Quarterly Economic Update

March 10, 2021

MACROECONOMIC COMMENTARY

Fiscal/Monetary Policy

By Michael McNair

Trillion is the New Billion in Washington

The House recently passed a $1.9 trillion, stage 5, COVID relief bill. The measure now moves to the Senate where it faces several obstacles due to the Democrats' thin majority. Democrats do not have the 60 votes need to pass legislation in the traditional process, therefore, they are using the budget reconciliation process which only requires 51 votes to pass.

The budget reconciliation process has become an increasingly popular path for Presidents to push through major legislation. Reconciliation was used by President Obama to pass a portion of the Affordable Care Act and President Trump to pass his 2017 tax cut.

The budget reconciliation requires Congress to approve a budget with a specific amount earmarked for spending and revenue changes. The Senate then passes legislation related to those spending and revenue changes without the ability for a Senate filibuster. The result is that legislation can pass with 51 votes instead of the traditional 60. The drawback is that the budget reconciliation process can only be fiscal and cannot directly change policy. Therefore, budget reconciliation limits the type of stimulus measures that can be passed. For this reason, the Senate Parliamentarian recently found the $15 minimum wage hike to be out of compliance with reconciliation rules and therefore unable to be passed with 50 votes.

There are several other measures which the Senate Parliamentarian will need to determine if they violate the Byrd Rule (the Senate budget reconciliation rules) including COBRA subsidies, multiemployer pension provisions, the use of discretionary spending in reconciliation, re-routing of $350 billion of state aid to broadband investments, and for-profit education changes. Removal of the discretionary spending measures would cut $800 billion from the package; however, we expect the Parliamentarian to rule in favor of its inclusion.

If, and when, the Senate passes a stage 5 relief bill, the House and Senate Bills will then need to be reconciled. The House must decide to accept the Senate Bill in its entirety or move to a conference. However, any changes made to the Senate Bill in conference must adhere to the Senate reconciliation rules.

Progressive Democrats in the House have threatened to withhold support for the Senate Bill due to the exclusion of the minimum wage hike. Democrats can ill afford the loss of any support since the House Bill only passed by a narrow margin. The goal of these progressive Democrats is to help lower-income Americans; therefore, we do not believe these congressmen and women are willing to be responsible for preventing these same individuals from receiving a trillion dollars of financial assistance. Thus, we expect a nearly $1.9 trillion fiscal package to be passed into law by the end of March.

Phase	Date of Pass.	Amount
Phase 1	3/16/2020	$7.7 billion
Phase 2	3/18/2020	$192 billion
Phase 3	3/27/2020	$1800 billion
Phase 3.5	4/23/2020	$484 billion
Phase 4	12/29/2020	$900 billion
Phase 5	Proposed	$1900 billion
Total		5.3 trillion

The stage 5 bill could be the biggest of the 6 COVID relief bills and take the total federal relief legislative to over $5 trillion in less than a year.
Below is a breakdown of the major components of the proposed stage 5 Bill. Note that the lion's share of spending is going to transfer payments to individuals and local governments.

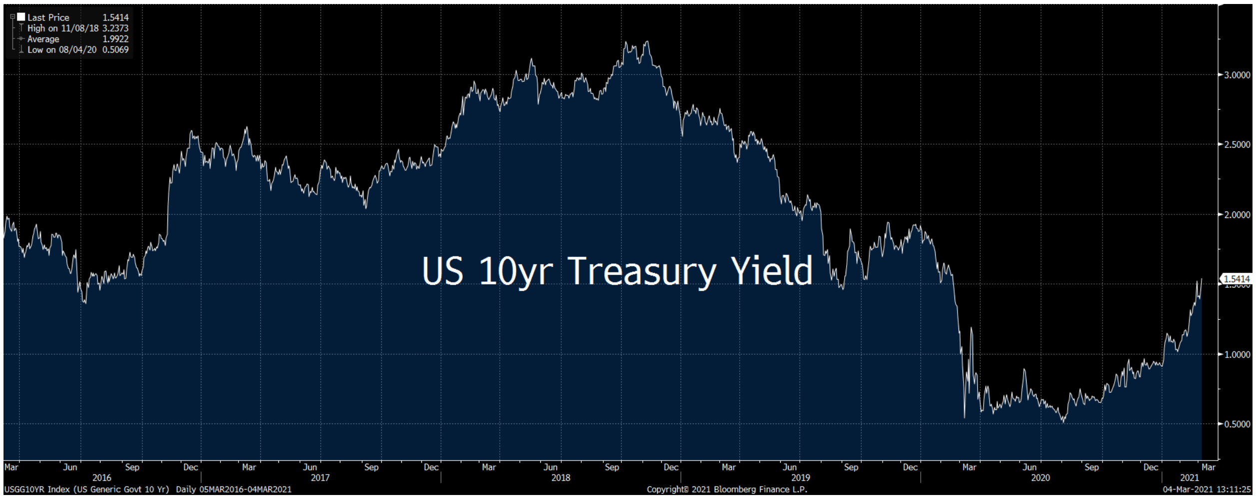
1. $1400 direct payments (mid-March). This would be the 3rd round of direct checks ($1200 in March & $600 in Dec).
2. Monthly payments to families with children (starting in July). IRS to provide $3,600 per child under the age of 6, as well as $3,000 per child of ages 6-17 (individuals under $75K & joint filers under $150K). Payments are sent monthly beginning in July to give enough time to create the program. Currently, Child Tax Credit provides up to $2,000 per child under the age of 17, & not paid in monthly installments.
3. Unemployment insurance (increases $300 supplemental to $400 and extends to Aug 29). Increases weekly supplemental that was re-added in Dec & extends the pandemic unemployment programs through Aug.
4. Increases PPP's lending authority by $7.25B to $813.7B
5. $350B state/local aid
6. $30B in emergency rental assistance
7. $20B to create a national vaccination program; $50B for virus testing
8. $25B for a Restaurant Revitalization Fund administered by SBA
9. $15B in airline industry assistance, extending the Payroll Support Program for airline workers and related contract workers through Sept 30, 2021
10. ACA Tax Credits, Medicaid & COBRA enhancements

Build Back Better Plan

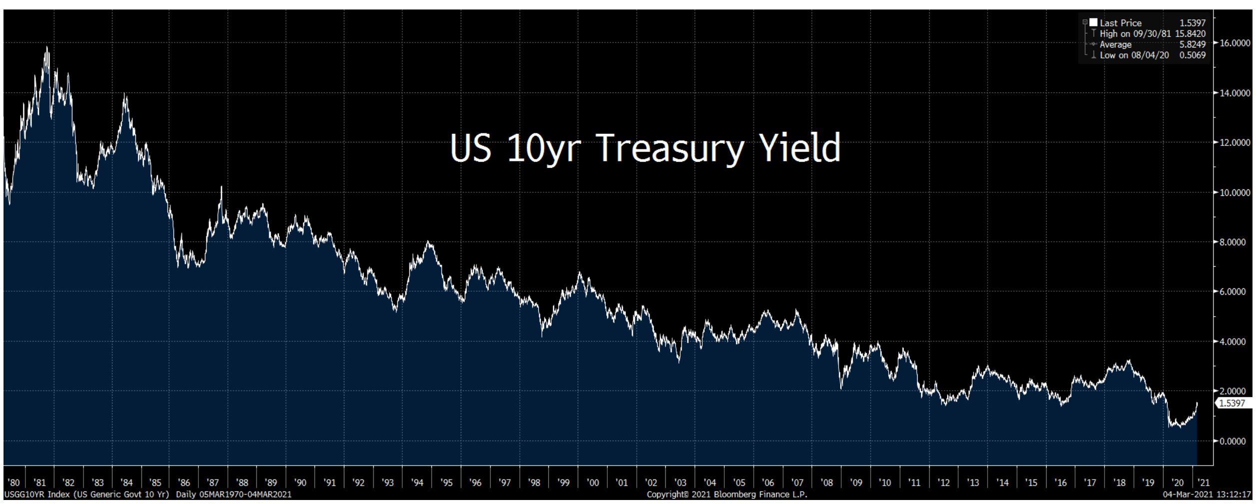
The stage 5 COVID relief package is just the first part of the Democrats' fiscal initiatives. Once the stage 5 package is passed attention will turn to the $2.7 - $4 trillion Build Back Better Plan, focused on infrastructure and climate spending. The BBBP is expected to be the focus of President Biden's State of the Union, which will be held at the end of March at the earliest.
We expect Democrats to once again use the budget reconciliation process to pass this legislation. However, getting the BBBP through Congress will be more difficult than the stage 5 COVID relief package due to the need for Congress to pay for more

infrastructure spending through tax increases. This may lead to a smaller and shorter package than what is being proposed.

The size of the fiscal response has been unprecedented outside of wartime. Expectations for large fiscal spending have helped drive the recent increase in US treasury yields. Rising yields are an expected occurrence as these fiscal programs will be highly reflationary.



However, it is important to keep the recent rise in yields in context with the bigger picture.



The Treasury Cash Balance (or the Treasury General Account at the Fed, or TGA)

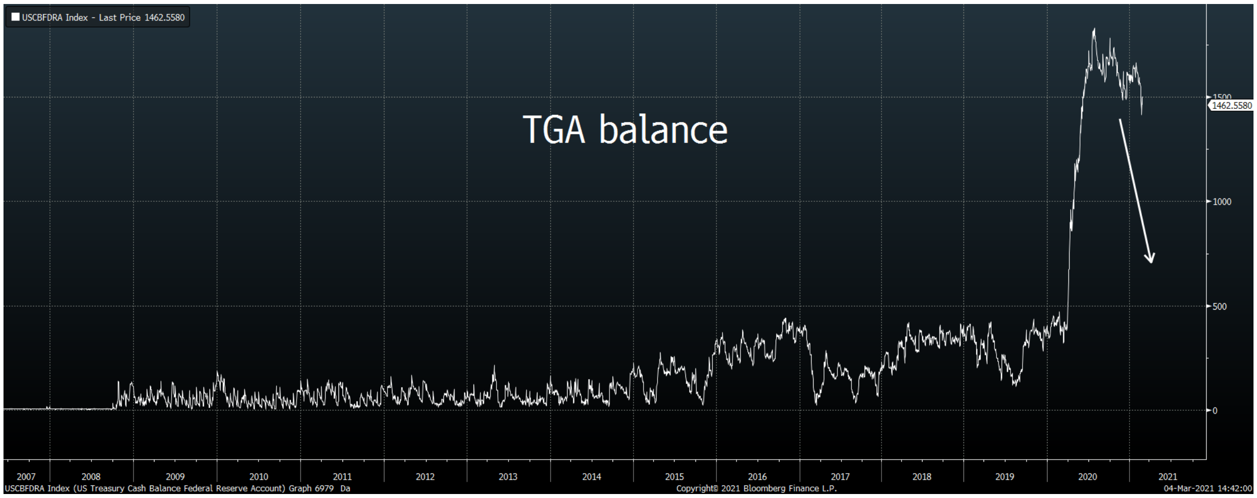
Since 2000 there have been two periods when the Treasury was within weeks of running out of cash because the closure of the debt markets prevented the issuance of treasury securities (after 9/11 and Katrina). However, the biggest liquidity risk came in the form of the political circus that was the debt ceiling showdowns. Congress would pass the budget which created the need to borrow, then threatened to unnecessarily force the United States into default by not allowing the Treasury to issue the debt needed to pay for the agreed-upon spending. So, in August of 2015, the Treasury Borrowing Advisory Committee set new guidelines for the TGA to provide a liquidity buffer for the Treasury. TBAC set a target for a cash balance, at that time around $350 billion, proportional to the size of the deficit and the perceived risks around hitting government spending and revenue targets. Under the guidelines the funds can only be used as 1) a contingency for natural disasters, 2) when Treasury funding markets may be temporarily closed, and 3) ahead of reaching a debt ceiling limit, to prevent the unnecessary furlough of government employees.

Up until last year, the swings in the balance largely reflected debt ceiling dynamics. If Congress failed to ratify a debt ceiling raise, the Treasury would draw down its balance to keep the government open as long as possible. Once the debt ceiling was raised, the Treasury would rebuild its balance. The TGA balance should have stabilized after the House passed the Gephardt amendment in 2019, which automatically raised the debt ceiling to fund any future spending bill. However, the pandemic took over for the debt ceiling and caused the largest fluctuation in the TGA balance to date.

The TGA is important because it has an outsized effect on financial conditions. The TGA balance increases when the Treasury issues more debt than they deficit spend. Critically, the TGA cash sits at the New York Fed and not in the commercial banking system where it could be lent out. When the balances are building It is the functional equivalent of stuffing cash under the mattress - it sucks money from the financial system - but adds to liquidity when the balance is being drawn down.

In 2020 concerns over debt market closure and the increased size and unpredictability of government revenues and spending caused the Treasury to issue $4.8 trillion of debt, but only did $3.5 trillion of deficit spending, leading to a $1.3 trillion increase in the TGA. The only reason TGA buildup did not tighten financial market liquidity is that the Fed was running an even larger QE program at the time.

Last month we received one of the most important announcements of the year when TBAC confirmed that the Treasury intends to draw down its cash balance at the Fed from $1.65 trillion to $800 billion by the end of March and $500bn by mid-year. This means that over a five-month period the Treasury will deficit spend over $1.1 trillion more than is issued in debt (which soaks up liquidity).



The TGA drawdown is a highly reflationary event – to go along with the highly reflationary fiscal stimulus - and it is unlikely to be a mere coincidence that the breakdown in performance of growth stocks relative to value stocks has occurred in lockstep with the drawdown of the TGA.

TGA balance (white); Growth vs Value (yellow, i.e. Growth stocks underperforming value when yellow line declining):

Economic Outlook

By Josh Husted

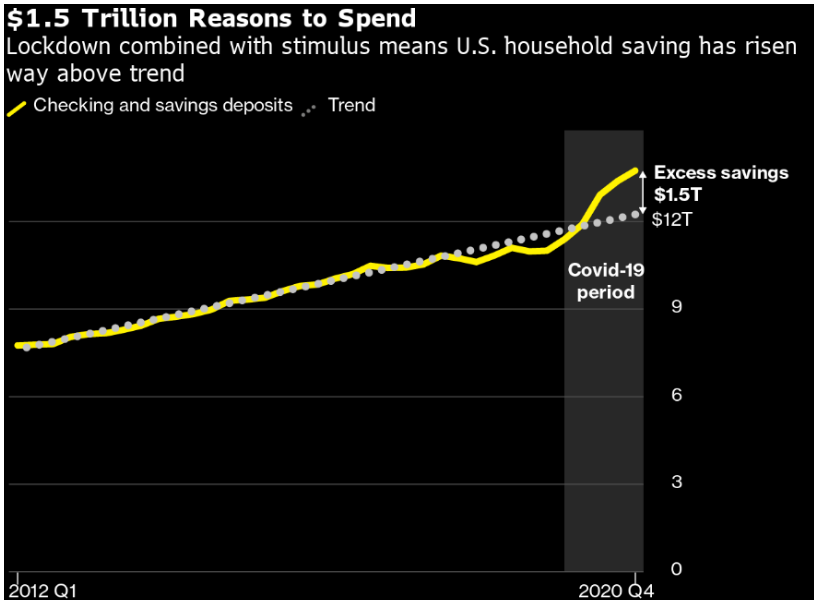
"Forgetting those things which are behind and reaching forward to those things which are ahead, I press toward the goal…" - Apostle Paul, Phil. 3:13-14

As we kick off year 2 of the '20s, one could be forgiven for still struggling to process year 1. Much like a boxer reeling from a round 1 knockdown, it's easy to succumb to the disillusionment of the immediate past. However, markets (and the boxer's opponent) won't wait around for us to catch our breath. Part of our training as analysts includes monitoring and avoiding cognitive biases in our investment process. Recency bias is a cognitive bias that gives "greater importance" to recent events over historic ones. We must analyze the information at hand, formulate a strategy that matches our present reality, and execute upon that. Applying this mindset to the current state of our economy frees us to see opportunities others might miss.

"History Doesn't Repeat Itself, but It Often Rhymes" - Mark Twain

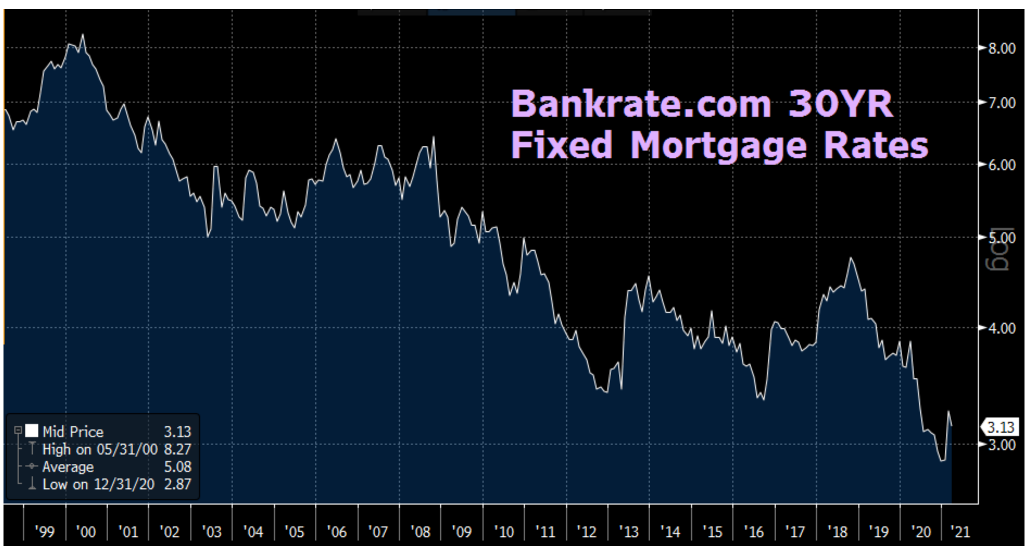
Savings

The backdrop for a repeat of the Roaring 20s looks eerily familiar. As in 1921, America is flush with cash, a global pandemic is in the rear-view mirror, and a deep recession is over. Globally, consumers in the world's largest economies amassed $2.9 **trillion** in excess savings during COVID-19 lockdowns. More than half of that total, $1.9 trillion and growing, is in the US alone. Consensus GDP estimates for '21 sit at 4.6%. If US consumers were to spend their excess savings this year, the ensuing shopping spree would propel economic growth to 9%.



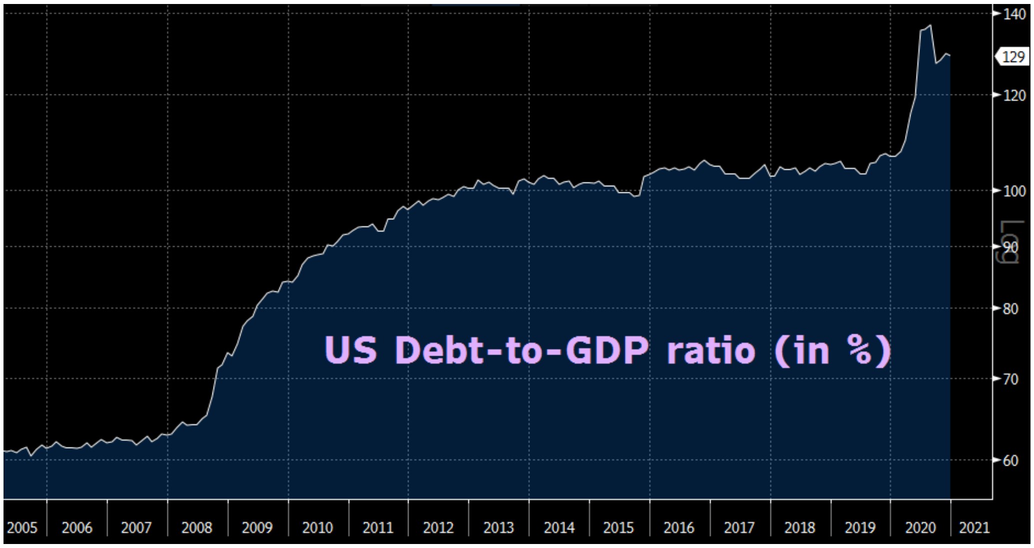
Source: Bloomberg

Interest Rates



Source: Bloomberg

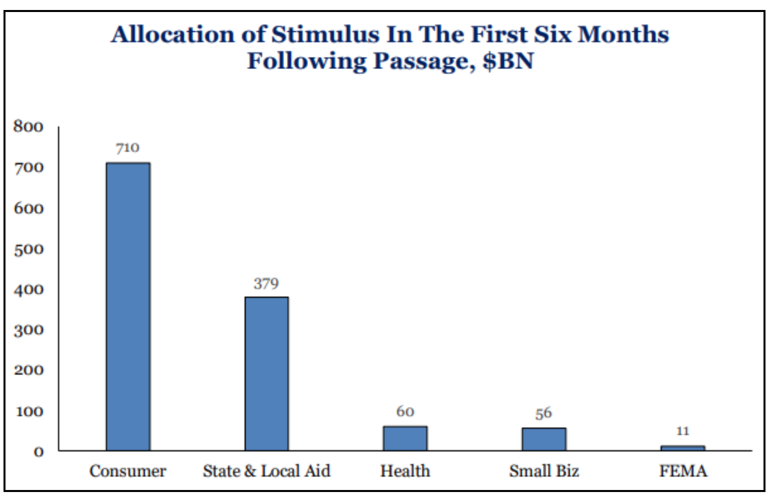
Ultra-low interest rates are a tailwind to the US economy. Consumer spending and capital expenditures are incentivized while saving is disincentivized. With the Fed continuing to backstop credit markets, purchase assets, and lend to the federal government, structurally low interest rates appear to be a defining characteristic of our time. While we will undoubtedly see periods of rising interest rates in the future, the current levels are supportive of continued strength in the consumer spending and business investment components of GDP. While the Fed still claims independence, only a fool would turn a blind eye to the obvious: it's in the Fed's best interest to keep the cost of debt low when its largest debtor's borrowings exceed GDP by 29%!



Source: Bloomberg

Fiscal Policy

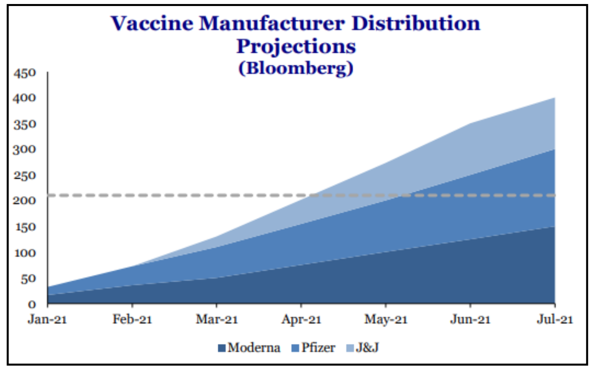
The election of Joe Biden was largely expected, but the prospect of divided government kept a lid on fiscal stimulus estimations. Georgia's shock election that sent two Democrats to the Senate and tipped the balance of power to the left blew that lid completely off. Congress is now talking in multiples of trillions, not billions, and the spigot does not appear to be closing any time soon. We expect to see vast amounts of federal dollars spent on progressive causes, including clean energy, healthcare, state budgets, education, and transfer payments to consumers. Government spending can be a powerful driver of certain sectors of the economy and it is important to monitor where the stimulus ultimately flows.



Source: Strategas

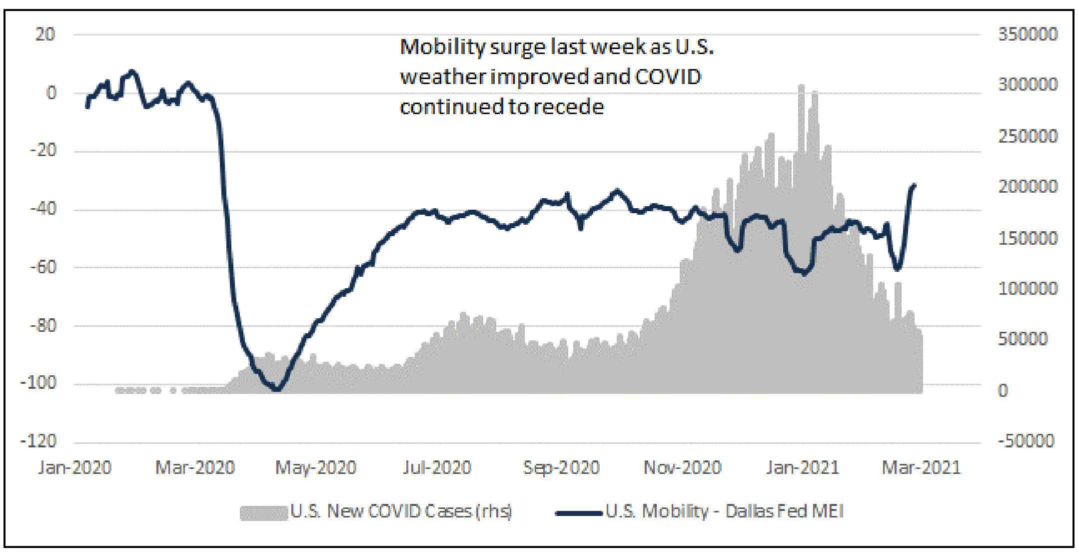
COVID Risk

Typically, citizens and their governmental representatives avail themselves of every tool possible to avoid economic contraction. In this unique instance, we as a society accepted the risk of recession to avoid what we viewed as the larger threat- a higher chance of contracting COVID-19 if economic mobility were allowed to continue at then-current levels.



Source: Strategas

Sixteen percent of the US has already received one or more vaccine doses. Nine percent have some level of natural immunity from a confirmed previous infection. Around 30% of the US had an asymptomatic COVID infection that was never captured in the confirmed case counts, depending on your data source. Summing these percentages would be inaccurate due to category overlap; however, it is fair to say that we are well on our way to normality. The latest estimates suggest ~140M COVID doses will be delivered in March alone, and the Biden administration just guaranteed a dose for every American by the end of May. Most importantly, 52.6% of citizens ages 65+ have received at least 1 dose of the vaccine. Collectively, the threat continuum is now reversing. The larger threat now is allowing economic mobility to continue at current levels.



Source: Evercore ISI

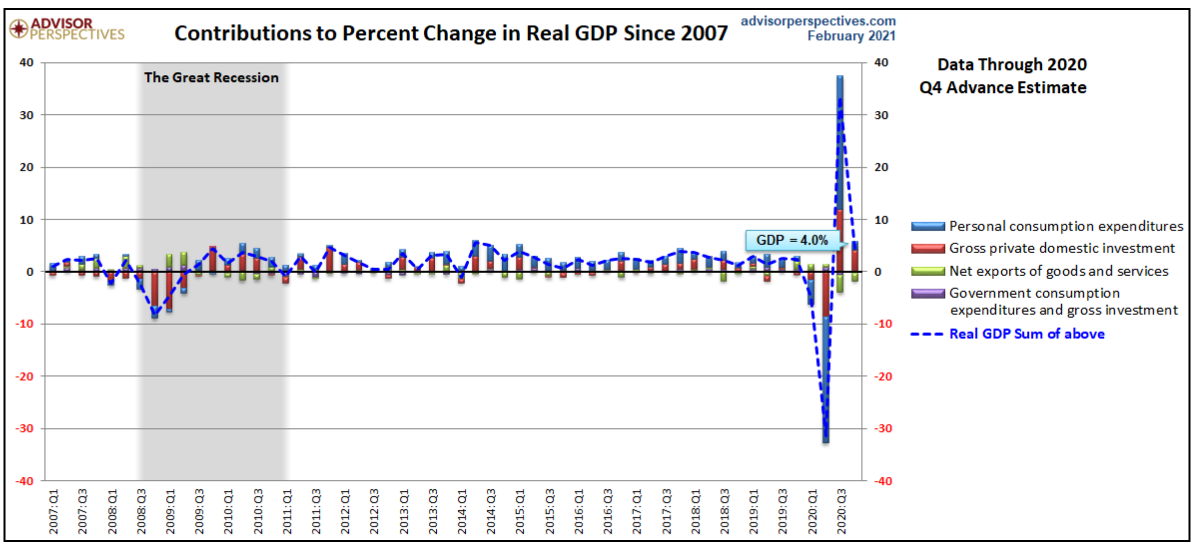
Public Policy

It is important to acknowledge and monitor the economic risks of public policy interventions through the pandemic and beyond. We understand that intervention was appropriate due to public health risks and trust that those decisions were made with the best of intentions. As public health policy becomes less restrictive, we expect a tailwind to economic growth. Economic outcomes could vary by geography as counties with rural populations and/or warm-weather climates can relax restrictions earlier due to less time spent indoors and within six feet of others.

We offer this outlook with the caveat that policymakers' concerns over COVID-19 variants or future viral outbreaks could quickly lead to a reinstatement of restrictions. More broadly, we believe it is prudent to monitor the potential risks to long-term economic growth if fiscal regulation and stimulus continue to increase as a percentage of GDP. Historically, excessive reliance on government intervention in and subsequent support of the private economy has limited economic growth and impacted businesses unevenly.

GDP

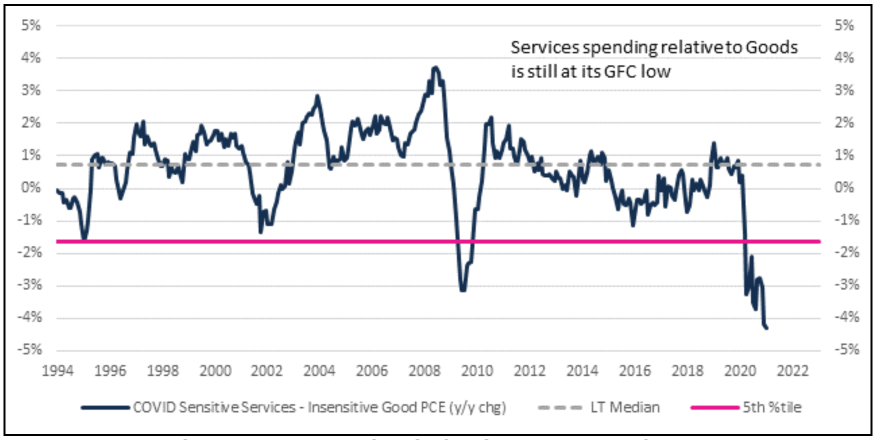
We typically present the following chart to our readers to display the level and composition of GDP. Most striking about this quarter's data; however, is the rapid rate of change of GDP. Rarely, if ever, has such a deep recession and subsequent rebound in economic data been compressed into adjacent quarters.



Source: Advisor Perspectives

How should one then think about the outlook for the economy? Given the aforementioned "dry powder" of consumers, the imminent elimination of COVID-19 as a serious risk factor, low interest rates, decreasing public policy risk, and additional incoming stimulus from accommodative fiscal policy, we are constructive on the pace of economic recovery and view consensus GDP forecasts optimistically.

We expect the services/goods ratio to reverse going forward as lockdowns are lifted, restrictions ease, weather warms, mask mandates are lifted, and personal risk of COVID-19 collapses. This should benefit sectors such as travel, energy, financials, consumer services, commodities, entertainment, airlines, hotels, construction, etc.



Source: Evercore ISI; *GFC = Great Financial Crisis

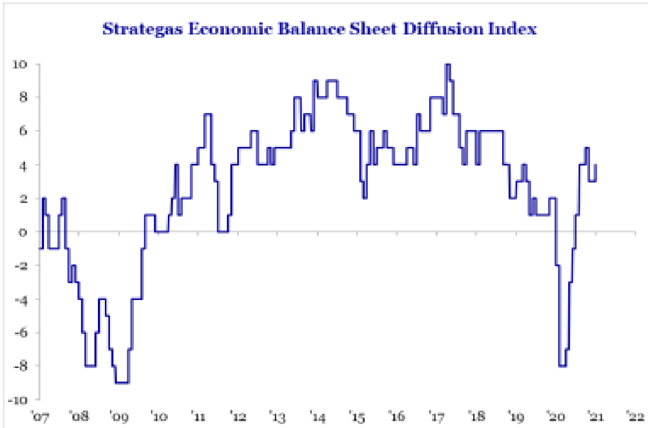
Inflation

One source of risk to the current expansion is the pace at which inflation expectations (and subsequently, inflation itself) rise. Inflation forecasts are rising, and the Fed has indicated it will allow core PCE to "overshoot" their long-term 2% target in order to raise the average inflation levels. If inflation continues to accelerate, it will be because of wage acceleration, say to +3.0% y/y in 4Q of this year and +3.5% in 4Q of next year. Anecdotal evidence of the tight labor market is shown from some of the nation's largest employers:

- Amazon's minimum wage is $15 / hour
- Costco announced plans to raise their minimum hourly wage to $16
- Walmart is boosting wages for its 425,000 US workers from $14 to $15 per hour

Economic Balance Sheet

We conclude our discussion of the economic outlook with a visual holistic view of the economy compiled by one of our research providers, Strategas. After a collapse in 2020, we appear to be back on solid footing and in the early-to-mid-innings of an economic expansion. We would caution that risks abound, including a Fed policy mistake, stagflation, hyperinflation, vaccine-resistant viral mutations, and public policy errors. While not every data point we track is trending in the same direction (they rarely are), we remain constructive on the health of the US economy and its ability to drive strong returns. As always, we will continue to closely monitor risk factors and adjust our views accordingly.



Assets	Neutral	Liabilities
Interest Rate Env	Govt Deficit	Nonres Constr
Housing	Trade Deficit	
Manufacturing	Wage Inflation	
Cons Spending	Price Inflation	
Capex Eqp	Credit Environ	
	Cons Conf	
	Employment	
	Business Conf	

Economic:	Jan '20	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan '21
Assets	2	1	1	1	1	1	3	5	5	6	4	4	5
Liabilities	4	9	9	8	4	2	2	1	1	1	1	1	1
Net	-2	-8	-8	-7	-3	-1	1	4	4	5	3	3	4

Source: Strategas

RSA PORTFOLIO STRATEGY

Interest Rates and Fixed Income Strategy

By Nick Prillaman

At our previous meeting in mid-December, the yield curve was steepening as inflation expectations were rising which elevated the long end of the curve while the Federal Reserve was keeping the front tethered to zero. The hope of vaccines combined with potential fiscal stimulus were the drivers of higher projections for inflation. Excessively low yields combined with significant tightness in bond spreads made fixed income investing a very difficult endeavor. All this being said, not much has changed since then. From the meeting on December 16th, the markets persisted in their trajectories until the month finished. Treasuries oscillated sideways with the 10-year Treasury yield closing within 1 bp from where it was mid-month. Overall, the risk-free asset class returned -.28 bps in December which included a spike in yields on the first day of the month. The S&P 500 marched higher to return 3.84 percent. BofA Securities said despite worsening Covid numbers, the combination of the passage and signing of the $900 billion stimulus package along with the FDA approval of the Pfizer/BioNTech and Moderna vaccines caused risk assets to rally.

Spread products ground tighter for December. In mortgages, the Bloomberg Barclays US MBS Fixed Rate OAS narrowed from 49 bps to 39 bps. For agencies, the Credit Suisse US Agency 3-5 Year Spread fell from 6.20 bps to 2.00 bps. In the corporate bond realm, high-yield bonds led the way with a 1.91 percent return while high-grade returned 49 bps. BofA said pipelines were the strongest high-grade sector delivering 233 bps of excess return whereas retail-discounters were the laggard at 29 bps. For the entire year, paper and forest products provided the best excess returns at 368 bps while metals and mining came in second at 305 bps. Most high-grade sectors tallied positive excess returns with the largest exception being the oil and gas sector which posted an abysmal 649 bps of negative excess return.

While the epic Gamestop Corp. short squeeze was in the midst of playing out in January, most broad asset classes produced low negative rates of return. This was in contrast to a brightening picture for the broad economy as BofA said, “The outlook for the US economy improved in January on the back of the Democratic sweep leading to expectations of a bigger stimulus, a rapid decline in Covid-19 cases and hospitalizations, and rollout of the vaccines.” These factors put upward pressure on the long-end of the Treasury curve with the 10-year Treasury yield rising 15 bps and 18 bps for the 30-year. The 2-year Treasury yield actually fell, so the entire curve steepened considerably. In total, Treasuries fell 1.12 percent which was similar to the 1.01 percent decline in the S&P 500 per BofA.

The spread compression in the mortgage market was impressive with the Bloomberg Barclay’s MBS Fixed Rate OAS falling from 39 bps to 18 bps. Agencies tightened as well with the Credit Suisse Agency 3-5 Year Spread dropping from 2 bps to negative 1 bp. The total return for agencies was better than Treasuries but the improvement in spreads could not offset the adverse Treasury move. Among corporate bonds, high-grade spreads tightened 1 bp for a total return of negative 1.23 percent and high-yield spreads came in by 7 bps, returning a positive 37 bps per CreditSights. The lower levels of duration among high-yield borrowers was a clear benefit for investors. BofA showed paper and forest products outpacing Treasuries by 71 bps while technology entities were the worst at negative 32 bps of excess returns within high-grade corporates.

The interest rate sell-off that started in January went into overdrive on February 25th after progressively marching higher for the majority of the month. For example, the 5-year Treasury yield rose roughly 20 bps before the 25th and then popped 22 bps higher on that day. BofA said “a rapidly improving Covid-19 situation and prospects for a max fiscal stimulus” were the drivers behind the “large bear steepener move in rates.” A poor 7-year Treasury auction along with mortgage convexity hedging flows were also contributors to the move. Treasuries posted a negative 2.29 percent total return in this environment. Agencies fared better at a negative 93 bps in total return per BofA. The Bloomberg Barclay’s US Mortgage Backed Securities Index posted a negative 67 bp return as the short duration of the Index was vital in helping it relatively outperform Treasuries.

Corporate bonds experienced healthy spread tightening with the OAS in investment-grade issuers contracting 8 bps while high-yield OAS came in 27 bps. Total returns were accretive over Treasuries with investment-grade posting a loss of 1.99 percent and high-yield generating a positive 29 bp return. Along the credit rating sprectrum, CCC’s were the best with a 1.51percent total return versus AAA’s who were the worst at a total return of negative 3.31 percent according to CreditSights. Duration was an issue for the most pristine bond issuers.

The RSA made a number of changes to the fixed income portfolio over the last couple months. For Treasuries, we purchased a block of 10-year bonds as well as 20-year bonds to take advantage of the steepening of the yield curve. Given that we were underweight the asset class combined with a short duration position, we felt it was the right time to start easing into a few safety trades. The back-up in long-dated interest rates has been robust as one can see in the chart below of the 10-year Treasury. Since the Corona virus low of 31 bps last march, yields have risen an impressive 110 bps.

Source: Bloomberg

The interest rate movement on the front-end of the curve has been vastly different. This next chart is of the 1-year Treasury and it reveals an oscillating pattern that tilts downward for the bulk of the pandemic.

Source: Bloomberg

Primary drivers of the steepening yield curve include large amounts of fiscal stimulus to revive the economy, vaccine progress and implementation, and a very accommodating Federal Reserve. We do need not see the steepening moving too far afield given the outlook for monetary policy. Fed Chairman Powell recently said “The economy is a long way from our employment and inflation goals, and it is likely to take some time for substantial further progress to be achieved.” This indicates there are no interest rate hikes for the foreseeable future and this will provide a natural anchor for the entire interest rate curve. The Federal Reserve will need to begin tapering their bond purchases before even contemplating a rate hike, which they haven't even hinted at. The most they have signaled on that front is to switch their MBS purchases to Treasuries. If the long-end rate movement does begin to get out of hand, the Fed could implement some sort of "Operation Twist" and target its Treasury purchases out the curve. Given this Federal Reserve's propensity to go big in the terms of doing whatever it takes to keep the economy going, I would not bet against them in maintaining order the Treasury market.

Activity in the agency portfolio was comprised of various adjustments which included purchasing a 2027 Federal Farm Credit note at a spread of 15 bps to reinvest proceeds from a recent maturity. The bond appeared attractive as the 1-year call option provided additional basis points of spread over a comparable bullet issue. It was also on a steep part of the curve which should provide benefits in the future. Other changes included selling a 2030 Federal Farm Credit bond which helped reduce the duration on the agency portfolio. This seemed prudent given the outlook for interest rates given the further fiscal stimulus and greater inflation expectations. We also let a small agency issue roll off and didn't reinvest the balance due to limited reinvestment options within the sector.

Given that bullet agencies trade almost flat to Treasuries, we do not find broad value in the space. Callables are more attractive than bullets, but from a historical perspective, those bonds are rich as well. The long-end of the curve provides the most opportunity from a yield perspective, but since we are a little long on the duration front relative to the index, our appetite for picking up long-dated agencies is muted in the midst of a backup in interest rates. We see better prospects in other asset classes but will continue to make trades to optimize the performance of the agency portfolio.

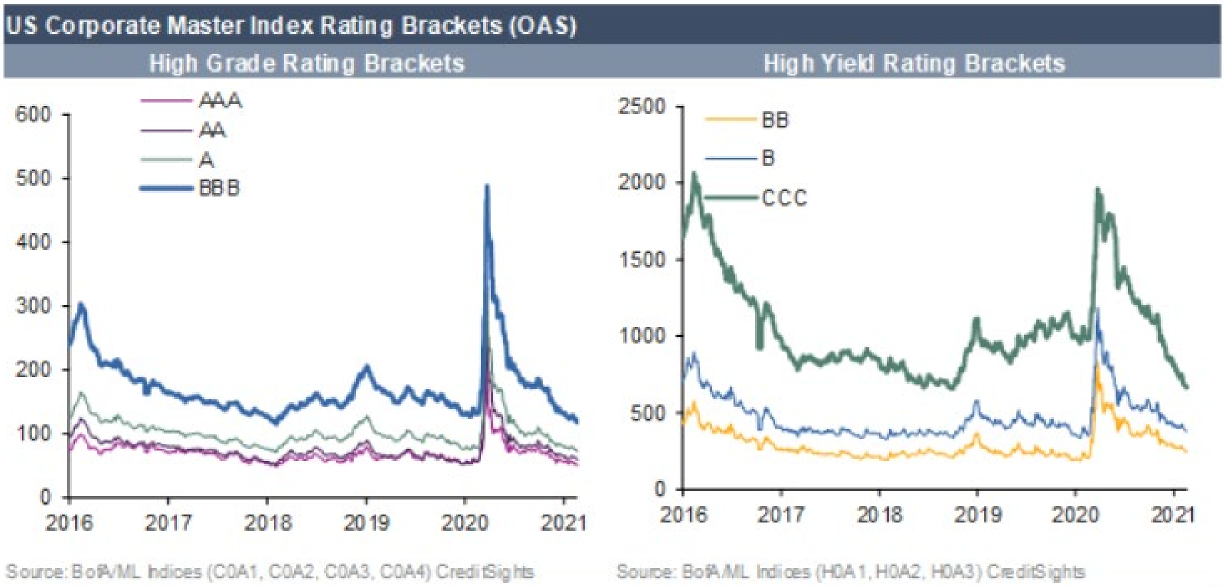
The mortgage portfolio was adjusted in January with the purchase of three 30-year 2.5s that included two Fannie Maes and one Freddie Mac. The trades were undertaken to reinvest a portion of the month's prepayments. Two of the pools were of the $175k max Quicken variety and the third was a $150k max Quicken. The RSA continues to like these types of pools as they provide two-sided convexity benefits as they prepay slower than the generic cohort in a rally while prepaying faster than the generic cohort and the particular loan-balance cohort in a large interest rate backup. The option-adjusted spreads on these mortgage backed securities were around 30 bps which was attractive versus other government-related products.

In February, we passed on reinvesting our prepayments, because the value in the mortgage market was not there. As you can see in the chart below, the Bloomberg Barclay's U.S. MBS Agency OAS dropped to the exceedingly low level of 11 bps on February 8th. Spreads have risen some but are still not where one would consider them cheap. Over the near term, we are not projecting a major increase in spreads as the Federal Reserve continues to buy $40 billion per month. This outlook could however change in the coming months. Tom Tzitzouris at Strategas Research Partners recently said that, "Powell made it clear that the Fed has no interest in trimming QE any time soon, but he also let it slip (intentionally) that there is some justification for pivoting MBS purchases back to the Treasury market later in the year." If and when the Fed does begin to taper, MBS spreads will experience upward pressure and the performance of mortgages will struggle relative to other asset classes. Given this potential negative event combined with relatively low option-adjusted spreads, the RSA will continue to make portfolio adjustment trades, but will refrain from large scale mortgage purchases.

Source: Bloomberg

Adjustments to the corporate bond portfolio were primarily comprised of buying high-yield companies that produce free cash flow. For example, we purchased a block of June 2023 ADT Corp. bonds with a spread of 156 bps. Other securities included a 2021 Sprint bond at a spread of 120 bps and a 2027 Kraft Heinz bond at 173 bps. Beyond high-yield, Boeing issued new debt in February where we participated in the 2023 issue at a spread of 105 bps. We are of the opinion that taking credit risk in names we are confident in is a better strategy in this low interest rate environment than trying to increase returns by taking greater interest rate risk on the long-end of the curve.

The fund has had multiple bonds called or tendered recently which has been difficult from a reinvestment perspective given the extremely low interest rate backdrop as well as the tightness in corporate bond spreads. One can see in the chart below how compressed spreads are. The US investment-grade index stands at 94 bps while the OAS on high-yield is 341 bps per CreditSights. Relative to other fixed income asset classes, corporate bonds, however, do offer the best opportunity to maximize returns. The time to buy corporate bonds en masse was back in March 2020 when Covid-19 fear was at its high. Now, the strategy is one of precision in the terms of acquiring names rather than in bulk.



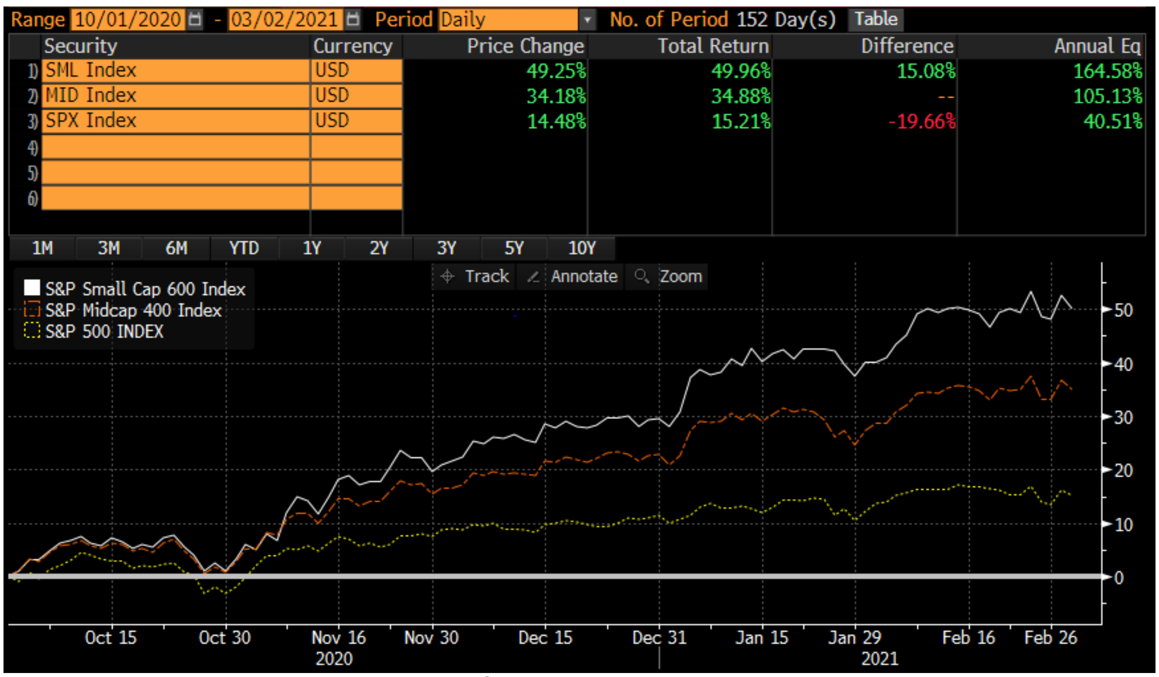
Source: CreditSights

Domestic Equity Strategy

By Kevin Gamble

While there are a lot of moving parts under the surface, U.S. equity markets have turned in a blockbuster performance with just over 40% of fiscal 2021 in the books. In a reversal of last fiscal year, smaller cap indices have dramatically outperformed. Exhibit 1 takes a visual look at performance fiscal year-to-date of the three major S&P equity indices. To say we are off to a strong start this fiscal year on the equity side of the ledger would be an understatement.

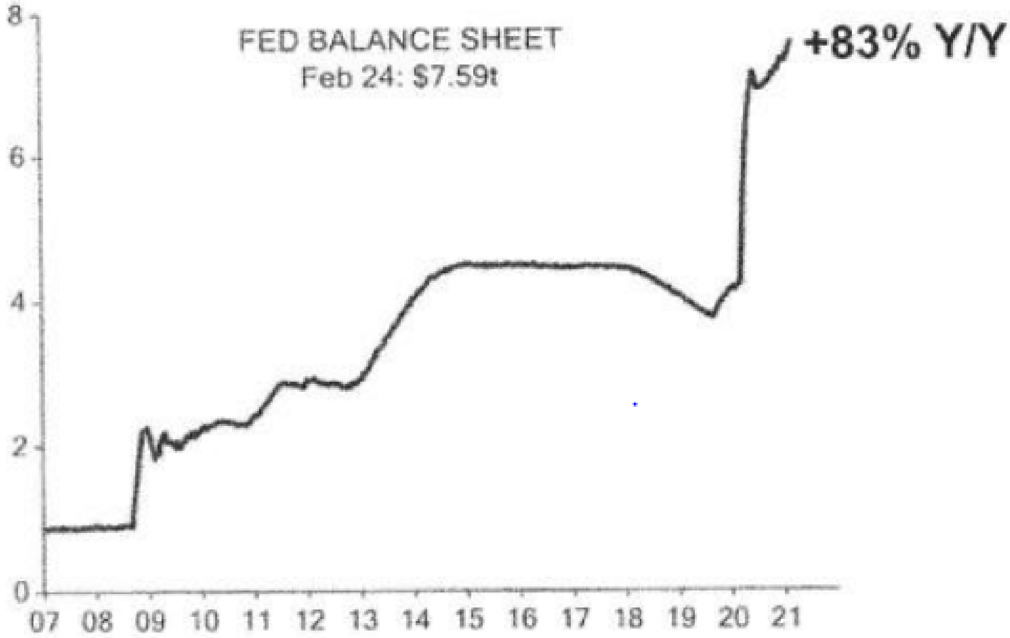
Exhibit 1: S&P Equity Index Performance Fiscal Year-to-Date



Source: Bloomberg

Does it make sense that equity markets have performed so well during a historic pandemic? Equity markets and the real economy can often diverge as equity markets are forward looking in nature. Clearly a big assist to the domestic equity rally goes to Fed chairman Jerome Powell who has taken aggressive steps to provide unprecedented liquidity to financial markets. In 2020 alone, the Fed expanded its balance sheet by $3 trillion. To put this amount of money in perspective, this is more than 4x our national defense budget and roughly 15% of U.S. GDP in 2020! In addition, the Fed is currently on pace to expand its balance sheet by at least another $1.5 trillion in 2021. While this type of aggressive action does not come without risk of negative unintended consequences, the decision to flood the financial system with money has clearly been made. It should also be noted that Jay Powell is not alone in this mission as many central bankers around the world have followed suit.

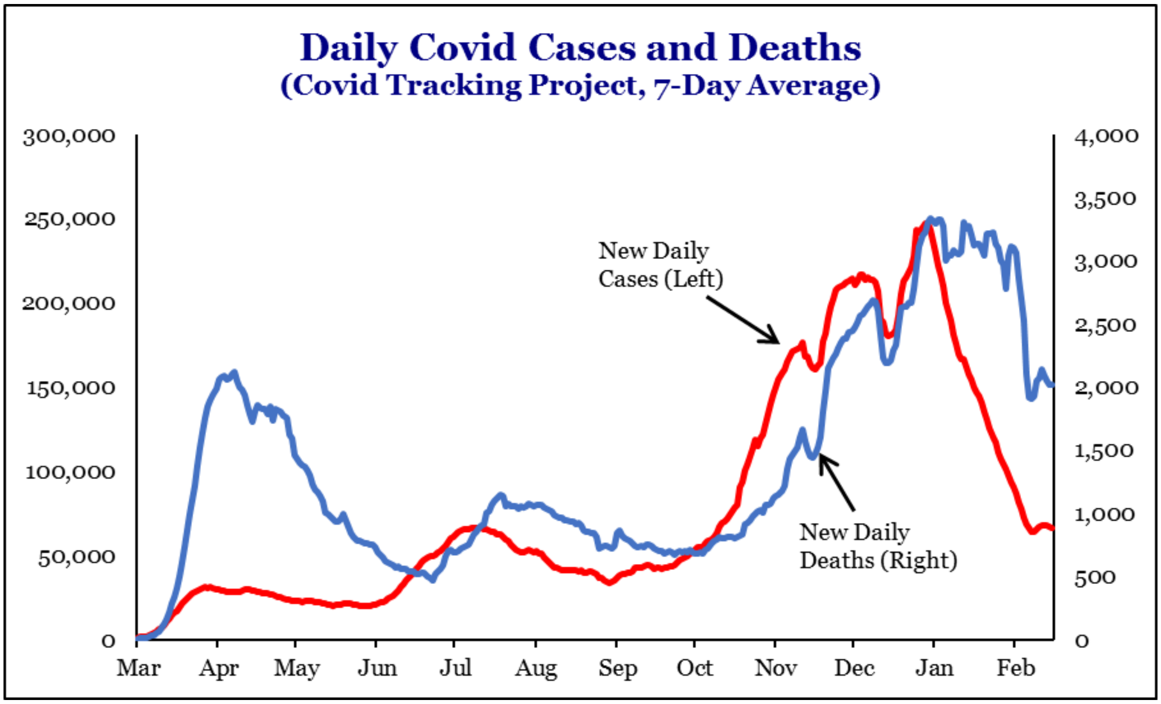
Exhibit 2: U.S. Federal Reserve Balance Sheet



Source: Evercore ISI

To help understand the current situation, I have found it helpful to reflect on the tragedy that struck my hometown of Enterprise, Alabama 14 years ago this month when an EF4 tornado struck the high school I attended as a youngster. Clearly there is no way to replace the lives of the 8 high school kids whose life was cut short that day in the same way there is no way to replace the lives of the over 500,000 U.S. citizens whose life has been cut short by the current pandemic. For survivors, there is a desire to memorialize and remember our losses as we attempt to “Build Back Better” on the other side of a devastating time. For Enterprise, building back better is reflected in a beautiful new high school and a memorial honoring each of the lives lost during the tornado. For the United States, building back better is still to be determined, but likely reflects doing the best we can to make sure markets are higher, states are made whole, and as many people and businesses as possible are in better shape than ever on the other side of the pandemic.

Exhibit 3: Daily Covid Cases and Deaths



Source: Strategas

In similar form to presentations in the past, what I would like to accomplish in this strategy piece is to outline the top 10 things that we as an investment team think you as a board member should know about the current state of the U.S. equity market. Will the current upward trajectory of the US equity markets be sustainable as we move through the remainder of fiscal 2021? Clearly the markets are focused on what America 2.0 looks like on the other side of the pandemic now that multiple vaccines have begun to be widely distributed.

RSA Top 10 list

1) We have a social dilemma in this country

Netflix released its popular documentary *The Social Dilemma* in the fall of 2020. The docudrama included many interviews with former social media employees. The takeaway was that what started out innocently with an altruistic motivation can also have a dark side when it comes to data mining, addiction, and manipulation. Interestingly, my brother and sister-in-law attended Harvard at the time Facebook was just insular to the school and I remember attending their graduations and taking note that many of the speeches jokingly referred to "how many friends" students have at the school. The platform has certainly evolved to be much more than a simple network of Harvard students as it now approaches 3 billion monthly active users or close to 50% of the world's population!

Just a few short months after the release of the film, we have all seen this social dilemma on full display with the January 6th insurrection of the U.S. Capitol building and the absolutely unbelievable images from inside the hallowed halls of Congress, congressional offices, and the floors and galleries of the House and Senate chambers. How could so many people be led to do such irrational things?

Another example of the social dilemma we face is with the current influence on the markets of the Reddit and WallStreetbets crowd. While the future influence is still to be determined, the recent short squeeze in Gamestop shares sending the stock, which was below $3/share in April of last year and below $20/share prior to entering 2021, to over $483/share before the end of January is unprecedented and just one extreme example of irrational movement in individual stocks during this timeframe. While it is impossible to fully know everyone's rationale for a trade, I think it is fair to say many of the trades were not based on any rationale other than to collectively stick it to the hedge fund manager or the "suits." YOLO or "you only live once" has come to define some of the speculative trading among the online communities.

Exhibit 4: Fiscal Year-to-Date Chart of Gamestop

Source: Bloomberg

2) We have wisely avoided investing your money in black box hedge funds

While we would certainly never claim perfection over the years, one thing we have wisely done is avoid investing your money in black box hedge funds which typically charge their clients 2% of assets under management in addition to 20% or more of profits in many cases. Shorting stocks is a difficult situation as your gains are capped at 100% while the losses are unlimited in theory. By managing your equity assets in-house, we have avoided paying the steep management fees over the years, and perhaps more importantly, we know what we own. The latter part is especially important when market dislocations such as Gamestop occur causing margin calls at funds such as Melvin Capital which threaten the assets of the entire firm and certain segments of the financial markets. It has been comforting to have direct knowledge of our equity assets as we watch the drama unfold in selected stocks. Any hedges we have put in place have been funded by selling covered calls which is the ultimate safe option strategy as we own the underlying assets that we are agreeing to sell at a higher price.

Exhibit 5: Hedge Fund Performance in the Era of Fed Balance Sheet Expansion

Year	Hedge Funds (HFRI Equity Hedge)	S&P 500 Total Return	Hedge Funds Outperform	Fed Balance Sheet ($Bn)
1990	14.4%	-3.1%	YES	$319
1991	40.1%	30.5%	YES	$347
1992	21.3%	7.6%	YES	$369
1993	27.9%	10.1%	YES	$409
1994	2.6%	1.3%	YES	$440
1995	31.0%	37.6%	NO	$438
1996	21.8%	23.0%	NO	$454
1997	23.4%	33.4%	NO	$481
1998	16.0%	28.6%	NO	$512
1999	44.2%	21.0%	YES	$560
2000	9.1%	-9.1%	YES	$590
2001	0.4%	-11.9%	YES	$624
2002	-4.7%	-22.1%	YES	$678
2003	20.5%	28.7%	NO	$740
2004	7.7%	10.9%	NO	$776
2005	10.6%	4.9%	YES	$815
2006	11.7%	15.8%	NO	$847
2007	10.5%	5.5%	YES	$874
2008	-26.7%	-37.0%	YES	$1,202
2009	24.6%	26.5%	NO	$2,084
2010	10.5%	15.1%	NO	$2,317
2011	-8.4%	2.1%	NO	$2,748
2012	7.4%	16.0%	NO	$2,868
2013	14.3%	32.4%	NO	$3,479
2014	1.8%	13.7%	NO	$4,338
2015	-1.0%	1.4%	NO	$4,488
2016	5.5%	12.0%	NO	$4,472
2017	13.3%	21.8%	NO	$4,462
2018	-7.1%	-4.4%	NO	$4,284
2019	13.7%	31.5%	NO	$3,919
2020	17.9%	18.4%	NO	$6,333

Source: Strategas

3) Who let the dogecoin out and why is it still out?

Cryptocurrencies have grown largely unchecked by any regulation. Bitcoin crossing the $1 trillion value mark in February shows its increasing relevance as a “store of value.” Bitcoin has now found its way onto corporate balance sheets including Tesla, Microstrategy, and Square in addition to the “digital wallets” of many individuals. Are cryptocurrencies digital tulips? Digital gold? A new form of Internet currency? A new form of saving? Why has there been no regulation? Can people now create and invent their own digital money? Is this a historic bubble like Dutch tulip mania or the South Sea bubble? Lot of unanswered questions, but the lack of any regulation or government hearings as it grows in relevance and acceptance is a little surprising. The longer and wider the influence of cryptocurrency grows, the more pain that could potentially come from future regulation. It is estimated there are over 100,000 bitcoin millionaires based on current prices for the digital coin. Square saw 1 million users buy bitcoin for the first time in January.

What likely started out as a protest, check against central bank money printing, and a way to protect against monetary inflation has grown into Twitter folklore. Some professional athletes are now asking to be paid in Bitcoin. Dogecoin started out as a Twitter meme and a joke in 2013 and has grown to a paper value of $9 billion! The founder of Dogecoin, Billy Markus, even recently admitted he is baffled at the “value” that has been created by the meme coin.

Will we all have a digital wallet before it is over with to protect ourselves against the money printers or will the “asset class” come under increasing scrutiny by monetary authorities? Should be interesting to monitor moving forward.

Exhibit 6: Chart of Bitcoin

Source: Bloomberg

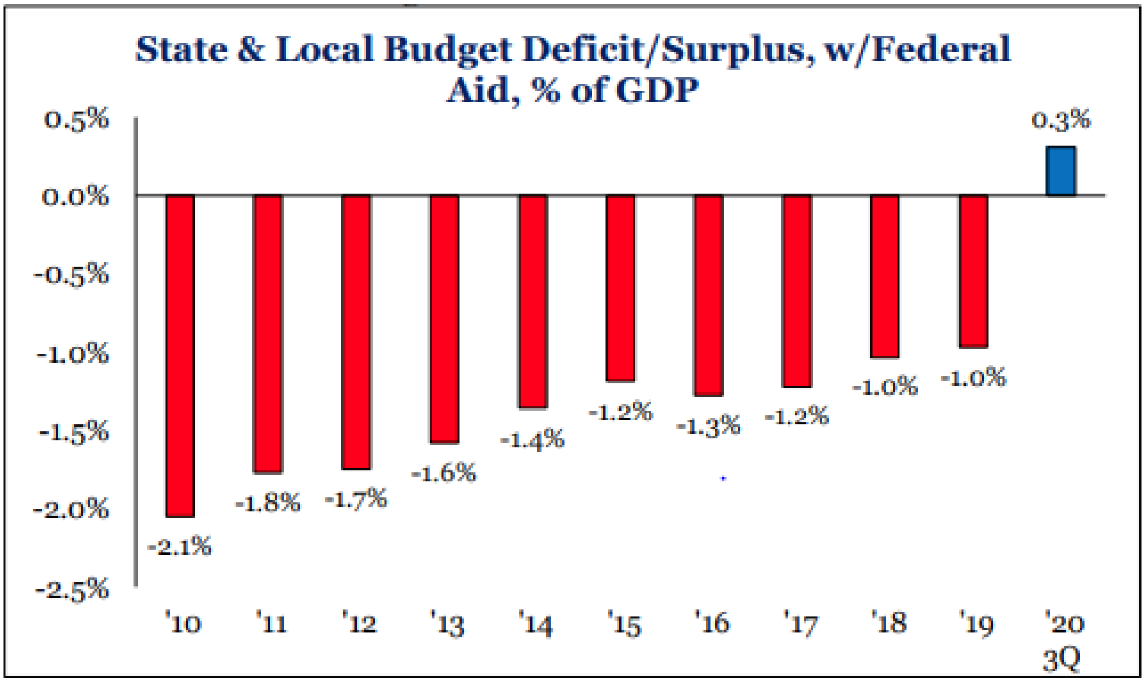
4) States budgets are in better shape moving forward than one might think

Making sure state budgets do not suffer during the pandemic and thus add to the recessionary pressures has been a focus of lawmakers in Washington. The initial CARES act was a strong first step which has bridged the gap to 2021. In addition, lawmakers are likely to provide states such as Alabama, which refused to expand Medicaid, another bite at the apple with an even more attractive value proposition to expand the government healthcare program (paying 95% of the bill instead of the current 90%).

The latest stimulus package is set to provide $195 billion in direct aid for state governments which would give states on average 20% of their entire tax revenue collections. Should the proposal pass, every state in the union will be made whole from tax revenue declines in 2020!

In Alabama, if you combine federal state aid with the potential for a comprehensive gaming bill to raise needed revenue for the state, lawmakers could be in as good a shape as ever to address and solve problems for the citizens of this great state.

Exhibit 7: State and Local Budget Deficit/Surplus with Federal Aid as a % of GDP



Source: Strategas

Exhibit 8: Proposed Stimulus as a % of Tax Revenue for Each State

State	Y/Y Revenue Increase, $BN	Proposed COVID Relief, $BN	Net Surplus, $BN	Covid Aid, % of Tax Revenue
VT	0.2	0.7	0.9	41.8%
AZ	0.4	4.7	5.1	39.2%
NV	-0.5	2.6	2.1	38.5%
NH	0.0	1	1.0	38.4%
MT	0.0	0.9	0.9	35.9%
CO	0.9	4.7	5.6	34.3%
MO	0.1	3.3	3.4	33.0%
FL	-2.6	10.2	7.6	32.6%
LA	-0.6	2.9	2.3	31.8%
OK	-0.5	2	1.5	30.9%
TX	-4.9	16.7	11.8	30.1%
WV	-0.1	1.3	1.2	28.2%
MS	0.0	1.7	1.7	27.7%
ID	0.5	1.1	1.6	25.1%
ME	0.1	1	1.1	24.8%
AR	0.3	1.4	1.7	23.1%
MI	0.3	6.1	6.4	22.6%
SC	0.3	2.2	2.5	22.3%
GA	-0.4	5	4.6	21.3%
NC	0.4	5.4	5.8	21.1%
TN	0.3	4	4.3	20.7%
WA	0.6	4.8	5.4	20.4%
KY	0.3	2.4	2.7	20.2%
PA	-0.1	7.1	7.0	20.2%
DE	-0.3	0.9	0.6	19.9%
VA	-0.2	3.8	3.6	19.6%
NJ	0.2	5.9	6.1	19.5%
NE	0.2	1	1.2	18.8%
KS	-0.1	1.4	1.3	18.6%
CA	4.2	27.3	31.5	18.1%
WI	1.2	3.2	4.4	17.9%
CT	-1.7	2.9	1.2	17.2%
MA	0.6	4.8	5.4	17.2%
UT	0.5	1.4	1.9	17.2%
IN	-0.1	2.8	2.7	16.8%
IL	-0.7	7.8	7.1	15.8%
NY	-1.3	12.2	10.9	15.5%
OH	1.2	5.5	6.7	15.4%
AL	0.5	1.9	2.4	15.2%
IA	-0.2	1.3	1.1	13.8%
MN	-0.5	2.6	2.1	11.7%
DC	-0.4	1	0.6	10.7%

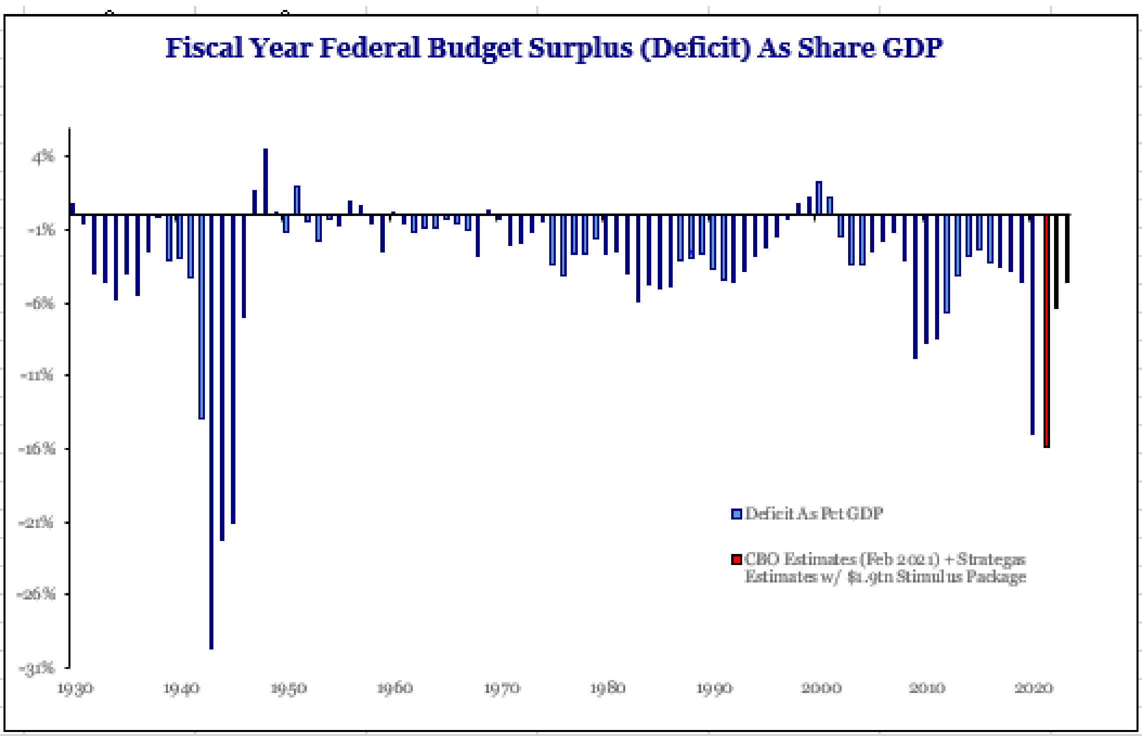
Source: Strategas

5) Deficit spending federal government continues to support growth

The deficit spending by the federal government during the coronavirus pandemic has continued to support growth. As a matter of fact, there is a growing sentiment that the risk is in not doing enough deficit spending rather than doing too much. With Democrats now in charge of both houses of Congress and the White House combined with record low interest rates, the calls for more and more deficit spending are unlikely to end anytime soon. The Unites States has not run a surplus at the federal government level in over 2 decades! Neither side of the aisle at this point has much credibility when it comes to fiscal discipline which could make it harder for the Republicans to push back against aggressive deficit spending measures.

Looking out past the trillion-dollar coronavirus relief bill, there will likely be another large trillion-dollar plus “Build Back Better” infrastructure bill focused on growing the economy and replenishing the nation’s aging infrastructure. This bill has a chance to be more bipartisan in nature given the growth component and could be a big boost for industrial type stocks levered to the spending.

<u>Exhibit 9: US Budget Deficits as a Share of GDP</u>



Source: Strategas

6) Is the great bull market in bonds over? What does that mean for stocks?

Bond yields have been steadily falling for the better part of four decades. With falling yields comes increasing bond prices. Almost everything in the financial markets are priced off bond yields as government bond yields set the risk-free rate of return. Lots of money is still invested in the bond market, and for the most part, all types of fixed income investors across the risk spectrum have been rewarded over the many years of the bond bull. It is a worthwhile exercise to ask the question: What does it mean if the great bull market in bonds is over? After all, rates can't fall forever and are even thawing out from negative territory in many places around the world.

Paul Volcker is credited with "breaking the back" of inflation in the early 1980s which set the stage for the beginning of the great bond bull market. Jay Powell is seemingly setting himself up to be the bookend to Paul Volcker by breaking the proverbial back of deflation or disinflation. This can be seen in his change of policy to inflation targeting of 2% and his stated willingness to let inflation run hot above his ideal target for a period of time to insure against deflationary pressures.

Could a steep backup in yields challenge the deficit spenders in Washington D.C.? Certainly, a reasonable possibility.

Exhibit 10: US 10-Year Yields

Source: Evercore ISI

7) There is a late 1990s type speculative fever currently in markets

Without a doubt, there is a speculative fever to segments of the market today which is only reminiscent of the late 1990s period in my lifetime. The retail investor is back in the game with the assistance of the commission free Robinhood platform and Twitter personalities such as Barstool Sports founder Dave Portnoy. Stocks are once again a topic of conversation among friends. Many a peer of mine has asked their mom to retrieve baseball cards out of the attic to look for the Wayne Gretzky card, which recently sold for over a million dollars, or the 1986 Fleer Michael Jordan rookie card which can fetch up to $750,000 in mint condition.

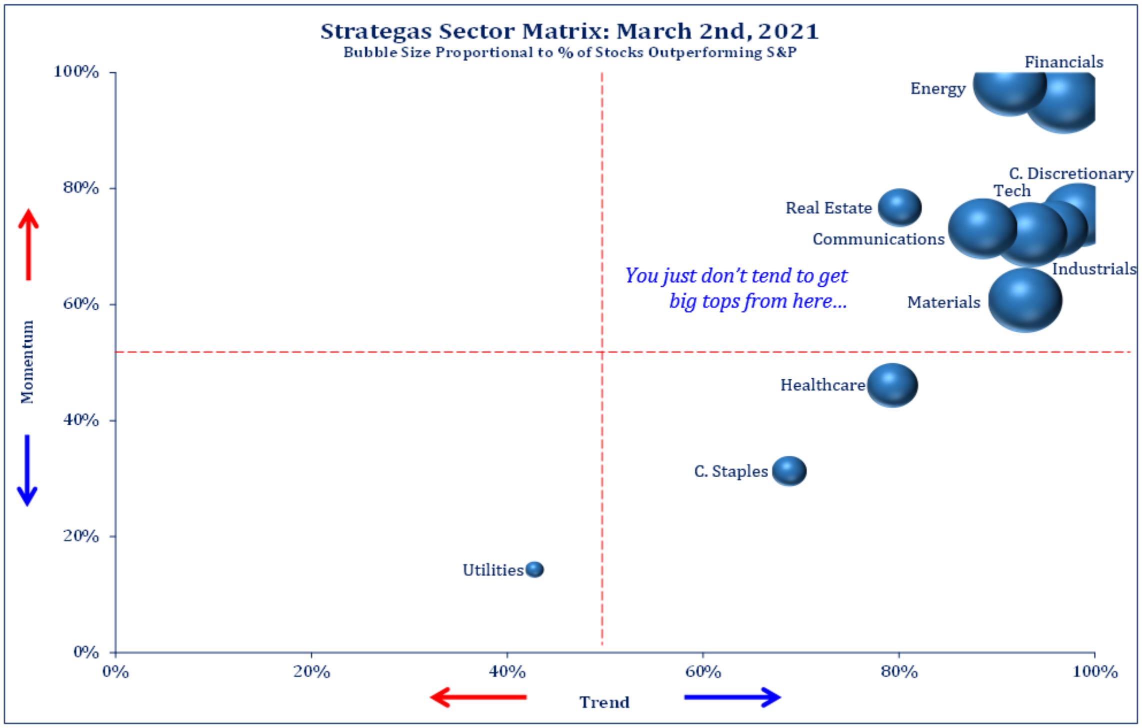
Within the financial markets, the recent explosion in penny stock volume is highly speculative and speaks to the current fever that everything is rising. IPOs and SPACs are coming to the market and pricing at astronomical valuation levels. There are even rap songs now about SPACs! The asymptotic growth in assets of Cathy Wood's Ark Investment Management is very similar to the unit investment trusts which came along in the late 1990s to capture interest in Internet and dot com themes.

Investor sentiment is arguably offsides to the positive as measured in the elevated bull/bear ratio and put/call ratios as well as the psychological idea of FOMO, or "fear of missing out". Euphoric sentiment is perhaps one of the biggest risks to the domestic equity market at the current time.

8) The technical setup of the market does NOT look like late 1990s

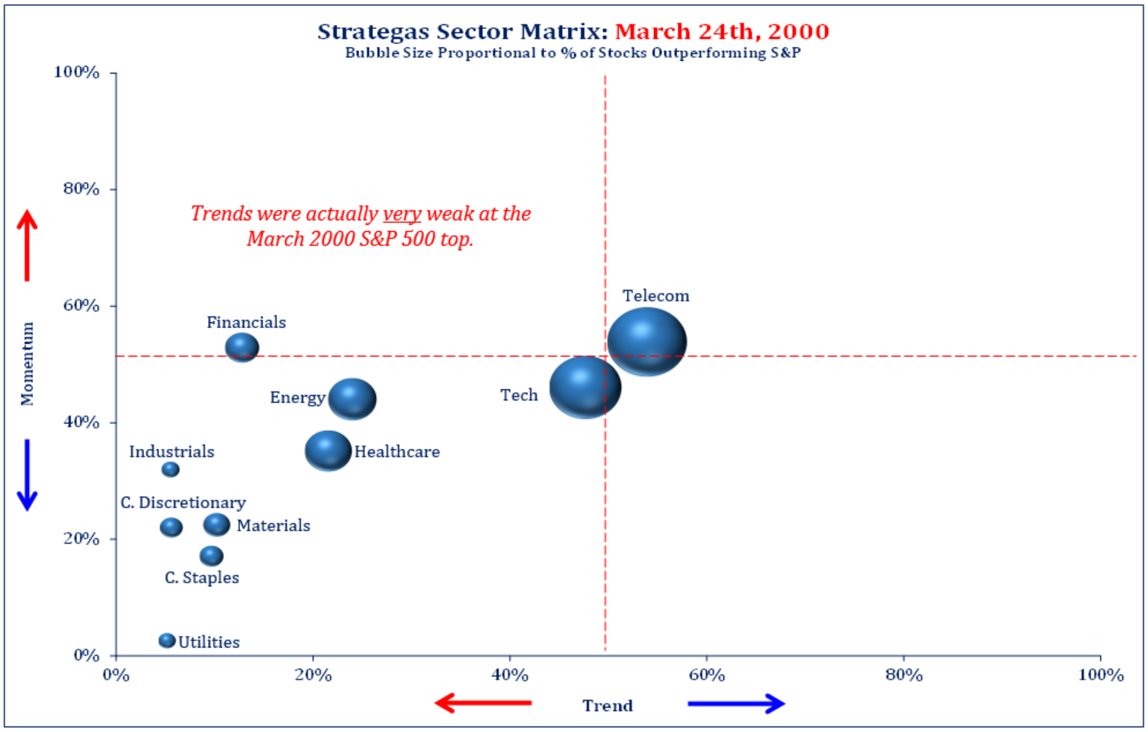
While there are many similarities to the late 1990s period, the composition of the market itself does NOT look like the latter stages of the 1990s at all. Quite the opposite. The composition of the current market tends to argue for further gains given that all the cyclically exposed stocks remain strong while more defensive groups like utilities and staples are the only sign of weakness. In other words, the equity market continues to have broad participation among the sector groups bulls would like to see lead the market higher. In contrast, at the peak in 2000, the market was very narrow with technology holding up the entire market while other sectors had already retreated. So, while the sentiment surely feels reminiscent of that time frame, the composition is notably different.

Exhibit 11: Present Equity Sector Matrix



Source: Strategas

Exhibit 12: March of 2000 Equity Sector Matrix



Source: Strategas

9) The S&P 500 is Very Top-Heavy w/Mega Tech – Risk of Regulation and/or Taxation?

Following the pandemic, the S&P 500 is as top heavy as it has ever been. The top 6 market caps (Apple, Microsoft, Amazon, Google, Tesla, and Facebook) combine for a total market capitalization of roughly $8 trillion or roughly 38% of US GDP and 23% of the S&P 500. At the peak of the Nasdaq bubble in March of 2000 the top 6 names (Microsoft, Cisco, General Electric, Intel, Exxon Mobil, Walmart) combined for $2.6 trillion in market cap or 27% of US GDP and 18.5% of the S&P 500 at the time.

What is obvious from comparing the list is that Microsoft is the only company from 2000 which has been able to maintain its dominant status over time. It is hard to stay on top for many reasons and we expect lawmakers to turn their attention to the monopoly mega tech players once we are comfortably on the other side of the pandemic. Could governments impose a monopoly tax? The U.S. government will need some tax revenue to attempt to pay for all the deficit spending and going after big tech monopolies is a logical target.

Market cap of top 6 names today:

AAPL $2.2 trillion
MSFT $1.6 trillion
AMZN $1.6 trillion
GOOGL $1.2 trillion
TSLA $800 billion
FB $700 billion

Total market cap of top 6 names = $8.1 trillion

US GDP in 2020 = $21.5 trillion

The market cap of top 6 companies is 38% of US GDP today

In March of 2000, these were top 6 market cap names:

MSFT $553 billion
CSCO $538 billion
GE $512 billion
INTC $440 billion
XOM $271 billion
WMT $251 billion

Total market cap of top 6 names in March of 2000 = $2.6 trillion

US GDP in 1999 = $9.6 trillion

The market cap of the top 6 companies was 27% of US GDP in March of 2000

10)America 2.0 – Are we headed into a Roaring 2020s?

There are some who think that coming out of the coronavirus pandemic, America will experience a decade of prosperity similar to the 1920s following the Spanish Flu outbreak. The potential certainly exists for revolutionary change brought on by 5G technologies, artificial intelligence, driverless car technology, potential for flying cars, space travel, supersonic aircraft, high speed rail, green technologies, biotechnology advancements, etc…..

Without a doubt, people have cabin fever and there is pent up demand for a return to normal activities. This combined with stimulus and elevated savings make the threat of a recession a very small probability.

Equity Strategy Moving Forward

We live in strange times. I think it is safe to say that no mortal human knows exactly what the future holds. It certainly seems as though the uncertainty of what lies ahead even tomorrow is as high as I can remember. Jeremy Grantham sees a bubble in asset prices and is waiting on "the last dance" as he calls it while legendary investor Stanley Drukenmiller has recently called the stock market an "absolute raging mania" against the backdrop of the "wildest cocktail" of market forces he has ever seen. We even have "Roaring Kitty" testifying in front of Congress! I think this constitutes as strange.

We think it is likely the equity market will continue to focus on the reopening of the economy and what the new economy will look like in the post Covid 19 world. We think it is logical that equity market returns will be much more correlated with earnings growth moving forward with less of a tailwind from the multiple expansion of the last few years. It is possible there could even be some multiple contraction in selected growth names should interest rates continue to move higher on the acceleration of the real economy. We would expect the combination of Janet Yellen in Treasury and Jay Powell at the Fed combined with a Democratic government to be very dovish and liberal in their spending in the years ahead to support the economic recovery in their quest for price stability, full employment, and happy constituents.

We still see the equity market as more attractive than the bond market at current levels. The dividend yield on the S&P 500 is roughly equivalent to the 10-year treasury yield and we should continue to get earnings growth in the future with a fairly low risk of recession in the coming years. The composition of the equity market continues to argue for further gains and when looking at Ed Hyman's maturing business cycle dance, we are nowhere near what it typically looks like at the very end.

Of course, corrections can occur at any time and having one between now and the end of our fiscal year is perhaps even likely. We do have a modest level of put spread collar protection in place should this occur to cushion the effect of any short-term drawdown in equities while still maintaining ample upside between now and the end of the fiscal year.

Exhibit 13: The Typical Maturing Business Cycle Dance

Here We Go,
Economy Good,
Rates Go Up,
Earnings Go Up,
Rates Go Up,
Economy Better,
Rates Go Up,
Economy Great,
Rates Go Up,

NEW ERA THINKING!

Yield Curve Inverts

No Problem!

Bear Market Starts

RECESSION

The End

Source: ISI

International Equity Strategy

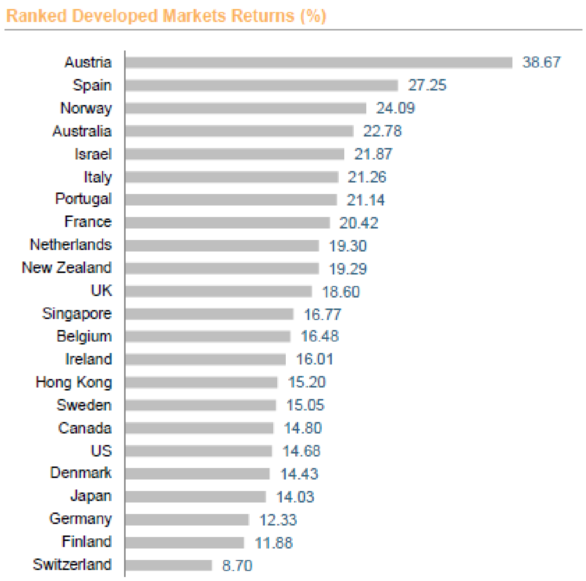
By Steve Lambdin

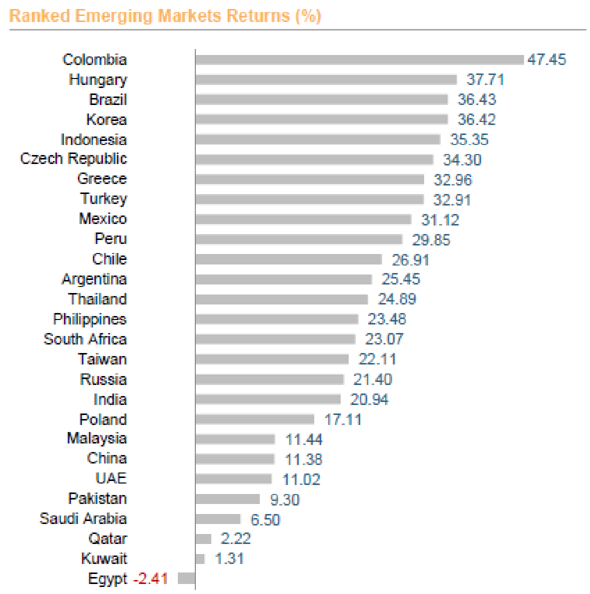
The global equity markets continued to move higher in the fourth quarter as the onslaught of stimulus measures, promising news on several coronavirus vaccines, and the prospects for much better economic readings pushed most equity markets to new record highs. Investors responded with an emphasis of equities over bonds, value stocks overgrowth stocks, international equities over domestic equities, and cyclicals over momentum. Also, the uncertainty of the U.S. presidential election was over as Joe Biden defeated President Donald Trump in a very tight race. With this result, investors seem to be pointing to a de-escalation in trade tensions, which is yet another catalyst for the global equity markets. The policy environment in nearly every corner of the world remains firmly supportive with a multitude of monetary and fiscal actions designed to lift each region out of the economic doldrums from the pandemic. In addition, the United Kingdom (UK) and the European Union (EU) reached a Brexit trade deal at the "11th hour", which ended a few years of economic uncertainty from these trade discussions. Needless to say, there was not a shortage of good news for all of us to digest in the period. Attention will now be diverted to the depth and magnitude of the reflation and recovery in this new economic cycle we are embarking upon. This will be on most investors minds' in early 2021 and will set the direction for equity markets over the next several months.

	December 2020		4Q 2020		YTD 2020	
Equity index returns (%)	U.S. dollar	Local currency	U.S. dollar	Local currency	U.S. dollar	Local currency
S&P 500	3.8	3.8	12.1	12.1	18.4	18.4
MSCI ACWI	4.6	3.8	14.7	12.8	16.3	14.2
MSCI ACWI ex USA	5.4	3.5	17.0	12.6	10.7	6.0
MSCI World	4.2	3.5	14.0	12.4	15.9	13.5
MSCI Emerging Markets IMI	7.4	6.1	19.9	16.1	18.4	19.2
MSCI EAFE	4.6	2.5	16.0	11.4	7.8	0.8
MSCI Europe	4.7	2.2	15.6	10.3	5.4	–2.2
MSCI Pacific	4.5	2.8	16.7	13.2	11.9	6.2

Source: RIMES; Capital Group

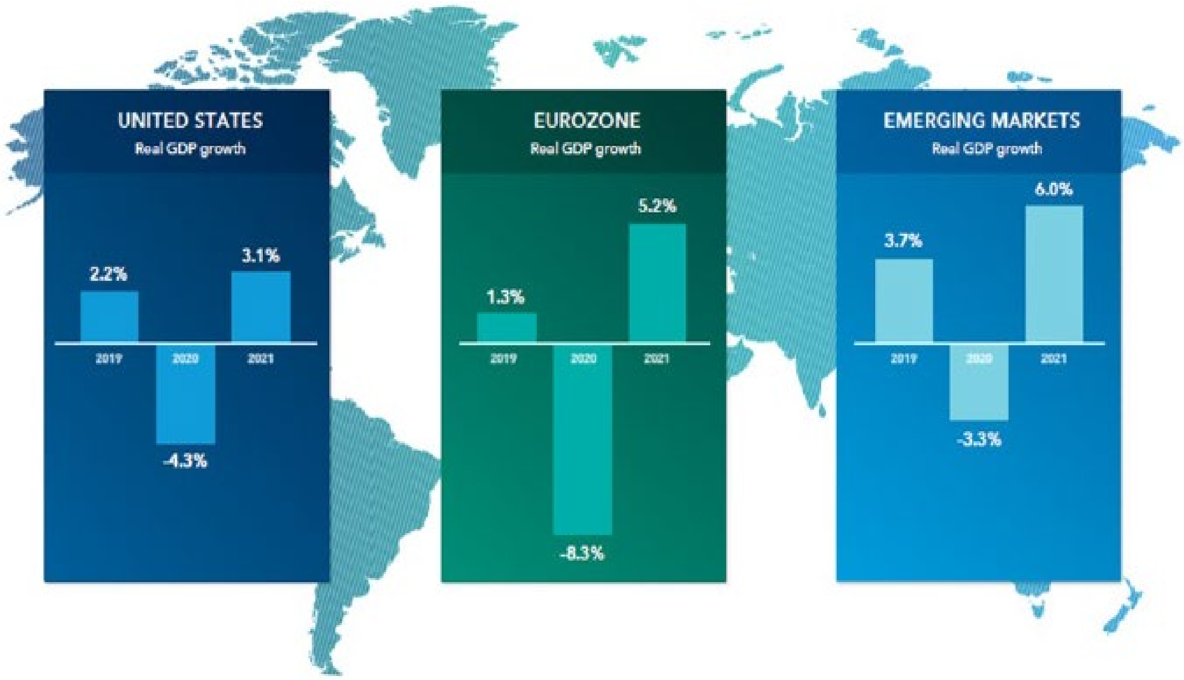
The MSCI EAFE Index (net dividend) and the MSCI Emerging Markets Index returned +16.05% and +19.70% respectively during the fourth quarter of 2020 vs. +12.15% for the S&P 500 Index. Investors continued to emphasize emerging market and international developed market equities as the global economies reflate and pick up steam along the way. The U.S. dollar continued to weaken in the quarter as global equities garnered further appeal with investors and provided an additional +4.6% return for unhedged U.S. investors. As was the case in the previous quarter, the Pacific region was slightly stronger than the European region as the equity markets in Australia and Singapore were very strong. All eleven sectors of the MSCI EAFE Index posted gains, but Energy, Financials, and Consumer Discretionary led the way. Also, commodities were very strong benefitting from ongoing reflation, as most hard and soft commodities rose substantially.





Sources: Resource Consulting Group, MSCI

So far through the end of February, global equities have been on a bit of a roller coaster ride but seem to be pushing higher on the margin as the coronavirus vaccine is being widely distributed in most parts of the world as these economies are “re-opened”. Also, economic data points are continuing to rebound from the lows of several months back. Further stimulus packages continue to be debated in Europe, Japan, and the U.S., which are giving rise to more investor confidence with the birth of a new economic cycle. All of this is very conducive to further equity market gains. The MSCI EAFE Index and the MSCI Emerging Markets Index are up approximately +1.5% and +4.0% respectively through February, vs. +1.7% for the S&P 500 Index.

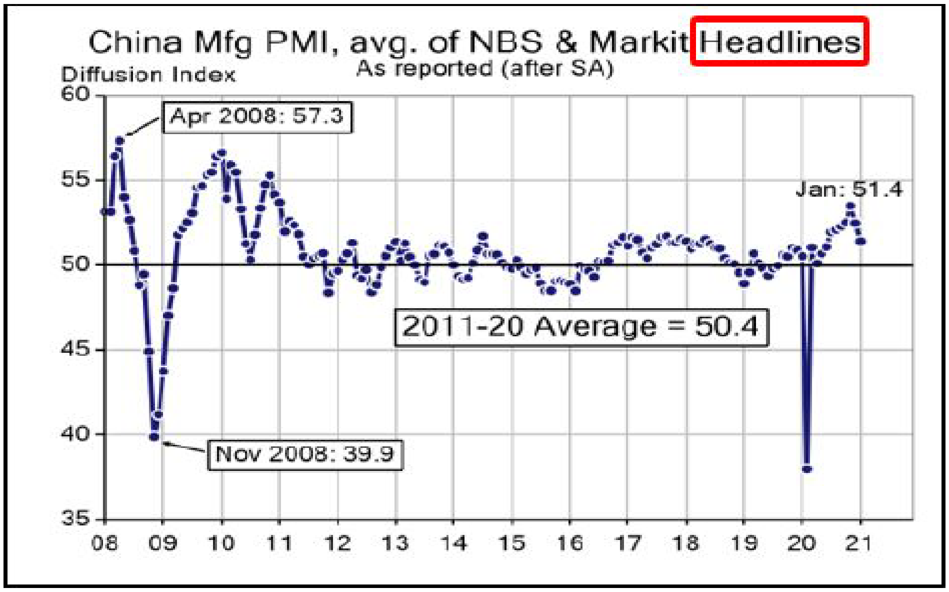


Source: International Monetary Fund; World Economic Outlook October 2020; Eagle Global Advisors

Asia Update

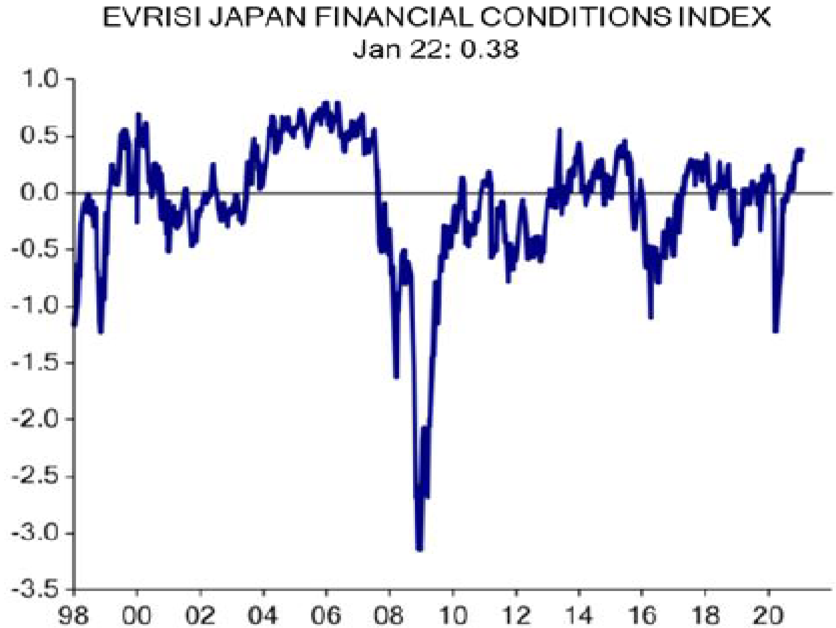
The Asian equity markets continued to push higher in the fourth quarter as favorable news on the vaccine front was a nice catalyst for the "re-opening" trade to garner further momentum with investors. With this re-opening trade came the prospects for increased trade with the U.S. and Europe and better economic readings. In Japan, Prime Minister Yoshihide Suga promised new initiatives for improving productivity aimed at Japan's small businesses utilizing a subsidized capital expenditure program. This was well received by investors. Also, the continued efforts of the Bank of Japan (BOJ) and The Peoples' Bank of China (PBOC) to pass coronavirus relief measures kept investors interested in these equities in the quarter. This helped the Japanese equity market to rise +15.3% to a 31-year high. Also, the Australian equity market rose nearly +23% as the country benefited from increased trading prospects with China as the global recovery gains traction. Overall, the MSCI Pacific region rose +16.7% in the period, which was the best performing region in the MSCI EAFE Index. The setup for further gains seems excellent at the moment.

China's economy continued to display resiliency vs. the rest of the world as fourth quarter GDP rose by +6.5% from a year earlier. This pushed growth for all of 2020 to +2.3%. This economy is the only major economy around the world to post GDP growth in 2020 in what was the worst of economic times seen in many of our lifetimes. Since this economy was the first region to fall prey to the coronavirus, it would only seem natural that it should the first to put the economic effects behind it. However, this growth did come at a high cost as debt surged. China's share of world GDP grew substantially as every other region faced a contracting economy. With 2020's economic growth, we could see China overtake the U.S. as the world's largest economy in eight to nine years, several years sooner than anticipated before the coronavirus. The economy really benefitted from a surge in exports related to medical supplies and equipment to the U.S. and Europe. It has been estimated that China shipped over 200 billion masks to other parts of the world. With the growth we saw in this economy over the last two quarters, we believe leaders will gradually withdraw stimulus actions in 2021 to cure the imbalances in the region. China will be the first major economy to proceed down this path and could provide the framework for other regions to follow later in 2021. Industrial production was impressive as December production rose +7% from a year earlier, picking up a little pace from the previous month. Going forward, supply chains are still very delicate and could be subject to disruptions at any time in the current climate. Fixed asset growth rose +2.9% for all of 2020, which we find to be decent considering what the coronavirus did to the economy here and around the world. We look for this to pick up quite a bit in 2021. Exports remained strong, as December exports rose +18.1%, which is just a slight decrease from November's level. Exports to the U.S. remained strong in the fourth quarter as key medical supply shipments were robust as mentioned earlier. Retail sales continued to trend higher as December sales are up +4.6% from a year earlier, which was near the best levels of the year. However, for all of 2020, retail sales fell -3.9% as the consumer held back on purchases due to the uncertainty with the pandemic. This should get much better in 2021. CPI has been limping near zero lately as December rose only +.2% from a year earlier. We expect this deflation scenario to be short lived and should get better as we move through 2021. We don't expect the PBOC to take any action over the near term on CPI but could do so if it becomes more of a longer-term issue. As we move through the early part of 2021, we continue to see the economy strengthening as China will be the first of the major economies to move past the pandemic and get back to more normal growth rates. We expect the rest of the world will follow China's lead as this unfolds. This could be good for the equity markets here as well.



Source: Evercore ISI

The Japanese economy continued a recovery path as fourth quarter GDP rose +3.0% from the previous quarter, or +12.7% from the previous year. This was the second quarter in a row of good economic growth as the country tries to emerge from the grips of the pandemic and puts the contraction at -4.8% for all of 2020. This is smaller than the hit took in 2009 from the Great Recession. Business spending, rising trade, and better household spending were all better than expected in the quarter and contributed to the growth. Previous economic stimulus packages are beginning to flow through the economy and should continue to impact growth in the early part of 2021. Exports continued to push ahead as December exports rose +2.0% from a year earlier. Gains were led by semiconductor equipment and plastics to destinations of China, Hong Kong, and the U.S. as we are seeing global shortages in these industries. Industrial production was a bit of a mixed bag in the fourth quarter as December fell -1.6% from the previous month, or -3.2% from a year earlier. We just saw no consistency in the quarter as fresh lockdowns from the coronavirus in certain areas of the country were tough to overcome. Japan's leading economic index continued to inch higher as December's reading of 95.3 was just under the highs of the last year. We would expect this to continue to move higher as we move into 2021. Consumer confidence was weak lately as January's level of 29.6 was the lowest levels in nearly six months. We believe the consumer will remain rather subdued until they see a full roll-out of the vaccine in the coming months. Conditions in the labor market seemed to have stabilized in late 2020, as December's jobless rate fell back to 2.9%, while the jobs-to-applicant ratio rose slightly to 1.06. This region seems to have escaped severe damage from an employment perspective from the pandemic. As we gauge the next several months, we believe we will see an acceleration in the economic recovery in Japan as the vaccines become more available and we move past mandated lockdowns in some areas of the country. Also, exports could be healthy as well as the rest of the world moves past this pandemic. This should be good news for investors and could push equity markets higher in the next few months.



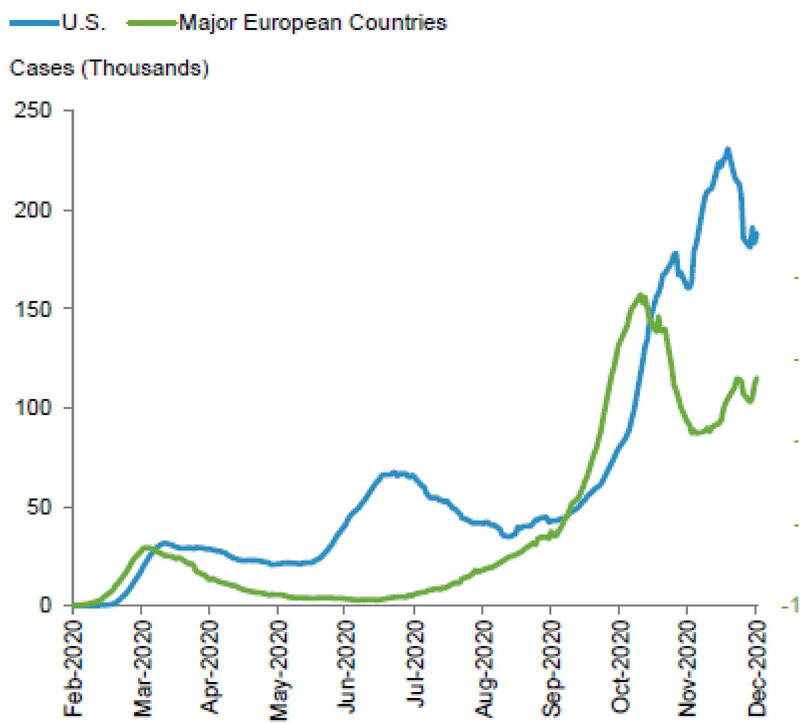
Sources: Evercore ISI

Europe Update

The fourth quarter was much the same as the previous quarter as coronavirus news flow, continued green shoots of an economic recovery, and a massive stimulus package by the EU seemed to be the perfect recipe for continued investor confidence in the region. We saw fresh lockdowns in several countries early in the quarter as new infections and the death toll from the virus reached fresh highs, only to be relaxed heading into the Christmas season. On the fiscal side, EU leaders approved a massive 1.82 trillion-euro long term budget and EU Recovery Fund to heal from the dire economic reality of the coronavirus. This was an expansion upon a smaller program and resulted in the largest stimulus package ever passed in the region. Embedded in this plan are many policies aimed at “green initiatives” and digital transitions designed to make the region more competitive in world trade for years to come post the pandemic. On top of these unprecedented actions, we witnessed a bottoming in many key economic datapoints with many of these improving as we moved through the quarter. All of this was well received by investors and pushed the MSCI European Index (ex. U.K.) +15.2% in the quarter and near all-time highs for this index. This fourth quarter move made the overall return for calendar year 2020 a respectable +10.9%. The equity markets in Spain, Italy, and France led the way with returns of +27.7%, +21.3%, and +20.4% respectively in the quarter. The rebound has been quite pronounced coming off such a low base many months back.

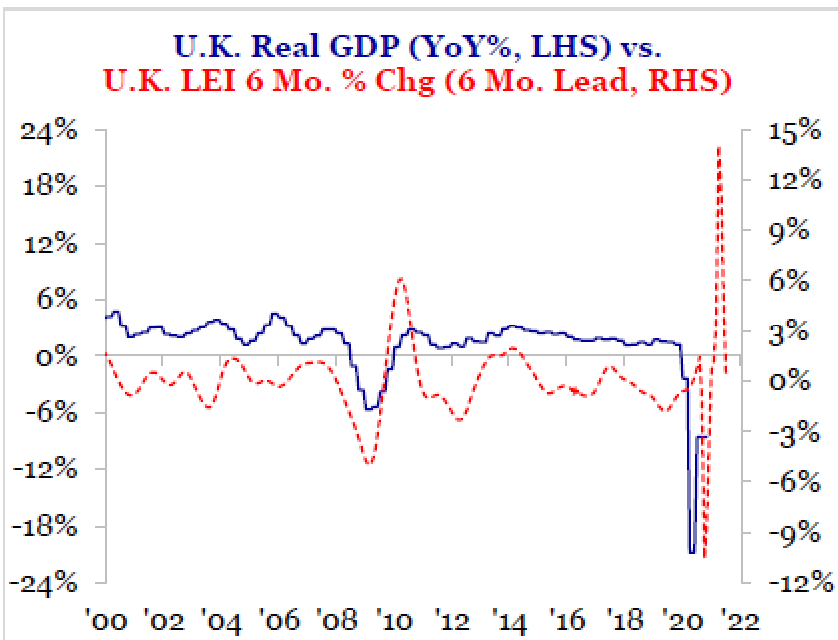
The European economy slipped back into negative territory as fourth quarter GDP fell -.7% from the previous quarter or -5.0% from a year earlier. New lockdown measures early in the quarter wound up being too much to overcome even as we saw some of these restrictions eased toward the end of the quarter. Officials became more worried as a new more deadly variant of the coronavirus began to show up in several places in Europe. It became a game of cat and mouse as officials took measures to slow down the spread of the virus, but these measures resulted in a constriction of the economy. The economies of Italy and France contracted the most of the big four European economies, while the German economy managed to eke out a slight gain on the strength of its manufacturing and construction industries. Eurozone industrial production slipped -1.6% in December after posting successive increases in October and November. The industrial recovery remained spotty and delicate from country to country with no clear direction month to month. However, we see good prospects for a more pronounced recovery developing in the first half of 2021 as worldwide demand is set to increase as the vaccine roll-out continues. The economic confidence index continued to move higher as December rose to 90.4 from a low November reading. This has a good chance to move even higher in the coming months as many businesses are making plans to bring back more and more production to satisfy increasing demand. Retail sales are showing some signs of life as December sales were up +2.0% from November. The biggest gains are coming from the countries that experienced a more severe shutdown as consumption was quicker to come back. Core CPI is starting to move away from deflationary risks as January core prices rose +1.4% from the prior year as services inflation picked up noticeably from late 2020. This should take a little pressure off the European Central Bank (ECB) in its efforts to fight deflation across the region. Employment readings are moving in the right direction, but at a trickle of a pace. The December unemployment rate fell to 8.3%, down slightly from the end of the third quarter. This varies from country to country as well but is trending in the right direction. We are looking for a stronger recovery story to develop in the Eurozone as we enter 2021. This should be a base case as China is in full recovery mode and the U.S. is not that far behind. News flow on new virus infections and vaccine distribution will play a key role.

Newly Reported COVID-19 Cases



Source: World Health Organization; Fidelity Investments; Bloomberg

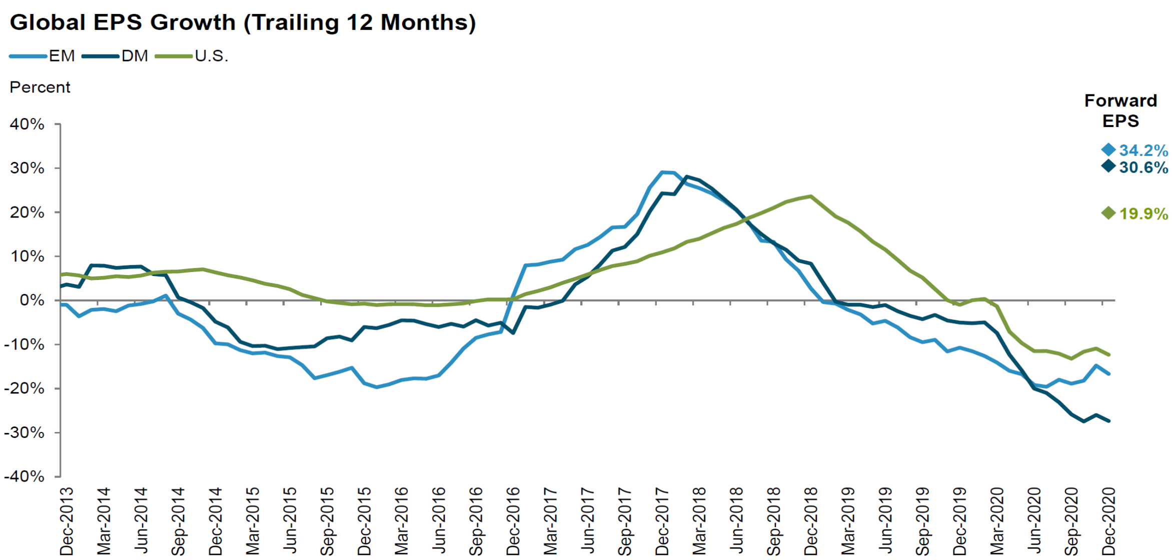
Just when you think things could not get any worse for the U.K. economy on the coronavirus front, a new strain of the virus hit the region in the fourth quarter prompting government officials to institute fresh lockdowns to control the spread of this more deadly strain. While it looks like these aggressive actions did work remarkably well by many estimates, it did push out a recovery in this economy a bit longer than we were expecting. However, as disappointing as this news was, we did have a major piece of good news, as the U.K. and the EU reached a last-minute trade agreement on Christmas Eve. The economic agreement will cover bilateral trade worth more than 650 billion pounds. The deal has implications for the medical, automobile, chemical, professional services, and the fishing industry. The U.K. is free to set its own standards and companies in the EU will have the ability to challenge aid provided U.K. companies in the U.K. court system. We see this as a major impediment lifted to the fundamental outlook of this economy. This pushed the MSCI U.K. Index up +18.6% in the fourth quarter, which was one of the best performing major markets around the world. GDP rose +1.0% in the fourth quarter from the previous quarter but fell -7.8% from a year earlier. Slow roll out of the vaccine and tight restrictions on large parts of the populations led to this subpar growth. However, we expect growth to rebound sharply as restrictions are lifted in the early part of 2021. Industrial production continued to move ahead at a crawl as December's reading showed only +.2% growth from the previous month. The mining and the oil & gas industries were the weakest as workers in these industries were hit hard by lockdowns and restrictions. Retail sales growth has been lackluster as December sales rose only +.4% from a month earlier. Clothing sales from the Christmas season rose nicely in the period, while supermarkets and department stores declined. We don't expect too much from retail sales in early 2021 as the effects from the lockdown still have a firm grasp. Core CPI rose +.3% in December from the previous month as inflation remains subdued from the lockdowns. This should stay very manageable over the near term and not even half of the Bank of England's (BOE) stated goal. At its early February meeting, the Monetary Policy Committee (MPC) voted to maintain its main benchmark interest rate at .10% and keep its bond purchase target at 895 billion pounds. The MPC delivered a fairly optimist economic outlook for 2021 in a post-pandemic view that will probably derail any further significant monetary easing if this unfolds. This is probably a bit more optimistic than the view held by many investors. Fourth quarter unemployment rose to 5.1%, which is the highest level in four years. A lot of furloughed workers that were expected to come back on the payrolls in the quarter have had their furloughs extended even further into early 2021. Perhaps these workers will be back on the payrolls in the months to come. Going forward, the Brexit deal reached in late December should remove a major overhang on this economy and set the stage for an economic lift to the region once we get on the other side of this pandemic.



Sources: Strategas

Emerging Markets

As investors continued to become more comfortable with progress on the vaccine front in the quarter, emphasis was put on adding risk with the "re-opening trade" as many of the emerging market economies seemed to be set up for a significant economic rebound. As a result, emerging market equities were some of the best performing regions in the December ending quarter. Commodity prices continued to move higher for the second consecutive quarter and a further weakening of the U.S. dollar aided returns in the period. The equity markets in Brazil, South Korea, and Indonesia were extremely strong in the period from the rebound in commodity prices, while the Chinese equity market was a relative under performer in the period as investors focused attention to other countries that might offer better returns over the near term. The MSCI Emerging Markets Index rose +19.7% in the fourth quarter and +18.3% for all of 2020, significantly outperforming large cap developed market equities outside of the U.S. Looking out into 2021, we do like what we see in most of the emerging markets. Economies are set to grow well above the developed markets, inflation still looks manageable now, and investors preference for a rotation to more cyclically oriented equities all should benefit this asset class. Returns could have a long way to go over the next few years as ten-year returns with this asset class are still rather dismal vs. returns with U.S. stocks and large cap stocks outside of the U.S. In addition, we see earnings growth in 2021 well above other regions around the globe and equity valuations in the emerging markets are about the only region that don't seem to be overly stretched vs. other parts of the world.



Sources: Bloomberg; MSCI; Fidelity Investments 1Q Chartbook

International Equity Activity/Strategy

As we put our thoughts into the first half of 2021, while the easy gains of the past couple of quarters might be behind us, we still believe the setup for further upside in the global equity markets is quite positive. We see an environment of more fiscal stimulative policies in place in almost every region of the world and this should add to the "recovery trade" that is taking place in the equity markets in a post pandemic world. This is a powerful force at the moment even as most markets are near all-time highs and peak valuations. Many of the issues that we have been concerned with in the past, such as Brexit, U.S. elections, and U.S./China relations are either behind us or are much better on the margin. Also, the coronavirus vaccines are in full distribution and widely available in early 2021. So, what concerns investors going forward? Massive debt levels from stimulus actions, rising deficits, and the potential for rising inflation in many parts of the world. This is already pushing interest rates higher in some parts of the world. Many are now debating at what level do interest rates present a real problem for equity investors. But even taking these issues into consideration, we are maintaining our case for further global equity market gains in early 2021.

Considering our positive outlook for global equities, we did add approximately $300 million to our large cap EAFE portfolio in mid-December through a structured note linked to the MSCI EAFE Index designed to give us the return of this index plus a small out-performance component over a 15-month period. Also, we continue to be very active with our put/call writing strategy on EEM, as premiums remain very attractive for this in the current equity market and interest rate climate. Emerging market equities remain an asset class that looks attractive to us going forward over the long-term. Our current allocation to Emerging Market equities is approximately 3.91% of total assets and approximately 11.15% for MSCI EAFE equities across our TRS, ERS, and JRF portfolios. *(Credit is given to the following entities for charts provided: Bloomberg, Strategas, MSCI, Fidelity Investments, WHO, Resource Consulting Group, Morningstar, Evercore ISI, World Economic Outlook, Eagle Global Advisors, IMF, RIMES, Capital Group)*