Great-West Profile Funds

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Three kings:

The virus, the economy and government policy drove the narrative in 2021

Three things drove market narrative in 2021: the virus, the economy and government policy. While connected to one another in obvious ways, they each marked their own time and progressed at their own pace throughout the year. For example, fiscal and monetary policy were at their loosest during January and February but became progressively less accommodative as the year wore on. By November, the Federal Reserve had begun tapering its bond purchases and was openly talking about "lift-off" — that point, still somewhere in the future, when the Federal Funds rate will no longer be pegged at zero.

As far as COVID is concerned, widespread vaccine availability was still a relatively new thing as the year began, meaning that COVID case numbers, mitigation policies designed to curb the spread of the virus, and the associated stress on society and the healthcare system that both those things imply were still setting the tone in early 2021. COVID seemed to take a short breather during the spring and early months of summer, but then two separate variants — first delta and later omicron — forced the pandemic back to the front of the market's consciousness as the year drew to a close.

Of course, the policy environment and the stubbornness of the virus created a feedback loop that in turn helped dictate the rhythm of economic growth. The reflexive spike in economic growth that occurred in 2020 immediately after the worst of the lockdowns ended had largely played itself out by the time the calendar turned to 2021, and both the U.S. and global economies spent much of last year relearning how to stand on their own two feet as months and months of official support began to wane. Progress was uneven, however, with some areas such as consumer demand remaining robust throughout the year while others — most notably labor markets and global supply chains — remain distorted by the pandemic even today. But the defining feature of 2021's economy was a resurgence in inflation: Consumer prices are now rising at the fastest pace seen since the early 1980s, presenting both businesses and investors with a set of problems they haven't had to face in a generation.

The interaction of these three factors created a market environment that might best be described as varied. Equity markets were upbeat, especially during the summer months when all three kings — the virus, the economy and policy — were generally aligned in positive ways. Indeed, except for a brief period in the fall when it was becoming clear inflation wasn't really transitory at all and the delta variant was causing COVID fears to surge, stocks marched relentlessly higher during 2021.

Underneath the surface, however, things were far less uniform. The on-again/off-again progress against the virus and continued economic uncertainty caused investor preferences to whipsaw between the relatively expensive growth stocks that aligned well with COVID-era policies on one hand and the less expensive, value-oriented stocks that were better at capturing trends associated with a post-pandemic resumption of more orderly and predictable economic growth on the other. Domestic equity markets outperformed non-U.S. markets throughout much of the year, likely owing to the persistent (if not clichéd) view that U.S. markets are somewhat less risky and more liquid than many foreign markets, as well as expectations that the U.S. might recover faster and in more robust fashion than other countries. Emerging markets struggled for obvious reasons against such an environment and were one of the few asset classes to end 2021 with losses.

Trends were mixed below the surface of fixed-income markets as well. Credit spreads, which are sometimes viewed as a referendum on the health of the corporate sector in general, began 2021 at very tight levels and remained there throughout the year — a clear vote of confidence for borrowers that remained more or less unchanged for all of 2021.

The environment for rates, however, was far more interesting. Interest rates rose moderately for much 2021 as the U.S. and global economies continued to dig out from the worst the pandemic could throw at them, but the Fed's zero-rate policy acted as a heavy weight on shorter-term rates throughout the first half of the year. That changed, however, as soon as markets — and ultimately the Fed itself — came around to the notion that inflation was deeper and more persistent than originally thought. It quickly became obvious the Fed would have to adjust to that reality by tightening policy faster than many investors had assumed, and money began flowing out of shorter-term debt at a faster pace, in turn causing rates at the short end of the yield curve to accelerate during the fourth quarter. Longer-term rates, which are sometimes viewed as more sensitive to expectations surrounding economic growth than to Fed policy, rose more slowly, creating a modest performance disparity between strategies that focus on short-term debt and those with a longer-term horizon.

Performance of the Great-West Profile Funds

The Great-West Profile Funds were naturally subject to these trends throughout 2021. We believe the Profile Funds are capable of performing well across an entire range of market and economic scenarios, and full-year performance provides at least some support for that idea: Despite continued crosswinds generated by the stubbornly uncertain environment, three of the five finished toward the top of their respective peer groups in 2021.

But in the short term, there are a number of market-oriented factors that can influence performance in subtle but important ways. For example, the Profile Funds typically benefit from a tailwind when value-oriented equities are outperforming growth or when smaller-capitalization stocks are outperforming larger ones. Beyond equities, the environment most favorable to the Profile Funds is one in which shorter-term and high-yield bonds are in favor together with real estate. These broad, macro-oriented trends rarely move in the same direction simultaneously and, when they do, we would expect performance to be unusually strong. But when one or more are working against us, as is often the case, other aspects of the strategy may have to work a little harder to overcome the associated headwinds. That was the case during the fourth quarter, when a mixed bag of influences created mixed results when viewed on a quarterly basis: While three of the five Profile Funds beat a majority of their peers during the period, all five underperformed their respective benchmarks during the fourth quarter. To a large extent, this benchmark-relative shortfall can be traced to differences in how the funds' benchmarks are created. While our benchmarks consist only of broad market aggregates (such as the Wilshire 5000 Index for U.S. equity exposure), the funds themselves are allocated with greater strategic and stylistic precision. That gives rise to style tilts, such as an emphasis on value over growth, smaller- and mid-cap stocks over large-caps, and international over domestic stocks within the equity portion of each fund. A similar dynamic exists on the fixed-income side, giving rise to small style "misfits," such as exposure to high-yield and global bonds within the funds that simply doesn't exist in our benchmarks. When there are big differences in performance across different subsectors of the same broad asset classes, that can create modest underperformance like we suffered during the fourth quarter.

A prime example of this mismatch was our exposure to emerging market equities. While emerging markets exposure tends to be only a small portion of each funds' asset base, it is entirely absent from the international equity portion of our benchmark. Moreover, emerging market equities were unique among equity asset classes during 2021 as the one major sub-class of global stock markets that actually finished the year with a loss, a fact that pressured benchmark-relative returns. Our lone holding in the space, the Great-West Emerging Market Equity Fund, performed adequately during the quarter, and we will continue to utilize it to gain exposure to this important — and highly diversifying — corner of the market.

Meanwhile, standouts included our exposure to real estate equities, which performed well during both the fourth quarter and full-year 2021. This was undoubtedly a result of a confluence of trends that lifted both pricing and net operating income for real estate operators that aided the sector in general. Within real estate we choose to utilize a passively managed strategy, Great-West Real

Estate Index Fund. That fund had an exceptional quarter, finishing well within the top quartile of its peer group and contributing to relative performance in a positive way.

Within traditional equities, Great-West Mid Cap Value Fund was a top performer. While the market's preference for growth reasserted itself among the largest of large stocks during the quarter, that wasn't the case further down the capitalization spectrum. Value-oriented strategies outperformed growth in small- and mid-cap strategies during the final three months of the year in what might prove to be a durable trend during the new year. Either way, Great-West Mid Cap Value Fund — managed by the QIS team at Goldman Sachs — took full advantage and ended the quarter (and full-year 2021) well ahead of many of its peers.

For each of the four Profile Funds than maintain an allocation to fixed income, the Great-West Inflation Protected Securities Fund provided a significant and positive contribution to absolute returns. Inflation-linked bonds participated in an updraft that was in turn related to the dramatic surge in inflation that occurred particularly during the latter half of the year. The Inflation-Protected Securities Fund lagged somewhat from a peer-relative perspective at least in part because of its greater focus on shorter-duration bonds than some of its competitors, but performance nonetheless remained acceptable. Performance elsewhere across our fixed-income exposure generally met our expectations during both the quarter and full-year 2021, with the vast majority of our holdings posting acceptably strong results from both benchmark- and peer-relative perspectives.

Outlook

As we look forward to 2022, we're hopeful — as I'm sure you are as well — that the world will finally catch a break after nearly two years of virus-related drama. While it's too early to say for sure, it's beginning to look more and more like the omicron variant might represent COVID's last stand — at least as far as its ability to dictate entirely the pace of social and economic activity worldwide is concerned. In any case, it feels as if we've become increasingly used to living with the virus and all its fallout, giving us all hope that 2022 will finally represent a return to something approximating normal.

That doesn't necessarily mean it will be smooth sailing, though. Interest rates are almost certainly set to rise further as the Federal Reserve and central banks worldwide switch from stimulus to inflation-fighting mode. That will present a new set of challenges for companies and consumers alike as the benefits of literally years' worth of accommodative policies continue to fade. From a pure consumer perspective, it's fair to wonder whether the dizzying pace of demand growth witnessed throughout the latter stages of the pandemic will prove sustainable as consumers work down the stores of dry powder accumulated during its worst months. That naturally carries implications for corporate earnings and economic growth writ large, making the sustainability of robust demand one of the most important questions for investors to ponder as we enter the new year. Meanwhile, markets themselves will eventually be forced to reckon with excesses of their own, not the least of which are stretched valuations and stylistic imbalances that developed over long months of plainly abnormal conditions.

It therefore almost goes without saying that things are likely to remain unsettled regardless of what ultimately happens with COVID. As always, we view a portfolio that is well diversified across not only asset classes but investment styles as well as the approach most likely to perform well despite such lingering uncertainty.

Morningstar ratings and rankings as of December 31, 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	★★★ 189	★★★ 117	★★★ 98	(35/189)
Great-West Moderately Agg Profile Instl	MXHRX	5/1/15	U.S. Fund Target-Date 2020	★★★ 320	★★★ 207	★★★ 180	(217/320)
Great-West Moderate Profile Instl	MXITX	5/1/15	U.S. Fund Target-Date 2025	★★ 710	★★★ 462	★★ 420	(459/710)
Great-West Moderately Cnsrv Profile Instl	MXJUX	5/1/15	U.S. Fund Target-Date 2030	★★★ 503	★★★ 172	★★★ 157	(127/503)
Great-West Conservative Profile Instl	MXKVX	5/1/15	U.S. Fund Target-Date 2035	★★★★ 193	★★★★ 40	★★★★ 32	(36/193)

Fund performance as of December 31, 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	19.82	19.48	13.17	10.84
Great-West Moderately Agg Profile Instl	MXHRX	5/1/15	0.66	0.69	14.64	15.76	10.75	8.90
Great-West Moderate Profile Instl	MXITX	5/1/15	0.57	0.63	12.15	13.89	9.51	7.90
Great-West Moderately Cnsrv Profile Instl	MXJUX	5/1/15	0.48	0.56	9.48	11.41	7.88	6.60
Great-West Conservative Profile Instl	MXKVX	5/1/15	0.43	0.51	6.64	9.03	6.30	5.33

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1 The definition of what constitutes a bull and bear market is a subject for debate, but by my math, it took about 22 days for the S&P 500® Index to slip into bear territory and around 75 for it to regain bull status. That's almost unbelievably fast.

2 The net expense ratio reflects contractual fee waivers or reimbursements that expire on April 30, 2022, unless re approved by the adviser. Absent waivers or reimbursements, the performance would have been lower.

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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