GALECKI FINANCIAL MANAGEMENT — FINANCIAL SENSE

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	3.71%	-4.60%	-4.60%
Russell Midcap Index	2.56%	-5.68%	-5.68%
Russell 2000 Index	1.24%	-7.53%	-7.53%
Dow Jones Industrial Average	2.49%	-4.10%	-4.10%
Morgan Stanley EAFE Index	0.64%	-5.91%	-5.91%
DJ US Real Estate Index	6.59%	-6.50%	-6.50%
S&P Commodity Index	9.63%	33.13%	33.13%
Barclays Aggregate Bond Index	-2.78%	-5.93%	-5.93%

INDEX RETURNS

Stocks pulled back sharply in the first quarter of 2022. The S&P 500 dropped 4.60% in the quarter but was down at one point around 13%. Growth stocks got hit the hardest with the Russell 1000 Growth index declining 9.04%. The Russell Mid-cap index was down 5.68% and small-cap stocks were down 7.53%. Both Mid-Cap and Small-Cap growth stocks were down about 12% in the quarter. Real Estate pulled back 6.5%.

International stocks saw comparable results as the MSCI EAFE Index declined 5.91%. Germany was hit hard with declines of around 12%. Emerging Market stocks also declined with the MSCI EM Index dropping 6.97% lead by China's 14.19% pullback.

Bond markets have seen rates move higher so far this year. The Barclays Aggregate Bond index correspondingly dropped 5.93% in the first quarter. Global bonds were hit even harder with a decline of 9.93%. Traditional bonds could struggle for the remainder of the year with the Fed increasing short-term interest rates.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy had a slow start to the year. January saw a decline in economic activity due to the surge of the Omicron variant. The entire service sector saw a major slowdown from restaurants to airline traffic. The Russia-Ukraine invasion caused a slowdown in Europe and a spike in energy prices around the globe. This has enhanced the already problematic inflation situation to a point where the Consumer Price Index jumped 8.5%. This all means that we are looking at slower GDP growth in the 1-2% range for the first quarter.

Restaurants are now down 3% from pre-pandemic levels. Hotels are down 6% and TSA Traffic is down about 11%. The Leading Economic Index was up 0.3% in February to 119.9 following the 0.5% decrease in January and a 0.8% increase in December. Industrial Production increased 0.5% in February after moving up 1.4% in January. The Capacity Utilization rate (which measures how much slack is in the economy) was up 0.3 percentage points to 77.6.

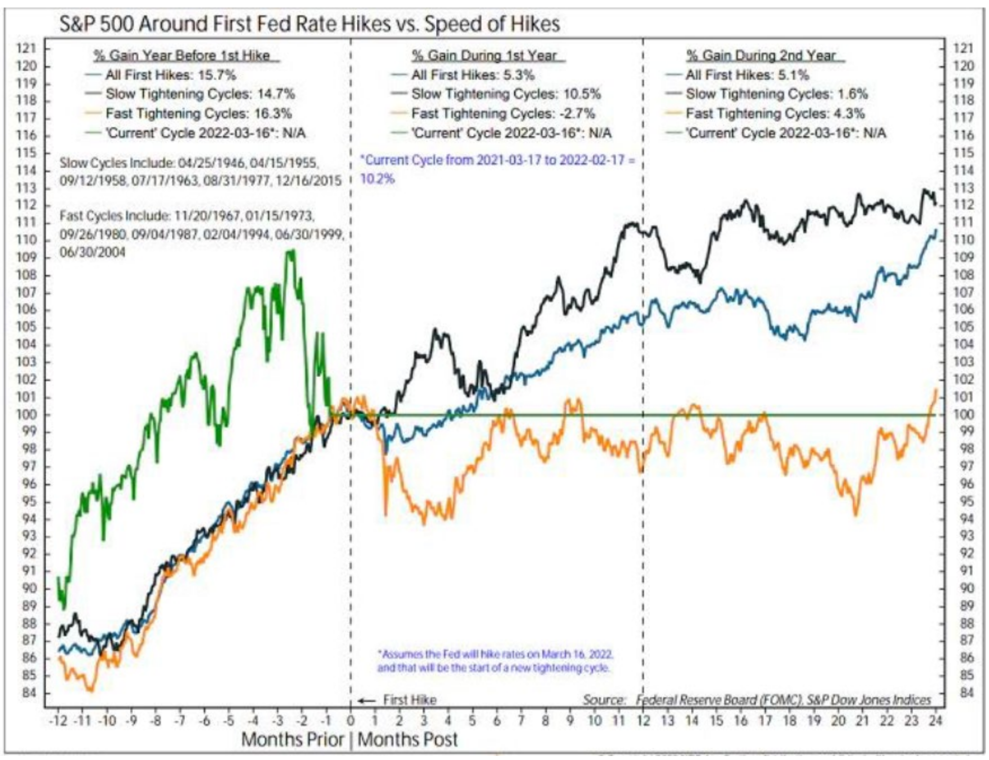
Non-farm payrolls rose by 431,000 in March and the unemployment rate fell to 3.6 percent. Weekly unemployment claims were 166,000 for the week ending April 2, 2022. The four-week moving average dropped to 170,000. There were 11.2 million job openings at the end of February. This is near an all-time high and is roughly 3 million more jobs than unemployed Americans. Job openings decreased in the Midwest region but increased out West.

Manufacturing decreased to 57.1% on the ISM PMI index in March. This was a drop of 1.5% from February. The New Orders Index came in at 53.8% which was a drop of 7.9% from February. The ISM Services index was at 58.3% in March which was an increase of 1.8% from February. This marks the 22nd straight month of growth for the services sector. The Business Activity Index came in at 55.5% and New Orders were at 60.1%.

Global economies are still growing but have begun to slow. The JPM Global Manufacturing PMI was at 52.7 in March was down from 53.5 in February. This does however mark the 20th straight month of expansion. The European zone was at 54.9. The United Kingdom lead the way with a reading of 60.9 followed by France at 56.3. Brazil and India showed strong results with readings of 56.6 and 54.3.

EQUITY AND BOND MARKETS

Domestic equity markets corrected in the first quarter with a peak to trough drop of 13% for the S&P 500. Returns continued to vary wildly based on sectors. Energy was up 31% in the quarter while information technology was down roughly 10%. Growth stocks dropped by roughly 8%, 12% and 12% for large-caps, mid-caps, and small-caps respectively. Whereas value stocks held up much better with returns of -0.1%, -0.6%, and -1.6% for large-caps, mid-caps, and small-caps. Outside of the U.S. also showed wide variations in returns. The Netherlands dropped 16% while Brazil was up 35% and Mexico was up 8%.



The chart above shows the average returns for the S&P 500 during rate hike cycles going back to 1946. The first third of the chart represents returns leading up to the first rate hike. The middle section represents market returns during the first year and the final section represents market returns during the second year. There were 13 occurrences over this time frame. The blue line is the average of all 13. You can see that on average, the market is higher a year later and two years later. The yellow line represents fast tightening cycles and the black line represents slow tightening cycles. There is a difference in the pace of the rate hikes on market returns.

The P/E ratio for the S&P 500 was at 23 times earnings at the end of 2021. This is significantly higher than the 25-year average of 16.5. Recent market corrections have brought the P/E ratio back down to 18.5 times earnings, which is just above historical standards. International investments could offer equity investors additional diversification over the next 5-10 years. International valuations are more attractive, their dividend yields are higher, and the U.S. Dollar typically struggles during rate hike cycles. If this happens again, international investments could boost portfolio returns.

The Fed has started a new rate hike cycle with the expectation that we could see 5-6 additional increases. This has caused rates to move higher across the fixed income board. The 10-year Treasury yield is now at 2.7%, which is up from 1.7% at the beginning of the year. With inflation running high, investors will be searching for more yield to protect their purchasing power. One area that is benefitting is real estate. Housing prices and rents have moved higher as landowners must try to stay profitable with higher lending rates on properties.

PORTFOLIO MANAGEMENT

The Investment Committee continues to monitor current allocations and risks to the portfolio. One of the biggest challenges recently has been taxes on investments. Growth in the market over the last few years created some internal capital gains for many mutual funds. Those mutual funds distribute those gains to their shareholders which is then reported on IRS Form 1099. This is not a problem for retirement accounts, but for those with larger taxable portfolios, capital gains distributions in 2021 were substantial.

The Investment Committee is continuing to look at ways to reduce taxes through mitigating taxable gains or trying to avoid capital gains distributions as much as possible. Using more Exchange Traded funds will help this endeavor. The difficult thing to navigate is the fact that the funds that produced the largest capital gains distributions were also the best performing funds over the last few years.

We are continuing to hold firm in our international holdings. While they have underperformed the S&P 500 over the last 14 years, at some point they will provide some excess returns for the portfolio. Emerging markets should truly benefit from the Russia-Ukraine conflict and corresponding oil crisis.

The fixed income side of the portfolio continues to be challenging. With rates continuing to rise, bond prices have been hit hard and correlations to equities have been high. It is just hard to get excited about 2.7% over a ten-year time frame if inflation is going to run north of 7%. Therefore, we are maintaining our holdings in high-yield bonds, convertible bonds, and real estate. We are also maintaining our large position in the Market Neutral fund which offers fixed income like returns but is less interest rate sensitive.

FINANCIAL PLANNING

Property and Casualty Insurance is a topic that we don't often cover. The proper amount of coverage you need in this area should be determined by your licensed property and casualty insurance agent. However, we'd like to bring a few topics to your attention that have been on our radar over the last few years.

Auto Insurance:

- Work from Home verses Commuter. Some auto insurance companies are offering lower rates for individuals who work from home verses working in an office. However, this is very carrier specific. Some insurance companies actually increase the premium for individuals working from home as those individuals may be more likely to leave during the day than they would if they were working in a traditional office.
- Leisure Use. If you have recently retired, you may be able to save on premiums by listing your autos as leisure use only.

Homeowners Insurance – Guaranteed Replacement Cost. The price of homes has rapidly appreciated over the last few years. The cost of materials and labor to build or repair a home have likewise followed suit. You should review your homeowner's policy to ensure your Dwelling coverage is accurate. Having Guaranteed Replacement Cost on your policy can help to ensure you are fully protected from a loss.

Umbrella Liability Insurance – Umbrella insurance is additional liability protection that kicks in after the liability of an underlying policy (homeowner or auto) has been exhausted. Usually, homeowner's or auto policies have liability limits up to only $500,000. That amount of coverage is insufficient if net worth is above that amount. A general rule of thumb is to have Umbrella equal to net worth up to $5 million.

Identity Theft Insurance – This type of coverage varies across insurance companies. Typically, the coverage helps to cover the cost to "clean-up" your credit report if someone steals your identity. New versions of this insurance help to offset costs associated with various cyber threats. Examples include: data recovery costs, cyber extortion reimbursement, and cyber bullying (therapy sessions).

Please speak with your trusted licensed insurance agent if you have any concerns regarding your property and casualty insurance coverages.

COMPANY NEWS

Congratulations to Elizabeth Tulloch and Ryan Waggoner for earning the Financial Paraplanner Qualified Professional (FPQP®) designation this year. The FPQP® program is offered through the College of Financial Planning. The designation covers financial planning topics such as: estate, tax, retirement, insurance and investments.

We are committed to giving our staff opportunities to expand their knowledge in all areas of personal financial planning. Elizabeth and Ryan are the seventh and eighth members of our staff to achieve this designation.

- Galecki Financial Management Investment Committee

If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com