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QUARTERLY MARKET COMMENTARY | Q2 2021

# Falling Rates and Climbing Vaccinations Boost Equities, Bonds and Commodities

## Quarterly Snapshot

- Developed-market equities outpaced their emerging-market counterparts in the second quarter; U.S. shares gained the most among major markets, followed by Europe, the U.K., Hong Kong and mainland China. Japanese equities were slightly negative.
- The world's daily COVID-19 infection rate climbed to an all-time high at the end of April, while the daily number of virus-related deaths reported globally remained significantly below its early-year peak.
- Vaccination rates have slowed in developed regions, leaving more shots available to the rest of the world. We therefore expect a rolling reopening of the global economy that will extend well into 2022; this should resemble an extended up-cycle that keeps the pressure on supply chains and leads to continued shortages of goods and labor.

The broad-based advance in equities, commodities and riskier fixed-income asset classes since earlier this year accelerated during the second quarter.

Trendwise, a shift among global investors toward favoring cyclical and value-oriented asset classes that began in the second half of 2020 halted in mid-June. Market observers attributed this to the Federal Open Market Committee (FOMC)—the Federal Reserve's monetary policymakers—deciding to increase its projection for the federal-funds rate in 2023. Meanwhile, for the first time since April this year, the seven-day moving average of new COVID-19 cases reported in the U.S. stopped falling in mid-June after an impressive period of declines that brought cases to their lowest levels since March 2020. The FOMC development and the bottoming of COVID-19 cases can both be taken as evidence that the rebound taking place as the U.S. economy reopens may be near its peak.

Developed-market equities outpaced emerging markets for the second quarter. U.S. shares gained the most among major markets, followed by Europe, the U.K., Hong Kong and mainland China. Japanese equities were modestly negative.

U.S. Treasury and U.K. gilt rates declined across most maturities for the first two months of the second quarter; short-term rates bounced in June to finish higher for the second quarter as intermediate-to-long-term rates continued to drop—resulting in flatter yield curves. Conversely, eurozone government-bond rates climbed throughout April and May before falling in June, but generally ended up higher compared to the beginning of the quarter.

Emerging-market debt was the best-performing fixed-income asset class. U.S. corporate bonds followed—with investment grade outpacing high yield, and inflation-protected securities also performed notably well.

The Bloomberg Commodity Index increased by 13.3% during the second quarter, with most of the advance occurring in April and May. The FOMC's modest evolution toward tighter monetary policy spurred the U.S. dollar higher in June, tempering the rally in commodities; although the U.S. dollar finished the three-month period slightly lower, according to the U.S. Dollar

## Key Measures: Q2 2021

| | | |
|---|---|---|
| **EQUITY** | | |
| Dow Jones Industrial Average | 5.08% | ↑ |
| S&P 500 Index | 8.55% | ↑ |
| NASDAQ Composite Index | 9.68% | ↑ |
| MSCI ACWI Index (Net) | 7.39% | ↑ |
| **BOND** | | |
| Bloomberg Barclays Global Aggregate Index | 1.31% | ↑ |
| **VOLATILITY** | | |
| Chicago Board Options Exchange Volatility Index<br>PRIOR QUARTER: **19.4** | 15.83 | ↓ |
| **OIL** | | |
| WTI Cushing crude oil prices<br>PRIOR QUARTER: **$59.16** | $73.47 | ↑ |
| **CURRENCIES** | | |
| Sterling vs. U.S. dollar | $1.38 | ↑ |
| Euro vs. U.S. dollar | $1.19 | ↑ |
| U.S. dollar vs. yen | ¥111.11 | ↑ |

Sources: Bloomberg, FactSet, Lipper

Index (DXY). The price of West Texas Intermediate crude oil increased by 24.2% during the quarter to $73.47 per barrel.

The world's daily infection rate climbed past the peak recorded in January to an all-time high at the end of April as India continued to battle a severe COVID-19 outbreak. While the daily number of virus-related deaths reported globally also increased during the second quarter, it remained significantly below its early-year peak. India's daily case count began to rapidly decline in early May, leaving Brazil with the highest country-level count by the end of the second quarter.  At this time, countries reporting cases at or near their all-time peaks were concentrated in Southeast Asia, Sub-Saharan Africa and the Caribbean-Central America region.

As for COVID-19 vaccination trends, Canada, the U.K. and Chile reported the largest numbers of people (relative to their total populations) that received at least one vaccine dose by the end of the three-month period. Perhaps as a result, the daily average number of deaths in the U.K. attributed to COVID-19 remained in the low double digits despite a resurgence in new infections that began in mid-May and topped 20,000 cases per day as the quarter came to a close.

The prospect of a bipartisan U.S. infrastructure deal appeared to brighten in mid-June as a group of Senate Republicans and Democrats agreed to a White House compromise that would direct $1.2 trillion toward improving the country's structures and facilities over an eight-year period. The plan would provide about $580 billion in new spending and sidestep tax increases. However, the possibility of a party-line vote on a larger package by President Biden's Democrats remained on the table as Republicans took issue with plans by the Democrats to enact other parts of their spending agenda once the infrastructure deal had concluded.

## Economic Data

- Multiple PMI surveys depicted U.S. manufacturing at red-hot growth levels during the second quarter. The Institute for Supply Management reported record manufacturing activity during May, while IHS Markit's June reading was the strongest on record since 2007. U.S. services activity peaked during May at the highest level on record dating back to 2009, according to IHS Markit's PMI survey, before slowing to a still-remarkable pace of growth in June. U.S. nonfarm payrolls increased at an accelerating pace throughout the second quarter—by 269,000 in April, 583,000 in May, and 850,000 in June (with 343,000 new leisure and hospitality jobs during June alone)—as new U.S. jobless claims declined from about 700,000 per week at the end of the first quarter to 364,000 in late June. The overall U.S. economy grew by a 6.4% annualized rate during the first quarter.

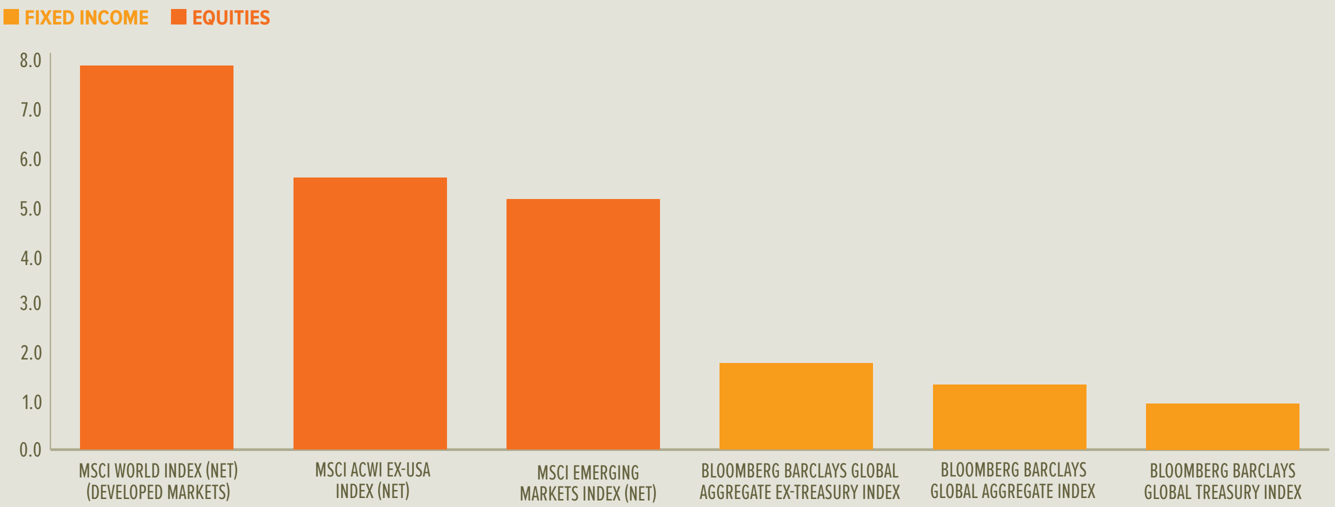
- The U.K.'s manufacturing frenzy reached the fastest pace of growth since 1994 in May before cooling ever so slightly in June, according to the IHS Markit / CIPS UK Manufacturing Purchasing Managers' Index (PMI) survey. Similarly, services growth peaked in May at its strongest pace since 1997 before slowing somewhat in June. The U.K. claimant count (which calculates the number of people claiming Jobseeker's Allowance) declined by about 56,000 in April and 93,000 in May, with claimants representing 6.2% of the population as at May's reading. The overall U.K. economy contracted by 1.6% during the first quarter and 6.1% year over year through March.

- Eurozone manufacturing measured its fourth straight month of record-high growth in June, according to IHS Markit's PMI survey, with Spain and Greece reaching their greatest levels in more than 20 years. Services activity in the eurozone emerged from contraction to start the second quarter before accelerating to the fastest rate of growth in more than three years by June, according to IHS Markit's PMI survey. The eurozone unemployment rate declined steadily, from 8.1% at the end of the first quarter to 8.0% in April and 7.9% in May. The overall eurozone economy shrank by 0.3% during the first quarter and 1.3% year over year in March.

## Central Banks

- The FOMC held the federal-funds rate near zero throughout the second quarter and continued its asset purchases apace ($80 billion in Treasurys and $40 billion in agency mortgage-backed securities per month). Its latest Summary of Economic Projections (SEP), released in mid-June, featured a projected increase in the federal-funds rate to 0.6% in 2023 (up from 0.1% in its March projection). The SEP also

Major Index Performance in Q2 2021 (Percent Return)

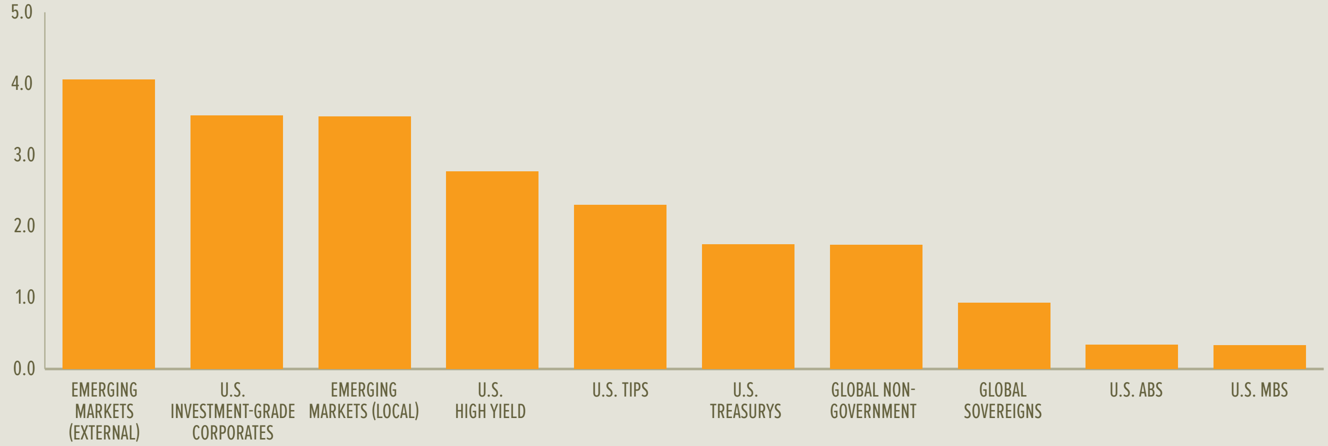



Sources: FactSet, Lipper

depicted significantly higher real gross domestic product (GDP) and inflation projections for 2021, although out-year projections were only modestly higher.

- The Bank of England's (BOE) Monetary Policy Committee (MPC) kept the bank rate at 0.1% and retained an £895 billion maximum allowance for asset purchases throughout the second quarter. It shared a projection following its late-June meeting that inflation would temporarily top 3% amid the country's economic reopening before returning toward 2%.
- The European Central Bank (ECB) began the second quarter with a pledge to increase the pace of asset purchases under its €1.85 trillion Pandemic Emergency Purchase Programme (PEPP). It reaffirmed the acceleration at its June meeting. Purchases averaged about €80 billion per month during the second quarter after running closer to a monthly pace of €60 billion during the first quarter.
- The Bank of Japan (BOJ) announced following its June meeting that the central bank's emergency pandemic-related programs would extend past their scheduled September 2021 end date. A new program targeted at promoting lending to counteract climate change was also announced in June. The BOJ intends to announce final plans for the program by the end of 2021, but has said it will likely be based on offering banks attractive loan terms when their lending supports mitigating the effects of climate change.

## Fixed-Income Performance in Q2 2021 (Percent Return)




Sources: FactSet, Lipper. See "Corresponding Indexes for Fixed-Income Performance Exhibit" in the Index Descriptions section for more information.

## Regional Equity Performance in Q2 2021 (Percent Return)


Sources: FactSet, Lipper. See "Corresponding Indexes for Regional Equity Performance Exhibit" in the Index Descriptions section for more information.

# Portfolio Review

U.S. stocks advanced sharply again during the second quarter, with large caps essentially doubling the gains of small caps. Our U.S. large-cap strategies[1] lagged their benchmarks for the quarter. Poor selection in the healthcare and information technology sectors more than offset contributions from selection in consumer discretionary and financials. Our U.S. small-cap strategies performed in line with their benchmarks. Headwinds to value and quality exposures during the quarter were counterbalanced by favorable selection in the consumer discretionary, healthcare and financials sectors. An overweight to energy contributed as well, although it was mostly offset by negative selection within the sector. The steep climb for equities also continued overseas, where developed and emerging markets were evenly matched. Our international developed-market equity strategy slightly trailed its benchmark, with strong stability-oriented exposures offset by the underperformance of value exposures. Our emerging-market equity strategy lagged its benchmark during the quarter. Weak company-specific selection concentrated in health care and financials were the key detractors.

Our core fixed-income strategy led its benchmark during the second quarter as non-government fixed-income sectors mostly outperformed comparable U.S. Treasurys. An overweight to the long end of the yield curve contributed as long-term yields declined. Within corporates, the strategy also benefited from overweights to financials and industrials; selection in the industrials energy sub-sector was particularly advantageous. An allocation to non-agency mortgage-backed securities (MBS) continued to contribute, while an overweight to asset-backed securities (ABS) also contributed. A higher-quality bias within commercial MBS (CMBS) detracted, but selection in those higher-quality tranches was strong. An overweight to agency MBS weighed on performance as

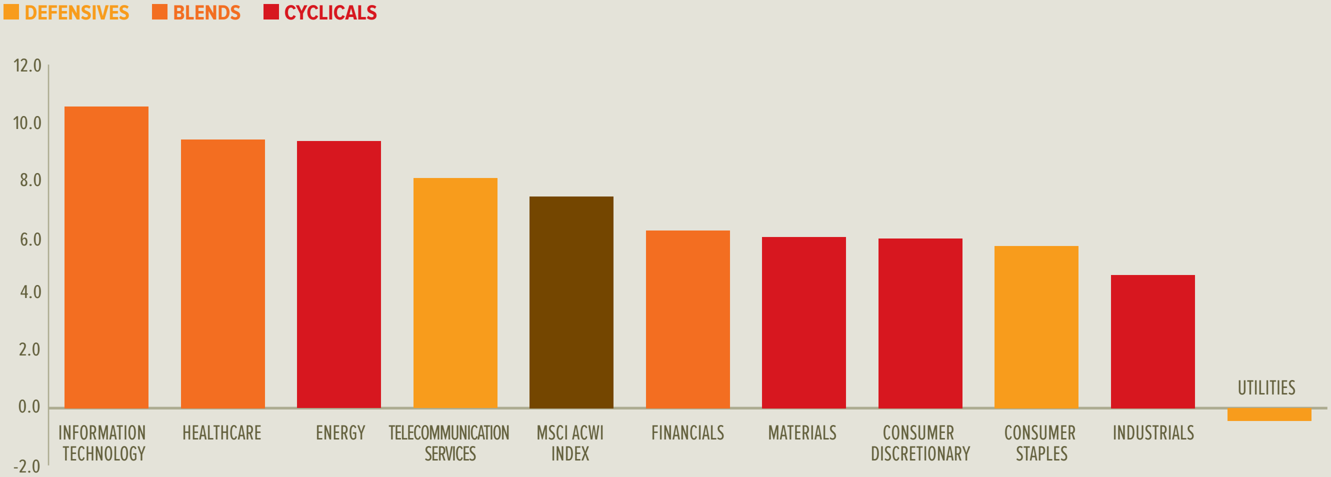
[1] Individual holdings will differ between strategies. Not representative of our passive strategies.

some Fed officials raised questions about whether the mortgage market needs ongoing central-bank support; an underweight to taxable municipal bonds also detracted. High-yield bonds continued to perform well during the quarter, and our high-yield strategy outperformed its benchmark. An allocation to collateralized loan obligations (CLOs) was the top contributor, followed by selection in energy and healthcare. Selection in financials detracted the most, while selection in transportation and an underweight to and selection in consumer goods also hurt relative performance. Emerging-market debt (EMD) had a strong second quarter as well, and our EMD strategy outperformed its blended benchmark. Significant contributors included an overweight to local-currency debt and an underweight to foreign-currency debt. At the country level, an overweight to Mexico and off-benchmark allocations to Ukraine and Egypt were the top contributors, while underweights to China and Philippines were the biggest detractors.

## Manager Positioning and Opportunities

Our U.S. large-cap strategies continued to overweight value stocks given their unusually wide valuation discount relative to growth stocks. At the sector level, our largest active positions were an overweight to financials and an underweight to communication services. Our small-cap strategies retained an overweight to value and slightly smaller overweight to stability-oriented stocks, and increased a small overweight to momentum during the second quarter. Our international developed-market equity strategy remained overweight technology with a concentration in growth areas despite bottom-up-driven reductions in this exposure. Utilities and real estate remained underweight given their elevated valuations and limited growth opportunities; the strategy was also underweight financials in favor

Global Equity Sector Performance in Q2 2021 (Percent Return)




Sources: FactSet, Lipper. MSCI ACWI Index Components (as defined by SEI).

of increased exposures elsewhere, while an underweight to the energy sector shrank. Our emerging-market equity strategy remained overweight technology (growth prospects) and financials (selective exposure to high-quality insurers and banks in underpenetrated markets). Expensive valuations in internet-related companies drove underweights to the communication services and consumer discretionary sectors.

With long-term yields rising but still near historically low levels, our core fixed-income strategy has gradually adjusted its yield-curve posture—reducing an overweight to the 25-to-30-year segment of the yield curve, and increasing exposure in the 5-to-7-year segment. We added to an overweight in corporate financials after heavy bank issuance in April came to market at attractive levels. Overweights to ABS and CMBS remained (with an emphasis on higher-quality holdings) given competitive risk-adjusted yields. We maintained an allocation to non-agency MBS with an eye on the market's reaction to the expiration of mortgage forbearance and payment delay programs set to arrive in the coming months, while we moved to an underweight in agency MBS during the quarter as the Fed began to talk about the tapering of asset purchases. Our high-yield strategy's largest position remained an allocation to CLOs; we continue to view them as attractive, particularly given the high yields on lower-rated debt and equity tranches. Telecommunications and capital goods were the strategy's largest underweights. Our emerging-market debt strategy significantly increased its overweight to local-currency debt and its underweight to foreign-currency debt. Our most significant active country-level position was an underweight to Thailand, followed by overweights to Mexico and Korea. The greatest country-level changes during the second quarter were decreased underweights to Peru, Philippines and Colombia.

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## SEI's View

Equity markets have long anticipated the economic improvement we now are watching unfold. There is increasing concern, however, that equity prices have risen so much that there is little appreciation potential left, even if the global economy continues to forge ahead into 2022.

The last several weeks have witnessed a partial unwinding of the rotation trade that began last autumn. So far, this appears to us as a temporary pause in a longer-term upswing. The global recovery and expansion have a long way to go, especially since many countries are still imposing lockdown measures to varying degrees.

We can't rule out a choppier and more lackluster performance for U.S. equities in the months ahead given their strong outperformance since March 2009 and elevated stock-market valuations relative to much of the rest of the world. We don't think there's reason to be overly concerned if stock-market volatility increases; corrections that range from 5% to 10% can occur without any fundamental reason.

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In today's environment, with economies opening up and interest rates still at extraordinarily low levels, we believe the dominant trend favors further price gains over the next year or two. Still, investors must take into account that the U.S. economy appears to have reached "peak growth."

Growth slowdowns, not just recessions, can lead to equity underperformance versus bonds. The relative performance of equites versus bonds was phenomenal over the past 15 months; we believe a major narrowing of the performance gap is inevitable. Yet, with interest rates still at exceptionally low levels, it is hard to see equities losing ground to fixed-income securities while economic growth remains so robust. Not only should consumer demand remain strong as the economy opens up, but businesses, too, are in a spending mood, desperately seeking materials and workers.

In the meantime, companies are expected to enjoy a great deal of pricing power and will almost certainly pass along at least a portion of their increased costs to customers. Unfortunately, one person's pricing power is another person's inflation. The big question is whether the price pressures seen this year are transitory, as central bankers around the world say they are.

Investors in the bond market seem to agree with the central bankers. Although U.S. bond yields rose sharply in the first quarter, they have fallen over the past three months. There's no telling how long bond investors will maintain such a calm perspective if prices keep rising at a pace that has not been seen in almost 30 years.

In his latest testimony, Federal Reserve (Fed) Chairman Jerome Powell reiterated that the U.S. labor market still has a long way to go before it reaches full employment. Job openings in the country are now soaring. If the rise in the Employment Cost Index accelerates as we expect, inflation could become a greater concern for investors than appears to be the case at the moment.

Markets reacted negatively to a surprising extent when the central bank revealed the FOMC's updated "dot plot" of federal-funds rate projections on June 16. The median FOMC forecast now calls for two rate hikes in 2023, which was exactly what futures traders had already priced in. Those same traders have now priced in three rate hikes by the end of 2023, but a lot can happen between now and then.

The recent stumble in the rotation theme was exacerbated by the shift in Fed expectations. It is clear, however, that the U.S. central bank will be cautiously moving away from its current policy stance. The first move will likely be the tapering of its bond-buying program which may be announced in late August at the annual Jackson Hole conference, with actual tapering beginning in the first quarter of 2022 (at the earliest).

The path of U.S. fiscal policy is harder to decipher given strained bipartisanship and the narrowness of the Democratic majority in the Congress. A traditional infrastructure bill is a good bet, but the push for non-traditional forms of infrastructure—and the taxes to pay for all the added spending—will depend on whether the Democrats in the Senate can come to terms with each other.

We believe the combination of (1) above-average economic growth, (2) significantly higher inflation than seen in the past decade, (3) a fiscal policy that expands the size of federal government spending, and (4) extreme monetary ease aimed at suppressing interest rates is the perfect backdrop for risk assets—and for the creation of speculative bubbles.

The relative success of the U.S. vaccination effort and the country's state-by-state response have resulted in a significantly stronger economy this year than in other major developed countries. Fortunately, vaccination rates are accelerating in Europe and Japan. We anticipate that other advanced economies will record strong economic results in the second half of the year and into 2022, exceeding the pace in the U.S.

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Although economists correctly point out that the U.S. has employed direct fiscal measures (emergency spending, income support and tax breaks) more aggressively than any other nation, other countries have used different tactics that far exceed the U.S. effort.

Several European nations and Japan have relied on equity injections, loans and guarantees. Italy (35% of GDP), Japan and Germany (both at 28%) are the most notable, according to the International Monetary Fund. In the eurozone, some of these loan commitments have only just begun to flow. Italy and Spain are big beneficiaries of the eurozone's €750 billion in loans and grants as part of the so-called NextGenerationEU program.

The ECB also seems dedicated to maintaining its pandemic-related monetary support at least through March 2022. As a percentage of GDP, the ECB's balance sheet has risen more than 25% since the beginning of the COVID-19 crisis, more than any other major central bank besides the BOJ (30%). The ECB's actions have succeeded in keeping peripheral Europe's sovereign bond yields well behaved through the crisis period.

While the U.S., the U.K. and Canada seem to be enduring a much sharper inflationary increase than Japan or the eurozone, the latter two are probably relieved to have a respite from the deflationary pressures that have been afflicting their economies for many years. There seems little reason for the ECB or BOJ to join the Fed when it comes to discussing a near-term reduction in asset purchases, much less raising their policy rates ahead of the U.S.

The trade-weighted U.S. dollar jumped to its highest level in three months against other major currencies in the days following the Fed's latest announcement, although the currency remains some 10% below its March 19, 2020 high. Since any serious policy move by the Fed is still rather far in the future, we continue to expect the U.S. dollar to weaken over time as the rest of the world gains economic strength.

In the meantime, we do not see much sign that the Fed's shift toward an earlier lift-off in rates is leading to a 2013-style "taper tantrum" among emerging economies. A strong U.S. dollar would certainly threaten the bull market in commodity prices.

We are still bullish on the outlook for commodities, but we are watching price trends carefully. Commodity prices of all types have enjoyed a spectacular run since March 2020 and were already in the process of consolidating or correcting in the weeks before the Fed revised its views.

We remain optimistic that the more cyclical and value-oriented areas within emerging markets will bounce back from their modest stumble in June. But there are near-term challenges besides the shift in perceptions about Fed policy and the future course of the U.S. dollar and commodity prices. Credit growth has decelerated significantly in China, similar to the slowdowns recorded in 2013 and 2018—years when the performance of emerging markets was less than stellar.

Another potential source of market volatility could stem from the increasingly fraught relationship between China and the U.S. and its allies. If there is any consensus in Washington nowadays, it is focused on countering China's growing economic and military strength; although market participants have mostly managed to look past political tensions to date.

Fundamentally, emerging markets continue to look relatively cheap versus most other regions. The forward price-to-earnings multiple of the MSCI Emerging Markets Index is still selling at a 36.5% discount to that of the MSCI USA Index. Outside the March-to-April 2020 low point, this is as cheap a relative multiple against the U.S. as seen at any time in the past 16 years.

We are counting on the advanced economies to take up the slack while vaccines ramp up in developing countries. There is a tremendous amount of excess savings and pent-up demand in North America and Europe. That said, as the northern hemisphere enters the autumn and winter, the possibility of regional spikes in COVID-19 cases cannot be dismissed. If severe enough, markets could switch back to a decidedly risk-off position.

As vaccination rates slow in the developed world, more shots will be available for the rest of the world. We expect a rolling reopening of the global economy that will extend well into 2022. This wave of recovery could resemble a prolonged up-cycle that keeps the pressure on supply chains, leading to continued shortages of goods and labor. Investor faith in the "transitory inflation" narrative probably will be tested as we head into year end and enter 2022.

## Glossary of Financial Terms

**Asset-backed securities:** Asset-backed securities are a type of securitized debt that are backed by loans, leases or credit card debt, but not mortgages. Securitized debt consists of a portfolio of assets, such as mortgages or bank loans, which have been grouped together and repackaged as individual securities.

**Bank of England's Monetary Policy Committee:** The Bank of England's Monetary Policy Committee is the committee of the Bank of England responsible for setting monetary policy.

**Bull market:** A bull market refers to a market environment in which prices are generally rising (or are expected to rise) and investor confidence is high.

**Collateralized loan obligations:** Collateralized loan obligations are a type of security that have been created by pooling together smaller high-yielding fixed income assets, such as bank loans. These pools are then packaged into various tranches according to credit quality, maturity, and other factors.

**Cyclical stocks:** Cyclical stocks or sectors are those whose performance is closely tied to the economic environment and business cycle. Managers with a pro-cyclical market view tend to favor stocks that are more sensitive to movements in the broad market and therefore tend to have more volatile performance.

**Emerging-market debt:** Emerging-market debt is securitized debt issued in emerging markets.

**Federal funds rate:** The Federal funds rate is the interest rate at which a depository institution lends immediately available funds (balances at the Federal Reserve) to another depository institution overnight in the U.S.

**Fiscal policy:** Fiscal policy relates to decisions about government revenues and outlays, like taxation and economic stimulus.

**Fiscal stimulus:** Fiscal stimulus refers to government spending intended to provide economic support.

**Forward price-to-earnings (PE) ratio:** The forward PE ratio is equal to the market capitalization of a share or index divided by forecasted earnings over the next 12 months. The higher the PE ratio, the more the market is willing to pay for each dollar of annual earnings.

**International Monetary Fund (IMF):** The International Monetary Fund promotes international financial stability and monetary cooperation. It also facilitates international trade, promotes employment and sustainable economic growth, and helps to reduce global poverty. The IMF is governed by and accountable to its 190 member countries.

**Inflation-Protected Securities:** Inflation-protected securities are typically indexed to an inflationary gauge to protect investors from the decline in the purchasing power of their money. The principal value of an inflation-protected security typically rises as inflation rises, while the interest payment varies with the adjusted principal value of the bond. The principal amount is typically protected so that investors do not risk receiving less than the originally invested principal.

**Jobseeker's Allowance:** Jobseeker's Allowance is an unemployment benefit paid by the government of the United Kingdom to people who are unemployed and actively seeking work.

**Monetary policy:** Monetary policy relates to decisions by central banks to influence the amount of money and credit in the economy by managing the level of benchmark interest rates and the purchase or sale of securities. Central banks typically make policy decisions based on their mandates to target specific levels or ranges for inflation and employment.

**Mortgage-Backed Securities:** Mortgage-Backed Securities (MBS) are pools of mortgage loans packaged together and sold to the public. They are usually structured in tranches that vary by risk and expected return.

**NextGenerationEU:** NextGenerationEU is an economic recovery fund established by the EU and totaling more than €800 billion projected to be spent between 2021 and 2027. The centerpiece of the programme is a €723.8 billion facility for loans and grants to EU countries for investments.

**Pandemic Emergency Purchase Programme (PEPP):** PEPP is a temporary asset purchase programme of private and public sector securities established by the ECB to counter the risks to monetary policy transmission and the outlook for the euro area posed by the COVID-19 outbreak.

**Purchasing managers' index (PMI) survey:** A PMI survey is compiled from responses to questionnaires sent to a panel of purchasing managers working, for example, in the manufacturing and business services sectors. PMI surveys are most often referencing reports by IHS Markit, and the Institute for Supply Management produces PMI surveys for the U.S. as well.

**Quantitative easing:** Quantitative easing refers to expansionary efforts by central banks to help increase the supply of money in the economy.

**Summary of Economic Projections:** The Fed's Summary of Economic Projections (SEP) is based on economic projections collected from each member of the Fed Board of Governors and each Fed Bank president on a quarterly basis.

**Taper tantrum:** Taper tantrum describes the 2013 surge in U.S. Treasury yields, resulting from the U.S. Federal Reserve's announcement of future tapering of its policy of quantitative easing.

**Transitory inflation:** Transitory inflation refers to a temporary increase in the rate of inflation.

**Yield:** Yield is a general term for the expected return, in percentage or basis points (one basis point is 0.01%), of a fixed-income investment.

**Yield curve:** The yield curve represents differences in yields across a range of maturities of bonds of the same issuer or credit rating (likelihood of default). A steeper yield curve represents a greater difference between the yields. A flatter curve indicates the yields are closer together.

## Index and Benchmark Descriptions

**All indexes are quoted in gross performance unless otherwise indicated.**

**The Bloomberg Barclays 1-10 Year US TIPS Index** measures the performance of inflation-protected public obligations of the U.S. Treasury that have a remaining maturity of 1 to 10 years.

**The Bloomberg Barclays US Asset Backed Securities (ABS) Index** measures the performance of ABS with the following collateral types: credit and charge card, auto and utility loans. All securities have an average life of at least one year.

**The Bloomberg Barclays Global Aggregate Index** is an unmanaged market-capitalization-weighted benchmark, tracks the performance of investment-grade fixed-income securities denominated in 13 currencies. The Index reflects reinvestment of all distributions and changes in market prices.

**The Bloomberg Barclays Global Aggregate ex-Treasury Index** is an unmanaged market index representative of the total-return performance of ex-Treasury major world bond markets.

**The Bloomberg Barclays Global Treasury Index** is composed of those securities included in the Bloomberg Barclays Global Aggregate Bond Index that are Treasury securities.

**The Bloomberg Barclays US Corporate Bond Index** is a broad-based benchmark that measures the investment-grade, fixed-rate, taxable corporate bond market.

**The Bloomberg Barclays US Mortgage Backed Securities (MBS) Index** measures the performance of investment-grade, fixed-rate, mortgage-backed, pass-through securities of Government National Mortgage Association (GNMA), Federal National Mortgage Association (FNMA) and Freddie Mac (FHLMC).

**The Bloomberg Barclays US Treasury Index** is an unmanaged index composed of U.S. Treasurys.

**The Bloomberg Commodity Index** is composed of futures contracts and reflects the returns on a fully collateralized investment in the Index. This combines the returns of the Index with the returns on cash collateral invested in 13-week (3-month) U.S. Treasury bills.

**The Employment Cost Index** is a quarterly economic series published by the U.S. Bureau of Labor Statistics that details the growth of total employee compensation. The index tracks movement in the cost of labor, as measured by wages and benefits, at all levels of a company.

**The ICE BofA U.S. High Yield Constrained Index** contains all securities in The ICE BofA U.S. High Yield Index but caps exposure to individual issuers at 2%.

**The ICE BofA U.S. High Yield Index** tracks the performance of below-investment-grade, U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

**The Chicago Board Options Exchange Volatility Index (VIX)** tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

**CBOE Volatility Index (VIX Index):** The VIX Index tracks the expected volatility in the S&P 500 Index over the next 30 days. A higher number indicates greater volatility.

**The Dow Jones Industrial Average** is a widely followed market indicator based on a price-weighted average of 30 blue-chip New York Stock Exchange stocks that are selected by editors of *The Wall Street Journal*.

**The FTSE All-Share Index** represents 98% to 99% of U.K. equity market capitalization. The Index aggregates the FTSE 100, FTSE 250 and FTSE Small Cap Indexes.

**The JPMorgan EMBI Global Diversified Index** tracks the performance of external debt instruments (including U.S. dollar-denominated and other external-currency-denominated Brady bonds, loans, eurobonds and local-market instruments) in the emerging markets.

**JPMorgan GBI-EM Global Diversified Index** tracks the performance of debt instruments issued in domestic currencies by emerging-market governments.

**The MSCI ACWI Index** is a market-capitalization-weighted index composed of over 2,000 companies, representing the market structure of 48 developed- and emerging-market countries in North and South America, Europe, Africa and the Pacific Rim. The Index is calculated with net dividends reinvested in U.S. dollars.

**The MSCI ACWI ex-USA Index** includes both developed- and emerging-market countries, excluding the U.S.

**The MSCI Emerging Markets Index** is a free float-adjusted market-capitalization-weighted index designed to measure the performance of global emerging-market equities.

**The MSCI Emerging Markets Latin America Index** captures large- and mid-cap representation across five emerging-market countries in Latin America.

**The MSCI EMU (European Economic and Monetary Union) Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of countries within EMU. The Index consists of the following 10 developed-market country indexes: Austria, Belgium, Finland, France, Germany, Ireland, Italy, Netherlands, Portugal and Spain.

**The MSCI Europe ex-UK Index** is a free float-adjusted market-capitalization-weighted index that captures large- and mid-cap representation across developed-market countries in Europe excluding the UK.

**The MSCI Frontier Emerging Markets Index** is a free float-adjusted market capitalization index designed to serve as a benchmark covering all countries from the MSCI Frontier Markets Index and the lower size spectrum of the MSCI Emerging Markets Index.

**The MSCI Pacific ex Japan Index** captures large- and mid-cap representation across four of five developed-market countries in the Pacific region (excluding Japan).

**The MSCI Japan Index** is designed to measure the performance of the large- and mid-capitalization stocks in Japan.

**MSCI United Kingdom Index** is designed to measure the performance of the large- and mid-cap segments of the U.K. market.

**The U.S. Dollar Index** measures the value of the U.S. dollar relative to a basket of foreign U.S. trade-partner currencies.

**MSCI USA Index** is designed to measure the performance of the large- and mid-cap segments of the U.S. market.

**The MSCI World Index** is a free float-adjusted market-capitalization-weighted index designed to measure the equity market performance of developed markets. The Index consists of the following 23 developed-market country indexes: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Hong Kong, Ireland, Israel, Italy, Japan, Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland, the U.K. and the U.S.

**The MSCI World ex-USA Index** is a free float-adjusted market-capitalization-weighted index that is designed to measure the equity market performance of developed markets, excluding the U.S.

**The NASDAQ Composite Index** is a market-value-weighted index of all common stocks listed on the National Association of Securities Dealers Automated Quotations (NASDAQ) system.

**Russell 1000 Growth Index** measures the performance of the large-cap growth segment of the U.S. equity universe. It includes those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

**The Russell 2000 Growth Index** measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 Index companies with higher price-to-value ratios and higher forecasted growth values.

**The Russell 1000 Value Index** measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 Index companies with lower price-to-book ratios and lower expected growth values.

**The Russell 2000 Value Index** measures the performance of small-cap value segment of the U.S. equity universe. It includes those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

**The Shenzhen Stock Exchange Composite Index** tracks performance of A share stocks (which are denominated in renminbi, the local currency) and B share stocks (which are denominated in Hong Kong dollars, an offshore currency) on China's Shenzhen Stock Exchange.

**The S&P 500 Index** is a market-capitalization-weighted index that consists of 500 publicly-traded large U.S. companies that are considered representative of the broad U.S. stock market.

**The TOPIX, also known as the Tokyo Stock Price Index,** is a capitalization-weighted index of all companies listed on the First Section of the Tokyo Stock Exchange. The Index is supplemented by the subindexes of the 33 industry sectors. The Index calculation excludes temporary issues and preferred stocks, and has a base value of 100 as of January 4, 1968.

## Corresponding Indexes for Fixed-Income Performance Exhibit

| | |
|---|---|
| U.S. High Yield | ICE BofA U.S. High Yield Constrained Index |
| Global Sovereigns | Bloomberg Barclays Global Treasury Index |
| Global Non-Government | Bloomberg Barclays Global Aggregate ex-Treasury Index |
| Emerging Markets (Local) | JPMorgan GBI-EM Global Diversified Index |
| Emerging Markets (External) | JPMorgan EMBI Global Diversified Index |
| U.S. Mortgage-Backed Securities (MBS) | Bloomberg Barclays US Mortgage Backed Securities Index |
| U.S. Asset-Backed Securities (ABS) | Bloomberg Barclays US Asset Backed Securities Index |
| U.S. Treasurys | Bloomberg Barclays US Treasury Index |
| U.S. Treasury Inflation-Protected Securities (TIPS) | Bloomberg Barclays 1-10 Year US TIPS Index |
| U.S. Investment-Grade Corporates | Bloomberg Barclays US Corporate Bond Index |

## Corresponding Indexes for Regional Equity Performance Exhibit

| | |
|---|---|
| United States | S&P 500 Index |
| United Kingdom | FTSE All-Share Index |
| Pacific ex Japan | MSCI Pacific ex Japan Index (Net) |
| Japan | TOPIX, also known as the Tokyo Stock Price Index |
| Europe ex U.K. | MSCI Europe ex UK Index (Net) |
| EM Latin America | MSCI Emerging Markets Latin America Index (Net) |

## Disclosures

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*There are risks involved with investing, including loss of principal. International investments may involve risk of capital loss from unfavorable fluctuation in currency values, from differences in generally accepted accounting principles or from economic or political instability in other nations. Emerging markets involve heightened risks related to the same factors as well as increased volatility and lower trading volume. Narrowly focused investments and smaller companies typically exhibit higher volatility. Bonds and bond funds will decrease in value as interest rates rise. High-yield bonds involve greater risks of default or downgrade and are more volatile than investment-grade securities, due to the speculative nature of their investments.*

*Diversification may not protect against market risk. Past performance does not guarantee future results. Index returns are for illustrative purposes only and do not represent actual portfolio performance. Index returns do not reflect any management fees, transaction costs or expenses. One cannot invest directly in an index.*

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