Overview

The first three months of 2022 brought on a variety of external issues that directly or indirectly affected individuals in almost every country: the political and economic tragedies and uncertainties surrounding the Russian-Ukrainian war, possible risks associated with additional variants of the COVID-19 virus, disrupted supply chains, high inflation, rising interest rates, and fiscal and monetary tightening by most major central banks were a few of note.

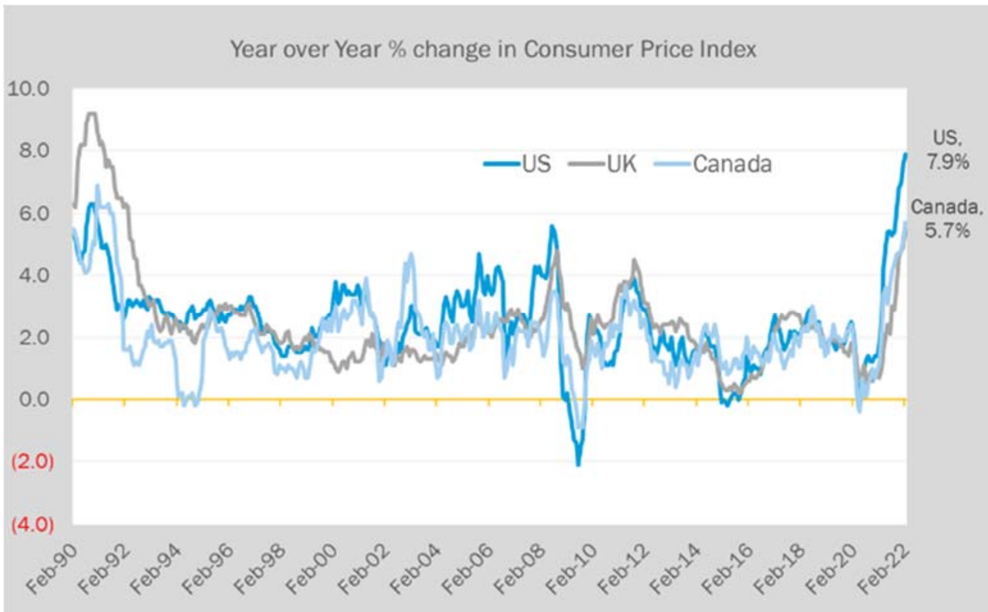


Figure 1. Source: U.S. Bureau of Labor Statistics, Bk of Canada, UK Office for Nat'l

Despite geopolitical concerns, underlying economic growth prospects remain positive as many economies continue to open, making it possible for business services, travel, and work to move towards pre-pandemic activity levels. In the U.S., unemployment came in at 3.6% in March 2022, close to 3.5% in February 2020, as the demand for labor continues to surpass supply. This demand has supported higher wage growth and raised concerns around inflation factors that could be "sticky".

Sanctions on Russian Oil by Western countries put further upward pressure on the oil price and the output price in all the industries where Energy/Transportation is an essential cost factor. It remains to be seen whether inflationary pressures wane because global reflation of trade improves supply channels fast enough to help temper price increases or whether the stance taken by central governments to raise rates to slow demand is aggressive enough to reverse the trend of economic growth and rising employment.

Macroeconomic and geopolitical uncertainties heightened market volatility across equity and fixed-income markets for the quarter. After sharp downturns through early March, most equity markets bounced during the last few weeks to post positive returns for the month. For the full quarter, global equity markets were down 5.3%, while Emerging Market equities fell 7%.

The impact of higher volatility was relatively greater in fixed income markets. Ten-year U.S. Treasury yields jumped from 1.5% at the end of December 2021 to 2.3% on March 31, 2022. German 10-year Bunds with negative yields for over five years jumped from -0.18% in December to a positive 0.48% at the end of the first quarter. Commodity-exporting economies such as Australia saw their 10-year bond rates jump from 1.7% to 2.8%. The dramatic move in yields at these low levels represents a meaningful pullback in capital value. The broad Barclays U.S. Aggregate Index and Global Aggregate Index were down 6.0% for the quarter, lagging the -5.3% return from the global MSCI ACWI Equity Index.

Equities

The volatility in returns of the broad indices was most evident in the dispersion of performance across the underlying economic sectors. Swings in commodity prices and geopolitical concerns caused a "risk-off" environment in which dividend and value securities held up better than the traditional growth sectors such as technology, consumer discretionary, and communication services.

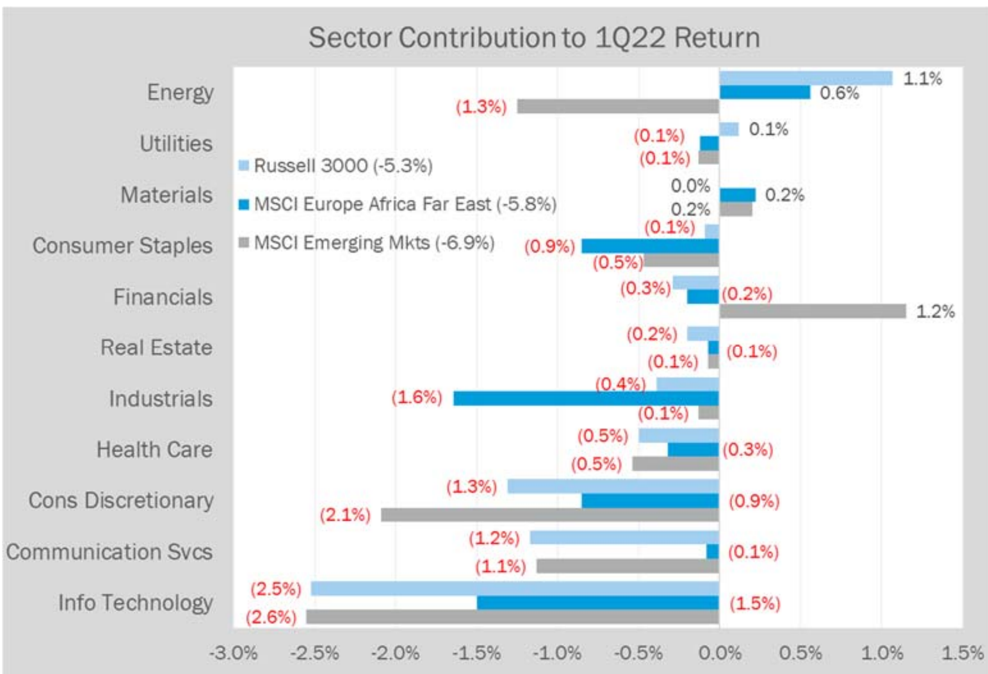


Figure 2. Source: MSCI, Inc., FTSE Russell

The Energy sector makes up less than 5% of the broad U.S. and non-U.S. indices at this time but had a meaningful impact given the jump in oil prices from $75 to $100 within the quarter. The significant surge in Oil prices was a positive for the integrated oil companies that make up a large component of the U.S. Energy sector, which made a positive contribution to the Russell 3000 Index and the MSCI EAFE Index. In the Emerging Markets Index, Russian oil companies were a large component of the sector exposure. During the first quarter, as part of the sanctions against Russia, MSCI marked the value of Russian companies down to zero and removed them from the Index, hurting its performance by 1.3%.

Managers with a value style fared better for the quarter; however, active managers with an underweight to energy and materials were at a disadvantage relative to the broad benchmarks. Growth segments saw a pullback in their valuations despite positive fundamentals amidst fears of higher costs and rising rates. The Technology sector, which makes up over 27% and 22% of the Russell 3000 and MSCI EM Index, respectively, dragged their performance by over 2.5%. Within the EAFE Index, industrial companies, which make up 15% of index weight, were a bigger detractor to the performance for the quarter.

Our global equity segment had less than 0.3% exposure to Russia at the beginning of the quarter. The markdown of this segment had a minimal effect on the portfolio. Our non-U.S. segment is balanced with value and growth style managers with a tilt towards strategies that capture long-term growth fundamentals in these economies.

Fixed Income

The fixed income markets performed exceptionally poorly amid heightened inflation pressures globally. In the U.S., the Federal Reserve's move to end the bond-buying program and its resolve to increase the Federal Funds rate specifically to reduce inflation drove short-term rates dramatically higher. The rate for 2-year Treasuries went from 0.73% on 12/31/21 to 2.28% on 3/31/22, while 10-year Treasuries were yielding 2.32% at the end of March, up from 1.5% at the end of 2021. Long-dated 30-year Treasury rates increased 54 bp to 2.44%, reflecting the market view that inflation concerns may be more in the near to intermediate-term.

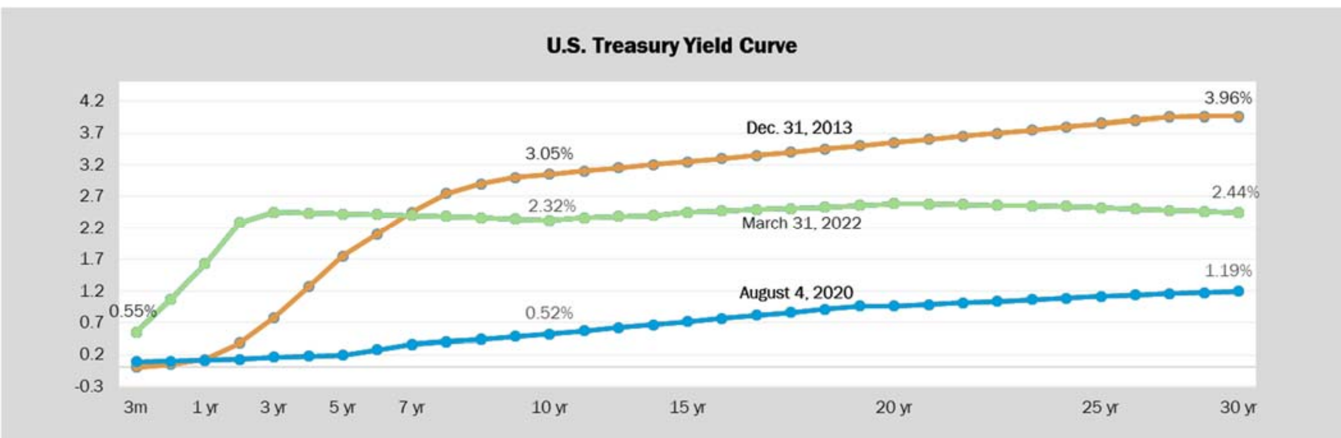


Figure 3. Source: U.S. Treasury

For the quarter, the Barclays U.S. Aggregate, which has a duration of 6 years, was down 5.9%. While we did not anticipate the strong jump in short-term rates over one quarter, we were positioned in the portfolio for a rising rate environment.

On a relative basis, we benefited from the lower duration in our fixed income portfolio, the exposure to non-core elements such as high yield and structured securities, and our active managers' portfolio construction and security selection. Our non-U.S. global managers had some exposure to Russian bonds and the Russian Ruble as a hedge against inflation. The aggregate exposure to Russia was 0.64% of the fixed income segment at the beginning of the quarter. This exposure was reduced to below 0.1% at the end of March 2022.

We remain shorter than benchmark duration in the fixed income segment and look to our managers to take advantage of opportunities created by volatility in this marketplace. Looking forward, we feel that higher rates also improve the chances of generating higher income, as capital can be reinvested at higher rates and provide some cushion to total returns, even as we face the headwinds of rising rates.

Real Assets

While hard assets are considered a hedge against higher prices, not all real assets react to higher inflation in the same manner. Oil prices dropped from $83 a barrel in October 2021 to $66 a month later amidst news of the spread of the Omicron virus. Between December 2021 and March 2022, the price of WTI Crude Oil went from $75 to $100 per barrel. The Dow Jones Commodity Index returned 31% for the first quarter of 2022, while the FTSE NAREIT Index and U.S. TIPs returned -7.3% and -2%, respectively. The very low rate environment that we have been in over the last few years has distorted the pricing of many assets, including those dependent on leverage, such as real estate and infrastructure. While higher rates tend to reduce demand and the rate of price appreciation, it can also be the impetus for slower economic activity, especially as we move into the late stage of an economic expansion that began with the Federal stimulus at the onset of the pandemic.

The Real Asset segment generated positive returns for the first quarter, reflecting the price appreciation of the commodity components of this segment. This segment also includes exposure to floating rate securities and TIPs. These components were down, as income remained low and prices adjusted to higher rates. Going forward, these securities will benefit from the coupons adjusting positively with higher rates.

Hedge Funds

Hedge funds tend to be variable and heterogeneous investment strategies that have more tools to employ in the management of their portfolios. Individual strategies tend to have highly disparate risk/return profiles, with certain multi-strategy funds having more latitude to manage their exposures to equity market risk.

Canterbury tends to use fundamental strategies that use moderate and prudent levels of leverage where we can assess the manager's value add over time. Over the last few years, the volatility in financial markets and the divergence in economic activity across sectors have provided a fertile environment for corporate bankruptcies, reorganizations, as well as M&A. Managers that have taken long and short positions within a specific corporation’s capital structure or have invested in other “special situations” have been able to weather market volatility given the inherent hedging in their portfolio.

The choppy equity markets made it difficult for long-short equity managers to escape the market's volatility, particularly if they have a bent toward growth-oriented companies and a long bias in the portfolio. We monitor our managers closely within their individual styles and expect them to add value over their fees in a risk-adjusted manner over a complete market cycle. In the environment we experienced during the first quarter, we saw managers with a more value style orientation make up for some of their underperformance over the last few years when growth style returns were stronger.

Private Equity

We have been systematically committing to private equity in portfolios with the capacity for longer-duration investments and can take on some level of illiquidity. We see this as an essential component to meet our client's long-term growth objectives. Our commitment schedules are dictated by our pacing models that identify the strategies and commitment amounts that need to be made each year for the build-up and ongoing exposure to this asset class. We have seen this asset class evolve with expanded opportunities, even as more capital has flowed into this segment. Nearly 40% of the broad private equity segment commitments go into buyout strategies. Over the last 15 years, we have seen the capital move towards leveraged buyout investments and financing "add-on" investments in merging and acquiring companies that can provide operational leverage and expanded business prospects. This "buy and build" strategy can create both vertical integrations and market breadth, providing companies with more control from suppliers to distribution channels. Strategies that seek to take companies from a commercially viable stage to more organic growth of their business presence continue to be an important but smaller part of the private equity world, as this takes on more operational and execution risk at the company level.

Another segment of the private equity market that we have seen grow rapidly has been the Secondaries market. Activity has doubled from just 5–6 years ago, largely as investors have become more proactive in managing their mature portfolios and selling positions in tail-end funds with little residual value. Where sellers perceive this as a way to manage their administrative burden, it creates activity in the secondary market. General partners of funds have also taken more proactive roles in helping manage tail-end funds and individual positions that have a longer duration than the life of the fund will allow. Collectively, we see a growing set of opportunities that secondary funds can capture.

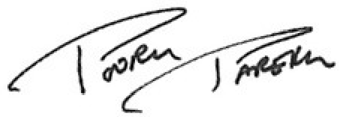
Figure 4 & 5. Source: Pitchbook, JP

Overall Thoughts

As we move forward into the latter stages of an economic expansion with the prospect of Federal Reserve tightening, we expect markets to continue to be volatile. We will not be able to predict the timing and nature of the next economic downturn or the performance of the markets over the short term. However, we want to ensure we have enough liquidity to take advantage of any short-term opportunities that may become available with a market dislocation. Our clients have a long-term investment horizon and can weather these market cycles. We continue to monitor their ongoing spending requirements and help clients determine if and how much they need to keep aside so as not to jeopardize their near-term obligations.

If you have questions or concerns, please do not hesitate to let us know. We remain grateful for your trust in us.

Sincerely,



Poorvi, R. Parekh, CFA
Director of Outsourced Investments

Ms. Parekh is a member of the Board of Directors, a shareholder of Canterbury, and directs the Canterbury Outsourced CIO platform, which caters to institutions and private clients seeking to outsource the day-to-day management of their portfolios. In this role, Ms. Parekh is the chair of the Canterbury Outsourced CIO Committee and a member of each of the firm's five Manager Research Committees. Joining Canterbury in 1996 as the manager of analytics, she directed the firm's account analysts and client services group, securing many of the asset allocation modeling and research software tools we use today. In 2001, she became the director of manager research — responsible for oversight of all manager, fund, and product research; maintenance of Canterbury's proprietary research database; and chairing the Investment Manager Research Committee. Ms. Parekh graduated from the University of Hong Kong with a Bachelor of Arts in economics and completed her Master of Business Administration at Shenandoah University.

About Canterbury
Canterbury Consulting is an independent investment advisory firm based in Newport Beach, CA. Canterbury provides consulting services to tax-exempt organizations, including community foundations, educational endowments, religious organizations, arts and cultural foundations and health care organizations, as well as individuals and family offices. Founded in 1988, the firm designs and manages custom investment programs aligned with each client's goals. Canterbury acts as the investment office for its diverse clients and provides objective investment advice, asset allocation, manager selection, risk management, implementation, and performance measurement.

Named one of the Best Places to Work in Money Management by Pensions & Investments in 2020 and 2021 as well as one of the Best Places to Work in Orange County by the Orange County Business Journal in 2021, 2020, and 2015. Canterbury Consulting strives to deliver performance and service that exceeds the needs and expectations of its clients. Learn more about Canterbury at www.canterburyconsulting.com.