QUARTERLY INSIGHTS
Looking Back at Q1 2022 and Ahead to the Next

We saw a bit of a bounce in stock markets in March, but not enough to recover from a terrible first quarter. For the month of March, US markets were up between 2-4%, and developed markets managed to squeak out a small gain, but everything else was down 1-3%. For the quarter, everything was down, between 3-8%, with blue chip companies doing the best and tech stocks getting hit the hardest.

Looking Back

Inflation. There were two reasons behind the markets' poor performance in the first quarter. First, the continuing strength of the economy, along with the lingering supply chain problems, pushed inflation to a 40 year high. This forced the Federal Reserve to raise interest rates for the first time since the start of the pandemic. That increase, and the fear of more, drove interest rates higher around the world, shaking financial markets.

Ukraine War. Second, of course, was the Russian invasion of Ukraine. This unsettled markets and created the prospect of energy and food shortages, generating even more uncertainty around the global economy. It was a hard start to the year for markets.

Jobs and Spending Growth. Despite that hard start, things in the US kept improving. Covid cases ended the quarter at the lowest level since last summer. Hiring was extremely strong, which supported current consumer confidence and spending growth as well as business investment and confidence. By the end of the quarter, both medical and economic standpoints were much better than they had been at the start. After pricing in the expected interest rate increases, as well as the emerging risks from the Russian invasion, markets started bouncing back in March.

Looking Ahead

Continued Recovery. The question is whether that improvement will continue into the second quarter. On the whole, it looks like it will. On the medical side, progress has slowed, and we may face the prospect of another wave. But the economy has proven to be robust through prior waves. With current high levels of immunity, any damage should be limited, and not derail the recovery.

Economic Growth. On the economic side, we have seen little or no direct damage from the Ukraine war in the data. Even future damage, such as energy or food shortages, is likely to be limited as much of the price effects are already showing up. In other words, while real risks

remain for the economy, much of the damage looks likely to be limited. The next quarter should see continued economic growth, even if we do see another wave of the pandemic.

Strong Markets. The markets are also sending this message of continued growth. Now that markets are expecting multiple hikes, it has already been priced in – and markets can react to better economic and earnings news. Similarly, uncertainty about the Ukraine war spiked in March, but many of the worst possibilities failed to materialize – leaving the potential for upside ahead. The big picture is that the first quarter priced in several risks – Covid, inflation, and continued supply chain issues. For the upcoming quarter, those risks are now part of the picture, rather than a shock. And with a solid base, the fact that companies are proving they can operate and make money under these conditions is a green light for progress as we move into the second quarter.

Headlines. That's not to say nothing bad can happen. Covid could surge again, the Ukraine war could expand, hiring could slow substantially, and if/when those bad things happen, we will likely see more market volatility. As always, the headlines will drive much of market performance in the short term – as we saw in the past quarter. But as we also saw, despite the headlines, the fundamentals will drive both the economy and the markets. And the fundamentals are likely to remain strong over the second quarter.

The Bottom Line

Looking back, the first quarter was a difficult one for markets, driven primarily by expected rate hikes, which were caused by a strong economy. Looking forward, that strength is likely to continue. While we have seen substantial volatility – and may see more – it has provided a good foundation going forward. With a solid medical and economic base, the prospects show the second quarter will be better for markets than the first.

Sincerely,

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