Email Body 3-1-2022

**Ukraine, the Federal Reserve, and the U.S. Response**

The unfolding tragedy that is the Russian invasion of Ukraine will have immediate as well as long-term effects on global economies and financial markets. In addition to the geopolitical risks this re-ignition of a cold (hot?) war between east and west brings to us as a nation, we and our children will feel its impacts for a long time. Hopefully, in this email I can supply some clarity about how what is transpiring will impact our lives and portfolios.

COVID-19 UPDATE

The good news I do not expect to be talking about covid much longer. Most people are done and restrictions on life are falling rapidly. We have “vaccines” and other therapeutics in addition to two years of experience in dealing with this virus. We are now in a place of learning to live with it as much as we have learned to live with other deadly viruses. Cases, hospitalizations, and deaths have fallen dramatically prompting all levels of government to begin to allow people to return to normal. Hopefully, most of us can return to normal.

MARKETS, WAR AND THE ECONOMY

The financial markets have started the year off with a correction largely driven by ever-more hawkish expectations of interest rate hikes. The bond markets started the year off pricing in four rate hikes over the next 18-24 months and slowly expanded that to six-seven hikes totaling two full percentage points (2%). The stock market has responded with a more than 10% correction as it repriced growth stocks for higher interest rates. It remains to be seen if the correction was overdone.

The Russian invasion of Ukraine adds another element of potential impact on the economy and stock market by creating uncertainty and dampening consumer sentiment. It can also take a toll on economic activity. In its current iteration, the Ukraine conflict is causing energy prices to surge exacerbating supply-driven inflation. A protracted conflict creates greater potential to negatively impact the global economy and by extension, the financial markets. Policy responses by global governments may also help or hurt depending on their nature and significance.

Non-energy related sanctions against Russia, while significant to them, mean little to the rest of the world in that Russia’s economy is less than 3% of global GDP. However, if energy related sanctions are imposed, the effect on energy prices could be significant, that if sustained for a long enough time, could result in a recessionary environment. Policy responses that result in increased energy production (i.e. re-opening ANWAR and drilling on U.S. Federal lands, etc.) could offset much of the impact. Additionally, I expect both the Federal Reserve and other central banks to move more cautiously with interest rate hikes than the markets have priced in as they review the impact of the conflict on economic growth.

Historically, unless war is accompanied by recession, stocks tend to take wars in stride. Stocks advanced over 50% during WWII and by 43% during the Vietnam war period. So, the lesson here is to avoid a recession by implementing policies to offset the expected impacts of the war. Assuming the Federal Reserve and other central banks act as expected and move less quickly with interest rate hikes, that reduces one of the biggest risks to the stock market. With oil currently sitting at $106/barrel, we cannot wait long to respond. Unless the Ukraine conflict were to resolve quickly (e.g. the impacts of the outcome is another story), we need to see energy prices drop by increasing supply soon, otherwise we risk a recession and a bear market.

With respect to assets invested for the long-term I do not propose that you take any action to reduce risk. I believe the probabilities favor an outcome that reduces interest rate and energy risk, which should result in the current correction reversing course and the stock markets returning to reflecting an economy likely to grow between 2% and 3% this coming year.

I am always available to you via phone, zoom conference or in person. I look forward to talking with you over the next few weeks. If you have any questions or if we can be of any help, please do not hesitate to contact Linda or me.

*Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results.*

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