MEKETA
INVESTMENT GROUP

GLOBAL MACROECONOMIC INVESTMENT COMMITTEE

Near-term Market Assessment September 2021

Purpose

This document provides summary observations made by a group of Meketa investment professionals on a monthly basis that are based on a variety of market and economic factors. It is meant to be a high level overview of our aggregated views on current market trends. These views are used in different ways to inform near-term portfolio construction.

Current Market Conditions

US equity markets continued to make new highs in August supported by Fed Chair Jerome Powell reassuring investors that the Fed would take a cautious approach to removing support, the continued backdrop of economic reopening, and strong corporate earnings. Pressure on the "reflation" trade continued to be another key theme in equities, with growth outpacing value within large- and mid-cap equities. However, small cap value stocks continued to outperform small cap growth stocks. The Fed's emphasis of the belief that inflation will be transitory, growth being pulled forward due to a successful vaccination campaign in the US, and growing fears about the Delta variant of COVID-19 all likely contributed to the continued shift. Questions remain though about whether the rotation will persist given that growth is still above trend, and monetary policy remains supportive. International developed and emerging market equities gained for the month too, although less than the US. Improvements in vaccination programs helped developed markets, while China's equity market took a pause on its recent slide driven by fears over greater regulation. Yields ticked up slightly in August due to inflation concerns and the likely near-term start of the Federal Reserve's tapering program.

Overall, we remain cautiously optimistic on US equities with further gains possible due to high cash balances on corporate balance sheets, continued policy support, and a relatively successful vaccination program. These positives are balanced by concerns related to the new Delta variant, the strong recent run, and the potential that companies will not be able to continue to pass along higher material and labor costs to consumers. Given the recent regulations issued by China and its relatively early reopening of the economy last year, we expect weaker results going forward. Recent issues with highly leveraged property developer, Evergrande, also could weigh on results. This could continue to put pressure on emerging market equity returns through a potential decline in Chinese demand for industrial materials from emerging market exporters and through its very large weighting in the emerging market indices. Beyond China, struggles with containing COVID-19 in other countries also dampen our view of emerging markets equities. We view equities in developed markets favorably, given some progress made in containing the virus and the cyclical sector focus. Fixed income has become more attractive, particularly longer-dated issues, as a hedge against the many uncertainties facing the market and economy and as inflation fears moderate. Our view on shorter-term bonds has also improved given higher rate expectations and potentially less inflationary pressures. Although credit spreads remain extremely tight, we remain neutral on high yield bonds, recognizing that issuers generally continue to maintain strong balance sheets in an economic recovery. We also remain neutral on commodities as supply issues ease and given the potential impact on demand if economic conditions related to the virus deteriorate.

High Level Views

	Strongly Negative (●)	Negative (●)	Neutral (●)	Positive (●)	Strongly Positive (●)
Rate Sensitive			●		
Credit			●		
Equities			●		
Real Assets			●		

Asset Class Views

	Strongly Negative (●)	Negative (●)	Neutral (●)	Positive (●)	Strongly Positive (●)
Within Rate Sensitive					
Cash / ST Gov't Bonds		○	→ ●		
Long-Term Gov't Bonds			○	→ ●	
TIPS			●		
Core Bonds			●		
Within Credit					
EM Debt Local			●		
High Yield Bonds			●		
Within Equities					
US Equity			●		
EAFE Equity				●	
EM Equity			●		
Within Real Assets					
REITs			●		
Public Natural Resources			●		
Commodities Futures			●		
Pairs					
Stocks vs. Bonds			●		
US Equities vs. Int'l Equities			●		
Growth vs. Value (US Equities)			●		
Large vs. Small (US Equities)			●		
Short vs. Long Duration		● ←	○		
Nominal Bonds vs. TIPS			●		
High Quality vs. High Yield			●		
Risk Assets vs. Cash			●		

→ Indicates change in view from previous month

○ Indicates former position of previous month's view

Asset Class	Rationale Supporting Our Position
Within Rate Sensitive	
Cash / ST Gov't Bonds ●	While short-term Treasury yields remain pinned near zero as a result of the Fed's accommodative policy stance, inflationary pressures have shown signs of potentially topping, and rate hikes from the Fed could start as early as the end of 2022 – *view changed from negative to neutral.*
Long-Term Gov't Bonds ●	Recently, long-term rates declined as inflation concerns fell. Long-term government bonds still offer a yield pick-up over cash, and the risk of the potential for yield curve steepening has moderated as the economic growth outlook has become less clear and as stimulus begins to roll off. Long-term bonds are also an attractive hedge against the myriad of uncertainties facing the market including the path of the pandemic, stretched valuations in the US, and risks in China, to name a few – *view changed from neutral to positive.*
TIPS ●	Despite break-even's decline from their peak, they remain above long-term averages as inflationary concerns remain. The strong recent gains in TIPS and still robust inflation expectations make inflation-linked bonds less attractive going forward – *view unchanged.*
Core Bonds ●	Core bonds continue to provide an offset to equity risk with a yield pick-up over Treasuries. However, with spreads remaining tight, corporate bonds are priced for perfection, especially considering that debt expanded, rather than contracted, in 2020. The Fed has also begun unloading corporate bonds it purchased in the initial response to the COVID crisis – *view unchanged.*
Within Credit	
EM Debt Local ●	Yields remain attractive relative to developed market credit, but a search for yield has caused spreads to remain well below long-term averages, making emerging markets debt less appealing. Continued strength in the US dollar could also weigh on the sector – *view unchanged.*
High Yield Bonds ●	Despite very tight spreads amid credit growth accelerating, issuers are in better 'health' in a growing/recovering economy, and the proliferation of covenant-light debt allows for more flexibility rather than forced technical defaults if issuers fail to meet debt obligations – *view unchanged.*
Within Equities	
US Equity ●	With monetary/fiscal policy still supportive, above trend growth, significant progress made with the COVID-19 pandemic, and cash-heavy corporate balance sheets that could be used for share buybacks, US equities could continue to do well. Still, we remain cautious given concerns about the Delta variant, stretched valuations, inflationary risks, the looming debt ceiling debate, and a likely change in monetary policy – *view unchanged.*
EAFE Equity ●	Key EAFE markets in Europe outside of the UK have not managed the vaccine rollout as effectively as in the US, inhibiting economic recoveries. However, recent progress in the vaccine rollout, a lower technology sector focus, and attractive valuations compared to the US makes EAFE equities relatively attractive. US dollar strength, should it persist, would act as a headwind for US investors going forward – *view unchanged.*
EM Equity ●	Although EM equities provide a compelling barbell of value- and growth-oriented economies and many countries could benefit from improving risk sentiment, we note that continuing challenges in the Chinese equity market are likely to weigh down emerging markets given that China accounts for roughly 40% of the index. Increasing regulation of the tech sector in China and recent concerns related to highly indebted real estate developer Evergrande could cause Chinese equities to continue to lag the broader emerging markets. Beyond China, other major EM economies – most notably India and Brazil at present - continue to struggle to contain the virus, hampering their recoveries – *view unchanged.*
Within Real Assets	
REITs ●	REITs have been one of the strongest performers in 2021 due to a search for yield, inflation concerns, and reopening themes. Significant impairment from rental losses and an uncertain path forward of key REIT sectors like industrial property weigh on the space. The rise of the Delta variant, and potentially others, add uncertainty for the sector as well as potential contagion from Chinese property markets related to Evergrande – *view unchanged.*
Public Natural Resources ●	As the COVID-19 pandemic recedes, natural resources represent a potentially appealing asset class. However, natural resource equities' strong start to the year has recently shown signs of weakening given uncertainties related to the path forward for the economy – *view unchanged.*
Commodities Futures ●	Early in 2021 we saw price spikes in a variety of commodities like lumber, iron, corn, and copper from increased demand as economies reopened and given supply issues. While supply issues will likely take additional time to resolve, we have recently seen a pullback in some commodities. Demand for the rest of 2021 remains uncertain with the emergence of the Delta variant – *view unchanged.*

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