

Quarterly Commentary: Factor-Enhanced Quantitative Portfolios (QPs)

Large Cap V+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+Q strategy generated negative absolute returns in the quarter, but outperformed the benchmark on a relative basis. The strategy generated a total return of -2.76% compared with the -5.34% return of the CRSP US Large Cap Index.

Each of the factors that the strategy strives to capture—value and quality—generated positive returns in the quarter, with value delivering especially strong performance. As a result, each of the tilts was a positive contributor to performance, with value contributing 480 basis points, and quality adding five basis points. 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 contributed two basis points to performance, whereas stock selection within sectors contributed 256 basis points during the quarter. The sectors in which positive stock selection occurred included Financials and Communication Services. Sectors that experienced negative stock selection included Consumer Discretionary and Industrials.

Positively contributing to the Factor-Enhanced Large Cap V+Q strategy's performance during the quarter was an overweight to Berkshire Hathaway Inc. Class B (BRK.B), which gained more than 18%.

The portfolio also benefited from having an underweight to Meta Platforms Inc. Class A (FB). The interactive media company declined by 34% in the quarter, contributing 35 basis points to performance.

The overweight position of Alleghany Corp. (Y) relative to the benchmark resulted in a 28 basis-point contribution for the portfolio. The stock of the insurance company gained almost 28%.

An overweight position to D.R. Horton Inc. (DHI) detracted 28 basis points from the portfolio's active return. The homebuilder slumped more than 31% in the quarter.

Chevron Corp. (CVX) experienced a 40% gain during the quarter, detracting 25 basis points from the portfolio's performance as a result of not having exposure to the stock.

The portfolio also suffered during the quarter from having an underweight to PulteGroup Inc. (PHM). The homebuilder slid 26% 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 + Quality

Model Portfolio Attribution

	Performance Driver	Active Return Contribution	Portfolio Exposure	Average Weight in Model	Comments
Contributors	Berkshire Hathaway Inc. Class B (BRK.B)	+52 bps	Overweight	3.57%	The financial services giant's stock gained more than 18% in the quarter.
	Meta Platforms Inc. Class A (FB)	+35 bps	Underweight	1.05%	The interactive media company declined by 34% in the quarter.
	Alleghany Corp. (Y)	+28 bps	Overweight	1.02%	The stock of the insurance company gained almost 28%.
	Baker Hughes Co. Class A (BKR)	+26 bps	Overweight	0.53%	The energy equipment manufacturer advanced about 60%.
	Archer-Daniels Midland Co. (ADM)	+23 bps	Overweight	0.83%	The food products company added more than 34%.
Detractors	D.R. Horton Inc. (DHI)	-28 bps	Overweight	1.01%	The homebuilder plunged about 31% in the quarter.
	Chevron Corp. (CVX)	-25 bps	No exposure	0.00%	The oil and gas company's stock gained 40%.
	PulteGroup Inc. (PHM)	-22 bps	Overweight	0.98%	The homebuilder sank by more than 26% in the quarter.
	Lennar Corp. Class A (LEN)	-18 bps	Overweight	0.71%	The stock of the household durables manufacturer was off by 30%.
	Apple Inc. (AAPL)	-17 bps	Underweight	2.30%	Apple's stock was down only about 2%.

Q | R | G

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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