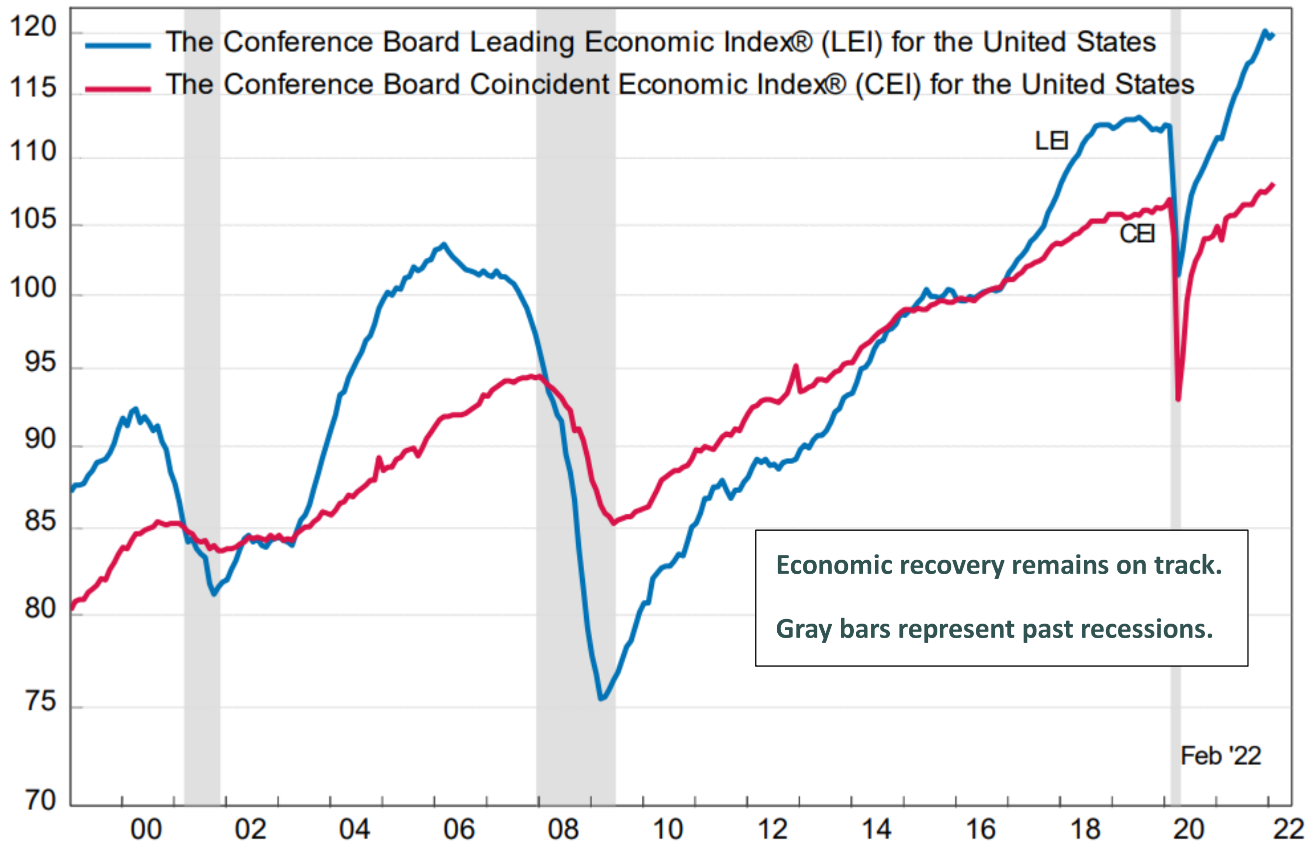
Monthly Investment Update

April 2022

Since our last monthly update, it's fair to state that the Russia / Ukraine war and resulting energy and commodity price increases have clouded the outlook for US and global economic growth. These increases in prices occur at the same time that inflation has already been running at multi-decade highs, potentially forcing the US Federal Reserve to raise interest rates faster than they might have intended just a few months ago. However, despite all of these reasons for caution, many risk assets recovered during the month, including large US companies as represented by the S&P 500 index which advanced nearly 4% in March.

To chart the path of future economic growth, we use leading economic indicators (amongst other data). The series in the chart below denoted by the blue line represents a composite of leading economic indicators (LEI), which includes components of the economy such as the labor market, manufacturing, credit conditions, home building, and consumer sentiment. The series, which has been in a sharp uptrend since early 2020 has begun to show some signs of degradation. In the balance of this letter, we will dissect these indictors and analyze their health. In summary, the economic recovery remains on track, driven primarily by a robust labor market and financially healthy households (on average, relative to history). We anticipate that the pace of economic growth will slow relative to earlier periods of the pandemic recovery and relative to expectations prior to the Russia / Ukraine war, but we do not anticipate a US recession in the next year.



Implications for Portfolio Management

The core of our investment thesis is that human progress will continue in spite of unending obstacles. The core tenants of capitalism provide an ecosystem for intelligent, innovative individuals and companies to create goods and services that will add value, which will drive profit. Investors in these enterprises will experience volatility along the way, but ultimately be rewarded with returns that will outpace inflation and create value over time. While we feel confident in our base case assumption that a US recession is not likely in the near future, the events of the last few years have served to remind all of us that the future is anything but fully predictable.

That said, we advocate for investors to remain focused on their long-term investment strategy and not be overly reactionary to current events. This does not mean that portfolios should or do remain static. Beneath the surface, we continually seek opportunities to purchase good companies at attractive prices relative to their long-term potential to compound value for shareholders. In fact, the events of the past several months have, in our opinion, created many unique opportunities and you may see increased activity in your portfolios as we seek out those opportunities. Of course, the possibility of unexpected events that drag us into a recession or bear market are always present (admittedly, more likely today than normal), which is why we recommend that portfolios remain diversified with levels of risk not meaningfully above long-term target levels.

Risk-Taking Score Subcomponents

Economy
- Labor
- Earnings
- Sentiment
- Inflation
- Financial Conditions

Valuations
- Equity
- Credit

Technical
- Trend
- Sentiment

- Leading Economic Indicators continue to imply growth in 2022, but commodity price spike resulting from Russia / Ukraine conflict may have a material adverse impact on household & business sentiment.
- On the surface, equity and credit valuations appear fair. Beneath the surface, a very high level of dispersion of valuation exists across sectors, industries, and companies today, presenting opportunity for active portfolio managers.
- Long-term technical trends still favor holding risk assets, particularly commodities. Investor sentiment has declined, but only briefly has extreme bearishness been exhibited (a hallmark of a market bottom).

Economy

The Leading Economic Indicator Series is comprised of the following ten components[1]:

Labor

1. Average weekly initial claims for unemployment insurance

Manufacturing

2. Average weekly manufacturing hours worked
3. Manufacturers' new orders, consumer goods and materials
4. Manufacturers' new orders, non-defense capital goods (excluding aircraft)
5. ISM Manufacturing New Order Index

Housing

6. Building permits, new private housing units

Interest Rates, Credit, & Stocks

7. Interest rate spread, 10-year Treasury bonds less federal funds
8. Leading Credit Index
9. Stock prices, 500 common stocks

Sentiment

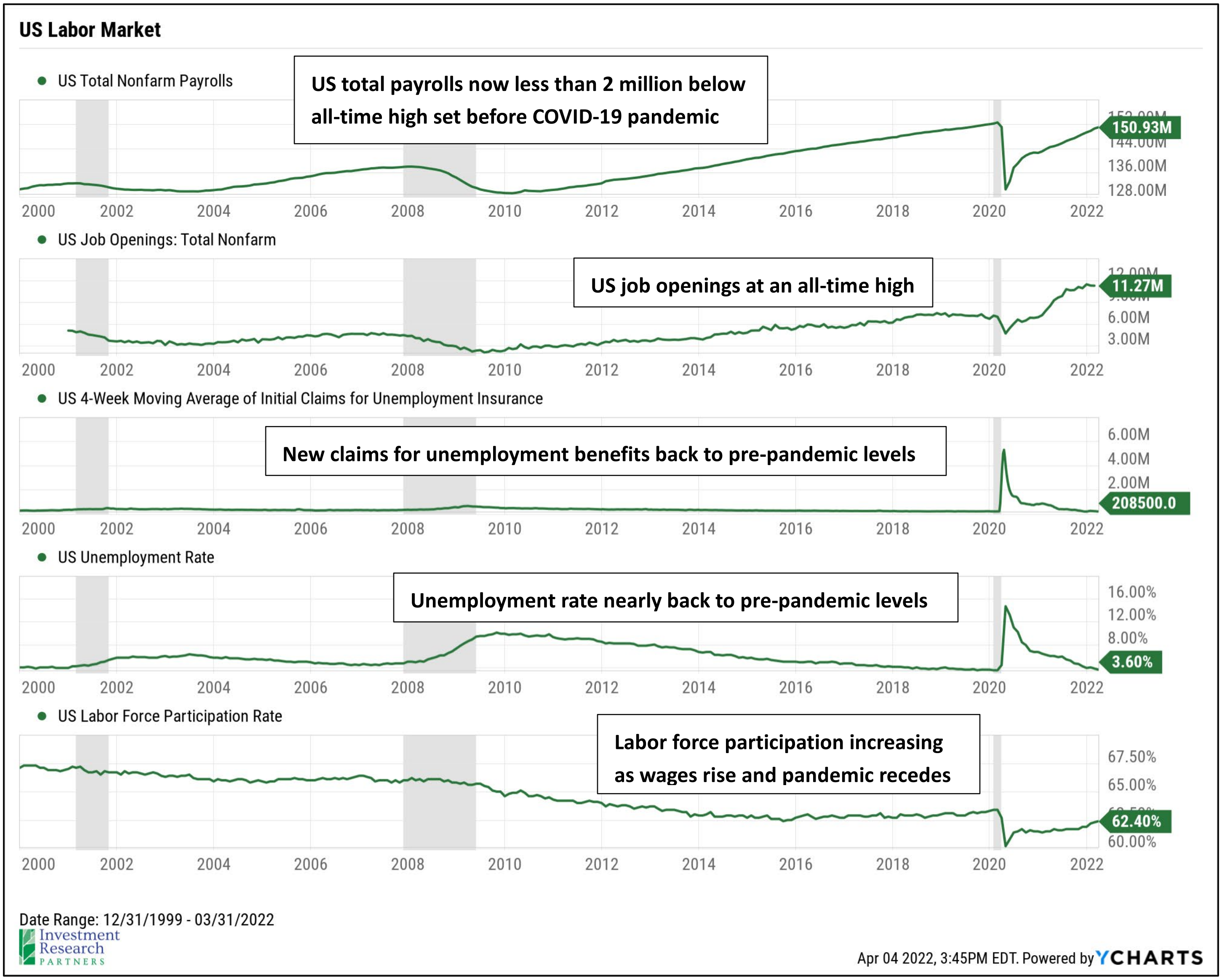
10. Average consumer expectations for business and economic conditions

In addition to these metrics, there are multiple other considerations that influence our outlook of economic health, which we will walk through below. Most elements of the LEI remain healthy and in growth mode, though inflation and household sentiment are our primary causes for concern.

[1] https://www.conference-board.org/data/bci/index.cfm?id=2160

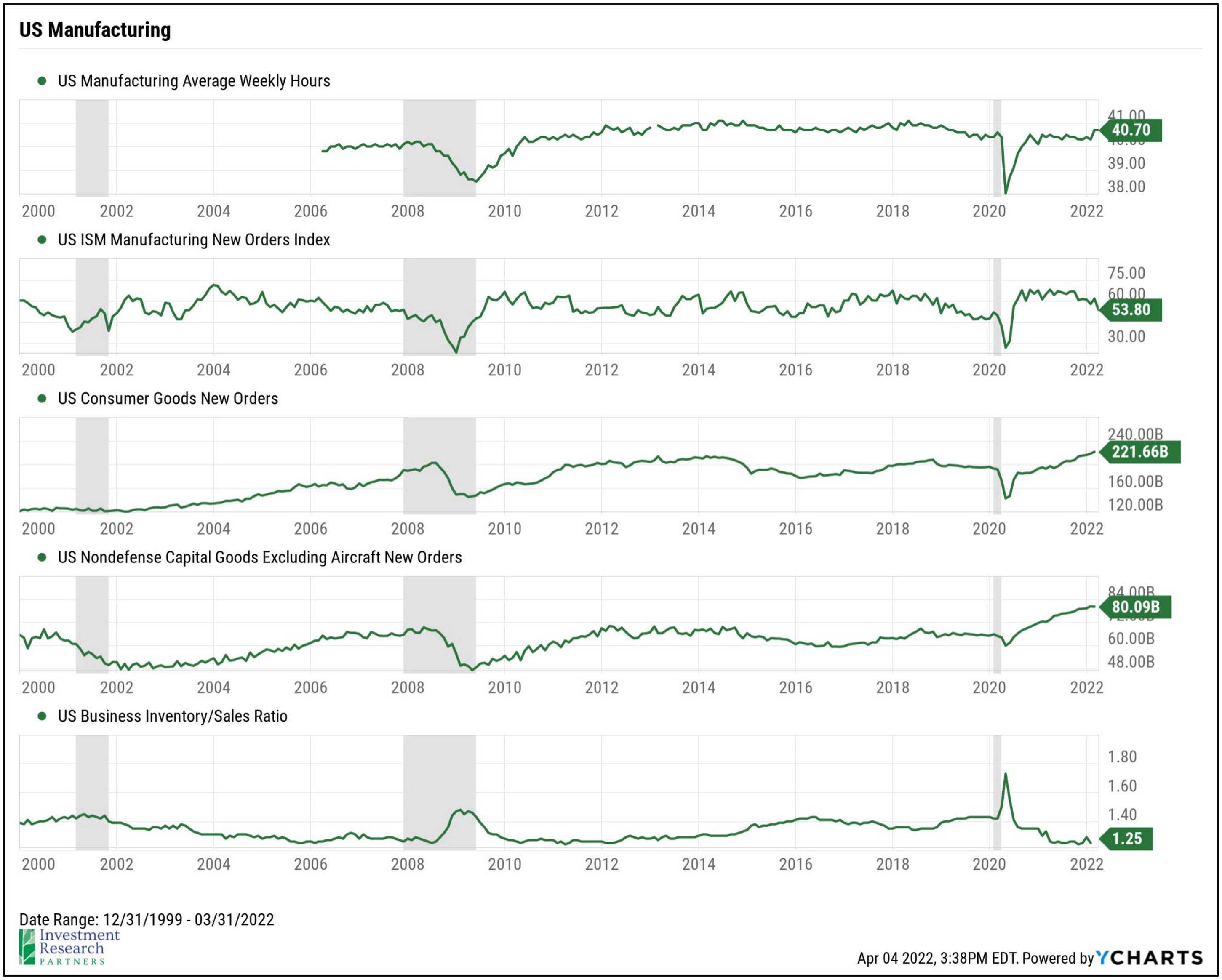
US Labor Market

The Bureau of Labor Statistics announced that the US economy added 431,000 jobs in March and the unemployment rate declined to 3.6%. The gains were led by the leisure and hospitality industries (112,000 jobs added), which is not surprising given the significant decline in new COVID-19 cases and the anticipation of warmer weather in the US. The labor market remains very healthy and within striking distance of the all-time high in US total payrolls witnessed just before the onset of the COVID-19 pandemic. Additionally, the number of job openings is solidly at record levels. However, absent a significant increase in immigration or labor force participation, it will be difficult for the labor market to further improve without leading to meaningful labor cost inflation and the potential to erode corporate profitability.



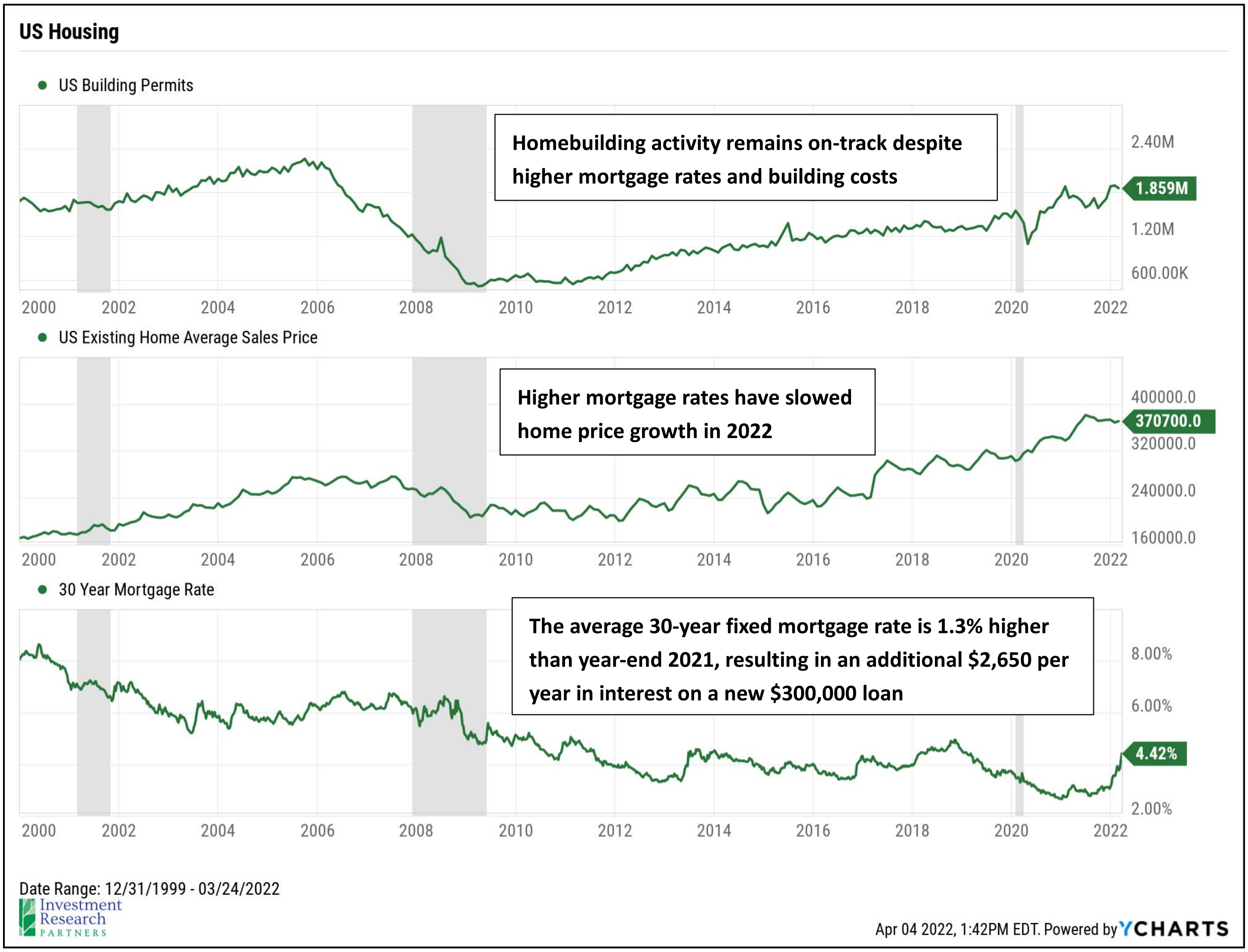
Manufacturing

US Manufacturing activity remains healthy, and end market demand for goods is strong as well. Average hours worked per week is above 40, and consumer and durable goods orders continue to rise. Inventories are being quickly sold, implying healthy end demand.



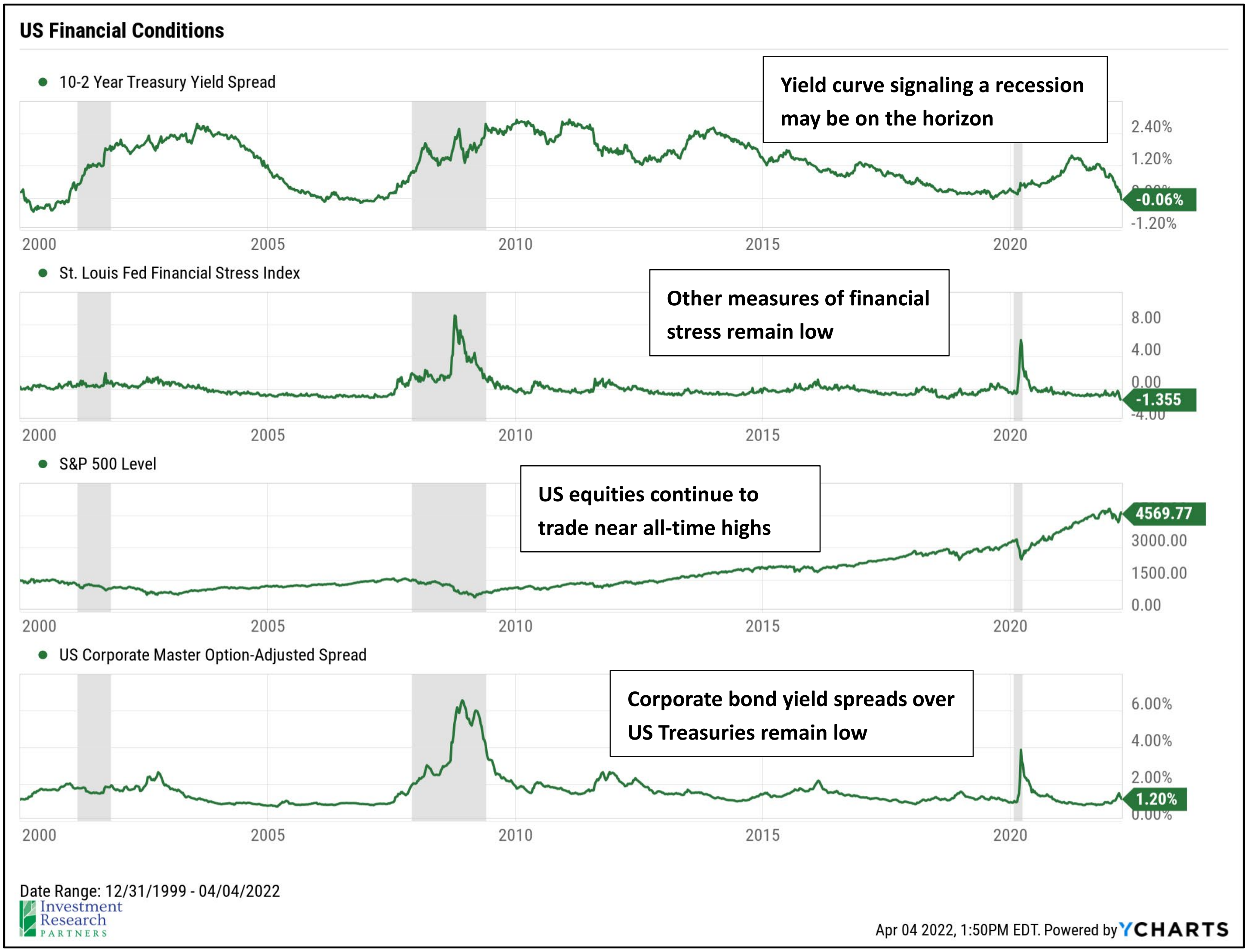
Housing

Demand for housing remains robust in the US. Mortgage rates have increased significantly in the last 3-6 months, which has led to a dampening effect on home price growth. However, this may be healthy for the housing market as ultra-low interest rates seemed to have been driving up home prices at an unsustainable pace and pushing many prospective buyers out of the market. Relative to the end of 2021, a new 30-year fixed mortgage costs 4.4% versus 3.1%. On a $300,000 loan, this equates to an additional $2,650 per year in interest cost, which is meaningful for the average household, so it's not surprising that home prices have moderated.



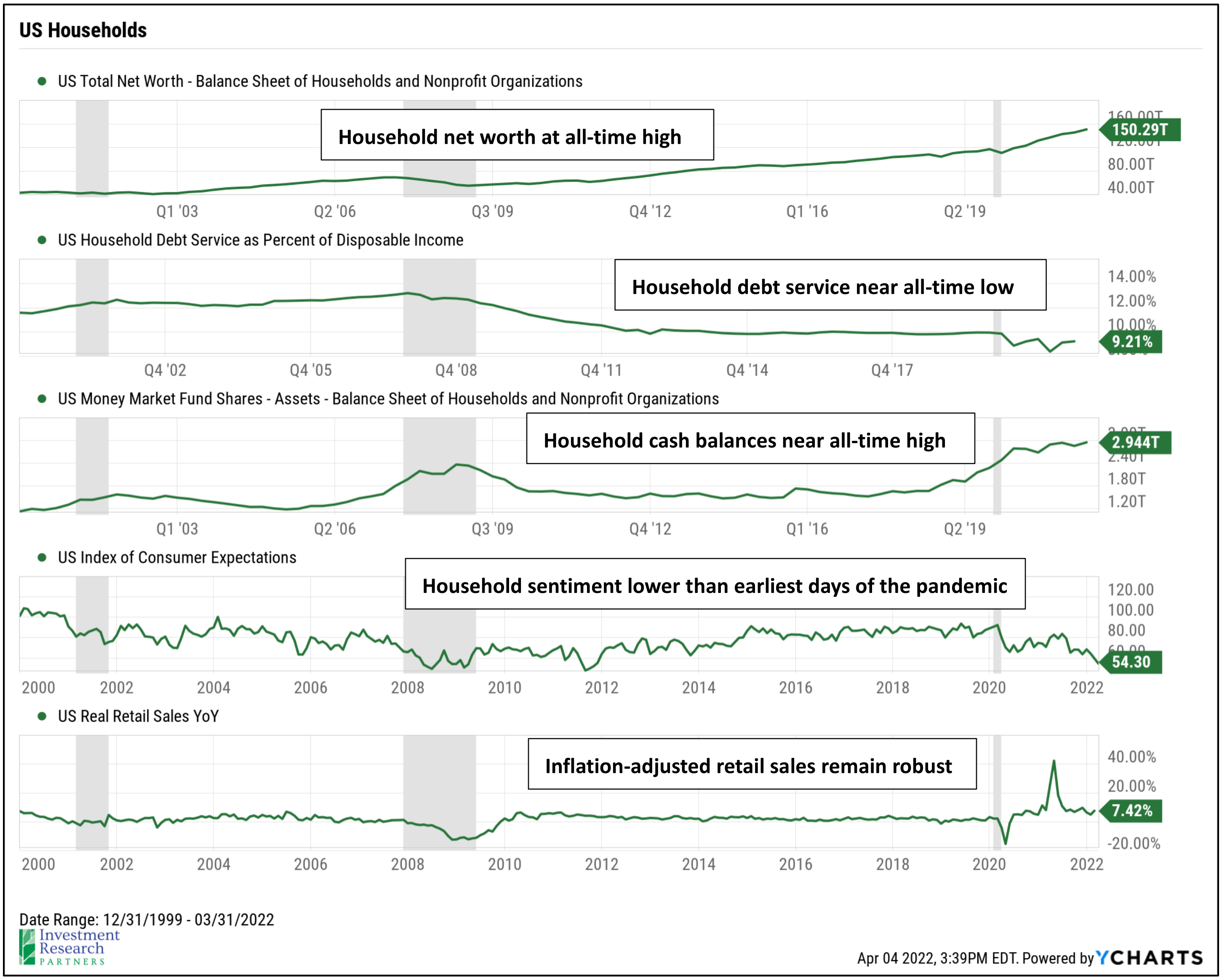
US Financial Conditions

Much attention has been paid this past month to the "inversion of the yield curve" which has historically signaled an impending recession. An inversion refers to the phenomena whereby longer-term US Treasury security interest rates fall below shorter-term ones, most commonly measured by the interest rate of 10-year Treasury bonds minus the interest rate of 2-year Treasury notes. When investors have concerns about longer-term economic prospects, they often sell stocks and favor the perceived safety of longer-term US Treasury bonds, serving to bid up their prices and drive down their yields. In many cases, this occurs simultaneously as the US Federal Reserve is on a path toward raising interest rates in order to maintain price stability in the economy (rein in inflation), thus supporting shorter-term yields. The 10-2 yield spread did invert last month, but so far concerns about slowing economic growth have not been confirmed by equities, credit or other measures of financial stress.



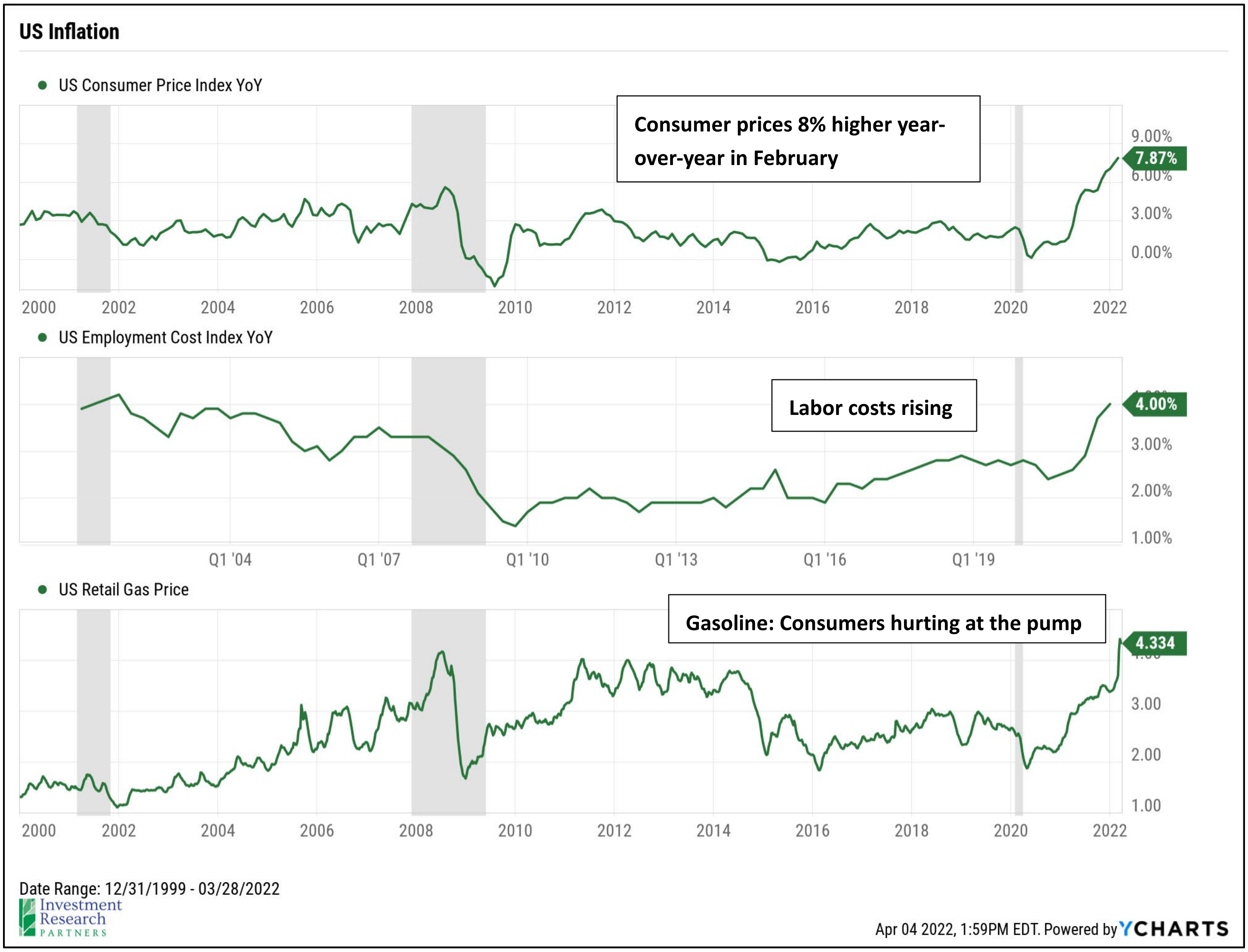
Households

US Households, on average, remain in a healthy financial position, thanks in part to years of stimulus payments and low interest rates that allowed many to refinance their mortgages. High home and stock prices have also led to an all-time high in household net worth which could continue to propel economic growth as the "wealth effect" leads to increased confidence and spending. However, when surveyed about expectations for their future financial condition and the future of the US economy, households, on average, appear relatively pessimistic, which is reason for caution. When asked, one of the most commonly cited reasons for this concern is inflation and its potential to erode living standards and prosperity. It will be important to track inflation-adjusted household spending in 2022 to determine if rising prices begin to force consumers to pare back their spending which would dampen economic growth.



Inflation

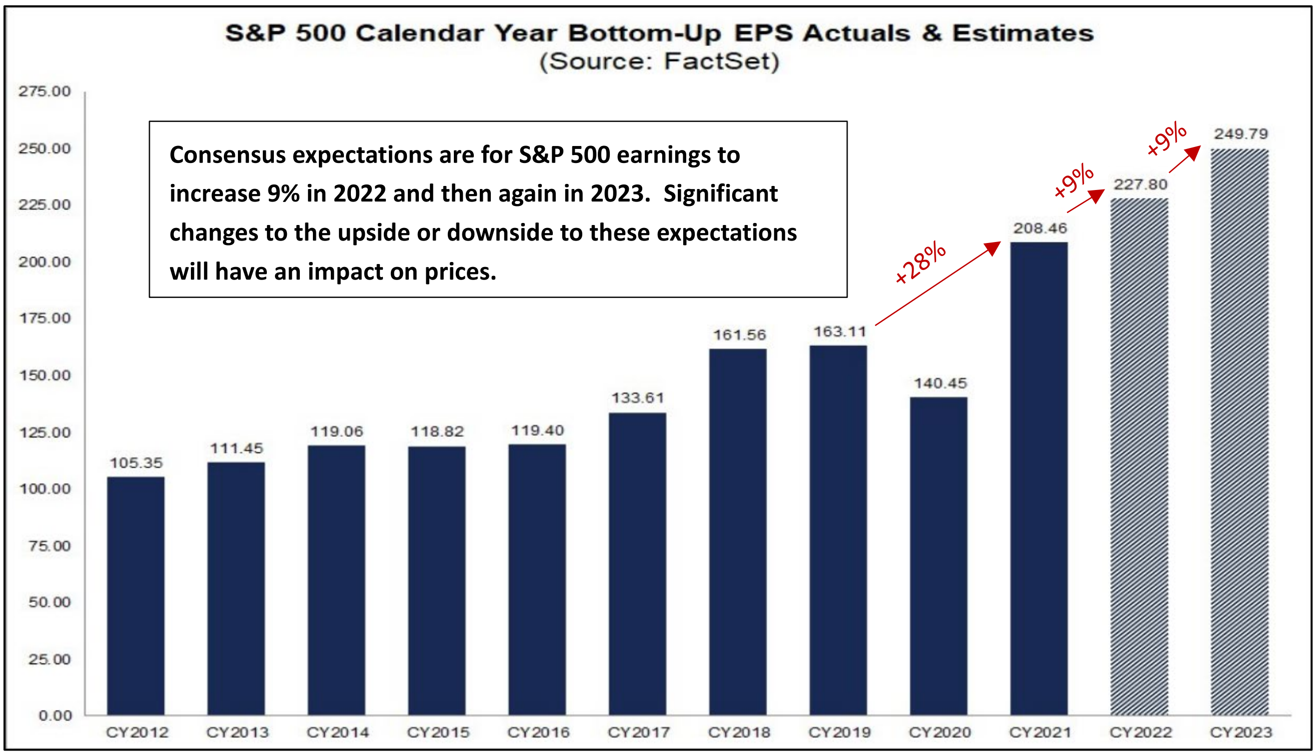
Rising prices were already a key concern for investors, economists, and Central Bankers before the war in Ukraine pushed energy and commodity prices significantly higher in the first quarter. Russia is a significant exporter of fossil fuels to the world, particularly to Europe, so the global rebuke of purchasing Russian exports, and thus funding their war efforts, has led to a spike in the prices of oil, natural gas, and gasoline (amongst other things). In response, the White House has announced a plan to tap up to 180 million barrels from the nation's strategic petroleum reserve[2] in an effort to dampen the impact on US households, particularly in the costs of heating their homes and fueling vehicles. Prior to the energy price spike, households, on average, were already citing inflation and declining living standards as key reasons for concern when surveyed. We expect household spending and economic growth to moderate in 2022 relative to earlier pandemic recovery years.



[2] https://www.npr.org/2022/03/31/1089942595/u-s-emergency-oil-stash-strategic-petroleum-reserve-biden-russia-ukraine

US Corporate Earnings

Large US public companies, as measured by the S&P 500 index, increased earnings by 48% in 2021 relative to 2020 and by 28% relative to 2019 (the last full calendar year before the COVID-19 pandemic began to impact economies). A consensus of analysts expect that the index's earnings will rise 9% in 2022 and by another 9% in 2023[3]. It would appear that these corporations were able to navigate the pandemic and resulting supply chain disruptions very well, aided by a robust economic recovery. The next challenge will be inflation and its potential to erode profitability. Large companies like Amazon and Starbucks are witnessing pockets of their labor force successfully push to form unions. Others, like Tesla, have cited the potential need to raise prices to consumers because of rising input costs. In order for companies to meet investor expectations in 2023, the ability to maintain profitability in the face of higher costs of doing business will be paramount.

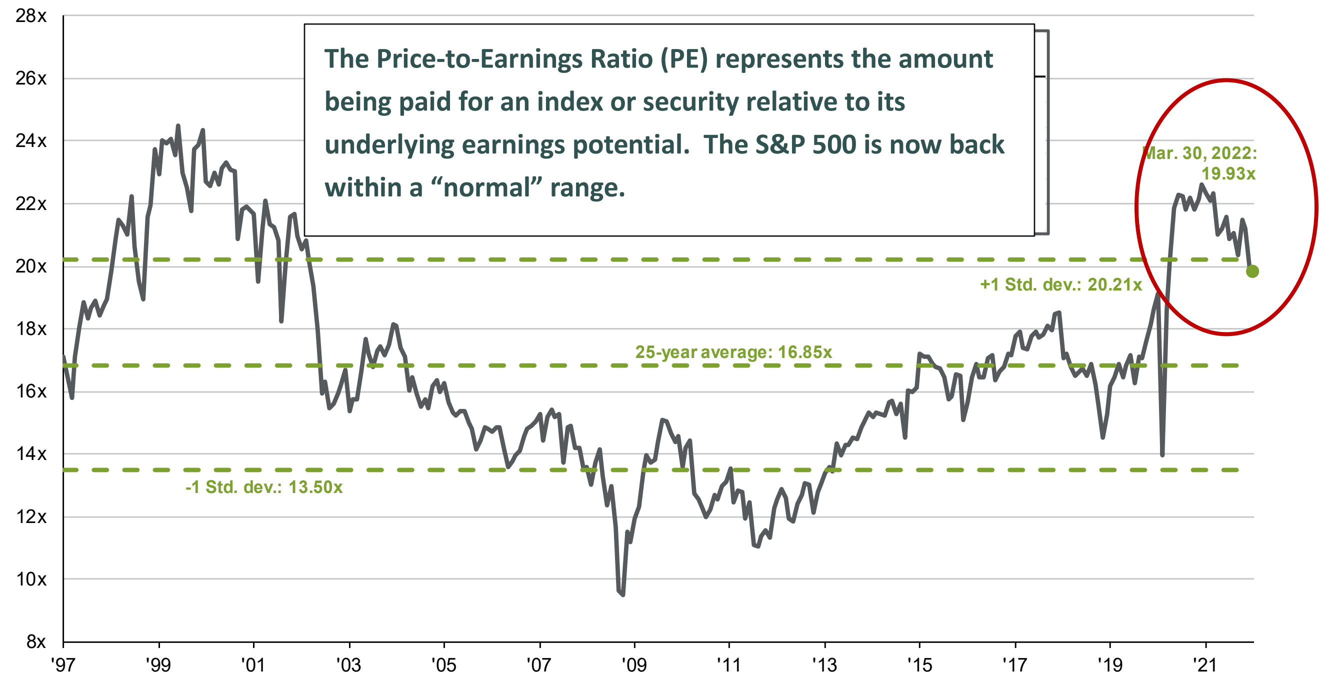


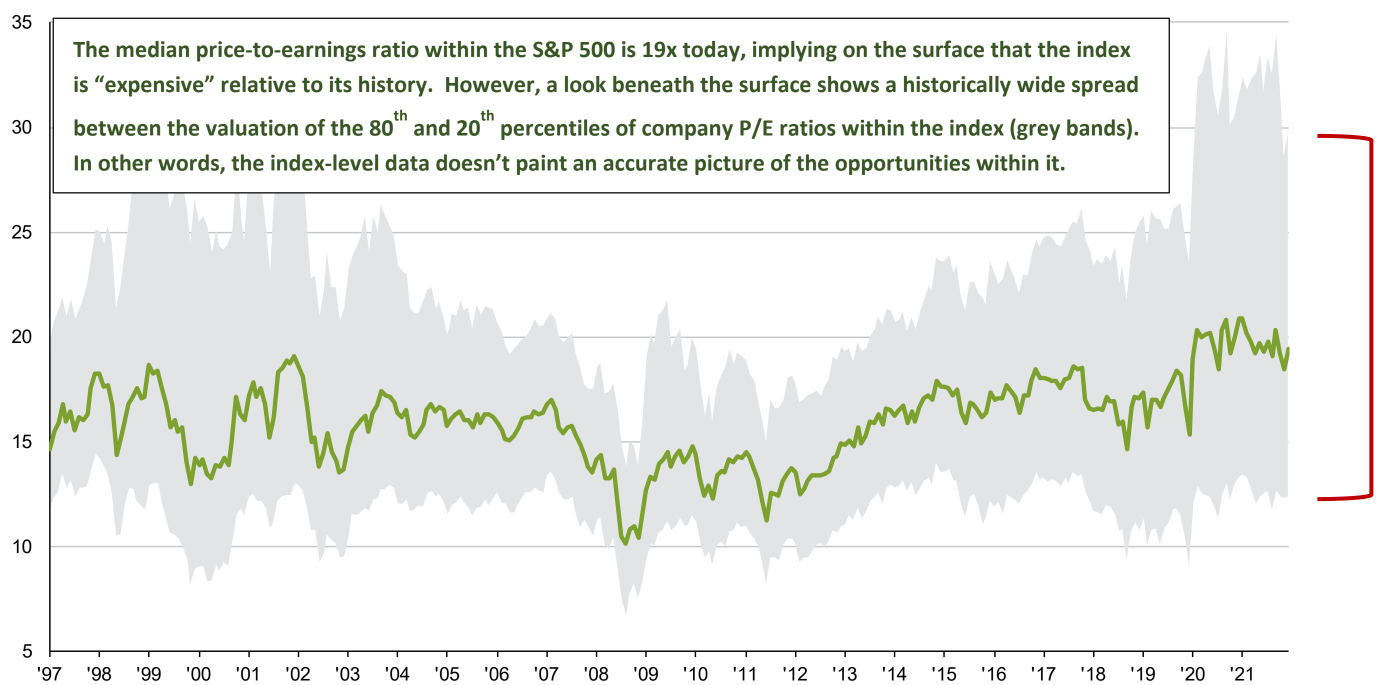
[3] https://advantage.factset.com/hubfs/Website/Resources%20Section/Research%20Desk/Earnings%20Insight/EarningsInsight_040122B.pdf

Valuation

Market declines in 2022 have pushed the valuation of broad stock and bond indices back toward long-term average levels. However, the index had become historically top-heavy in high growth companies such as Tesla and Nvidia. The index itself has become reasonably more attractive relative to a year ago, but we continue find opportunities within sectors, industries, and companies beneath the surface.

S&P 500 Price-to-Expected Earnings





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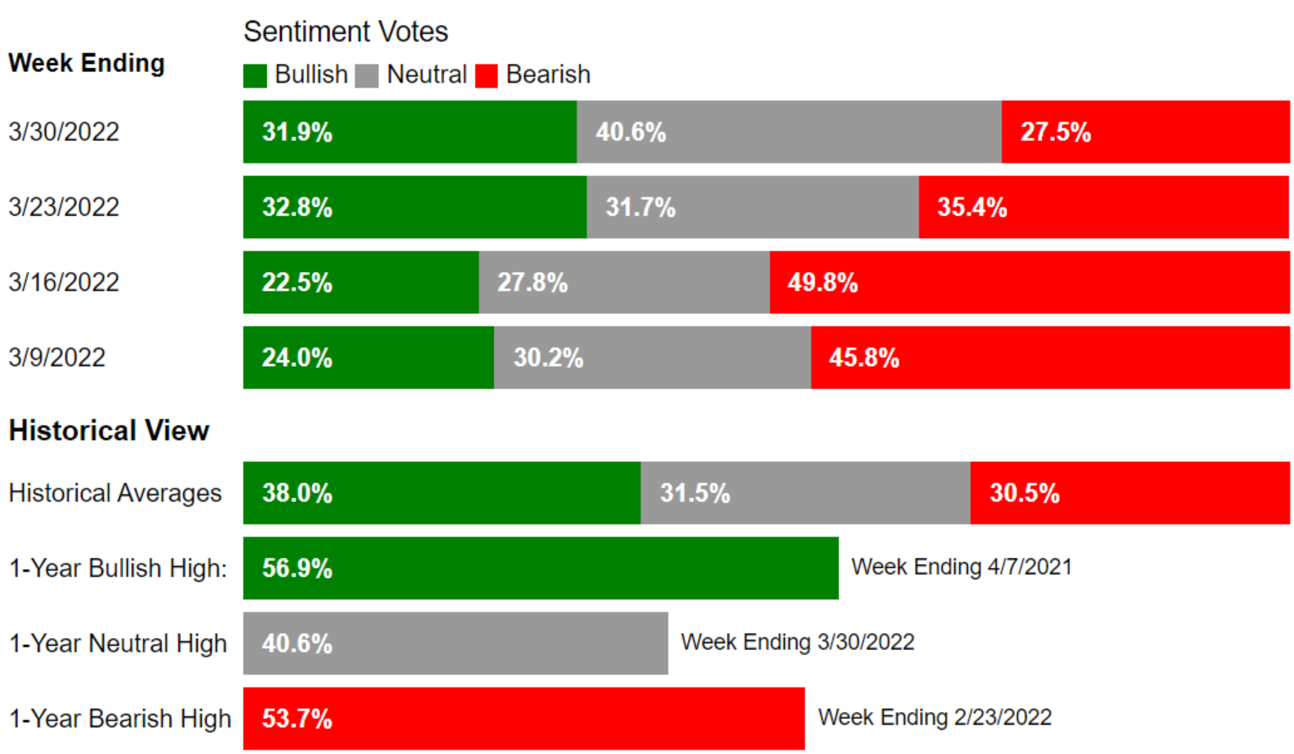
Technical

Our technical analysis of markets involves multiple tools that seek to identify buy / sell signals and trends across various asset classes and securities. In January, many parts of the market that had been in strong upward trends for nearly two years, such as technology stocks, broke down. This breakdown has been further exacerbated by the Russia / Ukraine conflict (with the exception of commodities which are in a very strong uptrend). We are now looking for signs of a "bottoming process", which simply means that selling is no longer overwhelming buying of a particular asset or asset class, and the emergence of a new uptrend.

Since 1987, The American Association of Individual Investors (AAII) has been asking its members the same question every week: "What direction will the stock market move in the next six months?" The results are compiled into three categories: bullish, neutral, and bearish. Extreme bullishness or bearishness have often represented useful contrarian signals for investors (reminiscent of Warren Buffet's famous quote, "be greedy when others are fearful, and fearful when others are greedy"). It is potentially concerning that despite such significant turmoil and upheaval in geopolitics and markets that investors remain fairly neutrally balanced in their view. We typically watch for a washout in investor sentiment in order to help confirm that a market bottom may be forming.



Source: AAII as of April 4, 2022

Prices & Interest Rates

Representative Index	February 2022	Year-End 2021
Crude Oil (US WTI)	$100.28	$75.21
Gold	$1,949	$1,828
US Dollar	98.31	95.97
2 Year Treasury	2.44%	0.73%
10 Year Treasury	2.38%	1.52%
30 Year Treasury	2.44%	1.90%

Source: Morningstar, YCharts, and US Treasury as of March 31, 2022

Asset Class Returns

Category	Representative Index	March 2022	YTD 2022
Global Equity	MSCI All-Country World	2.2%	-5.3%
Global Equity	MSCI All-Country World ESG Leaders	2.4%	-6.3%
US Large Cap Equity	S&P 500	3.7%	-4.6%
US Large Cap Equity	Dow Jones Industrial Average	2.4%	-4.2%
US All Cap Equity	Russell 3000 Growth	3.7%	-9.3%
US All Cap Equity	Russell 3000 Value	2.8%	-0.9%
US Small Cap Equity	Russell 2000	1.2%	-7.5%
Foreign Developed Equity	MSCI EAFE	0.8%	-5.8%
Emerging Market Equity	MSCI Emerging Markets	-2.2%	-6.9%
US Fixed Income	Bloomberg Barclays Municipal Bond	-3.2%	-6.2%
US Fixed Income	Bloomberg Barclays US Agg Bond	-2.8%	-5.9%
Global Fixed Income	Bloomberg Barclays Global Agg. Bond	-3.1%	-6.2%

Source: YCharts as of March 31, 2022