EST 1913
COLONIAL TRUST
COMPANY

2ND QUARTER
2022

COLONIAL TRUST *Quarterly*

IN THIS ISSUE

1ST QUARTER OVERVIEW

THE FIRST QUARTER PROVED DIFFICULT FOR CAPITAL MARKETS.

The S&P 500 returned -4.6% and all major US indices were in the red. The tech-heavy Nasdaq index returned -8.9%, while the small cap Russell 2000 index was down 7.5%. International markets offered no relief, with the MSCI EAFE index of developed markets falling 5.8%, while the MSCI Emerging Markets index returned -7.0%. Bond prices, which move inversely with interest rates, fell for the quarter and the Bloomberg US Aggregate Index fell 5.9%.

Within the S&P 500, only two of the eleven sectors were positive on the quarter, with energy returning 39.0% and utilities 4.8%. The worst performing sectors were communication services, down 11.9%, and consumer discretionary, down 9.0%.

The S&P 500 hit an all-time high on January 3rd only to reach a year-to-date low on March 8th. The decline was 13.0%, putting the broad market in a correction during the quarter. This was our first correction since March of 2020 and Wall Street's fear gauge, the VIX, rose 120% from January 3rd to March 7th. From the March 8th low, the S&P 500 rallied 8.6% through quarter end, cutting the year-to-date losses from 12.5% to 4.6%.

Market weakness can be chalked up to an increasingly hawkish monetary policy from the Fed. This change in policy is necessary to combat rising inflation, which is worsened by Russia's invasion into Ukraine. From the pandemic lows of March 2020 through January 3rd, the market sentiment was "risk on" aided by dovish monetary policy and robust fiscal policy. The sentiment changed in January with the release of the Fed's December meeting minutes, which highlighted its concerns about rising inflation. On March 16th, the Fed increased interest rates for the first time since December 2018 and signaled more rate increases to come. The inflation situation was exacerbated by the Russian invasion, which drove WTI oil prices to $123.70/bl.

The February CPI reported that headline annual inflation increased 7.9% and core inflation rose 6.4%. Producer prices for the same period were 10.0% on headline and 8.4% for core. These are the highest reads since the early 1980's, but this measure was recorded prior to the Russian invasion. Inflation reads for March and April will surely be higher as higher oil prices impact this reading.

THERE ARE MANY EXPLANATIONS FOR HIGHER INFLATION, INCLUDING STIMULATIVE FISCAL AND MONETARY POLICY, SUPPLY CHAIN ISSUES, CHINA'S ZERO-COVID POLICY, LABOR SHORTAGES, AND THE WAR.

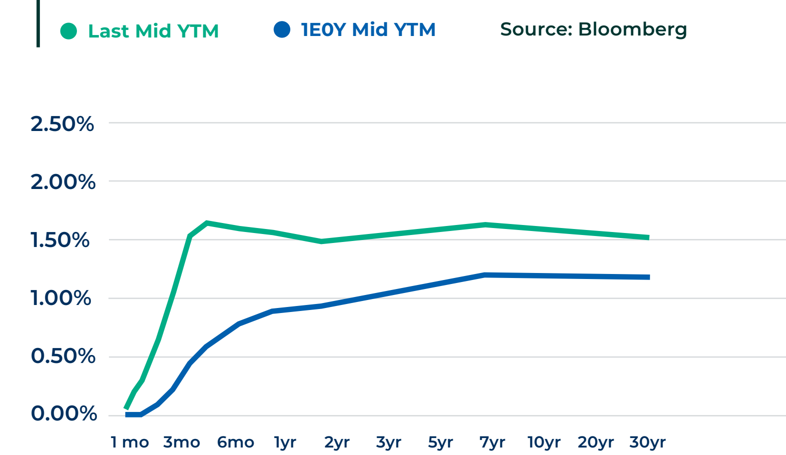
While each explanation has merit, the reality is the US and global economy are experiencing synchronized inflation. This is an investment landscape not seen in decades, after nearly 40 years of falling inflation. This puts the Fed's credibility on the line and Jay Powell has signaled his intention to reduce inflation expectations through hawkish policy.

Inflation is pushing bond yields higher in anticipation of further Fed rate increases. The futures market implies a Fed Funds rate of 2.5% by December 2022, up from 0.25% today. The treasury yield curve has priced in Fed rate hikes with the 2yr treasury yield increasing from 0.73% at year end to 2.34% on March 31st. The 10yr treasury yield has increased from 1.51% to 2.34% over the same period. The yield curve has flattened over the quarter and parts of the curve have inverted. A flattening yield curve is sign of slowing economic growth and an inverted curve can signal a recession. A yield curve inversion occurs when it is more expensive to borrow money for shorter time periods than longer time periods. This occurs when markets expect faltering economic growth and lower demand for credit in the future.

The most respected part of the curve is the 2yr to 10yr treasury curve and this curve has inverted 28 times since 1900, with recessions occurring 22 of the 28 times. While this has been a good indicator of a recession, the lag between the inversion and the recessions varies. The average of the last 22 recessions has been 22 months. The last six recessions have ranged from six months to three years. Evaluating this signal in 2022 is further complicated by the Fed's massive bond buying program over the last two years, where it purchased $3.2 trillion of treasury securities, pushing yields down. We begin the second quarter with the 2yr/10yr curve inverted by 6.9bps and this bears watching for the remainder of the year.

The economy is slowing from its strong pace of 2021 and the Atlanta Fed GDPNowcast forecasts 1.5% growth in the first quarter. Most economic data is strong, as we will outline below; however, there are areas of concern. Employment is robust with 1.685 million jobs created in the quarter and the unemployment rate is 3.6%. Additionally, there were 11.3 million job openings in February, which is leading to annual wage increases of 5.6%. The manufacturing sector is strong, with ISM Purchasing Managers Index (PMI) readings above 57 for each read since October 2020 (any read above 50 signals expansion). Capacity utilization has recovered to 77.6%, its highest reading since March 2019. Growth in the service sector slowed in the first quarter due to the Omicron variant, but Services PMI was 56.5 in February. The consumer has been shopping, with retail sales reading for February

US TREASURY YIELD CURVE



of $658.1bn, up 25.2% from prepandemic levels of February 2020. Businesses are also spending, with the Business Roundtable CEO survey of capital spending plans at the highest levels since September 2018.

THESE COINCIDENT INDICATORS POINT TO STRENGTH, BUT THERE ARE ECONOMIC CHALLENGES.

Higher interest rates are beginning to impact housing. The 30yr mortgage rate has increased from 3.27% at year end to 4.91% today. This is pressuring affordability when materials and labor costs were already a challenge. There are clearly issues with supply chains, which are increasing costs for businesses, increasing delivery times, and leading to shortages. Businesses are forced to either raise prices, absorb higher costs, or increase productivity. Additionally, high gas prices can result in demand destruction as consumers are forced to reduce discretionary spending to fill up their gas tanks.

SO WHERE DO WE GO FROM HERE?

ECONOMIC GROWTH IS SLOWING MORE THAN WAS EXPECTED WHEN WE BEGAN THE YEAR.

Estimates for 1Q22 GDP growth from the Bloomberg® survey have fallen from 4.0% to 1.5%. Analysts have reduced estimates for the remainder of the year; however, they still expect a post Omicron rebound to 2%-3% growth for the balance of the year. Estimates for the Fed Funds rates have moved higher, with the futures markets predicting a Fed Funds rate of 2.5% in December 2022 compared to 0.82% three months ago. Analysts' estimates for inflation for 2022 have moved higher from 4.4% at year end to 6.2% today. The economy is facing slower growth, higher inflation, and higher bond yields going into the remainder of the year.

Higher labor, inventory, and material costs pressure corporate profit margins and challenge corporate profits. Wage growth is running at its highest rate since the BLS began tracking this measure in 2007; however, real wage growth is negative after adjusting for inflation. This pressures consumers' ability to increase spending, impacting corporate revenue growth.

These pressures have yet to feed into analysts' estimates for corporate earnings growth. Earnings for 4Q21 showed S&P 500 profit margins were at record levels of 13.4%, up from 12.1% prior to the pandemic. The Street forecasts companies will be able to maintain high profit margins through price increases and enhanced productivity. Estimates for 2022 S&P 500 earnings have increased by 2.5% during the first quarter and the current estimate is for 8.3% earnings growth in full year 2022. Bear in mind, these are nominal estimates and if inflation is running at 7%, real earnings growth of 8.3% is barely positive.

We agree that economic and earnings growth will decelerate in 2022.

The inflationary pressures are unlikely to abate quickly, and the Fed will tighten monetary policy. Higher interest rates will hamper economic growth. This will result in continued volatility in the capital markets. There are risks to the upside and downside to our expectations: including the Ukraine situation, China's Covid policy, and the stubborn labor force participation rate. These factors could break to the positive or the negative and change our forecast. Then there are the unknown unknowns, as coined by Donald Rumsfeld, which could surprise us all in 2022.

The market has discounted some of the changing investing landscape in the first quarter. The S&P 500 earnings multiple has fallen by 8.1% in the first quarter, from 21.2x at yearend to 19.5x today. Moreover, the earnings multiple for all but the 10 largest stocks in the market is 16.6x, which is near its 25yr average. The correction in 1Q22 has made valuations more reasonable for the market and attractive in certain areas of the market. The appropriate valuation is a function of the actual level of earnings growth and the level of interest rates. We expect earnings to grow in 2022, but we expect rates to increase. This will create a push and pull in markets for the remainder of 2022.

IN THIS ENVIRONMENT, WE ARE REVIEWING OUR CLIENTS' HOLDINGS TO EVALUATE THEIR ABILITY TO MANAGE THROUGH THIS CHALLENGING ENVIRONMENT.

We are focused on quality companies with pricing power, attractive margins, and strong balance sheets. Over the last few years, we have managed through a pandemic, rising geopolitical tensions, and now rising inflation. Market watcher Ed Yardeni commented during the first quarter, "Stop the world, I want to get off." During the quarter, we have shared that sentiment; however, that is not an option for any of us. Rather, as facts on the ground change, we are assessing their impact on our holdings and will change our forecast as appropriate. We value all of our clients and friends and take very seriously the confidence you place in Colonial Trust. We believe we will manage through the remainder of 2022 together and that better times for our clients, our country, and our world are ahead. As always, please reach out to us to discuss our thoughts and your situation.

IN THE SPOTLIGHT

Henry E. Batts III, AWMA®
Financial Advisor & Trust Officer

HENRY E. BATTS III, AWMA®, Financial Advisor and Trust Officer, joined the Colonial Trust Columbia office in October 2021. He is an experienced financial professional with ten years of comprehensive investment management and planning. Before Colonial, Henry served as a Financial Advisor with Janney Montgomery Scott, LLC in Columbia, SC. Henry holds the distinguished AWMA® (Accredited Wealth Management Advisor SM) designation, FINRA Series 7 and Series 66 licenses, and his Life, Accident, and Health Insurance License.

Henry's responsibilities include assisting in financial advisory, trust officer, and portfolio management roles for general wealth management and trust clients. In his spare time he enjoys cycling, cooking, woodworking and tinkering with most anything that needs fixing (all while listening to his favorite podcast, Stuff You Should Know).

He is a graduate of the University of South Carolina – Darla Moore School of Business, where he majored in Finance & Marketing and was fortunate to meet his wife, Morgan. Henry and Morgan often spend their weekends traveling to the coast with their dog Lilly or tending to the ever expanding garden at the Batts homestead.

We are glad to welcome Henry to our Columbia team and excited that he is representing Colonial Trust in the Columbia community. Henry will be an asset to our investment and trust team to support the growth and success of the broader firm.

IMPROVING PARTICIPANT OUTCOMES IN YOUR 401(K) PLAN

BY REID THOMPSON

Defined contribution plans can be an important piece of the overall benefits package a firm offers.

The ultimate goal of the plan is successful participant outcomes and it can be wise to regularly do a check up on your plan to make sure it is working hard to that end. According to the latest Principal Retirement Security Survey, 50% of plan sponsors are concerned that their employees may not be adequately prepared for retirement.

HOW WE SERVICE FIRMS WITH A RETIREMENT PLAN

1 **PLAN OPTIONS:** Whether your firm has an existing plan or plan to start one, Colonial Trust can help you refine or implement it. Colonial Trust has extensive experience with 401(k)s, profit sharing, defined benefit and cash balance plans.

2 **SERVICES:** Colonial Trust serves as the quarterback of a plan and manages all pieces of the puzzle. We are fiduciary designees and employ a strict process to run a plan efficiently and help participants toward a successful retirement.

3 **OUR APPROACH:** Colonial Trust's four part process is to organize, formalize, implement and monitor. These steps are all in conjunction with recordkeepers and TPAs (if necessary).

4 **INDEPENDENCE AND TRANSPARENCY:** As an independent firm, our only loyalty is to the clients we serve. This allows us to tailor a plan to the firm without restrictions. Colonial Trust prides itself on accountability and transparency which allows a firm to plainly see the value we provide.

WHAT CAN FIRMS DO TO IMPROVE RETIREMENT READINESS?

5 **PLAN DESIGN:** Consider a re-enrollment in the plan with investment choices and savings rates. This allows the plan sponsor to give the participant a reset with increased savings rates and potentially increased asset allocation through a QDIA (Qualified Default Investment Alternative). This can sound daunting, but recordkeepers do most of the work and participants typically stick with the new parameters. According to Vanguard, after 1 year of a re-enrollment, 92% of participants remained in the QDIA and 81% of the savings rates remained.

6 **PARTICIPANT EDUCATION:** One on one education can solidify this re-enrollment. Regular office visits from the adviser allows him or her to meet with each participant and help guide them through not only re-enrollments, but individual situations. This can even include the adviser helping the participant budget to make room for their contributions

7 **PROVIDER SELECTION:** It requires many puzzle pieces to create a sound 401(k) plan and all teams need to work together. Provider search and selection for financial advisers, funds inside the plan, recordkeepers and TPAs (Third Party Administrators) should be evaluated occasionally to make sure they are a good fit. The plan's goal should be to receive the best value for the cost.

8 **FIDUCIARY PROTECTION:** While the plan sponsor can never be absolved of all fiduciary responsibility, 3(38) advisory services and 3(16) services that are available from TPAs can be a wise decision to outsource some of this responsibility.

OUR LEADERSHIP

H. Walter Barre

Bert D. Barre, CFA

Barry D. Wynn

Camp R. Wynn, CFA

Henry E. Batts III, AWMA®

Charles W. Clementson

James C. Fiske, CFP®

Jamison W. Hinds, JD

Karen H. Longhurst, ATFA, CTFA

Pamela G. McCauley

Ansley J. Mitcham

Kathryn A. Smith, CPA/PFS, CFP®

Reid E. Thompson, AIF®

Carolyn L. West

W. Charlton Wieters, CTFA

LOCATIONS

SPARTANBURG

359 S. Pine St.
Spartanburg, SC 29302

864.582.3356

GREENVILLE

101 E Washington St.,
Suite 200
Greenville, SC 29601

864.370.0737

COLUMBIA

6 Calendar Ct.,
Suite 1
Columbia, SC 29206

803.782.7646

CHARLESTON

578 East Bay St.,
Suite B
Charleston, SC 29403

843.577.0444

COLONIALTRUST.COM