



Liberty National Wealth Management Newsletter

In this Q1 recap: Global financial markets rattled by the Russian invasion of Ukraine. Inflation pressures rise as oil prices surge and supply chains become further stressed. The Federal Reserve is taking its first steps toward monetary normalization.

Quarterly Economic Update

A review of Q1 2022, Presented by Liberty National Wealth Management

THE QUARTER IN BRIEF

Financial markets abhor uncertainty, and Russia's invasion of Ukraine added new uncertainties to a market already wavering from accelerating inflation and the prospect of higher interest rates. After a year of strong economic growth and solid stock market returns, heightened inflation and the unclear pace of monetary policy tightening triggered market volatility right from the start of the new year. The potential of rising interest rates propelled bond yields higher and hurt stock valuations, especially the previously high-flying, high-growth technology names.

Stock market weakness continued into February as investors worried that the Fed's slow response would lead them to address high inflation with more rate hikes than investors initially anticipated. When Fed Chair Jerome Powell announced plans to shrink the Fed's balance sheet, the fears of a more aggressive monetary policy grew.

Financial markets were roiled by the lead-up to the Russian invasion of Ukraine, with prices becoming more volatile as investors reacted to the building tensions on the Russian-Ukrainian border and momentary glimpses of a potential diplomatic solution. Stocks slumped on news that hostilities had started as investors assessed the global economic impact of the invasion and the economic sanctions that followed. The flight to safety sent bond yields lower, halting, at least temporarily, the march toward higher yields.

In the final month of the first quarter, stocks continued to be volatile as intensifying hostilities in Ukraine added to inflation and supply-chain concerns. However, by mid-March, stocks staged a strong turnaround that reversed much of the quarter-to-date declines as investors welcomed the clarity on monetary policy following the Federal Open Market Committee's March meeting and encouraging economic data.

Overlooked by these headline concerns, corporate profits for the fourth quarter exceeded market expectations. With 95% of S&P 500 constituent companies reporting, 76% reported a positive earnings surprise, posting an



average earnings growth rate of 30.7% in the fourth quarter. This earnings momentum may likely moderate in the first quarter to a 4.6% increase and 8.5% for the full year.¹

THE U.S. ECONOMY

In the fourth quarter, the U.S. economy grew at a robust annualized rate of 6.9%, led by strong retail sales, services, and exports. The economy overcame several substantial headwinds, including a surge in Omicron infections, accelerating inflation, continued bottlenecks in the global supply chain, a labor shortage, and the anticipation of a tighter monetary policy.²

The solid economic performance in the fourth quarter helped drive the unemployment rate from 4.8% in September to 3.9% in December, a favorable trend that carried over into the first quarter of 2022, with the unemployment rate falling further to 3.8% in February.³

The first quarter's economic expansion is likely to be modest due to the drag of Omicron, but the Ukrainian invasion may further dent economic growth. The Federal Reserve Bank of Atlanta, which attempts to track GDP growth in real-time, reported that its "GDP Now" forecasting model lowered its nearly 2.0% Q1 GDP pre-invasion annualized growth rate estimate to 1.3% as of March 31, 2022.⁴

The Atlanta Fed is not alone. In one survey of economists two weeks after the invasion, findings lowered the average of 14 earlier forecasts by 0.3 percentage points. The first and second quarters felt the most significant impact of the projected economic deceleration before stabilizing in the year's final two quarters.⁵

Elevated inflation was a dominant concern throughout the quarter. The cost of consumer goods jumped 7.9% year-over-year in February, the most significant increase since July 1981. This boost comes atop year-over-year increases in the Consumer Price Index of 7.5% in January and 7.0% in December 2021.⁶

With lower economic projections ahead, the Fed set upon a new course in its monetary policy with the end of asset purchases and the implementation of a 0.25% interest rate hike, the first such increase since 2018. The Fed also signaled the possibility of a total of seven quarter-point rate hikes this year and three or four next year to combat inflation and its intention to announce a plan for reducing its \$9 trillion balance sheet.⁷

In the quarter to come, economic growth will be challenging in an uncertain geopolitical landscape, further interest rate hikes, the persistence of elevated inflation, and supply-chain stresses.



GLOBAL ECONOMIC HEALTH

The impact of war in Europe has led to downward revisions in the 2022 growth estimates for major global economies. Further supply chain disruptions and more significant inflationary pressures are likely to weigh upon economic activity.

The economic repercussions of Russia's invasion of Ukraine are widespread. Commodities prices, from oil and agricultural products to natural gas and base metals, may stay elevated for the foreseeable future. This sustained elevation may be due to the combination of sanctions, the destruction of infrastructure, and supply uncertainty, resulting from the disruption of supply chains, as land- and sea-based trade routes have become impeded or completely closed down.

While the measure of the invasion's economic impact remains fluid and imprecise, according to the Economist Intelligence Unit (EIU), a British-based economic research and analytics group, economic growth in Europe may slow down by nearly 50% from a pre-war estimate of 3.9% to about 2.0%. The impact on eurozone countries may be less severe, with estimates revised from 4.0% to 3.7%. EIU also projects that global growth will be shaved by 0.5 percentage points, from 3.9% to 3.4%.⁸

The United Kingdom is facing a similar outlook. The British Chamber of Commerce downgraded its forecast for economic growth in 2022, reducing its initial 4.2% growth projection to 3.6% in the wake of the Russian invasion.⁹

The Japanese economy saw a steep slowdown in the first quarter due to a surge in Omicron infections. A Reuters poll of analysts lowered their median Q1 GDP annualized growth rate from 4.5% to 0.4%. Japan's economy may remain under pressure as a declining yen has exacerbated rising energy and commodity prices.¹⁰

Finally, China set its 2022 growth rate target at 5.5%, the lowest in more than 25 years. Even this modest goal may be challenging to reach amid struggles to manage a surge in COVID-19 infections that have led to shutdowns of cities and factories and regulatory pressures in its property and technology sectors.¹¹

The MSCI-EAFE Index, which tracks developed overseas markets, slid 6.61% in Q1, while emerging markets, as measured by the MSCI-EM (Emerging Markets) Index, fell 7.32%.¹²

TIP OF THE QUARTER



Adult children may ask you to help them with business financing or a down payment on a property. While it's tempting to say yes, it may be best to determine if your finances can handle it.



LOOKING BACK, LOOKING FORWARD

Blindsided by one of the "known unknowns" that are always lurking in the background and can upset existing market narratives, markets reacted to Q1's rising inflation. Investor expectations coming into 2022 were modest – economic growth may come slowly but remain solid, and stocks were forecast to rise, though not at the pace of 2021.

In the new year, investors were fully aware that inflation was proving more durable than "transitory" and that interest rates could head higher. Yet, it was only upon the turn of a calendar page that investors seemingly contemplated what that potentially meant, i.e., a more aggressive Fed, a slowdown in corporate earnings growth, and a devaluing of high-growth companies whose earnings may be in the distant future.

In one respect, the market correction in the first quarter (defined as a decline of 10-20% from recent market highs) shouldn't have come as a surprise to experienced investors since there have been 27 such declines since World War II, with the last one occurring in 2018. By historical standards, a correction was overdue. Past corrections have had an average decline of 13.7% and last for about four months (not including corrections that turn into bear markets, i.e., a decline of 20% or more).¹³

Nevertheless, historical performance is only a guide, not a guarantee of the future. So, as investors look forward, they may see three significant headwinds for the market: inflation, higher interest rates, and potentially wider geopolitical issues.

While a tighter monetary policy is the Fed's primary tool in fighting inflation, its ability to dampen inflation over the near- to intermediate-term may be limited since higher interest rates take time to work through the economic system. Also, a tighter monetary policy will do very little to solve current supply chain problems – a significant contributor to rising prices.

While higher rates may be effective for lowering inflation longer term, it may come at a short-term cost to investors. Higher interest rates, along with any shrinking of the Fed's balance sheet, may reduce liquidity in the markets, which may put some downward pressure on stocks.

The wild card seems to be what Russia does next, which could be as disparate as agreeing to a withdrawal from Ukraine with a promise to respect Ukraine's territorial integrity to invading additional countries and ratcheting up tensions with the West.

A peaceful resolution to the Ukraine crisis may be met with deep relief by investors, potentially allowing markets to rally and return the focus to economic fundamentals, like GDP growth, inflation, and corporate profits.

A widening of tensions may prove problematic to the financial markets and the economy, especially if they involve Russia taking steps that violate the borders of NATO countries or if China pursues an invasion of Taiwan.

We've seen markets unsettled by war in the past. They tend to regain their balance in a relatively short period. However, the conflict in Ukraine is very different from more recent wars, which is why the market's near-term prospects may first and foremost turn on the outcome of events in Eastern Europe.



Liberty National
BANK
Wealth Management Division

MARKET INDEX	Y-T-D % CHANGE	Q1 % CHANGE	Q4 % CHANGE
DJIA	-4.57%	-4.57%	+7.37%
NASDAQ	-9.10%	-9.10%	+8.28%
S&P 500	-4.95%	-4.95%	+10.65%

BOND YIELD	3/31 RATE	1 MO AGO	1 YR AGO
10 YR TREASURY	2.33%	1.84%	1.75%

Sources: Wall Street Journal, March 31, 2022, Treasury.gov (Bond Yield)

The market indexes discussed are unmanaged and generally considered representative of their respective markets. Individuals cannot directly invest in unmanaged indexes. Past performance does not guarantee future results. U.S. Treasury Notes are guaranteed by the federal government as to the timely payment of principal and interest. However, if you sell a Treasury Note prior to maturity, it may be worth more or less than the original price paid.

QUOTE OF THE QUARTER



“A learning experience is one of those things that say, ‘You know that thing you just did? Don't do that.’”

DOUGLAS ADAMS

If you are interested in learning more about the services Liberty National Bank can provide, please contact us for a free consultation at our wealth management locations in Downtown Sioux Falls or Dakota Dunes.



L to R: Jordan Hermanson; Jerus Campbell, JD; Leon Rozeboom.

133 S. Main Avenue
Sioux Falls, SD 57104
Phone: 605-782-4505

324 Dakota Dunes Blvd.
Dakota Dunes, SD 57049
Phone: 605-217-4425



PAST PERFORMANCE DOES NOT GUARANTEE FUTURE RESULTS – INVESTMENTS NOT FDIC INSURED – MAY LOSE VALUE – NO BANK GUARANTEE

This material was prepared by MarketingPro, Inc., and does not necessarily represent the views of the presenting party, nor their affiliates. The information herein has been derived from sources believed to be accurate. Please note - investing involves risk, and past performance is no guarantee of future results. Investments will fluctuate and when redeemed may be worth more or less than when originally invested. This information should not be construed as investment, tax or legal advice and may not be relied on for the purpose of avoiding any Federal tax penalty. This is neither a solicitation nor recommendation to purchase or sell any investment or insurance product or service, and should not be relied upon as such. All market indices discussed are unmanaged and are not illustrative of any particular investment. Indices do not incur management fees, costs, or expenses. Investors cannot invest directly in indices. All economic and performance data is historical and not indicative of future results. The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks. The NASDAQ Composite Index is a market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System. The Standard & Poor's 500 (S&P 500) is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. NYSE Group, Inc. (NYSE:NYX) operates two securities exchanges: the New York Stock Exchange (the "NYSE") and NYSE Arca (formerly known as the Archipelago Exchange, or ArcaEx®, and the Pacific Exchange). NYSE Group is a leading provider of securities listing, trading and market data products and services. The New York Mercantile Exchange, Inc. (NYMEX) is the world's largest physical commodity futures exchange and the preeminent trading forum for energy and precious metals, with trading conducted through two divisions – the NYMEX Division, home to the energy, platinum, and palladium markets, and the COMEX Division, on which all other metals trade. The CAC-40 Index is a narrow-based, modified capitalization-weighted index of 40 companies listed on the Paris Bourse. The DAX 30 is a Blue Chip stock market index consisting of the 30 major German companies trading on the Frankfurt Stock Exchange. The FTSE 100 Index is a share index of the 100 most highly capitalized companies listed on the London Stock Exchange. BSE Sensex or Bombay Stock Exchange Sensitivity Index is a value-weighted index composed of 30 stocks that started January 1, 1986. Nikkei 225 (Ticker: ^N225) is a stock market index for the Tokyo Stock Exchange (TSE). The Nikkei average is the most watched index of Asian stocks. The Hang Seng Index is a free float-adjusted market capitalization-weighted stock market index that is the main indicator of the overall market performance in Hong Kong. The All Ordinaries (XAO) is considered a total market barometer for the Australian stock market and contains the 500 largest ASX-listed companies by way of market capitalization. The SSE Composite Index is an index of all stocks (A shares and B shares) that are traded at the Shanghai Stock Exchange. The S&P/TSX Composite Index is an index of the stock (equity) prices of the largest companies on the Toronto Stock Exchange (TSX) as measured by market capitalization. The MSCI Emerging Markets Index is a float-adjusted market capitalization index consisting of indices in more than 25 emerging economies. The MSCI World Index is a free-float weighted equity index that includes developed world markets and does not include emerging markets. The CBOE Volatility Index® is a key measure of market expectations of near-term volatility conveyed by S&P 500 stock index option prices. The S&P SmallCap 600® measures the small-cap segment of the U.S. equity market. The Russell 2000 Index is a small-cap stock market index of the bottom 2,000 stocks in the Russell 3000 Index. Additional risks are associated with international investing, such as currency fluctuations, political and economic instability and differences in accounting standards. This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. MarketingPro, Inc. is not affiliated with any person or firm that may be providing this information to you. The publisher is not engaged in rendering legal, accounting or other professional services. If assistance is needed, the reader is advised to engage the services of a competent professional.

CITATIONS:

1. Factset.com, February 25, 2022
2. BEA.gov, March 30, 2022
3. Statista, March 7, 2022
4. AtlantaFed.org, April 5, 2022
5. CNBC, March 6, 2022
6. Bureau of Labor Statistics, March 15, 2022
7. WSJ.com, March 17, 2022
8. Economist Intelligence Update, March 3, 2022
9. British Chambers of Commerce, March 4, 2022
10. Reuters.com, February 27, 2022
11. WSJ.com, March 4, 2022
12. MSCI.com, April 5, 2022
13. CNBC, February 27, 2022