Quarterly market update

Private Wealth Management

Jason Feldman's
Reflections and Observations, Q1 2022

Perhaps it is in the direction of Pascal's Wager… There is this old saying I have heard murmured many times over my decades on Wall Street, "It is difficult to bet on the end of the world! It only happens once." By extension, one might conclude, that well within the fattest part of the bell curve, we are likely to, once more, survive this current exciting, concerning, and disturbing snapshot in history.

As we muddle through the moment, let's first back up, to a few short months ago. After a decade of becoming acclimated to concerningly low rates of growth and inflation, we were suddenly getting a real blast of higher readings. It seemed clear, this renewed activity and inflation had at its roots in several widely recognized and extremely fundamental factors.

Perhaps the first such factor was an enormous spike in money supply and savings caused by 1) money being pumped into the system by central banks around the globe to put a safety net under the global economy during the lockdowns and 2) that while the globe was largely shut down during the pandemic, money quickly "pooled" in savings as opposed to being spent and/or otherwise allocated in the more normal manner. Then, when things began to re-open, the effect of that pile of money chasing products and services, which due to unevenness along supply chains as well as labor mismatches and simply the sheer magnitude of demand at this moment, helped to pressure prices higher at a pace not seen in decades.

Russia/Ukraine/Oil prices

Enter the Russia/Ukraine (and everyone else) conflict… In the last few weeks, on top of the surge in prices due to a reopening economy awash with cash, the prospect of oil and gas supplies, and other commodities, being disrupted while sanctions are being placed anew each day on a variety of goods, further pushes prices- and inflation expectations- higher. Sure, as it relates to the energy aspect specifically, we see the immediate signs at the pump and on home heating bills, but most anything produced using petroleum by-product or farmed needing heavy machinery or needing to be transported by sea, rail, road, or air will likely soon see its price rise further.

The good news might be, as it has been said: "The solution to higher prices is higher prices." The issue is how myriad central banks, most specifically our Fed Reserve, are going to interpret the problem and look to solve said problem. Will they assume oil will further fan durable inflation forcing them to raise rates more aggressively or will they conclude that both higher rates along the yield curve and higher costs on oil, gas and other sanctioned products will do some of their job for them, acting to dampen growth enough so as to have it be less necessary to see central banks raise rates quite as fast and quite as far as one might otherwise think- if they were to, otherwise, look at the raw inflation numbers in a vacuum, that is?

In the same line of query, will the abundant liquidity in the system further fan inflation or simply provide an adequate buffer for—or a safety net under—an economy hit by a spike in energy prices? If higher prices dampen demand on a wide range of services and products, this might be much of what is needed to, more organically, cool things off. And, so, if a good part of this last spike higher in oil and gas prices are, at least partially, due to concerns around supply disruptions, central banks should realize raising rates will not solve that part of the problem. In other words, raising rates alone will not bridge the gap, helping to increase the supply in a tight fossil fuels market. And more to the point, raising rates to cool things may not be as necessary if it becomes apparent higher prices, acting like a tax, are already slowing things down.

This is where the whole conversation regarding "policy mistake" comes into play. Economists will often point to the poor record of central bankers to measure policy so as to achieve the, so called and all illusive, "soft landing." It would not be without precedent to get close enough, though Monday morning quarterbacks will always pontificate, after the fact, how it should have been done. Perfection is not really necessary- nor is it truly attainable. Given just a little time, data from the economy as well as, perhaps, the markets' behavior will give the Fed the room needed to breathe so as not to need to react- or overreact- blindly to, for instance, these next few quarterly readings of CPI and PPI numbers in a vacuum.

Rising interest rates

As I write this letter, Congress is having their time grilling oil industry execs. Such beltway events, are mostly, as always, for show. I sometimes wonder if those getting dragged in front of our showboating political class should be the ones asking the questions; but I digress. Far more important than such political cinema, the coming data during the next few quarters may begin to provide the higher quality clues as to how things are unfolding more broadly. In the last few days, the 10-year Treasury has breached 2.7% and headlines tell of the average 30-year mortgage rate topping 5%. All this combined should help slow things down enough so as to provide a pretty handsome set up for global markets, say, 12 months out, after we've been bumped around well enough by the deluge of eye-popping economic data and disturbing coverage out of Ukraine.

To cap off, there is one more subject well worth touching upon. Amongst the most fascinating of all the topics brought to the fore because of the recent geopolitical crisis, it is this idea that Germany, and Europe as a whole- and US by extension- has become vulnerably dependent on Russian oil and gas during these last few decades. It is often said the US needs to lead the globe in one initiative or another. We have seen this discussed with humanitarian efforts, with various geopolitical conflicts and with such issues as climate change.

With this said, one surprising and enormously positive by-product that may very well come out of this troubling moment, is a much more complete and honest discussion around fossil fuel usage and the business of meeting the demand for said "dirty energy." Like most topics, the solution is well within the gray, not at the overly simplified extremes of the black nor the white of this argument. Policy in the US, which is often driven by an over-simplified narrative, catering to one sleeve or another of the voting public, is by it's nature volatile. That volatility in policy and, by extension, regulation makes the private sector oil companies of the West's democracies less efficient than they could otherwise be. It is very difficult to plan and make multi-year investments under such circumstances. Obviously, public opinion in places like Russia, Saudi Arabia, Iran, and Venezuela doesn't move policy in the same way, in essence removing a major complication for their largely state-run or state-controlled oil complexes.

Being old enough to remember lines for gas during the oil embargo of 1979 and having had a father who was, during the years around this event, like many investors of that time, interested in the sector, the "oil patch" was one of my first interests when I began looking at the markets and the economy as a teenager. Looking back, much of the advancement in exploration, drilling, refining, shipping, and piping seems to have been made by US and other western-based companies.

These advancements have resulted in, not only, more economical approaches to meeting the globe's fuel needs- so, lower prices, but also safer and more clean techniques and technologies. Given demand for such fuels is not expected to fall anytime soon, our efforts to continue to lead the way is of paramount importance and should certainly not be left to our frenemies and enemies, many of whom are likely to use any economic leverage they would have against us and, more to the point, are much less motivated to be disciplined regarding the environment. If it isn't us helping to responsibly meet the demand of the future, should we trust this task to Russia, Iran- or our good friends in Venezuela? I think not.

When I closed my last letter saying, "Needless to say- but as I often pause to say- nothing should be expected to unfold in a straight line…," I certainly didn't think we'd find ourselves quite where we are at this moment. Still, I would say with the globe now first digesting recent geopolitical events, and yet awash with liquidity and not yet fully open nor acclimated to the demand that has pent up, the markets' resilience, all things considered, could be a hint of stability to come.

Let's connect

I encourage you to reach out to share your thoughts and challenge mine. Please call anytime. I can be reached on the team's direct toll-free number 888-804-8467 or on my direct line: 212-713-9338.

Jason I. Feldman, CPWA®, CIMA®
Private Wealth Advisor
Senior Vice President–Wealth Management
Senior Portfolio Manager–Portfolio Management Program

UBS Financial Services Inc.
Private Wealth Management
1285 Avenue Of The Americas
New York, NY 10019
212-713-9676

advisors.ubs.com/fs

UBS