At the start of 2022, there were a myriad of catalysts that warranted a watchful eye in relation to their potential negative impact on the economy and markets. These included a rising inflationary environment and the accompanying shift in Fed policy towards increasing interest rates, strained supply chains and disorder in global trade, new COVID variants and lockdowns (or lack thereof) globally and heightened valuations in equity markets. One catalyst that was not accounted for: war. What was already shaping up to be a challenging investing environment has been completely upended by Russia's invasion of Ukraine on February 24th.

Putin's unprovoked, brash and senseless actions have injected much uncertainty into not only the markets, but to the greater global order. Russia's actions have further exposed the schism between Western democracies and those countries that operate either under the guise of democracy or outright authoritarian rule. While the resolve of NATO and other like-minded nations is a bright spot in the conflict, the lasting impacts on global trade and economic cooperation, remain to be seen. Already inflated prices and strained supply chains have been further disrupted, as Russia is a major player in the energy, metals and food markets, the impacts of which will certainly persist into the foreseeable future.

The stock market has not been immune to the volatility created by an international conflict, with the S&P down nearly 12% at its nadir in March, only to rebound and close out the first quarter with a -4.6% return. As much as the war in Ukraine has impacted sentiment, made headlines and unsettled markets, the main driver remains the inflation picture, the Fed's response and higher interest rates. The first quarter saw an unprecedented rise in inflation, as the CPI increased 8.5%, year-over-year in March, the largest such increase in 40 years. Consequently, statements from the Fed have become increasingly hawkish; the Treasury market began the year pricing in roughly three rate hikes totaling 0.75% and ended the quarter indicating 2% of rate increases. The yield on the 10-year Treasury sits at 2.7%, up over 1% from the end of 2021 and even more drastically the 2-year Note has risen 1.6%, to yield 2.37%. The magnitude of these moves has been shocking, especially considering the fact that we've been living in a world of falling interest rates for nearly 40 years.

However, despite these eye-popping moves, there are now signs that inflation may have peaked in March. While the year-over-year CPI readings have shown no signs of slowing, the underlying rate of change has started to decrease and there are indications that consumers are starting to feel the pinch of higher prices and adjust their spending accordingly. Mortgage rates are over 5% for the first time since 2011 and while the housing market contends with other structural forces and externalities, eventually rising rates will cool the sharp run-up in prices seen since the beginning of the pandemic. As we view it, the principal risk to the market is now an overshoot by the Fed. Their goal is a so-called 'soft landing,' where rising rates serve to temper an inflationary environment, but stop short of causing a near-to-medium-term recession, a veritable threading of the needle.

Nonetheless, there is cause for optimism, as the employment picture remains robust, with both hiring and wages increasing. Similarly, household balance sheets are healthy and while consumers may cut back on spending in some categories due to inflation, expenditure growth will persist. Supply chains will remain pressured, as the world grapples with lingering COVID impacts and the war in Ukraine and the commodities markets will also continue to experience disruption, yet we expect visibility will come with time. Given that the equity markets have already been in correction territory, are trading well off of their 2021 highs and consensus earnings estimates have actually increased since the beginning of the year, we feel it reasonable to believe that things will stabilize, albeit with heightened volatility.

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Our focus remains on quality, industry-leading domestic companies, with healthy balance sheets and pricing power, who are able to somewhat insulate themselves from external constraints and generate cash throughout market cycles. Rising interest rates have, for the first time in several years, finally yielded attractive prospects in the fixed income space and we may look to shift some of our holdings to take advantage of those opportunities. While this certainly seems like a scary, unsettled time, rest assured that we are tirelessly working to navigate the uncertainty and remain committed to providing stability and value throughout. As always, we are here to help in any way possible and look forward to hearing from you!

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