Q3 2022

INVESTMENT REVIEW

Market Review and Outlook

By Michael R. Eisner, CFA; Chief Investment Officer

The third quarter provided no respite to investors, with more declines putting the equity markets firmly in Bear Market territory for the year.

Third quarter market performance continued the bear market theme, with just about all asset classes falling sharply. The S&P 500 dropped another 4.9%, international stocks (EAFE) fell 9.4% and emerging markets were even worse, declining over 11%. Year-to-date results (see table) are all firmly in bear market territory (a drop of over 20%). For the third quarter in a row, bonds provided no respite, with high quality municipals falling 3.5%, high quality taxable bonds (Bloomberg US Aggregate) dropping 4.8% and Treasuries declining anywhere from 2% to 9% depending on their duration.

The main culprit for the disastrous financial results has been persistently high inflation and global central banks' roles in trying to contain this. In the U.S., the Federal Reserve (Fed) projected in their December 2021 Summary of Economic Projections that inflation in 2022 would average 2.6% and the Fed Funds rate would end the year at 0.9% (three 0.25% rate hikes during the year). Fast forwarding just nine months, the Fed's inflation gauge is running at an annualized 6.2% and the Fed has raised interest rates 3% (including three 0.75% hikes!) and expects to hike further, ending the year at 4.25%! This incredibly poor forecast by the Fed has forced it to quickly readjust interest rates during 2022, creating the havoc we see in financial markets today.

The Federal Reserve's preferred inflation measure is the Personal Consumption Expenditure (PCE) index. Many readers will be more familiar with the Consumer Price Index (CPI) which is running at an over 8% annualized rate.

One of the side effects of high inflation and the quick rise in interest rates to curtail this problem is a possible recession. Higher rates make borrowing costs more expensive, leading to slower investment in businesses and making home ownership less affordable. Labor costs have also risen precipitously with inflation putting stress on corporate margins and profits. Less profitable companies might lay off employees who then might cut back on goods and services they might otherwise purchase. This starts a vicious cycle that doesn't stop until an economic equilibrium is found, which might entail the Fed ultimately lowering interest rates to restart the economy. Consensus seems to be pricing in a recession in 2023, with the Fed not changing its interest rate stance until 2024.

From an economic perspective (more thoroughly discussed later in this report), the U.S. economy is showing signs of slowing. We expect this slowdown to

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Index	3Q22	YTD	1-Year	3-Year	5-Year	10-year
S&P 500	-4.9	-23.9	-15.5	8.1	9.2	11.7
Russell 2000 (Small Cap)	-2.2	-25.1	-23.5	4.3	3.5	8.5
MSCI EAFE (Int'l)	-9.3	-26.7	-24.7	-1.3	-0.3	4.3
MSCI Emerging Markets	-11.5	-27.0	-27.9	-1.8	-1.5	1.4
BBG/Barclays Municipal Index	-3.5	-12.1	-11.5	-1.9	0.6	1.8
BBG/Barclays Muni High Yield	-4.8	-16.0	-15.1	-1.4	2.3	3.5

Note: *Returns are in %; returns greater than 1 year are annualized.* Source: *Bloomberg*

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temper the red hot inflation in the economy, ultimately allowing the Fed to follow its current path of pausing rate hikes next year. It remains to be seen how hard or soft our landing will be and if we truly enter a recession as the confluence of higher rates, lower inflation and a slowing economy all come together next year.

A small silver lining may be that markets have now adjusted to the higher interest rate regime and priced in a possible recession. The VIX, a measure of short-term volatility in the markets, has not reacted as violently as it did earlier this year with each new Fed pronouncement. During January, March and May's selloffs, the VIX hit highs in the 32 – 36 range. After the Fed's hawkish meeting at the end of September, the VIX just touched 32 and is still around 33 even as rates have moved much higher. This does not mean markets are ready to begin an upward march, but may reflect that investors have now fully adjusted their views and have already repositioned portfolios for the expected bad news.

There are still additional risks outside of the Fed's activity. Third quarter earnings season begins this week and CEO reports will provide a good deal of color on how bad the slowdown might be and the impact on future earnings. This will go a long way to influencing pricing in markets. In addition, foreign markets, especially those in Europe, show increasing stress due to energy issues, their own inflation problems, plus fallout from the war in Ukraine. The lower equity prices in these markets are justly deserved and the risks still give us pause to making new commitments.

One positive aspect of higher interest rates is that bond portfolios should provide a better return over the next 10 years compared to the previous 10 years when Fed Funds rates were 0% and the 10-year Treasury yielding between 1.5% - 3%. A rule of thumb is that bond returns over their maturity should be somewhere close to their current yield, so with 10-year Treasuries now close to 4%, the expected return for bond portfolios should be 1% - 2% higher than the last 10 years.

The most frequent question we get is "is it time to get back into the markets yet?" We have no ability to time markets (and anybody who tells you they can is lying to you), but know from experience that the starting price of an investment is one of the most important factors in long-term returns. Given that most equity markets are down 20%+ this year from their highs (and many individual stocks are down 50% or more), today's entry prices are much more attractive than at the beginning of the year. Our view is that we are still in the midst of the bad news, which makes it hard to make significant moves back into the market. Given we are still in the most volatile time of the year historically but coming up to the most favorable seasonality, it may pay to remain patient for a few more months until certain variables (inflation, earnings, Fed projections) gain a bit more clarity.

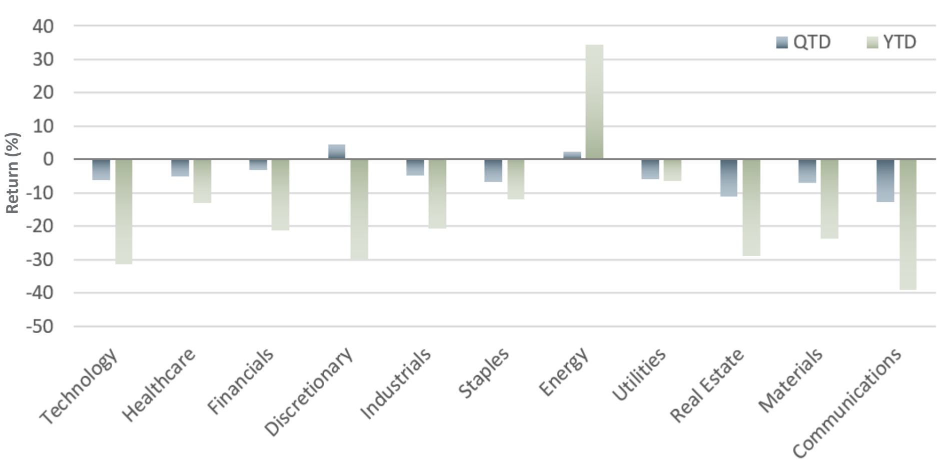
U.S. Equities

Highlights *by James Talalas; Investment Analyst*

All Eyes Remain on the Fed Throughout Another Turbulent Quarter

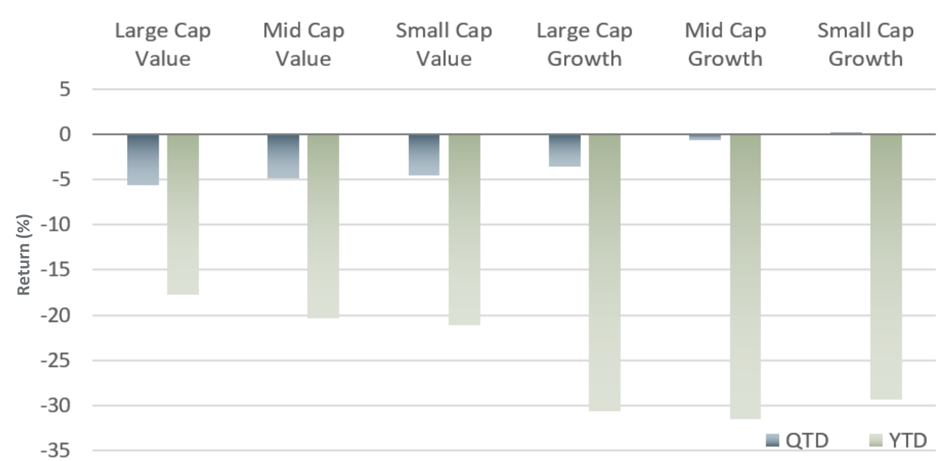
- Despite a short run of optimism at the start of the quarter, U.S. Equity markets continued their downward plunge, reaffirming that the current market climate is unlike 2020's V-shaped recovery. The S&P and Dow were quick to retrace their early gains, falling a respective -4.9% and -6.2% during the quarter.
- Sentiment shifted on a whim during this tumultuous quarter as investors speculated on the possibility of an end to the Federal Reserve's hawkish rate hikes. The S&P 500 rebounded over 17% between mid-June and mid-August as hopes ran high. Chairman Powell's August speech at Jackson Hole, however, was quick to remind investors of the Fed's steeled resolve toward controlling inflation. Markets were quick to return the rally's gains and find new lows entering the fourth quarter.
- Inflation remains top of mind for U.S. markets going into the end of the year. Despite some marginal decline being seen in topline inflation, core inflation, which excludes the volatile food and energy sectors, remains stubborn at 6.3%. This, paired with upcoming fiscal stimulus in the form of President Biden's Student Loan Debt Relief Plan, continues to force the Fed to maintain its hawkish rate setting agenda. The Federal Reserve hiked interest rates by 75 basis points two consecutive times in the third quarter at both the July and September meetings, with two additional hikes likely to be seen during Q4.
- The Discretionary and Energy sectors outperformed in the third quarter, up 4.4% and 2.2% respectively, with Energy continuing its run as the only sector remaining in positive territory YTD (up 34.5%). Communications and Real Estate were the worst performing sectors, down a respective -12.7% and -11.0% as rising interest rates continue to decelerate Real Estate growth. Cyclical sectors, including Communications, Technology, and Consumer Discretionary, continue to suffer the worst year to date, down a massive 39.0%, 31.4%, and 29.9%.
- Growth Stocks notched some minor outperformance over Value Stocks in the third quarter with small cap growth managing to be the only style to stay in the green, up 0.2%. Year to date however Growth stocks have severely underperformed, with large cap growth (-30.7%) significantly underperforming large cap value (-17.8%) and small cap growth (-29.3%) also underperforming small cap value (-21.1%) as the market continues its rotation away from high multiple stocks.

U.S. Sector Returns *QTD vs YTD*



Source: *Bloomberg*

U.S. Style Returns *QTD vs YTD*



Source: *Bloomberg*

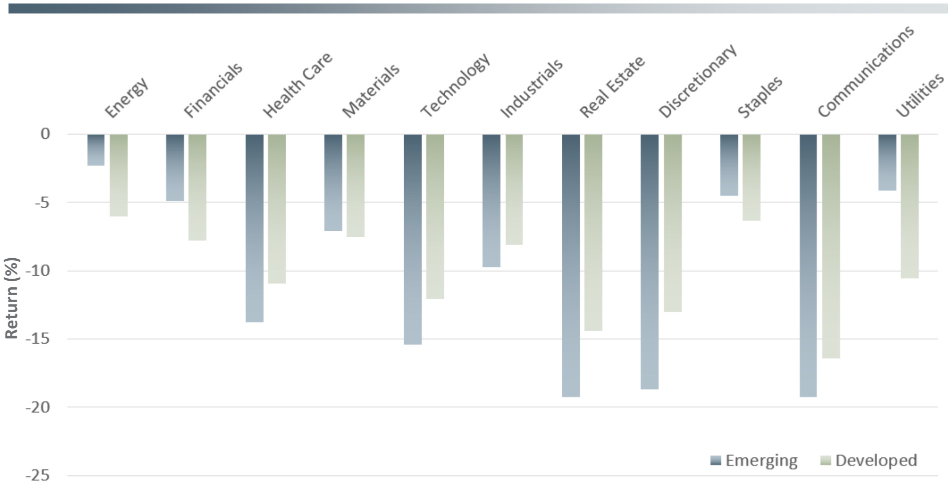
International Equities

Highlights *by James Talalas; Investment Analyst*

Central Banks Pick Up the Pace as Inflation Rages

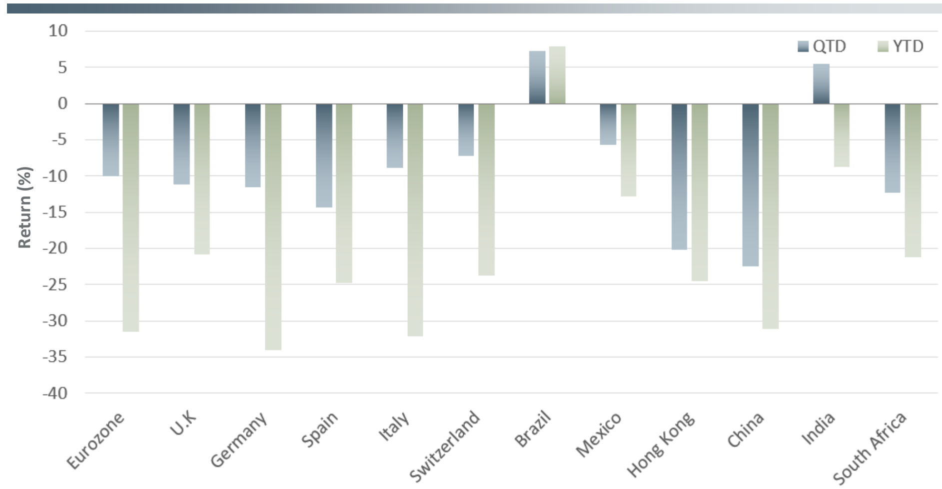
- The MSCI World Ex USA IMI index ended the quarter down -9.6% as a swath of troubling economic news befell countries worldwide. The MSCI EAFE index fell by -9.3% while the MSCI Emerging Markets index contracted by a substantial -11.5%.
- U.K. markets declined by -11.2% in the third quarter as newly elected prime minister Liz Truss made a splash in her first month in office, contradicting the Bank of England by promising expansionary fiscal policy, hoping to cut taxes and delivering a stimulus package to prop up the U.K.'s floundering economy. The U.K. will have many challenges going into the fourth quarter and 2023, as it is now led by a prime minister with worse polling numbers than controversial predecessor, Boris Johnson. The country must fend off a recession, combat a pension crisis, and tame runaway inflation.
- For the Eurozone (down -10.0% for the quarter) a recession seems to be almost a guarantee with nations still suffering from a lack of Russian natural gas as temperatures have begun to drop heading into winter. Eurozone inflation continues to be a daunting issue for ECB president Christine Lagarde to tackle, crossing the 10.0% mark and is now 8.0% away from the central bank's target. Though the ECB has finally hiked rates out of negative territory, it is likely to need to continue making larger and more frequent rate hikes if it hopes to bring inflation back to healthy levels.
- Chinese markets contracted by 22.4% as President Xi remains obstinate in maintaining his zero-COVID policy and locking down the country, severely hampering the nation's ability to export and causing reverberations to dependent countries. The Chinese government rolled out a swath of fiscal and monetary stimulus in the third quarter in hopes to circumvent the issues caused by lockdowns without easing restrictions, passing a trillion-yuan infrastructure stimulus package and cutting interest rates.
- Cyclical sectors continued their underperformance across international markets as nations worldwide continue to move closer and closer to recession territory. Communications, Real Estate, Consumer Discretionary and Technology all found themselves down between 10-20% as investors continue their flight toward more defensive sectors. Technology has had particularly poor YTD performance, down over -40% in both Emerging and Developed markets, as rising interest rates batter speculatively valued companies.

Developed vs. Emerging Markets *Sector Returns Q3*



Source: *Bloomberg*

Country Returns *QTD vs YTD*



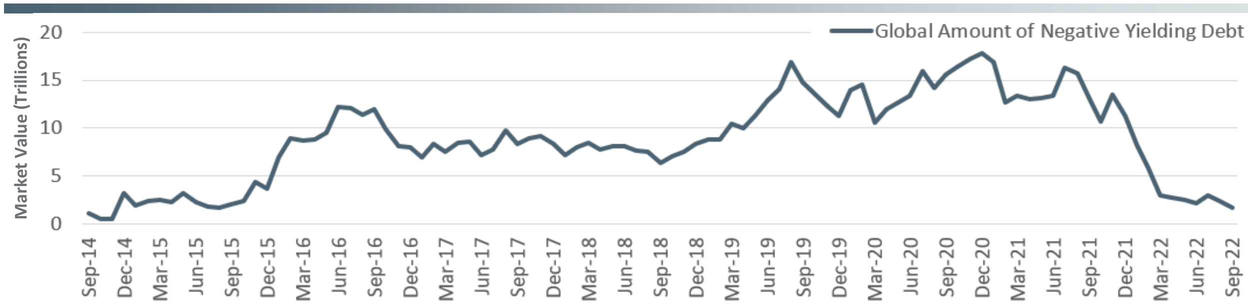
Source: *Bloomberg*

Highlights *by Ross Miller, CFA, CAIA; Portfolio Manager*

A Recession Indicator Flashes: "Because I Was Inverted" Hawkish central banks are proving their resolve to slow economic growth in the battle to lower inflation. Tighter monetary policy has pushed bond yields to levels not seen in over a decade and in the process has erased $10 trillion in value of negative yielding debt.

- The Federal Reserve (Fed) hiked interest rates by 0.75% twice in the third quarter bringing the total number of hikes to 5 for a Federal Funds Rate range of 3-3.25%. As a result of the hikes, Treasury yields continued higher, inverting the yield curve for the first time this year. Historically, inversion of the 10 and 2-year Treasury yields precede a recession. As the Fed moves forward with tighter policy, the inversion is likely to deepen but the timing of a recession from inversion is very uncertain. Comparing to the 1980s, the deepest inversion was -2.41% while in 2022, we have only hit -0.52%.
- "I feel the need, the need for speed," as Maverick stated in Top Gun, bond yields have also felt that need. As the Fed hiked rates a cumulative 1.5% in the third quarter, yields move higher in rapid fashion. Treasury yields rose quickly in the third quarter with 2-year yields rising by 1.3% to 4.22% (highest since 2007) and 10-year yields rising 0.85% to 3.83% (highest since 2010). These rapid moves pushed Treasury returns down 4.34% in the third quarter. Year-to-date the 2-year and 10-year yields have risen 3.49% and 2.31%, respectively, in only 9 months, the second fastest 9-month move on record (1981 remains fastest at 3.63% and 3.41%, respectively).
- The municipal bond market fell 3.46% in the third quarter with benchmark yields rising 0.96% to 3.55%, the highest since December 2008! The municipal market continues to struggle amid higher yields and a dearth of issuance as states and local issuers remain in strong fiscal positions. Refinancings, which make up a large portion of supply, have stalled as higher rates make the process less attractive. Municipals summer effect of large cash payments and limited supply helped July returns, but the overall yield rise was too much to offset a limited bounce back in demand and fund flows.
- High-yield municipal bonds underperformed with a -4.83% return in the third quarter. High-yield municipal benchmark yields rose to 6.03%, putting them right on top of their 20-year average of 6.04%. High-yield municipals benefit from a 9.27% tax-equivalent yield, but higher rates and economic concerns are headwinds. High-yield municipal defaults remain low and most issuers are in strong financial positions making the higher tax-equivalent yield and its fundamentals attractive. However, the expectation of higher rates going forward will likely weigh on future returns.
- High-yield corporate bonds outperformed its fixed income peers with a small 0.64% decline in the third quarter helped by a strong 5.9% return in July. High-yield corporate bonds remain a risky asset class with benchmark yields at 9.69%, well above its long-term average of 8.04%. Given the expectation of a slowing economy and unattractive rates to refinance, the high-yield corporate bond market is starting to show signs of stress. High-yield corporate bonds have a history of outperforming in rate-hiking cycles but given high macroeconomic uncertainty and spreads only slightly above average, it is hard to see how history may repeat itself.

Remember Negative Yielding Debt?



Need for Speed: Large Yield Moves in 2022

Source (both charts above): *Bloomberg*

Global Economy

Highlights *by Ross Miller, CFA, CAIA; Portfolio Manager*

As the Federal Reserve hikes interest rates to slow growth and fight inflation, let's review it's impacts and progress.

- The U.S. economy has been dealt a body blow with a cumulative 3.0% worth of rate hikes by the Federal Reserve (Fed) in only nine months. The goal of the rapid and large rate hikes is to slow the U.S. economy and push inflation back to its average target of 2%. There are signs of success with durable goods inflation falling from 18% in February 2022 to just 7% in September, but most of that can be attributed to demand already declining and a significant easing in supply chain constraints. However, the bad news is that services inflation rose 7.4% year-over-year (YoY) in September and is still increasing. Food inflation is a concern from a political, economic and humanitarian standpoint but its price moves are much more volatile given the bevy of impacts such as transportation costs, energy costs and weather, not just demand.
- A key metric to watch is the ISM Services Index as the survey acts as a guide to demand. In a typical year, the September ISM Services Index reading of 56.7 would be good news but in our current inflationary environment that's too high. The U.S. economy is 67% consumer oriented, so the longer services demand remains elevated, the higher rates will need to go to cool inflation's trajectory. We will need to see further declines in the ISM Services Index and services inflation measures before we can get excited about progress.
- Housing was the rising star in the economy for the last two years with record levels of home buying and home price growth. However, its shining star has dimmed as interest rates have moved to levels not seen in ten years. Home price growth has only just started to slow and so have home sales. It's not hard to see why as the median existing home sales price is $396,000 (down from $415,000 in May!) and 30-year mortgage rates spiked to 6.7% at the end of September, a 3.9% increase from the start of 2022. The cost of a median home now, even with 20% down and excluding property taxes, would be $2,045.79 a month, $700 more per month than for the same price in January. As mortgage rates rise, affordability will continue to fall as will demand. While bad for home buyers and sellers, this is good for the Fed as it should hopefully translate into lower owner's equivalent rent and rental inflation, which constitutes 31% of the consumer price index.
- Consumers remain relatively resilient with retail sales up 9.1% YoY but this is on a nominal, not an inflation adjusted (real) basis. The average growth of retail sales is 2% in 2022 when adjusting nominal sales by the consumer price index. While low, its right around its long-term average of 2.05% and is unlikely to be viewed positively by the Fed. However, we are seeing some progress in the retail space with cuts to earnings guidance and rising inventories, showing consumer demand is slowing.

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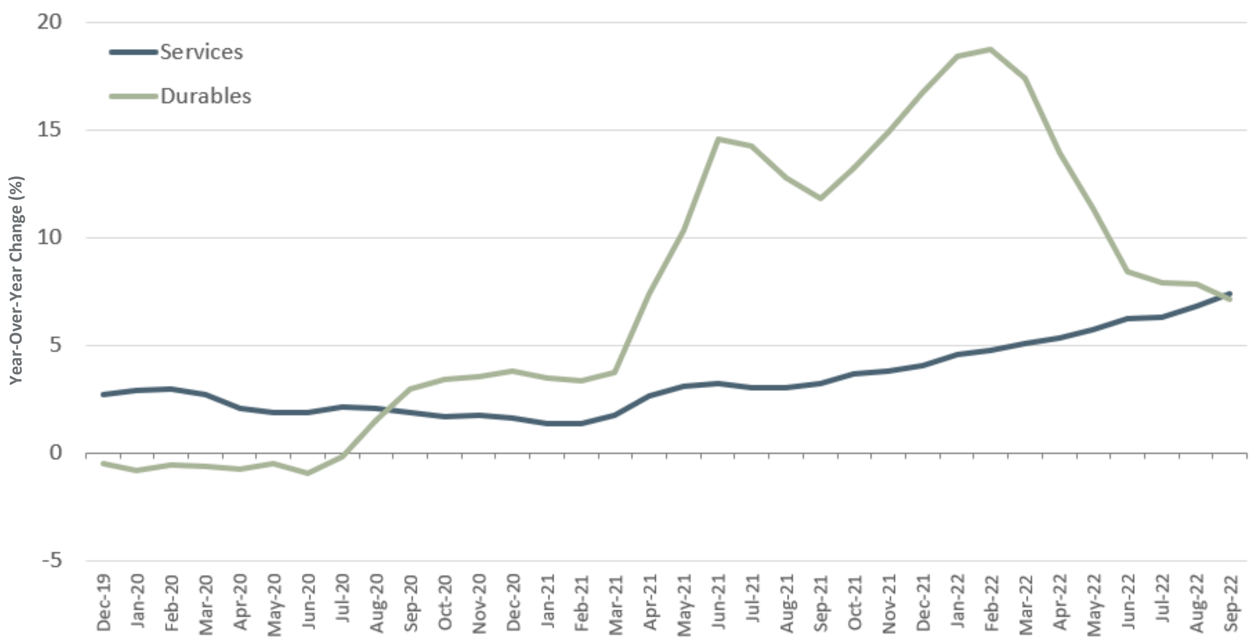
Durable Goods Inflation Down, Services Inflation Up



Source: *Bloomberg*

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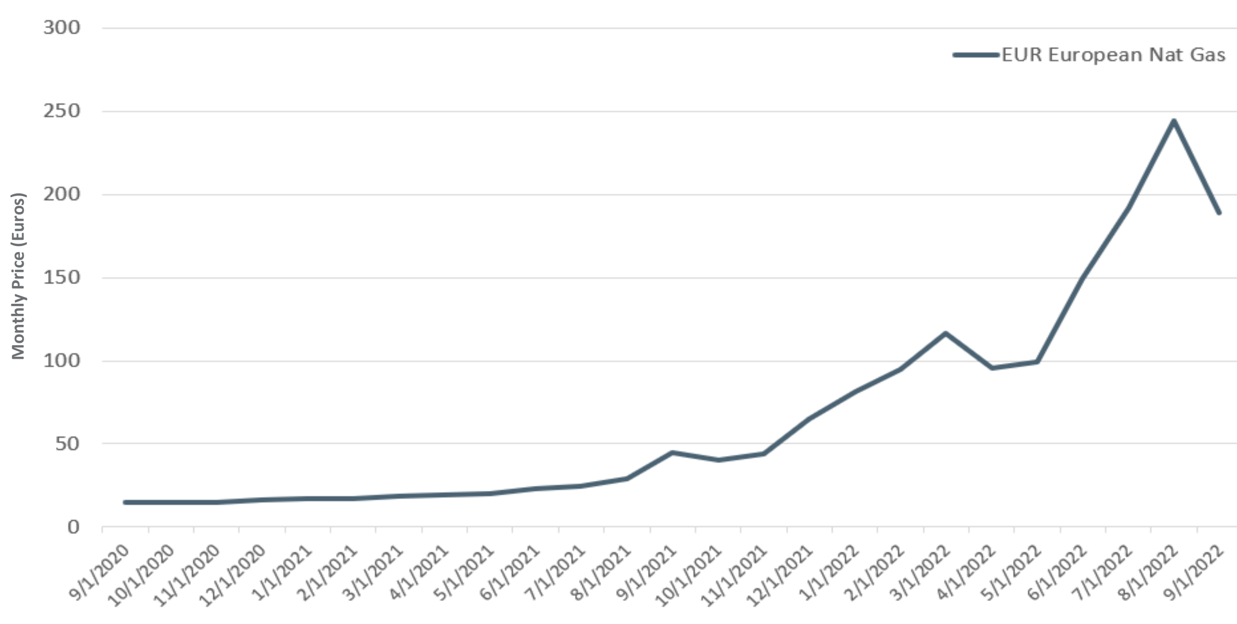
- Part of the Fed's expectations from higher interest rates is a looser labor market. The Fed expects unemployment to rise as part of its policy tightening and is likely intended to be through an increase of the labor force participation rate and not through job cuts. So far, we've seen unemployment rise to 3.65% before falling to 3.5% in September with the labor force population hitting a new high and the participation rate increasing. The August JOLTS job opening report showed 10.1 million jobs available down 1.1 million from July. Companies have also started leaving open positions unfilled and reduced hiring expectations. However, the labor market remains tight with low unemployment and plentiful job openings. Initial and continuing jobless claims will be the most real-time view into the temperature of the labor market as both claims numbers remain well below longer-term averages, which means little cooling progress.
- While second quarter GDP reports have fared better in Europe than in the U.S., Europe is facing an energy crisis amid the continued Russian invasion of Ukraine while its economic data weakens. The Eurozone's services, manufacturing and composite PMIs have all fallen into contraction territory (below 50). On top of that, Europe is predominately an exporter, so global trade has a big impact on its economic trajectory. Its two largest trading partners, China and the U.S., are seeing slowing growth, add in a strong dollar and rising energy costs, and it paints a very bleak picture for the European economy.
- While U.S. inflation has started to pull back from its peak, European inflation is still rising. The consumer price index for the Eurozone hit 10% YoY in September and its producer price index rose to 43.3% in August. The rise in inflation is due to the energy crisis at hand. European natural gas prices have almost doubled since May which impacts consumers, manufacturers and restaurants. While a slowing global economy will have a negative impact, a sustained energy crisis will hurt the European region and can reverberate back into the global economy.
- China has been a bastion of growth for the global economy but its COVID zero policy and its stringent restrictions has taken a toll on the economy. Its 20th party congress begins October 16th and the Chinese government has mounting policy obstacles in its way with a deteriorating housing market, a weaker export market and a restricted consumer. It is unlikely that President Xi will target a GDP growth rate but China requires watching as it is the largest trading partner for emerging markets along with being a significant contributor to global growth. China could see a rebound in consumer spending if there is an easing in its COVID zero policy but continued economic weakness could exacerbate the already slowing global economy.

European Natural Gas Prices



Source: *Bloomberg*

Highlights *by Ross Miller, CFA, CAIA; Portfolio Manager*

Commodities saw broad price declines amid a stronger dollar, higher interest rates and economic growth concerns that weighed on demand across the asset class.

- The entire commodity complex saw price declines in the third quarter with the exception of Lithium. The mineral benefitted from a continued focus on renewables, batteries and electric vehicle demand. Lithium is the main material in electric vehicle batteries and pricing was supported amid data showing a significant supply deficit to meet even current demand going forward, let alone a sizable increase. Elevated demand and an energy transition focus should continue to support higher Lithium prices. Adding to its strong first quarter, Lithium prices have risen 123% in 2022.
- Oil had been a commodity price leader throughout the first half of 2022 but saw a swift decline in the third quarter. Oil prices fell 25% amid easing U.S. demand and continued Covid lockdowns in China. The decline in crude oil prices was felt at the gas pump with daily average prices falling to their lowest levels since March. The oil market is expected to be volatile with OPEC+ likely to cut oil production by 2 million barrels per day in October following small production increases over the last year. Prices will remain elevated but it is likely actual supply will not be severely impacted given most OPEC+ producers are not hitting their increased quotas as is. However, oil markets were tightly supplied before this cut, so oil prices should be biased higher going forward.
- Natural gas prices fell during the third quarter with the entire decline occurring in September. Higher natural gas pricing was supported by a fire at a U.S. liquified natural gas (LNG) facility as well as strong export demand as Russia continues to limit or outright stop natural gas flows to continental Europe. Prices eased amid a resumption of flows at the LNG facility and as European storage for the upcoming winter hit necessary levels. Natural gas demand will remain elevated (and prices) especially as Europe continues to wean its reliance off Russian energy and as Russia tries to use its energy assets as an economic weapon.
- Precious and industrial metals declined in the third quarter. Copper continued to fall with a 7% decline in

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Components of the S&P Goldman Sachs Commodity Index (1-Year Return) *% change since 09/30/2021*

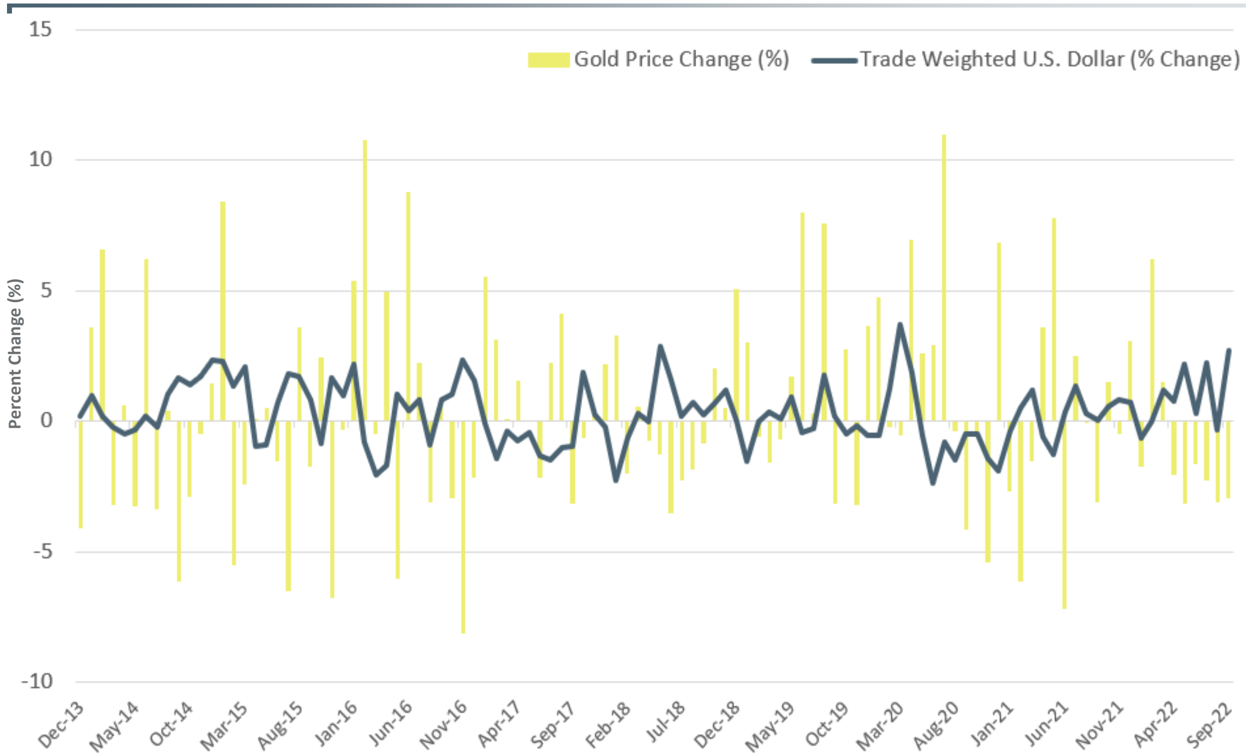
Source: *Bloomberg*

(Continued)

the third quarter, marking a 21% decline in 2022. Copper has fallen amid economic growth concerns, especially with weakening growth in China. Precious metals, gold and silver, saw declines as U.S. dollar strength weighed heavily on metal demand. The Federal Reserve's continued tight monetary policy, which is pushing rates higher (along with the U.S. dollar), will continue to be a headwind to metals.

- Real estate suffered another double-digit decline in the third quarter with REITs declining 10% on the continued interest rate rise. Across U.S. REITs, Offices were the worst performer with a 13% decline, while Warehouses and Industrial REITs that had held up well throughout 2022 fell 12%, as economic growth concerns started to emerge. Real estate will continue to struggle globally amid higher rates, which increases both competition for income producing assets and recessionary concerns.

Strong Dollar, Weaker Gold



Source: *Bloomberg*

Tactical Asset Allocation

Market Street Growth Strategy *Third Quarter 2022*

ASSET CLASS	NEGATIVE		NEUTRAL		POSITIVE
CASH				■	
INVESTMENT GRADE BONDS		■			
Municipal Bonds		■			
HIGH YIELD DEBT		■			
High Yield Municipal Bonds			■		
High Yield Corporate Bonds	■				
Emerging Market Debt		■			
HEDGED ASSETS				■	
Long/Short Equity				■	
Distressed/Structured Credit					■
EQUITIES				■	
U.S. Equities - Large Cap			■		
U.S. Equities - Small Cap			■		
Developed Market Equities	■				
Emerging Market Equities		■			
Private Equity					■
REAL ASSETS		■			
MLPs				■	
Global Real Estate/REITs		■			
Natural Resources/Energy			■		

Portfolios maintain an underweight to high quality investment grade fixed income and a medium overweight to cash. A poor start to the year sees municipal bonds historically attractive relative to Treasuries. The continued increase in yields has made municipal bonds more attractive, but we remain patient as the Fed continues to signal more rate hikes.

We maintain a neutral exposure to municipal high yield debt as yields have improved. Prospects of higher taxes along with a rotation to higher yielding bonds has slowly stemmed outflows from high yield municipals. We maintain tactical allocations to closed-end funds and will leverage a higher cash exposure to tactically reallocate when more attractive entry points occur.

We are maintaining neutral to overweight allocations to hedge funds as we believe that these strategies make sense given current volatility, plus their diversifying and less correlated attributes. We continue to refocus hedge fund exposures towards unique alpha-generating opportunities (like structured credit) that can provide attractive risk-adjusted returns.

Portfolios maintain a full U.S. equity exposure as we believe there is value in these markets despite higher expected volatility. Equity allocations have been repositioned to increase exposures to those areas of the market that benefit from rising interest rates. We maintain a significant underweight to international equities given the disruptive effect the war in Ukraine and energy issues are having on the region. While we favor emerging markets over developed markets within the asset class, we believe a slowing global economy makes these assets less attractive. Market Street's private equity program continues to provide attractive exposures that cannot be obtained in the public markets, and we are maintaining an overweight to the asset class for those clients for which it is a prudent investment.

We believe MLPs and energy related stocks continue to offer the potential of very appealing total returns. Although recession risks may blunt energy demand, we see no reason to believe that the supply/demand imbalance will be resolved in the near-term. Increased recession risks will be a headwind for natural resources, offsetting the positive effect supply chain imbalances have had on the sector.

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