RVK

Capital Markets Review | 2nd Quarter 2021

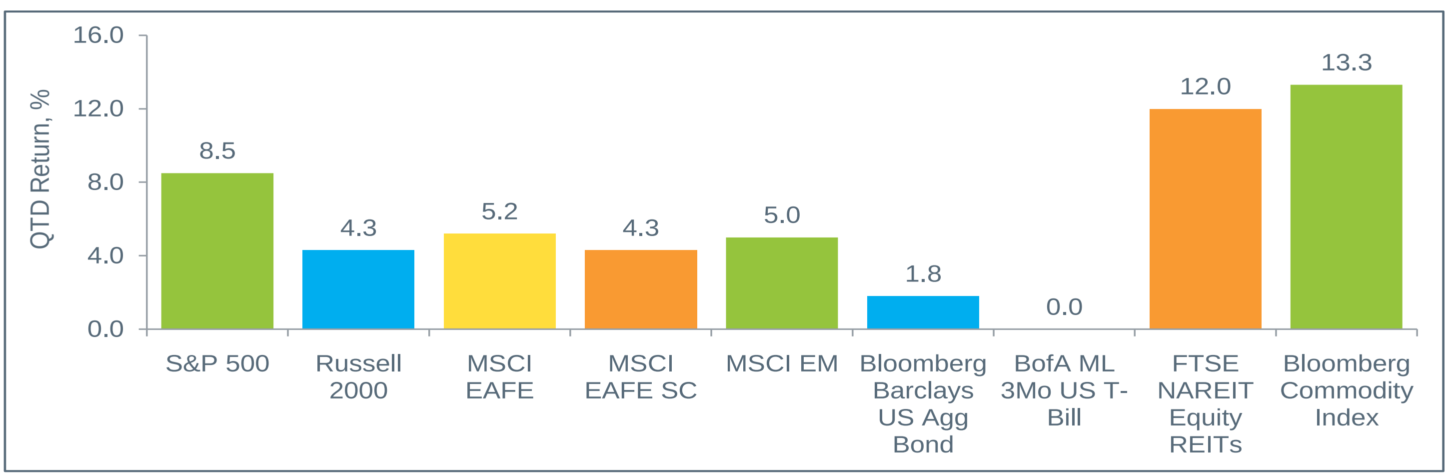
June 30, 2021

Overview

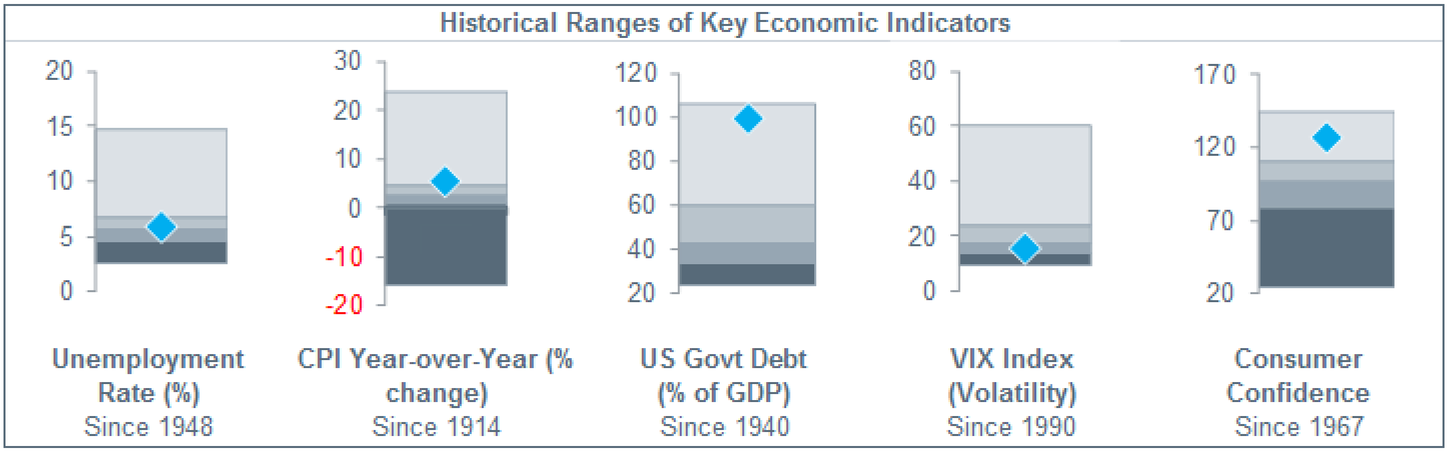
In Q2, markets were defined by optimism stemming from reopening efforts, an accelerating global vaccine rollout, continued accommodative global central bank policy, and expectations for further fiscal expansion in the US. The supportive policy backdrop and expectations for improving global growth led to a strong quarter for risk assets. Global equities were paced by the US, as substantial upward earnings revisions during the quarter helped the S&P 500 index to an 8.5% gain, bringing YTD returns to 15.3%. An uneven pace of coronavirus vaccine distribution outside of North America and Europe weighed modestly on equity returns in certain regions. The more transmissible “delta” variant of the coronavirus grew to account for a substantial portion of new COVID-19 cases worldwide, compromising reopening efforts for countries whose vaccination campaigns lagged behind the rest of the world. The MSCI EAFE and MSCI Emerging Markets indexes still produced returns of 5.2% and 5.1% respectively during the quarter, as increasingly confident market participants looked past virus-related disruptions. Commodities and fixed income assets both rallied, moving together in Q2 as declining rates helped longer duration investments pare back losses from earlier in the year.

Broad US economic conditions remained robust as the recovery took hold, though labor market frictions weighed on job growth and the unemployment rate (relative to consensus expectations) in April and May. Nonfarm payroll growth still averaged 567,000 jobs per month during the quarter. Payrolls increased by 850,000 alone in June, with the leisure and hospitality sectors accounting for an outsized portion of gains as states relaxed pandemic related restrictions. On the employer side, companies are hiring at an unprecedented pace. Job openings reached an all-time high during the quarter at 9.3 million, prompting some states to eliminate supplemental pandemic unemployment assistance programs prior to their country-wide expiration in September in an effort to nudge prospective employees back to work. Despite these frictions, key indicators point to strong growth in important sectors. The ISM Manufacturing and Services Purchasing Managers' Indexes (PMIs) ended June at 60.6 and 60.1, respectively. PMI levels above 50 indicate sector expansion. The Federal Reserve Bank of Atlanta's GDPNow model, which uses high frequency indicators to estimate GDP in real time, estimated Q2 annualized growth at 7.9% with data available through early July. Despite the robust growth environment, the unemployment rate remained high at 5.9%–above the US Federal Reserve's long run projection for unemployment in the range of 3.8% to 4.3%. *(continued on next page)*

Quarter-to-Date Performance



Overview (Continued)

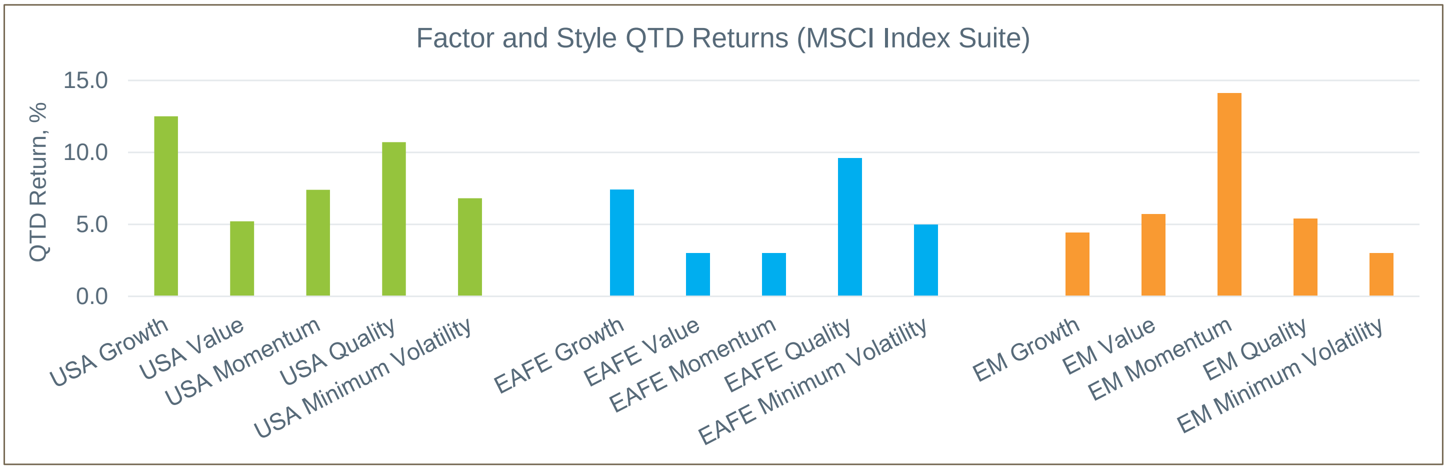


Supply constraints, amid heightened demand for goods and the rapid pace of economic growth, led to a series of above-consensus price level changes during the quarter. June's CPI release indicated year-over-year price level changes of 5.4%, with core CPI (ex. food and energy) increasing at 4.5%. The increase in core CPI is the highest reading since November 1991. While the Federal Open Market Committee (FOMC) viewed the heightened levels of inflation as transitory and remained committed to Average Inflation Targeting, the Committee did substantially pull forward its expectation for interest rate increases—to two in 2023—according to the widely scrutinized "dot plot" indicator. Prior to the June meeting, the median FOMC member anticipated zero interest rate increases until 2024. With rate hikes largely off the table in the near-term, investor focus remained on the Fed tapering its $120B monthly asset purchase program, with a consensus building around the December meeting for an announcement, assuming the pace of economic recovery continues as expected.

Outside the US, the European Central Bank maintained the status quo of asset purchases under its Pandemic Emergency Purchase Program and nudged up its 2023 inflation forecast to 1.4%, while the Bank of England announced a tapering of its asset purchase program amid robust growth and above-target inflation. Overall, the global economic recovery continues to advance, with the International Monetary Fund forecasting a global GDP growth rate of 6.0% and 4.4% in 2021 and 2022, respectively.

Expanded Review of Key Economic Indicators

	Q2 2021	Q1 2021	Q4 2020	10 Year Average
Federal Funds Rate	0.08%	0.06%	0.09%	0.63%
Treasury - 1 Year	0.07%	0.07%	0.10%	0.74%
Treasury - 10 Year	1.45%	1.74%	0.93%	2.08%
Treasury - 30 Year	2.06%	2.41%	1.65%	2.81%
Breakeven Inflation - 5 Year	2.50%	2.60%	1.97%	1.74%
Breakeven Inflation - 10 Year	2.34%	2.37%	1.99%	1.93%
Breakeven Inflation - 30 Year	2.28%	2.31%	2.00%	2.04%
BB US Corp: Hi Yld Index - OAS	2.68%	3.10%	3.60%	4.64%
Capacity Utilization	75.38%	74.40%	74.63%	76.50%
Unemployment Rate	5.90%	6.00%	6.70%	5.92%
ISM PMI - Manufacturing	60.60%	64.70%	60.50%	53.97%
Baltic Dry Index - Shipping	3,383	2,046	1,366	1,153
Consumer Confidence (Conf. Board)	127.30	109.70	88.60	98.60
CPI YoY (Headline)	5.40%	2.60%	1.40%	1.76%
PPI YoY - Producer Prices	9.40%	5.90%	-0.50%	1.26%
US Dollar Total Weighted Index	112.24	114.13	111.55	106.80
WTI Crude Oil per Barrel	$73	$59	$49	$67
Gold Spot per Ounce	$1,770	$1,708	$1,898	$1,420



US Equity

US equity markets built on the solid start to 2021 with strong performance in Q2. Sentiment was driven by continued monetary and fiscal stimulus, along with increased vaccination rates that led to economic reopening efforts across the country. The S&P 500 Index finished Q2 up 8.5% with its forward P/E ratio remaining above historical levels; however, this valuation measure saw a slight decrease relative to Q1.

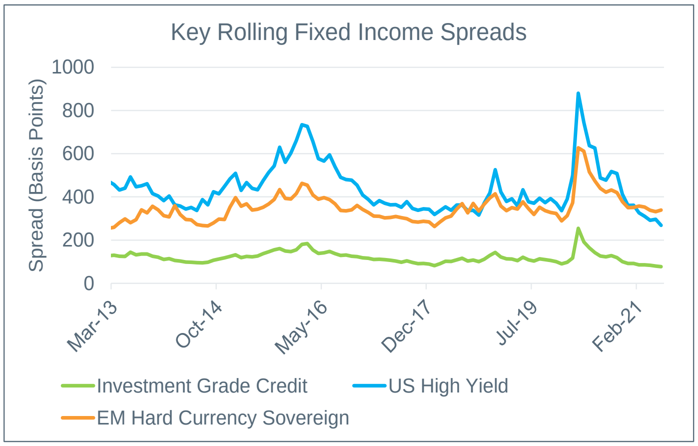
Large- and mid-cap growth stocks outperformed value in Q2; however, value stocks continued to lead growth stocks in the small-cap space. The Russell 1000 Growth Index returned 11.9% versus 5.2% for the Russell 1000 Value Index. Meanwhile, the Russell 2000 Value Index returned 4.6% versus 3.9% for the Russell 2000 Growth Index. All sectors posted positive returns in Q2, with the exception of utilities. Real estate outperformed all other sectors as housing prices continued to rise, and energy had another positive quarter. Growth-oriented technology stocks bounced back from a poor Q1 as earnings were stronger than expected, and their growth potential attracted investors as expectations for a slower economic recovery surfaced.

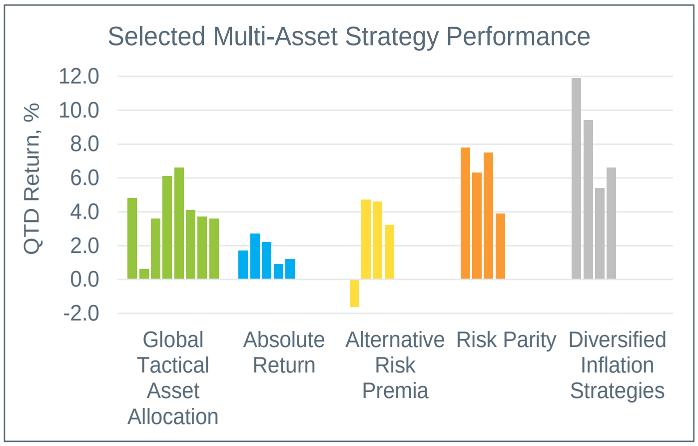
Active management generally struggled in Q2, as the majority of large- and mid-cap managers failed to keep pace with their respective benchmarks. However, small-cap managers fared well, with the majority outpacing their benchmarks.

Non-US Equity

Developed international markets delivered positive returns in Q2 as growth outperformed value—a reversal of the value rally experienced in Q1—while small-cap stocks slightly trailed large-cap. Many developed countries built upon positive returns from Q1, although New Zealand was again a negative outlier. Across multiple developed countries, accelerating vaccination efforts and the subsequent economic reopening provided an additional market tailwind on top of continued stimulus programs. Active management did well this quarter, with a majority of developed international equity managers beating their benchmarks in both the large- and small-cap universes.

Emerging markets lagged developed markets in Q2, but they still continued a trend of positive performance. Contrary to the reversal seen in developed markets, emerging market value stocks continued to outperform growth, while small-cap stocks also continued their outperformance over large-cap. All emerging market regions saw positive returns for the quarter led by Latin America, which was driven by strong returns in Brazil. Protracted vaccine rollouts across emerging markets (with the exception of China) has notably limited their economic recovery compared to recoveries experienced in developed markets. Active manager results in emerging markets were mixed, with just under half outpacing their benchmarks for the quarter.





Fixed Income

The Bloomberg Barclays (BB) US Aggregate Index returned 1.8% in Q2, partially retracing losses from Q1, while overall remaining down -1.6% YTD. Treasury yields fell back despite an easing of pandemic related restrictions, which supported economic growth and rising inflationary pressures. The 10-year Treasury yield declined to 1.45% on June 30, 2021 from 1.74% as of March 31, 2021. The decline in yields was one of the few clear catalysts driving fixed income performance in Q2, resulting in outperformance of long-dated bonds as measured by the BB US Government Long Treasury Index returning 6.4% and the BB US Long Credit Index returning 6.5%.

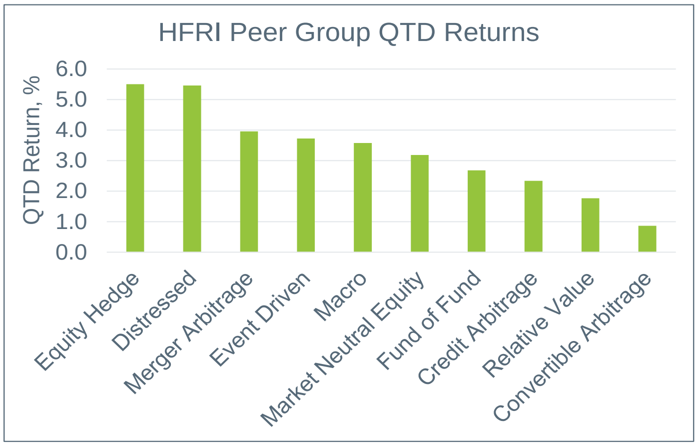
Lower quality investment-grade rated debt (specifically debt rated BBB) outperformed both the investment grade and high yield credit markets, a departure from the trend in past quarters of the lowest quality credit outperforming higher grade debt. In Q2, the Bloomberg US Credit Index returned 3.3% with the Bloomberg BBB Credit Index returning 3.7%. The Bloomberg US High Yield Index returned 2.7% in Q2, with less performance dispersion among below-investment-grade quality ratings than previously seen.

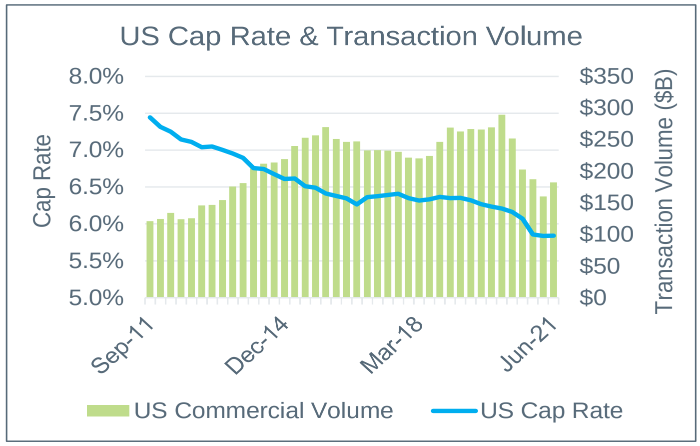
Emerging market debt saw improved performance compared to Q1 due to falling US Treasury yields and rising commodity prices. Dollar-denominated emerging market debt outperformed both local currency and emerging market corporate debt, with the JPM EMBI Global Diversified Index returning 4.1% in Q2.

Multi-Asset

Global Tactical Asset Allocation strategies that RVK follows closely largely generated positive absolute returns in Q2, ranging from the low- to mid-single digits. Long-biased strategies produced mixed results versus a less diversified blended benchmark of 60% US equity and 40% US fixed income, which returned 5.8% in Q2. Generally, strategies that have maintained a value bias, especially within emerging markets, outperformed relative to peers. Multi-asset managers that target reduced correlations, volatility, and market sensitivity generally produced positive absolute returns, though most underperformed long-biased peers that held relatively higher exposures to global equity markets.

Diversified Inflation Strategies that RVK follows closely primarily generated strong positive absolute performance, ranging from the mid-single digits to low double-digits. In Q2, commodities, listed infrastructure, natural resource equities, REITs, and TIPS all posted positive absolute returns. Commodities led the way, with the Bloomberg Commodity Index posting a 13.3% return, largely driven by energy, with metals and agriculture also posting strong returns. Inflation, as measured by the year-over-year change in Headline CPI, was reported as 5.4% for June, a significant increase from 2.6% at the end of Q1. The sharp rise was notable, but is somewhat magnified by comparisons to depressed CPI readings from 2020. Market-based measures of future inflation expectations moved slightly lower in Q2, with 10-year breakeven inflation decreasing from 2.37% to 2.34%.





Diversified Hedge Funds

Diversified hedge funds posted another strong quarter, returning 4.0% and bringing YTD returns to 10.0% according to the HFRI Fund Weighted Composite Index. The peer group's asset-weighted counterpart, which relies far less heavily on directional long/short equity strategies, returned 3.2% for the quarter and is now up 6.0% in 2021.

Heightened levels of activity across convertible bond issuance, IPOs, SPACs, and M&A provided fertile ground for event-driven funds, and equity beta tailwinds continued to add to returns in the hedged equity space. Event-driven strategies have outperformed relative value YTD, and directional strategies have outperformed low net exposure and market-neutral approaches. The multi-strategy groups RVK follows closely generally exhibited performance in line with these broad industry takeaways, though with some positive outliers.

Within hedged equities specifically, manager dispersion was largely driven by stylistic tilts and short selling. In the second half of Q2, cyclicals sold off on a relative basis as the reflation theme cooled. Short selling has been particularly difficult in the consumer and communication services sectors, though this has been balanced with good alpha generation on the long side in more cyclical sectors. Gross leverage levels in the US remain in the top decile dating back to 2010, according to available prime brokerage data, while net exposure levels across all regions (US, Europe, and Asia Pacific) remain similarly elevated.

Real Estate

Core private real estate generated a positive 3.9% return in Q2 (on a preliminary and gross of fee basis), as reported by the NFI-ODCE Index, with the total return comprising of 1.0% income and 2.9% price appreciation. While the income trends in line with historical levels, price appreciation rebounded meaningfully by 1.8% from the level recorded in Q1. Transaction volume has started to increase in the US with cap rates continuing to trend downward, mainly driven by declining cap rates in the apartment and industrial sectors.

Publicly traded real estate investments outperformed their private market counterparts by a meaningful margin. Publicly traded real estate delivered a second quarter total return of 11.7%, as measured by FTSE/NAREIT All REITs Index. Among publicly traded securities, return volatility remains high given the correlation with public equity markets.

Real estate continued to recover from the impact brought on from the pandemic which has brought a collective sense that a particularly challenging period impacting real estate fundamentals is in the rearview mirror. However, there remains uncertainty ahead with respect to government policy around eviction moratoriums abating, additional stimulus dollars and potential impact from higher inflation. Historically, real estate investments have performed well in inflationary environments as rents are regularly reset to market rates.

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RVK

RVK was founded in 1985 to focus exclusively on investment consulting and today employs over 100 professionals. The firm is headquartered in Portland, Oregon, with regional offices in Boise, Chicago, and New York City. RVK is one of the ten largest consulting firms in the US, as reported by *Pensions & Investments' 2019 Special Report – Consultants*. Additionally, RVK received a notable award in April 2020 when it was named a Greenwich *Quality Leader* among large US investment consultants, based upon Greenwich Associates' 2019 study. Greenwich is an industry-recognized third-party firm which asks plan sponsors to rank their consultants on a series of key metrics. Notably, RVK is the only firm among large US consultants to receive an award for a fourth consecutive year.[1] RVK's diversified client base of nearly 200 clients covers 30 states, and covers endowments, foundations, corporate and public defined benefit and contribution plans, Taft-Hartley plans, and high-net-worth individuals and families. The firm is independent, employee-owned, and derives 100% of its revenues from investment consulting services.

[1]Between July and October 2020, Coalition Greenwich (formerly known as Greenwich Associates) conducted in-person and phone interviews and online surveys with 856 individuals at 704 of the largest tax-exempt funds in the US–including corporate and union funds, public funds, endowments and foundations, insurance general accounts, and healthcare organizations, with either pension or investment pool assets greater than $150 million. Study participants were asked to provide quantitative and qualitative evaluations of their asset managers and investment consultants, including qualitative assessments of those firms soliciting their business and detailed information on important market trends. RVK is one of three firms recognized in the large investment consultant category. The ratings may not be representative of any one client's experience with RVK; rather they are representative of those clients that chose to participate in the survey. The results are not indicative of RVK's future performance.

To read the Greenwich press release, please refer to the following URL: https://www.greenwich.com/press-release/covid-19-crisis-put-investment-consultant-advisory-capabilities-test