Weekly Investment Insights

February 26, 2024

Key Takeaways:

- U.S. Leading Indicator Index falls to lowest level since April ’20.
- Fed minutes cast doubt over rate cuts.
- Existing home sales climb given lower mortgage rates.
- Mega-Cap tech leads U.S. equities higher.
- Yields inch lower on Fed uncertainty.
- Crude oil drops as rate cut hopes dwindle.

Weekly Economic Recap –

Fed Needs “More Confidence” of Inflation Easing Before Cutting Rates

The U.S. Leading Economic Indicator Index fell more than expected (-0.4% vs. -0.3%) in January to the lowest level (102.7) since April 2020. Leading the weakness was average weekly hours worked and ISM new orders. The Index has declined for 22 consecutive months. There has only been one other time since the series was created (in 1959) that the Index has fallen for this many consecutive months and it was the Great Recession of 2007-2009.

The FOMC released the January meeting minutes which indicated participants believe "the policy rate was likely at its peak, but did not expect it would be appropriate to reduce [interest rates] until they achieve greater confidence that inflation was improving to the 2% target." Many participants also noted that officials should consider an "eventual decision" on slowing the pace of balance sheet runoff.

Initial claims for unemployment increased less than expected (201K vs. 216K estimate) while continuing claims, which run a week behind the headline number, fell to the lowest level in a month.

Sales of existing homes increased by the most since August in January as mortgage rates retreated from their October highs. Inventory of homes for sale increased by 2% MoM but remains at roughly a 3-month supply. Six-month supply is considered a balanced market.

Weekly Market Recap –

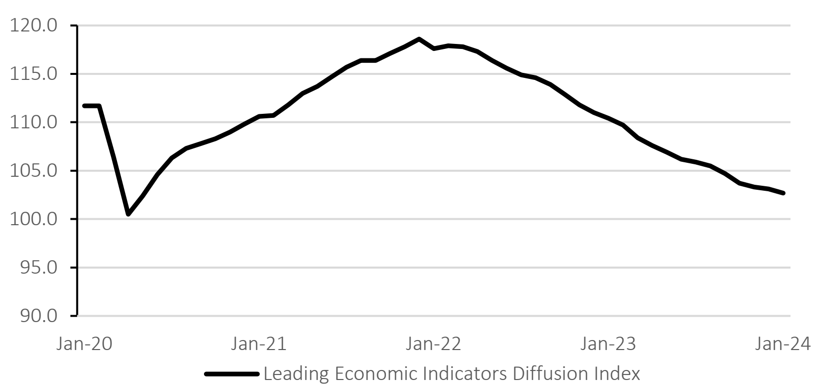
U.S. Equities Lead Global Markets as Mega-Cap Tech Outperforms

Equities: The MSCI AC World Index was higher for the fifth straight week despite hawkish Fed minutes indicating the committee does not have enough confidence on inflation to cut interest rates. All three major averages in the U.S. were higher driven by outperformance from mega-cap technology names, including NVIDA, on the heels of quarterly results.

Fixed Income: The Bloomberg Barclays Aggregate Index was higher for the first time in three weeks as Treasury yields inched lower during the week. U.S. TIPS were the only area of fixed income lower for the week while outperformance came from riskier areas of credit, including EM debt (USD) and high yield corporates.

Commodities/FX: The Bloomberg Commodity Index was lower for the second straight week. Crude oil prices fell for the first time in three weeks as rate cut hopes dwindle. Grains rose, specifically wheat, on new sanctions imposed against Russia.

Leading Indicators Fall to Lowest Level Since April 2020



Footnotes: Data is as of January 2024.
Source: FactSet Research, Verdence Capital Advisors

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Past performance is not indicative of future returns

Key Takeaways:

- Two years since Russia invaded Ukraine.
- Economic impact has been massive and to worsen for Russia.
- Grain disruptions still problematic for the world.
- Europe is successfully moving from Russia natural gas.
- Emerging market equities have been major loser of multiple geopolitical instabilities.

Two Years Since Russia Invaded Ukraine

Two years ago on February 24, 2022 Russia egregiously invaded Ukraine and it has been deemed the largest attack on a European country since World War II. There have been at least 500,000 troops killed on both sides in the atrocity. It may be much worse given the fact that Moscow has been known to undercount its casualties and Kyiv does not disclose official figures.[1] As of now, Russia has control of ~20% of Ukraine and the fighting does not look to be letting up. In this weekly, we focused on some of the major global impacts we have seen as a result of Russia's invasion of Ukraine.

- **Economic impact:** Ukraine was likely able to produce low single digit economic growth in 2023. This was after a nearly 30% decline in GDP in 2022. The primary drivers of growth in 2023 were international aid, the ability to get some exports out of the country and stabilizing Ukraine's electricity supply so that businesses could operate. The Ukrainian government is looking to build on this in the future by finding alternate routes to export their goods, entice international developers to rebuild the country and restore their energy sector. Russia's economy only fell ~2% in 2022, thanks to their continued ability to export energy products. However, the international sanctions are painful for Russia. The Russian ruble is worthless, inflation has increased 20% from year end 2021 to 2023. In addition, they have had to double their defense spending and €300 billion worth of central bank reserves are blocked in the international markets. Lastly, 70% of assets in the Russian banking system are under sanctions.[2]

- **Grains exports are a global problem:** Prior to the start of the war, Ukraine was one of the top five largest exporters of grains. Russia initially blocked all grain exports in the early stages of the war. However, a brokered deal with international allies called the Black Sea Initiative, gave Ukraine the ability to move grains through the Black Sea. Unfortunately, Russia backed out of that deal. Now shipping grains is becoming pricier and taking longer. With food prices up more than 15% because of the pandemic, any disruption in food supply is problematic, especially items like corn and wheat as they make up ~75% of food exports. Emerging and developing countries rely on grains for food given their affordability.

- **Natural gas has not been the weapon Putin thought:** In the early stage of the war natural gas prices skyrocketed and put Europe at risk given its dependence on Russia as an exporter. However, Europe and the world have shifted to find other energy alternatives, specifically liquified natural gas (LNG). Europe boosted their infrastructure to store and transport LNG and the U.S. became the largest LNG supplier to the EU in 2023.

The Bottom Line:

The pandemic was one of the first drivers that brought the thought of deglobalization to a reality. However, the ongoing war between Russia/Ukraine, Israel/Hamas, China uncertainty and tensions in the Red Sea have made many countries continue to reevaluate where to source the imports that are necessities for their countries. From an investment perspective it has also increased the premium investors require to take the risk of investing in emerging and even some developing nations. Since Russia invaded Ukraine, the MSCI EM Index is up 5%, compared to 28% for the MSCI EAFE and 59% for the S&P 500.

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