CONWAY• JARVIS LLC
Investment Outlook

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Update

Event Risk Overtakes Cyclical Risk

Investor sentiment took a hit this week as the Russian incursion into the eastern regions of the Ukraine became a full-scale invasion. The capital, Kyiv, came under siege along with several other major cities in the country's interior as a miles-long Russian convoy snaked its way westward. What was thought to be a brief, localized outbreak of hostilities as a prelude to a negotiated settlement regarding the separatist controlled states was in actuality a planned invasion of the country with the goal of replacing its democratically elected government with one friendly to the interests of Russia. History has shown events such as this one to be short-lived and thus *not likely* to derail the current expansion. That said, one can't predict Putin's mindset and that casts a veil of uncertainty over the economic landscape.

The global response to the invasion was immediate and took the form of coordinated economic sanctions by a coalition of developed nations in the West. These were designed to cripple the Russian economy and those who support Putin. The one shortfall among those sanctions was the absence of a prohibition of oil imports from Russia. That is currently being crafted and should serve to paralyze the Russian economy and its markets. That will require a shared sacrifice at the pump by those living in the US and EU. This week we saw the price of oil spike to a level just shy of its all-time high. While temporary, that will be reflected throughout the economy in the form of increased input and transportation costs. That's a reason for investors to rethink near-term market expectations while the war continues.

In addition to sanctions, the EU and NATO are supplying arms and monetary support to the Ukraine as civilian casualties mount and more than a million refugees flee westward. So far, Putin shows no signs of consenting to a negotiated settlement even as pressure to do so mounts within Russia and abroad. One can't venture a guess as to the duration or outcome of the conflict. What is certain is that the Ukraine *alone* can't withstand the onslaught indefinitely. The commitment of the US and its allies to NATO in preserving nations' sovereignty and right of self-determination will be tested. It may require a commitment to *action* from a unified coalition of those in the EU to convince Russia of that commitment. Until then, and absent a negotiated settlement, the markets will likely remain under pressure from event risk and could flirt with entering bear market territory for a time.

For some, that raises the prospect of recession ending the current economic expansion. That would be a stretch, considering current GDP growth, low unemployment, and inflation expectations. We can expect to see some P/E compression in selected issues and slower earnings growth at this stage of the recovery, especially with the current shift in monetary policy. With recent events in mind, the Fed made a rare admission this week that it would raise its key rate by only 25bp as opposed to 50bp expected by some experts. That's good news in that they're taking a cautious approach to crafting a soft landing for the economy and avoiding recession. That'll require threading the needle between the effects of the war on consumer confidence, investor sentiment and addressing persistent inflation due to higher oil prices. That's not an easy task under the best of conditions and why a quick end to the hostilities would be welcome. Stay tuned.

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