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Chartwell Strategies Current Outlook and Investment Strategy

"Luck favors the prepared mind"
-Louis Pasteur,
French scientist

Summary

- *Stock prices retreated across a broad front in the first quarter as higher interest rates led to concerns of recession. High tech growth stocks were most vulnerable to this trend, while value-oriented stocks such as energy companies and other natural resource-related stocks performed well.*
- *The Chartwell-managed accounts outperformed the major indices by a significant margin and experienced modest declines of 2.5 percent or less.*
- *The consumer price index (CPI) registered an 8.55 percent gain in the first quarter as rising commodity prices pervaded the entire economy.*
- *The Federal Reserve Board (FRB) has taken a more aggressive position to mitigate inflationary pressures and expects to be raising interest rates in 25 to 50 basis point (bp)* increments.*
- *Although poised to participate in any rebound, Chartwell portfolios have been modified to reflect the uncertainties presented by the Russian/ Ukraine war, increased government spending and the FRB's commitment to fight inflation.*

Background

Inflation was the important economic story in the first quarter of this year. Inflationary pressures began to surface during the second quarter of 2020 when agricultural commodity prices started to rise across a broad front. The prices of corn, cotton, soybeans, and wheat rose sharply, no doubt in response to the shutdown of the world economy caused by the pandemic. As the pandemic began to recede and world economies started to expand, inflation spread to other commodities such as aluminum, copper, iron, lumber, natural gas, and oil. Oil, which had been trading at $60 per barrel prior to the pandemic, fell to $10 per barrel during the shutdown, recovered to $60 per barrel in early 2021 and then advanced steadily to $130 per barrel after the passage of the $1.9 trillion American Rescue Plan in March 2021.

The United States uses twenty-million barrels, and the world uses one-hundred million barrels of oil on a daily basis. That oil is refined into different hydrocarbons required to make many different products such as asphalt, diesel fuel, gasoline, heating oil, jet fuel, plastics, polyurethane, synthetic fabrics, tires and hundreds of intermediate and end user goods. Obviously, oil is fundamental to the world economy, however, the FRB's Chairman, Jerome Powell, clung to the belief throughout the second half of 2021 and first quarter of this year, that these inflationary forces were "transitory."

The definition of a basis point is one hundredth of one percent.

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FLUCTUATIONS IN U.S. NATURAL GAS PRICES OVER A TWENTY YEAR PERIOD
2002-2022

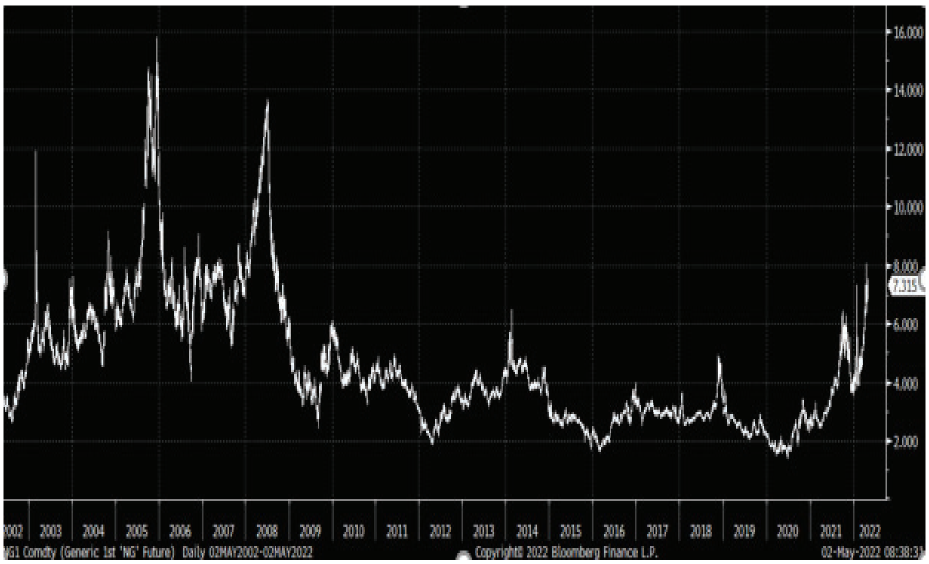

Figure 1. AFTER BOTTOMING IN JUNE 2020, NATURAL GAS PRICES HAVE SOARED IN RESPONSE TO WORLDWIDE DEMAND
Source: BLOOMBERG

Meanwhile, copper prices rose 77 percent and lumber prices vacillated widely, making it impossible to predict housing costs; in recent days, lumber prices have been trading 158 percent higher than pre-pandemic prices. Natural gas is the most widely used heating fuel in the United States. Before the process of "fracking"* shale bearing deposits of natural gas was perfected, the price of natural gas was erratic and its use more limited. However, as shown in Figure 1, in the past twelve years, the price of natural gas has fallen as innovative drilling and related technologies increased its availability. After reaching a low of $1.43 per mcf (one thousand cubic feet) in June 2020, natural gas prices have now soared to $7.30 per mcf.

In our view, the inflation witnessed in oil and natural gas prices are symptomatic of overly zealous environmental impediments, an unfriendly judicial system and governmental rules and regulations that have reduced private investment in all domestic extractive industries. In addition, the exceptional rise in natural gas prices is due to the dependency of Europe upon Russian natural gas, which may be replaced, in part, by liquid natural gas (LNG) shipments from the United States.

When the inflation rate hit 8 percent in March 2022, Chairman Powell finally declared that it was too high, no longer transitory and that the FRB would be engaging in a tighter monetary policy, designed to raise interest rates and reduce inflation. Of course, this change in policy must be executed carefully, but could conflict with the policies of an Administration that is willing to add further stimulus to the economy in the form of unfunded legislative programs and Presidential edicts, such as the forgiveness of student debt. Fortunately, Congress seems to be less amenable to further legislative action.

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**The definition of fracking is a colloquial term for the process of extracting oil and/or natural gas from fossil fuel bearing shale.*

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YIELD* ON THE TEN YEAR TREASURY BOND
12.31.2019-04.30.2022

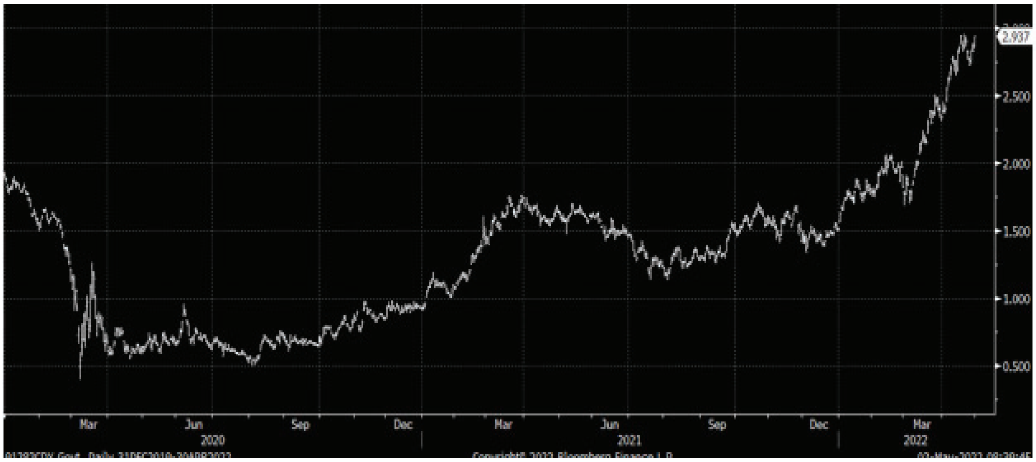

Figure 2. IN THE FIRST FOUR MONTHS OF 2022, THE INTEREST RATE ON THE TEN-YEAR TREASURY BOND ROSE SHARPLY FROM 1.5% TO 2.94%
Source: BLOOMBERG

Figure 2 depicts the interest rate on the ten-year Treasury Bond since the pandemic started. After the pandemic began, interest rates fell sharply as the economy fell into a brief recession; the yield on the ten-year bond bottomed in March 2020 at 0.4 percent. As the economy began to recover, rates moved higher and the yield on the ten-year stabilized around the 1.5 percent level. However, this year the ten-year bond yield has gone from 1.49 percent to 2.88 percent in only four months. The good news is that the belated actions of the FRB are having the desired effect of slowing the economy. On a preliminary basis, the U.S. economy is believed to have contracted in the first quarter by 1.4 percent. After adjusting for inventory and foreign trade changes, final sales rose 2.6 percent. Accordingly, the report of weaker growth may begin to moderate the inflation rate and temper the FRB's appetite for a continuation of a series of twenty-five, or fifty basis point interest rate hikes.

Higher interest rates have had their anticipated effect on stock prices. Stock market favorites, selling at high price-to-earnings ratios**, fell the most in the first quarter; for example, FaceBook, Netflix and Peloton fell 33.9 percent, 37.8 percent, and 26.1 percent, respectively. However, Apple, Amazon, and Alphabet (Google) experienced losses of less than four percent. (In April, Amazon came under severe selling pressure.)

On the other hand, some stocks, perceived as inflation hedges, did very well in the first quarter. In particular, stock prices of companies related to the energy markets outperformed. This group included oil and natural gas production and exploration, oil refining, oil and natural gas pipelines, and even coal mining companies.

The invasion of Ukraine by Russian forces, which started on February 24th, has created an unforeseen element to the inflationary problem and become a major factor in the further disruption of agricultural and steel prices, both global industries. Ukraine is the world's largest exporter of wheat, and both Ukraine and Russia are major producers of fertilizer. Ukraine is the world's eighth largest steel producer and third largest exporter of iron and steel. Responding to potential shortages in these areas, agricultural, fertilizer and steel stocks were also strong performers in the first quarter.

The financial markets are reacting to this complex inflation situation in a predictable manner; stocks selling at higher valuations have suffered most, but as discussed above, companies benefiting from inflation have seen their stock prices rise. So far, an outright panic has not developed. However, the FRB still has a difficult path to navigate in order to avoid a recession, but, has little control over fiscal spending and no control over the disruptive economic forces of a war. Consequently, the immediate future for the stock market is especially difficult to predict, making our value-oriented approach a particularly welcome strategy at this time.

**The definition of yield is the earnings generated and realized on an investment over a particular period of time.*
***The definition of price-to-earnings ratio is the current price divided by forward 12-month earnings expectations.*

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Current Strategy

As outlined above, the inflationary trend which began as long ago as mid-2020, was not a surprise as 2022 began. However, the accelerated rise in interest rates (the 10-yr Treasury yield rose from 1.51% to 2.32% in the first quarter) and most certainly the invasion of Ukraine by Russia were not anticipated events. Consequently, in retrospect, the interruption in the bull market, or market correction, experienced in the quarter is not surprising. Despite those effects, our portfolios did relatively well. The Chartwell Growth Composite declined by 2.13% in the quarter, holding up better than the Russell 2000 Value's fall of 2.40% and slightly worse than the Russell Midcap Value's 1.82% decline. The Chartwell Balanced Composite fell 2.38%, well ahead of the benchmark's decline of 3.72%. Finally, our Dividend Equity Composite, down 0.78%, was in-line with the Russell 1000 Value's negative return of 0.74%.

The modest declines of our composites in the first quarter highlight the advantage of our value style; in contrast, both the Russell MidCap and Small Cap Growth Indices were down 12.6%. In periods of rising interest rates, "longer duration" assets such as growth stocks often fare poorly.

The three best performers for Q1 in the Growth and Balanced accounts were: Baker Hughes (BKR, 2.7%)*, up 52.4%; CF Industries (CF, 1.4%), up 46.2%; and Hess Corp. (HES, 3.1%), up 45.2%. It's no surprise that the first two stocks are those of energy companies, as that sector was far and away the best performer in the quarter, owing to supply/demand imbalances, caused in part, by the war in Ukraine. CF also gained in a similar manner to energy companies; prices rose for the key commodities of this fertilizer company. The three worst performers in the Growth and Balanced accounts were: Foot Locker (FL, 0.0%), down 30.9%; General Motors (GM, 1.8%), down 25.4%; and Western Digital (2.0%), down 23.9%. The first two of these companies are in the consumer discretionary sector, which was the worst-performing sector in Q1; ongoing concerns about inflation and higher interest rates -- and newer fears about a recession -- weighed on the group. Western Digital fell after they announced production disruptions at two of their factories.

In the Dividend Equity accounts, the three best performers in Q1 were: CF Industries (CF, 1.4%), up 46.2%; Exxon Mobil (XOM, 4.0%), up 36.5%; and Abbvie, Inc. (ABBV, 3.6%), up 21.0%. CF Industries and Exxon benefited from the supply disruptions associated with fertilizer and energy companies, respectively, as discussed above. Pharmaceutical company Abbvie received an approval for the use of "Rinvoq" in atopic dermatitis, continuing the momentum in their immunology franchise. The three worst-performing stocks in the Dividend Equity accounts were: Foot Locker (FL, 0.0%), down 30.9%; General Motors (GM, 2.2%), down 25.4%; and Seagate Tech (STX, 2.1%), down 19.8%. FL and GM are covered above. Seagate was on the best-performers list last quarter, but in March they announced that they were tracking to the low end of expectations for this quarter, citing China weakness and logistics costs.

We executed a number of trades for the Growth & Balanced accounts. Petco Health & Wellness (WOOF, 2.1%) was a new purchase. This was partly to balance the sales of Foot Locker and Pulte Group, and the trim of GM, all in the Consumer Discretionary sector. We think that Petco will be more of a "defensive" consumer holding (not subject to the same economic sensitivity as Foot Locker and Pulte), as pet ownership grew during the pandemic. Defensiveness was also the thought as we bought utility company PPL (PPL, 2.0%) and added to Constellation Energy Corp. (CEG, 1.6%), which was spun out of our other utility holding, Exelon Corp. (EXC, 2.4%). Travel & Leisure Co. (TNL, 1.9%) was also a new buy, to play the "reopen" theme; the company has a portfolio of nearly twenty resort, travel club, and lifestyle travel brands. We added to our positions in Mueller Water (MWA, 3.0%), Apollo Global Management (APO, 2.4%), and Bloomin Brands (BLMN, 2.8%) on weakness. Vonage (VG) was sold in conjunction with the company take-out by Ericsson, and Assured Guaranty (AGO) was also eliminated, to consolidate our holdings in the Financial sector. Other trims of existing positions included: Micron Tech (MU, 2.1%); CF Industries (CF, 1.4%) after a very strong run – covered above; and Owens Corning (OC, 2.1%).

Trades in the Dividend Equity accounts were relatively light. In financials, we swapped out Assured Guaranty (AGO) for a new purchase of bank PNC Financial (PNC, 2.2%), which we think will be a beneficiary of rising interest rates. We added a new utility-company stock, PPL Corp. (PPL, 2.1%), as we were underweight in that sector and wanted to take advantage of its defensiveness. We also added to cell-tower REIT Crown Castle (CCI, 2.8%) on weakness. On the sell side, besides AGO, we eliminated Foot Locker (FL) after a very disappointing earnings report that raised the risk in the stock. Similarly, we sold Citigroup (C) after they posted a second consecutive quarter of results that undermined our original investment thesis (along with the heightened risk of their global footprint as it pertains to the Russia/Ukraine war, sanctions, and European recession probabilities). Pulte Group (PHM) was the final sale, on concerns that the sharp rise in rates could potentially dampen housing demand. These trades left the accounts with somewhat higher cash than normal, as we continue to search for compelling investment opportunities.

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**The numbers in parentheses following each company mentioned reflect the percentage of the portfolio's net assets comprised of such securities as of 03/31/2022. Holdings are subject to change. A full listing of portfolio holdings is available upon request.*
***All composites reflect net-of-fee returns.*

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For both the Growth & Balanced and the Dividend Equity accounts, in total, last quarter's trades reflect a dialing back of risk, or the addition of some incremental defensiveness (one and the same). The confluence of events in geopolitics and U.S. economics warrant this, we believe. While we see no reason to believe that a recession is on the horizon, the Federal Reserve's (The Fed) well-telegraphed trajectory of higher rates for months to come could be an impediment to equity returns, especially as they attempt the balance of fighting inflation while trying to engineer a "soft landing" for the economy. There are still many stocks in the portfolios that take advantage of economic growth – this is by no means a "bunker" mentality – but we thought it prudent to become somewhat more cautious (you might also see higher levels of cash from time to time for the same reason).

Chartwell News

As previously mentioned on October 20, 2021, it was announced that the parent company of Chartwell Investment Partners, TriState Capital Holdings (NASDAQ: TSC), has agreed to be acquired by Raymond James Financial, Inc. (NYSE: RJF), a leading diversified financial services company, headquartered in St. Petersburg, FL. The deal is still under regulatory review, and we do anticipate the deal to close in the 2nd quarter of 2022. Upon the close, Chartwell will continue to operate independently, as an affiliate of Carillon Tower Advisers, the $77 billion asset management subsidiary of Raymond James. There will be no changes to your account management. Your account(s) will not change custodians, investment, or client service personnel. This transaction will be seamless to you, our clients.

However, if you still have questions on the transaction, or your account, or want to discuss changes in your investment objective, please do not hesitate to call Mike Magee (610.407.4867) or Pete Schofield (610.407.4858).

A current copy of Form CRS is available upon request.

Past performance is no guarantee of future performance. Investment involves a risk of loss.

This commentary is for informational purposes only. It is not an offer to buy or sell any security and should not be construed as investment advice. The views in this report were those of the Adviser at the time of writing this report and may not reflect our views on the date this report is first published or anytime thereafter.

*The Chartwell Growth Strategy Composite includes all fully discretionary, fee-paying equity accounts with a growth objective whose asset size is $300,000 or greater at the beginning of the measurement period. For individual bond holdings the fee is 5/8 of 1% and for bond mutual funds, including exchange traded funds, the fee is 3/8 of 1%. The fee for these accounts is negotiable.

*The Chartwell Balanced Strategy Composite includes all fully discretionary, fee-paying accounts with a balance between growth and income as a principal objective whose asset size is $300,000 or greater at the beginning of the measurement period. For individual bond holdings the fee is 5/8 of 1% and for bond mutual funds, including exchange traded funds, the fee is 3/8 of 1%. The fee for these accounts is negotiable.

The composites do not include accounts where total cash flows exceed 10% of the account's value during any quarterly period or accounts holding securities purchased by anyone other than the Advisor. No accounts using leverage or short positions are included in the composites. An individual client's account may have performed better or worse than the composites' returns presented above. The composites contain taxable and non-taxable accounts. The returns are before taxes and net of all advisory fees and commission charges. The net performance results for each composite are presented after deducting the actual fee charged to each account in the composite based on the management fee schedule in the Firm's Brochure or the fee negotiated between the account holder and Chartwell. Returns include the reinvestment of dividends and interest (total return). Returns for other Chartwell composites are available upon request.

As of 03/31/2022 Chartwell managed $11.2 billion in assets, $10.49 billion as advisor and $761 million as sub-advisor. During the most recent quarter, the Chartwell Growth Strategy Composite consisted of 8 accounts which represented 8.8% of total Chartwell Strategy Individually Managed Accounts and 0.1% of total Chartwell assets. During the most recent quarter, the Chartwell Balanced Strategy Composite consisted of 18 accounts which represented 35.4% of total Chartwell Strategy Individually Managed Accounts and 0.4% of total Chartwell assets. The Chartwell Growth Dividend Strategy Composite consisted of 6 accounts which represent 3.6% of total Chartwell Strategy Individually Managed Accounts and less than 0.0% of total Chartwell assets.

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