Catholic Foundation of Northeast Kansas (CFNEK)

Investment Committee Responsibilities:

- Monitor appropriate risk posture and time horizon of both the Equity Portfolio (EP) and Fixed Income Portfolio (FIP)
- Monitor target allocation
- If allocation is not "in line," understand why and take appropriate steps to correct
- Monitor rebalancing procedures
- Monitor investments according to the CFNEK Investment Policy Statements (IPS) guidelines, including Catholic value screens
- Perform reviews quarterly

CFNEK 2023 First Quarter

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The year started on a positive note with both equities and bonds posting gains. The S&P 500 increased by 7.5% and international equities added 8.02% in the quarter. The CFNEK Equity Fund rose by 5.43% versus the blended benchmark return of 7.09%. The equity portfolio underperformed in the first three months because of its value tilt and underweight in large cap domestic stocks. The CFNEK Fixed Income Fund performance was 1.85% compared to 2.33% for the benchmark. Interest rates across the yield curve retreated in the quarter. The portfolio has a shorter duration than the benchmark, which led to underperformance year to date, but this positioning has been beneficial since the beginning of 2022. The portfolio continues to comply with USCCB Socially Responsible Guidelines. The total portfolio compliance is over 97% for both funds.

Andrew Comstock
Chair, Investment Committee
www.cfnek.org/IPS.

Country Club Trust Company (CCTC) has been the investment manager for the CFNEK funds since mid-2017*. The first two months -July and August 2017 - were a transition period for the funds. During this time assets were received by CCTC/TWM from the previous manager and repositioned to funds and assets employed by CCTC/TWM. Due to the transition of the assets during the months of July and August, performance numbers are not available on the individual solutions in each of the Equity and Fixed Income Funds for these two months. Hence, we are only able to provide performance for the total Equity Fund and Fixed Income Fund during this time. CCTC's investment performance for the two Funds has an inception date of August 31, 2017.

One of the primary goals the CFNEK Board has for the management of these funds is a strict adherence to the United States Conference of Catholic Bishops (USCCB) Socially Responsible Guidelines. The Board set a target of 97.00% compliance with the USCCB Guidelines. The compliance ratio for the portfolios is subject to change due to fluctuations in the prices of individual assets and new additions to the USCCB noncompliance list. CCTC typically monitors the compliance ratio for all assets of the funds multiple times per month to help assure that the portfolio stays at, or above, the 97.00% level.

At the end of the quarter, the Equity Fund compliance level was 97.1%. The compliance ratio at quarter end for the Fixed Income Fund was 99.9%. A hypothetical balanced portfolio of 60% stocks and 40% fixed income therefore would have resulted in compliance of approximately 98.2%.

CFNEK Equity Fund (EF)

During the first quarter, a variety of adjustments were made to the stock strategies, primarily for allocation reasons, but also USCCB purposes. Of particular note were additions to the domestic mid-cap and international developed areas, with slight reductions to CCTC USCCB Equity Income, Vanguard Russell 1000 Growth ETF and Vanguard Russell 2000 ETF.

An end of the first quarter "look-through" that classifies all the stock positions for the total Equity Fund portfolio reflected the following allocation: U.S. Large Cap 60.0%; U.S. Mid/Small-Cap 12.0%;

International Large-Cap 13.5%; International Mid/Small-Cap 5.9%; and Emerging Markets 7.2%. The remaining approximately 1.4% was in Cash Equivalents.

The total Equity Fund performance for the first quarter was 5.43% compared to 7.09% for the blended benchmark; -7.05% vs. -7.41% for the last twelve months. For the 67 months of CCTC measured performance, the Equity Fund's annualized return was 7.43% (7.61% excluding legacy alternatives) vs. 8.61% for the blended benchmark. The benchmark for the Equity Fund consists of 70% Russell 3000 and 30% MSCI All Country World Index ex-US (ACWI ex US), which closely reflects the current and long-term make-up of the portfolio.

The majority of the portfolio's underperformance during the quarter occurred during the month of March as stock volatility spiked in digestion of the potential repercussions of the Silicon Valley Bank failure and related stress in that sector. This dynamic particularly impacted the Fund's tilt toward the value style and underweight in large capitalization domestic stocks, as smaller company equities significantly underperformed during the month. For the quarter overall, growth style large capitalization stocks, for example, outperformed their value counterparts by approximately 14% to 1%, and large-caps in general outpaced small-caps by about 7.50% to 2.75%.

The CCTC performance numbers presented in this section are stated net of fees.

CFNEK Fixed Fund (FF)

The total return of the Fixed Income Fund during the first quarter was 1.85% vs. 2.33% for the Barclays Intermediate Government/Credit Index; -1.12% vs. -1.66% for the last twelve months. For the 67 months of CCTC management, the annualized return was .44% versus .95% for the index.

With a duration of approximately 2.8 years for the Fund, mostly geared to protect the portfolio from a rising rate environment, and compared to 3.8 years for the relative benchmark, the portfolio underperformed for the quarter by and large in light of a decline in yields. The rate on the ten-year U.S. Treasury Note closed at 3.49% at the end of March compared to 3.84% at the end of 2022 and 1.50% on December 31, 2021. The yield on the two-year also sank during the quarter, to 4.06% versus 4.41% on December 31 and .73% at yearend 2021. The Fund's underperformance for the quarter was predominantly due to the overweight of the shorter portion of the yield curve, and therefore a shorter duration than the benchmark.

In addition to the reinvestment of cash receipts, including proceeds from maturing and called bonds, we continued to somewhat reduce our exposure to U.S corporate bonds, while the allocation to U.S. government bonds was consequently increased.

The CCTC performance numbers presented in this section are stated net of fees.

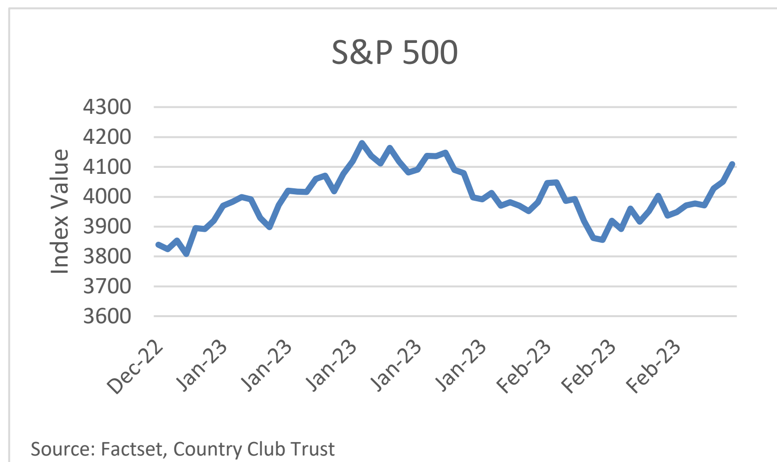
General Market Comments

There is an old saying that the Federal Reserve raises rates until something breaks and break it did. Interestingly to some, the Fed subsequently raised rates again. In addition, futures markets are telling us that there is greater than a 50/50 chance that another hike is coming in May. We will see. Milton Friedman is often quoted as saying "Monetary actions affect economic conditions only after a lag that is both long and variable." This long and variable lag is often thought of in economic circles to be 12-18 months. And, wouldn't you know it, we may be seeing some subtle signs that past rate hikes are starting to have their intended effect. Right on time! The current hiking cycle began on March 16, 2022.

We aren't short of material to write about. As usual, there was plenty of news during the quarter. Incoming data is always abundant. Markets gave both the bulls and the bears plenty to think about. We heard about a hard landing, a soft landing, and finally, a no landing. The Fed met two times, raising rates in both instances, and providing additional fodder for recession calls. Inflation was sticky, of course, but we remain optimistic that we are headed in the right direction. The employment picture remained strong, but we see cracks potentially forming.

What Worked and What Didn't

The S&P 500 finished up 7.5% in the first quarter, driven mostly by growth stocks. The Russell 1000 value returned just 1.0%, while the Russell 1000 growth was up 14.4%. Growth was up, in part, due to the benefit of falling interest rates. But we can't ignore the quality factor. Growth names that drove equity markets during the quarter tended to be large capitalization, high free-cash flow producers with low liquidity needs. In other words, they tend to be self-financing enterprises with limited use of outside capital provided by debt and/or equity markets. We can see this by examining returns of smaller companies, like those that make up the Russell 2000 growth index. This index returned 6.1% in the first quarter, 8.3 percentage points less than its large-cap cousin, the Russell 1000 growth Index. The top sectors in the quarter were technology, communication services and consumer discretionary.

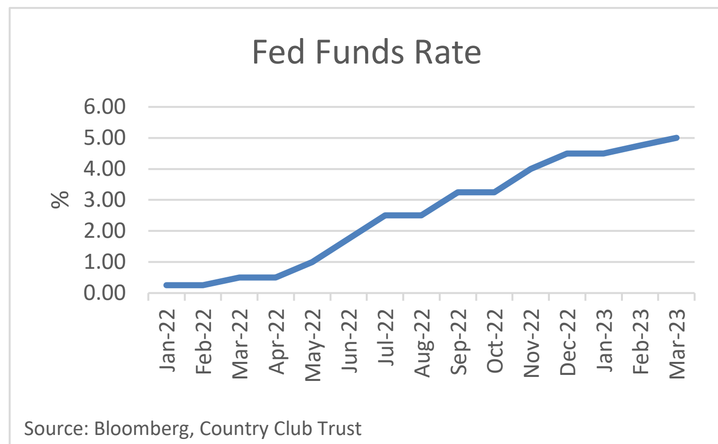


Source: Factset, Country Club Trust

International stocks traded in-line with domestic markets, with emerging markets trailing developed. The MSCI All Country World Index ex. U.S. was up 7.0% for the quarter, while the MSCI Emerging Market Index rose 4.0%. Again, the quality factor was at work.

Domestic bonds rallied into the end of March quarter, driven by lower Treasury yields. Longer maturity bonds benefited the most, as the Treasury market began pricing in slower growth/inflation ahead. 30-year Treasuries returned 6.0% during the quarter, while the 10-year total return was 3.8%. Corporate bonds, as represented by the Bloomberg Barclays U.S. Corporate Index, were up 3.5% in the quarter.

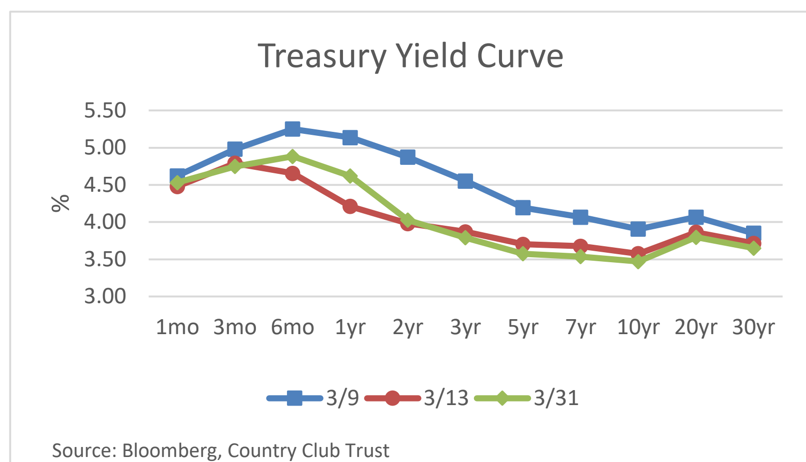
Fed May be Done



The Fed held meetings in both January and March, raising the Fed Funds rate by 0.25 percentage points at each. This was the ninth consecutive hike over the past year and has raised the effective Fed Funds rate by approximately 4.5 percentage points. The purpose of the raises, of course, is to slow the economy and stamp out the inflationary impulse we have experienced as a result of pandemic era fiscal and monetary stimulus. Higher interest rates work by making credit more expensive, raising the cost of capital used to finance a new car, a new home, business expansion, etc. Fed Funds futures are currently projecting an additional .25 percentage point hike at the May meeting but also a possible cut by September.

Four times a year, the Federal Reserve releases a summary of Federal Open Market Committee (FOMC) participants' projections for GDP growth, the unemployment rate, inflation, and the appropriate policy interest rate. These projections typically don't change much with each new release. And, after all, they are modeled estimates of an extremely complex economy. Take them for what they are. However, we believe the timing and estimates of the most recent projections, released March 22, seem to be pointing to a Fed view that a recession is imminent. Interestingly, the most recent median projection for 2023 real GDP growth is 0.4%, while the projection for the year-end unemployment rate is 4.5%. At the time of release, the Atlanta Fed's model, GDPNow, was projecting first quarter 2023 real GDP growth of 3.5% and an unemployment rate of 3.6%. The math doesn't work unless an economic contraction occurs in 2023.

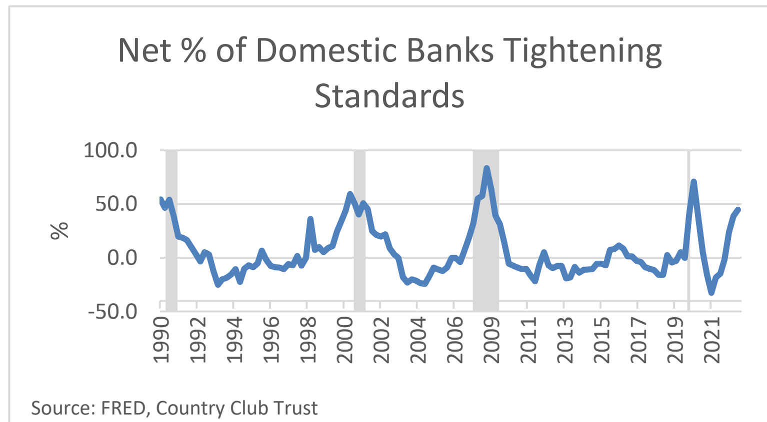
Hike Until Something Breaks



The FDIC seized control of regional bank, Silicon Valley Bank, on March 10, after a run on deposits left it insolvent. While it appears the bank failure was mostly idiosyncratic in nature, due to an outsized duration mismatch between its assets/liabilities and an extremely high concentration of technology related companies as its customers, both equity and bond investors reacted quickly to shed risk and seek safe-haven investments. The S&P 500 was down 3.4% in the days surrounding the event. It's large-cap constituents and diversification handled the shock fairly well. However, the small-bank heavy Russell 2000 was off 7.2% and the SPDR S&P Regional Banking ETF (KRE) was down 23.8%.

If volatility in the equity market didn't cause concern, moves in the Treasury yield curve made investors take notice. Bond investors viewed the event as highly contractionary in nature. Yields on the 2-year Treasury, which market prognosticators look at to gauge the direction of the economy, were down 0.89 percentage points in only 2-days of trading. The bond market seems to be projecting that both the Fed Funds rate and economic growth (inflation), will come in lower than previously thought due to further contraction in the availability of credit. We tend to agree.

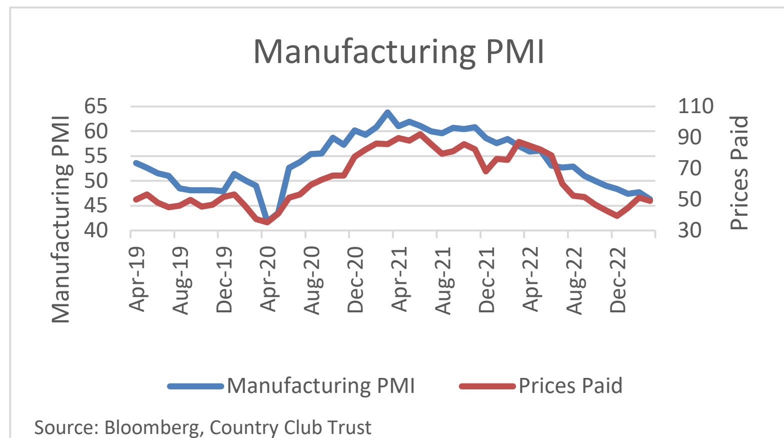
Credit Contraction



The quarterly Senior Loan Officer Survey is a good gauge of perceived credit risk by banks. As we look at the net percentage of banks tightening lending standards, we see that loan officers' overall appetite for additional credit risk is low. We believe the next survey, to be released in May, will show further contraction in the availability of credit. As mentioned previously, higher interest rates affect the demand-side for credit. Tighter loan standards affect the supply-side. Typically, these supply/demand dynamics work hand-in-hand in slowing the economy and lowering inflation. Tightening lending standards could decrease the need for additional interest rate increases.

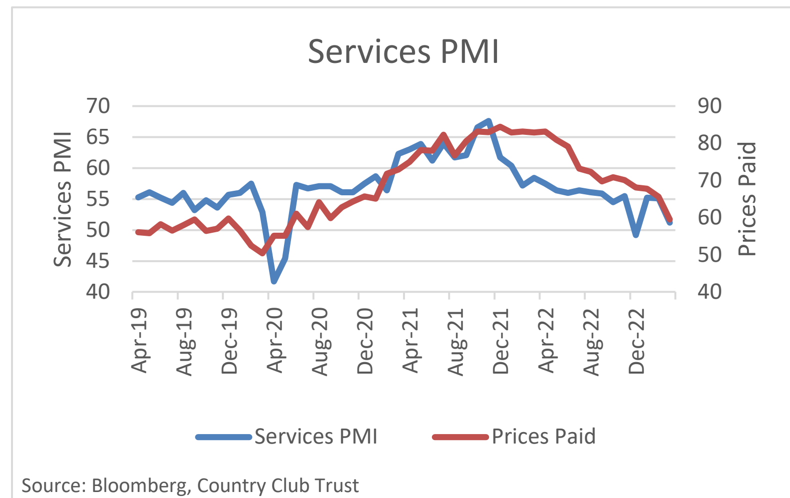
ISM PMI's – Output Trending Down in Manufacturing, Not in the Service Economy

About the closest thing we can get to real time information on the state of the economy comes from the Institute for Supply Managements (ISM) monthly survey of purchasing managers. In the survey, the ISM asks if variables related to business activity are expanding or contracting. A reading above 50 suggests that variable is expanding, while a reading below 50 suggests contraction.



During the month of March, Manufacturing PMI's continued to contract, showing a reading of 46.3. In fact,they have been contracting since November of 2022. Importantly, March was the first month in which all the variables in the survey were at levels below 50 in this business cycle. Although the manufacturing sector has been in contraction for several months, that data point does not necessarily mean we are on the verge of a

recession. Quite often, the manufacturing sector contracts while the service sector continues to drive growth. The service sector represents approximately 80% of the U.S. economy.

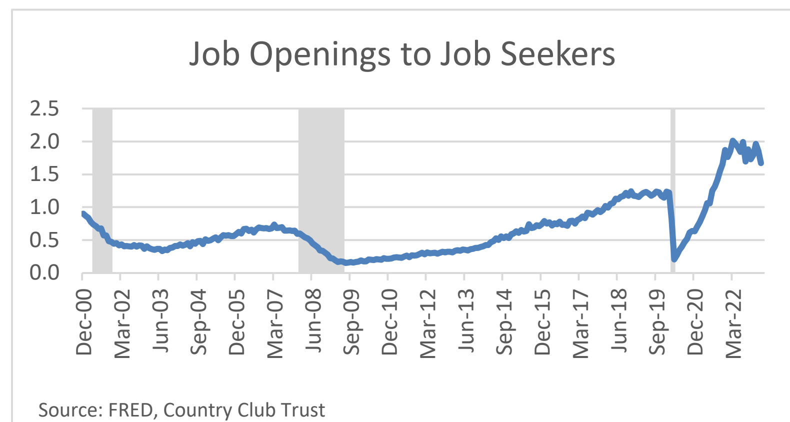


Source: Bloomberg, Country Club Trust

Case in point, the services PMI continues to expand, albeit at less aggressive rates than the recent past. The services PMI peaked in November of 2021 at 67.6, and has fallen to a reading of 51.2 in March. Increased interest rates are definitely having an impact on services PMI components. The largest constituent of the services PMI (real estate, rental and leasing), making up almost 14% of GDP, was listed as the component having the largest decrease in new order activity.

Markets are closely watching the prices paid component of the PMI surveys, as indicators of future rate hikes by the Fed. March presented us with a mixed bag of news. In the manufacturing sector, the prices paid figure dropped about 2%, to 49.2, from a reading of 51.3 in February. This suggests prices are fairly sticky. The prices paid component has been in a range of 52.5 to 39.4 since August, 2022. The March services price index figure, which economists view as a sign of consumer spending inflation, came in at 59.5. This suggested a fever break after 29 consecutive months of readings north of 60. We saw 10 months above 80 and an all time high of 84.5 in December of 2021. Prices paid have dropped rapidly, but are still at worrisome levels for the Fed.

The ***Really*** Important Stuff – Employment



Source: FRED, Country Club Trust

If you really want to know the state of the economy, look no further than the labor market. Expansion in employment leads to increased national income and most likely, increased spending. The labor market has been incredibly resilient, post the pandemic shut-down.

The Job Openings and Labor Turnover Survey (JOLTS) can be a useful indicator of where the labor market is heading. The February report showed total private job openings were down 599,000 from January, though still at a healthy level from a historical perspective. The greatest

number of openings continue to be found in service industries such as professional and business services, health care and social assistance, accommodation and food services, and retail trade. These industries accounted for 63% of non-government job openings. Importantly, the number of openings in these service industries fell by 625,000 from January levels. These industries have been important drivers of labor demand since pandamic lock-downs began to fade, and may be an indicator that the red-hot labor market is starting to crack. In the past, a downturn in the job openings to unemployed has been a useful indicator of a pending downturn in the economy.

In Summary

We believe rate increases are beginning to bite the economy and will work to drive inflation down to sustainable levels. We saw signs of this emerge in data collected before recent bank struggles. Keep in mind, we have only recently begun to feel the effects of past rate hikes, and they will continue to filter their way through the economy. We also believe that the availability of credit will continue to decline as banks preserve capital. The result, we believe, is economic contraction as we move into the back-half of 2023. It is important to note that this is our belief, and not a certainty. Events could play out to form a different outcome, and we must be prepared for that as well.

The performance data presented reflects past performance which is no guarantee of future results as investing involves risk of loss. Country Club Trust Company (CCTC) restructured its investment division by forming a wholly owned subsidiary, Tower Wealth Managers, Inc. (TWM), a Registered Investment Advisor, on July 11, 2007. The inception date for TWM investment management was 08/31/2017.

Performance is calculated as a total return, which includes the impact of varying levels of cash held in the strategy. Pre-CCTC/TWM performance is calculated by: using information provided to TWM by CFNEK from inception of their portfolio through 06/30/2017 (net of fees) and an internal rate of return for the months of July and August 2017. Performance is calculated gross of fees, unless otherwise stated. Effective 4/1/2023, for net performance calculation purposes, all fees are considered investment management fees. For additional information regarding performance, please refer to the CFNEK quarterly report.

Some information provided above may be from an outside source believed to be reliable, but no representation is made as to its accuracy or completeness. Commentary provided is for discussion purposes only and should not be considered a recommendation.

*As of 12/31/2021, TWM was merged into CCTC and CCTC was subsequently merged into its parent company, Country Club Bank. CCTC continues as investment manager for CFNEK.