RVK

Capital Markets Review | 4th Quarter 2021

December 31, 2021

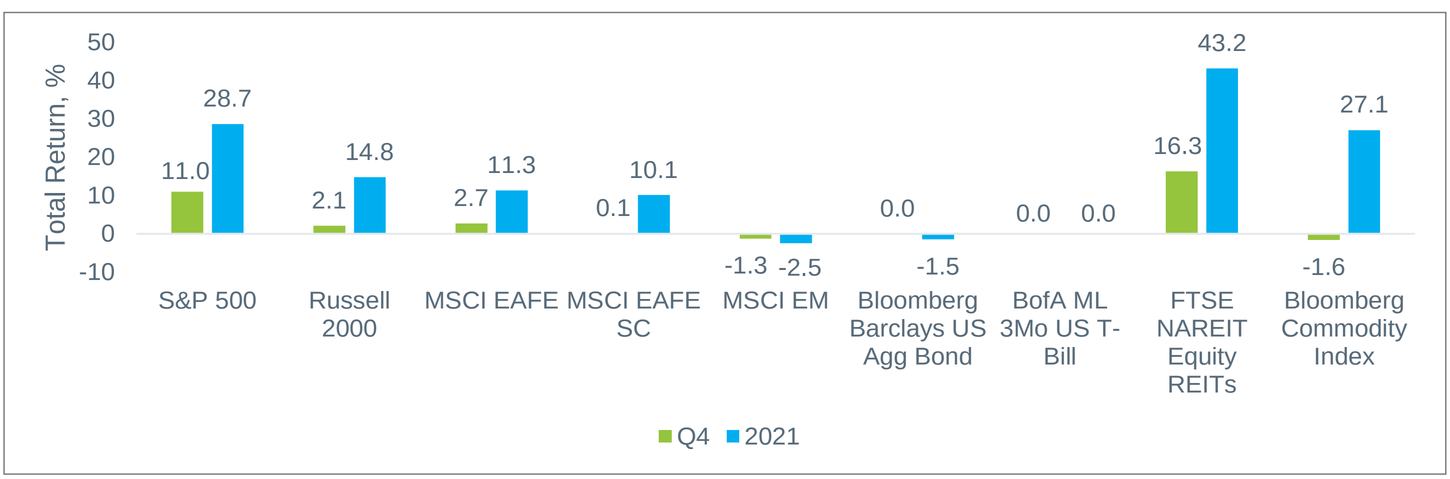
Overview

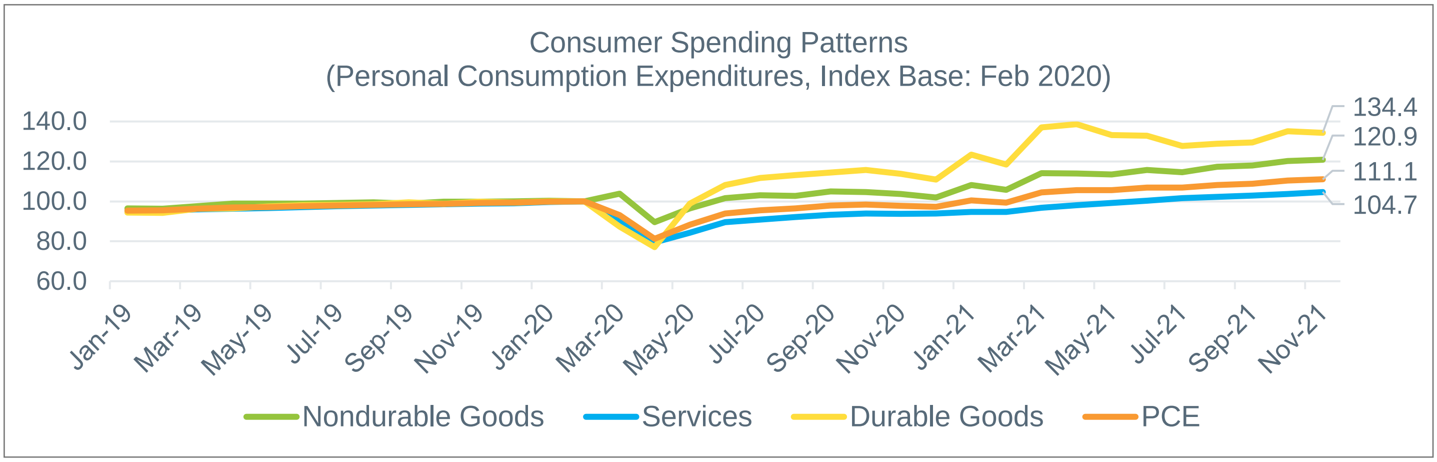
Inflation in the United States finished December at 7.0%, according to the year-over-year change in the Consumer Price Index—a level not seen since 1982. The combination of supportive monetary policy, which kept long-term interest rates low, and an unprecedented $5 trillion-plus in fiscal stimulus related to pandemic relief buoyed household balance sheets and fueled aggregate demand. As the emergence of new variants prolonged the pandemic, the rise in consumer spending flowed toward durable and non-durable goods, while services spending remained below its pre-pandemic peak in real terms through November. The world economy also experienced a negative supply-side shock from pandemic-related issues such as factories closing in Asia and periodic shortages of available workers in Europe and the United States. These combined supply and demand factors created upward pressure on prices throughout much of the global economy.

Throughout much of 2021, the Federal Open Market Committee (FOMC), led by Federal Reserve Board of Governors Chair Jerome Powell, made clear its intent to let inflation run somewhat above target to achieve a quicker labor market recovery. Although non-farm payroll growth slowed in Q3 and Q4 relative to the first six months of the year, the unemployment rate still fell precipitously, ending the year at 3.9%. The decline in the unemployment rate, which gives a more immediate read on labor supply and associated wage growth pressures, occurred faster than committee members had initially forecasted, as the labor force participation rate remained well below pre-pandemic levels (at 61.9% compared to 63.4% in February 2020). The faster than anticipated improvement in US labor market conditions, combined with the significant increase in inflation, forced the FOMC to reevaluate its accommodative monetary stance. As recently as the June meeting, the median FOMC member anticipated zero interest rate increases until 2024. By the December meeting, the median member anticipated three interest rate hikes in 2022 alone, significantly pulling forward the path for tightening monetary policy. The FOMC also announced a tapering of its asset purchase program in November—and accelerated the timeline during the December meeting—with market participants now expecting an end to asset purchases by March 2022. Markets are predicting that an initial rate hike might occur as early as March 2022.

November also saw significant fiscal policy activity with President Biden signing a $1.2 trillion infrastructure bill that Congress had passed on a bipartisan basis. *(continued on next page)*

4th Quarter and Calendar Year Performance



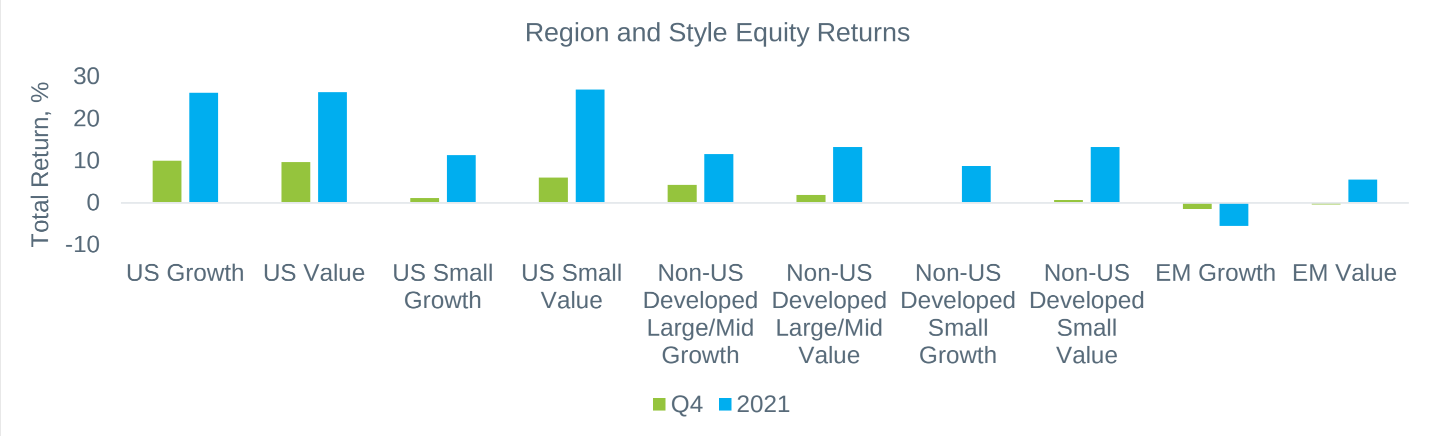


However, President Biden's more expansive "Build Back Better" agenda was stymied by moderate Democrats in the Senate and failed to pass by the party's self-imposed Christmas deadline. While debate over the bill's provisions continues, it remains uncertain if or when some form of the proposed legislation will become law.

Despite the evolving economic and political environment, risk assets performed well in Q4, primarily due to strong fundamentals in corporate earnings and the relative strength of the broader economy. The S&P 500 Index returned 11.0% in Q4, leading major equity markets higher. Although valuations remain elevated relative to historical averages, the 2021 index return of 28.7% was supported by year-over-year earnings growth of 45.3%, according to analyst estimates from FactSet. Calendar year equity returns in developed markets were more modest at 11.3% according to the MSCI EAFE Index, while emerging market equities finished the year at -2.5% as measured by the MSCI EM Index. The relative strength of dollar assets coupled with Chinese regulatory changes for certain industries put downward pressure on prices for many Asia-based companies during the second half of the year. Commodity performance was mixed during Q4, though the asset class still finished the year up 27.1%, the highest returning year for the Bloomberg Commodity Index since 2000. While the rate curve flattened during Q4, duration sensitive assets finished the year in negative territory.

Expanded Review of Key Economic Indicators

	Q4 2021	Q3 2021	Q2 2021	10 Year Average
Federal Funds Rate	0.07%	0.06%	0.08%	0.63%
Treasury - 1 Year	0.39%	0.09%	0.07%	0.74%
Treasury - 10 Year	1.52%	1.52%	1.45%	2.04%
Treasury - 30 Year	2.08%	2.08%	2.06%	2.73%
Breakeven Inflation - 5 Year	2.53%	2.53%	2.50%	1.79%
Breakeven Inflation - 10 Year	2.59%	2.38%	2.34%	1.95%
Breakeven Inflation - 30 Year	2.38%	2.29%	2.28%	2.04%
BB US Corp: Hi Yld Index - OAS	2.83%	2.89%	2.68%	4.44%
Capacity Utilization	76.49%	76.44%	75.38%	76.49%
Unemployment Rate	3.90%	4.80%	5.90%	5.71%
ISM PMI - Manufacturing	58.70%	61.10%	60.60%	54.35%
Baltic Dry Index - Shipping	2,217	5,167	3,383	1,248
Consumer Confidence (Conf. Board)	115.80	109.30	127.30	101.76
CPI YoY (Headline)	7.00%	5.40%	5.40%	1.89%
PPI YoY - Producer Prices	12.20%	11.80%	9.40%	1.54%
US Dollar Total Weighted Index	115.32	114.08	112.24	107.29
WTI Crude Oil per Barrel	$75	$75	$73	$66
Gold Spot per Ounce	$1,801	$1,757	$1,770	$1,425



US Equity

US equity markets finished the year with a strong Q4, providing low double-digit returns despite heightened volatility due to the Omicron variant, inflation fears, and global growth concerns. Volatility expectations, as measured by the CBOE Volatility Index, jumped above 30 in early December for the first time since January 2021. However, investor uncertainty subsided shortly after due to research indicating that the variant was less likely to cause severe infections. Ultimately, the S&P 500 Index return of 28.7% in 2021 was its third highest calendar year return since 2000.

In early Q4, growth stocks outperformed value across all market capitalizations before a rotation into value stocks occurred later in the period; a trend even more accentuated among small- and mid-cap stocks. Overall, the Russell Top 200 Growth Index returned 13.7% versus 7.4% for the Russell Top 200 Value Index in Q4. In contrast, the Russell 2000 Value Index was up 4.4% while the Russell 2000 Growth Index was flat. Similarly, the Russell Mid Cap Value Index returned 8.5% compared to 2.8% for the Russell Mid Cap Growth Index.

Active management generally performed well in Q4, except for large-cap growth managers, who struggled to keep up with their respective benchmarks as stocks with loftier valuations were impacted by the prospect of a rising interest rate environment. Small-cap managers performed best with a majority outpacing their respective benchmarks by a significant margin.

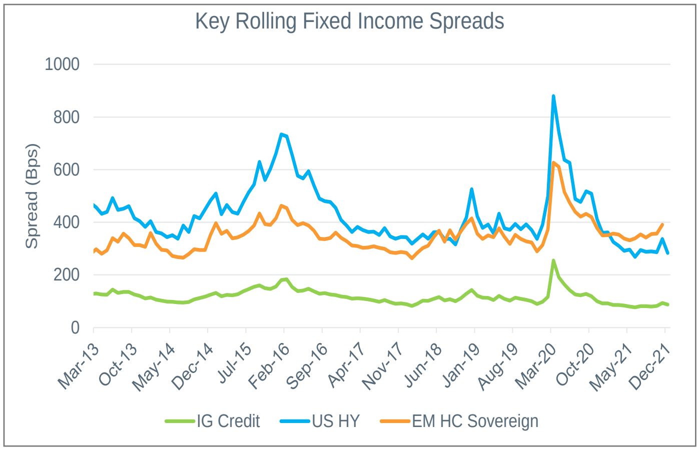
Non-US Equity

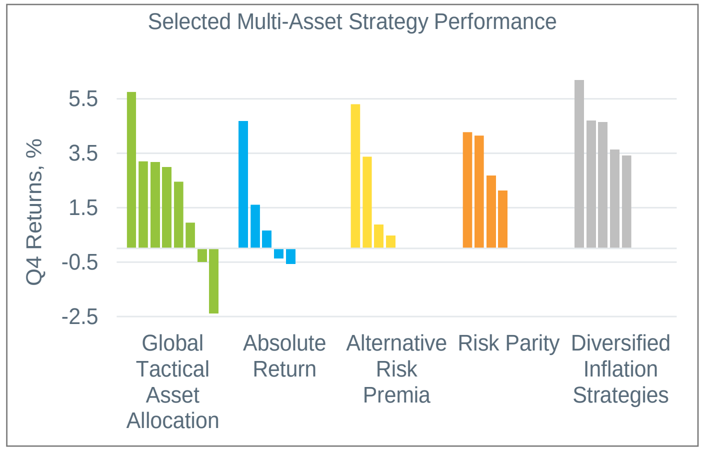
While international markets lagged the US equity market in Q4, developed international equities continued to participate in the recovery despite the COVID-19 surge led by the new Omicron variant. The MSCI EAFE Index saw a positive return of 2.7% for the quarter as growth stocks continued to outperform value stocks from the prior quarter resulting in both growth and value performing in line for the calendar year. Large-cap stocks outperformed small-cap stocks.

Both Africa/Mideast and Europe led developed market equities higher while Asia/Pacific posted negative returns. Japan was the largest country detractor for the quarter due to its comparatively underwhelming pace of recovery despite the unveiling of a new stimulus package, record high industrial production, and a slower pace of COVID-19 infections compared to its developed peers.

Emerging markets experienced moderately negative returns in Q4 with the MSCI EM Index returning -1.3% for the period. Value stocks continued their outperformance over growth stocks while small-cap stocks outperformed large-cap stocks. China continued to be the main drag on regional returns due to the ongoing regulatory and political environment combined with concerns over corporate debt levels within the country.

Median manager returns suggest that a majority of active managers outpaced their respective benchmarks over the course of 2021 across the developed and emerging market regions.





Fixed Income

The Bloomberg US Aggregate Index ended the quarter flat, capping off the third most negative calendar year on record for the index with an overall annual return of -1.5%. An abrupt rise in interest rates at the start of the year, in the face of inflation concerns and a shifting outlook, followed by a year of interest rate volatility and continued economic uncertainty impacted returns and yields. Treasury yields were unchanged in Q4 but ended the year up 59 basis points relative to the start of the year at 1.52% as measured by the 10-year US Treasury yield.

US investment grade credit detracted -1.1% in 2021, while US High Yield returned 5.3%, as measured by the Bloomberg US Credit Index and Bloomberg US High Yield Index, respectively. The divergence in returns demonstrates the recent outperformance of lower quality debt as investors sought yield in a low interest rate environment. In particular, the lowest quality debt was a contributor to performance, as demonstrated by Ca-D rated debt returning 12.5% in 2021.

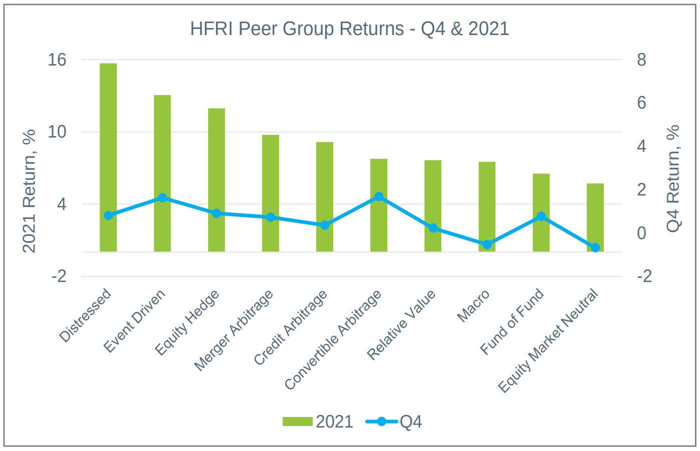
Despite a positive Q4, emerging market debt largely contracted over 2021, as each of the primary emerging market debt indices declined during the full year period. In particular, the JPM GBI-EM Global Diversified Index declined -8.8% in 2021, as currency impacts detracted in part due to a strengthening US Dollar and higher US interest rates.

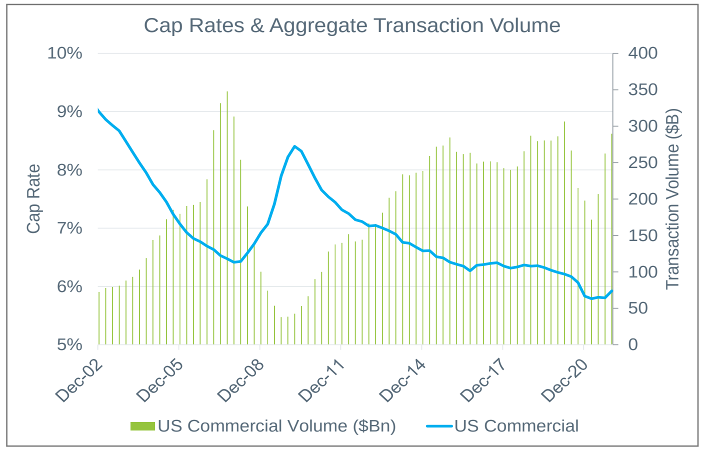
Multi-Asset

Global Tactical Asset Allocation strategies that RVK follows closely generated disparate performance in Q4. The top performing long-biased GTAA strategies either exclusively held US equity exposure or tended to hold a larger proportion of US equities.

In contrast, those who underperformed peers tended to hold larger foreign allocations, particularly within Japanese equity and emerging markets equity. Multi-asset managers who target lower correlations, volatility, and market sensitivity also produced disparate absolute returns, though generally with a narrower relative range compared to long-biased peers.

Diversified Inflation Strategies that RVK follows closely responded to increased inflationary measures with strong positive absolute performance. Managers with larger global listed infrastructure, natural resource equities, and REIT exposures posted the strongest positive absolute returns. Whereas, on a relative basis, those with larger commodities and TIPS allocations underperformed a strong peer group for the quarter. Inflation, as measured by the year-over-year change in Headline CPI, was reported as 7.0% for December. Market-based measures of future inflation expectations remain around a more moderate 2.6% as reflected in the 10-year breakeven inflation rate.





Diversified Hedge Funds

Hedge fund results were mixed in Q4. Many high-profile macro and relative value trading firms struggled as the yield curve flattened in October and November, while equity long/short (ELS) funds faced headwinds from underperforming, crowded long trades amid significant factor rotations. The industry still returned 0.6% during Q4 according to the HFRI Fund Weighted Index, bringing returns to 10.3% for 2021, the industry's third straight year of double-digit returns.

While absolute returns were positive across most ELS strategies that RVK follows closely, market index-relative returns were disappointing. Prime brokers reported that long alpha was firmly negative for the year, which has only occurred on one other occasion since the GFC. Despite the negative alpha generated in Q1, stock picking on the short side ended the year in positive territory. Meanwhile, long books struggled to remain in front of COVID-related market rotations. Selection across consumer, healthcare, and technology stocks was most challenged, compounded by a selloff of expensive growth names in the final weeks of Q4.

Event-driven approaches were some of the top performers in 2021, driven by record IPO issuance and the emergence of robust SPAC activity, heightened levels of M&A, and a significant recovery in the stressed and distressed debt complex. Trend followers also performed well, adding 3.0% in Q4, bringing 2021 returns to 9.1% according to the SG Trend Index.

Real Estate

Core private real estate generated an 8.0% return in Q4 (on a preliminary and gross of fee basis), as reported by the NFI-ODCE Index, with the total return comprising of 1.0% income and 7.0% price appreciation. While the income return continues to trend in line with historical levels, price appreciation returns remain elevated. This positive quarter brought the preliminary calendar year return of the NFI-ODCE Index to 22.2% with price appreciation accounting for a dominant share of the annual return.

Investors in publicly traded real estate outperformed their private market counterparts by a meaningful margin. Publicly traded real estate delivered a robust Q4 total return of 15.2%, as measured by the FTSE/NAREIT All REITs Index.

Among publicly traded securities, the REIT sector had a banner year with a total return of 39.9%, the highest annual total return for the index in over 40 years. Volatility in REIT returns is expected to remain elevated given the correlation with public equity markets.

Preliminary data suggests that transaction volume for the fourth quarter was very robust, indicating continued recovery in broad property fundamentals and demand for the asset class as investors put capital to work. Relatedly, cap rates remained below historical levels. The industrial and multifamily property sectors saw the most activity from investors.

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RVK

RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm is headquartered in Portland, Oregon, with regional offices in Boise, Chicago, and New York City. RVK is one of the five largest consulting firms in the world, as reported by Pensions & Investments' 2021 Special Report–Consultants. Additionally, in April 2021, RVK received a notable award as a Coalition Greenwich Quality Leader among large US investment consultants, based on Greenwich's 2020 study. Coalition Greenwich is an industry-recognized third-party firm which asks plan sponsors to rank their consultants on a series of key metrics. Notably, RVK is the only firm among large US consultants to receive an award for a fourth consecutive year.[1] RVK's diversified client base of over 200 clients covers 30 states, and covers endowments, foundations, corporate and public defined benefit and contribution plans, Taft-Hartley plans, and high-net-worth individuals and families. The firm is independent, employee-owned, and derives 100% of its revenues from investment consulting services.

[1]Between July and October 2020, Coalition Greenwich (formerly known as Greenwich Associates) conducted in-person and phone interviews and online surveys with 856 individuals at 704 of the largest tax-exempt funds in the US–including corporate and union funds, public funds, endowments and foundations, insurance general accounts, and healthcare organizations, with either pension or investment pool assets greater than $150 million. Study participants were asked to provide quantitative and qualitative evaluations of their asset managers and investment consultants, including qualitative assessments of those firms soliciting their business and detailed information on important market trends. RVK is one of three firms recognized in the large investment consultant category. The ratings may not be representative of any one client's experience with RVK; rather they are representative of those clients that chose to participate in the survey. The results are not indicative of RVK's future performance.

To read the Greenwich press release, please refer to the following URL: https://www.greenwich.com/press-release/covid-19-crisis-put-investment-consultant-advisory-capabilities-test