GIA PARTNERS

4th Quarter 2021

Highlights

- **A resurgence of the virus via the Omicron variant imposed new constraints on the economy and markets. Interest rates rose modestly and spreads widened which muted our performance;**
- **The economy ended the year with good momentum, although the appearance of Omicron and rising inflation may constrain 2022's growth rate. The Fed will likely initiate a rate-hiking cycle by March;**
- **Inflation hit four-decade highs in December and factors pressuring prices are not improving. As often happens, well-intended policies may worsen the problem.**

Markets

		Returns (%)			
GIA*	Average Quality	4Q21 Gross	4Q21 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**0.15**	**0.07**	**0.26**	**-0.09**
Global Investment Grade Composite	**(A-)**	**0.39**	**0.29**	**-0.29**	**-0.69**
Global Credit Plus Composite	**(BBB)**	**0.17**	**0.04**	**0.59**	**0.09**
High Yield Composite	**(BB-)**	**0.60**	**0.46**	**6.57**	**5.99**
Emerging Market Corporate Debt Composite	**(BB)**	**-0.35**	**-0.50**	**3.29**	**2.67**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	0.01		-1.54	
Treasury	(AAA)	0.18		-2.32	
Corporate	(A-)	0.23		-1.04	
Mortgage	(AAA)	-0.37		-1.04	
Government/Credit	(AA)	0.18		-1.75	
ICE BofA U.S. Corporate & Yankees	(A-)	0.16		-1.03	
ICE BofA U.S. Corporate	(A-)	0.17		-0.95	
ICE BofA U.S. High Yield	(B+)	0.66		5.36	
ICE BofA EM Corporate Plus	(BBB)	-1.19		-1.58	
ICE BofA Global Gov't ex-US	(AA-)	0.06		-2.30	
JPM Emerging Markets EMBI GD	(BB+)	-0.44		-1.80	
JPM CEMBI Broad Diversified	(BBB-)	-0.61		0.91	
JPM GBI-EM Global Diversified	(BBB+)	-2.53		-8.75	
Benchmark Equities					
S&P 500	NA	10.65		26.89	
Nasdaq Composite	NA	8.28		21.39	
Russell 2000	NA	1.86		13.70	
MSCI EAFE	NA	2.40		8.78	
MSCI Europe	NA	5.65		13.99	
MSCI Japan	NA	-4.23		-0.11	
MSCI Emerging Markets Equity	NA	-1.68		-4.59	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

During the fourth quarter of 2021, financial markets confronted many events that historically might derail a run of favorable results, especially for equity investors. The Fed finally acknowledged inflation was a problem and their highly accommodative posture needed to change, setting up likely rate-hiking by early to mid-2022. Equities rallied on the news. Labor markets remained imbalanced with demand well exceeding supply, yet payroll employment data repeatedly disappointed. Then, as the world prepared to bid Covid-19 goodbye, the Omicron variant hit the globe like a tidal wave. While these and other developments caused volatility to surge, ultimately U.S. equity markets closed near record highs and European equities delivered another year of superior performance. In fixed income, higher short-end rates produced negative returns in many sectors, yet higher risk assets did relatively well. Furthermore, despite leading the world in all the negative Covid-related statistics, the U.S. dollar appreciated, the economy grew at a healthy pace, and commodity prices easily overcame the mid-quarter Omicron scare.

Investment grade credit posted modestly positive returns for the quarter on largely flat longer-end rates and slightly wider spreads. However, the sector recovered well from underperformance in November. For the full year corporate bonds outperformed by earning their superior yield. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was up 0.17% during the quarter and down -0.95% year-to-date. By comparison, the U.S. treasury index (G0Q0) returned 0.35% for the quarter and -2.38% year-to-date. Corporate option adjusted spreads (OAS) widened by 9 b.p. to 97 b.p., while the yield to worst of the index increased from 2.12% to 2.34%. For the full year, investment grade spreads narrowed by 6 b.p., while the yield to worst rose by 50 b.p. Investment grade issuance continued at a healthy pace, although December saw the lowest monthly volume of the year. For the quarter, issuance reached $318.7 billion taking the full year to a sizeable $1.67 trillion. This volume was the second largest ever and combined with the largest, 2020's $2.1 trillion, brought corporate public markets borrowing to nearly $4.0 trillion during the two Covid-impacted years.

The high yield market had a schizophrenic quarter with two months of negative returns followed by the best month of the year in December. Ultimately, the sector delivered an excellent year in both absolute and relative terms. The combination of improved creditworthiness, negligible default rates and abundant liquidity helped the market thrive. The ICE BofA U.S High Yield Index (H0A0) was up 0.66% for the quarter and 5.36% for the year. While service-related industries suffered a year-end setback with Omicron, energy and retail performed well. Energy, the largest industry in the index, returned 1.43% for the quarter and 13.70% year-to-date. The spread to worst widened by 2 b.p. from 325 b.p. to 327 b.p., while the yield to worst rose from 4.00% to 4.28%. High yield retail investors followed market sentiment by withdrawing funds in November and adding in December. Ultimately, they withdrew $1.1 billion for the quarter and $13.6 billion for all of 2021. This was a partial reversal of the hefty $44.3 billion investors contributed in 2020. The default rate including distressed exchanges decreased to a record low of 0.29% in December, a decline of 647 b.p. for the year. The new issue market cooled in the final quarter, although new borrowing still set a record in 2022. Quarterly borrowing was only $73.3 billion, but issuance totaled $483 billion easily surpassing the prior record of $449 billion in 2020.

Emerging markets bonds had an eventful quarter and year. Struggles with the pandemic joined challenging political developments to sour sentiment in many countries. These were offset by robust commodity markets and unfilled demand for goods. Ultimately, most countries delivered better economic performance than forecast helping many debtors do well. Exceptions included homebuilders and technology in China, utilities in Mexico and Chile, and local government obligors in Turkey and Ukraine. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was down -0.4% bringing the year-to-date result to -1.8%. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) suffered from deteriorating sentiment for the quarter, returning –0.8%, yet produced a +0.9% gain for the full year. The JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index suffered from both rising rates and currency depreciation to decline -2.6% for the quarter and -8.7% for all of 2021.

Economy

The year ended on a high note for equity markets, particularly in the U.S. where stock indices closed near record highs. The S&P 500 returned over 16% per annum over the last five years. In 2021, the economy likely posted a growth rate nearing 5.7% with an unemployment rate of 3.9%, near-record high consumer savings, robust corporate balance sheets, and a very healthy banking system. Setting aside that the world was recovering from a pandemic, is currently confronting a record number of covid infections, and government policy prescriptions engendered a four-decade high inflation rate, the economy is doing great. In fact, it is likely overheating.

The Omicron variant was identified in November 2021, about three months after the Delta variant seemed to be under control. A bit over a month later, Omicron showed itself to be much more infectious and, so far, less virulent. While policy makers had strong initial reactions and many firms imposed temporary closures, it appears the variant may cause less damage than its predecessors. More likely, Omicron or a similar variant will become endemic and eventually be treated like a permanently present flu strain.

With the virus repercussions still unfolding, many economists and multilateral institutions reduced their growth expectations for the first half of 2022. Forecasts for the full year remain upbeat, however, with the World Bank recently calling for 4.1% global growth. While expectations might be higher absent the covid constraints, a more troublesome factor for financial markets is inflation which is forcing monetary authorities to raise rates and reverse stimulus.

Our review of industries highlighted these inflationary concerns as companies repeatedly cited rising costs, supply constraints, and labor shortages when discussing 2022 outlooks. Specifically, consumer products companies have been forced to raise prices because raw materials and labor costs keep rising. Similarly, auto manufacturers, industrials, utilities, and service companies all face labor-related challenges and rising costs. Utilities, in particular, face rising energy costs along with expensive renewable generation directives that are raising consumer’s electric bills.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing about 3.5% at an annual rate in 1Q, and then accelerating to a 4.0% rate in 2Q 2022. The U.S. economy closed 2021 with solid momentum despite supply constraints and the quarter-end appearance of Omicron. The newest version of the virus will likely hold back the economy in the short-run by prolonging the supply constraints and labor shortages. However, once infections crest, we believe consumers will again spend some of their plentiful savings. While we believe the Fed will initiate a rate hiking cycle by March, corporate balance sheets and consumer leverage are in strong enough shape to withstand the tightening. Away from the U.S., we expect a similar pattern to emerge as the new variant gains and loses traction. A region that might experience a delayed return to full growth potential is Asia where policies continue to seek virus eradication rather than management. PROBABILITY 65%

2. A second scenario has the economy expanding at an even faster pace of 5.0% at an annual rate during the first half of 2022. The phenomenal jump in Omicron infections may be met with an equally rapid plateauing of cases, a manageable hospitalization rate, and few deaths. On these terms, the world may accept the endemic presence of Covid-19 and move on to fully reopen. In this scenario, many of the supply related impediments begin to clear up and output rises. PROBABILITY 20%

3. A third scenario has the economy slowing to a rate of 2.0 to 3.0% at an annual rate during the first half of 2022. Similar to the third quarter of 2021, this scenario could take hold if Omicron proves more virulent than expected or a new, more damaging, variant emerges. In this scenario, the permanence of an undefeatable pathogen

becomes the new normal leading companies and people to downshift their expectations for a healthy return. Consumers and companies would likely delay spending and rethink their expansion plans. PROBABILITY 15%

Market Outlook

During the first half of 2022, financial markets will likely face conflicting messages and economic data. On the positive side, consumers will likely spend some of their savings giving a nice boost to GDP. On the negative side, the Fed will likely initiate a rate hiking cycle which historically has humbled equity markets. For fixed income, early reaction to high inflation and the Fed's abrupt policy shift has been a move higher in interest rates. While real rates remain decidedly negative, economists expect inflationary pressures to ease as the year progresses, suggesting the possibility that long-term rates do not need to rise continually until the Fed's cycle ends. In credit markets, corporate balance sheets and business prospects remain healthy with default rates likely to stay near recent lows in 2022. We do not believe credit spreads will narrow much from current levels, although with improved creditworthiness and a strong economic backdrop, keeping exposure to higher quality names continues to make sense.

January 11, 2022

Important Information

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Index Definitions

Bloomberg U.S. Aggregate Index

The Bloomberg U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg U.S. Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg U.S. Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg U.S. Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg U.S. Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index

The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index

The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.
MSCI Japan Index

The index is a The MSCI Japan Index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.