OPUS INVESTMENT MANAGEMENT

Investments in harmony with you℠

Quarterly Commentary

December 31, 2021

Executive Summary

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MARKET COMMENTARY

After delivering essentially flat returns in the third quarter, the S&P 500 delivered an 11% return for the final quarter of the year and lifted the full year's performance to almost 29% – its eighth best gain since the benchmark adopted a 500-stock format in 1957. In dollar terms, this represents a record $8.7 trillion increase in market capitalization during the year, which when combined with increases in housing values and liquid assets, results in 2021 recording some of the largest increases in household net worth since the Federal Reserve began making these estimations.

Fixed income investors were not as fortunate, with the quarterly return for the Bloomberg U.S. Aggregate Bond Index at 0.01% and the full year figure at -1.54%. While long-term rates, to close the year, have not moved above the high reached at the end of the first quarter, the front-end of the curve shifted substantially higher in the fourth quarter as messaging from the Federal Reserve became less accommodative. In response to stubbornly high inflation and unemployment falling below 4.5%, the Federal Open Market Committee (FOMC) pulled forward its rate hike expectations, now forecasting three rate hikes for each of the next two years. Additionally, a faster pace for tapering purchases of treasury and mortgage-backed securities was announced just one month after the initial taper announcement. The tapering program is expected to conclude around the end of the first quarter of 2022, a quarter earlier than originally expected. For the time being, intermediate and long duration interest rates have exhibited stability as investors believe greater Fed action and dissipating COVID disruptions will cool the rate of inflation.

As mentioned above, inflation figures trended higher throughout the year, with the latest CPI print hitting 6.8%. This has been driven by supply chain disruptions due to COVID, chip shortages, and an incredible rebound in demand fueled by fiscal stimulus. Consumer sentiment has dissipated in recent months as these pricing pressures, along with failed attempts to pass President Biden's Build Back Better economic plan, have weighed on consumer expectations. Further, the reemergence of COVID cases through the highly transmissible Omicron variant led to over 3 million new cases in a recent seven-day period, a U.S. COVID record. This has led to downward revisions on the growth outlook for 2022 and could further impact supply chains, elevate inflation, and impact consumers' willingness to spend their built-up savings.

Considering the uncertainty surrounding the future pace of economic growth as monetary policy becomes less accommodative, the tenuous potential for additional fiscal stimulus, and limited compensation for taking investment risk, Opus remains focused on creating portfolios biased towards fundamental financial strength, capital preservation and liquidity.

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Economic Outlook

Equities continued to post strong returns in 2021, while fixed income returns were mostly negative due to rising rates

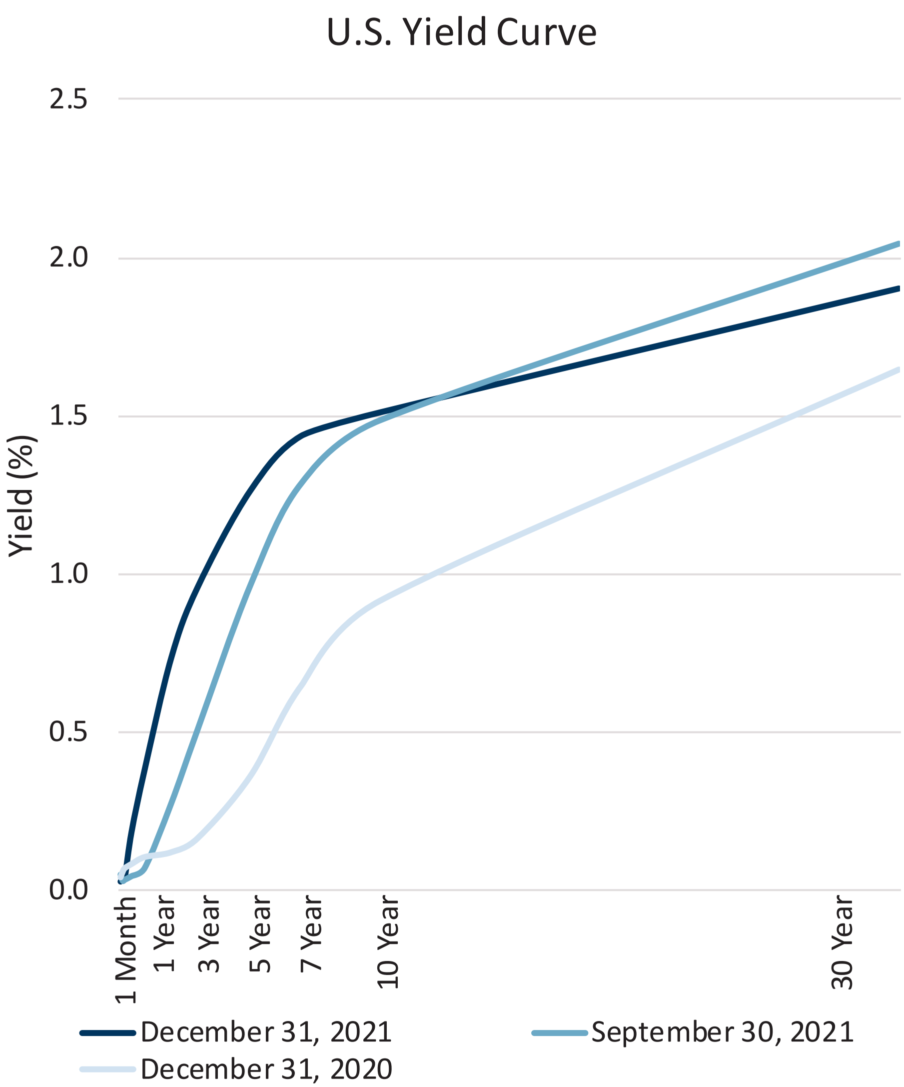
2017	2018	2019	2020	2021
22.1%, Large Cap	1.0%, Securitized	31.4%, Large Cap	21.1%, Large Cap	42.1%, Commodities
17.1%, Mid Cap	0.9% Treasuries	28.1%, Mid Cap	19.0%, Small Cap	29.3%, Mid Cap
16.2%, Small Cap	0.3% Govt Related	27.4%, Small Cap	9.9%, IG Corporate	27.5%, Large Cap
7.5%, HY Corporate	-2.1%, HY Corporate	17.6%, Commodities	8.0%, Treasuries	18.2%, Small Cap
6.4%, IG Corporate	-2.5%, IG Corporate	14.5%, IG Corporate	7.1%, HY Corporate	5.3%, HY Corporate
5.8%, Commodities	-4.4%, Large Cap	14.3%, HY Corporate	5.9%, Govt Related	-1.2%, Securitized
4.2%, Govt Related	-9.3%, Small Cap	9.0%, Govt Related	4.2%, Securitized	-1.2%, IG Corporate
2.5%, Securitized	-12.4%, Mid Cap	6.9%, Treasuries	2.5%, Mid Cap	-1.3%, Govt Related
2.3%, Treasuries	-13.8%, Commodities	6.4%, Securitized	-23.7%, Commodities	-2.5%, Treasuries

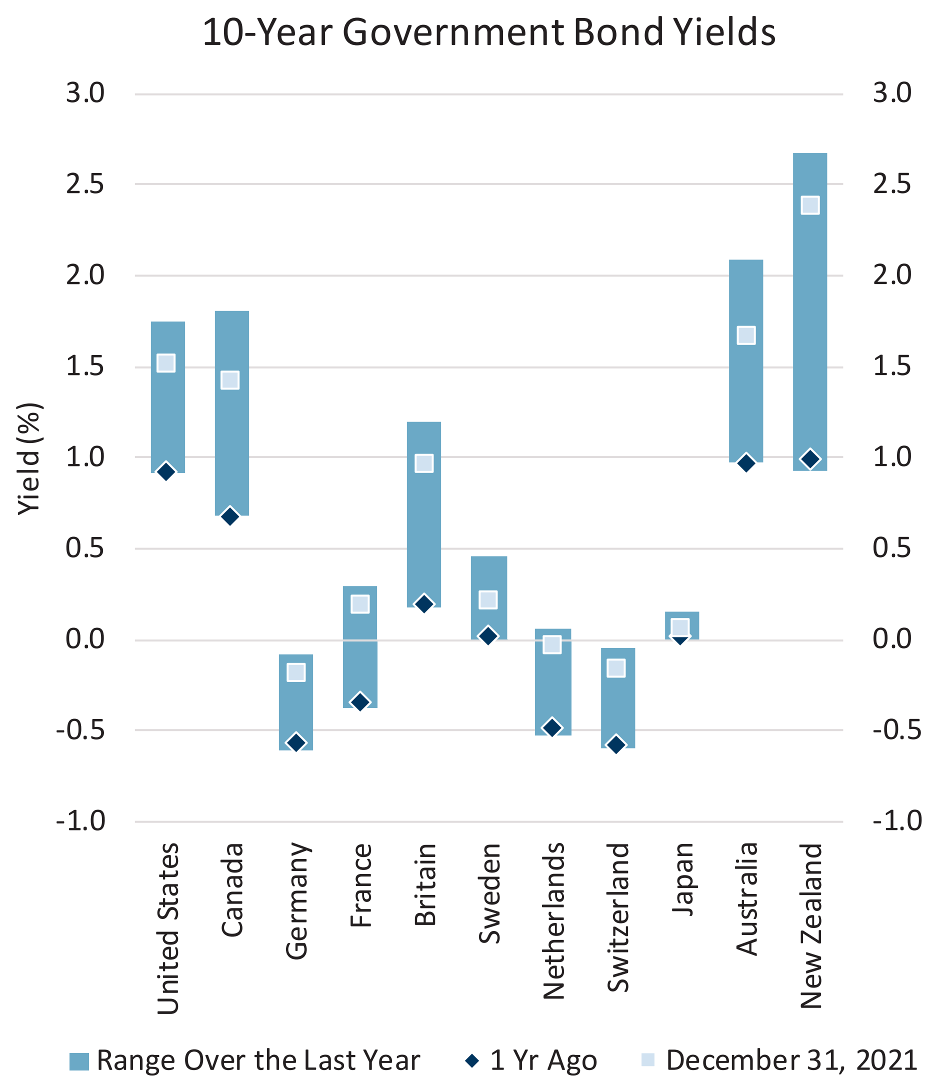
- **Commodities** – Standard & Poor's GSCI Index
- **Mid Cap** – CRSP Mid Cap Index
- **Large Cap** – CRSP Large Cap Index
- **Small Cap** – CRSP Small Cap Index
- **HY Corporate** – Bloomberg U.S. High Yield Corporate
- **Securitized** – Bloomberg U.S. Agg. Securitized
- **IG Corporate** – Bloomberg U.S. Agg. Corporate
- **Govt Related** – Bloomberg U.S. Agg. Government Related
- **Treasuries** – Bloomberg U.S. Agg. Treasuries

Source: Opus, Bloomberg, CRSP, S&P

Economic Outlook

Front-end of U.S. yield curve shifted up in response to evolving central bank policy

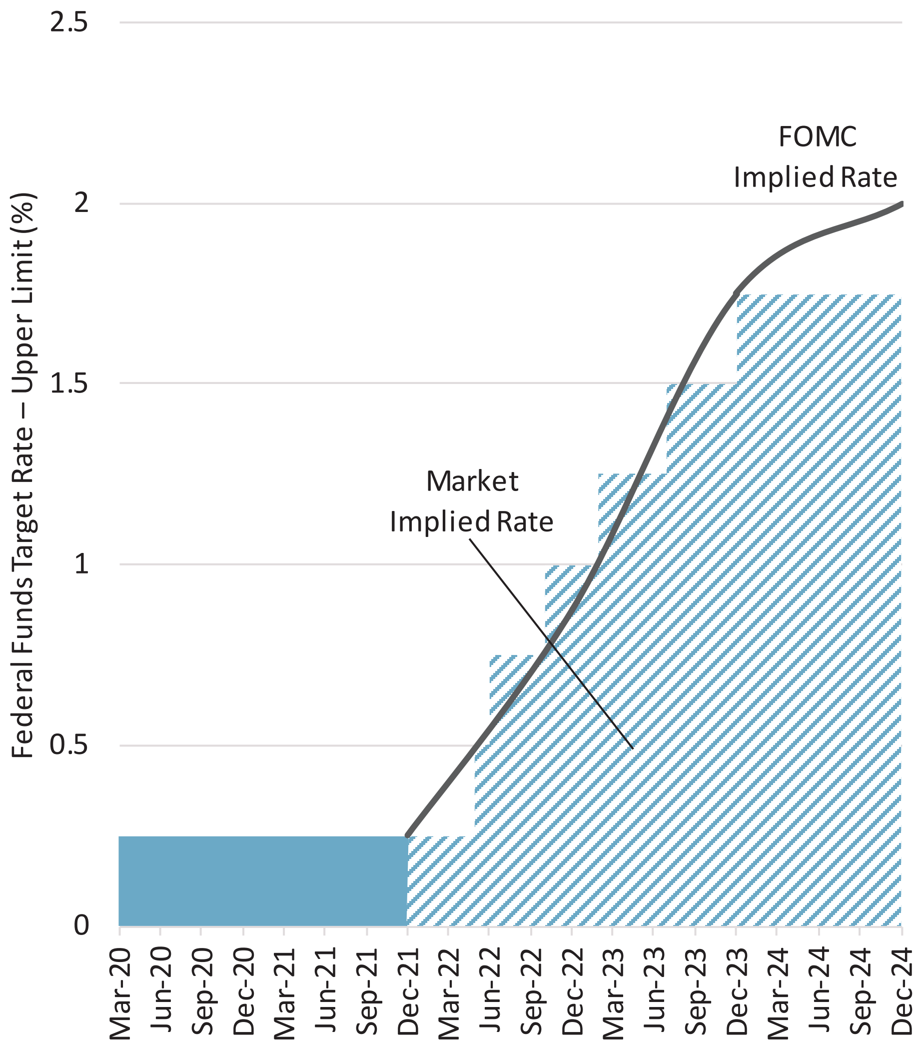


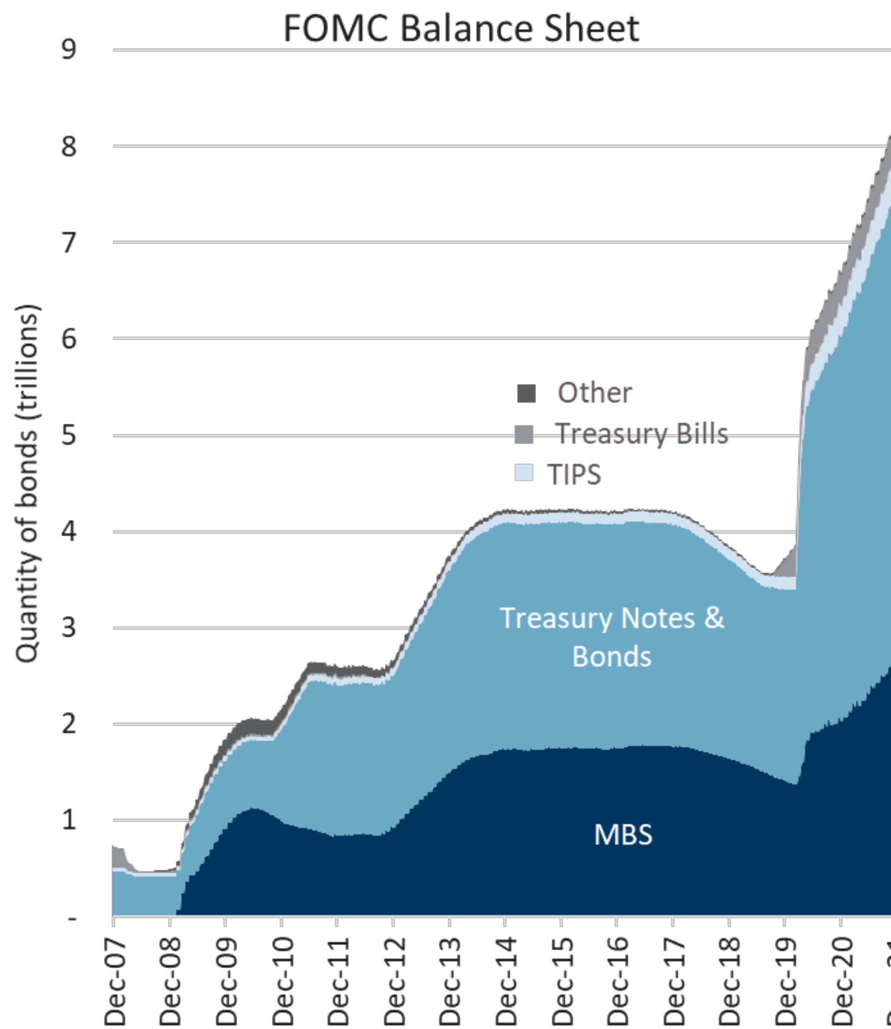


Source:: Opus, Bloomberg, Federal Reserve

Economic Outlook

Federal Reserve expected to conclude its asset purchase program in early 2022, likely followed by increases in the overnight target rate

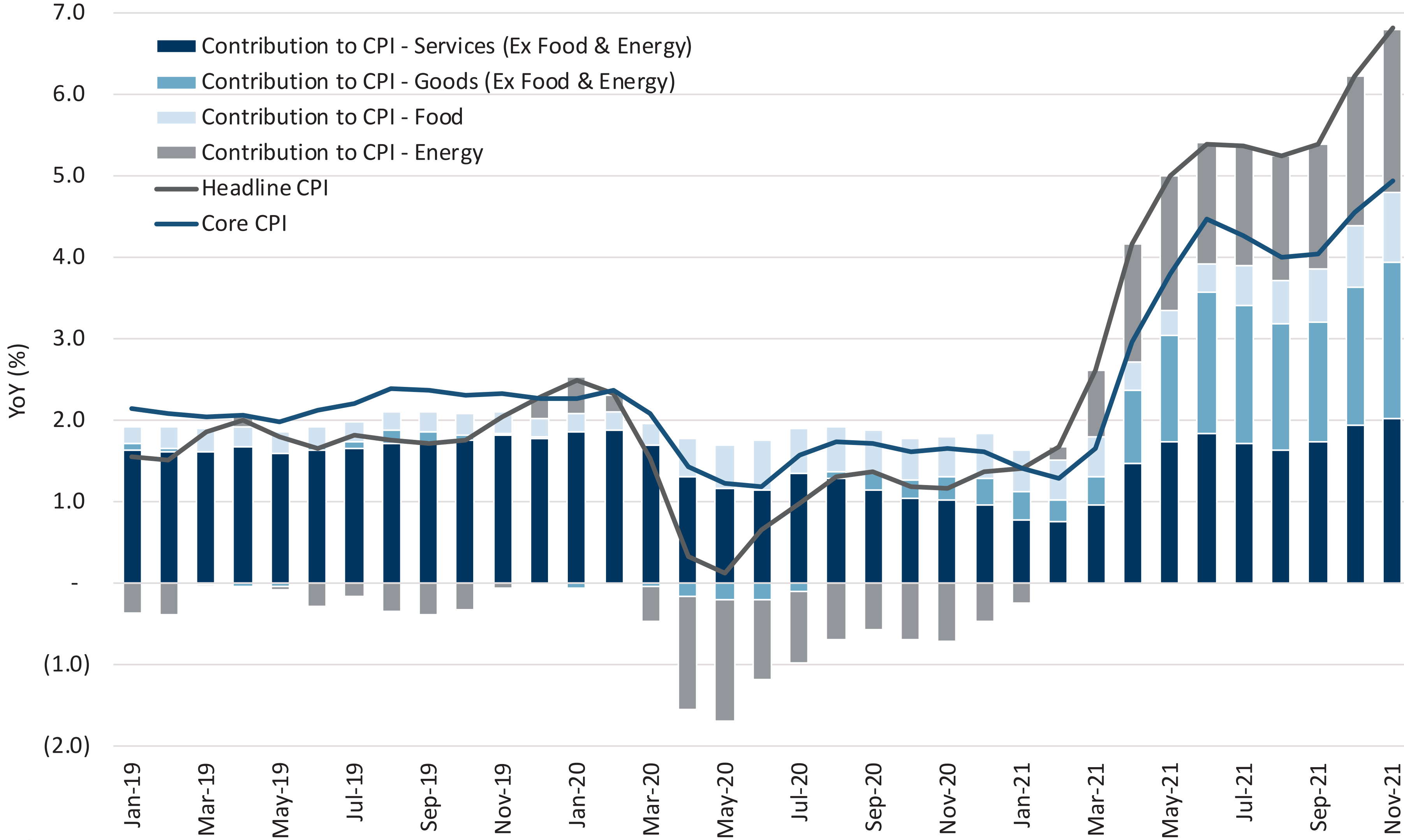




Source:: Opus, Bloomberg, Federal Reserve

Economic Outlook

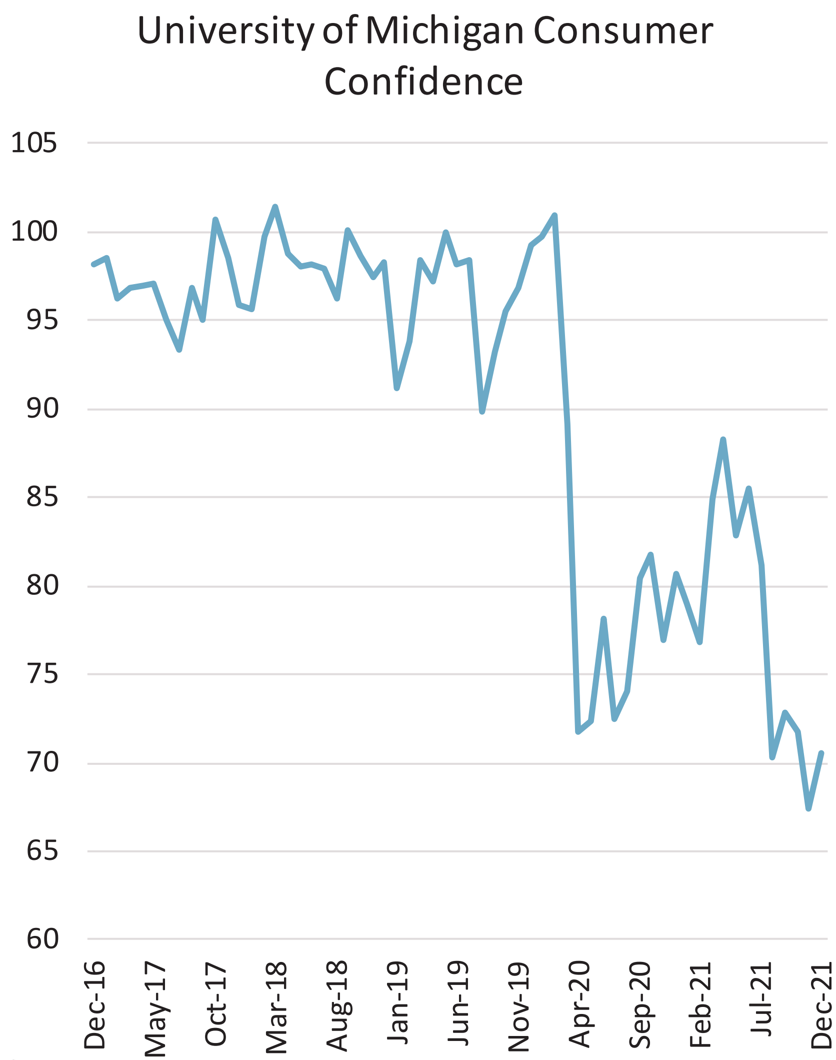
More volatile food and energy prices have been significant contributors to the current elevated inflation environment, but core inflation is also elevated

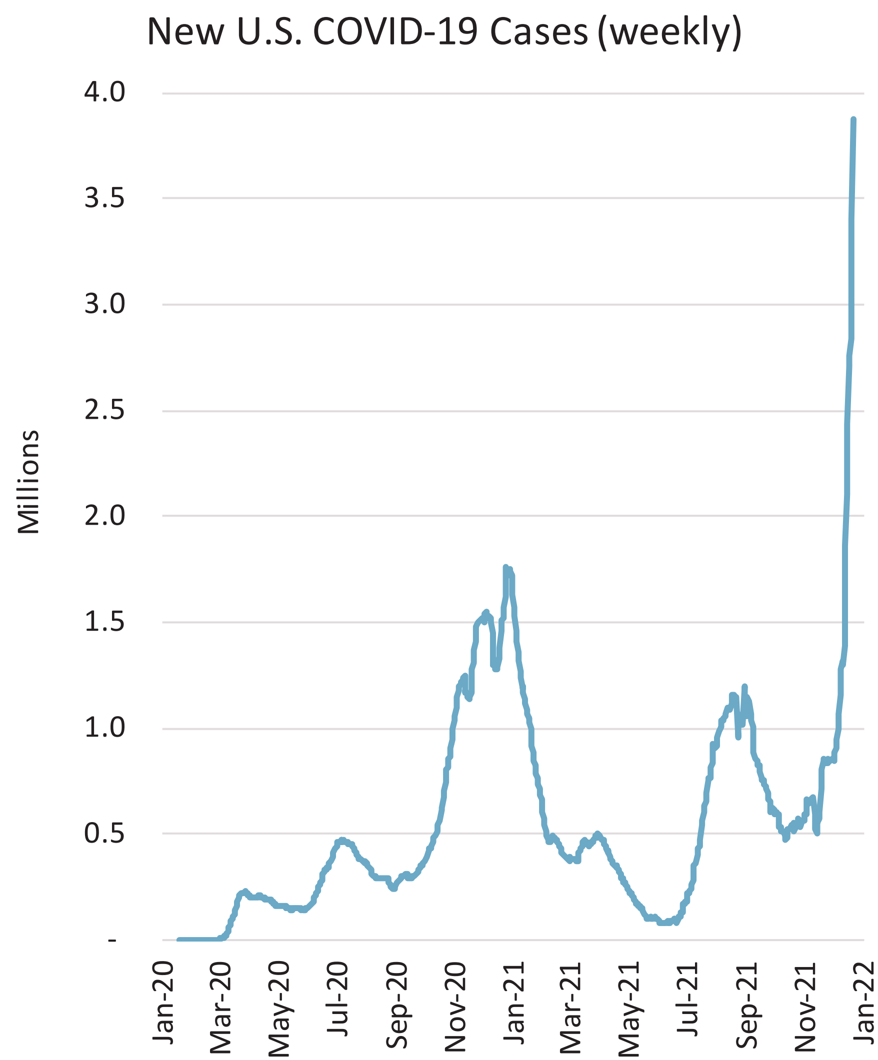


Source: Opus, Bloomberg, Bureau of Labor Statistics

Economic Outlook

Stubbornly high inflation and the reemergence of COVID are negatively impacting consumer confidence



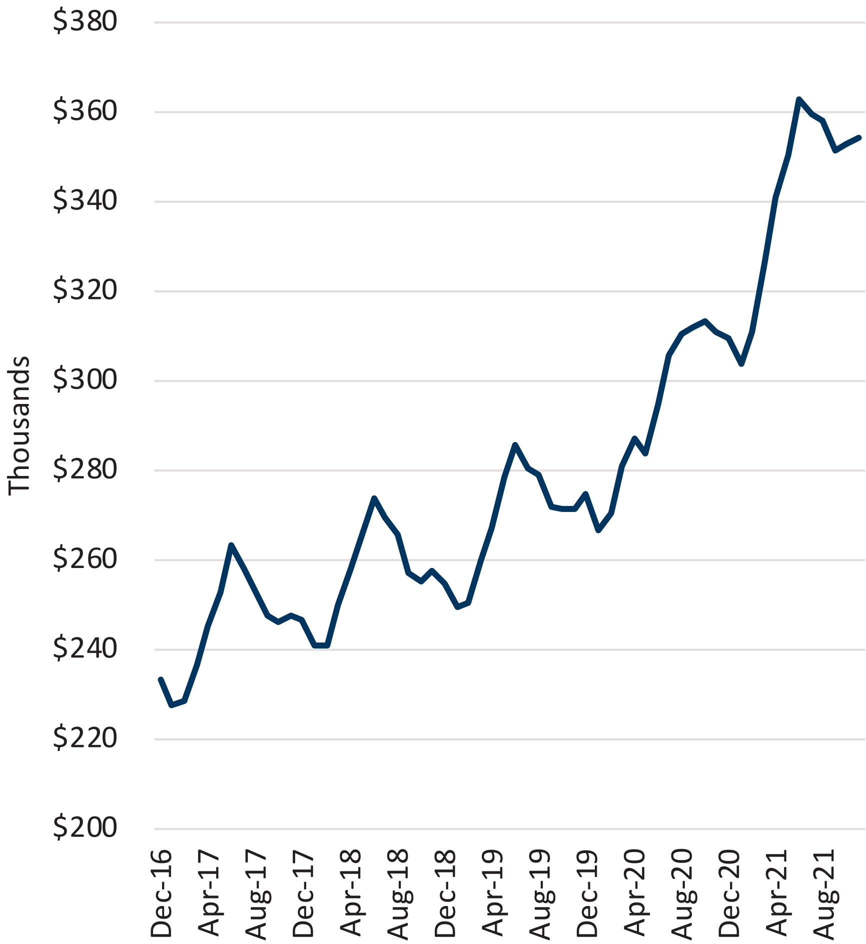


Source: Opus, Bloomberg, John Hopkins

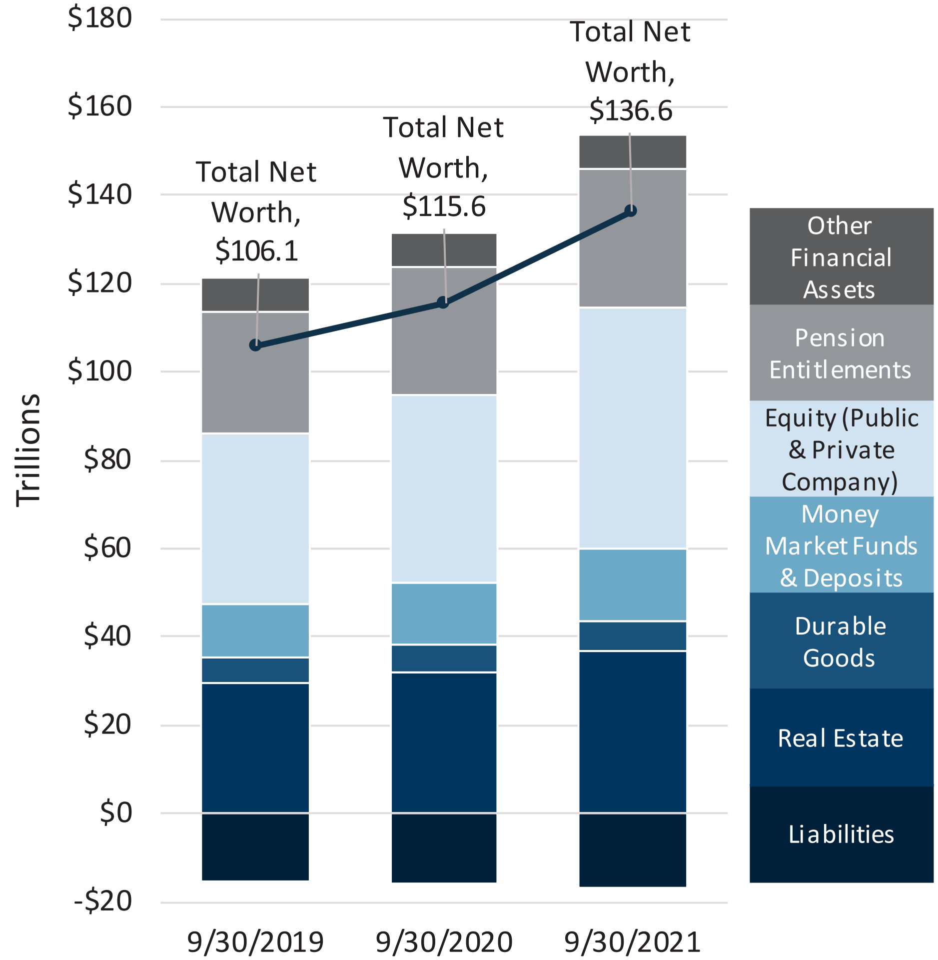
Economic Outlook

U.S. consumers have seen substantial increases in net worth due to rising home prices, increased savings, and equity valuations

US Existing Home Sales Median Price



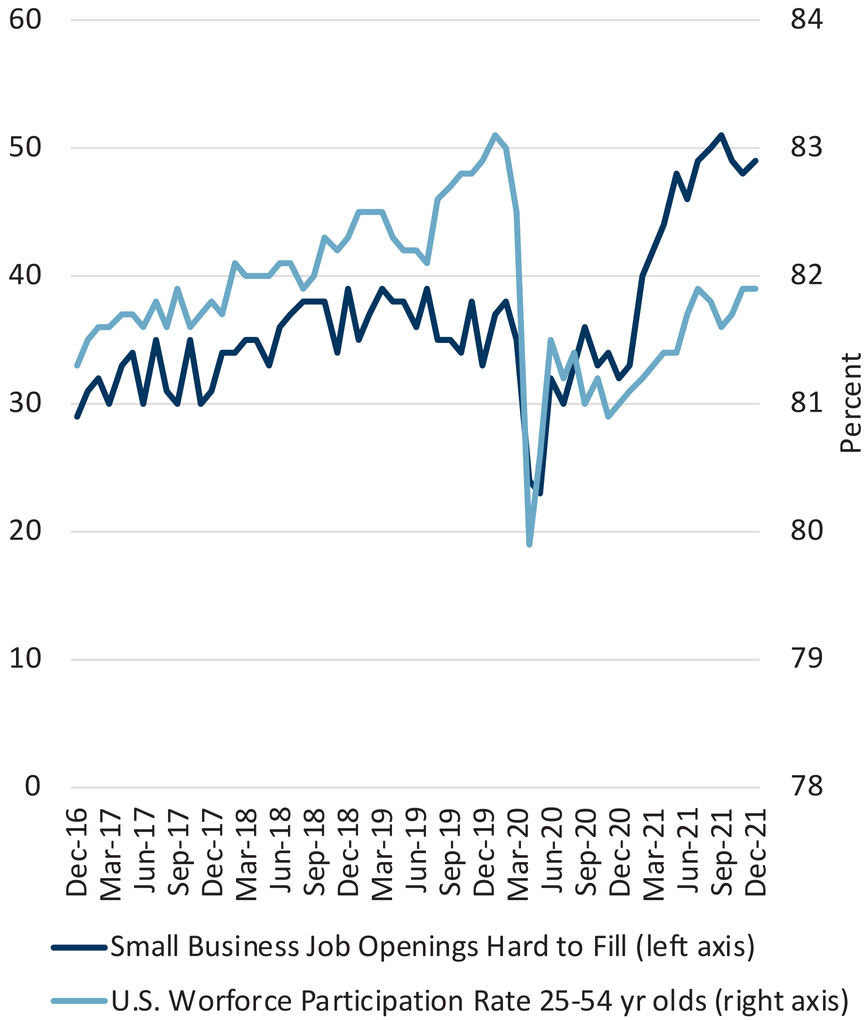
Household Net Worth

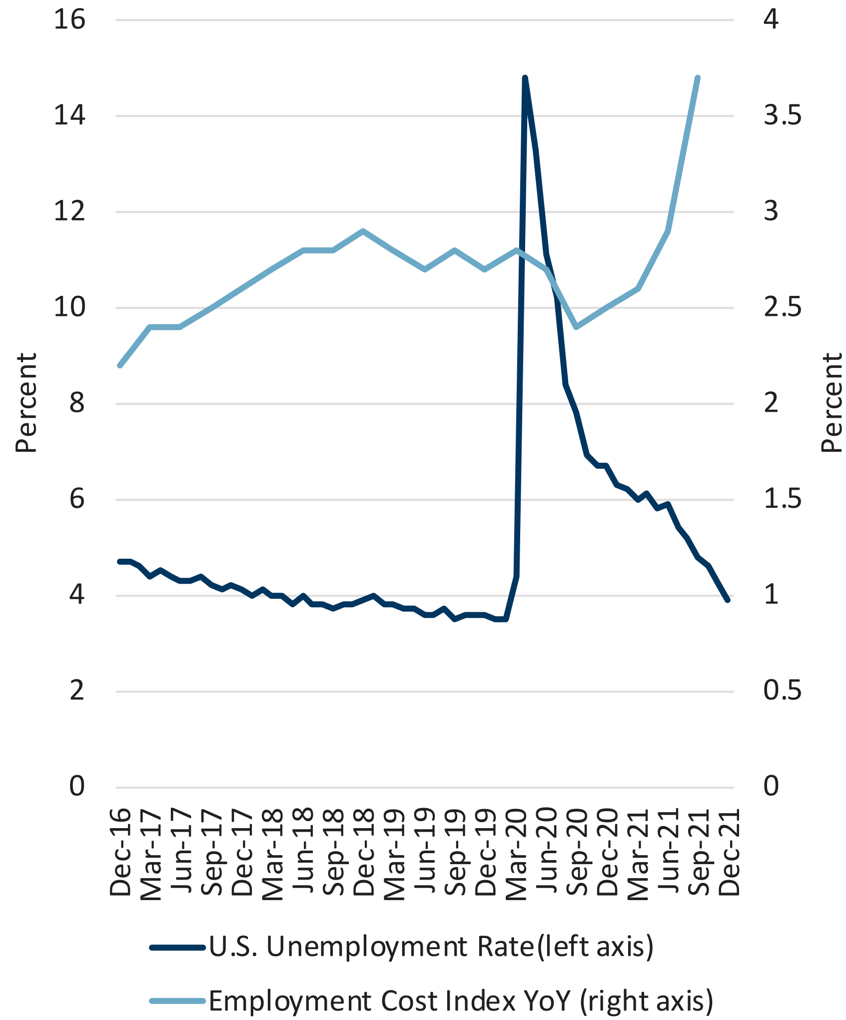


Source: Opus, Bloomberg, National Assoc. of Realtors, Federal Reserve

Economic Outlook

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

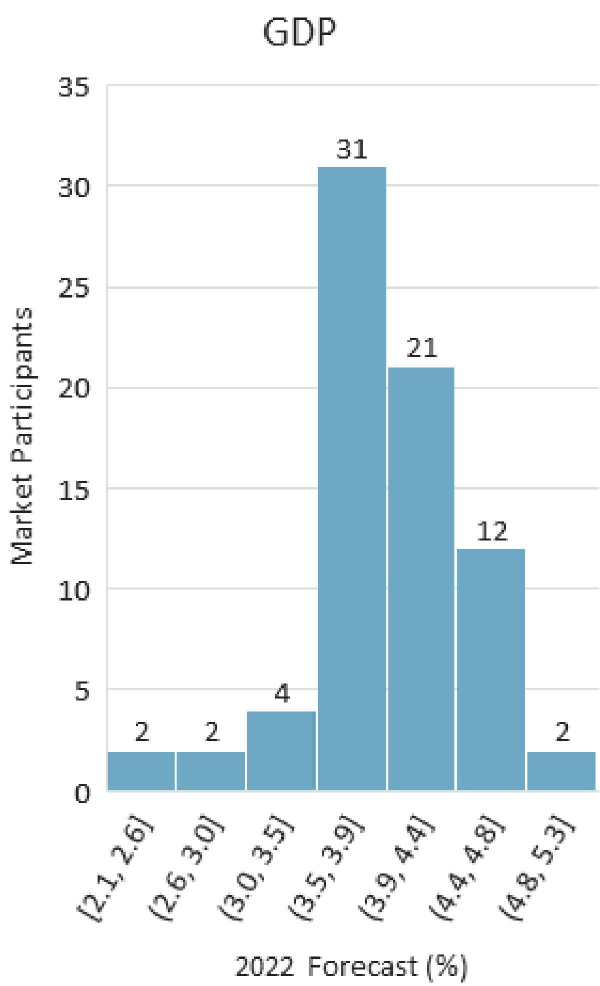


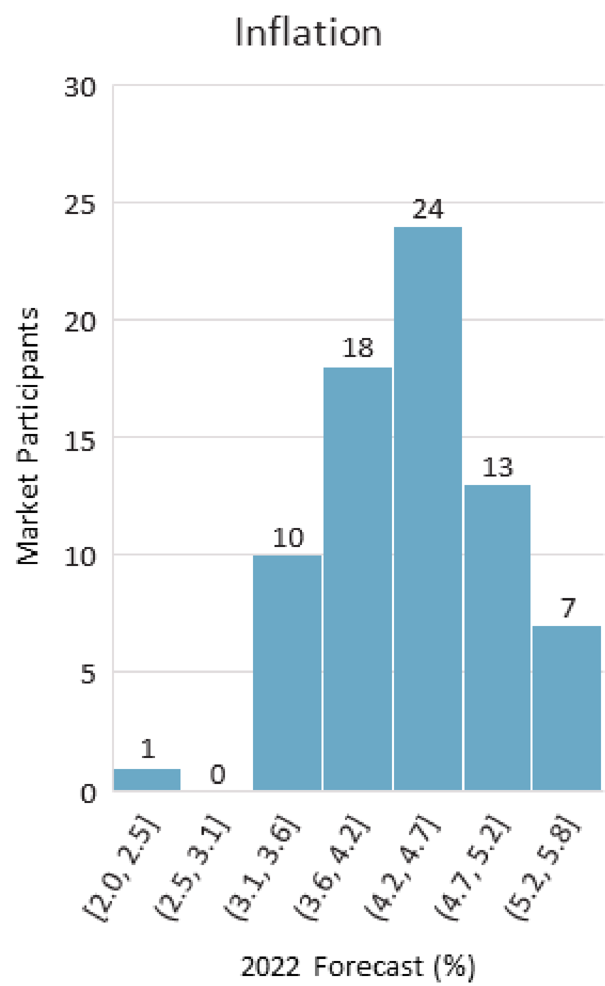


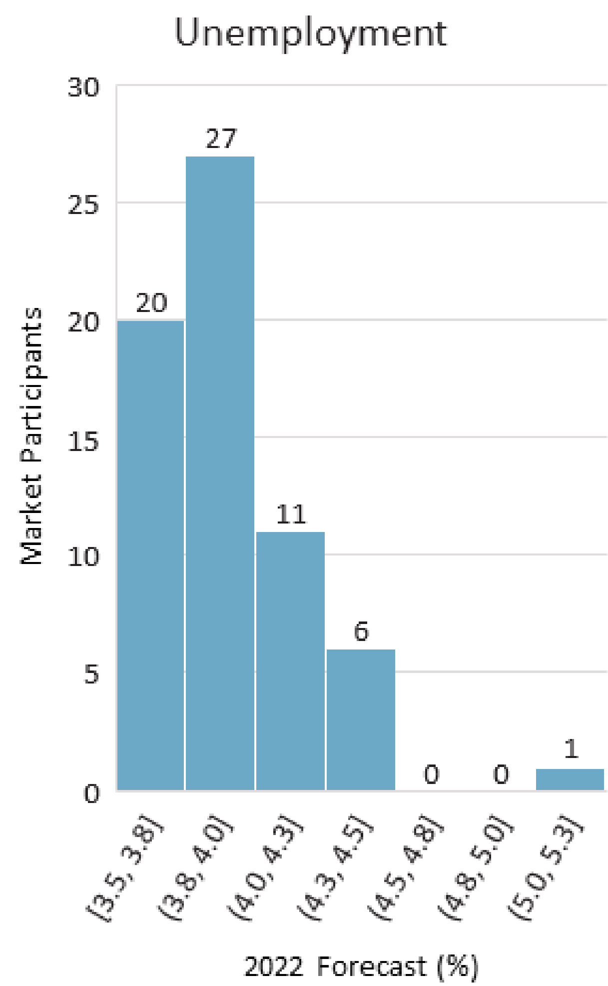
Source: Opus, Bloomberg, Bureau of Labor Statistics, NFIB

Economic Outlook

Market participants forecast declining unemployment, above-trend GDP growth, and elevated inflation for 2022



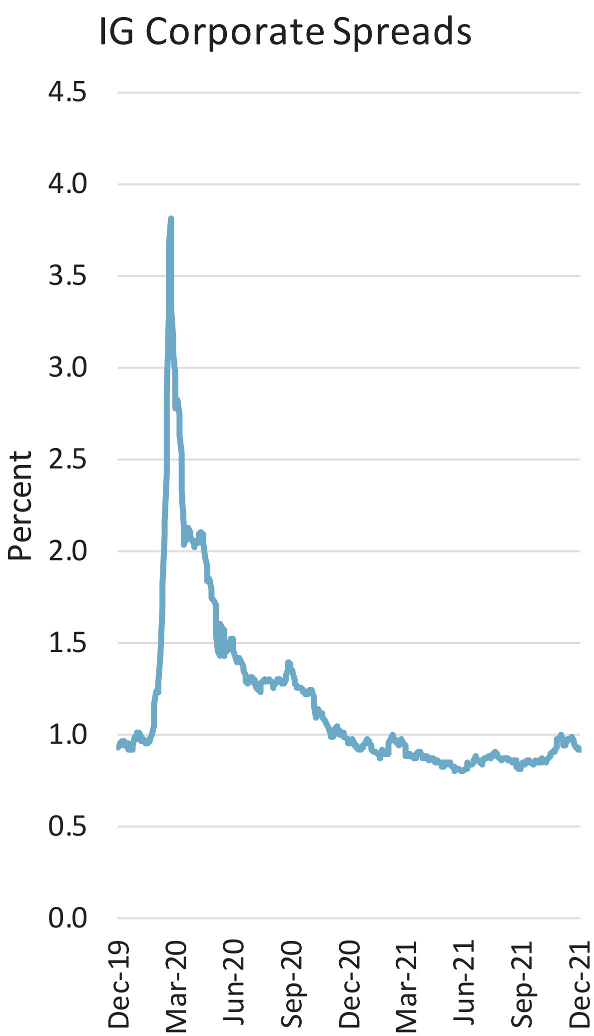


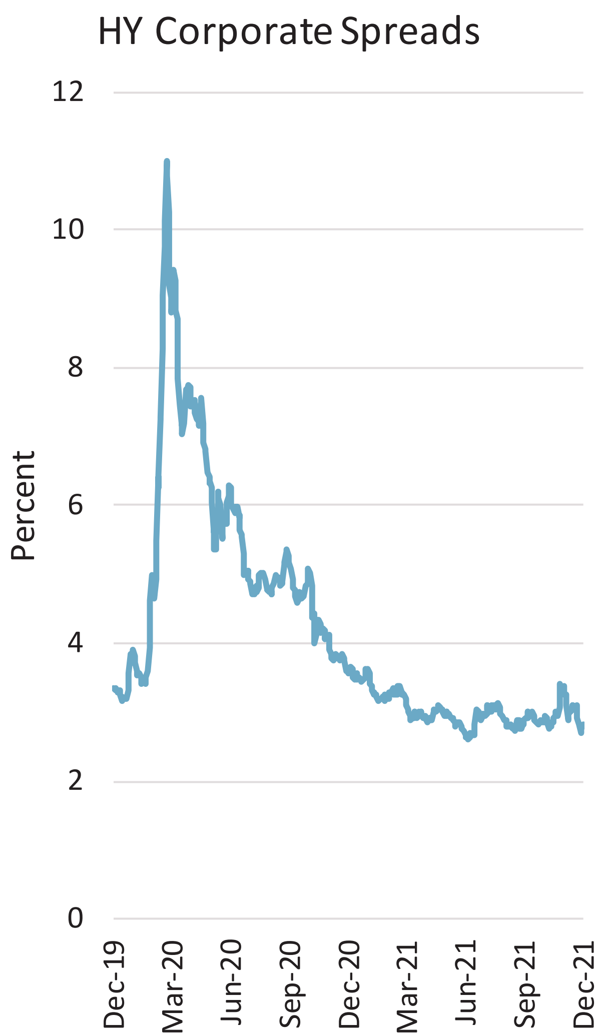


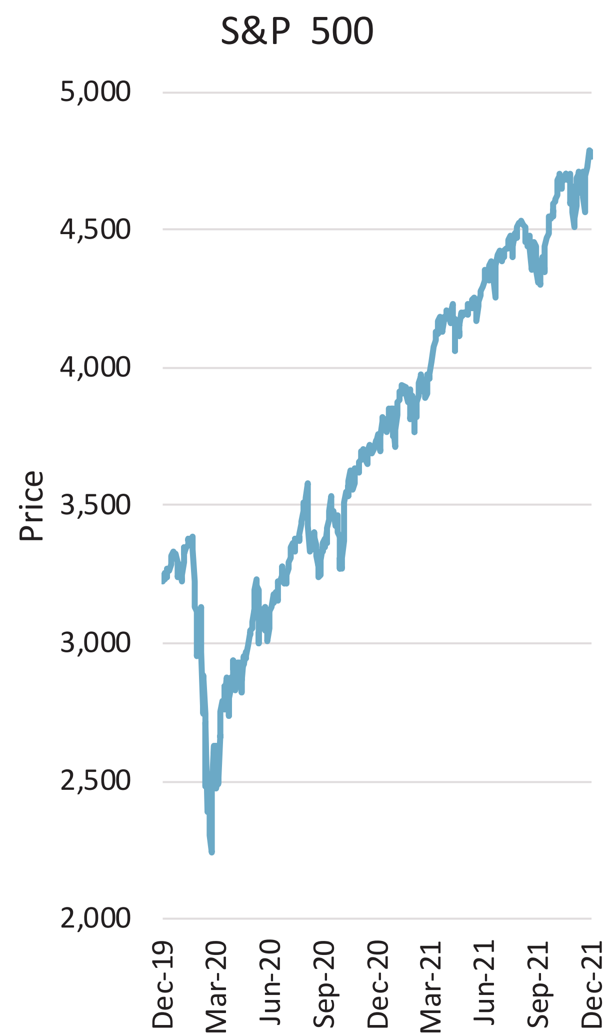
Source: Opus, Bloomberg

Economic Outlook

Spreads remain near lows, while equity markets continue to rally







Source: Opus, Bloomberg

Economic Outlook

All eyes on fiscal and monetary policy reactions to COVID and inflationary pressures

FOMC foreshadowing tighter policy in the years to come

- Inflation remains stubbornly high at 6.8% year-over-year due in part to supply chain disruptions and elevated consumer demand
- Labor market improvement has accelerated FOMC timing for liftoff from current zero-rate policy
- The FOMC is now guiding toward six hikes over the next two years and a faster taper of asset purchases

Consumer sentiment declining, even as wealth has improved

- Equity market performance, increased housing valuations, and massive fiscal stimulus have increased household wealth
- Record COVID cases in the U.S. and globally, due to the highly transmissible Omicron variant, have increased uncertainty
- Consumer sentiment is fading as pandemic-related stimulus ends and additional stimulus is indefinite

Valuations may be underpricing risk

- S&P 500 returned nearly 29% during 2021 with real GDP growth expected to be near 5.5% for the year
- Front-end yields have shifted in response to FOMC projection changes, however longer duration Treasuries are relatively unchanged, creating a flatter yield curve
- While uncertainty has increased, market valuations have remained robust, seemly immune to the risk

IMPORTANT INFORMATION

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