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2022 2nd-Half Outlook

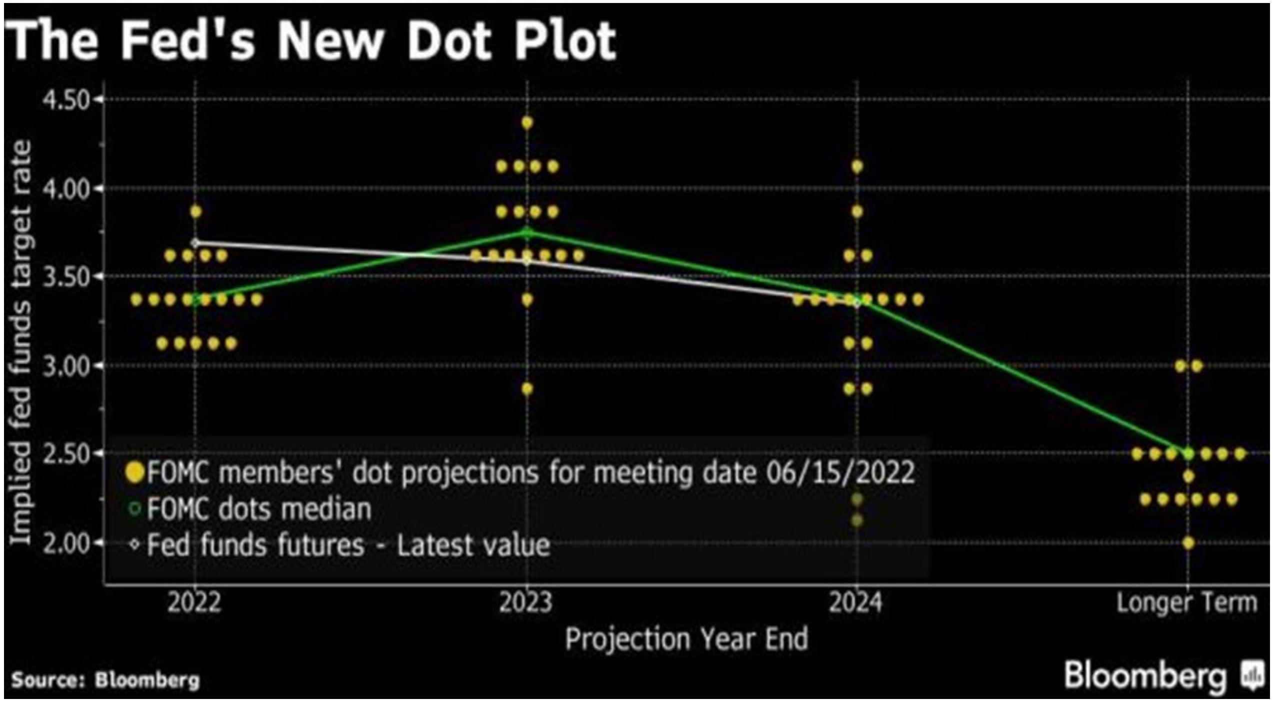
Economic Outlook

- The Fed has decided that it is necessary to bring inflation down at the cost of slower growth and a likely recession. During the June meeting, FOMC members indicated that they were likely to raise rates above 3.25% by year end. This was a major shift from the 1.75% level they indicated during the March meeting. A higher-than-expected May CPI report gave the Fed room to get more aggressive in order for markets to take their mandate seriously. Inflation staying higher for longer, has caused market disruptions as both equity and bond markets became more volatile during the 2nd quarter. The biggest uncertainty going forward is around timing of a recession and if it will force the Fed back to a position of lowering interest rates. Most strategists put the probability of a recession in the next year at better than a coin toss, with a high likelihood of it being short and shallow. A big debate we are likely to hear will center on the timing of a recession. Most people think that the definition of a recession is two consecutive quarters of negative GDP growth. While that usually happens during a recession that is not the official definition. The official announcement of a recession is the responsibility of the NBER (National Bureau of Economic Research). They look at Real GDP, but also other factors. It is very likely that we will not see an official announcement of a recession this year even if we see two consecutive quarters of negative GDP growth. This will set up for some entertaining mid-term election debates. A key statistic to watch is the U.S. jobless claims report. Jobless claims jump right at the beginning of a recession. Strong employment is the primary reason why most strategists have assigned a lower probability of a recession, considering most indicators are flashing a warning sign.

- Inflation is not only squeezing consumers, it's beginning to hit companies as well. We will continue to see a divergence between those that can pass along higher prices and those that can't. Earnings can increase for many companies as nominal prices move higher. Higher prices means more revenue and if a company can maintain its margins they can realize higher earnings. Equity markets bottomed out in June with the S&P 500 down about 22% from its peak. This would price in a significant slowdown, but not necessarily a full fledge recession. The S&P 500 would typically be down about 30% during a recession. While this may well play out, the distributions of individual companies can vary. Many growth names have already moved below the 30% threshold, while other stocks have not. This environment is one where active management can pay off.

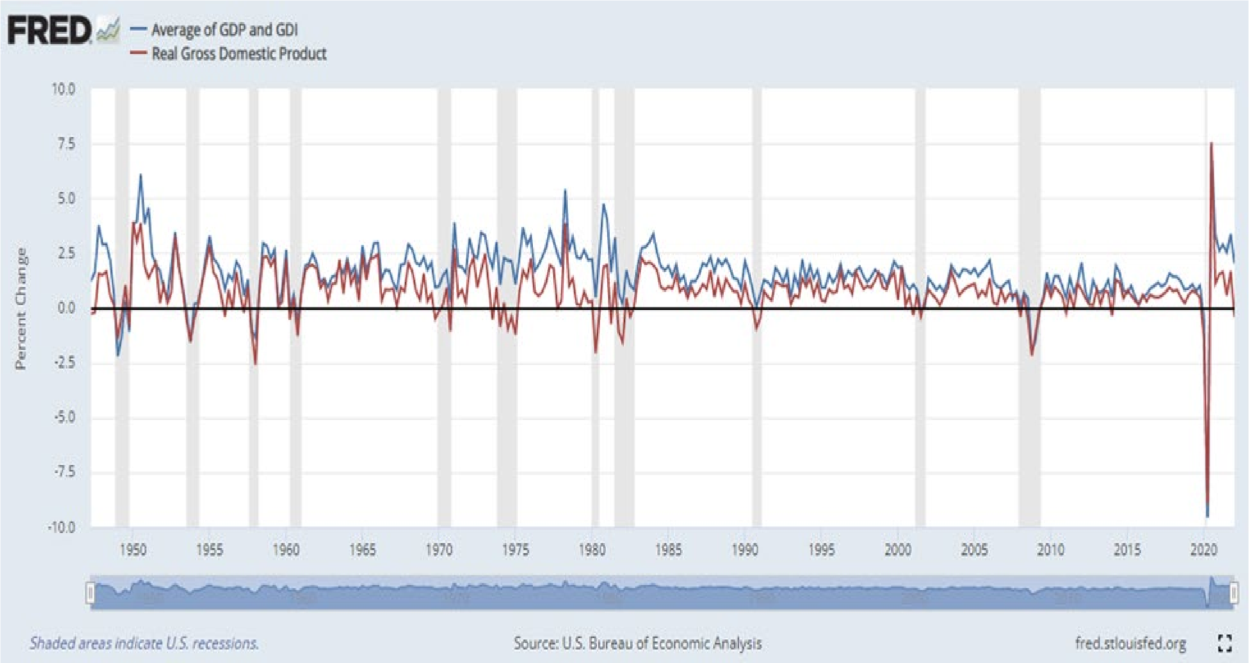
June FOMC meeting

- The FOMC member's dot plot measures expected Fed Funds Target Rate. During June meeting members anticipate higher rates through 2023 then cuts in 2024 and beyond.
- For reference, the Fed is accurate on projections about 1/3 of the time.



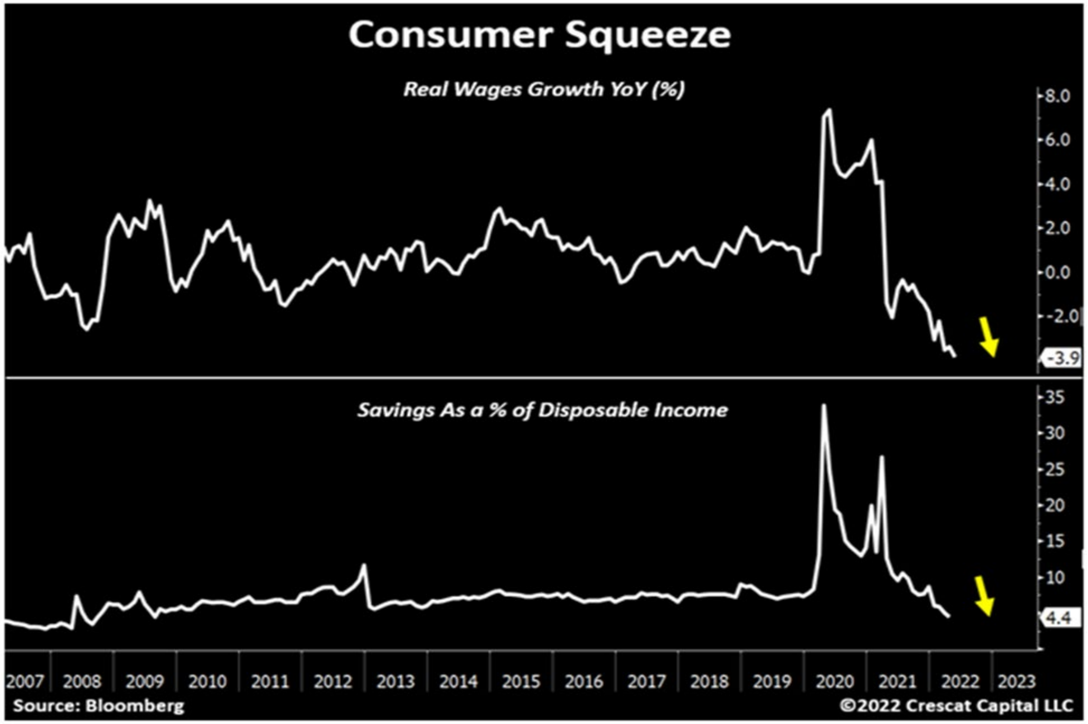
Different Measures of Economic Growth

- GDP is the historical measure of economic growth, but GDI (Gross Domestic Income) has been viewed as an alternative measure and will get more attention.
- GDI measures income (wages, profits, interest income, etc.) whereas GDP measures spending (Consumption, Investment, Government Spending, etc.).
- The last time we had wide dispersions between the two was in the high inflationary environment of the 1970's and early 1980's



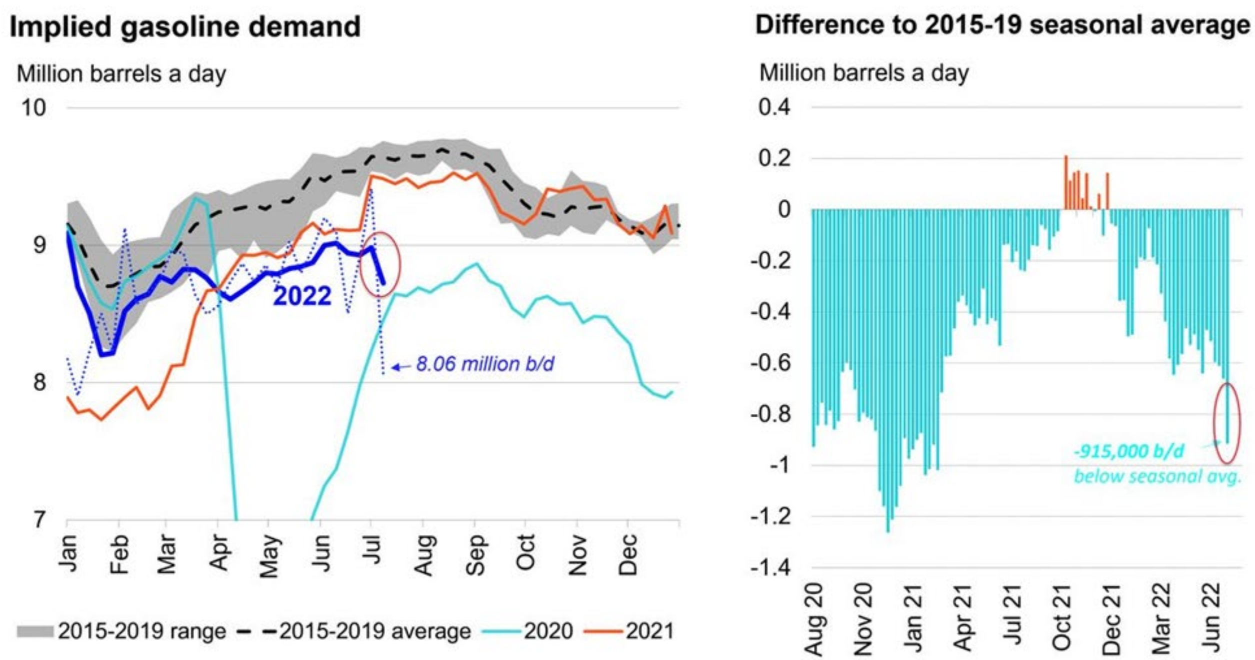
Consumers are Getting Squeezed

- While wages have been increasing, they haven't kept up with inflation. After inflation, real wages are declining.
- The extra savings that consumers had during the pandemic have dried up. Higher prices are hurting consumers and are not sustainable.



Gas demand has fallen

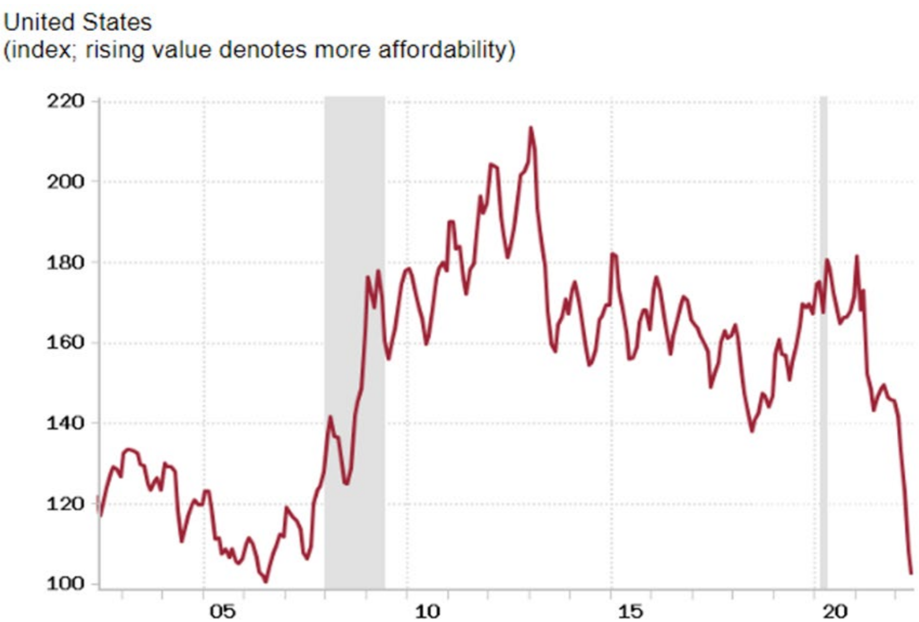
- "The cure for high prices, is high prices"
- Gas demand rebounded to pre-covid levels in the 2nd half of 2021, but have been below average since mid-March.
- While demand may fall, prices will not necessarily fall back to 2020 levels due to less supply available.



Source: BloombergNEF, EIA

NAR Housing Affordability Index

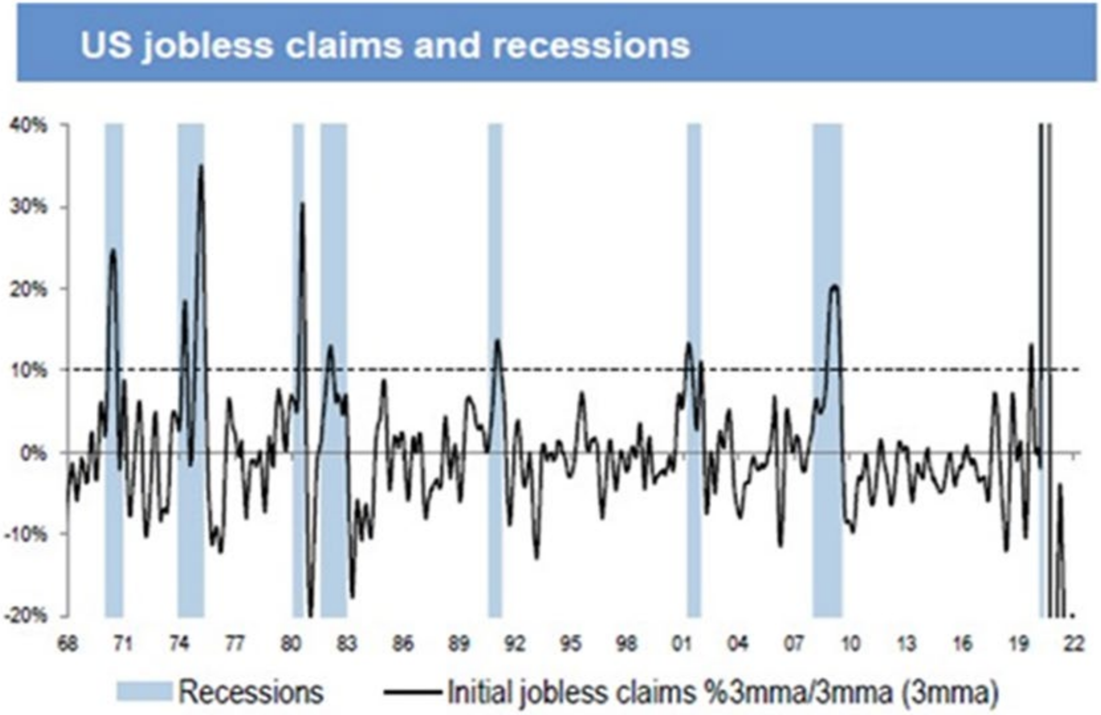
- Mortgage rates moving significantly higher and prices at all time highs, has pushed housing affordability to the lowest level since 2006.
- While we are not likely to see the massive decline of 2008, it is likely that housing prices have room to fall.



Shading indicates recession
Source: Haver Analytics, Rosenberg Research

Jobless Claims

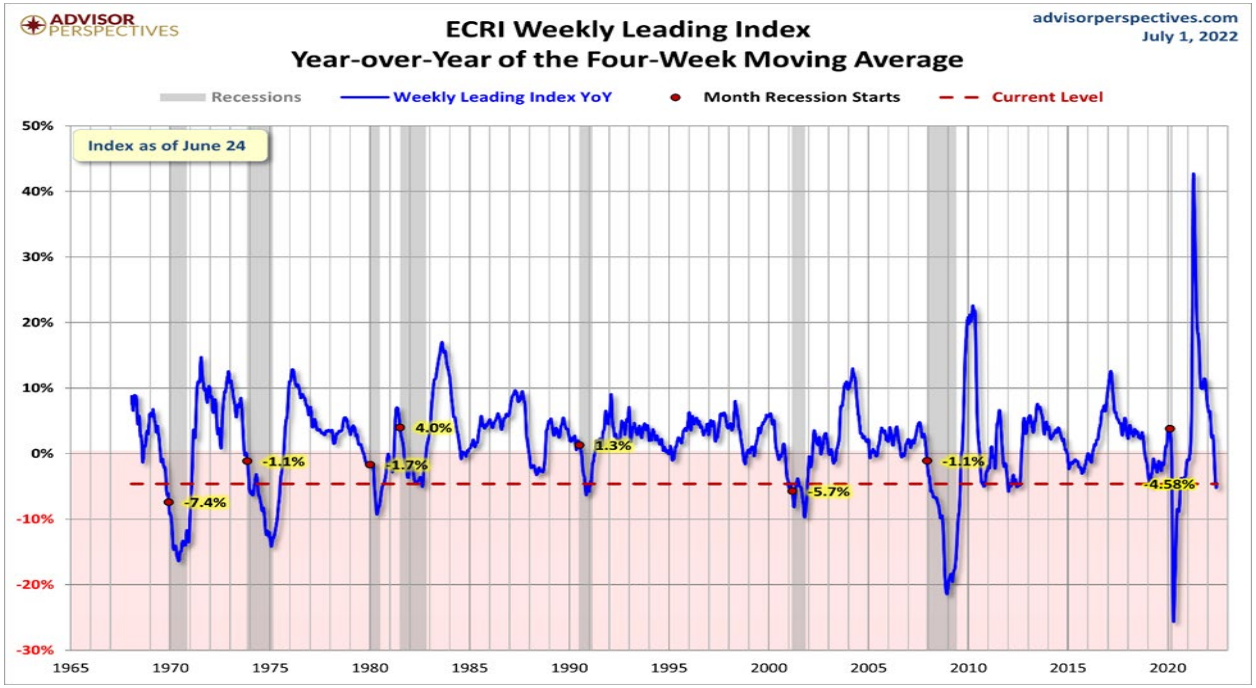
- Many strategists and investors have commented on the strong employment and how it is hard to see a recession with unemployment below 4%.
- Initial jobless claims can jump quickly and typically move higher just right before or at the beginning of a recession.



Source: fred.stlouisfed.org

Leading Indicators Turning Down

- Leading economic indicators have turned down and are at or near levels of prior recessions.
- Indicators making up the index include: initial jobless claims, mortgage applications, real Treasury yields, and stock prices in addition to a few others.



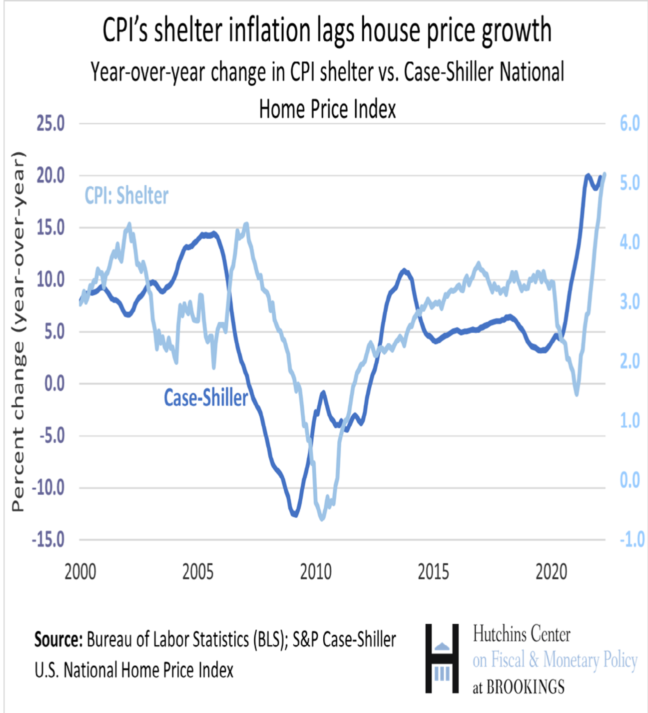
Corporate Profit Margins Peak

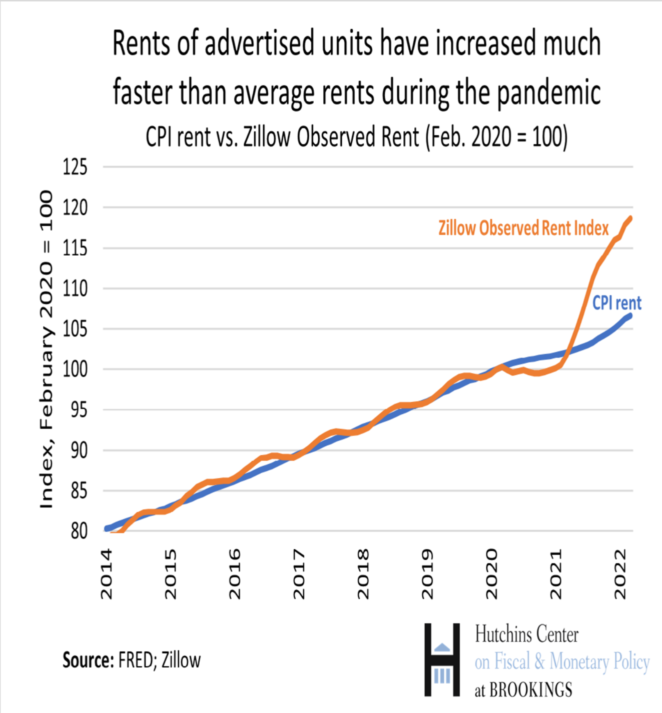
- While some companies have been able to deal with higher input and labor costs, most haven't. Corporate Profits as a % of GDP has declined from a peak 12.5% to 11%.

Source: Bloomberg

Housing Inflation

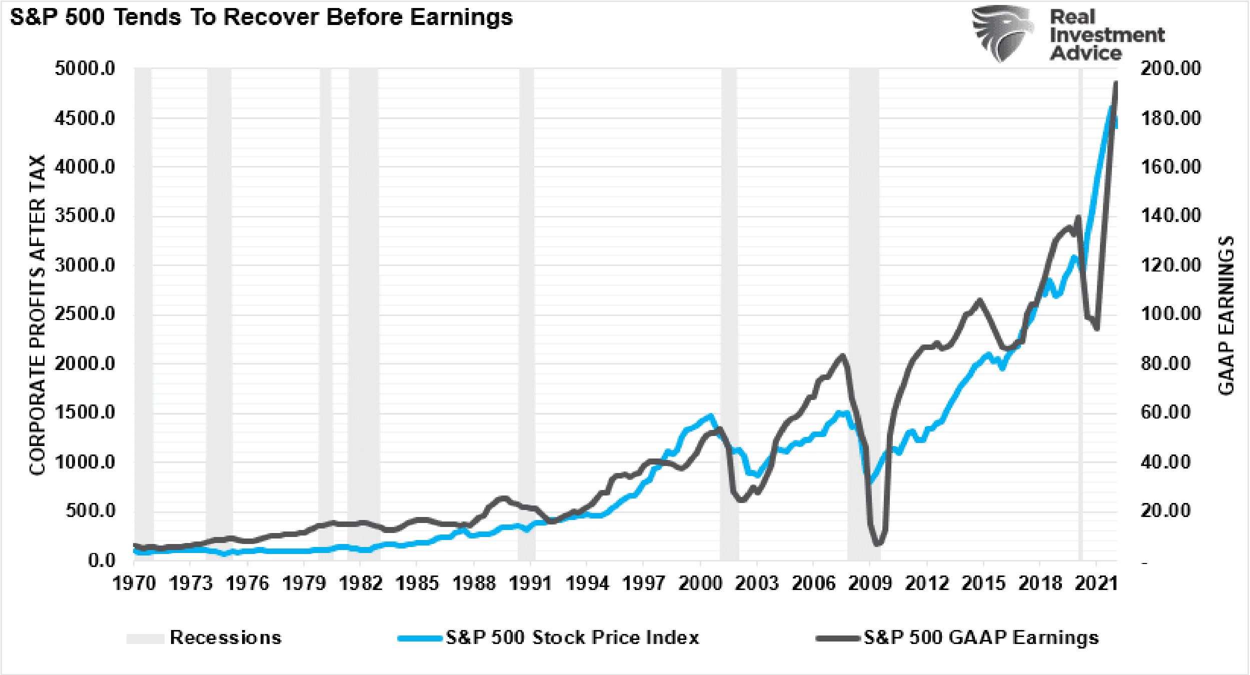
- The one area of inflation that is likely to persist into 2022 is Housing.
- There tends to be a lag in the increase in rent and the housing component of CPI. Inflation from housing can go a little higher even if housing prices start to soften with higher interest rates.





Market Anticipates Earnings

- Earnings estimates have been too high and are beginning to come down. Markets anticipate turns in earnings peaks and troughs.
- Due to higher inflation and dispersion among companies that will pass on higher costs vs. those that can't, earnings estimates are even harder to predict than in the past.



Market Positioning

- We maintain our quality tilt within our equity portfolios as well as overweighting emerging markets relative to Europe.
- Historic bond market adjustment has led to significant re-pricing. We see a less aggressive Fed in the 4th quarter.
- Within Hedge Funds, we see opportunity to add to less correlated strategies such as: Material and Mining, Commodities, Weather Catastrophe Bonds, Venture Credit, etc.

- **Equity**: Pressure on high growth companies that lose money and trade at extreme multiples of Revenue. Overseas markets cheaper relative to U.S.
- **Fixed Income**: Continue to target strong/quality issues. Extended duration slightly to take advantage of rates above 3%. Maintain exposure to 3-5 year U.S. Treasuries.
- **Hedge Funds**: Increase exposure to Absolute Return strategies that can benefit from rising rates and provide diversification away from equity and fixed income risk.
- **Private Equity**: Focus on Small-Mid Buyout strategy, which is less frothy than Venture. Balance smaller emerging managers with those with persistent track records.

Summary

Whether we experience a soft landing or a recession will determine if markets are at fair value or have more room to fall. The odds are about evenly split on where we go. Even if we had a strong view on which way the economy will go it is extremely difficult to time the market. The S&P 500, for example, tends to go up as earnings estimates are still bottoming out. We believe the moves we have made will mitigate more downside, while benefiting from a move higher if things aren’t as bad as expected. Being diversified across multiple strategies and active managers has helped mitigate the fall in both the equity and fixed income markets.

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