

**Communis Fund of the
Diocese of Rochester**

As of 6/30/2022



Alesco Advisors

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Table of Contents

Executive SummaryPage 1

Asset AllocationPages 2-4

Portfolio Activity and Performance.....Pages 5-10

Portfolio Holdings.....Pages 11-12

Investment Policy Statement.....Pages 13-17

Market Commentary & Outlook.....Pages 18-21

Executive Summary

Communis Fund of the Diocese of Rochester

As of 6/30/2022

- **Assets** – The Communis Fund assets totaled \$271,075,340 as of June 30, 2022, a decline from the balance of \$310,575,537 as of March 31, 2022. There were net withdrawals of \$3.9 million in the quarter.
- **Asset Allocation** – The Fund was within policy target ranges for equity and fixed income during the quarter.
- **Performance** – The Fund returned -11.6% in the quarter, outperforming the benchmark return of -12.0%. For the fiscal year (July 1, 2021 to June 30, 2022), the Fund returned -12.2%, ahead of the benchmark return of -12.7% for the same time period. Over the trailing three years (July 1, 2019 to June 30, 2022) the Fund gained 4.5% per year annualized versus the benchmark return of 4.7%.

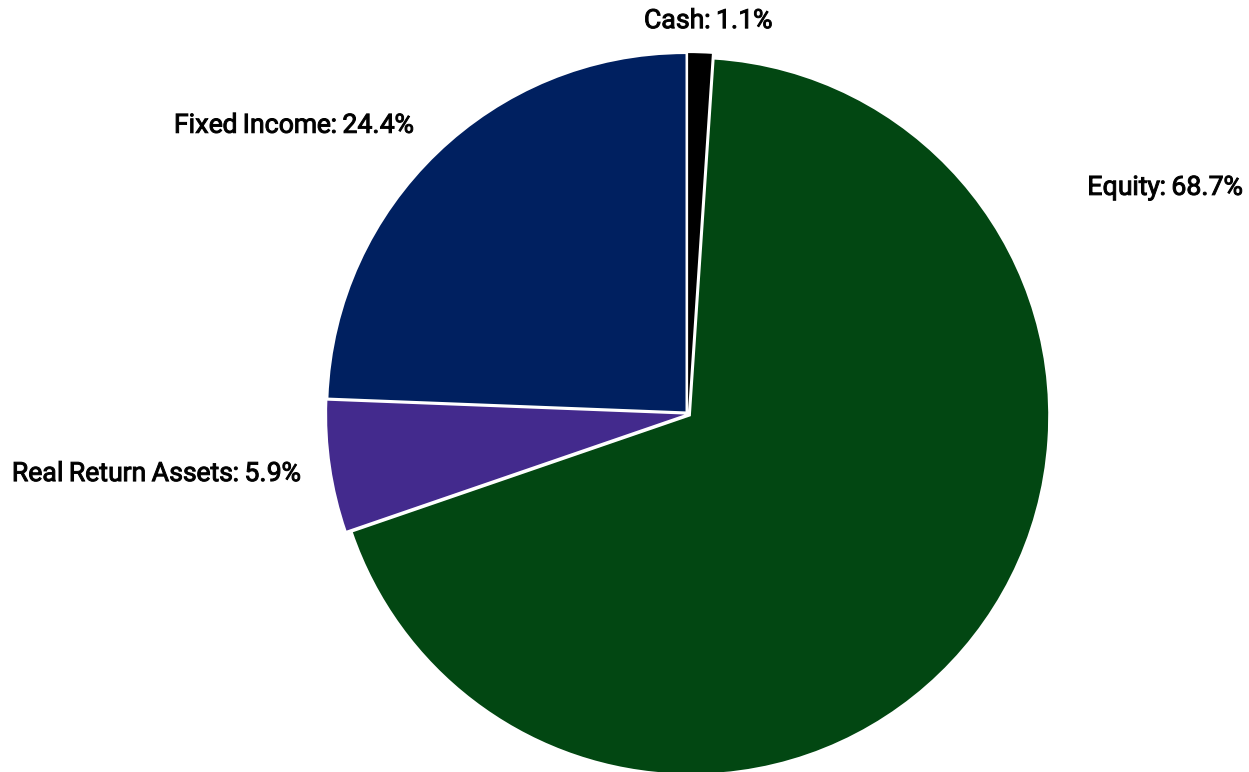


SERVICE
INTEGRITY
VALUE

Overall Portfolio

Communis Fund of the Diocese of Rochester

As of 6/30/2022



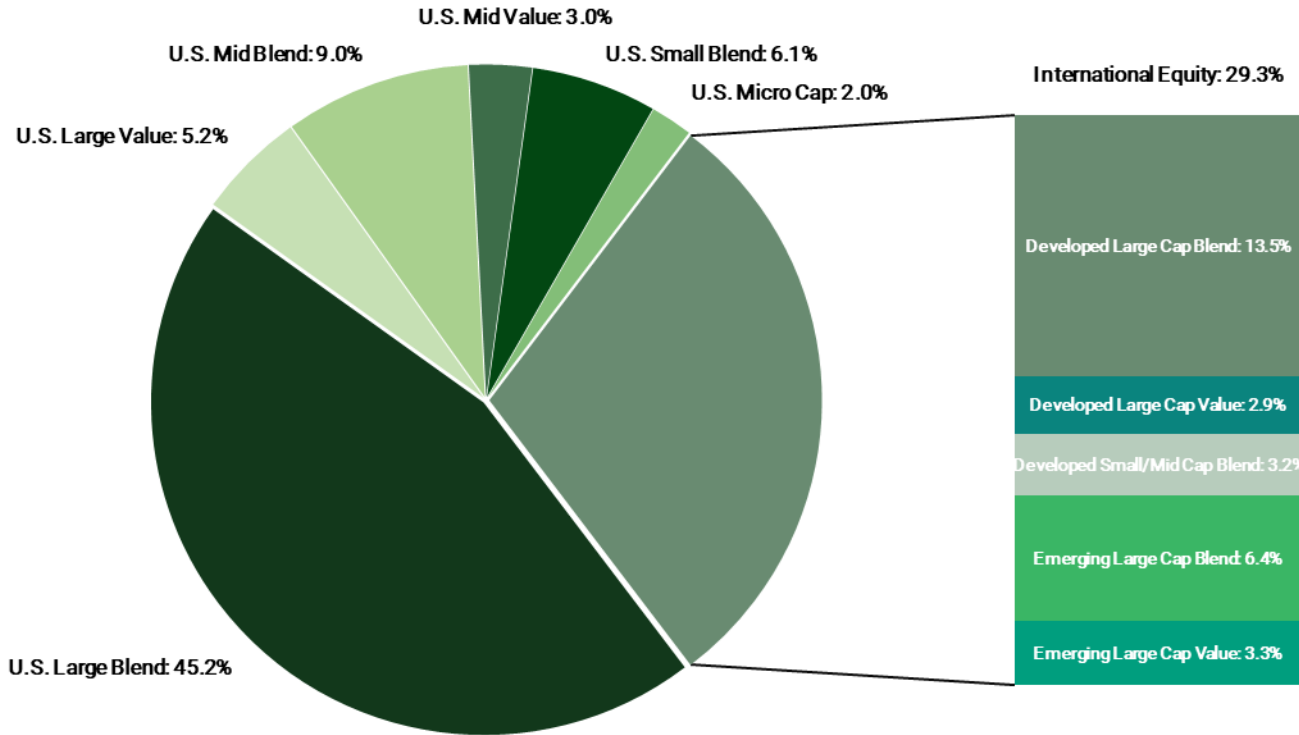
The sum of the values may not equal 100% due to rounding.



Equity

Communis Fund of the Diocese of Rochester

As of 6/30/2022

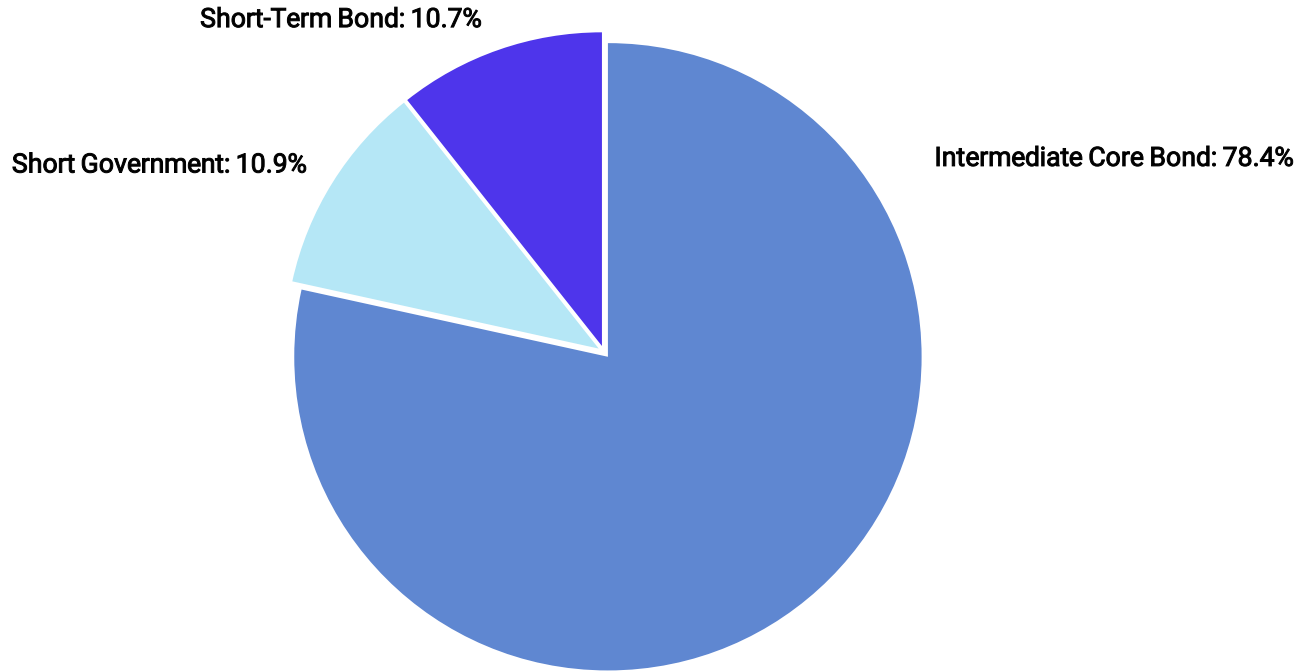


The sum of the values may not equal 100% due to rounding.

Fixed Income

Communis Fund of the Diocese of Rochester

As of 6/30/2022



Portfolio Statistics		Benchmark Statistics	
Average Credit Quality	AA	Average Credit Quality	AA
Average Duration	5.8	Average Duration	6.4
Average Maturity	7.5	Average Maturity	8.7
Average Yield to Maturity	3.3%	Average Yield to Maturity	3.7%

The sum of the values may not equal 100% due to rounding.



Portfolio Activity

Communis Fund of the Diocese of Rochester

As of 6/30/2022

Activity	Quarter (4/1/22-6/30/22)	CYTD (1/1/22-6/30/22)	FYTD (7/1/21-6/30/22)	3 Years (7/1/19-6/30/22)	5 Years (7/1/17-6/30/22)	Since Inception (2/5/13-6/30/22)
Value at Beginning of Period	310,575,537.04	354,662,399.26	344,111,828.82	279,102,090.31	247,434,543.96	64,775,961.68
Contributions	1,132,070.25	3,065,657.33	6,349,472.60	25,274,620.93	55,154,331.45	224,301,445.81
Withdrawals	-5,080,266.66	-34,424,873.16	-41,260,961.11	-75,166,968.86	-105,736,570.95	-132,260,196.23
Income Received	2,012,801.96	2,952,818.75	9,344,198.02	22,295,290.98	38,076,824.55	50,133,205.18
Capital Gain/Loss	-37,564,802.40	-55,180,661.99	-47,469,198.14	19,570,306.83	36,146,211.18	64,124,923.75
Value at End of Period	271,075,340.19	271,075,340.19	271,075,340.19	271,075,340.19	271,075,340.19	271,075,340.19
Total Investment Gain after Fees	-35,552,000.44	-52,227,843.24	-38,125,000.12	41,865,597.81	74,223,035.73	114,258,128.93
Performance						
Portfolio Return	-11.6%	-15.7%	-12.2%	4.5%	5.3%	6.3%
Weighted Benchmark ¹	-12.0%	-16.4%	-12.7%	4.7%	6.0%	6.8%
Consolidated Portfolio Return ²					5.2%	6.2%

Portfolio performance is net of fees. Performance for periods greater than twelve months are annualized.

¹Weighted Benchmark is currently comprised of: 46.2% Russell 3000 / 19.8% MSCI ACW ex. U.S. / 11.0% Real Return / 23.0% Bloomberg Aggregate.

²Includes the performance of investment managers external of Alesco Advisors.



Monthly Cash Flow

Communis Fund of the Diocese of Rochester

As of 6/30/2022

	<u>April</u>	<u>May</u>	<u>June</u>	04/01/22 <u>to 06/30/2022</u>
Contributions	\$100,000	\$366,332	\$665,739	\$1,132,070
Withdrawals	-\$2,021,808	-\$1,390,048	-\$1,668,410	-\$5,080,267
Investment Income	\$156,104	\$13,926	\$1,874,022	\$2,044,052
Bank Fees	\$0	\$0	-\$31,250	-\$31,250

	<u>Semi-Annual Management Fee¹</u>	<u>Date</u>
Alesco Advisors	-	N/A

¹Management fees are semi-annual based on the following schedule: 0.125% on assets under management from \$0-\$50MM; 0.100% on assets under management from \$50MM-\$100MM; and 0.075% on assets under management >\$100MM.



Performance

Communis Fund of the Diocese of Rochester

As of 6/30/2022

	Quarter (4/1/22-6/30/22)	CYTD (1/1/22-6/30/22)	FYTD (7/1/21-6/30/22)	3 Years (7/1/19-6/30/22)	5 Years (7/1/17-6/30/22)	Since Inception (2/5/13-6/30/22)
Equities	-14.62%	-18.45%	-13.75%	6.71%	7.12%	9.26%
Equity Blended Benchmark ¹	-15.81%	-20.28%	-15.51%	7.24%	8.17%	9.84%
<i>Russell 3000</i>	<i>-16.70%</i>	<i>-21.10%</i>	<i>-13.87%</i>	<i>9.75%</i>	<i>10.59%</i>	<i>11.93%</i>
S&P 500	-16.10%	-19.96%	-10.62%	10.60%	11.31%	12.55%
S&P MidCap 400	-15.42%	-19.54%	-14.64%	6.86%	7.03%	9.80%
S&P 600 Small Cap	-14.11%	-18.94%	-16.81%	7.30%	7.21%	10.50%
MSCI AC World ex. U.S.	-13.73%	-18.42%	-19.42%	1.35%	2.50%	3.37%
MSCI EAFE	-14.51%	-19.57%	-17.77%	1.07%	2.20%	3.81%
MSCI Emerging Markets	-11.45%	-17.63%	-25.28%	0.57%	2.18%	1.67%
Fixed Income	-4.10%	-9.32%	-9.25%	-0.56%	1.03%	1.50%
Bloomberg US Agg Bond	-4.69%	-10.35%	-10.29%	-0.93%	0.88%	1.52%
Real Return Assets	-3.93%	-5.59%	-2.42%	0.08%	2.25%	-0.24%
Real Return Blended Benchmark ²	-3.42%	-5.11%	-2.03%	-0.88%	1.54%	-1.31%
CPI	2.65%	5.43%	9.00%	4.97%	3.88%	2.62%
Total Portfolio	-11.55%	-15.68%	-12.21%	4.51%	5.25%	6.34%

Total portfolio performance is net of fees. Performance returns for periods greater than twelve months are annualized.

¹Equity Blended Benchmark is currently comprised of: 70% Russell 3000 / 30% MSCI ACW ex. U.S.

²As of 06/30/2020 the Real Return Blended Benchmark is comprised of: 100% Bloomberg Barclays TIPS.



Fund Detail

Communis Fund of the Diocese of Rochester

As of 6/30/2022

	Expense Ratio	Category Average Expense Ratio	TRAILING RETURNS					
			Quarter	YTD	1-Year	3-Year	5-Year	10-Year
Equities								
Vanguard Institutional Index I (VINIX)	0.04	0.80	-16.11	-19.97	-10.65	10.58	11.28	12.93
S&P 500 TR USD			-16.10	-19.96	-10.62	10.60	11.31	12.96
iShares Core S&P 500 ETF (IVV)	0.03	0.80	-16.11	-19.97	-10.64	10.57	11.27	12.91
S&P 500 TR USD			-16.10	-19.96	-10.62	10.60	11.31	12.96
SPDR® Portfolio S&P 500 Value ETF (SPYV)	0.04	0.91	-11.25	-11.40	-4.87	8.23	8.16	10.85
S&P 500 Value TR USD			-11.27	-11.41	-4.86	8.23	8.19	10.97
iShares Core S&P Mid-Cap ETF (IJH)	0.05	0.94	-15.42	-19.56	-14.70	6.81	6.97	10.83
S&P MidCap 400 TR			-15.42	-19.54	-14.64	6.87	7.02	10.90
SPDR® S&P 400 Mid Cap Value ETF (MDYV)	0.15	0.98	-13.49	-14.04	-8.73	7.83	6.99	10.79
S&P MidCap 400 Value TR USD			-13.49	-14.01	-8.64	7.93	7.09	10.97
iShares Core S&P Small-Cap ETF (IJR)	0.06	0.98	-14.13	-18.98	-16.90	7.24	7.17	11.23
S&P SmallCap 600 TR USD			-14.11	-18.94	-16.81	7.30	7.20	11.26
Bridgeway Ultra-Small Company Market (BRSIX)	0.79	1.15	-17.33	-20.78	-30.38	8.10	4.85	9.24
Russell Micro Cap			-18.96	-25.11	-30.73	5.05	4.55	9.04

Fund Detail

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As of 6/30/2022

	Expense Ratio	Category Average Expense Ratio	TRAILING RETURNS					
			Quarter	YTD	1-Year	3-Year	5-Year	10-Year
Equities								
iShares Core MSCI EAFE ETF (IEFA)	0.07	0.93	-13.58	-19.77	-18.19	1.41	2.42	-
MSCI EAFE IMI NR USD			-15.00	-20.37	-18.75	1.06	2.12	5.61
iShares MSCI EAFE Value ETF (EFV)	0.35	0.99	-10.98	-11.52	-11.45	0.28	0.53	4.13
MSCI EAFE Value NR USD			-12.41	-12.12	-11.95	0.18	0.52	4.25
DFA International Small Company I (DFISX)	0.39	1.15	-15.01	-21.30	-19.77	2.80	1.93	6.97
MSCI World Ex USA Small Cap NR USD			-17.94	-23.87	-23.02	1.97	2.16	6.70
iShares Core MSCI Emerging Markets ETF (IEMG)	0.09	1.17	-10.84	-17.34	-24.44	1.20	2.40	-
MSCI EM IMI NR USD			-12.10	-17.94	-24.75	1.15	2.33	3.20
DFA Emerging Markets Value I (DFEVX)	0.45	1.17	-10.72	-10.25	-12.88	1.88	2.66	3.24
MSCI EM Value			-10.83	-13.89	-18.59	-0.97	1.25	1.46

Fund Detail

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	Expense Ratio	Category Average Expense Ratio	TRAILING RETURNS					
			Quarter	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income								
Vanguard Total Bond Market Index I (VBTIX)	0.04	0.59	-4.71	-10.41	-10.39	-0.92	0.86	1.50
Bloomberg US Agg Float Adj TR USD			-4.73	-10.46	-10.38	-0.91	0.90	1.56
Schwab Short-Term US Treasury ETF™ (SCHO)	0.03	0.67	-0.52	-3.00	-3.54	0.13	0.85	0.70
Bloomberg US Treasury 1-3 Yr			-0.52	-3.01	-3.51	0.18	0.90	0.77
Vanguard Short-Term Corp Bd Idx I (VSTBX)	0.05	0.67	-1.95	-5.58	-6.15	0.28	1.41	1.89
Bloomberg USD Corp Bd 1-5 Yr TR USD			-1.94	-5.60	-6.14	0.38	1.49	2.00
Real Return Assets								
Vanguard Inflation-Protected Secs I (VIPIX)	0.07	0.59	-5.98	-8.59	-4.98	3.05	3.15	1.69
Bloomberg US Treasury US TIPS TR USD			-6.08	-8.92	-5.14	3.04	3.21	1.73
Vanguard Shrt-Term Infl-Prot Sec Idx Ins (VTSPX)	0.04	0.59	-1.13	-1.42	0.99	3.41	2.95	-
Bloomberg US TIPS 0-5 Year TR USD			-1.10	-1.40	1.06	3.46	2.99	1.65

Portfolio Holdings

Communis Fund of the Diocese of Rochester

As of 6/30/2022

Security	Symbol	Quantity	Unit Cost (\$)	Total Cost (\$)	Price (\$)	Value (\$)	Percent of Portfolio
Cash							
SWEEP ASSET	CASH:SWEEP	437,245.39	1.00	437,245.39	1.00	437,245.39	0.16%
DREYFUS INST PFD TREAS HAMIL 466	99VVCCW71	2,433,697.38	1.00	2,433,697.38	1.00	2,433,697.38	0.90%
TOTAL				2,870,942.77		2,870,942.77	1.06%
Equity							
ISHARES CORE S&P MID-CAP ETF	IJH	74,375.00	125.37	9,324,212.81	226.23	16,825,856.25	6.21%
ISHARES CORE S&P SMALL-CAP ETF	IJR	122,600.00	47.15	5,781,011.24	92.41	11,329,466.00	4.18%
ISHARES CORE S&P 500	IVV	119,250.00	221.35	26,396,210.64	379.15	45,213,637.50	16.68%
DFA EMERGING MARKETS VALUE	DFEVX	224,334.78	25.43	5,705,581.55	27.64	6,200,613.29	2.29%
BRIDGEWAY ULTRA-SMALL COMPANY MARKET	BRSIX	350,036.95	12.20	4,269,795.90	10.83	3,790,900.15	1.40%
SPDR S&P 500 VALUE ETF	SPYV	265,350.00	27.77	7,369,579.60	36.82	9,770,187.00	3.60%
DFA INTL SMALL COMPANY INSTL	DFISX	345,862.46	17.48	6,044,827.05	17.04	5,893,496.30	2.17%
VANGUARD INSTITUTIONAL INDEX I	VINIX	121,556.59	137.07	16,661,762.10	320.61	38,972,258.96	14.38%
ISHARES MSCI EAFE VALUE	EFV	125,150.00	42.85	5,362,608.88	43.40	5,431,510.00	2.00%
SPDR S&P 400 MID CAP VALUE	MDYV	93,700.00	47.40	4,441,264.00	60.50	5,668,850.00	2.09%
ISHARES CORE MSCI EMERGING MARKETS	IEMG	244,725.00	48.86	11,958,482.55	49.06	12,006,208.50	4.43%
ISHARES CORE MSCI EAFE	IEFA	425,750.00	55.31	23,547,821.48	58.85	25,055,387.50	9.24%
TOTAL				126,863,157.80		186,158,371.45	68.67%



Portfolio Holdings

Communis Fund of the Diocese of Rochester

As of 6/30/2022

Security	Symbol	Quantity	Unit Cost (\$)	Total Cost (\$)	Price (\$)	Value (\$)	Percent of Portfolio
Fixed Income							
VANGUARD TOTAL BOND MARKET INDEX I	VBTIX	5,231,735.08	10.96	57,331,471.10	9.91	51,846,494.65	19.13%
SCHWAB SHORT-TERM US TREASURY	SCHO	146,500.00	50.96	7,466,085.00	49.19	7,206,335.00	2.66%
VANGUARD SHORT-TERM CORP BOND INDEX INSTL	VSTBX	277,703.08	27.12	7,530,419.99	25.37	7,045,327.19	2.60%
TOTAL				72,327,976.09		66,098,156.84	24.38%
Real Return							
VANGUARD INFLATION PROTECTED SEC INSTL	VIPIX	899,282.55	10.86	9,768,528.30	10.22	9,190,667.70	3.39%
VANGUARD SHORT-TERM INFLATION PROTECTED SECS INDEX INSTL	VTSPX	272,357.98	24.88	6,776,690.86	24.81	6,757,201.43	2.49%
TOTAL				16,545,219.16		15,947,869.13	5.88%
GRAND TOTAL				218,607,295.82		271,075,340.19	100.00%



Exhibit A - Investment Policy Statement

The Communis Fund of the Diocese of Rochester, Inc. Investment Policy Statement

I. PHILOSOPHY

The Communis Fund of the Diocese of Rochester, Inc. (“Communis”) is a New York not-for-profit corporation organized exclusively for religious, charitable or educational purposes and not for pecuniary or financial gain. Under the direction of a Board of Directors (the “Board”) elected by the Diocesan Bishop, the Vicar General and the Chancellor of the Diocese of Rochester as Members, Communis receives funds from the Diocese, and its parishes, schools, institutions and organizations for investment. In addition, Communis receives funds from the Diocese of Rochester Priests’ Retirement Plan Trust and the Diocese of Rochester Lay Employees’ Retirement Accumulation Plan Trust for investment. The Diocese, in conjunction with the record keeper and trustee, The Bank of New York Mellon, maintains an accounting system to segregate funds by participant.

The assets held by Communis support an ever-broadening array of activities that assure the Diocese’s future mission. The Communis Board of Directors, ever mindful of their stewardship, have caused this statement to be prepared as a policy framework for a disciplined process that seeks to add value and minimize risk for the Diocese as well as those who benefit from these assets.

The principal reason for developing a long-term Investment Policy and for putting it in writing is to protect against ad hoc revisions to the long-term investment strategy. The written Investment Policy will help maintain a long-term perspective when short-term market movements may be distressing and emotional reactions are most apt to occur.

II. ROLES AND RESPONSIBILITIES

Board

The Board of Directors of Communis are elected by the members of the Communis Corporation: the Bishop, the Vicar General and the Chancellor of the Diocese of Rochester. The Board is responsible for this Investment Policy and for the management of the business and affairs of Communis. The Board oversees the operations of Communis including selection of service providers.

Investment Advisors

The Board shall select one or more independent Investment Advisors (the “Advisors”) to manage the investment assets of Communis. The Advisors have ultimate fiduciary responsibility for the Communis assets. The Advisors will manage the assets on a discretionary basis within the parameters of this Investment Policy. The Advisors will periodically reviews investment performance with the Board and ensures compliance with the Investment Policy. The Advisors should also periodically review the propriety of this Investment Policy considering the investment needs of Communis.

Recordkeeper

Currently, The Bank of New York Mellon serves as the record keeper of the individual participant's balance.

Custodian

Currently, The Bank of New York Mellon serves as Custodian of the funds invested in Communis.

III. SPENDING GUIDELINES**Spending and Spending Limitations****Endowment/Quasi-endowment Funds**

The amount of endowment return available for current spending (distribution) during the fiscal year is to be determined on the basis of the market value as of the preceding December 31st. Based on the long term duration and preservation of the endowment funds or principal, the purposes of the Diocesan Organizations and their endowment funds, general economic conditions, the possible effects of deflation or inflation, the expected total return from income and the appreciation of investments, other resources of the Diocesan Organizations, alternatives to expenditure of the endowment funds where appropriate and circumstances would otherwise warrant, and the investment policies of the Diocesan Organizations, the distribution is not to exceed 5.0 percent of the average market value for the last 20 quarters unless otherwise approved by the Bishop's Stewardship Council of the Diocese of Rochester.

Retirement Funds

Distributions from the retirement funds will be used to pay retirement benefits and other expenses as required.

IV. INVESTMENT OBJECTIVES**Time Horizon & Risk Tolerance**

The investment objectives are based upon a very long-term investment horizon, so interim fluctuations should be viewed from that perspective. Similarly, the asset allocation approach is based on this same perspective. Risk is inherent in all forms of investment, and in particular, the types of long-term assets in Communis will be susceptible to capital risk. The time horizon of Communis gives it the ability to ride out considerable fluctuations in value, but stops short of the risk level associated with full investment in stocks on a constant basis.

Prioritization of Investment Objectives

- A. The primary objective is the pursuit of long-term capital growth, with a goal of meeting the long-term needs of Communis.

- B. The secondary objective is for the rate of investment return to exceed the rate of inflation over the long-term.
- C. A third objective, much lower in priority than the other two, will be moderation of portfolio volatility.

This Investment Policy is explicitly designed to encourage a long-term investment horizon. This means that the majority of the assets will be invested in long-term (i.e. higher risk and higher return) securities at virtually all times. Consequently the market value of the funds invested in Communis will be subject to material levels of short-term volatility. Further, the secondary objective establishes that these assets will primarily be stocks, with bonds and cash playing a minority role. However, there is still a role for bonds and cash, as there is a desire to dampen the more extreme swings of volatility associated with stocks, as reflected by the last objective.

V. INVESTMENT GUIDELINES

Types of Assets

The Advisors will act in a fiduciary manner consistent with the Investment Advisors Act of 1940. Holdings will be consistent with such standards, and the Communis portfolio must be diversified by allowing the Advisors the flexibility to invest in various types of assets. The following types of assets are among those approved for investment.

Equity Investments

Types

- Common Stocks
- Preferred Stocks
- Convertible Securities (including Debentures)
- Foreign Stocks, excluding direct foreign investments in emerging markets (Emerging market ADR's permitted)

Diversification

The equity portfolio should be well-diversified to avoid undue exposure to any single economic section, industry group or individual security. No more than 10% of total Communis assets at market at time of purchase shall be invested in the securities of any one issuer. No more than 30% of the total Communis assets at market at time of purchase shall be invested in any one industry. For the purpose of this Investment Policy, mutual funds and exchange traded funds shall not be considered the issuer of securities, but rather the diversification guideline will apply to the underlying securities of those funds as a percentage of the Communis assets.

Equity Allocation Limits

Equity investments are expected to comprise no more than 80% and no less than 30% of the total market value of the Communis assets at the time of purchase. These allocation parameters will become effective after the period of initial positioning of the Communis assets.

Fixed Income/Cash Investments

Types

- U. S. Government and Agency Securities (Bills, Notes and Bonds)
- Commercial paper
- Certificates of Deposit
- Corporate Bonds
- Master Notes
- Insurance Company Contracts
- Money Market Funds

Diversification

No limitations are placed on investments in U. S. Government guaranteed obligations (including any full guaranteed Federal Agency obligations). Investments in any one issuer (excluding direct or indirect obligations of the U.S. Government) shall not exceed 10% of total Communis assets at time of purchase. Fixed income holdings should not represent more than 10% of a total particular issue. For the purpose of this Investment Policy, mutual funds and exchange traded funds shall not be considered the issuer of securities, but rather the diversification guideline will apply to the underlying securities of those funds as a percentage of the Communis assets.

Fixed/Cash Allocation Limits

Fixed income and cash equivalent investments are expected to comprise no less than 20% and no more than 70% of the total market value of the Communis at the time of purchase. Fixed income investments will maintain an average credit quality, as defined by Standard and Poor's Investor Service, of "A" or better at all times. Any idle cash not invested by the Advisors shall be invested daily in interest bearing securities through an automatic sweep provided by the custodian.

Total Portfolio Guidelines

All assets selected for inclusion in Communis must have a readily ascertainable market value and must be generally considered marketable at time of purchase. The following types of assets or transactions are expressly prohibited (unless approved by the Board):

- Direct investment in Commodities and Futures
- Warrants
- Eurobonds
- Naked Option Transactions
- Margin Purchase of Securities
- Unregistered or Restricted Stock

- Investments classified as level 3 by the Financial Accounting Standards Board Statement Number 157 (FASB 157)
 - Private Placements or equity
 - 144a Securities
 - Hedge Funds
- Do not buy directly in companies identified as engaging in abortion activities, embryonic stem cell research and human cloning
- Do not buy directly in companies identified as having unacceptable involvement in pornography or producing contraceptives
- Do not buy directly in companies primarily engaged in military weapons production or anti-personnel landmines.

Summary of Allocation Limits (at time of purchase)

	<u>Maximum</u>	<u>Minimum</u>
Total Stocks (U.S. & Foreign)	80%	30%
Fixed Income (Bonds, Notes, & Cash)	70%	20%

VI. PERFORMANCE MEASUREMENT OF INVESTMENT OBJECTIVES

- A. The Board may hire Advisors on an evaluation of their investment philosophies and long-term performance. Advisors must adhere to their stated investment philosophies and goals.
- B. Investment performance results shall be monitored on a periodic basis, with a written quarterly report presented to the Board and evaluated in accordance with the following:
 - Return/downside protection trade-off vs. market indexes
 - Comparison against a peer group or market benchmark with similar long-term asset allocation levels
 - Long-term Treasury Bonds
 - The Consumer Price Index (Inflation)
- C. The Board recognizes that performance statistics only become meaningful over full market cycles, and thus will base performance evaluation on a market cycle analysis.
- D. The Advisors must advise the Board, in writing, of any material changes in the Advisor's organization, decision making structure, ownership, investment style, key personnel or any other significant change affecting the Advisor's relationship with the Communis assets along with a statement as to the anticipated impact on the Advisors ability to provide the same style and type of money management on a continuing basis, as required by the Investment Advisors Act of 1940.

MARKET COMMENTARY & OUTLOOK

Q2 2022

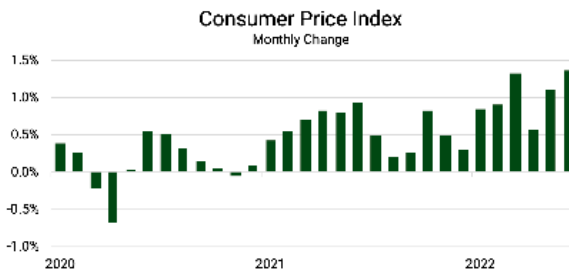
The first half of 2022 was very difficult for investors. Persistently higher inflation rates have solidified a need for increasingly restrictive monetary policy from the Federal Reserve, including significantly higher interest rates. These actions may be the medicine needed to treat inflation, but many investors fear they may come with a side effect of tipping the economy into a recession. As a result, pricing was sharply lowered across almost all major asset classes, including U.S. stocks, international stocks, low quality bonds, and even the safest bonds from the U.S. Treasury.

	2Q2022	YTD
S&P 500 Large Cap	-16.1%	-20.0%
S&P 500 Growth	-20.8%	-27.6%
S&P 500 Value	-11.3%	-11.4%
MSCI EAFE	-14.5%	-19.6%
MSCI Emerging Markets	-11.5%	-17.6%
Bloomberg Aggregate Bond	-4.7%	-10.4%
Bloomberg TIPS	-3.0%	-8.9%

Total returns. Source: Bloomberg

Inflation and Interest Rates

Contrary to expectations, the rate of price changes continued to climb in the second quarter instead of beginning to decline. The annual change in the Consumer Price Index (CPI) increased to 9.1% in June, the highest level since 1981.



Source: U.S. Bureau of Labor Statistics

Inflation began accelerating in 2021 due to a rapid increase in money supply from fiscal stimulus that boosted consumer demand, pandemic-related supply constraints, and escalating energy costs. Some of these issues appeared to be on the brink of dissipating by April, but price pressures have continued to build. The Omicron variant induced new supply chain issues (especially following broad-based lockdowns in China), the effects of the war in Ukraine impacted the availability of energy and food, and surging demand for workers increased labor costs and impacted business operations.

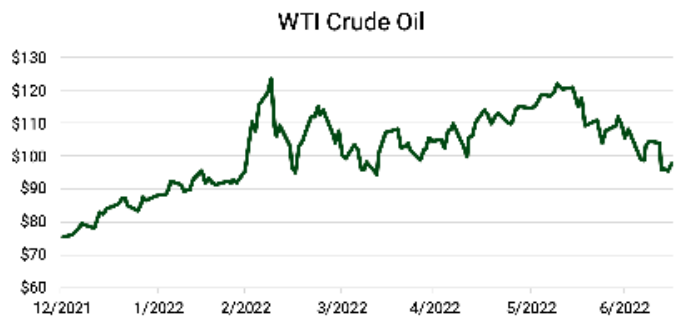
Inflation has been driven by a mix of components that could prove to be shorter-term along with other components that could be longer-lasting. The most variable factors are energy prices, which contributed 3.6% of the 9.1% CPI increase. Global energy supplies have been impacted by restricted availability of resources resulting from the Russia-Ukraine war. There has been a reluctance on the part of energy producers to make the long-term commitments needed to bring additional production online for what could be a temporary spike in prices. The cost of refining crude oil into end products such as gasoline and heating oil has also jumped due to a longstanding lack of capital investment in refineries as well as the absence of refined materials previously imported from Russia.

Although energy markets are encountering systemic challenges resulting from environmental policies and expectations for a changing composition of future energy sources, energy's impact on price levels may still be temporary. Energy prices tend to be very responsive to shifts in demand. As economic growth projections have been declining in recent weeks, energy prices have already been trending lower. The price for West Texas Intermediate crude oil has declined from \$122 per barrel on June 8 to \$102

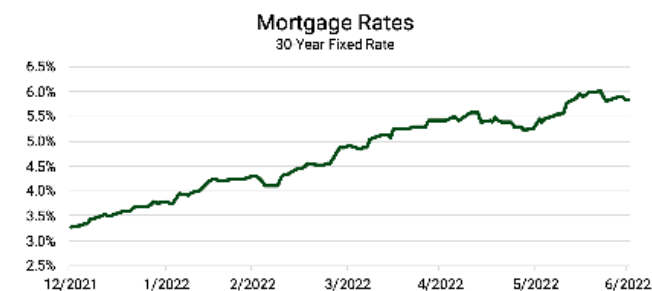
on July 20 and has returned to similar levels as those in February prior to Russia's invasion of Ukraine.

Prices for a broad range of commodities have been declining recently. The Bloomberg Commodity Index measures a variety of raw materials, including energy, metals, and agricultural products. The Index has fallen by 14% from June 9 through July 20. Of course, prices remain high following the surge earlier in the year, but this could be evidence of some relief. Similarly, shipping costs for cargo moving from Shanghai to Los Angeles remain extremely elevated but have come off their peak; current rates that are five times the average rate from 2019 actually appear favorable when compared to rates last fall that were eight times the average.

Meanwhile, some of the forces driving up inflation may not be so easily suppressed. The price of shelter has increased 5.6% in the most recent CPI calculation, contributing 1.8% to the overall inflation rate. Housing costs within CPI are not directly derived from the price of purchasing a home, but rather from rental rates or a statistic known as "owners' equivalent rent", which together comprise 32% of CPI. Rental costs are typically slower moving than housing prices due to the length of lease terms. Therefore, we will likely see continued increases in owners' equivalent rent as rental rates catch up with the 15% increase



Source: Bloomberg, WTI - West Texas Intermediate



Source: Bloomberg, Bankrate.com

in the median sale price for a single-family home over the past year. The rapid rise in mortgage rates (from 3.3% at the start of January 2022 to 5.8% at the end of June, according to Bankrate.com) is likely to prevent some households from purchasing homes, resulting in additional demand for renting, at least until home prices and rent prices can recalibrate again. There is evidence that higher mortgage rates are beginning to put pressure on the housing market; according to Redfin Corp, 15% of home purchase contracts in

June were canceled prior to closing.

Another significant influence on inflation has been wages. The extraordinary demand for workers and resulting labor shortages have placed a real strain on many employers. According to the most recent NFIB small business survey, more than half of all small business owners reported having job openings that could not be filled. This has caused increased competition for qualified workers and higher wages throughout the economy. According to the Federal Reserve Bank of Atlanta, average wage growth has continued to accelerate in recent months and increased at an annualized rate of 6.7% in the second quarter.

Interest Rates

The Federal Reserve is tasked with two principal objectives for monetary policy: achieving full employment and maintaining price stability. These priorities are often in conflict, and there is currently a severe imbalance, with unemployment extremely low and prices increasing rapidly. As a result, the

Federal Reserve became significantly more aggressive in responding to inflation during the second quarter.

One key tool the Fed uses to control inflation is higher interest rates. After raising short-term interest rates by 0.25% in the first quarter, the Fed moved much more quickly, with 1.25% of rate increases between April and June. Expectations are for an additional 1.9% in the second half of this year according to futures markets. In addition to changing short-term interest rates, the Fed has also taken steps to begin reducing the amount of bonds it owns. It purchased nearly \$5 trillion of bonds between March 2020 and March 2022 to hold down longer-term interest rates. Conversely, it is now reducing the amount of bonds it owns by \$47.5 billion per month, which is planned to increase to \$95 billion per month in September; this will be a continuing source of upward pressure on interest rates for the foreseeable future. By doing this forcefully, the Fed attempts to curtail demand throughout the economy. While this has negative implications for economic growth, the Fed is unwilling to allow high inflation to become entrenched for too long, even if that means risking a recession.

U.S. Consumers

Current economic data continue to reflect a very strong job market. U.S. employers added 372,000 new workers to their payrolls in June, significantly exceeding expectations and leaving the unemployment rate at an extremely low level of 3.6%. The “underemployment rate” (known as U-6), which measures unemployment plus those with part-time work who want full-time work, has declined to 6.7%, marking its lowest level ever since data began in 1994.

Despite strong job growth, signs of weakening demand are emerging, beginning with consumer spending. The sharp reduction in government transfers to households in 2021 and high levels of inflation have reduced consumer spending on an inflation-adjusted basis by 0.4% in the past twelve months through May. Maintaining spending has come at the expense of savings rates, which have declined to below average levels, as many households are experiencing financial pressure from higher food and energy prices.



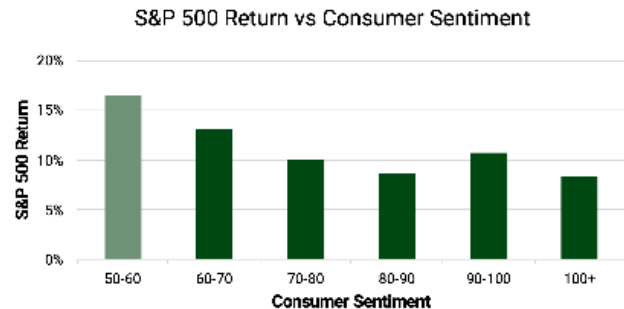
Source: Bloomberg

Expectations and Returns

Pessimism has become widespread among consumers, businesses, and investors. Consumer sentiment, as measured by the University of Michigan, is already at levels consistent with the depths typically experienced in severe recessions, including 2008 and 1980. Confidence among manufacturing companies has declined to levels last seen in the spring of 2020 according to the OECD (Organization for Economic Co-operation and Development). Investors are also showing concern according to surveys from AAI (American Association of Individual Investors), with the proportion of investors who are bearish outweighing those who are bullish by a 2:1 margin, which is rare even during extreme market events.

While this may at first be concerning, historical data indicate that pessimism has typically been a

positive signal for future stock market returns. Based on a survey from the University of Michigan, low levels of consumer sentiment have been correlated with higher returns for the S&P 500 over the subsequent twelve months. Meanwhile, the June 2022 sentiment reading was 50, marking the lowest level in the survey's history dating to 1978. There is no guarantee that investment returns will be high over the next year, and the coming months may feel uncomfortable, but history is on the investor's side in times like these.



Source: Bloomberg, University of Michigan; S&P 500 return is price return for next twelve months; data since 1978

Importantly, long-term investors should remain focused on valuations across capital markets. Although markets may be sensitive if upcoming earnings reports disappoint, lower asset prices have returned stock market valuations to normal levels, following several years of very high valuations. Additionally, pricing for smaller cap stocks, value-oriented stocks, and international stocks remain more attractive relative to their history than U.S. large cap growth stocks, and Alesco is maintaining investments in these areas. International stocks have also been negatively impacted by an unusually strong U.S. dollar. Any reversal in this trend could serve as a tailwind for future values of investments denominated in foreign currencies. Valuations in fixed income have also improved. High quality bonds are now yielding 3.7% on average, their highest since 2009 based on the Bloomberg Aggregate Bond Index. The combination of improved valuations in both stocks and bonds points to a clearer path for balanced portfolios to generate healthy rates of return going forward.

Capital markets have shown throughout history that the best investment opportunities lie in times of fear and uncertainty. There may still be difficulties ahead, but the market selloff has also resulted in investment prices that are more attractive now than in the past. We do not know what the catalyst will be for markets to turn around. It could be a reduction in inflation rates, a decline in the value of the U.S. dollar that would improve the trade balance, advancement towards peace in Ukraine, or something else entirely that is not at the forefront of investors' minds. Regardless of the reason, it is much easier to exceed expectations when markets are expecting the worst.

Warren Buffett famously offered the advice, "to be fearful when others are greedy and to be greedy only when others are fearful." Now is a time when others are fearful. Accordingly, we are closely monitoring portfolios and rebalancing into equities as appropriate in order to have a full allocation of stocks. This is in preparation for when the markets rebound and is the most predictable tool we have to ensure that your portfolio value recovers as quickly as possible.

In the meantime, we continue to monitor the pricing and prospects across market segments while maintaining a focus on a long-term strategy that aligns with your long-term investment goals. As always, we are grateful for the trust that you have placed in Alesco Advisors.

CONTACT US

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