Market Commentary

As of March 31, 2022

Economy & Market Review

First Quarter 2022

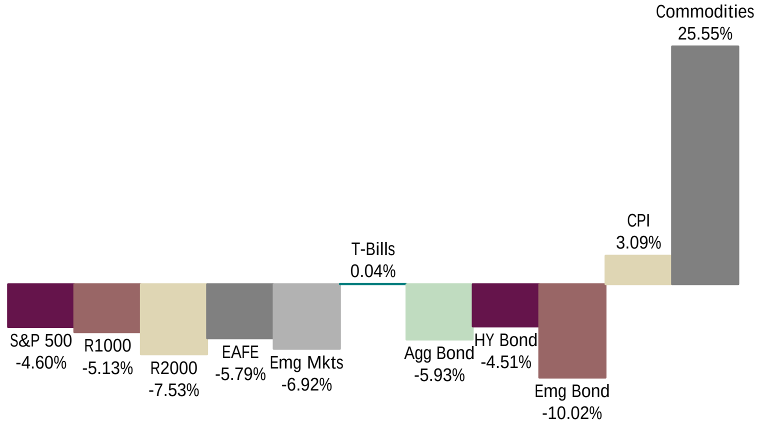
The quarter was rocky by recent temperate market standards. Markets are dealing with geopolitical risks, tightening monetary policy, rising interest rates, increasing inflation, and slowing US economic growth. By now, everyone is feeling the effects of inflation, the question remains how durable are the price increases. Some areas of the economy (shelter, travel-related, and transportation) may have stickier prices for the long-term. Areas such as energy and other commodities may be more apt to find equilibrium at lower rates as higher prices incentivize increased production and therefore increased supply driving prices down over time. For instance, US oil and gas offshore rig counts are currently trending higher. With inflation running hot (the central bank's goal), wages are also trending higher, but still not keeping pace. This results in a loss of purchasing power for many households providing a possible growth headwind. As a result, the Federal Reserve (Fed) is raising rates and may reduce its balance sheet by $95 billion per month this year to diminish inflation. The market is pricing in 9-10 rate hikes now over the next few years which, as recently as a few months ago, was only a few hikes. All of the risks above along with stretched asset valuations led to the repricing of risk assets in the first quarter. US large cap stocks fell 4.6%, US small caps moved lower 7.5%, non-US stocks were down 5.3%, and emerging market equities fell 6.9%. Bonds, usually a ballast for stocks, dropped a whopping 5.9% during the quarter. The -5.9% return of the Bloomberg Barclays Aggregate Bond Index is the 3rd worst quarterly return all-time and the worst in the last 40 years.

Although most of the impact from Fed actions have yet to permeate the economy, currently the US economy continues its resiliency. Recent US Labor Department initial jobless claims for state unemployment benefits fell to 187,000, the lowest level since September 1969 and the unemployment rate is at a two-year low of 3.8%. Based upon JOLTS (Job Openings and Labor Turnover Survey), over 11 million jobs are still available in the economy which is 1.8 open positions per unemployed person. The strong labor market is quite different than the wobbly University of Michigan Consumer Sentiment Index which is at its lowest point since 2011 as families expect a decrease in real income based on current inflationary pressures.

Global Market Performance

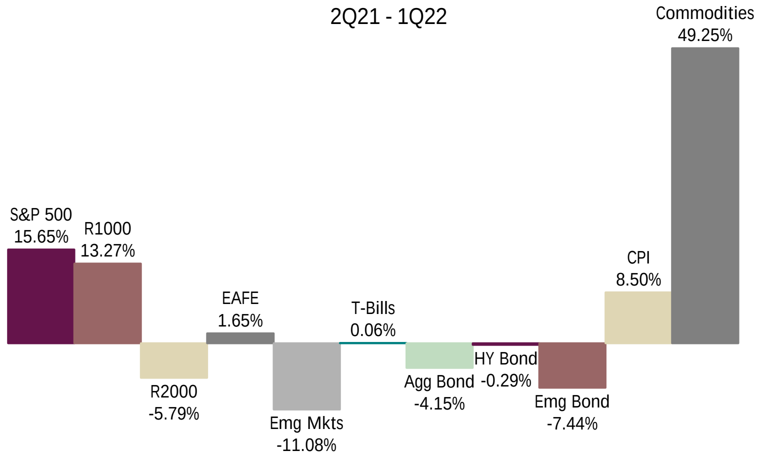
Quarter Performance

1Q22



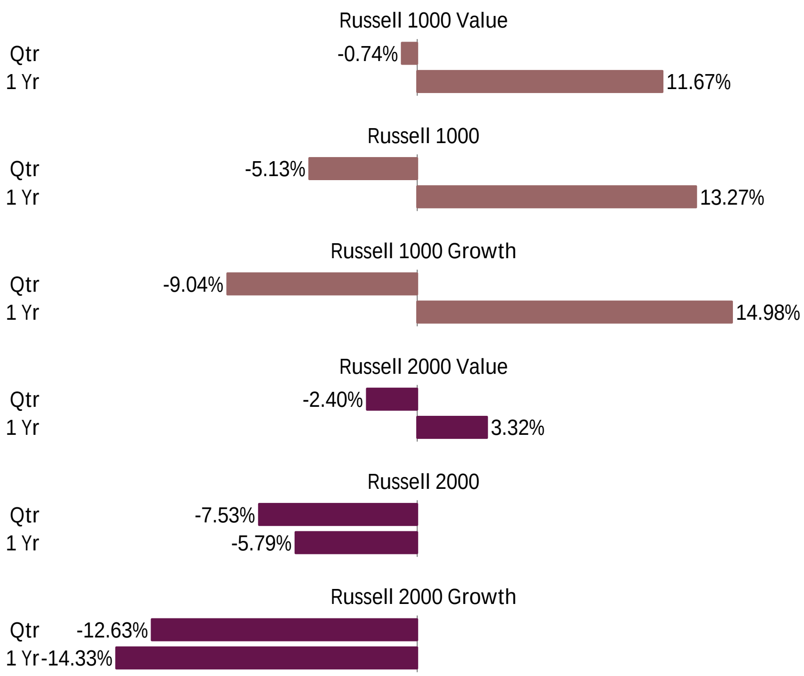
One Year Performance

2Q21 - 1Q22



U.S. Equity Markets

U.S. Equity Style Performance

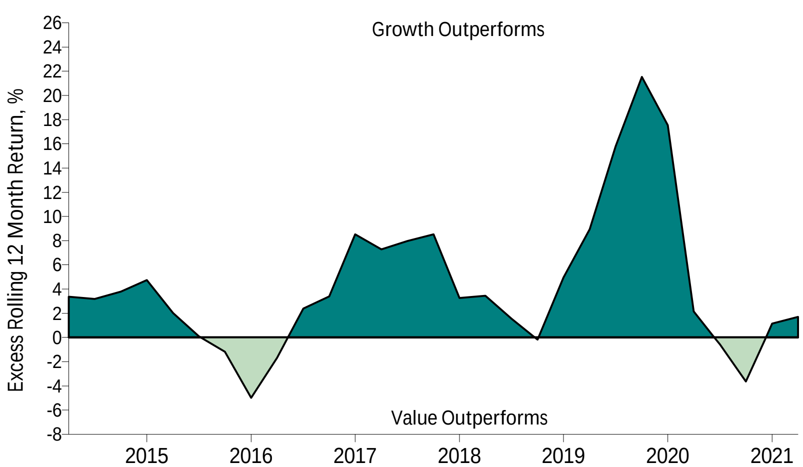


After a year of exceptional performance during 2021, equity markets had a minor reset in the first quarter of 2022. The S&P 500 Index of large cap stocks decreased 4.6% during the quarter and small cap stocks as measured by the Russell 2000 Index fell even more during the quarter. Even with the negative performance, US stock valuations are still above average. As corporate margins are impacted by increased wage growth and higher input prices, earnings fundamentals might start to matter again.

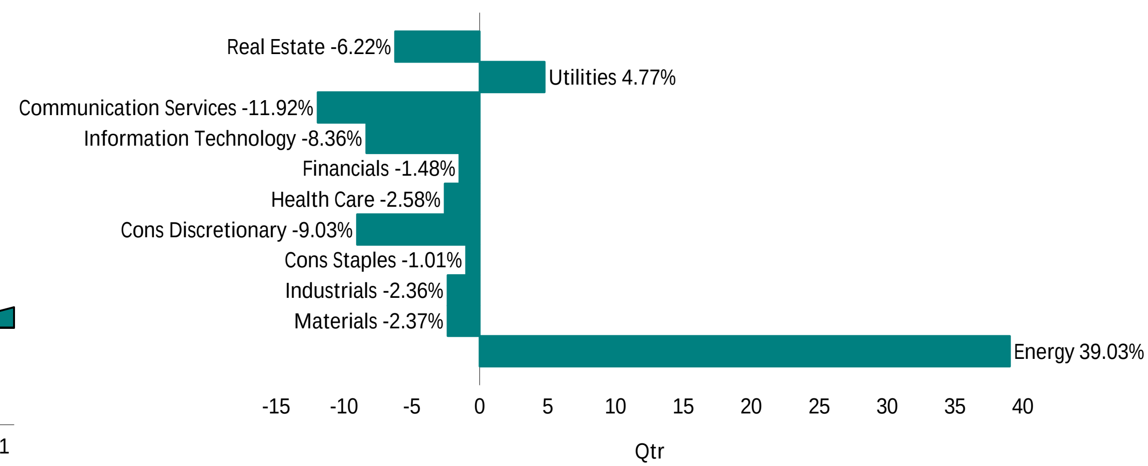
Value stocks continued their recent outperformance relative to growth stocks, but still trail growth over the last decade. Mid cap and small cap value continued to outperformed their growth brethren by a fairly wide margin for the quarter. From a valuation perspective based upon a comparison of current P/E to 20-year average P/E, only small-cap value and small cap blend trade at a discount.

Commodity price inflation continued to attract investors as Energy was easily the best performing sector. Investors also became more defensive as Utilities were the second best sector performer. Those were the only two positive sector performers. Communication Services, Consumer Discretionary, and Technology sectors were the worst performers and all have large growth companies underlying each sector that weighed on the sector as a whole.

Growth Relative to Value (Russell 1000)

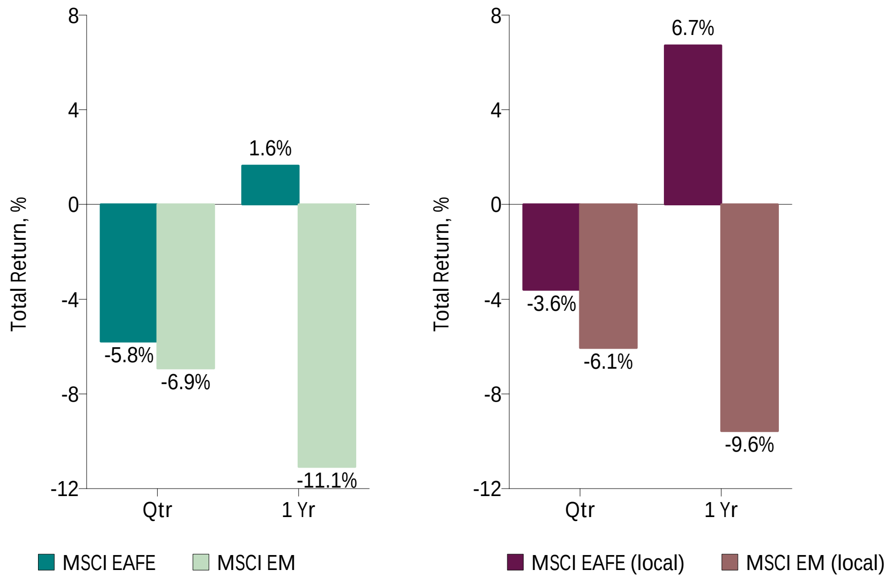


U.S. Equity Sector Performance (S&P 500)



International Equity Markets

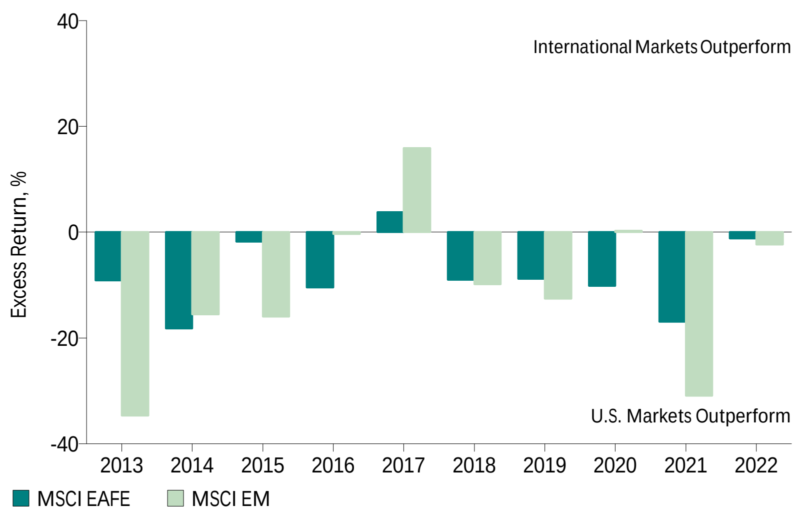
Non-U.S. Equity Performance



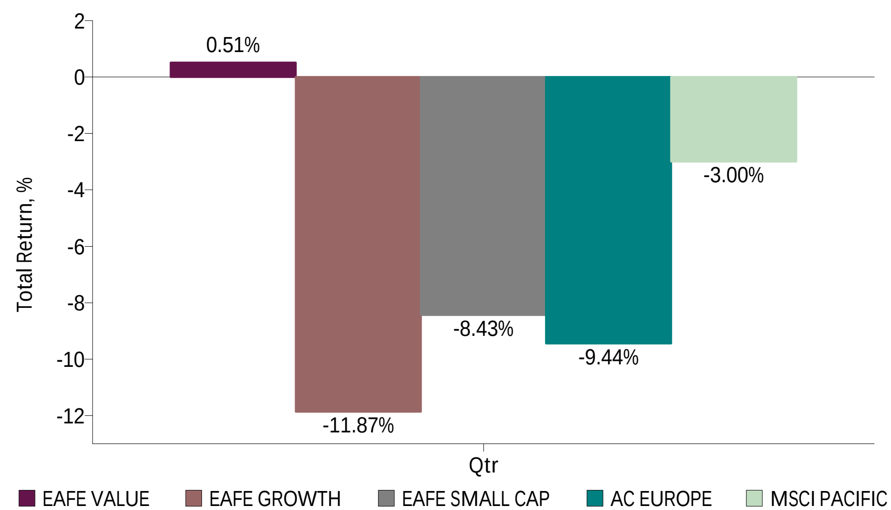
The Eurozone outlook has been upended by Russia's invasion of the Ukraine. Aside from the tragic humanitarian crisis in the Ukraine, the major financial challenges in the Eurozone are energy price inflation, food price inflation, and supply chain disruption. Europe obtains more than 40% of its natural gas and 20% of its oil from Russia. Russia could, but likely won't, shut down energy exports to Europe pushing Europe into recession, but Russia needs the revenue from those sales to support its economy and the war. From a food price perspective, Russia and the Ukraine supply around a quarter of the world's wheat. Somewhat surprisingly, the MSCI EAFE Index, a proxy for large international developed equity markets, was down only 5.8% during the quarter, but still trailed the US markets.

Another quarter of underperformance for emerging markets (EM) compared to both developed international and US markets was instigated again by China. China's stock market negatively impacted EM performance as it was down over 14% for the quarter. As a result, the MSCI Emerging Market Index was down 6.9% for the quarter. The Chinese economy continues to face pressures from a zero-tolerance Covid policy to a property sector that is in a perilous position. Even with these challenges, a recent emphasis on economic stability may elicit more easing measures from the Chinese Central Bank including interest rate cuts and additional infrastructure spending.

Non-U.S. Equity Returns Relative to U.S. (S&P 500)

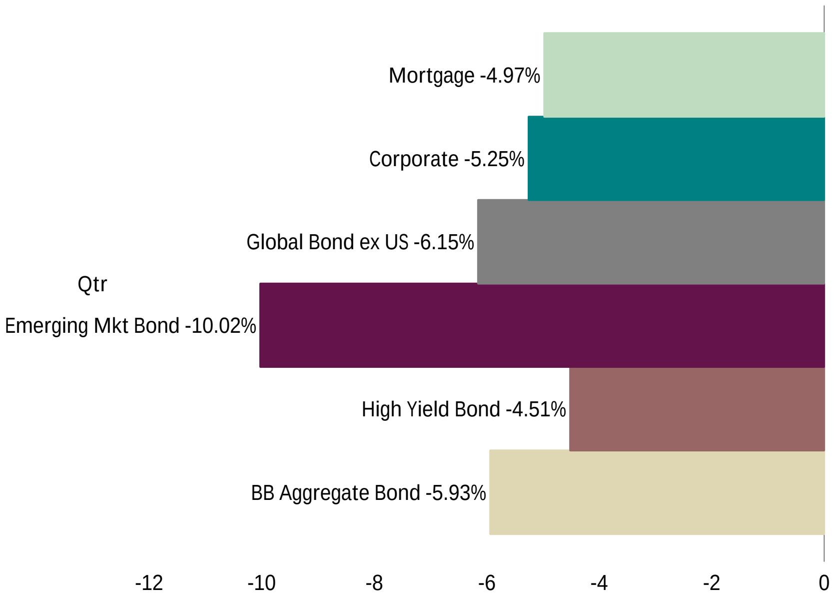


Style and Regional Non-U.S. Equity Performance



Fixed-Income Markets

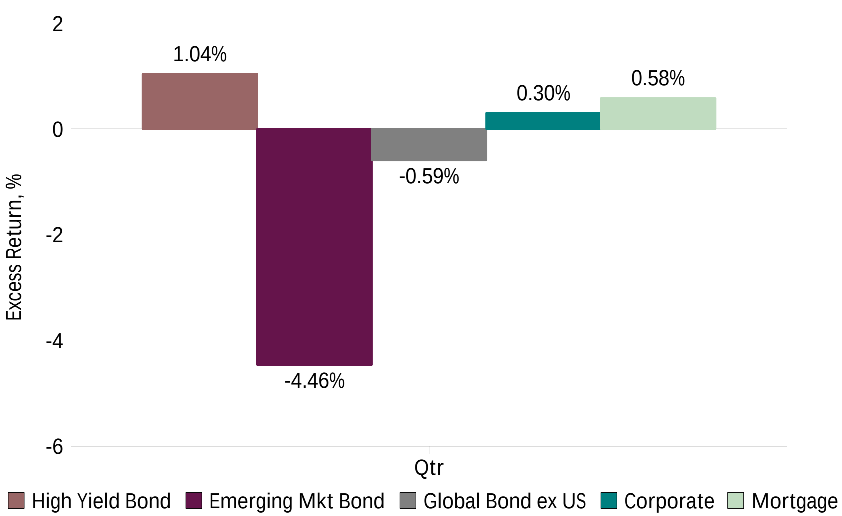
Fixed Income Performance



Over the last 30 years, bond market volatility, especially downside volatility has been fairly subdued. The first quarter was anything but restrained. With central banks around the world becoming much more “hawkish” (supports raising interest rates to fight inflation, even to the detriment of economic growth and employment), interest rates have risen dramatically during the year. This increase has placed more stress on longer duration fixed income holdings. For example, the 2-year treasury had a return of -2.5% while the longer duration 10-year treasury had an outsized -6.9% return. Another input of fixed income returns are credit spreads which have widened (generally a negative for returns), but investment grade credit performed worse than high yield (more risky) as investment grade bonds usually have longer duration.

The yield curve is simply the treasury rates at maturities from 1 month up to 30 years. The curve sometimes gives investors some guideposts as to what the future may hold. In particular, an inverted yield curve (shorter maturities earning more than longer maturities) may portend future economic recession. Currently, the 2–10-year curve is fairly flat with the 2-year yielding 2.50% and the 10-year yielding 2.61%. At the beginning of the year, the 2-year yield was only 0.78% and the 10-year yielded 1.63% highlighting the dramatic move in the shorter-term maturities as the Fed set course for rate hikes and balance sheet reductions.

Excess Performance to Treasuries



Yield Curve

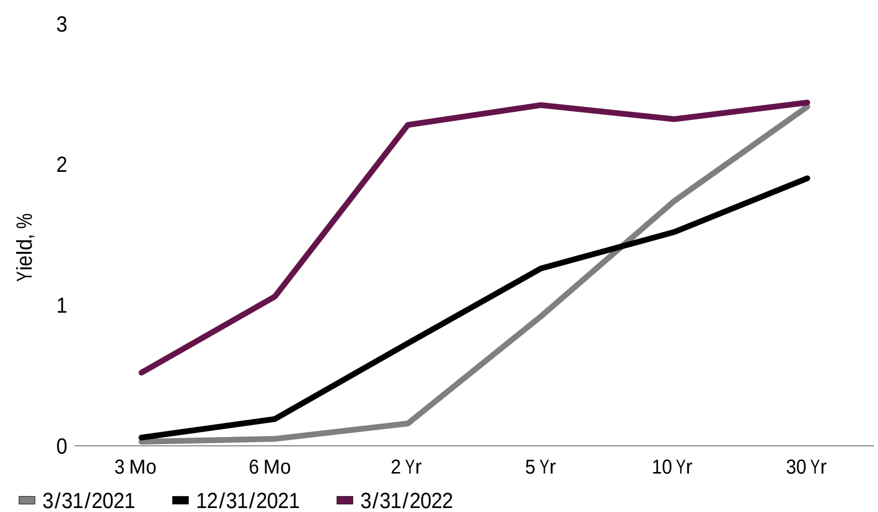


Chart of the Quarter

Inflation Rises 8.5%

The classic definition of inflation is too much money chasing too few goods and services. Massive intervention on the part of the Federal Reserve over the last 12 to 15 years has held interest rates lower than they otherwise would have been. We shouldn't be surprised that the accommodative policies of the Fed, along with the significant amount of government transfer payments due to COVID, coupled with the voracious appetite of consumers buying durable goods has resulted in inflation like we haven't seen since the early eighties. The aggressive unwinding of Fed stimulus due to inflation will put the economy in reverse at some point leading to recession.

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	Annualized Return
					Small Cap Stocks 21.31%	Emerging Mkt Stocks 37.75%		Large Cap Stocks 31.43%			
	Emerging Mkt Stocks 18.63%				High Yield 17.49%	International Stocks 27.77%		Small Cap Stocks 25.52%	Gold 24.61%		
	International Stocks 17.39%				Large Cap Stocks 12.05%	Large Cap Stocks 21.69%		International Stocks 22.13%	Large Cap Stocks 20.96%		
	Large Cap Stocks 16.42%		Large Cap Stocks 13.24%		Commodities 11.77%	Small Cap Stocks 14.65%		Emerging Mkt Stocks 18.90%	Small Cap Stocks 19.96%		
Real Estate 15.99%	Small Cap Stocks 16.35%		Real Estate 12.49%		Emerging Mkt Stocks 11.60%	Gold 12.66%		Gold 18.43%	Emerging Mkt Stocks 18.69%	Commodities 27.11%	-3.85
Gold 8.93%	High Yield 15.58%	Small Cap Stocks 38.82%	US Bonds 5.97%		Real Estate 8.76%	60/40 Blended Index 12.07%		60/40 Blended Index 16.50%	60/40 Blended Index 12.24%	Large Cap Stocks 26.45%	15.09
US Bonds 7.84%	60/40 Blended Index 11.09%	Large Cap Stocks 33.11%	60/40 Blended Index 5.51%		Gold 8.10%	Intl/EM Bonds 10.41%		High Yield 14.41%	International Stocks 11.13%	Real Estate 22.18%	10.94
Intl/EM Bonds 5.88%	Real Estate 10.94%	International Stocks 15.78%	Small Cap Stocks 4.89%	Real Estate 15.01%	60/40 Blended Index 7.85%	Real Estate 7.62%		Intl/EM Bonds 9.98%	Intl/EM Bonds 7.90%	Small Cap Stocks 14.82%	11.53
High Yield 4.38%	Intl/EM Bonds 10.60%	60/40 Blended Index 14.85%	High Yield 2.50%	Large Cap Stocks 0.92%	Intl/EM Bonds 5.77%	High Yield 7.48%		US Bonds 8.72%	US Bonds 7.51%	60/40 Blended Index 10.05%	7.73
Large Cap Stocks 1.5%	Gold 8.26%	Real Estate 13.94%	Intl/EM Bonds 2.08%	US Bonds 0.55%	International Stocks 5.01%	US Bonds 3.54%	Real Estate 8.35%	Commodities 7.69%	High Yield 6.17%	International Stocks 8.29%	5.66
60/40 Blended Index 0.49%	US Bonds 4.22%	High Yield 7.42%	Gold 0.12%	60/40 Blended Index 0.11%	US Bonds 2.65%	Commodities 1.70%	3-month T-Bills 1.87%	Real Estate 5.35%	Real Estate 1.17%	High Yield 5.36%	6.51
3-month T-Bills 0.1%	3-month T-Bills 0.11%	3-month T-Bills 0.07%	3-month T-Bills 0.03%	3-month T-Bills 0.05%	3-month T-Bills 0.33%	3-month T-Bills 0.86%	US Bonds 0.01%	3-month T-Bills 2.28%	3-month T-Bills 0.67%	3-month T-Bills 0.05%	0.58
Small Cap Stocks (4.18)%	Commodities (1.06)%	US Bonds (2.02)%	Emerging Mkt Stocks (1.82)%	Intl/EM Bonds (2.42)%			Gold (0.93)%		Commodities (3.12)%	US Bonds (1.54)%	3.34
Commodities (13.32)%		Emerging Mkt Stocks (2.27)%	International Stocks (3.44)%	Small Cap Stocks (4.41)%			High Yield (2.26)%			Emerging Mkt Stocks (2.22)%	3.42
International Stocks (13.33)%		Intl/EM Bonds (4.13)%	Commodities (17.01)%	High Yield (4.64)%			Intl/EM Bonds (3.17)%			Gold (4.33)%	2.30
Emerging Mkt Stocks (18.17)%		Commodities (9.52)%		International Stocks (5.25)%			60/40 Blended Index (3.71)%			Intl/EM Bonds (4.44)%	3.33
		Gold (27.33)%		Gold (12.11)%			Large Cap Stocks (4.78)%				
				Emerging Mkt Stocks (14.60)%			Small Cap Stocks (11.01)%				
				Commodities (24.66)%			Commodities (11.25)%				
							International Stocks (13.78)%				
							Emerging Mkt Stocks (14.25)%				