April 2022

Economic Update

A Review of First Quarter 2022

For the first time during the last few years, the Covid-19 pandemic is no longer the biggest global news story at quarter end. Unfortunately, the pandemic has now been supplanted by the Russian invasion of Ukraine on February 24. As of April 1, Reuters estimates that there have been at least 24,000 total deaths, $565 billion in property damage and over 10 million people displaced.

In terms of direct economic impact on the United States, the war has exacerbated the inflationary pressure that we already had been seeing for the past few months. In turn, this has led to strong language out of the Fed about raising short term interest rates to combat it - and ultimately to a significant sell off in the bond market during the last few weeks as bond holders look to get ahead of those upcoming rate increases.

U.S. Economy

Inflation continues to be a problem for consumers. The consumer price index rose 7.9% in February versus one year prior. Higher food and energy prices contributed to but were not the sole reason for the increase. Excluding food and energy, core inflation was up 6.4% over that time. Both figures are the highest levels seen since 1982, per the U.S. Bureau of Labor Statistics.

Oil prices have been volatile as of late. Futures for West Texas Intermediate crude fell 13% in one week following President Biden’s announcement of plans to release 1 million barrels of oil per day from U.S. strategic reserves. As of this writing, however, prices are still relatively high at $103.33 per barrel. While this might seem alarming, note that high oil prices may actually now be a positive for our economy since the U.S has been a net oil exporter since 2020. For instance, Exxon Mobil Corporation has recently announced that their total profit could approach $11 billion for the first quarter of 2022.

Of course, while good for U.S. oil companies, high oil prices certainly do not benefit the average consumer. Consumer confidence is very low, according to the monthly Consumer Sentiment Survey conducted by the University of Michigan. The final reading for February was 62.8. Note that the survey was conducted before the Russian invasion of Ukraine. Inflation and rising interest rates were cited as the primary factors for the low number, resulting in the most negative respondent expectation for the long-term prospects of the U.S. economy registered during the past decade.

One of the Fed’s primary objectives is to keep inflation under control. While initially assuming that the inflation we were seeing was merely transitory, they now have shifted their stance. In March, they raised the Fed rate by 25 basis points and project nine more increases soon. Specifically, their current forecast is for a raise at each of the six remaining Fed meetings during 2022, three more in 2023, and then no further increases during 2024. If that comes to pass, the net result will be a Fed rate roughly 25 basis points higher than where we were just prior to the pandemic.

On a positive note, jobs growth continues to be strong. Per the Bureau of Labor Statistics, the U.S. economy added 431,000 jobs during March, 750,000 in February and 504,000 in January. The total number of unemployed persons is now down to 6.0 million and the unemployment rate is now down to 3.6%. Both values are quickly approaching the pre-pandemic levels of 5.7 million and 3.5% respectively.

Jobs growth would likely be even higher if we weren't seeing such a significant labor shortage. Per the Bureau of Labor Statistics, job openings are now up to 11.3 million nationally, nearly double the total number of unemployed persons. Not surprisingly, this is leading to a continued surge in wage growth, which the Atlanta Federal Reserve estimates to be 5.8% for the 12 months ending February 2022.

International Economy

The European economy is more dependent on Russian money and natural resources than the U.S. economy is, which likely led to Vladimir Putin's anticipating less European push back over his decision to invade Ukraine. However, European countries have surprised many observers in their willingness to participate in the U.S.-led sanctions on the Russian financial system. The U.K. has been freezing assets despite London having been a known safe haven for Russian oligarchs and their money, to such an extent that the city had previously been nicknamed "Londongrad".

Now Germany, which had been the largest European consumer of Russian energy, has agreed to stop certification of the $11 billion Nord Stream 2 pipeline and announced that they will work to be virtually independent of Russian oil by the end of this year.

China has not participated in the sanctions on Russia, so they should reap the benefits of cheaper energy imports for the near future. However, the country is currently mired in another Covid-19 outbreak, which is at its highest level in that country since the pandemic began. Note that their actual infection rates are still lower than those seen in many other countries, but the Chinese government takes a much stronger stance on quarantining than most other governments do. As of this writing, Shanghai, a city of over 25 million people, has been completely locked down for nine days with no end in sight.

Markets

Developed equity markets experienced a poor quarter for returns due to the economic uncertainty throughout the world today. U.S. large-cap equities, as represented by the S&P 500 Index, lost 4.60% during the quarter. Developed international equity markets, as represented by the MSCI EAFE Index, fared even worse. That index finished the quarter down 5.91%. Real estate struggled as well. The Wilshire REIT Index lost 3.87% during the quarter.

Bond indexes were hit with relatively large losses, given what is typical for the category. This is because March saw a significant rise in intermediate term interest rates, which heavily influence bond prices. The Barclays U.S. Aggregate Bond Index and the Barclays Global Aggregate Bond Index lost 5.93% and 4.97% respectively during the quarter. Even the Barclays U.S. Inflation-Linked Bond Index was not immune, also losing 3.02% for the period.

Emerging markets also struggled given their more direct exposure to Russia. It is unclear when Russia will be investable for the West again. The MSCI Emerging Markets Index finished the quarter down 6.97%. Just about the only major asset class with positive return was Commodities, which benefited from the inflation spike in energy and other materials. The Dow Jones UBS Commodity Index gained 25.55% during the first quarter of 2022.

Through Mar. 31, 2022

% Return

	Quarter-to-Date	Year-to-Date	1-Year	3-Year	5-Year
T-Bills	0.08	0.08	0.11	0.66	1.07
Bloomberg US Agg Bond Index	-5.93	-5.93	-4.15	1.69	2.14
Bloomberg Global Agg Bond Index	-4.97	-4.97	-3.92	1.30	2.25
Bloomberg US Infl Linked Bond Index	-3.02	-3.02	4.29	6.22	4.43
S&P 500 Index	-4.60	-4.60	15.65	18.92	15.99
MSCI EAFE Index	-5.91	-5.91	1.16	7.78	6.72
MSCI Emerging Markets Index	-6.97	-6.97	-11.37	4.94	5.98
Bloomberg Commodity Index	25.55	25.55	49.25	16.12	9.00
Wilshire REIT Index	-3.87	-3.87	29.14	11.94	10.04

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Outlook

Inflation and an unexpected war led to economic losses for most people during the first quarter of 2022. Of course, the human toll for Ukrainians has been far worse. Let's hope that there is a resolution to the conflict as quickly as possible.

Still, global markets had a very strong run over the last three years, even with a global pandemic going on for much of that time. Whatever the reason, in retrospect it should not be surprising that markets would pull back at some point as sentiment can turn quickly. Of course, that goes both ways. Market sentiment is negative right now but that likely won't last forever either. As always, we recommend a diversified portfolio containing a reasonable amount of equity exposure for any investor with a long enough time horizon.

Bloomberg US Aggregate Bond Index: The Aggregate Bond Index is a broad-based benchmark that measures the investment grade, dollar-denominated, fixed-rate taxable-bond market, including Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS. The Aggregate rolls up into other Bloomberg flagship indices such as the multi-currency Global Aggregate Index and the Universal Index, which includes high-yield and emerging markets debt. The Aggregate Index was created in 1986, with index history backfilled to Jan. 1, 1976.

Bloomberg Global Aggregate Bond Index: The Global Aggregate Index provides a broad-based measure of the global investment grade fixed-rate debt markets. The Global Aggregate Index contains three major components: the Aggregate (USD 300mn), the Pan-European Aggregate (EUR 300mn) and the Asian-Pacific Aggregate Index (JPY 35bn). In addition to securities from these three benchmarks (94.0% of the overall Global Aggregate market value as of Dec. 31, 2010), the Global Aggregate Index includes Global Treasury, Eurodollar (USD 300mn), Euro-Yen (JPY 25bn), Canadian (USD 300mn equivalent) and Investment Grade 144A (USD 300mn) index-eligible securities not already in the three regional aggregate indices. The Global Aggregate Index family includes a wide range of standard and customized sub-indices by liquidity constraint, sector, quality and maturity. A component of the Multiverse Index, the Global Aggregate Index was created in 1999, with index history backfilled to Jan. 1, 1990.

Bloomberg Global Inflation-Linked Index: The Global Inflation-Linked Index (Series-L) includes securities that offer the potential for protection against inflation as their cash flows are linked to an underlying inflation index. All securities included in the index have to be issued by an investment-grade-rated sovereign in its local currency. The list of eligible currencies is the same set of currencies eligible for inclusion in the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) represents a stand-alone multi-currency index exposed to the real yield curve for each relevant currency. As such, the index does not contribute to the Global Aggregate Index. The Global Inflation-Linked Index (Series-L) was created on Oct. 31, 1997.

S&P 500® Index: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the stock market. It measures the movement of the largest issues. Standard & Poor's chooses the member companies for the 500 based on market size, liquidity and industry group representation. Included are the stocks of industrial, financial, utility and transportation companies. Since mid-1989, this composition has been more flexible and the number of issues in each sector has varied. The returns presented for the S&P 500 are total returns, including the reinvestment of dividends each month.

MSCI EAFE Index: The MSCI EAFE® Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure developed-market equity performance, excluding the U.S. and Canada. As of April 2002, the MSCI EAFE Index consisted of the following 21 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom.

MSCI Emerging Markets Index: The MSCI EMF (Emerging Markets Free) Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of April 2002, the MSCI EMF Index consisted of the following 26 emerging-market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand, Turkey and Venezuela.

Bloomberg Commodity Index: Bloomberg Commodity Index℠ and Bloomberg Commodity Index Total Return℠ the DJ-UBSCI℠ family includes both the BSCI℠, which is calculated on an excess-return basis, and the BSCITR℠, a total return index based on the BSCI℠. The former reflects the return of underlying commodity futures price movements only, while the latter reflects the return on fully collateralized positions in the underlying commodity futures.

Wilshire US REIT Index: Introduced in 1991, the Wilshire REIT index is intended as a broad measure of the performance of publicly traded real estate equity securities. The index is market-capitalization weighted of publicly traded real estate securities, such as Real Estate Investment Trusts (REIT), Real Estate Operating Companies (REOC) and partnerships. The index is composed of companies whose charters are the equity ownership and operation of commercial real estate.

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