FIRST QUARTER 2022

Matt's Market Update

IN THIS REPORT

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Market Review

Global equity markets suffered their largest quarterly declines since Q1 2020. Outside of commodity themed investments, positive returns were elusive during the incredibly volatile quarter. Three major concerns dominated the headlines in Q1 and will likely do so for the remainder of the year. First, the ongoing inflation problem, the outbreak of war in Ukraine and uncertainty over the Federal Reserve's plan for interest rate hikes this year. More on each issue below.

Breaking down U.S. stock performance for the quarter, large-caps outperformed small-caps with the S&P 500 index declining -4.6%, compared to a decline of -7.53% for the Russell 2000 index. Value strategies significantly outperformed Growth across all market caps. The average Large Value manager in the Morningstar peer group held up reasonably well for the quarter with only a -0.20% decline, but the average Large Growth manager registered a decline of -10.79%.

Rapidly rising interest rates and lofty valuations acted as the perfect recipe for technology stock declines. The NASDAQ index was the worst performer in Q1 with a decline of -9.10%.

While equity volatility garners most of the headlines, it's the fixed-income market that is currently in a historical bear market that may only get worse if the Fed follows through on their promise of multiple rate hikes this year. In fact, the current period represents the longest drawdown (number of months) in the history of the Bloomberg Barclays US Aggregate Bond Index, but not yet the largest price percentage decline.

The Fed finally raised their benchmark interest rate by 0.25% in March, but the bond market is expecting much more to come. In fact, expectations have shifted rapidly in Q1 to the point where most market participants are expecting 50 basis point rate hikes at the May and June Fed meetings.

BLOOMERG BARCLAYS US AGGREGATE: DRAWDOWNS >3% (MONTHLY, 1976 - 2022)

Start Month	End Month	# Months	Max Drawdown (Monthly)	New High Month	# of Months (Low to New High)
Aug-20	**Mar-22**	**20**	**-7.6%**	?	?
Aug-16	Nov-16	4	-3.3%	Aug-17	9
May-13	Aug-13	4	-3.7%	May-14	9
Apr-08	Oct-08	7	-3.8%	Dec-08	2
June-03	Jul-03	2	-3.6%	Dec-03	5
Feb-96	May-96	4	-3.2%	Oct-96	5
Feb-94	June-94	5	-5.1%	Feb-95	8
Mar-87	Sep-87	7	-4.9%	Dec-87	3
Feb-84	May-84	4	-4.9%	Jul-84	2
May-83	Jul-83	3	-3.5%	Sep-83	2
Jul-80	Sep-81	15	-9.0%	Nov-81	2
Aug-79	Feb-80	7	-12.7%	May-80	3

Source: @CharlieBilello, Powered by YCHARTS

The Big Three

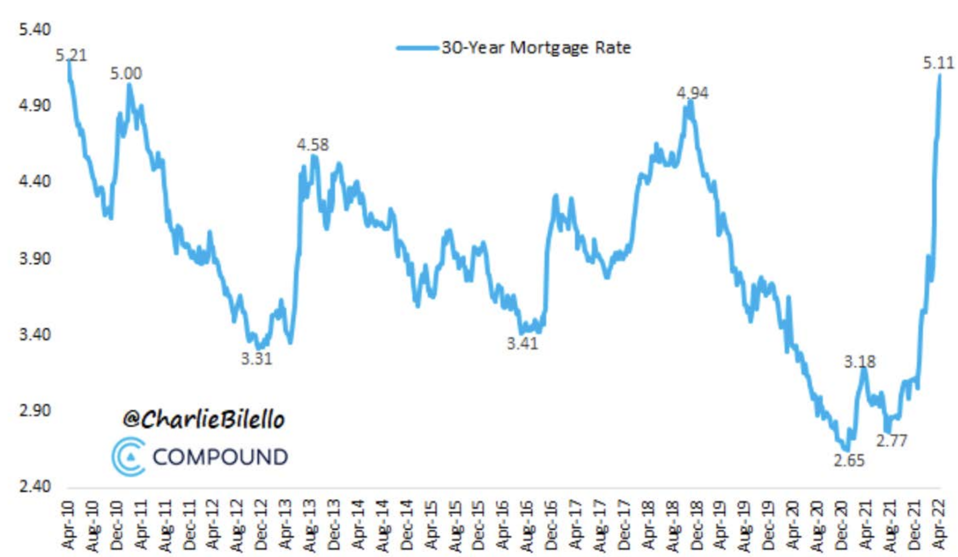
Three topics of discussion dominated the economic and market headlines during Q1.

1. Inflation. The March Consumer Price Index (CPI) registered a year-over-year gain of 8.5%, its highest level since December 1981. The largest 12-month price changes were registered in Fuel Oil (+70.1%), Gasoline (+48.0%) and Used Cars (+35.3%). There's an old saying that goes, "the cure for higher prices is higher prices". In other words, the high prices act as a deterrent for demand, thus supply eventually catches up and prices fall to more reasonable levels. This is also known as demand destruction. As these widespread price hikes across virtually every good and service take hold, economic growth will slow and eventually inflation recedes. One example of declining demand in the face of higher prices is in U.S. new home sales. Figures for March were recently released. While analysts were expecting a third straight monthly decline, they severely underestimated the severity of the downturn with sales off -8.6% compared to February and -12.6% on a year-over-year basis. This correlates to the year-to-date surge in the rates for traditional 30-Year fixed mortgages.

2. Russia / Ukraine. Needless to say, the humanitarian impact of the current war in Ukraine is devastating. Nothing supersedes this in importance. As the war drags on and other news events move to the front pages, it may be easy to forget the true economic impact that will result from the loss of production from Ukraine. Global food production and supply chains were already under great stress and the war has only added to these problems. Consider the following factoids we've sourced from Wikipedia and elsewhere regarding the Ukrainian economy. When you read the following (and there's so much more we haven't listed), it becomes clear that even with a near-term resolution to the war, the global economic impact will be felt for a considerable period of time.

- Ukraine is the second largest country in Europe based on total land, but number one in terms of arable land with a population over 41 million people.
- Ukraine ranks in the top ten in the world for exporting the following food items: corn (4th), wheat (8th), barley (4th), eggs (9th) and sunflower oil (1st).
- In terms of reserves of natural resources, Ukraine has the following ranks: iron ore (2nd), coal (7th), shale gas (3rd) and titanium (10th).
- In terms of other key miscellaneous contributions to the global supply chain, Ukraine globally ranks: steel production (10th), nuclear power plant capacity (8th) and natural gas pipeline infrastructure (4th).

30-YEAR FIXED MORTGAGE RATE (FREDDIE MAC) 2010-2022

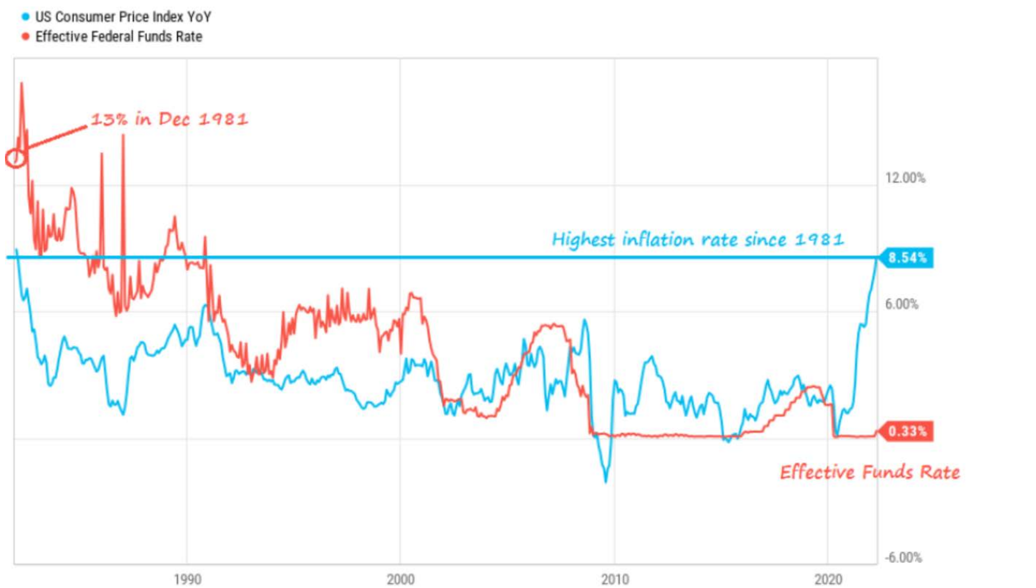


The 30-year mortgage rate in the US rises to 5.11%, its highest level since 2010. Last year it hit an all-time low of 2.65%. The 2% spike in mortgage rates over the last 16 weeks is the largest 16-week increase we've seen since 1980.

Source: @CharlieBilello, Powered by YCHARTS

3. The Fed. Many would say that the Fed is trapped or at a minimum between a rock and a hard place when it comes to setting interest rate policy going forward. Last year's narrative of "transitory" inflation has been replaced with the reality of rising prices across a wide spectrum of goods and services. While the war in Ukraine and the lingering impact of damaged supply chains from Covid are clearly contributors, the inflation problem is one mostly of the Fed's own creation. Excessive money printing over the years combined with poorly targeted pandemic relief programs last year have finally pushed CPI inflation numbers to levels previously unseen since the 1970's. The most vocal member of the Fed, St. Louis Fed President James Bullard, was quoted by CNBC as saying the Fed is "behind the curve" in a call for the Fed to act aggressively on raising interest rates. The definition of "behind the curve" is shown in the chart on this page which depicts the highest level of inflation since 1981, while interest rates remain effectively at zero. But the Fed has never hiked rates into such a volatile environment before – an overseas war, lingering pandemic, declining stock market and a slowing domestic economy. The choice really comes down to this: raise rates rapidly to fight inflation (and risk tipping the economy into recession) or take a more gradual approach to rate hikes and thus allow inflation to potentially rage higher for longer. For now, we're taking the Fed's word that they intend to be aggressive with rate hikes near-term. That being said, they've been known to lose their resolve for higher rates (ex. 2018) if financial markets suffer enough. At what level of downside pain for the markets does the Fed back off on their plans for aggressively higher rates?

"BEHIND THE CURVE"



Source: @CharlieBilello, Powered by YCHARTS, Apr. 12, 2022

Wealth Management Corner

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When I was growing up, I remember my mom sitting at a table and balancing her checkbook. Yes, that's right. Physically balancing her checkbook with an old calculator. She still does it and says it keeps her mind sharp and finances in check. I also remember going to my dad's work. He was a comptroller for a division of a sizable tape company at the time. Part of my excitement was to sit at his desk, pretend I was him and push the buttons of his oversized calculator as fast as I could. Ah, memories.

Fast forward to today and even though I don't physically balance my checkbook (don't tell my mom), I am in the numbers business. I did take accounting in high school. Didn't like it too much but I liked it better than a lot of other courses. Luckily, I did well in the class and think it had an impact on how I started to envision my future career. I knew I didn't want to be an accountant yet part of the class was talking about important personal finance topics like buying a car, credit card debt, paying for college and everyone's favorite topic, taxes.

Many years removed from high school, I recently saw an article in the NY Post titled "Florida to require high school financial literacy class." This got me thinking. How after all these years can we just be talking about this as a requirement? Keep in mind that this is not an op-ed on the public education system, or private education for that matter. This is an alarm bell for our country. I may be biased, yet I literally cannot think of a more relevant topic to get our children ready for life in the big wide world. How many of us know children that need help in this area? I do and I'm sure you do too.

Researching further, there are currently only 10 of our states that require a standalone personal finance course, while another 13 have some of the topic integrated into another course. This really needs to change. Per the National Student Clearinghouse Research Center High School Benchmarks report dated December 1, 2021, "in fall 2020, higher-income high school graduates were still far more likely to enroll in college immediately than those from low-income schools (65% and 49%, respectively)." Looking at these numbers tells us that somewhere between 35 and 51% of our high school graduates are not going to college right away.

How are these young adults going to face life's fiscal challenges without learning how to handle them? Parents are certainly the frontline on this education, yet schools are also part of the team.

There are real world challenges in our financial system that do not appear to favor the financially illiterate. It is our responsibility as parents and citizens to help prepare our children for a successful financial future. Without them, we have no future. We can all help. If your local high school and state don't require this education, it is time to make that change.

Our Portfolio Strategy & Allocation Outlook

The first quarter was one of those rare times where nothing seemed to work. Of course, a few niche areas like gold and energy were certainly helpful, but these asset classes are typically small in portfolios. Despite the lack of yield, cash proved beneficial as a source of dry powder to take advantage of lower prices as they materialize. We've had several conversations with plan sponsors and individual wealth management clients over the past quarter. Here are some of our latest thoughts on positioning within fixed-income and equity.

We've been positioned in short duration bonds, which has helped on a relative basis vs. broad benchmarks, but it hasn't prevented drawdowns. The market's reaction to the threat of higher interest rates has been extremely fast. The bond market has re-priced lower in the face of extraordinary inflation and the very real threat of a hostile Fed. While we continue to think inflation will be an ongoing issue, we also think the rate of change higher will begin to slow and even peak out this year. The time to rapidly reduce exposure to bonds has passed in our opinion (specific to high quality issues…..we would still avoid the high yield sector). Pessimism in the bond market has rarely been higher and this is a good thing as it typically means the worst of the selling is over with. We don't recommend major changes at this point to your long-term bond allocations, unless you're trying to lower duration or increase credit quality. As the impact of higher interest rates and lower demand weighs on the economy, bond prices should start to recover. For individuals outside of retirement plans, we like the traditional bond ladder strategy. Owning high quality bonds (or bond ETFs) and holding them until maturity at various points in the future is a technique that can reduce the interest rate risk of a bond allocation.

Recent trends in the market are likely to persist. Namely, U.S. stocks outperforming foreign stocks, large-caps beating small-caps and Value over Growth. Within a broadly diversified equity portfolio, we think these tilts still make sense. Specific to the emerging market sector, the Russia / Ukraine war, the strong dollar and slowing growth out of China are strong headwinds for investors near-term. We still believe in an allocation to emerging markets, but it's far too soon to be overweight the sector.

It's worth repeating our message from the last quarterly update. U.S. equities finished 2021 with well-above average long-term returns that were likely to moderate for any number of reasons. Those reasons have come knocking in Q1. Dollar cost averaging with your new investments is a great strategy in this market as opposed to trying to pick a bottom for stocks. Resist the urge to market time. One theme we continue to like is the high quality dividend payers. Blue chip companies with the best balance sheets and market positions, can withstand inflation and still reward shareholders with dividends and stock buybacks. Stick with quality for your equity allocations.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

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Market Scoreboard

Index Returns (%)	Q1 2022	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	-4.60	-4.60	15.65	18.92	15.99	14.64
DJIA	-4.10	-4.10	7.11	12.57	13.40	12.78
NASDAQ	-9.10	-9.10	7.35	22.53	19.19	16.49
Russell 2000	-7.53	-7.53	-5.79	11.74	9.75	11.04
MSCI ACWI Ex USA	-5.44	-5.44	-1.48	7.51	6.76	5.55
Barclays Aggregate Bond	-5.93	-5.93	-4.15	1.69	2.14	2.24

Source: Morningstar
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Diversification and asset allocation do not ensure a profit or protect against loss.

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

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Date of First Use: 5/1/2022 QMR-103-01252022

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