The Times They Are A-Changin'

The 1964 song by Bob Dylan certainly applies to the world in 2022. Russia's invasion of Ukraine will likely have long lasting implications, both geopolitically and economically. Globalization was already under threat with the rise of populist political parties across the globe. The West's use of economic warfare in response to Russia's aggression plus the desire of all countries to become more self-sufficient means globalization has reached its peak. We will be monitoring the implications of these changes over the coming years.

In addition to the war, financial markets are contending with high and persistent inflation and an increasingly hawkish Federal Reserve. Given these events it's not surprising that markets stumbled in the first quarter. Things really looked bleak in the middle of the quarter when technology stocks were in bear market territory and the S&P 500 slid by -13% peak to trough. By the end of the quarter the declines were less scary with the S&P 500 down by -4.6%, just about what the broad bond market fell due to sharply rising interest rates.

Given the breadth of serious challenges many market commentators are surprised at the resiliency of the stock market. Our best guess is that TINA (there is no alternative) is still alive and well. As mentioned above bonds are not a refuge. Cash is acceptable in the short-term but not in the long-term because of inflation. In addition, corporate America is flush with cash and are buying back loads of stock, which supports the market (see chart below).

Our belief is the key to future performance is whether the economy enters a recession. The yield on the two-year Treasury note rose above the 10-year note, an inversion of a segment of the Treasury curve that many times has predicted a recession. Fortunately, other areas of the credit markets are benign. Spreads between high-yield bonds and Treasuries remain well below any signal of distress.

Consumers are going to have to get by on their own as the pandemic support has ended. Already the University of Michigan's consumer sentiment index regarding economic conditions has steadily deteriorated near the lowest since 2011, and the saving rate has dropped back to pre-pandemic levels. These conditions are not necessarily fatal since household balance sheets are solid and the jobs market is strong. In fact, there are **one million more Americans working** full-time compared to the eve of the pandemic.

There are strong arguments for both bulls and bears so a forecast of a muddle-through environment where there are neither large gains nor large losses may be the wisest. We continue to maintain a well-diversified portfolio with a tilt to the Value and Low-Volatility factors that so far is working out well in 2022.

If you would like to discuss your personal Portfolio and Allocation, please feel free to give us a call.

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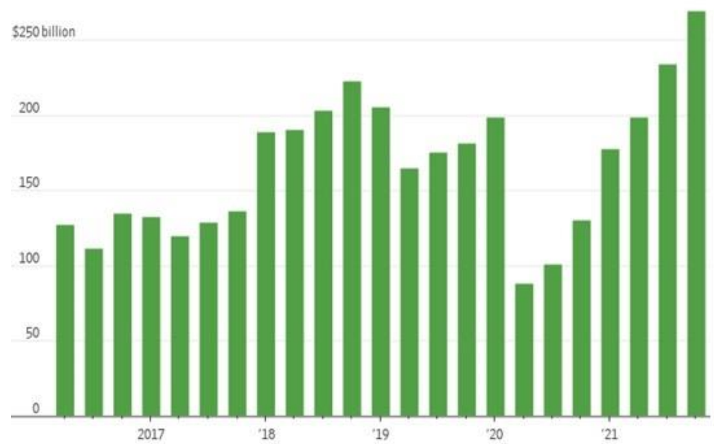
S&P 500 stock buybacks, quarterly



Note: 4Q21 data is preliminary
Source: S&P Dow Jones Indices

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