Capital Markets Review
Quarter Ending March 31, 2022

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Summary Capital Market Commentary – 1st Quarter 2022

- **Russia's invasion of Ukraine in late February caused a global shock. The grave human implications fed through into markets, with equities declining and bond yields rising (meaning prices fell). Commodity prices soared given Russia is a key producer of several important commodities including oil, gas, and wheat. This contributed to a further surge in inflation as well as supply chain disruption. Elsewhere, Chinese equities were negatively affected by renewed Covid-19 outbreaks, leading to new lockdowns in some major cities.**

- Equity Markets
  - US stocks declined in Q1. Russia's invasion of Ukraine drew widespread condemnation and elicited a range of strict sanctions from the US and its allies. President Biden targeted what he termed "the main artery of Russia's economy" by banning Russian oil imports. Sanctions also struck at the Russian financial system. Assets of the Russian central bank were frozen, while coordinated steps were taken with numerous allies to seeking to deny Russia access to the global financial system.
  - Eurozone shares fell sharply in the quarter. The region has close economic ties with Ukraine and Russia, particularly when it comes to reliance on Russian oil and gas. The invasion led to a spike in energy prices and caused some fears about security of supply. Germany suspended the approval of the Nord Stream 2 gas pipeline from Russia. The European Commission announced a plan – RePowerEU – designed to diversify sources of gas and speed up the roll-out of renewable energy. However, in the meantime there are fears that the high energy prices will weigh on both business and consumer demand, hitting economic activity. The ongoing war in Ukraine and rising inflation led to a small pullback in forward-looking measures of economic activity. The flash eurozone composite purchasing managers' index (PMI) slipped to 54.5 in March from 55.5 in February, though a level over 50 still represents expansion.
  - After weakness in January and February, the Japanese stock market rose in March to end the first quarter just slightly below its end 2021 level. This was despite the change in outlook for US interest rates, the outbreak of war in Europe and sharply higher energy prices. Despite the geographical proximity, Russia is a relatively small trading partner for Japan, accounting for around 1% of exports and 2% of imports. The balance is skewed by the import of energy from Russia, especially LNG, while exports are predominantly in auto-related areas and most auto makers are now moving to suspend these links.
  - Share prices in China were sharply lower in the quarter while shares in Hong Kong and Taiwan also fell. The number of Covid-19 cases in Hong Kong and China spiked to their highest level in more than two years during the quarter despite the Chinese government pursuing one of the world's strictest virus elimination policies.

Source: Schroders & SAA

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- **Russia's invasion of Ukraine in late February caused a global shock. The grave human implications fed through into markets, with equities declining and bond yields rising (meaning prices fell). Commodity prices soared given Russia is a key producer of several important commodities including oil, gas, and wheat. This contributed to a further surge in inflation as well as supply chain disruption. Elsewhere, Chinese equities were negatively affected by renewed Covid-19 outbreaks, leading to new lockdowns in some major cities.**

- Bond Markets
  - Russia's invasion of Ukraine amplified existing concerns over inflation pressures, particularly through food and energy, although US economic data otherwise remained stable. The US unemployment rate dropped from 3.8% in February to 3.6% in March. Wages continue to rise but have not yet matched the rate of headline inflation. The annual US inflation rate, as measured by the consumer price index, hit 8.5% in March.
  - Government bond yields rose sharply (bond prices and yields move in opposite directions). Central banks were surprisingly hawkish and markets priced in a faster pace of monetary normalization. The extent of yield moves differed across markets -- the US Treasury market is in the midst of one of its worst sell-offs on record, but moves were less pronounced in core Europe.
  - The Fed's rhetoric turned more hawkish and "lift-off" came as expected in March, with the Fed implementing a 25 basis point rate hike. Investors expect several more, at a swift pace, in 2022. The US 10-year Treasury yield increased from 1.51% to 2.35%, with the 2-year yield rising from 0.73% to 2.33%.
  - Corporate bonds saw significantly negative returns and wider spreads, underperforming government bonds. High yield spreads widened more than investment grade, although they saw less negative total returns due to higher coupon income.

Source: Schroders & SAA

Capital Markets' Performance

Index	Asset Class	Jan-22	Feb-22	Mar-22	Q1-2022	Trailing 1 Yr	Trailing 3 Yr	Trailing 5 Yr	Trailing 10 Yr
S&P GSCI Crude Oil	U.S. Equity	18.00%	10.35%	8.10%	40.76%	86.81%	-2.40%	2.03%	-11.05%
S&P GSCI Commodities	U.S. Equity	11.63%	8.77%	9.63%	33.13%	64.55%	13.40%	9.98%	-3.31%
Alerian MLP	Master Limited Partnerships	11.07%	4.82%	2.05%	18.81%	36.56%	2.70%	-0.07%	1.28%
Citigroup 3-month T-bill	Cash/Cash Equivalent	0.00%	0.01%	0.02%	0.03%	0.06%	0.76%	1.09%	0.60%
S&P/LSTA US Leveraged Loan Index	U.S. Fixed Income	0.36%	-0.51%	0.05%	-0.10%	3.25%	4.22%	4.01%	4.30%
S&P Composite 1500 Value	U.S. Equity	-1.83%	-1.19%	2.86%	-0.22%	12.12%	14.12%	11.05%	11.92%
Barclays U.S. Treasury: U.S. TIPS	U.S. Fixed Income	-2.02%	0.85%	-1.86%	-3.02%	4.29%	6.22%	4.43%	2.69%
Dow Jones U.S. Select REIT	U.S. Real Estate	-6.46%	-3.53%	6.71%	-3.71%	27.72%	9.90%	8.89%	9.17%
Dow Jones Industrial Average	U.S. Equity	-3.24%	-3.29%	2.49%	-4.10%	7.11%	12.57%	13.40%	12.77%
Barclays Intermediate U.S. Government/Credit	U.S. Fixed Income	-1.47%	-0.66%	-2.45%	-4.51%	-4.10%	1.50%	1.81%	1.85%
S&P 500	U.S. Equity	-5.17%	-2.99%	3.71%	-4.60%	15.65%	18.92%	15.99%	14.64%
S&P Composite 1500	U.S. Equity	-5.34%	-2.66%	3.50%	-4.64%	14.57%	18.49%	15.53%	14.43%
MSCI World Ex. US Index	World Equity	-4.40%	-1.54%	1.27%	-4.68%	3.56%	9.10%	7.68%	6.78%
Barclays Capital U.S. Corporate High Yield	U.S. Fixed Income	-2.73%	-1.03%	-1.15%	-4.84%	-0.66%	4.58%	4.69%	5.75%
S&P MidCap 400	U.S. Equity	-7.21%	1.11%	1.38%	-4.88%	4.59%	14.14%	11.10%	12.20%
5-Year US Treasury	U.S. Treasury	-1.57%	-0.43%	-3.10%	-5.03%	-5.44%	0.94%	1.28%	1.21%
MSCI World Index	U.S. Equity	-5.27%	-2.50%	2.81%	-5.04%	10.60%	15.55%	13.01%	11.49%
BofA Merrill Lynch US Convertibles	U.S. Convertible Bond	-6.55%	0.03%	1.20%	-5.41%	-2.21%	18.00%	14.38%	12.16%
Merrill Lynch US Treasury Master	U.S. Fixed Income	-1.89%	-0.76%	-3.01%	-5.56%	-3.35%	1.47%	1.83%	1.77%
S&P SmallCap 600	U.S. Equity	-7.27%	1.40%	0.37%	-5.62%	1.23%	13.58%	10.89%	12.56%
MSCI EAFE Index	International Equity	-4.82%	-1.76%	0.76%	-5.79%	1.65%	8.29%	7.23%	6.77%
MSCI EAFE (Net)	International Equity	-4.83%	-1.77%	0.64%	-5.91%	1.16%	7.78%	6.72%	6.27%
Barclays Capital U.S. Aggregate	U.S. Fixed Income	-2.15%	-1.12%	-2.78%	-5.93%	-4.15%	1.69%	2.14%	2.24%
Barclays Capital Municipal Bond	U.S. Fixed Income	-2.74%	-0.36%	-3.24%	-6.23%	-4.47%	1.53%	2.52%	2.88%
Barclays U.S. Government/Credit	U.S. Fixed Income	-2.44%	-1.17%	-2.85%	-6.33%	-3.85%	2.12%	2.44%	2.45%
Citigroup WorldBIG Index	World Fixed Income	-2.25%	-1.43%	-3.03%	-6.57%	-7.27%	0.40%	1.58%	0.98%
10-Year US Treasury	U.S. Treasury	-2.39%	-0.36%	-4.12%	-6.75%	-3.31%	1.62%	1.84%	1.92%
MSCI EM (Emerging Markets)	World Equity	-1.89%	-2.98%	-2.22%	-6.92%	-11.08%	5.31%	6.35%	3.73%
Barclays Capital U.S. Corporate Investment Grade	U.S. Fixed Income	-3.37%	-2.00%	-2.52%	-7.69%	-4.20%	3.02%	3.34%	3.65%
S&P Composite 1500 Growth	U.S. Equity	-8.52%	-4.09%	4.13%	-8.64%	16.63%	21.74%	19.19%	16.42%

Key Take Away:

- **After the Federal Reserve's March meeting and expected rate hike, the markets continued to process the dramatic expectational shifts regarding anticipated Fed rates hikes and balance sheet reduction actions for 2022/2023. As a result, risk assets and investment-grade fixed income sectors (except cash) posted sharply negative total returns for Q1-2022.**
- **Inflation expectations and supply chains disruptions are further complicated by Russia's invasion of Ukraine. Additionally, it's much too early to discern how the growing web of world governmental sanctions against Russia coupled with voluntary corporate actions to reduce and/or eliminate Russian exposure will persist and impact the global economy and geopolitical landscape.**

Indices sorted high/low by Q1-2022 performance.

Source: Zephyr StyleAdvisor

Fixed Income Yields

Index YTW	12/31/2021	2/28/2022	3/31/2022	Chg Prior Month	Chg Calendar Yr	CORE Current Real Yields	HEADLINE Current Real Yields
Aggregate	**1.75%**	**2.33%**	**2.92%**	▲ **0.59%**	▲ **1.17%**	▼ **-3.58%**	▼ **-5.58%**
Intermediate Aggregate	**1.55%**	**2.16%**	**2.81%**	▲ **0.65%**	▲ **1.26%**	▼ **-3.69%**	▼ **-5.69%**
U.S. Treasury	1.23%	1.76%	2.42%	▲ 0.66%	▲ 1.19%	▼ -4.08%	▼ -6.08%
U.S. 2-Yr Treasury	0.73%	1.45%	2.32%	▲ 0.87%	▲ 1.59%	▼ -4.18%	▼ -6.18%
U.S. 5-Yr Treasury	1.26%	1.73%	2.45%	▲ 0.72%	▲ 1.19%	▼ -4.05%	▼ -6.05%
U.S. 10-Yr Treasury	1.50%	1.83%	2.33%	▲ 0.50%	▲ 0.83%	▼ -4.17%	▼ -6.17%
U.S. 30-Yr Treasury	1.89%	2.16%	2.44%	▲ 0.28%	▲ 0.55%	▼ -4.06%	▼ -6.06%
U.S. Agency MBS	1.98%	2.48%	2.99%	▲ 0.51%	▲ 1.01%	▼ -3.51%	▼ -5.51%
ABS	1.13%	1.88%	2.84%	▲ 0.96%	▲ 1.71%	▼ -3.66%	▼ -5.66%
CMBS	1.88%	2.55%	3.26%	▲ 0.71%	▲ 1.38%	▼ -3.24%	▼ -5.24%
U.S. Credit	2.25%	2.99%	3.52%	▲ 0.53%	▲ 1.27%	▼ -2.98%	▼ -4.98%
A-Rated Corporates	2.11%	2.83%	3.34%	▲ 0.51%	▲ 1.23%	▼ -3.16%	▼ -5.16%
BBB-Rated Corporates	2.58%	3.43%	3.89%	▲ 0.46%	▲ 1.31%	▼ -2.61%	▼ -4.61%
Municipal Bond	1.11%	1.86%	2.60%	▲ 0.74%	▲ 1.49%	▼ -3.90%	▼ -5.90%
Taxable Municipal Bond	2.33%	2.81%	3.48%	▲ 0.67%	▲ 1.15%	▼ -3.02%	▼ -5.02%
U.S. High Yield	4.21%	5.62%	6.01%	▲ 0.39%	▲ 1.80%	▼ -0.49%	▼ -2.49%
Global Aggregate (USD)	1.32%	1.76%	2.15%	▲ 0.39%	▲ 0.83%	▼ -4.35%	▼ -6.35%
U.S. Agg. vs. Global Agg.	▲ **0.43%**	▲ **0.57%**	▲ **0.77%**	▲ **0.20%**	▲ **0.34%**	Using Core Inflation Rate at 3/31/2022 which was 6.5%	Using Headline Inflation Rate at 3/31/2022 which was 8.5%
Curve Steepness: UST 2yr-10yr Spread (bps)	**77.0**	**38.0**	**1.0**	▼ **-37.0**	▼ **-76.0**		
Curve Steepness: UST 5yr-30yr Spread (bps)	**63.0**	**43.0**	**-1.0**	▼ **-44.0**	▼ **-64.0**		

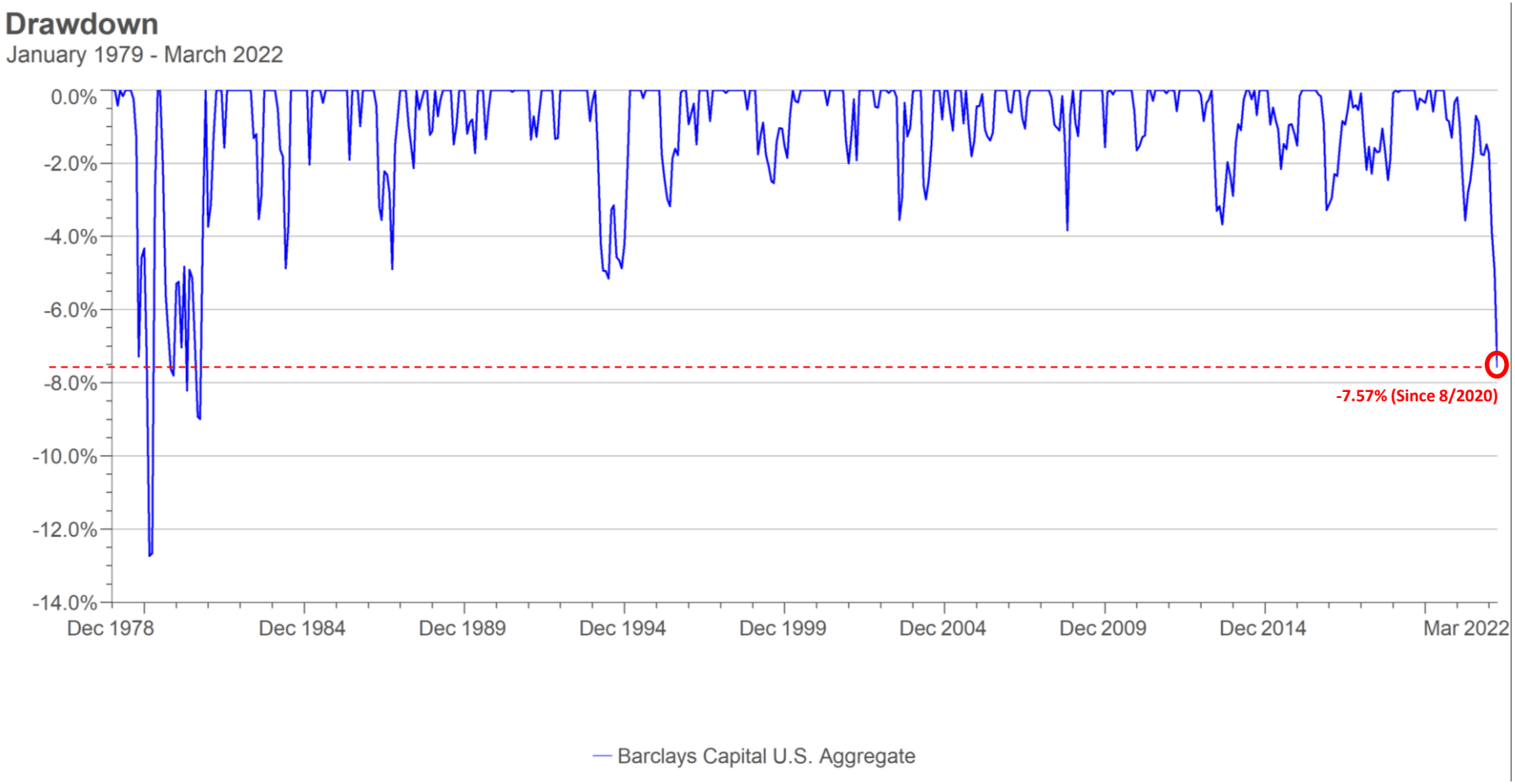
Source: Bloomberg Barclays Indices & BofA ICE Indices

Key Take Aways:

- **Nominal market yields were significantly higher at the close of Q1-2022 generating sharply negative total returns across all fixed income sectors. However, higher reinvestment yields will generate additional earned income and curtail the decline of book yields across all core fixed income portfolios.**
- **More sobering is to look at real rates (nominal rates minus current inflation rate – rightmost columns) where all fixed income sectors' real yields are sharply negative, which may facilitate a rethink of investment strategy depending on an organization's risk appetite, investment horizon, and available capital to support investment volatility.**

Source: Bloomberg Barclays & ICE Fixed Income Indices

Worst Fixed Income Market Drawdown Since 1979

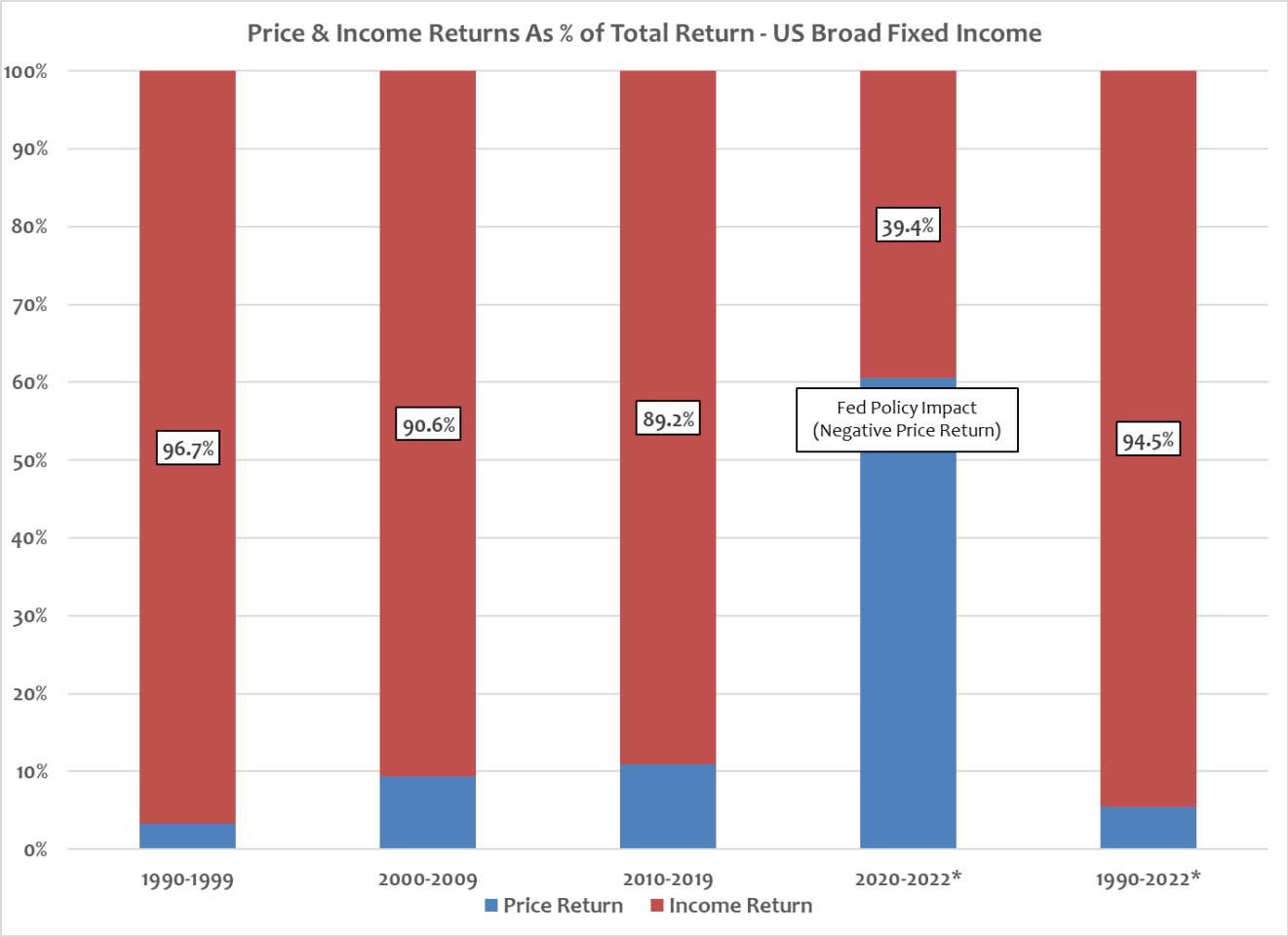


Key Take Aways:

- ❑ **Quantitatively speaking, the last time investors experienced a fixed income market meltdown like this was 1979 as the Fed hiked rates to quash inflation, which was at an even higher level than it is today.**
- ❑ **Although fixed income portfolios continue to produce steady income, the decline in fixed income portfolio market values (due to sharply higher yields) has outpaced the positive, steady income return (i.e. clipping coupons) and generated a period of sustained drawdown going back to August 2020.**

Source: Zephyr StyleAdvisor

Bond Math & Market Disruption



Key Take Aways:

- ❑ **Investment-grade fixed income total return is almost entirely generated by embedded yield and always something to keep in mind when considering asset allocation.**
- ❑ **Over the past thirty-two years, nearly 95% of the annualized total return of the ICE-US Broad Market Index was attributed to embedded yield.**
  - ❑ **Thinking of today's environment and the previous slide - Barring a need to liquidate a fixed income security to support operations and most likely generate a realized loss, a fixed income security's unrealized loss position will ultimately dissipate and then disappear upon maturity leaving only the return from its embedded yield behind.**

Source: Bloomberg, ICE Fixed Income Indices, * Through April 11, 2022

IMMEDIATE OUTLOOK

Over the past five decades, history points to short-lived volatility around geopolitical events…

Event	Start of sell-off	Duration of sell-off (trading days)	Duration to recover to prior level (trading days)	Size of sell-off
Israel Arab war / oil embargo	29-Oct-73	27	1475	-17.1%
Shah of Iran exiled	26-Jan-79	9	34	-4.6%
Iranian hostage crisis	5-Oct-79	24	51	-10.2%
Soviet invasion of Afghanistan	17-Dec-79	12	6	-3.8%
Libya bombing	21-Apr-86	20	7	-4.9%
First Gulf War	1-Jan-91	6	8	-5.7%
Kosovo bombing	18-Mar-99	4	9	-4.1%
9/11 attacks	10-Sep-01	6	15	-11.6%
Iraq war	21-Mar-03	7	16	-5.3%
Arab spring (Egypt)	27-Jan-11	2	3	-1.8%
Ukraine conflict	7-Mar-14	6	13	-2.0%
Intervention in Syria	18-Sep-14	21	12	-7.4%
Average	**1973-2014**	**12**	**137**	**-6.5%**

Russia's contribution to global commodity production is significant:

Energy –
natural gas (17%)
crude oil (12%);

Industrial metals –
nickel (9%)
aluminum (6%)
copper (4%)

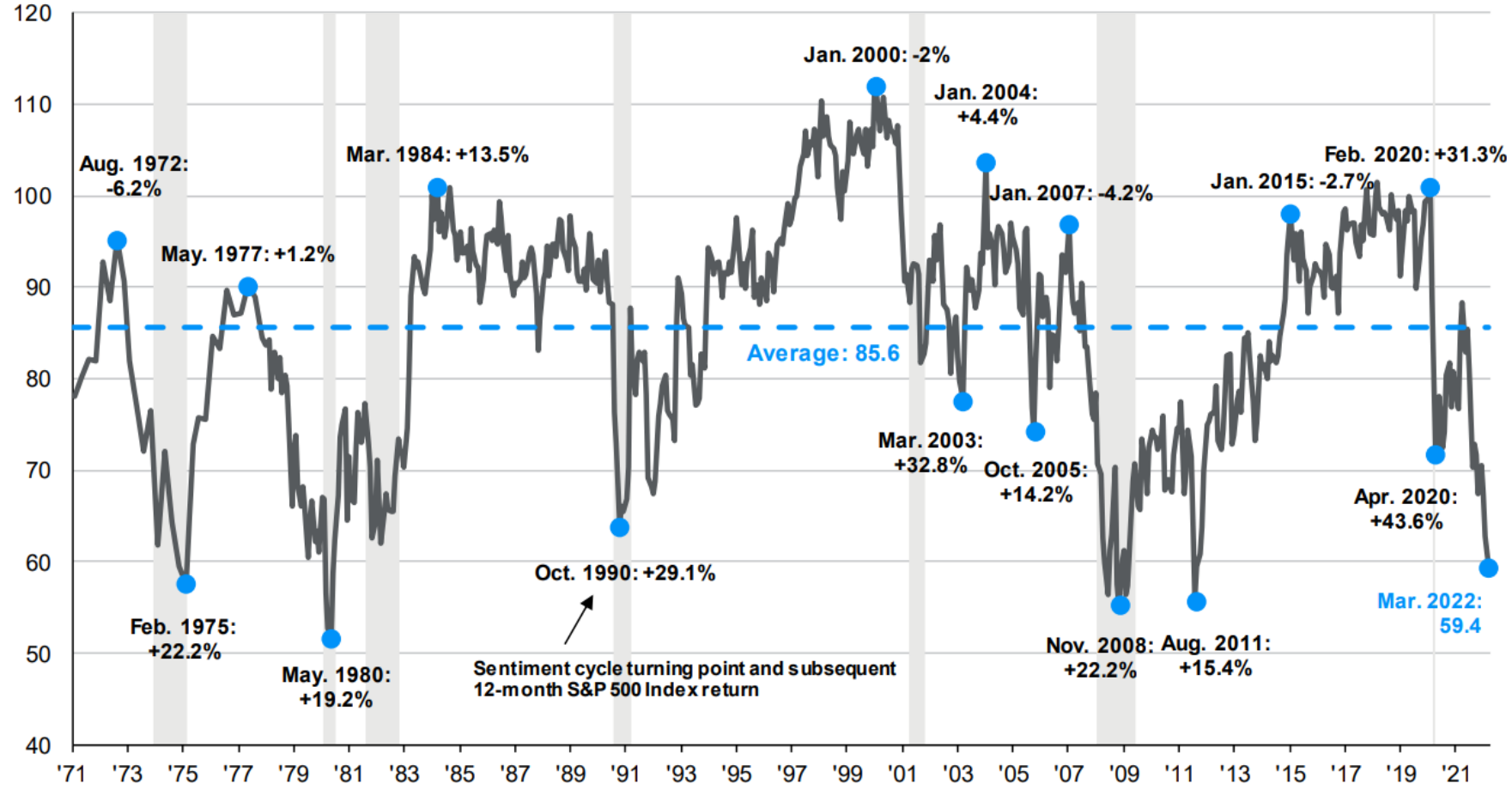
Precious metals –
palladium (40%)
platinum (12%)

Agriculture –
wheat (9%)
fertilizers (8-16%).

Source: Deutsche Bank, Refinitiv Datastream, Standard & Poor's, J.P. Morgan Asset Management..
Data are as of February 23, 2022.

Consumer Confidence & The Stock Market

Consumer Sentiment Index and subsequent 12-month S&P 500 returns

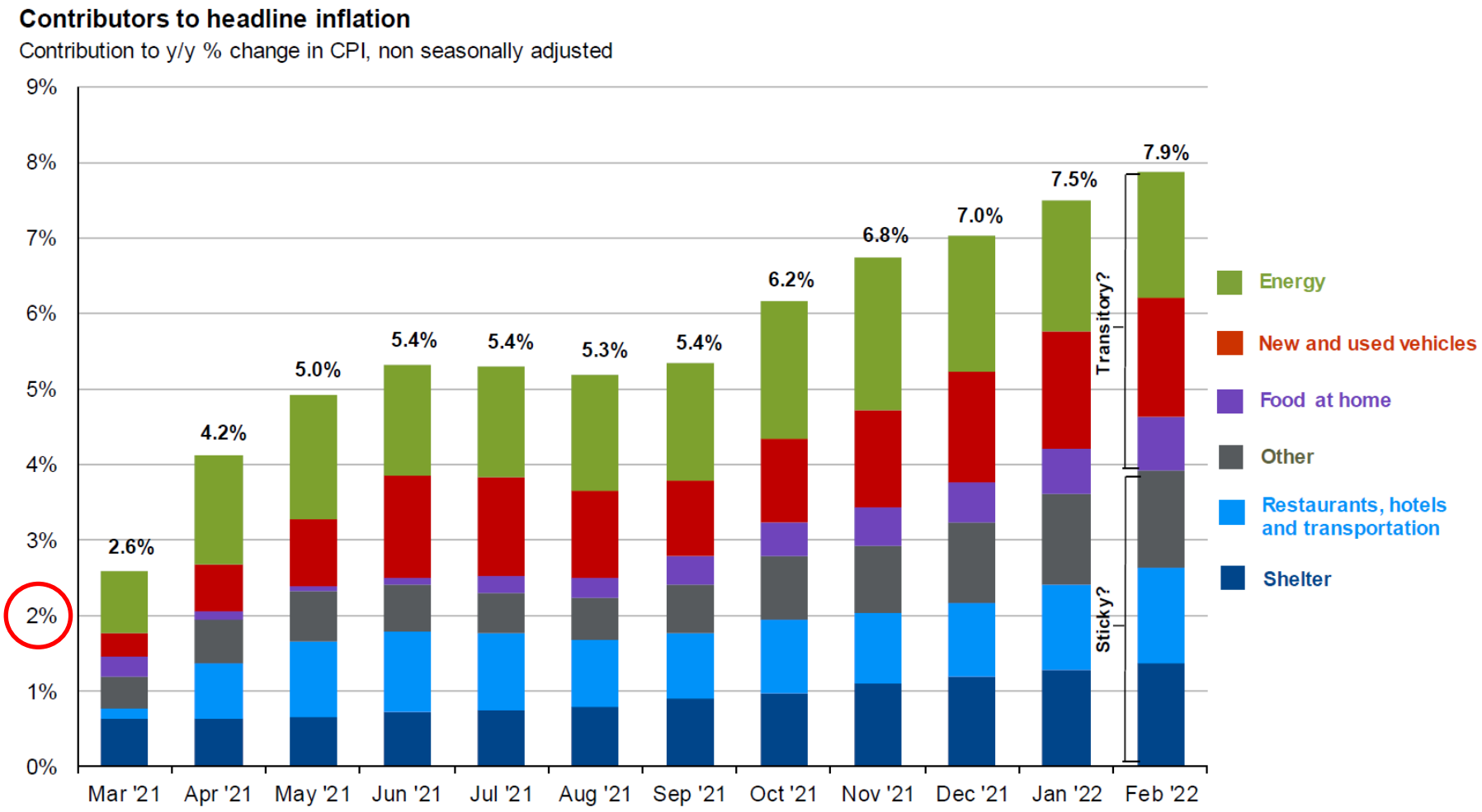


Key Take Aways:

- ❑ **The consumer sentiment index has fallen precipitously from 100+ pre-Covid to 59.4 as the cost-of-living for many Americans has risen sharply and looks to continue.**
- ❑ **Drops in consumer sentiment (i.e. once a sentiment cycle turning point is found) usually spawn positive equity market returns in the subsequent 12-months.**

Source: Factset, Standard & Poor's, University of Michigan, J.P. Morgan Asset Management.
Peak is defined as the highest index value before a series of lower lows, while a trough is defined as the lowest index value before a series of higher highs. Subsequent 12-month S&P 500 returns are price returns only, which excludes dividends.
Guide to the Markets- U.S. Data are as of April 8, 2022.

Inflation Components



Key Take Aways:

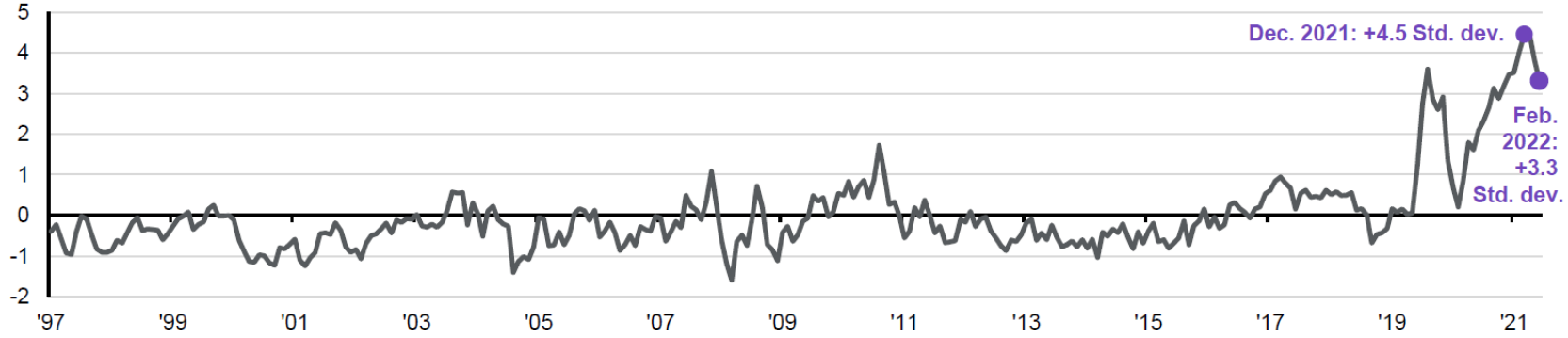
- **Inflation continues to accelerate for both "sticky" and "transitory" components and far exceeds the Fed's 2% average inflation target as surging consumer demand continues to collide with supply chain disruptions even more exacerbated by the Russian invasion of Ukraine. U.S. consumers still possess excess spending potential as they continue to emerge from the Covid hibernation, and SAA expects strong demand for goods to continue in 2022-23 and for consumers to shift spending back toward services as Covid is now more endemic than pandemic.**

Source: BLS, FactSet, J.P. Morgan Asset Management.
Contributions mirror the BLS methodology on Table 7 of the CPI report. Values may not sum to headline CPI figures due to rounding and underlying calculations. "Shelter" includes owners equivalent rent and rent of primary residence. "Other" primarily reflects household furnishings, apparel and medical care services. Data are as of April 8, 2022.

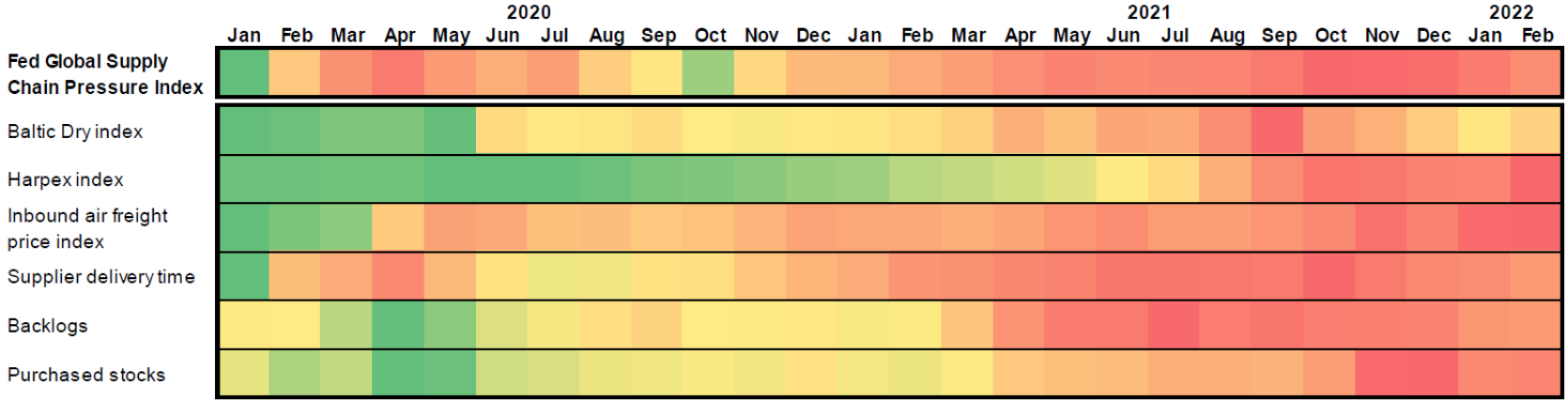
Global Supply Chain Pressures (it's going to be awhile longer…)

Fed Global Supply Chain Pressure Index*

Standard deviation from average value



Fed Global Supply Chain Pressure Index subcomponents



Source: Federal Reserve Bank of New York, HIS Markit, J.P. Morgan Asset Management.

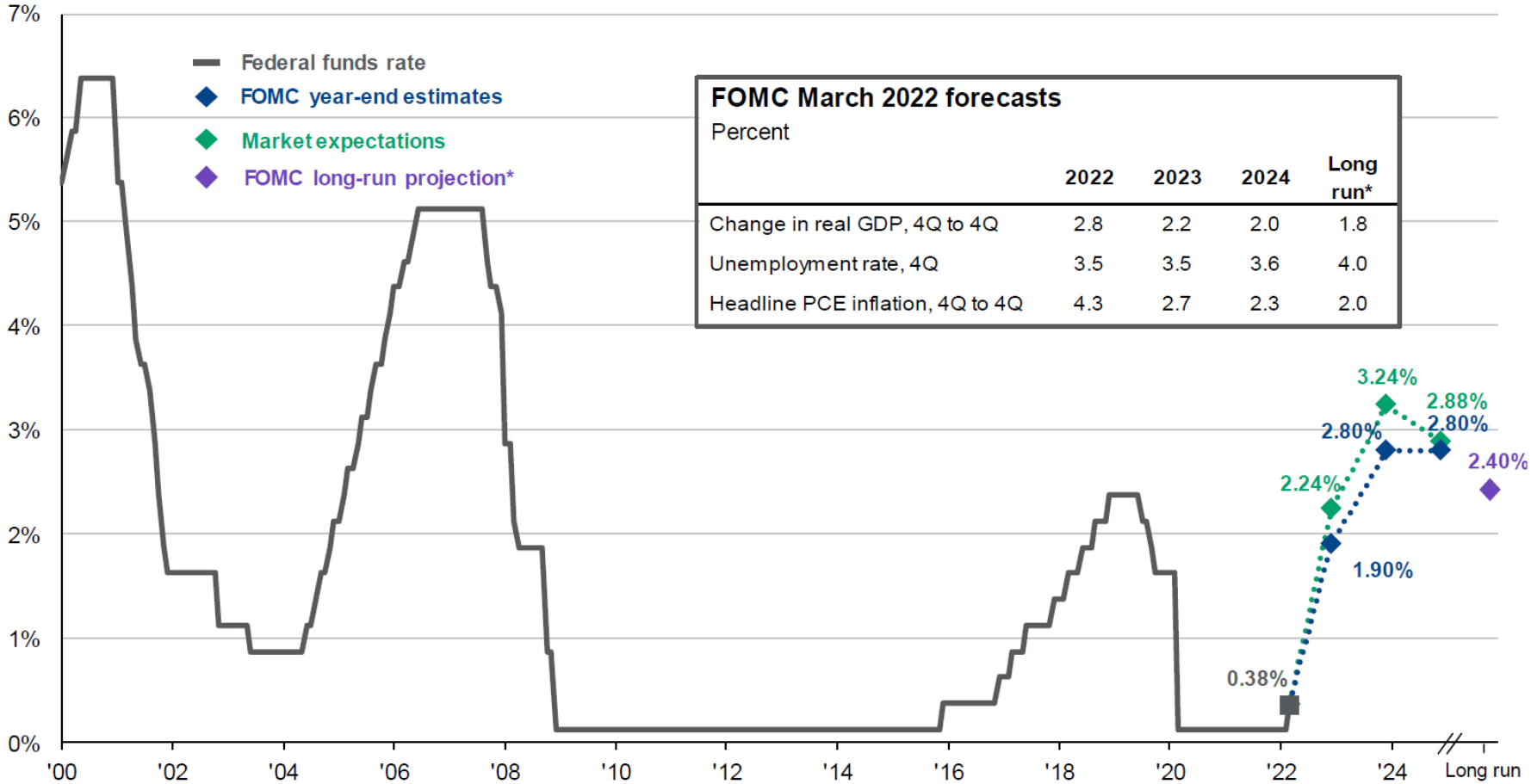
*The Federal Reserve Bank of New York bases its Global Supply Chain Pressure Index on the Baltic Dry Index (benchmark for the price of moving raw materials by sea), Harpex Index (benchmark for the rate liners pay to charter ships), BLS airfreight cost indices (benchmarks for measuring change in rates for air transportation), and 3 PMI supply chain-related components: delivery times (the amount of time elapsed between the time an order is placed and the time it is shipped), backlogs (the volume of orders that a company has received, but not yet fulfilled) and purchased stocks (the level of inventory of materials purchased in the current month compared to the month prior) for manufacturing firms across seven interconnected economies: Chins, the euro area, Japan, South Korea, Taiwan, the United Kingdom, and the United States. Heatmap colors determined by that month's level compared to the 10-year average. Red = Very slow/constrained, Yellow = Average/moderate, and Green = Fast/least constrained.

Guide to the Markets- U.S. Data are as of April 8, 2022.

The Fed & Interest Rates

Federal funds rate expectations

FOMC and market expectations for the federal funds rate



FOMC March 2022 forecasts

Percent

	2022	2023	2024	Long run*
Change in real GDP, 4Q to 4Q	2.8	2.2	2.0	1.8
Unemployment rate, 4Q	3.5	3.5	3.6	4.0
Headline PCE inflation, 4Q to 4Q	4.3	2.7	2.3	2.0

Key Take Aways:

- **Markets currently expect the Fed to be lowering rates in 2024, which implies a recessionary environment two years from now?**

Source: Bloomberg, FactSet, Federal Reserve, J.P. Morgan Asset Management. Market expectations are based off of the respective Federal Funds Futures contracts form December expiry. *Long-run projections are the rates of growth, unemployment and inflation to which a policymaker expects the economy to converge over the next five to six years in absence of further shocks and under appropriate monetary policy. Forecasts are not a reliable indicator of future performance. Forecasts, projections and other forward-looking statements are based upon current beliefs and expectations. They are for illustrative purposes only and serve as an indication of what may occur. Given the inherent uncertainties and risks associated with forecasts, projections or other forward-looking statements, actual events, results or performance may differ materially from those reflected or contemplated.
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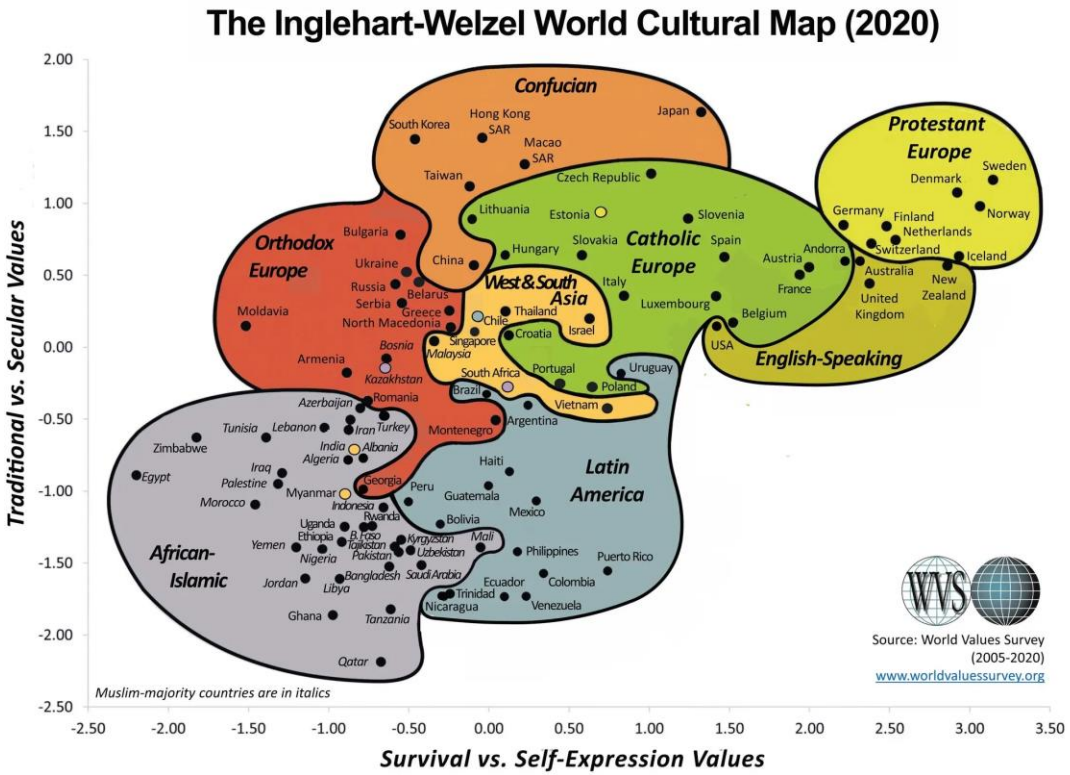
Thinking Long-Term: World Values Survey



Summary Background:

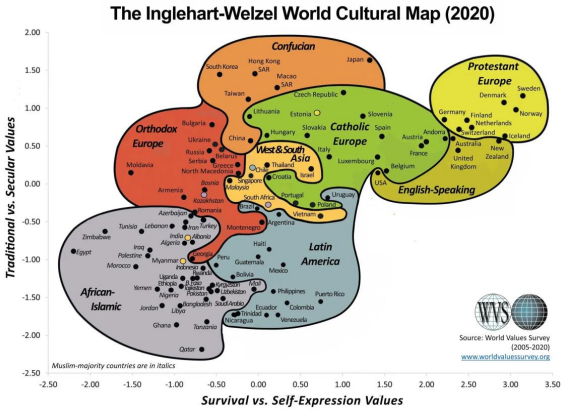
- **The World Values Survey has over the years demonstrated that people's beliefs play a key role in economic development, the emergence and flourishing of democratic institutions, the rise of gender equality, and the extent to which societies have effective government. The Inglehart–Welzel Cultural Map as seen above groups the world's cultural clouds by weighting across four key values:**
  - **Traditional values emphasize the importance of religion, parent-child ties, deference to authority and traditional family values. People who embrace these values also reject divorce, abortion, euthanasia and suicide. These societies have high levels of national pride and a nationalistic outlook.**
  - **Secular-rational values have the opposite preferences to the traditional values. These societies place less emphasis on religion, traditional family values and authority. Divorce, abortion, euthanasia and suicide are seen as relatively acceptable. (Suicide is not necessarily more common.)**
  - **Survival values place emphasis on economic and physical security. It is linked with a relatively ethnocentric outlook and low levels of trust and tolerance.**
  - **Self-expression values give high priority to environmental protection, growing tolerance of foreigners, gays and lesbians and gender equality, and rising demands for participation in decision-making in economic and political life.**

Key Take Away:

- **Does the drifting of English-Speaking and Protestant Europe cultural values further away from the world's other cultural groupings misguide assessments, expectations, and the decision-making process of U.S. and Western European governments/corporations and, by extension, foster unintended consequences that negatively affect the global economy and capital markets?**

Source: The Inglehart-Welzel World Cultural Map - World Values Survey 7 (2020) [Provisional version] -www.worldvaluessurvey.org

Thinking Long-Term: World Values Survey



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  - **Survival values place emphasis on economic and physical security. It is linked with a relatively ethnocentric outlook and low levels of trust and tolerance.**
  - **Self-expression values give high priority to environmental protection, growing tolerance of foreigners, gays and lesbians and gender equality, and rising demands for participation in decision-making in economic and political life.**

Key Take Away:

- **Does the drifting of English-Speaking and Protestant Europe cultural values further away from the world's other cultural groupings misguide assessments, expectations, and the decision-making process of U.S. and Western European governments/corporations and, by extension, foster unintended consequences that negatively affect the global economy and capital markets?**

Source: The Inglehart-Welzel World Cultural Map - World Values Survey 7 (2020) [Provisional version] -www.worldvaluessurvey.org