CHOATE
INVESTMENT
ADVISORS

2022 Q1 REVIEW

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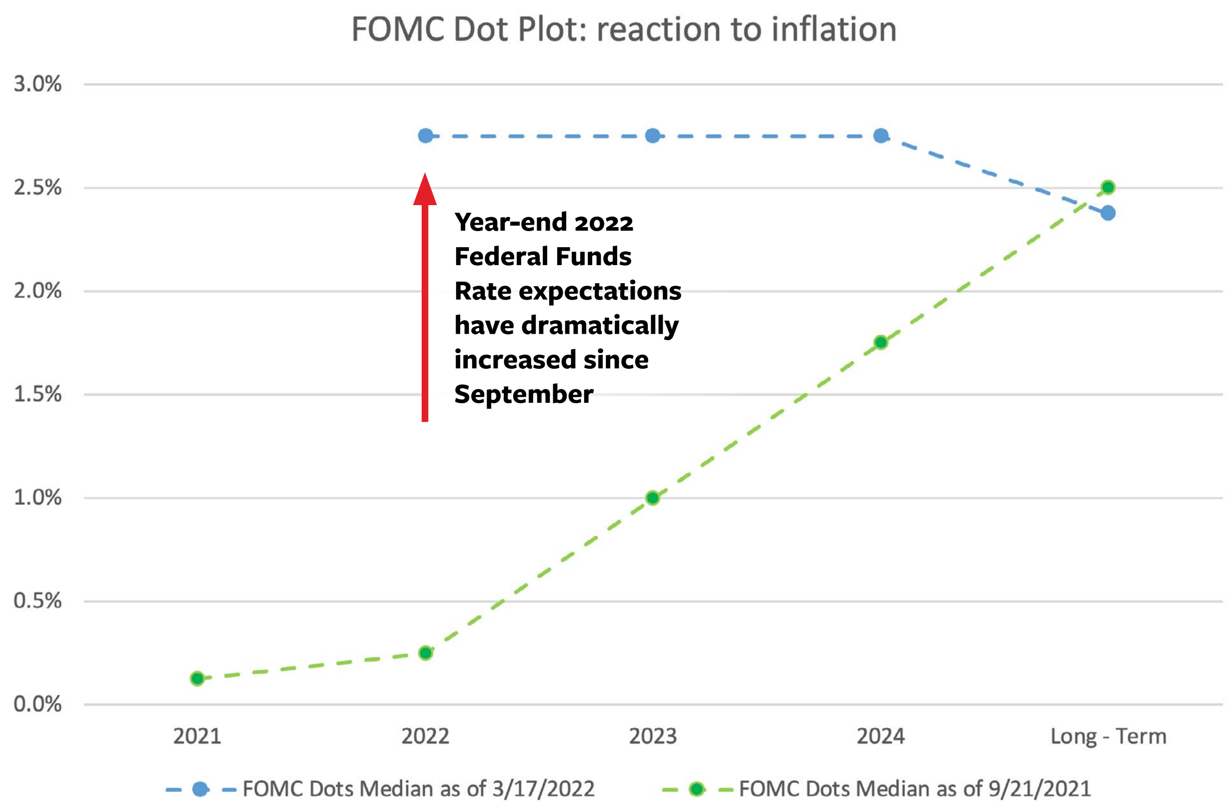
2022 First Quarter Review

The economic world has changed dramatically over the past several months. First, persistent inflation forced central banks to raise interest rates and sent interest rate forecasts higher. Then, the war in Ukraine created additional strain on the global economy and commodity markets, further pressuring inflation. The Federal Reserve scrambled to keep up and telegraphed a dramatic shift in interest rate policy. In response, the ChoateIA team has shifted some of our investments in an effort to mitigate the impact of these changes.

Federal Reserve "dot plot" with median year-end forecast for the Fed Funds rate:



Source: Bloomberg

In September 2021 the Open Market Committee ("FOMC") forecasted a 2022 year-end rate of 0.3%, but last month the forecast increased to 2.7%. Moreover, the September 2021, forecast mentioned only one possible rate hike, but that has recently changed to an expectation of over eight rate hikes by the end of 2022. These changes in expectation prompted a volatile and disappointing quarter for investors, as both bond and stock prices declined. The surge in interest rates led to a significant decline of 5.9% in the Bloomberg Aggregate Bond Index. Stocks were also affected by uncertainty stemming from the conflict in Ukraine. The S&P declined 5.0% and the MSCI All Country World Index declined 5.4%. In addition, there was significant dispersion within equity markets. The Russell 1000 Value Index was down 0.7%, while the Russell 1000 Growth Index was down 9.0% and the Quality Index was down 7.2%.

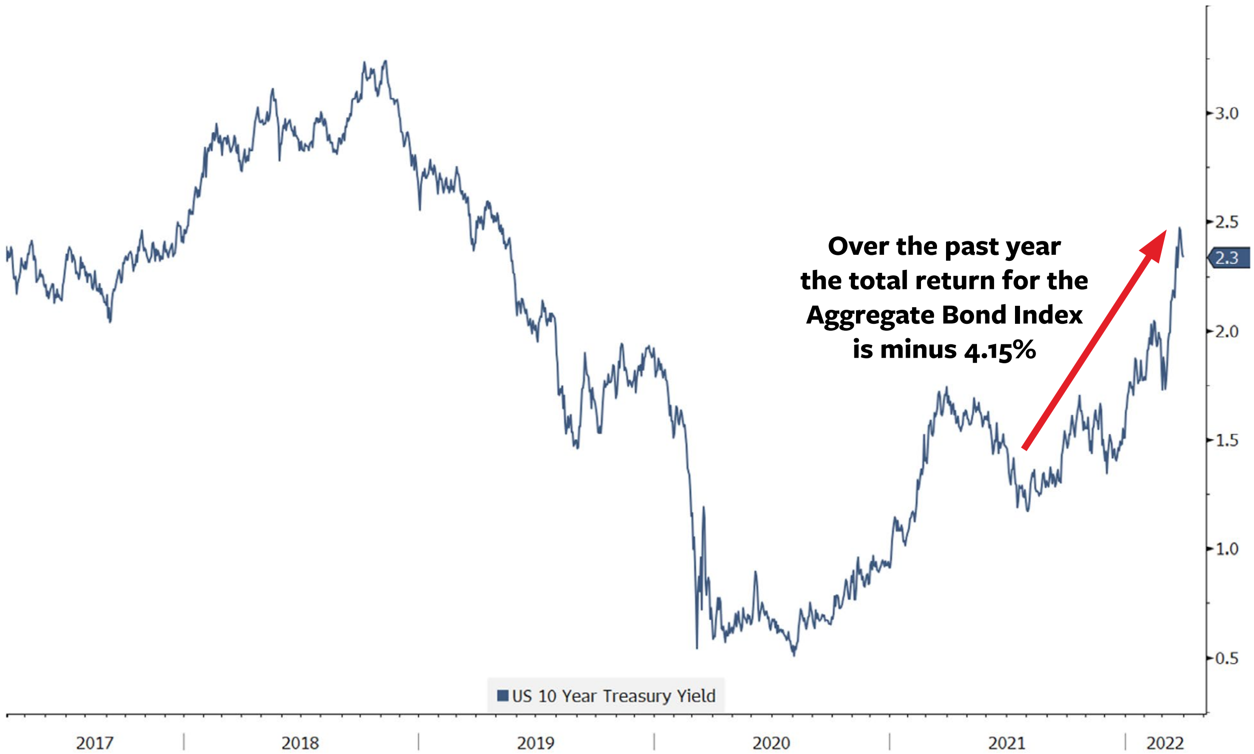
As we have discussed in the past, ChoateIA invests for long-term appreciation. We favor companies that we believe will be "resilient" because they have both "growth" and "quality" characteristics. We are disappointed that most of our stock fund managers underperformed their respective benchmarks in the first quarter. Within fixed income, we have adjusted our allocation to shorter maturity securities, lessening our investment in longer maturities. This decision mitigated some of the impact of higher bond yields, and most of our bond funds performed well against the Bloomberg Aggregate Bond Index. In summary, this was a difficult quarter. However, we continue to anticipate that the companies we recommend will grow profitably over time. We do not expect a quick rebound in overall stock prices, although we do hope to see upward movement in the relative price of our holdings.

In a prior update, we outlined what we look for in the companies we seek out for investment, noting that we particularly look for the following long-term characteristics:

1. **Financial Strength.** Companies with significant recurring revenues, high returns on capital, and low financial leverage are better positioned to ride out a crisis.
2. **Unique Product.** Companies with unique product offerings have stronger market position.
3. **Secular Tailwinds.** Companies benefiting from long-term economic trends have an advantage.

In the first quarter of 2022, many of our portfolio companies experienced poor stock performance. Market prices decreased in general, and the prices of these stocks went down in particular. Valuation became quite stretched in late 2021, resulting in stock prices becoming vulnerable to changes in market outlook. Rising inflation prompted a significant upward shift in interest rates and, as a result, investors discounted the future value of growth-oriented companies.

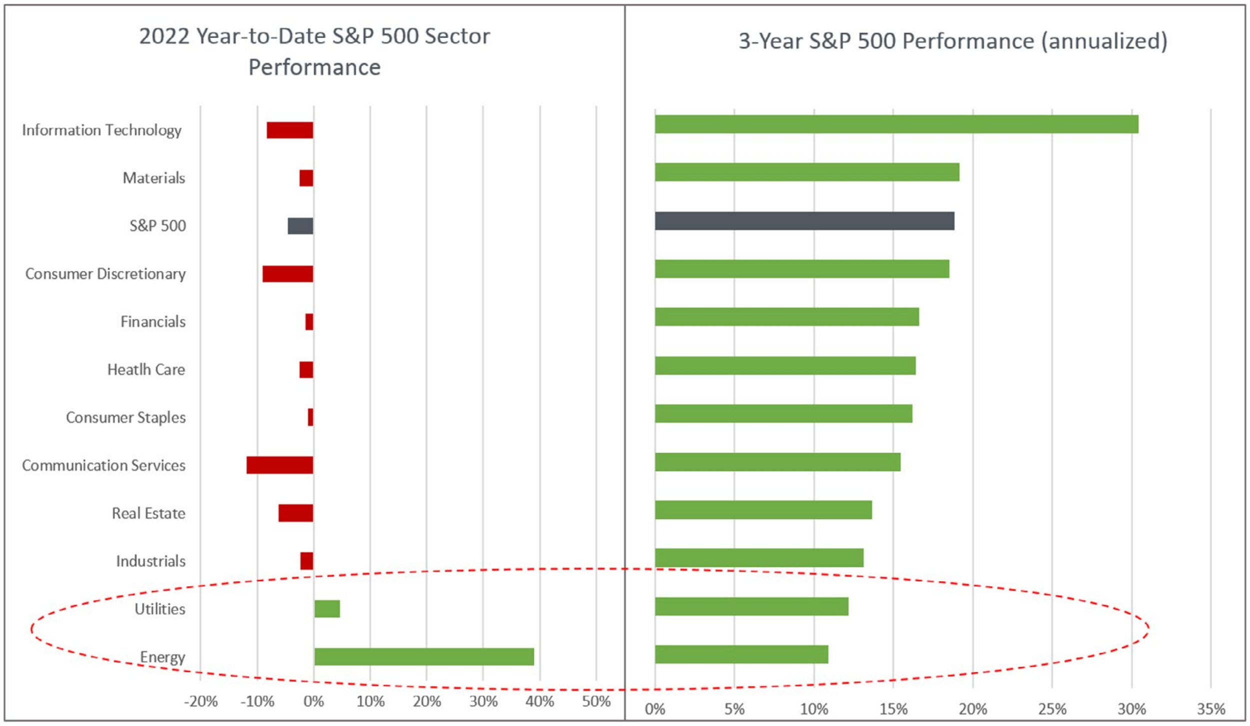
10-year US Treasury yields surged in early 2022, affecting bond prices as well as stocks:



Source: Bloomberg. Data as of 03/31/2022.

Many of these changes occurred in January, as investors sought to move away from growth technology companies and into more cyclical companies (at lower valuations), such as banks and commodity companies. In February and March, the war in Ukraine then pushed commodity prices even higher, further encouraging this rotation.

Despite the positive performance of energy stocks in Q1, the energy sector was still the worst performing sector over the past three years. ChoateIA strategies remain underweight in the energy sector.



Source: Bloomberg. Figures as of 03/31/2022.

It is important to emphasize that although stock prices have been declining during this quarter, most of our holdings posted strong earnings. In fact, the companies in our portfolios continue to have higher returns on equity (ROE) and higher earnings growth than the market at large. In our view, return on equity is an important metric because it measures the profit efficiency return for every dollar the equity owners have invested in the firm.

Currently, according to the figures available in Factset, an aggregate of the companies in our US managers' portfolios have a 26% return on equity (better than the S&P figure of 21%) and an expected future earnings growth of 17% per year (better than the S&P figure of 13%). In short, the companies our managers own continue to grow more rapidly and more profitably than those in the market as a whole. If this trend continues, we should expect these companies' stock prices will eventually recover, as a small advantage in growth rate or profitability compounds over time. We continue to assess the shifting market conditions, but we see no need to change our investment philosophy and we continue to focus our investing on long-term horizons.

In response to the current situation, however, we have taken several steps to shift portfolios.

1. We sold our small cap growth position, except in our most aggressive portfolios. The fund that we had been holding included several investments in fast growing but currently unprofitable companies. With interest rates rising and economic growth facing more headwinds, these types of companies remain vulnerable to further downward pressure. We first trimmed in early Q4 2021 and completed the sale in January.
2. In response to the war in Ukraine, we reduced our international holdings. We do not know the extent nor the long term impact of the conflict. However, we do expect that 1.) the impact will be a negative for the global economy, and 2.) European economies are more affected than the US economy, due to their reliance on Russian energy and closer trade links with Russia.
3. We invested these proceeds in short term US bonds, as well as large US companies. Thus, ChoateIA portfolios now own fewer equities than they did in December, and are now more overweight in large US companies.

We expect equity returns to be closely linked to future company earnings, and we are in regular contact with our managers. In addition, we also track our underlying stockholdings to gain a "bottom up" perspective.

The global economic situation remains very fluid and overall uncertainty is very high. The US domestic economy is also beset by many cross-currents: job growth is strong, unemployment is low, and household and corporate balance sheets remain strong; yet, inflation is high, some supply chain issues continue, and mortgage rates have surged. Anecdotally, we also see evidence of consumers changing behavior in response to high gas prices. The Federal Reserve is determined to increase interest rates in order to curtail inflation. We expect that we may need to adapt yet again to changing circumstances, and we will always seek to be tax efficient while fixing our eye on improving long-term appreciation.

Please contact us if you have any questions. And just in case you missed it, we sent the following updates and podcast in Q1 in an effort to keep you informed of our latest thinking and positioning throughout this turbulent period:

ChoateIA Podcast: Economic Impact of Russia-Ukraine Conflict

2022 March Market Update

2022 February Market Update

For more information

Choate Investment Advisors offers objective, independent, institutional-quality investment management tailored to the needs of each client.

Choate Investment Advisors offers comprehensive, integrated wealth management to high net worth individuals and families, providing a range of well-diversified investment strategies across the risk spectrum. Our open-architecture approach and substantial assets allow us to select from a wide array of asset classes and to work with the highest quality investment vehicles. As a subsidiary of Choate Hall & Stewart, our clients receive world-class estate tax planning and other family office services.

If you have any questions, please contact your Choate Investment Advisors team.

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