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SUMMARY

- Some may worry that higher oil prices are signaling a recession, but we do not believe the US will go into a recession in the next 9-12 months.
- The US economy has been bolstered by lower levels of unemployment, strong corporate profits, a healthy consumer, and robust manufacturing trends, in our view.
- Our risk management processes help us navigate through changing market conditions.

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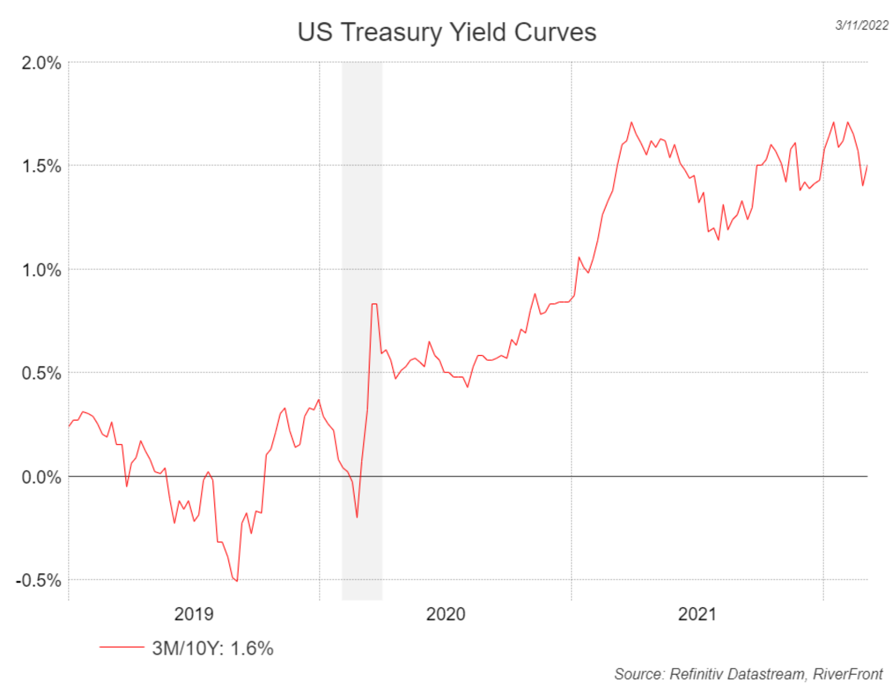
Could Oil Price Levels Cause a Recession?

Shifting Gears for the Climb Ahead

Car enthusiasts will tell you that driving a car with a manual transmission is more fun. The driver feels more connected to the vehicle and is more aware of changes in road conditions. As long as the road is dry and flat, it is a fairly simple task. However, when travel conditions are slippery or one is faced with an incline ahead, it takes more skill to prevent the engine from stalling. We believe this analogy fits today's economic environment as rising oil prices could stall growth in the coming months, and we must adjust our driving style to navigate changing conditions.

Recession fears are rising: Over the past two weeks, oil prices have responded to the crisis in Ukraine by spiking to a 14-year high resulting in gasoline prices surging to $4.25 per gallon as of March 9, 2022. Almost immediately, Wall Street economists began lifting their probabilities for a recession to occur in the United States within the next two years. Recently, Ed Hyman, one of Wall Street's top economists, noted that gasoline prices are signaling a recession, but he believes gasoline prices are only part of the picture. We agree that they are only part of the picture. One of the indicators we watch for signs of a potential recession is the US Treasury Yield Curve, specifically the 3M/10yr curve. Investors worry the yield curve is going to invert (meaning short term yields are greater than long term yields) as inflationary conditions worsen. Many believe this typically signals a recession. While the curve has narrowed in recent weeks, it remains positive.



Source: Refinitiv Datastream, RiverFront. Data as of 3/11/2022. Shown for illustrative purposes only. See Important Disclosure Information for definitions.

As inflationary fears increase, the Federal Reserve is slated to enact the first of their policy change actions this week. We believe Federal Reserve officials will raise the Fed funds rate by 25 bps (bps = 1/100th of 1%) at the March 16th meeting. Consensus expectations vary as to the speed and levels of future rate increases as the Fed seeks to dampen inflation without stalling out the growth engine driving the US economy. We believe there will be at least five rate hikes this year with a pause at one or two of the seven meetings remaining in 2022.

A look in the rear-view mirror serves as a reminder that the US. economy is still growing. With worries about slowing growth ahead, we believe it is important to examine the fundamentals underpinning the US economy:

- **The unemployment rate is back to pre-pandemic levels:** The most recent report from the Bureau of Labor Statistics showed an acceleration of job growth with the unemployment rate falling to 3.8%, which is only slightly higher than the 3.5% unemployment rate in February 2020, just before the shutdown from the pandemic.
- **Corporate profit margins remain above average, and earnings are still growing.** Current FactSet estimates are for profit margins for S&P 500 companies to be around 12% for the first quarter of 2022, which is above the five-year average. Further, data from the Department of Commerce shows that profit margins are at their strongest level in decades which speaks to the pricing power of large corporations to help offset the inflationary pressures they have already experienced. Corporate earnings trends remain positive for 2022 as well. Current consensus growth expectations are for year-over-year growth in the 8%-10% range.
- **Purchasing Managers Indexes (PMIs) remain above 50 which bodes well for growth**. The most recent ISM manufacturing index came in at 58.6%, revealing a higher-than-expected increase in US manufacturing activity during February. This was encouraging in light of the lingering impacts from supply chain disruptions. The ISM services component also remains above 50, with the most recent reading coming in at 56.5%.
- **Consumer spending is holding up well despite inflation worries.** In January, retail sales rose 3.8% month to month, which was the strongest increase since March of 2021 and raised overall retail sales to the highest level since the government started tracking the data in the early 1990s. Additionally, a recent Bank of America report noted strong trends in a number of categories including travel, restaurants, and public transportation suggesting consumers are resuming more in-person activities as COVID-19 fears subside.

We believe oil prices will be the determinant of future growth trends. The US economy has remained resilient despite the inflationary pressures created by COVID-19-induced supply chain disruptions. As strong as the data is, we know the look ahead is increasingly worrisome. Headline inflation, as measured by the Consumer Price Index (CPI), rose 7.9% year-over-year in February. Energy costs were the primary driver for the surge as gasoline prices rose over 6% in a one-month period. The conflict in Ukraine ensures the March CPI report will move even higher. For consumers, higher prices at the pumps could impact spending in areas considered discretionary such as eating out or travel.

It is also important to remember that higher oil prices impact more than just gasoline and heating oil. The average barrel of oil can also make everything from crayons and candles to asphalt. Businesses are also negatively impacted by higher energy costs and could alter hiring or expansion plans to offset them. We believe it will be critical to monitor consumer spending and business sentiment trends in the months ahead for changes in patterns. While consumer spending trends have been robust to date, the preliminary University of Michigan Consumer Sentiment data released last week was the lowest reading in over ten years. This suggests to us that energy prices are already having an impact.

Additionally, business sentiment is turning more pessimistic as evidenced by the most recent data from the National Federation of Independent Businesses (NFIB). In February, the NFIB Small Business Optimism Index fell to one of the lowest levels in five years, as labor shortages and supply chain issues continued to hamper business conditions. Further, 26% of small business owners pointed to inflation as the single biggest problem they faced in operating their business. This was the highest reading since 1981 for that metric.

Risk Management in Motion: Navigating markets requires focus and discipline, especially now when headlines and datapoints are sending mixed signals. Our Risk Management processes provide the road map for our way forward. We have systematically lowered the risk profile of all of our strategies over the past few months by lowering exposures to international equities and increasing cash levels in our balanced strategies. Our base case is still that the US does not go into a recession in the next 9-12 months, but we believe the risks of recession have clearly risen. Our view remains that markets can move higher by year end, but we are realistic enough to understand that changing conditions could warrant a change in our views and further adjustments to our positioning.

Important Disclosure Information

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In a rising interest rate environment, the value of fixed-income securities generally declines.

Investing in foreign companies poses additional risks since political and economic events unique to a country or region may affect those markets and their issuers. In addition to such general international risks, the portfolio may also be exposed to currency fluctuation risks and emerging markets risks as described further below.

Changes in the value of foreign currencies compared to the U.S. dollar may affect (positively or negatively) the value of the portfolio's investments. Such currency movements may occur separately from, and/or in response to, events that do not otherwise affect the value of the security in the issuer's home country. Also, the value of the portfolio may be influenced by currency exchange control regulations. The currencies of emerging market countries may experience significant declines against the U.S. dollar, and devaluation may occur subsequent to investments in these currencies by the portfolio.

Foreign investments, especially investments in emerging markets, can be riskier and more volatile than investments in the U.S. and are considered speculative and subject to heightened risks in addition to the general risks of investing in non-U.S. securities. Also, inflation and rapid fluctuations in inflation rates have had, and may continue to have, negative effects on the economies and securities markets of certain emerging market countries.

Stocks represent partial ownership of a corporation. If the corporation does well, its value increases, and investors share in the appreciation. However, if it goes bankrupt, or performs poorly, investors can lose their entire initial investment (i.e., the stock price can go to zero). Bonds represent a loan made by an investor to a corporation or government. As such, the investor gets a guaranteed interest rate for a specific period of time and expects to get their original investment back at the end of that time period, along with the interest earned. Investment risk is repayment of the principal (amount invested). In the event of a bankruptcy or other corporate disruption, bonds are senior to stocks. Investors should be aware of these differences prior to investing.

Basis Points (bps) - A basis point is a unit that is equal to 1/100th of 1%, and is used to denote the change in a financial instrument. The basis point is commonly used for calculating changes in interest rates, equity indexes and the yield of a fixed-income security. (bps = 1/100th of 1%)

Treasury yield is the return on investment, expressed as a percentage, on the U.S. government's debt obligations.

The Treasury yield curve, which is also known as the term structure of interest rates, draws out a line chart to demonstrate a relationship between yields and maturities of on-the-run Treasury fixed-income securities.

The National Federation of Independent Business (NFIB) is an association of small business owners in the United States. It is headquartered in Nashville, Tennessee, with offices in Washington, D.C., and all 50 state capitals. NFIB aims to advance the interests of small business owners, which it defines as minimizing government regulation.

Index Definitions:

Standard & Poor's (S&P) 500 Index TR USD (Large Cap) measures the performance of 500 large cap stocks, which together represent about 80% of the total US equities market.

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.

The Purchasing Managers Index (PMI) is a measure of the prevailing direction of economic trends in manufacturing. The PMI is based on a monthly survey of supply chain managers across 19 industries, covering both upstream and downstream activity.

The Consumer Price Index (CPI) measures the average change in prices over time that consumers pay for a basket of goods and services.

The National Federation of Independent Business (NFIB) Small Business Optimism Index is a composite of ten seasonally adjusted components calculated based on the answers of around 620 NFIB members.

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