

## 2022 YEAR IN REVIEW

Rising Inflation Rates and Interest Rates  
Cause Financial Markets to Decline



## Top 5 takeaways in this year's letter:

1. GSIS client fully implemented diversified model portfolios significantly outperformed their customized investment policy benchmark by 5%+ in 2022, which was driven by defensive asset allocation positioning and exceptional semi-liquid private market manager performance versus public markets.
2. 2022 was one of the worst years on record for a balanced public only 60% equity / 40% fixed income strategy, which returned **-16.2%**. Despite all the negative news surrounding international markets, non-U.S. equities led U.S. equities for the year by **+3.5%** in 2022. U.S. Large Cap Growth was the worst performing global equity asset class. Bond returns were the worst in modern history, with the Bloomberg Barclays Aggregate index down **-13.0%** for the full calendar year.
3. The Federal Reserve inflation-fighting hawkish actions raised interest rates by 4.25% in 2022, which drove public stock and bond markets significantly lower. The Fed is expected to raise the Fed Funds at least another 50 bps in 2023 as they continue to fight inflation. The Treasury yield curve remains inverted (shorter maturity bonds with higher yields than longer maturity bonds).
4. U.S. Job Market remained strong, unemployment dropped to low levels, wages increased, and significant jobs are available for those seeking employment, which could extend the inflation cycle.
5. Global Equity valuations improved in 2022 and ended up right around fair value to cheap. We continue to utilize buffered equity strategies to mitigate Fed driven market volatility. Similarly, public fixed income forward looking expected returns are meaningfully higher than at the start of the year.

## 1. GSIS Allocation Shifts Provide Significant Excess Returns

Despite a very challenging market environment in 2022, GSIS client accounts enjoyed a strong relative year and outperformed their policy benchmark by 5%+ depending on the customized allocation. Our active strategic asset allocation approach incorporates a myriad of factors, such as valuation, sentiment, momentum, and technical analysis. This rigorous approach was the key driver of excess returns.

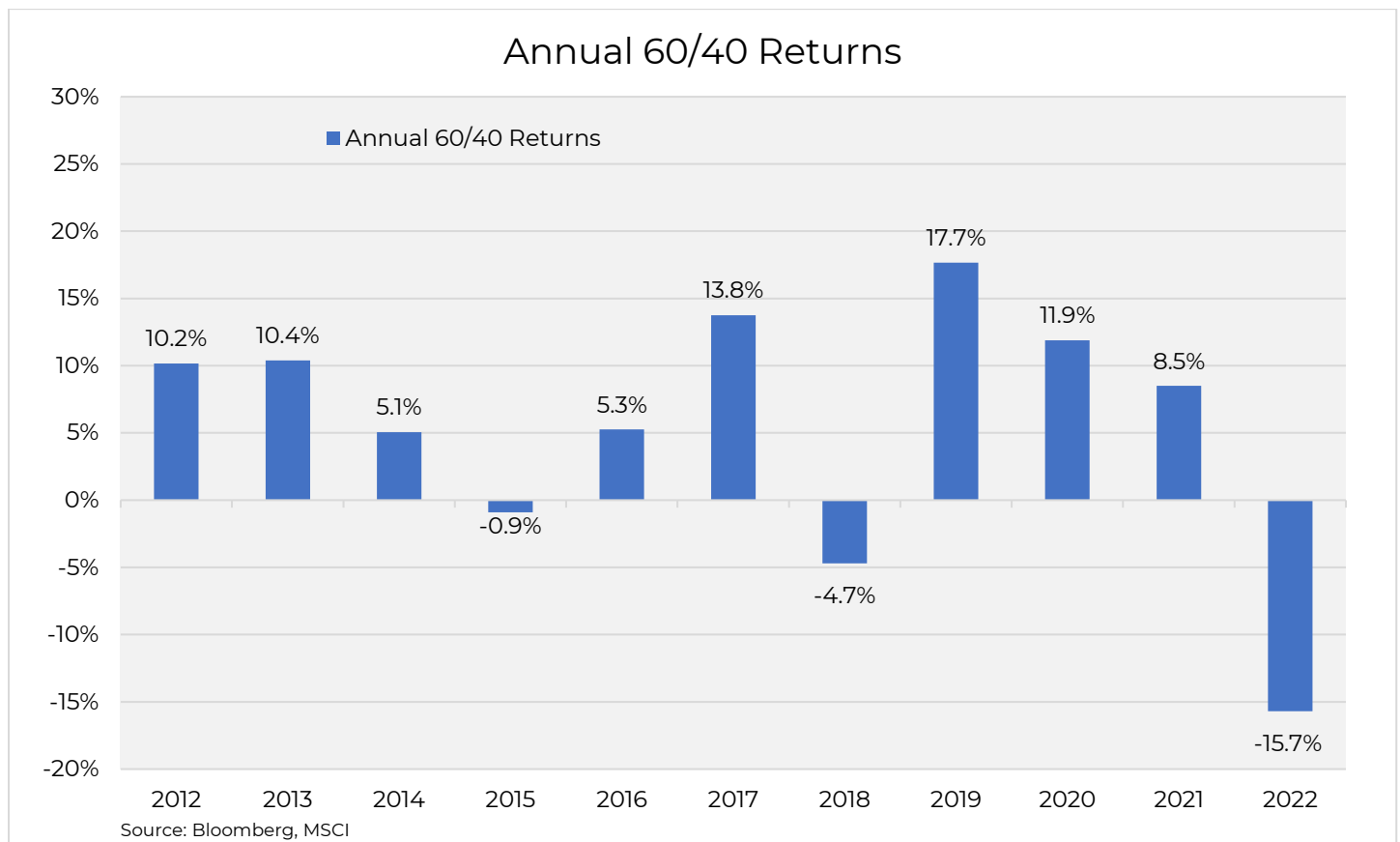
- Within **public fixed income** we maintained a short duration posture along with floating rate opportunistic fixed income. This positioning shielded portfolios meaningfully from the impact of rising interest rates.
- We implemented **semi-liquid private credit** portfolios that primarily consist of floating rate securities and shorter-term loan agreements. These benefitted from rising interest rates and generated significant positive absolute returns.
- The **semi-liquid private real assets** allocation in our client accounts focused on high quality, income-paying core real estate with an emphasis on residential (multi-family, college housing), industrial, and data centers. These assets enjoyed significant rental increases to offset inflation. Our allocation of **semi-liquid private credit** and **semi-liquid private real assets** allocations were sourced mainly from U.S. Core Bonds, and have generated double digit excess performance.
- The **semi-liquid private equity** allocation we employ in client accounts emphasizes secondary and direct/co-investments within growth equity and buyout, two of the most conservative segments of private equity. The semi-liquid private manager team significantly outperformed the MSCI ACWI public global equity index with less price volatility and was the best performing asset class in client portfolios.
- In **global public equities**, we tilted towards more attractively valued non-U.S. and U.S. Large Cap Value equities. In addition, we implemented buffered equities, which protect against negative returns while participating in positive performance to a cap, across all the equity asset classes. These tilts significantly protected our clients' portfolios from the decline in public equities.

## 2. 2022 Produced the Worst Ever Balanced Portfolio Returns

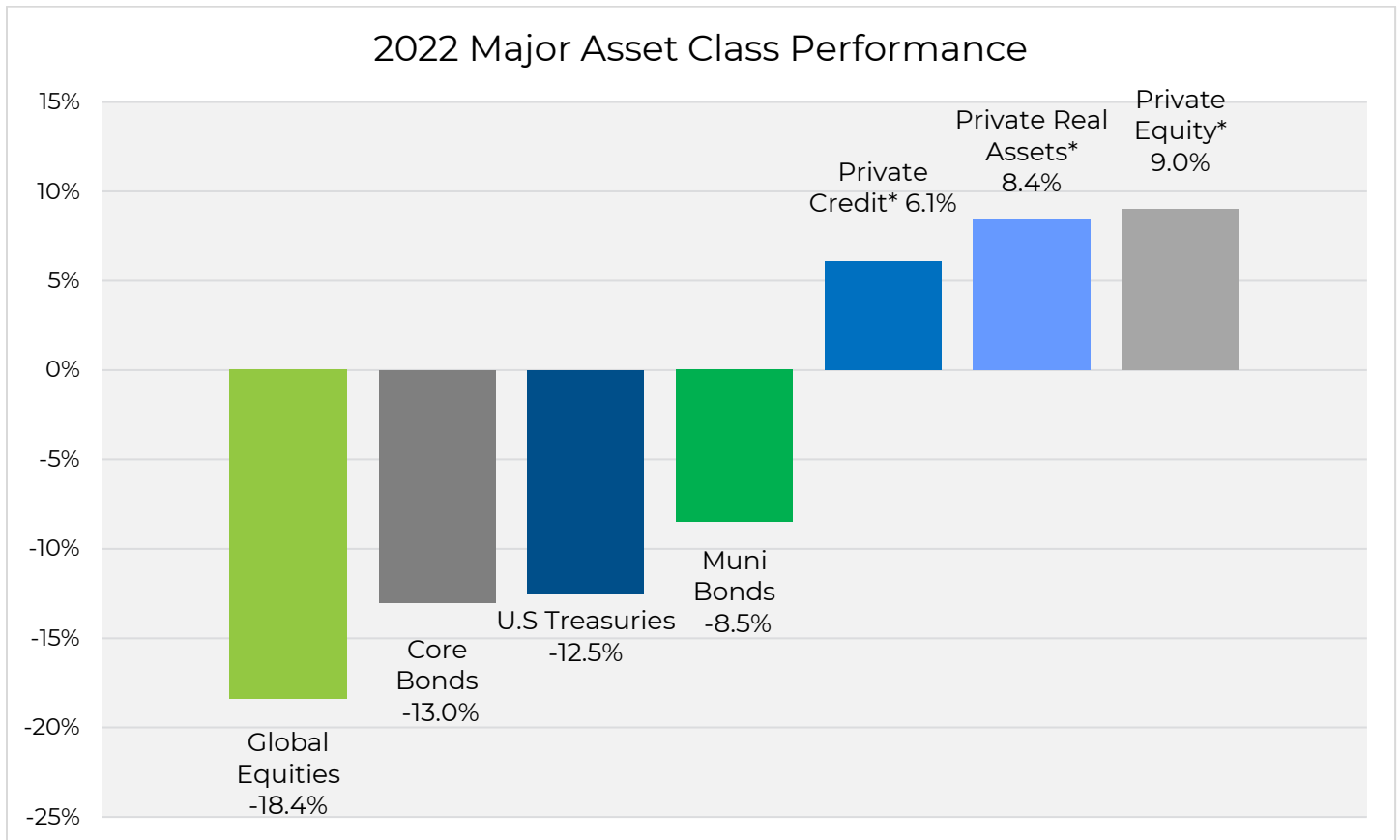
The 2022 economic backdrop weighed heavily on both stock and bond prices. After 3 straight years of strong market returns, investors saw public asset values decline.

This year's U.S. stock market decline was outsized but is not necessarily unique. In 6 of the last 10 years, the markets have experienced intra-year declines of -10% or more.

The more unusual outcome occurred in the US Fixed Income market. U.S. Core bonds had by far their worst year in a very long time due to the hawkish actions by the Federal Reserve. We have to go back to 1980 to find the second worst drawdown in U.S. Fixed Income. In 1980, the index dropped 9% during the year, only to recover back to positive territory.



Longer duration assets, namely growth stocks and long maturity bonds, were negatively impacted the most, whereas value stocks and short duration bonds held up significantly better. Semi-liquid Private Markets posted positive returns for the year. Part of the original thesis of investing in these asset classes was to 1. participate with higher interest rates and 2. benefit from higher inflation.



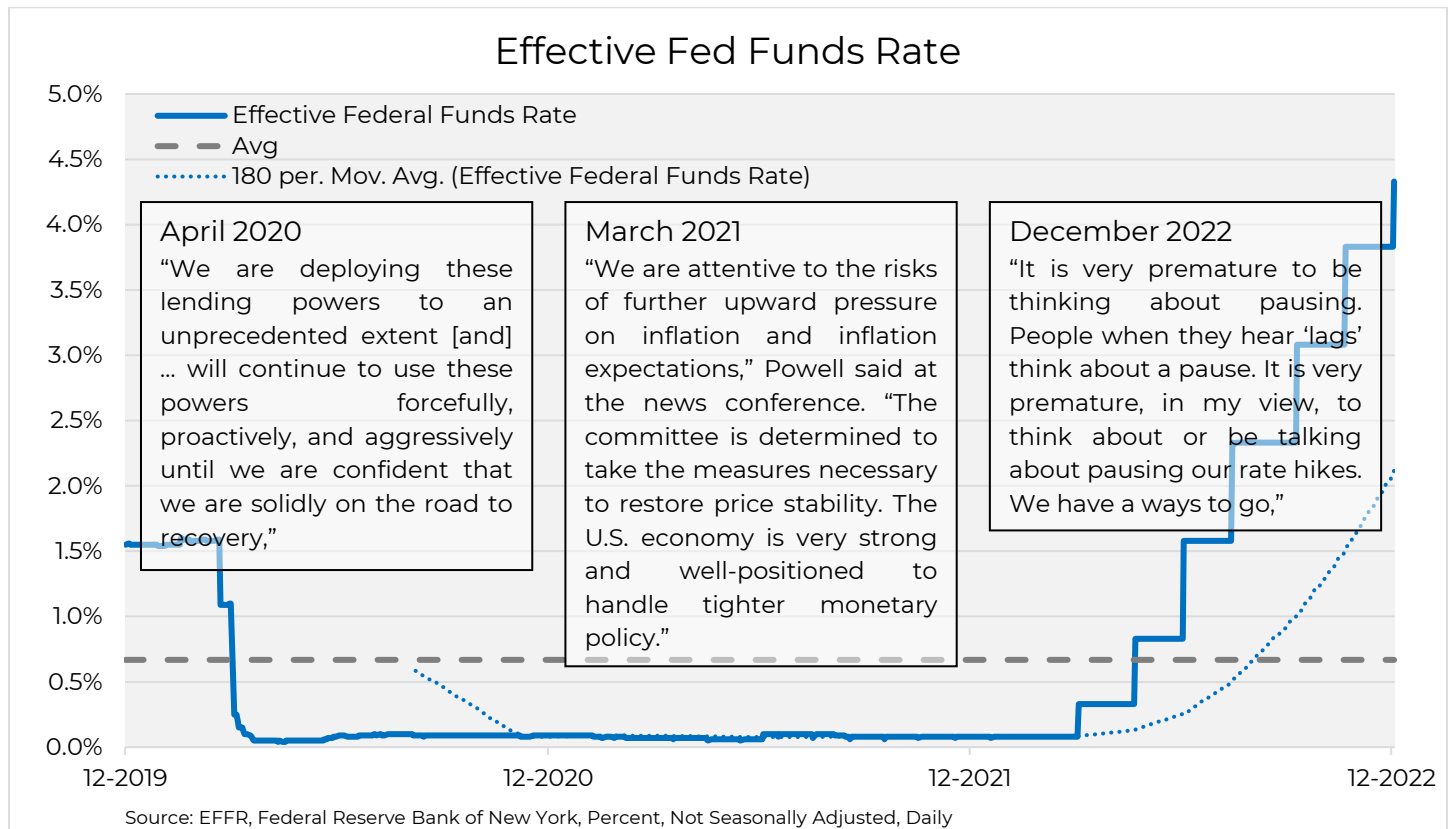
\*GSIS Model Weight Semi-Liquid Private Market Returns Through 11/30/2022. GSIS Calculations.

### 3. High Inflation Leads to Higher Interest Rates

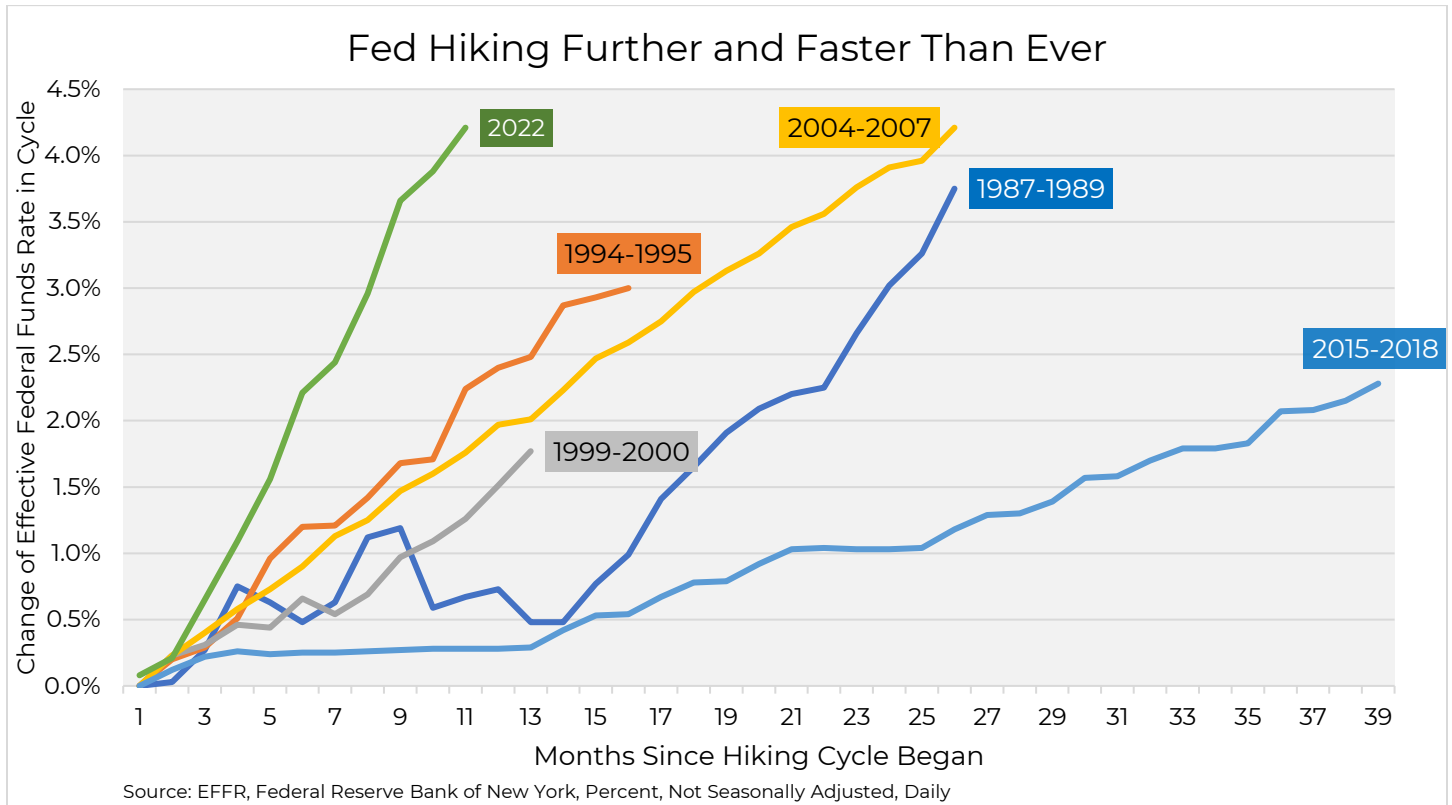
The two largest market catalysts in 2022 were [inflation](#) and [interest rates](#). These factors drove market volatility and uncertainty, with investors closely monitoring the Federal Reserve actions and any developments on these fronts.

Inflation has been a major concern as rising prices have put pressure on companies' profit margins and weighed on their stock prices. Meanwhile, the ongoing debate over the level of interest rates has also been a key factor, as the sharp rise in rates negatively impacted the economy and financial markets. Overall, these two factors remain key drivers of market movements and will likely continue to be closely watched by investors throughout 2023.

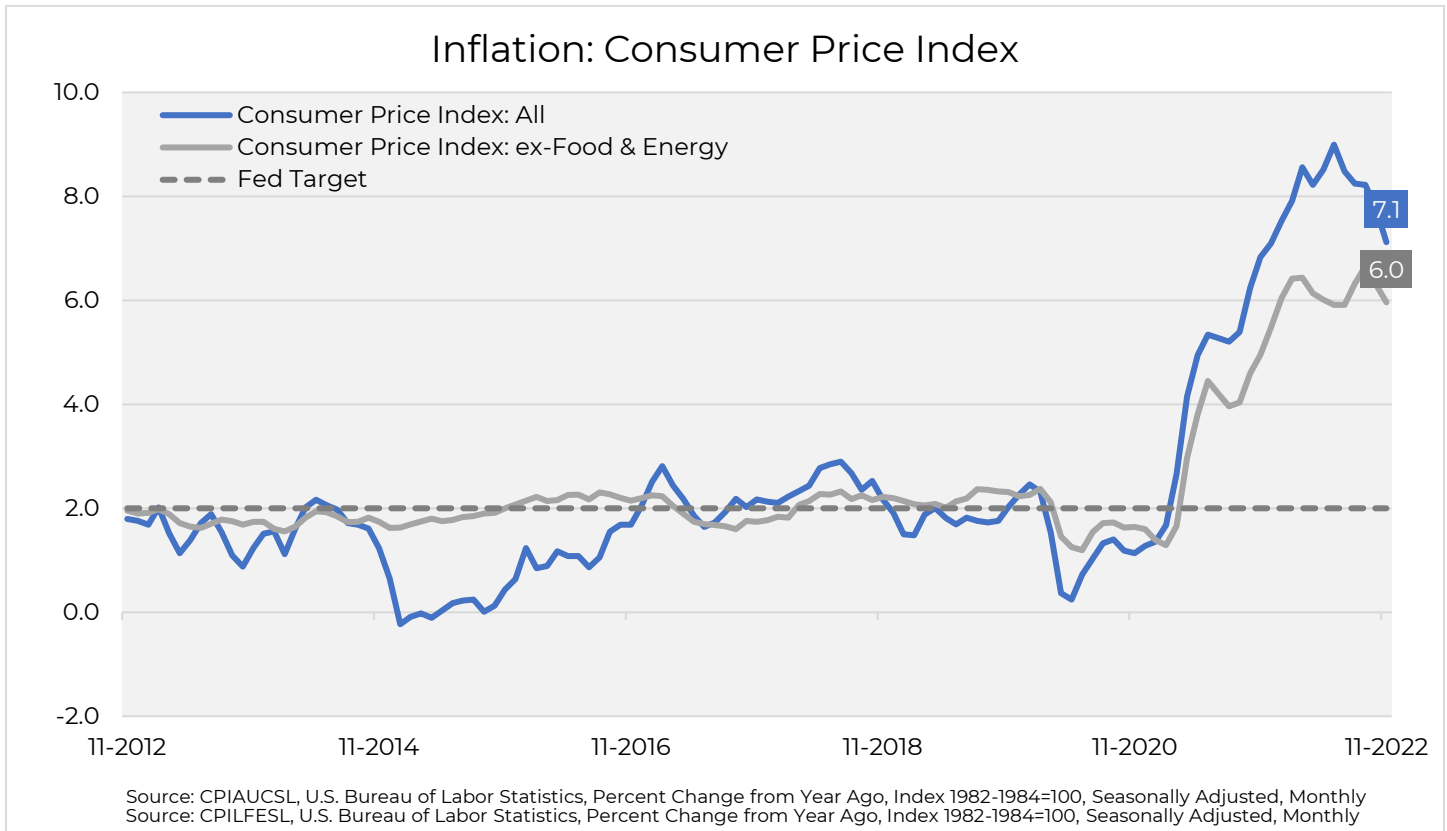
The Federal Reserve, as expected, began to unwind accommodative policies in 2022 by raising the Federal Funds rate and initiating quantitative tightening to fight high levels of year over year inflation.



During the year, the Fed raised the Fed Funds rate to 4.3% from practically 0%. This tightening cycle has raised the Fed Funds rate further and faster than any of the past 6 rate hike cycles.



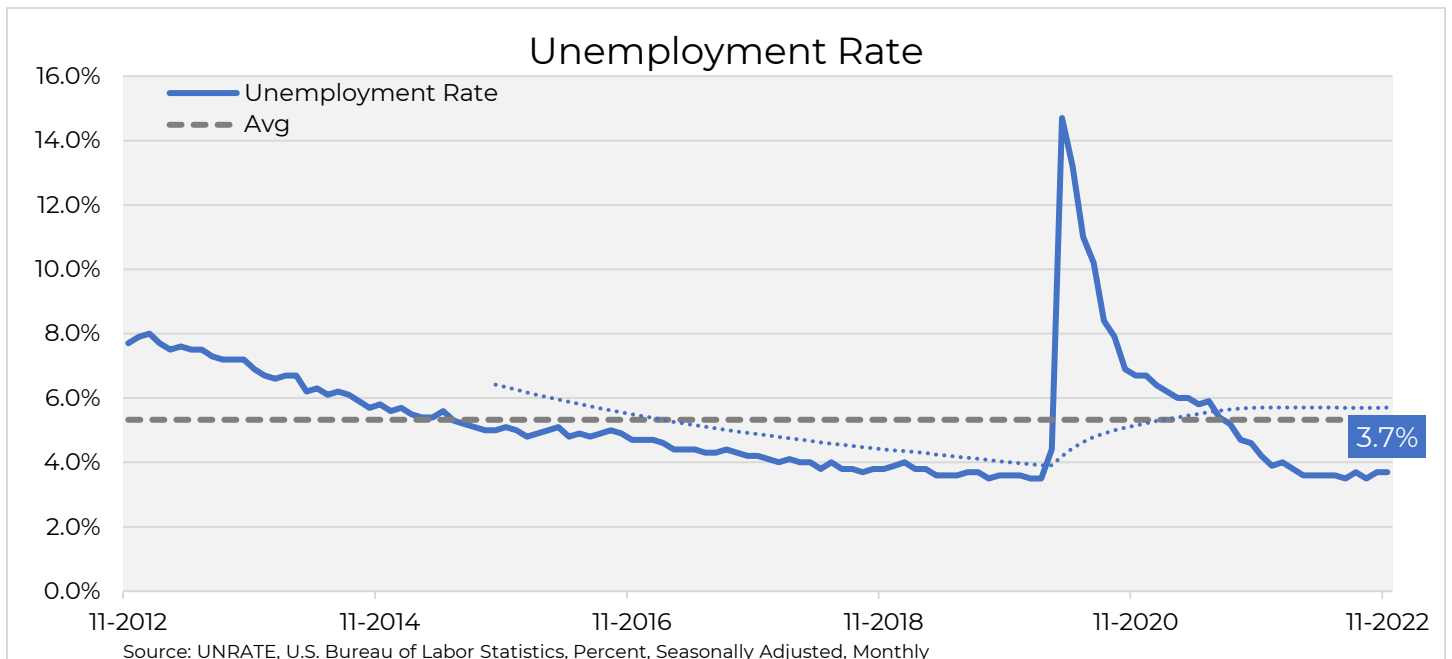
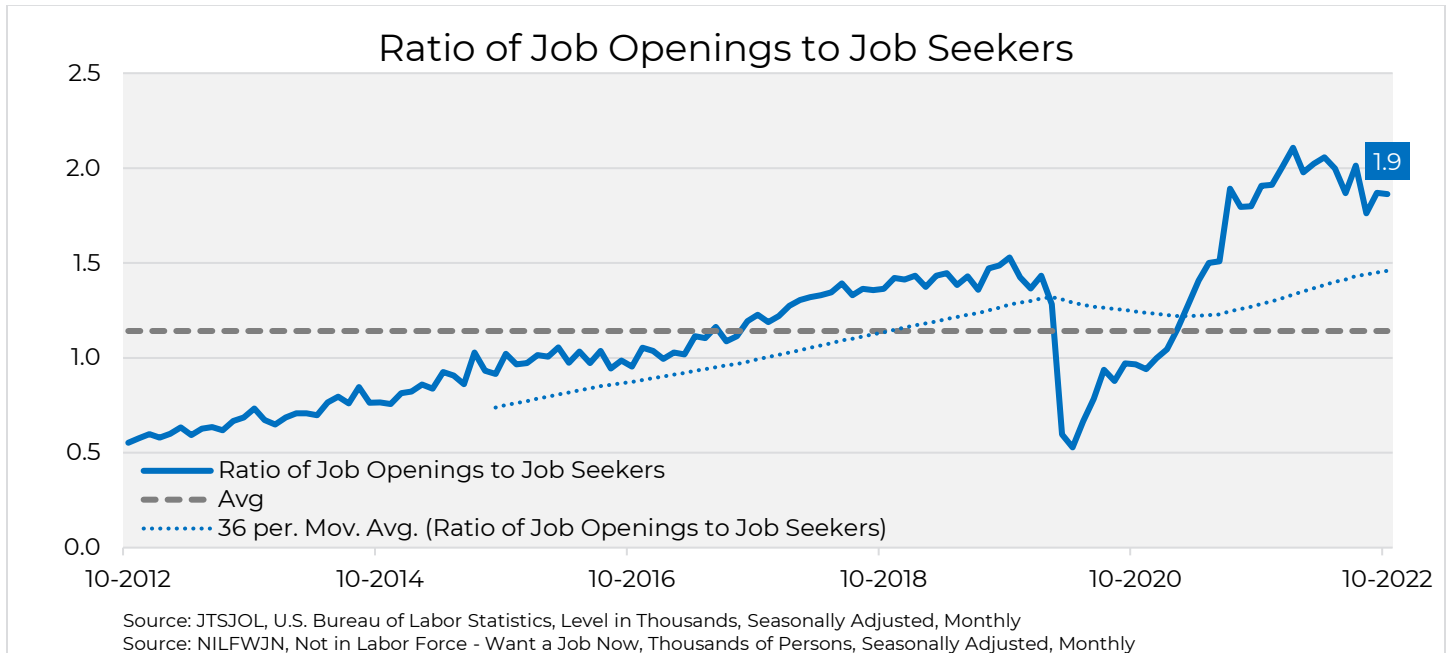
Most recently, the Fed lowered the size of the rate increases from 0.75% to 0.50% but stated that there will be more increases in the Fed Funds rate in 2023. The Fed's stance seems to be extremely strong while inflation metrics are signaling an ease in the year-over-year calculation.



The inflation rate has now dropped for 5 consecutive months. Some impactful lagged indicators, like falling home prices, are showing weakness but have not factored into the inflation numbers yet. In October, [existing home sales](#) in the US saw a sharp decrease of 5.9%. This marks the lowest level since December 2021. Existing home sales have dropped for 9 consecutive months. This decline is attributed to high starting home prices and high 30-year mortgage rates (20-year high), which has deterred potential buyers from entering the market.

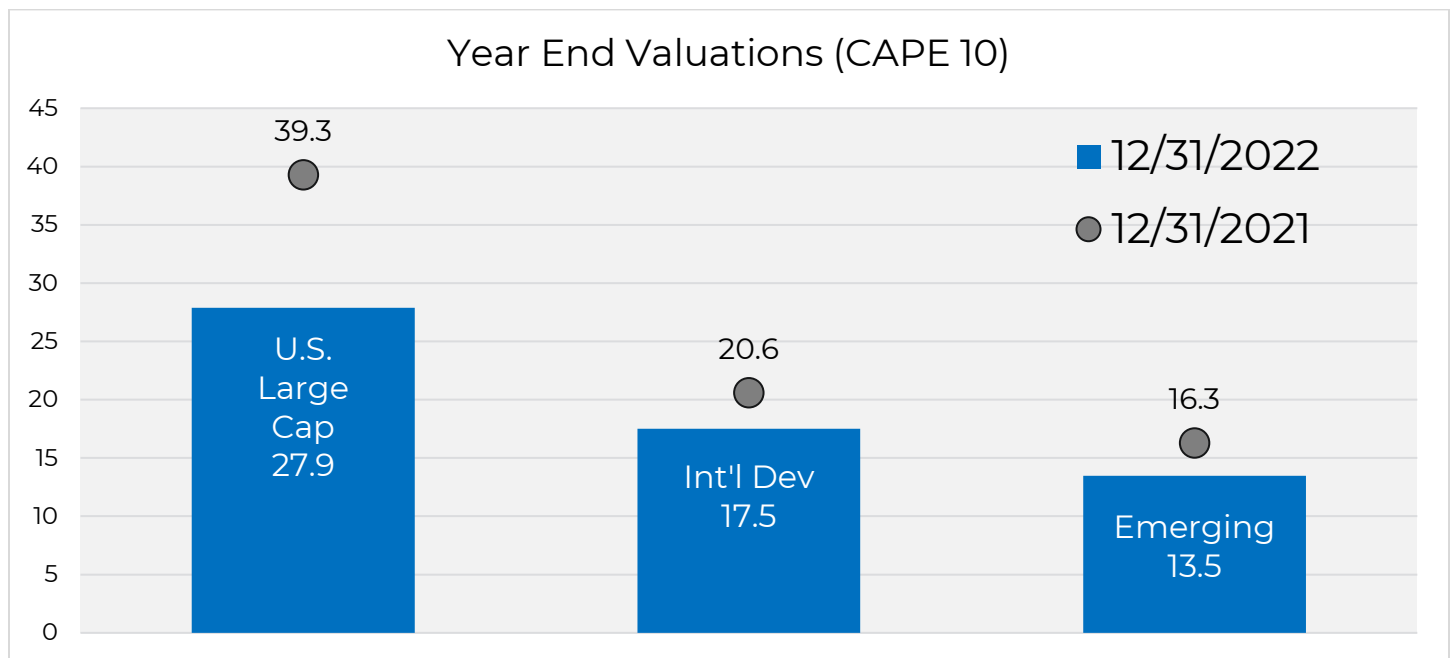
## 4. U.S. Job Market Remains Strong Despite Late-2022 Layoffs

Fed Chairman Powell is cognizant that their hawkish policies may cause **unemployment** to rise, but the Fed has not seen that impact in the markets as job vacancies remain high and there continues to be a “structural labor shortage.” As you can see from the chart below, the number of vacancies per job seeker is relatively high.



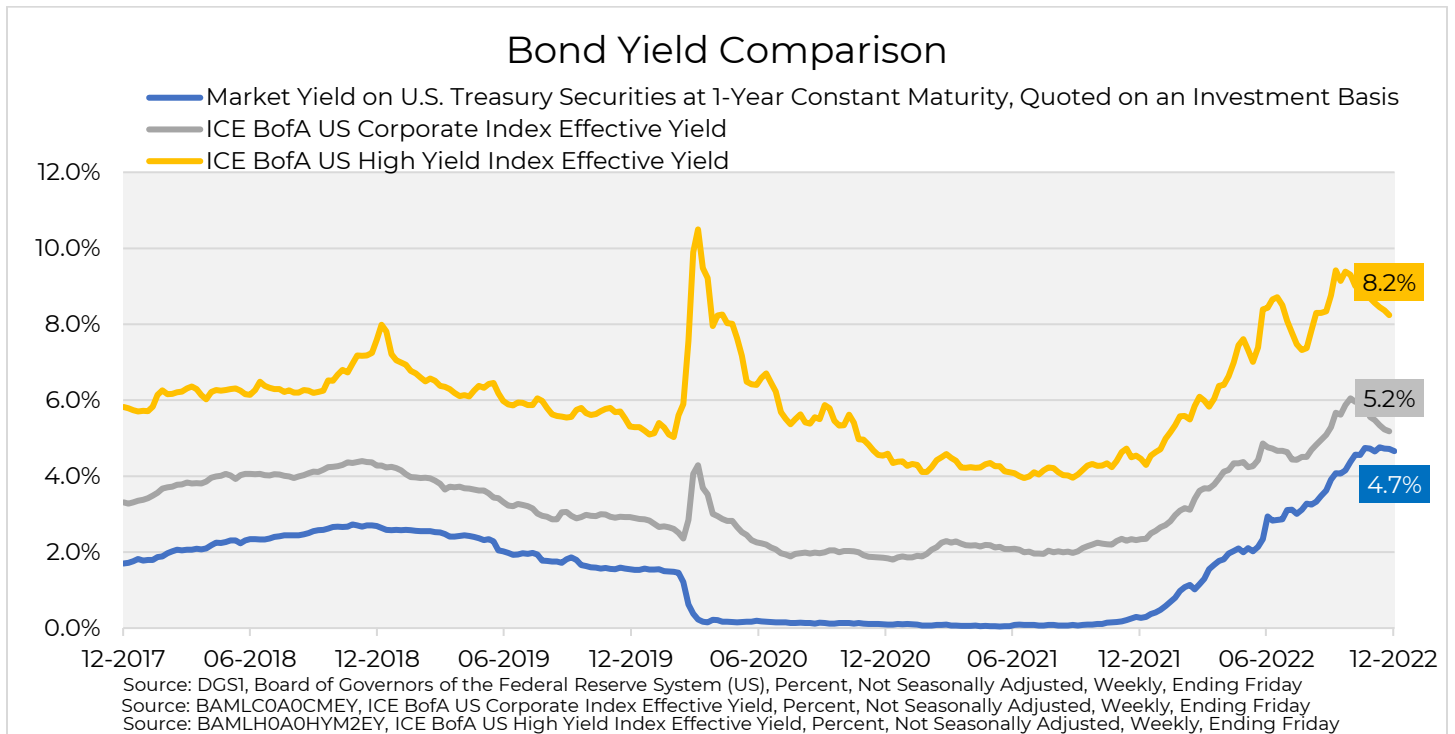
## 5. Public Market Valuations Much Improved in 2022

**U.S. Equities** were hit hard in 2022 as the Fed Stimulus band-aid was ripped off. Stock market valuations are more appealing today than a year ago but elevated inflation and interest rates, coupled with a weak earnings outlook, could continue to put pressure on global stock markets in 2023. China could be a positive surprise in 2023 for emerging markets as long as accommodative economic policies and recent relaxed Covid restrictions remain in place.

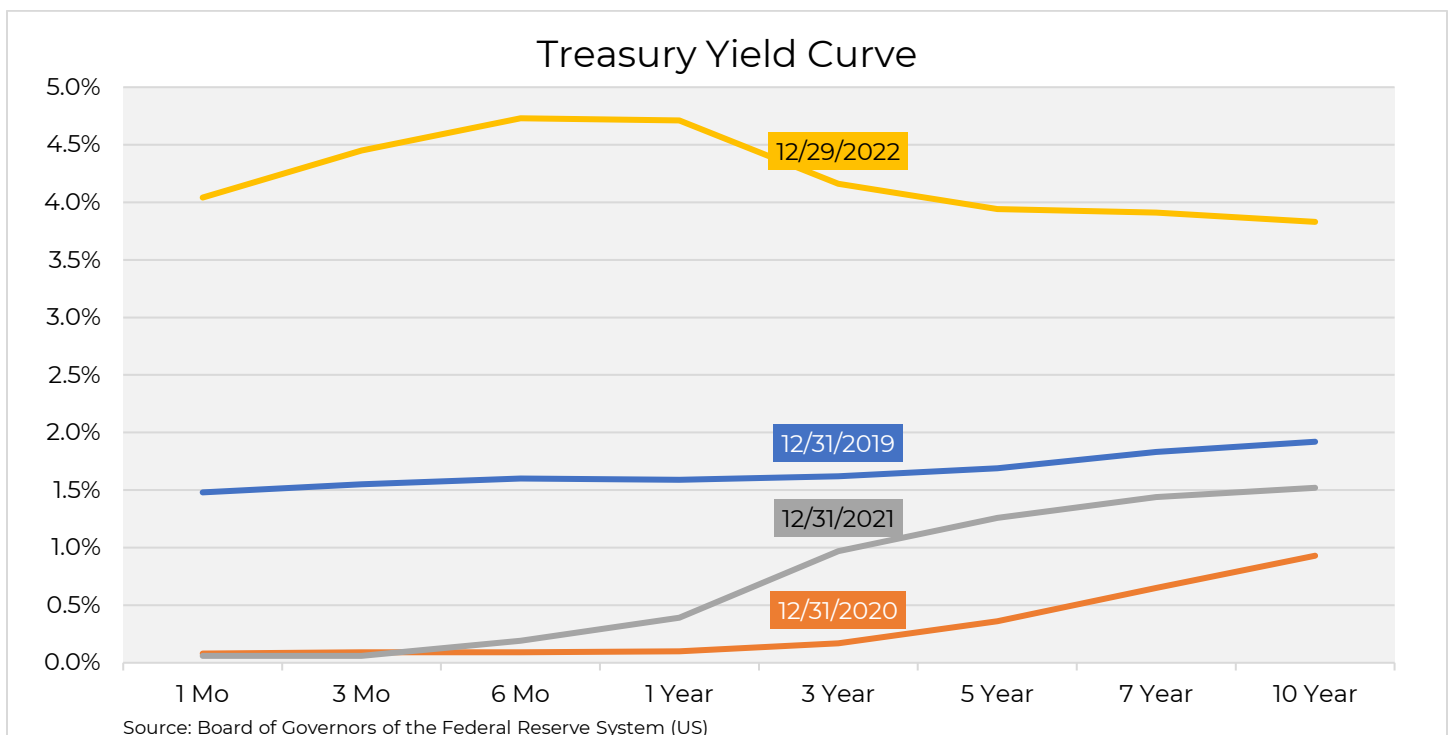


2022-year end valuations have improved from a year ago. Although U.S. stocks are rich relative to non-U.S. stocks, they remain fairly priced when compared to core and municipal bonds. Both equities and fixed income assets valuations have improved.

Bonds are once again an attractive holding in balanced portfolios. Core & High Yield Bonds' expected returns have risen significantly and are back near long term averages.



We continue to favor shorter duration exposure in US Treasuries, Core Bonds and High Yield due to the inverted yield curve.



## LOOKING AHEAD

- The Federal Reserve is expected to raise rates in 2023, potentially causing the yield curve to invert further. For example, a 6-month T-Bill yields 4.73%, whereas the 10-Year Bond yield is only 3.83%.
- The Fed may also accelerate their quantitative tightening by reducing their \$8.6T balance sheet, causing Treasury yields to rise and potentially leading the U.S. into a recession.
- Europe is facing an energy crisis due to cut supplies of Russian gas. Recently, Russia has indicated they are willing to negotiate an end of the conflict.
- Money market fund investments remain at near record levels (roughly \$5T) and could fuel a potential rally in 2023 if inflation moderates and the US avoids a recession.
- Private market strategies remain attractive, though their advantage relative to public assets has narrowed.

Thank you for your Trust and Confidence.



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## Global Index Performance & Key Indicators as of 12/31/2022

Asset Class	Index	QTD	YTD	1 Year	3 years	5 Years
<b>Global Equity</b>	<b>MSCI ACWI</b>	<b>9.8%</b>	<b>-18.4%</b>	<b>-18.4%</b>	<b>4.0%</b>	<b>5.2%</b>
US Large Cap	S&P 500	7.6%	-18.1%	-18.1%	7.7%	9.4%
US Large Cap Growth	Russell 1000 Growth	2.2%	-29.1%	-29.1%	7.8%	11.0%
US Large Cap Value	Russell 1000 Value	12.4%	-7.5%	-7.5%	6.0%	6.7%
US Small Cap	Russell 2000	6.2%	-20.4%	-20.4%	3.1%	4.1%
International	MSCI EAFE	17.3%	-14.5%	-14.5%	0.9%	1.5%
Emerging Markets	MSCI Emerging	9.7%	-20.1%	-20.1%	-2.7%	-1.4%
<b>Commodities</b>	<b>S&amp;P Global Natural Resources</b>	<b>18.0%</b>	<b>10.2%</b>	<b>10.2%</b>	<b>11.2%</b>	<b>6.8%</b>
<b>Real Estate</b>	<b>CRSP US REIT</b>	<b>4.3%</b>	<b>-26.2%</b>	<b>-26.2%</b>	<b>-0.4%</b>	<b>3.7%</b>
Muni Bonds	Bloomberg Municipal Bond	4.1%	-8.5%	-8.5%	-0.8%	1.3%
Taxable Bonds	Bloomberg Aggregate Bond	1.9%	-13.0%	-13.0%	-2.7%	0.0%
High Yield Bonds	Bloomberg High Yield Bond	4.2%	-11.2%	-11.2%	0.0%	2.3%

Indicator	Metric	Last	1Y Ago	3Y Ago	5Y Ago
Yield	10 Year US Treasury	3.83%	1.52%	1.92%	2.40%
Fed Funds Rate	Effective Fed Funds	4.33%	0.07%	1.55%	1.33%
Unemployment	US Unemployment	3.7%	3.9%	3.6%	4.1%
Inflation	Core CPI	7.1%	7.0%	2.3%	2.1%
Inflation	Core PCE	4.7%	5.0%	1.6%	1.7%