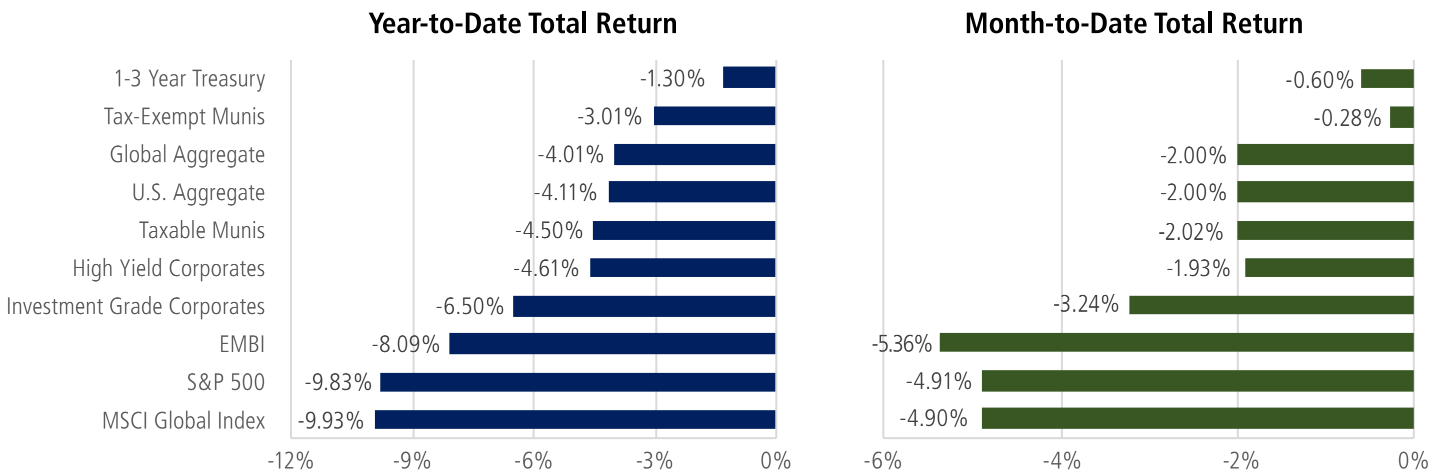
Week Ending: **February 25, 2022**

From Bad To Worse

Economic Overview:

Investors comfort themselves amid volatile markets by taking the long view. Historically, geopolitical events prove ephemeral in terms of market impact. But context matters. Supply chain snarls have already led to elevated inflation readings. Now, bottlenecks will likely worsen due to Russia's invasion of Ukraine. Case in point: energy prices, the main driver of high inflation readings across Europe last year, shot up again this week. Unfortunately, the European Union's "energy dependency," the percent of total energy consumption from imports of energy products such as natural gas, crude oil, and coal, has grown from 56% to 60% over the last two decades. So higher prices will no doubt boost inflation again. The worse news: higher energy prices will also impair economic growth (the 2021 gas price surge chopped 0.2% from GDP growth in the euro area). Faced with higher inflation and slower growth, how will central banks respond? It's tricky, but since Europe will feel the fallout from Russia and Ukraine most acutely, geopolitics may delay the European Central Bank's exit timeline.

Total Returns by Asset Class



Source: Bloomberg

Highlights of the Week:

- **High Yield:** While the Russian invasion of Ukraine has increased risk asset volatility, we don't expect the war to have a material impact on developed market high yield defaults as issuers' exposure to both countries, directly and indirectly, is limited.
- **Corporates:** It was an eventful week for credit markets with tensions between Russia and Ukraine progressing to a full-fledged invasion by the former. On Wednesday, the investment-grade (IG) CDX index, a measure of corporate credit risk, rose to its highest levels since September 2020 while corporate spreads widened every day this week and currently sit at an option-adjusted spread (OAS) of +124 basis points (bps), 32 bps wider on the year. Expect persistent heightened volatility going forward.
- **Securitized Products:** Higher interest rates and geopolitical instability have slowed but not yet stopped the juggernaut that is the commercial mortgage-backed securities (CMBS) new issue market. While a few deals struggled to build order books this week (including one deal which was pulled), issuers continue to bring supply across the conduit, commercial real estate (CRE) collateralized loan obligation (CLO), and single asset/single borrower (SASB) markets. We do expect new issue supply to slow further, as real estate borrowers adjust to higher capital market financing costs.
- **Equities:** U.S. equity markets focused on geopolitical events in Ukraine and ended down on the week after volatile trading sessions. Cyclical sectors like consumer discretionary and financials led markets lower, while defensive sectors like health care and real estate provided down-market protection.