



INVESTMENT STRATEGIES IN A CHANGING ECONOMY

Wednesday, Oct. 12, 2022

EMBRACE
THE POSS/IBLE®

Today's speakers



Lisa Schneider, CFA
Managing Director, Head of Client Solutions
Russell Investments



Erik Ristuben
Chief Investment Strategist
Russell Investments

Russell Investments' global market outlook

ECONOMIC VIEWS



U.S. ECONOMY

- Fed Reserve trying to stick an elusive “soft landing”
- Household and corporate finances are healthy
- Recession risk sitting at 45% thru mid-2023



EUROPEAN ECONOMY

- Natural gas flows from Russia have been curtailed
- High gas prices make a European recession likely
- Fiscal policy is trying to limit the damage
- Severity of winter weather will inform how bad it gets



CENTRAL BANKS RATE HIKES

- Fed Reserve maintains inflation as top priority
- ECB likely to move policy rate to around 2.0-2.5%
- Bank of Japan remains accommodative.



INFLATION

- US headline inflation coming down with gasoline prices but to remain volatile around geopolitics
- Core inflation may have peaked in the U.S.



U.S. LABOR MARKETS

- Overheating but some cooling likely as economy slows and higher wages lure workers back to the labor force
- Currently two job openings for every worker looking

ASSET CLASSES



GLOBAL EQUITIES

- More attractive valuations favor non-US stocks
- Cyclical and geopolitical risks moderate this view.
- Factor preferences are modest. Slight nod for Low Vol over Quality as preferred defensive lever.
- Security selection is primary driver of returns.



FIXED INCOME

- U.S. government bonds offer good value
- Japanese, German, and UK bonds are more expensive
- Bonds may serve as a useful diversifier if central banks are forced to pause or cut rates in the face of an economic recession



REAL ASSETS

- Infrastructure and REITs could prove attractive if Ukraine conflict subsides and inflation concerns continue
- Commodity demand likely weakened by slower growth



CURRENCIES

- If global economic activity cools, USD could strengthen as investors seek quality assets
- If hostilities were to end in Europe, that could cause EUR to strengthen relative to USD

There is no guarantee the stated expectations will be met.

As of 9/19/22. Forecasting represents predictions of market prices and/or volume patterns utilizing varying analytical data. It is not representative of a projection of the stock market, or of any specific investment.

Key takeaways

Recession risk is elevated

- **Stiff macroeconomic headwinds**

- Good news: retail gasoline prices have fallen over 20% in the US from mid-June, supply chains are healing, inflation expectations still anchored
- Bad news: The labor market is still overheating, and stickier inflation categories (like shelter and wage-sensitive areas) remain red hot
- Net: pressure remains on the Fed to keep hiking rates well into the danger zone of a restrictive policy stance
- Bear economic scenario probability sits at 45% - moderate US recession becoming more likely
- European recession seems very likely now with Russia curtailing natural gas flows and natural gas prices spiking

- **Equity sentiment** is bumping up against panic extremes again on post Jackson Hole sell-off

- **Equity valuations** were in the vicinity of fair value at mid-June lows but have never been clearly cheap YTD

- **Elevated uncertainty** and the tug of war between our cautious macro-outlook and very pessimistic market psychology leaves us to prefer a neutral tactical asset allocation—anchored near strategic targets

Source: Russell Investments. September 2022.

U.S. economic outlook and recession probability

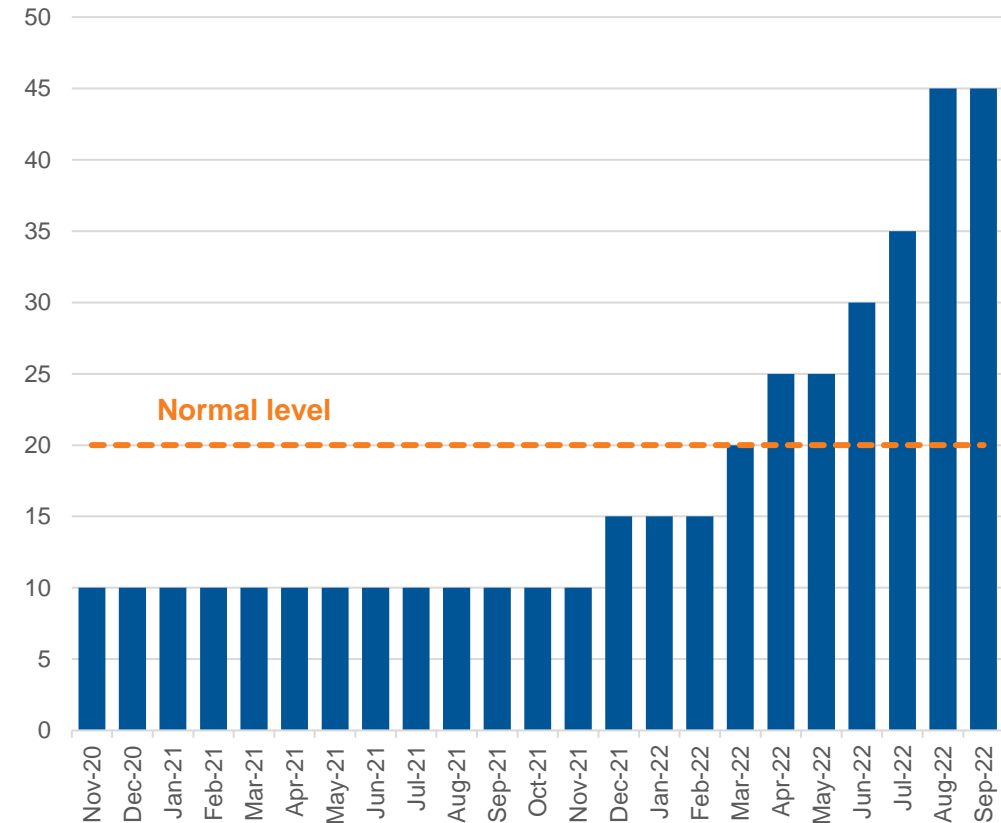
Downside risks remain as Fed closes in on restrictive monetary policy stance

Cycle assessment for US equity

+2 = max positive



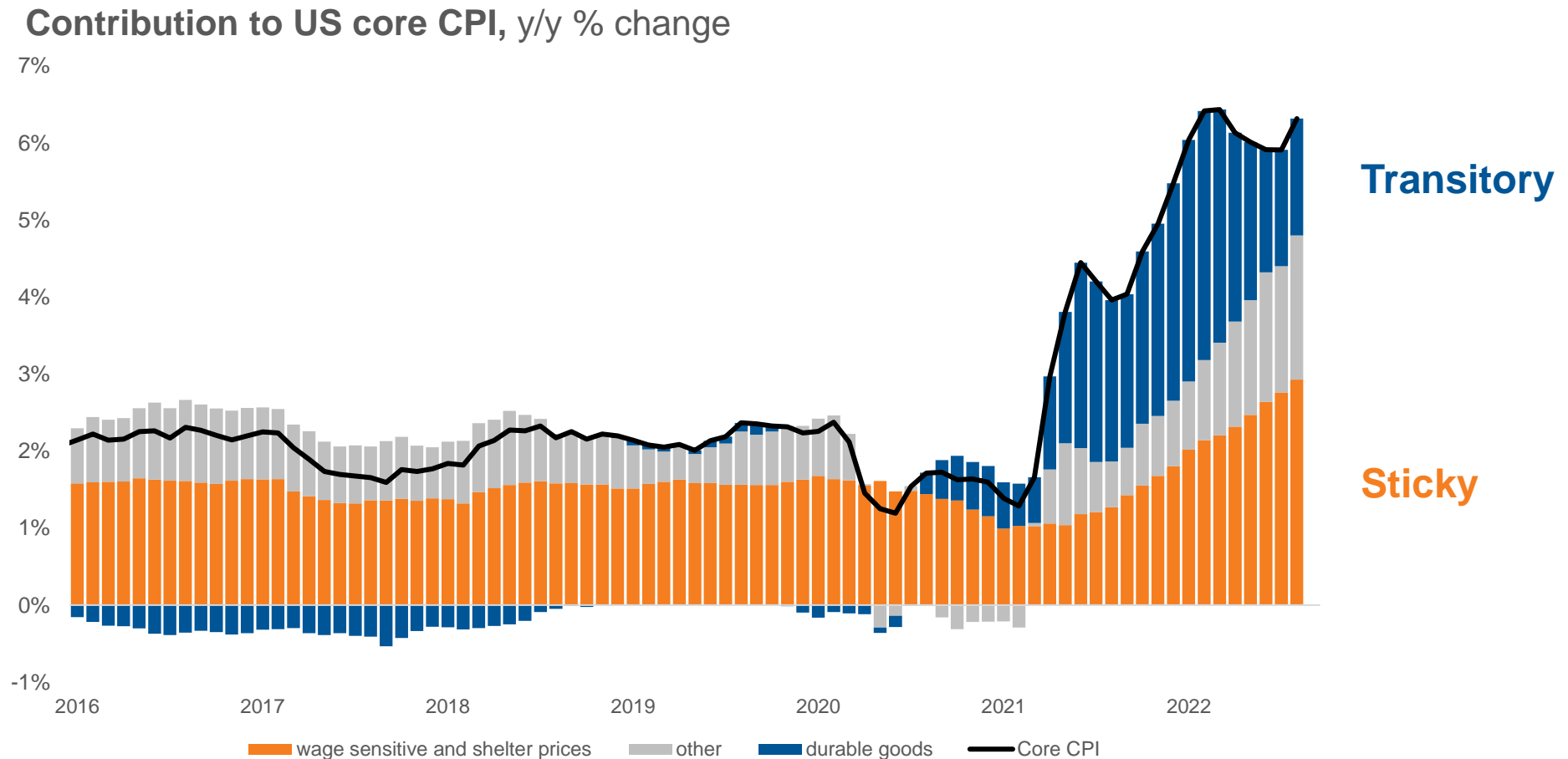
Bear (recession) scenario probability



Source: Russell Investments, September 2022

U.S. inflation surprised to the upside in August

With continued strength in sticky items like shelter and wage sensitive service prices

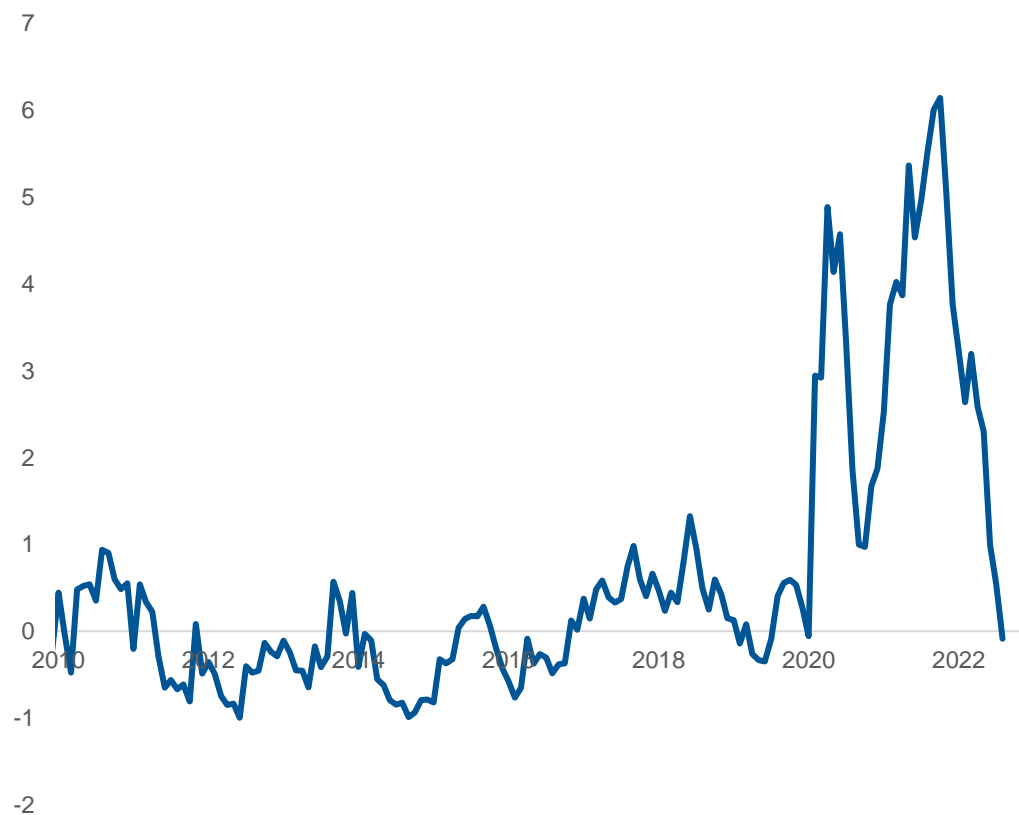


Source: Refinitiv Eikon/Russell Investments, September 13th 2022.

Disinflation expected in goods prices

As supply chain pressures ease and dollar strength takes a bite out of core import prices

A composite measure of supply chain issues



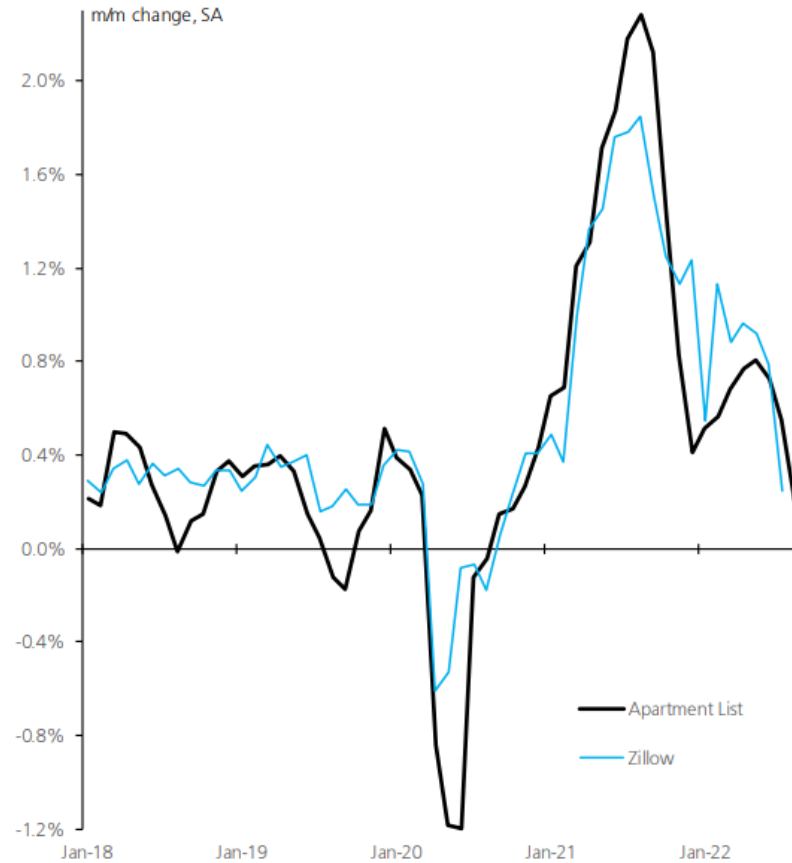
\$ impact on core PCE inflation, ppt



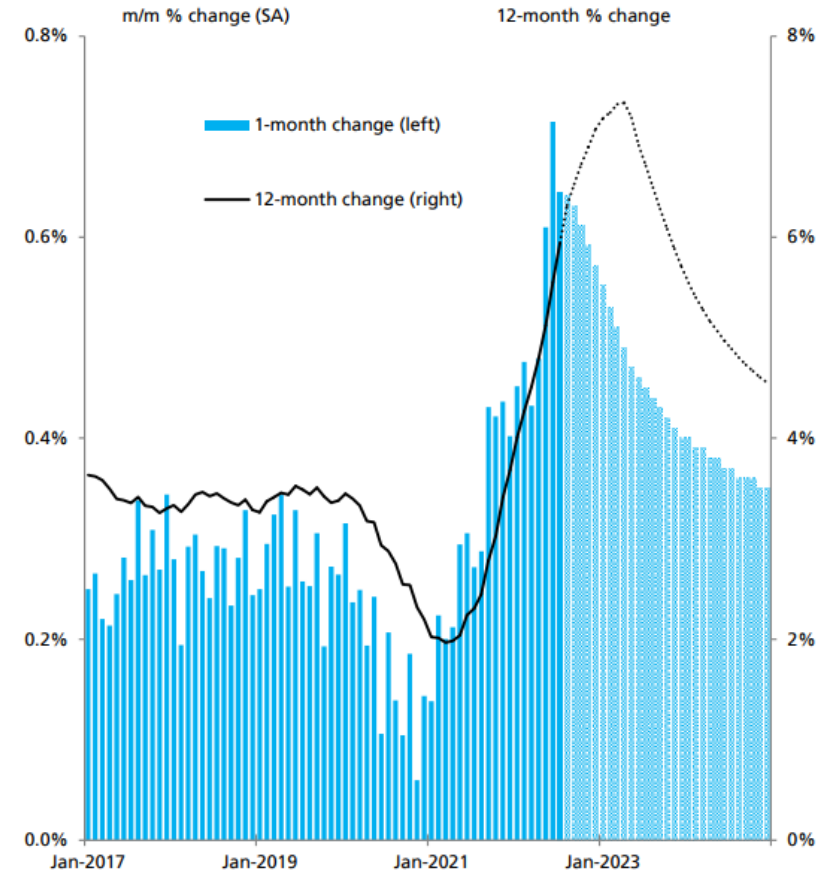
Left chart: Refinitiv data as of August 2022. Russell Investments adaptation of the Global Supply Chain Pressures Index from the Federal Reserve Bank of New York. Right Chart: Refinitiv data as of September 2022. For more details of the estimation technique see "The Transmission of Exchange Rate Changes to Output and Inflation" from former Vice Chair of the Board of Governors of the Federal Reserve System – Stanley Fischer – November 2015.

Stickier shelter prices should (eventually) moderate

Increases in rents for leases by new tenants peaked in August/September last year, but are still rising a little faster than pre-pandemic



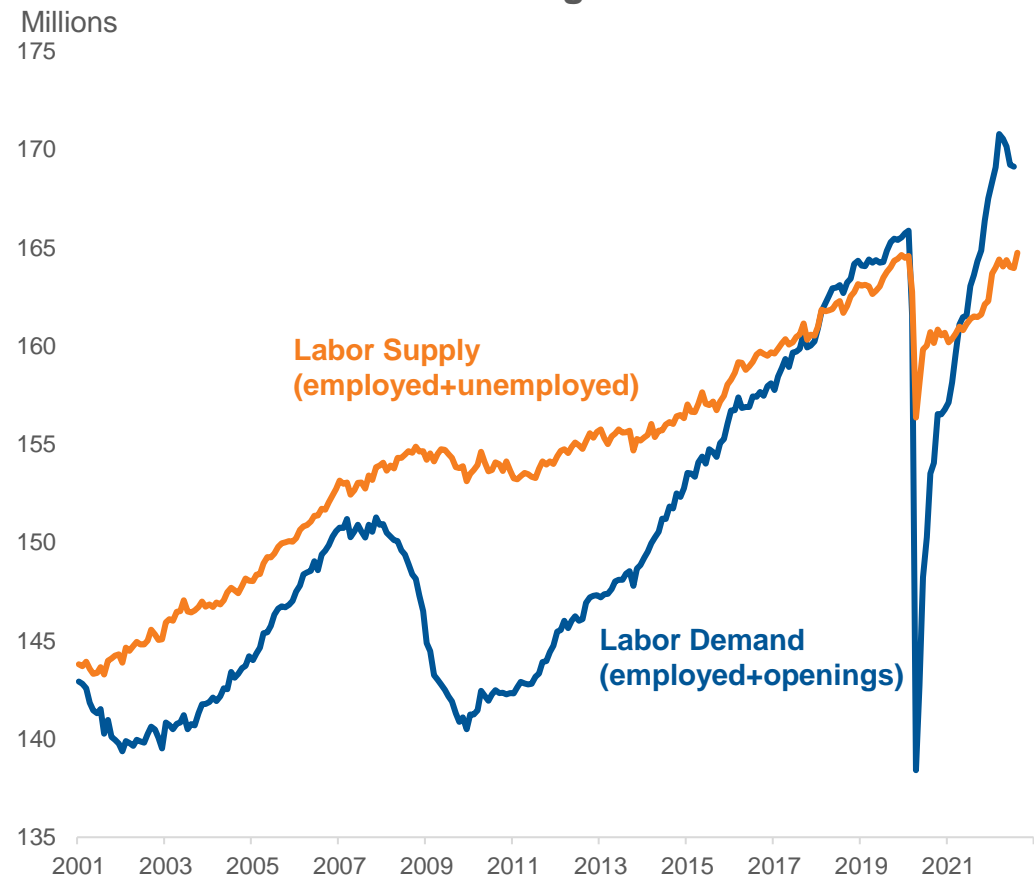
CPI shelter rents (OER + tenants' rent) have risen sharply. While the monthly prints are peaking, the 12-month change will likely increase until around Q2 next year



Source: UBS, Zillow, Apartment List Bureau of Labor Statistics. September 6th 2022.

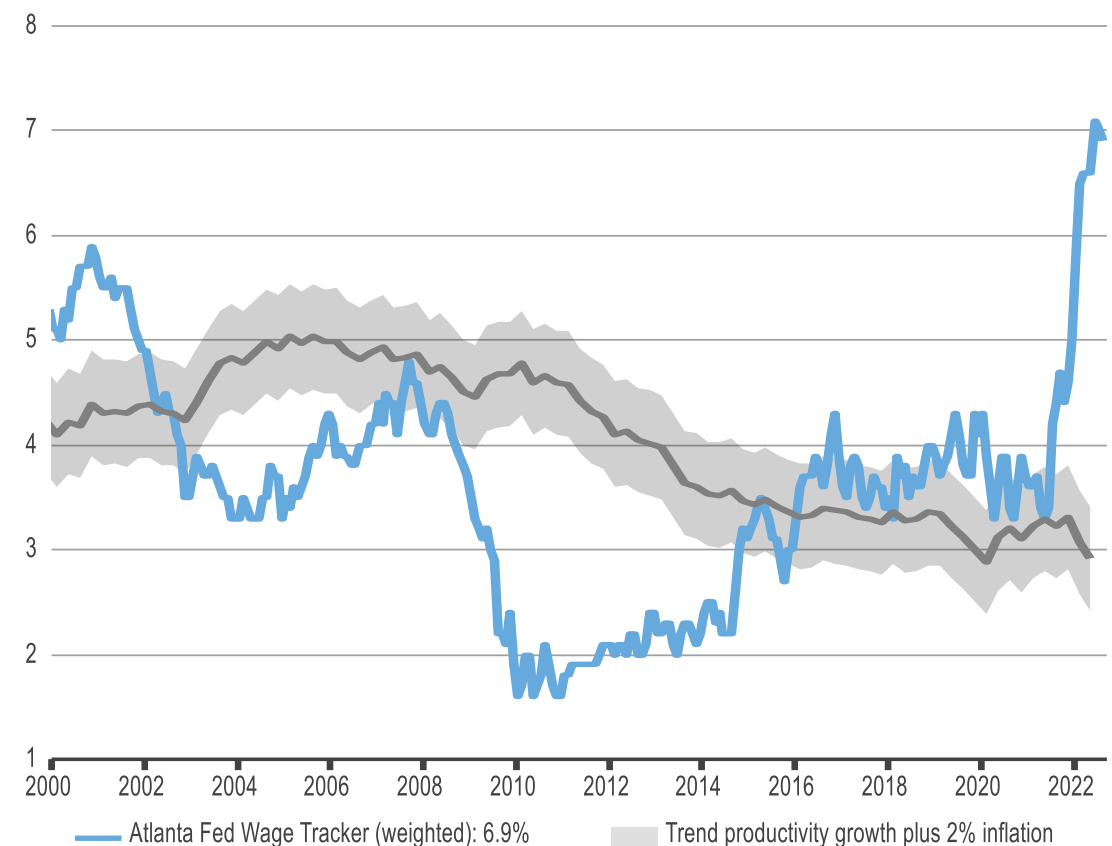
Rapid wage growth is a problem for core service prices

The labor market is overheating



Source: Refinitiv. August 2022.

Atlanta Fed Wage Tracker



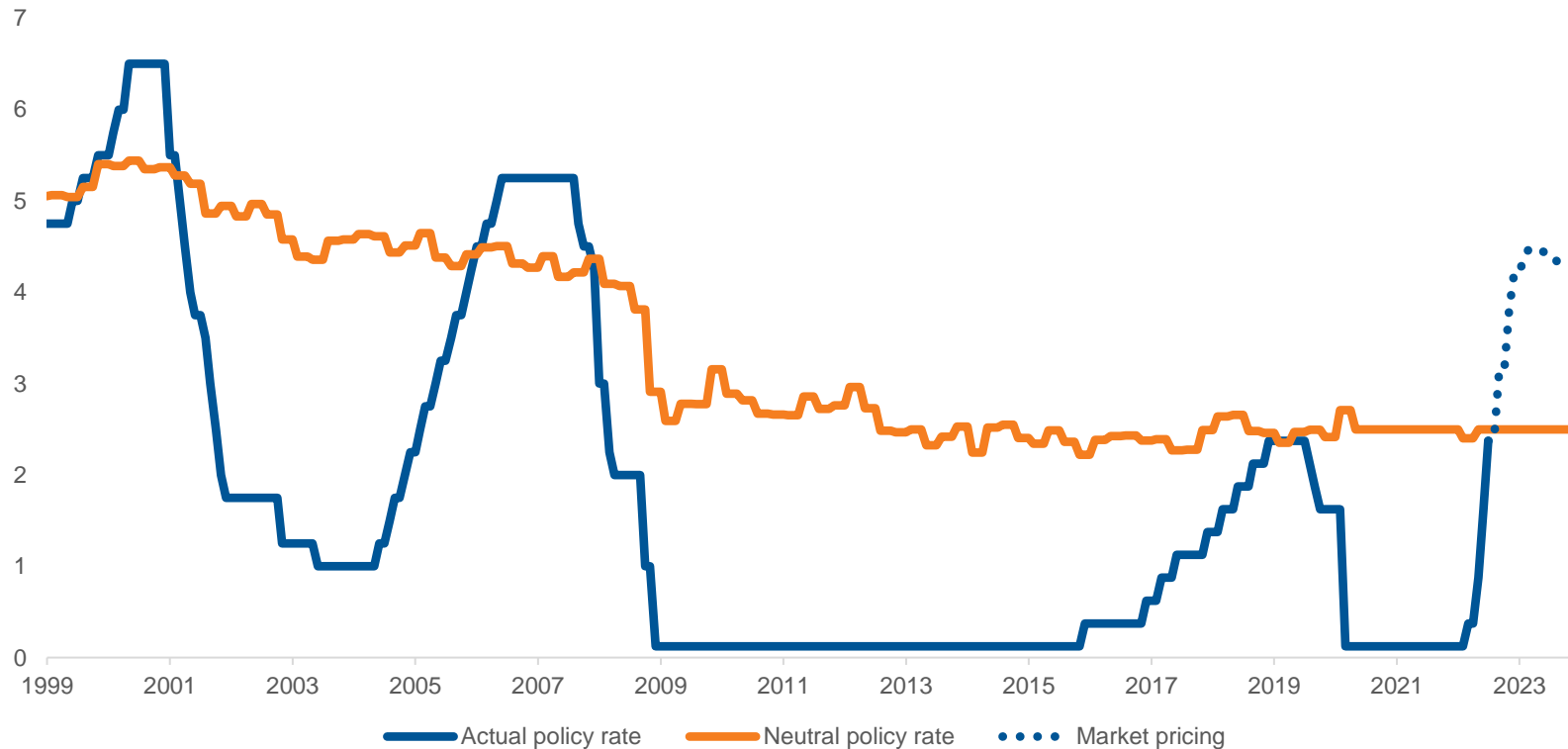
Source: Refinitiv Datastream, Aug 22

Fed policy stance likely to turn restrictive in September

A hallmark late cycle indicator

Fed on the cusp of a restrictive policy stance

Percent

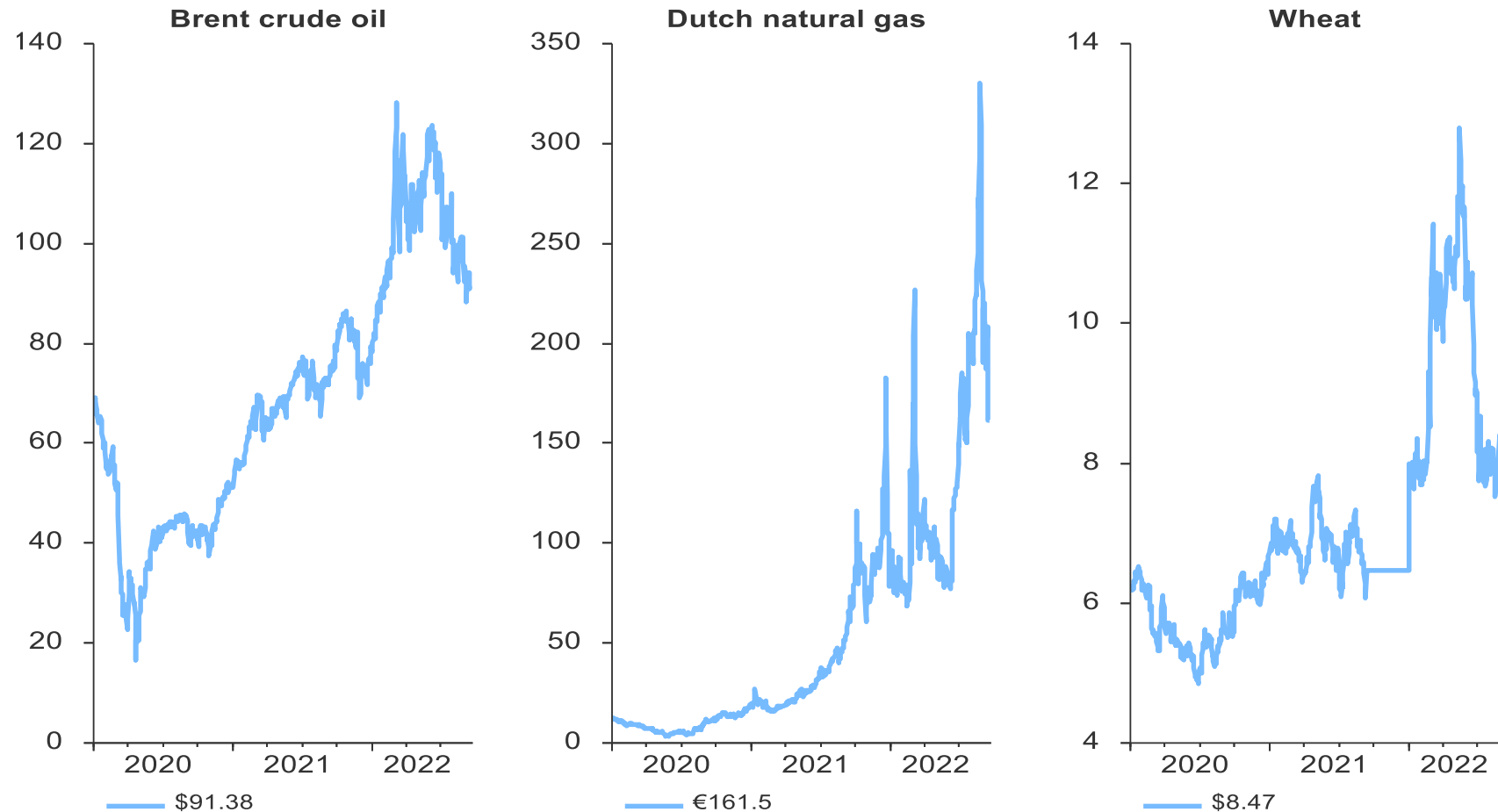


Source: Refinitiv Eikon, September 19th, 2022

Russia/Ukraine market watchpoints

Limited natural gas flows and high prices are likely to trigger a European recession

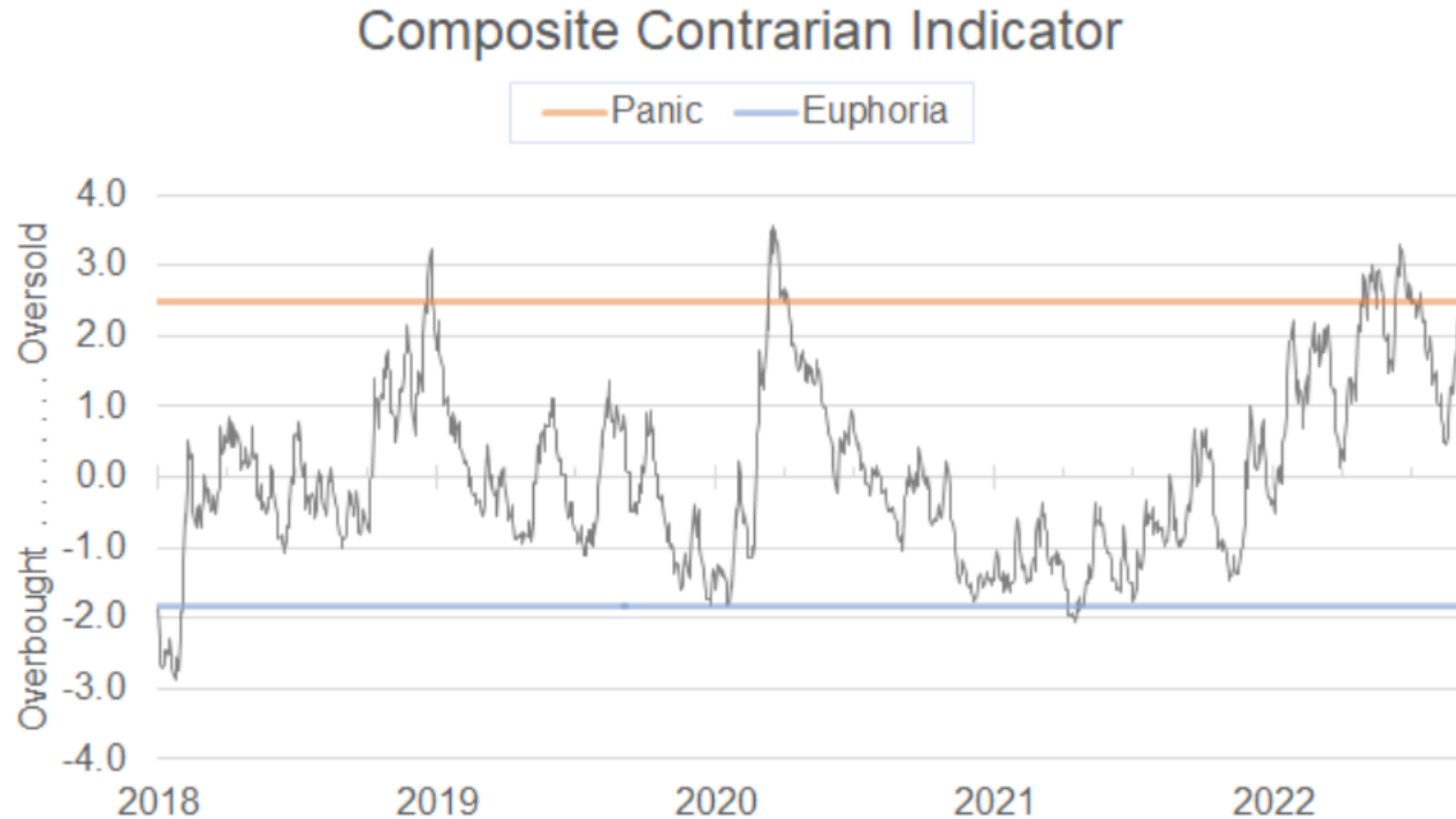
Russia-Ukraine war commodity price tracker



Source: Refinitiv Datastream, September 16, 2022

Market psychology shifting back to extreme pessimism

A positive in our tactical framework

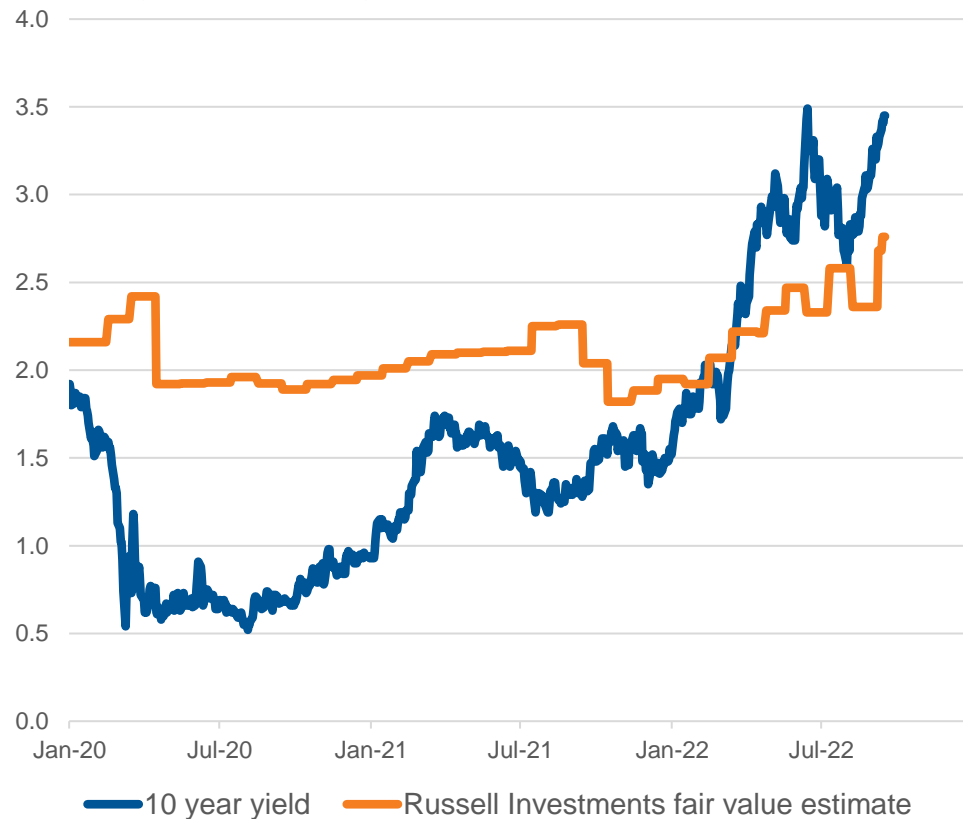


Source: Russell Investments, September 15, 2022

Treasuries offer value after the sharp YTD yield rise

Yields have risen moderately above our estimate of fair value

US 10-year Treasury valuation assessment



Treasury market performance during historical economic recessions

peak	trough	price Δ , %	coupon equivalent Treasury yield Δ , bps								
		S&P 500	0Y	1Y	2Y	3Y	5Y	7Y	10Y	20Y	30Y
Dec-69	Nov-70	-6%	-413	-278	-215	-174	-125	-96	-80		
Nov-73	Mar-75	-23%	-449	-91	-11	25	55	67	76		
Jan-80	Jul-80	15%	-407	-269	-148	-84	-33	-13	11		69
Jul-81	Nov-82	7%	-1216	-545	-460	-399	-330	-300	-280		-277
Jul-90	Mar-91	5%	-218	-160	-121	-94	-64	-48	-33	-14	-21
Mar-01	Nov-01	-8%	-353	-251	-165	-112	-55	-26	-3	12	6
Dec-07	Jun-09	-38%	-444	-266	-197	-149	-89	-56	-29	-11	-16
Feb-20	Apr-20	-10%	-154	-130	-113	-103	-93	-88	-84	-74	-68

Source: Refinitiv, Russell Investments fair value estimates, September 16, 2022.

Impacts for healthcare systems

- **Inflationary environment** placing pressures on operating, financing, and investment strategy; effective integration is crucial to meeting mission goals, increasing productivity of assets, and managing ongoing risks
- **Investment strategy considerations:**
 - As cost of capital increases and stress on operations rises, does your investment strategy need to evolve?
 - Do you need to re-assess return targets, risk levels and liquidity within balance sheet assets?
 - Is the risk level within self-insurance pool tolerable?
 - Are foundation assets able to continue mission objectives?
 - Has funded status of the pension plan improved such that de-risking should be considered?
- **Decisions should be made using a holistic approach** to enterprise risk management that considers and prioritizes resources across the operating, financing and investment activities





THANK YOU!

Important information

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

Russell Investments' ownership is composed of a majority stake held by funds managed by TA Associates, with a significant minority stake held by funds managed by Reverence Capital Partners. Russell Investments' employees and Hamilton Lane Advisors, LLC also hold minority, non-controlling, ownership stakes.

Frank Russell Company is the owner of the Russell trademarks contained in this material and all trademark rights related to the Russell trademarks, which the members of the Russell Investments group of companies are permitted to use under license from Frank Russell Company. The members of the Russell Investments group of companies are not affiliated in any manner with Frank Russell Company or any entity operating under the “FTSE RUSSELL” brand.

Copyright © 2022. Russell Investments Group, LLC. All rights reserved. This material is proprietary and may not be reproduced, transferred, or distributed in any form without prior written permission from Russell Investments. It is delivered on an "as is" basis without warranty.

First Used: October 2022 AI-29452-10-23