Nadler Financial Group

Investment and Financial Consultants

Nadler Financial Group, Inc.
155 North Pfingsten Road • Suite 160
Deerfield, Illinois 60015-4903
Phone: 847.940.4040 • Fax: 847.940.7246
www.nadlerfinancial.com

FIRST QUARTER 2022 ECONOMIC AND FINANCIAL MARKETS REVIEW

Last year the stock market appreciated mainly because investors took advantage of the Federal Reserve Board's highly accommodative monetary policy. This policy included keeping interest rates near zero and printing money to help stimulate economic growth. However, during the first quarter of this year, investors became concerned because the Fed began raising interest rates and decreasing the money supply in order to fight inflation. This has led to rising interest rates in the bond market and a volatile stock market. In addition to worries about tightening monetary policy, investors became anxious about the Russian invasion of Ukraine. This conflict drove up energy prices as economic sanctions created additional financial and geopolitical uncertainty. As a result, the S&P 500 Index finished the first quarter down 4.95%, while the Dow Jones Industrial Average lost 4.57%. The Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index declined 4.51% during the first quarter.

When the Federal Reserve Board lowers short-term interest rates or prints money to buy government bonds, thereby lowering longer-term interest rates, it stimulates the economy. The reason is that it reduces the cost of borrowing for consumers and businesses leaving them with more money to spend. At the start of the pandemic, the Fed lowered interest rates to near-zero and began printing $120 billion per month to purchase government-backed bonds. This policy was intended to prevent another financial crisis, grow the economy, and help support the job market. The stock market generally appreciates when the Fed keeps interest rates low because, in addition to helping grow the economy, it makes fixed-income investments with low yields unattractive to investors, thereby creating more demand for stocks.

Unfortunately, this highly accommodative monetary policy can also lead to inflation. The Fed has been stimulating an already growing economy, leading to greater demand, while supply chain disruptions and other geopolitical factors have reduced the supply of goods. The labor market is also extremely tight, which has led to significant wage increases. The result is the highest rate of inflation in decades.

To fight inflation that it helped create, the Fed has decided to terminate its extremely accommodative monetary policy and begin the process of tightening the money supply by raising interest rates and ending its money-printing program. When the Fed raises interest rates meaningfully, the stock market typically declines because investors begin to anticipate that they can earn a higher yield investing in fixed-income investments such as bonds, CDs, and money market funds. Although interest rates are still meager, stock investors are already anticipating much higher interest rates by the end of this year, so they started selling stocks early in the year. Stocks have also declined because investors fear that the Fed will raise interest rates too much, leading to an economic recession. The stock market will likely remain volatile until the Fed signals that they are finished raising interest rates this cycle, and they have successfully slowed the inflation rate.

In addition to inflation and interest rate fears, investors became concerned because the war in Europe led to higher energy prices, which could precipitate a slowdown in economic activity. This problem and other uncertainty created by the war led to additional stock market volatility. However, historically, although wars have created short-term declines for stocks, they have not led to long-term bear markets that typically occur during global recessions.

While this year did not start on a positive note, it is possible that solid corporate earnings will help offset fears of higher inflation and geopolitical concerns as the year goes on. Most U.S. corporations continue to beat their earnings expectations due to the resilient economy and strong demand for goods and services as the government removes Covid restrictions. In addition, during the year, the Fed will likely communicate with investors regarding how many times and for how long it will raise interest rates. This communication could lead to greater confidence that the Fed will not raise interest rates so much that it will create a recession.

We continue to recommend short-term bonds rather than longer-term bonds because short-term bonds are less sensitive to rising inflation and interest rates. We also prefer large company stocks over small company stocks because large-company stocks are typically less volatile than small-company stocks during times of geopolitical uncertainty and rising rates. After several years of U.S. stocks outperforming, foreign stocks appear relatively inexpensive. Finally, gold prices should continue to benefit this year if inflation and geopolitical uncertainty persist.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions or concerns regarding your portfolio or the financial markets in general.

* *Index returns were obtained from the Wall St. Journal and Bloomberg Barclays on April 1, 2022.*