Confidence must be earned

January 2022

Opportunity in Flexible, Multi-asset Investing

MARKET OUTLOOK

Key Points

- Record amounts of government stimulus and the continued reopening of the global economy may lead to rising interest rates and higher inflation over time.
- This scenario sets the stage for conditions that equity and fixed income markets have not experienced during the past 30-40 years, and in our opinion, may lead to a market environment that is better suited for a flexible investment approach rather than a static approach.
- We believe that in this market environment, a flexible, multi-asset approach, compared to a traditional static 60/40 allocation (focused on traditional US Aggregate bond sectors), can potentially be more effective in generating real yields and capital appreciation above the rate of inflation.
- Flexible managers who utilize a multi-asset approach (beyond the traditional, more rigid framework of stocks and bonds within a fixed allocation) may be able to target diverse opportunities across asset classes and sectors to help meet investor objectives in this emerging new environment.

A Changing Macroeconomic Environment

Investors consider a wide range of market and macroeconomic conditions when making decisions about asset allocation; and recent market conditions, heavily influenced by COVID-related factors, create a myriad of challenges. Changes in government monetary and fiscal policy, regulation, geopolitical risks, and an evolving economic landscape have produced market imbalances unlike any in previous decades. Historically, for many investors, a balanced portfolio consisting of a 60 percent allocation to stocks and 40 percent allocation to traditional bonds including US government, Agency and investment grade corporate bonds, has represented a traditional model starting allocation aiming to diversify* and balance risk.

However, with the reopening of the global economy, the macroeconomic landscape is shifting, particularly in light of unprecedented intervention in the form of both government and central bank stimulus to combat the challenges associated with the COVID-19 pandemic. While these important interventions have helped to sustain the global economy, the increased level of liquidity, consumption demand and disposable income, have all boosted asset prices and induced significant inflationary pressure. Interest rates around the globe have begun to react in anticipation of the fact that these moves may not be transient in nature, which if confirmed, could ultimately produce the effect of lowering return forecasts for stocks and bonds alike. Changes in interest rates have a direct effect on bond pricing; bond prices decrease in a rising rate environment. Changes in interest rates can also impact equities. A rising rate environment can increase borrowing costs for both corporations and consumers, potentially influencing company earnings due to associated changes in top line results and gross margins. Additionally, higher discount rates in an increasing rate environment can reduce the net present value of future cash flows.

Debate around the direction and level of rates topic remains ongoing. However, a structurally rising interest rate market is not something financial markets have experienced in decades, and uncertainty has the propensity to increase volatility. In this environment, we expect that employing a traditional 60/40 mix of stocks and bonds may prove insufficient, particularly in light of the risks that rising rates pose specifically for longer duration assets (i.e. bonds and low dividend/low free cash flow producing stocks). We believe current conditions warrant a more flexible approach with the ability to access a variety of asset types offering different characteristics that can help meet specific investment objectives despite mounting pressures in traditional bond categories.

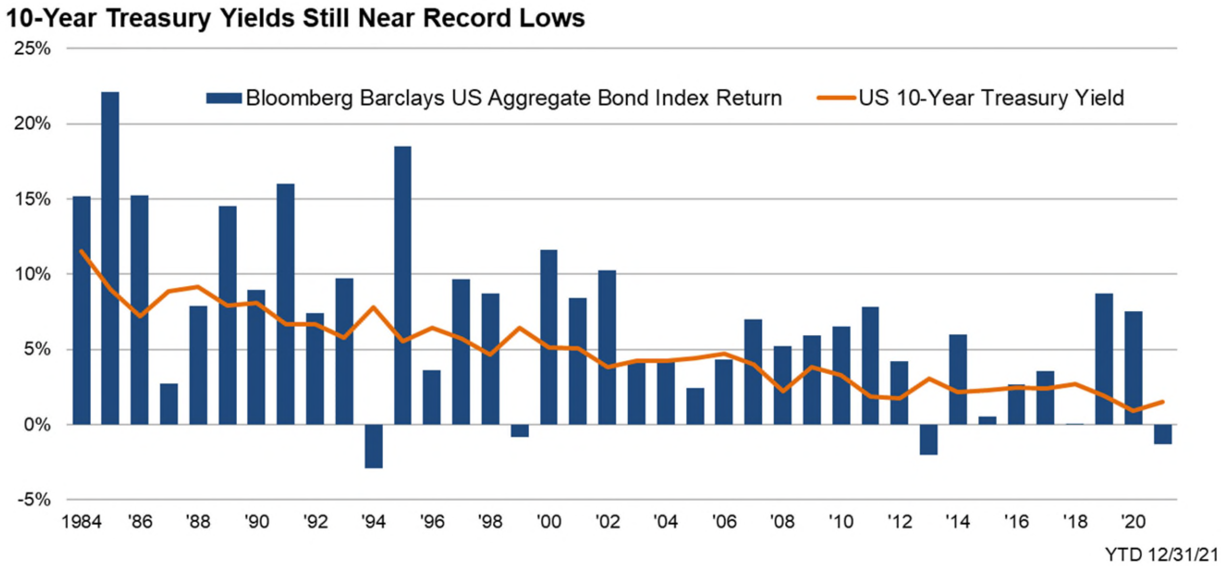
*Diversification does not guarantee a profit or protect against loss.

Rising Rates and Inflation

The 60/40 allocation has been popular among investors in part due to the diversifying effects traditional bonds have had in acting as a "buffer" to equity volatility. Furthermore, over longer periods of time, bond returns have enjoyed strong tailwinds, supported by low inflation and declining interest rates. However, due to the current changing environment, we believe the return and risk characteristics of nearly all asset classes, particularly amongst fixed income sectors heavily weighted to US Aggregate bond sectors, are likely to change.

For example, consider the challenge rising rates pose for fixed income investments, in particular long-duration government bonds. As the chart below demonstrates (Exhibit 1), interest rates have been in secular decline since the early 1980s, which has provided a tailwind for bond returns. In fact, from 1984 to 2021 as rates declined, the cumulative total return of the Bloomberg US Aggregate Bond Index, a measure of the US bond market, was just over 1,120%, or 6.8% annualized, based on Bloomberg data (it is not possible to invest in an index).

Exhibit 1



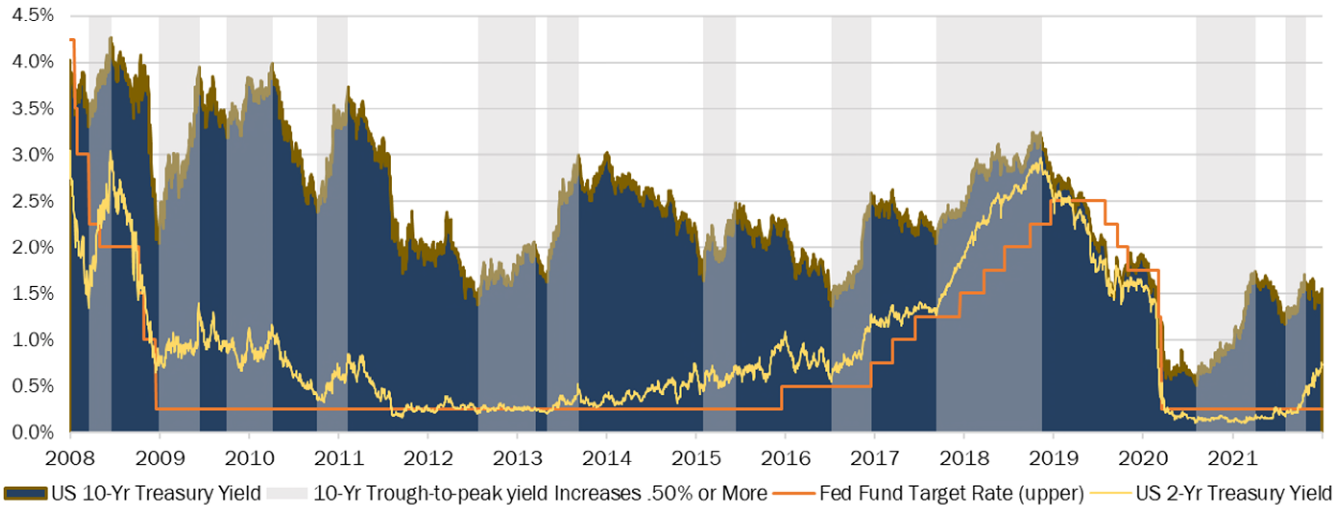
Source: Bloomberg as of 12/31/21. Annual returns.

However, change is inevitable. Rising rates and increasing inflation may present a different picture for a 60/40 allocation due to the effects these conditions are likely to produce in financial markets – bonds in particular. Looking at history via the chart above, years marked with a rise in rates (the orange line peaks) were also met with the weakest returns for these particular fixed income assets.

If the next few years are defined by a more persistent and pronounced rise in rates, investors will face an unfamiliar challenge. In more recent years (see Exhibit 2, next page), rates have largely been in decline. However, as we consider periods of time where rates rose momentarily, bond return results in these sectors have been decidedly negative.

Exhibit 2

Bond Index Performance When Rates Rose 0.50% or More



Date Ranges and Total Return Summary

Start Date	End Date	Bloomberg US Agg	Start Date	End Date	Bloomberg US Agg
03/17/2008	06/16/2008	-2.20%	05/02/2013	09/05/2013	-4.87%
12/30/2008	05/07/2009	0.36%	01/30/2015	06/10/2015	-2.77%
10/01/2009	04/05/2010	0.91%	07/08/2016	12/15/2016	-4.28%
10/07/2010	02/04/2011	-2.75%	09/07/2017	11/08/2018	-2.96%
07/24/2012	03/14/2013	-0.30%	08/06/2020	03/31/2021	-3.73%
			08/03/2021	10/21/2021	-2.03%

Source: Bloomberg, BofA ML. Last data point 12/31/21

Benefits of a Multi-Asset Approach

Fixed income returns have been boosted by the overall declining rate environment (and thus producing capital appreciation versus pure income generation), which may present headwinds as the environment changes toward one with a more inflationary posture. Given this challenge, we believe equity positions can and should play a role. However, in accordance with a shifting macroeconomic environment, correlation and yields evolve, suggesting that effective diversification will require more than just one or two asset classes to achieve an acceptable level of diversification. While a balanced fund will typically invest only in traditional stocks and bonds, a flexible multi-asset strategy can capture opportunities across a much broader array of asset classes including other non-traditional fixed income instruments less sensitive to rate changes, and potentially increase the possibility of meeting the needs of investors.

As Exhibit 3 (next page) demonstrates, the opportunity set for most asset classes can change dramatically over time. A more flexible asset allocation approach, in our opinion, offers substantial benefit in the face of a changing global economy through its ability to adjust exposures toward assets that possess the most desirable characteristics.

Exhibit 3

Asset Class Performance Varies Year over Year
10 Years of Asset Class Returns

2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	10 Years Annualized
Real Estate 19.74%	Russell 2000 38.82%	Real Estate 30.19%	Real Estate 4.68%	Russell 2000 21.31%	MSCI EM 37.28%	Munis 1.28%	S&P 500 31.49%	Russell 2000 19.96%	Real Estate 46.19%	S&P 500 16.55%
MSCI EM 18.22%	S&P 500 32.39%	S&P 500 13.69%	Munis 3.30%	US HY 17.13%	MSCI EAFE 25.03%	Treasuries 0.80%	Real Estate 29.01%	S&P 500 18.40%	S&P 500 28.71%	Russell 2000 13.23%
MSCI EAFE 17.32%	MSCI EAFE 22.78%	Munis 9.05%	S&P 500 1.38%	S&P 500 11.96%	S&P 500 21.83%	Bank Loans 0.60%	Russell 2000 25.52%	MSCI EM 18.31%	Russell 2000 14.82%	Real Estate 13.11%
Russell 2000 16.35%	US HY 7.44%	Treasuries 6.02%	Treasuries 0.83%	MSCI EM 11.19%	Russell 2000 14.65%	BBG US Agg. 0.01%	MSCI EAFE 22.01%	BBG Global Agg. 9.20%	MSCI EAFE 11.26%	MSCI EAFE 8.03%
S&P 500 16.00%	Bank Loans 5.41%	BBG US Agg. 5.97%	BBG US Agg. 0.55%	Bank Loans 10.36%	Real Estate 10.85%	BBG Global Agg. -1.20%	MSCI EM 18.42%	Treasuries 8.22%	Bank Loans 5.42%	US HY 6.83%
US HY 15.81%	Real Estate 1.60%	Russell 2000 4.89%	Bank Loans 0.10%	Real Estate 3.39%	US HY 4.93%	US HY -2.08%	US HY 14.32%	MSCI EAFE 7.82%	US HY 5.28%	MSCI EM 5.49%
Bank Loans 9.76%	BBG US Agg. -2.02%	US HY 2.45%	MSCI EAFE -0.81%	BBG US Agg. 2.65%	BBG Global Agg. 4.41%	Real Estate -2.22%	BBG US Agg 8.72%	BBG US Agg 7.51%	Munis 1.52%	Bank Loans 4.94%
Munis 6.78%	Munis -2.55%	Bank Loans 1.82%	BBG Global Agg. -3.15%	BBG Global Agg. 2.09%	Munis 3.57%	S&P 500 -4.38%	Bank Loans 8.70%	US HY 7.11%	BBG US Agg -1.54%	Munis 3.72%
BBG Global Agg. 4.32%	BBG Global Agg. -2.60%	BBG Global Agg. 0.59%	Russell 2000 -4.41%	Treasuries 1.14%	BBG US Agg. 2.27%	Russell 2000 -11.01%	Munis 7.54%	Munis 5.21%	Treasuries -2.38%	BBG US Agg 2.90%
BBG US Agg. 4.21%	MSCI EM -2.60%	MSCI EM -2.19%	US HY -4.47%	MSCI EAFE 1.00%	Bank Loans 2.03%	MSCI EAFE -13.79%	Treasuries 6.99%	Bank Loans 3.50%	MSCI EM -2.54%	Treasuries 2.22%
Treasuries 2.16%	Treasuries -3.35%	MSCI EAFE -4.90%	MSCI EM -14.92%	Munis 0.25%	Treasuries 1.92%	MSCI EM -14.57%	BBG Global Agg. 6.84%	Real Estate -2.17%	BBG Global Agg. -4.71%	BBG Global Agg 1.77%

Source: Morningstar as of December 31, 2021. **Data is based on past performance, which is no guarantee of future results.** Yearly figures are for the calendar years ended 12/31/21. Chart returns updated quarterly. Asset classes represented by the following indices**: US Stocks** – S&P 500 Index. **Small Cap Stocks** – Russell 2000 Index. **US High Yield Bonds** – BBG (Bloomberg) US High Yield Index. **Bank Loans** - S&P/LSTA Leveraged Loan Index. **Municipals** – BBG Municipal Index. **US Treasuries** - ICE BofA US Treasury Index. **US Bonds** – BBG US Aggregate Bond Index. **Global Investment Grade Bonds** – BBG Global Aggregate Bond Index. **Non-US Developed Stocks** - MSCI EAFE (Europe, Australasia, and Far East) Growth Index. **Emerging Market Stocks** - MSCI Emerging Markets (EM) Free Index. **Real Estate** – S&P 500 Real Estate. See Appendix for more information on indices.

In Conclusion

In our opinion, a multi-asset approach can be a beneficial strategy to help investment managers navigate the challenges of an ever-changing macroeconomic environment and market landscape. Market and investment complexity has heightened the need for more sophisticated tools and techniques to help enhance returns and manage risk, and recent low bond yields and stretched valuations have made it more difficult for investors to achieve long-term financial goals. Multi-asset solutions are not constrained by limitations of a more static approach, and accordingly are not benchmark-driven with respect to their construction and underlying security selection.

We believe the combination of flexibility and diversification inherent in a flexible multi-asset approach provides the ability to adapt to changing market conditions, thereby enhancing the likelihood of meeting investor objectives – whether that is income, capital preservation or capital appreciation.

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Index Definitions

- **Bloomberg Global Aggregate Bond Index –** Provides a broad-based measure of the global investment grade fixed income market.
- **Bloomberg Municipal Bond Index –** A broad-based measure of the municipal bond market.
- **Bloomberg US Aggregate Bond Index –** A measure of the US bond market. Subset includes BBG Barc Non-Agency CMBS Aggregate Total Return Index (Unhedged).
- **Bloomberg US High Yield Index –** A measure of the broad non-investment grade bond market
- **ICE BofA US Treasury Bill Index –** Tracks the performance of US dollar-denominated US Treasury Bills publicly issued in the US domestic market.
- **MSCI EAFE (Europe, Australasia, and Far East) Growth Index –** A commonly used measure of international growth stocks.
- **MSCI Emerging Markets (EM) Free Index –** A free float-adjusted market capitalization index that is designed to measure equity market performance of emerging markets.
- **Russell 2000® Index** – Measures the performance of US small cap stocks. Russell 2500 Index - A broad index featuring 2,500 stocks that cover the small and mid cap market capitalizations.
- **S&P 500® Index** – A commonly used measure of the broad US stock market.
- **S&P 500® Real Estate Index** – Comprises stocks included in the S&P 500 that are classified as members of the Global Industry Classification Standard (GICS®) real estate sector.
- **S&P/LSTA Leveraged Loan Index** – A capitalization-weighted syndicated loan index based upon market weightings, spreads and interest payments for the US market.

Important Information

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