ADVISER INVESTMENTS

Adviser Outlook

SECOND QUARTER 2022

QUICK TAKES

- ✔ Market volatility left its mark on the first three months of 2022
- ✔ Investors face inflation, a series of interest-rate hikes, talk of recession and the war in Europe; all are concerning, but none spell economic or market doom
- ✔ Healthy consumers are a bright spot for the U.S. economy—unemployment has fallen and household finances are strong

The first quarter was dominated by fears of inflation, recession and then, suddenly, war. The result: A big pickup in stock market volatility—something we expect to have to deal with throughout 2022.

How volatile were stocks? Since 1962, the average intraday move for the S&P 500 index has been 1.4%. Yet it swung 2.5% or more on 12 different days within the first quarter—compared to six times for all of 2021. If you felt like you were riding a rollercoaster, you weren't alone.

U.S. stocks hit correction territory (a decline of 10% or more from a prior high), dropping 13.0% before regaining ground. While disconcerting, a drawdown of this magnitude is not atypical—the S&P 500 has declined an average of 14% from its high each year since 1970. And considering the economic and geopolitical factors at play, a steeper decline wouldn't have been a surprise.

What's more unusual is that both stocks and bonds lost ground in Q1. Bonds also posted a negative return year-over-year through March, down 4.2%, their largest 12-month drop since the period ending in July 1981. When a portfolio of "safe" assets, like bonds, experiences a protracted decline, it's important to keep in mind that they serve as a long-term stock market buffer. There's also an upside to falling bond prices—higher yields, a good thing for investors like us.

Volatility increased in part due to Russia's war on Ukraine; heartrending to watch, the effects will continue to reverberate across Europe and the global economy. Front of mind are rapidly rising oil prices, increasing food prices due to worries about shortages, and concerns that Russian hostilities could worsen in Ukraine and possibly extend beyond it.

China, the world's second-largest economy, reverted to more COVID-19 lockdowns. Combined with the crackdown on private industry last year, this caused the Chinese economy and market to flounder to the extent that the government promised to do whatever it takes to support them going forward. Time will reveal how believable that pledge is. In the meantime, worries that Russia's Ukraine aggressions will embolden China to invade Taiwan are growing.

All the above factors led to inflation reaching a 40-year high. Finally, the Federal Reserve seems to get this, and it has started to raise interest rates to combat rising prices. This is unsettling, but as we will discuss, none of the above is a reason to abandon your long-term investment objectives, particularly given the continuing strength of the job

QUARTER REVIEW

- ✔ The S&P 500 declined 4.6% in the first quarter, while the Bloomberg U.S. Aggregate Bond index slipped 5.9%
- ✔ Overseas markets were also down; the MSCI EAFE index of developed markets fell 5.9% and the MSCI Emerging Markets index was down 7.0% in Q1
- ✔ The only U.S. sectors with gains in Q1 were energy, up 39.0%, and utilities, up 4.2%

market and the U.S. consumer, the main driver of our economy's growth.

When volatility increases, so do investment opportunities. For us, that means focusing on quality investments that can weather myriad economic conditions—and that's exactly what our fund managers are doing.

First Quarter Review

After hitting correction territory, U.S. stocks rebounded to finish the first quarter down between 5.3% (the MSCI U.S. Broad Market index) and 4.1% (the Dow Jones Industrial Average), essentially where they were before the onset of hostilities. Even with the pullback, the S&P 500 is up 15.6% over the last 12 months, and the Dow and the broad market index also made gains over that period.

It's no surprise that the Russian invasion made more of an impact on foreign developed markets and emerging markets stocks—the MSCI EAFE index fell 5.9% in Q1 and is up only 1.2% over the last year, while the MSCI Emerging Markets index declined 7.0% year-to-date and 11.4% from this time last year. What may be surprising is that those declines were not steeper. Still, we are amazed that European markets had nearly recovered to pre-invasion levels by the end of Q1.

Energy prices took off. They were already rebounding due to the COVID-19 reopening trade, but sanc-

Invasion and Inflation Fears Take a Toll

INDEX	Q1	12-MO.
Dow Jones Industrial Average	-4.1%	7.1%
S&P 500	-4.6%	15.6%
MSCI U.S. Broad Market	-5.3%	12.3%
MSCI EAFE	-5.9%	1.2%
Bloomberg U.S. Aggregate Bond Index	-5.9%	-4.2%
MSCI Emerging Markets	-7.0%	-11.4%

Note: Ranked by Q1 returns. Performance numbers are total returns, reflecting reinvested dividends through 3/31/22. Source: Morningstar.

PERSONAL FINANCE FOCUS

Support Your Cause and Save on Taxes

THE HUMAN SUFFERING IN UKRAINE has many investors wondering what they can do to help. Whether you wish to support humanitarian efforts in Eastern Europe, have other favorite causes or are simply looking to benefit from the tax advantages of charitable giving, here's our primer on four effective strategies:

1 Direct cash donations are not the most tax-efficient giving strategy, and we tend to advise against them. But they're usually the simplest for you and the organizations you're supporting. You can deduct cash donations up to 60% of your adjusted gross income (AGI) each year.

2 Stock donations help you avoid the capital gains tax bite that comes with a stock sale. Giving stock directly also allows you to deduct the full value of the shares from your taxable income up to 30% of your AGI.

3 Donor-advised funds (DAFs) combine the ease and simplicity of cash and stock donations with the longevity and flexibility of more complex charitable vehicles. Rather than giving to a charity directly, you contribute cash or, more likely, highly appreciated stocks to the DAF for an immediate tax deduction. Once funded, you direct donations to charitable organizations over time. Any contributions that aren't immediately used for giving can be invested in one of several options available in the DAF, growing tax-free.

4 Qualified charitable distributions (QCDs) enable you to trim your tax bill by directing some or all of your retirement accounts' required minimum distributions to philanthropic efforts—reducing your AGI up to $100,000 ($200,000 for married couples filing jointly) per year.

Remember that scammers are happy to take advantage of wars and natural disasters by creating bogus charities. Visit websites such as charitynavigator.org or charitywatch.org to make sure the organization is legitimate and has a track record of using your funds for direct relief as opposed to covering their corporate overhead. Also, DAFs vet organizations before they approve them for gifts.

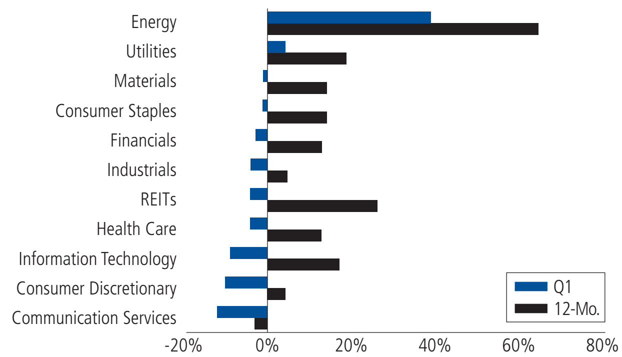
For more, check out our special report, *Making the Most of Your Charitable Giving* (adviserinvestments.com/cg/). If you'd like to discuss charitable giving strategies or adjust your current giving plan, call us and we'd be happy to help.

OUR OUTLOOK

- ✔ The value vs. growth pendulum has swung toward value, spotlighting the benefit of owning both in a diversified portfolio
- ✔ Inflation-fighting interest-rate hikes from the Fed will boost bond yields over time, part of bonds' "self-healing" factor, and history shows that stock, bond and cash returns have on average made gains in the 24 months following the start of a new rate-hike cycle
- ✔ Recession and the yield-curve inversion may be making headlines, but we're not seeing strong evidence to support a near-term economic contraction

U.S. Sector Performance

Ranked by Q1 Return



Source: Morningstar.

tions against Russia further boosted the price of oil and gas. Stocks in the U.S. energy sector gained 39.0% in Q1 and are up 64.6% over the last year. Other "value" sectors also fared better than "growth" sectors in Q1, including utilities, which were up 4.2%. The quarter's worst performers were growthier fare. In particular, the communications services sector lost 12%, driven by a 34% decline for Meta (Facebook).

Concerns about aggressive interest-rate hikes and persistent inflation turned bonds into an unloved asset class in the first quarter, with the Bloomberg U.S. Aggregate Bond index declining 5.9%. Over the year's first three months, the yield on the U.S. 10-year Treasury bond rose from 1.52% to 2.32%.

Our Outlook

Investors' eyes are clearly focused on inflation, interest rates and recession as the second quarter opens.

Spiking energy prices and protracted supply chain delays have led to longer wait times and rising prices on everything from groceries and rent to coffee and croissants. As a result, the Federal Reserve plans to tackle inflation with its primary policy lever: The fed funds rate. In essence, the Fed will raise interest rates in an attempt to cool demand by making it more expensive to borrow money and more rewarding to build savings.

The Fed's first rate hike since 2018, the 0.25% March increase, was merely a taste of what's to come. It's not our baseline expectation, but analysts predict we could see as many as nine additional 0.50% increases this year and next, which would bring the fed funds rate, which began 2022 at 0.25%, to somewhere north of 4% in 2023.

We think rate hikes are necessary, but know they are not without risk, nor are they carved in stone. An overly aggressive, policy-driven economic recession is one of two worrisome scenarios when a new rate-hike cycle begins. The other is that stocks and bonds will decline as a result. However, this latter concern has rarely played out. In our special report, ***What Interest Rate Hikes Really Mean for Your Portfolio*** **(adviserinvestments.com/irh/)**, we take a deep dive into the prior seven rate-hike cycles and find that, on average, stocks and bonds have posted positive returns over the two-year period following the Federal Reserve's first interest-rate increase.

COMPANY NEWS

Wellness Wherever We Are

ADVISER INVESTMENTS has carefully adopted new technologies and new ways of working while continuing to welcome new colleagues. Our latest companywide initiative launched this month: Every employee has been given access to a health coach through the RestoreResilience app to improve their emotional and physical well-being. The program is confidential, and employees can work with a coach to come up with a program based on their own unique health goals. We're excited to get started—and wanted to thank team members Diana Linn, Karrie Pettiglio and Laura Sweeney for helping us stay focused on wellness for our workforce.

Naturally, the Fed's March rate hike increased what we call "recession obsession." Adding to it: In late March, we saw a yield-curve inversion wherein the two-year Treasury bond briefly offered a higher yield than the 10-year Treasury bond. While past inversions have preceded economic recessions, they tend to be an advance indicator, flashing yellow anywhere from nine to 24 months before the economy actually contracts. And the inversion between the two-year and 10-year bond was not accompanied by an inversion in the three-month and 10-year yields. In fact, the "10–3 spread," as it's known, was moving in the other direction.

We are keeping a close eye on the yield curve as one indicator of economic duress, but other trends, like historically low unemployment, robust consumer spending and corporate earnings growth, would have to reverse course for our recession fears to mount.

What we know: Inflationary environments can turn the market tide. Commodities may look more attractive when the Fed is hiking rates or inflation is higher, but they are far more susceptible to rapid boom-bust cycles, which typically don't fit most investors' appetite for portfolio risk. This is why we prefer exposure to industries that can benefit from rising commodity prices but are not totally dependent upon them for profitability. We prefer to let the fund managers we invest with seek out individual opportunities in both growth stocks selling at discounted values and value stocks with growth potential.

There's no doubt bonds have been in a funk, but prices have already fallen and yields are rising. That extra income will start to make up for price declines, which makes them self-healing. It's frustrating in the short term, but if you are looking to manage stock market risk in a portfolio, bonds are still one of the best ways to do so, and last quarter doesn't change that. For more in defense of bonds, please read our Q2 bond outlook: **adviserinvestments.com/bonds-22q2/**.

If you are worried about the current landscape and its impact on your portfolio, do not hesitate to contact us. We are here to listen and can review and revise your financial plan (or help you create one) so that you can have peace of mind during turbulent times. Adviser Investments is also available to help you stay on top of not only your investment portfolio, but important financial deadlines, tax-reduction strategies, required minimum distributions and whatever other needs arise throughout the year. We look forward to speaking with you!

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