MARKET INSIGHTS

Opportunities do exist, even in a volatile market environment

JUNE 2022

New York Life Investments

Our multi-boutique business model is built on the foundation of a long and stable history, which gives our clients proven performance managing risk through multiple economic cycles. With capabilities across most asset classes, market segments, and geographies, our family of specialized, independent boutiques and investment teams allows us to deliver customized strategies and integrated solutions for every client need.

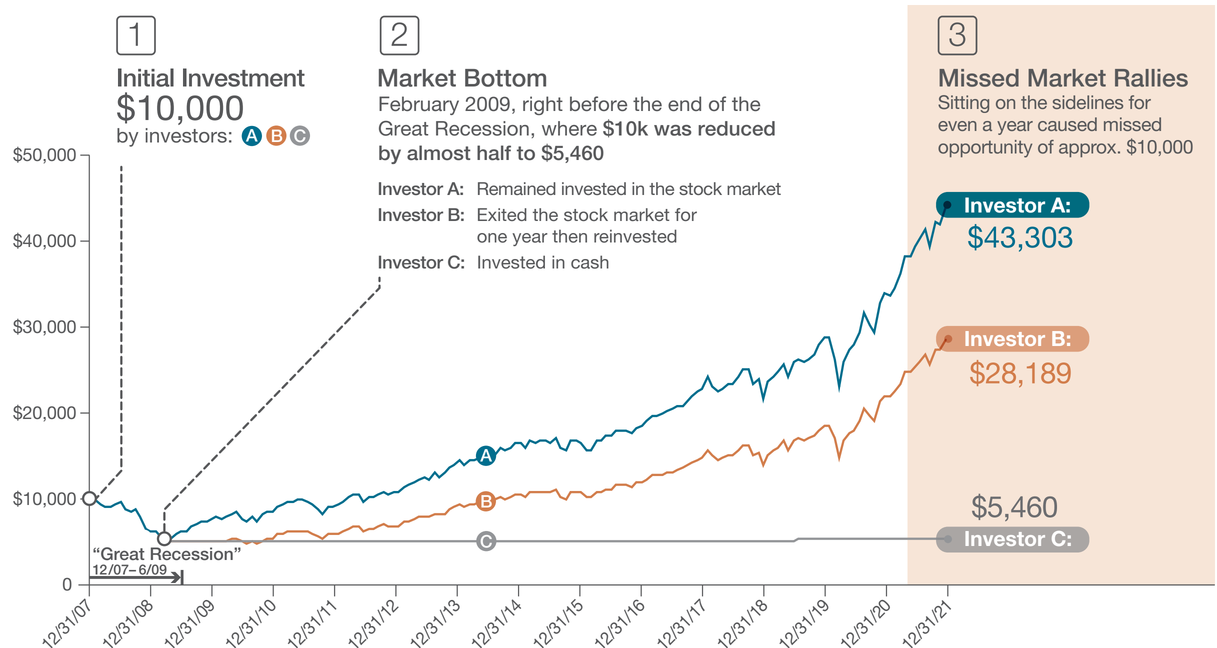
Our investment managers offer deep domain expertise and diversity of thought, generating deeper insights alongside a strong conviction to deliver better outcomes. Our global capabilities combined with local presence drive a more nuanced perspective and a greater personal experience for our clients.

Volatility is now a given for asset allocation—and there is no shortage of market commentary about the topic. Themes contributing to market pressure include the rise in costs of goods and services, COVID lockdowns in China, the Russia-Ukraine war, de-globalization, climate change, and more.

During a volatile market, it may be tempting to sit on the sidelines and wait until things get better. However, no one can predict what the market will do a day, a week, or even a year from now. So, "timing" the market in the short term may not be as prudent as maintaining "time in" the market.

Attempts to time the market may lead to missed market rallies[1]

December 2007 – December 2021

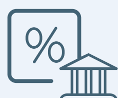


Source: Morningstar, 12/31/21. This example is hypothetical in nature and does not reflect actual investment results. This is for illustrative purposes only and is not indicative of any investment. The stock market is represented by the S&P 500 Index. Cash is represented by the 30-day U.S. Treasury bill. The data assumes reinvestment of income and does not account for taxes or transaction costs. Past performance is no guarantee of future results. It is not possible to invest in an index. Index definitions and full source disclosure can be found at the end of this piece.

INVESTMENTS

Not FDIC/NCUA Insured	Not a Deposit	May Lose Value	No Bank Guarantee	Not Insured by Any Government Agency

To help understand which asset classes may offer the greatest investment opportunity potential during these times, we reached out to the seasoned investment experts across New York Life Investments to obtain their insights on the market.



High Yield Bonds

Insights from

MacKay Shields

What's trending?

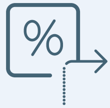
- Underlying demand for the U.S. high-yield market has remained stable in 2022, even though market weakness caused retail outflows.

Outlook/analysis

- If interest rates continue to rise, we believe the U.S. high-yield market is better positioned than most fixed-income asset classes due to its higher spreads, bigger coupons, and shorter maturities.
- Today's high-yield market is more vulnerable than it has been historically since coupons have shrunk, even though the overall credit quality has improved.
- On a positive note, spreads have begun to widen in line with their historical median, while the dollar price of bonds has declined.
- The yield on the ICE BofA U.S. High Yield Index has increased by over 3% in 2022, given the rise in U.S. Treasury rates—and now stands at 7.2% (as of May 2022) vs. 4.3% at the beginning of the year.[2]
- Yields at these levels are comparable to what was seen in mid-2018 to 2019 and are now above long-term median levels.
- The average dollar price of the U.S. high-yield market, as measured by the Index, is now approximately $92—meaning there is now more potential for capital appreciation.[3]
- Spreads also recently widened and were 430 basis points (bps) at the end of May—up from 330 bps at the start of 2022.[3]

Opportunities and risks

- 1Q22 earnings from high-yield issuers have shown the effects of cost inflation, strained supply chains, and scarce raw materials.
- Cost inflation in Europe is particularly concerning—even though most U.S. high-yield issuers are focused domestically; others have manufacturing operations in Europe experiencing severe cost shocks (e.g., natural gas prices in Europe vs. the U.S.).
- The broader credit risk profile of the U.S. high-yield market continues to remain strong even though inflation has been severe and persistent.
- The credit quality of the U.S. high-yield market improved in 2021, with 58% of new issues rated BB, and then continued in 2022, with 54% of new issues rated BB (up from 43% at the end of 2011).[4]
- Regarding positioning, we continue to maintain a duration that is half a year below the benchmark.
- At the end of May, we were overweight in **energy** and **materials**, while underweight in **telecom**, **industrials**, and **financials**.
- We also continue to believe the U.S. high-yield market represents a reasonable, lower-duration fixed-income investment option.
- In today's environment, unleveraged stable income is difficult to obtain.



Convertible Bonds

Insights from

MacKay Shields

What's trending?

- Economic data continues to show that inflation is not subsiding, and recent spikes in commodity prices will likely increase cost pressure.
- While the ICE BofA U.S. Convertible Index performed inline with the S&P 500 Index on the downside (approximately down 17%), it has done reasonably well vs. the stocks of companies with convertibles—as those are down nearly 30% YTD.[5]
- Widening credit spreads have also hurt convertibles on the downside.
- On a more positive note, about 40% of the convertible bond market is busted—meaning the underlying stock is trading below the conversion price, causing the security to act solely as a bond—and should have limited downside from here unless spreads widen out further.

Outlook/analysis

- Although the convertible bond market is starting the year with losses, we expect equity-linked securities to recover as the outlook for strong corporate earnings prevails over fears of rising interest rates.
- The recent decline in convertible bond prices positions the asset class in a slightly more defensive position with the lower delta, or equity sensitivity, now associated with the market.
- This should provide some measure of downside risk management if equities continue to fall.
- We expect new issuance to decline from the near-record pace of the past two years. However, the rise in interest rates may stimulate more investment-grade companies to access the convertible market as the cost to borrow in the straight debt market rises.
- Convertibles have tended to outperform in rising rate environments[5] and, unlike nearly all other classes of fixed-income instruments, have almost no correlation to the movement in interest rates.
- We believe convertible bonds remain an excellent vehicle through which to participate in equity advances.
- We believe that at current valuations, convertible bonds should participate in most of the stock market's advances and approximately half of any decline in the event that our outlook for equities is wrong.

Opportunities and risks

Risks to the convertible bond market remain tied to the performance of the underlying equities.

- However, with the sharp decline in most technology stocks, many bonds issued in the past two years have become more defensive—as they trade below their issue price, and in some cases, are close to their theoretical "bond floors."
- If interest rates rise markedly, bond floors for these securities will likely drop—all other factors being constant.
- We continue to believe that opportunities exist in the **energy** and **materials** sectors.
- U.S. inventories of crude oil and natural gas are 16% and 17% below their respective five-year average,[6] and for various reasons, production has not increased meaningfully in response to high prices.
- We expect commodity prices to remain elevated for the foreseeable future. The stocks of most energy companies do not reflect durable elevated commodity prices.

Municipal Bonds

Insights from

MacKay Shields

What's trending?

The municipal bond market was off to the most challenging start in decades—until recently when we've seen a 4%-6% recovery. We attribute this primarily to:

- Rising rates, including a more aggressive tone by the Fed regarding future tightening.
- A market where liquidity has declined over the years, which has become even more apparent in recent months as banks and broker dealers have further reduced risk and their balance sheets.
- A weaker tax season period, as some clients sell municipal bonds to pay their tax bill. While April 15 has come and gone, we do not believe it is fully behind us as it seems to be taking a lot more time for tax payment checks to clear corresponding municipal bond accounts.

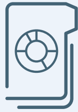
Outlook/analysis

While the municipal bond market has contended with an array of headwinds in 2022, and it is difficult to pinpoint a recovery, there are several positive attributes we believe will lead to a more solid footing:

- We are entering a strong technical season for municipal bonds, and the "lag effect" of tax season will eventually be behind us.
- In June, July, and August, increased demand is anticipated as a high volume of principal and income reinvestment capital is scheduled.
- This, coupled with manageable supply projections, results in net negative supply—meaning there are currently more dollars chasing fewer bonds.
- At the same time, even a modest increase in bank broker-dealer inventory intended to satiate this demand could provide material market support.
- Credit fundamentals are strong: Income tax, sales tax, and property tax collections have exceeded expectations, and this, paired with stimulus programs, have boosted municipal credit profiles.
- Rating agency upgrades are far exceeding downgrades. For example, Moody's has assigned 54 upgrades vs. only four downgrades so far in 2022.
- We attribute the strong 4%-6% partial recovery in recent weeks to: rates rallying, crossover buyers adding municipal bonds to portfolios at attractive levels, the dealer community modestly adding bonds to their balance sheet, and mutual fund flows starting to turn positive.

Opportunities and risks

- In the months ahead, it is our belief investors will continue to focus on inflation readings, the Fed's rate hike path, and any subsequent impact on domestic growth.
- As a result, volatility is expected to remain elevated until we get a clearer sign of any of the three above.
- Against this backdrop, it is our opinion that active management is paramount to delivering structure and total return potential until the market returns to some form of normalcy.
- As we've seen in prior dislocations, we believe two of the most important variables to monitor will likely continue to be mutual fund buying/selling behavior and municipal bond market liquidity.
- Municipal bonds are still compelling at these levels and there are many places to reference, including increased distribution yields/tax-free income streams and ratios that are still elevated.



Floating Rate Bonds

Insights from

NYL Investors

What's trending?

- Heightened concerns about the risk of recession and a "hard landing" as the Federal Reserve battles inflation have led to a repricing of risk across markets and asset classes.
- Loans have been insulated from the repricing of risk but have not been immune.
- To highlight, the YTD return on the S&P 500 Index, as of close on 5/24/22, was down 16.6%. During this same period, loans were down 2.5%.[5]
- That approximate 14% difference in return on equities has caused most other asset classes to weaken, including floating rate loans due to the increase in risk premiums demanded by investors.

Outlook/analysis

- In recent sessions, we have seen a flight to quality trade take hold as investors seemingly had nowhere else to turn.
- After reaching a high of 3.13% on 5/6/22, the 10-year U.S. Treasury is currently yielding 2.73% after starting 2022 at 1.63%.[5]
- While the initial widening went further and faster than most expected, the recent trading range feels "about right."
- Like the Fed, the market is "data dependent" at this point—updated GDP and inflation reports will give the market clearer signals of where we are headed.
- There are challenges in this high inflation economy, but companies are generally seeing growth in revenues and operating profits, upgrades still outpace downgrades; and pent-up demand from consumers as we continue to recover from the COVID-related slowdown should continue to support the market.
- Fed President Jerome Powell recently confirmed his view supporting that the central bank should boost short-term interest rates by 50 bps at both the June and July meetings.
- We believe that if the market truly is so close to recession it seems illogical for the Fed to remain so hawkish with rates risking a more severe slowdown in the economy.

Opportunities and risks

- Floating rate loans may be down 2.5% YTD as of 5/24/22, but compared to the -10.2% return for high yield, the -13.0% return of investment-grade corporates, and the -16.6% return on the S&P 500 Index, floating rate loans have shown resilience.[5]
- We continue to favor floating rate loans as fundamentals remain adequate and considering corporate defaults remain at 10-year lows.
- Yields on floating rate loans have increased about 50 bps YTD, and we expect rates to continue to rise further at the next Fed meetings.[5]
- In such periods of market volatility, we like BB-rated credit—especially now that rates have moved higher.
- Our deepest worry is that market concerns about the economy can become self-fulfilling, as we witnessed in late 2018-19. Back then, concerns about the economy stalling due to the U.S. trade posturing vs. China caused businesses to pull back on their investments, and the economy ultimately slowed. The current economic challenges could cause investors to follow a similar path at a vulnerable time.

Listed Infrastructure

Insights from

CBRE Investment Management

What's trending?

- The market continues to grapple with a confluence of macro risks that we believe pose more substantial risks to the earnings power of companies outside the infrastructure space—which may lack pricing power and could suffer a compression in margins as costs increase.
- We believe infrastructure should continue to garner support from investors seeking a stability of regulated and contracted cash flows, which comes from essential assets also offering inflation impact offset potential.
- On a YTD basis through 5/31/22, fund flows to open-end infrastructure mutual funds and ETFs are net positive ($1.6 billion).[2]
- Given the defensive nature of infrastructure assets, the FTSE Global Core Infrastructure 50/50 Index is up 2.22% YTD, outperforming broad equities and fixed income by a wide margin.[2]

Outlook/analysis

- As a byproduct of recent events, we expect European countries to hasten their energy security approach, including broadening access to liquefied natural gas (LNG) from the Middle East and North America.
- Integrated electric utilities in Europe and the U.S. should benefit from increased investment and policy support over time.
- We also expect U.S. midstream stocks positioned to meet the need for increased natural gas exports to benefit.
- We believe U.S. and U.K. regulated utilities are also well-positioned to benefit from inflation as they can pass through the increased costs to the users of the assets while also making an investment to make the grid network more efficient to handle the increased renewable generation.
- Toll roads are our preferred transportation sector as traffic has recovered to 2019 levels in most markets, allowing companies to reinstate dividends back to pre-COVID levels while also benefiting from tariffs that rise with inflation.
- From a macro perspective, conditions remain favorable for the infrastructure asset class. Inflation is persistent, and while global growth is moderating, infrastructure companies are seeing accelerating growth in cash flows and dividends.

Opportunities and risks

- The outlook is positive for infrastructure. The defensive nature of the assets, durable earnings growth, inflation impact offset potential, and attractive valuations should continue to support infrastructure stocks in this volatile macro environment—with the potential for private infrastructure investor interest providing a bonus support for the stocks.
- The private infrastructure thematic continues to support listed infrastructure valuations. YTD activity includes private equity bids for a U.S. gas utility, a U.S. data center company, an Italian toll road company, and a European renewable generation company.
- The listed infrastructure market remains significantly discounted; therefore, we believe it will likely continue to see merger and acquisition activity that supports the valuations of the listed market.

Large-Cap Growth

Insights from

Winslow Capital

What's trending?

- Equity market volatility for high-growth companies, that first manifested in the fourth quarter of last year, has continued and broadened in the first five months of 2022.
- Stagflation, a word associated with 40 years ago, has become a mounting global risk, sharpening the need for effective global monetary policy.
- All major global equity indices declined in this risk-off environment.
- Large-cap growth equities, which had handily led the markets for the prior five years, were the worst performers.

Outlook/analysis

The investment backdrop changed markedly over the past two-plus quarters, so in recognition of these changes, we acted by further shifting our investment strategy across the three types of growth—consistent, dynamic, and cyclical:

- **Consistent growth** currently stands at 46% of the strategy—up 18% from year-end and an approximate 14% overweight vs. the Russell 1000 Growth Index. This reflects the greater level of macro/geopolitical uncertainty and the view that these highly profitable, high free cash flow generating companies are not as susceptible to higher interest rates.
- **Dynamic growth** holdings were materially reduced and now represent 28% of the strategy; 14% lower vs. year-end 2021, and a 6% relative overweight vs. the Index. The decrease in dynamic growth's weight came largely in the "high-growth cohort," as we believe that segment is very unlikely to regain the valuation multiples they enjoyed during the work from home/zero interest rate/government stimulus-driven days of 2020 and 2021.
- **Cyclical growth's** weight also declined 4% from 29% to 25% and now stands at a 21% underweight vs. the Index—underscoring our preference for secular growth stocks in a slowing growth environment and the increasing likelihood of a U.S. recession.

Opportunities and risks

- The growth equity markets' sell-off and corresponding valuation compression has restored much of the growth equity markets' long-term value and provided a compelling entry point for select growth companies with advantaged business models that are well-positioned to generate strong, long-term secular growth.
- Periods of volatility present opportunities to be seized, and we model a return to potentially stronger absolute and relative returns for the strategy in the months ahead.
- We believe the greatest near-term risk is that an aggressive Fed, while focused on fighting inflation, chokes off economic growth driving the U.S. into recession—which would likely lead to greater near-term risk as corporate earnings decline.

Value Equities

Insights from

Wellington Management

What's trending?

- U.S. equities have sold off YTD and are trading near bear market territory.
- This was driven by a combination of a 40-year high in inflation and a rise in interest rates.
- High inflation increases costs for businesses (impacting earnings/margins) and has led to a 35-year low in consumer confidence due to rising energy costs.
- Against this backdrop, value equities (Russell 1000 Value Index) have outperformed the broad markets (S&P 500 Index) by approximately 700 bps and growth equities (Russell 1000 Growth Index) by approximately 17% (as of 5/31/22).[2]
- Only two sectors are positive YTD—value oriented energy and utilities (as of 5/31/22).[2]

Outlook/analysis

- Our U.S. macroeconomic strategists believe we will likely see interest rate hikes over the next few Fed meetings. The Fed may have to reevaluate its path during the second half of the year depending on how much financial conditions tighten and growth slows.
- The market is pricing in a Fed Funds rate above 3%.
- While economic conditions are tightening, there are key supports in the economy that should help to mitigate some of the impact of slowing growth: an elevated level of household savings, elevated household wealth, low household debt service levels, high cash balances by corporations, and room to increase credit growth.
- Higher inflation/interest rates continue to favor value equities, and a weaker U.S. dollar (due to rising interest rate expectations abroad) may provide a tailwind for cyclical equities (i.e., industrials and consumer stocks).
- Health care remains a sector that is defensive and has historically done well in rising rates.

Opportunities and risks

- Economic upside opportunities include positive news surrounding event-driven risks such as the zero-COVID policy in China (i.e., positive for supply chains), the war in Ukraine (i.e., lower energy prices), or if the Fed needs to hike less than the market has priced in (i.e., a soft landing).
- Downside risks include persistently high inflation/tight conditions that lead to an elevated probability of recession, an increase in the unemployment rate due to businesses stalling hiring, and a recession in Europe that may have spillover effects on the U.S.
- Given the mix of upside and downside risks, we believe in maintaining a balanced strategy that doesn't lean heavily into any one economic outcome, and keeping a valuation discipline may be appropriate.

INDEX DEFINITIONS

The **ICE BofA U.S. Convertible Index** is a market capitalization-weighted index of domestic corporate convertible securities. To be included in the Index, bonds and preferred stocks must be convertible only to common stock. The **FTSE Global Core Infrastructure 50/50 Index** constituents are grouped by Industry Classification Benchmark (ICB) subsector into three core infrastructure sector groups. Weights are capped at both the sector group level and the constituent level. The **ICE BofA U.S. High Yield Index** tracks the performance of U.S. dollar-denominated below investment-grade rated corporate debt publicly issued in the U.S. domestic market. The **Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 companies with higher price-to-book ratios and higher forecasted growth values. The Russell 1000 Growth Index is constructed to provide a comprehensive and unbiased barometer for the large-cap growth segment. The **Russell 1000 Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower forecasted growth values. The Russell 1000 Value Index is constructed to provide a comprehensive and unbiased barometer for the large-cap value segment. The **S&P 500 Index** is widely regarded as the standard for measuring large-cap U.S. stock-market performance. **Treasury securities** are backed by the full faith and credit of the U.S. government as to payment of principal and interest if held to maturity.

DEFINITIONS

Active management is an investment strategy involving ongoing buying and selling actions by the investor. Active investors purchase investments and continuously monitor their activity to exploit profitable conditions. There are typically higher fees associated with active investment management. A **basis point (bp)** is a unit of measure used to describe the interest rate changes in a financial instrument. One basis point equals 0.01%, or 0.0001. **Bull market** is the condition of a financial market in which prices are rising or are expected to rise. **Bear market** is when the overall stock market drops in value by 20% or more from its recent highs. **Correlation** is a statistic that measures the degree to which two securities move in relation to each other. Correlations are used in advanced portfolio management, computed as the correlation coefficient, which has a value that must fall between -1.0 and +1.0. **Credit ratings** are rated on a scale from AAA through C. AAA through BBB represents investment grade, while BB through C represents non-investment grade. **Delta** is a risk metric that estimates the change in price of a derivative, such as an options contract, given a $1 change in its underlying security. **Free cash flow** is the cash a company generates after taking into consideration cash outflows that support its operations and maintain its capital assets. **Municipal/Treasury bond ratio** is a comparison of the current yield of municipal bonds to U.S. Treasurys. It aims to ascertain whether municipal bonds are an attractive buy in comparison. **Tax-loss harvesting** is the timely selling of securities at a loss to offset the amount of capital gains tax due on the sale of other securities at a profit.

1. Source: Morningstar, 12/31/21. This example is hypothetical in nature and does not reflect actual investment results. This is for illustrative purposes only and is not indicative of any investment. There are certain limitations inherent in hypothetical portfolios and hypothetical results, particularly that they are based on assumptions and do not reflect trading in actual client accounts and do not reflect the impact that material economic and market factors may have had on an actual account. The stock market is represented by the S&P 500 Index. Cash is represented by the 30-day U.S. Treasury bill. The data assumes reinvestment of income and does not account for taxes or transaction costs. Stocks have been more volatile than bonds or cash. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. Past performance is no guarantee of future results. It is not possible to invest in an index.
2. Source: Morningstar, 5/31/22.
3. Source: ICE Data, 5/31/22.
4. Source: ICE Data, 3/31/22.
5. Source: Morningstar, 5/24/22.
6. Source: U.S. Energy Information Administration, 4/15/22.

For more information
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