Market Review Commentary

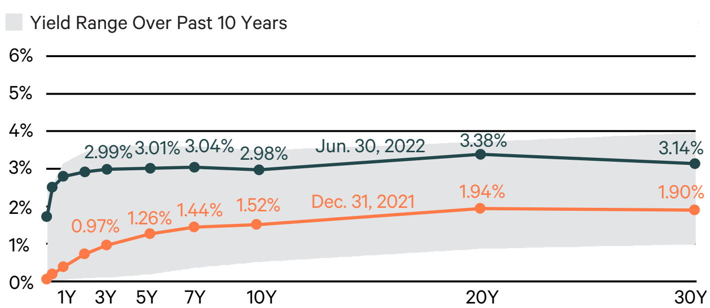
Second Quarter 2022

Kayne Anderson Rudnick
Investment Management

Equities and fixed income experienced a horrendous first half of 2022. The S&P 500 Index entered official bear market territory in the second quarter and finished down 19.96% for the first six months. Bonds provided no support during the decline with the Bloomberg U.S. Aggregate Bond Index finishing down 10.35% for the first half of 2022. It was only the second time in more than 40 years where both stocks and bonds declined for two consecutive quarters. Growth stocks continued to lead the decline with the Russell 1000 Growth Index down 28.07% year-to-date. Value stocks fared better only declining 12.86% year-to-date. Foreign stocks provided no diversification help for investors with the MSCI EAFE Index down 19.57% for the first half of the year. Emerging markets performed slightly better with the MSCI Emerging Markets Index declining 17.63% for the same period. Even areas that had been holding up, such as energy, materials, and utilities, started to succumb to selling pressure late in the second quarter.

Interest rates continued their climb with the 10-year U.S. Treasury yield moving from 2.36% to 2.98% during the quarter. Continued supply chain disruptions and high energy prices continued to produce unacceptable inflation results. Municipal bonds (as measured by the Bloomberg Municipal Bond Index) outperformed the Bloomberg U.S. Aggregate Bond Index declining 8.98% in the first half of the year. Credit-sensitive fixed income markets underperformed with high yield (as measured by the ICE BofA U.S. High Yield Index) down 14.04% and emerging market debt (as measured by the JPMorgan Emerging Markets Bond Index Global) down 18.83% for the year-to-date as recession fears continued to grow. The yield curve continued to flatten this quarter and credit spreads continued to widen which indicates the markets' increasing concern with a slowdown and/or a recession.

FIGURE 1: U.S. TREASURY YIELD CURVE



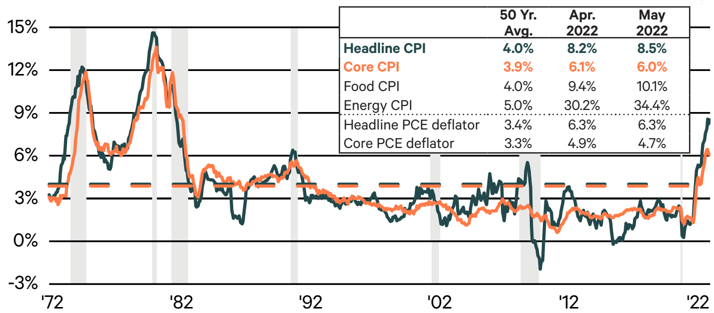
Data presented is as of June 30, 2022 and is obtained from FactSet, Federal Reserve and J.P. Morgan Asset Management and is assumed to be reliable. ***Past performance is no guarantee of future results.***

INFLATION, INFLATION, INFLATION

Inflation remained the market's principal concern in the second quarter with headline CPI continuing to report unacceptable results. The May headline CPI of 8.5% was particularly disappointing to investors who had been looking for a peak in reported inflation statistics.

FIGURE 2: CPI AND CORE CPI

% Change vs. Prior Year, Seasonally Adjusted



	50 Yr. Avg.	Apr. 2022	May 2022
Headline CPI	**4.0%**	**8.2%**	**8.5%**
Core CPI	**3.9%**	**6.1%**	**6.0%**
Food CPI	4.0%	9.4%	10.1%
Energy CPI	5.0%	30.2%	34.4%
Headline PCE deflator	3.4%	6.3%	6.3%
Core PCE deflator	3.3%	4.9%	4.7%

Data presented is as of June 30, 2022 and is obtained from BLS, FactSet and J.P. Morgan Asset Management and is assumed to be reliable. CPI used is CPI-U and values shown are % change vs. one year ago. Core CPI is defined as CPI excluding food and energy prices. The Personal Consumption Expenditure (PCE) deflator employs an evolving chain-weighted basket of consumer expenditures instead of the fixed-weight basket used in CPI calculations. ***Past performance is no guarantee of future results.***

Continued Chinese lockdowns due to their zero COVID policies and export restrictions on Russian oil and gas led to higher-than-expected inflation numbers and investor concern that the Federal Reserve will have to be even more aggressive in raising interest rates. The Fed funds rate stands at 1.50% to 1.75% and , in our view, will probably approach 3.5% by year end 2022. However, the yield curve is already very flat, and longer-term rates have started to decline despite the Fed's 75 basis point move in June and a high probability of another 75 basis point increase in July.

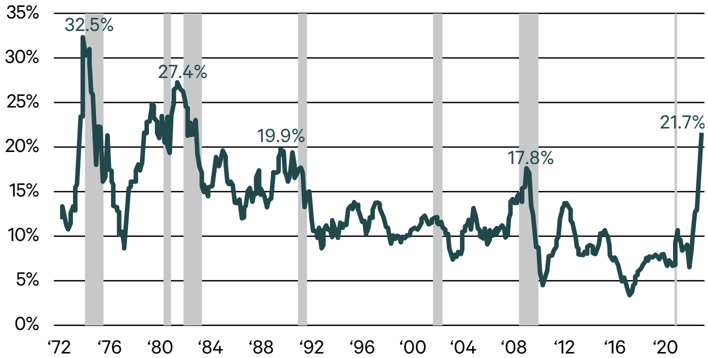
IS IT POSSIBLE LONG-TERM INTEREST RATES HAVE ALREADY PEAKED THIS CYCLE?

It is important to remember the Federal Reserve only controls the short end of the yield curve, not the long end. Many times historically the Fed has pushed up short-term rates only to see the long end of the curve invert or actually fall in yields. This happens when the market believes the Fed has gone too far and will create much slower growth or a recession in the near term. In this cycle, the Fed has made it clear that reducing inflation is its top priority, so in order for long-term rates to have truly peaked already we need to see clear progress on reducing inflation. The Fed cannot control every input to the inflation equation (i.e., supply chain, zero COVID, Russian war), but we believe it is important to not underestimate the power of monetary policy.

IS TIGHTENING MONETARY POLICY WORKING?

Classic monetary policy works with a lag of typically 6-to-18 months from the first interest rate increase. We would argue that tightening actually started with the Fed's transparent jawboning last November 2021. So we believe we are eight months into this tightening cycle and signs of a slowdown in the economy are becoming increasingly obvious. Starting with the consumer (70% of GDP), we have seen material retail sales shortfalls at large retailers and consumer confidence has hit 40-year lows.

FIGURE 3: CONSUMER STRESS INDICATOR
Food at Home, Mortgage Rates, & Gasoline Prices



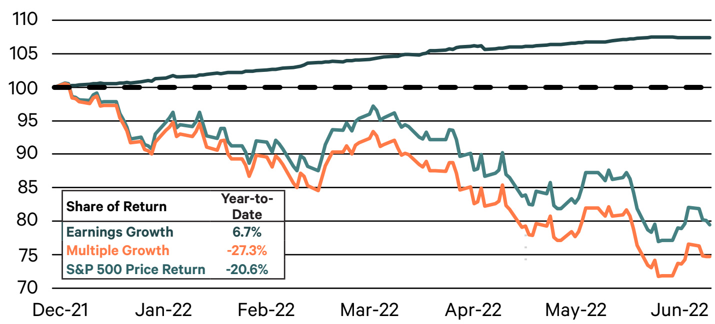
Data presented is as of June 30, 2022 and is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

New orders for the Purchasing Managers' Index (PMI) have fallen below 50 which signals contraction. Raw materials, such as copper, aluminum, nickel, and zinc, have already experienced significant declines in price in the second quarter. Late in the quarter, even the strongest sectors (oil and semiconductors) started to show significant weakness. A few economists on the Street have started to reduce second quarter 2022 GDP growth from a small positive to a negative. If this is correct, then the U.S. is already in at least a technical recession which is two consecutive quarters of negative GDP. Our point here is that the Fed may be closer than investors realize to bringing inflation under control.

WHAT SHOULD OUR INVESTORS DO?

This has been a frustrating and painful time to be in equities while the Fed has aggressively launched its inflation fight. The significant weakness in stocks has anticipated a material slowdown in the economy overall and many companies' businesses. A slowdown and/or a recession is becoming increasingly obvious, and once it becomes clearer, headwinds from rates may abate, at which point we believe equities could start to experience improved conditions. At this point, we are not sure if it even matters whether it is a material slowdown or a recession, but from our perspective, valuations have become attractive longer term. As we have mentioned many times, market timing is a fool's game, but it is a fact today that many stocks have declined off their highs, and speculation in IPOs, SPACs, and meme stocks is virtually non-existent which we believe is a more favorable environment for long-term investing.

FIGURE 4: PERCENT CHANGE IN S&P 500®, EARNINGS, AND VALUATIONS*



*Data presented is as of June 30, 2022 and is indexed to 100. Data is obtained from Compustat, FactSet, Standard & Poor's and J.P. Morgan Asset Managementand is assumed to be reliable. Historical EPS levels are based on annual operating earnings per share. Earnings estimates are based on estimates from Standard & Poor's and FactSet Market Aggregates. *Earnings and multiple growth are both year-to-date percent changes of next twelve-month estimates.* ***Past performance is no guarantee of future results.***

In our view, quality companies have started to perform better on a relative basis given the slowing environment and flattening yield curve.

As always, we will stay focused on quality companies that we believe have competitive advantages. We thank you for your trust and confidence in these difficult markets.

Douglas S. Foreman, CFA
Chief Investment Officer

Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 36 years of investment experience.