Daniel Wildermuth's
MARKET COMMENTARY

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Market Recovers, but Headwinds Growing

After reacting quite negatively at first to the war in the Ukraine, the market has stabilized and recovered much of its lost ground. Despite an end-of-the-month pullback, March has rewarded investors with growth of over 3% leaving the S&P 500 down less than 5% on the year. This performance is good considering the market's rich valuations and the eruption of the most significant conflict since WWII. Over the last six months, the market remains solid in positive territory, with the S&P 500 up over 5%.

As the year progresses, the war will deservedly garner many headlines, but the underlying economic fundamentals will continue to drive stock prices. While much continues to go well, particularly in the U.S. economy, headwinds seem to be growing, and pressures from the Fed and lack of new government money could be enough to cause a bigger correction.

Inflation is a problem that is not going away. January and February's consumer-price index headline numbers both were higher than anticipated coming it at 7.5% and 7.9%—both four-decade highs. These numbers were notched before Russia invaded the Ukraine.

"Russia's equity stock market has been quickly crushed, dropping over 55% in less than two weeks"

Disruption to global supply chains will worsen, at least in the short-term. The Fed is finally admitting that it let inflation run free for too long and raised its inflation forecast to 4.3%, a big adjustment up from its earlier projections of 2.6% made only three months ago.

More than half of the Federal Open Markets Committee (FOMC) members expect a rate hike of at least 75 bps (0.75%) by the end of 2022. Projections are for the short-term rate to hit 1.9% this year and 2.8% by the end of 2023, up from the near zero level it's been stuck at for two years. The Fed also downgraded its median forecast for economic GDP growth this year to 2.8% from 4% in December.

More concerning is the long-term inflation outlook. U.K. central banker Charles Goodhart predicted in early 2020 that inflation would hit between 5% and 10% in 2021. He reasoned that a long glut of inexpensive labor that had kept prices and wages down for decades would give way to an era of worker shortages. The 85-year-old economist predicted that inflation in advanced economies will settle at 3% to 4% around the end of 2022 and remain at that level for decades, compared with about 1.5% in the decade before the pandemic.

Another headwind is the lack of continued government stimulus. Between April 2020 and March 2021 congress gave low- and middle-income adults $3,200 each plus $2,500 per dependent to cope with the pandemic. Many instead used their payments to play the stock market, according to Harvard Business School and New York University economists. Robinhood, the no-commission fee firm popular with many new traders, agrees. "We might be negatively impacted as the pandemic wanes, stimulus is phased out, and customers spend less time at home," the company warned in its fourth-quarter earnings report.

Continued……

Market Commentary by Daniel Wildermuth
11525 Park Woods Circle | Alpharetta, GA 30005 | Ph. 678/506-3200 | www.AsteriaWealth.com

Its active monthly users declined by nearly 20% between last June and December.

Good news remains, but the potential problems for markets appear to be growing, and we now face the uncertainty of a war and its impact on various elements of the global economy.

Domestic equities are relatively well insulated from the Ukraine/ Russia conflict versus international developed and emerging markets. We continue to monitor the investment environment on both macro and micro perspectives, seeking out opportunities with compelling return/risk dynamics.