Please note: This is a transcription so there may be slight grammatical errors.

Mike Vogelzang:

The first three months of 2022 have been a turbulent, tense, and at times intimidating start to the year. We're living in a world of two wars, one real, the other financial, both causing lots of indigestion for markets.

One war is, of course, on the battlefield, horrific with casualties and destruction. Its cost is measured in destroyed cities and human lives. The other is a financial war on inflation, which has recently increased in intensity. This is a war that's measured in dollars and euros, yuan and yen. And while it can never compare to the tragic horrors in Ukraine, both wars have profound implications for investors. Last quarter, US and international stocks fell between five and 8%, high-quality bonds, which usually act as a counterweight during pockets of lower prices also declined by a whopping 6%. It's uncommon for stocks and bonds to decline in tandem. In fact, it's only happened six other calendar quarters in the last 30 years, but the first quarter of 2022 was that rare period when diversification didn't add value for most investors. To quote Martha and the Vandellas, investors had "nowhere to run, nowhere to hide."

Back in 2021, during the depths of the pandemic, policymakers tried to minimize COVID's damage to the economy through massive stimulus and rock-bottom interest rates. This gave people money to spend while factories were shuttered and supply chains were jammed. The result was higher inflation that most investors including us expected to be temporary, but late last year, it became evident that higher prices were spreading throughout the economy. Then came the war in Ukraine, which turbocharged global inflation. To slow both the economy and inflation, the Fed uses many tools. One is raising interest rates, think mortgage rates and the prime rate. These higher rates increase borrowing costs, reduce consumer demand, and cool the economy. Another tool is so-called quantitative tightening, that is to shrink the size of the Fed's balance sheet by selling the enormous portfolio of bonds purchased during the crisis. This type of tightening has never been attempted at this scale, which is making markets and investors nervous.

So, when the fed raised rates in March and signaled stronger and faster path for quantitative tightening, markets reacted, bond yields rose, pushing prices down, and stocks fell over fears that higher rates may push the economy into recession. With the lingering effects of the pandemic, inflation, the Fed's attempts to contain it, and a war in Eastern Europe, investors have plenty to worry about it. However, as discipline investors, it's important to weigh these worries against the many positive aspects of our economy, or, in other words, what might actually go right. The US economy is still very strong and expanding as we emerge from COVID isolation. Interest rates remain historically low, even though rising. US companies are still very profitable with growing earnings. Corporate balance sheets are strong. In fact, companies return more than a trillion dollars to shareholders in 2021 through a combination of dividends and share buybacks.

So, where does this mixture of good and bad leave us as investors? Here at CAPTRUST, our outlook remains cautious. After three strange but incredibly strong years for markets, there is now a wider range of outcomes today than last year, including more that could go wrong. For example, the war in Europe might escalate. The Fed could make a policy error fighting inflation, oil prices may rise again and stay higher for longer, not to mention a COVID pandemic that still poses risks.

At the end of last year, we warned that markets were returning to a more normal, likely higher level of volatility. Little did we know that it would kick off in the first week of January, but now we're in an event-driven market where investors' outlooks are shaped by almost hour-to-hour unpredictable headlines. That's a recipe for even more uncertainty. However, this doesn't mean investors should head for the exit because usually some of the best days in the markets come during the depths of a crisis

when the all-clear isn't yet obvious. Remember it's far better to remain invested with a diversified portfolio that's resilient to a wide range of outcomes. For now, caution and patience are our investors' best friends as we let these two wars play out.

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