1Q22 Market Commentary

Into the unknown

The last two years have been confusing and frustrating on many fronts. We can add another adjective to that list after Russia invaded Ukraine in February—frightening. While we focus on the economy and stock market movements each quarter in this piece, in no way do we want to minimize the horrors of war, which we are all seeing up close on a daily basis. The war is an unnecessary tragedy and economic impact is a distant second in importance right now. However, there are and will continue to be real economic consequences to contend with.

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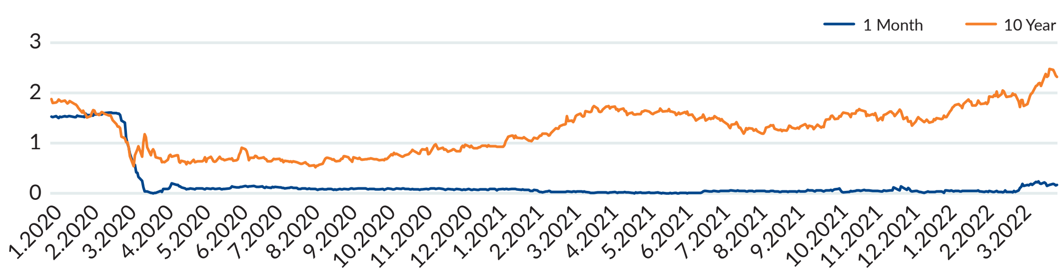
What happens next is anyone's guess. We are facing more uncertainty than we have in a very long time. This is leading to spikes in stock market volatility and confusion over the "correct" course of action. Any predictions around how the war might end and what it means for the global economy and stock market should be taken with appropriately sized grains of salt.

Inflation and bonds

What is clear, however, is that the Federal Reserve will continue to raise interest rates this year and most likely will continue to do so in 2023. This means short-term interest rates are going up, likely reaching 2% before the end of the year. This may cause the 10-year Treasury rate to breach 3%, a level not seen since late 2018. The 10-year interest rate is important as it is the rate off of which many financial transactions are based, including mortgages, auto loans and credit card rates. Predicting the movement of the yield curve is challenging, but the Fed will clearly telegraph all rate increases as they do not want to induce further volatility by making ambiguous statements or unexpected moves. The chart below shows the short term (1 month) and 10-Year Treasury rates between 2020 and March 2022.

CHART 1: **TREASURY BOND RATES**



Source: US Department of the Treasury

Inflation will remain uncomfortably high for much longer than anyone would like. What had been a fairly narrow range of sectors impacted by extreme price increases in 2020 and early 2021 (cars and semiconductors for example) is broadening to include food, oil, natural gas, and other necessities. This will eventually dampen what had been a roaring recovery from the COVID-19 pandemic-induced recession. The chart below shows CPI, a measure of inflation, from the heights in the early 1980s through early 2022.

CHART 2: **CPI**

Source: U.S. Bureau of Labor Statistics

A significant point to note for investors is that rising inflation tends to diminish the traditional negative correlation between equity and bonds, which we have seen so far this year. Typically, investors hold bonds to soften the blow when the equity market sells off, but this year, the bond market has sold off more significantly than the equity market.

Domestic stocks

With all eyes on Russia, it's important to remember that the direct impact on the US economy is small—the US imports less than 7% of oil from Russia and even less natural gas. While there's been much said about the wheat and corn production from both Russia and Ukraine, the US is an exporter of both commodities. All of these commodities, however, are priced globally, which means prices rise and fall based on global supply and demand. We are seeing high prices on these commodities due to the shrinking supply. These higher prices will eventually make their way to the gas pump, electric bill, and the supermarket, impacting American consumers.

Another angle is the exposure to Russia of US corporations. For most domestic companies, exposure is relatively small, though certain companies and sectors may feel more pressure from either pulling out of Russia entirely or from a depressed Russian economy. These risks are company- and sector-specific, so investors who eschew individual stocks in favor of broadly diversified mutual funds should be insulated from any single company undergoing significant deterioration due to those circumstances.

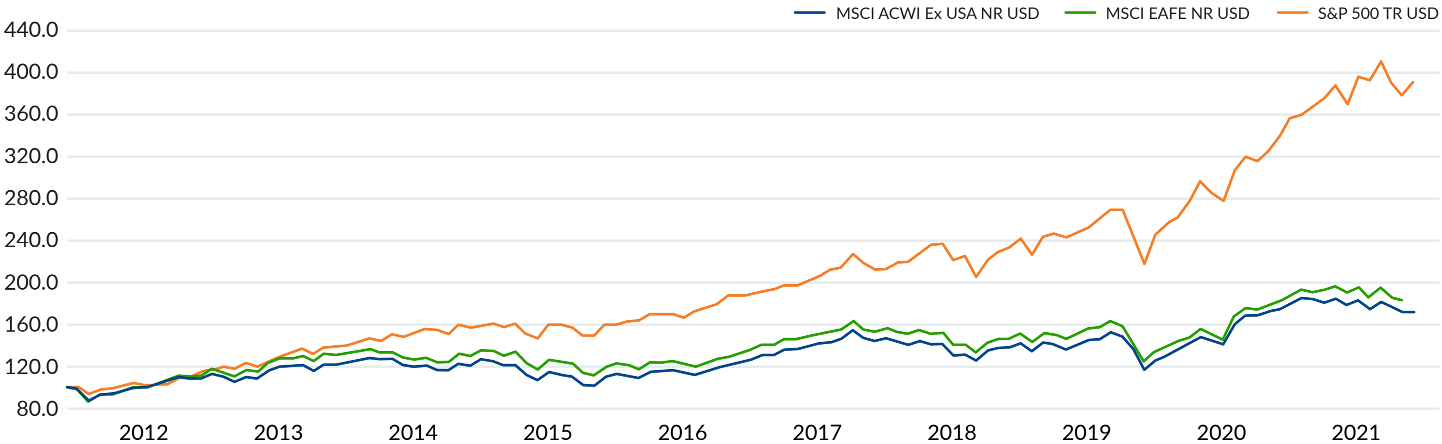
Elsewhere in the domestic stock market, the tech-focused NASDAQ Index entered correction territory (down 10%) in late January and fell into bear territory (down 20%) in mid-March. The S&P 500 Index reached a correction in late February, and did not fall into bear territory before beginning an impressive rebound towards the end of the quarter.

So where does this leave us? Some pundits believe the US stock market is "oversold" meaning the impact to the domestic economy from the war, rising interest rates, and inflation is not as bad as the drop in stock prices accounts for. Others note that with inflation continuing to rise and high oil prices for the foreseeable future, domestic GDP growth will be hampered. Both sides may be right, though until there's more clarity around the war in Ukraine, volatility and downside risk remain high.

Europe and the United Kingdom

Europe and the United Kingdom have a lot of headwinds. First and foremost, it has to deal with a war that is close to home. While European countries have increasingly relied on Russia for natural gas and oil, those relationships seem untenable going forward. A push for green energy in Europe can revitalize its economy and stock market (which has lagged the US stock market for over a decade), but getting there will be messy. Natural gas prices are already high and this is not a commodity that travels easily. Inflation could be quite elevated in Europe and the United Kingdom for some time, hitting consumers and lowering GDP growth. The chart below shows the growth of $1,000 invested in the MSCI ACWI ex US Index (this incudes emerging market stocks), the MSCI EAFE Index (this excludes emerging markets stocks), and the S&P 500 Index over the last decade.

CHART 3: **INVESTMENT GROWTH | 4.1.2012 – 3.31.2022**



Source: Morningstar Direct.

Emerging markets

Because the Russian stock market largely remains closed, Russian stocks have been marked to zero by most asset managers and non-Russian stock exchanges. All losses from those holdings are baked into current performance numbers, so the negative impact of holding Russian stocks in a given mutual fund, for example, is over. Russia opened its stock market for trading towards the end of the quarter and prices did rise, but the government will not allow foreigners to sell stocks at this time, therefore mark to market prices remain at zero.

The bigger impact to emerging markets returns is likely China, which accounts for a third of the MSCI Emerging Markets Index. China had a tough 2021 given its zero-COVID policy and a clampdown on private companies by the government late last year. The Chinese market dropped 22% in 2021, compared to a 29% gain for the S&P 500 Index. The government softened its stance on some private companies during the first quarter of 2022, but lockdowns in major cities as the Omicron variant ripped through the country drove Chinese stocks lower still—the Chinese market lost 14% last quarter. Given the tight government control in China, predicting the future there is especially difficult.

With Russia's influence and natural resources receding from the world stage, there's room for smaller countries to gain ground—Venezuela may again produce oil that is bought and sold in the global markets; Africa is a producer of wheat and corn and may step into the global economy. Emerging market countries are very different from one another, making wholesale predictions challenging in "normal" times. We are entering a phase when countries and companies will have vastly different outlooks and return potential.

What now?

Now, more than ever, is the time to move slowly and carefully when it comes to making investment decisions. When the market moves fast, a long-term investor should move slow. It's fine to do nothing—keep investing from your paychecks, of course, but you don't have to check your balance as regularly. Wait it out if it makes you too unsettled to see your retirement account dropping in value. Now is a great time to gut check your portfolio allocation. Perhaps it's too risky for your liking. If that's the case, you can slowly rebalance your portfolio, or if you can manage to wait it out, do so after the market volatility has calmed down.

Market metrics

Last quarter encapsulated much of the seesaw in 2021—optimism around the "end" of the pandemic, soured by new, more transmissible variants and concerns over whether inflation is transitory or a more worrisome trend. In all, investors took this news in stride, with most major developed stock market indexes posting positive returns for the quarter and the year.

	Total Return (%)					
Name	**1Q2022**	**YTD**	**1 Yr**	**3 Yr**	**5 Yr**	**10 Yr**
S&P 500	(4.60)	(4.60)	15.65	18.92	15.99	14.64
MSCI EAFE	(5.91)	(5.91)	1.16	7.78	6.72	6.27
MSCI Emerging Markets	(6.97)	(6.97))	(11.37)	4.94	5.98	3.36
BBgBarc Agg Bond	(5.93)	(5.93)	(4.15))	1.69	2.14	2.24

Source: Morningstar as of 3.31.22. Past performance is not indicative of furture results.

About Mesirow

Mesirow is an independent, employee-owned financial services firm founded in 1937. Headquartered in Chicago, with locations around the world, we serve clients through a personal, custom approach to reaching financial goals and acting as a force for social good. With capabilities spanning Global Investment Management, Capital Markets & Investment Banking, and Advisory Services, we invest in what matters: our clients, our communities and our culture. To learn more, visit mesirow.com and follow us on LinkedIn.

Sources: CBOE, Morningstar, U.S. Department of the Treasury, U.S. Bureau of Labor Statistics.

The Bloomberg Barclay's Aggregate Bond Index is a broad-based, market capitalization-weighted bond market index representing intermediate-term investment grade bonds traded in the United States.

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.

The MSCI ACWI ex US Index is comprised of non-U.S. stocks from developed markets and emerging markets.

The MSCI EAFE Index is designed to represent the performance of large and mid-cap securities across 21 developed markets, including countries in Europe, Australasia and the Far East, excluding the U.S. and Canada.

The S&P 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies.

The NASDAQ Index is stock market index that includes almost all stocks listed on the Nasdaq stock exchange. Along with the Dow Jones Industrial Average and S&P 500, it is one of the three most-followed stock market indices in the United States.

The Consumer Price Index (CPI) measures the change in prices paid by consumers for goods and services. The CPI reflects spending patterns for each of two population groups: all urban consumers and urban wage earners and clerical workers.

Treasury Inflation Protected Bonds (TIPS) are a type of Treasury security issued by the U.S. government. TIPS are indexed to inflation in order to protect investors from a decline in the purchasing power of their money. As inflation rises, TIPS adjust in price to maintain its real value

The indices are unmanaged and does not incur management fees, transaction costs or other expense-associated with investable products. It is not possible to directly invest in an index.