The Weekly
Economic & Market Recap

March 18, 2022

3/18/2022		Wk	Wk		YTD	12 Mos
		Net	%	Div	%	%
STOCKS	Close	Change	Change	Yield	Change	Change
DJIA	34,754.93	1810.74	5.50	1.86	-4.36	5.76
S&P 500	4,463.12	258.81	6.16	1.39	-6.36	13.99
NASDAQ	13,893.84	1050.03	8.18	0.71	-11.19	5.93
S&P MidCap 400	2,705.81	135.05	5.25	1.49	-4.79	3.55

TREASURIES	Yield	**FOREX**	Price	Wk %Change
2-Year	1.94	Euro/Dollar	1.10	0.75
5-Year	2.14	Dollar/Yen	119.17	1.86
10-Year	2.15	GBP/Dollar	1.32	0.63
30-Year	2.43	Dollar/Cad	1.26	-0.52

Source: Bloomberg/FactSet

What Caught Our Eye This Week

Over the past three weeks, the financial markets have been reacting to the war in Ukraine. The Russian Army's lack of traction since its invasion is confounding military analysts. There are reports of miles-long convoys stalled in the road, mechanical breakdowns, outdated equipment, lack of food and fuel, and a lack of command and control. Since 2011, Russia has conducted an extensive modernization and restructuring of its military, spending hundreds of billions of dollars. Its efforts have focused on nuclear and air force modernization, with a lesser focus on its navy and perhaps the least focus on its ground capability. Nevertheless, the Russian Army is formidably equipped. Relative to the modest Ukrainian military, Russia has over 11x Ukraine's annual military budget, 4.5x its active duty personnel, 5.8x its number of tanks, 5x its artillery pieces, and an air force which is 17x the size of Ukraine's. Russia has deployed only a fraction of its army to Ukraine. Russia's problems stem primarily from a political miscalculation in thinking that the Ukrainian Armed Forces and its citizens would quickly surrender; and it did not plan accordingly. We have witnessed a huge failure in logistics, which is the supply of food, fuel, parts, equipment, munitions, and maintenance services to its troops. Russia has a history of poor execution in logistics and coordinating combined arms operations. Russia also failed to leverage its considerable strength in air combat capability and its electronic warfare capacity.

Economy

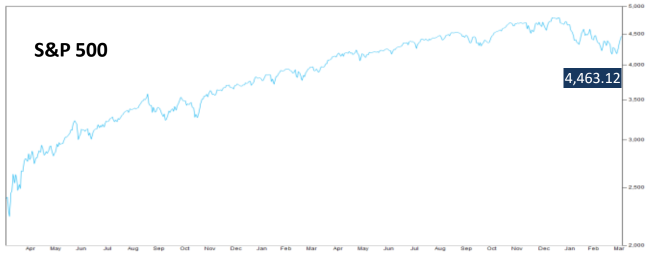
The most anticipated report this week was the retail sales report, which was released on Wednesday. Retail sales increased 0.3% in February which was very close to the consensus forecast. Over the past 12 months, retail sales were up 17.6%. Gasoline station sales led the way surging 5.3%, restaurants and bars gained 2.5%, and non-store retailers declined 3.7%. Overall, 7 of 13 major sales categories showed positive growth in February. The "control" category, which excludes food service, autos, gas and building materials, decreased 1.2%. This was a significant disappointment relative to the consensus forecast. In other news this week, the producer price index (PPI) came in close to expectations, rising 0.8% in February. The "core" PPI rose 0.2%, which was the softest monthly gain in over a year. On Thursday, housing starts posted an increase of 6.8% in February to 1.769 million units at an annual rate. Finally, on Friday, existing home sales disappointed, dropping 7.2% in February to 6.02 million units at an annual rate. The median sales price of an existing home sold has soared 15% year-over-year.

Fixed Income/Credit Market

Through Thursday's close, fixed income performance has been negative year-to-date (YTD) for all the sectors that we follow. The majority of underperformance can be attributed to the rapid rise in global interest rates due to the anticipation of monetary tightening by central banks to address inflation. In the U.S., Treasury yields were up as much as 116.5 basis points (bps) at the 2-year tenor at the close of trading on Thursday. While the shape of the Treasury curve has flattened, the 10-year tenor was also materially higher by 62.3 bps. The sectors that have weathered the storm the best have been Treasury Inflation-Protected Securities (TIPS), senior loans, and short-term Treasury bonds which have returned -1.1%, -1.66%, and -1.93%, respectively. Conversely, many other sectors have not been able to hold up as well and have experienced significantly worse losses. Long-term bonds, emerging market debt (non-currency hedged), and preferred equity have returned -10.54%, -9.54%, and -8.24% YTD, respectively. With the FOMC expected to raise the key rate 25 bps six more times in 2022, fixed income investors must remain defensive.

Equities

U.S. equities finished on Friday to close out their best weekly performance since November 2020. The S&P posted a 6.16% rise, while the Dow and NASDAQ both notched 5.5% and 8.18% gains. Investors have been showing renewed confidence in stocks as they digest the implications of the Fed's interest rate hike and the ongoing war in Ukraine. Investors are focusing on solid corporate fundamentals despite inflation and geopolitical issues. Moreover, the nation's strong labor market may improve consumer spending and the overall economy. All sectors except energy had positive weekly gains. Consumer discretionary led the group, up 9.27%. Growth outperformed its value counterpart, 8.34% to 4.33%.



Our View

The Federal Reserve's Federal Open Market Committee hiked rates after its March meeting earlier this week. It was the first rate increase by the Fed in four years and marked the initial salvo in what could be an extended tightening cycle. The Fed guided expectations higher regarding the number of quarter-point rate increases this year to seven in total, with the fed funds rate reaching an expected 1.75% to 2.00%. Given recent inflation statistics, with the Consumer Price Index rising 7.9 percent year-over-year through February, it is not hard to understand the Fed's need to be more aggressive in fighting inflation. At the recent FOMC meeting, the Federal Reserve raised its forecast for Core Personal Consumption Expenditures Price Index, its preferred inflation gauge, to 4.1 percent in 2022 from 2.3 percent only a few months ago. The adjustment was staggeringly large. Although the economy is an extensive open system with millions of interacting interdependent variables, and the relationship between variables is constantly changing, it is unusual for the Federal Reserve's prediction of economic conditions to need such a significant modification. Considering that the economy's general price level is one of the Fed's primary mandates and something they closely monitor, it is striking that they would be that surprised by the intensity of the inflationary pressures. Unneeded fiscal stimulus overstimulated demand, and inflation has been allowed to build for too long. The impact of a significant spike in energy prices and additional global supply uncertainties due to the war in Ukraine has only added fuel to the inflationary fire. The war and its impact were an unknown for the Fed late last fall when it established the timeline for rate normalization. Many of the forces driving prices higher, such as energy, will be self-correcting either through increased supply or demand destruction. Supply chain issues will lessen over time. As we look out over the next 12 to 18 months, the key variables impacting financial markets will be wage rates and inflation expectations. If the expectation for higher levels of future inflation become embedded in the market, the tightening path will be much more arduous for the Fed and dangerous for investors.

COMING UP NEXT WEEK		Consensus	Prior
03/23 New Home Sales SAAR	(Feb)	810.0K	801.0K
03/24 Markit PMI Manufacturing SA (Preliminary)	(Mar)	55.8	57.3
03/24 Markit PMI Services SA (Preliminary)	(Mar)	56.3	56.5
03/24 Durable Orders SA M/M (Preliminary)	(Feb)	-0.45%	1.6%
03/25 Michigan Sentiment NSA (Final)	(Mar)	59.7	59.7
03/25 Pending Home Sales M/M	(Feb)	1.0%	-5.7%

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