Schaper, Benz & Wise
INVESTMENT COUNSEL
Trusted Advisor for Generations

18 Jewelers Park Dr., Suite 200 | P.O. Box 628
Neenah, WI 54957-0628 | 920.727.1137

Economic & Market Summary
April 2022

Supported by a strong labor market, the US economy is generally in a good position. After steady improvement over the last few months, payrolls and unemployment have nearly returned to pre-pandemic levels and job openings still outnumber the jobless. However, economic growth forecasts for the first quarter and full year have come down, likely reflecting the impact of Omicron, economic disruptions from the Russia-Ukraine conflict, and unhealthy inflation. Running at 5-8% depending on the measure, inflation is too high and represents the biggest risk to economic growth in our view. Despite a strong labor market, wages have lagged inflation over the last 12 months leading to a decline in consumer purchasing power. If left unchecked, economic growth could suffer.

The Federal Reserve has finally acknowledged that inflation is problematic and monetary policy needs to tighten. Throughout the year and potentially into next, the Fed will raise short-term interest rates and reduce the size of its balance sheet. These actions effectively lower the amount of money in circulation thus counterbalancing inflation. But because it's waited so long, the Fed is in a precarious position. Inflation needs to be controlled soon but if the Fed tightens too aggressively, the economy could tip into a recession. If it moves too slowly, inflation becomes entrenched and difficult to control without restrictive, potentially recession-inducing policy later on. Given the Fed's past track record, our expectations for a perfect "soft landing" are measured.

The Fed, and many forecasters, expect inflation to moderate in the second half of this year driven by tighter monetary policy and untangling supply chains. We see several risks to this view. First, unless recent retirees reenter the workforce or immigration increases, US labor supply will remain tight. This puts upward pressure on wages and potentially prices. Second, rent inflation has room to accelerate. Rent has lagged overall inflation probably due to pandemic eviction moratoriums, but those ended last August. Third, Russia's attack on Ukraine is adding to inflation. Global energy markets are being disrupted and food markets are probably next. Ukraine produces a sizable amount of grain and the conflict has curtailed exports and is surely impacting the spring planting season. Sanctions are also impacting fertilizer markets. Additionally, Russia and Ukraine supply a significant amount of the world's palladium and neon gas which are used in semiconductor manufacturing. Disruptions there could worsen chip shortages, putting further upward pressure on vehicle prices and other areas.

Financial markets are off to a soft start, reflecting expectations for tighter monetary policy, reduced fiscal stimulus, high inflation, and geopolitical instability. Bond yields are up across the maturity curve especially at the short end where the Fed exerts the most influence. Long-dated bond yields still look too low to us given the inflationary environment. After correcting 13%, the S&P 500 recovered to end the quarter down around 5%, the first negative quarter in two years. But this isn't surprising. While the backdrop is a contributor, stock valuations were high relative to historical norms making prices vulnerable to a correction. The pressure has been greatest for emerging growth companies whose valuations are relatively sensitive to changes in interest rates. Full year corporate earnings estimates currently imply a healthy 9% gain vs 2021. However, with cost structures rising and economic growth potentially slowing, we foresee some downward revisions later this year. Given the unsettled environment, more market volatility seems probable. However, stock prices tend to overshoot both up and down. High-quality companies go on sale as short-term concerns push prices below fair market values. Challenging environments often yield great opportunities for patient investors.

Mark J. Sprtel, CFA

If you're financial situation has materially changed or you would like to discuss your accounts in detail, please contact your investment manager. To request our SEC Form ADV Part II, please contact Mark J. Sprtel, Chief Compliance Officer, at the address above.