

Quarterly Commentary: Factor-Enhanced Quantitative Portfolios (QPs) Large Cap V+M+Q*

First Quarter (Q1) 2022

Market Environment

The US economy generated accelerated growth in the quarter, as pandemic-related restrictions had increasingly been lifted and the Omicron variant emerged too late to have affected the data. Against this backdrop, the Bureau of Economic Analysis released the third estimate of the fourth-quarter 2021 real GDP, a seasonally adjusted annualized increase of 6.9%, slightly lower than the prior estimate, but a meaningful improvement over the 2.3% increase in the prior quarter. The employment situation surprised on the upside in the quarter, as gains were far above expectations. The February report showed that employers added 678,000 jobs in the month, and that the unemployment rate fell to 3.8%. The Federal Open Market Committee (FOMC) began what is expected to be a long cycle of interest rate increases, raising its federal funds rate target range to 0.25%-0.50%, from a range of 0%-0.25%. The FOMC signaled that this increase will be the start of what it referred to as an "ongoing" series of increases. Analysts expect the FOMC to implement an additional five or six rate hikes by year end as it attempts to cool inflation while not harming the economy.

Portfolio Commentary

The Factor-Enhanced Large Cap V+M+Q strategy generated negative absolute returns in the quarter, and also outperformed the benchmark on a relative basis. The strategy generated a total return of -4.39% compared with the -5.34% return of the CRSP US Large Cap Index.

Each of the factors that the strategy strives to capture—value, momentum, and quality—generated positive returns in the quarter. As a result, each of the tilts was a positive contributor to performance, with value contributing 276 basis points, quality adding four basis points, and momentum benefiting performance by one basis point. However, the portfolio's slight size bias detracted from performance, as larger capitalization stocks outpaced smaller capitalization companies.

Sector selection has a relatively minor effect on performance, as the QPs are constructed to be sector neutral at rebalancing. Accordingly, the portfolio's relative performance was driven primarily by individual security selection. Sector allocation detracted 33 basis points from performance, whereas stock selection within sectors contributed 128 basis points during the quarter. The sectors in which positive stock selection occurred included Communication Services and Consumer Staples. Sectors that experienced negative stock selection included Consumer Discretionary and Information Technology.

Positively contributing to the Factor-Enhanced Large Cap V+M+Q strategy's performance during the quarter was an overweight to Archer-Daniels Midland Co. (ADM), which jumped by 34%.

The portfolio also benefited from having an overweight to Berkshire Hathaway Inc. Class B (BRK.B). The stock of the financial services giant gained more than 18%, contributing 48 basis points to performance.

A lack of exposure to Meta Platforms Inc. Class A (FB) resulted in a 37 basis-point contribution to the portfolio's performance. The interactive media company's stock sank 34% in the quarter, materially underperforming the -11% return of the Information Technology sector.

The portfolio's primary detractor was an overweight position to Johnson Controls International PLC (JCI). The position detracted 27 basis points from the portfolio's active return, as the stock declined 19% in the quarter.

Chevron Corp. (CVX) experienced a 40% advance during the quarter, detracting 25 basis points from performance as a result of the portfolio's lack of exposure.

The portfolio also suffered during the quarter from having an overweight to Zebra Technologies Corp. Class A (ZBRA). The electronic equipment manufacturer's stock declined more than 30% in the quarter.

Inflation is at the highest level in more than 40 years, and investors are anxious about how the FOMC will attempt to dampen further price increases. Supply chain issues persist, but economic growth is expected to continue over the next few quarters. New virus variants and an expansion of geopolitical tensions could create additional financial markets volatility, as could the lead-up to this fall's mid-term elections.

*Value+Momentum+Quality

Model Portfolio Attribution

	Performance Driver	Active Return Contribution	Portfolio Exposure	Average Weight in Model	Comments
Contributors	Archer-Daniels Midland Co. (ADM)	+52 bps	Overweight	1.73%	The food products company's stock surged by 34% in the quarter.
	Berkshire Hathaway Inc. Class B (BRK.B)	+48 bps	Overweight	3.37%	The stock of the financial services company gained more than 18%.
	Meta Platforms Inc. Class A (FB)	+37 bps	Underweigh	0.99%	The interactive media company's stock sank 34% in the quarter, underperforming the -12% return of the Information Technology sector.
	Nucor Corp. (NUE)	+30 bps	Overweight	0.90%	The stock of the materials company advanced about 31%.
	The Kroger Co. (KR)	+25 bps	Overweight	1.00%	The grocery store chain's stock added more than 27%.
Detractors	Johnson Controls International PLC (JCI)	-27 bps	Overweight	1.89%	The building products stock shed 19% in the quarter.
	Chevron Corp. (CVX)	-25 bps	No exposure	0.00%	The oil and gas giant's stock surged by 40%.
	Zebra Technologies Corp. Class A (ZBRA)	-22 bps	Overweight	0.79%	The electronic equipment manufacturer's stock declined more than 30% in the quarter.
	Teradyne Inc. (TER)	-22 bps	Overweight	0.86%	The semiconductor manufacturer's stock dropped by about 28%.
	D.R. Horton Inc. (DHI)	-19 bps	Overweight	0.71%	The stock of the homebuilder declined 31%.



Disclosure

The **Russell 1000 Index** is a market capitalization weighted benchmark index made up of the 1000 largest U.S. companies in the Russell 3000 Index. The **Russell 1000 Value Index** refers to a composite of large and mid-cap companies located in the United States that also exhibit a value probability. The **CRSP US Large Cap Index** includes U.S. companies that comprise the top 85% of investable market capitalization.

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