Q1 MARKET INSIGHTS

Spring 2022

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Financial markets are off to a rocky start in 2022. Market volatility has spiked due to persistently high inflation data and expectations of an acceleration in central bank tightening. Adding to volatility is Russia's full-scale military invasion of Ukraine, marking the first major military conflict in Europe in decades. These factors fueled a rise in volatility, driving stocks lower in the first three months of the year. During the first quarter of 2022, the S&P 500® Index entered correction territory, falling 13.1% from its high on January 3rd through March 8th. Corrections in the stock market are never welcome, but it was not a total surprise given the S&P 500's return of 28.7% last year and 18.4% in 2020. However, the S&P 500 did rebound in late March to finish the quarter down only 4.6%. Foreign markets fell victim to the same factors that drove equity market performance here in the U.S. Foreign developed markets, represented by the MSCI Emerging Markets Index, posted a negative first quarter return of 5.77%, and emerging markets, as represented by the MSCI EAFE Index, were down 6.99%. Switching to fixed income markets, bonds registered some of the worst performance in years, as the Bloomberg Barclays U.S. Aggregate Bond Index was down 5.93% for the first quarter. It was quite unusual to see the index underperform the S&P 500, as bonds, due to their low correlation with stocks, typically outperform when the stock market declines. Most major bond indices declined as investors exited fixed income holdings in the face of high inflation and increasing expectations that the Federal Reserve (the "Fed") may need to raise interest rates at a faster pace.

UKRAINE WAR COMPLICATES FED STRATEGY

Russia's invasion of Ukraine will continue to dominate near-term headlines, yet we believe the two factors that will determine the ultimate direction of the financial markets here in the U.S. will be Fed policy and economic growth. On March 16th, the Fed took its first step in addressing inflation by raising interest rates by 0.25% as inflationary pressures continue to permeate the U.S. economy with the Consumer Price Index ("CPI"), which measures a wide-ranging basket of goods and services, posting an annual increase of 7.9% as of the end of February (a 40 year high!). Most price gains can be attributed to supply chain issues resulting from the COVID-19 pandemic. These inflationary pressures related to the supply chain are expected to subside later this year (or early 2023), and would limit the amount by which the Fed would need to increase rates. However, the conflict in Ukraine has added a new wrinkle to the situation. The attack on Ukraine and the related sanctions levied against Russia are likely to raise inflation via higher costs to produce food and other goods. Russia is at or near the top in global exports for oil, several industrial metals, grains, and fertilizer. Ukraine is the world's eighth largest producer of wheat, and together with Russia, is responsible for 24% of global wheat exports. The longer this war lasts, the greater the likelihood that inflation remains higher for an extended period of time both here in the U.S. and abroad. The full degree to which the war will affect the broader U.S. economy remains to be seen, and it is difficult to foresee how the crisis in Ukraine will evolve in the coming weeks. While the situation remains very fluid, the longer it takes for Russia and Ukraine to find a resolution, the greater the impact on inflation. As such, the Fed may have to be more aggressive in raising interest rates, depending upon how the inflation outlook develops in the coming months. As we highlighted in our Q4 2021 update, the Fed is in a precarious position where it must carefully try to dampen inflation (via raising interest rates) without tipping the U.S. into a recession (due to the historically high

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levels of debt in the economy). The possibility of a Fed policy error was already a concern before geopolitics factored into the calculus, and now that risk appears to have increased.

At the end of March, another noteworthy event occurred as the spread between the 2-year U.S. Treasury Note and the 10-year U.S. Treasury Note briefly inverted. An inverted yield curve is a cause for concern for investors as an inverted yield curve (specifically between the 2-year and 10-year notes) has historically been a precursor to a recession. Since 1900, the 2-year and 10-year yield curve has inverted 28 times, and in 22 of those instances a recession has followed. While this has been a reliable indicator, warning investors that a recession may be on the horizon, it is a terrible guide for telling investors when a recession may actually occur. The lag between a yield curve inversion and the start of a recession has averaged about 22 months since 1900. Over the past four recessions (going back to 1990), the range has lagged from as little as 6 months to just over 33 months. Given the time lag, the worst thing for investors to do is panic. Historically, the stock market has done well between the first instance of an inverted yield curve and the market top that preceded any recession-induced drawdown in equities. The last four times the 2-year and 10-year curve inverted, the S&P 500 was up an average of 28.8% before it peaked, with the peak occurring an average of 17.1 months after inversion, while the ensuing recession started on average 21 months after inversion (see table to the right).

Yield Curve Inversions and Ensuing Stock Performance

2 Year/10 Year Yield Curve Inversions

Date of Inversion	Date of Bull Market Peak	Months Until Market Peak	S&P 500 Return
12/13/1988	7/16/1990	19.1	33.2%
5/26/1998	3/24/2000	22.0	39.6%
12/27/2005	10/9/2007	21.4	24.6%
8/27/2019	2/19/2020	5.8	18.0%
Average		**17.1**	**28.8%**

Source: St. Louis Fed, Bloomberg; See disclosures for additional notes

We believe the yield curve is telling us that the risk of a policy error by the Fed has increased, complicated by both an economic and territorial war — for which the outcome is difficult to accurately predict. A quick resolution to the events in Ukraine may help reduce this risk, and hopefully avert a recession. At the same time, if the Fed is forced to continue to raise rates, and does push the U.S. towards a recession, we believe they will quickly reverse course and re-implement monetary stimulus that will benefit both the equity and bond markets.

IT'S ALL ABOUT EARNINGS

Given the complicated geopolitical environment, the near-term path for U.S. equity markets will likely be dependent upon earnings. The outlook for U.S. corporate earnings has been relatively stable despite the backdrop of war in the Ukraine. U.S. companies have very little direct exposure to both Russia (~0.6% for the Russell 1000 Index) and Ukraine (<0.1%) based on disclosed revenues. Although the official start of the first quarter earnings season is still a few weeks away, we have not seen any major negative pre-announcements (this is usually about the time when they are released). Secondly, the pandemic appears to finally be behind us, which is terrific news, and should lead to further normalization of business, social and travel activities. This should support economic growth in the U.S. through the summer months. Lastly, the companies that make up the S&P 500 have been quite resilient at protecting profit margins despite the inflationary headwinds. Since the fourth quarter of 2020, the companies that make up the S&P 500 have managed to expand their gross margins every quarter. At the same time, their aggregate Selling, General, and Administrative costs have declined for four consecutive quarters. The net result has led to record high profit margins. While some sectors have seen a margin squeeze from higher costs (specifically consumer staples and capital equipment manufacturers), most companies have been able to pass along their added costs to customers. According to Empirical Research Partners (an independent research boutique that provides research on portfolio strategy and other quantitative topics based in New York) about 65%

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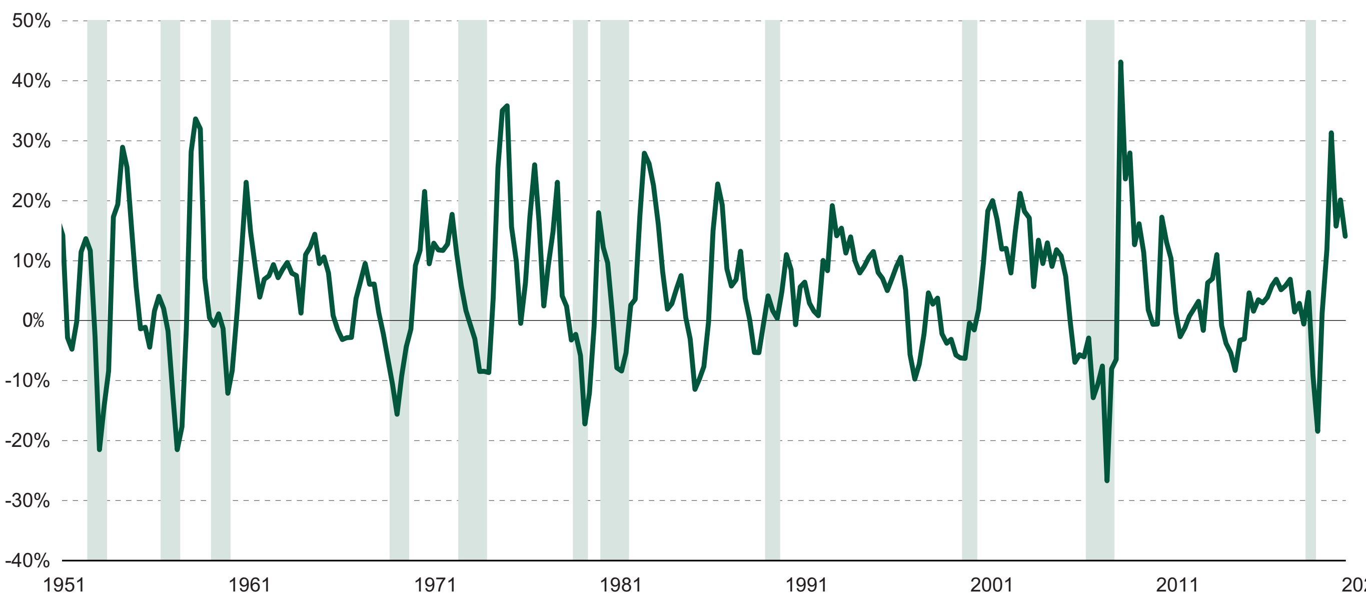
of the companies that discussed cost pressures during their last three quarterly conference calls said that they were able to pass them along or offset them in some other way. This helps underscore our assertion from our previous letter that the largest U.S. public companies are basically oligopolies, as most industries are now dominated by a few big firms that enjoy substantial market share, high barriers to entry, and very little competition. This construct gives companies the ability to raise prices without much risk of losing business to a competitor. Therefore, we believe that as long as the post-pandemic recovery is not stifled by higher interest rates, revenue and earnings growth should follow — providing support for equity prices. Furthermore, it is important to note that there has never been a recession when corporate profit growth is positive (as demonstrated in the chart below which shows the year-over-year percentage change in U.S. corporate profits, displayed by the green line, as well as recessions which are represented by the light green shaded areas).

US Corporate Profit Growth

(YoY change)



Source: St. Louis Fed as of December 31, 2021

OPPORTUNITIES IN FIXED INCOME

It was a very difficult start of the year for bonds, including U.S. government bonds, which posted their worst quarterly performance since 1973. For the past few quarters we have had the opinion that bond investors are not being properly compensated for taking any risk in fixed income due to the historically low levels of interest rates. However, given the recent weakness in bond prices it may be beneficial to increase the duration within fixed income allocations with high quality long-term U.S. government bonds where appropriate. As of March 31st the market is expecting the Fed to raise the Fed Funds rate by an additional 2.25% over the next 11 months. As we outlined earlier, the Fed is in a precarious position, and we don't think they can allow rates to increase that much. Our hope is for a quick resolution to the events in the Ukraine, allowing some of the inflationary pressures to subside so the Fed can engineer a soft landing by raising rates only a few more times. If that occurs, interest rate expectations should recalibrate lower and bonds should react positively. Alternatively, if the Fed is forced to continue to raise rates and causes a recession, the Fed would likely need to re-start quantitative easing, which should force rates lower and bond prices higher.

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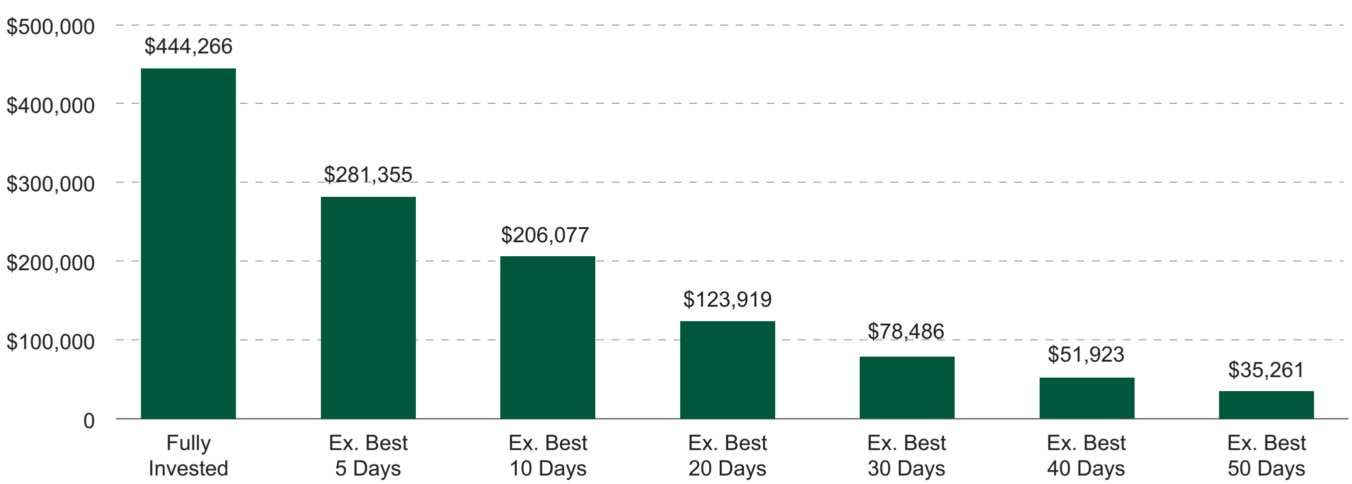
PERSEVERANCE

Markets are facing the most uncertainty since the start of the COVID-19 pandemic, as the implications from the war in Ukraine complicates the course of Fed policy. Until there is more clarity on a resolution between Russia and Ukraine, we expect to see increased levels of volatility across all asset classes. In addition, we would expect to see an increase in volatility due to diminishing levels of liquidity. Along with raising interest rates, the Fed has indicated that it will reduce the size of its balance sheet. The amount of securities the Fed holds on its balance sheet has risen significantly as they implemented quantitative easing programs in order to provide liquidity to markets in the aftermath of both the Global Financial Crisis of 2008 and the recent pandemic. By reducing the size of their balance sheet, the Fed is effectively removing liquidity from financial markets. This will likely impact how well security prices can absorb a given change relative to their fundamental value. In other words, the reduction in liquidity may lead to wild swings in the prices of securities and contribute to excessive market gyrations. How investors respond to volatility is key to achieving beneficial long-term results. One of the most important things to do is not panic. Many investors tend to panic, fueled by the fear-mongering of the media, which compels them to make short-term decisions that can rob them of their desired long-term outcomes. The best solution is to create a plan that can weather bouts of volatility through economic and market cycles. Nobody can plan for the timing, magnitude, and cause of market corrections, but history shows they occur regularly. Since 1928, the S&P 500 has corrected at least 10% about once every 19 months, while a decline of 20% or more (also classified as a bear market) has occurred every 7 years or so. Therefore, it is prudent to create a plan with an asset allocation that can withstand these types of declines, because trying to accurately time the market is an unrealistic goal (since we cannot predict when economic or market cycles start or end). In fact, history has shown that missing only a few days of positive returns may lead to under-performance over time. A study, courtesy of mutual fund firm Baron Capital, revealed that over the past four market cycles (from August 1982 through March 2020), missing the best five days of performance in the S&P 500 would have resulted in a 36.7% lower value of a hypothetical $10,000 investment, and missing the best 10 days would have resulted in a 53.6% lower value (see the following chart). Of course, the reverse is also true. If you are not invested in the stock market, you also miss the worst days. However, big down days are often closely followed by big up days, and those investors who panic by selling on the down days are likely to miss out on the ensuing up days. While it can be tempting to sell investments during periods of volatility, the best defense is to have a well-executed and diversified, long-term financial plan with an asset allocation based on your financial position, risk tolerance, and investment timeline.

We thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate these financial markets.

Best wishes and happy spring!

Growth of $10,000 Hypothetically Invested in the S&P 500 Index



Source: Factset, Baron Capital; See disclosures for additional notes

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Additional notes from Yield Curve Inversions and Ensuing Stock Performance Table: S&P 500 Returns are price returns and do not include the re-investment of dividends

Definitions:

S&P 500® Index is a registered trademark of Standard & Poor's Financial Services LLC, a division of S&P Global ("S&P"). S&P 500 Index is an unmanaged index used as a measurement of change in U.S. equity markets. Performance numbers for the index are total return with dividends reinvested in the index.

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The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are not managed and do not incur fees or expenses. Performance numbers for the index are total return with dividends reinvested in the index.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Performance numbers for the index are total return with dividends reinvested in the index.

The Bloomberg Barclays US Aggregate Bond Index provides a measure of the total return performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corporate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the United States.

Quantitative easing (QE) is defined as large scale purchases of securities, typically fixed income, by a monetary authority such as the Federal Reserve. In theory, the result is an increase in demand for those securities, putting upward pressure on their prices and pushing yields down. Quantitative easing allows a monetary authority the ability to influence longer duration securities, while traditional monetary tools can only directly influence shorter duration securities.

The Consumer Price Index (CPI) is issued by the U.S. Bureau of Labor Statistics and is a measure of the average change over time in the prices paid by urban consumers for a market basket of consumer goods and services. Indexes are available for the U.S. and various geographic areas.

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