The Shobe Financial Group

Market Perspectives

2nd Quarter 2022

Market Outlook for Q2

As we enter the second quarter, conversations about interest rate's effect on the equity sector and Russia's effect on the oil market seem to be top of mind.

The Relationship Between The Market and Fed Tightening Cycles

The Federal Reserve (Fed), the central bank of the U.S., uses monetary policy tools such as the federal funds rate to curb inflation. In the last 40 years, there have been a total of 6 cycles where fund rates were raised. Even though the reasons for the hikes were not similar, the equity sector specifically has historically experienced positive returns up to two years after the first increase.

Looking closer, Technology, Energy, and Industrials had the highest returns in these periods. Communication Services, Consumer Discretionary, and Consumer Staples also had positive returns despite underperforming.

These historical trends should give investors some confidence that rate increases will likely not have a large or long-term negative impact on the markets.

Why the Oil Market is a Story Itself Apart from the Russia Conflict

This year, oil prices reached their highest prices in over a decade which adds to the energy sector's continued outperformance. The sector's performance, on the other hand, has contributed to the worsening inflation situation. Oil prices are not anticipated to lower much, with the West Texas Intermediate crude estimated to be $100/Bbl. (bottle of crude oil) this year and $90/Bbl.in 2023.

While the ongoing Russia conflict has contributed to the strain on supply, it is not the only the reason why there has been a focus on the oil market. Other geopolitical conflicts in Yemen and Libya have added to the already elevate oil prices but all these issues have pointed to a bigger global issue: the oil marketing fundamental of supply and demand. Oil market inventories declined by nearly 2 million bpd (barrels per day) this year thus far. It is expected to take some time for new drilling activities to make a meaningful impact on supply.

Still, while these parts move into place, the growing energy transition is expected to gain more steam. Lack of supply and higher prices will tempt consumer to move away from fossil fuels to electric vehicles. Globally, it is forecast that the EV market share will increase to 25% in the next 3 years, followed by an increase to 50% by 2030.

With the consumer desire for electric vehicles growing, an aggressive push toward an EV friendly infrastructure will be needed as well.

Questions

If you have any questions about these topics, please let our team know.

Economic Snapshot

The US economy entered 2022 with good momentum. The outlook remains positive, but uncertainty has increased. Job growth has remained strong. Inflation has remained elevated, and price increases have further broadened across sectors. The Federal Reserve (Fed) has begun raising short-term interest rates and is now signaling a more aggressive outlook for rate increases in the quarters ahead, but will be nimble. Russia's invasion of Ukraine has uncertain implications for the US economy, but will likely weigh against growth and add to inflation pressures in the near term.

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth is expected to moderate (relative to the strong pace of 2021) but remain a bit beyond a long-term sustainable pace in 2022.
FAVORABLE	EMPLOYMENT	Nonfarm payrolls are still below where they were before the pandemic, but labor demand is strong. Higher oil prices and better wages should lure many of those on the sidelines back into the workforce.
FAVORABLE	CONSUMER SPENDING	Job and wage growth should remain supportive, although wages are generally not expected to keep pace with inflation (implying some reduction in consumer purchasing power).
FAVORABLE	BUSINESS INVESTMENT	Business fixed investment is expected to remain strong, supported by continued strength in earnings. However, the situation in Ukraine and expectations of tighter Fed policy may be restraints.
FAVORABLE	MANUFACTURING	Supply chain difficulties, materials shortages, and labor issues have continued, restraining output growth in a number of industries, but we should see improvement over the course of 2022.
FAVORABLE	HOUSING AND RESIDENTIAL CONSTRUCTION	Housing demand remains strong, but supply and affordability issues are constraints. Mortgage rates have picked up (although still relatively low by historical standards).
FAVORABLE	THE DOLLAR	The trade deficit is likely to widen further, putting some downward pressure on the dollar (if not offset by increased capital inflows). However, a stronger US economy ought to be supportive over the long term.
NEUTRAL	LONG-TERM INTEREST RATES	Despite elevated inflation, bond yields remain low by historical standards. Bond yields ought to rise as the Fed begins unwinding its balance sheet.
NEUTRAL	FISCAL POLICY	A reduction in fiscal stimulus (compared to the massive levels of 2020 and 2021) will subtract from GDP growth in 2022, but the impact should be more than offset by increased private-sector demand.
NEUTRAL	REST OF THE WORLD	The virus is still a factor globally. The conflict in Ukraine will have a bigger impact on Europe's economy than in the US. Inflation is higher everywhere, which is a bigger problem for emerging economies.
UNFAVORABLE	INFLATION	Elevated. Price increases have continued to broaden. We ought to see some rollback in prices of consumer durable goods, but inflation in services (which account for more than half of spending) has been picking up.
UNFAVORABLE	MONETARY POLICY	Behind the curve on inflation, the Fed has begun to raise short-term interest rates and is expected to move faster if inflation fails to moderate. This raises the risk of overdoing it, leading to a possible recession in 2023.

Raymond James, "April 2022 " *Investment Strategy Quarterly,* Pg. 4-10, 14-17 Web.

One Oak Square | 8280 YMCA Plaza Drive, #4 | Baton Rouge, LA 70810
225.763.7010 | 800.942.2777 | fax 225.763.7040
www.shobe.com