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MARKET REVIEW
JUNE 2022

SMB Trust Services

WAGE-PRICE SPIRAL UNLIKELY TO OCCUR

The slow recovery in labor force participation since the pandemic's onset and surge in job openings as the economy reopened has led to a labor shortage and jump in wage growth as businesses compete to attract and retain labor. Wages were up 4.5% over the last year, according to the Employment Cost Index in March. That was the fastest growth rate on record going back to 2001. The mismatch between supply and demand of labor appears to be at a historic level with a record two job openings per unemployed worker in March. The tight labor market has been a major driver of higher wages recently, but some economists and investors have begun to worry that elevated inflation might push wage growth even higher and lead to a wage-price spiral like the 1960s-1970s.

A wage-price spiral can occur when workers expect elevated inflation to persist and demand higher wages to preserve their purchasing power. Businesses may comply with demands for higher compensation to remain competitive when hiring and retaining employees. In turn, businesses raise their prices to pass on higher labor costs to customers and limit profit margin compression. Higher prices lead to stronger inflation which can lead to further demands for higher wages. The situation can spiral from there with wage growth and inflation fueling each other. The risk of a wage-growth spiral can be a catalyst for the Federal Reserve to raise interest rates more aggressively to try to limit the spiral's damage to the economy. Given the current economic and policy backdrop, it seems unlikely that a wage-price spiral will materialize.

WAGE-PRICE SPIRAL OF THE 1960s-1970s

The most widely cited example of a wage price spiral in a large, developed economy occurred in the U.S. during the late 1960s and 1970s. Most economic historians agree the key ingredients behind this development were: an extended period of elevated government spending, easy monetary policy in the 1960s, and oil supply shocks in 1973 and 1979. Perhaps most importantly, however, was a peak in the collective bargaining power of labor unions in the 1970s.

Favorable post-World War II demographic trends combined with elevated federal government spending in the 1960s to usher in a period of relatively strong growth in both the broad economy and wages. Inflation began to climb in the late 1960s spurred by increased federal outlays to fund the Vietnam War and President Lyndon Johnson 's Great Society programs. That spending resulted in increased consumer and business demand for goods and services, which drove prices higher well before the dual oil price shocks of the 1970s.

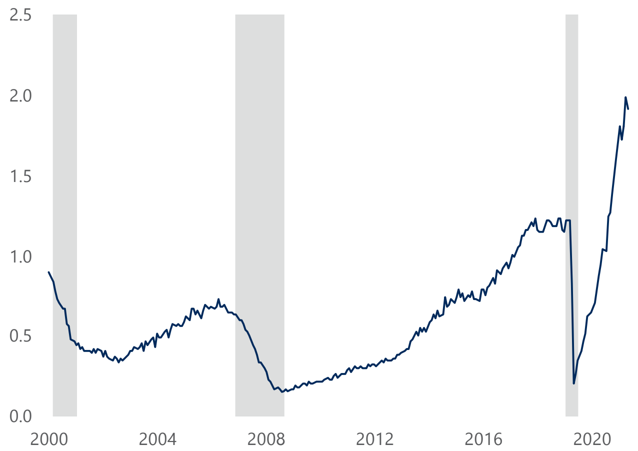
In 1971 and 1972, President Nixon applied intense pressure on Federal Reserve Chair Arthur Burns to avoid hiking the central bank's policy rate in response to building inflationary pressures. Nixon wanted to promote the flow of credit and strong economic growth to position himself well for reelection in 1972. Meanwhile, the political and social power of U.S. labor unions to negotiate higher wages for members continued to grow. By 1968 the annual rate of increase in nominal hourly wages was 6.5% and rose to peak of nearly 8.5% per year in the late 1970s. In a recent interview with *Marketplace*, Joe Brusuelas, economist at consulting firm RSM, observed that labor unions represented roughly one-quarter of all U.S. workers in the 1970s. Brusuelas further noted "in the late 1970s, the United Mine Workers were able to extract almost a 12% increase in pay – in one year – linked specifically to inflation." Minimal competition from low-wage manufacturing labor in poor, developing counties in the 1960s and 1970s compared to future decades likely increased the ability of organized labor to demand cost of living wage adjustments that either met or exceeded the pace of consumer price inflation.

When OPEC embargoed crude oil imports to the U.S. in 1979, American businesses responded to sharply higher energy input costs by accelerating price hikes. Most union contracts had cost-of-living provisions that triggered pay raises when inflation rose. A vicious circle then emerged in which workers and businesses began to expect and depend upon escalating wage and price increases.

LONG-TERM INFLATION EXPECTATIONS ANCHORED

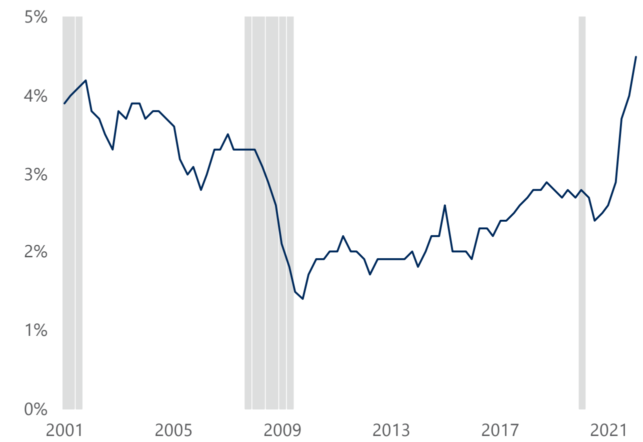
One of the foundations of a wage-price spiral is a requirement for individuals to expect high inflation to persist. That is not the case today as longer-term inflation expectations remain anchored. The Federal Reserve Bank of New York Survey of Consumer Expectations, conducted in May, shows that individuals expect inflation to average 6.6% over the next one year, 3.9% over three years, and about 3% over five years. This suggests consumers expect high inflation to fade over time and for inflation to remain relatively low and stable in the long-term.

CHART 1
RECORD LABOR SUPPLY AND DEMAND MISMATCH
JOB OPENINGS PER UNEMPLOYED WORKER



Source: Federal Reserve Bank of St. Louis.
Past performance does not guarantee future results.

CHART 2
JUMP IN WAGE GROWTH
EMPLOYMENT COST INDEX YOY



Source: Bloomberg.
Past performance does not guarantee future results.

SIGNS OF SOFTENING WAGE GROWTH

In addition to the plentiful number of job openings and labor shortage, another related factor that has been contributing to wage growth is increased job switching. The rate of job switching, as measured by the employment-to-employment rate (EE), rose significantly over the last year and a half to a multi-year high as more workers sought out higher compensation amid the record number of job openings. The EE rate shows the ratio of workers that have changed employers to the total number of employed workers. Increased job switching and a shortage of labor gave currently employed job candidates more bargaining power to negotiate higher compensation. The Federal Reserve Bank of Atlanta's Wage Growth tracker showed that wage growth for job switchers was 7.5% in May compared to overall wage growth of 6.1%. The EE rate appears to have peaked last fall and has trended lower this year. Bloomberg economists' analysis shows that historical trends in the EE rate lead wage growth by roughly five months, likely because less employee turnover reduces wage competition. If this historical relationship holds then the lower EE rate might be signaling that wage growth peaked this spring.

Surveys of consumer and business expectations are also indicating that wage growth may slow. The University of Michigan Consumer Sentiment Survey showed consumer expectations for wage growth over the following twelve months peaked in December and have moved lower this year. Similarly, the National Federation of Independent Business (NFIB) Compensation Plans Index, which measures the percent of businesses planning to raise compensation, also peaked in December and has trended lower this year. Some businesses are becoming more cautious with raising wages as management teams grow wary of approaching a tipping point that might weigh on sales when raising prices to pass on higher labor costs to customers. Minutes from the Federal Reserve's Federal Open Market Committee meeting in May noted that a few Fed officials said some of their business contacts were starting to report that higher prices from passing on increased wages and input prices were hurting sales. Chief Executive Officer Jonas Prising of ManpowerGroup, a global staffing company with over 100,000 clients, said "we've reached a level of wage inflation where employers are going to say, 'I've done as much as I can. My consumers and customers aren't going to accept me passing these costs on any further, so we need to start to mitigate them.'"

IMPROVING LABOR SUPPLY

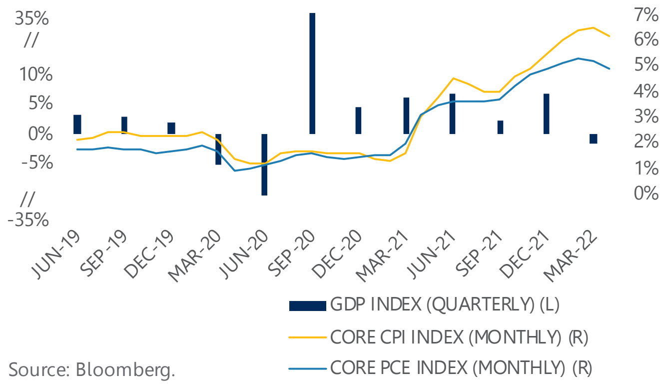
There have been some nascent signs of improving labor supply in recent months. Recovery in the labor force participation rate has picked up this year, rising to 62.3% in May from 61.9% in December. The participation rate has already risen by the same amount this year as it did in all of 2021. Other economic reports are starting to illustrate the improvement in labor supply. The ISM Manufacturing PMI report in May noted that companies are seeing an improvement in their ability to hire and are making more progress with addressing labor shortages. An improvement in the mismatch between supply and demand for labor could lessen wage pressures.

CONCLUSION

Despite multi-decade highs in inflation and wage growth, the U.S. will likely avoid a wage-price spiral. Some businesses have indicated a diminishing ability to pass higher labor costs onto customers, while improving labor supply could ease wage pressures. Most importantly, consumers and businesses expect inflation and wage growth to weaken in the medium-term rather than persist. Any signs of shifting expectations toward the persistence of dramatically elevated inflation and wage growth would suggest an increased probability of a wage-price spiral.

ECONOMY

GDP AND CONSUMER PRICES
JUNE 2019 THROUGH MAY 2022



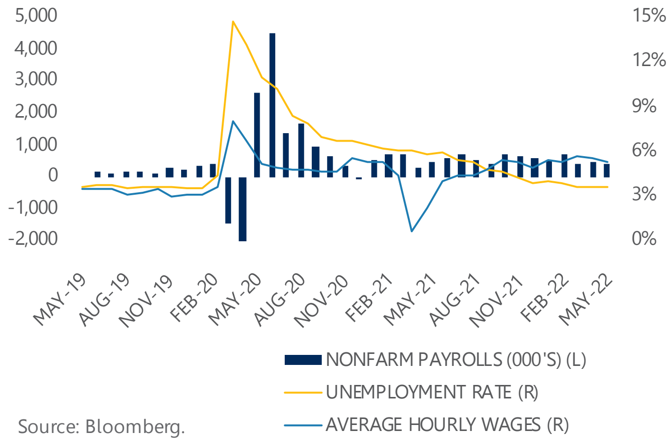
Source: Bloomberg.

U.S. first quarter GDP growth was revised slightly lower to an annualized rate of -1.5% from an initial reading of -1.4%. As of June 8, the Atlanta Fed's GDPNow model estimated second quarter U.S. GDP growth of 0.9%, down from 1.9% on May 27.

The U.S. Consumer Price Index (CPI) rose 1.0% in May and increased 8.6% from a year earlier, marking a fresh 40-year high. Core CPI, which excludes food and energy prices, climbed 0.6% in May and 6.0% on a year-over-year basis.

The Core Personal Consumption Expenditures (PCE) index, which Federal Reserve policymakers use for their inflation target, rose 0.3% in April to an annualized rate of 4.9%. This reading is down from a year-over-year increase of 5.2% in March.

LABOR MARKET
MAY 2019 THROUGH MAY 2022



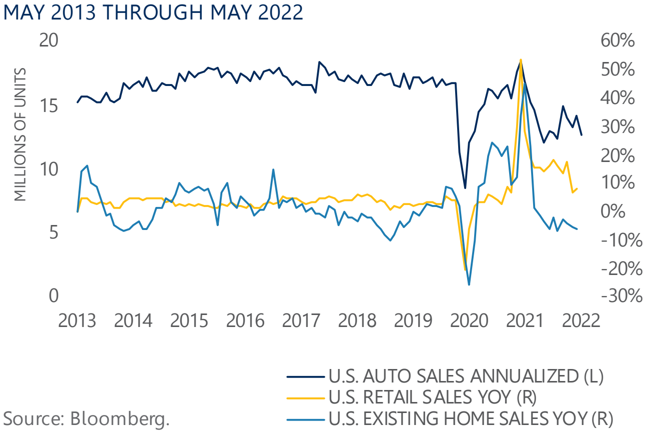
Source: Bloomberg.

The domestic labor market recovery continued in May as the U.S. economy added 390,000 jobs, surpassing the Bloomberg median estimate of 318,000. Job growth accelerated the most in leisure and hospitality, signaling a shift in consumer demand from goods to services as COVID-related restrictions abate.

The unemployment rate remained at 3.6% for the third consecutive month. Average hourly wages climbed 5.2% in April from a year prior, slightly lower than the 5.5% annual increase in April.

The number of Americans working or looking for jobs rose by 330,000, bumping up the labor force participation rate from 62.2% to 62.3%. Continued labor market strength likely means Fed policymakers will maintain a bias toward tightening monetary policy in coming months.

HOUSING, AUTO AND RETAIL SALES
MAY 2013 THROUGH MAY 2022



Source: Bloomberg.

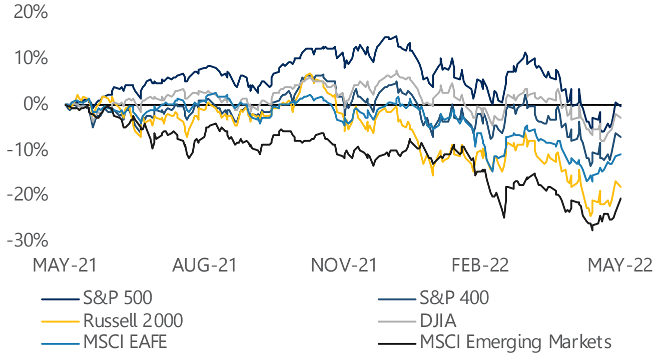
U.S. vehicle sales unexpectedly fell in May to a seasonally adjusted annualized rate of 12.68 million units from the prior month's reading of 14.29 million units as continued supply-chain constraints weighed on purchases. The Bloomberg consensus estimate was for auto sales to increase to 15.0 million units.

Consumer spending remained strong in April despite rising costs as retail sales climbed 0.9% and surged 8.2% from a year prior. Lower-income U.S. consumers have begun to shift to cheaper private-label grocery brands and rely more on credit card balances.

Existing home sales fell 2.4% in April to an annualized rate of 5.61 million units, down 5.9% from a year ago. Housing affordability has declined significantly in recent months due to higher mortgage rates and surging home prices.

EQUITY

TRAILING 12-MONTH EQUITY RETURNS
PRICE APPRECIATION, MAY 2021 THROUGH MAY 2022

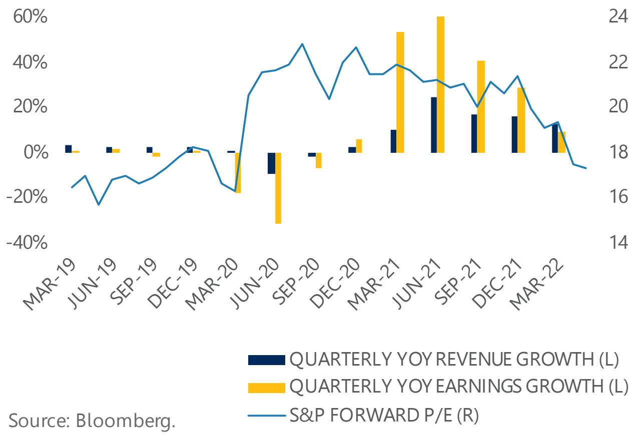


Source: Bloomberg. Past performance is no guarantee of future results.

The S&P 500 briefly fell into bear market territory in May with a decline around 21% from the index's January high. Volatility remained elevated during the month as high inflation, Fed policy tightening, and a slowing economy continued to pressure stocks. However, stocks rallied late in the month amid some signs that inflation could potentially be slowing. The S&P 500 rallied 8.45% from its intraday low on May 20 through month end and ended the month with a small 0.18% gain.

The MSCI Emerging Market index posted its first positive return month of the year, led by an 8.43% monthly gain in the MSCI Brazil index. The Brazil index is up 27.22% this year largely due to heavy exposure to commodities with the materials and energy sectors accounting for 44% of the index.

S&P 500 YOY EARNINGS & REVENUE GROWTH
BY QUARTER, MARCH 2019 THROUGH MAY 2022

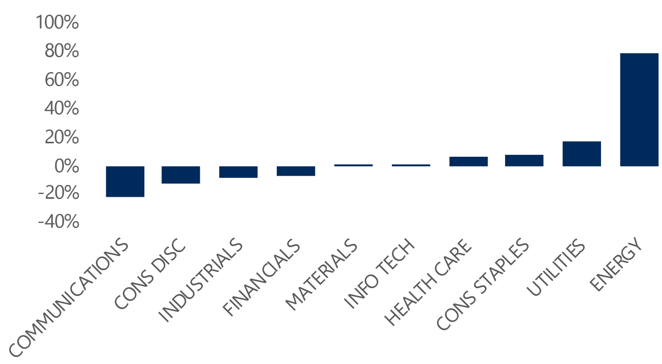


Source: Bloomberg.

First quarter earnings reporting season is almost complete with 498 S&P 500 companies reporting results. S&P 500 earnings are on pace for 9.13% growth compared to analysts' initial projection for 5.19% growth. Cyclical and commodity-driven sectors such as energy, materials, and industrials are reporting the strongest earnings growth.

Inflation is weighing on corporate profitability with more than half of S&P 500 companies reporting higher costs of goods sold (COGS). The S&P 500's gross margin declined 1.5% year over year in the first quarter. Analysts project a 0.9% gross margin decline in the second quarter, followed by margin expansion in the second half of the year.

S&P 500 SECTORS 12-MONTH PRICE RETURNS
MAY 2021 THROUGH MAY 2022



Source: Bloomberg.

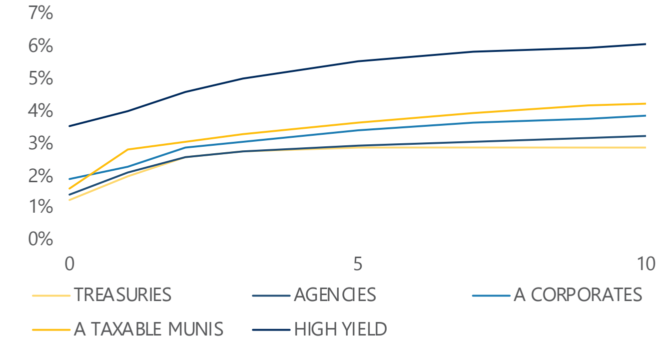
The energy sector regained its footing after hitting a speed bump in April and rose 15.77% in May. The energy sector was lifted by higher prices of West Texas Intermediate (WTI) crude oil which increased 9.53% in May to a two-month high near $115 per barrel. China's improved oil demand outlook caused by the country's easing COVID-19 lockdown restrictions provided a boost for oil prices.

The consumer discretionary and consumer staples sectors both declined nearly 5% in May. Disappointing earnings results from retailers Walmart (WMT) and Target (TGT) contributed to concerns that inflation is impacting corporate profits. Shares of WMT and TGT fell 15.56% and 28.81% in the month, respectively.

FIXED INCOME

CURRENT YIELD CURVES

YIELD CURVES AS OF MAY 2022



Source: Bloomberg. Past performance is no guarantee of future results.

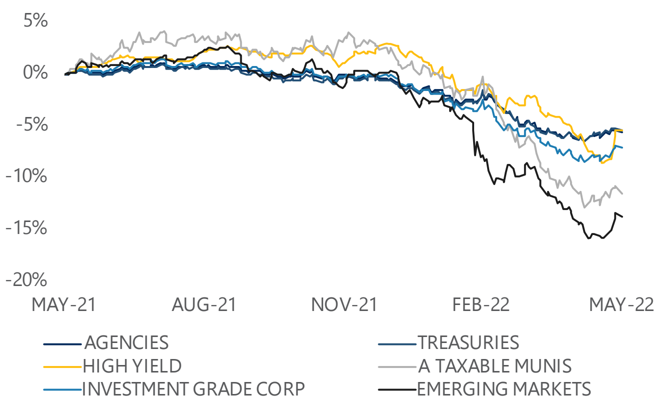
The U.S. Treasury curved steepened slightly in May. Yields on the 2-year U.S. Treasury note fell by 0.15% to 2.56% in the month, while yields on the 10-year maturity declined by 0.09% to 2.84%. The closely watched spread between the 2-year and 10-year U.S. Treasury maturities widened approximately 0.06% during month.

Single A-rated taxable municipal bonds are significantly outyielding single A-rated corporates beginning at the one-year mark, despite possessing similar credit quality and taxability status.

As of the end of May, U.S. agency bonds began to see some pick-up in yield over their government counterpart Treasuries beginning at around five years on the maturity spectrum.

12-MONTH RETURNS, TAXABLE BOND SEGMENTS

MAY 2021 THROUGH MAY 2022



Source: Bloomberg. Past performance is no guarantee of future results.

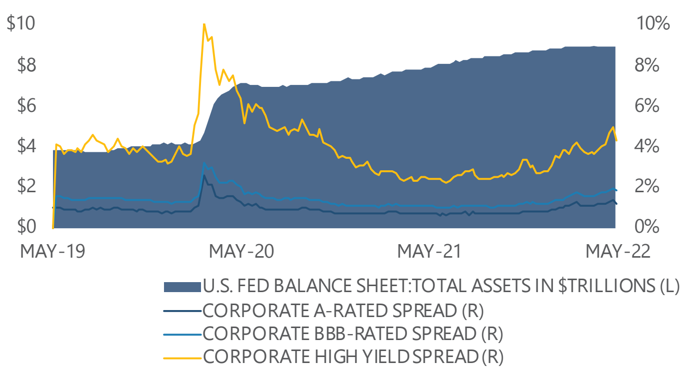
Increased expectations for higher rates led every bond segment to post a negative 12-month return of at least 5.3%, as shown in the accompanying chart. In broad terms, shorter duration fixed income portfolios posted smaller losses than longer duration portfolios over the previous 12 months.

Domestic high yield corporate bonds significantly outperformed emerging market bonds despite both segments exhibiting similar credit quality. Relative dollar strength in the past 12 months has contributed to the considerable performance difference.

As expected, the two highest quality bond segments in the accompanying chart, U.S. Treasuries and U.S. Agencies, have held up best in the first five months of 2022 as market interest rates climbed and credit spreads widened.

FED BALANCE SHEET EXPANSION AND CREDIT SPREADS

MAY 2021 THROUGH MAY 2022



Source: Bloomberg.

The Fed's balance sheet expanded by roughly 112% during the pandemic to $8.9 trillion in May from $4.2 trillion in February 2020. The Fed announced at their May 3-4 meeting that they will begin reducing their balance sheet size in June.

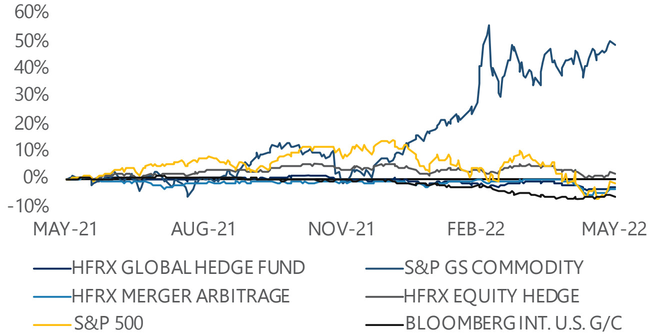
According to the Fed's projections, their balance sheet will be reduced by $522.5 billion this year to roughly $8.375 trillion, a modest 5.87% decrease. In 2023, the balance sheet is projected to be reduced by $1.14 trillion to around $7.235 trillion, a 13.6% decrease.

U.S. corporate high yield, BBB-rated, and single A-rated credit spreads have steadily widened since August 2021. As of May 31, both spreads exceeded the highest levels seen during all of 2019.

ALTERNATIVES

ALTERNATIVES, 12-MONTH RETURNS

MAY 2021 THROUGH MAY 2022



Source: Bloomberg. Past performance is no guarantee of future results.

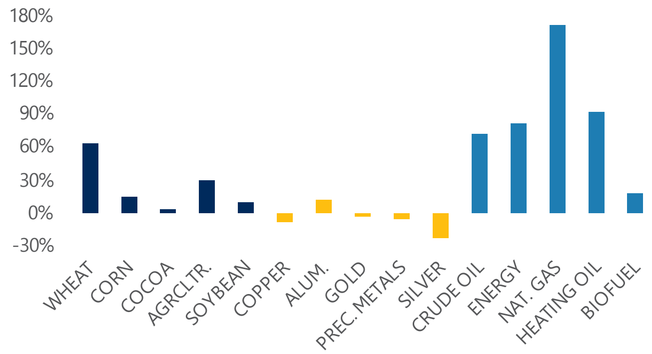
In May, the broad commodities asset class continued to stand out amongst its peers amid elevated inflation, sanctions on Russian energy exports and war-related disruptions to supplies of key agricultural commodities.

The S&P GSCI Index, a broad measure of price performance in commodity markets, climbed 3.93% during the month compared to gains of 0.18% and 0.74% for the S&P 500 and Bloomberg Intermediate Government/Credit Index, respectively.

Year to date, the HFRX Equity Hedge Index (-2.76%) and HFRX Event Driven Merger Arbitrage Index (-2.53%) have held up better than both the S&P 500 (-12.76%) and the Bloomberg Intermediate Government/Credit Index (-5.72%). The performance gap is driven by the varying magnitudes of equity short positions taken by strategies that comprise the two indexes.

COMMODITIES, 12-MONTH SPOT RETURNS

MAY 2021 THROUGH MAY 2022



Source: Bloomberg. Past performance is no guarantee of future results.

West Texas Intermediate (WTI) crude oil futures climbed 9.5% from $104.69 per barrel on April 29 to $114.67 per barrel on May 31. An agreement between European Union leaders to cut 90% of Russian oil imports by the end of the year pushed prices higher.

Wheat prices rose roughly 3.1% in May and have surged 63.9% over the last 12 months. Acute restrictions on exports from Russia and Ukraine, a recent export ban from India and expectations for a poor harvest in the U.S. have led to sharply higher prices.

Gold fell 3.14% in May as higher real yields and pronounced U.S. dollar strength weighed on the precious metal.

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NOT A DEPOSIT	NOT FDIC INSURED	MAY LOSE VALUE	NOT BANK GUARANTEED
NOT INSURED BY ANY FEDERAL GOVERNMENT AGENCY			