CBL WEALTH MANAGEMENT
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Market Brief

April 2022

Commentary:

Market Snapshot	
Closing Values as of 04/12/2022	
Dow	34,222
S&P 500	4,397
Nasdaq	13,371
Gold	$1,971

As 2022 began, inflation was already a top-of-mind concern for global investors – and then Russia's invasion of Ukraine added fuel to the fire. Suddenly, one of the world's top commodities producers became the target of punishing sanctions from the West, and an agricultural powerhouse, Ukraine, became a war zone, cutting off its grain exports and putting global food security at risk. Now, as the war continues and sanctions against Russia continue to intensify, more commodities shortages and even higher consumer prices seem like very real prospects.

The economy is still strong...for now

Although the first quarter has presented a number of new challenges (YOY consumer inflation has topped 8.5% and YOY producer prices have increased more than 11%), the U.S. economy is still strong, making the chances of recession in the near-term less likely than many fear. Consumers are in excellent shape and business activity has been robust, both having proven extremely resilient in the face of shortages and rising prices. Households are sitting on $2 trillion in excess savings and personal leverage is the lowest on record. Jobs are plentiful, with millions more job openings than job seekers and new jobless claims at a 53 year low. Wage growth is strong (although, slower than the current rate of inflation) making more income available to more workers. Demand for goods and services remains exceptionally strong. And, even with the cost of borrowing on rise, corporations are spending heavily to replenish inventory and investments in supply chain on-shoring are growing.

But inflation will require aggressive rate hikes from the Fed

Pandemic related demand distortions, supply chain disruptions and pandemic-era Fed policy have played a major role in pushing inflation to 40-year highs. However, more recent events such as the Russia/Ukraine war, commodity & raw material shortages, rising energy costs and an accelerating trend toward de-globalization have added significantly to current inflation and longer term inflation expectations as well.

The Fed was right to take such bold actions amid the pandemic, injecting massive amounts of stimulus to fuel the economic recovery post pandemic. Now, with YOY inflation raging, the time has come for the Fed to take equally bold action to slow economic growth and extinguish what has become a prairie-fire of inflation. To do this, the Fed has indicated it plans to aggressively raise rates in the months ahead and begin reducing its balance sheet by as much as $95 Billion per month starting in May. If the recent movements in the treasury/bond markets are any indication, the Fed is expected to push the Fed Funds rate to 3.5% by summer 2023, with the bulk of that move happening before year end (many Fed members have supported this idea). In any case, the Fed's aggressive tightening (QT) and rapid rate increases will dramatically reduce liquidity and weigh heavily on the pace of economic growth. If the Fed gets it just right, we can have several years of modest growth and inflation will slowly recede. If the Fed tightens too much, too quickly, they could indeed send the economy into recession.

Looking ahead

In a 'normal' economy the rocket-hot jobs market, high level of household savings and businesses borrowing/spending heavily to restock empty shelves and on-shore supply chains would give the Fed a LOT of room to tighten before they risk causing a recession. However, the current economy is anything but typical. Rather than simply dealing with a post-pandemic "hot economy", we find ourselves navigating a flurry of concurrent economic hurdles, including Russia's invasion of Ukraine, lingering supply disruptions from China's efforts to contain a fresh Covid-19 outbreak, soaring inflation and rapidly rising interest rates.

Prices that consumers pay for everyday items surged in March to their highest levels since 1981. Despite marking a new 40 year high the big news in the March CPI report was that core price pressures finally appear to be moderating, increasing at a slower rate in March than in the months prior. The slowing rate of increase in core CPI is seen as a sign that March may mark the peak for inflation. Whether or not we have seen peak inflation or not is yet to be seen (I do not think we have seen peak inflation yet). However, if we are indeed seeing a slowing increase in core CPI it is a very welcome development in the effort to bring down inflation.

Perhaps more frightening than the prospect of even higher inflation, stagflation or a recession brought on by overly aggressive Fed tightening is the idea we may be forced to endure a series of global food and commodity shortages. At the same time we are already dealing with a serious inflation issue, we find ourselves facing enormous supply-side shocks in food, metals, energy and a number of other commodities as a result of the Russia/Ukraine war, supply disruptions in China (due to fresh Covid outbreaks) and several developing environmental/health factors impacting crop & animal production. Even if these supply-side shocks don't result in disturbing inflationary impulses on their own, they could very well lead to dangerous global shortages or widespread humanitarian crises lasting well into 2023 and 2024.

Survive and Advance …Don't try to be a hero in today's environment

Today's environment is VERY fluid and should be expected to evolve as transient pandemic influences, Fed actions and other global influences work their way through the economy. Long term investors should be prepared to balance owning equities as a hedge against persistent inflation with the need to protect their portfolios against slowing growth, potential recession and growing geopolitical risks. This generally means owning stock in quality companies with pricing power and higher cash flow, limiting certain types of bond exposure and/or holding more cash in the portfolio than typical… then regularly evaluating conditions and rebalancing or re-allocating as conditions warrant.