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I guess if you expect the unexpected, you won't be disappointed or surprised!

An attack on Ukraine may have been included in the range of possible events at the beginning of 2022, but it would have also been a low probability event. The shock and horror of the damage Russia has inflicted on the people and country of Ukraine in just a few short weeks is stunning. Although the Ukrainians have done an admirable job of turning back the Russian Army around Kyiv, it appears the fighting in Eastern and Southern Ukraine is likely to go on for some time. The humanitarian, environmental, and economic devastation is significant.

Russia's actions have caused a massive shift in the geo-political world as we have known it since the end of World War II. What all of the implications of this shift will be are yet to be found. But the overall level of uncertainty and stress will be felt in many aspects of our lives.

To me the last few months have included a series of contradictions and some Catch-22 events with interest rates and inflation at the top of that list.

First, interest rates are, and have been, too low in the overall scheme of economic activity. In other words, the balance between the savers and the investors is at least somewhat out of synch. Notwithstanding the current inflation situation, if the Fed's inflation target is 2%, then saver's returns should, at the very least, be somewhat above this level to have a positive real return.

That being said, and even though higher interest rates can be an effective tool to curb inflationary pressures, I'm not certain that higher interest rates will be effective in dealing with the current iteration of inflation.

For example, eggs and poultry prices are going up because of a significant outbreak of avian bird flu – higher interest rates will not change this situation. Wheat and other ag commodities have increased substantially as a result of several things. For example, the fighting in Ukraine will significantly reduce their 2022 wheat harvest. Higher interest rates will not result in more bread anytime soon. Higher wheat prices will result in more acres planted this fall, but for harvest in 2023.



Supply chain issues continue to be a challenge. This is one that higher interest rates may actually worsen. In many cases, it will likely take more capital investment to solve some of these issues. Higher interest cost will make some of these investments harder to justify.

In addition, the changing geo-political environment has certainly put a halt to globalization. If we are going to re-shore our supply chain from low cost/low wage economies to the United States, higher consumer prices may result. Good or bad, offshoring is a key factor in why domestic inflation has been so low over the last few decades.

Finally, the good news, the United States has become an energy exporter so our supply should be secure. Now the unwelcome news, since oil is a global commodity, it's priced in the world market. Therefore, price volatility will be global and everything energy related will cost more!

The first quarter of 2022 was not a friendly one for savers. Inflation made the negligible nominal returns on savings sharply negative in real terms. Even though principal was unchanged, the purchasing power was severely diminished.

Investors experienced significant volatility as the overall stock market declined from about 4.1% for the Dow Jones Industrials to 7.5% for the small cap Russell 2000 Index. Fixed income investors did not fare any better as the likelihood of higher interest rates resulted in a negative 5.9% total return for the Barclays Aggregate Bond Index.

Going forward the key drivers will likely be the impact of the Fed's inflation fighting strategy – a recession may be likely, but how severe is the question. Putin's strategy and ultimate goal for Ukraine [and Eastern Europe] will continue to impact all commodities. And, as we're seeing in China, COVID is still a factor!

Of course, you can't rule out the unexpected or the unknown!

So, what to do? If you have faith in democracy and capitalism, things will likely be fine in the end. But it may be really challenging in the middle as we find opportunities to capitalize on.

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