Great-West Lifetime 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 Lifetime 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 Lifetime 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 encouraging to us that the third quarter's underperformance was relatively modest. Given that our stylistic tilts are more prominent in the underlying composition of our equity allocations than they are in fixed income, it's not surprising those shortfalls become even less pronounced as you move from the longer-dated vintages where equity exposure comprises the bulk of fund assets (i.e., Great-West Lifetime 2055 and 2060 Funds) to the shorter-dated vintages (i.e., the 2015 and 2020 funds), where fixed income is emphasized. The same was generally true with respect to performance relative to our peers: Performance for near-dated vintages — those funds generally held by investors at (or nearer to) retirement — held up better than those more aggressively positioned vintages with more runway remaining until retirement.

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.

Elsewhere, our exposure to non-U.S. real estate also lagged. Real estate in general has been one of the more controversial sectors of the market during the COVID-19 pandemic as investors try to reason out the longer-term implications of things like accelerating rents and prices, urban out-migration, and the durability of the work-from-home trend on property owners. Third quarter, that pressure was even more intense outside the U.S., with domestic (U.S.) property markets generally outperforming those that focus exclusively on international (non-U.S.) markets. That allowed our U.S.-focused real estate holdings to perform generally up to expectations, but it also caused the peer rankings of one of our holdings in the space — DFA International Real Estate — to suffer given its exclusive focus on non-U.S. properties. That places the fund at a disadvantage to other managers in the sector who combine both foreign and domestic properties in their portfolios when international markets are more volatile. We've discussed this quirk in past commentaries and remain comfortable with — and even prefer — the fund's approach given the clear and unambiguous exposure it provides to property markets outside the United States.

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 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 the 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.

In terms of changes to the Lifetime Funds, we recently completed the annual glide path update, acting in concert with our GWCM Asset Allocation Committee and Morningstar Investment Management, who act as advisors to the funds. As mentioned, we believe it is nearly impossible to be successful by responding to market events in the short term and have remained true to that philosophy by implementing primarily only those changes necessary to de-risk the funds in line with their strategic objectives as their retirement dates near. Other changes were small and limited to sub-asset class allocations in areas where long-term capital market assumptions, developed with 10- and 20-year time horizons, have changed sufficiently to warrant adjustment. This year, these changes included small decreases in inflation-linked bonds (Treasury inflation-protected securities (TIPS)) and high yield in favor of intermediate-term bonds as well as a small decrease in emerging market equities in favor of international developed market equities. We also made slight downward adjustments to the size of the value overweight in U.S. large- and mid-cap equities while leaving intact the value exposure to small caps. None of these changes are significant enough to materially change the expense profile or directionally alter the underlying risk and return characteristics of the funds.

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 fund 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 Lifetime 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	RATING/ TOTAL # OF FUNDS 3-YEAR	RATING/ TOTAL # OF FUNDS 5-YEAR	RANK/[1] # OF FUNDS 1-YEAR
Great-West Lifetime 2015 Instl	MXNYX	5/1/15	U.S. Fund Target-Date 2015	★★★ 116	★★★ 110	★★★ 76	(21/116)
Great-West Lifetime 2020 Instl	MXAKX	4/28/16	U.S. Fund Target-Date 2020	★★★ 174	★★★ 161	★★★ 122	(40/174)
Great-West Lifetime 2025 Instl	MXQBX	5/1/15	U.S. Fund Target-Date 2025	★★★ 222	★★★ 204	★★★ 163	(51/222)
Great-West Lifetime 2030 Instl	MXAYX	4/28/16	U.S. Fund Target-Date 2030	★★★ 223	★★★ 203	★★★ 163	(56/223)
Great-West Lifetime 2035 Instl	MXTBX	5/1/15	U.S. Fund Target-Date 2035	★★★ 215	★★ 201	★★★ 160	(62/215)
Great-West Lifetime 2040 Instl	MXBGX	4/28/16	U.S. Fund Target-Date 2040	★★★ 217	★★ 203	★★★ 163	(57/217)
Great-West Lifetime 2045 Instl	MXWEX	5/1/15	U.S. Fund Target-Date 2045	★★ 215	★★ 201	★★ 160	(57/215)
Great-West Lifetime 2050 Instl	MXBSX	4/28/16	U.S. Fund Target-Date 2050	★★ 217	★★ 203	★★ 163	(40/217)
Great-West Lifetime 2055 Instl	MXZHX	5/1/15	U.S. Fund Target-Date 2055	★★ 215	★★ 201	★★ 157	(57/215)
Great-West Lifetime 2060 Instl	MXGUX	5/1/19	U.S. Fund Target-Date 2060+	N/A 210	N/A 187	N/A 124	(60/210)

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 Lifetime 2015 Instl	MXNYX	5/1/15	0.45	0.49	27.13	8.20	8.21	6.65
Great-West Lifetime 2020 Instl	MXAKX	4/28/16	0.48	0.51	29.77	8.57	N/A	8.73
Great-West Lifetime 2025 Instl	MXQBX	5/1/15	0.50	0.52	33.90	9.24	9.66	7.65
Great-West Lifetime 2030 Instl	MXAYX	4/28/16	0.52	0.54	39.05	9.80	N/A	10.51
Great-West Lifetime 2035 Instl	MXTBX	5/1/15	0.55	0.56	45.61	10.59	11.57	9.02
Great-West Lifetime 2040 Instl	MXBGX	4/28/16	0.56	0.57	50.97	11.06	N/A	12.13
Great-West Lifetime 2045 Instl	MXWEX	5/1/15	0.57	0.58	54.54	11.36	12.51	9.72
Great-West Lifetime 2050 Instl	MXBSX	4/28/16	0.57	0.58	55.57	11.33	N/A	12.58
Great-West Lifetime 2060 Instl	MXGUX	5/1/19	0.59	0.60	55.94	N/A	N/A	15.52

The date in the name of the target date fund is the assumed date of retirement. The asset allocation becomes more conservative as the fund nears the target retirement date; however, the principal value of the fund is never guaranteed.

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.

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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Morningstar Percentile Rankings are based on the fund's actual rank within its category, total return and the number of funds in that category. The returns assume reinvestment of dividends and/or capital gains, do not include any applicable sales charges or redemption fees, but include 12b-1 fees. Rankings for each share class will vary due to different expenses. The highest (or most favorable) percentile rank is 1, and the lowest (or least favorable) percentile rank is 100. Had sales charges or redemption fees been included, total returns would be lower.

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