

Passive Perspectives

Second Quarter 2022

Key Points

- Sell-off intensifies in Q2 as persistent inflation raises recession risk
- 2000 Roadmap: Markets echo Dotcom unwind
- Themes: Defensive equities outperform, whereas demand wanes for the inflation trade
- Despite heavy losses in June, market decline was quite orderly

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Q2 2022 makes 'The List'

The S&P 500 fell 16.10% in Q2 2022. In historical context, the market had its 9th worst quarter in post-war history, claiming its spot on the Worst 10 Quarters list by displacing the quarter containing 9/11/2001 (Exhibit 1). By comparison, the Stratified LargeCap index, which holds the same stocks as the S&P 500, but with more diversified weights fell 12.98%, outperforming the cap weighted index by 3.12% and the equally weighted S&P 500 by 1.37%.

Major sell-offs were seen across all size segments in the US and internationally. The S&P MidCap 400 and S&P SmallCap 600 fell 15.42% and 14.11% respectively and the MSCI EAFE index fell 14.51%. Stratified weight indices outperformed in all comparative benchmarks, except for the S&P 600, which marginally underperformed (Exhibit 2).

Exhibit 1: S&P 500 Post-WWII performance

Rank	Quarter	QoQ
1	Q3 1974	-26.1%
2	Q4 1987	-23.2%
3	Q4 2008	-22.6%
4	Q2 1962	-21.3%
5	Q1 2020	-20.0%
6	Q2 1970	-18.9%
7	Q3 1946	-18.8%
8	Q3 2002	-17.6%
9	Q2 2022	-16.1%
10	Q3 2001	-15.0%

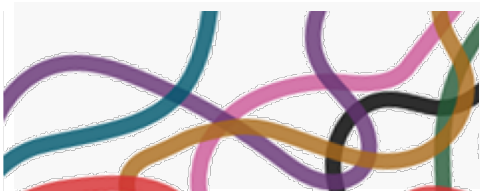
Source: Bloomberg

Exhibit 2. Core Index Comparison

Index	Benchmark	Q2 2022 (%)			12 months (%)		
		Stratified	Benchmark	Rel.	Stratified	Benchmark	Rel.
Stratified LargeCap	S&P 500	-12.98%	-16.10%	3.12%	-6.91%	-10.62%	3.70%
Stratified MidCap	S&P MidCap 400	-14.31%	-15.42%	1.10%	-15.63%	-14.64%	-0.99%
Stratified SmallCap	S&P SmallCap 600	-14.80%	-14.11%	-0.69%	-20.09%	-16.81%	-3.29%
SEADM*	MSCI EAFE	-14.08%	-14.51%	0.43%	-20.57%	-17.77%	-2.80%
Stratified LargeCap	S&P 500 Eq. Wt.	-12.98%	-14.36%	1.37%	-6.91%	-9.38%	2.47%

Source: Syntax, S&P Dow Jones Indices, MSCI. Total return performance does not reflect fees or implementation costs as an investor cannot directly invest in an index. Performance as on 6.30.2022.

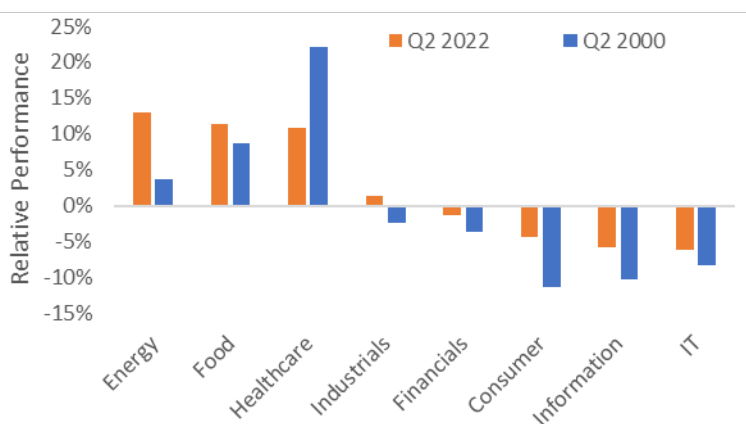
* Syntax Stratified Europe & Asia Developed Markets Index, based on the MSCI EAFE universe.



2022 follows the DotCom roadmap

In Q2 2022, the US LargeCap Consumer, Information and IT sectors (49.2% of the S&P 500) underperformed the market by over 4%, whereas Energy, Food and Healthcare all outperformed significantly (Exhibit 3). This pattern of sector performance within the US LargeCap universe highlighted the similarities between the current market regime and that of the market environment surrounding the bursting of the DotCom Bubble in mid-2000 (Exhibit 4).

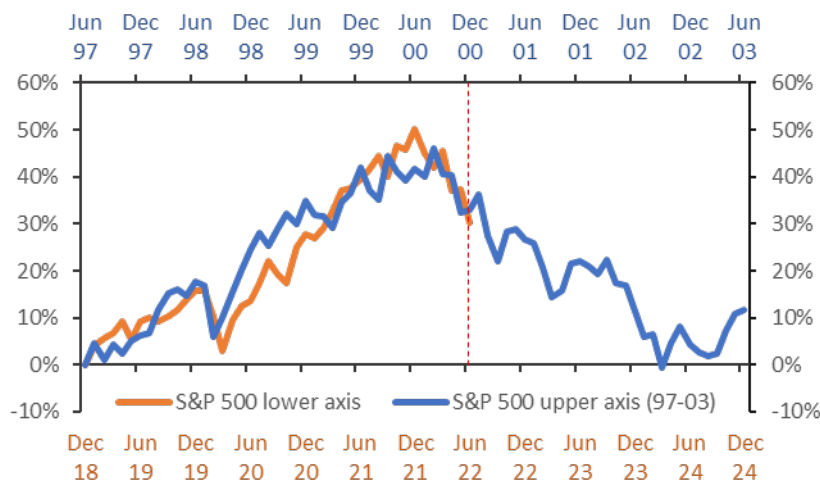
Exhibit 4. Sector Comparison



Source: Syntax, S&P Dow Jones Indices, MSCI.

The similarities in the broad market performance have also mirrored the performance in 2000. Note that the correction in H2 2000 persisted for over two years (Exhibit 5).

Exhibit 5: DotCom market unwind compared with current sell-off



Source: Syntax, S&P Dow Jones Indices.

Exhibit 3: S&P 500 Sector performance

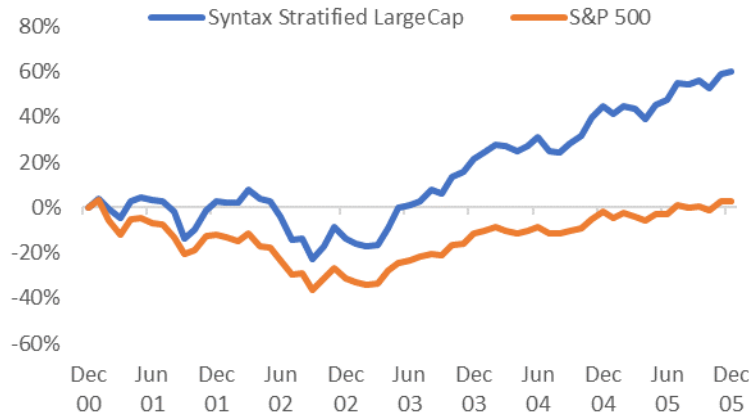
	Q2 2022
Energy	12.9%
Food	11.3%
Healthcare	10.9%
Industrials	1.4%
Financials	-1.4%
Consumer	-4.3%
Information	-5.8%
IT	-6.1%

Source: Bloomberg

The S&P 500 fell for the two years following December 2000 as the excesses of the DotCom bubble unwound

After the bubble burst, technology stocks fell out of favor with investors and their unrealistic valuations and high levels of institutional ownership persistently unwound. Cap weighted indices consistently underperformed alternatively weighted products such as the Stratified LargeCap index in the US, due to their outsized weight in the technology sectors (Exhibit 6).

Exhibit 6: Stratified LargeCap consistently outperformed from 2000-2005

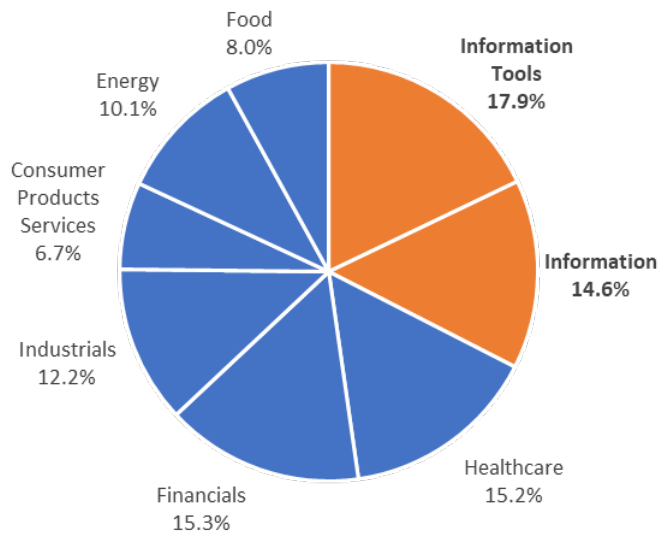


The Stratified LargeCap index outperformed the S&P 500 throughout the bursting of the DotCom Bubble

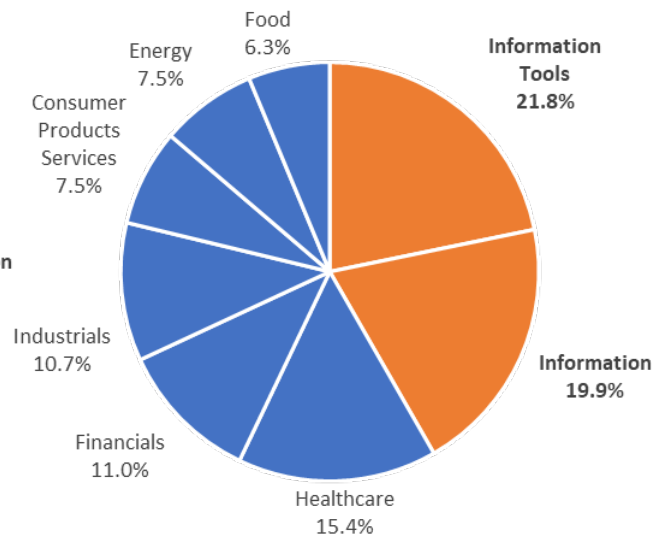
Source: Syntax, S&P Dow Jones Indices

Even in light of the significant underperformance of IT and Information stocks this year, the S&P 500 is more heavily skewed towards technology than it was in December 2000 (Exhibit 7), fueling concerns that the recent market environment could persist as it did back then.

Exhibit 7: S&P 500 Weights December 2000



S&P 500 Weights June 2022



Source: Syntax, S&P Dow Jones Indices

Investors seek shelter of Defensive equities

Given the severity of the sell-off in Q2, it was unsurprising that the Affinity Defensive theme was one of our best performing strategies – Defensive companies outperformed non-Defensive ones by 12.7% for the quarter. The theme captures defensive characteristics across three broad segments (Utilities, Staples and Healthcare) and excludes the non-defensive business risks, such as early-stage pharma. In Q2, all broad defensive groups outperformed the rest of the market by over 10% on average (Exhibit 8).

Exhibit 8: Performance of the Affinity Defensive Theme in S&P 500

	Q2	12M	3Y	5Y	10Y
Defensive	-4.2%	3.6%	7.5%	6.5%	9.8%
Defensive Utilities	-5.4%	10.3%	3.6%	3.7%	6.8%
Consumer Staples and Necessities	-3.8%	-0.8%	6.9%	5.6%	9.2%
Defensive Healthcare	-4.3%	3.5%	8.8%	5.5%	11.1%
other Defensive Businesses	-2.7%	5.9%	12.5%	13.4%	12.2%
Non-Defensive	-16.9%	-13.8%	8.1%	8.9%	11.7%

Source: Syntax Affinity™. Equal Weighted group performance as of 6.30.2022.

Stratified Weight Indices have a consistently higher allocation to defensive business risks (Exhibit 9) due to their diversified methodology which does not favor any one sector or industry (such as technology in the S&P 500 or Industrials in MSCI EAFE). The result is that Stratified Weight has less cyclicity and a higher weight in the defensive business groupings.

Exhibit 9: S&P 500 Exposure to Defensive Equities

	Stratified LargeCap	S&P 500	Difference
Consumer Staples and Necessities	13.62%	7.07%	6.55%
Defensive Healthcare	4.19%	7.04%	-2.85%
Defensive Utilities	3.23%	1.75%	1.48%
other Defensives Businesses	2.64%	1.32%	1.32%
Defensive	23.68%	17.18%	6.50%

Stratified LargeCap has a significantly higher weight in Defensive stocks than the cap weighted benchmark

Source: Syntax Affinity™. Weights as of 6.30.2022

Despite 8.3% decline, markets showed signs of order in June

Even though the S&P 500 officially entered a bear market in Q2, the declines were not met with the same pandemonium that we saw during September 2001, or the early days of the Pandemic. In Q2, the market declined for more

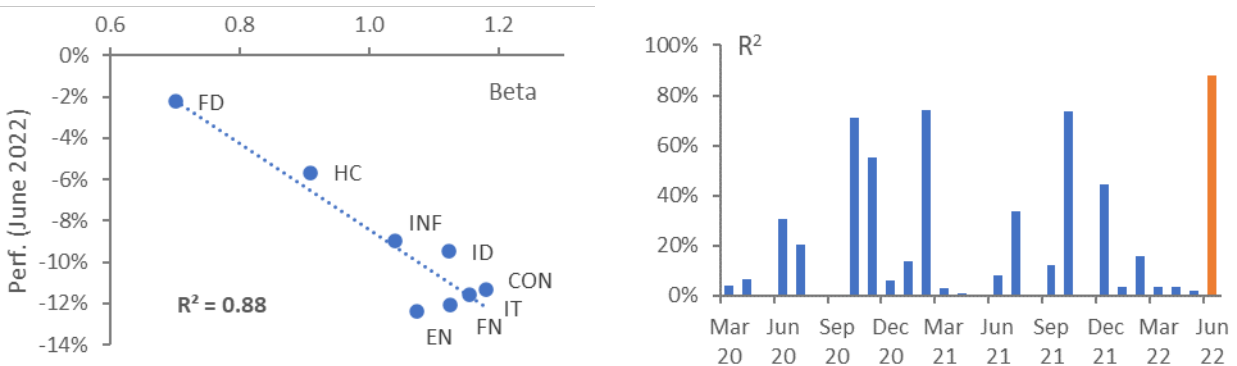
traditional reasons, namely that high inflation, rising rates and waning growth raised the probability that the US will enter a recession. Despite being disastrous for risk assets (as reflected by a 16% decline in the S&P 500 in Q2), a cyclical recession is usually easier to price than the impact of a war or a pandemic. Hence, we saw a reassuring sign in the dismal stock performance of June 2022 – a resurgence in the efficacy of the CAPM.

The CAPM is one of the most basic tenets of equity market analysis, basically stating that the expected return of an asset depends on how risky it is relative to the broad market. In other words, higher risk (beta) should lead to higher returns. However, the CAPM hasn't had the best track record since the Pandemic took hold as the market has been driven by different risks.

Beta reasserts itself as a dominant driver of returns

In June, beta reasserted itself as the key driver of return as shown by the correlation of sector betas with sector performance. The R-squared between sector beta and sector return was 88% in June, suggesting that sector risk explained 88% of the variance of sector returns that month. This was the highest the R-squared has been since the Pandemic began in 2020 (Exhibit 10).

Exhibit 10: Relationship between sector risk and return in June and since Pandemic began



Source: Syntax. The charts show the relationship between sector performance and sector beta (one month lagged). FD=Food; HC=Healthcare; INF=Information; ID=Industrials; CON=Consumer; IT=Information Technology; FN=Financials; EN=Energy.

Though this observation is likely to be little consolation to most investors, it does represent a vote of confidence to those of us who believe in the Foundations of Finance. Namely that risk drives return, earnings drive prices and diversification is the only free lunch¹. In a world previously driven by a herd oftentimes agnostic to value or risk (GameStop anyone?), signs that the market is reverting to a more rational regime are welcome, even when they are painful to endure.

¹ <https://www.cnbc.com/2017/12/27/diversification-the-oldest-trick-in-the-investment-book.html>

**The market is reverting to a
more rational regime**

Exhibit 11. Thematic Performance and Exposure within the US LargeCap universe

	3M	12M	10Y	Full		3M	12M	10Y	Full
S&P 500 Equal Weight	-14.4%	-9.4%	12.7%	11.5%	S&P 500 Equal Weight	-14.4%	-9.4%	12.7%	11.5%
Distribution Models					Recurring Revenue Model	-14.8%	-9.7%	8.8%	8.1%
Sell Through a Retailer	-9.9%	-11.3%	8.4%	7.7%	Telecommunication Services	-7.9%	-19.5%	1.2%	3.5%
Sell to an OEM	-18.8%	-22.7%	15.4%	8.6%	Content Subscription	-20.9%	-22.4%	31.7%	11.8%
Direct-to-Consumer	-16.1%	-14.4%	9.9%	9.0%	Real Estate Rental	-18.5%	-7.8%	4.1%	5.2%
Government-Subsidized	-7.2%	3.8%	16.2%	12.0%	Rate Regulated Utilities	-5.4%	10.3%	6.7%	5.0%
Advertisement Revenue Model	-23.1%	-28.2%	10.4%	8.1%	Software Subscription	-20.4%	-27.8%	14.7%	15.0%
Franchisor	-11.6%	-2.5%	11.0%	7.5%					
Supply Chains					Commodities	-14.7%	11.9%	6.6%	8.5%
Electronics Supply Chain	-21.7%	-19.2%	15.0%	11.8%	Energy Commodities	-9.1%	32.3%	1.2%	6.9%
Industrial Equipment Supply Chain	-12.2%	-10.9%	15.3%	10.6%	Agricultural Commodities	-15.8%	16.8%	13.3%	12.2%
Transportation Equipment Supply C	-14.1%	-15.0%	10.8%	6.7%	Metal Commodities	-28.5%	-11.3%	7.1%	7.7%
Consumer Goods Supply Chain	-15.1%	-25.1%	5.5%	6.8%	Commodity Rail Transport	-21.5%	-11.0%	13.1%	11.2%
Pharmaceutical and Medical Equip.	-11.8%	-9.5%	12.5%	12.3%	Chemical Commodities	-15.3%	-16.7%	10.9%	8.7%
Food Supply Chain	-6.5%	2.7%	11.0%	9.5%					
Energy Supply Chain	-7.0%	19.6%	5.1%	6.8%	Infrastructure	-10.2%	3.8%	9.0%	6.8%
Cross-Sector Thematics					Infrastructure Suppliers	-20.9%	-9.2%	10.7%	7.8%
Aerospace	-13.5%	-12.6%	13.0%	9.9%	Construction and Engineering	-6.3%	16.0%	5.5%	1.7%
Automotive	-12.1%	-10.2%	11.5%	6.5%	Infrastructure Operators	-7.4%	1.7%	8.7%	7.2%
Consumer	-16.2%	-19.4%	9.2%	9.0%					
Retail	-16.0%	-15.7%	9.6%	8.6%	Defensives	-4.2%	3.6%	9.8%	8.9%
Technology	-19.0%	-20.4%	16.2%	13.0%	Defensive Utilities	-5.4%	10.3%	6.8%	5.0%
Telecoms	-15.0%	-16.2%	10.1%	9.7%	Consumer Staples and Necessities	-3.9%	-1.6%	9.4%	9.3%
					Defensive Healthcare	-4.3%	3.5%	11.1%	10.8%
					other Defensive Businesses	-2.7%	5.9%	12.2%	9.5%

Source: Syntax, Affinity, S&P Dow Jones Indices. Performance is calculated as the weighted average total return of the subset of the S&P 500 Equal Weight Index constituents who are members of the Affinity Theme. QoQ shows total return for 3.31.22 to 6.30.22. YoY shows total return from 6.30.21 to 6.30.22. Full performance period uses period from 12.31.1991 when available. Performance does not reflect fees or implementation costs.

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