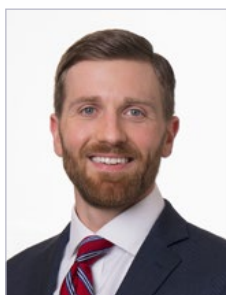


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Baird Trust Market Commentary

Investing in Uncertain Times



John C. Watkins III, CFA®

Senior Vice President
Equity Portfolio Manager

"We underrate the unpredictability of the future, because we overrate the inevitability of the past."

— Marc Andreessen, Co-Founder of
VC firm Andreessen Horowitz

Today's investment environment feels more uncertain than ever. Inflation is surging, interest rates are rising, there's a war in Europe, commodity prices are climbing rapidly, and stock volatility has returned. Even though the future is always uncertain, there

are times when the range of future outcomes seems wider than normal. Elevated uncertainty often leaves investors confused and uneasy about their portfolios.

While there are many contributing factors, we believe there are two key drivers of today's uncertainty. First, the Federal Reserve (Fed) is at the beginning of a radical policy shift to tackle rising inflation. Second, Russia's invasion of Ukraine introduced substantial geopolitical upheaval after a long period of relative calm.

The End of an Era

The past 15 years were characterized by highly accommodative monetary policy from the Fed – quantitative easing (QE) and near-zero interest rates. In fact, the Fed Funds rate was below 1% for 71% of this 15-year period (128 out of 180 months) and was above 1% and rising only 11% of the time (19 months). Additionally, the Fed's aggressive bond purchasing through QE expanded its balance sheet 10-fold from \$900 billion in 2007 to

nearly \$9 trillion today. This period of accommodative policy began with the onset of the 2008/2009 Global Financial Crisis and, aside from a brief period in 2017/2018, continued through the COVID-19 pandemic.

Low rates act as an accelerant to business activity as consumers and businesses can borrow cheaply and refinance existing debt at a lower cost. Low rates also boost stock prices. They make bonds less attractive, encouraging money to shift from bonds to stocks. And they allow businesses to be valued more richly because the present value of future cash flow is worth more when rates are low. Low rates are not the only reason for the strong performance of the stock market since 2008, but they provided a helpful tailwind.

However, with inflation at a 40-year high and moving higher, the future path of Fed policy is likely to look very different than that of the past 15 years. The Fed recently indicated it would "do whatever it takes" to combat inflation, which means higher interest rates, perhaps materially, and the withdrawal of QE. The tailwinds many investors became accustomed to since 2008 are likely to reverse going forward, creating potential headwinds to business activity and stock prices.

War in Europe

In addition to the shifting monetary policy environment, the geopolitical environment is becoming more complicated. This marks a significant shift from the relative global stability and increasing globalization of the past 15+ years, which ended emphatically with the Russian invasion of Ukraine.

This conflict, combined with COVID-19 driven supply chain disruptions, laid bare the downsides of too much globalization. Because of this, many countries are reevaluating the economic and national security impacts of global interdependence, and

we may be entering a period of de-globalization. It is impossible to predict what the impacts will be, but the next decade will likely see companies bringing production closer to home.

Furthermore, the invasion exacerbated the domestic inflation issues as energy and commodity prices surged higher. The Fed must now adjust its policy faster than what was expected just six weeks ago while also being careful not to go too far and cause a recession. Threading this needle and avoiding a policy error, whether that be prolonged inflation or a recession, will be extraordinarily difficult.

Return of Market Volatility

These two profound shifts drove uncertainty to the forefront of investors' minds in the first quarter of 2022. Elevated uncertainty often coincides with elevated stock market volatility, which was on display with stocks gyrating wildly in the quarter.

After reaching an all-time high of 4,796 on January 3rd, the S&P 500 fell 10% by January 27th, rebounded 6% by February 2nd, and then fell another 9% to 4,170 by March 8, down 13% from the high. However, in the face of rising pessimism, the S&P 500 rallied sharply through the end of March to end the quarter at 4,530 – up 9% from its low and only down 4.6% on the year.

This price movement is in stark contrast to the benign volatility in 2021 where the largest peak-to-trough drawdown was only 5%, and there were 70 new all-time highs. With uncertainty over Fed policy and the conflict in Europe remaining elevated, it is likely we will see continued stock market volatility for the foreseeable future.

Prognostications Are Unreliable

However, we believe it is important to remember that guesses about the future are just that – guesses. The range of future outcomes is always wide, and today's environment is no different. We do not know precisely how the shifting Fed policy or the geopolitical upheaval will impact the economy or the stock market.

It is easy to assume uncertainty is always bad for stock prices. On the surface, rising inflation and rising interest rates *seem* like they should disrupt markets. And a war that has the potential to develop into a broader global conflict *seems* like it would be obviously bad for stocks.

However, using history as a guide, this relationship is not clear. The S&P 500 generated positive returns in many of the rising rate environments of the past 50 years. And U.S. stocks performed well through some past geopolitical conflicts when measured from beginning to end, including major conflicts like WWI and

WWII, albeit with volatility along the way. For example, from September 1, 1939, through August 31, 1945, the Dow Jones Industrial Average increased 50% or roughly 7% annually.

Human nature craves certainty, even if it is false certainty. This is why prognosticators and macro strategists get so much air time in the press despite their abysmal track record of accurate predictions. And it's especially true with predictions of doom and gloom. At the end of the day, we believe stock market prognostications should be ignored, and we agree with Warren Buffett when he said, "I have long felt that the only value of stock forecasters is to make fortune tellers look good."

Embracing Uncertainty

How does today's elevated uncertainty impact our investment process? In short, it doesn't. Investors never know with certainty what the future holds. The events of the past five years are a stark reminder of this fact. Although the feeling tends to ebb and flow over time, future uncertainty is always high, and the range of future outcomes is always wide.

We aim to embrace this idea, stay humble about our ability to predict the future, and build it into our investment process. As the father of value investing, Ben Graham, said in his 1949 classic *The Intelligent Investor*, "At heart, uncertainty and investing are synonyms."

The next 10 years will likely hold many surprises that we can't predict or understand today. It is easy, especially during times of market volatility, to focus on the negative – a Fed policy error or geopolitical disruption – and become pessimistic about the future.

But what about the positive surprises? The technological and medical breakthroughs that fundamentally improve our lives. The new businesses that will be formed that revolutionize industries for the better and even create entirely new industries. In the short term, the dynamism of the U.S. economy is often underappreciated, but for investors with a long-term time horizon, it has always paid to be optimistic about the future.

Preparing for Uncertainty

Because we know that the future will hold surprises, we focus on building client portfolios with high-quality investments that are sturdy enough to make it through any environment. In fixed income, we aim to own high-grade bonds that will act as a port in the storm during market volatility. In equities, we aim to own high-quality businesses that have sustainable competitive advantages, that are run by talented and honest CEOs and that trade at attractive prices. Furthermore, we often seek businesses that benefit from long-term tailwinds that will help fuel their growth over decades.

Fortunately, successful long-term investing does not require us to accurately predict the future of the economy or geopolitics. Over the past 30 years we have managed client portfolios through many turbulent times – the technology bubble of the late 90s and its subsequent collapse, the September 11th terrorist attack, a commodity bubble and collapse, a housing bubble and collapse, a global credit crisis, wildly different political environments, a trade war, and a global pandemic.

Our success was not determined by predicting these events – we didn't – but by sticking to our time-tested process, which is built to endure all sorts of diverse environments. By always striving to own companies that can navigate the inevitable uncertainties, we are prepared for both the tough times and the good times before they arrive.

Our ultimate goal is to help you compound your wealth at attractive rates over the long term. This is easier said than done, but it is our true north. We thank you for the trust you place in us as we remain steadfastly committed to this goal every day.

Baird Trust Is Growing!



Mark Nickel, CFP®

President
Chief Investment Officer

Over the last 10 years Baird Trust has been working to open branch offices well beyond our headquarters in Louisville. Today I am excited to share that we now have Baird Trust offices in Indiana, Ohio, and Tennessee and will soon be adding one in Greenville, South Carolina.

Our geographic expansion has grown out of a desire to position ourselves closer to our clients. Even with the adoption of working remotely, Zoom

calls, etc., we believe our proximity to our clients still matters. We have given great thought to building a presence in states that allow us to take advantage of favorable fiduciary law and income tax regimes. Additionally, we've found excellent talent to join our team in Baird's corporate headquarters in Milwaukee. All of this geographic growth has enabled us to better deliver on our goal of continually enhancing our service and offerings.

In addition to new locations, over the last 10 years Baird Trust has grown from \$3 billion in assets to over \$17 billion. Our asset growth is due to a combination of factors. First is that we continue to make decisions based on what is best for you, our clients. We remain vigilant in not taking our eye off of our most important goal – serving you. We know the best way to serve clients is by partnering with Baird Financial Advisors and in collaboration with a Trust Officer and Portfolio Manager, developing the right client-centric plan leading to a high level of service. It doesn't hurt that we've been in the trust and investment management business for nearly 40 years,

so our experience in serving complicated families has led to excellent outcomes. And I would be remiss if I didn't point out our outstanding long-term investment returns, which have contributed to our asset growth over the years.

Lastly, I should mention that we've added over 20 new associates just since the beginning of the pandemic. The reason for the additions is to address a few retirements of senior associates, and to ensure that we are appropriately resourced to serve our clients. I have to say, it is extremely exciting to witness the quality of our new associates. We've been able to bring in high-character, quality people who are credentialed and experienced in our industry. I feel strongly that Baird Trust is well positioned to serve you, our clients, for years to come.

Thank you for the faith that you place in our ability to serve you and your families. You have my commitment that we will not take our eye off the ball in ensuring that your needs are at the forefront of everything we do.

Protect Your Portfolio From Rising Prices



Gail B. Tway, CFP®

Director
Portfolio Management

We have all noticed increases recently in prices at the gas pump and in the grocery store. Bidding wars are happening across the country when homes go on the market, and in some cases used cars cost more than a brand new one of the same make and model. What we are all feeling is the effect of inflation.

Consumer prices rose 7.9% in February, which means that inflation

is at a level we have not seen in more than 40 years. Initially, many thought that inflation would be transitory, but it's clear that Jerome Powell's thoughts have changed, and the Federal Reserve has indicated that they plan to start raising interest rates in March to try to cool the steady increases in prices.

This will be an interesting balancing act, attempting to get inflation under control while at the same time attempting to avoid throwing the economy, which is still weakened by the pandemic, into a recession.

Where does this leave us as investors? At its basic level inflation represents the rise in the price of goods and services. It reduces the purchasing power of our dollar. In this environment, consumers may lose purchasing power unless their income rises, and Fed action to get inflation under control can damage growth and employment.

The war in Ukraine is also complicating the inflation picture. Russia and Ukraine produce about 30% of the world's grain. Shortages in grain will increase the prices of many consumer goods, including bread, meat and even alcohol. Additionally, sanctions on Russian oil have increased prices at the pump. Oil price gains reverberate through the economy, affecting business profitability and the cost to ship items to consumers as well as the cost of travel.

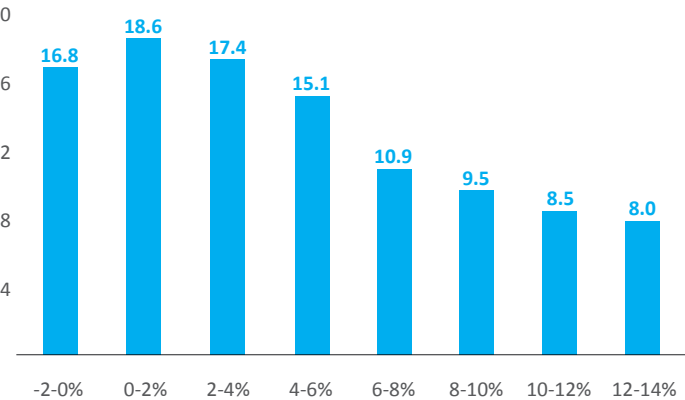
Early in the cycle before a rate hike, the market tends to perform well. It also performs well relatively early in the rate hike cycle.

S&P 500 return (%) in the months before and after a cycle's first interest rate hike

Date of first rate hike	Six months prior	Three months prior	Three months after	Six months after
3/31/83	30.1%	10.0%	11.1%	11.0%
1/5/87	1.9%	8.8%	20.0%	23.0%
3/30/88	-18.4%	5.3%	7.0%	7.4%
2/4/94	6.2%	3.4%	-3.3%	-1.0%
6/30/99	12.1%	5.9%	-6.2%	7.4%
6/30/04	3.7%	1.7%	-1.9%	7.3%
12/16/15	0.0%	4.5%	-1.6%	1.4%
Average	5.1%	5.7%	3.6%	8.1%
Median	3.7%	5.3%	-1.6%	7.4%

But we also know that in periods of high inflation, P/E ratios (the price of a stock relative to its earnings) tend to compress. The higher the level of inflation, the more this happens, and stock prices fall in the short term. A rate of inflation at around 4% seems to be where we begin to see more significant multiple compression. Increasing earnings for businesses can help put a damper on this phenomenon.

Average S&P 500 TTM P/E by CPI Y/Y tranche
1950 – Current



Source: Strategas Research Partners

Knowing this, should investors be running for the door to get out of the market? Quite the contrary. Over time stocks are the best way to hedge against inflation. If we have set the asset allocation of a client’s portfolio with an appropriate mix of stocks, bonds and cash, clients should be able to weather the volatility. The purchasing power of cash is eroded during times of high inflation, so we are recommending that investors limit their cash holdings to whatever is needed in the event of an emergency or to provide funds for known upcoming expenses.

For our bond allocations, we also advise clients to keep the duration of their portfolios very short. Interest rates rise in periods of high inflation. The longer the term of the bond or the lower the quality, the more the bond price will fall when rates increase. Staying short and remaining in high-quality bonds is a defensive strategy that also allows us to take advantage of higher rates as bonds mature.

The best way to hedge against inflation over the long term has been to own high-quality businesses. Looking back over time at various asset classes, stocks have outperformed. When inflation kicks up, we frequently get asked whether we should add gold as an investment option in our client accounts.

Annualized returns of different asset classes over the last ~50 years

Date	S&P 500 TR	3-mo. T. Bill	US T. Bond	Baa Corp Bond	Real Estate	Gold
1970s	5.9%	6.3%	5.4%	7.1%	8.7%	31.0%
1980s	17.3%	8.8%	12.0%	14.1%	5.9%	-2.6%
1990s	18.0%	4.8%	7.4%	9.5%	2.7%	-3.2%
2000s	-1.0%	2.7%	6.3%	8.4%	4.0%	14.1%
2010s	13.4%	0.5%	4.1%	7.1%	3.8%	3.4%
2020s	23.1%	0.1%	3.2%	5.6%	18.3%	9.2%
Total	11.0%	4.4%	6.8%	9.0%	5.3%	7.9%

Source: Aswath Damodaran/NYU, FactSet, Baird

As the chart above displays, stocks have provided a superior return over time when compared to gold. Gold tends to do well during periods of market panic, but as a long-term holding, we would much prefer to own a high-quality company with a competitive business advantage that should make it a leader in its industry. We take a long-term business owner approach to owning stocks. Our focus on the business, the management, and the price we pay for our equity holdings has allowed Baird Trust clients to build wealth over full market cycles.

We appreciate the trust you have placed in your team at Baird Trust and encourage you to reach out if you have any questions or concerns.



State-of-the-Art Conference Center Opens Over Downtown Louisville

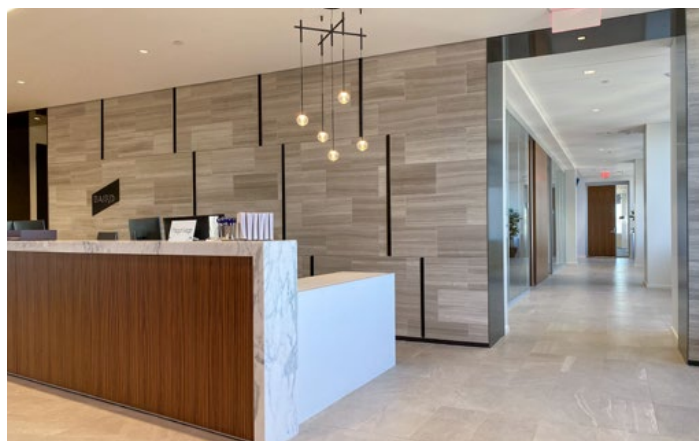
Our brand-new Client Conference Center, looking out over downtown Louisville and the Ohio River, opened earlier this year, and we couldn't be prouder to show it off. Since 1854, when our predecessor organization, Hilliard Lyons, was founded, we have called Louisville home, and the new center celebrates and continues our commitment to the community.

Features within the Client Conference Center highlight the rich history of Louisville – including room names like Derby and Bourbon, or the 1854 and 1919 rooms, which reflect the founding years of Hilliard Lyons and Baird.


"The Conference Center combines cutting edge technology, exceptional amenities and unmatched panoramic views of Louisville and the surrounding area," said Baird Trust President Mark Nickel. "It is the ideal venue for meetings, receptions and gatherings of all types. And our conference center support team is second to none when it comes to delivering warm hospitality with attention to detail."

The conference center will also be available to local organizations who wish to hold meetings and events there. The state-of-the-art technology allows for videoconferencing to engage with remote participants in an interactive, personal way.

We encourage you to come to the Client Conference Center, on the 29th floor at 500 W. Jefferson in downtown Louisville, for your next meeting with Baird Trust. Talk to your Financial Advisor about a visit today.



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