Quarterly Economic Update

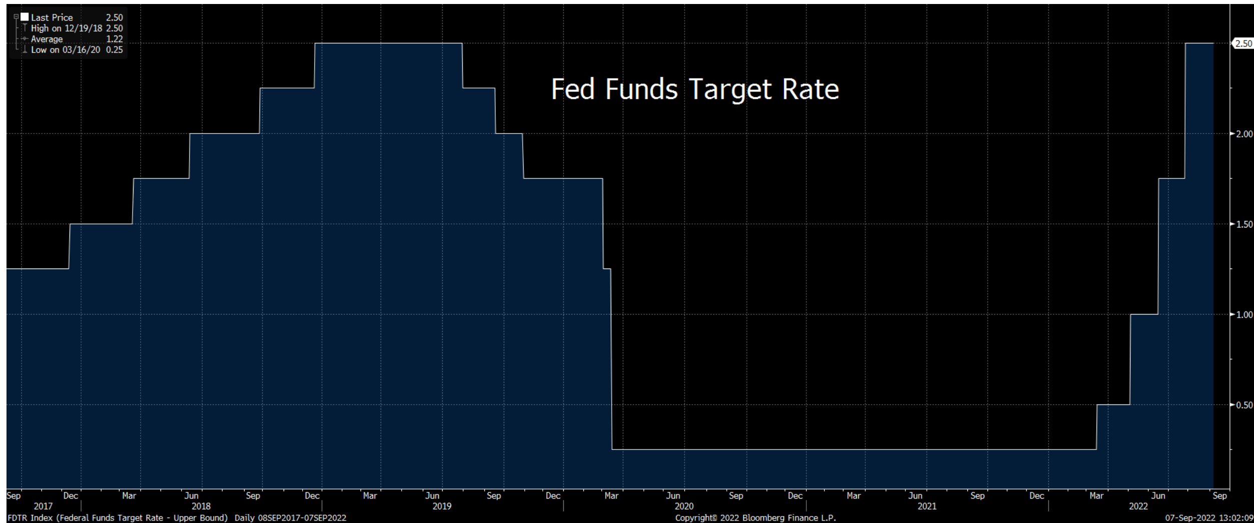
September 14, 2022

MACROECONOMIC COMMENTARY

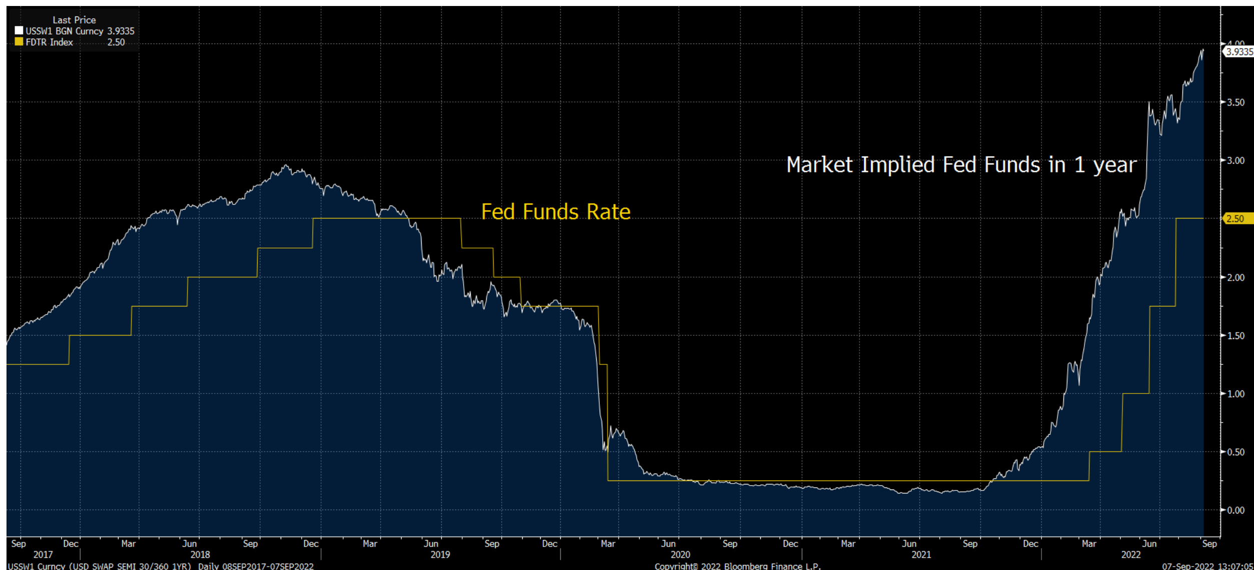
Monetary Policy

By Michael McNair

The Fed began raising the Fed Funds rate in March of this year and has continued hiking at each subsequent Fed meeting. The current 2.5% rate is equal to the level reached in the previous hiking cycle.

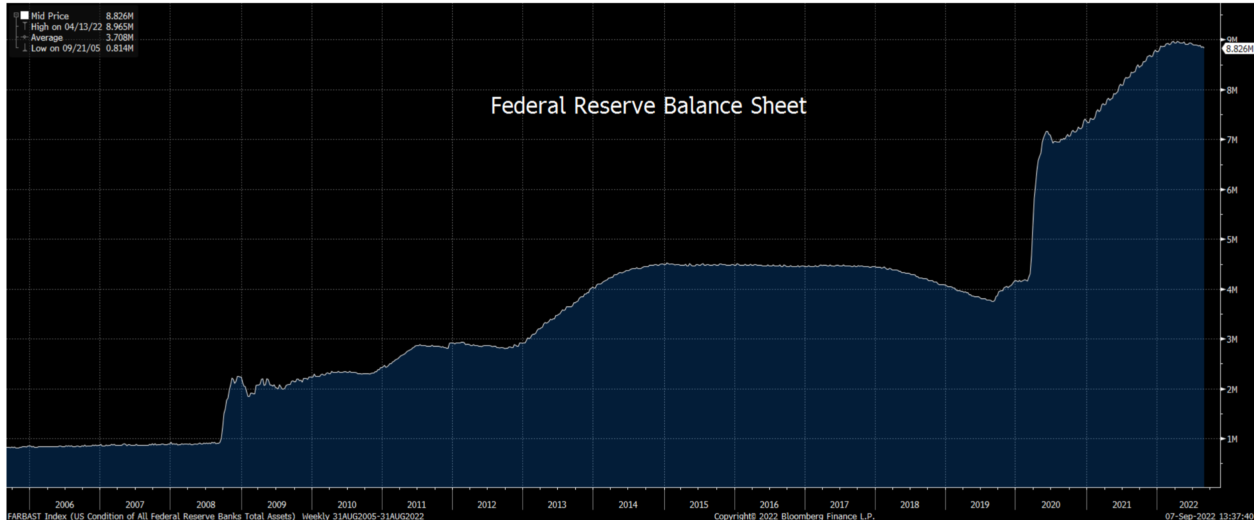


The Fed is likely to continue hiking rates over the next year. The market is currently pricing in that the Fed Funds rate will be nearly 4% a year from now, or nearly 1.5% higher than today.



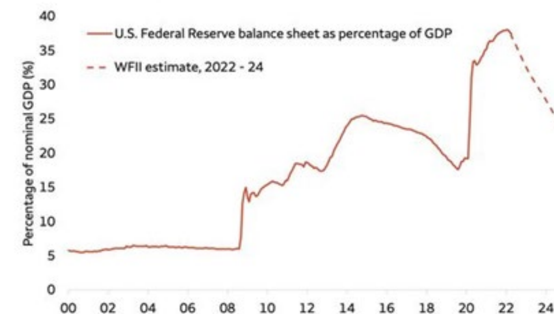
The traditional tool for managing monetary policy is the setting of the Fed Funds rate. But in the wake of the 2008 Financial Crisis, the Fed began using non-traditional tools, such as Quantitative Easing (known as QE). Quantitative Easing is a form of monetary policy where the Federal Reserve buys non-traditional financial securities, such as mortgage-

backed securities and longer-term government treasury bonds. QE expands the Fed's balance sheet; therefore, the size of the Fed's balance sheet is a way to measure the magnitude of its quantitative easing programs. Since the Financial Crisis, the Fed's balance has grown to nearly $9 trillion.



The Fed can expand its balance sheet to loosen monetary policy (QE), or it can reduce its balance sheet to tighten policy – quantitative tightening (QT). QT is the reversal of QE, whereby the Fed will begin selling treasuries and mortgage-backed securities back to banks while removing deposits from the banking system.

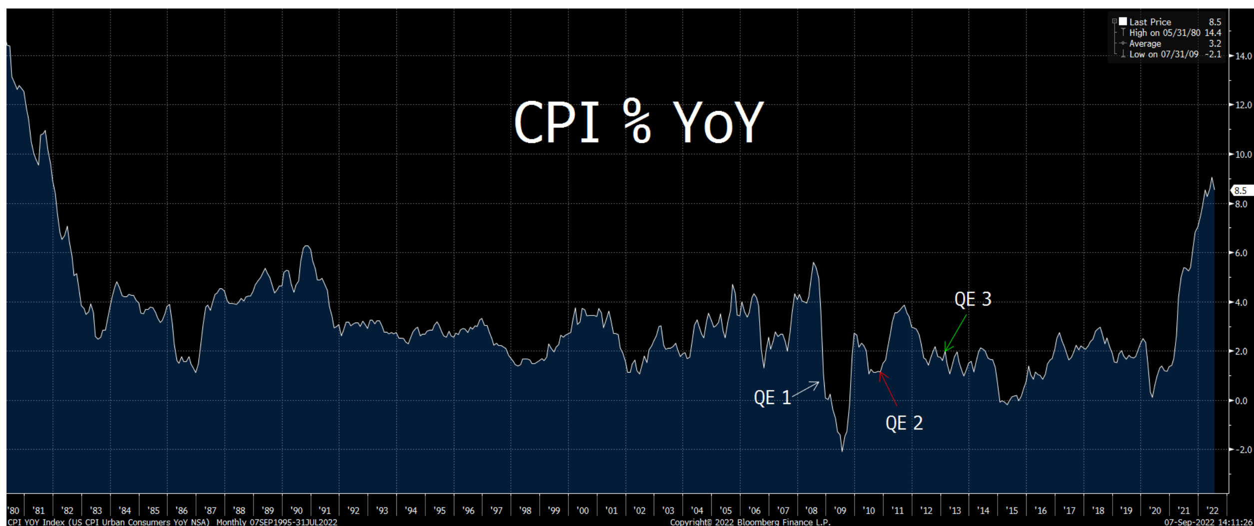
The Fed has decided to implement QT to supplement the Fed Funds rate in tightening monetary policy. The Fed initiated its QT program at the beginning of June by allowing maturing securities to roll off their balance sheet and no longer reinvesting the proceeds of its securities. Thus far, QT has been a minimal $139 billion, but the Fed is now ramping up the asset runoff to its maximum rate of $60 billion of Treasuries and $35 billion of agency mortgage-backed securities each month. Between asset sales and the roll-off of maturing securities, the Fed estimates its balance sheet will shrink by $1.5 trillion by the end of 2023 (a 17% reduction). According to the Fed, "this $1.5 trillion reduction in the balance sheet could be equivalent to another 75 – 100 basis points of tightening."



Sources: U.S. Federal Reserve, Bloomberg, and Wells Fargo Investment Institute (WFII). Latest data as of April 29, 2022. GDP = Gross domestic product. The Fed's balance sheet is defined as Reserve Bank Credit as a ratio of nominal GDP. Forward-looking nominal GDP estimates are derived from WFII estimates for real GDP growth and the GDP deflator.

Quantitative Easing and Tightening

Quantitative Easing is referred to as “printing money” because the Fed seemingly prints money out of thin air to purchase treasuries and mortgage-backed securities from the private sector. However, printing money is an unfortunate misnomer for QE. When the Fed initiated the QE program in 2008, the financial press was filled with draconian prognostications of the coming inflationary spiral. The reality is that QE 1, and subsequent rounds of QE 2 and QE 3, failed to unleash the inflationary genie from the bottle. The most common measure of inflation – the consumer price index (CPI) – hovered at the lowest level in over 40 years.



Part of the confusion over QE is a result of Fed Chairman Ben Bernanke intentionally hyping the inflationary impact of QE because he wanted to fight the deflationary mindset among US consumers and businesses. Bernanke hoped that creating a perception of QE as printing money would help break the back of deflation.

While QE and QT seemed to have no impact on goods and service inflation, even the most casual market observer will note the impact the Fed’s ever-expanding balance sheet plays in driving the stock market.

An increase in the Fed's balance sheet (white line) correlates with a rising stock market (yellow):

Several questions surrounding QE cannot be explained by the traditional understanding of QE. Why does QE increase financial asset prices but not increase goods and services output or prices? Why does QE seem to increase financial asset prices more in some countries than others?

Members of the Fed have stated that QE works in practice but not in theory. That's obviously because they don't have the right theory. We present a mental model that explains how QE actually "works" and unravels these mysteries.

The Asset Allocation Theory of Financial Assets

At any point in time, every financial asset in existence (stocks, bonds, cash) must always be held in an investor portfolio. Investors can only switch who holds the asset.

If no one can be found to hold an asset at the going market price, then the price will fall, and vice versa. For stocks and bonds, this is an easy process to understand, but cash is special. First, cash isn't just an asset but a medium through which trades occur. Secondly, if no one wants to hold cash, the only way it can depreciate is by the price of everything else appreciating.

We can think of these assets in terms of supply. The supply of the asset is equal to the total market value of the asset. If supply of an asset is insufficient relative to demand by investors, then the price will increase, and vice versa. Again, for cash, the market price can never increase or decrease, so it can only do so in relative terms. Importantly, it is price that changes to ensure supply and demand balance.

QE Anomalies Answered

How does QE increase the price of financial assets?

When the Fed conducts QE, they purchase bonds, such as treasuries, from the private sector, and the seller receives a bank reserve in return. Reserves are "near cash" assets that show up as an increase in deposits in the banking system. The important point is that QE is merely an asset swap and does not add net financial assets to investor portfolios.

Recall that cash can only depreciate in relative terms. Therefore, if the Fed swaps risk assets for cash in investor portfolios and investors do not want to have an increasing allocation to cash, then the prices (i.e., supply) of the other financial assets must increase such that the percent allocation to cash in investor portfolios does not increase.

Why does QE seem to cause stock prices to increase more in the US than it does elsewhere?

Japan has been engaging in QE for decades with seemingly no impact on inflation or its stock market. Europe has a shorter history with QE than Japan but with just as little impact on its stock market.

The reason that QE has less effect on risk asset prices in Europe and Japan is due to its negative and 0% interest rate regime. When bonds offer the same rate as cash, investors are indifferent to getting swapped bonds for cash. Thus, QE in Japan and Europe doesn't have the same effect as it has in the US.

You'll notice that the process being described – falling demand to hold cash – sounds a lot like consumers not wanting to hold cash during inflationary environments. While the psychology is the same, swapping bonds for cash can create financial asset price inflation, but it is separate from goods and service inflation.

How can QE increase financial asset prices but not increase goods and services output or prices?

Milton Friedman famously said: "Inflation is always and everywhere a monetary phenomenon, in the sense that it is and can be produced only by a more rapid increase in the quantity of money than in output."

We agree with Friedman's statement, but we add the qualifier: "the quantity of money" …properly measured.

M1 and M2 are the most popular measures of the money supply. According to Investopedia, "M1 is the money supply that is composed of currency, demand deposits, and other liquid deposits—which includes savings deposits. M1 includes the most liquid portions of the money supply because it contains currency and assets that either are or can be quickly converted to cash." These are the most liquid form of money. "M2 includes

all elements of M1 as well as 'near money.' Near money refers to savings deposits, money market securities, and other time deposits. These assets are less liquid than M1 and not as suitable as exchange mediums, but they can be quickly converted into cash or checking deposits."

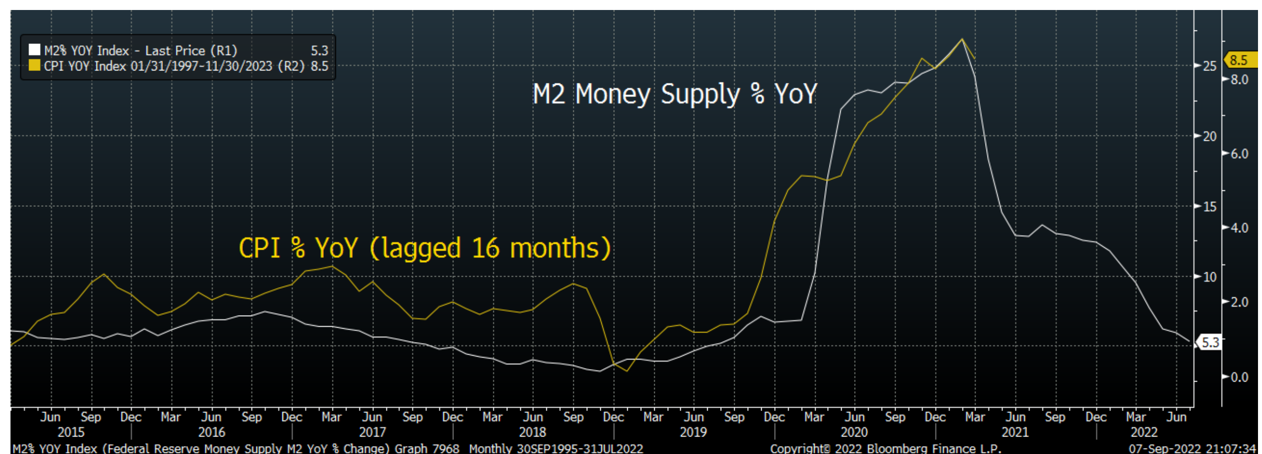
Central Bank QE simply swaps bonds for reserves – which shows up as increasing deposits. Since reserves are captured by the M1 and M2 money supply measures, all else equal, QE will result in a rise in M1 and M2 money supply measures. However, there will be an exactly equal reduction in bonds from investor portfolios; however, this reduction is not captured by the monetary aggregates. The net result is a complete wash. QE does not add financial assets to the system; it merely swaps the composition of assets held by investors.

Notably, QE increases the portion of financial assets – money – that is captured by the M1 and M2 money supply measures, which has created widespread confusion that QE is equivalent to "printing money" when no new money has been created.

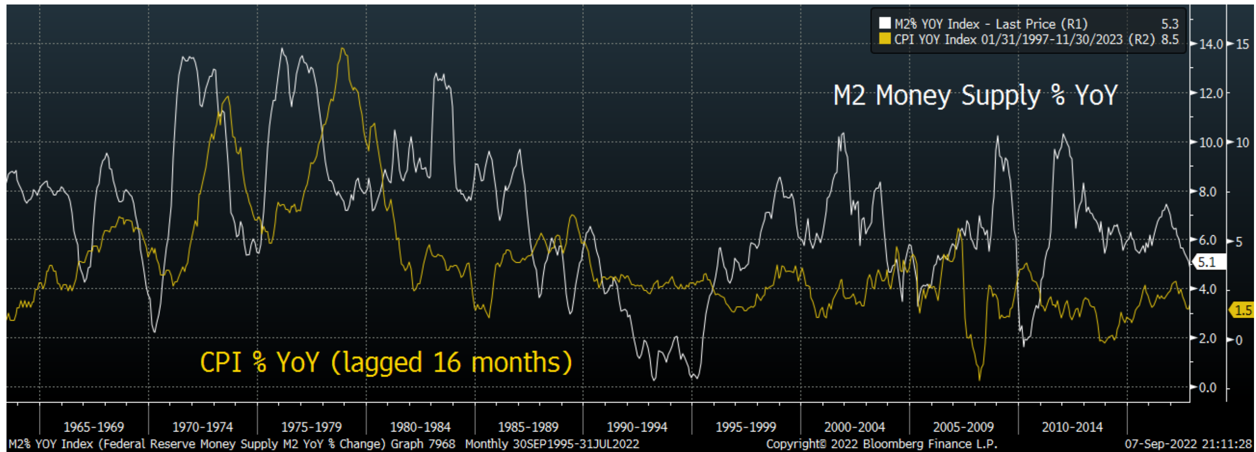
The Money Supply Enigma

"The Fed started printing money, and then we got inflation."

Anyone who has seen a graph of 2020 M2 money supply growth leading to recent consumer price inflation will be skeptical of our assertion that QE does not cause inflation. The chart below shows M2 money supply growth in white and CPI in yellow. CPI is lagged by 16 months to show how M2 allegedly led to the recent spike in CPI – with a 16-month lead time.

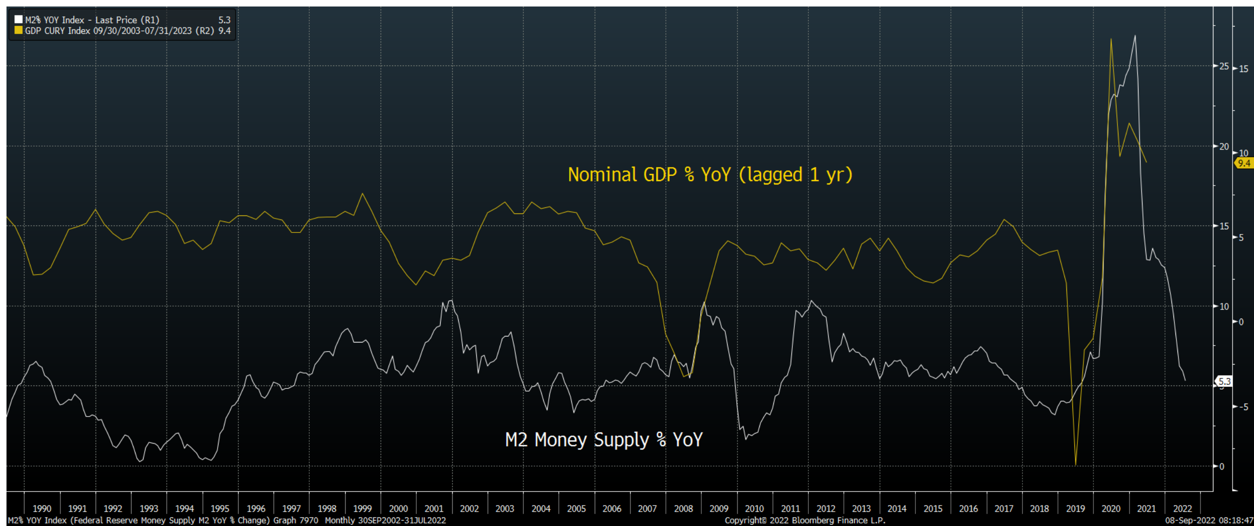


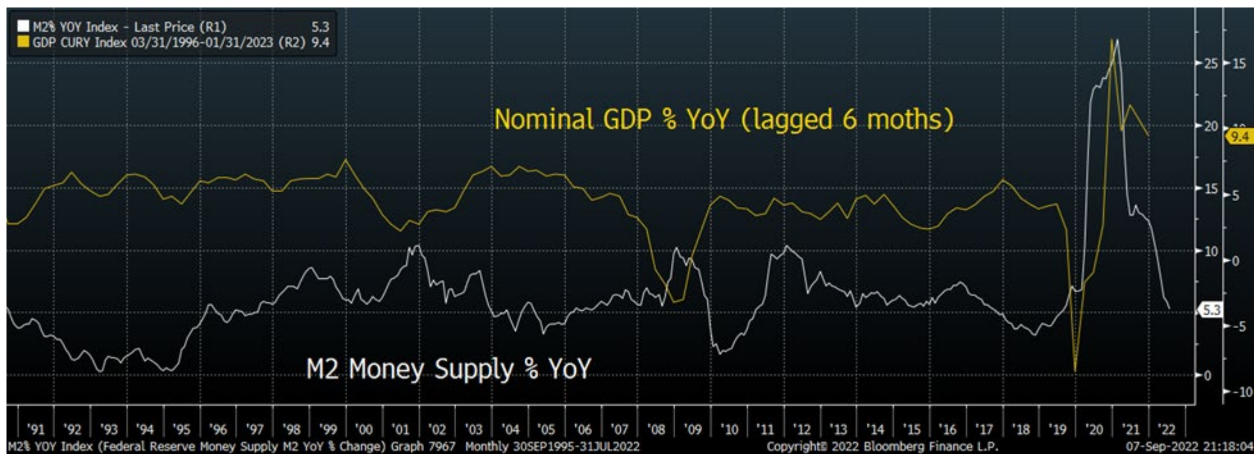
The chart appears convincing, but a longer-term examination of relationship paints a different picture. Below is the same chart but from the 1960s through 2019.



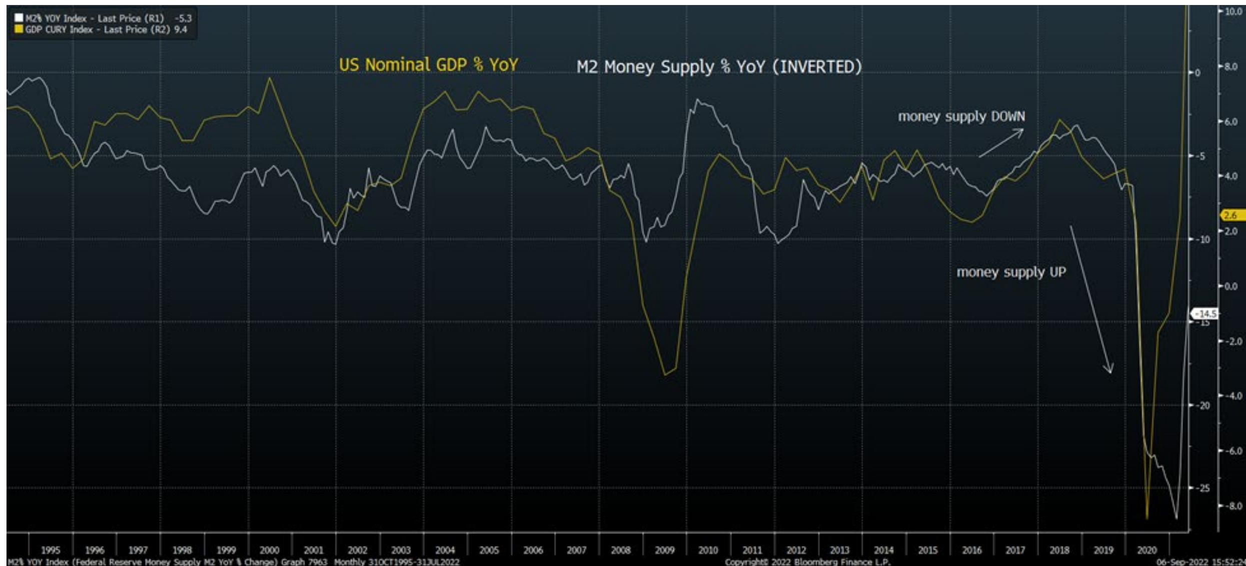
It's clear that M2 is not a reliable leading indicator for inflation, but is it a reliable coincident or leading indicator for nominal GDP growth?

The above chart shows the M2 growth is not positively correlated with nominal GDP growth, but a common argument is that money supply growth leads nominal GDP growth. In the following chart, we test this view by lagging nominal GDP growth by 1 year and 6 months to see if M2 is a good leading indicator:

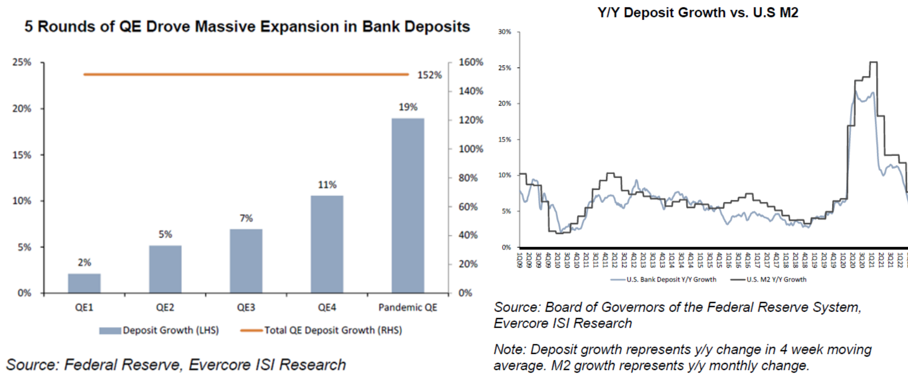




Once again, these relationships do not seem to hold up. Readers will be relieved to know the M2 money supply does have a tight relationship with nominal GDP – it's just that the correlation is the exact opposite of what you might think: M2 money supply is NEGATIVELY correlated with nominal GDP. Note that in the chart below, M2 money supply (white line) is inverted, so that a declining money supply is depicted as the white line rising in the chart, and vice versa.



The reason for the negative correlation is that the Fed responds to slowing economic growth by taking monetary policy actions that increase the M2 measure of money supply. This fact has only increased in the post-Financial Crises era, as QE has played an outsized role in determining bank deposit growth, and by extension, the M2 measure of money supply growth. Since the deposit growth associated with the Fed's monetary operations does not represent an increase in the purchasing power of the economy, M1 and M2 money supply measures are not a reliable indicator of future inflation or nominal growth.



Source: Federal Reserve, Evercore ISI Research

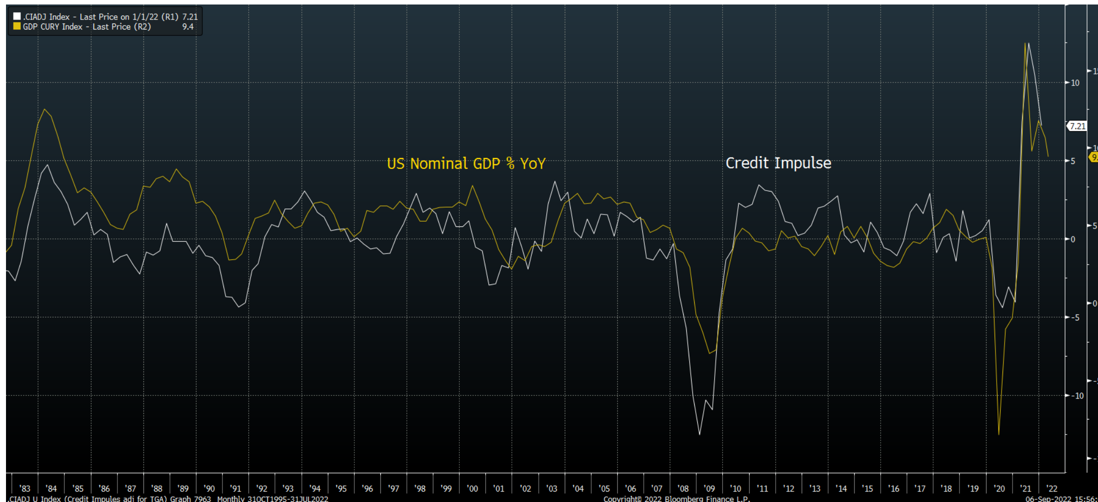
Source: Board of Governors of the Federal Reserve System, Evercore ISI Research

Note: Deposit growth represents y/y change in 4 week moving average. M2 growth represents y/y monthly change.

QE changes the composition of assets that investors hold but not the net amount. QE shows up as an increase in deposits, but households and non-financial corporates – the economic agents who buy goods and services - do not suddenly have an increased ability to exchange financial assets for goods and services.

The growth in goods and service purchasing power is dependent on the growth in the net amount of financial assets held by households and non-financial corporates, not the composition of how much is held as cash at any single point in time. The true change in the quantity of money (i.e., the supply of net financial assets) is driven by changes in credit creation by 1) households and non-financial businesses and 2) the public sector via government deficit spending.

A better measure of the money growth is the credit impulse, which measures the change in new credit creation by households and non-financial corporates.



It's worth noting that M2 growth is not simply a function of monetary policy. M2 growth can also be driven by new lending, which IS associated with the creation of new money/purchasing power. Monetary policy is typically countercyclical, but the 2020-2021 surge in M2 was unique because the Fed implemented QE during a period of surging deficit spending and private sector credit growth.

The dramatic increase in economic output in the 2nd half of 2020 – 2022 is the result of rising government deficits combined with surging private sector credit growth, which increased the quantity of money for purchasing goods and services. A rising quantity of money need not lead to inflation if the production of goods and services rises as the quantity of money grows. Several factors, including a supply shock due to COVID shutdowns and the Russo-Ukrainian War, ensured that output failed to keep pace with the rapid increase in credit growth. Once the quantity of money exceeds production capacity, any increase in money will only lift prices and not output.

Bottom Line

Monetary policy actions, such as QE and QT, change the composition of financial assets but not the net amount held by economic agents. A change in the composition of financial assets can impact the relative price of financial assets. However, these policy tools do not expand the net financial assets in the economy and, therefore, have no direct impact on increasing demand or prices for goods and services.

As the Fed ramps up its QT program, the impact will be felt on financial asset prices but will not reduce goods and service inflation.

One caveat is that if QE increases financial wealth in the economy, then it can increase the willingness of households to borrow money from a bank. A process that DOES create an increase in net financial assets in the economy. And that increase in financial liabilities

can lead to an increase in demand for goods and services. And if that increased demand exceeds the production capacity of the economy, then prices will increase, but output will not – inflation.

Economic Outlook

By Josh Husted

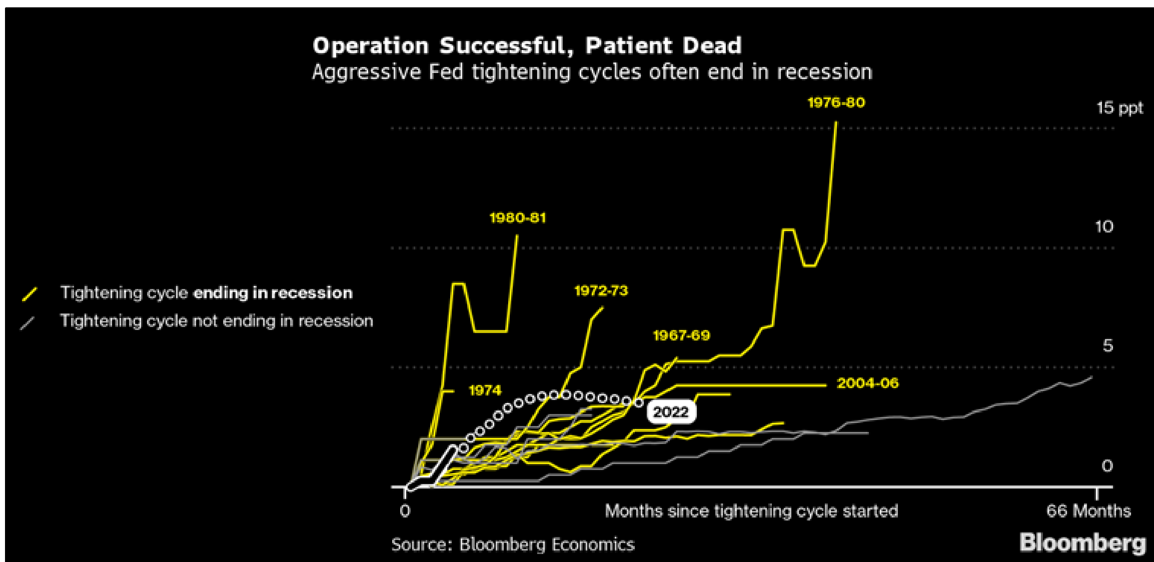
"Follow the ~~science~~ data…"

…the data:

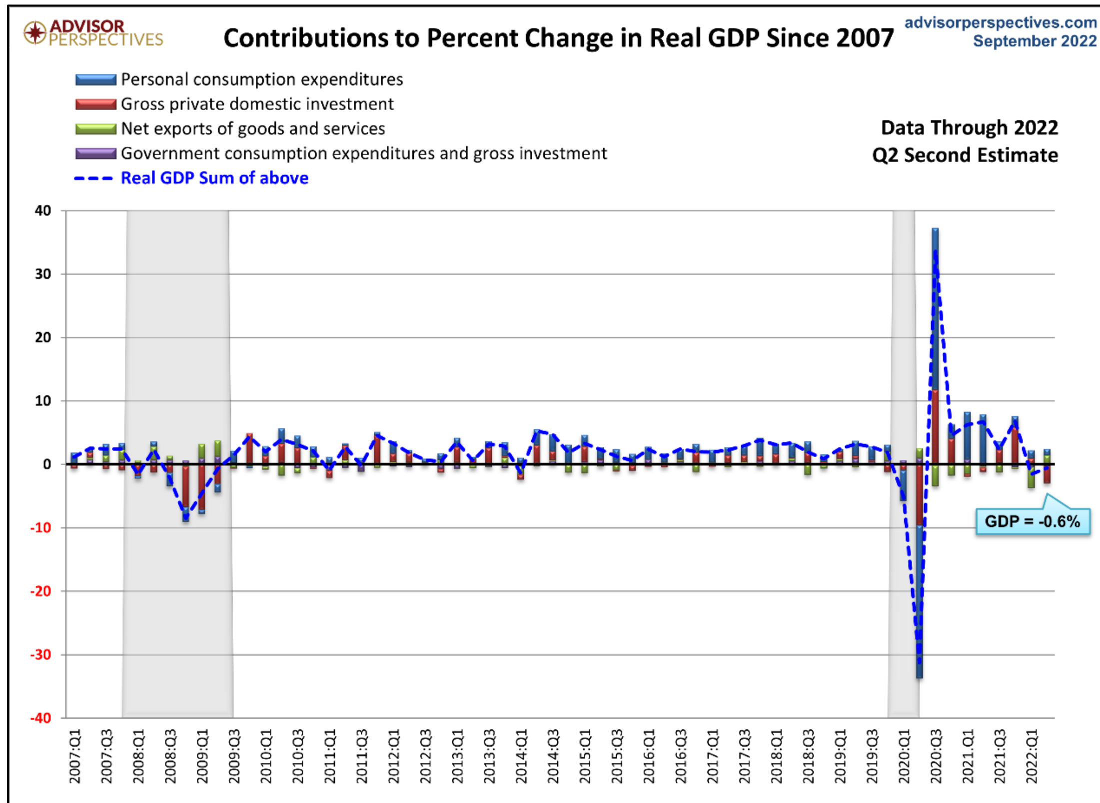
As the third calendar quarter of 2022 grinds to an end, nothing in this author's mind appears as important to the market outlook as the steady stream of economic data points. Yet, identifying a potential driver of the market is only half the battle.

At issue are the reverberations of the COVID-induced shock that have upended the efficacy of traditional economic data cues. Much like a snow globe that is violently shaken by a youngster giddy over the Christmas holidays, our economy has experienced quite the shock. And much like those little bits of fake snow that will inevitably land in different places, we are seeing bits of our economy reorganize and restructure in ways that prove difficult to predict using traditional roadmaps.

To underscore why you, dear reader, should care so much about economic data points, we will point no further than the $8.8 Trillion gorilla in the room- the Federal Reserve. Fed Chair Jerome Powell stated in his most recent speech at Jackson Hole, "Our decision at the September meeting will depend on the *totality of the incoming data* and the evolving outlook." Nine sentences earlier, he described the latest economic data as "mixed." Given the correlation between equity market returns and the Fed balance sheet in the QE era, our advice is simple- *pay attention to what the Fed is watching.*



Total Output, Income, and Spending



GDP

In the second quarter of 2022, according to advance estimates, real gross domestic product (GDP) in chained (2012) dollars fell 0.9 percent (annual rate), current dollar GDP rose 7.8 percent, and the chained price index rose 8.7 percent. Per a Bloomberg survey of 65 economists conducted from Sept. 2 to Sept. 7, the US economy will expand 1.6% in 2022, 0.9% in 2023, and 1.6% in 2024. Their estimate of a recession risk over the next 12 months stands at 50%.

Personal Income

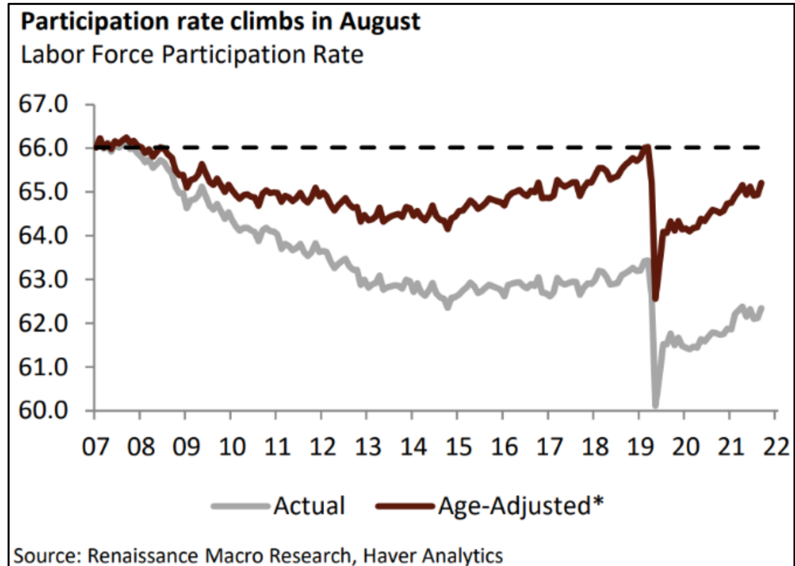
Personal income rose $133.5 billion (annual rate) in June, following an increase of $128.0 billion in May. Wages and salaries rose $52.2 billion in June, following an increase of $62.8 billion in May. According to advance estimates, per capita disposable personal income in chained (2012) dollars fell 0.7 percent (annual rate) in the second quarter of 2022.

Corporate Profits

In the first quarter of 2022, according to current estimates, corporate profits before tax rose $87.1 billion (annual rate) and profits after tax rose $26.4 billion. In the second quarter of 2022, according to advance estimates, nonresidential fixed investment in chained (2012) dollars fell $0.5 billion (annual rate) and residential fixed investment fell $25.8 billion. Inventories rose $81.6 billion, following an increase of $188.5 billion in the fourth quarter.

Employment, Unemployment, and Wages

Labor Force

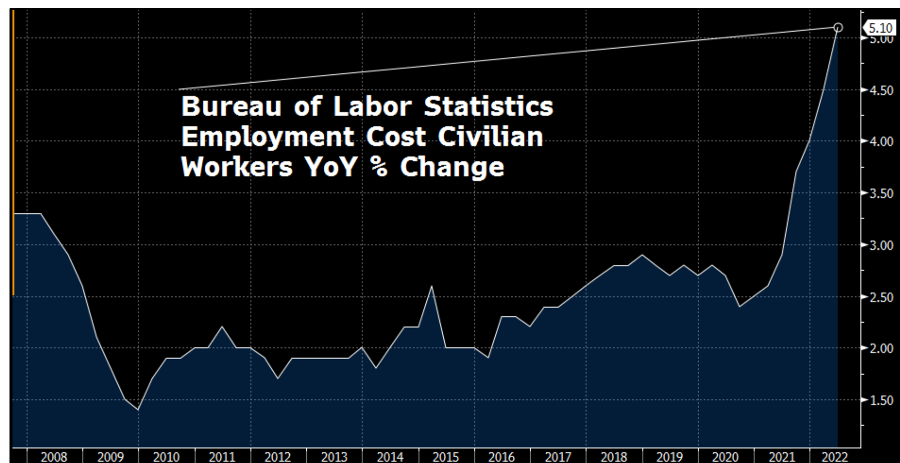


In July, the unemployment rate fell at 3.5 percent, while unemployment as measured by the household survey fell 242,000 to 5.7 million. In July, the percentages of the unemployed who had been out of work for less than 5 weeks, for 15 to 26 weeks, and for 27 weeks and over fell, while the percentage for 5 to 14 weeks rose. The mean duration of unemployment fell to 22.1 weeks and the median duration remained at 8.5 weeks. Encouragingly, the labor force participation rate jumped sharply.

Nonagricultural Employment

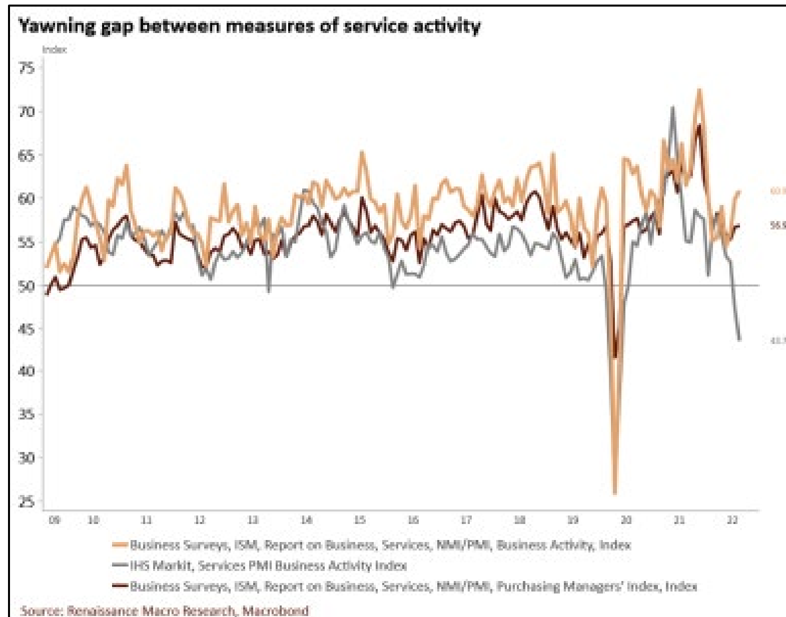
Total nonagricultural employment, as measured by the payroll survey, rose by 528,000 in July and an additional 315,000 in August. Over the last three months, job growth has averaged 378,000. That's a very strong rate of job growth- more than sufficient to push the jobless rate down over time.

Earnings



In July, average gross weekly earnings were up 5.3% year over year, with average weekly hours at 34 (vs. 34.3 in July '21) and average gross hourly earnings at $27.57 for private, nonagricultural businesses and $25.09 for manufacturing. Over the last three months, average hourly earnings for all employees rose 4.8% (at the seasonal adjusted annual rate). If one assumes 1% productivity growth, this is consistent with wage cost inflation of 3.5 – 4.0%. The civilian employment cost index was up 5.1%.

Production and Business Activity



Industrial Production and Capacity Utilization

Underscoring Powell's "mixed" moniker for economic data- we find a sharp divergence between two popular measures of service industry activity. The ISM Services PMI is firm, climbing to 56.9 in August, the highest since April. On the other hand, the S&P Global (Markit) US Services PMI sank to 43.7, the lowest on record, excluding the initial pandemic shock. Encouragingly, traveler throughput and restaurant dining are both running somewhat above the same holiday period in 2019.

Business Sales and Inventories—Manufacturing and Trade

In May, according to preliminary estimates, manufacturing and trade sales rose 0.7 percent. In June, manufacturing and trade inventories rose $3.3 billion and retail inventories rose $14.1 billion. In June, retail sales rose 1.0 percent, while retail and food services sales rose 1.0 percent. Industrial production and capacity utilization fell, while manufacturers' shipments, inventories, new orders, and unfilled orders rose.

Housing

Existing home sales fell for the 6th consecutive month, declining 5.9% m/m in July to 4.81 million units SAAR, the lowest level since May 2020 and down 20.2% y/y. July inventory stood at 1.31 million, up 4.8% from June, equating to a 3.3-month supply at the current sales pace, up from 2.9 months in June, still tighter than a balanced 6-month figure. Sales were down in all US regions, with the greatest decline observed in the West Region (9.4%). First-time buyers account for 29% of all resale purchases while cash deals represent roughly one-fourth of sales, the same as in June. Individual investors or second-home buyers, who account for a higher proportion of cash sales, purchased 14% of homes in July, 2ppt lower from June. The median national sales price was $403k in July, up 10.8% y/y, while for single-family homes, the median price was $410.6k in July, up 10.6% y/y.

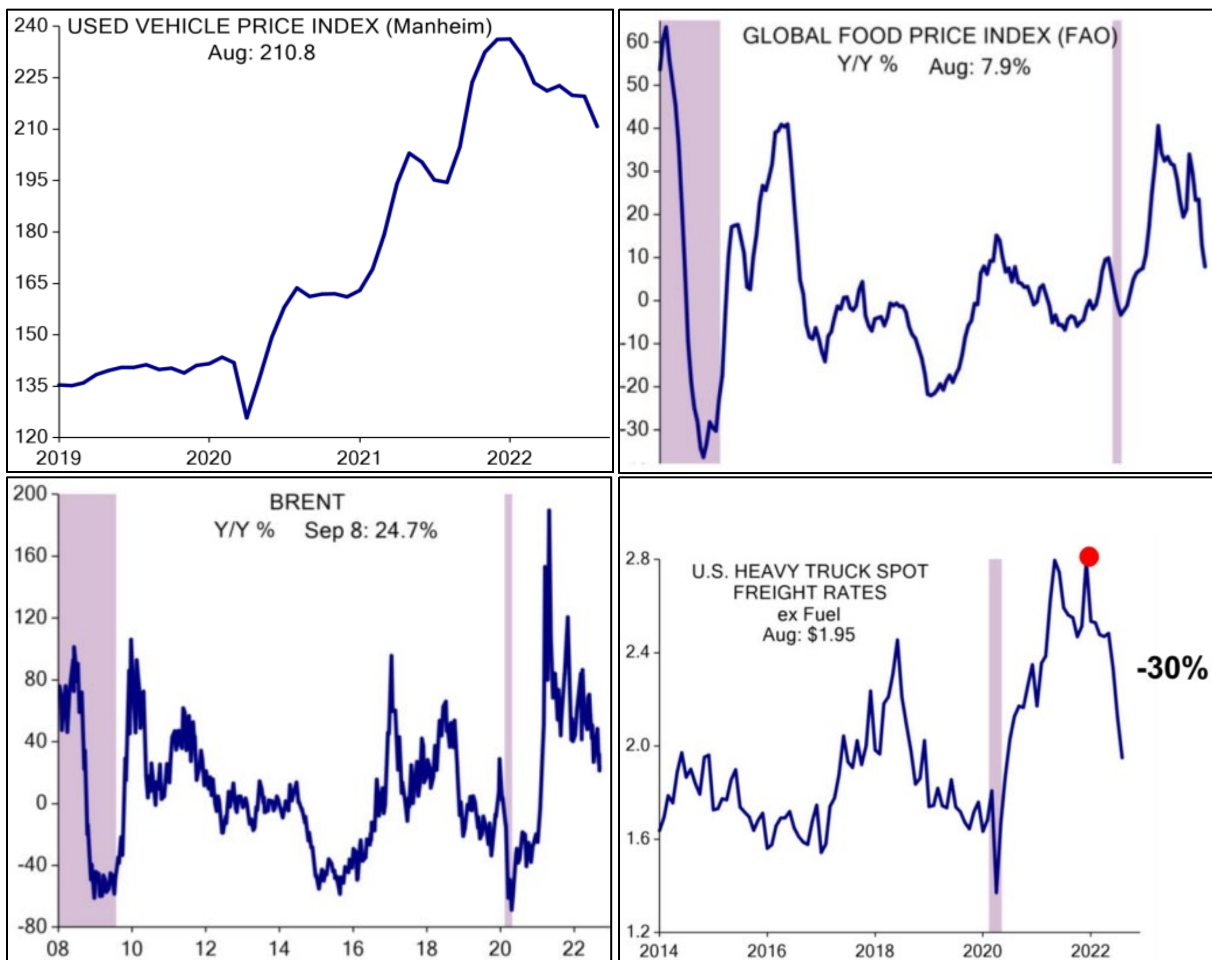
Prices

Producer Prices

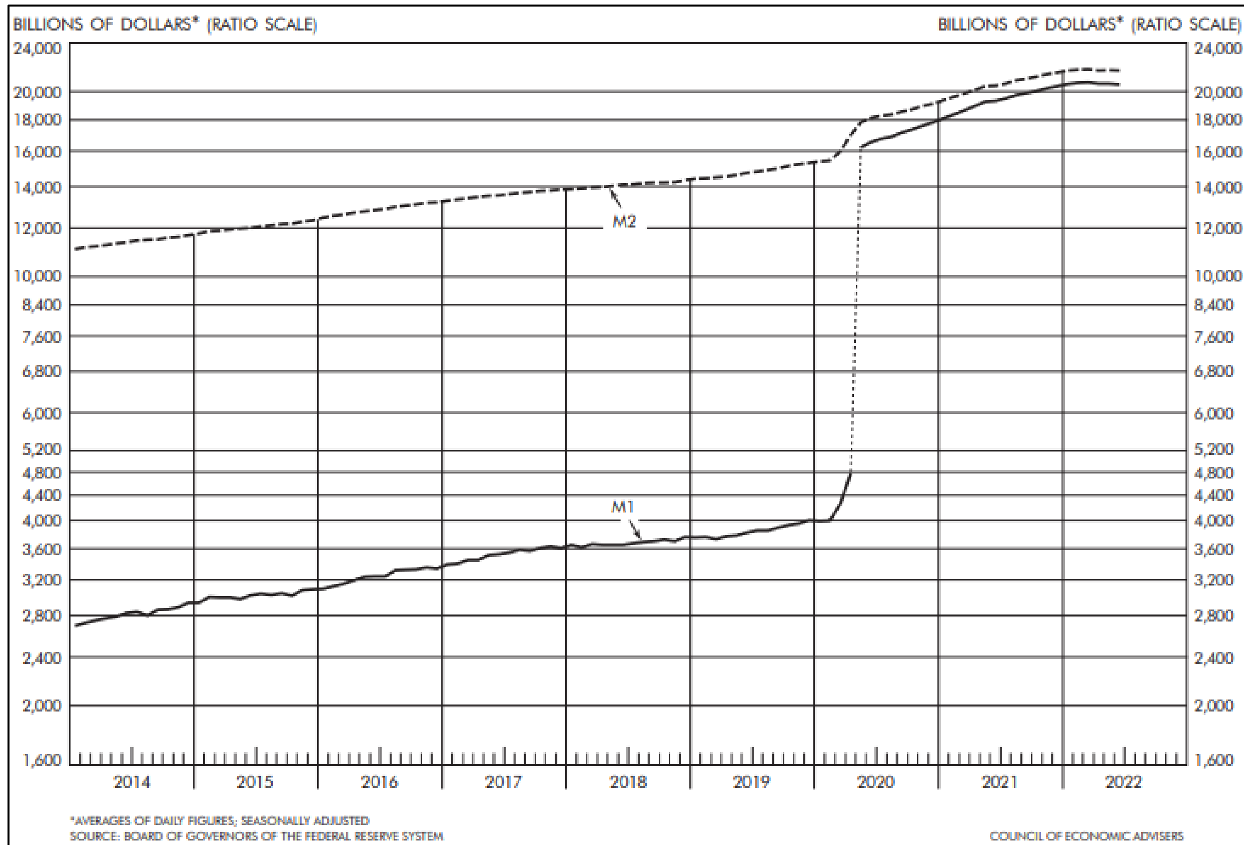
The producer price index for final demand rose 1.1 percent in June. Prices for final demand goods rose 2.4 percent and prices for final demand services rose 0.4 percent. Pricing power surveys are weakening while wage inflation continues to run above trend.

Consumer Prices

In June, the consumer price index for all urban consumers rose 1.3 percent; it rose 1.4 percent before seasonal adjustment. The index rose 9.1 percent from its year-earlier level. The charts below, courtesy of our friends at Evercore ISI, provide an anecdotal panel of CPI components, evidencing cooling inflation trends across many core categories:



Money, Credit, and Security Markets



M2

In June, M2 fell for a 3rd consecutive month from its peak in March. While still elevated on absolute levels, the rate of change has plunged from almost +30% y/y last year to approximately +4% last week. With M2 growth already headed towards zero and QT doubling this month, M2 could contract for the first time since the 1930s.

Interest Rates and Bond Yields

Interest rates were mixed in July. The Fed QT program is draining public demand for Treasuries; with QT, private demand must increase to fill the hole of no net purchases by the Fed. Mutual fund flows into fixed income were in negative territory but improved last week.

Stock Indices & Yields

The S&P 500 rallied sharply to begin the 3rd quarter, breaching its 50- & 100-day moving averages. The rally stalled in mid-August, then retraced to its current levels, hovering around both moving averages.

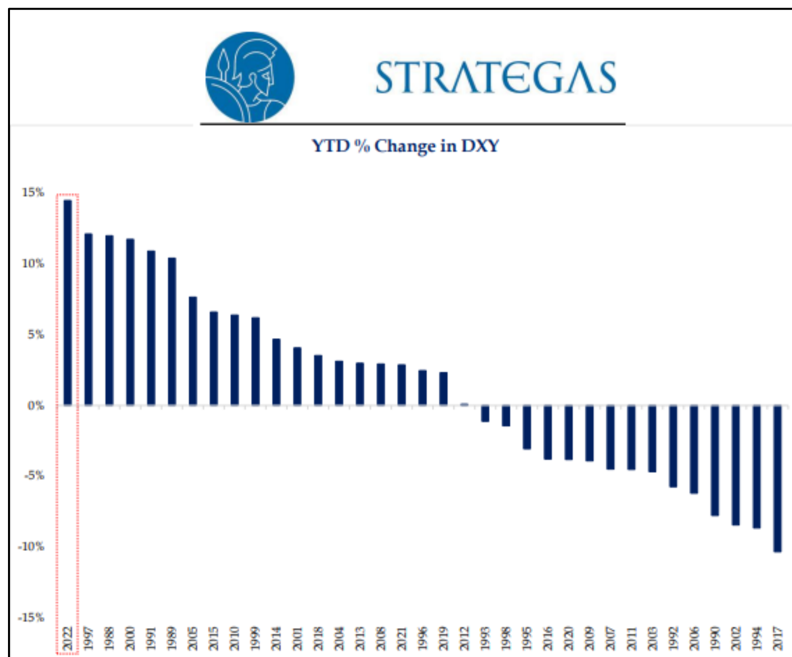
Federal Finance and International Statistics

Federal Finance

In the first nine months of fiscal year 2022, the deficit was $515.1 billion, compared with a deficit of $2.2 trillion a year earlier. In the first nine months of fiscal year 2022, receipts were $779.3 billion higher than a year earlier, and outlays were $943.5 billion lower. In the second quarter of 2022, according to advance estimates, Federal current expenditures rose $73.6 billion (annual rate); Federal current receipts are incomplete.

International Trade

In the first quarter of 2022, the current account deficit widened to $291.4 billion from $224.8 billion in the fourth quarter. The goods and services deficit widened to $283.8 billion from $225.0 billion in the fourth quarter. In the financial account, US net borrowing was $277.5 billion in the first quarter of 2022, resulting from a net increase in US financial assets of $343.1 billion, plus a net increase in financial derivatives of $5.8 billion, less a net increase in US liabilities of $626.4 billion. US net borrowing was up from $203.9 billion in the fourth quarter.



Currency

This has been the strongest year-to-date move for DXY going back to 1988, up nearly 14.5% YTD, surpassing the move in 1997 that eventually lead to the Asian currency crisis. This year, the BOJ and ECB's suppression of interest rate volatility has come with a price as their currencies act as release valves for said volatility suppression. Historically, a rising DXY has favored domestic equities relative to international and emerging market equities; consistently, it will likely continue to weigh on companies with high foreign sales exposure.

Fixed Income

By Nick Prillaman

At our previous meeting in June, equity markets were moving lower while interest rates were approaching their previous highs. Employment was strong as evidenced by the robust May jobs number, and elevated inflation data pushed up rate hike expectations. On June 10, the May Consumer Price Index data from the U.S. Bureau of Labor Statistics was released with a 1.0% gain month-over-month, and the University of Michigan's reported long-term inflation expectations rose to 3.3%. Prior to these numbers, the Federal Reserve was expected to raise rates by 50 bps. After these datapoints, rate hike expectations rose to 75 bps for June per BofA Securities. On June 15, the Federal Reserve did increase the fed funds target rate by 75 bps and said, "Inflation remains elevated, reflecting supply and demand imbalances related to the pandemic, higher energy prices, and broader price pressures." In the wake of a more aggressive Federal Reserve, various parts of the Treasury curve actually fell in yield as recession fears weighed on investors' minds through the rest of June. The 2s/10s Treasury curve managed to stay positive for the month though it came within less than a basis point of going negative on June 13.

Spread products suffered in the risker portions of the market. Bloomberg said agencies returned -.71%, which outpaced the -.88% in Treasuries by 17 bps. MBS returned -1.601% and trailed Treasuries by 72 bps as spreads widened. Corporate bonds fared poorly as Wells Fargo showed high-grade bonds posting a negative 2.80% total return. High-grade spreads widened by 26 bps and posted an excess return of -168 bps. Tobacco and Cable/Satellite lagged the most among high-grade sectors tallying excess returns of -343 bps and -297 bps. High-grade new issuance was $71 billion, which was the lightest June since 2013. In terms of high-yield corporates, performance was materially worse than high-grade as the asset class lost 6.73% in total return.

The month of July was completely different than the previous month. The S&P 500 returned 9.22%, the best month since November 2020, as "better than expected financial results from some of America's biggest companies and bets that the Federal Reserve could curtail its policy of constraining the economy sooner than previously expected" fueled the rally per Joe Rennison at *The New York Times.* The 2Q GDP preliminary estimate by the U.S. Bureau of Economic Analysis came out in July and showed the economy contracting 90 bps. According to BofA Securities, this data point caused markets to begin "to price a potential Fed pivot or the Fed shifting attention away from inflation and towards growth." The Federal Reserve met on July 27 and raised its target rate again by 75 bps. At the press conference, Fed Chair Jerome Powell said, "While another unusually large increase could be appropriate at our next meeting, that is a decision that will depend on the data that we get between now and then." The market interpreted the overall press conference to be less hawkish.

In terms of performance, Treasuries were more muted when compared with the large moves in other asset classes. The 2-year Treasury yield fell around 7 bps, but longer portions of the curve experienced greater yield declines with the 10-year Treasury yield

falling around 36 bps. These movements caused the 2s/10s curve to materially invert and ended the month at -23.5 bps. Bond investors clearly became concerned about economic growth failing to materialize in the near future.

For government-related spread sectors, Bloomberg said agencies underperformed Treasuries by 51 bps while MBS handily outpaced Treasuries by 162 bps as the Bloomberg Agency Fixed Rate MBS Average OAS compressed by a stellar 19 bps. The lack of duration impeded the total return of agencies. Corporate bond total returns were excellent in the month of July as risk assets rallied. Wells Fargo said high-grade corporates posted a 3.24% total return and high-yield registered a 5.90% total return. Railroads lead the way among high-grade credits with 218 bps of excess return. Airlines' excess return was the worst at -23 bps. High-grade new issuance was $90.4 billion, which was similar to last year's period.

The month of August saw risk assets performing well in the first half as inflation exhibited signs of cooling. Jesse Pound at CNBC.com said the averages were boosted by the positive inflation news, with the Consumer Price Index remaining flat from June to July, the Producer Price Index showing an unexpected decline, and import prices falling more than expected as well. However, the second half of the month was difficult for investors as the Federal Reserve's Jackson Hole Economic Symposium drove markets. Leading up to the conference, U.S. equities fell as "investors braced for a hawkish message from the Federal Reserve," per Sarah Min at CNBC.com. Once Fed Chair Powell delivered his remarks on August 26, stocks fell precipitously as the message was decidedly hawkish.

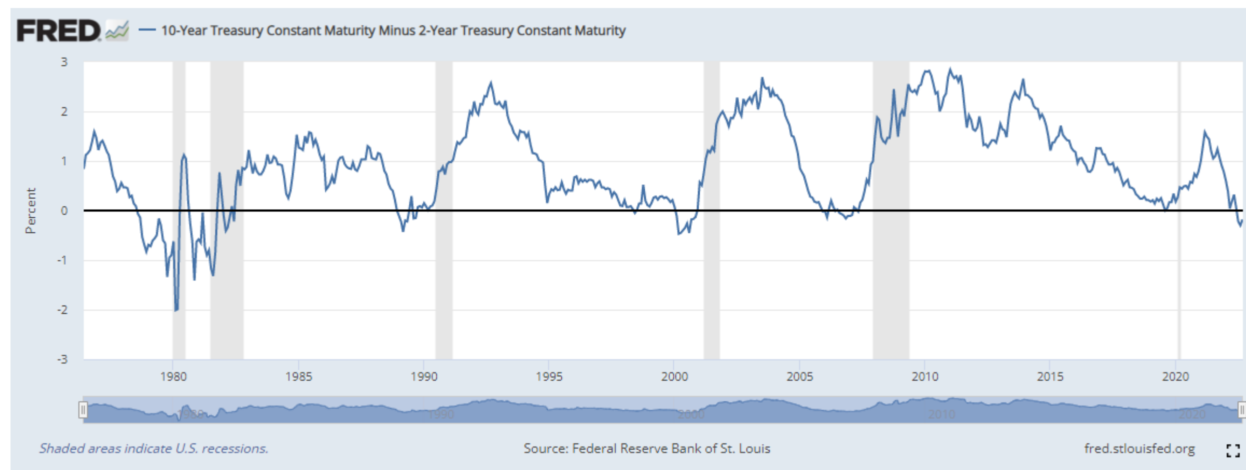
Treasury yields ground higher through the month even as the mood of the stock market changed. The 2-year Treasury yield rose 61 bps while the 10-year yield increased by 54 bps. The yield curve remained inverted and reached its nadir at -49 bps. According to Bloomberg, Treasuries returned -2.48% in August, which handily beat the -3.42% return in mortgages but failed to outpace agencies at -1.67%. The short duration of agencies was the driver of outperformance.

Corporate bond fared decently given the turbulence in the back part of the month. According to Wells Fargo, high-grade total return came in at -2.93%, with spreads tightening by 3 bps, while high-yield returned -2.30%, with spreads widening by 15 bps. Among high-grade sectors, Airlines snapped back and registered a 1.63% excess return, while Pharmaceuticals were the worst with excess returns of -.64%. On the supply front, high-grade issuance was robust at $114.7 billion, while high-yield posted a slim $8.1 billion in new issuance.

Volatility has continued into the first week of September with Russia stopping the gas flow to Europe via Nord Stream 1. The announcement from the Institute for Supply Management didn't help either as the report showed an expansion in the Services Index from 56.7 to 56.9, which according to Rita Nazareth at Bloomberg, "just reinforced market bets on more hikes." Hopefully, the financial markets will get through this bout of disorder and eventually stabilize.

In terms of activity in RSA's fixed income portfolio, we made multiple adjustments to the Treasury portion. We purchased a February 2028 note at a yield of 3.421% to increase our weighting to the intermediate part of the curve where we lacked exposure. It seemed like an opportune time to establish the position after yields had materially spiked over the previous two weeks. The RSA also swapped out of a short 2023 Treasury and purchased a 2032 bond to increase duration. The portfolio had benefitted from the backup in yields with its short-duration position, so we felt it to be prudent to hedge against a drop in longer-dated yields arising from a policy mistake. A third trade was selling a portion of the recently purchased 2028 issue to take advantage of the price gains after bond prices surged in response to rising recessionary fears. We felt we would have another opportunity to redeploy the funds as central banks appeared driven to further push interest rates higher. Finally, we monetized the gain in the 2032 bond that was mentioned above for similar reasons as the 2028 bond sale.

The outlook for the Treasury market is that interest rates will continue to move higher until economic data allows the Fed to pivot towards a more accommodative interest rate regime. A combination of the war in Ukraine, gigantic fiscal stimulus, Covid-19, and too much monetary stimulus for too long, has caused inflation to handily exceed the Federal Reserve's inflation target of 2%, which is why they are having to take drastic action to reduce the price gains. While they can't change the supply issues in the economy, they can affect aggregate demand, which is what they are targeting. They are hoping to accomplish this by interest rate hikes as well as by quantitative tightening, which is described later in the mortgage section. Since our last meeting, the Federal Reserve has raised rates by 75 bps at both the June and July meetings. This fast pace of interest rate hikes has caused the Treasury curve to invert. It briefly inverted in April, but finally went negative in a sustained fashion at the beginning of July and has maintained the position since. The curve currently stands at -21 bps at the time of writing. The 2-year is at 3.41%, while the 10-year 3.20%. Typically, a sustained negative yield curve is a harbinger for a recession, and as one can see in the chart below, a negative curve preceded the popping of the Technology Bubble in 2000 as well as the Great Recession in 2008. This time might be different, but one must be mindful of the historical precedent of the indicator.



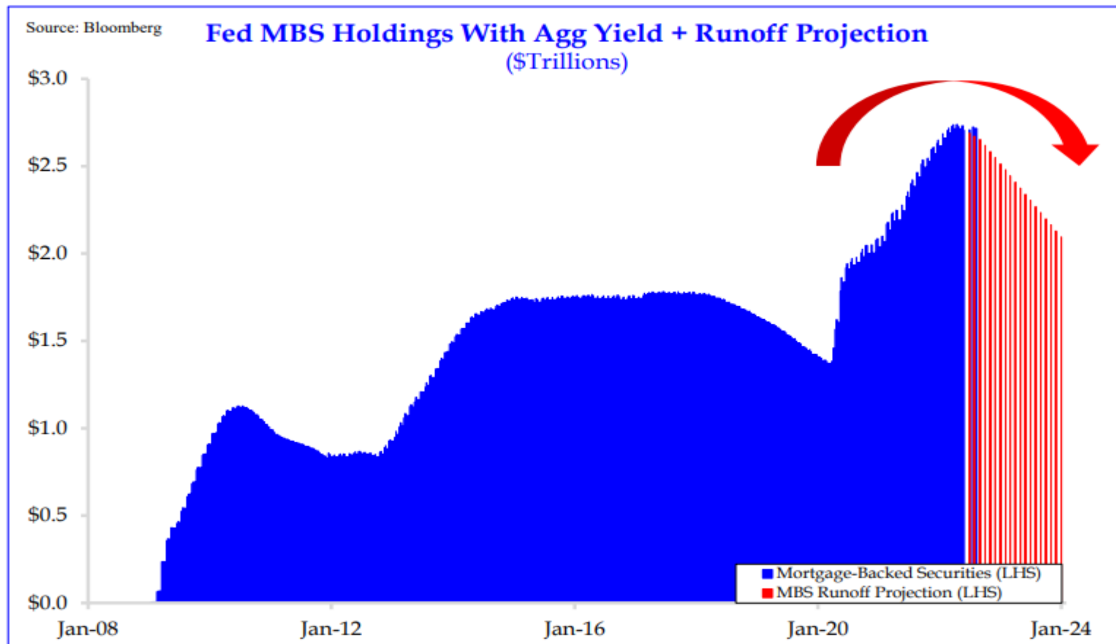
Source: Federal Reserve Bank of St. Louis

Even though the Federal Reserve has materially raised rates, they do not appear to be finished. In August, the Fed held its Jackson Hole Economic Symposium, and investors were sorely disappointed as Fed Chairman Powell did not back down from his inflation-fighting posture. On the whole, his remarks were deemed very hawkish. For example, he said, “Restoring price stability will likely require maintaining a restrictive policy stance for some time. The historical record cautions strongly against prematurely loosening policy. He also stated, “We are taking forceful and rapid steps to moderate demand so that it comes into better alignment with supply, and to keep inflation expectations anchored. We will keep at it until we are confident the job is done.” With these comments, one must wonder how high rates could go. Cleveland Federal Reserve President Loretta Mester said in late August that she “sees benchmark interest rates rising above 4% by early next year” per CNBC.com. According to Bloomberg, the April 2023 Federal Funds Futures contract is showing the terminal rate to be 3.905%. Regardless of the market’s expectations, the future path of interest rates is going to depend on future economic data. In the meantime, we are going to maintain flexibility in dealing with the current interest rate environment and make adjustments as markets dictate.

For agencies, we purchased a June 2032 Federal Farm Credit note right before our last meeting that becomes callable after one year. With yields near their highs at the time of purchase, combined with a healthy spread of 140 bps over Treasuries, this security appeared attractive. Also, with rates projected to keep rising, the probability of the bond getting called was low. This trade helped to maintain our duration to almost neutral versus the index, which seemed wise given the large recent interest rate movements. We also added a June 2024 Federal Home Loan Bank note to essentially replace a maturing bond at spread levels not seen since the initial phase of the pandemic. The outlook in the agency space is that while spreads have already expanded over the recent time frame, they could continue to widen further in the face of an increasingly adverse economic environment. However, when compared with other risk assets, agencies spreads should stay fairly contained due to their government-related nature. We are roughly neutral in duration when compared with the index. We will continue to perform maintenance-type trades as securities mature and will be opportunistic in the market, especially if volatility spikes even more, which could provide an additional attractive entry point into callable securities.

Activity in the mortgage portfolio included buying a Fannie Mae 30-year 3.0% coupon to reinvest prepayments at attractive yields, raise our weighting in mortgages and increase the duration of the portfolio. It also helped increase our weighting in the 30-year 3.0% coupon where we were underweight. The pool had an estimated static yield of 3.614% and a spread of 70 bps over the 5-year Treasury. The purchased pool had a maximum loan size of $250,000, while Rocket Mortgage was the servicer. These two attributes should provide two-sided convexity benefits. Our view for the asset class is that volatility is going to be a problem for the foreseeable future with the Federal Reserve’s plan for quantitative tightening being the principle driver. The Federal Reserve stepped up the maximum pace of balance sheet reduction to $95 billion per month on September 1, with $60 billion coming from Treasuries and $35 billion from mortgages. The cap was $47.5

billion, which started in June per Isabelle Lee at Bloomberg. Shown below is a graph from Strategas Research illustrating the projected runoff of mortgages from the Fed's portfolio.



Source: Strategas Research Partners

With the Federal Reserve ceasing to buy large quantities of mortgage-backed securities, spreads should move higher and thus hurt performance in the space. Even with the potential for increasing spreads, mortgages continue to offer better yields than other government-related sectors, and since large portions of the asset class trade below par, prepayment risk is more muted than usual, which makes mortgages more attractive. The fixed income portfolio is underweight mortgages as corporate bonds remain the sector with the highest yields. We will continue to reinvest prepayments as yields appear attractive, given where they were a few years ago, and will remain open to additional purchases should quantitative tightening cause dislocations in the market.

In the corporate bond sector, we added a number of bonds like a block of April 2024 Energy Transfer LP at a spread of 116 bps for a total yield of 4.634%, an August 2025 Pricoa Global Funding bond which is a Prudential Security at a spread of 83 bps, and a 2033 Waste Connections note at 153 bps in spread. JPMorgan, Celanese, Teva, and various other company bonds were purchased as well. The combination of wider spreads with higher yields offered a compelling buying opportunity for the fund to take advantage of. As the chart below shows, both the high-grade and the high-yield indexes are trading wider than their 5-year average and are meaningfully above 2021's levels. Year-to-date as of September 2, the high-grade index has moved 52 bps higher in spread and sits at an overall spread of 150 bps, while the high-yield index is 196 bps higher with a current

overall spread of 506 bps per CreditSights. It seems probable that with a recession appearing to loom on the horizon, credit spreads will continue to widen until the Federal Reserve pivots from its hawkish tone. The widening should be less severe than prior economic slowdowns given the various actions corporations have taken over the last couple of years. Low interest rates and tight spreads have allowed companies to refinance and push out maturity walls which will help them better weather a recession from a credit perspective. With that being said, we prefer high-grade corporates as high-yield bonds appear somewhat rich given the economic backdrop. Long term, corporates outperform other fixed-income asset classes, which is why we continue to be overweight and are short-duration to limit the portfolio's interest rate risk.

Source: CreditSights

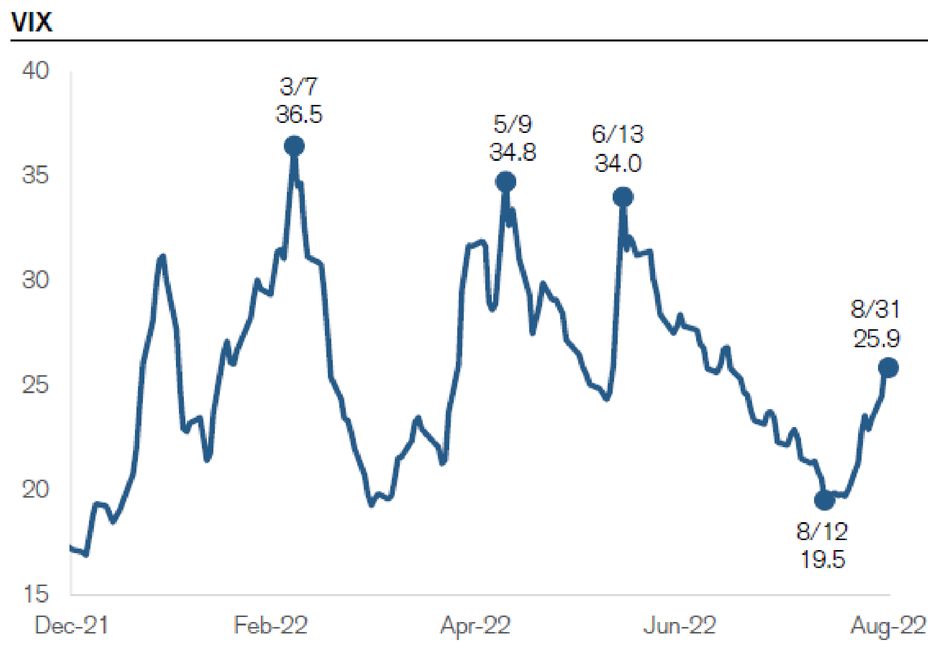
Domestic Equity Strategy

By Allan Carr

Our last economic update was on June 15, which was the day the Fed raised rates 75 basis points, the largest rate hike since 1994. Just a year prior at the June FOMC meeting, futures were indicating the Fed's tightening campaign wouldn't start until May 2023 and would end with roughly a 2% terminal rate. The Fed went 75 bps again in July, and odds are increasing of a third 75 bps hike in September. The futures curve now shows a terminal funds rate of 4% in May 2023.

I last wrote in December of last year and said we expected 2022 to be much tougher and volatile. Not that it was going out on a limb following how impressive 2021 was and that we were about to transition from QE to QT. Throw some geopolitical unrest on top and it's been tougher and more volatile than many thought (exhibit 1, CSFB).

EXHIBIT 1



On June 16, the S&P closed at the low of the year, down over 23.5% from the all-time high set on the first trading day of 2022. Then the market rallied sharply into late August, recouping 17.4% of the decline. The predominant reason for the turnaround was once again a strong showing by Corporate America. Following two negative quarters of GDP, there was some angst about the reporting season. However, 2Q earnings surprised to the upside with EPS growth of over 10% versus the consensus of 5-6%, and over half of the companies beat expectations.

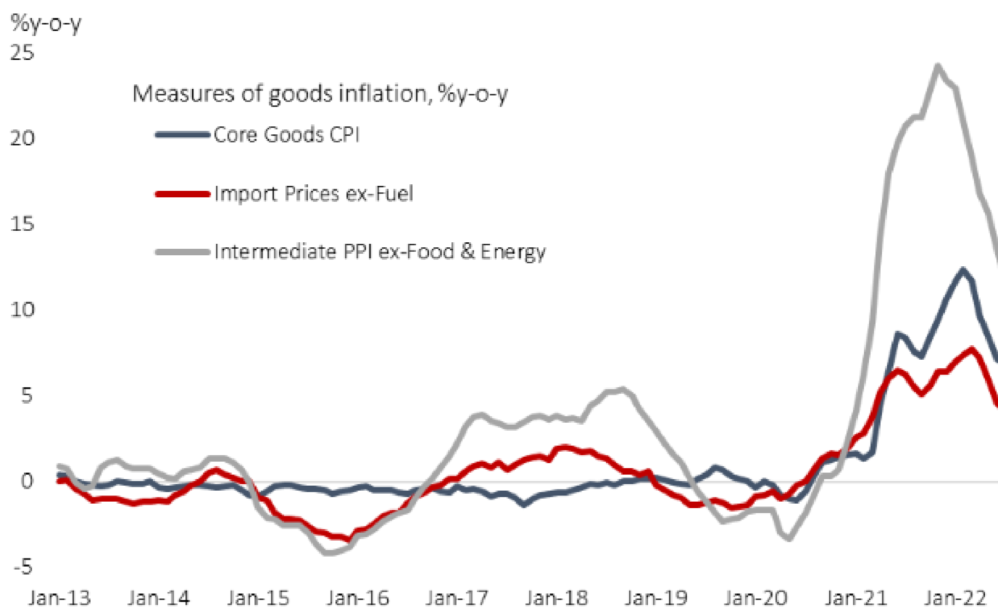
Just as a growing chorus was calling for a possible Fed "pause" later in the year, Chairman Powell squashed that possibility in his speech at Jackson Hole on August 26

when he described the policy outlook as “sufficiently restrictive.” Markets did not like the hawkish tone, with the S&P falling just shy of 3.5% on the day. The following week saw another nearly 4% selloff, then a similar bounce back in the last 3 days as we go to print.

As we look ahead, there’s a laundry list of areas to worry about both here and abroad. The overwhelming focus domestically is can the Fed succeed in taming inflation without crushing the economy. It’s no small task given the unprecedented fiscal and monetary stimulus thrown at the economy in 2020-2021. Not only is there no longer a “Fed Put,” they are now hawkishly committed to stamping out inflation. The way to get to their goal is through higher rates and some mixture of lower wages and job losses. That historically has led to recessions.

Refer to the Fiscal and Economic portions of the update for more detailed information on inflation, but to touch on it briefly in this section, as all eyes are on inflation and the Fed. There have been improvements on the goods side of the equation via commodity and import prices, as well as supply chain issues easing, to where we’ve likely seen peak inflation on the goods side (exhibit 2, GS).

EXHIBIT 2



Source: Haver Analytics, GS MarketStrats.

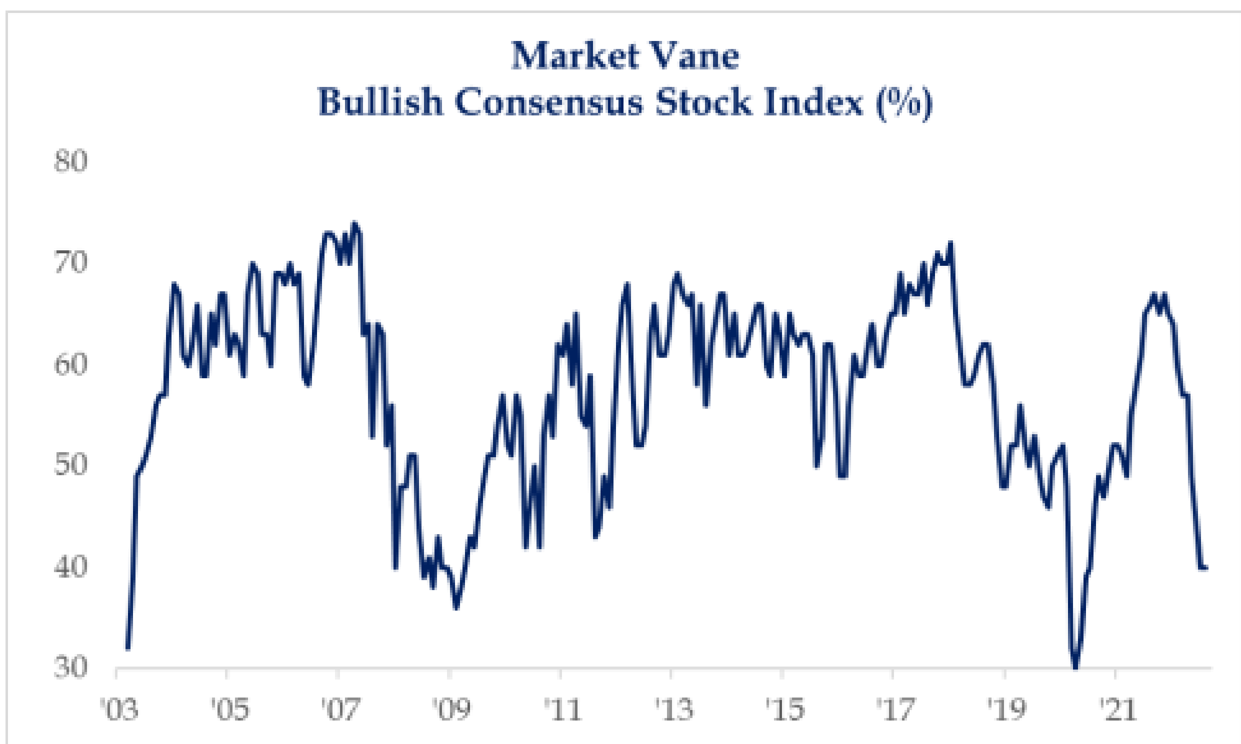
The attention now is on the services side and what will happen with employment and wages. The August jobs report showed a headline beat, but the details showed some slack with downward revisions to prior reports, an increase in the participation rate, stable wage gains, and an uptick in the unemployment rate. Per Goldman Sachs, of the roughly 100 companies that mentioned labor in their 2Q earnings calls, 35 talked about labor availability improving versus only 1 saying it has worsened. While only a blip, it is the first sign of any slack in labor.

It should be noted that the bear case is no secret by any means. Inflation and rate hikes are talked about everywhere and by everyone. Recent weakness post-Powell's speech has resulted in many saying the June S&P low will be taken out and recession is a foregone conclusion. The bears are loud and plentiful currently.

In times where there appears to be an overwhelming consensus, it's important to look and try to find what's discounted in the markets and where opportunities lie. We will take a stab.

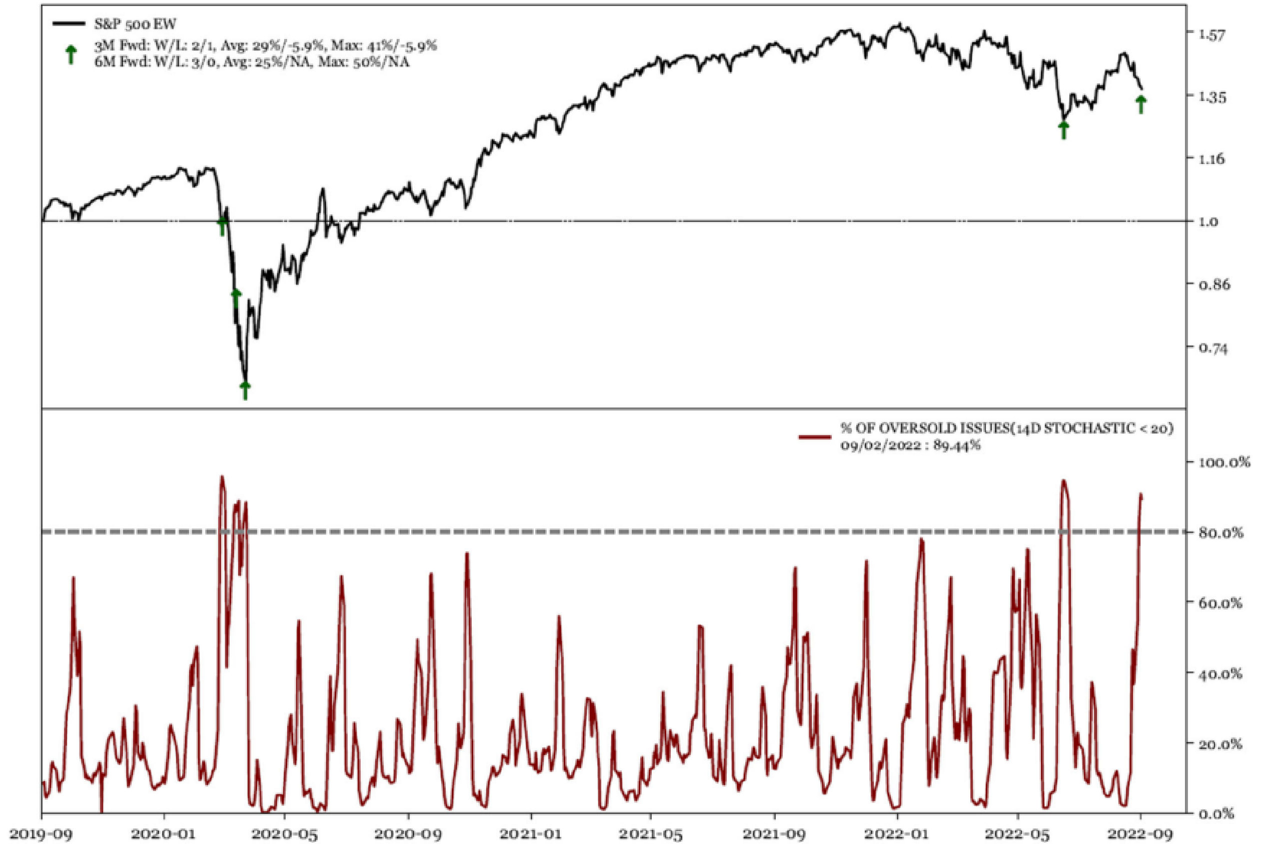
For starters, and not surprisingly, sentiment is really lousy (exhibit 3, Strategas).

EXHIBIT 3



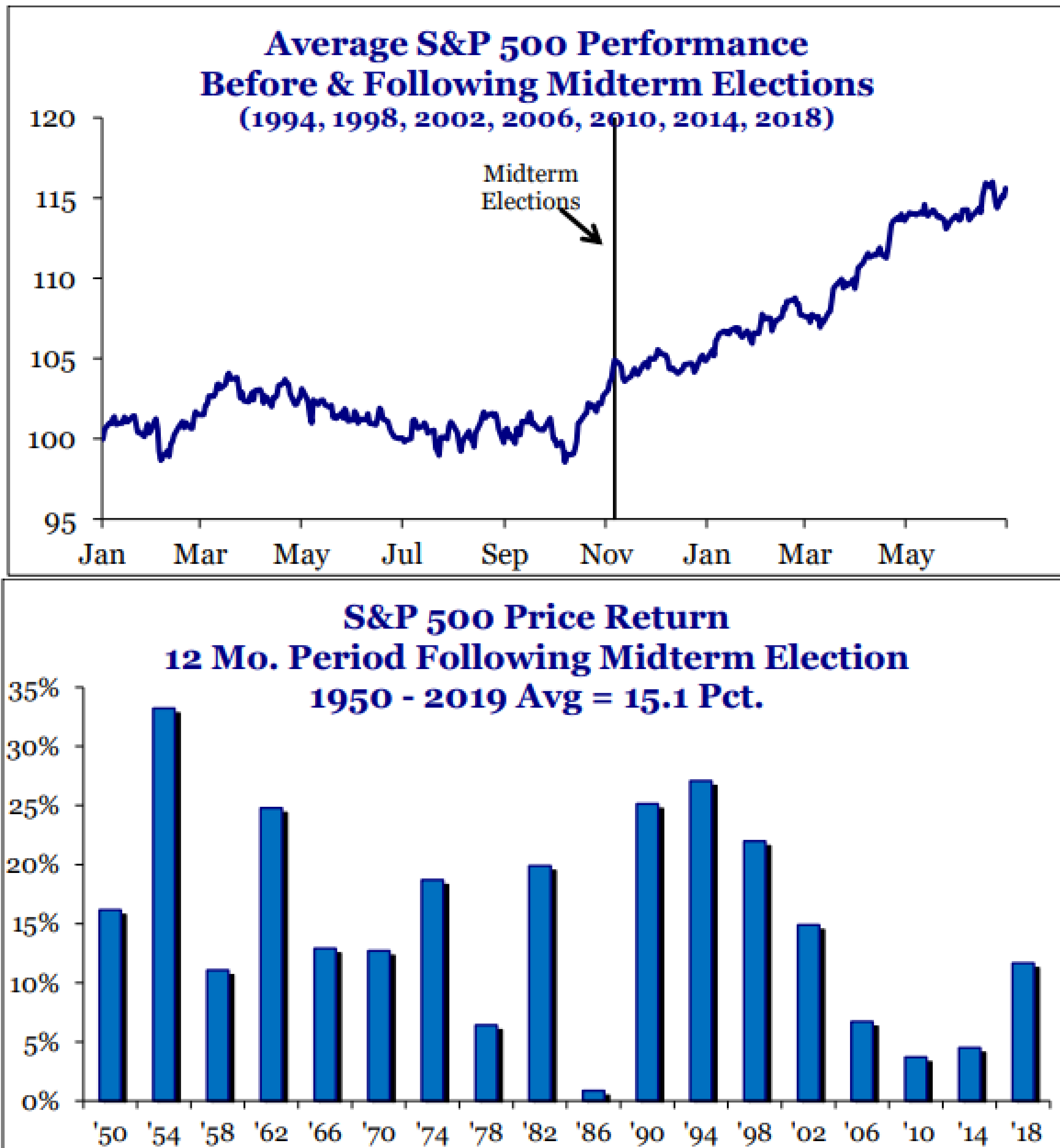
Additionally, given the sharp selloff post-Jackson Hole, nearly 90% of names in the S&P were oversold on a technical basis (exhibit 4, Renmac).

EXHIBIT 4



Midterm elections are closely approaching, and it's no longer a given that the Republicans will take the House and Senate, with the odds now showing Democrats holding on to the Senate. Who knows how it will shake it in two months, but history shows that the markets tend to do well once the outcome is known (exhibit 5, Strategas).

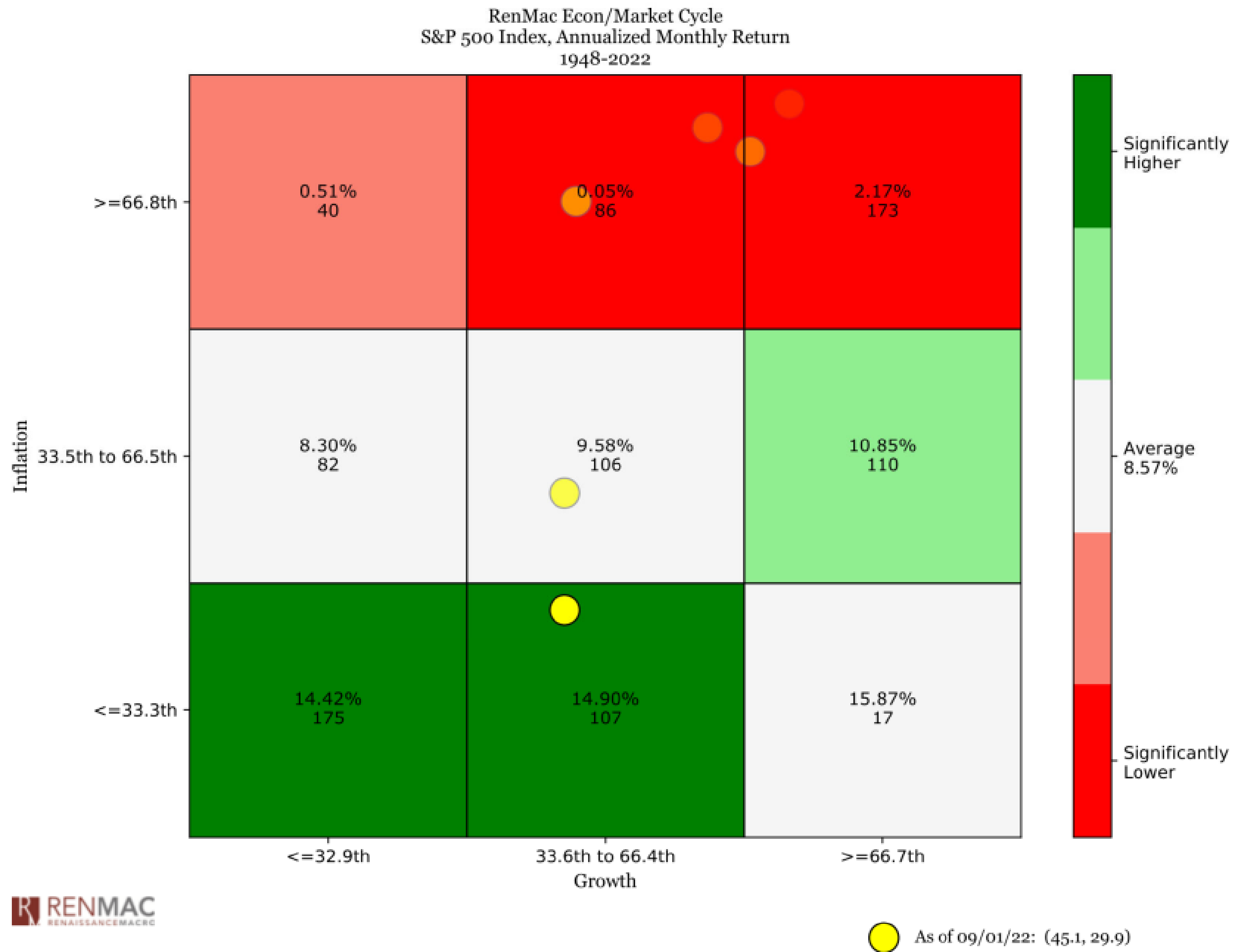
EXHIBIT 5



Lastly, the Renmac "market cycle clock" is something that has our attention in that it is so out of consensus. The sweet spot for this reading is an environment of modest growth combined with decelerating inflation. It takes time for rate hikes to kick in, and this model is suggesting that higher rates are in fact working to bring down inflation more than people

realize. The most recent reading on their model shows the market is in the zone where 12-month returns are in the 15% range (exhibit 6, Renmac).

EXHIBIT 6



Looking ahead, sentiment, oversold conditions, and the consensus being so negatively tilted is a more favorable position to be in as we head into the seasonally weakest month of September. From there, eyes will turn to 3Q earnings to see if Corporate American can continue to deliver. Then we move into midterm elections and the seasonally strong half of the calendar.

We recently tested and held the key support level of 3900 level on the S&P. Further slack in the labor market would certainly increase the odds of the Fed navigating a soft landing. We still believe the US remains in a much better position than other markets. But where the market goes from here is tough to answer. Range bound and volatile is probably the best guess. But as Ed Hyman, who's seen a lot more than I have during his career, recently wrote, "The current situation is unprecedented. So when it comes to forecasting, humility is a good idea."

International Equity Strategy

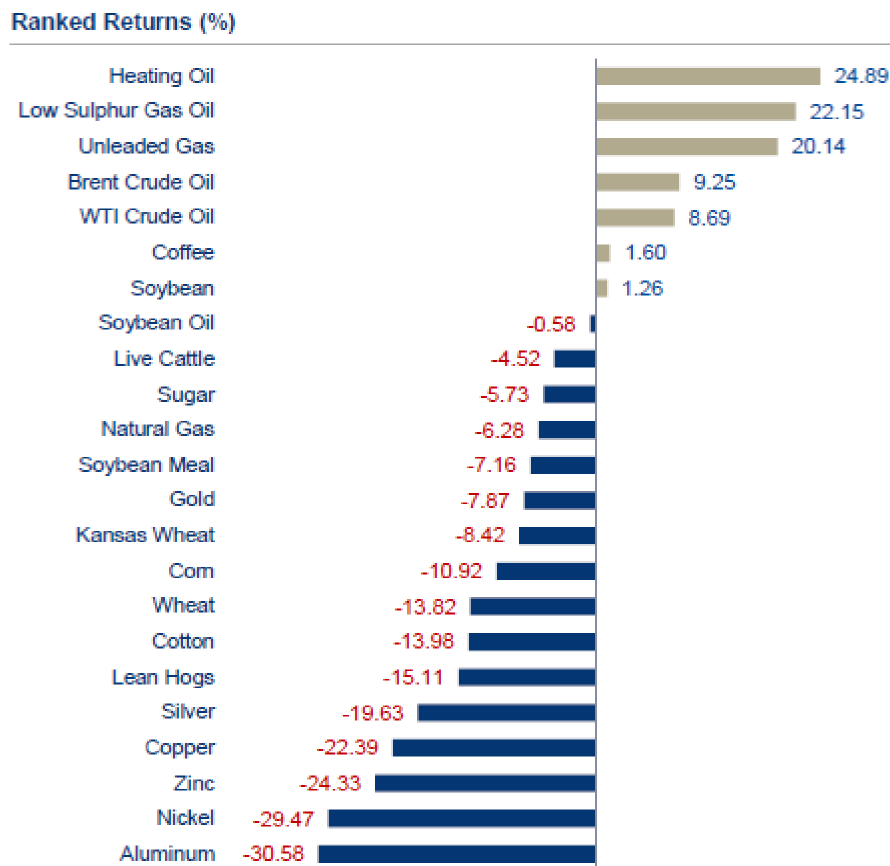
By Steve Lambdin

Financial markets remained a mess in the second quarter as most global equity markets fell in the face of central bank interest rate hikes, sharply higher inflation readings, Covid-19 lockdowns, the war in Ukraine, U.S./China relations, supply chain problems, and a multitude of weakening economic data points. These issues pushed investor anxiety and sentiment to fresh low levels. Many of the central banks embarked on a cycle of interest rate increases aimed at combating inflation in the period. This made for sharply lower equity and bond markets as many markets hit “bear market territory,” and investors were left gauging just how high will interest rates need to move. We saw global consumer confidence fall sharply as higher inflation and energy prices slashed household income substantially. Wage increases helped consumers to some degree, but not to a level to fully offset the inflationary impact. On the supply chain front, we did see many companies report slightly better news as some key components of production were more available in the period vs. the previous quarter, but still not to the level of what is considered normal. On the geopolitical front, the war in Ukraine raged on as casualties and equipment losses mounted on both sides. Russia continued to wreak havoc on Europe with rhetoric around the shutting of the Nord Stream natural gas pipeline. Shutting this pipeline could create a Eurozone recession as key industries in Germany could be shuttered with very little gas availability in the coming months. In addition, energy bills for Eurozone households would rise substantially, pressuring household income even further. China continued to fight Covid-19 in the period, as some areas came off lockdown measures while other areas were hit with fresh lockdown orders. Not all news was negative in China, as we did see positive developments with more stimulus measures being proposed and a relaxing of the recent crackdown on the technology sector. This pushed the equity markets to positive territory and helped the emerging markets lose a bit less than the other developed markets around the globe. Overall, this was a quarter to forget for most equity investors. Going forward, we expect the global equity markets to be volatile as investors digest the multitude of economic data points and news as the recessionary backdrop gains more traction.

	June 2022		2Q 2022		YTD 2022	
Equity index returns (%)	U.S. dollar	Local currency	U.S. dollar	Local currency	U.S. dollar	Local currency
S&P 500	–8.3	–8.3	–16.1	–16.1	–20.0	–20.0
MSCI ACWI	–8.4	–7.4	–15.7	–13.6	–20.2	–17.7
MSCI ACWI ex USA	–8.6	–6.0	–13.7	–8.3	–18.4	–11.9
MSCI World	–8.7	–7.8	–16.2	–14.3	–20.5	–18.3
MSCI Emerging Markets	–6.6	–4.6	–11.4	–8.1	–17.6	–13.7
MSCI EAFE	–9.3	–6.3	–14.5	–7.8	–19.6	–11.3
MSCI Europe	–9.9	–7.7	–14.5	–8.7	–20.8	–13.6
MSCI Pacific	–8.1	–3.8	–14.4	–6.0	–17.1	–6.5

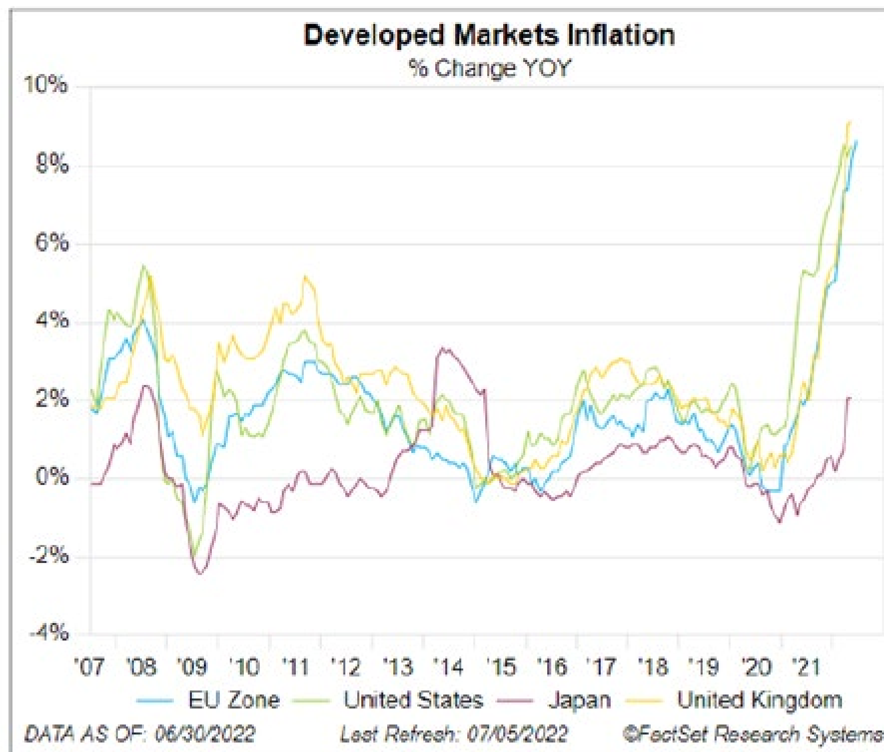
Sources: RIMES; Capital Group

The MSCI EAFE Index (net dividend) and the MSCI Emerging Markets Index returned -14.5% and -11.4%, respectively, during the second quarter of 2022 vs. 16.1% for the S&P 500 Index. This was the first quarter since late 2020 that global equities outperformed U.S. stocks. This was the case even as the U.S. dollar continued to rise in the second quarter and depressed returns by -6.7% for unhedged U.S. investors in the MSCI EAFE Index and, to a lesser extent, in the emerging markets. The Pacific region and the European region had nearly identical returns in the period. All eleven sectors of the MSCI EAFE Index posted negative returns, with the energy sector being the least negative. As recessionary concerns mounted in the period, commodities struggled as the Bloomberg Commodity Index fell -5.66%, led by aluminum -30.5% and nickel -29.4%.



Sources: Resource Consulting Group, Bloomberg

Quarter-to-date thru the end of August, most global equity markets are nearly flat and have been in a seesaw-type pattern as central bank actions are taking center stage. Investors are watching economic readings with a heightened sense of scrutiny in order to keep a watchful eye on a potential global recession developing in 2023 as global growth outlooks continue to be cut. The MSCI EAFE Index and the MSCI Emerging Markets Index are virtually flat, while the S&P 500 Index is up +4.7%.

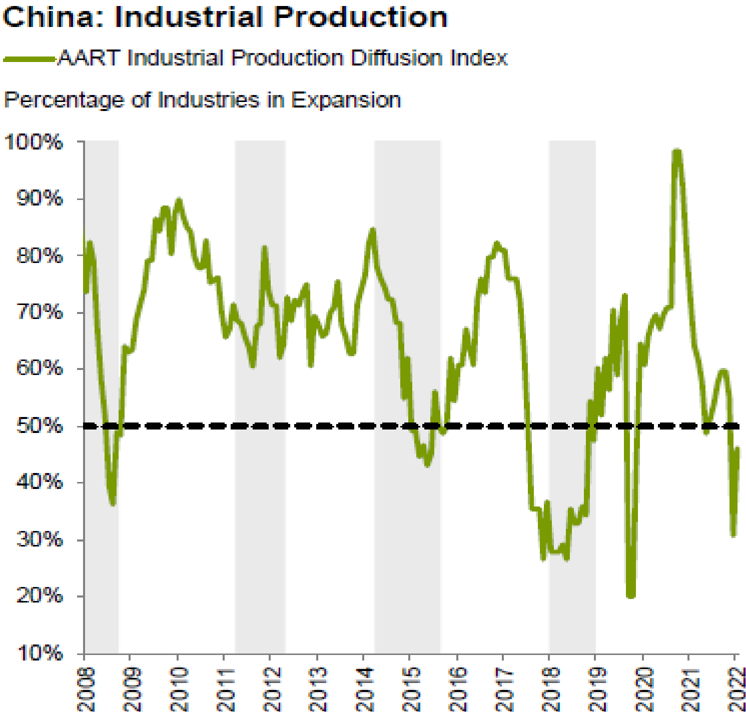


Sources: Eagle Global Advisors; Factset

<u>Asia Update</u>

The Chinese economy continued to slow as Covid-19 lockdowns zapped all growth from the region, as second quarter GDP fell -2.6% from the previous quarter but managed to eke out a gain of +.4% from the year-earlier period. This was the third straight quarter of economic deceleration in this economy and only the second quarter of negative growth since 2011. Industrial production growth continued to trend downward but still grew as June growth slipped to +3.9% from the previous year. Government stimulus actions are helping on the margin as a recent tax cut on automobile purchases helped auto production increase by +16% in June. We also saw better growth in electric machinery and communication equipment in the period. In response to a weakening outlook, The People's Bank of China (PBOC) cut its key lending rates in mid-August to stimulate demand going forward from the recent Covid-19 lockdowns. We believe this is a step in the right direction, but with more needed. Exports rose +17.9% in June and benefited from a recovery in transportation capacity as well as an inflationary impact. We don't see this level of growth as sustainable over the balance of 2022 as growth slows in Europe

and other parts of the world. As expected, fixed asset growth continued to slide as the second quarter showed growth of +6.4%, a marked downturn from the previous quarter as Covid-19 lockdowns in the period put pressure on this key statistic. Retail sales continued its recent recovery as July sales rose +2.7% from a year earlier, marking the second month in a row of better sales as consumers came out from lockdown in several regions in the country. July CPI rose +2.7% from the previous year, which was a two-year high with this key data point. Meat prices and fresh vegetables have pressured consumer wallets recently. We would expect this trend to continue over the next few months as CPI will probably move above 3%. However, we still see inflation as not being much of an issue as other regions around the globe deal with the highest inflation rates in decades. Over the next few months, we should see interest rate cuts by the PBOC, more infrastructure spending, and some form of consumption vouchers aimed at cranking up more growth in the economy. Overall, we see this region's economy as decently positioned relative to most other parts of the world provided Covid-19 lockdowns pass without many new ones being initiated in the coming months. This could continue to provide a good climate for investors in the near term.



Sources: AART; Fidelity Investments; PBOC; National Bureau of Statistics

The Japanese economy forged ahead as second quarter GDP rose +.5% from the previous quarter, or +2.2% from the previous year. In addition, first quarter GDP was revised upward to show a slight expansion vs. a small contraction previously. The economy here has now recovered to the pre-pandemic level, even as the recovery took longer than many of the other developed economies around the globe. The end of pandemic restrictions in early second quarter led a rebound in consumer and business capital spending. Leisure travel also saw a lot of pent-up demand in the period. The region reported a trade deficit for the 11th month in a row as the Yen was very weak and imports

rose +46% in June from a year ago, as rising crude oil, liquified natural gas, and coal were tough to overcome. Unfortunately, we expect very little in the way of relief over the near term as the Yen remains near 24-year lows and supply disruptions from China's lockdowns continue. Industrial production broke a pattern of recent losses as June production rose 8.9% from May. We saw rising output of automobiles, LCD panels, and chip-making equipment in the month as factories pushed to rebuild inventories. We expect this trend to continue in the third quarter as parts of China open back up from recent lockdowns. Japan's leading economic index remained very steady in the second quarter as June finished at 100.9. This needs to move higher if we are to see a better economic climate ahead. Consumer confidence weakened in the period as July's reading fell to 30.2, the lowest level since January 2021. This should improve as we move further away from pandemic restrictions that have just recently been lifted. The labor market showed resilience in the quarter, as the June unemployment remained at 2.6%, while the jobs-to-applicant ratio rose further to 1.27. The abundance of jobs should push wage gains higher over the balance of the year. The economy here should benefit from the recently announced Grand Design economic plan from Prime Minister Kishida as well as the continuing accommodative policies from the Bank of Japan (BOJ). The BOJ remains one of the few central banks around the world to continue these policies. The biggest risk to this region remains a heightened chance of a recession in 2023 in Europe and the U.S., which would cut global trade.

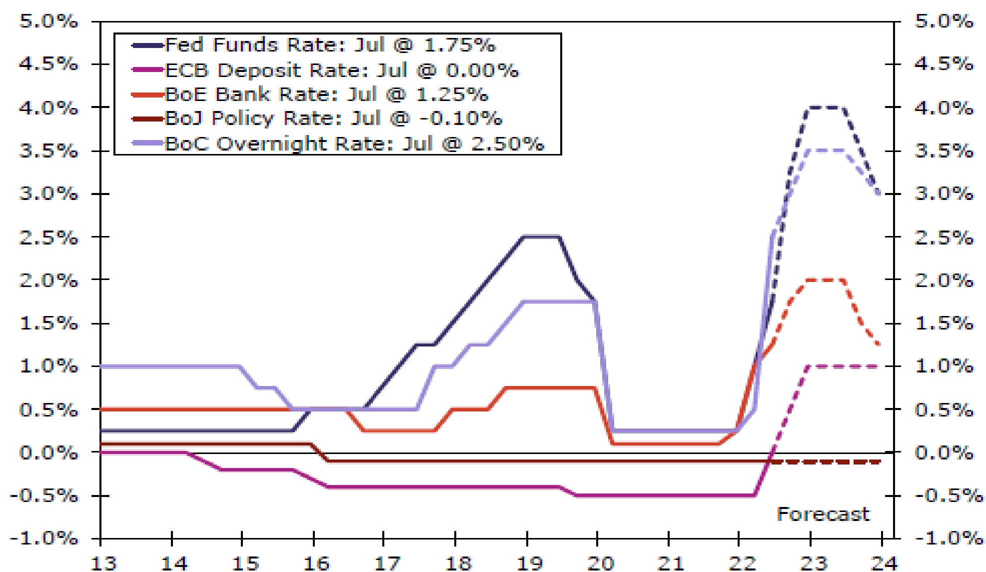
Japanese Yen Spot Currency

Source: Bloomberg

Europe Update

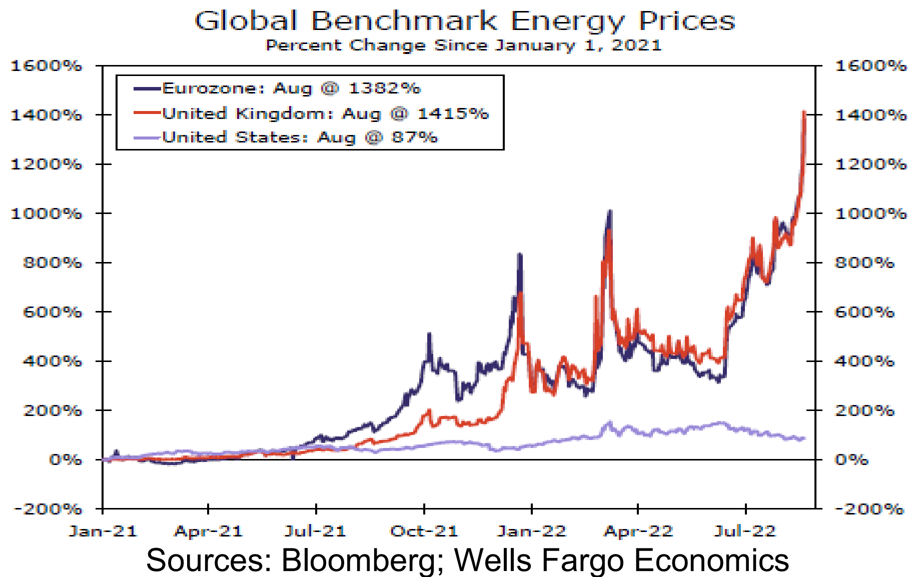
We saw a broad selloff in European equities in the second quarter as record-high inflation, the ongoing war in Ukraine, and the resurgence of Italian debt concerns made for some very nervous markets. Spurring the record inflation has been spiking energy costs from Russian threats to shut off a major gas line supplying much of Europe. Russia followed through with its threats in early September and shut off the Nord Stream natural gas pipeline. No doubt, this will have major ramifications for the Eurozone economy in the months ahead.

Looking at the quarter, the European economy did manage to surprise us as GDP rose +.8% from the previous quarter or +4.1% from a year earlier. Household spending led the way as consumers were eager to re-engage in the economy and this was enough to offset the drag from net trade. The economies in Spain, France, Italy, and the Netherlands were strong in the quarter, while the key German economy posted little growth as business confidence eroded over fresh recessionary concerns going forward. Eurozone industrial production was stronger than expected as June production rose +.7% from the previous month. Most of this surprise can be attributed to capital goods production, as automobile manufacturers throughout the region saw an easing in supply chain issues which allowed for better production. The economic confidence index continued to trend downward as July fell to 98.9, which was the lowest level in over 1 ½ years. This was not that surprising when considering the region's grim near-term outlook. Retail sales continued to look lackluster as June sales fell -.4% from May. As we saw in the previous quarter, energy costs continued to take a bigger wallet share of consumers budgets. Inflation continued to be a major problem in the period as core CPI rose +4.3% in August from prior year levels and headline inflation, which includes food and energy, was reported at an eye-popping +9.1% in the month. This is the highest level in the 23-year history of the Eurozone economy. At this point, we are pushing our projection of peak inflation to the right by a few months as the energy situation becomes even more dire over the near term. The June unemployment rate fell to 6.6%, which is another fresh new low since the beginning of the Eurozone. The economic outlook looks very cloudy over the next few months. Investors are bracing for a series of interest rate increases for the balance of the year to thwart inflation in the economy. This coupled with the effects of the war in Ukraine creates a nervous investing climate with a recession almost a near certainty in the coming quarters. This is usually an environment that makes equity market gains tough to come by.



Sources: Bloomberg; Wells Fargo Economics

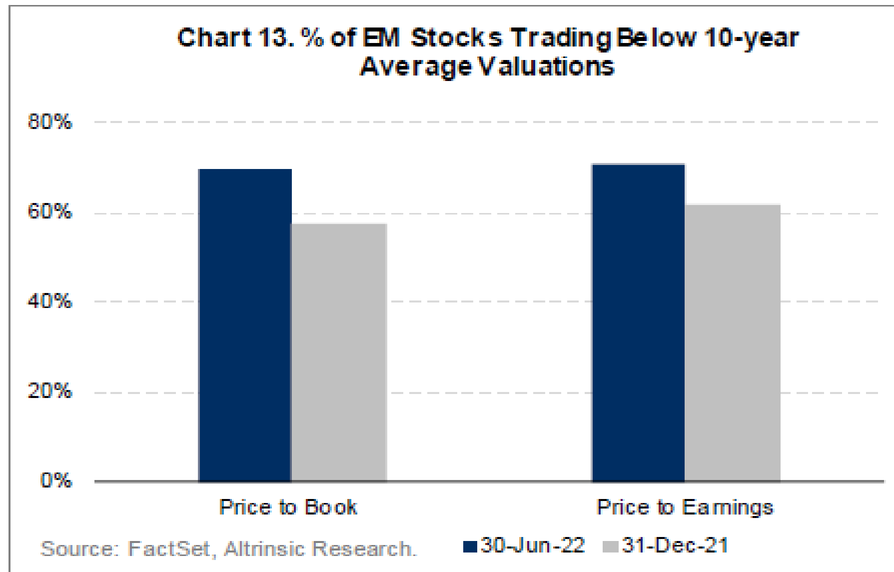
The U.K. equity market wound up being the best house in a bad neighborhood in the second quarter as this market was the best performing region in the MSCI EAFE Index. This market benefitted from its value orientation as it is one of the cheapest markets in the index as well as having a leading dividend yield. The MSCI U.K. Index fell only -10.5% in the quarter, which was much better than the MSCI European Index (ex U.K.) -15.7%. GDP struggled in the second quarter, as it fell -.1% from the previous quarter but grew +2.9% from a year earlier. This nearly breakeven outcome was better than widely expected by many investors. Industrial production was weak for most of the second quarter as June fell -.9% from the previous month. Chemical, plastic, and electrical equipment production were weak spots in the period, while computer and transportation equipment were strong. Retail sales have swung between gains and losses in recent months, but June sales rose +.4% from the previous month as food sales posted a healthy increase. Perhaps spending can increase over the next few months as fuel expenses tick down from the recent drop in crude oil prices. Core CPI continued its upward trend as July rose +6.2% from the year-earlier period. Headline inflation was even worse at +10.1% vs. the prior year and a 40-year high. The U.K. has the highest inflation rate amongst the major developed markets around the world. Food inflation was especially worrisome, as prices rose +2.3% in July or +12.7% from a year earlier. We expect headline inflation to move even higher over the next few months, perhaps peaking in the +12% to +13% range. This would be five times the Bank of England’s (BOE) official target. At its June and August meetings, the Monetary Policy Committee (MPC) voted to raise its main benchmark by +.25% and +.50%, respectively, to 1.75% and continue to unwind its government bonds held in the Asset Purchase Facility. This is the fifth interest rate hike over the last nine months with little effect on rampant inflation. We expect to see more rate hikes over the balance of the rest of the year as the inflation fight is much tougher than most expected this time last year. Unemployment has been very steady over the last few months as the second quarter unemployment rate rose just slightly to 3.8% and remained near decades low. This has put upward pressure on wages as regular wage growth was near +5% in August. At this point, we expect the economy to soften in the coming months as inflation remains stubbornly high with the futures market predicting many more interest rate hikes on the horizon. This is usually a difficult time for good equity market performance.



Sources: Bloomberg; Wells Fargo Economics

Emerging Markets

While the emerging markets were weak in the second quarter, these equities did manage to fall the least in the period. The Chinese equity market was one of the few global markets to post a positive return in the period. The prospect of further government stimulus, as well as moving past the Covid-19 lockdowns in the coming months, seemed to resonate positively with investors. However, other markets did not fare as well. The resource-driven economies of Brazil and South Africa struggled as commodity prices fell sharply in the period, dampening investor enthusiasm. In addition, the South Korean and Taiwan equity markets were weak as semiconductor companies warned of continued shortages of processors. Outside of China, most of the emerging markets are raising interest rates, with Brazil recently reaching its highest benchmark level of 13.25% since 2017. Overall, the MSCI Emerging Markets Index fell -11.4% in the second quarter of 2022, faring better than most of the developed markets. Looking out over the next few months, geopolitical concerns with China, rising interest rates, and slowing economic readings will be points investors will be watching with this asset class.



International Equity Activity/Strategy

Heading into the last few months of 2022, the investing landscape remains as treacherous as we have seen in recent memory. Investors are faced with a clearly slowing global economy, significantly rising short-term interest rates, mid-term elections in the U.S., slowing corporate earnings, deteriorating relations with China, and the ongoing Russian/Ukraine war. Each one of these issues could push equity markets lower. Investor growth expectations continue to be cut and the odds of a global recession sometime over the next year are rising. While peak inflation may have just happened in the U.S., many still see peak inflation a few months away in Europe. The Russian gas situation in Europe is not helping and remains a giant wildcard with several potential outcomes. Covid-19 lockdowns should start to improve in China over the rest of the year, and this should ease a bit of pressure on supply chains. On a positive note, many global markets have already corrected -20% year-to-date and could have already discounted this gloomy outlook as bearish sentiment of this level can sometimes lead to a positive rally over the short term. I guess we will find out.

We continue to sell a few out-of-the-money puts and calls on the Emerging Markets Index as we position ourselves to add to this asset class on any significant weakness over the near term, as well as sell just a bit of exposure in a decent short-term rally if this happens. Premiums remain attractive in the current equity market and interest rate climate. Emerging market equities remain an asset class that looks attractive to us going forward over the long term. Our current allocation to Emerging Market equities is approximately 3.15% of total assets and approximately 10.8% for MSCI EAFE equities across our TRS, ERS, and JRF portfolios. *(Credit is given to the following entities for charts provided: BofA Global Investment Strategy, Factset, Altrinsic Research, Bloomberg, RIMES, Wells Fargo Economics, PBOC, National Bureau of Statistics, Eagle Global Advisors, Bloomberg, Fidelity Investments AART, Resource Consulting Group, RIMES, Capital Group)*

Chart 1: BofA Bull & Bear Indicator

Remains at 0.0

Source: BofA Global Investment Strategy