LEAVELL
INVESTMENT MANAGEMENT

First Quarter 2022 Commentary

Dear Clients,

Please find enclosed your March 31, 2022 Investment Reports.

Financial markets had a rough first quarter across the board — stocks, bonds, U.S., international and emerging markets — hurt by rising interest rates, inflation and the war in Ukraine. Global stock markets all felt the impact, with U.S. Large-cap stocks dropping 5.1%, developed international stocks down 5.0% and emerging market (EM) stocks down 5.2%. The declines for the full quarter masked the intra-quarter volatility. At its low point on March 8, the S&P 500 was down 13% from its high on January 3. The developed international and EM stock indexes had declines in the 16-17% range during the quarter, before recovering some of their losses by quarter end. The damage was worse in the U.S. core bond market than for U.S. Large-cap stocks. The U.S. core bond Index fell 5.9% for the quarter. This was the second-worst quarter for core bonds since the first quarter of 1980, when Paul Volcker's Fed was in full-bore tightening mode. Periods of rising inflation and rising interest rates create challenges for both stocks and bonds, and in turn for a traditional balanced portfolio.

Commodities have been a bright spot in terms of asset class returns, driven by exposure to various energy products (e.g., crude oil, natural gas, heating oil), as well as agricultural markets like wheat, corn, and soybeans. Many of these assets were benefitting from inflationary pressures coming into the year, and some experienced additional gains due to Russia's invasion of Ukraine (both are major agricultural exporters, and Russia is a major energy exporter). Oil prices are up more than 30% this year to around $100 per barrel. On a positive note, it is important to consider that the impact of higher oil prices in the U.S. has dropped sharply over the past four decades. As a net exporter of petroleum, the U.S. economy is less sensitive to oil price spikes and much less exposed than during the 1970's OPEC oil crisis.

Benchmark Returns

	Last Quarter	Last Twelve Months	Last Five Years
US Large Cap Stocks	-5.1	14.9	16.6
US Mid Cap Stocks	-6.3	8.9	13.0
US Small Cap Stocks	-5.7	0.7	11.3
Developed International Stocks	-5.0	2.0	7.7
Emerging Market Stocks	-5.2	-7.7	6.7
US Bonds	-5.9	-4.2	2.1
Global Bonds	-6.1	-7.9	1.3
US REITs	-4.3	25.0	8.4

Data source: Morningstar Direct. Past performance does not guarantee future results. It is not possible to invest directly in an index. Last five years data is annualized. Market indexes include:

US Large Cap Stocks: CRSP US Mega Cap TR USD
US Mid Cap Stocks: CRSP US Mid Cap TR USD
US Small Cap Stocks: CRSP US Small Cap TR USD
Emerging Market Stocks: FTSE Emerging TR USD
Developed International Stocks: FTSE Developed Ex US TR USD
US Bonds: Barclays US Aggregate Bond TR USD
Global Bonds: Barclays Global Aggregate Ex USD TR USD
US REITs: MSCI US REIT NR USD

The war in Ukraine has caused significant human suffering. From an economic and investment perspective, it has added to already-high uncertainty, degraded the near-term growth outlook, and added additional fuel to the inflationary fire. As we write this, the path, timing, impact and ultimate outcome of the war are highly uncertain. We hope and pray that there will be a quicker and less destructive resolution than the current consensus.

The horrific and disheartening events in Ukraine came as the COVID-19 pandemic news was getting better, with the Omicron wave sharply receding. Of course, the risk remains for new or more severe waves of the virus. There has been a recent uptick in new cases globally — in China (leading to full lockdowns in the affected areas under China's "zero-COVID" approach), other Asian countries and Europe. The U.S. may soon face a similar uptick. But

over time, with continued rising immunity rates, vaccines, medical advancements, and social and business adaptation, the economic damage and disruption should continue to recede. If so, this should both support economic growth via consumer and business spending and mitigate some of the inflationary pressures the U.S. and global economy experienced last year caused by widespread supply-chain bottlenecks.

As a result of the war in Ukraine, most economists and investment strategists have lowered their 2022 economic growth forecasts and upped their inflation forecasts. On the growth side, for example, the Federal Reserve, at its March FOMC meeting, cut its 2022 U.S. real GDP growth forecast from 4% to 2.8%. However, several recent U.S. economic data points have been solid, including record-high job openings, record-low weekly new unemployment claims, and a positive Leading Economic Indicator. Household wealth and savings are also high, which should support consumer borrowing and spending even with high inflation and rising interest rates. Corporate balance sheets are also generally in good shape.

On the inflation front in the U.S., the news has gotten worse over the past three months as can be seen across any number of inflation measures. The highest inflation by far is still coming from the consumer goods side of the economy, where the supply/demand imbalances due to COVID are worst. These imbalances should recede as the pandemic recedes, reducing at least some of the broad inflationary pressure. While most forecasters expect U.S. inflation to be lower by year-end than it is now, the consensus estimate has risen compared to three months ago. This includes the Fed. At its March FOMC meeting it projected core inflation of 4.1% for this year, up from its 2.7% forecast last December. The persistence of high and broadening inflation has led to a hawkish (i.e. higher rates) shift in the Fed's monetary policy stance.

The path to higher interest rates started with a 25-basis point (0.25%) increase in the fed funds policy rate at the March FOMC meeting. While the consensus outlook was for the Fed to begin slowly raising rates this year, it now appears that their intention is to raise rates at each of the six remaining meetings this year, with perhaps one or more 50 basis point hikes thrown in. In his post-FOMC meeting comments, Fed chair Jerome Powell clearly stated that fighting inflation is the Fed's focus, now that the labor market has reached maximum employment. Powell and the Fed are in a tough spot. They know they need to tighten to combat high inflation without crimping aggregate demand too severely, knowing that much of the current inflation is driven by exogenous supply-side disruptions due to COVID and the Ukraine war that the Fed cannot control.

In these uncertain times, we are especially grateful for your confidence and trust and we remain committed to helping you achieve your financial goals and objectives.

Leavell Investment Management, Inc.

Please advise us if you would like copies of our annual Securities & Exchange Commission Disclosure Brochure (Form ADV), a Prospectus for The Government Street Funds or a record of how your proxy statements were voted.