4Q21 Market Review and 2022 Outlook

Market Backdrop

The US economy expanded in 2021, as policymakers continued to support growth with extraordinary monetary and fiscal stimulus aimed at combating the effects of the pandemic.

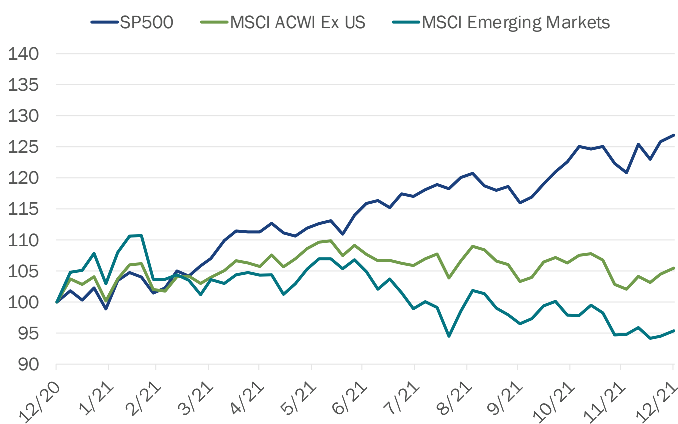
The final three months of the year were marked by the emergence of the Omicron variant of COVID-19, as well as heightened concerns over inflation, which led the Federal Reserve to announce an accelerated plan of reduced asset purchases. Against this backdrop, equity markets rose to all-time highs to close out the year. Growth equities with high valuations, however, underperformed meaningfully. Many of these shares were also at a peak in prices, when concerns arose about the potential impact of rising interest rates on valuations.

Corporate earnings remained strong, finishing a year of robust recovery from pandemic lows. The effects of monetary and fiscal stimulus were visible in the record levels of household and corporate cash, which bolstered demand, and strength in capital expenditure. While supply chains remained tight, the worst of the port and logistics congestion showed signs of easing as the year ended. Holiday shopping took place earlier than normal, but overall supply appeared to keep pace with the seasonal step-up in demand.

Employment continued to rebound, with minimum wage increases, bonus payments, and benefit enhancements instituted across a broad spectrum of industries to retain talent and encourage workers to return to the labor force. Despite these developments, “the great resignation” continued. Consumer confidence remained strong, though off its highs of the year, following the emergence of the Delta and, more recently, Omicron variants of COVID-19.

Congress largely met the challenges of increasing the federal debt ceiling and passing the Infrastructure Investment and Jobs Act. However, President Joe Biden’s larger Build Back Better bill remained in limbo.

Market Index Performance



As of December 31, 2021. Source: Jennison, FactSet, MSCI

Style Performance

- In the fourth quarter, large-cap growth stocks once again led the markets; however, small-cap growth was the weakest segment.
- In 2021, mid- and small-cap value were the best performers followed closely by all large-cap market segments. Small cap growth also trailed significantly for the full year.
- Large caps growth dominated market performance over longer time periods but the spread over mid and small is narrowing.

Style Index Performance

4Q21

	Value	Core	Growth
Large	7.8	9.8	11.6
Mid	8.5	6.4	2.8
Small	4.4	2.1	0.0

Trailing 1-year

	Value	Core	Growth
Large	25.2	26.5	27.6
Mid	28.3	22.6	12.7
Small	28.3	14.8	2.8

Trailing 3-Year

	Value	Core	Growth
Large	17.6	26.2	34.1
Mid	19.6	23.3	27.5
Small	18.0	20.0	21.2

Trailing 10-Years

	Value	Core	Growth
Large	13.0	16.5	19.8
Mid	13.4	14.9	16.6
Small	12.0	13.2	14.1

As of December 31, 2021. Source: Jennison, FactSet, MSCI

Sector Performance

- In the fourth quarter, real estate was the best performing sector as it benefited from the reopening of the economy. Information technology followed closely behind.
- For the trailing one-year, energy led market returns. Real estate, information technology, and financials also performed well. Defensive sectors like consumer staples and utilities underperformed.
- Information technology and consumer discretionary maintained their leadership positions for the three-, five-, and trailing ten-years.

GICS Sector Performance - S&P® 500 Index

	4Q	One Year	Three Years	Five Years	Ten Years
Real Estate	18	46	23	15	13
Information Technology	17	35	43	32	24
Materials	15	27	24	15	13
Consumer Staples	13	19	19	12	12
Utilities	13	18	14	12	11
Consumer Discretionary	13	24	29	21	20
Health Care	11	26	20	18	17
Industrials	9	21	20	13	14
Energy	8	55	5	-1	1
Financials	5	35	21	13	16
Communication Services	0	22	26	11	12
Total	11	29	26	18	17

As of December 31, 2021. Source: Jennison, FactSet, MSCI

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Earnings Results

- Third-quarter earnings results were solid with 83% of the S&P 500's constituents meeting or beating expectations.
- Information technology companies continue to post the best results with 97% of companies topping or meeting expectations. Health care and energy also had strong results with only 9% and 10% respectively missing consensus estimates.
- Energy, materials, and utilities had less than 70% of companies beating or meeting expectations.

Sector Name	% of Companies Beating/Meeting	% of Companies Missing
S&P 500	83%	17%
Information Technology	97%	3%
Health Care	91%	9%
Energy	90%	10%
Financials	87%	13%
Industrials	85%	15%
Consumer Discretionary	79%	21%
Consumer Staples	78%	22%
Communication Services	77%	23%
Materials	68%	32%
Real Estate	66%	34%
Utilities	64%	36%

As of December 31, 2021 (most recent available) reflecting the end of the third quarter 2021 reporting season.
Source: Standard & Poors

Sector Weights as of December 31, 2021

	S&P 500	MSCI ACWI ex US	Russell 1000 Growth	Russell 1000 Value
Communication Services	10	6	12	7
Consumer Discretionary	13	12	18	6
Consumer Staples	6	9	4	7
Energy	3	5	0	5
Financials	11	19	2	21
Health Care	13	9	9	18
Industrials	8	13	6	12
Information Technology	29	14	46	10
Materials	3	8	1	4
Real Estate	3	2	2	5
Utilities	2	3	0	5

As of December 31, 2021. Source: Jennison, FactSet, MSCI

S&P 500® Index - YoY EPS Growth

As of December 31, 2021. YoY = Year over Year. Source: FactSet. Forecasts may not be achieved and are not a guarantee or reliable indicator of future results.

S&P 500® Index - NTM P/E

As of December 31, 2021. Source: Jennison, FactSet, MSCI

Outlook from Jennison's Growth Teams

We are nearly two years into the COVID-19 pandemic, and much remains uncertain. US economic activity in 2021, as measured by GDP growth, rebounded remarkably, after the pandemic-driven contraction in 2020. Navigating this environment has required a shift in behavior from policymakers, corporations, and individuals, alike.

Low levels of absolute and real interest rates have been a feature of the economic landscape for the better part of a generation. The efforts to forestall economic collapse over the past two years haven taken this accommodative policy to an extreme and driven inflation to levels not seen in half a century. Debates around the duration of both wage and goods inflation abound. With little settled in this regard, policymakers in November took the first steps to rein in accommodation by announcing a plan to curtail asset purchases, as well as the telegraphing the likelihood of increases in the Federal Funds rate at points along the way in 2022. Curtailed fiscal stimulus, tighter monetary conditions, and higher inflation build a case for slowing economic activity in the coming year. Rising interest rates in many emerging economies are already acting as a brake to their growth, thereby strengthening the case for a US slowdown.

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We use the framework of secular growth to think about the future over our investment time horizon, as many pre-pandemic trends continue to hold or even gain pace. While we acknowledge that forecasting is unusually difficult in the current environment, we have identified drivers of growth that are not tied US GDP growth. However, we expect that the policy backdrop may lead to further valuation pressure, similar to that witnessed in the fourth quarter. Moreover, many of the important beneficiaries of the pandemic are facing challenging year-over-year comparisons. We believe, however, the impact from this comparison effect should ease over the course of 2022.

Sector Views

Information Technology

Led by the mega-cap companies, the S&P 500 Index's information technology sector rose 17% in the fourth quarter of 2021 and was the second best performing sector in the broader market S&P 500 (+11% in the fourth quarter). Real Estate was the best performing sector (benefiting from the continued reopening post-COVID). Information technology also outperformed over the trailing one year, advancing 35% compared to the S&P 500's 29% gain.

Recent technology sector earnings reports continue to be strong, confirming the underlying strength in many companies and secular trends. We believe the market should continue to favor companies with asset-light business models, disruptive products, and faster organic growth in the current COVID-19-affected environment and as the world returns to normal.

It is important to recognize that technology is no longer a distinct sector; rather, it is woven through every industry in which we invest; a backdrop that creates an attractive environment for long-term champions of innovation. For example, we expect continued accelerated CAPEX spend on tech, software, and R&D, especially since these expenditures have now become a "necessity for survival" for businesses instead of a way to reduce costs and a "nice to have." The long-term implications of this change in CAPEX spend will likely be profound. We also see continued acceleration and long duration technology demand from the large global millennial population, given their early uptake of so many digital economy related products that are solving real-world problems.

However, unlike the last 2009-2019 economic cycle, valuations are more reflective of these powerful secular trends, and market broadening is still in-place given the large expansion in GDP growth expected for 2021 and 2022, along with the consensus views that higher rates and inflation are ahead (albeit from a very low starting-point). So on a go-forward basis we can expect continued volatility and consolidation for the technology sector, both relative and absolute.

The pandemic has accelerated the adoption of digital technologies by several years, and we expect that many of these changes will be permanent. Companies are understanding that to remain competitive in this new environment they must value technology's strategic importance as a critical component of business, not just as a source of cost efficiencies. As a result, businesses are making the kinds of investments that are likely to ensure the trend's perpetuation. This can be seen across multiple fronts: technology-heavy capital expenditures; ecommerce strategies; the enterprise transition to the cloud; direct-to-consumer business models; and software applications that extend across businesses.

Consumers have adapted even more rapidly, with consumption behaviors shifting dramatically over the past year toward digital. We believe this mass adoption and new baseline will be the foundation for continued superior growth for the right companies. We believe large, global-oriented total addressable markets provide an ample runway for long-duration top- and bottom-line growth, with many disruptive trends expected to double over the next 3-5 years. Historically, earlier stages of mass adoption have spurred more innovation, greater ease of use, and an expansion of the ecosystem, which in turn has kept the virtuous cycle spinning with yet greater adoption.

Strong earnings growth isn't limited to "tech" companies grouped in the index's information technology sector. It extends to other businesses with technologically driven advantages in other sectors, as well, such as social media companies, classified as "communication services," internet retailers and streaming entertainment providers, grouped in "consumer discretionary," and robotic surgery, diagnostic, and biopharmaceutical companies classified as "health care."

Investment Themes & Areas of Focus

- The use of digital technologies to create new (or alter existing) business processes, cultures, and customer experiences has become a strategic imperative as enterprises seek to meet changing business and market needs. This digital transformation has been driven by digital technologies such as social media, mobile devices, artificial intelligence, and cloud computing.
- Software as a service (SaaS), another of these transformative digital technologies, delivers mission-critical cloud applications and services that are disrupting the software industry. Initially adopted by internet- and cloud-native businesses, and still in the nascent stages of utility, SaaS has begun to penetrate the mother lode of large mainstream enterprise markets. As the strategic necessity of implementing software enhancements as they become available becomes increasingly apparent, businesses are being driven to adopt the SaaS model. With penetration rates remaining relatively low, SaaS expansion opportunities over the coming decade look substantial.
- We look for companies positioned to benefit from increased business spending on technology. This includes investing in industries such as 5G, SaaS, business intelligence (AI), semiconductors, cloud storage and software, and life sciences tools.
- We think the continued ramping-up of data/information/ entertainment usage across a broad range of devices and applications, along with digital payments, are among the areas that offer long-duration opportunities and huge addressable markets for companies with the right technologies. Business and consumer behaviors have clearly changed, with adoption and uptake rates inflecting higher.

Health Care

In 2021's fourth quarter, the Health Care sector of the S&P 500® Index performed mostly in-line with the overall Index, which advanced 11.0%. Over the trailing 12-months, the Health Care sector rose 25% compared to the S&P 500's 29% gain.

A year and a half after the start of the pandemic, the market continues to be driven by sentiment trading as it relates to the virus. Any given positive or negative COVID-related data point has the ability to create large moves across markets, particularly various

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industries of healthcare. 4Q21 began with COVID-19 infections trending favorably, however, the appearance of the Omicron variant in November introduced new risks to the recovery story in the short term and ushered in a wave of volatility. That said, many additional factors have contributed to uncertainty within the healthcare sector over the past year, including:

- A pause in elective procedures due to the global spike in the number of COVID-related cases and hospitalizations from the Delta and Omicron variants.
- The implication of higher COVID related costs to the US health care system has impacted the near term sentiment of many healthcare equipment & supply companies, and healthcare providers & service companies.
- False assumptions the US would endure significant drug pricing reforms as well as meaningful cuts to Medicare Advantage weighed heavily on the sector until recently.
- Nearly ten months without appointing a permanent commissioner which ended on 11/12/21 when US President Joe Biden nominated Robert Califf, a former head of the Food and Drug Administration (FDA), to lead the agency once again.

Although healthcare has faced headwinds over the past year, we believe the sector's short-term underperformance can be reversed as investors place more emphasis on company fundamentals and the significant alpha generating opportunity that broad innovation in the sector can provide. Furthermore, we remain hopeful that as we have finally received some clarity on drug pricing, the 6-year overhang on the drug industry, in particular biotech, can be lifted. We are pleased to see that the most negative elements of drug pricing reform are now off the table and expect the final details of the reform to be manageable. More specifically, now that some "action" is being taken on drug pricing the likelihood of any draconian changes that were potentially negative for the industry are off the table. A "no news" stance out of Washington, coupled with the announcement of a FDA commissioner, should position healthcare well into 2022.

Investment Themes & Areas of Focus

Health care is one of the fastest growing sectors in the global economy which is driving rapid scientific and technological advancements. The convergence of technology and consumerization is fueling an unprecedented flow of innovation to address unmet medical needs and reduce costs. This evolution will have a lasting impact on the patient experience as Healthcare is switching to more preventive medicine and an outcome-based economic model. This backdrop presents unique opportunities to allocate capital to multiple healthcare industries.

- We expect that productive research and development activity will yield effective disease treatments that improve the quality of patients' lives. These characteristics historically have been the source of longer-term outperformance in the sector.
- We believe many biotherapeutic companies have compelling fundamentals and innovative products and pipeline drugs.
- The number of drug candidates in biopharma pipelines continues to be high. Increased research and development investment by large global pharma companies, as well as advancements in drug screening and discovery, are driving the increase in drug candidates.
- Larger multinational pharmaceutical companies, especially those with patent-expiration pressures, will continue to make acquisitions of smaller cap companies with single products or promising pipeline assets.
- Many tools and diagnostic companies are engaged in improving the physician decision making process, accelerating the drug development & approval process and integrating biology faster
- Medical device companies are improving the quality of life, offering less invasive procedures, increasing the ease of use for both doctor and patient, all of which reduces facility stays
- The healthcare service companies we focus on are leading sources to improve access to care, increase patient engagement, improve disease management, shift treatments to lower cost, more convenient sites of care, and lower overall cost of care.

Utilities

After lapping a full year of underperformance following the announcement of the COVID-19 vaccine in late 2020, the S&P 500's utilities sector rallied in December to close 4Q21 modestly ahead of the broader market. Most defensive sectors finally caught a bid following the emergence of the omicron variant of COVID around Thanksgiving, providing a tailwind for utilities. The sector rose significantly in December following the omicron news as fears around the potential impact of new restrictions on the global economy drove investors to safer havens. Utilities finished 4Q21 up 13%, ahead of the 11% return of the S&P500.

While finishing the year strong, utilities has been one of the worst-performing sectors over the past 12-month period, despite strong underlying fundamentals. In fact, even during this period of economic volatility, the group has continued to execute operationally and has been able to deliver strong earnings while also de-risking their portfolios. Continued solid execution, along with the potential growth opportunities from renewable energy investments, should help to drive the sector's earnings going forward. The discrepancy between utility fundamentals and performance underscores both the attractive absolute and relative opportunity in the sector, especially given the lower-than-average interest rate environment.

Utilities represents a compelling defensive growth proposition for investors for several reasons, both sector-specific and macro-related:

- **The Renewables Opportunity:** improving economics in wind and solar power continue to remain a growth driver for the overall sector; companies are only now beginning to incorporate renewables into their capex plans, allowing them to earn a regulated rate of return on their renewable investments.
- **Predictable cash flow and earnings:** Utilities are by nature a defensive sector and those companies with regulated or quasi-regulated (renewables) businesses generate long-duration cash flows and predictable rate base earnings; in addition to providing stable dividends even in periods of uncertainty, growth in renewables should help drive earnings above the sector's historical 3%-5% growth rate.
- **Continued low interest rate environment:** rates remain low from a historical perspective; in a "lower for longer" interest rate environment, utilities should continue to benefit from the lower cost of capital – savings that eventually should flow directly to the bottom-line.
- **Policy tailwinds:** renewables should continue to benefit from government stimulus packages tailored to a green recovery, as well as development tailwinds that should sustain dividend growth.

Investment Themes & Areas of Focus

- **Regulated Utilities** - companies operating in favorable regulatory environments and geographies, with above-average projected earnings and/or dividend growth driven by regulatory rate-base investment.
- **Renewable Electricity** – the energy transition is driving ongoing investment and usage of renewables and should continue to provide unique investment opportunities over the long-term.
- **Water Utilities** – a focus on improving water quality, as well as pipeline replacement and maintenance, provides 10-years of transparency into spending and income plans.
- **Communications Infrastructure** - wired broadband network and datacenter operators are capitalizing on exponential global data demand growth; tower operators provide critical infrastructure and strong free cash-flow generation due to multi-year contracts.
- **Midstream Energy** - specifically companies with exposure to natural gas, a critical bridge fuel.

Midstream Infrastructure

While midstream infrastructure (Alerian Midstream Energy Index) has been a strong performer in the 13 months since the COVID vaccine announcement in late 2020, the group plateaued in 4Q21. Despite being the best-performing sector during 2021, energy broadly has been a laggard for the last two quarters. While midstream was essentially flat in 4Q, the group started the quarter off strong, gaining over 9% by mid-October, but then selling off over 8% through the end of the year. Fears around the supply-demand dynamics of oil and gas markets were already starting to weigh on the energy sector when news of a new COVID variant emerged around Thanksgiving. The compounding fear of the potential impact of new COVID-induced restrictions on the global economy fueled the sell-off. For the full 3-month period, the Alerian MLP Index gained 55bps, while the Alerian Midstream Energy Index, which includes a broader group of midstream infrastructure companies as well as MLPs, fell 37bps.

Midstream energy has been a sector in transition for several years. Most of the larger midstream companies have taken decisive measures to conserve cash and “right-the-ship” during this global pandemic, and we believe this disciplined behavior will continue. Cash-flow metrics have improved across the board after companies reduced capex and growth spending over the last 18+ months. Many larger companies are now free cash flow positive for the first time, an important inflection point. Added cost reductions and increased asset optimization should continue to fortify balance sheets, while offering management teams further opportunities to reduce debt levels and also returning cash to shareholders.

Moreover, improvements in fundamentals are finally starting to be reflected in stock prices. However, while a recovery is clearly underway, uncertainty as to the pace and timing of a full re-opening of the US and global economy may give investors pause – once again evidenced by performance this quarter. As economic activity continues to slowly ramp, stocks should increasingly price in not only the short-term recovery, but also the long-term positive benefits from the significant transformational corporate reform that has occurred over the past few years. All of which should spell better times ahead for the midstream group.

The global energy transition will require multiple sources of energy to be successful. Hydrocarbons will continue to have a role, driving future demand not just for the commodities but for the essential logistical systems that move them. With physical steel in the ground, midstream infrastructure companies have difficult-to-replicate asset networks with high barriers to entry, and whose adaptability to transport other energy sources is underappreciated. Management teams are increasingly aware of the role they will play in our energy future, focusing not just on the environmental impact of their operations but also on how their asset bases can and will be part of a greener future.

Investment Themes & Areas of Focus

- “Reformed” companies – those companies exhibiting higher capital discipline, and healthier, more conservative balance sheets that can withstand a downturn, along with improving ESG metrics such as solid corporate governance.
- Integrated business models – the larger, more integrated companies with multiple touch points along the energy value chain, higher barriers-to-entry, and steady cash-flows.
- Firms with exposure to the natural gas liquid (NGL), liquefied natural gas (LNG), and natural gas demand export themes.
- Companies with liquids exposure that will benefit from the re-opening of the economy.
- Renewable energy companies to get exposure to an area of significant growth as part of the global energy transition.

Financials

In what was a choppy quarter due to the emergence of the omicron variant of COVID, the S&P 500’s financials sector (financials) posted modest gains but trailed the performance of the broader market S&P 500. With a tailwind from strong performance late in 3Q, financials gained ground for the first two months of the quarter. However, news of the new omicron variant around Thanksgiving roiled the markets as fears around the virus’ impact on the global recovery once again resurfaced and certain cyclicals, like financials and energy, recovered more slowly than other sectors in December. Financials returned 5% for 4Q21, trailing the 11% return of the S&P 500 Index. Nevertheless, for the full year 2021 financials outperformed the broader market 35% vs. 29% for the S&P500.

Since the announcement of a COVID-19 vaccine in November of 2020, the sector has continued to be a strong performer (both relative and absolute). While mitigated somewhat by concerns about the rise of the delta and omicron variants, the earnings recovery continues to move forward. 4Q21 tailwinds for the sector have been primarily driven by the vaccine/booster rollout, continued (but non-linear) strength in the economic recovery coinciding with the reopening, better credit conditions, forward expectations for higher interest rates, and the lingering effects of the second stimulus.

The November 2020 news of a COVID-19 vaccine (both efficacy and timing) served as a boost to the broader market and, in particular, to sectors that had underperformed for most of 2020. The worst-performing sectors of last year continue to be the best-performing sectors in 2021. However, while the end of the pandemic and return to pre-2020 growth levels are starting to come into view, the timeframe for a full recovery is still unknown due to lingering effects on consumer and business confidence and balance sheets. Specifically, many of the longer-term macro concerns that plagued the sector and other economic/rate sensitive areas of the market before the pandemic are still in-place;

the Fed has signaled that interest rates will remain at depressed levels at least through 2022, and there is still no certainty around whether a higher nominal environment can be sustained.

The current backdrop remains favorable for universal banks and brokers/asset managers as the capital markets are robust and expenses well-controlled. Scale has become a competitive advantage, and we are positive on business models with a broad reach along with higher profitability metrics. Also, the potential for higher interest rates (especially with a steeper yield curve) translate into higher interest revenue and earnings for the regional banks, though this is largely priced into those stocks.

Investment Themes & Areas of Focus

- Overall, banks are significantly better-positioned today than they were in 2008-2009 financial crisis across a broad range of balance sheet, capital, and risk management metrics. High yields spreads at historically low levels (in the low 3% range) are signaling this.
- Despite the rally since the fall of 2020, valuations remain very attractive and are near their lower historical bounds on a both relative and absolute basis. They compare favorably to years immediately following the Global Financial Crisis, despite much stronger company fundamentals and forward prospects. Clearly, the rally in financials reflect better fundamentals and forward prospects.
- Looking forward for the next few years, consensus is expecting rates to stay historically low and the curve to remain generally flat. Although potential credit risks are expected to remain stable across a broad range of bank and insurance company assets, we expect the rate environment to drive continued headwinds that work against traditional fundamentals and market sentiment, which will continue to put downward pressure on P/E’s.
- Fundamentals for P&C insurance companies are very strong (driven by favorable pricing dynamics) and valuations very attractive as this segment has lagged in the rally.
- Secular growth companies with defensive attributes (low leverage rates, asset light models, sustainable, high margin, and high free cash flow businesses) should continue to fare better in this type of environment. Several digital payment and financial technology companies meet these criteria and have demonstrated superior fundamentals and stock price performance through the COVID-19 crisis especially.

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