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Amadeus Wealth Alternatives
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In this week's recap: Ukrainian War impacts global economy.

Weekly Economic Update

Presented by Ed Papier, March 14, 2022

THE WEEK ON WALL STREET

Intensifying hostilities in Ukraine continued to unsettle markets, as investors grappled with the war's impact on the global economies.

The Dow Jones Industrial Average lost 1.99%, while the Standard & Poor's 500 dropped 2.88%. The Nasdaq Composite index fell 3.53% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, gained 0.90%.[1,2,3]

MARKETS REMAIN STRESSED

Markets gyrated last week as Russia escalated its attacks on Ukraine, the U.S. banned imports of Russian oil, and more companies announced the suspension of business in Russia. Eastern Europe has added complexity to the Fed's plans for raising interest rates to manage accelerating inflation, which has been exacerbated by a sharp rise in energy and other commodity prices.

The stock market saw brief moments of respite. Stocks rallied Tuesday on a news report that Ukraine would promise not to pursue NATO membership, but lost momentum before the close. Stocks rallied on Wednesday as oil prices tumbled, but were unable to follow-through on Thursday and then faded further into Friday's close.

A FOUR-DECADE HIGH

Consumer prices rose 0.8% in February as energy and commodity prices pushed higher. This latest monthly report showed a year-over-year inflation rate of 7.9%, the highest level since January 1982. Excluding the more volatile food and energy prices, the 12-month increase was 6.4%, a slight bump from last month's 6.0% year-over-year increase.[4]

Many economists hoped that inflation pressures would ease, but February's inflation number suggested that the impact of sanctions and supply-chain disruptions due to the invasion of Ukraine may likely feed further price increases for the foreseeable future.

THE WEEK AHEAD: KEY ECONOMIC DATA

Tuesday: Producer Price Index.

Wednesday: Retail Sales. Federal Open Market Committee (FOMC) Announcement.

Thursday: Housing Starts. Jobless Claims. Industrial Production.

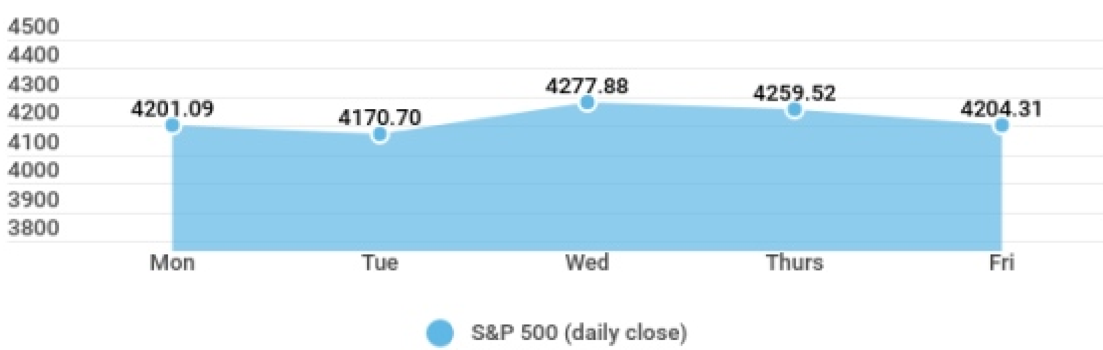
Friday: Existing Home Sales. Index of Leading Economic Indicators.

QUOTE OF THE WEEK

*People will do anything, no matter how absurd,
in order to avoid facing their own souls. One does not become enlightened by imagining figures of light, but by making the darkness conscious."*

CARL JUNG

Market Index	Close	Week	Y-T-D
DJIA	32,944.19	-1.99%	-9.34%
NASDAQ	12,843.81	-3.53%	-17.90%
MSCI-EAFE	2,053.78	+0.90%	-12.08%
S&P 500	4,204.31	-2.88%	-11.79%



	Treasury	Close	Week	Y-T-D

Treasury	Close	Week	Y-T-D
10-Year Note	2.00%	+0.25%	+0.48%

Sources: The Wall Street Journal, March 11, 2022; Treasury.gov, March 11, 2022
Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, March 4, to Friday, March 11, close. Weekly performance for the MSCI-EAFE is measured from Friday, March 4, open to Thursday, March 10, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

A few weeks ago, there was still a reasonable debate about whether US inflation would soon begin to peak. Whatever the merits of the argument, it's been obliterated by the economic blowback from the war in Ukraine.

The central bank is now facing stark choices on monetary policy that can only be described as choosing from the lesser of bad options as a perfect storm of macro conditions triggered by the Ukraine war spreads across the globe.

Some of the Fed's predicament is tied to leaving monetary policy too loose for too long and assuming that the recent rise in inflation would be "transitory." There are signs that the supply-chain disruption is easing, which was/remains responsible for a significant chunk of the sharp increase in pricing pressure to date. As recently as mid-February that narrative had traction. But it's mostly a moot point now as a war-related energy shock drives up inflation.

Recent news that US consumer inflation continued to increase in February is especially worrisome because the ongoing acceleration does not yet reflect the Ukraine effect. Headline CPI rose 7.9% on a year-over-year basis through last month, a new 40-year high.

The challenge for Fed policy is easily summarized by comparing current interest rates to inflation. Even before the Ukraine shock is fully absorbed into prices, the Fed is far behind the curve with a 0%-to-0.25% target rate. Using core CPI for reference, the Fed funds rate is roughly 6 percentage points below inflation. That's a dramatic undershoot, and one that's almost certain to widen in the near term as the Ukraine-related supply shock ripples through the global economy.

The Treasury market is dramatically underpricing inflation. There are several ways to interpret this, starting with the view that the market will be under strong pressure to raise yields (i.e., cut bond prices sharply).

Deciding when the forces of disinflation will become dominant again has become unusually challenging since Russia's invasion of Ukraine. Several major macro forces are now under severe stress, including globalization and energy supply. The uncertainty of war makes forecasting the return of something approximating "normal" macro conditions highly unclear at the moment. Accordingly, markets will likely require a bigger discount for this surge in uncertainty - i.e., higher yields in the Treasury market.

In fact, there are several facets to the uncertainty. On one hand, there's a strong case for tighter Fed policy to deal with surging inflation. But the shockwave of higher energy prices raises the risk that economic growth will slow, perhaps sharply, to the point of tipping the economy into recession. On that basis, the Fed may decide to slow and/or delay rate hikes.

Adjusting the calculus of what's likely and what's not will, until further notice, be a game of reassessing risk factors hour by hour and day by day as the Ukraine war unfolds. Since no one knows how the conflict will evolve, or how the global repercussions will manifest, adjusting Fed policy has rarely been more difficult or prone to error. It may be too extreme that the central bank is flying blind, but as relevant metaphors go, that's pretty close. The risk of a policy mistake, in sum, is high. Unfortunately, so are the economic stakes, perhaps for years to come.[5]

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The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the NASDAQ stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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CITATIONS:

1. The Wall Street Journal, March 11, 2022
2. The Wall Street Journal, March 11, 2022
3. The Wall Street Journal, March 11, 2022
4. The Wall Street Journal, March 10, 2022
5. seekingalpha.com/article/4495067-fed-policy-is-wedged-between-rock-and-hard-place