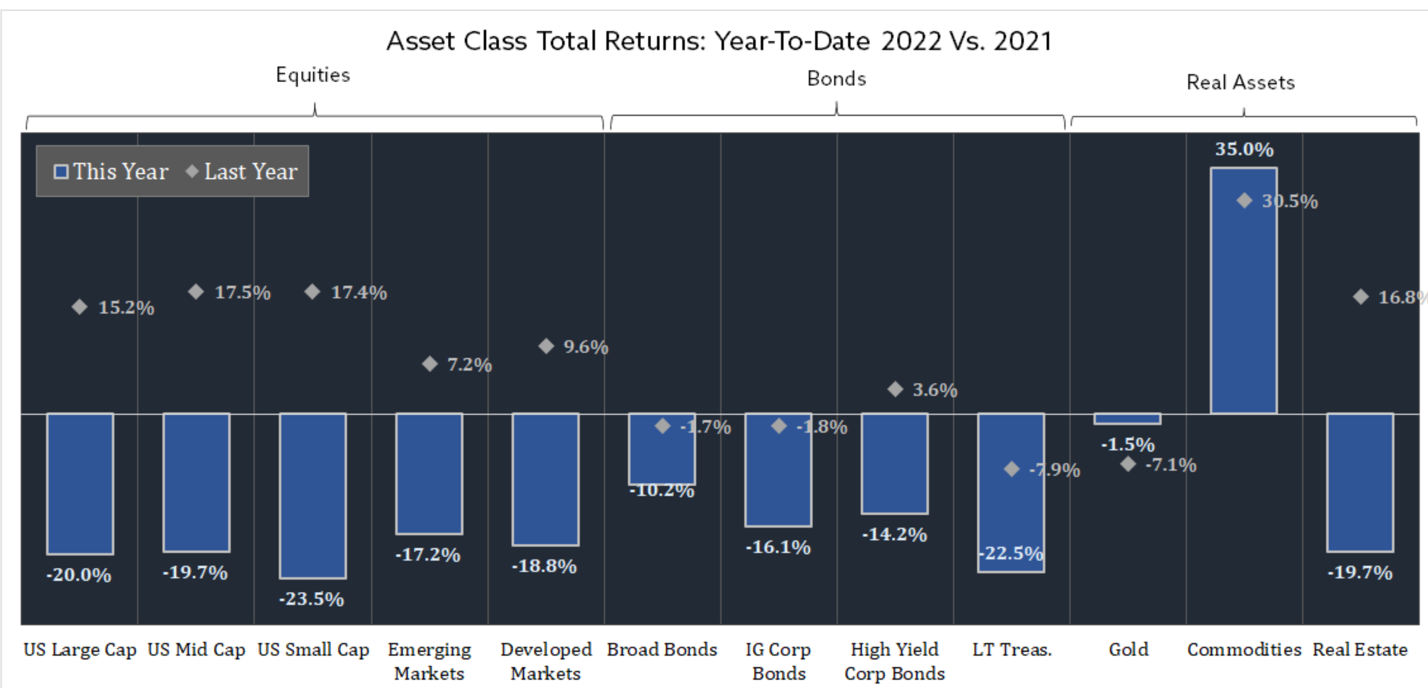
PENDLETON STREET
BUSINESS ADVISORS

Pendleton Street Advisors
2nd Quarter 2022 Investment Commentary
July 14, 2022

Index Returns	2nd Quarter	Year-To-Date	Trailing Twelve Months
S&P 500 US Large Cap Stock Index	-16.1%	-20.0%	-10.6%
Russell 2000 Small Cap Stock Index	-17.2%	-23.4%	-25.2%
MSCI All Country World Ex-USA Stock Index	-13.7%	-18.4%	-19.4%
Barclays Capital US Aggregate Bond Index	-4.7%	-10.3%	-10.3%
US Core Consumer Price Index - (Inflation)	1.5%	3.2%	6.0%

The challenging environment for markets that began in the first quarter continued into the second, driving stocks into a bear market as economic and geopolitical headwinds to growth grew in number and magnitude. Bond prices have also been affected negatively, declining by -4.7% in the second quarter, for total year-to-date decline of -10.3%; the worst performance for that asset class since 1973.[1] Commodities – the only asset class to increase for the year – slowed markedly in their march higher, increasing in price by 2% in Q2 compared to 32.4% in Q1.

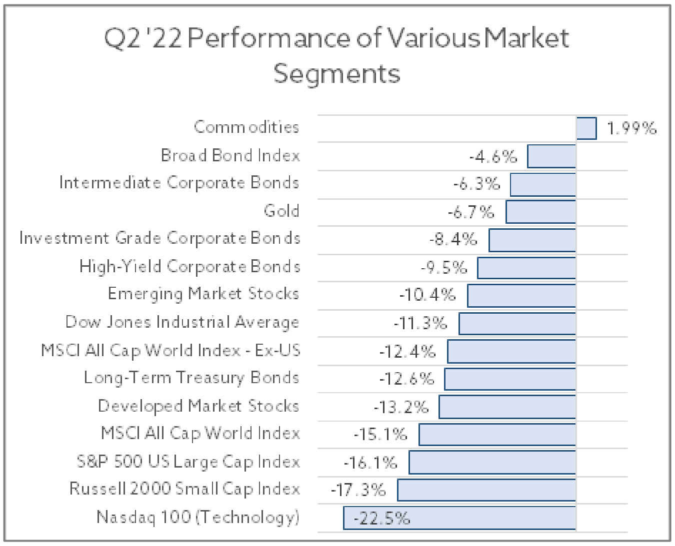
Heading into the second half of the year, we remain cautious in our outlook for markets and the economy and maintain defensive positioning in client portfolios. With the Fed's continuing hawkishness indicating more rate hikes ahead, and with midterm elections around the corner, our challenge going forward is to position portfolios to limit the impact of short-term market volatility while also setting them up to benefit when markets begin to appreciate again. Below, we discuss where market drivers (interest rates, inflation, and growth) point us for opportunities to meet that challenge.

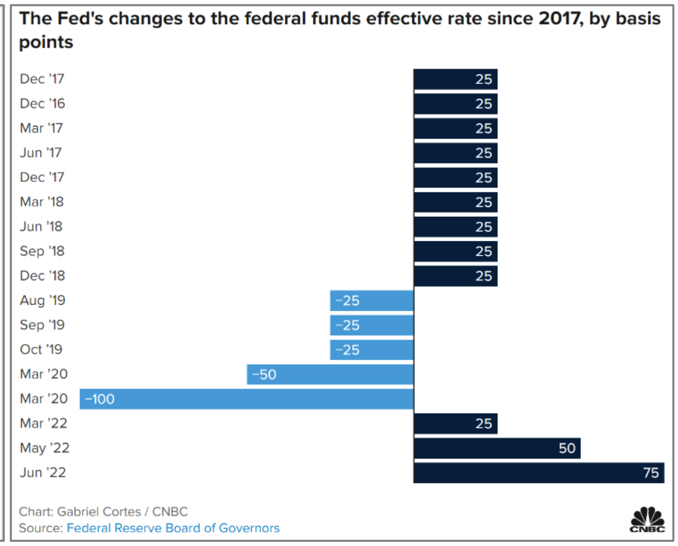


[1] https://www.reuters.com/markets/rates-bonds/brutal-first-half-puts-bonds-line-worst-year-decades-2022-06-30/

Market Summary:

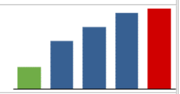
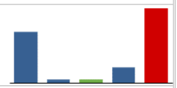
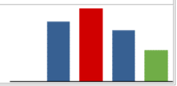
Markets continued to decline during the second quarter, with the worst performance coming from stocks of technology companies. The only major market category to narrowly escape negative performance was commodities, driven largely by energy prices that continue to rise due to the effects on global supply of the war in Ukraine. Bonds, which have historically had a stabilizing effect on portfolios during downturns in the stock market, continued to fall. Some segments of the bond market (primarily longer-term maturities) actually declined more than some segments of the stock market during the quarter (for example, "Long-Term Treasury Bonds" decline of -12.6% versus -11.3% for the Dow Jones Industrial Average).





Since the beginning of the fiscal year 2022 investors have been in the claws of a bear market. But what is a bear market?: A bear market occurs when prices fall by 20% or more from their most-recent all-time high. A bear market alone does not cause or even indicate a recession. In fact, for all of the 26 bear markets that have occurred since 1929, only 15 were accompanied by recessions. However, when layoffs and unemployment increase materially and consumers and businesses spend and invest less resulting in two consecutive quarters of negative GDP growth, a bear market can be added to the ingredients to form recession.

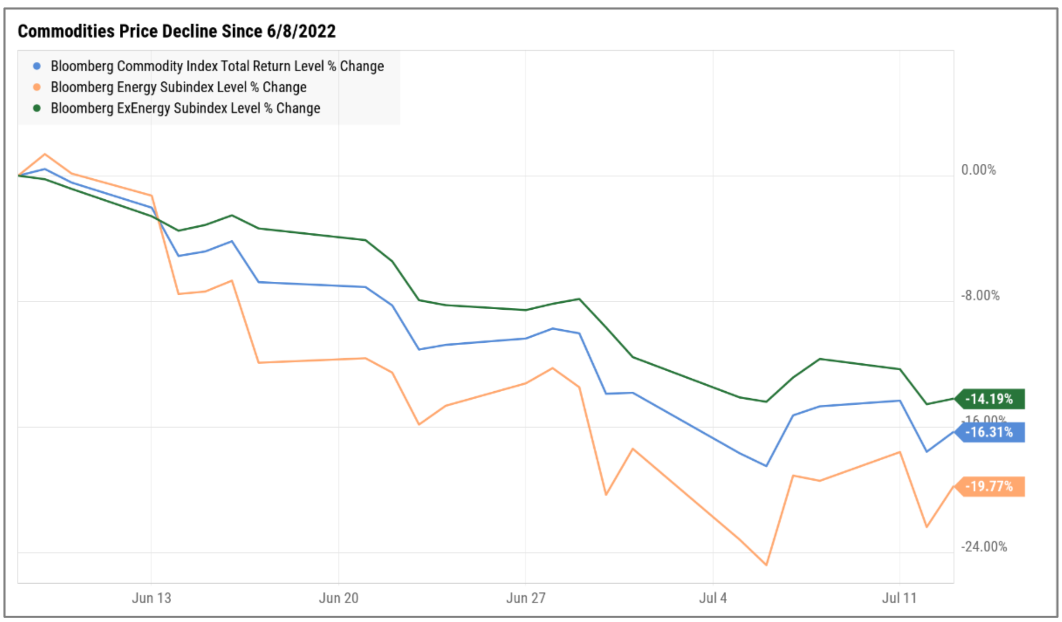
In the last two quarters' commentaries, we discussed the importance of shifts in key financial variables that drive markets; and that those drivers appeared to be at a critical turning point. Shifting expectations around Inflation, Interest Rates, and Growth drove large changes in how markets view and value stocks, bonds, and everything in between.

	Indicator Levels As Of...					
	5-Year Average	**Year-Ago**	**2021 Year-End**	**Q1 ' 22**	**Most-Recent**	
Inflation (CPI Year-Over-Year %-Change)	**2.5%**	**5.4%**	**7.0%**	**8.5%**	**9.1%**	
Source: Bureau of Labor Statistics		*6/30/21*	*12/31/21*	*3/31/22*	*6/30/22*	
Effective Federal Funds Rate	**1.09%**	**0.08%**	**0.07%**	**0.33%**	**1.58%**	
Source: Federal Reserve		*6/30/21*	*12/31/21*	*3/31/22*	*6/30/22*	
FOMC 2022 Estimated Real GDP Growth		**3.30%**	**4.00%**	**2.80%**	**1.70%**	
Source: Federal Reserve		*3/17/21*	*1/5/22*	*3/31/22*	*6/15/22*	

The table above indicates that those drivers are, for the most part signaling a **challenging road ahead** for both markets and the underlying economy. We discuss these in more detail below, but from a birds' eye view:

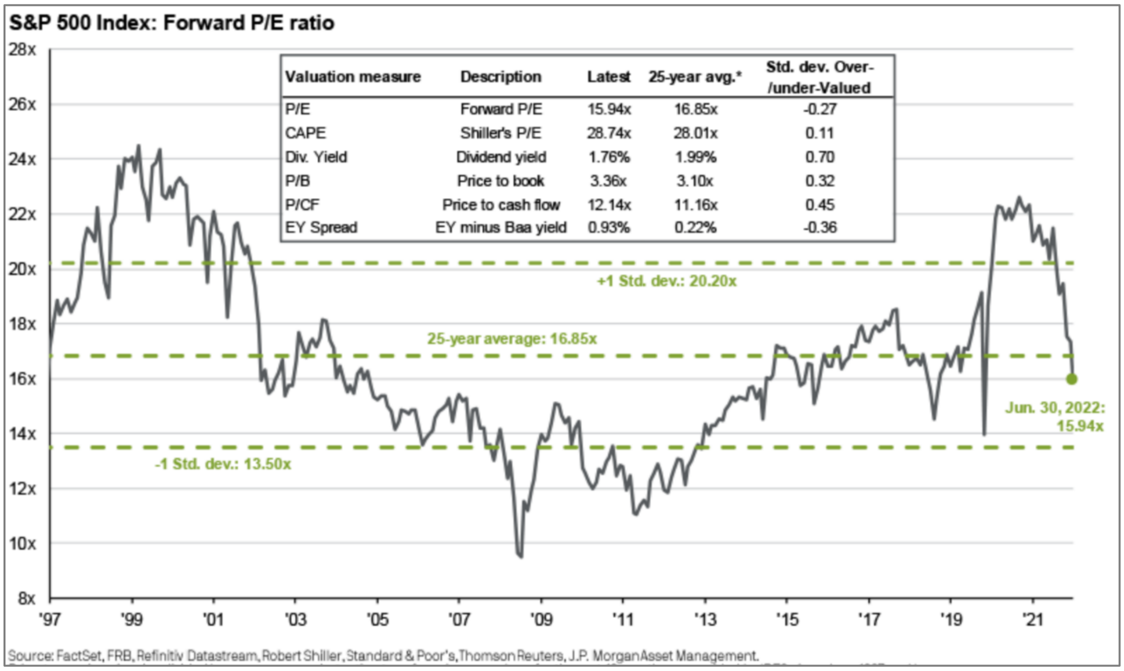
- **Inflation** is at its highest level in 40 years and has not begun to normalize, as had previously been expected.
- **Interest rates** have increased as the Fed has raised the Fed Funds rate and are expected to continue climbing based on recent statements by Federal Reserve officials.
- **Growth** in the economy is expected to continue, albeit at a slower pace as the Fed's actions begin to impact demand via consumer spending, the housing market, and business investment, and as supply of key materials across the supply chain remain constrained. After negative growth in GDP in the first quarter and as the Fed and other economists have continued to reduce their estimates of GDP growth going forward, **we believe the risk of economic recession has increased significantly**. That said, many economic indicators are still pointing to a strong economy.

Market declines in the first quarter primarily reflected a decrease in asset valuations due to rising interest rates; but, we believe the second quarter's decline marked a shift in investors' concern – that the Fed's continuing fight against inflation with its primary policy tools (short term interest rates, its balance sheet, and signaling to markets via policy statements) will go too far and drive the economy into recession. The most recent reading on inflation was 9.1%, in June. But, since the beginning of June prices of energy commodities (the primary driver of historically high inflation, along with housing) have declined in aggregate by nearly 20%. The price of Gasoline alone has declined by 17.5%.



Commodities Price Decline Since 6/8/2022

There is growing evidence in our data to suggest that markets have beaten the Fed to the punch, going too far in pricing in an expected economic downturn. If the trend of declining prices in commodities continues, which it appears to be, then we would expect inflation to begin falling also. If inflation begins to moderate, we expect the Fed to become less aggressive in its efforts which would provide stability for markets and give investors space to determine a more realistic assessment of the strength of underlying companies.



While we believe portfolios are prepared for a sustained period of high inflation, we continue to invest in the securities of high quality companies with strong profit margins, sufficient cash flow, and a proven ability to manage for growth in value through economic cycles, because those are the companies that will emerge from this downturn stronger and, frankly, with less competition.

On a personal note, I began a two-week road trip with my family on the 11th. We began from home in South Carolina and drove northwest to Ohio, and yesterday drove south to our current destination of St. Louis, Missouri. Next, we head south to Arkansas and eventually we will end up in southwest Texas for a family reunion before turning around and heading home. The amount of construction and the volume of freight activity on interstates has been staggering, and the skylines of each city we have visited so far have been filled with cranes. While anecdotal, with the amount of economic activity I have observed so far on this trip it is difficult to believe that the economy is headed into a downturn.

Our firm values frequent communication with you to discuss changing conditions and to ensure that we understand and stay updated on your objectives. Our client-service staff will be reaching out to you as usual to schedule a meeting. If you would like to set up a meeting sooner, please contact us at your convenience. We look forward to hearing from you.

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