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Markets in a Minute
Ukraine Part 2, Plus Inflation & the Fed: Things Aren't Feeling Great Right Now

With the war in Ukraine approaching its one-month mark and inflationary pressures rising, many investors are asking: What's there to feel good about? The Fed is mulling the same question as it contemplates its next steps. Our latest Markets in a Minute offers some answers.

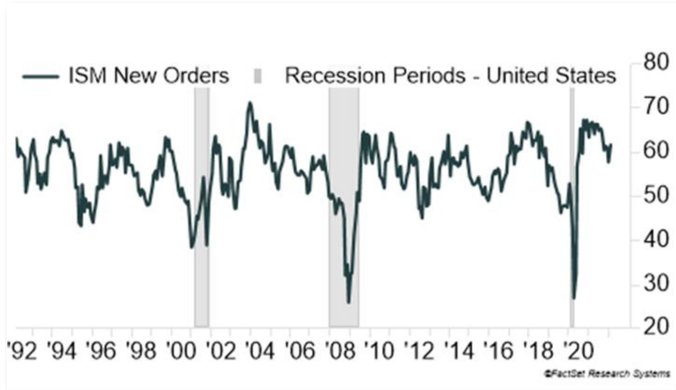
As the Federal Reserve contemplates its next steps, it's keeping a close eye on the war in Ukraine and the implications for the U.S. economy. The war, however, hasn't changed the Fed's playbook: The central bank will remain largely focused on the same economic metrics it's been monitoring all along.

Many economic indicators monitored by the Fed are holding up relatively well amid inflationary pressures and other risks:

- The labor market, for instance, is still remarkably tight. Job openings remained near record highs in January, and the number of unemployed people per job opening (0.6) was near pre-pandemic lows. That's according to the Labor Department's monthly Job Openings and Labor Turnover Survey report, a contemporaneous look at hiring trends.
- The Institute for Supply Management (ISM) Manufacturing New Orders Index has retreated from its post-pandemic high but remained at healthy levels as of last month. The New Orders Index is a subindex of the composite ISM Manufacturing Purchasing Managers' Index (PMI). The PMI reliably predicts growth across the U.S. economy.
- The U.S. Treasury yield curve, another reliable predictor of economic activity, has declined since the start of the year but remained in positive territory as of last week. The yield curve depicts the difference in yields (or spread) between 2- and 10-year Treasury bonds.

(See the chart on next page)

ISM New Orders

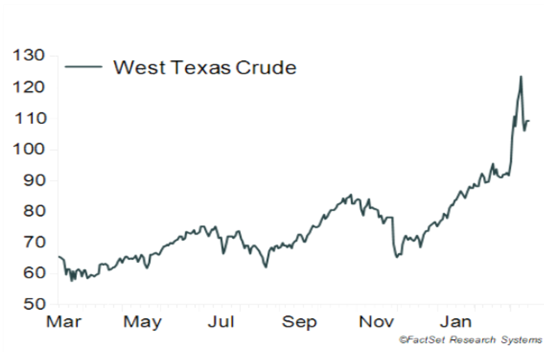


Source: Factset

With the release of key indicators for March, the Fed and investors will have a better sense of the war's economic fallout. We're likely to see a bigger impact on Europe than on the United States — and not just because we're farther away from the battlefield:

- Energy prices have surged since the start of the invasion, and Europe depends more heavily on Russian energy imports than we do. The U.S. produces a lot of its own energy, and a big portion of our domestic spending has shifted from commodities to services over time.
- Higher energy prices benefit the vast U.S. oil and natural gas industry, which accounts for an estimated 8 percent of GDP.
- It's worth noting that lower-income Americans tend to be more affected by high gas prices than consumers with high levels of disposable income. But they've also benefitted disproportionally from wage gains during the recovery, which should help to mitigate some of the pain at the pump.

Price of West Texas Intermediate Crude March 2021 - current



Source: Factset

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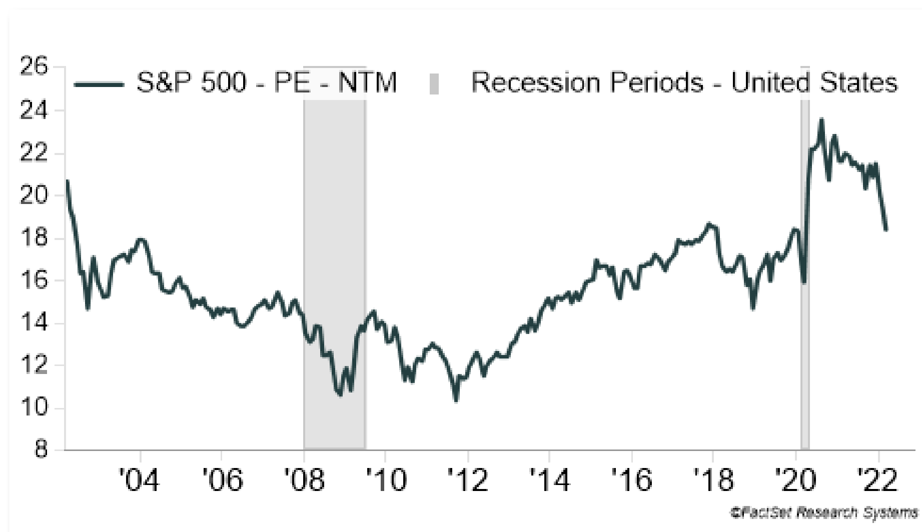
The most-likely probability for the year-end Fed Funds target rate has remained fairly consistent since early February, according to the CME Group's FedWatch Tool:

- On February 9th — about two weeks prior to the invasion of Ukraine — investors in the Fed-funds futures market assigned a roughly 40% probability to a cumulative rate hike of 175 basis points by year's end. The same held true on March 2, 8 and 9.
- Yet, over the same period, market expectations for an even higher year-end target rate have climbed. Some investors now believe there's a slight probability that the Fed could raise its target rate by a cumulative 250 basis points by the end of the year.

Tighter monetary policy, high inflation and the war in Ukraine have weighed on U.S. stocks. But there is a silver lining to market's recent downturn. By most metrics, S&P 500 valuations have retreated since the start of the year. In fact, the market's price-to-forward earnings ratio has fallen to pre-pandemic levels.

S&P 500 Price to Earnings Ratio: Last 20 Years



Source: Factset

While stocks aren't cheap, they're less expensive than they were in late 2021, which may present investors with good buying opportunities. As the recovery matures, we continue to favor high-quality stocks, or those with reliable growth models and strong balance sheets. Market downturns may also be an opportune time for investors to rebalance their portfolios, with the aim of buying low and selling high. *See next page for Important Disclosures*

Important Disclosures

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