CIO View

Monthly Strategy Snapshot

June 2021

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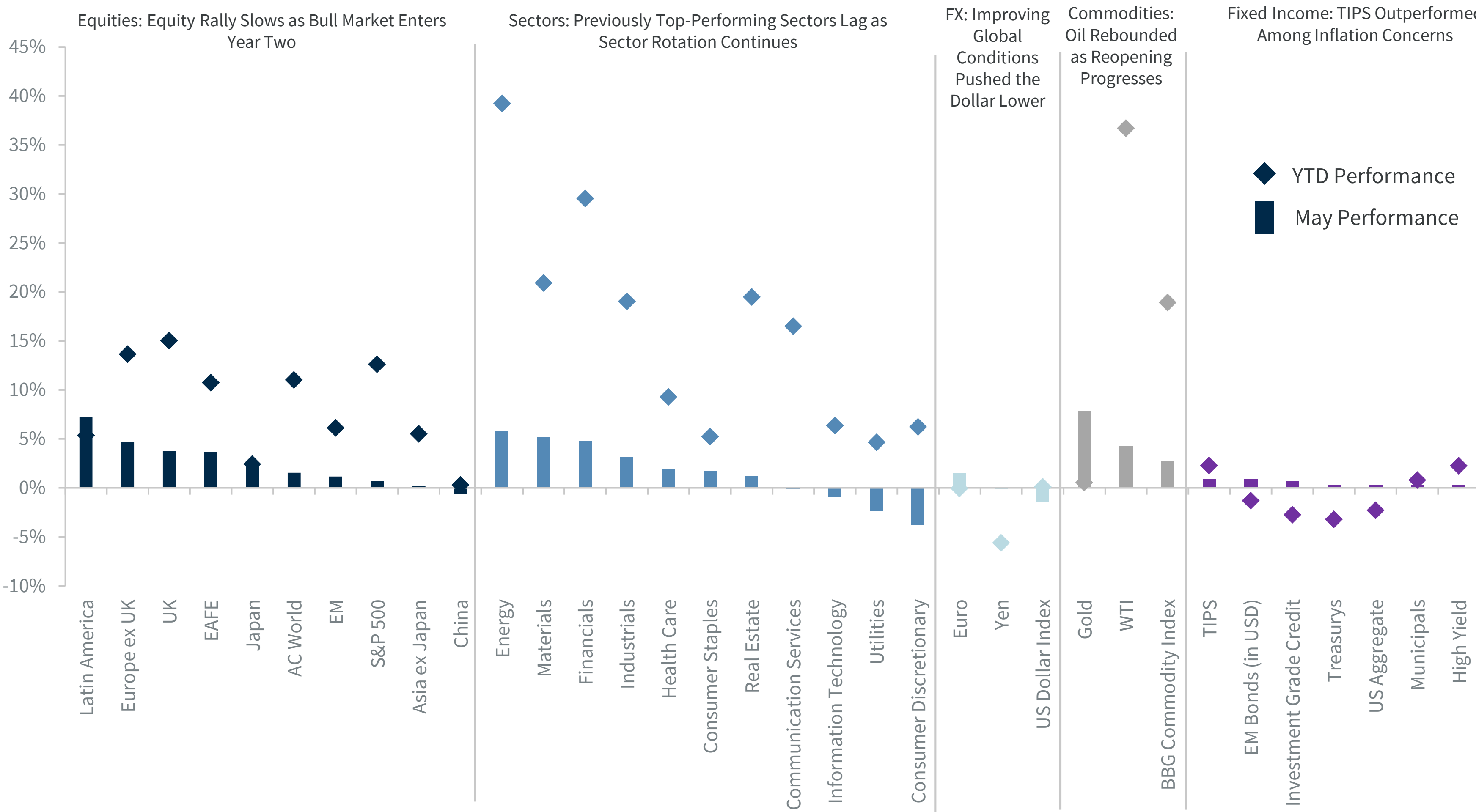
Chief Investment Officer

Returns By Asset Class | Month and Year-to-Date Returns

Returns by Asset Class



Data as of May 31, 2021. All international equity indices are MSCI indices and in USD. Diamonds represent the year-to-date total returns and bars represent monthly returns.

Global Economy | Inflation Concerns Worry Consumers

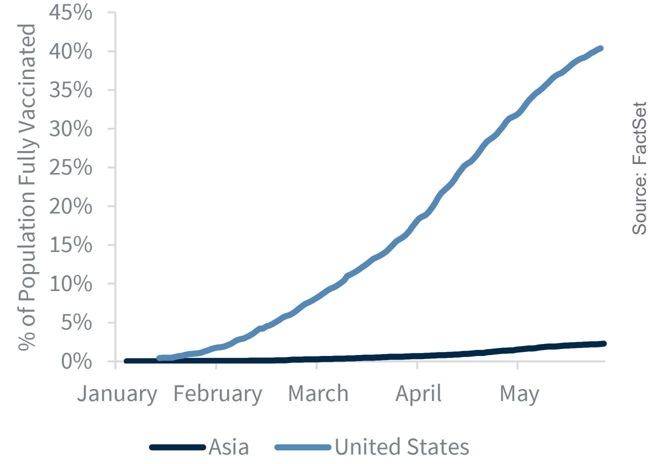
Global Economy | Recent Trends

- The COVID pandemic is improving dramatically in the US **with daily new cases down ~95% from their peak** in January of this year. Globally, although daily new cases **have declined ~58%** from their peak at the end of April, conditions vary greatly across regions. Currently Southeast Asia is experiencing a **record level of cases due to low vaccination rates** within the region.
- April's CPI report sparked concern in the market as the index **rose 0.8% for the month and 4.2% year-over-year**. However, this increase was largely due to base effects (a rebound in prices that were depressed during last year's lockdowns) and re-start pressures (supply chain bottlenecks and materials shortages). The Fed reaffirmed its belief that **higher inflation should be temporary**, but indicated that if inflation increases significantly, it has the tools to bring it down.
- A $928 billion counteroffer by Republicans to President Biden's $1.7 trillion revised infrastructure proposal **raises the overall floor of the likely final infrastructure package**, and moves us closer to a final package with around $1 trillion in deficit spending. We continue to believe that an infrastructure bill **in the $2-3 trillion range will advance** without Republican support.
- Leading Economic Indicators **rose 1.6% to an all time high in April**, with the recent drop in jobless claims accounting for half of the increase. Initial claims reached 406,000 – **another pandemic low – though still well above the pre-pandemic levels** (~220,000 in February of 2020).
- Consumer Confidence was little changed in May (117.2 v 117.5 in April). Evaluations of current job conditions **improved back to pre-pandemic levels**, but optimism about the next six months fell.

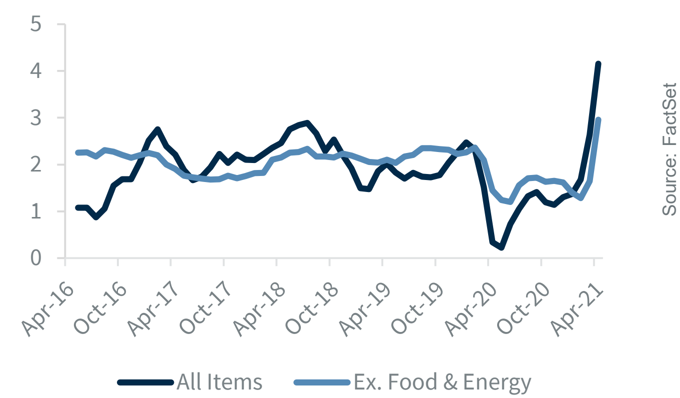
Global Economy | 2021 Outlook

- **Global economic momentum is likely to continue in 2021** as most G20 countries are likely to experience between 3% and 9% GDP growth for the year as social distancing measures wane and economies return to more normal activity. Similarly, **we expect US GDP to grow at ~5.8% in 2021**, as recovering mobility metrics combined with a sharp uptick in consumer spending and fixed corporate investment should drive US economic growth. While sweeping lockdowns as seen in the spring of last year are unlikely to return, COVID remains a key risk as several countries around the world continue to impose localized shutdowns in response to the recent case surge.
- Over the medium to longer term, continued **aggressive actions from policymakers (both from a fiscal and monetary perspective) will remain supportive of economic growth**. Globally, central bank balance sheets are increasing while governments continue to pursue additional fiscal stimulus. The Fed will likely continue the current pace of quantitative easing through 2021.
- As vaccines become more widely available, **we expect spending on services to increase after the COVID-related decline in 2020.** As services make up ~66% of total US consumer spending, the increase will be a boost to economic growth going forward.

US COVID Improvements Due to Higher Rate of Vaccinations



April CPI Report Sparks Inflation Concern



Equities | Returns Slow as Bull Market Ages

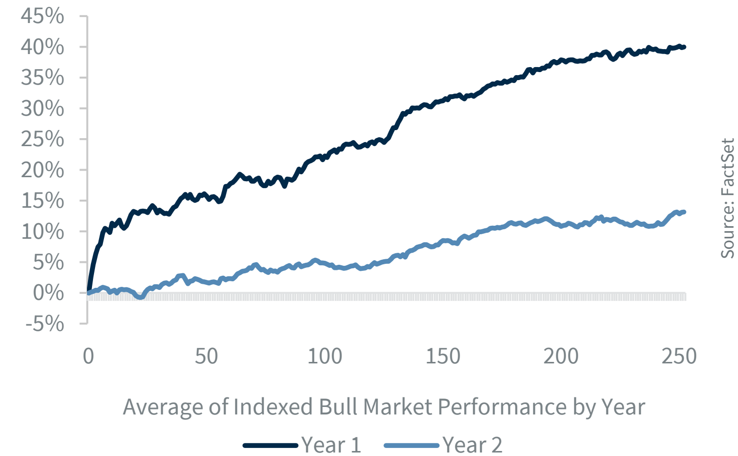
Global Equities | Recent Trends

- S&P 500 performance in May, **while still positive, was less robust than prior months** (0.7% vs. 5.2% in April). It is common for the rate of market ascent to slow in year two of a bull market and the recent fear of inflation following the April CPI report (**4.2% increase year-over-year**) could be the catalyst for a moderation in the market's pace of ascent. However, **the intermediate-term fundamental and technical backdrops remain strong**.
- We continue to recommend a pro-cyclical approach to portfolios with new money slanted **to the 'recovery' areas** (Consumer Discretionary, Industrials, Financials) while sticking with those that have **operated well in the stay-at-home environment** (Comm. Services).
- We are constructive on small caps, as they have **outperformed large caps by 3% YTD** and have **much higher growth prospects** (69% YoY growth for small cap vs. ~35% for large).
- **Value has outperformed growth by ~10%** since the beginning of the year as the economic recovery escalates sector rotation. In May, **value sectors were the top performers**, with Energy returning 5.7% and Financials returning 4.7% for the month.
- We **continue to favor US equities** as the pace of the vaccine rollout has led to improved COVID conditions compared to other areas of the world. **While we still favor EM over developed international, we recommend selectivity**, as China, the largest component of the emerging market index, remains weak – down ~15% from its highs in February.

Global Equities | 12-Month Outlook

- While stretched technicals may lead to periods of elevated volatility, **we believe that equities will be higher over the next 12 months on the back of rebounding economic and earnings growth.** However, investors need to dial back their return expectations, as strong EPS growth ($190 2021 S&P 500 earnings forecast) will likely be partially offset by P/E multiple compression. Our year-end 2021 **S&P 500 price target is 4,180.**
- We remain biased to select cyclical sectors that should benefit from improving economic growth and stronger earnings growth. We favor **Energy, Comm. Services, Financials, Consumer Discretionary, and Industrials—**sectors that can benefit from additional fiscal stimulus, rising confidence and the economic reopening.
- **We favor large cap relative to small cap in the near term** as it has a larger allocation to our favorite sectors. We suggest investors be more tactical within small-cap industries as select industry valuations are elevated within the space.
- **We remain constructive longer term on global equities,** especially EM, due to the expected rebound in global economic growth, but prefer the US over other developed markets due to favorable sector exposure and more resilient economic growth.

Bull Market Typically Slows in Year Two



Sector Rotation Boosts Value Sectors

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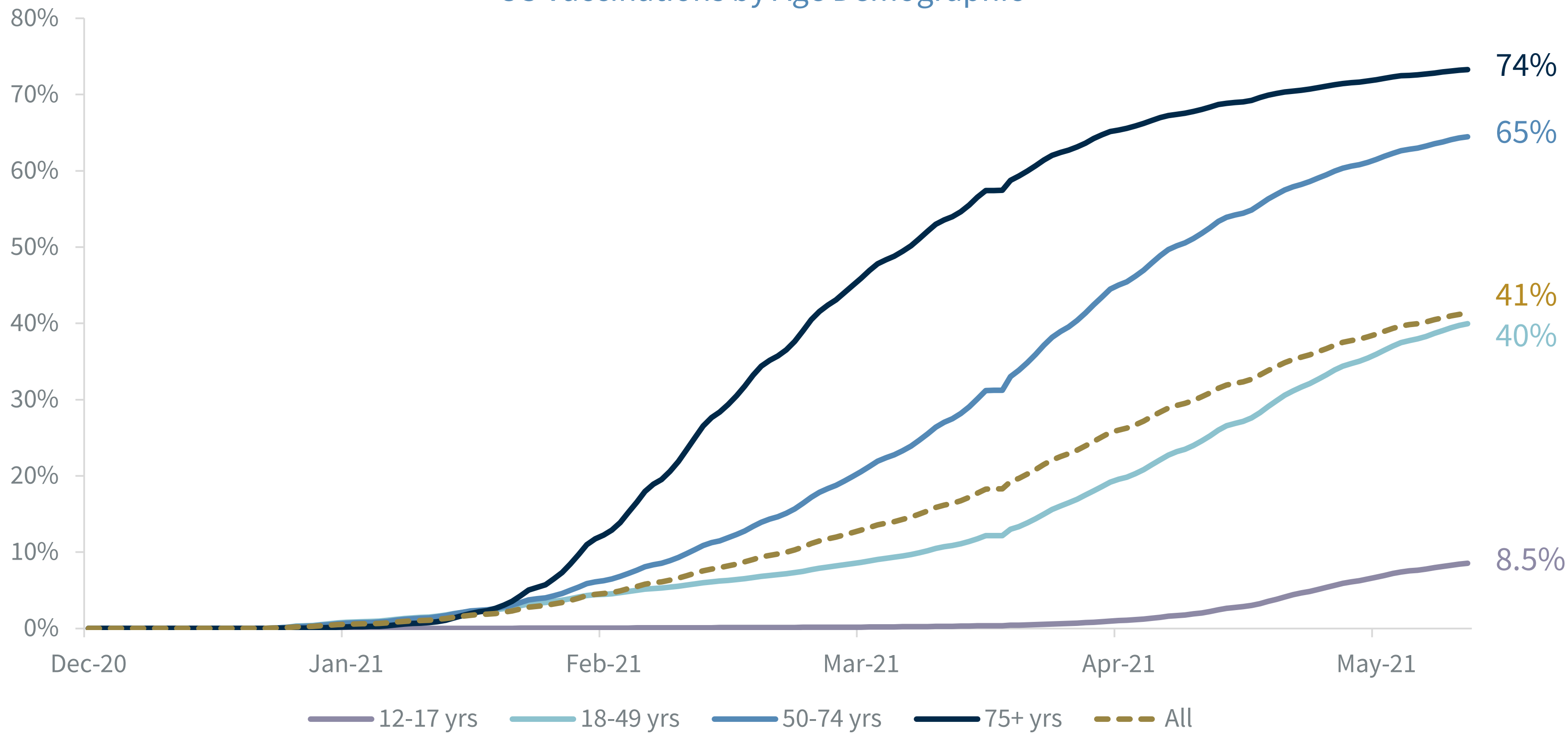
Vaccines | US Vaccine Demographics

VACCINE RACE AGAINST TIME

- While ~41% of the US population is fully vaccinated, the older, more vulnerable populations have a higher rate of vaccination (~73% for those aged 75+), thereby reducing the number of resultant hospitalizations and deaths.

US Vaccinations by Age Demographic*



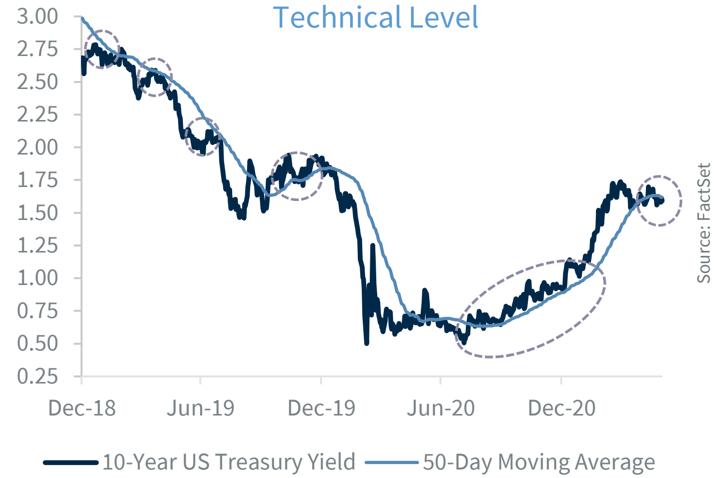
Source: FactSet as of 5/31/2021 *Percentage of population fully vaccinated

Fixed Income | Treasury Yields Ease

Global Bonds | Recent Trends

- While the 10-year Treasury yield remains up ~110 bps off of the August lows on the back of improving US economic activity, rising inflation and tightening labor markets, the rise in the **10-year Treasury yield cooled further in May and posted its second consecutive monthly decline (-5 bps to 1.58%).** The 10-year yield is now 10 bps off of recent highs.
- **Treasury yields moved lower as falling real yields offset the continued rise in inflation breakeven rates** (10-year breakeven rate at an eight-year high). Ultimately, we expect real yields to move higher from current levels as US economic activity continues to strengthen and as we move closer to the Fed tapering asset purchases (likely later this year).
- **The rise in inflation expectations has boosted TIPS**, as TIPS have outperformed nominal Treasurys for 13 out of the last 14 months and by ~1100 bps over the last 12 months.
- The risk asset rally and improving economic activity continue to support credit-related assets, **as spreads in investment grade and emerging market bonds fell to multi-year lows.** High-yield spreads rose modestly but remained near the lowest level since 2007.
- As President Biden is pushing for an increase in taxes on the wealthy, **municipal bonds continued to rally** as muni spreads (relative to Treasurys) fell to the lowest level since 2007.

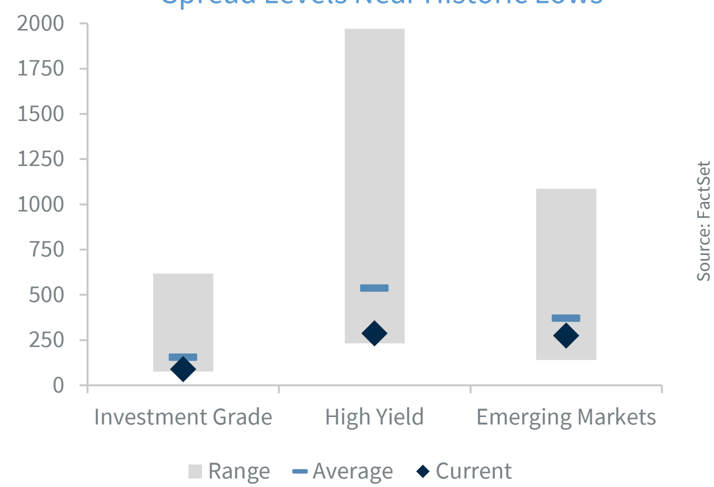
10-Year Treasury Yield Breaks Key Technical Level



Global Bonds | 12-Month Outlook

- As the market is pricing in continued economic recovery through 2021 and the potential for additional fiscal spending in an infrastructure package, **we forecast the 10-year Treasury yield to end 2021 at ~2.0%**. However, **we anticipate the rise in yields to be limited** due to transitory inflation, continued buying from global central banks, increased demand from foreign investors, and the overall interest rate sensitivity of the economy.
- While our forecasted rise in yields will likely lead to **limited, if any, capital appreciation for bonds in 2021**, **fixed income remains an important piece within investors' portfolios** as it limits/hedges equity market risk and provides increased diversification.
- Given our expectation for a modest rise in longer-duration interest rates while the Fed is set to leave policy rates unchanged for the foreseeable future (keeping shorter-term rates low), **we suggest a shorter than benchmark duration for bond portfolios.**
- From a credit perspective, while spreads have narrowed dramatically from their post-crisis highs, **we expect them to continue to tighten** in 2021. We would favor holding higher-quality bonds and therefore **favor investment grade over high-yield bonds**. In general, we would **prefer to add additional risk in the equity market over high yield** as we believe investors are better compensated for taking on risk in the equity market.

Spread Levels Near Historic Lows



Commodities & Currencies | Commodity Rally Regains Strength

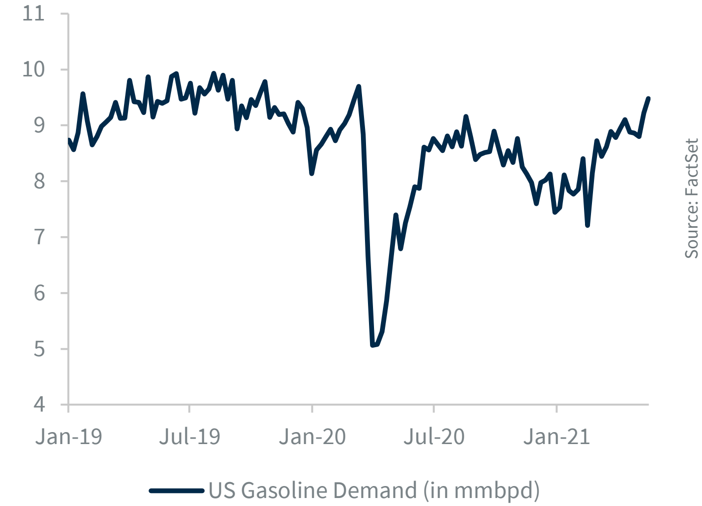
Commodities & Currencies | Recent Trends

- The commodity rally continued in May as **the Bloomberg Commodity Index rallied for the seventh time in the last eight months.** Commodities rose on improving economic activity (particularly in the US), rising vaccine inoculations, supply constraints and a weakening dollar. Commodities are now up 46% over the last 12 months.
- Similar to broad commodities, the crude oil rally continued in May as **crude oil rallied for the seventh time in the last eight months**. Despite OPEC and Russia agreeing to a modest crude oil production hike, crude oil rallied on increased global demand (including both gasoline and jet fuel), accelerating economic activity and rising COVID vaccine inoculations.
- Consistent with global risk-on sentiment, **the US dollar declined for the second straight month**. Pressuring the dollar lower was improving COVID inoculations in the rest of the world (particularly Europe), as this led to stronger global economic activity. Also hampering the dollar was narrowing US interest rate differentials relative to other parts of the world.
- On the back of declining real interest rates, a weaker US dollar and dovish messaging from the Fed, **gold continued to shine and rallied for the second consecutive month in May.**
- Due to improving global demand and supply chain disruptions, **industrial metals (3.8% MoM) strongly rallied in May.** As a result, Copper surged to a 10-year high.

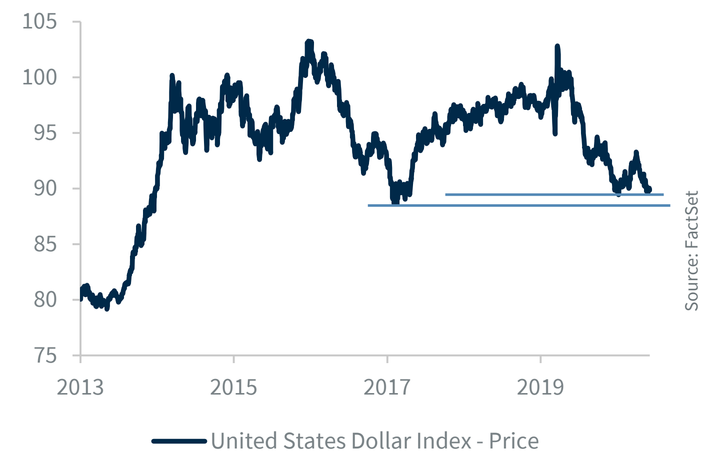
Commodities & Currencies | 12-Month Outlook

- As US economic activity recovers following the continued roll out of vaccines and reopening of the economy, **crude oil prices will remain strong over the next 12 months (year-end 2021 WTI target: $75/barrel) due to improving global demand.**
- However longer term, as the price of crude oil is above current breakeven levels for US producers (thereby incentivizing more capital investment), **rising US crude oil production as well as increasing OPEC production will likely limit a substantial further rise in prices.**
- While the US dollar has improved over recent months, **we expect the dollar to weaken over the next 12 months**. Pressuring the dollar lower will be fundamental factors, as improving global economic activity and falling global economic policy uncertainty (due to the counter-cyclical nature of the USD) will likely reduce demand for the dollar. Additionally, **aggressive US fiscal and Fed monetary policy easing**, leading to rapid money supply growth and widening fiscal deficits will also likely lead to a weaker dollar.
- While gold has been a solid hedge for investors throughout the COVID-crisis, **the demand for gold will likely continue to wane** as US economic activity improves in 2021 and 2022 and on the expectation that real interest rates will move modestly higher from current levels.

Gasoline Demand Increases



USD Nearing Key Technical Levels



Summary | Views and Key 2021 Year-End Targets

1 ECONOMY

2021 US GDP: ~5.8%

Faster than expected vaccinations, combined with additional fiscal stimulus continue to boost economic activity and upward growth revisions. The economic rebound is likely to continue over the next 12 months especially if policymakers continue to exhibit an accommodative approach to policy.

2 BOND MARKET

2021 10-Year Treasury: ~2.00%

We forecast that the 10-year Treasury yield will be ~2.00% by year-end 2021, supported by improving economic activity and continued fiscal stimulus. As we prefer higher-quality bonds, we prefer investment grade over high yield. Bond exposure should be viewed as a portfolio diversifier in mitigating the overall risk of a balanced portfolio and help in providing some stable income generation.

3 EQUITIES

2021 S&P 500: 4,180

Our expectation for a rebound in 2021 economic activity and stimulus from the Fed and Congress should support equities. In contrast to recent years, we expect positive returns to be driven by EPS growth rather than P/E expansion. Use pullbacks as buying opportunities within our favorite sectors (Financials, Communication Services, Industrials, Consumer Discretionary and energy).

4 DOLLAR DIRECTION

2021 EUR/USD: 1.25

Our expectation is that aggressive fiscal and monetary policy and a burgeoning budget deficit may cause the dollar to modestly weaken throughout 2021. Separately, the easing of trade restrictions from the Biden presidential administration may weaken the dollar relative to other currencies. However, the potential for near-term volatility in riskier assets is likely to support the dollar.

5 OIL

2021 WTI: $75/bbl

Over the next 12 months, crude oil will be supported by the reduction in social distancing measures, increasing economic activity in 2021 and thereby improving demand. However, as prices rise above breakeven levels to a point that incentivizes US oil producers and OPEC similarly raises production levels, the rise in oil prices will likely be limited by increased supply.

6 ELEVATED VOLATILITY

Volatility: ↓

After a year of unpredictable events (e.g., COVID crisis, 2020 election) we expect the overall level of volatility to decrease in 2021 due to the continued roll out of vaccines, a more stable political environment in the US, improving global economic activity, still accommodative global central banks, and easing trade rhetoric (particularly between the US and Europe).

DISCLOSURES

Diversification does not ensure a profit or guarantee against a loss

INTERNATIONAL INVESTING | International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

OIL | Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

CURRENCIES | Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

GOLD | Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

FIXED INCOME | Fixed-income securities (or “bonds”) are exposed to various risks including but not limited to credit (risk of default of principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise.

US TREASURIES | US Treasury securities are guaranteed by the US government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value.

US DOLLAR | The US Dollar Index is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies,[1] often referred to as a basket of U.S. trade partners' currencies.[2] The Index goes up when the US dollar gains "strength" (value) when compared to other currencies.

DEFINITIONS

AGGREGATE BOND | **Bloomberg Barclays US Agg Bond Total Return Index:** The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

HIGH YIELD | **Bloomberg Barclays US Corporate High Yield Total Return Index:** The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below.

CREDIT | **Bloomberg Barclays US Credit Total Return Index:** The index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

MUNICIPAL | **Bloomberg Barclays Municipal Total Return Index:** The index is a measure of the long-term tax-exempt bond market with securities of investment grade (rated at least Baa by Moody’s Investors Service and BBB by Standard and Poor’s). This index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

BBG COMMODITY INDEX | Bloomberg Commodity Index is calculated on an excess return basis and reflects commodity futures price movements.

S&P 500 | The **S&P 500 Total Return Index:** The index is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

EMERGING MARKETS EASTERN EUROPE | **MSCI EM Eastern Europe Net Return Index:** The index captures large- and mid-cap representation across four Emerging Markets (EM) countries in Eastern Europe. With 50 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

ASIA EX JAPAN INDEX | **The MSCI AC Asia ex Japan** Index captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries* (excluding Japan) and 9 Emerging Markets (EM) countries in Asia. With 983 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country.

AC WORLD INDEX | **The MSCI AC World** Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI) and is comprised of stocks from 23 developed countries and 24 emerging markets.

EMERGING MARKETS LATIN AMERICA | **MSCI EM Latin America Net Return Index:** The index captures large- and mid-cap representation across five Emerging Markets (EM) countries in Latin America. With 116 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

EMERGING MARKETS | **MSCI Emerging Markets Net Return Index:** This index consists of 23 countries representing 10% of world market capitalization. The index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 23 countries.

JAPAN | **MSCI Japan Net Return Index:** The index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 319 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

EUROPE EX UK | **MSCI Europe Ex UK Net Return Index:** The index captures large and mid cap representation across 14 Developed Markets (DM) countries in Europe. With 337 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across European Developed Markets excluding the UK.

MSCI EAFE | The **MSCI EAFE** (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

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DATA SOURCES

FactSet as of 5/31/2021.

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