PRIVATE WEALTH
MANAGEMENT

CITY OF ALBANY POLICE & FIRE PENSION FUND

June 30, 2022

PRESENTED BY:

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Senior Vice President

Table of Contents

1. Portfolio Review
   - Asset Allocation
   - Analysis of Changes in Market Value
   - Investment Performance Results
2. Economic and Investment Overview

Asset Allocation

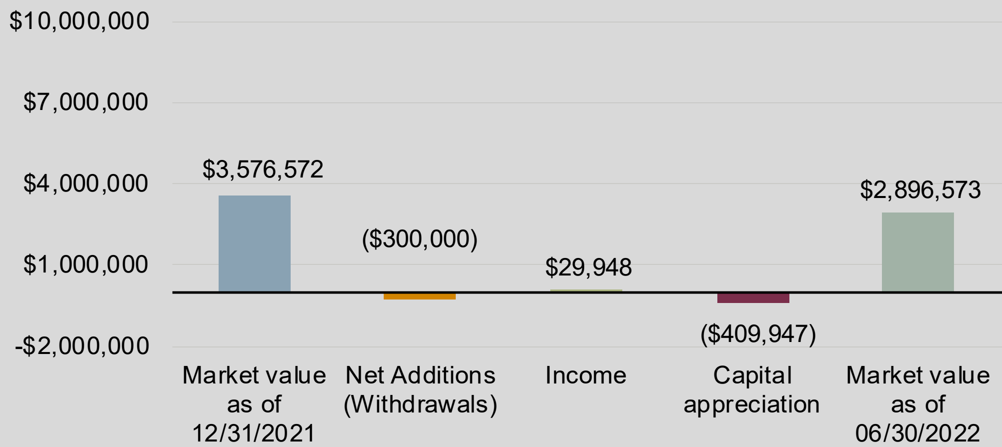
Value as of 06/30/2022

Total portfolio as of 06/30/2022			
Asset allocation		Market value	Current allocation
Cash & Equivalents	**$**	**72,297**	**2%**
Fixed income	**$**	**1,190,509**	**41%**
PIMCO Inv. Grade Corp. Bond Fund	$	595,952	21%
Dodge & Cox Income Fund	$	594,557	21%
Equity	**$**	**1,633,767**	**56%**
Dodge & Cox Stock Fund	$	1,633,767	56%
Total	**$**	**2,896,573**	**100%**

Change in Market Value – YTD 2022

Market value as of 06/30/2022

Market value as of 12/31/2021	**$**	**3,576,572**
Net Additions (Withdrawals)	$	(300,000)
Income	$	29,948
Capital appreciation	$	(409,947)
Total Return	**$**	**(379,999)**
Market value as of 06/30/2022	**$**	**2,896,573**



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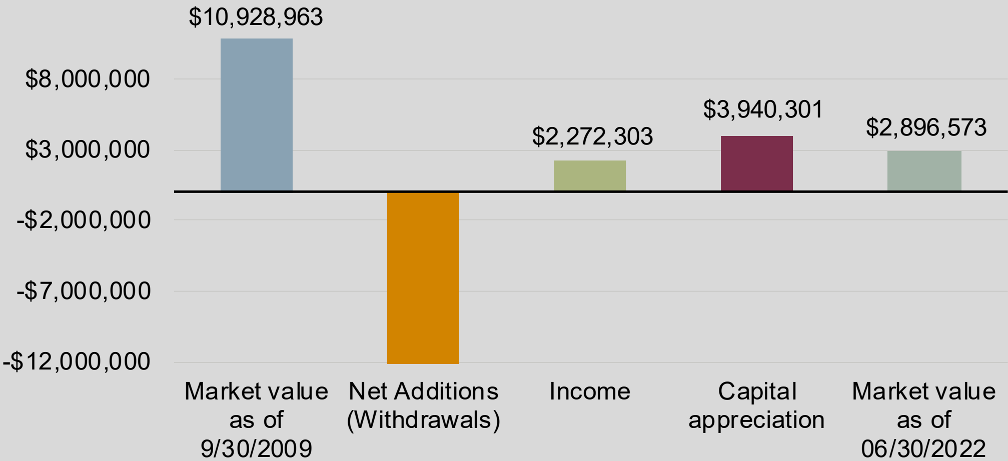
Change in Market Value – Since Inception

Market value as of 06/30/2022

Market value as of 9/30/2009	**$**	**10,928,963**
Net Additions (Withdrawals)	$	(14,244,994)
Income	$	2,272,303
Capital appreciation	$	3,940,301
Total Return	**$**	**6,212,604**
Market value as of 06/30/2022	**$**	**2,896,573**



Investment Performance Results

Period ending 06/30/2022

All numbers in % and gross of fees	YTD	Last 3 Years	Annualized Since Inception	Inception Date
Total Portfolio	**-10.79%**	**4.48%**	**6.70%**	**9/30/09**
Fixed Income	**-11.72%**	**-0.53%**	**3.63%**	**9/30/09**
Barclays Gov/Corp Intermediate	*-6.77%*	*-0.16%*	*1.61%*	
Equity	**-11.54%**	**11.42%**	**11.07%**	**9/30/09**
Dodge and Cox Stock Fund	**-11.54%**	**11.28%**	**9.59%**	**9/30/09**
Russell 1000 Value Index	*-12.86%*	*6.86%*	*10.48%*	
S&P 500 with Income	*-19.96%*	*10.59%*	*12.73%*	

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FINANCIAL MARKETS MONITOR

Third Quarter 2022

A look back: Market scorecard

Q2 2022: Stocks and bonds into bear market territory

The intense sell-off in equities continued, driven by high inflation, tighter policy from the Fed and worries about recession down the road.

Interest rates rose across the yield curve. Credit spreads widened, and corporate securities underperformed.

Commodity prices continued to soar for most of the quarter but receded in June as recession fears grew. Supply concerns continued to stoke oil prices.

Total returns as of June 30, 2022

	Year-to-Date	Trailing 1-year	Trailing 3-year
Stocks			
US	-19.96%	-10.62%	10.60%
Developed International	-19.57%	-17.77%	1.07%
Emerging Markets	-17.63%	-25.28%	0.57%
Bonds			
Long-Term Treasuries	-21.25%	-18.45%	-2.94%
Intermediate Govt/Corp	-6.77%	-7.28%	-0.16%
Corporate High-Yield	-14.19%	-12.81%	0.21%
Commodities			
Bloomberg Commodity Index	18.44%	24.27%	14.34%
Oil (Brent)	57.34%	75.01%	24.89%
Gold	-1.53%	1.31%	6.95%

Source: FactSet SPAR, June 30, 2022. Indices used are S&P 500, MSCI EAFE (net), MSCI Emerging Markets (net), Bloomberg US Agg Long-Term Treasury Total Return Index, Bloomberg Intermediate US Govt/Credit Total Return Index, BofA Merrill Lynch High Yield Master Index, Bloomberg Commodity Index, Bloomberg Brent Crude Oil Total Return and Bloomberg Gold Subindex Total Return.

Investment themes

- There are gathering signs of recession risk, and inflation readings remain elevated. Thus, the economic backdrop is sub-optimal for financial markets.
- Federal Reserve (Fed) Chair Jerome Powell pronounced his anti-inflation resolve as "unconditional." We take him at his word and expect a series of rate hikes into 2023. An inverted yield curve is increasingly likely.
- While most of the damage in this equity bear market has probably already occurred, there is likely some additional downside ahead. Moreover, the bottoming process could be elongated before a sustainable recovery occurs.
- The following conditions would be necessary for us to get more bullish on equities: A convincing decline in inflation, a "downside surprise" on the peak for the Fed's tightening cycle, and more realistic corporate earnings estimates.

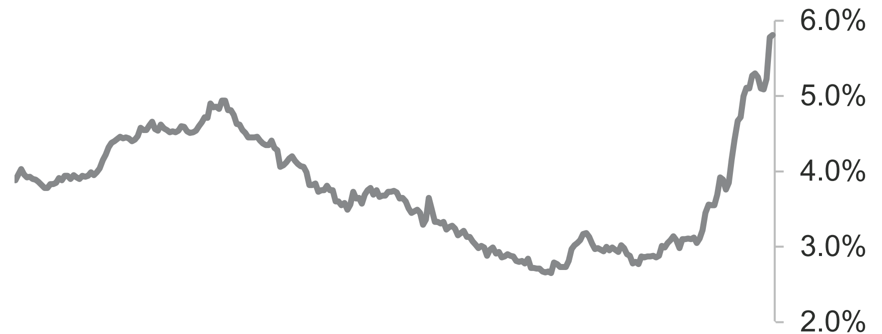
US economy

The economic expansion is at risk

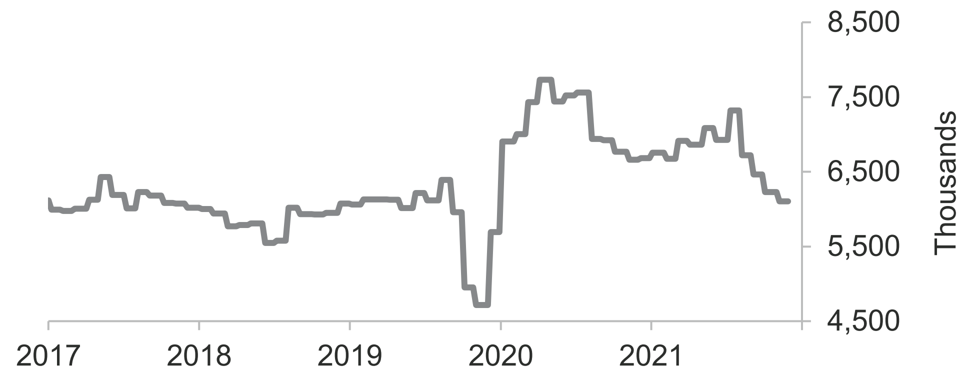
- **High inflation and the Federal Reserve's policy response are beginning to take a toll on economic growth. Interest rate-sensitive sectors such as housing have already slowed.**
- With further rate hikes ahead and early signs of wobbles in the job market, we believe recession risks are rising. In a recent survey of economists, 70% expect a US recession next year.*
- The best chance of recession avoidance would be a quick and dramatic slowing of price pressures. While we believe inflation is close to a peak, it appears unlikely that it will retreat significantly on its own. The demand destruction inherent in a recession could be deemed necessary by the central bank to bring inflation down to an acceptable rate.
- A sub-optimal mix of high inflation and weaker growth is likely to continue for several quarters, producing a challenging backdrop for investors.

Housing market: Higher interest rates, lower sales

Average 30-year mortgage rate



Total home sales (new and existing)



*Source: Financial Times/Univ. of Chicago survey, June 12, 2022.

Source: FactSet, as of June 29, 2022.

Global economy

Different regions, different challenges

- The global economy is marked by diverging challenges and related policy responses.
- Europe is plagued by high inflation, slowing economies and the continued threat of energy insecurity due to the Russian invasion of Ukraine. The European Central Bank is four months behind the Fed in enacting interest rate hikes.
- **China and Japan—the second- and third-largest economies (respectively)—face a different set of issues: slow growth, low inflation and depreciating currencies. The lack of price pressures means their central banks can employ stimulative monetary policy to prop up their economies. They have begun to do so.**
- As China looks toward its National Congress of the Communist Party in the fall, the government is likely to pull all available levers to create momentum leading into the affirmation of another term for President Xi. Monetary, fiscal and regulatory policies are likely to turn more friendly and boost economic activity in the months ahead.

Source: FactSet, as of May 31, 2022.

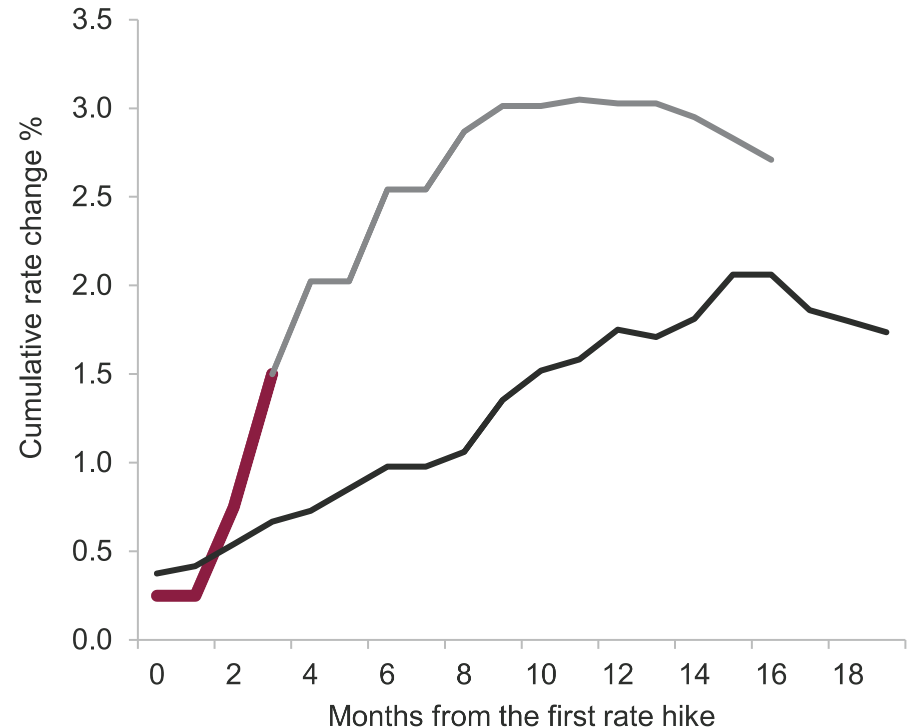
Federal Reserve

Aggressive response

- Data released in the second quarter disappointed hopes for "peak inflation" and sparked a repricing of expectations for monetary policy. Markets lifted short-term rates in the days leading up to the Fed's June 15 meeting, and the central bank confirmed those expectations with their largest rate hike in 28 years.

- The Fed also raised projections for the level of short-term rates required to bring inflation under control and expressed a willingness to increase rates by 0.50% or 0.75% at upcoming meetings.

- **The path of rates signaled by the Fed and anticipated by markets would bring the policy target above 3.25% by the end of 2022. The cumulative increase in rates would be the most of any Fed tightening cycle since the Paul Volcker-led moves of the early 1980's and indicates a greater willingness to accept a recession in exchange for price stability.**



Source: Bloomberg, CIBC Private Wealth, July 1, 2022.

Credit markets

Credit risks are rising, but businesses seem prepared

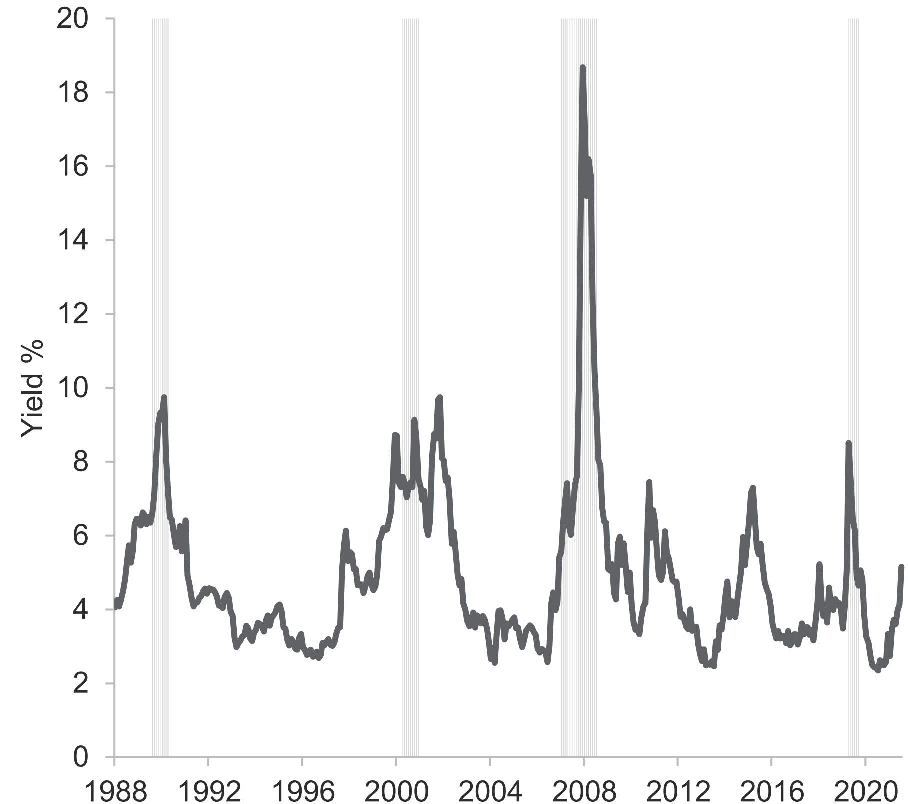
- The Fed's pivot to focus on inflation coincided with higher risk premiums in all asset classes. Prior sell-offs tended to contribute to economic slowdowns, as those in need of capital were not able to access markets at affordable levels.

- **High-yield corporate bond spreads in the last four economic recessions averaged nearly 9%. Current spreads in the riskiest area of corporate credit remain well below prior recessions and could be reflecting healthier corporate balance sheets.**

- Net leverage for nonfinancial borrowers is lower than the pre-recession average for the last four business cycles, and financial borrowers have built in greater equity buffers as a result of regulatory requirements imposed after the Great Financial Crisis.

- Fed tightening cycles restrict access to capital and can expose borrowers to greater refinancing risk. The average nonfinancial corporate borrower appears better positioned in the current cycle and should be able to weather a period of market volatility.

High-yield bond spreads



Source: Federal Reserve, Bureau of Economic Analysis, Bloomberg, June 28, 2022.

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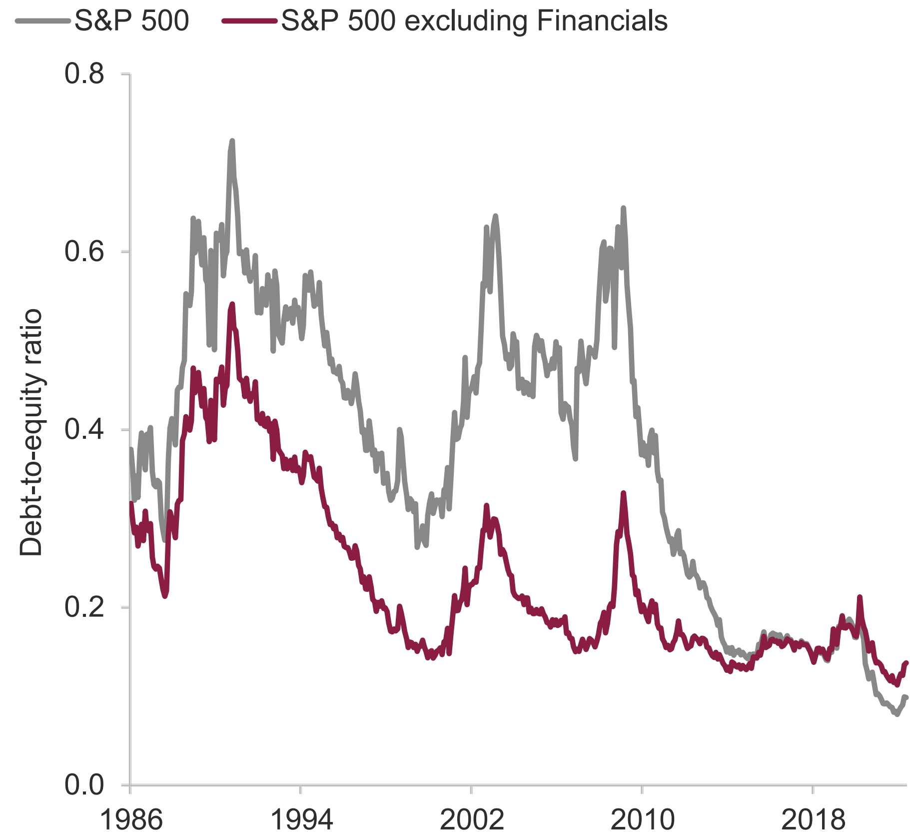
US equities

Corporate leverage remains low relative to history

- US equities experienced their worst quarter since the pandemic sell-off in the first quarter of 2020, and the worst first half of a year since 1970. Increasing levels of inflation, higher interest rates and the Russia-Ukraine conflict pushed equities down as investors began to question the potential for a US recession ahead.

- Consumer discretionary, communication services and technology sectors underperformed the broader market. Energy was the sole sector positive on the year, while energy-oriented sectors, including industrials and materials, outperformed along with safe havens, such as consumer staples, healthcare and utilities. Value significantly outperformed growth, and large caps bested smaller market capitalizations. Highly speculative investments fared the worst in the pullback.

- **As the Fed moves to reduce the highest level of inflation in a generation, investors are closely watching for signs of market stress. Corporate balance sheet leverage—historically, a pressure point at times—has been well behaved since the Great Financial Crisis. Thus, there is less worry over a systemic shock to the financial system as economic growth slows and recession risk rises.**



Source: FactSet, BofA Securities, May 31, 2022.

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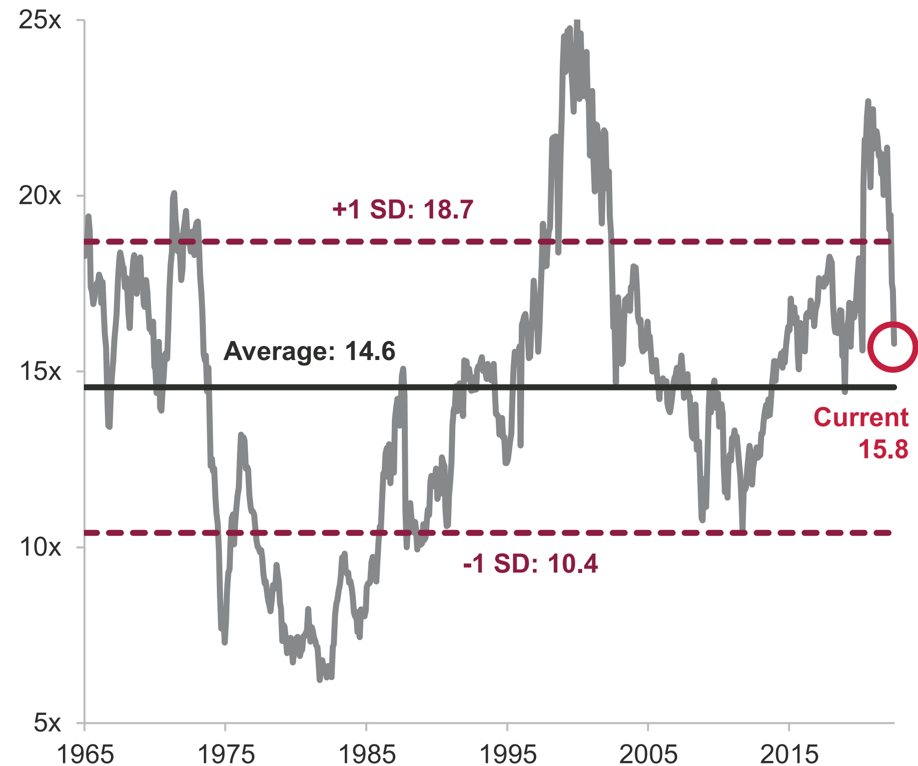
US equities

Equity market valuations back to average, but don't tell the whole story

- **Valuations of US equities have moderated significantly from well above average to average. This has been a direct result of rising interest rates as the Fed attempts to reverse measures of high inflation. While a segment of investors consider the improved valuation level as a "buy the dip" moment, additional near-term caution is warranted. We currently have poor visibility on a potential upcoming recession.**
- Stock prices pulled back; however, forward earnings expectations continue to rise. We expect some moderation of earnings expectations in the second half of 2022, and potentially significantly more if a recession develops going into 2023. Therefore, stocks appear less attractively valued since they are based on current earnings estimates that we view as unduly optimistic.
- Additionally, investors tend to embrace equity drawdowns at lower valuation levels. Trough valuations after market sell-offs are historically well below today's average valuations—especially as short-term interest rates are expected to continue to move higher, serving as a governor on the market's multiple. Should visibility into a short and shallow recession develop, the opportunity may not be far off, but we advocate some degree of caution as the economic and earnings deceleration is likely ahead of us.



Source: Standard & Poor's, FactSet, Refinitiv, Credit Suisse, June 30, 2022.
P/E = price-to-earnings ratio. SD = standard deviation.

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Volatility tends to expose speculative markets

Drawdown in the crypto sector has been severe

- The increase in volatility across markets has put pressure on global digital currencies, as well as the entire cryptocurrency industry. The implication of the drawdown could have a lasting impact, but probably not material to the overall global economy.
- **At midyear, cryptocurrencies were down more than 75% from the November 2021 peak, and it is estimated that over $2 trillion has been wiped out of the crypto industry since that time period.***
- The crypto mining industry is facing headwinds from both lower coin prices and higher costs associated with the electricity needed to mine those coins. Firms lending to mining and blockchain companies could be at risk, given their highly-leveraged positions.
- The potential fallout from the recent drawdown is typical of an emerging industry. We believe the overall industry is going through a cycle that will end up with winners and losers. Calls for more regulation are likely to get louder and may shake out speculative investors.

Bloomberg Galaxy Crypto Index

*Source: CoinMarketCap, June 29, 2022. CIBC Private Wealth does not currently offer direct investments in cryptocurrencies. Information is intended for educational purposes only.

Source: Bloomberg, June 27, 2022. Index measures the performance of the largest cryptocurrencies traded in US dollars. The top five holdings are Bitcoin, Ethereum, Cardano, Solana and Avalanche, making up over 85%. The index is co-branded by Galaxy Digital Capital Management.

Asset class views—portfolio strategy

Q3 2022

Global equities—neutral

US Equities: A much more aggressive policy stance by the Fed to combat stubbornly high inflation remains a headwind on US equities. Investors are becoming increasingly concerned over the chance for a recession as economic data shows a slowing economy. We remain cautiously optimistic but will be watching earnings guidance in the near term. Valuations have started to become more attractive.

International Developed Equities: Higher commodity prices and greater dependance on energy imported from Russia increase economic risks to Europe vs. the US. Inflation pressures have increased along with a slowdown in economic activity. The European Central Bank announced its intention to hike rates in July—the first hike in over a decade.

Emerging Markets: The COVID-19 outbreaks in China that resulted in lockdowns are starting to ease. However, growth has slowed in many emerging economies. The Russia-Ukraine conflict has also impacted developing economies due to tighter trade ties in energy, agriculture and technology.

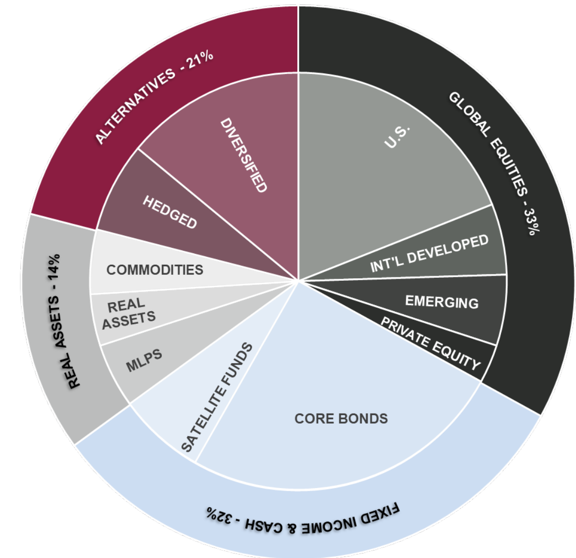
Fixed income and cash—underweight

Core Fixed Income: Tighter Fed policy and persistently higher inflation has put upward pressure on shorter-term yields. The yield curve has flattened recently as investors are becoming more concerned about a slowdown in the economy. Credit spreads have widened as well.

High Yield: High-yield spreads to Treasuries have continued to move wider as concerns grow over a slowdown in economic activity. The more aggressive Fed tightening cycle could continue to put pressure on high-yield credit. Expected default rates have recently started to move higher, according to Moody's.

Recommended portfolio strategy allocation:

Moderate risk profile



Real assets and alternatives—overweight

MLPs: The ongoing conflict in Ukraine with Russia has led to a greater focus on securing reliable energy from North America. Although economic data has weakened, demand for energy remains high with supplies low. Elevated inflation periods tend to contribute to better relative performance for the energy sector.

Real Estate: Residential housing has been impacted by higher mortgage rates, while rental demand has increased. Office vacancy rates have slowly declined as workers are returning to offices. Industrial and hotel properties have fared well, according to the National Association of Realtors.

Alternatives: Elevated volatility and expectations for moderate returns from traditional assets can provide an opportunity for lower-correlated diversified hedge fund strategies. We believe opportunistic strategies are becoming more attractive, given the drawdown in both equity and credit markets in 2022.

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