CURBSTONE FINANCIAL
MANAGEMENT CORPORATION

From the Curb

Letter to Clients
Quarter Ending March 31, 2022

After a historically calm 2021, volatility returned in the first quarter of 2022. Inflation surged to 40-year highs, prompting the Federal Reserve to re-think the timing and magnitude of their interest rate policy. The markets reacted well to this more hawkish stance, as investors unanimously agreed that lower prices are beneficial to everyone. Russia, on the other hand, surprised the world with a full-scale military invasion of the Ukraine, marking the first major military conflict in Europe in decades. Those factors fueled a rise in volatility and pushed stocks lower in the first three months of the year.

The prospect of sooner-than-expected interest rate hikes weighed on the sectors with the highest valuations, specifically growth-oriented technology stocks. The steep declines in the tech sector exacerbated market volatility in January. Additionally, while the fourth-quarter earnings season was solid, there were several large, widely held technology companies that posted disappointing results or tempered their forecasts, which further contributed to the general market decline. In February, the market's primary concern shifted from monetary policy to geopolitics as Russia amassed troops on the Ukrainian border, prompting warnings from the United States and other Western countries of an imminent invasion. That additional uncertainty, combined with still-stubbornly high inflation readings, kept markets guessing throughout most of the month. The conflict sent prices of essential commodities like oil, wheat, corn, and natural gas surging as producers and end users feared production disruptions and reduced supply. As one would expect, markets dropped as investors realized higher commodity prices will only add to existing inflation pressures, and in turn, possibly stress earnings and reduce consumer spending.

Markets remained volatile in early March, as hopes for a relatively quick ceasefire in Ukraine faded. In a show of unity, the developed world united in a never-before-seen way against Russia, imposing crushing economic sanctions. But while that demonstrated important solidarity against Russian aggression, it became clear that the sanctions would also have a negative impact on Western economies, especially in the EU, raising concerns about a global economic slowdown. Despite this action, stocks mounted a relief rally in late March, dampening the negative returns realized in January and February.

As we start the second quarter, major commodity prices continue to climb, making it unlikely that key inflation indicators like the Consumer Price Index will meaningfully decline anytime soon. Until there is a definitive peak in inflation, the Federal Reserve is likely to continue to aggressively raise interest rates in an attempt to slow the economy, while reducing its balance sheet. Finally, the Russia-Ukraine war continues on, and the geopolitical implications have spread beyond the battlefield, as relations between Russia and the West have hit multi-decade lows. The longer those factors persist, the greater the chance we see a material slowdown in the global economy.

It is however, important to note that the U.S. economy is very strong and unemployment remains historically low. Additionally, interest rates are rising but remain far below levels where most economists forecast that they will begin to slow the economy. Finally, consumer spending, which is one of the main engines of growth for the U.S. economy, is robust, and corporate and

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personal balance sheets are healthy. So, while risks remain, there are multiple positive factors supporting markets.

Portfolios remain well-diversified with equity allocations at the lower end of the range for your investment objective. This is a great time to remember that your asset allocation is based on your personal financial position, risk tolerance and investment time horizon.

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Wishing you an enjoyable spring season!

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