



Economic & Market Outlook

June 30, 2022

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An aerial photograph of a city skyline, likely Austin, Texas, featuring a river (the Colorado River) with several bridges, surrounded by dense greenery and modern high-rise buildings under a clear blue sky.

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An aerial photograph of a city skyline, likely Minneapolis, Minnesota, featuring a river (the Mississippi River) with several bridges crossing it. The skyline is composed of numerous high-rise buildings, including a prominent blue glass skyscraper. The foreground shows green trees and a road with a bridge. The sky is a clear, deep blue.

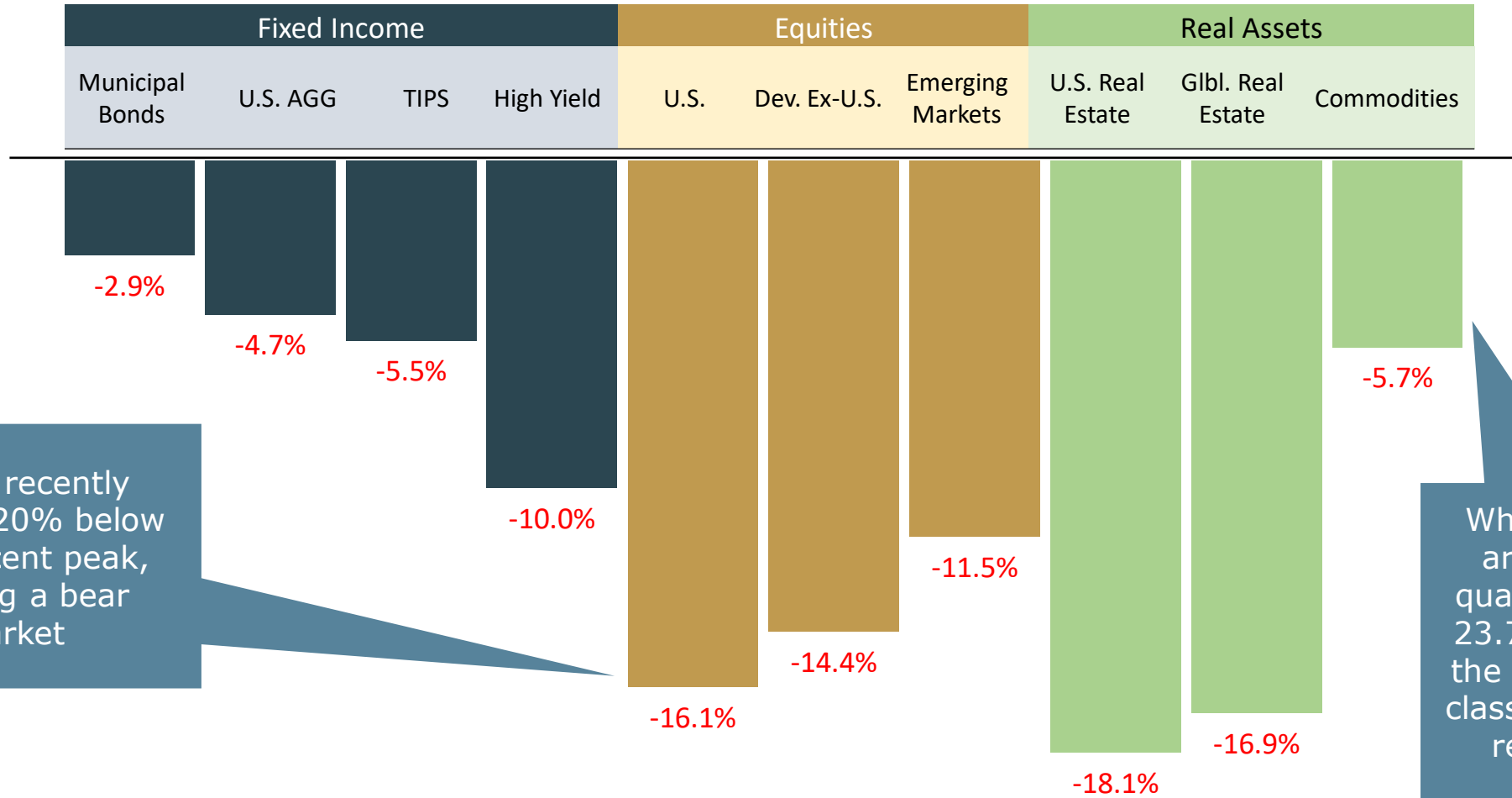
Market Review

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Market Review

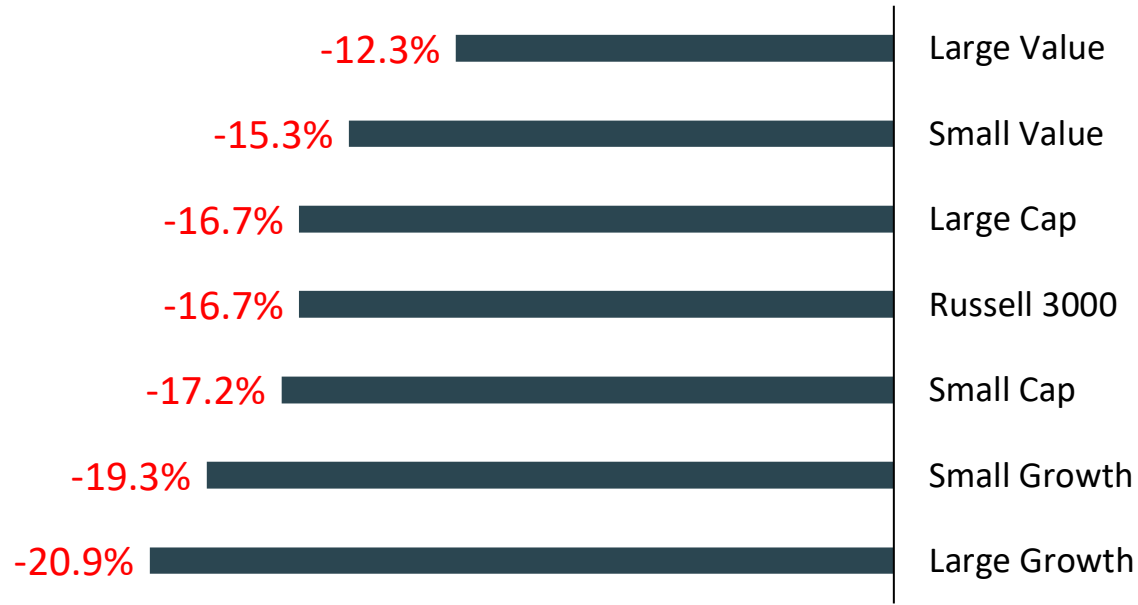
Q2 '22 Returns



US Indexes

Equity Index Returns

Q2 2022



For Q2 2022 and the trailing one year, value stocks outperformed growth stocks, reversing a multiyear trend

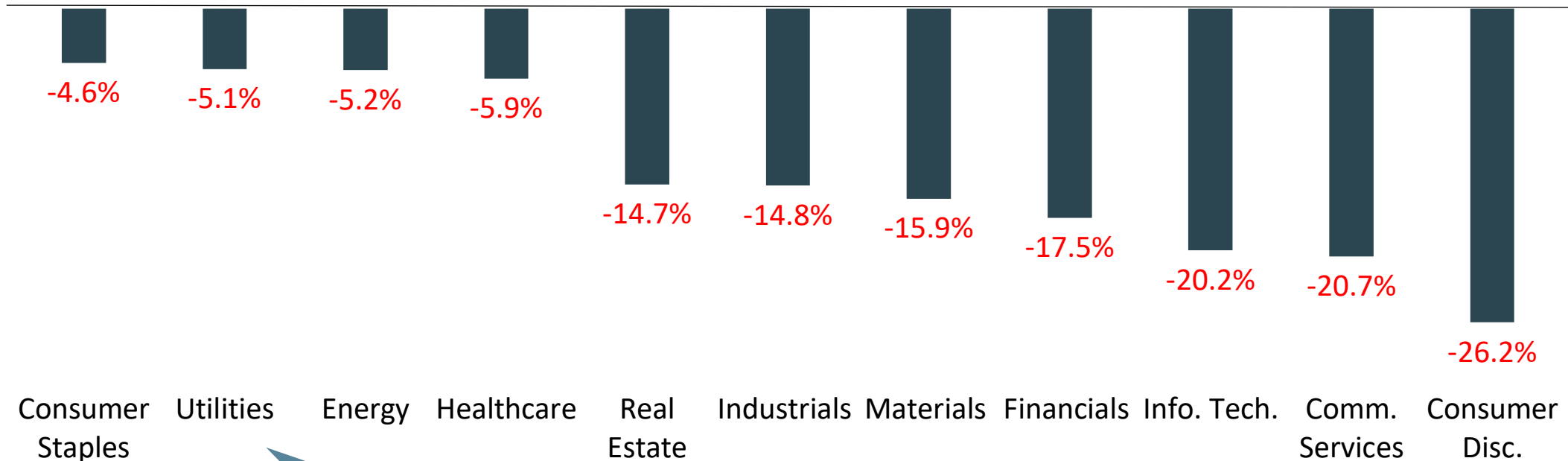
Period Returns, Annualized %

Asset Classes	1 Year	3 Years	5 Years	10 Years
Large Value	-6.1	6.6	7.2	10.6
Small Value	-11.0	7.1	5.1	9.2
Large Cap	-12.1	10.0	11.1	13.1
Marketwide	-12.5	9.7	10.7	12.8
Large Growth	-17.6	12.6	14.5	15.2
Small Cap	-19.4	5.1	5.4	9.4
Small Growth	-27.3	2.2	5.0	9.6

Over the three-, five- and ten-year periods, large growth stocks outperformed

US Equity Sector

Q2 2022 Sector Returns



Defensive sectors outperformed the broad market as they tend to be less susceptible to changes in economic growth

Consumer discretionary stocks lagged on concerns around high inflation

International Indexes

Non-US Equity Returns

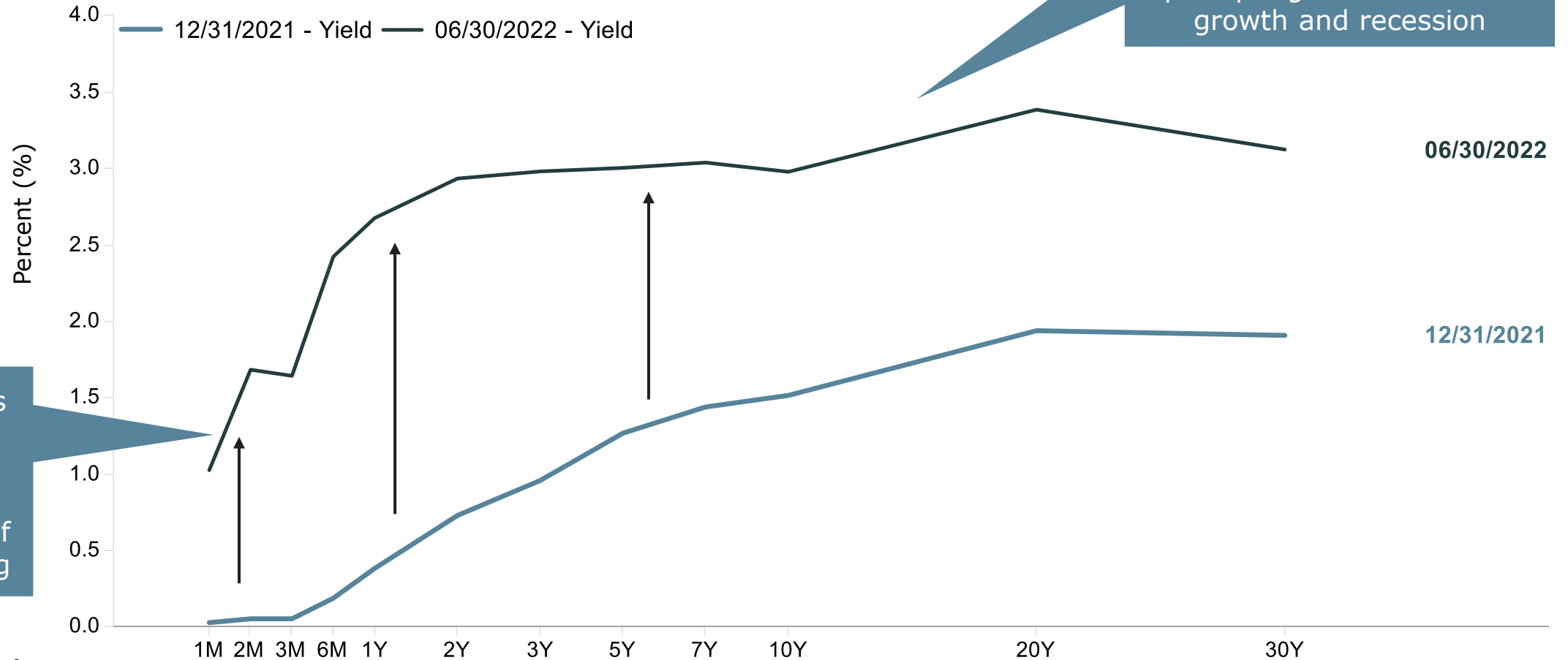
- Non-U.S. stocks generally declined in Q2, mimicking weakness in the U.S.
- China was an exception after significant underperformance in 2021 and as the economy began to open back up after Covid-related restrictions

Period Returns, Annualized %

Global Markets	Q2 '22	1 Year	3 Years	5 Years	10 Years
Shanghai China	5.7	-13.1	7.0	6.0	8.3
Hong Kong	-1.1	-13.9	-2.1	2.4	6.9
UK	-3.2	2.9	3.1	3.6	7.1
Japan	-3.2	-0.7	10.0	6.2	11.9
Europe 350	-7.2	-4.9	5.6	5.0	8.5
India	-8.9	2.1	11.7	12.8	13.3
Singapore	-14.4	-16.2	-5.6	-0.9	2.3
Mexico	-15.2	1.7	7.4	2.4	4.1
Canada	-15.9	-2.4	8.0	7.7	8.3
Brazil	-24.4	-19.3	1.3	11.2	8.2

Fixed Income

Treasury Yield Curve



Interest rates of varying maturities increased in anticipation of Fed tightening

The long end of the curve has flattened or even inverted (with shorter-term yields rising above longer-term yields) in places, prompting fears of slower growth and recession

Fixed Income

Bond Index Returns

- After disappointing results in Q1, most areas of fixed income declined again in Q2
- Even TIPS did not offer a safe haven; even though current inflation rates are at historic highs, longer-term inflation expectations – which TIPS are priced off of – have not risen

Period Returns, Annualized %

Asset Class	Q2 '22	1 Year	3 Years	5 Years	10 Years
U.S. Treasury Note 3-Month	0.1	0.2	0.7	1.1	0.7
U.S. Treasury Note 1-Year	-0.5	-1.5	0.5	1.1	0.7
U.S. Municipal Bond	-2.9	-7.9	0.2	1.8	2.4
World Government Bond	-3.9	-8.1	-1.2	0.8	1.9
U.S. Aggregate Bond	-4.7	-10.4	-0.6	1.0	1.5
U.S. TIPS	-5.5	-4.7	3.4	3.5	1.7
U.S. Corporate Bond	-8.3	-14.6	-0.6	1.6	2.6

Detailed Index Returns

- Not a single major asset class had positive performance for the quarter
- Even on a one-year basis, only commodities and international value stocks were up
- Over the past ten years, both stocks and bonds continue to have positive performance; commodities remain an exception at essentially flat for the longer time period.

Period Returns, Annualized %

Asset Class	Q2'22	1 Year	10 Year
U.S. Treasury	-3.3%	-8.4%	0.9%
U.S. Aggregate	-4.7%	-10.4%	1.5%
Commodities	-5.7%	21.1%	-1.5%
U.S. High Yield	-10.0%	-14.6%	2.6%
Emerging Markets Value	-10.7%	-14.5%	4.5%
International Value	-11.4%	0.6%	7.8%
Emerging Markets	-11.5%	-20.9%	6.2%
Emerging Markets Growth	-12.0%	-26.6%	7.6%
U.S. Large Cap Value	-12.3%	-6.1%	10.6%
International	-14.4%	-5.6%	8.8%
U.S. Small Cap Value	-15.3%	-11.0%	9.2%
S&P 500	-16.1%	-10.1%	13.2%
Emerging Markets Small Cap	-16.4%	-15.3%	7.3%
U.S. Large Cap	-16.7%	-12.1%	13.1%
U.S. Marketwide	-16.7%	-12.5%	12.8%
Global ex US REITS	-16.9%	-19.2%	3.7%
International Small Cap	-17.1%	-12.1%	10.3%
U.S. Small Cap	-17.2%	-19.4%	9.5%
U.S. REITS	-18.1%	-10.0%	6.4%
U.S. Small Cap Growth	-19.3%	-27.3%	9.6%
U.S. Large Cap Growth	-20.9%	-17.6%	15.2%
International Growth	-21.1%	-6.6%	9.0%
Bitcoin	-58.7%	-34.0%	124.4%

Q2 '22: Downshifting Picks Up Speed

- In the second quarter of 2022, inflation fears gripped policymakers and investors alike
- Higher prices proliferated throughout the U.S. and global economy, sending central banks into aggressive tightening mode
- While consumer and commercial balance sheets remain strong and earnings are still growing, some leading indicators suggest significant economic slowing ahead
- With equity markets down more than 20% from their peak, much of the damage of this slowing has already occurred
- Any sign that inflation is slowing could prove to be a positive catalyst for markets



An aerial photograph of a city skyline, likely Minneapolis, Minnesota, featuring a river (the Mississippi River) with several bridges, including the Hennepin Avenue Bridge and the Stone Arch Bridge. The skyline is dominated by modern high-rise buildings, with a prominent blue-glass skyscraper in the center. The foreground shows lush green trees and a road with a few cars. The overall scene is captured in a slightly dim, dusk-like lighting.

Economic Overview

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Economic Dashboard

After expanding 5.7% in 2021, the fastest pace since 1984, U.S. economic growth will likely slow throughout 2022 as the economy adjusts to higher inflation and tighter monetary policy.

While current economic indicators suggest the economy remains healthy, the speed at which those indicators are decelerating will pose a challenge for both businesses and consumers.



Labor



The unemployment rate and other labor market measures are among their tightest levels in decades



Manufacturing



Manufacturing rates are in positive territory but decelerating rapidly



Consumer



Consumer balance sheets are healthy and wages increasing, yet confidence is low



Housing



Housing inventory remains extremely tight but affordability remains low and homebuyer sentiment is declining



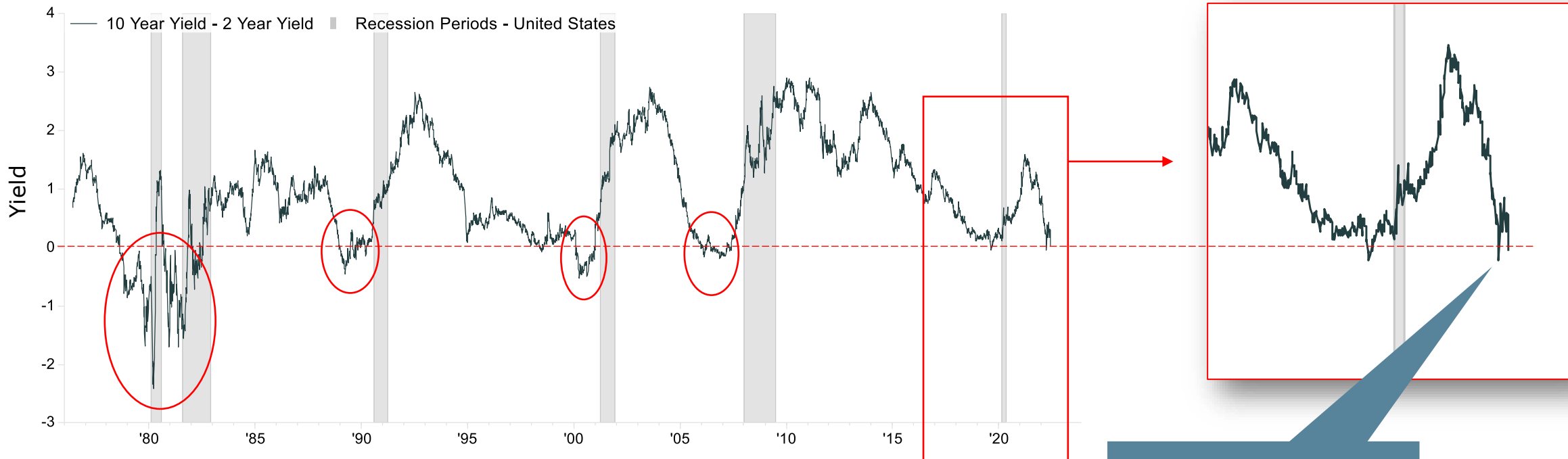
Monetary Policy



The Federal Reserve is rapidly increasing interest rates to slow inflation

Mixed Signals from the Treasury Yield Curve

Yields on the 10-year Treasury bond are about equal with 2-year yields. In previous periods when the 10-year yield has dropped below the 2-year, a recession has followed within 6 months to 2 years.

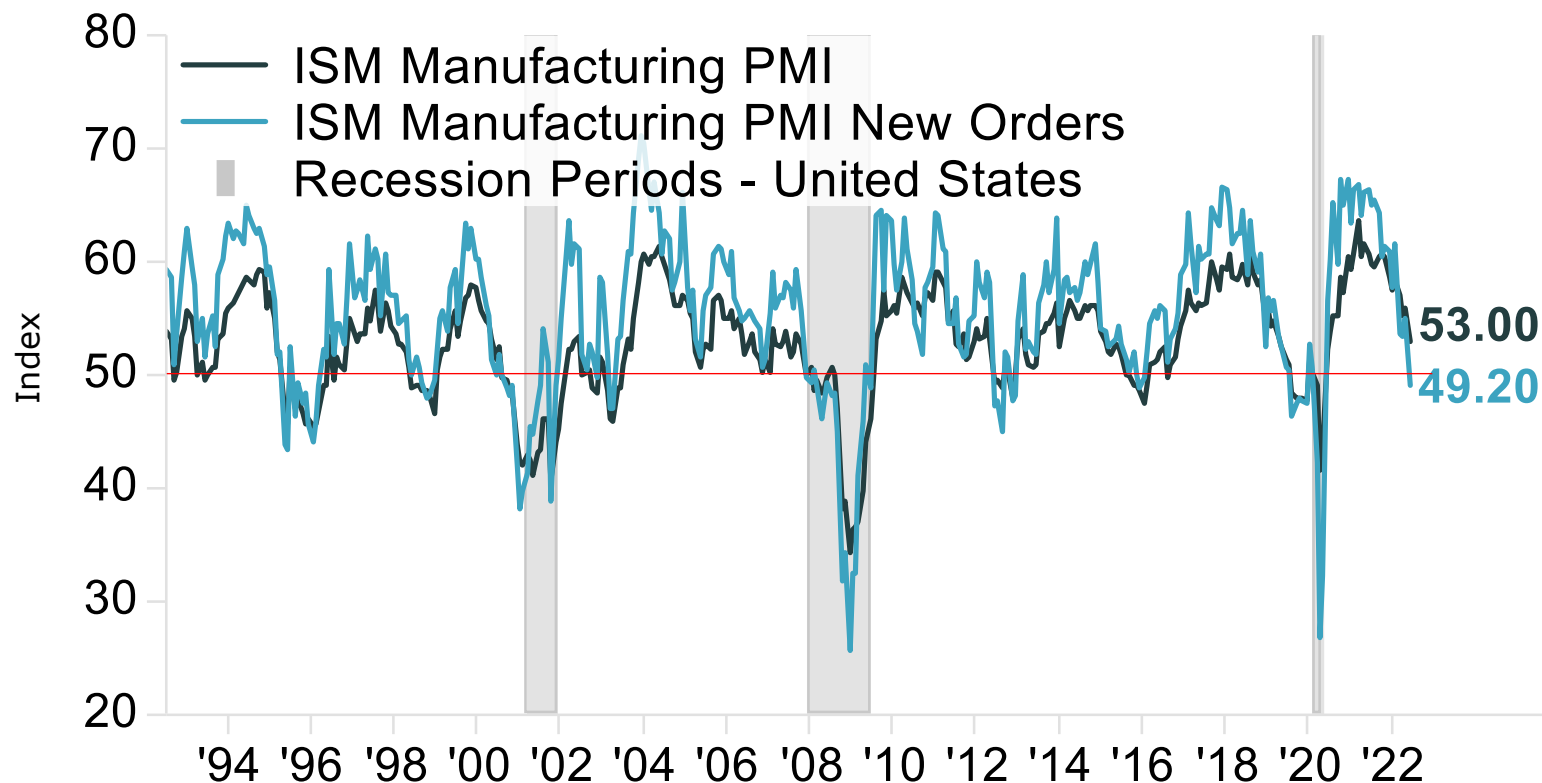


Yield curve has inverted briefly on a few occasions

Manufacturing Activity Slowing

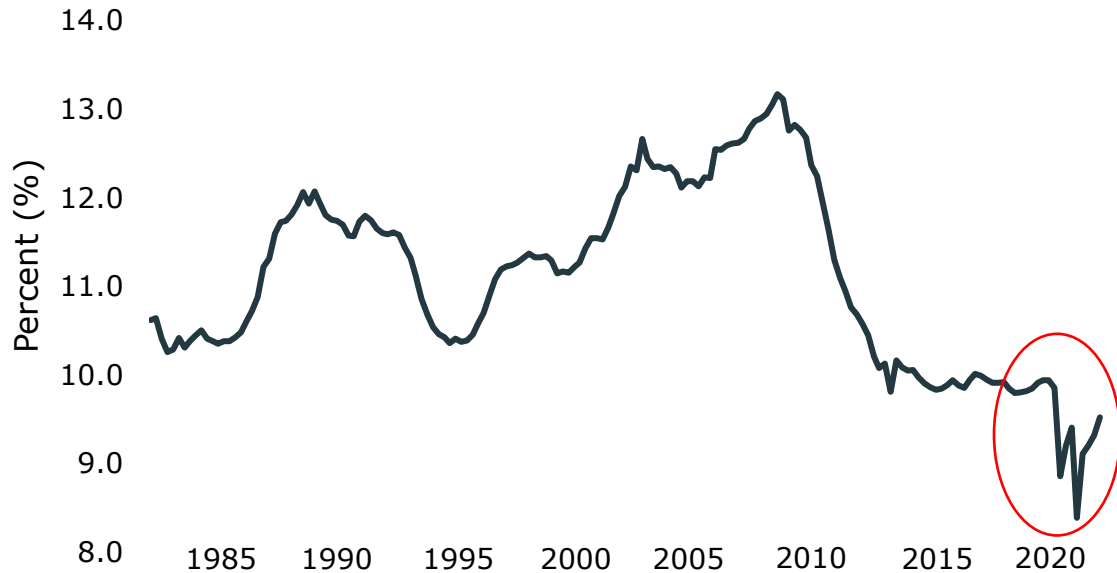
- ISM Manufacturing Purchasing Managers Index has retreated from its post-Covid peak
- New orders are now declining, suggesting even softer growth ahead

ISM Manufacturing PMI



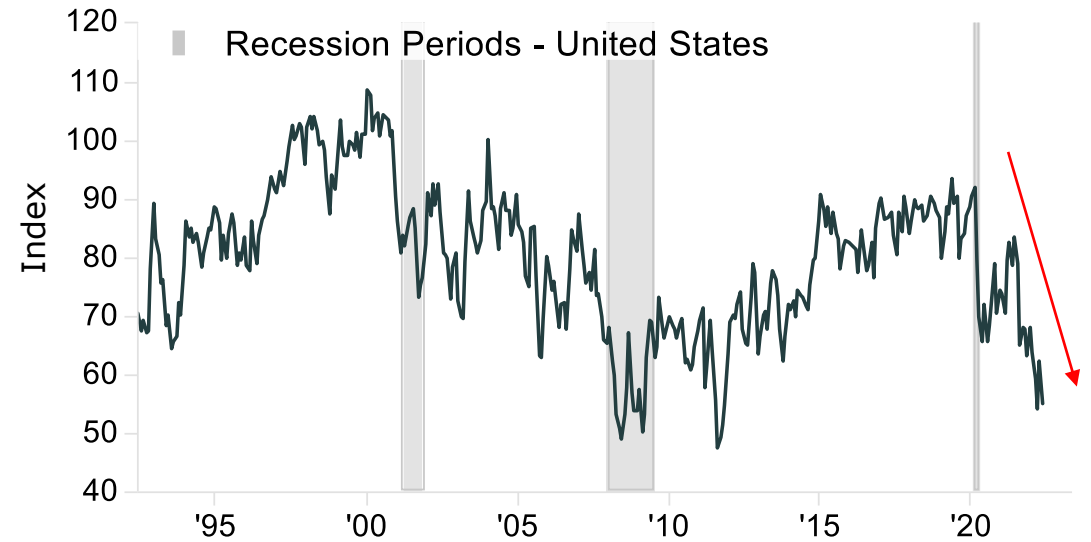
Consumer Balance Sheets Healthy, Yet Confidence Is Low

Household Debt Service Payments as % of Disposable Personal Income



Consumer debt payments remain low compared to pre-Covid levels and previous peaks, but are rising with higher interest rates

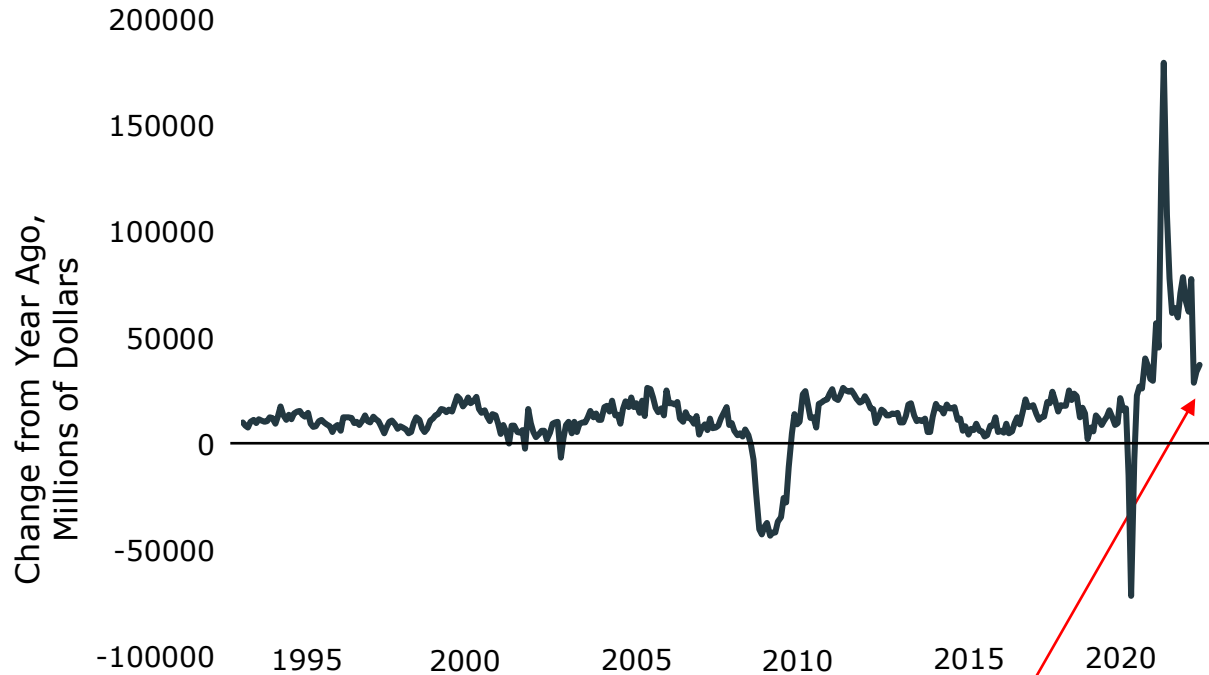
Consumer Expectations Index



Consumer confidence continues to fall, largely because of inflation

Consumers Are Beginning to Slow Spending

Advance retail sales: retail trade, year-over-year % change

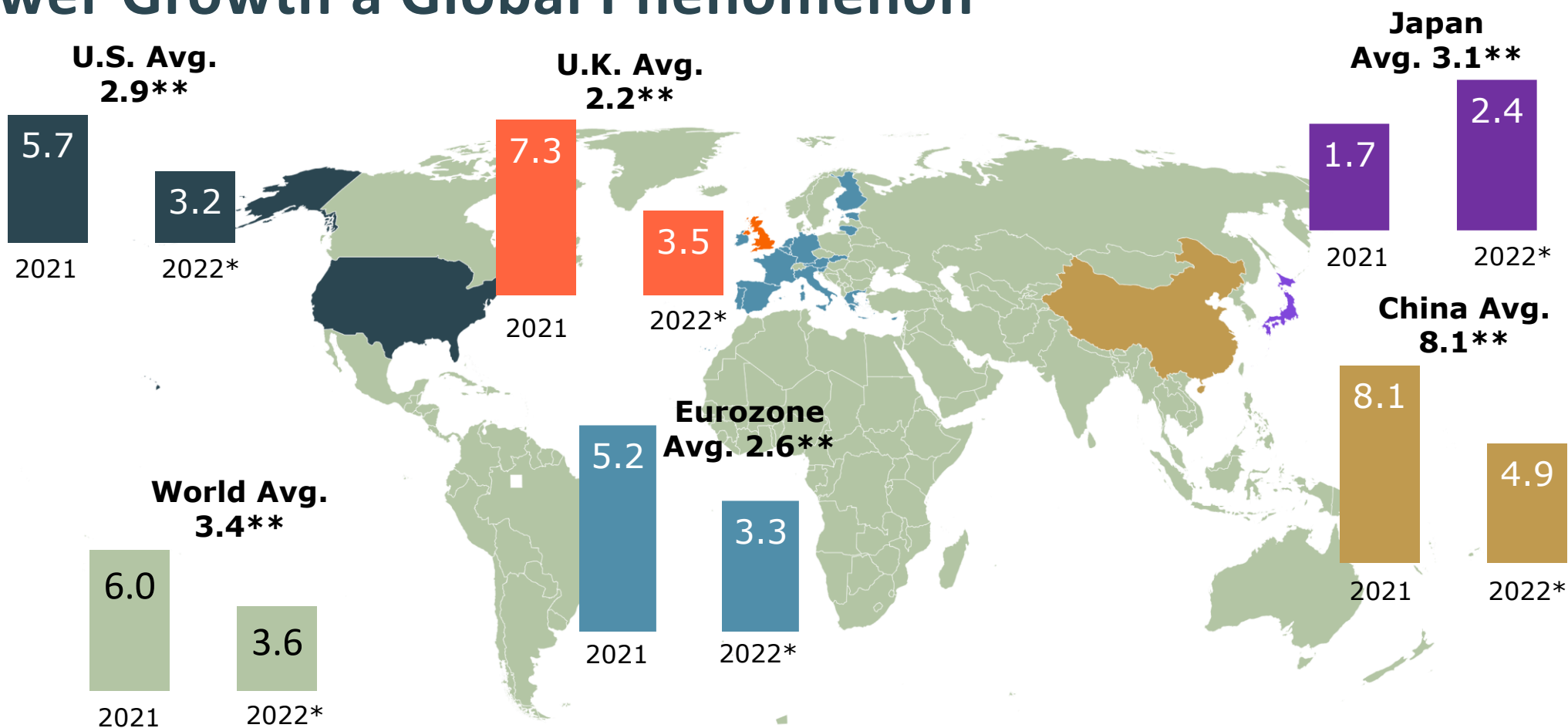


Flashback to Q1 2022 Outlook:

“Personal savings rates are back to pre-pandemic levels, which will limit future spending”

Consumers are buying less than they were during Covid, though sales are still above trend

Slower Growth a Global Phenomenon



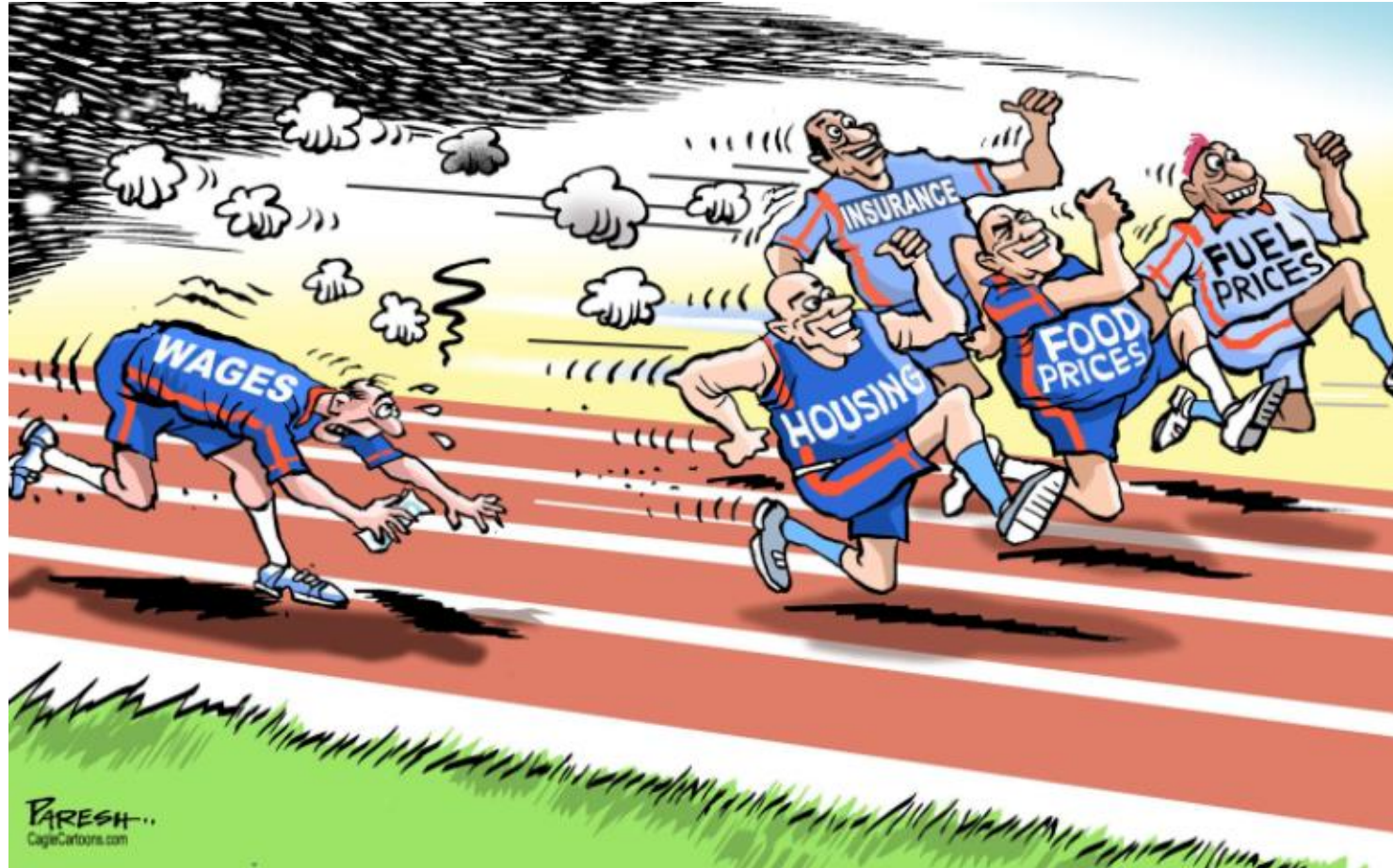
Estimates for this year and next are slowing, but for most of the world they continue to be above trend

An aerial photograph of a city skyline, likely Minneapolis, Minnesota, featuring a river (the Mississippi River) and several bridges. The skyline is composed of numerous high-rise buildings, including a prominent blue glass skyscraper. The foreground shows green trees and a bridge with a road. The sky is a clear, deep blue.

Inflation

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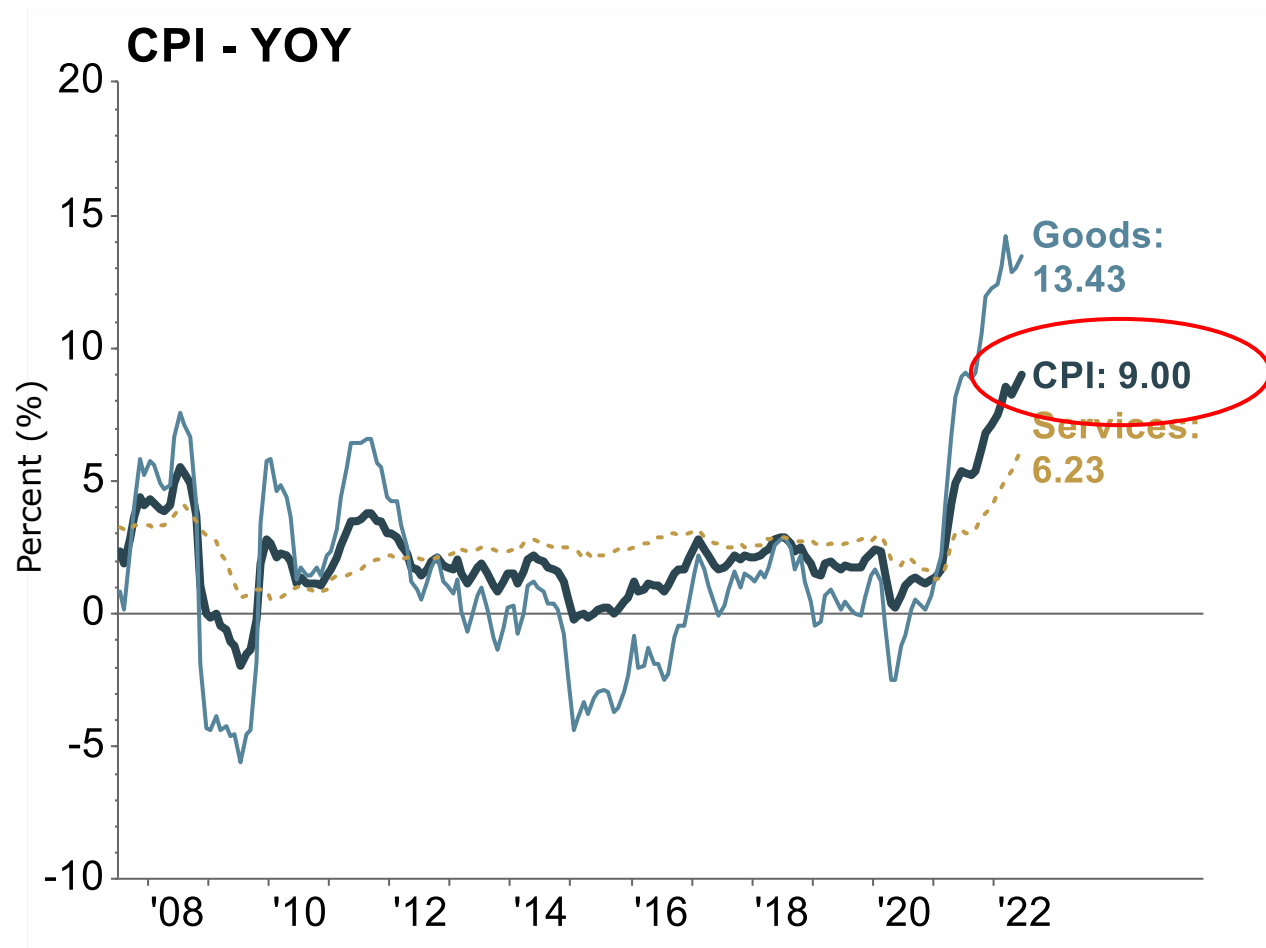
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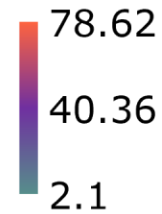
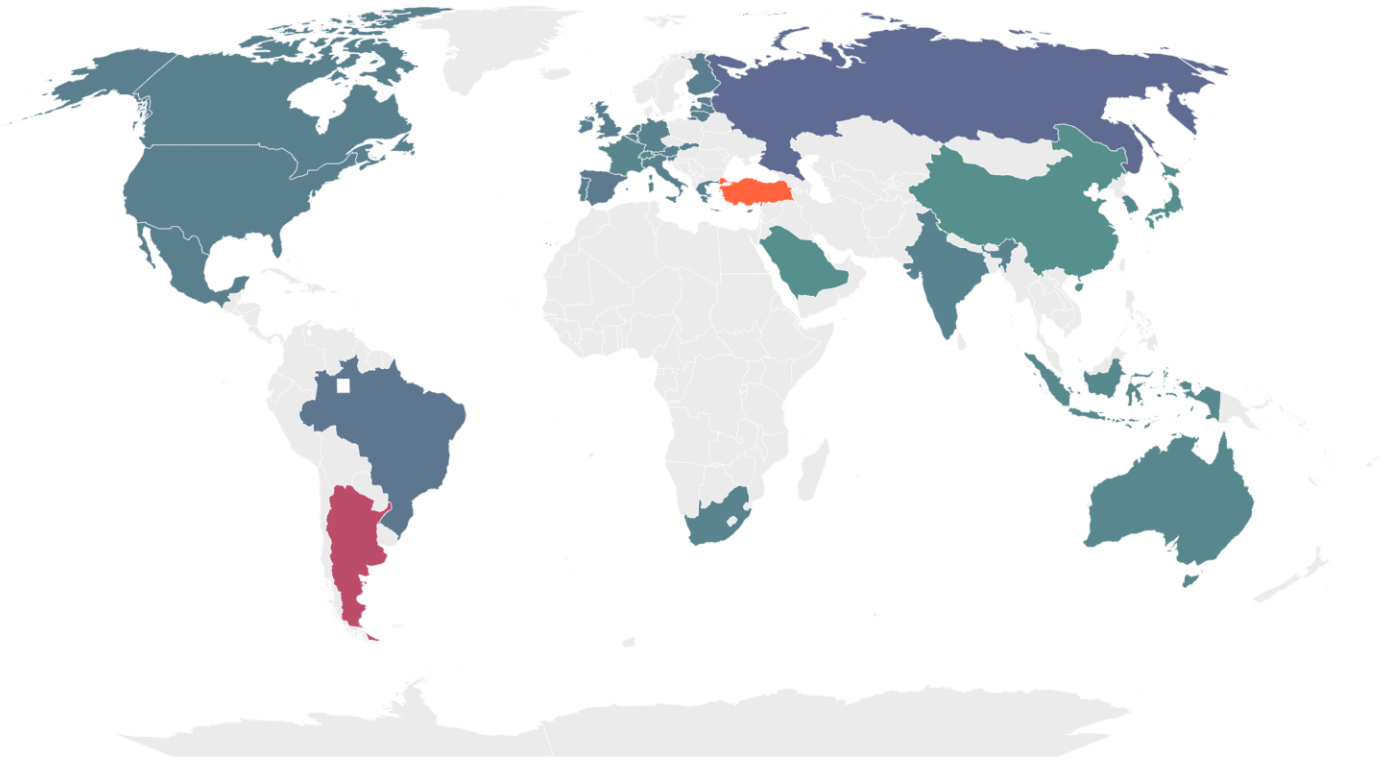
Inflation at New Highs

Price Increases for Goods Are Driving the Overall Consumer Price Index Higher

- Consumer prices are soaring by the fastest pace in over a decade
- Goods prices are much more likely to be impacted by supply chain disruptions



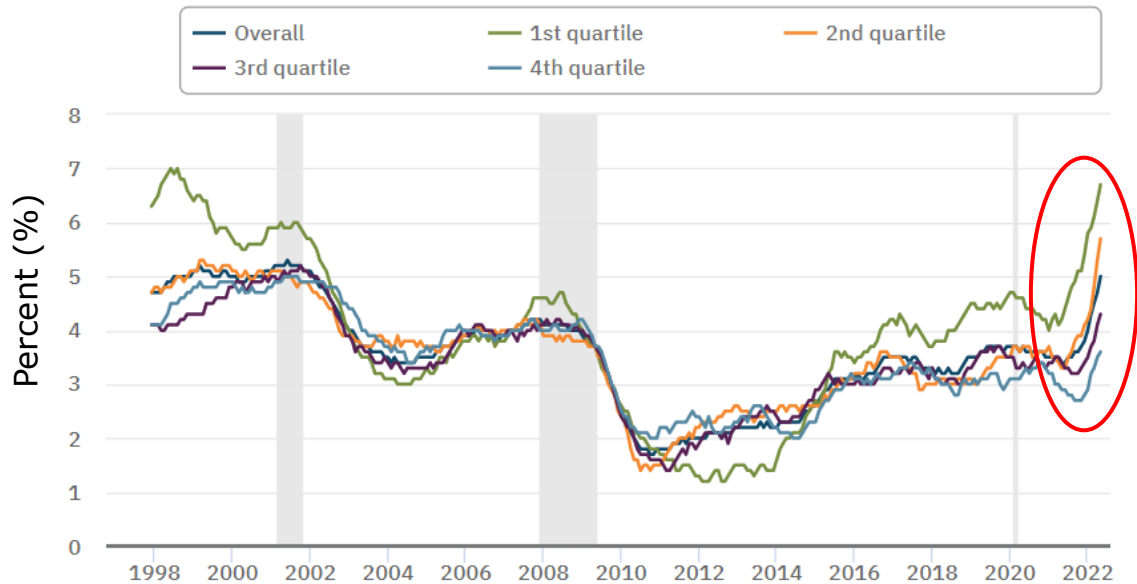
Inflation Around the World



Country	% Change
Turkey	78.6
Argentina	60.7
United Kingdom	9.1
United States	9.1
Australia	5.1
Japan	2.5
China	2.1

Wage Gains Have Proliferated

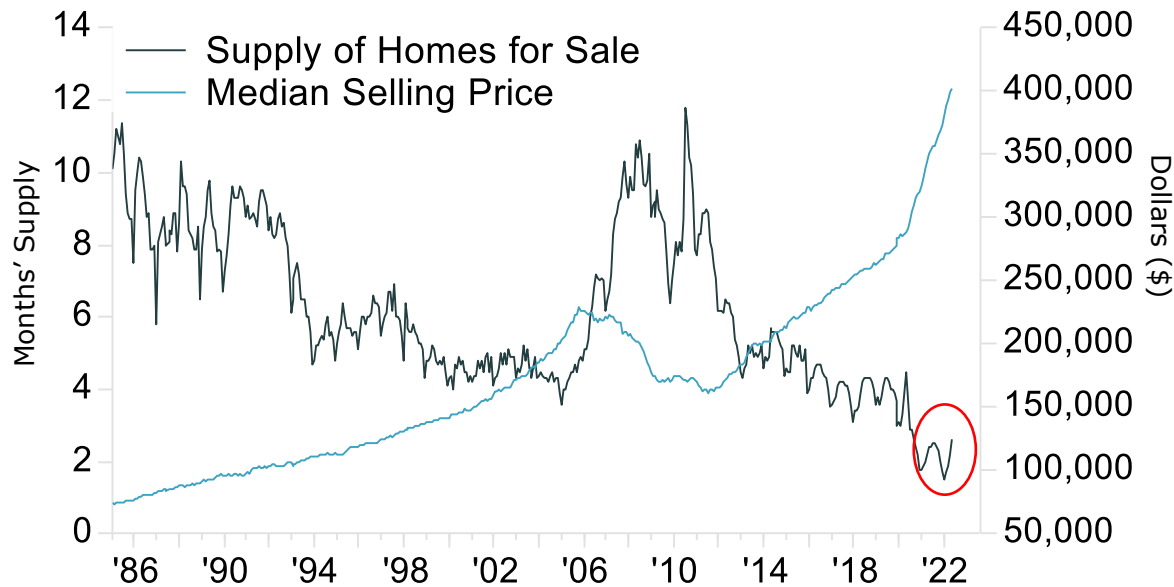
Median Wage Growth by Level of Wages
12-month moving average, hourly data



- The labor market remains very tight with employment costs rising
- The unemployment rate is the lowest we've seen in many decades, but this tends to be a lagging indicator
- As high as wage gains have been, they have not kept up with price increases, hurting consumer purchasing power
- The lowest paid workers continue to see the largest gains, but wage growth has been growing throughout all levels of wages

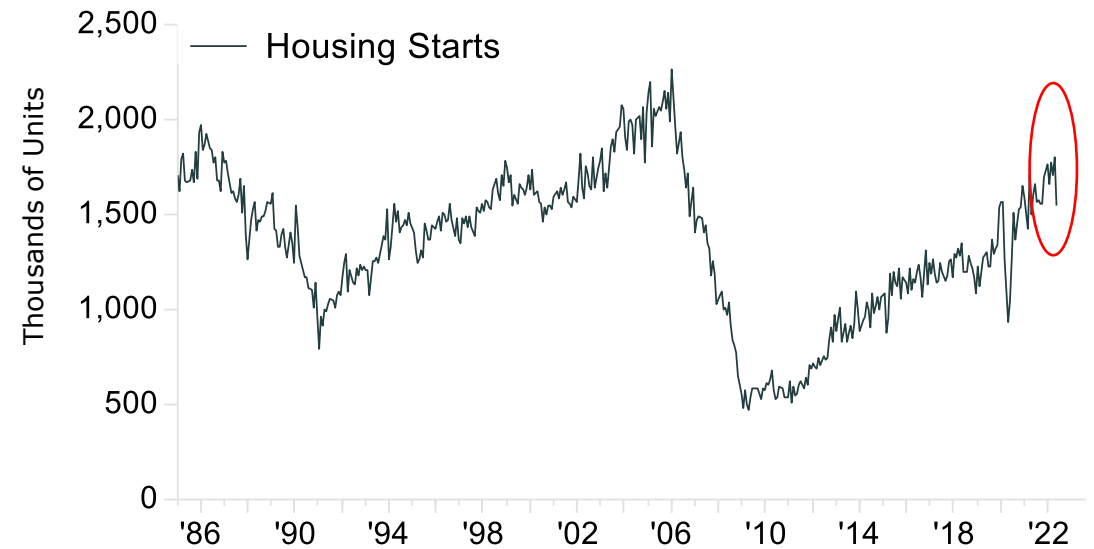
Housing Market Remains Very Tight Despite Higher Rates

Housing supply has started to increase



- Higher mortgage rates will likely dampen demand for housing, pressuring prices

Housing starts have slowed



- Long-term demographic trends and lack of excessive homebuyer borrowing will likely mitigate those pressures over time

Supply Chain Pressures Easing

Drewry World Container Index (\$/40ft)

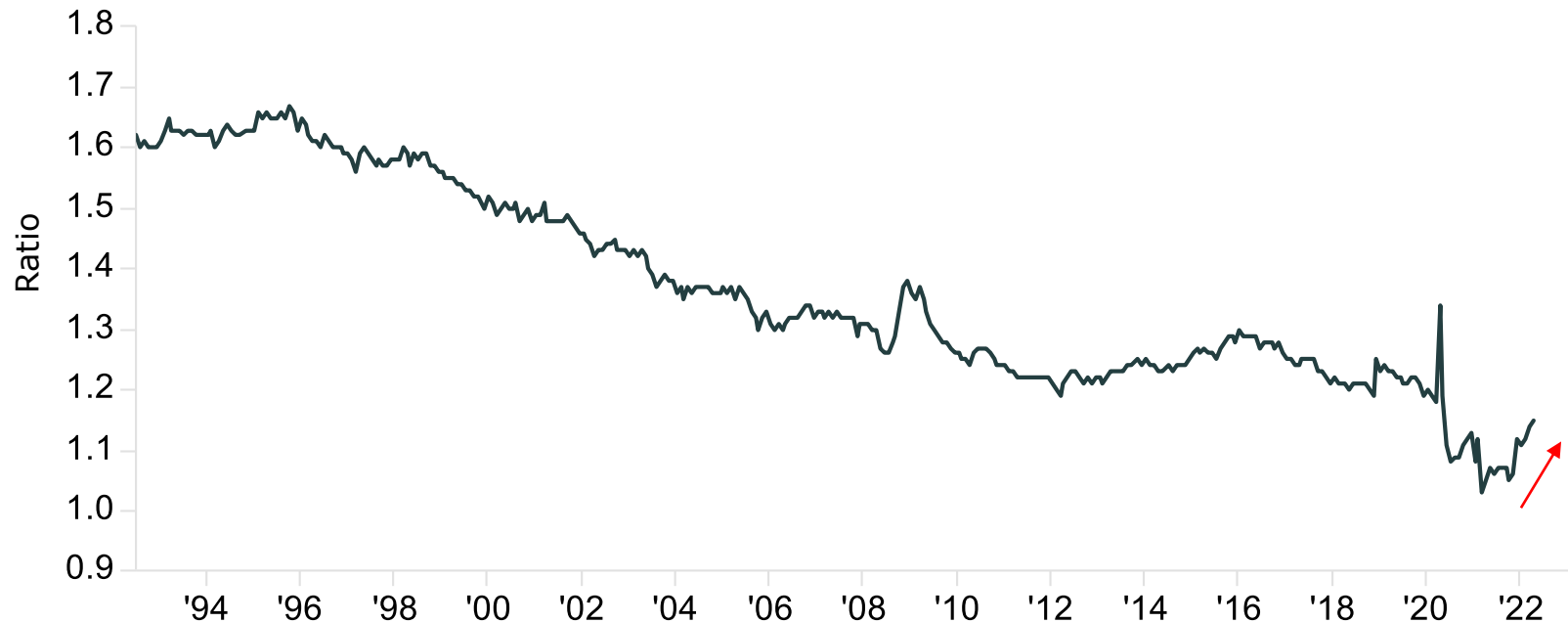


Flashback to Q1 2022 Outlook:
"Goods price inflation will abate as supply chain disruptions ease in the second half of 2022"

In a sign that supply chain disruptions are easing, the cost of shipping containers of goods from overseas continues to decline. Given softening demand, this trend will likely accelerate.

Retail Inventories Building

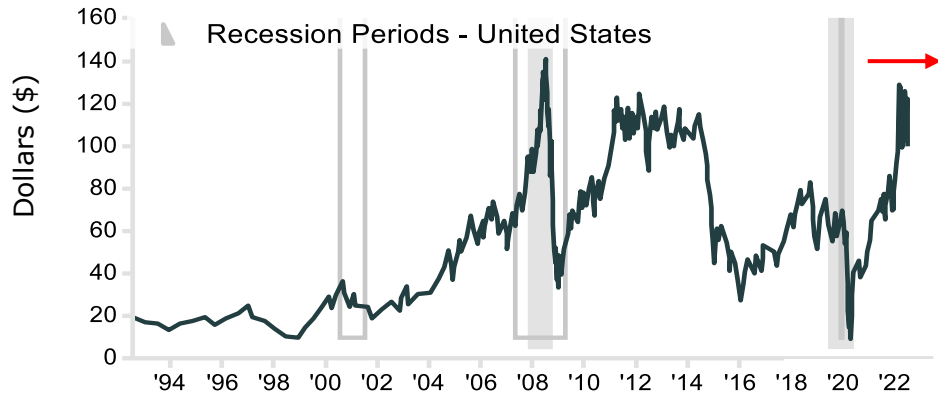
Retail Inventories/Sales Ratio, Excluding Motor Vehicle and Parts Dealers



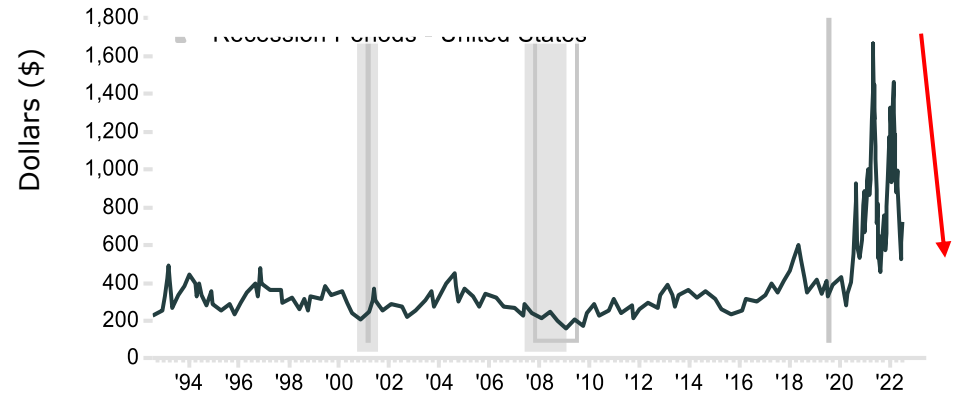
After taking out autos, retail inventories are building faster than sales, which will likely help slow goods price increases

Commodities Reversing Course

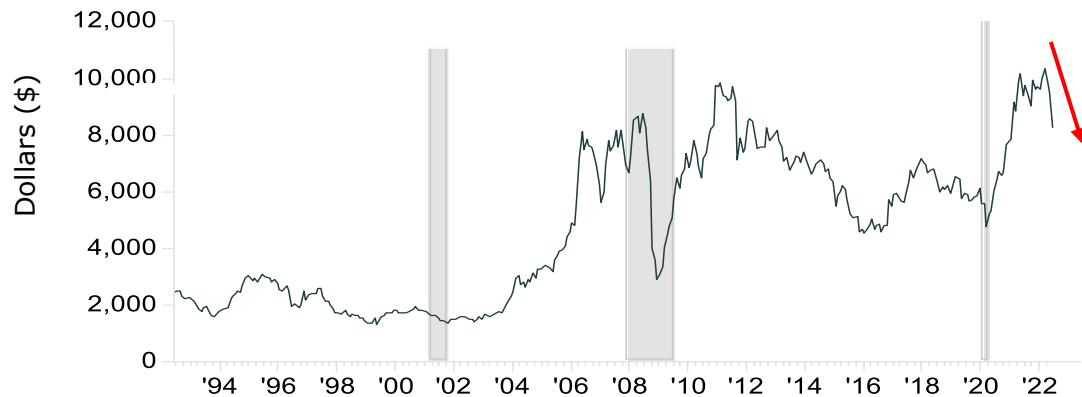
Crude Oil Brent



Lumber



Copper

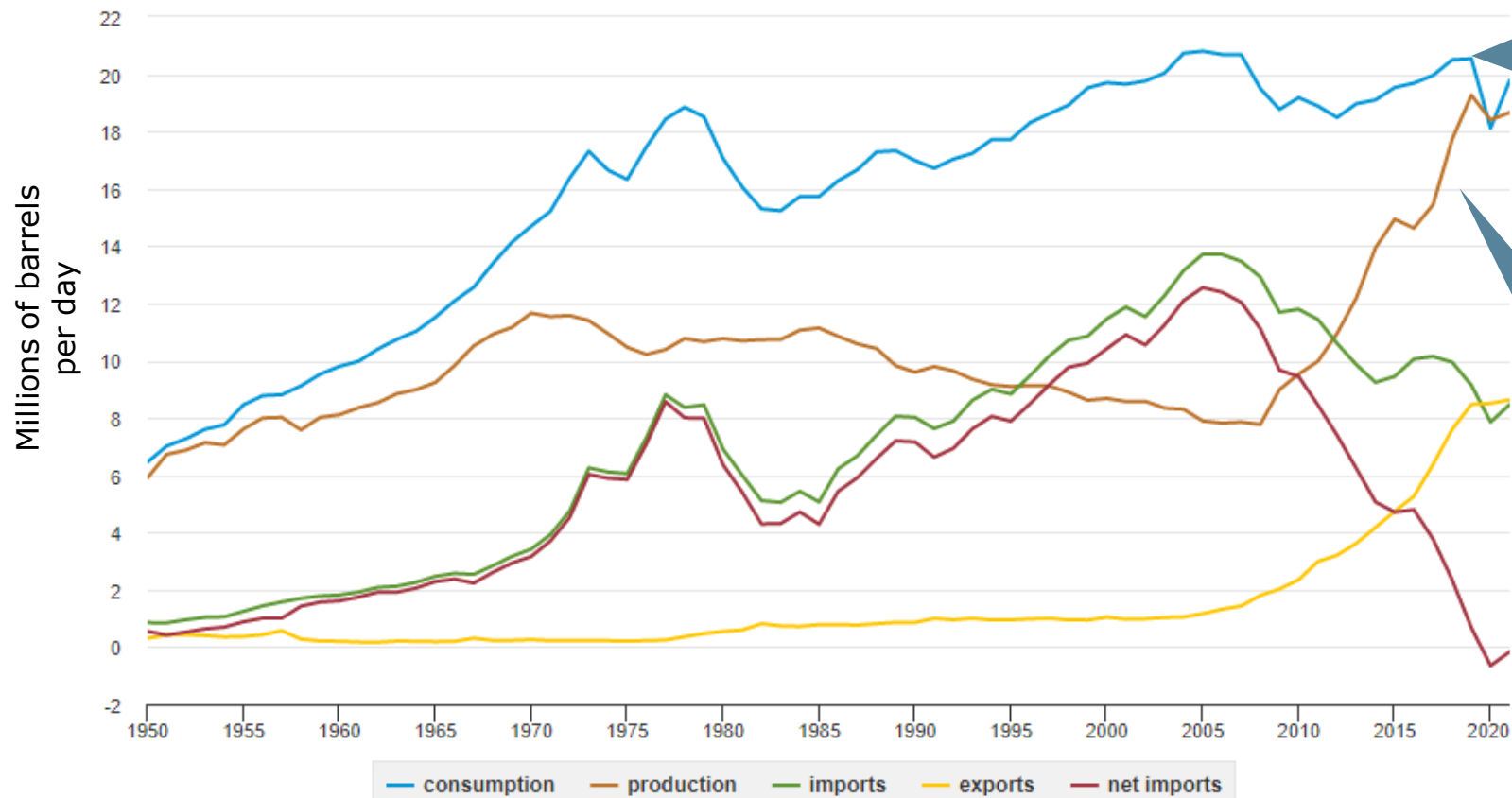


Wheat



US Much More Insulated from High Energy Prices

U.S. petroleum consumption, production, imports, exports and net imports, 1950-2021



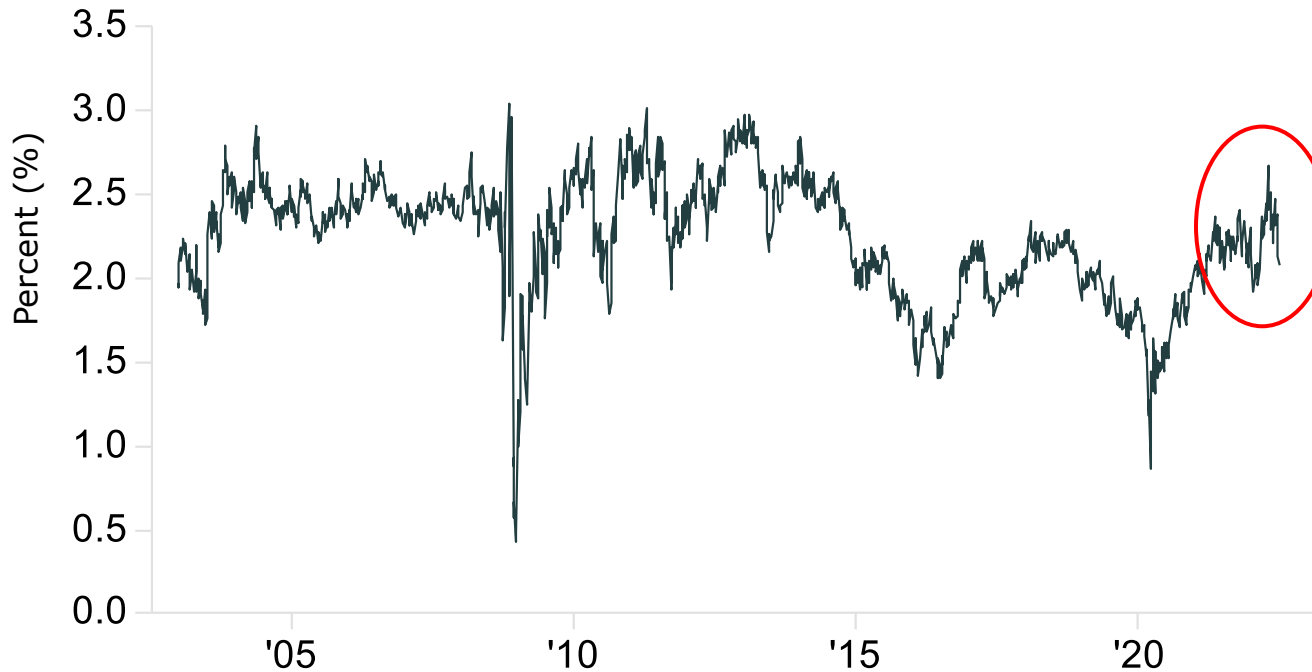
Consumption of petroleum has been largely flat since 1970 despite population growth

While domestic production has soared

Longer-Term Inflation Expectations Abating

5 Year, 5-Year Forward Inflation Expectation Rate

This series is a measure of average expected inflation over the five-year period that begins five years from today

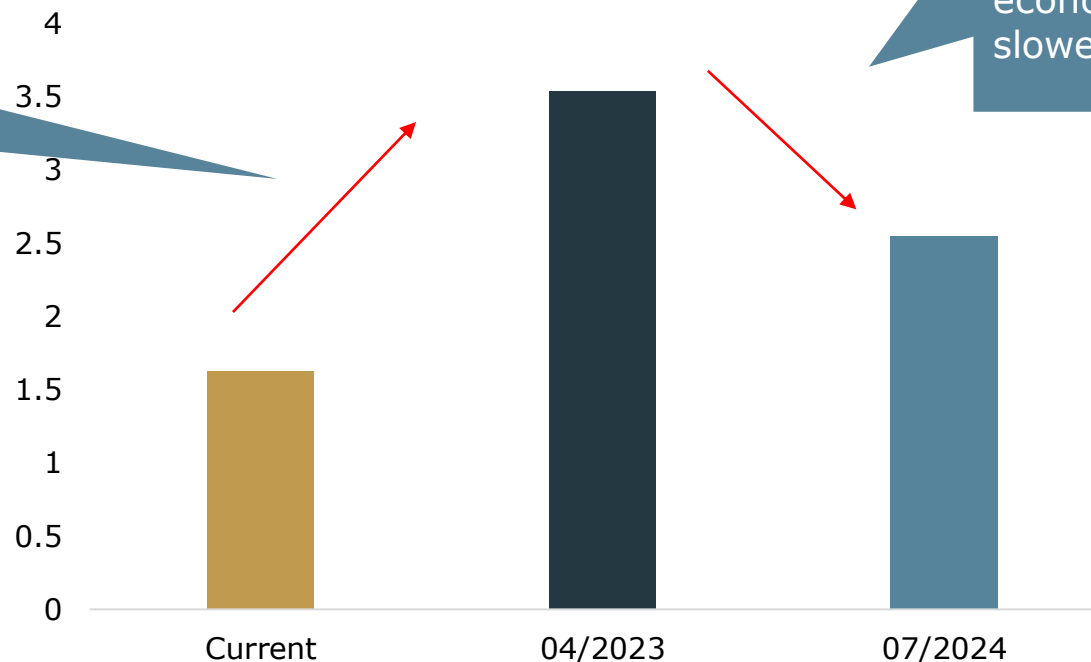


Futures markets anticipate inflation to fall back to 2% over the medium term

Fed Rate Hikes – and Then Cuts?

The futures market is pricing in continued aggressive Fed tightening over the next 9 months

Fed Funds Futures, 30 Day



In an unusual twist, by the second half of 2023, the futures curve is predicting that the Fed will have to start cutting rates, presumably because economic growth will have slowed too much

Flashback to Q1 2022 Outlook:

“Abating goods price inflation will allow the Federal Reserve to raise rates more slowly than the market currently expects”

An aerial photograph of a city skyline, likely Minneapolis, Minnesota, featuring a river (the Mississippi River) and several bridges. The skyline is composed of numerous high-rise buildings, including a prominent blue glass skyscraper. The foreground shows green trees and a bridge with a road. The sky is a clear, deep blue.

Stocks and Bonds

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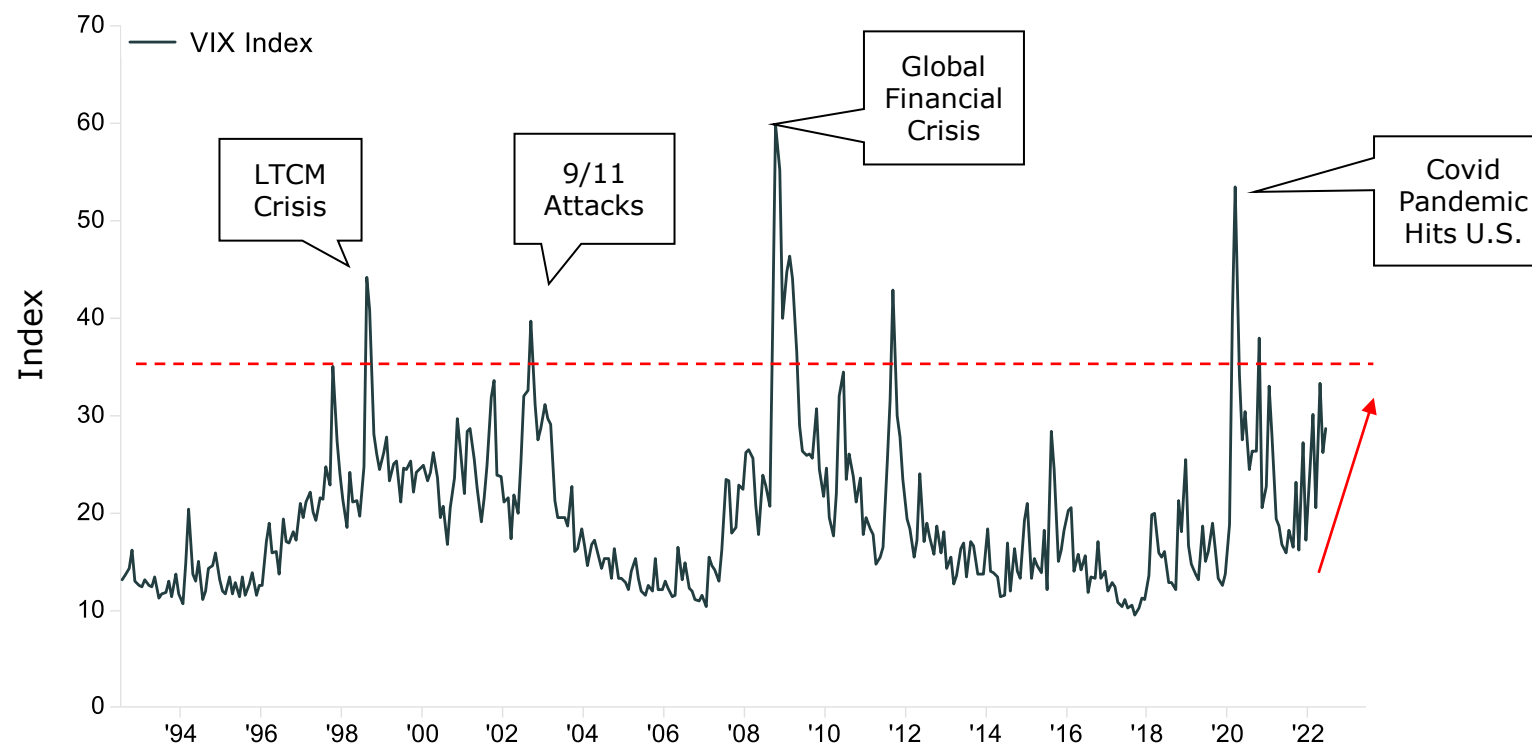
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NO, IT'S NOT CONTAGIOUS... HE'S JUST TAKEN A REAL BEATING IN THE MARKET THIS PAST WEEK

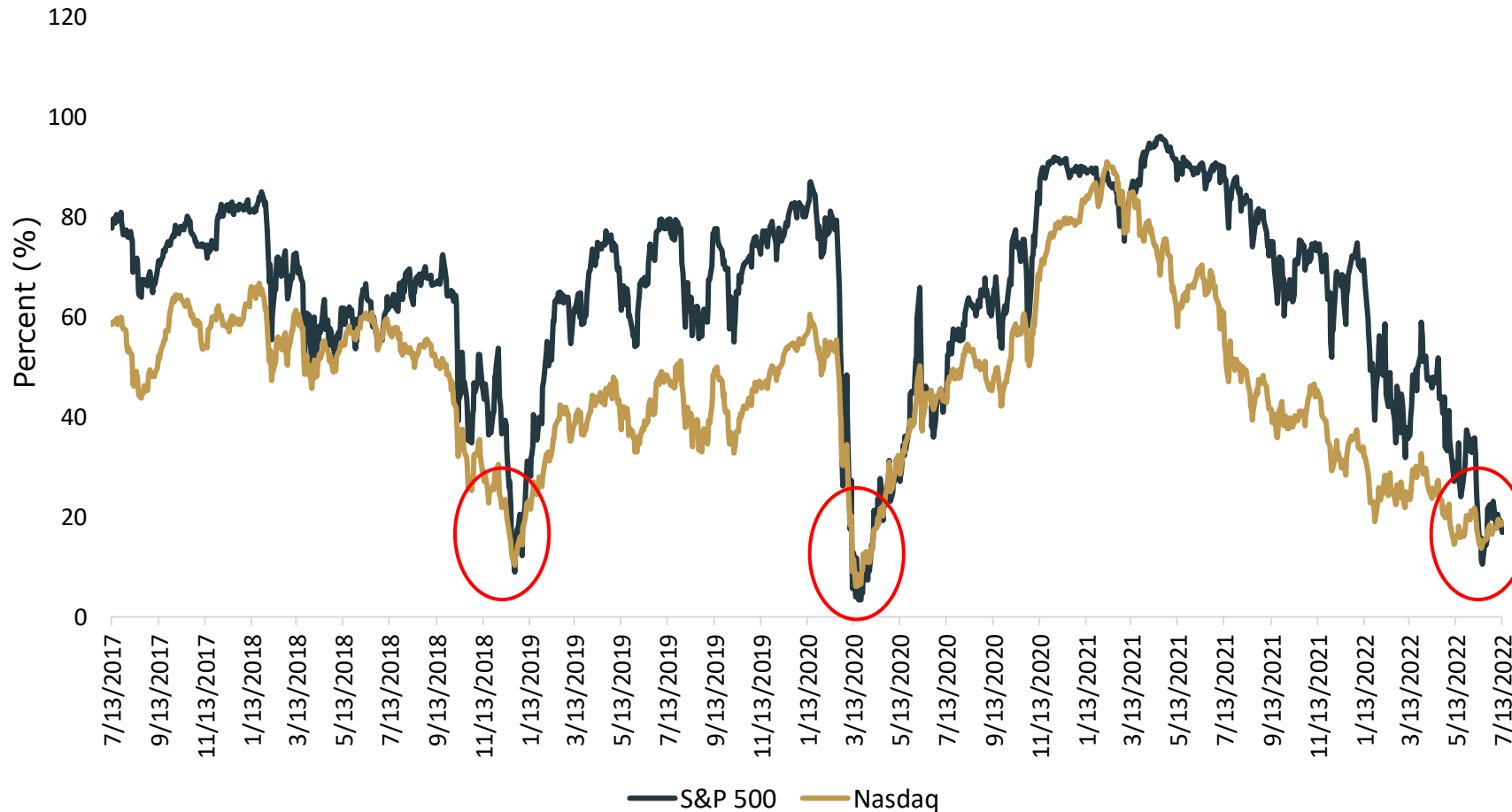
Equity Market Volatility Has Been Increasing

- Higher uncertainty generally drives volatility and the VIX index higher
- In previous periods, when the VIX has crossed above the 36 to 40 range, it has often provided a contrarian signal, meaning it was followed by a market rebound
- We have not quite reached those panic levels



Few Stocks Have Been Spared

Percentage of Stocks Above their 200-Day Moving Average



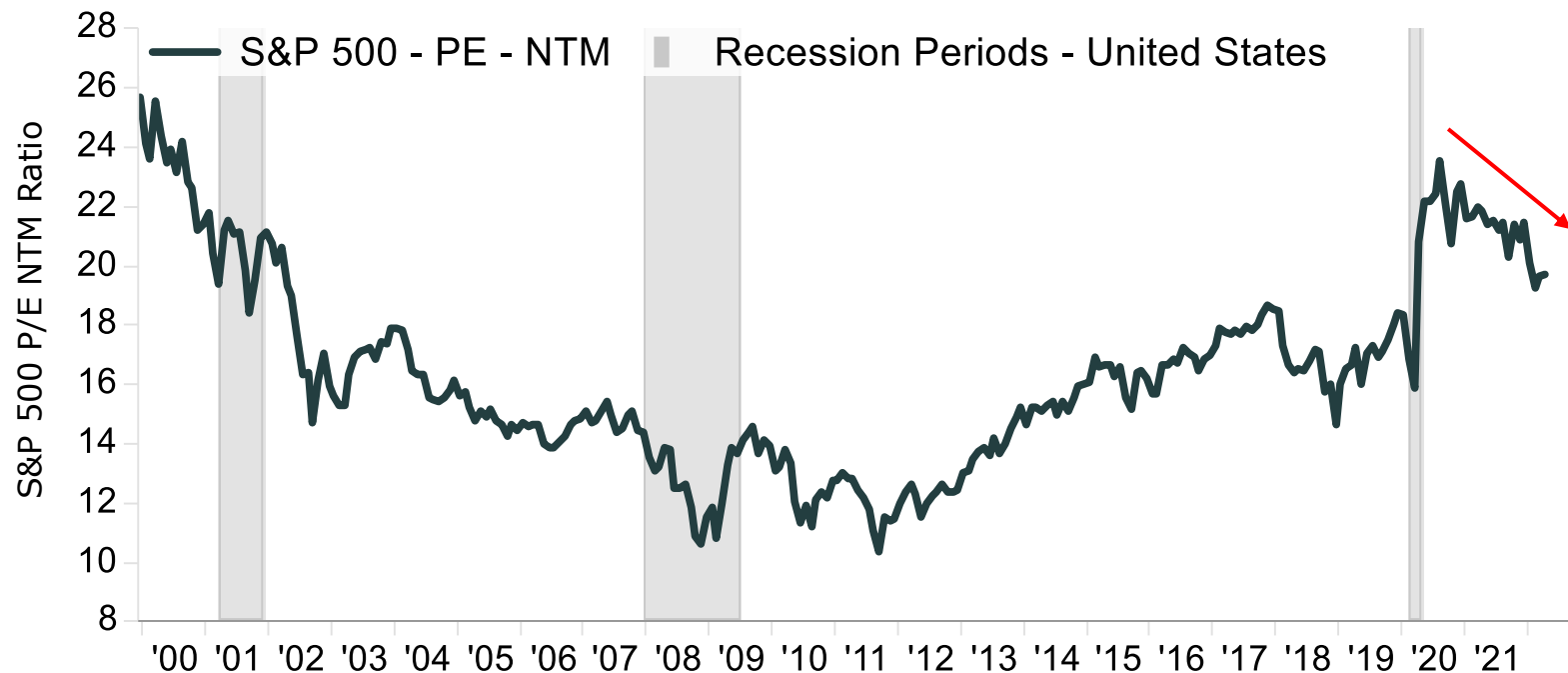
- Only about 20% of stocks in the S&P 500 and Nasdaq are above their average price of the last 200 trading days
- The pervasive weakness in stocks has reached a level close to where markets have bottomed previously

Valuations Have Backed Off Their Lofty Heights

Valuations have declined through a combination of lower equity values and higher earnings

Flashback to Q1 2022
Outlook:

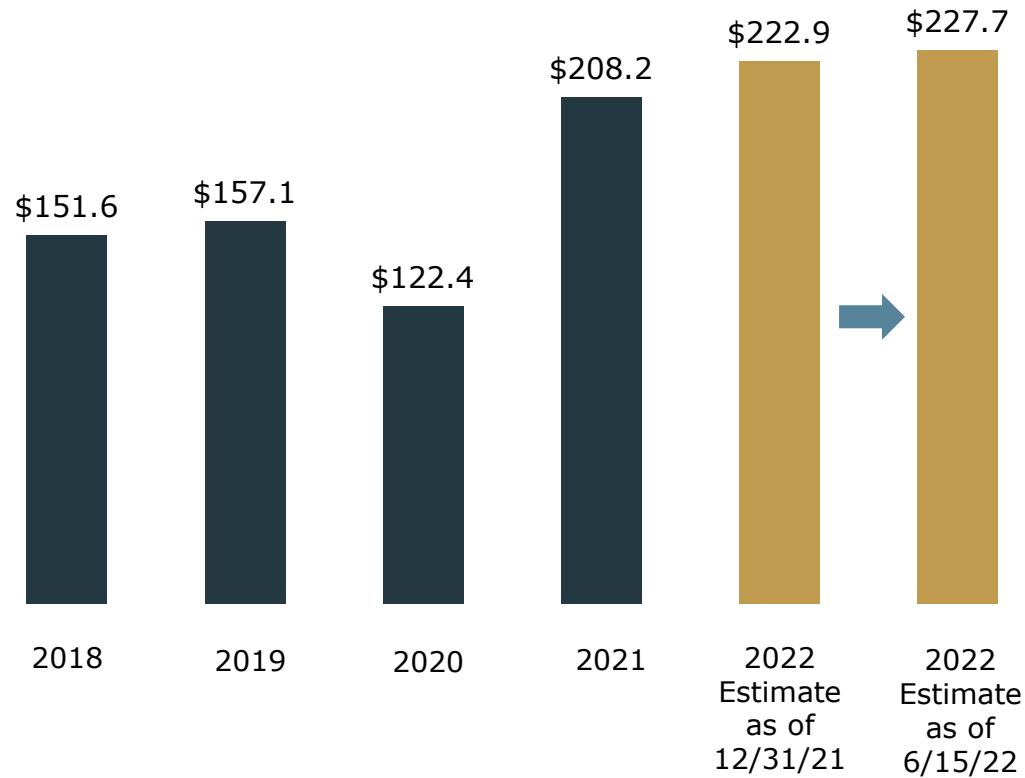
“Equity valuations are high by almost any measure and will likely constrain returns going forward; Fed tightening and persistent inflation remain risks”



Valuations look much more reasonable on a historic basis

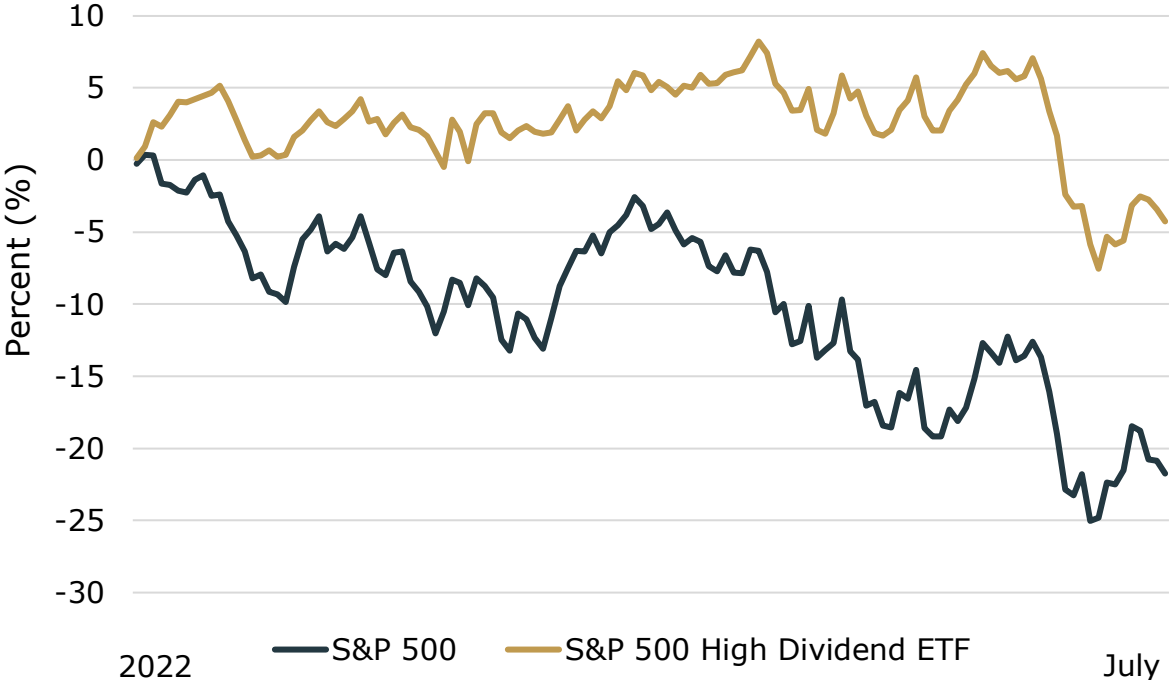
Corporate Earnings

S&P 500 earnings per share, historical and forward estimates

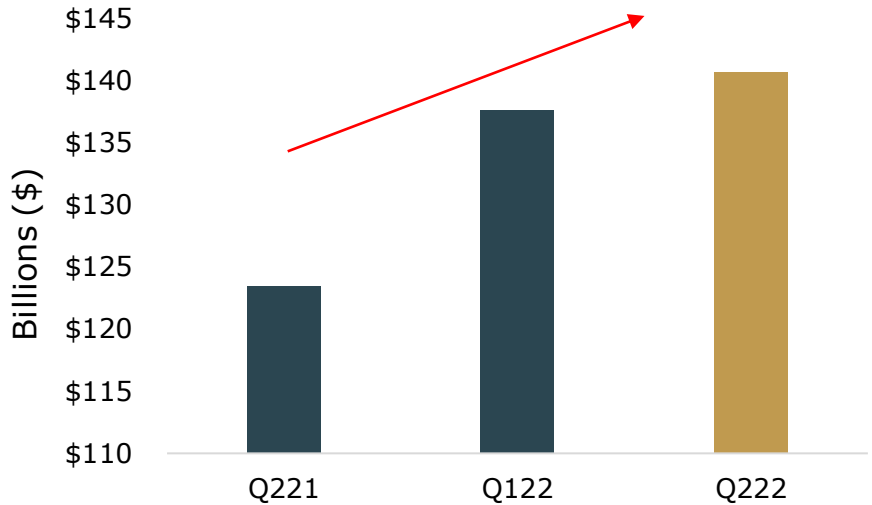


- Despite the negative headlines, earnings estimates have increased since the beginning of the year
- Current estimates represent 9% growth over 2021 earnings levels
- Given the tightening in business conditions, expect earnings estimates to decline from here, especially for the second half of 2022

Dividend Payouts Hit Record High



S&P 500 Dividend Payout

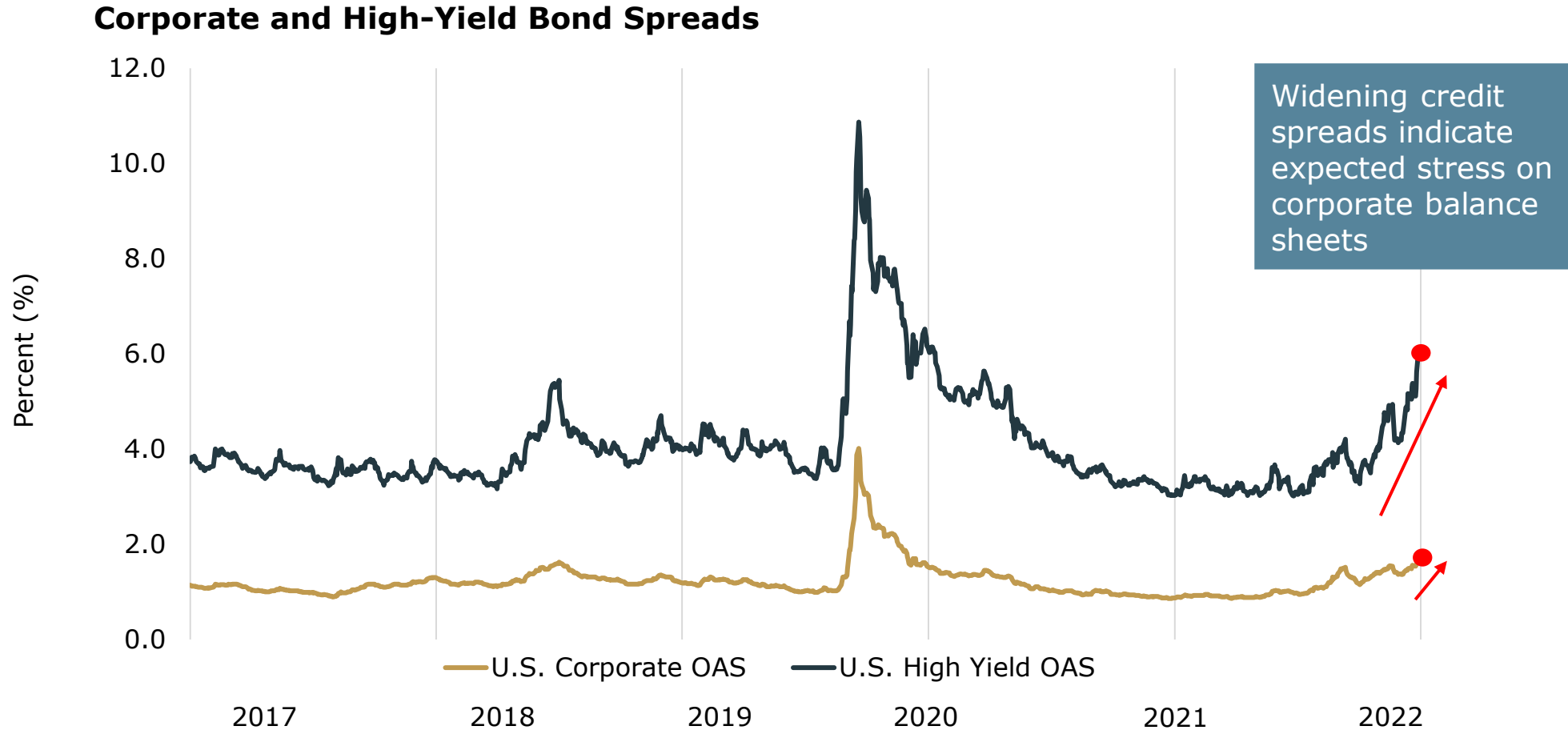


Flashback to Q4 2021 Outlook:
 "Companies will be under increased pressure to boost payouts"



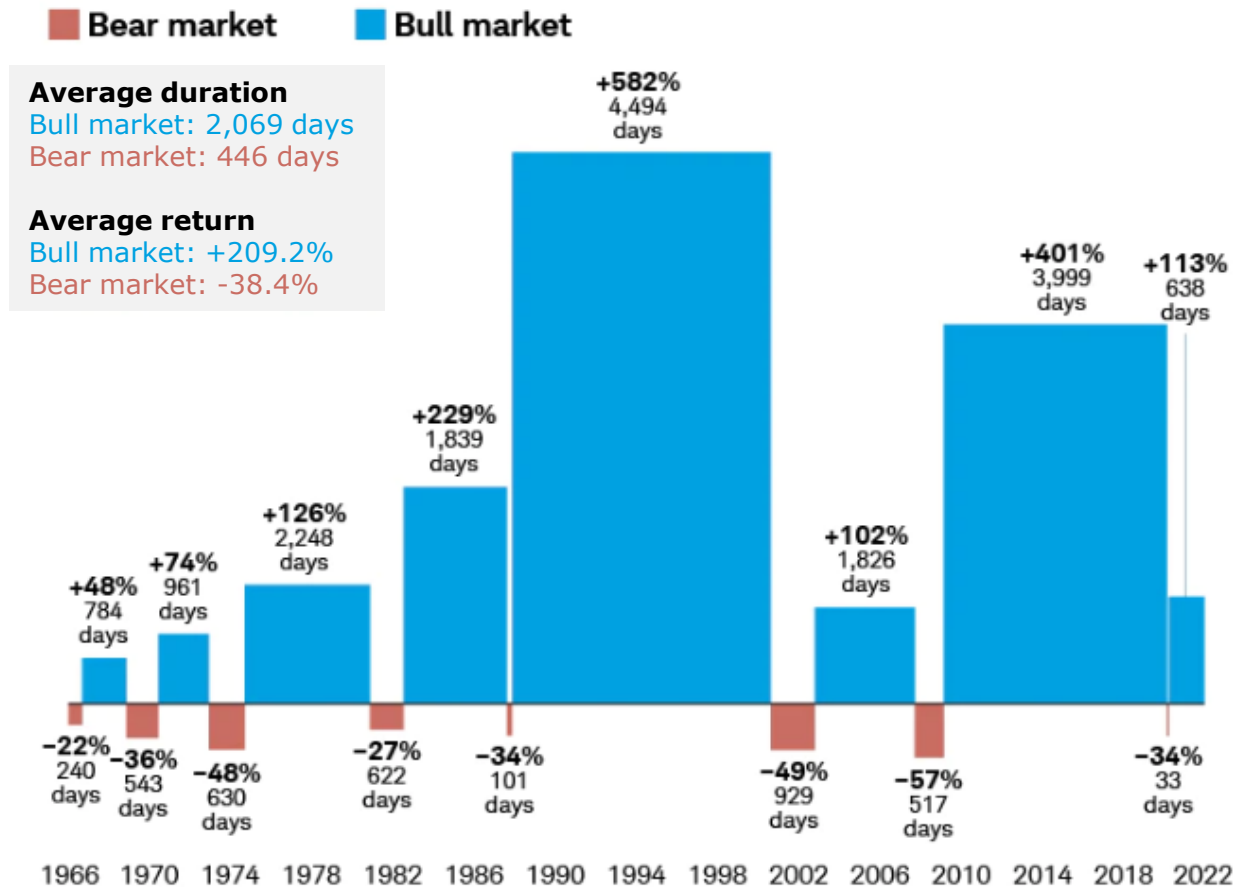
Past performance is not a reliable indicator of current or future results. Indexes are unmanaged and not subject to fees. It is not possible to invest directly in an index. Source: Kestra Investment Management with data from FactSet. Index proxies: S&P 500 Index and SPDR S&P 500 High Dividend ETF. Data as of July 13, 2022.

Corporate and High-Yield Spreads Widening



Bear Markets Don't Live Forever

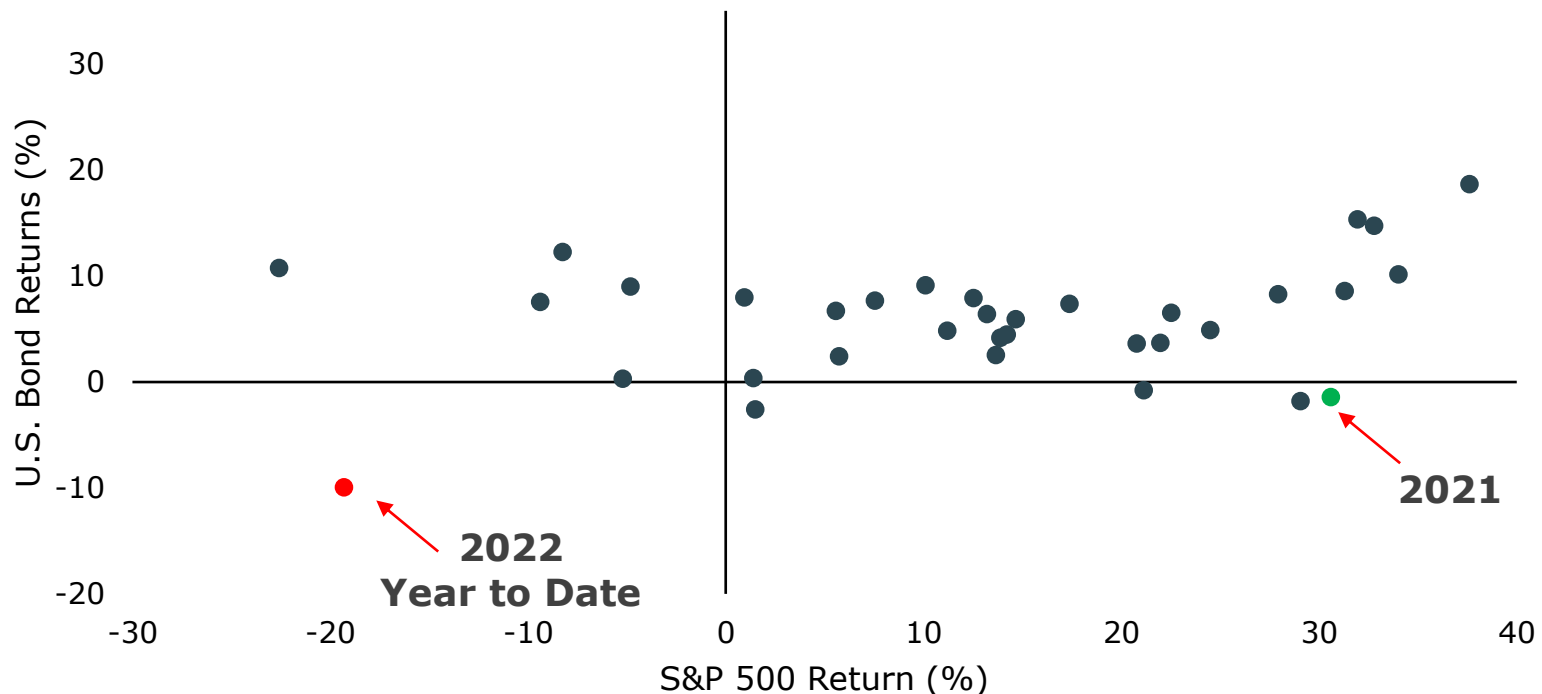
Past Bear Markets Have Tended to Be Shorter than Bull Markets



On average, bull markets have lasted almost five times longer than bear markets

Tough Start to the Year Presents an Opportunity

S&P 500 vs. U.S. AGG, annual returns, 1988-2022



“In terms of historical analysis, most of our work shows that if you have longer than a one-year time horizon, now is the time to be putting money to work rather than raising cash. Remember, the goal is to buy low and sell high, not buy high and sell low!”

— Bespoke Investment Group
6/13/22



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Live Richly**

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