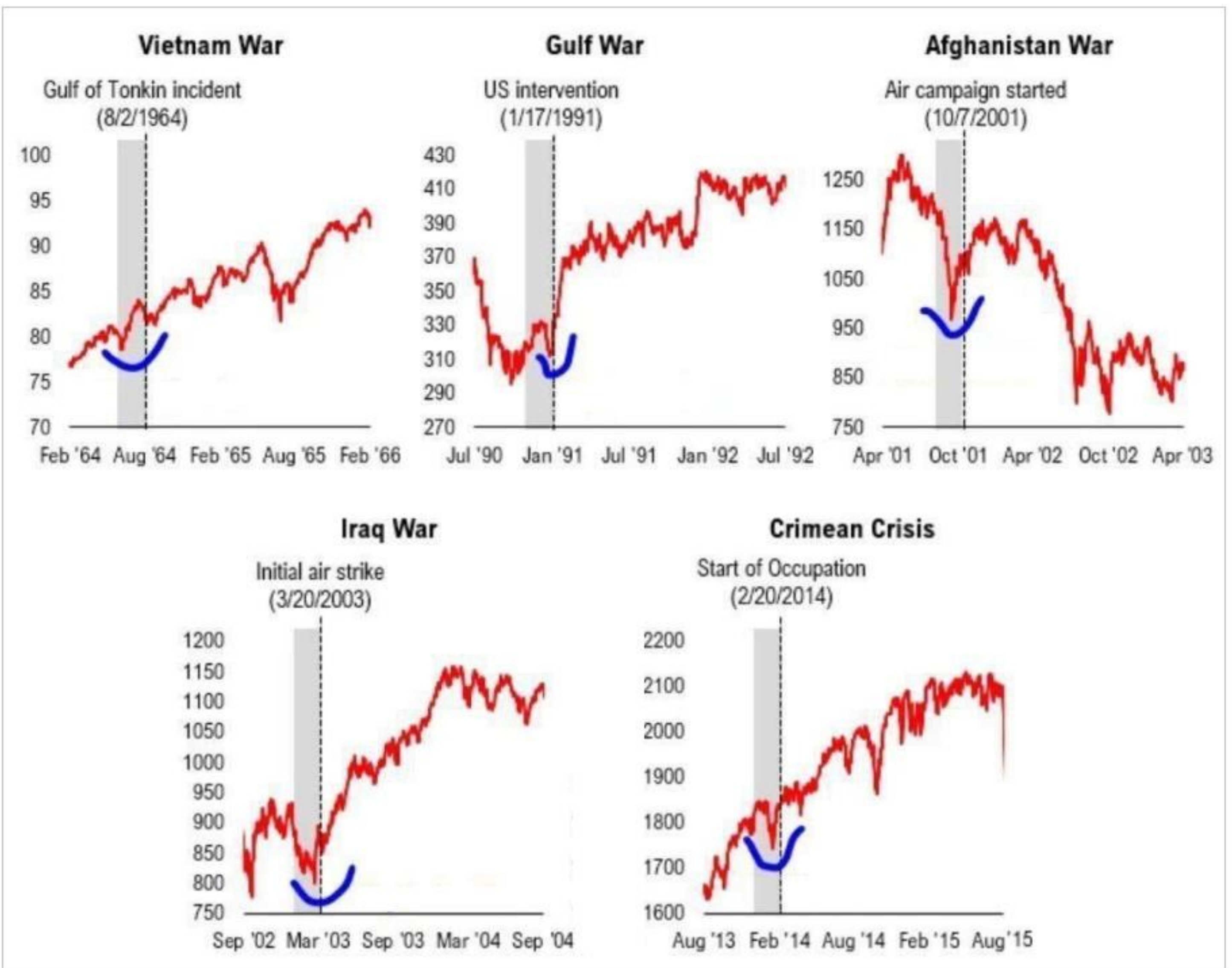
CHART OF THE MONTH

MARCH 2022



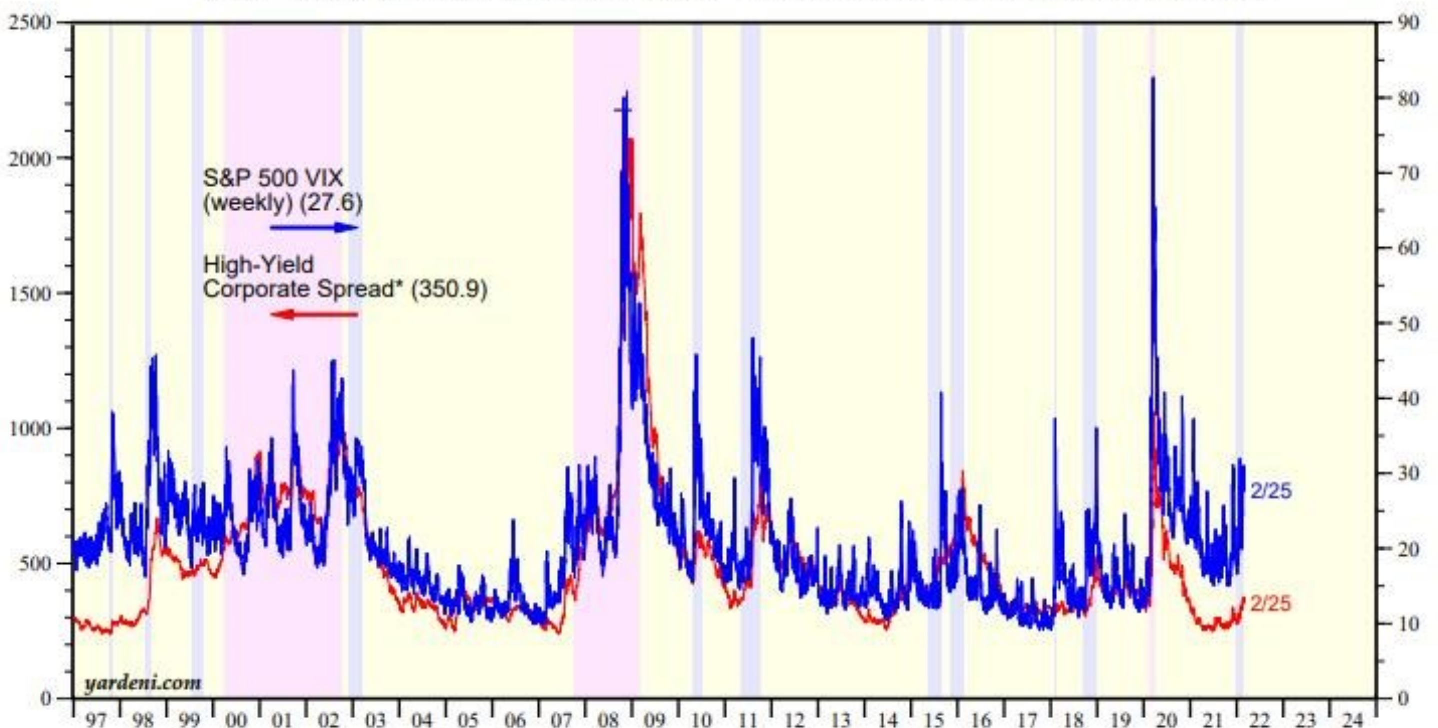
We have been closely monitoring the conflict between Russia and Ukraine with a particular emphasis on the financial markets. We are pleased to report that our clients do not own any individual stocks or bonds (including sovereign debt) based in this region.

As to how the invasion relates to the stock market as a whole, it is important to note that investors have usually taken similar geopolitical events in stride (see examples above). The selloffs have generally been short lived with the fundamentals of the economy and markets winning out in due time. Going back to the beginning of World War II, the median *drawdown* has been roughly 5% (with a maximum of 25%) according to Haver Analytics. Of note, the median *rebound* was 7.7% and 13.0% six months and one year, respectively, from the bottom.

While the S&P 500 declined 2.6% intraday in response to Russia's large-scale attack on Ukraine on February 24, the index bounced back and closed 1.5% higher that day (in the largest such swing since March 26, 2020) and has since gained an additional 2% through the end of February. Granted, the S&P is still down nearly 9% from its high, but it was off more than 12% at its worse levels last week. The downturn was mostly related to inflation readings unseen in 40 years, rising bond yields, and prospects that the Federal Reserve would begin to tighten monetary conditions by raising short-term interest rates in March and throughout the balance of the year.

As we pointed out in our January Chart of the Month, the stock market has averaged a correction of 10% or more once per year. We added that "it would be highly unusual for the market to decline 20% without an economic recession," noting a recession does not appear to be on the horizon. Lastly, perhaps counter intuitively, "the S&P 500 was higher a year later every time after the first rate hike in each of the previous eight cycles."

The graph below shows there has been a disconnect between the highly correlated S&P 500 Volatility Index (VIX) and High-Yield Corporate Bond Spreads. The VIX, an index that measures the market's expectation of volatility over the following 30 days, is often referred to as a fear gauge. The higher the level, the higher the fear. Historically, when the VIX (in blue) rises, the spread between high-yield debt and the 10-year Treasury bond yield (in red) goes up as well. However, the yield spread, while above its 2021 levels, remains near record lows at approximately 350 basis points (3.50%), suggesting (1) the stock market anxieties may be overly elevated and (2) little or no concerns for a near-term recession.



* US high-yield corporate bond yield less 10-year Treasury bond yield (basis points).
Note: Shaded red areas are S&P 500 bear market declines of 20% or more. Blue shaded areas are correction declines of 10% to less than 20%. Yellow areas are bull markets.
Source: Chicago Board Options Exchange, Bank of America Merill Lynch, and Federal Reserve Board.

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