Summary

Economic data for the week included a slight revision to prior-quarter GDP, a continued gain in house prices, and continued lower jobless claims. However, the Russian invasion of Ukraine dominated most other news.

Global equity markets initially fell sharply last week, in the ramp-up to the Russian invasion, which had been brewing for weeks. However, stocks recovered after the military activity started and rumors of negotiations came. U.S. bonds started strong but fell back as interest rates ticked higher along with a return to inflation worries. Commodities gained across the board, notably in energy and agriculture, due Russian and Ukrainian-specific supply concerns.

Economic Notes

(0/+) The second reading of **4th quarter 2021 GDP** saw a revision higher by 0.1% to 7.0%, in keeping with broader market expectations. Revisions upward for equipment, structures, and government spending for the quarter were offset by downward revisions in consumer spending and net goods exports. Inventories, a typical wildcard, were little changed. Headline PCE inflation was revised down a bit to an annualized rate of 5.5% for the quarter, while the core PCE price index was revised up by 11 basis points to an annualized rate of 5.0% for the quarter, and the year-over-year core rate in at 4.5%. These were generally line with expectations.

That GDP growth rate remains one of the fastest since the early 1980s, although this surge is expected to decelerate rapidly into 2022 as fiscal stimulus effects wear off. Expected GDP for Q1-2022 is better than multi-year trend, but estimates have steadily fallen. The Atlanta Fed's GDPNow model as of Friday predicted 0.6% annualized growth, with the group of Blue Chip estimates falling in a wide range of 0.5-3.5%—with average being just under 2%.

(0) **Personal income** was unchanged in January, which actually surpassed the -0.3% decline expected—overall growth was held back by continued dwindling personal transfer receipts, which offset higher wage income. In fact wage income is up 11% from a year ago. **Personal spending** for January reversed course by rising 2.1%, compared to the 1.6% rise expected. The personal savings rate declined by -1.8% to 6.4%, below the level seen prior to Covid. The headline PCE index rose 0.6%, a tenth stronger than expected, while the core PCE gained 0.5%, on track with consensus—both similar to the prior month figures. On a year-over-year basis, the headline and core PCE indexes rose 6.1% and 5.2%, respectively. These are lower than the popular CPI measure, largely due to their compositional differences.

(+) **Durable goods orders** for January rose by 1.6%, exceeding expectations calling for 1.0%. Removing transportation reduced the increase to 0.7%, while core capital goods orders rose by 0.9%. Core capital goods shipments gained 1.9% for the month, exceeding the 0.5% increase expected by consensus.

(+) The **S&P/Case-Shiller home price index** rose by 1.5% in December, which beat the prior month as well as the median forecast calling for 1.1%. Every city experienced a price increase, led by 2%-or-more readings in San Diego, Seattle, and Dallas. The year-over-year rate of change accelerated by another 0.3% to 18.6%.

(+) The more comprehensive **FHFA house price index** rose by 1.2% in December, matching the prior month and exceeding the consensus forecast of 1.0%. All nine U.S. reporting regions saw gains, led by New England and East North Central (the five Great Lakes states), which were each up 1.5-2.0%. The year-over-year change was unchanged from the prior month's 17.7%—still running at a high level. These two metrics continue to demonstrate very robust home price growth, led by historically low interest rates (with increases not having occurred until 2022 was underway), lack of housing inventory, still-catching up building activity, and a significant spending capacity from the prior two years' worth of fiscal stimulus.

(+) **New home sales** for January fell back by -4.5% in January to a seasonally-adjusted annualized rate of 801k homes, beyond the median forecast calling for a more muted -1.0% drop, and a reversal from the prior month's 12% increase (which had been revised higher). Regionally, sales in the West gained 3k, while those in the other three national segments lost ground, especially in the South, down -35k. The months' supply of new homes ticked up by 0.5 of a month to 6.1, as inventories picked up. The median new home price is up 13% from last year, at $423,300, with the average price up 19% to $496,900. New home sales are down -19% from last year, which is problematic, but based on a lack of homes being available, which itself is related to a lack of available labor. (However, the number of homes under construction has been steadily rising, to levels not seen in 15 years.) Consistently rising prices and a recent increase in mortgage financing rates have played a role as well.

(-) **Pending home sales** for January fell by -5.7%, contrary to expectations for a 0.2% rise. Sales in the West rose by over a percent, while the other three regions fell by over -5% each for the month, with the Northeast down over -12% (likely weather-related). As noted earlier, higher mortgage financing rates and a tight inventory situation remain headwinds, with lower pending sales numbers often translating to lower existing home sales results in subsequent months.

(+) The final **Univ. of Michigan index of consumer sentiment** for February showed a tick upward of 1.1 points to 62.8, surpassing the 61.7 level expected. This reversed an over -5 drop in the initial reading. Consumer assessments of current economic conditions fell slightly, while expectations for the future improved by several points. Inflation expectations for the coming year rose by 0.1% to an even 5.0%, while those for the next 5-10 years fell by -0.1% to 3.0%. The latter data point has remained interesting, as, unlike in the 1970s inflation episode, assumptions for long-term inflation have remained fairly well-anchored. However, they are decently above the Fed's 2.0% policy target.

(0) The Conference Board **index of consumer confidence** for February fell back by -0.6 of a point to 110.5, just ahead of consensus expectations calling for 110.0. Consumer assessments for current conditions actually rose a half-point, which was offset by future expectations falling by over a point. The labor differential, which measures the ease at finding employment ticked down by a point but remained at a very high level.

(+) **Initial jobless claims** for the Feb. 19 ending week fell by -17k to 232k, just below the median forecast of 235k. **Continuing claims** for the Feb. 12 week fell by -112k to 1.476 mil., well below the 1.580 mil. expected. Initial claims fell by the largest amounts in MO, while CA and MI saw at least a 10k increase each. Continuing claims fell to their lowest level since 1970.

Market Notes

Period ending 2/25/2022	1 Week (%)	YTD (%)
DJIA	-0.03	-5.99
S&P 500	0.84	-7.80
NASDAQ	1.10	-12.37
Russell 2000	1.59	-8.99
MSCI-EAFE	-2.49	-6.58
MSCI-EM	-4.85	-4.78
Bloomberg U.S. Aggregate	-0.33	-4.00

U.S. Treasury Yields	3 Mo.	2 Yr.	5 Yr.	10 Yr.	30 Yr.
12/31/2021	0.06	0.73	1.26	1.52	1.90
2/18/2022	0.35	1.47	1.82	1.92	2.24
2/25/2022	0.33	1.55	1.86	1.97	2.29

U.S. stocks were mixed to higher on the holiday-shortened week, despite sharp day-to-day and intraday volatility. The market closure for President's Day on Monday may have been fortunate, due to an otherwise global pullback in assets as tensions with Russia and Ukraine continued to escalate, leading to an actual invasion by the end of the week. By sector, defensive and domestically-oriented health care and utilities saw gains of over 2%, while consumer discretionary, consumer staples, and materials fell back by 2-3%, with higher goods inflation uncertainty. Real estate rose over 2% as a bit of a safe haven, despite higher interest rates for the week.

The S&P 500 officially entered -10% correction territory at the close of Tues., Feb. 22, having fallen from a peak level set Jan. 3 (it had come close earlier, on Jan. 27, down -9.8%, which could have been considered a correction, depending how picky one wanted to be about rounding). When correction levels are reached, technical trading responses can exacerbate volatility a bit further, even if fundamental conditions haven't worsened. In this case, the Russian incursion caused further distress into Thursday, pushing the S&P down to -15% territory briefly, but reversed by the end of the session and led to Friday gains as some rumors of diplomatic negotiations were in the works. The classic market axiom of 'buy the rumor, sell the news' seemed as appropriate as ever, along with a flurry of market strategist pieces urging investors to 'stay the course', etc. As we've noted, the human cost of war and economic impact perceived by markets are often very different—with the shock of military action often fading quickly with conditions becoming 'less bad' improving market sentiment. This has been the case for centuries.

Hope of perhaps a 'limited' scope of military action and/or breakoff of certain pro-Russian provinces could have represented a more challenging diplomatic issue and lessened sanctions against Russia, but the now broader military offensive has encouraged even reluctant nations to approve sanctions and provide aid (including weaponry). This includes removal from the European-based SWIFT financial transfer system to a large degree, which has been controversial, although there are workarounds for global money transfers. The most complicating element may be Russia's role as a leading energy and metals producer, as prices for those products have already been driven higher due to prior supply issues. Russia had been strengthening itself from sanction effects from the West over the past decade, by reducing dollar reserves and increasing gold holdings, for example, as well as developing an alternative to SWIFT. However, current sanctions imposed could be deeper and broader than those seen before in response to the outrage over the human cost in Ukraine.

Foreign stocks fared negatively, as expected, due to the proximity of the Russia-Ukraine conflict and European reliance on Russian energy a factor in keeping deeper sanctions at bay. However, as the human cost has become more evident, pressures to apply sanctions have strengthened as well over recent days.

As an emerging market side note, Russian stocks had fallen by about -50% since last October (and over -30% last week alone) as chances for invasion escalated. As we noted in an earlier piece, the Russian equity market represents an extremely small part of most foreign stock indexes (a few percent at best). Hence, most investor portfolios have minimal exposure to the region. Even prior to last week's events, the Russian equity market was not considered high quality fundamentally, due to an extreme reliance on natural resources, and financial institutions tied to such resources, not to mention concern over state-owned enterprises, such as in China. The timing of the Russian invasion could well be related to recent strength in commodity prices, and reliance of developed nations on them. This translates to the potential for Russian foreign policy and military actions to turn more aggressive when this extra leverage is there for the taking.

U.S. bonds fared well early in the week in classic 'risk-off' fashion, but fell back as interest rates ticked higher by Friday—along with rising commodity inflation concerns. Corporate credit spreads widened, resulting in outperformance by treasuries. The stronger dollar pulled down foreign bond returns a bit. This was especially true in emerging market debt, which contains a small Eastern European component that experienced more extreme spread widening due to the proximity of the conflict.

Commodities were generally higher, driven by a variety of price spikes after Russian's incursion into Ukraine—based on the commodity production importance of the two nations. The price of crude oil rose sharply on Thurs. alone, but ended the week just 1.5% higher at just above $91.50/barrel, in a natural war-based reaction (of higher petroleum prices), but also potential supply disruptions from any implemented sanctions. Brent crude, which is used as a pricing metric for European markets, closed just under $98—after moving over $100—obviously more directly impacted by Russian supply. Commodities have been increasingly discovered by investors this year as one of the few reliable hedges against inflation and idiosyncratic geopolitical events.

Have a good week.

Ryan M. Long, CFA
Director of Investments
FocusPoint Solutions, Inc.

Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), Amundi Asset Management, Associated Press, Barclays Capital, Bloomberg, Citigroup, Deutsche Bank, FactSet, Financial Times, First Trust, Goldman Sachs, Invesco, JPMorgan Asset Management, Marketfield Asset Management, Morgan Stanley, MSCI, Morningstar, Northern Trust, PIMCO, Standard & Poor's, StockCharts.com, The Conference Board, Thomson Reuters, T. Rowe Price, U.S. Bureau of Economic Analysis, U.S. Federal Reserve, Wall Street Journal, The Washington Post. Index performance is shown as total return, which includes dividends. Performance for the MSCI-EAFE and MSCI-EM indexes is quoted in U.S. Dollar investor terms.

Notes key: (+) positive/encouraging development, (0) neutral/inconclusive/no net effect, (-) negative/discouraging development.