MARKET UPDATE:

Since our last market communique on the Ukraine war, cross-asset volatility has remained high as the war has proven more intense and geopolitically unpalatable.

A FURTHER ESCALATION

This has led to a ratcheting-up of economic sanctions on Russia that are rapidly crippling their economy. While economic sanctions are common pressure points applied to wayward countries in times of war, the breadth and scale of sanctions implemented thus far by the US and her allies on Russia (including freezing Russian central bank assets, denying access to the global payments system called SWIFT, and now today boycotting Russian oil in the US) is without modern day precedent. One commentator has called this the economic equivalent of dropping a nuclear bomb on Russia—already incinerated nearly half the value of the Russian currency since hostilities began.

STAGFLATION?

From a market and economic perspective, the greatest risk remains the knock-on effects of rising commodity prices (especially oil & wheat) on global inflation.

The war has already induced a commodity supply shock, and it's happening at a time when inflation was already running at 40-year highs. The best corollary to the current situation is 1973, when geopolitical events in the Middle East led to an oil shock when inflation was similarly high. Like the 1970s analogue, a serious risk today is that commodity prices move high enough to slow the economy while simultaneously keeping sustained upward pressure on inflation—resulting in stagflation (i.e. high inflation with weak growth). In this situation the Fed would have to choose between the lesser of two evils: 1) fight inflation (by raising interest rates and tightening conditions that could slow growth still more) or 2) defend growth (by deferring rate hikes…but allowing inflation to run hot). Historically, the Fed has favored defending growth.

During the 1970s, the Fed consistently lagged its policy response to inflation in an attempt to preserve growth—believing that the underlying pressures were only temporary given the geopolitical nature of the oil shock. While they did raise interest rates, the hikes were ultimately too slow and modest to prevent inflation from being a problem for a decade (until the Volker rate hikes of the 80s). The potential parallels to today's Fed are obvious.

To be clear, the situation today in the US is better than it was in the 70s. Today, the US is a major producer and net exporter of oil, which mitigates both supply and price risk to Americans. Europe, by comparison, is not energy self-sufficient and is in a far more tenuous position (which is probably why they haven't yet sanctioned Russian oil and gas).

We believe that over time, geopolitical tensions will be lessened and inflation pressures reduced, but right now we are keeping a sharp eye on these current global challenges and have opportunistic plans in place as the market volatility continues.

400 Market Street ● Suite 200 ● Williamsport PA 17701

570.326.9500 ● 866.855.0569 ● fax: 570.326.9577 ● www.hudockcapital.com