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Capital Perspectives

Monthly investment analysis and insights from Wilmington Trust Investment Advisors

ON THE RECORD

Decades in Weeks, Portfolios for Months

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Tony Roth
Chief Investment Officer

"There are decades where nothing happens; and there are weeks where decades happen." This quote—in addition to representing an exquisite irony—has proven as true in the first quarter of 2022 as it was when it was said by founder of the Russian Communist Party Vladimir Lenin over 100 years ago.

The last few months have seen an escalation of economic, market, and geopolitical risks across the globe. The S&P 500 has responded with the first negative quarterly return in two years. At the same time, the index is down just 5.2% from its all-time high, and we cannot shake the feeling that a fire alarm is going off in the building and few are rushing for the exits. That is not to say the building is burning, but the market today does not appear to adequately reflect downside risks. We believe a more cautious stance in portfolios is warranted, and we have taken down equity exposure in recent weeks.

Risks rising

Our latest Wilmington Wire blog post highlighted three interrelated risks to equity markets: 1) a commodity price spike associated with the war in Ukraine; 2) deteriorating sentiment among consumers and small businesses, in large part due to historic inflationary pressures; and 3) a hawkish Fed, which by the market's expectations could hike the fed funds rate by 2.25% this year.

We need to add a fourth headwind to that list: the recent spike in COVID cases in China. The Chinese are working hard to stave off potentially high death counts that could ensue from the Omicron variant in light of the relatively poor vaccination profile of its overall population. To this end, the country has remained steadfastly committed to a "zero-tolerance" COVID policy and on March 27 announced a "rolling lockdown" of Shanghai, in addition to lockdowns in other less populous cities.

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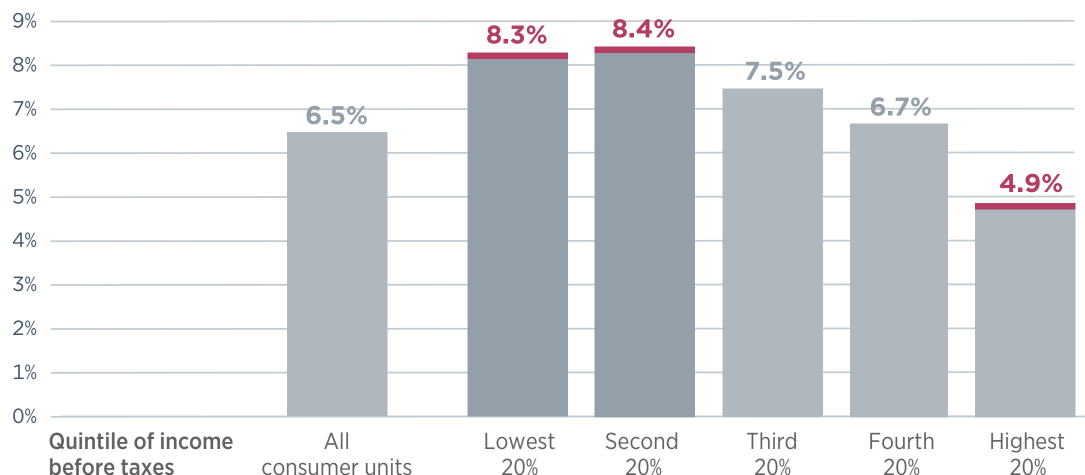
Figure 1

Energy (gasoline, natural gas, electricity) share of expenditures

As a share of total expenditures (household market)



Data as of December 31, 2019.

Source: BLS Consumer Expenditure Survey (2019).

Higher energy prices weigh disproportionately more on low-income households, where energy wallet share is nearly double.

Inflation is the single biggest risk to the economy and markets. It is contributing to the lowest level of consumer sentiment since the 2011 debt ceiling crisis.

Shanghai's population of 26 million people will be subjected to mass COVID tests, contact tracing, and isolation. Policymakers are doing their best to blunt the impact on economic growth and manufacturing, with shorter lockdown periods for key manufacturing firms like Apple supplier Foxconn. However, global supply chains remain stretched thin, and prolonged shutdowns of Chinese manufacturing plants or ports risk exacerbating shipping delays, input costs, and broader inflationary pressures.

Inflation is the single biggest risk to the economy and markets. It is contributing to the lowest level of consumer sentiment (as measured by the University of Michigan survey) since the 2011 debt ceiling crisis. Higher energy prices weigh excessively on lower-income households, with the share of total spending on energy for the lowest quintile by income twice that of the highest quintile (Figure 1). Businesses are feeling the pinch of higher costs as well, which is likely to erode record-high corporate profit margins, though by how much? The highest net percent of small businesses on record are indicating they are raising prices.[1] At the same time, small business job openings and hiring plans are coming off the boil, and the historical relationship with wages would suggest more modest wage gains going forward. That is a key determination in our call for inflation to slow to 4.5% year over year (y/y) on the Consumer Price Index, or CPI (measures the average change in prices over time that consumers pay for a basket of goods and services).

Even if our projection for inflation pans out, the Federal Reserve is in the hot seat. If the CPI ends the year at 4.5% y/y, that will mean it spent the better part of 2022 above 6%. Absent a meaningful slowing in month-over-month inflation figures, the Fed will feel pressure to keep its foot on the brake until the policy rate is closer to neutral (the estimated rate at which Fed policy neither stimulates nor slows the economy). Expectations for Fed tightening are already being felt in the mortgage market, where the 30-year fixed rate is now 4.9% and the highest since April 2011 (Figure 2). With housing, energy, and food eating up a larger share of spending,

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[1] Source: National Federation of Independent Business, February 2022.

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Figure 2

30-year fixed mortgage rates

(April 2011-March 2022)

Data as of April 1, 2022.

Source: Macrobond.

The rapid reassessment of U.S. monetary policy has driven up short-term Treasury rates at a faster pace than longer rates, inverting the yield as measured by 2/10 spreads as we start the second quarter. An inversion of the yield curve has preceded every recession in the past 4.5 decades.

discretionary purchases on goods and services could slow.

Inflation is rampant outside of the U.S. as well. February inflation for the eurozone rose to a new record high of 5.9% y/y.[2] Germany's CPI surged to 7.3% y/y in March—the highest since the 1980s—and Spain's inflation rate is nearly 10%.

The rapid reassessment of U.S. monetary policy has driven up short-term Treasury rates at a faster pace than longer rates, inverting the yield as measured by 2/10 spreads as we start the second quarter.[3] An inversion of the yield curve has preceded every recession in the past 4.5 decades.

Investors asleep at the wheel?

Why does the equity market appear to be shrugging off these clear alarm bells—evidenced in part by the 10% rally in the S&P 500 since March 8? I highlight some possible reasons and explain why we are cautious but not yet bearish.

Part of the narrative we think the market—and members of the Federal Open Market Committee—has latched onto is the comparison to 1994, when the Fed raised the federal funds rate by 3% in one year before pausing and eventually cutting rates in 1995, all while the economy avoided recession and continued to grow into one of the longest expansionary cycles on record. There are definitely some similarities between today and the mid-1990s, particularly the growth backdrop. Our expectation of 3% U.S. GDP growth coming into the year gives considerable cushion to withstand aggressive policy tightening and is a key reason we do not expect a recession in the next nine to twelve months. But the inflationary backdrop and anticipated slowdown in consumer spending raise the stakes for a "soft landing" by the Fed. Given the low starting level of rates, the Fed's current tightening cycle could be the most aggressive in history on a relative basis. A safe landing—that is, taming inflation without recession—is definitely possible, but it could get very bumpy and unpleasant for equity investors during the descent.

[2] Sources: Bloomberg, Eurostat.

[3] We define an inverted yield curve as the 2-year Treasury yield exceeding the rate on the 10-year Treasury yield. There are other definitions that utilize different portions of the term structure of interest rates.

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The one area of the equity complex where we retain a modest overweight is to emerging markets equities. Here the picture is quite different than the U.S. equity market. Valuations for emerging markets equities are incredibly cheap compared to U.S. equities on a relative basis, so downside risk appears more limited than in domestic markets.

Inflation is not necessarily a reason to get negative on stocks, as stocks have historically proven to be an effective hedge. Two conditions must be met, however, for stock values to hold up: 1) companies must still have pricing power, which appears to be the case broadly but will not continue indefinitely; and 2) growth cannot slow too abruptly. While true stagflation (high inflation and a contracting economy) is unlikely, if inflation persists at these levels and growth slows more aggressively than we are anticipating, that environment could prove more challenging for stocks than bonds or commodities.

The yield curve is another reason to be cautious but not overly bearish. It is true that yield curve inversions have historically preceded recessions, but the lagged and variable timing on this indicator tells us little more than we are late cycle. If one were to prematurely have taken a cautious stance in portfolios at the time of past yield curve inversions, it would have come at the cost of significant equity gains (Figure 3). The yield curve's signal may be further distorted by quantitative easing, the Fed's policy of buying longer-maturity Treasuries to keep rates artificially low. As the Fed steps back from the market, the long end of the curve could get some lift. At the very least, investors need to consider that the Fed is starting this tightening cycle with the yield curve artificially flat.

Positioning

Due to the numerous economic and geopolitical factors at play today, market uncertainty seems to be at unprecedented levels. Markets have proven relatively resilient, and we have taken the opportunity to reduce risk in portfolios—first through a reduction in international developed equities and, most recently, by taking down exposure in U.S. large- and small-cap equities to neutral versus our strategic benchmark. We added the proceeds from these trades to investment-grade fixed income and cash, the former having already experienced one of the worst drawdowns in history and the latter providing optionality in a higher-volatility market. Treasury inflation-protected securities (TIPS) may seem like an obvious asset class to which to allocate, but the 10-year breakeven rate is still at the highest since data started being recorded in 1998. In other words, that market is already pricing inflation, and if inflationary pressures do recede, that market could see outflows, which would result in lower prices. We are slightly underweight to TIPS versus our strategic benchmark.

The one area of the equity complex where we retain a modest overweight is to emerging markets equities. Here the picture is quite different than the U.S. equity market. Valuations for emerging markets equities are incredibly cheap compared to U.S. equities on a relative basis, so downside risk appears more limited than in domestic markets. China—a full 30% of the emerging markets equity index—is struggling with an ailing property market and COVID lockdowns but is likely to ease monetary, fiscal, and regulatory policy to support the economy. Otherwise, policymakers' 5.5% GDP goal for 2022 will be virtually unattainable. Outside of China, several Latin American emerging markets economies, such as Brazil, Colombia, Argentina, and Mexico are net commodity exporters that benefit from the

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Figure 3

High-net-worth portfolios with private markets*

	Tactical tilts	— NEUTRAL +	Positioning
Equities	U.S. Large Cap	○ ○ ○ ● ○ ○ ○	Overweight
	U.S. Small Cap	○ ○ ○ ● ○ ○ ○	
	International Developed	○ ○ ○ ● ○ ○ ○	
	Emerging Markets	○ ○ ○ ○ ○ ● ○	
Fixed Income	Investment Grade	○ ● ○ ○ ○ ○ ○	Underweight
	Tax-Exempt High Yield	○ ○ ○ ● ○ ○ ○	
	Taxable High Yield**	○ ○ ○ ○ ● ○ ○	
Real Assets	Inflation-linked Bonds	○ ○ ● ○ ○ ○ ○	Underweight
	Global REITs	○ ○ ○ ● ○ ○ ○	
	Other/Commodities	○ ○ ○ ● ○ ○ ○	
Alternatives	Equity Long/Short Hedge	○ ○ ● ○ ○ ○ ○	Underweight
Private Markets	Equity/Debt/Real Estate	○ ○ ○ ● ○ ○ ○	Neutral
Cash		○ ○ ○ ○ ○ ● ○	Overweight

Data as of April 1, 2022.

Positioning reflects our monthly tactical asset allocation (TAA) versus the long-term strategic asset allocation (SAA) bench-mark. For an overview of our asset allocation strategies, please see the disclosures.

*Private markets are only available to investors that meet Securities and Exchange Commission standards and are qualified and accredited. We recommend a strategic allocation to private markets we do not tactically adjust this asset class.

**Taxable high-yield bonds are not included in the strategic asset allocation benchmark for tax-sensitive portfolios primarily invested in municipal bonds. In this case, the Investment Committee saw an opportunity to invest in short-term, taxable leveraged loans (high yield) for both taxable and nontaxable portfolios.

Don't miss the latest episode of Capital Considerations, *1Q in the Rearview Mirror: What's ahead in the 2022 investment landscape?* where our Head of Investment Strategy Meghan Shue and I delve deeply into the events that have shaken market optimism and stirred macro uncertainty—and discuss what we believe is yet to come.

surge in prices for energy, metals, and agriculture commodities. For these reasons, we like emerging markets as an optimal target for a small beta overweight.

Most of our clients are diversified and hold a mix of stocks, bonds, and other assets. On a relative basis, it has been an even more challenging quarter for bonds than for stocks. An aggregate index of Treasury bonds returned -5.6% in the first quarter.[4] That is the worst return for the index since Bloomberg started to record data in 1973. It is rare for the equity market to be down in a quarter and the bond market to be down by more. This does not mean diversification or the "60/40 portfolio" is dead. Rates are likely to continue to rise but have done much of the heavy lifting for the year at both the long and short ends of the curve. Going forward, investors will be clipping a larger coupon on their fixed income investments, while giving their portfolios the benefits of diversification and downside mitigation in most markets. Long-term investors are likely to see their bond holdings recover as interest-rate volatility recedes and credit conditions remain stable.

Best,

Tony

[4] Source: Bloomberg US Treasury Total Return Unhedged USD index, as of March 31, 2022.

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ASSET CLASS OVERVIEW

International Equities

Clement Miller, CFA
Senior Portfolio Manager

AS OF MARCH 31, 2022

	Month	YTD	Trailing 12-month return
MSCI EAFE (Developed) Index	0.64%	-5.91%	0.65%
MSCI EAFE (Developed) Growth Index	0.62%	-12.30%	-2.43%
MSCI EAFE (Developed) Value Index	0.67%	0.33%	3.46%
MSCI Euro Area Index	-1.79%	-11.60%	-4.88%
MSCI Japan Index	0.50%	-6.61%	-6.66%
MSCI Emerging Markets Index	-2.26%	-6.98%	-12.62%
MSCI China Index	-8.00%	-14.19%	-34.18%

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 big story over the last 12 months has been that global demand for many goods, including crude oil, metals, food, and semiconductors, has outstripped supply. Reasons for this state of affairs include several global waves of COVID variants, hitting different regions at different times, with conflicting policy responses across countries; in particular, China's proclivity for wide-scale lockdowns. Putin's invasion of Ukraine, together with sanctions imposed on Russia, has worsened these existing supply-demand imbalances. While these imbalances have helped oil/gas and mining stocks, they have hurt European and Japanese industrials and consumer discretionary stocks, such as automakers. Moreover, inflationary expectations are boosting bond yields, helping banks' net interest margins but hurting rate-sensitive technology stocks.

We have also seen Xi Jinping's China become less friendly to investment capital. The Communist Party has engaged in numerous interventions into the business operations of China's internet platform stocks, even to the point of forcing them to make large contributions to the Party for its social priorities. For many such stocks, earnings and share prices have fallen sharply. Additionally, China's actions to quash political dissent in Hong Kong and send jet fighters into Taiwanese air space have dismayed investors. Moreover, U.S. trade, technology, and investment restrictions (beefed up under the Biden administration) constrain China's investment opportunity set, especially for U.S. investors.

What's changing

The West is now facing a protracted economic and financial Cold War with China and Russia. The U.S., Japan, and Australia have already been partially decoupling from China, a large trading partner. Likewise, in response to Putin's invasion of Ukraine, the European Union has now partially decoupled from Russia, a large trading partner. Both sides in this new Cold War will be courting trading partners in Asia, Latin America, and the Middle East. We are thus witnessing an acceleration of "de-globalization," perhaps more accurately described as a "re-regionalization" into distinct trading blocs. This reordering of trade ties will not be without costs, as China has been a low-cost supplier of manufactures, and Russia a low-cost supplier of natural gas.

What we expect

By the time COVID fully transitions from pandemic to endemic status, we anticipate that supply and demand for many products will have found an equilibrium, lowering prices for many material inputs, and withdrawing some of the impulse for higher inflation and bond yields. Industries that have recently been in disfavor may revert to being held in higher regard, and vice versa. In particular, we envision bright prospects for consumer discretionary and industrials stocks. Further, we believe China and Russia will seek to avoid outright military conflict with the West, and vice-versa. Thus, we see a new Cold War as mainly playing out along economic and financial lines. Within emerging markets, we envision that investors will increasingly prefer democratic states with a rule-of-law tradition over authoritarian states, such as China and Russia.

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Investment Positioning

Portfolio targets effective April 1, 2022, for high-net-worth clients with Hedge Funds

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large Cap	31.5%	Neutral
U.S. Small Cap	5.5%	Neutral
International Developed	16.0%	Neutral
Emerging Markets	5.5%	Overweight
Fixed Income		
U.S. Investment Grade–Tax-Exempt	28.5%	Underweight
High-Yield–Tax-Exempt	2.0%	Neutral
High-Yield-Taxable	0.0%	Overweight
Real Assets		
U.S. Inflation-Linked Bonds	1.0%	Underweight
Global REITs	1.5%	Neutral
Other	1.5%	Neutral
Nontraditional Hedge	5.0%	Underweight
Cash & Equivalents	2.0%	Overweight
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.

This material is for informational purposes only and is not intended as an offer or solicitation for the sale of any financial product or service or a recommendation or determination that any investment strategy is suitable for a specific investor. Opinions, estimates, and projections constitute the judgment of Wilmington Trust and are subject to change without notice. Allocations presume a long-term investment horizon. Wilmington Trust's 2022 Capital Markets Forecast is available on www.wilmingtontrust.com/cmf-2022 or upon request from your Investment Advisor. There is no assurance that any investment strategy will be successful. Investing involves risks and you may incur a profit or a loss.

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

Source: WTIA.

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Investment Positioning

Portfolio targets effective April 1, 2022, for high-net-worth clients with Private Markets*

Growth & Income

	Strategic Asset Allocation (long term)	Tactical Asset Allocation (short term)
Equities		
U.S. Large Cap	24.3%	Neutral
U.S. Small Cap	4.3%	Neutral
International Developed	11.6%	Neutral
Emerging Markets	4.1%	Overweight
Fixed Income		
U.S. Investment Grade–Tax-Exempt	24.7%	Underweight
High-Yield–Tax-Exempt	2.0%	Neutral
High-Yield–Taxable	0.0%	Neutral
Real Assets		
U.S. Inflation-Linked Bonds	0.9%	Underweight
Global REITs	1.3%	Neutral
Other	1.3%	Neutral
Nontraditional Hedge	6.0%	Underweight
Private Markets	17.5%	Neutral
Cash & Equivalents	2.0%	Overweight
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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Alternative assets, such as strategies that invest in hedge funds, can present greater risk and are not suitable for all investors.

Any positioning information provided does not include all positions that were taken in client accounts and may not be representative of current positioning. It should not be assumed that the positions described are or will be profitable or that positions taken in the future will be profitable or will equal the performance of those described.

Indices 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 will reduce returns.

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.**

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Disclosures Continued

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: 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**.)

Paragon
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.

Gold
The gold industry can be significantly affected by international monetary and political developments as well as supply and demand for gold and operational costs associated with mining.

ESG
A strategy that integrates environmental, social, and governance (ESG) factors into the investment process may avoid or sell investments that do not meet criteria set forth by the investment manager. Such investments may perform better than investments selected utilizing ESG factors.

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.

Basis points refers to a common unit of measure for interest rates and other percentages in finance. One basis point is equal to 1/100th of 1%, or 0.01%, or 0.0001, and is used to denote the percentage change in a financial instrument.

Beta is a measure of how an individual asset moves when the overall stock market increases or decreases. Thus, beta is a useful measure of the contribution of an individual asset to the risk of the market portfolio when it is added in small quantity.

The Bloomberg Agriculture Subindex Total Return (BCOMAGTR), formerly known as Dow Jones-UBS Agriculture Subindex Total Return (DJUBAGTR), is a commodity group subindex of the Bloomberg CITR composed of futures contracts on coffee, corn, cotton, soybeans, soybean oil, soybean meal, sugar and wheat and reflects the return on fully collateralized futures positions and is quoted in USD.

The Bloomberg Commodity Total Return index (BCOMTR) is composed of futures contracts and reflects the returns on a fully collateralized investment in the BCOM and combines the returns of BCOM with the returns on cash collateral invested in 13 week (3 Month) U.S. Treasury Bills.

The Bloomberg Dollar Spot Index tracks the performance of a basket of 10 leading global currencies versus the U.S. Dollar. It has a dynamically updated composition and represents a diverse set of currencies that are important from trade and liquidity perspectives.

The Bloomberg Energy Subindex Total Return (BCOMENTR), formerly known as Dow Jones-UBS Energy Subindex Total Return (DJUBENTR), is a commodity group subindex of the Bloomberg CITR composed of futures contracts on crude oil, heating oil, unleaded gasoline and natural gas and reflects the return on fully collateralized futures positions and is quoted in USD

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Disclosures Continued

The Bloomberg Industrial Metals Subindex Total Return Index (BCOMTNT), formerly known as Dow Jones-UBS Industrial Metals Subindex Total Return (DJUBINTR), is a commodity group subindex of the Bloomberg CITR composed of longer-dated futures contracts on aluminum, copper, nickel and zinc and reflects the return on fully collateralized futures positions and is quoted in USD.

The Bloomberg Precious Metals Subindex Total Return (BCOMPRTR), formerly known as Dow Jones-UBS Precious Metals Subindex Total Return (DJUBPRTR), is a commodity group subindex of the Bloomberg CITR composed of futures contracts on gold and silver. It reflects the return on fully collateralized futures positions and is quoted in USD.

The Bloomberg 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.

The Bloomberg US Treasury US TIPS TR USD index measures the performance of rules-based, market value-weighted inflation-protected securities issued by the U.S. Treasury. It is a subset of the Bloomberg US Treasury Inflation-Linked Bond Index (Series-L), which measures the performance of the US Treasury Inflation Protected Securities (TIPS) market. Federal Reserve holdings of US TIPS are not index eligible and are excluded from the face amount outstanding of each bond in the index.

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.

The federal funds rate is the target overnight inter-bank lending interest rate set by the Fed.

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. They are broadly constructed indices designed to capture the breadth of hedge fund performance trends across all strategies and regions.

The ISM manufacturing index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms and is considered to be a key indicator of the state of the U.S. economy.

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 All Country World Index (ACWI) is a stock index designed to track broad global equity-market performance. Maintained by Morgan Stanley Capital International (MSCI), the index comprises the stocks of about 3,000 companies from 23 developed countries and 26 emerging markets.

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 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 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 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.

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Disclosures Continued

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.

The S&P Developed Property index defines and measures the investable universe of publicly traded property companies domiciled in developed markets. The companies in the index are engaged in real estate related activities, such as property ownership, management, development, rental and investment.

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

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