



Investment Perspective — 2021 Review

Economic Focus

Inflation became the predominant focus for investors late in 2021, a year that featured strong U.S. stock market performance, ongoing COVID challenges, supply chain issues, and much talk about cryptocurrencies. Monetary and fiscal stimulus helped propel the U.S. stock market, but also helped bring on large year-over-year increases for inflation not seen in 40 years.

According to the latest Federal Reserve Beige Book (December 1, 2021) economic activity grew at a modest to moderate pace in most Federal Reserve Districts during late 2021, though several Districts noted that despite strong demand, growth was constrained by supply chain disruptions and labor shortages. There have been more than 10 million job openings every month since June 2021, according to data from the Labor Department and jobs site Indeed. Consumer spending increased modestly, and low inventories held back sales of some items. Manufacturing and construction activity generally increased but were both held back by materials and labor shortages. While the outlook for overall activity remained positive, issues surrounding the supply chain and labor supply were cause for uncertainty.

	2022			2023		
	October '21 Survey	December '21 Survey	Change	October '21 Survey	December '21 Survey	Change
US GDP	4.0%	3.9%	-0.1%	2.4%	2.5%	0.1%
World GDP	4.5%	4.4%	-0.1%	3.5%	3.6%	0.1%
US Inflation	3.3%	4.3%	1.0%	2.3%	2.4%	0.1%
US Unemployment Rate	4.2%	3.9%	-0.3%	3.6%	3.5%	-0.1%
10 year Treasury yield	1.88%	1.87%	0.0%	2.27%	2.38%	0.1%
30 year Treasury yield	2.48%	2.25%	-0.2%	2.76%	2.54%	-0.2%

Source: Bloomberg, Monthly Survey of Economists, January 13, 2022

The Fed's friendly policies kept rates near zero throughout the year, but bond buying support is expected to end in March 2022 with increases in the Federal Funds Rate to begin as early as the same month. Furthermore, expect the Fed to continue to steadily increase the Federal Funds Rate throughout 2022 and into 2023 in an effort to tighten overall financial conditions and quell inflation. Despite these increases, and Fed Chair Powell saying the Omicron variant could slow the economy, expect rates to still be historically low and likely supportive of the economy and stock markets.

The 10-year U.S. Treasury Bond closed the year at 1.51%, up from 0.92% at year-end 2020, and down from 1.92% at year-end 2019. The 30-year U.S. Treasury Bond closed at 1.91%, up from 2020's close of 1.65%, and still down from 2019's close of 2.30%.

¹ The Wall street Journal, "Jobless Claims Holding Near Historic Lows," January 6, 2022

Inflation remains in territory not witnessed since the early 1980's. Price hikes were widespread across sectors of the economy in 2021 and leading indicators of inflation remain firm. Supply shortages may be reduced in 2022, but labor shortages continue amid the precipitous decline in employment brought on by the pandemic, keeping inflation on the rise. We expect inflation to continue to be above the Fed's long-term 2% target in 2022 driven by the persistent, rather than transitory challenges with prices paid for labor, houses, commodities, and most finished raw goods at or near all-time highs.

Markets Snapshot

U.S. stocks beat ex-U.S. shares broadly, propelled by energy stocks, big tech, and strong earnings. The S&P 500 posted a 28.71% return (including dividends) for the year, with 434 issues gaining and all 11 sectors posting double-digit gains. Record earnings, sales, and margins supported another strong year. Large cap growth (S&P 500 Growth Index) led large cap value (S&P 500 Value Index) 32.01% versus 24.90%, indicating that COVID challenges continued to weigh on prices of value/cyclical companies which are more reliant upon consumer and business spending. The extended markets did not fare as well as the broader market, but still turned in strong, double-digit performance. The S&P MidCap 400 Index returned 24.76% while the S&P SmallCap 600 Index came in at 26.82%. Looking ahead, we believe earnings will remain strong (S&P estimates a rise of 8.7% over 2021) providing support for another year of stock market gains.

As noted, the energy sector had a strong rebound and led the market and all other sectors in 2021, returning 48%. This came after a significant drop in 2020 given the initial surge of COVID. Other sectors that outperformed the broad market were real estate at 43%, and both information technology and financials at 33%.

What was good for stocks in 2021, was bad for bonds. The high inflation sent bond prices lower, posting their first losses since 2013. The U.S. bond market, represented by the Bloomberg U.S. Aggregate Bond Index, fell 1.67%. Credit-sensitive assets rose along with inflation—high yield corporates were up 4.35% as investors continued to reach for yield. U.S. Treasury Inflation-Protected Securities outperformed nominal Treasuries—the Bloomberg US Treasury Inflation Protected Index rose 5.96%. The prospect of continued higher interest rates will likely continue to impact bond markets in 2022.

CLOs had a record year in 2021, as they were among the top-performing debt investments and became the largest securitized-credit sector in the country. Strong demand and low default rates in underlying leveraged loans contributed to performance. Higher inflation also contributed to CLO sales as the securities make payments that rise and fall with short-term interest rates versus longer term bonds that pay a fixed rate. We expect this to support further sales of CLOs in 2022 as inflation and rates rise. We continue to believe leveraged loan volume will remain strong next year.

Factor Performance

High Beta was the best-performing S&P 500 factor index for 2021, followed by Enhanced Value and Buyback factors. The S&P 500 Low Volatility Index came on strong at the end of the year, placing first among large-cap U.S. factors both for December and 4Q. Momentum finished as the worst-performing S&P 500 factor over the calendar year, but it is important to remember that there is a cyclical to factor returns. Also, large tech stocks had a significant impact on the performance of the S&P in 2021. The relative weights of these stocks across each factor were a strong determinant in how successful they were this year.

The S&P 500® Factor Rotator Daily Risk Control 7% Index (ER), designed by Security Benefit and sponsored by S&P, trailed the S&P 500 Index, returning 1.8% for 2021. Factor Rotator's index allocation ended the year by shifting to Low Vol and Quality factors, though the strategy had lower performance than the S&P Low Vol during December as Quality underperformed Low Vol. Factor Rotator had rotated the leading factor from Quality to Low Vol in November, which was the 10th leadership change in 2021 vs. an average of 3.80 annual leadership changes in its history. The rotation strategy typically works better when the leading factor establishes a longer-term trend of outperformance.

² The Wall Street Journal, "CLOs Wrap Up Record Year," January 1, 2022

Transition to SOFR

LIBOR has been around for decades and has been used as the interest rate for trillions of dollars of financial products. Over the years though, with changes in financial markets, the robustness of the rate has dwindled and governing bodies across the world have looked to find an alternative rate to replace LIBOR. In the US, the Alternative Reference Rates Committee (also known as ARRC), was convened by the Federal Reserve Board of New York to recommend a successor rate, and they selected Secured Overnight Funding Rate (also known as SOFR) as LIBOR's successor. They also directed the industry to transition to SOFR and stop issuing new contracts linked to LIBOR starting January 1, 2022.

SOFR is based on short-term borrowing transactions between financial market participants that are collateralized by U.S. Treasuries. One can think of the "overnight SOFR" rate as an interest rate that applies to lending for 1 day, whereas the "term SOFR" rate is an interest rate applicable to lending for longer periods like months. Both LIBOR and SOFR are sensitive to rate hikes by the Federal Reserve. In an environment where interest rates in general are increasing, both rates would be expected to go up and vice-versa.

Investment Overview

We have benefitted from the lift in over-all yields due to our strong liquidity position, with a weighted average life in our fixed income allocation of roughly 4 ½ years. We've added 8 bps of weighted average yield on the fixed income portion of our portfolio from September to November (5.05%), excluding commercial mortgage loans and equities. We're positioned to continue executing on our strategy of delivering compelling performance, consistent loan underwriting and strong governance. Supported by a strengthening US and global economic recovery, we forecast further extension of the credit cycle and low defaults.

About Our Investment Approach

While the broader U.S. Life Insurance industry continues to try to pursue private asset strategies, we employ the same prudent approach that we've been executing for over a decade. Our investment strategy entails focusing on less crowded segments of the market, which we believe offer higher returns while being appropriately balanced, diversified, liquid and risk managed at origination. Structured credit assets, which include collateralized loan obligations ("CLOs") and asset-backed securities ("ABS"), produce a higher expected return than other securities while, in our view, still providing high credit quality and diversification, which attributes are strengthened by the amortization features present in many such investments. This differentiated approach in the U.S. Life Insurance industry has delivered market leading returns which bring, maintain, and build policyholder loyalty and growing investment operating earnings. We believe most of the broadly syndicated investment grade fixed income market just doesn't work for the U.S. Life Insurance Industry business model. Issuing retail annuity contracts, taking deposits, and investing the money to maturity at 2% leads to a predictable, certain outcome – negative profitability – which isn't in the best interest of any long-term stakeholders, including consumers, appointed producers, distribution partners, employees, and shareholders.

About Security Benefit

Security Benefit Corporation (“Security Benefit”), through its subsidiary Security Benefit Life Insurance Company (SBL), a Kansas-based insurance company that has been in business for 130 years, is a leader in the U.S. retirement market. Security Benefit together with its affiliates offers products in a full range of retirement markets and wealth segments for employers and individuals and held nearly \$50.5 billion in assets under management as of September 30, 2021. Security Benefit, an Eldridge business, is one of the fastest growing U.S. retirement companies and continues its mission of helping Americans To and Through Retirement®. Learn more at SecurityBenefit.com and follow us on LinkedIn, Facebook or Twitter.

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