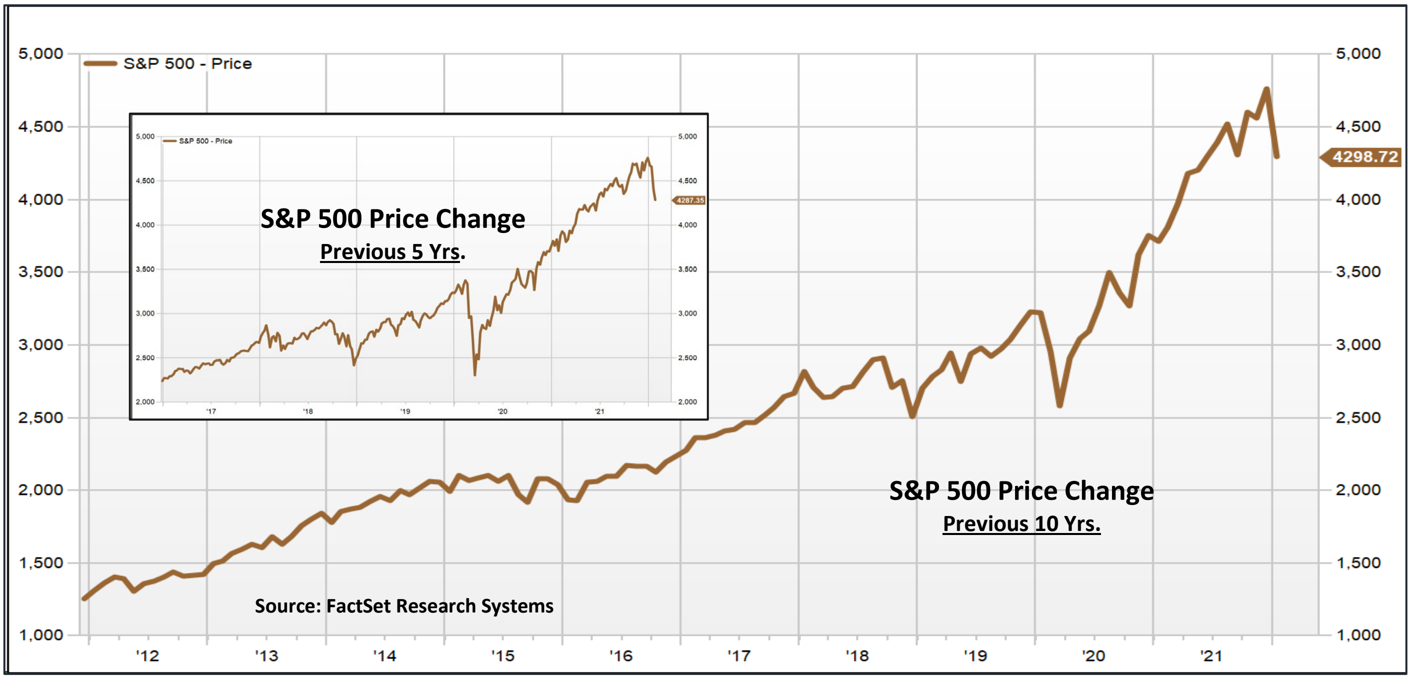
# ECONOMIC/FINANCIAL MARKET COMMENTS

### 1st Quarter 2022

## "Challenging" Start / Maintaining Perspective



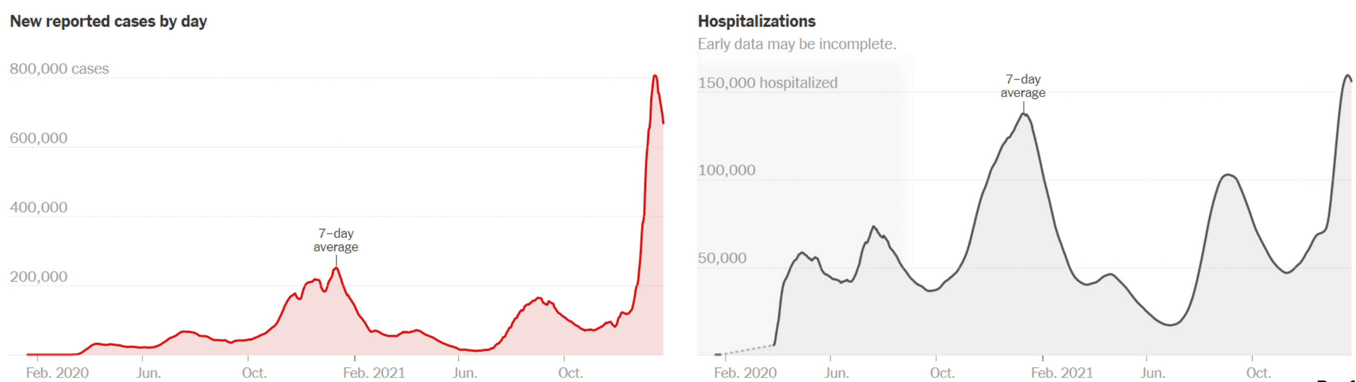

### Strong Returns & A Rude "Awakening"

After a rewarding (+28.7%[i]) 2021, the equity markets (S&P 500 as proxy) have begun this year, weak, volatile and in negative territory. A correction that isn't unexpected given the strong market performance the past 20 months. Covid, rising interest rates, inflation, worker shortages and geopolitical issues have all become front page headlines and refocused investors' attention on these important, but hopefully transitory issues. Stock market weakness and volatility is never easy to accept, however, investors should keep these declines in perspective. Even though last year was another period of strong stock market returns, there were periods during the year of concern and volatility e.g., the rapid increase in Covid cases, supply chain issues, rising inflation, the withdrawal from Afghanistan and the uncertainty of future Federal Reserve policy. Yet strong positive returns were achieved.

One should also be mindful that the compound annual rate of return of the S&P 500 (equity market proxy) for the five and ten-year periods ending 12/31/2021 have been +18.5%[ii] and 16.6%[iii]compounded ***annually***. Those rates of return are each significantly higher than the historic annual rate of return of the S&P 500. During the past five years through 12/31/21, the S&P 500 increased 129%[iv] not including dividends.

### Thoughts On The Issues

**U.S. Covid Trends**




**Source: John Hopkins University Hospital & The New York Times for both charts**

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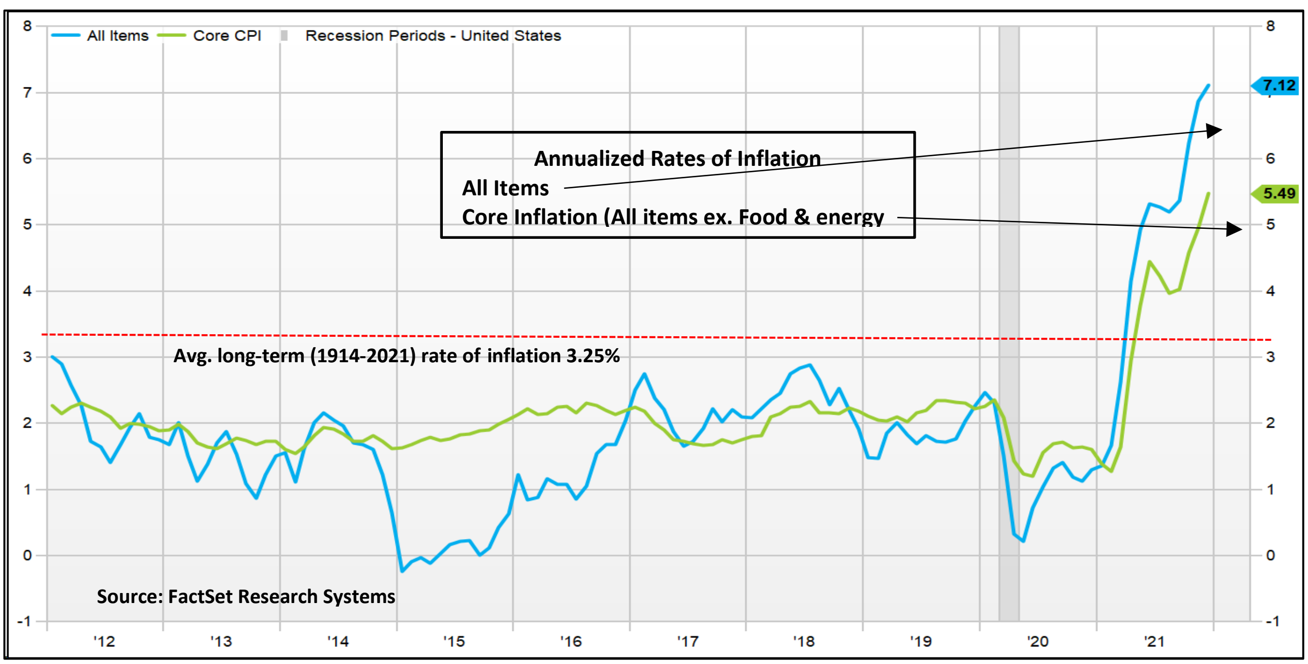
You may recall (previous chart) that it was about this time last year (2021) that the U.S. was dealing with a spike in cases of the Coronavirus, but by June, cases and hospitalizations had declined rapidly. It appeared that through social distancing and vaccinations, the country was past further immediate worry; and then along came the Delta variant. More vaccinations and social distancing and cases of the Delta variant declined, but the Omicron variant appeared, and reinfections and cases have increased. We believe that the recent concerns regarding Omicron have impacted and slowed economic growth over the past few months, but that growth will resume in the 2nd quarter as cases decline into Spring and early Summer.

While we are cautious about making economic/financial market forecasts based solely on our (or anyone else's) coronavirus expertise, it does appear that the recent spike in the virus has reached a peak and begun to decline. At the same time, the U.S. has reached levels of fully vaccinated of 63%, 72% and 88% for the All Ages, 12 & up, and 65 & up, groups respectively[v]. The U.S. is not likely to reach a 100% level of vaccination but as the vaccinated numbers increase, the country gets closer to a state of herd immunity which is estimated to be 83% to 94%[vi] of people vaccinated or previously infected. Declining cases and a higher likelihood of heard immunity suggests that the economy should not be threatened by a recession and that the normal pace of business should resume creating more jobs, improving income, increasing consumer/investor sentiment and furthering economic growth.

### U.S. Inflation




After more than a decade of below average inflation, U.S. inflation increased at its fastest pace in almost 40 years in December with an annual rate of 7.1% for All items and 5.5% for Core items[vii].

Supply chain disruptions and shortages of goods and materials created by the Covid pandemic, coupled with strong demand by consumers with lots of cash from government stimulus ($4**T** in 2020 & $1.9**T** in 2021)[viii] is in large part responsible for the sharp rise in prices. Prices for used vehicles, for example, increased at an annual rate of 37% in December[ix].

While inflation is likely to remain above historic rates during the next several quarters, the inflation rate should begin to subside by the second half of this year. The rational for declining inflation is based upon the expectation that with declining covid cases (more workers available), improving supply-chain dynamics and a slowing demand for durable goods, pricing pressures will moderate.

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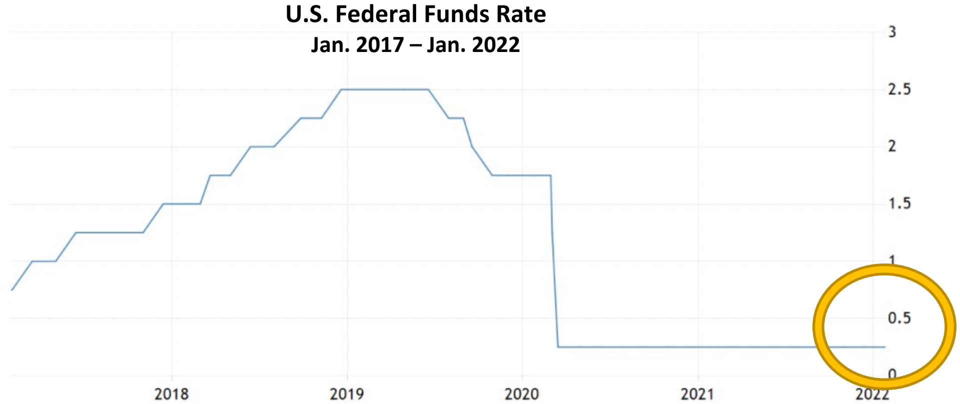
In addition, the U.S. Federal Reserve’s commitment to end its stimulative, money supply creating purchases of U.S. Treasury, and mortgage-backed securities and to gradually raise the Federal Funds rate, should also help reduce final demand and inflationary pressures.

Despite the expectation that interest rates will increase during 2022, we expect them to remain low by historic standards. Even a four-fold increase in the current level of Fed Funds would raise that rate to approximately 1.0%, which is meaningfully below the average five-year rate as seen in the chart below.

**U.S. Federal Funds Rate**
**Jan. 2017 – Jan. 2022**




**Source: Trading Economics**

Lastly with respect to interest rates and inflation, you may recall that in previous communiques, we have often mentioned that additions to fixed income investments, in portfolios that hold bonds, have been made primarily in U.S. Treasury Inflation Protected Securities (TIPS). While you may be familiar with TIPS, we thought for those who may not, that Exhibit I. at the end of this communique might be a good way to explain the rationale and benefit of this unique investment.

Investors typically think of stocks as the way to grow their financial assets and protect against inflation, and stocks are the primary vehicle to do just that. However, our responsibility, is to preserve and grow assets of all types, particularly in periods of increasing inflation, hence the investment in TIPS. We have purchased the TIPS investments through an ETF that invests only in those types of securities, and which provide a high level of liquidity and maturity diversification. We hope you will find the short explanation clear and interesting.

### Geopolitical Issues (Russia)

Economic globalization was supposed to make it harder for countries to initiate military conflict because if everyone is “tied” together economically then all countries/economies would be negatively impacted by a large conflict. Currently, Russia is demonstrating that the rationale for globalization may be invalid.

In large part, Western Europe’s dependance on Russia’s natural gas is allowing Russia to attempt to regain influence primarily in Ukraine, but also other previous Soviet Union countries e.g., Georgia, Latvia, Lithuania, etc. by threatening military incursions and/or curtailing energy supplies. As part of its demands, Russia is insisting on a “greater say” in Ukraine’s long-term economic and military plans, a cessation to all future NATO military exercises in that country and, most importantly, a requirement that NATO pledge not to invite Ukraine to become a member of that organization.

Repression in Russia, and the possibility of political change in any of its allied countries e.g., Kazakhstan and Belarus are clearly establishing a reason for creating instability abroad and flexing Russia’s muscles. The outcome of this geopolitical quagmire is clouded at this time, but we are optimistic that all parties will see the benefits of compromise rather than escalation. We are monitoring this situation closely as the price of oil and natural gas prices could be significantly impacted depending on an action or resolution.

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### Actions Taken

Based upon recent negative price actions in the financial markets, one might conclude that the issues of inflation, rising interest rates, geopolitical events and high equity valuations suddenly arose. As you know, they did not. We have discussed and written about these challenges multiple times during the past year, but more importantly, we took investment action to reduce the impact of these important, but likely limited-term issues. We have taken proactive action multiple times in the past 18 months to rebalance portfolios during periods of market strength (i.e., the market hitting new highs). We will be reactive and add to fundamentally strong stocks should the market present us with opportunity due to an oversold market.

During several sharp, but short-lived declines in the S&P last year, we opportunistically added to existing positions held in equity portfolios or initiated positions in new ones that met our demanding quality disciplines. However, as equity markets rose rapidly (71 new highs during 2021)[x], valuations increased, and equity allocations spread beyond target levels, we sold stocks and increased fixed-income positions. Those new fixed-income investments were primarily Treasury Inflation Protected Securities (TIPS) that help preserve asset value by increasing in value during periods of inflation (Exhibit I). The action of "capturing" gains was done as tax-efficiently as possible. After two decades of increasing stock market values, that is becoming a greater (but welcome) challenge.

### Looking Ahead

While vigilant and sensitive to the current challenging issues, we remain confident regarding market opportunities and returns. Future equity market returns are apt to be more in line with historic returns in the high single digit range rather than the elevated returns recorded during the past several years. Still very rewarding, but not achieved without volatility. Staying focused on a long-term disciplined approach is paramount.

As previously mentioned, the fastest pace of the post-covid economic recovery is likely behind us. However, due to the impact (delayed spending/demand) of the recent Delta and Omicron variants, shortages of certain items, particularly automobiles, increasing capital spending and the impact of the recently passed infrastructure bill, economic activity will be robust.

On a year-over-year basis, U.S. economic (GDP) growth will not match 2021's growth rate, the highest in 35 years, but annual growth of +2.5%-3.0%[xi] will still exceed average GDP growth during the past decade. The pace of Inflation should dissipate, as previously mentioned as inventories are rebuilt, demand lessens, and supply-chains are renovated.

The Fed has reduced the stimulative process of increasing money supply and will raise short-term rates several times during the next several quarters, but rates are not likely to increase to a level that will cause recession.

While the negative impact of the coronavirus is often discussed, as it should be, there are also numerous longer-term positives that have resulted from this challenging period. Medical research and new approaches to drug development, increased productivity e.g., fewer (600MM) commuting hours, (1.4MM) fewer salespeople, and office staff (greater internet usage), $300B spent on consumer IT equipment, increasing use of Tele-health procedures, etc.,[xii]are just a few. A focus on technology and healthcare sectors is warranted.

We anticipate that corporate earnings, the engine that drives stock prices, will increase by an additional 8-10% in 2022 (2022 Est. $235/sh. +/-)[xiii] after the significant increase last year. The recent decline in stock prices combined with the anticipated increase in earnings, makes stock valuations (P/Es) reasonable in relation to historically low current and expected interest rates.

As we have often stated, as investors, we don't attempt to "time" the market with short-term trades. We remain committed to our fundamental disciplines, longer-term viewpoints and achieving your financial expectations. We are confident about the foreseeable future but cognizant of the current challenges. Should economic, valuation, or geopolitical issues change meaningfully, we would not hesitate to modify our expectations or the construction of your portfolio. But not without communicating our rationale.

Our discipline remains to focus on long-term consistent tax-efficient growth of principal and income while accepting moderate volatility. We achieve this by staying diversified and investing in investments that are comprised of exceptional fundamental characteristics. Investors should not measure wealth and investment management "success" by a recent high value in their portfolio (merely a point in time), but rather a focus on consistent tax-efficient long-term growth of capital in one's portfolio to protect one's purchasing power effectively and efficiently, and to ultimately satisfy current and future distribution/withdrawal needs. This is a wealth management process over time with a goal to achieve new highs in one's portfolio over the longer term. A measured, consistent discipline aids in meeting this objective.

## Thank You

We appreciate your continued confidence in our capabilities and value highly our relationship and friendship. We enjoy meeting and communicating with you regularly and look forward to doing so (particularly meeting with you) again this year.

If you have any questions, comments or critique, please do not hesitate to contact us at any time.

## Exhibit I
## U.S. Treasury Inflation Protected Securities (TIPS)

Treasury Inflation Protected Securities (TIPS)[xiv] are a U.S. Treasury security issued by the U.S. government. TIPS are indexed to inflation to protect assets (in this case bonds) from a decline in purchasing power. As inflation rises, as we have experienced to a greater degree this year and at other times in the past, TIPS adjust in price and interest payments to maintain their real value. The bonds are a safe investment because, like all U.S. Treasury bonds, they are backed by the full faith and credit of the U.S. government.

The strategy of investing in TIPS during certain periods is critical because they help reduce the inflation risk that can erode the value of the principal and income stream (yield) that occurs with investment in more traditional fixed-rate bonds. Inflation is a greater risk with most other types of bonds because the interest rate on those bonds remains the same (fixed) for the life of the bond e.g., the bond's interest payments don't keep up with inflation and thus interest payments received "today" purchase less than they did a year ago.

The following example of how principal and interest payments on a TIPS bond are adjusted help explain why we believe this type of investment makes sense for most client portfolios.

For example: if you own a $1,000 TIPS bond with a coupon of 1.0%, you will receive $10 in interest payments during the first year of ownership. If inflation rises by 3.0% in the following year, the $1,000 principal will adjust by +3.0% to $1,030. The bond's interest (coupon) rate of 1.0% will remain the same, but it will be multiplied by the adjusted principal amount ($1,030) and thus the interest payment will increase to $10.30 for the year.[xv]

Under these same conditions, a traditional bond, with a fixed rate of interest, would not experience an increase in its value or the amount of interest paid to its owner. However, the bond's stated interest rate at the time of purchase is likely to be higher than the interest rate on the TIPS bond with a similar maturity. The higher interest rate is because the traditional bond provides no protection against inflation.

If deflation, the opposite of inflation occurs, the value of the TIPS bond would be adjusted downward as would the interest payment. The U.S. has experienced only a few periods of deflation in its history and is not anticipated to occur in the foreseeable future.

The above example is a simple one, but it describes how the value of principal and interest payments from a TIPS bond are adjusted based upon increases in inflation. The impact of a single year's inflation, while important, is not critical. However, if inflation continues at even a moderate rate for multiple years, its eroding effect on income/purchasing power can be meaningful. That's the rationale for investment in this type of security.

**The Positives of Investing In TIPS:**

- Bond principal increases with inflation.
- Interest payments increase as inflation increases the bond principal value.

**The Possible Negatives of Investing In TIPS:**

- The interest rate on the bond is usually lower than most fixed-income bonds that do not have an inflation adjustment provision.
- If inflation does not occur while holding TIPS, there is no advantage.

Parkview Partners generally does not purchase individual TIPS bonds in managed accounts. Instead, an Exchange Traded Fund (ETF) which owns many TIPS with multiple maturity dates is used for diversification purposes.

ETF's trade like stocks, are subject to investment risk, fluctuations in market value and may trade at prices above or below the ETF's net asset value (NAV). Upon redemption, the value of fund shared may be worth more or less than their original cost. ETF's carry additional risks such as not being diversified, possible trading halts and index tracking errors.

There is no guarantee that a diversified portfolio will enhance overall returns or outperform a non-diversified portfolio.

Diversification and asset allocation do not protect against market risk. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly. Investing involves risk including loss of principal.

The economic forecasts set forth in this material may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

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[i] S&P Dow Jones Indexes, LLC 12/31/21

[ii] S&P Dow Jones Indexes, LLC 12/31/21

[iii] S&P Dow Jones Indexes, LLC 12/31/21

[iv] FactSet Research Systems, Inc.

[v] The Mayo Clinic 1/26/22 (website)

[vi] The Mayo Clinic 1/26/22 (website)

[vii] United States Bureau of Labor Statistics1/12/22

[viii] United States Treasury Department 12/27/20

[ix] Bureau of Labor Statistics 1/12/22

[x] FactSet Research Systems & S&P Dow Jones Indexes, LLC

[xi] Organization of Economic Development & The Economist (The World Ahead 20220

[xii] CNBC News

[xiii] Evercore ISI

[xiv] United States Treasury Department

[xv] United States Treasury Department & Investopedia