



Institutional Perspectives

Monthly investment analysis and insights from Wilmington Trust Investment Advisors

ON THE RECORD

Investment Intermission: Our Views for Act II

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Tony Roth
Chief Investment Officer

The calendar has officially hit the halfway mark, providing investors with an opportunity to take stock of their portfolios, evaluate what has worked as expected, and craft a plan for the second half of the year. Can risk assets continue their ascent? And within equities, does cyclical leadership have further to run? Our assessment of the economic environment leads us to respond “yes” to both questions. Elevated volatility in the second half of this year is likely at some point as we expect a 5% to 10% correction before year end. Notwithstanding any such consolidation, we also expect domestic equities to end the year 5% or so higher than current levels. We are therefore positioning client portfolios with an overweight to risk assets, a mild preference for cyclical, and plenty of diversification across asset classes and factors.

First-half recap: a tale of two quarters

The first half of this year resulted in a very strong 15% total return for the S&P 500, with the index logging a positive return for five of the six months. The 10-year Treasury yield increased by 56 basis points (0.56%). U.S. stocks outperformed their non-U.S. counterparts.

But these figures gloss over a stark reversal in interest rates and market leadership between the first and second quarters (Figure 1). While the first quarter was dominated by higher interest rates and dramatic outperformance of cyclical and value equities (i.e., those that trade at a discounted valuation and may be more dependent on the economic cycle for profit growth), the second quarter saw the 10-year Treasury yield retrace to as low as 1.35%, paving the way for a resumption of command by growth-oriented, tech-related, and more expensive securities.

Continued

Figure 1

Value minus growth, and change in 10-year yield and yield curve in 1Q vs. 2Q 2021

	1Q change	2Q change
Value minus growth (%)	9.86%	-1.97%
10-year yield (bps)	81	-29
10-year/2-year spread (bps)	78	-38

Data as of June 30.

Source: Macrobond.

Value minus growth shows the performance of the Bloomberg US Pure Value Factor Index vs. the Bloomberg US Pure Growth Index.

There is much debate about whether the inflation pressures for raw materials, inputs, and finished goods are transitory, meaning they are likely to fade as supply-chain disruptions recede, price levels return to pre-pandemic levels, and demand normalizes.

The economic trend is still our friend

Our view for the overall equity market, as well as factor leadership beneath the surface, hinges on expectations for the economy and monetary policy as we approach and enter 2022.

The U.S. economy likely grew at an annualized rate of 8%–12% in the second quarter, and the median estimate among Wall Street economists (according to Bloomberg) is for U.S. GDP growth of 6.6% for calendar year 2021. We are anticipating stronger growth than consensus estimates for 2021—approximately 7.5% GDP growth—but weaker growth than consensus in early 2022 as the burst of demand from post-pandemic reopening and government relief payments fades.

While all indications point toward an economy that is at or just beyond the peak pace of growth for the cycle, we are still optimistic. Consumer spending and capital expenditures represent solid pillars to support above-historical-trend growth through 2022. Consumers have accumulated more than \$3 trillion of excess savings above the pre-pandemic trend, which we expect to be deployed more heavily into the services sector of the economy. The labor market has deep scars, but there is room for rapid improvement as we head into the fall. There is little disagreement that the slow improvement in the labor market is an issue of labor supply rather than demand, as job openings currently sit at record levels. Capital expenditures are also poised to move higher, following their historical relationship with corporate profits.

The great inflation debate

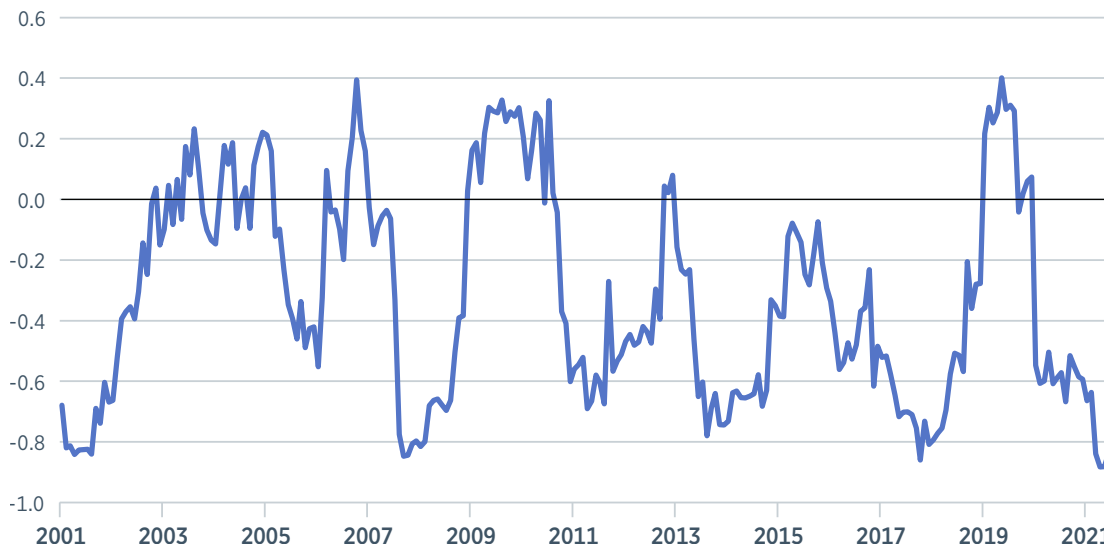
The pivotal open question remains the trajectory for inflation. The Consumer Price Index (CPI) increased at a rate of 4.99% year over year in May, the highest level since 2008. Month-over-month inflation in excess of 0.5% has also raised some eyebrows. Certain categories within the CPI, like used cars and trucks or airline fares, have increased 25%–30% over the past year.

There is much debate about whether the inflation pressures for raw materials, inputs, and finished goods are transitory, meaning they are likely to fade as supply-chain disruptions recede, price levels return to pre-pandemic levels, and demand normalizes. This perspective contrasts with those concerned that government spending and easy monetary policy have already laid the groundwork for inflation well above the Federal Reserve’s target, putting policymakers on the back foot and necessitating a faster tightening of policy in the near future.

Continued

Figure 2

12-month rolling correlation between value and growth factors



Data as of June 30, 2021.

Source: Bloomberg.

Shows 12-month rolling correlation between Bloomberg pure growth and value and growth factor indices.

The trajectory of Fed rate hikes is more important for the economy and equity market than the date of “liftoff.”

Our analysis suggests inflation pressures will indeed prove transitory, with fairly balanced upside and downside risks to 2022 inflation. We forecast overall inflation to slow to 2%–2.5% by mid-2022, with price dynamics for different categories normalizing at different rates. Pent-up demand for services could result in inflation for that sector of the economy, accelerating further as goods-related prices start to stabilize. Supply-chain pressures, transportation shortages, and strains on manufacturing capacity will likely ease as the virus subsides globally and job openings are filled. Increases in wages and new-hire bonuses, arguably a precursor to higher consumer prices, will also likely slow as the extra unemployment benefits finally roll off in September 2021.

Market views

If our forecast is correct, then the Fed will not need to slam on the policy brakes to halt the economic cycle. The trajectory of Fed rate hikes is more important for the economy and equity market than the date of “liftoff.” The first interest rate hike may very well occur by the end of 2022, as the market is currently predicting, but the rate-hike trajectory is likely to be slow and shallow; we expect just two to three hikes of 25 basis points each by end-2023.

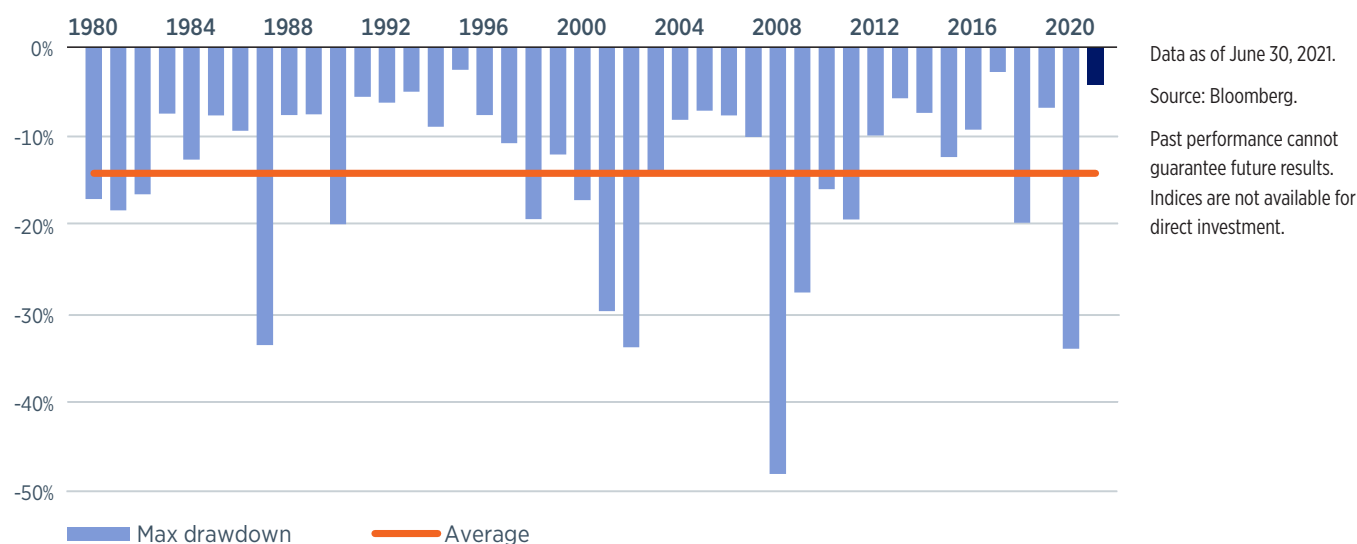
That is a recipe for an extended global economic recovery and a continuation of the corporate profit cycle. We expect interest rates to move higher, with the 10-year Treasury yield around 2% a year from now and the yield curve steepening, though only slightly from current levels. Above-trend economic growth, higher than 2% inflation, a rising 10-year yield, and a steeper yield curve all form a supportive backdrop for cyclical equities, the value factor, and reflationary assets such as commodities.

Equity returns should slow relative to those experienced over the past year, but they are still expected to outpace the total return on investment-grade bonds.

Continued

Figure 3

S&P 500 maximum drawdown by calendar year



The correlation between value and growth over the past few months has been the most negative since 2000.

We have held an overweight to equities since November 2020, and we most recently added to that overweight in May. Our proprietary sector strategy is overweight financials, energy, materials, and industrials, and we have positioned client portfolios with a slight overweight to the value factor across asset classes and managers. We also maintain a slight overweight to commodities, which, together with equities, should offer some protection against inflation overshooting our expectations.

Despite our preference for value stocks, we are steadfastly committed to diversification across factors. This translates today into a neutral allocation to the growth factor (stocks that are projected to generate above-average levels of revenue or profit growth but may trade at loftier valuations) and the technology sector. The correlation between value and growth over the past few months has been the most negative since 2000 (Figure 2). Generally, that means when value has been working, growth has been hurting, and vice versa. It also means the potential benefit from diversification across factors has rarely been greater. Technology and growth-oriented names also remain extremely important for our long-term views of a capital expenditures recovery and technological disruption across sectors.

Expecting higher volatility

We are constructive on the equity market over the next year, yet we also expect an increase in volatility and a concomitant drawdown at some point over that time period. Since March 2020, the equity market has been on a relatively steep and steady ascent, with no pullback in the S&P 500 of more than 10% and only three pullbacks of more than 7%. The rate of economic growth has likely peaked, and policy—both monetary and fiscal—could be shifting as we approach year end. Specifically, the Fed is likely to announce in August the details of a tapering of asset purchases, possibly to begin before the year draws to a close. President Biden and

Continued

Current tactical asset allocation

	Tactical tilts	-	NEUTRAL	+	Positioning
Equities	U.S. Large Cap	○ ○ ○ ○ ● ○ ○ ○			Overweight
	U.S. Small Cap	○ ○ ○ ○ ● ○ ○ ○			
	International Developed	○ ○ ○ ○ ○ ● ○ ○			
	Emerging Markets	○ ○ ○ ○ ○ ● ○ ○			
Taxable Fixed Income	Investment Grade	○ ● ○ ○ ○ ○ ○ ○			Underweight
	High Yield	○ ○ ○ ○ ● ○ ○ ○			
Real Assets	Inflation-linked Bonds	○ ○ ● ○ ○ ○ ○ ○			Overweight
	Global REITs	○ ○ ○ ● ○ ○ ○ ○			
	Other/Commodities	○ ○ ○ ○ ● ○ ○ ○			
Alternatives	Equity long/short hedge	○ ○ ● ○ ○ ○ ○ ○			Underweight
Cash		○ ○ ○ ● ○ ○ ○ ○			Neutral

President Biden and his administration have been on a government spending spree, but the focus could shift soon to raising taxes on corporations, high-earning individuals, and capital gains.

his administration have been on a government spending spree, but the focus could shift soon to raising taxes on corporations, high-earning individuals, and capital gains. COVID-19 variants remain a risk.

There are enough catalysts for an equity market correction, but we would expect any pullback to be in line with a typical nonrecessionary selloff less than 15%. Over the last 31 years, the equity market has experienced an average pullback of 14% in a calendar year, including recessionary periods (Figure 3), and we encourage our clients to be prepared for but not react to such an event.

Paragon[®], our proprietary planning software that provides historical and projected risk and return analysis, can be quite helpful in understanding possible drawdown exposure and helping to ensure that a particular risk profile may be the appropriate one for a client's goals. Now may be a great time for a midyear check-in with your advisor to revisit your goals and risk tolerance and prepare for a possible resumption of higher market volatility.

We also take the opportunity in this month's "In Focus" to revisit a few of our themes and expectations outlined in our [2021 Capital Market Forecast](#). This issue presents a combined July/August publication, so we wish everyone a nice summer and encourage you to keep an eye on our [Wilmington Wire](#) blog posts for real-time market and economic insights.

Best,



Tony

* Paragon is a portfolio analysis, risk assessment, and goal optimization tool. The Paragon report uses hypothetical examples in conjunction with forecasts for inflation, economic growth, and asset class returns, volatility, and correlation and provides you with general financial planning information and to serve as one tool in helping you develop a strategy for pursuing your financial goals. It is not intended to provide specific legal, investment, accounting, tax or other professional advice. For specific advice on these aspects of your investments, you should consult your professional advisors.

Forget the Trees, How Does the Forest Look?



Luke Tilley
Chief Economist



Evan Kurinsky
Research Analyst

At a glance:

- We maintain our view that the investments businesses have made are contributing to their improving earnings estimates and share prices
- We believe the increase in long-term inflation expectations is durable and will help to lift up long-term yields on a structural basis to a higher point than they had been in the previous economic cycle
- Mergers and acquisitions activity has continued at a rampant pace; looking forward, all signs point to a strong second half of the year

Given how much it felt like the year 2020 would never end, it's equally astonishing how quickly 2021 seems to be racing by. At midyear, we are encouraged the economy and markets have mostly fulfilled our expectations as laid out in our [Capital Markets Forecast \(CMF\)](#), where we presented our case for optimism based on vaccinations, stimulus, and continued growth. The economy continues to improve, and risk assets have performed well. Here, we check in on three components of this year's CMF that have driven markets thus far and we believe will continue to do so going forward.

Productivity

The importance of productivity is a drum we've been beating for years. It's the driver of economic growth, real wages, and profitability—and it keeps inflation in check. After digging into the technologies of the Fourth Industrial Revolution two years ago, in this year's CMF [we argued](#) adoption of those technologies was accelerated by the pandemic and the effects would play out over 2021 and for years to come.

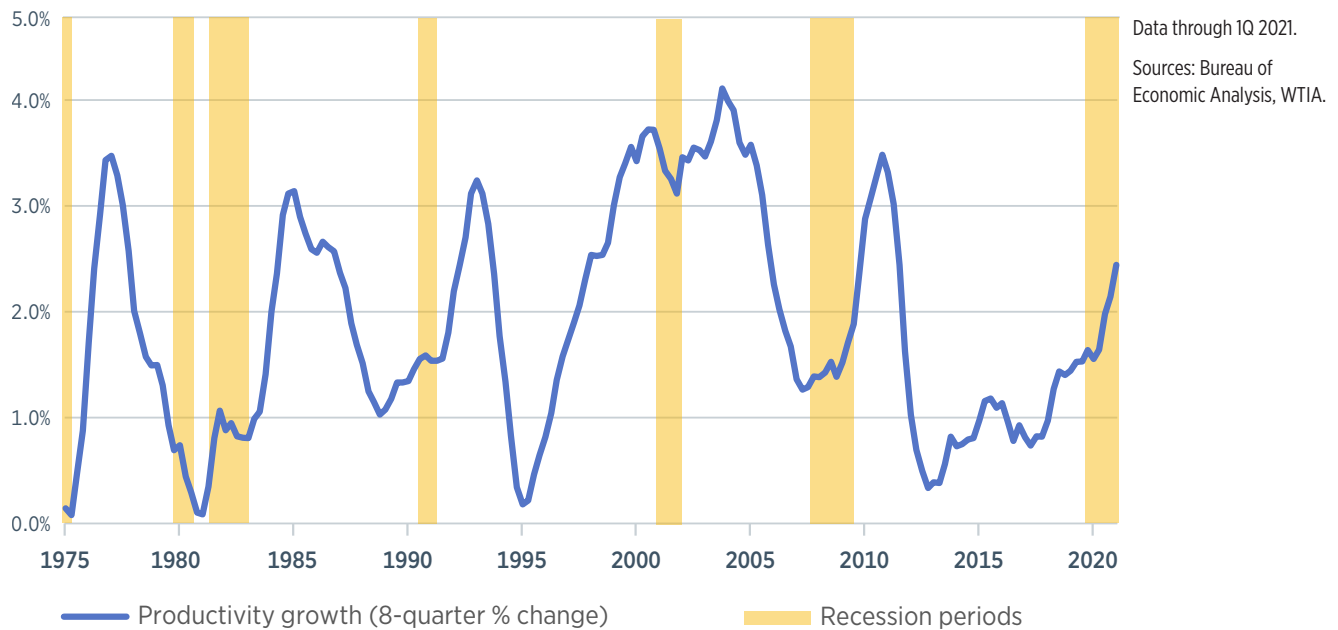
Firms have come through on that expectation in a massive way and all indications are that it will continue. Although capital expenditures were just 1% above the pre-pandemic level in 1Q 2021, the underlying detail reveals a push in tech with spending on computers and software up 26% and 10%, respectively. It is visible with large firms that get the headlines. Apple plans to spend \$430 billion domestically over the next five years in technology and manufacturing capacity; Walmart plans \$350 billion over 10 years; and Intel is shelling out \$20 billion this year. It's also visible in our everyday lives: restaurants and coffee shops whether local or corporate that previously had clumsy, barely functioning online presences now have efficient online ordering and menus viewable by scanning QR codes—and retail shopping is similarly enhanced.

All of this translates to strong productivity at the aggregate level and can be seen in the data. U.S. manufacturing output is down just 0.5% from pre-pandemic levels even though employment in the sector is down 4%. Similarly, retail sales are up 20% while employment in the sector is down 2.5%. Figure 1's refresh of our original CMF chart shows economy-wide productivity is now expanding at the fastest rate since the early days of the previous recovery. While we acknowledge that spurts of

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Figure 1

U.S. labor productivity growth
(2-year change in %)



In this year's CMF we argued adoption of those technologies was accelerated by the pandemic and the effects would play out over 2021 and for years to come. Firms have come through on that expectation in a massive way and all indications are that it will continue.

productivity are normal and expected immediately after a downturn as the economy recovers but hiring lags, we maintain our view that the investments businesses have made are contributing to their improving earnings estimates and share prices.

Inflation

We highlighted inflation as an important component of the outlook for the year, but our record is mixed. Except for the base effects we've now seen in measuring year-over-year inflation to the shutdown months of March, April, and May 2020, we expected inflation to remain lower than it has thus far this year. We were optimistic about the vaccine rollout, but did not expect reopening to come as quickly as it has, and we definitely did not plug in a near-\$2 trillion stimulus in March, a key driver of the recent acceleration in prices.

However, the more important component of [our inflation outlook](#) was that *long-term inflation* expectations would move higher after drifting too low for the preceding five years. The downward drift in 2014 was initially triggered by the collapse of oil and gasoline prices, but a confluence of other factors, including Federal Reserve rate hikes and falling import prices, also contributed. Low expected inflation hits investors by dragging down long-term bond yields and also limits the Fed's ability to effectively operate monetary policy.

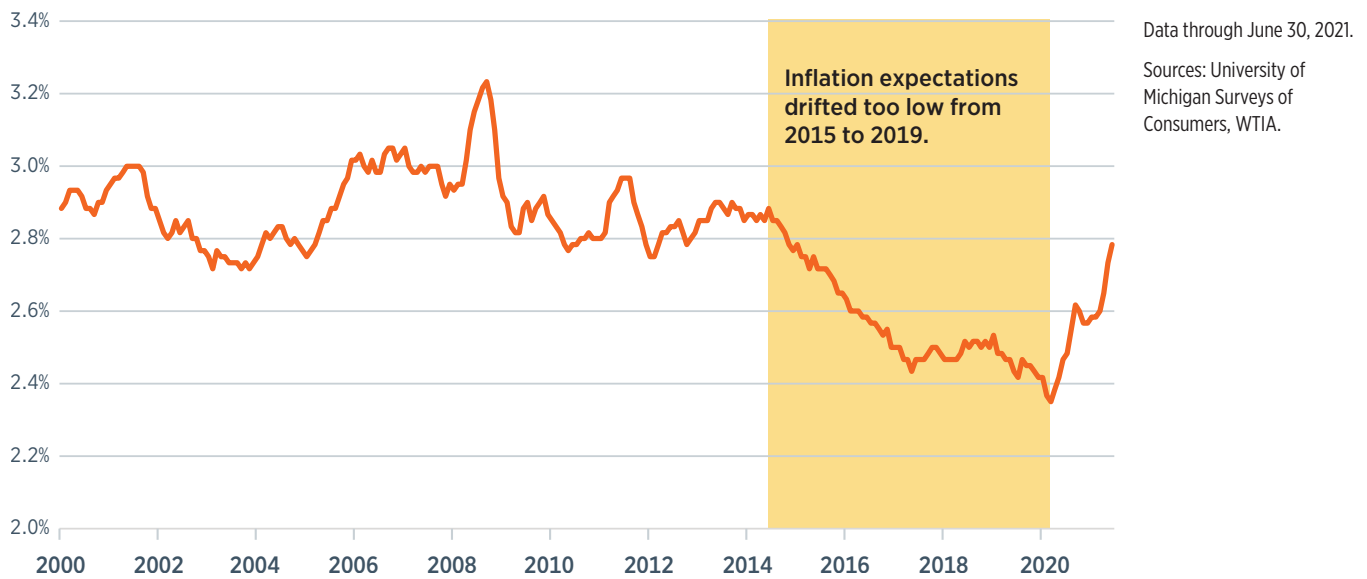
In our outlook, we projected an inflection point in the decades-long decline in inflation and bond yields, coming from multiple factors. The Fed's [revamped approach](#) to monetary policy to achieve higher inflation and firms' reorganization of [supply chains](#), along with the recovery from the virus-induced recession, should

Continued

Figure 2

Long-term consumer expectations of inflation over the next 5-10 years

(%, 6-month average)



M&A activity has indeed continued at a rampant pace, as companies awash with liquidity reshaped business models to better compete in a post-pandemic world.

push higher those critical long-term inflation expectations. Thus far, consumers have followed suit, bringing back those expectations to levels that prevailed before the recent collapse. We believe this increase is durable and will help to lift long-term yields on a structural basis to higher than they had been in the previous economic cycle.

Industry consolidation

In addition, we examined how a multidecade trend of increasing industry consolidation put greater power in the hands of fewer companies over time. At the time of writing, the mergers and acquisitions (M&A) market was witnessing a resurgence of activity following a pandemic-induced pause earlier in the year and we expected momentum to accelerate further in 2021.

M&A activity has indeed continued at a rampant pace, as companies awash with liquidity reshaped business models to better compete in a post-pandemic world. From January through May of this year, global M&A volumes surpassed \$2.5 trillion, marking the strongest first five months on record and a 178% increase from the same period in 2020.¹ Deal activity increased substantially across all regions and sectors relative to 2020, but it was technology that took the spotlight with M&A volume leading all sectors and increasing nearly fourfold from the same period in 2020.

We anticipated that technology deals would be increasingly sought after this year as the pandemic accelerated digital adoption, on both consumer and enterprise levels, but perhaps more surprising has been fierce competition not only from companies making strategic acquisitions, but also from private equity firms, which have shifted focus to higher growth investments. In addition, after an IPO renaissance in 2020, [special purpose acquisition companies \(SPACs\)](#), which raise

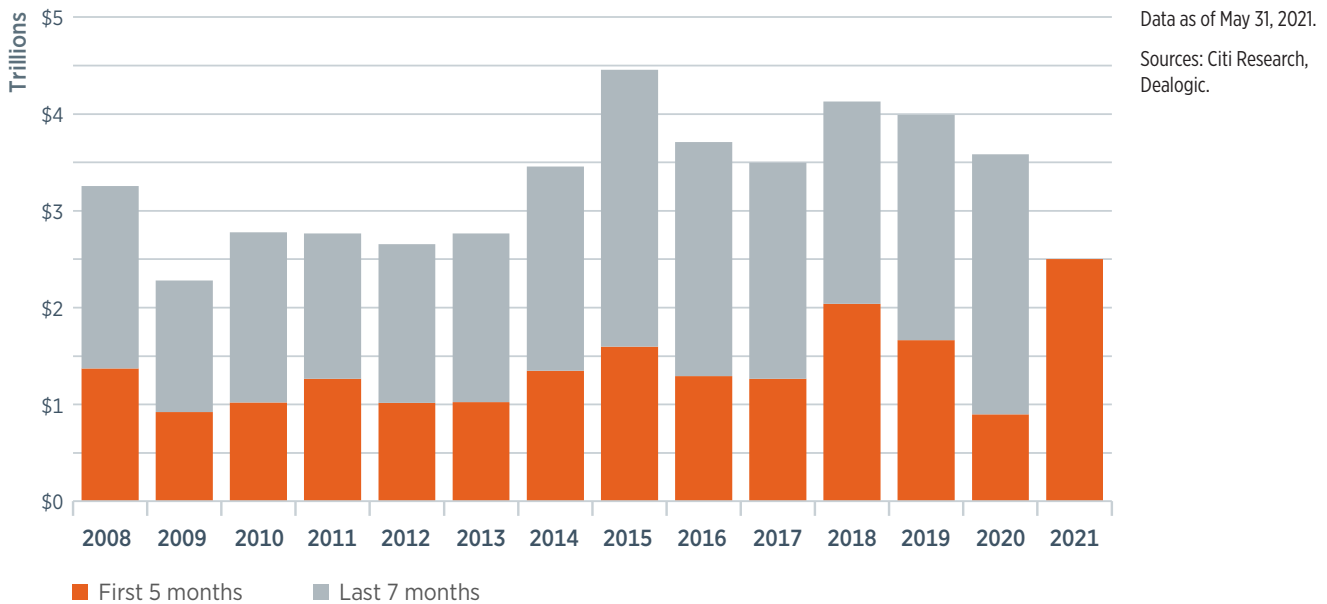
¹ Citi Research, Dealogic.

Continued

Figure 3

Following a pandemic-influenced hiatus, M&A activity experienced a resurgence in 2021

(Global M&A volume by year)



money first through an IPO before finding a private business to take public, have had an insatiable appetite for tech, and accounted for roughly \$110 billion of technology M&A volume in 1Q 2021.

The overarching question of whether industry consolidation increased as expected this year is a bit more nuanced to answer. On the one hand, many companies have pursued larger and more transformative transactions, with a record number of deals over \$5 billion in size. On the other hand, many of the remainder decided that bigger isn't necessarily better and opted to narrow their focus. Corporate divestitures hit an all-time record for the first five months of the year as many firms sold less productive assets to strengthen balance sheets and center their attention on core segments.

Looking forward, all signs point to a strong second half of the year for M&A. Rising vaccinations across the world are providing a light at the end of the pandemic tunnel and companies remain well capitalized. However, two important factors could put a lid on deal flow further down the line. First, the looming risk of higher taxes may pressure management teams to fast-track transactions this year rather than wait. Lastly, the risk of stricter antitrust laws and heightened scrutiny from regulators could potentially reduce activity, particularly for mergers involving the largest technology firms.



ASSET CLASS OVERVIEW

Municipal Fixed Income

Jason Hannon, CFA

Head of Municipal Strategy and Senior Fixed Income Portfolio Manager

AS OF JUNE 30, 2021

	Month	YTD	Trailing 12-month return
S&P Municipal Bond Index	0.3%	1.2%	5.0%
S&P Municipal High Yield Index	1.2%	5.5%	6.0%
S&P Municipal Bond New York Index	0.3%	1.6%	4.3%
S&P Municipal Bond California Index	0.2%	0.8%	4.9%

Sources: FactSet, Bloomberg. Investing involves risks and you may incur a profit or a loss. Past performance cannot guarantee future results. Indices are not available for direct investment.

What we are seeing now

The first half of 2021 continued to produce strong cash flows and positive returns for the municipal market. Fund flows for the year are proving to be the strongest on record, currently at \$58 billion, making them the third-highest among full-year calendar flows. As of June month end, the municipal bond market delivered a year-to-date return of 1.24% while the high-yield municipal bond market returned 5.50%. Thanks to a combination of federal stimulus dedicated to municipal issuers and sectors, as well as increased vaccination rates, we have seen stronger views of the municipal market as credit spreads tightened in all credit and rating sectors. The largest credit spread compression has been in the high-yield and BBB parts of the market as positive fund flows are causing investors to look lower in the credit spectrum in an effort to find attractive yield. As of the end of the first half of 2021, credit spreads for all ratings sectors are at or are approaching their historical tight levels, with high yield still offering the widest spread differential to their tights.

What's changing

The summer usually brings a cyclical lack of new issue supply in the market with July and August maturity and coupon payments providing a supply/demand imbalance. Should fund flows continue to be strong during this time adding to the imbalance, we would expect to see credit spreads continue to tighten as maturities and fund flows compete to find attractive yield in the primary and secondary markets. Taxable municipal issuance currently accounts for approximately 30% of all new issuance, further adding to the imbalance of supply in the tax-exempt municipal market. Combined, these market dynamics could help the overall market continue its trend of credit spread compression, in our view.

What we expect

The Biden administration currently has many plans that, if approved and implemented, would have direct effects on the municipal market. The most direct would be an increase to the personal and corporate tax rates, which would increase demand for municipal products, though no tangible details are available. While a small increase in the personal tax rate (37% to 39.6%) may produce little extra demand for municipals, we feel an increase in the corporate tax rate from 21% to 28% would bring back many property & casualty and life insurance companies into the municipal market. Moreover, these types of corporate buyers of municipal bonds tend to be investors in the long-term part of the yield curve, possibly helping to keep issuers' long-term borrowing costs lower, given their increased demand.

On June 24, President Biden announced a \$579 billion bipartisan infrastructure deal that included directly subsidized municipal bonds as a source of financing, which is reminiscent of the Build America Bond program used during the Obama administration. While there are currently no details of the program, the plan would increase the supply of taxable municipal bonds in the marketplace. For reference, the Build America Bond program was responsible for approximately \$187 billion of taxable municipal issuance between 2009 and 2010. However, there was no mention of a reinstatement of tax-exempt advance refunding in the president's infrastructure deal. Many groups have been advocating for tax-exempt advance refunding as a debt refinancing tool. If reinstated, it would bring more supply into the tax-exempt market. The infrastructure deal still faces a complicated path in Congress and there are many still forthcoming. However, both above-mentioned line items can bring increased supply and change to the municipal market.

Investment Positioning

Portfolio targets effective July 1, 2021, for institutional clients with Private Hedge Funds

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large-Cap	27.5%	Overweight
U.S. Small-Cap	5.5%	Overweight
International Developed	15.8%	Overweight
Emerging Markets	5.5%	Overweight
Fixed Income		
U.S. Investment Grade-Taxable	24.2%	Underweight
High-Yield-Taxable	3.0%	Neutral
Real Assets		
U.S. Inflation-Linked Bonds	1.0%	Underweight
Global REITs	1.5%	Neutral
Other	1.5%	Overweight
Private Hedge Funds	12.5%	Underweight
Cash & Equivalents	2.0%	Neutral
Total	100.0%	

Note: Totals may differ slightly from the allocation building blocks due to rounding.

TAA, or Tactical Asset Allocation, represents our *current recommendation* for each model strategy.

SAA, or Strategic Asset Allocation, represents our *current benchmark* allocation for each model strategy.

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For an overview of our asset allocation strategies, please see the disclosures.

Source: WTIA.

Disclosures

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Alternative assets, such as strategies that invest in hedge funds, can present greater risk and are not suitable for all investors.

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Indexes are not available for direct investment. Investment in a security or strategy designed to replicate the performance of an index will incur expenses, such as management fees and transaction costs that would reduce returns.

Past performance cannot guarantee future results. Investing involves risk and you may incur a profit or a loss. Asset allocation and diversification cannot ensure a profit or guarantee against a loss.

An overview of our asset allocation strategies:

Wilmington Trust offers seven asset allocation models for taxable (high-net-worth) and tax-exempt (institutional) investors across five strategies reflecting a range of investment objectives and risk tolerances: Aggressive, Growth, Growth & Income, Income & Growth, and Conservative. The seven models are High-Net-Worth (HNW), HNW with Liquid Alternatives, HNW with Private Markets, HNW Tax Advantaged, Institutional, Institutional with Hedge LP, and Institutional with Private Markets. As the names imply, the strategies vary with the type and degree of exposure to hedge strategies and private market exposure, as well as with the focus on taxable or tax-exempt income.

Model Strategies may include exposure to the following asset classes: U.S. large-capitalization stocks, U.S. small-cap stocks, developed international stocks, emerging market stocks, U.S. and international real asset securities (including inflation-linked bonds and commodity-related and real estate-related securities), U.S. and international investment-grade bonds (corporate for Institutional or Tax Advantaged, municipal for other HNW), U.S. and international speculative grade (high-yield) corporate bonds and floating-rate notes, emerging markets debt, and cash equivalents. Model Strategies employing nontraditional hedge and private market investments will, naturally, carry those exposures as well. **Each asset class carries a distinct set of risks, which should be reviewed and understood prior to investing.**

Allocations:

Each strategy is constructed with target weights for each asset class. Wilmington Trust periodically adjusts the target allocations and may shift away from the target allocations within certain ranges. Such tactical adjustments to allocations typically are considered on a monthly basis in response to market conditions. The asset classes and their current proxies are: large-cap U.S. stocks: Russell 1000® Index; small-cap U.S. stocks: Russell 2000® Index; developed international stocks: MSCI EAFE® (Net) Index; emerging market stocks: MSCI Emerging Markets Index; U.S. inflation-linked bonds: Bloomberg/Barclays US Government ILB Index; international inflation-linked bonds: Bloomberg/Barclays World exUS ILB (Hedged) Index; commodity-related securities: Bloomberg Commodity Index; U.S. REITs: S&P US REIT Index; international REITs: Dow Jones Global exUS Select RESI Index; private markets: S&P Listed Private Equity Index; hedge funds: HFRI Fund of Funds Composite Index; U.S. taxable, investment-grade bonds: Bloomberg/Barclays U.S. Aggregate Index; U.S. high-yield corporate bonds:

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Disclosures Continued

Bloomberg/Barclays U.S. Corporate High Yield Index; U.S. municipal, investment-grade bonds: S&P Municipal Bond Index; U.S. municipal high-yield bonds: Bloomberg/Barclays 60% High Yield Municipal Bond Index / 40% Municipal Bond Index; international taxable, investment-grade bonds: Bloomberg/Barclays Global Aggregate exUS; emerging bond markets: Bloomberg/Barclays EM USD Aggregate; and cash equivalents: 30-day U.S. Treasury bill rate.

All investments carry some degree of risk. Return volatility, as measured by standard deviation, of asset classes is often used as a proxy for illustrating risk. Volatility serves as a collective, quantitative estimate of risks present to varying degrees in the respective asset classes (e.g., liquidity, credit, and default risks). Certain types of risk may be underrepresented by this measure. **Investors should develop a thorough understanding of the risks of any investment prior to committing funds.**

Quality ratings are used to evaluate the likelihood of default by a bond issuer. Independent rating agencies, such as Moody's Investors Service and Standard & Poors, analyze the financial strength of each bond's issuer. Ratings range from Aaa or AAA (highest quality) to C or D (lowest quality). Bonds rated Baa3 or BBB and better are considered **Investment Grade**. Bonds rated Ba1 or BB and below are **Speculative Grade** (also **High Yield**).

Definitions:

Alpha is a measure of performance on a risk-adjusted basis. The excess return of the fund relative to the return of the benchmark index is a fund's alpha.

The Bloomberg Barclays US Credit Index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

Duration risk is the risk associated with the sensitivity of a bond's price to a one percent change in interest rates. The higher a bond's duration, the greater its sensitivity to interest rates changes.

Equity risk premium is the extra return that's available to equity investors above the return they could get by investing in a riskless investment like T-Bills or T-Bonds or cash.

Event-driven hedge fund strategies attempt to take advantage of temporary stock mispricing before or after a corporate event takes place. An event-driven strategy exploits the tendency of a company's stock price to suffer during a period of change.

Global intangible low-taxed income (GILTI) is a category of income that is earned abroad by U.S.-controlled foreign corporations (CFCs) and is subject to special treatment under the U.S. tax code.

HFR® (HedgeFundResearch) Indices are the established global leader in the indexation, analysis and research of the hedge fund industry.

LIBOR is the average interbank interest rate at which a selection of banks on the London money market are prepared to lend to one another.

Macro hedge fund strategies generally focus on financial instruments that are broad in scope and move based on systemic or market risk (not security specific). In general, portfolio managers who trade within the context of macro strategies focus on currency strategies, interest rates strategies, and stock index strategies.

MSCI AC Asia ex Japan Index captures large- and mid-cap representation across two of three developed markets countries (excluding Japan) and nine emerging markets countries in Asia. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI China Index captures large- and mid-cap representation across China A shares, H shares, B shares, Red chips, P chips and foreign listings (e.g. ADRs). The index covers about 85% of this China equity universe. Currently, the index includes large-cap A and mid-cap A shares represented at 20% of their free float adjusted market capitalization.

MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the US and Canada. With 902 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI EAFE Growth Index captures large- and mid-cap securities exhibiting overall growth style characteristics across developed markets countries around the world, excluding the U.S. and Canada.

MSCI EAFE Value Index captures large- and mid-cap securities exhibiting overall value style characteristics across developed markets countries around the world, excluding the U.S. and Canada.

MSCI Emerging Markets Index captures large- and mid-cap representation across 26 emerging markets countries. The index covers approximately 85% of the free float-adjusted market capitalization in each country.

MSCI Europe Index captures large- and mid-cap representation across 15 developed markets (DM) countries in Europe. The index covers approximately

85% of the free float-adjusted market capitalization across the European DM equity universe.

MSCI Japan Index is designed to measure the performance of the large- and mid-cap segments of the Japanese market. The index covers approximately 85% of the free float-adjusted market capitalization in Japan.

MSCI United Kingdom Index is designed to measure the performance of the large- and mid-cap segments of the UK market. The index covers approximately 85% of the free float-adjusted market capitalization in the UK.

Relative value hedge fund strategies cover a variety of low-volatility trading strategies with the consistent theme of attempting to reduce market risk, i.e., the manager seeks to generate a profit regardless of which direction the markets are moving. All relative value strategies minimize market risk by taking offsetting long and short positions in related stocks, bonds, and other types of securities.

S&P 500 index measures the stock performance of 500 large companies listed on stock exchanges in the U.S. and is one of the most commonly followed equity indices.

Stagflation is persistent high inflation combined with high unemployment and stagnant demand in a country's economy.

Limitations on use:

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