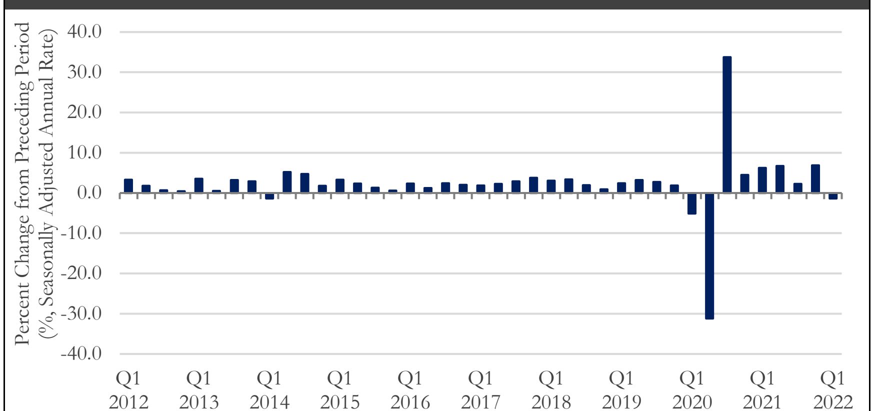
Economic Commentary & Capital Market Update

Recap

After the strongest annual average growth in nearly 40 years (5.7%) in 2021, U.S. economic growth has shown clear signs of slowing at the outset of 2022. Real U.S GDP growth contracted at a -1.4% quarter-over-quarter rate in Q1. Underneath the surface, domestic demand – spending by American households and businesses has continued to grow at an above-trend rate, but supply chain challenges, a drop in government spending, a pullback in inventory investment, and weak foreign activity have weighed on economic growth.

Real GDP Growth: U.S.



Source: U.S. Bureau of Economic Analysis

Small business confidence continued to trend lower in March as the share of businesses expecting an improvement in the economy fell to an all-time low. Inflation, which had already risen to worrisome levels, has continued to be a threat because of the war in Ukraine and shutdowns in China. Higher food and energy prices will reduce consumers' purchasing power and slow growth in personal consumption expenditures – the biggest component of GDP – this year.

The good news is that the labor market has continued to perform very well, with surprising job growth and only a modicum of deceleration in recent months. Labor demand is looking strong, with job openings still at very high levels. A recent increase in the labor force participation rate has been another source of optimism, indicating that the scarring that occurred because of the pandemic may finally be healing.

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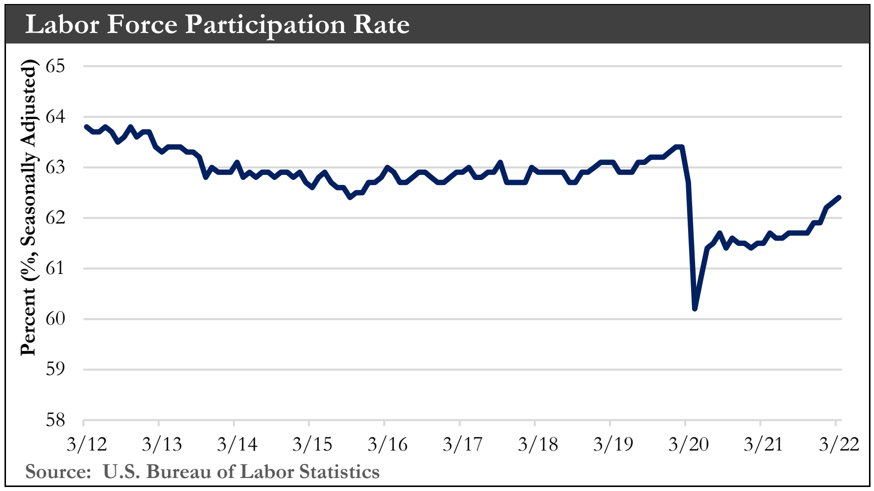

Business investment has been another bright spot, accelerating at the outset of the year and likely to remain healthy. High energy prices will be a boon to American energy producers who are likely to increase investment to raise production.

All told, with inflation running hot and still no major cracks in the economic armor, the Federal Reserve will need to follow through with the speedy removal of monetary stimulus to try and rein in inflation. Interest-sensitive sectors, such as housing, which has already shown some signs of cooling, would be first on the list to feel the pinch from the higher rate environment.

Overall, solid annual average economic growth of 3.2% is expected in 2022. The ongoing lockdowns in China would represent a risk to this outlook. The U.S. economy is tightly linked to the global economy, and a supply-side recovery at home will not fully resolve the inflation problems if supply chains deteriorate further in major manufacturing hubs such as China.

Inflation

An unrelenting rise in U.S. inflation hit another new four-decade peak of 8.5% in March from the same month a year ago, driven by skyrocketing energy and food costs, supply constraints, and strong consumer demand.

Despite another month of wide-ranging price increases in March, this likely marks the peak in post-COVID inflation. Over the near term, some reprieve in gasoline prices should make its way to the pumps, as both the U.S. and International Energy Agency have decided to release some reserves of oil.

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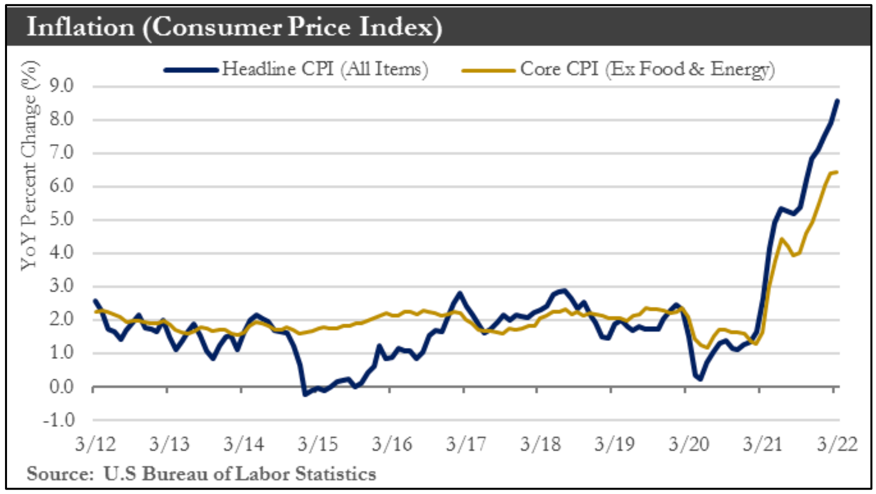

However, inflation's descent will remain painfully slow for consumers, businesses, and policymakers alike. Challenges for supply chains have endured, while the tight labor market has kept wage growth elevated. Meanwhile, long-term inflation expectations have remained at the top end of the past decade's range.

Housing

The anticipation of rising mortgage rates has likely pulled some home-buying forward into the early part of this year, and new and existing home sales should cool off a bit this spring and summer. Even with some pullback, the housing market is expected to remain relatively active, as there are plenty of potential buyers waiting in the wings for more homes to come onto the market. Homebuilders also have a long backlog to work through.

Higher mortgage rates are likely to prove particularly challenging for first-time buyers, who have taken a step back from the market. Pending home sales and homebuilder sentiment have both fallen in recent months, and mortgage applications for the purchase of a home have declined. The inventory of existing homes should increase in the coming months, as sellers begin to experience a bit of the fear of missing out that had previously been on the buyers' side. With sellers becoming more active, home price appreciation should moderate.

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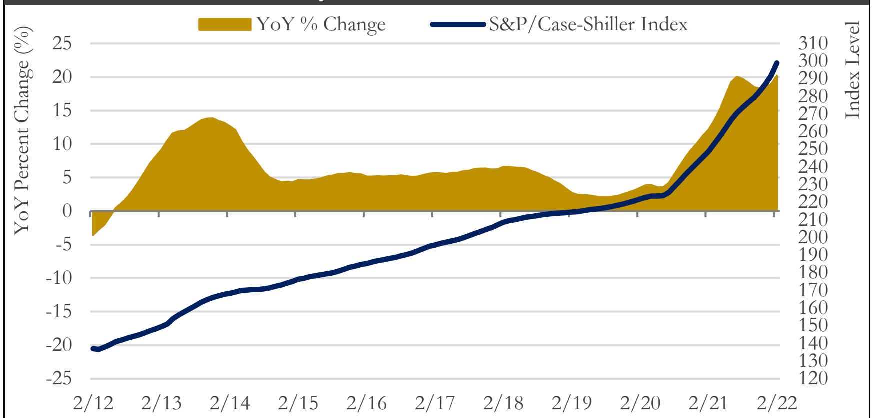
S&P Case-Shiller 20-City Home Price Index



Source: S&P / Case-Shiller

Labor Market

Job growth continued at a solid rate in March. However, the trend ahead is still likely downward, as the more mature recovery leaves less room for a catch-up. Job openings and hiring plans have both lost steam in recent months and suggest demand for workers has plateaued at a high level. Further increases in the labor supply should help employers translate the substantial number of job openings into hires. The labor force participation rate should continue rising in the coming months as more workers are drawn back into the labor force by plentiful job opportunities and increasing financial need. The rebound in the labor force along with slower growth in demand for workers should help keep wages from spiraling higher, even as the unemployment rate, currently at 3.6%, falls over the next year or so. Restrictive monetary policy in 2023, however, is likely to generate substantially slower job growth and push unemployment slightly higher late in the year.

Monetary Policy

The Federal Reserve has set out to do something it has never accomplished before: reduce inflation by four percentage points without significantly raising unemployment. Calibrated interest rate increases should hopefully slow booming demand just enough to take the steam out of an overheated economy. It will require skill and also good luck.

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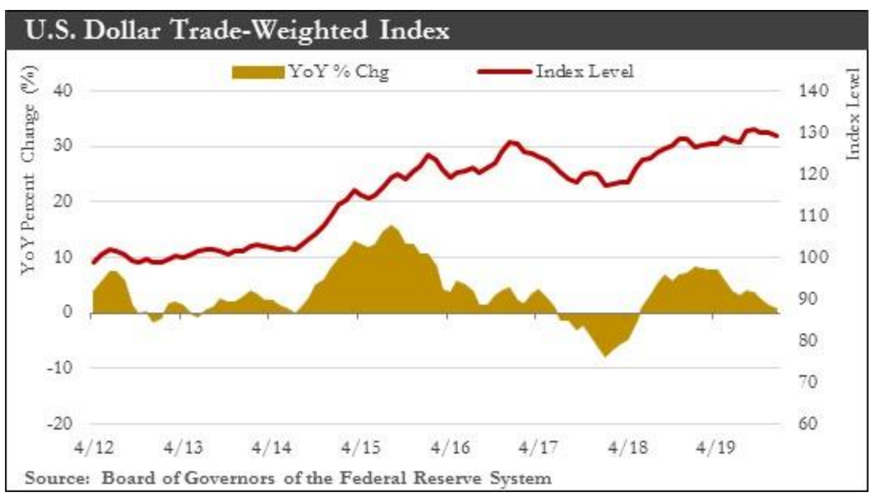
The FOMC is expected to raise the fed funds rate by 50 bps per meeting in May and June, followed by a more gradual pace of 25 bps per meeting starting in July until the fed funds target range has reached 3.00%-3.25% in the second quarter of 2023. The FOMC is also expected to announce at its upcoming meeting, plans to start shrinking its balance sheet by no longer reinvesting the principal payments received from its securities holdings, up to a monthly cap. The more aggressive path of policy tightening is expected to lead to deeper inversions between shorter-dated and longer-dated Treasury securities later this year.

U.S. Dollar

The dollar is about to reach nearly two-year highs against the Japanese yen and Euro, lifted by looming interest-rate increases from the Federal Reserve, strong U.S. growth, and geopolitical jitters overseas. One major factor lifting the dollar is expectations that U.S. growth could outpace the recovery elsewhere, with the Fed signaling a rapid course of interest rate increases to tame inflation. Russia's invasion of Ukraine has also buoyed the dollar, sparking a run to safe-haven investments. U.S. dollar strength is expected versus most foreign currencies over the medium term.



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Eurozone

The Eurozone economy has had an unsettled start to 2022, as a temporary surge in COVID cases and Ukraine-related uncertainties have weighed on activity. From a longer-term perspective, there has also appeared to be some softening in consumer fundamentals.

In contrast, Eurozone headline CPI inflation has moved sharply higher, and core inflation has also firmed, though to a much lesser extent. Still, even if price gains do not become broad-based, persistently elevated energy prices and headline CPI inflation could still prompt a response from the European Central Bank (ECB).

Earlier and more rapid monetary tightening is expected from the ECB than previously. An initial 25 bps increase in the Deposit Rate is expected at the September 2022 meeting. Beyond that, a steady series of 25 bps increases would be expected at the December 2022, March 2023, and June 2023 meetings, which would lift the Deposit Rate to +0.50% by the middle of next year. Based on the current fluid situation, the Eurozone GDP growth forecast has been lowered for 2022 slightly to 3.0%.

Global Economy

Accelerating inflation, the war in Ukraine, and lockdowns in China dented international commerce in March, a sign the global economy is entering a rough patch as policymakers have battled to sustain growth.

Global economic growth is expected to slow significantly this year as the repercussions of the war in Ukraine have spread worldwide, a setback for many nations already grappling with the Covid-19 pandemic, rising inflation, and interest rates. The world's economy should expand about 3.6% this year, down from 6.1% last year.

Finally, the war intensified the supply-chain disruptions and inflation that many countries were facing because of the pandemic. Price pressures could strengthen more than anticipated in the coming months and prompt more aggressive fiscal tightening measures from policymakers. That, in turn, would further dent the growth in both rich and developing worlds, while risking widespread debt distress among highly indebted lower-income nations and corporate borrowers.

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Outlook

The U.S. economy grew at a moderate pace in early spring as Covid-19 cases declined, high inflation rippled throughout the U.S. economy, and the Ukraine war created new economic uncertainty. Going forward, the economy could start to slow for three reasons.

First, fiscal policy pushed demand up in both 2020 and 2021, through stimulus checks, enhanced unemployment insurance, money for state and local governments, an expanded child tax credit, and forgivable business loans. Almost all have expired and, apart from a few steps such as state-level tax cuts, nothing new has taken their place. Fiscal support contributed 7.6 percentage points to inflation-adjusted GDP in the first quarter of 2021. It subtracted 2.1 points in the first quarter of this year.

The second reason for a slowdown would be purchasing power has been sapped by inflation. Some of that pressure will ease in the coming months if gasoline prices, used car prices, and some other items decrease, as expected. Meanwhile, consumers will be coping with a third headwind of rising interest rates.

Predicting the effect of these headwinds could be complicated by the unusual nature of this cycle. Much of the surge in demand and inflation in the last two years has been concentrated on goods. Some of that might reflect a once-only spending spree as consumers equipped home offices, bought exercise equipment, or replaced appliances. This could leave businesses vulnerable to the "Peloton effect," a sudden drop off in orders as consumers conclude they have enough stuff.

On the other hand, consumers are flush with money from the past stimulus and rising stock prices, which could sustain spending for a while. Finally, demand has been so far above supply that a modest pullback might not affect production plans much, especially with inventories relatively low.

Nonetheless, some softening of demand seems inevitable.

Whether such a slowdown becomes a recession would depend critically on the job market and inflation. Payroll growth, which has averaged a stunning 600,000 a month for the last six months, would have to fall a lot before turning negative, a prerequisite for a recession.

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Indeed, if higher interest rates and weaker real incomes serve mostly to trim excess demand, they could ease some of the pressure on supply chains that have fueled inflation. In that case, the Federal Reserve would not have to raise interest rates as much—also reducing the risk of recession.

Sources: Department of Labor, Department of Commerce, Morningstar, Bloomberg

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Index Performance as of: 4/30/2022

	1 Week	1 Month	QTD	3 Month	YTD	1 Year	3 Year	5 Year	10 Year
Russell									
3000 Value	-3.35	-5.78	-5.78	-4.12	-6.57	0.79	9.48	8.89	11.06
3000	-3.33	-8.97	-8.97	-8.39	-13.78	-3.12	13.10	13.01	13.29
3000 Growth	-3.31	-12.09	-12.09	-12.46	-20.22	-6.83	15.84	16.58	15.18
1000 Value	-3.33	-5.64	-5.64	-4.10	-6.34	1.32	9.57	9.06	11.17
1000	-3.29	-8.91	-8.91	-8.42	-13.59	-2.10	13.56	13.44	13.53
1000 Growth	-3.25	-12.08	-12.08	-12.52	-20.03	-5.35	16.67	17.28	15.56
Mid Cap Value	-3.67	-5.94	-5.94	-3.54	-7.65	0.00	10.19	8.62	11.40
Mid Cap	-3.49	-7.70	-7.70	-6.02	-12.94	-6.10	10.48	10.66	11.99
Mid Cap Growth	-3.10	-11.26	-11.26	-10.93	-22.42	-16.74	8.72	12.06	12.17
2000 Value	-3.66	-7.76	-7.76	-4.40	-9.97	-6.59	8.38	6.75	9.81
2000	-3.94	-9.91	-9.91	-7.82	-16.69	-16.88	6.73	7.24	10.06
2000 Growth	-4.25	-12.27	-12.27	-11.48	-23.35	-26.46	4.14	7.09	9.95
Standard & Poors									
S&P 500	-3.26	-8.72	-8.72	-8.17	-12.92	0.21	13.84	13.66	13.67
Consumer Disc	-7.88	-13.00	-13.00	-12.37	-20.85	-10.83	11.14	13.39	14.94
Consumer Staples	-2.05	2.56	2.56	2.94	1.53	16.51	14.02	10.50	11.77
Energy	-1.23	-1.54	-1.54	14.93	36.89	60.87	10.45	7.03	4.13
Financials	-4.53	-9.87	-9.87	-11.26	-11.21	-3.00	9.59	10.24	12.95
Health Care	-2.51	-4.71	-4.71	-0.44	-7.16	9.17	15.64	13.65	15.34
Industrials	-3.31	-7.53	-7.53	-5.23	-9.71	-5.25	8.79	9.16	11.95
Information Technology	-1.26	-11.28	-11.28	-12.68	-18.70	1.90	22.85	23.19	19.36
Materials	-0.82	-3.49	-3.49	1.13	-5.78	4.37	16.42	12.16	11.06
Real Estate	-5.65	-3.56	-3.56	-1.15	-9.56	12.01	12.57	11.78	10.66
Communication Services	-4.09	-15.62	-15.62	-20.76	-25.68	-22.51	6.87	6.63	7.51
Utilities	-4.05	-4.25	-4.25	3.71	0.32	10.13	10.24	10.28	11.07
Other U.S. Equity									
Dow Jones Industrial Avg.	-2.47	-4.82	-4.82	-5.67	-8.73	-0.82	9.77	11.96	12.20
Wilshire 5000 (Full Cap)	-3.40	-9.27	-9.27	-8.64	-14.31	-4.46	12.63	12.73	13.07
International Equity - Broad Market									
MSCI EAFE	-2.20	-6.47	-6.47	-7.53	-12.00	-8.15	4.44	4.77	5.77
MSCI EM	0.08	-5.56	-5.56	-10.45	-12.15	-18.34	2.24	4.32	2.89
MSCI Frontier Markets	-1.70	-2.71	-2.71	-7.12	-10.40	-0.39	6.24	5.14	5.70
MSCI ACWI	-2.63	-8.00	-8.00	-8.44	-12.94	-5.45	9.41	9.46	9.21
MSCI ACWI Ex USA	-1.57	-6.28	-6.28	-7.99	-11.38	-10.32	4.30	4.94	5.04
MSCI AC Asia Ex Japan	0.68	-5.16	-5.16	-9.95	-12.74	-21.02	2.65	5.17	5.19
International Equity - Country Region									
MSCI Brazil	-6.91	-13.71	-13.71	3.77	17.28	1.09	-2.63	2.10	-2.12
MSCI BRIC	2.06	-4.57	-4.57	-15.77	-17.24	-27.45	-2.89	2.76	1.96
MSCI China	5.10	-4.08	-4.08	-15.19	-17.70	-36.20	-5.05	2.12	3.75
MSCI Europe	-2.48	-5.75	-5.75	-8.51	-12.69	-6.69	4.88	4.93	5.89
MSCI India	-0.71	-1.67	-1.67	-2.16	-3.50	16.99	12.01	10.29	8.99
MSCI Japan	-1.36	-8.80	-8.80	-10.28	-14.83	-13.40	3.13	3.95	5.83
MSCI EM Latin America	-6.07	-12.98	-12.98	3.14	10.74	3.67	-1.64	1.23	-2.13
Fixed Income									
Barclays U.S. Aggregate	-0.01	-3.79	-3.79	-7.51	-9.50	-8.52	0.38	1.20	1.73
ICE BofAML US 3M Trsy Bill	0.00	0.01	0.01	0.06	0.05	0.08	0.75	1.12	0.63
Barclays U.S. Gov't	-0.03	-3.05	-3.05	-6.66	-8.41	-7.31	0.45	1.00	1.22
Barclays U.S. Credit	-0.38	-5.24	-5.24	-9.37	-12.27	-10.14	0.81	1.87	2.75
Barclays High Yield Corp.	-0.91	-3.56	-3.56	-5.64	-8.22	-5.22	2.84	3.70	5.26
Barclays Municipal	-0.25	-2.77	-2.77	-6.26	-8.82	-7.89	0.46	1.80	2.48
Barclays TIPS	-0.19	-2.04	-2.04	-3.04	-5.00	0.75	5.37	3.88	2.27
Barclays Gbl Agg Ex USD	-1.69	-6.83	-6.83	-10.81	-12.56	-15.56	-2.32	-0.43	-0.77
Barclays Global Aggregate	-0.97	-5.48	-5.48	-9.45	-11.30	-12.64	-1.09	0.33	0.35
JPM EMBI Global Div	-1.34	-5.59	-5.59	-12.56	-15.05	-14.51	-1.97	0.23	2.98
Alternative Investments									
Alerian MLP	-3.10	-0.09	-0.09	6.88	18.71	27.36	3.13	0.17	1.04
Bloomberg Commodity	0.37	4.14	4.14	20.19	30.75	43.57	17.87	10.22	-0.26
FTSE NAREIT Equity REIT	-5.44	-4.39	-4.39	-1.32	-8.08	11.93	9.56	8.63	9.01
S&P Global Natural Res.	-1.90	-4.36	-4.36	7.59	11.71	20.14	13.65	11.57	5.20
S&P N. Amer Natural Res.	-1.62	-3.17	-3.17	13.40	25.28	41.85	12.70	7.53	3.31

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