INVESTMENT SOLUTIONS GROUP

Capital Markets View

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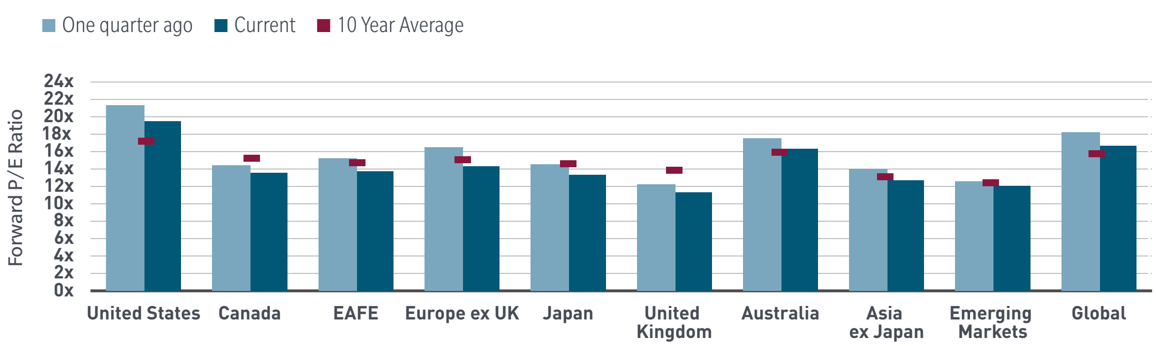
GLOBAL EQUITY SUMMARY

Global equity market volatility increased in the first quarter as Russia's invasion of Ukraine raised a new concern for markets already on edge over central bank hawkishness. Corporate earnings remained strong, although expectations dimmed as companies grappled with higher input costs, most notably around energy and commodities. Several large-cap technology companies, the darlings of the past two years, declined precipitously, with investors discounting higher rates and slower growth as economies began to normalize. Energy and utilities were the strongest performers, with communications services, consumer discretionary and information technology the laggards. Investors are pricing in an increasingly aggressive US Federal Reserve, with markets now expecting as much as 200 basis points of additional tightening in 2022 and an aggressive balance sheet runoff starting as early as May. Strong earnings and some correction in prices resulted in more reasonable valuations, although they remain somewhat rich relative to history. On a forward-looking basis, US equities are trading at around 19 times earnings while non-US developed market ones are trading at 15 times. Emerging market equities declined on the quarter as Chinese equities, a 30% weighting in the index, extended the decline that began in early 2021.

For the full story see page 3

Forward Price to Earnings



Source: FactSet as of 31 March 2022. United States = S&P 500, Canada = MSCI Canada, United Kingdom = MSCI United Kingdom, Japan = MSCI Japan, Australia = MSCI Australia, Global = MSCI AC World, Europe ex UK = MSCI Europe ex-UK, EAFE = MSCI EAFE, Asia ex Japan = MSCI Asia ex Japan, Emerging Markets = MSCI Emerging Markets.

	SALES GROWTH (YOY%)		NET PROFIT MARGIN (%)		DIVIDEND YIELD (%)	
	Current	10-Year Average	Current	10-Year Average	Current	10-Year Average
United States	14.5	3.5	13.7	10.7	1.4	1.9
Canada	14.1	4.9	14.5	10.5	2.7	3.0
EAFE	10.5	1.5	10.0	7.1	3.1	3.3
Europe ex UK	12.1	1.7	10.7	7.3	3.0	3.3
Japan	6.9	1.9	6.9	5.0	2.3	2.1
United Kingdom	14.3	0.6	11.1	8.0	3.9	4.1
Australia	7.8	1.7	17.3	14.1	4.5	4.5
Asia ex Japan	15.4	6.9	10.6	9.5	2.5	2.5
Emerging Markets	16.9	7.1	11.6	9.5	3.0	2.7
Global	13.5	3.2	12.0	9.0	2.0	2.5

Source: FactSet as of 31 March 2022. Data shown are trailing (last twelve months). United States = S&P 500, Canada = MSCI Canada, United Kingdom = MSCI United Kingdom, Japan = MSCI Japan, Australia = MSCI Australia, Global = MSCI AC World, Europe ex UK = MSCI Europe ex-UK, EAFE = MSCI EAFE, Asia ex Japan = MSCI Asia ex Japan, Emerging Markets = MSCI Emerging Markets.

GLOBAL FIXED INCOME SUMMARY

By fixed income standards, global aggregate fixed income markets suffered steep declines as rising yields, signals of tighter monetary policy and high inflation spooked investors. Emerging market central banks have so far been the most aggressive in combating persistent price pressures, though developed markets are beginning to play catch-up. The Fed has signaled a willingness to hike rates in 50-basis-point increments and will begin an aggressive balance sheet runoff soon. Eurozone inflation is at record levels, exacerbated by spiraling energy costs stemming from Russia's invasion of Ukraine. The European Central Bank is likely to end its asset purchases around midyear; rate hikes may have to wait until later in the year. Credit spreads widened during the quarter but have pulled in from the levels reached in early March, shortly after the invasion. The global macro environment, which looked constructive at the start of the year, now appears more uncertain, amid inflation, central bank hawkishness and an unsettled geopolitical backdrop.

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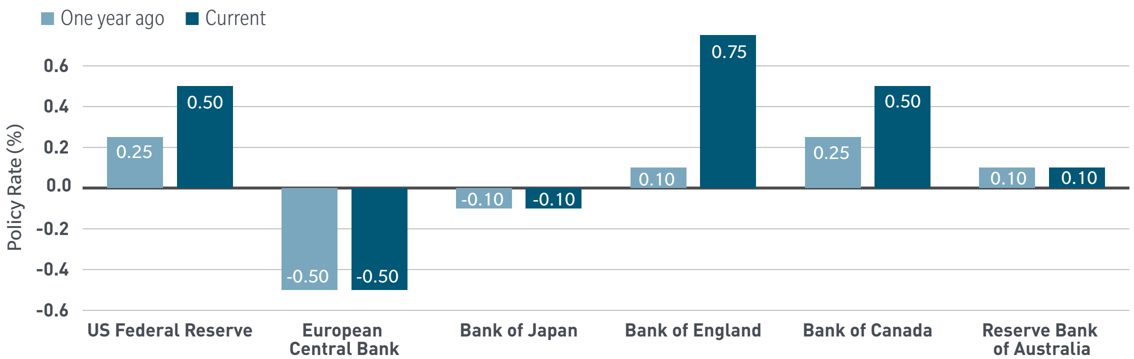
Central Bank Policy Rates



Source: FactSet as of 31 March 2022.

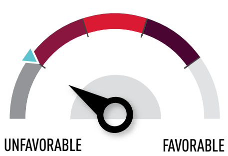
	YIELD TO MATURITY (%)		DURATION (YEARS)	
	Current	10-Year Average	Current	10-Year Average
US Treasuries	2.4	1.5	6.8	6.1
Global ex US Sovereigns	1.7	1.2	7.7	7.4
Emerging Markets Debt	5.9	5.6	7.8	7.3
Global Investment Grade	3.1	2.5	7.0	6.6
Global High Yield	6.6	6.5	4.3	4.2
US Municipal Bonds*	2.6	2.1	5.6	6.2

Source: FactSet as of 31 March 2022. US Treasuries = Bloomberg US Aggregate Government Treasury Index, Global Sovereigns ex US = Bloomberg Global Aggregate ex US, Emerging Market Debt = JP Morgan EMBI Global, Global Investment Grade = Bloomberg Global Aggregate Corporate, Global High Yield = Bloomberg Global High Yield, Municipal Bond = Bloomberg US Municipal.

*yield to maturity unavailable for the municipal bond, so yield to worst is shown instead.

OUTLOOK	EQUITY INSIGHTS	LONG-TERM VIEW

OUTLOOK

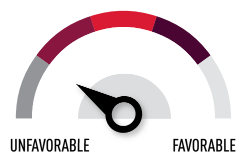


EQUITY INSIGHTS

UNITED STATES

- After a market correction of more than 10% in mid-March, US equities rebounded to end the quarter, but remain well below where they opened the year.
- Energy was the best-performing sector last quarter, up around 40%, partially due to supply constraints stemming from Russia's invasion of Ukraine. Except for the utilities sector, which was up 6%, all other sectors in the S&P 500 were either flat or negative for the quarter.
- With strong earnings growth and a modest move down in prices, valuations declined to about 19.5x forward earnings, still well above the 15-year average of 15.5x. Profit margins continue to defy expectations, rising to more than 13%, well above the 15-year average of 9.3%.
- For Q1, earnings expectations declined, the first fall since Q2 2020, while further out quarterly estimates have slightly increased. Pricing power, wage pressures and higher input costs will be key determinants of profitability in coming quarters.
- Consumer spending will also be critical to economic growth and corporate profitability as households grapple with eroding purchasing power. Though consumption has been a key driver of the recovery so far, consumer confidence has begun to slip.
- On the macro front, US GDP growth is expected to slow from its rapid 2021 pace in the first half of 2022. While the bounce-back from the depths of the 2020 recession was substantial, both in terms of speed and magnitude, the sustainability of the recovery is now in question as fiscal and monetary stimulus wanes.
- The US yield curve has inverted across multiple maturities, including the closely watched 2-year and 10-year curve, the inversion of which has occurred before every US recession since 1980. However, the timing of the signal has been highly variable, ranging from a few months to a few years, and has sent false signals in the past.
- As inflation continues to run well above target and broadens beyond supply chain disruptions, the US Federal Reserve has pivoted to an increasingly hawkish stance. Markets are pricing in multiple rate hikes in 2022, including some 50-basis-point hikes, as the central bank attempts to move policy rates toward neutral, which is assumed to be in the mid-2% range.

LONG-TERM VIEW



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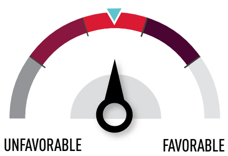
OUTLOOK	EQUITY INSIGHTS	LONG-TERM VIEW

OUTLOOK

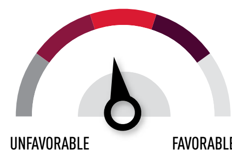


EQUITY INSIGHTS

CANADA

- Canadian equities rose 2.9% in Q1, supported by energy and materials, the best-performing sectors year to date. Information technology declined significantly in the first quarter.
- Inflation reached its highest level since 1991, rising 5.7% year over year in February, primarily driven by higher food and energy prices. Already elevated price pressures, due primarily to supply chain bottlenecks, are likely to persist amid the Russia–Ukraine conflict, which will likely put further upward pressure on a broad range of commodities.
- In response to rising inflation and economic slack being absorbed, the Bank of Canada recently raised rates by a quarter of a percentage point to 0.5%. Markets are pricing in eight further rate hikes by end of 2022.
- Canada's economy is benefiting from global demand for raw materials as supplies of base metals, fertilizers, grains and oil from Russia have been harder to come by due to disruptions. While rising consumer prices could limit demand, the receding Omicron wave may provide an offset, unleashing pent-up spending. Growth is expected to average around 4% in 2022.
- Labor markets remain tight, with the unemployment rate at 5.5%, below prepandemic levels, and wage growth rising 3.1% year over year.
- Valuations, on a next-12-months basis, remain below their 10-year average at 13.9x, and forward EPS, while still positive, has started to decline. Both sales growth and net margins have remained strong, above their 10-year averages.

LONG-TERM VIEW



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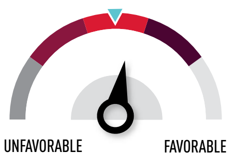
OUTLOOK | **EQUITY INSIGHTS** | **LONG-TERM VIEW**

OUTLOOK

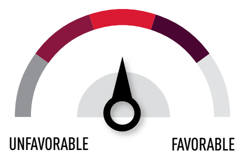


EQUITY INSIGHTS

EUROPE EX UK

- After outperforming US shares in early 2022, European equities fell sharply in the wake of Russia's invasion of Ukraine, slumping around 8.6% compared with about a 4.9% decline for US shares. Europe's reliance on Russia for a significant portion of its energy supply has been a major headwind for the region.
- While Russia's oil and gas industry has not been sanctioned directly, the country's isolation from much of the world's financial infrastructure has contributed to a dramatic rise in energy prices. The European Union has taken steps to reduce its dependence on Russian energy products, but the transition will take time. Imports of liquified natural gas from the US are expected to offset some of what Russia currently supplies.
- Europe's manufacturing sector remains challenged owing to ongoing disruptions in global supply chains. While Asian supply chains appear to be slowly untangling, new hurdles have emerged as supplies of components from Russia and Ukraine have been cut off, forcing firms to scramble to source inputs from elsewhere.
- Potentially supportive factors for European markets, especially if geopolitical tensions ease, are improving COVID-19 trends, the deployment of European recovery funds, an expected dramatic increase in defense spending and an ECB that appears likely to follow a more gradual path toward monetary policy normalization than the Fed. Despite caution over tightening monetary policy, markets are pricing in around 50-basis-point of hikes before year- end.
- As in much of the world, inflation is running well above target, reaching a record 7.5% in the eurozone in March. Interest rate volatility has been particularly intense since the outbreak of hostilities in Ukraine.
- On a valuation basis, European equities are their cheapest since the onset of the pandemic two years ago at 14.3x NTM earnings, which is just below their 10-year average.

LONG-TERM VIEW



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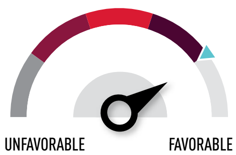
OUTLOOK	EQUITY INSIGHTS	LONG-TERM VIEW

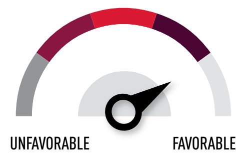
UNITED KINGDOM

Outlook:



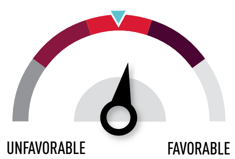
- UK shares outperformed most of their peers, rising 3.5% in Q1.
- Strong performance by energy and materials helped offset some of the drag from declines in the information technology and consumer discretionary sectors.
- As is the case in most of the developed world, inflation is the top concern, a factor only exacerbated by the Russian invasion of Ukraine. The Bank of England increased rates at its last three meetings, and investors anticipate additional hikes ahead despite growth worries stemming from a rapid rise in energy costs.
- Business and consumer confidence are both declining amid uncertainty caused by Russia's invasion of Ukraine and broadening price pressures. The cost of living is pressuring disposable incomes as power costs rise.
- The potential for margin compression is rising as historically tight labor markets and the rising cost of living prompt workers to seek larger pay packages from employers.
- The value-heavy UK market has been a relative beneficiary of a rising rate environment.
- UK shares continue to derate, trading at 11.3x next year's earnings estimate. It remains one of the few developed markets to trade below its 10-year average earnings multiple (13.3x).

Long-term view:



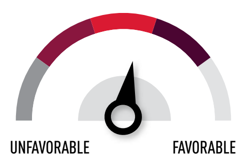
JAPAN

Outlook:



- Japanese shares outperformed their developed market peers in Q1, as a weak yen (-7% in Q1) provided shares of Japanese exporters with a brisk tailwind. On the quarter, Japanese shares slipped 2.5%.
- Inflation in Japan has begun to tick up, driven by higher energy and food prices, but remains below the Bank of Japan's target. The recent rise in JGB yields has been driven more by external factors than domestic ones as higher global inflation has caused most developed market central banks to adopt tighter monetary policies. Yield curve control policies have required the BOJ to intervene repeatedly to limit a rise in yields.
- Japan's economy continues to recover from the effects of the pandemic, but the rebound has been less robust than those experienced by peers such as the US, as private consumption remains restrained amid high levels of economic uncertainty. Japanese businesses remain reluctant to pass on rising input prices to consumers, crimping profit margins.
- Rising food and energy costs have prompted the government of Prime Minister Fumio Kishida to propose a supplemental budget to counter the economic drag from rising inflation.
- The energy, financials and utilities sectors have been standout performers so far this year, though information technology and health care have been the largest drags on the MSCI Japan index.
- From a valuation perspective, Japan remains relatively attractive, trading at 13.3x next year's earnings, below the 10-year average of 14.1x

Long-term view:



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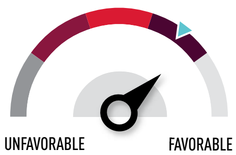
OUTLOOK	EQUITY INSIGHTS	LONG-TERM VIEW

OUTLOOK

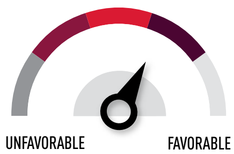


EQUITY INSIGHTS

ASIA EX JAPAN

- Having fallen about 7% in Q1, equities in the region modestly underperformed developed markets. While all of the four largest constituent countries represented in the index were lower in Q1, India was the best performer, declining just 0.1%, while China was the worst, falling nearly 14%.
- The rapid spread of the Omicron variant in parts of China has led to strict lockdowns in some of the country's most important population and commercial centers, raising concerns that recent supply chain improvements will be reversed and casting doubt over whether China will be able to reach its 5.5% 2022 GDP growth target.
- Amid continued growth concerns stemming from rising energy prices, coronavirus restrictions and lingering strains in the property sector, accommodative monetary and fiscal policies are expected from Chinese authorities this year, as is an easing of the regulatory crackdown instituted last year. Though differences remain, regulators in the US and China are moving closer to an agreement over US requirements for increased audit transparency for Chinese firms that are listed on US exchanges.
- Exporters of natural resources such as Indonesia and Malaysia have benefited from rising prices of raw materials and disrupted supply chains elsewhere.
- The region, like much of the world, faces a challenging combination of higher inflation and slower growth. Amid still-high valuations in parts of the developed world such as the US, Asian valuations look relatively attractive at 12.7x next year's earnings, right in line with its 10-year average of 12.6x.

LONG-TERM VIEW



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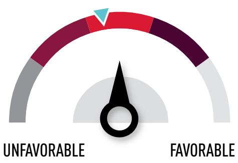
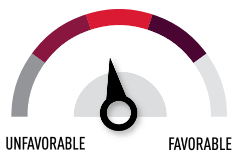


EQUITY INSIGHTS

AUSTRALIA

- Equities outperformed their developed market peers, rising 2.2% in Q1
- Australia's economy rebounded as the lifting of coronavirus lockdown measures unleashed a wave of consumer spending, which lifted GDP to a 3.4% rate to end last year. 2022 is forecast to grow 4.5%. Amid disrupted global supply chains for energy and other raw materials, Australia is well positioned to be a beneficiary.
- After taking a patient approach toward tighter monetary policy, the Reserve Bank of Australia switched gears in early April, signaling to markets that a rate hike may be expected as early as June.
- The unemployment rate fell to 4% in February, the lowest rate since August 2008. The RBA forecasts that the jobless rate will fall below 4% this year, the lowest level since the mid-1970s.
- Inflation has picked up more quickly than the Reserve Bank expected but remains lower than in many other countries. The central forecast is for core inflation to increase in coming quarters to around 3.25%, before declining to around 2.75% over 2023 as the supply-side problems are resolved and consumption patterns normalize. CPI could spike higher due to higher oil prices.
- Australia's residential property price rose 24% in 2021 fueled by low interest rates and government stimulus, which was the strongest annual growth on record.
- The energy, materials and financial sectors were Australia's strongest performers while information technology and consumer discretionary were drags on the index.
- Valuations derated slightly during the quarter (as market volatility spiked amid geopolitical concerns) but ended slightly above their 10-year average on a forward basis at 16.3x.

LONG-TERM VIEW



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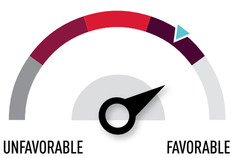
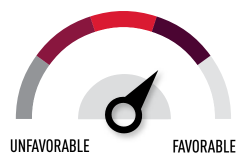


EQUITY INSIGHTS

EMERGING MARKETS

- Emerging markets lagged developed ones in the first quarter of the year (-6.5% versus -5%). The Russia–Ukraine crisis put a spotlight on the Eastern European portion of the index, which at of the end of January comprised 74% Russia, 17% Poland, 6% Hungary and 3% Czech Republic. After the invasion, MSCI removed Russian equities from its indices, citing investability concerns.
- Chinese equities fell nearly 14% in Q1. Lockdowns intensified late in the quarter as the Omicron variant spread in important population centers such as Shanghai and Shenzhen, raising fears that economic growth will fall short of target and global supply chain disruptions will take longer to untangle. In response to continuing market fears over the government's year-long regulatory crackdown, China's State Council recently took the unusual step of pledging to support the economy and capital markets. However, fears persist that US-listed shares of Chinese companies may face delisting if US and Chinese regulators cannot come to an agreement on auditing standards while foreign investors remain concerned that China may be subject to Western sanctions over its support for Russia.
- Taiwan, with its heavy exposure to semiconductor fabrication, benefited from a rally in the information technology sector in the last weeks of the quarter. Local shares (-3.5%) outperformed emerging (-6.5%) and developed (-5%) markets.
- India has been a standout performer with local shares, falling only 0.1% in Q1 amid one of the world's fastest economic growth rates (projected in the 8% to 9% range). India's favorable demographic profile, growing middle class and access to Russian raw materials puts it in a relatively strong position compared with many emerging economies.
- Driven by strong performances by Brazil, Chile, Colombia and Peru, the MSCI LatAm index rose 12.7% in Q1, while oil-exporting nations in the Middle East are up on average about 17.5%.
- Emerging markets face headwinds from declining global liquidity, surging inflation and a strong dollar.
- From a valuation perspective, emerging markets look more attractive than developed ones, trading close to their 10-year average of 12 times next year's earnings.

LONG-TERM VIEW



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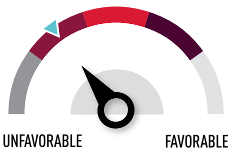
OUTLOOK | **FIXED INCOME INSIGHTS** | **LONG-TERM VIEW**

OUTLOOK

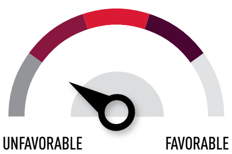


FIXED INCOME INSIGHTS

US TREASURIES

- Fundamentals warrant further bear flattening of the Treasury curve and higher yields across the curve. Inflation has continued to surprise to the upside, reaching levels last seen in the 1980s. Losing control of the inflation narrative is a rising risk, so the Fed has moved from a focus on tapering to lift-off on rates, with the beginning of the roll-off of the balance sheet soon to follow.
- The Fed appears ready to risk recession by being willing to hike rates to above what it deems the long-term neutral rate, and quickly.
- The strength of the economy which is characterized by a positive output gap combined with a tight labor market, could demand a relatively aggressive policy response versus those of recent tightening cycles if inflation is to be successfully brought to heel. The task ahead of the Fed — engineering a soft landing — therefore represents a formidable challenge. While recession is not our base case, we acknowledge an increasing probability of that outcome.
- Russia's invasion of Ukraine is likely to exacerbate existing bottlenecks by further stressing global supply chains and in the end should prove both inflationary and growth-depleting.
- Technicals look mixed. On the one hand, an expected fall in new Treasury coupon issuance in 2022 should prove supportive. On the other hand, plans to let bonds on the Fed's balance sheet roll off means should be an offset. On technicals, we remain cautious given the Fed's fairly aggressive plan to reduce the size of its balance sheet.
- TIPS could be especially susceptible to investor outflows once the market gains confidence that inflation has peaked. They are also subject to technical challenges related to Treasury's intention to increase TIPS issuance as a percentage of overall coupon issuance, even as the Fed begins to roll off its balance sheet holdings, which were disproportionately skewed toward TIPS.
- The Treasury's market valuation has improved markedly due to the recent rate selloff in response to the Fed's plans to remove monetary policy accommodation. Nevertheless, we still see upside risk in both nominal and real yields. As a result, we favor remaining underweight duration, with underweights notably at the front end of the curve.
- Agency mortgage-backed securities (MBS) are becoming more fairly valued, but we remain concerned by the headwind from impending Fed quantitative tightening and the rising net supply of MBS the Fed's exit will engender. With banks also likely to scale back purchases, the natural buyer of this increased supply will shift to price-sensitive money managers. Against the present backdrop, we slightly favor agency MBS over Treasuries.
- Overall, we favor remaining underweight MBS given the current mix of fundamentals, technicals and valuation. However, one area where we see opportunity is in agency CMBS.

LONG-TERM VIEW



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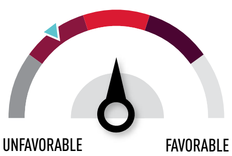
OUTLOOK	FIXED INCOME INSIGHTS	LONG-TERM VIEW

OUTLOOK

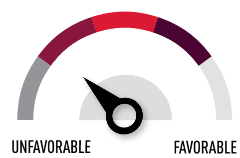


FIXED INCOME INSIGHTS

GLOBAL EX US SOVEREIGNS

- After the sharp Q1 selloff, there are an increasing number of non-US rates markets which appear attractive. For example, 10-year German yields are well above 0% for the first time in three years. We feel inflation risk is higher in the US and UK compared to the eurozone, where the output gap is larger and labor markets less tight.
- Marked differences in the reaction-function of different non-US central banks should increase dispersion and increase opportunities for active rates and FX managers.
- Core European bonds are now priced for an aggressive tightening path that the ECB might struggle to meet against a backdrop of geopolitical uncertainly and falling consumer confidence.
- Although valuations have improved in European periphery bonds as a result of the more hawkish tilt of the ECB, we remain cautious given signals that central bank asset purchases will soon come to an end and due to rising political uncertainty in France.
- Short and intermediary Japanese bonds continue to be supported by the Bank of Japan, which stepped in to defend its self-imposed 0.25% limit on 10-year JBGs during the quarter. Japan continues to provide a more defensive place to hold duration compared with other developed markets.
- China's monetary cycle looks increasingly out of step with the West, providing some diversification benefit. However, following a period of huge outperformance since late 2020, Chinese bonds look expensive on a hedged-to-USD basis as the 10-year spread to US Treasuries has narrowed over 200 bps.
- While we dislike longer-maturity UK bonds, we feel there is some value in shorter maturities. The Bank of England might need to walk back some of its hawkish rhetoric as the strain on household spending from sharply rising living costs weighs on economic activity. We also like expressing this view by shorting the pound.
- While we are avoiding the front-end and the belly of the curve, we favor long-end Australian bonds, where the curve is still relatively steep. The ending of quantitative easing should pave the way for rate hikes later in the year, which could flatten the curve, as has been the case in other markets.
- We also like markets where normalization cycles are underway, and where forward curves are already pricing aggressive central bank tightening, such as New Zealand.
- Within FX we prefer those currencies with more hawkish central banks whose economies will likely lead the recovery compared with their regional peers. Examples include the NOK and CZK against the EUR. We like CAD, which should be supported by a more hawkish stance from the Bank of Canada relative to market expectations. The country is also benefiting from the economic reopening and improving terms of trades on higher commodities prices.

LONG-TERM VIEW



KEY: January '22 April '22

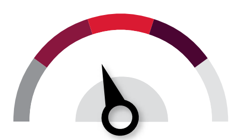
OUTLOOK	FIXED INCOME INSIGHTS	LONG-TERM VIEW

EMERGING MARKETS

- Rising inflation, tightening global monetary conditions, continued supply bottlenecks, the after-effects of the Omicron wave and a slow and troubled Chinese economy led us to a defensive perspective as we started the year. For the immediate future, those concerns and risks have been exacerbated by Russia's invasion of Ukraine and the quick and severe Western response.
- Higher energy prices resulting from the crisis and Western sanctions will hit Europe particularly hard, given its reliance on Russian natural gas supplies.
- However, higher energy prices tend to have a depressing impact on growth as well. Fiscal and monetary policies are tightening at a time when the growth/inflation mix is becoming more challenging, leaving little room for a policy mistake. Complicating the situation is rising concern over spread of the Omicron variant in China exacerbated by the apparent ineffectiveness of Chinese vaccines and low levels of natural immunity. China's zero-COVID policy has led to widespread lockdowns that risk further pressure on supply chains.

Outlook:

Long-term view:



- While the global economic environment remains challenging overall, commodity-exporting EM countries can do relatively well in the current environment. Unlike previous crises, a number of EM economies have entered this period of heightened volatility with strong external accounts, which provides a buffer amid the current risk-off environment.
- Later in the year, we see positive signs for EM local debt as we expect inflation to peak in many countries and think many of these hiking cycles will wind down in Q2 and Q3, leaving local rates at attractive long-run levels. As inflation decelerates, real rates will climb. We think this will be supportive for both currencies and local rates.
- History suggests that Fed tightening cycles are negative for EM local debt. However, in this cycle, EM central banks have led rather than followed the Fed. As a result, we think local debt will be much better insulated from Fed rate hikes.
- Valuations remain attractive relative to the benchmark's five-year history and to US investment- grade and high-yield corporates even if we adjust for the recent massive deterioration in Russian and Ukraine spreads. EM currencies are relatively cheap but are susceptible to volatility resulting from rising US rates and near-term growth concerns. Due to higher carry and attractive bond yields, EM FX and rates in countries that are far along in their monetary tightening process could offer opportunities.
- While we don't favor adding risk against the current market backdrop, we'd favor taking advantage of price dislocations resulting from increased volatility.

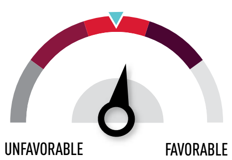
KEY: January '22 April '22

OUTLOOK	FIXED INCOME INSIGHTS	LONG-TERM VIEW

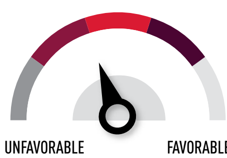
GLOBAL INVESTMENT-GRADE CORPORATES

- Credit market volatility rose in early 2022 as concerns around the Omicron variant gave way to rising inflation, an increasingly hawkish Fed and the Russian invasion of Ukraine. Initially, weakness was driven by rising interest rates, but the risk-off tone intensified in late February amid heightened geopolitical and economic uncertainties. From mid-March, the market stabilized as spreads recouped some of their losses. Global investment-grade corporate spreads peaked at 149 bps but ended the quarter at 124 bps, 27 bps wider than where they started.
- Europe underperformed the US, reflecting Europe's greater exposure to the war in Ukraine due to its reliance on Russian energy imports and inputs to production.
- Corporate fundamentals remained strong as most companies reported positive 4Q21 earnings and cash flows, putting the median company above pre-COVID levels. Profit margins remained a bright spot despite supply chain challenges and rising input costs. Balance sheet leverage also remained below its 2020 apex. However, with peak stimulus behind us, we anticipate some erosion in credit fundamentals in coming quarters.
- Credit ratings migrations were positive and included a number of rising stars from high yield, a trend we expect to continue due to ongoing corporate balance sheet repair and declining leverage. However, corporate margins and the potential for demand destruction bear watching given growing headwinds from rising labor and producer prices.
- Despite market volatility, the primary market in the US remained active in Q1, with year-to-date new issuance volumes exceeded the busy 1Q21 period. This contrasted with low issuance in Europe. The notable US drivers were heavy merger and acquisition financing and Yankee issuers accessing the US market.
- Heavy M&A activity within industrial sectors continues to highlight the relative attractiveness of the banking and insurance sectors. We expect European banks to be a relatively stable sector in 2022 despite an expectation of rising senior supply as extraordinary ECB liquidity programs are wound down. As a result, regulators may allow banks to return more capital to investors.
- We currently view European investment grade favorably, as spreads already imply higher default rates and an economic slowdown. Despite the ECB's hawkish pivot, it remains one of the more accommodative central banks and will continue quantitative easing until Q3. Meanwhile both EURIBOR forward rates and inflation breakevens have already moved to price in a more aggressive ECB and higher structural inflation.

Outlook:



Long-term view:



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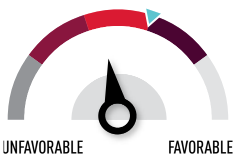
OUTLOOK	FIXED INCOME INSIGHTS	LONG-TERM VIEW

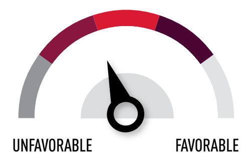
OUTLOOK



GLOBAL HIGH-YIELD CORPORATES

- The high-yield market experienced sharply negative returns during the first quarter. Given its greater duration sensitivity, the BB quality segment led the market lower as the asset class initially sold off due to rising interest rates. However, as the quarter progressed, lower-credit-quality portions underperformed as the market began to price in an increasingly cloudy economic outlook. European high yield underperformed the US given the greater exposure to supply disruptions stemming from Russia's invasion of Ukraine. Meanwhile, the US market benefited from rising commodity prices given its higher energy exposure. Nonetheless, the overall widening of credit spreads did not fully reflect the asset classes' beta to other risk assets.
- Fundamentals within the high-yield market remain constructive. The 4Q21 earnings season was largely positive. Companies have been focusing on extending their maturity profiles, reducing debt and adding cash to balance sheets. The pressures from rising input cost and supply chain disruptions were widely referenced as a headwind on profit margins which is something we are watching closely. However, overall companies are in a solid fundamental position relative to past credit cycles. This is reflected in the historically low levels of distress and defaults.
- The supply and demand environment has evolved in line with the broader market backdrop, and unsurprisingly, increased volatility has been accompanied by strong outflows from mutual funds. However, the level of new issuance has also declined, as issuers are hesitant to issue into a weak market.
- Overall, we are watching global high yield closely because of its sensitivity to the economic backdrop. While a near-term recession is not our base case, the risk of one has risen given rising inflation pressures, continued supply chain issues and a hawkish pivot from central banks. In our view, high yield valuations do not yet fully reflect these risks. However, on a constructive note, the all-in yield for the global high yield index increased by 160 bps during the quarter, to 6.2%. These higher yield levels should make the asset class more attractive relative to illiquid private market alternatives.

LONG-TERM VIEW



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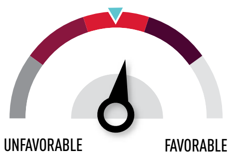
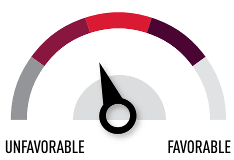
OUTLOOK	FIXED INCOME INSIGHTS	LONG-TERM VIEW



US MUNICIPAL BONDS

- The supportive 2021 technical backdrop for municipal assets turned negative this year. Accelerating inflation and the Fed's hawkish stance increased volatility and pushed the Treasury and tax-exempt curves higher while dragging municipal returns lower, and negative returns and the fear of higher rates spurred investor outflows. To end the first quarter, municipal funds and ETFs reported net redemptions for 12 consecutive weeks.
- The selloff resulted in an improvement in the valuations of municipal assets, but the picture remained mixed. The yield relationship between AAA tax-exempt munis and US Treasuries reflected a more attractive proposition for municipals with 5-, 10-, and 30-year ratios moving from 48%, 70%, and 81% to 83%, 96% and 106%, respectively, in Q1. Further, AAA tax-exempt yields are at their highest absolute levels since April 2019, excluding a brief period at the beginning of the pandemic in March 2020. Within the municipal asset class spreads became marginally more attractive across the investment-grade tiers but high-yield spreads tightened slightly. Spreads on single-As, for instance, increased around 15 bps while in HY, they decreased 1 bp in Q1.
- Taxable municipal yields, whether absolute or duration-adjusted, ended Q1 at their highest levels since 1H 2019 — including the risk-off period in early 2020. Index-level yields of taxable munis finished the quarter slightly lower than US corporate yields, though they provided incremental spread to US corporates in all investment-grade-rating segments except AAA.
- The adjustment in municipal assets was attributable to technical, rather than fundamental, factors as the fundamentals for state and local municipal entities and revenue-supported issuers remained extraordinarily strong and economic growth has supported income, sales and property tax revenues. To illustrate, state tax revenues grew 22% year over year in Q4 2021.
- Entering the second quarter, higher yields and the adjustment of municipal/UST ratios are positives for municipal assets. However, in our view, over the near term, rate volatility is likely to continue to be a headwind until spreads become more attractive and inflows return. In late 2Q, seasonally higher levels of municipal bond calls and maturities should also contribute to demand.



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Capital Markets View
April 2022

MFS Capital Markets View is published each quarter to provide a broad perspective on current risks and opportunities across asset classes and regions.

The Current Outlook and Long-Term View illustrations include return and risk expectations for equity, fixed income and alternative asset classes across country, regional and global markets. The focus of these illustrations is to provide a strategic, long-term, current and forward-looking view of various global markets. We use a proprietary top-down approach by employing quantitative, country-based models as the foundation for our expectations and then integrating bottom-up fundamental views from our global equity and fixed income investment teams to inform our final expectations.

Our expectations are developed across 26 countries comprising 18 developed countries and 8 emerging market countries.

Capital Markets View is for informational purposes only and any general commentary on market activity, industry or sector trends, or other broad-based economic or political conditions, does not constitute a recommendation or investment advice.