



Oklahoma Center for Non Profit Sector Call

Economic & Financial Market Update
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Key points

1

The Russian invasion into Ukraine and China's zero-COVID policy are impacting commodity prices and supply chains, leaving inflation persistently elevated.

2

The Federal Reserve has begun its tightening cycle, via raising rates and reducing the size of its balance sheet, to fight the biggest bout of inflation the U.S. has experienced in 40 years.

3

Tightening financial conditions are slowing the economy. Globally, reduced demand should cause inflation to decline as the year progresses.

4

Equities remain volatile, and bond prices have fallen significantly to start the year. Heightened economic and policy uncertainty could cause volatility to remain in place into the fall.

5

Downside risks to the economy and markets have increased; we have positioned portfolios more defensively as a result.

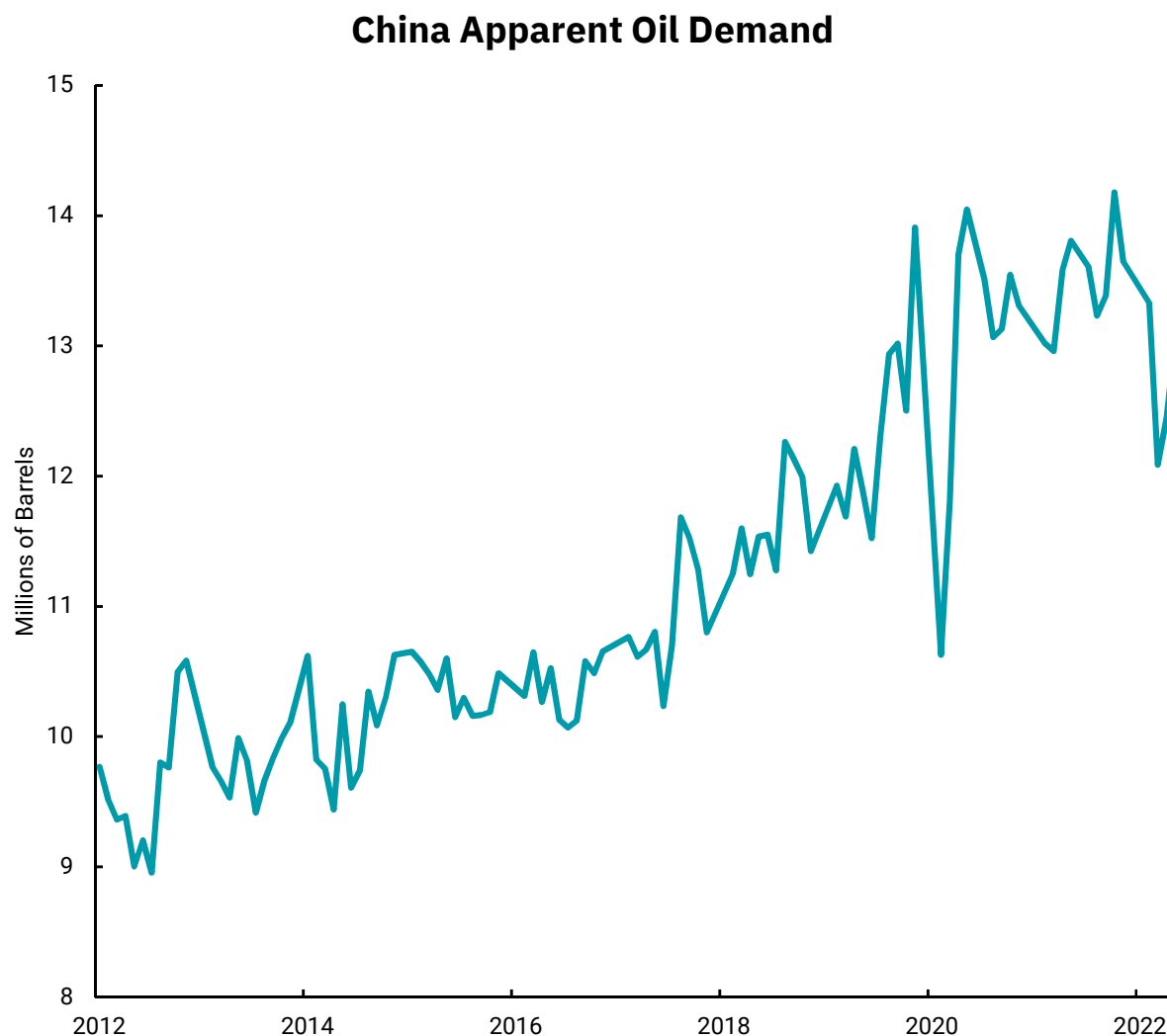
Russian invasion exacerbates inflation

- The Russian invasion of Ukraine is the largest military conflict in Europe in 75 years.
- In a world already struggling with goods inflation, supply disruptions across commodities markets pose a significant risk to global price stability.
- Higher energy prices act as a tax on consumption, lowering global real GDP potential for 2022.

Russia's share in global commodity production in 2020 (in percent)	
Palladium	44%
Potash	20%
Natural Gas	17%
Platinum	14%
Oil	12%
Wheat	11%
Gold	10%
Aluminum	6%
Nickel	6%
Coal	5%
Silver	5%
Copper	4%

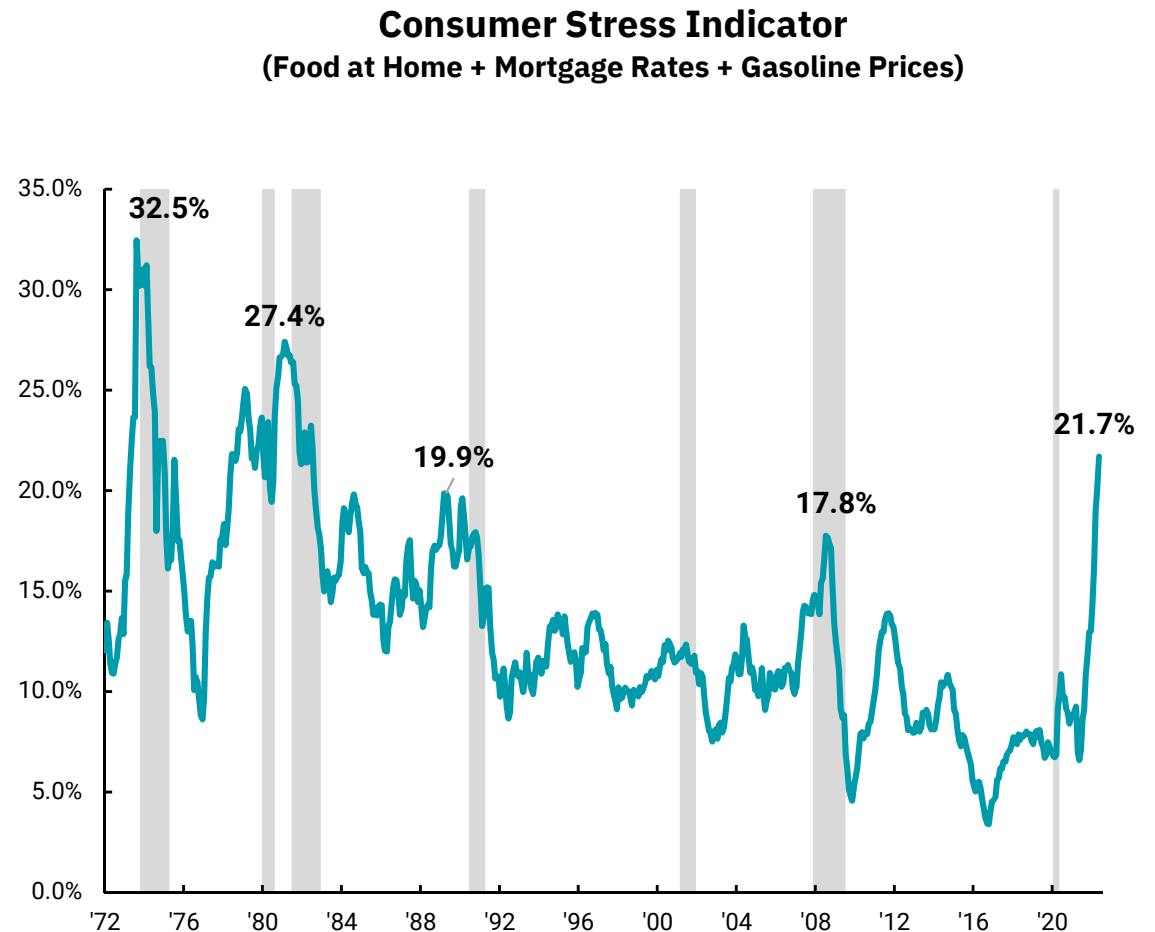
China may drive commodities higher

- The impact of China's COVID lockdowns can be seen in the decline in Chinese oil demand.
- Despite the decline in demand, oil prices have remained near \$100 per barrel globally.
- Unfortunately, the next million barrel change in oil demand from China is likely higher – putting additional pressure on global oil markets.



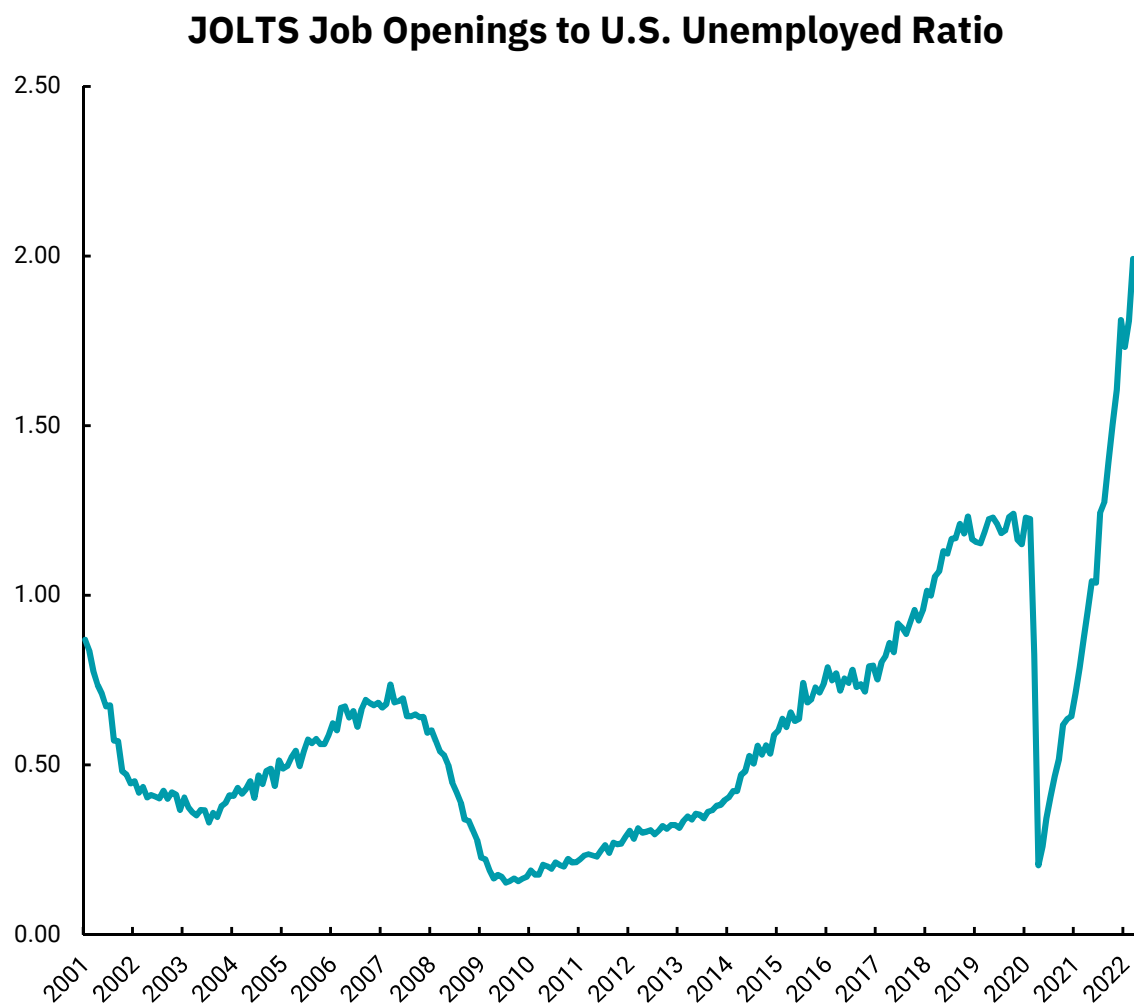
Consumer stress is rising

- Lower income consumers spend a materially higher percentage of incomes on food and energy.
- Higher costs for food and energy remain a significant concern for the Fed.
- Higher food and energy costs globally may lead to political uncertainty and unrest this year.



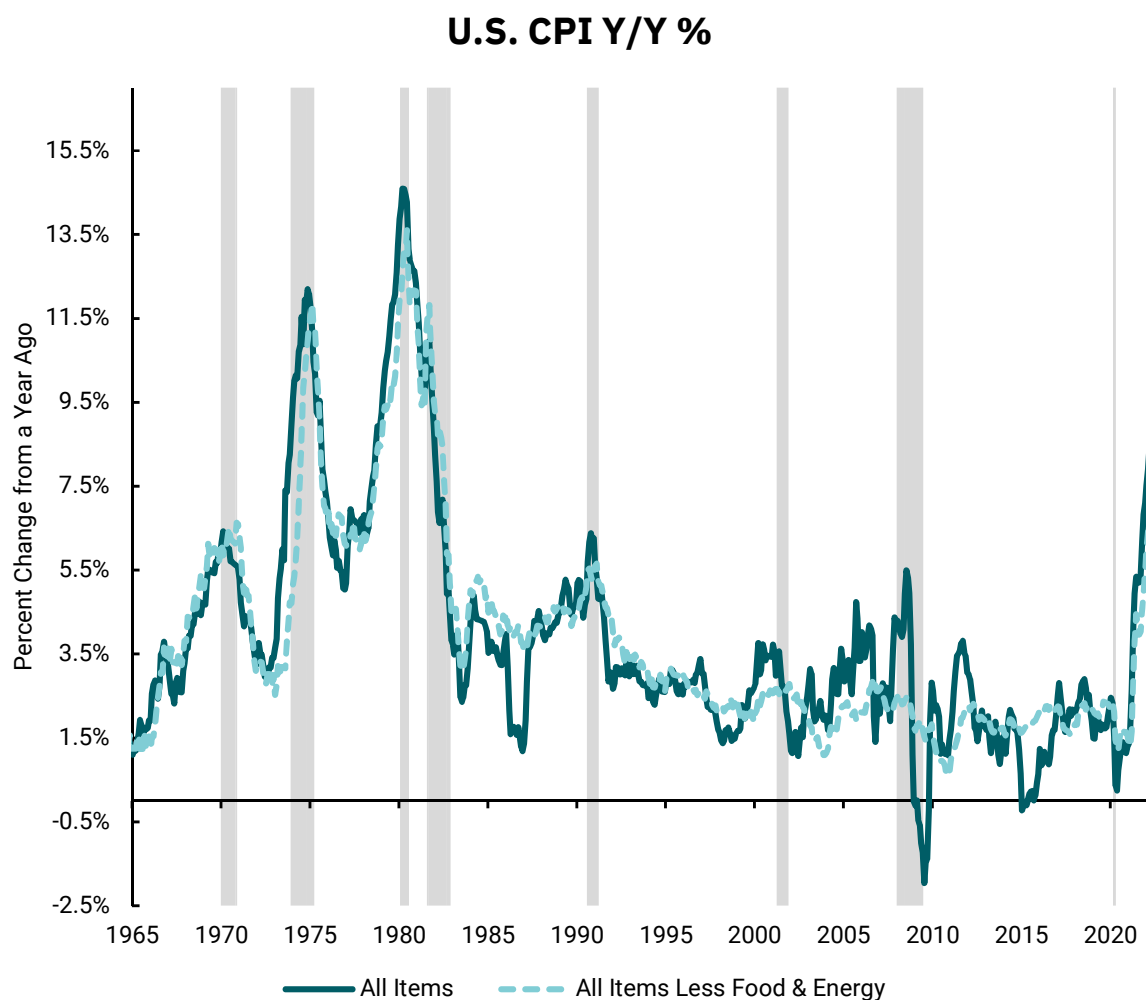
Tight labor market

- Jobless claims have hit all-time lows as COVID has moved to the back burner.
- For every unemployed person, there are nearly two job openings.
- Many businesses report their biggest challenge is finding qualified labor.
- This imbalance favors labor and higher wages, which could cause systemic inflation.
- The Federal Reserve is targeting a decline in job openings as an outcome from higher rates and QE.



Inflation is the focus of the Federal Reserve

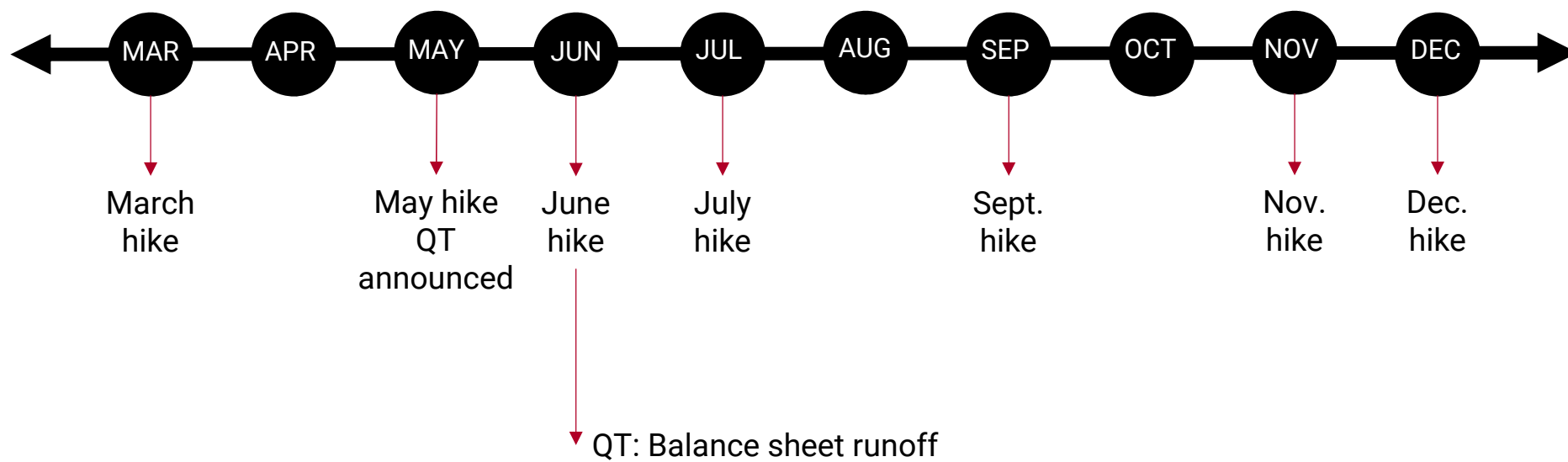
- Inflation is at a 40-year high as supply constraints collide with stimulus-driven demand.
- A wage-price spiral remains a material threat to economic and price stability.
- The Federal Reserve has indicated they are willing to slow growth to recessionary levels to arrest continued intolerable inflation.
- There are multiple measures of inflation, but every measure is above the Fed's target of 2%.



The Fed is focused on inflation

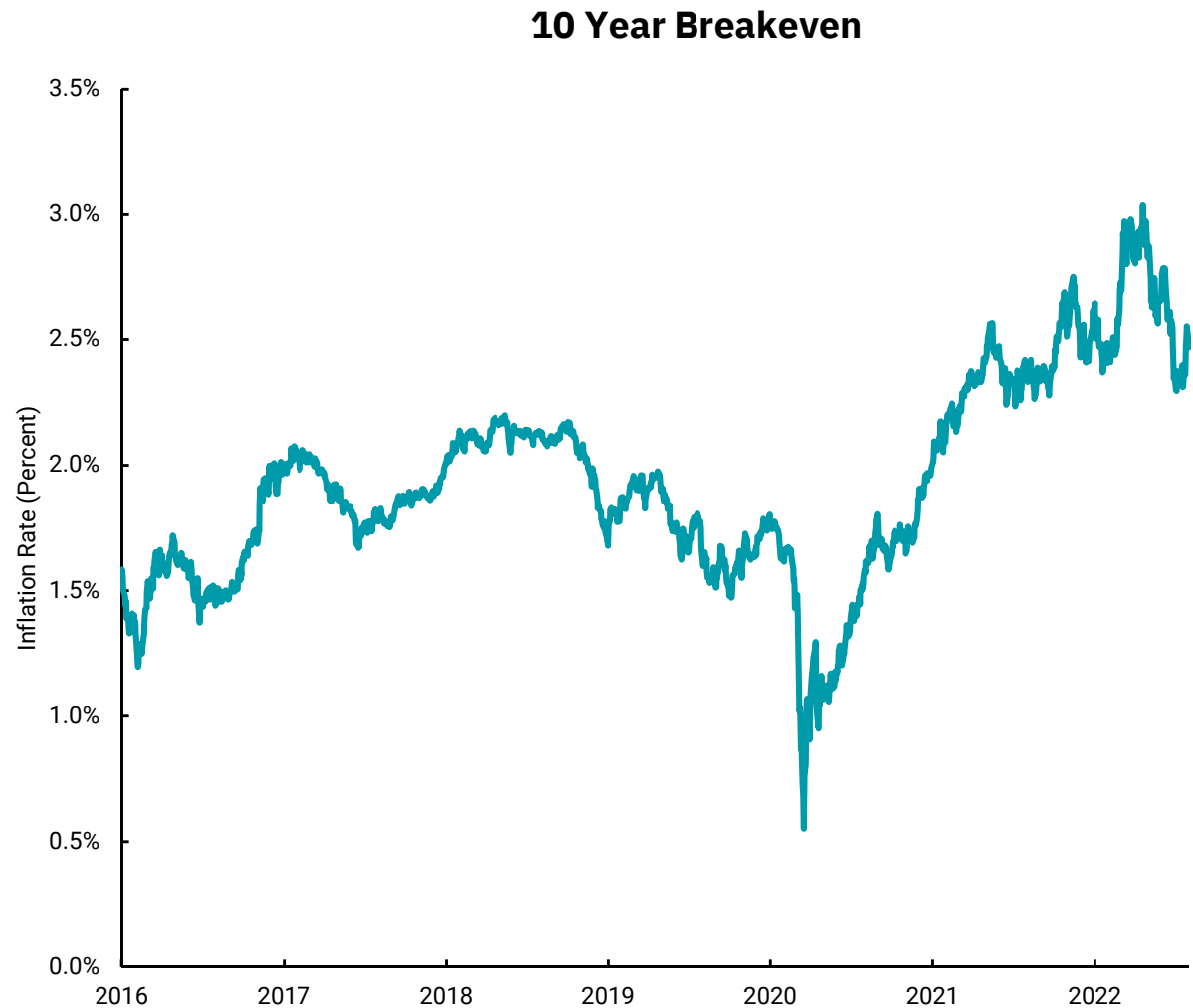
- The Fed hiked rates by 0.25% in March, another 0.50% in May, 0.75% in June, and 0.75% in July with expectations for continued rate hikes at every meeting this year.
- The market expects rates to end 2022 above 2.5%, which was the peak of the previous rate hike cycle from 2015-2018.
- Current year-end rate expectations are 3.25-3.5%.

2022 FOMC Meeting Schedule



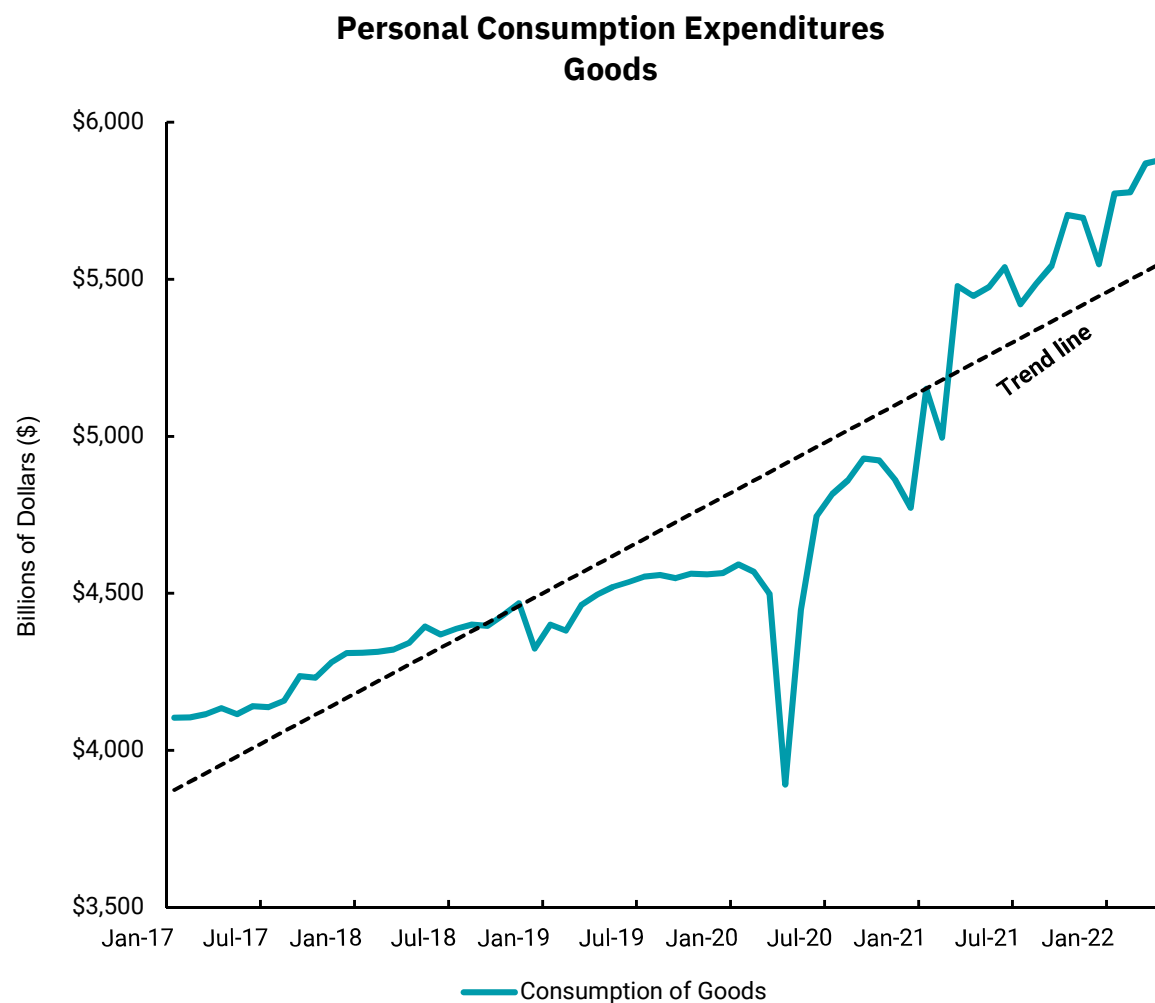
Inflation expectations are declining

- As the Fed begins its tightening cycle, inflation expectations have stalled and turned lower.
- We are monitoring data such as this to determine how effective the Fed policy is in lowering expectations.



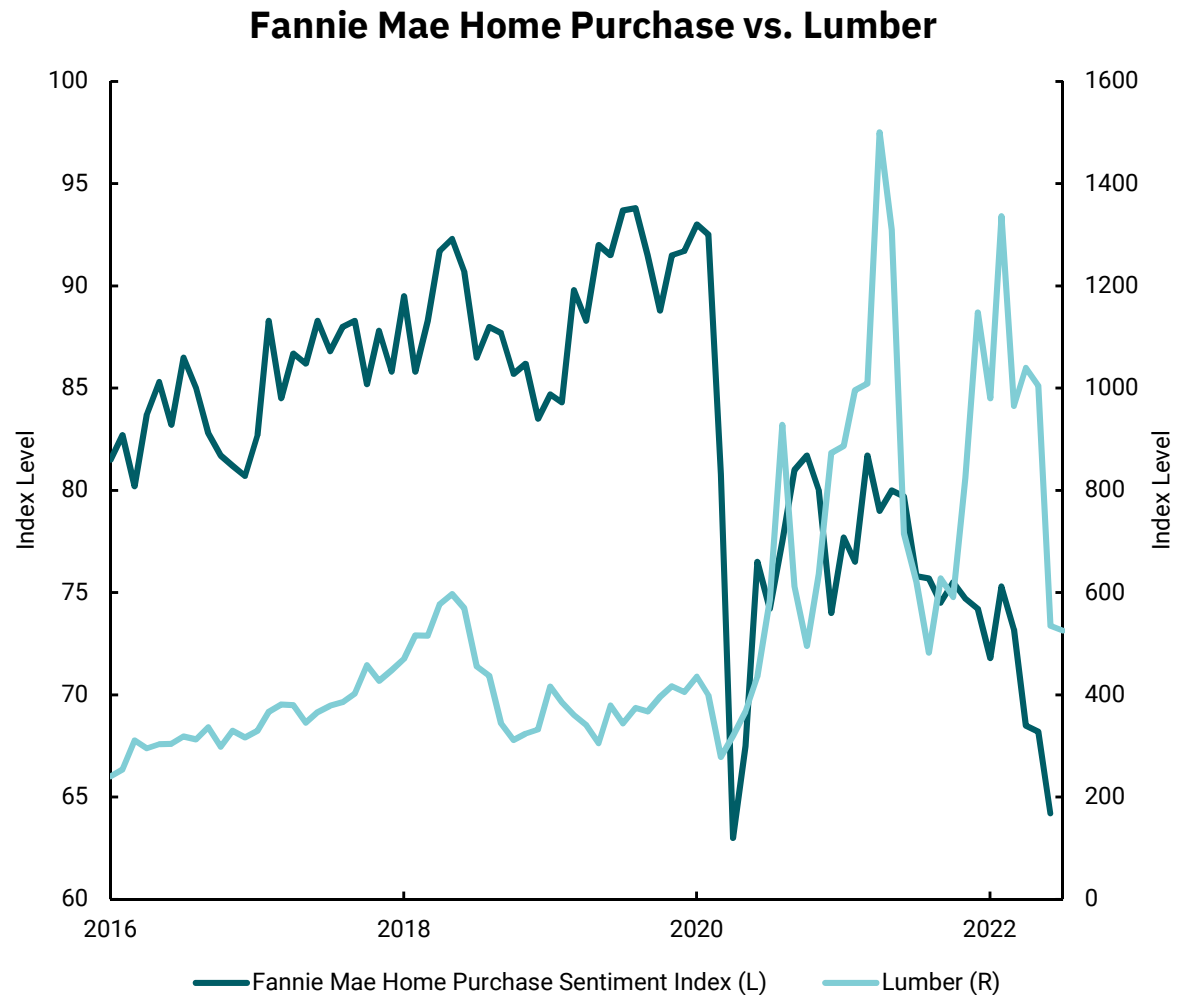
Goods pullback would help inflation

- After an initial drop from the pandemic, consumption of goods rebounded to all-time highs, well above trend.
- Federal transfer payments, stimulus checks, and higher savings boosted the demand for goods by 5-times above the pre-pandemic growth rate.
- The booming demand for goods has led to shortages, bottlenecks, and elevated inflation.
- Current consumer sentiment towards buying conditions for large household goods is poor due to high prices.



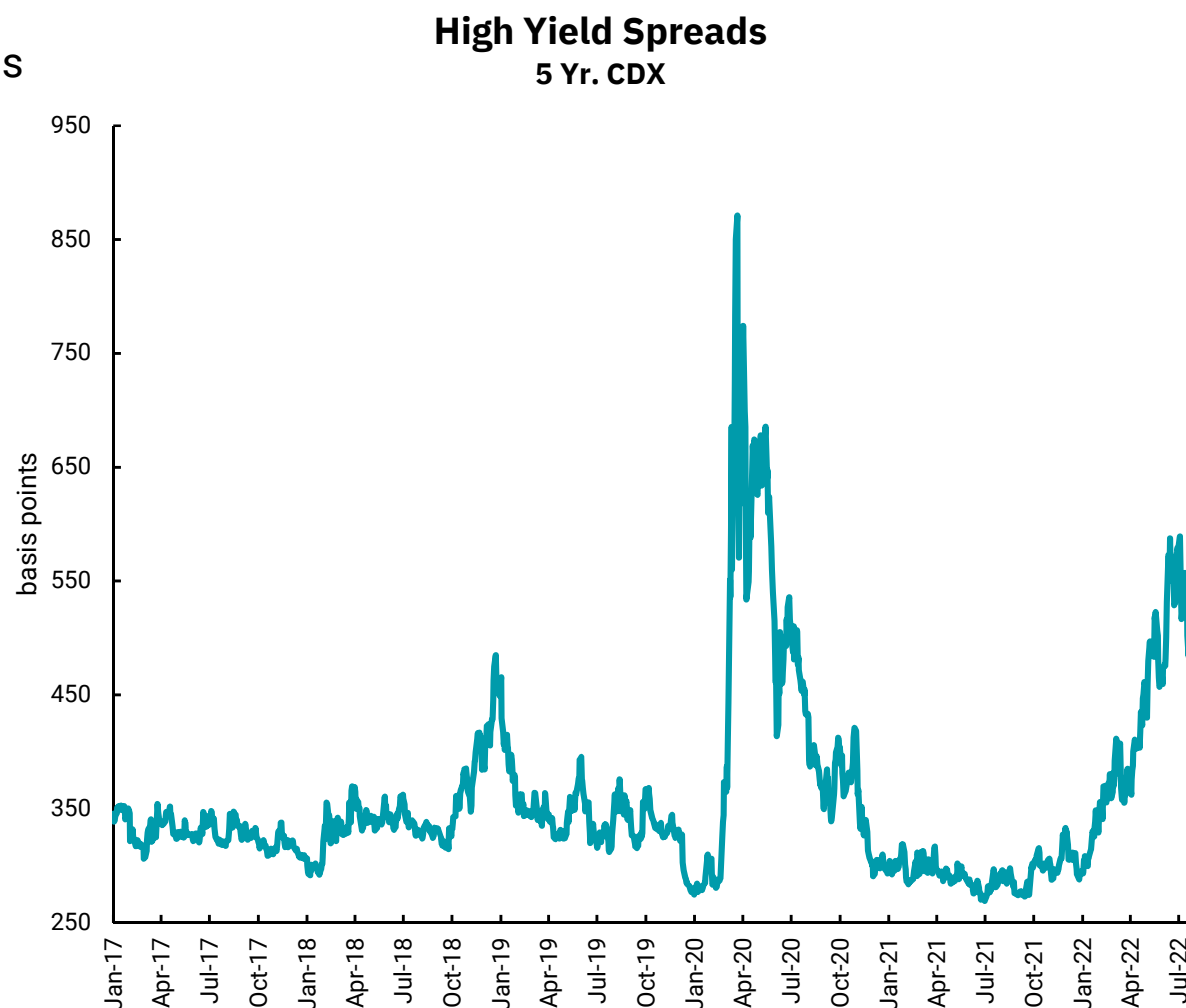
Housing likely to slow

- Fewer potential homebuyers see now as a good time to purchase a home.
- Housing activity is sensitive to interest rates, and we are seeing the market slow.
- Lumber prices are also falling, potentially indicating a slowing in demand for housing.



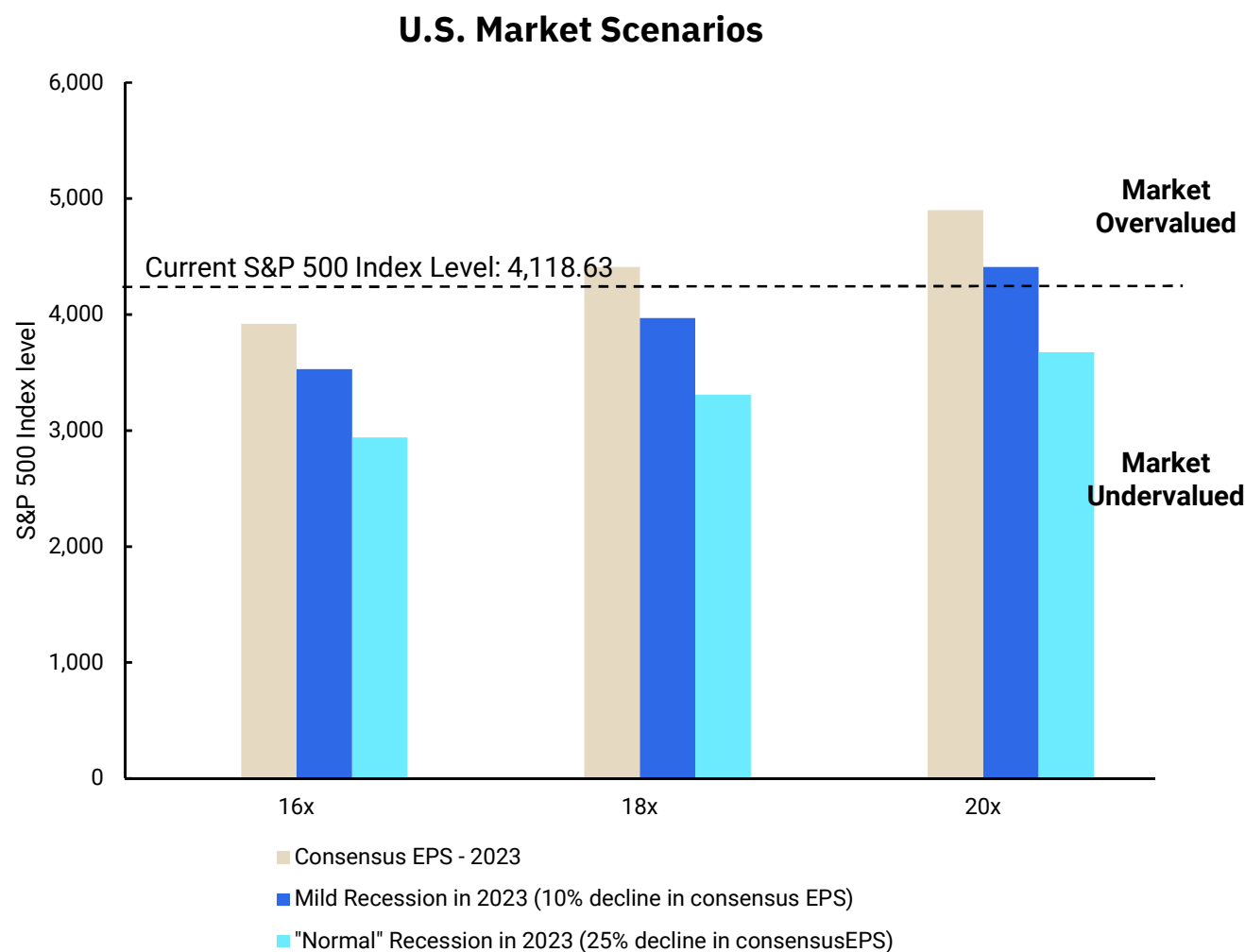
Credit spreads have widened

- Rising credit spreads have been a good historical indicator of concerns about future growth prospects.
- High yield credit spreads have moved to levels of historical concern.
- Higher spreads may result in fewer new borrowings, thus slowing economic growth.
- If a recession is avoided, there may be opportunities developing in pockets of the bond market.

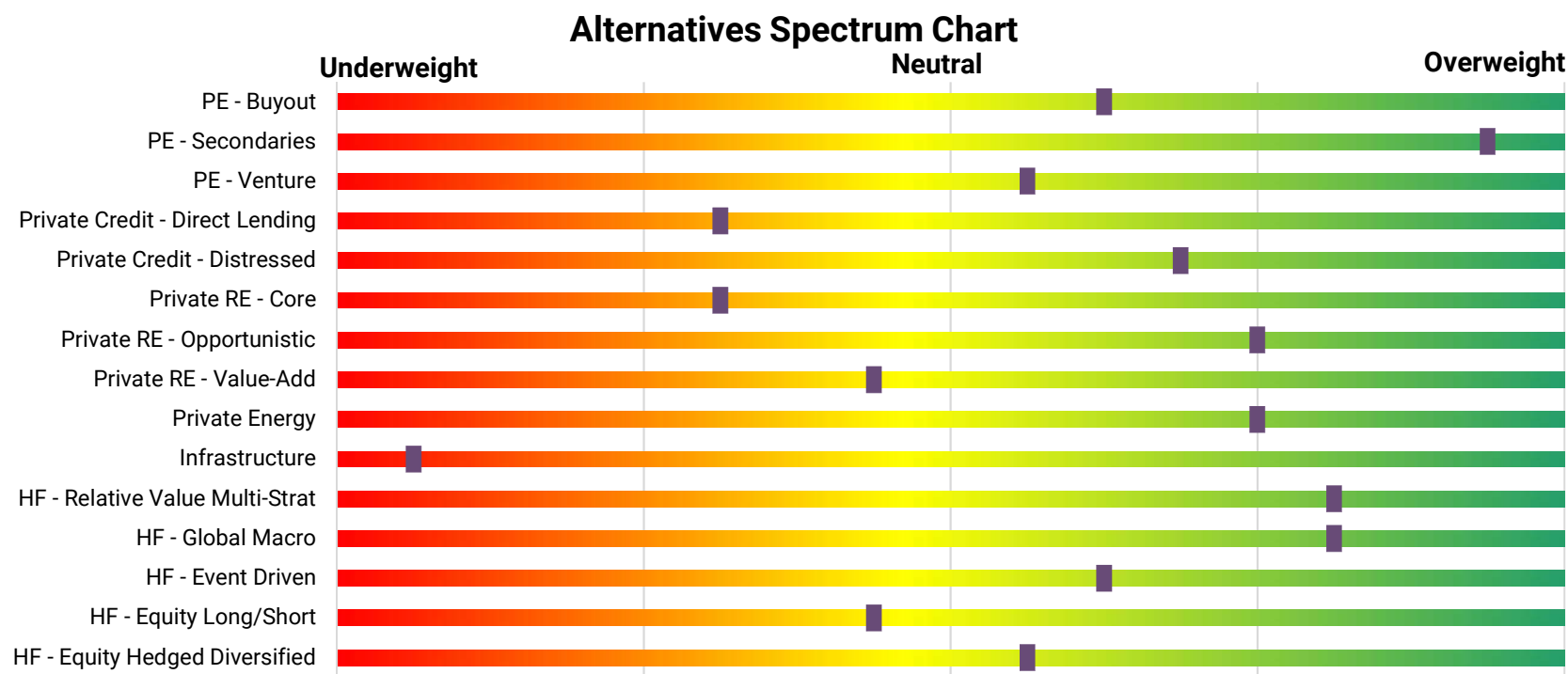


U.S. market scenarios

- It appears the market is pricing in earnings growth in 2023 vs. 2022. However, we think earnings estimates will trend lower.
- A mild recession in 2023 is possible, and valuations are starting to reflect that possibility.
- A normal recession, where earnings drop 25%, would result in further losses in equity markets.
- A recession is not our base case.
- Upside is possible if inflation comes down more quickly than the market expects.



Alternatives: Our 2022 outlook



Market expectations

- Amid a backdrop of rising interest rates and persistent inflation.
- Deal activity in private market slowing.
- Private equity downward fair market value adjustments.
- Risks to returns include supply chain disruptions, aggressive Fed, COVID variants, and China/US relations.

Areas of emphasis

- In private equity, we favor opportunistic credit and PE secondaries.
- In real estate, we favor opportunistic strategies in industrial and multifamily.
- Higher value on current income.
- For hedge funds, we favor uncorrelated returns across multiple strategies.

Base case outlook



Economy

Economic growth slows as consumers face higher prices and uneven supply of goods.

Risks: Russia-Ukraine war persists and China maintains a zero-COVID policy.



Policy

The Federal Reserve continues to accelerate its response to decade-highs in inflation while fiscal policy is muted.

Risk: Monetary policy actions don't slow inflation.



Markets

Bond markets struggle as rates rise. Equities remain volatile though many stocks now reflect recession valuations.

Risk: Earnings are below expectations and growth stalls.

How does this apply to the Nonprofit Sector?

1

Mission Delivery

The organization's board and leadership maintains a responsibility and duty of loyalty to the preservation of organization's mission. Recognize how the capital markets and economic outlook apply to/impact the delivery of the mission of the organization.

2

Financial Sustainability

Market and economic information should be considered during the budgeting process; crafting and reviewing the investment and spending policies of the organization; and recognizing how the global, national, and local economies could impact donor giving.

3

Fiduciary Responsibility

Organizations are responsible for having individuals on their governing boards, finance, and investment committees who have qualifications and backgrounds in finance and investments. Governing boards and committees must look at market and economic information through an objective lens. Organization decisions must never be based on emotion, or how they would manage their personal investments or budget. Furthermore, due diligence should be done when considering outside counsel; ensuring they have the background and experience in working with nonprofit institutional clients.

Best Practices

1

Investment Policy Statement

With your Institutional Advisor, review your investment policy statement at least once a year; with a more comprehensive review occurring every 3 years.

2

Spending Policy

With your Institutional Advisor, review your spending policy regularly. It is here that you have the greatest control over the stress on your portfolio, as well as, your ability to sustain the buying power of the distributions.

3

Education of Board and Committee Members

It is imperative to orient new board and committee members and provide regular education for existing board members on their fiduciary responsibility, as well as, the finances and investment portfolios of the organization.

4

Transparency and Communication with Donors

The leadership and governing board of the organization must recognize donors as investors in their organization and mission. Therefore, intentional, proactive communication and transparency of the current financial health organization, as well as, the board's long term financial sustainability plan is integral in the donor cultivation and stewardship strategy.

Questions ?



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