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Capital Markets Review and Outlook

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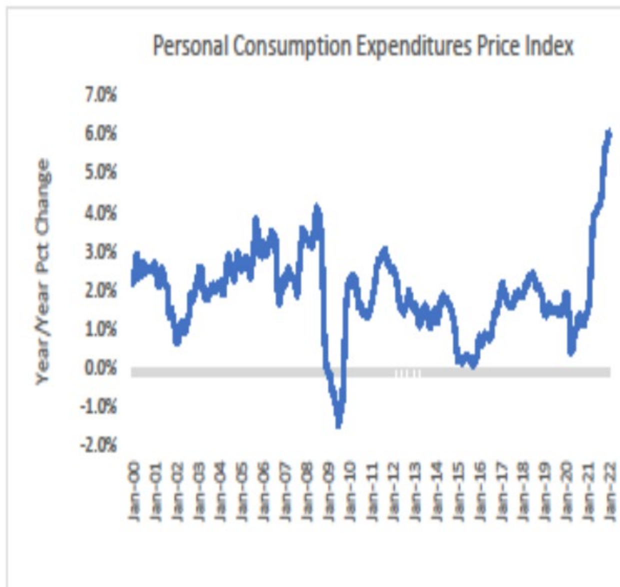
Economy and Outlook

Just as some semblance of normalcy was slowly creeping in with the sharp drop in the number of daily infections and mortalities from Covid-19, the world was roiled by Russia's totally unwarranted and unprovoked invasion of Ukraine, an independent sovereign nation, towards the end of February. The invasion and ensuing widespread sanctions imposed on Russia by much of the world have significant ramifications. Russia is the world's 3rd largest oil producer, and its exports of 5 million barrels per day account for 12% of global trade. In natural gas, Russia's exports represent an even larger percentage (25%) with 85% of its exports going to Europe. Other commodities are also affected by the war. For example, Russia and Ukraine account for 14% of global wheat production with Russia the largest producer and exporter in the world. Pandemic-induced global supply chain bottlenecks which had started to ease, are now coming under pressure again. Already high inflation is also likely to be pushed even higher. Historically, geopolitical flare-ups have not had a lasting effect on the global economy and markets. However, the backdrop this time may be somewhat different. The Russian president, Vladimir Putin, appears to have been emboldened by NATO's (and the world's) relatively muted response during his country's past incursions such as the illegal annexation of Crimea in 2014. Mr. Putin has dug himself into a hole this time and is facing an unexpectedly united world (except for China) that is taking strong economic measures against Russia. In the face of stiff resistance by Ukrainians and the humanitarian toll that is taking place, the only positive scenario is for a regime change in Russia that results from the likelihood of a near-collapse of the isolated Russian economy. Despite the negative effects from Russia's invasion of Ukraine, the U.S. Federal Reserve has no choice but to embark on its expected tightening of monetary policy conditions by raising interest rates in March. While annual inflation (CPI) has now increased by an extraordinary 7.5%, the graph on this page shows that even the Federal Reserve's preferred gauge, the personal consumption expenditures (PCE) price index is up 6.1%, well-above the Fed's target of 2%. The labor market also remains tight



Source: U.S. Bureau of Economic Analysis

as reflected in the strong gains of 678,000 jobs in February with the unemployment dropping to a near pre-pandemic low of 3.8%. As we have indicated in our prior monthly write-ups, volatility in risk assets remains under pressure. Even without the recent geopolitical crisis, a much-needed renormalization and recalibration of interest rates and valuations is likely to remain an overhang for risk assets.

Equity Markets

Equity markets extended their declines in February as Russia's invasion of Ukraine weighed on the markets. The broad domestic equity market represented by the Russell 3000 index lost -2.5% in February bringing its decline for the first two months of the year to -8.3%. For the year ending 2/28/22, the index was up +12.3%. In a reversal from January, Small Cap (+1.1%) outperformed Large Cap (-2.7%) shrinking Large Cap's lead for the year-to-date to +0.5%. In terms of performance by style, Value outperformed Growth across all capitalizations for the second consecutive month. Sector performance was differentiated by the dominance of Defensives over Cyclicals, also for the second month in a row. Communications (-7%) and Technology (-4.9%) were the worst performing sectors, while Health Care (-1%) held up better. The only sector with a positive return for the month was Energy which rose +7.1% on the heels of the sharp rise in energy prices with crude oil (WTI) ending the month at $103 a barrel, its first close above the $100 mark in 8 years. In just the first 2 months of the year, the Energy sector is up a remarkable +27.6%. International equity markets also lost ground in February with the declines exacerbated by the strength in the U.S. dollar. The MSCI Developed Markets ex-US equity index lost -1.8% for the month. European markets were hit hard because of their reliance on energy imports from Russia. Germany (-6.9%), Italy (-4.8%) and France (-4.5%) were the worst performers. On the other hand, surging demand for its exports and higher commodity prices benefitted Australia and led to a strong equity market gain of +5.8% in February. The United Kingdom (+0.8%) and Japan (-1.1%) also held up much better than Europe. The MSCI Emerging Markets index (-3%) underperformed its Developed Markets counterpart due to declines in two of its major constituents – China (-3.9%) and India (-4%). The latter continues to be buffeted by the government's increased policing of private companies and high debt levels. Year-to-date, the Emerging Markets index (-4.8%) is ahead of the Developed Markets index (-6.5%), a reversal from the former's significant relative underperformance in 2021.

Fixed Income Markets

February was marked by sharp swings in U.S. Treasury yields. Earlier in the month, the yield on the 10-year Treasury broke back above 2% as markets anticipated a possibly 50 bp initial hike by the Federal Reserve in March. This was then followed by a sharp reversal in yields as investors digested the implications of Russia's invasion of Ukraine. For the month, 2-year Treasury yields climbed 26 bp to 1.44%. Yields rose by less further out the curve with the 10-year Treasury yield rising 4 bp to 1.83%. The Treasury yield curve continued its flattening trend as the 2-year/30-year Treasury yield spread narrowed by 20 bp to end the month at +73 bp. A year ago, this spread was almost three times wider at +203 bp. The credit markets also sold-off in February mirroring the decline in the equity markets. Investment grade spreads widened by

19 bp pressured by heavy supply in addition to the geopolitical issues and impending Federal Reserve interest rate hikes gripping investors. The best performing investment grade sectors were Technology and Transportation with spread widenings of 12 bp and 16 bp respectively. Automotive and Media/Entertainment underperformed with spread widenings of 24 bp. For the month, the investment grade credit sector lost -1.9% bringing its year-to-date decline to -5%. While the high yield sector also extended its losses in February, the sector held up better than its investment grade counterpart as the high yield sector was cushioned by both a smaller widening in spreads (+15 bp) and a higher coupon. Relative performance in high yield was differentiated by quality with the lower quality CCC and Single-B sectors underperforming the higher quality BB-rated sector. Outperforming sectors include Metals/Mining and Industrials while Housing and Retail underperformed. In February, the high yield sector lost -1%, roughly half the decline of the investment grade sector. Year-to-date, the sector is down -3.5%. Like the U.S. bond market, developed international government bond yields were also volatile in February. In the first half of the month, yields rose sharply as central banks moved to a more hawkish stance as inflation remained high. The Bank of England hiked interest rates for the second consecutive time bringing its Bank Rate to 0.5%. This marks the first back-to-back interest rate increases by the BoE since 2004. By the end the month, there were retracements of much of the increases in developed market bond yields due to the geopolitical crisis created by Russia's invasion of Ukraine. As a result of the stronger U.S. dollar (+1.1% for the dollar index, DXY), the FTSE non-US Government Bond index lost -1.3% in February compared to the -0.7% decline for the U.S. government bond index. Year-to-date, the U.S. government bond market is outperforming the non-U.S. market by +100 bp, -2.5% versus -3.5%.

			Returns as of 2/28/22 (In %)			
		Month	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-2.5	-8.3	12.3	17.6	14.7
Russell 1000®	US Large Cap Equity	-2.7	-8.2	13.7	18.1	15.1
Russell 1000® Growth	US Large Cap Growth	-4.2	-12.5	12.5	23.2	20.2
Russell 1000® Value	US Large Cap Value	-1.2	-3.5	15.0	12.2	9.5
Russell Midcap®	US Mid Cap Equity	-0.7	-8.0	7.1	14.3	12.0
Russell Midcap® Growth	US Mid Cap Growth	-1.2	-14.0	-4.3	14.7	14.9
Russell Midcap® Value	US Mid Cap Value	-0.5	-4.7	13.8	12.7	9.2
Russell 2000®	US Small Cap Equity	1.1	-8.7	-6.0	10.5	9.5
Russell 2000® Growth	US Small Cap Growth	0.4	-13.0	-17.4	9.2	10.5
Russell 2000® Value	US Small Cap Value	1.7	-4.3	6.6	10.9	8.0
MSCI ACWI ex-US	Global Equity ex-US	-2.0	-5.6	-0.4	7.7	7.3
MSCI EAFE	Global Developed Mkts Equity	-1.8	-6.5	2.8	7.8	7.2
MSCI EM	Emerging Mkts Equity	-3.0	-4.8	-10.7	6.0	7.0
Bloomberg/Barclays US Agg	US Core Fixed Income	-1.1	-3.2	-2.6	3.3	2.7
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.8	-2.2	-2.6	2.5	2.2
Bloomberg/Barclays US Credit	US Corporate Bonds	-1.9	-5.0	-3.3	4.5	3.7
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-1.0	-2.4	-2.9	1.9	1.9
Bloomberg/Barclays US Corp HY	US High Yield	-1.0	-3.7	0.6	5.3	4.9
FTSE Non-US WGBI	Global Fixed Income ex-US	-1.3	-3.5	-9.3	0.3	1.6

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