PENOBSCOT
FINANCIAL ADVISORS

MARKET COMMENTARY

Q1 2022

MARKET REVIEW

The first quarter gave investors plenty to chew on, including the impact of inflation, higher interest rates, and the Russia-Ukraine war. All the while, the COVID pandemic saw its largest spike yet with the Omicron wave cresting in mid-January. The economic and market reaction to each successive wave has become more muted as the world becomes more able to maintain economic activity around this health crisis.

By quarter's end most major stock and bond indexes had declined. However, Treasury yields, the dollar, gold, and crude oil prices ended the first quarter higher. Among the market sectors, energy increased nearly 40.0%, while utilities climbed about 5.0%. The remaining sectors ended the quarter in the red, with consumer services (-12.0%) and information technology (-8.0%) losing the most.

The yield on 10-year Treasuries rose nearly 80 basis points, or 0.8%. Crude oil prices increased nearly $28.00 per barrel, or 38.0%, in the first quarter. The dollar gained nearly 2.8%, while gold prices advanced more than 6.0%. The national average price for regular gasoline was $4.231 per gallon on March 28, almost one dollar higher than the January 3 price of $3.28 and $1.38 higher than a year ago.

Although it was a losing quarter for most indexes, January began the quarter with stocks reaching new all-time highs. Unfortunately, that was the high point of the month for Wall Street, with the remainder of January being rough for investors. The Russell 2000 lost 9.7%, the Nasdaq slid 9.0%, the S&P 500 dipped 5.3%, and the Dow fell 3.3%. Internationally, the Global Dow slipped less – only 0.6%. In all, despite the rally during the first two days, January produced the worst first-month stock performance since 2009. Shrugged off was the good news of U.S. GDP advancing at an annualized rate of 6.9%, while nearly 200,000 new jobs were added. In focus was inflation, slowing industrial production and a decline in new orders for durable goods.

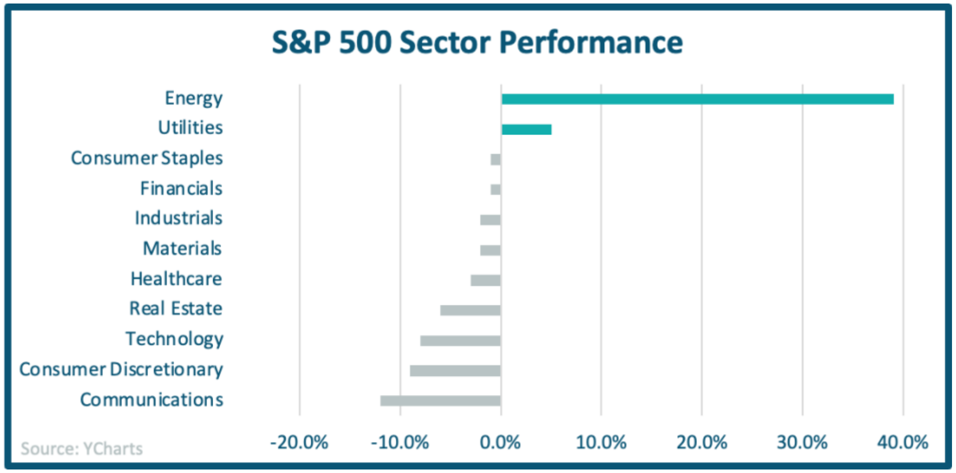
Like January, February also opened the month on a high note, but stocks tumbled into the red by the end of the month. The S&P 500 fell to its lowest level since June 2021. Not only were investors still coping with rising inflation and interest-rate hikes, but a new crisis emerged in February — Russia's invasion of Ukraine on February 24. The United States, and several other nations, imposed sanctions against Russia, some of which were aimed at curtailing Russian oil and natural gas exports. As a result, Crude Oil prices jumped 8%, while the Dow, the S&P 500, and the Nasdaq fell more than 3.0%. The dollar and gold prices rose.

Hopes for a peaceful resolution in Ukraine disintegrated in March, prompting the imposition of more economic sanctions against Russia. Inflationary pressures continued to mount, which led the Federal Reserve to raise interest rates 25 basis points with additional rate hikes anticipated.

Nevertheless, stocks showed resilience. Each of the benchmark indexes posted gains from February. The S&P 500 rose 5.0%, the Nasdaq gained 4.7%, the Dow added 3.6%, the Russell 2000 climbed 2.1%, and the Global Dow increased 1.9%. Although crude oil prices were trending lower by the end of March, they were still $8.00 per barrel higher than where they began the month.

Broad downturn

It was hard to find returns in most industry sectors in the first quarter. Given that many money managers (including PFA) are limiting exposure to fossil fuels and that bonds suffered in the rising rate environment, most investors felt the sharp declines in Q1



ECONOMIC REVIEW

Employment: Employment rose by 678,000 in February, notably higher than the January revised total of 481,000. Despite the increase, employment is down by 2.1 million, or 1.4%, from its pre-pandemic level in February 2020. The unemployment rate inched down by 0.2 percentage point to 3.8%. The number of unemployed persons decreased 243,000 in February to 6.3 million. By comparison, in February 2020 prior to the coronavirus (COVID-19) pandemic, the unemployment rate was 3.5%, and the number of unemployed persons was 5.7 million.

There were 202,000 initial claims for unemployment insurance for the week ended March 26. Over the first three months of 2022, initial weekly claims and total claims for unemployment insurance benefits steadily decreased. As of March 19, there were 1,307,000 total claims for unemployment benefits. This is the lowest level for insured unemployment since December 27, 1969, when it was 1,304,000. A year ago, there were 3,753,000 total claims for unemployment insurance benefits.

FOMC/interest rates: Following its meeting in March, the Federal Open Market Committee increased the federal funds target rate range by 25 basis points to 0.25%-0.50%. In support of its decision, the Committee noted that inflation remains elevated due to imbalances related to the pandemic, higher energy prices, the Russia-Ukraine conflict, and broader price pressures. In addition, the FOMC anticipates six more rate hikes, some could be by as much as 50 basis points.

GDP/budget: Gross domestic product rose 6.9% in the fourth quarter of 2021 compared with a 2.3% advance in the third quarter. Contributing to this were increases in private inventory investment, exports, personal consumption expenditures, and nonresidential fixed investment. These were partly offset by decreases in both federal and state and local government spending. Imports, which are a subtraction in the calculation of GDP, increased. Consumer spending, as measured by personal consumption expenditures, was 2.5% in the fourth quarter (2.0% in the third quarter). Spending on goods rose by 1.1%, while spending on services climbed 3.3%. The Treasury budget deficit came in at $216.6 billion in February, a notable jump from the surplus of $118.7 billion in January. By comparison, the deficit in February 2021 was $310.9 billion. Through the first five months of fiscal year 2022, the deficit sits at $475.6 billion, 55.0% lower than the deficit over the same period in fiscal year 2021.

Inflation/consumer spending: According to the latest Personal Income and Outlays report for February, personal income rose 0.5%, while disposable personal income increased 0.4% after each increased 0.1% in January. Consumer spending increased 2.0% following a 2.7% jump in January. Consumer prices climbed 0.6% in February after advancing 0.5% in January. Consumer prices have risen 6.4% since February 2021. Year over year, energy prices vaulted 25.7%, while food prices increased 0.8%. The Consumer Price Index climbed 0.8% in February after climbing 0.6% in the previous month. Increases in the indexes for gasoline, shelter, and food were the largest contributors to the CPI increase. The gasoline index rose 6.6% in February and accounted for almost a third of the overall February increase. Since February 2021, the CPI has risen 7.9% — the largest increase since the period ending January 1982.

Housing: Sales of existing homes reversed course, falling 7.2% in February after advancing 6.7% in January. Year over year, existing home sales were 2.4% under the February 2021 estimate. According to the latest survey from the National Association of Realtors®, housing affordability continues to be a major challenge, as buyers are getting a double whammy: rising mortgage rates and sustained price increases. The median existing-home price was $357,300 in February, up from $350,300 in January and 15.0% more than February 2021 ($310,600). Unsold inventory of existing homes represents a 1.7-month supply at the current sales pace. Sales of existing single-family homes also fell, down 7.0% in February after rising 6.5% the previous month. Since February 2021, sales of existing single-family homes have fallen 2.2%. The median existing single-family home price was $363,800 in February, up from $357,100 in January.

Manufacturing: Total industrial production in February was 7.5% higher than it was a year earlier. Since February 2021, manufacturing has risen 7.4%, mining has jumped 17.3%, while utilities decreased 1.2%. February saw new orders for durable goods decrease 2.2%. This decrease, down after four consecutive monthly increases, followed a 1.6% January increase. Excluding transportation, new orders fell 0.6% in February. Excluding defense, new orders dropped 2.7%. Transportation equipment, down following three consecutive monthly increases, led the decrease, declining 5.6%.

Imports and exports: Import prices rose 1.4% in February after advancing 1.9% in January, according to the U.S. Bureau of Labor Statistics. Higher fuel and nonfuel prices drove the increases in both months. Contributing to the increase in February import prices was a 6.9% jump in fuel prices. Prices for nonfuel imports rose 0.8% in February. For the 12 months ended in February, prices for imports have advanced 10.9%. Over the same period, prices for fuel have increased 53.0%. Prices for U.S. exports advanced 3.0% in February following a 2.8% rise the previous month. The February advance in export prices was the largest since January 1989. Higher prices for both agricultural and nonagricultural exports in January contributed to the overall increase in U.S. export prices. Export prices have risen 16.6% since February 2021. Due partially to the larger price increases on exports relative to imports, the trade deficit declined $1.0 billion, or 0.9%, from January.

International markets: While business activity in the United States picked up, despite the turmoil in Ukraine, Europe hasn't been quite as fortunate. Most of Europe has seen the war exacerbate already strained supply chains, which has sent prices for raw materials and energy soaring — despite the lifting of most pandemic-related restrictions. The European Central Bank lowered its forecast for economic growth in the eurozone from 4.2% to 3.7%, while acknowledging that the impact of the Russian invasion could be larger. In Japan, the government proposed more measures to boost the economy. China saw a drop in stock prices after reports of a worsening coronavirus outbreak across the mainland. Overall, for the markets in March, the STOXX Europe 600 Index rose 3.1%. The United Kingdom's FTSE gained 2.0%. Japan's Nikkei 225 Index climbed 6.2%, while China's Shanghai Composite Index fell 6.3%.

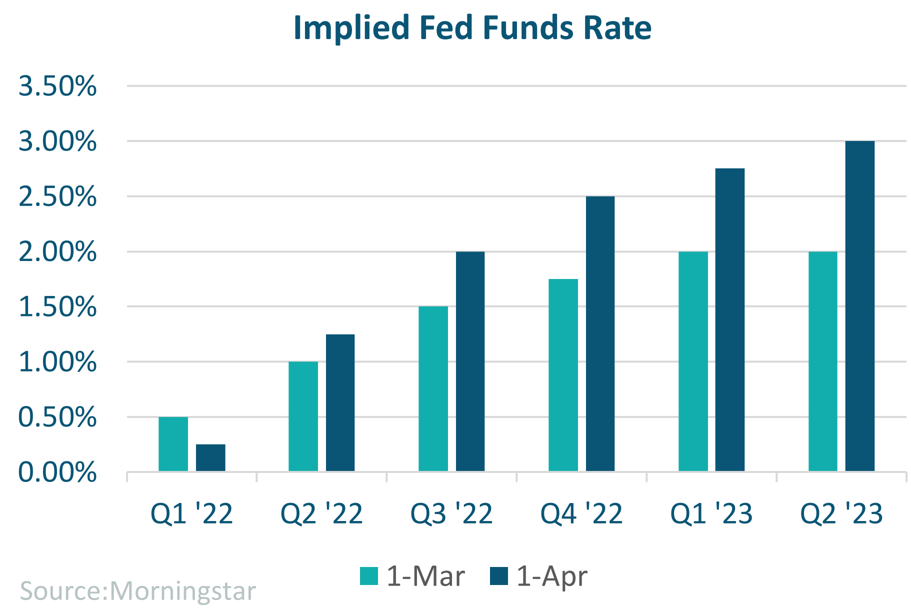
Consumer confidence: The Conference Board Consumer Confidence Index® rose slightly in March following a decline in February. The index stands at 107.2, up from 105.7 in February. The Present Situation Index, based on consumers' assessment of current business and labor market conditions, improved to 153.0 in March, up from 143.0 in February. The Expectations Index, based on consumers' short-term outlook for income, business, and labor market conditions, declined to 76.6 in March, down from 80.8 in February.

LOOKING FORWARD

Despite accelerating inflation, the war in Ukraine, and rising interest rates, most economic indicators are still demonstrating varying degrees of strength. However, as April unfolds, March data may begin to show some economic slowing. Gross domestic product, which ran at an annualized rate of nearly 7.0% in February, is likely to recede, while the pace of job growth may decelerate. While the Federal Open Market Committee does not meet in April, it is expected to push the Fed Funds rate up by 0.5% in May, and it may very well do the same thing in June. And for reasons that extend well beyond the economy and markets, we are all hoping that a resolution to the Russia-Ukraine conflict is near!

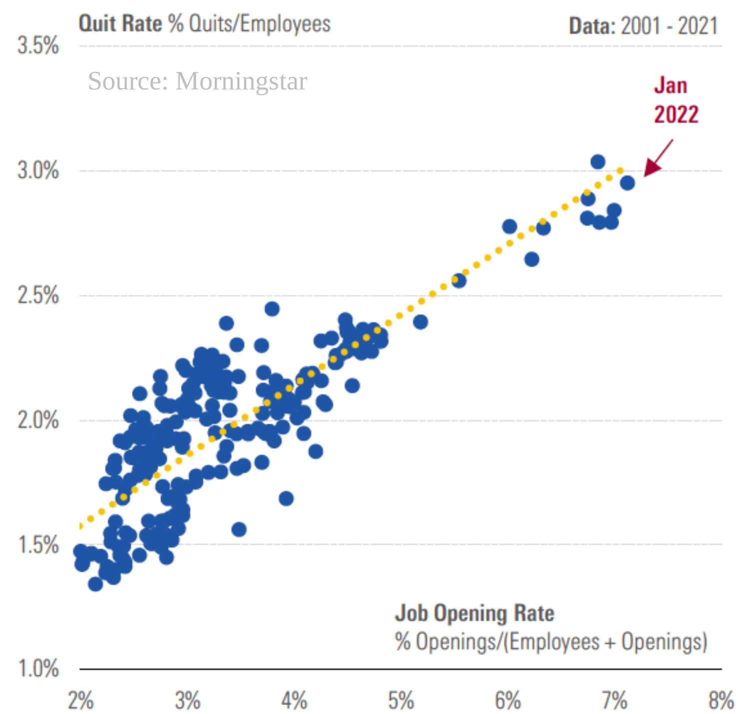
Interest rate expectations on the rise

Futures markets point to a much more hawkish Fed than just one month earlier. Not only do they indicate a belief that the Federal Reserve will hike interest rates more aggressively, the Futures point to the end of the cycle bringing the rate to 3% instead of 2%. This is an indication that the Fed is more worried about inflation than it was a month earlier.



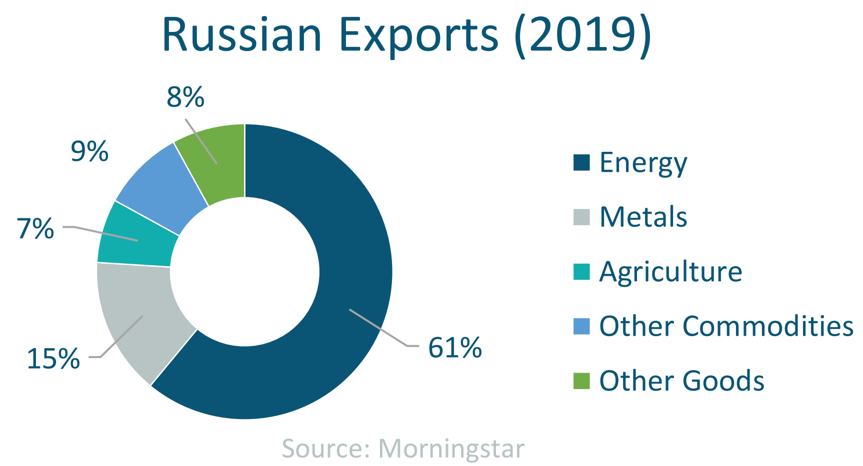
Labor market tightness driving turnover

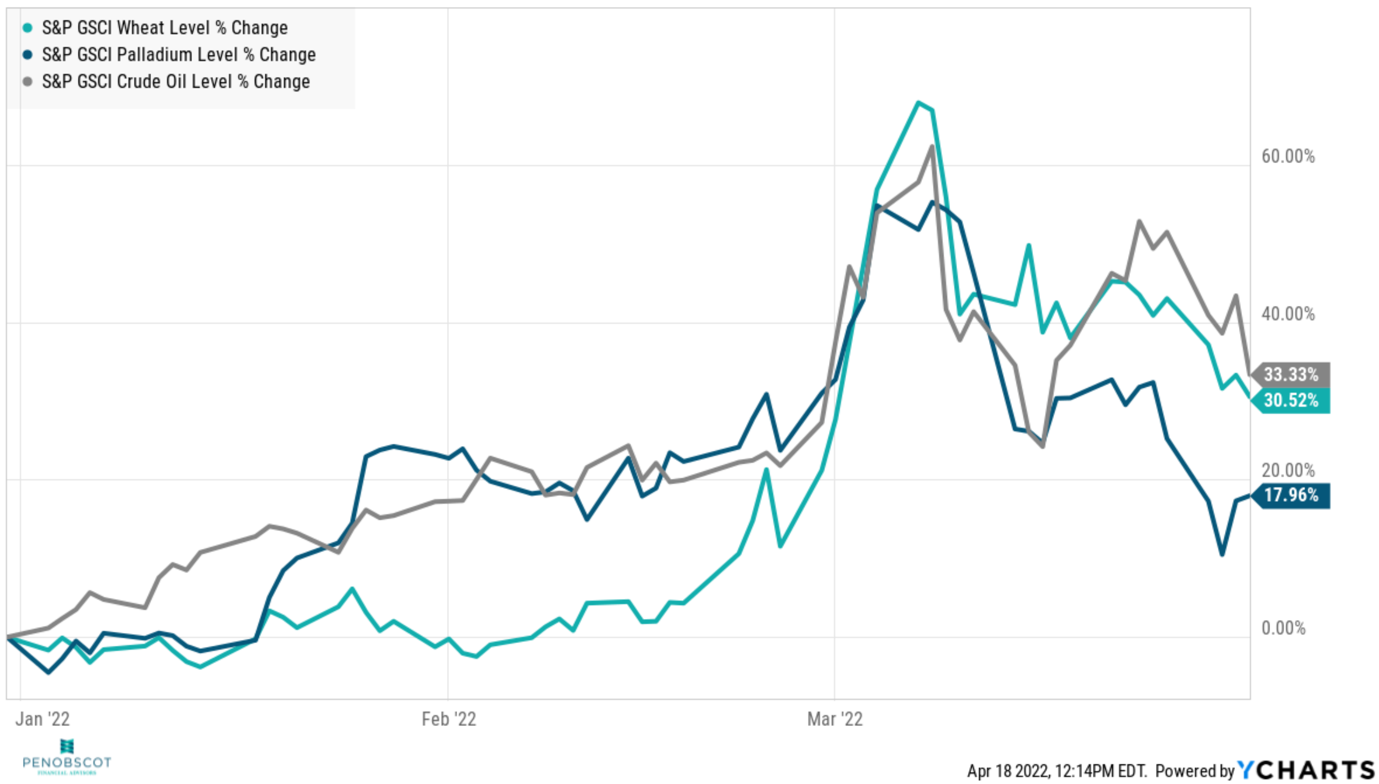
Much has been made of the 'Great Resignation', but there is evidence that, rather than it being a phenomenon of people leaving the workforce, that the high level of 'quits' is more a result of the high level of job openings and the fact that employers have been willing to 'pay up' for talent and staffing.



Commodity price pressures

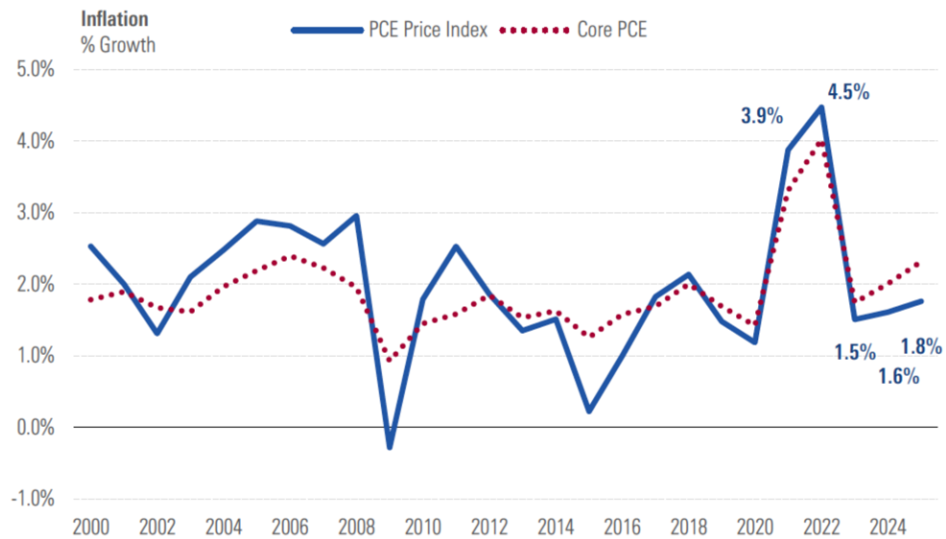
Despite sweeping sanctions being imposed by many western countries, most European nations have not cut off the fuel imports from Russia since the February 24th invasion. Other imports, largely sanctioned by the US, continue to flow out of Russia, so prices that originally shot up have moderated slightly. Still, overall price pressure on commodities of all types is something we feel will be with us for much of 2022.





Peak inflation?

Most economists concur that the March and April inflation data will represent the peak and that a slowing in price growth will develop as the year goes on. The question is: how rapidly will price growth return to the 2% target.



Source: Morningstar

Equity valuations

Throughout much of 2021, we were seeing extended valuations in much of the market. Only smaller company stocks and 'value' stocks (those companies whose valuations don't rely as heavily on lofty growth targets) spent much of the year trading below their intrinsic value. After the price movements in the first quarter, most stocks are seen as being at or below their intrinsic value.

	All Coverage	Value	Core	Growth
All	1.05	0.96	1.14	1.05
Large	1.05	0.97	1.15	1.05
Mid	1.05	0.95	1.10	1.12
Small	0.94	0.88	1.02	0.99

12/23/2021

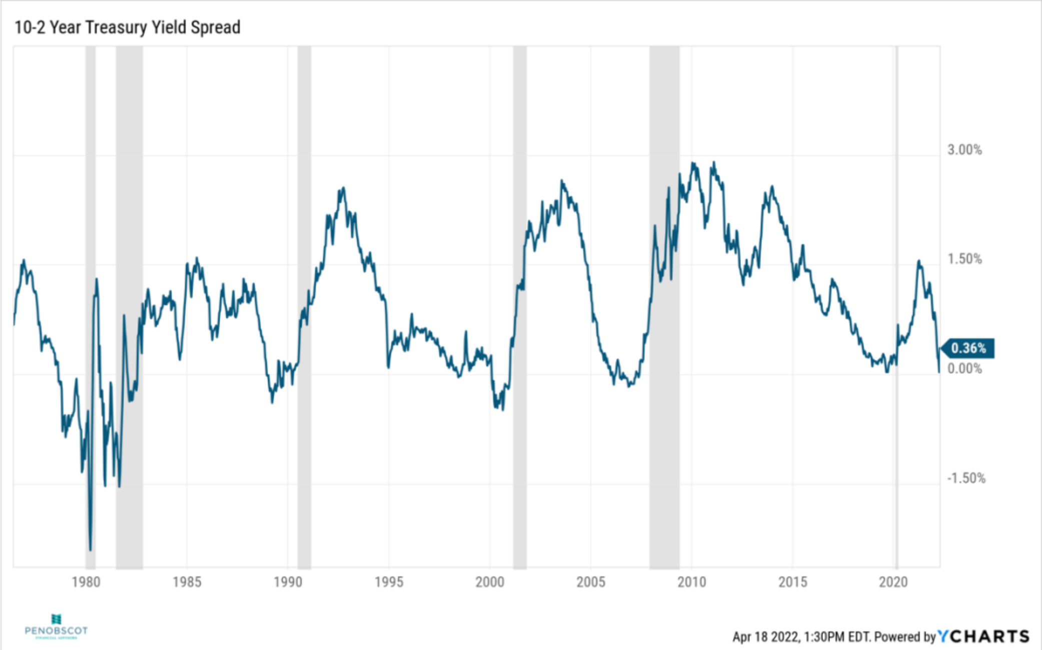
	All Coverage	Value	Core	Growth
All	0.98	0.95	1.01	0.97
Large	0.98	0.95	1.02	0.98
Mid	0.97	0.96	1.01	0.94
Small	0.84	0.81	0.89	0.85

3/28/2022

Source: Morningstar

Yield Curve Inversion

Bond yields, like CDs, normally get higher the further out their maturity dates. However, occasionally there are points where shorter-maturity bonds yield more than longer maturities. When this happens, we call that an 'inverted yield curve'. Some see such a phenomenon as an omen of an upcoming recession, and for good reason. We can see in this chart that the past six recessions have followed a period when the spread between the 2-year treasury bill and the 10-year treasury bill became negative (indicating the 2-year having a higher yield than the 10-year).



Caution is warranted, though, before we apply too much import to the current situation. First, the yield curve only 'inverted' for a short period of time and has since steepened. Second, there have been numerous times historically when the 2-year, 10-year curve has inverted and this has not been closely followed by a recession. This chart shows that the median length between a yield curve inversion and a recession is 20 months. And S&P 500 returns typically remained positive following the last 9 inversions.

S&P 500 Returns Following 10Y–2Y UST Yield Curve Inversions (%) Positive Negative

Inversion	3 months	6 months	12 months	24 months	Time to recession
Dec 1965	-5	-6	-12	2	49 months
May 1968	2	8	9	-14	20 months
Feb 1973	-5	-10	-19	-31	10 months
Aug 1978	-11	-6	1	16	18 months
Dec 1988	6	18	25	16	20 months
May 1998	-1	5	25	34	35 months
Feb 2000	4	3	-5	-18	14 months
Dec 2005	4	0	13	17	25 months
Aug 2019	8	18	18	53	7 months
Median	**2**	**3**	**9**	**16**	20 months
% Positive	**56**	**56**	**67**	**67**	

Source: Goldman Sachs Global Investment Research