Passive Perspectives

First Quarter 2022

Key Points

- Major benchmarks fell in Q1; Stratified LargeCap index outperformed
- Investors are positioning for persistent inflation
- Regime Shift from Growth to Value benefits Alternative Weight indices
- Market turbulence prompts move to defensive groups

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Major benchmarks fell in Q1, Stratified LargeCap outperformed

Following a particularly strong fourth quarter of 2021, equity markets have struggled to maintain their momentum this year. The Russia-Ukraine conflict, coupled with higher bond yields caused a strong headwind for growth assets, especially those which are market cap weighted. In Q1 2022, the S&P 500 fell 4.60%; MSCI EAFE fell 5.91% and the S&P SmallCap 600 fell 5.62%.

The Stratified US LargeCap Index outperformed both the cap-weight and equal-weight S&P 500 benchmarks (by 2.71% and 0.83% respectively; see Exhibit 1). This outperformance was due to greater business risk diversification, which resulted in relatively lower exposure to poorly performing growth segments (which are overweighted in the S&P 500) and relatively higher exposure to the strongly performing Energy and value stocks, which are under-represented in the S&P 500.

Exhibit 1. Core Index Comparison

		Q1 2022 (%)			12 months (%)		
Index	**Benchmark**	**Stratified**	**Benchmark**	**Rel.**	**Stratified**	**Benchmark**	**Rel.**
Stratified LargeCap	S&P 500	-1.89	-4.60	2.71	14.23	15.65	-1.41
Stratified MidCap	S&P MidCap 400	-4.52	-4.88	0.36	2.05	4.59	-2.54
Stratified SmallCap	S&P SmallCap 600	-6.48	-5.62	-0.86	-1.68	1.23	-2.91
SEADM*	MSCI EAFE	-7.17	-5.91	-1.26	-4.61	1.16	-5.77
Stratified LargeCap	S&P 500 Eq. Wt.	-1.89	-2.72	0.83	14.23	13.11	1.12

Source: Syntax, S&P Dow Jones Indices, MSCI. Total return performance does not reflect fees or implementation costs as an investor cannot directly invest in an index. Performance as on 3.31.2022.

* Syntax Stratified Europe & Asia Developed Markets Index, based on the MSCI EAFE universe.

Rising inflation drives a business risk rotation

Equity markets appear to have largely discounted the long-term effects of the Pandemic, with the S&P 500 approximately 25% above its pre-COVID peak in February 2020. However, rising instability in the form of persistently high commodity prices due to the Russia-Ukraine war, coupled with COVID-related staffing shortages and supply chain bottlenecks, caused an inflation shock that rattled global markets this year.

Inflation is a symptom of economic instability

Inflation is often a symptom of economic instability. With inflation looking less transient than the market and the Fed had previously predicted, investors are rotating into inflation-sensitive or inflation-hedging equities. Using the Affinity™ engine, we calculate the performance of hundreds of business groupings. By isolating inflationary periods over the past twenty years, we find that the groups that are most likely to outperform during an inflation market regime are, unsurprisingly, those with direct involvement with the extraction of commodities. Indeed, the Affinity 'Resource Extraction' Activity, which includes companies in the business of extracting Oil, Metals, Lumber and any other natural resource is the best performing group during inflationary periods (Exhibit 2). Since the group spans multiple sectors (e.g. Energy, Industrials and Materials in GICS), it is difficult to measure using traditional classification systems.

Affinity offers a simple way to measure inflation sensitivity

This year, as the inflation rate rose from 7.0% to 8.5%, an equally weighted basket of Resource Extraction companies returned 31.76%.

Exhibit 2: The most inflation sensitive groups in the S&P 500

Taxonomy	Business Risk	Inflationary Period	Not Inflationary Period	Differential	2022*
Activity	Resource Extraction	19.01	-0.70	19.71	31.76
Commodities	Exploration and Production	18.79	2.94	15.86	44.51
Sector	Upstream Energy	15.93	1.71	14.22	47.56
Commodities	Industrial Metals	22.38	8.25	14.13	19.19
Activity	Real Estate Construction	14.20	2.25	11.94	6.23
Activity	Rail Transportation	24.99	13.17	11.82	1.28
Supply Chains	Natural Gas Supply Chain	12.36	2.00	10.35	25.49
Commodities	Agricultural Seeds and Chemicals	30.61	21.01	9.60	30.79

Source: Syntax, Bloomberg. Total return performance, conditional on inflation and non-inflationary periods and does not reflect fees or implementation costs as an investor cannot directly invest in an index. *2022 returns to 3.31.2022

Regime Shift from Growth to Value continues

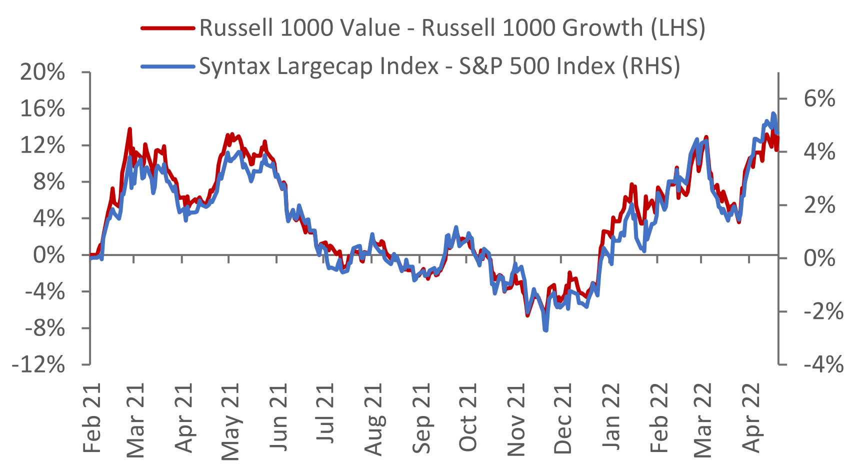
As a result of rising inflation, US bond yields have risen precipitously in 2022, with the flagship US 10-year bond yield nearly doubling from 1.5% at the start of the year to 2.9%. As we wrote in our recent note, "Regime Shifts - Why the S&P 500 could underperform Alternative Weighted ETFs", a rise in interest rates has a profound effect on the relative fortunes of Growth stocks, and in turn the performance of cap versus alternatively weighted indices.

Higher interest rates are often a headwind for growth companies, since Growth stocks often rely on future earnings potentially more than their Value counterparts, hence they have a higher sensitivity to changes in the discount rate. When interest rates rise, their future earnings are discounted heavily and therefore earnings are downgraded more for Growth names than Value ones. The oversized weight of Tech (growth) within the S&P 500 means that any underperformance of Growth stocks will lead to underperformance of cap weight vs alternatively weighted products (as evidenced by the strong correlation in Exhibit 3). This year the S&P 500 Value index has outperformed the S&P 500 Growth index by 15.0% and the Syntax Stratified LargeCap index has outperformed the S&P 500 index by 5.7% (to 4.28.2022).

US 10-year bond yield

Source: Bloomberg

Exhibit 3: S&P 500 recently underperforms as Value outperforms



Source: Syntax, Bloomberg. Cumulative total relative return, 2.1.2021-2.1.2022. Performance does not reflect fees or implementation costs as an investor cannot directly invest in an index.

We note that the style biases that are so pronounced in the US LargeCap universe are not prevalent in other regions or size segments, where tech is far less dominant. We believe that a significant value exposure explains why the MSCI EAFE and the S&P 600 have fared better in relative terms versus their alternatively weighted counterparts so far this year.

Market turbulence drives renewed interest in defensive equities

The recent market volatility stemming from the Russia-Ukraine conflict amidst rising interest rates has prompted stocks in selective defensive groupings to outperform in Q4 2021 and Q1 2022 (Exhibit 4).

Exhibit 4: Performance of the Affinity Defensive Theme in S&P 500

	2022*	6M	12M	3Y	5Y	10Y
Defensive	**-0.2%**	**10.0%**	**12.9%**	**9.9%**	**7.2%**	**9.5%**
Defensive Utilities	6.1%	17.9%	16.4%	6.8%	5.2%	8.1%
Consumer Staples and Necessities	-2.2%	7.8%	6.7%	9.2%	6.8%	9.6%
Defensive Healthcare	2.2%	9.7%	15.3%	9.4%	6.0%	9.7%
other Defensive Businesses	-8.2%	2.2%	16.1%	10.3%	9.7%	8.7%

Source: Syntax Affinity™. Equal Weighted group performance as of 3.31.2022.

Stratified Weight Indices have a consistently higher allocation to defensive business risks (Exhibit 5) due to their diversified methodology which does not favor any one sector or industry (such as technology in the S&P 500 or Industrials in MSCI EAFE).

Exhibit 5: S&P 500 Exposure to Defensive Equities

	Stratified LargeCap	S&P 500	Difference
Consumer Staples and Necessities	12.92%	6.55%	6.37%
Defensive Utilities	4.02%	2.18%	1.84%
Defensive Healthcare	3.96%	5.60%	-1.64%
other Defensives Businesses	1.95%	1.06%	0.89%
Defensive	**22.84%**	**15.40%**	**7.44%**

Stratified LargeCap has a higher weight in Consumer Staples and Necessities

Source: Syntax Affinity™. Weights as of 3.31.2022

The result is that Stratified Weight has less cyclicality and a higher weight in the defensive business groupings for all our major regions and size segments (Exhibit 6).

Exhibit 6: Core Benchmark Exposure to Defensive Equities

Universe	Stratified Weight	Cap Weight	Difference
S&P 500	22.84%	15.40%	7.44%
MSCI EAFE	22.15%	21.24%	0.91%
S&P SmallCap 600	22.88%	11.53%	11.35%

Source: Syntax Affinity™. Weights as of 3.31.2022

Conclusion

The decline in the S&P 500 this year has been attributed to (amongst other things) stress from the Russia-Ukraine conflict and rising inflation and interest rates. We believe that historically high levels of concentration, due to the cap weighted index methodology is exacerbating the decline.

The index is not only overexposed to Technology-related business risks, but also by extension overexposed to rising interest rates, inflation, the business cycle and unrealistic earnings expectations.

Now more than ever, we believe that the S&P 500 is taking diversifiable risks in its attempt to capture the market equity risk premium and that a more diversified index, namely the Stratified LargeCap Index offers a better representation of the broad market for those investors wishing to invest in equities without taking an outsized view on any sector, industry or company.

Exhibit 4. Thematic Performance and Exposure within the US LargeCap universe

	3M	12M	10Y	Full
S&P 500 Equal Weight	**-2.7%**	**13.1%**	**14.0%**	**12.1%**
Distribution Models				
Sell Through a Retailer	-6.0%	1.5%	9.1%	8.0%
Sell to an OEM	-10.5%	1.5%	15.8%	9.5%
Direct-to-Consumer	-3.4%	6.5%	11.4%	9.6%
Government-Subsidized	5.6%	19.1%	16.3%	12.6%
Advertisement Revenue Model	-5.2%	-9.2%	10.7%	7.8%
Franchisor	-9.3%	16.5%	12.8%	8.0%
Supply Chains				
Electronics Supply Chain	-13.1%	7.5%	15.5%	12.6%
Industrial Equipment Supply Chain	-5.4%	5.0%	15.7%	12.2%
Transportation Equipment Supply C	-9.2%	5.3%	11.3%	7.3%
Consumer Goods Supply Chain	-15.5%	-7.8%	6.4%	7.4%
Pharmaceutical and Medical Equip.	-5.2%	11.6%	13.9%	12.8%
Food Supply Chain	2.5%	14.4%	11.8%	9.8%
Energy Supply Chain	19.4%	35.0%	5.6%	7.1%
Cross-Sector Thematics				
Aerospace	6.0%	1.5%	14.0%	10.4%
Automotive	-10.0%	8.7%	11.7%	7.0%
Consumer	-7.2%	0.1%	10.7%	9.6%
Retail	-8.2%	7.1%	11.0%	9.3%
Technology	-9.6%	5.5%	17.6%	13.7%
Telecoms	-8.3%	5.8%	11.4%	10.4%

	3M	12M	10Y	Full
S&P 500 Equal Weight	**-2.7%**	**13.1%**	**14.0%**	**12.1%**
Recurring Revenue Model	**-3.6%**	**14.6%**	**10.6%**	**8.7%**
Telecommunication Services	-3.3%	-6.7%	2.4%	3.8%
Content Subscription	-19.1%	17.1%	30.7%	12.8%
Equipment Rental and Leasing	1.4%	17.2%	22.6%	7.0%
Rate Regulated Utilities	6.1%	16.4%	8.1%	5.2%
Software Subscription	-14.4%	1.2%	16.7%	16.0%
Commodities	**20.5%**	**39.4%**	**7.6%**	**9.0%**
Energy Commodities	38.6%	61.7%	1.2%	7.3%
Agricultural Commodities	22.0%	40.2%	15.9%	13.0%
Metal Commodities	14.3%	29.0%	8.7%	8.9%
Commodity Rail Transport	1.3%	15.1%	16.8%	12.2%
Chemical Commodities	-10.1%	2.7%	12.8%	8.9%
Infrastructure	**3.2%**	**18.4%**	**10.1%**	**7.3%**
Infrastructure Suppliers	4.1%	22.7%	10.8%	8.7%
Construction and Engineering	6.9%	27.5%	5.6%	2.0%
Infrastructure Operators	0.8%	12.9%	10.1%	7.5%
Real Estate	**-0.6%**	**15.7%**	**7.7%**	**9.0%**
Real Estate Owners/Operators	-6.5%	10.8%	8.6%	9.0%
Real Estate Construction	4.6%	4.1%	10.7%	11.7%
Real Estate Services	-1.8%	8.7%	16.3%	5.5%
Real Estate Components	-21.2%	-1.3%	15.3%	8.5%
Real Estate Financial Products	-5.5%	6.7%	6.9%	0.4%

Source: Syntax, Affinity, S&P Dow Jones Indices. Performance is calculated as the weighted average total return of the subset of the S&P 500 Equal Weight Index constituents who are members of the Affinity Theme. QoQ shows total return for 9.30.21 to 12.31.21. YoY shows total return from 12.31.20 to 12.31.21. Full performance period uses period from 12.31.1991 when available. Performance does not reflect fees or implementation costs.

Exhibit 5. Sector performance for Stratified US size segments and Stratified International universes

	US LargeCap		International		US MidCap		US SmallCap	
	Q1	12 months	Q1	12 months	Q1	12 months	Q1	12 months
Index	**-1.9**	**14.2**	**-7.2**	**-4.6**	**-4.5**	**2.0**	**-6.5**	**-1.7**
Financials	**-1.0**	**15.7**	**-3.3**	**1.1**	**-4.0**	**7.3**	**-6.1**	**3.9**
Banking	-6.0	10.8	-3.1	4.5	-3.1	2.8	-6.5	8.8
Insurance	12.4	24.8	-3.7	3.1	0.7	6.6	-3.7	-3.9
Real Estate	-8.9	10.7	-3.0	-4.1	-9.3	11.9	-8.2	6.8
Energy	**22.1**	**40.7**	**6.3**	**10.8**	**12.1**	**21.7**	**24.4**	**36.9**
Oil And Gas	37.9	58.4	15.9	21.0	22.7	42.7	42.2	53.1
Gas And Electricity	6.2	22.6	-1.4	2.7	4.0	7.0	2.1	18.7
Industrials	**-1.8**	**15.5**	**-7.4**	**-1.6**	**-3.2**	**5.0**	**-2.9**	**4.3**
Industrial Materials	8.9	31.0	-4.9	-3.3	1.6	16.6	8.4	24.8
Industrial Components	-10.8	5.3	-12.5	-5.5	-6.6	1.3	-8.5	-2.7
Industrial Equipment	-3.0	4.4	-4.0	-0.6	-7.7	-5.0	-10.1	-9.4
Industrial Services	-2.2	22.2	-7.7	3.1	0.1	7.2	2.0	9.5
Information Tools	**-10.4**	**16.4**	**-13.8**	**-2.3**	**-10.0**	**9.6**	**-13.1**	**0.6**
Integrated Circuits	-12.4	13.6	-15.3	6.3	-14.7	8.0	-14.1	21.1
Hardware	-8.0	21.4	-12.6	-13.5	-10.6	17.7	-11.8	-9.1
Software	-10.7	13.1	-13.5	0.5	-3.6	0.4	-13.1	-10.4
Information	**-5.8**	**2.1**	**-11.6**	**-10.1**	**1.5**	**1.5**	**-8.2**	**0.4**
Commercial	-4.0	13.6	-10.3	-1.2	-0.2	11.7	-6.3	8.4
Consumer	-0.5	-9.5	1.7	-2.0	2.0	-2.8	-10.7	-7.7
Internet Services	-13.5	1.6	-24.9	-25.8	2.2	-4.3		
Consumer	**-14.5**	**-6.0**	**-14.6**	**-20.2**	**-14.4**	**-11.3**	**-14.6**	**-14.1**
Hhld & Personal Prod.	-13.1	-2.6	-12.2	-23.3	-17.1	-21.2		
Apparel	-18.9	-16.6	-24.2	-21.3	-10.6	-16.0	-15.6	1.3
Home Office	-15.6	-5.3	-16.3	-21.5	-21.6	-10.1	-12.1	-22.6
Consumer Transport	-10.7	0.5	-5.4	-15.8	-7.9	0.3	-16.3	-20.8
Food	**0.4**	**15.3**	**-3.7**	**-2.3**	**-7.7**	**-5.7**	**-1.6**	**2.0**
Food Production	4.3	11.2	-4.1	-4.1	-9.5	-13.5	0.9	18.0
Food Sales	-3.3	19.0	-3.2	-0.4	-5.7	2.4	-4.0	-12.0
Healthcare	**-1.8**	**18.0**	**-9.7**	**-7.2**	**-3.4**	**-1.4**	**-4.9**	**-7.9**
Pharmaceuticals	0.3	18.5	-1.4	-1.0	-0.7	-12.4	-4.9	5.2
Healthcare Industry	-3.6	17.1	-17.7	-13.6	-14.5	3.1	-1.0	-12.3
Consumer Healthcare	-2.1	16.1			5.2	4.3	-8.8	-17.3

Source: Syntax, Affinity™. Performance does not reflect fees or implementation costs.

Syntax STRATIFIED
The Difference is Weighting™

Syntax Core Index Suite

Index	Ticker (TR)	Base Universe
Stratified Benchmark Indices™		
Syntax Stratified LargeCap	SYLCTR	S&P 500
Syntax Stratified MidCap	SYMIDTR	S&P MidCap 400
Syntax Stratified SmallCap	SYSCTR	S&P SmallCap 600
Syntax Stratified Core	SYCORETR	S&P 900
Syntax Stratified US Total Market	SYUSTMTR	SYLC + SYMID + SYSC
Syntax Stratified 1000	SY1KTR	Russell 1000
Syntax Europe & Asia Developed Markets	SEADMTR	MSCI EAFE
Syntax Stratified Wilshire 5000	SW5KTR	Wilshire 5000
Stratified Sector Indices™		
Syntax Stratified Financials	SYFINTR	S&P 900
Syntax Stratified Energy	SYENYTR	S&P 900
Syntax Stratified Industrials	SYINDTR	S&P 900
Syntax Stratified Info. Tools	SYITTR	S&P 900
Syntax Stratified Information	SYINFOTR	S&P 900
Syntax Stratified Consumer	SYCPSTR	S&P 900
Syntax Stratified Food	SYFOODTR	S&P 900
Syntax Stratified Healthcare	SYHLTHTR	S&P 900
Stratified Thematic Indices™		
Syntax US Large Cap Value	SPVT	Custom US Large Cap
Syntax US Social Core Tier 1	SOCIAL1TR	Custom US Large & Mid Cap
Syntax US Social Core Tier 2	SOCIAL2TR	Custom US Large & Mid Cap
Syntax Real Asset	SRAIT	Custom Large & Mid Cap
Syntax Stratified LargeCap ESG	SYESGTR	Custom US Large Cap

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