Quarterly Market Report

First Quarter 2022

Vogel Consulting

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First Quarter Highlights

Inflation related news dominated an eventful and turbulent quarter for financial markets

Financial Markets

- Most global equity markets sold-off for much of the quarter as high inflation, the onset of monetary policy tightening, continued supply chain issues, and the impacts related to the Russian invasion of Ukraine soured investor sentiment. Markets in commodity heavy countries had strong gains benefiting from the supply issues.
- Global bond yields moved up significantly as high inflation spurred interest rate hike expectations. U.S. Treasury bond yields moved up to the highest levels since early 2019. U.S. bond returns were the worst in a decade.
- Oil prices rose to over $100 per barrel, the highest since 2008 and natural gas prices in Europe surged due to supply worries made worse by the Russian invasion of Ukraine and related sanctions.
- Prices for agricultural commodities and industrial metals spiked, some to all-time highs, due to supply disruptions from the Russia/Ukraine war since those countries are key suppliers of several commodities.

Overview of the Economy

- Earnings reports for the fourth quarter were robust with a majority of companies beating analyst forecasts.
- The Omicron COVID wave caused a dip in industrial and service activity early in the quarter, but new orders and production increased again in February and March.
- The U.S. labor market remains tight with the unemployment rate dipping to 3.8% and a ratio of 1.8 job openings for every unemployed person.
- The consumer price index (CPI) in several countries hit multi-decade highs. The CPI in the U.S. rose to 7.9%.
- Economic activity in China slowed in part due to new COVID control lockdowns in several large population cities.

Notable Events

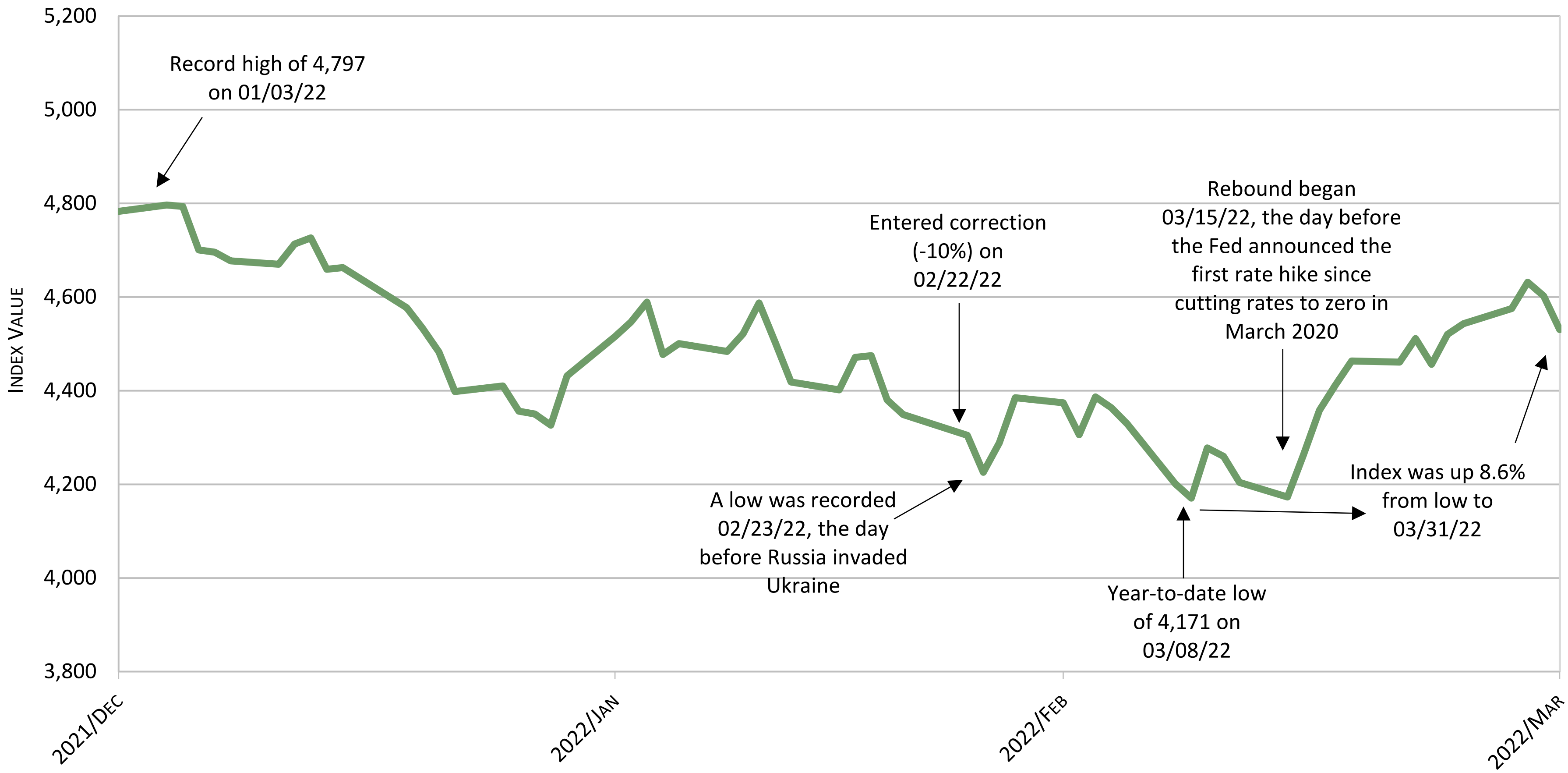
- The Federal Reserve Open Market Committee (Fed) raised its policy rate to 0.25%-0.50% from near zero.

First Quarter Highlights

Equity markets were volatile falling from recent highs then retracing much of the decline

The spillover of the 2021 rally was short-lived in 2022 as the prospect of supply shortages and rising commodity prices pushing inflation up and leading to tighter monetary policy depressed investor sentiment and drove equity prices down sharply until a rebound late in March.

S&P 500 Index[1]



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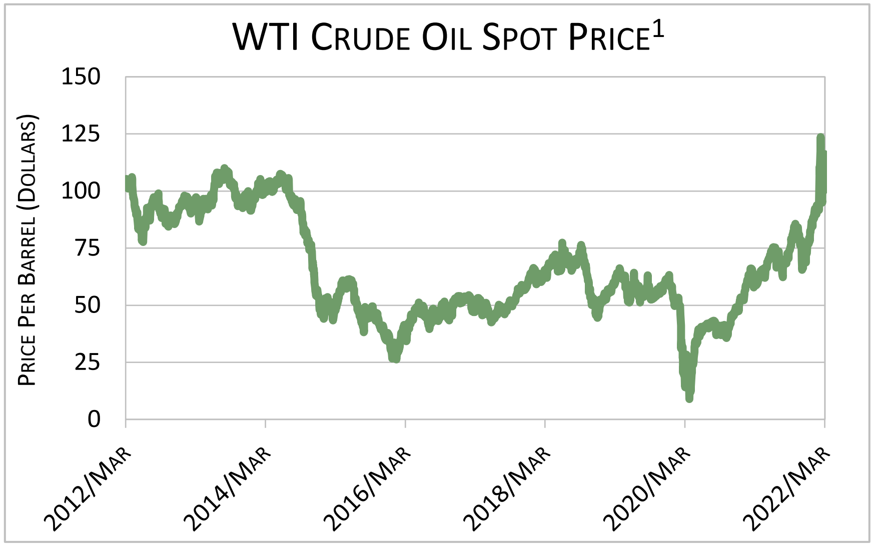
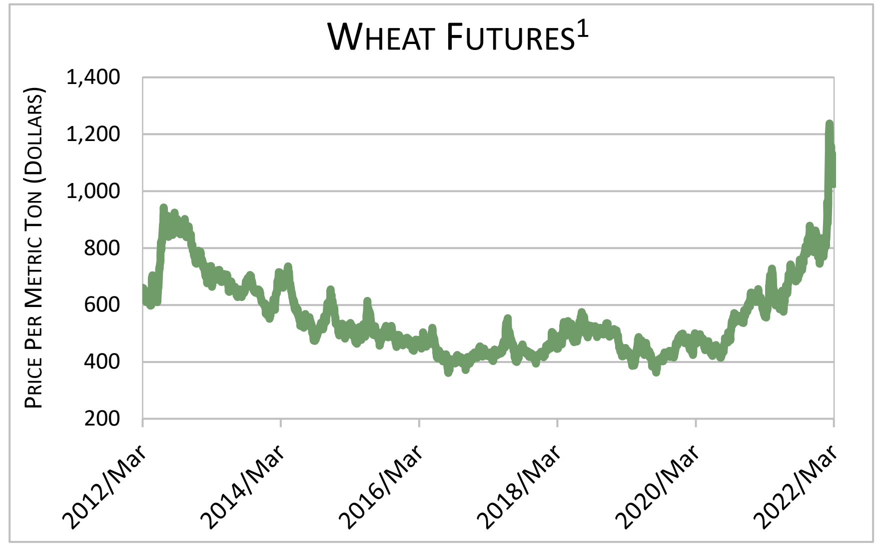
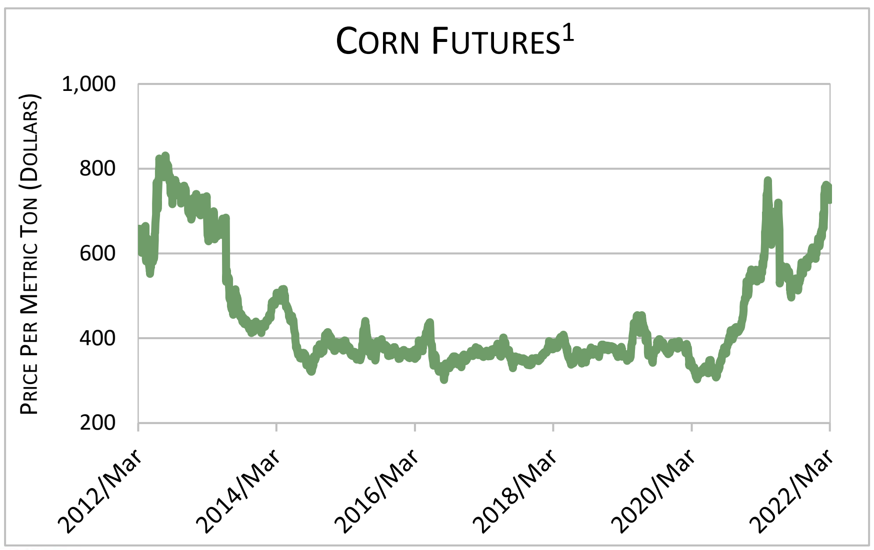
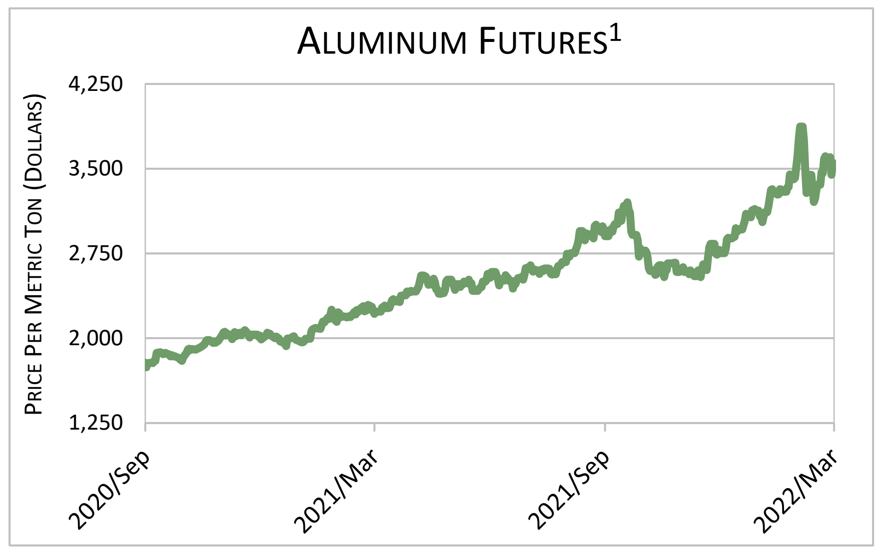
First Quarter highlights

Commodity prices hit multi-year highs on supply disruption concerns









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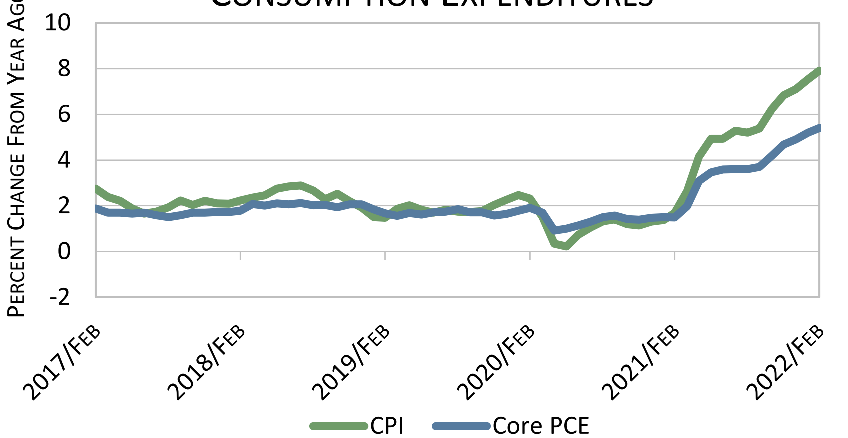
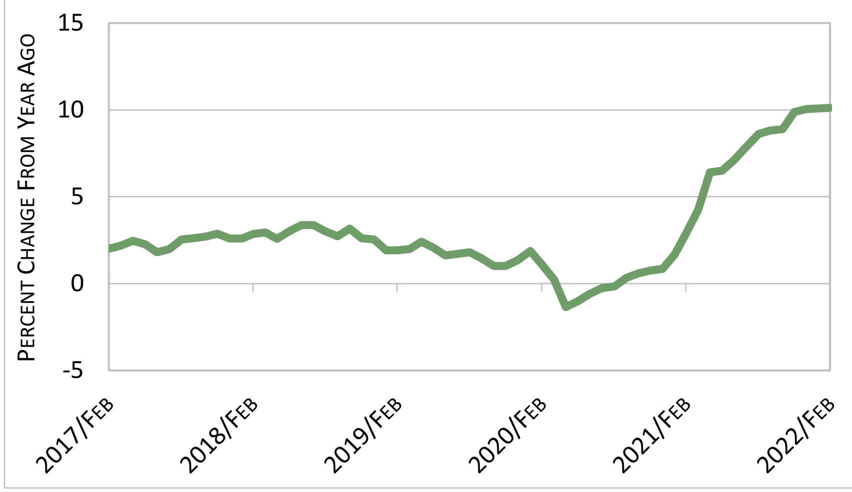
First Quarter highlights

Inflation rates hit multi-year highs

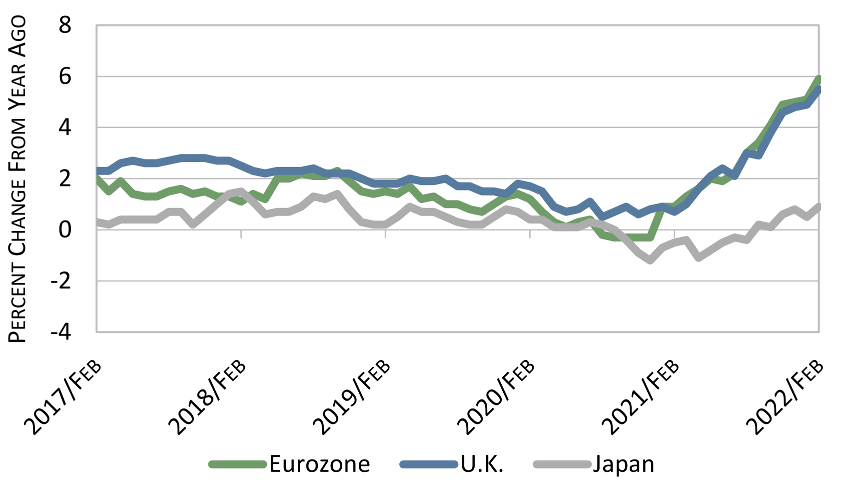
U.S. CPI[1] and Core Personal Consumption Expenditures[2]



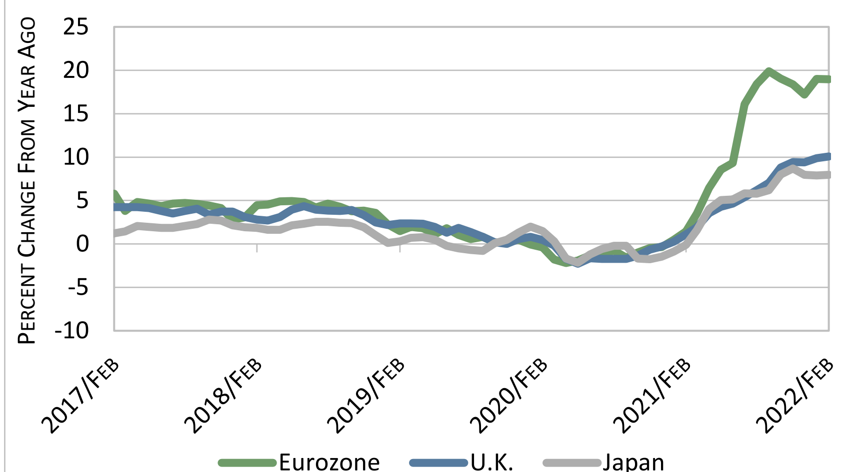
U.S. Producer Price Index[1]



International Consumer Price Indices[3]



International Producer Price Indices[4]



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FIRST QUARTER HIGHLIGHTS

CENTRAL BANKS TOOK ACTION TO TIGHTEN MONETARY POLICY TO COMBAT SPIKING INFLATION

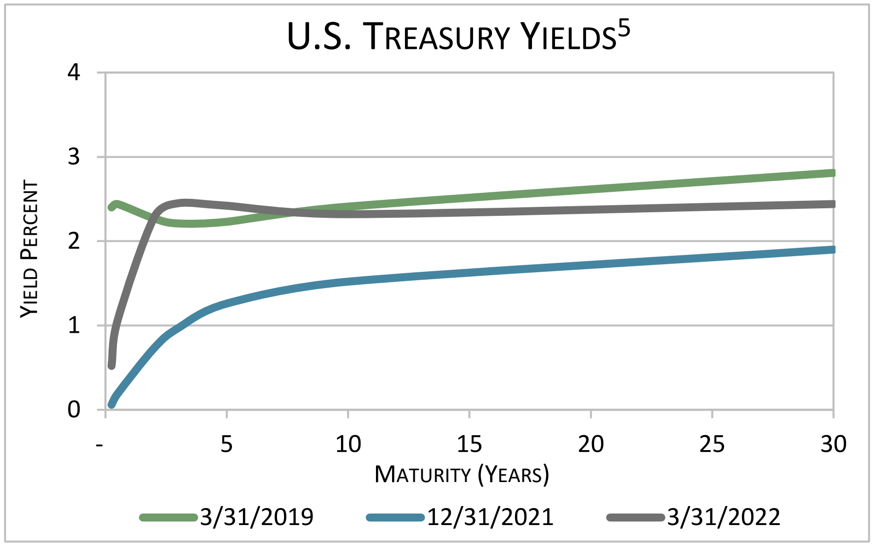
SELECT MONETARY POLICY HEADLINES IN THE FIRST QUARTER	
COUNTRY	**POLICY DECISION**
Canada	• Raised a key rate to 0.50%, first hike since October 2018. Signaled will start to shrink balance sheet in April.
Brazil	• Raised a key interest rate twice, up to 11.75%
Gulf States (UAE, Saudi Arabia, Bahrain, Kuwait)	• Each raised a key rate by a quarter of a percentage point
Mexico	• Raised a key rate for the sixth time. Rate now 6.0%.
New Zealand	• Raised a key rate for the third time. Rate now 1.0%, which is back to prepandemic level. Signaled more hikes to come.
United Kingdom	• Raised key rate twice up to 0.75% from 0.25%. Started to shrink balance sheet.
United States	• Raised fed funds rate range by a quarter of a percentage point to 0.25% - 0.50%. First hike since 2018. Forecast to raise rate six more times in 2022. Signaled will announce a plan to shrink its balance sheet.

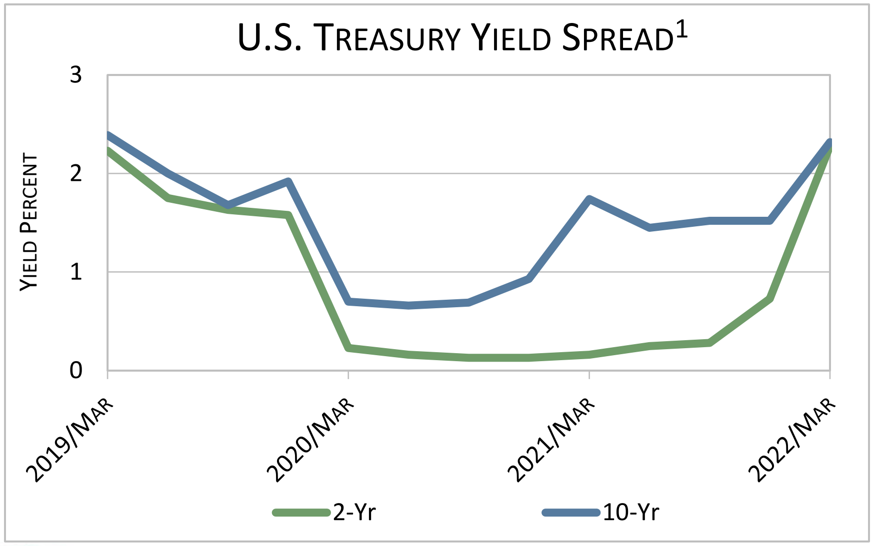
First Quarter Highlights

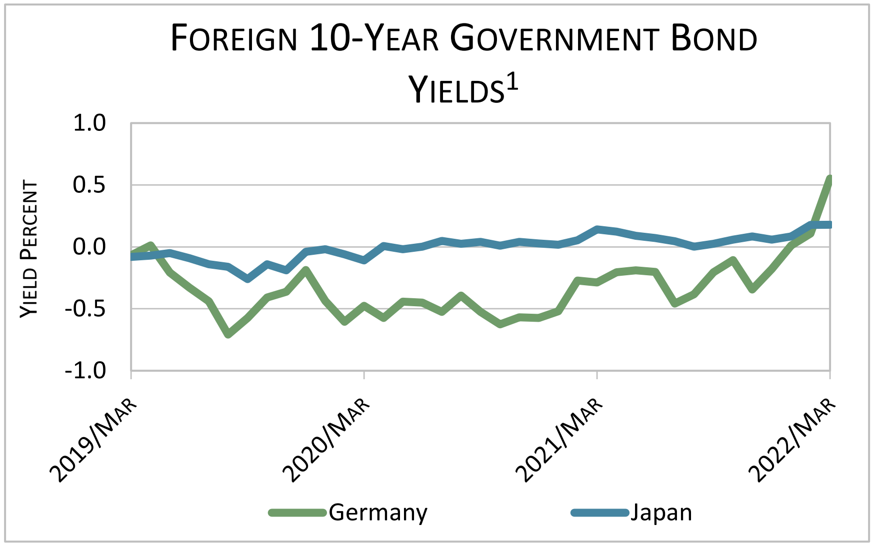
BOND YIELDS ROSE SHARPLY AS INFLATION SPIKED AND TIGHTER MONETARY POLICY IS EXPECTED

U.S. Treasury bond yields spiked from year-end 2021 levels across the entire maturity range. The steepest increase was in short maturity bonds. The 2-year through 5-year part of the yield curve is back above 2019 levels. Investors also focused on the fact that the spread between the 2 and 10-year yields has closed, which is often seen as a sign of a future recession. (This indicator has been of little use in predicting the timing between an inversion and a possible recession.)

The 10-year German government bond yield turned positive for the first time since 2019.







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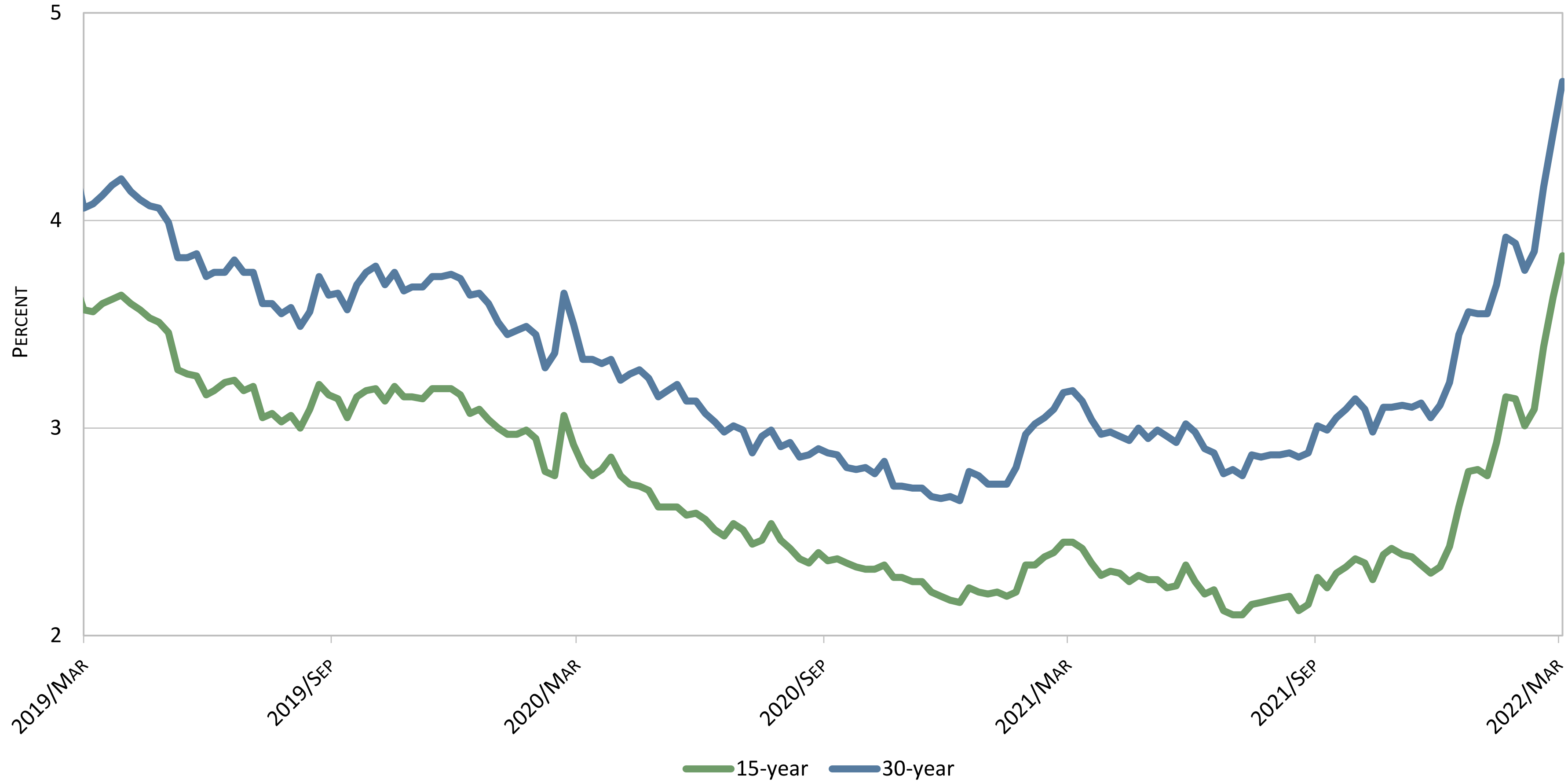
First Quarter Highlights

Mortgage rates surged to the highest levels in over three years

Mortgage rates climbed rapidly in the first quarter following the increase in U.S. Treasury bond yields as investors priced in policy rate hikes by the Fed. The higher mortgage rates have already slowed applications for refinancings.

U.S. Fixed Mortgage Rates[6]

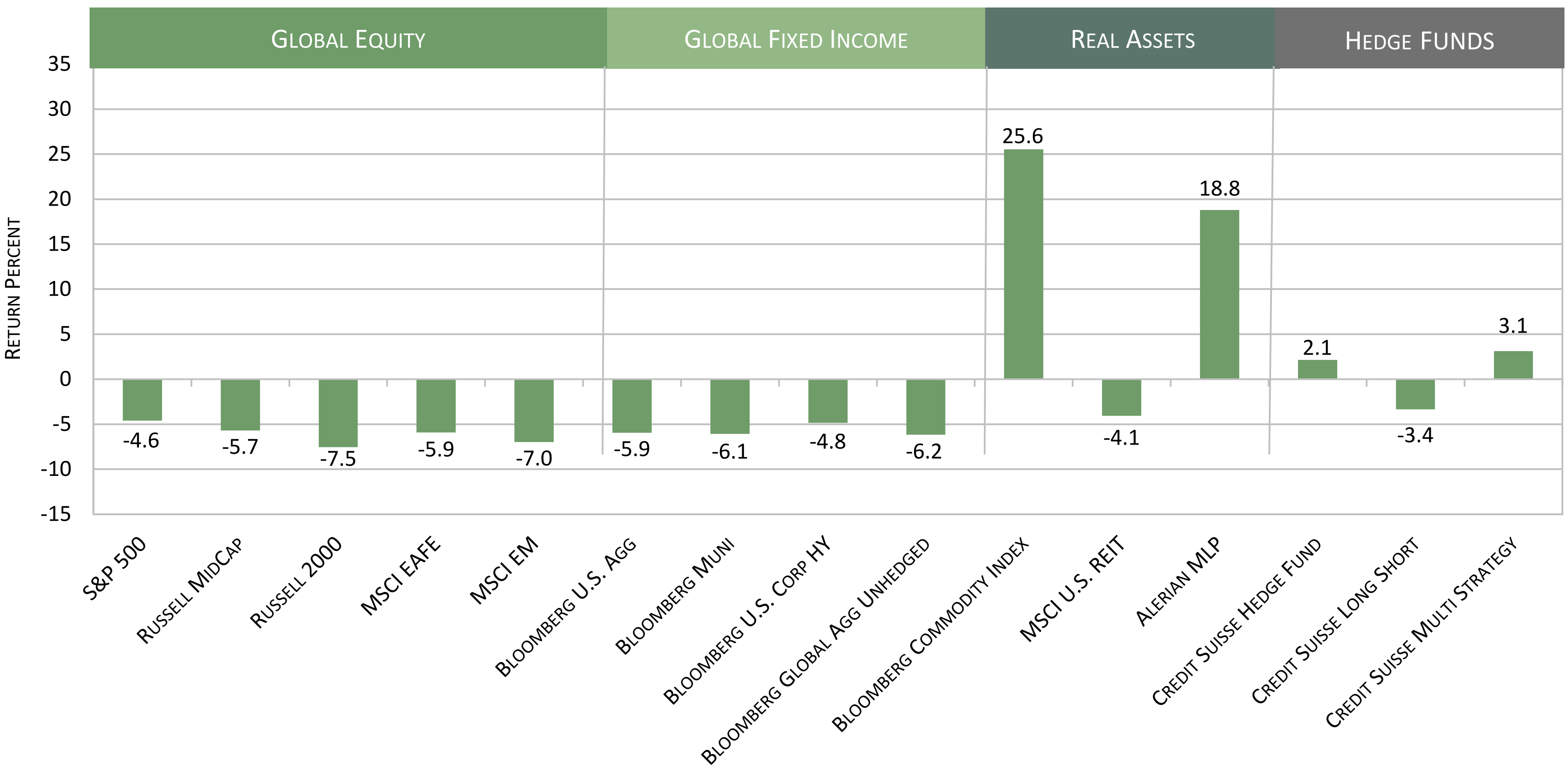


First Quarter Highlights

Natural resources advanced in a quarter that saw large declines for both stocks and bonds

Supply disruptions and high production costs pushed commodity prices to multi-year highs. Global equities declined as sentiment soured. EM lagged hurt by China and Russia. Bonds had the worst returns in decades as high inflation fueled expectations for aggressive rate hikes.

Market Returns: First Quarter 2022[7]



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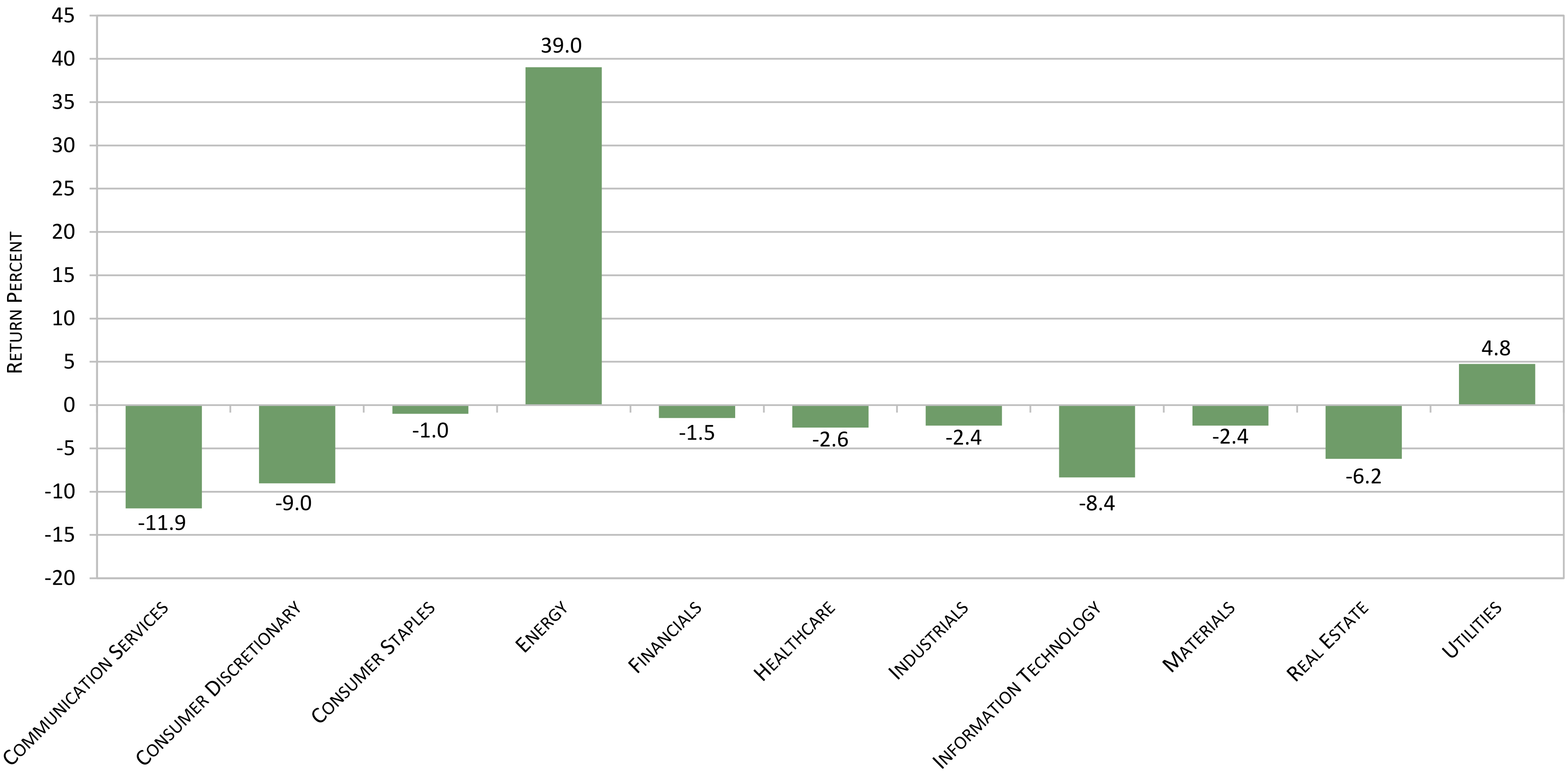
First Quarter Highlights

Sector returns were mostly negative with energy and defensives outperforming growth

Prices for stocks with high price/earnings ratios and no earnings (mostly growth sectors) were hurt by increasing interest rates. Utilities, staples and other sectors with more stable cash flows and lower valuations held up better. Energy stocks surged on growing risks to supply.

S&P 500 Sector Returns: First Quarter 2022[7]



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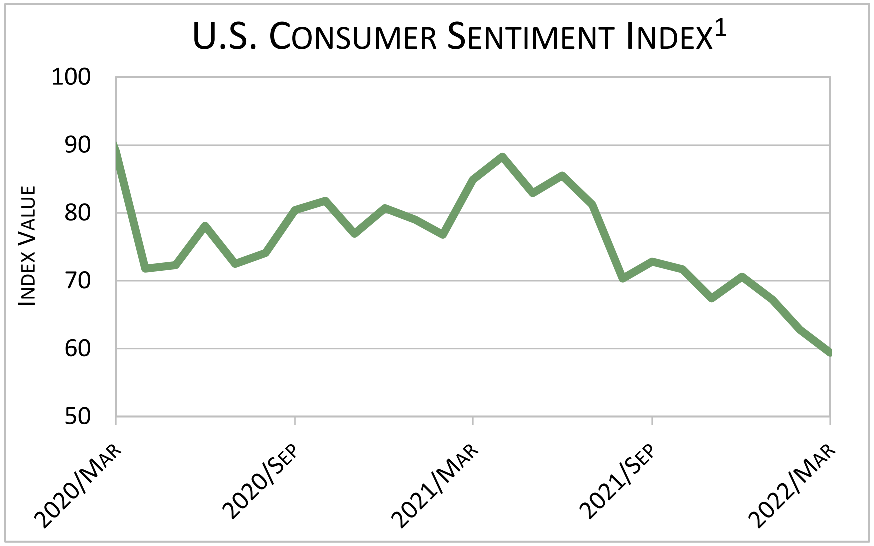
Outlook

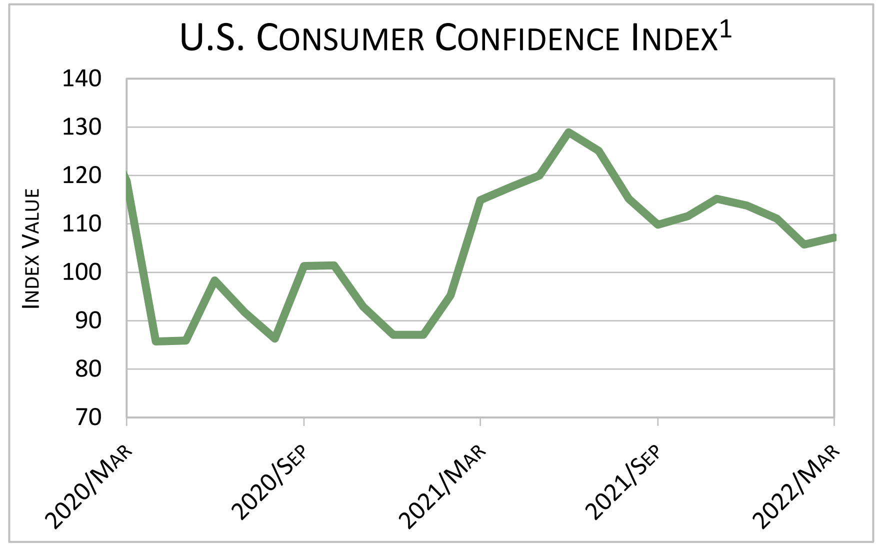
Pent-up demand supports growth outlook. Inflation and action to control it are key risks.

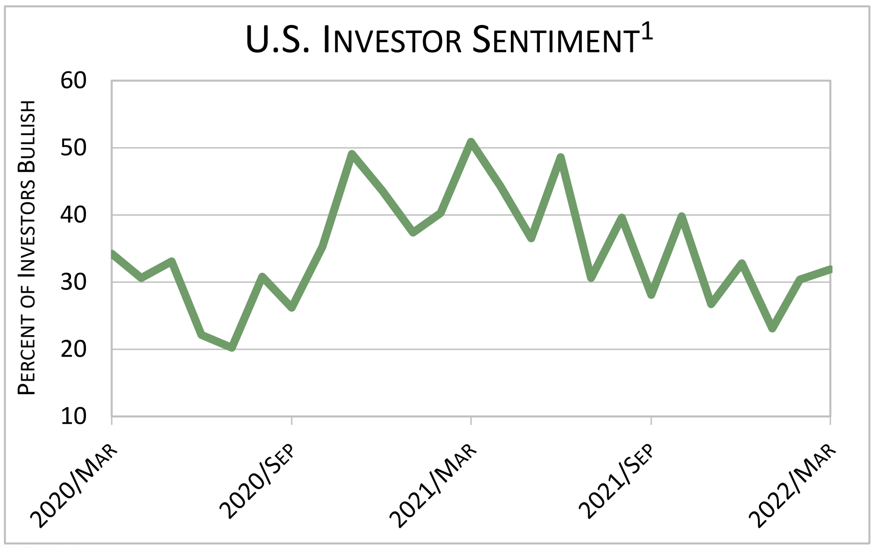
- The monetary tightening cycle has begun. Fiscal stimulus is not likely this year. Inflation looks to remain high. Therefore, economic growth likely will slow from after stimulus fueled growth in 2021. The probability of recession this year in the U.S. is low. Europe may be at higher risk due to Ukraine/Russia war impacts and China may slow more than initially forecast due to COVID shutdowns and high commodity prices. Certain regions are benefiting from higher commodity prices.
- Positives for economic and financial markets outlook:
  - Strong labor markets are supportive for consumer spending which accounts for a majority of GDP. In the U.S. hiring continues at a solid pace and job openings remain near all-time highs.
  - Pent-up demand especially for services as COVID impacts fade will likely be an important economic driver.
  - The manufacturing sector globally is in expansion as shown by purchasing managers index (PMI) data. Low inventories and strong demand are positive for production and enable producers to pass on higher input costs.
- Risks:
  - Inflation likely will remain high due to strong demand in a time of supply chain issues. The Ukraine/Russia war will likely keep food, energy, and commodity prices high due to reduced supply. How long the conflict and related sanctions persist is a key risk to commodity supplies and prices. China's shutdowns of large cities to control the spread of COVID are contributing to supply chain disruptions again. High inflation could result in demand destruction which would slow economic growth.
  - Fed projections indicate the fed funds rate moving up to 1.9% by the end of 2022. Higher rates mean higher discount rates applied to future earnings which could pressure stock prices, especially growth stocks. Rates are rising in several other countries with Europe likely to start hiking later this year.

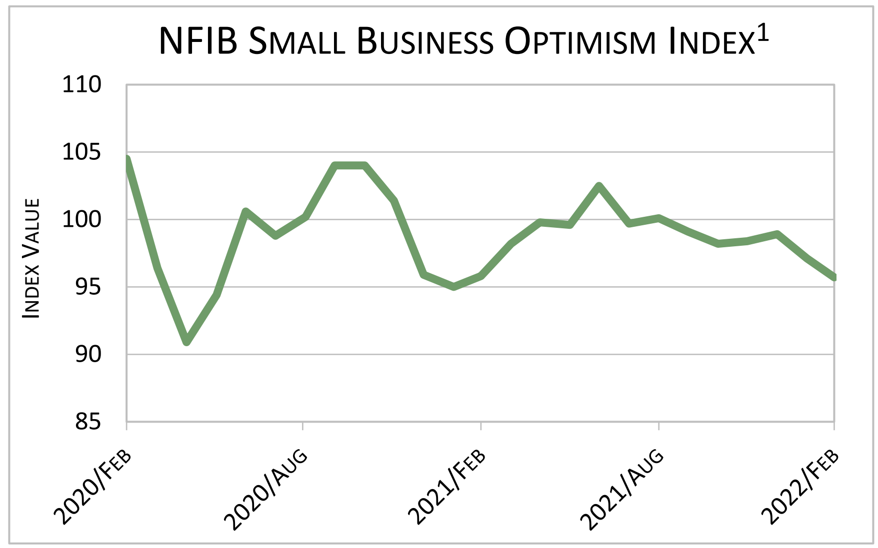
Outlook

Consumer, business, and investor sentiment trending lower on inflation, rates, and war news









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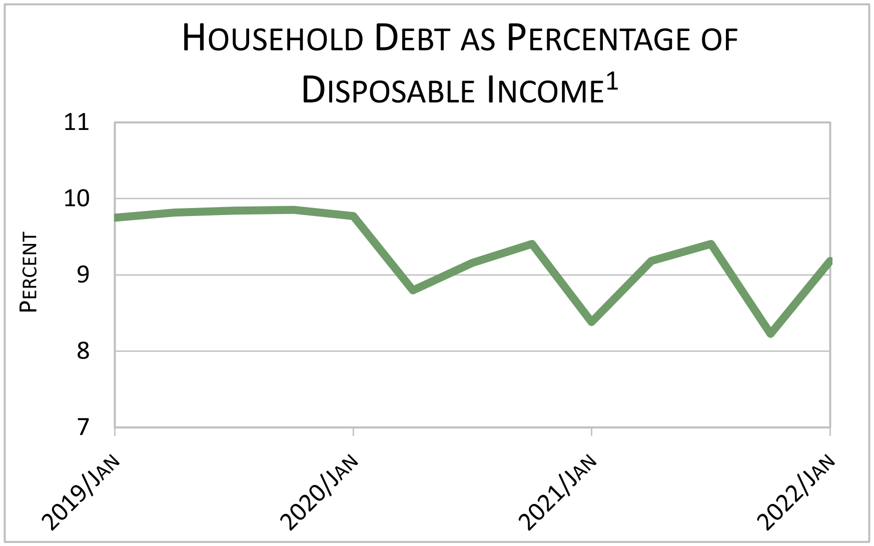
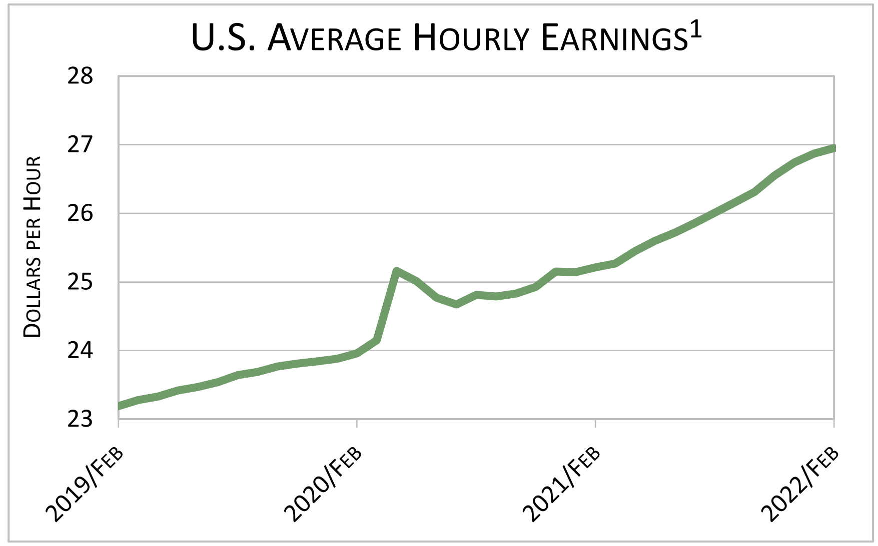
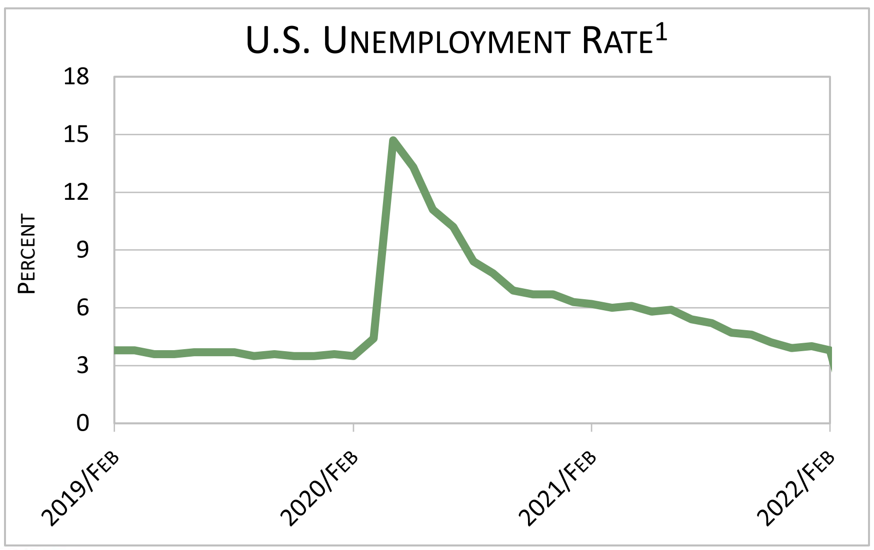
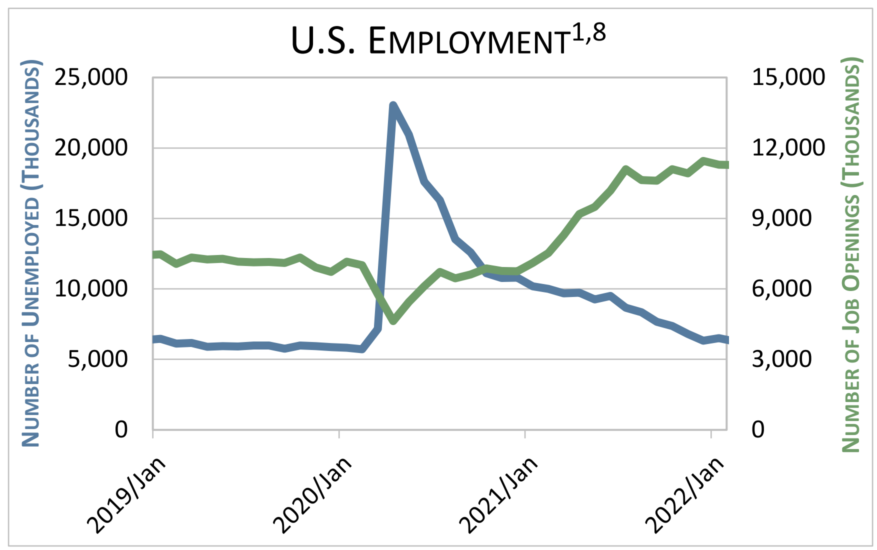
Outlook

The consumer sector is healthy which is supportive for economic and earnings growth









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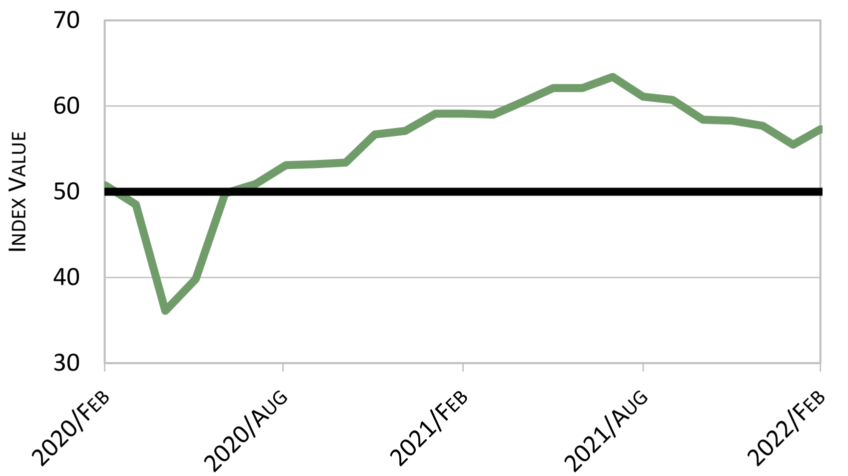
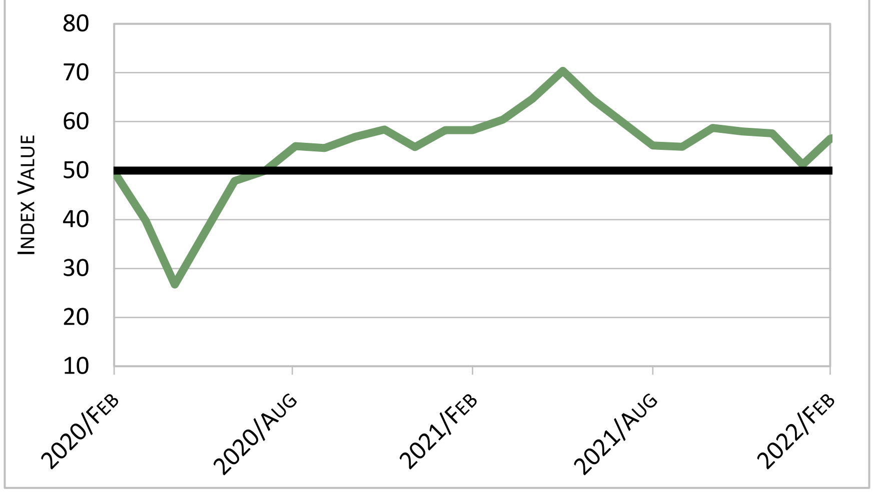
Outlook

Business sector conditions are mostly still pointing to expansion but seeing some moderation

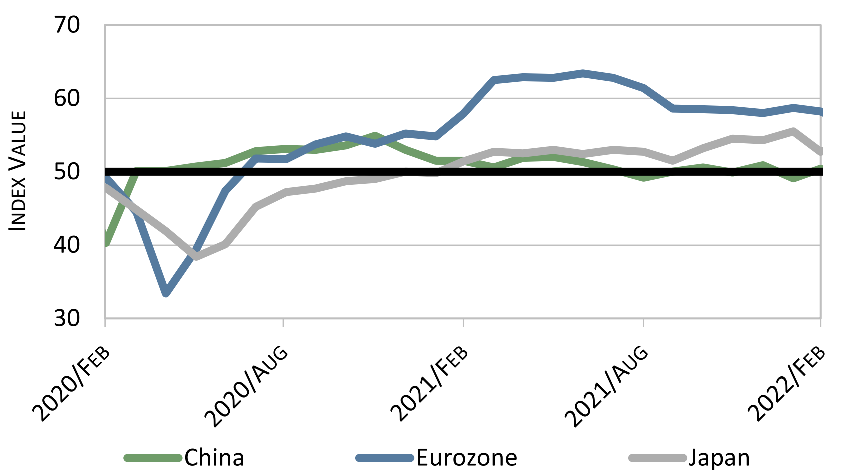
U.S. Manufacturing PMI[1]



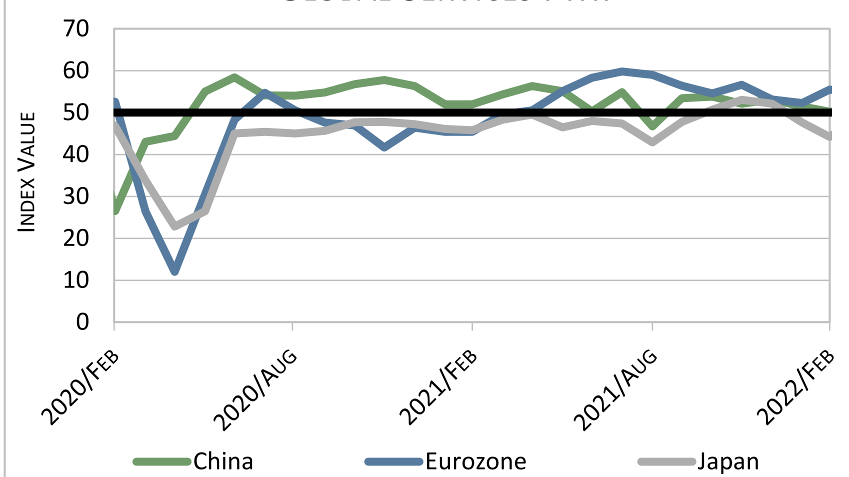
U.S. Services PMI[1]



Global Manufacutring PMI[1]



Global Services PMI[1]



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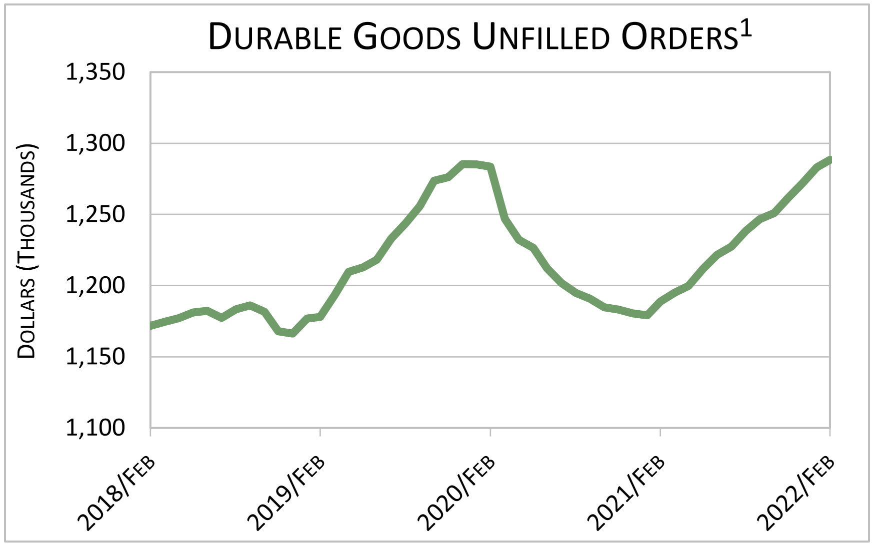
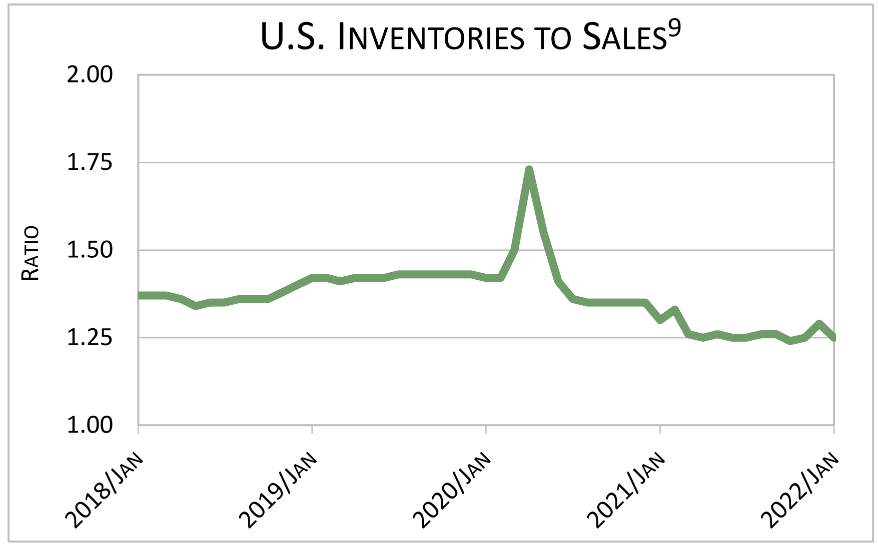
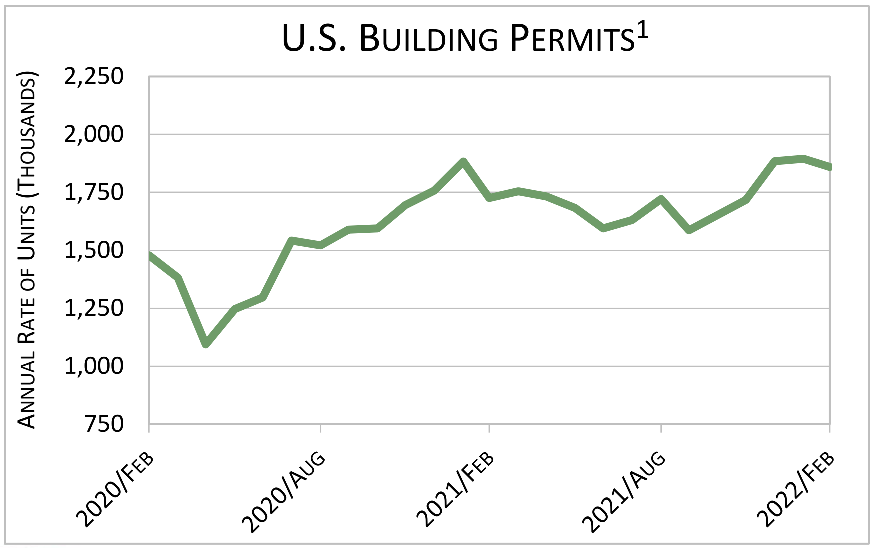
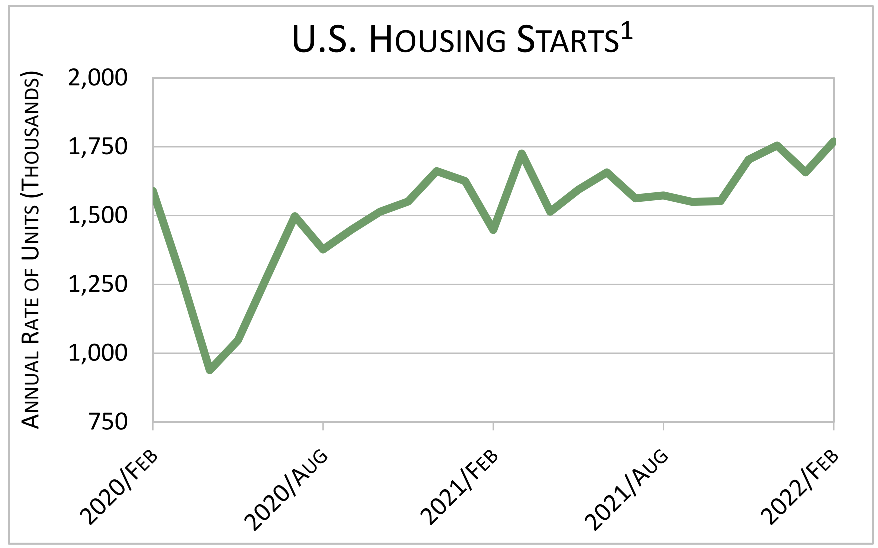
Outlook

Various economic data continue to show support to economic growth









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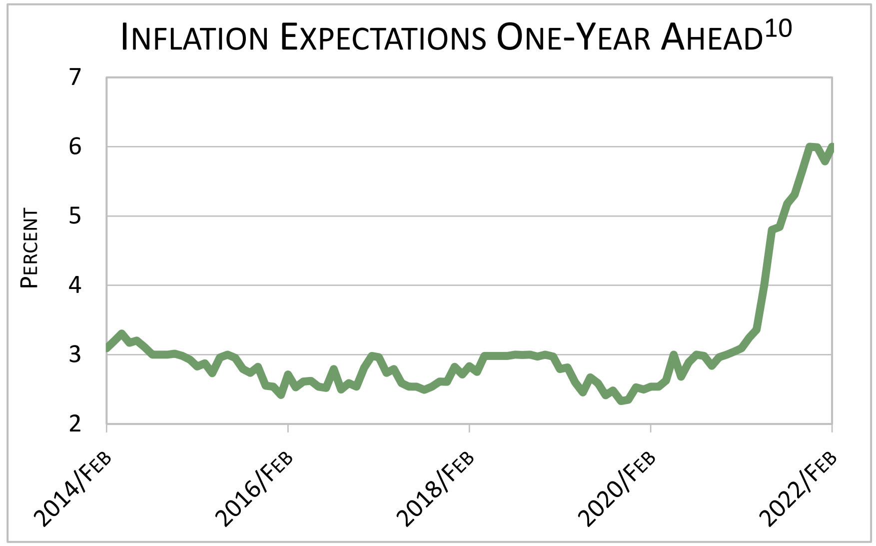
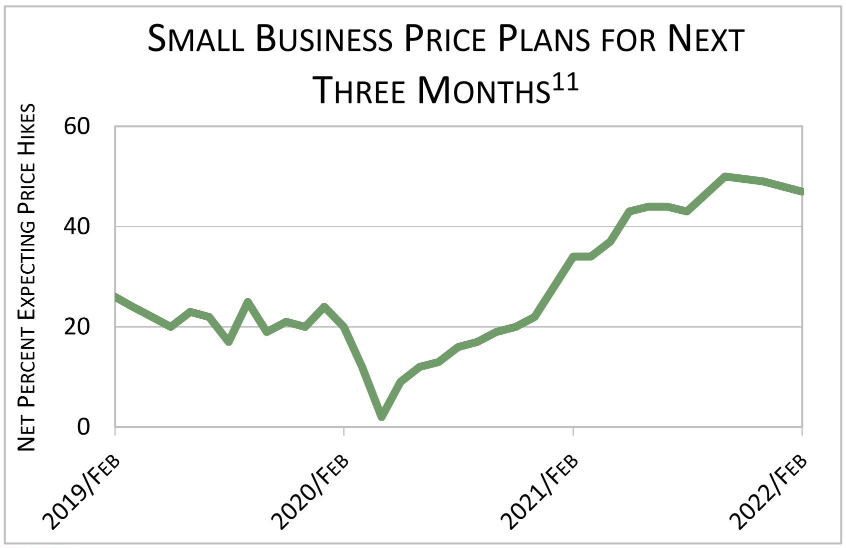
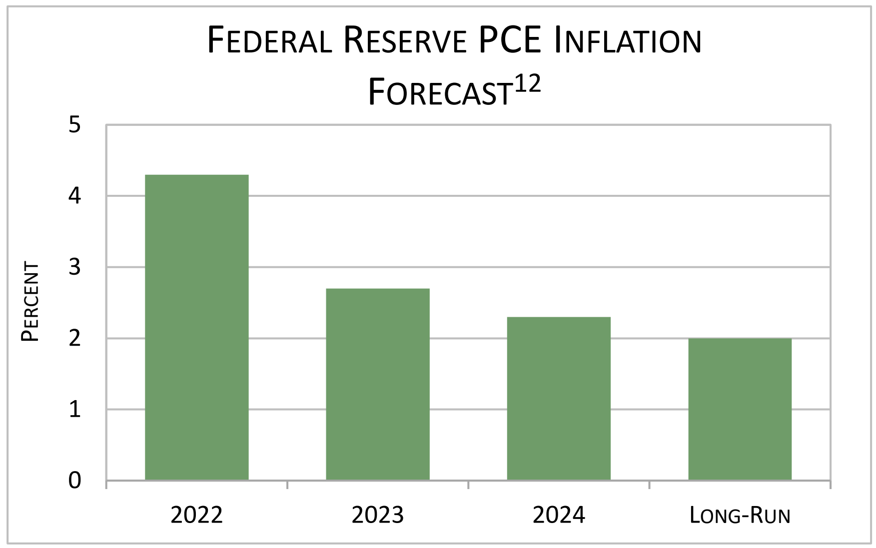
OUTLOOK

CONSUMERS EXPECT HIGH INFLATION BUT THE FED SEES A LOWER RATE. BUSINESSES EXPECT TO RAISE PRICES.

The Fed raised its inflation forecast for 2022-2024 measured by the core personal consumption expenditure index (PCE) but still expects inflation to slow from current high levels. It sees the full year 2022 inflation rate at 4.3% and the 2023 rate moving down to 2.3% close to its target. However, consumers are expecting inflation at multi-year highs. Those expectations could dampen spending plans and therefore economic growth and earnings. About half of small businesses report plans to raise prices over the next three months which will keep inflation as a focus of consumers and the Fed.







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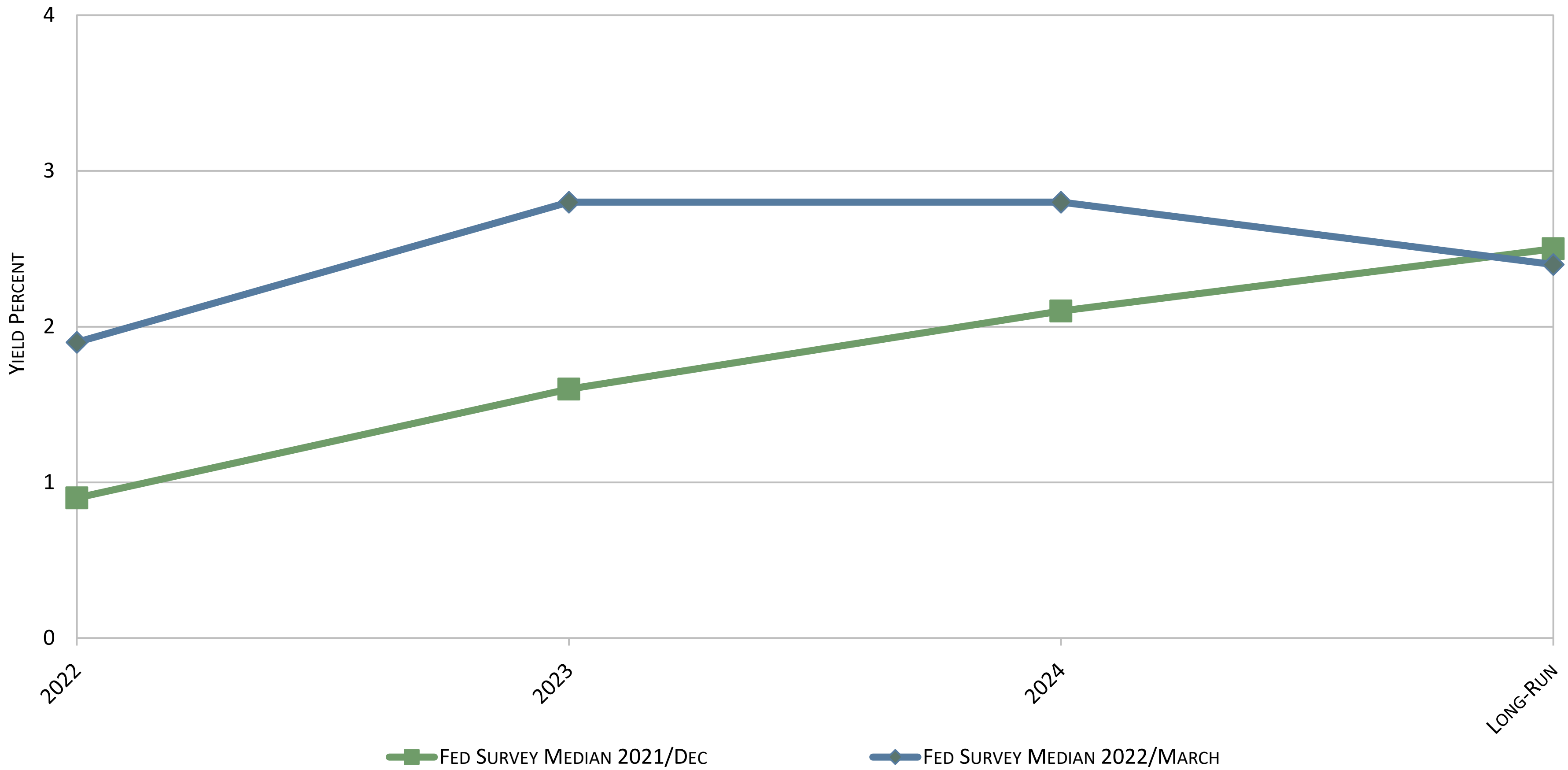
Outlook

Interest rates are set to move higher to combat rising inflation

Updated projections show the Fed's more aggressive interest rate policy given the persistent high rate of inflation. Some Fed members want 0.50% rate hikes rather than the typical 0.25% move. More will be announced about reducing the Fed's bond holdings which will also work to tighten monetary conditions.

Federal Funds Target Rate Projections[12]



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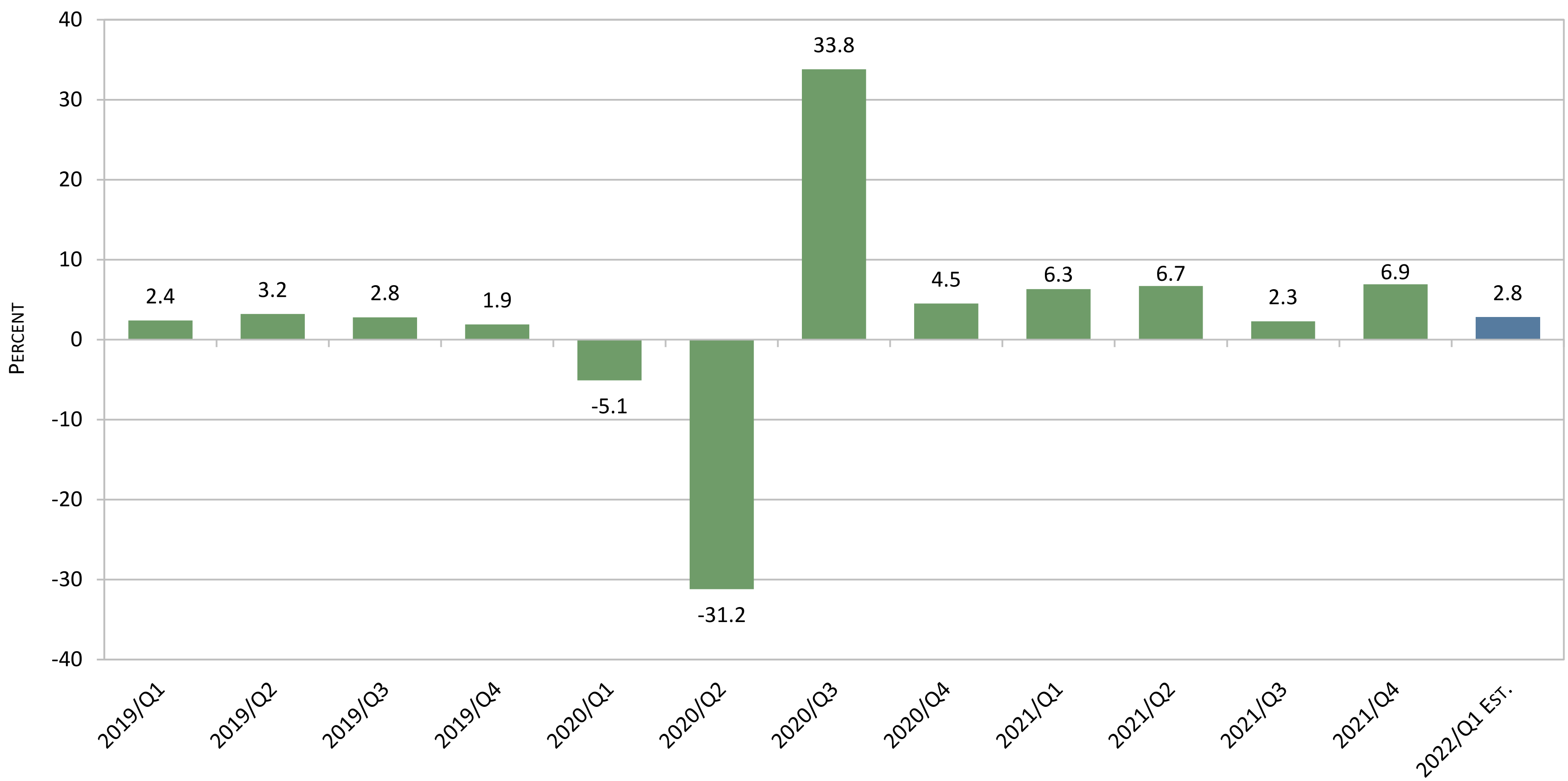
OUTLOOK

A KEY RISK FOR FINANCIAL MARKETS IS IF INFLATION WILL PUSH THE ECONOMY INTO RECESSION

Economic activity is expected to slow in 2022 down from the stimulus boosted growth rates in 2020 and 2021. However, the Fed is forecasting gross domestic product growth of 2.8% which is in line with various private economist forecasts and back to pre-COVID levels.

GROSS DOMESTIC PRODUCT ANNUAL GROWTH RATE[1,12]



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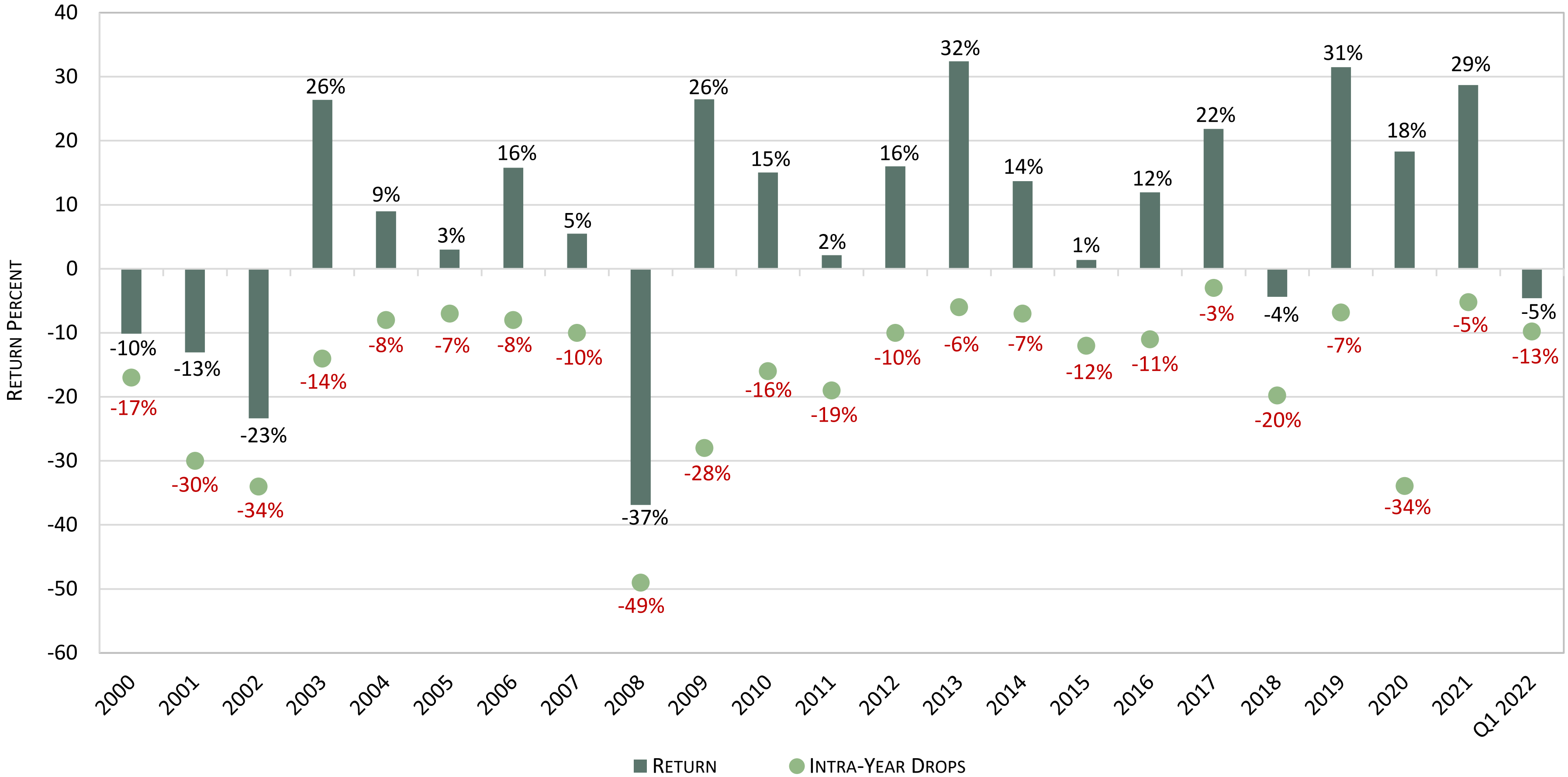
OUTLOOK

LARGE DRAWDOWNS ARE NOT UNUSUAL IN EQUITY MARKETS

As a reminder, the S&P 500 had a sizeable valuation drop from a peak to a trough during each year since 2000 so the decline in the first quarter is within historical norms. Despite the intra-year declines, returns were negative in only five years of the last 22 calendar years.

S&P 500 INTRA-YEAR DECLINES[1,7]



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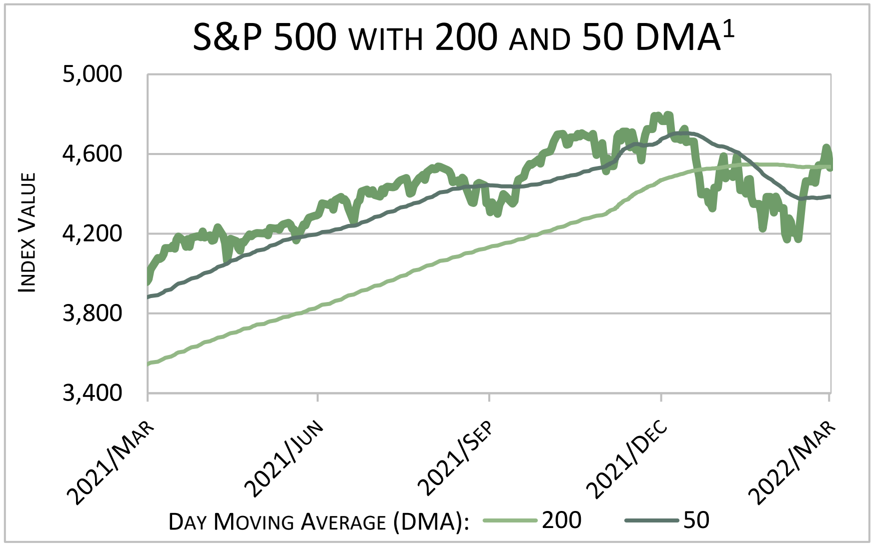
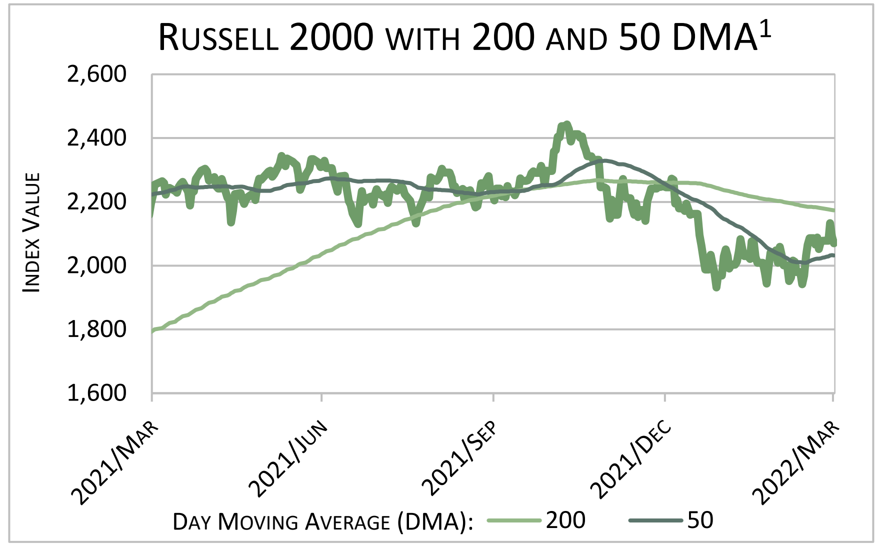
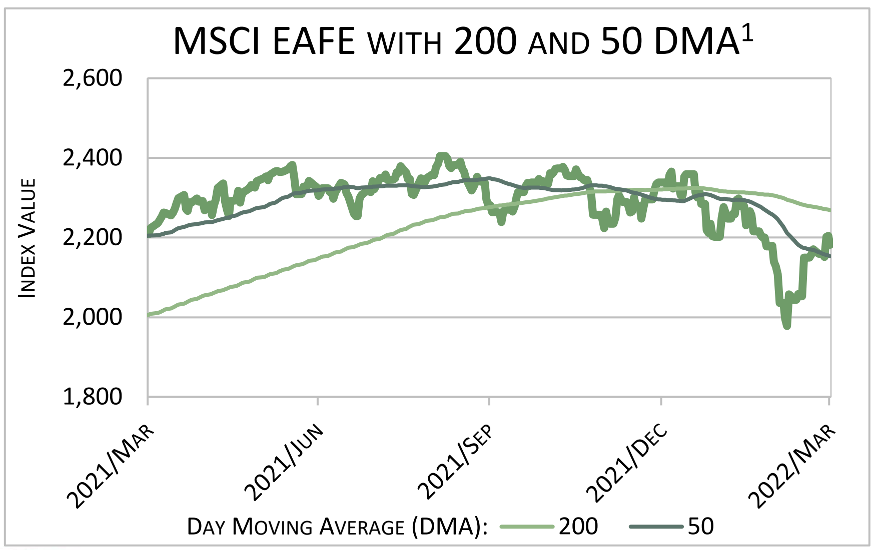
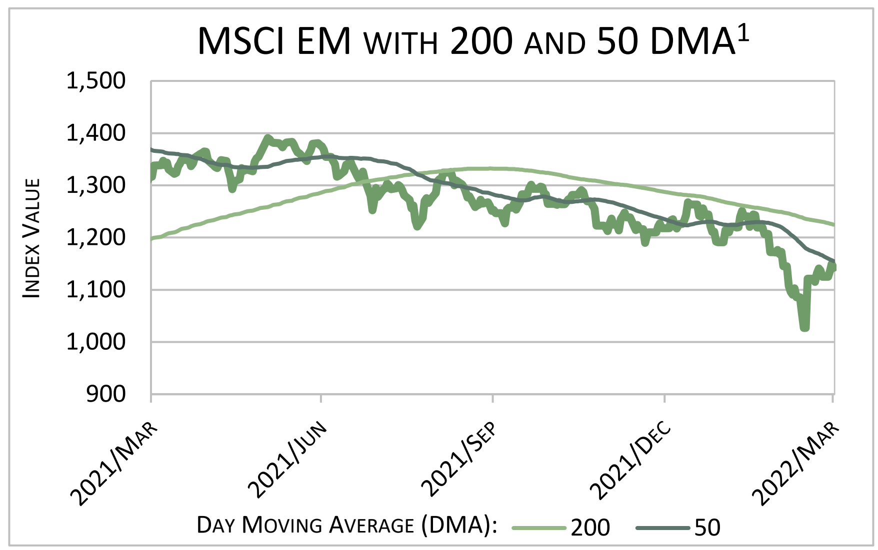
Outlook

Technical and sentiment indicators are neutral suggesting markets likely in a trading range









Vogel Tactical Recommendations

Favor equities over bonds and U.S. over developed international equities

Asset Class	Action	Commentary
Domestic Large-Cap Equity	Overweight	Earnings growth supported by strong labor market and COVID rebound impacts enabling pricing power for many companies. Volatility expected in reaction to news.
Domestic Mid-Cap Equity	Overweight	Earnings growth supported by strong labor market and COVID rebound impacts enabling pricing power for many companies. Volatility expected in reaction to news.
Domestic Small-Cap Equity	Overweight	Wider than average valuation gap with large-cap stocks but also expect wider price swings in reaction to news.
International Developed Equity	Underweight	Stimulus programs still supportive for certain regions. Expect dollar to stay firm which is a headwind for dollar-based returns. Heavy export exposure to slowing China and impacts of high energy costs related to the Ukraine war likely to also be headwinds.
International Emerging Market Equity	Equal weight	Strength in commodities and geopolitical events are benefiting certain economies. Slowing economic data in China and new COVID shutdowns could be a source of volatility in the short-term.
Fixed Income	Equal weight	Yields are highest in over two years so are a source of income and diversification. However, yields are likely to move up (and prices down) as Fed tightens policy to fight inflation. Corporate fundamentals remain strong so credit risk low.
Hedge Strategies	Underweight	The flexibility to position for various risk scenarios can provide return opportunities, but rapid and sharp market swings can be challenging for some strategies.
Real Assets	Equal Weight	Attractive dividend yields offer inflation protection. The outlook for certain sectors is positive since demand is strong and supply remains tight, but volatility likely in reaction to changing geopolitical events.
Cash	Overweight	Keep 12 months of reserves for liquidity needs since periods of volatility are a risk if consensus expectations are not met or interest rates move higher.

QUARTERLY MARKET REPORT

DISCLOSURES

Important Disclosures:
This report is being provided to you for your review and consideration and does not constitute a recommendation to purchase, sell or hold any security, and should not be construed as investment advice. Past financial performance is no guarantee of future results.

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Sources: *Number below corresponds to the superscript notation in chart titles and text blocks*

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