DT INVESTMENT PARTNERS, LLC

Q2 2022
FINANCIAL MARKETS COMMENTARY

Inflation Fears vs. Recession Fears

RISK-BASED ASSETS PERFORMANCE SUMMARY

- During the second quarter, global stock prices fell while bond yields soared. After three consecutive years of double-digit gains, the stock market is suffering a difficult first half of the year. The S&P 500 Index is down 20% so far this year, making it the worst first half of a year since 1970. Stock prices have been hurt by rising interest rates in response to high inflation and slowing economic growth. A weak Chinese economy and a war in Ukraine that surprised commodity markets have also weighed on stocks.
- Stubbornly high inflation caused the Fed to pivot towards more aggressive monetary policy tightening, making investors reluctant to add to risk positions. Inflation is at its highest level in 40 years. At its June Federal Open Market Committee meeting, the Fed raised interest rates by 0.75% to a range of 1.50-1.75%. This was the largest per meeting rate increase since 1994. Implied fed funds futures currently project the Fed to raise the overnight fed funds rate to at least 3.25% by year end.
- Most Risk-Based Assets declined in value during the quarter. U.S. Large Cap Growth stocks led the way lower. Since stock prices reflect the present value of future earnings, the higher the interest rate, the less future earnings are worth. Given that growth companies are expected to generate more of their earnings in the future, they presumably have more to lose from rising rates. Australian stocks and U.S. Small caps also generated sizable losses during the quarter. Australia's central bank increased interest rates to tame surging inflation, while U.S. Small Cap stocks are very dependent upon economic growth and bank financing, in lieu of capital markets. During the quarter, banks significantly raised lending rates and became more credit risk averse (See Page 5).
- All U.S. Large Cap sectors fell in price during the quarter led lower by Consumer Discretionary, Communication Services, and Technology sectors. With multiple interest rate increases on the horizon, inflation at multi-decade highs, and the likelihood of lower future economic growth, investors heavily sold growth-oriented sectors.

BOND PERFORMANCE SUMMARY

- Rising inflation combined with expectations of more Fed interest rate increases contributed to a continued sell-off in the bond market during the second quarter. Bond yields rise as prices fall. The yield on 10 year maturity U.S. Treasury Notes rose to its highest level since 2011. The yield on 2 year Treasuries rose to its highest level in more than a decade. It's yield has converged with the 10 year and 30 year yields. This flattening of the yield curve signals that the bond market is anticipating a possible near-term U.S. recession. The economy has entered a recession in four of the last six times the Fed has embarked upon tightening monetary policy (raising overnight fed funds rate).
- During the final month of the quarter, yields across the Treasury curve fell/prices rose as bond investors turned their primary focus away from higher inflation and towards weaker global economic growth. Signs of an economic slowdown began to emerge as data on consumer spending, retail sales, home sales, and average hourly earnings all declined. Meanwhile, Chair Powell has stressed that the Fed will keep raising rates until it believes inflation is under control, even if that causes a recession. The Fed believes that while recessions are painful, high inflation is worse because waiting to address it could require an even more severe economic downturn in the future.
- All fixed income sectors generated negative total returns for the quarter (See Page 5). Municipal bonds had their worst start to a year in decades. From Fed rate increases to reduced investor demand, not much went right for municipal bond prices during the quarter. Once the Fed's tightening path becomes clearer, the market is primed for opportunity with some of the most attractive yield levels in a decade.

CONTRIBUTORS & DETRACTORS TO PERFORMANCE

- Contributors for the quarter vs. the Global Stock/Intermediate Bond blended benchmark included our overweight to U.S. government bonds, our bond duration shorter than the benchmark (3.5 years vs. 4.0 years), and our overweight to U.S. Large Cap Value stocks.
- Detractors to performance included our overweight allocation to risk-based assets and our underweight to fixed income. In addition, our underweight allocation to Emerging Market stocks and our outside-of-benchmark allocation to U.S. Small Cap stocks hurt performance.

- Each of the 12 recessions over the past 70 years featured a contraction in economic output and a rise in unemployment. Although output contracted in the first quarter of 2022 and appears likely to do the same in the second quarter, the unemployment rate has remained near historical lows. One of the many challenging aspects of the current economic environment is trying to forecast how likely a recession is to occur given that employers are struggling to fill the 11.4 million job openings at the end of April and the May unemployment rate sits at 3.6% (3.5% is the lowest national unemployment rate on record). Signs of further economic slowdowns will allow employers to eliminate these open/unfilled positions first before actually laying off employees. When people have jobs, they are making money. When they are making money, they are spending money which helps the economy grow. In addition, the overall level of consumer savings is still high thanks to the extraordinary amount of fiscal stimulus given out in 2020 and 2021. According to Fed data, households held $18.5 trillion in checking, savings, and money market accounts. Businesses have nearly $4 trillion in cash. Although corporate profits are slowing, margins are very high at 18% of sales over the past year. Lastly, the banking system is well capitalized and banks are still reporting that the consumer is strong and loan losses remain low. If there is a recession, we believe that it will be very shallow/mild.

- The Fed's tightening cycle is well underway with the overnight fed funds rate currently sitting at 1.50 - 1.75%, after starting the year at 0-0.25%. At its June 15th Federal Open Market Committee (FOMC) meeting, the Fed approved the largest interest-rate increase (0.75%) since 1994 and signaled it would continue lifting rates this year at the most rapid pace in decades to fight inflation that is running at a 40 year high. The 18 officials who participated in the meeting all expect the Fed to raise rates to at least 3% this year, with at least half of forecasting the fed funds rate might need to rise to 3.375% by year end. Fed Chair Powell noted "we're not trying to induce a recession now. Let's be clear about that," but he said it was becoming more difficult to achieve a soft landing, in which the economy slows enough to bring down inflation while avoiding a recession. Investors, via implied fed funds futures, are forecasting the Fed will hike rates by 0.50% in July and September, followed by 0.25% increases in November and December bringing the funds rate to 3.25% by the end of 2022, before cutting rates 0.75% by mid year 2023.

- Through monetary policy, the Fed can only slow demand to bring down inflation. They can't do anything about the supply side of the economy. We do not believe that inflation, primarily caused by a supply-side, exogenous shock (pandemic) to the global economy, will be fixed by raising interest rates. The only way for the Fed to ease supply side-induced inflation will be to shrink the economy by reducing demand. Perhaps higher prices and higher interest rates are starting to do this as economic growth is weakening. The cure for higher prices is eventually higher prices because they lead to demand destruction. Higher fuel and food costs are starting to strain budgets for consumers and businesses.

- Longer-term, the biggest question facing investors is whether or not the economy will return to secular stagnation as characterized by the pre-pandemic world of low interest rates, low inflation, and low economic growth. In such an environment, the macro forces of globalization, aging demographics, massive debt, excess savings, and technological innovation dominate the economic landscape. Or, are we moving towards a new paradigm in which de-globalization (isolating China & Russia), empowered workers, stronger unions, reduced immigration, and declining fertility rates cause a higher inflationary environment for years to come. ***Getting the answer to that question correct will be the key to generating future, strong, real risk-adjusted returns.***

- In the meantime, as the Fed faces the challenge of moderating economic growth by enough to slow inflation without driving the economy into recession, financial market volatility is likely to remain quite elevated. The Fed is in a no-win situation. If they raise rates by too much, they risk inducing an economic recession. If they tighten monetary policy too little, they risk inflation spiraling higher for longer. The challenge for investors is that the optimal portfolio in each of these scenarios is very different. A recession resilient portfolio would likely hold an overweight to U.S. Large Cap Value companies tilted towards defensive sectors such as Consumer Staples, Healthcare, and Utilities along with a large weighting in U.S. Treasuries and Cash. An inflation fighting portfolio would have large allocations to Commodities and U.S. Large Cap stocks in the Energy, Materials, and Financial sectors along with short maturity bonds.

- The stock and bond markets are very oversold. The speed and magnitude of the YTD draw down has been almost unprecedented. We believe that stock prices are much closer to bottoming than dropping another 10% or more. Bonds have already started to rally in price based upon the notion that the current path of projected Fed interest rate increases will cause the economy to slow by enough later this year to make the Fed pause rate hikes and then reverse course.

- In order for there to be a sustained rally in stocks, investors need clarity of where interest rates are heading and how quickly the Fed will be able to control inflation. Some combination of a few of the following needs to occur. First of all, investors need to see signs that inflation has peaked. Currently, headline CPI is 8.6%, while the Fed's preferred measure – Core PCE is 4.7%. The Fed has explicitly stated that it would like to see Core PCE move much closer to 2%.

- While 1-2 months of data do not make a trend, signs are starting to emerge that inflation may soon be slowing. Perhaps the Fed's efforts to slow the economy by raising interest rates are reducing demand. Average hourly earnings are trending lower, while home prices are beginning to decline. Home price growth is decelerating and existing home sales have dropped in four consecutive months. Oil prices appear to have peaked in early June while the prices of natural gas, copper, aluminum, lumber, wheat, soybeans, corn, and cotton have all been declining over the past two months or more. The University of Michigan final June reading of long term U.S. consumer inflation expectations fell from a 14 year high. Consumer Confidence is at the lowest level in more than a year and retail sales plunged in May.

- Weaker economic data can lead to weaker inflation data and potentially a pause or end to Fed interest rate increases. In addition, a continued easing of Covid-lockdowns in China and eventual re-opening of the economy should help to ease supply chain

- pressures, enabling supply to come back into better balance with demand. The Chinese government recently reduced quarantine period for travelers. Lastly, and most unlikely, any truce or end to the war in Ukraine would possibly bring about a further global drop in energy and food prices. There are no current signs of this happening.

- We continue to believe that being patient and letting the stock market work itself out is the best strategy. Going to cash right now can have negative tax implications and does create the future problem of when to get back into the market at possibly higher prices. Human behavior studies validate that in highly volatile times, it is much easier to decide when to sell than when to buy/get back in.

- We are close to neutral versus our strategic targets for risk, bonds, and cash. In particular, we are overweight U.S. Large Cap stocks, Gold, and Government bonds and have very little to no allocation to Emerging Market stocks, High Yield bonds, and Mortgage-Backed Securities. For the first time in a long time, bond yields look relatively attractive. Municipal bond demand dwindled to start the year, though we expect that to increase. Fundamentals remain strong as the sell-off so far has not put undue strain on credit in the municipal market. We will continue to focus on credit and preservation of capital and look to take advantage of the rise in yields.

- While no investment process can completely avoid losses, we want to reassure you that we have an investment discipline that revolves around fundamental analysis, valuations, and technical analysis. While there is no denying that this type of volatility is unpleasant as no one likes to see their account values decline, times like this validate the importance of investing in an asset allocation that is consistent with each investor's risk tolerance and long-term investment goals. We will continue to keep you updated on our thoughts and any future portfolio changes.

Andrew Zimmerman, Chief Investment Strategist

ASSET CLASS TOTAL RATE OF RETURN PERFORMANCE SUMMARY AS OF 6/30/2022

Stock Indices	Asset Class	QTD Return	YTD Return	1 Year Return
MSCI AC World Daily TR N	Global Equities	-15.66%	-20.18%	-15.75%
S&P 500 INDEX	U.S. Large Cap Equities	-16.11%	-19.97%	-10.64%
RUSSELL 1000 GROWTH INDX	U.S. Large Cap Growth Equities	-20.92%	-28.07%	-18.77%
RUSSELL 1000 VALUE INDEX	U.S. Large Cap Value Equities	-12.22%	-12.87%	-6.86%
S&P 400 MIDCAP INDEX	U.S. Mid Cap Equities	-15.44%	-19.57%	-14.69%
RUSSELL 2000 INDEX	U.S. Small Cap Equities	-17.21%	-23.45%	-25.24%
MSCI EAFE	International Developed Market Equities	-14.32%	-19.23%	-17.26%
MSCI Daily TR Net Austra	International Developed Market Equities - Australia	-18.11%	-12.18%	-13.05%
MSCI EM	Emerging Market Equities	-11.40%	-17.57%	-25.08%
U.S. Large Cap Sector Stock Indices				
S&P 500 ENERGY INDEX	U.S. Large Cap Equities - Energy Sector	-5.29%	31.64%	39.55%
S&P 500 HEALTH CARE IDX	U.S. Large Cap Equities - Health Care Sector	-5.91%	-8.33%	3.37%
S&P 500 CONS DISCRET IDX	U.S. Large Cap Equities - Consumer Discretionary Sector	-26.16%	-32.82%	-24.20%
S&P 500 CONS STAPLES IDX	U.S. Large Cap Equities - Consumer Staples Sector	-4.62%	-5.58%	6.66%
S&P 500 INFO TECH INDEX	U.S. Large Cap Equities - Information Technology Sector	-20.24%	-26.91%	-13.56%
S&P 500 UTILITIES INDEX	U.S. Large Cap Equities - Utilities Sector	-5.09%	-0.56%	14.29%
S&P 500 INDUSTRIALS IDX	U.S. Large Cap Equities - Industrials Sector	-14.78%	-16.79%	-13.43%
S&P 500 COMM SVC	U.S. Large Cap Equities - Communication Services	-20.71%	-30.16%	-29.05%
S&P 500 MATERIALS INDEX	U.S. Large Cap Equities - Materials Sector	-15.90%	-17.90%	-8.73%
S&P 500 FINANCIALS INDEX	U.S. Large Cap Equities - Financials Sector	-17.50%	-18.73%	-12.72%
S&P 500 REAL ESTATE IDX	U.S. Large Cap Equities - Real Estate Sector	-14.72%	-20.11%	-5.31%
Commodities Indices		**QTD Return**	**YTD Return**	**1 Year Return**
ISHARES GOLD TRUST	Gold	-6.84%	-1.44%	1.78%
S&P GSCI Tot Return Indx	Broad Commodities	2.01%	35.80%	45.05%
Bond Indices				
U.S. Aggregate	Core Bonds	-4.69%	-10.35%	-10.29%
Intermediate	Intermediate Government & Corporate Bonds	-2.37%	-6.77%	-7.28%
U.S. Corporate High Yield	High Yield Debt	-9.83%	-14.19%	-12.81%
U.S. Treasury	U.S. Treasuries	-3.77%	-9.14%	-8.90%
U.S. TIPS	U.S. TIPs	-6.08%	-8.92%	-5.14%
U.S. Agency	U.S. Government Agencies	-1.86%	-5.98%	-6.48%
U.S. MBS	Mortgage-Backed Securities	-4.01%	-8.78%	-9.03%
Corporate	Corporate Debt	-7.26%	-14.39%	-14.19%
Municipal Bond Index	Municipal Debt	-2.94%	-8.98%	-8.57%
S&P PREFER STOCK IX CME	Preferred Stock	-9.54%	-18.01%	-19.23%

Sources: Bloomberg and DT Investment Partners. Investors cannot invest in a market index directly, the performance of an index does not represent any actual transactions and its performance does not reflect the deduction of any fees or expenses associated with actual investing. Market performance information is included on this slide solely to demonstrate the potential benefits historically associated with long-term investing in a portfolio of well-diversified asset classes and does not represent or suggest results DT Investment Partners would or may have achieved when managing client portfolios

Notes

The DT Investment Partners' Commentary and Outlook discusses general developments, financial events in the news and broad investment principles. It is provided for information purposes only. The material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. Investments in various asset classes entail different investment risks. For example, small cap stocks tend to be more volatile than large or mid-cap stocks. International and emerging markets stocks have exposure to currency fluctuations, foreign taxes, political instability and the possibility for illiquid markets. Fixed income investments involve interest rate and credit risks among others. Real estate investing includes risks such as declines in value of real estate, changing economic conditions, tax laws or property taxes. Commodities' investing is highly volatile and subject to changing economic conditions and the vagaries of speculators among other risks. One cannot invest directly in an index. Past performance does not guarantee future results.