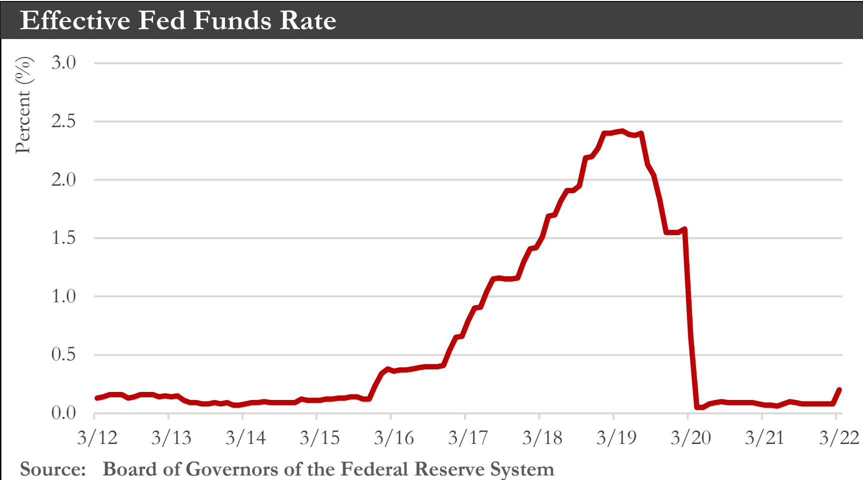
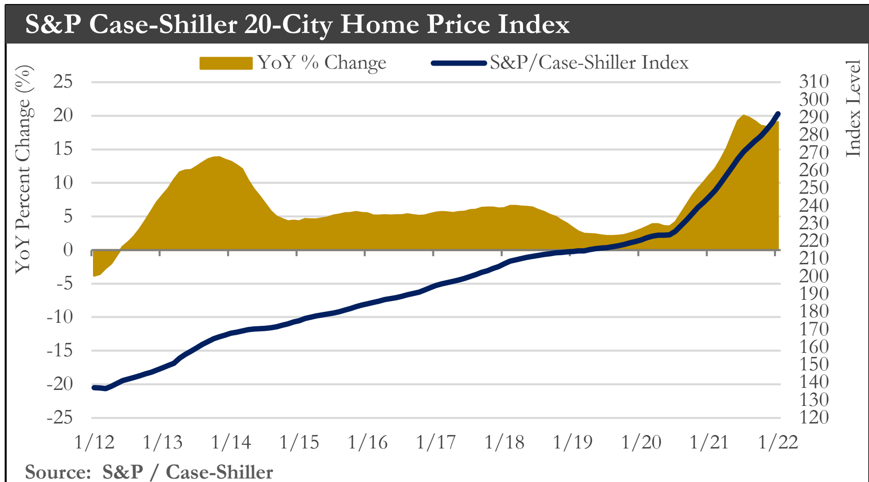
ECONOMIC COMMENTARY & CAPITAL MARKET UPDATE
APRIL 2022

Recap: Russia's invasion of Ukraine continues to loom large on the global economy as the war has intensified. Western countries have introduced a series of sanctions on Russia, including a U.S. ban on Russian oil and energy imports. The full degree to which the war will affect the broader U.S. economy remains to be seen, and it is difficult to foresee how the crisis on the ground will evolve in the coming weeks.

Separately, the U.S. economy is pushing through the Omicron surge reasonably well. Against a backdrop of soaring case counts, employment growth, retail sales, and industrial production each expanded at a robust pace during the first few months of the year. The expansion of economic activity at the beginning of the year is an encouraging sign that not only are households and businesses taking new waves of the pandemic in stride, but they are also standing tall in the face of supply chain disruptions, labor shortages, and the hottest inflation in over 40 years. Keeping this fairly auspicious start to the year in mind, real GDP is expected to expand by 3.5% in 2022 as a whole, which is a significant moderation compared to the blazing 5.7% pace registered in 2021, yet still above the average rate of growth seen in recent history before the pandemic. Not only will growth moderate, but the drivers will shift, with consumer spending on goods abating and a larger share of growth coming from business fixed investment and inventory rebuilding.



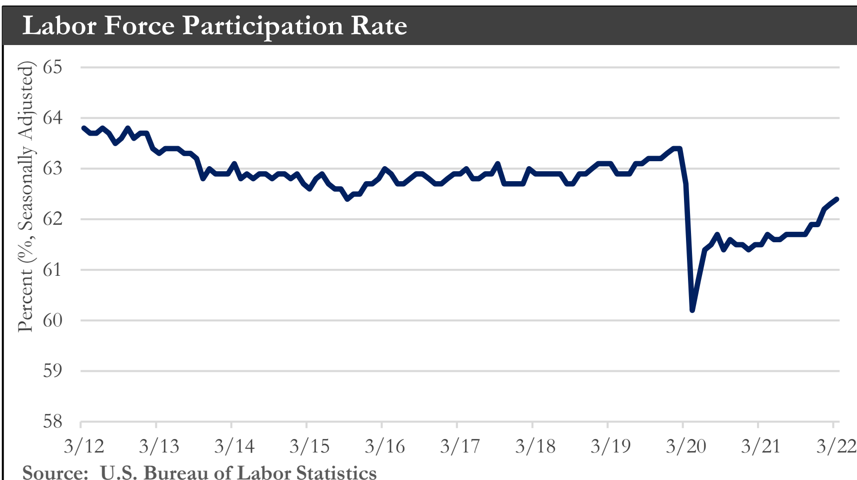
While COVID cases are now plummeting, the lengthy list of supply-side problems that have accompanied the public health crisis stubbornly persist. Tangled supply chains and multiple rounds of fiscal support from years past have resulted in a broadening of inflation pressures, which has spurred a hawkish pivot from the Federal Reserve. The most notable change in the economic outlook is that the Fed is now expected to raise the federal funds rate five more times in 2022, bringing the current target range of 0.25%-0.50% up to 1.5%-2.0% at the end of the year. The Fed is also expected to complete its taper of asset purchases and begin to gradually shrink its balance sheet later this Summer. The result of such actions will be modestly higher interest rates across the board.



Housing: The U.S. housing market has been a surprising source of strength throughout the pandemic. Strong demand has eaten into already-thin housing inventories, lowering them to record lows. Meanwhile, the supply-demand imbalance has encouraged strong price gains. Over the next year, the housing market is expected to transition to a more balanced phase. Part of this will be due to elevated construction activity, which will gradually bring more product to market. Multiple hurdles, such as a shortage of labor and materials will weigh on the ability of home builders to quickly wrap up residential construction

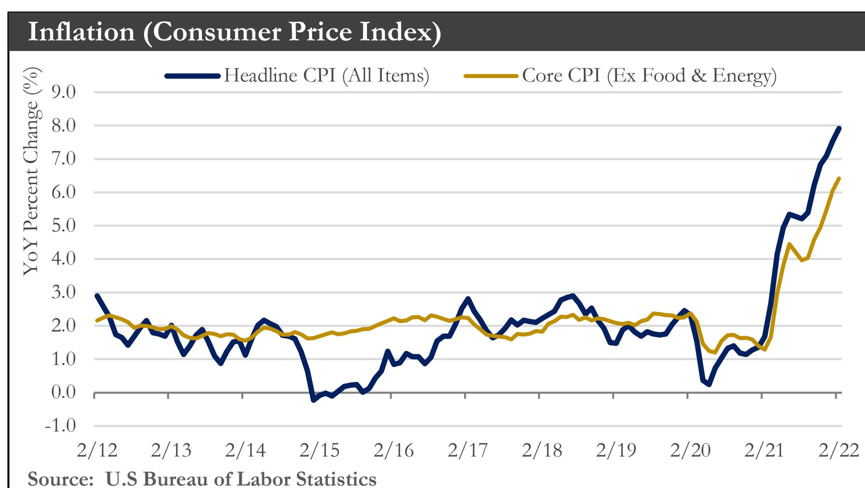
projects and stretch completion timelines in the near term. However, some of these issues will dissipate as the pandemic moves further into the rear-view mirror. With this in mind, homebuilders are expected to bring around 1.5 million new homes to market through the end of this year. This will not be a panacea for an imbalance that took years to build, but the additional completions will help soothe supply-side pressures. Higher interest rates are also poised to play a role in bringing about a more balanced market this year as they take some steam out of demand.

Labor Market: The U.S. labor market continues to be quite hot as the economy added 678,000 jobs in February. Employers continued to boost wages in February as they competed over a depleted pool of workers. However, wage growth slowed, a potential sign that the labor shortage is easing as more people enter the workforce. The jobless rate fell from 4.0% to 3.8% as more people entered the labor force while the labor force participation rate rose to 62.3% from 62.2%.



But the labor market is suddenly facing new threats that could impede further job growth: soaring oil prices, geopolitical turmoil in Europe, and looming interest rate increases from the Federal Reserve. While virus infections have fallen sharply since their peak in mid-January, employers continue to struggle to find workers as they respond to an elevated level of spending from households.

Three shifts could lead to stronger job growth this spring. The first is the continuing decline in virus cases. The second is the move by some states and cities in recent weeks to lift rules that required customers to be vaccinated and wear masks. The third is a potential decline in household savings, which could pressure people to rejoin the labor market to collect a paycheck, particularly as inflation rises and the stock market wobbles.



Inflation: Energy prices have surged since Russia invaded Ukraine. CPI inflation is now expected to peak at around 8.5% in April, although the timing and degree will depend heavily on the highly volatile and uncertain path of oil prices. Besides energy, food-related commodity prices have also shot up 9% since the start of February and will influence consumer prices for months to come.

In addition, supply chains face new logistical hurdles and higher production costs, suggesting the easing in goods inflation will be slower to come by, barring a more significant drop in demand. All of this comes as services inflation is still gaining steam and inflation expectations are at the top end of the past decade's range. With considerable price pressures remaining in place, core PCE is expected to still be above 4% throughout this year, even as the FOMC tightens policy.

Federal Reserve: The Federal Reserve has raised its benchmark federal-funds rate in March by a quarter percentage point to a range between 0.25% and 0.5%, the first interest rate increase since 2018.

The combination of higher inflation with slower growth poses a dilemma for the Federal Reserve. With this hike, the Fed signaled greater concern that higher inflation might persist due to a tight job market with record job openings and wages up at their fastest pace in years. On balance, slower growth is not necessarily a problem as long as it remains near its long-run potential of 2% or so, particularly at a time when the labor market is near or at full employment.

A series of rate hikes are expected to take place over the coming months. The FOMC is expected to raise rates by 25 bps at its upcoming meetings in May, June, July, September, and December. With the economy showing no signs of ebbing and inflation at multi-decade highs, there is considerable pressure on the Fed to get rates up to a level that can break the current inflation trend. The Fed is expected to lift the Fed funds rate to nearly 2% by the end of this year. The FOMC will likely decide at its May meeting to shrink its balance sheet starting in June, and it is anticipated that balance sheet runoff will start slowly but ramp up at a well-defined pace in the following months. Balance sheet reduction will act as an additional form of monetary tightening.

Dollar: The economic effects of the war in Ukraine, combined with the expectations that the U.S. will outperform global markets, has propelled the dollar to an unusually sweet spot. The escalating conflict between Russia and Ukraine has sent investors dashing to safer assets, propelling the dollar to its highest level since the coronavirus-induced volatility of two years ago.

Investor anxiety swelled as Russia advanced across Ukraine, upending markets across the globe and sending traders scrambling for assets perceived as safer, such as gold, U.S. government bonds, and the dollar. The recent move by the dollar builds on earlier strength that began last year amid expectations of higher interest rates in the U.S.

Concerns have mounted that the war and the sanctions inflicted by the West will ripple across the European continent, stunting growth while inflationary pressures rise. For now, investors believe the U.S. economy, in contrast, will be relatively insulated from the war, prompting bets by traders on U.S. stocks. Both the euro and the British pound have lost against the dollar.

Eurozone: For the eurozone, the Ukraine war could significantly dampen the eurozone's economic growth by dragging on trade and sentiment, while also pushing inflation considerably higher in the near term. It is likely to curb exports, strain already-stressed supply chains, and drive-up energy and commodity prices for households and the region's large manufacturing sector. The war is likely to be a stagflationary shock for Europe, which borders and has deep trade relations with Russia, including a heavy reliance on Russian energy.

Even before the Ukraine conflict, Europe's economic recovery had less momentum than that of the U.S., partly because of lower government spending. The conflict is likely, in the short term, to push up eurozone inflation that, at 5.8% in February, is already almost three times the ECB's 2% target.

With the cessation of hostilities in Ukraine a distant prospect, for now, eurozone growth looks likely to slow sharply, which could force the ECB to switch its focus from inflation back to growth and labor demand.

For now, the ECB signaled it is more focused on high inflation than slowing economic growth. The ECB would phase out its large bond-buying program sooner than expected and pave the way for interest-rate increases later this year.

Outlook: The global economic landscape has changed considerably since the Russian invasion of Ukraine. Soaring commodity prices, sweeping financial sanctions, and the potential for a ban on energy imports from Russia are threatening to hobble a global economy still weakened by the Covid-19 pandemic. Although not many Western governments have outright banned the importation of Russian petroleum, with the notable exception of the United States, many Western oil companies have essentially implemented self-imposed boycotts of Russian oil. This conflict is likely to drag on for some time. Even if the war comes to an end in the near term, the West will continue to reduce purchases of Russian oil for the foreseeable future. Consequently, oil prices will likely remain elevated in the coming quarters.

Higher petroleum prices likely will lift U.S. inflation rates even higher than expected just a month ago. Rising inflation will erode growth in real income, which likely will lead to slower growth in real consumer spending. Consumer spending is not expected to collapse unless oil prices rise significantly higher than currently expected. Household balance sheets are generally in solid shape at present, and the household savings rate could fall further to support continued growth in consumer spending.

U.S. real GDP is expected to expand by 3.5% in 2022, which is above the average pace seen over the past few decades before the pandemic. While stimulus from monetary and fiscal policy is set to fade, a massive stockpile of consumer savings and increased household wealth will drive growth in the years ahead. Corporate balance sheets are also exceptionally strong. Overall, economic growth is moderating a bit, but it is still expected to maintain a strong pace.

On both sides of the Atlantic, inflation is at levels that haven't been seen for decades and are still rising. International stock markets are wilting and the dollar is surging against other currencies as investors rush for the safety of U.S. assets. This may lead to a possible bout of stagflation, particularly in Europe. Europe, with its geographical proximity to the conflict and heavy dependence on Russian energy, is potentially facing its third recession in two years.

In Russia, we expect an economic contraction of as much as 10%, which the nation hasn't experienced since the messy post-Soviet economic overhauls of the 1990s. The initial shock is likely to be followed by a prolonged period of low growth or stagnation as Russia is pushed into economic isolation.

In China, growth is slowing, and high energy costs are a mounting concern. The country is still implementing a zero-Covid-19 policy, and household consumption has been weak, while policymakers are cracking down on excesses in the housing market. Further easing of monetary policy and fiscal support is expected to offset reduced purchasing power. For now, China's economy is expected to grow a little over 5% this year.

Capital Market Commentary

Recap: With the COVID pandemic receding from the headlines, news of war, surging and sticky inflation, rising interest rates, and continued supply chain issues have filled the headline gap. Adding to that is the uncertainty of an as-yet unformed changed world economic order brought on by sanctions on Russia. Investors are groping for what it may all mean to business relationships, cash flows, and profits. There seems to be widespread agreement that no one knows the answers especially since the course of the war is unknowable. It is this uncertainty that has created the conditions for recent greater market volatility.

An important backdrop however to global stock performance will be corporate earnings comparisons 2022 vs. 2021. It is expected that corporate earnings growth will continue to be strong in 2022 but just not at 2021 levels. This is because earnings growth in 2022 will be compared to earnings in 2021 and those comparisons will be lower and perhaps much lower than expected just weeks ago. With that said, it will be no surprise if 2022 US equity performance comes in lower than in 2021 for no other reason than corporate profit growth will slow. Rising interest rates especially in the U.S. will eventually take a bite out of the economy and slow demand for goods and services with inflation likely following suit.

The recent ambivalence about the persistence of inflation displayed by the bond market, with low rates in the face of inflation, appears to have disappeared. Market rates have now climbed with the 10-year U.S. Treasury bond trading well north of 2% hitting almost 2.5% in the first quarter. With the Fed raising short-term rates in the U.S., it is reasonable to expect this will take a bite out of consumer and business demand so inflation should soften in the months ahead (which in itself should help supply chain disruptions). This action should take some steam out of the rising long-term interest rate trend. In addition, this increase in interest rates in the U.S. and better relative economic performance here than overseas should keep the dollar strong relative to foreign currencies. This strength should attract foreign capital seeking safe and higher yields. That demand for U.S. dollar-based assets will put some downward pressure on rates and also be a positive for U.S. stock prices. Assuming that is true, the question is what will the shape of the yield curve look like in the months ahead? Does

it stay normally sloped or does it flatten and perhaps even invert presaging a recession in the quarters ahead? We shall all find out.

There remains a litany of other factors that will have their impact on earnings, stock, and bond prices that cannot be forecasted but must be considered. First the course of the war in Europe is unknowable. Does it wind down? Does it spiral out of control pulling NATO and the US into a broader conflict? Does it continue to grind away week after week with more death and destruction? What is the global impact of the sanctions? The pundits do not know themselves so some investment caution would seem appropriate.

Second, interest rates seem sure to rise and that will have an effect on the performance of companies in different economic sectors and of different fundamental quality. This rise in rates should help value stocks (e.g., financial companies) lead the market after years of lagging growth stocks. Rising rates should benefit companies that do not need to tap the capital markets to fund business operations and hurt those whose borrowing costs are going up. So, the quality factor should also profile stock market leaders.

Third, as rates rise economic growth will begin to slow with the Fed hopefully able to engineer a “soft landing” in the quarters ahead rather than tipping the economy into recession. As the economy slows, stocks that pay reliable and growing dividends should attract investor attention. A growing percentage of stock market return should be coming from dividends rather than capital appreciation driven by rapid earnings growth and or multiple expansion.

But strategic asset allocation and portfolio diversification remain key. Spreading risk out across asset classes in a period of rising uncertainty is prudent given the unknowns. Tilting portfolio capital allocations to market segments that should have the wind at their back, but within the context of a broad strategic asset allocation plan, could make the difference in higher relative portfolio returns.

Sources: Department of Labor, Department of Commerce, Bloomberg, Morningstar, European Central Bank

Index Performance as of: 3/31/2022	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Russell									
3000 Value	0.05	2.77	-0.85	-0.85	-0.85	11.11	12.99	10.16	11.61
3000	0.21	3.24	-5.28	-5.28	-5.28	11.93	18.24	15.40	14.28
3000 Growth	0.36	3.71	-9.25	-9.25	-9.25	12.87	22.67	20.16	16.64
1000 Value	0.05	2.82	-0.74	-0.74	-0.74	11.68	13.02	10.29	11.70
1000	0.23	3.37	-5.13	-5.13	-5.13	13.28	18.71	15.82	14.53
1000 Growth	0.41	3.91	-9.04	-9.04	-9.04	14.99	23.59	20.89	17.04
Mid Cap Value	0.41	3.04	-1.82	-1.82	-1.82	11.46	13.68	10.00	12.01
Mid Cap	0.34	2.56	-5.68	-5.68	-5.68	6.93	14.89	12.62	12.85
Mid Cap Growth	0.20	1.61	-12.58	-12.58	-12.58	-0.89	14.80	15.11	13.52
2000 Value	-0.07	1.96	-2.40	-2.40	-2.40	3.32	12.72	8.57	10.54
2000	-0.21	1.24	-7.53	-7.53	-7.53	-5.79	11.74	9.75	11.04
2000 Growth	-0.36	0.46	-12.63	-12.63	-12.63	-14.34	9.88	10.33	11.21
Standard & Poors									
S&P 500	0.24	3.71	-4.60	-4.60	-4.60	15.66	18.92	15.99	14.64
Consumer Disc	0.59	4.91	-9.03	-9.03	-9.03	9.80	18.59	17.16	16.70
Consumer Staples	1.91	1.81	-1.01	-1.01	-1.01	16.11	14.00	10.16	11.52
Energy	-1.00	8.96	39.03	39.03	39.03	64.36	11.04	6.73	4.20
Financials	-1.78	-0.19	-1.48	-1.48	-1.48	14.70	16.75	12.36	13.86
Health Care	0.87	5.56	-2.58	-2.58	-2.58	19.11	16.47	15.10	15.87
Industrials	-0.15	3.38	-2.36	-2.36	-2.36	6.15	13.18	11.27	12.71
Information Technology	0.20	3.49	-8.36	-8.36	-8.36	20.91	30.53	26.81	20.57
Materials	-0.24	6.11	-2.37	-2.37	-2.37	13.93	19.22	13.28	11.35
Real Estate	3.75	7.79	-6.22	-6.22	-6.22	25.77	13.76	12.62	11.33
Communication Services	-0.55	0.95	-11.92	-11.92	-11.92	-0.93	15.50	9.58	9.93
Utilities	3.77	10.36	4.77	4.77	4.77	19.95	12.19	11.42	11.76
Other U.S. Equity									
Dow Jones Industrial Avg.	-0.09	2.49	-4.10	-4.10	-4.10	7.11	12.57	13.40	12.77
Wilshire 5000 (Full Cap)	0.14	3.18	-5.55	-5.55	-5.55	10.78	17.88	15.20	14.10
Intl Equity - Broad Market									
MSCI EAFE	1.15	0.64	-5.91	-5.91	-5.91	1.16	7.78	6.72	6.27
MSCI EM	0.49	-2.26	-6.97	-6.97	-6.97	-11.37	4.94	5.98	3.36
MSCI Frontier Markets	0.93	-0.14	-7.90	-7.90	-7.90	9.40	7.28	5.96	5.89
MSCI ACWI	0.47	2.17	-5.36	-5.36	-5.36	7.28	13.75	11.64	10.00
MSCI ACWI Ex USA	0.87	0.16	-5.44	-5.44	-5.44	-1.49	7.51	6.76	5.55
MSCI AC Asia Ex Japan	0.14	-2.77	-7.99	-7.99	-7.99	-14.65	5.14	6.75	5.75

Index Performance as of: 3/31/2022

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Intl Equity - Country Region									
MSCI Brazil	2.21	14.86	35.92	35.92	35.92	24.73	2.02	5.14	-1.30
MSCI BRIC	0.21	-5.84	-13.28	-13.28	-13.28	-22.98	-0.82	4.11	2.25
MSCI China	-1.03	-8.00	-14.19	-14.19	-14.19	-32.56	-3.01	3.52	4.55
MSCI Europe	1.72	-0.10	-7.37	-7.37	-7.37	3.51	8.23	6.92	6.27
MSCI India	2.25	3.65	-1.86	-1.86	-1.86	17.88	12.85	11.08	8.64
MSCI Japan	-0.22	-0.50	-6.61	-6.61	-6.61	-6.48	6.84	6.10	6.46
MSCI EM Latin America	1.95	13.06	27.26	27.26	27.26	23.55	3.17	4.09	-1.14
Fixed Income									
Barclays U.S. Aggregate	0.26	-2.78	-5.93	-5.93	-5.93	-4.15	1.69	2.14	2.24
ICE BofAML US 3M Trsy Bill	0.01	0.03	0.04	0.04	0.04	0.06	0.81	1.13	0.63
Barclays U.S. Gov't	0.08	-3.09	-5.53	-5.53	-5.53	-3.69	1.40	1.76	1.67
Barclays U.S. Credit	0.75	-2.51	-7.42	-7.42	-7.42	-4.16	2.81	3.18	3.44
Barclays High Yield Corp.	0.75	-1.15	-4.84	-4.84	-4.84	-0.66	4.58	4.69	5.75
Barclays Municipal	-0.37	-3.24	-6.23	-6.23	-6.23	-4.47	1.53	2.52	2.88
Barclays TIPS	-1.00	-1.86	-3.02	-3.02	-3.02	4.29	6.21	4.43	2.69
Barclays Gbl Agg Ex USD	0.69	-3.20	-6.15	-6.15	-6.15	-7.90	-0.19	1.27	0.06
Barclays Global Aggregate	0.51	-3.05	-6.16	-6.16	-6.16	-6.41	0.69	1.70	1.04
JPM EMBI Global Div	1.08	-0.90	-10.02	-10.02	-10.02	-7.44	0.01	1.69	3.74
Alternative Investments									
Alerian MLP	0.43	2.05	18.81	18.81	18.81	36.59	2.70	-0.07	1.28
Bloomberg Commodity	-3.66	8.65	25.55	25.55	25.55	49.29	16.12	9.00	-0.70
FTSE NAREIT Equity REIT	3.12	6.51	-3.89	-3.89	-3.89	26.47	11.11	9.63	9.81
S&P Global Natural Res.	-0.14	7.48	16.81	16.81	16.81	30.82	15.36	12.45	5.50
S&P N. Amer Natural Res.	-0.42	9.31	29.37	29.37	29.37	51.63	14.07	7.56	3.48

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