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INVESTMENT MANAGERS

ECONOMIC UPDATE MARCH 2022

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February was another tough month for stocks and bonds. Large cap stocks in the S&P 500 index were down -2.99% for the month bringing their year-to-date loss to -8.01%. Small cap stocks in the Russell 2000 were actually up 1.07% so now their year-to-date loss is -8.66%. International stocks in the MSCI EAFE index had a loss of -1.77% and emerging market stocks lost -2.99% so now their year-to-date returns are -6.52% and -4.83% respectively. Yields jumped further in February resulting in a -1.12% monthly loss and -3.25% year-to-date loss for the Barclays US Aggregate Bond Index.

The COVID numbers have backed down again and cities are again easing their mask and other mandates. New York City was the first US city to require vaccinations at restaurants, theaters and sports arenas and announced they will lift those effective March 7 if COVID indictors continue to show a low level of risk. A new strain of Omicron is beginning to surface so it is unlikely that we are at the end of the pandemic just yet but with more people vaccinated or COVID recovered, hopefully the spread will be less extensive and we are closer to resuming normal life.

Economic growth for fourth quarter was revised up to 7%. The full year estimate did not change from the 5.7% previously reported. Analysts are starting to increase their estimates for first quarter GDP growth. Originally growth was thought to be between 0% and 1%. David Kelly of JPMorgan is now projecting 1% to 2% growth. Brian Wesbury of First Trust is projecting full year GDP growth of 2.5%.

Fourth quarter earnings reports continue to come in strong. Fourth quarter earnings are projected to be 31.2% higher and revenues are projected to be 15.0% higher than the year ago quarter. Full year earnings are up 45.3% in 2021 versus 2020. The current Zacks projections are for 10.4% earnings growth and 8.4% revenue growth in 2022. Brian Wesbury projects earnings growth of 10%-15%.

Inflation is still at 40-year highs. The annual inflation rate of 2021 was 7.0% according to the US Labor Department and in January it was reported at 7.5% compared to a year ago. Energy prices are still a big part of that with a 27% increase over the year. In addition, used cars are up 40% and new car prices increased 12%.

The Russian invasion of Ukraine has created a lot of volatility in asset prices. The analysts seem to agree that oil prices will stay higher longer so inflation is not likely to go down as quickly as previously expected. We'll also continue to see supply chain disruptions. Europe is dependent on Russia and Ukraine for oil, natural gas, and food. The push for green energy will continue so that Europe is not as dependent on oil and natural gas as they are now, but it will take decades before the transition to green energy could be completed.

Also with the Russian/Ukraine situation, analysts think the Fed will not be able to raise rates as quickly as they had planned. JPMorgan had been projecting 7 to 9 increases over the next year. Brian Wesbury says that the market had been pricing in 6 1/2 rate hikes but that estimate is now down to 5 1/2. He believes the Fed will only raise 4 times. A lower Fed Funds rate may be the reason for recent support for technology stocks.

JPMorgan and Brian Wesbury have a 2.5% target for the 10-year Treasury bond. It is currently at 1.84%. If the Fed only raises 4 times, then the yield curve should remain upward sloping reducing the risk of inversion. Bond manager Lacy Hunt has been concerned about an inverted yield curve signaling a coming recession. He's also been concerned about the diminishing returns phase of debt – the more debt we take on, the less good it does to boost the economy. The pandemic spending packages are mostly over but now we are faced with debt that needs to be repaid.

Investors have valid reasons for concern and volatility is likely to continue. We continue to advocate against market timing and in favor of investing for the long term according to your risk tolerance. As always, please contact us with any questions or concerns.

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