Capital Markets Review
For the Quarter Ending December 31, 2022

STRATEGIC ASSET ALLIANCE
THE INSURANCE INVESTMENT SPECIALIST

Summary Capital Market Commentary – Q4/2022

- **Stock markets rounded off a tumultuous year with gains in Q4. Asian shares were boosted by China's relaxation of its zero-Covid policy, while European equities also advanced strongly. Government bond yields edged up towards the end of Q4 and reflected some market disappointment at major central banks reiterating plans to tighten monetary policy, even as inflation showed signs of peaking.**

- Equity Markets
  - US equities made robust gains in Q4, with much of the progress made in November. Investors balanced ongoing caution from the Federal Reserve with indications that the pace of policy tightening would slow, and signs that elevated inflation could be cooling. There were also especially strong corporate earnings in certain sectors. Annualized Q3 GDP for the US was confirmed at 3.2% in December, which was stronger than the second estimate of 2.9%. Unemployment remains at 3.7%. 263,000 jobs were added in November; the lowest number since April 2021.
  - Eurozone shares notched up a strong advance in Q4, outperforming other regions. Equity gains were supported by hopes that inflation may be peaking in Europe as well as in the US. Data showed that the eurozone economy grew by 0.3% quarter-on-quarter in Q3, slowing from 0.8% growth in Q2. Forward-looking indicators continued to point towards contraction although the rate of decline moderated. Falling gas prices, amid unusually mild weather for much of the period, helped to alleviate some cost pressures.
  - After rising for most of October and November, the Japanese stock market declined in December. Nevertheless, the total return for the fourth quarter remained positive, at 3.3% in yen terms. A key for investors in Q4 was the decision by the Bank of Japan to widen the band within which it has been maintaining 10-year bond yields. Although such a change had always been recognized by investors as a logical first step towards policy normalization, the timing of the decision was a complete surprise. Although the change in yield-control policy is not a de-facto interest rate rise, it was still sufficient to drive a sharp strengthening of the yen in December. The earlier than expected move by the central bank may also reflect a belief that Japan's inflation rate is finally moving into a more sustainably positive range after decades of deflation.
  - Asia ex Japan equities achieved robust gains in the fourth quarter, with almost all markets in the index ending the period in positive territory. China, Hong Kong and Taiwan all achieved strong growth over the quarter, with share price growth particularly strong in November after US President Joe Biden and Chinese leader Xi Jinping signaled a desire to improve US-China relations at a meeting ahead of the G20 summit in Indonesia. The recovery in Hong Kong and Chinese share prices continued in December after Beijing loosened its pandemic restrictions that have constrained China's economic growth since early 2020.

Source: Schroders & SAA

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- Bond Markets
  - Markets ended the year on a mixed note as government bond yields edged up towards the end of Q4, reflecting some market disappointment at the hawkish tone from some central banks, despite mounting evidence of slowing economic growth. Credit spreads tightened across the quarter on improved risk sentiment. Although strong performance was tempered slightly into year end, US and European investment grade and high yield credit generated positive returns and outperformed government bonds over the quarter.

  - The Federal Reserve (Fed) raised rates twice during the quarter, ending at 4.5%. The US 10-year yield rose from 3.83% to 3.88%, with the two-year rising from 4.28% to 4.42%.

  - The eurozone faced its most challenging year for inflation in its history, though signs emerged towards the end of Q4 that there may be some respite as the region's latest indicators signaled slowing headline inflation, helped by falling energy price pressures. Nevertheless, the European Central Bank (ECB) continued to tighten monetary policy conditions, maintaining its hawkish message and indicating future rate hikes. Germany's 10-year yield increased from 2.11% to 2.57%.

Source: Schroders & SAA

Capital Markets' Performance

Index	Asset Class	Oct-22	Nov-22	Dec-22	Q4-2022	Year 2022	Trailing 3 Yr	Trailing 5 Yr	Trailing 10 Yr
MSCI EAFE (Net)	International Equity	5.39%	11.28%	0.11%	17.40%	-14.01%	1.34%	2.03%	5.16%
MSCI EAFE Index	International Equity	5.38%	11.26%	0.08%	17.34%	-14.45%	0.87%	1.54%	4.67%
MSCI World Index	World Equity	5.53%	10.67%	-0.45%	16.26%	-13.82%	1.77%	2.32%	5.11%
Dow Jones Industrial Average	U.S. Equity	14.07%	6.04%	-4.09%	16.01%	-6.86%	7.32%	8.38%	12.30%
S&P Composite 1500 Value	U.S. Equity	11.58%	6.00%	-4.04%	13.49%	-5.47%	6.39%	7.48%	10.85%
S&P MidCap 400	U.S. Equity	10.52%	6.12%	-5.54%	10.78%	-13.06%	7.23%	6.71%	10.78%
Alerian MLP	Master Limited Partnerships	14.76%	0.67%	-4.69%	10.11%	30.92%	9.38%	4.08%	1.99%
MSCI World Ex. US Index	World Equity	7.21%	7.00%	-4.21%	9.89%	-17.73%	5.45%	6.69%	9.44%
MSCI EM (Emerging Markets)	International Equity	-3.09%	14.85%	-1.35%	9.79%	-19.74%	-2.34%	-1.03%	1.81%
S&P SmallCap 600	U.S. Equity	12.37%	4.17%	-6.71%	9.19%	-16.10%	5.80%	5.88%	10.82%
S&P Composite 1500	U.S. Equity	8.34%	5.58%	-5.77%	7.79%	-17.78%	7.59%	9.15%	12.40%
S&P 500	U.S. Equity	8.10%	5.59%	-5.76%	7.56%	-18.11%	7.66%	9.42%	12.56%
Dow Jones U.S. Select REIT	U.S. Real Estate	4.49%	5.79%	-5.24%	4.76%	-25.96%	-1.37%	2.50%	5.74%
S&P GSCI Crude Oil	U.S. Equity	10.76%	-5.65%	-0.21%	4.29%	27.55%	-6.36%	-2.63%	-10.56%
Citigroup WorldBIG Index	World Fixed Income	-0.47%	4.78%	-0.08%	4.21%	-17.14%	-4.98%	-1.98%	-0.54%
Barclays Capital U.S. Corporate High Yield	U.S. Fixed Income	2.60%	2.17%	-0.62%	4.17%	-11.19%	0.05%	2.31%	4.03%
Barclays Capital Municipal Bond	U.S. Fixed Income	-0.83%	4.68%	0.29%	4.10%	-8.53%	-0.77%	1.25%	2.13%
Barclays Capital U.S. Corporate Investment Grade	U.S. Fixed Income	-1.03%	5.18%	-0.44%	3.63%	-15.76%	-2.88%	0.45%	1.96%
S&P GSCI Commodities	U.S. Equity	6.70%	-1.71%	-1.38%	3.44%	25.99%	10.49%	6.46%	-3.30%
S&P/LSTA US Leveraged Loan Index	U.S. Fixed Income	1.03%	1.24%	0.44%	2.74%	-0.60%	2.55%	3.31%	3.67%
Barclays U.S. Treasury: U.S. TIPS	U.S. Fixed Income	1.24%	1.83%	-1.02%	2.04%	-11.85%	1.21%	2.11%	1.12%
S&P Composite 1500 Growth	U.S. Equity	4.91%	5.12%	-7.51%	1.99%	-28.66%	7.41%	9.92%	13.33%
Barclays Capital U.S. Aggregate	U.S. Fixed Income	-1.30%	3.68%	-0.45%	1.87%	-13.01%	-2.71%	0.02%	1.06%
Barclays U.S. Government/Credit	U.S. Fixed Income	-1.24%	3.57%	-0.48%	1.80%	-13.58%	-2.57%	0.21%	1.16%
BofA Merrill Lynch US Convertibles	U.S. Convertible Bond	3.25%	1.58%	-3.14%	1.59%	-18.71%	8.12%	9.27%	10.01%
Barclays Intermediate U.S. Government/Credit	U.S. Fixed Income	-0.44%	2.17%	-0.18%	1.54%	-8.24%	-1.26%	0.73%	1.12%
5-Year US Treasury	U.S. Treasury	-0.54%	2.13%	-0.44%	1.14%	-9.77%	-2.04%	0.20%	0.42%
Citigroup 3-month T-bill	Cash/Cash Equivalent	0.25%	0.29%	0.34%	0.87%	1.50%	0.71%	1.25%	0.74%
Merrill Lynch US Treasury Master	U.S. Fixed Income	-1.52%	2.81%	-0.52%	0.72%	-12.85%	-2.72%	-0.14%	0.61%
10-Year US Treasury	U.S. Treasury	-1.88%	3.74%	-1.12%	0.65%	-16.28%	-3.75%	-0.59%	0.19%

Key Take Aways:

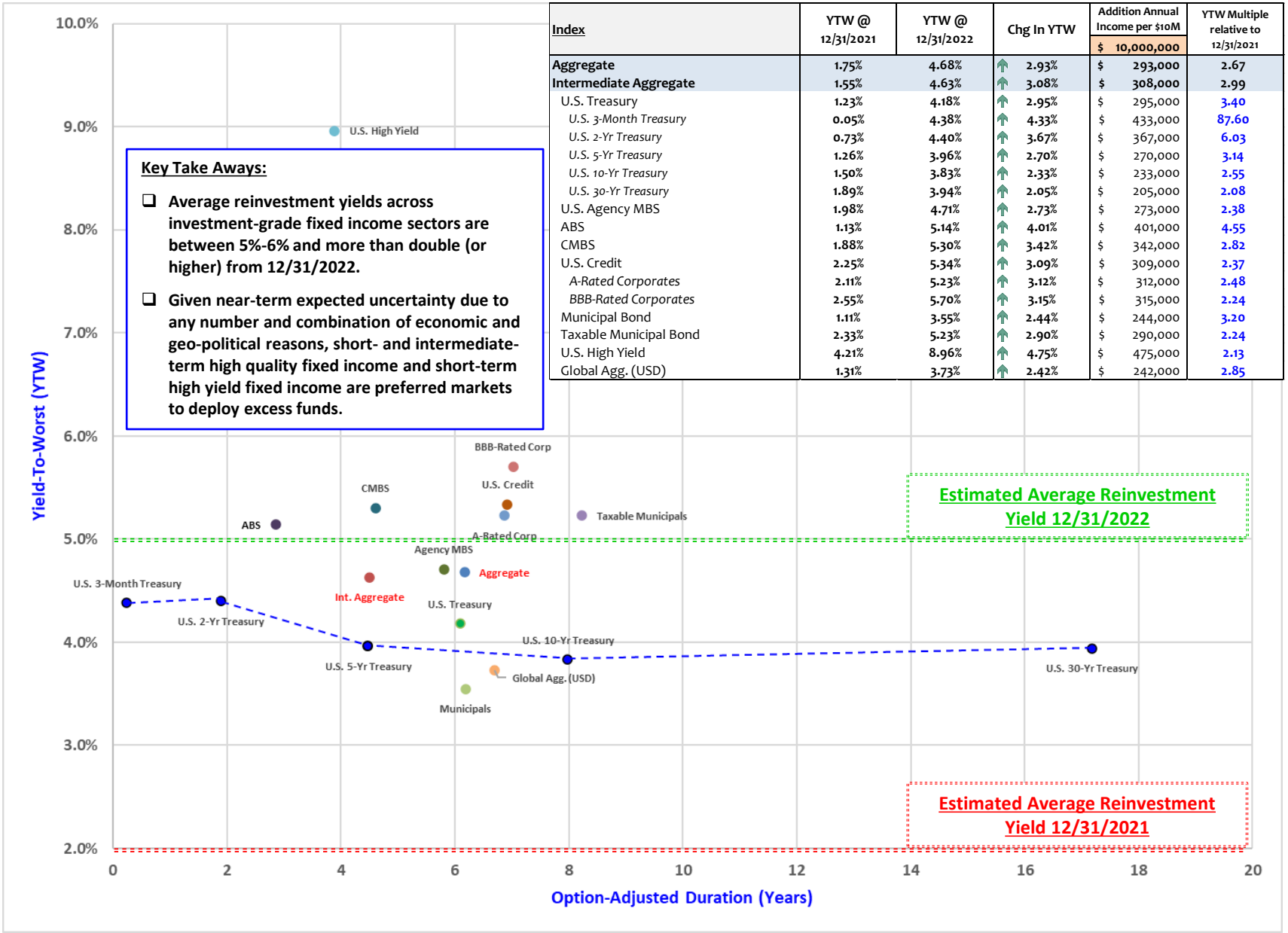
- **Q4 positive performance was primarily buoyed by changing market expectations that the Fed's pace of policy tightening would slow on signs that elevated inflation could easing. Markets remain ever-skeptical of the Fed's position; so, follow the data, especially the labor markets, and expect rates and reinvestment yields to remain elevated in 2023.**
- **Meanwhile, investors' concerns about recession and/or declining economic growth punished equity and fixed income markets with simultaneously. Cash, energy-related securities, and commodities have really been the only place to hide in the short-term.**
- **Fixed income allocations will continue throughout 2023 to generate materially higher earned income per dollar of reinvestment leading to higher book yields across all core fixed income portfolios.**

Indices sorted high/low by Q4-2022 performance.

Source: Zephyr StyleAdvisor

Fixed Income Duration & Yields – 12/31/2022

Index	YTW @ 12/31/2021	YTW @ 12/31/2022	Chg In YTW	Addition Annual Income per $10M	YTW Multiple relative to 12/31/2021
				$ 10,000,000	
Aggregate	1.75%	4.68%	2.93%	$ 293,000	2.67
Intermediate Aggregate	1.55%	4.63%	3.08%	$ 308,000	2.99
U.S. Treasury	1.23%	4.18%	2.95%	$ 295,000	3.40
U.S. 3-Month Treasury	0.05%	4.38%	4.33%	$ 433,000	87.60
U.S. 2-Yr Treasury	0.73%	4.40%	3.67%	$ 367,000	6.03
U.S. 5-Yr Treasury	1.26%	3.96%	2.70%	$ 270,000	3.14
U.S. 10-Yr Treasury	1.50%	3.83%	2.33%	$ 233,000	2.55
U.S. 30-Yr Treasury	1.89%	3.94%	2.05%	$ 205,000	2.08
U.S. Agency MBS	1.98%	4.71%	2.73%	$ 273,000	2.38
ABS	1.13%	5.14%	4.01%	$ 401,000	4.55
CMBS	1.88%	5.30%	3.42%	$ 342,000	2.82
U.S. Credit	2.25%	5.34%	3.09%	$ 309,000	2.37
A-Rated Corporates	2.11%	5.23%	3.12%	$ 312,000	2.48
BBB-Rated Corporates	2.55%	5.70%	3.15%	$ 315,000	2.24
Municipal Bond	1.11%	3.55%	2.44%	$ 244,000	3.20
Taxable Municipal Bond	2.33%	5.23%	2.90%	$ 290,000	2.24
U.S. High Yield	4.21%	8.96%	4.75%	$ 475,000	2.13
Global Agg. (USD)	1.31%	3.73%	2.42%	$ 242,000	2.85

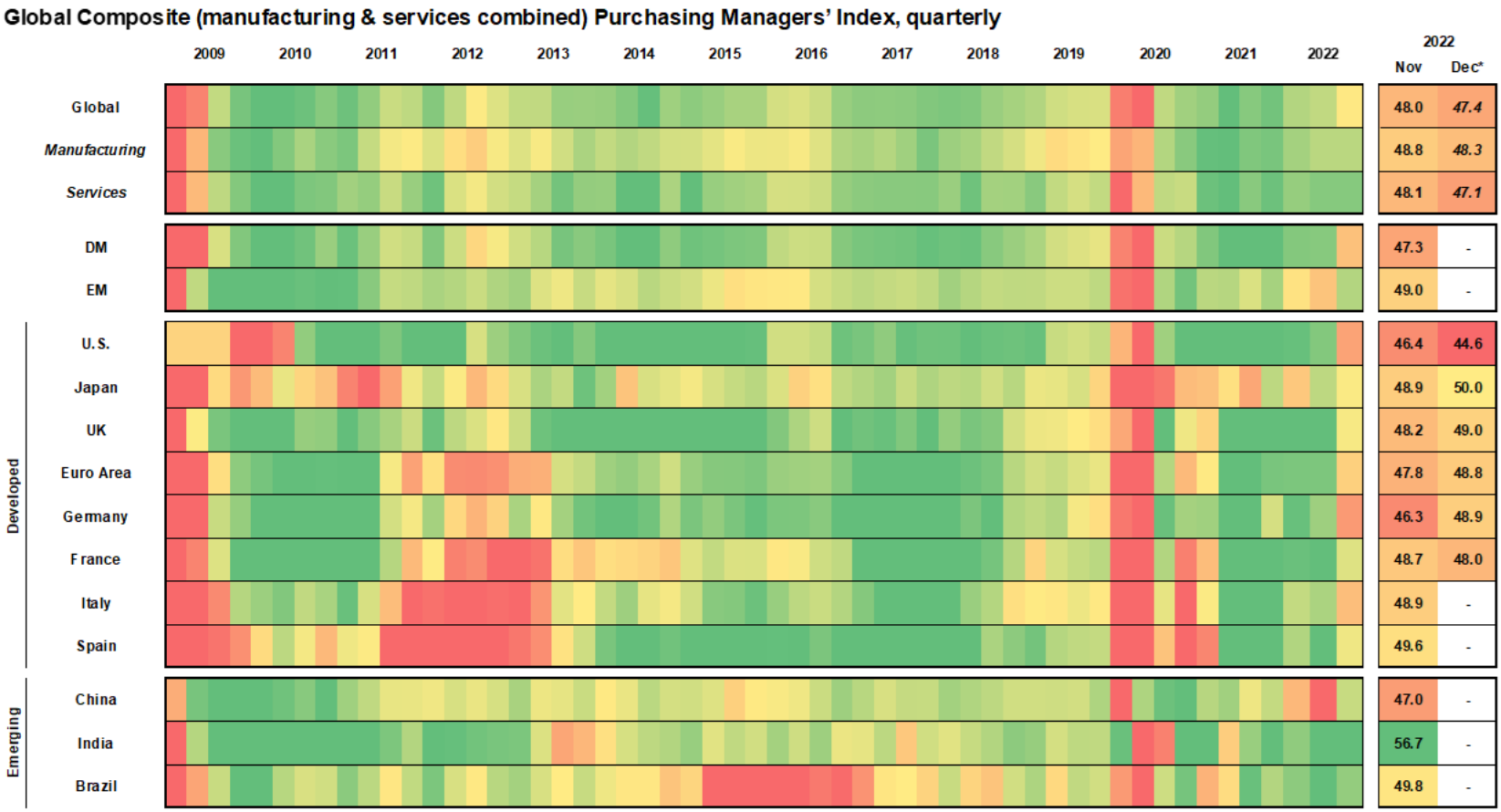


The information contained herein has been obtained from sources believed to be reliable, but the accuracy of the information cannot be guaranteed.

Source: Bloomberg Barclays & ICE Fixed Income Indices

IMMEDIATE OUTLOOK

Global Economic Activity Trends: When might to expect recession?

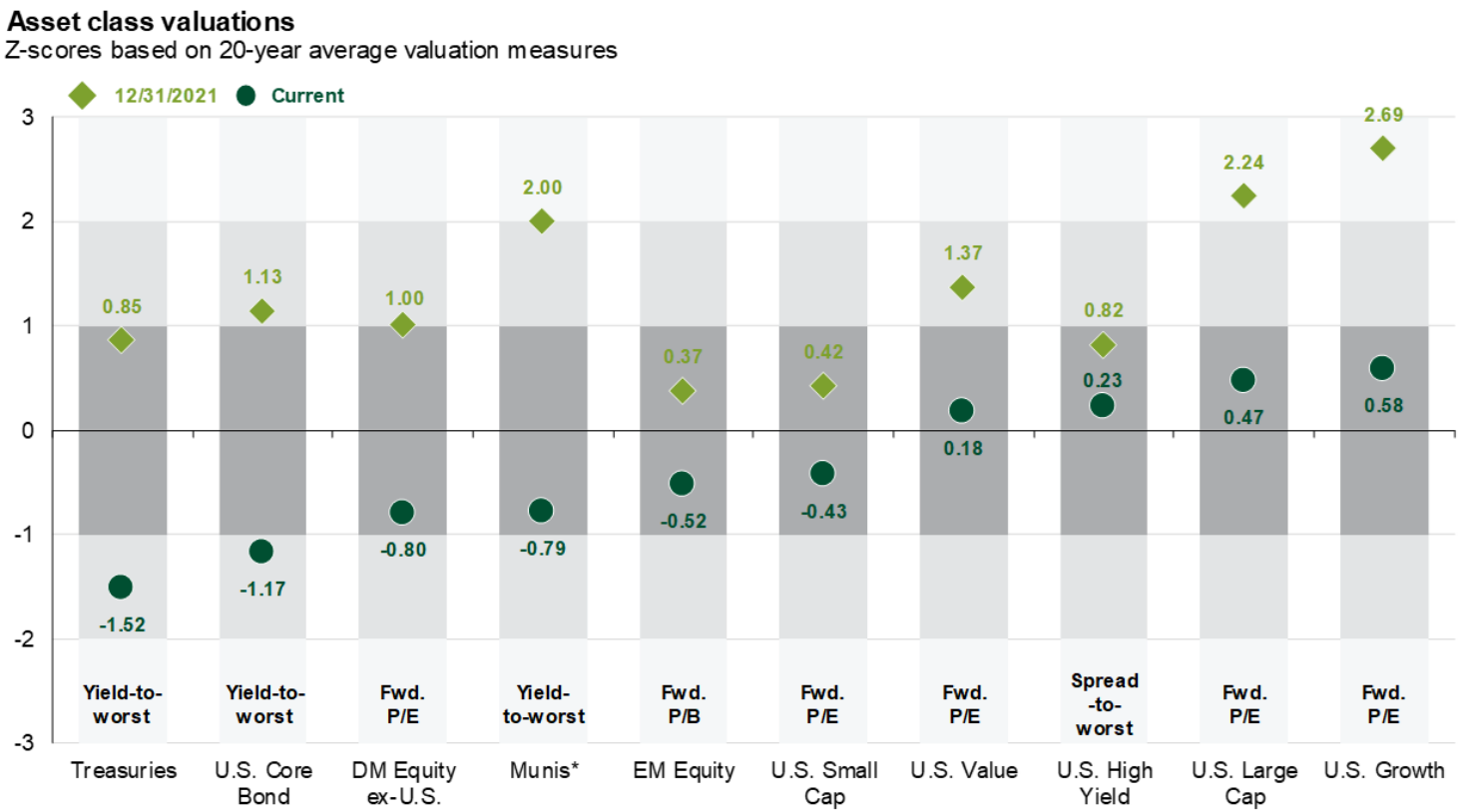


Key Take Aways:

- ❑ **Global economic activity is moderating largely as result of "inflation-busting" actions of the largest global central banks (Japan being the exception).**
- ❑ **With the abrupt end of the zero-COVID policy, the wave of demand for goods/services is poised to be unleashed by the Chinese consumer. Will this demand wave exacerbate the global inflationary environment or provide support to global growth as other economies cool during 2023?**
- ❑ **In SAA's view, the effects of the COVID pandemic will continue to muddy the economic metrics across the globe.**

Source: Standard & Poor's, J.P. Morgan Asset Management.
The Composite PMI includes both manufacturing and services sub-indices. Heatmap colors are based on PMI relative to the 50 level, which indicates acceleration or deceleration of the sector, for the time period shown. Heatmap is based on quarterly averages, with the exception of the two most recent figures, which are single month readings. Data for the U.S. are back-tested and filled in from December 2007 to September 2009 due to lack of existing PMI figures. DM and EM represent developed markets and emerging markets, respectively. *September Global Composite, Manufacturing and Services PMIs are J.P. Morgan Asset Management estimates.
Guide to the Markets – U.S. Data are as of December 31, 2022.

Asset Allocation Implications – Valuations Monitor

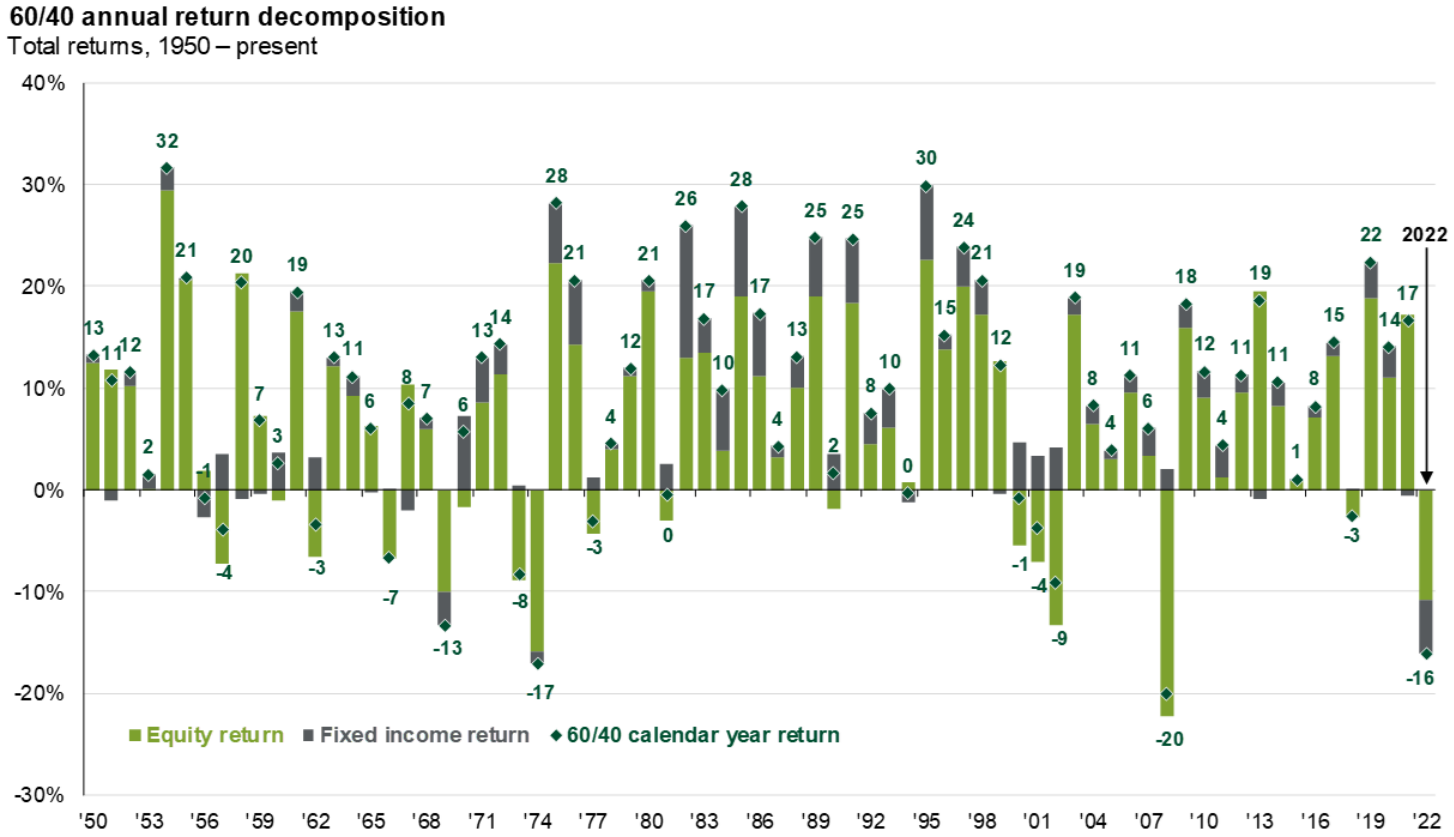


Key Take Aways:

- ❑ **Elevated inflation and tighter financial conditions across the globe sparked a global reset in valuations that spared few asset classes.**
- ❑ **The above exhibit shows 10 major asset classes and styles and their valuations, expressed as z-scores versus their respective 20-year history. Using z-scores allows us to illustrate how normal, or abnormal, current valuations are compared to history. Most asset classes are much cheaper today compared to the end of 2021. In particular, the sharp rise in yields have left U.S. Treasuries and core fixed income about 1 standard deviation below their average valuation levels.**
- ❑ **With fixed income reinvestment yields double or triple what they were just a year ago, the opportunity cost of holding cash and cash equivalents has been significantly diminished. With rising claims payments and reinsurance premiums, having additional liquidity may be prudent in 2023 with minimal opportunity cost as short-term yields move toward 4%-5%.**

Source: Bloomberg, BLS, CME, FactSet, MSCI, Russell, Standard & Poor's, J.P. Morgan Asset Management.
U.S. Large Cap: S&P 500, U.S. Small Cap: Russell 2000, U.S. Mid Cap: Russell Midcap; EM Equity: MSCI EME, DM Equity: MSCI EAFE, U.S. Value: Russell 1000 Value, U.S. Growth: Russell 1000 Growth, U.S. High Yield: J.P. Morgan Domestic High Yield Index, U.S. Core Bond: Bloomberg US Aggregate, Treasuries: Bloomberg U.S. Aggregate Government – Treasury, Munis: Bloomberg Municipal Bond. *Munis yield-to-worst is based on the tax-equivalent yield-to-worst assuming a top-income tax bracket rare of 37% plus a Medicare tax rate of 3.8%.
Guide to the Markets – U.S. Data are as of December 31, 2022.

Asset Allocation Implications – 60/40 Annual Returns



Key Take Aways:

- **Performance in 2022 was unique because the bear market in stocks was accentuated by a bear market in bonds. Diversification took a vacation during 2022 as the Fed's aggressive inflationary policy pivot negatively overwhelmed all nearly asset classes. A portfolio with 60% invested in the S&P 500 and 40% in the Bloomberg U.S. Aggregate Bond index fell 16% in 2022, marking the second worst year for a 60/40 portfolio since 1974.**
- **However, a negative correlation between stocks and bonds is still overwhelmingly the norm. As shown in the exhibit above, most drawdowns in equity markets have been offset by gains in fixed income. Moreover, as investors assess performance going forward, large drawdowns in both stocks and bonds have never repeated themselves the next year.**
- **In today's investing environments and ever-changing headlines, it's easy to lose sight of long-term strategic asset allocation. Don't! Unless underlying operations are facing material changes, long-term asset allocation targets should most likely remain in place.**

Source: FactSet, Standard & Poor's, Robert Shiller, Yale University, Bloomberg, Ibbotson/Strategas, J.P. Morgan Asset Management.
The 60/40 portfolio is 60% invested in S&P 500 Total Return Index and 40% invested in Bloomberg U.S. Aggregate Total Return Index. S&P 500 returns from 1950 – 1970 are estimated using the Shiller S&P Composite. U.S. fixed income total returns from 1950 – 1975 are estimated using data from Strategas/Ibbotson. The portfolio is rebalanced annually.
Guide to the Markets – U.S. Data are as of December 31, 2022..