Economic Outlook

First Quarter 2022

The New World (Dis)Order

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SEI recently released its first-quarter Economic Outlook. A summary of the conclusions is provided below:

- The Russian war against Ukraine is a seminal event that has worsened the shortages and inflation pressures already felt as a result of the COVID-19 pandemic.
- Even if peace breaks out tomorrow, Russia will be isolated economically and become dependent on China, financially and economically.
- The Federal Reserve (Fed) and other central banks have no choice but to transition from supporting economic growth with extremely expansive monetary policies to fighting inflation with higher interest rates and quantitative tightening.
- Fiscal policy, especially in Europe, will likely continue to be expansionary in order to mitigate the impact of price spikes in food and energy, provide military support to Ukraine and open-ended aid to millions of war refugees, bolster NATO defenses, and improve energy security.
- The global disruption to the supply of commodities had a predictable result: commodity-price inflation. Prices have been soaring since the pandemic lows recorded in March 2020. The upward trajectory in commodities inflation is nearly as sharp as in the early 1970s. Eventually, higher prices lead to more investment and increased supply, while those same higher prices force a sharp pullback in demand and may result in an economic recession.
- Fears of a recession in the U.S. and Europe this year or next appear misplaced, although growth will likely be slower than had been anticipated prior to the invasion. The odds of recession will climb beyond next year, however, as global interest rates adjusted for inflation rise and the financial positions of households and business deteriorate.
- Equity markets rebounded surprisingly sharply during the closing weeks of March, highlighting the resiliency and adaptability of publicly-traded companies. Despite this, investors should continue to expect more volatility and mixed equity performance as a result of war uncertainty, stubbornly high inflation and tighter monetary policies.
- The threat of stagflation (below-average economic growth combined with above-average inflation) is the greatest it has been since the 1970s. In that earlier period, value equities, small-cap stocks and commodities were among the best-performing asset classes, while bonds and stocks with high earnings multiples lagged badly.
- While the past is not necessarily prologue, SEI notes that the best-performing areas in the year-to-date have been commodities, commodity equities, value-oriented equity and defensive sectors. Active managers also have had an easier time outperforming passive benchmarks as mega-cap stocks saw significant declines.
- From the years-long COVID pandemic and supply-chain shocks to inflation and war, the world is an unpredictable place where events both far from home and right in your neighborhood can sometimes have dramatic effects on financial markets. Unsettled times further reinforce our belief in diversification as a sound investment strategy.

A full-length paper is available if you wish to learn more about these timely topics.

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