SPRING 2022

Perhaps it's a sign of age, but the passing of months (and years) seems to happen more rapidly these days. We have completed the first quarter of 2022 and look forward to the coming of spring and summer in Maine. More remarkable, perhaps, than the speed of the passing months, are the dramatic events, unforeseen by many, that may occur in any given three-month period.

At the turn of the new year, we commented that we began the fourth quarter virtually unaware of the impending crisis of Omicron, and, had we known, we certainly would not have anticipated the strong performance of the stock market in the last quarter of 2021. We began this year with a somewhat cautious outlook due to concerns about inflation among other worries, but we did not foresee a war in Ukraine. Had we known we might have expected the relatively poor performance of stocks so far in 2022 but the war only added to the challenges facing investors this year.

In the first quarter of 2022, the Standard & Poor's 500 (S&P 500) declined 4.6%. The Dow Jones Industrial Average (DJIA) declined by 4.6% and the Nasdaq by 9.1%. All three indices recovered somewhat from yearly lows during March. The stock market, as measured by these indices, was trending lower before the war however, due to ongoing concerns about inflation and interest rates among other worries. In addition to the tragic human consequences, Russia's invasion of Ukraine added to the existing instability in the global economy and exacerbated the rise in energy costs.

Adding to the challenges in the first quarter of 2022 was the increase in consumer prices. Oil prices as measured by the West Texas Intermediate index, rose 39% in the first quarter while other consumer prices also spiked. Gasoline and heating oil prices have increased dramatically over the last few months and food, housing, automobiles, and other essential items have also become more expensive.

Interest rates have risen in response to inflation with the 10-year U.S. Treasury note at 2.37% as of March 31, 2022, up from 1.71% at year end. The recent increase in the two-year note has been more remarkable reaching 2.45% at the end of the quarter, up from 0.73% at year end. The higher rate on the two-year note versus the ten-year note is a yield curve inversion, which may be a harbinger of a recession.

While recessions do tend to follow yield curve inversions, the indictor is not always reliable, and the recession, if it happens at all, may occur one or two years after the inversion. Many analysts are concerned that the unprecedented size of the Federal Reserve's holdings of treasury notes, particularly 10-year notes, has distorted the markets. According to Richard Bernstein Associates[1], without the massive Fed holdings, the yield on the ten year might be closer to 3.70%, well above the two-year yield. If a recession is imminent, it is not apparent in much of the current economic data as job growth and unemployment numbers remain robust.

The Federal Reserve does have a difficult task however, in raising interest rates to cool inflation without causing a recession. These so called "soft landings" are not easy to accomplish and the toll of higher prices and interest rates may cause a slow-down in the economy. According to Argus Research[2], the Mortgage News Daily reported that the 30-year fixed rate mortgage hit 4.95% in March, up from about 3.5% a year ago. Higher financing costs coupled with far higher housing prices may significantly reduce the demand for houses, dampening all the positive economic effects of household formation.

These economic concerns have been reflected in the performance of many stocks during the first quarter of 2022. Stocks associated with housing or household formation like Pulte Group and Whirlpool are down 33% from 12-month highs. Large international banks like J.P. Morgan and Citigroup are down 22% and 35% respectively, due to global economic worries. Many technology companies like Intel and Microsoft, are down for the year and well below their 12- month highs but have recovered from lows reached in the first quarter.

We have learned over many years that predicting recessions is beyond our abilities and even if we had that foresight, it would not alter our long-term investment discipline. We are due for higher interest rates and inflation remains a major

[1] CNBC Patti Dom Market Insider 3/31/2022
[2] Argus Research Market Digest 3/31/2022

concern. The Fed has a difficult task ahead and there may be consequences for the stock and bond markets. Global instability is a constant concern, and we have no idea how the situation in Ukraine will evolve. However, we do believe that sticking to a sound investment strategy with a diverse portfolio of solid companies and funds will prevail in the long run. We appreciate your confidence, and we wish you all the best.

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