ECONOMIC & INVESTMENT PERSPECTIVES

FEBRUARY: GLOBAL EQUITY CORRECTION
GEOPOLITICAL IMPACT ON MARKETS

Figure 1: 2/28/2022 Returns (source: Bloomberg)
Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Month	YTD	1YR	vs. 52-wk High	vs. 52-wk Low
US Aggregate Fixed Income	AGG	-1.1%	-3.1%	-2.6%	-5.5%	1.2%
Investment Grade Corp Bonds	LQD	-2.1%	-5.6%	-3.5%	-8.8%	2.1%
U.S. Treasury Bonds	GOVT	-0.8%	-3.4%	-2.2%	-4.8%	1.4%
20+ Year Treasury Bonds	TLT	-1.6%	-5.5%	-0.7%	-9.8%	5.0%
Muni Bonds	MUB	-0.5%	-2.9%	-0.7%	-4.5%	0.5%
High Yield	HYG	-0.9%	-3.5%	0.8%	-5.1%	2.2%
Non-US Corp Bonds	IBND	-1.9%	-4.8%	-10.4%	-14.5%	1.9%
Emerging Markets Bond LC	EMLC	-4.9%	-4.5%	-10.0%	-15.6%	1.5%
Global Equity						
ACWI Global Equity	ACWI	-3.1%	-7.5%	7.7%	-8.9%	7.9%
United States	VTI	-2.5%	-8.4%	12.0%	-9.4%	13.9%
International Developed	EFA	-3.4%	-6.9%	2.3%	-11.0%	3.2%
Emerging Markets	EEM	-4.3%	-4.3%	-11.3%	-16.8%	3.8%
Global Equity by Region						
United States	VTI	-2.5%	-8.4%	12.0%	-9.4%	13.9%
Europe	IEUR	-5.2%	-8.5%	4.8%	-11.5%	3.5%
Asia ex-Japan	AAXJ	-3.7%	-4.9%	-15.1%	-19.3%	3.7%
China	MCHI	-6.4%	-6.6%	-32.1%	-34.8%	3.5%
Japan	BBJP	-1.6%	-5.7%	-5.6%	-16.1%	3.6%
Latin America	ILF	5.6%	14.7%	9.7%	-17.3%	19.2%
US Equity						
US S&P 500	IVV	-2.9%	-8.0%	16.4%	-9.0%	17.5%
NASDAQ 100 QQQ	QQQ	-4.5%	-12.8%	10.9%	-15.1%	16.6%
US Large Growth	IWF	-4.2%	-12.5%	12.4%	-14.3%	17.9%
US Large Value	IWD	-1.2%	-3.5%	14.8%	-5.5%	13.8%
US Eqwt S&P 500	RSP	-0.9%	-5.2%	16.6%	-6.5%	16.9%
US Mid Cap	IJH	1.2%	-6.1%	8.0%	-9.0%	10.5%
US Small Cap	VTWO	1.1%	-8.8%	-5.9%	-17.1%	8.0%

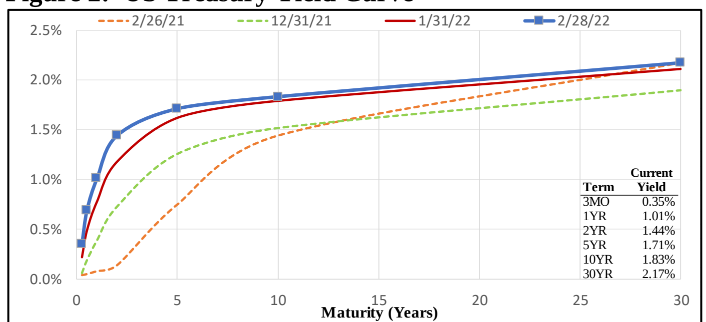
Stocks continued to fall in February in reaction to Russia's invasion of Ukraine. Commodity prices jumped on fears of trade and supply disruptions (oil, metals, agriculture) and a flight to safety (gold and silver). Oil spiked to nearly $100 per barrel, worsening inflation pressures as the Fed prepares to raise rates. Performance highlights for the month and year-to-date (YTD) are below.

- Bonds: The U.S. Aggregate index (AGG) fell 1.1% (-3.1% YTD) as interest rates rose. Corporate bonds (LQD) were down 2.1% (-5.6% YTD), and high yield bonds (HYG) fell 0.9% (-3.5% YTD) as credit spreads widened. Emerging market credit (EMLC) lost 4.9% for the month (-4.5% YTD).
- Global equity (ACWI): -3.1% in February (-7.5% YTD).
- U.S. Equity: Stocks spent most of the month in correction territory (down >10% from highs). The broad market (VTI) ended February down 2.5% (-8.4% YTD), while the S&P 500 (IVV) lost 2.9% (-8.0% YTD). Large, growth-oriented stocks (QQQ and IWF) continued to fall with rising interest rates, but small caps gained 1.1% (-8.8% YTD). Energy stocks (XLE) rose 7.1% and are now up 27.2% YTD with spiking oil prices.
- Non-U.S. Equity: Developed markets (EFA) fell 3.4% (-6.9% YTD), led lower by Europe (IEUR -5.2%, -8.5% YTD) as energy disruptions raised recession concerns. Emerging markets (EEM) fell 4.3% (-4.3% YTD) despite gains in Latin America (ILF +5.6%, +14.7% YTD). Russian stocks fell over 50%.

Interest Rates and the Economy

The US yield curve (Figure 2) plots the yields (Y-axis) for various maturities (X-axis) of U.S. Treasuries. Yields rose across the board in February as the Fed prepares to raise interest rates to combat inflation. The yield curve remains flat at longer maturities, likely signaling longer-term growth concerns as the Fed removes accommodative policy measures. The benchmark 10-year bond yield rose above 2.0% before ending the month at 1.83%.

Figure 2: US Treasury Yield Curve

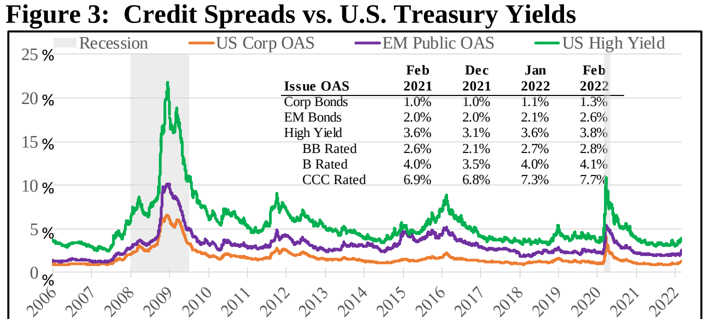


Source: Board of Governors of the Federal Reserve System via FRED

For bonds other than U.S. Treasuries, we track the option-adjusted yield spread (OAS) versus Treasuries of comparable maturities. Low or narrowing spreads signal optimism while high or rising spreads signal fear. Spreads widened this month, reflecting the risk-averse tone of equities amid rising geopolitical tensions.

- Investment grade corporate bond spreads rose to 1.3% this month after remaining remarkably stable for the past year.
- High yield (non-investment grade) spreads widened to +3.8% this month, up from 3.1% at 2021 year-end and +3.6% one year ago. The riskiest bonds (rated CCC & below) rose slightly to +7.7% over Treasuries; this "junk bond" segment has a disproportionately high exposure to energy-related credit.
- Emerging market bond spreads widened to +2.6% with geopolitical tensions after remaining stable around +2.0% for the past year. Non-U.S. bonds have under-performed U.S. bonds due to rising spreads and the strength of the dollar in the past year.

Figure 3: Credit Spreads vs. U.S. Treasury Yields



Source: Ice Data Indices, LLC via FRED

Geopolitics and Financial Markets

The world finds itself in the midst of the most serious geopolitical conflict in recent memory. First and most importantly, our hearts and thoughts are filled with concern and hope for the safety and security of the Ukrainian people as their country is invaded by Russian forces. Secondarily, the crisis brings uncertainty to global financial markets as the conflict exacerbates global trade and supply disruptions, especially of oil. Figure 4 plots the price of oil per barrel, which has now breached $100, a level not seen since 2014. With inflation already running at elevated levels (CPI for January was +7.5% year-over-year) largely due to spiking commodity prices, increasing global supply disruptions and ever-rising energy prices could cause the inflationary cycle to persist.

Figure 4: Oil Prices (WTI $/barrel)

source: U.S. Energy Information Administration via FRED

While it is not our intent to in any way trivialize the growing crisis in Ukraine, it is important to take a step back and view it through the lens of history. Figure 5 at the bottom of this page shows the growth of the S&P 500 over the last 50+ years, with annotations of some of the most serious geopolitical conflicts when they occurred. Several observations are striking. First, it is startling to see just how many significant conflicts have taken place over the time period. Second, the powerful rise of the stock market has continued almost unabated through them all. Sooner or later, the trend may be broken, but the lesson of history is that developed financial markets weather the storm over time.

Given the uncertainty of Russia's intentions regarding the goals and scale of their military aggression, it is difficult, if not impossible, to predict when and how the crisis will be resolved or its ultimate impact on the global economy (and stability). But, again, history can offer insight into how the market has performed in and around other crises. Figure 6 contains a list of the geopolitical conflicts back to WW II, their dates, and the performance of the S&P 500 over various time periods (1-12 months).

Figure 6: Geopolitical Events and S&P 500 Performance
(source: Strategas Securities, LLC)

		S&P 500 Returns After Event			
Date	**Geopolitical Event**	**+1Mo**	**+3Mos**	**+6Mos**	**+12Mos**
12/7/1941	Pearl Harbor	-1.0%	-10.2%	-7.2%	7.3%
10/31/1956	Suez Canal Crisis	-1.1%	-1.0%	2.2%	-6.4%
10/20/1962	Cuban Missile Crisis	8.7%	18.4%	26.7%	36.3%
10/17/1973	Arab Oil Embargo	-5.3%	-10.7%	-12.6%	-32.6%
11/3/1979	Iranian Hostage Crisis	3.7%	13.8%	5.9%	32.8%
12/25/1979	USSR Invades Afghanistan	6.0%	-6.7%	11.5%	33.1%
8/3/1990	Iraq Invades Kuwait	-6.1%	-8.7%	1.3%	16.2%
1/17/1991	First Gulf War	12.9%	20.0%	18.1%	31.8%
8/17/1991	Gorbachev Coup	0.3%	0.0%	8.6%	12.5%
2/26/1993	World Trade Center Bombing	1.2%	3.0%	5.5%	8.1%
9/11/2001	9/11	0.6%	4.4%	7.7%	-15.5%
3/20/2003	Second Gulf War	2.2%	14.2%	19.3%	28.9%
2/20/2014	Russia Annexation of Crimea	1.9%	2.3%	9.1%	17.1%
	Average	**1.9%**	**3.0%**	**7.4%**	**13.0%**

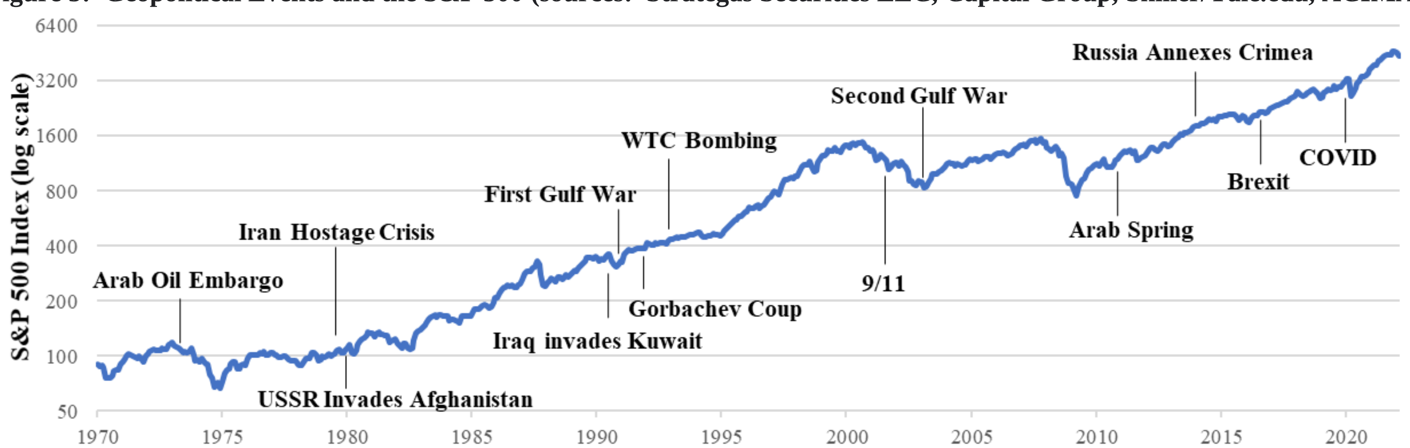
Again, it is startling to realize just how many wars and threats of war there have been. But markets have been resilient in almost every case. On average, the return of the S&P 500 has been +13% one year after such events. Eight of the 13 events were followed by double-digit gains over the next 12 months. Only three of them resulted in negative stock market returns over the ensuing 12 months; those events (marked in gray in Figure 6 above) were the only ones that led to or contributed to economic recessions.

Bottom Line

As we watch the humanitarian crisis unfold in eastern Europe, our hearts go out to the Ukrainian people. Global markets are rightly concerned with the spiraling sequence of events, but history shows us that markets are resilient over time. The key concern, beyond the safety of the Ukrainian people, is whether or not this conflict causes a global and/or U.S. recession. With inflation running hot, the markets were already spooked by the potential for tighter monetary policy (rising interest rates, less accommodative policy) in the U.S. and around the world. The conflict has caused commodity prices to rise further, exacerbating inflation, but this kind of inflation cannot be controlled through Fed policy. Rising energy prices threaten growth, especially in Europe and the U.S.; therefore, recession probabilities increase as the conflict persists.

For many reasons, we hope for a diplomatic resolution in the Russia-Ukraine crisis, not the least of which is the stability of global markets. We do expect the Fed to begin raising interest rates in March, but how far they go may depend on the resolution of the current conflict and the increasing potential for recession. Diversification remains critical in this volatile environment. Equities remain attractive, but some moderation of risk is appropriate.

Figure 5: Geopolitical Events and the S&P 500 (sources: Strategas Securities LLC, Capital Group, Shiller/Yale.edu, ACIMA)



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