



Economic Review & Outlook

SECOND QUARTER | 2022

A War on Two Fronts

As Ukrainians bravely stand up to the Russian invasion of their country, Western powers look to provide aid and push back against Russian President Vladimir Putin without setting off a global confrontation. At the same time, the U.S. Federal Reserve (Fed) is locked into another battle, fighting against persistently rising inflation without either stifling economic growth or rattling investors. These two conflicts are intertwined, and the delicate balancing act has led to levels of market volatility we have not seen since the onset of COVID-19. Are these market concerns justified, or is this just part of investing in an inherently uncertain and unstable world?

In this issue, we'll look at the war and its impact on markets and dive into the issues of inflation and the Fed's new path forward. We'll also offer insights into how we're closely monitoring the markets and positioning portfolios.

Trust and investment management accounts and services offered by Ronald Blue Trust, Inc. are not insured by the FDIC or any other federal government agency, are not deposits or other obligations of, nor guaranteed by any bank or bank affiliate, and are subject to investment risk, including possible loss of the principal amount invested. Ronald Blue Trust is a Tennessee chartered public trust company.

Economic Overview

RUSSIA INVADES UKRAINE

For the first time in more than two years, COVID-19 took a backseat to other headlines as we saw the largest military conflict in Europe since World War II. Putin's invasion of Ukraine launched a tragic humanitarian crisis, driving about one-quarter of Ukraine's 40-million-plus people from their homes and spreading refugees across eastern Europe and elsewhere. Putin believes that Ukraine, part of the Soviet Union until its 1991 collapse and Ukraine's declaration of independence, is a fundamental part of Russia. While many eastern European countries joined NATO as the alliance expanded in eastern Europe, Ukraine has not been able to fulfill that goal. In 2008, NATO stated that it planned to admit Ukraine at some point. That remains a hotly debated topic, but inclusion seems far from imminent.

After the 2014 ousting of a Putin ally from the Ukraine presidency, Russia annexed Crimea and took control of parts of eastern Ukraine through a war that continues today. In 2021 and early 2022, Russia expanded its military build-up near the border of Belarus and other areas north of Ukraine, recognized the independence of two breakaway regions in eastern Ukraine, and launched an invasion in late February. The U.S. and its allies have refused to send troops into the country, instead providing military hardware, money, intelligence, and diplomatic support. The West's primary tool in the battle is a massive series of economic sanctions targeting Russian banks, industry, oligarchies, and other leaders. As hundreds of Western businesses across multiple industries suspended operations in Russia, the Russian ruble collapsed, the country's stock market shut down for a month, and the economy reeled. Economists are projecting a potentially deep recession and double-digit inflation in Russia over the coming months.

INFLATION CONTINUES TO RUN HOT

Entering 2022, inflation was the number-one market concern in the U.S., and it remained high on the list as the Russia-Ukraine war added more upward pressure on prices, especially energy. Oil prices surpassed 2008 highs, and U.S. gasoline prices reached all-time highs, comparable to early 1980s levels when adjusted for inflation. The U.S. consumer-price index rose to a 7.9% annual rate in February, its fastest climb in 40 years, led by energy, food, and services. The Fed's preferred measuring stick, the Personal Consumption Expenditures price index, or PCE, hit a 40-year high in February at 6.4%. Central banks remain confident that they can control inflation while avoiding a recession, though the situation in eastern Europe means things could get worse before they start getting better. The Fed projects inflation will be at 4.3% by the end of 2022 and Fed chair Jerome Powell said in late March that inflation should move back near the central bank's 2% target level over the next three years.

INTEREST RATES ON THE RISE

As rising inflation continued to be a mounting concern for consumers and markets, expectations built that the Fed would start aggressively raising the federal funds rate from zero as well

as tapering bond purchases, which spiked during the pandemic. Indeed, the Fed raised its key rate to 0.25% - 0.5% on March 16, marking the first increase since 2018, and signaled additional hikes for all six remaining policy meetings in 2022, plus more in 2023. After near-zero increases for nine of the last 16 years, the Fed's March 2022 projections pointed to rates near 2% by year-end, up from the December 2021 projection of 1.6%.

Later in the month, Powell and other policymakers said the Central Bank is prepared to raise rates more aggressively to combat inflation, including some moves in 50-basis-point increments. This statement was a shift from their previous stance. As recently as September 2021, half of the Fed's Federal Open Market Committee expected no change in the federal funds rate throughout 2022, and no member expected a rate hike of 75 basis points or more. The Fed also said it would end its bond purchase program, part of the Central Bank's efforts to maintain market liquidity amid the pandemic, in March and could start to shrink its massive balance sheet as soon as the second quarter.

Asset Class Performance

JANUARY	FEBRUARY	MARCH	YTD
Commodities 8.8%	Commodities 6.2%	Commodities 8.7%	Commodities 25.6%
Gold -1.9%	Gold 5.8%	U.S. Stocks 3.7%	Gold 6.6%
Emerging Market Stocks -1.9%	Diversified Bonds -1.1%	Gold 2.7%	U.S. Stocks -4.6%
Diversified Bonds -2.2%	Int'l Developed Stocks -1.8%	Int'l Developed Stocks 0.8%	Int'l Developed Stocks -5.8%
Int'l Developed Stocks -4.8%	Emerging Market Stocks -3.0%	Emerging Market Stocks -2.2%	Diversified Bonds -5.9%
U.S. Stocks -5.2%	U.S. Stocks -3.0%	Diversified Bonds -2.8%	Emerging Market Stocks -6.9%

Indices used: Commodities—Credit Suisse Commodity Index, Diversified Bonds—Barclays Aggregate U.S. Bond Index, Gold—S&P GSCI Gold Index, U.S. Stocks—S&P 500 Index, Int'l Developed—MSCI EAFE Index, Emerging Markets—MSCI Emerging Markets Index. Indices do not reflect the deduction of advisory fees, transaction charges, and other expenses. You cannot invest directly in an index. Past performance does not indicate future returns.

Equities broadly declined in the first quarter, weighed down by the war in Ukraine combined with concerns about inflation and rising interest rates. The University of Michigan U.S. Consumer Sentiment Index closed the quarter at its lowest point in over a decade. Technology stocks, which led markets higher over the last

decade-plus and through the bull market that began in early 2020, sold off amid concerns about high valuations and the impact of a rising interest rate environment. Within the S&P 500® Index, the only sectors to advance for the quarter were utilities and energy as oil prices rallied sharply. Inflation fears rattled bond markets even before the invasion, with broad U.S. indexes posting quarterly declines similar to stocks. The Bloomberg U.S. Aggregate Bond Index returned -5.9% in the first quarter, reflecting expectations around the Fed’s turn away from ultra-easy monetary policy.

Oil prices rose approximately 50% during the quarter, briefly doubling the price from a year prior, as the U.S. banned imports of Russian oil and the EU restricted investment in Russia’s energy sector and pledged to sharply reduce the amount of Russian natural gas it buys. Commodity prices, already at multi-year highs, sailed higher as the war continued, as sanctions and war disrupted supply chains for key Russian exports beyond oil and gas, such as aluminum, palladium and nickel, coal, steel and wood, as well as agricultural staples such as wheat and key fertilizer ingredients. Ukraine and Russia are both notable suppliers of wheat and oilseeds, such as sunflower. Overall, the Bloomberg Commodities index rose 25.6% in the first quarter.

Our Perspective

BETWEEN A ROCK AND A HARD PLACE

Central banks’ main tools for battling inflation are raising short-term lending rates and intervening directly in bond markets through quantitative tightening. Since the great financial crisis of 2007-2008, and through the COVID-19 pandemic, the Fed has become more interested in stabilizing markets and boosting economic growth than keeping inflation in check. Thus, the Central Bank used their toolbox in an extraordinary manner—holding interest rates near zero and buying bonds in an aggressive quantitative easing (QE) program. As 2022 dawned, economic growth and labor markets both appeared strong coming out of coronavirus shutdowns.

Meanwhile, inflation spiked to levels not seen since the 1980s, and it seemed certain that the Fed would aggressively try to bring their policies and rates closer to historically normal levels.

This perspective became much less clear-cut once Russian tanks rolled across Ukraine’s border, setting off a level of geopolitical tensions that, arguably, investors have not seen since the terrorist attacks of 9/11. The Fed wants no part in pushing us into a recession through rising interest rates and quantitative tightening, but clearly feels the need to act to reign in surging prices. The Fed’s goal, according to Powell in a March 2022 speech: “The economy achieves a soft landing, with inflation coming down and unemployment holding steady.”¹ The worst possible outcome would be a period of stagflation, combining weakening economic growth and high inflation. So, what will the Fed do? What should we do as investors?

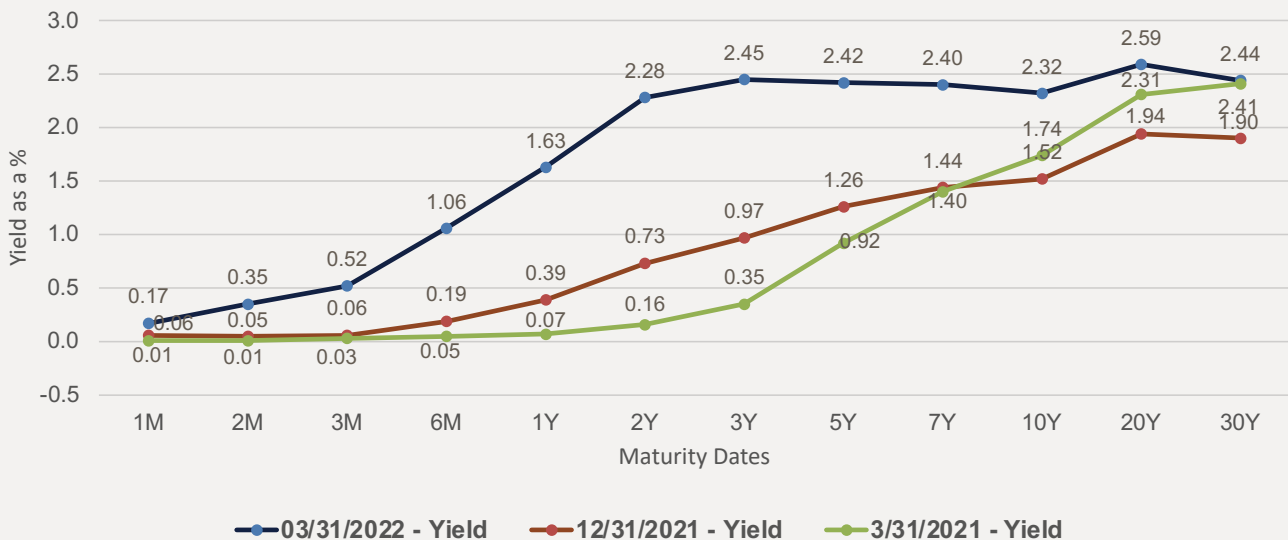
A DELICATE BALANCE

The Fed wants to move interest rates and their balance sheet, currently hovering around \$9 trillion after the run of QE, to levels appropriate for the current economic environment. The underlying data looks strong. While many forecasters lowered economic growth projections in early 2022, the Fed expects U.S. gross domestic product (GDP) growth of 2.8% for 2022, down from December 2021’s projected 4.0%. The updated estimate is in line with calls from The Conference Board (3.0%) and many others, most with caveats surrounding inflation, the Ukraine conflict, and the diminishing but still present threat of COVID-19. The labor market, in the words of Fed chair Powell, “has continued to strengthen and is extremely tight,” with unemployment at post-pandemic lows and other numbers, such as initial and continuing jobless claims, at levels not seen in decades.

Part of the challenge is that markets have grown accustomed to low interest rates after a long cycle where they’ve been near zero. The Fed’s answer is not to quit suddenly, but rather to articulate plans and go slowly, monitoring the health of the economy and making

¹ www.federalreserve.gov/newsevents/speech/powell20220321a.htm

U.S. TREASURY YIELD CURVE



Source: www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yield

adjustments as necessary. For now, the Fed seems to believe that the economy and labor market can handle tighter monetary policy as policymakers work to tame inflation. Still, managing inflation without straining growth and jobs is typically not an easy task.

WE ARE ALREADY WELL UNDER WAY

We could conclude that since the Fed has only increased rates one time so far, all of the work is ahead of us. That perspective could worry bond investors. While it is true that there is a long way to go, the Fed has already done part of their job well by simply outlining their plan (known as forward guidance). More importantly, while the Fed has direct control of the Fed funds rate and can have some influence on bond prices through direct purchases, bonds on the open market trade just like any other security and are subject to daily supply and demand. Therefore, bond prices (and interest rates) can react long before the Fed takes any direct action. We believe that's what we've seen thus far during this cycle, as evidenced by the striking movement in yields (which have risen sharply), prices (which have fallen), and the flattening of the yield curve—the relationship between short-term and long-term yields—over the past year.

As you can see, markets have already moved significantly based on expectations as opposed to actual interest-rate increases. This trend is particularly true of short- and intermediate-term bonds. Longer-term bonds tend to represent a more optimistic outlook on longer-term inflation and have not moved nearly as much to this point.

WHAT LIES AHEAD

Investors entered the year and spent much of the first quarter worried about inflation and the delicate balance of the Fed going forward. The invasion, a geopolitical event that not only adds downward pressure to prices but also has the potential to slow global growth, thrust itself into that picture. We all felt the injection of uncertainty as tanks rolled into Ukraine—the markets did too—but wars and conflicts are, unfortunately, a normal, recurring part of investing. History tells us that they generally don't have as much of a negative impact as we might think. Since World War II, the market has lost an average of approximately 1% on the initial news of a major conflict, bottomed out after a 5.5% decline over 24 days, and then climbed back to even after 52 days.² In short, the associated volatility from geopolitical events such as this war tends to be a short-term blip, followed by a quick recovery.

Turning to the Fed, expectations going forward vary and continue to evolve. Coming out of its March meeting, the Central Bank's Federal Open Markets Committee expects to see the Fed funds rate at 1.9% by the end of 2022 and rising to 2.8% in 2023. The median expectation for the number of rate hikes in 2022, which was three as recently as the December 2021 meeting, stands at seven. Closer to the end of the quarter, several Fed officials expressed a willingness to consider half-point interest-rate hikes, reflecting Powell's comments about the potential for more aggressive actions. Outside the committee, economists' expectations for rates were largely higher than the Fed's and rising toward the end of March. Meanwhile,

expectations for the number of rate hikes also evolved, currently sitting at the equivalent of 9-10 quarter point rate hikes this year, though some may be combined into larger increases of 0.5%.

U.S. STOCK MARKET RETURNS

GEOPOLITICAL EVENT	START DATE	1 YR LATER	5 YRS LATER	10 YRS LATER
Korean War	Jun 1950	22.9%	22.0%	16.9%
Soviets into Hungary	Nov 1956	-6.4%	12.4%	9.4%
Soviets into Czechoslovakia	Aug 1968	-3.5%	5.3%	4.1%
Soviets into Afghanistan	Dec 1979	32.3%	14.6%	17.4%
U.S. invades Grenada	Oct 1983	3.8%	14.6%	14.6%
Iraq invades Kuwait	Feb 1991	22.7%	16.3%	17.3%
Serbians into Kosovo	Feb 1998	23.5%	-2.2%	4.6%
U.S. invades Iraq	Mar 2003	35.8%	11.5%	8.2%
European Debt Crisis	Dec 2009	9.9%	16.1%	13.7%
Arab Springs	Dec 2010	7.5%	14.9%	14.4%
Syrian Civil War /Refugee Crisis	Mar 2011	4.9%	10.6%	13.6%
Rise of ISIS	May 2013	21.4%	13.5%	n/a
Russia into Crimea	Nov 2014	7.0%	11.1%	n/a
AVERAGE		14.0%	12.4%	12.2%

Source: FactSet; returns shown are of S&P 500 annualized returns.

It's important to stress that market rates and Fed policy are both difficult to anticipate over time, because they are always evolving. Future actions will depend on many things—the war in eastern Europe, COVID-19, economic growth and inflation, and market sentiment among them. As we know, the Fed has already changed course many times in recent years due to unforeseen circumstances, and given the uncertainty as we look ahead, it's wise to assume that it could happen again.

At the moment, the Fed has unquestionably shifted its primary focus to inflation and kicked off a new, rising-rate environment. That move has been reflected in one of the hottest areas of the market, housing, where costs have risen quickly amid a lack of supply and rising demand, fueled in part by Americans relocating amid the pandemic. Mortgage rates rose sharply in early 2022, from the 3% range in the depths of the pandemic in 2020 and 2021 to nearly 4.5%. In February, new home construction reached its fastest pace in 15-plus years, led by multi-family housing as rental rates continued to

² www.bloomberg.com/news/articles/2022-02-28/wary-bulls-clinging-to-history-of-war-s-fleeting-market-impact?sref=C2JZ5EIG

rise sharply. The building pipeline remains full going forward, as builders look to boost low levels of inventory and satisfy buyers, and as more millennials enter the housing market. For now, we believe that construction will likely continue its upward trend.

Our Investment Strategy

As always, our approach is much less about trying to predict the future with certainty in an uncertain world and more about building portfolios to help our clients meet their goals. Here are a few takeaways for the current environment based on that approach.

Bonds still play a role. It's easy to look at recent negative performance in bonds and the prospect of rising rates and be tempted to throw in the towel and exit fixed income altogether. However, bonds are rarely the most attractive asset from a long-term performance perspective; generally, that is stocks. Bonds aren't meant to be a growth engine in a portfolio, but rather to protect against shorter-term volatility and adverse economic or equity market outcomes. Even though bond returns have been negative, they have exhibited less downside than we've seen in equity markets to this point.

Diversification and a value approach matters in all asset classes. We often talk about these as "pillars" of our process relating to equity management, and we still believe that broad company and country diversification is as important now as ever. Finding new opportunities by looking at markets with more attractive valuations and growth prospects, such as emerging markets, is a key to successful equity investing. These concepts are just as important for bonds. Not all bonds pay the same level

of interest or react the same to economic developments. For example, short- and intermediate-term treasuries appear to offer a more attractive risk/return profile than long-term treasuries. Additionally, different sectors such as high-yield bonds and Treasury Inflation-Protected Security (TIPS) can offer yields without being as directly tied to broad market interest rates.

Geopolitical and economic concerns are expected. If we chose to only invest during times when risks were not present, then we would never have the opportunity to invest. Investing always involves risk and managing it may be the most important quality of successful investors. Over and over markets have shown resiliency in the face of these types of events, particularly over the long term.

Conclusion

These are trying times. The images filling our screens from Ukraine are disturbing and watching the market's volatility is unsettling. It is sometimes tempting to make impulsive, emotional decisions about your portfolio, such as pulling out completely. However, history tells us that decision can be costly, and that we're better off showing patience, sticking to our plan, and riding out short-term downturns and challenging environments (as well as market run-ups and bull markets) by keeping our focus on the long term. That's the process we're following, and we implore you to do the same.

In closing, we would like to send our thoughts and prayers to those in Ukraine, Russia, and elsewhere who have been—or will be—impacted by the war, from battlefield casualties to the millions of people caught up in the refugee crisis. We hope for a quick resolution to the conflict and a return to peace.

RonaldBlueTrust®

Wisdom for Wealth. *For Life.*®

For more information please contact your financial advisor, call us at **800.841.0362**, or visit our website at **www.ronblue.com**.

Ronald Blue Trust advisors apply biblical wisdom and technical expertise to help clients make wise financial decisions to experience clarity and confidence and leave a lasting legacy. With over \$13.5 billion of assets under advisement and a nationwide network of 16 offices, we offer comprehensive financial services and objective advice to over 9,000 clients across the wealth spectrum in all 50 states. As of 4/1/2022 and subject to change.

The views expressed herein are provided by Ronald Blue Trust. Ronald Blue Trust is discussing the asset classes, sectors and portfolios they oversee at a macroeconomic level. They are not recommending or endorsing the purchase of any individual security. Any investment strategies presented may not be appropriate for every investor and investors should review the terms, conditions and risks involved with specific products or services with their financial professional. Unless stated otherwise, any estimates, projections (including performance and risk), or predictions (including in tabular form) given in this presentation are intended to be forward-looking statements. Although Ronald Blue Trust believes that the expectations in such forward-looking statements are reasonable, it can give no assurance that any forward-looking statements will prove to be correct. Such estimates are subject to known and unknown risks, uncertainties, and other factors that could cause actual results to differ materially from those projected. These forward-looking statements speak only as of the date of this review. As with any investment strategy, there is the potential for profit as well as the possibility of loss. Ronald Blue Trust does not guarantee any minimum level of investment performance or the success of any portfolio or investment strategy. Past performance does not guarantee future results.

Diversification does not guarantee investment returns and does not eliminate loss.

14789570-04-22