Stocks ramp, the Fed clamps, war persists in rival camps.

That should take down this pesky little weed…

After a slow start, stocks raced higher in March as investors reacted positively to more visibility on interest rates, inflation, and war-time restrictions. The S&P 500 gained over 4% in March which helped ease the magnitude of the large cap index's first quarterly loss in 2 years (-4.9%).

The growth-oriented tech heavy Nasdaq index fared almost twice as worse during the first quarter (down 7.6%) but led the rally back in March with a nearly 6% gain. Value stocks, led by enormous gains in Energy (+40%), were the only investment style to survive the first quarter with positive returns.

Interestingly, there weren't many positive developments in the month of March. The two-week 8% rally to end the quarter is likely best explained as investors being happy that bad situations didn't further develop into horrible situations. The Russia-Ukraine war is no closer to being resolved than it was in February, but all economic doomsday scenarios have been widely discussed and planned for. The Fed announced a rate hike but it was the well telegraphed 0.25% hike and not a shocking 50 basis point or more rise that may have spooked investors. There are new Omicron variants but lower hospitilization and death rates. All in all, investors were happy to get a much needed reprieve from worsening developments.

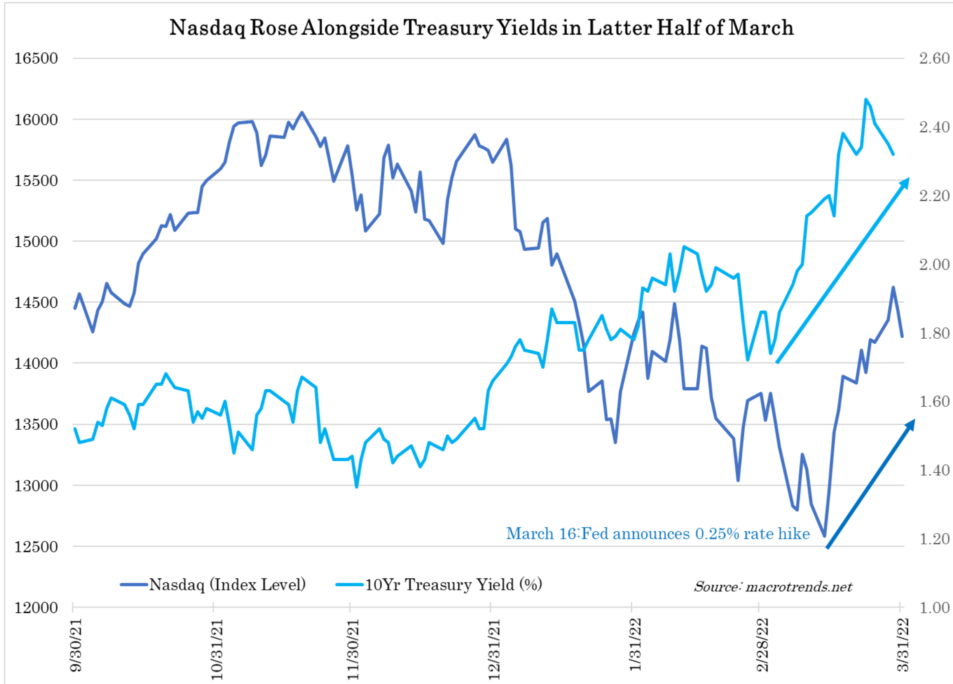
Rate liftoff spikes yields AND growth stocks.

Surprising no one, the Fed announced a 25 basis point increase in the benchmark federal funds rate. In doing so, Fed Chair Powell signalled (and verbally reiterated) that inflation is squarely at a level that needs to be addressed with increasingly restrictive monetary policy. These declarations of surging inflation were backed up by February CPI readings showing the highest annualized growth rate in 40 years.

As expected, the 10 year treasury yield spiked as high as 2.50% on news of the rate liftoff. Contrary to the normal pattern of yield spikes corresponding with retreats in growth stocks, the Nasdaq Composite gained roughly 6% post-announcement. Increased investor risk appetite may have been an attempt to capitalize on oversold conditions after a 10-week 25% decline in the Nasdaq to start the year.

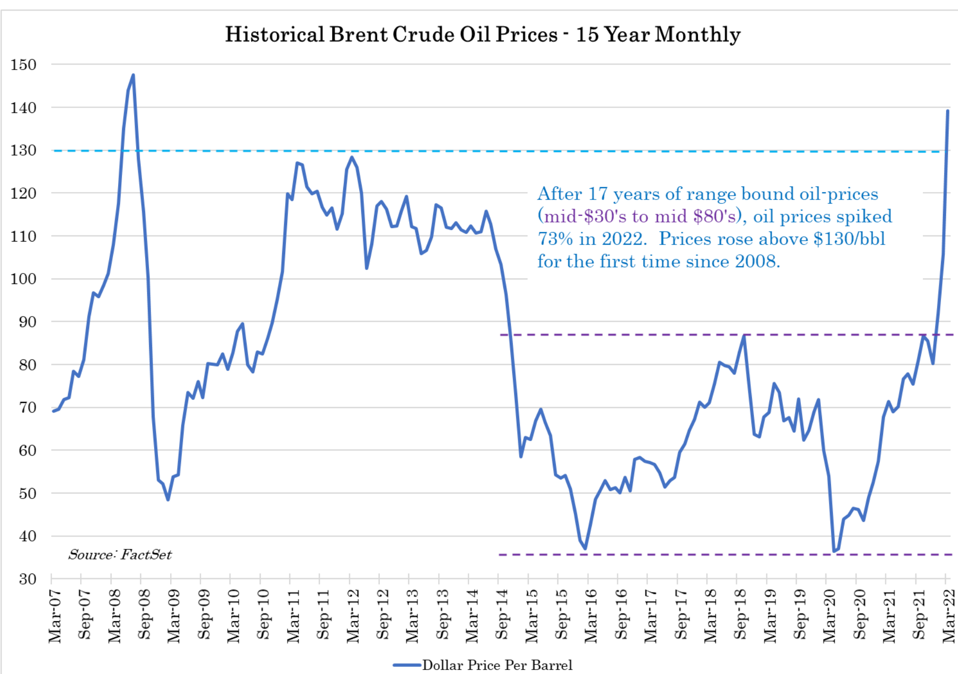
Raging war and commodities:

The first two weeks of March were dominated by war headlines.



Ukranian troops have provided formidable resistance to Russian attempts to capture major cities which has unfortunately led to an increasing intensity of Russian attacks. Global spectators, led by the US, are pushing for the countries to pursue a quick resolution while simultaneously increasing the magnitude and severity of economic sanctions.

The major knock-on effect of the war has been the exacerbation of inflationary pressures caused by sharp increases in commodity prices. Oil prices in particular eclipsed $130/barrel for the first time since 2008 while prices of important Russian-Ukranian exports such as wheat, corn, and fertilizer also spiked. Corporate entities raced to shun Russian exports and customers but have already begun signalling that expected supply chain issues and reduced sales will pressure near-term earnings growth.



Outlook: Runway is Receding

Buying the dips has been a much more comfortable endeavor in an environment of low inflation and accomodative monetary policy. When the opposite of these scenarios occur, recessions tend to stop by for a visit.

Recent developments (brief 2-10 year yield curve inversion, falling manufacturing indices, inflation flare ups) have momentarily suggested that recession is a real possibility. However, history has shown that the beginning of restrictive monetary policy (widely believed to lead to recessions) is positive for markets. Additionally, April is a consistently strong month for the markets. April has been positive in 14 of the last 15 years with a (pandemic-skewed) average gain of 3.2%. Short-term investors still have decent odds but mid to long-term gains will be determined by how well inflation-induced recession is fended off by the Fed.