

March 7, 2022 – Weekly Notes

Economic Commentary:

As the war in Ukraine continues and the price of oil rises in anticipation of supply disruptions, the challenges multiply for the US and global economies and the policy makers attempting to guide their economics forward in growth and price stability. The focus of most central bankers – most notably the US Federal Reserve --- remains laser-like on inflation, with a deep awareness that rising natural gas, oil and refined product prices make a reduction in inflation exceedingly difficult in the short run. Only very recently have economic growth concerns started to seep into the monetary policy thought process. Later this week, the European Central Bank (ECB) will meet to discuss, among other things, the outlook for the Eurozone; analysts currently estimate anywhere from 1-1.5 percentage points of EU growth lost to the various impacts of the Ukraine war. The ECB may better illuminate the near-term economic forecast, incorporating increased defense spending and social spending to assist refugees, humanitarian assistance, etc. The Federal Reserve Open Market Committee (FOMC) will meet on March 16, and the follow-on statement and Chairman Powell's press conference will certainly present new economic growth numbers and some better sense of how high inflation will go in the next few months. The US nonfarm payroll numbers for February (and January, revised upwards) knocked the cover off the ball, giving the Fed perceived room to fight inflation and slow spending without substantially reducing economic activity; more than 1 million jobs created in January and February is not consistent with the conventional definition of "stagflation". However, we have seen, time and again, over the last two years an economy capable of turning-on-a-dime, with a myriad of repercussions.

Data to Watch:

- US Core and Total Inflation, year-over-year for February, released Thursday, March 10
- US Initial Jobless Claims for the week of March 5, released Thursday, March 10
- ECB Meetings and Commentary, Thursday, March 10
- Michigan Consumer Sentiment Survey (preliminary) for March, released Friday, March 11

Suggested Reading:

- <https://www.nytimes.com/2022/03/07/business/economy/treasury-competition-report.html>
- <https://www.wsj.com/articles/oil-company-bp-shell-exxon-russia-ukraine-11646620145>
- <https://www.theguardian.com/business/2022/mar/07/west-impact-russia-sanctions-oil-gas>
- <https://www.bls.gov/news.release/jec.nr0.htm>

Investment Commentary*:

Elevated Uncertainty and Fear

The Russian invasion has led to a policy response from Western governments with unprecedented sanctions imposed but excluding a universal ban of purchasing Russian oil and gas. Last week, the conflict increased volatility as measured by the VIX "fear/greed index" rising to the mid-30s vs. long term average of ~19. Additionally, commodity prices surged further to fresh multi year highs with the Bloomberg Commodity Index achieving its largest 1-day gain in 13 years. Europe relies on Russia for crude oil and natural gas but has become more open to the idea of banning Russian products but not oil and gas. The United States relies far less on Russian crude and products, but a ban would contribute to higher prices. A universal oil/gas ban is likely to be more harmful to Western countries (especially Germany) than Russia.

There are several macro considerations the Investment Office is monitoring including (i) wage price inflation, (ii) the level and duration of higher oil prices that would potentially tip Europe and the U.S. into a recession and (iii) the central bank reaction function to more persistent and widespread inflation.

Market Considerations

Historically, geopolitical events are not drivers of risk markets more than six from the trigger date and the underlying economic environment and fundamental outlook becomes the more dominate factor. We are reminded that prior to the invasion the U.S. and Europe were in strong economic shape as the baton was being passed from fiscal support to consumer and corporate demand. Recent U.S. non-farm payrolls reflect a strong labor market and an unemployment rate of 3.8%. Additionally, consumer balance sheets with excess saving and strong corporate balance sheets are well positioned to absorb the initial waves of uncertainty. The equity markets dramatically repriced the speculative young

unprofitable companies (“YUC”). Expectations of higher rates and margin pressure are compressing multiples and widening spreads across even higher quality businesses. The Investment Office believes that portfolios that incorporate alternative strategies addressing real return assets and quality are important to stay invested in the short-term while helping capture long-term risk/reward opportunities.

Wealth Planning Commentary:

Tax season

We are in the midst of tax season and the regular filing deadline for 2021 is April 18th unless you filed for an extension. The New York Times reports that the IRS is more backlogged than usual due to staffing shortages and aging systems. Those filing electronically can expect quicker processing times than returns filed by paper. Client that are closing out an estate will experience the longest waiting times; the IRS’s estate processing center is particularly understaffed and some of the forms necessary to close an estate are not available electronically.

There are still a few tax saving strategies for the 2021 tax year that may be available to you:

- An IRA may be created, and tax-deductible contributions may be made until April 15th. Clients may also contribute to their HSA, which is a triple tax advantaged vehicle until this time.
- For self-employed and small business owners: SEPs and Defined Benefits (DB) plans may be established, and contributions can be made up to filing or extended filing date. SEP and DB plans offer relatively large tax-deductible contributions and tax-free growth.

Also note that the filing deadline for a business entity to be treated as an S-Corp for 2022 is March 15th.

More 2021 tax savings strategies may be found in this article:

<https://www.fa-mag.com/news/time-running-out-for-popular-tax-saving-strategies-66617.html>

New tax legislation...potentially

Joe Manchin, the Senator who opposed the Build Back Better (BBB) act, publicly stated that he could support a reconciliation package that reforms the tax-code and lowers the cost of prescription drug. Also, Manchin wants tax revenue increases to fight inflation and support climate change initiatives.

Political analyst Andy Freidman, who publishes the Washington Update, said that the Democrat leadership wants to pass at least some items that were in the BBB before the midterm elections in November. He believes that the tax provisions Joe Manchin supported in the past are the most likely to move forward:

- Increase in the corporate tax rate from 21% to 25%, including a 15% minimum tax.
- Top income tax rate increased from 37% to 39.6%, capital gains rate from 20% to 28%
- 5% surtax for families with income over \$10 million and an additional 3% surtax, on families with over \$25 million in income.

We are far from concrete legislation and if these provisions are passed, they will likely become effective in 2023.

**Source: Bloomberg
Disclosures*

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