The Weekly Market Update – 2/28/22: Despite a Friday Rally, Geopolitical Risk Remains

Major Indices (Price Returns)	Close	Last Week	Quarter-to-Date	Year-to-Date	Trailing 12-Months	All-Time High	% to High
S&P 500	4,384.65	0.82%	-8.00%	-8.00%	18.05%	4,796.56	9.4%
Dow Jones Industrial Average	34,058.75	-0.06%	-6.27%	-6.27%	13.59%	36,799.65	8.0%
NASDAQ Composite	13,694.62	1.08%	-12.47%	-12.47%	4.77%	16,057.44	17.3%
Russell 2000	2,040.93	1.57%	-9.10%	-9.10%	-1.58%	2,442.74	19.7%
MSCI EAFE (USD)	2,177.75	-2.60%	-6.78%	-6.78%	2.53%	2,398.71	10.1%
MSCI Emerging Markets (USD)	1,171.99	-4.85%	-4.87%	-4.87%	-11.85%	1,444.93	23.3%
Bloomberg Commodity Index	112.40	0.69%	13.34%	13.34%	40.32%	237.95	111.7%
Barclays U.S. Aggregate Bond	100.08	-0.41%	-4.44%	-4.44%	-7.97%	112.07	12.0%

Source: FactSet

U.S. investors appeared to discount the Russian invasion last week as equities rallied to close the week, but much uncertainty remains and we expect ongoing volatility. While the widely followed S&P 500 index rallied 3.8% on Thursday and Friday and closed the week up 0.8%, the index had declined 5.6% over the four days (2/16/22 to 2/23/22) leading up to, and including, the attack. Through Friday, 2/25/22, the S&P 500 remained down 8.0% year-to-date (and the growth-oriented Nasdaq Composite index was down 12.5%). We attribute the late week rally to positive investor reaction to the initial round of U.S. and European sanctions on Russia as they did not include specific measures to restrict either oil exports or access to the global interbank transfer system (called "SWIFT"). In addition, we believe that investors expect that the U.S. Federal Reserve Bank will move more slowly (in the near-term) to increase short-term interest rates. Clearly, much uncertainty remains between Russia and Ukraine, and we are not qualified to make a prediction on potential outcomes. As of Monday morning, battles are ongoing as Ukraine defends itself, international sanctions have increased, and the United Nations is holding an emergency meeting. New sanctions now include limiting Russian access to the SWIFT banking system and multiple countries sending military supplies and aid to Ukraine (including Germany). U.S. equity markets were lower early Monday, but moved off the lows by mid-morning. Energy prices rallied (West Texas Intermediate), gaining 5% early Monday to $96 per barrel, but below the high of $100.50 last week. Sanctions on Russia from the West could slow the global GDP recovery while also stoking inflation, putting the Fed in a tough position to combat inflationary pressures, and could create ongoing market volatility and weakness. We argue that investors should stay the course and use market weakness to upgrade portfolio quality, add exposure to market-leading companies, and improve sector and style (value and growth, cyclical and defensive) diversification.

U.S. interest rates have moved lower since mid-February and the yield curve has flattened. The U.S. 10-year Treasury yield was 1.87% on 2/28/22, down from its 2022 high of 2.05% on 2/16/22. Over the same period, the 2-year Treasury yield has dropped to 1.43% from 1.87%. During periods of crisis it is not uncommon to see demand for the security of U.S. government bonds, driving prices higher and yields lower. The difference between the 10-year and 2-year yield, or "spread", has dropped to 44bp, down from 53bp on 2/16/22, and 78bp at year-end. This suggests to us that bond investors see the potential for slowing U.S. GDP growth (a concern that was present prior to the Russian attack) and lower long-term rates that could restrict the Fed's cadence in raising short-term rates to combat inflation. While two weeks ago there was much discussion about the Fed raising its overnight fed funds target by 50bp at its 3/16/22 meeting, the futures market now expects a 25bp hike.

While we expect Russian aggression and response to dominate market action in the week ahead, there is an active schedule of potential market-moving events. President Biden will give his State of the Union address Tuesday evening, with Russia and COVID likely the leading topics. Fed Chair Jerome Powell addresses Congress on Wednesday and Thursday, with likely commentary on Russia and inflation, and the oil cartel OPEC+ meets on Wednesday to discuss its oil production targets over the next six months. Of key interest will be OPEC's willingness to increase output if Russian production is curtailed. The BLS reports February jobs data on Friday; new nonfarm payrolls are estimated (FactSet) at 400 thousand.

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