Holiday Economic Update

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Financial Insights
WEALTH MANAGEMENT

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As Chief Investment Officer, Brian is responsible for the research and analysis that shapes Financial Insights investment philosophy and implementation processes; and together with other members of the investment committee, Brian directs firm-wide strategic allocation policies.

Brian has over 27 years of experience in the industry and obtained the Chartered Financial Analyst (CFA) and Chartered Alternative Investment Analyst (CAIA) designations. Brian also received a degree in Finance from Pacific Lutheran University.

Agenda

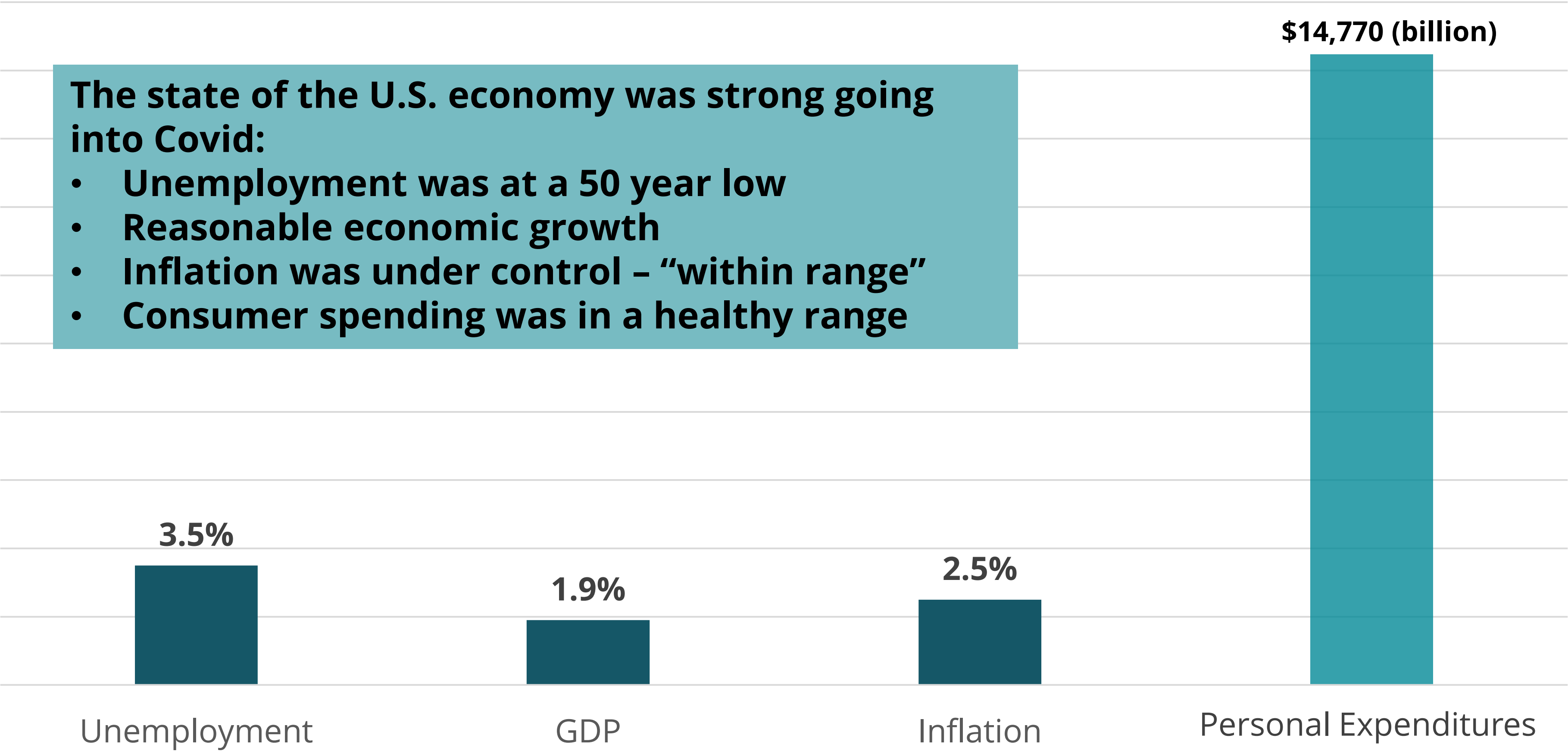
- A review of Covid's effects on the economy and financial markets
- The response of policy makers and results thus far
- A review of inflation

Covid-19’s Impact on the Economy and Markets

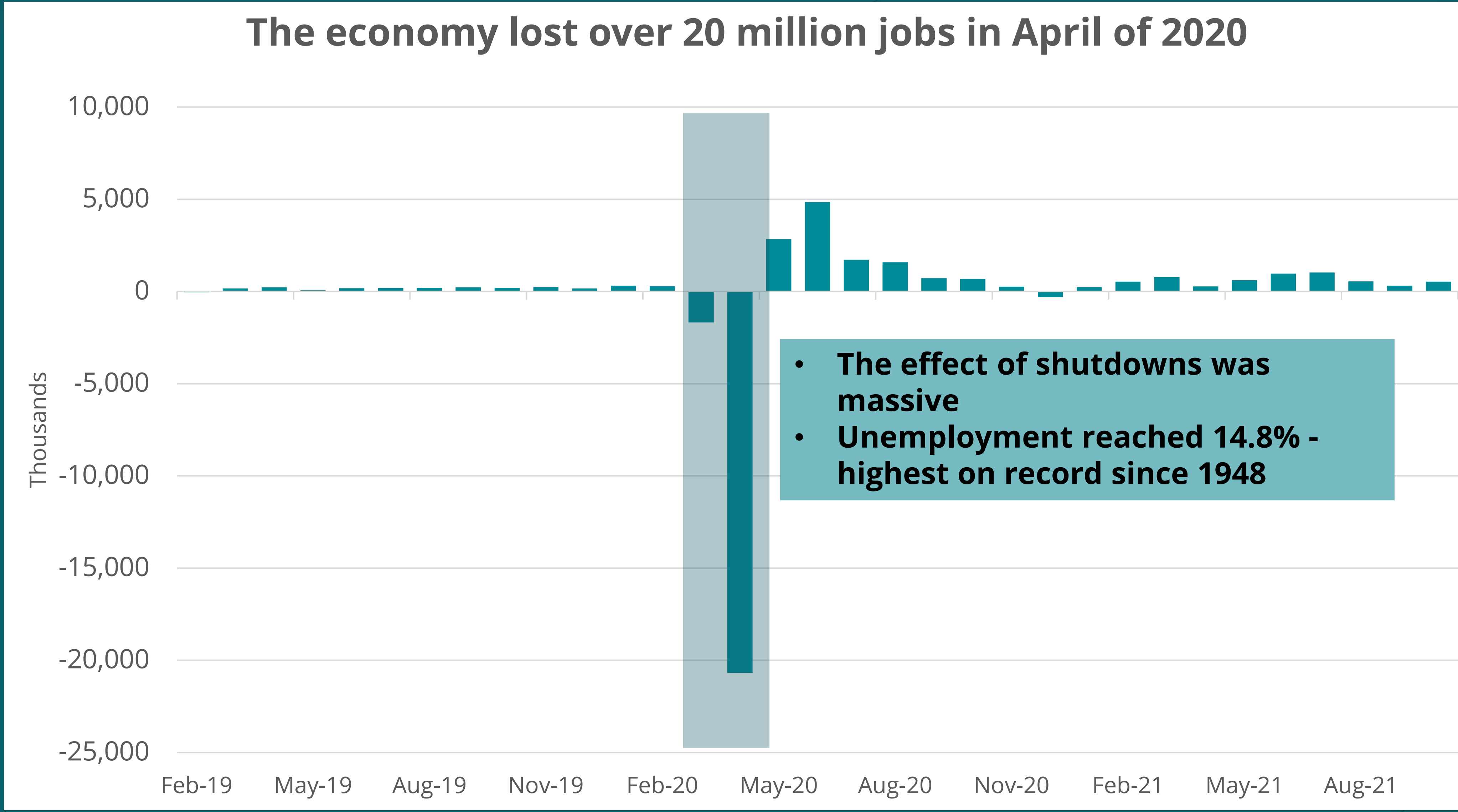
Economic Activity
Prior to Pandemic (Late 2019/Early 2020)

The state of the U.S. economy was strong going into Covid:

- **Unemployment was at a 50 year low**
- **Reasonable economic growth**
- **Inflation was under control – “within range”**
- **Consumer spending was in a healthy range**

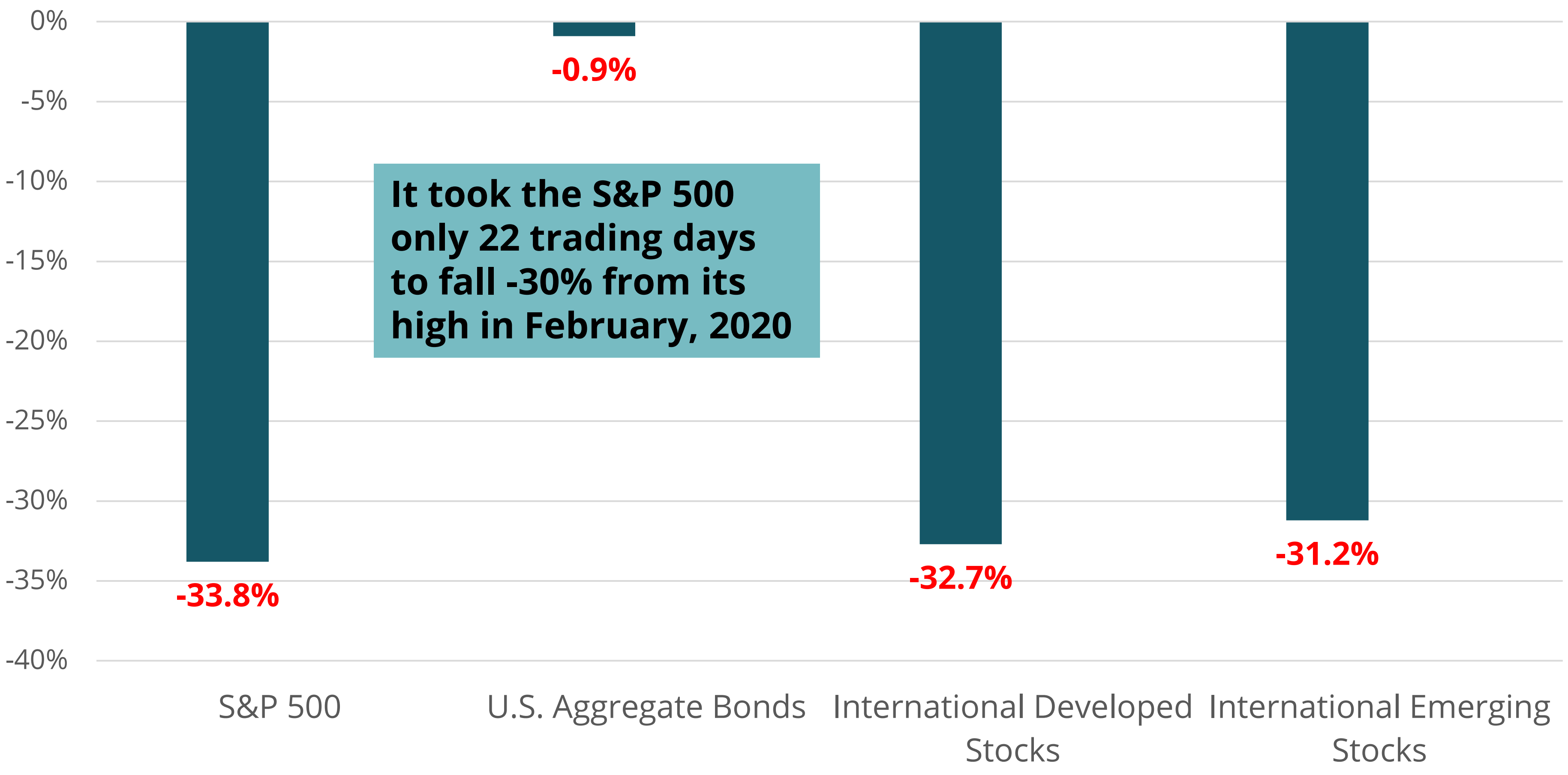


Source: fred.stlouisfed.org



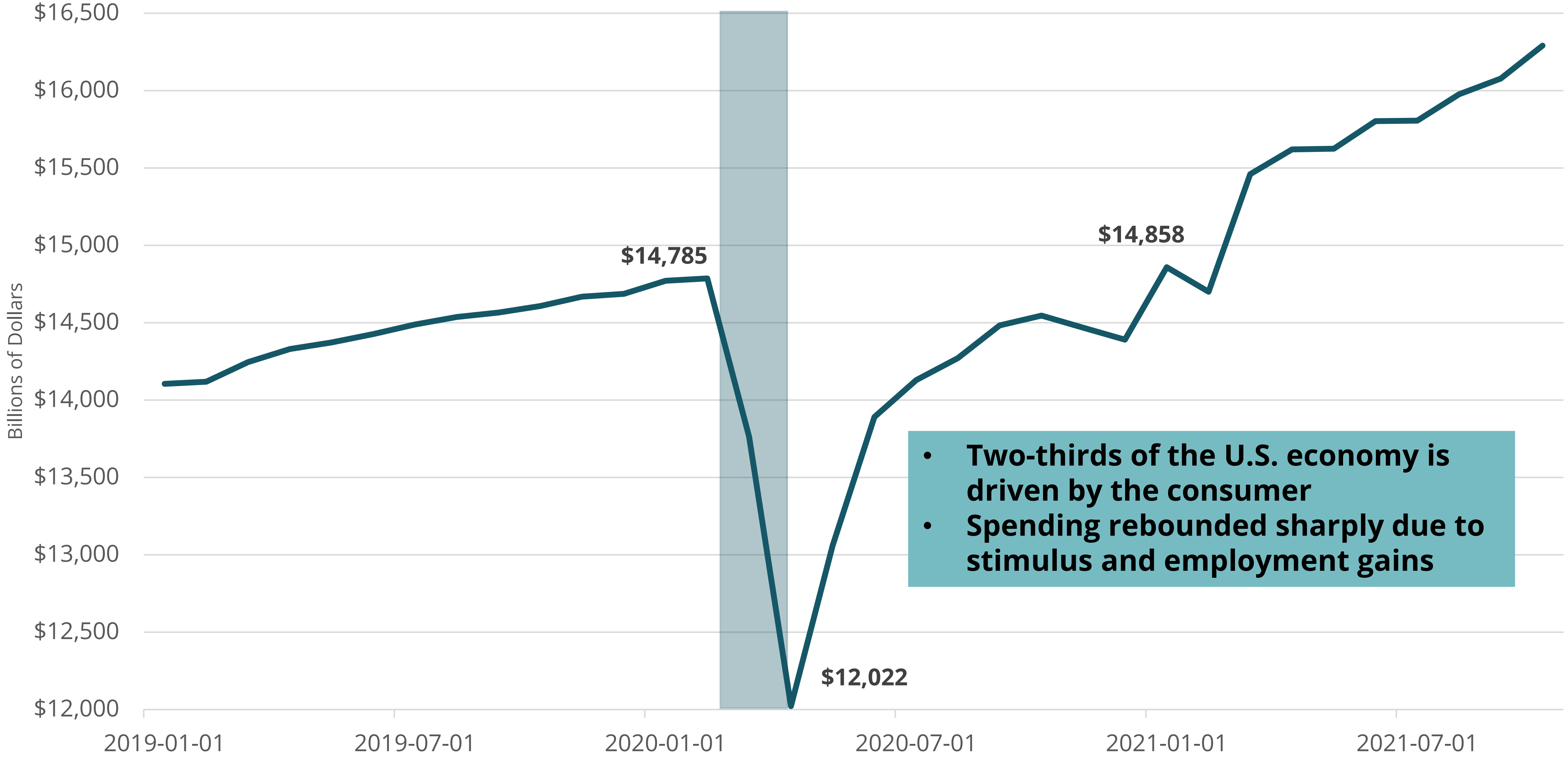
Source: U.S. Bureau of Labor Statistics

In Anticipation of Economic Fallout Financial Markets Experienced The Fasted Decline in History - (February 2020 – Peak to Trough)



Sources: YCHARTS: Standard and Poor's S&P 500 Stock Index ; U.S. Aggregate Bonds: Bloomberg Barclay's U.S. Aggregate Bond Index; International Developed Stocks: MSCI EAFE Index – net returns; International Emerging Markets Stocks: MSCI EM Index net returns

Consumption (PCE) fell by -19% During The Pandemic Followed by a Sharp Rebound (year-over year-figures)

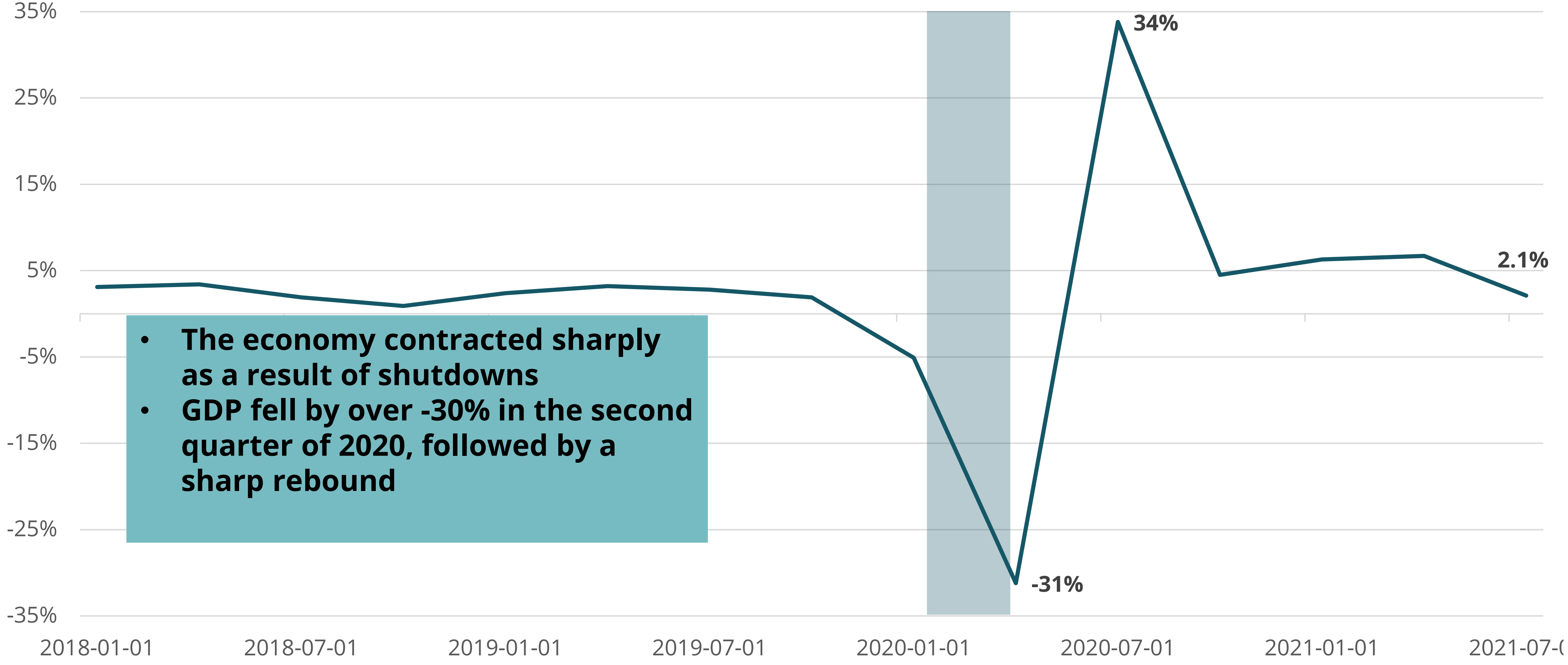


- **Two-thirds of the U.S. economy is driven by the consumer**
- **Spending rebounded sharply due to stimulus and employment gains**

Source: fred.stlouisfed.org

Gross Domestic Product Plummeted in 2020

Quarter-by-Quarter Growth or Decline



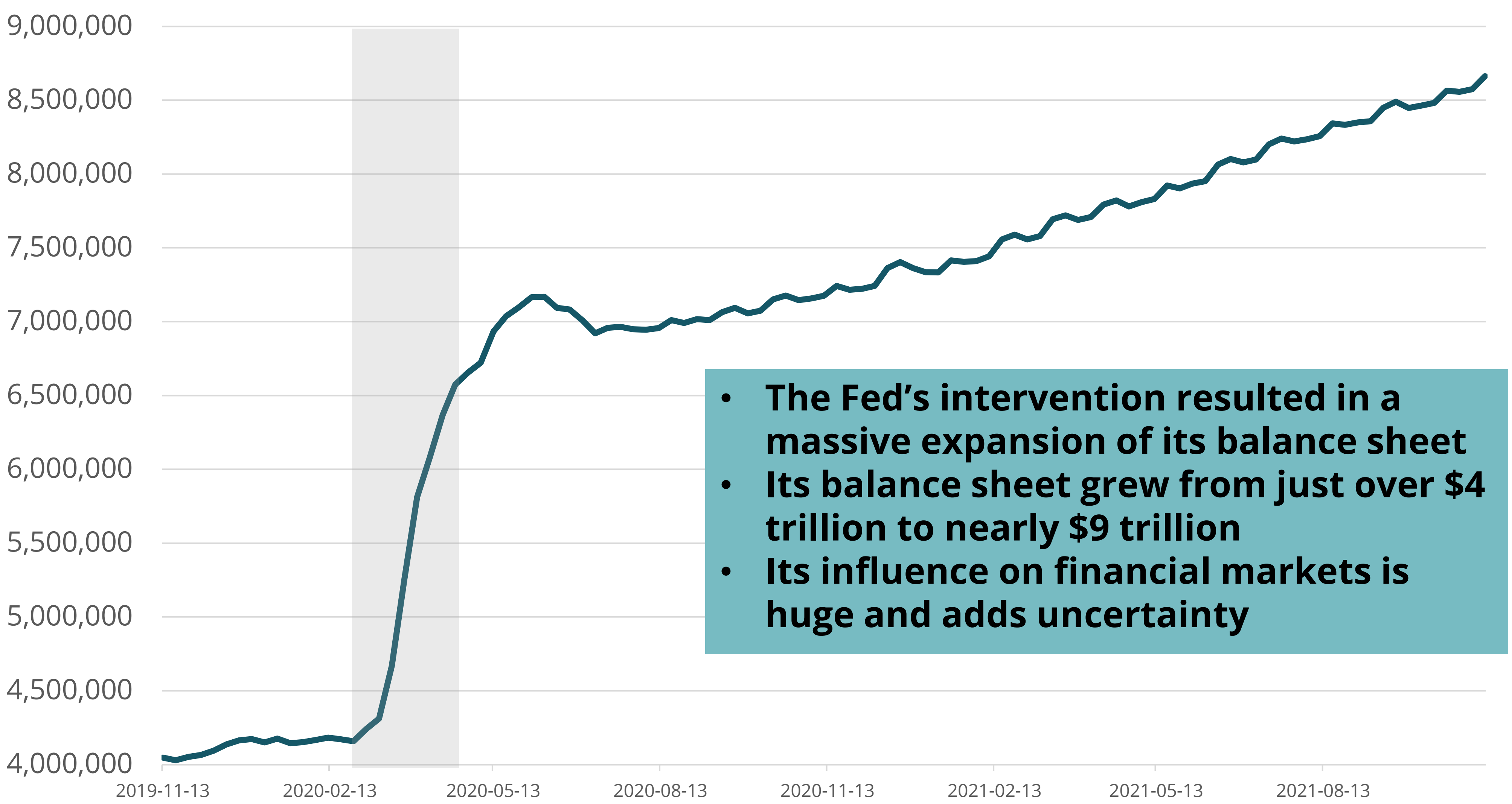
Source: fred.stlouisfed.org

The Response by Policymakers and Financial Markets

The U.S. Federal Reserve Made Huge Efforts To Stem The Damage:

- Restarted Quantitative Easing (i.e. bond purchases)
- Municipal Liquidity Facility
- Main Street Lending Program
- Commercial Paper Funding Facility (CPFF)
- Primary Dealer Credit Facility (PDCF)
- Money Market Mutual Fund Liquidity Facility (MMLF)
- Primary Market Corporate Credit Facility (PMCCF)
- Secondary Market Corporate Credit Facility (SMCCF)
- Term Asset-Backed Securities Loan Facility (TALF)
- Paycheck Protection Program Liquidity Facility (PPPLF)
- Central Bank Liquidity Swaps
- Temporary Foreign and International Monetary Authorities (FIMA) Repo Facility

Fed Balance Sheet (Trillions)



- **The Fed's intervention resulted in a massive expansion of its balance sheet**
- **Its balance sheet grew from just over $4 trillion to nearly $9 trillion**
- **Its influence on financial markets is huge and adds uncertainty**

Source: fred.stlouisfed.org

For Their Part, Lawmakers acted quickly with supporting the development of vaccines and six stimulus bills

❖ The government aided in the quickest development and deployment of vaccines in history, while stimulus bills included:

1. Coronavirus Preparedness and Response Supplemental Appropriations Act, 2020, $8.3 billion

2. Families First Coronavirus Response Act, $225 billion

3. CARES Act, $2.2 trillion

4. Paycheck Protection Program and Health Care Enhancement Act, $483 billion

5. Consolidated Appropriations Act, 2021 - signed into law on Dec. 28, 2020, $920 billion

6. American Rescue Plan, 2021, $1.9 trillion

Source: usatoday.com

Paycheck Protection Program

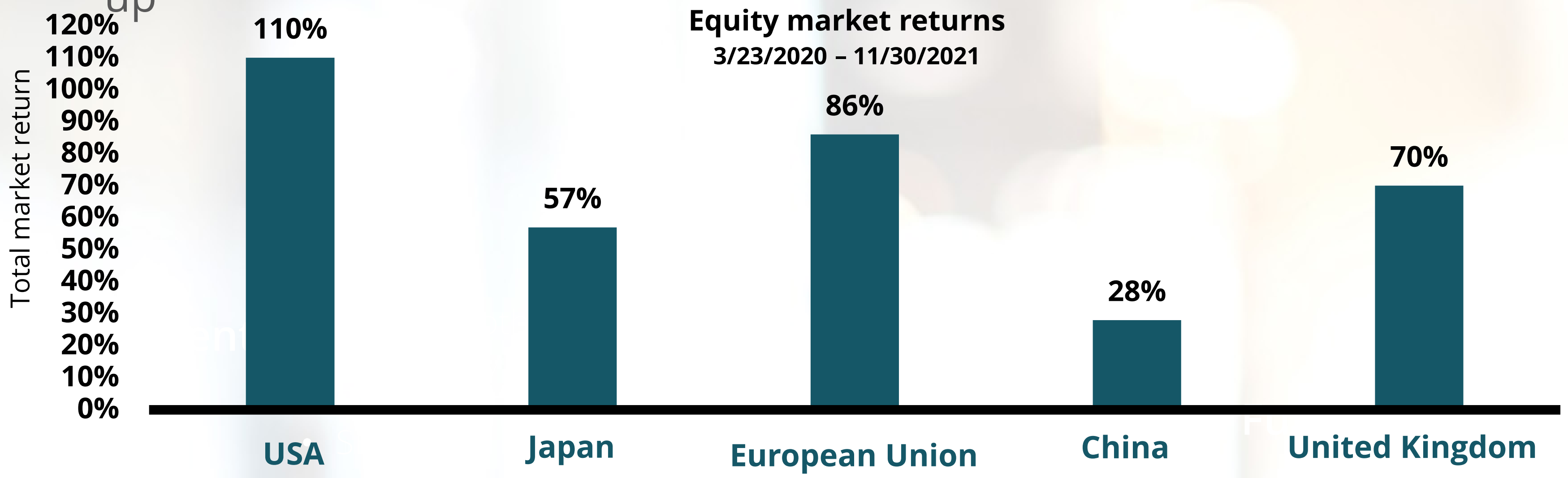
Ended as of 5/31/2021

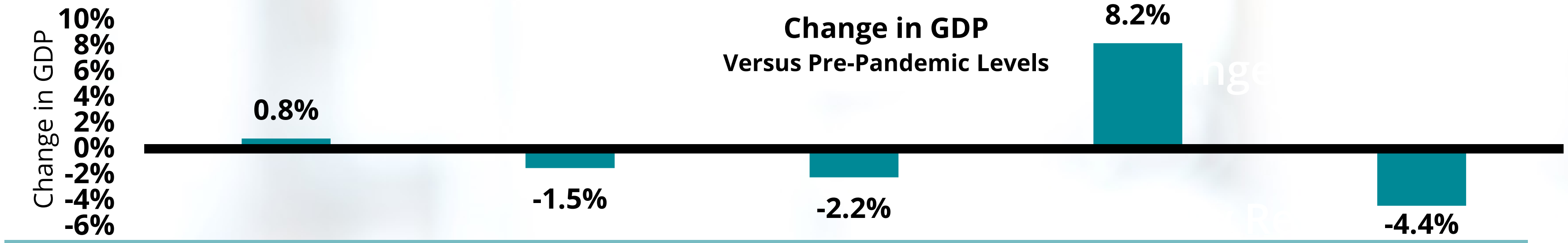
Source: sba.gov

- **The Paycheck Protection Program was massive in size and helped maintain jobs**
- **Remember many of these loans did not need to be repaid by employers – essentially another form of stimulus**

Recoveries across the globe – The economy and Financial markets

U.S. has made a full recovery while many other economies are still catching up



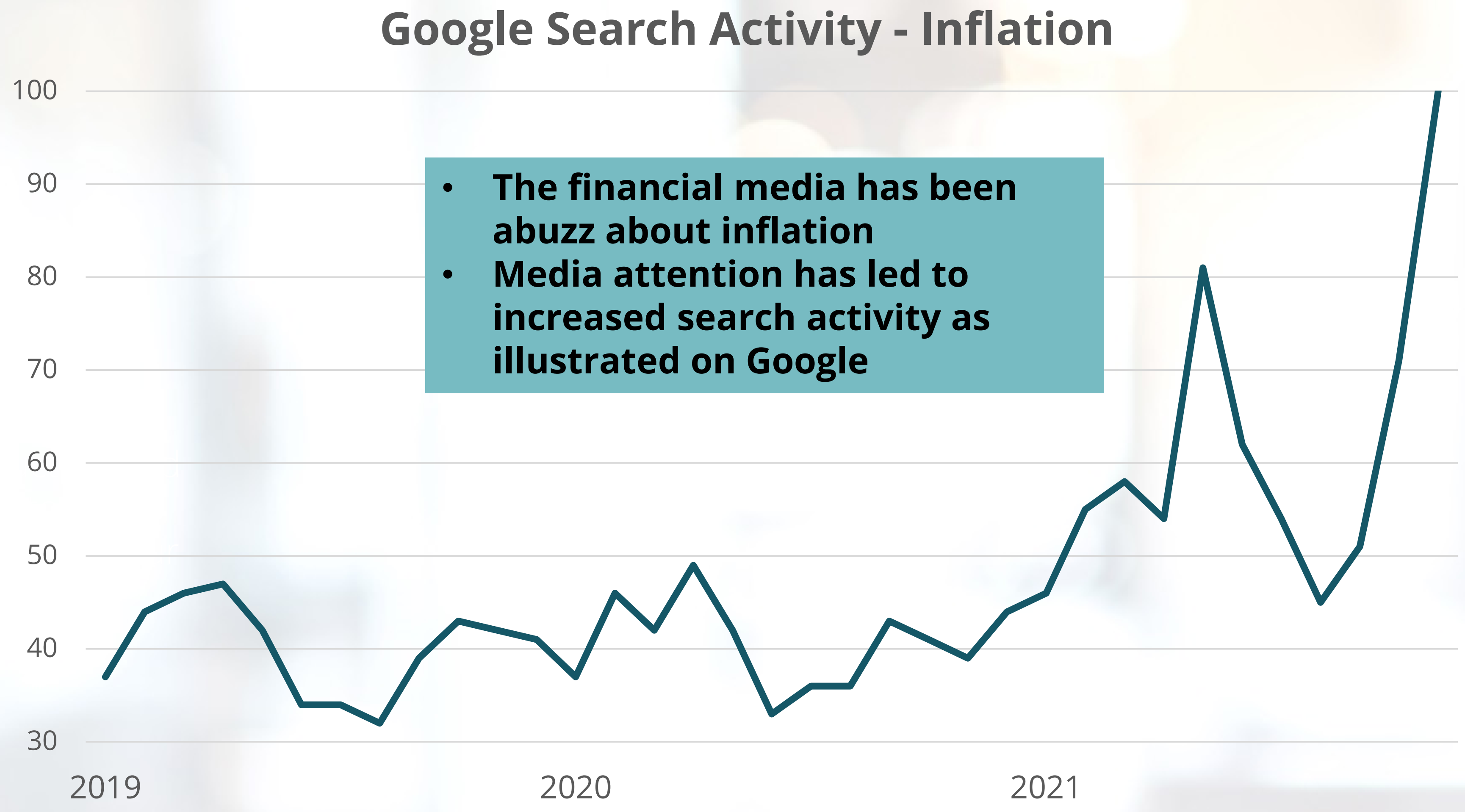


- **Economic activity is above pre-covid levels in U.S. and China but still recovering in other major developed regions**
- **Foreign countries may have a larger upside as the reopening continues**
- **We must consider variants as a threat to reopening around the world**

Sources: Russell Investments, OECD and Morningstar. Equity market returns represented by S&P 500, MSCI United Kingdom, MSCI EU, MSCI China and MSCI Japan. Index returns represent past performance, are not a guarantee of future performance, and are not indicative of any specific investment. Indexes are unmanaged and cannot be invested in directly.

A Brief Review of Inflation

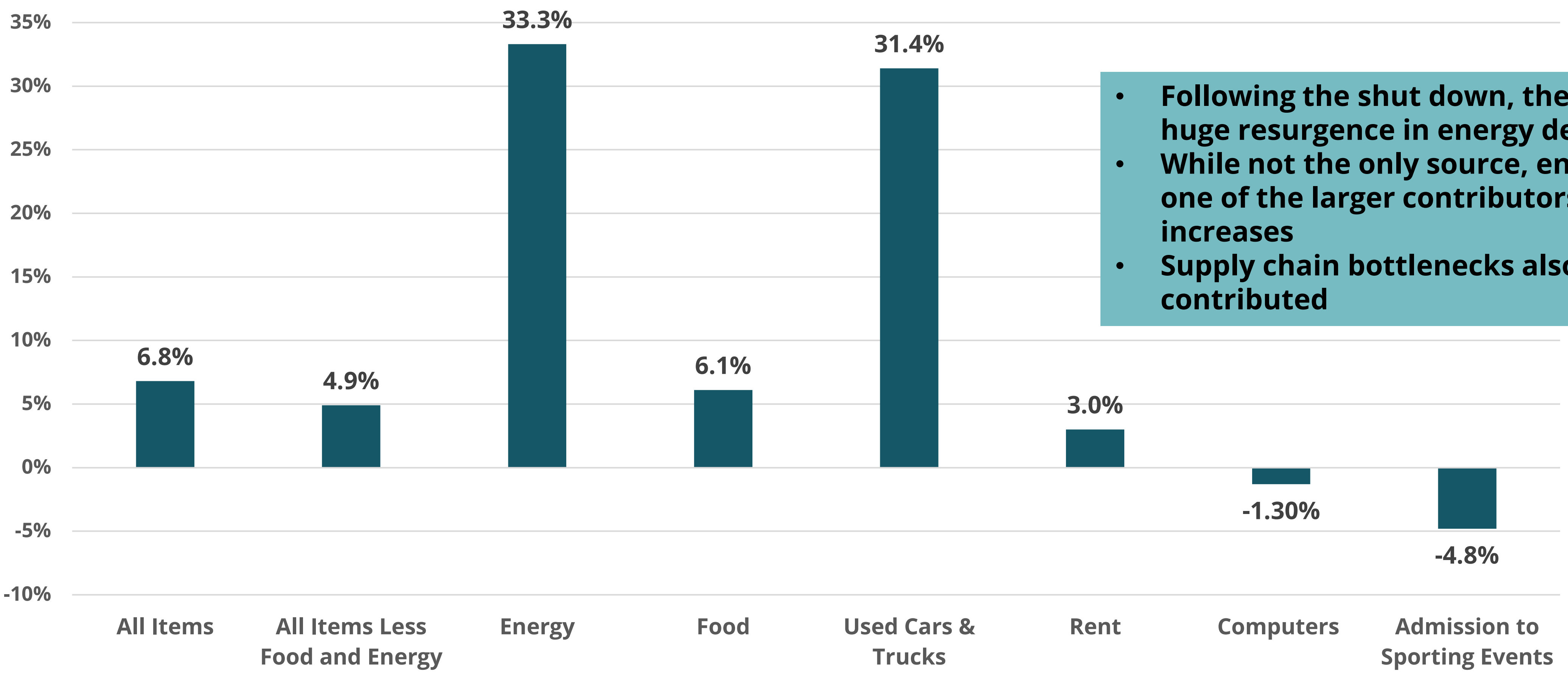
What About Inflation?



- **The financial media has been abuzz about inflation**
- **Media attention has led to increased search activity as illustrated on Google**

Source: google.com

Year-over-Year Inflation
(as of November, 2021)

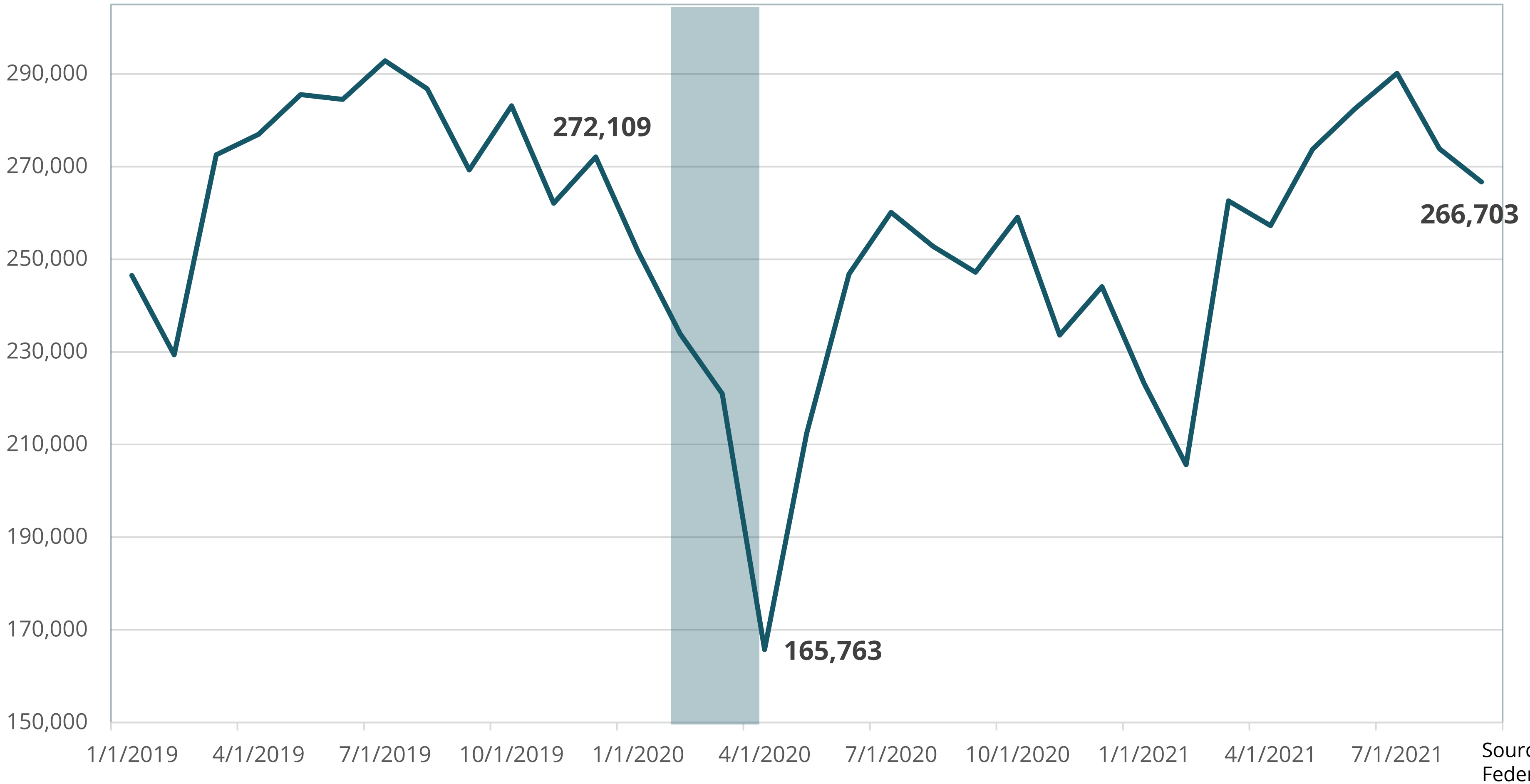


- **Following the shut down, there was a huge resurgence in energy demand**
- **While not the only source, energy was one of the larger contributors to price increases**
- **Supply chain bottlenecks also contributed**

Source: U.S. Bureau of Labor Statistics

U.S. Monthly Miles Driven

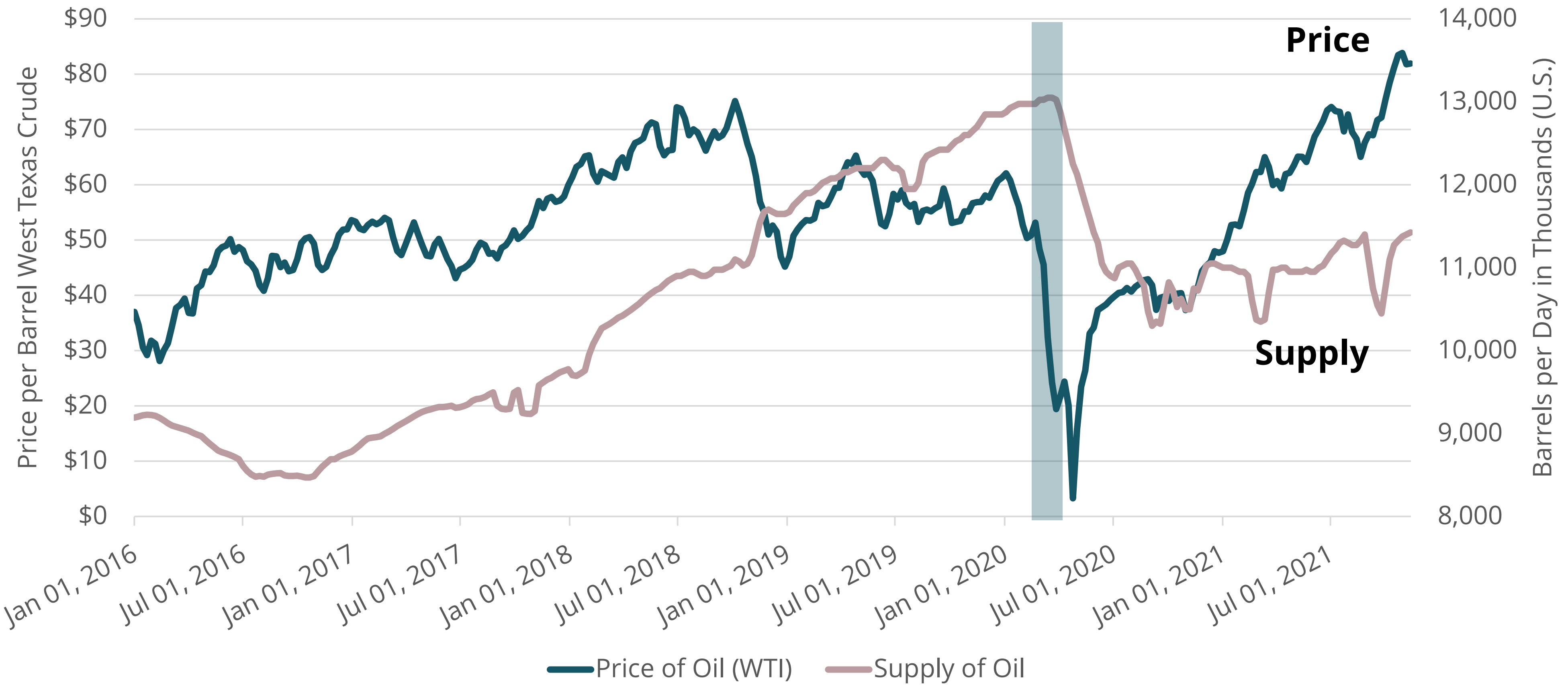
60% increase between April, 2020 and September, 2021



Sources: ycharts.com,
Federal Highway administration

- **Miles driven in the U.S. dropped dramatically during the pandemic**
- **They increased sharply in 2021 – highlighting the increase in demand for energy**

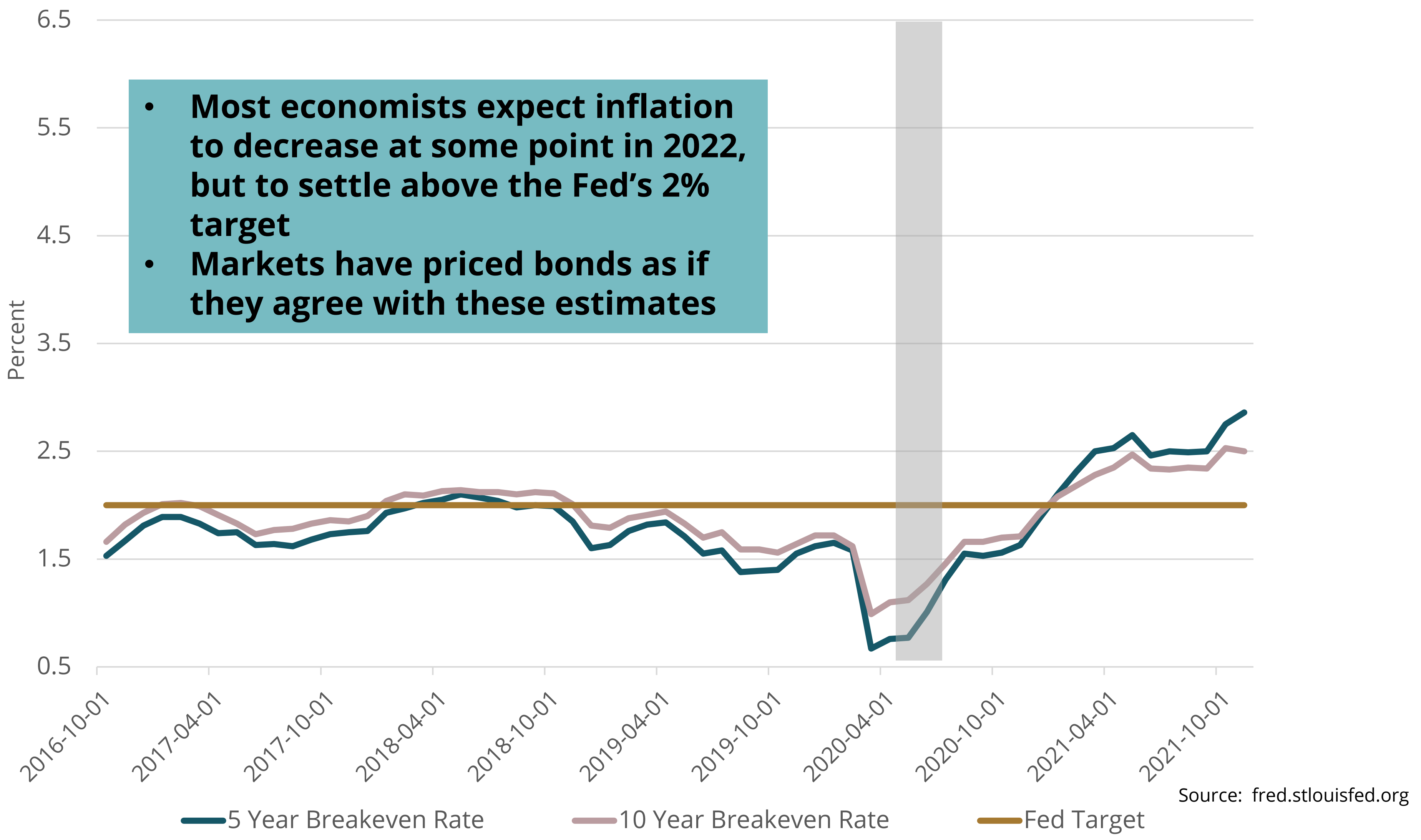
A Look at Energy:
Price of Oil vs. Supply - U.S. Oil Production



- **The price and supply of oil fell significantly in 2020**
- **Since then, supply has not increased much, pushing prices higher (i.e. leading to higher inflation)**

Source: eia.gov

Market Implied Inflation Rates - 5 Years and 10 Years From Now



What Are The Forces Influencing Inflation?

Short-term Influences / Covid:

- 2021 results were compared to low prices in 2020. During the pandemic there were worries about possible deflation (declining prices)
- Variants made it difficult to ramp up production in less developed countries
- Factory shut downs led to shortages in some goods (i.e. semi-conductor chips)
- Shipping backlogs have not helped and have contributed to supply chain bottlenecks

Long-term Considerations:

- Most economists expect supply chain issues to be resolved and demand to shift
- Aging demographics may mean less consumption and lower demand overall, leading to downward pressure on inflation
- Advancements in technology have led to lower production costs, lower prices and lower inflation

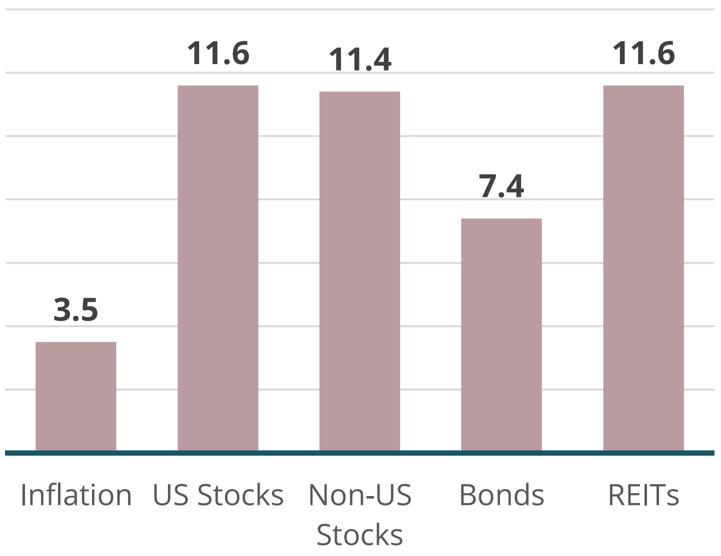
Risks:

- More variants could cause countries to shut down production once again (i.e. Omicron)
- Labor shortages may persist resulting in higher wage pressure
- Inflation becomes self-fulfilling, meaning people expect inflation in the future and “buy now”, driving prices higher instead of waiting

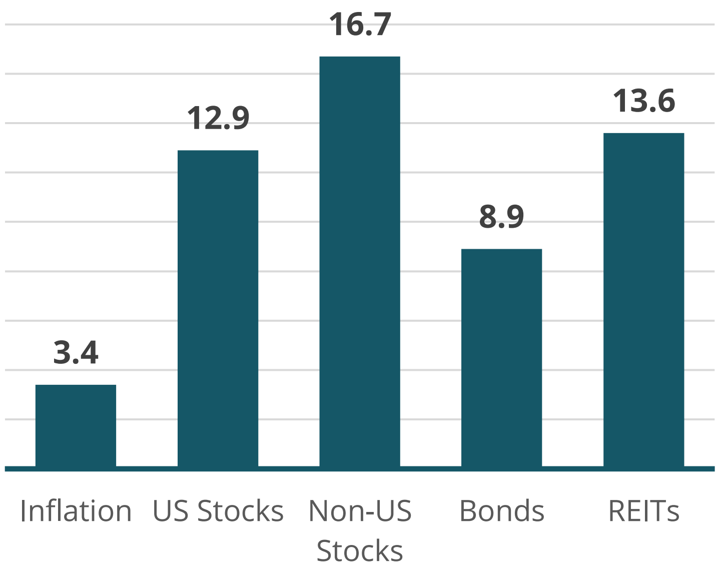
Markets Have Held Up Under Past Inflation Regimes

Above average inflationary periods and corresponding returns (early 1985 – early 2021)

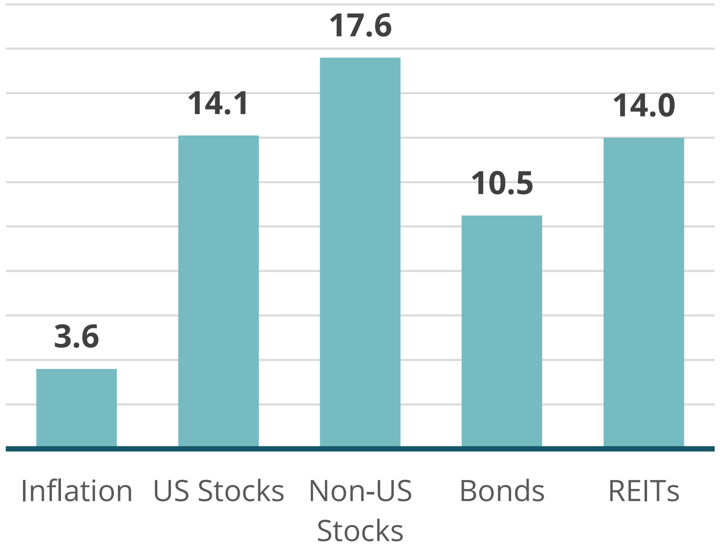
One Year Periods of high inflation and annualized market returns (%)



Three Year Periods of high inflation and annualized market returns (%)



Five Year Periods of high inflation and annualized market returns (%)



- **Inflation has averaged 2.6% since the mid 1980's**
- **Likelihood of above average inflation increases during periods of an economic expansion**
- **Stocks and real assets tend to produce higher than average results during these periods**

Sources: Russell Investments, Inflation: US Consumer Price Index, US Stocks: Russell 3000 Index; Non-US Stocks: MSCI EAFE Index; Bonds: Bloomberg Barclays Aggregate Bond Index; REITs: FTSE EPRA/NAREIT Developed Index (2004 – Mar 2021) linked to FTSE NAREIT All Equity REITs Index (1980 – 2003); Commodities: Bloomberg Commodity Index (1991 – March 2021) linked to Goldman Sachs Commodity Index (1980 – 1990). "High inflation" refers to time periods where US CPI was greater than the historical average of 2.5%.

Take-Aways:

- The economic shutdown caused by Covid-19 created huge consequences for jobs, consumption and U.S. GDP
- Policy makers acted quickly and made major interventions into markets and the economy
- The economy experienced the quickest turnaround in history. However, in most cases, supply was not able to keep up with rebounding demand from consumers
- Due to increased demand and supply chain bottlenecks, inflation increased. Most economists feel that supply will gradually catch up with demand and inflation will settle at lower readings than current levels
- Financial markets also experienced a rebound of their own as vaccines and stimulus efforts have taken hold - “rebound” is an understatement
- Companies have bolstered cash on their balance sheets in case a variant causes more economic pain
- Given the run up in stocks, waning support from the Federal Reserve, an increase in volatility during 2022 would not be surprising

Our Approach In Light of Conditions:

In light of market conditions, we recommend the following approach which includes:

1. **<u>Confirm your goals</u>** Clearly identified goals help us build an investment portfolio designed to achieve them. Without them, short term factors can lead to reactive and ill-timed decisions.

2. **<u>Stay the course</u>** Once we've confirmed your goals, we rely on long term asset allocation which has proven to be the major determinant of success. Staying the course also means monitoring market valuations and rebalancing toward target allocations as conditions warrant. We are constantly monitoring risks and opportunities.

3. **<u>Resist the temptation to time the markets</u>** Several academic studies have reached the same conclusion: no one has been able to consistently and successfully time the market – don't confuse an "expert's" luck with skill.

4. **<u>Remain diversified</u>** The most powerful protection against errors in forecasts is diversification. Every company (MSFT), economic sector (technology), region (Japan) and asset type (stocks) is at risk of periods of poor performance that can unexpectedly last for a decade or longer.

It Pays to Stay Diversified – Market Leadership Changes Rapidly

2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
U.S. Fixed Income 8.43%	Glbl ex-U.S. Fixed 22.37%	Emerging Market Equity 55.82%	Real Estate 37.96%	Emerging Market Equity 34.00%	Real Estate 42.12%	Emerging Market Equity 39.38%	U.S. Fixed Income 5.24%	Emerging Market Equity 78.51%	Small Cap Equity 26.85%
High Yield 5.28%	U.S. Fixed Income 10.26%	Small Cap Equity 47.25%	Emerging Market Equity 25.55%	Real Estate 15.35%	Emerging Market Equity 32.17%	Dev ex-U.S. Equity 12.44%	Glbl ex-U.S. Fixed 4.39%	High Yield 58.21%	Real Estate 19.63%
Cash Equivalent 4.42%	Real Estate 2.82%	Real Estate 40.69%	Dev ex-U.S. Equity 20.38%	Dev ex-U.S. Equity 14.47%	Dev ex-U.S. Equity 25.71%	Glbl ex-U.S. Fixed 11.03%	Cash Equivalent 2.06%	Real Estate 37.13%	Emerging Market Equity 18.88%
Small Cap Equity 2.49%	Cash Equivalent 1.78%	Dev ex-U.S. Equity 39.42%	Small Cap Equity 18.33%	Large Cap Equity 4.91%	Small Cap Equity 18.37%	U.S. Fixed Income 6.97%	High Yield -26.16%	Dev ex-U.S. Equity 33.67%	High Yield 15.12%
Emerging Market Equity -2.61%	High Yield -1.37%	High Yield 28.97%	Glbl ex-U.S. Fixed 12.54%	Small Cap Equity 4.55%	Large Cap Equity 15.79%	Large Cap Equity 5.49%	Small Cap Equity -33.79%	Small Cap Equity 27.17%	Large Cap Equity 15.06%
Glbl ex-U.S. Fixed -3.75%	Emerging Market Equity -6.16%	Large Cap Equity 28.68%	High Yield 11.13%	Cash Equivalent 3.07%	High Yield 11.85%	Cash Equivalent 5.00%	Large Cap Equity -37.00%	Large Cap Equity 26.47%	Dev ex-U.S. Equity 8.95%
Real Estate -3.81%	Dev ex-U.S. Equity -15.80%	Glbl ex-U.S. Fixed 19.36%	Large Cap Equity 10.88%	High Yield 2.74%	Glbl ex-U.S. Fixed 8.16%	High Yield 1.87%	Dev ex-U.S. Equity -43.56%	Glbl ex-U.S. Fixed 7.53%	U.S. Fixed Income 6.54%
Large Cap Equity -11.89%	Small Cap Equity -20.48%	U.S. Fixed Income 4.10%	U.S. Fixed Income 4.34%	U.S. Fixed Income 2.43%	Cash Equivalent 4.85%	Small Cap Equity -1.57%	Real Estate -48.21%	U.S. Fixed Income 5.93%	Glbl ex-U.S. Fixed 4.95%
Dev ex-U.S. Equity -21.40%	Large Cap Equity -22.10%	Cash Equivalent 1.15%	Cash Equivalent 1.33%	Glbl ex-U.S. Fixed -8.65%	U.S. Fixed Income 4.33%	Real Estate -7.39%	Emerging Market Equity -53.33%	Cash Equivalent 0.21%	Cash Equivalent 0.13%

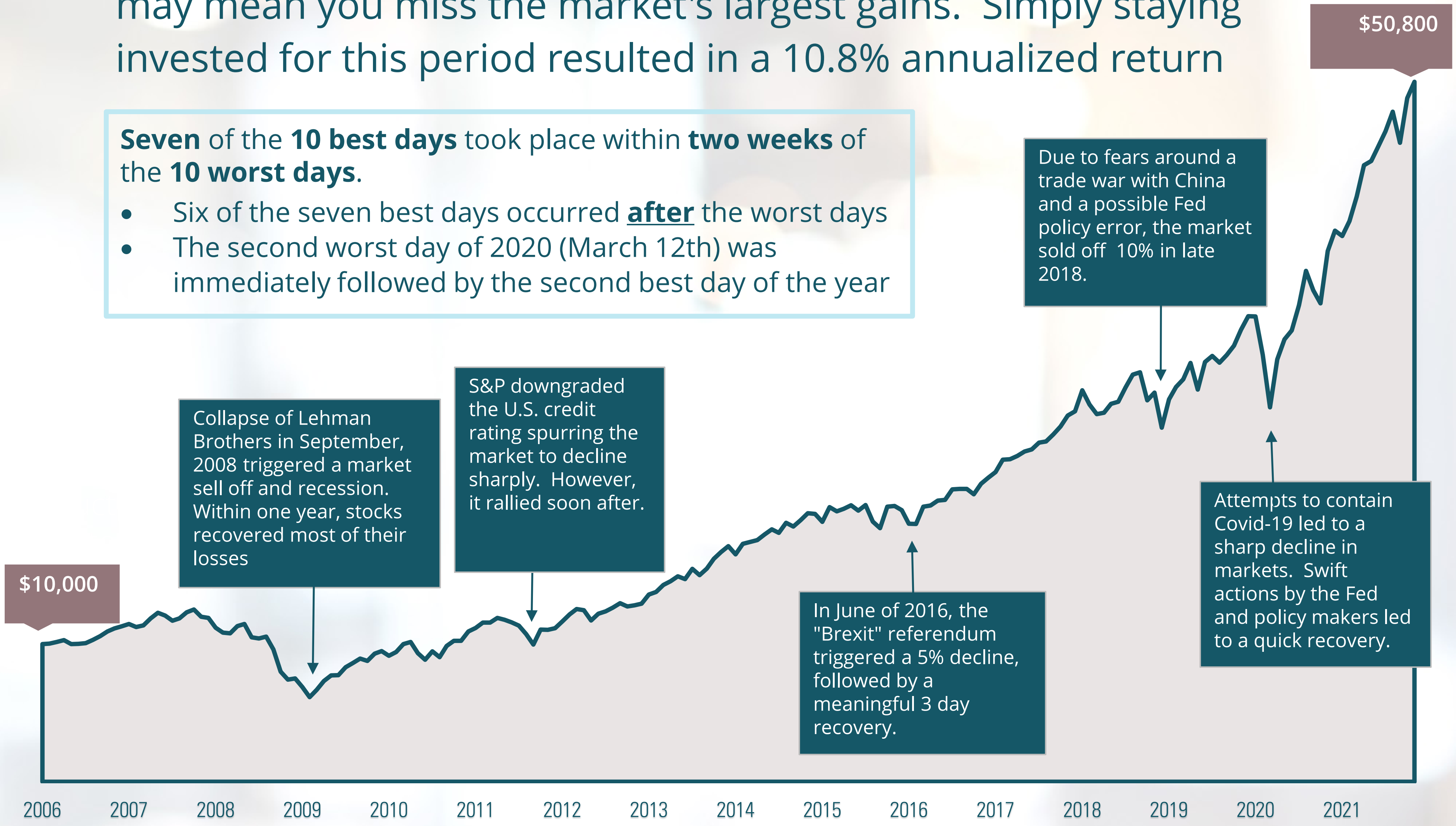
2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
U.S. Fixed Income 7.84%	Real Estate 27.73%	Small Cap Equity 38.82%	Real Estate 15.02%	Large Cap Equity 1.38%	Small Cap Equity 21.31%	Emerging Market Equity 37.28%	Cash Equivalent 1.87%	Large Cap Equity 31.49%	Small Cap Equity 19.96%
High Yield 4.98%	Emerging Market Equity 18.23%	Large Cap Equity 32.39%	Large Cap Equity 13.69%	U.S. Fixed Income 0.55%	High Yield 17.13%	Dev ex-U.S. Equity 24.21%	U.S. Fixed Income 0.01%	Small Cap Equity 25.52%	Large Cap Equity 18.40%
Glbl ex-U.S. Fixed 4.36%	Dev ex-U.S. Equity 16.41%	Dev ex-U.S. Equity 21.02%	U.S. Fixed Income 5.97%	Cash Equivalent 0.05%	Large Cap Equity 11.96%	Large Cap Equity 21.83%	High Yield -2.08%	Dev ex-U.S. Equity 22.49%	Emerging Market Equity 18.31%
Large Cap Equity 2.11%	Small Cap Equity 16.35%	High Yield 7.44%	Small Cap Equity 4.89%	Real Estate -0.79%	Emerging Market Equity 11.19%	Small Cap Equity 14.65%	Glbl ex-U.S. Fixed -2.15%	Real Estate 21.91%	Glbl ex-U.S. Fixed 10.11%
Cash Equivalent 0.10%	Large Cap Equity 16.00%	Real Estate 3.67%	High Yield 2.45%	Dev ex-U.S. Equity -3.04%	Real Estate 4.06%	Glbl ex-U.S. Fixed 10.51%	Large Cap Equity -4.38%	Emerging Market Equity 18.44%	Dev ex-U.S. Equity 7.59%
Small Cap Equity -4.18%	High Yield 15.81%	Cash Equivalent 0.07%	Cash Equivalent 0.03%	Small Cap Equity -4.41%	Dev ex-U.S. Equity 2.75%	Real Estate 10.36%	Real Estate -5.63%	High Yield 14.32%	U.S. Fixed Income 7.51%
Real Estate -6.46%	U.S. Fixed Income 4.21%	U.S. Fixed Income -2.02%	Emerging Market Equity -2.19%	High Yield -4.47%	U.S. Fixed Income 2.65%	High Yield 7.50%	Small Cap Equity -11.01%	U.S. Fixed Income 8.72%	High Yield 7.11%
Dev ex-U.S. Equity -12.21%	Glbl ex-U.S. Fixed 4.09%	Emerging Market Equity -2.60%	Glbl ex-U.S. Fixed -3.09%	Glbl ex-U.S. Fixed -6.02%	Glbl ex-U.S. Fixed 1.49%	U.S. Fixed Income 3.54%	Dev ex-U.S. Equity -14.09%	Glbl ex-U.S. Fixed 5.09%	Cash Equivalent 0.67%
Emerging Market Equity -18.42%	Cash Equivalent 0.11%	Glbl ex-U.S. Fixed -3.08%	Dev ex-U.S. Equity -4.32%	Emerging Market Equity -14.92%	Cash Equivalent 0.33%	Cash Equivalent 0.86%	Emerging Market Equity -14.57%	Cash Equivalent 2.28%	Real Estate -9.04%

Source: Callan Institute, callan.com

Attempting to predict the best time to buy and sell may mean you miss the market's largest gains. Simply staying invested for this period resulted in a 10.8% annualized return

Seven of the **10 best days** took place within **two weeks** of the **10 worst days**.

- Six of the seven best days occurred **after** the worst days
- The second worst day of 2020 (March 12th) was immediately followed by the second best day of the year



Sources: YCHARTS: Standard and Poor's S&P 500 Stock Index

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- Registration as an investment adviser does not imply any level of skill or training.
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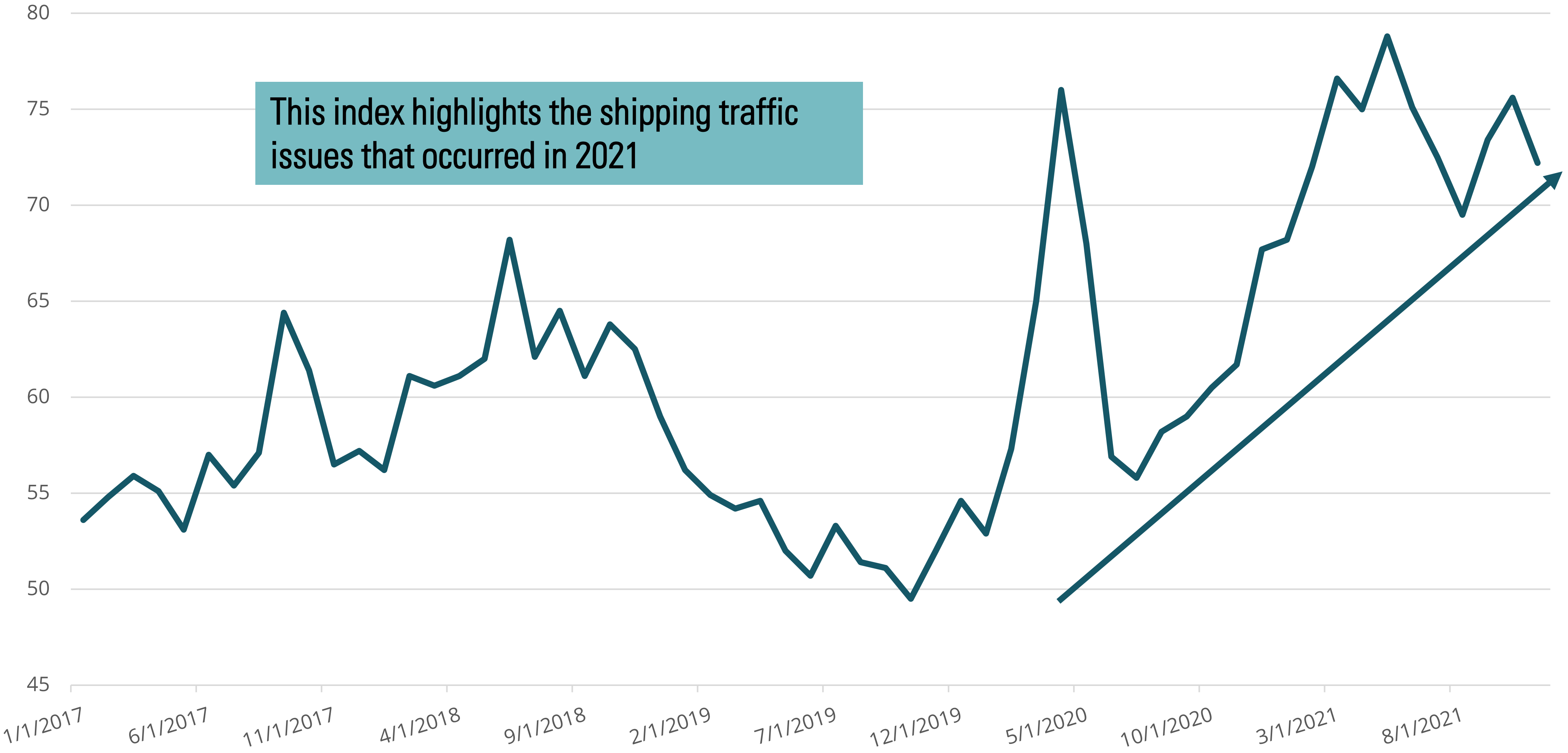
APPENDIX:
Additional Charts

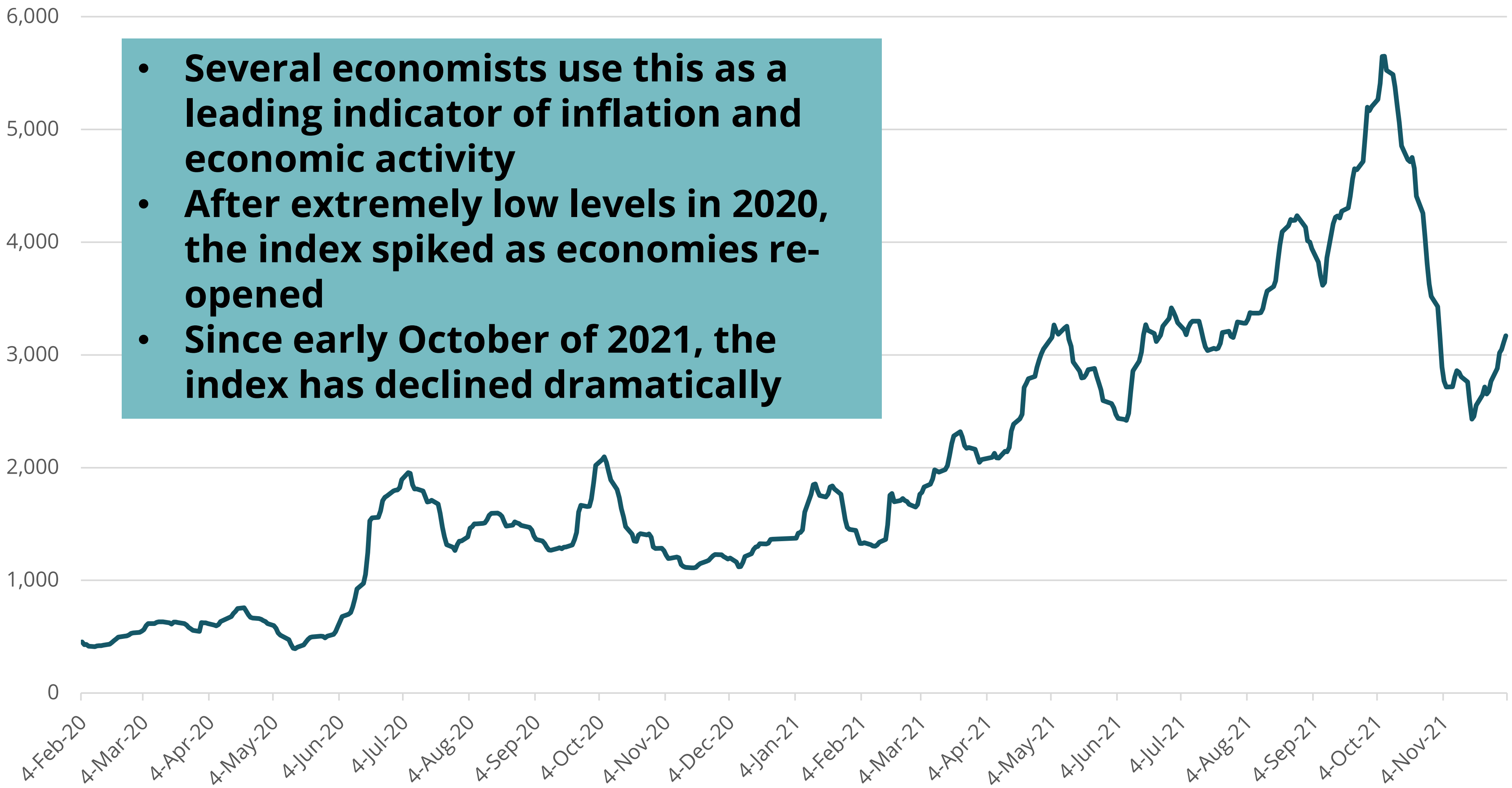
ISM Deliveries Index
Highlights Issues With Shipping Expediency
(reading above 50 indicates slower than normal)



Source: YCHARTS & Institute for Supply Management

Baltic Dry Shipping Index

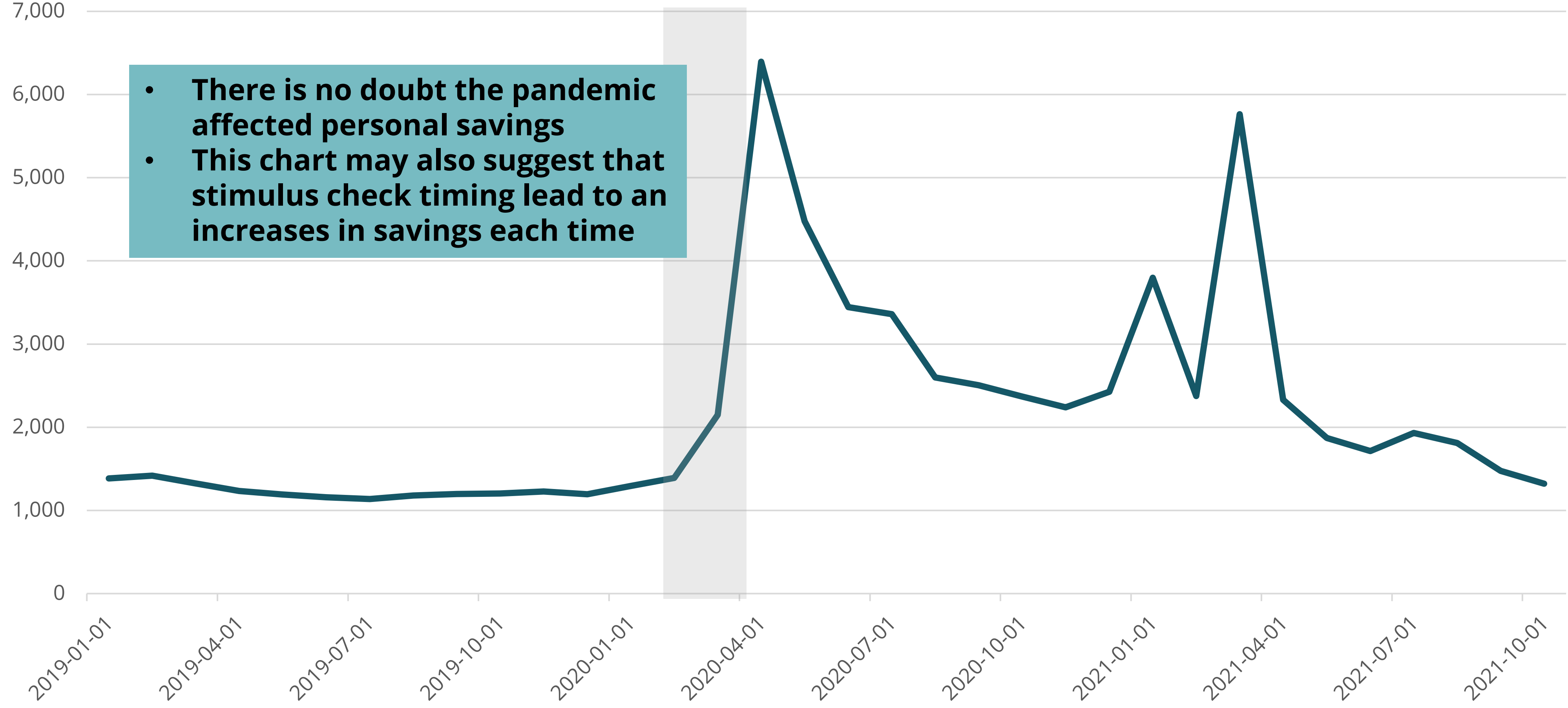
- Several economists use this as a leading indicator of inflation and economic activity
- After extremely low levels in 2020, the index spiked as economies re-opened
- Since early October of 2021, the index has declined dramatically



Source: investing.com

Personal Savings

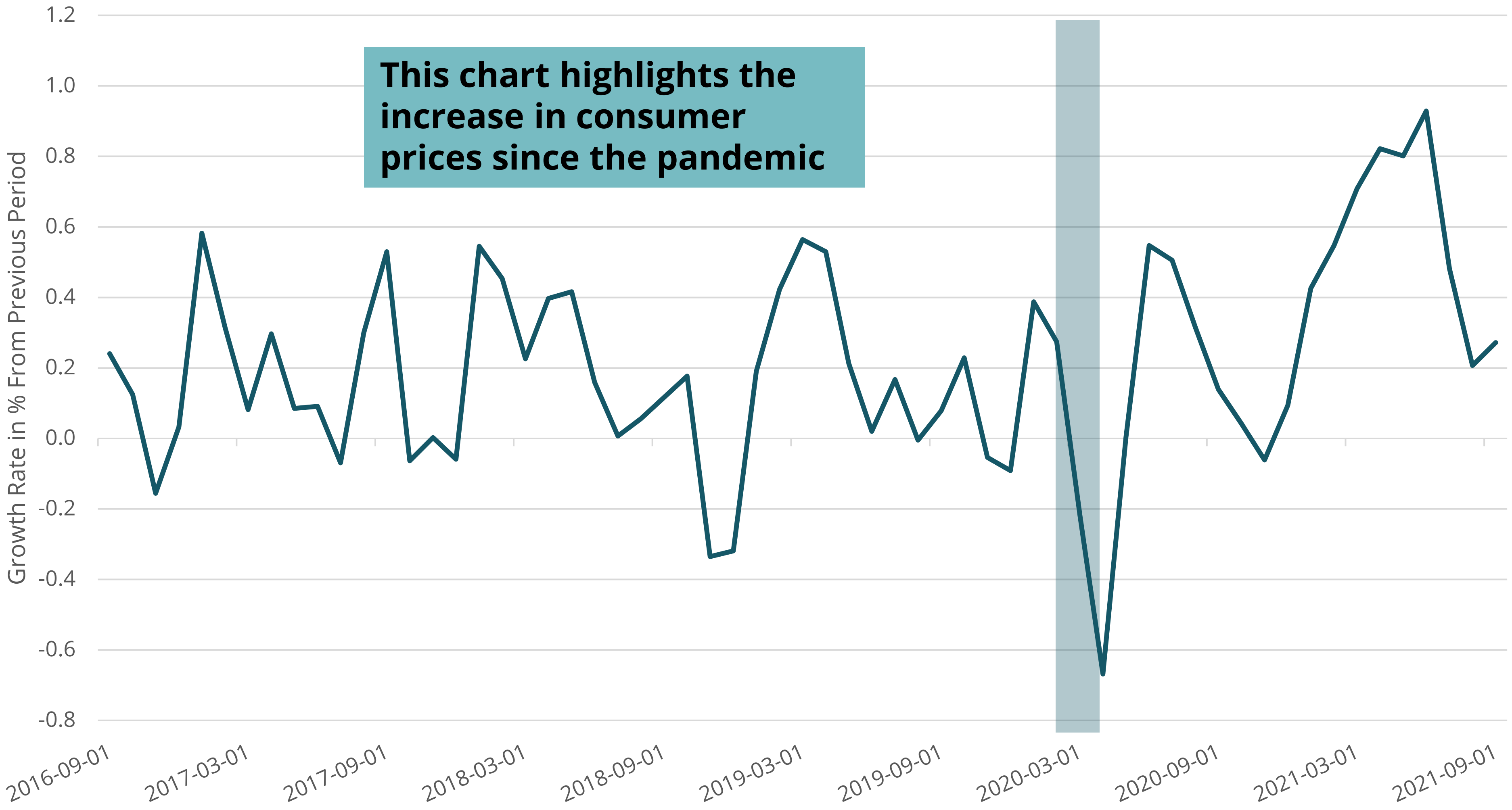
(in Billions)



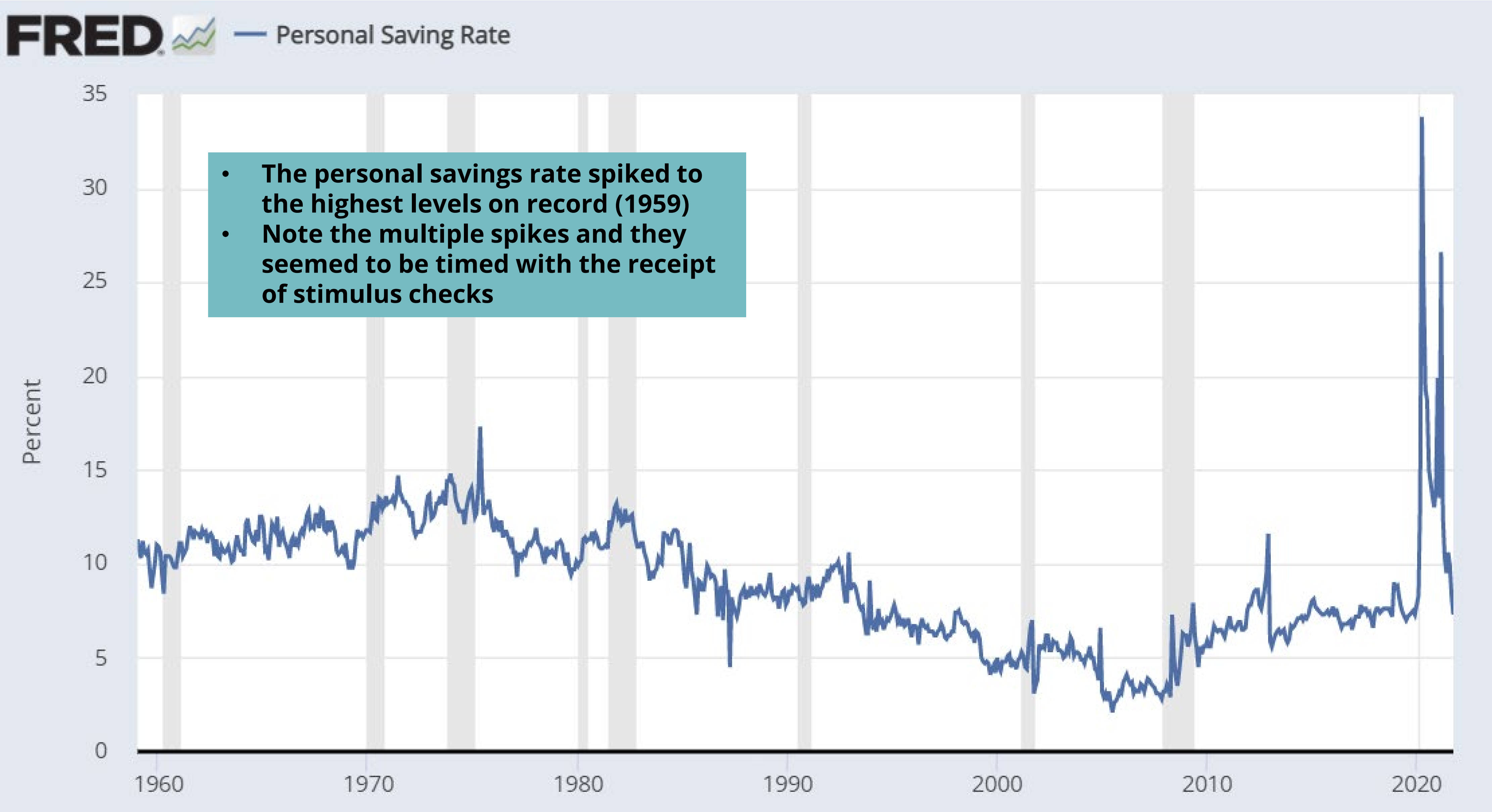
- **There is no doubt the pandemic affected personal savings**
- **This chart may also suggest that stimulus check timing lead to an increases in savings each time**

Source: fred.stlouisfed.orgc

Consumer Price Index



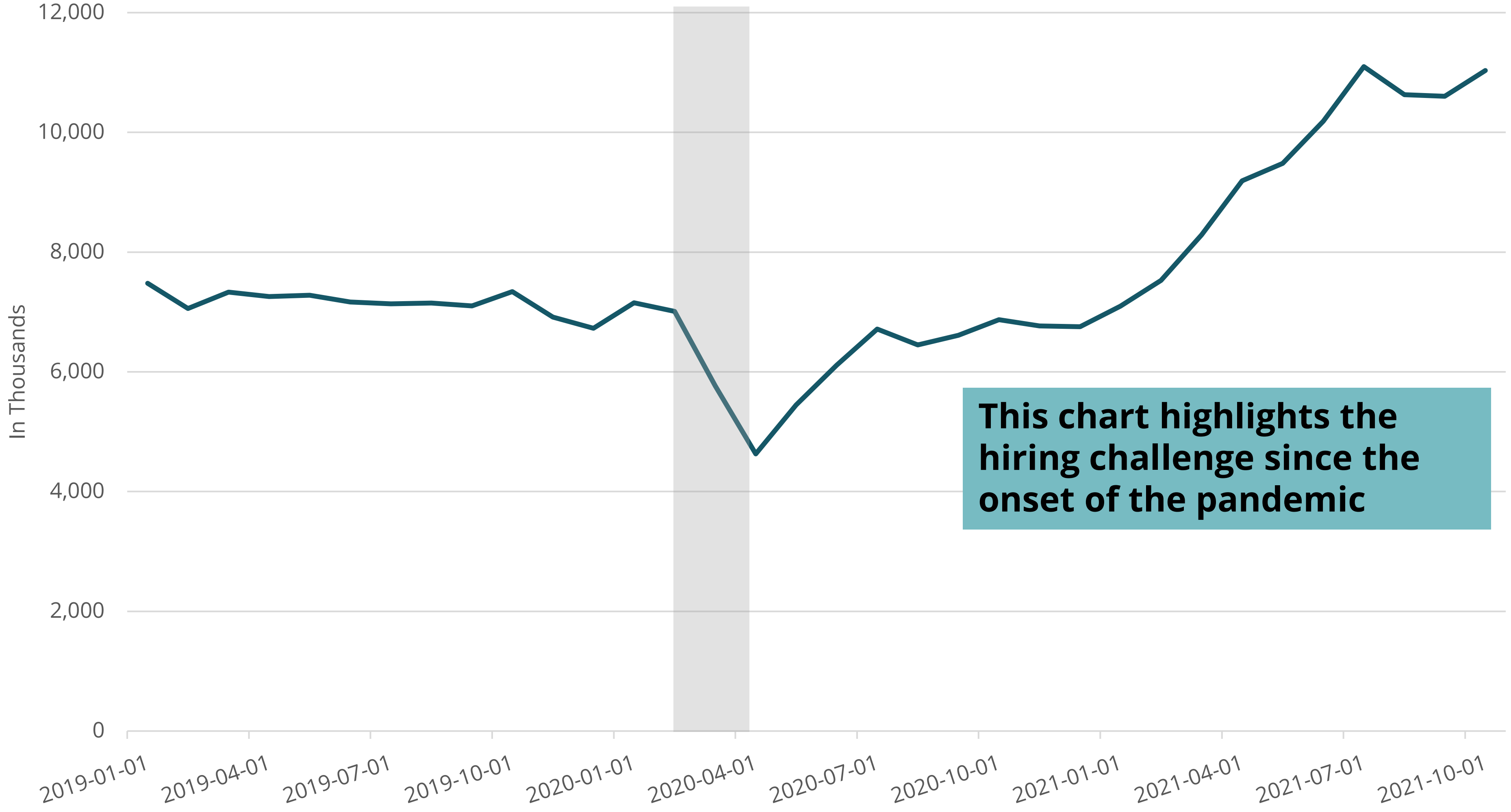
Source: fred.stlouisfed.orgc



- **The personal savings rate spiked to the highest levels on record (1959)**
- **Note the multiple spikes and they seemed to be timed with the receipt of stimulus checks**

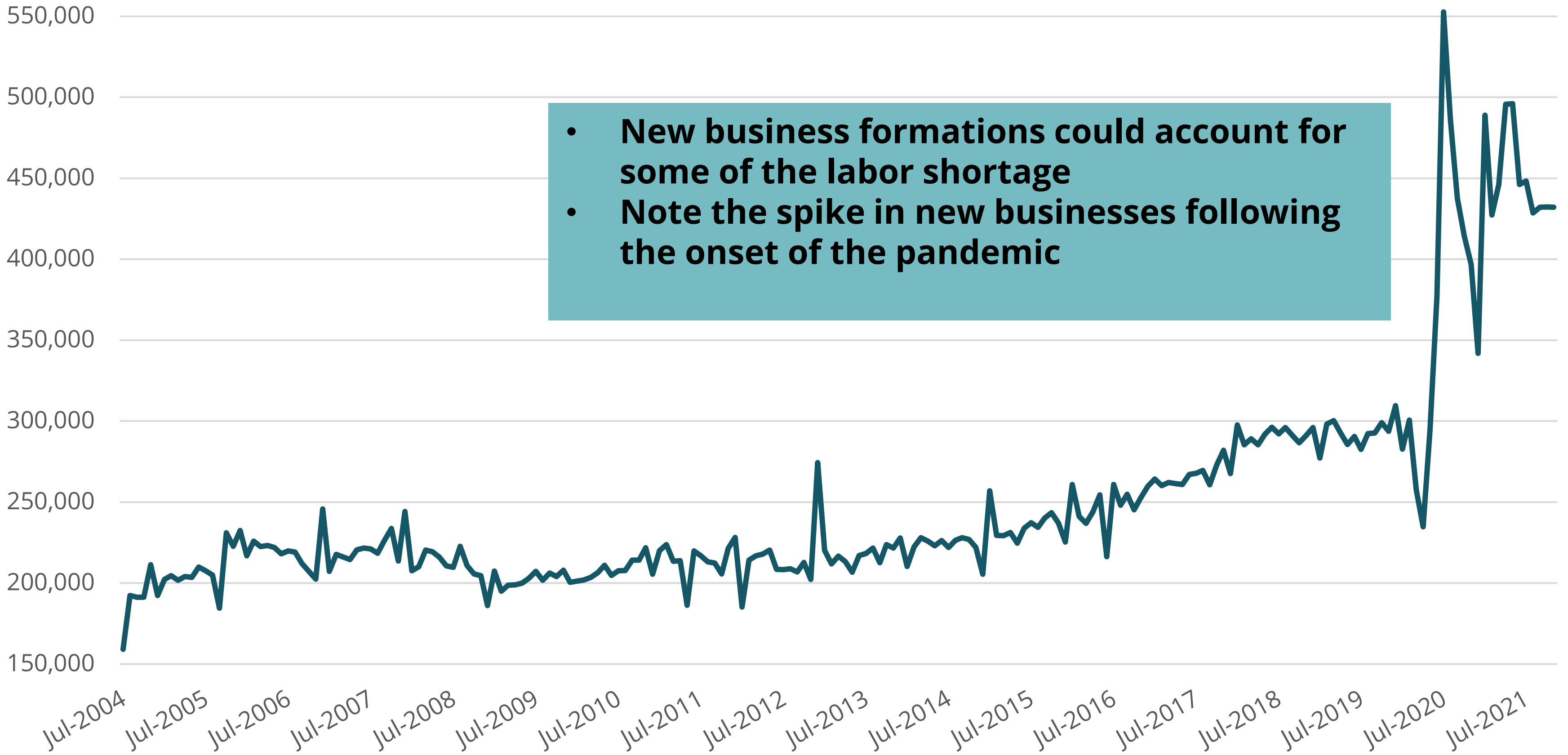
Source: fred.stlouisfed.org

Job Openings



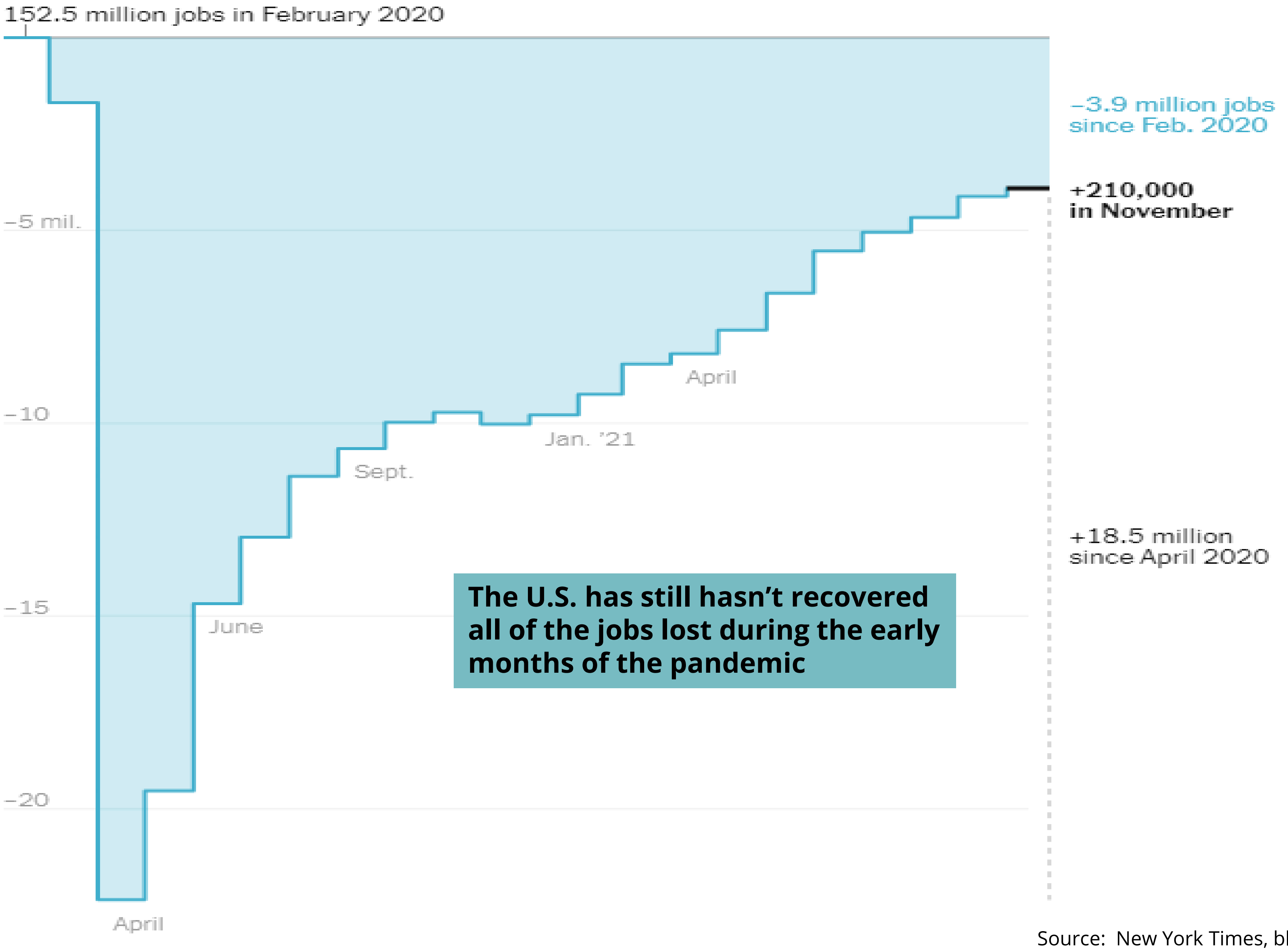
Source: bls.gov

New Business Formations



- **New business formations could account for some of the labor shortage**
- **Note the spike in new businesses following the onset of the pandemic**

Source: census.gov



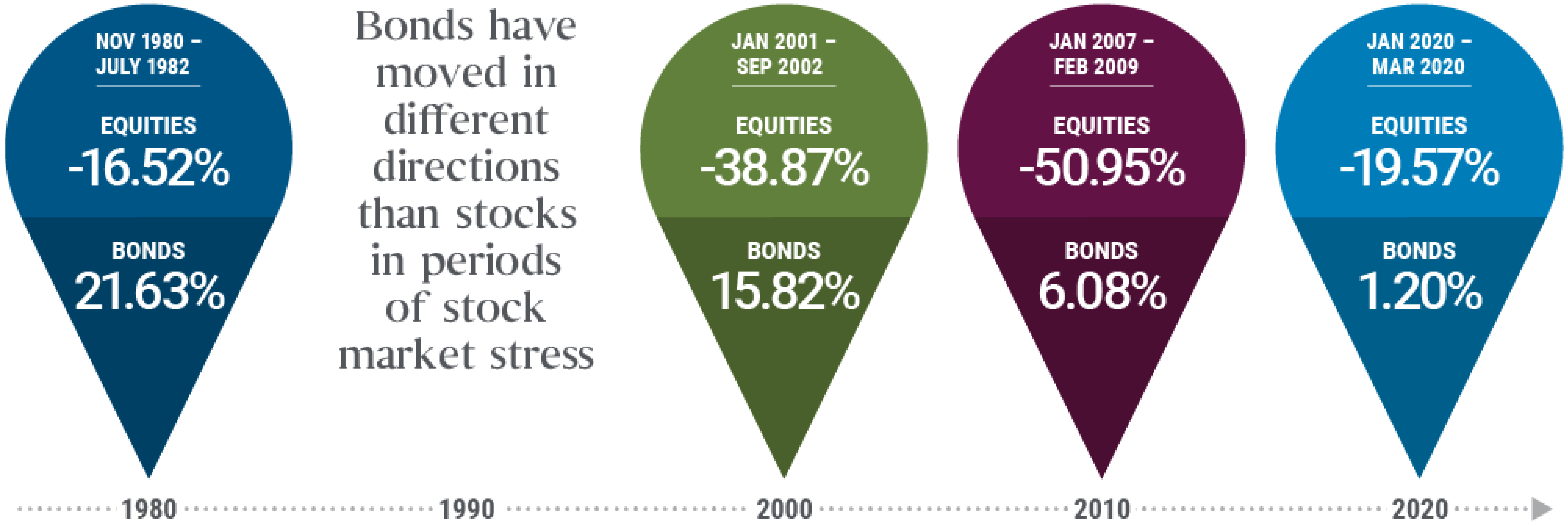
The U.S. has still hasn't recovered all of the jobs lost during the early months of the pandemic

Source: New York Times, bls.gov

Why Hold Bonds In Your Portfolio?

- **Bonds act as ballast for a portfolio and can help stabilize them during periods of stress in the stock market**
- **They also provide income**

The Case for Bonds: Diversification



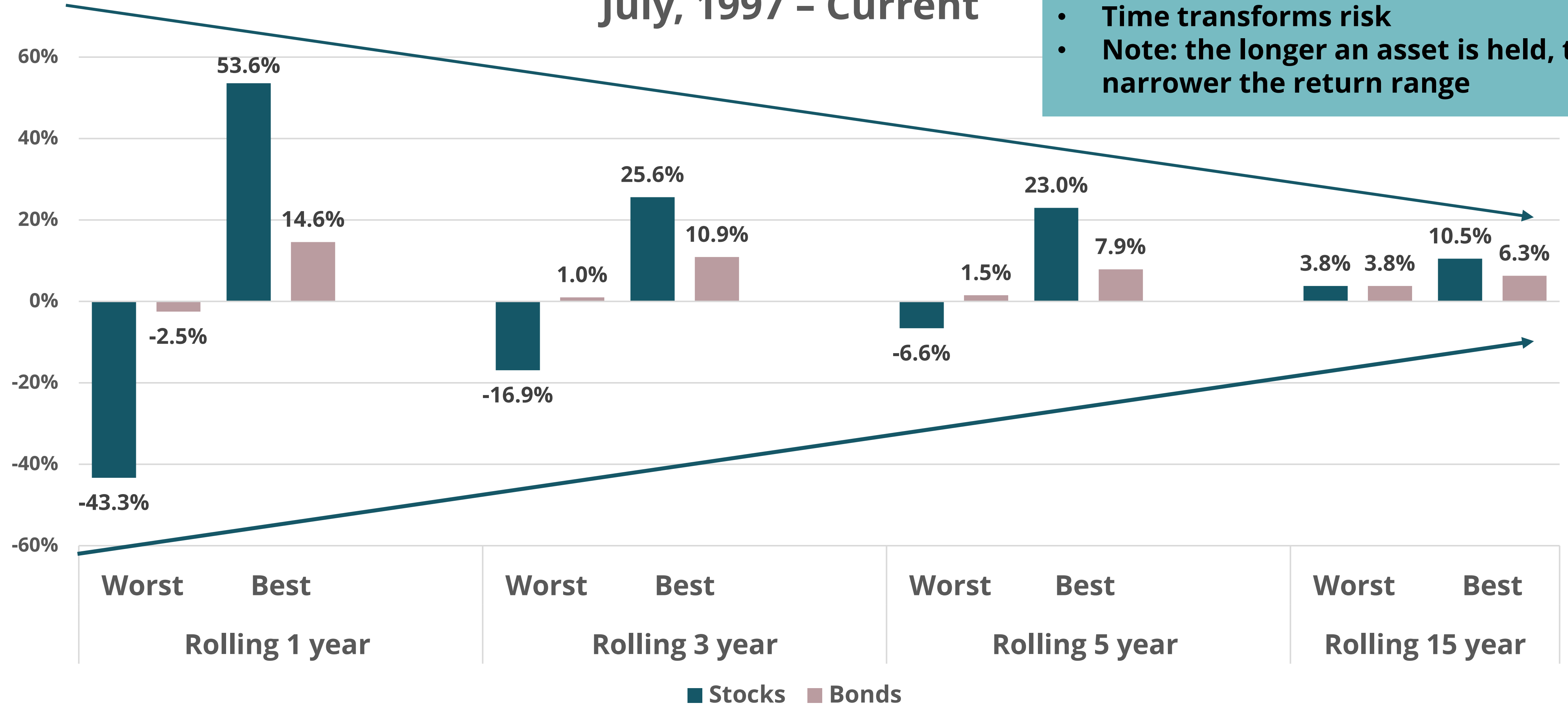
Source: Bloomberg, PIMCO. Stocks represented by S&P 500 Index. Bonds represented by Barclay's U.S. Aggregate Index.
Past performance is not a guarantee or a reliable indicator of future results.

- **The purpose and expectation of different investments is included below**
- **All of these assets are held in our portfolios**

U.S. and Foreign Stocks	Diversified Fixed Income	Intermediate Term Bonds	Cash & Short Term Bonds
Purpose: -Long-term growth engine for the portfolio -May help hedge inflation -Dividends may help with long term results -Used to fund cash flows 10-15 years in the future	**Purpose**: -Used as a portfolio diversifier -Should help grow the portfolio over long term. -Used to fund cash flows 7-10 years from now	**Purpose**: -Used as a portfolio stabilizer -Help produce income for the portfolio -Used to fund cash needs over the next 3-7 years	**Purpose**: -Used as capital preservation -These assets help fund near term cash needs -Act as "sleep at night" portion of the portfolio
Performance and Volatility Expectations: Equities and similar investments should be the highest performing assets over the long term. Since equities may experience large fluctuations in the short term, they should not be used to fund near term cash flows.	**Performance and Volatility Expectations:** These assets should help a portfolio grow over the long term but not quite as much as stocks. Diversified fixed income offers somewhat of a middle ground between stocks and bonds. They are expected to help drive performance over the long term but with less risk than stocks.	**Performance and Volatility Expectations:** Since bonds are thought of as a portfolio stabilizer, we expect them to offer a lower return than stocks and diversified income. Bonds act as ballast for a portfolio when stocks go through periods of volatility.	**Performance and Volatility Expectations:** These assets should not be considered as a source of returns or income. However, they offer liquidity in times of stress. The rates earned on these types of instruments are not expected to keep pace with inflation.

Maximum & Minimum Returns Over Time For Stocks and Bonds Captured in Rolling Time Periods (1, 3, 5 and 15 years) July, 1997 – Current

- **Time transforms risk**
- **Note: the longer an asset is held, the narrower the return range**



- **Depending on the time frame, each asset's minimum return goes positive (bonds at 3 years, stocks at 15 years)**
- **Overall, bonds offer stability, while stocks are the growth engine for a portfolio**
- **We can also use each asset class to match your cash needs (i.e. bonds for the short term and stocks for cash needs in future)**

Sources: ycharts: stocks represented by S&P 500 Index, bonds represented by Bloomberg Barclays U.S. Aggregate Bond Index