Astoria's Q2 Investment Outlook:

A Recession for Long Duration Assets but a Secular Bull Market in Inflation Sensitive Assets

Q2 2022

Astoria's Current & Prospective Economic Outlook

We've had plenty of growth scares over the past decade. This one is being driven by rates which are screaming higher.	The Fed is massively behind the curve, but we think their lessons have been learned. We expect rate hikes to be front loaded.	Expect Fed Funds to be 3%-3.5% before their end of this tightening cycle.
The average time between a rate cut vs. the last rate hike is 5 months. Will we see rate cuts in 2023?	Inflation sensitive assets were ignored for the past 10 years. They are still cheap and serve as a good hedge against the deflation risks prevalent in most portfolios.	We think CPI stays above 5% for another 2-3 years.
Stay OW short duration assets. Avoid long duration assets.	Whereas 2021 was characterized by easy money, peak economic growth, and peak corporate profits, 2022 is nearly the opposite. Money is being taken out of the system and we likely won't repeat the robust economic and earnings growth.	We might see *peak* inflation in 2022. However, that doesn't mean the bull market in inflation sensitive assets is over, but the rate of change could slow.

Astoria's Current & Prospective Economic Outlook (Continued)

Portfolio diversification will be crucial. Bear markets (and we are in one) must be invested very differently.

Should you fear a yield curve inversion? The answer is no, but portfolios should be properly diversified, include alternatives, and have a margin of safety.

Take profits in your winners especially if they are in the longer duration bucket.

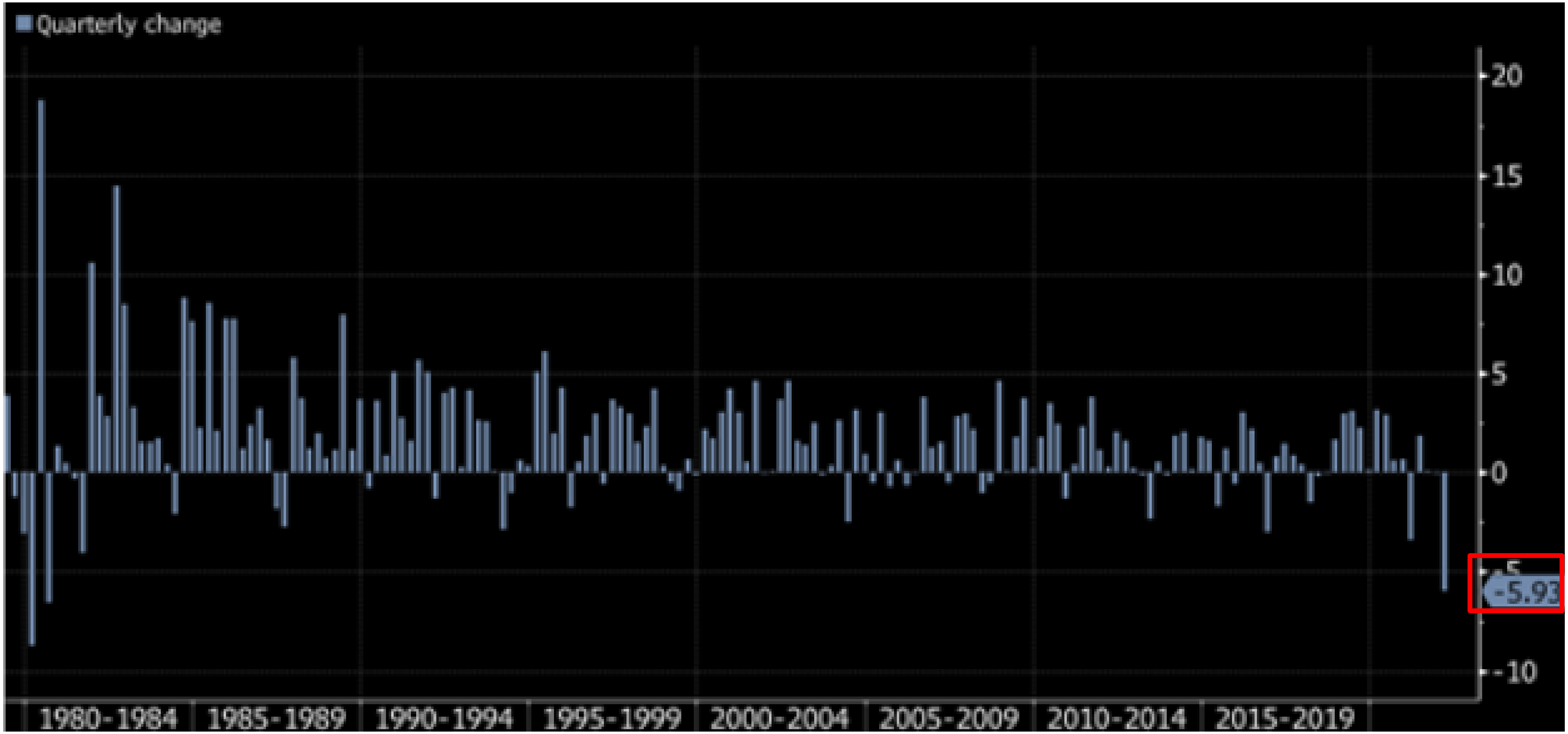
Will the bear make its ways from long duration assets (tech, bonds) over to value stocks, and inflation sensitive assets? Our base case is no, but we acknowledge that the Fed has very rarely ever managed a soft landing.

What's the best case scenario for the Fed? They hike rates aggressively, tone down their balance sheet unwind, and the recession is contained to a few pockets of the market.

Astoria's Macro Insights

Bonds had a treacherous Q1

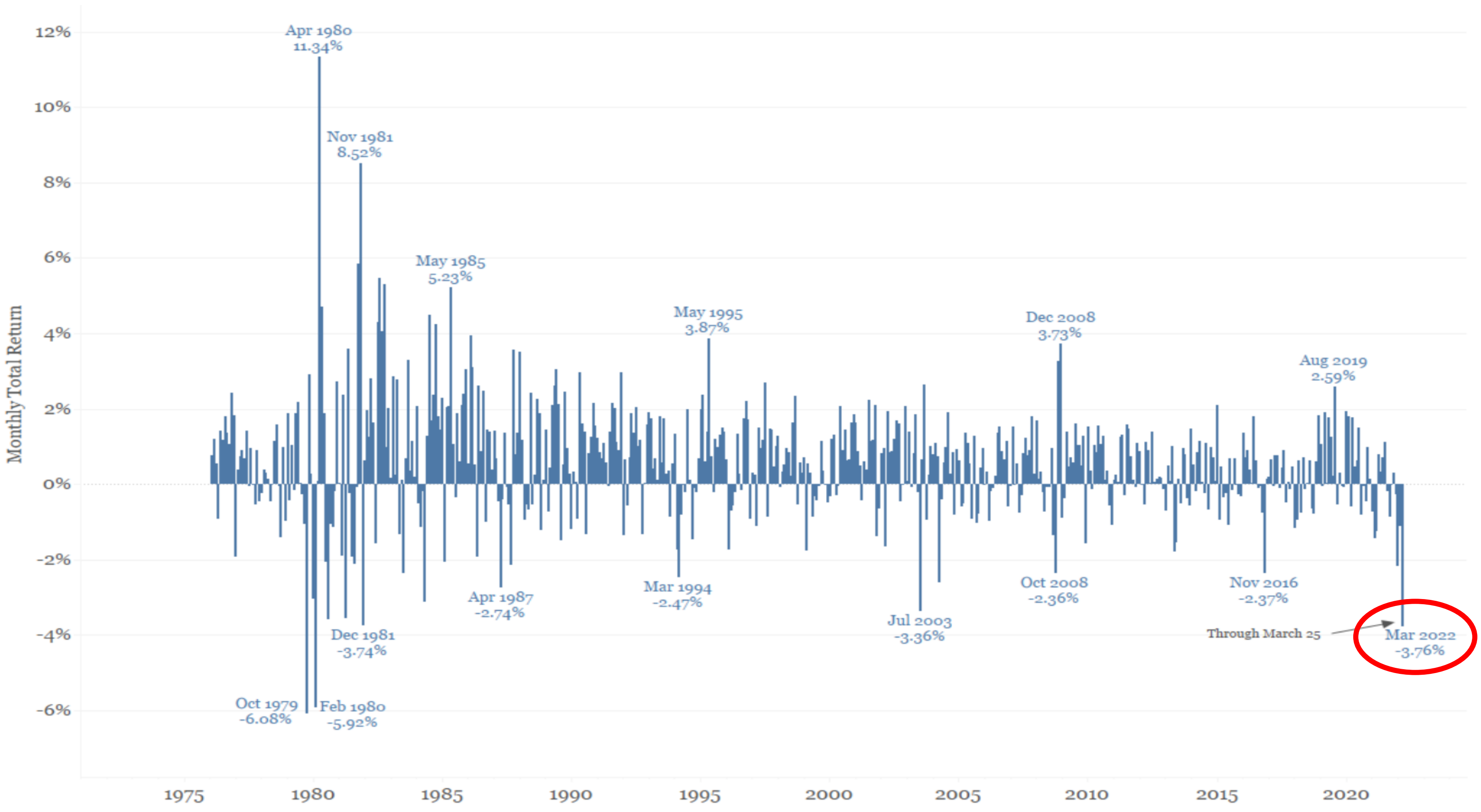
US Investment Grade Bonds Suffer Worst Quarter Since 1980



Source: Bloomberg

Let's not forget that bonds were in a bull market for the past 40 years

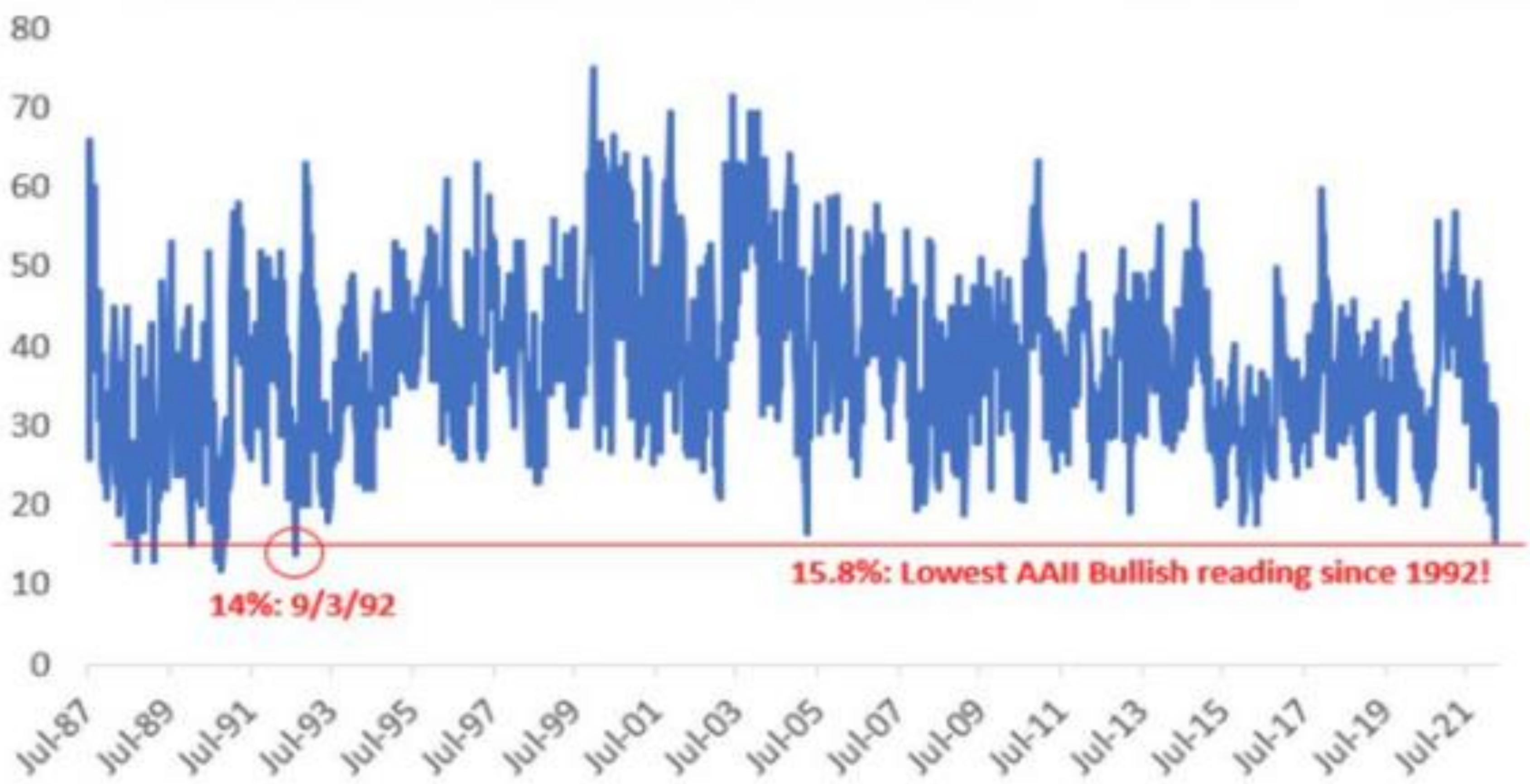
Bloomberg US Aggregate Index Monthly Total Returns



Source: Ryan Labs, Bianco Research, LLC

Sentiment is at 30 year lows. Is this a contrarian signal? We think so.

AAII Investor Bullish Sentiment: 1987-Present



Source: Bespoke Investment Group, American Association of Individual Investors (AAII.com)

Per a CNBC segment at the Exchange: An ETF Experience Conference, inflation is #1 worry for advisors

Inflation is the #1 Worry for Advisors

Source: CNBC TV

Astoria has been ahead of the curve with our Inflation Solutions. Our Inflation Sensitive ETF SMA model portfolio was created back in November of 2020.

PPI in the Inflation Conservation

TD Ameritrade

BUSINESS INSIDER

A 20-year Wall Street veteran who manages one of the top-performing inflation ETFs this year lays out 2 types of assets and 4 sectors to bet on as the prices of everything continue to surge

Astoria's John Davi Highlights Inflation Sensitive ETF

InvestmentNews

ETFs give advisers varied tools for fighting inflation

Source: AXS Investments, Astoria Portfolio Advisors

Inflation is a global problem

Inflation Numbers in Both Germany and Spain are Shockingly High

Source: Bloomberg

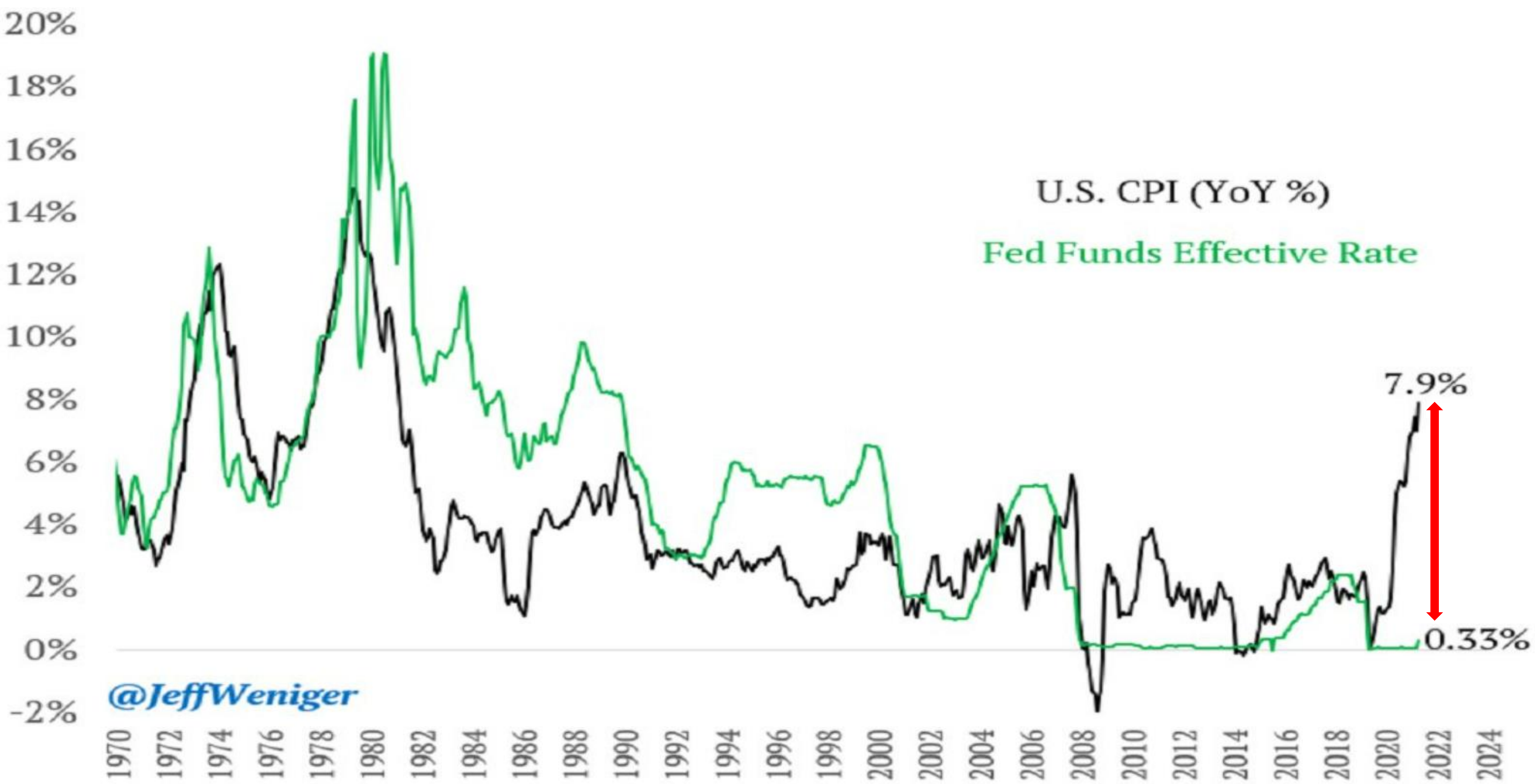
PPI in Italy remained at about 40% for a second month

Italy PPI Manufacturing YoY 2010=100 – Last Price

Source: Bloomberg

Either the Fed Funds rate needs to meaningfully rise, or CPI falls significantly. Our view is that the former is more likely to occur.

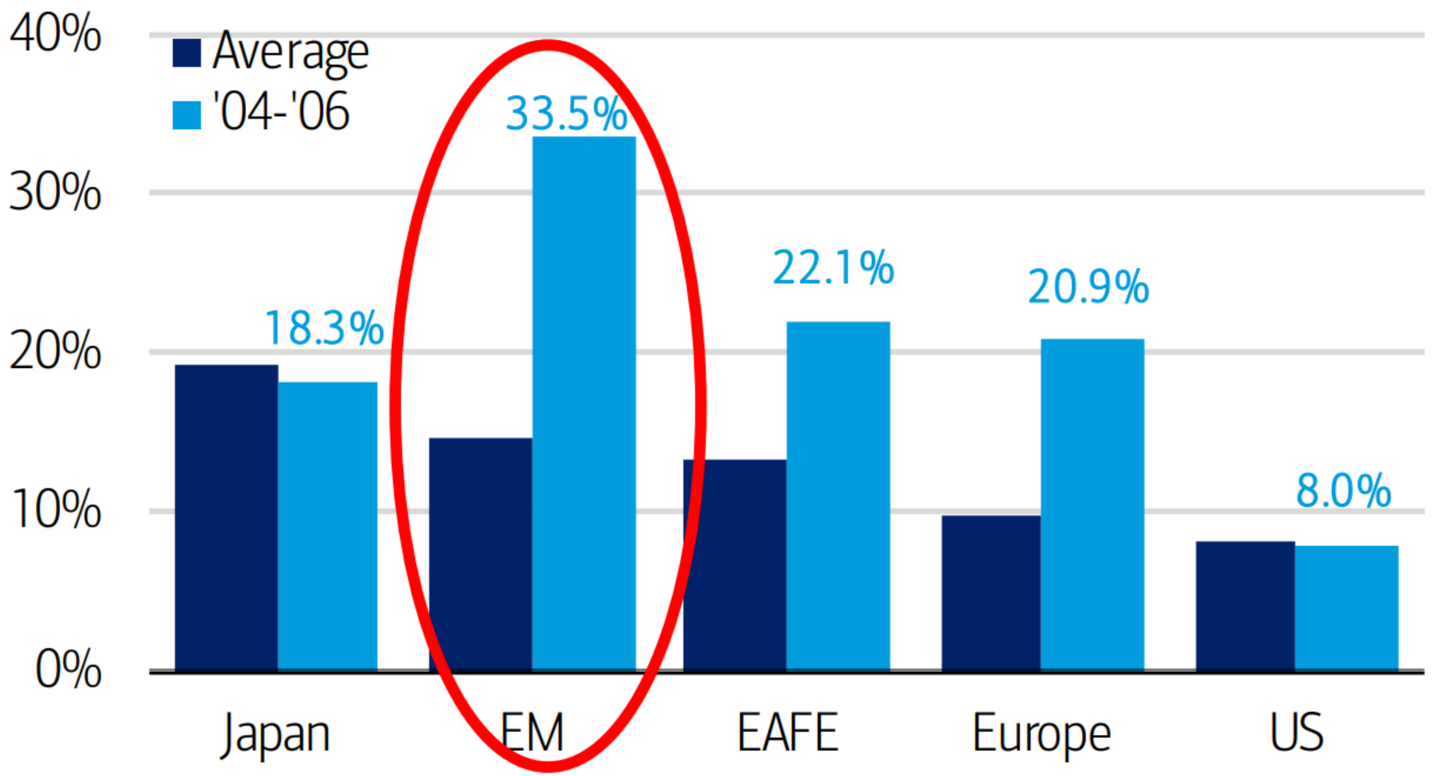
US Inflation vs. Fed Funds Rate



Source: Refinitiv, BLS, Federal Reserve, Twitter @JeffWeniger. Data as of 3/21/2022.

US equities have historically underperformed both developed and emerging market stocks during previous hiking cycles

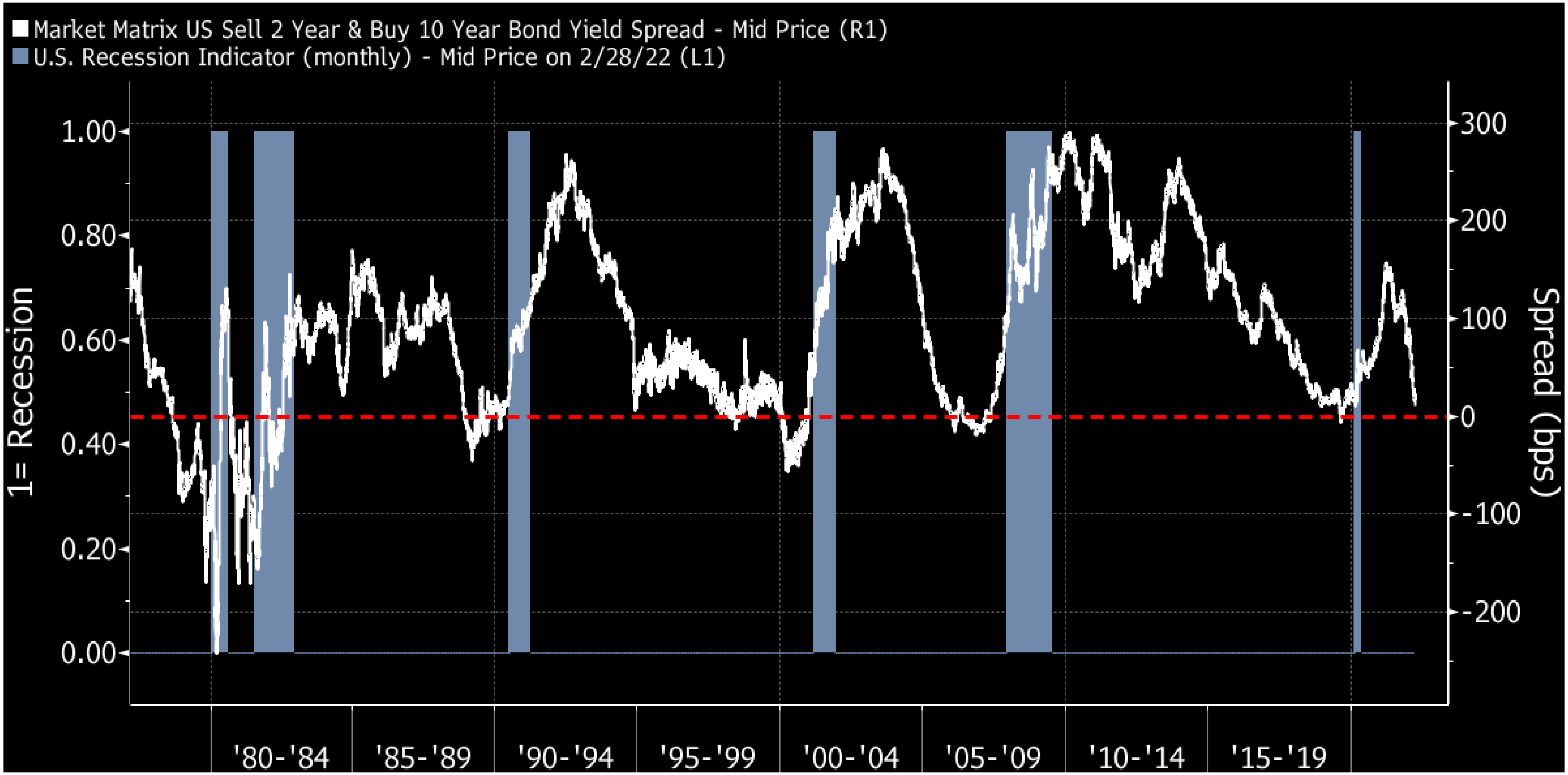
Annualized Equity Total Returns for Hiking Cycles back to 1954



Source: Bank of America Research Investment Committee, Global Financial Data, Bloomberg

Year curve inversions tend to precede a recession. However, the recessions usually occur with a lag once the curve inverts.

2-Year and 10-Year Yield Curve



Source: Bloomberg

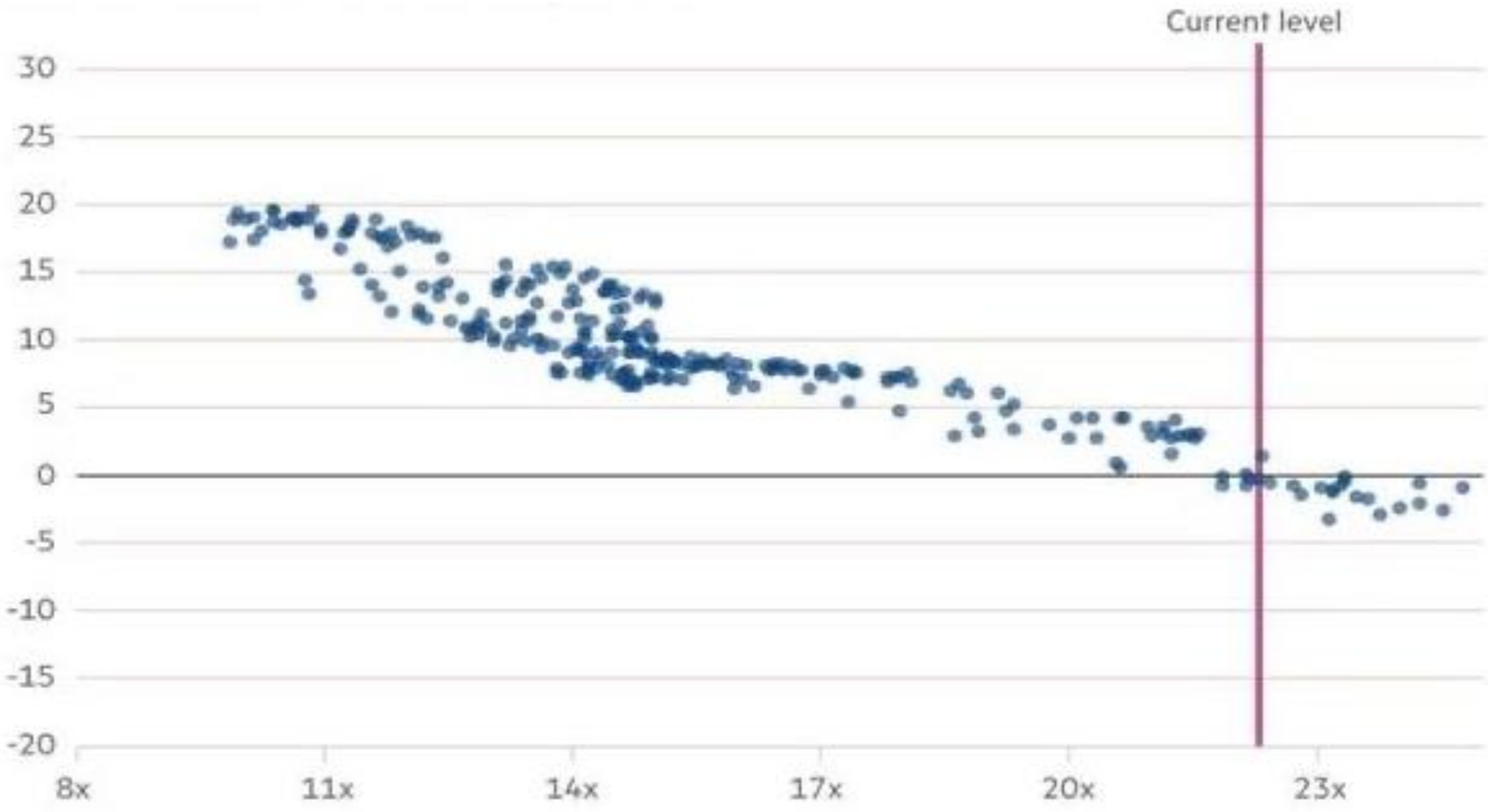
Multiples for large-cap indices have historically compressed when interest rates rose

Higher Interest Rates Tend to Mean Lower Stock Valuations

Source: LPL Research, FactSet. Data from March 1962 through March 23, 2022. Indexes are unmanaged and cannot be invested in directly. Past performance is no guarantee of future performance. PE = price/earnings ratio.

High PE ratios have historically led to lower S&P 500 Index returns

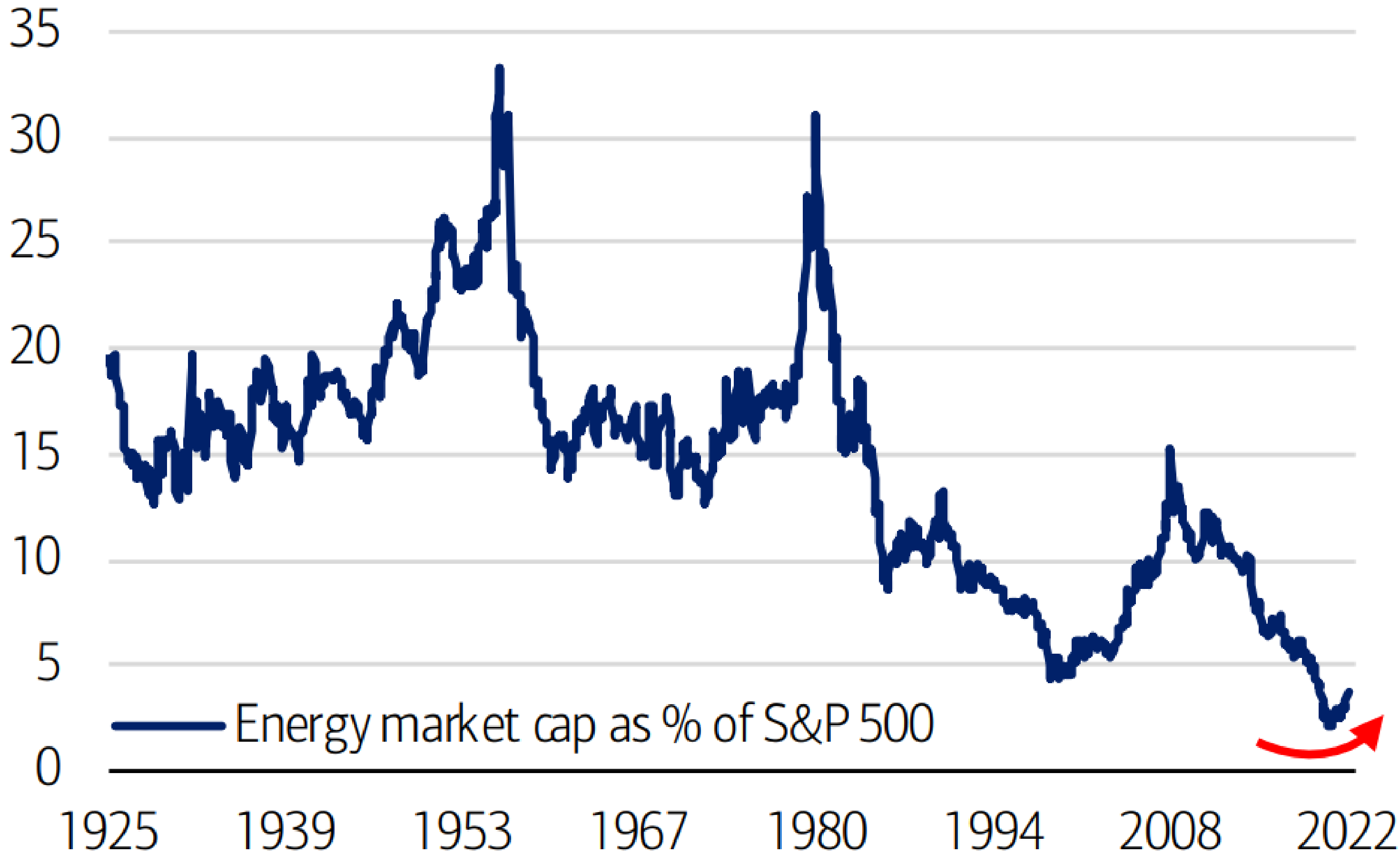
S&P 500 Forward PE Ratios & Subsequent 10-year Returns



Source: IBES, Refinitiv Datastream, Standard & Poor's, JPMorgan Asset Management. Total annualized in percentage points. Data represents monthly data points since 1988.

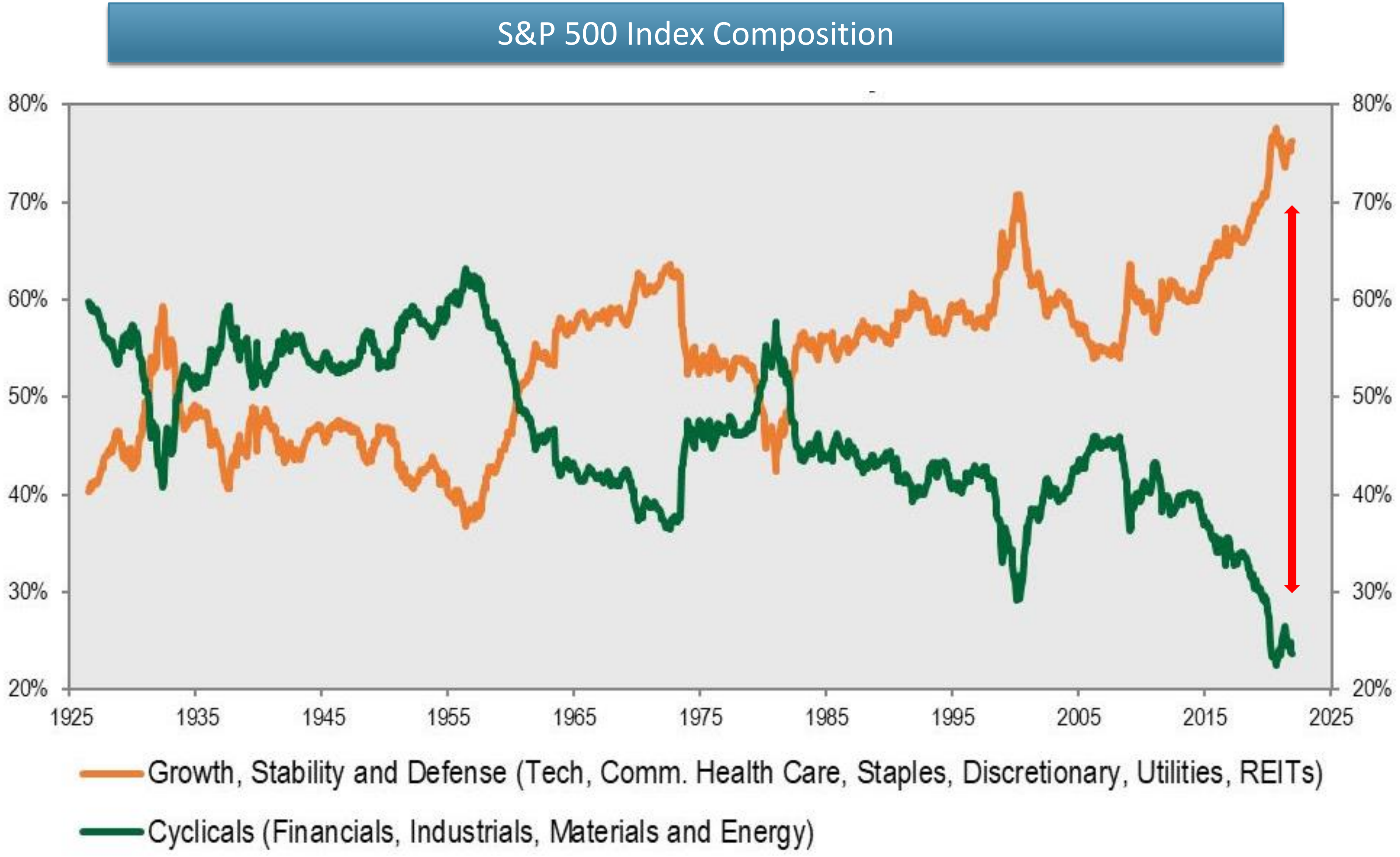
The Energy sector represents *only* 3% of the S&P 500! Back in 2008, the sector was 15% of the index.

US Energy Market Cap as a % of the S&P 500



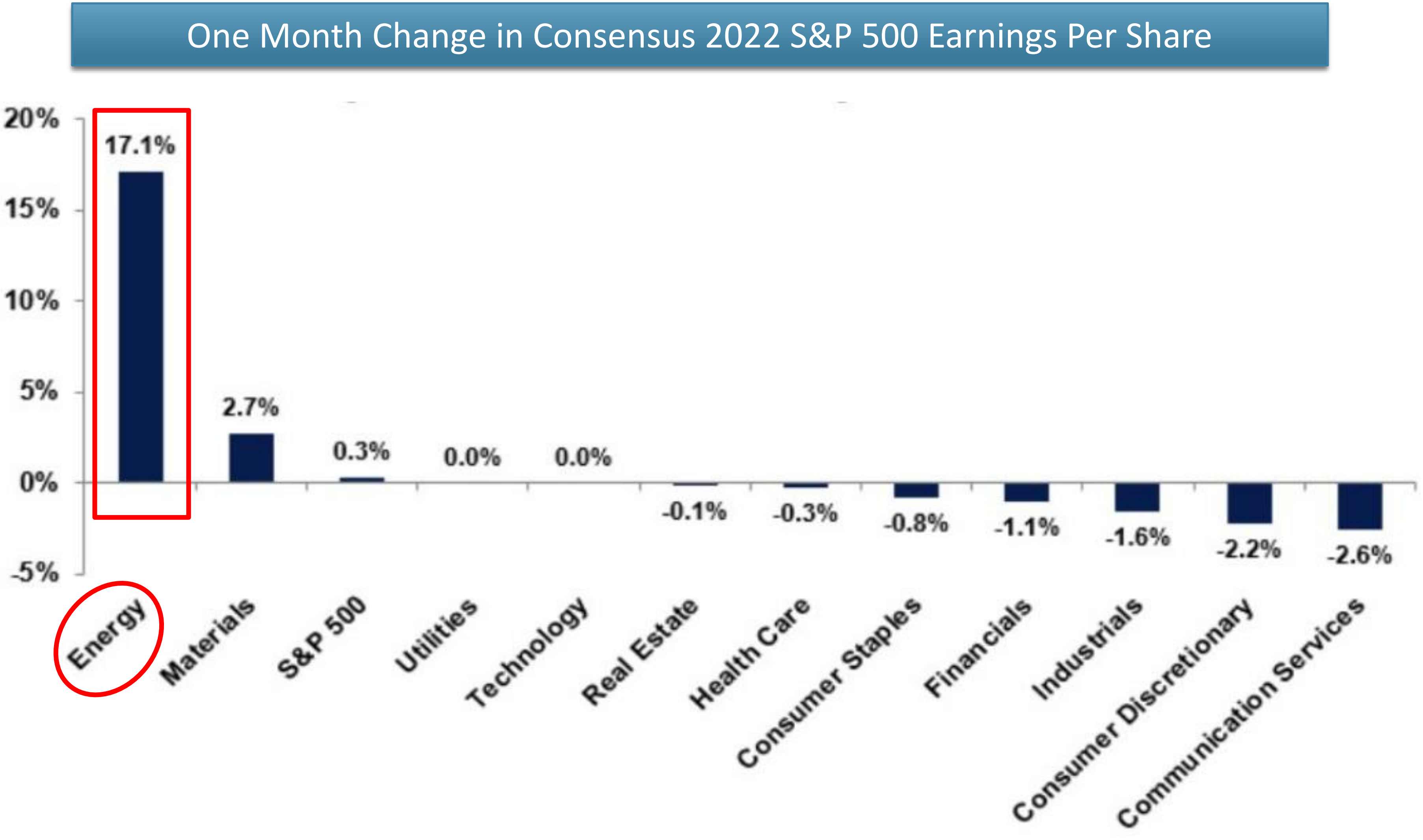
Source: Bank of America Research Investment Committee, Global Financial Data

The weight of cyclicals in the S&P 500 is at 100-year lows



Source: Twitter @MichaelKantro

Energy earnings estimates have risen sharply over the past month



Source: LPL Research, FactSet. Data as of 4/13/22. Indexes are unmanaged and cannot be invested in directly.

Astoria has been quite clear about avoiding long duration assets

Astoria on Bloomberg TV

John Davi @AstoriaAdvisors · Apr 9 ···

Thanks again @EricBalchunas for inviting me to come to @BloombergTV

Here is a clip to my segment which discusses why we continue to like Value ETFs, inflation hedges, and why we are avoiding long duration assets.

Source: Twitter @AstoriaAdvisors, Bloomberg, Astoria Portfolio Advisors

Will we see rate cuts in 2023?

Number of Months from Last Rate Hike to First Cut

Last Hike	First Cut Of Next Cycle	# Of Months
Dec-18	Jul-19	7
Jun-06	Sep-07	15
May-00	Jan-01	8
Feb-95	Jul-95	5
Feb-89	Jun-89	4
Aug-84	Oct-84	2
May-81	Jun-81	1
Mar-80	Apr-80	1
May-74	Jul-74	2
Avg		5

Source: Twitter @MichaelKantrowitz

Astoria's Current & Prospective Economic Outlook

How Portfolios Should be Allocating in 2022

Diversification is always smart. However, sticking to the same allocations may not pay off in inflationary times. The inflation sensitivity of the assets you hold will factor heavily into overall portfolio performance. Certain cyclical stocks and commodities have traditionally fared better in times of high inflation and others have characteristics suited for Inflation 2022-style. The key is in the selection of the sectors and players most likely to benefit from rising prices.

2022 = Different

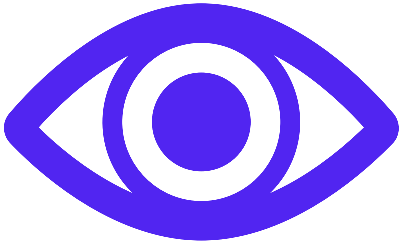
Whereas 2021 was characterized by easy money, peak economic growth, and peak corporate profits, 2022 appears to be the opposite. Money is being taken out of the system, and the economy likely won't repeat the robust economic and earnings growth from last year.

We believe that the current weakness in the equity and bond market can be attributed to a growth scare and not a full-blown pending recession. Admittedly, we have seen pockets of acute weakness in sectors such as long dated nominal bonds, unprofitable technology, and hyper growth stocks. However, our base case is that this extreme weakness does not spread more broadly to all US equity sectors. **Inflation sensitive assets avoided the acute weakness and relatively outperformed in Q1.**

Inflation

How Portfolios Should be Allocating in 2022 (Continued)

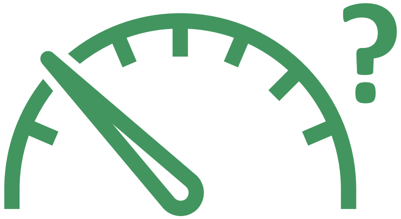
Our view is that the Fed has been slow to react to the high growth of inflation and will lean on aggressive rate hikes to tame the stubbornly high levels of inflation. We estimate that the Fed Funds effective rate could reach as high as 3% before this tightening cycle is over. From our perch, despite a large year-to-date rally in inflation sensitive assets, such assets may still provide a level of portfolio protection and may have the potential to further benefit from higher levels of inflation. Inflation was notably lower over the past decade as interest rates fell and the overall cost of capital was cheap. Our view is that these dynamics spurred the growth of the technology sector which resulted in lower prices for goods and services and dampened inflation. Those forces are now working in reverse as interest rates and inflation are rising.



How Portfolios Should be Allocating in 2022 (Continued)

As a result of the deflationary forces over the past decade, inflation sensitive assets were largely ignored as capital was allocated to deflationary sectors such as technology, consumer staples, and utilities, as well as nominal bonds. These asset classes performed well on a risk-adjusted basis which enforced the concept of reflexivity. The better these asset classes performed, the more capital flowed into them. However, our view is that we are entering into a paradigm shift where interest rates are on the rise and could remain structurally higher in the years to come. Under this new paradigm shift, assets that performed well when the discount rate was low may not produce the same level of risk-adjusted performance as interest rates rise.

Many inflation sensitive assets are still trading at a discount compared to the broader US large-cap core index and growth indices. For instance, the S&P 500 Energy sector trades at a 10.6 Price-to-Earnings ratio based on 2022 estimates while the S&P 500 and NASDAQ-100 index trade at a 19.6 and a 25.5 Price-to-Earnings ratio, respectively, based on 2022 estimates.



Admittedly, inflation sensitive assets have seen strong returns over the past 12-18 months. That does not imply that the upside is limited, but we acknowledge that the rate of change could slow in the future.

How Portfolios Should be Allocating in 2022 (Continued)

As the inflation outlook remains heightened, investors will likely be paying strong attention to the next FOMC Meeting which is scheduled for May 3rd – May 4th. Market participants will likely focus on the possibility of any inter-meeting rate hikes, which could cause heightened levels of volatility if unanticipated. The size of the next increase, whether the hike is 25bps or 50bps, is also likely to be debated by the market in the coming weeks.

We expect heightening volatility to be one of the main stories for the balance of 2022. There is a direct linkage between easy money and lower levels of volatility. This reflexive concept is apparent when looking at the size of the Fed balance sheet, equity prices and implied volatility.

How Portfolios Should be Allocating in 2022 (Continued)

Moreover, the spread between the 2-year US Treasury and the 10-year US Treasury is close to inverting. This has historically sent an ominous signal to the marketplace. What does this mean for overall portfolio construction? We believe broadly owning a portfolio of diversified sets of asset classes, as well as owning multiple factors, inflation hedges, and alternatives will be paramount in 2022.

In summary, we believe there are three notable risks that the economy faces: 1) the Fed is behind the curve 2) the Fed is looking to unwind its balance sheet at the same time it's hiking interest rates 3) inflation continues to remain high. Will the economy be able to withstand these risks without going into a recession? Only time will tell, and we plan on addressing these risks in coming blogs and research reports.

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