DT INVESTMENT PARTNERS, LLC

Q4 2022
FINANCIAL MARKETS COMMENTARY

Investor Concerns Shift from Inflation to Economic Growth

DT INVESTMENT PARTNERS

RISK-BASED ASSETS PERFORMANCE SUMMARY

- For most of the fourth quarter, stock prices rose in anticipation of the Fed slowing its level and pace of interest rate increases. Various measures of inflation appear to have peaked and are beginning to slow. Even though the Fed has raised its overnight funds rate from 0% to 4.50% since March, the economy, jobs market, and corporate profits were not signaling that a recession was imminent. Optimistic views for a soft landing (falling inflation without economic contraction) infused the risk-based financial markets.

- And then on December 14th, at the final Federal Open Market Committee meeting of the year, the Fed squashed investor optimism by signaling plans to raise interest rates through the spring, though likely in smaller (0.25%) increments, to fight inflation which has recently been showing signs of weakening. Most committee members were hawkish relative to expectations with the median projection of where rates will end up between 5.0% and 5.5% which would mean another 0.75% of monetary policy tightening. Back in September, Fed members projected rate increases to end at 4.6% in early 2023.

- Despite the hawkish surprise from the Fed's last meeting of the year, all Risk-Based Assets rose higher in value during the quarter led by International Developed Market and U.S. Large Cap Value stocks **(See Page 5).** After a once-in-a-generation rally in the value of the U.S. dollar for much of the year, the dollar declined 8% during the quarter and investors sought areas of the market that offered attractive relative valuations. Value stocks include dividend payers which have historically performed well in inflationary markets. Although negative earnings revisions have recently increased thanks to profit margin pressure from inflation and monetary policy tightening, more than 90% of S&P 500 firms that pay a dividend report that they plan to keep or increase their dividend.

- Except for Consumer Discretionary and Communication Services stocks (Tesla, Amazon, Meta & Google), all U.S. Large Cap sectors rose in price led by Energy, Industrials, and Materials. Investors favored companies with high dividend yields and low valuations.

BOND PERFORMANCE SUMMARY

- Investment grade bonds posted consecutive yearly losses for the first time ever. However, after rising in yield/declining in price for each of the previous five quarters, yields fell/prices rose during the final quarter of the year, reflecting optimism that inflation will soon begin to fall. When considering the aggressive pace and level of Fed rate increases since March, fixed income investors bought intermediate to long maturity Treasuries during the quarter in anticipation of a rapidly slowing economy once the full impact of Fed tightening was felt. Yields on longer-term Treasuries fell further below short-term Treasuries by the most in decades indicating that traders expect the Fed will eventually need to reverse course and slash interest rates to counter a slowing economy. As the fourth quarter ended, 2 Year Treasuries yielded 4.43% and 10-Year Treasuries yielded 3.88%.

- An inverted yield curve signals that investors believe short-term interest rates will be lower in the longer-term than in the near-term because the Fed will need to cut rates (reduce borrowing costs) to revive a weakening economy. In the bond market, an inverted yield curve has been a very reliable predictor of recessions. In the past 40 years, only once has an inverted yield curve not predicted an economic downturn within 18 months after the yield curve inverts.

- The yield cushion now provided by bonds protects the investor against negative total returns significantly more than it did at the beginning of the year. Investment grade bond yields are at their highest levels in the past 15 years. Investors took notice of the attractive opportunity to generate income and provide stability to a portfolio as Treasury yields for 3–30 maturities fell/prices rose, and all fixed income sectors generated positive total returns for the quarter (See Page 5). Municipal bonds rebounded nicely during the quarter and outperformed most taxable fixed income sectors for the year.

CONTRIBUTORS & DETRACTORS TO PERFORMANCE

- Contributors for the quarter vs. the blended benchmark (Global Stock/Intermediate Bond) index included our overweight allocations to U.S. Large Cap Value and U.S. Mid Cap stocks.

- Detractors included our underweight to risk-based assets, particularly International stocks, and our slight overweight to cash.

- The fourth quarter began with hopes that the Fed would see enough weakening in the inflation data that it would pivot to a pause in interest rate increases and then begin to cut rates. The Consumer and Producer Price indices for both October and November posted their smallest monthly advances in more than a year, indicating the worst of inflation has likely passed.

- The Consumer Price Index rose 7.1% year-over year in November, a slowdown from 7.7% in October. Overall inflation has been decelerating on a year-over-year basis since hitting a peak near 9% in June. After stripping out the volatile food and fuel prices, the index climbed by 6%. The slowdown in inflation was driven by food, energy, and used vehicles. Food price inflation slowed, but grocery bills remain historically high. Oil prices moved slightly lower while the cost of gasoline fell by 54% from its 14 year high reached on 8/22.

- China has begun to ease Covid lock-down restrictions and global supply chains have come back into better balance as consumers turn their spending away from goods to services. It appears that inflation has peaked and is coming down, albeit at a relatively slow pace. Meanwhile, cracks have started to emerge in the economy. Industrial production, factory orders, retail sales, new and used car purchases, new and exiting house purchases, and manufacturing and services purchasing manager indexes have all been trending lower.

- While inflation may have peaked and appears to be easing and various other economic indicators are pointing to an economic slowdown, the labor market remains tight. Although the U.S. Job Openings Rate has been falling, there are still 1.6 job openings per unemployed person. The job market remains tight with an unemployment rate of 3.7%. Wage growth doesn't appear to be letting up with average hourly earnings growing at 5.1% from a year earlier. Clearly, the demand for workers remains higher than the supply which may cause the Fed to either increase rates higher than forecast or keep rates at restrictive levels for longer.

- Interest rate derivatives currently suggest that the Fed will raise the overnight fed funds rate from 4.50% to 5.25% by the middle of 2023 before cutting rates in the second half of the year in response to slowing economic growth and falling inflation.

- Essentially, investors think inflation will decline by enough and a deep economic recession will be avoided. Futures markets are indicating a 2% cut in interest rates by the Fed from mid-2023 thru mid-2024. However, the Fed's median interest rate projections show the funds rate peaking at 5.25% next year as the Fed pauses rate increases but holds them there until at least 2024. In otherwards, markets are forecasting that the Fed will be reducing rates sooner than what Fed members are forecasting.

- The Fed has continually stated their desire to raise interest rates to a level that they determine will be enough to lower inflation closer to their 2% target, even it means raising unemployment and reducing economic growth. ***Historically, monetary policy has acted with long lags so the inevitable economic slowdown will take some time to play out. The U.S. economy appears to be on a path of low, but sustainable growth. Given the underlying strength in the labor market, the economy may be on this path for quite some time.***

- The labor market has recently cooled a bit, but wages are still rising faster than what would be compatible for the Fed's 2% inflation target. The unemployment rate currently sits at 3.7% . Signs of further economic slowdowns will allow employers to eliminate historically high open/unfilled positions first before laying off employees. When people have jobs, they are making money. When they are making money, they are spending money and the economy is growing.

- If the U.S. economy does enter recession (negative Gross Domestic Product for at least two consecutive quarters) in 2023, it will be the most anticipated recession in the history of mankind. The consensus view broadly calls for a mild recession or very weak economic growth with the damage to corporate earnings offset by the Fed cutting interest rates by the end of next year and stocks generating small, but positive returns. We are skeptical about the consensus forecast because it has been so widely talked about for the past several months. Financial markets tend to deliver the maximum amount of punishment to as many investors as possible when a mass of market participants all think the same thing and possession their portfolios in the same fashion, a.k.a. the Pain Trade.

- We are closely watching for two potential alternatives to the view of the herd. First, if a recession does materialize, and end up being much deeper and longer in duration than expected, corporate earnings would deteriorate significantly along with stock prices, while bonds would rally in price/yields fall. The second alternative would involve the economy being able to shrug off aggressive Fed policy tightening and start to rapidly grow if inflation does prove to be transitory. Stocks should do well if this were to occur, while bonds may struggle.

- **The bearish narrative for stocks has shifted. A few months ago, it was persistently high inflation necessitating a more aggressive Fed. Currently, it is fear of recession in 2023 that will hurt corporate earnings.** Either way, bears would say common stocks are not worth buying. ***Bulls would argue that historically, when interest rates start to fall, investors have been rewarded by looking beyond the immediate trough in earnings and buying stocks in anticipation of a better economy ahead. We agree.***

- Most bond investors remain hopeful that inflation has peaked and will fall in 2023, are concerned about economic growth in 2023, and are skeptical that the Fed will be able to raise interest rates much higher from current levels. ***Individual investment grade bonds currently present an attractive opportunity to generate income and provide stability.*** U.S. Treasury yields are at their highest levels since 2007. Most, if not all, of the rise in bond yields for this economic cycle may have already occurred. In our view, there is a greater likelihood that we have seen the peak in yields and over the next year, bond yields will be lower/prices higher.

- If inflation does ultimately prove to be transitory, it will be because the macro headwinds of aging demographics, declining fertility rates, massive global debt levels, and rapid technological innovation are still too great for inflation to become permanently entrenched.

- The biggest question facing investors right now is do we return to the pre-pandemic world of low rates, low inflation, and low economic growth with relatively easy monetary policy because the macro forces of globalization, aging demographics, massive debt levels, abundant savings, and technological innovation dominate the economic landscape or does de-globalization (isolating China & Russia), empowered workers (stronger unions), and reduced immigration lead to a higher inflationary environment and tighter monetary policy (higher rates) for years to come? We will keep you informed of our thoughts and findings as the situation progresses.

- For now, we are slightly under-weight our strategic targets for risk and bonds, and overweight cash. Specifically, we are overweight U.S. Large, Mid, and Small Cap stocks and U.S. Government bonds. We are equal-weight High Yield bonds and Gold and underweight International Developed Market stocks and Investment Grade Corporate bonds. We have no direct allocation to Emerging Market stocks, Real Estate, and Mortgage-Backed Securities.

- After having their worst performance year since 1981, Municipal bond prices should rebound in 2023 given the technical and fundamental outlook. Supply is slated to drop in 2023, while demand should be robust. Income will be the key component of total return next year as yields are likely to be range-bound. We will continue to focus on credit and preservation of capital first and foremost.

- As the Fed faces the challenge of moderating economic growth by enough to slow inflation without driving the economy into recession, market volatility is likely to remain elevated. With our overweight in cash, we continue to search for opportunities to add to risk and bonds at some of the cheapest levels since 2007-08.

Andrew Zimmerman, Chief Investment Strategist

ASSET CLASS TOTAL RATE OF RETURN PERFORMANCE SUMMARY AS OF 12/31/2022

Stock Indices	Asset Class	QTD Return	1 Year Return
MSCI AC World Daily TR N	Global Equities	9.76%	-18.36%
DOW JONES INDUS. AVG	U.S. Large Cap Equities	16.01%	-6.86%
NASDAQ COMPOSITE	U.S. Large Cap Equities	-0.78%	-32.51%
S&P 500 INDEX	U.S. Large Cap Equities	7.55%	-18.13%
RUSSELL 1000 GROWTH INDX	U.S. Large Cap Growth Equities	2.19%	-29.14%
RUSSELL 1000 VALUE INDEX	U.S. Large Cap Value Equities	12.40%	-7.56%
S&P 400 MIDCAP INDEX	U.S. Mid Cap Equities	10.76%	-13.10%
RUSSELL 2000 INDEX	U.S. Small Cap Equities	6.20%	-20.46%
MSCI EAFE	International Developed Market Equities	17.40%	-13.92%
MSCI Daily TR Net Austra	International Developed Market Equities - Australia	15.68%	-5.25%
MSCI EM	Emerging Market Equities	9.62%	-19.94%
U.S. Large Cap Sector Stock Indices			
S&P 500 ENERGY INDEX	U.S. Large Cap Equities - Energy Sector	22.74%	65.43%
S&P 500 HEALTH CARE IDX	U.S. Large Cap Equities - Health Care Sector	12.80%	-1.95%
S&P 500 CONS DISCRET IDX	U.S. Large Cap Equities - Consumer Discretionary Sector	-10.18%	-37.03%
S&P 500 CONS STAPLES IDX	U.S. Large Cap Equities - Consumer Staples Sector	12.72%	-0.62%
S&P 500 INFO TECH INDEX	U.S. Large Cap Equities - Information Technology Sector	4.74%	-28.19%
S&P 500 UTILITIES INDEX	U.S. Large Cap Equities - Utilities Sector	8.64%	1.56%
S&P 500 INDUSTRIALS IDX	U.S. Large Cap Equities - Industrials Sector	19.18%	-5.51%
S&P 500 COMM SVC	U.S. Large Cap Equities - Communication Services	-1.38%	-39.89%
S&P 500 MATERIALS INDEX	U.S. Large Cap Equities - Materials Sector	15.05%	-12.28%
S&P 500 FINANCIALS INDEX	U.S. Large Cap Equities - Financials Sector	13.56%	-10.57%
S&P 500 REAL ESTATE IDX	U.S. Large Cap Equities - Real Estate Sector	3.82%	-26.21%
Commodities Indices			
ISHARES GOLD TRUST	Gold	9.71%	-0.63%
S&P GSCI Tot Return Indx	Broad Commodities	3.44%	25.99%
Bond Indices	**Asset Class**	**QTD Return**	**1 Year Return**
ISHARES CORE U.S. AGGREGATE	Core Bonds	1.58%	-13.02%
ISHARES INTERMEDIATE GOVERNM	Intermediate Government & Corporate Bonds	1.48%	-8.29%
SPDR PORTFOLIO HIGH YIELD BO	High Yield Debt	4.79%	-10.58%
ISHARES 3-7 YEAR TREASURY BO	U.S. Treasuries	1.15%	-9.51%
ISHARES TIPS BOND ETF	U.S. TIPs	1.92%	-12.24%
ISHARES AGENCY BOND ETF	U.S. Government Agencies	0.68%	-7.77%
ISHARES MBS ETF	Mortgage-Backed Securities	2.22%	-11.74%
ISHARES 5-10Y INV GRADE CORP	Corporate Debt	3.68%	-14.01%
ISHARES NATIONAL MUNI BOND E	Municipal Debt	3.68%	-7.35%
S&P PREFER STOCK IX CME	Preferred Stock	-3.77%	-23.91%

Sources: MSCI, Standard & Poor's, Dow Jones, NASDAQ, Russell, & Blackrock IShares. 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

DT INVESTMENT PARTNERS

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.