GIA PARTNERS

2[2ndt] Quarter 2022

Highlights

- **Fixed income markets had their worst first half performance in history due to rising inflation and interest rates. Our portfolios underperformed as credit spreads widened.**
- **Consumer demand was robust despite headwinds from energy prices and a more aggressive Fed. Economists raised their recession probabilities, although company earnings remained solid.**
- **High yield bonds declined precipitously in June reflecting fears a recession would damage the sector. Robust earnings and pandemic era refinancing put HY borrowers into good shape.**

Markets

		Returns (%)			
GIA*	Average Quality	2Q22 Gross	2Q22 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**-5.95**	**-6.03**	**-11.42**	**-11.73**
Global Investment Grade Composite	**(A-)**	**-6.65**	**-6.74**	**-12.82**	**-13.17**
Global Credit Plus Composite	**(BBB+)**	**-7.04**	**-7.16**	**-12.70**	**-13.13**
High Yield Composite	**(BB-)**	**-9.41**	**-9.53**	**-12.58**	**-13.06**
Emerging Market Corporate Debt Composite	**(BB+)**	**-8.72**	**-8.86**	**-14.70**	**-15.21**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	-4.69		-10.29	
Treasury	(AAA)	-3.78		-8.90	
Corporate	(A-)	-7.26		-14.19	
Mortgage	(AAA)	-4.01		-9.03	
Government/Credit	(AA)	-5.03		-10.85	
ICE BofA U.S. Corporate & Yankees	(A-)	-6.44		-13.60	
ICE BofA U.S. Corporate	(A-)	-6.71		-13.83	
ICE BofA U.S. High Yield	(B+)	-9.97		-12.66	
ICE BofA EM Corporate Plus	(BBB)	-6.17		-16.14	
ICE BofA Global Gov't ex-US	(AA-)	-4.83		-8.90	
JPM Emerging Markets EMBI GD	(BB+)	-11.43		-21.22	
JPM CEMBI Broad Diversified	(BBB-)	-5.62		-14.25	
JPM GBI-EM Global Diversified	(BBB+)	-8.63		-19.28	
Benchmark Equities					
S&P 500	NA	-16.45		-11.92	
Nasdaq Composite	NA	-22.44		-23.96	
Russell 2000	NA	-17.49		-26.08	
MSCI EAFE	NA	-15.37		-19.90	
MSCI Europe	NA	-15.05		-19.45	
MSCI Japan	NA	-14.55		-21.35	
MSCI Emerging Markets Equity	NA	-12.36		-27.20	

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

Markets

For financial markets, the second quarter of 2022 might be aptly described as the struggle between countervailing forces. Financially healthy consumers and companies loaded with enthusiasm over the pandemic reopening were confronted by an unprovoked war, ongoing supply chain disruptions, elevated inflation, and the abrupt withdrawal of monetary stimulus. Not surprisingly, interest rates rose in reaction to inflation and a central bank that grew increasingly concerned its actions were too late to address the price spiral. The sharp rise in rates combined with inflation and other headwinds weighed heavily on stocks and other financial assets. Only commodities and the U.S. dollar gained, although the gains related to the war's distortions rather than roaring demand. Fixed income was the worst performing sector in relative terms with the Bloomberg Aggregate Index (Agg) delivering its largest first half decline in history. The Agg returned -4.69%% for the quarter and was down -10.35% for the half year. Each of the Agg's core market sectors fared poorly with investment grade credit returning an abysmal -14.12% for the six months. Away from bonds, equities also suffered historic declines as growth fears and higher discount rates brought down prices. The S&P 500 index returned -16.45% for the quarter and was down -20.58% for the first half of 2022. Nasdaq did worse declining -22.44% for the quarter and -29.51% for the half year as growth rates came into question. European equities were not much better with the Euro Stoxx 50 index down -26% in dollars for the half year and the MSCI emerging markets index was down -18.78% over the same period. Many speculative investments that enjoyed traction while the Fed's largess buoyed markets were particularly hard hit. As examples, Bitcoin declined nearly -60% while ARKK, a technology focused ETF, fell -57.84%%.

Investment grade credit posted the worst returns among fixed income sectors as the combination of higher yields and wider spreads affected the longest duration securities. Liquidity was poor in the first half of 2022 and investment grade funds suffered constant outflows. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down -6.71% for the quarter and -13.93% year-to-date. By comparison, the U.S. treasury index (G0Q0) returned -3.85% for the quarter and -9.19% year-to-date. Corporate option adjusted spreads (OAS) widened by 43 b.p. to 163 b.p., while the yield to worst of the index increased from 3.59% to 4.66%. Investment grade issuance decelerated as market volatility, wider spreads and higher yields made issuers hesitate. For the quarter, issuance was $333.1 billion compared to $457.1 for the second quarter of 2021. For the first half, issuance totaled 844.4 billion compared to $980.9 billion in 2021. After two years of record-breaking issuance due to low rates and investor demand, public market borrowing will likely moderate in 2022.

The high yield market gave up its first quarter outperformance and delivered disappointing returns. Mounting worries about recession caused spreads to widen significantly, even though creditworthiness remained healthy. The ICE BofA U.S High Yield Index (H0A0) was down -9.97% for the quarter and -14.04% year-to-date. As concerns about persistent inflation and decelerating growth lifted default expectations, the sector's performance bifurcated by ratings with BB rated bonds widening by 190 b.p., B rated bonds by 282 b.p., while CCC rated bonds widened 533 b.p. Despite higher oil prices, energy, the largest industry in the index, did not escape higher interest rates and spreads returning -8.62% for the quarter and -13.53% for the six months. The spread to worst of the sector widened by 226 b.p. from 364 b.p. to 590 b.p, while the yield to worst rose from 5.93% to 8.88%. High yield retail investors compounded the market's fragile sentiment by withdrawing funds every month this year for a quarterly total of $15.3 billion, and a year-to-date sum of $42.5 billion, the largest six-month outflow on record. The default rate including distressed exchanges rose to 1.08% (0.86% not including distressed exchanges), however remained well below the historical average of 3.2%. The new issue market cooled meaningfully after record borrowing last year. For the quarter, issuance was only $24.6 billion and $71 billion for the six months, about $230.3 billion below last year's volume.

Emerging markets bonds did not escape the flight from risk assets during the quarter. After Russia was removed from fixed income indexes in March, the sector seemed to gain footing along with rising commodity prices. However, the conflict worsened the outlook for emerging Europe, China's Covid policy prolonged supply chain disruptions, and electoral shifts in Latin America combined to poison sentiment. Like U.S. credit sectors, EM experienced fund outflows and limited liquidity which exacerbated the sector's negative performance. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index that included Russian and Ukrainian external debt,

was down -11.43% and a further -20.31% year-to-date, the JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) which included Russian and Ukrainian corporate bonds fared better declining -5.62% for the quarter and -13.94% for the six months through June, and the JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, declined -8.63% for the quarter and -14.53% year-to-date.

Economy

The headwinds that confronted the global economy during the first quarter gained strength during the second. In particular, the war-induced energy crisis became more acute boosting oil prices and with them inflation. Complacent central banks were forced into action with the U.S. Fed raising rates by 50 b.p. in May and 75 b.p. in June, the largest hike since 1994. Compounding the price worries, China extended its lockdowns and aggravated the supply chain bottlenecks. Economists moved quickly to lower their global growth forecasts further, and they lifted their recession probabilities.

Illustrative of the rapid and sharp adjustments, respondents to the WSJ June 2022 Economic Survey lowered their 2022 growth forecasts for the U.S. from 2.57% in April to 1.28% in June. Confirming the message, the average Fed Funds forecast jumped to 3.32% from 2.0%, inflation expectations from 5.52% to 6.97% and the probability of recession leaped to 44% from 28%. Financial markets reacted as expected with significant losses across asset classes.

Counteracting the headwinds, Federal Reserve first quarter data confirms that both personal and corporate deposits remained near or at record highs. Furthermore, labor and wage data suggest conditions for consumers will remain sturdy even as economic activity slows. The uncommon evolution of the current economy complicates the outlook and justifies a range of outcomes.

Ahead of second quarter earnings, a review of industries confirms companies remain more focused on meeting consumer demand than adjusting to a looming recession. While cost pressures intensified, especially in energy, a more pressing challenge remains labor availability. Despite abundant demand, the labor participation rate stayed depressingly low during the first half of the year. Notable in the discussion, travel and leisure industries continue to experience solid demand. Banks, often challenged when economies weaken, continue to report clean loan books and modest consumer delinquencies. They even passed strenuous Fed stress tests. Finally, offering glimmers of hope for inflation, transportation rates for shipping and trucking began to decline, suggesting improvement in supply chain normalization.

Scenarios

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

1. Our most likely case has the U.S. economy growing about 2 to 2.5% at an annual rate in 3Q and slower (1.5 to 2.0%) in 4Q. June data on employment, manufacturing, and consumer finances supports the notion of a still-growing economy. Industry outlooks, while tempered, focused more on hurdles to generating more rather than less output. Opposing these healthy observations, inflation readings provide the Fed ammunition for more aggressive tightening. On balance, we believe the characteristics of the supportive factors will cushion the Fed's harsh measures and keep the economy growing, albeit at a slower pace. PROBABILITY 50%

2. A second scenario has the economy slowing to a rate of 0 to 1.0% at an annual rate during the next six months. In this scenario, the economy's headwinds prevail leading consumers and corporations to retrench. Specifically, high prices, Fed tightening, deteriorating financial conditions, and ongoing Covid disruptions drag the economy down. The "reopening" euphoria that caused havoc at airports, airlines and other leisure venues gets postponed again. A new pause enables logistics networks to adjust relieving a significant price and supply burden on the economy. PROBABILITY 35%

3. A third scenario has the economy expanding at a faster pace of 3.0 to 3.5% at an annual rate during the next six months. In this scenario, personal consumption remains robust aided by low unemployment and higher income. Factors that played a meaningful role in the price spiral may ease, including more flexible Covid policies in China and a cessation in Russian hostilities. While these are unexpected, enabling the unimpeded flow products would have an immediate effect on prices permitting monetary authorities to temper their tightening policies. This scenario would quickly boost global activity, including in the U.S. PROBABILITY 15%

Market Outlook

Financial markets will likely continue to experience volatility while a resolution of the struggle between countervailing forces emerges. Markets already have information on many factors, even if the timing of events remains unknown. Specifically, the war will likely be prolonged so relief from sanctions and product shortages cannot be expected. Also, the Fed emphasized its resolve with a 75 b.p. hike in June, leading markets to adjust terminal rate assessments. Finally, the worst forecasts for inflation will not likely materialize because consumers (and suppliers) were quick to adjust to elevated prices. What remains in question is the Fed's actual tightening path, China's Covid battle, and the ultimate effect of tighter financial conditions on the global economy. We continue to believe economic growth slows, but a recession can be avoided.

Given this outlook and the market's first half performance, we believe credit markets have become more attractive. Creditworthiness remains robust across most industries, especially in investment grade and higher quality high yield. We expect longer-term rates to be range-bound around 3% (+/-25 b.p.) which combined with current spreads gives portfolios with allocations to credit compelling income while monetary authorities navigate their tightening cycle.

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Important Information

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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.