

Summary

Economic data for the week included the consumer price index rising to another multi-decade high, job openings continued to show strength, while jobless claims were little changed.

Global equity markets lost ground again in keeping with the geopolitical and economic aftermath of the Ukraine conflict, although hopes for diplomacy resulted in a few positive days. Bonds fell back as well, with interest rates rising on net along with record inflation data. Commodities prices pulled back after a strong run since the start of the conflict.

Economic Notes

(-) The **consumer price index** for February rose another 0.8% on a headline level, and 0.5% for core, when removing the impact of food and energy prices. Both were largely in line with expectations. Prices for energy commodities rose 6.7% for the month, dominating the total index, while food prices were up a full percent. Gains in core groups were far less dramatic, such as in medical care and new cars, but areas like transportation showed increases due to their connection to energy prices. Other gains were seen in airfares and hotel rooms, which continue to recover from lower usage levels during the pandemic.

On a trailing year-over-year basis, headline and core inflation have risen 7.9% and 6.4%, respectively. These exceeded expectations and registered yet another set of 40-year highs. The energy commodities complex was a key catalyst, up nearly 40%. Other contributors were used and new cars, up 41% and 12%, respectively, in keeping with persistent supply shortages. However, housing costs were also up just short of 5% for the year, on the heels of recovering rents and strong single-family house prices.

(0/-) The **NFIB small business optimism index** fell by -1.4 points in February to 95.7, which represented the lowest level in a year. Businesses noted inflation being a significant problem (by a quarter of respondents), as were supply and logistics issues; however, about two-thirds noted the ability to push through price increases to consumers thus far. However, inflation has cut into earnings and revenue generation.

(-) The preliminary **Univ. of Michigan index of consumer sentiment** for March showed a drop of -3.1 points to 59.7, disappointing relative to the gain to 61.0 expected and, in fact, the lowest reading in over a decade. Assessments of current conditions fell slightly, but expectations for the future fell further, by -5 points. Inflation expectations for the coming year rose by a half-percent to 5.4% (the highest level in 40 years); those for the next 5-10 years were unchanged at 3.0%. Anecdotal comments with the report noted that inflation and Ukraine were weighing on general opinion.

(+) The **JOLTS government job openings report** for January fell back by -185k to 11.263 mil., which did follow a significant revision upward, and still above the 10.950 mil. level expected by consensus. The decline was primarily led by a -288k drop in hotel/restaurant jobs, with the omicron variant still a factor earlier in the year. The job openings rate fell by a tenth to 7.0%, while the hiring rate was unchanged at 4.3%. On the departure side, the total quits rate fell back by a tenth (lower quits in the information and construction sectors), but remained at a historically-high level of 3.2%; the layoffs rate rose by a tenth to 0.9%. Overall, the JOLTS measure continues to point to strong labor conditions, with the advantage tilted toward a large number of available jobs surpassing the number of willing/available workers.

(0) **Initial jobless claims** for the Mar. 5 ending week rose by 11k to 227k, above the 217k median forecast. **Continuing claims** for the Feb. 26 week rose 25k to 1.494 mil., exceeding consensus expectations calling for 1.450 mil. Results were mixed by state, with an increase of 15k claims in NY leading other states, but overall levels remain near cycle lows, which points to continued improvement in employment conditions nationally.

Market Notes

Period ending 3/11/2022	1 Week (%)	YTD (%)
DJIA	-1.91	-8.93
S&P 500	-2.84	-11.53
NASDAQ	-3.51	-17.79
Russell 2000	-1.03	-11.66
MSCI-EAFE	0.55	-12.18
MSCI-EM	-5.08	-11.68
Bloomberg U.S. Aggregate	-1.76	-4.79

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
3/4/2022	0.34	1.50	1.65	1.74	2.16
3/11/2022	0.40	1.75	1.96	2.00	2.36

U.S. stocks started down several percent Monday morning, leading the Dow to official -10% correction territory (if anyone watches the Dow closely anymore), and vacillated the rest of the week in keeping with the progress of Ukraine-Russia peace talks and commodity prices.

By sector, energy was the only group with a positive return last week, with higher oil and gas prices, while consumer staples and technology lost the most ground. Several mega-cap staples firms were down upon the impact of shutting down operations in Russia, which will affect ongoing revenues more than in several other sectors. These included big global names, such as McDonalds, Procter & Gamble, and Starbucks, among many others feeling pressure to exit the country. (How assets of these firms will be treated in Russia remains to be determined.) On the logistical side, an announced stock split (20:1) by Amazon boosted the consumer discretionary group temporarily, despite the fact that stock splits don't affect an underlying stock's value, only make it more 'buyable' for smaller shareholders). Real estate also lost ground as interest rates rose.

The S&P 500 and Russell 2000 remain down in the range of -10% to -15% from highs in early January, bouncing around a bit over the past month, but not falling far beyond that threshold. This had resulted from the prior weekend's rhetoric about sanctioning Russian oil ramped up volatility significantly. This has been the one 'safety valve' in Western sanctions, largely due to Russia's status as a significant producer of oil and gas, as we discussed in more depth last week. (It is important to note that while U.S. imports of Russian oil are relatively low, making a ban more symbolic, Europe is far more dependent, and financial market sentiment abroad has been punished accordingly.) Russia did announce that military operations would end if several conditions would be met by Ukraine, including a constitutional change disavowing NATO or EU membership forever, and giving up the territories of Crimea and several Eastern separatist republics that had been contested prior to this current conflict. The market has rallied from time to time during this crisis upon rumors of Ukraine or Russia (the former more than the latter) being willing to accept certain terms. By the end of the week, however, it appeared no diplomatic solution had been found and bombing of key cities continued.

Interestingly, it appears U.S. corporations have been ramping up buyback activity in the wake of the recent drawdown in stock market prices. At the same time, earnings growth estimates for Q1 have been pared back due to the impact of higher oil prices, which has affected U.S. and European revenues. Ironically, though, higher oil prices can have a positive effect on overall S&P 500 earnings to some degree, as these raise profits for energy and materials companies; however, too much and the negative impact on prices and consumer spending starts to reverse the improvement. GDP growth and earnings estimates have already been pared down a bit for early 2022, although not dramatically so yet. The odds of recession, based on Eastern European

events, remain low but have certainly risen, up to perhaps a quarter or a third chance over the next year. But these odds remain difficult and extremely fluid, especially in a higher-inflation environment.

Foreign stocks declined in keeping with the military conflict in the Ukraine. In short, Europe has higher energy import exposure to Russia, which is threatened by sanctions and cross-sanctions, and explains the much of the sentiment difference between Europe and the U.S. The ECB policy meeting ended with a decision to ramp up the speed of exit from quantitative easing, given the limited downside growth effects from the Ukraine war so far, while inflation was staying high. They're obviously behind the U.S. in the discussion of any rate hikes from a cyclical standpoint. China's government set their GDP target at 5.5%, the first time in 30 years of a target below 6%, noting global challenges, the zero-Covid policy, and crackdowns internally on selected technology and entertainment sectors—not to mention real estate debt. Over the past few days, the Chinese 'zero-Covid' policy has again resulted in the shutdown of at least one major city—an activity which has been a key contributor to supply chain disruptions.

Overall equity sentiment remains poor globally, following the sharp correction, which has tended to be a positive contrarian influence going forward, especially with now-lower valuations. This is even more pronounced in Europe, with greater commodity concerns and proximity to the fighting. According to reports and conference calls, sanctions are being felt in Russia already by citizens, while price effects of higher prices in the West for energy, metals, and grains may take longer to play out.

U.S. bonds fell back as interest rates ticked higher, with more record inflation readings offsetting negativity and risk-off sentiment due to the Ukraine war. Treasuries fared better than corporate credit, as spreads widened. Watching the treasury yield curve shape has become popular again, with inversions (when long rates, like the 10-year, fall below short-rates, like the 3-month or 2-year) correlating strongly with future near-term recessions. The curve remains positive, but the expected upward movement of short rates through Fed actions and safe haven buying on the long end have created a flattening dynamic. Foreign bonds were mostly down, as rates ticked higher in developed markets as well, while risk sentiment stayed poor in emerging markets, along with a stronger dollar. It appeared holders of Russian bonds will be split into two camps in regard to coupon payments: nations that have sanctioned (bad) and have not sanctioned (good), with some speculation now that an upcoming bond payment to USD-holders of debt would be paid in depreciated rubles this week, which could be considered a technical default. (It's important to note that Russia had been considered an investment-grade credit up until the time of the invasion and sanctions; it's rated CCC now, but a default would drop that further.)

Commodities fell back last week, as hopes for diplomatic resolution created a pause in the upward price trajectory. The energy sector fell back by -8%, with lesser declines for agriculture, while precious metals gained slightly. After peaking at \$125/barrel during the week, the price of crude oil fell back by over -5% to just over \$109/barrel by Friday as the UAE announced higher production, although OPEC has remained quiet on raising levels in general. The price of nickel doubled and more last week, due to sanction-based supply issues as well as short-covering in the market on the technical side, causing a trading pause in the London contract. (The practical effects of nickel shortages may be felt in higher prices for stainless steel, batteries, and other industrial products, used for its ability to resist corrosion.)

The ongoing problem with petroleum has been that the incentive for ramping up production and infrastructure is highest when prices are high. However, such investments take time to get on line, and conditions can normalize rapidly. On the other hand, the prior lower oil price environment offered far less incentive for a ramp-up. While not a politically-popular story, creation and adoption of green technologies is not happening overnight, and current dynamics during the evolution has resulted in a bout of unexpected demand pulling on not nearly enough petroleum supply.

How is this solved? Being discussed again now in the commodities space is the economic concept of ‘demand destruction’, which implies that exponentially rising prices will eventually reach a point where the buying slows, at least down to a sufficient enough pace to again bring down prices. However, this also means metals, grains, and petroleum aren’t being purchased in the same quantities as prior, which could have the side effect of depressing manufacturing and consumer behavior, and pull down potential economic growth. There appear to be some parallels here to the 1970’s, with Russia playing the role of the Middle East from that time, but the world has evolved to be less energy-intensive to some degree as well. Europe has been taking the brunt of the pain this go-around, as opposed to the U.S., but there are plenty of ramifications globally.

Another policy possibility is temporarily lowering gasoline taxes (specifically in Europe, where these tend to be a high percentage of total cost) and/or implementing temporary price caps, which would be government-subsidized. These wouldn’t control overall global cost, but redirect it toward governments and away from consumers. Gasoline prices tend to take an outsized role in consumer sentiment, and high prices are a very public negative in a mid-term election year.

Have a good week.

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

Sources: FocusPoint Solutions, American Association for Individual Investors (AAII), 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.

The information above has been obtained from sources considered reliable, but no representation is made as to its completeness, accuracy or timeliness. All information and opinions expressed are subject to change without notice. Information provided in this report is not intended to be, and should not be construed as, investment, legal or tax advice; and does not constitute an offer, or a solicitation of any offer, to buy or sell any security, investment or other product. FocusPoint Solutions, Inc. is a registered investment advisor.

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