

## OBSERVATIONS

- The Bloomberg Long U.S. Treasuries Index — treasury bonds with maturities greater than 10 years — has now declined -28% from its peak reached in early March of 2020. This marks the worst drawdown since the data's inception of over 40 years ago.<sup>1</sup>
- Meanwhile in Europe, corporate bond markets face their worst drawdown in history, eclipsing the maximum drawdowns experienced during the Great Financial Crisis. The Bloomberg Euro Aggregate Corporate Bond index has lost -8.6% since reaching its peak in August of last year.<sup>1</sup>
- Futures markets are now pricing nearly 10 quarter point rate hikes by year end, resulting in a Federal Funds Rate of 2.75% come December. The market is now pricing in the potential for successive 0.50% increases in the Fed Funds Rate during the May and June Fed Meetings.<sup>1</sup>
- The World Bank and the IMF both cut their outlooks for the global economy as they now expect global GDP growth of 3.2% and 3.6% for 2022, respectively.<sup>2</sup>
- With no clear end in sight in the Russian-Ukraine conflict leading to tight supplies, natural gas futures reached a 13-year high last week amid unseasonably cold temperatures driving spring demand for gas.<sup>1</sup>
- March figures for existing home sales slipped -2.7% from February and are down -4.5% compared to existing home sales in March-2021.<sup>3</sup> However, new housing starts and permits both increased in March from February as well as from March-2021.<sup>1</sup> Meanwhile mortgage applications have softened—weekly applications were down -5% from the previous week, but down -68% from the same period last year.<sup>4</sup>

## EXPECTATIONS

- Moscow passed a law last week that requires all Russian firms with foreign listings to delist on any foreign exchange by 5-May. No Russian shares have traded on foreign exchanges—Russian ADRs/GDRs are primarily listed/traded on London or NYC exchanges—since 28-February. Meanwhile stock trading reopened in Russia after a nearly 4-week pause, but foreign investors cannot trade shares freely nor exchange Rubles for any foreign currency. As such, US mutual funds have marked the value of any Russian holdings to zero.<sup>5</sup>
- Q1 earnings estimates are largely positive with 79% of those companies that have reported beating estimates—which is slightly above the 5-year average of 77% of companies with positive earnings surprises. Only 20 firms have reported as of last Friday, but thus far eight firms have issued negative guidance and four have issued positive guidance, but this week will be important for this earnings season with numerous bellwether companies reporting—Microsoft, Coca-Cola, Google, Visa, Capital One, Apple, and Caterpillar.<sup>6</sup>

## ONE MORE THOUGHT<sup>7</sup>: Operating at potential, now what?

As part of its ten-year economic outlook, the Congressional Budget Office (CBO) estimates the potential of the U.S. economy — expressed as real potential GDP. Potential GDP is an estimation of the “maximum sustainable output of

<sup>1</sup> Bloomberg LP

<sup>2</sup> Bloomberg LP, <https://www.cnbc.com/2022/04/19/imf-cuts-global-growth-forecasts-on-russia-ukraine-war.html>

<sup>3</sup> <https://www.nar.realtor/newsroom/existing-home-sales-slip-2-7-in-march>

<sup>4</sup> <https://www.mba.org/news-and-research/newsroom>

<sup>5</sup> <https://www.ft.com/content/8813a840-3433-4a33-8fec-eb17841c027f#post-521d3963-9ae1-482a-bc32-10817acad114>

<sup>6</sup> [https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight\\_042222.pdf](https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_042222.pdf)

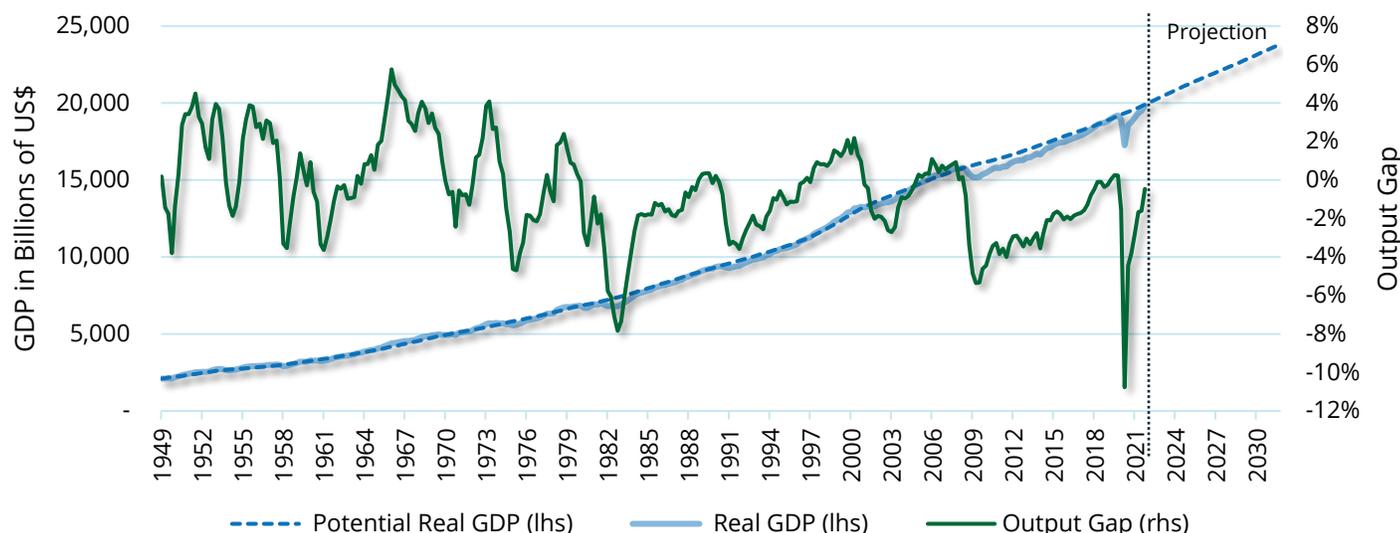
<sup>7</sup> <https://www.brookings.edu/blog/up-front/2021/02/22/what-is-potential-gdp-and-why-is-it-so-controversial-right-now/>,

<https://research.stlouisfed.org/publications/page1-econ/2021/05/03/minding-the-output-gap-what-is-potential-gdp-and-why-does-it-matter>

the economy” based in part on the assumption of labor and capital being employed at their maximum sustainable levels. The difference between actual GDP and potential GDP is known as the ‘output gap’. A positive output gap suggests that actual GDP is higher than its potential, while a negative output gap is associated with GDP that falls below its potential. The former is a function of the economy operating beyond its long-term sustainable capacity and, in theory, likely to create inflation, while the latter can often times be a function of recessions. In the post Great Financial Crisis period, it took the economy ten years to get back to potential, meaning for the duration of that time period from 2008-2018, GDP was running below potential (negative output gap). Therefore, not really a surprise that inflation was muted during that same period. In this most recent period, however, the CBO estimates that GDP has reached its theoretic potential after just over a year since the Covid pandemic began and now the key question emerges of whether the economy can sustain its growth trajectory and grow above its potential. Since the late 1970s it is more common for the U.S. economy to operate below its theoretic potential than to operate above this estimate. Should this indeed be the case again in the coming years the result is likely to be associated with moderating inflation rates during the back half of the decade.

**CHART OF THE WEEK**

The U.S. economy is finally operating near its potential



Source: Clearstead, U.S. Bureau of Economic Analysis, Real Gross Domestic Product [GDPC1], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPC1>, April 18, 2022, U.S. Congressional Budget Office, Real Potential Gross Domestic Product [GDPPOT], retrieved from FRED, Federal Reserve Bank of St. Louis; <https://fred.stlouisfed.org/series/GDPPOT>, April 18, 2022.

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