



## Toroso Market Commentary Feb 2022

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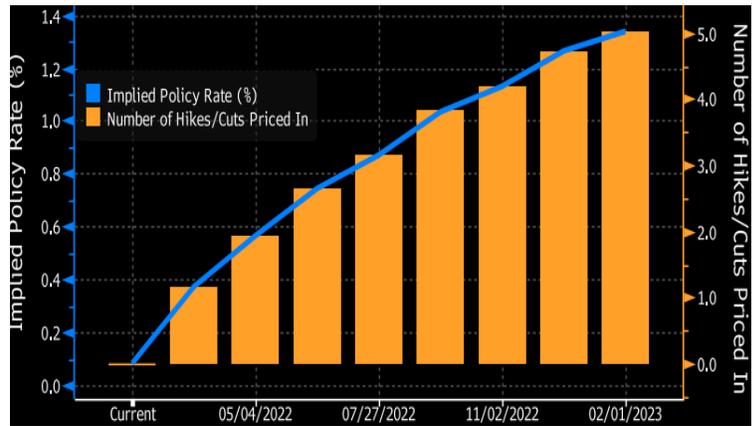
### Real Time Price Discovery

In our last commentary, we opened by discussing the drastic change in expectations in the 18 months that followed a truncated 2-month recession. We went from worrying about losses to beating the S&P 500, then the QQQs, then ARKK, then Bitcoin and Ethereum, and finally, the Bored Ape Yacht Club NFT. Reality has set in. Stocks across the board are down, QQQ is down -11.37% alone through January 28<sup>th</sup>. As a market, we are actively participating in price discovery in this new pandemic-becoming-endemic hybrid economy on the backs of never-ending quantitative easing (QE). The best way to describe the current state of QE is to compare it to the healthcare industry. Our economy is essentially forever hooked up to a dialysis machine with no chances of detaching - only small tweaks in our dependency on it for survival.

Real time price discovery means our larger assumptions on value shift often. Is every piece of real estate on the planet really worth more today than it was January 2020? How can that be if tech stocks are plummeting? What are the effects of every echo chamber thinking they were “right?” Is inflation here to stay? Could it morph into stagflation or deflation even? It’s difficult to even assess an asset without considering the massive amount of printing done by central banks. Real estate assets across the country are currently up 35%. Even in major cities, with huge business centers still starving for patrons to return to their storefronts, are currently up 20% in value from pre-pandemic levels. It is our belief that the whole viewpoint on housing has shifted. While there is a pendulum swing to almost every change in market, the lasting effects of what we desire from our “home” has changed. The single 20-year-olds in major cities who boasted about their shoe-box-sized homes but spent every waking hour outside of them are now clamoring for a two-bedroom apartment to give their home office its own portion of the living space. We desire more square feet per human in our household, if we have the means. The world is changing, evolving with each passing week. Markets are trying to catch up. New expectations of what an open economy will look like, with the pause in reopening due to omicron, are likely going to make some rethink their reopening plan all together.

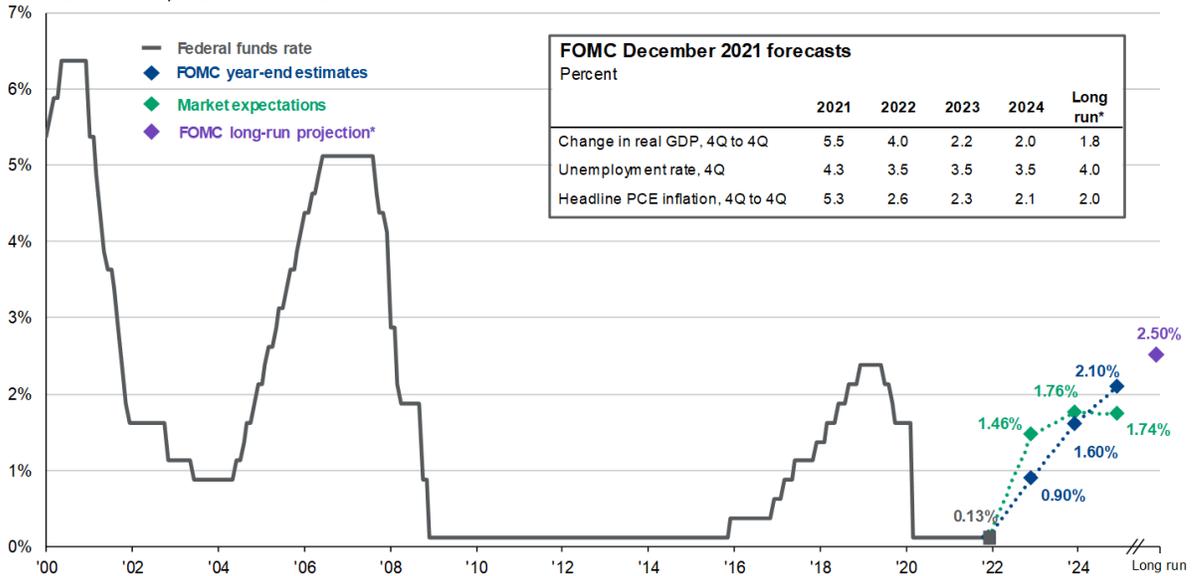
## Fixed Income Markets Playing Chicken with the Federal Reserve

Either bonds are lying, or the Fed is. Spreads between the 2 and 10-year treasury yields are collapsing, all while the market is pricing lofty 5-rate hikes. The odds of the Federal Reserve raising interest rates into an inverted yield curve in a mid-term election year are really, really low, and the market is calling the Fed's bluff. The 2- to 10-year spread has collapsed from 1.6% to 0.6% in less than a year. The FOMC long-run projection seems like a thing of fairy tales, giving more credence to new asset classes such as virtual real estate. The time for hedge rates was in November. Now is a more appropriate time to potentially rebalance back into longer duration.



### Federal funds rate expectations

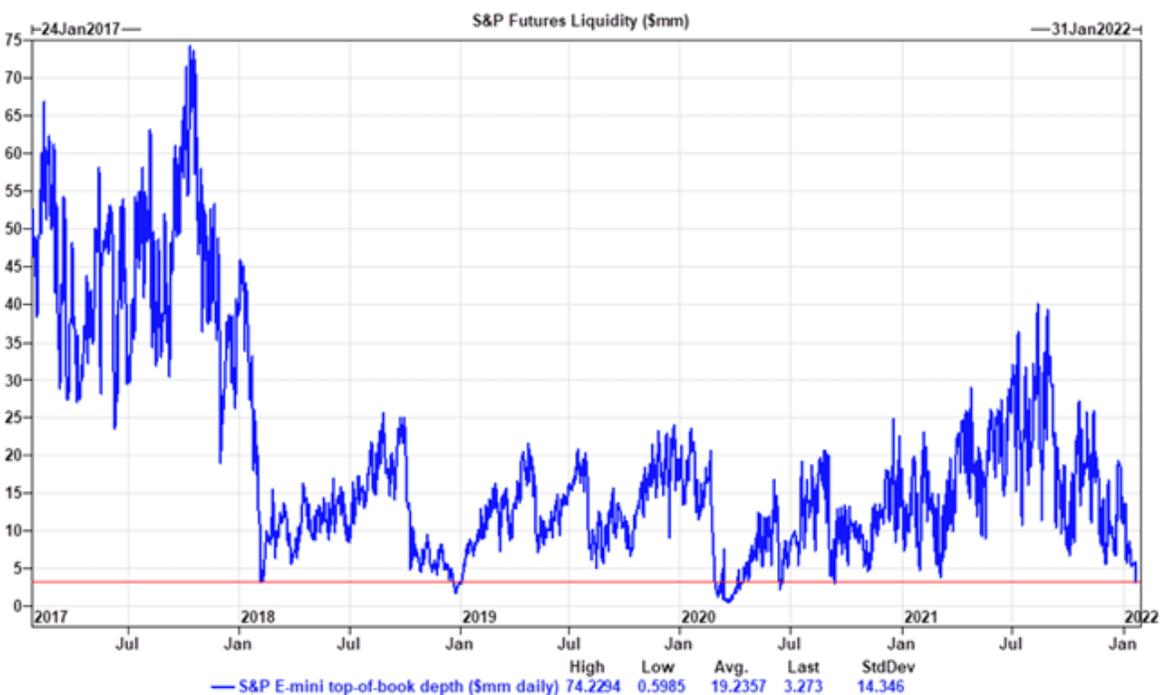
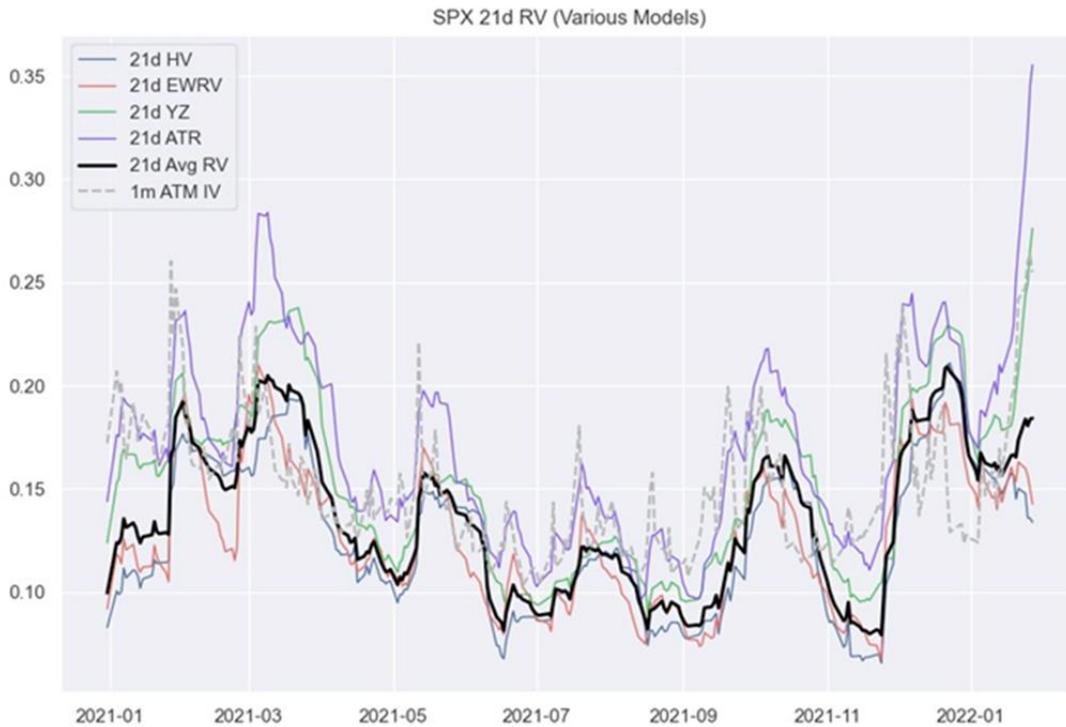
FOMC and market expectations for the federal funds rate



Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management. Market expectations are based off of the USD Overnight Index Forward Swap rates. \*Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated. Guide to the Markets - U.S. Data as of January 26, 2022.

## The Crazyness that has been 2022 Markets

The red line on the chart below represents the close-to-close market volatility. The purple line represents intraday volatility. We are currently seeing record intraday market volatility. This is all occurring while liquidity in S&P 500 futures is drying up. Societe Generale estimated that their 20,000+ SPX puts, sold Monday around lunch, are what squeezed the market up to positive territory in the afternoon.



## The MOVE is on the Move

We have started showing this chart, overlaying the federal reserve's balance sheet with the MOVE Index, and it appears the correlation is even more positively correlated, with the MOVE creeping all the way up to 85. The negative correlation between the two seems to be gone, and we are trending towards very correlated



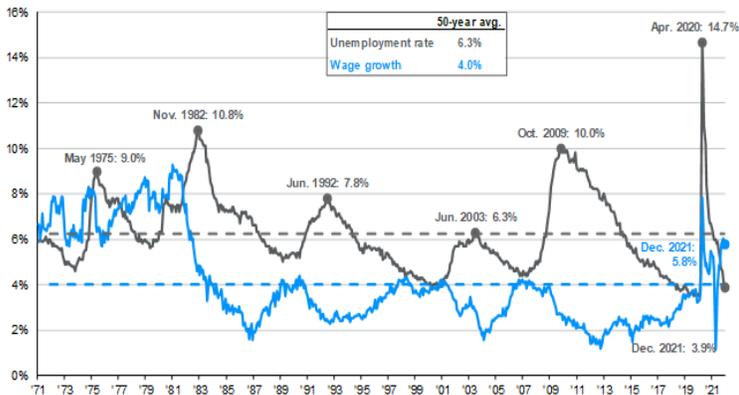
movements with the MOVE growing to 85. The MOVE Index represents volatility in the treasury bond market as volatility in this space grows.

## Can the Great Resignation Withstand a Further Drawdown in Crypto?

We are in no way insinuating a crypto winter is here. In fact, we remain quite bullish on the asset class being the solution to the broken math equation shown above. However, it is interesting to see a dip in JOLTS job openings. Will wage growth persist, or will labor markets balance out? One of the key differentiators between inflation and stagflation is the lack of actual economic and wage growth. Continued wage growth is the last hope for inflation in our opinion. We see pressure to margins, and expect we are headed more towards stagflation, or even deflation, with inventories building back up. If supply chain issues subdue after the Chinese New Year, there could be a huge rebound in the ecommerce space. Outcomes for the next few months range from geopolitical war, to continued inflation, to a reversion, to a deflationary tech boom with shipping routes opening and shipping costs plummeting. All roads are possible at this point. With mid-term elections on the horizon, a stagflation or even slightly deflationary response, with yields dropping and tech rebounding, is possible.

**Civilian unemployment rate and year-over-year wage growth**

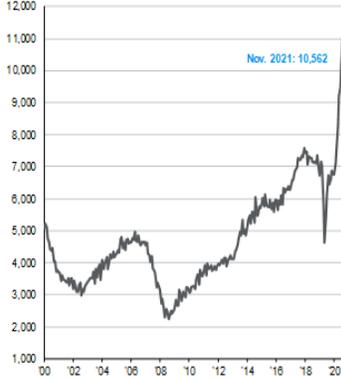
Private production and non-supervisory workers, seasonally adjusted, percent



Source: BLS, FactSet, J.P. Morgan Asset Management. Guide to the Markets - U.S. Data as of January 26, 2022.

**JOLTS job openings**

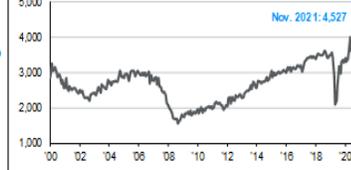
Total nonfarm job openings, thousands, seasonally adjusted



Source: U.S. Department of Labor, J.P. Morgan Asset Management. Guide to the Markets - U.S. Data as of January 26, 2022.

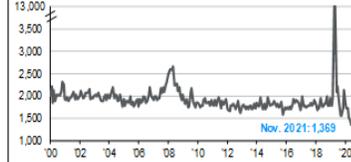
**JOLTS quits**

Total nonfarm quits, thousands, seasonally adjusted



**JOLTS layoffs**

Total nonfarm layoffs, thousands, seasonally adjusted



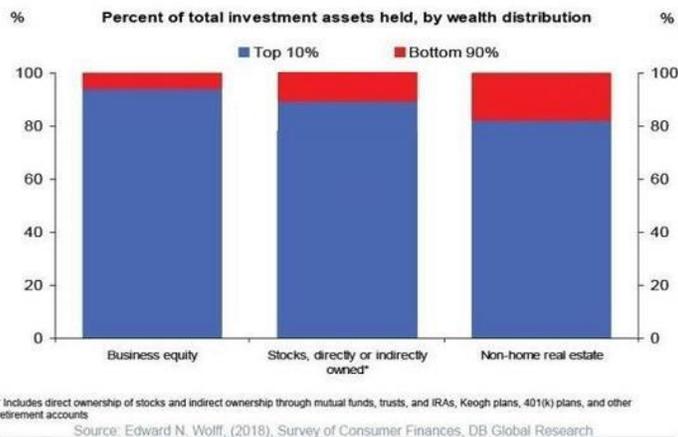
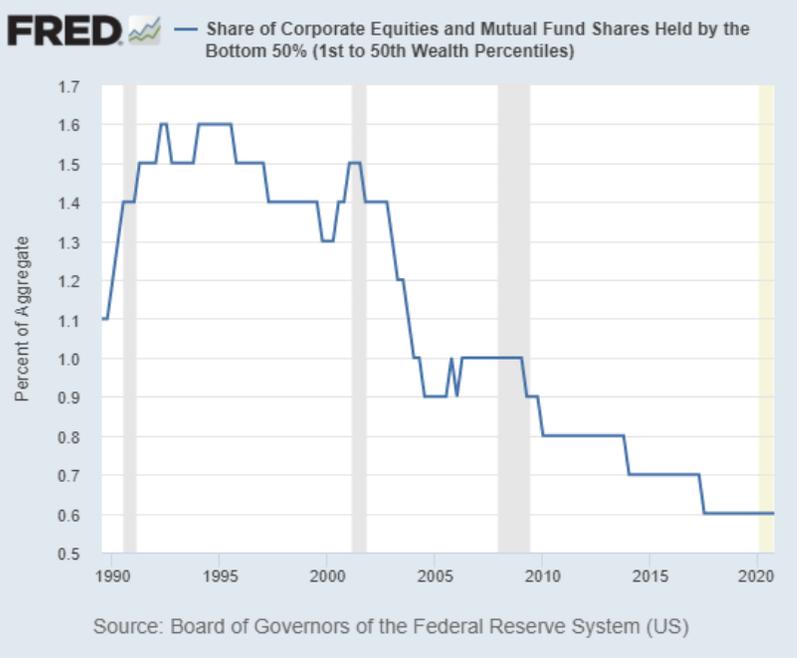
Source: U.S. Department of Labor, J.P. Morgan Asset Management. Guide to the Markets - U.S. Data as of January 26, 2022.



## Politics Bleeding into Economies in this Mid-Term Election Cycle

The bottom 50% of the economy own almost no capital. The spending we are currently experiencing, heading towards record level profits in the US economy, is on the back of asset appreciation of the top 5-10%, not income growth by any socioeconomic segment.

10% of the US population own 84% (now 88%) of all stocks held by households



## An Excerpt from Zero Hedge that Framed the Inequality Beautifully:

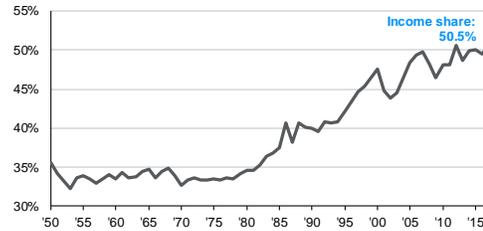
*“Ten percent of Americans now control 97 percent of all capital income in the country. Nearly half of the new income generated since the global financial crisis of 2008 has gone to the wealthiest one percent of U.S. citizens. The richest three Americans collectively have more wealth than the poorest 160 million Americans... For the top 5%, it increased by 4%, to \$4.8 million. In contrast, the net worth of families in lower tiers of wealth decreased by at least 20% from 2007 to 2016. The greatest loss -- 39% -- was experienced by the families in the second quintile of wealth, whose wealth fell from \$32,100 in 2007 to \$19,500 in 2016.... As a result, the wealth gap between America's richest and poorer families more than doubled from 1989 to 2016. In 1989, the richest 5% of families had 114 times as much wealth as families in the second quintile, \$2.3 million compared with \$20,300. By 2016, this ratio had increased to 248, a much sharper rise than the widening gap in income.”*

Since virtually all the wealth is concentrated in the top tier, it only affects the spending of the top tier. Spending by the bottom 95% has stagnated, and so the policy "fix" for this monumental inequality, generated by inflating asset bubbles, is to give cash to the bottom 90% via various "stimulus" programs. The problem with making your entire economy dependent on spending generated by asset bubbles is that eventually, all bubbles pop. Strangely enough, printing trillions of dollars, borrowing additional trillions and blowing trillions on stock buybacks have consequences beyond just further inflating asset bubbles. In fact, these actions come with systemic consequences which will eventually deflate all the bubbles. The top 5% are now the key to the entire economy. If they start selling assets to lock in profits or reduce risk, the asset bubbles will pop because the bottom 95% don't have the wealth or income to buy tens of trillions of dollars' worth of assets from the top 5%. The top 5% buy and sell to each other, because no one else has the income or wealth to buy so much. If the top 5% reduce spending for any reason, then the economy craters. Since the spending of the top 5% has been the only source of higher consumption, the economy has been optimized to serve the top 5%. Hence the proliferation of fine-dining restaurants, pricey Airbnb rentals in exotic destinations, luxury brand boutiques, etc.

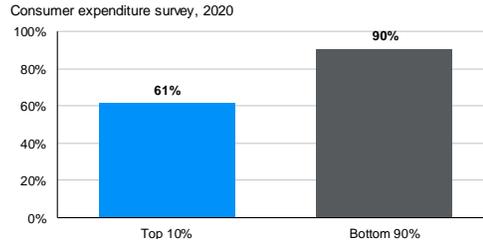
As we've commented before, the ratio of Assets to GDP is at an all-time high, closing 2021 at a staggering 5.6x (displayed below), while we bottom 90% fight to keep up with housing, food and gas prices.

Imagine if you split the US population into categories based on 4 criteria. First, their age – specifically, whether they are over 33 and have experienced the great financial crisis, or under 33 and have not. Second, by political party; those who will vote democrat in 2022 midterms, and those who will vote republican. Third, whether or not they support vaccination mandates. Fourth, those in the top 10% of wealth in the US and those in the bottom 90%. You are left with 16 completely different groups of people, all with drastically different opinions on the events of the past 2 years and how it affected them. The New York Times published an article titled “Two Covid Americas,” essentially stating that democrats are vaccinated and boosted, yet still terrified. Meanwhile republicans, are vaccinated and boosted at a much lower rate, and going about their lives as normally as they can.

Top 10% share of pre-tax national income



Spending as a share of income after tax



Ratio of U.S. financial assets to GDP

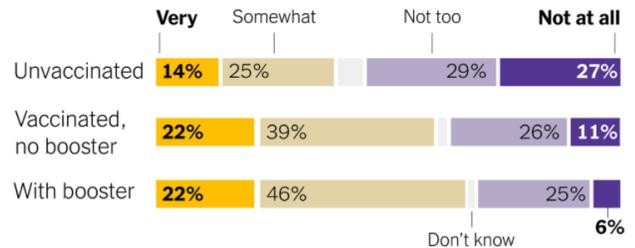


Source: Bureau of Labor Statistics, Piketty, Saez, J.P. Morgan Asset Management; \*4Q21 estimates are from J.P. Morgan Asset Management; (Top Left) “Income Inequality in the United States, 1913-1998” by Thomas Piketty and Emmanuel Saez, updated to 2018. Income is defined as market income and excludes government transfers but includes capital gains. In 2018, top decile includes all families with annual income above \$135,000; (Bottom Left) Consumer Expenditure Survey 2020; (Right) Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.

Guide to the Markets – U.S. Data are as of January 26, 2022.

This perfectly illustrates how irrational our “rational” market can be. It seems that those most concerned with inflation are those with means to be worried about it: the 1%, gobbling up more and more real estate and hard assets to protect against it. Similarly, it’s the unvaccinated living worry-free, and the boosted terrified to leave their house. The New York times goes on to state “It’s a remarkable disconnect between perception and reality. A majority of the boosted say they are worried about getting sick from Covid. In truth, riding in a car presents more of a danger to most than the virus does.” Remember to fasten your seatbelts around your mask please. We are not rational actors in this market, and the market is not acting rationally, as it can’t even take the Fed’s expectations seriously anymore.

**How worried are you about getting sick from Covid-19 within the next year?**



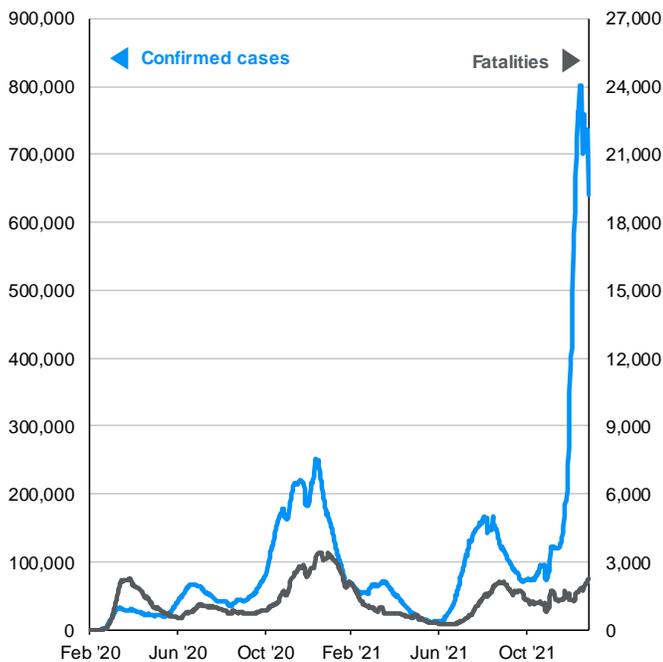
From a survey of 4,411 people conducted in Jan. 2022. | Source: Morning Consult

## Covid-19: Cases, Fatalities and Immunity

It does appear that, while Covid cases are at an all-time high, the move towards omicron does appear to be shifting the global pandemic to an endemic. The real test of our new hybrid economy will be in full view by fall, at the very latest, but likely sooner. Any employer that wants their employee base in the office 2, 3 or even 5-6 days a week will likely reinstate such mandates sometime in Q2, if not definitely when school reopens in the fall.

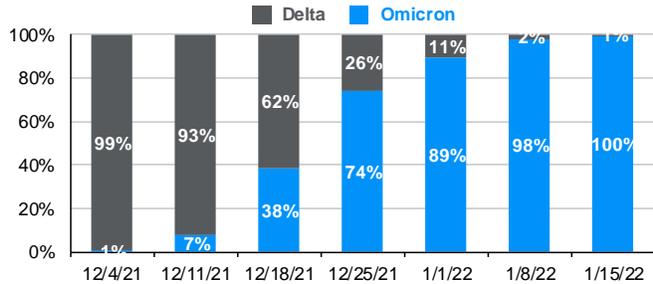
**Change in confirmed cases and fatalities in the U.S.**

7-day moving average



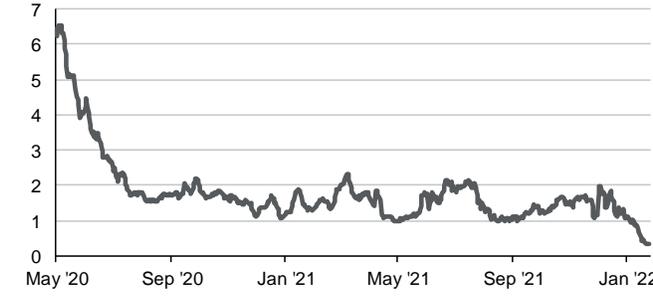
**Variant proportions**

% of total cases, week ending



**Covid-19 mortality**

# of fatalities per 100 confirmed cases lagged 18 days, 7-day MA

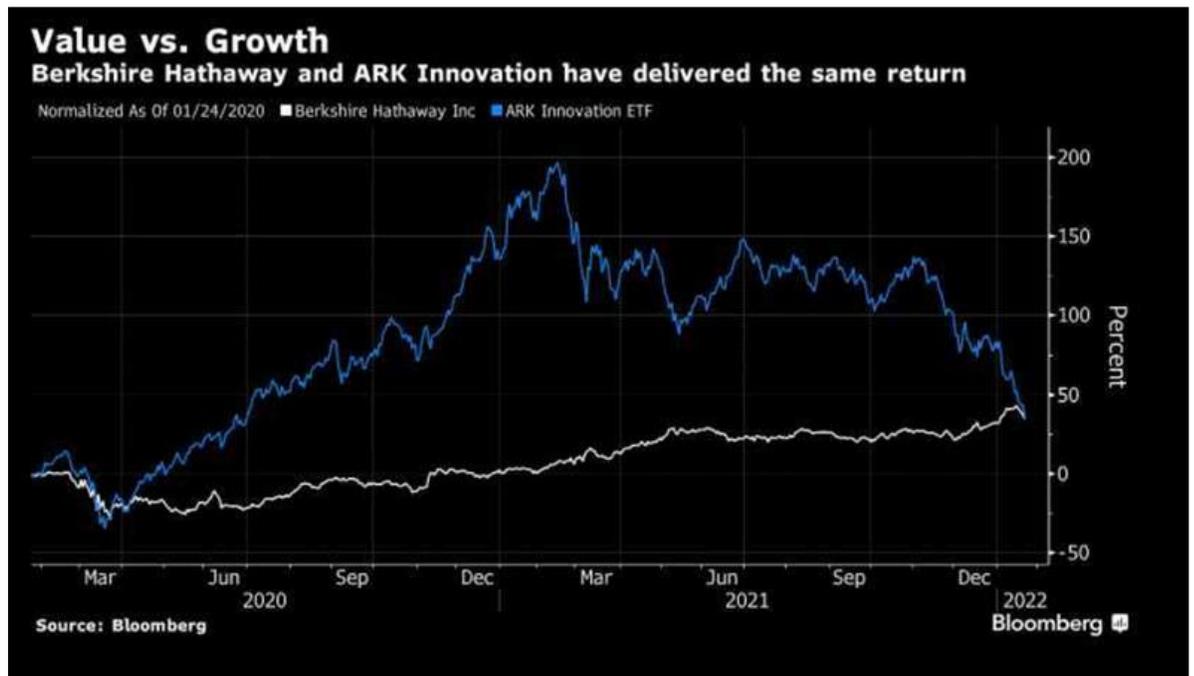
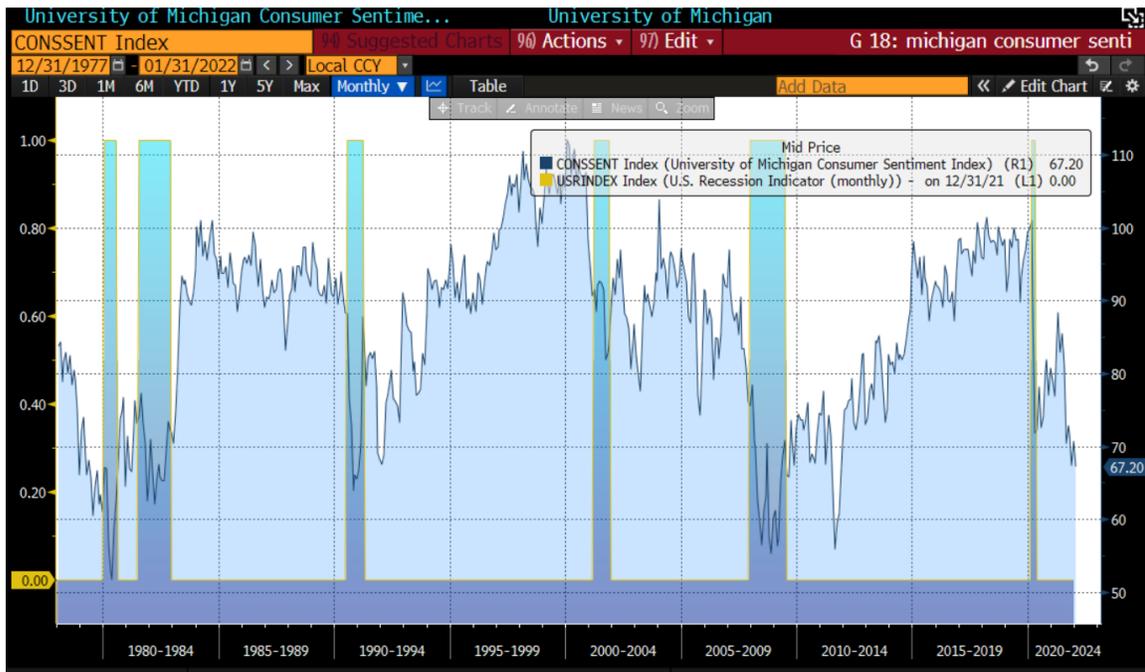


Source: Centers for Disease Control and Prevention, Johns Hopkins CSSE, Our World in Data, J.P. Morgan Asset Management.

Guide to the Markets – U.S. Data are as of January 26, 2022.

## Market at a Crossroads

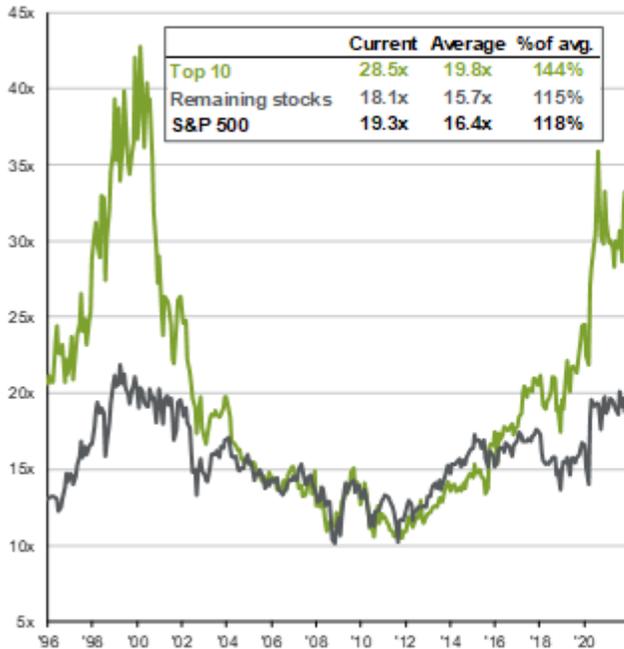
Consumer sentiment has plummeted. Ark investments has round-tripped and is in line with Berkshire Hathaway, despite its meteoric rise. Value investors are screaming market regime change, and growth investors are saying the innovation wave has just begun. We are back to prices last seen between 2018 -2020, pre-pandemic. Our best recommendation is to invest on essentially all extremes, deep value, rocket ship growth, negatively correlated alternatives, and rebalance without emotion. This means you either just bought or will soon buy growth stocks at a discount.



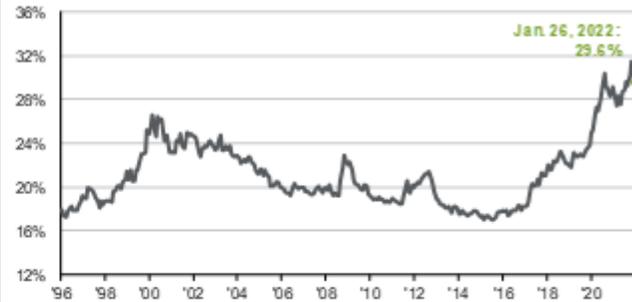
## US Equities

Despite the changing economy, changing landscape of growth and value, and the changing landscape of the fixed income market, the dominance of our megacap oligopolistic tech giants holds strong, making up still 29.6% of the S&P 500, despite their earnings contribution falling to 26%. If you recall in the first tech bubble, market giants such as Microsoft fell 75% (400 billion down to 100 billion, the price of many unprofitable unicorns in today's SPAC world) before finding a bottom. Which leaves us with the question: is this market about to completely roll over?

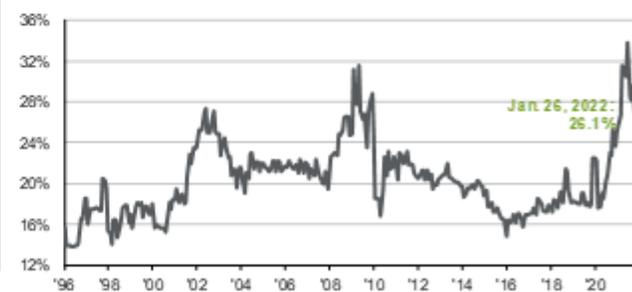
**P/E ratio of the top 10 and remaining stocks in the S&P 500**  
Next 12 months



**Weight of the top 10 stocks in the S&P 500**  
% of market capitalization of the S&P 500



**Earnings contribution of the top 10 in the S&P 500**  
Based on last 12 months' earnings



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management.

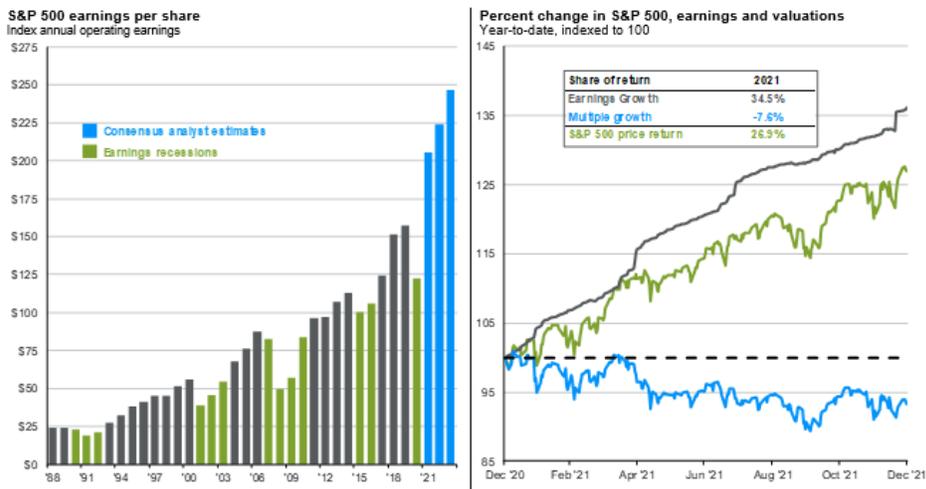
The top 10 S&P 500 companies are based on the 10 largest index constituents at the beginning of each month. The weight of each of these companies is revised monthly. As of 12/31/2021, the top 10 companies in the index were AAPL(6.9%), MSFT (6.3%), AMZN (3.6%), GOOGL(2.2%), TSLA (2.1%), GOOG (2.0%), FB (2.0%), NVDA (1.8%), BRK.B (1.4%), UNH (1.2%), and JPM (1.2%). The remaining stocks represent the rest of the 484 companies in the S&P 500.

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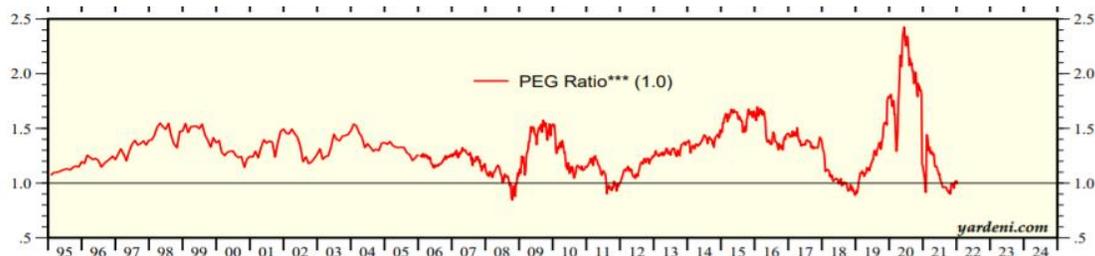
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We are currently pricing in massive earnings in 2022. The reverberating growth effects thereafter have led to a plummet in the PEG Ratio. This is an inflection point in the markets. Will corporate earnings soar, and the Fed take a page from its decades-old book and calmly raise rates to cool off the economy? Will income continue to rise, eat at earnings and take some of the wealth from corporations?

We do believe that, with the volatility experienced in the last few weeks, the market has ample opportunity for those with the stomach for volatility. Love her or hate her, Cathie Wood has called out all investment firms and challenged them to put their best foot forward in an active ETF product. There are many new strategies in the wave of new issuances we've experienced, that are truly a best-of-breed investment team in their wheelhouse. Put down the dividend strategy that follows an index created 20 years ago and barbell your active share in both thematic, active, multi-thematic, deep value, unique dividend ETFs.



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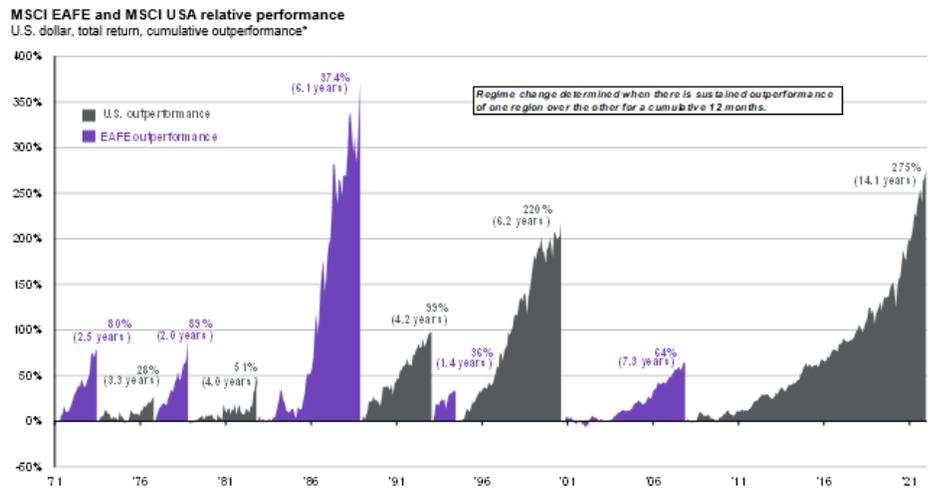


\* Price divided by 12-month forward consensus expected operating earnings per share.  
\*\* Sector or industry forward P/E relative to S&P 500 forward P/E.  
\*\*\* Sector or industry forward P/E relative to sector or industry consensus 5-year LTEG forecast.  
Source: I/B/E/S data by Refinitiv.

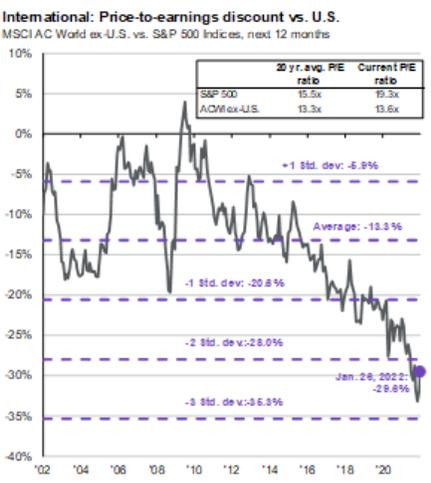
- Ballast Small/Mid Cap ETF (MGMT)
- Distillate (DSTL)
- Cambria Shareholder Yield (SYLD)
- Alpha Architect US Quantitative Val (QVAL)
- JPMorgan Equity Premium (JEPI)
- Sofi Gig Economy (GIGE)
- Amplify Transformation Data (BLOK)
- Franklin Disruptive Commerce (BUYZ)
- BlackRock Future Innovators (BFTR)
- Innovator Loup Frontier Tech (LOUP)
- ARK Genomic Revolution (ARKG)

## International Developed and Emerging Market Equities

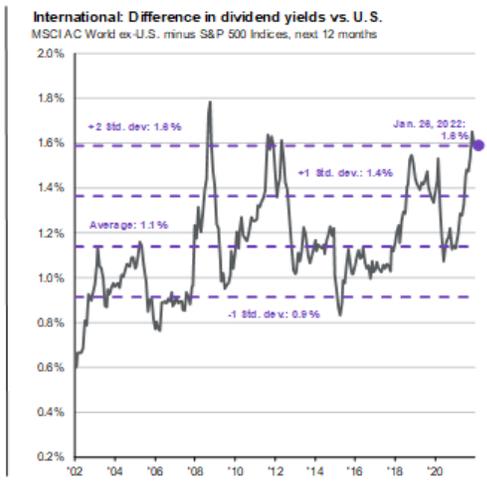
International developed equities are the value play of all value plays, or a perpetual value trap led by an unhealthy banking system hooked on the ECB but yielding quite more than their US counterparts. They continue to be further behind the US in its vaccination rollout. The story in emerging markets is China. China's "common prosperity" is an attempt to mix capitalism with socialism. Everything from defaulting real estate markets to increased bond yields, beaten down tech giants, and fears of US inflation spreading to the emerging markets (as it historically does), has left selective opportunities for significant returns in the future. The US outperformance on EAFE has now extended to 14 years, double the previous length of outperformance in either direction. Price to earnings discounts, when comparing global ex US equities with US, is near an all-time low for the past 20 years at -30%. Equity yields internationally at 1.6% higher than those in the US. As we mentioned above, nothing is clear in these markets, but a bounce back in US & emerging market growth, along with international developed value stocks, is very possible. Looking into the more thoughtfully structured, unique, even active ETFs in this space also makes sense. There's always opportunity with volatility.



Source: FactSet, MSCI, J.P. Morgan Asset Management. "Cycles of outperformance include a qualitative component to determine turning points in leadership. Guide to the Markets - U.S. Data are as of January 26, 2022.



Source: FactSet, MSCI, Standard & Poor's, J.P. Morgan Asset Management. Guide to the Markets - U.S. Data are as of January 26, 2022.



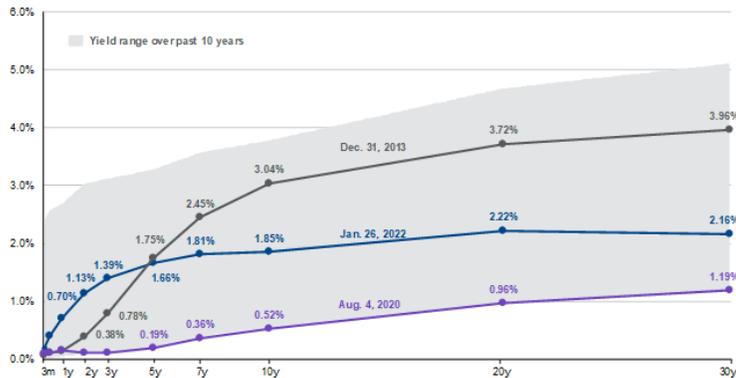
J.P. Morgan

Broad	Narrow
<ul style="list-style-type: none"> <li>WisdomTree EM ex-SOE (XSOE)</li> <li>FlexShares Mstar Dev Mkts ex US Factor Tilt (TLTD)</li> <li>Distillate Int Fundamental Stability &amp; Value (DSTX)</li> </ul>	<ul style="list-style-type: none"> <li>Davis Select International (DINT)</li> <li>Emerging Markets Internet &amp; Ecommerce (EMQQ)</li> <li>FMQQ</li> <li>KEMQ</li> </ul>

# Fixed Income

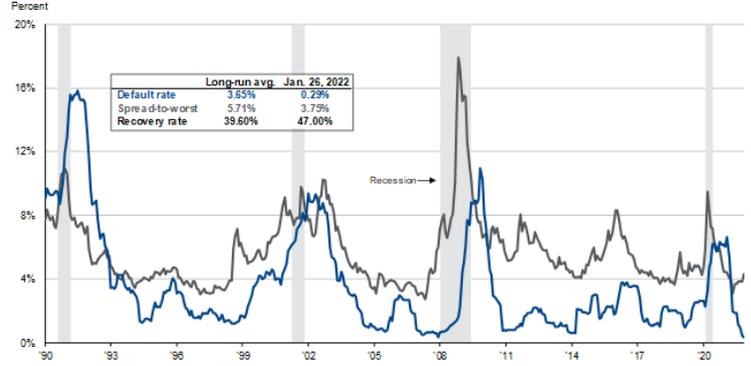
Market cap weighted indexes in fixed income continue to make less and less sense. With most of the corporate world residing in *just* above high yield, being held together by the tape balance sheet of the Federal Reserve, durations of your favorite bond indexes are longer than ever, and credit spreads are still near all-time lows. We have been writing for years that a traditional correction cannot occur until credit spreads blow out, but this world is far from traditional.

U.S. Treasury yield curve



Source: FactSet, Federal Reserve, J.P. Morgan Asset Management. 12/31/2013 is the date the yield curve reached one of its steepest levels in reaction to the Fed announcing it would begin paring down its bond-buying program. 08/04/2020 is the date of a record low on the 10-year, driven by ~~high~~ <sup>high</sup> demand and pessimism around the U.S. pandemic recovery.   
 Guide to the Markets - U.S. Data are as of January 26, 2022.

Default rate and spread-to-worst

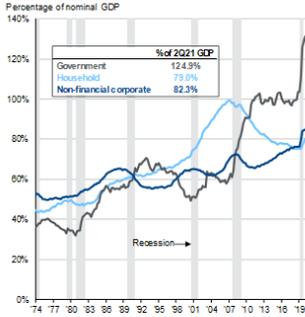


Source: J.P. Morgan Global Economic Research, J.P. Morgan Asset Management.   
 Default rates are defined as the par value percentage of the total market trading at or below 80% of par value and include any Chapter 11 filing, prepackaged filing or missed interest payments. The default rate is an LTM figure (last 12 months) and tracks the % of defaults over the period. Recovery rates are based on the price of the defaulted bonds or loans 30 days post the default date. Default and recovery rates are as of December 2021. Spread-to-worst indicated are the difference between the yield-to-worst of a bond and yield-to-worst of a U.S. Treasury security with a similar duration. High yield is represented by the J.P. Morgan Domestic High Yield Index.   
 Guide to the Markets - U.S. Data are as of January 26, 2022.

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U.S. debt to GDP ratios



Source: FactSet, J.P. Morgan Asset Management. (Left) Bank for International Settlements (BIS). (Top and bottom right) Bloomberg. Government, household and non-financial corporate debt refers to gross debt. Canadian government debt is comprised of core debt instruments that include currency and deposits, loans and debt securities. All debt values are shown at market value.   
 Non-financial corporate debt is based on the Bloomberg U.S. Aggregate Investment Grade Corporate Credit Index.   
 Guide to the Markets - U.S. Data are as of January 26, 2022.

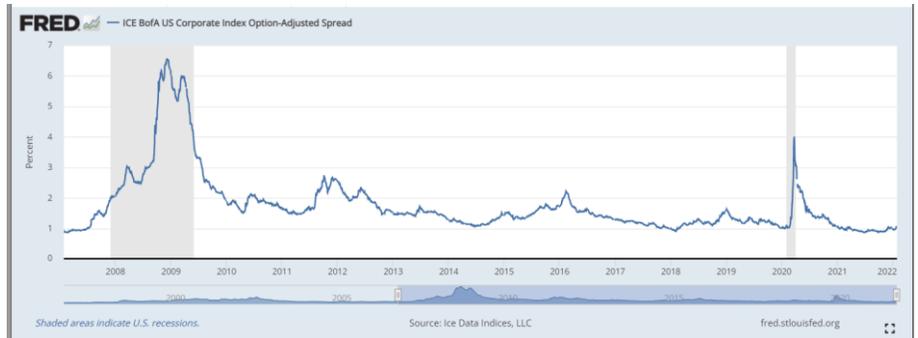
Baa corporate debt\*



Duration of investment-grade corporate credit universe



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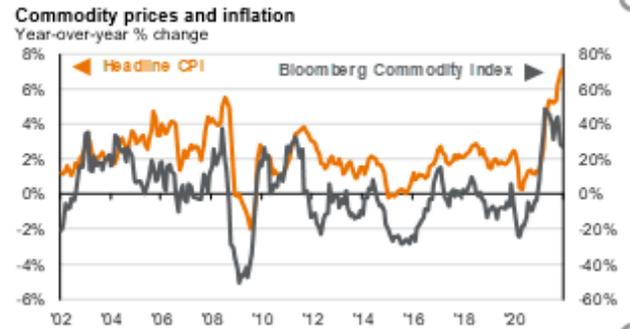
- PIMCO 25+ Year Zero Coupon US Treasury (ZROZ)
- SPDR DoubleLine Total Return Tactical (TOTL)
- First Trust TCW Opportunistic (FIXD)
- Simplify Interest Rate Hedge (PIFX)
- FolioBeyond Rising Rates (RISR)
- Saba Closed-End Funds ETF (CEFS)
- VanEck Vectors CEF Municipal Income ETF (XMPT)

## Alternatives

Invesco Optimum Yield Diversified Commodity Strategy ETF (PDBC) was up 41.87% in 2021. Oil was up 65%.

Bitcoin entered 2021 at 32,000 and appears to be entering February 2022 around 38,000. I wonder how many allocators actually booked a gain in crypto in 2021 (The IRS is interested as well). The type of product available in the ETF wrapper has continued to push to new categories, as investors have scalpel-like tools to

unwind and even bet against duration. The Simplify Interest Rate Hedge ETF (PFI) and FolioBeyond Rising Rates ETF (RISR) are shining thus far. Crypto, commodities, long duration treasuries, gold, negative duration hedges, strong dollar, structurally negative duration market neutral. Sometimes it's better to accept you will have a .333 batting average and throw the kitchen sink when volatility spikes correlations. We don't see Oil going above \$110 and expect it to end 2022 lower than it is today.



## A Hypothetical High-Active-Share Reconstruction of a Traditional 60/40:

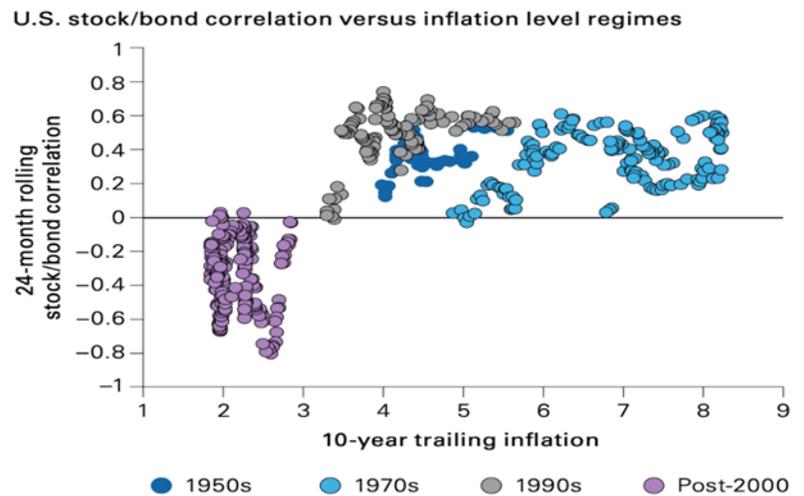
- 5% PIMCO 25+ Year Zero Coupon US Treasury Index ETF (ZROZ)
- 7.5% Saba Closed-End Funds ETF (CEFS)
- 5% AGFiQ US Market Neutral Anti-Beta (BTAL)
- 2.5% Simplify Interest Rate Hedge (PFI)
- 2.5% FolioBeyond Rising Rates (RISR)
- 2.5% Invesco Optimum Yield Diversified Commodity (PDBC)
- 5% SPDR Gold MiniShares Trust (GLDM)
- 7.5% Amplify Transformational Data Sharing ETF (BLOK)
- 5% Sofi Gig Economy ETF (GIGE)
- 5% Franklin Disruptive Commerce (BUYZ)
- 7.5% BlackRock Future Innovators (BFTR)
- 5% Emerging Markets Internet & Ecommerce (EMQQ)
- 2.5% FMQQ The Next Frontier Internet & Ecommerce (FMQQ)
- 5% Ballast Small / Mid Cap ETF (MGMT)
- 7.5% JPMorgan Equity Premium Income (JEPI)
- 5% ETF 6 Meridian Small Cap Equity (SIXS)
- 5% Alpha Architect US Quantitative Val (QVAL)
- 5% Cambria Shareholder Yield (SYLD)
- 5% Distillate International Fundamental Stability Value (DSTX)
- 5% Distillate US Fundamental Stability & Value ETF (DSTL)

## Conclusion: Evolving Markets and What to Watch For

It's unlikely we reach 1970s inflation levels. But the damage to your portfolio does not require that level of inflation to hurt the golden standard of the 60% equity 40% bond portfolio. It's time to get more serious about your alternative sleeve. Negative correlation assets, long duration treasuries, negative duration hedges, and making the hard rebalance, which might include shaving off some of that inflation/interest rate hedge.

- The decoupling of equities as we begin to localize markets and supply chains, and the decoupling of the internet of things stocks, both internationally and within the US.
- Widening market multiples.
- Margins Margins Margins: Inflation, shipping costs and semi-conductor chips, can the margins explosion continue? Or are the worst of the supply chain issues behind us?
- Credit Spreads & Default Rates – a matter of when, not if. This could be kicked down the road many times before it ultimately causes a real market disruption.
- Options markets, retail, and target dated funds moving markets; will retail options trading continue to gain steam or level out / decline in volume?
- Will ARKK experience outflows?
- If growth turns how high can crypto go?

**Figure 5. High inflation as seen during the 1950s, 1970s, and 1990s is associated with positive correlation regimes**



Sources: Vanguard, using data from Refinitiv and Global Financial Data.

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