



**GRANT STREET ASSET MANAGEMENT, INC**  
**QUARTERLY LETTER**  
**2<sup>ND</sup> QUARTER 2022**  
**JULY 15, 2022**

The pull-back in both equity and bond markets that began in the first part of 2022 intensified over the second quarter as investors reacted to a number of changes in the economy. The first quarter of the year was marked by an unexpected conflict in Europe between Ukraine and Russia as well as a U.S. Federal Reserve poised for a steady interest rate hiking campaign throughout the year. These factors weighed on markets early in the year and resulted in single digit negative returns, but the impact on broader U.S. economic growth was thought to be relatively contained. Talk of recession was a mere whisper at the end of March.

As a result of second quarter developments, investors have experienced significant market swings and a broad revaluation of global equities during the first half of 2022.

<b>Equity Index</b>	<b>1Q 2022</b>	<b>2Q 2022</b>	<b>Year-to-date 2022</b>
S&P 500 (Large Companies)	-4.6%	-16.1%	-20.0%
Nasdaq 100 (Technology-heavy)	-8.9%	-22.3%	-29.2%
S&P 400 (Mid-sized Companies)	-4.9%	-15.4%	-19.5%
Russell 2000 (Small-sized Companies)	-7.5%	-17.2%	-23.4%
MSCI EAFE (Europe, Australia & Far East)	-5.9%	-14.5%	-19.6%
MSCI Emerging Markets	-6.9%	-11.4%	-17.6%
MSCI ACWI (All Country World Index)	-5.5%	-15.8%	-20.5%

Similar to equities, all fixed income sectors suffered during the quarter, except 3-month T-bills, which are widely seen as a cash equivalent.

<b>Fixed Income Index</b>	<b>1Q 2022</b>	<b>2Q 2022</b>	<b>Year-to-date 2022</b>
Bloomberg U.S. Aggregate Bond	-5.9%	-4.7%	-10.3%
U.S. 10-year Treasury	-6.6%	-4.9%	-11.3%
Bloomberg 1-3 yr. U.S. Treasury	-2.5%	-0.5%	-3.0%
U.S. 3-month T-Bills	0.0%	0.1%	0.1%
Bloomberg U.S. Corp. High Yield	-4.8%	-9.8%	-14.2%
Bloomberg Municipal Bond	-6.2%	2.9%	-9.0%

What developed over the second quarter was three-fold. First was a realization that inflation was remaining higher for longer than expected. Inflation began its ascent in 2021 as a result of temporary supply chain issues related to Covid and a hot housing market, but the increased food and energy prices resulting from the Russia-Ukraine conflict added fuel to the fire. The Fed, committed to reducing inflation, abandoned its plan for a steady increase in rates and surprised investors with a one-time +0.75% hike, the largest one-time increase since 1994. Pivots like this are notoriously hard for markets to digest, and this time was no different. The Fed has since indicated it will be as aggressive as possible with future rate increases to contain inflation. Since higher interest rates make it more expensive for consumers and corporations to borrow money, this has led to a growing consensus of much slower growth in the second half of the year.

The second development was evidence that consumers were depleting savings and increasing credit balances to finance consumption. The consumer entered this higher inflation environment in very strong financial condition: savings rates were high following Covid lockdowns and Government stimulus, debt was low, employment has been plentiful, and wages are increasing. However, sustained inflation has started to eat into reserves, and the data began to show some cracks in the consumer's armor. Since consumer spending makes up approximately two thirds of U.S. GDP growth, this development also raised alarms of a potential recession this year and not just a slow-down.

The third impact came from cautious forward guidance given by corporations unsure of whether the many headwinds they faced in the second quarter (higher interest rates, a stronger dollar, higher inflation, etc.) will dissipate for the remainder of the year. Admittedly, this is a difficult environment for corporations to forecast, and resulting layoff announcements from Tesla, Netflix, JPMorgan, Redfin and Coinbase helped to pull equity markets lower over the quarter.

Despite the challenging returns across equities for the first half of 2022, the economic picture is not dire by any means. The job market remains strong, with nearly two jobs open for every one person employed. Even if this figure comes down, we expect employment to remain historically strong. Higher wages are also a "sticky" type of inflation and are difficult to reduce, so consumers income is likely to be maintained at these higher levels. Likewise, corporations, despite uncertainty about how the second half of 2022 may play out, are also coming from a position of strength. At the start of this year, corporations were operating at record profit margins, and they had significant cash reserves and strong debt coverage. In short, they had room to absorb higher costs and wage inflation while continuing to grow and remain financially healthy. In fact, aggregate earnings reported by companies in the S&P 500 (500 largest US companies) during the second quarter grew at a very strong 13.5% year-over-year. Our takeaway is that if we do enter a recession this year (or if we are already in recession), we anticipate a mild and short-lived one.

Finally, while economic data tells us today what happened in the recent past, markets move ahead of recessions and expansions and are forward looking. Equity markets often bottom before a recession is even officially announced. Following the recent pull-back, the S&P 500 now trades below its long-term historical average P/E ratio, presenting an attractive long-term entry point for investors. Likewise, bond yields are now above 3% for many corporate and government bonds segments and are beginning to offer potential for positive returns moving forward.

With the volatility in the markets, Grant Street has made some adjustments within the defensive side of portfolios in the second quarter, but we continue to believe stocks will drive growth over the next twelve months. Early in the quarter we reduced our interest rate sensitivity as higher inflation was forcing The Fed to consider a faster increase in rates. Later in the quarter, as recession chatter got louder, we increased the quality of the defensive section and reduced below investment grade debt for higher quality debt. Within equities, we continue to favor a diversified portfolio with a focus on U.S. large cap stocks with a balance across core, value, and growth styles. We also acknowledge valuations in international markets continue to be compelling, and we maintain a modest allocation in this asset class for long-term opportunity. We are staying attentive to the near-term environment in which we invest while maintaining an eye towards the future for the growth and protection of your assets. As always, we value and appreciate your trust in our team.

**GSAM Update:**

We also wish to announce a promotion within our team. Nick O'Neill has recently been promoted to Senior Vice President of Client Services. Nick has been a part of the Grant Street team since 2018, and he has focused primarily on client operations. Nick's new role will be to manage and grow the client operations team as well as manage the technology experience for clients and advisors. We are grateful for his contribution to our team!