Quarterly Update – March 31, 2022

A resurgence of market volatility spread across both the stock and bond markets in 2022. A number of events such as rising interest rates, persistent inflation, spiking oil prices, and to a lesser extent the lingering impact of COVID have investors concerned. Many areas of the financial markets have pulled back in response to investors reducing risk in portfolios. In addition, the Federal Reserve raised the short term rates by 0.25% while signaling more rate increases were on the way.

In the 1st quarter, most of the major asset classes were in negative territory. Both US and international stocks have fallen about –5% to –7% as bonds also dipped. Often the bond market will rally when stocks struggle, but that has not been the case so far this year. Interest rates continue to rise which forced the Barclay's Aggregate Bond Index to fall –5.93%. This is just the 19th time since 1976 that the US market has had a negative quarterly return from both stocks and bonds. [1] The only major asset class posting a positive return was dividend paying stocks as the Dow Jones Dividend Index posted a gain of 5.27%.

Here are the returns of the major asset classes in 2022:

Asset Class	Index	1st Q	Year to Date	1yr	3yr*	5yr*
US Large Cap Stocks	S&P500	-4.60%	-4.60%	15.65%	18.91%	15.98%
US Mid Cap Stocks	Russell Midcap	-5.68%	-5.68%	6.92%	14.88%	12.61%
US Small Cap Stocks	Russell 2000	-7.53%	-7.53%	-5.79%	11.73%	9.74%
Dow Jones Industrial Avg	DJIA	-4.10%	-4.10%	7.11%	12.56%	13.39%
US Dividend Paying Stocks	DJ Select Dividend	5.27%	5.27%	16.30%	13.75%	11.30%
NASDAQ	NASDAQ	-9.10%	-9.10%	7.35%	22.51%	19.18%
Int'l Developed Mkt Stocks	MSCI EAFE	-5.91%	-5.91%	1.16%	7.78%	6.71%
Int'l Emerging Mkt Stocks	MSCI EM	-6.97%	-6.97%	-11.37%	4.93%	5.97%
US Bonds	Bar Aggregate Bond	-5.93%	-5.93%	-4.15%	1.69%	2.14% [2]

* return is annualized

Dividend paying stocks outperformed in the 1st quarter as investors continued to reallocate equity exposure towards companies that offer compelling shareholder yield (pay a dividend or buy back shares). In addition, investors also favored commodity companies as they benefited significantly from the spike in inflation. The commodity boom appears to be driven by a combination of supply chain issues, overspending during the COVID response, US energy policy, and the oil price shock from the Russia/Ukraine war. The Bloomberg Commodity Index which includes oil, natural gas, gold, silver, grains, industrial metals and livestock was up 25.55% in the quarter.[3] We expect this growth trend in commodities to continue throughout 2022, but we anticipate it will moderate later in the year if inflation subsides.

[1] Source: Strategas, "Daily Macro Brief: Negative Return Quarters For Both Atocks & Bonds Are Rare" April 7, 2022 p. 1
[2] Source: Raymond James Client Center Reporting
[3] Source: Bloomberg.com, "Bloomberg Commodity Index 2022 Target Weights"

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As we move into the Spring, we would love nothing more than to be able to tell you that we think the market has signaled an "all clear" sign and we have smooth sailing ahead. However, the headwinds for the economy and the market are starting to mount and we think volatility continues throughout the summer. We are becoming increasingly cautious in the short term while looking for buying opportunities in stocks that have already pulled back significantly. Here are a few recent headlines:

US economy flashes a recession warning sign

Are odds of recession increasing from oil prices, Russian invasion?

US barreling toward recession, experts say, as inflation hits 40-year-high

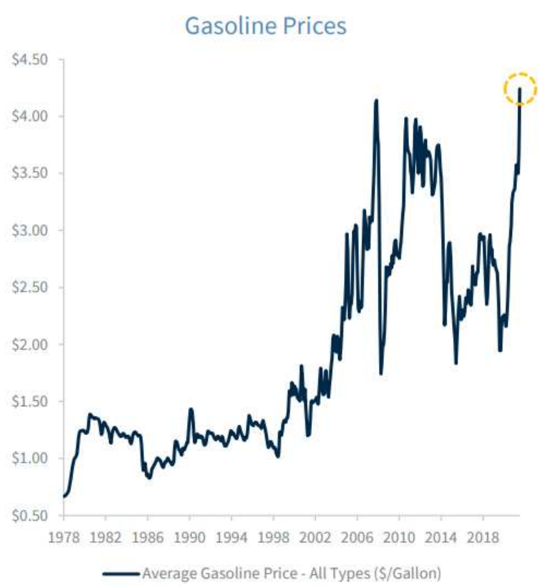
Chance of recession in the U.S. now 'well above average' as gas prices rise

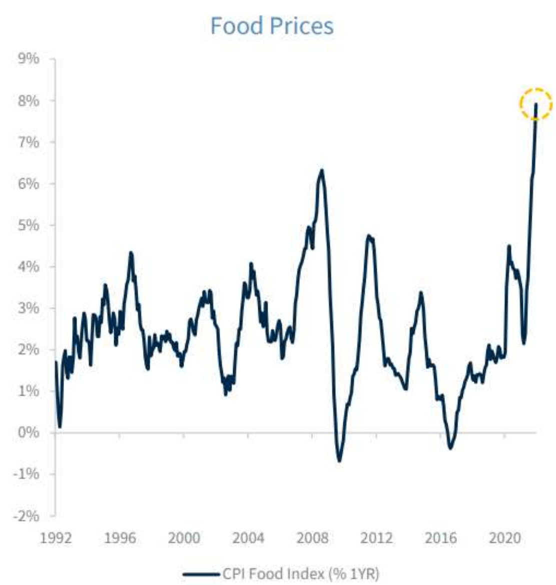
Recession Risks Are Piling Up And Investors Need to Get Ready

Fed's Best Hope Increasingly Looks Like a 'Semi-Hard' Landing

A Recession Warning Sign? Part of U.S. Yield Curve Inverts for First Time Since 2006 [4]

Some of the major headwinds for the economy are rising inflation, rate hikes from the FED, slow supply chain, and the always evolving macro worries (such as Russia/Ukraine, immigration crisis, and uneasy relations with China). Rising inflation is an immediate tax on consumers as we all immediately feel the price hikes at the gas pump and the grocery store. We are tracking price spikes across the spectrum of the economy from copper to the cost of bacon. We are concerned about the consumer's ability to continue to absorb these price increases.





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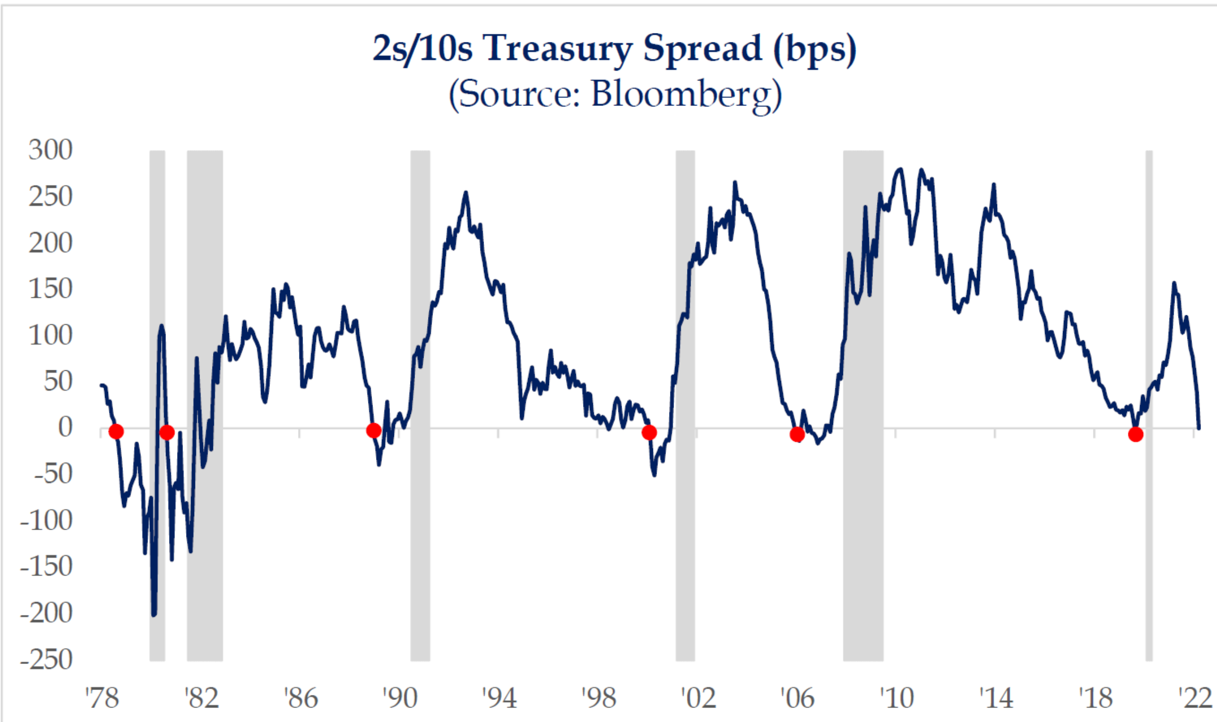
[3] Source: Raymond James, "Quarterly Coordinates" p. 9
[4] Source: Raymond James, "Quarterly Coordinates" p. 18

The Federal Reserve raised short term rates by 0.25% in March. Because many economists believe the FED is still far from making an impact on inflation, they expect the FED to raise rates again in May and June as they also possibly reduce their balance sheet. The market reaction to the FED has caused an inversion in the 2yr/10yr yield curve, which means short rates are higher than long rates. Historically this inversion has been a signal that recession risks are rising. The chart below shows that since 1978, the yield curve typically inverts about a year prior to the next recession.



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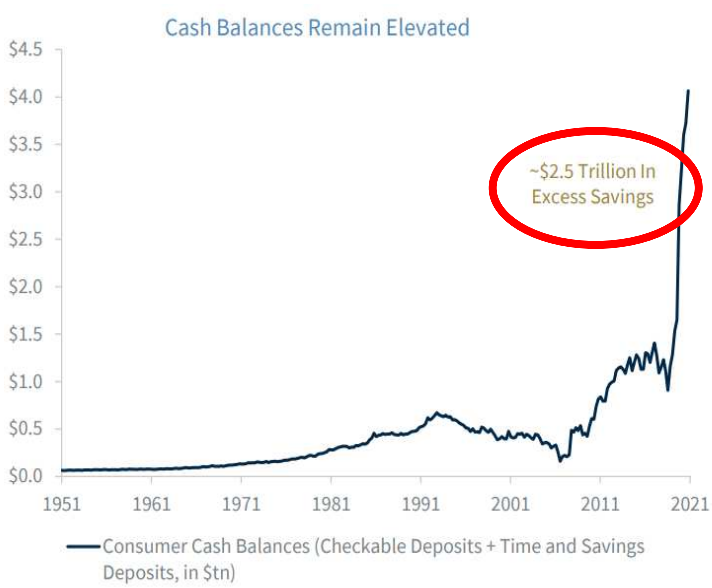
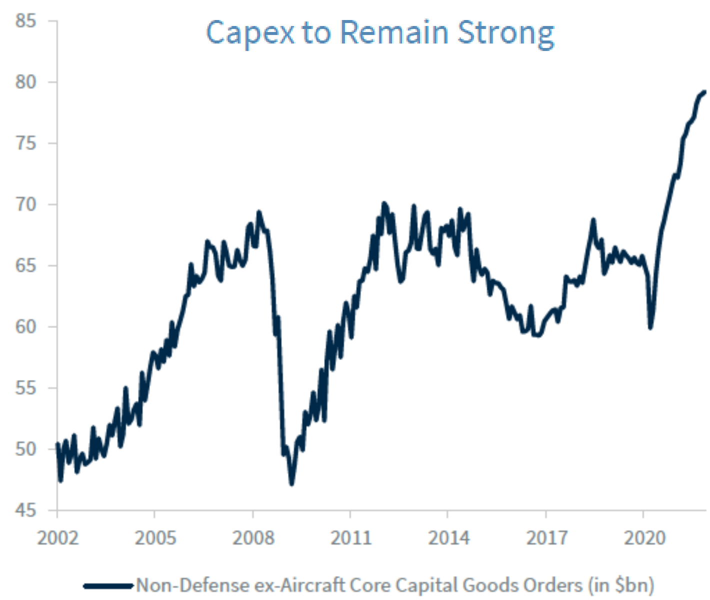
Today the main questions regarding the FED are how much and how fast should they raise rates in order to fight inflation. Again they raised rates last month for the first time since 2015, while signaling to the market that there are more rate hikes to come over the summer months. We are starting to wonder if the FED can effectively raise rates to slow inflation but not go too far and kill the growth drivers of the economy causing a recession. There is an old saying that goes something like this, "bull markets don't die of old age, they are usually killed by the FED." Which means they usually wait too long to start raising rates and then go too far. We will watch employment numbers, inflation readings, and some economic leading indicators very closely over the coming months to stay aware of the recession risks.

With all these concerns surrounding us, we still have to consider the possibility we may avoid a recession and experience a "mid-cycle" slowdown that leads to growth reaccelerating in 2023. Corporate revenue growth is strong, the job market is still robust for consumers, both consumers and

[6] Source: Strategas, "Quarterly Review in Charts" p. 12

corporations have plenty of cash, COVID issues in the US have subsided (even though China is still locking down), and capital spending is improving. Here is a current snapshot showing the extraordinary amount of cash currently in the hands of consumers. In addition, we believe that capital spending may continue as companies reinvest in their future growth and reinvest in manufacturing capabilities. The average age of the current manufacturing capital stock is the oldest in the US since World War II. [7] Capex spending may be strong enough to offset the impact of a slowing consumer in the coming months.





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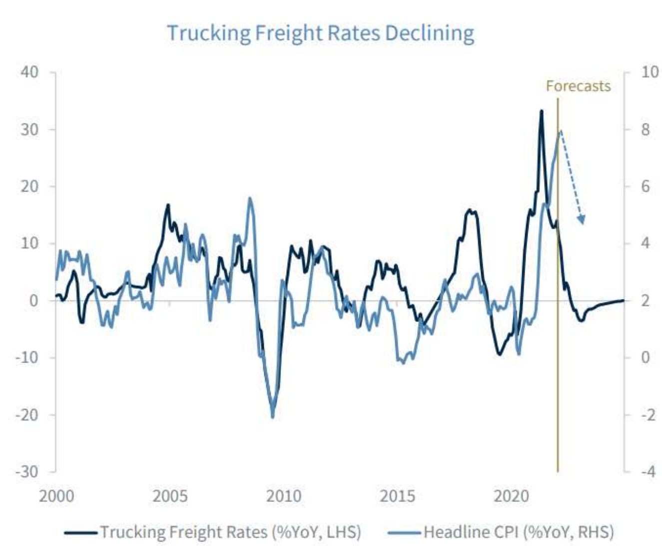
As much as we worry about the impact of inflation on most consumers, we think there is a chance that inflation may peak this summer and start to subside by the fall. We come to that conclusion by looking at data points starting to normalize for items such as lumber cost, inventory levels, delivery times, global shipping container rates, and trucking freight delivery rates.

Here is a chart of US trucking rates relative to US CPI (a gauge for inflation). You can see there is a pretty strong correlation between trucking rates and CPI over the last 20 years. Trucking rates are showing signs of improvement which leads to the expectation that we may see inflation start to improve as well.



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[7] Source: Raymond James, "Quarterly Coordinates" p. 12
[8] Source: Raymond James, "Quarterly Coordinates" p. 12, 15
[9] Source: Raymond James, "Quarterly Coordinates" p. 20

In conclusion, there are a number of mixed signals in the market right now and we are watching for signs of both deterioration and improvement. Generally, we still believe investors will be well served by reducing any significant overweight allocation to stocks as we could be in a volatile environment for the remainder of the year. We also want to point out that the yields on bonds are actually starting to look interesting again. Over the last few years we have recommended most investors stay slightly under-allocated to bonds because of low yields and the outlook for rising rates. However, since rates have moved up significantly over the last 12 months, we are starting to see compelling yields on corporate and municipal bonds trading in the 2yr to 7yr range.

We also still like dividend paying stocks and many areas typically considered to be alternative investments. We think market neutral funds, long/short equity, hedge funds, inflation focused funds, and absolute return focused fixed income funds continue to make a compelling investment case. Dividend payers seem to be garnering most investors attention at this point, but we continue to recommend a balance between growth stocks and value stocks. Value is outperforming today, but we could see a resurgence in beaten up growth stocks if we get inflation under control this year.

Good luck to everyone throughout 2022 and Thank You for the trust you place in our team.

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