KEY POINTS

As investors entered 2022, the U.S. stock market was coming off back-to-back years of gains of over 20% per year. Since the Covid-lows in March 2020, the S&P 500 had only experienced one 5% correction, which is unusual. Typically, the stock market has a 10% correction roughly once a year and a 15% correction every 15 months. As the year began, the combination of a hawkish Fed pivot toward raising interest rates to cool down persistent inflation and the lack of additional fiscal stimulus pressured equity markets. With that backdrop, Russia's invasion of Ukraine tipped the S&P 500 into a 10% correction, while NASDAQ entered a 20% correction in late February.

The Russian invasion of Ukraine is a human tragedy that will increase short-term market volatility and will lead to long lasting geopolitical repercussions. The Russian invasion will raise inflation over the near term and slow global growth. Russia's economy is only about 2% of the global economy and Russia has limited financial linkages with the rest of the world. However, Russia is a major commodity producer accounting for 10% of global energy production, and over 40% of Europe's energy. Russia is a dominant supplier of natural gas to Europe. In the near term, Russia's action will lead to higher oil and commodity prices causing additional global inflationary pressures and slower global economic growth.

Direct effects on the U.S. economy will be limited as trade links are weak between the U.S. and Russia, and energy prices are likely to be affected less in the U.S. than in Europe. Europe's economy was slowing before the invasion and is more exposed to disruptions of energy supplies and higher natural gas prices. Recession risk will increase in Europe if energy prices surge and remain elevated.

The Russia geopolitical event pushes inflation higher in the short-term and complicates the Federal Reserve's and other central bank's tightening of monetary policy to rein in inflation. Historically, the Fed has delayed major policy changes during geopolitical uncertainty. However, the heightened geopolitical risk will not stop the Fed from hiking interest rates in March, although the increase will likely be 25 bps (0.25%), not 50 bps (0.50%).

Stagflation risks are rising as higher inflation puts additional pressure on global central banks to tighten monetary policy, which will further slow global growth. Financial conditions have tightened across developed economies due to central banks becoming less accommodative. The U.S. economy remains in a strong position as corporate earnings continue to grow, consumer and corporate balance sheets remain strong, savings are high, the labor market is tight and the effects of COVID continue to wane. We expect U.S. and global economic growth to slow in 2022.

Overall, the Russian invasion of Ukraine increases geopolitical uncertainty and volatility that will continue as the situation unfolds. Historically, past geopolitical crises have led to sharp market corrections, which are typically followed by a rebound as events stabilized.

Positioning: Entering 2022, we trimmed our equities overweight to neutral and raised cash and short-term fixed income holdings expecting heightened volatility as the Fed moves to raise interest rates and supply disruptions persist. We prefer balanced positioning and diversification in portfolios with an emphasis on quality and portfolio diversifiers (inflation protection, monetary metals).

ECONOMIC DATA

- Global growth rebounded in 2021 as the economy reopened leading to estimated U.S. growth of 5.6% and global growth of 5.8%. Growth will slow the next two years. For 2022 and 2023, U.S. consensus growth is forecasted to slow to 3.7% and 2.5%, respectively, while global growth is estimated to slow to 4.3% and 3.6%, respectively.
- S&P 500 earnings were $163 (+2%) in 2019, $140 (-14%) in 2020 and an estimated $208 (+48%) in 2021 (+16% revenue growth). Consensus earnings estimates for 2022 are $225 (+9%) with revenue growth of 8.1% (FactSet), indicating slowing growth.
- A new economic cycle began in the third quarter of 2020 after the longest U.S. expansion in postwar history (11 years) ended due to the pandemic.
- Valuations are at 12-year highs. Warren Buffett's favorite valuation measure, the stock market capitalization to GDP ratio, is at historic highs as is Professor Shiller's CAPE ratio.
- The trailing 12-month operating PE ratio is 20.5 times operating earnings compared to the 50-year average of 14.2 times earnings.
- The forward operating PE ratio is 19.0 times earnings, which exceeds the 5-year historical average of 18.6 times earnings and the 25-year average of 16.7 times earnings.

LOOKING FORWARD

Our base case view is for above-trend economic growth in 2022 as the global growth recovery continues, although at a slower, mid-cycle pace. We would change our view if the Russian-Ukraine conflict spreads or another Covid wave emerges. We expect supply chain disruptions and inflationary pressures to moderate somewhat but remain higher over the medium term. Monetary policy is becoming less accommodative but central banks are likely to keep interest rates below historical levels and real yields in deeply negative territory. We see higher inflation to be challenging for bonds similar to 2021. We emphasize tactical allocation across geographies, markets, and sectors. In navigating the landscape, our focus is on building portfolios that have a quality bias, are resilient and well diversified.

PORTFOLIO POSITIONING

Strong growth, solid corporate and household balance sheets, historically low real rates, and pent-up demand are favorable for risk assets. While we remain constructive, we expect equity returns in 2022 to be challenging as the Fed has entered a tightening cycle and the Russian invasion increases risk. Tactically, we reduced our equity overweight to neutral, raised cash/short-term investments and stay underweight government bonds and duration. Portfolio diversifiers are important in hedging downside risks. High quality bonds provide balance to equity risk in portfolios. Inflation-linked bonds and gold provide a hedge against inflation surprises and excessive monetary creation. We have cash and short-term fixed income investments to minimize the risk of rising yields and for dry powder to take advantage of opportunities.

Equities are supported by solid economic fundamentals and historically low real yields, balanced against elevated valuations and rising geopolitical tensions. Tactically, we are neutral equities and lean toward cyclical regions/sectors as global growth remains above trend. We are overweight large cap U.S. equities and lean toward international markets for cyclicality. With prospects for a lower dollar and less expensive valuations overseas, we increased our non-U.S. exposure. In fixed income, we keep duration below benchmark, as interest rates are likely to rise due to inflation, high debt levels, and less accommodative monetary policy. We prefer U.S. investment grade bonds with relatively higher yields, providing greater ballast for portfolios to hedge equity risk. We remain overweight inflation-linked bonds (TIPS) that are high quality government bonds providing a hedge against rising inflation expectations. In the credit sector, we prefer floating rate loans and emerging market debt with higher yields, but keep a neutral allocation.

We continue to incorporate diverse asset classes including gold, short-term investments, investment grade bonds, alternatives, and cash that act as portfolio diversifiers and provide liquidity. Our gold allocation provides an effective hedge against financial uncertainty and the printing of money.

In an environment with near record low interest rates and rich valuations, forward-looking asset class returns are lower than historical averages. We see the potential for higher volatility due to diminishing monetary and fiscal stimulus, higher inflation/interest rates, and geopolitical uncertainties. Overall, our dynamic tactical asset allocation continues to enhance returns and reduce risk.

MONTHLY **INVESTMENT OUTLOOK** | MARCH 2022

MARKET RECAP (AS OF FEBRUARY 28, 2022)

- The U.S. stock market made a record high early in January before a hawkish Fed pivot to tightening and the Russia invasion led to a correction. The S&P 500 declined 8%, while international equities fared better falling 6.2% and emerging equities fell 5.1%. Large cap and value style outperformed smaller stocks and the growth style.
- In fixed income, bond indexes struggled as yields spiked higher with the yield on the 10-Year U.S. Treasury jumping 0.28% (28 bps) to end the month at 1.78%. Global bonds and the Barclays Aggregate Bond Index each fell over 3%. The bond sector was broadly lower with the only sector near flat being floating rate loans that were lower by 0.2%.
- Gold broke out of a range gaining 3.9% and was one of the few asset classes that were positive for 2022. WTI oil prices soared 28% reaching a 7-year high trading over $90 per barrel. Commodities continued to surge higher with a gain of 15% as prices rose due to supply bottlenecks and pent-up demand. Alternatives benefited from higher interest rates and volatility ending with positive returns.

Period Ending February 28, 2022 *Source: Bloomberg.* *Past performance is not indicative of future results.*

		Trailing Performance (annualized for periods > 1 year)					
Asset Class	**Index**	**MTD**	**YTD**	**1Y**	**3Y**	**5Y**	**10Y**
EQUITIES							
Benchmark	MSCI All Country World IMI	(2.3)	(7.4)	6.9	13.2	11.2	9.8
Large Cap	S&P 500	(3.0)	(8.0)	16.4	18.2	15.2	14.5
Long-Short	S&P 500 / LIBOR plus 3	(1.5)	(4.0)	8.2	9.5	8.1	7.6
Small/Mid Cap	Russell 2500	1.1	(7.3)	0.4	12.9	11.2	12.0
International	MSCI World Ex US (net)	(1.5)	(6.2)	3.8	8.5	7.5	6.3
Emerging Markets	MSCI Emerging Markets (net)	(2.9)	(5.1)	(9.1)	6.6	7.1	3.5
FIXED INCOME							
Benchmark	FTSE World Broad Investment Grade	(1.4)	(3.6)	(6.2)	1.9	2.2	1.2
U.S. Aggregate	Barclays US Aggregate	(1.1)	(3.2)	(2.6)	3.3	2.7	2.5
U.S. TIPS	FTSE U.S. Inflation Linked Securities	0.9	(1.2)	6.1	7.5	4.8	2.7
Tax Exempt	BOFA Merrill Lynch US Municipal	(0.5)	(2.9)	(0.4)	3.2	3.2	3.2
U.S. Corp High Yield	Barclays US Corporate High Yield	(1.0)	(3.7)	0.6	5.3	4.9	5.9
U.S. Floating Rate	S&P/LSTA Leveraged Loan	(0.5)	(0.2)	3.2	4.1	4.0	4.4
International	FTSE Non USD WGBI	(1.3)	(3.5)	(9.3)	0.3	1.6	(0.1)
Emerging Markets	JPM Emerging Markets	(6.5)	(9.2)	(7.5)	0.8	1.9	3.9
REAL ASSETS							
Benchmark	Gold	5.8	3.9	9.9	13.0	8.7	0.6
Inflation	Consumer Price Index (CPI)	0.0	0.6	7.5	3.7	2.9	2.2
Commodities	Bloomberg Commodities	6.2	15.6	34.4	12.9	6.6	(2.0)
ALTERNATIVES							
Benchmark	LIBOR + 3	(0.6)	(1.6)	(1.6)	3.3	3.9	3.4
Multi-Strategy	Hedge Fund Research HFRI RV Mu			0.4	6.5	4.3	4.8
Global Macro	Credit Suisse Global Macro Ind			3.4	12.0	6.3	4.6
Managed Futures	Credit Suisse Managed Futures			1.4	7.7	3.1	1.8