Capital Markets Review
Third Quarter 2021

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

REVIEW

Summary Capital Market Commentary – 3rd Quarter 2021

- **GLOBAL FINANCIAL MARKETS – EQUITIES**
  - US equities notched up a small positive return in Q3. Strong earnings had lifted US stocks in the run up to August, when the Federal Reserve (Fed) seemed to strike a dovish tone, confirming its hesitance to tighten policy too fast. However, growth and inflation concerns late in the quarter meant US equities retraced their steps in September.
  - Eurozone equities were flat in Q3. The energy sector was one of the strongest performers, as was information technology with semiconductor-related stocks seeing a robust advance. Consumer discretionary stocks were among the weakest for the quarter, with luxury goods companies under pressure amid suggestions that China could seek greater wealth redistribution, which could hit demand.
  - The Japanese equity market traded in a range through July and August before rising in September to record a total return of 5.2% for the quarter. The yen showed little trend against the US dollar for most of the period before weakening at the very end of September to reach its lowest level since the start of the pandemic in early 2020.
  - Emerging market equities declined in Q3, which saw a sell-off in Chinese stocks, concern over continued supply chain disruptions, and worries over the implications of higher food and energy prices for some markets. Regulatory actions in China were the initial trigger for market weakness. These were compounded by the re-imposition of some Covid-19 restrictions and supply chain disruption in August, worries about possible systemic financial system risks stemming from the potential collapse of Evergrande, and power shortages.

Source: Schroders & SAA

Summary Capital Market Commentary – 3rd Quarter 2021

- **GLOBAL FINANCIAL MARKETS – FIXED INCOME**
  - Global sovereign bond yields were little changed in the quarter. The US Federal Reserve said it would soon slow the pace of asset purchases.
    - The Fed stated in September that tapering of quantitative easing (i.e. a slowdown in the pace of asset purchases) will be announced at the November meeting, as expected, and will finish by mid-2022. Meanwhile, the fed funds rate projections now show a faster rate hiking schedule than they did in June. The median rate expectation for 2023 moved up to three hikes from two in June, with three additional hikes in 2024. Fed officials were evenly split 9-9 on a rate hike in 2022. The shift comes in the context of revised real GDP growth - down to 5.9% for 2021 from the 7% growth estimated in the last meeting - while inflation has risen. The Fed now sees inflation running to 4.2% this year, above its previous estimate of 3.4%. The Fed raised its GDP projections for 2022 and 2023 to growth of 3.8% and 2.5%, respectively.
    - The US 10-year Treasury yield finished at 1.52%, four basis points (bps) higher from 6/30. Yields fell initially, as the rapid economic recovery appeared to be moderating. However, as the market's focus turned to rising inflation and the prospect of the withdrawal of monetary policy support, yields rose back to similar levels seen at the beginning of the quarter.
    - In Europe, the German 10-year yield was one basis point (bps) lower at -0.19%. Italy's 10-year yield finished 4bps higher at 0.86%. Economic activity continued at a robust pace, the region benefiting from the release of pent-up demand, having come out of lockdowns relatively late. Eurozone inflation hit a decade high of 3.4% year-on-year in August.
    - Among corporate bonds globally, high yield made positive returns, while investment grade credit was little changed. European investment grade outperformed government bonds, while the US market was in line with Treasuries.

Source: Schroders & SAA

Capital Markets' Performance

Index	Asset Class	Jul-21	Aug-21	Sep-21	Q3-2021	YTD	Trailing 1 Yr	Trailing 3 Yr	Trailing 5 Yr
S&P GSCI Commodities	U.S. Equity	1.57%	-2.30%	6.03%	**5.22%**	**38.27%**	58.30%	-1.49%	3.64%
S&P GSCI Crude Oil	U.S. Equity	1.53%	-7.09%	9.92%	**3.69%**	**57.76%**	86.75%	-19.54%	-5.81%
Barclays U.S. Treasury: U.S. TIPS	U.S. Fixed Income	2.67%	-0.18%	-0.71%	**1.75%**	**3.51%**	5.19%	7.45%	4.34%
S&P Composite 1500 Growth	U.S. Equity	3.55%	3.99%	-5.66%	**1.59%**	**16.10%**	29.52%	19.48%	20.54%
Dow Jones U.S. Select REIT	U.S. Real Estate	5.32%	1.75%	-5.52%	**1.25%**	**24.48%**	40.56%	8.32%	5.68%
S&P/LSTA US Leveraged Loan Index	U.S. Fixed Income	-0.01%	0.47%	0.64%	**1.11%**	**4.42%**	8.40%	4.14%	4.58%
Barclays Capital U.S. Corporate High Yield	U.S. Fixed Income	0.38%	0.51%	-0.01%	**0.89%**	**4.53%**	11.28%	6.91%	6.52%
S&P 500	U.S. Equity	2.38%	3.04%	-4.65%	**0.58%**	**15.92%**	30.00%	15.99%	16.90%
S&P Composite 1500	U.S. Equity	2.13%	2.95%	-4.56%	**0.35%**	**16.02%**	31.38%	15.50%	16.55%
MSCI World Index	World Equity	1.82%	2.52%	-4.11%	**0.09%**	**13.43%**	29.39%	13.72%	14.34%
Barclays Capital U.S. Aggregate	U.S. Fixed Income	1.12%	-0.19%	-0.87%	**0.05%**	**-1.55%**	-0.90%	5.36%	2.94%
Barclays U.S. Government/Credit	U.S. Fixed Income	1.32%	-0.20%	-1.07%	**0.04%**	**-1.93%**	-1.13%	5.94%	3.24%
Barclays Intermediate U.S. Government/Credit	U.S. Fixed Income	0.77%	-0.16%	-0.58%	**0.02%**	**-0.87%**	-0.40%	4.63%	2.60%
Citigroup 3-month T-bill	Cash/Cash Equivalent	0.00%	0.00%	0.00%	**0.01%**	**0.03%**	0.06%	1.14%	1.13%
Barclays Capital U.S. Corporate Investment Grade	U.S. Fixed Income	1.37%	-0.30%	-1.05%	**0.00%**	**-1.27%**	1.74%	7.45%	4.61%
Merrill Lynch US Treasury Master	U.S. Fixed Income	1.34%	-0.16%	-1.20%	**-0.03%**	**-2.71%**	-3.60%	4.94%	2.24%
5-Year US Treasury	U.S. Treasury	0.96%	-0.24%	-0.95%	**-0.25%**	**-1.94%**	-2.16%	4.61%	1.92%
Barclays Capital Municipal Bond	U.S. Fixed Income	0.83%	-0.37%	-0.72%	**-0.27%**	**0.79%**	2.63%	5.06%	3.26%
10-Year US Treasury	U.S. Treasury	1.99%	-0.29%	-1.97%	**-0.31%**	**-4.40%**	-6.22%	6.14%	1.83%
MSCI EAFE Index	International Equity	0.76%	1.77%	-2.83%	**-0.35%**	**8.79%**	26.29%	8.13%	9.33%
MSCI EAFE (Net)	International Equity	0.75%	1.76%	-2.90%	**-0.45%**	**8.35%**	25.73%	7.62%	8.81%
BofA Merrill Lynch US Convertibles	U.S. Convertible Bond	-0.64%	1.85%	-1.67%	**-0.49%**	**6.38%**	27.30%	20.18%	17.35%
MSCI World Ex. US Index	World Equity	0.68%	1.62%	-2.80%	**-0.56%**	**9.65%**	27.10%	8.41%	9.42%
S&P Composite 1500 Value	U.S. Equity	0.57%	1.77%	-3.27%	**-0.99%**	**15.93%**	34.29%	10.53%	11.68%
Citigroup WorldBIG Index	World Fixed Income	1.34%	-0.47%	-1.85%	**-1.00%**	**-4.47%**	-1.71%	4.16%	2.04%
Dow Jones Industrial Average	U.S. Equity	1.34%	1.50%	-4.20%	**-1.46%**	**12.12%**	24.15%	11.00%	15.68%
S&P MidCap 400	U.S. Equity	0.35%	1.95%	-3.97%	**-1.76%**	**15.52%**	43.68%	11.08%	12.97%
S&P SmallCap 600	U.S. Equity	-2.39%	2.02%	-2.43%	**-2.84%**	**20.05%**	57.64%	9.44%	13.57%
Alerian MLP	Master Limited Partnerships	-6.31%	-2.31%	3.02%	**-5.71%**	**39.40%**	84.63%	-4.32%	-2.42%
MSCI EM (Emerging Markets)	International Equity	-6.67%	2.65%	-3.94%	**-7.97%**	**-0.99%**	18.58%	8.96%	9.62%

Key Take Away:

- **Since Feb/Mar when the first real concerns regarding higher inflation rattled markets, the overall level of market/economic uncertainty has risen significantly and generating higher volatility across both fixed income and risk assets. As a result, investors are struggling to absorb information and realign risk/reward expectations.**

Indices sorted high/low by Q3-2021 performance.

Source: Zephyr StyleAdvisor

Fixed Income Yields

Index YTW	12/31/2020	6/30/2021	8/31/2021	9/30/2021	Chg Prior Month	Chg Prior Qtr	Chg Calendar Yr	Current Real Yields
Aggregate	**1.12%**	**1.50%**	**1.42%**	**1.56%**	▲ **0.14%**	▲ **0.06%**	▲ **0.44%**	▼ **-2.42%**
Intermediate Aggregate	**0.83%**	**1.22%**	**1.15%**	**1.29%**	▲ **0.14%**	▲ **0.07%**	▲ **0.46%**	▼ **-2.69%**
U.S. Treasury	0.57%	0.95%	0.86%	1.01%	▲ 0.15%	▲ 0.06%	▲ 0.44%	▼ -2.97%
U.S. 2-Yr Treasury	0.12%	0.25%	0.21%	0.29%	▲ 0.08%	▲ 0.04%	▲ 0.17%	▼ -3.69%
U.S. 5-Yr Treasury	0.36%	0.88%	0.78%	0.98%	▲ 0.20%	▲ 0.10%	▲ 0.62%	▼ -3.00%
U.S. 10-Yr Treasury	0.91%	1.45%	1.31%	1.52%	▲ 0.21%	▲ 0.07%	▲ 0.61%	▼ -2.46%
U.S. 30-Yr Treasury	1.64%	2.07%	1.92%	2.08%	▲ 0.16%	▲ 0.01%	▲ 0.44%	▼ -1.90%
U.S. Agency MBS	1.25%	1.77%	1.71%	1.83%	▲ 0.12%	▲ 0.06%	▲ 0.58%	▼ -2.15%
ABS	0.45%	0.47%	0.51%	0.62%	▲ 0.11%	▲ 0.15%	▲ 0.17%	▼ -3.36%
CMBS	1.28%	1.50%	1.42%	1.58%	▲ 0.16%	▲ 0.08%	▲ 0.30%	▼ -2.40%
U.S. Credit	1.68%	1.97%	1.91%	2.05%	▲ 0.14%	▲ 0.08%	▲ 0.37%	▼ -1.93%
A-Rated Corporates	1.52%	1.82%	1.76%	1.89%	▲ 0.13%	▲ 0.07%	▲ 0.37%	▼ -2.09%
BBB-Rated Corporates	2.04%	2.26%	2.22%	2.35%	▲ 0.13%	▲ 0.09%	▲ 0.31%	▼ -1.63%
Municipal Bond	1.07%	1.00%	0.95%	1.12%	▲ 0.17%	▲ 0.12%	▲ 0.05%	▼ -2.86%
Taxable Municipal Bond	2.10%	2.18%	2.08%	2.24%	▲ 0.16%	▲ 0.06%	▲ 0.14%	▼ -1.74%
U.S. High Yield	4.18%	3.75%	3.87%	4.04%	▲ 0.17%	▲ 0.29%	▼ -0.14%	▲ 0.06%
Global Aggregate (USD)	0.83%	1.12%	1.03%	1.17%	▲ 0.14%	▲ 0.05%	▲ 0.34%	▼ -2.81%
U.S. Agg. vs. Global Agg.	▲ **0.29%**	▲ **0.38%**	▲ **0.39%**	▲ **0.39%**	**0.00%**	▲ **0.01%**	▲ **0.10%**	Using Core Inflation Rate at 8/31/2021 which was 3.98%
Curve Steepness: UST 2yr-10yr Spread (bps)	**79.0**	**120.0**	**110.0**	**123.0**	▲ **13.0**	▲ **3.0**	▲ **44.0**	

Source: Bloomberg Barclays Indices & BofA ICE Indices

Key Take Away:

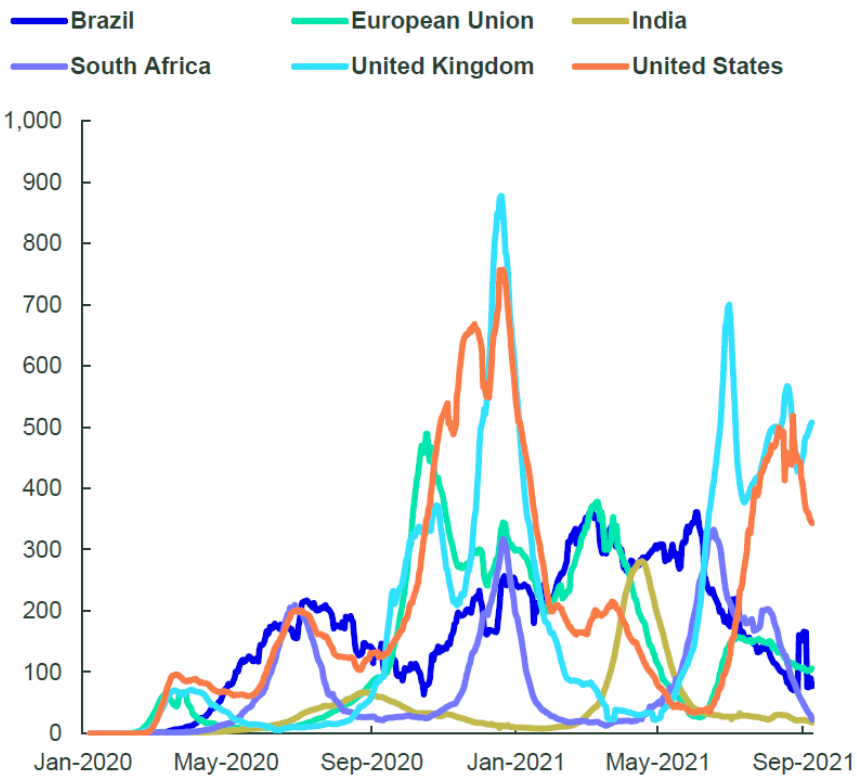
- **Nominal rates are up YTD across all fixed income sectors shown above except High Yield. Rates did rise marginally from Q2 as the fear from higher-than-expected inflation would prompt the Federal Reserve to accelerate plans to reduce quantitative easing (QE) and raise the Fed Funds rate, which then forced investors to reevaluate their expectations. More sobering is to look at real rates (nominal rates minus current inflation rate – rightmost column) where all investment-grade fixed income sectors' real yields are sharply negative, which may facilitate a rethink of investment strategy depending on an organization's risk appetite, investment horizon, and available capital to support investment volatility.**

Source: Bloomberg Barclays & ICE Fixed Income Indices

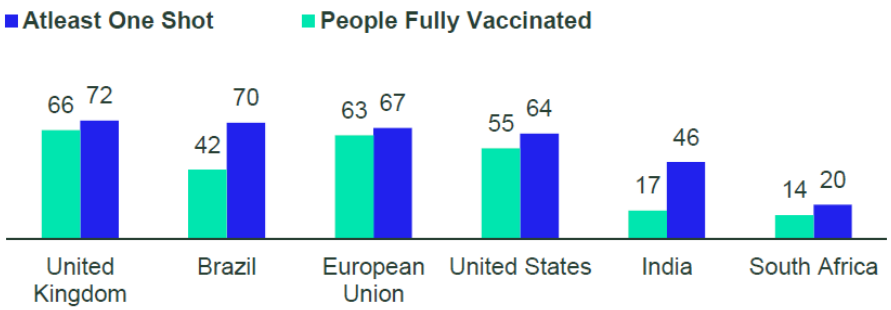
IMMEDIATE OUTLOOK

COVID-19 World Update

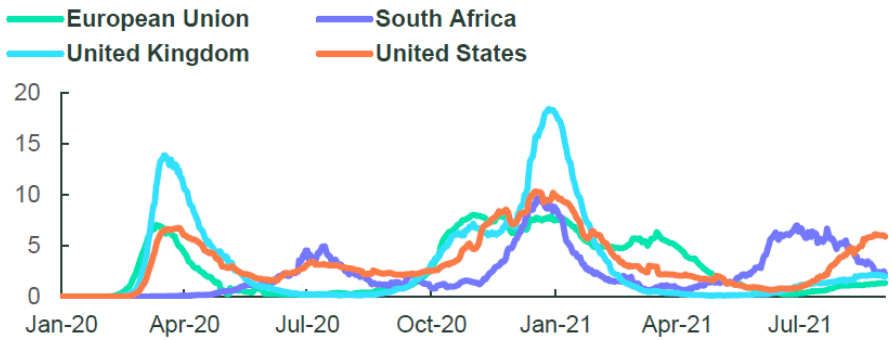
Daily New Confirmed COVID-19 Cases
Rolling seven-day average, per Million people of the population



Received one dose vs. full dose of COVID-19 Vaccine
% of total population



COVID-related New Deaths
Rolling seven-day average, per Million people of the population

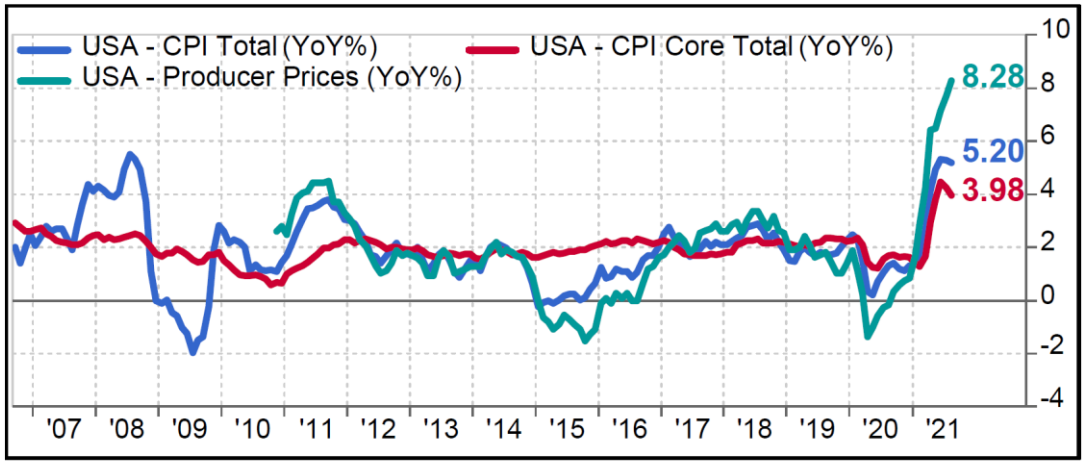


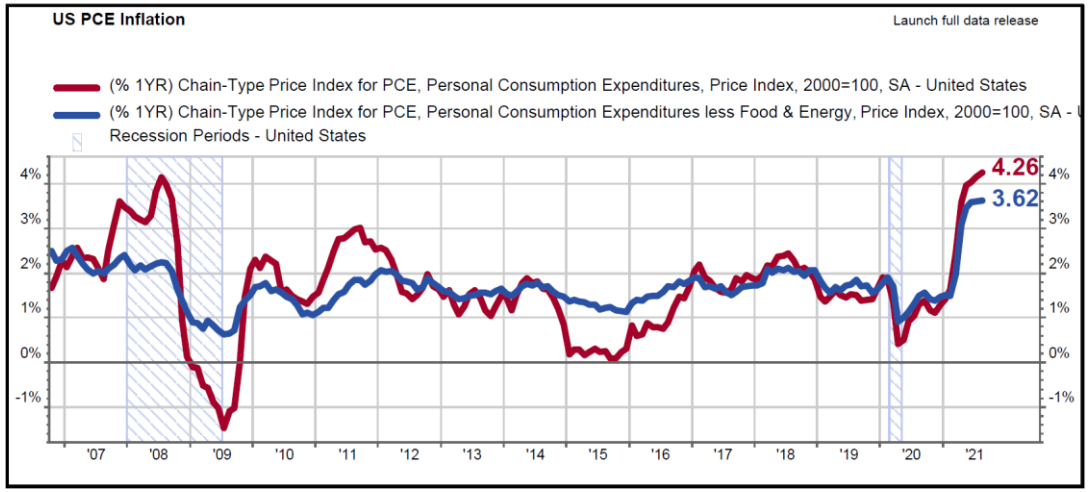
Key Take Away:

- ❑ **Global confirmed COVID deaths increased by more than 800K during the quarter, finishing Q3 at nearly 4.8M**
- ❑ **New daily confirmed cases are trending lower globally as we appear to be grinding through the Delta-Variant wave. The largest risk to this downward trend, however, is fading immunity of vaccinated people.**
- ❑ **Public health officials globally continue to stress the importance and effectiveness of vaccines as booster shots are now being administered in some countries.**

Source: Performa, State Street Global Advisors, Our World In Data, & Bloomberg L.P. as of 9/30/2021

Inflation



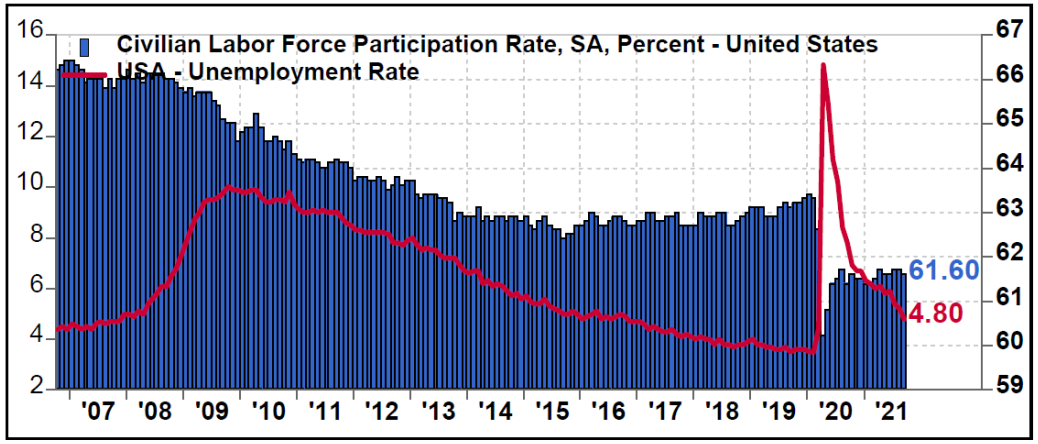


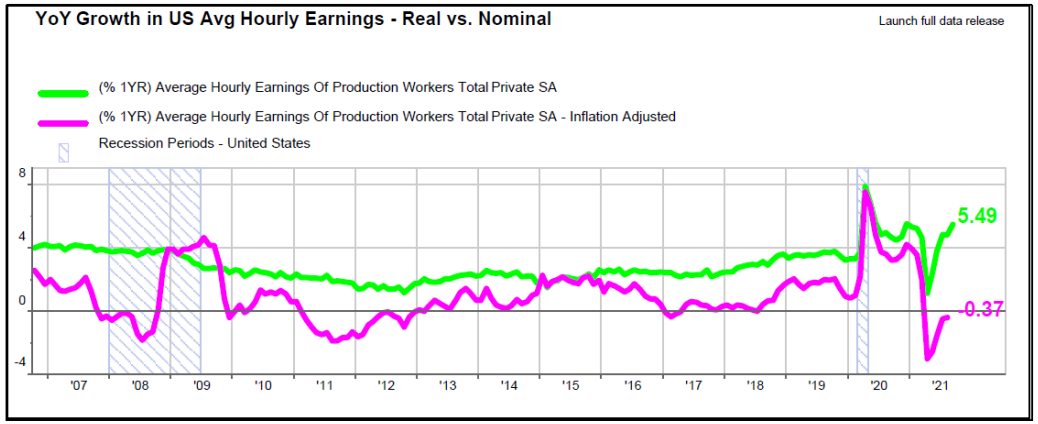
Key Take Away:

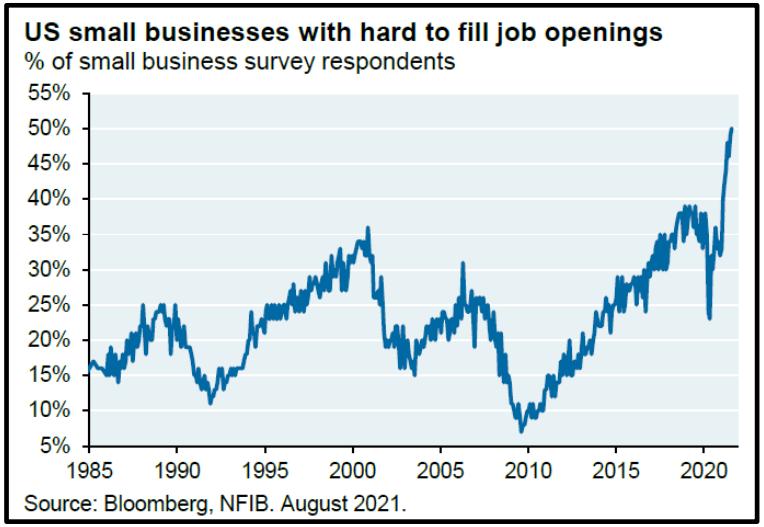
- ❑ **Inflation continues to run hot (even more so for producers), far exceeding the Fed's 2% target as surging consumer demand collides with supply chain disruptions, which have been larger and lasted longer than the Fed anticipated (paraphrased from Chairman Powell comments).**
- ❑ **At what point does "transitory inflation" turn into "real inflation" that materially affects consumer behavior and, by extension, GDP growth?**
- ❑ **How will any major Infrastructure program impact inflation trends and expectations?**

Source: Proforma, Julex Capital

U.S. Labor Market





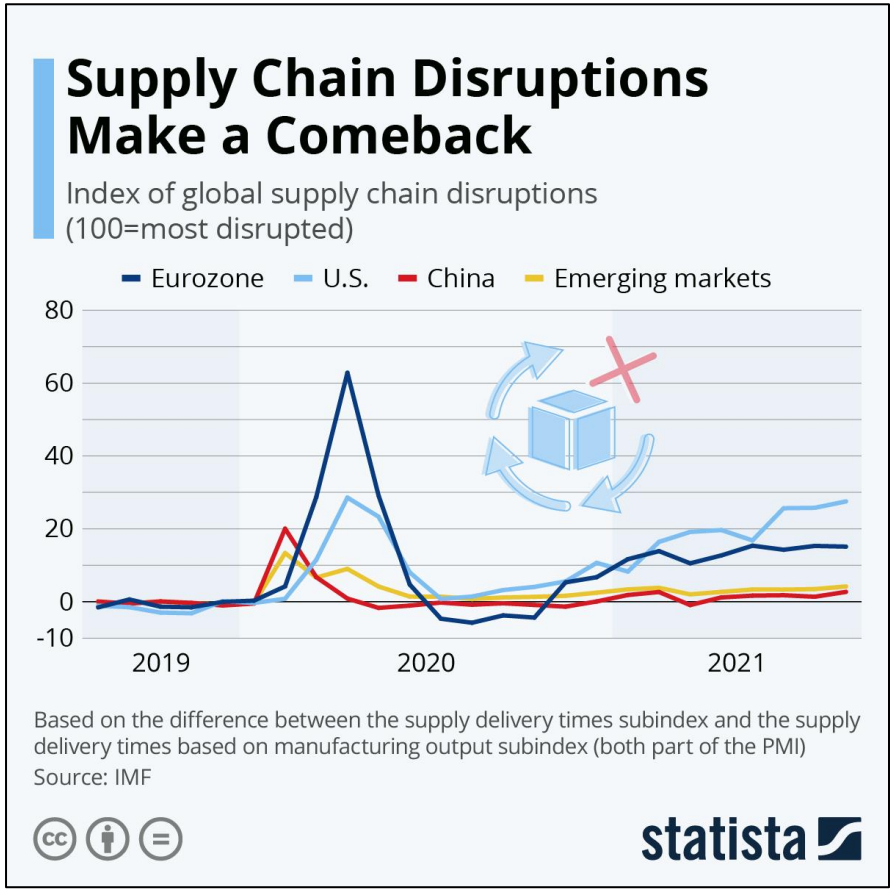


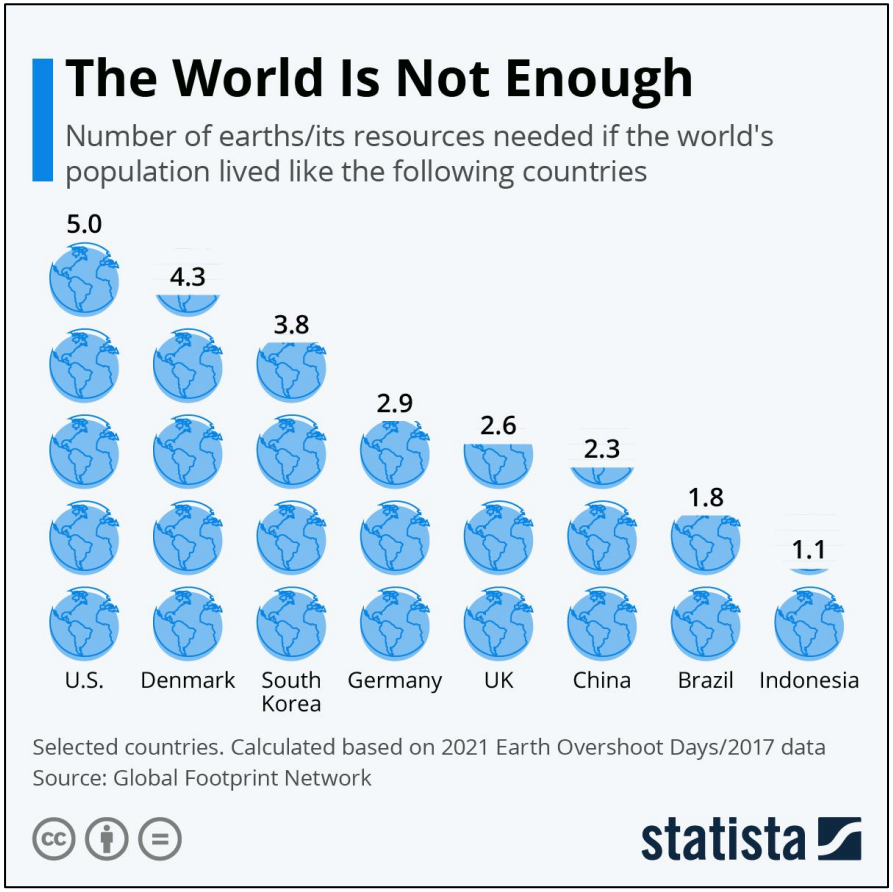
Key Take Away:

- ❑ **Even with rising wages, the decline in the unemployment rate is driven more by the falling labor participation rate than open positions being filled by eager workers. In fact, U.S. small businesses as of August are reporting the highest level on record for job openings they can't fill. Often cited as the sole factor, COVID-19 benefit programs do not fully explain the labor shortage or growth differentials between US states that terminated subsidies versus those that did not.**
- ❑ **How will labor shortages continue to affect ongoing supply chain disruptions? Where will the workers come from in support of whatever big-dollar Infrastructure bill gets passed in Washington?**

Source: Julex Capital, JP Morgan

Supply Chain Disruptions & Reflections on Sustainability





Key Take Away:

- ❑ **As the world continues its pivot toward sustainable investing (i.e. ESG Investing), the current impacts and inconveniences of global supply chain disruptions also helps put into stark perspective to what end the world's population aspires.**
- ❑ **While methodology and assumptions will always be up for debate, the reality is that current developed-country consumption levels are not sustainable when translated to the global population. How will generational sentiment, investment horizons, innovation, and capital flows strive toward sustainability?**

Source: Statista

APPENDIX – ABOUT SAA

Who We Are

Independent Investment Consulting Firm

Founded in 1994 that Only Focuses on
Insurance Organizations and Governmental Risk Pools

49*
Insurance Co. Clients

$10.2B*
Assets Under Advisement

- Headquartered in Bellingham, WA with an office in Maine.
- Staff of six, including one CEO, one Managing Director and one Director.
- Clients span various segments, including:
  - Governmental Risk Pooling organizations
  - Commercial P&C
  - Commercial Life
  - Commercial Health
  - Captives

*As of 9/30/21
*Within 31 Client Relationships

Who We Are: SAA Principals

Alton Cogert
President & CEO

Phone: (360) 255-2500
Email: acogert@saai.com

Mr. Cogert founded Strategic Asset Alliance in 1994.

Prior to founding SAA, Mr. Cogert accumulated more than twenty years of financial institution experience, including over ten years experience in senior financial management.

Daniel Smereck
Managing Director

Phone: (207) 706-9288
Email: dsmereck@saai.com

Mr. Smereck is the primary consultant for SAA's governmental risk pooling clients.

Mr. Smereck has over twenty years of experience across investments, insurance, corporate finance, statistical analysis, and information technology.

Our Investment Philosophy

Investment Process

- Asset allocation drives the great majority of returns based on historical studies
- Accountability & Transparency is key within the overall process

Active Management Makes Sense for Fixed Income Mandates Due to:

- The less efficient nature of the asset class due to its over-the-counter structure
- The necessary customization involved in managing insurer fixed income portfolios

Passive Management Makes Sense for Developed Market Equity Mandates

- In general, passive management makes more sense for developed market equity mandates (Large Cap, Mid Cap, Small Cap) due to:
  - The greater level of efficiency in these markets
  - The higher level of fees associated with managing active equity mandates
  - The difficulty in outperforming benchmarks given the fee drag and adjusting for risk

In general, we don't believe alternatives (i.e. hedge funds), make sense for insurers due to:

- The high level of fees, potential lack of liquidity, agency problems and impact to capital ratios

What Services Do You Receive?

Summary of Deliverables

SWOT Analysis	Initial SWOT Analysis of the investment process, providing blueprint and priority ranking for improvement
Asset Allocation	Advice on the current investment asset allocation and risk profiles, subject to current insurance regulations
Policy Review	Review, consultation and recommendations about the client's investment policy and guidelines
Benchmarking	Advice on establishing benchmarks for the various investment managers
Ongoing Monitoring	Ongoing monitoring of investment portfolio holdings and risks
Manager Evaluation	Review, consultation and recommendations about the performance of the investment managers
Performance Reviews	Performance reporting and monthly/quarterly review with management
On-site Attendance	Attendance and performance reporting at Finance/Investment Committee meetings
Manager Selection	Recommendations and assistance in selecting outside investment managers, when/if necessary.
Peer Analysis	Development of an annual peer group analysis
Ad Hoc Analysis	Ad hoc investment related analysis as necessary

Using SAA's Experience to Help You

WISDOM

Meeting Your Unique Goals and Objectives

In working with insurers for 27+ years, SAA recognizes what should work for your company, given your unique goals.

BEST PRACTICE

Understand What's Worked for Other Insurers

Based on our collective industry experience, SAA will provide insight on what's made peers successful and how those what processes/strategies were applied.

GUIDANCE

Avoiding Common Mistakes and Issues

In SAA experience, insurers face many of the same issues. SAA will guide your insurer in its decision-making to avoid these same situations.

Investment Policy (SWOT Example)

STRENGTHS

- Investment Policy has many of the basic requirements, that make it easily operational from the investment manager's point of view.

WEAKNESSES

- Performance reporting should be specifically stated to be according to GIPS standards with additional requirement for meeting investment income goals.
- No minimum credit rating for any given bond in Core Portfolio.
- Diversification limits set irrespective of credit rating/ state concentration (for municipals).
- No industry concentration limit for fixed income or equity portfolios.
- No specific exclusions, except as required by WA law.

OPPORTUNITIES

- We would recommend that only investment grade fixed income securities be part of the Core Portfolio with all other investments part of the Capital Growth Portfolio.
- There are several other opportunities for consideration that will arise from future discussions.

THREATS

- New investment products may/may not be adequately handled under the existing policy.