



BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, APRIL 2022

The adage “don’t fight the Fed” seems as true as ever. Since the Great Recession, the Fed’s accommodative ‘easy money’ policy has provided powerful stimulus to the economy and significantly contributed to investors’ long-term stock market returns. In a recent major policy shift, the Fed is now focusing their full attention on taming inflation, and we believe that the resulting quantitative tightening creates potential headwinds for equity markets as growth incentives are eliminated. As mentioned in our previous commentary, we disagreed with the Fed’s position that rapidly spiking inflation was simply a transitory economic byproduct of the pandemic. We shared our view that the Fed has historically been slow to respond to inflation and often overreached with ‘too much too late’ as a result. This once again appears to be the case as the Fed’s tardy change of heart came with their announcement of multiple rate hikes only after inflation had risen to its highest levels in forty years. Our concern is that the combination of rising rates and persistent inflation may stifle further economic recovery as well as equity valuations.

We’re mindful that the impact of persistent inflation and rising interest rates, while not unprecedented, will be felt everywhere. Consumers have reduced purchasing power as a greater percentage of income is now dedicated to higher food and gas prices, leaving less for discretionary items including clothing, cars, and entertainment. Corporate profitability declines as consumer demand for its goods and services wanes, borrowing costs rise, and escalating material costs and wages weigh on the bottom line. The ultimate fallout from less purchasing power, less spending, and higher input costs is likely a slower growing economy.

Market declines and volatility during the quarter reflected these overarching issues. In March, equities touched into bear market territory (declines of 20% or more) as the Nasdaq dropped 22% before recovering 15% in a late-month rally. The S&P 500 Index entered a correction (declines of 10% or more) dropping more than 12% until similarly rallying 9% by the quarter’s end. We have been suggesting that the stock market looked vulnerable to a sell-off with inflation being the primary area of concern.

Investor angst also materialized in the bond market leading to its worst sell-off in decades. Bond prices swiftly declined in a direct response to inflation worries compounded by rising wages and commodity price increases as well as the Fed’s new rate hike program. The bond market’s sell-off was particularly noteworthy considering fixed income investors have largely enjoyed upward moving bond prices since 1981. Consider too that a casualty of the Fed’s new aggressive interest policy may be the housing market, a key component of GDP. We have rarely seen home sale activity at such a fast pace, along with home prices which have escalated to almost unheard-of valuations. This is an area of concern as 30-year mortgage rates recently crossed 5% and will likely put a damper on future home sales and overall economic growth.

As we also think about the Russian invasion of Ukraine, this senseless and inhumane war seems out of place in our modern world and will further instigate a global trade conundrum. Before the invasion began, the free flow of trade afforded the world's richest nations easy access to low-priced goods and raw materials providing stability and a boost to their respective economies. However, a major consequence of the Russian invasion and subsequent global trading sanctions is the Russian economy has been essentially shut down, and their sovereign partners are now scrambling to replace essential goods and supplies without disruption. As one of the largest exporters of oil, metals, wheat, and many other products, Russia's trading partners must now secure new arrangements to obtain the goods that flow through their countries and partners worldwide. Certainly, replacing their material needs is quite complex and near-term, this may continue to be disruptive to global economies and financial markets.

Despite current events, we remain quite optimistic. Your portfolio holds large, diversified, financially strong companies that are leaders in their industries. As we so often share with you, a key investment discipline of Blue Granite is to add to positions prudently and opportunistically during market dips to enhance your long-term performance. Over the long haul, we know that the best-run, industry leading corporations will continue to grow their companies' values along with their share prices.

Please don't hesitate to contact us with any questions that you might have. Wishing you a wonderful Spring.

With warmest regards,

Scott, John, Dave, and Richard