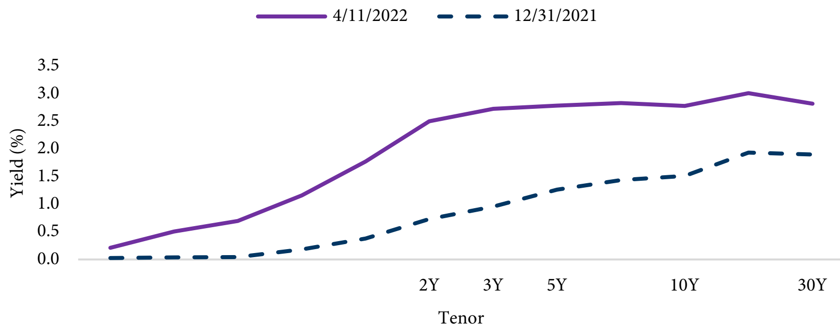
April has started with an unpleasant jolt to both bonds and stocks. After a reprieve in March, interest rates have risen with U.S. Treasury securities yielding between 2.50% (2-year maturity) and 2.75% (ten-year maturity). The increase in interest rates is negatively affecting the stock market, especially stocks of companies that sport higher price to earnings multiples and companies whose earnings growth rates are less secure.

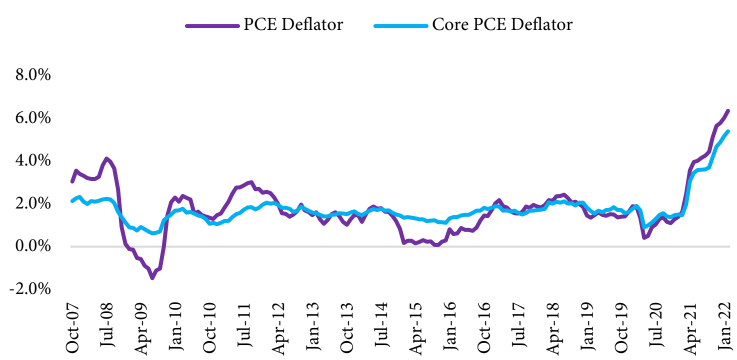
Figure 1 **U.S. Treasury Yield Curve at Year End 2021 & April 11th 2022**



Source: Bloomberg

The rise in rates is considered a negative for economic growth but does have two positives: higher current interest rates for bond investors will also act as a counterbalance for inflation. On that score, inflation is too high and if left unchecked would undermine future economic prospects. However, rates *are* rising, both longer-term rates set by the market and short-term rates set by the Federal Reserve Board. In addition, consumers and businesses have begun to substitute lower priced or alternative products as prices have risen. Inflation readings in both March and April will remain uncomfortably high but should come off the boil as the summer progresses and we anniversary the price surge of 2021.

Figure 2 **Personal Consumption Expenditure Price Indices 2007-2022**



Source: FactSet

Inflation is high primarily because the U.S. economy is strong, but there are other contributing factors: supply chain disruptions, war, and two years of unprecedented monetary and fiscal stimulus. But aggregate demand – consumer, business, and government spending, remains very high. This is unlikely to change in the next twelve months. Aggregate demand, the strength in spending, will continue to support the economy and corporate earnings growth. Company earnings will continue to drive the US stock market although we expect there to be some additional bumps and turbulence along the way.

This is an unusual economic period. Headlines blare inflation warnings, the job market readings show an undersupply of workers, and the supply chains have been disrupted by first a pandemic and now a war. The economic fundamentals also speak but are more difficult to hear. The economy remains robust, and earnings growth should support stock prices. The current challenges appear unique, and indeed some are, but financially sound companies with experienced management teams should be able to adapt and respond to the current challenges. Companies with strong pricing power should be able to grow earnings along with inflation. A diversified portfolio of high-quality stocks, with equally high-quality bonds for income and capital preservation, remains the investment program of choice.

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April 2022

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