

Reasons for Hope in a World of Bad News

It's extremely difficult to watch the news and not feel overwhelmed by the avalanche of negative headlines. Some of them, such as the war in Ukraine, are heartbreakingly negative, outright terrifying, and tragic. Others such as inflation, the corresponding looming Fed hikes and extreme volatility are clearly linked, but, at the same time, add to the sense of gloom that pervades the current US equity markets.

Despite this glut of negativity that we see playing out on television each day, are there reasons to be constructive on market performance for the remainder of 2022? Believe it or not, we believe there are.

Let's start with the on-going war in Ukraine. Clearly what is happening there is a human tragedy on a level that is hard to find adequate words for. Further, it's clear that it has had a negative effect on the market for a litany of reasons. Setting aside the incredible human cost, what effects are likely to impact the market for the remainder of 2022? We will not pontificate on how we see this ending other than to say it feels like a poorly planned miscalculation on the part of Putin. We would feel arrogant attempting to claim we know how this will end, particularly when Putin seems to be relying less on calculated precise strategy and more on pure emotion. While this event is casting a scary pall over the market, it is not the first nor the last "bad news" event that in the moment feels like a headwind that can never be overcome. We aren't suggesting any of the below events carry the same magnitude as today's current events, but, for example, if you flashback to March of 2020 at the onset of the Pandemic, was the market convinced at that time that the market would be materially higher over the next 18 months? No. Circumstances change and markets evolve.

SOME EXAMPLES OF REASONS NOT TO INVEST

Year	Event	Cumulative total return ¹
1999	Y2K	467.1%
2000	Tech wreck; bubble bursts	368.5%
2001	September 11	415.4%
2002	Dot-com bubble: market down -49%	484.9%
2003	War on Terror – U.S. invades Iraq	650.9%
2004	Boxing Day Tsunami kills 225,000+ in southeast Asia	483.5%
2005	Hurricane Katrina	426.2%
2006	Not a bad year, but Pluto demoted from planet status	401.6%
2007	Sub-prime blows up	333.2%
2008	Global Financial Crisis; bank failures	310.6%
2009	GFC: market down -56%; depths of despair	S&P 500 551.8%
2010	Flash crash; BP oil spill; QE1 ends	415.4%
2011	S&P downgrades U.S. debt; 50% write-down of Greek debt	347.9%
2012	2nd Greek bailout; existential threat to Euro	338.6%
2013	Taper Tantrum	278.1%
2014	Ebola epidemic; Russia annexes Crimea	185.6%
2015	Global deflation scare; China FX devaluation	151.2%
2016	Brexit vote; U.S. election	147.8%
2017	Fed rate hikes; North Korea tensions	121.3%
2018	Trade war; February inflation scare	81.7%
2019	Trade, impeachment inquiry, global growth slowdown	90.0%
2020	COVID-19 pandemic, U.S. Presidential Election	44.5%
2021	Omicron variant, China regulatory crackdown, what's next?	22.0%

There always seems to be a reason to be nervous about investing

- While some of these events had significant short-term impacts, the market has always found a way to recover.
- There are always going to be events and headlines that make investors nervous and emotional when investing.
- Admittedly, the up-close-and-personal nature of COVID-19 is different, and has the potential to sway investor sentiment more than other historical events.
- But this too shall pass: markets have already posted a phenomenal recovery off the lows, and the global economy continues to heal.

Sources: J.P. Morgan Private Bank. FactSet. [1] Cumulative total returns for S&P 500 are calculated from December 31 of the year prior until January 31, 2022.

Clearly, each of these headwinds were unique, but the point is that it seems reasonable that the current war alone should not be enough to keep the market negative. We have priced in quite a bearish scenario as we look at individual companies from a valuation perspective.

What about inflation and the corresponding rate hikes? The CPI release on March 10, 2022, was just the most recent data point reflecting high inflation and the necessity for rate hikes (with the first 25 basis points of tightening occurring on 3/16). Our last piece from February 2022 that can be found [here](#) made the strong case that small cap equities had historically experienced strong performance following the first Fed rate hike in a cycle. The chart below, which we included in that piece makes a strong case for the potential for positive market performance of small cap stocks over the rest of 2022 despite the looming rate hikes.

RUSSELL 2000 INDEX RETURNS FOLLOWING FED FUNDS RATE INCREASE

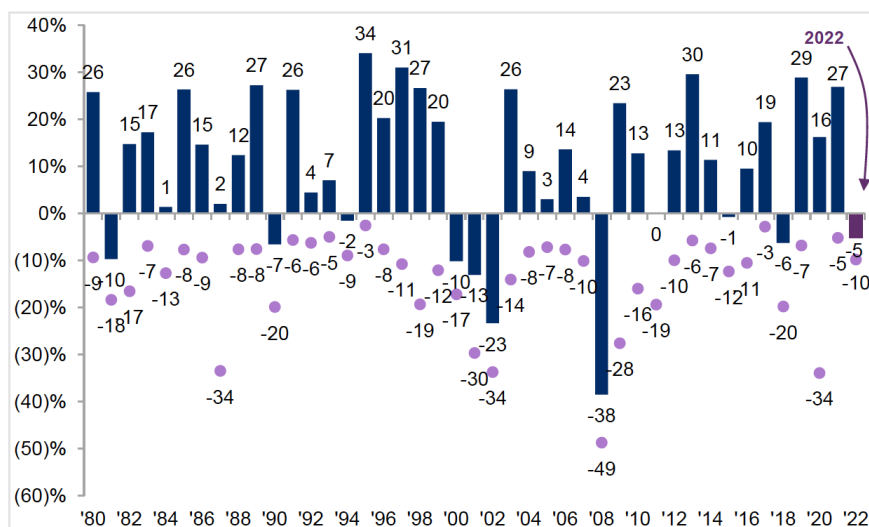
Hike Date	3 months after	12 months after	18 months after	36 months after
2/1/83	n/a	26.97%	5.20%	49.22%
10/1/86	1.75%	29.02%	7.47%	40.02%
2/4/94	-2.54%	-2.69%	16.85%	47.57%
6/30/99	-6.32%	14.32%	7.60%	1.71%
6/30/04	-2.86%	9.45%	15.88%	48.00%
12/15/15	-5.36%	22.63%	17.55%	9.14%
Averages	-3.07%	16.62%	11.76%	32.61%

Source: Perritt Capital Management

Not surprisingly, war and inflation lead to high volatility. This is to be expected. However, historically this kind of volatility has both presented buying opportunities and has not normally resulted in negative annual returns for the US equity markets. As the chart below shows, despite average peak to trough drops of 14.1%, the market has had a positive annual return in 31 of 41 years.

S&P 500 INTRA-YEAR DECLINES (MAX DRAWDOWNS) & CALENDAR YEAR RETURNS

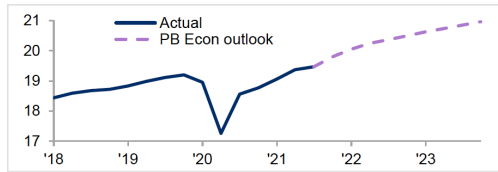
Despite average intra-year drops of 14.1%, annual returns were positive in 31 of 41 years



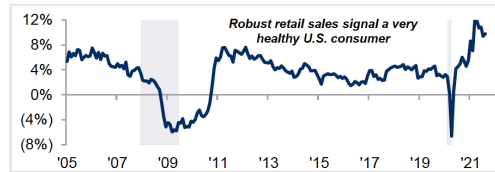
Sources: FactSet, Standard & Poor's, J.P. Morgan Asset Management - Guide to the Markets. Returns are based on price index only and do not include dividends. Intra-year drops refer to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to present year. Data is as of January 31, 2022. It is not possible to invest directly in an index. Analysis is based on the J.P. Morgan Guide to the Markets – Principles for Successful Long-term Investing.

By far, the most fundamental reason to maintain a positive outlook on US equities for the remainder of 2022 is that the US economy remains strong and is expected to grow, and a strong US economy means continued earnings growth.

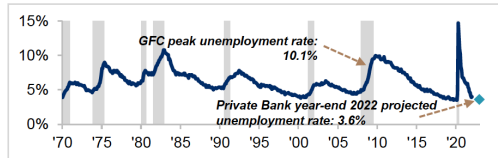
THE U.S. ECONOMY HAS MOVED FROM RECOVERY TO EXPANSION
U.S. average quarterly real GDP (trillions 2012 dollars, SAAR)



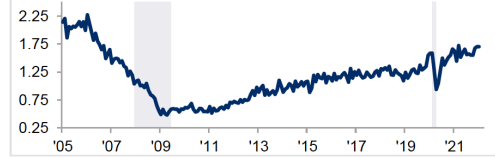
THE CONSUMER IS AN ANCHOR OF THE EXPANSION
U.S. retail sales, annualized two-year % change



THE UNEMPLOYMENT RATE HAS FALLEN RAPIDLY
U.S. unemployment rate, %



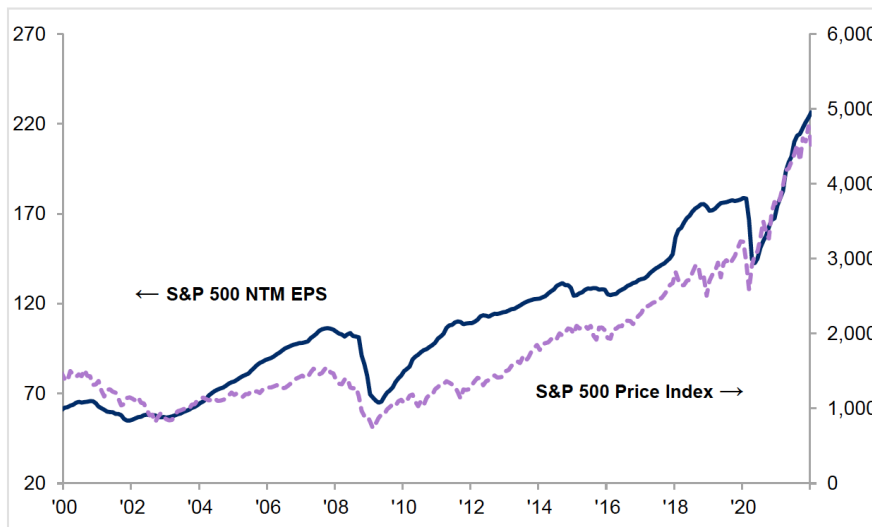
HOUSING REMAINS STRONG
U.S. housing starts, millions, seasonally adjusted annual rate



Sources: (Top left) Macroeconomic Advisers, Bloomberg Finance L.P., J.P. Morgan Private Bank. Data is as of November 30, 2021. Note: Actual GDP extended through September using Fed Weekly Economic Index. (Bottom left) Bureau of Labor Statistics, NBER, Haver Analytics. Data is as of January 31, 2022. (Top right) U.S. Census Bureau, NBER, Haver Analytics. Data is as of January 31, 2022. (Bottom right) U.S. Census Bureau, NBER, Bloomberg Finance L.P. Data is as of January 31, 2022.

Further, all of the above negative factors should ultimately be overwhelmed by strong earnings growth, which currently most analysts believe that we will continue to see. Investing in companies that are able to navigate through these myriad issues and grow their earnings has historically been a winning formula.

S&P 500 PERFORMANCE REMAINS CLOSELY TIED TO EARNINGS GROWTH
S&P 500 NTM EPS S&P 500 Price Index



Sources: Standard & Poor's, FactSet, J.P. Morgan Asset Management. Data as of January 31, 2022. S&P 500 NTM EPS refers to analyst estimates for S&P 500 earnings over the next 12 months.

One final reason that we see for optimism around the US equity market is actually somewhat counterintuitive. The two charts below show the VIX and consumer confidence during various bull markets over the years. As you can see, volatility, as measured by the VIX, is extremely high despite the bull market that US equity markets have been experiencing. This suggests that despite the run up in the market, many investors have trepidations. Further, consumer confidence is as low as it has been during a bull market—another indication of underlying concern. This suggests to us that despite the strong upward move in the market since 2020, there has remained a constant fear amongst investors. We believe this fear has caused the market to sell very quickly on any hint of bad news, but further, and importantly, it has likely provided a floor to market sell offs as nervous investors have likely already taken steps to manage downside risk given the jitters that the charts below imply they are experiencing.

Chart 1
Median S&P 500 VIX® Volatility Level*
During First 484 Trading Days of Bull Markets
1949 to 2022

*Prior to 1990, the VIX was approximated using the standard deviation of the past 21-day changes in the log of the S&P 500. These daily VIX estimates were then spliced together with the actual VIX Index working backward from January 1990.

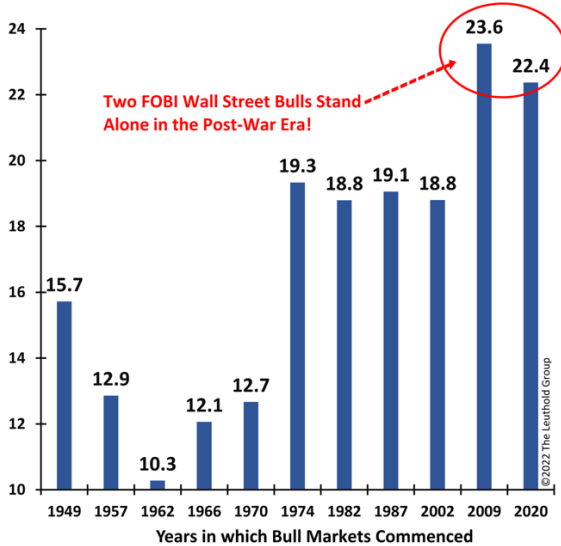
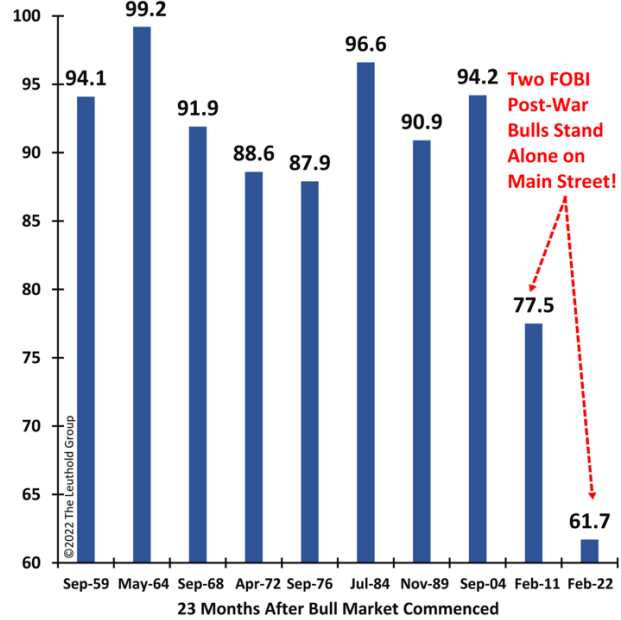


Chart 2
Level of U.S. Consumer Confidence
23 Months into Every Bull Market Since 1950*

*Consumer Confidence Index is a composite of the University of Michigan Consumer Sentiment Index, the Conference Board Consumer Confidence Index, and the OECD U.S. Consumer Confidence Index.



Source: The Leuthold Group

Note: The information discussed above is solely the opinion of 180 Degree Capital Corp. Any discussion of past performance is not an indication of future results. Investing in financial markets involves a substantial degree of risk. Investors must be able to withstand a total loss of their investment. The information herein is believed to be reliable and has been obtained from sources believed to be reliable, but no representation or warranty is made, expressed or implied, with respect to the fairness, correctness, accuracy, reasonableness or completeness of the information and opinions.