Investors have for a decade enjoyed high returns from their financial assets in markets that suggested there was very little to worry about, that is to say, with little risk. Companies that were little more than an idea and required vast sums of capital before turning a profit did very well. Consider Netflix, for example. When you sell addictive entertainment content for a low subscription price, you need more and more content. And quality entertainment content costs a great deal. A business plan like Netflix's is very, very risky, yet Netflix stock was one of the last decade's big winners.

Compare Netflix to a more traditional company like Oshkosh Trucks, which makes specialty trucks for everything from cement companies to fire departments. Oshkosh takes the risk of designing and bidding on contracts for these specialty vehicles, and its stock has done well, but nothing like Netflix. Investors over the past decade internalized the mentality that there is less risk in the financial markets than there was before, and they chased the riskier investments with great results. The meme stocks, SPACs, and “coin” stocks of the last two years were the most extreme examples of the minimization of risk concerns.

Market disruptions since 2009 have been historically brief. Even the sharp downturn in early 2020 was largely reversed by June of that year. The market's resilience over the past decade contributed to the sense in the financial community that we were in a fundamentally different system, one in which old relationships between financial factors no longer applied. Even when inflation came roaring back in 2021, the predominant response was to describe it as "transitory," due to an unrepeatable logistics issue related to the worldwide shutdown. An historic risk factor like inflation was dismissed with "this time is different."

Enter stage right Vladimir Putin's army into Ukraine. A unified policy response by the West tried to harm Russia financially through sanctions and to help Ukraine militarily by sending arms. The mega-media technology platforms tried to help by canceling Russia internet style, which was a reversal from the old approach of beaming into the opposition territory our messaging through platforms like Voice of America.

The current situation is that risk has returned to the financial markets. Inflation, it turns out, is more difficult to stop than it is to start. The lockdowns are over and the distribution systems are clearing, but costs keep going up. Gasoline prices had been rising before the Russian-Ukraine war, but it turns out war is not deflationary.

Wage gains were scarce for the common worker over the past thirty years because of the constant threat of moving factories to China, but the military conflict has illuminated the lack of total policy alignment between the United States and China. Globalization has turned out not to be risk free. Changing corporate logistics is a risk now on the horizon, as companies do not want to find their factories are located in places where politics might overwhelm corporate interests. So, US workers might get a raise and a larger share of the corporate budget, which is a risk financial analysts have not had to consider for thirty years.

Interest rates have been declining since 1981, and we have had almost a decade of near-zero returns on cash. This policy facilitated dramatic global increases in debt of all kinds. Individuals, companies, and countries took on debt because the cost was low and the returns elsewhere seemed to be guaranteed. But inflation control is one of the mandates our Federal Reserve must meet. When inflation could no longer be dismissed as transitory, the governors announced a plan to raise the short term rates they directly control, and they said they would stop buying bonds further out the curve, which impacts longer term rates indirectly.

Continued on Next Page ☞

The current shape of the yield curve is odd, by anyone's definition. Its shape reflects the reintroduction of risk factors that had not been of concern to the financial community previously, and the ongoing changes suggest there could be new risk factors to consider. A significant risk factor investors are facing is the possibility that the US Dollar's status as the sole global monetary standard might be weakened or even lost. Already Russia has forced cold Europeans to pay for their heating gas in rubles, which sets the stage for other commodity transactions to be conducted in something other than US Dollars. This risk wasn't mentioned even 90 days ago, but it is something important for financial investors to now factor in their analysis.

ZWJ is an "old school" investment shop. With partner shareholders from their early thirties to their early sixties, you can be sure our investment discussions are robust. Our ages may be different, but we have always been attuned to the risk factors only recently back in the news because we never forgot the first lesson taught in every college economics class: there is no such thing as a free lunch.

We have steadfastly refused to believe "it's different this time." That stance did keep us from participating in things that worked, like Netflix, but it also helped us avoid some things that didn't, like Rivian. We've always been willing to include in our client portfolios a few ideas that could really pan out if things go well, but we mostly hold names that should be fine even if things are not perfect.

We've always chosen the bond from a high quality issuer even if there were higher rates offered by others. We've been keeping our bond portfolio duration relatively short because we never believed interest rates could never rise. As interest rates have recently risen, we are extending average portfolio maturity somewhat. But we are staying with our insistence on high quality issuers.

The markets are being reminded that risk is a real factor. We never forgot. The financial community is being reminded that there is no such thing as a free lunch. We've taken on debts personally and know how much discipline is required to pay them down, so we are not surprised at the current debt environment after a decade or more of global spending that exceeds revenues.

The world is a dangerous place, and financial markets are no less exposed. ZWJ understands its mandate: protect what our clients have saved and then try to obtain a good return in a risky world. Welcome back, risk; we remember you from way back.

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