Michigan Schools 403b/457 Retirement Group - Investment offerings
Q4 2022 Summary

Markets
Developed equity markets rebounded during the fourth quarter, but still finished the year down overall. U.S. large-cap equities, as represented by the S&P 500 Index, gained 7.56% during the quarter, but were down 18.11% in total for the year. Developed international equity markets, as represented by the MSCI EAFE Index, fared a little better. That index was up 17.34% for the quarter and down 14.45% for the year. Real estate had a poor year as well. The Wilshire REIT Index gained 4.05% during the quarter, but finished the year down 26.81%

Bond indexes moved similarly. Longer-term interest rates, which heavily influence bond prices, moderated during the quarter after six months of steady increases. The Barclays U.S. Aggregate Bond Index and the Barclays Global Aggregate Bond Index earned 1.87% and 0.99% respectively during the quarter and lost 13.01% and 11.22% respectively for the year. The Barclays U.S. Inflation-Linked Bond Index posted similar results, gaining 2.04% for the quarter, but losing 11.85% for the year overall.

Emerging markets also posted the same good quarter/poor full year results. The MSCI Emerging Markets Index finished the quarter up 9.70% and the year down 20.09%. Commodities were one of the few asset classes to break the trend. The Dow Jones UBS Commodity Index gained 2.22% for the quarter and finished up 16.09% over the full year.

Outlook
Markets have continued to be volatile over the last few quarters as investors have been trying to successfully guess when the Fed will decide that inflation is finally under control and pivot in a new direction.

Even now, as of this writing, the Fed expects to continue to raise another 75 bps during 2023 while the Fed futures market consensus is that they will stop after roughly 25 bps. Because of this difference in expectations, we expect market volatility to continue for the near future, at least until the Fed finally does pivot because they are convinced that our current bout of inflation has fully been put to rest.

The Federal Reserve System operates under a dual mandate of maximum employment and price stability. Given that they have already signaled that they are willing to accept some employment losses, expect the Fed to continue to primarily focus on price stability, meaning that they will keep taking whatever actions that they feel are needed to fight inflation. Even more so because they were specifically called out by many economists for not recognizing the onset of this inflationary period quickly enough in the first place.

On a positive note, stock market losses during 2022 have resulted in more reasonable stock valuations going into 2023. So, while the current choppiness might continue for the near future, we still believe in the stock market over the long run. As always, we recommend a diversified portfolio containing a reasonable amount of equity exposure for any investor with a long enough time horizon.

Investment Offering

Recommended for Removal

None

Watch List

Harbor Capital Appreciation Retirement (HNCAX) – performance

- The Harbor Capital Appreciation fund was added to the Watch List at the end of Q4 2022 due to performance.
- During 2022, the fund severely underperformed the category average and finished the year with an absolute return of -37.5%; again, poor security selection in technology and communication services and a meaningful overweight allocation to consumer cyclical, specifically Tesla Inc., hurt the most.
- In 2021, the fund underperformed the category average by over 4.5%; poor security selection in technology and communication services and a meaningful overweight allocation to consumer cyclical significantly detracted from performance.

American Funds EuroPacific R6 (RERGX) - performance

- The American Funds Europacific Growth fund was added to the Watch List at the end of Q4 2021 due to performance.
- During 2022, the fund outperformed the category average, security selection in Latin America, health care and basic materials along with an overweight allocation to energy drove performance. The fund’s security selection in Brazilian companies contributed significantly to the performance; consumer cyclical company MercadoLibre, Inc., basic materials company Vale S.A. and energy company Petróleo Brasileiro S.A. – Petrobras were the primary winners as the Brazilian economy found strength during the post-COVID period. The Japanese health care company Daiichi Sankyo Company, Limited, was the primary driver of performance in the fund’s health care exposure as revenues related to its oncology business drove revenues.
- In 2021, security selection in healthcare and technology weighed significantly on performance and an underweight allocation to and security selection in industrials also contributed to relative underperformance; an overweight allocation to Latin America and security selection in Japan further dragged performance lower.
- For 2020, the fund performed well with security selection in consumer cyclical, healthcare, communication services, and technology driving performance; security selection in industrials and financials detracted from performance.

PIMCO Total Return (PTTRX) - performance

- The PIMCO Total Return fund was added to the Watch List at the end of Q3 2022 due to performance.
- For 2022, the fund underperformed due to longer duration positioning in the U.S, largely in the first quarter of the year, as interest rates rose; the fund cut its duration overweight in late March to increase protection from further potential interest rate volatility. In the second half of the year, sector allocation within securitized assets, largely in non-agency mortgage-backed securities, also detracted from relative returns.
- In 2021, the fund underperformed its category by a small margin but outperformed its benchmark, the Bloomberg US Aggregate, by a larger spread; short duration positioning in the UK and areas of non-domestic currency exposure also detracted from relative performance.
- During 2019, the fund underperformed due to an underweight allocation to investment grade credit, as credit spreads tightened; the fund's lower than average duration dragged on relative performance as the risk on market environment led to yields broadly dropping throughout the year.

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