Great-West Profile Funds

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Crosswinds:

Some move in your favor, others hit you in the face, but they all have the potential to send you off course

As someone who spends a fair amount of time in a bicycle saddle, I can attest to the fact that few things are as frustrating or exhausting as a stout crosswind. Unlike persistent headwinds or tailwinds — both of which you can reliably plan and adjust for — crosswinds are often completely unpredictable and have a habit of hitting you exactly when you are least prepared. If you aren't careful, a gusty crosswind can even send you careening into a ditch.

At the risk of over-dramatizing, the crosswind analogy does a pretty decent job of describing the current environment faced by investors: Some move in your favor, others hit you in the face, but they all have the potential to send you off course. Consider a few of the things that have occurred recently that might ordinarily represent a tailwind to markets: a surge in vaccination rates and an associated decline in COVID case growth, the acceleration of numerous economic indicators toward record highs, and a promised hand-off from monetary support for the economy to fiscal support. Now consider that each of these tailwinds also had a corresponding headwind: geographically uneven vaccination rates and the unexpected persistence of the Delta variant, declining consumer confidence, a labor market that seems to be stuck in neutral, and rancor in Washington that recently threatened not only a shutdown of the federal government but also a potential sovereign default by the U.S. Treasury. Add to all that the steady gales of supply chain stress and decades-high inflation rates that are either temporary and benign or persistent and caustic (depending on who you talk to), and you're left with an environment for investors that's a lot more like a sloppy and disorganized late-autumn thunderstorm than a steady but predictable windstorm.

Nowhere have these crosswinds been as apparent as they are in preferences by investment style. During the early months of the COVID-19 pandemic, equity investors' pre-pandemic preference for growth over value only became more pronounced as the economy retreated and the stay-at-home-lifestyle favored many of the tech- and convenience-oriented business models that high-growth companies just happened to employ. Fast forward to December of last year and the advent of several viable vaccines to combat the virus, and value investing was suddenly back in vogue as investors began looking ahead to a time when COVID was no longer the only thing calling the shots and the economy could begin the slow climb back toward normal. But even more recently, the unexpected persistence of the Delta variant, diminishing confidence that inflation will quietly fade away as supply chains right themselves and obvious political dysfunction in Washington served only to cause a shift back toward the more familiar territory of growth.

There were echoes of this in fixed income markets as well. When COVID first arrived, the Federal Reserve wasted no time cutting rates to zero. Market rates generally followed, allowing the economy to enjoy some of the cheapest rates for money in a generation. When the recovery began to accelerate, so did rates — at least in some cases. Longer-term rates in particular started to rise in anticipation of a robust economic recovery, even as shorter-term rates remained anchored by the expectation that the Federal Reserve would wait until labor markets had truly healed before lifting official rates off the zero floor. Even more recently, the prospect of technical default on U.S. Treasuries as a result of the rancorous debt ceiling debate — first thought to be an issue for debt maturing this October but now delayed until at least December — has created an unusual "blister" or "wart" at the very short end of the U.S. yield curve that stood as a visible reminder of exactly how fluid and dysfunctional the policy environment truly is. Add to all this the predictable, upbeat response of inflation-linked bonds to persistent fears about inflation, and you can see that the crosswinds buffeting bonds are no less intense than those pushing equity markets from one side of the lane to the other.

Performance of the Great-West Profile Funds

We've always believed that trying to predict such crosswinds and adjust our portfolios to reflect those predictions is a losing game, but the Great-West Profile Funds are certainly not immune to them in the short term. On the contrary, our funds carry small but deliberate tilts toward some of the things most exposed: things like a value bias and a tendency to overweight smaller-cap stocks within our equity allocation or a slight bias toward shorter-duration bonds on the fixed-income side. While we believe that we will be compensated for these exposures over the long term, at various times during the current cycle these have represented a headwind to performance (as in the early stages of the pandemic) while at others they have represented a tailwind (when vaccine-related optimism allowed the so-called "reflation trade" to take hold). During the third quarter, many of these tailwinds once again became headwinds.

Given this unpredictable (and frustrating) environment, it's perhaps not surprising that performance for the Great-West Profile Funds was somewhat mixed during the third quarter. As in the past, benchmark-relative performance was driven by small differences in the composition of the benchmarks themselves, rather than strategic differences in how the funds are positioned. That's because the benchmarks against which the Profile Funds are measured reflect the funds' strategic allocations very closely and only substantially differ in how those strategic allocations are reflected. For example, while the Profile Funds actively maintain exposures to diverse investment styles (i.e., growth and value) as well as various market capitalizations (large, mid and small) within the U.S. equity universe, our benchmarks include a single U.S. equity yardstick — the multi-style and multi-cap Wilshire 5000. The same can be said for our international exposure, where emerging markets factor in the funds but not in the benchmarks, as well as the fixed-income portion of the portfolios. These differences at the sub-asset class level are small, but they can matter when market returns are dominated by specific areas of the market (such as large caps or developing markets) while sub-asset class returns are more diverse. That was true in the third quarter, and the funds generally lagged their benchmarks to a modest or moderate degree as a result. Given the greater influence of these differences on the equity side of the ledger compared to the fixed-income side, the size of this underperformance was larger for the more aggressive funds in the Profile suite, where equity allocations play a greater role.

Individual holdings worth mentioning from the third quarter include the Great-West Emerging Markets Fund, one of the avenues through which we gain exposure to the small but important emerging market equity asset class. Emerging markets in general have been pressured by a host of issues, including uneven vaccination and economic growth rates across different geographies and a rising U.S. dollar — something that has traditionally created debt-servicing issues for emerging market firms who borrow in U.S. dollar terms. These, together with other factors, caused emerging market stocks to rank among the worst performers among major equity asset classes during the third quarter. More specific to our funds, though, was a notable increase in heavy-handed regulation by Chinese authorities in recent months that applied particular pressure to UBS, one of the subadvisors we invest with. UBS employs a concentrated, high-conviction approach to emerging markets that can allow temporary disruptions like an uptick in Chinese regulations to visibly influence performance in the short term. However, we have high confidence in the team at UBS and are comfortable that the issues will resolve fairly quickly. Moreover, the other subadvisor on the fund, Lazard, employs a much more diversified and highly structured investment approach that serves to smooth out volatility. Together, this pairing creates what we believe is a very compelling way to access emerging markets as an asset class, and we remain committed to the strategy.

On the positive side of the ledger, two funds merit mention. The first, Great-West Small Cap Value Fund, is celebrating its one-year anniversary as a stand-alone fund after the October 2020 merger of two previous holdings, the Great-West Invesco Small Cap Value Fund and the Loomis Sayles Small Cap Value Fund. As you may recall, part of that merger also included the removal of Invesco in favor of Hotchkis & Wiley, a deep-value manager that tends to favor smaller, more aggressively priced stocks and is responsible for 35% of the fund's assets. That provides a strong complement to Loomis, manager of the remaining 65% of the fund, who employs a more traditional approach to value. Together, these two subadvisors performed well on a relative basis even though the environment for both value and small caps was exceptionally difficult during the period.

Next, the Great-West Inflation-Protected Securities Fund was also a standout performer. As mentioned earlier, inflation has become the central issue defining the capital market narrative as investors, economists and policymakers alike debate whether the obvious uptick in prices is temporary or permanent. Investors are increasingly coming to believe that there is more substance to rising inflation than was once believed, and inflation-sensitive assets have risen in sympathy with that view. Moreover, our holding in this space — subadvised by the team at Goldman Sachs — benefited more than most given the strategy's focus on bonds with a shorter overall duration than many of its peers. That mattered in the third quarter given that the one thing both sides of the inflation debate agree on is that, permanent or not, inflation in the short term is real; only the longer-term direction of prices is up for debate. That allowed the fund to top the vast majority of its peers during the period.

Finally, Great-West Investments made changes to the subadvisors responsible for two of the underlying fixed-income funds in our portfolio during the period. First, longtime manager Templeton was removed from Great-West Global Bond Fund after an extended period of underperformance and replaced with London-based BlueBay Asset Management. BlueBay will join the portfolio alongside incumbent manager Mellon, with each now managing half the assets in the Great-West Global Bond Fund. Similarly, Great-West hired Goldman Sachs as a subadvisor in the Great-West Core Bond Fund. Goldman will now manage half the assets in that fund alongside remaining incumbent Wellington. This change was made after Great-West removed Federated from the fund earlier in the year. We believe all of the associated changes are positive for shareholders of the Great-West Profile Funds as well as the underlying fixed-income funds themselves.

Outlook

Looking forward, the crosswinds that have caused the underlying asset classes in which we invest to fluctuate so dramatically since the pandemic began have shown few signs of abating. In fact, the next several months might well see some of those gusts intensify as political dysfunction continues, the economy cools and the inflation debate continues to rage. Meanwhile, investors have placed a great deal of faith in companies to deliver on still-rising earnings expectations, and while we generally share that optimism, it might take only a small handful of missteps or a sudden turn in the direction of the economy to cause a wholesale re-rating of those expectations.

Regardless, one thing we are increasingly sure of is that no matter how uncertain the environment, no matter how intense the crosswinds become, the right approach always involves powering through the gusts and staying on course, mindful of any potholes the market may put in the road ahead. With regard to your investments, that means a steadfast application of the investment processes that have allowed us to be successful over the long term while always holding our investment partners to exactingly high standards and remaining vigilant for fundamental changes in the environment. That, as always, is our promise to you, our shareholders.

Morningstar ratings and rankings as of September 30, 2021

Rating based on risk-adjusted returns and ranking based on total return

FUND NAME	TICKER	INCEPTION	CATEGORY	RATING/ TOTAL # OF FUNDS OVERALL	3-YEAR	5-YEAR	RANK/[1] # OF FUNDS 1-YEAR
Great-West Aggressive Profile Instl	MXGTX	5/1/15	U.S. Fund Target-Date 2015	★★★ 166	★★★ 154	★★★ 140	(23/166)
Great-West Moderately Agg Profile Instl	MXHRX	5/1/15	U.S. Fund Target-Date 2020	★★★ 311	★★★ 288	★★★ 262	(121/311)
Great-West Moderate Profile Instl	MXITX	5/1/15	U.S. Fund Target-Date 2025	★★★ 689	★★★ 653	★★★ 596	(203/689)
Great-West Moderately Cnsrv Profile Instl	MXJUX	5/1/15	U.S. Fund Target-Date 2030	★★★★ 515	★★★ 480	★★★★ 427	(105/515)
Great-West Conservative Profile Instl	MXKVX	5/1/15	U.S. Fund Target-Date 2035	★★★★★ 194	★★★★ 178	★★★★★ 162	(44/194)

Fund performance as of September 30, 2021

FUND NAME	TICKER	INCEPTION	NET EXPENSE RATIO[2] (%)	GROSS EXPENSE RATIO (%)	1-YEAR RETURN (%)	3-YEAR RETURN (%)	5-YEAR RETURN (%)	SINCE-INCEPTION RETURN (%)
Great-West Aggressive Profile Instl	MXGTX	5/1/15	0.80	0.80	33.00	11.43	12.49	10.28
Great-West Moderately Agg Profile Instl	MXHRX	5/1/15	0.66	0.69	24.19	9.98	10.23	8.50
Great-West Moderate Profile Instl	MXITX	5/1/15	0.57	0.63	20.07	9.20	9.08	7.60
Great-West Moderately Cnsrv Profile Instl	MXJUX	5/1/15	0.48	0.56	15.46	7.90	7.53	6.37
Great-West Conservative Profile Instl	MXKVX	5/1/15	0.43	0.51	10.93	6.71	6.03	5.19

Current performance may be lower or higher than performance data shown. Performance data quoted represents past performance and is not a guarantee or prediction of future results. For performance data current to the most recent month end, please visit ***greatwestfunds.com****. The investment return and principal value of an investment will fluctuate so that, when redeemed, shares/units may be worth more or less than their original cost.*

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Performance for institutional class shares before their inception is derived from the historical performance of initial class shares, which has not been adjusted for the lower expenses; had it been, returns would have been higher.

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A benchmark index is not actively managed, does not have a defined investment objective, and does not incur fees or expenses. You cannot invest directly in a benchmark index.

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