SAPPHIRE
FIDUCIARY ADVISORS

April 27, 2022

Dear clients and friends of Sapphire,

A combination of factors, which included a hawkish Fed, extraordinary inflation, and war produced a difficult first quarter for investors.

Persistent and accelerating inflation data coupled with a red-hot jobs market, resulted in the worst start to a year for bond returns in five decades. Prevailing interest rates increased rapidly and caused bond prices to decline. The yield on the U.S. Aggregate bond index increased from 1.8% on December 31, 2021 to 2.9% as of March 31, 2022 and posted a total return of negative 5.9% during the quarter. Reflecting expectations of multiple, half-point increases in short-term interest rates over the coming quarters, bonds failed to provide cover for equity investors seeking safety during the first quarter of 2022.

Spikes in the price of food, fuel, and many other commodities were due to supply chain constraints and, in part, to war in Ukraine – a humanitarian tragedy and an unpredictable variable. In February, food inflation and energy inflation reached 7.9% and 25.7%, respectively.

High equity valuation multiples are often associated with companies that are expected to produce strong earnings growth for many years into the future. In a rising interest rate environment, equity analysts using discounted-cash-flow valuation models increase the *discount rate*, which results in a lower estimated, present value of future cash flows – what Warren Buffett calls the *intrinsic value* of the security. When analysts publish a lower "target price" based on this type of analysis, downward pressure on the market price of the stock often follows. Although the aggregate earnings of companies in the S&P 500 Index increased during the quarter, multiple contraction (a reduced, aggregate price-to-earnings ratio of stocks in the S&P 500 Index) resulted in a negative 4.6% total return.

It is worth noting that the top ten companies (as measured by market capitalization) in the S&P 500 Index had a forward P/E multiple of nearly 31x as of March 31. The remaining stocks in the Index had a forward P/E multiple of less than 17x. This is something to keep in mind when comparing the merits of active investing to passive, index-oriented alternatives.

Please contact Sapphire at any time if you would like to discuss your portfolio or to learn more about how we can be of service to you.

Respectfully,

Paul Stropkay, CFA

Sources

- J.P. Morgan Asset Management *Guide to the Markets®* 2Q 2022 as of 03/31/22

Disclosure

Past performance is no guarantee of future results. No guarantees are implied. The views in this letter are intended to assist investors in understanding the firm's present investment methodology and do not constitute investment advice.