QUARTERLY MARKET UPDATE

JULY 2022

MARKET LANDSCAPE

Name	2022 YTD Returns (%)
Barclays US Aggregate Bond	-10.3
Barclays US Credit	-13.8
S&P 500 TR USD	-20.0
Barclays US Corporate High Yield	-14.2
MSCI Emerging Markets	-25.3
MSCI EAFE	-19.6
Russell 2000 TR USD	-23.4

Data Source: Morningstar Direct

Another Challenging Quarter

Selling pressure in global capital markets continued during the second quarter of 2022, allowing for the Standard and Poor's (S&P) 500 to register a -20% return for the first half of the year, and bonds as measured by Barclays US aggregate bond index, to be down over 10% during the same time span.

Adding to investor anxiety was the high correlation of negative price movements across traditionally low correlated asset classes. Bonds are typically about 20% as volatile as equities, yet this year we have seen that figure more than double. This creates fear for investors in traditionally diversified portfolios.

The conditions witnessed over the past few years which have aided risk assets have given way to a myriad of challenges and uncertainties. This year has seen the emergence of rampant inflation, concerns over US Federal Reserve (Fed) policy, questions regarding economic growth, and of course the Russia/Ukraine conflict.

All these issues are interrelated; including the zero-tolerance COVID-19 policies in China and their impact to global growth prospects. This dynamic has perhaps been under-appreciated as a destabilizing force in the global economic picture. When the world's second-largest economy effectively shuts down economic activity in response to any COVID-19 outbreak, the stifling impact to economic activity is more than significant.

Despite the multitude of challenges facing world economies, markets now have a more defined understanding of the current situation. This was not the case six or nine months ago, as the nature of inflation and the potential responses by world central banks were yet unclear. Additionally, the prospect of Russia invading Ukraine was negligible.

Despite all this, the rate of change in inflation metrics has diminished, or perhaps even peaked, and investors realize the Fed understands the significance of the problem.

The current situation boils down to, per usual, concerns regarding the health of the US economy. Ultimately, markets are trying to understand the nature of the tension between inflation and slowing growth. Which is the bigger threat, and to what degree will the Fed act to address either or both (understanding that efforts to address one issue likely amplifies the other)?

Given the current trends in economic data, it is reasonable to conclude that inflation trending lower for the remainder of the year is certainly possible. However, until this materializes, markets will remain nervous about Fed messaging and actions.

Sector Returns

S&P 500 Sectors	2022 YTD Returns (%)
Communication Services	-11.9
Consumer Discretionary	-32.8
Consumer Staples	-5.6
Energy	31.8
Financials	-18.7
Health Care	-8.3
Industrials	-16.8
Information Technology	-26.9
Materials	-17.9
Real Estate	-20.0
S&P 500	-20.0
Utilities	-0.6

Data Source: Morningstar Direct

Asset Class Performance

All major US stock indexes posted negative returns in the second quarter. As mentioned, higher inflation and interest rates, combined with fears of a significant slowdown in growth continue to facilitate a rotation from higher valuation, higher growth companies to sectors of the market less sensitive to these conditions.

Large-cap stocks continued outperformance versus their small-cap counterparts, as larger firms are typically less dependent

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on financing conditions negatively impacted by higher interest rates. Large-cap names usually benefit from an intra-asset class flight to safety during periods of economic stress.

Unlike the first quarter of this year, where value style stocks registered positive returns, both value and growth styles were negative in quarter two, though the magnitude of decline in value stocks was generally less than those of growth companies, continuing the year-to-date outperformance of value.

From a sector standpoint, energy remains the only sector to post positive returns for the first half of 2022, despite small negative returns in quarter two. This is of course due to inflated global energy prices. Year-to-date underperformers include consumer discretionary, communication services, and technology companies due to the broad rotation away from high growth and valuation names.

Despite the Russia-Ukraine conflict and its negative impact on developed international economies, international markets generally outperformed US markets, as foreign central bank actions were seen as more accommodative or certainly less punitive than those of the US Federal Reserve. This dynamic speaks to the importance of monetary policy conditions on markets. Developing economies also performed relatively well largely due to elevated commodity prices.

US fixed income markets continued their downward trajectory, negatively impacted by more hawkish than anticipated Fed interest rate increases. Corporate bonds fared worse than government-issued securities; they were impacted by the interest rate risk, but also faced the headwinds of elevated credit risk due to recession fears.

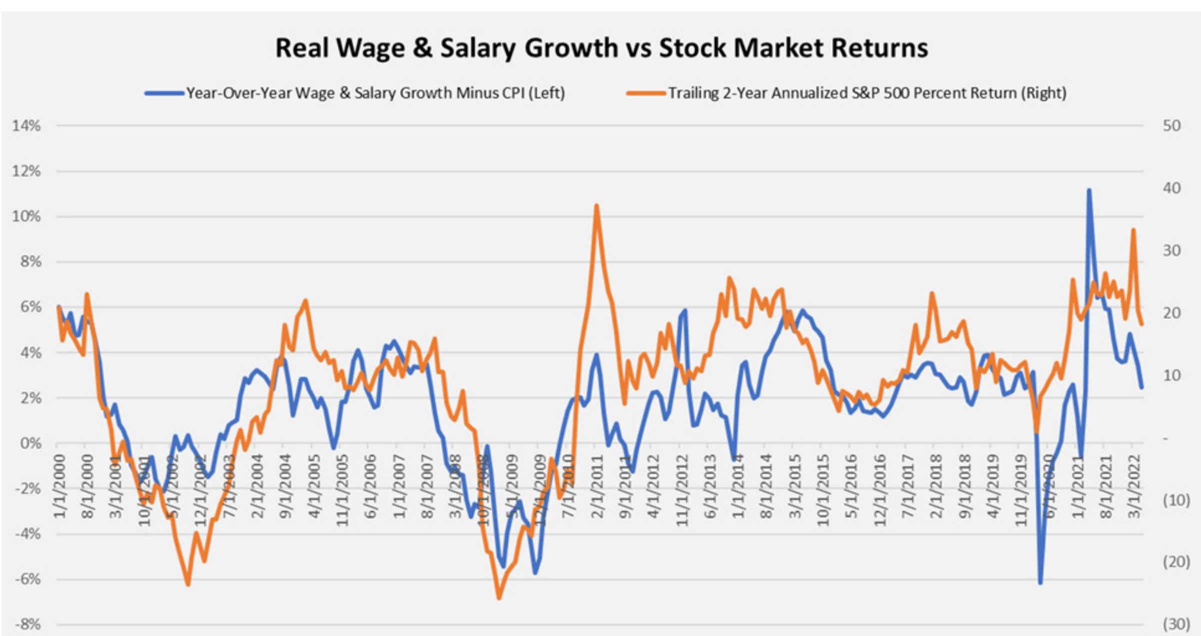
Inflation – Fed Tightening

The annual inflation rate in the US currently sits at 8.6%. Significant drivers to this figure are of course energy and food products. Absent these elements, core inflation sits at a lower 6.0%. If oil and gas prices remain elevated, exacerbated by global conflict and supply chain issues, consumer spending will likely remain impacted.

The main contributors to higher core inflation revolve around durable goods such as automobiles, appliances, etc., where availability and price levels have also been impacted by supply chain issues present since the pandemic. Though taking longer than anticipated, expectations regarding the eventual normalization of these prices are realistic.

One of the more complicated dynamics facing the Fed (and ultimately capital markets) as it attempts to address inflation in the least economically destructive fashion, involves wage-growth

Chart 1 - Wage Growth and Equity Returns



Source: ***YCharts***

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dynamics across the economy, especially in the service sectors.

From a labor supply standpoint, it is difficult to reduce inflation while maintaining strong labor force participation and wage-growth, where higher labor costs are passed on to the end consumer, which ultimately amplifies inflation tendencies.

Chart 1 demonstrates how this conundrum negatively impacts risk assets. When wage growth does not keep up with inflation (even when wages are increasing), market psychology and liquidity negatively impact stock levels. Therefore, it seems the reemergence of sustained equity market strength is contingent upon lower inflationary inputs, save that of wage growth. This is a difficult proposition.

Given the hard task at hand, markets remain unconvinced that the Fed can contain inflation without causing a recession. Business leaders and economists are attempting to calculate the likelihood that a recession occurs in the next 12 months. Estimates vary, but citing Bloomberg Economics as a proxy, the probability currently sits at 38%.

While the risk of recession has substantially risen, it is no guarantee as consumers and businesses are in generally good financial shape. Household debt-to-GDP (67%) remains at historically low levels, certainly well below levels seen over the last 15 years, and households have accumulated almost $2.5 trillion in excess savings between March 2020 and January 2022. Additionally, debt-service costs are low. According to the Federal Reserve, the household debt-service and financial obligations ratio is currently 14.2%, which is below pre-COVID-19 levels dating back to 1980.

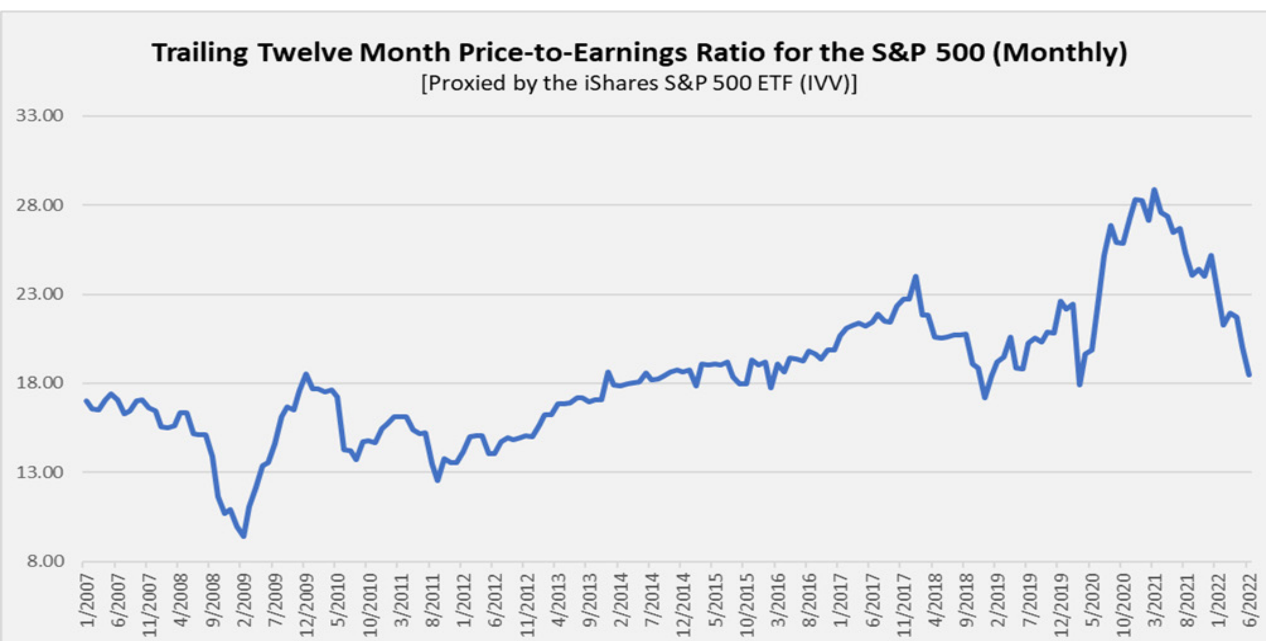
From a business perspective, companies have been replenishing inventories at an elevated pace, creating inventory overhang in certain sectors. However, this pace will slow as supply and demand dynamics normalize, and these inventory levels, in aggregate, are still low relative to sales for manufacturers, retailers, and wholesalers alike.

Summary – Outlook

The first half of 2022 has obviously been troublesome for investors. With stocks, bonds, and other asset classes all experiencing downward price movement, there have been few opportunities to avoid the wholesale risk-off attitudes in global markets. Case in point, the S&P 500 just registered its worst first-half calendar-year performance in over 50 years.

These results are not terribly surprising given the emergence of inflation, the magnitude, and pace at which the Fed has initiated interest rate increases, the restricted economic growth in China,

Chart 2 - S&P 500 P/E Ratio



Source: ***Morningstar***

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and geopolitical conflicts headlined by the Russia-Ukraine war.

As difficult a period as this has been, it is worth recognizing that with challenges come opportunity. The onslaught of macroeconomic headwinds and the resulting price pressure in markets have significantly reduced valuation levels. Chart 2 demonstrates this by presenting historical price-to-earnings (P/E) multiples. Current levels of this relative valuation metric highlight a much more favorable environment than eighteen months ago. The ability to generate historically attractive long-term returns is much more probable from current price levels.

Concurrently, investor sentiment sits at historically extremely low (negative) levels, signifying that most of the bad news, uncertainty, and arguably prospective negative scenarios are largely priced into markets. This offers the potential for upside surprises to markets if worst-case scenarios do not materialize.

Of course, no one can predict the future. Continued energy inflation exacerbated by the Russian-Ukraine war, combined with continued hawkish Federal Reserve policy could push the US economy into recession, most likely in 2023. On the other hand, declining inflation resulting from the conflict's resolution, combined with material levels of demand destruction already in progress could augment consumer attitudes and spending and provide a catalyst for markets to head higher.

Regardless of which scenario emerges, it will likely be several months before the requisite clarity develops. Until then, we fully expect ample levels of both up and downside volatility as markets react to new information. We are cognizant of the issues facing global economies and markets and remain vigilant in monitoring developments.

We also recognize that economies and markets are separate entities, which do not necessarily move fundamentally in concert with each other. Given that markets reflect the aggregate psychology of the investor universe, it is important to understand that markets can trade away from fundamentals for considerable periods of time.

We view investing as a long-term proposition, and therefore continue to council patience and advocate for a diversified investing approach consistent with your long-term planning needs.

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