

The Great Unwind

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Discipline Drives Performance®

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The markets suffered dismal performance in the first half of 2022. According to Deutsche Bank, U.S. bonds posted the most severe decline since 1788 (using proxies for U.S. 10-year bonds). Moreover, the Bloomberg U.S. Aggregate Index plunged -10.7%, the worst first-six month return since 1975, when data was first compiled. For the past six months, investors had to price in inflation and rate risks, but as U.S. economic activity decelerates, recession risks for both public and private markets are being factored into equity valuations and credit spreads. The probability of a recession has risen substantially as the Fed has a herculean task of combatting the flames of inflation without dampening the engines of economic growth. The U.S. has experienced 12 recessions since WWII. Historically, demand destruction and rising unemployment were the root causes of recessions. However, this potential "stimulus unwind" recession could be different due to a tight labor market and excess liquidity in the system. After 14 years of easy monetary policies, which spurred asset value inflation and risk-taking, the "Great Unwind" may be unfolding amid a confluence of factors including: embedded general inflation, higher rates, supply-chain disruptions, sharply higher commodity prices, peaking real estate values, shifting demographics, a tech sell-off, and the crypto crash. While the credit markets have not been unscathed during this volatile readjustment period, the probability of rebound appears more likely given the structural nature of the bond markets with contracted income and principal repayments.

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The S&P/LSTA Leveraged Loan Index is a market value-weighted index designed to measure the performance of the U.S. leveraged loan market based upon weightings, spreads and interest payments.

The Refinitiv US All-Cap Convertible Bond Index has an inception date of December 1993, is a subset of the Refinitiv US Convertible Bond Index and includes securities that have a price between 60 and 140 and a conversion premium of < 100%, among other criteria. The Refinitiv US Convertible Bond Index includes convertible securities that are denominated in USD, have a market value of over \$300mm, and have underlying stocks that trade on US equity markets.

The Dow Jones Industrial Average is a price-weighted average of thirty blue-chip stocks that are generally the leaders in their respective industries.

The Russell 2000 Index measures the performance of the small-cap segment of the U.S. equity universe. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The S&P 500 Index is designed to reflect the U.S. equity markets and focuses on the large-cap sector of the market, which includes the 500 leading companies in leading industries of the U.S. economy.

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The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries. With 1,398 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

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