Research Review

JUNE 2021

May presented investors with broad-based gains across most major asset classes and categories, as the ongoing resumption of global economic activity appeared to have gathered pace and sent inflation rates higher in the process. Incoming economic data during the month suggested the sharpest annualized inflation rate increase in nearly 30 years based on the personal consumption expenditure (core) measure—the Federal Reserve's (Fed's) preferred gauge—potentially applying near-term pressure to begin reining in COVID-related accommodative policies. With the exception of most growth indices, performance across global equities was broadly positive in May, particularly among international developed markets, which have generally lagged their domestic counterparts since last spring. Across the bond markets, total returns were positive for both interest rate-sensitive and credit-sensitive sectors, with nominal interest rates drifting modestly lower on the month but credit risk premiums generally remaining unchanged and well-below historical norms. Real assets performance continued to appear robust, benefitting from a recent weakening of the U.S. dollar, ongoing risk-on preferences by global asset allocators, and pro-growth governmental policies.

INSIDE THIS ISSUE

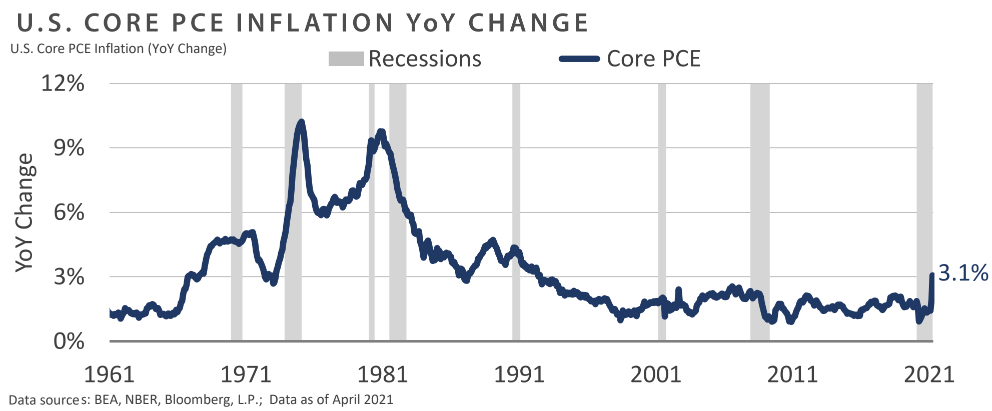
CAMDEN CAPITAL

Economic Update

Federal Reserve's Preferred Inflation Gauge Rises to Nearly 30-Year High

Much focus has been placed on percolating inflationary pressures in recent months, a predictable—and potentially temporary—development given the sharp rise across inflationary expectation gauges over the trailing one-year period, spurred by ultra-accommodative global fiscal and monetary policy initiatives and the ongoing restart to global economic activity.

Through April, for example, the Fed's preferred gauge of realized inflation, the Bureau of Economic Analysis's (BEA) Personal Consumption Expenditure (core PCE) series, which seeks to measure price fluctuation across personal consumption expenses—excluding the volatile food and energy sectors—increased to the highest level since 1992 on an annual basis. Compared to the Fed's 2% targeted rate, the core PCE accelerated 3.1% for the 12-month p … cross PCE core inflation since t



Data sources: Bureau of Labor Statistics, National Bureau of Economic Research, Bloomberg, L.P.

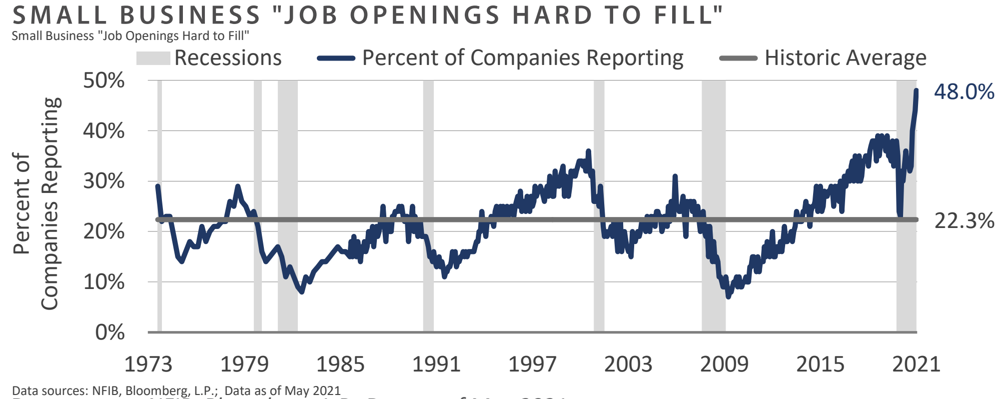
The material progress made on the inflation front since the depths of COVID-19 containment measures last spring—including some measures pointing to the strongest inflationary backdrop since the 1990s—may sway the Fed in favor of reining in its $120 billion per month of asset purchases. Any change in policy will likely be announced at the Fed's upcoming annual economic symposium, set to take place in late-August in Jackson Hole, Wyoming.

Despite the significant rebound across inflation rates over the trailing year, the labor market continues to exhibit a meaningful degree of "slack," which may alter the near-term course of inflation and economic growth.

While the number of U.S. job openings continued to surge, increasing to 9.2 million through April—the highest level in the 20-plus-year history of the BLS JOLTS data—the official count of unemployed persons stood at a similarly elevated level nearly matching the number of open positions, at 9.3 million unemployed persons through May.

Moreover, the stimulus payments sent to a large subset of the population over the trailing 14-months have given rise to speculation that a share of the workforce is finding it uneconomical to return to gainful employment, provided this stimulus continues in some fashion. This friction has helped result in labor shortages, particularly for small businesses, which often have a material proportion of lower-paid workers comprising their staffing.

Through May, for example, the National Federation for Independent Business (NFIB) reported nearly 50% of the companies in their sample set found it difficult to fill the current level of open positions, the highest reading in the nearly 50-year history of the data.



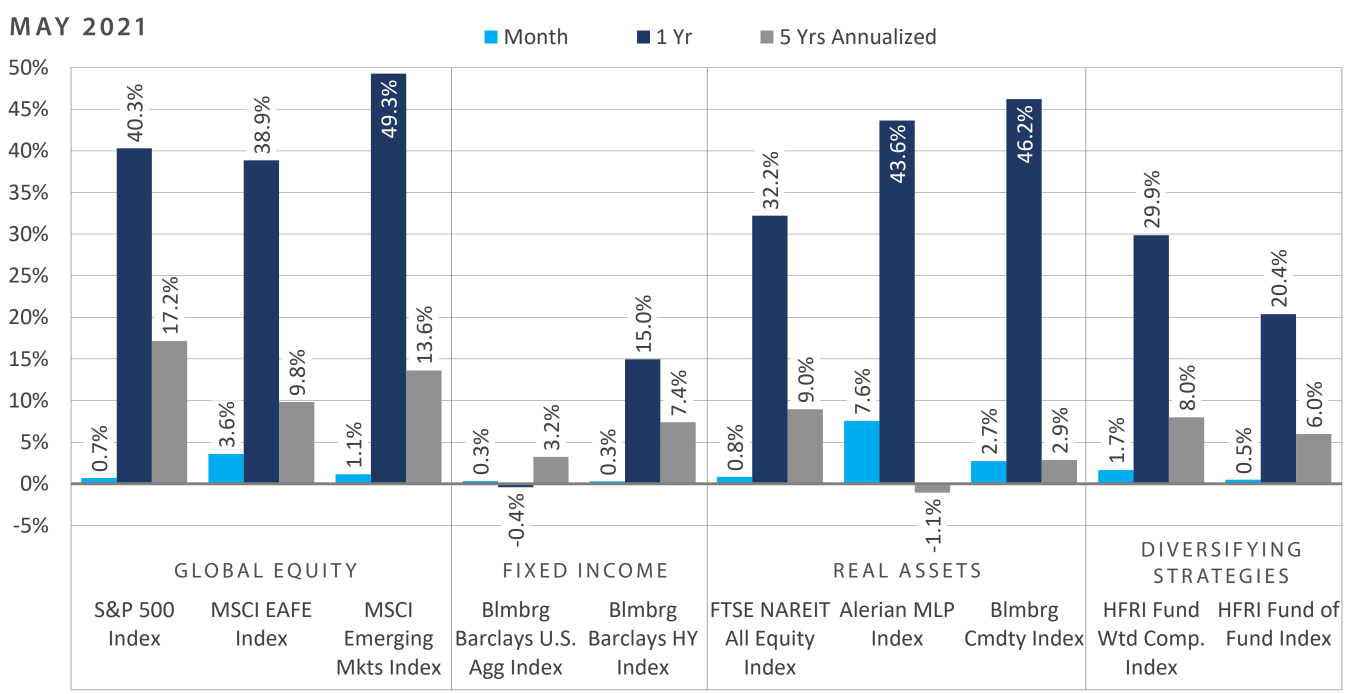
Data sources: NFIB, Bloomberg, L.P.; Data as of May 2021

Intuitively, the above data series has historically ebbed and flowed with the natural evolution of the business cycle, peaking near business cycle peaks, and bottoming near business cycle troughs. The current historically elevated reading may suggest the cyclical inflection from the prior approximate 10-year business cycle to the next multi-year expansion may still be playing out, as the bottoming in this ratio should loosely coincide with the early stages of the next business cycle expansion.

In summary, performance across most asset classes and categories surveyed by FEG generated positive returns in May, buoyed by a continued lush liquidity backdrop and immense pro-inflationary sentiment. Labor market strains remain however, particularly in relation to labor shortages, which could take multiple quarters to dissipate.

Market Returns

May 2021



Data sources: Lipper, HedgeFund Research

Global Equity

- Global equity markets rallied during May due to a strong downtrend in unemployment numbers and rebounding economic activity—especially in developed markets—despite persistent concerns about inflation. In the U.S., robust economic growth was evidenced by a record-setting Purchasing Managers' Index (PMI) reading. Despite a mid-month sell-off, U.S. equities ended the month in positive territory. As U.S. corporate earnings results poured in, most companies easily beat expectations and reported stronger than expected sales, as well as positive forward guidance.

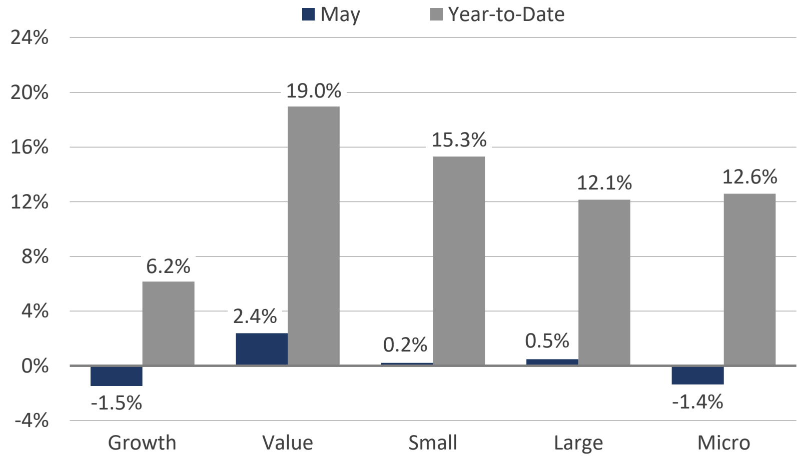
- Inflation concerns coupled with a global cyclical rebound incentivized investors to continue favoring value stocks over their growth counterparts, causing the Russell 2000 Value Index to gain nearly 3% while the Russell 2000 Growth Index declined by roughly the same amount. Small cap stocks continued to outperform large and mid cap stocks, in part due to a rally in small cap energy and consumer staples stocks and the challenging environment for large technology stocks.

- Equities in the UK rallied for the month due to eased lockdown restrictions and increased consumer demand for retail and hospitality. However, investor sentiment slightly dampened in the face of supply bottlenecks and rising input costs, which pose new challenges for businesses seeking to fulfill consumer appetite as the economy reopens. Meanwhile, the MSCI Europe ex-UK Index was the best-performing major equity index in May on the improved economic outlook due to increasing vaccination rates and the reopening of tourism in some parts of the European Union (EU). While inflation accelerated across the EU, negative market reactions were eased by reassurance from the European Central Bank and its plans to continue its asset purchasing program.

- In Asia, Vietnam and Indian equity markets were the strongest performers despite increases in COVID-19 cases in both countries—especially in India, where daily infection rates reached record highs.

VALUE DOMINATES IN THIS YEAR'S STYLE REVERSAL

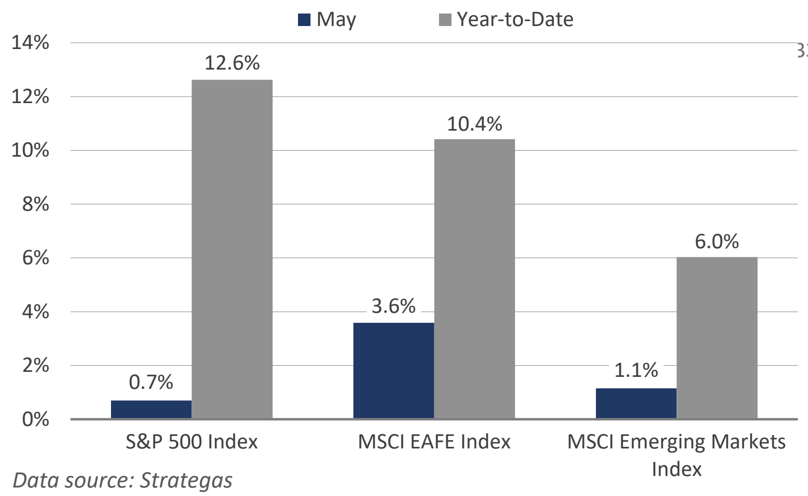
U.S. Style Returns



Data source: FTSE Russell

DEVELOPED INTERNATIONAL MARKETS WERE THE STRONGEST IN MAY

Equity Indices Performance Returns (U.S. Dollars)



Data source: Strategas

Conversely, Taiwan was the worst-performing market in the Asia-Pacific region, as tighter lockdown restrictions were imposed after a strong increase in case counts. Chinese equity returns were modestly positive during the month, but investor concerns on sustained economic growth returned as the employment index fell and export demand weakened. Overall, emerging markets were positive during May, particularly boosted by strong returns in Latin American equities.

Fixed Income

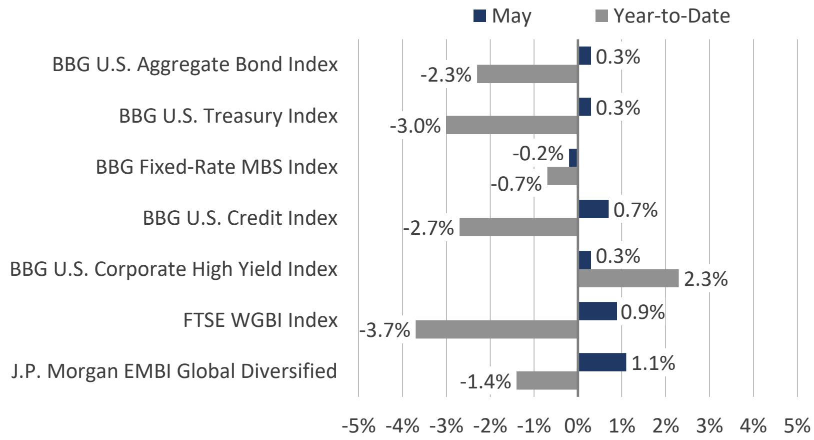
- 10-year Treasury yields declined modestly in May following a sharp rise during the first four months of the year, with yields falling seven bps to 1.58%. Uncertainty regarding the forward path of interest rates remained elevated following mixed economic data, with non-farm payrolls missing expectations while year-over-year inflation printed at 3%.

- Utilization of the Fed's reverse repo program (RRP) grew by $296 billion (162%) during the month of May, as money markets grappled with excess liquidity primarily caused by the Treasury's reduction in cash balances held at the Fed. The Fed increased the maximum amount an approved entity can invest in RRP from $30 billion to $80 billion and also extended program eligibility to smaller participants.

- Investment-grade and high yield spreads remained relatively flat during May. In a reversal of year-to-date performance themes, investment-grade credit out-performed high yield, returning 0.7% and 0.3%, respectively, as the former was supported by a modest decline in long-term Treasury yields.

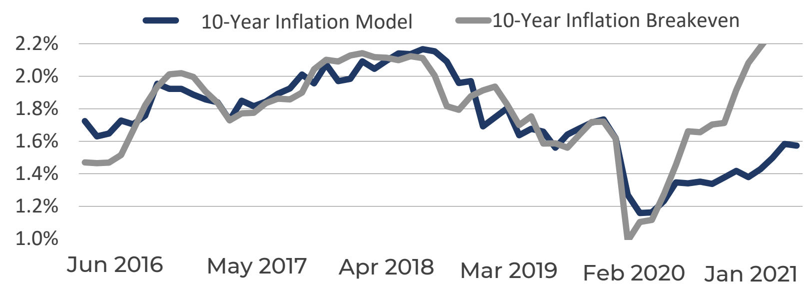
- The Fed's "Beige Book" release supported anecdotes of labor shortages and rising job vacancies. In response, several states decided to end emergency unemployment benefits. May also saw a year-over-year increase in April headline and core CPI prints of 4.2% and 3.0%, respectively, fueling market expectations of asset purchase tapering.

BOND RETURNS MOSTLY POSITIVE IN MAY
Fixed Income Index Returns



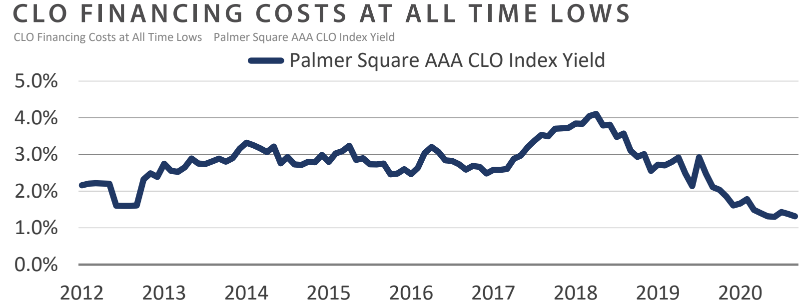
Data sources: Bloomberg, L.P., Lipper

GROWING DIVERGENCE BETWEEN MARKET AND FED's INFLATION MODEL



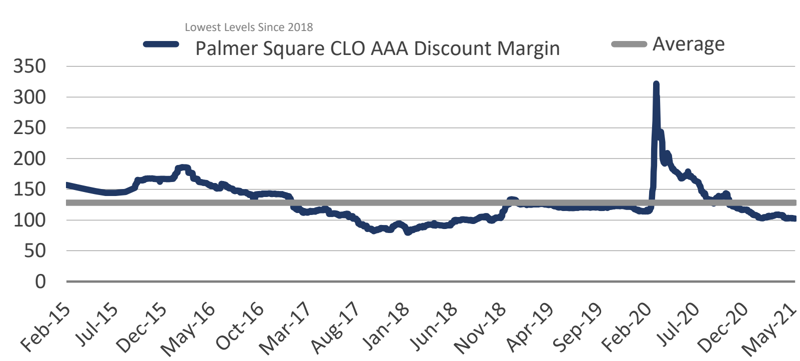
Data sources: Federal Reserve Board of Cleveland, FRED

CLO FINANCING COSTS AT ALL TIME LOWS



Data source: Palmer Square Capital Management

CLO AAA DISCOUNT MARGIN HIT LOWEST LEVELS SINCE 2018



Data source: Bloomberg, L.P.

Real Assets

Real Estate

- U.S. REITs gained 9.0% over the month, bringing year-to-date returns to 18.1%. Despite mass write-offs of deferred 2020 rents, regional malls continued to see outperformance versus the rest of the REIT market, with retail sales across most sectors showing growth over 2019 levels. Regional malls are now one of the most richly valued property types relative to net asset value, at a 28% premium, exceeded only by triple net lease—which is trading at a 53% premium to NAV—and towers, which are trading at a 36% premium to NAV.

- Residential REITs continued to experience strong performance over the month, with single-family, apartment, and manufactured housing demand all picking up.

- Hotels posted the greatest decline in the sector—despite improving U.S. travel statistics and leisure demand. According to Green Street, hotels posted positive EBITDA in May for the first time since the onset of the pandemic in March 2020. Business travel is unlikely to improve until the back end of 2021, however, as many companies are still allowing employees to work from home or have instituted travel restrictions.

Natural Resources

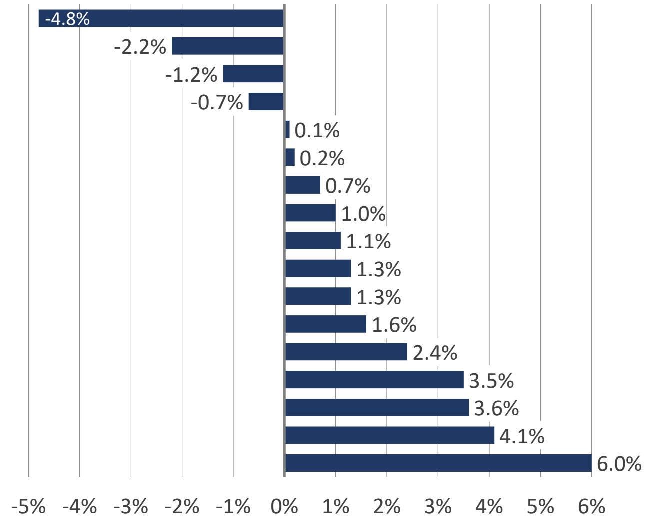
- Oil prices continued to strengthen throughout the month, with the front month contract increasing 4.3%, to close at $66.32/ BBL. To date, production declines across the U.S. and OPEC have been largely supportive of oil prices. However, production from the U.S. and OPEC is expected to increase over the coming months, provided the current rig count and announced capacity increases. U.S. rig counts currently stand at 87% over pandemic lows.

- Investors are carefully watching the renegotiations of the Iran nuclear deal, which the U.S. unilaterally exited in 2018. Reinstating this agreement may lift the sanctions on Iranian oil exports, resulting in the addition of approximately two MBBL/day.

- Commodity prices, as measured by the Bloomberg Commodity Index (BCOM), ended April up 8.3% for the month and 15.8%year-to-date, driven primarily by strong returns across agricultural products.

MALLS LEAD AGAIN, LODGING LAGS WITH SLOW BUSINESS TRAVEL

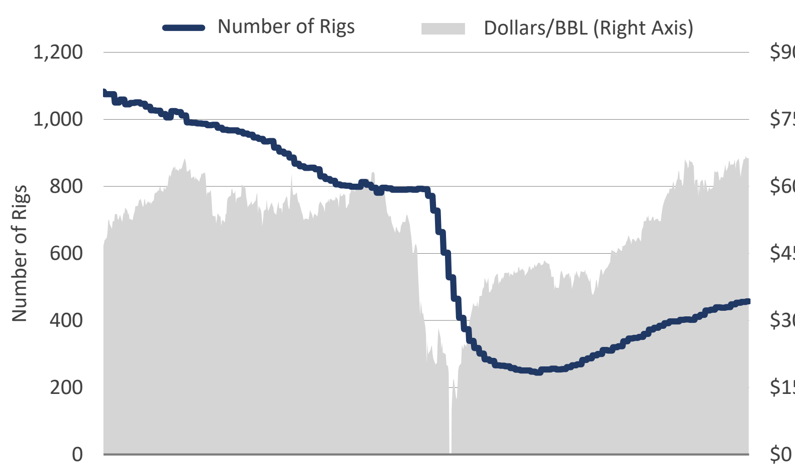
NAREIT Sector Month-to-Date Performance



Data source: Bloomberg, L.P.

RIG COUNTS CLIMBING WITH RISING OIL PRICES

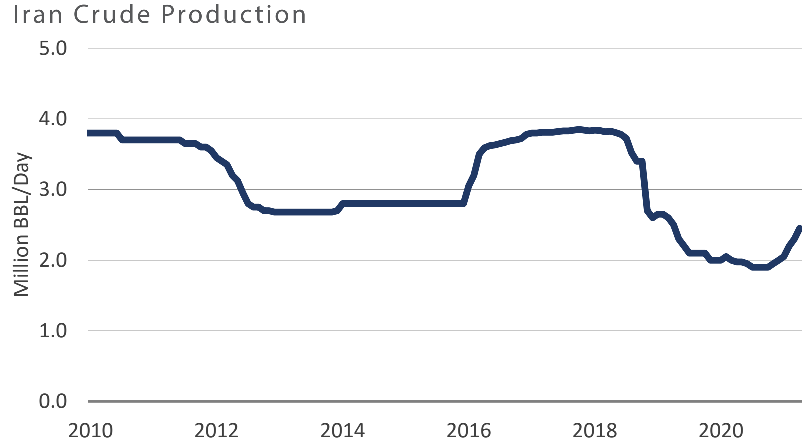
U.S. Rig Count and WTI Price



Data source: Bloomberg, L.P.

IRANIAN OIL PRODUCTION COULD JUMP TO PRIOR LEVELS

Iran Crude Production



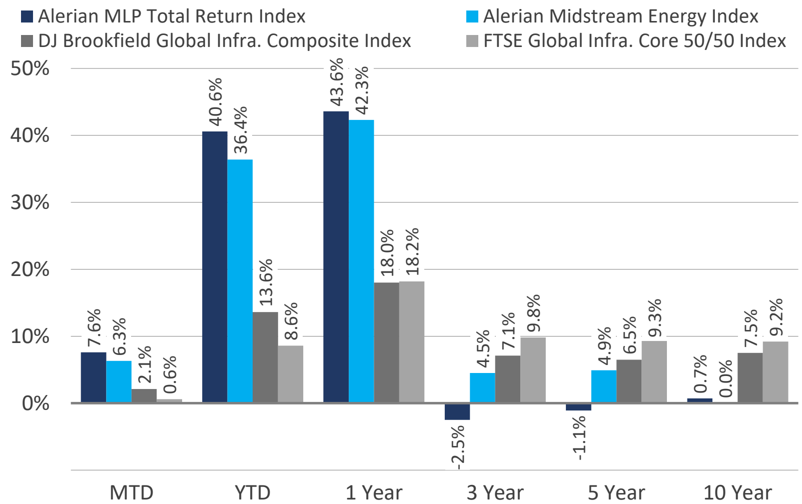
Data source: EIA; Data as of April 30, 2021

Infrastructure

- Midstream energy infrastructure MLPs continued their recovery. The strong performance follows gains in energy commodities and strength across the broad energy sector. The financial position of most midstream energy companies continues to improve amidst ongoing share buybacks and balance sheet deleveraging.
- On May 7, 2021, Colonial Pipeline reported that it was the victim of a cyberattack. The pipeline shut down operations to mitigate the impact of the attack and maintained reduced operations for nearly a week. The pipeline moves transportation fuels across the East Coast from the Gulf region. Reliant on regional inventories, U.S. gasoline prices increased following the event, with Atlantic regions seeing the largest increases.
- Listed infrastructure was nearly flat over the month, returning 0.6%. This lackluster performance was largely due to limited utilities returns.

INFRASTRUCTURE ADDS TO STRONG YTD RETURNS

Trailing Infrastructure Returns



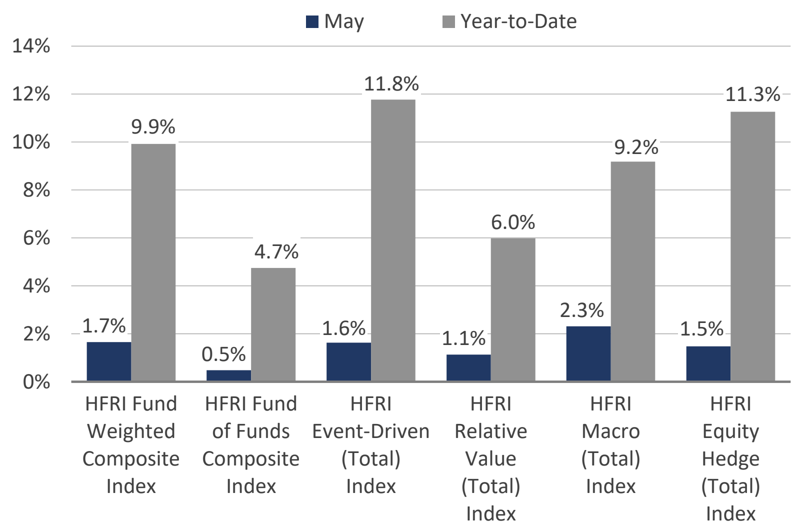
Data source: Bloomberg, L.P.

Diversifying Strategies

- Hedge funds generated strong performance through the end of May as the ongoing reopening of global economies continued to gain momentum. Global macro and event-driven strategies led performance for the month.
- Global macro performance was driven by discretionary thematic and commodity strategies benefitting from the ongoing global vaccine rollout and supply chain disruptions driving certain commodity markets higher.
- Event-driven managers finished with strong performance for the month, led by activist, distressed/restructuring, and special situations strategies.
- Equity hedge performance continued its positive run into May, even as equity volatility increased as a result of rising inflationary concerns. High-beta and long-biased energy, fundamental, and multi-strategies led performance for the month.

HEDGE FUNDS PERFORMING WELL

HFRI Indices Performance Returns (U.S. Dollars)



Data Source: HedgeFund Research

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Investments in private funds are speculative, involve a high degree of risk, and are designed for sophisticated investors.

All data is as of May 31, 2021 unless otherwise noted.

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