NORTH STAR
Resource Group

# MARKET UPDATE
QUARTER 1, 2022

First and foremost, heartfelt thoughts and prayers to the people of Ukraine.

What a difference three months can make in the world and for the stock and bond markets. Geopolitical headlines with the invasion of Ukraine and large increase in inflation numbers, globally, not just the US, have adversely affected the markets. This quarter, the stock markets did reach correction territory, down more than 10%, but strong performance in the last three weeks of March quickly saw the market bounce off these lows.

The epic market run in 2021 came to an end. The US Large Cap Index the S&P 500 was down for the quarter -4.60%, the small caps in the Russell 2000 index were down -7.53%, the international MSCI EAFE index was down -5.91%. [1] By far the biggest surprise was the drop in the fixed income markets and the Barclay's Aggregate Bond Index, down -5.93% as these inflation number came in much higher than expected. Inflation as measured by the Headline CPI is up 7.9%, well above the 4.7% reading in 4Q21[2] and the Fed Target of 2%. We have to go back to the late 70's and early 80's, 1982 to be exact [2], to see inflation numbers this high. Given this was 4 decades ago, most current investors are not familiar with inflation, let alone the effects it will have on the markets, portfolios, and consumer spending.

These higher inflation numbers have become a game changer for the stock markets. The market rotation has turned into an outright sell of the growth side, small and mid-cap stocks sold off the most, down -12.6% with large cap growth down -9.0%.[2] On the value side, large cap value was only down -0.7% and small cap down -2.7%.[2] Only two sectors had positive returns for the quarter, Energy and Utilities, up 39% and 4.8% respectfully.[1] The war in Ukraine and sanctions on Russia disrupted oil and natural gas supplies worldwide causing prices and perceived profits to increase for Energy, in addition, US investors headed to the safety of Utilities. The sectors that lagged the most were Communication Services, Consumer Discretionary and Technology, down -11.9%, -9.0% and -8.4% respectfully.[1]

The one-year return for the S&P 500 is still positive at 15.6%, whereas the small caps in the Russell 2000 were down -5.8% and the Barclay's US Agg Bond index was off -4.15%.[1] All of the sectors for the one-year are positive, with the exception of Communication Services down -1.0%, led by Energy up over 64%. As the stock market sold off, the Forward Price to Earnings, P/E ratio, of the S&P500 cheapened to 19.46x, now under 1 standard deviation to the 25-year average of 16.83 times.[2] Value continues to be cheap to growth.

A couple of notable observations around portfolio management. Normally you are rewarded for taking on risk, in the first quarter, the 5 portfolio benchmark composites were down between -5.63% and -5.45%. Surprisingly, the Income Portfolio at 20/80, percentage equity to fixed income, was down the most at -5.63% and the best performer, Conservative Growth at 60/40 was down -5.45%. For comparison, the 3 Year performance numbers have a more defined characteristics look you would expect over the risk and return spectrum: Aggressive Growth, 100/0 up 14.51%, Growth, 80/20 up 12.16%, Conservative Growth, 60/40 up 9.90%, Income & Growth, 40/60 up 7.2% and Income, 20/80 up 4.88%. [1] Historically when performance numbers cluster together it is an indication markets are in a state of flux and unsure of direction.

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The war in Ukraine and other geopolitical concerns have weighed on the global stock markets, more specifically the commodities markets. The war, and subsequent sanctions imposed on Russia, have disrupted commodity supply chains around the world, which has resulted in increasing oil, natural gas, metals and agricultural pricing and futures. For the US economy inflation has been the biggest disrupter of the markets. The first inflation gauge in January at 7.5%[2] anticipated more and faster rate increases by the Fed, the Headline CPI reading in late March of 7.9% led the markets to believe the Fed would have to act more aggressively at raising rates. The initial expectation of 3 Fed rate increases in 2022 has quickly escalated to 8 to 11 increases between now and the end of 2023.[2]

The components contributing the most to the increase of inflation are energy - in the form of higher gas prices, new and used vehicles, restaurants and hospitality and shelter - in house prices and rents. Another component, not recorded in headline CPI, is wage growth, the March reading of 6.7% is also a number not seen since the early 80's and well above the 50-year average of 4%.[2] This is reflecting the disparity between the number of jobs open and number of workers, as companies are having to pay more for workers across all job levels. While some of these are transitory and others are sticky, these recent large increases will cause more to be sticky and may be harder to bring under control. The Fed is hoping to create an environment of a "soft landing" rather than a hard crash.

On the fixed income side, Treasury market sold off with the inflation numbers and expectation the Fed would increase rate hikes. The quarter ended with short term rates rising faster than long term rates, ending with an inverted yield curve. Across the yield curve the 2yr jumped from .73% to 2.28%, the 3yr jumped from .97% to 2.45%, the 5y from 1.26% to 2.42%, the 10yr from 1.52% to 2.42% and the 30yr from 1.90% to 2.44%.[2] These big jumps in Treasury yields are a significant reason the fixed income markets and bond are down in price. The Treasury market is directly correlated to bond prices and most other investment grade fixed income markets trade on a spread basis to the Treasuries. As a reminder, there is a negative correlation between fixed income prices and interest rates, as interest rates go up, from either market expectation or Fed Rate hikes, the price of bonds will go down. Short duration bonds have lost value, but should recover the fastest, as their shorter maturities will renew more quickly with higher yields and coupon rates.

For those astute investors, you may be aware that an inverted yield curve can be a signal for a possible economic slowdown or a recession. An inverted yield curve is where short term rates are higher than long term rates. Yields on US Treasury bonds signal future expectations of economic growth. To better understand what is happening with an inverted yield curve, know the markets are expecting growth in the near term to be better than that of the future - or simply put: an economic slowdown. Additionally, 10 of the last 11 recessions have been proceeded by an inverted yield curve on a 12 to 18 month delay. Economists feel because of the war in Ukraine, flight to quality, and Fed bond buying, Quantitative Easing, is putting buying pressure on the long end of the curve, and inflation on the front end of the curve, it is not much of a concern. The definition of an inverted yield curve is the 2yr yielding more than the 10yr, although rare, this did happen the last few days of the first quarter. It will attract media attention.

Taking the long-term view at North Star Investment Resource Center, we continue to believe diversified portfolios and disciplined investment strategies continue to provide the best opportunities for those investors seeking growth.

We welcome investment discussions, should you have any questions or concerns, or if there is a change in your investment time horizon or financial circumstances, please feel free to contact us at your convenience.

Written by North Star Investment Resource Center

*(Average Annual Returns chart on next page)*

| AVERAGE ANNUAL RETURNS FOR PERIODS ENDING 3/31/2022 | | | | | | |
|---|---|---|---|---|---|---|
| **INDEX** | **1ST Q** | **YTD** | **1 YR** | **3 YRS** | **5 YRS** | **10 YRS** |
| S&P 500 | -4.60% | -4.60% | 15.65% | 18.92% | 15.99% | 14.64% |
| Russell 2000 | -7.53% | -7.53% | -5.79% | 11.74% | 9.74% | 11.04% |
| MSCI EAFE (U.S. dollars) | -5.91% | -5.91% | 1.16% | 7.78% | 6.72% | 6.27% |
| Barclays US Aggregate Bond | -5.93% | -5.93% | -4.15% | 1.69% | 2.14% | 2.24% |
| **BENCHMARK COMPOSITES** | **1ST Q** | **YTD** | **1 YR** | **3 YRS** | **5 YRS** | **10 YRS** |
| Aggressive Growth | -5.52% | -5.52% | 6.16% | 14.51% | 12.23% | 11.72% |
| Growth | -5.53% | -5.53% | 4.07% | 12.16% | 10.36% | 9.91% |
| Conservative Growth | -5.45% | -5.45% | 2.94% | 9.90% | 8.62% | 8.16% |
| Income and Growth | -5.54% | -5.54% | 0.72% | 7.20% | 6.49% | 6.17% |
| Income | -5.63% | -5.63% | -0.91% | 4.88% | 4.70% | 4.49% |
| **USD VS LCL** | **1ST Q** | **YTD** | **1 YR** | **3 YRS** | **5 YRS** | **10 YRS** |
| MSCI EAFE NR USD | -5.91% | -5.91% | 1.16% | 7.78% | 6.72% | 6.27% |
| MSCI EAFE NR LCL | -3.73% | -3.73% | 6.21% | 8.23% | 6.55% | 8.61% |

S&P 500 - The S&P 500 Index is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S. Please note an investor cannot invest directly in an index.

Russell 2000 - Russell 2000 Index is an equity index that measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. Please note an investor cannot invest directly in an index.

MSCI EAFE - The MSCI EAFE Index is the Morgan Stanley Capital International Index and is designed to measure the total return of the developed stock markets of Europe, Australia and the Far East. Investment risks associated with international investing, in addition to other risks, include currency fluctuations, political and economic instability and differences in accounting standards when investing in foreign markets. Please note an investor cannot invest directly in an index.

Barclays US Agg Bond - The Barclays U.S. Aggregate Bond Index is a broad-based bond index comprised of government, corporate, mortgage and asset-backed issues, rated investment grade or higher, and having at least one year to maturity. Please note an investor cannot invest directly in an index.

MSCI ACWIxUS - The MSCI ACWI ex US Index is a market capitalization weighted index was designed to provide a broad measure of equity-market performance throughout the world. It is comprised of stocks from 22 of 23 developed countries (excluding the US) and 25 emerging markets. Please note an investor cannot invest directly in an index.

Source: [1]Morningstar Direct, [2]JPMorgan – Guides to the Market

The Benchmark Composite returns are a weighted average of index data comprised in the following manner. Aggressive Growth is 45% S&P 500, 25% Russell 2000 and 30% MSCI EAFE. Growth is 35% S&P 500, 20% Russell 2000, 25% MSCI EAFE and 20% Barclays US Aggregate Bond. Conservative Growth is 30% S&P 500, 10% Russell 2000, 20% MSCI EAFE and 40% Barclays US Aggregate Bond. Income and Growth is 20% S&P 500, 5% Russell 2000, 15% MSCI EAFE and 60% Barclays US Aggregate Bond. Income is 15% S&P 500, 5% MSCI EAFE and 80% Barclays US Aggregate Bond.

This material represents an assessment of the market environment at a specific point in time and is not intended to be a forecast of future events, or a guarantee of future results. This information should not be relied upon by the reader as research or investment advice regarding any funds or stocks in particular, nor should it be construed as a recommendation to purchase or sell a security. Investments will fluctuate and when redeemed may be worth more or less than when originally invested.

Investments that focus in one sector may involve a greater degree of risk and volatility than an investment with greater diversification.

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