

2022 OUTLOOK

Threading the Needle



John Chatmas - Chief Executive Officer
Bennett Woodward - Chief Investment Officer
Don Simoneaux - Director of Alternative Investments
Trey Graham - Senior Analyst
Tim Sittler - Senior Wealth Advisor
Logan Moulton - Investment Analyst

Outlook 2022: Threading the Needle

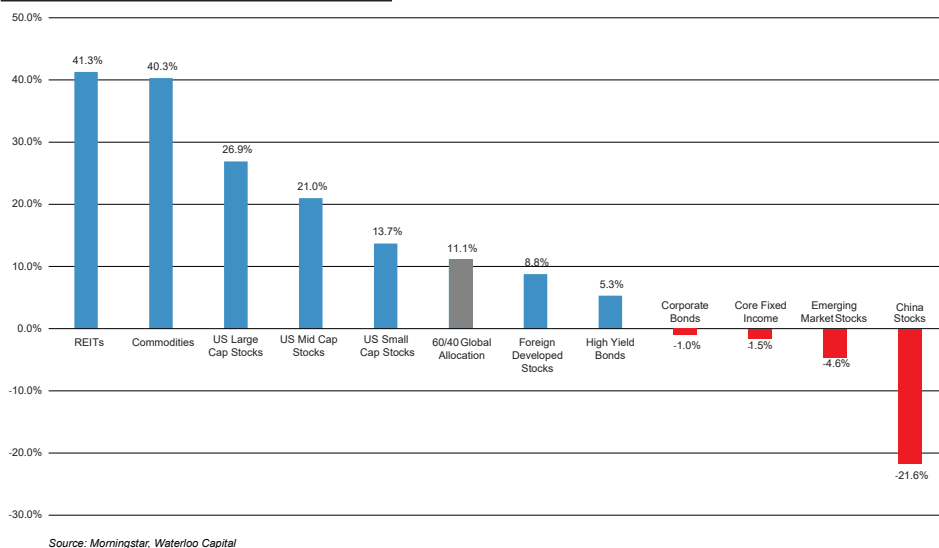
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2021 Review

2021 was a year defined by momentum in risk assets, investor confidence in the trajectory of the global economy, and the lack of replacement options for equities in the ongoing TINA (there is no alternative) environment. Globally, stocks continued their post-covid rally as the combination of unprecedented fiscal and monetary policy stimulus helped fuel a resurgence in the global economy. Many economies moved swiftly from the recovery phase to the expansion phase which helped global GDP climb past its pre-pandemic peak. As we moved into the back half of the year, equity markets navigated elevated volatility beneath the surface. The pattern of shallow sell offs at the index level had investors buying every dip and buoying markets. This buy-the-dip mentality coupled with weak performance from bonds, exemplified the TINA nature of 2021 markets. The MSCI All Country World Index returned 16.8% for the year.

Early year performance was primarily driven by cyclical and value stocks. Increases in vaccine adoption and the re-opening of restaurants, offices, and schools helped support the narrative of a strong demand rebound for economically sensitive sectors. These sectors also benefitted from inflation given they are more positively correlated with rising prices than growth sectors like technology. Market dynamics shifted during the summer as fears of a covid resurgence dented confidence in the economic recovery and shifted demand back towards growth leaders such as consumer discretionary, healthcare, and technology. The middle of the year also brought more questions about inflation, supply chains,

2021 Asset Class Returns

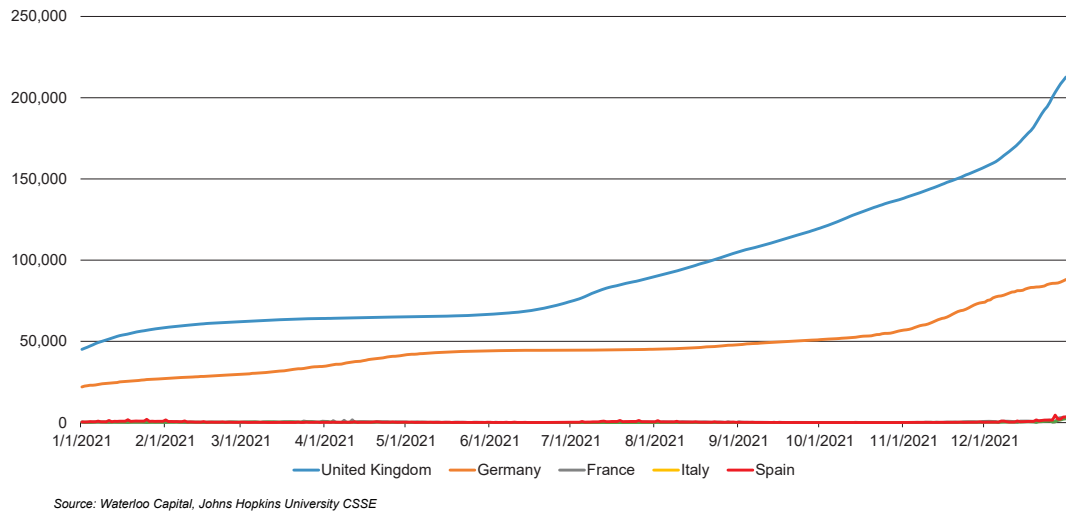


labor markets, and monetary policies. Headline risks regarding each of these topics were a constant influence on company outlooks and market volatility through the end of the year.

In the US, optimism reigned and demand for stocks lifted the markets to 70 new all-time-highs throughout the year. Signs of a strong labor market, exceptional earnings results, and growth in consumer spending far outweighed fears of a covid related reversal in economic prospects. US equities only experienced two extended drawdowns of more than 5% and never closed in a correction, marked by 10% decline from recent highs. Volatility was rekindled during the last few months of the year. The Fed announced plans for reducing market support and covid continued to show its resilience through the spread of new variants. Investors viewed these changes in the risk landscape as temporary and optimism grew once again as 2022 came into view. The year-end rally helped equity indexes finish

another banner year. The S&P 500 rose 26.9%, the NASDAQ rose 21.4%, and the DJIA rose 18.7%. Global markets were unable to keep pace with the US last year. Persistently weak growth in Europe and uncertainties surrounding the differences in how each country handled new covid breakouts weighed on the region. Central banks fueled the poor outlook by maintaining unprecedented monetary

European Covid Cases (7-day rolling average per million people)



stimulus measures which was seen as a sign of distrust in the region's recovery. Ongoing supply chain issues also created headwinds for export driven economies such as Germany. In a region which prides itself on inter-country commerce and workforce opportunities the lack of movement by both people and products capped consumer activity and market upside. Other developed markets posted mixed results for the year. Canada performed well as the economy continued a strong recovery. The Bank of Canada raised rates in a vote of confidence in the trajectory of the nation's economy. A high exposure to energy and materials also boosted results. The MSCI Canada Index returned 26.9%. Heading east, Australia struggled to overcome heavy handed vaccine mandates and lockdowns. Uncertainty and confusion over rules for individuals and businesses led to more fits and starts in their recovery. The MSCI Australia Index returned 11.0%. Japan also struggled to overcome the covid mindset. An overall lack of consumer activity, confidence in the administration, and business leadership led to weak results on a USD basis. Despite a recovery in company earnings and signs of an improving labor market the MSCI Japan Index returned just 2.0% for the year. Overall, the MSCI ACWI Ex-US Index returned 8.3%.

Emerging markets (EM) underperformed as an asset class throughout the year. EM exporters faced covid issues within countries where vaccine rates remained low. Many were forced to shut down ports or other supply chain operations during localized virus outbreaks. These issues made it difficult for countries to take advantage of the low supply and high demand imbalances around the globe. EM equities were also dragged down by the reversal of fortune in China. A slowdown in Chinese consumer activity and domestic growth weighed on EM indexes. Also, the Chinese government crackdown on the stock market and private businesses increased uncertainty in the strength of Chinese markets and caused a sell-off in the once red-hot Chinese tech sector. Lastly, the fallout from Evergrande, China's largest speculative real estate development company, was difficult to navigate. There were a few bright spots for EM, but given the outsized weight of China in the index these uncertainties and pullback in the growth outlook dragged down the entire asset class. The MSCI EM Index lost -4.6%.

After years of performance positively correlating with the equity markets the bond market struggled in 2021. Though rates ended up bouncing around a steady range during year, damage to total returns was done during large rate spikes at both the beginning and end of the year. Higher interest rates were a global phenomenon as central banks began removing covid stimulus measures and actively raising benchmark rates. Long-duration bonds posted the worst performance within fixed income as yield curves steepened for most of the year. A weaker long-term outlook for the global economy led to some yield curve flattening in Q4 which provided support for bond prices but was not enough to pull index returns into positive territory. High-yield bonds, which trade more in line with stocks, were the top performing sub-asset class. With global interest rates remaining persistently low, the high yield space was boosted by massive demand amidst average bond issuance. Spreads between high yield bonds and investment grade bonds, a measure of the risk of default in the high yield space, contracted to near historical lows which also helped boost prices. TIPS were another bright spot in the bond market. The inflation adjusted bonds were in high demand as global inflation rates rose. Overall, the Bloomberg US Agg Index fell -1.5%, the Bloomberg Global Agg Index fell -4.7%, and the Bloomberg Global Agg Ex US Index fell -7%. On the positive side, the Bloomberg US Treasury TIPS Index rose 6.0% and the Bloomberg High Yield Corporate Index rose 5.3%.

Private equity performed well as IPO activity remained strong, the SPAC boom continued, and M&A activity picked up. A recovery in corporate spending, massive amounts of liquidity in the institutional investing space, and high public market valuations comps led to a record number of PE deals. Add-on deals were the most popular with many companies looking to adjust their business models in the wake of pandemic driven change. Private debt also performed well, significantly outpacing public debt. As we have touched on in the past, the ability of many private debt strategies to adjust contracts and terms as interest rates rise provides insulation against rising rates. Additionally, ongoing uncertainty for companies which are active borrowers in the alternative debt space allowed capital providers to demand higher interest rates.

Hedge fund strategies performed well as volatility in interest rates and dispersions in global market performance helped boost returns for many strategies. Although many strategies lagged the equity market, risk adjusted returns far outpaced assets with similar volatility metrics. The HFRI Composite Index returned 10.3% for the year. The best performing sub-strategies were Equity Hedged which returned 12.0% and Event-Driven strategies which returned 13.0%.

**2021 WAS ONCE AGAIN A "TINA" MARKET
DRIVING RISK ASSETS TO ALL TIME HIGHS**

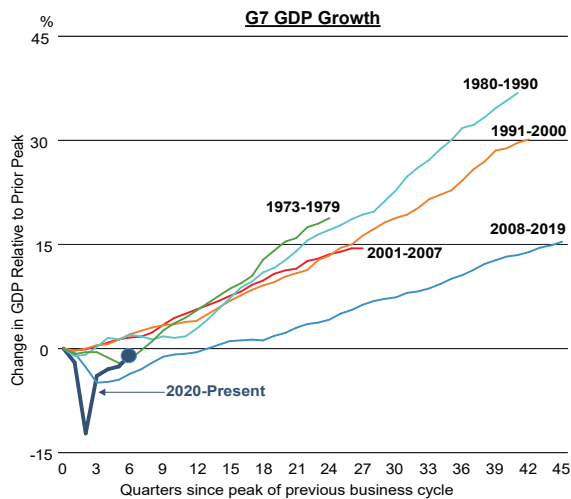
Outlook 2022: Threading the Needle

2022 Intro

The launch from pandemic lows has been exceptional. Unprecedented stimulus measures from governments and central banks pulled forward massive amounts of demand and accelerated the business cycle. Valuations for both stocks and bonds are at or near all-time highs. The world is awash with liquidity from central bank and government programs. Inflation is at its highest level in decades. Global growth has overtaken pre-pandemic levels. Heading into the new year it is difficult to find many areas of weakness in the markets and the economy. The question now is, can too much of a good thing become a bad thing?

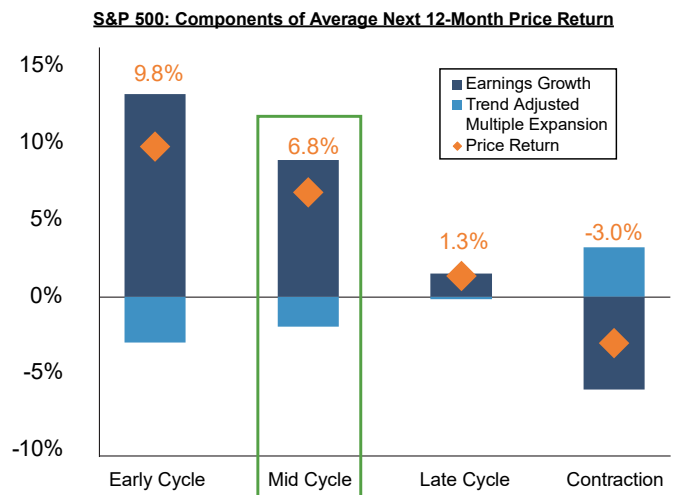
2022 will be our first attempt to answer this question. We are entering a defining point for the current market cycle. Early cycle dynamics were accelerated by covid stimulus and are beginning to fade as we move into a mid- to late-cycle environment. This shift will be driven by multiple factors. Monetary and fiscal measures which have supported growth in recent years are diminishing or reversing. Also, the dramatic year over year increases in many datapoints is likely to slow with the base effects of 2020 comparisons rolling off. The return to moderation for both growth and policy support will be a test for the markets.

The V-Shaped recovery put global markets back on a similar trend to historical market cycles



Source: Invesco, Macrobond, Organisation for Economic Co-operation and Development (OECD), and US Bureau of Economic Analysis. As of October 31, 2021.

Mid-cycle performance is driven by earnings growth



Source: Census Bureau, BLS, BEA, ISM, NAHB, Conference Board, Haver Analytics as of November 30, 2021

In our opinion, the markets are well prepared to take on these tests. A strong foundation has been laid for 2022 to build upon. Jobs remain plentiful, corporate profits and earnings are strong, and consumer spending remains resilient despite inflation. That said, after two years marked by excess, a return towards longer-term growth rates is likely. Growth will continue, but we expect the rate of change will be slower as markets digest normalization in the policy and economic landscape.

What does this mean for your portfolio in 2022? Investors should be prepared for more aggressive and longer periods of volatility, a showdown between the central banks and the markets, inflation rising then potentially reversing later in the year, and an ongoing struggle for yield in a rough environment for fixed income. We are moving into an environment where smaller changes can lead to significant impacts in investment trajectory. The ability to take advantage of the relative rotations driven by these shifting factors and trends defines our 2022 outlook. Risk management will be crucial, and investors may need to step out of their comfort zones and be prepared to be more active and precise in their

Outlook 2022: Threading the Needle

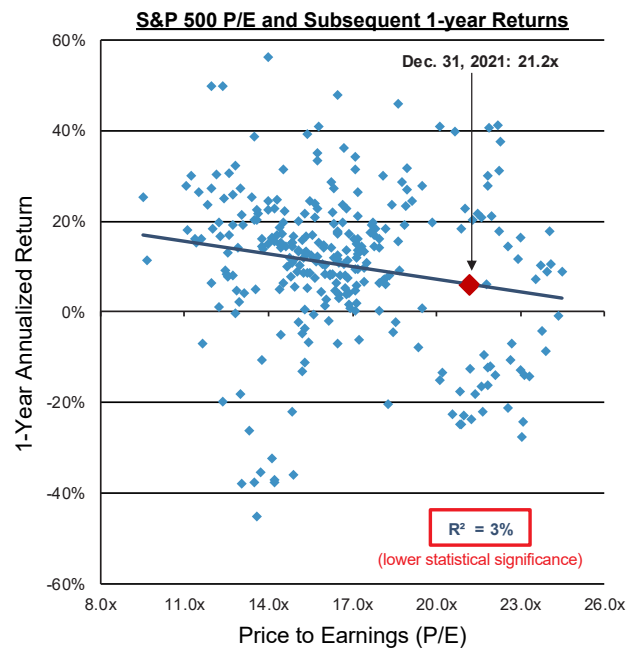
allocations throughout the year. As potential issues such as rising interest rates, stickier inflation, and valuation resets begin to cling to equities and bonds, gravity may start to take hold. Overall, we believe markets can defy the pull of these issues and have farther to travel before we start the initial descent.

With valuations for most markets at or near all-time highs it is important to remember that when it comes to future returns your starting valuation still counts. Using the price to earnings ratio (P/E) can help give us an idea of where long-term returns may be heading, but it is a poor prognosticator of one year return expectations. Entering 2022 the S&P 500 sits at just over a 21x P/E which would suggest average returns in the low single digits over the next five years. With many factors we have not seen in decades coming back into the foray and a move deeper into a mid-cycle market regime, this year will likely exhibit higher volatility and a more jagged path to our return target.

We expect global equity markets returns of 5% to 7% and see higher upside for more focused country, sector, and industry exposure. We also favor domestic equities over foreign but expect the performance gap to close significantly. Our expectations for traditional fixed income are less optimistic, with returns likely in the -2% to 2% range. Alternative strategies can help fill this portfolio gap and provide risk management during periods of volatility. We expect to continue increasing allocations to private markets this year with private equity returns likely to be in the 8% to 12% range and total returns from private debt coming in around 4% to 8%.

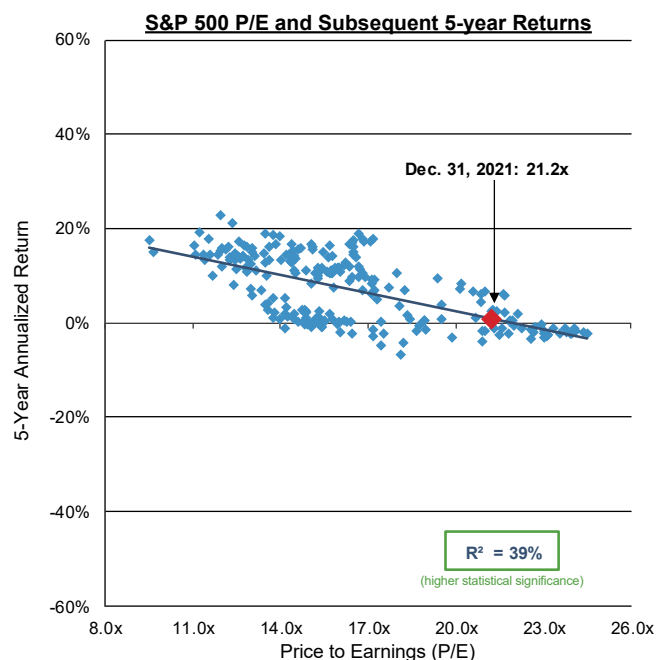
We look forward to the opportunities in 2022 and will continue to focus on our process. We are constantly taking in new data and using our proprietary analytical tools and research to manage risk and find the areas of the market with the highest probability of investment success. On behalf of Waterloo Capital, we want to thank you for reading our 2022 Market Outlook.

S&P 500 Forward P/E does not have statistical significance when projecting subsequent 1-yr. returns...



Source: JPM Asset Management

...Over 5-years the significance increases and shows lower, but still positive, return expectations



Source: JPM Asset Management

Outlook 2022: Threading the Needle

<i>Tactical Decision</i>	<i>2022 Allocation Outlook</i>
Relative Risk	Risk Off ←————— ●—————→ Risk On
U.S. Equity Style	Value ←—————●————— —————→ Growth
U.S. Market Cap	Large-Cap ←—————●————— —————→ Small-Cap
Regional Equity Selection	U.S. ←—————●————— —————→ Non-U.S.
Non-U.S. Equity Market Preference	Developed ←—————●————— —————→ Emerging
Fixed Income Quality	Investment Grade ←●————— —————→ High Yield
Fixed Income Duration	Short ←●————— —————→ Long
Regional Bond Selection	U.S. ←—————●————— —————→ International

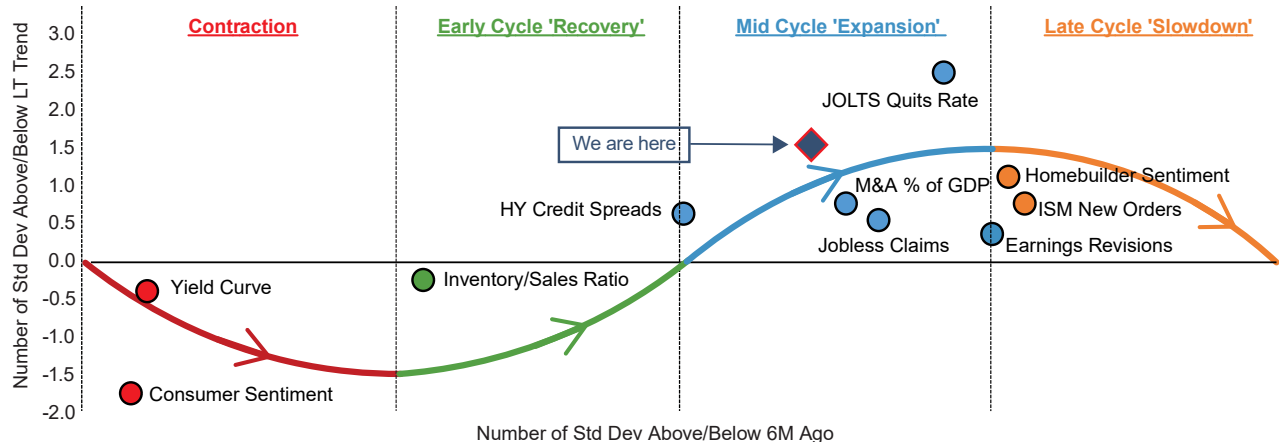
Source: Waterloo Capital

WE ARE ENTERING A DEFINING POINT
FOR THE CURRENT MARKET CYCLE

Markets: Volatility Loves Uncertainty

Quicktake: At high valuation levels volatility and drawdowns are much more likely. Given where valuations stand for both stock and bond markets, and uncertainty regarding the trajectory of the economy and Fed policy, we expect bigger price moves to both the upside and downside. The trajectory of growth will begin to taper from the sharp spike we experienced post-pandemic as the economy moves deeper into mid-cycle territory. Uncertainty regarding the effects of higher inflation and a tighter labor market on profitability will lead to wider price movements during earnings seasons. Finally, The first rate hike cycle in over a decade will likely have a destabilizing effect on markets as policy support is reduced. Higher interest rates will force a repricing of valuations and risks for both stocks and bonds. The concentration of long duration assets in stock and bond indexes will also contribute to volatility at the index level. Quality will be the most important factor this year. Focus on valuation, solid fundamentals, cash flows, and earnings growth to build a portfolio core and take advantage of volatility by tactically allocating to short-term opportunities.

The recovery phase is ending and the mid-cycle expansion is underway



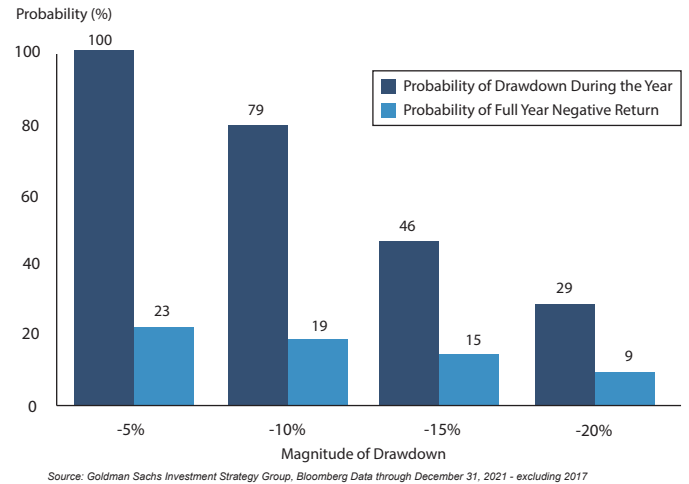
Source: Bloomberg Data as of November 30, 2021

The US economy is firmly in mid-cycle territory after moving swiftly through early-cycle stages coming off the pandemic lows. Due to the amount of government stimulus and benefit packages handed out over the past two years future spending was pulled forward. We expect US economic growth to continue accelerating in 2022 but at a more moderate pace. Mid-cycle environments are defined by moderating growth, high profitability, and a shift to more neutral monetary policies. They also tend to be the phase of the cycle where the most market corrections take place. Slower growth does not mean zero growth, and we think the economy is on track to keep the momentum going this year. That said, economic data may be harder to interpret, and we will likely see more volatility around data releases. In fact, many year-over-year numbers could show declines because of comparisons to 2021 measures which were extreme outliers. It will take time to get a better understanding of incoming data which may look worse on the surface than it actually is. Uncertainty in the headline numbers will add noise and volatility to markets, but ultimately, the direction of the trend is more important than individual data points.

Outlook 2022: Volatility Loves Uncertainty

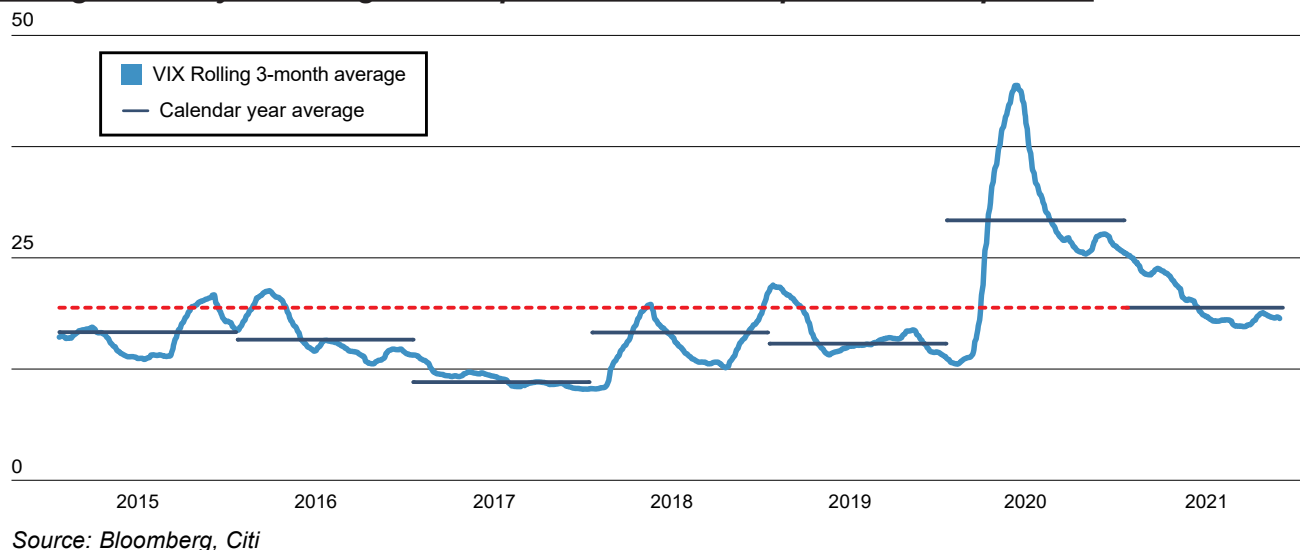
Additionally, look for volatility to ramp up during earnings seasons this year. Rising P/E ratios, or multiple expansion, had been driving the majority of market returns in recent years, but as valuations reach excessive levels this tailwind has begun to fade. After surging nearly 40% last year, earnings will once again be the most important factor supporting equity markets. Like most other measures, earnings will moderate, but we are still expecting growth in the high single to low double-digit range. This level of growth will support equity market appreciation, but we expect significant divergences between sectors, industries, and companies. Investors have been willing to pay higher prices given the rosy 2022 expectations for many companies, but if earnings growth fall short of expectations, we will see a significant repricing.

When valuations are in the upper deciles on a historical basis drawdowns are more likely



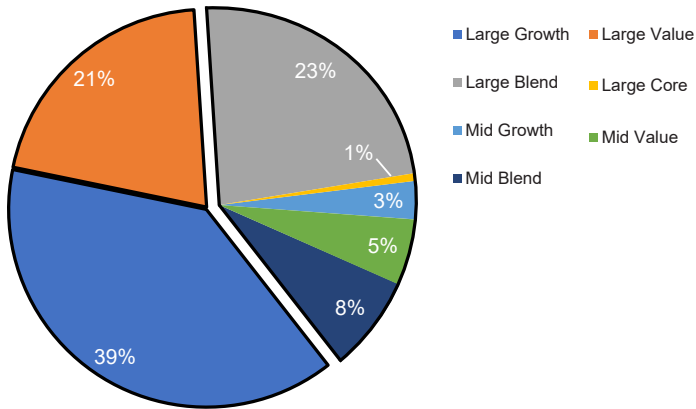
Finally, we expect to see additional volatility in both the bond and stock market as the Fed moves from QE to QT and interest rates begin to rise. One of the main reasons higher interest rates may create issues for the markets is the exposure of major indexes to long duration assets. Duration is a measure of the sensitivity of an asset's price to changes in interest rates. The measure is typically applied to bonds, but the concept can be applied to stocks as well. Longer duration assets are more sensitive to changes in interest rates and shorter duration assets are less sensitive. For bonds, the longer the time to maturity the longer the duration. For stocks, the longer the time to return capital to shareholders through earnings or dividends the longer the duration.

Average volatility is still higher than pre-covid levels despite investor optimism



Outlook 2022: Volatility Loves Uncertainty

Growth exposure outweighs value exposure by nearly 2x in the S&P 500



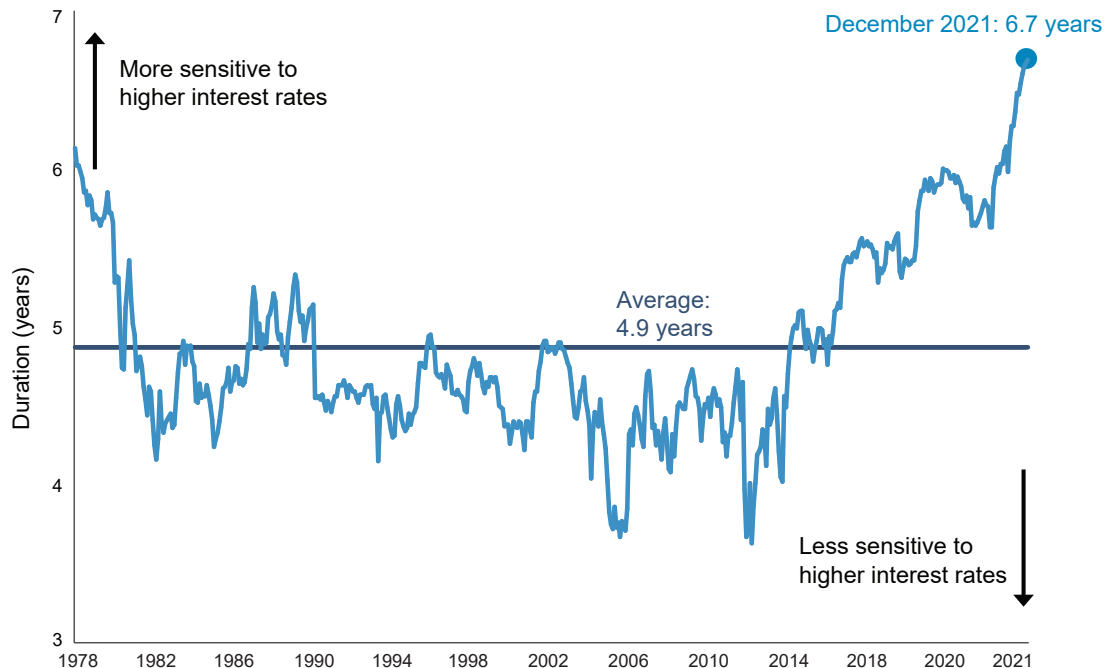
Source: Morningstar, Waterloo Capital

Many growth companies can be classified as long duration because they have low, or sometimes, no earnings and rarely pay dividends. Both the S&P 500 and the Barclays US Agg have experienced increases in duration exposure in recent years. The strength of growth stocks has pushed the S&P 500 exposure to the growth factor to nearly double the value factor. The duration of the Barclays US Agg has been rising since 2014 and is now the highest it has been since the 1970s. The changing characteristics of both indexes has helped support strong returns while interest rates declined, but the knife cuts both ways. Major indexes are likely to exhibit higher volatility as interest rates rise with long duration shifting out of favor and

strength rotating towards the lower weighted factors and sectors. With rates expected to rise we still like equities over bonds and expect drawdowns to coax capital back into the market. Until real yields begin to trend higher, we will remain in a TINA environment where stocks maintain a high risk premium versus bonds and draw demand from investors looking for yield and inflation hedges.

As volatility spikes become more commonplace tactical investors stand to benefit by being able to capitalize on rapid internal rotations in market leadership. Investors should look to diversify not only between asset classes, but also between passive and active management. Additionally, as the risk and return outlook for fixed income has deteriorated, we think that investors can benefit from holding a higher allocation in cash or short-term bond alternatives as “dry-powder” to take advantage of trading opportunities throughout the year.

The duration of the Barclays Agg Bond Index has risen significantly since 2014



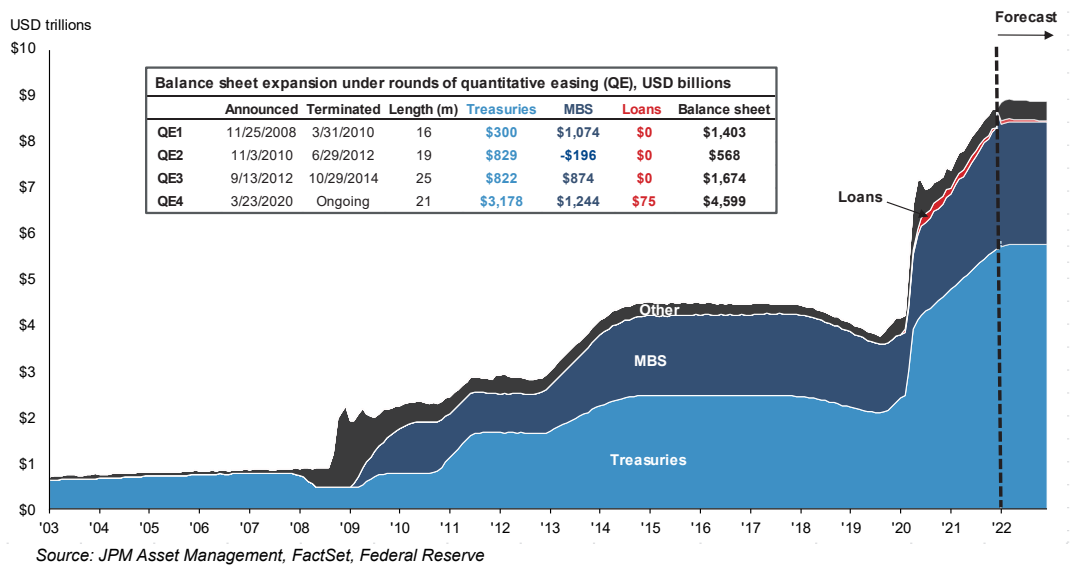
Source: Barclays Live, Bloomberg, and Hartford

The Fed: Threading the Needle

Quicktake: The Fed is attempting to thread the needle and engineer a smooth transition for the economy as they begin the first rate hike cycle we have seen in over a decade. Their motivation is two-fold. First, economic growth has been exceptionally strong since the pandemic lows which indicates the economy has gained enough momentum to continue growing without policy support. Second, policy makers are worried that inflation may be more durable than initially expected. Financial conditions are still at their loosest levels in history, and QE is not over yet, but major policy changes will likely be disruptive to markets. Market cycles typically end due the decline in spending and credit availability brought about by rising interest rates. Markets typically continue rising after digesting initial rate increases, and we think a soft landing is possible, but a Fed policy mistake is near the top of our list of downside risks.

The Fed will be on the front of every investor’s mind this year. 2021 was defined by a continuation of extraordinary accommodation from the Fed and global central banks. The Fed has purchased almost \$5 trillion of bonds since the start of the pandemic, expanding its balance sheet to nearly \$9 trillion and pushing interest rates near the zero lower bound. This process of quantitative easing (QE) provided substantial amounts of liquidity to financial markets, and paired with the amplifying effects of fiscal policy out of Washington, has supported asset prices and kept interest rates low. Without question, the culmination of these actions helped protect the economy from a prolonged recession following pandemic related shutdowns.

The Federal Reserve balance sheet has grown to over \$9 trillion



The Fed has had their backs against the wall for years, but they have consistently found a way to take a few steps further back because of unforeseen risks cropping up in the economy and markets. Now, with their mandates of full employment and inflation data convincingly met, the walls are closing in again and they will be forced to make a move in 2022. The shift to a more hawkish policy began in November 2021 when the Federal Reserve announced it would reduce QE purchases by \$15 billion per month. Given elevated inflation and a rapidly decreasing output gap, it took all of one month for the central bank to double the speed of reductions \$30 billion per month and announce a timeline to end the bond buying program by the middle of this year. In addition to ending QE, the Fed has signaled

Outlook 2022: Threading the Needle

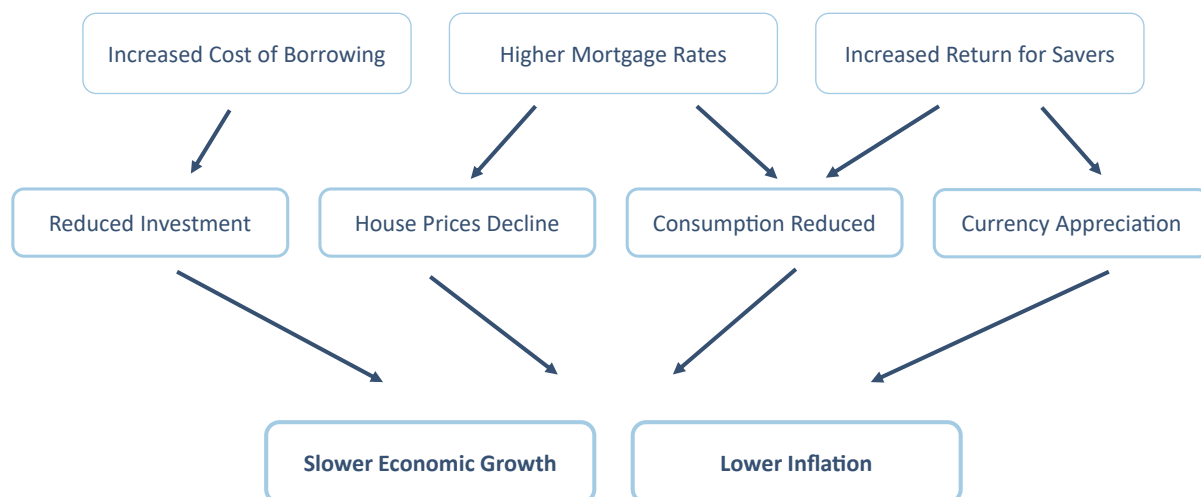
rate hikes are on the horizon and even hinted at QT (quantitative tightening) by rolling assets off the balance sheet. We expect the Fed to start rate liftoff as planned during their first meeting in March and continue raising rates for at least the first half of the year. Markets are now pricing in five rate hikes for 2022 which would indicate consistent hikes throughout the year. How many ultimately become a reality remains a large question that will affect the return potential for both stocks and bonds.

QE tapering alone does not always create outright tighter credit policies for the economy, but it does create tighter financial conditions for markets. As the Fed reverses the tide that has lifted all boats, liquidity will be reduced which is a headwind for financial markets. On the interest rate front, higher rates increase borrowing costs for companies, consumers, and the government. Additionally, investors using loans to purchase assets on margin will have to pay more for leverage. This could cause many market participants to reduce or remove leverage which would further reduce liquidity in the system.

Markets are trying to correctly price in these scenarios, and the Fed will be trying to thread the needle and engineer a soft landing which does not disrupt financial markets. However this is an enormously difficult task, and history is not in their favor. In 2017, the Fed tried tightening QE purchases which had been in place since the 2008 global financial crisis. Then-Fed Chair, Janet Yellen, said that tapering would be "something that will just run quietly in the background over a number of years" and equated it to "watching paint dry". While the process started without a hitch, other global central banks gave signals they would also be tightening their own policies. Fears of a credit crunch sending lenders scrambling for cash caused the dollar to strengthen which put enormous pressure on emerging market borrowers with dollar denominated debt. Global stock and bond prices slid, and credit spreads across developing nations soared. By the end of 2018, US markets had tumbled over 15% in three weeks and many were arguing the Fed had moved too fast. The fallout caused the Fed to abandon course and reconsider how quantitative easing should be phased out.

Although the words "this time is different" are dangerous to use in the investment world, the Fed has worked hard to communicate their plans for 2022 well in advance and help the markets know what to expect. Also, economic growth is expanding much faster than in the previous cycle which started after the Great Recession. On the other hand, risk premiums are much lower, valuations are much higher, and the size of the balance sheet has skyrocketed. If aggressive policy changes coincide with a reversal in positive supply and demand dynamics, the Fed may have to pivot to avoid rate hikes becoming

Higher interest rates affect all levels of the economy and eventually lead to slower growth



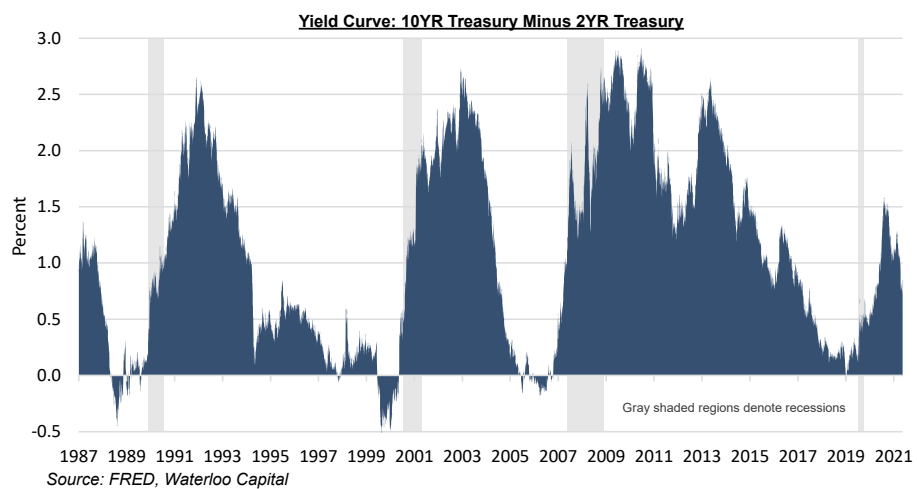
Source: Waterloo Capital

Outlook 2022: Threading the Needle

detrimental to growth. Additionally, the potential resurgence of new covid variants increases forecasting uncertainty and could continue to disrupt supply chains and broaden price pressures. Yet, if the Fed doesn't act quickly they risk losing face by sending the wrong signals to markets which are already pricing in tighter financial conditions.

Generally, when the Fed is tightening or less accommodative it creates headwinds for financial markets. Projections on tapering, rate hikes, and balance sheet reductions will dominate major headlines and inject volatility into markets, but separating what the Fed says and what they follow through on will be key. Financial conditions are still the loosest in history, rates are currently still at zero, and QE is still running. A strong consumer and healthy housing and labor markets have also helped bring us to this point and look strong enough support economic growth despite reduced policy support. It might take actual action for investors to react to the rhetoric. That said, markets practically have a Pavlovian response to any hints or talks of tightening and there will be pockets of elevated volatility surrounding Fed meetings throughout the year, further supporting a cautionary approach for investors.

The Fed risks making a policy mistake leading to lower growth expectations and a potential a yield curve inversion



Finally, given the Fed does not know how much of the recent rise in inflation is monetary induced or due to supply and demand shocks, being data dependent and flexible will be ever important for both policymakers and investors. If the Fed is right and supply side shocks are the primary driver of inflation higher prints are unlikely to be long lasting. However, monetary inflation tends to be more systemic and durable. Stronger economic reports and consistently hotter inflation prints could raise concerns of faster or larger than expected hikes, while easing inflation and poorer economic news could counterintuitively ease investor concerns by delaying future policy changes. Historically, equity returns have been turbulent around initial rate hikes, but markets ultimately digest the policy changes as a sign of a strong underlying economy and continue climbing. We think this trend will continue this year, but the situation is fluid. With the potential for slower growth in the back half of the year mixed with disruptive inflation prints a Fed policy mistake is a risk at the top of our list.

Inflation: Not Partying Like It's The 1970s

Quicktake: No matter how you measure it inflation is high. Pandemic production cuts left massive gaps in supply chains which has led to ongoing supply and demand shocks. The real question is whether or not this trend is here to stay. Ongoing supply issues, wage growth, and housing costs will keep inflation elevated early in the year. Looking ahead, we expect inflation to remain above historical trends, but we see the current climb peaking earlier rather than later. Breakeven rates and consumer expectations indicate inflation expectations are falling over longer time frames. Also, shifts in consumer activity and a rebound in inventory production should help alleviate pressure from the demand side. Finally, multiple secular deflationary factors including low money velocity and technological innovation remain in force.

Supply chain disruptions, surging oil prices, labor shortages, and pent-up demand from the lows of the pandemic have pushed global inflation to multi-decade highs. The Consumer Price Index (CPI) is at +7% year over year while the Fed's preferred gauge, Personal Consumption Expenditures (PCE), is up over 4%. It's interesting to note that in 1981 the Bureau of Labor Statistics (BLS) changed the way inflation is calculated and using the pre-1981 math, 2021 prices would have actually been 3-5% higher than reported. No matter how you look at it or what index you use, inflation is back.

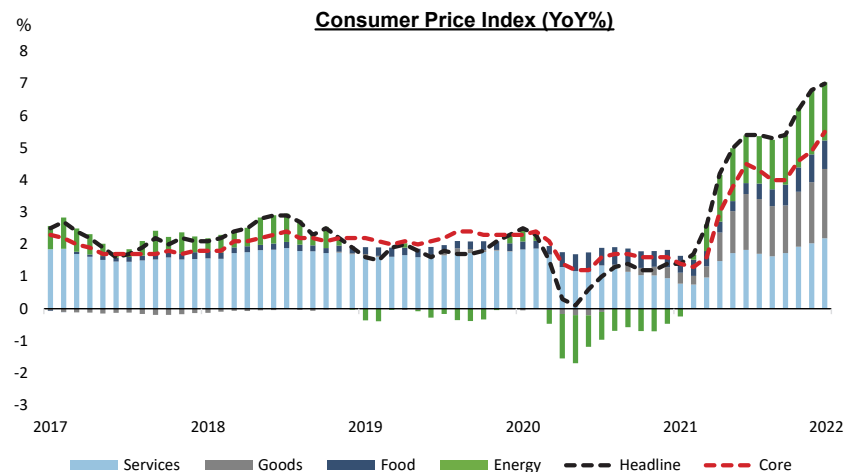
The headline shocks many investors and consumers are experiencing turn our attention to the real question: Is inflation is here to stay?

In normal times, these types of numbers would be a clear sign for central banks to pump the brakes and begin a rate hike cycle. But the last couple years have been anything but normal. Just 18 months ago the world was arguing whether deflation was going to be long lasting given the massive demand disruption in global economies caused by the pandemic.

This disruption caused a myriad of interruptions to global supply chains,

as many corporations closed factories and laid off workers in response to and in anticipation of worldwide lockdowns. The tables quickly turned. Exploding consumer demand for goods combined with surplus capital from stimulus measures was a recipe for one of the largest demand bottlenecks we have ever seen. Raw material shortages, scarce transportation labor, factory closures, and port congestion were just a few of many problems in what has been dubbed the "everything shortage". Supply imbalances and the threat of ongoing local lockdowns in key supply regions pushed managers to source goods domestically. This shift to domestic supply and production continued to put upward pressures on prices. Economics 101 teaches us that when supply contracts at the same time demand is rising prices will increase. That theory became a reality throughout 2021. Used car prices spiked 45%, lumber was up over 100%, and oil prices rose as much as 75% in 2021.

Inflation is spiking but will the trend continue?

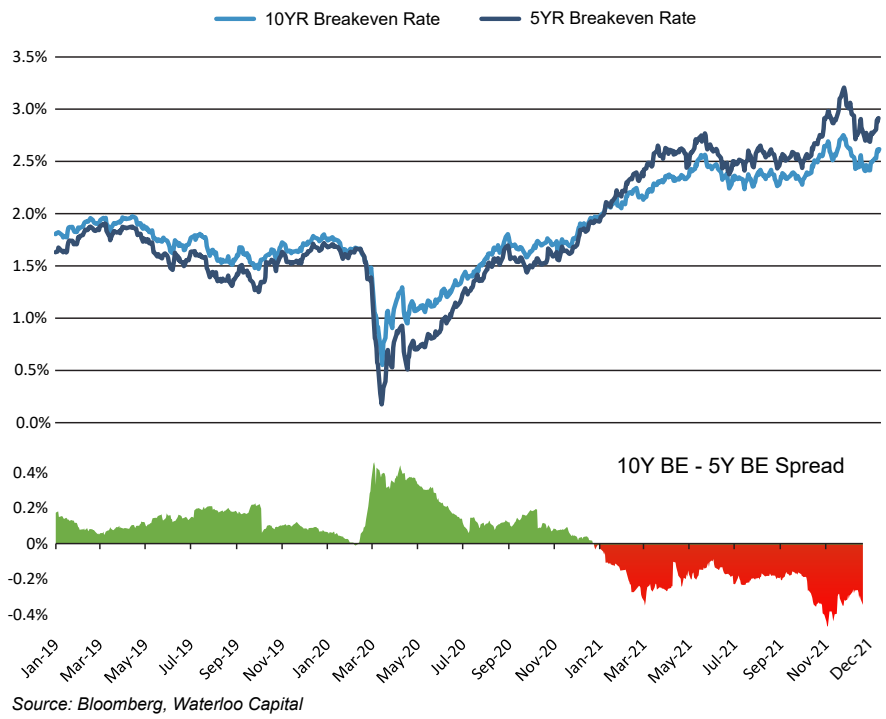


Source: Bloomberg, Waterloo Capital

Outlook 2022: Not Partying Like It's The 1970s

As we head into 2022, we expect inflation to remain elevated above historical trends, but we believe we are nearing the peak. We recognize that the recent trend towards deglobalization and supply chain disruptions can persist, but many of the current distortions are unlikely to be permanent events. If using the word transitory means that the supply and demand relationship will move back toward equilibrium then we support that view. Just from an arithmetic standpoint, the year over year comparisons from such high levels in 2021 will be a headwind going forward for higher CPI prints. Looking at the gauges for input costs and barometers of inflation many are at or past their peak. Additionally, a shift in consumer spending from goods to services appears underway which should also help elevate some pricing pressures.

Break even spreads show the market does not expect inflation to become a secular long-term issue



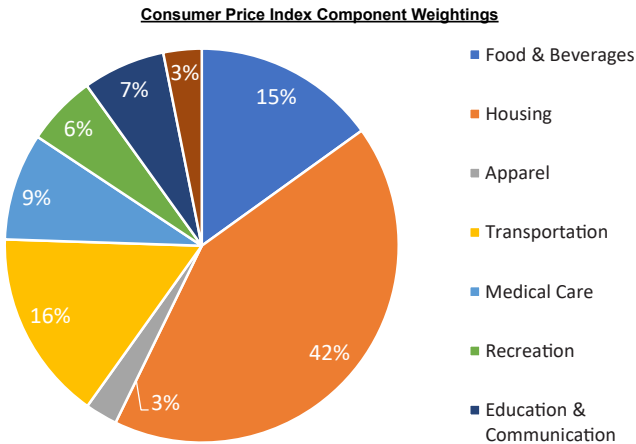
The fixed income market is a great place to look for clues as to where market participants think inflation will be. Textbooks tell us that nominal yields are calculated by adding economic growth to inflation. By extension that means rising inflation should lead to higher rates. However, over the last year nominal yields are not rising out of control.

Looking at the breakeven rates provides even more insight into the potential peak in inflation expectations. Breakeven rates are market-based measures of expected inflation. They are calculated by comparing the nominal yield of a bond to the yield on an inflation linked bond with the same maturity. Clearly, we can see expectations of future inflation point to weaker price growth as the economy normalizes. Additionally, if we observe two key maturities of breakeven rates, the 5 Year and 10 Year, it tells an even better story. When the spread is negative that means that the shorter-term inflation expectations are higher than the longer-term expectations. Effectively the market is telling us that inflation will remain higher in the short run but taper off in the long run, further supporting our view. Even the public's longer run viewpoint of price pressures is retreating, though by a modest

Outlook 2022: Not Partying Like It's The 1970s

margin. Consumer inflation expectations are important as they can build on themselves and lead to a feedback loop. The latest expectations survey waned to 4% in November 2021 from 4.2% in both September and October. It ended a four-month string of increases and marked the sharpest decline since September 2020. Furthermore, recent manufacturing PMI reports show that businesses are reflecting the same narrative. Supplier delivery delays, a good gauge of supply bottlenecks, declined from 75.6 in October to 72.2 in November to 64.9 in December. Drilling down to inflation itself, the prices paid index (PPI) sank from 82.4 to 68.2 in December which marked the lowest reading since November 2020.

Housing is the largest component of the Consumer Price Index

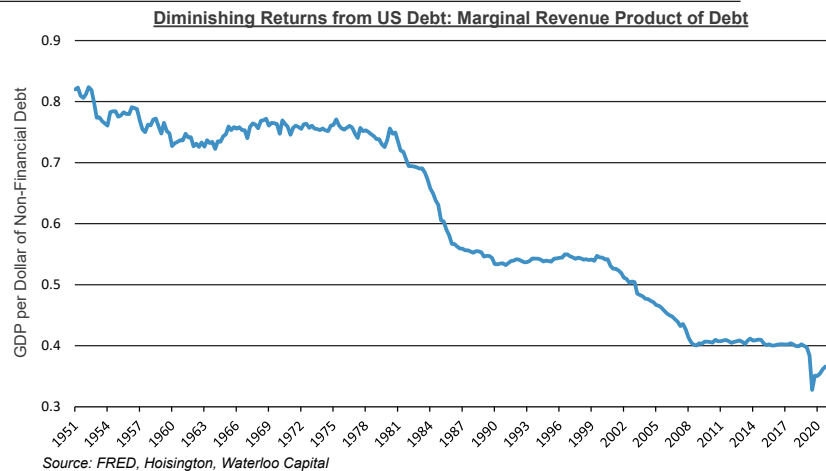


Though we see supply chains and some input costs easing over the course of the next year and beyond, labor and rent could be key factors in stickier inflation. The latest JOLTS report reflected a tight labor market showing job openings at 10.6 million while the number of people looking for jobs is a little over 6 million. In tight labor markets workers can find jobs more easily and are likely to receive higher wages as businesses pay up to fill positions. This can cause a wage price spiral in which higher wages lead firms to increase prices on goods and services to cover costs, which in turn, leads workers to ask for higher wages to cover their own costs. This phenomenon remains a risk especially as the

decrease in labor force participation rates may reflect secular changes in the economy. On the housing front, shelter costs are up over 4% for the year which is the largest increase since 2007. Shelter makes up about around 40% of the inflation index and is reported on a multi-month lag. Although many house prices and apartment rents may be near their peak, the lag in reporting could keep headline CPI elevated early in the year especially as input costs and wage pressures remain high.

Over the long term, many secular deflationary forces remain intact. Before the pandemic, inflation was kept in check due to a combination of high debt levels, increased globalization, aging demographic trends, and technological innovation. The rising level of both public and private outstanding debt is a problem facing many of the largest global economies today. Debt is not so much a problem if the economic growth per dollar of debt issued is increasing. Unfortunately, the marginal return on debt is at historic lows.

Debt has been increasing but it has not been as accretive to growth

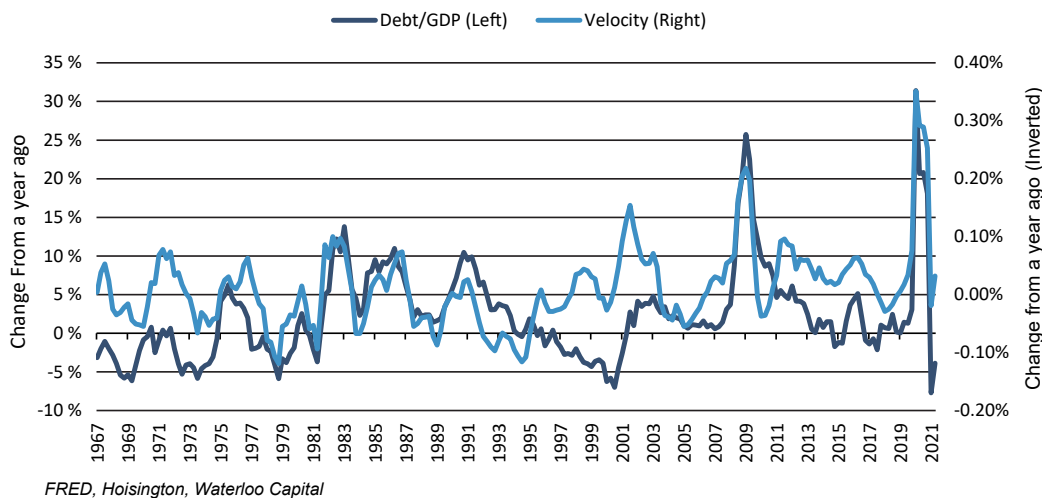


Outlook 2022: Not Partying Like It's The 1970s

The creation of debt leads to growth in money supply, and the destruction of debt equates to a contraction of capital which expands the output gap between actual and potential GDP growth. As all debts must be repaid, debt is by nature is deflationary over the long term.

To get a meaningful sustained increase in inflation, we would need to see an increase in the velocity of money. Money velocity is a function of debt, or money supply, relative to economic growth and there is an inverse relationship between the two. A bet on inflation over the long term is a bet on the increase in the marginal productivity of debt and economic growth exceeding debt growth. Additionally, although some secular disinflation trends like globalization were temporarily disrupted, one remains unimpeded. Technology has constantly increased worker productivity over time, putting downward pressure on inflation. As we put the pandemic behind us and businesses invest in technology and equipment upgrades there should be a productivity rebound which will put downward pressure on prices.

A bet on inflation is a bet on a sustained increase in velocity



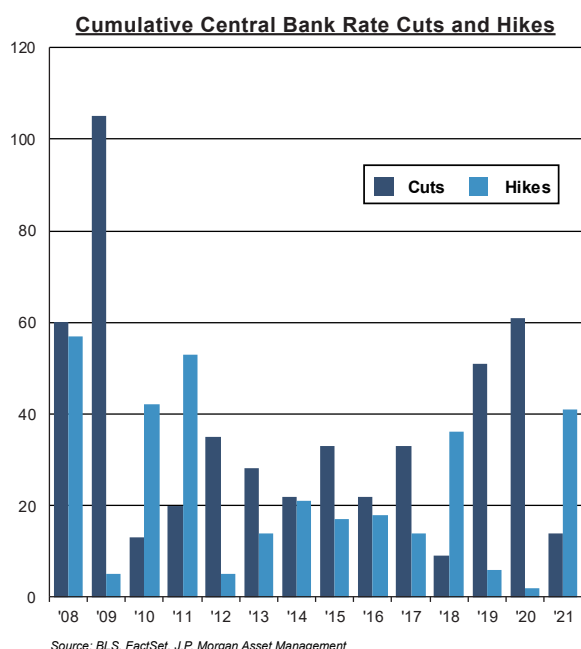
WITHOUT A PICK UP IN MONEY VELOCITY
INFLATION BECOMES TRANSITORY AGAIN

Bonds: Return Free Risk

Quicktake: The trajectory of interest rates is moving higher around the globe. The combination of rising rates, hawkish central banks, and higher inflation will be extremely difficult for bonds to overcome. Even with the potential for a flatter yield curve if growth expectations decline later in the year, the total return outlook for bonds is unattractive at current real interest rate levels. Outside of a recession, bonds will likely add return free risk to a portfolio and should be viewed as diversification and portfolio insurance rather than return drivers. Investors should look to alternative investments and private markets to compensate for low return expectations in traditional fixed income. We recommend an underweight to traditional credit and government bonds and overweight to floating rate, TIPs, and alternative fixed income strategies.

2021 was a difficult year for fixed income investors. Outside of high yield bonds, which have a higher correlation to equity returns, many major bond indexes posted flat or negative returns. Drawdowns were swift, and generated by just two significant spikes in yields at the beginning and the end of the year. Entering 2022, central banks are front and center once again, and they will be the bane of fixed income investors. Globally, we have seen central banks reverse course from extremely accommodative monetary policy to tightening financial conditions by reducing asset purchases and raising interest rates. More than 10 major central banks have already started raising rates, and many more are expected to follow. As a reminder, bond prices move inversely of yields which sets up 2022 to be a difficult environment for bonds from the outset. Additionally, we are finally seeing signs of consistent inflation, but it is coming on stronger than policy makers wanted. As we have touched on in our other themes, higher inflation influences monetary policy by forcing central banks to either allow inflationary pressures or raise interest rates to combat higher prices, usually at the expense of growth. Investors will need to be cautious as we enter this transition phase.

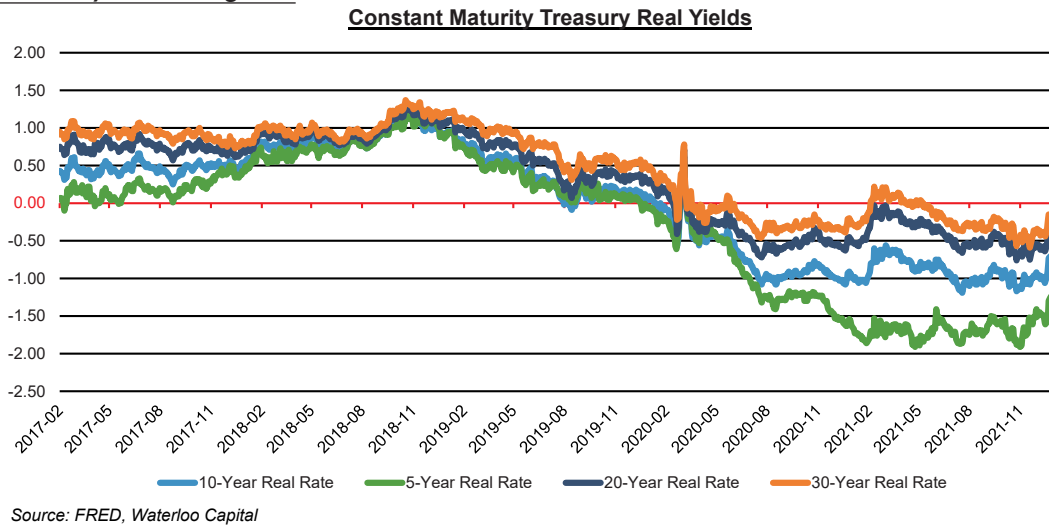
Global central banks have been aggressively raising rates



Having benefitted from over twenty years of declining interest rates, bonds enter the year with valuations near all-time highs. Now, rates are on the rise and the market is becoming riskier. Credit spreads are historically low, and at these levels, small moves in rates can lead to large moves in prices. For example, an increase of roughly 20 basis points or 0.20% in the US 10-year Treasury bond would wipe out a year of income from the bond's price. An increase of a full percentage point in the benchmark rate would cause losses of about 9%. Tack inflation onto the equation and real return expectations would be deep in negative territory. Real interest rates, which subtract inflation from current rates, have been negative since February 2020, meaning investors are actually losing spending power by holding bonds with yields that are lower than inflation. With inflation tracking above 5%, nearly all fixed income options enter the year in the negative real yield category.

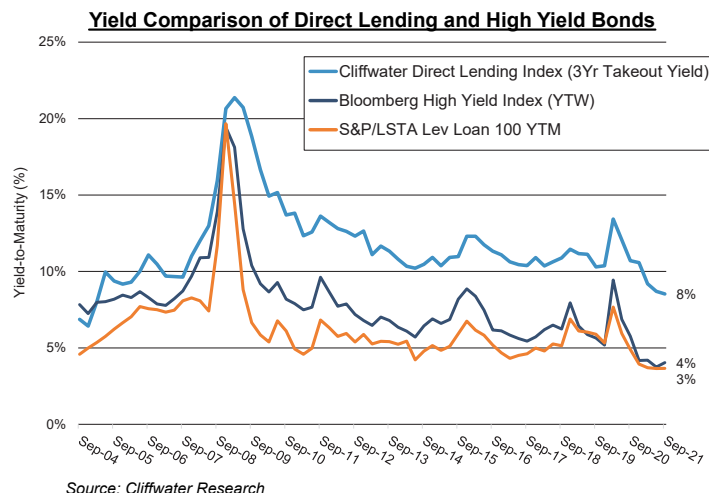
Outlook 2022: Return Free Risk

**Real rates began moving higher after the Fed announced tapering plans...
...but they are still negative**



Ultimately, higher inflation and rising real rates will inhibit total returns and handicap income generation from traditional bond investments. We expect bond index returns to be close to flat or negative this year. This means fixed income allocations will need to be more innovative than in the past. We are looking to alternatives to help fill the total return and income gaps. Investors should look to add unique fixed income exposures through investments like direct lending and infrastructure strategies. Alternatives provide higher yields as compensation for illiquidity and more concentrated credit exposures. Additionally, many alternative income strategies can benefit from a rising rate environment by including floating rate covenants or adjusting rates higher alongside the yield curve. Investors who are comfortable with illiquidity will benefit from carving out a significant portion of their fixed income portfolio for an allocation to alternatives. If alternative strategies are inaccessible or increasing illiquid exposure is unfeasible, we recommend holding a higher allocation to short duration assets and cash to start the year. Real yields are still well below trend, but they have been rising. While an aggressive steepening above previous highs is unlikely, we do expect real rates to climb as inflation peaks and the effects of Fed rate hikes gain momentum. Investors holding short-term bonds and extra cash will be able to ladder in exposure and ideally reinvest capital at higher interest rates throughout the year.

**Gross yields for direct lending
have averaged 4% higher yields
than high yield bonds over the
last 15 years.**



Domestic Equities

Quicktake: The early cycle snapback from pandemic lows could be nearing an end as the economy moves into the mid- to late-cycle phases of the market cycle. The back end of market cycles are characterized by weaker breadth and higher volatility. In this environment, tactical allocations and security selection will be more important to improving outcomes than passive index exposure. The TINA environment is still intact, but inflation and rising interest rates pose significant risks to market valuations. With valuations offering little appeal, earnings growth will determine the path of where the markets head in 2022. Favor value and growth at a reasonable price over high-octane, high-multiple growth. Tactical strategies will be a key component of domestic equity exposure and will perform well during periods of volatility and internal rotations. Ultimately, valuations, moderating economic growth, and multiple contraction will bring expected returns back in line with historical mid-single digit levels.

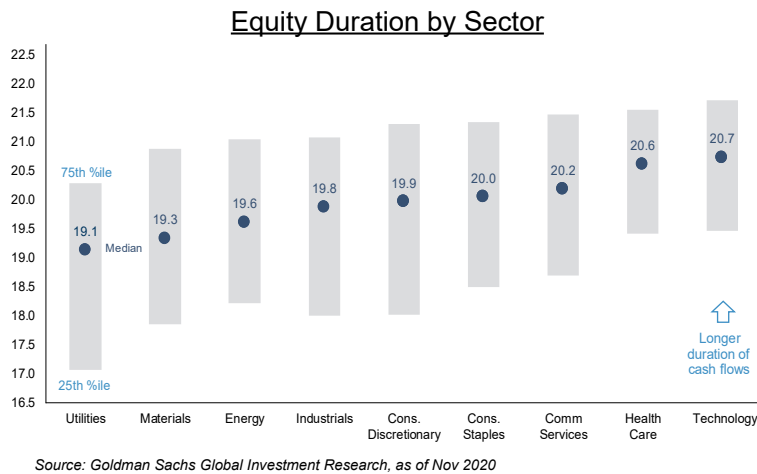
In 2021 US equity markets performed better than expected. Headline indices hit record highs propped up by positive sentiment and a mix of record profit growth, vast amounts of fiscal and monetary liquidity, and a stronger consumer. The culmination of these factors pulled forward business and consumer demand which provided massive tailwinds for markets and pushed prices and valuations to near record levels. While the economic backdrop has been strong, we believe that in markets, where you start from still matters. To begin 2022, nearly every traditional financial metric suggests that domestic equity markets are expensive relative to history. We believe the early market cycle snapback from the pandemic could be nearing an end as we move into the mid- to late-cycle of the market cycle. This transition will shift the economy away from policy-fueled growth levels and back towards normal historical growth rates. While valuations do tend to dictate long term results, narratives and psychology can often have greater influence over short term market action. Mid- to late-cycle markets are characterized by weaker breadth and higher volatility. This year we believe investors will need to retool their investment portfolios away from purely passive index exposure and lean on more tactical security selection to find prospective leaders and investment success.

The pendulum shift from the Fed in response to higher inflation will continue to test expensive market valuations. The vast amount of liquidity provided by the Federal Reserve and government has certainly helped drive markets to all-time highs, but it has also created fragility by disrupting traditional asset pricing formulas. Stocks are long duration assets, and interest rates have a strong influence on how these assets are valued. Rising interest rates are the top risk for valuations this year. If interest rates rise consistently, a higher discount rate will cause markets to reset at lower stock valuations. The rate of change in yields will likely matter more than the absolute level. Faster tightening brings valuation risk forward and increases the potential for valuation adjustments to overshoot to the downside. We have already started seeing this play out among many of the high-flying growth names coming out the pandemic. Tactically, underweighting positions with longer duration and being more comfortable taking exposure as a trade rather than a long-term buy-and-hold will be key this year.

**RISING INTEREST RATES ARE THE TOP RISK
TO MARKET VALUATIONS THIS YEAR**

Outlook 2022: Domestic Equities

Growth oriented sectors have the longest durations



Relatively speaking we believe equities are a more constructive asset class than fixed income. The TINA (“There Is No Alternative”) environment, although weakening, is still intact with interest rates near historically lows and earnings growth near historically highs. Going into 2022 the price to earnings (P/E) ratio was over 20x. When applying the same price to earnings methodology to bonds we see why stocks remain relatively attractive despite higher valuations. You would need to buy a bond yielding around 5% to achieve an 20x P/E ratio and match the

value you gain for each dollar you invest in the stock market. Considering the longest maturity treasury yield, the US 30-year, was only yielding 2% at the end of the year, yields would need to dramatically increase to start making bonds look more attractive on a relative valuation basis. Other measures such as Shiller’s excess CAPE yield also show that equities are attractively priced relative to their long-term average excess yield of 2.6% over bonds. Long-term valuation data on many of these models, however, may be biased due to periods of low and stable inflation which was the norm for many decades. If cost and inflation trends from 2021 persist, equities valuations could become less attractive, further increasing the probability of margin compression and downside price movements.

Valuations are high for both stocks and bonds, but on a relative basis stocks are still more attractive

Stocks, Bonds and the P/E Ratio

Stocks at current P/E levels $\rightarrow \frac{\$100}{\$5.00} = 20 \text{ P/E}$ Stocks are trading above their long-run average valuation...

Bonds Assuming a 2.0% Yield $\rightarrow \frac{\$100}{\$2.00} = 50 \text{ P/E}$... but at low interest rate levels equities still look attractive compared to bonds

The P/E ratio of the S&P 500 was around 20x at the end of 2021. This tells us that investors were willing to pay \$20 for every \$1 in expected S&P 500 earnings they would get back. A quick rearranging of the P/E formula shows this would indicate an "earnings yield" of about \$5.00.

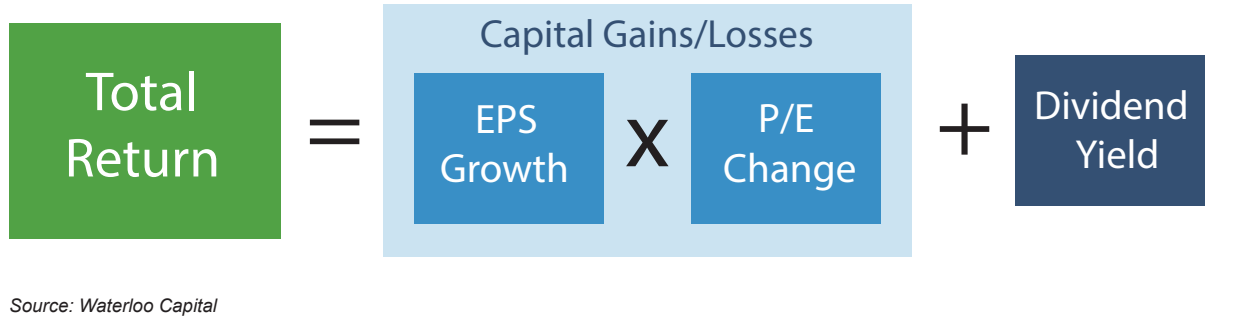
Applying the same process to bonds, we can take the 30-Year Treasury yield of 2.0% and calculate a P/E ratio of 50x.

Source: Waterloo Capital

Outlook 2022: Domestic Equities

An equity's total return is made up of 3 main parts: earnings growth, changes in the level of the price to earnings ratio, and dividend yield. Last year even as price to earnings (P/E) ratios fell, the surge in earnings drove outsized returns. This year, we will likely see modest downward pressure on P/E ratios given higher risk premiums and the potential rise in interest rates as discussed above. Since the dividend yield of the index is largely unchanged, earnings growth will determine the path for where markets head in 2022.

Valuations are facing headwinds which means earnings growth will be key to improving total returns

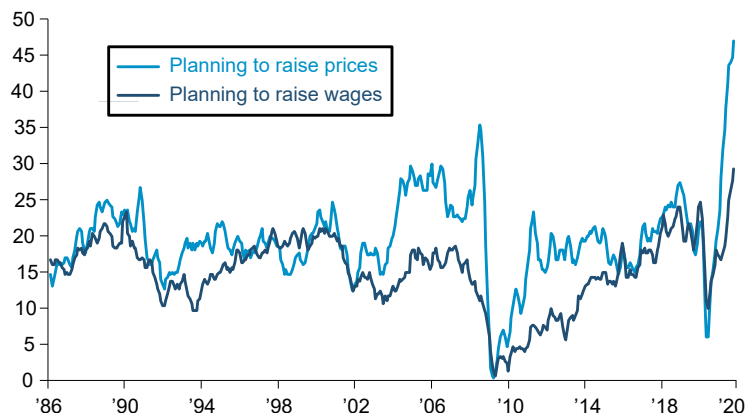


Source: Waterloo Capital

We expect solid earnings growth in 2022 as a result of durable consumer balance sheets and near-term economic momentum, but the growth rates of last year will moderate from elevated levels. So far, rising profit margins have protected stocks from rising inflation and interest rates. Many corporations have been able to either pass higher costs on to their customers or find efficiency gains in their production processes. This year, companies will likely enjoy above average revenue growth, but earnings could be squeezed if factors such as higher input costs, wage increases, and supply chain bottlenecks continue. The impact these issues have on companies' profit margins will be felt unequally among sectors and individual names. Cyclical companies have a higher sensitivity to profit margin compression compared to defensives, and watching how the economic growth outlook progresses will be key for differentiating winners and losers. Ultimately, earnings are likely to remain elevated compared to historical averages, but given the market's forward-looking nature we expect earnings misses and lowered forecasts to be punished more severely as many names may be priced to perfection heading into reporting.

Businesses have been able to pass higher costs on to customers which has kept high profit margins intact

US NATIONAL FEDERATION OF INDEPENDENT BUSINESS SURVEY:
% of respondents, three-month moving average



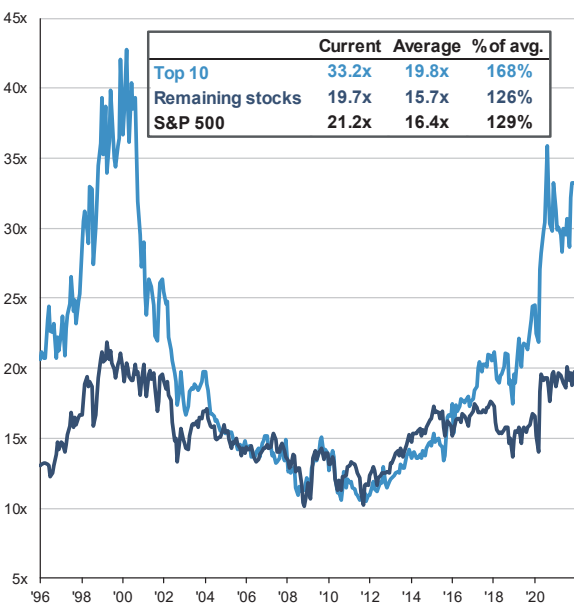
Source: National Federation of Independent Business, Refinitiv Datastream, JP Morgan Asset Management
Data as of Nov 2021

Outlook 2022: Domestic Equities

While we remain constructive on the outlook for US equities, we acknowledge that downside risks have been building. High index prices, questions regarding what Fed policy will look like, and the influences of external risks from geopolitical developments are likely to stir up volatility this year. As markets have been increasingly influenced by factors and sentiment rather than fundamentals, price reactions to both the positive and negative side will likely be more aggressive. Given the outsized weight of a handful of stocks on the index, we also believe market concentration risk is elevated going into the new year. The top names; Apple, Google, Facebook, Netflix, Amazon, Nvidia, and Tesla, account for nearly 30% of the S&P 500 capitalization. Early in 2021, the other 493 names in the index had strong returns as the rebound off the pandemic fueled an everything rally. As we moved into the latter half of the year, the top mega cap names began to mask damage beneath the surface. If these large names lose their dominant strength it would put downward pressure on the entire index. If economic and earnings growth expectations begin to fade the new mantra may become sell-the-rip rather than buy the dip.

A handful of stocks have an outsized impact on the index

P/E ratio of the top 10 and remaining stocks in the S&P 500
Next 12 months



Source: Factset, JP Morgan Asset Management

Weight of the top 10 stocks in the S&P 500
% of market capitalization of the S&P 500



Earnings contribution of the top 10 in the S&P 500

Based on last 12 months' earnings



We favor value over growth, short duration over long, and recommend focusing on high quality names growing at a reasonable price, not any price. Our upgrade of the quality factor means that we favor large cap equity exposure over small caps which tend to have higher debt exposure and weaker balance sheets. Growth at a reasonable price (GARP) factors such as lower price to sales (P/S), price to book (P/B), and price to earnings growth (PEG) help determine whether a company is priced attractively relative revenue and earnings growth. Many cyclical and value companies exhibit these trends, and we expect value to continue gaining relative strength versus growth this year. However, new variants and fears of economic disruption weighed on the value factor. Pure cyclical value names which are especially sensitive to the economy typically outperform during periods of consistent above trend economic growth, but given we are dusting off the mid- to late-cycle playbook we favor more defensively oriented value names. This does not mean that investors should completely abandon growth. Growth will still need to be owned to take advantage of long-term structural and secular

Outlook 2022: Domestic Equities

trends. Investors, though, should be prepared to be more defensive in growth allocations and be wary of names trading at high valuations with excessive price to sales ratios and low cash flows.

Finally, we expect domestic markets will be characterized by heightened volatility and returns will be harder to find than in years past. We believe investors should continue to diversify not only at the position level, but also between passive and active management. Tactical investing approaches are designed to perform well in environments which are driven more by sentiment than fundamentals. As with traditional allocation strategies which focus on stocks and bonds, this added layer of diversification allows investors to take advantage of short-term opportunities and rapid market rotations. We believe these opportunities will be more frequent due to heightened volatility and the lack of better alternatives to investing in stocks. Additionally, we think that investors can benefit from holding a higher allocation in cash or short-term bond alternatives as “dry-powder” to take advantage of trading opportunities throughout the year.

At Waterloo we supplement our decision-making process by utilizing our neural network powered screening and trend identification tool, Newton. Our Newton models serve to provide opportunities to catch price shifts to the upside and protect portfolios on the downside by identifying potential trend reversals before traditional analysis techniques, staying in harmony with underlying market trends, and avoiding outsized drawdowns. As prices and optimism continue to climb, we are persistently pursuing strategies to take advantage of attractive short-term opportunities while refraining from adding unnecessary risks.

S&P 500 Return Potential: Earnings Growth Will Be Key

P/E \ EPS	17X	18X	19X	20X	21X	22X	23X
0%	(25.2%)	(20.8%)	(16.4%)	(12.0%)	(7.6%)	(3.2%)	1.2%
3%	(22.9%)	(18.4%)	(13.9%)	(9.4%)	(4.8%)	(0.3%)	4.2%
6%	(20.7%)	(16.1%)	(11.4%)	(6.7%)	(2.1%)	2.6%	7.3%
9%	(18.5%)	(13.7%)	(8.9%)	(4.1%)	0.7%	5.6%	10.3%
12%	(16.2%)	(11.3%)	(6.4%)	(1.5%)	3.5%	8.4%	13.3%
15%	(14.0%)	(8.9%)	(3.9%)	1.2%	6.2%	11.3%	16.4%
18%	(11.8%)	(6.6%)	(1.4%)	3.8%	9.0%	14.2%	19.4%
21%	(9.5%)	(4.2%)	1.1%	6.5%	11.8%	17.1%	22.4%

Source: Waterloo Capital

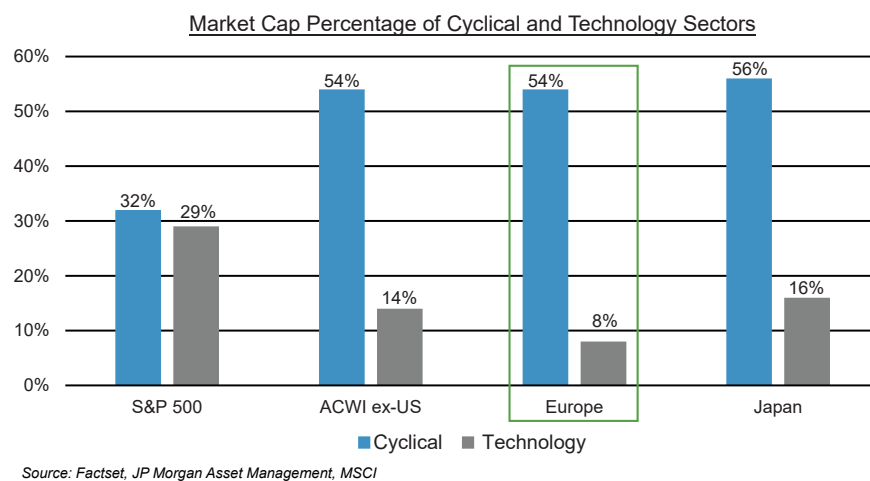
TACTICAL INVESTING WILL PERFORM WELL IN AN ENVIRONMENT WHERE VOLATILITY IS MORE COMMON

Foreign Equities: Europe

Quicktake: High exposure to value oriented, defensive, and inflation beneficiary positions provide Europe with an attractive backdrop. Additionally, ongoing monetary and fiscal policy support will help boost sentiment and provide some volatility protection. These positives could be overrun by the dislocations in local European economies and a slowdown in global growth prospects later in the year. We think both the upside and downside potential are lower than US equity markets. With relative outperformance more likely to come from shallower drawdowns rather than higher peaks, an allocation to European equities will provide diversification benefits if US markets struggle to cope with high valuations and policy headwinds.

On the positive front for European markets, corporate profits have gained momentum and consumer demand is trending in the right direction. Earnings growth exceeded even the highest expectations last year and comes into 2022 with strong momentum. Multiple expansion is likely to dissipate this year, but expectations of double-digit earnings growth will support strength in the region. Also, European equities will likely benefit from their relatively higher exposure to value and defensive sectors versus other developed markets. These sectors historically perform well when inflation and interest rates are rising. During the last resurgence in European equities, which occurred during 2010 and 2011, foreign markets outperformed or performed in-line with US equities. Positive momentum heading into 2022 and strong performance in these inflation sensitive sectors could help close the gap that the growth heavy US stock indexes have widened in recent years. Finally, 2022 may be the year when relative valuations matter. Many European countries are trading at significant valuation discounts to peers and may attract capital as investors look for value and quality opportunities during volatile market periods.

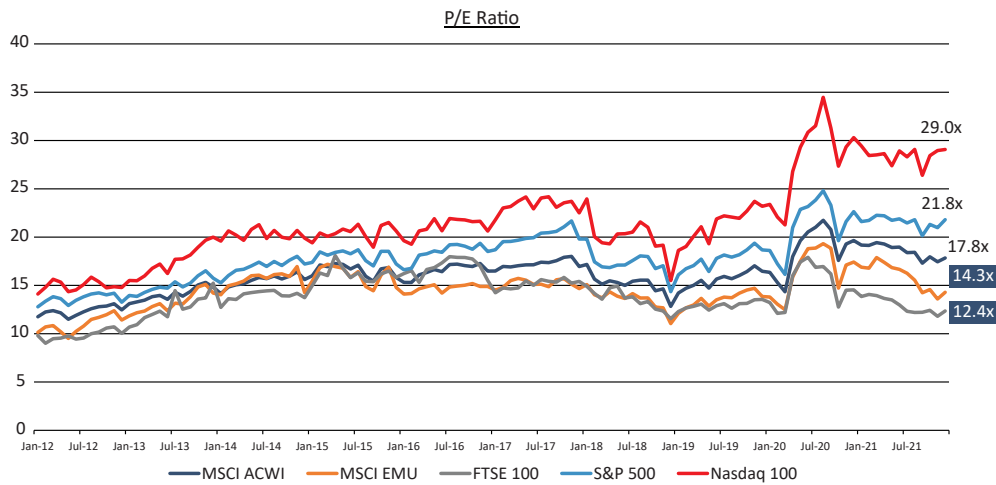
European markets have the lowest exposure to high-growth technology stocks



Central bank influence may be more important than ever this year, but this time around we are watching for ways central bankers may stymie growth rather than support it. The ECB continues to kick the can down the road and has stated that rate hikes might not happen until 2023. ECB president Christiane Lagarde has made some suggestions that policy makers are targeting the second half of 2022 for their first rate hike, but at this point we'll believe it when we see it. The good news is that forward guidance remains extremely transparent. Markets hate uncertainty, and if the ECB continues to put their money where their mouth is, policy error risks will be subdued. Ongoing policy support

Outlook 2022: Foreign Equities

Relative valuations for European equities have rarely been deeper over the last 10 years



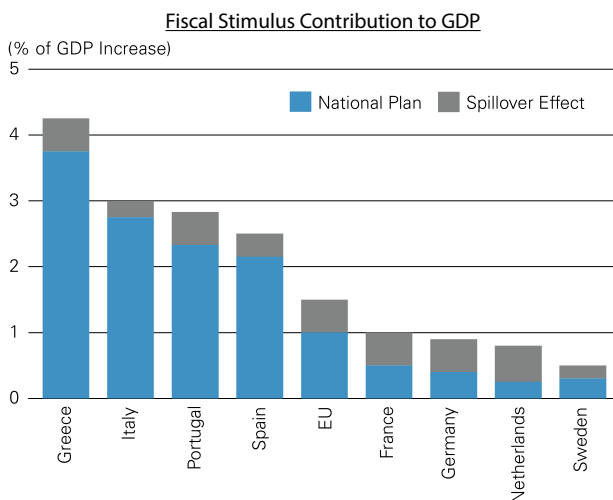
Source: Morningstar, Waterloo Capital

from the central bank and government is a feature we expect to become harder for investors to find this year. In Europe, both monetary and fiscal stimulus measures remain supportive which could fuel demand for equities or put a backstop behind market drawdowns.

Stimulus measures from the European Commission (EC) will provide ongoing support for business and government spending this year. The long-term EU budget and the Next Generation EU stimulus package included more than two trillion euros to support digital modernization, clean energy, healthcare, and agriculture. The long-term nature of many of these projects makes it difficult to gauge the effects on the equity market this year, but markets are always looking forward as investors try to price in the potential ramifications. Signs of positive results from the initial outlays would boost sentiment for higher future revenues, but earnings may not be affected until late Q3 or Q4 of this year.

As the year goes on, signs that the market cycle may be closer to injury time than half time would be a major headwind to European equities and lead to a continuation of lackluster relative performance.

Fiscal stimulus is expected to add a significant boost to periphery European economies



Source: European Commission

Unfortunately, we think this may be the case and the negatives will begin to outweigh the positives towards the middle of the year. Overall, the underlying exposures and policy supports are likely to lead to a less volatile price range for European markets to both the upside and the downside. We see value in the region to provide some volatility protection and diversification benefits. That being said, while a strengthening global economy is likely to provide upside, we think relative outperformance is still more likely for US equities. Based on the unbalanced upside and downside relative return expectations we recommend a market weight to begin the year with the potential to shift towards a relative overweight should we see greater downside risks for US assets as the economic and interest rate landscapes evolve.

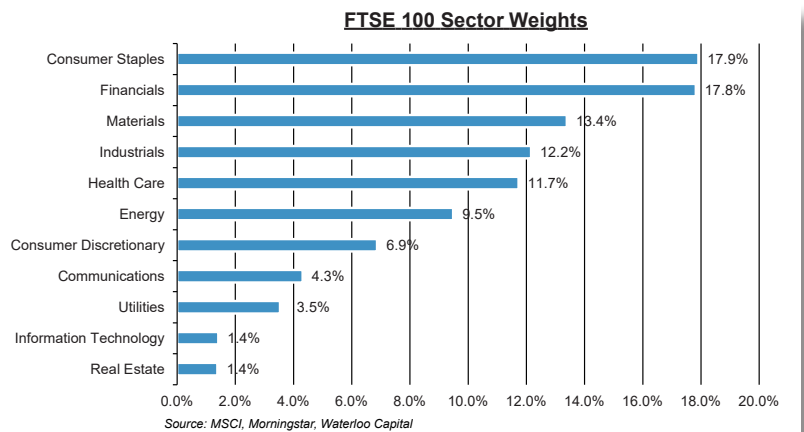
Foreign Equities: United Kingdom

Quicktake: Sitting firmly in the global value category the UK offers intriguing exposure to financial, cyclical, and defensive positions at historically low relative valuations. These factors also tend to perform well during mid-cycle expansions. Political uncertainty and a habit of aggressive covid lockdowns have turned many investors away from the relatively smaller equity market. Brexit uncertainty is still an issue which will need to be watched given its effect on foreign trade which makes up a large portion of the UK's GDP. Additionally, the Bank of England (BoE) and their lack of concrete forward guidance has embedded unnecessary volatility in the bond and stock markets. Positive policy and government activity would support greater upside for the region, but to start the year, we prefer foreign developed exposure in the euro area over a more concentrated UK allocation.

The FTSE 100 has remained stuck below its pre-pandemic levels which makes the UK one of the worst laggards of the post-covid recovery. After a lackluster relative year, we see signs of momentum building for UK earnings growth which will provide much needed support for the equity market. With one of the lowest P/E ratios (12.4x) and P/B ratios (1.8x) in Europe, UK shares are trading at more than a 40% valuation discount versus global peers. The UK stands to benefit from attractive valuations on both an absolute and relative basis at a time when macro trends are beginning to favor value factors.

As with their EU neighbors, the UK markets are highly exposed to cyclical and defensive sectors. Sectors which tend to exhibit high valuations and growth factors such as Information Technology, Consumer Discretionary, and Communications make up a combined 12.6% of the index versus 50.7% for the S&P 500. A lower exposure to factors which are negatively impacted by higher interest rates and inflation will help support UK equities in an environment of higher but steady interest rates and inflation while a defensive tilt offers some protection against market volatility.

UK index exposure is dominated by cyclical and defensive sectors



UK markets should also benefit from a rebound in consumer mobility and activity as the Omicron wave subsides. Rapid spikes in activity following the April and May re-opening measures indicate strong demand for a return to normal activity. A strong labor market and covid stimulus have shored up consumer balance sheets, and another rebound in activity will brighten the outlook for revenue growth early this year.

We would be remiss to ignore the shifting monetary landscape in Great Britain. The Bank of England (BoE) was one of the first to blink in the face of post-covid economic normalization and inflation conditions. The BoE raised rates for the first time since 2018, and policy makers have given forward guidance for rate hikes to continue over the next two years. The move was a vote of confidence in the trajectory of the UK economy, and additional hikes should quickly move the key rate back up to the

Outlook 2022: Foreign Equities

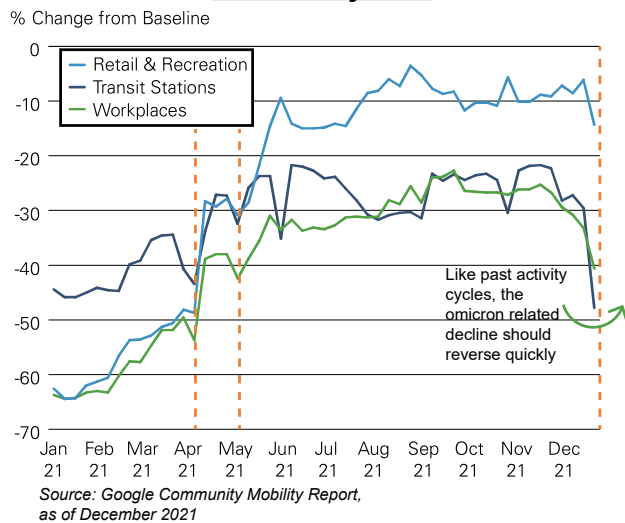
bank's 0.5% target. A nearly 18% index weighting to financials will help the FTSE benefit from the Bank of England's (BoE) rate hike trajectory. Going forward, persistent inflation could put pressure on policy makers to raise rates further, but future hikes are unlikely to occur until later in the year after the flow through effects of the first hikes have been observed. Forward guidance has been opaque at best, but the negative reaction of both the stock and bond markets to recent surprises in central bank activity should encourage more thorough guidance going forward.

The potential for a rebound in relative performance is there, but potential means it has not been done yet. Risks to our outlook include uncertainty around politics, Brexit, and the potential for the BoE to move too fast and stymie the current recovery. UK markets have a bigger reliance on strength in foreign economies than many other developed markets. Nearly 80% of company revenues come from

outside the UK. As the global market cycle continues to mature, a decline in demand would lower our return expectations. Additionally, this leaves the UK more susceptible to foreign inflation and currency shifts. A stronger pound would negatively impact export prices and weigh on export demand. Brexit risks cannot be fully discounted yet either. On the political front, the ongoing implementation of post-Brexit import and export rules and the potential for government turnover raise more risks. Persistent political uncertainty would likely lead to reduced business spending and a decline in future production and revenue projections as companies take a wait-and-see approach to investing. Finally, the BoE runs the same risk that many of its peers have taken on this year in raising rates enough to combat inflation, but not enough to create headwinds to growth. Raising rates too quickly could create the opposite of the intended effects and keep UK equity performance near the bottom of the developed markets category.

We expect a quick turnaround in consumer activity post-omicron

UK Mobility Data



VALUATIONS AND CYCLICAL SECTOR EXPOSURES ARE 2022 TAILWINDS FOR EUROPEAN MARKETS

Foreign Equities: Japan

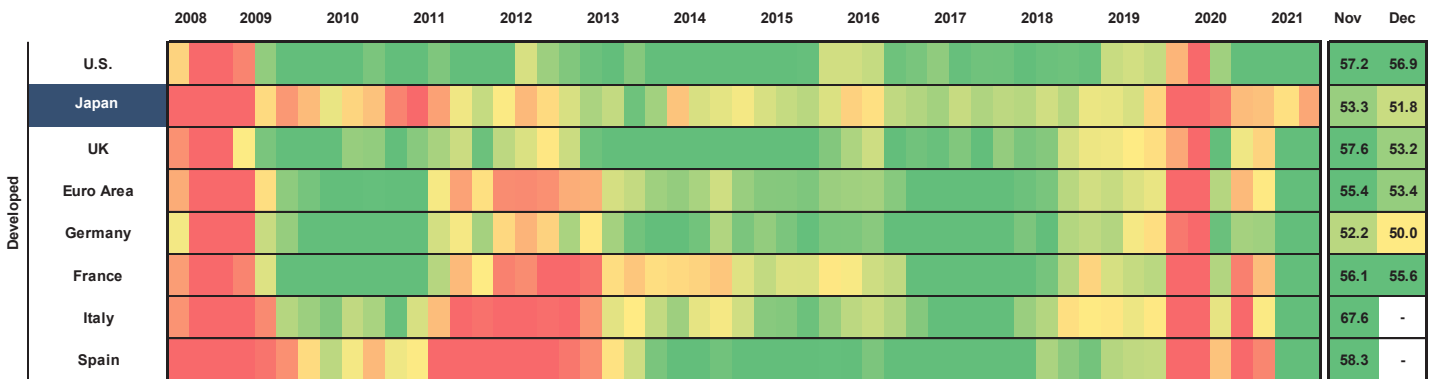
Quicktake: Japan is likely to see a re-acceleration in domestic activity this year, but we find the outlook for Japanese equities to be too reliant on assumptions of a reversal in consumer activity and sustainable strength in foreign demand to get too excited about early 2022 prospects. Second half prospects may improve as stimulus measures make their way through the economy. Fiscal and monetary policies remain highly accommodative and should help boost consumer activity and earnings projections. Additionally, any supply chain improvements will help support export growth. The risk of additional restrictions related to new covid variants, the propensity of the population to increase savings rather than spend, and weaker than expected export demand could thwart optimistic recovery efforts. We recommend an underweight and wait and see position for Japanese equities.

The covid driven decline in consumer activity has taken a significant toll on the Japanese economy. Compliance with strict activity restrictions has left Japan's recovery lagging behind other developed economies. GDP growth has failed to surpass pre-covid levels, but recent developments in fiscal policy and earnings projections support a more optimistic outlook for the second half of this year.

The fiscal outlook improved dramatically following the October 2021 general elections. Prime Minister Fumio Kishida's ruling party gained key representative seats which alleviated fears of a split government and revolving door of leadership. The outcome also paved the way for a seventy-nine trillion Yen spending package that includes support for business and sending checks directly to families.

Similar to the last global recession and recovery, Japan has struggled to keep up with DM growth rates

Global Composite (manufacturing & services combined) Purchasing Managers' Index, quarterly



Source: Markit, JP Morgan Asset Management

On the monetary policy front, the Bank of Japan (BoJ) has continued to promote easy money policies and has avoided the rate hike or QE tapering conversation. This year, the bank will be required to maintain bond purchases as the government seeks funding for fiscal spending measures. The BoJ has been the largest purchaser of government bonds since the QE program began, and is unlikely to relinquish this position any time soon. These highly accommodative fiscal and monetary supports are encouraging to the outlook for Japanese markets, but they will take time to work their way through the economy.

A sustainable recovery in consumer spending would support a bull case for Japanese equities. Japan has been in a long-term deflationary cycle which has led to a history of high savings rates. If inflation picks up and cash handouts encourage consumer confidence, we could see savings habits shift to

Outlook 2022: Foreign Equities

spending habits, but the timing and magnitude of such a shift is uncertain. Additionally, manufacturing and export activity make up a sizable portion of the economy. Global demand appears to be improving, but supply chain issues may have caused a short-term overshoot in recent orders. The potential for plateauing demand later in the year as inventories are replenished is a headwind to Japanese outperformance. The foundation for a rebound has been laid, but potential only goes so far. We would like to see how the first few floors of the building are coming along before entering in.

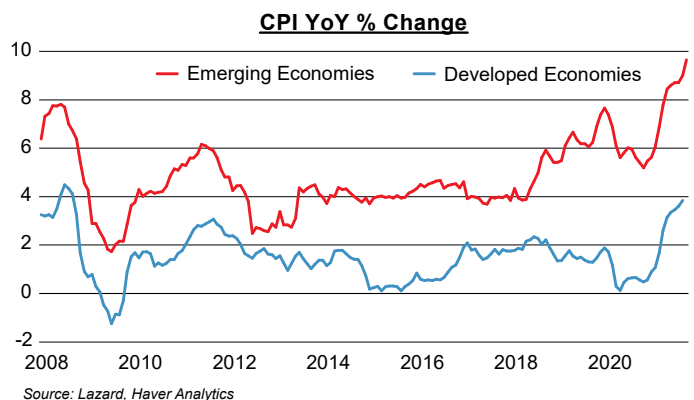
Foreign Equities: Emerging Markets

Quicktake: Emerging markets (EM) are facing more headwinds than developed markets. If we are correct in our view of a mid-cycle slowdown, emerging markets are unlikely to post outsized relative returns due to weaker support from developed market demand. The slowdown in China, hawkish central bank activity, inflation, rising US interest rates and a stronger US dollar, along with precarious risk sentiment, are all hurdles facing emerging market economies. We expect opportunities to be more idiosyncratic in the asset class this year, and recommend tactical exposure to individual regions and countries, rather than broad based EM exposure. Our outlook for EM would improve if inflation subsided, China surprised to the upside, and developed market central banks pull back on policy tightening measures. Clarity on these factors is unlikely to occur until Q2 or later, and volatility in global markets will likely cap demand for this risky asset class. Take an underweight position relative to developed markets to begin the year while remaining abreast of potential individual opportunities in commodity producing countries where exposure can be added during periods of risk-on sentiment.

The return outlook for emerging markets is overly sensitive to consistent growth in developed economies, inflationary pressures, and both domestic and foreign interest rate risks. Each of these factors will support or curb volatility throughout the year. Because EM is a high-risk position in many investors' portfolios, it is also one of the first allocations to be sold during periods of uncertainty and rising risk-off sentiment.

EM central banks have been working hard to battle inflation, but so far, they are losing the fight. Fourteen EM central banks have been raising rates over the past year to try and get back ahead of the curve. The moves have strengthened some currencies, but we could see that trend reverse as the Fed begins to raise rates in the US which will lead to a stronger US dollar. Currencies have a much greater impact on EM stocks than on developed stocks. A stronger US dollar typically leads to weaker local spending power and higher debt costs which ultimately weighs on EM GDP growth. Also, PMIs in emerging markets are lagging developed market economies. The data shows multiple countries flirting with the line between expansion and contraction. Consistent reports showing expansion have been encouraging, but as we have said before, the direction of the trend in the data is more important than the absolute level. The longer we see the data stuck in a tight range, the lower the probability of a sustainable breakout.

Inflation is rising faster in EM economies despite aggressive central bank activity

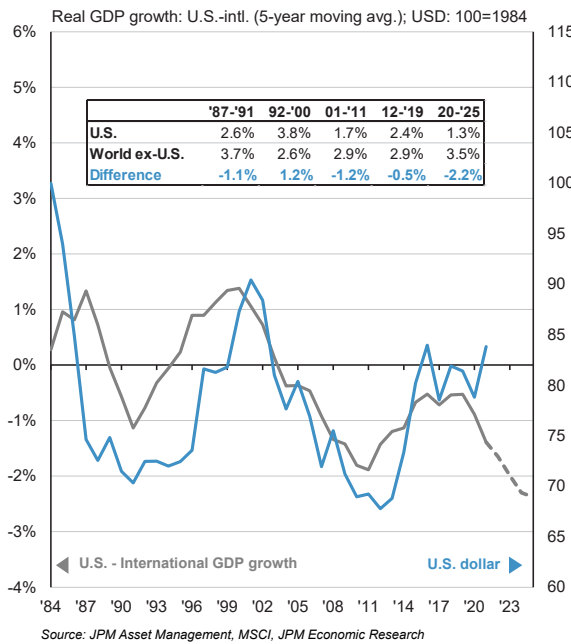


Outlook 2022: Foreign Equities

Finally, new covid strains could lead to a disruption in the pace of EM economic growth by lowering consumer spending expectations and negatively impacting supply chains and local production.

A stronger US dollar negatively impacts international GDP growth

US Dollar and International GDP Growth

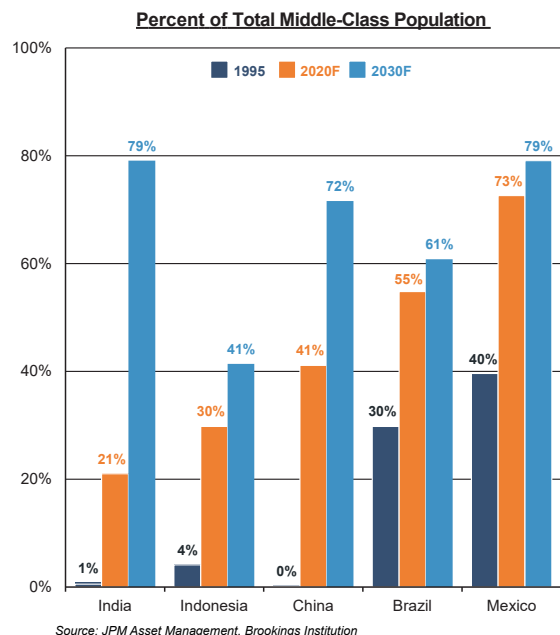


While many headwinds exist, we do see some green shoots. The supply and demand imbalance in commodities will be a major tailwind for multiple EM countries. Agriculture, mining, and energy production have significant demand gaps to close, and EM will play a key role in these markets. Pricing power is high and demand will likely be strong throughout the year providing a solid baseline for higher revenues. We find many examples of these dynamics in Latin America where real asset production dominates local economies.

Additionally, a trend of deglobalization and China turning its focus inward could create opportunities for EM growth. This trend will also provide favorable prospects to countries which have been more open to outside investment and are working towards building a middle-income population. The ultimate benefits will likely take longer than twelve months to take hold, but companies willing to increase capex

now stand to benefit from the future normalization of global supply chains. We think Asia-Ex Japan and India stand to benefit the most from this opportunity. The differences in return drivers for specific regions and countries will lead to wider distributions in emerging market returns this year. In this market environment, what you do not own can be just as important as what you do. We favor more concentrated exposure to trends which benefit from higher real interest rates and developed market demand rather than casting a wide net over the entire asset class.

Emerging market countries that are able to attract foreign investment and invest locally today can see a massive rise in future wealth.

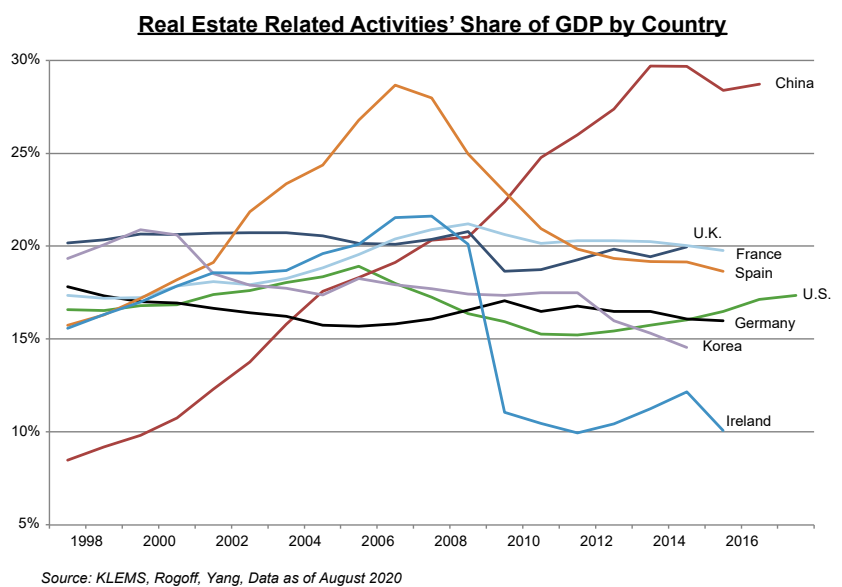


Foreign Equities: China

Quicktake: The leader out of the covid bottom has fallen towards the back of the pack and the prospects for a sustainable reversal have been slow to develop. China is facing threats of destabilization in the real estate market, its key positioning in the global supply chain, and government intervention in many of its fastest growing industries. Growth is likely to remain below target this year as China keeps its "covid zero" policies in place leading to reduced consumer activity and mobility in major metropolitan areas. The central bank shifted back to easing policies late last year to backstop growth, but any signs of additional financial instabilities like the Evergrande default will hinder their plans. Further default scenarios would lead to a reduction in credit growth which has been vital to China's recent expansion. China does enter the year as one of the most unloved investments, which typically means things won't be as bad as expected. This could lead to strong counter-rallies during risk-on periods. That said, in a global growth environment where the rest of the world is also moderating, any areas growing below trend will be easy candidates for an underweight recommendation.

China has struggled to maintain momentum after leading the world economy out of the covid trough. The world's second largest economy is facing issues in areas which had been key to the success of its markets in recent years. One of the most public issues has been the default of Evergrande, one of the largest real estate companies in China. The default has led to the air leaking out the red-hot property market and a debate on whether this is a temporary slowdown or a bubble popping. The initial fallout looked to be contained, but recent struggles for other developers have come to light and raised concerns that weakness may be more contagious than previously thought. This could lead to deeper structural problems as the real estate sector makes up a much larger part of the country's GDP compared to other global economies. The next big threat has come from the government. China's ruling party has pulled back from its laissez-faire support of the markets and is now taking a firm stance against the free market success of multiple industries. Their reasoning is utilitarian at heart. China's leaders are trying to build up the middle class in the country, and the majority of the new rules have focused on maximizing the economic benefits to lower- and middle-class populations. The attempt to keep the wealth gap with the upper class from rapidly widening is commendable, but it has also created significant uncertainty regarding how strong handed the government will be and which industries may be negatively affected in the future. Additionally, China's credit impulse has been rapidly declining. Credit growth is an important building block of economic expansion, and without it there will likely be less business spending, public spending, and infrastructure development. The People's Bank of China (PBOC), China's central bank, has been providing support by cutting reserve

Real estate makes up a disproportionate amount of China's GDP



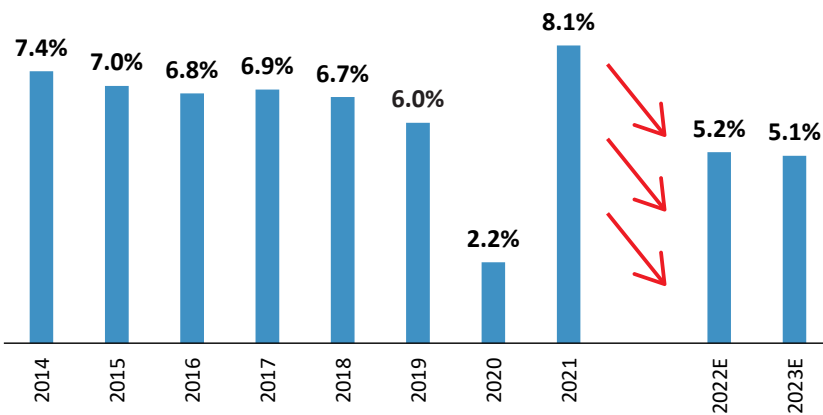
Outlook 2022: Foreign Equities

requirements to provide banks with more capital to lend, but so far there haven't been many new customers to lend to. A reversal in this trend would support a brighter outlook for 2022 growth.

Finally, manufacturing and consumer activity remain below trend. A primary reason for the decline is China's "zero covid" policy under which the government has vowed to eradicate covid within China. The policies may have led to less infections, but the cost has been weaker consumer activity and sentiment. Regulatory pressures may be fading, but instability in the consumer and manufacturing spaces will be harder to overcome. Ongoing supply chain issues have led many countries to turn inward and attempt to expand domestic manufacturing capacity. China is unlikely to lose its place as a global manufacturing hub, but the combination of a deglobalization ideology and an attempt to build wealth by shifting employment towards domestic services could weigh on manufacturing prospects.

China's GDP growth is expected to remain below trend

China Yearly GDP Growth and Estimates



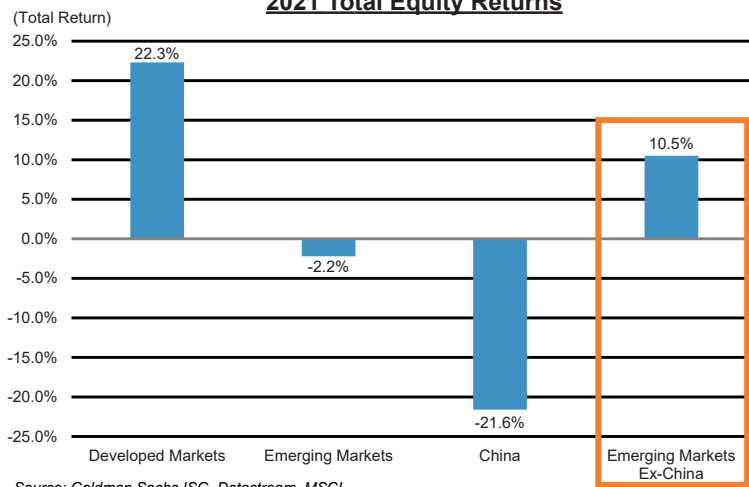
Source: Bloomberg, Waterloo Capital

Slower growth in China drives our weak outlook for emerging markets as an asset class. China makes up more than one-third of major emerging market exchange traded funds (ETFs) on average. Additionally, weak growth China has historically been associated with weak relative returns for emerging markets. Since 1992, EM equities have trailed DM equity markets by around 10% on average when China's economy grows below target.

When all looks lost it benefits investors to review positions from a different perspective. China does enter the year as one of the most unloved investments, which typically means things won't be as bad as expected. We enter the year with an underweight rating for China, but we will be watching for signs that expectations are simply too low. To flip the script, we would need to see a rebound in credit growth, upward trending manufacturing and industrial production data, less restrictive covid protocols, and an ensuing pickup in consumer spending. Without this momentum, positive surges in Chinese equities are likely to be attractive but ultimately short-term in nature. We do think the markets are closer to putting in a bottom rather than churning lower, but a climb higher will go through many short-term peaks and troughs.

China has a significant influence on EM asset class performance

2021 Total Equity Returns



Source: Goldman Sachs ISG, Datastream, MSCI

Fixed Income: United States

Quicktake: Bonds are facing a near perfect storm of obstacles this year. Excessive valuations, central banks raising rates, higher inflation, and uncertainty about the strength of the economy without covid subsidies. The return prospects for traditional bond index exposure are low this year. Total returns are likely to be flat to negative. Real returns, which account for inflation, will be worse. Investors will benefit from lowering duration exposure and holding higher levels of cash to deploy as interest rate rise. Floating rate and inflation protected bonds are also more attractive this year given their insulation from some of the biggest threats facing the fixed income markets. Investors should also add alternative or private credit strategies to fixed income portfolios where possible. Bonds still hold a key position in a prudent long-term portfolio allocation, but this year expect their role to be more about insurance than income.

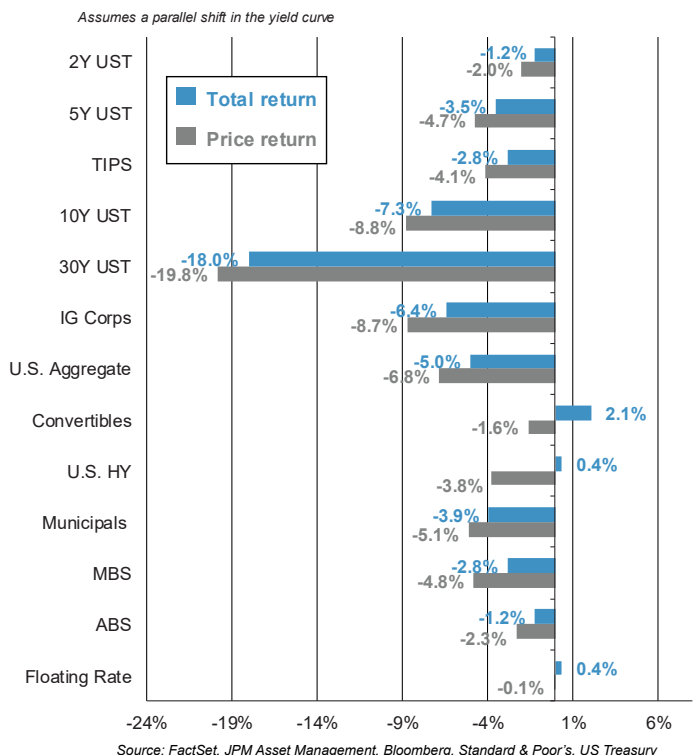
The bond market hasn't operated on its own since 2008, and once again, the Fed will be the judge, jury, and executioner in 2022. That said, the case being argued is different this time. After years of needing a helping hand, the markets and the economy have made it through the rehabilitation process. Now, the Fed is ready to reset and move back toward normal policies. The determination of the Fed to raise rates multiple times in 2022 creates a difficult outlook for fixed income. We think the Fed is making the right decision, but it will no doubt be a volatile path forward. The Fed is expected to raise its benchmark rate at least five times this year. Thankfully, policy makers have been transparent in their decision making processes and the timing of expected rate hikes. This forward guidance will be key to keeping interest rates at levels the economy can digest and keeping bond market volatility in check.

We think the current projection for total hikes this year is high, but regardless of the number, the environment will be a major test for bond markets and bond investors.

As the inverse relationship between yields and bond prices goes, higher yields mean lower prices for outstanding bonds. Assuming a 1% uniform increase along the yield curve, no major fixed income investment would generate a positive price return. Only floating rate debt, high yield, and convertibles would potentially generate positive total returns. Even with the potential for a flatter yield curve if growth expectations diminish, the total return outlook for bonds is unattractive at current real interest rate levels. As interest rates begin to rise, we think longer duration positions should be viewed as trades or short-term hedges rather than passive core holdings. While shorter duration issues lack an attractive yield component, they will continue to add value to a portfolio by dampening volatility and providing some downside protection during market corrections. In this environment, total returns are likely to be disappointing once again.

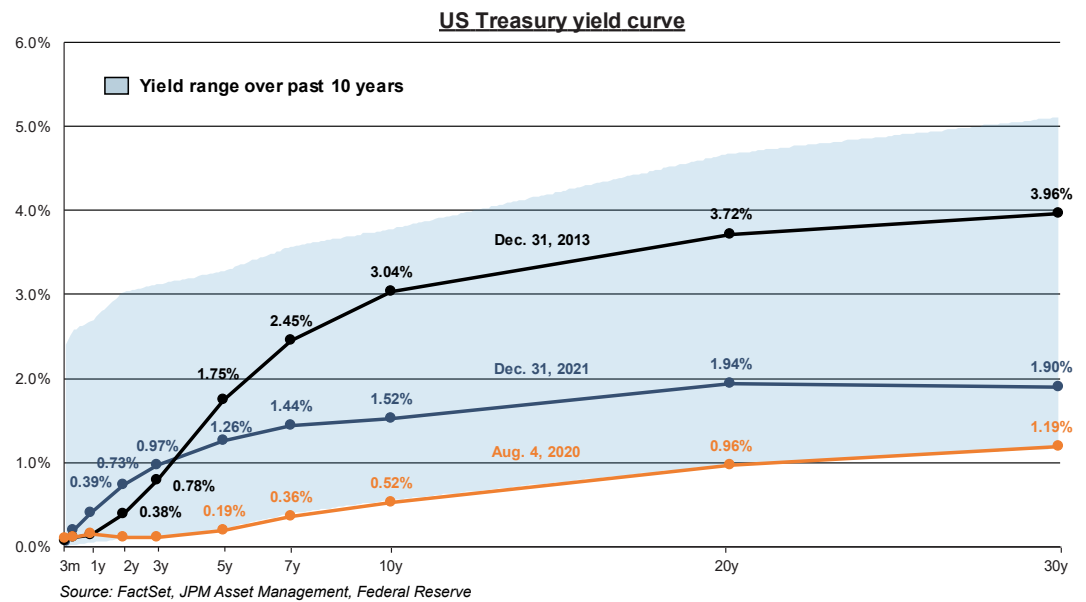
Yields rising from a low base will be a significant drag on bond returns

Impact of a 1% Rise in Interest Rates



To compensate for the lack of attractive opportunities in core bond positions, we advocate maintaining a base allocation to shorter duration positions while adding exposure to positions with a higher correlation to rising inflation and yields such as Treasury Inflation Protected Securities (TIPS) and floating rate bonds. We also recommend holding a higher cash allocation in fixed income portfolios to help mitigate volatility and potentially take advantage of rising rates during the year. Holding extra cash can benefit income-oriented investors by providing the option to ladder in exposure to higher yields. This can be achieved as the Fed begins raising rates by opportunistically investing cash in longer duration and higher yielding positions. Allocating cash and recycling capital as rates rise will incrementally improve total return and help manage risk should rates rise more than expected. Additionally, alternative yield and credit strategies will continue gaining prominence this year. Investors who can take on higher levels of illiquidity and access high quality private credit strategies should carve out a significant portion of their fixed income allocation for these strategies. Overall, bonds still hold a key position in a prudent long-term portfolio allocation, but this year, expect their role to be more about insurance than income or total returns.

The yield curve has risen significantly - especially on the short-end



BONDS ALLOCATIONS WILL BE MORE ABOUT INSURANCE THAN INCOME THIS YEAR

Fixed Income: International

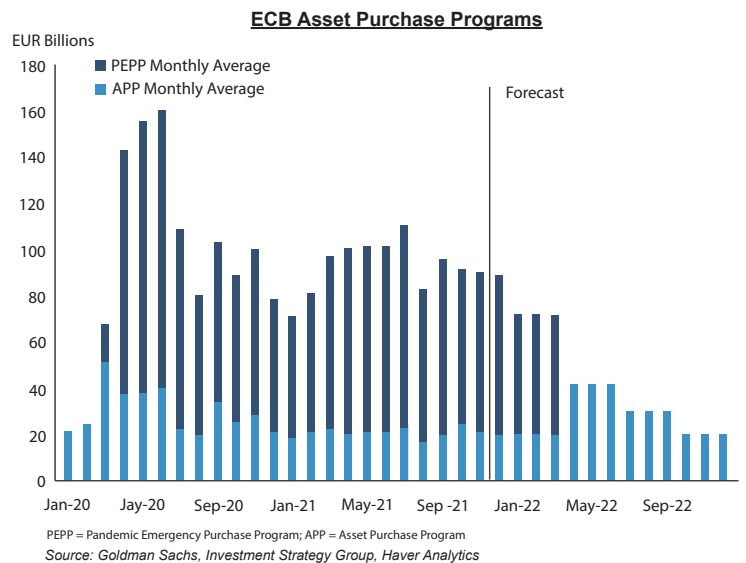
Quicktake: International bonds are facing many of the same headwinds we are seeing in the US. A rebound in economic activity and a tight labor market are pushing inflation higher and many central banks are scrambling to adjust policies. Intentional markets are beginning to show some divergences in policy paths. The European Central Bank (ECB) is holding rates near 0%, effectively keeping many eurozone countries' yields in negative territory, and the Bank of Japan (BoJ) has maintained its purchases to peg interest rates at key levels. Meanwhile, the Bank of England (BoE) and Bank of Canada (BoC) have already started raising rates. Fiscal spending measures are on track to take over as policy support in many areas which should make it easier for the lagging central banks to also begin normalizing policies. Many emerging market (EM) countries began aggressively raising rates through the end of 2021 and the trend is on pace to continue. Higher yields in EM debt may be attractive to boost income generation but exposure should be kept relatively low given the risk and return dynamics. Overall, with valuations near historical highs in many developed economies, and rate hike cycles well underway elsewhere, we do not recommend adding exposure to foreign debt.

As with the United States, a rebound in economic activity and inflation put upward pressure on interest rates in Europe last year. The inflation surprises in 2021, however, were more noise than a materialization of the ECB's policies. The central bank is still worried about financial conditions in more vulnerable eurozone countries and expansive accommodative measures put downward pressure on rates which softened the rise in sovereign yields and spreads. The ECB has been a key pillar for company funding by implementing their 1.85 trillion euro pandemic emergency purchase program (PEPP). Purchases should end during Q1; however, a separate policy scheme will remain at a lower purchase rate which will continue to impact interest rates. Investors in eurozone bonds had a difficult year in 2021, but the 2.9% loss in intermediate maturity securities would have been even deeper in the absence of these measures.

As we head into 2022, many European countries have market yields sitting firmly near 0%, or in some cases still in negative territory. Given high valuations, extremely low yields, and the threat of rising inflation eating into total returns, we do not recommend adding foreign developed bonds to fixed income allocations this year.

We believe the ECB will eventually follow in the footsteps of the Fed and be more accepting of tighter financial conditions in the bloc. The shift in perspective may be born out of necessity due to upside surprises in inflation and above trend economic growth. Headline inflation sits 3% above the central bank's inflation target which marks the highest level since the eurozone was formed in 1999. Lagarde is still cautious about unwinding ultra-accommodative support and has stated her belief that eurozone

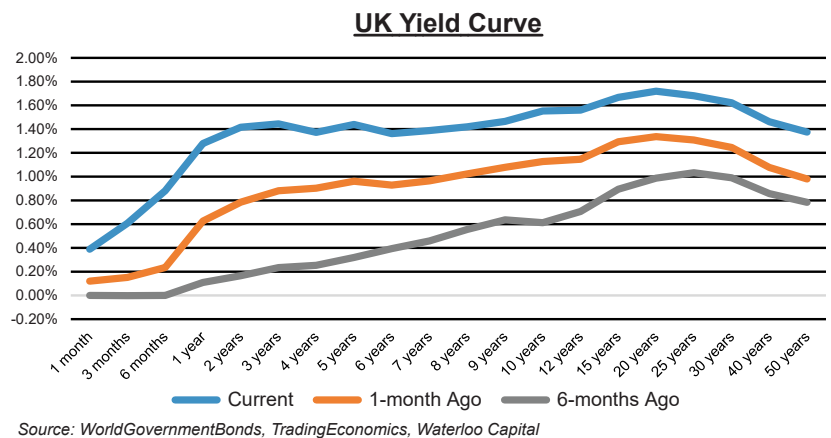
The ECB is phasing out pandemic relief programs



inflation is temporary. Relatively speaking, the ECB is a lot less hawkish than its US equal, and we think interest rate hikes during the first half of the year are unlikely. Just as its global counterparts, the ECB is trying to engineer an impeccable balancing act as it begins to reduce policy support from the pandemic and lay the foundation for rate hikes without upsetting financial markets and creating volatile price moves. Based on a history of cautiousness we expect the ECB to err on the side of inaction rather than action.

Demand for European bonds should remain stable due to the ECB continuing their purchasing programs and traditional asset class diversification coming back in vogue after 2020 highlighted the benefits of risk-management and lowering portfolio correlations. Yet, in a bond market with negative yields, and the risk the ECB does not decisively fight inflation, eurozone bonds should be avoided. Overall, we have low expectations for foreign bond returns in 2022 and will be monitoring how strong of a policy stance the ECB takes as the European recovery plays out.

The Bank of England was one of the first major central banks to raise rates



Unlike the ECB, the Bank of England (BoE) has been aggressive in the face of elevated inflation and a strong labor market. In December, they were one of the first major central banks to start raising policy rates. The move came despite the country's uneven post-pandemic economic recovery and new, post-Brexit, trading relationship with Europe. The BoE delivered a 0.15% hike in December and additional hikes planned for Q1 should quickly move the key rate back near the bank's 0.5% target. We expect yields to move higher in the UK as the BoE continues their tightening cycle. Again, like the eurozone, fixed income in the United Kingdom offers a low margin of safety due to low yields and hotter inflation. Exposure should only be taken against unforeseen shocks, and we remain underweight the asset class.

Japan is one of the few inflation outliers within developed markets. Inflation is still stubbornly below the bank's target and is likely to remain there for most of the year, if not longer. The BoJ forecasts the inflation rate to climb to just 1% by the end of 2023. Based on weak inflation and a historically dovish tone we do not expect the BoJ to begin a rate hike cycle this year. After shifting strategies from directly lowering or raising interest rates to targeting yield curve control through purchasing specific bonds, the BoJ has been more hesitant to lower rates. We expect this trend to continue this year as the country focuses on supporting fiscal reform. The long-end of the yield curve has been steadily

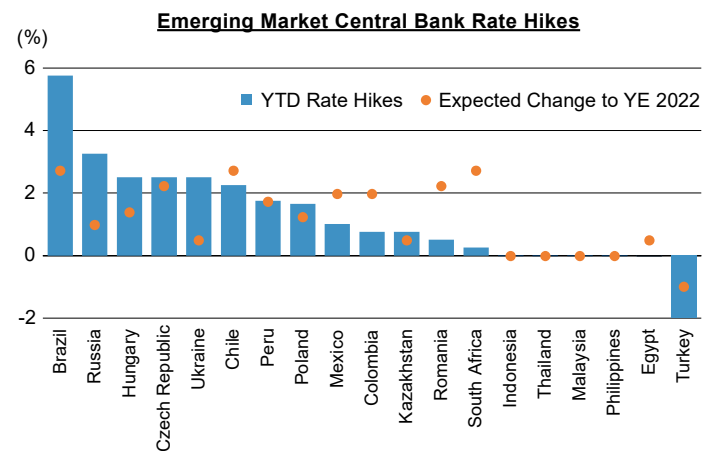
steepening, and yield-curve control on the short-end will keep rates rangebound. Policy makers will continue working behind the scenes buying bonds to help fund fiscal stimulus measures and manage interest rates. The BoJ has now cut back its gross purchases of bonds to around 69 trillion yen per year, and its net purchases are set to drop to less than 10 trillion yen per year in 2022 owing to an increase in redemptions of BoJ-owned issues. On the margin, this action could make yields more sensitive to exogenous factors, but the central bank's powerful policy of anchoring rates at zero will likely offset any tightening because of a reduction of purchases. As with bonds in other developed market economies, we do not find the risk and reward outlook attractive enough to warrant an allocation.

Emerging Market central banks were forced to hike rates sharply last year in the face of surging inflation. Inflation has risen globally, but emerging economies have felt the rise more intensely because of a higher sensitivity to energy and food prices.

The asset class deteriorated quickly as the drawdown from both currency depreciation and duration more than offset higher coupon payments. The losses also came despite record inflows.

However, nearly all the inflow came from China, which contributed to a 7.8% return in Chinese local debt. We expect further central bank hikes next year, though potentially at a slower pace than 2021 given the front-loading that occurred last year. Additionally, given the path of a tighter monetary policy from the Fed, a stronger US dollar will weigh on emerging markets bonds. The extra yield generated by EM bonds can add value for a yield-oriented investor comfortable with adding risk to their fixed income allocation. However, because of the equity-like nature of EM debt, we recommend keeping a relative allocation small and pairing any exposure with lower risk short-term instruments and cash to offset volatility.

EM central banks have been aggressively raising rates



Source: Lazard, Bloomberg

FOREIGN DEBT IS UNATTRACTIVE GIVEN VALUATIONS AND THE UPWARD TRAJECTORY OF GLOBAL YIELD CURVES

Real Assets

Quicktake: For the first time in a decade, commodities outperformed the S&P 500 in 2021 and notched their best year since 2009. Strong near-term demand and lengthier timelines to increase production should keep the asset class climbing higher next year. The mismatch in demand and production expectations can lead to feedback loops in real assets where higher prices beget higher prices until the supply and demand realign. Overall, we favor oil given its necessity as an input in the economic recovery and favorable supply dynamics which may be compounded by evolving energy policies. We also like the prospects for a continued recovery in the real estate market. Being opportunistic and selective in 2022 will be important as we expect rotations within the group. We like industrials and multifamily, along with less economically sensitive sectors such as self-storage and student housing. Higher interest rates will pressure valuations in real estate this year which will put a premium on projects with improving cash flows.

Metals

With news of inflation dominating conversations and headlines many might have assumed that gold, which is considered a classic hedge against rising prices, would have had a spectacular year. Unfortunately, the commodity has been caught between the push and pull forces of inflation, which is supportive, and higher real interest rates, which are unfavorable. Additionally, a stronger dollar has weighed on gold. Real yield is the return on a bond adjusted for inflation, and along with the US dollar it has historically had an inverse relationship with gold. Given the prospects of higher real yields and tempering of high inflation readings, we believe precious metals will continue to lose their luster. Geopolitical tensions causing heightened volatility, a sticker inflation scenario, or slower real rate rises could be scenarios where we see a recharge in demand for precious metals, but policy headwinds will be difficult to overcome.

Rising real yields have been a headwind for gold despite higher inflation



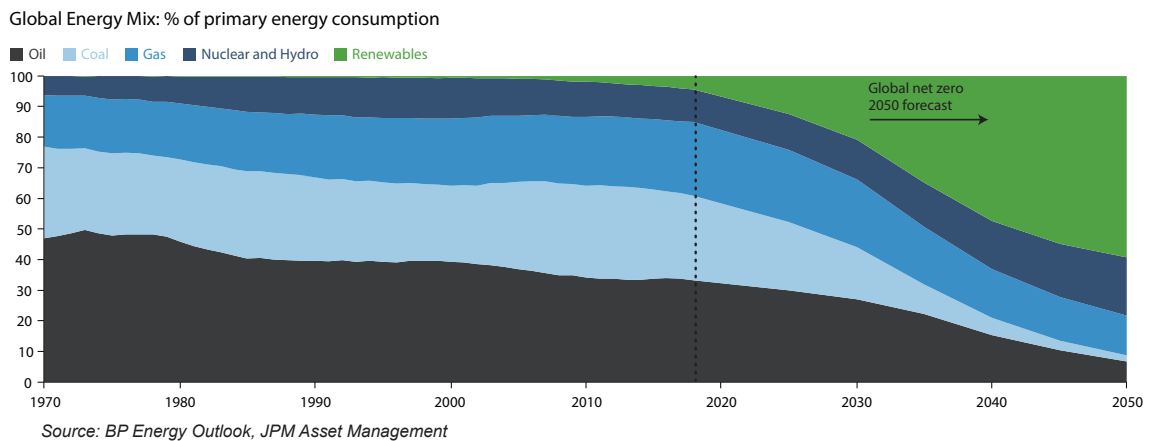
The rapid rally from pandemic lows shocked metal and mineral supply chains which had been shut down during the crisis. Production increases have been slow-moving at best, with many producers fully embracing higher prices after years of limited pricing power. We are beginning to see exploration and production activity increase, and we expect more supply to come online this year. Looking ahead, we believe the group will soften due to headwinds from increased supply chasing higher prices and from China's slower pace of real estate and infrastructure growth.

Oil

After falling into unprecedented negative territory in 2020 oil prices increased over 60% last year. Current dynamics point to further momentum in the new year, and we think oil represents the best combination of positive valuations and fundamentals within the commodity spectrum. Recent covid strains have not kept demand down for long, which is a constructive sign that we may be returning to a more elastic demand environment for one of the world's most important commodities. The good news for oil prices, and the bad news for inflation, is that production has not been reacting to price increases as quickly as it has in the past. Despite the focus on OPEC+, we think the US is still in the best position to be the swing producer going forward. OPEC+ has the deck stacked in their favor heading into the year, and we think higher prices will keep the group motivated to maintain production levels. In the US, energy companies have been working hard to clean up their balance sheets and return capital to shareholders. The results have been a decline in spending on exploration and drilling new wells. The success of this conservative stance, and the potential for policy uncertainty related to drilling rights and renewables will continue to cap new supply. We expect demand to continue improving and potentially widen the spread with supply which will lead to higher oil prices this year.

In 2022 and beyond, the secular push to renewable energy makes the picture of the global energy mix more complicated. The push towards renewables is a main target for many recently passed global fiscal policies. The countries accounting for 70% of global CO2 emissions and GDP have pledged to reach net zero commissions by 2050. This is a tall task that will require a severe shift in the use and production of global energy. According to current forecasts the share of fossil fuels will need to decrease from 80% in 2022 to 20%, while renewable energy use will need to increase from just over 10% to 60% over the same period.

The Energy Mix Needs to Drastically Change for Net Zero to be Achieved



Until renewables can play a greater role in production and gain efficiency and scale, demand for oil and natural gas will rise. At the same time, given the push to a greener economy, supply for fossil fuels is being progressively constrained by the lack of investment in new capacity. The implication in the short run is support for oil prices. In the long run, given the massive demand and future investment goals of global governments, renewable energy is expected to perform well. However, much of the future growth is priced in throughout equity markets and picking the winners and losers in the industry will be ever challenging in the years ahead. The prospects are high, but for investors it will be more complex than just a simple strategy of buying clean energy and selling traditional "old energy" stalwarts.

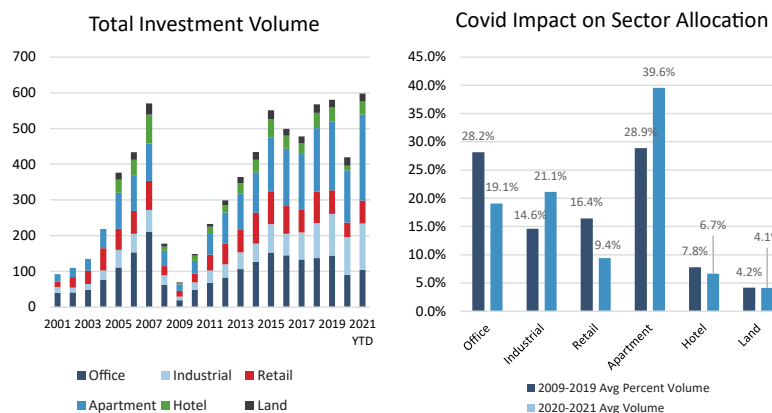
Finally, we expect manufacturing companies to continue ramping up production this year to meet high demand and take advantage improvements in global supply chains which should also boost the outlook for energy. Oil is an essential input in nearly all parts of product life cycles. From collecting raw materials, to production, to shipping, to stocking the shelves at your local stores. Energy demand from consumers is also likely to increase as travel habits return to normal. Overall, we expect economic growth and constrained capacity investment will help support oil prices even if the industry remains out of favor with the new administration.

Real Estate

Higher valuations and the potential for uncertain economic conditions create an outlook defined by combining both offensive and defensive strategies in real estate. We believe looking within the sector and focusing on categories with a history of higher growth and lower correlation to public markets is the best strategy for the existing environment, however risks linger ahead. Higher inflation levels could still support elevated valuations, but rising real interest rates dampen our overall outlook for price appreciation. We expect turbulence this year to also come from rising input costs, such as lumber and copper, and ripple effects from the slowdown in China. On a positive note, dynamics such as shutdowns due to new covid variants, labor shortages, and supply disruptions that held back progress in 2021 should ease. Additionally, investor demand for commercial Real Estate should dampen less and experience less volatility as public markets as the Fed looks to tighten monetary policy.

Demand for commercial properties has recovered and remains strong

Commercial Real Estate Volume by Sector



Source: Real Capital Analytics, Virtus Real Estate Outlook 2022

The supply and demand imbalance within the office sector has created a wide dispersion of opinions on its future growth. We think the sector remains advantageous for occupiers as landlords become more appealing given the shift towards a more sustainable remote work environment. For now, although physical occupancy remains low, leases are typically long-term and are still being paid. Office properties with amenities that enhance wellness and collaboration will fare best and we expect to see more properties ramping up perks to help employers market in a competitive labor environment.

The industrial sector was the star again last year, hardly breaking a step, as it continues to be propped up by the growth in online shopping and last-mile delivery efforts. E-commerce sales boomed during the onset of the pandemic and according to CBRE Research, they currently make up around 20% of

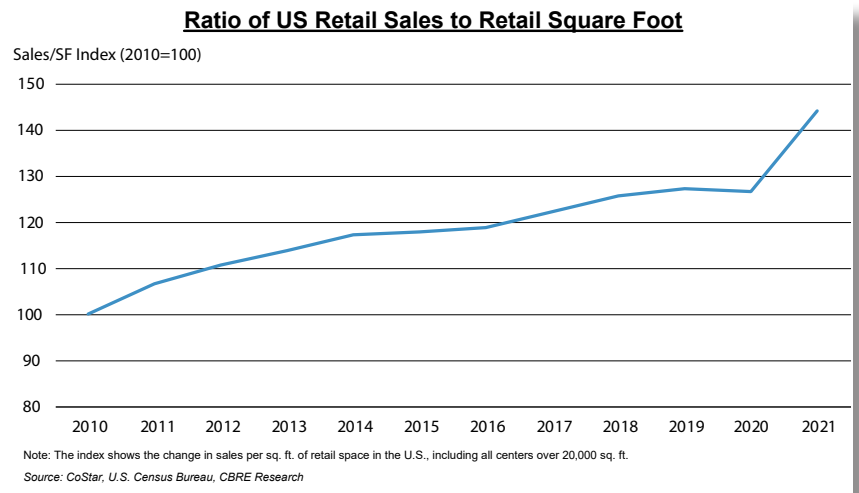
Outlook 2022: Real Assets

total retail sales. Rents are at elevated levels amid extremely tight supply and high demand and landlord should continue to have pricing power this year. A growing economy, higher e-commerce sales, and the desire to hold more inventory as safety stock to avoid supply disruptions will continue to boost demand for industrial space. We expect industrial properties to continue thriving this year based on low vacancy rates and growth in both location and size of distribution and warehouse facilities. Although industrial and warehousing has strong fundamentals, investor interest has caused skyrocketing valuations, which is a potential headwind. Additionally, the dependence on a few dominant firms creates concentration risk which could lead to declines if the policies or fortunes in these firms change.

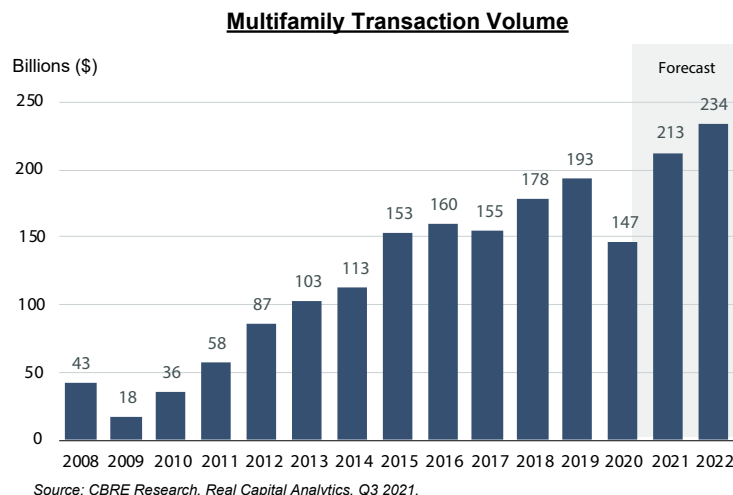
Traditional retail is still dealing with unfavorable secular shifts despite the lifting of lockdown measures. Long-term headwinds may be growing based on changes in consumer activity, but on a relative valuation basis, the retail space is cheap. The sector has been using space more efficiently, reflected by improving sales per square foot, which has led to improved margins. However, it will take savvy specialists to pick the bright spots due to the greater number of losers than winners in the near term. Within the space we favor grocery-anchored and neighborhood centers. According to CBRE, grocery-based e-commerce is expected to grow more than 20% in 2022 and double by 2025 providing a solid foundation for centers of expansion.

We still favor multifamily as it continues to surprise to the upside in both occupancy and rental rate growth. Downtown properties are recovering and seeing demand near pre-pandemic levels. Fewer restrictions on urban amenities and the reopening of office space should continue to support demand in the space. Being selective and balancing risk and reward will be key as downside risks are present. Markets that have proposed increased regulation on rent controls will limit income opportunities from rent growth and will require increased operational skill to drive net operating income.

Shifting consumer activity has required retailers to improve in-store margins



Multifamily transaction volume is expected to hit record highs



Finally, we also believe real estate debt is positioned to succeed in the current environment. The demand for yield outside of traditional government and corporate bonds should boost investor interest in the space given its physical collateral backing and ability to provide stable income. We are focused on finding opportunities targeting more senior positions in the capital stack backed by properties with consistent occupancy rates in high density areas. Given the potential downside risks in the space, we also prefer to invest in debt issuers with operating capabilities. The ability to take over an asset in the event of a default and continue generating income adds an extra layer of protection for investors.

REAL ESTATE REMAINS ATTRACTIVE BUT HIGHER INTEREST RATES WILL SLOW PRICE APPRECIATION

Alternative Investments: Private Equity

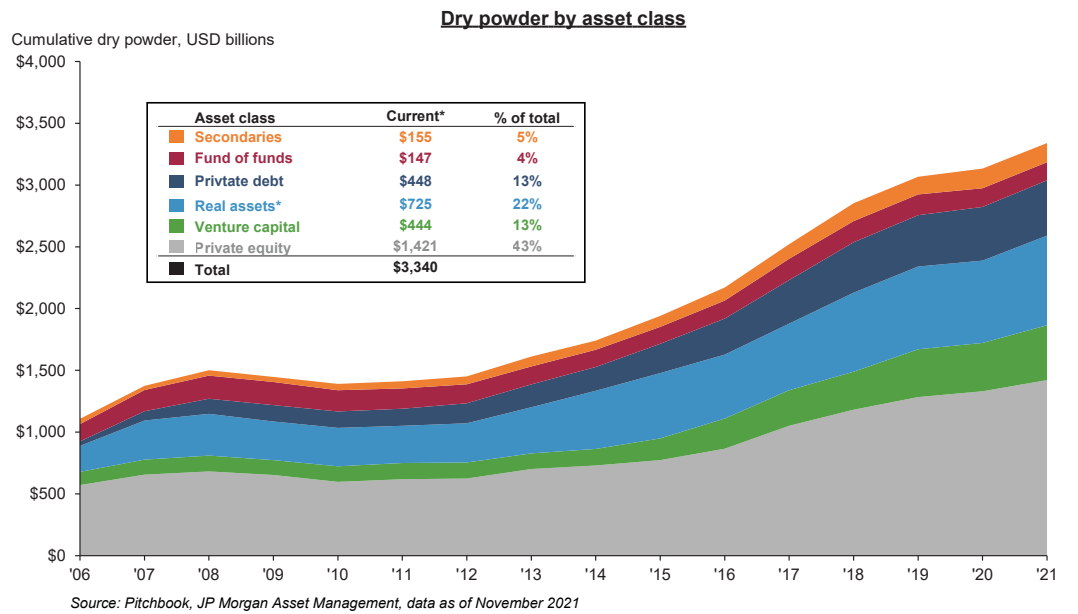
Quicktake: Nearly \$3.5 trillion in dry powder has accumulated in the alternative investment ecosystem. Demand will continue to grow, and the asset class is poised for another bullish year of investment and exit activity. Corporate activity will also lead to higher M&A deal flow. In private equity focus on managers targeting mid-market opportunities where sponsors have more control over terms and deeper cooperation with portfolio companies. Private debt and alternative income offer better options than public markets with similar risk levels, and they are now essential to include in income generating portfolio. Alternative income strategies have a built-in hedge against higher rates because of their control over terms and common floating rate structures. Hedge funds will act as both risk mitigators and return enhancers this year. Volatility is good for the asset class, and divergences in global rates, currencies, and markets will be tailwinds.

Private equity has continued to see unprecedented capital inflows and deal activity. Dealmaking and exit activity both set records in 2021 with more than \$1 trillion in total deal value completed, over 50% above the previous high-water mark. Fundraising activity also remains elevated. Nearly \$3.5 trillion in dry powder was held across the alternative landscape. With the tailwinds of high demand, plenty of liquidity at the corporate and sponsor levels, and moderating valuation multiples, private markets are poised for another bullish year of investment and exit activity.

We expect deal flow to continue at high levels this year. Many businesses and fund managers are still flush with cash. With finances stabilized, we expect capex and acquisition activity to ramp up as companies look to expand operations and production. Additionally, trends that were accelerated by the pandemic such as work from home, expanding technology offerings across business lines, and changes in consumption and living patterns will continue rewarding companies that invest in innovation.

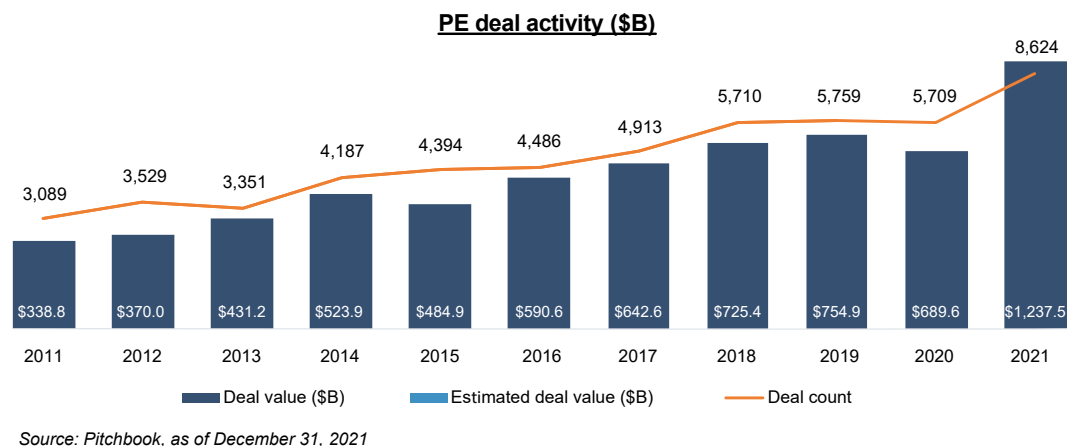
The valuation multiple arbitrage opportunities between the public and private markets are likely to decline this year. IPO and SPAC exit activity was particularly strong last year because of the multiples

Alternative investment dry powder is once again at all-time highs



companies were able to capture in the public markets. IPO activity will still be an important exit strategy, but we think public market multiples are likely to retreat which will shift more exit and deal making activity towards traditional routes like add-ons and corporate acquisitions. Additionally, high levels of dry powder within the private market ecosystem will boost deal activity from fund sponsors and continuation funds. This environment supports our focus on partnering with managers targeting middle-market growth opportunities. As mega-funds struggle to deploy capital there will be ample opportunities for managers targeting small to mid-size companies for both investments and exits. From an investment perspective, deals in the middle market space tend to be less competitive and provide general partners more flexibility when structuring terms. Smaller companies typically have simplified capital structures which allow for deeper connections and direct cooperation between company leadership and private equity partners.

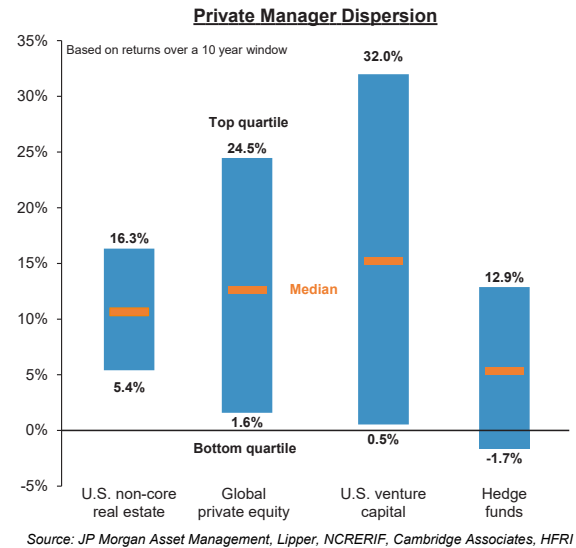
Total deal value in 2021 was more than 50% higher than the previous record



Outlook 2022: Private Markets

The market cycle is maturing, and the financing landscape is changing as monetary policy normalizes. Manager selection in private markets is extremely important given the spread in outcomes over the long-term fund life cycles of alternative investments. The issues private companies and founders face will evolve in this new setting. Given it has been more than a decade since the last market cycle matured, notably younger teams will benefit from the guidance of experienced investment partners. We place a premium on fund managers who take a definitive hands-on approach with their portfolio companies and provide connections and support which are rarely found organically.

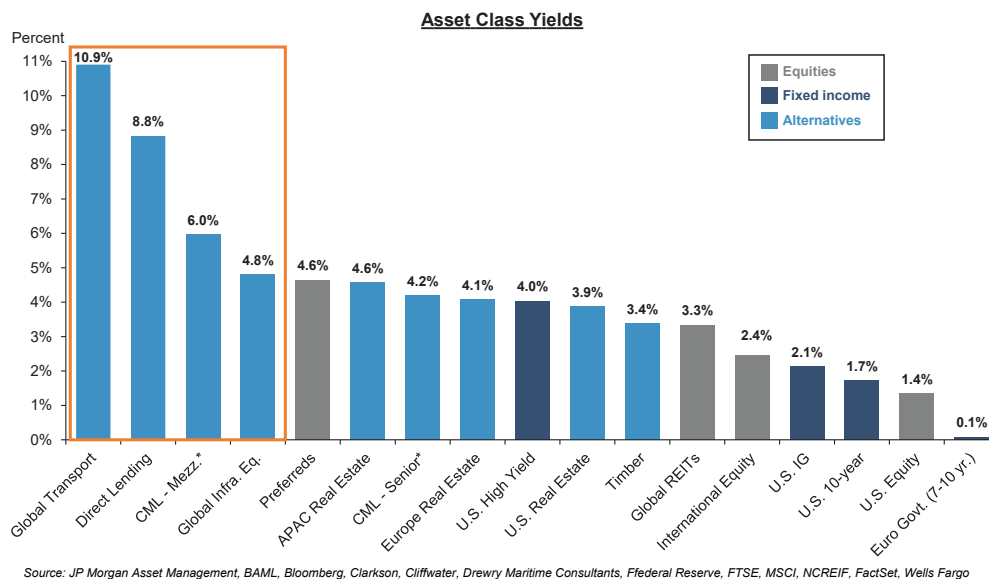
Alternative manager outcomes are broad



Private Debt and Alternative Income

The theme throughout our outlook of high valuations, volatility, and rising interest rates cannot be ignored when considering the prospects for private debt and alternative income strategies. Our outlook for traditional fixed income has become increasingly negative, and with central banks just starting to rev up the rate hike engine alternative strategies are essential to include within income generating portfolio allocations. Interest rates are rising which will eventually help saver and income-oriented investors, but the issue now is higher than expected inflation crashing total return prospects. With higher inflation, the search for yield has now become the search for real yield. Even at the far-end of the risk spectrum high yield bonds are yielding under 5% which is not enough to compensate for current inflation levels. Private debt and alternative income strategies offer multiple investment opportunities with higher yields and similar or lower risk profiles. Given this environment, we believe private credit and alternative lending strategies offer compelling opportunities in 2022.

Alternative strategies dominate the yield landscape

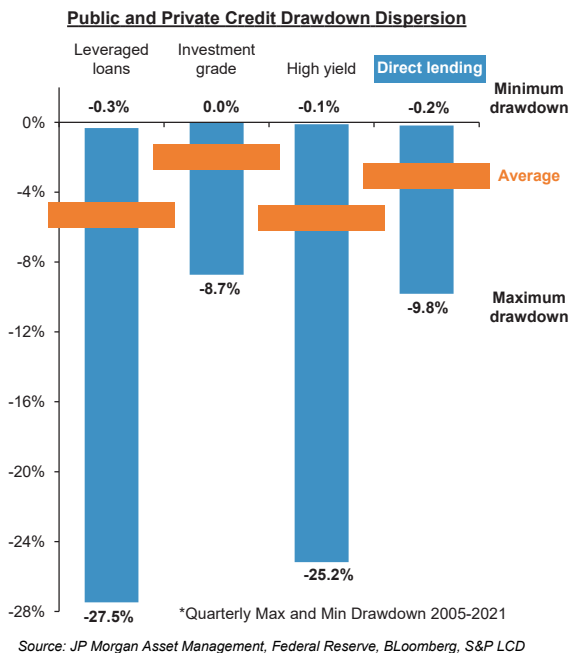


Outlook 2022: Private Markets

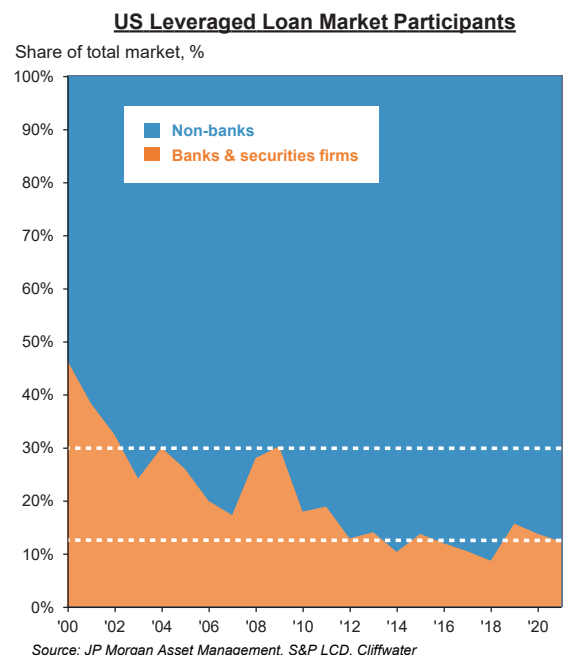
Direct lending strategies offer more than 4x the yield of investment grade bonds with similar drawdown characteristics. We expect demand for the asset class continue growing significantly this year. In the private credit space, we prefer asset-backed financing deals which provide built in downside protection while still offering attractive yields. Senior positioning within the capital stack is also important for mitigating risk. This position gives lenders better control over potential downside scenarios by allowing more customization in terms and covenants.

We are also finding opportunities in leveraged loans, consumer lending, and infrastructure lending and financing. Non-bank lending has gained nearly 20% of the leveraged loan financing market since the Global Financial Crisis in 2008-2009 when banks were forced to cut excessive lending strategies from their balance sheets. We expect the importance of non-bank lenders to continue growing as we move deeper into the market cycle and interest rates rise. Higher rates could keep banks from being able to offer financing based on simplified rules which flag all higher rate debt as higher risk. While we acknowledge the correlation of risk and return is strong, not all risks are created equal. When underwriting a strategy which utilizes leverage we focus on debt coverage ratios based on income interest payments, collateral protection, and first loss provisions.

Higher yields and IG level drawdowns are attractive



Non-Bank lending is an essential part of the economy



Private debt strategies also provide a level of protection against interest rates and inflation which is harder to find in public markets. The position of alternative managers as both the underwriter and lender allows for more flexibility in loan terms. Most non-bank loans include provisions tying interest to a rate which adjusts with treasury or other key rates. Additionally, strategies such as infrastructure investment have typically been positively correlated with inflation given the relationship of pricing power with hard asset demand. Overall, we think the income and total return outlook for private debt and alternative income strategies outweigh the risks, and we expect to increase long-term allocations to the asset class.

Hedge Funds

Market rotations and bouts of volatility supported inflows into hedge funds last year. Returns have been strong over the last few years. Equity strategies have been led by long/short managers who have been able to capitalize on rapid rotations in market leadership. Distressed situation strategies also rebounded during and subsequent to pandemic selloff. This year, an increase in the dislocations between winners in losers in global equities, fixed income, and macro-economic success creates an opportunistic environment for hedge fund managers. We expect hedge funds will act as both risk mitigators and return enhancers in 2022. Volatility is good for the asset class and divergences in global rates, currencies, and markets will be tailwinds. Corporate activity will also benefit event driven and M&A strategies as companies look to put cash to work quickly before inflation eats into spending power. Distressed situation funds could experience another increase in their target market if higher interest rates filter into the high-yield space and lead to a tick up in defaults.

Hedge Fund Strategy Returns (as of November 2021)

2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	YTD	YTD	2001-2020	
												Ann.	Vol.
Global Bonds 5.6%	Global Equities 16.8%	Global Equities 23.4%	Global Macro 5.6%	Eq. Market Neutral 4.3%	Distressed 15.1%	Global Equities 24.6%	Merger Arbitrage 3.3%	Global Equities 27.3%	Equity Long/Short 17.9%	Global Equities 16.2%	Distressed 7.2%	Global Equities 18.2%	
Merger Arbitrage 1.5%	Relative Value 10.6%	Equity Long/Short 14.3%	Global Equities 4.7%	Merger Arbitrage 3.3%	Global Equities 8.5%	Equity Long/Short 13.3%	Relative Value -0.4%	Equity Long/Short 13.7%	Global Equities 16.8%	Distressed 16.2%	Global Equities 6.7%	Equity Long/Short 10.6%	
Relative Value 0.1%	Distressed 10.1%	Distressed 14.0%	Relative Value 4.0%	Relative Value -0.3%	Relative Value 7.7%	HFRI Composite 8.6%	Eq. Market Neutral -1.0%	HFRI Composite 10.4%	HFRI Composite 11.8%	Equity Long/Short 12.9%	Relative Value 5.7%	Distressed 9.2%	
Distressed -1.8%	Equity Long/Short 7.4%	HFRI Composite 9.1%	Eq. Market Neutral 3.1%	Equity Long/Short -1.0%	Equity Long/Short 6.5%	Global Bonds 7.4%	Global Bonds -1.2%	Relative Value 7.4%	Distressed 11.8%	HFRI Composite 11.1%	HFRI Composite 5.5%	HFRI Composite 7.9%	
Eq. Market Neutral -2.1%	HFRI Composite 6.4%	Relative Value 7.1%	HFRI Composite 3.0%	HFRI Composite -1.1%	HFRI Composite 5.4%	Distressed 6.3%	Distressed -1.7%	Global Bonds 6.8%	Global Bonds 9.2%	Merger Arbitrage 10.1%	Equity Long/Short 5.4%	Relative Value 6.0%	
Global Macro -4.2%	Global Bonds 4.3%	Eq. Market Neutral 6.5%	Equity Long/Short 1.8%	Global Macro -1.3%	Merger Arbitrage 3.8%	Relative Value 5.1%	Global Macro -4.1%	Merger Arbitrage 6.8%	Global Macro 5.4%	Global Macro 9.3%	Global Bonds 4.8%	Global Bonds 5.9%	
HFRI Composite -5.3%	Eq. Market Neutral 3.0%	Merger Arbitrage 4.7%	Merger Arbitrage 1.7%	Global Equities -1.8%	Eq. Market Neutral 2.2%	Eq. Market Neutral 4.9%	HFRI Composite -4.7%	Global Macro 6.5%	Merger Arbitrage 5.2%	Relative Value 7.9%	Global Macro 4.6%	Global Macro 4.6%	
Global Equities -6.9%	Merger Arbitrage 2.8%	Global Macro -0.4%	Global Bonds 0.6%	Global Bonds -3.2%	Global Bonds 2.1%	Merger Arbitrage 4.3%	Equity Long/Short -7.1%	Distressed 2.9%	Relative Value 3.4%	Eq. Market Neutral 6.5%	Merger Arbitrage 4.4%	Merger Arbitrage 4.6%	
Equity Long/Short -8.4%	Global Macro -0.1%	Global Bonds -2.6%	Distressed -1.4%	Distressed -8.1%	Global Macro 1.0%	Global Macro 2.2%	Global Equities -8.9%	Eq. Market Neutral 2.3%	Eq. Market Neutral -0.1%	Global Bonds -4.8%	Eq. Market Neutral 2.7%	Eq. Market Neutral 3.1%	

Source: MSCI, JP Morgan Asset Management, Bloomberg, HFRI, Facset, data as of November 2021

We continue to advocate for allocations to low-correlation strategies which can take the place of traditional fixed income allocations within portfolios. With interest rates rising from historical lows there is little room for bond price appreciation and total returns will be muted. Hedge fund strategies offer investors an attractive asset to fill the gap left in the wake of central bank manipulation of global bond markets. We expect macro hedge funds, which invest in directional trends in bonds, currencies, and equities, to provide additional diversification and return benefits for alternative asset investors this year. Hedge funds continue to offer attractive risk management, alternative yield, and risk adjusted returns which will improve portfolio efficiencies in 2022.

**“A STRATEGIC ASSET
ALLOCATION PAIRED WITH
ACTIVE QUANTITATIVE
ANALYSIS IS THE BEST
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WHATEVER THE FUTURE
HOLDS.”**

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CAPITAL

2700 Via Fortuna STE 100 Austin, TX 78746 • (512) 777-5900
5553 Peachtree Rd, Suite 155, Chamblee, GA 30341 • (470) 552-5903
www.WaterlooCap.com