March 1, 2022

Dear Clients,

We are all watching with sadness and dismay the events that are taking place in Ukraine. Russia's aggression has led to sanctions that have upended Russia's markets, and fears about commodity prices will continue to affect markets globally. Prior to any military action, however, the markets were already under stress from other factors. As stewards of capital, our job is to consider all things that affect the markets, to assess what the impact may be on your investment portfolios, and to position accordingly.

We entered 2022 with concerns about higher energy prices, higher inflation, and slowing growth. When combined with elevated starting equity valuations, we expected to see a combination of higher volatility and lower equity returns than we have seen in recent years, which has proven to be the case thus far. The S&P 500 had already declined by 5% this year prior to the Eastern European events and is now down 9%. The volatility index (VIX, or "fear index") has climbed to 31, more than 50% higher than its 2021 average of 20. Treasuries have also become more volatile and corporate bond spreads have widened, signaling increased concern in credit markets as well.

On top of this, inflation has remained stubbornly high, with the Consumer Price Index (CPI) up 7.5% year-over-year and the Fed's preferred inflation gauge – the Personal Consumption Expenditure Index (PCE) – clocking in at 5%. As a measure to curb inflation, the Fed is expected to increase the Federal Funds rate at its March meeting, followed by several more increases throughout 2022. The Fed is also slated to stop growing its balance sheet, and possibly start shrinking it, in the second quarter of 2022. These actions are still likely to occur, although the pace at which they occur may be dampened.

We believe that the recent events in Eastern Europe will magnify and accelerate the increase in commodity prices, such as oil, wheat, and corn, and put additional upward pressure on inflation, both in the US and globally. They have already – and will likely continue to – lead to heightened volatility in asset prices. In addition, we may see an increase in cyber-attacks, both in Europe and across the globe.

Historically, when military events occur, equity markets often initially decline, but subsequently exhibit positive returns 6- and 12-months later. This is particularly true when the underlying economy is not in a recession. Moreover, both Russia and Ukraine are relatively small as a percentage of global Gross Domestic Product (GDP) and global equity market capitalization, so the direct effect on developed world equity markets could be quite limited. To cite a few recent examples, after Russia annexed Crimea in 2014, the US equity market initially declined, but returned 8% over the next 6 months and 12% over the next 12 months. Similarly, after the "Arab Spring" in 2011, while the initial US equity market decline was 3%, 6- and 12-month subsequent returns were each 3%. Looking back at

54 crisis events since 1907, the Dow Jones Industrial Average has fallen an average of 7.1% during the initial crisis period, according to global investment research firm Ned Davis Research. That research also shows that the Dow gained an average of 9.7% in the six months following a crisis. This is not to say that the heightened uncertainty resulting from military actions does not matter, but rather, that other things matter as well, namely economic conditions and corporate earnings.

Greater uncertainty does emerge when looking at second- and third-order effects. Therefore, we are also analyzing additional areas: What will sharply higher energy prices do to the German and broader European economies? Will the shift toward alternative energy sources be accelerated? How assertively will China support Russia, and do recent events change China's view toward Taiwan? Will the sanctions imposed on the Russian central bank and Russian companies drive capital toward safe-haven US dollar assets, or instead accelerate the development of non-U.S. dollar-centric payment systems? Although answers to these questions may not impact markets in the near-term, they will shape the context for investing in future years.

Returning to economic and market fundamentals, we anticipate solid US corporate earnings growth in 2022, albeit at a slower pace than the 49% we saw in 2021. Equity valuations remain somewhat above historical levels, driven primarily by high valuations in some of the largest companies in the S&P500. On the other hand, valuations of many smaller companies, value stocks, and international companies are not nearly as stretched. Given higher volatility and greater uncertainty, we believe it more important than ever to remain disciplined and diversified.

On a final note, 5% – and even 10% – corrections in the equity markets are common and should not in and of themselves be viewed as cause for concern. As one of my colleagues puts it, this volatility is the price equity investors pay for the significantly higher returns they receive over time relative to less volatile asset classes such as bonds or cash. Further, for long-term investors, volatility offers disciplined investors the opportunity to buy or add to attractive investments at more reasonable prices.

Sincerely,

Ellen K. Hazen, CFA®
Chief Market Strategist

Disclosures