Market Outlook
First Quarter 2022

RETIREMENT PLAN ADVISORS

THE FUTURE IS BETTER THAN YOU THINK

MARKET SNAPSHOT

Stock markets had a rough first quarter across the board. Global stocks fell 5.4% for the quarter. Among global markets, the S&P 500 was a relative outperformer, dropping 4.6%, compared to developed international markets down 5.9% and Emerging-market stocks down 7.0%.

The damage was worse in the U.S. core bond market, with the Bloomberg U.S. Aggregate Bond Index (the "Agg") falling 5.9% for the quarter.

The war in Ukraine has had wide-ranging impacts on the global economy. The sanctions imposed on Russia by the West are having, and will continue to have, a material impact on global economic growth and inflation.

The U.S. and global economy still look likely to post above-trend growth this year, albeit lower than was expected three months ago.

The inflation backdrop in the U.S. has gotten worse over the past three months.

As a result of higher inflation, the Fed has finally begun to raise interest rates, starting with a 25-basis point increase in March. The Fed also indicated it will start to shrink its $9 trillion balance sheet.

Market Recap

Financial markets had a rough first quarter across the board, hurt by rising interest rates, inflation, and the war in Ukraine. Global stocks (MSCI ACWI Index) fell 5.4% for the quarter. Among major global markets, the S&P 500 was a relative outperformer, dropping 4.6%, compared to developed international markets (MSCI EAFE Index) down 5.9% and emerging-market (EM) stocks down 7.0%.

The relatively mild declines for the full quarter masked the intra-quarter volatility. At its low point on March 8, the S&P 500 was down 13% from its high on January 3. The developed international and EM stock indices had drawdowns in the 16-17% range during the quarter, before rebounding roughly 10% by quarter-end.

Unusually, the damage was worse in the U.S. core bond market than the U.S. stock market. The benchmark Bloomberg U.S. Aggregate Bond Index (the "Agg") fell 5.9% for the quarter. This was the second-worst quarter for the Agg since the first quarter of 1980, when Paul Volcker's Fed was in full-bore tightening mode.

Macro Backdrop

We remain cautiously optimistic, but inflation and recession risks have risen. The war in Ukraine has had wide-ranging but diverse impacts on the global economy and individual regions. Besides Ukraine itself, the most direct and damaging economic impact is on Russia. While Russia's economy is less than 2% of global GDP, Russia is a major producer and exporter of oil and natural gas—to Europe in particular, accounting for roughly 50% of Europe's natural gas imports and 25% of its oil imports—as well as certain agricultural commodities and base metals. As such, the war and the sanctions imposed on Russia by the West are having, and for the foreseeable future will continue to have, a material impact on global economic growth and inflation.

With the war in Ukraine, most economists and investment strategists have lowered their 2022 economic growth forecasts and upped their inflation forecasts. On the growth side, for example, Capital Economics cut their global real GDP growth forecast from 4% to 3.2% for this year, which is only slightly above the economy's long-term trend growth rate. In March, the Federal Reserve cut its 2022 U.S. real GDP growth forecast from 4% to 2.8%.

The weight of the evidence also suggests a U.S. recession in the next 12 months is unlikely—we'd call it in a rough ballpark of 25% odds or less. Several recent U.S. economic data points have been strong, including expansionary Purchasing Manager Index (PMI) readings, record-high job openings, record-low weekly new unemployment claims, and a positive Leading Economic Indicator (LEI). Household wealth and savings are also high, which should support consumer borrowing and spending even with high inflation and rising interest rates. Corporate balance sheets are also generally in good shape. As a result, the U.S. and global economy still look likely to post solid, above-trend growth this year, albeit lower than was expected three months ago.

Moving on to the inflation backdrop in the U.S., the news has gotten worse over the past three months as can be seen across any number of inflation measures. While most forecasters expect U.S. inflation to be lower by year-end than it is now, the consensus estimate has risen compared to three months ago. This includes the Fed, which in March projected inflation in core Personal Consumption Expenditures of 4.1% for this year, up from its 2.7% forecast last December.

Monetary Policy

The Fed has finally begun to raise interest rates (the Fed Funds Policy Rate), starting with a 25-basis point (0.25%) increase in March. The Fed also indicated it will start to shrink its $9 trillion balance sheet of Treasury and government agency mortgage-backed securities this year. This is another form of monetary tightening—quantitative tightening (QT), the opposite of quantitative easing (QE).

In his comments following the Fed's March meeting, Fed Chair Jerome Powell clearly stated that fighting inflation is the Fed's focus, now that the labor market has reached maximum employment and then some. "We need to get rates back up to a more neutral level as quickly as we practicably can and then move beyond neutral if it turns out to be appropriate," he said. As to the Fed's full employment mandate, Powell was surprisingly hawkish, pointing to "a very, very tight labor market; tight to an unhealthy level, I would say."

On the more positive side, longer-term inflation expectations remain mostly "anchored" in a range consistent with the Fed's 2% long-term core inflation target. Short-term (12-month) inflation expectations have spiked higher, consistent with the recent sharp rise in gasoline prices and the overall Consumer Price Index. Should the longer-term measures move higher, we'd expect the Fed to accelerate its tightening pace.

Economic Outlook

Taking all of these factors into account, our base case shorter-term (12-month) economic outlook is for decelerating economic growth and still-high but moderating inflation. Absent a recession, which of course we can't rule out, this macroeconomic backdrop should be generally supportive for "risk asset" returns, such as global equity and credit markets, and a headwind for core bonds in the face of rising government bond yields.

We've seen the latter play out so far this year, with sharply negative bond returns. Risk asset markets have also been generally negative, but not much worse than core bonds and in some cases better. As we'll discuss in the next section, looking forward we believe equities and credit have relatively attractive return potential from current levels.

Financial Markets Outlook

As noted in our Market Recap above, there was a lot of volatility in the first quarter. But as the quarter ended, most major global equity markets were only 5%-7% below where they started the year. Lower prices are a long-term investor's friend, as they set the stage for higher future expected returns, all else equal. But of course, volatility is unsettling in the moment.

The consensus is for S&P 500 earnings per share (EPS) growth of around 6%-8% this year. This seems a reasonable ballpark base case, given the macro backdrop. (The S&P 500's long-term average EPS growth has been 6%.) Key downside risks are the Ukraine war, spiraling inflation, and/or aggressive Fed and fiscal tightening beyond expectations—although monetary policy typically acts with a long lag on the real economy. In the short term, changes in valuations (P/E multiples) driven by investor sentiment and emotion can have a big impact on stock returns. Despite the recent drop, the S&P 500 still looks expensive on an absolute valuation basis.

Once again in the first quarter international stocks were harder hit, due largely to the war in Ukraine. Consensus earnings estimates have come down this year as the economic risks have risen. But unlike the S&P 500, international stock indices are selling at reasonably attractive valuations, both absolute and relative to bonds. They are also selling at deep discounts to the U.S. market—deeper than their historical discounts.

Our broad outlook for fixed-income assets has not materially changed. We have been expecting interest rates to rise and put continued pressure on core bond returns, and that played out in spades in the first quarter of 2022. With the core bond index now yielding 3%, expected 5-year returns have increased. But they are still very low and are susceptible to heightened inflation risk over the near term and medium term.

Closing Thoughts

The war in Ukraine has caused massive human suffering. From an economic and investment perspective, it has added to already-high uncertainty, degraded the near-term growth outlook, and added additional fuel to the inflationary fire. Crises, as painful as they are, often create opportunities. However, the equity and fixed-income markets have reacted quickly to the headlines, and as currently priced aren't offering any compelling new opportunities, in our view.

As always, thank you for your continued confidence and trust.

Best regards,

Retirement Plan Advisors

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Market Indicators
First Quarter 2022

RPA
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S&P Sectors

	QTR	YTD	1Y	5Y
S&P Technology Select Sector TR USD	-8.51	-8.51	20.64	26.11
S&P Financial Select Sector TR USD	-1.48	-1.48	14.69	12.36
S&P Consumer Disc Select Sector TR USD	-9.35	-9.35	10.88	17.46
S&P Health Care Select Sector TR USD	-2.58	-2.58	19.10	15.07
S&P Industrial Select Sector TR USD	-2.36	-2.36	6.14	11.76
S&P Cons Staples Select Sector TR USD	-1.26	-1.26	13.99	9.84
S&P Energy Select Sector TR USD	39.08	39.08	63.26	6.89
S&P Utilities Select Sector TR USD	4.77	4.77	19.93	11.43
S&P Real Estate Select Sector TR USD	-6.22	-6.22	25.75	12.64
S&P Materials Select Sector TR USD	-2.37	-2.37	13.95	13.21
S&P Telecom Select Industry TR USD	-8.60	-8.60	0.51	6.92

Market Returns

	QTR	YTD	1Y	5Y	10Y
S&P 500	-4.60	-4.60	15.65	15.99	14.64
Russell Mid Cap	-5.68	-5.68	6.92	12.62	12.86
Russell 2000	-7.53	-7.53	-5.79	9.75	11.04
MSCI EAFE	-5.91	-5.91	1.16	6.72	6.27
MSCI Emerging Markets	-6.97	-6.97	-11.37	5.98	3.36
BBgBarc U.S. Agg Bond	-5.93	-5.93	-4.15	2.14	2.24
High Yield	-4.84	-4.84	-0.66	4.69	5.75

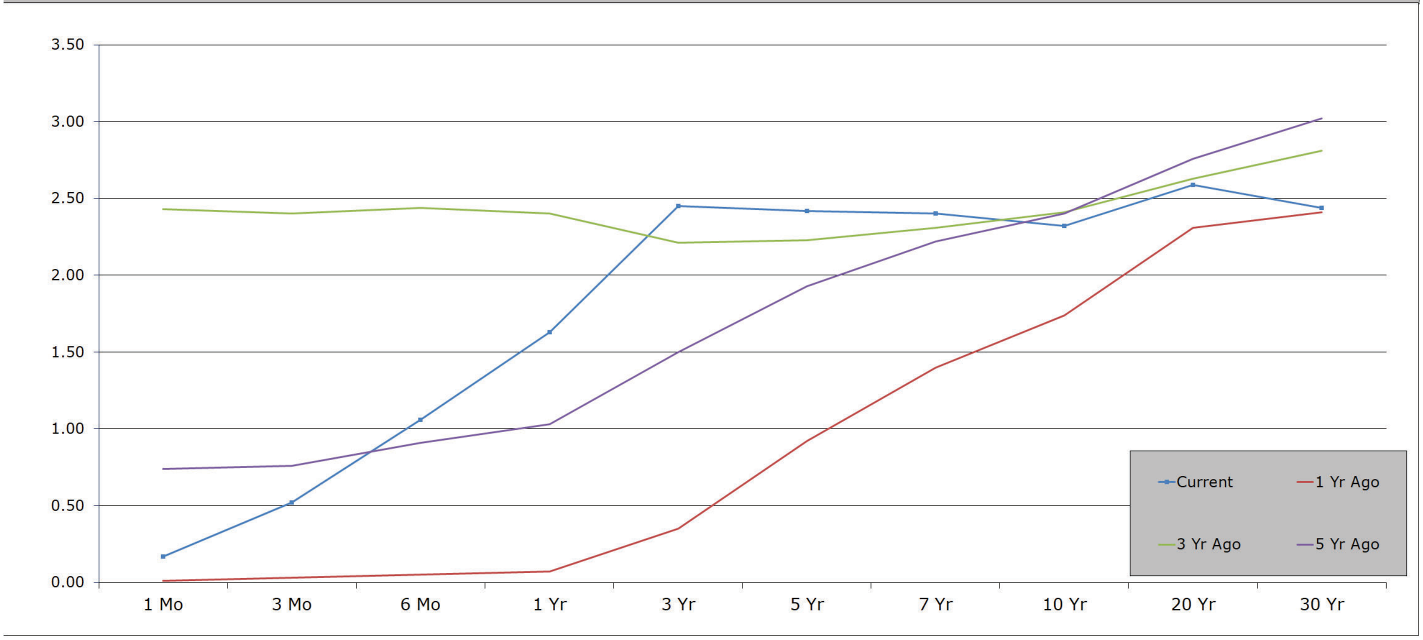
Value / Growth Returns

	YTD			Previous Calendar Year		
	Large	Mid	Small	Large	Mid	Small
Value	-0.16	-0.60	-2.01	24.90	30.65	28.77
Growth	-8.59	-9.04	-9.51	32.01	18.90	22.62

Index Characteristics

	LTM P/E	NTM P/E	Div Yld	Earn Yld
S&P 500	21.92	20.01	1.29	5.00%
Russell Mid Cap	18.99	17.51	1.14	5.71%
Russell 2000	14.83	13.93	1.02	7.18%
MSCI EAFE	14.30	13.30	3.56	7.52%
MSCI Emerging Markets	12.40	11.32	2.16	8.83%

Long-Term Outlook on Treasury Yield Curve



Source: Morningstar

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