INVESTMENT PERSPECTIVE

Quarterly Report

31 March 2022

U.S. equity markets declined modestly in the first quarter with the S&P 500 falling 4.6% and the Russell 2000 Value falling 2.40%. International equity markets also declined with the MSCI EAFE decreasing 8.5%. The Bloomberg Aggregate Index finished the quarter down 5.9%. The ICE BofA AAA-A Municipal Index declined 4.4% in the quarter. Capital market performance during the quarter was dominated by Russia's invasion of Ukraine and NATO's sharp response. These events further supported inflationary pressures and are an additional weight to future economic growth. We continue to expect economic growth to slow materially over the next several quarters. Even with the added cost pressures from the invasion of Ukraine, inflation will remain elevated relative to recent history but should ease as we move through 2022.

During the quarter, the Federal Reserve raised the Fed Funds rate by 25 basis points, kicking off the first Fed hiking cycle since 2018. The current high inflation environment has thus far proven to be stickier than expected and, coupled with the unemployment rate at 3.5%, the market is forecasting at least eight more 25 basis points Fed Fund hikes in 2022. We expect the U.S. Federal Reserve to end quantitative easing and continue raising interest rates although the economic slowdown will likely force a pause in rate hikes much sooner than current market participants expect. With inflation elevated, the cost of capital rising, liquidity conditions deteriorating, and earnings estimates set for negative revisions, we anticipate heightened equity market volatility and downside risks over the near term.

Elevated uncertainties including higher interest rate volatility and the Russia-Ukraine war pushed investment grade credit spreads twenty basis points wider to +108 basis points over Treasury yields. With the Fed reducing its monthly bond purchases and raising short term interest rates, we expect more volatility in the bond market. This will provide opportunities to generate alpha within spread sectors and opportunistic yield curve positioning. In preparation for higher rates, we continue to maintain a shorter average duration relative to the benchmark across our fixed income strategies. For the first time since 2020, the 10-year single-A tax-exempt benchmark yield closed higher than the after-tax yield for the single-A corporate benchmark. We expect to see strong demand from taxable investors to add tax-exempt municipal bonds without sacrificing yield.

Investors should understand the conflict in Ukraine is a larger geopolitical confrontation between world powers that is going to accelerate the restructuring of the current U.S. dollar reserve based monetary framework that has been in place since Nixon closed the gold window in the early 1970's. Over the last five years, pressure has been building to modify the current system. Russia and China weaponizing the commodity markets and global supply chains is the final straw to force a change. Such a restructuring will necessitate material shifts in global trade, cost of and access to capital, and geopolitical alliances. We have been studying and monitoring these shifts for several years and feel comfortable that we understand the forces at play and will be able to respond appropriately as political and policy choices are implemented.

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Effective March 31, 2022, Carlos Gonzalez will be assuming the role of Chief Compliance Officer (CCO) for Vaughan Nelson Investment Management (VN) culminating a transition which has been occurring over the last six months. Mr. Gonzalez has over 28 years of experience with 15 of those years at VN, currently as Director, Compliance. He will be supported by Ken Palermo, Mark VanOvermeiren and Lemitra Rhodes. Richard Faig, the current CCO, will be retiring at that time.

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