



FULLEN FINANCIAL GROUP

Quarterly Market Summary – Q1 2022

Market Results as of the First Quarter of 2022

Selected Index Results for Q1 – 2022

<u>Index⁽¹⁾</u>	<u>%Growth For FY 2021</u>	<u>%Growth For YTD 2022</u>	<u>%Growth For Q1 2022</u>
DJIA	18.73%	-4.57%	-4.57%
Core U.S. Aggregate Bond Index (U.S. multi-sector bond)	-3.48%	-6.12%	-6.12%
S&P 500 (large cap)	26.89%	-4.95%	-4.95%
S&P 400 (mid cap)	23.21%	-5.22%	-5.22%
Russell 2000 (small cap)	13.69%	-7.80%	-7.80%
MSCI EAFE Index (developed international)	7.84%	-6.46%	-6.46%
iShares MSCI Emerging Market Index	-5.46%	-7.57%	-7.57%
iShares Dow Jones US Home Construction	48.60%	-28.53%	-28.53%
MSCI US REIT Index	38.61%	-4.68%	-4.68%
Amex Oil Index	48.67%	33.67%	33.67%
Barclays Global Agg ex-US Corp Bond Index	-8.73%	-7.80%	-7.80%

(1) These results do not include reinvestment of dividends.

Q1 Quick Summary

- On February 24, 2022, Russia launched a military invasion of Ukraine, which was met with severe economic sanctions and triggered a shock to commodity prices worldwide. This is likely to extend inflationary pressures and weigh on economic growth as we move through 2022.
- The U.S. inflation rate reached 8.5% in March, the highest year-over-year inflation reading in more than 40 years. With the recent surge in energy prices resulting from the war in Ukraine, it is possible the inflation rate has not yet peaked.
- In response to these inflation pressures, the U.S. Federal Reserve increased the benchmark Fed Funds rate by 0.25% in March and has signaled a willingness to tighten more aggressively in the months to come. Current estimates project a Fed Funds rate of 1.75% by the end of 2022.
- Supply chain conditions showed some signs of improvement in the first quarter, with transportation costs starting to moderate and inventories rebuilding. Labor shortages persist, however, with widespread job openings across industries, and an unemployment rate at 3.6%.
- Covid-19 has faded to the background for the time being, as economies re-open and authorities relax Covid mandates. China remains an exception with its aggressive zero-Covid policy.

The Fog of War

This economic outlook update takes place amidst heavy uncertainty brought on by the Russian invasion of Ukraine. The longer the duration of this conflict, the greater the downside risks that build to the global and U.S. outlook. This means that every forecast must be grounded with base assumptions that will need



to evolve with geopolitical events. For global stocks, the key question is whether the conflict will result in a European recession. Historically, global stocks have recovered and posted gains after periods of armed conflict, except when a recession has followed.

U.S. investors are keeping a close eye on soaring energy prices and rising inflation, which typically hurt household spending. The shock to commodity prices, even if it proves short-lived, will result in much higher near-term inflation. When combined with the likelihood of longer-term sanctions on Russia, this can leave prices at structurally higher end points this year due to lags in reorienting supply chains, particularly against a backdrop where the American economy is already in excess demand. The net effect will weigh on real disposable income and take some steam out of consumption, particularly in Europe.

Fiscal supports are already being announced within various economies to provide some relief to households and businesses, but this is a double-edged sword. The extent to which these supports are broad across incomes and households may delay or limit the needed demand shifts that would ease pressure on key commodity markets with supply shortfalls. Likewise, this could have the unintended impact of maintaining higher inflation patterns than previously expected, creating an even thinner tightrope for central banks to walk along.

Inflation Still Searching for a Peak

Inflation has continued to surprise to the upside globally, with energy prices playing a prominent role in the U.K. and Europe. Faced with growing unease about the persistence of price gains, monetary policymakers have struck a more hawkish tone. Quantitative easing programs are winding down and the conversation has shifted to the pace of quantitative tightening.

U.S. consumer price inflation hit 8.5% in March, its highest rate in more than 40 years. Elevated inflation is no longer characterized as "transitory" by the Federal Reserve, which has become more forceful in its communication to bring inflation back to target. On the positive side of the ledger, overall American domestic demand impulse is already slowing, and supply constraints are improving. In addition, the Fed will be responding to high inflation with earlier rate hikes than markets were predicting only a few months ago, as well as an earlier follow-through of quantitative tightening.

The weight of these actions will be borne first on interest rate-sensitive sectors, dovetailing with areas of demand that have been igniting inflationary pressures. In particular, auto prices have risen 23% year-on-year and have boosted core inflation by 2.2 percentage points over the past year – accounting for just under 40% of the increase. Demand for other durable goods is also easing, and price pressures should follow. On the flip side, other significant areas, like shelter inflation, are likely to accelerate over the next several months as they catch up to home prices and asking rents. This acceleration is expected to add at least 0.5 percentage points to headline consumer price inflation over the course of 2022 relative to its contribution in 2021.

As a result, even as price growth in the hottest, most supply-constrained sectors cools, inflation is likely to remain well above 3% on a year-on-year basis through the end of 2022. Rising interest rates will eventually reset demand and expectations towards the Fed's 2% target at the tail end of 2023. Of note, expectations for future inflation have started to come down. Consumer expectations for inflation three years from now are down from 4.2% in October, to 3.5% today.



Progress on the Supply Chain

The past few months have seen initial signs of improving supply chain conditions. The long queue of ships waiting at the Port of Los Angeles has been whittled down to all but a few. Indeed, the costs of moving goods are showing some signs of reprieve in both ocean freight and trucking costs. The direction of developments is positive, but prices need to adjust further on the downside.

Monthly Manufacturing Purchasing Managers' Index (PMI) indicators of supply conditions across countries are showing improvement, however the situation remains fragile. In the G-7, January's data showed supplier delivery times continue to lengthen, although the intensity has improved since the fall. Inventories were also trending in the right direction. Inventories of intermediate inputs (purchases) are rising and on an upward trend. Although inventories of finished goods are still in contractionary territory, it's the best position since before the pandemic. It's important to note that the supply chain disruptions are also a product of tremendous consumer demand. This is now showing signs of ebbing, particularly in the U.S. where durable goods expenditures are down 14.4% from their peak in March 2021.

There continue to be downside risks for supply chain recovery, particularly related to the conflict in Europe. The sharp rise in oil prices will impact transport costs, at least temporarily. In addition, Russian and Ukrainian influence on the supply chain will be noticeable, particularly in wheat supply and in certain commodities such as aluminum and nickel. The impact and duration of these disruptions is yet to be determined.

Central Banks In a Bind

The U.S. Federal Reserve increased the benchmark Fed Funds rate by 0.25% in March and has signaled a willingness to tighten more aggressively in the months to come. Current estimates project a Fed Funds rate of 1.75% by the end of 2022. The Russia-Ukraine war has resulted in two seemingly contradictory market reactions: rising inflation and lower bond yields. Commodity prices have soared as sanctions on Russia reduce the flow of energy products, metals and grains to the global markets, sending inflation sharply higher. However, the supply-side shock produced by the crisis is simultaneously reducing growth expectations and boosting demand for safe-haven assets like U.S. Treasuries. This leaves the Federal Reserve and other major central banks in a bind.

Late last year, the Fed was surprised by strong growth coming out of the pandemic and rising inflation due to limited supplies of goods. It was clear that the policy setting for the U.S. was too easy given the strength of the economy, and the Fed indicated in December that it was going to shift to tighter policy in early 2022, which it has done. Fed Chair Jerome Powell expressed that the committee wanted to return its policy setting to "neutral"—a level that is appropriate for steady economic growth without generating inflation. The Fed's longer-run target for the neutral rate is 2.5%. Now we're in a different world where the global economic outlook is much weaker. High energy costs will likely act as a tax on consumers and reduce business investment longer term.

With that backdrop, the Fed is in a tough spot. If it fails to follow through on tightening, it could lose its inflation-fighting credibility. On the other hand, if it tightens policy too much, too fast it could push the economy into a recession. Moreover, it will be tightening policy during a period of turmoil in global



markets that will likely lead to lower growth and reduced liquidity. Markets are already showing doubts about the ability of the Fed to reach its “neutral rate.” The implied path of short-term interest rates has shifted in the past few weeks. The five-year forward short-term interest rate (which measures the expected inflation rate over the five-year period that begins five years from today) has dipped below the one-year forward rate. In the past, that has happened near the peak of Fed tightening cycles—not before they begin. Based on the futures market, expectations are for the Fed’s rate hikes to peak in 2023 and then decline.

Covid Takes a Back Seat

Although global economic activity dipped in the winter months as the Omicron variant took hold, its effects appear to have been severe but brief. In most advanced economies, newly identified cases have fallen and restrictions have been rolled back. Once again, the virus has created a displacement pattern in economic activity, stealing it from the winter months and moving into the spring. Looking further out, several countries are indicating an intention to end of Covid-era public health restrictions as tolerance thins within the general population and healthcare systems are buttressed by high vaccination rates.

In the U.S., Omicron shuffled the deck on the quarterly growth pattern but is expected to have only a modest impact, especially in comparison to peer countries. Overall, U.S. real GDP is expected to slow below 2% (annualized) in the first quarter but rebound swiftly in the second quarter to around 4%. For 2022 as a whole, growth is estimated to be 3.7%, marking a downward revision from previous forecasts in the 4% range.

Covid continues to be a wild card, as the pandemic is still with us, and the emergence of new variants could result in renewed restrictions that hamper the supply chain. In fact, case counts have begun to increase again in April with the emergence of the new BA.2 variant. In addition, China remains committed to a zero-Covid policy, as demonstrated most recently in Shanghai. Given its position as a global production hub, stricter containment measures in China could easily put new strains on a recovering supply chain.

Conclusions

We spoke last quarter about the number of significant uncertainties facing U.S. investors, and a war in Europe was added to that list in the first quarter. The range of outcomes on each of these issues continues to be wide, which we know contributes to ongoing market volatility. Government policy responses can also vary significantly from market expectations, and the Fed’s ability to achieve its monetary policy goals has become even more challenging.

Projecting stock market direction is always rife with problems, doing so in such an environment can quickly make even the most thoughtful projections irrelevant. In a rapidly growing economy with rising inflation, assets with exposure to high nominal growth rates, including value stocks and commodities, may hold up well, whereas bonds could struggle. Should tightening Fed policy, higher inflation or a change in consumer sentiment start to weigh heavily on the economy, however, bonds will be seen as a safe-haven alternative to equities. This highlights the benefits of a well-diversified portfolio and a consistent investment strategy to navigate through the volatility.



Fundamentally, stock valuations are based on long-term expectations for dividend payments and price appreciation. Assuming continued success in combatting the virus and returning the economy to more “normal” levels of activity, the long-term impact on economic growth and equity values should not be significant. However, as we have stated previously, the ongoing and unprecedented level of government stimulus, both fiscal and monetary, continues to raise concerns about deficit spending and the corresponding growth in national debt. While such stimulus may be critical in times of stress, the long-term implications for economic growth are likely to be negative. In the near term, uncertainties around these policies (among other developments) will likely result in continued high levels of market volatility.

In periods of higher market volatility, maintaining investment discipline will be more difficult emotionally. However, we need to remember that market timing as an investment strategy has never worked consistently (and results in lower longer-term yields). Trying to time markets has a high probability of creating permanent losses.

As always – stay with a consistent and disciplined investment strategy – it is the only course of action with any track record of success (in any investment environment). There is no reason to believe, even with the changing economic dynamics, that the disciplined approach to investments will be less effective than in the past at delivering the best possible relative returns.

At the most fundamental level, match your investment time horizon to your spending timeline – if you have short term cash needs then those funds should be in short term investments. These are simple asset/liability matching principles practiced by the most sophisticated investment managers every day (but far too complex to explain in sound bites and not conducive to selling products). Additionally, don’t try to solve short-term financial problems with long-term equity exposure. If you try to chase returns, you may get lucky sometimes but, if pursued long enough, it always ends in extreme frustration and often with serious financial losses. The reality is that no one has ever consistently predicted investment markets and they never will - and there is always a consequence to continued unsound financial behavior.

As always, if your personal or family situation has changed (or is likely to), a discussion with us as to how this may impact your financial plan and your overall asset allocation is warranted. Or, if you simply feel a need to discuss any aspect of your portfolio and/or financial plan, or you haven’t had a planning update within the last 12 months, please contact us to review your financial plan and investments.

Risks

Investors should be aware of the risks associated with all portfolio strategies and variable market conditions. Monetary policy changes, military activity abroad, the level and change in market interest rates, corporate earnings, domestic and foreign governmental policies, global economic data, vaccine missteps, other geopolitical events can have a substantial effect on portfolio performance and the effectiveness of strategic and tactical portfolio approaches.

Your financial plan is the most important financial document that you possess! Keep it updated and use it.



Please note that you are entitled to receive Fullen Financials' Form ADV whenever you would like to. This document outlines many details of who Fullen Financial is, their investment methodologies and their advisor's education and experience. You may do so by contacting Paula Miller (paula@fullenfinancial.com) and requesting such. Alternatively, you can go to the Fullen Financial website at www.fullenfinancial.com and click on "Resources" in the top menu bar, and then on "Client Forms."

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Appendix: Economic Indicators and Outlook

Economic Indicators: G7 & Europe					Global Economic Outlook				
	2020	2021	2022F	2023F	Annual Per Cent Change Unless Otherwise Indicated				
Real GDP (annual per cent change)					2019 Share*		Forecast		
					Real GDP	(%)	2021	2022	2023
G7 (30.1%)*	-5.0	5.1	3.3	2.3	World	100.0	6.0	3.9	3.4
U.S.	-3.4	5.7	3.2	2.5	North America	19.2	5.5	3.1	2.5
Japan	-4.5	1.6	2.8	1.5	United States	15.8	5.7	3.2	2.5
Euro Area	-6.5	5.2	3.4	2.3	Canada	1.4	4.6	3.9	3.0
Germany	-4.9	2.8	3.2	2.8	Mexico	1.9	5.2	2.2	2.3
France	-8.0	7.0	3.3	1.9	European Union (EU-28)	15.4	5.2	3.5	2.2
Italy	-9.0	6.5	3.2	1.7	Euro Area (EU-19)	12.5	5.2	3.4	2.3
United Kingdom	-9.4	7.2	4.0	2.1	Germany	3.5	2.8	3.2	2.8
Canada	-5.2	4.6	3.9	3.0	France	2.4	7.0	3.3	1.9
Consumer Price Index (annual per cent change)					Italy	2.0	6.5	3.2	1.7
G7	0.8	3.3	5.8	1.9	United Kingdom	2.4	7.2	4.0	2.1
U.S.	1.2	4.7	7.0	2.4	EU accession members	2.9	5.2	4.1	2.1
Japan	0.0	-0.2	1.5	0.7	Asia	43.2	6.4	4.6	4.7
Euro Area	0.3	2.6	5.2	1.5	Japan	4.1	1.6	2.8	1.5
Germany	0.4	3.2	5.3	1.4	Asian NIC's	3.5	5.2	3.2	2.4
France	0.5	2.1	4.4	1.3	Hong Kong	0.3	6.5	2.0	3.2
Italy	-0.1	1.9	5.8	1.4	Korea	1.7	4.0	3.0	2.5
United Kingdom	0.9	2.6	7.2	2.2	Singapore	0.4	7.2	4.4	2.4
Canada	0.7	3.4	5.0	2.1	Taiwan	0.9	6.3	3.6	2.3
Unemployment Rate (per cent annual averages)					Russia	3.1	3.5	-8.0	-0.2
U.S.	8.1	5.4	3.6	3.5	Australia & New Zealand	1.2	4.7	3.6	2.8
Japan	2.8	2.8	2.9	2.5	Emerging Asia	31.4	7.5	6.2	5.9
Euro Area	8.0	7.7	7.5	7.4	ASEAN-5	5.7	3.3	5.7	5.4
Germany	5.9	5.7	5.2	5.0	China	17.3	8.4	5.4	5.6
France	8.0	7.9	7.6	7.6	India**	7.1	8.7	8.8	7.0
Italy	9.3	9.5	9.2	9.0	Central/South America	5.6	7.4	2.2	2.3
United Kingdom	4.5	4.5	4.3	4.0	Brazil	2.4	4.9	0.7	1.7
Canada	9.6	7.4	5.4	5.4	Other Emerging Markets	13.0	5.5	4.1	2.9
*Share of 2019 world gross domestic product (GDP) at PPP. Forecast as at March 2022. Source: National statistics agencies, TD Economics.					Other Advanced	1.1	4.7	3.7	2.2
					*Share of world GDP on a purchasing-power-parity (PPP) basis. Forecast as at March 2022. **Forecast for India refers to fiscal year. Source: IMF, TD Economics.				

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Investors should consult with their investment advisor to determine the appropriate investment strategy and investment vehicle. Investment decisions should be made based on the investor's specific financial needs and objectives, goals, time horizon and risk tolerance.

Except for the historical information contained in this report, certain matters are forward-looking statements or projections that are dependent upon risks and uncertainties, including but not limited to such factors and considerations such as general market volatility, global economic risk, geopolitical risk, currency risk and other country-specific factors, fiscal and monetary policy, the level of interest rates, security-specific risks, and historical market segment or sector performance relationships as they relate to the business and economic cycle.