OPUS INVESTMENT MANAGEMENT

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Quarterly Commentary

September 30, 2021

Executive Summary

ANN TRIPP
President

MARKET COMMENTARY

Risk markets continued to rally throughout the third quarter, with the S&P 500 enjoying 12 all-time high closing prices in the month of August alone. However, a mounting number of headwinds are threatening to slow the post-pandemic recovery as we head into the final quarter of 2021. Concern around these headwinds resulted in a small equity market correction during September. The S&P 500, which had returned 5.49% in the first two months of the quarter, gave almost all of it back in September, finishing with a modest 0.58% return. Fixed income investors saw yields on U.S. Treasuries decline to near recent low levels in early August, only to entirely reverse in September, ending the with the 10-year at 1.49%, slightly above where we started the quarter. The result was only a 0.05% return for the Bloomberg U.S. Aggregate Bond Index during the quarter, and a year-to-date return of -1.55%.

Markets interpreted the results of the September Federal Reserve's Open Market Committee (FOMC) meeting as slightly more hawkish than expected because it brought forward the potential timing of the first hike of the overnight target rate to 2022 from 2023. The update also included the first glimpse into 2024 policy expectations, with the overnight target rate projected to rise to 1.75%. Chairman Powell also continued his messaging that the amount of U.S. Treasuries and MBS purchased by the FOMC will begin to slow later this year, with purchases concluding in mid-2022. Finally, the markets were also caught off guard by the Bank of England's (BOE) announcement that two of nine central bankers had voted to end quantitative easing in England. Indications that the FOMC and BOE may be shifting their policies resulted in rising U.S. Treasury rates, with the 10-year yield increasing 25 basis points in the days following both meetings. Although FOMC messaging has continued to state that inflation will be transitory in nature, the shift in expectations of the first rate hike begs the question of whether the FOMC governors are comfortable with their preferred inflation measure at its current level of 3.4%

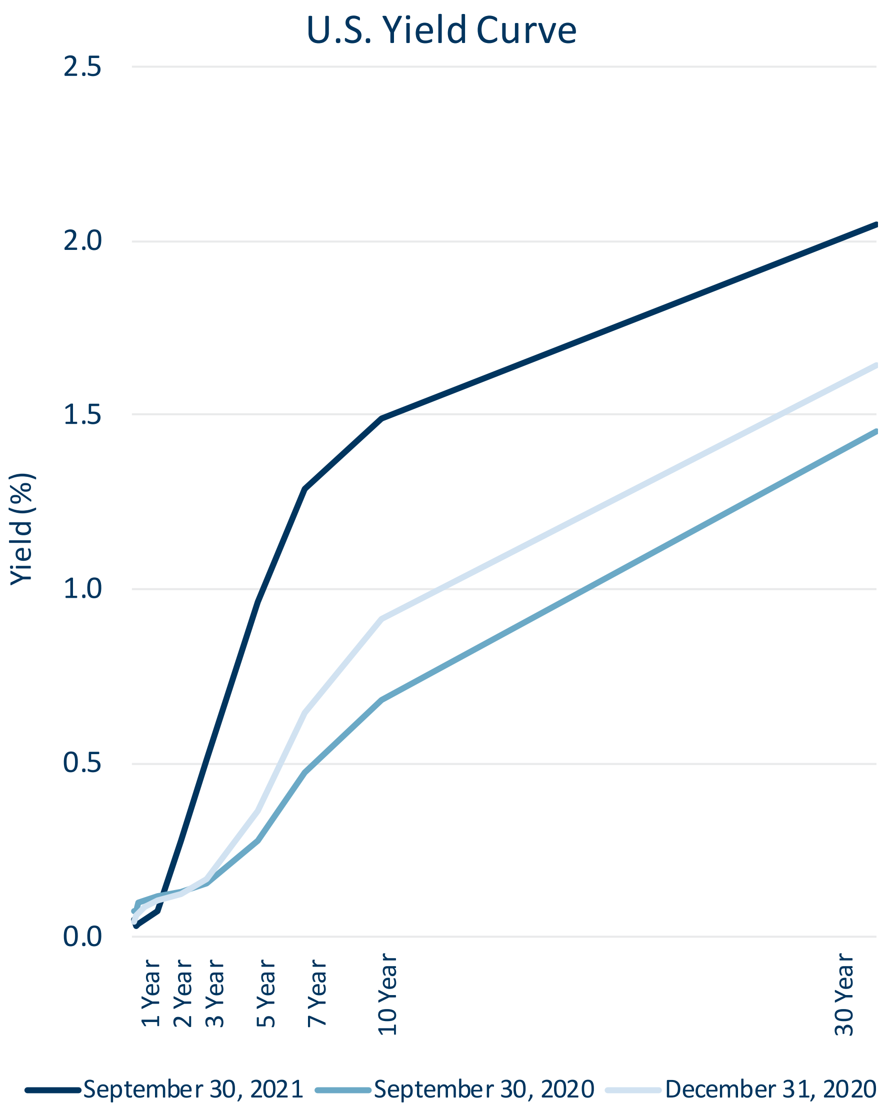
Investors are also contending with a stalemate in Congress that is threatening the passage of the bipartisan infrastructure bill and the $3.5 trillion spending resolution. Political gridlock has often brought about agreements on budgetary items at the last minute, as was the case with the short-term spending bill to fund the government through November temporarily avoiding a federal government shutdown. However, the funding agreement did not include a debt limit suspension, but a short-term agreement appears to be imminent, allowing the U.S. to avoid a technical default on October 18th per Treasury Secretary Yellen but setting up another deadline in December

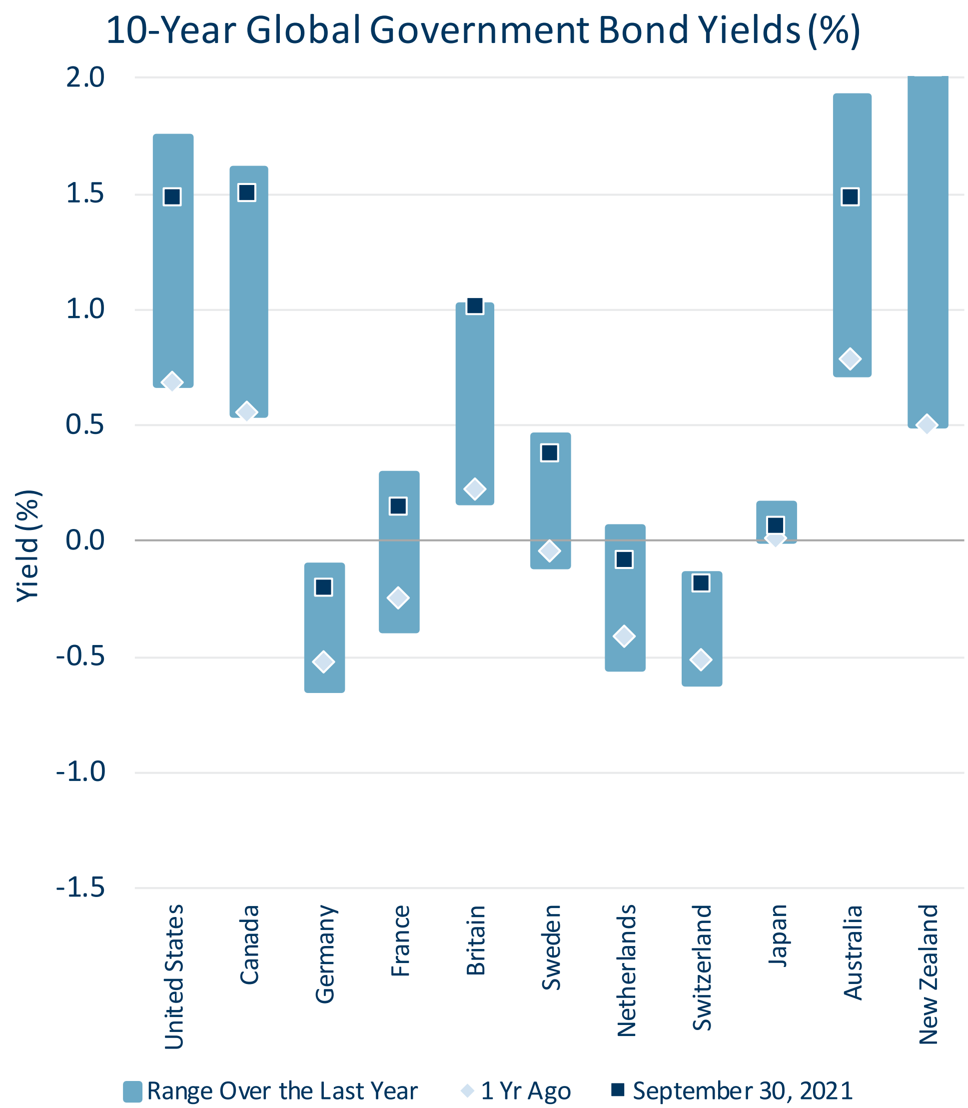
Despite the aforementioned headwinds, fixed income valuations continue to be priced for perfection, due in large part to the robust economic recovery, additional fiscal stimulus, and monetary policy. However, with each of these showing signs of slowing or transitioning, we are focused on creating portfolios biased towards fundamental financial strength, capital preservation and liquidity.

Ann

Economic Outlook

Sovereign yields below one-year highs even as global growth and inflation expectations increase

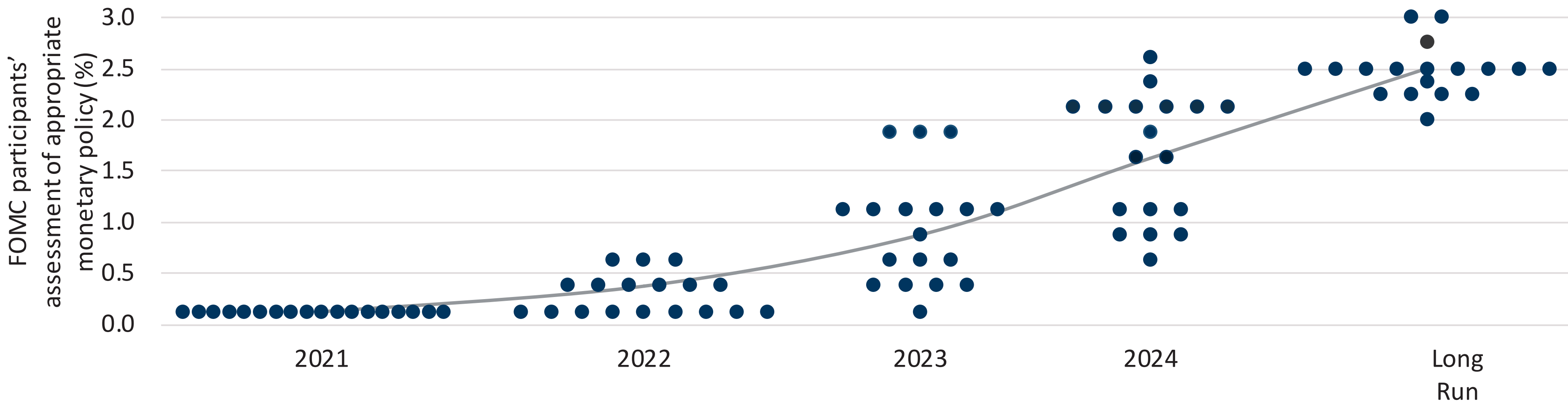


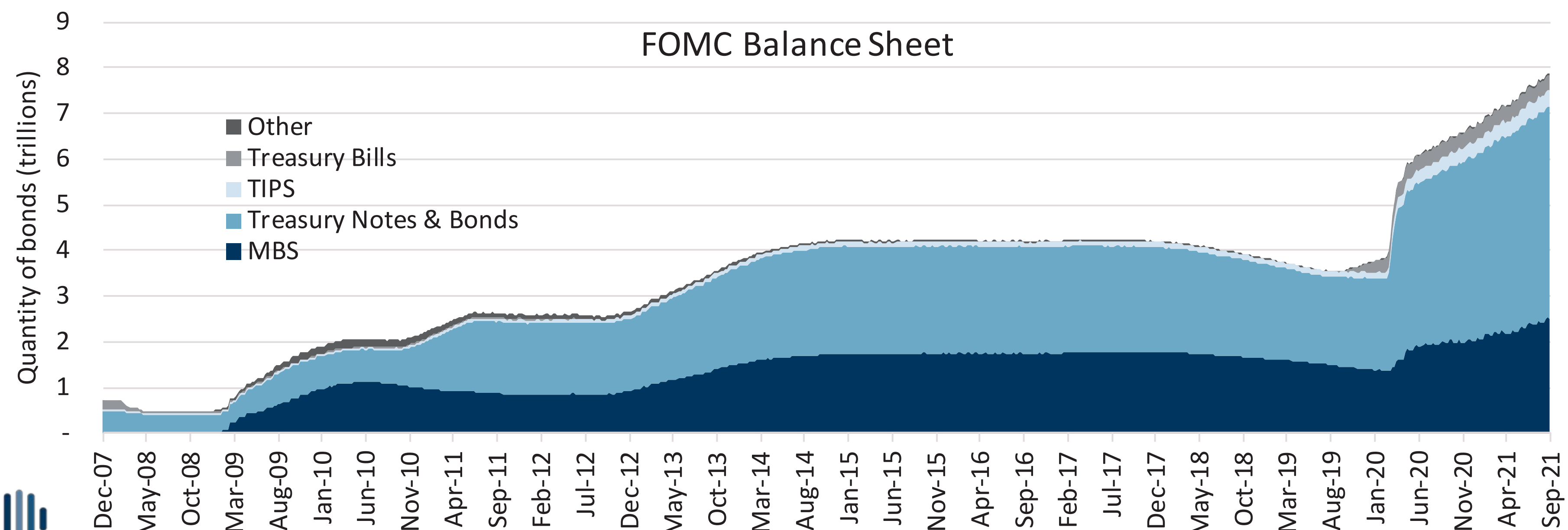


Source: Opus, Bloomberg

Economic Outlook

Federal Reserve "Dot Plot" shifts first potential rate hike to 2022; however, tapering of monthly securities purchases to begin first

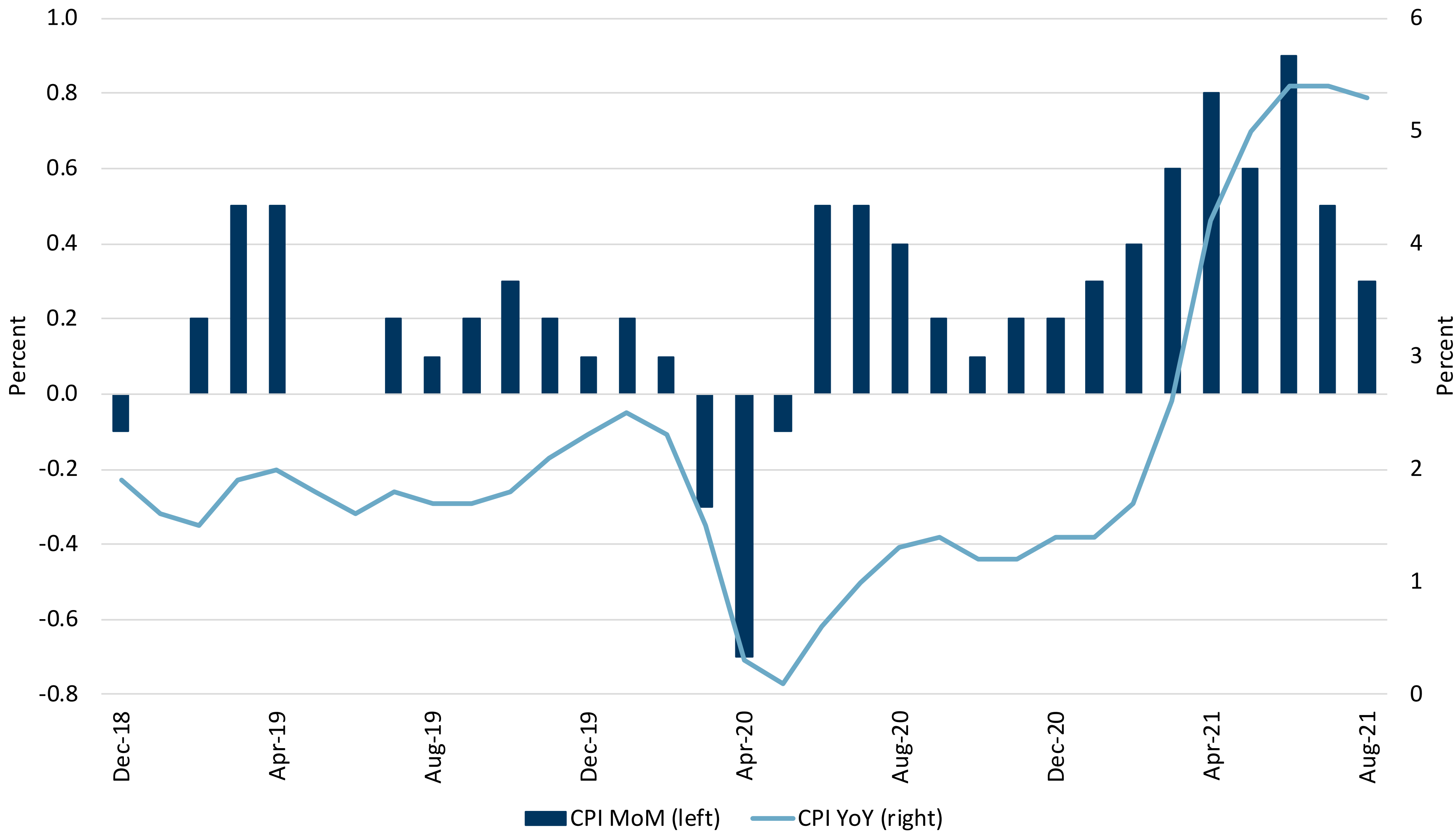




Source:: Opus, Bloomberg, Federal Reserve

Economic Outlook

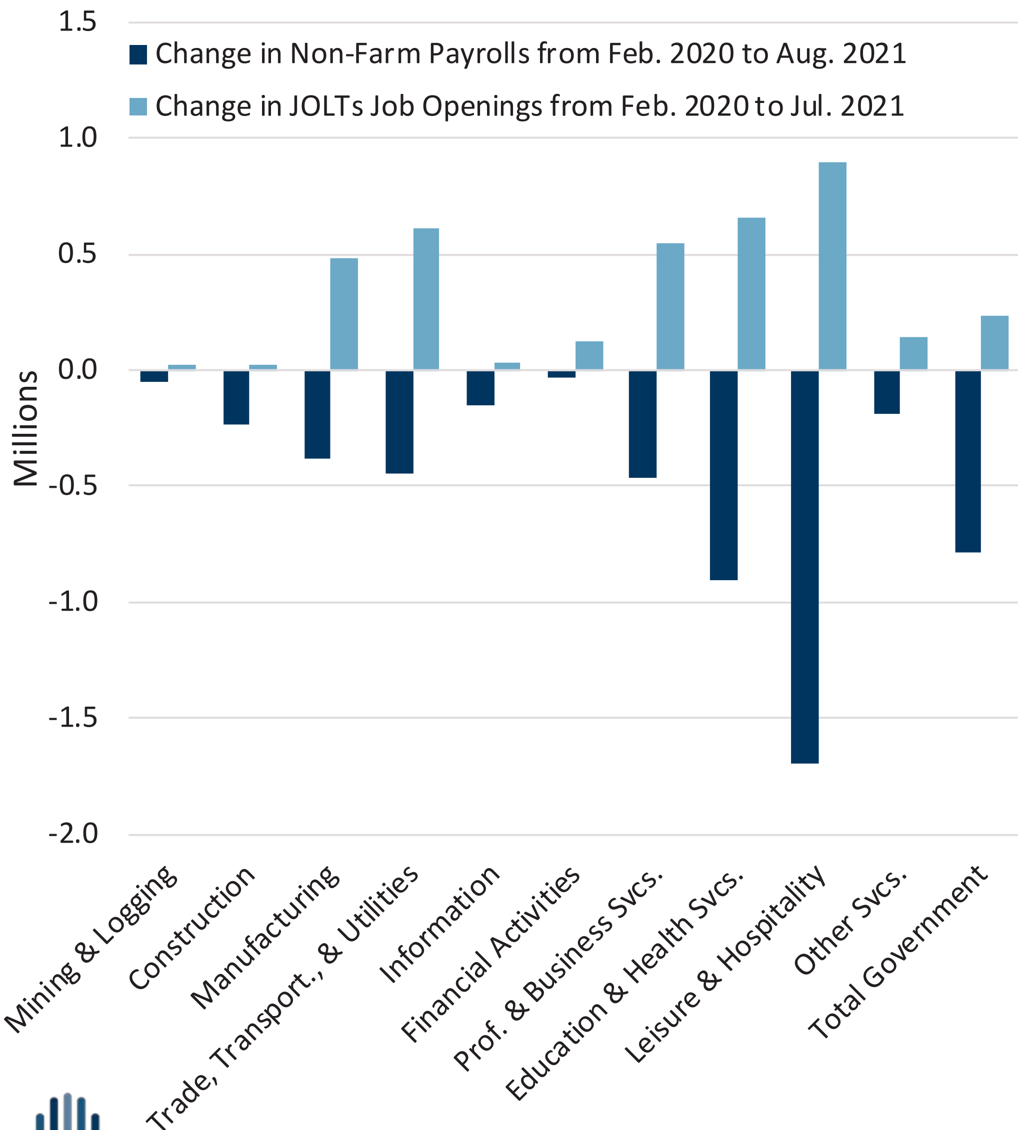
Supply chain issues and tight inventory combined with pent-up demand have influenced inflation

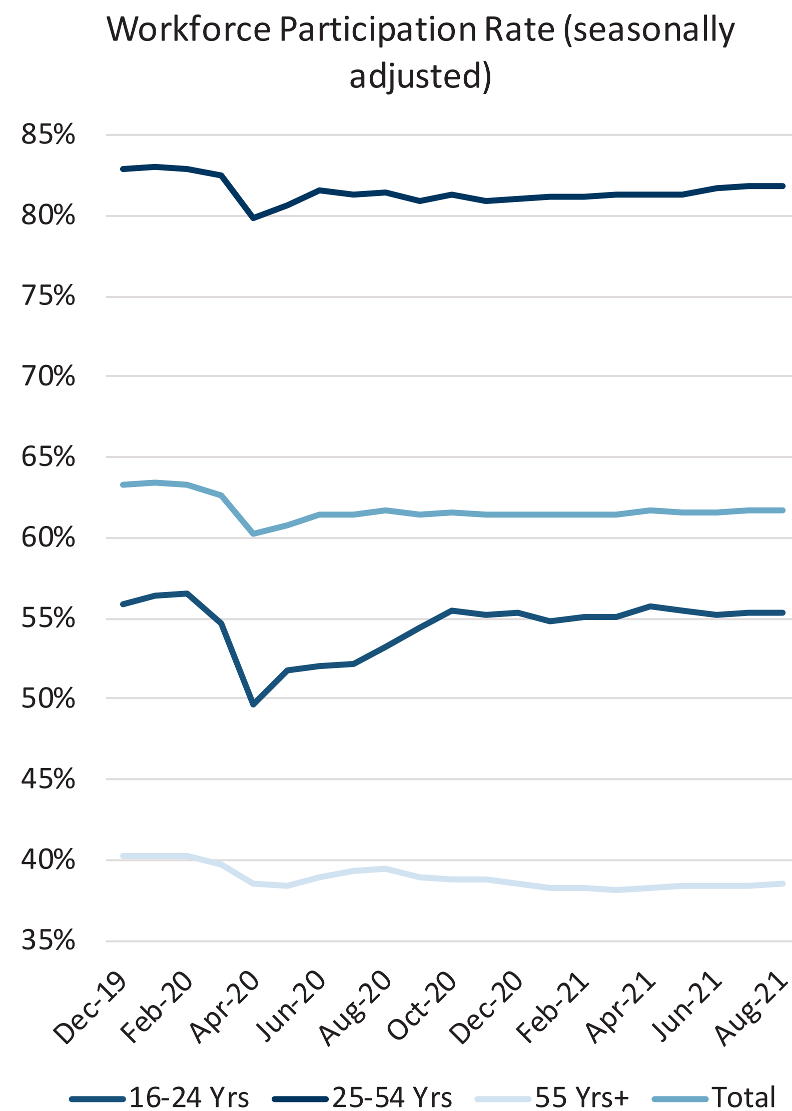


Source: Opus, Bloomberg, Bureau of Labor Statistics

Economic Outlook

Workers slow to return following the pandemic, creating new challenges for employers





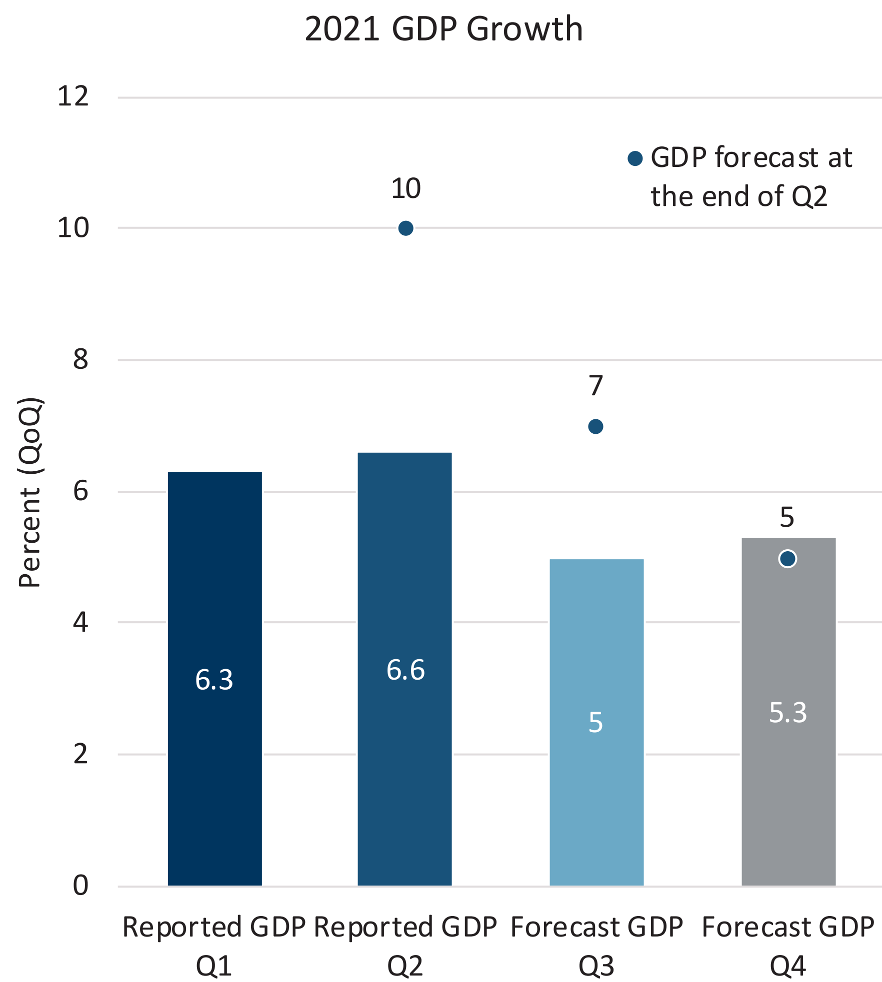
Source: Opus, Bloomberg, Bureau of Labor Statistics

Economic Outlook

While GDP growth remains strong relative to historical averages, forecasts have declined due to pressure related to supply chain constraints and increased concern over the Delta variant

(YoY%)	2020	2021	2022	2023
Real GDP	-3.4	5.9	4.2	2.4
Consumer Spending	-3.8	7.9	3.7	2.3
Government Spending	2.5	1.0	1.7	1.5
Private Investment	-5.5	8.7	6.8	3.3
Exports	-13.6	4.7	5.8	5.0
Imports	-8.9	13.2	4.9	4.1

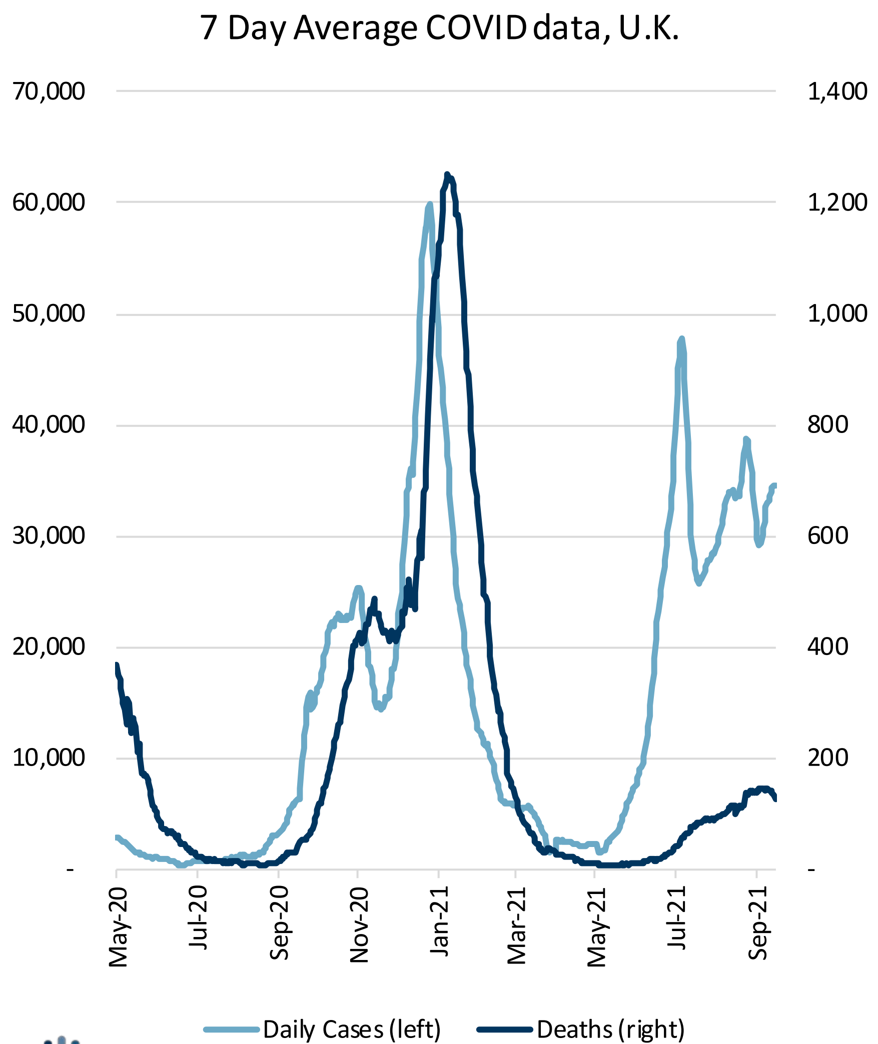
Bloomberg Consensus growth outlook

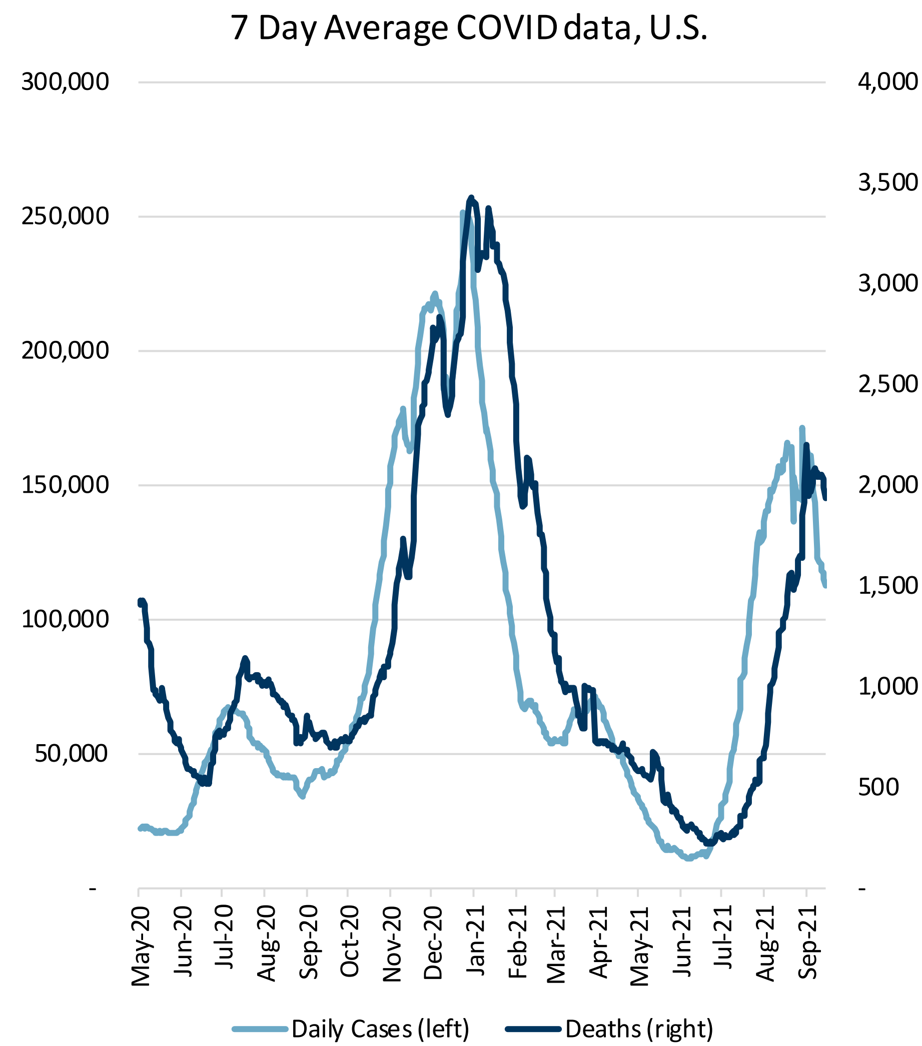


Source: Opus, Bloomberg, Bureau of Economic Analysis

Economic Outlook

Rise in Delta variant impacting consumer behavior and economic activity

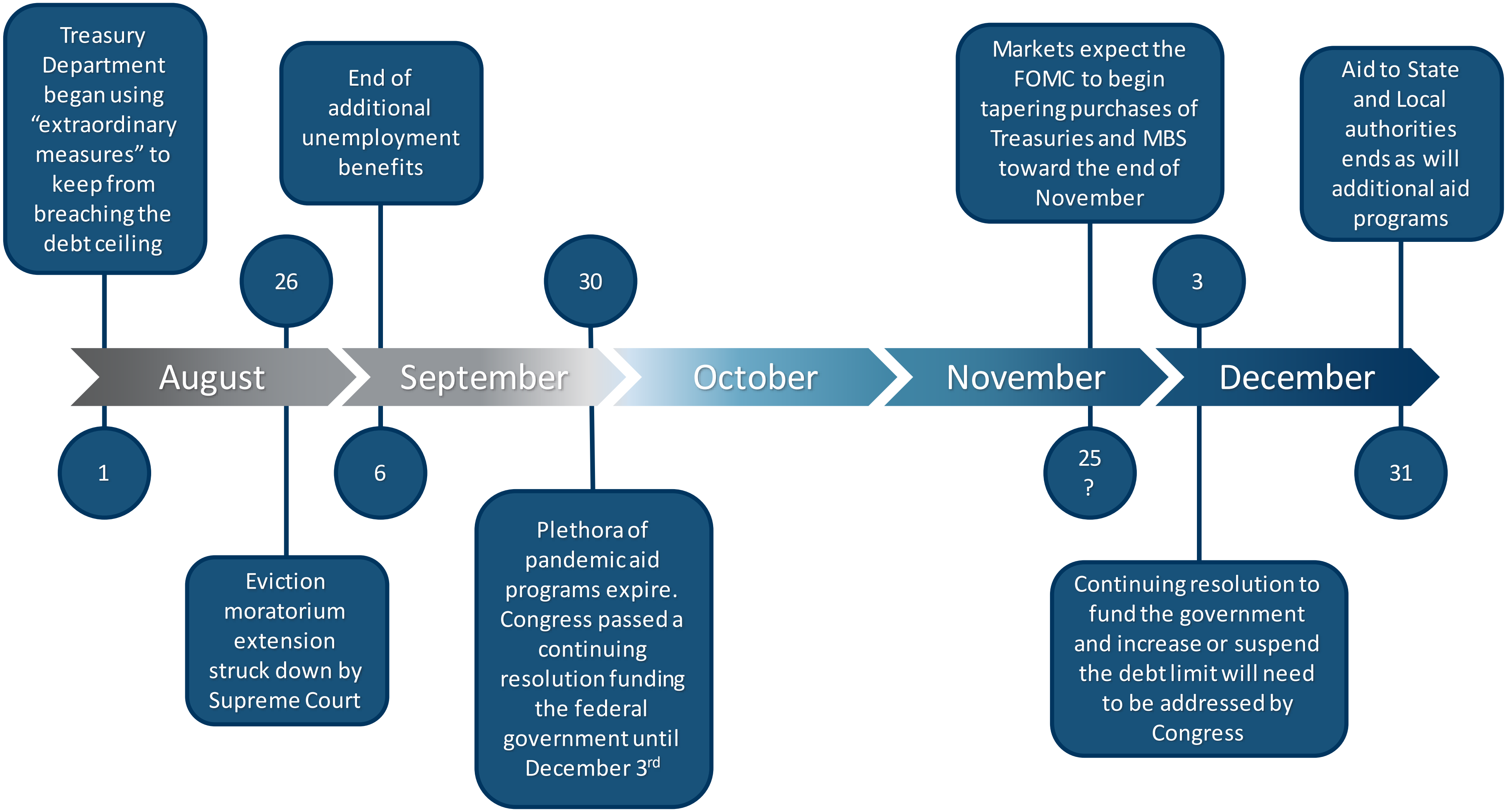




Source: Opus, Bloomberg, John Hopkins

Economic Outlook

Expiration of pandemic related aid, transitioning monetary policy, and uncertainty surrounding the debt limit could keep volatility elevated

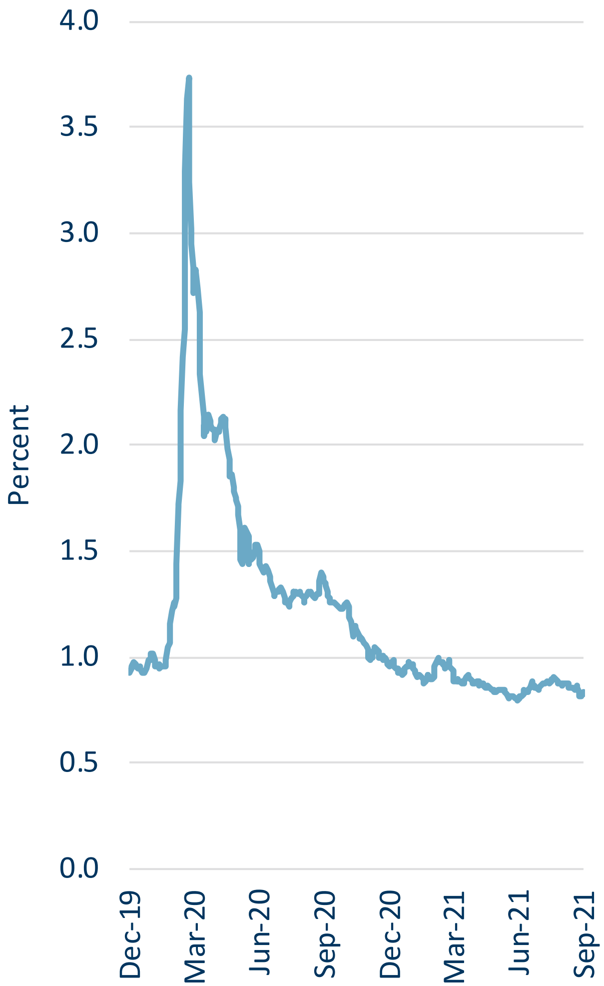


Source: Opus, Bloomberg, Committee for a Responsible Federal Budget

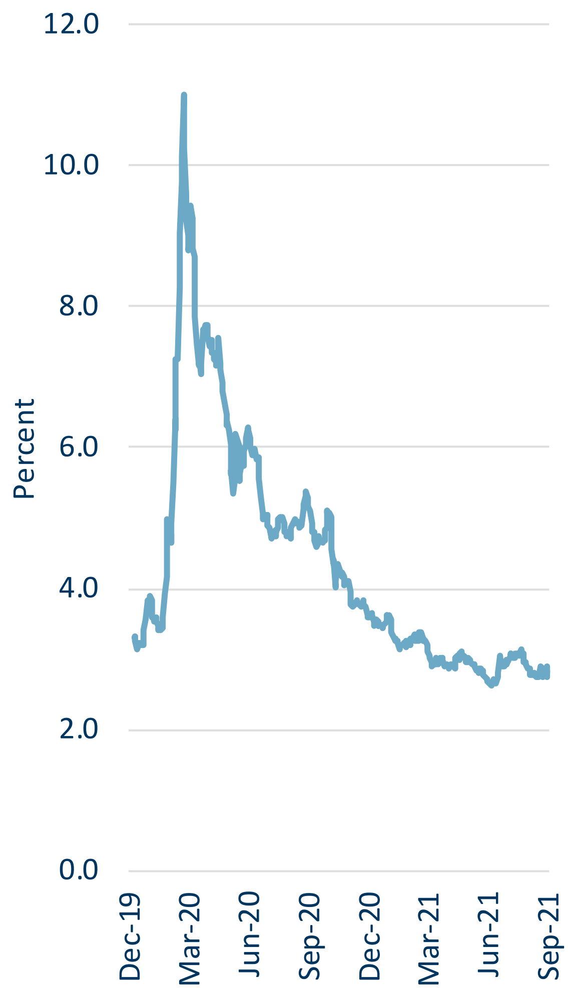
Economic Outlook

Spreads remain near historic lows, while volatility has led to equity declines

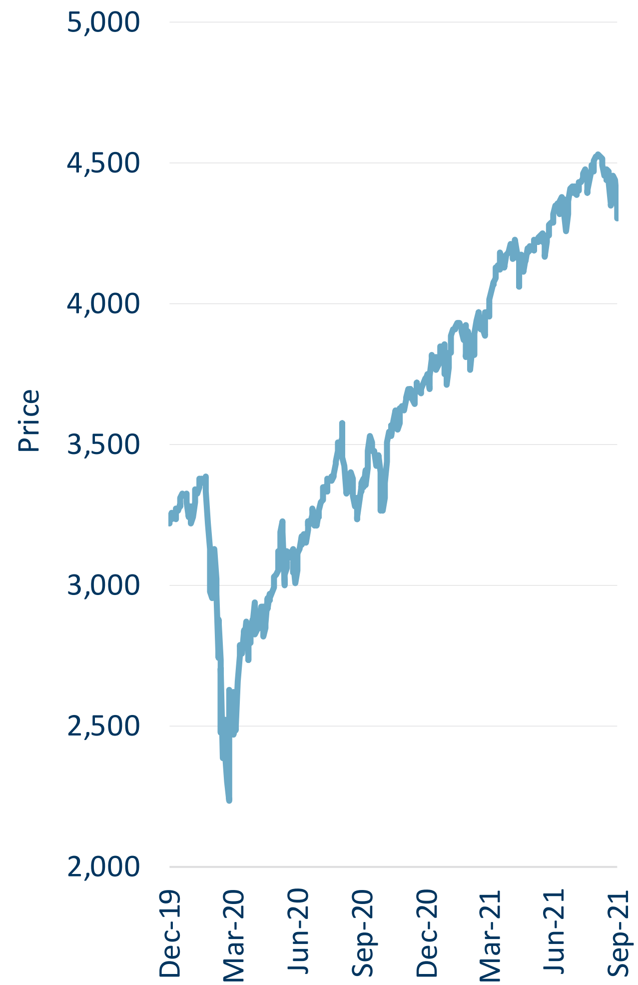
IG Corporate Spreads



HY Corporate Spreads



S&P 500



Source: Opus, Bloomberg

Economic Outlook

In spite of increased volatility, the FOMC remains the focus moving forward

Monetary and fiscal stimulus beginning to transition

- FOMC's forecasted target rate indicates the first rate hike may occur in 2022 rather than 2023.
- The pace of quantitative easing in the U.S. is expected to begin to slow in coming months as the FOMC tapers its monthly securities purchases.
- Political gridlock over spending and the debt ceiling could rattle markets in the short term.

Growth above trend, but pressures building

- Despite positive earnings forecasts, volatility has increased due to fiscal uncertainty, and increased deaths and hospitalizations due to the rise of the Delta variant.
- U.S. growth estimates remain strong at 5.9% for 2021, though supply chain constraints, employment gaps, and inflation have decreased forecasts.
- Spreads on fixed income securities remain near historic lows.

Will market volatility persist?

- After 55 new all-time highs prior to September, the S&P 500 remains down since the most recent high on September 2nd.
- Timing and transparency of FOMC policy remains integral to avoid undesirable market reactions.
- In response to the shift in FOMC policy and inflation pressures the yield curve has shifted higher, pressuring total returns of fixed income securities.

Source: Opus, Bloomberg

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