MARKET COMMENTS

March 1, 2022

Economic Background

U.S. Economy - Although GDP growth slowed in the second half of 2021 and will likely continue to slow this year as the impact of prior fiscal stimulus begins to wane, we expect growth to remain above the economy's long-term trend due to solid consumer spending and inventory rebuilding.

Inflation – The headline consumer price index year-over-year is currently over 7.0%. Inflation as measured by core PCE, which is the preferred inflation measure of the Federal Reserve, is currently running at 5.2% year-over-year versus the Fed's long-term average target of 2.0%. Inflation will moderate as the year progresses due to base effects and the unsustainability of price increases in many categories. Additionally, as supply constraints begin to ease in many areas, we expect a better supply/demand balance for many product categories.

Employment – The economy has been producing over 400,000 jobs for many months and the unemployment rate has fallen to 4.0%. The labor market has been strong. We expect job growth to moderate toward a rate of between 200k to 250k per month and we estimate that the unemployment rate will continue to fall in an uneven pattern as workers return to the labor force. The labor force participation rate of 62.2% in January is still modestly below the pre-pandemic rate of 63.4% and there are still roughly 6.5 million unemployed persons.

Fiscal Policy – After more than $6.1 trillion in deficit spending over the last two years, the relative decline in fiscal spending will be a significant drag on the economy in the second half of 2022.

Monetary Policy – The Federal Reserve is expected to begin hiking rates at its March meeting after fully completing the tapering of its bond purchases. The Fed's balance sheet is now over $8.9 trillion, which is more than double the level prior to the Covid pandemic. The Fed abruptly shifted the direction of monetary policy last November in response to inflation that remained elevated at historically high levels – inflation is now at 40-year highs. The futures market expects approximately five 25-basis point hikes this year. Typically, the fed funds rate peaks in a rate tightening cycle at 50 basis points (bps) above the yield of the 10-year Treasury bond. The timing and length of the tightening cycle is an important consideration for investors and will be dependent on the future economic growth rate, inflation and, more importantly, inflation expectations.

Ukraine/Russian War Impact

Energy and Inflation – The Russian attack on Ukraine and the sanctions imposed on Russia will have a meaningful impact on energy prices and inflation. In the short-term, higher energy prices caused by the dislocation of the Russian supply of oil and natural gas will be inflationary. Higher energy prices find their way into most products because of their impact on shipping costs. Russia produces approximately 10.5 million barrels of oil per day and exports over 7.0 million barrels. Oil analysts believe the rest of the world has the potential to increase output perhaps by an additional 4.0 to 4.5 million barrels. As oil prices escalate, it will weigh on demand and help relieve a portion of the supply shortage. Although the Russian natural gas and oil has not been shut off, energy markets are repricing higher and are factoring in the potential of a disruption. Oil shocks impact consumers by acting like a tax increase as higher prices consume a greater amount of personal income, which causes consumer spending on other items to slow. Slower spending eventually is disinflationary.

Europe – The European Union imports about 27% of its oil and approximately 40% of its natural gas from Russia. This is a considerable vulnerability for the 27-member union. Conversely, about half of Russia's federal budget is funded from

its oil and gas revenues and Ukraine contains major pipelines which link the oil and gas fields in central and eastern Russia with Europe. Ukraine and Russia also produce approximately 1/3rd of the world's global wheat exports.

The headwind from higher energy prices and the increase in economic uncertainty more directly impact the EU and is weighing on the near-term outlook for the Eurozone's economic growth. The risk of a recession has increased but remains limited because the trade exposures remain relatively small and energy consumption represented only 2% of GDP prior to the invasion. With higher energy prices and energy consumption becoming a larger percentage of GDP, overall GDP growth will be negatively impacted but energy consumption as a percent of GDP would have to double to potentially cause a recession in the Eurozone.

Russia – The sanctions and the cessation of business activities by many corporations has driven the Russian economy into a deep recession. The Russian central bank has increased its main interest rate from 9.5% to 20% to support the ruble which has collapsed because the Russian central bank is unable to access its foreign currency reserves. Capital controls have been instituted. Both businesses and the Russian public have been scrambling to convert their money to hard currency. The targeted SWIFT ban makes it very difficult for Russian financial institutions to conduct cross-border trade.

United States – The U.S. is largely insulated from the economic fallout from the Ukrainian crisis despite having some economic drag due to higher oil prices. Some of this impact will be offset by higher domestic oil and gas production. More meaningfully, the slower potential ramp toward monetary policy normalization will lower the near-term risk of a policy miscalculation.

Federal Reserve – The Fed and other central banks are likely to take a more deliberate approach as the rate-tightening cycle begins. As it currently stands, monetary policy in both the U.S. and Europe remains accommodative. The heightened uncertainty regarding the magnitude of the economic impact of the Ukraine/Russia war will cause the central banks to begin the lift of rates moderately and move forward cautiously with respect to monetary policy tightening. Monetary policy works with a lag, so a more temperate pace in the face of a more uncertain environment will allow the Fed to more accurately assess the impact of their actions and of course correct if necessary.

Market Impact

When geopolitical risks flare up such as the Ukraine/Russian War, equity markets react negatively on the initial news. Historically, the initial drawdown has been 6.5% and the duration of the selloff has lasted approximately 12 days. The market usually recovers relatively quickly. The average return in the equity market six months and one year from the geopolitical event has been up 7.2% and 12.7%, respectively. The extent of the market drawdown will largely be determined by how Russia prosecutes the war, with the destruction of Ukrainian cities and the civilian population, and how Russia responds to the formidable sanctions.

S&P 500 NTM EPS Change Following Significant Historical Events

Event	Date	Day Of	+20-Days	+65-Days	+125-Days	+250-Days
Iraq Invades Kuwait	8/2/1990	0.1%	-0.3%	-1.4%	-3.7%	-4.8%
Soros Breaks Bank of England	9/16/1992	-0.2%	0.6%	1.3%	2.7%	7.3%
1st World Trade Center Bombing	2/26/1993	0.0%	0.2%	2.1%	3.8%	8.5%
Asian Financial Crisis	10/8/1997	0.0%	0.5%	1.6%	1.7%	3.8%
U.S.S Cole Yemen Bombing	10/12/2000	-0.3%	-0.8%	-4.4%	-4.6%	-9.7%
9/11 Terror Attacks	9/11/2001	0.0%	-3.4%	-4.2%	-1.7%	2.1%
Iraq War	3/20/2003	0.1%	0.6%	2.2%	5.8%	11.9%
Bear Stearns Collapse	3/14/2008	0.0%	0.0%	0.6%	-1.3%	-34.4%
Lehman Brothers Collapse	9/15/2008	0.0%	-4.7%	-20.5%	-34.5%	-29.2%
U.K. Votes to Leave EU (Brexit)	6/24/2016	0.0%	0.6%	1.9%	4.4%	9.5%
NBA Shutdown (COVID)	3/11/2020	-0.3%	-14.1%	-18.9%	-12.3%	0.8%
	Median	0.0%	0.0%	0.6%	-1.3%	2.1%

Strategas Securities, LLC – Market Catechism

Financial Market Risk

Investors have more uncertainties, crosscurrents, and potential risks to consider in the current environment than they have had in many years. Inflationary pressures not only complicate the calculus for the Federal Reserve but have the potential to impact the nominal yield curve, corporate margins, and earnings growth. Additionally, the markets will begin to refocus on the midterm elections. Financial markets have been adjusting to the dramatic shift in monetary policy. The primary risk in the current environment is the potential that the Fed tightens too aggressively. This is particularly true considering the new risks introduced as a result of the war in Ukraine and the economic sanctions levied on Russia.

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