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Capital Markets Review and Outlook

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Economy and Outlook

The war in Ukraine is raging for a second month as Ukrainians mount fierce resistance to the unwarranted invasion of their country by Russia. The unfolding humanitarian crisis with millions of Ukrainians fleeing their country is the worst since World War II. Although news about the coronavirus pandemic is being eclipsed by the war in Ukraine, the disease is still prevalent. There are, however, signs of optimism. Infection and mortality rates are both declining, and infections from new variants of Covid-19 appear to be less severe. Also, the number of vaccinations administered globally continues to rise and is now over 11 billion. The effects of the pandemic pressured prices higher across a wide swathe of the economy for over a year. The war in Ukraine is now driving prices even higher globally both directly, due to a scarcity of inputs, and indirectly by further straining already fragile supply chain systems that were beginning to recover from the supply/demand imbalances that resulted from the coronavirus pandemic. The global effects of the war and the consequences of economic sanctions imposed on Russia are profound. For example, more than a dozen countries in Africa rely on Russia and Ukraine for half of their wheat imports. Inflation is becoming a problem, even in regions such as Europe, where policymakers endeavored unsuccessfully for years to nudge higher extremely low levels of inflation. The latest figures for the Eurozone show the annual inflation rate spiking higher to 7.5%. In the United States, the Federal Reserve's preferred gauge for inflation, the personal consumption expenditures price index climbed to 6.4%, its fastest pace in 40 years. A recent Gallup poll at the end of March showed that rising prices was the #1 economic concern for Americans. The chart on this page shows that consumer sentiment is now at its lowest level in over 10 years. The Federal Reserve bears some responsibility for the surge in prices. By maintaining a monetary stimulus policy of 'pedal to the metal' for over two years and calling the early signs of inflation 'transitory', the Fed now finds itself behind the curve as inflation continues to accelerate while the economy remains buoyant.

Despite raising its official interest rates by 25 bp in March for the first time in three years, the central bank now needs to aggressively tighten monetary policy to bring inflation under control. Such a policy shift raises the risk of a hard landing for the economy. Volatility is, therefore, likely to remain elevated for risk assets until there is a normalization and stabilization of the interest rate backdrop.

Equity Markets

Despite several negative factors including the war in Ukraine, sharply higher inflation and rising interest rates, equity markets rebounded in the final month of the 1st quarter as investors focused on economic growth and corporate earnings. The broad domestic equity market represented by the Russell 3000 index rose +3.2% in March trimming its losses for the 1st quarter to -5.3%. For the 1-year and 3-year periods ending 3/31/22, the index gained an annualized +11.9% and +18.2% respectively, while the 5-year annualized return was +15.4%. Performance by capitalization reversed yet again in March with Large Cap (+3.4%) outperforming both Mid Cap (+2.6%) and Small Cap (+1.2%). For the 1st quarter of the year, Large Cap (-5.1%) led Small Cap which lost -7.5%. In terms of performance by style in March, Growth (+3.9%) led Value by over +100 bp only in Large Cap. In both Mid and Small Cap, Value outperformed Growth. For the 1st quarter, Value dominated Growth across all capitalizations by a significant margin ranging from +800 to over +1000 bp. Sector performance in March was mixed. While as expected in an up market, some Cyclicals outperformed Defensives such as Consumer Discretionary (+4.9%) vs Consumer Staples (+1.8%), Communication Services gained only +1% while Health Care rose +5.6%. Also, despite the sharp rise in Treasury yields, Utilities (+10.4%) was the best performing sector and Real Estate gained +7.8%. The massive flattening in the Treasury yield curve weighed on Financials which lost -0.2%. Despite the volatility in energy prices and a lower closing price for oil (WTI) below $100, the Energy sector rose +9% in March, the 2nd best performer for the month. For the 1st quarter, Energy was the best performer with a gain of +39% as WTI rose +29%. International equity markets underperformed U.S. markets in March as major economies such as Germany and Italy came under pressure due to their stronger economic links with and dependence on Russia, especially for energy. In March, the German and Italian equity markets declined -2.8% and -3% respectively. For the 1st quarter, Germany was the worst performer with a loss of -12.9%. On the other hand, the strong rally in commodities boosted commodity producers such as Australia and Canada which gained +11.1% and +5.3% in March. A similar story played out in emerging markets with Brazil up +14.9% for the month and a remarkable +35.9% for the 1st quarter. In the foreign exchange markets, a similar play book unfolded with the U.S. dollar falling against commodity producers and rising against other currencies. The largest currency decline among developed markets was the -6.6% decline in the Japanese yen against the U.S. dollar on the significant widening in expected interest rate differentials based on anticipation of the Federal Reserve's interest rate hiking path. The largest emerging market, China, remained under pressure due to heightened regulations and continuing concerns about high levels of debt. This led to an -8% decline in the Chinese equity market for the month and a loss of -14.2% for the 1st quarter. Overall, the MSCI

Developed Markets ex-US index rose +0.6% in March, while the Emerging Markets index declined -2.3%. For the 1st quarter, the corresponding returns were -5.9% and -7% respectively.

Fixed Income Markets

Interest rates shot up in March by more than the combined increases in the first two months of the year as inflation continued to surge higher amidst a sturdy economy as reflected in the strong employment report for March with the unemployment rate moving down further to 3.6%. For the month, 2-year Treasury yields rose sharply by 84 bp to 2.28%. The combined yield increase in January and February was +71 bp. The yield on the 10-year Treasury note increased by +49 bp to 2.32%, while the 30-year Treasury bond closed the month at 2.44%. The Treasury yield curve flattened significantly with the 2-year/30-year Treasury yield differential narrowing a remarkable 57 bp in March to end the month at +16 bp. At the beginning of this year, this spread was +117 bp. In line with the strong rebound in equity markets, the credit markets also rallied in March. Investment grade spreads narrowed by 10 bp for the month resulting in an excess return of +80 bp. However, for the 1st quarter, the investment grade sector underperformed with an excess return of -173 bp as spreads widened by 24 bp. For the month, the best performing sectors in terms of excess return were Energy (+153 bp), Healthcare/Pharma (+130 bp) and Utilities (+114 bp). The Automotive sector (-38 bp) was an underperformer. For the month, the Bloomberg/Barclays investment grade credit index lost -2.5% as sharply higher Treasury yields more than offset the tightening in credit spreads. For the 1st quarter, the investment grade index is down -7.4%. In March, the high yield sector outperformed its investment grade counterpart as high yield spreads narrowed by more than investment grade spreads. On a total return basis, Diversified Media (+0.6%) and Energy (+0.5%) were the best performing sectors while Automotive (-1.9%) and Transportation (-1.9%) were the worst performers. Also, as is typically seen when spreads rally, the lower rated Single-B sector outperformed the higher quality BB sector by +65 bp in total return. In March, the Bloomberg/Barclays High Yield index declined -1.1% which is less than half the loss for the investment grade index. For the 1st quarter, the High Yield index posted a decline of -4.8%. Inflation fears permeated international markets as well. Yields in international developed bond markets were also sharply higher as a result. In the United Kingdom, 5-year and 30-year bond yields rose by +66 and +39 bp respectively, while the 30-year bond yield in Germany rose +41 bp in March. For the month, the FTSE non-US Government Bond index lost -3.7% compared to the -3.1% decline for the U.S. government bond index as the U.S. dollar rallied against most major currencies. For the 1st quarter, the U.S. government bond market (-5.5%) outperformed the non-U.S. market (-7.1%) by +160 bp.

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			Returns as of 3/31/22 (In %)				
		Month	Q1	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	3.2	-5.3	-5.3	11.9	18.2	15.4
Russell 1000®	US Large Cap Equity	3.4	-5.1	-5.1	13.3	18.7	15.8
Russell 1000® Growth	US Large Cap Growth	3.9	-9.0	-9.0	15.0	23.6	20.9
Russell 1000® Value	US Large Cap Value	2.8	-0.7	-0.7	11.7	13.0	10.3
Russell Midcap®	US Mid Cap Equity	2.6	-5.7	-5.7	6.9	14.9	12.6
Russell Midcap® Growth	US Mid Cap Growth	1.6	-12.6	-12.6	-0.9	14.8	15.1
Russell Midcap® Value	US Mid Cap Value	3.0	-1.8	-1.8	11.5	13.7	10.0
Russell 2000®	US Small Cap Equity	1.2	-7.5	-7.5	-5.8	11.7	9.7
Russell 2000® Growth	US Small Cap Growth	0.5	-12.6	-12.6	-14.3	9.9	10.3
Russell 2000® Value	US Small Cap Value	2.0	-2.4	-2.4	3.3	12.7	8.6
MSCI ACWI ex-US	Global Equity ex-US	0.2	-5.4	-5.4	-1.5	7.5	6.8
MSCI EAFE	Global Developed Mkts Equity	0.6	-5.9	-5.9	1.2	7.8	6.7
MSCI EM	Emerging Mkts Equity	-2.3	-7.0	-7.0	-11.4	4.9	6.0
Bloomberg/Barclays US Agg	US Core Fixed Income	-2.8	-5.9	-5.9	-4.2	1.7	2.1
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-2.5	-4.7	-4.7	-4.4	1.2	1.7
Bloomberg/Barclays US Credit	US Corporate Bonds	-2.5	-7.4	-7.4	-4.2	2.8	3.2
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-2.6	-5.0	-5.0	-4.9	0.6	1.4
Bloomberg/Barclays US Corp HY	US High Yield	-1.1	-4.8	-4.8	-0.7	4.6	4.7
FTSE Non-US WGBI	Global Fixed Income ex-US	-3.7	-7.1	-7.1	-10.4	-1.2	0.8

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