QUARTERLY REPORT

INVESTMENT PERSPECTIVE

31 March 2021

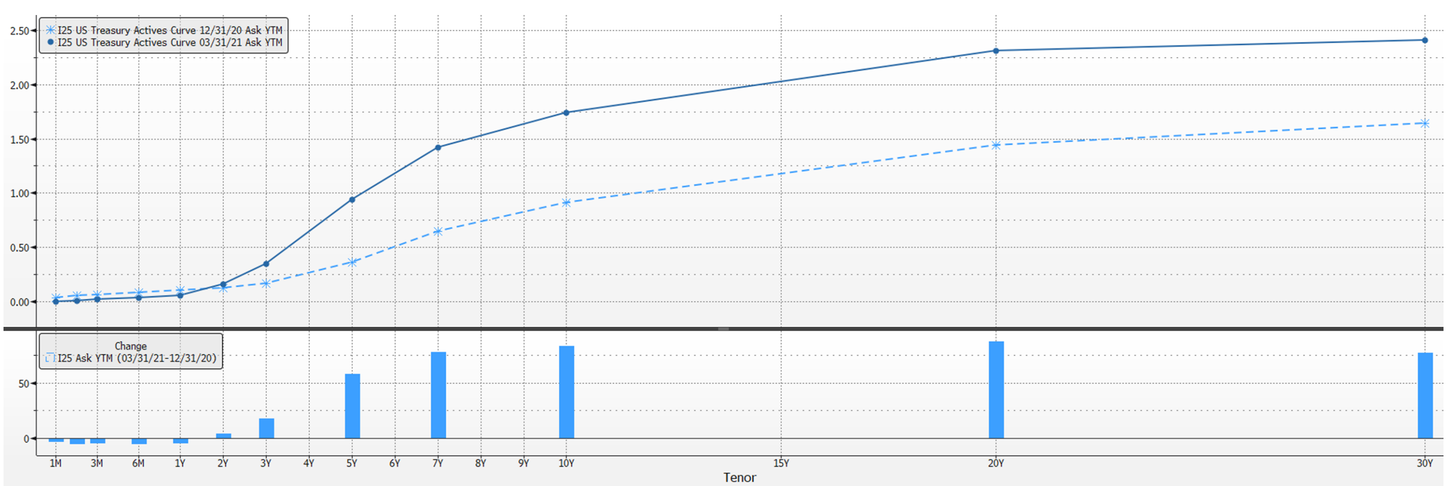
Financial markets continued to recover during the first quarter with the S&P 500 and Russell 2000 Value rising 6.17% and 21.17%, respectively. Continuing the trend from the fourth quarter, the market was led by small caps over large caps and value over growth. Buoyed by a new round of stimulus checks and an accelerated roll out of Covid 19 vaccines, cyclical sectors and securities with high beta and high short interest led the equity market to new all-time highs. Coincident with the equity market rally fixed income markets experienced a significant rise in U.S. Treasury rates. With the short end of the treasury curve anchored near the zero bound, the steepening yield curve served as a powerful rally for the financial sector.

Strength in the housing market has been a key pillar in the economic recovery. Rising interest rates are a medium-term benefit to the financial sector; however, we expect a near term cooling in home price appreciation and residential real estate activity as the housing market adjusts to the swift move higher in mortgage rates. Rapid improvement in employment gains in the services sectors is expected as the economy continues to reopen with the vaccine roll out. Industrial activity has been leading the recovery and, despite its best efforts, has yet to make headway in replenishing inventories to normalized levels. Industrial activity continues to be hampered with component shortages and dysfunctional supply chains. These issues will dampen near-term industrial growth but help extend the recovery into late 2021.

With a combination of fresh fiscal stimulus and continued resumption of economic activity, we will experience very strong real and nominal GDP growth in the second and third quarters of 2021. Once again as fiscal policy fades and the economy fully reopens, the economy should return to its baseline fundamental 1%'ish real growth and low inflation. Our longest leading indicators are already signaling such conditions are potentially developing. Further fiscal stimulus in the form of infrastructure and investment may become necessary to sustain sufficient economic growth beyond 2021.

The Bloomberg Barclays Aggregate Index declined 3.4% during the first quarter. Bonds sold off as the economy reopened with investors anticipating stronger growth and higher inflation. With the Federal Reserve on hold, the front end of the curve was stable while Treasury yields in the 7-year to 30-year area backed up about 80 basis points. For example, the 10-year Treasury yielded 0.91% at the beginning of the year and finished the quarter at 1.74% (Chart 1).

Chart 1
Treasury Yield Curve



Over for conclusion.

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Credit reacted positively to the economic recovery with spreads improving to +86 basis points over Treasury yields from +92 basis points at the beginning of the year. Now that intermediate to long-dated Treasury yields have returned to pre-pandemic levels, we are slightly extending the duration of the portfolio to take advantage of the steeper curve. We remain overweight the Corporate bond sector and continue to focus on A or better credits in the 5 to 10-year area while still maintaining a shorter duration relative to the benchmark.

The ICE BofA AAA-A Municipal Index declined 0.40% in the quarter. The recently proposed Biden infrastructure plan is a positive for municipal bonds as it will likely boost GDP growth and lead to tighter spreads. Further, the proposed corporate tax hike to 28% should increase the demand for municipal bonds from corporate buyers.