May | 2022

WEALTH MANAGEMENT | ARVEST

INVESTMENT MANAGEMENT GROUP | ARVEST

# Viewpoint

# Executive Summary

***- The "60/40 portfolio" became commonplace for balanced stock/bond allocations . . . (Page 2),*** And for a few decades this strategy has worked exceptionally well–outperforming even portfolios of 100% equity.

***- Professional money managers and individual investors must consider possible allocation alternatives if facts begin to confirm a more lasting change. (Page 3),*** But it is still too early to make an assured conclusion of such a drastic shift in market regime.

***- What is the average investor's preferred investment option should a regime change appear likely? (Page 3),*** In such an event, an allocation to real assets should prove advantageous.

***- Unsurprisingly, the FOMC chose to raise the policy rate by 50 basis points (0.50%). (Page 3-4),*** they also released additional details on their balance sheet reduction plans (quantitative tightening).

***- What did seem to catch the market by surprise, . . . was Chair Powell's comments that (Page 4),*** a 1) a 75-basis point increase was not seriously being considered and 2) 50 basis point hikes on the next "couple" of meetings instead of the market expectation of three.

***- The risk of recession continues to remain low. (Page 5),*** The Q1 GDP contraction took many by surprise, however, when we delve into the components a couple of themes emerge, which are mostly positive.

***- The bottom line from the Q1 GDP print is that while the number itself may appear jarring . . . the opposite may be true. (Page 8),*** Personal consumption expenditures remain a source of support for the U.S. economy and spending is expected to continue to normalize toward services.

***- Bond investors have faced additional challenges in April (Page 9),*** as market expectations for movements by the Federal reserve have pushed upward and placed further pressure along the Treasury curve.

***- We elected to lift our portfolio duration band . . . to a new range of 87.5% to 97.5% of the relevant benchmark (Page 12),*** to be somewhat less sensitive to sifts in interest rates.

***- For the full year 2022, earnings growth of 9.3% is now expected. (Page 14),*** With the market drop, valuations are much less outrageous, and there should be more long-term optimism towards equities going forward.

## Asset Class Outlook

| Equity | Current | Previous |
|---|---|---|
| *U.S. Equity* | Neutral | Slightly Unfavorable |
| *Int'l Equity* | Slightly Favorable | Neutral |
| *Emer. Mkts* | Slightly Favorable | Neutral |

| Real Assets | Current | Previous |
|---|---|---|
| *Real Estate* | Slightly Unfavorable | Slightly Unfavorable |
| *Infrastructure* | Neutral | Neutral |
| *Commodities* | Neutral | Neutral |

| Fixed Income | Current | Previous |
|---|---|---|
| *Invest. Grade Credit* | Neutral | Neutral |
| *Treasury/Agency* | Neutral | Neutral |
| *Mortgage Backed* | Slightly Unfavorable | Slightly Unfavorable |
| *Commercial MBS* | Slightly Favorable | Slightly Favorable |
| *Asset Backed (ABS)* | Favorable | |
| *High Yield* | Neutral | Neutral |
| *Emer. Mkts Debt* | Neutral | Neutral |
| *Taxable Muni* | Slightly Favorable | Slightly Favorable |
| *Tax-Exempt* | Slightly Favorable | Slightly Favorable |
| *TIPS* | Slightly Unfavorable | Slightly Unfavorable |

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## The 60/40 Portfolio is Dead! Long Live the 60/40 Portfolio!

*"The report of my death was an exaggeration."* – Samuel Clemens/Mark Twain

For as long as this portfolio manager can remember, the prevailing wisdom among institutional investors and market researchers was that a portfolio allocated at 60% stocks and 40% bonds was the optimal mix when risk/return and long-run performance is considered. As a result, endowment funds, which are designed to be invested in perpetuity with a regular withdrawal of about 5% annually, commonly invested with the 60/40 allocation. (At least until David Swensen, legendary CIO of the Yale Endowment, changed the paradigm, but that is a different story for a different time.) Periodically the portfolios were rebalanced back to 60% equity/40% bonds on a predetermined schedule, or when asset allocations strayed too far from the targets.

Consequently, the "60/40 portfolio" became commonplace for balanced stock/bond allocations for individual investors as well (even if the allocations weren't exactly 60% equity/40% fixed income). And for a few decades this strategy has worked exceptionally well—outperforming even portfolios of 100% equity.

The performance of the 60/40 was due largely to three factors:

1) The lower overall portfolio volatility helped avoid full participation in large stock market downdrafts, and regular rebalancing forced unemotional buying of equity after stock market drawdowns, often before stocks rose again in value. (Historically bonds have about one-third of the volatility of the stock market.)

2) Since the early 1980s bonds have been in a fantastic bull market as interest rates fell from the high teens to near zero percent, with a subsequent rise in bond prices.

3) Stock and bond prices have been largely uncorrelated for the past four decades. Only in rare, extreme cases did both stocks and bonds drop meaningfully in price at the same time. In other words, when stock prices fell, high quality bonds would remain steady or increase in price. If bond prices fell, it often occurred while stocks were rising.

And then something different happened. First, the stark economic slowdown due to the COVID pandemic and the unprecedented level of central bank bond buying (quantitative easing) in response pushed the U.S. 10-year Treasury yield below 1%. Many Wall Street strategists and market pundits began citing the historically low rates as evidence that the bond bull had just experienced its death throes. There was nowhere for rates to go but up, thus further significant price gains from bonds were no longer possible. As a result, bonds would no longer be a ballast for the 60/40 portfolio, thereby rendering the strategy unadvisable, i.e., "dead."

Secondly, for the last four months—December 31, 2021 through the end of April—the stock market (S&P 500) has declined by 13% while the Bloomberg Aggregate bond index has a total return of -9.5%, leading to one of the worst four-month periods for the 60/40 portfolio on record. Obviously, the common thinking goes, a confirming coffin nail.

Undoubtedly, this warrants attention. Additionally, the potential for an interest rate regime shift—from bond bull to bond bear, potentially driven in part by an inflation spiral—must be taken into account. Professional money managers and individual investors must consider possible allocation alternatives ***if*** facts begin to confirm a more lasting change. But it is still too early to make an assured conclusion of such a drastic shift in market regime, at least in our opinion.

The arguments for a prolonged bond bear are well known. Just peruse a sampling of leading financial media or market/economic commentary. But let us consider a counter argument:

- Inflation, while more persistent than originally anticipated, should ebb, alleviating some of the pressure on interest rates.
- Economic growth could slow due to pandemic mitigation efforts in China, slowdowns in U.S. productivity and lack of labor supply contributing to slower GDP gains, and/or higher prices and dwindling savings leading to a reduction in discretionary spending activity. (Slowing economic growth tends to lead to lower interest rates.)
- Aging global demographics contributing to elevated demand for safer savings vehicles like quality fixed income, keeping bond prices elevated and putting a cap on yields.
- The Federal Reserve, now fully in inflation fighting mode (albeit belatedly and behind the curve), could move too aggressively in raising rates and tightening financial conditions, ultimately tipping the U.S. economy into a slowdown or recession later this year or, more likely, sometime next year. And let's not assume that central banks, led by the Fed, Bank of Japan, Bank of England, and the ECB, will be quick to cease intervention in financial markets with new rounds of quantitative easing, or suspending quantitative tightening, during times of financial stress or uncertainty.

Are these contra-arguments our base case or prediction? No. The point is that it is too early to have firm conviction in either an interest rate/inflation regime change, or lower-for-still longer interest rates. Additionally, as Dennis Whittaker outlines in the fixed income notes below, we currently see opportunity, at least for the short-to-intermediate term, investing in select areas of the bond market.

Of course, it is prudent to also have contingencies for the potential of steadily higher rates and a pernicious inflation environment, so it begs the question: what is the average investor's preferred investment option should a regime change appear likely? In such an event, an allocation to real assets should prove advantageous. Arvest Wealth Management-Investment Management Group portfolios already allocate to real assets—commodities, energy infrastructure, and real estate investment trusts. Furthermore, should evidence point to a regime change these allocations can be reasonably increased. But it is important to point out real assets would be a portion of a diversified portfolio, not the entire portfolio, as they carry their own unique risk profile. And, as stated above, it is not yet conclusive that expanding real assets allocations is warranted.

**The Federal Reserve Moving "Expeditiously"**

As we were putting the final touches on this month's Viewpoint the Federal Reserve's Open Market Committee (FOMC) concluded their May meeting, released their prepared statement, and Chair Powell held his usual post-meeting press conference. Unsurprisingly, the FOMC chose to raise the policy rate by 50 basis points (0.50%). They also released additional details on their

balance sheet reduction plans (quantitative tightening). In June they will allow $30 billion in treasuries and $17.5 billion in mortgage securities--$47.5B in total—to roll off, increasing to an ongoing $95B per month reduction by September ($60B treasury/$35B mortgages). One could postulate that this is a relatively cautious pace given prior telegraphing by certain FOMC members and considering how far behind the inflation curve and financial markets the Fed is. Still, none of these announcements were all that surprising.

What did seem to catch the market by surprise, leading to a rally in stocks and bonds Wednesday afternoon was Chair Powell's comments during the presser that 1) a 75-basis point increase was not seriously being considered (contrary to some rate strategist's ponderings), and 2) 50 basis point hikes on the next "couple" of meetings instead of the market expectation of three 0.5% hikes, and 3) a verbal slip that the neutral policy rate could be "2%—3%." This is slightly below the range previously hinted at by the Fed and estimated by most economists and rates strategists. It will be interesting if FOMC members walk-back Powell's neutral rate statement as they rejoin their public speaking engagements. Barring that, market participants surmised that, while hawkish on inflation, the FOMC was not as hawkish as they might have been—a positive, at least in the short-term, for stocks and bonds.

What is more concerning for this writer is that Chair Powell seemed to express high confidence that the FOMC can orchestrate a "soft-landing" for the economy while taming inflation. While it is common for Fed Chairs to express calm and control, it was implied that the Fed knows what the future holds for the economy, employment, and inflation. They don't. Perhaps no one does in this exceptional economic environment.

Given, this level of uncertainty, we assess that the wise action for investors is to stay over their skis—neither too aggressively positioned nor too conservatively allocated in their portfolios.

As we've shared many times before (because it is tried-and-true), the best course of action for investors is a balanced asset allocation driven by the financial planning process, rebalancing as needed, and keeping investment time horizons front of mind to avoid emotionally driven large-scale changes that derail the financial plan.

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Clay is responsible for the strategic investment direction of the investment models and portfolios managed by the Investment Management Group and Arvest Bank Trust. He oversees the development of capital market assumptions, the development and management of asset allocations, research on mutual funds, ETFs and outside managers, and communication of investment strategy to Arvest Wealth Management associates and clients. A graduate of Wichita State University, Clay has completed Columbia University's Academy of Certified Portfolio Management and is a member of the Chartered Financial Analyst Institute and Kansas City Society of Chartered Financial Analysts.

## Current Economic Snapshot

### Quarterly & Fiscal Year GDP Growth (Average Annual)

| Source | FY21 (Actual) | 1Q22 (Actual) | 2Q22 (Forecast) | 3Q22 (Forecast) | 4Q22 (Forecast) | 1Q23 (Forecast) |
|---|---|---|---|---|---|---|
| *Bloomberg* | **5.70%** | **-1.40%** | **3.00%** | **2.50%** | **2.35%** | **2.10%** |
| *AWM/IMG* | **5.70%** | **-1.40%** | **3.00%** | **3.00%** | **2.50%** | **2.00%** |

*Sources: Bloomberg, Bureau of Economic Analysis; Methodology: Average Annual Return*

### Investment Management Group's Recession Indicators

| Indicator* | Current | Previous | Short Term Trend | Long Term Trend |
|---|---|---|---|---|
| CB Leading Econ. Indicators | +6.4% | +7.6% | Neutral | Positive |
| 3–Mon./10–YR. Yield Curve Spread | +2.21% | +1.87% | Positive | Positive |
| New Orders–to–Inventories | +1.9 | -1.7 | Neutral | Neutral |
| Cap. Goods New Orders | +10.3 | +10.7 | Neutral | Positive |
| Initial Jobless Claims | 180k | 202k | Positive | Positive |
| New Building Permits | 1,873k | 1,859k | Neutral | Positive |

*Sources: Bloomberg*
**See the Appendix for description of each indicator*

## A Look Under the Hood

We have elected to maintain our quarterly GDP forecasts for the second through fourth quarters of 2022 (including the forecast for Q1 2023), however, in light of the recent negative Q1 2022 GDP print, we are reducing our full year 2022 forecast from 3.5% to 2.7%. We had previously forecast a Q1 2022 Real GDP growth rate of +1.5% (annualized)[1]. There has been little that's changed with respect to the ongoing geopolitical climate and continuing challenges to the global economy. The Russia/Ukraine conflict shows no sign of slowing and China continues to maintain a zero COVID policy that has seen large sections of the country shut down. Our growth forecast remains above trend, albeit less so. We will dissect the Q1 GDP figure in greater detail in the sections that follow and provide an update on inflation.

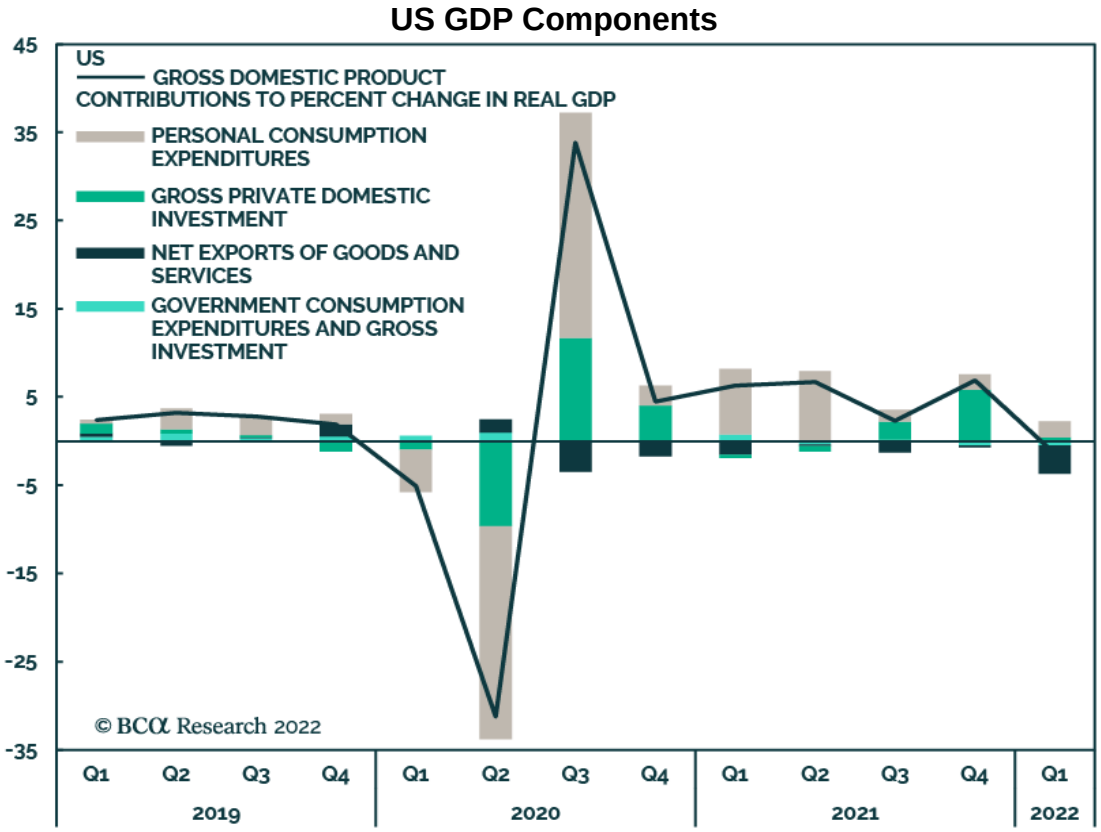
Leading indicators remain mostly positive, and the risk of recession continues to remain low. The Q1 GDP contraction took many by surprise, however, when we delve into the components a couple of themes emerge, which are mostly positive. The four main components of GDP are Personal Consumption, Domestic Investment, Government Spending, and Net Exports (Exports minus Imports). The sum of these components produces the GDP figure.

From the chart below on the next page, it's apparent that the largest drag on Q1 GDP growth was the Net Exports figure (including the effects of the change in private inventories). Net Exports subtracted 3.2% from the Q1 GDP growth figure. A slower pace of inventory accumulation subtracted an additional 0.8% from GDP growth. Taken together, these effects subtracted 4% from the Q1 GDP growth figure.

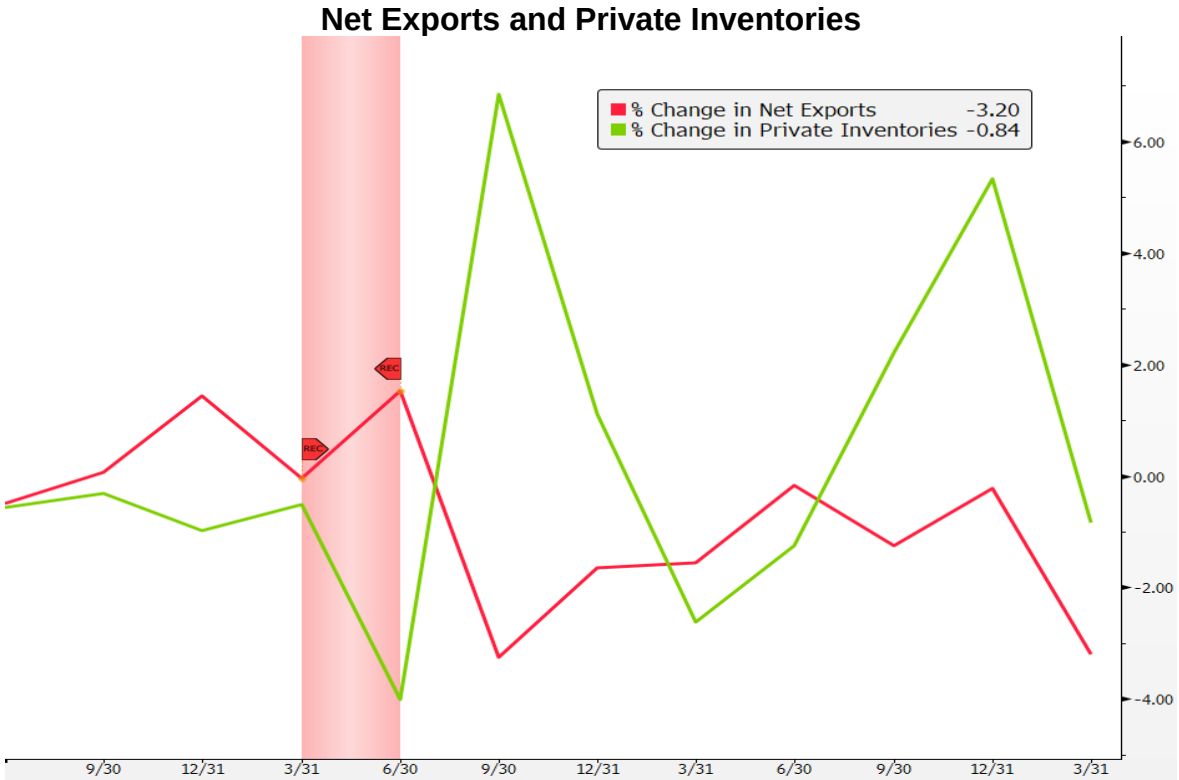
[1] Quarterly Real GDP growth forecast is calculated by taking the quarterly forecast figures and annualizing them.

## Economic Indicators

*Emil Suqi, CFA*




*Source: BCA Research 2022*

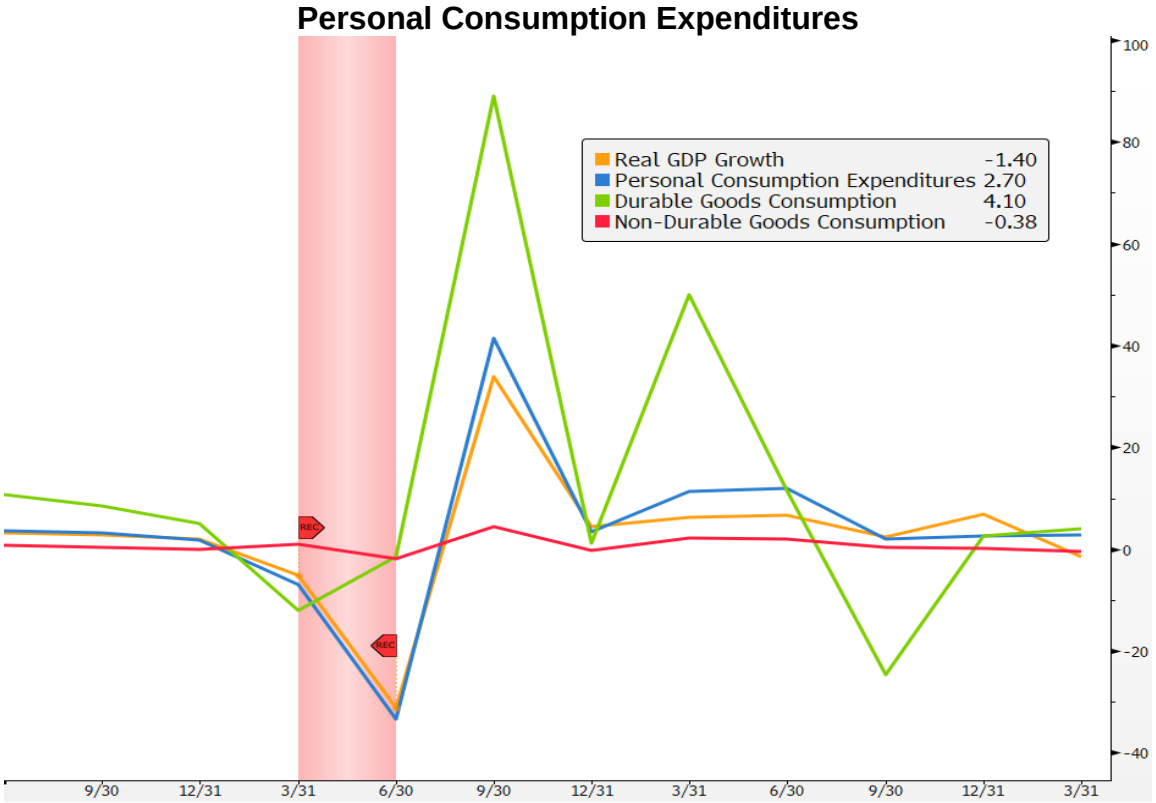



*Source: Bloomberg; Copyright 2022 Bloomberg Finance L.P.*

## Economic Indicators

*Emil Suqi, CFA*

The stark decline in net exports highlights that the path of recovery from the COVID-19 pandemic has been somewhat asymmetric between the US and the remainder of the world. This is further highlighted by the decline in inventories. It is our view that as supply chains normalize and the remainder of the world catches up to the US, inventories will accumulate at a faster pace and the US will export more goods, thus these effects will reverse later this year. Not illustrated in the above chart is government spending, which represents about 7% of the total GDP calculation and declined by 2.7%.



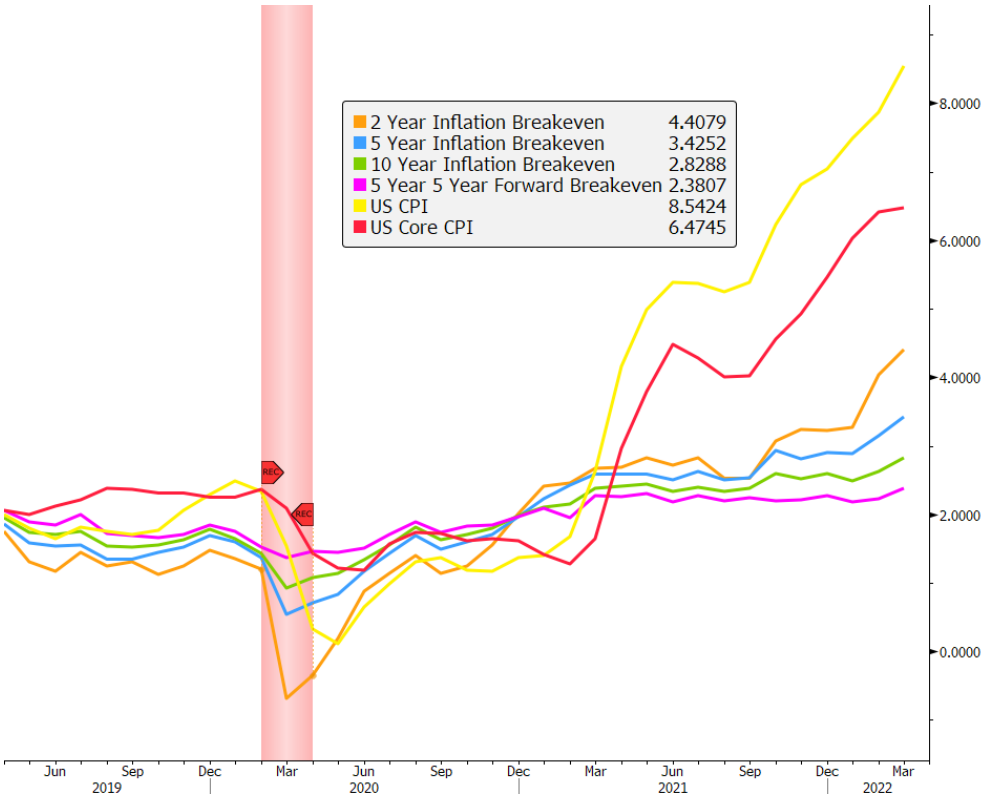

*Source: Bloomberg; Copyright 2022 Bloomberg Finance L.P.*

The silver lining in the GDP print is that personal consumption expenditures, which are by far the largest component of GDP (representing about 2/3 of the measure), increased slightly from 2.5% in Q4 2021 to 2.7% in Q1 2022. Additionally, consumption of services and durable goods (those which typically will have a longer life span) increased 4.3% and 4.1% respectively in Q1 2022. Spending on non-durable goods declined by 0.38%, largely reflecting a reduction in cash outlays due to rising energy prices. This is all to say that the US consumer remains strong, consumer spending remains robust and shows signs of normalizing.

## Economic Indicators

*Emil Suqi, CFA*

**Inflation Breakevens and US CPI**




*Source: Bloomberg; Copyright 2022 Bloomberg Finance L.P.*

Levels of inflation in the US remain uncomfortably high. That said, it appears that the bulk of the inflation in goods, especially durable goods, has potentially peaked and should abate in the remainder of the year. The Fed's preferred measure of inflation expectations (5 year/5 year forward inflation breakeven) hit a local maximum of 2.57% in mid-April and has since come back down to 2.4%.

Uncertainty around energy prices and food continue to remain top of mind and make up the spread difference between CPI and the core measure. Ongoing geopolitical tensions and supply chain disruptions will continue to contribute to higher and more uncertain energy and food prices.

The bottom line from the Q1 GDP print is that while the number itself may appear jarring, it is not an indication of an impending recession. In fact, the opposite may be true. Personal consumption expenditures remain a source of support for the U.S. economy and spending is expected to continue to normalize toward services. We believe overall inflation within the economy will moderate as a result.

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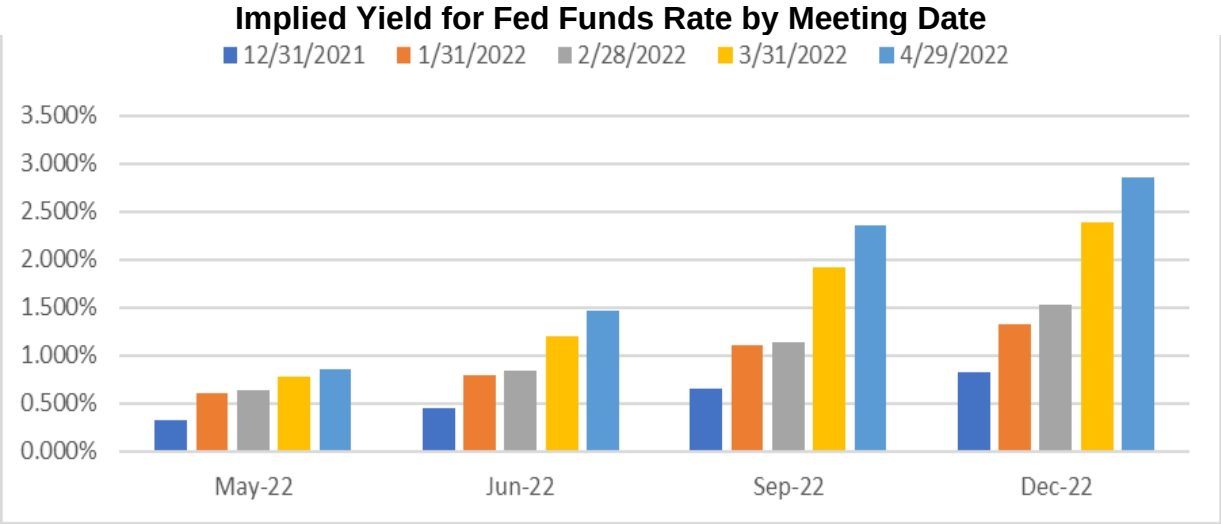
Emil manages fixed-income separate account portfolios for Arvest Wealth Management Trust and Investment Management Group clients. Additionally, he contributes to fixed-income investment strategy and outlooks, as well as client and advisor communications and presentations. A graduate of the University of Illinois, Emil is a CFA Charterholder, a member of the Chartered Financial Analyst Institute and Chicago Society of Chartered Financial Analysts.

# Taxable Bond Market

*Dennis J. Whittaker, CFA*

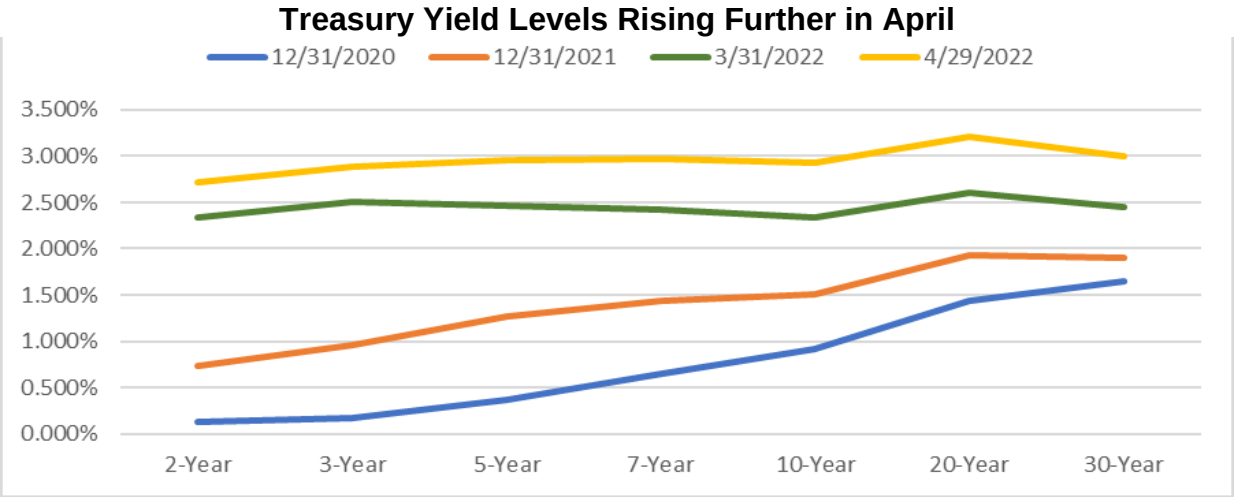
## The Wrong Kind of April Showers

Following on the heels of a difficult quarter in 1Q2022, bond investors have faced additional challenges in April, as market expectations for movements by the Federal Reserve have pushed upward and placed further pressure along the Treasury curve. Indeed, as can be seen in the chart below, the implied yield for the September 2022 Fed Funds contract rose from 1.922% to 2.36%, while the implied yield for the December 2022 contact increased from 2.395% at the end of March to 2.86% at the end of April.




*Source: Bloomberg: WIRP Screen*

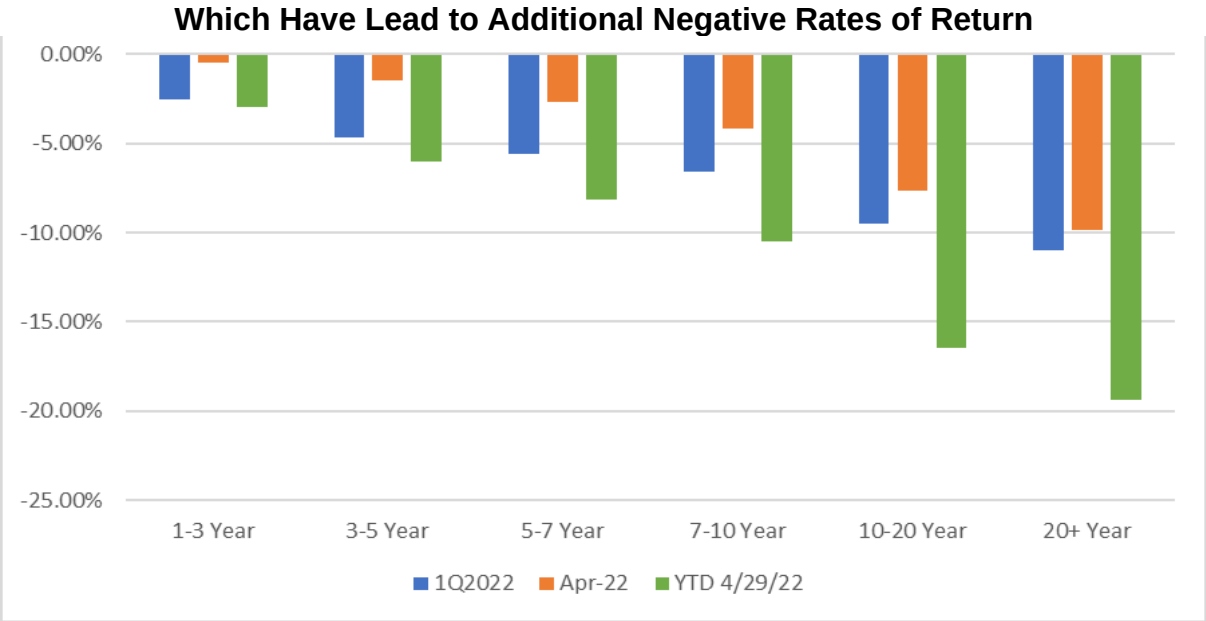
Unsurprisingly, the growing expectations for additional and more aggressive action by the Federal Reserve helped to fuel additional upward pressure along the Treasury curve during the month of April. As can be seen in the graph below, Treasury yields pushed upward by 37.4 to 60.8 basis points for the 2-30-year segment of the curve. Given this upward movement, bondholders accrued additional mark to market losses beyond those experienced in 1Q2022. (see Treasury Total Returns Chart at the top of the next page for additional details).




*Source: Bloomberg*

## Taxable Bond Market

*Dennis J. Whittaker, CFA*




*Source: Barclays; Bloomberg*

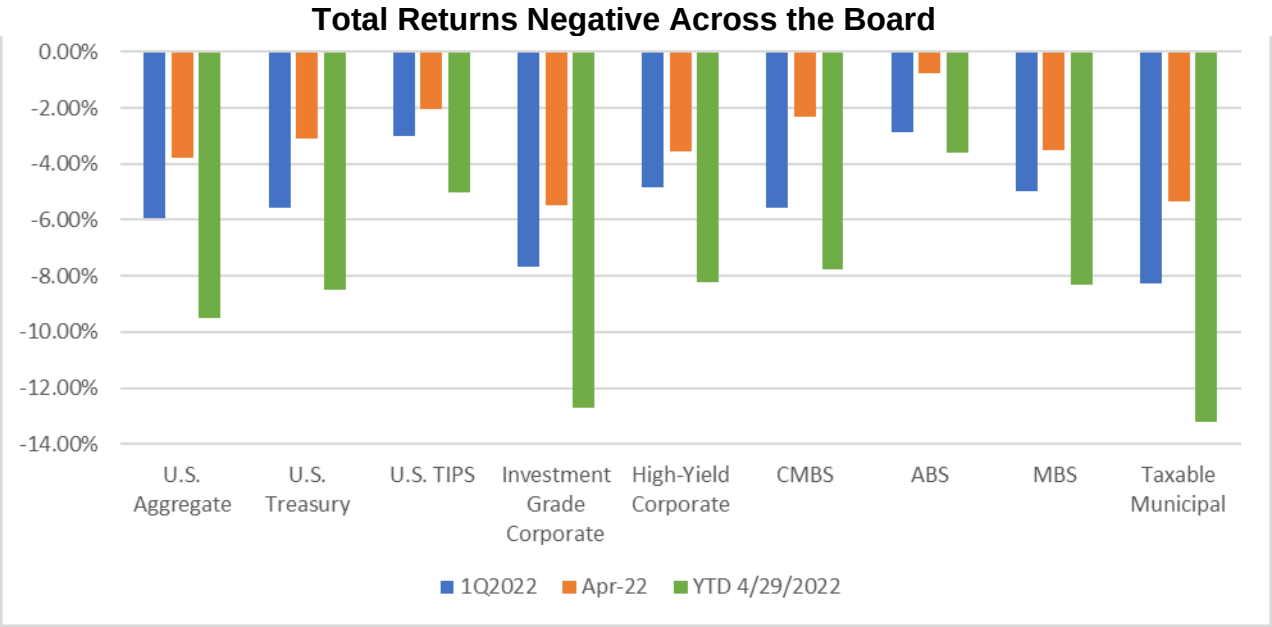
As can be seen in the chart above, longer dated securities have suffered relatively larger losses so far in 2022 with Treasury maturities of 20 years along longer down almost -20% in the first four months of 2022. Still, even an investor solely focused on the 3-5-year segment of the Treasury curve would have experienced a negative total return of -6.04% for the year-to-date period ended April 29, 2022.

Additionally, bond investors continued to face pressure from widening spreads on investment grade corporate, commercial mortgage-backed securities and taxable municipal securities. Although we elected to reduce our exposure for corporate bond securities to "neutral" versus "overweight" in late April, the focus on these sectors likely have caused us some performance drag in the first four months of 2022.

**Bond Market Considerations Table**

| | 4/29/2022 | 3/31/2022 | Change | 12/31/2021 | Change |
|---|---|---|---|---|---|
| Inv. Grade Corp. OAS | 135.00 | 16.00 | 19.00 | 92.00 | 43.00 |
| High Yield OAS | 379.00 | 325.00 | 54.00 | 283.00 | 96.00 |
| HY OAS/IG OAS | 2.81 | 2.80 | 0.01 | 3.08 | -0.27 |
| USD FRA/OIS 3M | 20.63 | 13.70 | 6.93 | 6.90 | 13.73 |
| Mort. Backed Sec. (MBS) OAS | 40.00 | 24.00 | 16.00 | 31.00 | 9.00 |
| MOVE (Treasury Vol.) | 128.40 | 106.88 | 21.52 | 77.10 | 51.30 |
| Asset Backed Sec OAS | 69.00 | 57.00 | 12.00 | 38.00 | 31.00 |
| Commercial MBS (CMBS) OAS | 87.00 | 85.00 | 2.00 | 68.00 | 19.00 |
| Agency CMBS | 50.00 | 48.00 | 2.00 | 38.00 | 12.00 |
| Taxable Muni OAS | 124.00 | 118.00 | 6.00 | 94.00 | 30.00 |
| Emerging Markets (EM) USD OAS | 338.00 | 320.00 | 18.00 | 297.00 | 41.00 |
| EM OAS/HY OAS | 0.89 | 0.98 | -0.09 | 1.05 | -0.16 |

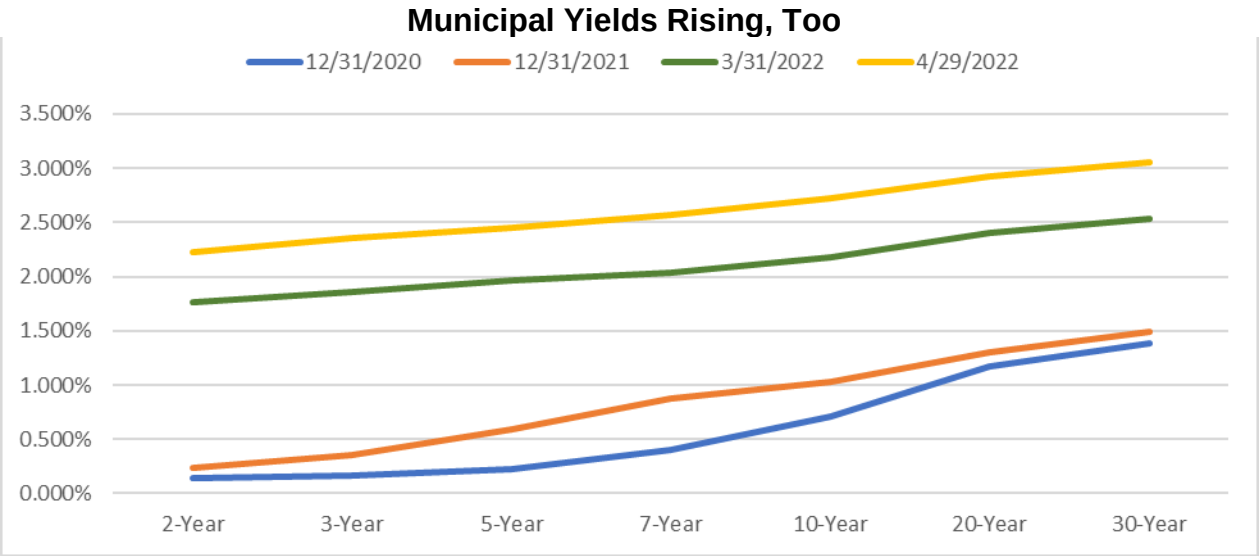
*Source: Bloomberg; ARVEST Wealth Management*




*Source: Barclays; Bloomberg*

**Tax-Exempt Market Comes Under Additional Pressure as Well**

Unsurprisingly, given the upward pressure on Treasury yield levels last month, municipal yields followed suit and marched higher. Indeed, as can be seen in the chart below, municipal yields rose by an additional 39 to 52 basis points across the AAA General Obligation curve last month. For the year-to-date period, municipal yields have increased by 156 to 201 basis points.




*Source: TM3*

As a result, total rates of return in the tax-exempt market are decidedly negative for the year-to-date period. Much as their Treasury cousins, longer-dated municipal bonds have experienced more significant declines so far in 2022; however, even an investor focused on just the 4-6-year

segment of the municipal curve would have experienced a negative total return of nearly -6.7% in the first four months of 2022.

**Municipal Total Returns Decidedly Negative Year-to-Date**

| | April 2022 Returns (through 04/29) | March 2022 Returns (through 03/31) | 2022 Calendar Year Return (through 4/29) |
|---|---|---|---|
| Overall Muni Index | -2.77% | -3.24% | -8.82% |
| 1 Year (1-2) | -0.40% | -0.83% | -2.01% |
| 3-Year (2-4) | -1.00% | -1.66% | -4.52% |
| 5-Year (4-6) | -1.65% | -2.35% | -6.66% |
| 7-Year (6-8) | -2.14% | -2.74% | -7.72% |
| 10-Year (8-12) | -2.66% | -3.13% | -8.72% |
| 15-Year (12-17) | -3.32% | -3.82% | -10.24% |
| 20-Year (17-22) | -3.51% | -3.92% | -10.46% |
| Long-Bond (22+) | -4.62% | -4.80% | -12.87% |

*Source: Bloomberg*

**Strategy Thoughts:**
We recently elected to lift our portfolio duration band from its former range of 85% to 95% to a new range of 87.5% to 97.5% of the relevant benchmark duration[1] to be somewhat less sensitive to shifts in interest rates while retaining overweight positions in commercial mortgage-backed securities and taxable municipal securities. We also elected to reduce our overweight in investment grade corporate bond securities to neutral to reflect growing concerns about the potential impact of more aggressive action from the Federal Reserve this year.

While we also hold out of index (i.e., not part of the U.S. Bond Aggregate Bond Index) positions in U.S. High-Yield Corporate Bond sector via an exchange traded fund (ETF) and in Treasury Inflation Protected Securities (TIPs), we did make a reduction in our targeted mid-point for TIPs to reflect our view that valuations have become more expensive.

We have also maintained underweight positions (i.e., less than allocated in the passive benchmark) in “traditional” government bond securities as well as in agency-backed mortgage-backed securities (MBS). Still, we reduced the scope of our underweight (i.e., we have a higher targeted allocation, but the targeted allocation remains below the benchmark weighting) to reflect the impact of better valuations in the sector. Finally, we have created a new allocation into asset backed securities (ABS) given the recent spread widening (i.e., better valuations) that sector has experienced.

While we believe these past decisions have allowed us to outperform our passive benchmark, we also recognize that the general rise in yields and widening of spreads (i.e., yield differential between a non-Treasury bond and Treasury security) have resulted in a significantly negative

[1] -- Duration is often utilized as rough proxy for the sensitivity of a bond’s price to a movement of 100 basis points in interest rates. For example, a bond with an estimated duration of 5 years would be expected to decline in value by 500 basis points for an immediate 100 basis point increase in yields.

total return for accounts managed versus either the Bloomberg Aggregate Bond or the Bloomberg Intermediate Aggregate Bond indices.

As we move further into the second quarter, we recognize that bond holders face the prospect of additional rate hikes from the Federal Reserve as well as the potential impact of reductions in the central bank's balance sheet. As such, we wouldn't be surprised to see additional turbulence in the bond market over the next few months as investors continue to struggle with both geopolitical uncertainties as well as an uncomfortable inflation environment. Nevertheless, we remain of the mindset that the bond market has priced in a significant portion of the tightening in monetary policy that the Federal Reserve is likely to be able to employ during the course of calendar year 2022. Indeed, if the 10-year Treasury were to test the 3.25% to 3.50% level for yields, we may well explore moving our portfolio duration band to an even tighter position versus the benchmark (i.e. setting our band higher).

Finally, while we recognize the negative impact the movement in the interest rate had on existing bond portfolios during the first four months of 2022, we also recognize that higher yields ultimately provide the opportunity for a better total return experience as fresh money and reinvestment dollars are put to work. As such, we caution investors not to overreact to the headline of the negative total return experienced so far this year and continue to assess the need for bonds as potential ballast and portfolio diversifier within their overall allocations.

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Dennis is responsible for the construction and management of several fixed income portfolios. Prior to rejoining Arvest Wealth Management in 2006, he managed a tax-exempt mutual fund for an investment advisory firm and prepared all their fixed income research. Dennis has a BSBA in economics and holds the Chartered Financial Analyst designation. He is a member of the Fixed Income Analysts Society and the Board of Directors for the Southern Municipal Finance Society, previously serving as chair, and a former member of the Board of Governors of the National Federation of Municipal Analysts.

## U.S. Equity Market

*Christopher Magee, Ryan Ritchie, and Bret O'Meara*

The stock market had an exceptionally bad month in April. The S&P 500 was down nearly 9% and the Nasdaq fell by more than 13%. International stocks were down 6.4% for the month, and emerging markets were down 5.6%. Now, in early May, the YTD performance of the S&P 500 is -12% and 12.5% off the high set in December of last year. Although in a correction, the S&P 500 is one of the few major indices that is not in a bear market. The Nasdaq is 22.5% off its peak. The Russell 2000 (small cap) and MSCI Emerging Market indices are also off their highs by slightly more. The cause of the most recent selling can be attributed to the Fed's plans of increasing rates to tame inflation.

Approximately 300 S&P 500 companies have reported first-quarter earnings. Results have been decent thus far. Eighty percent of companies that have reported have beaten earnings estimates, by an average of 7%. This is a bit lower than the average positive surprise of 13% over the last four quarters, as earnings predictability becomes a bit more certain with pandemic restrictions gone. Seventy Three percent of companies have beaten revenue estimates by an average of 2%. This too is less than the average surprise over the last four quarters of 3.7%.

Finally, earnings thus far in Q1 2022 are 10% higher than Q1 2021, which is a positive. However, excluding the energy sector, whose earnings have skyrocketed with increasing oil prices, the growth rate is only 4.4%. This is somewhat troublesome as inflation over the last year is considerably higher than that. The financial sector has been the weakest. Earnings are down approximately 19% from Q1 2021. Merger and acquisition (M&A) and initial public offering (IPO) activity has stopped with weaker markets and the war in Ukraine. Also, last year, an excessive amount of loan loss reserves were released which inflated earnings then, making current comparisons weaker.

After the middle of May, the focus will shift away from earnings and back to economic data such as inflation and the Fed's actions, the war, and the pandemic, (especially how it is affecting China). But for the full year 2022, earnings growth of 9.3% is now expected. This is slightly better than the 8.4% growth expected on January 1st at the start of the year. Similar growth is expected in 2023. With the market drop, valuations are much less outrageous, and there should be more long-term optimism towards equities going forward, regardless of what happens during the second quarter.

### Market Indices Performance

| | Trailing Returns (Price + Dividends) | | | | | | 2022 EPS |
|---|---|---|---|---|---|---|---|
| Index | YTD | 1-Month | 3-Month | 12-Month | Yield | Forward P/E | Growth (est.) |
| S&P 500 | -12.92 | -8.72 | -8.17 | .20 | 1.55 | 17.6 | +9.0% |
| S&P 400 | -11.65 | -7.11 | -4.78 | -7.06 | 1.55 | 13.3 | +10.9% |
| S&P 600 | -13.01 | -7.81 | -6.19 | -8.61 | 1.30 | 13.4 | +10.6% |
| MSCI World ex-US | -11.79 | -6.40 | -7.32 | -7.64 | 3.35 | 12.8 | +10.8% |
| MSCI EM | -12.13 | -5.55 | -10.43 | -18.09 | 3.16 | 11.3 | +10.5% |

*Source: Bloomberg, I/B/E/S data from Refinitiv, as of 4/30/2022*

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Bret assists and supports the management of investment portfolios through research, analysis, and trading, specializing in equity securities. He joined Arvest Wealth Management in 2010 as a member of the Retirement Plan Services Group before transitioning to the Investment Management Group. Bret has a BSBA in economics and finance and MBA. He previously worked at a Northwest Arkansas bank for two years and taught courses in accounting and economics at Northwest Arkansas Community College for six years. Bret is a CFA charterholder and a member of the CFA Society of Arkansas

### Christopher Magee

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Christopher is the lead manager of the Arvest Bank Group Equity Fund and the Investment Management Group DIG Equity Portfolio and is responsible for construction of equity portfolios for institutional and retail clients, including equity research, security selection, sector weightings and trading. Prior to joining Arvest Wealth Management in 1992, he served as a trust investment officer at a national bank in Shreveport, Louisiana and a bank in Amarillo, Texas. He has a BSBA in finance, with an emphasis in investments, and is a graduate of Cannon Financial Institute's Advanced Trust Investments School.

### Ryan Ritchie

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Ryan is co-manager of the Arvest Bank Group Equity Fund and co-lead manager of the Investment Management Group's strategic portfolios and is responsible for the construction of equity portfolios for institutional and retail clients, including equity research, sector weightings, and trading. Additionally, he is responsible for directing the implementation of Arvest Wealth Management's equity strategy throughout trust and brokerage relationships. Ryan has a BSBA in finance with an emphasis in financial management. Ryan has been managing portfolios since 2002.

# Appendix

## ***Investment Management Group Team Members***

*Clay Nickel, Chief Investment Officer & Strategist*

*Christopher Magee, Sr Equity Portfolio Manager*

*Ryan Ritchie, Portfolio Manager*

*Bret O' Meara, Client Portfolio Manager*

*Dennis Whittaker, Sr Portfolio Manager*

*Emil Suqi, Fixed Income Portfolio Manager*

*Alex Jantsch, Portfolio Analyst*

*Josh Warner, Portfolio Analyst*

*Abbey Vibhakar, Fixed Income Analyst*

*Jake Baker, Fixed Income Analyst*

*Curtis Jones, Fixed Income Analyst*

*Jennifer Tichenor-Turner, Adv Solutions Support Specialist*

*Colton Nix, Advisory Solutions Support Specialist*

*Dylan Goswick, Division Intern*

*Charles Kurtz, Executive Assistant*

## ***Description of IMG Recession Indicators***

- Conference Board Leading Economic Indicators (LEI) - The indicator tracks the Year-over-Year percentage change in the Conference Board Leading Economic Indicators Index. The index is an American economic leading indicator intended to forecast future economic activity. It is calculated by The Conference Board, a non-governmental organization, which determines the value of the index from the values of ten key variables.

- U.S. Treasury Yield Curve (3-month to 10-year Spread) – This indicator measures the spread between the fixed income yields of the 3-month Treasury Bill and the 10-Year Treasury Bond. The lower this number, the flatter the yield curve is. The flatter the yield curve is, the less longer term investors are getting compensated over shorter term investors for the inherent interest rate risk. If the spread goes below zero, this means that the yield curve has inverted.

- ISM New Orders-to-Inventories Spread – This indicator looks at the spread of reported new order levels versus reported current inventories levels. The Institute for Supply Management (ISM) surveys 300 manufacturing firms on numerous manufacturing data points to get data points for both new orders and inventories.

- Core Capital Goods (New Orders) – This indicator tracks the Year-over-Year percentage change in the value of new orders received during the reference period. Orders are typically based on a legal agreement between two parties in which the producer will deliver goods or services to the purchaser at a future date.

- Initial Jobless Claims – This indicator tracks the number of initial unemployment claims of people who have filed jobless claims for the first time during the specified period with the appropriate government labor office. This number represents an inflow of people receiving unemployment benefits.

- New Building Permits – This indicator tracks the number of construction permits that have been issued and approved for new construction, additions to pre-existing structures, or major renovations.

DISCLAIMER: These are not the only indicators that the IMG team looks at, and no decision should (or will) be made on any single indicator. These are simply what the IMG team utilizes to *help* forecast potential for a recessionary environment.

# Disclosures

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