Week in Review

Equity Markets:

The market ended the week down 1.6%. Adding to the heightened volatility we have seen this year from inflation and new Fed policy, a new factor has entered investors' minds. The Russia-Ukraine conflict has the market on edge as an escalation appears imminent. It is important to note that geopolitical events have been handled well by the markets historically. They are likely to cause short-term volatility and market pullbacks. It is not common for geopolitical events to have a long-lasting impact on the markets. There may be market segments that see more pressure, such as the natural gas and oil markets.

Fourth quarter earnings have silently been solid, but have remained in the shadow of the daily headlines about inflation, rate hikes and Russia. Almost 90% of companies have reported this quarter, and earnings are on pace to increase 30.9% year over year, according to data tracked by FactSet. So far, 77% of companies have reported positive earnings surprises and 78% have reported positive revenue surprises. Both of these are above the 5-year average.

Fixed Income Markets:

The Fed minutes that were released last Wednesday eased investors' concerns around the pace of rate hikes. In recent weeks, we have heard expectations of as many as seven rate hikes in 2022, including a 1% increase by July, and news that the market has priced in a 0.5% increase in March. These concerns were unwarranted, as the Fed indicated they were not going to take aggressive rate actions in March. The minutes also indicated that the Fed is eyeing a substantial balance sheet reduction. March appears to be the date that an actual shift in policy will occur.

The 10-yr ended the week at 1.93%, as a shift to safe haven assets occurred due to the Russia-Ukraine situation.

Economic:

Economic numbers were mixed for the week. A few key indicators have started to soften. The Leading Economic Index declined 0.3% for the first time in a year. Jobless claims and regional manufacturing reports also showed weakness compared to expectations.

Looking Ahead

Equity Markets:

The Russia-Ukraine conflict will likely garner a lot of attention this week. We believe that it is important for investors to remember what impacts stock prices over the long-run. Corporate earnings are the main driver of the stock market over time. As long-term investors, we must consistently remind ourselves that the noise we hear on a given day may effect the short-term, but the majority of the noise will have very little, if any, impact on long-term corporate profitability.

Having a well-positioned, diversified portfolio through these times of volatility is vital. Not all segments of the market move in unison. After a strong run from small cap stocks last year, large cap started to recover. But, over the past two weeks, small cap has held up much better than its large-cap counterpart. The Russell 2000 Index is up ~0.3% over this time frame and large cap is down almost 4%.

Fixed Income Markets:

The fixed income markets have priced in a very aggressive Fed tightening policy. We believe that this is a slight overreaction. While not impossible, seven rate hikes this year is not likely in our opinion. The Fed does not want to risk putting a damper on the recovery by overreacting. Their data dependent policy allows them to take action in smaller increments and to see if some of the inflationary pressures still lingering from the pandemic work themselves out. The pandemic has added many complications in assessing the current environment. Ramifications from the global shutdown still exist. It is unknown if these are long lasting (i.e. Congestion at the ports), or just taking longer to reach normalcy. The Fed will take action because, at minimum, some of the components of inflation are not "transitory."

Rates backed off of their highs, returning to below 2% for the week. We see this action continuing with a slope upwards until the 10-yr treasury finds its new range. We believe this range is likely in the 2.25-3% unfolding over the next 12-18 months.

Economic:

Next week will see preliminary manufacturing and services PMIs from Markit. Another important reading will be the Consumer Confidence Index and followed by the Michigan Consumer Sentiment Index.

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