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March 2022 Crescent Commentary

Last month, we discussed how much stocks had fallen as a result of the Ukraine invasion, and we provided data showing that the average time it took U.S. stocks to recover from historical geopolitical events was 47 days. This month, we can report that as of the end of March, U.S. stocks increased 12% from their February lows.[1]

Yet while stocks experienced a period of recovery in March, Bonds continued their decline from last November, when the Fed announced it would begin to reduce its economic stimulus by raising interest rates. Although the war in Ukraine rightfully gets international attention as a humanitarian crisis, the war the Fed is waging against inflation could have a larger impact on investment markets.[1]

As a result of the Fed's war on inflation, U.S. stocks still sit 7% below their peak of last November, and the U.S. bond market sits 9% below its November peak level. Why? Interest rates act like gravity on all asset prices – stocks, bonds, real estate, etc. This is why bonds and stocks have declined since last November when the Fed said it would begin increasing interest rates. You might then wonder why stocks increased in March when the Fed announced its first interest rate increase since 2018. The answer is that the Ukraine crisis has created uncertainty which likely caused the Fed to increase interest rates less aggressively than it otherwise would have.[1][2]

While the Ukraine crisis may have caused the Fed to raise interest rates more slowly in the short term, it has actually made the inflation problem worse as a result of increases in oil and other commodity prices. This may actually mean the Fed will have to act more aggressively in increasing interest rates / reducing stimulus.

What do higher inflation and interest rates mean for your investments and retirement planning? For one thing, we expect a more challenging road ahead for investment markets than the one we travelled down over the past five to ten years. We will certainly drive over more potholes along this road as our country works through higher inflation and interest rates. We may also spend more time driving uphill in comparison to the mostly downhill driving of the past five or ten years. And second, your money won't go as far as it used to. Individuals saving for retirement will have to save more and those currently retired will find budgeting more challenging.

Given the more challenging backdrop that may lay ahead, how should investors position themselves to achieve their financial goals? To understand that, you need to look back several decades. The last time our country experienced a period of elevated inflation, increasing interest rates, and a spike in oil prices was the 1970s. The Dow Jones index was flat from 1972 to 1982. You might think that stock investors got no return over those ten years. But investors who reinvested their dividends over those ten years actually earned a 69% return, rather than the zero percent return of the index. This emphasizes the importance of owning steady businesses that generate strong and stable cash flows, and pay those cash flows out to shareholders in the form of dividends.[3]

More recently, we can look to the late 1990s and mid 2000s as time periods when the Fed increased interest rates. During that time, our nation experienced first the bursting of a technology stock bubble, and then the bursting of a home price bubble. There's no doubt that there are echoes of those time periods today as companies with no profits have experienced soaring stock prices and the residential real estate market has gone wild with bidding wars and FOMO. So what happened with investments during those time periods? Obviously, assets that formed bubbles did crash. From 1999 to 2009, technology stocks crashed 52% while U.S. stocks as a whole fell 7%. The housing market was a shambles for several years. Yet stable assets that generated strong and steady cash flows did just fine. Consumer staples stocks increased 66%, health care stocks increased 30%, and industrial stocks increased 8%. Again, this underpins the importance at the present time of owning assets that generate stable cash flows and pay them out to investors as dividends.[4]

The future road of bond investing continues to look like a mixed bag with the Fed raising interest rates. While bonds can serve as a more stable source of funds when stocks are in a panic, the increase in bond prices that we experienced over the past forty years is likely over. The good news is that as rates increase, bond investors can potentially find more attractive interest rates to generate income.

While we foresee a more challenging road ahead for investors, we remain steadfastly confident in the ability of your asset allocation to deliver the results you need. As the above data show, the stable, cash-generative investments that we have selected for you have a demonstrated track record of resilience during difficult times. We also didn't mention how consumers around the world flocked to the products of the investments we own during the covid-19 crisis – the most recent example of the resilience of stable, cash-generating investments. And while we are in the midst of a time period of uncertainty, it's important to take stock of the positives that the economy and investment markets have going for them. For one thing, the U.S. economy remains strong, with near record-low unemployment. The Ukraine crisis will get resolved, just as every crisis has resolved over time. When that happens, a major veil of uncertainty will lift from the economy, commodities prices will moderate and thus so will inflation, and financial markets will certainly reflect those positives. And finally, supply chain disruptions and labor shortages that our economy has experienced as a result of covid-19 have already started moderating – executives at investments we own stated on conference calls this past month that they have experienced that, expect it to continue, and expect it to help moderate the inflation problem as the year progresses. So while there are reasons to feel gloomy at the moment, there's also potential for some of that gloom to lift as the year progresses. As the greatest living investor Warren Buffett said during the Financial Crisis, "if you wait for the robins to sing, spring will be over."[5][6]

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Sources:

(1) Yahoo Finance
(2) CNBC
(3) Roger Thomas
(4) Richard Bernstein Advisors
(5) Company Reports
(6) New York Times