GENERAL ECONOMY

- The improving evolution of COVID hospitalizations and morbidity took a back seat in February, following the Russian invasion of Ukraine. Western countries were unified in their condemnation and repudiation of Russia's actions, as they implemented what can best be described as an economic blockade. Russian banks have been disconnected from the SWIFT international payment system, their exports are being shunned, and imports of critical technology cut off. Additionally, Western companies are unilaterally stopping operations in Russia. The net impact of these actions has been devastating to the Russian economy and financial markets and will have ripple effects throughout the world.

- Despite being a modest contributor to global economic growth, Russia and Ukraine have an outsized role in global commodity exports. Russia is Europe's largest supplier of natural gas, supplying roughly 40% of the continent's natural gas supply, and it produces roughly 10 million barrels a day of crude oil, which is equivalent to about 10% of global demand. The region is also a significant exporter of precious metals, industrial metals, and agricultural products.

- Escalating prices for energy, grain, and metal commodities will likely cut into discretionary spending for consumers, but the U.S. consumer base is bolstered by a strong employment backdrop, healthy personal balance sheets, and rapidly improving Covid case trends to offset some of the pressure. In February, the U.S. job market once again outpaced expectations adding 678k new payrolls to the economy compared to expectations for just 400k net new jobs. The unemployment rate fell to just 3.8%.

STOCK MARKET

- Volatility has remerged in equity markets in 2022 due to economic fallout from the Russia-Ukraine conflict and a pivot in policy from central banks towards tightening financial conditions. We anticipate that volatility will remain elevated near-term and that U.S. stock returns will be more modest over the next few years as economic growth cools and valuations come in from extended levels. However, equity returns still maintain a higher probability of providing a positive return net of inflation than cash and fixed income over longer term horizons.

- We remain overweight to U.S. equities over international markets. U.S. markets, while not immune, face lower direct economic risk from the Ukraine-Russia conflict than Europe and the U.S. dollar is seen as a safe haven currency that outperforms in risk-off periods.

- While the macro outlook remains cloudy, broad market volatility provides growing opportunity at the individual company level where investors can gain greater clarity and conviction on earnings prospects and valuation. We seek companies that are leveraged to major secular tailwinds but that also demonstrate strong existing profitability, consistent cash flow, and solid balance sheets. In an environment of cooling growth, elevated inflation, and tightening financial conditions, we prefer defensive companies with pricing power and strong and growing dividends.

BOND MARKET

- With inflation accelerating to 7.5% in February, the Fed is widely expected to begin hiking rates at their March meeting. The futures market has now priced in 6 to 7 hikes, in 25 basis point increments.

- The conflict in Ukraine has caused some risk metrics to begin to rise. We will be paying particular attention to the evolution of credit spreads and the shape of the yield curve, which has been flattening since the conflict began.

- The Federal Reserve will continue to use all tools necessary to keep U.S. economic activity expanding and credit markets functioning. High debt levels of corporate and government issuers (especially in China), recent elevated inflation, lingering banking troubles and extreme monetary policies all demand caution in the global bond markets.