DANN ASSET ADVISORS, LLC

First Quarter 2022 Update

April 11, 2022

1Q22 Highlights

- Stocks rebound strongly in March, erasing a good part of early-quarter declines
- Exacerbated by spiking commodity prices, inflation rises to levels last seen in the early 1980s
- Bonds have a very poor quarter in response to inflation and a more aggressive Fed
- War in Ukraine adds to the market's near and longer-term uncertainties
- Covid recedes as a current concern

The table below summarizes the performance of some key indices during the first quarter:

Market Performance	
Index	% Ch. 1Q22
S&P 500	-4.6
Russell Mid-Cap	-5.7
Russell 2000 (small cap)	-7.5
MSCI All Country World ex US	-5.4
US Aggregate Bond	-5.9
Liquid High Yield	-4.4

Source: Morningstar, iShares

Equities. It was a roller coaster quarter for stocks as the market reacted to surging inflation, Fed commitments to tighten monetary conditions, and the war in Ukraine. From an all-time high on January 4, the market fell nearly 14% through March 8 before rebounding 9% to close the quarter down 4.6% (as measured by the large-company S&P 500 index). Speculation more typical of a bull market returned late in the quarter, with the Ark Innovation ETF and meme stocks such as GameStop and AMC bouncing 35% to more than 100% from their March lows.

Below the surface, the big story in the quarter was the significant outperformance of value relative to growth stocks. For the quarter, the Russell 1000 Value index (consisting of large company stocks) was down less than 1% compared with a -9.0% return for the Russell 1000 Growth index. The variance was even wider in the small cap space, with the Russell 2000 Value index returning -2.4% vs. -12.6% for the smaller company growth index. Value stocks were helped by exposure to the energy and materials sectors, both of which were rising even before Russia invaded Ukraine and commodity prices spiked. And growth stocks were hurt by the increase in interest rates, which often compresses the multiple investors are willing to pay for higher growth companies.

Consistent with the last several years, international and small U.S. stocks trailed the S&P 500. However, the margin of underperformance was less than in 2021, which may reflect these areas finally beginning to appear more attractive to investors relative to large cap U.S. stocks. International markets having held up relatively well is notable given the war in Ukraine.

Fixed income. While stocks typically get the headlines, on a full-quarter basis it's really the bond market that was the bigger news in our opinion. According to Morgan Stanley, the first quarter was the worst quarter for U.S. treasuries in 50 years(1). The 10-year treasury yield began the year at 1.51% and rose as high as 2.56% before dropping to 2.33% at quarter end. Two-year

90 Riverside Drive, Ste. 4D · New York, NY 10024 | T. 917.575.5307 | F. 646.304.3017 | www.dannasset.com

treasury yields increased even more, from 0.73% on December 31, 2021, to 2.28%. Briefly toward the end of the quarter the two-year treasury yield exceeded that of the 10-year – often a sign of recession to come at some point in the next two years.

Among the reasons rates rose is inflation reaching its highest levels since the 1980s, the spike in commodity prices (which will filter into product costs) following Russia's invasion of Ukraine, and a pivot by the Fed to do whatever it believes necessary to prevent inflation from becoming ingrained in the economy. While rates remain low versus the levels of the last several decades, both short and longer-term rates are substantially above levels immediately prior to the pandemic. As of its most recent meeting, the Fed expected to raise rates by at least 25 basis points (a basis point is 1/100 of one percent) six more times in 2022, and an additional three times in 2023.

Market sectors(2). Reflecting the quarter's value-growth divergence, energy, utilities, and materials were the quarter's best performing sectors, with energy and utilities returning 39% and 4%, respectively, and materials down only 1%. Within materials, the metals and mining subsector was especially strong, rising 37%(3). The rise in energy and metals and mining stocks reflected higher prices across a wide number of the underlying commodities, with Russia's invasion of Ukraine accelerating increases in energy and some industrial metals prices. We believe the relatively strong performance of utilities stemmed from investors shifting to more defensive sectors later in the quarter as concerns about growth increased with rising interest rates and commodity prices.

The quarter's worst performing sectors were communication services, consumer discretionary, and technology, with declines of 11%, 10%, and 9%, respectively. Among the common themes in these groups are relatively higher valuations (typical for growth stocks), dependence on strength in consumer spending, and investors' unrealistic earnings expectations for several of the larger companies in these groups whose businesses had benefited from a pandemic-induced pull forward in demand (Meta Platforms, Netflix, Home Depot, for example). The valuation of growth stocks often compresses when interest rates are rising as investors become less willing to pay for earnings that might not be realized until far in the future.

Portfolio Positioning

Most clients' fixed income portfolios remain 85% or more in investment grade mutual funds and roughly 75% in short duration (which we define as three years or less) funds. We made no significant changes during the first quarter but believe fixed income markets are likely to continue to be more volatile than usual over the near term. Over time, this may create opportunities for reallocating to longer duration, higher yielding funds.

On equities, for most clients we sold an exchange traded fund (ETF) focused on the biotechnology sector. We'd first purchased this ETF in spring 2021 and had intended it to be a long-term holding. However, as interest rates rose, the more speculative, smaller-company stocks that comprise the majority of the ETF's holdings began performing poorly. Combining this with a market that was becoming more volatile and turning away from growth stocks led us to sell. Proceeds were put mostly into ETFs focused on the industrial and aerospace and defense sectors.

Analysis and near-term outlook. Inflation – its level, duration, and the Fed's reaction to it – is the key issue for the economy and market over the remainder of 2022 in our opinion. While the Fed was too soft on inflation during 2021, believing it was "transitory", it now appears to be taking a much tougher stance. In a March 21, 2022, appearance before the National Association for Business Economics, Fed Chair Pro Tempore Powell stated that, "We will take the necessary steps to ensure a return to price stability. In particular, if we conclude that it is appropriate to move more aggressively by raising the federal funds rate by more than 25 basis points at a meeting or meetings, we will do so. And if we determine that we need to tighten beyond common measures of neutral and into a more restrictive stance, we will do that as well."[(4)]

Higher interest rates/tighter monetary policies typically slow economic growth. Inflation of the magnitude we're currently experiencing also can slow the economy by causing consumers to cut back on discretionary spending, as relatively more is allocated to higher-priced food and energy-related necessities. At a minimum, the combination of inflation and the Fed's actions should cause economic growth to slow. If growth slows but remains positive, the Fed will have achieved its goal of a "soft landing" for the economy. In a more negative scenario, the combination of inflation and Fed tightening could lead to a recession.

Our base case is for a soft landing, given how strong the economy seems currently (unemployment rate nearly back to pre-Covid lows of early 2020). Bracketing our base case, we view a mild recession as much more likely than continued strong growth and moderating inflation. Finally, the war in Ukraine is devastating to observe but we believe it's important for the market only to the extent it impacts the world economy (putting aside worst-case scenarios of chemical/nuclear weapons and/or direct U.S.-Russian engagement). With Russia and Ukraine important suppliers of energy, wheat, and some key metals (e.g., nickel, used in stainless steel, and palladium, used in catalytic converters), prices of these resources spiked as the war caused questions about supplies. In recent weeks, these prices have moderated in some cases. Assuming the economy slows as we expect, we believe prices will continue to moderate.

(1) From Morgan Stanley US Equity Strategy report, April 4, 2022.
(2) Market sector performance numbers based on Vanguard sector ETFs' performance.
(3) 1Q22 return of SPDR S&P Metals & Mining ETF.
(4) Fed Chair Pro Tempore Jerome H. Powell, at "Policy Options for Sustainable and Inclusive Growth" 38th Annual Economic Policy Conference National Association for Business Economics, Washington, D.C.