

Research Review

Q4 2021

The ongoing global economic recovery that occurred throughout 2021 was accompanied by historically elevated returns across most risk-oriented corners of the market, particularly domestic sectors. The concluding quarter of the year presented risk-seeking investors with notably strong returns, despite the initiation of quantitative easing (QE) tapering by the Federal Reserve (Fed) in November. Global equity performance for both the fourth quarter and calendar year strongly favored domestic large cap, while smaller cap and internationally based indices lagged. Emerging market equities, as reflected by the MSCI Emerging Markets Index, underperformed domestic (S&P 500 Index) by more than 30 percentage points in 2021, representing the second sharpest calendar year underperformance, behind 2013, in at least two decades. Fixed income performance for both the fourth quarter and calendar year overwhelmingly favored credit-based sectors versus those of a more rate-sensitive nature, as rising inflationary pressures helped drive nominal interest rates higher. Real asset performance, in aggregate, was robust throughout the year, buoyed by a continued global expansionary bias, inflation rates at a multi-decade high, and expectations for a continuation of these tailwinds to performance over the near term.

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Economic Update

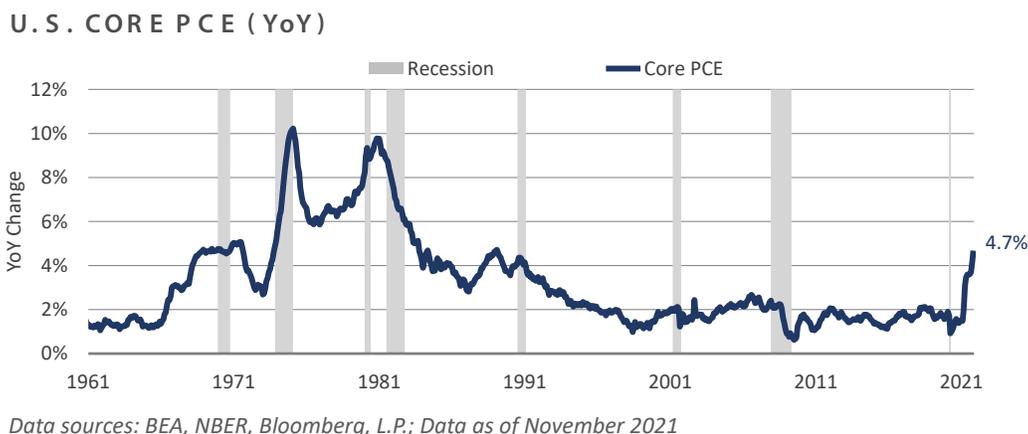
Risk Assets Shrug off Elevated Inflation, Fed Tapering, with Strong 2021 Performance

Against a complex backdrop of an overall expansionary bias and continued historically accommodative monetary and fiscal policy on one hand and sharply rising inflation rates pressing policymakers to rein in the pace of accommodation on the other, risk-based asset classes and categories generated elevated total returns in 2021.

The multi-year theme of domestic assets broadly outperforming their international peers remained firmly in place throughout most of the year, particularly when viewed through the lens of domestic versus emerging market equity relative performance. Relatedly, the U.S. dollar (USD) appreciated meaningfully against a broad basket of liquid emerging market currencies in 2021, placing some commonly referenced emerging market currency index gauges at multi-decade lows versus the USD.

In the second half of the year, a relatively robust domestic economic recovery called into question the continued need for near-zero policy rates and the previous COVID-era pace of monthly Fed asset purchases, which stood at \$120 billion per month before the initiation of Fed QE tapering in November.

Throughout 2021, the Fed was presented with ample evidence pointing to the need for a less accommodative posture. Their preferred inflationary gauge, for example, accelerated to a more than 30-year high through November, to a rate nearly 300 basis points ahead of their stated 2.0% targeted level.



With realized inflation running at a multi-decade-high pace, combined with significant improvement across headline measures of unemployment that have coincided with strong upward pressure on risky asset valuations, the Fed shifted gears to reflect a less accommodative stance in late 2021. In a widely telegraphed move, the Fed initiated the tapering of asset purchases in November by announcing a \$15 billion monthly reduction in their monthly pace of asset purchases, which pre-taper stood at \$120 billion per month in purchases.

With more timely employment and inflationary data available for their mid-December meeting, the Fed acknowledged the need for an even quicker pace of marginal policy accommodation removal and announced the doubling of the pace of QE tapering to \$30 billion, in addition to making upward revisions to the Fed's "dot plot" estimate of where committee members expect the policy rate to be in the coming years.

Market participants reflect comparable sentiment for tighter monetary conditions, with current market implied measures continuing to point to at least six 25 basis point Fed rate hikes in the coming 24-36 months, based on early 2022 data.

MARKET-IMPLIED PACE OF FED RATE HIKES

(Implied by Eurodollar Future Prices)

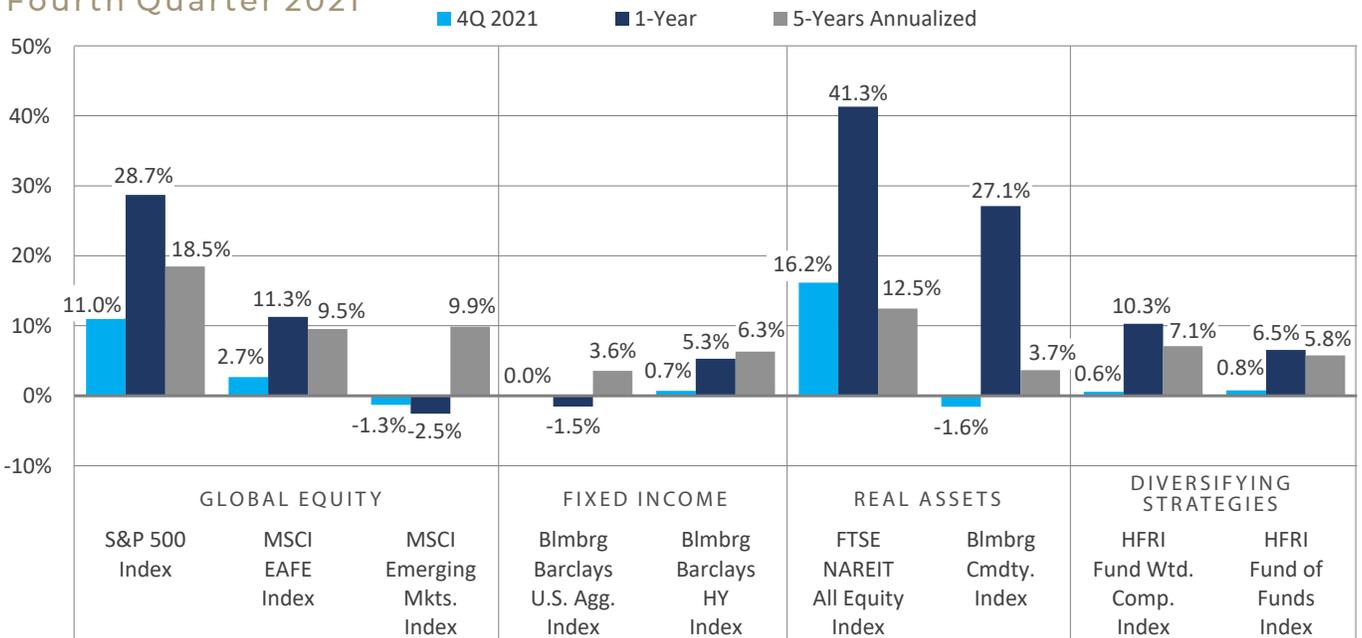


Data sources: Bloomberg, L.P., Morgan Stanley; Data as of January 6, 2022

In review, like 2020—albeit lacking the surprise exogenous event—calendar year 2021 presented global market participants with numerous potential volatility-inducing factors, including the outbreak of two dominant COVID-19 variants (i.e., Delta and Omicron), multi-decade-high inflationary rates, the announcement of the marginal removal of Fed policy accommodation, and a somewhat lackluster global economic recovery. Despite these seemingly mighty headwinds, risk assets generally posted historically elevated calendar year performance, with notably strong relative performance witnessed across domestic-oriented sectors. Over the near term, global market participants will be forced to grapple with the combination of near-record-low absolute interest rate and credit spread levels, historically elevated risky asset valuations, and attempts by policymakers to return to pre-COVID era monetary stances, despite weaker debt and demographic conditions.

Market Returns

Fourth Quarter 2021



Data sources: Lipper, HedgeFund Research

Global Equity

Global equity markets rose during the fourth quarter of 2021 due in part to strong earnings. Volatility increased in November as the highly infectious COVID-19 Omicron variant began spreading globally. Volatility quickly subsided, however, as emerging data suggested the new variant was less severe than previous COVID-19 strains.

Small cap stocks underperformed large cap stocks during the quarter due to a fear of weaker future growth prospects in the small cap universe. The Fed's signaling of rising rates concerned investors who worried increased rates could adversely affect small cap companies that do not have strong balance sheets and need access to cheap lines of capital for growth.

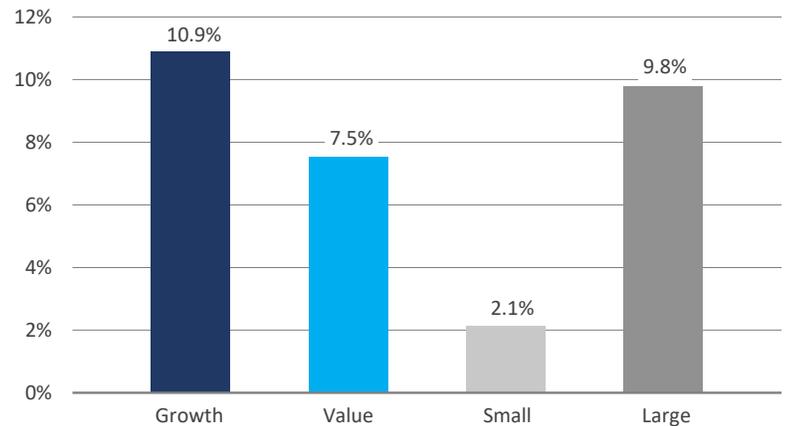
Although high beta was the best-performing factor within the S&P 500 Index in 2021, its opposite factor, low volatility, was the best-performing factor for the quarter, which returned just below 10% for December.

Europe faced an energy crisis during the quarter as the limited supply of Russian gas began to dwindle. As a result, gas and electricity prices rose sharply across the continent, coupled with falling investments in thermal energy and maintenance work on nuclear power plants.

Chinese equities significantly underperformed global equities due in part to the continued growth of COVID-19 resurgence concerns, as well as market participants digesting the ramifications of China's regulatory push. Renewed geopolitical tensions also weighed heavily on the country's market. In turn, given China's significant weight within the index, the Chinese market's underperformance weighed on the overall emerging market index.

THE MARKETS WERE LED BY GROWTH AND LARGE CAP STOCKS

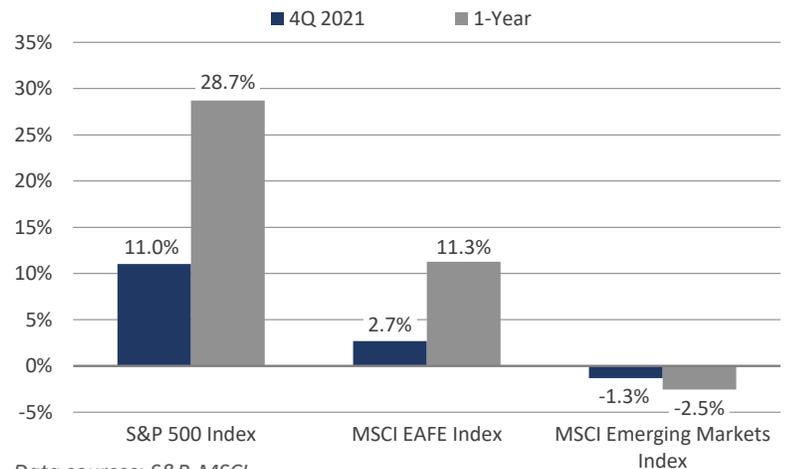
U.S. Style Returns



Data source: FTSE Russell

U.S. EQUITIES OUTPACED OTHER MARKETS

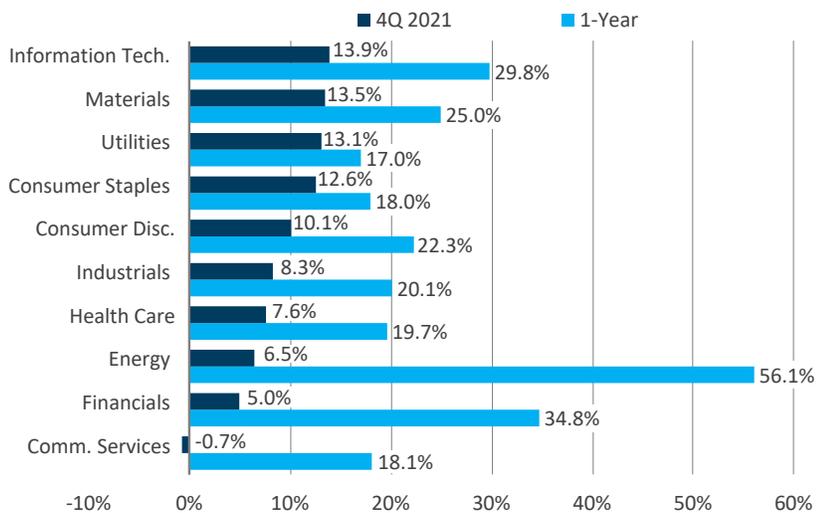
Equity Indices Performance (Returns in U.S. Dollars)



Data sources: S&P, MSCI

ALMOST ALL SECTORS FINISHED THE YEAR WITH STRENGTH

S&P 500 Sector Contribution



Data source: FTSE Russell

Fixed Income

Heightened interest rate volatility led to opposing movements along the yield curve. The 10-year U.S. Treasury yield remained unchanged for the fourth quarter at 1.52%. However, the 10-year/2-year Treasury spread decreased 45 bps to 0.79%. Movement on the front end of the curve was driven by hawkish Fed policy—specifically the Fed increasing the pace of the taper from \$30 billion per month to \$60 billion per month and hot inflation prints. This accelerated timeline will allow the Fed to raise rates as early as March 2022. Chair Powell has communicated that the Fed will not raise interest rates until the taper is complete. Long rates decreased for the quarter as the onset of the COVID-19 Omicron variant increased doubts over long-term growth.

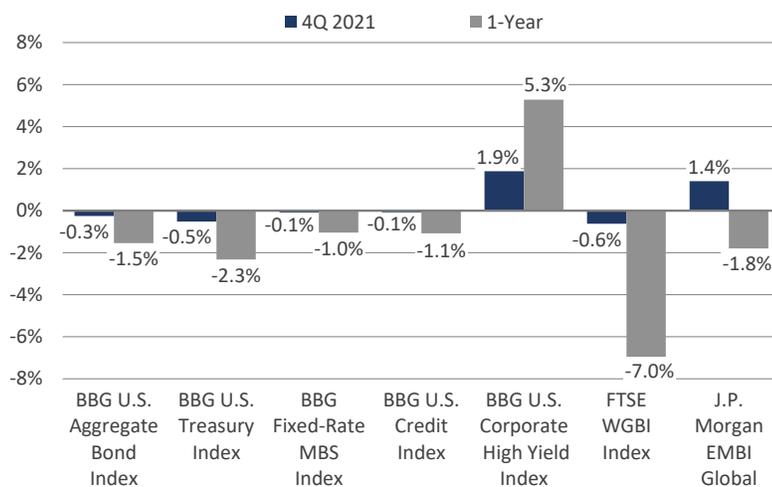
Economic data releases gave reason for concern for those with dovish sentiment during December. November's read of the Consumer Price Index (CPI) rose 0.8% on a month-over-month basis and 6.8% for the trailing 12 months, the fastest pace in nearly 40 years. Although November's non-farm payroll reading of 210,000 printed below expectations, the unemployment rate fell from 4.6% to 4.2% as the labor force participation rate ticked up 0.2% to 61.8%. The JOLTS survey identified more than 11 million job openings. Both inflation and labor readings suggest hawkish monetary policy should be a central theme in 2022.

Despite spread volatility, below investment grade corporate bonds outperformed their investment grade counterparts. December's return of 1.9% was the strongest monthly return of 2021. Technical factors contributed to performance. Since mid-December, a lack of new issue supply led to a supply-demand imbalance as investors looked to take advantage of Omicron-induced spread widening. December saw only \$8.8 billion in new issues, significantly lower than November's \$29 billion.

For the first time, 2021 CMBS sales were dominated by single-asset single-borrower (SASB) loans, as investors were willing to buy single-name single assets due to relatively more straightforward underwriting versus conduit securities. Full-year SASB issuance totaled \$77.8 billion, compared to \$31.2 billion for diversified conduits. Due to these factors,

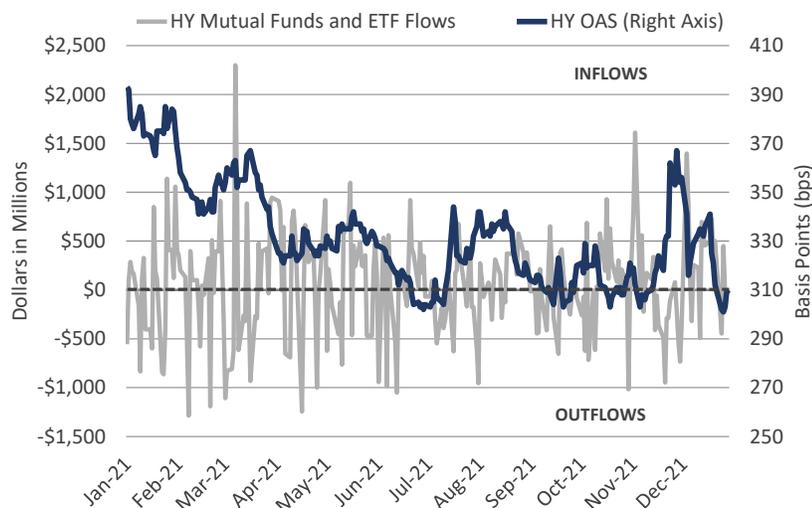
FIXED INCOME SUFFERED WITH RISING RATES

Fixed Income Index Returns



Data sources: Bloomberg, L.P., Lipper

CAPITAL STEPS INTO ACTION — NOVEMBER AND DECEMBER SEE THE GREATEST LEVEL OF INFLOWS AS HIGH YIELD SPREADS WIDEN



Data sources: Bloomberg, L.P., St. Louis Fed

the maturity wall for SASB securities has been extended past that of conduits. The market's appetite for SASB relative to conduit new issue will likely be a key theme in the future. Furthermore, CRE CLOs saw a staggering 371% increase in issuance versus 2020, with over \$45 billion of supply.

Real Assets

Real Estate

Despite concerns around the COVID-19 Omicron variant which emerged late in the year, U.S. REITs ended fourth quarter 2021 up 16.2% and finished the year with a gain of over 40%. Property sector trends remained consistent relative to previous quarters, while sectors tied to the “re-opening trade” (e.g., lodging, healthcare, and office) underperformed. In contrast, sectors considered defensive or experiencing supply-demand imbalances, such as industrial and single-family rentals, continued to have strong performance into year-end 2021.

Self-storage continues to attract capital, returning almost 80% for the year. The sector is viewed as a hedge against inflation because of its lower operational costs compared with property types that are more capital and labor-intensive. Month-to-month leases offer owners the ability to raise rents more frequently than properties with multi-year leases. Finally, the continued improvement in domestic employment has resulted in worker migration, driving demand for storage. As such, self-storage REITs have experienced attractive supply-demand dynamics, resulting in increased pricing power across the U.S.

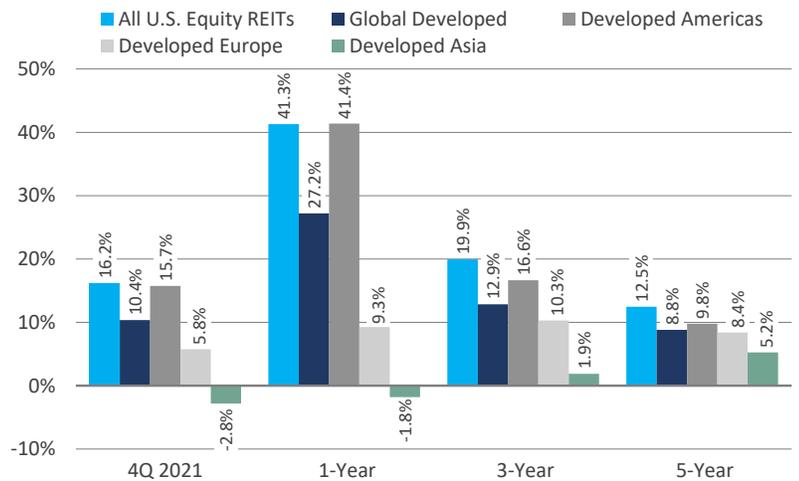
Natural Resources

Although oil markets experienced significant volatility during the fourth quarter, prices finished the period relatively unchanged at approximately \$75/bbl from the third quarter. Following a shock in late November, oil markets showed positive momentum into year-end, recovering to end the year with a gain of approximately 55% for 2021.

During the fourth quarter, natural gas prices moderated with an approximately 36% decrease from the previous high. However, relative to year-end 2020, natural gas prices have increased roughly 46%. Forward price fundamentals remain attractive as the world decarbonizes, emphasizing low-carbon power sources such as natural gas to help bridge traditional energy production to renewables. The U.S. recently became

REITs PROVIDED STELLAR 2021 RETURNS

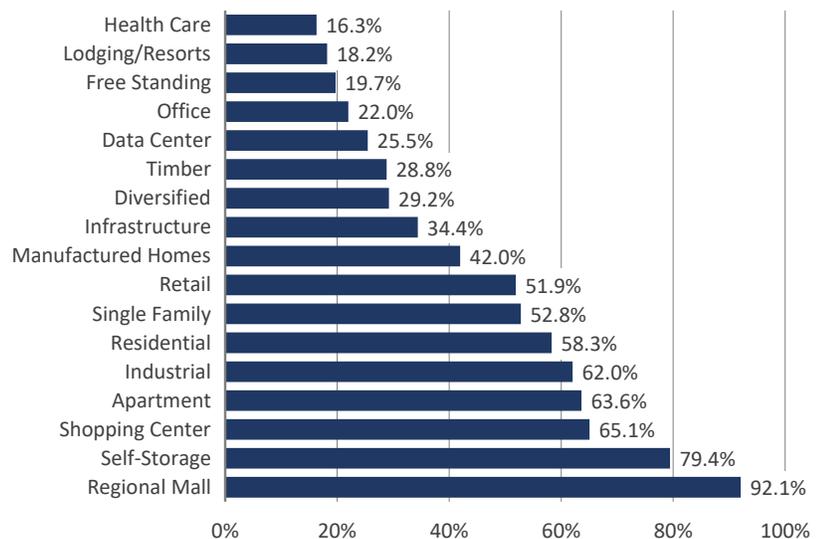
Trailing REIT Performance by Geography



Data source: Bloomberg, L.P.

REIT SECTOR RETURNS WERE A STORY OF GROWTH AND RECOVERY

U.S. REIT 2021 Performance by Property Type



Data source: Bloomberg, L.P.

the largest exporter of liquid natural gas, overtaking Russia, and now supplies much of the demand from Asia and Europe, regions rapidly becoming more dependent on natural gas for heating and power generation.

As measured by the Bloomberg Commodity Index (BCOM), commodity prices ended the quarter down 1.6%. Negative performance was primarily driven by natural gas and agricultural commodities such as lean hogs, sugar, and cocoa. Input metals such as zinc, nickel, and copper outperformed during the quarter. However, the index rose 27.1% for the whole year, as pent-up consumer demand, supply chain disruptions, and short labor supply resulted in increased demand for input materials and decreased available production and supply of commodities.

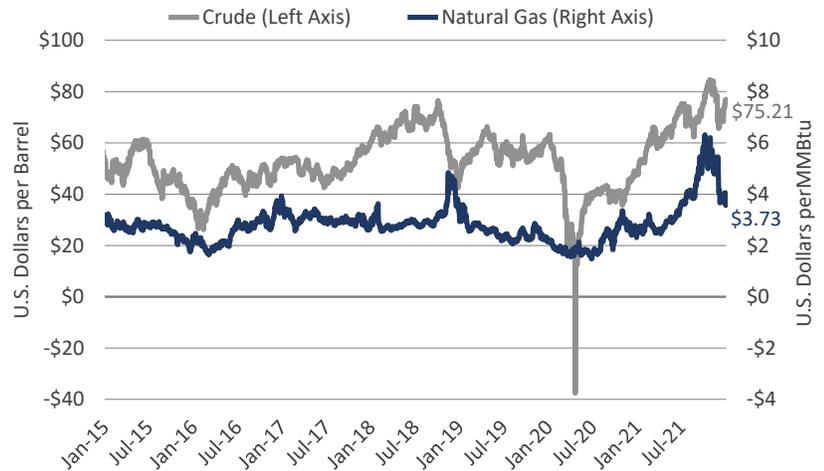
Infrastructure

Midstream energy infrastructure, as measured by the Alerian MLP Index, remained relatively flat on the back of moderating energy prices, ending the quarter up 0.6%. Continued uncertainty regarding domestic oil demand, inflationary concerns, moderating energy prices, and unclear future domestic upstream production contributed to the flat performance of the quarter.

Listed infrastructure stocks, as measured by the FTSE Global Core Infrastructure 50/50 Index, ended the fourth quarter up 7.7%. Performance for the quarter was primarily driven by railroads and water and electric utilities. Infrastructure names exhibited volatility on the quarter as investors grappled with concerns around COVID variants; however, previously beaten-down sectors benefitted from alleviating variant concerns.

NATURAL GAS PRICES FALL, BUT ARE STILL ELEVATED

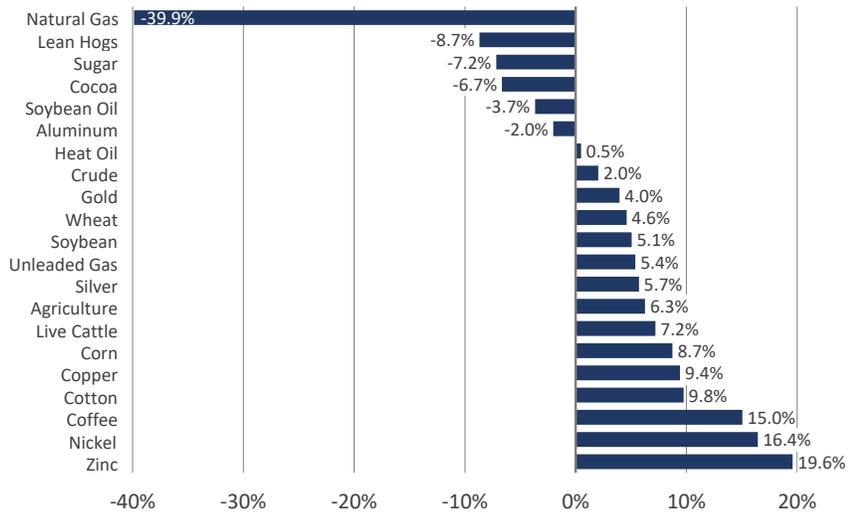
Front Month Crude and Natural Gas Price



Data source: Bloomberg, L.P.

INDUSTRIAL METALS STILL IN HIGH DEMAND

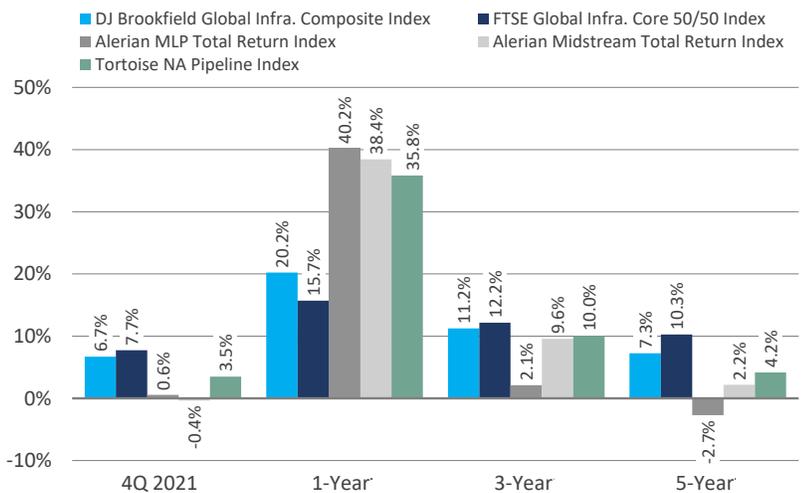
U.S. Commodity Trailing Performance



Data source: Bloomberg, L.P.

INFRASTRUCTURE POST STRONG 2021 GAINS

Listed Infrastructure Trailing Returns



Data source: Bloomberg, L.P.

Diversifying Strategies

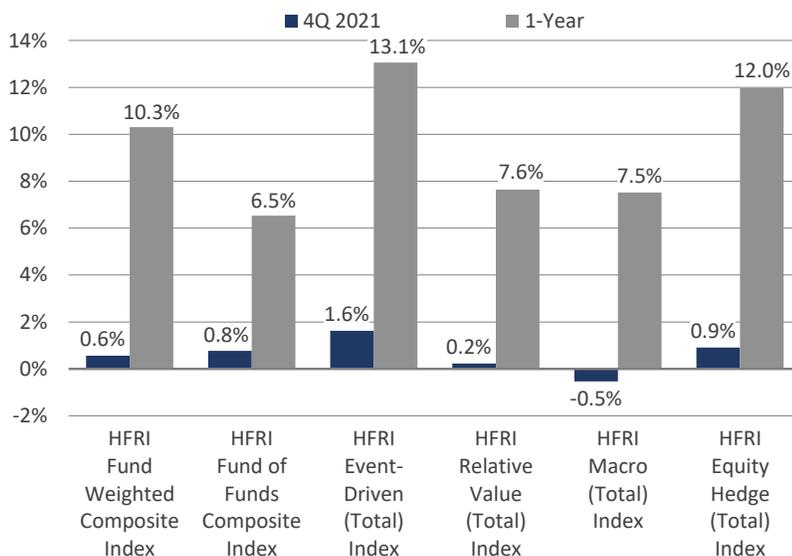
Hedge funds finished the year with solid performance across most of the strategies for the quarter. Event-driven and hedged equity strategies led performance to add to solid returns for 2021.

Within event-driven, activist managers enjoyed the most significant success rising over 5% in December. Special situations manager returns were also largely positive, as equity markets provided a tailwind to equity-oriented hedge fund strategies.

Hedged equity strategies witnessed significant gains in the healthcare and technology/healthcare sectors, which faced substantial price volatility to end the year. The largest detractor was the dedicated technology sector which faced pressures to end the year.

Within the global macro space, discretionary trading fared better than their systematic counterparts. Although, both strategies generated positive performance at the index level.

HEDGE FUNDS CAP A STRONG YEAR OF PERFORMANCE HFRI Indices Performance Returns (U.S. Dollars)



Data source: HedgeFund Research

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All data is as of December 31, 2021 unless otherwise noted.

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