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ECONOMIC UPDATE

The Bureau of Labor Statistics (BLS) February employment report confirmed the US economy continues to reopen, growing strongly, with job gains expanding rapidly against the backdrop of an extremely tight labor market, high inflation and the grim geopolitical situation in Ukraine. While the Fed's decision last week to begin tightening credit conditions presents a potential headwind to future growth, the Fed's pivot was, in our view, long overdue as inflation expectations threaten to become unanchored unless checked.

US economic activity expanded at a robust 5.25% rate last year reflecting progress on vaccinations and the reopening of the economy, fiscal and monetary policy support and the very healthy financial positions of households and businesses. While the rapid spread of the Omicron variant led to some slowing in economic activity early this year, cases have declined sharply since mid-January and the resulting slowdown appears to have been mild and brief. Although the invasion of Ukraine and the related reactions thereto represent a downside risk to the outlook for economic activity, economists foresee solid, above-trend growth ahead with the median real GDP forecast at 2.8% for this year and 2.2% in 2023.

The labor market has continued to strengthen and remains very tight. Over the first two months of this year, employment rose by more than one million jobs. In February, the unemployment rate hit a post-pandemic low of 3.8%, a bit below what is considered its longer-term normal run rate. The improvement in labor market conditions has been broad-based, including for workers at the lower end of the wage distribution. Labor demand is very strong, and while labor force participation has increased somewhat, labor supply remains subdued. As a result, employers are having difficulties filling job openings and wages are rising at their fastest pace in over a generation. Expectations are for a continuation of tight labor conditions, with the unemployment rate declining to 3.5% by year-end and remaining at that level thereafter.

INFLATION

Inflation remains well above the Fed's longer-run goal of 2%. Aggregate demand is strong, and bottlenecks and supply constraints are limiting how quickly production can respond. These supply chain disruptions have been larger and longer than had been generally expected, exacerbated by waves of the virus here and abroad. Price pressures have spread to a broader range of goods and services. Additionally, higher energy prices are driving up overall inflation. The surge in the prices of crude oil and other commodities that resulted from Russia's invasion of Ukraine are putting further upward pressure on near-term inflation domestically.

Driving the Fed's decision to begin removing its accommodation is its recognition that to support long-term economic growth, it must promote price stability. A firming in the stance of the Fed's monetary policy, which will also include measures to reduce the size of its balance sheet, should, over time, lead to a return to its 2% target. That said, it is likely to take longer to return to the desired price stability than previously expected. Economists currently forecast inflation as measured by the Fed's favorite metric, the Personal Consumption Expenditures Index (PCE), to reach 4.3% this year, with the risk to the upside, and to decline further thereafter.

The implications for the US economy of Russia's invasion of the Ukraine remain highly uncertain. In addition to the direct effects from higher global oil and gas prices, the invasion and related events may restrain economic activity abroad, particularly in Europe, and further disrupt supply chains, which would spill-over to the US economy through trade and other channels. The volatility in financial markets, if sustained, could also act to tighten credit conditions and effect growth.

The immediate impact of the war in Ukraine on the US economy is likely to operate principally through higher food, energy and commodity prices, in turn weighing on consumer demand. What was a sanguine outlook for the consumer late last year has now turned somewhat guarded. Elevated, broad-based and more persistent inflation lately has reduced real earnings and chipped away at the purchasing power of accumulated savings built up over the pandemic, which amounts to an outsized $2.5 trillion. And household balance sheets have taken a bit of a hit as equity price declines since the start of the year may have lowered household net worth by as much as 2% to 3%. With the Fed tightening monetary policy, consumers will soon be contending with costlier financing for houses, cars and other credit dependent purchases. Despite these headwinds, we expect consumer spending, which accounts for over 70% of real GDP, will remain strong through the year, buoyed by pent up demand, still strong balance sheets and tight labor markets.

Clearly, there are real risks to the economy in the form of upward pressures on inflation and inflation expectations, as well as slowing real GDP growth. Nevertheless, it's highly likely the Fed will deliver a series of interest rate hikes from their current historically low levels, as well as engineer measures to begin to shrink its balance sheet, all aimed at restoring price stability. While *near-term* forecasts for real GDP growth continue to trend lower in response to developments in the Russia-Ukraine war and the latest news on the latest COVID variant, the US economy is strong and well positioned to absorb tighter monetary policy without tipping it into recession.

FORWARD-LOOKING INDICATORS

Beyond the strong employment data, other key forward-looking inputs we have reviewed over the past month confirm both the economy's overall strength and the likelihood of further economic expansion over the months ahead. Below is a sampling of that data and our comments on each.

ISM MANUFACTURING INDEX increased to 58.6 in February exceeding expectations of 58.0. (Levels higher than 50 signal expansion; levels below 50 signal contraction).

The major measures of manufacturing activity were mostly higher in February and all stand above 50, signaling growth ahead. The production index rose to 58.5 from 57.8 the prior month while new orders increased to 61.7 from 57.9 in January. The employment index fell to 52.9 from 54.9 and the supplier deliveries index rose to 66.1 from 64.6. The two most forward looking indices, new orders and production, remain well into expansion territory. Respondents' comments highlighted strong demand from customers, but ongoing difficulties related to shortages of key inputs and transportation services. These issues have combined to keep manufacturing activity from rising quickly enough to meet the explosion in demand as the US economy reopens. However, there has been some recent progress. Despite the small increase in February, the supplier deliveries index is well below its high made in May 2021. However, the delays are far from over, as fifteen of the eighteen industries reporting are experiencing longer waits for inputs.

ISM NON-MANUFACTURING INDEX fell to 56.5 in February, below the consensus expected 61.1. (Levels higher than 50 signal expansion, levels below 50 signal contraction).

The major measures of activity mostly moved lower in February, but nearly all stand above 50, signaling growth. The new orders index fell to 56.1 from 61.7 the prior month, while the business activity index declined to 55.1 from 59.9. The supplier deliveries index ticked up to 66.2 from 65.7, while the employment index dropped to 48.5 from 52.3 in January. The services sector continued to expand rapidly in February, albeit at a slightly slower pace as rising inflation, labor shortages, and supply chain restraints continue to prevent activity from expanding more quickly. Gains were broad-based with fourteen of eighteen industries reporting growth. However, most major components moved lower, with the new orders and business activity indices continuing to trend downward from their record-setting highs in November. Survey comments continue to cite inflation, labor shortages and supply chain disruptions as problems their businesses face when fighting to meet the explosion in demand that has occurred since the economy began to reopen. And the "great resignation" was evident in the data as employees quit their jobs in droves, looking for better paying opportunities and more flexible work. This can be seen in the employment index, which moved back below 50 to 48.5 in February. Inflation, the other persistent issue, is also shown in the prices index, which increased to 83.1 and remains less than a point below its record-high set last December. Despite these persistent headwinds, the services sector, which accounts for over 80% of real GDP, remains well into expansion territory and there are reasons for optimism. Though still historically elevated, the backlog of orders index and supplier deliveries index remain subdued, down from previous record highs set earlier in the pandemic. Meanwhile, the recent movement in the inventories and inventory sentiment indices suggest businesses are finally able to restock their shelves, as both indices have broken into expansion territory.

INITIAL JOBLESS CLAIMS declined more than expected in the week ended March 12, falling by 214,000 from 229,000 the previous week. The four-week moving average of initial jobless claims, a reliable indicator of future employment growth and our preferred measure of claims, fell by 8,750 to 223,000, a level close to historic lows.

In addition to the above indicators, high frequency leading economic data, including our firm's proprietary Economic Model and the Leading Economic Indicators (LEI) signal expansion. Open market indicators we monitor, including credit spreads, remain favorable. The US banking system remains well capitalized; major banks have permission from their regulator to raise their dividends and have signaled increased share buybacks are in the offing. Unprecedented global liquidity, amounting to roughly $9.2 trillion, will cushion the financial fallout from the Russian invasion of Ukraine. Excess savings balances in US household accounts amounting to $2.0 trillion, augur well for future economic expansion absent a widening of the armed conflict in Ukraine.

EQUITY INVESTMENT POLICY

Following three consecutive years of double-digit equity market returns, 2022 began with the 5th worst start for the S&P 500 since 1927. From the beginning of this year through the 28th of February, the S&P declined 8.01%. Declines were not confined to large cap stocks: the S&P 400 Mid Cap Index fell 6.18% and small cap stocks, as measured by the S&P 600 Small Cap Equity Index lost 5.97% of their value. Shares of many formerly outrageously priced small cap technology stocks with little to no prospects of earnings in the foreseeable future, which had fallen as much as 75% last year, fell further, declining another 25% to 50%+ in the two-month stretch. The drawdowns were not confined to US domiciled shares: The MSCI International Developed Market Index fell 6.52% while the MSCI International Emerging Market Index fell 4.83%. (The bond market was no safe haven during that two-month period. Bonds with duration registered losses as open market rates rose in anticipation of the Fed's tightening). Equity markets spent January and February absorbing significant macro and geopolitical risks including higher and more persistent inflation amid an aggressive central bank pivot, geopolitical tensions resulting in severe sanctions, price shocks across commodities, and renewed supply chain and trade uncertainties, all of which weighed on equity valuations. Adding to the uncertainty, several high-profile market savants lowered their year-end targets for the market indices, adding to the negative sentiment.

More recently equities have rebounded sharply, as hopes have risen for a negotiated cease fire in the Ukraine, and the analysis of what is known about the Fed's recent meeting have lent some clarity to its intentions regarding tightening credit conditions. As of last Friday, the S&P 500 had regained almost 40% of its earlier decline and other indices have also rebounded. Whether the current market correction has further to go remains to be seen.

Rather than devoting our energies to forecasting the depth and duration of the stock market's short-term gyrations, a hopeless task in our view, we prefer instead to focus our energies on longer-term economic fundamentals, learning from our years of experience in navigating the inevitable economic cycles which informs our investment policy.

Currently, we judge US economic fundamentals to be favorable. Leading economic indicators are flashing expansion. The above-trend momentum in real GDP, robust corporate profit growth, gradually easing supply chain bottlenecks, unprecedented consumer and business liquidity, and a data-driven Fed that will tighten credit conditions only as necessary to bring down expectations for inflation are tailwinds for equity investors. The major risk for the stock market now that the Fed's decision to pivot is out of the way, is the small possibility the war in Ukraine will spill over into eastern Europe and beyond.

Accordingly, there has been no change in our firm's investment policy since our February client letter. Clients' equity portfolios remain fully invested within their guidelines, well balanced between domestic growth and value shares, tilted toward secular growth investments which has been our long-term bias. Taking advantage of the market break, we added selectively to stocks in clients' accounts which were less than fully invested.

Finally, as long-term investors, we are dedicated to our sole goal: Building our client's wealth in a disciplined manner. We are neither traders nor market timers. We have no products to sell, and we have no marketing goals to reach. Instead, we focus all our efforts on counselling with clients, on finding interesting new investment opportunities and on intensively monitoring the investments we hold in clients' portfolios. Maintaining an appropriate balance between *growth* and *value* investments is the never-ending challenge to our investment process.

FIXED INCOME INVESTMENT POLICY

Despite the significant rise in bond yields since their trough in mid-2020, the outlook for bonds with duration remains unfavorable. Interest rates are forecast to rise further as the economic cycle plays out and the Fed works to normalize rates. Therefore, since preservation of principle is the primary objective of our fixed income management, along with maintaining liquidity, bond portfolios under our supervision are invested defensively in a short ladder of highly marketable investment grade corporate obligations with a duration of less than 1.

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MBF

Indexes are unmanaged, do not include fees or expenses and are not available for direct investment. Definitions: Personal Consumption Expenditures Index (PCE): A measure of the prices that people living in the United States, or those buying on their behalf, pay for goods and services. The PCE price index is known for capturing inflation (or deflation) across a wide range of consumer expenses and reflecting changes in consumer behavior. Conference Board's Confidence Index: The Consumer Confidence Survey® reflects prevailing business conditions and likely developments for the months ahead. ISM Manufacturing Index: The ISM manufacturing index or purchasing managers' index is considered a key indicator of the state of the U.S. economy. It indicates the level of demand for products by measuring the amount of ordering activity at the nation's factories. ISM Non-Manufacturing Index: The Institute of Supply Management (ISM) Non-Manufacturing Index is an economic index based on surveys of more than 400 non-manufacturing (or services) firms' purchasing and supply executives. S&P500 Index: The S&P 500 Index, or Standard & Poor's 500 Index, is a market-capitalization-weighted index of 500 leading publicly traded companies in the U.S. S&P500 Growth Index: The S&P 500 Growth Index is a stock index administered by Standard & Poor's-Dow Jones Indices. As its name suggests, the purpose of the index is to serve as a proxy for growth companies included in the S&P 500. S&P500 Value Index: The S&P 500 Pure Value Index refers to a score-weighted index developed by Standard and Poor's (S&P). The index uses what it calls a "style-attractiveness-weighting scheme" and only consists of stocks within the S&P 500 Index that exhibit strong value characteristics.