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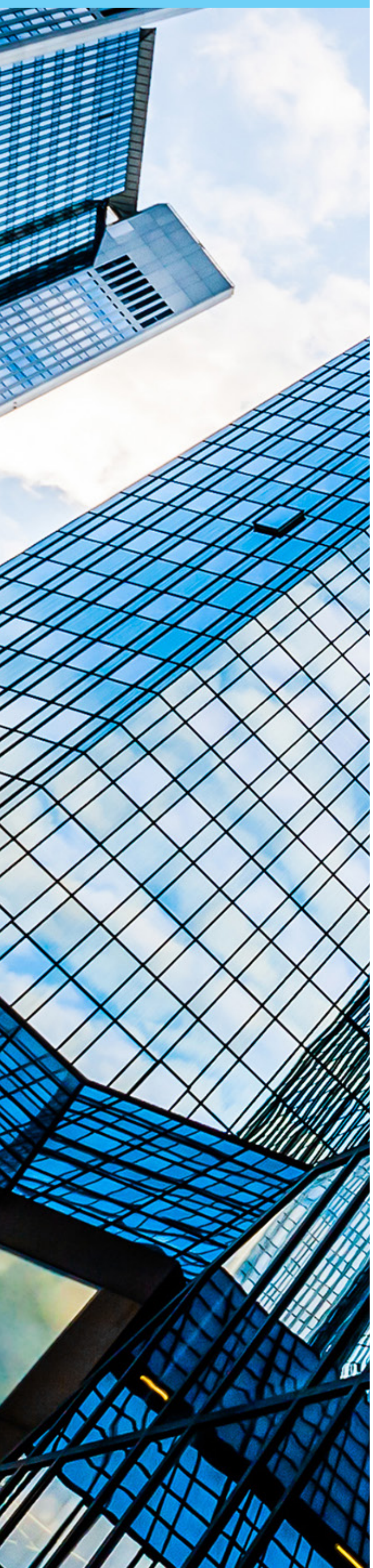

NEPC 2022 ASSET ALLOCATION LETTER

The Case for Curing Investment Amnesia

By NEPC Research

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Just as it is hard to remember our way of life before the pandemic, it may be difficult for investors to recall a time when market pricing was determined by fundamentals – instead of being bolstered by extraordinary support put in place by monetary and fiscal interventions.

Investors may need to shake off their amnesia as we appear to be at economic crossroads. Surging growth and an uptick in inflation may force policymakers to finally cede control to market forces. This restoration of the natural order has the potential to disrupt pricing, asset allocation and risk-taking for long-term investors, especially if inflation is persistently higher. We believe even amid this uncertainty, there is a way forward for portfolios to fulfil their objectives over the long run. Their success hinges on these basic but unforgettable principles of investing: vigilance, rebalancing and diversification.

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It is easy to forget a past way of life—not just pre-COVID—but further back, to a time before central banks and federal governments were the dominant forces driving capital markets. They entered the markets in 2008 with unprecedented infusions of liquidity to piece back the shards of the global economy shattered by the financial crisis. Subsequently, with interest rates at rock bottom, the Federal Reserve and its peers turned to expanding their balance sheets, so the spigot of easy money stayed on, to encourage markets during a period of muted growth and disinflation.

This support emboldened investors to take on greater risk and pushed stocks to newer highs, while overriding the investment impact of growth and inflation on assets. These policies also underscored the increasing willingness of central banks and federal governments to step in to boost investor sentiment, forming the underpinnings of our key market theme of *permanent interventions* in 2019.

These monetary and fiscal interventions took center stage in 2020 as the COVID-19 pandemic shuttered economies. As a result of these infusions, economic growth outpaced pre-pandemic levels and U.S. stocks surged in 2021. Unfortunately, so did inflation.

At this point, we believe the economy is at a crossroads: market forces may finally assume control from policymakers, but the path for this handoff is unclear. For instance, a road characterized by higher levels of growth and modestly higher inflation—reminiscent of the 1990s—would lead to an economy robust enough to wean itself off policy support with interest rates normalizing over time. For equities, the resetting of valuations to reflect higher discount rates may eclipse earnings growth; bonds too would feel pain amid rising rates.

A harsher exercise in remembering would be the path last traveled in the 1970s: entrenched inflation. Aside from repricing, markets would have to absorb rounds of monetary policy tightening. In addition to higher rates for bonds and lower equity valuations, a weaker dollar could deal a further blow to U.S. assets.

In these instances, moderately higher inflation (lower than current readings but higher than the muted inflation of the last 10 years) or sustained higher inflation (current levels or above) could strain equities—which usually serve as reasonable long-term hedges to inflation—for extended periods of time.

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We recommend investors evaluate their sensitivity to an uptick in inflation and consider the durability of their portfolios in the event of prolonged higher inflation. While the strategic posture on iAnflation sensitivity should not change based on recent higher CPI prints, reassessing objectives may be in order. Investors may consider building exposure to asset classes with characteristics like pricing power, floating-rate cash flows, shorter durations and reasonable starting valuations.

To be sure, going down memory lane may prove to be a futile exercise for investors if the path ahead signifies a return to secular stagnation. This would likely extend policy support, leaving rates, growth and inflation low. On this road, fund-amental pricing would take a backseat to policy and liquidity, favoring assets receiving the most backing.

THE ROADMAP

At NEPC, we believe the prudent way to deal with uncertainty is to rely on timeless principles of investing that remain the gateway to successful investment outcomes over the long term. These include:

1. **VIGILANCE**: Central bank liquidity and fiscal support have driven markets to new highs. It is vital to remember that these interventions cannot continue indefinitely. The forces that dominate one decade often lag the next. Be mindful of your investment biases and stay open to the potential of a shift in market dynamics. In this context, we recommend investors add or increase exposure to value stocks in equity portfolios, after the dominant run of growth stocks.

2. **DIVERSIFICATION**: It would be easy to capitulate after more than a decade of dominance from U.S. equities, but the crossroads at which we stand suggest a higher likelihood of outcomes less favorable to stocks and the United States (though it is certainly possible that U.S. equities continue to stay ahead in the near term). While equity exposure is almost always part of a well-diversified strategy, having other parts of the portfolio that can withstand different investment environments is sound and prudent.

3. **REBALANCING**: Buy low and sell high, and move back to long-term targets and neutral risk positions. Investors would do well to jog their memory and recall history teaching us the importance of rebalancing as a successful long-term investment strategy.

We urge investors to consider the reemergence of growth and inflation as significant influences on market pricing. We ask you to remember a time when market fundamentals weren't governed by monetary and fiscal interventions. Standing at these crossroads, we acknowledge the extended dominance of US stocks, while also recognizing the potential for a tougher road ahead. We believe there are still ways to meet your long-term investment objectives and we look forward to helping you achieve them.

IMPORTANT DISCLOSURES

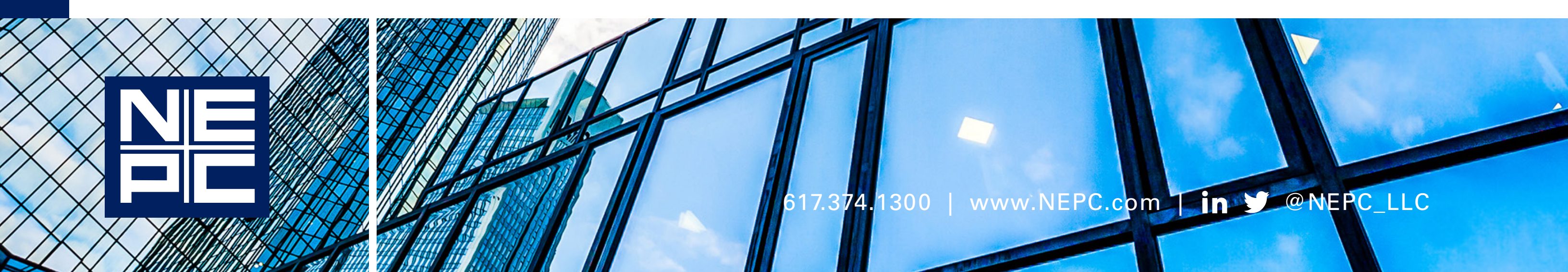
Past performance is no guarantee of future results.

All investments carry some level of risk. Diversification and other asset allocation techniques do not ensure profit or protect against losses.

This memo should not be considered customized investment advice. Please contact NEPC for advice specific to your investment program.

The information in this report has been obtained from sources NEPC believes to be reliable. While NEPC has exercised reasonable professional care in preparing this report, we cannot guarantee the accuracy of all source information contained within.

The opinions presented herein represent the good faith views of NEPC as of the date of this report and are subject to change at any time.



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