March Investment Outlook 2022

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Current Market Conditions

Geopolitical uncertainty higher from Russia's invasion of Ukraine

The current focus in capital markets is on the impact of the Russian invasion of Ukraine. Evaluating the economic impact from this event remains fluid, but it is important to note with concern the tragic human toll taking place. The global response of imposing sanctions, while tough, has been less onerous than otherwise could be, as the impact of severe sanctions could cause damage to the world economy. Russia's actions, and the global response to them, also raise concern about broader geopolitical stability. National leaders with territorial or other aggressive inclinations are carefully watching.

Pockets of disruption driving higher inflation

While Russia's share of the world's economy is relatively small, it provides significant energy supplies to Europe. Russia and Ukraine are also important providers of agricultural commodities to Europe. In the near term, reduced supplies of energy and agricultural products to Europe will likely add to already high global inflation expectations, which could exert downward pressure on global growth.

Market volatility higher, but manageable so far

After strong performance in 2021, the markets were already off to an uneven start in 2022 prior to Russia's invasion of Ukraine. The S&P 500 is down 8% year to date through February, while international developed markets are down 6%, and emerging markets are off nearly 5%. As a result, the price to earnings multiple of the S&P 500 has come down from 23x at the end of 2021 to 20x currently. Bonds have not proven to be a safe haven, with a broad measure of the fixed income markets down over 3%, and rising interest rates driving down bond prices. Although volatility, a frequent measure of uncertainty, has increased, it remains below levels of prior crises, as seen in the chart on the following page.

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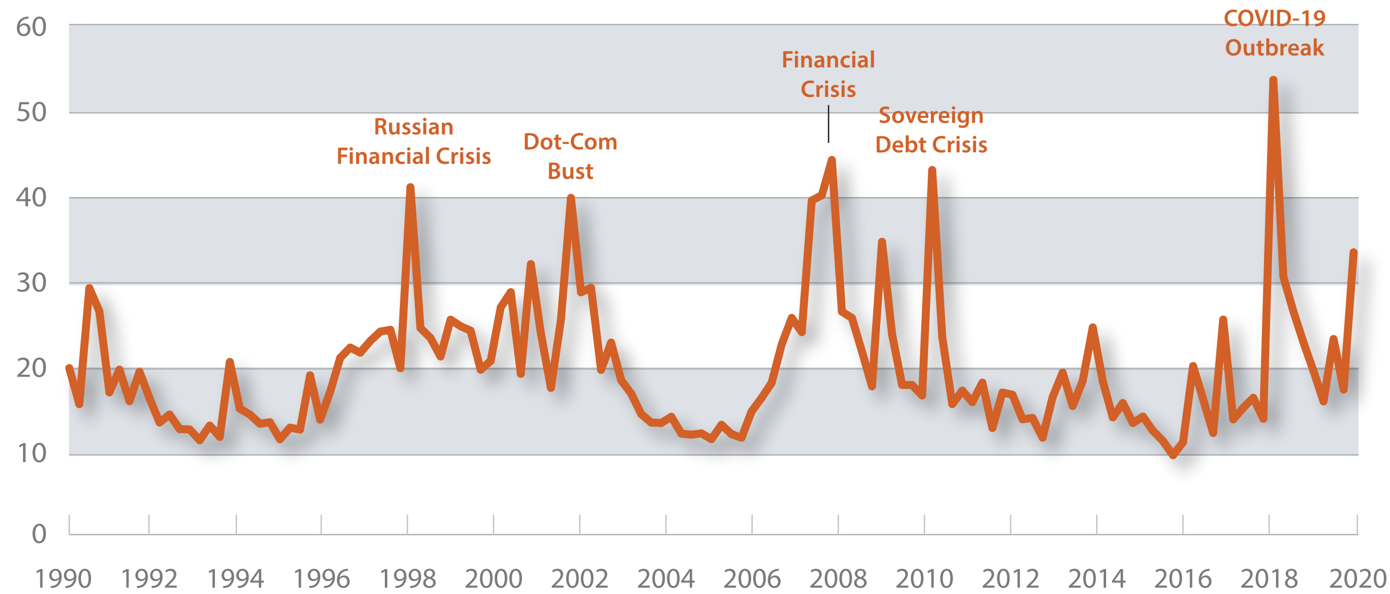
CBOE Volatility Index



Source: CBOE

Fundamentals still strong and supportive of capital markets

While inflation presents a challenging headwind to the U.S. economy, underlying economic fundamentals remain strong. After an initial slowdown from the Omicron COVID-19 variant, economies and consumers are signaling eagerness to reopen and return to normalcy. Supply chain disruptions persist, and may worsen in some areas, but port congestion on the west coast improved in February.

Manufacturing in the U.S. and Europe showed strong signs of improvement as well. Although the momentum of growth has slowed somewhat from the rapid pace of last year's recovery, the International Monetary Fund recently forecasted still healthy global growth of 4.4%.

Higher inflation presents a challenge to governments and central banks balancing the effects of fiscal and monetary policy. Recent forecasts for interest rate changes in the market have shifted to less aggressive positioning by central banks. Additional fiscal stimulus by governments remains possible should economies slow down faster than anticipated. The investing environment is more challenging as inflation expectations increase, but the aforementioned fiscal and monetary policies can be adjusted to provide stabilization.

We believe that the current geopolitical situation creates market volatility, but strong economic undertones will help buffer headwinds.

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Our Investment Approach and Strategy

Volatility can be uncomfortable, but uncovers opportunities

Russia's military assault on Ukraine introduces new factors to consider as we evaluate our investment positioning. We are not making any significant policy changes to our portfolios but believe the increased volatility will provide attractive opportunities. We expect equity markets to remain volatile both on the upside and downside, as markets generally have an aversion to uncertainty. News flow related to global stability will at times drive market rallies and likewise result in pullbacks.

There are many negative aspects to Russia's invasion of Ukraine, but we still believe global economic growth is strong enough to support investments in risk assets. Despite the recent increase in bond yields, we believe equity valuations remain relatively attractive versus fixed income. The higher level of volatility has resulted in opportunities to invest in strong companies and managers that just a few months prior were priced significantly higher.

Things We Are Watching

More than ever, we believe that moves in inflation, interest rates, governmental policies, and global growth will be critical to watch in terms of reassessing any future changes in our investment policy. Over the next several months, it will be important to watch and assess the impacts on global stability resulting from continued efforts to isolate Putin and Russia. We will be paying close attention to Russian aggressions, as well as other geopolitical hotspots.

We encourage you to contact us with any questions you may have at (212) 492-7000 or info@klingenstein.com.