GIA PARTNERS

*1st Quarter 2022*

**Highlights**

- **Fixed income markets had their worst quarterly performance in over forty years on the combination of higher interest rates and war. Our portfolios underperformed modestly.**
- **Despite the Omicron pause, the economy enjoyed momentum as the quarter started. Economic activity held in well given the quarter's headwinds. It will likely decelerate further in 2H 2022.**
- **The war worsened supply chain jams, boosted commodity prices, and altered economic outlooks. The Fed's predicament became more acute, prompting a yield curve inversion and talk of recession.**

## Markets

| | | Returns (%) | | | |
|---|---|---|---|---|---|
| **GIA*** | Average Quality | 1Q22 Gross | 1Q22 Net | 12 Months Gross | 12 Months Net |
| **Core Plus Composite** | **(A)** | **-6.13** | **-6.21** | **-3.24** | **-3.58** |
| **Global Investment Grade Composite** | **(A-)** | **-7.10** | **-7.19** | **-3.32** | **-3.70** |
| **Global Credit Plus Composite** | **(BBB)** | **-6.68** | **-6.79** | **-3.15** | **-3.63** |
| **High Yield Composite** | **(BB-)** | **-4.94** | **-5.07** | **-0.24** | **-0.79** |
| **Emerging Market Corporate Debt Composite** | **(BB+)** | **-6.85** | **-6.99** | **-3.31** | **-3.89** |
| *Benchmark Bonds* | | | | | |
| Bloomberg Barclay's U.S. Agg. Index | (AA+) | -5.93 | | -4.15 | |
| Treasury | (AAA) | -5.58 | | -3.67 | |
| Corporate | (A-) | -7.69 | | -4.20 | |
| Mortgage | (AAA) | -4.97 | | -4.92 | |
| Government/Credit | (AA) | -6.33 | | -3.85 | |
| ICE BofA U.S. Corporate & Yankees | (A-) | -7.73 | | -4.57 | |
| ICE BofA U.S. Corporate | (A-) | -7.74 | | -4.31 | |
| ICE BofA U.S. High Yield | (B+) | -4.51 | | -0.29 | |
| ICE BofA EM Corporate Plus | (BBB) | -9.02 | | -8.93 | |
| ICE BofA Global Gov't ex-US | (AA-) | -4.16 | | -4.19 | |
| JPM Emerging Markets EMBI GD | (BB+) | -10.02 | | -7.44 | |
| JPM CEMBI Broad Diversified | (BBB-) | -8.82 | | -7.25 | |
| JPM GBI-EM Global Diversified | (BBB+) | -6.46 | | -8.53 | |
| *Benchmark Equities* | | | | | |
| S&P 500 | NA | -4.95 | | 14.03 | |
| Nasdaq Composite | NA | -9.10 | | 7.35 | |
| Russell 2000 | NA | -7.80 | | -6.77 | |
| MSCI EAFE | NA | -6.61 | | -1.21 | |
| MSCI Europe | NA | -8.41 | | 0.79 | |
| MSCI Japan | NA | -7.61 | | -8.36 | |
| MSCI Emerging Markets Equity | NA | -7.32 | | -13.27 | |

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

## Markets

A quarter that started with optimism on the "reopening" was pummeled by surprising events that continue and are reshaping expectations for 2022 and beyond. Financial markets reacted fiercely to prospects of higher interest rates, an unprovoked war, and debilitating inflation. Fixed income markets suffered most in relative terms, posting their worst quarterly performance in over forty years. Returns were negative across almost every sector, including typically safe floating rate instruments. Longer duration sectors like U.S. treasuries and investment grade credit suffered sharp price declines as rates rose in reaction to inflation and the Fed's more aggressive tightening posture. Even mortgage-backed securities, traditionally shorter duration instruments, declined -5.05% with higher rates and lengthening duration. Equities did not escape the drawdown, although most markets finished well above their worst levels of the quarter. The S&P 500 returned -4.95%, after being down over -10.6% in mid-March. Nasdaq fared worse declining -9.11% after recovering from a near -20% pasting as of the close on March 14. The war did benefit some, including commodity investors (and producers) who witnessed rapid price increases across energy, metals, and grains. The Bloomberg Commodity Index rose +25.78% for the quarter.

Investment grade credit posted the worst returns among fixed income sectors as the combination of higher yields and wider spreads hurt this longer duration asset class. Thankfully, a recovery in the final two weeks of the quarter prevented a worse outcome. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down -7.74% for the quarter after being down nearly 9.0% through mid-March. By comparison, the U.S. treasury index (G0Q0) returned -5.56% for the quarter. Corporate option adjusted spreads (OAS) widened by 23 b.p. to 120 b.p., while the yield to worst of the index increased from 2.34% to 3.59%. Investment grade issuance was remarkably resilient considering the interest rate environment and Russia's actions. For the quarter, issuance reached $508.9 billion, including a healthy $243.6 billion in March, the highest monthly total since May 2020.

The high yield market had respectable relative performance, although it did not escape the volatility wrought by higher yields, rising inflation, and the conflict in Ukraine. High yield borrowers entered the year in strong financial shape with record low default rates and supportive financial conditions. The ICE BofA U.S High Yield Index (H0A0) was down -4.51% for the quarter. As the world pursued "reopening" attempts, interrupted by new Covid variants, service-related industries began to see increased demand and recovery. Energy, the largest industry in the index, returned -2.42% for the quarter, including a positive return in March, on the heels of higher oil prices. The spread to worst widened by 37 b.p. from 327 b.p. to 364 b.p., while the yield to worst rose from 4.28% to 5.93%. High yield retail investors compounded the fragile market sentiment by withdrawing funds every month for a total of $25.3 billion, the largest quarterly outflow on record. The default rate hit another record low of 0.23% in March, not including distressed exchanges, as only one company defaulted. Including distressed exchanges, the rate increased to 0.5% after media company Diamond Sports was forced to seek bondholder support. The new issue market cooled meaningfully after record borrowing last year. For the quarter, issuance was only $46.5 billion, about $112 billion below last year's first quarter volume.

Emerging markets bonds suffered during the quarter largely due to Russia's and Ukraine's presence in emerging markets indexes, and a tightening of financial conditions. Russian and Ukrainian bonds lost most of their value as sanctions affected Russia's ability to pay and destruction prevented Ukrainians from generating enough cash flow to pay. A silver lining for many other countries was the windfall from higher commodity prices. Away from Russia and Ukraine, reported 2021 economic data showed many countries delivered better growth rates than originally forecast due to successful vaccination campaigns and, apart from China, less restrictive isolation policies. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index that includes Russian and Ukrainian external debt, was down -10.02%, the JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) which includes Russian and Ukrainian corporate bonds suffered from the collapse of those prices, returned –8.82%, and the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index declined -6.63%.

## Economy

As if the global economy had not gone through enough after two years of Covid-19, an unprovoked and unnecessary war threw a whole new array of imponderables into the mix. Visible relief from pandemic-related supply chain disruptions got truncated and the likelihood of commodity shortages grew. The whole world was forced to recalibrate the economic outlook and adjust expectations for inflation, interest rates, central bank policies, corporate earnings, housing demand, and government response.

After more than a month of fighting, we believe a few conclusions can be drawn. Sanctions on Russia will likely persist as long as Putin remains in power. The country's $1.8 trillion dollar economy will likely contract by 20 to 30% over the next year and continue to deteriorate over the longer term. The hit to global growth from Russia's isolation will likely be about 0.5% in 2022 and rise closer to 1.0% over two years as collateral effects are included. However, Russia's isolation will prompt other countries and firms to fill the void by boosting production.

Acknowledging it was behind in addressing inflation, the Fed added urgency to its rate hikes and balance sheet reduction. Financial markets reacted negatively as fears of sharply higher rates caused credit spreads to widen and mortgage rates to jump. The yield curve even inverted at the end of the quarter, leading economists to voice recessionary concerns.

A review of industries confirmed the prevalence of cost pressures across products and services, including in the politically sensitive food and energy channels. A particularly acute concern was the shortage and cost of labor. Auto and industrial product supply chain woes appear unresolved with companies desperately searching for alternatives. Consumer products companies face an undesirable combination of higher raw materials prices and squeezed margins. With the withdrawal of Russian and Ukrainian grains, the world's food requirements will likely be unmet pressuring prices and incenting growers to plant more. In time, fertile regions like Brazil and the U.S. can fill the void, but this year's deficit may cause serious problems in poorer regions. Finally, leisure, entertainment, and travel services are enjoying a long-awaited recovery, although they are struggling to meet demand with fewer employees and lingering health care protocols.

## Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing about 3.5% at an annual rate in 2Q and slightly slower (2.5% to 3.0%) in 3Q. A mix of countervailing forces will likely drive economic activity over the next six months. On the positive side, pent-up demand for services like travel and entertainment will likely boost expenditures in those industries. Furthermore, ongoing investment activity like home purchases, building construction, renovations, and repairs will be completed during the next few months assuring ongoing demand into the summer. Holding back a more robust growth rate will be higher interest rates, supply chain disruptions, and high energy prices. These hurdles may slow housing demand, postpone some purchases, and cause consumers to delay plans. While these conflicting forces will still likely settle on a positive outcome, the constraints will likely cause the economy to decelerate toward the latter half of the year. PROBABILITY 60%

2. A second scenario has the economy slowing to a 1.0% to 1.5% annual growth rate during the next six months. The economy's headwinds: 1) a tightening Fed, higher interest rates, and sluggish financial markets; 2) inflation, supply chain jams, and personnel shortages; and 3) an armed conflict, economic sanctions, and the diversion of resources, may outweigh the tailwinds of healthy consumer and corporate balance sheets. Furthermore, Covid-19 took a back seat to the war even though the virus, and its variants, have likely become endemic. Some countries like China continue to pursue more aggressive policies that will likely reduce their growth prospects. In addition, the appearance of a more virulent variant could reverse the world's progress. All of this paints a scenario of quicker economic deterioration. PROBABILITY 20%

3. A third scenario has the economy expanding at a faster pace of 3.5 to 4.0% at an annual rate during the next six months. In this scenario, personal consumption remains robust, aided by low unemployment and higher income. A cessation in hostilities, although unexpected, could materialize. Such an event would be met with a concerted effort to reconstruct Ukraine and an ongoing effort to replace Russian products. These actions could boost global activity, including in the U.S. PROBABILITY 20%

**Market Outlook**

Russia's invasion of Ukraine and the ensuing sanctions threw a wrench into what many expected to be a controlled tightening cycle. Before the war broke out, the anticipated withdrawal of emergency stimulus by the Fed was cushioned by financially healthy consumers and corporations. The Fed's more recent actions were precipitated by elevated inflation that, in many respects, they believed was beginning to ease. The war changed everything, including the Fed's likely dominion over the economy's price change levers. As we enter the second quarter, known headwinds for the economy and financial markets are an aggressive Fed and a prolonged period of war and sanctions. Offsetting these constraints, consumers are sitting on record savings, corporations are healthy, and pandemic-affected industries are experiencing renewed demand.

The three most influential factors/events affecting the market outlook are the war, the Fed, and economic conditions (inflation, supply chains, reopening). GIA believes:

- The war will likely drag on and sanctions will not be lifted while Putin remains in power. Russia will continue to be isolated and the country's influence on the global economy will steadily diminish.
- The Fed will likely raise rates at every meeting this year, with more aggressive hikes in May and June. The Fed Funds rate will likely end the year at around 2%.
- After a robust 2022 first half - on the back of healthy consumers' pent-up demand - the economy will likely decelerate. The effects of inflation and supply constraints will likely pull down second half growth.

These expectations suggest:

- Away from the Fed Funds rate, the yield curve already discounts the Fed's aggressive posture and expects inflation to ease by the second half. GIA believes longer term rates will likely remain rangebound (+/- 50 bps from 3/31 levels) while the two-year may rise further, possibly leading to a yield curve inversion.
- Credit spreads may widen back to the worst levels seen during the first quarter, although they will likely be supported at those levels by robust creditworthiness and investor demand.
- The portfolios remain overweight credit in general with reasonable exposure to high yield and emerging markets. Strong creditworthiness and beneficial conditions from commodity prices justify those exposures even as the Fed tightens.

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## Important Information

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**Management Fees**, as well as account minimums and other important information are described in GIA's Form ADV - Part IIA. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

## Index Definitions

**Bloomberg U.S. Aggregate Index**

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

**Bloomberg U.S. Treasury Index**

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

**Bloomberg U.S. Government/Credit Index**

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

**Bloomberg U.S. Credit Index**

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

**Bloomberg U.S. Mortgage Backed Securities Index**

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

**ICE BofA U.S. Corporate & Yankees Index**

The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

**ICE BofA U.S. Corporate Index**

The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

**ICE BofA U.S. High Yield Index**
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

**ICE BofA Global Government Excluding the U.S. Index (N0G1)**
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

**JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)**
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

**JP Morgan EMBI+ Index**
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

**JP Morgan Government Bond Index-Emerging Markets (GBI-EM)**
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

**S&P 500 Index**
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

**Nasdaq Composite Index**
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

**Russell 2000 Index**
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

**MSCI EAFE Index**
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

**MSCI Europe Index**
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.

**MSCI Japan Index**

The index is a The MSCI Japan Index is a free-float weighted equity JPY index.

**MSCI Emerging Markets Equity**

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.