Market Overview
Q2 2022

CBIS
Catholic Responsible Investments

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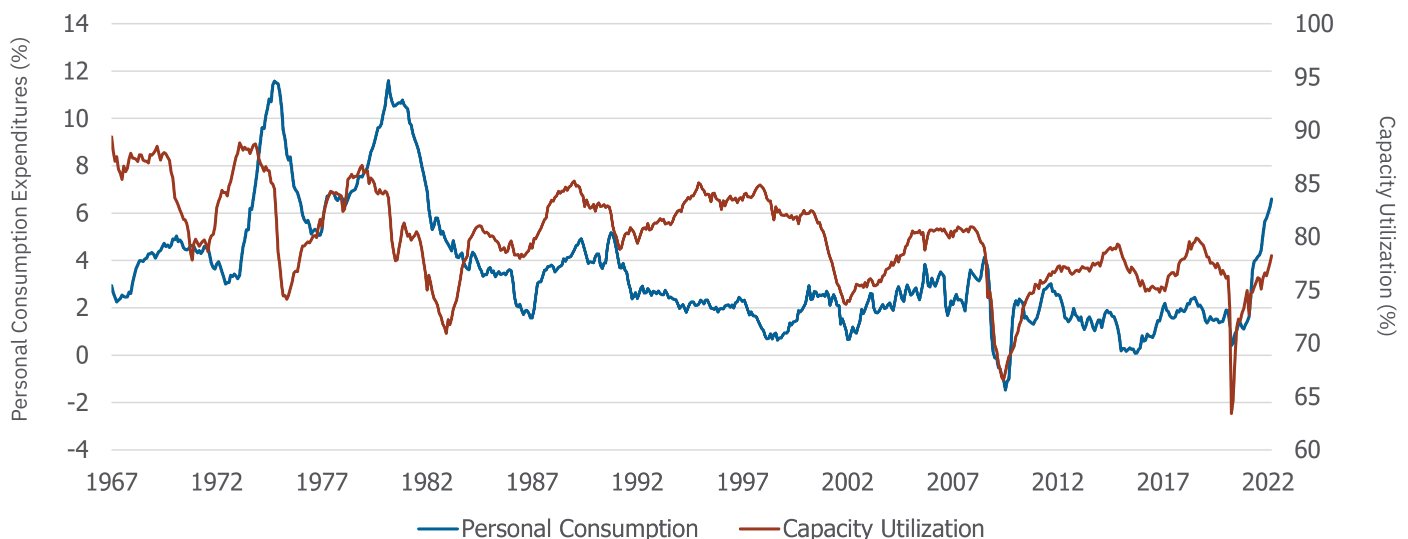
For months now, we've been warning of some kind of market correction. While investors have been somewhat spoiled by the market's resiliency over the last couple of years, here in a post-COVID world, a unique combination of supply issues, rising energy and food prices, and steadily increasing interest rates have led to meaningful economic headwinds. Meanwhile, businesses are beginning to consider the impacts of a trend towards deglobalization.

KEY POINTS

- Inflation is Fed's top priority
- Soft landings are hard to achieve
- Recessionary risk rising
- Valuations of both stock and bonds are becoming attractive
- Numerous crosscurrents support continued volatility

VOLATILITY IS IN PLAY

Think about these two statements: The market is down 18%, and, the market is flat over the last year. These are hypothetical numbers, of course, but in fact, these two statements could describe the same environment. My point is that volatile market corrections occur and we experience them differently across the long term. Right now, volatility is very much in play, and I believe we should prepare for more going forward.



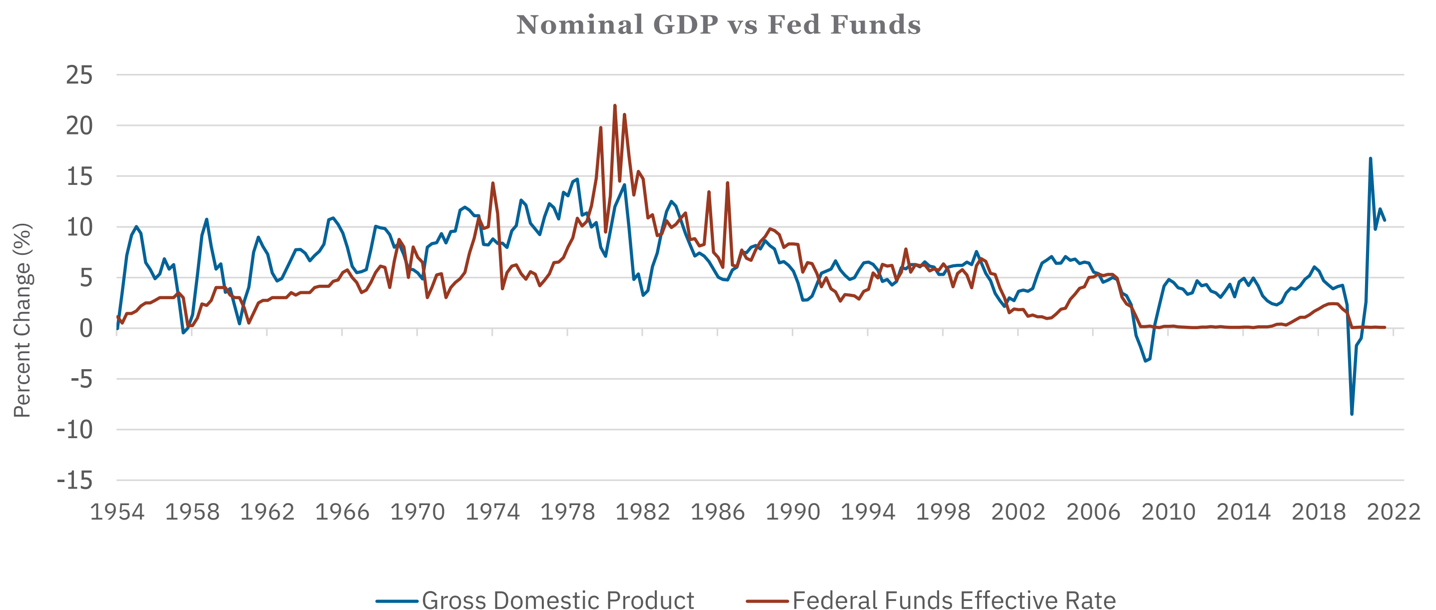
Source: Federal Reserve https://fred.stlouisfed.org
Period: 1/1/1967 – 3/1/2022

On the economic front, inflation is going up while capacity utilization, i.e., the extent the nation employs its productive capacity, is still relatively low, well under 80%. Typically, we don't see inflationary peaks until we're at much higher capacity utilization rates.

At first blush, this appears to be an unsolved problem. So, we go back to the basics. On analysis, what's different in this environment is the velocity of money. Historically, a fairly constant metric, the velocity of money declined dramatically during COVID as economic transactions literally ended. It's still low, but we expect to see it normalize as economies around the globe continue to open up.

Meanwhile, money supply expanded at extremely high rates into the COVID pandemic. Given collapse in velocity, this is a normal reaction. So, all in, we had economic growth slowing, the velocity of money declining, and money supply increasing. Recently, money supply has been coming down — that's good news.

For years now, really since 2007/2008, monetary policy has been excessively easy. At this hour, Fed funds are still below nominal GDP, meaning there is still room for the Fed to tighten. And it did in late July with a 75 basis-point increase. I'll suggest that there's still a fair amount of monetary tightening to come.

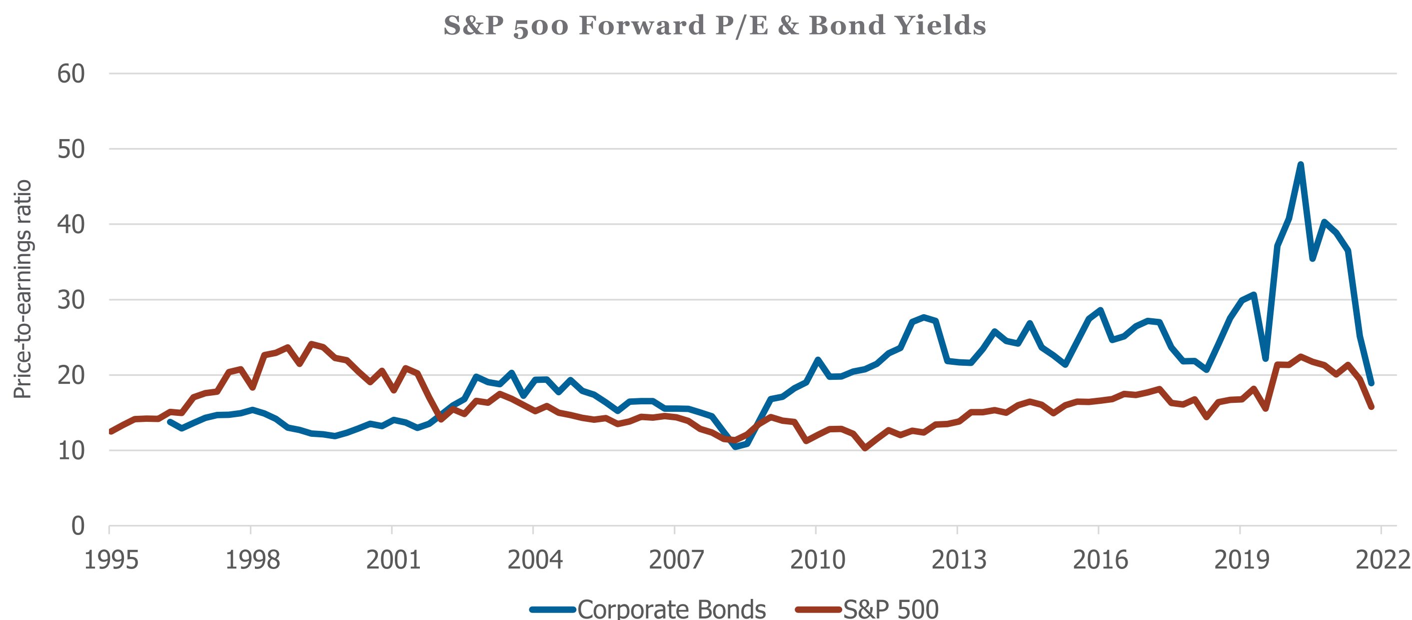


Period: 7/1/1954 – 1/1/2022
Source: Federal Reserve https://fred.stlouisfed.org

IS THE WORST OVER?

In this environment, it's only normal to be concerned about how the equity market is going to perform. If it's any reassurance, history tells us equites can do well in periods of inflation and in periods of recession. It all comes down to earnings. Equity analysts across the board are expecting earnings growth of almost 10% in 2022 on revenue growth of 10.7%. These are strong numbers. And at current valuations, the equity market is reaching levels that, in my opinion, are beginning to look attractive. Moreover, corporate health is good despite all the inflationary forces. That's an encouraging sign for the future.

In our work, we like to track the price-to-earnings ratio (P/E)* of the S&P 500 versus the P/E ratio of bonds, which is essentially the inverse of bond yields. Since 2008, the P/E of bonds has been significantly higher than the P/E ratio of stocks. To some extent, this atypical relationship has been supporting the stock market. But look at where we are now, the P/E ratio of the stock market is coming down, and the P/E ratio of the bond market is beginning to normalize versus stocks. This is a healthy development.



Source: FactSet
Corporate Bond Yields are represented by Bank of America US Corporate (7-10Y) (BBB)
Period: 9/29/1995 – 6/30/2022

*Price/Earnings is the ratio for valuing a company that measures its current share price relative to its per-share earnings. P/E helps to determine the relative value of a company's shares in an apples-to-apples comparison.

Performance quoted represents past performance and does not guarantee future results. Indexes are unmanaged, and one cannot invest directly in an index.

HOW WE'RE INVESTING

Our managers continue to seek out good companies at good prices for our equity funds. Whether it's growth, value, or core, our focus on quality and valuation is common across all of our funds. It’s worth noting that quality has faced headwinds this year and underperformed during this selloff. We do not expect this will continue. Our expectation is that quality will be the place to be as we go forward.

As an aside, the defensive characteristics of healthcare have been a headwind for CBIS due to our Catholic screens. While our screens do not impact performance over the long term, they can impact us in the short term.

On the fixed income side, we're going back to a more normal environment where the P/E ratio of the stock market and the P/E ratio of the bond market are more closely aligned, and corporate bonds are starting to become fairly attractive. We’ve underweighted corporates as a way to protect the portfolios, but we're beginning to see our managers capitalize on improved valuations.

Overall, interest rate sensitivity in our fixed income funds has actually moved closer to the benchmarks. Why? Because the odds of the Fed actually bringing inflation down while avoiding a recession are very, very low.

The Fed rarely pulls off a soft landing. Given a fairly high probability that we have an economic slowdown in 2023, our fixed income managers are taking more of a barbell position of cash and long bonds to avoid the part of the yield curve that will likely be negatively impacted.

Despite all the talk about the Fed tightening and inflation, expectations are the Fed may still need to reduce rates before we get to the end of next year.

BACK TO THE FUTURE

The Fed's dual mandate — managing price stability, i.e., inflation, and achieving maximum employment — is often in conflict. It's safe to say they're in conflict now. The Fed's top priority right now is bringing inflation under control.

We have to recognize that soft landings are very difficult to achieve. In the current market, recessionary risk is rising, but the valuations of both the stock and bond market are becoming attractive. But let's recall, there are numerous cross-currents. Taken together, these factors support the idea of continued volatility, and we need to be prepared for it.

For investors, the best risk management plan is to stick with their investment policy statements.

Before investing you should carefully consider the new Catholic Responsible Investments Funds' investment objectives, risks, charges and expenses. This and other information is available in the prospectus, or summary prospectus. Please read the prospectus carefully before you invest. The prospectus, or summary prospectus, can be obtained by calling 1-866-348-6466.

Mutual fund investing involves risk, including possible loss of principal. There can be no assurance that the Fund will achieve its stated objectives. Current and future holdings are subject to risk.

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