Capital Markets Review and Outlook

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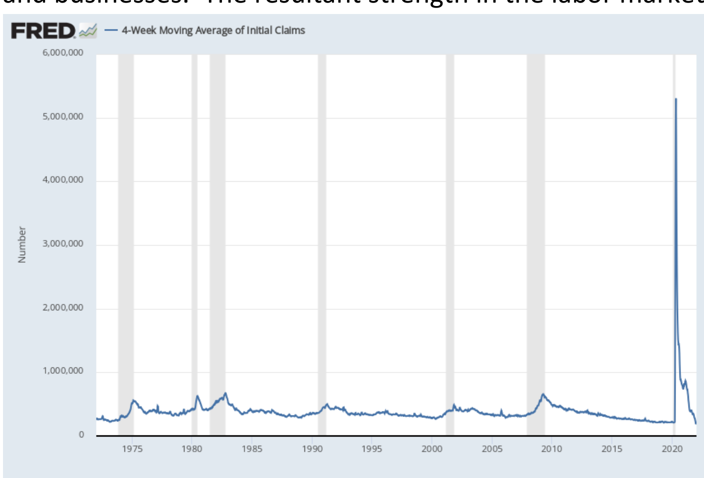
December 2021

Economy and Outlook

Omicron, the highly contagious and fast-spreading Covid-19 strain, became the dominant coronavirus variant in December. Globally, the number of confirmed cases is quickly approaching 300 million with the average number of daily cases accelerating to 2.3 million based on data from the World Health Organization (WHO). On a positive note, Omicron causes milder symptoms and results in fewer hospitalizations, especially for the vaccinated. The administration of vaccinations also continues to ramp up with over 9 billion doses administered worldwide. While the resurgence in infections and the accompanying disruptions are troublesome, there is a possibility that between the increasing number of people infected and the rising number vaccinated, the world may be moving closer to reaching herd immunity and an end to the pandemic. The speedy development of vaccines to combat the coronavirus and the massive stimulus injected into the economy by the U.S. government have enabled the economy to weather the effects of the on-going pandemic. The repeated relief and stimulus checks totaling in the trillions of dollars sent out by the government buoyed both households and businesses. The resultant strength in the labor markets is reflected in the chart on the left which shows the 4-week moving average of initial jobless claims at a 50-year low. Additionally, the Labor Department's most recent monthly Job Openings and Turnover Survey (JOLTS) report showed that a record 4.5 million workers quit their jobs, a sign of increased confidence in the economy. Preliminary data from the Federal Reserve Bank of Atlanta indicate the U.S. economy is likely to grow at an annualized rate of over 7% in the final quarter of 2021. The contrast between the United States and the rest of the world is quite stark – analyst estimates for the Eurozone and China are for economic growth rates of 2% and 4% respectively for the same period. The Federal Reserve is tapping the brakes on its monetary stimulus in response to the higher levels of inflation accompanying sturdy economic growth in the United States. The pace of reduction in the Fed's quantitative easing program has also increased which will result in the monthly bond purchase program



ending in March of this year. Interest rate hikes are likely to follow together with a reduction in the central bank's massive balance sheet which is currently over $8 trillion. Since both fiscal and monetary stimulus measures at extraordinarily high levels have been in place for an extended period of time, there is a risk that the Federal Reserve may need to move more quickly than anticipated in tightening monetary policy. This, in turn, could cause volatility to rise in risk markets as market participants anticipate a reduction in the liquidity that has helped drive up the markets for almost two years.

Equity Markets

Equity markets rebounded strongly in December as the effects of the Omicron variant were milder than initially feared and the economy continued its growth trajectory. For the month, the broad domestic equity market represented by the Russell 3000 index rose +3.9% and ended the year with a stellar gain of +25.7. In terms of performance by capitalization, Large Cap led the way with a gain of +4.1% in December, almost double Small Cap's return of +2.2%. For the full year, Large Cap's +26.5% return was almost +12 percentage points higher than the return for Small Cap. From a Style perspective, Value outperformed Growth handily in December across all capitalizations, ranging from +370 bp in Small Cap to +590 bp for Mid Cap. For the year, the outperformance in Small Cap Value over Growth was a remarkable +25 percentage points. However, in Large Cap, Growth (+27.6%) outperformed Value (+25.2%). Sector performance favored Defensives over Cyclicals in December. The worst performer for the month was Consumer Discretionary which lost -0.3%, while Consumer Staples was the best performer rising +10.3%. Real Estate (+10.2%), Utilities (+9.6%) and Health Care (+9%) were other standouts in December. Energy (+3.1%) rebounded as oil prices rose in December. For the year, Energy was the best performing sector with a gain of +54.6%. International equity markets also rebounded in December as fears about lock-downs due to Omicron abated. The MSCI Developed Markets ex-US equity index gained +5.1% for the month led by strong gains across the board. The leaders in the developed equity markets included the United Kingdom and Italy both of which rose +7.3% and France which gained +7.1%. While the U.S. dollar was little changed against the euro, it lost -1.7% against the British pound. The only major equity market laggard was Japan which rose +1.9% on the heels of a -1.5% decline in the Japanese yen versus the U.S. dollar. The emerging markets equity index rose a more subdued +1.9% in December due to the -3.2% decline in China, the largest emerging market. Continued fears about high debt levels and the fallout from the default by Evergrande, a large Chinese property developer with $300 billion in debt, remain an overhang for the Chinese markets. Unlike past episodes of volatility and declines in the Chinese markets, there was little spillover in other emerging markets. For the month, there were gains in Korea (+6.3%), Taiwan (+5.3%) and India (+3.7%). For the full year, the Developed Markets index with a gain of +11.3% has widened its lead over the Emerging Markets index which is down -2.5%.

Fixed Income Markets

The changing tone at the Federal Reserve suggesting the prospect for a more hawkish monetary policy drove Treasury yields sharply higher in December and led to a bearish flattening in the

Treasury yield curve. The yield on the 2-year Treasury note rose sharply by 21 bp to end the year at 0.73%. The 30-year Treasury bond's yield increased 12 bp to 1.9%. As a result, the 2-year/30-year Treasury yield spread flattened by 9 bp to end the month at +117 bp. At the beginning of the year, this spread was +152 bp. Mirroring the rebound in equity markets, the Bloomberg investment grade credit index option-adjusted spread (OAS) tightened by 7 bp to +87 bp leading to +58 bp of outperformance versus duration-matched Treasuries. As is typically seen during periods of outperformance, both the quality curve and the credit curve flattened in December. The BBB rated sector outperformed the Single-A rated sector by +30 bp in excess return, while long maturities outperformed short and intermediate maturities by an average of +45 bp. The Industrial (+72 bp) and Finance (+47 bp) sectors were the best performers while Utilities (+16 bp) lagged. Net new issuance of investment grade bonds was $561 billion in 2021, a little more than half the corresponding figure in 2020. Despite the spread tightening in December, the investment grade credit sector lost -0.1% for the month due to the sharp rise in Treasury yields. For the year, the index's total return was -1.1%. Investment performance in the high yield sector was much stronger compared to the investment grade sector. The OAS of the Bloomberg High Yield index tightened by 54 bp to end the year back below the 300 bp level at +283 bp. There was little differentiation in performance by quality or maturity in December. On a total return basis, the Single-B sector gained +1.96% compared to +1.9% for the Caa-rated sector and +1.82% for the Ba-rated sector. While all sectors had positive returns for the month, the best performers were energy-related with Oil Field Services (+3.4%) and Midstream (+2.9%) the leaders. The laggards include Banking (+0.5%) and Electric Utility (+1.0%). Despite the sharp rise in Treasury yields, the High Yield sector had a total return of +1.9% in December as the large OAS spread tightening combined with the index's high coupon swamped the negative effect from the rise in Treasury yields. For the year, the index gained +5.3%. Government bond yield changes in developed markets were mixed. Yields in Europe rose sharply in December with German and UK 30-year bond yields rising by 25 and 27 bp respectively, more than double the rise in US 30-year Treasury bond yields. On the other hand, government bond yields declined or rose much less in Canada and Australia. There was a similar mixed picture in the currency markets with the U.S. dollar rising against the Japanese yen (+1.5%) and Australian dollar (+2.1%) but declining versus the British pound (-1.7%) and the Canadian dollar (-1.2%). The net effect is that for the month, the FTSE non-US Government Bond index lost -0.7% compared to a loss of -0.5% for the U.S. Government Bond index. For 2021, the international government bond index lost -9.7% underperforming by a significant margin the U.S. government bond index's return of -2.3%.

consequent capital management

			Returns as of 12/31/21 (In %)			
		Month	Q4	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	3.9	9.3	25.7	25.8	18.0
Russell 1000®	US Large Cap Equity	4.1	9.8	26.5	26.2	18.4
Russell 1000® Growth	US Large Cap Growth	2.1	11.6	27.6	34.1	25.3
Russell 1000® Value	US Large Cap Value	6.3	7.8	25.2	17.6	11.2
Russell Midcap®	US Mid Cap Equity	4.1	6.4	22.6	23.3	15.1
Russell Midcap® Growth	US Mid Cap Growth	0.4	2.8	12.7	27.5	19.8
Russell Midcap® Value	US Mid Cap Value	6.3	8.5	28.3	19.6	11.2
Russell 2000®	US Small Cap Equity	2.2	2.1	14.8	20.0	12.0
Russell 2000® Growth	US Small Cap Growth	0.4	0.0	2.8	21.2	14.5
Russell 2000® Value	US Small Cap Value	4.1	4.4	28.3	18.0	9.1
MSCI ACWI ex-US	Global Equity ex-US	4.1	1.8	7.8	13.2	9.6
MSCI EAFE	Global Developed Mkts Equity	5.1	2.7	11.3	13.5	9.5
MSCI EM	Emerging Mkts Equity	1.9	-1.3	-2.5	10.9	9.9
Bloomberg/Barclays US Agg	US Core Fixed Income	-0.3	0.0	-1.5	4.8	3.6
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.1	-0.5	-1.3	3.6	2.8
Bloomberg/Barclays US Credit	US Corporate Bonds	-0.1	0.2	-1.1	7.2	5.1
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-0.1	-0.4	-1.0	3.0	2.5
Bloomberg/Barclays US Corp HY	US High Yield	1.9	0.7	5.3	8.8	6.3
FTSE Non-US WGBI	Global Fixed Income ex-US	-0.7	-2.0	-9.7	1.8	2.7