Michigan Schools 403b/457 Retirement Group
Q3 2021 Summary

Markets

Developed equity markets had a relatively flat quarter as surging cases slowed down the economic recovery. Markets actually started the quarter strong, but then September erased gains from the two months prior to that. U.S. large-cap equities, as represented by the S&P 500 Index, gained 0.58% during the quarter and are now up 15.92% year-to-date. Developed international equity markets, as represented by the MSCI EAFE Index, finished the quarter down 0.45% but have still gained 8.35% for the year thus far.

Emerging markets had a much poorer quarter, erasing all gains for the previous six months. The MSCI Emerging Markets Index finished the quarter down 8.09% and is now down 1.25% year to date. Recent inflation concerns continue to benefit both real estate and commodities. The Dow Jones UBS Commodity Index and the Wilshire REIT Index have gained 29.13% and 24.79% respectively for the year so far.

Bond indexes were relatively flat as interest rates increased slightly during the quarter. The Barclays U.S. Aggregate Bond Index was up a scant 0.05% for the quarter and is still down 1.55% for the year. The Barclays Global Aggregate Bond Index gained 0.09% during the last three months, but it is still down 1.43% year to date. The Barclays U.S. Inflation-Linked Bond Index, however, has fared better due to increasing expectations for inflation. That index is up 3.51% for the year so far.

Outlook

The global economic recovery experienced a few hiccups during the last few months, but OECD economists are expecting it to get back on track now that Covid-19 cases are on the decline once again. They are projecting strong growth for both the rest of this year as well as 2022.

Based on Markit PMI survey results, businesses around the world share their optimism. Corporations remain in a very favorable position with strong earnings, good growth prospects and generally healthy balance sheets. Supply chain issues and wage pressures have been managed thus far, and there is no reason to expect them to derail additional corporate earnings records over the next few quarters too. Jobs growth should continue to be strong as well.

On a cautionary note, however, market valuations are still a little stretched after the large gains that we have experienced over the last few years. There are also potential looming corporate tax increases assuming some sort of infrastructure bill comes out congress at some point soon. 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

Watch List

DFA US Small Cap I (DFSTX) - performance

- The fund was placed on watch as of Q4 2019
- The fund's process lends it to be very light in both the real estate and utilities sectors. Both of these sectors have been some of the better performing sectors for the 2019 year. As a result, they have been detractors to performance relative to the small blend peer group. More specifically for 2019, security selection in technology and an overweight allocation to energy contributed to the underperformance.
- As of September 30, 2021, near performance continues to improve with the one-year trailing returns ranked in the 28th percentile.
- For most of 2020, the fund's overweight to energy and financial services are the primary detractors to performance. During the 4th quarter, these 2 overweight sectors contributed positively to performance.
- For 2018 (60th percentile), an overweight allocation to the consumer cyclical sector hurt performance.
- During 2017 (61st percentile), security selection in healthcare and technology detracted from performance.

Additional Information – DFA philosophy

Fundamental principles:

1. Financial markets are largely efficient; DFA makes no attempt to increase returns through individual security selection or market timing

2. Higher returns are the reward for bearing greater risk
3. The most important “dimensions” to consider are company size, relative price and profitability
4. The high-level DFA goal is to deliver targeted exposure to attractive areas of the market in a cost-efficient manner. The fund avoids REITs, IPOs, ADRs and highly regulated utilities and tends to have a smaller average market cap than its peers.