

"Cup of Joe"

Due to the recent developments in Ukraine, we wanted to take this time to address the questions we are receiving as they pertain to the recent stock market volatility.
First, let's lay out what issues are at play:

- Inflation
- Federal reserve raising interest rates
- Gas Prices
- War between Ukraine/Russia

During periods of inflation, it's important to note that stocks perform the best (the manufacturers are the ones making the extra money you pay for goods and services) when compared to other assets, such as cash or bonds. Cash is currently losing 7% of its buying power per year (because the things you buy cost more) due to inflation. Bonds are looking to lose as interest rates rise over the next 5-10 years (when interest rates go up, the value of the bonds drop). This leaves stocks as the only alternative in which to invest. And when inflation rises, stocks generally hold up better, especially if this inflation comes with growth. What we do NOT want is stagflation, which occurs when inflation is going up and growth is declining (potentially caused by higher energy prices).

The Federal Reserve has its hands full right now when dealing with inflation. It's important to note that the FED has a dual mandate: 1) Keep inflation in check, and 2) Obtain full employment. And right now, with inflation elevated, the FED is being forced to raise interest rates to try and contain it. This comes during a time when higher gas prices could put a damper on the consumer's ability to spend, which could impede economic growth. (Note: the higher gas prices also can help reduce inflation by taking money out of the consumers pocket, making them less likely to buy things).

The double-edged sword of rising gas and energy prices can hurt the economy as well by removing money from the pockets of the consumer. And considering that 70% of GDP is generated by consumer spending, this could potentially hurt future growth projections if these energy prices remain high for a prolonged period. While researching this issue over the past few weeks, we want to point out an interesting dynamic that was **not** in play during the 2008 gas price spike. What very few analysts are taking into consideration is the financial health of the consumer. People, in general, have not been able to spend or travel over the last few years due to COVID. This resulted in an enormous amount of money being saved by the consumer - approximately $4 trillion dollars. With such a large sum of money in personal savings accounts, the unemployment rate at 3.8%, and higher wages, we feel the consumer is far better equipped to deal with these higher energy prices than in 2008. Let's also point out that, unlike in 2008, the banks are in far better shape. What we also believe is that no matter how high gas

prices get, this will not have a material effect on people's desire to get out of the house! They will spend money and enjoy themselves now that COVID looks to be in the rearview mirror. Do not underestimate the power of pent-up consumer demand that led to such events in history as the roaring twenties. And while the consumer continues to spend while the energy prices are elevated, this will start to drain that $4 trillion in savings we mentioned above. And as that money is spent, inflation should start to naturally come down as supply chain issues continue to improve as well.

Finally, the last issue at play is the war in Ukraine. We feel, from an optics standpoint, this issue is causing the most fear with our clients. The average retail investor is conjuring up memories of the Cold War Era with the Russians. From an institutional perspective, one must realize that Ukraine and Russia have virtually no impact on global trade. What this war is doing is causing energy prices to spike. What's important to note is that when investing money, you must be careful not to overreact to geopolitical events and instead, look at the underlying fundamentals. Throughout history, **MOST** of these events turn out to be nothing, thus things can turnaround very quickly. Having said that, I want to reiterate that we are watching the events very closely and are poised to act if need be. Events that are fast-moving, like the COVID market decline in March 2020, sometimes call for patience as we are viewing these events in real time. Remember, the market declined 37% during COVID and came all the way back in just months with our portfolio returns ending on a very positive note for the year.

All in all, we want our clients to remain patient as we work through this recent bout of volatility. We do think markets are getting into oversold territory and, on a longer-term basis, we believe there is a lot of value at these levels when comparing the valuation metrics over history. What hasn't changed is that the investor still needs a return to meet their goals which they can't get by staying in cash! And of course, bonds are paying very little interest as well. And on a more positive note, it's been rumored that oil may drop to $85/barrel by the second half of the year with new supply coming online. As we get closer to summer, remember that we have not had the "re-opening trade" yet (from what appears to be the end of COVID). We will be watching the recent events closely and hope a peaceful outcome can be reached in the days and weeks ahead. Our advice is to not panic and use this volatility to put money to work over the next few months.

We hope and pray for the best result which is a quick end to the conflict and a resumption of a more peaceful co-existence in this crazy world.

-Joe, Ryan, and the Chapel Hill Investment Team

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