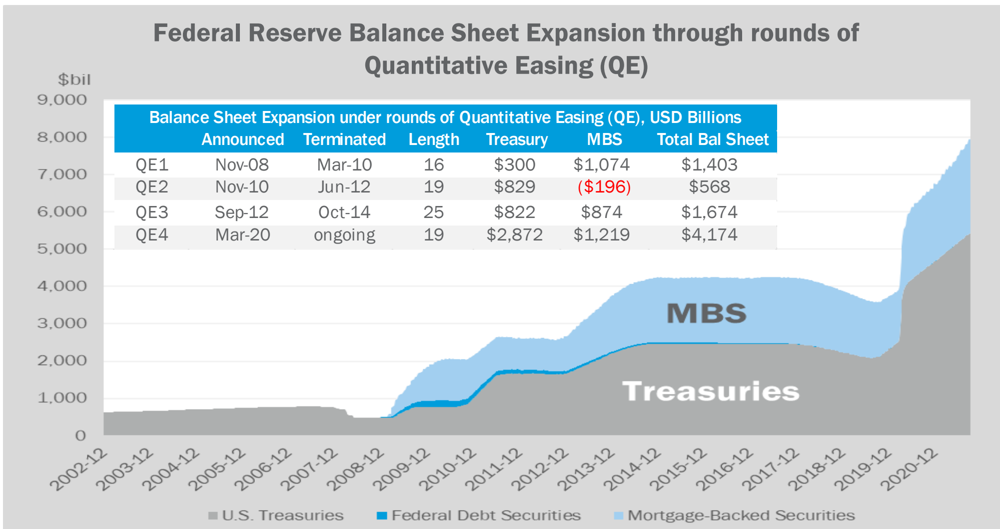
Overview

A robust macroeconomic backdrop, the decline in Delta variant cases, and a dovish Fed have supported the rally of global equity and risk assets. U.S. GDP grew by 12.2% for the year ending June 30. The very large stimulus plan that has been in place over the last 19 months has achieved its goal of helping the Federal Reserve reach its dual mandate of reflating the economy and full employment. Unemployment dropped to 5.3%, and year-over-year inflation was above 5% for the third month in a row at the end of August 2021.



Balance Sheet Expansion under rounds of Quantitative Easing (QE), USD Billions

	Announced	Terminated	Length	Treasury	MBS	Total Bal Sheet
QE1	Nov-08	Mar-10	16	$300	$1,074	$1,403
QE2	Nov-10	Jun-12	19	$829	($196)	$568
QE3	Sep-12	Oct-14	25	$822	$874	$1,674
QE4	Mar-20	ongoing	19	$2,872	$1,219	$4,174

Figure 1. Source: U.S. Federal Reserve

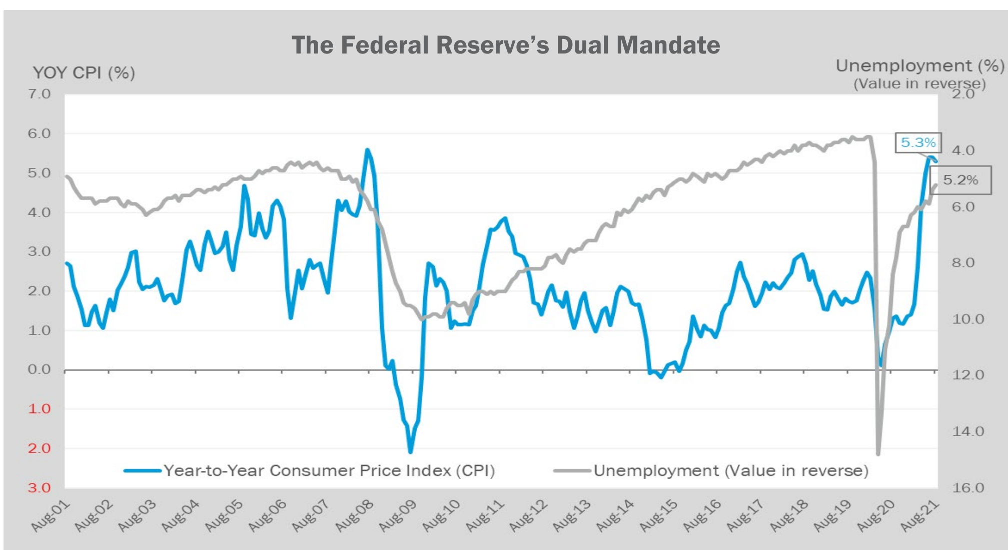


Figure 2. Source: U.S. Dept of Labor SVCS

Looking forward, the direction for the Federal Reserve is likely to be towards "tapering" of asset purchases on their balance sheet and eventually raising the Fed Funds rate, both of which will likely push interest rates higher. However, the pace remains uncertain. Corporate earnings and job growth will unlikely grow at the same pace from current levels compared to one year ago. The drop in commodity usage and prices during 2020 led to a cut back in the production of energy resources. While the increase in demand and prices this year has stimulated production, the return to prior capacity has been slow, given COVID-related labor shortages and operational hurdles. Many large, power-intensive industries such as aluminum, autos, and even consumer electronic supply components are impacted by the energy cutbacks and rise in labor costs. The longer global supply chain constraints continue to be a factor in higher prices, the higher the risk of inflationary pressures not being simply transitory, which may push rates up faster.

Higher interest rates would allow treasuries and other safer bonds to generate higher returns, which can attract capital flow to these areas and put downward pressure on the price of assets that see the capital outflow. The concern in the minds of asset managers is the pace of the rate increase. A steady rate increase can be supported by a slow to stable change in price, but a rapid change in rates would likely cause a more dramatic change in the price of higher-risk assets.

Outside the U.S., countries are at various stages of vaccination and reopening efforts, which has also been a positive driver of risk assets in those markets over the last 12 months. Across developed and developing countries, the impact of the pandemic seems to be receding. Economic activity is improving as offices slowly reopen and consumers return to shopping, dining, and traveling. Most non-U.S. markets have lagged those of the U.S. While this presents opportunities to invest at attractive valuations given long-term potential, near-term uncertainties on monetary policy in response to recovery and inflation also remain high. We have tapered our expectations on forward returns across most asset classes and feel that the focus is staying diversified and finding managers that can navigate their opportunity set with both skill and caution.

Equities

After a strong first half in 2021, global equity markets were slightly negative for the third quarter. The U.S. equity markets were flat, with the S&P 500 up 0.6% for the quarter and up 15.9% for the first nine months. All sectors were positive for the period, representing broad market participation. This has been a positive for active managers, as they have been able to add value over the benchmark through stock selection.

Even as other central banks have pushed large amounts of liquidity in their respective economies, non-U.S. equities have lagged their U.S. counterpart during this period of equity rebound. On a YTD basis through September 30, the ACWI ex U.S. Index was up 6.7% relative to a gain of 15.9% for the S&P 500. Many of the non-U.S. markets are trading at lower valuations while having strong dividend and earnings growth characteristics. We have about 45% of the global equity segment invested outside the U.S., which is in line with the ACWI index.

	S&P 500	MSCI EAFE	MSCI Emg Mkt	MSCI Asia Pacific
No of Holdings	505	845	1418	1555
Div Yield	1.34	2.18	1.77	1.79
Next 12 mth P/E	20.11	15.28	12.72	14.83
Price to Book	4.41	1.86	1.98	1.81
Price to Cash Flow	17.35	10.61	9.92	11.37
Est 3-5 yr EPS Gr	15.28	17.35	17.87	16.47

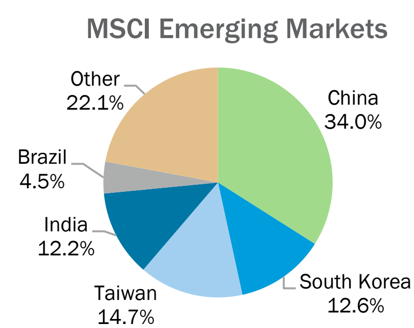


Figure 3 & 4. Source: MSCI, Standard and Poor's, 9/30/21

Once the large government stimulus began to wane, we saw general economic growth and markets driven more by fundamental factors, such as demographics, capital deployment, and productivity. We also expect market volatility to go up as stimulus-related liquidity goes down.

Emerging markets equities were down 4.0% for the quarter, which was largely due to the pullback in Chinese equities. Over the last 10 years, the EM Index has nearly 75% of its weighting in Asia, with 34% in China. We have employed active managers that do not "hug" the benchmark allocations. If they perceive adverse changes in the macroeconomic or political environment, they can rotate into areas with better prospects.

Fixed Income

Even as the Federal Reserve is still not looking to raise the Fed Funds at this time, rates in the intermediate and long end of the yield curve have gone up, reflecting the market concerns over the possibility of higher inflation over time. This has been negative for core bonds and long-duration bonds this year. We are still far from the interest rate levels seen at the end of 2013. The Federal Reserve's purchase of treasuries and other fixed-income securities continue to keep rates low. Should the Fed begin to taper, unless there are other entities that will pick up the demand for those securities, there could be upward pressure on their rates.

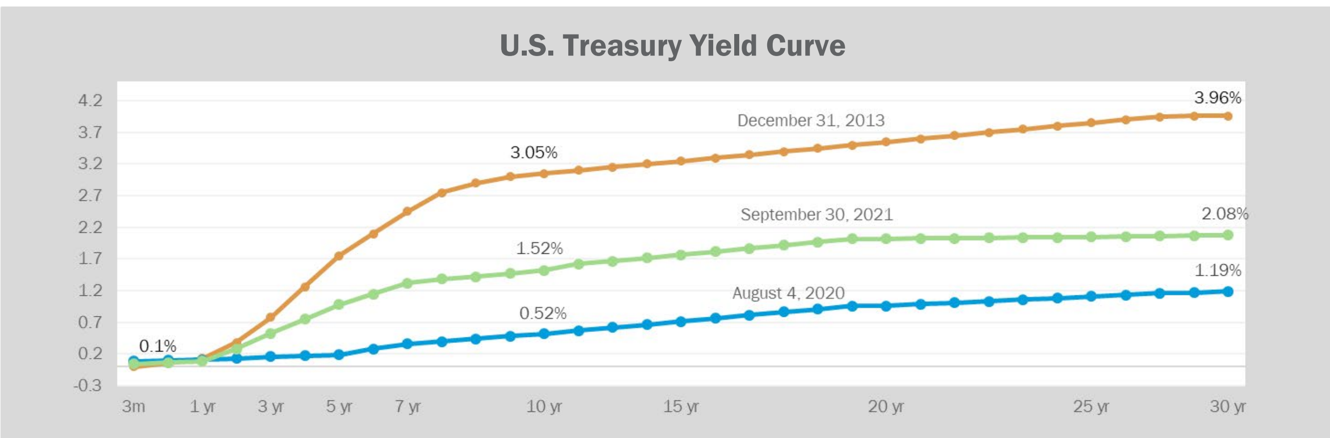


Figure 5. Source: U.S. Treasury

Compared to treasuries, we are constructive on credit, but both investment-grade and high-yield bonds have become richly priced, and lower-quality names are vulnerable to a change in sentiment. A year ago, managers could benefit from being overweight on certain sectors such as transportation, lodging, and energy but these are also trading at tight spreads today.

As much as economic data and Fed reaction will continue to drive markets, we also see credit and other spread products support by investors looking for yield. Expensive valuations make us more cautious, and we hold ample liquidity to add exposure if prices adjust.

Real Assets

The steady increase in economic activity has helped lift the price of basic materials. The DJ Commodity Index and the S&P Natural Resources Index are both up over 29% for the first nine months of 2021. The steady price increase has helped drive more capital towards incremental production activity, but continued supply constraints have kept prices elevated. Income-producing securities such as MLPs and REITs have benefited from increased demand for yield-oriented securities.

Our investment is in a multi-strategy program that invests across hard and soft commodities as well as floating-rate fixed income. The commodity exposure benefits from an unexpected rise in inflation, while the floating rate securities benefit positively from the rise in interest rates. This segment remains 5% of the portfolio at this time, but if we see elevated inflation become a more persistent feature, we may look to add to this segment of the portfolio.

Hedge Funds

Hedge funds have showed a strong performance by taking advantage of the “liquidity on” market rally in the equity and credit markets. Our managers take a fundamental approach to stock selection. The broad-based positive performance in equity markets has enabled equity managers to generate returns across regions, sectors, and styles.

We have seen that during periods of very high volatility, such as during March 2020, when there was indiscriminate selling and a dramatic correction in the equity markets, hedge funds tend to experience negative returns driven by both market exposure (beta) as well as security selection.

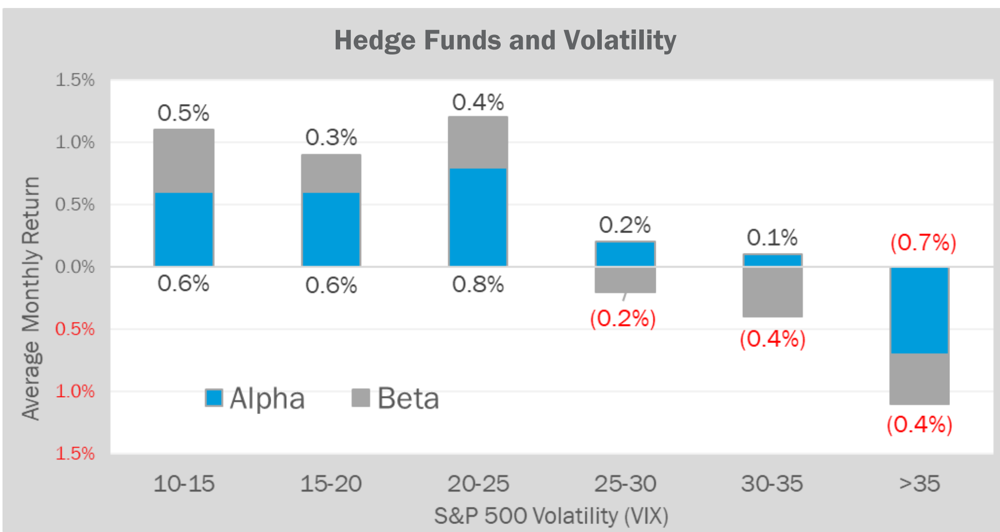
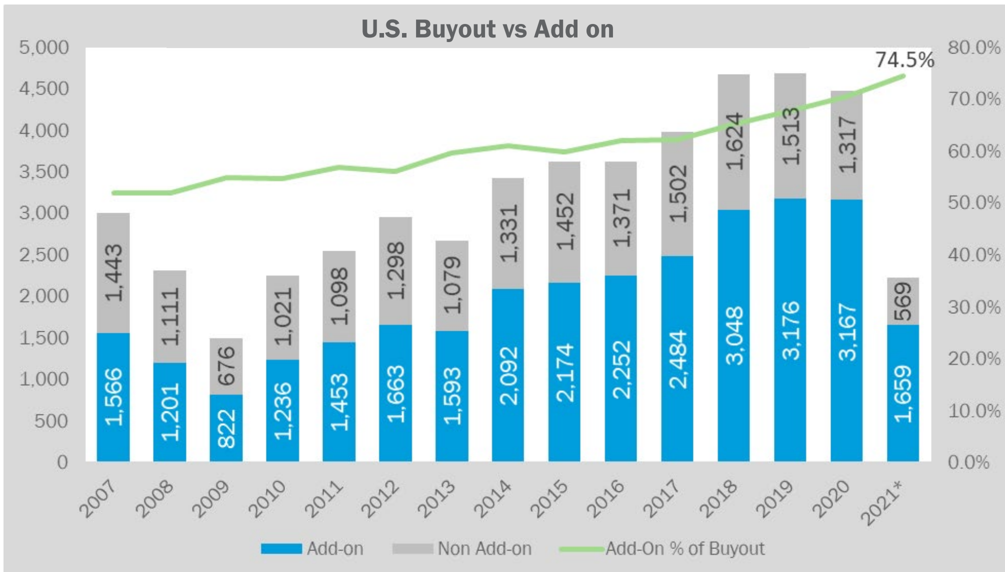


Figure 6. Source: Hedge Fund Research, JP Morgan

During other market environments, as the chart above indicates, most hedge funds are not completely hedged and do attribute some portion of their returns to market exposure. Higher volatility periods tend to hurt performance, while a trending lower volatile market can generate positive gains. As truly active strategies, hedge fund managers have more tools available to them through hedging, shorting, the use of certain derivatives, and niche strategies to generate positive performance. We have been selective in our search for managers that we feel have proven their skill over multiple market cycles and see this segment as a way to provide both diversification as well as some downside protection to our long-only segments.

Private Equity

Some of the largest gains in the last year across investment portfolios have been in the area of private investments. Endowments with more mature portfolios saw large gains across both private equity as well as venture portfolios.



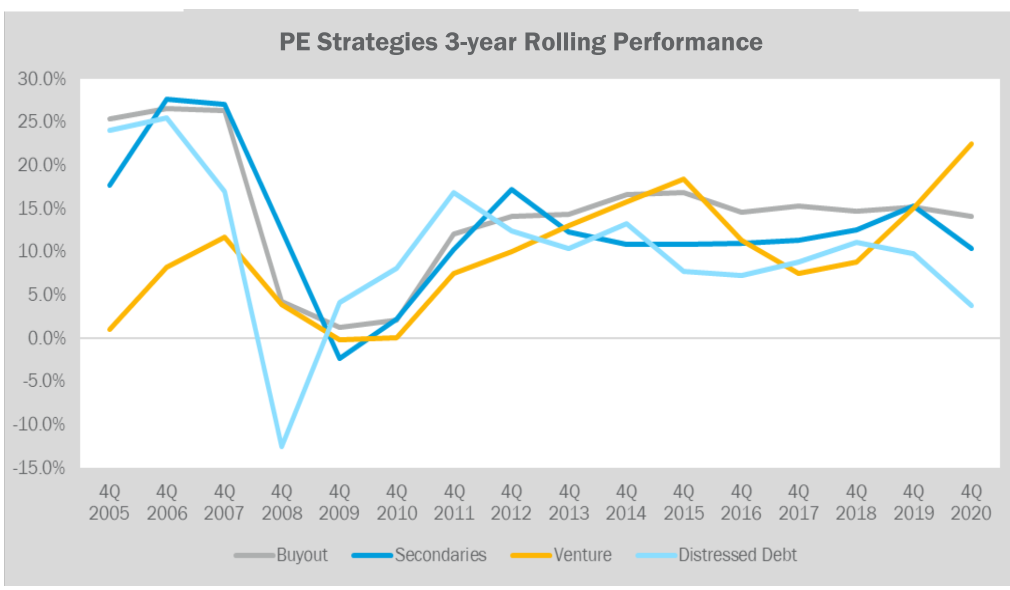


Figure 7 & 8. Source: PitchBook as of June 30, 2021.

The three-year rolling performance across private equity strategies shows an upturn in the performance of venture deals over the last few periods. While this performance has been associated with development in new and emerging technologies across industries, we are cautious of the fairly rapid gains across so many names. The recent inflow into private equity strategies has played a meaningful role in allowing purchase prices to be bid up. A lot of capital has gone towards successive rounds of financing in venture capital, which has helped boost valuations. In the buyout space, as the above chart indicates, over 70% of capital in recent years has gone towards add-on acquisitions versus new purchases.

Just as we have tempered our expectations on the forward return from public markets, we feel that private equity funds will likely see some tempering of performance. Our focus has been on managers that add value through operational improvements with their underlying companies while relying less on financial engineering. Even if there is a downturn in the economy or capital markets, the managers have time within the 10–12-year life of a fund to help the companies weather the downturn and improve their business.

Overall Thoughts

As we enter the mid-cycle phase of the economic recovery and market rebound, we anticipate that gains will be driven more by economic and company fundamentals, given that much of the liquidity push is behind us. We feel it is important to remain invested, as our clients have long investment horizons that allow them to weather market cycles to achieve their long-term growth objectives. At the same time, we maintain ample liquidity in the portfolio so that if there is a pullback in the market, we can take advantage of the opportunity.

We thank you for your trust in us and remain at your service.

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 one of the Best Places to Work in Orange County by the Orange County Business Journal in 2020 and 2021. 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.