RIVERBRIDGE QUARTERLY

1ST QUARTER 2022

MARKET COMMENTARY

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A strong March was not enough to lift the equity markets out of negative territory for the first quarter. Instead, the S&P 500 index suffered its first losing quarter in two years, breaking a seven-quarter win streak. Though corporate America had an impressive earnings season, it was not enough to offset a confluence of formidable market shaping events. The first quarter included an invasion of a European country, the Federal Reserve taking action to tighten monetary policy, inflation readings at a four-decade high, and wild market swings. The market optimism from 2021 could not overcome the paucity of positive first quarter news, leaving investors to ponder the direction of the rest of 2022.

> In many respects, it is remarkable that the equity markets did not post more significant losses in the first quarter. At one point, the Nasdaq Composite Index formally entered a bear market, as defined by a decline of 20% or greater, but the major equity indices rallied to pare their losses significantly.

Russia's invasion of Ukraine is difficult to assess purely from a market viewpoint. Neither Russia nor Ukraine are major economic powers. However, this attack has created a humanitarian crisis and has placed pressure on key energy markets, as Europe relies heavily upon Russian energy. The invasion and ensuing economic sanctions promise to complicate already stressed supply chains and place upward pressure on energy and other commodity prices. The longer-term consequences caused by this invasion will take time to fully gauge and measure.

Particularly worrisome and most consequential to investors is surging inflation. Inflation is at levels not seen in over 40 years and is eroding workers' wage gains. For the first time since 2018, the Federal Reserve raised interest rates to combat inflation. Additionally, they have signaled a series of interest rate hikes that will likely stretch over the remainder of the year. Investors fret that the Fed's restrictive actions will induce a recession. The resiliency of the American consumer, the heartbeat of the domestic economy, is being tested by higher gas prices, rising grocery bills, and increased borrowing costs. Should consumer spending slow, the recessionary risk increases.

Strong corporate earnings growth continues to be the stalwart for market optimism. Companies generally reported compelling first quarter earnings. Looking ahead to the rest of the year, most expect high single digit earnings growth. This earnings growth, combined with first quarter stock price declines, has resulted in more attractive valuation metrics. Against a backdrop of investor angst, should inflation show any sign of moderation, the equity markets may be catalyzed to move higher.

The Riverbridge portfolios are well positioned to thrive in the post-pandemic new economic normal. Though certainly not immune to inflationary pressures, our portfolio companies generally do not have business models that are significantly impacted by rising commodity prices. Lastly, as we seek companies that are internally financed, rising borrowing costs should have little impact. A long-term investment perspective is key to traversing these unsettled markets.