NRP

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MARKET COMMENTARY

4Q 2021

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Market Monitor 2021	Q4%	YTD%
MSCI ACWI Index	6.7	18.5
S&P 500 Total Return Index	11.0	28.7
Bloomberg Barclays Agg. Bond Index	0.0	-1.5

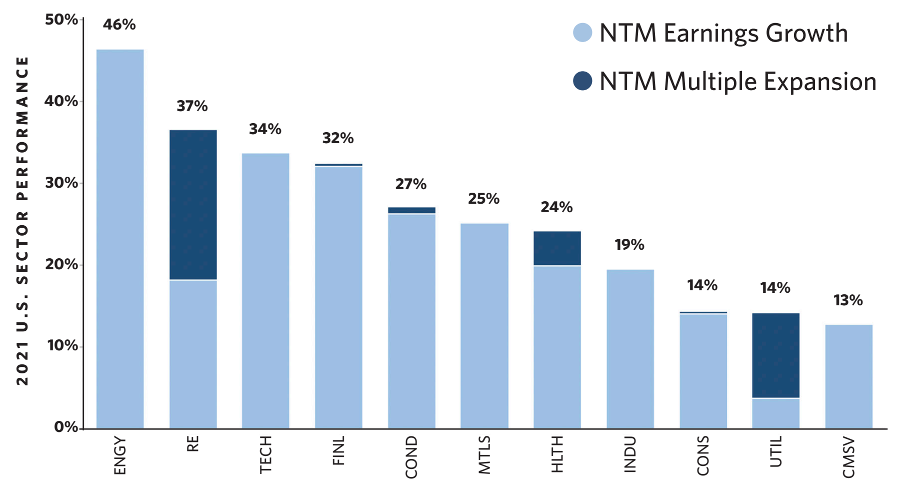
Performance is not correlated to portfolio holding period.

2021: A Banner Year for (most) Risk Assets

Strong returns in U.S. equity markets reigned throughout the year outpacing international markets.

- Headline index performance hid backyard brawls between market sectors and factors though, as coronavirus-induced changes in company performance and workforce participation levels created stress on the domestic and global economy.
- Strategies for portfolio diversification are needed to mitigate downside risks while allowing for upside participation as volatility and uncertainty prevail into the New Year.

EARNINGS GROWTH DROVE MARKET GAINS IN 2021



Disclosures: Data Sourced From Factset Note: Analysis Based On S&P 500 Sectors. Performance As Of 12/31/2021

Source: Market Desk.

Despite a Fed pivot and the onset of the coronavirus Omicron variant in November, the 4th quarter capped a great year for risk assets with the S&P 500 index generating an 11.0% return for the quarter (28.7% for the year) and global equities up 6.7% for the quarter (and 18.5% for 2021 per the MSCI ACWI index). Commodities and high yield also notched gains of 27.1% (Bloomberg Commodity index) and 5.4% (ICE BofA U.S. High Yield index) respectively.

U.S. markets paced the rest of the world with a relatively stronger economic recovery and stronger dollar as the MSCI EAFE index produced an 11.3% return for 2021 while the MSCI EM index fell 2.5%.

On the surface, equity gains in the U.S. look justified based on the earnings growth delivered over the course of the year. With rising earnings and expanding profit margins, it is surprising to note that U.S. valuation multiples exited the year at a slightly depressed level at a forward price-to-earnings multiple of 21.4 (vs. 22.6x to start 2021).

> *"The secret of change is to focus all of your energy, not on fighting the old, but on focusing on building the new."*
>
> *- Socrates*

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Beneath the Headlines Though, All is Not Well

The fourth quarter saw strong rotations between value and growth stocks along with a flight to perceived safety in large-caps relative to small-caps.

Notably, the rise in equity markets was increasingly narrow in the quarter as the top five companies in the S&P 500 accounted for 46% of the index's 2nd half performance and nearly 1/3 of the S&P's 29% return for the year. The NASDAQ index pushed further to the extreme with the top six companies accounting for 70% of the index's 22% return for the year.

The headline index numbers for the quarter covered up a lot of churn and pain underneath the surface as small-and mid-cap tech and biotech companies went on sale towards year end as highlighted by the poor performance of the ARK Innovation and Genomic ETFs highlighted in the following chart.

ARKK AND ARKG US EQUITY PERFORMANCE

Source: Bloomberg.

U.S. STYLE RETURNS (4Q 2021 IN %)

	VALUE	BLEND	GROWTH
LARGE	7.8	11.1	11.7
MID	8.5	6.5	2.9
SMALL	4.2	2.0	-0.1

DATA REFLECTS MOST RECENTLY AVAILABLE AS OF 12/31/2021

Source: Market Desk.

U.S. STYLE RETURNS (2021 IN %)

	VALUE	BLEND	GROWTH
LARGE	24.8	28.6	27.4
MID	28.0	22.4	12.6
SMALL	27.9	14.5	2.5

DATA REFLECTS MOST RECENTLY AVAILABLE AS OF 12/31/2021

Source: Market Desk.

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Looking for the Way Forward

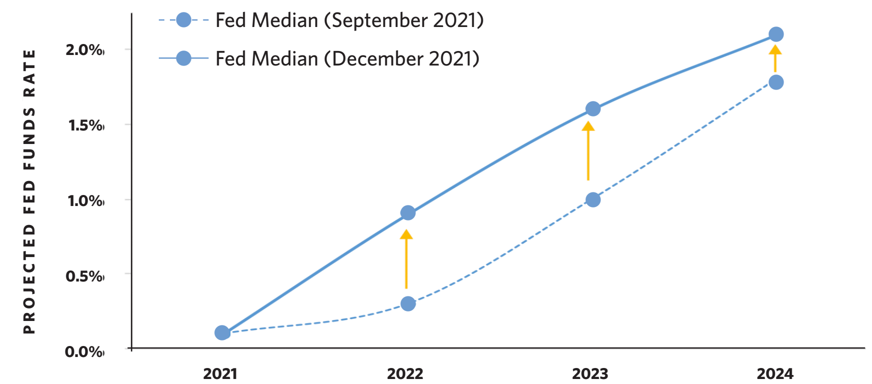
Entering 2022, nearly two-thirds of companies in the NASDAQ index were in a bear market (defined as a 20% decline from peak) with many off 40-50% from 1-year highs. The pain has been more acute with unprofitable tech and biotech companies but that has not spared the secularly growing, profitable technology companies. The selloff in growth and tech names has only intensified to start 2022, impacting both large-and small-caps alike.

With the increased volatility, it is clear that a mid-cycle transition is upon us and the Fed is clearly transitioning as well with a hawkish pivot in November, dropping “transitory” language around inflation and going on the offensive with six rate hikes priced in over the next two years.

As the coronavirus-induced supply shock across industries ebbs, constrained labor supply has also become a worrisome data point as labor force participation is still depressed. Data comparing U.S. labor force participation to our north border neighbors underscores the unique nature of this issue for the U.S. To help temper the elevated inflation, the Fed has put all on notice that the rate lift-off will begin in mid-March.

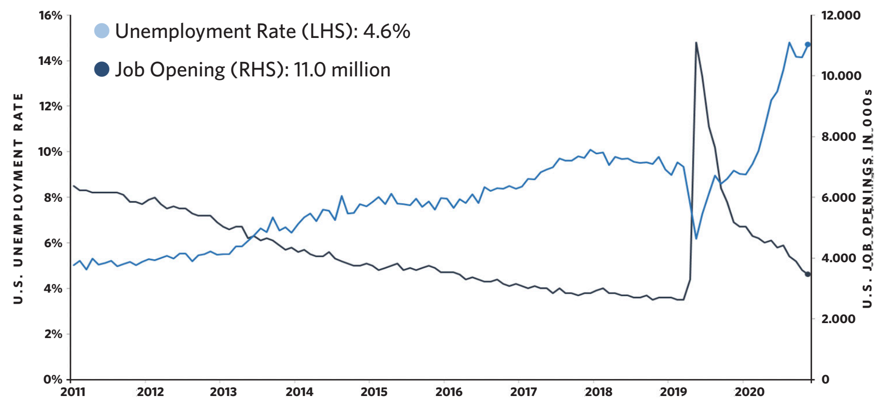
Historically, equity markets can handle a measured rate rise and moderate inflation; however, a fast-paced turn in inflation and interest rates has historically given markets indigestion, as highlighted by the market turbulence in the beginning weeks of 2022.

FEDERAL RESERVE MEDIAN PROJECTED FED FUNDS RATES



Source: Market Desk, Federal Reserve.

LABOR FORCE PARTICIPATION NOT CLOSING THE GAP



DISCLOSURES: The Unempoyment Rate Represents The Number Of Unemployed As A Percentage Of The Labor Force. Labor Force Data Is Restricted To People 16 Years Of Age And Older, Who Currently Reside In 1 Of The 5o States Or The District Of Columbia, Who Do Not Reside In Institutions (E.g., Penal And Mental Facilities, Homes For The Aged), And Who Are Not On Active Duty In The Armed Forces. Job Openings (Total Nonfarm) Is Provided By The U.S. Bureau Of Economic Analysis (St. Louis Federal Reserve Identifier: JTSJOL). Data Sourced From Federal Reserve And U.S. Bureau Of Economic Analysis. Rhs = Right Hand Side. Lhs = Left Hand Side.

Source: Market Desk.

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A Test of Conviction Levels During a Rate Regime Change

Given the advent of a rising rate regime and nagging inflation, one may think to press further on the growth to value rotation, leaving the once high-priced technology companies behind for cyclicals and value equities. However, the technology-focused fund managers we speak with have been quick to point out that technology stocks have outperformed in three of the past four tightening cycles and in the fourth (circa 2004), the tech index was still up 18%. Through their collective lens, some secular growth stocks have fallen 30-50% while revenues have increased 30-100%, equating to a strong compression in multiples.

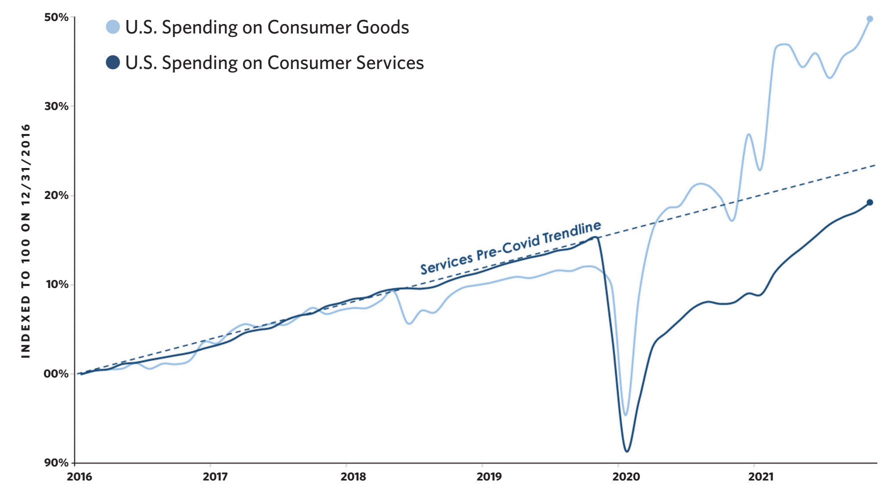
Those same Tech/Media/Telecom managers are picking through the rubble to find companies with long growth runways at very attractive valuations in both e-commerce and software SaaS. These growth runways are a different form of "duration" which has become so hated in a market focused on rising interest rates. Secularly growing, profitable tech has gotten caught up with the unprofitable tech sell-off which is not uncommon for the sector from time-to-time.

We believe that arguments on both sides of the value and growth divide have merit, and the market volatility gives investors the opportunity to add to those secular growth names that have declined to attractive valuations.

Taking Off the Value and Growth Labels

Meanwhile, there is an opportunity to add to more cyclical, value names that are primed to benefit from recovering service levels as economic re-opening continues and coronavirus reaches a more endemic stage, whereby coronavirus flare-ups remain an unfortunate part of daily life, but their impact becomes more limited over time. Furthermore, charts like the one here contrasting goods and services spending in the U.S. generally portend a good setup for hedged equity managers. These managers have the extra degrees of freedom to put aside value and growth labels and short those companies that are temporarily overearning while buying companies with enduring earnings growth profiles that have been derated despite no clear fundamental changes to their businesses. The role for such a strategy in a diversified portfolio is to mitigate downside and participate in the market upside in the face of increased volatility and uncertainty.

STARK CONTRAST IN SPENDING TRENDS POST ONSET OF COVID



Source: Market Desk.

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Lengthen Time Horizon, Seek Out Private Markets

Similarly, in the face of that uncertainty, we think investors should lengthen their time horizons, look through the noise, and seek out private market opportunities. Those markets remain inefficient despite the increased attention to the space of late.

The recent enthusiasm for private equity investments is not unwarranted as median returns for the industry have been strong over the past year and in the past 3-, 5-, and 10-year periods.

However, increasing deal valuations and fund sizes require investors to concentrate their commitments with funds that have a history of creating value in specific sectors and avoid paying prevailing multiples for their portfolio companies.

Further up the capital structure, private credit remains an attractive asset class in the current environment given its floating rate nature. While purchase price multiples for high quality businesses have increased, leverage multiples have stayed within a modest band. The resulting picture is a stronger credit position with a higher equity cushion and lower loan-to-value percentages for the best businesses. We continue to favor private credit relative to traded credit for these reasons to the degree investors can lengthen their time horizon and take on some incremental illiquidity.

Disclosure

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