SCHLINDWEIN ASSOCIATES
INVESTMENT COUNSEL

Uncertainty

Uncertainty is on the rise as a blizzard of fiscal policy changes defy easy analysis from Wall Street to Main Street and in the nation's capital as well. The expectation is for economic activity to be enhanced in the long run, but at what price in the short run. Consensus expectations still indicate no recession in the period ahead, but an increasing number of economic indicators point to a slowdown in activity. The Federal Reserve has held its policy rate steady as it weighs both growth and inflation measures. The U.S. stock market reached another new high in February but valuations clearly were stretched. As markets fare less well amidst rising uncertainty, this is a time to provide some perspective for investing ahead.

PERSPECTIVE

Nowhere is uncertainty more visible at this time than in economic policies. And this is a global phenomenon as shown in Chart I. The Global Economic Policy Uncertainty Index is a GDP-weighted average of national economic policy uncertainty indexes for 20 countries. Research has indicated that higher policy uncertainty is related to lower business activity. Lower business activity in turn can impact the levels of stock market prices. The most recent uncertainty index value is just shy of the historical peak reached in the early days of the COVID-19 pandemic. The index declined soon thereafter, and stock market prices rose quite dramatically.

Monetary policy is closely watched as changes in policy rates spill over into all areas of the economy and markets, both stocks and bonds. Chart II shows current market expectations for the Fed's target policy rate for the near term and later this year. At its policy meeting in January, the Fed concluded that the risks to achieving its employment and inflation goals were roughly in balance, warranting no change in their rate target. They went on to say that the economic outlook is ***uncertain***, and that they are attentive to the risks to both sides of their dual mandate. Most recently, inflation has been sticky and economic data has been softer. Lower rates appear in the offing, but the magnitude and timing of any such changes remain uncertain.

A stock market correction is underway. Chart III shows how far the S&P 500 has varied day-by-day since the presidential election from the February 19 all-time high. A +6% gain was posted from the election to the high. A -9% "correction" now has followed, with much larger losses amidst the previously favored tech-related stocks. A -10% decline in the overall market is the generally accepted definition of a correction and they are not that uncommon over time. Bond yields have eased, bringing a welcome offset of modest bond price gains to offset stock declines. This is the benefit of diversification. If a recession occurs, and especially if there was a meaningful pullback in corporate earnings, the stock market selloff could continue. But a turn in the business cycle is inevitable and with it would come a recovery in stock prices.

INVESTMENT IMPLICATIONS

A stock market correction never is welcome, but sometimes it brings a bit of a "cleansing" if stock valuations just are too high. If such is the case, the long-term investment return goes to the patient investor who can ride through such a period of uncertainty. Patience is a desired virtue which can be sorely tested amidst uncertainty. The natural instinct at such a time is to reduce one's level of portfolio risk. However, if the risk level has been set appropriately, i.e., it reflects goals, time horizons and risk tolerance, one can ride through uncertainty with greater confidence that goals will be achieved.

CHART I

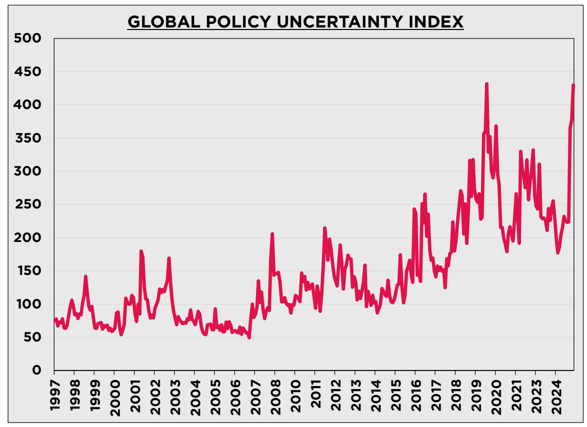

CHART II

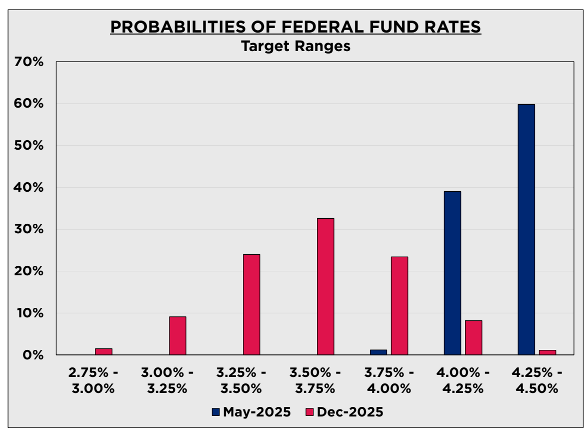

CHART III