C&N VANTAGE POINT

Quarterly Market Recap & Outlook | Second Quarter, 2022

Meet A Team Member

Scott Clark

Senior Financial Consultant and Trust Officer

Scott came to C&N in 2020 as Vice President & Trust Officer, with over 32 years of experience in the Financial Services Industry. Scott brings a wealth of knowledge and experience to help clients with the solutions needed to meet their financial needs. He has an Associate of Applied Science degree from the Pennsylvania College of Technology and graduated from the Graduate School of Retail Banking at the University of Virginia. In addition, Scott is Certified in Long Term Care, a Certified Mutual Fund Counselor and a Life Underwriter Training Council Fellow. He holds his Series 24, 7, 65 & 63 Securities Registrations, and holds Pennsylvania Life, Accident & Health Licenses.

Scott serves as a Board Member for the Deane Center for the Performing Arts, the Endless Mountain Music Festival, and enjoys various social organizations and volunteer activities with various charities in Tioga and Lycoming Counties. Scott and his wife, Dawn, have two adult Daughters and reside in Liberty, PA.

Key Equity Indexes - As of Quarter End	%YTD Return**	NTM P/E**	P/B**	Dividend Yield**
S&P 500	-19.11	15.99	3.97	1.59
Russell 2000	-22.54	17.40	2.01	1.27
Russell 1000 Growth	-27.35	21.25	10.16	0.92
Russell 1000 Value	-11.75	12.94	2.35	2.16
MSCI EAFE	-19.86	11.73	1.62	3.38
MSCI EM	-18.11	11.01	1.66	3.09

Sources: JP Morgan Weekly Market Recap; Northern Trust. Past performance does not guarantee future results, which may vary.
** As of 07/01/2022

Key Interest Rates	2022			
	10/1/21	12/31/21	4/1/22	7/1/22
2-yr Treasury Note	0.27	0.73	2.44	2.84
10-yr Treasury Note	1.48	1.52	2.38	2.88
30-yr Treasury Note	2.04	1.9	2.44	3.11
30-yr Fixed Mortgage	3.1	3.27	4.8	5.84
Corp. Bond Index	2.13	2.36	3.67	4.62
High-Yield Bond Index	4.68	4.86	6.23	8.86

Sources: JP Morgan Weekly Market Recap & Oppenheimer Markets Review At-a-Glance
Past performance does not guarantee future results, which may vary.

2022 YTD Style Performances**

	US Equity Style			MSCI World Style			US Fixed Income Maturity***			
Equity Size	Value	Core	Growth	Value	Core	Growth	Short	In-termed.	Long	Quality
Large	-11.75%	-20.05%	-27.35%	-10.53%	-19.67%	-28.33%	-3.84%	-5.33%	-20.76%	Government
Medium	-15.03%	-20.45%	-30.03%	-16.86%	-22.20%	-29.14%	-5.23%	-8.49%	-22.28%	Corporate
Small	-16.07%	-22.54%	-28.87%	-16.03%	-22.18%	-28.42%	-9.58%	-13.42%	-24.05%	High Yield

Source: Goldman Sachs Asset Management Market Monitor & Oppenheimer Markets Review At-a-Glance US Equity Style Returns - Russell Indices Past performance does not guarantee future results, which may vary.
**As of 7/1/2022

HOLDING THE LINE

Often assumed to be a military expression, the earliest use of the term "hold the line" is actually first traced back to American football (with the "line" being the line of scrimmage). But, of course, the term is often used in a number of circumstances – military or otherwise. And it can certainly be used today to address current dynamics playing out in the global economy and financial world.

Ukrainian armed forces. The most obvious application is to the war in Ukraine, recently surpassing its fourth month. A fairly well-established battle line has been drawn in the eastern part of the country – with the Russian army now occupying much of the Donbas area (about half the size of Iceland) and with little meaningful progress made of late by either side. Essentially both sides are holding the line at the moment. But Ukraine's recent success in taking back Snake Island was a strategic victory and may help reopen the Black Sea up for grain exports – badly needed. Wheat prices were up 85% at one point this year, but are moving back to more normal levels (now only up 8% for the year)[1]. More generally, supplies of all goods are – ever so slowly – increasing as global economic functioning normalizes.

Central banks. Here, investors really wish the Federal Reserve (and other central banks) would *not* hold the line. Historically, too much financial market weakness would prompt the Fed to curb its rate hiking plans (or initiate rate cuts) – but, this time around, the Fed has held strong. Managing inflation has taken priority over economic growth – and financial market – support. As such, a key economic variable for investors today is the core personal consumption expenditure deflator – a measure of core (ex-food and energy) prices and the specific inflation metric the Fed is attempting to bring to its 2% inflation goal. Right now, that metric sits at 4.7%. This is off slightly from its 5.3% February peak[1] – but investors want more decline (and more quickly) such that the Fed can ease up on its rate hike trajectory. At present, the markets predict a 75% chance of another 0.75% hike in July and a total of 1.75% more in 2022, which would put the Fed funds rate at 3.5%.

Corporations. For this economic expansion to continue, corporations will likely have to hold the line on investment, and not succumb to recessionary fears by cutting back on planned expenditures. The consumer (via government stimulus) has been the driving force of the post-pandemic expansion thus far. But corporations need to continue the current pace of hiring and maintain capital expenditure plans. The average analyst still expects double-digit S&P 500 earnings growth in 2022[1] – but should those numbers start to slip, so too could business investment.

The inflation line. All of the above dynamics are either driving or reacting to inflation. Constructive developments on the war in Ukraine would help cap commodity inflation, which may allow the Fed to slow its pace of tightening and encourage corporations to go on offense. Fed action thus far has brought longer-term inflation expectations down to a range of 2.2% to 2.6%. All we need now is a (fairly) quick and straight line from here to there.

SECOND QUARTER 2022 TOTAL RETURNS (%)

It was a difficult quarter across all asset classes (save cash) – including both risk-control and risk assets.

	RISK CONTROL					RISK ASSETS						
		FIXED INCOME					EQUITIES			REAL ASSETS		
	Cash	Muni	Inv. Grade	TIPS	High Yield	EM Debt	U.S.	Dev. Ex-U.S.	EM	NR	GRE	GLI
2Q22	0.1	-2.9	-4.7	-6.1	-9.8	-8.6	-16.8	-14.9	-12.0	-15.6	-17.0	-7.4
YTD	0.2	-9.0	-10.3	-8.9	-14.2	-14.5	-21.2	-19.2	-17.8	-1.4	-19.8	-0.5

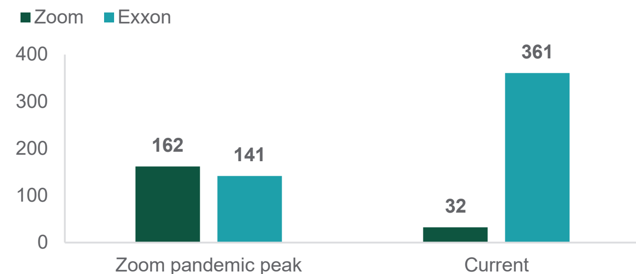
Source: Northern Trust Asset Management, [1]Bloomberg. NR: Natural Resources; GRE: Global Real Estate; GLI: Global Listed Infrastructure. Indexes are gross of fees.

KEY DEVELOPMENTS

Economic Transition

What a difference one year and nine months makes. In late October 2020, Zoom (the Covid-economy savior) carried a higher valuation than Exxon (the largest oil company in the U.S.). Since then Zoom has fallen by 80% while Exxon has gained 180%. Better than most any other data point, this fact captures the economic transition underway – less focus on the pandemic, more focus on inflation and gasoline prices. Clearly, the war in Ukraine played a large role in this transition – and will likely continue to influence the economic outlook.

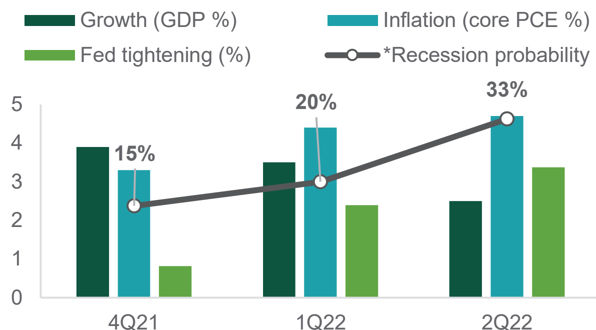
MARKET CAP SWINGS ($B)



Recession on the Radar?

Continued inflationary pressures have led to increased Fed hawkishness – which, in turn, has led to increased odds of recession. Coming into the year (the 4Q21 data in the chart), growth was fine, inflation was "transitory" and the Fed was only expected to gradually start the rate raising process. Recession odds sat at 15%. As we sit today, the Fed is expected to raise rates a total of ~3% (already having raised by 1.5% thus far). Its intention is to bring down inflation, but it may also harm growth. Recession odds now sit at one-third.

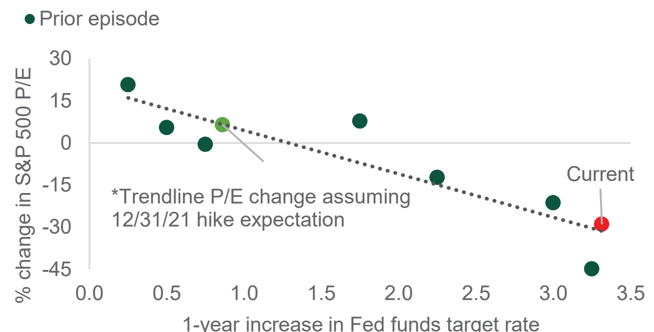
CONSENSUS EXPECTATIONS FOR 2022…



Rate Recalibration

The increase in expected Fed rate hikes has led to a decrease in equity valuations. Previous Fed rate hike campaigns have shown a strong correlation between the one-year rise in the Fed funds rate and the percent change in valuations (measured from six months prior to six months after the first hike). This makes sense – a higher expected discount rate means cash flows in the future are worth less. Valuations now appear fair based on expected Fed action (see chart). Concerns have now shifted to the extent of the growth slowdown.

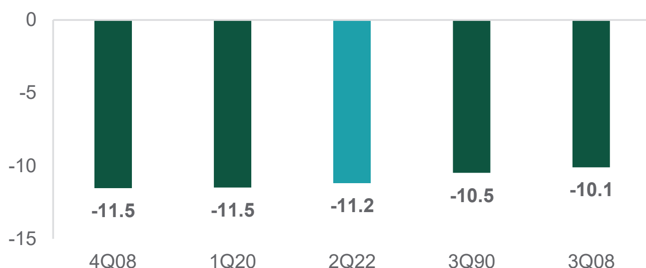
VALUATIONS 6M BEFORE VS. 6M AFTER INITIAL HIKE



Broad Bear Market

When the dust on the second quarter settled, we were left with the third worst performance for a 60/40 portfolio in the global history we have – using MSCI ACWI for equities and Bloomberg U.S. Agg for fixed income (data from 1987). Unlike previous down quarters, fixed income played a large part this time around – down nearly 5% when it should be providing offsetting gains. Interestingly, the only quarters with worse returns were 4Q08 (global financial crisis) and 1Q20 (pandemic). In each case, the next year saw large double-digit returns.

BOTTOM FIVE QUARTERLY 60/40 RETURNS (%)



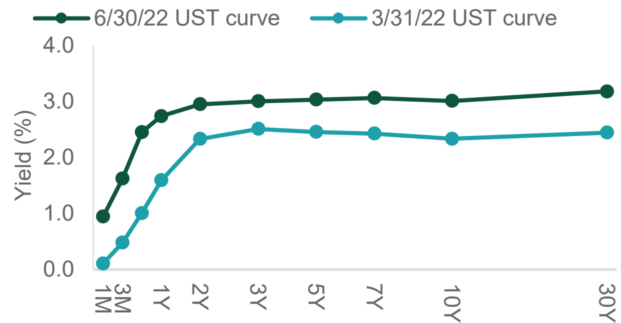
Source: Northern Trust Asset Management, Bloomberg. Consensus expectations from Bloomberg. *One-year forward recession probability. Data as of 6/30/2022.

MARKET REVIEW

Interest Rates

Global bond yields repriced higher as the Fed-led monetary policy tightening cycle gained steam. Across two meetings, the Fed hiked its policy rate by 1.25% to 1.75%, began to roll off its balance sheet and talked up a “strong commitment” to restoring price stability. With a resolute focus on bringing down inflation, central bank policy has set out to lower demand in line with supply. This, combined with stickier-than-expected inflation, reset U.S. interest rates higher. Toward quarter end, yields came off peaks over recession concerns.

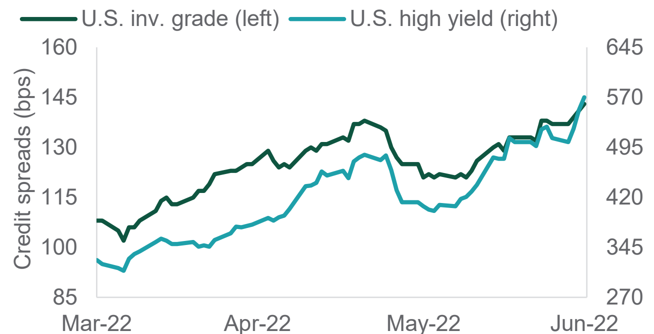
U.S. TREASURY YIELD CURVE



Credit Markets

Despite a fleeting rally in May on hope that the Fed may slow its pace of tightening, credit spreads trended wider during the quarter as capital markets priced in the economic costs of higher interest rates. High yield spreads sit a bit above non-recessionary levels and income yields are nearing Covid highs. While high yield fundamentals remain strong and technicals supportive, high yield underperformed IG fixed income (-9.8% vs. -4.7%) as the more economically-sensitive asset class suffered more from rising recession fears.

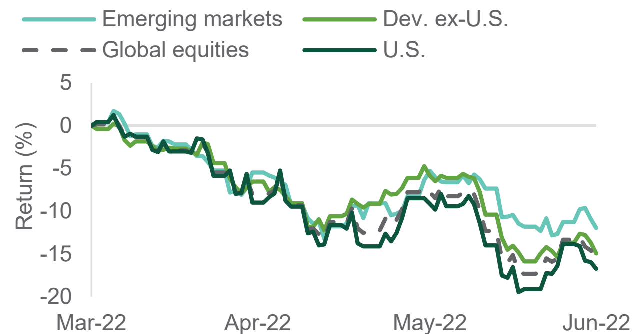
CREDIT SPREADS



Equities

Global equities entered bear market territory and ended the quarter down 15.5%. Against a more challenging economic growth backdrop, earnings expectations held up well, suggesting most of the decline came from lower valuations. Emerging market equities (-12.0%) notched the best returns, benefiting from government support and eased pandemic restrictions. Developed ex-U.S. equities (-14.9%) and U.S. equities (-16.8%) bore the brunt of persistent inflation and the consequent tighter-than-expected monetary policy.

REGIONAL EQUITY INDICES



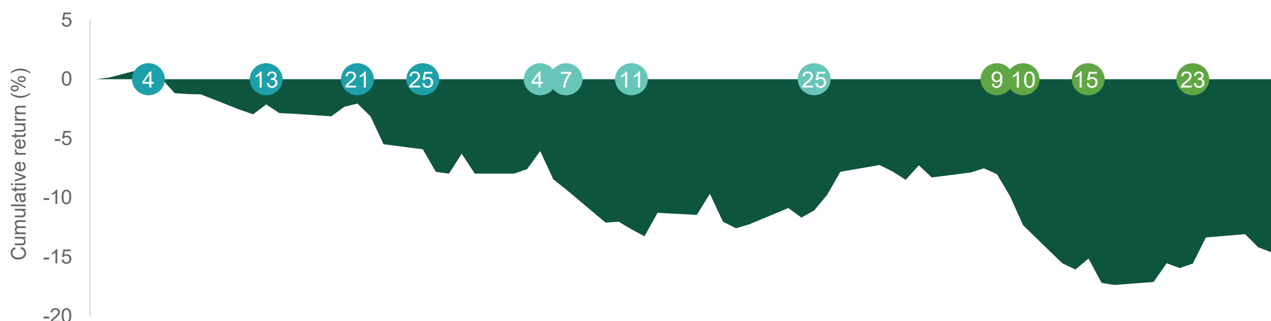
Real Assets

Living up to its historical track record of providing some inflation and downside risk protection, global listed infrastructure (-7.4%) handily outpaced global equities. Natural resources (-15.6%) gave back most of its year-to-date gains. Geopolitical threats to the global energy supply helped the asset class, but support waned as commodity prices came off highs due to weak China activity and slowing global growth. Global real estate (-17.0%) has interest rate and market exposure and took a hit from higher rates and slowing growth.

REAL ASSET INDICES

Source: Northern Trust Asset Management, Bloomberg. Bp(s) = basis point(s). Returns in U.S. dollar terms. UST = U.S. Treasury. Indexes are gross of fees.

MARKET EVENTS



APRIL	MAY	JUNE
4 Allegations of Russian atrocities lead to less room for peace talks and more room for sanctions.	**4** European Commission unveils plan for phased ban on Russian oil imports, EU reaches an agreement in early June.	**9** European Central Bank (ECB) announces it will end QE in July and opens the door to a 50 bp hike in September if the inflation outlook persists or deteriorates further.
13 1Q earnings season unofficially kicks off; U.S. earnings proceed to finish above expectations at +9% year-over-year, but lower valuations offset gains.	**4** Fed raises policy rate by 50 bps; equities rally following optimistic comments by Chair Powell but gains later reverse on the tighter policy.	**10** Treasury yields rise and the yield curve flattens after U.S. headline CPI (8.6% y/y) tops expectations and rises from the prior level.
21 Fed Chair Powell indicates a 50 basis point hike is on the table for May and notes it may be appropriate to front-load policy tightening.	**7** Terra (dollar-pegged stablecoin) starts to collapse, marking the start of a string of crypto issues that wipe off ~$2 trillion in crypto market cap.	**15** Fed hikes rates by 75 bps; upside inflation surprises drive expectations for more hikes, more inflation and less growth reflected in its new Summary of Economic Projections.
25 France President Emmanuel Macron is re-elected; his victory removes left-tail risk event for eurozone financial assets posed by his opponent.	**11** U.S. headline and core Consumer Price Index moderate y/y but both readings come in hotter than expected and remain elevated.	**15** In response to surging Italian bond yields, ECB announces plans to design anti-fragmentation instrument in a rare emergency meeting.
25 China contributes to global risk-off tone as it reports elevated Covid cases; China stocks stabilize later in the week on government stimulus plans.	**25** Equities rally after May Fed meeting minutes note front-loading policy tightening may allow for policy reassessment thereafter.	**23** Flash Purchasing Managers' Index (PMI) data for the U.S. and Europe underscore waning but still-positive economic growth.

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Prepared by Northern Trust Asset Management for Citizens & Northern Wealth Management.

Indexes used: Bloomberg (BBG) 1-3 Month UST (Cash); BBG Municipal (Muni); BBG Aggregate (Inv. Grade); BBG TIPS (TIPS); BBG High Yield 2% Capped (High Yield); JP Morgan GBI-EM Global Diversified (Em. Markets Fixed Income); MSCI U.S. Equities IMI (U.S. Equities); MSCI World ex-U.S. IMI (Dev. ex-U.S. Equities); MSCI Emerging Market Equities IMI (Em. Markets Equities); S&P Global Natural Resources (Natural Resources); MSCI ACWI IMI Core Real Estate (Global Real Estate); S&P Global Infrastructure (Global Listed Infrastructure).

C&N Wealth Management

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SLOWING

Market volatility has picked up of late as investors assess the outlook for global growth, inflation and monetary policy. The S&P 500 has failed to gain traction as the 10-year Treasury yield has moved from 2.9% to 3.2%. The root cause of the uncertainty remains the outlook for inflation, and its resulting impact on monetary policy and growth. Central bank policy is frequently described as working with a lag and major central banks are early in their hiking campaigns – but we think this understates its impact. As shown below, financial conditions – a broad measure including interest rates, credit spreads, equity valuations and exchange rates – have tightened much more than average over the prior five rate hike cycles.

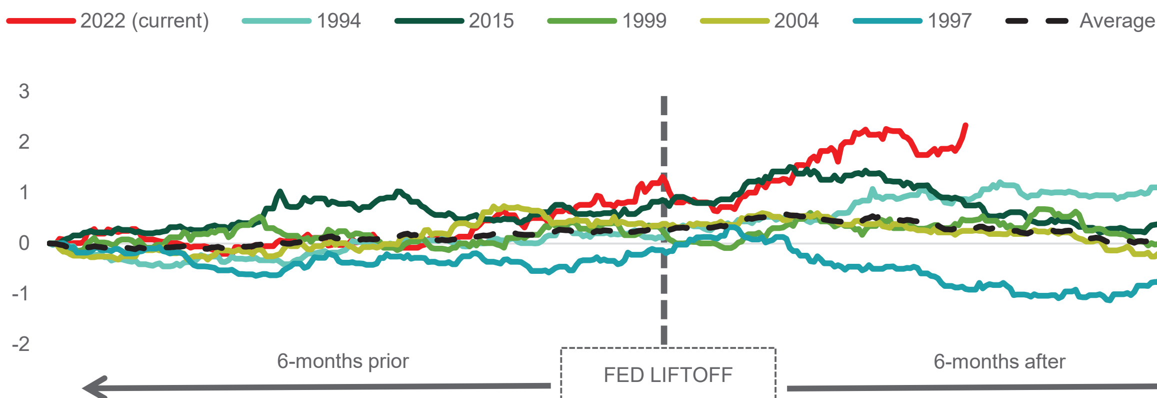
We now expect modestly disappointing growth in the U.S. over the next year – joining our cautious outlook toward European and Chinese growth – as the impact of tightening financial conditions takes hold. We have also seen the savings rate of the U.S. consumer fall to just 4.4% – the lowest level since the global financial crisis and down from 33% at the height of the pandemic. No doubt, this is a result of wage growth of just 5.2% over the last year while consumer prices have jumped 8.6%. Such a drawdown in savings will likely limit growth in consumer spending over the next year, as will financial market volatility. We do expect slowing growth to start to reduce pressure on inflation globally over the next year. But we see limited evidence of this so far, as May U.S. consumer prices exceeded estimates and European inflation of 8.1% was also above expectations. This underpins our risk case of Sticky Inflation, where stubbornly high inflation leads to more hawkish central bank policy.

Our base case calls for slower growth globally, as inflation and higher interest rates join risks from Ukraine and the Chinese zero-COVID policy to hamper growth. We are also focused on central banks' management of inflation expectations. In response to our more cautious outlook for U.S. growth, we made one change in our global policy model this month. We reduced our recommended allocation to U.S. equities by 2%, reinvesting in the more defensive global listed infrastructure asset class. Equity markets have adjusted significantly to higher interest rates and the more uncertain growth outlook. Looking out over the next year, we favor real assets like natural resources and global listed infrastructure which are benefiting from supply shortages and are an inflation hedge. We also continue to like high yield bonds, where we think the current yield of 7.8% is attractive as we think the market is overstating the odds of recession in 2023.

A QUICK TIGHTENING

Financial conditions, which directly impact future growth, have tightened the most of the last six rate hike cycles.

U.S. FINANCIAL CONDITIONS: % CHANGE INDEXED 6 MO. PRIOR TO FED LIFTOFF



Source: Northern Trust Asset Management, Bloomberg, Piper Sandler Cornerstone, Goldman Sachs. Fed liftoff is the date of the first Federal Reserve policy rate hike for hiking cycles dating back to 1994. Data as of 6/10/2022.

C&N PORTFOLIO POSITIONING:
NEUTRAL TO RISK

C&N Vantage Point
July 2022

Market Views:
Equities Challenged Short Term. Bottoming Process Likely In Coming Months.
Diversification Remains Paramount. Markets Will Be Choppy.
Fed Is Behind The Curve. Raises Rates At July & September Meetings.

Market Risks:
Federal Reserve Miscalculations Or Miscommunications.
Oil Prices & Supply Chain Issues Do Not Improve.
Inflation Increases From Current Elevated Levels.

Risk Type	Asset Class	Sector Category	Under Weight	Neutral	Over Weight	Viewpoints
	Cash/Cash Alternatives	**Ultrashort Bonds**			●	We added to our slight overweight in April, favoring it over cash. This remains a source of funds for a targeted trade should opportunities develop during market volatility.
Risk Control	Alternatives (Fixed Based)	**Absolute Return**	●			We retain our slight underweight to Absolute expecting interest rate hikes in 2022. Rising interest rates will likely be a headwind for this asset class.
Risk Control	Alternatives (Fixed Based)	**Inflation-Linked Bonds**	●			Inflation expectations impact TIPS pricing more than actual inflation. Expectations are leveling. We remain slightly underweight preferring US Large Value and Natural Resources as inflationary hedges.
Risk Control	Fixed Income	**US Investment Grade Bonds**	●			Yields have noticeably risen YTD given the selloff in bonds. The risk/reward for bonds has improved and we added to this asset class in April. Overall, we're slightly underweight but remain neutral on duration.
Risk Control	Fixed Income	**International Bonds**		●		A stronger dollar, anticipated rate hikes in the US, and Covid-related impacts on international economies have us maintaining our neutral postion.
Risk Control	Fixed Income	**Emerging Markets Bonds**		●		Many EM economies are more susceptible to the impacts of inflation, but they are more correlated to a global recovery. Russia/Ukraine war is a potential headwind. We maintain our neutral allocation.
Risk Assets	Fixed Income	**High Yield Bonds**			●	Coupons remain attractive relative to other fixed income asset classes and less issuance is expected in 2022. We retain our slight overweight but expect this to be the first source of rebalancing funds.
Risk Assets	Equities	**US Large Cap**			●	We remain overweight to Value for the cyclical trade and slightly underweight Growth. We trimmed Value for Natural Resources in January. Overall, we remain slightly overweight in this category.
Risk Assets	Equities	**Developed Ex-US**	⊖			Valuations are reasonable but Europe is facing greater recessionary pressures than the U.S. due to the war. We trimmed Large Cap to neutral and SMID to slight underweight to fund our IG bond trade.
Risk Assets	Equities	**US Mid & Small Cap**		●		We retain our neutral position with a slight overweight to Value for the cyclical and rising interest rate trade that we expect to benefit financials.
Risk Assets	Equities	**Emerging Markets**	⊖			We trimmed EM given multiple headwinds facing EM countries. Our reduction funded our Ultrashort trade. The move reduces some portfolio risk while we await better opportunities within equities.
Risk Assets	Alternatives (Equity Based) & Real Assets	**Real Estate**		●		REITs have been hurt by the volatile rate environment; however, they provide a long-term inflation hedge when inflation moderates. We remain neutral but will likely add funds when rebalancing.
Risk Assets	Alternatives (Equity Based) & Real Assets	**Commodities/Natural Resources**			●	Natural Resources should benefit from elevated commodity prices. We added to our position in January given inflationary pressures we expect to persist throughout 2022.

Note: Views are subject to change based on market conditions and other factors. These views should not be construed as a recommendation for any specific security or sector. Client portfolios may or may not be at the recommended weightings above due to, but not limited to: distributions, tax management limitations, systematic purchases, etc. NOT FDIC INSURED / MAY LOSE VALUE / NO BANK GUARANTEE

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