Monthly Update: How the Traditionally Best Month for Stocks Turned into Hell

Introduction

Being an investor over the last few months has been everything else than fun. The times when investing in almost anything and being in profit in a few weeks are way past us. Coming into April, we slowly started to grasp the new reality, and the rally in the second part of March made us feel a bit better for at least a brief moment. April is historically the best month of the year for stocks; the S&P 500 has closed positive in April in 15 out of the last 16 years with an average gain of 1.7%. However, April has been an exception to its historical average this year and will go in history as the biggest monthly loss for the tech sector since October 2008. So let's see what happened.

Performance comparison:

April Performance:

Portfolio: -14.3 %

NASDAQ: -13.3%

S&P500: -8.8%

ARKK: -29.0 %

Year to date Performance:

Portfolio: -24.6%

NASDAQ: -22.4%

S&P500: -13.5%

ARKK: -44.6%

Overall Market Analysis:

The difficult economic and market conditions are persisting. High inflation numbers, slower economic growth, the invasion of Ukraine, China's zero Covid policy, and tighter monetary and fiscal policies are a few of the persisting challenges felt throughout the market. As a result, the market sentiment shifted from the risk-on period in 2020 and entered into a complete risk-off period. Investors continue to diversify their holdings into perceived value and safeness of benchmarks, mainly in the form of passive index investing. Most of the assets in my portfolio are not in the benchmarks and, therefore, suffer additional selling pressure that is not based on fundamentals. Furthermore, it is assumed that the algorithmic trading in volume terms stands around 70-80% in the developed markets and, in current conditions, could be one of the significant contributors to the bad performance of growth-oriented portfolios. However, those are all forms of market inefficiencies that offer the potential for the long-term success of smart active management.

After many months of indications, the Fed is tackling inflation as its primary goal. The annual inflation rate in the U.S. accelerated to 8.5% in March, the highest since December 1981 from 7.9% in February, however, excluding energy and food categories, the CPI rose 6.5%. Fed raised interest rates by 50 bp this week. Chairman Powell reassured the market to some extent that a 75 bp hike is not planned for now, and we got a short market rally on Wednesday. I think that the Fed will do everything in its power to prevent going down in history as an example of how the failure in monetary policy can cause extreme and prolonged inflation. The risk of a recession is probably a way more minor worry for them than the destruction that excessive inflation could cause. However, there are many signals that inflation might have peaked. M2 growth has decelerated significantly from its peak of 27% in February last year to below 10% year-over-year now. Despite the war in Ukraine being far from over, we see oil prices stabilise a bit. The same slowdown is seen in Manheim's used car value index, which was a great predictor and contributor to the inflation last year. The rate of wage growth is high relative to pre-pandemic levels but is unchanged from the Q4 and not in line with inflation numbers. Fiscal spending has, as expected, slowed down significantly since last year. Gross domestic product in the U.S. declined at a 1.4% pace in Q1, below analyst expectations of a 1% gain. The consumer sentiment is down 26% year-over-year. Inventories are up. All those factors could play into lower demand and, together with market declines, could indicate to the Fed to be less aggressive going forward. The biggest challenge continues to be supply chain issues, and with China's zero Covid policy, the situation will persist in the following months.

Changes in the monetary policy are reflected in the bond market, which has had a catastrophic year. Global bonds delivered -5.5% in April, and the U.S. 10-year Treasury yield has gone from 1.13% to over 3%. Credit is definitely becoming much more expensive. The sentiment has shifted upside down over the last months, with the market pricing in significant further rate increases for this year. With the latest numbers, I think we might be surprised by fewer and more minor increases for the rest of the year.

The employment Friday provided a good report. Nonfarm payrolls grew by 428,000 for April, a bit above the Dow Jones estimate of 400,000 and identical to March. The unemployment rate is at 3.6%. On the other hand, worker productivity fell 7.5% in Q1, and the unit labor cost as measured against productivity soared by 11.6%. There are some indications of labor hoarding by the companies. Those numbers and the persisting difference between PPI (input) and CPI (output) inflation numbers could indicate future margin compression across the economy.

China has managed to keep Covid-19 under tight control over the last two years, and now they are struggling to contain a major outbreak. Contrary to my expectations, policymakers decided to prioritize the zero Covid strategy over the economy. We have all probably seen footage of the extreme measurements taken by the authorities there, and Shanghai spent all of the April in complete lockdown. On the other hand, less regulatory pressure and an indication of loser monetary and fiscal policy provided some relief. I hope the situation stabilizes in China because the valuations for companies there are great for value investing, especially in growth companies.

<u>*Earnings for some of the largest positions:*</u>

- **Tesla** beat analysts' expectations on the top and bottom numbers for Q1. They achieved another sales and earnings beat despite burgeoning production challenges and other macroeconomic impacts felt across the automotive industry. The company also recorded record automotive gross margins of 32.9%. With those results, I expect great further quarters, and therefore I increased my position size in the light of the recent fall in the stock price.

Revenue: $18.76 billion vs $17.80 billion expected
Earnings per share: $3.22 vs $2.26 expected

- **Teladoc** increased revenue by 25% year-over-year to $565.4 million. Also, the average revenue per U.S. paid member rose to $2.52 from $2.09 in Q1. Net loss of $6.7 billion was not comparable to previous quarters due to a large non-cash goodwill impairment charge of $6.6 billion (-$41.11 per share). The company is now guiding to revenue and net loss per share of $2.4B-$2.5 billion (vs. consensus of $2.58 billion) and -$43.50 to -$43 for 2022. I monitor the company in detail and plan to hold the position until getting further clarify whether this quarter is just a one-time event or an indicator of a significant decline in growth. Currently, I believe the former is more likely.

Revenue: $565.4 million vs $568.6 million expected
Earnings per share: -$0.44 vs -$0.52 expected

- **Illumina** beat consensus forecasts for both sales and earnings, but not by as much as Illumina's 2021 performance seems to have led investors to expect. Q1 sales rose 12% year-over-year to $1.22B. Illumina stuck to its guidance that Grail sales can reach $70 million to $90 million this year and also its previous growth guidance for the entire business. Investors seem to expected even more growth, therefore the stock price decline, however I find the numbers to be extremely positive.

Revenue: $1.22 billion vs $1.22 billion expected
Earnings per share: $1.07 vs $0.89 expected

- **Airbnb** had a robust Q1 beat and gave strong guidance for the Q2, which should be a record-breaking quarter for the company (business is highly seasonal). Airbnb reported 102.1 million nights and experiences booked in Q1, surpassing pre-pandemic levels and beating all expectations. I believe that despite the potential recession, travel is coming back big time this year and that Airbnb is in a fantastic position to benefit from that. The management impressed me during the pandemic and prepared the business to take off over the following years.

Revenue: $1.51 billion vs $1.45 billion expected
Earnings per share: -$0.01 vs -$0.24 expected

Portfolio Update:

I deposited new funds at the beginning of April. As promised, I did not rush to make the changes to the portfolio; instead, I was waiting to invest over the drops to get slightly better entry points and avoid paying for the spread in the most problematic positions (cryptocurrencies) when rebalancing. Diversification has helped me survive those difficult times as my results are similar to the NASDAQ over the last months compared to more significant drops in more growth-oriented benchmarks. However, I think that current levels offer another opportunity for long-term returns. Therefore I am reducing the number of assets in the portfolio and concentrating more on assets I have the highest combination of conviction and estimated return to risk ratio. At appropriate levels, I will continue to invest unallocated funds, the portfolio currently has a slightly below 15% cash position.

Final Thoughts:

April has been hell, and the beginning of May is not looking any better. We all have different role models. One of my biggest inspirations has always been Elon Musk. I remember when Tesla was close to bankruptcy trying to scale Model 3 production, he shared an alleged quote from Winston Churchill: "If you are going through hell, keep going." That quote always reminds me that the best always comes from the most challenging circumstances. Investing would be so simple if it was emotionless. If buying a dip and patiently waiting for years to see the fantastic results would be as simple as going into the store and purchasing a necessity at an amazing discount. Well, it is not. It can be hell. But the only way to profitability is to keep going. If it were easy, everyone would be wealthy from investing. Unfortunately, in reality, the vast majority of retail investors lose money. The main reason for that is the reality of how hard it is to keep going in times like that.