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Investment Insights Quarterly

From The Investment Strategy Committee

April 2023

Revisiting the Active/Passive Discussion

Since the end of the Global Financial Crisis, there has been a tremendous increase in the amount of assets in passive investment strategies. (For the purposes of this commentary, we define passive as investments that aspire to track, as close to possible, a widely recognized index). Over that timeframe, active management in most asset classes had struggled due to elevated correlations and low dispersion. From 2008 to 2021, markets largely benefited from easy monetary policy. However, a resurgence in active management could be upon us as policies have begun to shift. The top performing active managers provided effective risk management and downside protection throughout the volatility of 2022 (see table on page 2).

Last year proved to be one of the most rapidly evolving economic and financial market environments in history. Central banks around the globe made unprecedented monetary policy changes to combat persistently high inflation, and geopolitical issues became headline news when Russia invaded Ukraine, and subsequently Europe found itself with a looming energy crisis. Each of these policy changes and events caused wide dispersion between the best and worst performing stocks and sectors, and in general, the combination of rising interest rates, geopolitical shocks, and slowing global growth, led to a downturn that spanned asset classes.

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Across U.S. equity markets in 2022, active managers yielded better results down the market cap spectrum as at least half of the population of active small cap managers were able to beat the small cap indices. The results were slightly different for large cap. Active managers in the large cap value space provided greater excess returns than their core and growth counterparts. U.S. large cap growth and core continue to be difficult areas for active management to add value.

The top active international managers (EAFE, ACWI Ex-U.S., and Emerging Markets) provided decent results. In 2022, the biggest challenge for non-U.S. equity managers was navigating top-down idiosyncratic factors, from the War in Ukraine to political and regulatory risks in China.

Active U.S. and international developed equity managers that had allocations to (and good stock selection in) energy were able to benefit from the outperformance of this sector throughout the year.

With fixed income markets being heavily influenced by central banks and credit spreads remaining relatively narrow, active management in fixed income continues to yield very good results. We believe active management in fixed income is crucial when navigating an environment with duration risk, interest rate volatility, and elevated default risk in riskier credit sectors.

The inflation and interest rate environment has clearly shifted, and geopolitical risk is much higher than before. It will be crucial for active managers to navigate this unique environment that may cause wild sector and style rotations. An environment with low correlations and high dispersion should be optimal for active management.

Average Excess Returns
Median Percentile

Style	Since Inception (30 Years)	Past 10 Years	Past 5 Years
U.S. Large Cap Core	0.29%	-0.93%	-1.53%
U.S. Large Cap Growth	0.54%	-1.29%	-1.90%
U.S. Large Cap Value	0.48%	0.19%	0.61%
U.S. Small Cap Core	2.17%	0.74%	0.16%
U.S. Small Cap Growth	4.14%	1.93%	3.42%
U.S. Small Cap Value	1.40%	0.73%	-0.17%
EAFE Equity	1.86%	0.03%	-0.49%
ACWI-Ex-U.S. Equity	1.88%	1.13%	0.65%
Emerging Markets	1.53%	0.46%	-0.34%
Core Fixed Income	0.38%	0.41%	0.25%
Municipal Fixed Income	0.35%	0.41%	0.31%

Source: Conway Investment Research

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In Summary:

- We continue to believe that active management yields its best results during more difficult market environments (down markets) by limiting downside capture.
- Active management outside the U.S. has yielded better results since inception, but the last 10+ years have been a challenge with macro events dominating financial markets. Relative performance in less efficient areas of the market like small cap stocks and non-U.S., appeared to improve slightly.
- We continue to believe there are more opportunities outside the U.S. to add value at the country, sector, currency, theme, and security level. Each country has different drivers, so active management can capitalize on attractive opportunities while also avoiding problematic countries or sectors.
- The most crucial piece of information that should be drawn from this analysis is the importance of manager selection.
- Managers at or around the top of their peer group will likely beat their benchmark across market cycles.
- The proliferation of passive investing has made it more difficult for skilled managers to outperform their respective benchmarks.
- We believe that the active/passive performance debate is cyclical, and it will reverse at some point in the future. Active managers should add value during any protracted down period such as the recent Covid-19 drawdown, or a high inflationary, or recessionary environment.

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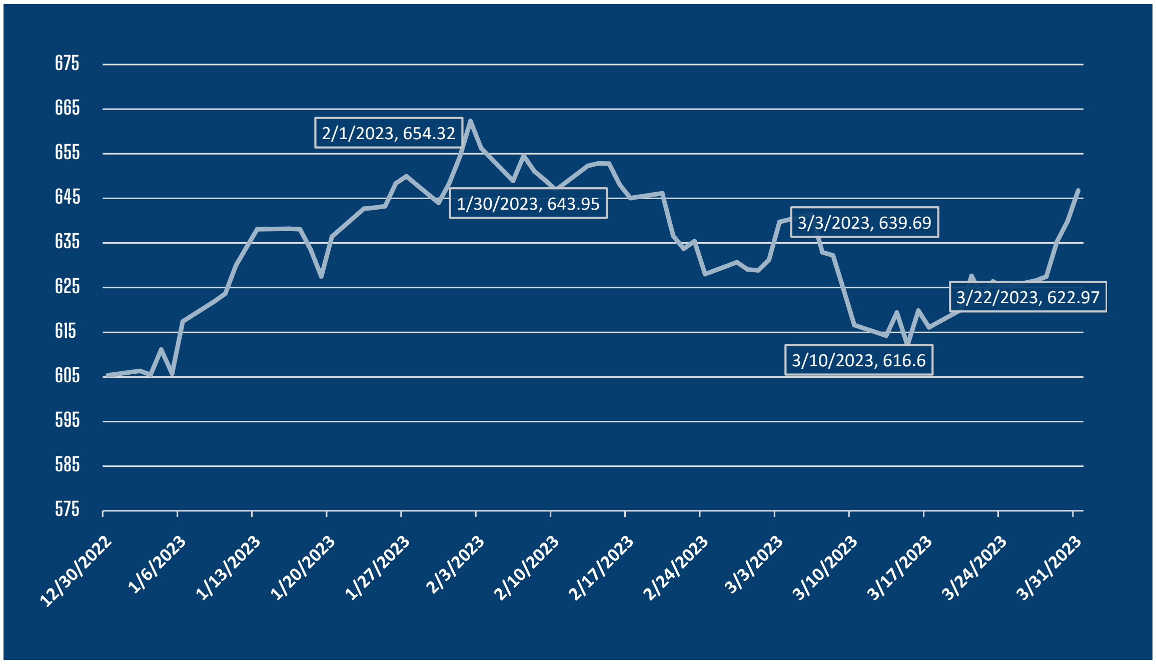
Key Q1 Dates

- January – The U.S. Dollar Index declines 1.35% in January and is down 10.5% from the September peak of 114.
- January 30 – Nasdaq posts best January since 2001, up 10.7%.
- February 1 – Federal Reserve finishes two-day meeting and raises the target Fed funds rate 25 basis points.
- March 3 – Fed Chair Powell tells Senate that recent data on demand, employment, and inflation coming in hotter than expected, would likely lead to further restrictive policy.
- March 10 – FDIC steps in and takes over Silicon Valley Bank after depositors pull billions of dollars.
- March 22 – Fed raises the target Fed funds rate 25 bps.

Global Stock Market
MSCI ACWI in USD



Source: Bloomberg

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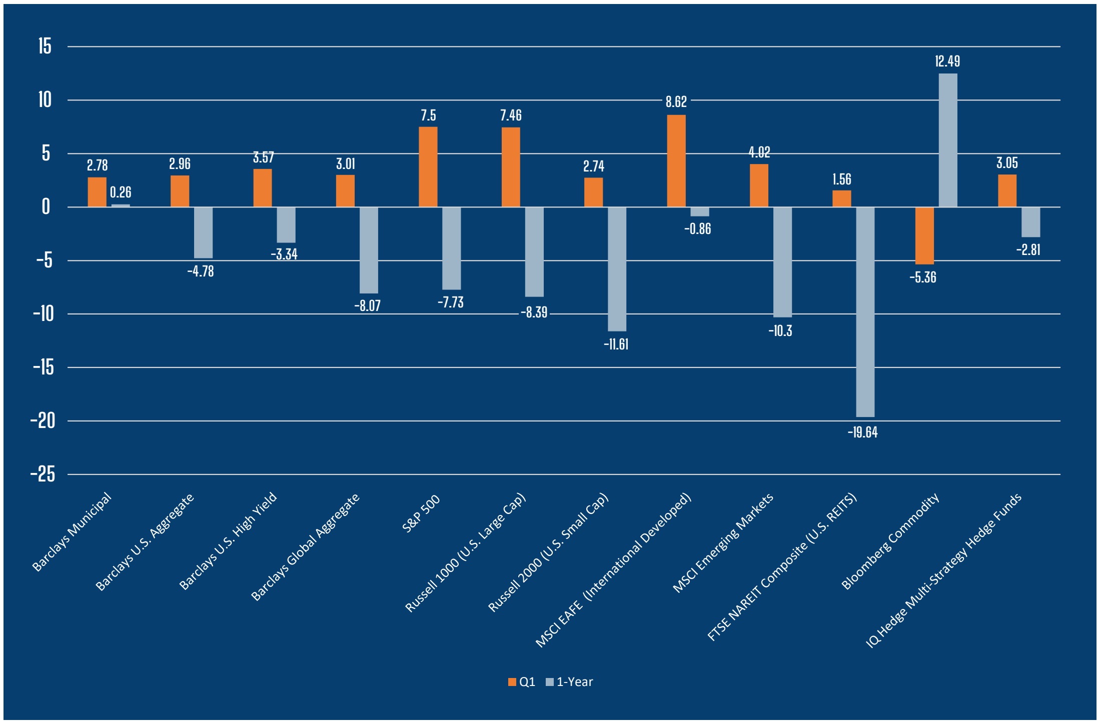
Asset Class Returns

Q1 2023



Source: Conway

Fixed Income

- Fixed income topped a good start to 2023 with strong March gains.
- Treasury and sovereign debt yields fell in March, providing a nice boost to core fixed income and municipals.
- Credit was a bit more challenged by the regional banking crisis which played out last month. Spreads widened a bit, but in most cases, carry (current income) provided a sufficient offset.
- The weaker U.S. dollar boosted non-U.S. assets.

Equities

- U.S. large caps outperformed in March led by the resurgence in growth/tech stocks.
- Growth beat value by a wide margin across the entire market cap spectrum.
- Small caps were particularly weak in March led by exposure to regional banks and the potential for tighter lending standards.
- Developed and emerging market equities posted a solid month of returns led by the global rebound in growth stocks.
- Similar to the U.S., small caps trailed large caps in international markets.
- The weaker U.S. dollar boosted international developed returns by 198 bps and emerging market returns by 87 bps.

Alternatives

- Real estate was weak in March on spillover concerns from the banking industry. REITS were slightly higher for the quarter but still down 20% from a year earlier.
- Commodities continue to struggle, down in March and the quarter. Concerns over global growth are weighing on raw materials.

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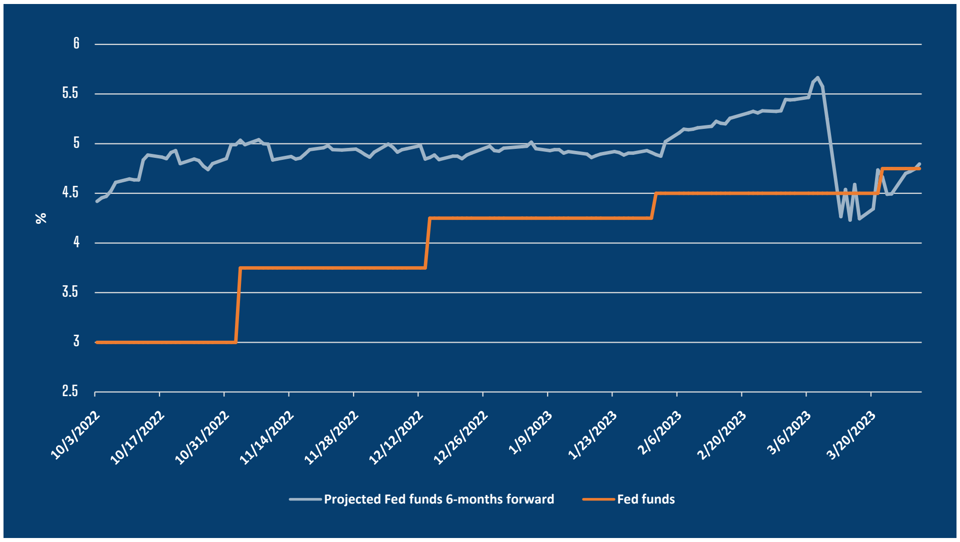
Fiscal and Monetary Policy Highlights

Fed Funds Target Rate vs. Projected Fed Funds Rate
6-months Forward



Source: Bloomberg, Haver

- The Fed has continued to increase the target rate, although in smaller increments.
- Recent Fed rhetoric indicates the board feels more firming in policy is necessary.
- Market expectations of future Fed policy, changed in mid-March when the banking industry came under pressure.
- Market participants are now looking for a Fed pivot in 2023.

Federal Reserve Economic Projections
Median of Members

Variable	2023	2024	2025	Longer Run
Change in Real GDP	0.4%	1.2%	1.9%	1.8%
December Projection	0.5%	1.6%	1.8%	1.8%
Unemployment Rate	4.5%	4.6%	4.6%	4.0%
December Projection	4.6%	4.6%	4.5%	4.0%
PCE Inflation	3.3%	2.5%	2.1%	2.0%
December Projection	3.1%	2.5%	2.1%	2.0%
Projected Appropriate Policy Path	5.1%	4.3%	3.1%	2.5%
Fed Funds Rate December Projection	5.1%	4.1%	3.1%	2.5%

Source: Federal Reserve

- The Fed cut its growth projections for the U.S. economy at its March meeting.
- The Fed slashed its estimate for 2023 GDP growth from 0.5% to 0.4%, with a similar downgrade to 2024.
- Current estimates for Q1 GDP growth stand at 2%-2.5% so assuming that plays out, the Fed and other economists generally expect negative GDP growth over the remainder of 2023.

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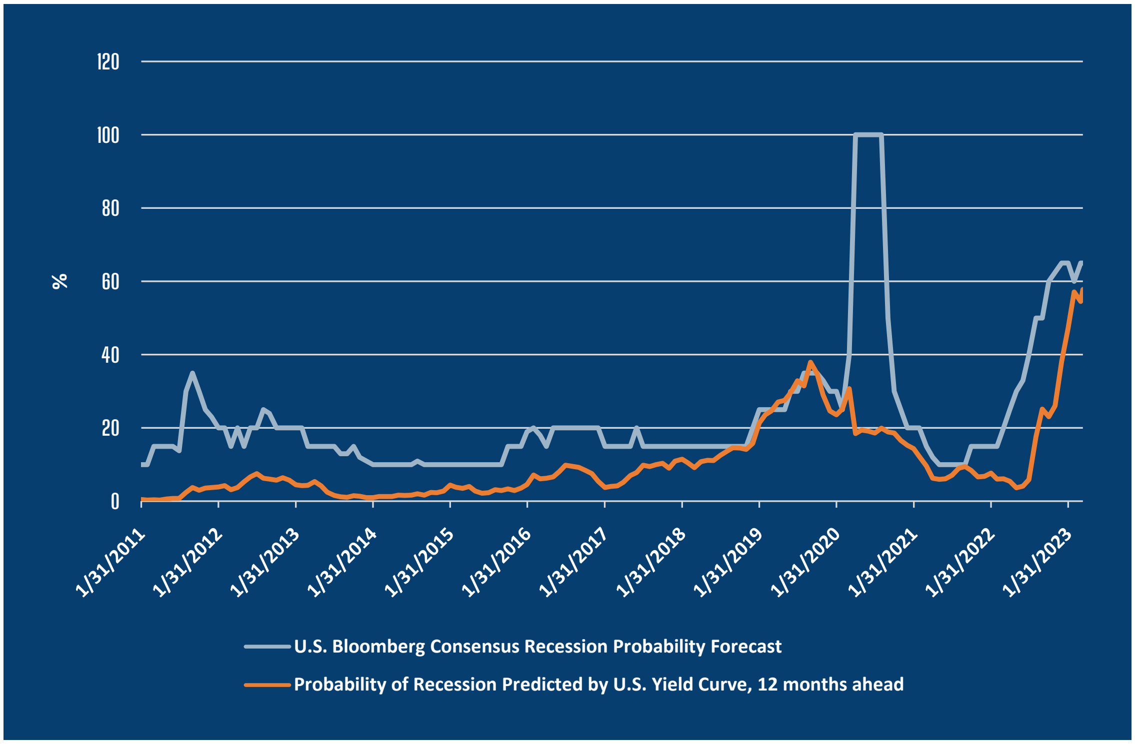
Hard Landing Concerns

Probability of U.S. Recession
Next 1 Year



Source: Bloomberg, Haver

- Recession fears (hard landing) increased during Q1.
- Leading indicators, the yield curve, and M2 growth (lack thereof) drove these fears.
- The recession fears spiked after the collapse of Silicon Valley Bank.

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U.S. Treasury Curve

The U.S. Treasury yield curve inversion deepened, reaching the most negative slope in over 40 years. Short yields moved higher, while longer maturity yields declined.

Treasury Yield Curve

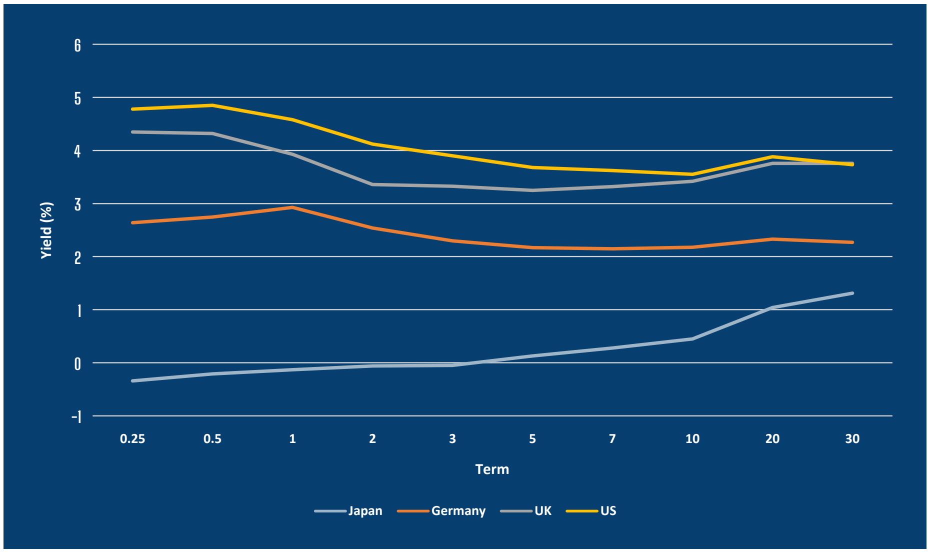
Source: Bloomberg

Government Bond Curves

Yield curve inversions generally deepened across the globe. Japan's sovereign yield curve remains upward sloping in contrast with most other developed countries.

Government Bond Yield Curves

End of Q1 2023

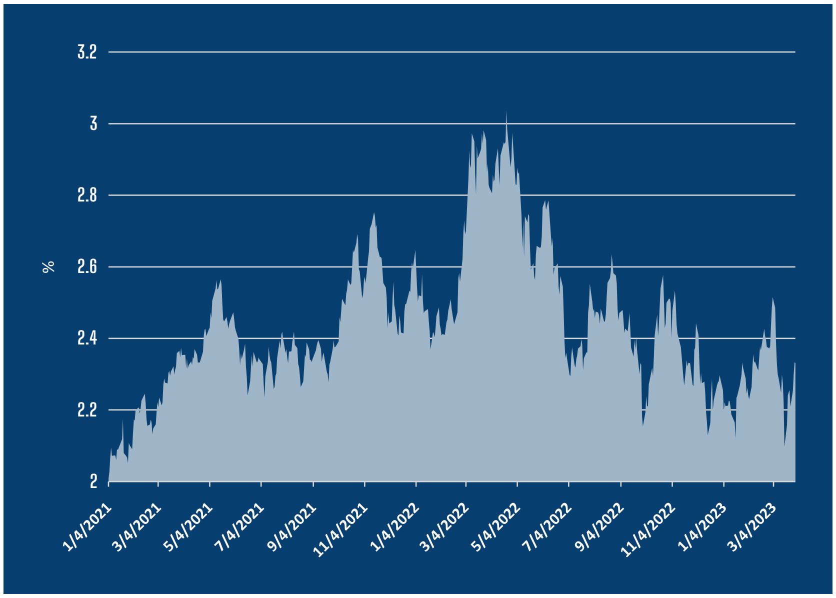


Source: Bloomberg

Inflation Breakeven Rate

Market expectations of future inflation can be calculated by the breakeven rate. The 10-year breakeven rate subtracts the yield of the 10-year TIP from the 10-year fixed rate Treasury. The difference is the expected inflation rate for 10 years. Despite heightened inflation, breakevens have remained relatively low, consistent with survey-based inflation expectations.

U.S. 10-Year Breakeven Rate

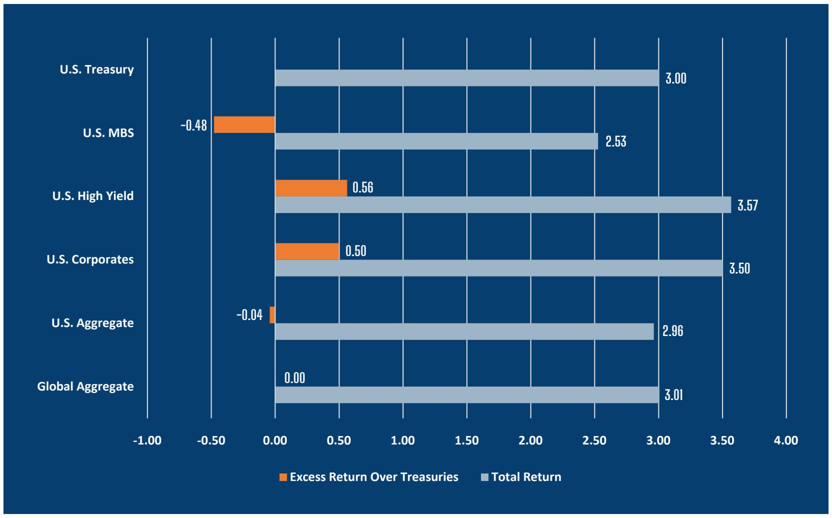


Source: Bloomberg

Fixed Income Performance (Q1)

Fixed income as an asset class posted strong returns as benchmark Treasury yields declined and credit spreads narrowed in sympathy with stronger equity markets. High yield posted the strongest performance with the tailwind of the highest yields in more than a decade.

Fixed Income Performance
Q1 2023



Source: Bloomberg

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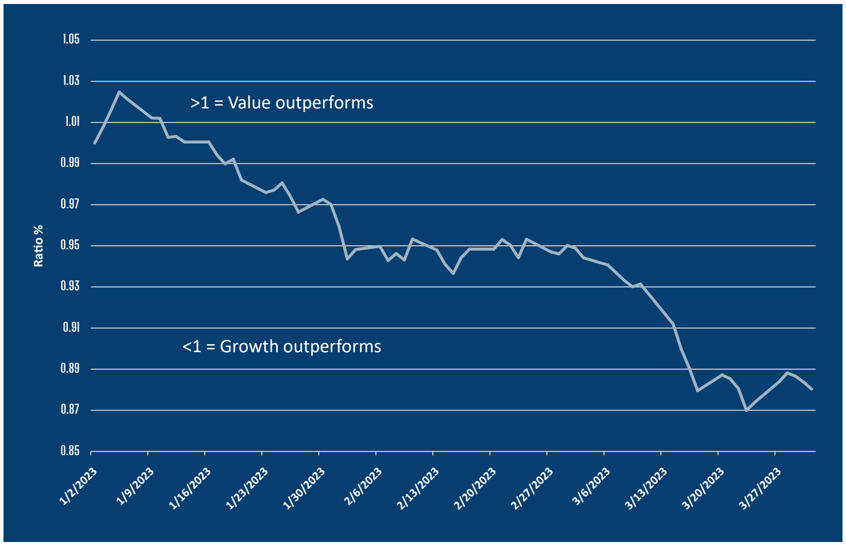
Equity – Value vs. Growth

Growth outperformed value during Q1.

Large Cap Value/Large Cap Growth – Q1 2023

Russell 1000 Value/Russell 1000 Growth



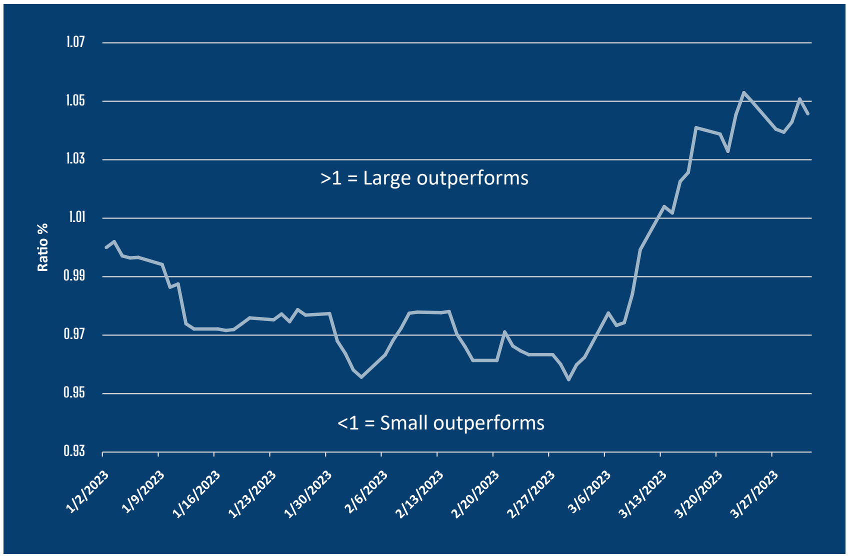
Source: Bloomberg

Equity – Large vs. Small

Large cap outperformed small cap during Q1 as mega cap growth names rallied strongly.

Large Cap/Small Cap – Q1 2023

S&P 500/Russell 2000



Source: Bloomberg

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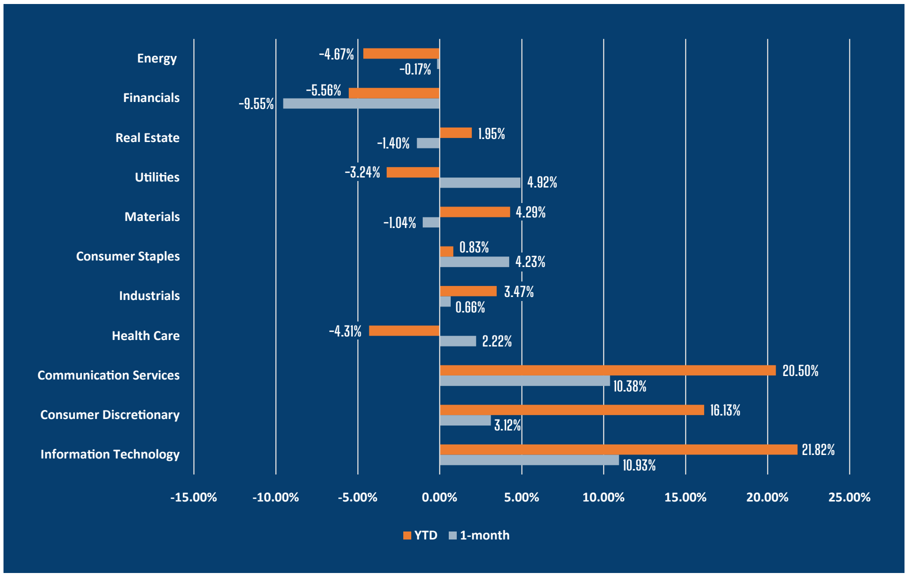
U.S. Equities – Return by Sector

Equities generally rallied in Q1. Some of 2022's biggest losers (by sector) posted the best gains. Technology and other growth sectors generally performed the best.

S&P 500 Sector Returns

Q1 2023

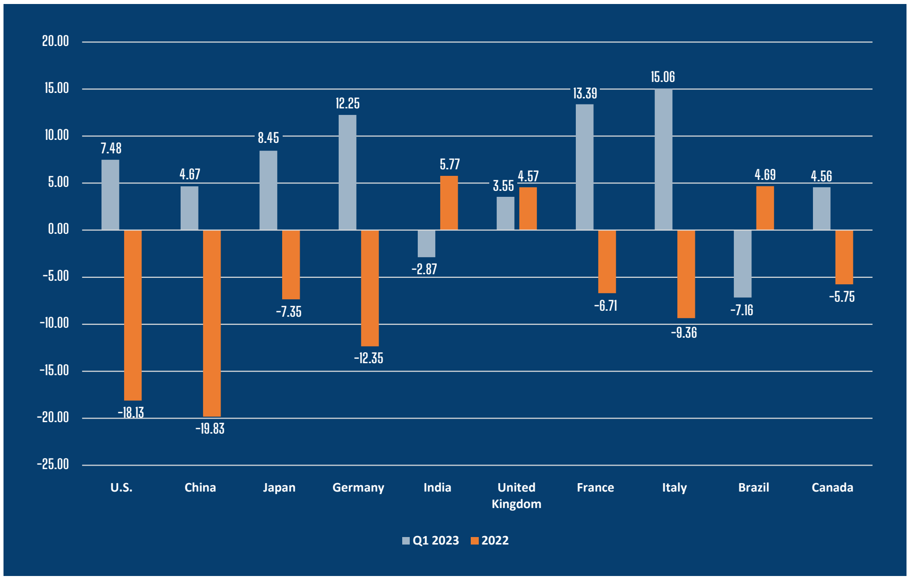


Source: Conway

Country Total Returns (%) – 10 Largest Economies

Global equities had a good start to the year after a tough 2022. Relative weakness in the U.S. currency has been a tailwind for foreign markets recently.

Country Total Equity Market Returns



Source: Bloomberg

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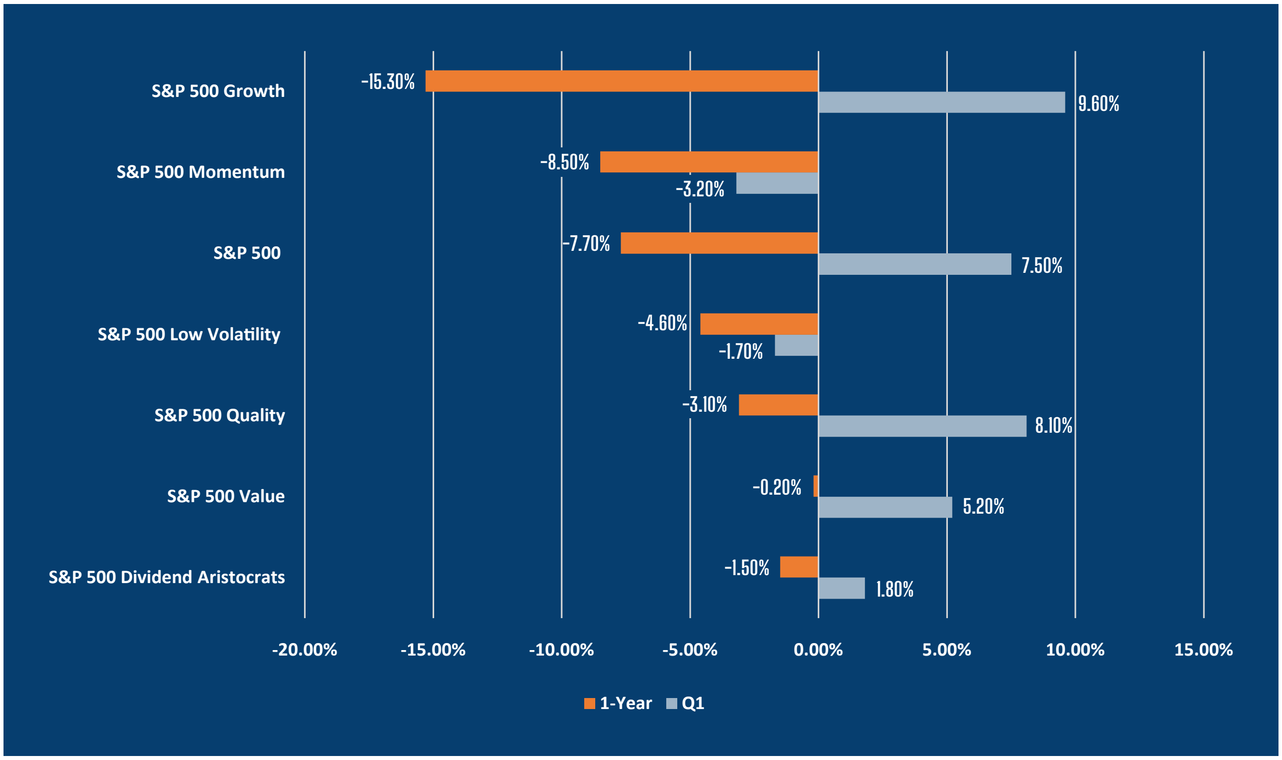
U.S. Equity Factors – Total Return (Q1)

Consistent with the broader markets, most of the core factors were higher in Q1. Mega cap growth names have been the leader through the first three months of the year.

Total Return: Core Factors
Q1 2023



Source: S&P

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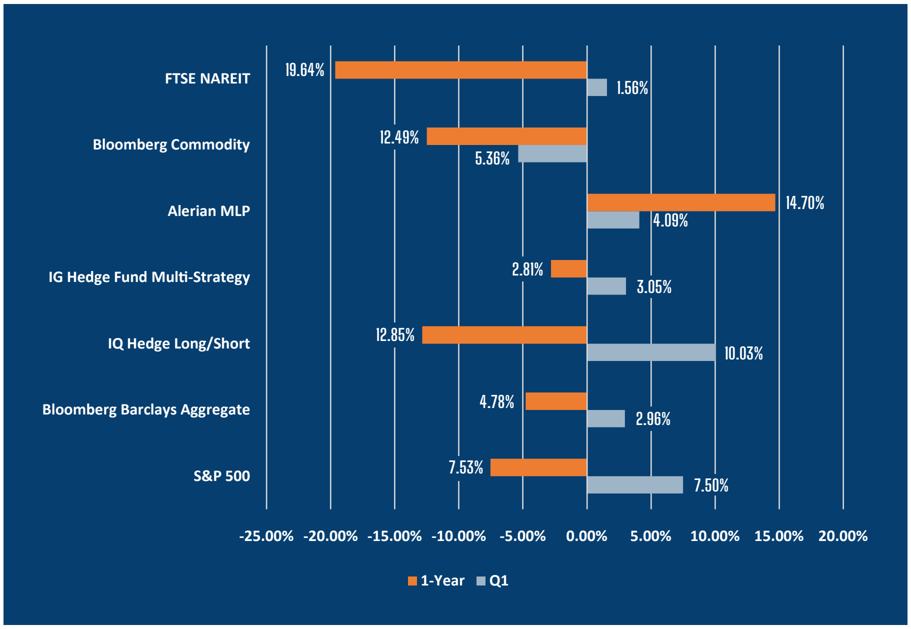
Alternative Returns

Alternative strategies and asset classes were mixed to higher in Q1 after a difficult 2022.

Alternative Returns

Q1 2023



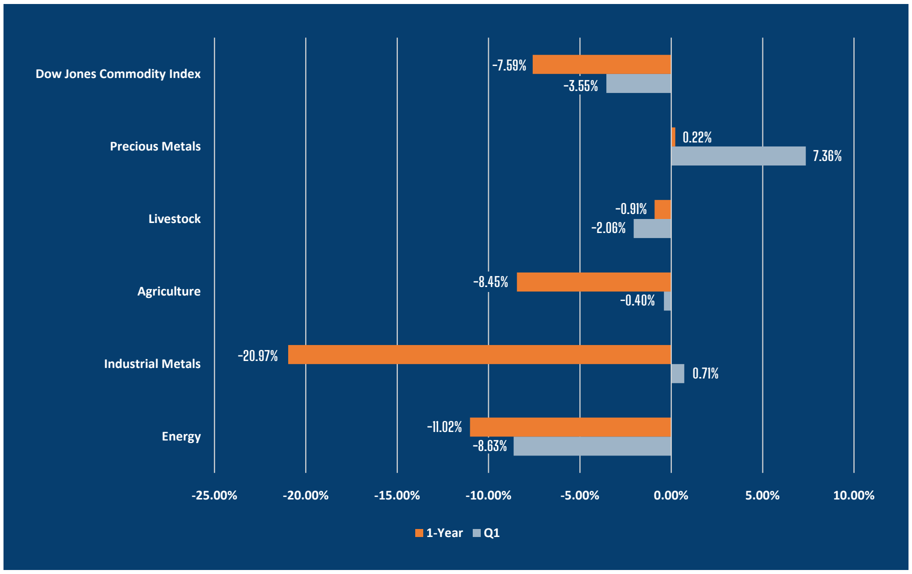
Source: Conway

Commodities

Concerns over weaker global growth and a reduced appetite for risk weighed on commodities last year.

Commodity Performance

Q1 2023



Source: S&P

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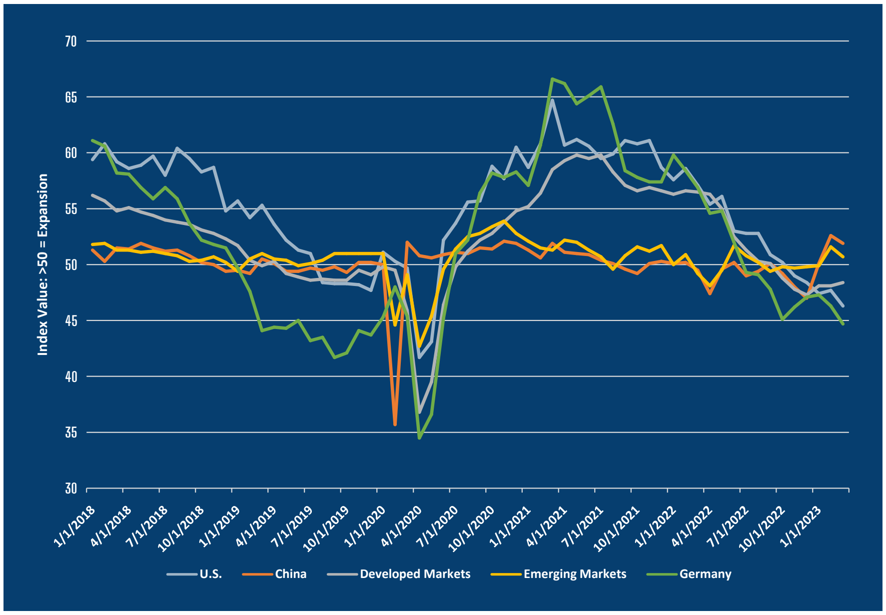
PMI Composites

The Purchasing Managers Index (PMI) is a survey-based measure of the prevailing direction of trends in the manufacturing sector. Readings >50 equal expansion and <50 contraction. Developing economies have been generally softening while emerging markets (including China) have shown more resiliency.

Global Manufacturing Surveys

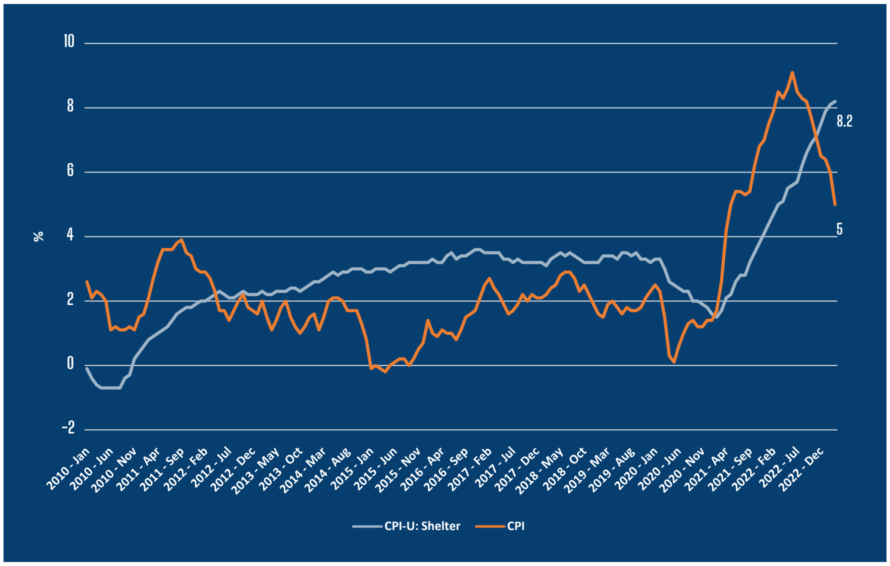


Source: Bloomberg, Haver

Inflation

Inflation continues to slowly decline from last year's peaks. One of the factors keeping it elevated is shelter. Shelter is the largest weight in CPI at 35% and is considered a lagging indicator.

CPI and CPI: Shelter



Source: Haver

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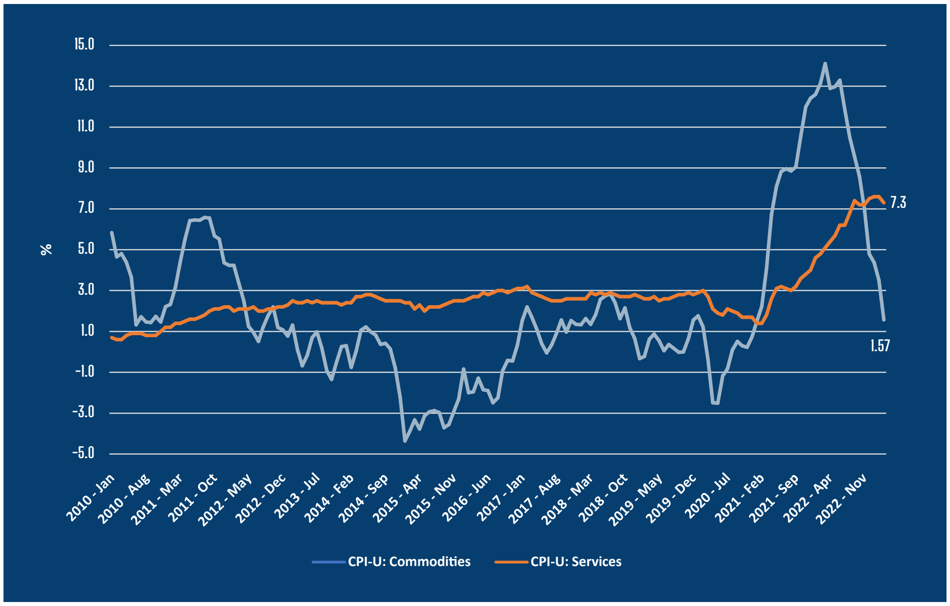
ECONOMIC REVIEW

Inflation

Service inflation continues to run hot.

Inflation: Services vs. Commodities



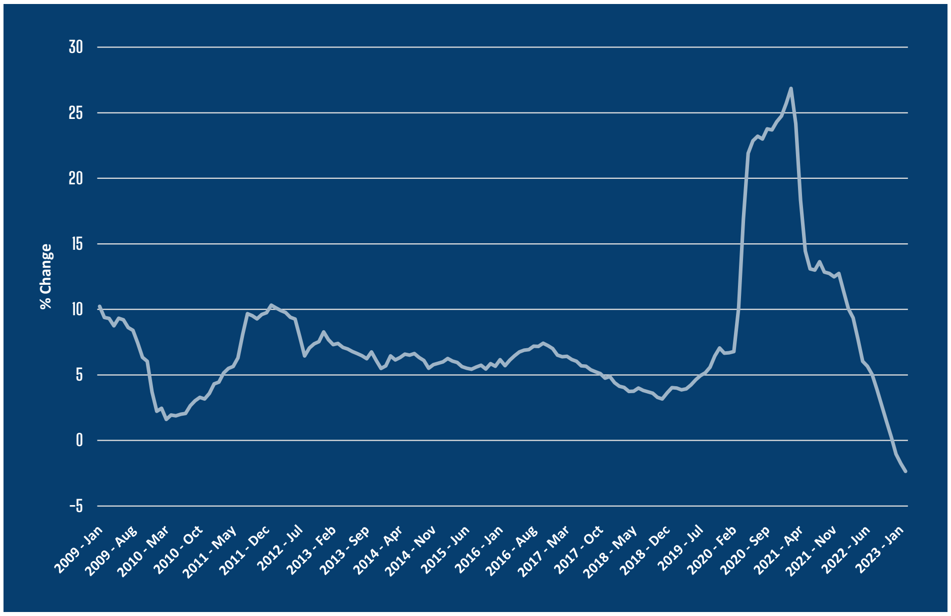
Source: Haver

Money Supply

M2 growth has fallen into negative territory (as measured year-over-year) for the last three months.

U.S. M2 Money Supply

Year over Year % Change



Source: Haver

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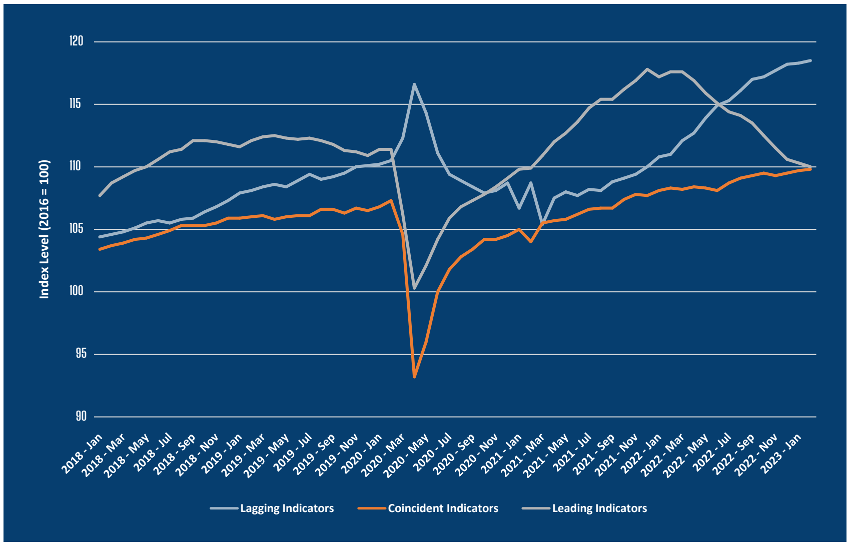
Leading Indicators

Coincident and lagging indicators are still rising while leading indicators (down 11 consecutive months) paint a picture of a slowing economy.

Leading, Lagging, and Coincident Indicators



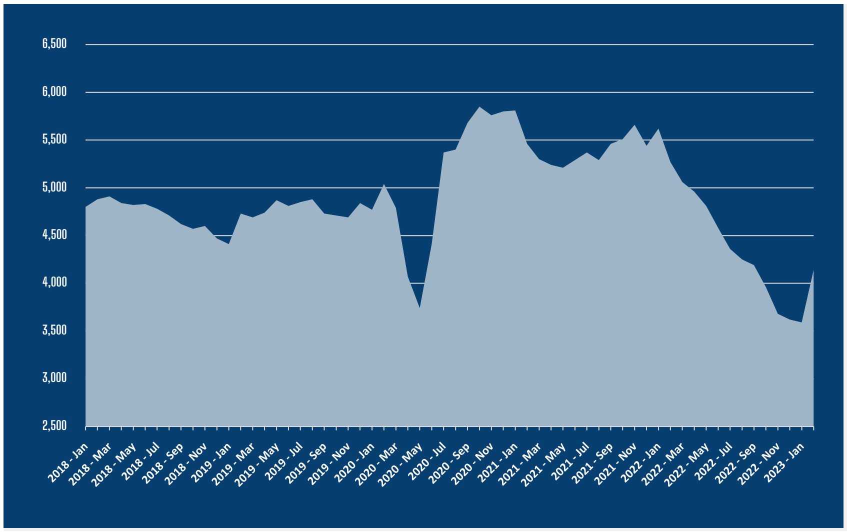
Source: Haver

Housing

Existing single family home sales rebounded in February after declining for an unprecedented 12 consecutive months.

Existing Single Family Home Sales

Seasonally Adjusted Annual Rate, Thousands



Source: Bloomberg

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March 31, 2023	MTD	QTD	YTD	1-Year	3-Year	5-Year	10-Year
Fixed Income Indices							
Barclays U.S. Treasury Bill 1-3 Month	0.40%	1.09%	1.09%	2.60%	0.91%	1.38%	0.84%
Barclays Municipal	2.22%	2.78%	2.78%	0.26%	0.35%	2.03%	2.38%
BBgBarc U.S. Govt/Credit Intermediate	1.45%	1.51%	1.51%	0.26%	-0.38%	1.26%	1.01%
Barclays U.S. Aggregate	2.54%	2.96%	2.96%	-4.78%	-2.77%	0.91%	1.36%
Barclays U.S. High Yield	1.07%	3.57%	3.57%	-3.34%	5.91%	3.21%	4.10%
S&P/LSTA Leveraged Loan	0.05%	0.05%	3.28%	2.44%	8.61%	3.64%	3.77%
Barclays Global Aggregate	3.16%	3.01%	3.01%	-8.07%	-3.43%	-1.34%	0.07%
JPM GBI EM Global Diversified	4.12%	5.16%	5.16%	-0.72%	0.87%	-2.37%	-1.52%
U.S. Equity Indices							
DJ Industrial Average	2.08%	0.93%	0.93%	-1.98%	17.31%	9.01%	11.15%
S&P 500	3.67%	7.50%	7.50%	-7.73%	18.60%	11.19%	12.24%
NASDAQ Composite (Price)	6.69%	16.77%	16.77%	-14.05%	16.65%	11.59%	14.10%
Russell 1000	3.16%	7.46%	7.46%	-8.39%	18.55%	10.87%	12.01%
Russell 1000 Growth	6.84%	14.37%	14.37%	-10.90%	18.58%	13.66%	14.59%
Russell 1000 Value	-0.46%	1.01%	1.01%	-5.91%	17.93%	7.50%	9.13%
Russell Mid Cap	-1.53%	4.06%	4.06%	-8.78%	19.20%	8.05%	10.05%
Russell 2500	-3.75%	3.39%	3.39%	-10.39%	19.42%	6.65%	9.07%
Russell 2000	-4.78%	2.74%	2.74%	-11.61%	17.51%	4.71%	8.04%
Russell 2000 Growth	-2.47%	6.07%	6.07%	-10.60%	13.36%	4.26%	8.49%
Russell 2000 Value	-7.17%	-0.66%	-0.66%	-12.96%	21.01%	4.55%	7.22%
Non-U.S. Equity Indices							
MSCI World	3.16%	7.88%	7.88%	-6.54%	16.96%	8.57%	9.44%
MSCI ACWI	3.15%	7.44%	7.44%	-6.96%	15.90%	7.46%	8.62%
MSCI ACWI Ex-U.S.	2.55%	7.00%	7.00%	-4.56%	12.32%	2.97%	4.65%
MSCI EAFE	2.61%	8.62%	8.62%	-0.86%	13.52%	4.03%	5.50%
MSCI EAFE Growth	5.44%	11.21%	11.21%	-2.45%	11.30%	5.26%	6.39%
MSCI EAFE Value	-0.10%	6.14%	6.14%	0.38%	15.29%	2.38%	4.35%
MSCI Europe	2.50%	10.74%	10.74%	2.03%	15.67%	4.99%	5.98%
MSCI Japan	4.15%	6.38%	6.38%	-4.83%	7.78%	1.65%	5.38%
MSCI AC Asia	3.74%	5.10%	5.10%	-7.23%	7.35%	0.84%	4.80%
MSCI EAFE Small Cap	-0.11%	5.05%	5.05%	-9.39%	12.52%	1.27%	6.25%
MSCI ACWI Ex-U.S. Small Cap	0.31%	4.81%	4.81%	-9.91%	15.53%	2.10%	5.47%
MSCI Emerging Markets	3.07%	4.02%	4.02%	-10.30%	8.23%	-0.53%	2.37%
MSCI EM Asia	3.63%	4.86%	4.86%	-9.04%	7.53%	0.50%	4.54%
MSCI China	4.52%	4.71%	4.71%	-4.57%	-2.51%	-3.87%	3.57%
MSCI EM Eastern Europe	-2.18%	4.18%	4.18%	-13.78%	-32.31%	-24.35%	-12.17%
MSCI EM Latin America	0.91%	4.04%	4.04%	-10.52%	18.65%	-1.45%	-1.51%
MSCI EM Small Cap	0.98%	3.94%	3.94%	-10.47%	21.25%	2.24%	3.56%
MSCI Frontier Markets	1.23%	3.18%	3.18%	-17.23%	8.25%	-2.56%	3.09%
Hedge Fund Indices							
IQ Hedge Long/Short	-0.07%	0.51%	0.51%	-7.20%	3.28%	2.30%	--
IQ Hedge Multi-Strategy	1.44%	3.05%	3.05%	-2.81%	2.89%	1.32%	2.38%
Real Assets Indices							
FTSE NAREIT Composite	-2.02%	1.56%	1.56%	-19.64%	10.38%	5.72%	6.04%
Alerian MLP	-1.18%	4.09%	4.09%	14.70%	47.08%	7.42%	0.57%
Bloomberg Commodity	-0.21%	-5.36%	-5.36%	-12.49%	20.82%	5.36%	-1.72%
S&P Global Infrastructure	2.39%	3.94%	3.94%	-3.45%	15.59%	5.88%	6.37%
Other							
Oil Price Brent Crude	-6.25%	-8.45%	-8.45%	-30.08%	46.66%	2.50%	-3.24%
CBOE Market Volitility (VIX)	-9.66%	-13.71%	-13.71%	-9.05%	-29.58%	-1.31%	3.95%

Source: Morningstar

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