

Quarterly Market Environment & Considerations

Fourth Quarter 2022

Market review & outlook

2022 Was a Difficult Year for both Stocks and Bonds



- Global markets moved higher for most of the quarter as signs emerged that inflation may have peaked. However, some of the quarter's gains were given back in December as fears of an economic slowdown and further Federal Reserve tightening weakened sentiment.
- Overall, Treasury yields saw modest changes during the quarter, outside of the short end of the curve where rates rose in line with Fed tightening. The 10-year Treasury yield peaked at 4.25% in late October, before moving lower and ending the quarter at 3.9%.
- The Bloomberg Aggregate Bond Index rose 1.9% in Q4, leaving it down 13% in 2022. The MSCI ACWI index rose 9.8%, but still ended the year 18.4% lower. For the calendar year, the simultaneous drawdown in both stocks and bonds left a traditional 60/40 portfolio down 16%.

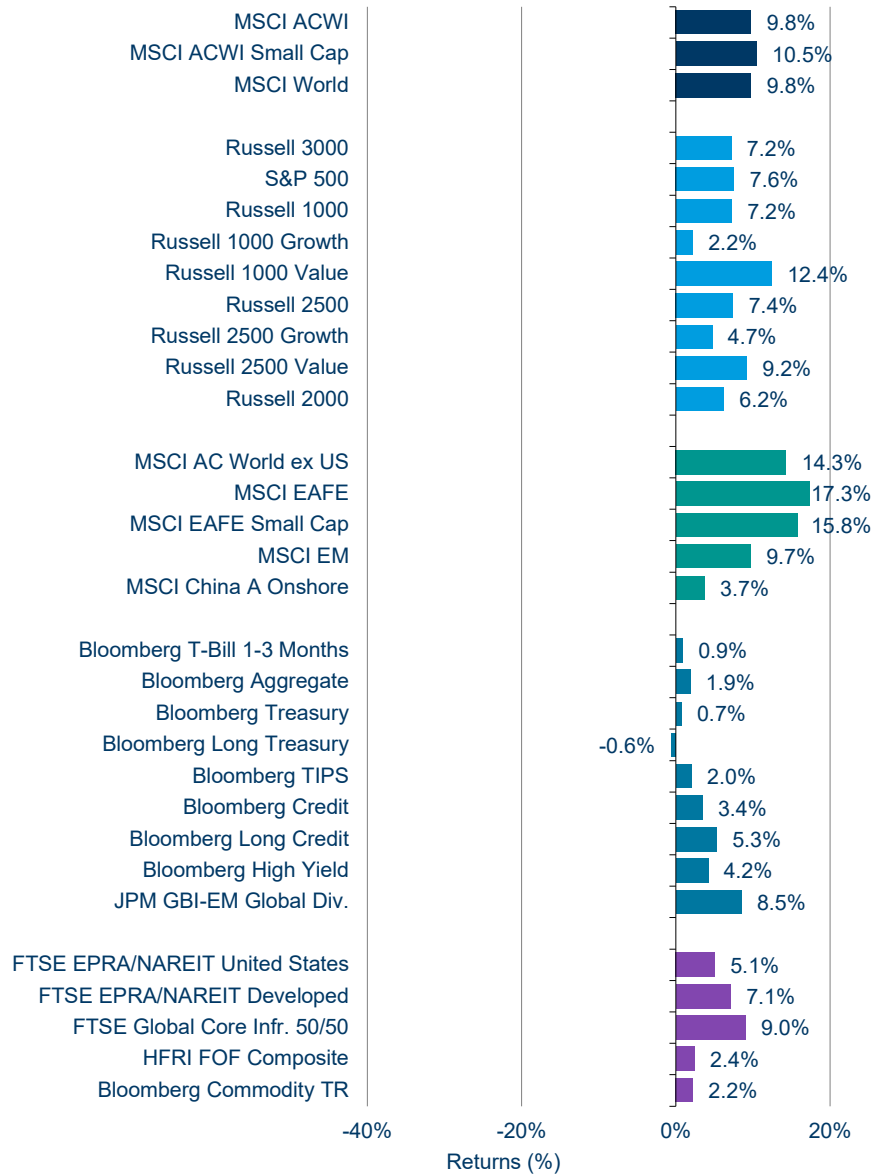
Outlook Remains Uncertain



- The drawdown in stocks and bonds last year appears to be a reasonable response to the Federal Reserve's ('Fed') tightening cycle and the resulting uncertainty for economic growth. The decline in equities can be explained by the rise in interest rates putting downward pressure on valuations. The outlook for inflation and its impact on Fed policy likely will remain the key driver of markets' direction in 2023.
- Encouragingly, inflationary pressures appear to be easing. A warmer than usual winter in Europe has eased energy supply and price concerns overseas. Energy prices in the US are also off of their peak levels, which should lead the headline inflation rate lower over time. The gradual easing of supply chain issues and weaker demand could also slow core inflation. Shelter inflation is also showing signs of a potential peak. One concern for the inflation outlook is the labor market which remains strong. Another concern is that the re-opening of China's economy could drive increased demand, particularly for commodities.
- US GDP grew in the third quarter after modest declines in the first half of the year. However, the tightening of financial conditions is only just beginning to be felt. The drag likely will intensify in 2023, increasing the risk of at least a mild recession.
- A mild recession that reduces inflation could prove supportive of both stock and bond markets. The prospect of the Fed halting rate increases and a fall in longer-term interest rates could more than offset the negative impact of weak earnings for equities in a mild recession. The biggest downside risk we see for balanced portfolios is if inflation remains sticky even as the economy slows. This could require a more forceful Fed response and a deeper recession. This likely would result in continued weakness in stocks and bonds.

Performance summary

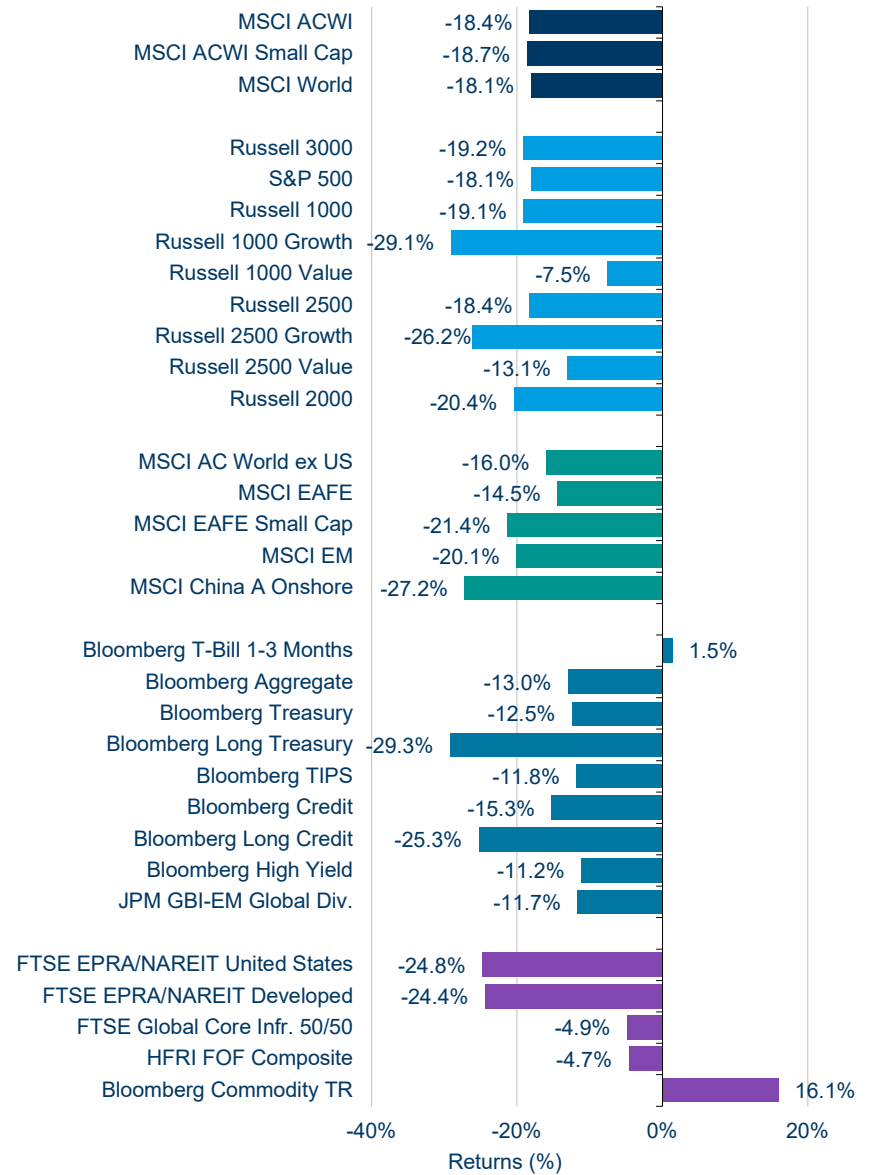
Market Performance Fourth Quarter 2022



Source: Standard & Poor's, Russell, MSCI Barra, NAREIT, Bloomberg; as of 12/31/22

Past performance is no guarantee of future results

Market Performance Year-to-Date

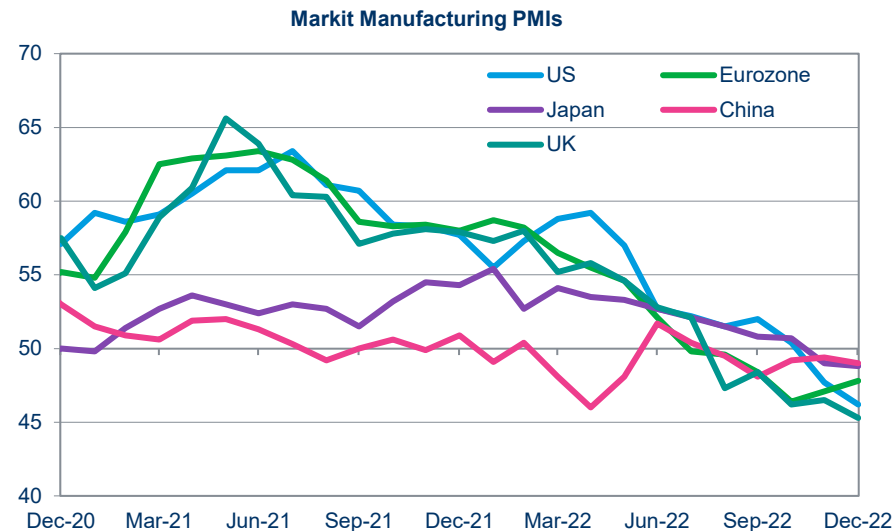


Source: Standard & Poor's, Russell, MSCI Barra, NAREIT, Bloomberg; as of 12/31/22

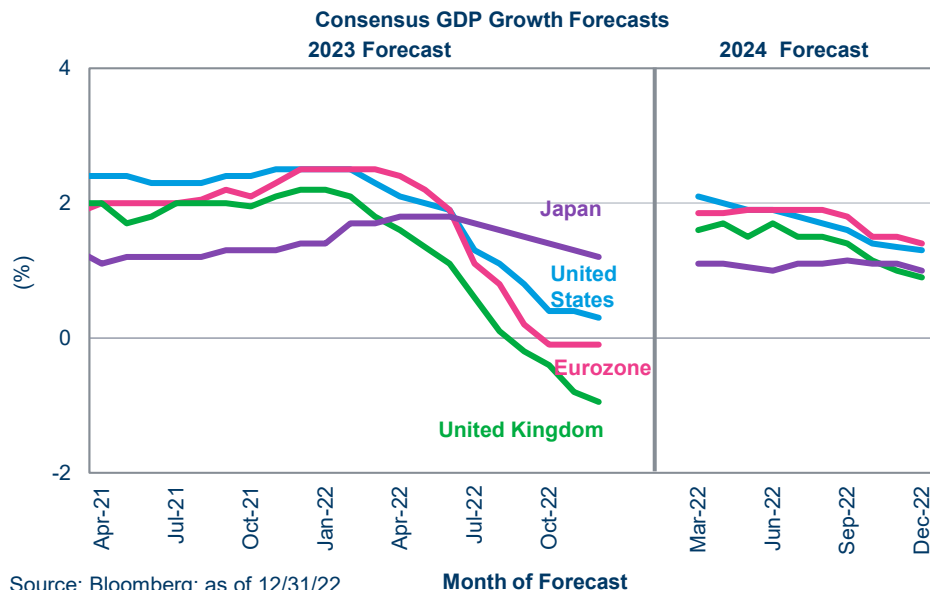
Economic fundamentals

Growth outlook deteriorating amid tightening financial conditions

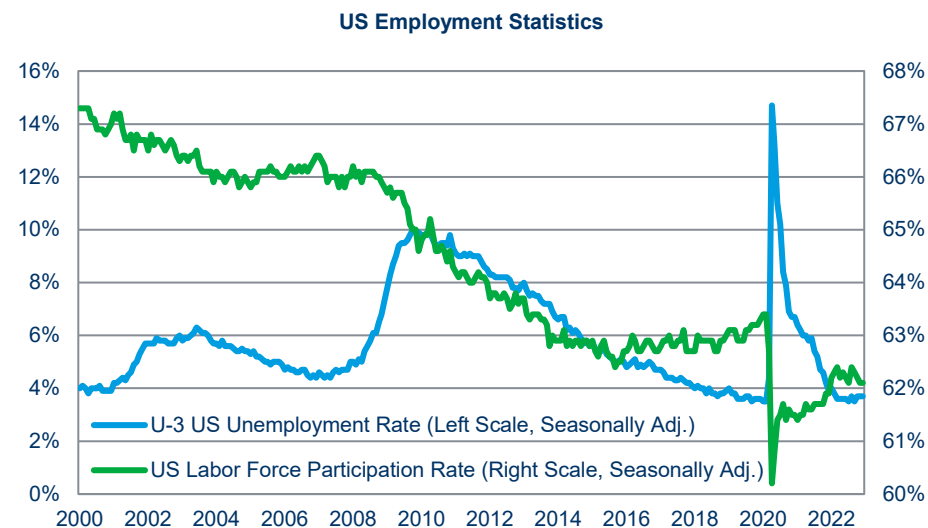
- The growth outlook continues to weaken as inflation drives most developed market central banks to maintain their hawkish stances. Consensus growth forecasts for 2023 continue to move lower for most regions.
- Manufacturing PMIs are at contractionary levels for most major regions amid a weakening demand outlook. The re-opening of China's economy could put upward pressure on demand in 2023.
- The US labor market remains tight, with the unemployment rate (U-3)¹ ending the year at 3.5%. However, wage growth has recently shown signs of moderation. The labor force participation rate remains roughly one percentage point below its pre-Covid level.



Source: Bloomberg; as of 12/31/22



Source: Bloomberg; as of 12/31/22



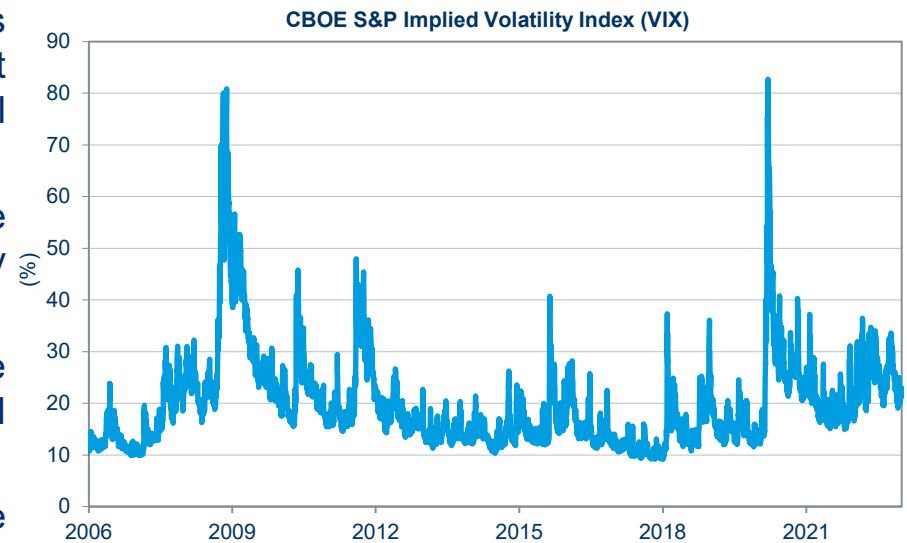
Source: Bureau of Labor Statistics; as of 12/31/22

¹ The U-3 unemployment rate represents the percentage of the civilian labor force that is jobless and actively seeking employment.

Risk factors

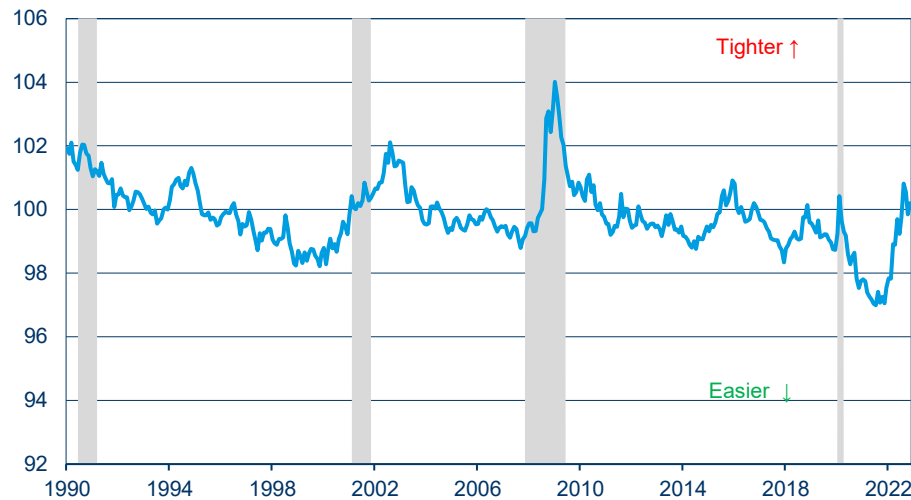
US inflation slows, but remains elevated

- US inflation moved lower during the quarter, but remains elevated. The recent downtrend is encouraging, but more sustained evidence is likely needed for the Federal Reserve to consider ending its tightening cycle.
- The VIX Volatility Index fell from 31 to 22 during the quarter. The index initially moved lower at a fairly steady pace before leveling out for most of December¹.
- Financial conditions were mostly unchanged during the quarter, with the Goldman Sachs US Financial Conditions Index easing slightly.
- The Russia - Ukraine conflict continues to cause geopolitical uncertainty and fears of potential escalation.



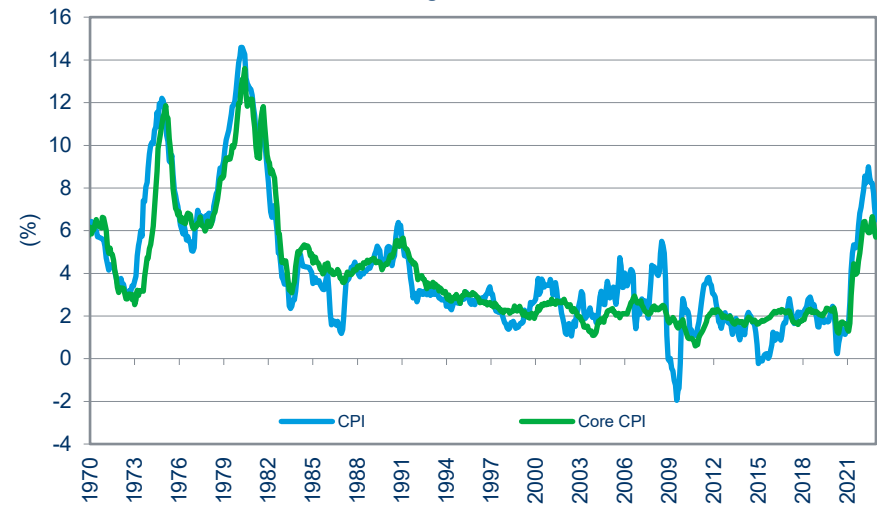
Source: Bloomberg; as of 12/31/22

Goldman Sachs US Financial Conditions Index



Source: Bloomberg; as of 12/31/22

Inflation Rolling 12-months



Source: Bloomberg; through 12/31/22

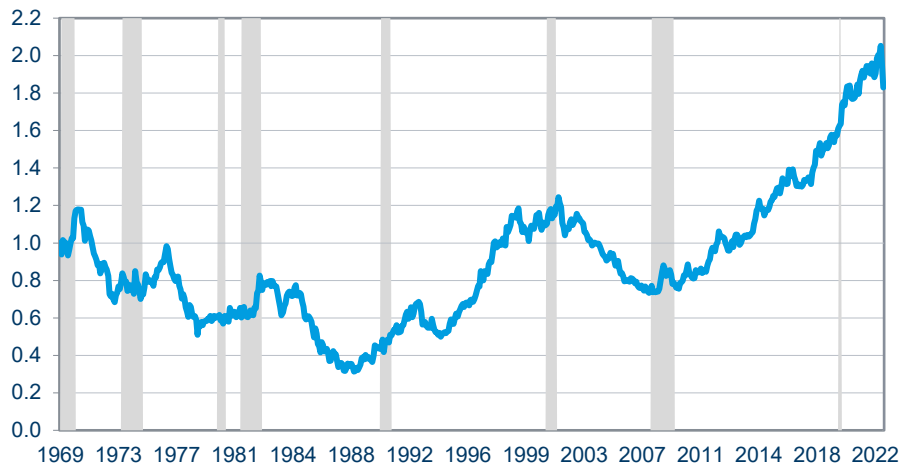
¹ Source: Bloomberg; as of 12/31/22

Regional equity returns

Global equities rebounded, but posted significant declines for 2022

- Global equities posted gains during Q4, with the MSCI ACWI index rising 9.8%. The index finished 2022 down 18.4%.
- The S&P 500 gained 7.6% during the quarter, and finished the year down 18.1%.
- International developed stocks gained 17.3% in Q4, ending the year with a 14.5% decline. Despite the strength of the dollar in 2022, international developed stocks outperformed US stocks.
- Emerging market equities rose 9.7% in Q4, finishing 2022 with a 20.1% decline. Asian emerging markets were the best performing EM region during the quarter largely due to China's support for the property sector, monetary easing and a reduction in Covid restrictions.

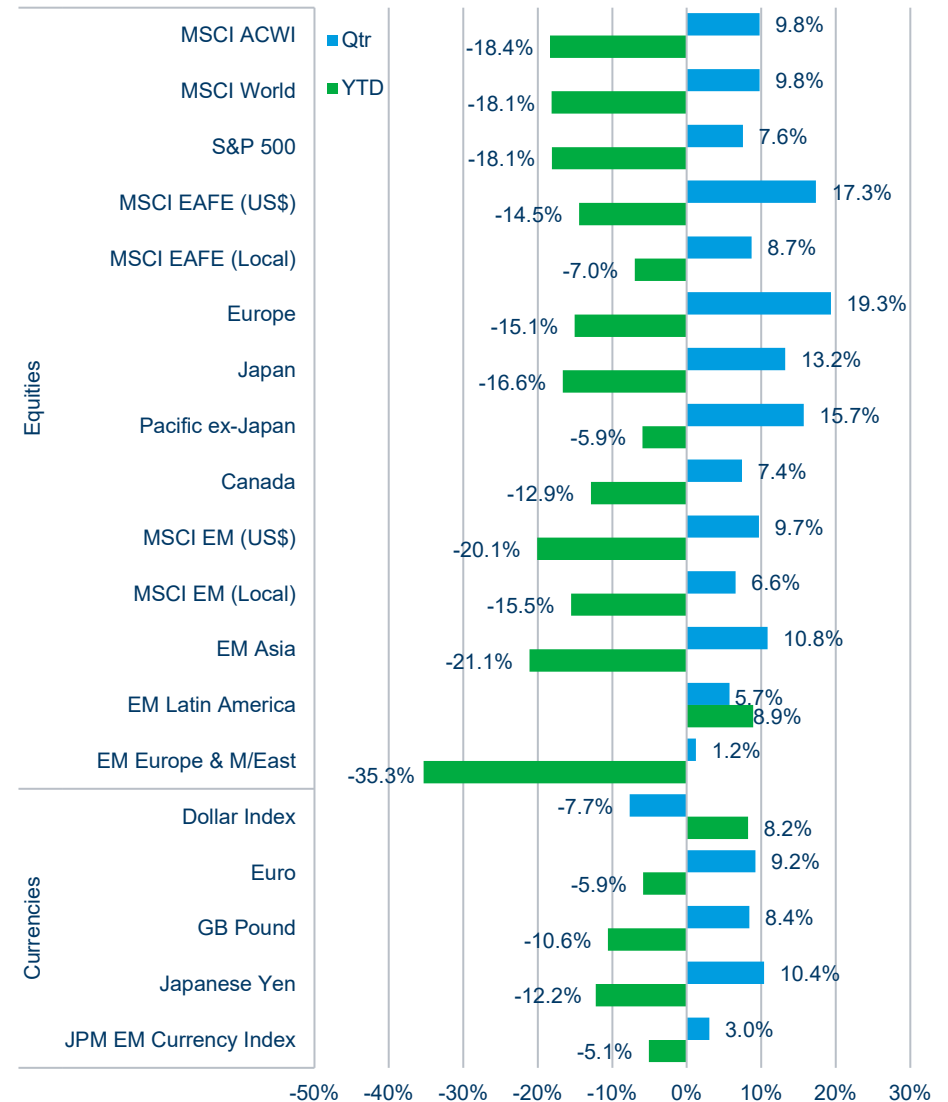
Ratio of MSCI US to MSCI EAFE (Relative Performance)



Source: Datastream; as of 12/31/22

Past performance is no guarantee of future results

Global Performance

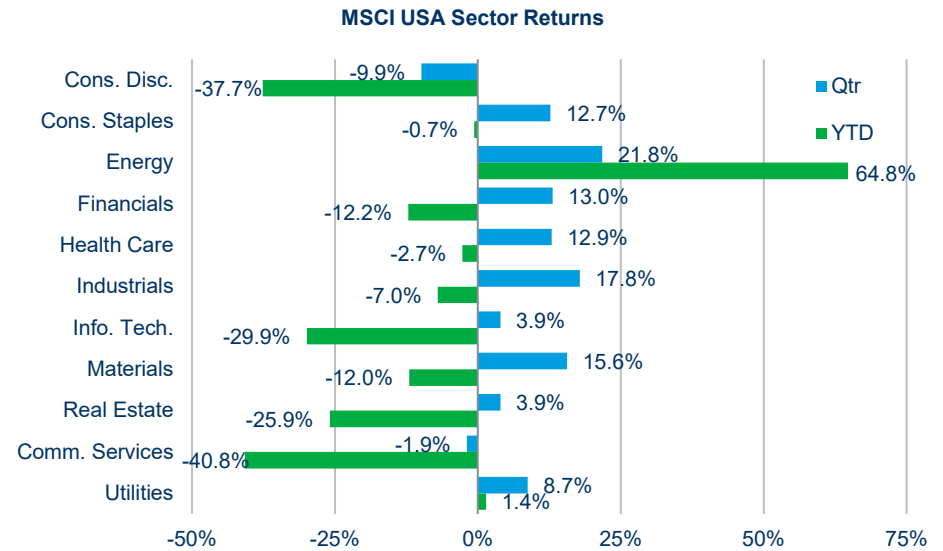


Source: Bloomberg, Datastream; as of 12/31/22

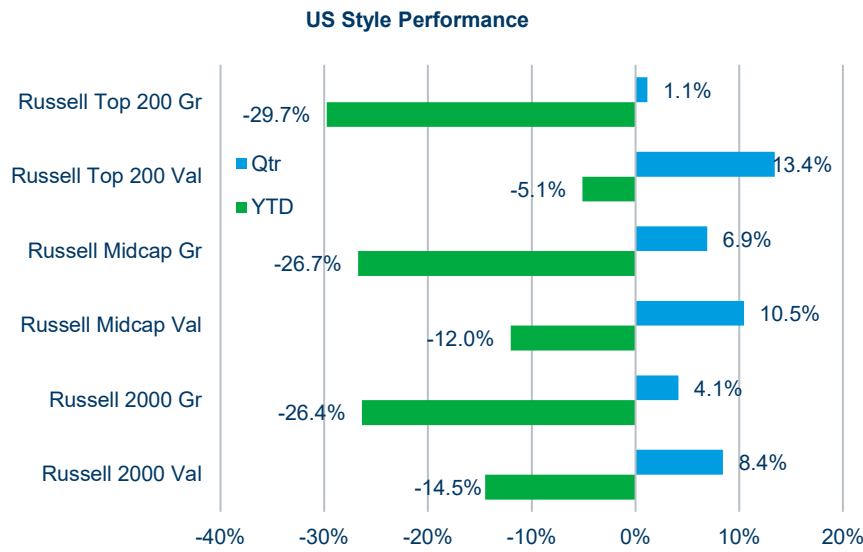
US equity factor and sector returns

Value stocks outperformed in 2022

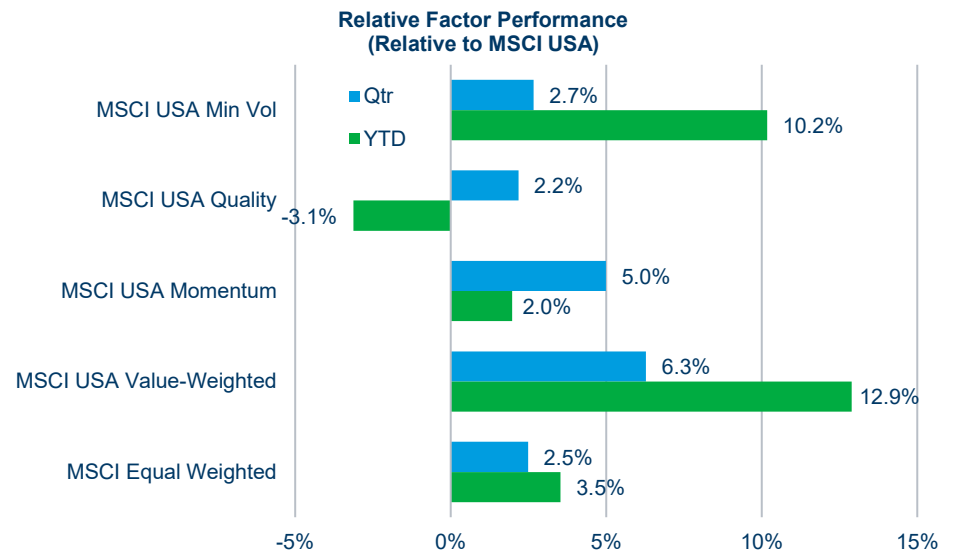
- Small-caps modestly underperformed large-caps during Q4 and for the 2022 calendar year. Value stocks outperformed growth stocks by a wide margin for both the quarter and 2022 as a whole.
- The value and momentum factors produced the strongest results during the quarter. Value and minimum volatility performed best for the calendar year. The quality factor detracted over the course of 2022.
- The energy sector posted the strongest results in Q4 and finished the year up almost 65%. The consumer discretionary and communication services sectors were the only sectors to post declines during Q4 and were the worst performing sectors for 2022.



Source: Bloomberg; as of 12/31/22



Source: Datastream; as of 12/31/22

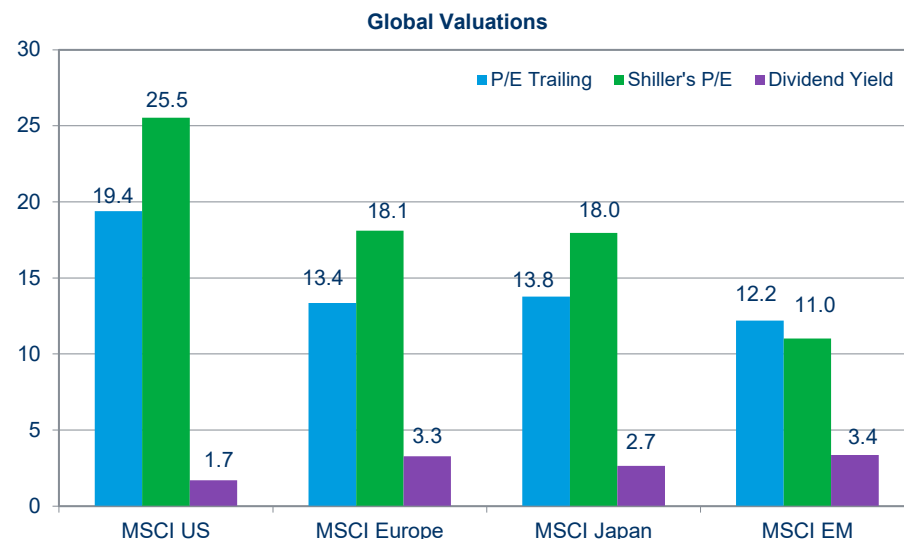


Source: MSCI; as of 12/31/22

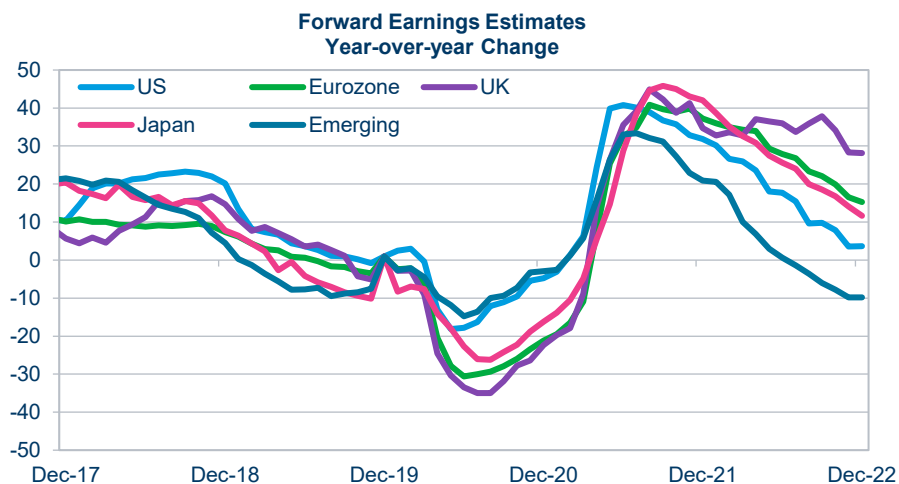
Equity fundamentals

Valuations worsened amid equity rebound

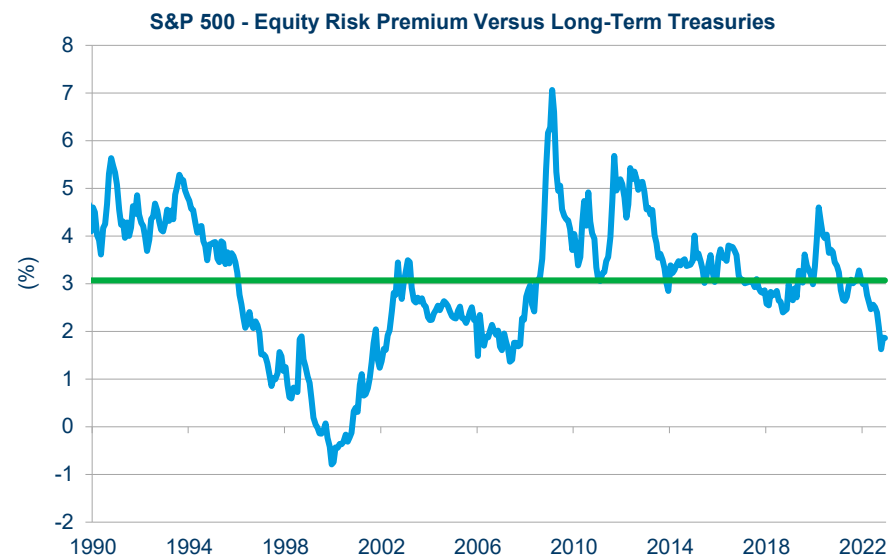
- Valuations worsened during the quarter due to the general increase in equity prices. The trailing P/E ratio on the MSCI US Index rose from 18.3 to 19.4¹. We estimate that the equity risk premium over long-term Treasuries fell from 2.1% to 1.9%², mostly due to rising valuations.
- International developed stocks remain more reasonably valued than US stocks. Energy prices have moderated in Europe due to a relatively warm winter, which should help to mitigate inflation concerns.
- Emerging market valuations remain more attractive than developed markets. The re-opening of China's economy should drive an increase in activity. Chinese officials also announced additional support for the property sector and new monetary easing policies during Q4.



Source: Bloomberg, Datastream, Mercer; as of 12/31/22



Source: Datastream; as of 12/31/22



Source: Bloomberg, Datastream, Mercer; as of 12/31/22

¹ Source: Refinitiv; as of 12/31/22

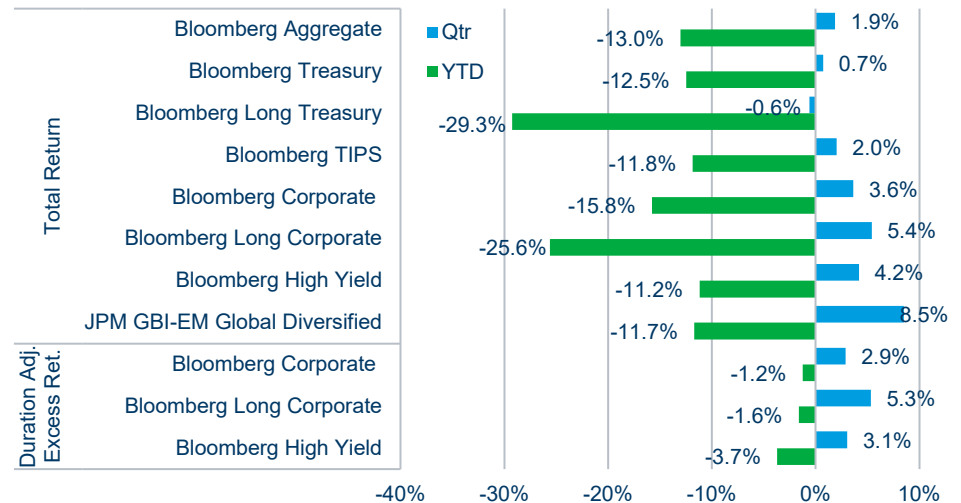
² Source: MSCI, Refinitiv, Mercer; as of 12/31/22

Interest rates and fixed income

Stable rates and declining spreads produced gains for most fixed income assets

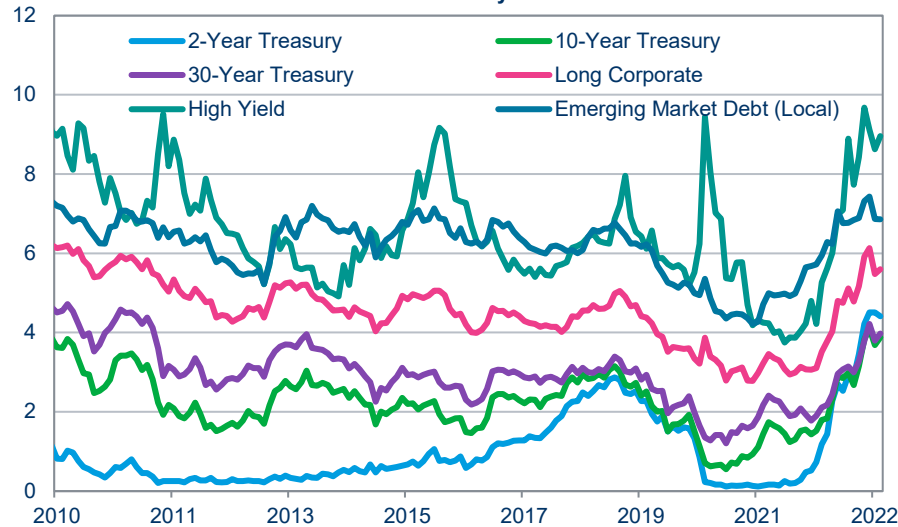
- The Bloomberg Aggregate gained 1.9% during the quarter. Treasuries gained 0.7%, lagging corporate bonds which gained 3.6%. The yield curve shifted higher at the short end of the curve, but otherwise saw modest changes during the quarter. The 3-month yield rose 109 bps, while the 30-year yield rose 18 bps¹.
- Credit spreads on investment-grade corporate bonds fell 29 bps during the quarter to 1.3%, which is roughly 17 bps above the long-term median level².
- High yield bonds gained 4.2% during the quarter, as credit spreads fell 84 bps to 4.7%. High yield spreads are 7 bps above the long-term median level of 4.6%. Local currency EMD gained 8.5% during Q4.

Fixed Income Performance



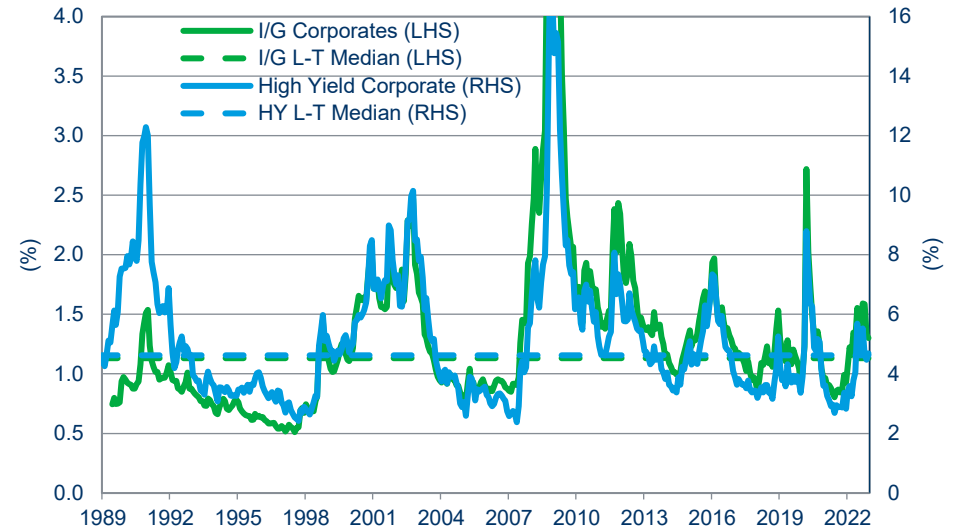
Source: Bloomberg, Datastream; as of 12/31/22

Yield History



Source: Bloomberg, Federal Reserve; as of 12/31/22

Credit Spread to Treasuries



Source: Bloomberg; as of 12/31/22

¹ Source: Federal Reserve; as of 12/31/22

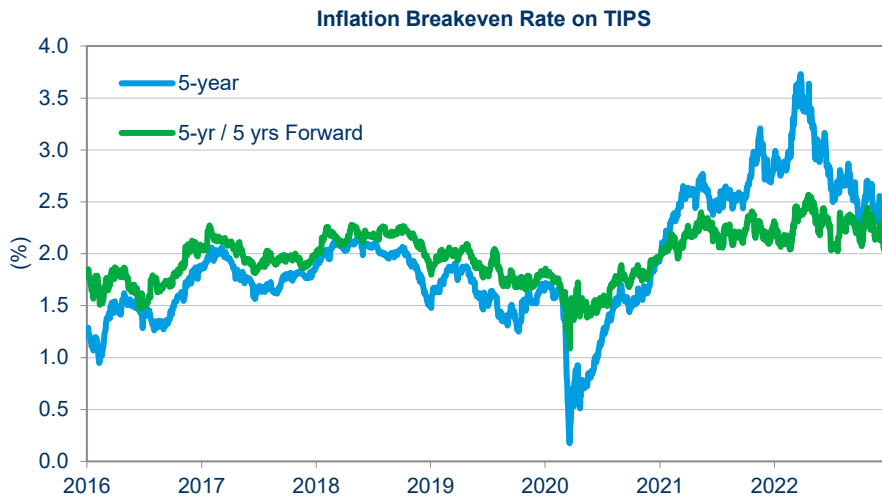
² Source: Bloomberg, Mercer; as of 12/31/22

Past performance is no guarantee of future results

Monetary policy

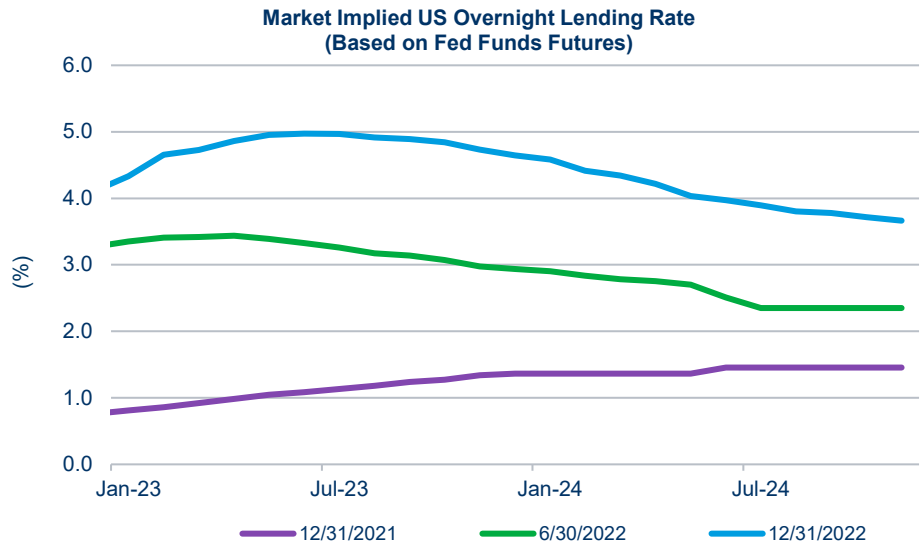
Most central banks remain hawkish

- In December, the Federal Reserve raised rates by 50 bps following 4 consecutive 75 bp increases. This brought its policy rate to 4.25% - 4.5%. The Fed's December dot plot suggests another 75 bps of tightening in 2023, while the market is pricing in more modest tightening.
- US inflation breakeven rates rose during the quarter, with 10-year inflation breakeven rates rising from 2.15% to 2.3%, slightly below the Fed's target of 2% PCE (roughly 2.5% CPI)¹.
- Overseas, most other central banks also raised rates, including the ECB and BOE. The notable exception was China, where easing measures were announced. The BOJ kept rate targets unchanged, but surprised markets by widening the band around its yield target.

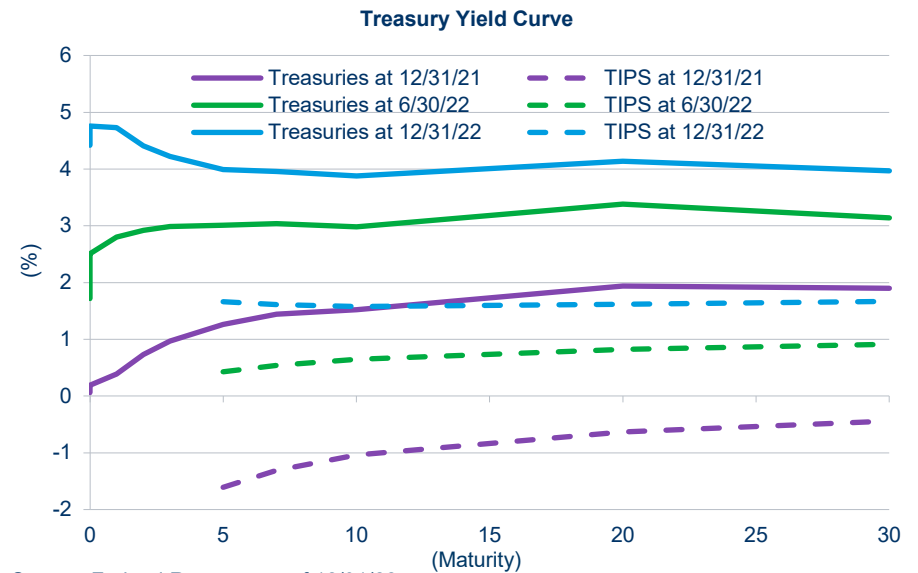


Source: Bloomberg, Mercer through 12/31/21

¹ Source: St. Louis Fed; as of 12/31/22



Source: Bloomberg; as of 12/31/22

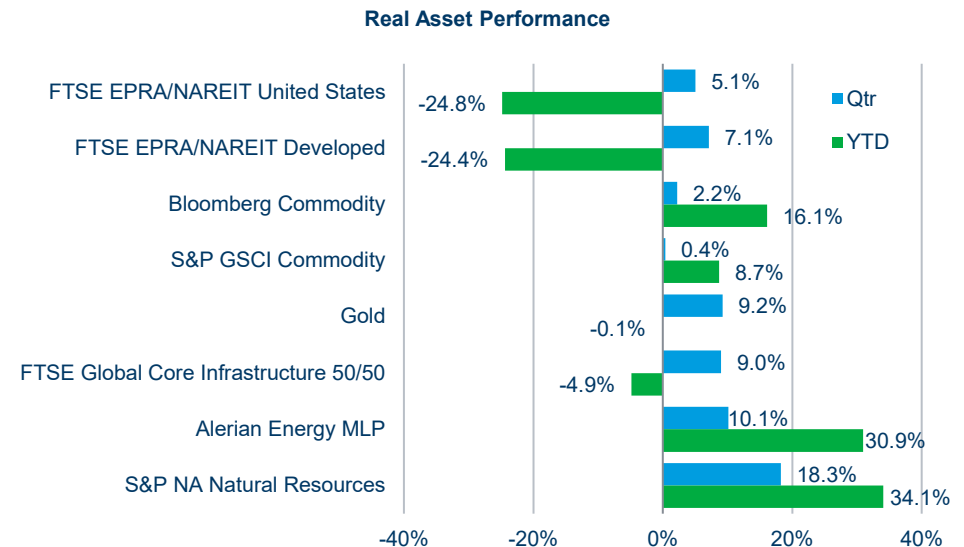


Source: Federal Reserve; as of 12/31/22

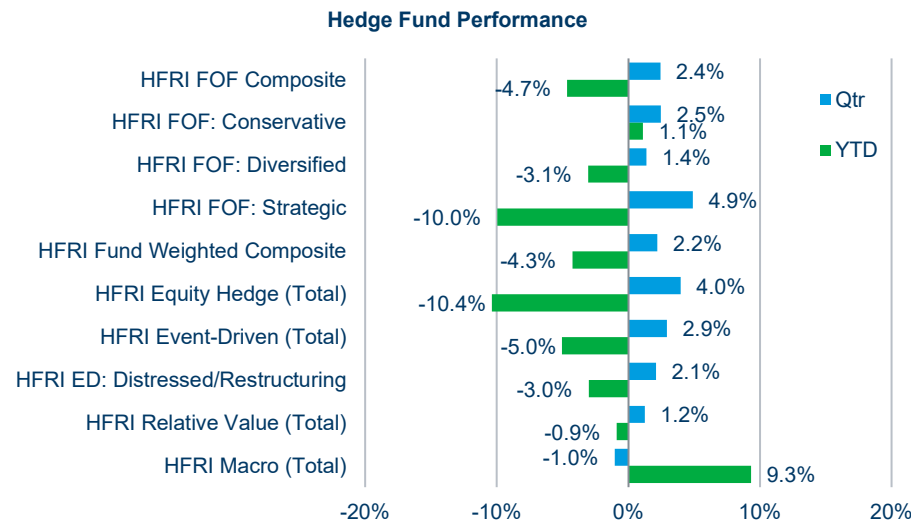
Alternative investment performance

Natural resources and MLPs outperformed, hedge funds delivered gains

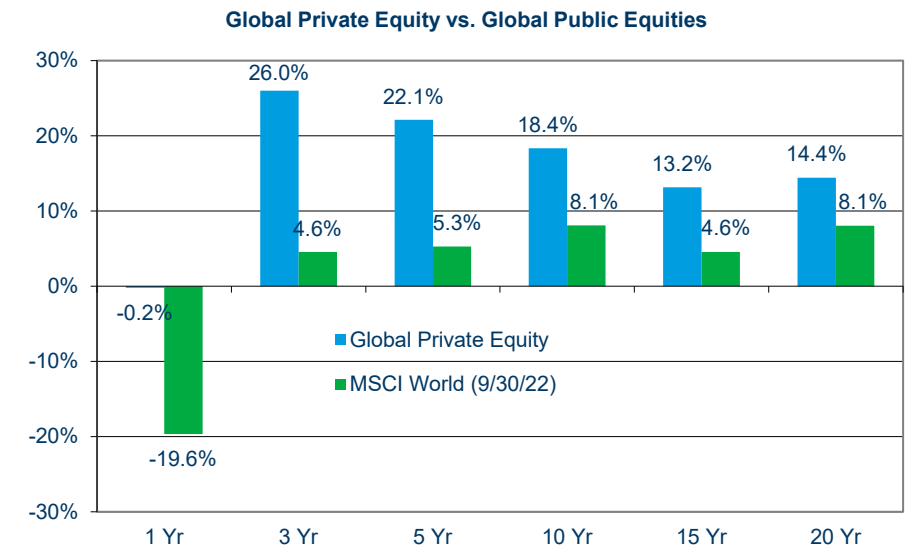
- Global REITs gained roughly 7% during Q4, lagging broader equity markets. Infrastructure stocks gained 9% during the quarter, in line with broader equity markets.
- Commodities posted modest gains during the quarter as economic activity slowed, but returns remained positive for 2022. Natural Resource stocks and MLPs delivered strong gains for the quarter and the calendar year.
- The HFRI FOF Composite Index gained 2.4% in Q4, leaving it with a 4.7% decline for 2022¹. Macro strategies outperformed in 2022, while equity hedge strategies lagged.
- Global private equity outperformed global developed stocks over the most recent trailing periods².



Source: Bloomberg, Datastream; as of 12/31/22



Source: Hedge Fund Research; as of 12/31/22



Source: Burgiss, Bloomberg; as of 9/30/22

¹ Source: Hedge Fund Research; as of 12/31/22

² Source: Burgiss, Bloomberg; as of 9/30/22

Valuations and yields

Ending December 31, 2022

Valuations

MSCI USA	12/31/2022	9/30/2022	6/30/2022	3/31/2022
Index Level	16879.3	15757.5	16534.2	19866.9
P/E Ratio (Trailing)	19.4	18.3	18.9	23.1
CAPE Ratio	25.5	24.7	26.6	33.0
Dividend Yield	1.7	1.8	1.7	1.4
P/B	3.9	3.6	3.8	4.7
P/CF	13.0	12.6	14.1	18.5
MSCI EAFE	12/31/2022	9/30/2022	6/30/2022	3/31/2022
Index Level	6583.4	5610.4	6189.6	7240.4
P/E Ratio (Trailing)	13.7	13.0	13.9	15.5
CAPE Ratio	14.7	14.0	15.6	17.0
Dividend Yield	3.3	3.6	3.4	2.9
P/B	1.6	1.5	1.6	1.8
P/CF	7.3	5.5	6.4	7.9
MSCI EM	12/31/2022	9/30/2022	6/30/2022	3/31/2022
Index Level	486.1	443.1	501.1	565.8
P/E Ratio (Trailing)	12.2	11.5	12.5	14.0
CAPE Ratio	11.0	10.1	11.6	13.7
Dividend Yield	3.4	3.6	3.1	2.5
P/B	1.6	1.5	1.7	1.8
P/CF	8.2	6.7	7.6	8.5

Source: Bloomberg, Thomson Reuters Datastream
Past performance is no guarantee of future results

Yields

Global Bonds	12/31/2022	9/30/2022	6/30/2022	3/31/2022
Germany – 10Y	2.57	2.11	1.34	0.55
France – 10Y	3.12	2.72	1.92	0.98
UK – 10Y	3.67	4.09	2.23	1.61
Switzerland – 10Y	1.62	1.23	1.07	0.60
Italy – 10Y	4.72	4.52	3.26	2.04
Spain – 10Y	3.66	3.29	2.42	1.44
Japan – 10Y	0.42	0.24	0.23	0.22
Euro Corporate	4.32	4.24	3.24	1.55
Euro High Yield	8.32	9.01	8.08	5.18
EMD (\$)	8.55	9.57	8.56	6.42
EMD (LCL)	6.86	7.31	7.06	6.23
US Bonds	12/31/2022	9/30/2022	6/30/2022	3/31/2022
3-Month T-Bill	4.42	3.33	1.72	0.52
10Y Treasury	3.88	3.83	2.98	2.32
30Y Treasury	3.97	3.79	3.14	2.44
10Y TIPS	1.58	1.68	0.65	-0.52
30Y TIPS	1.67	1.74	0.91	-0.03
US Aggregate	4.68	4.75	3.72	2.92
US Treasury	4.18	4.13	3.09	2.42
US Corporate	5.42	5.69	4.70	3.60
US Corporate High Yield	8.96	9.68	8.89	6.01

Source: Bloomberg, Thomson Reuters Datastream

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