Graves Light Lenhart
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Graves Light Lenhart February '22 Market Commentary

Russia/Ukraine Conflict Paints Somber Landscape

Market Overview:

The world anxiously honed its focus on the devastating conflict in Europe when the Russian military invaded Ukraine on February 24th. While the human costs of this invasion are immeasurable, global stock markets reacted to the incursion with erratic swings while finishing the month at modestly lower levels (with few exceptions). While risk of invasion was not entirely unexpected, it has increased the risk of a negative chain of events, including further military escalation as well as unanticipated difficulties for the global economy at an important juncture in its recovery from COVID-19 related disruptions. While the first-order economic impact would be most felt in Europe (immediately caused by rising energy costs), the secondary impact of a European slowdown may serve to slow the global economy.

Extending from January's sluggish tone (January Market Commentary), many parts of the market have now experienced a significant correction to start the year. This is also in large part due to a less accommodative US Federal Reserve (Fed) that is now promising to act in order to slow inflation. While expectations for the number of Fed rate hikes slightly lowered in tandem with the Russia/Ukraine conflict, the near-inevitable conclusion is that it remains "behind the curve" and will need to proceed in normalizing its aggressive, stimulative monetary policy. With the Fed belatedly aiming to tackle high and persistent inflation, markets must also traverse a fundamental shift in the current liquidity regime which appears to be occurring irrespective of the Russia/Ukraine conflict. The compounding effect on the markets were laid bare in February, as volatility was both consistent and heightened.

Asset Performance:

US equities experienced a challenging February. Both escalating geopolitical concerns involving Russia's invasion of Ukraine as well as uncertainty over the Fed's rate hike trajectory resulted in the S&P 500 briefly trading in official correction territory when compared to its recent highs. Indeed, towards the end of the month, the index had declined by 11.9% when compared to its record high level to commence the year.

Thematically, value-oriented securities continued to outperform their growth-biased brethren as valuation multiples continued to contract, creating more pressure on the pockets of the market which

were previously trading at a weighty relative premium. For the month, the S&P 500 Value index declined by 1.4% compared to a 4.5% decline for the S&P 500 Growth index. The Energy sector was one of very few industries to generate a positive return, being a direct beneficiary of higher oil prices as the Ukraine-Russia tensions roiled markets. Directly related, commodity prices continued to soar, contributing to inflationary pressures. They continued to do so in response to Russia's war on Ukraine since both countries are major producers and exporters of globally consumed commodities.

Government bonds staged a powerful late month rally as investors bet that the economic fallout from Russia's invasion would push central banks to raise interest rates more slowly than previously anticipated. While the 10-year US Treasury rate edged up slightly for the month, the direction of travel was anything but one-way. Having reached a mid-month peak of 2.05%, this key benchmark rate plummeted during the second half of the month as investors sought refuge from the coinciding market turmoil. The level of trading volatility in the US Treasury market – as measured by the Merrill Lynch MOVE index – ended the month at its highest levels registered since the worst of pandemic trading nearly two years ago. This combination of "risk-off" trading and interest rate volatility continued to weigh on High Yield bonds – otherwise known as "junk bonds" – with the Merrill Lynch US High Yield index continuing to slide with year-to-date returns (through February-end) at -3.6%. We emphasize that the level of compensation received for default risk, as measured by credit spread, has widened yet remains below levels that would entice us to add exposure to this asset class. Nonetheless, we continue to closely monitor this market as the entry yield appears increasingly attractive.

Key US Index Returns	YTD '22	February '22
S&P 500	-8.0%	-3.0%
Nasdaq	-12.0%	-3.4%
Dow Jones Industrial Average	-6.4%	-3.3%

Relevant Fixed Income Yields	YE 2021	February '22
US 10-Year Treasury Note	1.51%	1.84%
Investment Grade Corp. (C0A0)	2.4%	3.1%
High Yield Corp. (H0A0)	4.3%	5.6%

Source: Factset as of 03/01/22

Closing Thoughts:

The human cost of aggressive military action transcends financial considerations. While there is still much that is unknown regarding the extent and ultimate outcome of the Russia-Ukraine conflict, the situation remains fluid and could still very well be in its early stages. Historically, the uncertainty of both a conflict's duration and severity leads to initial selling and a flight to safe/haven assets, which is then often followed by improved clarity and by extension, a relief rally. However, each conflict has experienced its own unique circumstances which have not always led to positive near-term outcomes. Related to investment implications, we remind our clients that staying invested in a diversified, goals-oriented portfolio has paid off through countless geopolitical crises and should continue to do so. At its core, diversification – both across and within asset classes – remains key as volatility is expected to persist.

Warm regards,

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