Market Review and Outlook—April 11, 2022

War is Hell, for both Stocks and Bonds—While the US is not itself at war, Russian President Putin's invasion of Ukraine has wreaked havoc on markets across the globe. The direct economic impact is greatest on energy and food prices, as Ukraine and Russia both export a large amount of each. These are key components of the more volatile 'headline inflation' measure, which was worrisome even before the invasion in late February. Western Europe imports a lot of Russian energy, and the sanctions have threatened European growth. The Federal Reserve's announced changes, boosting interest rates, have led to a sharp selloff of bonds, especially quality bonds with longer maturities.

No More Fiscal Support—Congress and both President Trump and Biden passed historic fiscal stimulus the past two years. The training wheels are off, and the US economy is on its own. The good news is that most economists feel that the US economy has more than enough going for it to be fine, with (more than) full employment and the supply chain challenges emphasizing that our economy has no shortage of demand.

Monetary Headwinds—With near-record low unemployment and the highest headline inflation in decades, the Fed is not only taking its foot off the gas; it is applying the brakes. It has begun the initial steps to boost the overnight rate from near zero to as high as 3% by 2024. It is also beginning to steadily reduce its $9 trillion balance sheet, letting perhaps $100 billion in US Treasuries mature each month for several years, without replacing them. Note that their balance sheet stood at less than $1 trillion before the 2008 financial meltdown.

US Economy Recovers—The US economy, as measured by the real (after-inflation) GDP, has grown at an average 2% rate since 2000. While it collapsed in 2020 with COVID-19, it has almost climbed back fully to its trend, helped by three quarters in 2021 with growth of more than 6%. The Delta variant hampered the 3rd quarter of last year, and Omicron and the Russian invasion have knee-capped the 1st quarter of this year. However, significant pent-up demand resulting from the end of most pandemic-restrictions, coupled with much stronger consumer finances, lead to strong full-year sales and profit expectations for 2022 for the US.

Pause, Breathe, and Rebalance—The table below shows a lot of recent upheaval for investors. There are a lot of factors and moving parts. The first rule for long-term investors is to remember that we are long-term investors. Recent losses almost always indicate some good opportunities going forward. We are focused on the horizon, adjusting our course to get back on track, and holding on during the bumpy ride. A past returns table with only blue indicates a lack of bargains. We have no such disadvantage now.

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+0.01%	+0.55%	+0.84%	+0.44%
Intermediate Core Bond	-5.89%	-4.43%	+1.67%	+2.04%	+2.21%
Intermediate Muni Bond	-5.77%	-4.03%	+1.35%	+2.11%	+2.32%
Multisector Bond	-4.29%	-1.82%	+2.64%	+2.93%	+3.53%
Large-Cap Stock	-5.23%	+12.10%	+16.78%	+14.09%	+13.04%
Small-Cap Stock	-6.27%	+1.13%	+12.35%	+9.45%	+10.70%
Foreign Large-Cap Stock	-7.05%	-1.61%	+7.23%	+6.26%	+5.85%
Health	-9.28%	-2.53%	+11.04%	+11.31%	+13.94%
Real Estate	-5.09%	+21.77%	+10.99%	+9.23%	+9.18%
Technology	-13.70%	-3.47%	+21.09%	+20.29%	+17.22%
Moderate Allocation (60% stocks)	-4.63%	+4.55%	+9.85%	+8.47%	+7.89%

The data in this table comes from Morningstar and is as of March 31, 2022.

Are We Connected or Not?—Thomas Friedman wrote the book The World is Flat to emphasize that in recent decades most countries have become ever more connected. The current invasion of Ukraine has highlighted those connections. While Russia and Ukraine are both relatively minor players on the world economic front, they provide a sizeable proportion of Europe's energy needs, and they together provide a substantial amount of grain and fertilizer for the world. With very few exceptions, the world has joined together in historic sanctions against the Russian government. These are signs of significant connection.

At the same time, world leaders have worked diligently to contain the battleground. While weapons and supplies are supplied in large quantities to Ukraine, NATO forces are not engaging. Similarly, while oil prices jumped at the start of the invasion, they peaked on March 8th and have fallen over 20% through April 11th. Markets adjust, farmers adjust, and investors adjust. These adjustments serve to disconnect the rest of the world from the war in Ukraine.

JP Morgan's chief market strategist David Kelly typically focuses his attention on several levels—US economy and inflation, monetary policy (the Fed and interest rates), and various global markets (the US, Europe, Asia, emerging markets). This high-level approach is helpful in staying above the noise, and help remain focused on the horizon.

Economy—Despite the red-ink this year for US stocks, the US economy is looking bright. Both manufacturing and services are expected to do well this year at least. Unemployment is very low, which means that households are largely fully employed. While inflation is high at this time, we are finally seeing wage growth for US workers, and 2022 Social Security benefits rose almost 6%, assisting Americans ability to meet rising prices. Together, these projections lead to expectations of more record-setting US stock profits.

Inflation—CPI has risen sharply, especially the 'headline' figure that includes food and energy. As just noted, these two elements are particularly affected by the sanctions tied to the invasion. Some of the inflation that preceded the invasion was attributed to supply chain disruption, which was expected to sort itself out by mid-2022 or so. Complicating this matter, the current COVID-19 surge in China threatens to worsen the supply chain challenges just when we were hoping for improvements. An additional factor is the January Omicron surge and the late February invasion of the Russian army into Ukraine which together caused consumers and companies to pause. This pause cools both 1Q22 economic growth and related inflationary pressures.

Monetary Policy—Over the past six months the Fed has substantially adjusted its announced plans (raising rates, shrinking its balance sheet), in light of the persistent higher inflation. This has led to rising interest rates and bond fund losses, coupled with worries about the risk of recession. The 1Q22 pause has lessened the pressure on the Fed to speed up its plans. There is an exceptionally complicated balancing act underway. We expect that inflation will begin moderating shortly, that much of the bond market losses have been already suffered, and that current risk of a recession this year is fairly small.

Global Economies—As noted, the US economy is continuing its pretty stable, strong growth trend overall. Actually, there has been a rotation of sorts, as the growth segments are no longer leading (the table showed the extent of the quarterly loss for tech stock funds). Much of the rest of the world is looking healthy, economically, with a few exceptions. Obviously Russia and Ukraine are almost completely stalled. Much of Europe is largely healthy, however they have been very reliant on energy from Russia, and this alone could stall overall European growth this year.

China's immediate top challenge is addressing the current COVID-19 surge, as its zero-tolerance policy has dire economic fallout. There are also heightened tensions and concerns regarding China's desires to gobble up Taiwan, given Russia's recent actions to gobble up Ukraine. The lessons learned this year regarding the downside of relying on Russia's goods/services has led companies to consider the wisdom of relying too heavily on Chinese goods and services.

Here We Are—As investors we are bruised, and the path before us is unclear. However we do know that markets adjust, and bargains appear and dissipate. Uncertainty is pretty high right now. What I like a lot is that the forces of economic growth are substantial at this time, and that I know we are long-term investors.