Daniel Wildermuth's
MARKETCOMMENTARY

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# Economy Slowing, Inflation Persistent, and the War Continues

April was an awful month for most global equity markets. A drop of 3.63% on the last trading day of the month delivered an 8.8% loss in April and the S&P 500's worst April since 1970. The month's drop added to the previous year's losses leaving the S&P 500 down 13.3% with its worst January through April performance since 1939. Primary drivers appear to be the Fed's announcements of coming interest rate increases, another increase in inflation and the war in the Ukraine.

The U.S. economy contracted at a 1.4% annualized rate, and the U.S. Commerce Department announced consumer spending fell 0.4% in February from January after adjusting for inflation. Real spending has dropped in three of the last four months.

Decreased household purchasing power is likely contributing to the slowdown. Average hourly wages rose 5.6% in March from a year earlier, but that's still below the 8.5% jump in the Consumer Price Index according to the Labor Department. The University of Michigan's sentiment survey also revealed a 30% plunge in confidence in the last year.

Surveys of purchasing managers in major economies – Germany, U.S., and U.K. – also all reporting slower growth. Higher costs and supply chain interruptions were cited as major reasons. The International Monetary Fund (IMF) also reported that the global economic recovery will "slow significantly" this year due to the Russian invasion of Ukraine. The IMF projected growth at 3.6% for the next two years, down from previous projections of 4.4% and 3.8% for 2022 and 2023.

Back in the U.S., the lack of ongoing fiscal stimulus will likely continue to impact growth. After raising consumer purchasing power through 2020 and 2021, the lack of fiscal stimulus in 2022 will subtract 2.1% during first quarter according to the Hutchins Center on Fiscal and Monetary Policy, a think tank affiliated with the Brookings Institution. Inflation is likely a direct result of the unprecedented increase in the money

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supply, M2, which increased more than 40% since February 2020.

In reaction to elevated inflation, the Federal Reserve has embarked on its campaign to tighten monetary policy by raising interest rates. The Federal Reserve is setting out to do something it has never accomplished before: reduce inflation dramatically without significantly increasing unemployment.

The inversion in the Treasury market's yield curve, with rates on 2-year notes exceeding those on 10-year notes, posted an ominous sign given an inverted yield curve's history of preceding recessions. The inversion suggests the bond market believes that the Fed projections of raising short-term rates to 3% will not be enough. Even Fed Chairman Jerome Powel noted that "…very little is straightforward in the current context." Not surprisingly, various economists are predicting a recession or raising its likelihood.

Good news still exists in various parts of the economy, but it's getting harder to find. Recent market losses suggest that investors have grown a bit more nervous about future earnings, particularly at today's valuations that remain high by historical standards. Investors should likely brace for ongoing volatility. Given our long-term investing discipline, we still believe there is value to be found in the markets. We will continue to follow our fundamental approach to capitalize on good values in the market.




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