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<u>Update from Mercer on Recent Market Volatility</u>

Following the sell-off that began late during the week of January 29th, US equities have experienced a substantial increase in volatility, showing their biggest percentage drawdown since January 2016; these drops were consequently echoed around the globe with other developed markets feeling the full force of the events on Wall Street. This drop, albeit notable, is not extreme in percentage terms. Historically the markets have had similar falls every two years or so. However, after the extended period of extreme calm in the markets since 2009 and recent steady gains, this drop is quite jarring.

The apparent source of this decline was a higher than expected wage growth report on Friday, February 2nd which, coupled with a sustained increase in interest rates over the last month, sparked concerns of a continued move higher in nominal interest rates. Low rates have been a key support for the elevated valuation levels of the stock market, leading to concern that valuations will decline as rates rise. This became self-fulfilling and prices declined.

Bear markets rarely occur in isolation. It usually takes a recession to send the market to a lasting bear market, and we do not see a recession on the horizon. The fundamentals are generally good. Inflation has been gradually rising, but is still below the targets set by central banks. Economic growth is strong in the US and globally, and the latest tax cuts should provide some positive benefits. Corporate earnings are generally coming in strong and our expectation for the year is for strong earnings growth of well above 10%. Instead, it appears technical factors exacerbated this sell-off. In particular, there are strategies that reduce equity positions as volatility rises, which can then lead equities to fall further and spark a further increase in volatility.

We expect that this evolution will create higher volatility over the next few years, and we should be prepared for the potential for sharp drops from time to time. It is important to maintain discipline and focus on the long term.

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