Investment Update

April 2022

2022 First Quarter Update

Review:

Both equities and fixed income started off the year in negative territory. Despite being down 4.6%, the S&P 500 was one of the better performers in the quarter as international equities lagged due to the selloff in Chinese stocks and the onset of war in Ukraine. Concerns about inflation and potential tightening by the Federal Reserve led to US equities and fixed income selling off even prior to the invasion of Ukraine. The Barclays Aggregate Bond Index had one of its worst quarters on record, down 5.9% for the quarter.

Period	1Q22	4Q21	2021
S&P 500	*-4.6%*	*11.0%*	*28.7%*
MSCI EAFE[1,2]	*-5.8%*	*2.7%*	*11.8%*
MSCI Emerging Markets[2]	*-6.9%*	*-1.2%*	*-2.2%*
Barclays U.S. Aggregate Bond	*-5.9%*	*0.0%*	*-1.5%*
Barclays Municipal Bond	*-6.2%*	*0.7%*	*1.5%*

[1]Europe, Australasia, Far East

[2]MSCI returns are in U.S. Dollars

Inflation Has Persisted, but Stagflation Concerns Seem Misplaced

There had been signs of improvement or stabilization in some of the drivers of inflation prior to the invasion of Ukraine—e.g., services spending versus goods, supply chain bottlenecks, labor force participation rate. However, commodity prices spiked after the invasion, which led to concerns about a potential recession and, worse yet, 1970s style stagflation. While there are some similarities to the 1970s such as accommodative monetary and fiscal policy as well as supply disruptions, there are several key differences:

- Longer term inflation expectations still remain anchored at relatively low levels
- The Federal Reserve is more willing to respond in a timely and sufficient manner
- A strong dollar rather than the steep decline seen in the 1970s
- Different economic composition and level of energy intensity

On the last point, it is also important to provide a frame of reference on the impact to the consumer. As the chart on the next page shows, on a real (inflation adjusted) basis, oil prices remain well below the 2008 peak and the 1980 peak. Relative to disposable income, the current spike is

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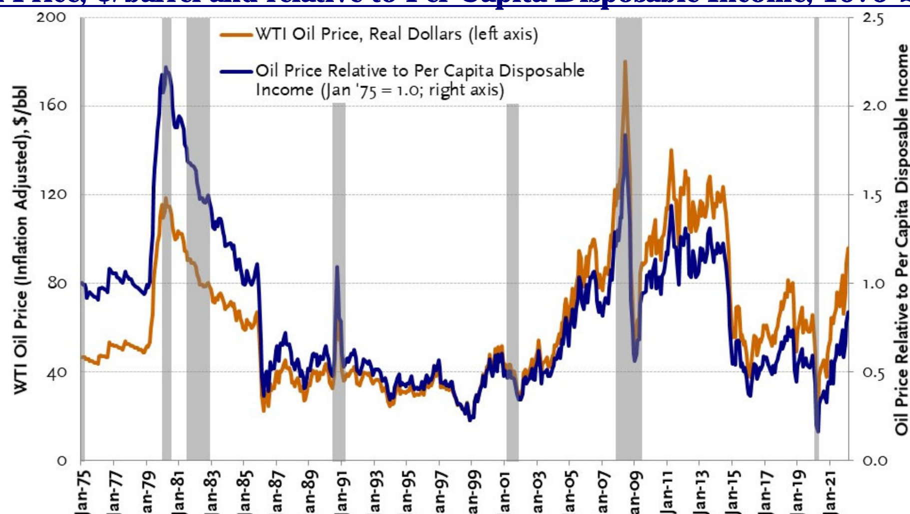
substantially below both peaks as well as most of the 2010-14 time period. This is not meant to suggest that the current commodity spike is insignificant. Clearly, it will have an incrementally negative impact on consumer spending. However, given the strength of the economy coming into 2022, it does support the view that it is likely that the commodity spike is not enough by itself to tip the United States into recession this year.

Oil Price, $/barrel and relative to Per Capita Disposable Income, 1975-2022



Sources: Bureau of Economic Analysis, FactSet; Note: shaded areas denote recessions

Outlook: US GDP growth is still expected to be positive this year, with a current consensus estimate of 3.4%, which should also support positive corporate earnings growth. As noted in last quarter's investment update, this does represent a slowdown versus 2021's robust 5.7% growth but remains higher than the 2010-19 average of 2.3%. The war in Ukraine does add to uncertainty, mostly around the path of inflation. However, the Federal Reserve is clearly willing to take action to try to tame inflation, both by raising rates and by reducing the size of its bond holdings.

The outlook for international growth has turned incrementally negative due to the war in Ukraine and continued economic headwinds in China. The continued strength in the dollar against most major currencies also represents a headwind.

Potential risks to our near-term outlook include:

- Escalation of the Russia-Ukraine conflict
- Wage price spiral, leading to expectations of persistently high inflation
- Overly aggressive Fed measures, impairing economic growth more than expected
- Greater than expected economic impact from COVID variants
- US-China tension

Strategy: Despite the selloff in fixed income year to date, we continue to believe that the risk-reward in equities is more attractive than fixed income given our economic outlook and expectations for bond yields. Volatility will likely remain elevated due to the uncertainty around inflation, the impact of tightening by the Federal Reserve, and geopolitical concerns. However, this should also lead to opportunities to buy high quality companies at attractive valuations that can deliver growth in the long run