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One North Brentwood Boulevard, Suite 850
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TF (855) 382-1600
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Investment Insights Monthly

From The Desk of Bill Hornbarger, Chief Investment Officer

November 2021

The Fed Acts

In response to the impact of the economic disruption of the Covid-19 pandemic, the Federal Open Market Committee (the Fed) cut short-term interest rates to zero, and enacted extraordinary monetary policy in the form of both targeted and large-scale asset purchase programs, often referred to as quantitative easing (QE). Since June of 2020, the Fed has been purchasing $80 billion of Treasury securities and $40 billion of agency mortgage-backed securities per month. The Fed has used QE repeatedly following the Global Financial Crisis when short-term interest rates were at the zero bound. Quantitative easing supports the economy by reducing longer-term bond yields (that mortgages and other consumer and business loans are tied to) and signaling the Fed's intention to use extraordinary monetary policy in support of the economy.

At its November meeting, the Fed took the first, widely anticipated steps towards normalizing monetary policy. The Fed announced that beginning this month, the Committee decided to reduce the pace of its net asset purchases by $10 billion for Treasury securities and $5 billion for agency mortgage-backed securities. The Fed also announced that in December there will be another reduction of the same size and said, "the Committee judges that similar reductions in the pace of net asset purchases will likely be appropriate each month, but it is prepared to adjust the pace of purchases if warranted by changes in the economic outlook." Under this schedule, the Fed would complete the process of tapering around July of 2022.

As the Fed begins its tapering program, it is important to remember that this doesn't reflect a reduction in the size of the Fed's balance sheet, but a reduction in the pace of expansion with a goal of slowly removing monetary stimulus. It also doesn't indicate that an increase in the target Fed funds rate is imminent. Fed Chairman Jerome Powell was quoted as saying, "we don't think it's time yet to raise interest rates," and indicated that "there is still ground to cover" before the Fed would do so. Fed officials have indicated they don't foresee interest rate increases until tapering is finished, and the so-called "dot plot" in the economic projections released in September indicates the possibility of one increase next year.

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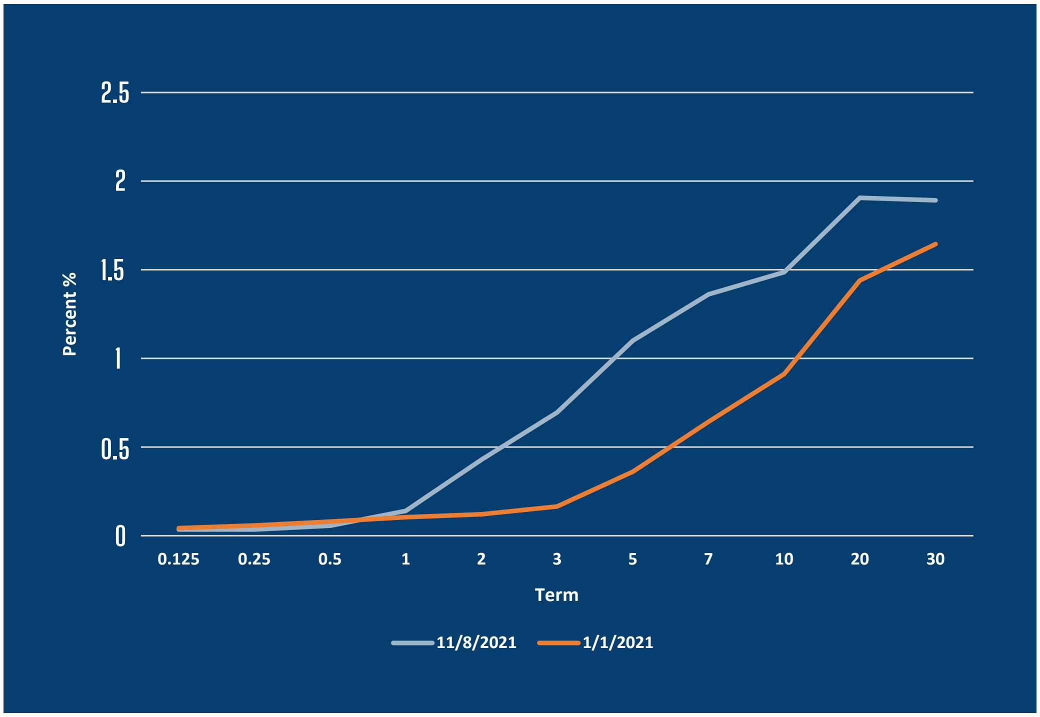
The Fed has been very transparent and clear in its communication surrounding evolving Fed policy for several reasons. First, the Fed's rhetoric is a powerful tool in its own right, with the ability to move markets. And second, the Fed wants to avoid a repeat of the 2013 "Taper Tantrum" when Treasury yields surged after then Fed chairman Ben Bernanke announced that the Fed would, at some future date, reduce the volume of its bond purchases. The ten-year Treasury yield almost doubled from May to the end of 2013 in response, a reaction the Fed would like to avoid this time.

As we wrote last month, Fed tapering – the prospects of change in the target Fed funds rate – and elevated inflation all argue for an upward bias to intermediate- and long-term benchmark Treasury yields. The bond market has reacted to the expectations that this move (tapering) would happen, with intermediate- and longer-term yields increasing and the yield curve flattening (see chart).

Change in Treasury Yield Curve
YTD 2021

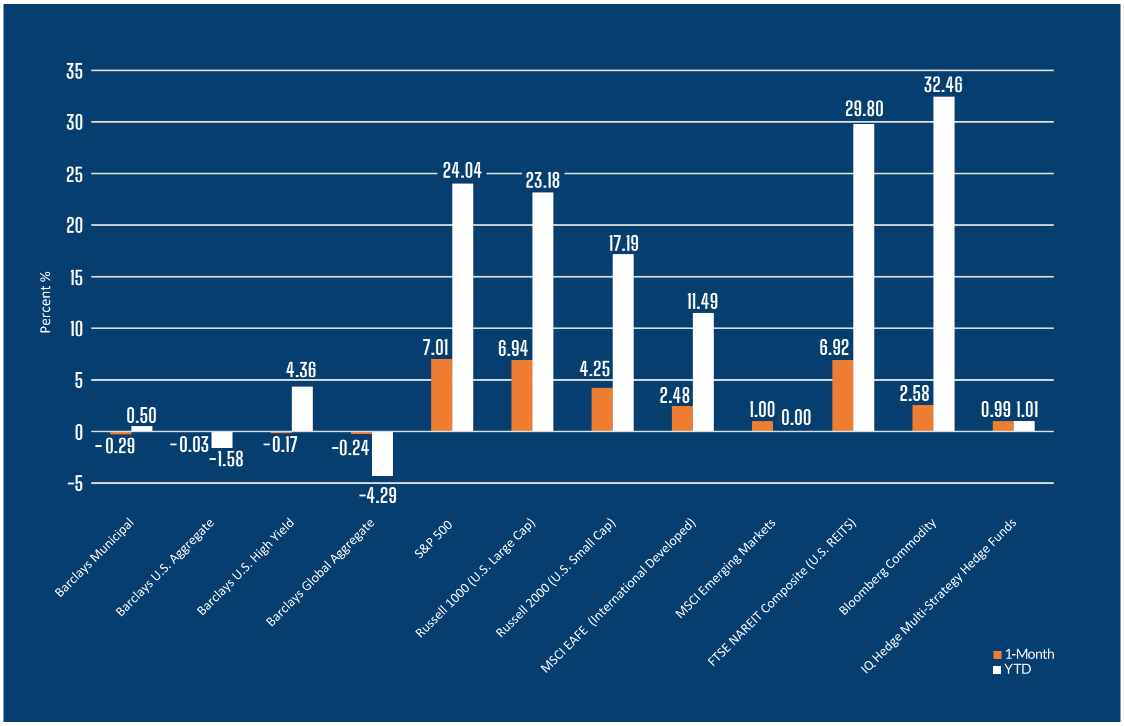


Source: Bloomberg

Despite the tapering announcement and elevated inflation, we believe any increase in intermediate- and longer-maturity Treasuries will be muted. It is important to remember that while U.S. yields remain low relative to what many investors remember, they remain high relative to most other developed countries, arguing that flows will remain positive and potentially mitigate any increase. The benchmark ten-year Treasury yield compares favorably to other developed nations such as the United Kingdom (0.85%), Japan (0.05%), Germany (-0.247%), and Switzerland (-0.243%). Even countries that have historically had significantly higher yields than the U.S. have experienced rates at depressed levels. Greece (1.064%), Australia (1.742%), and China (2.89%) are prime examples.

Asset Class Returns as of October 29, 2021

Comparing Recent Month and Year-to-Date Total Returns



Source: Morningstar

Fixed Income

- Treasury yields were fairly rangebound in October, and this led to slight losses in core fixed income and municipals bonds.
- Credit spreads widened during the month, and the sharp move higher in sovereign debt yields created losses in non-U.S. fixed income.

Equities

- U.S. equities rebounded sharply in October after exhibiting weakness during the previous month.
- Large cap stocks outperformed small caps, and growth surged past value in October.
- The tech-heavy Nasdaq was the best performing benchmark in October.
- Non-U.S. equities significantly lagged U.S. equities last month with particular weakness from Japan.
- Like what occurred in the U.S., growth beat value and large caps outperformed small caps.
- EM equities gained 1% in October, driven by a rebound in Chinese equities. Latin America was a weak spot last month.
- The weaker USD added 27 bps to MSCI EAFE returns and 9 bps to MSCI EM returns.

Real Assets

- Real assets continue to perform well as inflation concerns persist and some are starting to talk about sustained as opposed to transitory inflation.
- REITS had a very strong month on a combination of factors: strong equity markets and desire for income and inflation protection.
- The commodity basket was positive in October and is up over 30% for the year. Industrial metals (lead, nickel, zinc) and energy products (crude oil, gasoline) were strong performers for the month.

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October 29, 2021	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.00%	0.00%	0.03%	0.05%	1.05%	1.09%	0.58%
Barclays Municipal	-0.29%	-0.29%	0.50%	2.64%	5.17%	3.41%	3.88%
BBgBarc U.S. Govt/Credit Intermediate	-0.33%	-0.33%	-0.24%	-0.05%	2.72%	1.83%	1.41%
Barclays U.S. Aggregate	-0.03%	-0.03%	-1.58%	-0.48%	5.63%	3.10%	3.00%
Barclays U.S. High Yield	-0.17%	-0.17%	4.36%	10.53%	7.43%	6.40%	6.78%
S&P/LSTA Leveraged Loan	0.27%	0.27%	4.70%	8.47%	4.25%	4.47%	4.64%
Barclays Global Aggregate	-0.24%	-0.24%	-4.29%	-1.24%	4.55%	2.52%	1.70%
JPM GBI EM Global Diversified	-1.33%	-1.33%	-7.62%	0.84%	3.89%	1.96%	0.37%
U.S. Equity Indices							
DJ Industrial Average	5.93%	5.93%	18.77%	37.73%	15.09%	17.21%	14.32%
S&P 500	7.01%	7.01%	24.04%	42.91%	21.48%	18.93%	16.21%
NASDAQ Composite (Price)	7.27%	7.27%	20.25%	42.04%	28.49%	24.46%	19.16%
Russell 1000	6.94%	6.94%	23.18%	43.51%	22.01%	19.16%	16.30%
Russell 1000 Growth	8.66%	8.66%	24.20%	43.21%	29.41%	25.49%	19.42%
Russell 1000 Value	5.08%	5.08%	22.03%	43.76%	13.90%	12.39%	12.85%
Russell Mid Cap	5.95%	5.95%	22.02%	45.40%	19.85%	16.47%	14.78%
Russell 2500	4.90%	4.90%	19.41%	49.43%	18.43%	16.31%	14.25%
Russell 2000	4.25%	4.25%	17.19%	50.80%	16.47%	15.52%	13.50%
Russell 2000 Growth	4.68%	4.68%	7.64%	38.45%	18.64%	17.90%	14.57%
Russell 2000 Value	3.81%	3.81%	27.60%	64.30%	13.44%	12.61%	12.12%
Non-U.S. Equity Indices							
MSCI World	5.69%	5.69%	19.89%	41.05%	18.82%	16.06%	12.81%
MSCI ACWI	5.13%	5.13%	17.21%	37.86%	18.06%	15.31%	11.91%
MSCI ACWI Ex-U.S.	2.41%	2.41%	8.86%	30.23%	12.52%	10.28%	7.15%
MSCI EAFE	2.48%	2.48%	11.49%	34.80%	12.07%	10.32%	7.87%
MSCI EAFE Growth	3.28%	3.28%	10.70%	30.38%	17.23%	13.53%	9.75%
MSCI EAFE Value	1.64%	1.64%	12.01%	39.17%	6.63%	6.88%	5.82%
MSCI Europe	4.54%	4.54%	15.66%	41.75%	13.00%	11.20%	8.03%
MSCI Japan	-3.36%	-3.36%	2.65%	20.26%	9.90%	8.70%	8.33%
MSCI AC Asia	-0.40%	-0.40%	-0.40%	15.64%	12.41%	10.04%	8.05%
MSCI EAFE Small Cap	1.58%	1.58%	12.09%	36.24%	13.79%	11.78%	10.52%
MSCI ACWI Ex-U.S. Small Cap	1.59%	1.59%	14.36%	39.36%	15.20%	11.63%	9.12%
MSCI Emerging Markets	1.00%	1.00%	0.00%	17.33%	12.69%	9.79%	5.25%
MSCI EM Asia	1.28%	1.28%	-2.69%	12.03%	15.17%	11.69%	7.78%
MSCI China	3.16%	3.16%	-13.95%	-9.12%	11.64%	10.39%	7.71%
MSCI EM Eastern Europe	4.10%	4.10%	33.51%	79.68%	16.78%	15.57%	4.99%
MSCI EM Latin America	-5.27%	-5.27%	-10.37%	22.31%	-3.91%	-0.81%	-2.90%
MSCI EM Small Cap	0.25%	0.25%	17.85%	44.93%	17.92%	10.52%	6.58%
MSCI Frontier Markets	4.02%	4.02%	23.99%	36.47%	13.95%	10.79%	7.61%
Hedge Fund Indices							
IQ Hedge Long/Short	2.80%	2.80%	7.59%	20.00%	10.38%	7.89%	--
IQ Hedge Multi-Strategy	0.99%	0.99%	1.01%	6.56%	5.04%	3.96%	3.53%
Real Assets Indices							
FTSE NAREIT Composite	6.92%	6.92%	29.80%	46.15%	14.71%	10.87%	11.16%
Alerian MLP	4.98%	4.98%	46.34%	85.70%	-0.01%	-0.56%	0.71%
Bloomberg Commodity	2.58%	2.58%	32.46%	43.94%	8.56%	5.17%	-3.04%
S&P Global Infrastructure	3.61%	3.61%	10.83%	28.88%	9.42%	7.31%	7.45%
Other							
Oil Price Brent Crude	7.46%	7.46%	62.90%	125.25%	3.79%	11.80%	-2.60%
CBOE Market Volitility (VIX)	-27.93%	-27.93%	-28.53%	-57.23%	-8.51%	-0.96%	-5.93%

Source: Morningstar

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