the interconnected markets and investor psychology. Additional shocks to the financial system will also likely be met with less aggressive responses than investors are used to at this point in the cycle.
- After a protracted tug of war between the old leadership of higher momentum, higher risk stocks and their more conservative, valuation-oriented counterparts, the trend towards lower risk has finally firmly taken control since mid-November with acceleration so far this year. This trend could likely play out over several quarters and years with managers favoring these types of factors poised to finally have a strong tailwind for relative outperformance.

1st Quarter Scorecard		*Table 1*
Index	**Quarter**	**1 Year**
S&P 500	-4.6%	15.6%
Russell 1000	-5.1%	13.3%
Russell 2000	-7.5%	-5.8%
Russell 3000 Growth	-9.3%	12.9%
Russell 3000 Value	-0.9%	11.1%
Barclays Capital US Aggregate	-5.9%	-4.2%
3 Month T-Bills	0.0%	0.1%

Source: Bloomberg & Russell Investments

Graph 1

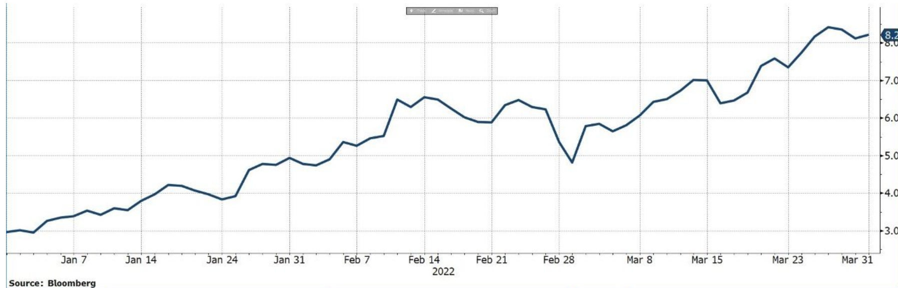


Source: FactSet

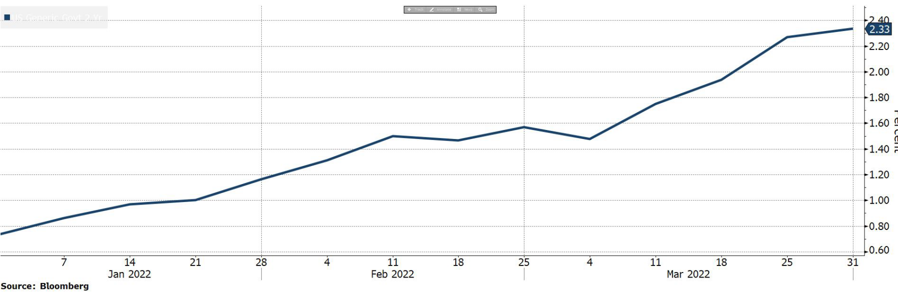
Fixed Income Market

- The first quarter of 2022 can be viewed only as a historically significant period of interest rate movements, as yields moved up across the curve in a dramatic fashion. Volatility seen across various parts of the investment grade market caused the Barclays Aggregate to return -5.9%, its worst quarterly return in 42 years. To put into context for the quarter, facing some of same issues, the S&P 500 fell only 4.6%.
- The biggest cause of the spike in yields was the continued onset of inflation and the expectations that the Federal Reserve would have to hike rates faster than initially expected. At the end of 2021, the market was pricing in 3 (twenty-five basis point) rate hikes for 2022. By the end of Q1 2022, the number of expected hikes rose all the way to 8 for the year (graph 2). While yields were up across the entire U.S. Treasury Curve, the front-end felt the most pressure with 2-year yields increasing by 160bps for the quarter (graph 3).
- In addition to the direction of interest rates, the shape of the yield curve was also a large driver of attribution for the quarter. The long-end of the curve was up "only" 54bps, relative to the 2-year U.S. Treasury up 160bps and 10-year U.S. Treasury up 83bps respectively. The flattening of the curve caused various maturities to invert, which has historically flashed as a cause of concern for an upcoming recession.
- Those economic concerns had a negative impact on the corporate bond market as investment grade spreads widened out by 24bps. Corporate bonds have generally been outperforming since the Fed intervention in early 2020 but, with questions about the economy and a less accommodative stance from the Fed expected going forward, there is an increased amount of uncertainty surrounding the asset class
- Looking forward, the Fed is attempting to operate a smooth landing, tempering inflation while concurrently preventing a recession. This path may be difficult and volatile, but the overall economy currently remains strong, and segments of inflation may begin to fade as global supply chains loosen up. Fortunately, the bond market sell-off has led to higher yields and interesting opportunities across asset classes. With a focus on risk controls, we will look to remain active and take advantage of these opportunities as they present themselves.

Graph 2 **Expected Rate Hikes**



Graph 3 **Two-Year Treasury Yield**



Interest Rate Summary					*Table 2*
	3/31/2022	12/31/2021	3/31/2021	Quarter Change	12-month Change
3 Month T-Bills	0.5	0.1	0.0	0.4	0.5
5 Yr Treasury	2.3	1.3	0.9	1.0	1.3
10 Yr Treasury	2.3	1.5	1.7	0.8	0.6
30 Yr Treasury	2.5	1.9	2.4	0.5	0.0
5 Yr Corporate (A)	3.0	1.7	1.3	1.4	1.7
10 Yr Corporate (A)	3.4	2.3	2.5	1.1	1.0
30 Yr Fixed Rate Mortgage	4.9	3.3	3.3	1.6	1.6

Source: Bloomberg (Graph 2, 3 & Table 2)

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