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Quarterly Economic Review

January

2022

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39 S. 4th Street,
Warrenton, VA 20186
(540) 878.5416

info@meridianfinancialpartners.com

Mailing Address:

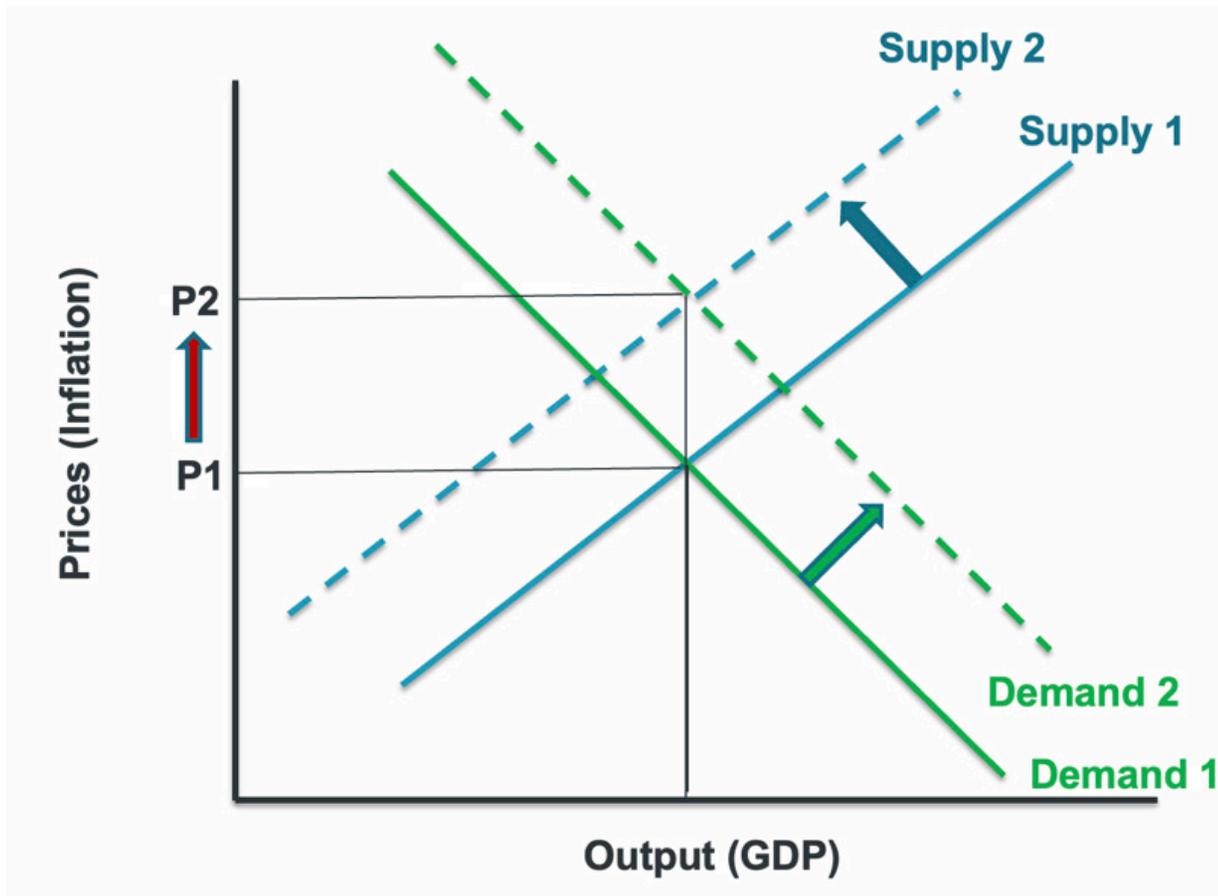
P.O. Box 879
Warrenton, VA 20188

Market Review

- Financial markets had a rough first quarter across the board—stocks, bonds, U.S., international and emerging markets—hurt by rising interest rates, inflation and the war in Ukraine.
- Global stocks (MSCI ACWI Index) fell 5.4% for the quarter. Among major global markets, the S&P 500 was a relative outperformer, dropping 4.6%, compared to developed international markets (MSCI EAFE Index) down 5.9% and Emerging Market (EM) stocks down 7.0%.
- The relatively mild declines for the full quarter masked the intra-quarter volatility. At its low point on March 8, the S&P 500 was down 13% from its high on January 3. The developed international and EM stock indexes had drawdowns in the 16-17% range during the quarter, before rebounding roughly 10% by quarter-end.
- Unusually, the damage was worse in the U.S. core bond market than the U.S. stock market. The benchmark Bloomberg U.S. Aggregate Bond Index (the “Agg”) fell 5.9% for the quarter. This was the second-worst quarter for the Agg since Q1 of 1980, when Paul Volcker’s Fed was in full-bore tightening mode.]
- As we’ve discussed, a period of rising inflation and rising interest rates creates challenges for both bonds and stocks, and in turn for a traditional balanced portfolio comprised only (or largely) of core bonds and stocks. Diversification into other asset classes, market segments and alternative strategies can be particularly valuable in such an environment.
- In the fixed-income markets outside of core bonds, high-yield (lower credit quality) bonds lost 4.5%

Inflation Drivers

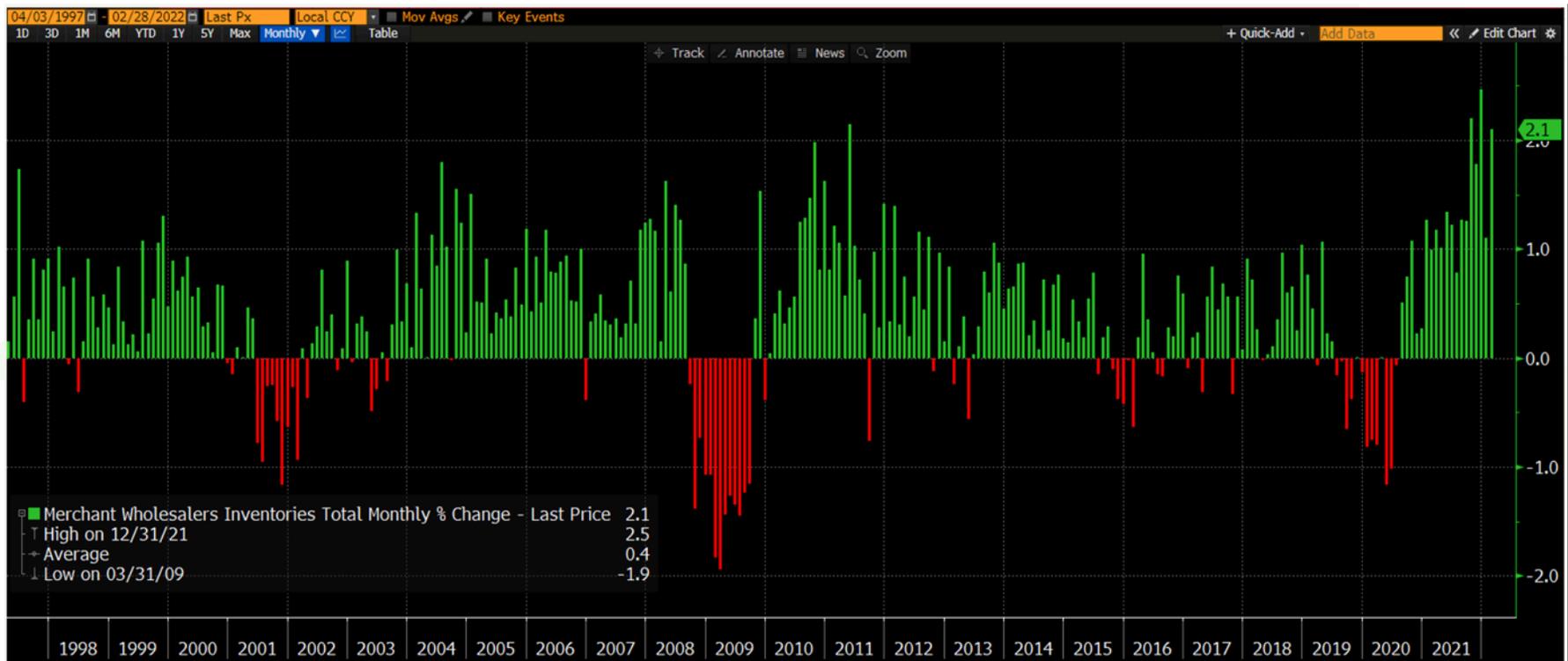
Back to Basics: Inflation Root Causes



- Supply Chains
- Lack of Workers
- Shutdowns
- Operating Uncertainty

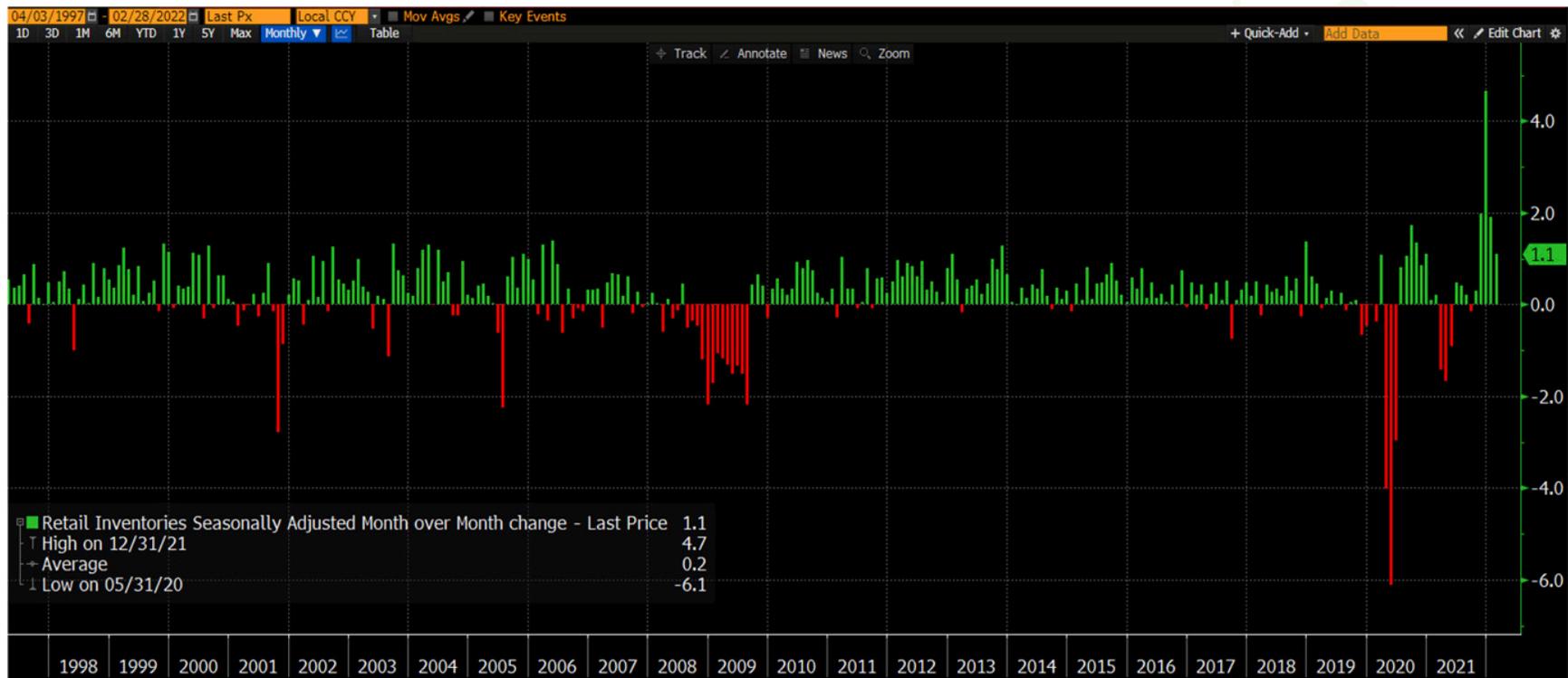
- Gov't Spending
- Stimulus (which was spent, not saved)
- Home repair/upfit
- "Stay at home" purchasing (Goods rather than Services)

Wholesale (Manufacturing) Inventories (3 of last 5m > 2%).



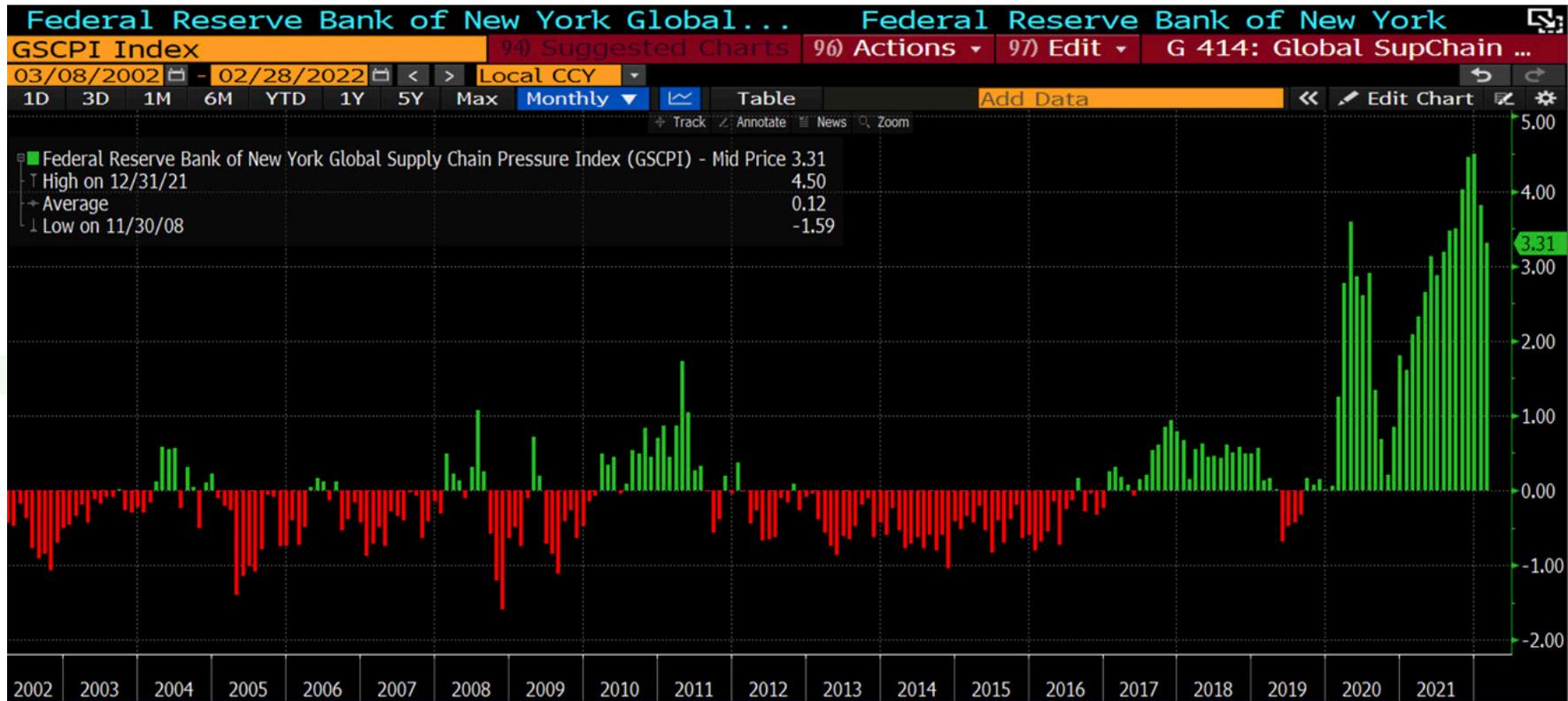
Source: Bloomberg, 2/28/2022

Retail Inventories



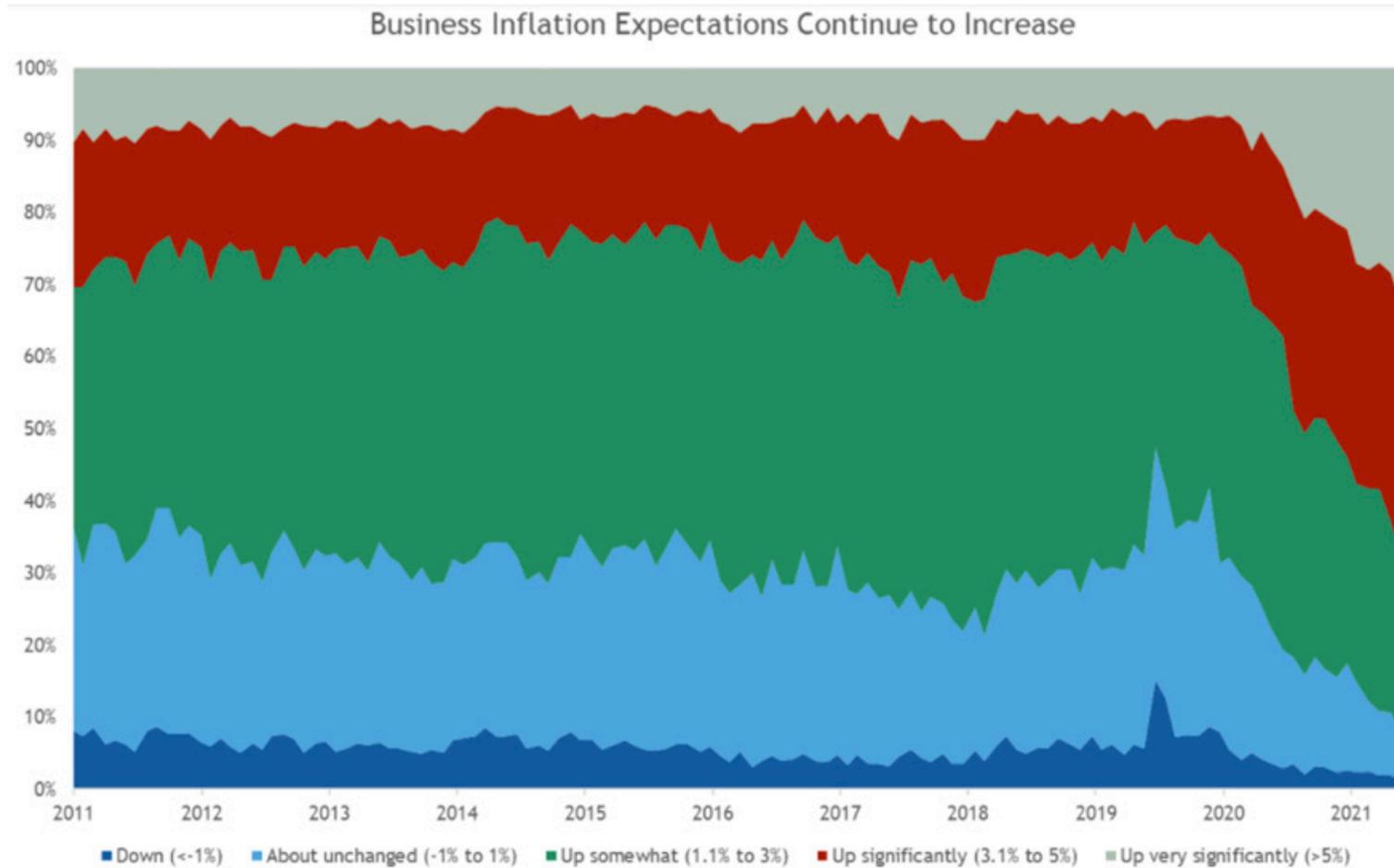
Source: Bloomberg, 2/28/2022

Supply Chain Pressures: Direction of Travel is helpful



Source: Bloomberg, 2/28/2022

Corporate Inflation Expectations are on the rise, though (Wages & Input costs)



Source: Bloomberg, 2/28/2022

Supply/ Demand works in the labor market, too.



Source: Bloomberg, 2/28/2022

Wage gains still mainly in lowest-earning segment – watching to see if this spreads.



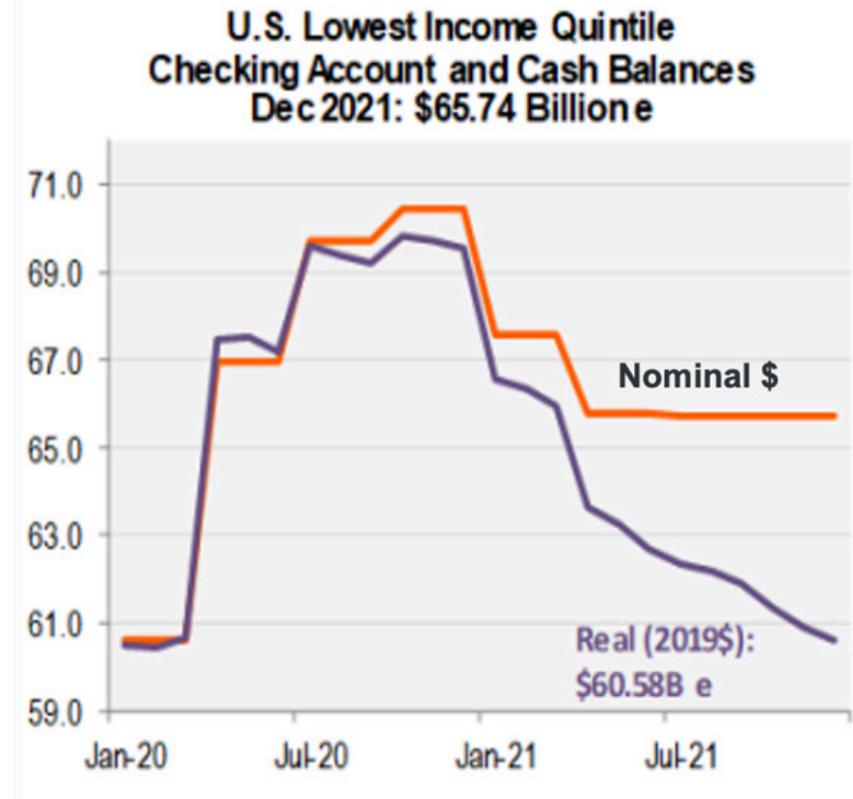
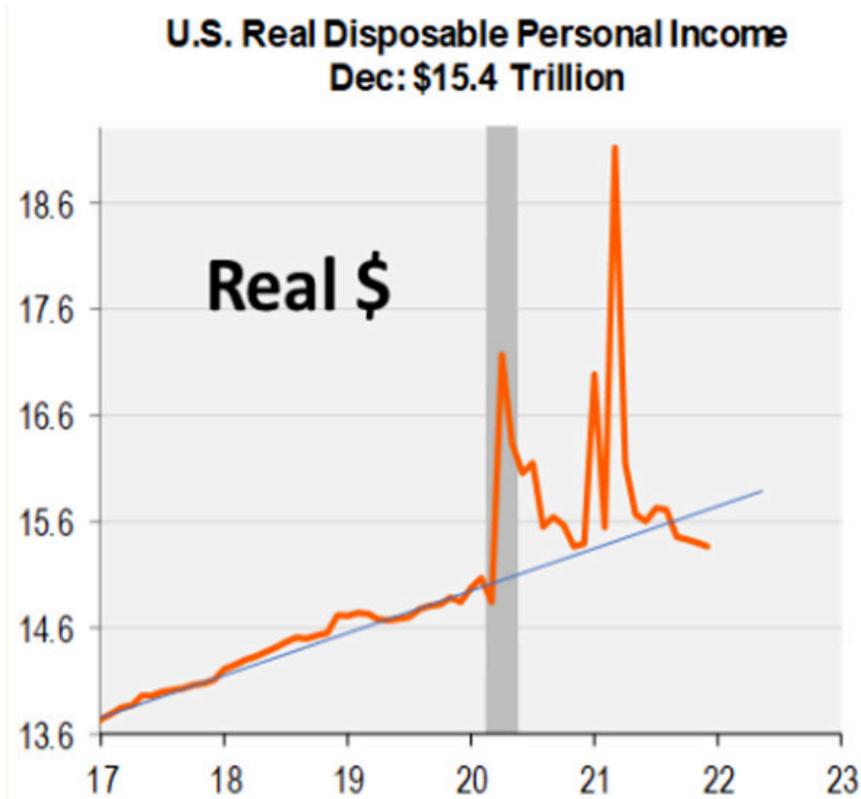
Source: Bloomberg, 2/28/2022

Younger workers are just starting to come back into the market.



Source: Bloomberg, 2/28/2022

And here's why... (more labor supply on the way most likely)



Source: Piper Sandler, 2/28/2022

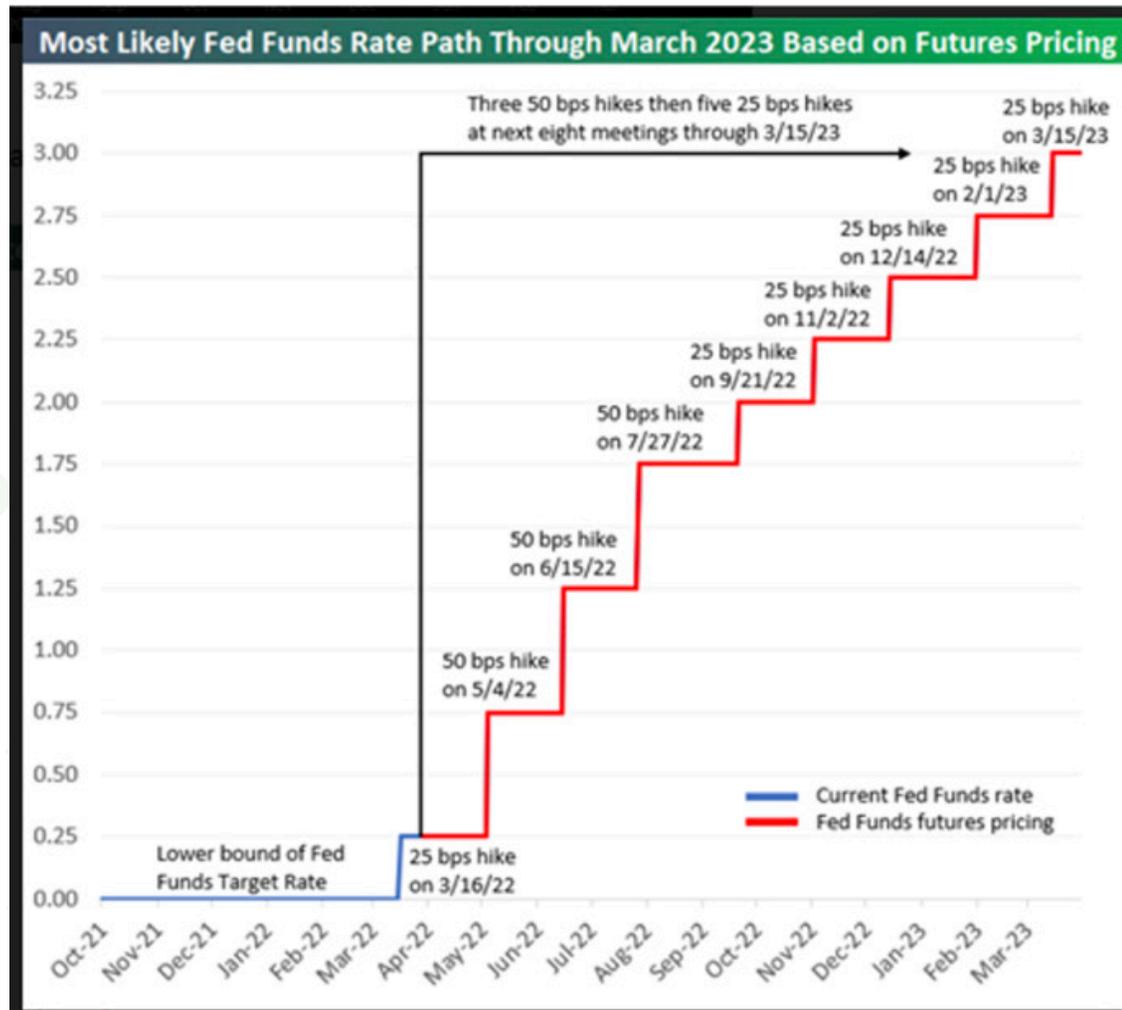
Market's Inflation Expectations – still anchored (Russia/ Ukraine War didn't help though)



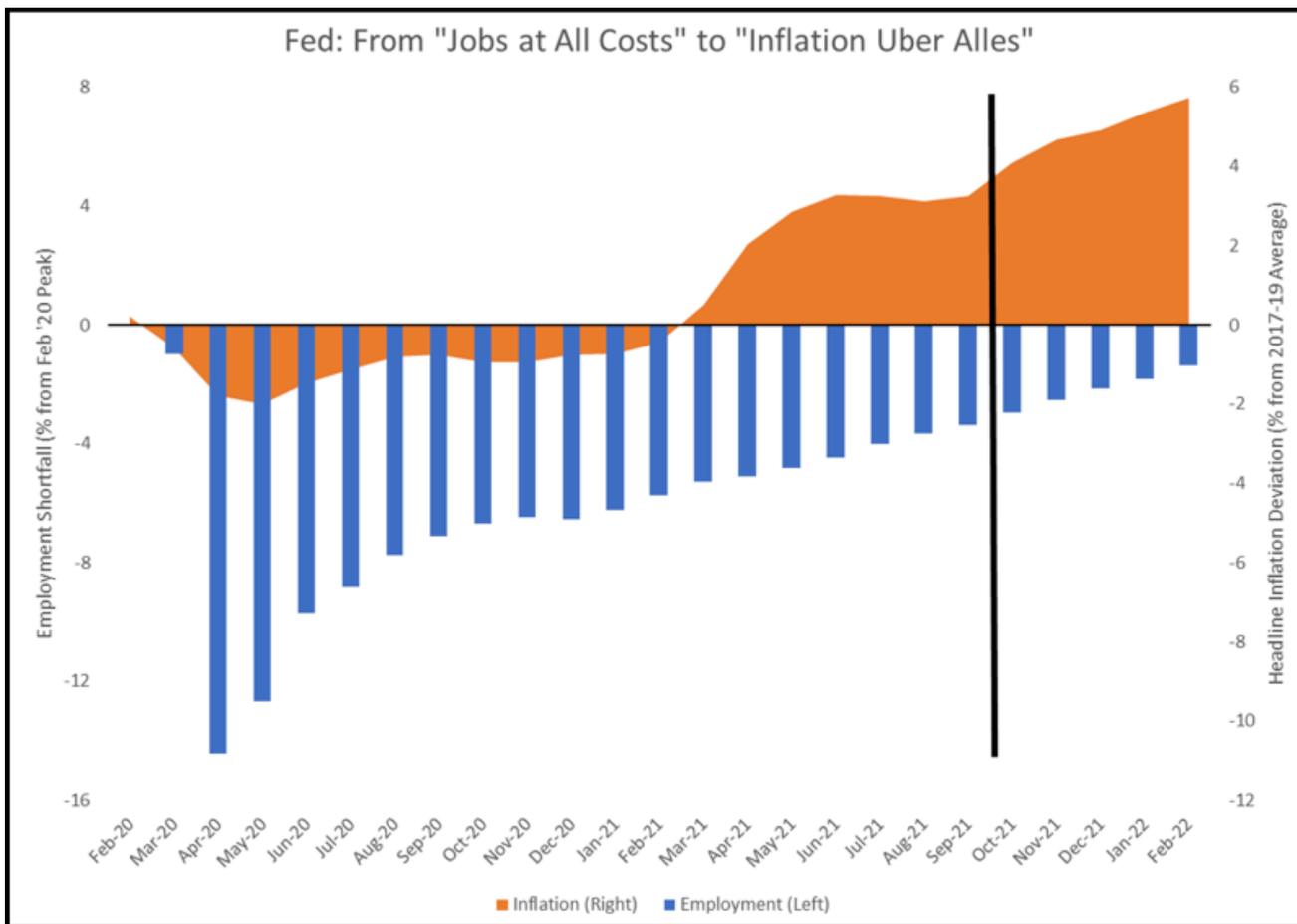
Source: Bloomberg, 3/31/2022

The Fed

Market Expectations for Fed Hike Path - 3x 50bp hikes to kick things off



Fed's M.O. has shifted from "jobs at any cost" to "kill inflation at any cost"



Source: Bloomberg, 3/31/2022

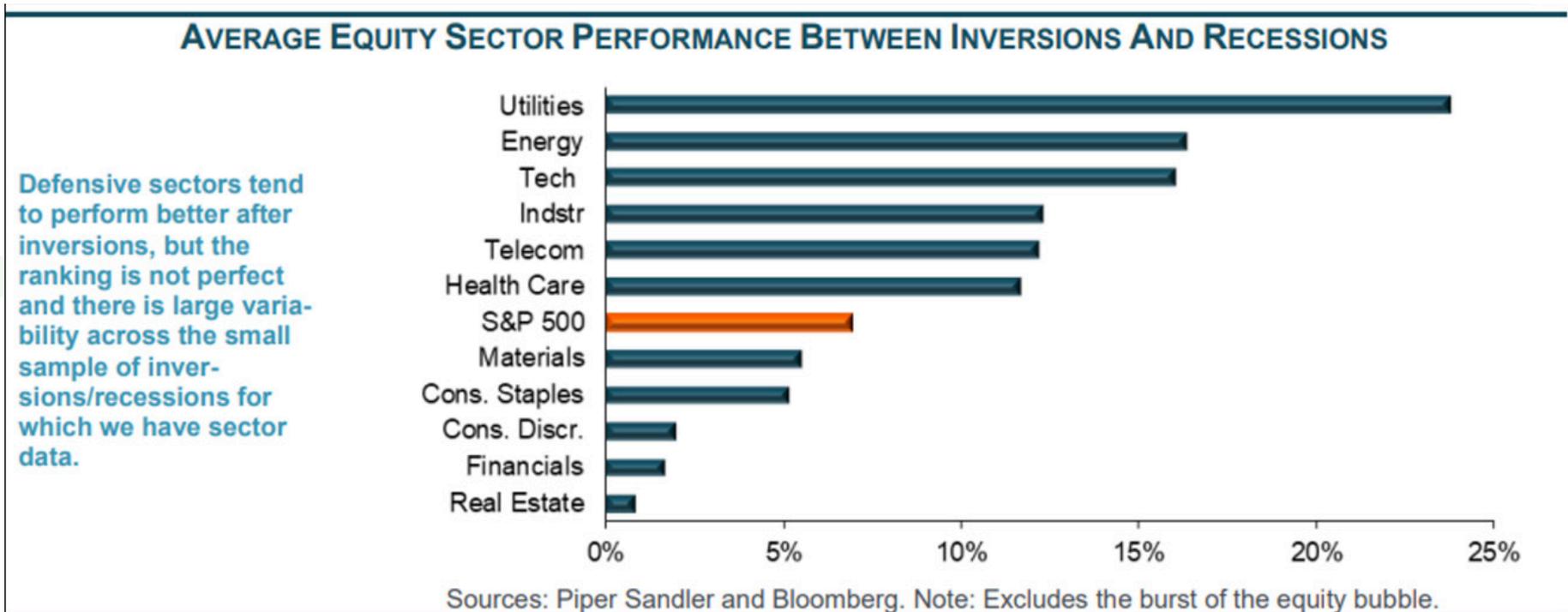
Market pricing in a Fed mistake?



Source: Bloomberg, 4/1/2022

Equity Markets

Yield Curve Inversions – Equity Market History



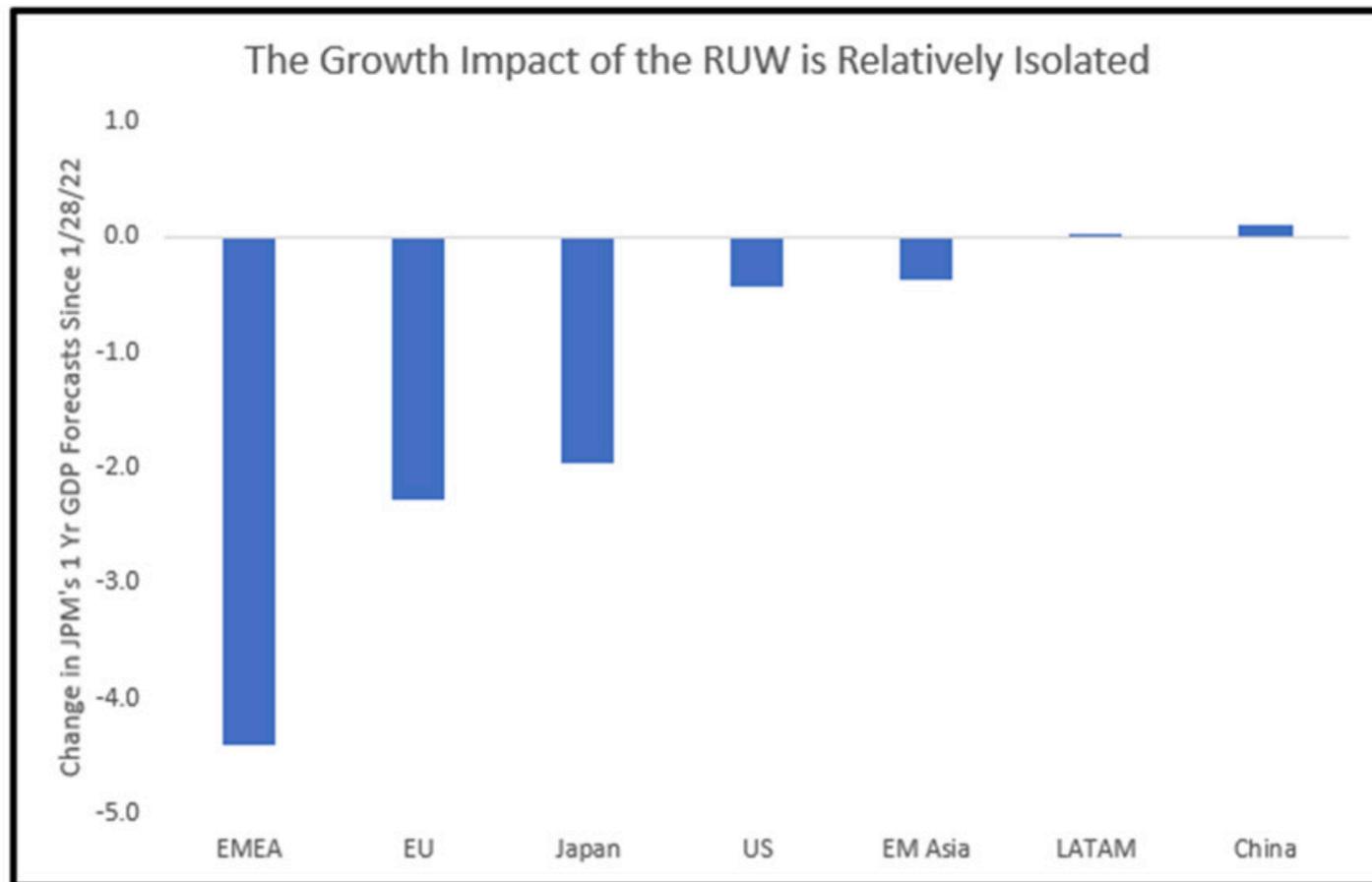
Source: PSC, 3/29/2022

Multiple Expansion Unlikely with tightening Cycle Underway - Equity Gains will need to come from Earnings this year



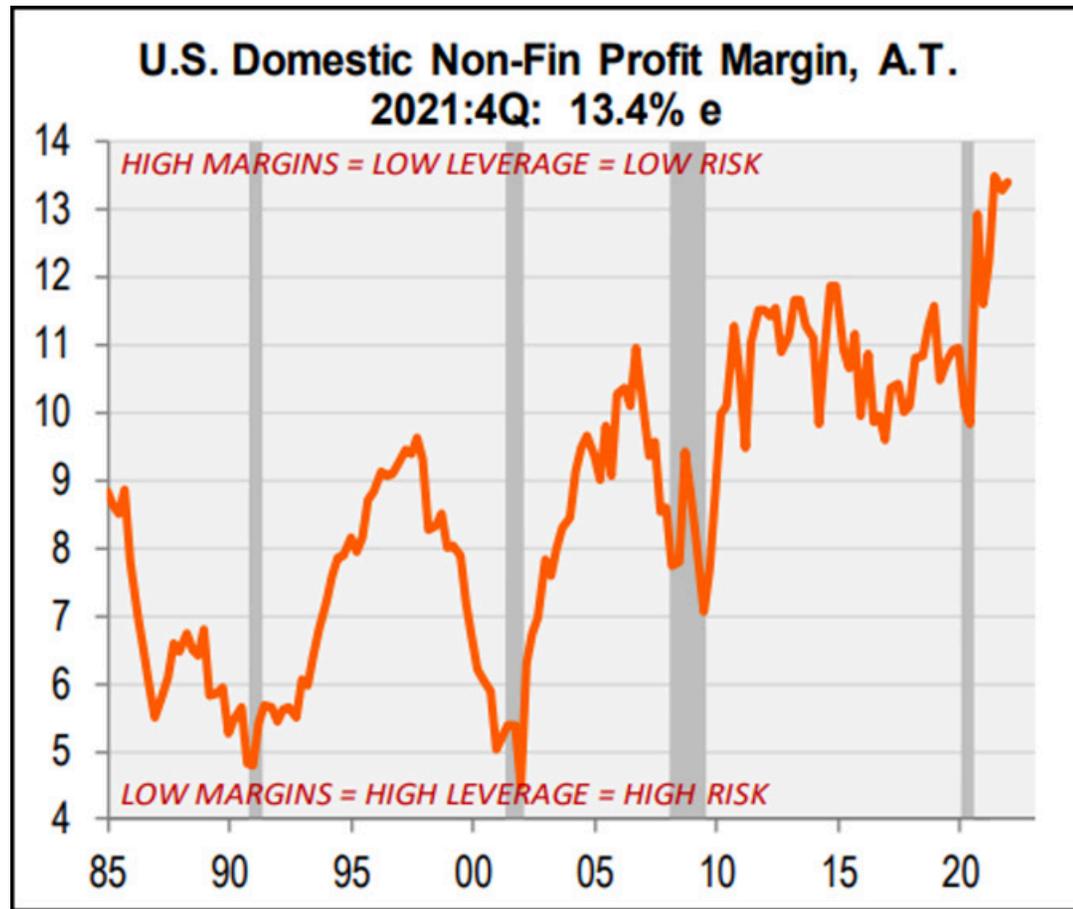
Source: Bloomberg, 3/29/2022

Russian/ Ukraine war having minimal impact on U.S. corporate earnings



Source: Bloomberg, 3/29/2022

Margin pressure coming, but the strong starting place matters!



Source: Piper Sandler, 3/29/2022

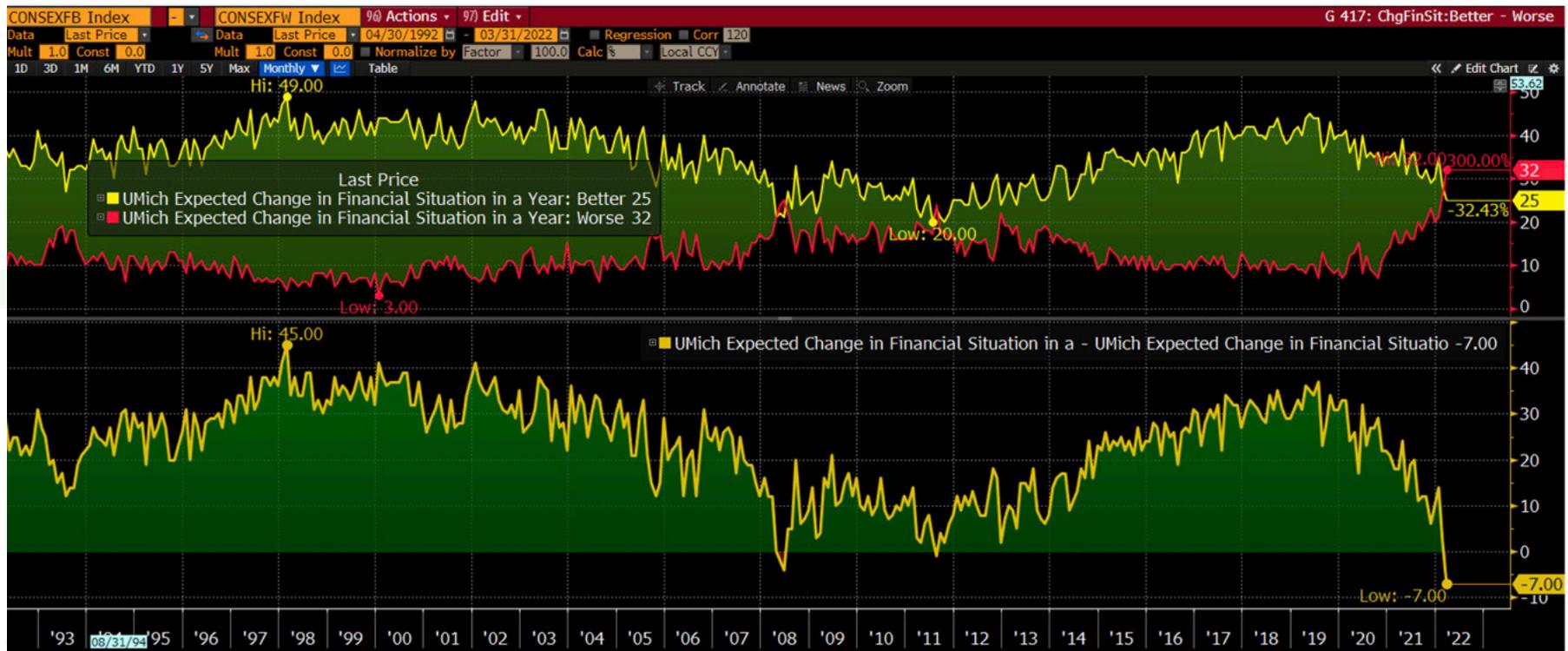
Consumer: How they feel vs. How they are

Consumer Confidence: Future Expectations falling relative to Current Situation



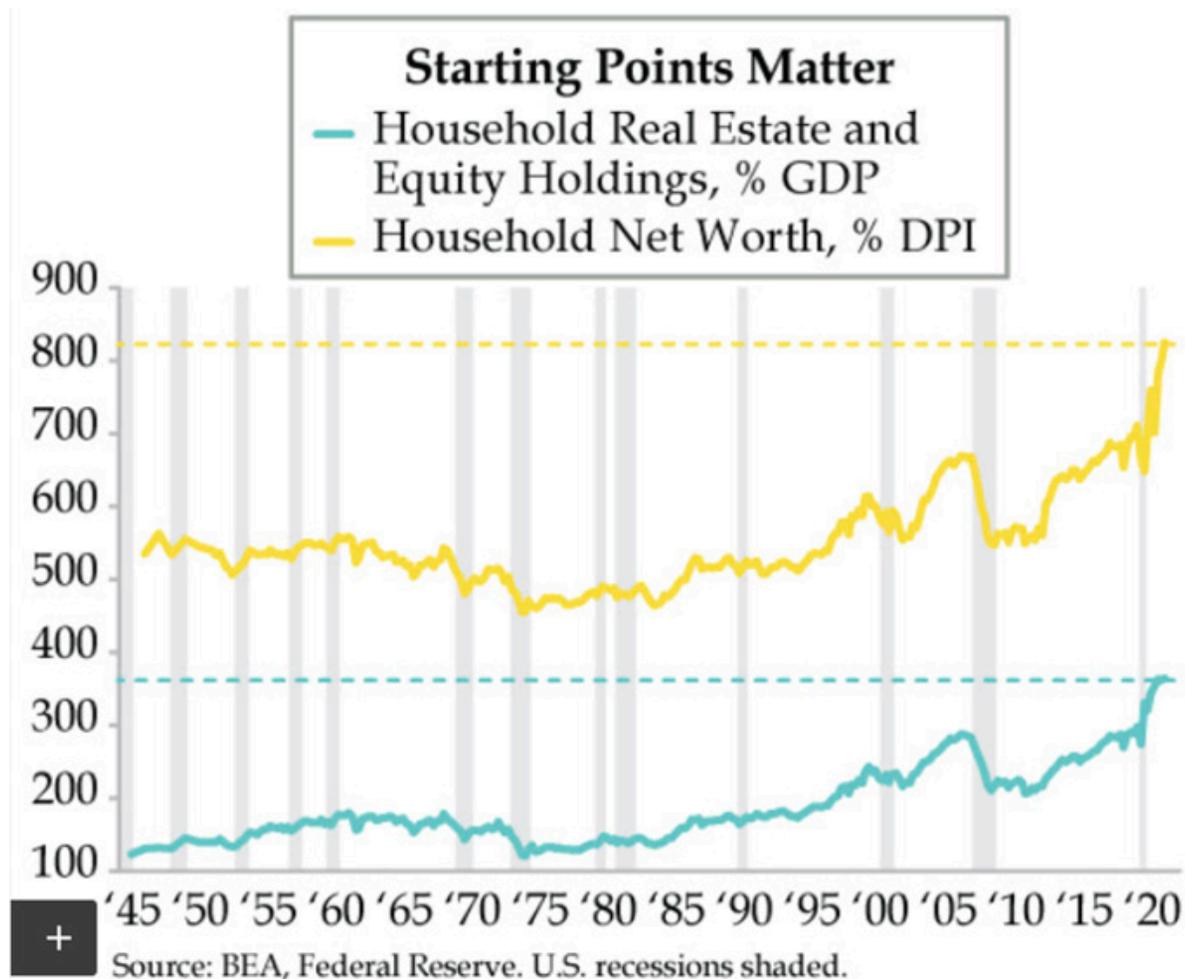
Source: Bloomberg, 3/31/2022

Consumer Confidence: Driven by deteriorating feelings about future financial situation? (because it isn't jobs!)



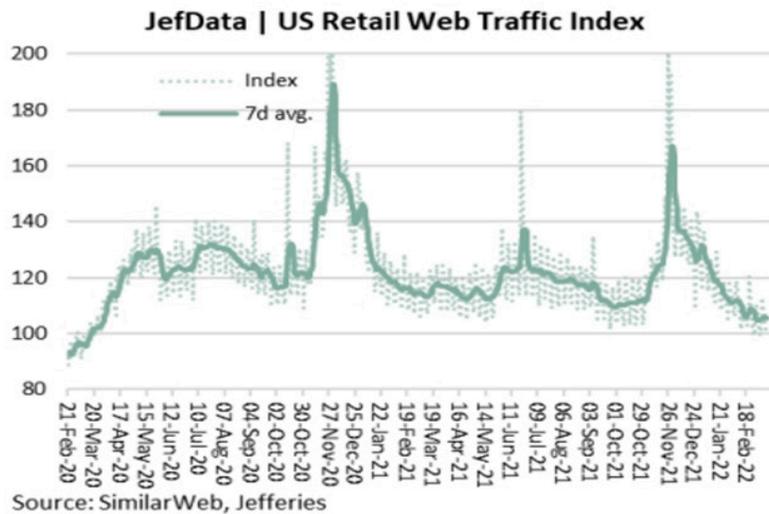
Source: Bloomberg, 3/31/2022

But the Consumer remains in incredible financial shape overall



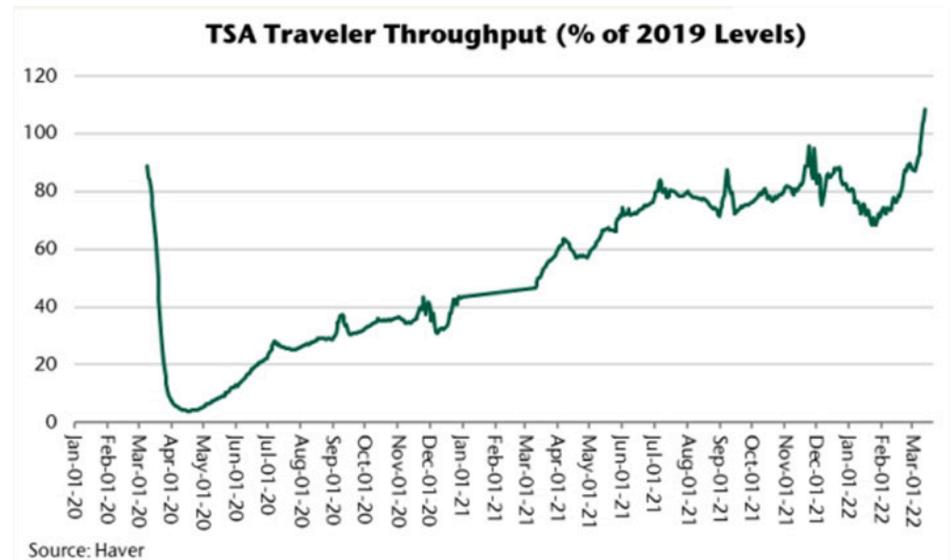
Source: Quill Intelligence, 3/11/2022

Goods-to-Services spending shift will help the inflation problem - and show consumer resilience (despite how they feel)



Daily US web traffic to numerous retailers' websites. 100 represents 'normal' level based on observations from 2019. Aggregated and normalized by Jefferies and sourced from SimilarWeb.

Source: Jefferies, 3/15/2022



Takeaways

- Inflation is a Supply/Demand phenomenon – current situation looks challenging, but there are some unheralded reasons to be optimistic on the topic in the 2nd half of the year
- Market expectations for inflation are currently well-anchored
- The Fed, however, has pivoted from a “jobs at any cost” position in 2021 to an “inflation at any cost” position in 2022 – virtually nothing will prevent them from hiking rates quickly for the next 4-6 months, in all likelihood
- Given that, the performance of Equity markets likely rests with Earnings
- And Earnings likely depend on the U.S. Consumer. Do they go on vacation this summer or do they retrench? We think the former, but it is the most important thing to watch for the next several months.

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