

Wentz Weekly

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Geopolitical and Fed Uncertainty



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The situation with Russia escalated last week, causing a selloff heading into the long weekend. It was a back-and-forth news cycle regarding the rising tensions between Russia western allies. For weeks, Russia has been amassing troops at the Ukraine border and conducting military exercises, leading the world to believe an invasion was imminent. The thought of an invasion all comes down to Putin wanting to take back separatists regions of Ukraine that were part of the Soviet Union and seal his place in Russian history. Russia has continuously stated this was false and markets bounced back at one point last week on word from Russia it had pulled back its troops from the border and concluded military exercises. The issue escalated on Presidents Day when Russia announced the recognition of the independence of Ukraine's separatist regions in the eastern part of the country that borders Russia and ordered troops into the regions. It appears to us Putin has been building a list of excuses on future military action and waiting until after the Olympics for its next big move, waiting to not upset its ally China. The White House said it received information Russian troops deployed to the two regions "for so-called peacekeeping functions."

The rising tensions add uncertainty for markets, leading to a risk off scenario and weakness in global markets. The U.S. will largely be unaffected by the situation as company's profits will be unaffected, but markets will remain in risk-off mode. The U.S. has responded by issuing economic sanctions on Russia and threatening of more severe sanctions in the future. Commodities will likely be most affected and with Russia a top global oil producer, even making up over 40% of Europe's supply, we may not see relief from higher oil/gas prices any time soon. We believe the markets will remain concerned about the situation short-term before shifting focus back to the Fed, earnings, and overall fundamentals of the U.S. economy. All of this makes us reiterate our recent thoughts – expect continued heightened volatility, as the market moves from focusing on earnings to focusing on geopolitics with the situation in Eastern Europe and macro events with the uncertainty on the Fed's pace of tightening monetary policy, with value, defensive and income stocks continuing to be in favor.

The Fed's FOMC meeting minutes from its most recent meeting in January released last week indicated the Fed will be ready to reduce its balance sheet at a faster pace than 2017-2019 and that a "significant" reduction in its assets is warranted. Participants acknowledged inflation has broadened beyond sectors directly impacted by covid. But they still expect inflation to moderate over the course of the year due to supply and demand becoming more balanced and the removal of monetary accommodation. Importantly, which we have been more of lately with comments from several Fed officials, several committee members supported ending tapering sooner than the current pace "to send an even stronger signal that the Committee was committed to bringing down inflation." The minutes were mostly as expected with no surprises and one could make the point it was even less hawkish than expected. That appeared to be the reason after the release markets moved higher. Since its January meeting though, we have received several inflation reports showing an acceleration in inflation with no signs of slowing, increasing the chance of a more aggressive tightening of policy and additional uncertainty for markets.

Retail sales came in very strong yet again for January. Monthly sales rose 3.8%, higher than the 2.0% increase expected, while December's sales were revised lower, from a decline of 1.9% to a decline of 2.5%. Sometimes, since they are such large purchases, vehicle sales drive much of the index higher or lower so we look at sales excluding auto and gas sales (while is volatile due to energy prices), which was still up 3.8% and a large beat compared to the expectation of a 0.6% increase. Overall sales are 13.0% higher than a year ago. The largest growth categories were furniture (+7.2%), e-commerce sales (+14.5%), vehicles/parts (+5.7%), building materials (+4.1%), and general merchandise stores (+3.6%), with restaurants (Omicron?), sporting goods and health care seeing small declines in the month. Taking inflation into consideration though, which gives us a look at sales on a real basis – with a 1.0% rise in prices in January and a 3.8% rise in retail sales, real growth in sales was 2.8%. Compared to a year ago inflation is 7.5% and retail sales growth was 13.0%, real growth in sales was 5.5% which is not as great as the headlines suggest, but still solid and growing which is key.

Sales of existing homes began 2022 on a solid note, rising 6.7% in the month, for the best monthly gain in 18 months, to a seasonally adjusted annual rate of 6.500 million and well above the expectation of 6.100 million. The increase was despite rough weather in January and could reflect home buyers rushing into the market before rates rise any further. Construction of new homes fell 4.1% in January to a seasonally adjusted annual rate of 1.638 million, and roughly flat from a year ago. The number of starts was below expectations but looks to have been impacted by weather, after one of the most warmest December's on record, in addition to the surge in Omicron cases. The number of housing starts should climb again in future months with builders having the highest backlog of housing units authorized but not yet started since the series began in 1999. The number of permits continue to climb. The housing market may be under pressure in future months though as affordability becomes a rising problem with the median price of an existing home up over 15% from a year ago and as rates steadily rise. According to the Freddie Mac weekly mortgage survey, the average 30-year prime rate climbed to 3.92% in the latest week, 23 basis points (0.23%) higher than the week prior and almost a full percentage point higher than where it began the year. Rates bottomed in January 2021 at 2.65%. We are seeing the affect in high frequency data – applications to refinance are down 9% from last week and down 59% from this time a year ago.

Company News

- Cedar Fair said last week it had rejected a merger offer from SeaWorld Entertainment in which Cedar Fair was offered \$60/share. In addition, the company reported 2021 attendance that was 70% of 2019 levels while per capita spending in parks was 28% higher than the year prior to a record \$62.03.
- In addition to reporting earnings results and subscriber numbers that beat expectations, ViacomCBS announced it will rebrand to be known as Paramount Global. The new name is to reflect its streaming strategy and comes at a time where a large wave of new content is set to be released.
- The WSJ reported early last week that Cisco was in talks to acquire data analytic firm Splunk for around \$20 billion. The report says it is a recent offer and the companies are no in active talks.

The Week Ahead

It will be another holiday shortened trading week after closed equity and fixed income markets from the Presidents Day holiday Monday. The earnings calendar will move to mostly retailers and smaller tech companies with another large wave of quarterly reports this week. Highlights will include; Home Depot, Macy's, Teladoc on Tuesday; Lowe's, TJX, Overstock.com, eBay, fuboTV on Wednesday; Alibaba, Coinbase, Etsy, Norwegian Cruise Line, Moderna on Thursday; and Footlocker and EOG Resources on Friday. The economic calendar is busy as well. Tuesday will see the Case-Shiller Home Price Index, which should show home prices remain elevated, followed by the PMI manufacturing survey and the survey on Consumer Confidence. Thursday's reports include the second revision on fourth quarter GDP (a small upward revision expected), weekly jobless claims, and new home sales for January. Wrapping the week on Friday is the durable goods orders report, survey on Consumer Sentiment, and the monthly consumer report on income and spending which will include the PCE price index, Fed's preferred measure of inflation. The week will also include several speeches from Fed members that markets will pay attention to.

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