MARKET REVIEW & OUTLOOK

March 2022

BREAKING NEWS

- The March employment report was released Friday missing expectations of 490,000, but still a respectable 431,000 with the unemployment falling to 3.6%. The problematic news for the Fed was that wage inflation continues to build coming in at 5.6%.

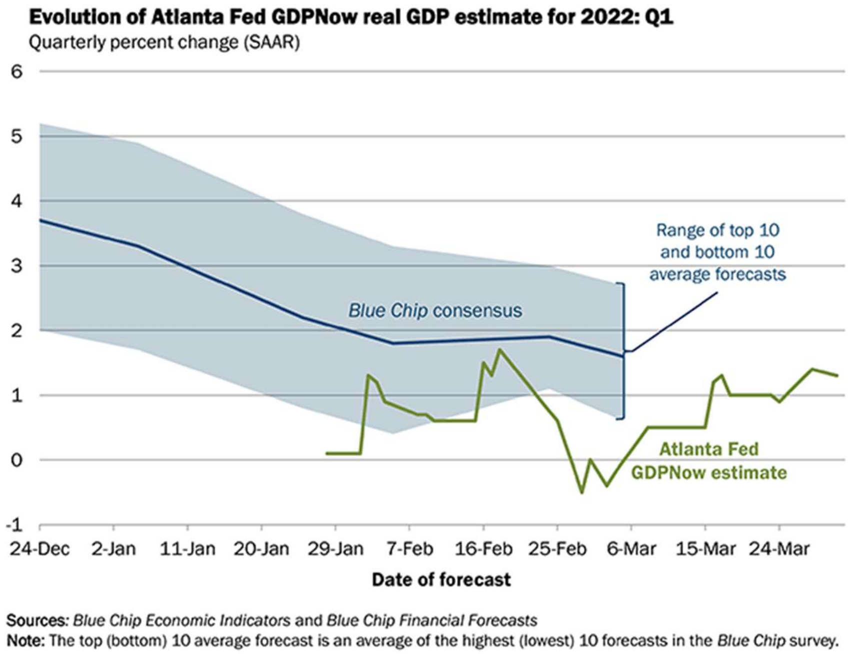
Back to our regularly scheduled programming…

KEY TAKEAWAYS

- The big news and market mover continues to be the Russian invasion of Ukraine. The wild swings in the market continued until a vigorous mid-month rally erased the losses.
- Interest rates continued marching higher for the month. The Fed did raise interest rates 25bps at the meeting in mid-March, as expected. Though now to show us they are serious about tackling inflation, there is talk of potentially a few consecutive 50 bps hikes in the ensuing months.
- Oil went parabolic to start the month, hitting a high of $130, but then 3 weeks of "peace is near", drove prices considerably lower from those heights.

The U.S. Economy

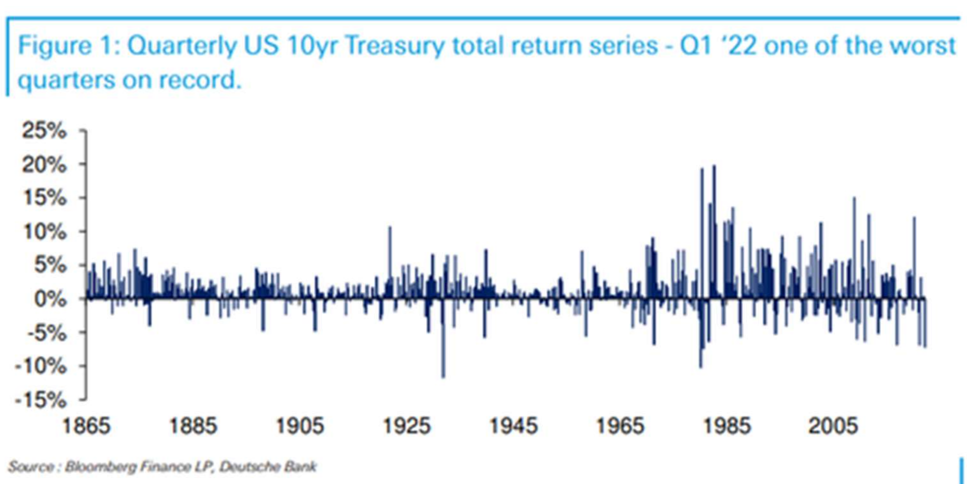
The final release of 4th quarter GDP came in slightly lower than expected, and matching the first print, at 6.9%. Further, the strength was led by the 2nd largest inventory restocking at a higher than previously reported 5.3% in history, or 77% of the 4th quarter growth. The 1st quarter GDP forecast has moved up modestly since last month, settling in the low 1% range for both GDPNow and the Blue Chip consensus as shown on the chart on the following page. The longer-term impacts of the Russian invasion of Ukraine, renewed supply chain issues and China's zero-covid policy in Shanghai are questions to be addressed as we move into the second quarter.



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

Interest rates continued marching higher as the hopes for transitory inflation continue to fade in the sunset. The specter of inflation expectations become unhinged are garnering more attention from Fed officials. As such, we are now getting a parade of Fed speeches discussing being serious about fighting inflation and comfortable looking at the next few meetings having 50-bps increases rather than the 25-bps traditional pace. Bonds have been hit very hard to start this year. The chart below shows that only the early 1980's and 1931 have been worse for 10-year Treasury bonds since 1865. The result for High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, finished the month with another big loss at -2.76%. The U.S. 10-year Treasury bond yield ended the month at the high end of the range, at 2.33%, up significantly from February's close of 1.84%.



Source: https://www.zerohedge.com/markets/global-bonds-suffer-worst-drawdown-record-massive-march-squeeze-rescues-stocks-rout

The Dow Jones Industrial Average climbed +2.32%, the S&P 500 rallied +3.58%, and the small cap Russell 2000 increased +1.08%. The international markets traded in the opposite direction of the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index eased -0.22%, and the MSCI Emerging Markets iShares Core ETF Index fell -2.10%.

In March, we had a lot of green thanks to a very strong second half rally.

The best performers were…

- Utilities: +9.61%
- Energy: +8.30%
- Real Estate: 7.21%

The lagging performers were…

- Financials: -0.52%
- Communication Services: +0.48%

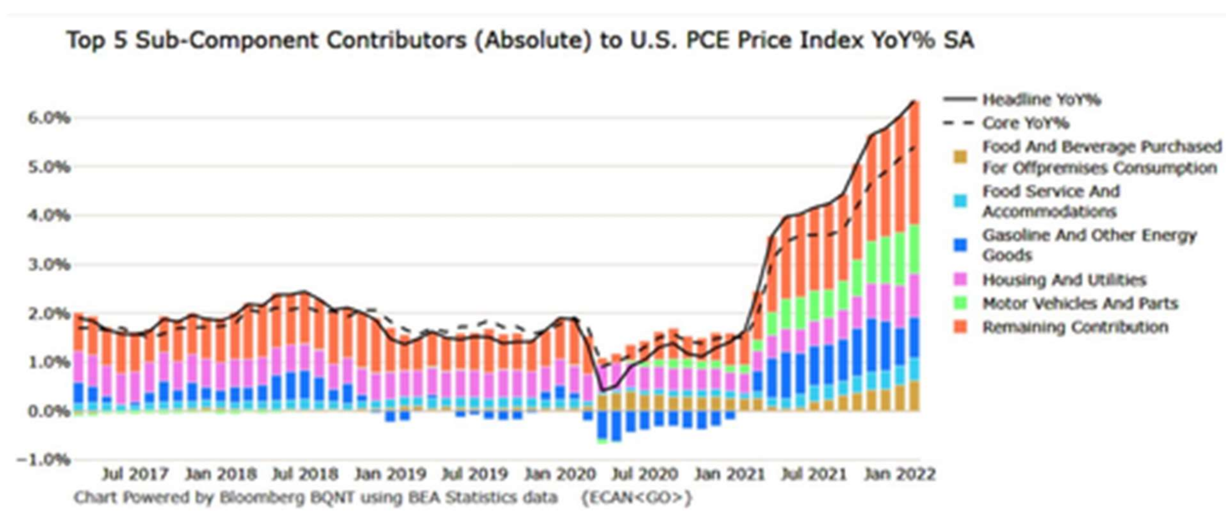
Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

The oil market rallied sharply to start the month and hit a high of $130 on March 7th on fears of supply disruptions if Russian energy was fully sanctioned by the West. As the reality that sanctioning Russian energy would basically be the nuclear option and would impact the global economy as much or more than the target, Russia. The specter of a cease fire drove prices lower. At the end of the month, Biden wants to release more emergency holdings from the SPR, and China has been doing rolling lockdowns in Shanghai raising concerns of demand destruction. The West still shows little interest of working to bringing an end to the conflict in Ukraine, so that wild card of significant supply disruption remains a potential threat. The current NYMEX WTI Crude Oil futures settled at $100.28 and posted a gain of over 4% from the prior month close of $95.72 a barrel, the highest levels since 2014, but well off the previously mentioned high of $130. The strength in oil also drove prices higher for RBOB gasoline, with a gain of over 7% vs February's close. The fear of demand destruction seems to be finally hitting in the U.S., with gas near $5 even here in Arizona. Other states along the West Coast are seeing prices north of $6. The forecasts are that we will see a strong driving season this summer as people have been locked up for 2 years and things seem to be returning to "normal". Not sure that will happen if prices remain this high.

The Rest of the Data

The February ISM Manufacturing Index increased 1.0 point to 58.6 from January's reading of 57.6. Additionally, the ISM Services Index dropped to 56.5 in February from January's print of 59.9. The prices paid component held steady at high levels for the Manufacturing and Services survey. Any reading above 50 generally indicates improving conditions. Consumer confidence increased to 107.2 in March, which compares to a downwardly revised figure of 105.7 in February. The unemployment rate declined, coming in at 3.8% and the economy added a robust 678,000 jobs in February, much higher than expectations of 423,000 jobs. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.8% in February, on a seasonally adjusted basis. Over the last 12 months, the All-Items Index increased to +7.9% on a non-seasonally adjusted basis, the highest since January 1982. The CPI ex Food and Energy, increased to 6.4% from last month's 6.0%. The breadth of inflationary pressure is captured well in the chart below. The economy is holding the line, employment is firm with wages increasing and inflation is all around us. The Fed is at least talking like they realize the tough spot they are in. Will they really hike 50-bps in May? How will inflation, the economy and the stock market react? Additionally, the Fed is talking about Quantitative Tightening starting sooner than expected. We will continue to closely monitor economic and geopolitical activity to see how long and hard the Fed needs to raise rates.



Source: Bloomberg

Source: https://www.zerohedge.com/economics/feds-favorite-inflation-indicator-surges-40-year-high-feb-real-spending-shrinks

Summary

1st quarter is now behind us, GDP growth appears weak, but still positive. Inflation is strong most everywhere you look, with many scenarios for another sharp push higher. The bond market has priced in 9 rate hikes (2.25%) before year end but is also pricing in 3 rate cuts as we look to late 2023/early 2024. The equity market, at least the last half of March is looking at the last half of the prior sentence, rate cuts and probably bringing with it more quantitative easing. That drove one of the strongest 2 week rallies we have seen in years. Unfortunately for equities, the rate cuts probably mean that at a minimum we will have an earnings recession, which is never positive for stock prices. This environment reminds me of the summers of 2000 and 2008. We had an initial shot across the bow in the Spring of both years. There was a summer rally before the real problems were felt in equity markets. The Fixed Income market suggests that there may be tougher times in store. The equity markets are looking across the valley, confident that it can clear the chasm easily. Time will tell, but generally the Fixed Income market gets it right more often than equities.

However, as bad as that all sounds, we retain our focus on what we can control, which is the amount of equity risk that is taken in a clients' portfolio in concert with the clients' risk tolerance and long-term goals. The markets will always face different "worries", today it is inflation/war vs. growth expectations, tomorrow it will be something else. We have built our asset allocation models with dynamic features and quarterly rebalancing, both in fixed income and equities. If the markets continue to march higher, we will capture some of those gains and reallocate to less volatile high-quality bonds. If the equity markets enter a period of negative performance, we have dynamic investment vehicles that utilize rules-based defense mechanisms to reduce the risk of the portfolio. Further, if the market gets too extended on the upside, some of the vehicles will capture partial gains and wait for the extension to correct.

These dynamic tools have been engaged. During the month a portion of equity shifted to Treasury Bills. Others transitioned back; U.S. Large Cap returned to full exposure. Additionally, the high yield allocation has also returned to full exposure.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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