Capital Markets Review and Outlook

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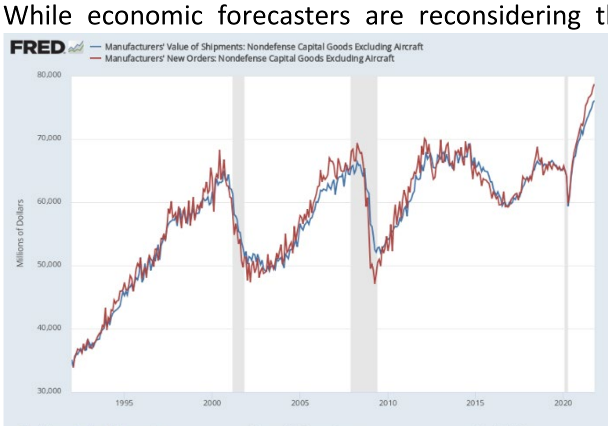
Economy and Outlook

As the month of November came to a close, anxiety and uncertainty resurfaced globally due to the emergence of a new and potentially far more contagious variant (Omicron) of the Covid-19 coronavirus. A number of governments closed their borders to travelers from several countries in southern Africa where Omicron was first reported. Despite these measures, the new variant has now been detected in over 40 countries including the United States. Early indications are that the new variant has higher transmissibility than the prevailing Delta variant. However, much remains unknown in terms of disease severity and mortality from the Omicron variant. Also, while the current vaccine regimens are expected to provide protection against Omicron, the degree of effectiveness is still being evaluated. Maximizing the number of people globally who are vaccinated against Covid-19 remains the best way to defeat the disease since this will lead to an inability for the virus to mutate. On that front, progress continues to be made with just under 8 billion vaccine doses administered. Many countries have well over half of their populations fully vaccinated. Of course, there are also many countries, especially in developing parts of the world, with low vaccination rates, and this remains a challenge. On a positive note, vaccine makers are confident in their ability to engineer new vaccines to combat new variants. While economic forecasters are reconsidering their economic growth projections due to Omicron, the positive backdrop for growth remains in place. The chart on the left shows the surge in spending for capital expenditures in both orders and shipments driven by the strength in corporate profits, high corporate cash levels and strong end-demand. The latter has in turn, been fueled by the over $2.5 trillion in households' excess savings from the various governmental stimulus programs and reduced spending since the pandemic began. The closely watched service industries index for the Institute for Supply Management (ISM) hit an all-time high of 69.1 in November. After contracting in April and May of last year, the index has increased for the past 18 consecutive months. All 18 service sector industries reported growth in November. Despite an employment report for the month of November which showed jobs gains of less than half of what was expected, the underlying data remain firm with the unemployment rate falling sharply to 4.2%. Just last December, the unemployment rate was 2.5 percentage points higher at 6.7%. Along with the strength in the economy, inflationary pressures continue to mount with average hourly wages in November higher by 4.8% from the previous year. This



will keep the Federal Reserve on track to begin the process of reducing its quantitative easing program. Interest rates and market volatility are both likely to move higher as a result, thereby, pressuring risk assets.

Equity Markets

Fears about the potentially damaging economic effects from the Omicron variant weighed on the equity markets in the final days of November. For the month, the broad domestic equity market represented by the Russell 3000 index lost -1.5% reducing its return for the year to a still strong +20.9%. In the sell-off, Large Cap (-1.3%) decisively outperformed both Mid Cap (-3.5%) and Small Cap (-4.2%) for the second consecutive month. For the year, Large Cap (+21.5%) is now firmly ahead of the other two capitalization categories by +370 bp to +920 bp after having lagged in the first half of the year. Growth also outperformed Value by +413 bp for the second consecutive month in the Large Cap space. However, for both Mid Cap and Small Cap, there was a reversal with Value outperforming Growth. In Small Cap, Value's lead over Growth has widened to almost 21 percentage points. Sector performance was mixed in November. While Information Technology, a Cyclical sector, was the best performer with a return of +4.3%, another Cyclical sector, Financials was the worst performer with a loss of -5.7% as the sector was weighed down by the decline in Treasury yields. The Energy sector continued to be buffeted by the volatility in oil prices, and the sector lost -5.1% for the month as crude oil prices plunged almost -19%. However, for the year, Energy is the best performing sector with a gain of +50%. Worries about the new coronavirus variant hit international equity markets hard with the MSCI Developed Markets equity index dropping -4.7% in November. Falling currencies versus the U.S. dollar and broad declines in commodity prices contributed to the weakness in international equity markets. Commodity exporters such as Australia and Canada were among the worst performing developed equity markets with declines of -6.5% and -4.9% respectively. Japan was a better performer due to its safe haven status; the Japanese yen was one of the few currencies that strengthened against the U.S. dollar rising +0.7% which helped cushion the equity market decline to -2.5%. Compared to the developed markets, emerging markets fared a little better with a decline of -4.1% for the month. China was the worst performer with its equity market index declining -6% on continued concerns about the effects of high corporate debt levels and increased government regulation. Taiwan (+2.6%), Brazil (-1.5%) and India (-3%) were relative outperformers. For the year, the Developed Markets index with a gain of +5.8% has a significant lead over the Emerging Markets index which is down -4.3%.

Fixed Income Markets

The flight to safety and quality in the U.S. Treasury market, due to perceptions of a negative economic effect from the Omicron variant, were seen in longer maturity Treasuries. The yield on the 5-year Treasury note declined by 4 bp while 10-year and 30-year maturity yields declined a much greater 11 bp and 15 bp respectively. The yield on the 30-year Treasury bond is now more than 20 bp below the key 2% level. On the other hand, the yield on the 2-year Treasury note rose by 4 bp to 0.52% as market participants expect the Federal Reserve to remain on track in starting the process of reducing its massive ($120 billion) monthly bond purchase program.

The Treasury yield curve continued its flattening trend with the 2-year/30-year yield spread narrowing a further 19 bp to end the month at +126 bp. In just the past two months, the yield curve has flattened by 54 bp. Mirroring the downturn in equity markets, the Bloomberg investment grade credit index option-adjusted spread (OAS) widened by 12 bp to +94 bp leading to -83 bp of underperformance versus duration-matched Treasuries. As is typically seen during periods of underperformance, both the quality curve and the credit curve steepened in November. The Single-A rated sector outperformed the BBB-rated sector by +25 bp, while short and intermediate maturities outperformed long maturities by an average of +88 bp. With the sharp drop in energy prices, Oil Field Services (-170 bp) and Integrated Energy (-149 bp) were among the worst performers. Outperformers for the month included Supranationals (+2 bp) and Gaming (-40 bp). Despite the credit index's significant spread widening in November, the investment grade credit sector rose +0.1% for the month due to the sharp decline in long maturity Treasury yields. For the year, the index has trimmed its loss to -1%. Investment performance in the high yield sector was worse than its investment grade counterpart. The OAS of the Bloomberg High Yield index widened sharply by 50 bp to +337 bp leading to an underperformance of -121 bp. Similar to the investment grade sector, the high yield quality curve also steepened as higher quality bonds outperformed. All high yield sectors underperformed in November with energy-related sectors performing the worst: Oil Field Services (-367 bp), Independent Energy (-161 bp). The relative outperformers include Automotive (-3 bp) and Paper (-9 bp). Despite the steep decline in Treasury yields, the High Yield sector lost -1% in total return in November because the large OAS spread widening overwhelmed the benefit from the drop in Treasury yields. For the year, the index is up +3.3%. Yields across international developed government bond markets also declined significantly in November due to concerns about the Omicron variant. In some regions, the drop in yields was more than in the United States: 10-year German bund yields dropped 23 bp, while the decline in 10-year UK Gilts was 26 bp. In contrast, the US 10-year Treasury's yield declined 12 bp. Despite the widening in yield spread differentials, the international government bond index underperformed due to the broad-based rally in the U.S. dollar. Except for safe-haven currencies such as the Japanese yen and the Swiss franc, the U.S. dollar rose by +2.1% versus the euro to over +5% versus the Australian dollar. For the month, the FTSE non-US Government Bond index lost -0.6% compared to a gain of +0.7% for the U.S. Government Bond index. Year-to-date, the underperformance of the international government bond index (-9.1%) versus the U.S. government bond market (-1.8%) has widened further.

		Returns as of 11/30/21 (In %)					
		Month	QTD	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-1.5	5.1	20.9	26.3	20.2	17.5
Russell 1000®	US Large Cap Equity	-1.3	5.5	21.5	26.7	20.6	17.9
Russell 1000® Growth	US Large Cap Growth	0.6	9.3	25.0	30.7	29.2	25.1
Russell 1000® Value	US Large Cap Value	-3.5	1.4	17.7	22.2	11.5	10.4
Russell Midcap®	US Mid Cap Equity	-3.5	2.3	17.8	23.3	17.5	14.4
Russell Midcap® Growth	US Mid Cap Growth	-4.2	2.5	12.3	17.7	23.3	19.8
Russell Midcap® Value	US Mid Cap Value	-3.0	2.1	20.8	26.3	13.0	10.3
Russell 2000®	US Small Cap Equity	-4.2	-0.1	12.3	22.0	14.2	12.1
Russell 2000® Growth	US Small Cap Growth	-4.9	-0.4	2.4	12.0	16.1	14.7
Russell 2000® Value	US Small Cap Value	-3.4	0.3	23.2	33.0	11.5	9.1
MSCI ACWI ex-US	Global Equity ex-US	-4.5	-2.2	3.5	9.1	10.0	9.3
MSCI EAFE	Global Developed Mkts Equity	-4.7	-2.3	5.8	10.8	9.8	9.2
MSCI EM	Emerging Mkts Equity	-4.1	-3.1	-4.3	2.7	9.3	9.5
Bloomberg/Barclays US Agg	US Core Fixed Income	0.3	0.3	-1.3	-1.2	5.5	3.7
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.0	-0.4	-1.2	-1.0	4.2	2.8
Bloomberg/Barclays US Credit	US Corporate Bonds	0.1	0.3	-1.0	-0.6	7.7	5.2
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-0.1	-0.3	-1.0	-0.7	3.7	2.5
Bloomberg/Barclays US Corp HY	US High Yield	-1.0	-1.1	3.3	5.3	7.4	6.3
FTSE Non-US WGBI	Global Fixed Income ex-US	-0.6	-1.3	-9.1	-7.0	2.8	2.6