

## Weekly Market Commentary March 14th, 2022

### Will Inflation Lead To Stagflation?

#### What is the impact of inflation on growth?

In the U.S., we see higher inflation having a negative impact on the economy, primarily through lower consumer demand and higher input prices for certain sectors like transportation. The consumer remains the backbone of the economy, accounting for about 70% of U.S. GDP, and now faces a dual-shock, not only from higher food and energy prices but also from higher prices on core goods like automobiles and homes. We could also see negative feedback loops for consumers and corporations broadly from lower stock-market prices and global growth potentially slowing.

However, the good news is that the U.S. economy is in a relative place of strength coming into this crisis. Three areas of resilience to highlight include:

1. The U.S. consumer is in relatively good shape coming into the crisis, supported by healthy financial positions and excess savings of nearly \$2.5 trillion versus where consumers stood before the pandemic. This can help cushion consumers broadly from higher gas and food prices. More recently, we have seen signs that consumers are now reemerging from the pandemic and the fading omicron variant. Measures like retail sales, personal consumption, and jobs data have all surprised to the upside recently.
2. The U.S. is now a net energy exporter, in oil, natural gas, and coal. So higher oil prices, while they may hurt the consumer at the gas pump, also help the U.S. energy producers. This acts as an offset to any potential demand erosion we may see.
3. Economic growth in the U.S. was on track for 3.0% to 4.0% for 2022, well above longer-term trends of 1.5% to 2.0%. Thus, while sustained higher oil prices over \$100 may lead to some decline in demand – perhaps reducing this year's GDP growth figure to under 3.0%– we do not see the U.S. economy falling into recession.

In Europe, however, the economy may face more downside risks, most notably because they are much larger importers of oil and gas from the Russian region (nearly 40% of Europe's natural gas comes from Russia) and have a larger trading partnership with Russia. In addition, while the U.S. consumer benefits from a cushion from the pandemic stimulus, Europe's stimulus packages were smaller in size and scope.

We have also seen this playing out in market performance. European equities are now down about 14% this year, down 6% this month alone. This compares with the S&P 500 down around 12% this year, and down 4% this month. We have also seen credit

spreads, an indicator of potential default stress in the economy, widen much more dramatically in Europe than in the U.S.

### U.S. High-Yield Credit Spreads vs European High-Yield Credit Spreads.

European high-yield spreads have widened more than U.S., indicating more potential distress in European credit markets.

### U.S. High-Yield Credit Spreads vs. European High-Yield Credit Spreads (basis points)



Source: FactSet

This chart displays the increase in credit spreads on the Russian/Ukrainian conflict. European spreads have increased more dramatically than U.S. spreads.

### Will higher inflation impact the Fed's decision?

In our view, the inflationary pressures we are seeing globally will keep the Fed on track for rate hikes, starting at its March 15-16 FOMC meeting. We see the Fed raising rates at the next four to five meetings, likely in 0.25% increments, as well as starting balance-sheet reduction in the second half of this year. If inflation or economic growth starts to slow meaningfully towards year-end, we believe there is scope for the Fed to move at a more gradual pace, which may also be welcomed by markets.

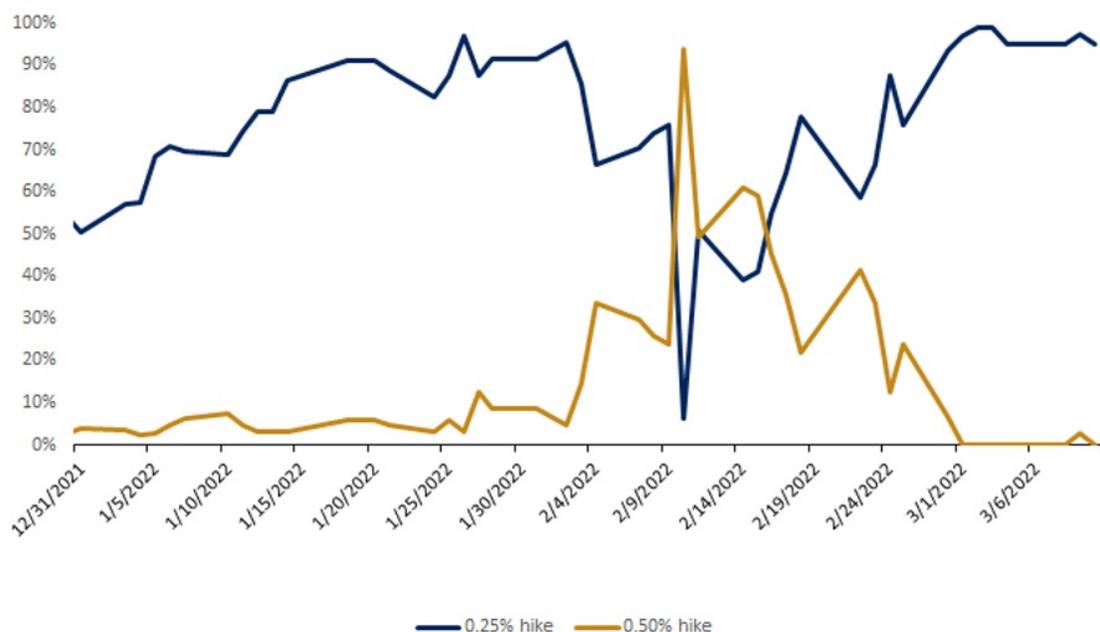
We will also be listening carefully to Jerome Powell's comments around how the Fed views the Russia/Ukraine crisis impacting their decision-making. In our view, the Fed will see this crisis as posing uncertainty and added risk to its outlook, but given the upward pressure to inflation, it will have little choice but to move forward with rate hikes. Perhaps, however, the likelihood of a 0.50% move any time soon is taken off the table, for now.

### Probability of a .25% vs .50% Fed rate hike.

The probability of a 0.50% Fed rate hike in March has fallen to near zero, after spiking higher before the Russia/Ukraine crisis.

## Probability of a 0.25% vs 0.50% Fed rate hike

### March FOMC meeting



(Source: oXYGen & Jones)

## Markets For The Week

INDEX	CLOSE	WEEK
Dow Jones Industrial Average	32,944	-2.00%
S&P 500 Index	4,204	-2.89%
NASDAQ	12,844	-3.52%
MSCI EAFE	2,054	-2.56%
10-yr Treasury Yield	2.00%	14.94%
Gold	\$1,988	.86%
Bonds	\$108.41	-1.71%

Source: Reuters/Wall Street Journal

## Five Items To Buy In March

- Winter Clothes And Coats** - So now that winter is winding down, most of you will be putting away your winter clothes to the back of the closet or boxes in the basement. If you were thinking about getting that cool North Face jacket or some new sweaters for your wardrobe, now would be a great time to look for those purchases as the latest fashions from last year's winter will be getting off the rack soon. You'll also see discounts on things like boots, hats, scarfs, and gloves which can all be excellent purchases. You can even make some early Christmas gift type purchases now in this category and have the surprises ready to go nine months from now.
- Luggage** - Even though spring break is upon many families throughout the

country, this is typically the time when luggage companies decide to roll out the new luggage lines and get the old ones off the shelves. Most of the vacationing is done during the summer, fall, and winter seasons, so if you were thinking about replacing a particular bag or an entire set this would be a great month to make that purchase.

3. **Gas Grills** - In a few months, these will be hotter than the temperature will be outside as everyone likes to get their grilling going from Memorial Day to Labor Day. The wintertime tends to be the best time to make a gas grill purchase even though your overall selection may be somewhat limited until you see the major home improvement stores increase their lines over the next month. If you are considering investing in a new backyard gas grill, this would be a great time to light a fire under your chair.
4. **Video Games** - The absolute worst time to go out and buy new video games is during the holiday season. Video Game makers release all the latest and greatest games to entice us to fill our kids' stockings stuffed with the latest game sensation. However, once everyone makes their returns to the game stores and uses up the Game Stop gift cards, March is a great time to get a markdown on new video games. You can do this at department stores or specialty stores, but you should be able to snag a deal on these now.
5. **Frozen Food** - It seems like we have a month for just about everything in today's day and age. Did you realize that March is National Frozen Food month? You would think that frozen food may be discounted more during something like the wintertime, but this month many frozen food makers offer special coupons.

## Earnings Highlights This Week

**Oracle:** Oracle met expectations for revenue but fell short on earnings for the fiscal third quarter. The database software maker said declines in two investments hurt its income.

**Stitch Fix:** Stitch Fix offered a weak outlook for its fiscal third quarter and slashed its forecast for the full year. In its latest quarter, the company said it experienced challenges with onboarding new customers and converting clients. Stitch Fix reported a per-share loss in line with analysts' estimates and revenue slightly above expectations for the three-month period ended Jan. 29.

**Dick's Sporting Goods:** Dick's Sporting Goods reported fiscal fourth-quarter profits and sales growth that topped analysts' estimates. The company is lapping massive gains from the prior year that were fueled by pandemic purchases of outdoor equipment and fitness accessories. The sporting goods giant offered a better-than-expected forecast for 2022 earnings and same-store sales. Dick's board also approved an 11% increase to its quarterly dividend.

**Lego:** On Tuesday, Lego said its annual revenue jumped 27%, reaching \$55.3 Danish krone, or about \$8.06 billion, up from \$43.7 Danish krone, or around \$6.36 billion, in 2020. Lego was one of the toy companies that saw massive gains during the pandemic, as consumers of all ages gravitated toward its building sets for entertainment. The company touted its diverse selection, which appeals to a wide range of ages, as well as its e-commerce business to account for the sales surge.

## News and Notes

### Is This The Right Time To Buy An Electric Vehicle?

**Is this a knee-jerk reaction that people should get out and buy an electric vehicle?**

- Gas prices hit a record high this week at \$4.32 a gallon (up more than 50% versus one year ago).

- This will cost the average family about \$2,000 a year to their budget if prices sustain at these levels. More if companies like landscapers charge fuel surcharges.
- Car companies are headed in this direction. Cadillac by 2030 and Honda by 2040 are no longer going to sell gas-powered vehicles.

### **Aren't electric vehicles more expensive to buy and maintain?**

- Kelly Blue Book- Average EV price \$62,876
- Average Overall Car Price \$46,404
- Insurance premiums are slightly higher, but not by much, and may be lower as insurance companies get more data.
- One study said EV's cost 3% more to maintain than gas cars, but still too early to say what parts will really cost.

### **Do you see a rise in Electric Vehicles in America?**

- As of now, there is a proposal for a \$12,500 tax credit for EV's, but nothing passed right now. (used to be \$7,500)
- 500,000 more charging stations (infrastructure plan)
- The range for EV's are getting longer (Tesla and Lucid more than 400 miles)
- In the end, a 'tank' of electricity for a Tesla Model Y is \$10.50 vs. average car roughly \$65 right now.

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