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Five Minutes with Commerce Trust's Chief Economist – Scott Colbert
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Scott Colbert:

Good afternoon, it's Friday, March 4th. The markets are closed. Of course, our eyes have been glued to the television focused on the Russian invasion of Ukraine that started nine days ago. There were some that thought perhaps this might have been a bluff.

We know differently today, and the markets, as they usually do, have discounted some of this event. They primarily discounted it in the stock markets, but they certainly haven't discounted it in the commodity space. I think you might be surprised to know that the S&P 500 is actually up 2% post-invasion.

Kind of surprised me, even when I looked at the numbers. Nasdaq stocks are up a little bit. Small-cap stocks are about flat. Bond returns have been positive because, of course, there was a flight to quality and interest rates came down a bit.

Bond markets up about 1%. Still, though, year to date the domestic markets have been tough, right? S&P 500 still down 10% year to date. The bond market still down 3.5%. Nasdaq and small-cap stocks have done worse. Over on the international side, though, as you might expect, the impacts have been larger.

Emerging market stocks have fallen 3.5% and international stocks have fallen 2%. A developed market stocks 2% since the invasion, as the impact of them is largely much more material and, of course, a lot closer to home.

The biggest impact really hasn't been so much on stocks and bonds as it has been in the commodity and energy markets. Oil prices, of course, have soared. You've noticed that at the gas pumps, the average price of a barrel of crude oil at the end of the year was only $77.

It's touching $115 to $116 here. Natural gas has been flat here in this country because we produce so much of it. Over in Europe Russia basically exports and, Europe imports 40% of its natural gas from Russia.

And those contracts have soared two to three, even four times higher. The biggest damage has been on Russia itself. The ruble is down 35% in terms of its purchasing power. So, the ruble's collapsed. Stock markets in Russia haven't even opened. The implied pricing is exceptionally low and the bond market has been decimated in Russia, bonds trading somewhere between 15 to 40 cents

if there's any type of Russian exposure. What does all this mean for you, though, and your portfolios? Well, you know that we have been concentrated largely in the U.S. sector. We've been underweight the international sector, but we feel that this is probably an opportunity to begin to nibble and have pushed up our international weighting as the international stocks have declined much more than domestic

stocks post the invasion. We still remain short the bond market. We think that interest rates are going to go up. Now they might not go up as fast as we thought they were going to go up.

My guess is they still probably will. But the Federal Reserve has already tipped its hands and told us that they're only going to raise rates 25 basis points at the first meeting. The market now is only expecting four to five interest rates hikes given the war over in Europe.

I still think with inflation surging seven and a half and likely to be even closer to an eight handle before it begins to roll over that the Federal Reserve will be almost forced to raise interest rates at every meeting, particularly with employment so strong.

Today we got our labor report and we've created over 1 million jobs so far year to date, essentially on the same pace as last year, where we created over 6 million jobs over the course of the year. So, we had 1 million just in the first two months.

So, we're running short the bond market, expecting the Federal Reserve to raise rates. And of course, we're a little more cautious on credit than we used to be. We've cut back a little bit on our plus sector and moved in into some floating rate sectors for you. This is a little hard to believe, but typically when geopolitical events like we're going through right now occur, about one year later, there's usually a positive outcome in terms of the financial markets. In other words, the markets discount these things pretty quickly.

I could take you through a number of events, including the Cuban Missile Crisis, President Nixon's resignation, the Iranian hostage crisis, the first invasion of Afghanistan by the Soviet Union, the Iraq War post-9-11, the Arab Spring, the Ukrainian conflict when it first started back in 2014, and even the recent Brexit vote. On average, the market is up 5 to 9% one year afterwards. That happens to kind of match exactly what happens after the Federal Reserve begins to raise interest rates. But that doesn't mean that there won't be some rocky times between now and a year from now.

It's why we've taken a slightly defensive posture. It's why we're trying to add back a little bit to the international markets that have been so beaten up recently. It's why we remain short bonds and up in credit just a little bit.

We do expect to see some pretty good opportunities going forward and expect to probably increase your risks at some point during the cycle. But for now, we're taking a cautious approach. I guess you'd say, like a lot of people, we're cautiously optimistic that we can work through this.

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