Market Review and Outlook
June 30, 2021

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Market Environment
June 30, 2021

- Economic
  - Vaccine distribution and administration in the US has led to a near full reopening of the economy; however the Delta variant has introduced some renewed caution as other, less vaccinated parts of the world have reintroduced restrictions.
  - Cash payments from stimulus packages have been made and have boosted consumption in Q2, so much so that supply chain disruptions and shortages, transportation issues, and lack of labor to maximize production and sales continue to be significant economic issues.
  - Input costs including commodities and raw materials, freight and transportation, manufacturing and operating, and employment have risen significantly, and companies are passing those costs along to increased final prices and fewer discounts.
  - Inflation remains on the rise with the impact from rising home prices, up over 15% YOY just starting to work through the data.
  - Oil prices have moved to over $70 and CPI hit 5.4% YOY including .9% in June and a 9.2% annualized rate in Q2.
  - Employment gains have been less robust than expected as continued excess unemployment benefits keep workers on the sidelines while the number of jobs available continue to grow. This has resulted in reduction of production and hours of operation across industries.
  - The fiscal year end 2020 fiscal package provided a significant, but short term pop in activity that quickly receded. We will see if the recent, larger package, will be more lasting amid broader reopening, vaccinations, and better weather.
  - Competing with the "unemployment wage" is hampering business ability to hire workers to support growth, providing a risk to growth.
- Policy
  - Fed policy is to hold interest rates near zero well into 2023 and continue purchasing $40B MBS and $80B Treasuries per month, however a number of Fed governors are discussing an end to stimulus sooner as it becomes difficult to justify.
  - A total of $5.5T in government programs has been passed, with a contentious infrastructure bill and another currently being debated.
- Markets
  - After rising significantly in Q1, interest rates are trading in a range off their recent high levels as rates are stuck between rising inflation and additional bond issuance, and a flight to quality as higher rates impact equity and risk assets.
  - Long term bonds rose in price, while Short-Term Treasury Inflation Protected Securities and High Yield bonds continued to perform well.
  - Treasury continues to $300B – $400B per month while additional fiscal packages are debated.
  - An argument in the market for falling long rates is the potential Fed Tightening sooner, which would stunt economic growth. Meanwhile equity markets continue to reach new record high levels across Dow, S&P, and Nasdaq.
  - Market leadership has shifted with Banks, Industrials, and Energy lagging while technology and other high flyers have resurfaced. Value and equal weight S&P have given back some of their outperformance YTD as growth has come back.
  - Inflation will be a key focus of markets in the near term as it continues to rise above expectations and may force the Fed to pull plans forward to remove excess stimulus. This may push rates higher and upset equity markets.

Market Outlook
June 30, 2021

- We are in the midst of perhaps one of the greatest policy mistakes, simultaneously on fiscal and monetary, in history.
- As the economy returns to its full functioning ability, with the lower side of the K shaped recovery returning amid vaccinations, reopening and better weather, it will be interesting to see how much of the pandemic adopted behavior remains.
- The reopening economy is meeting markets expectations, tracking a 6-8% rate of economic growth and evidenced by continued rising job openings, however those openings are not being filled rapidly due to government extended unemployment benefits and unemployment bonuses, threatening to slow overall economic growth.
- Monthly gains in payroll are falling well below expectations, and while weekly initial unemployment claims are drifting lower, the population is actually rolling to extended unemployment programs that have remained at extremely high levels.
- Evidence is showing businesses are having to raise wages to attract workers, while also cutting back on service hours and production as the cost and unavailability of labor prevents business growth.
- Rising costs of labor, raw materials, transportation, and other input costs are being passed through, with CPI printing 5.4% for June.
- Growth in core consumption in staples, nondiscretionary and discretionary spending has been significant on the back of excessive government cash payments and may continue; however, may be at risk amid end of stimulus, rising prices and limited availability.
- Corporate investment has slowed after a surge in technology needs during the pandemic.
- The yield curve has twisted with short rates rising, pulling forward Fed expectations, while long term rates fell reflecting fear of economic slowdown. Also, foreign demand for US Treasuries amid faltering economies such as China has increased.
- Moving forward, Government borrowing, economic growth and inflation should push longer term rates higher, which may help temper rate sensitive economic sectors such as housing, which is running hot with over 15% price gains last year and little inventory for sale.
- The Fed may be perfectly happy with rising long-term rates to temper activity as the market does the Feds work for it but will stay the course on communicating easy policy until inflation and employment goals are exceeded.
- Energy, Banks, and industrials have lagged recently amid doubts about longer term growth prospects. Utilities continue to languish.
- As previously discussed, manufacturing will likely exhibit continued growth amid onshoring of supply chains and growth in logistics, new technology, including alternative energy, electric vehicles, efficient operations and transportation of goods and services.

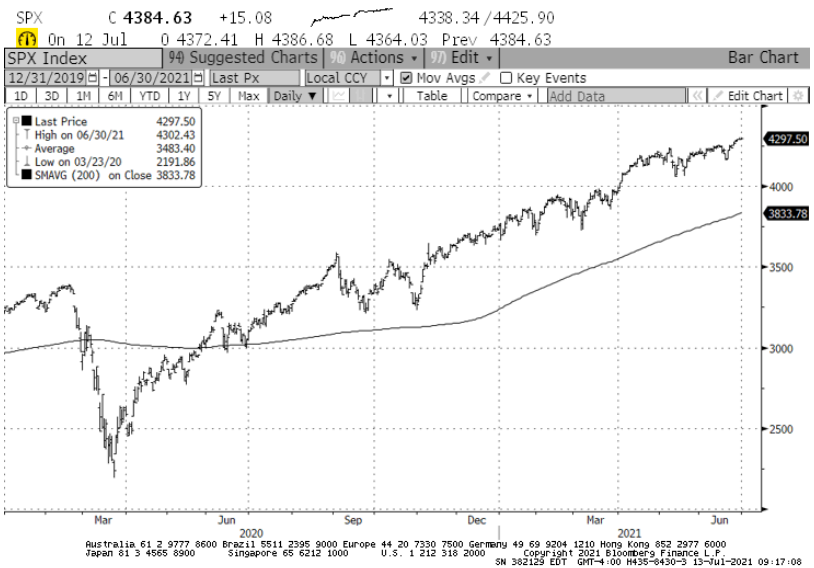
Investment Strategy
June 30, 2021

- After a recent adjustment to market valuations, with pandemic induced downtrodden sectors such as Energy, Banks, and Industrials making a strong recovery, and high-flyers such as Tech and speculative assets correcting, markets have moved closer to equilibrium from a relative value perspective, albeit at very high absolute valuations.
- During Q2, markets brought growth back to the forefront, with value sectors lagging.
- Markets are now shifting leadership with some frequency, supporting the argument of equilibrium.
- The excessive monetary and fiscal stimulus, along with vaccinations, reopening, and warmer weather is providing a foundation for relatively robust near-term economic growth.
- While many speculative assets have corrected a bit, significant excess liquidity continues to push markets higher and provide capital for funding new ventures. The upcoming earning season will be important to support current valuations.
- Continued themes of onshoring of supply chains and new technology will push growth allocations, while income producing value companies in banking, industrial, energy, and utility sectors will occupy core equity and corporate bond allocations.
- Fixed income allocations will continue to defend against interest rate sensitive longer-term bonds, while looking to generate income in shorter term securities across the range of sectors and quality and will include adjustable and fixed rate corporate, mortgage, Treasury and Inflation protected securities, and High Yield corporate where appropriate.
- Despite high current valuations, asset prices may move higher in this environment, along with interest rates, perhaps pushing the S&P 500 to 5,000 (likely driven by broader participation), and 10 year treasury yields to 2.25% over the next few quarters.
- As the year progresses, higher interest rates, a growing debt burden, and the expiration of current economic stimulus provides risk of decelerating economic activity. Rates could reach 2.25%, and S&P 500 could rise 20%, with a real risk of a 20% correction.
- While significant progress has been made against the pandemic, resurgence of the coronavirus, such as the Delta variant, amid reopening and continued shutdowns around the world will continue to provide headwinds to global economic growth.
- As we move through the year, the next discussion on the fiscal front will include increased tax burdens, which will detract from economic growth and corporate and individual profitability.
- The portfolio growth and income strategy will focus on income as a key source of return via bond income and equity dividends and focus its growth and capital appreciation allocation toward the technology sector, and the evolution of technology as it applies to consumer behavior, industry, health care, alternative energy, and the overall economy.

Market Review

S&P 500 – June 30, 2021

- Equity markets have continued to push higher while interest rates have receded from recent high levels, suggesting a mismatch in outlooks.
- This earnings season will need to support equity valuations amid a bond market that is suggesting slowing economic growth.



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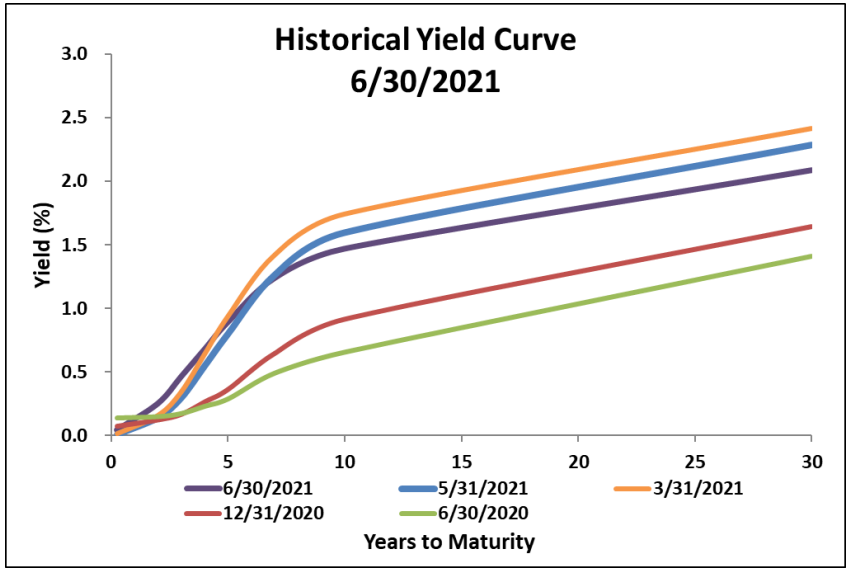
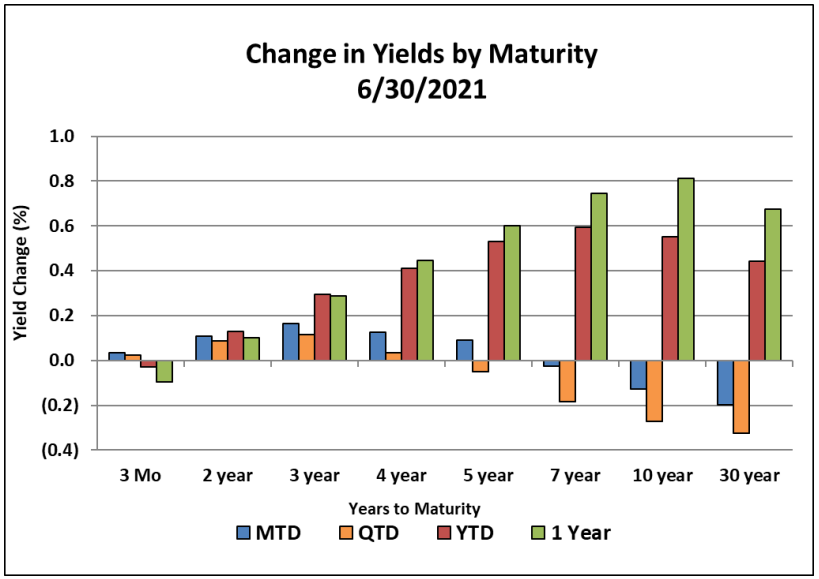
Market Review

Yield Curve – June 30, 2021

- After interest rates rose back to their pre pandemic levels, amid significant increased debt issuance, economic growth and rising inflation expectations, the yield curve twisted during Q4.
- Short term rates rose as markets pulled forward the timing of the first rate hike.
- Long term rates fell as markets began to doubt the strength of the US economy, and foreign buying emerged amid slowing global growth, particularly in China.
- Inflation continued to climb and significant Government debt issuance should continue to influence rates higher.





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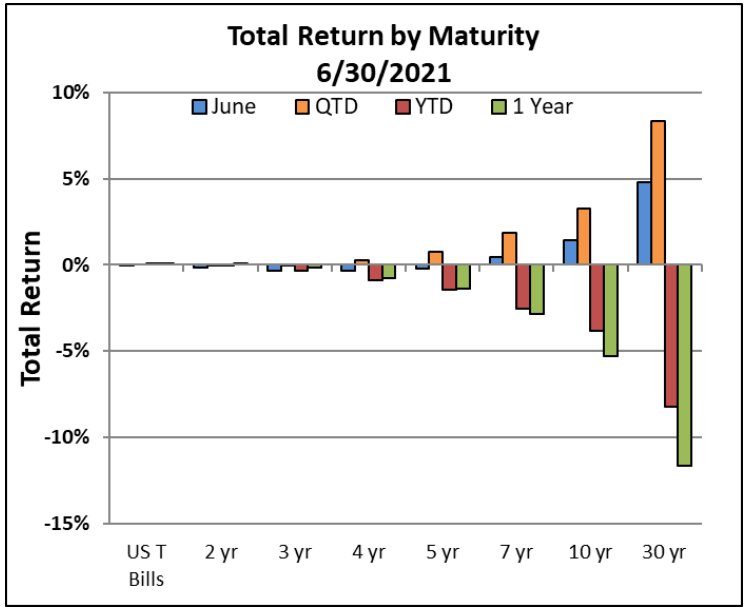
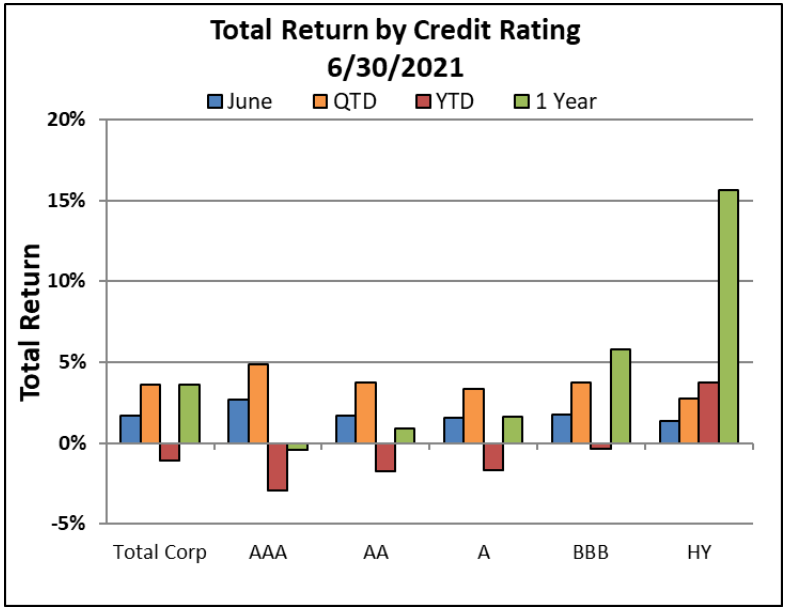
Market Review

Yield Curve and Credit Rating Returns – June 30, 2021

- Total returns on longer term Treasuries were positive in Q2 given the drop in rates, while shorter term Treasuries were slightly negative given the rise in short rates with little income to offset.
- Investment grade corporate bonds also generated positive returns in Q2 largely due to longer durations as yield spreads maintained historically tight levels. High Yield continued to perform well.
- Longer term securities are still vulnerable if rates continue to rise amid massive issuance and rising inflation, including longer term corporate bonds given relatively narrow yield spreads.





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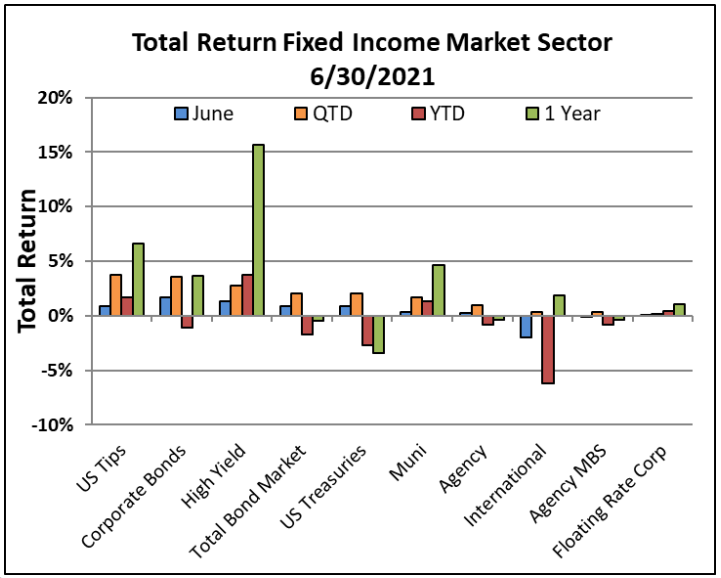
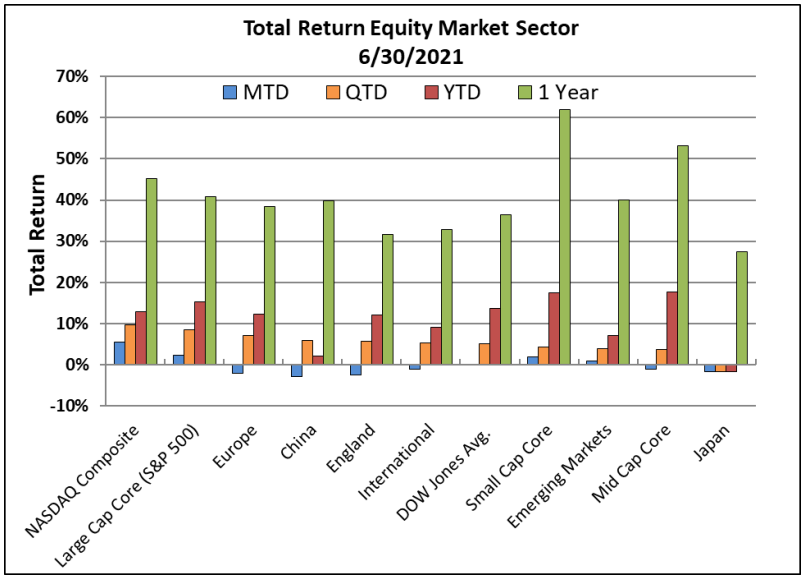
Market Review

June 30, 2021

- TIPS (Treasury Inflation Protected Securities) led fixed income returns in Q2, 2021 as inflation reached 5.4% on a Year over Year basis, and continues to accelerated.
- Lower rated and High Yield corporate bonds also led bond market returns amid a reach for Yield and a historically low default rate. MBS underperformed due to significant prepayment activity.
- FAANG was back as tech and growth stocks led equity market returns and continued to lead in June.
- Foreign equities turned in losses as China slows and pandemic concerns reemerged in less vaccinated countries. Small and Mid cap stocks retain their lead for the year.





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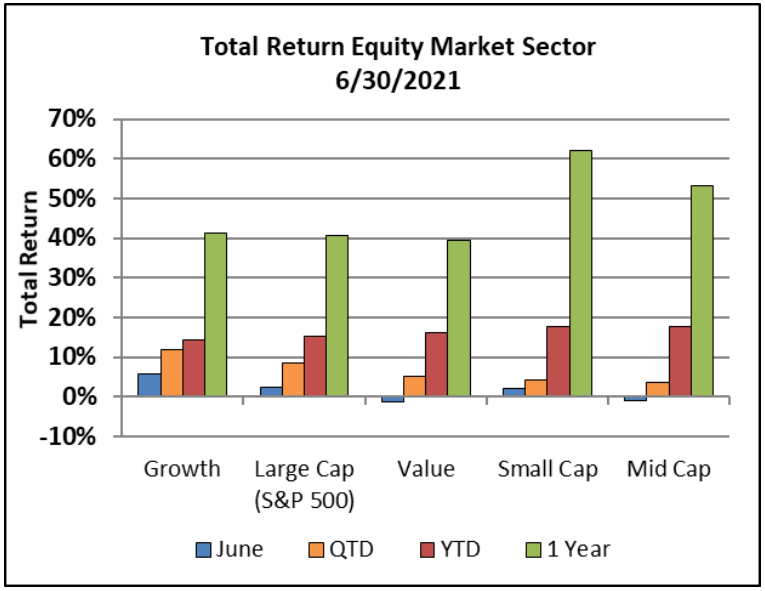
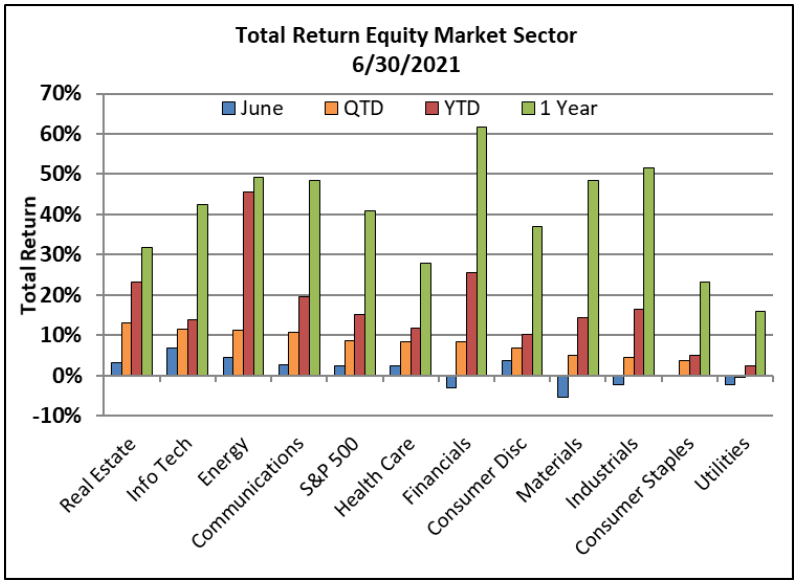
Market Review

Equity Market Returns – June 30, 2021

- Growth stocks regained their leadership and led markets higher to new records as interest rates moderated and value stocks lost their momentum.
- Energy stayed strong amid $70+ oil while REITS had a strong quarter.
- Banks and Industrials gave up their leadership and actually turned down in June.
- Utilities have continue to be stagnant, maintaining stability in down markets but not rising.





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Market Scoreboard
June 30st, 2021

Market Summary - June 30th, 2021					
Bond Market	**June**	**Q2 21**	**YTD**	**1 Year**	**Yield**
US TIPS (Inflation Prot.)	0.9%	3.7%	1.7%	6.6%	1.6%
International Bonds	-2.0%	0.3%	-6.2%	1.9%	0.2%
Floating Rate Corp	0.1%	0.2%	0.4%	1.1%	0.4%
Merrill Muni Index	0.3%	1.7%	1.4%	4.6%	1.3%
Corporate Bonds	1.7%	3.6%	-1.1%	3.6%	2.1%
High Yield Corporates	1.4%	2.8%	3.7%	15.6%	4.0%
Total Bond Market	0.9%	2.0%	-1.7%	-0.5%	1.4%
US Treasuries	0.9%	2.0%	-2.7%	-3.4%	1.0%
US MBS Index	0.0%	0.3%	-0.8%	-0.4%	1.6%
Commodities/Other	**June**	**Q2 21**	**YTD**	**1 Year**	**End Value**
Oil (WTI)	11.1%	25.2%	51.9%	81.6%	73.5
Gold	-7.2%	3.7%	-6.8%	-0.6%	1,770.1
Dollar Index	2.9%	-0.9%	2.8%	-5.1%	92.4

Market Summary - June 30th, 2021					
Stock Market Indices	**June**	**Q2 21**	**YTD**	**1 Year**	**End Value**
NASDAQ Composite	5.5%	9.7%	12.9%	45.3%	14,504
DOW Jones Avg.	0.0%	5.1%	13.8%	36.3%	34,503
Large Cap Core (S&P 500)	2.3%	8.5%	15.2%	40.8%	4,298
Large Cap Growth	5.7%	11.9%	14.3%	41.3%	2,934
Large Cap Value	-1.2%	5.0%	16.3%	39.5%	1,458
Mid Cap Core	-1.0%	3.6%	17.6%	53.2%	2,696
Mid Cap Growth	1.1%	3.4%	12.3%	45.4%	1,313
Mid Cap Value	-2.8%	3.8%	23.0%	61.4%	844
Small Cap Core	1.9%	4.3%	17.5%	62.0%	2,311
Small Cap Growth	4.7%	3.9%	9.0%	51.4%	11,361
Small Cap Value	-0.6%	4.6%	26.7%	73.3%	16,381
Europe	-2.1%	7.0%	12.2%	38.5%	452
England	-2.4%	5.6%	12.1%	31.5%	7,037
Japan	-1.6%	-1.7%	-1.7%	27.4%	28,792
China	-2.8%	5.8%	2.1%	39.8%	5,224
International	-1.1%	5.3%	9.1%	32.9%	2,305
Emerging Markets	0.9%	3.8%	7.2%	39.9%	55

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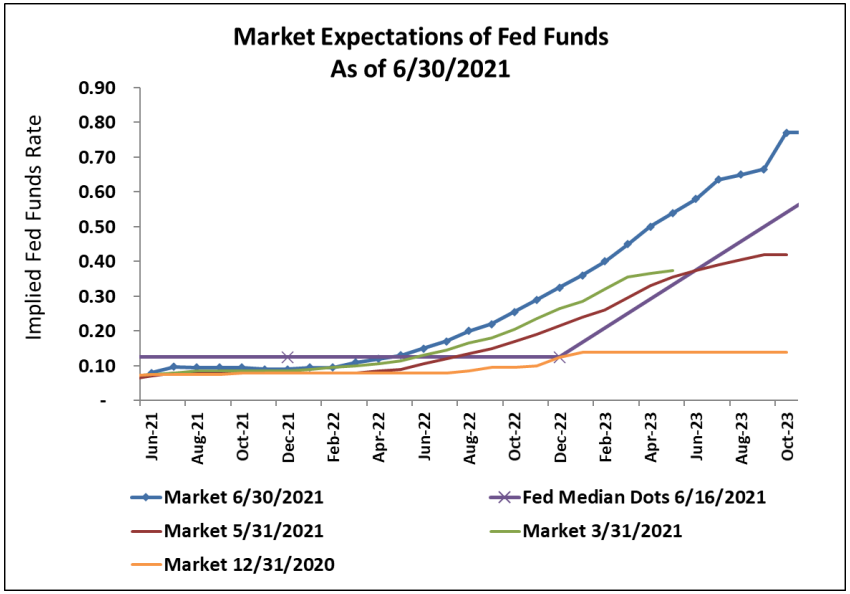
Market Review

Monetary Policy – June 2021

- The Fed held rates at their "lower bound" near zero, and continued purchases of Treasuries and Mortgages as the US Government issues record amount of debt to support Covid relief, and other programs. The Fed is buying $80 billion UST and $40 Billion MBS per month.
- The Fed has begun discussing reducing asset purchases, and a number of Fed Governors have pulled forward timing of the first rate hike, and the market has begun to price in the hike, but not the taper.
- Monetary policy will explicitly seek to let inflation run above targeted levels to achieve an average 2% over time, however actual inflation is accelerating well ahead of their expectations.



Federal Reserve Median Economic Projections
As of 6/16/2021

Change in GDP	Actual	2021	2022	2023	Longer Run
June 2021 Projection		7.0	3.3	2.4	1.8
Mar. 2021 Projection		6.5	3.3	2.2	1.8
Actual Q1 2021 yoy/qoq	**0.4%/6.4%**				
Unemployment Rate					
June 2021 Projection		4.5	3.8	3.5	4.0
Mar. 2021 Projection		4.5	3.9	3.5	4.0
Actual June 2021	**5.9%**				
PCE Inflation					
June 2021 Projection		3.4	2.1	2.2	2.0
Mar. 2021 Projection		2.4	2.0	2.1	2.0
Actual June 2021	**3.9%**				
Core PCE Inflation					
June 2021 Projection		3.0	2.1	2.1	
Mar. 2021 Projection		2.2	2.0	2.1	
Actual June 2021	**3.4%**				
Projected Policy Path- Fed Funds					
June 2021 Projection	0.1	0.1	0.1	0.6	2.5
Mar. 2021 Projection	0.07	0.1	0.1	0.1	2.5

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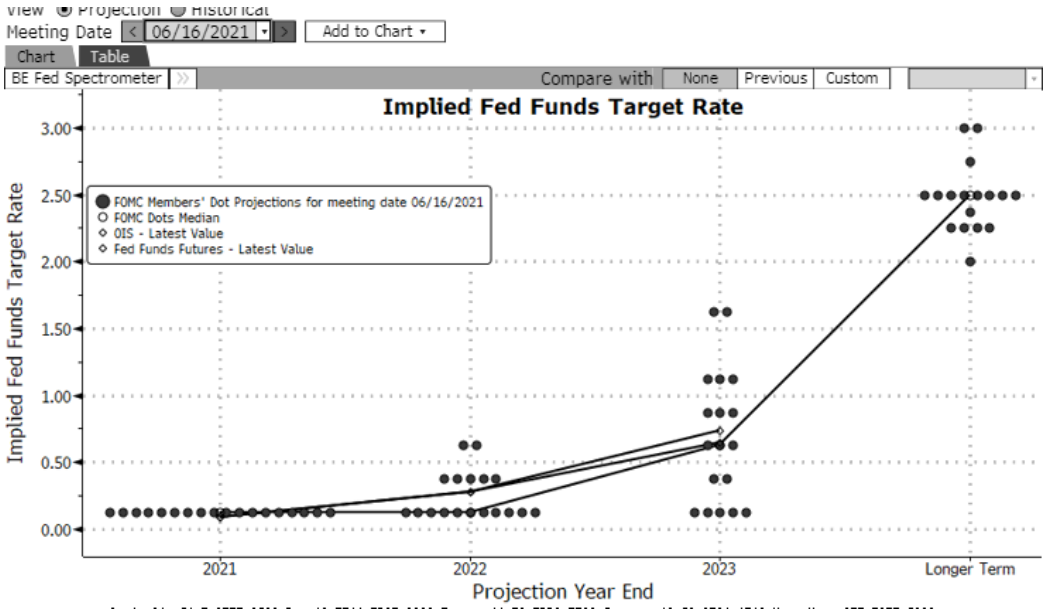
Market Review

Monetary Policy – June 2021

- Some Fed Governors pulled forward their expectations of the timing of the first tightening amid stronger than expected economic growth and rising inflation above expectations.
- Inflation expectations have risen but long term inflation implied by TIPS remain well below actual inflation and our expectations.
- The strong economy, particularly the housing market, is leaving the Fed with little reason to continue to purchase US Treasuries and MBS.



Current Fed Funds Rate
0.10

10 Year Tip	10 Year UST	Implied Inflation Premium
(0.95)	1.29	**2.25**

5 Year Tip	5 Year UST	Implied Inflation Premium
(1.75)	0.74	**2.49**

2 Year Tip	2 Year UST	Implied Inflation Premium
(2.61)	0.19	**2.81**

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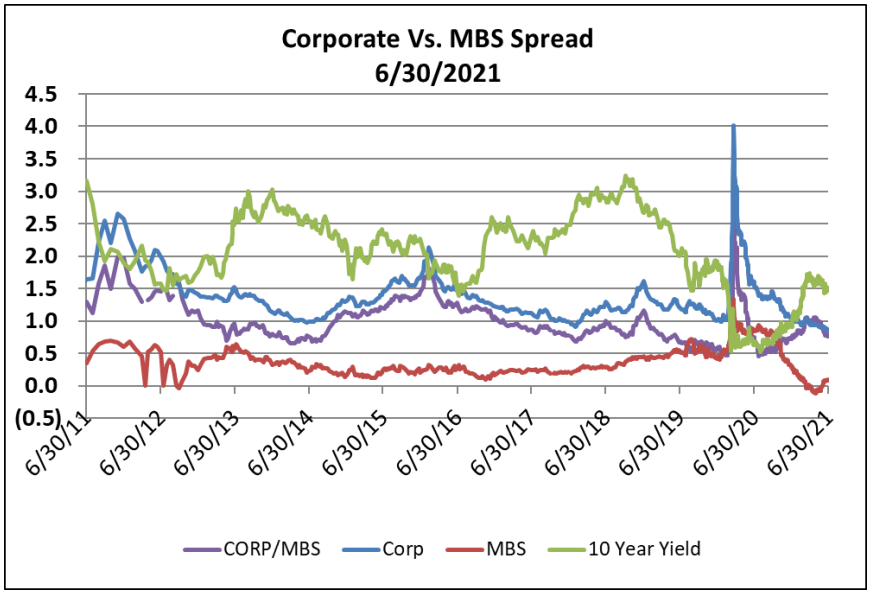
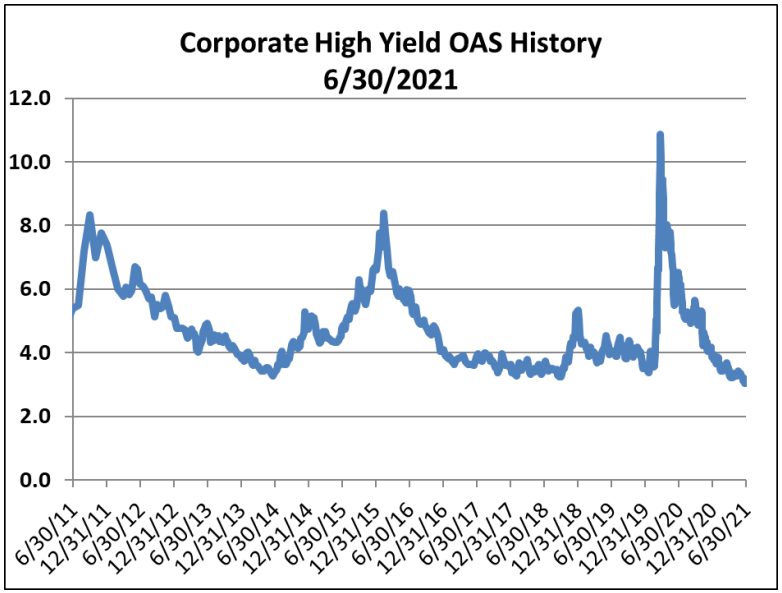
Market Review

Yield Spreads – June 2021

- Corporate yield spreads continue to grind tighter in 2021, MBS spreads dropped negative amid significant prepayment activity.
- Corporate credit conditions remain strong, and risk of default has not risen to the degree that would push credit spreads wider. Spreads may continue to grind lower through 2021.
- Some stressed sectors such as energy, airlines, and hotels risk premiums remain wide but have also tightened recently.





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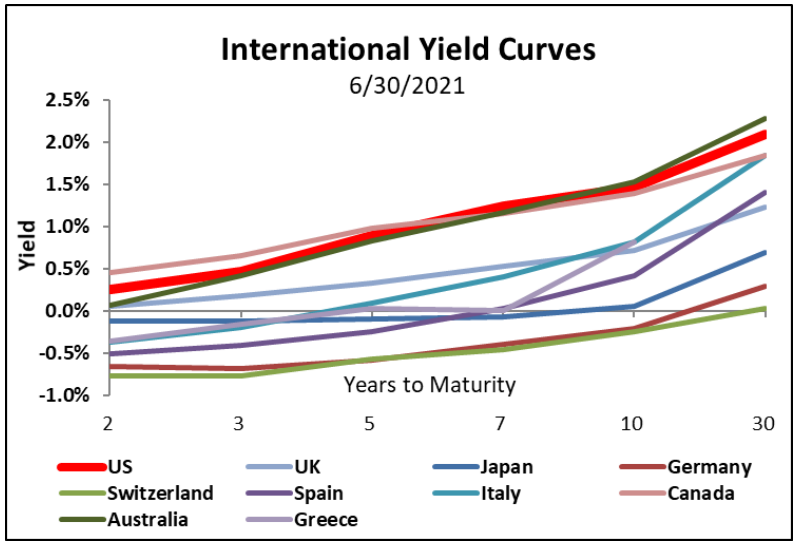
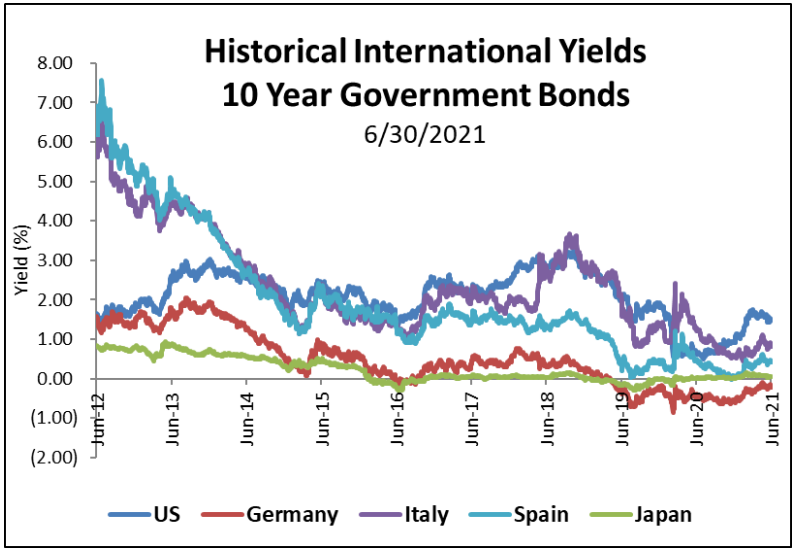
Market Review

International Yield Curves– June 2021

- Global central banks have continued easy monetary policy keeping rates low and significant bond purchases to support fiscal policy that provides relief for COVID-19 amid a global resurgence.
- The US continues as one of the highest yielding developed countries as rates remained negative in Europe and flatlined at 0% in Japan.





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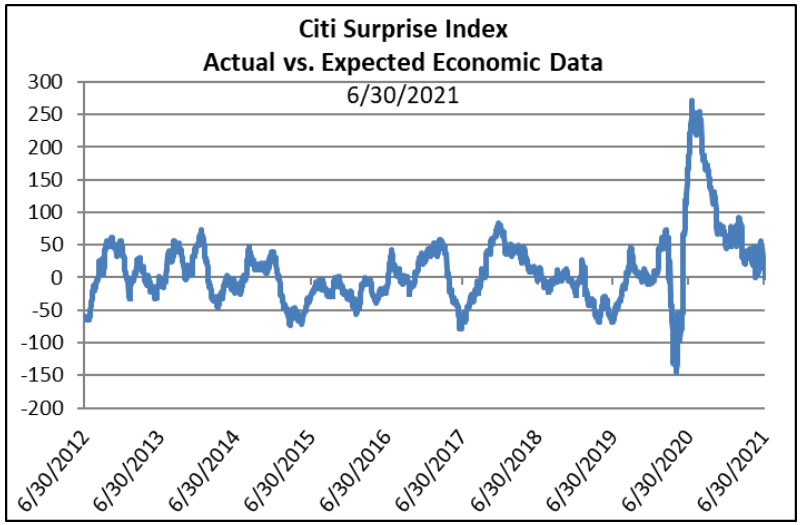
Economic Environment
June 2021

- Global GDP remains erratic country to country depending on the pace of vaccinations and spread of the new Delta strain of the virus.
- Inflation has moved higher with expectations of future inflation continuing to rise due to significant stimulus and the increased cost of doing business.
- The Citi surprise index has come down from its highs as economic results moderated and expectations began to rise. Expectations and actual economic activity have begun to move higher.



GDP YoY % Change			
	Q1 2021	One Year Ago	Change
US	0.40	0.30	0.10
Eurozone	(1.30)	(3.30)	2.00
Germany	(3.10)	(2.20)	(0.90)
France	1.20	(5.50)	6.70
Italy	(0.76)	(5.81)	5.05
UK	(6.10)	(2.20)	(3.90)
Canada	20.00	(16.50)	36.50
Mexico	(3.62)	(1.29)	(2.33)
Australia	1.10	1.40	(0.30)
Japan	(1.60)	(2.10)	0.50
China	18.30	(6.80)	25.10
Russia	(0.70)	1.40	(2.10)
Brazil	0.95	(0.27)	1.22

*Canada GDP as of 4/31/2021

Inflation YoY % Change			
	Jun-21	One Year Ago	Change
US	5.40	0.60	4.80
Eurozone	1.90	0.30	1.60
Germany	2.30	0.90	1.40
France	1.50	0.20	1.30
Italy	1.30	(0.20)	1.50
UK	2.10	0.50	1.60
Canada	3.60	(0.40)	4.00
Mexico	5.88	3.33	2.55
Australia	1.10	1.40	(0.30)
Japan	(0.10)	0.10	(0.20)
China	1.10	2.50	(1.40)
Russia	6.50	3.20	3.30
Brazil	8.35	2.13	6.22

*UK, Canada, & Japan CPI as of 5/31/2021
*Australia CPI as of 3/31/2021

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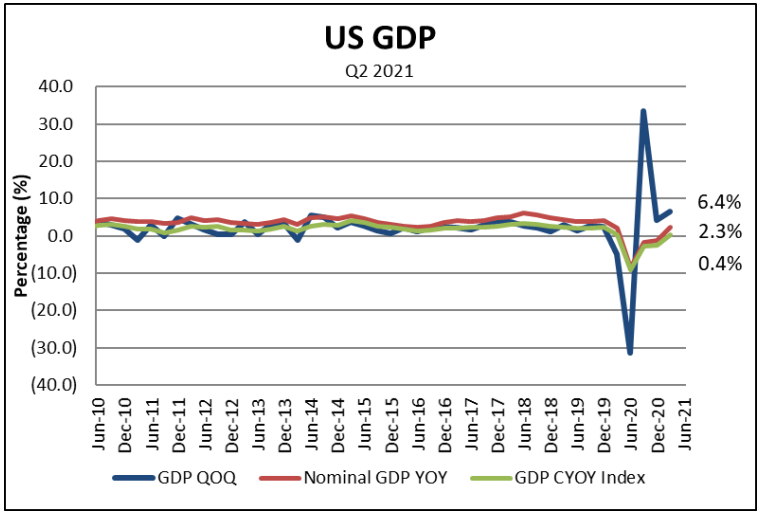
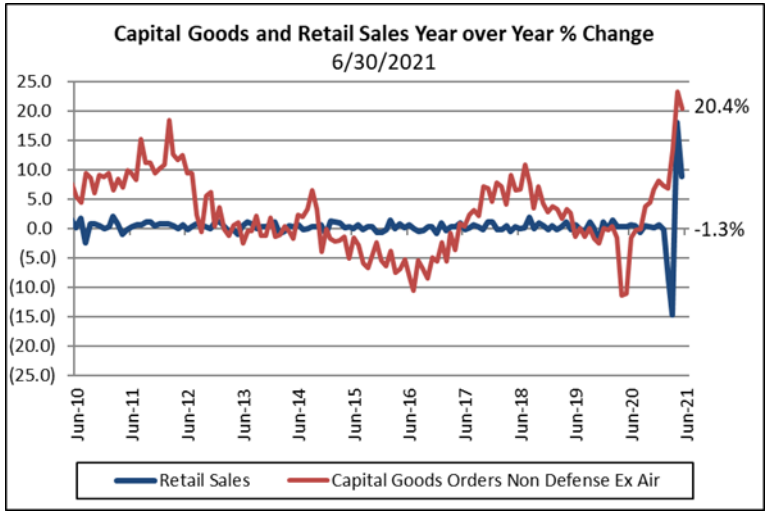
Economic Environment
June 2021

- US Economic activity is accelerating amid excessive monetary and fiscal stimulus, vaccination roll out, reopening of the economy, and warmer weather. We are evaluating potential growth for Q2 and Q3 as the economy fully opens amid the new Delta variant and people shake off pandemic habits.
- Consumption has been robust amid significant stimulus, including cars and homes, and associated goods and services, to the degree they have been available.
- Investment has been industry dependent, with significant growth in remote communications technology. Manufacturing has ramped up in Q1 in as production facilities come back online and to satisfy a need to rebuild inventories but has since stalled amid supply chain disruptions.





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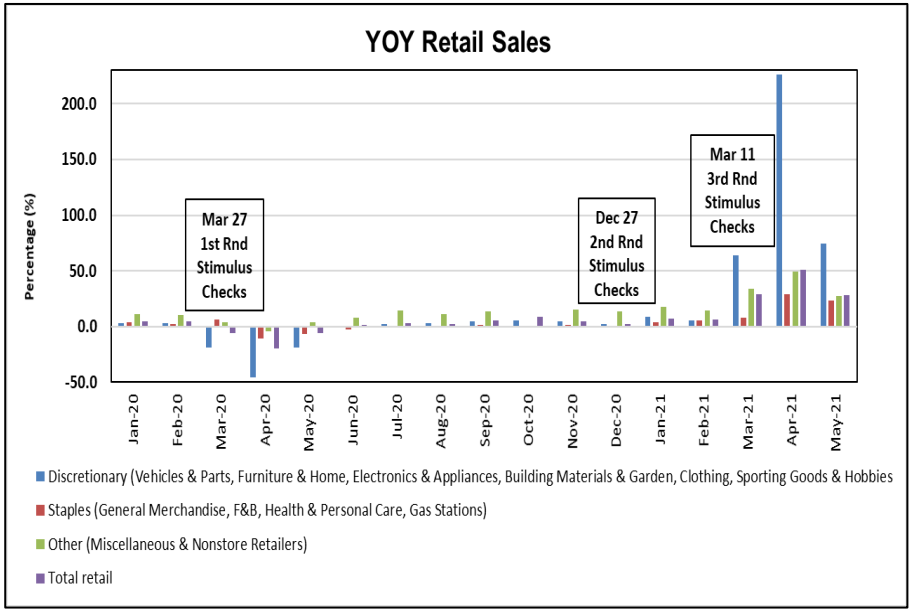
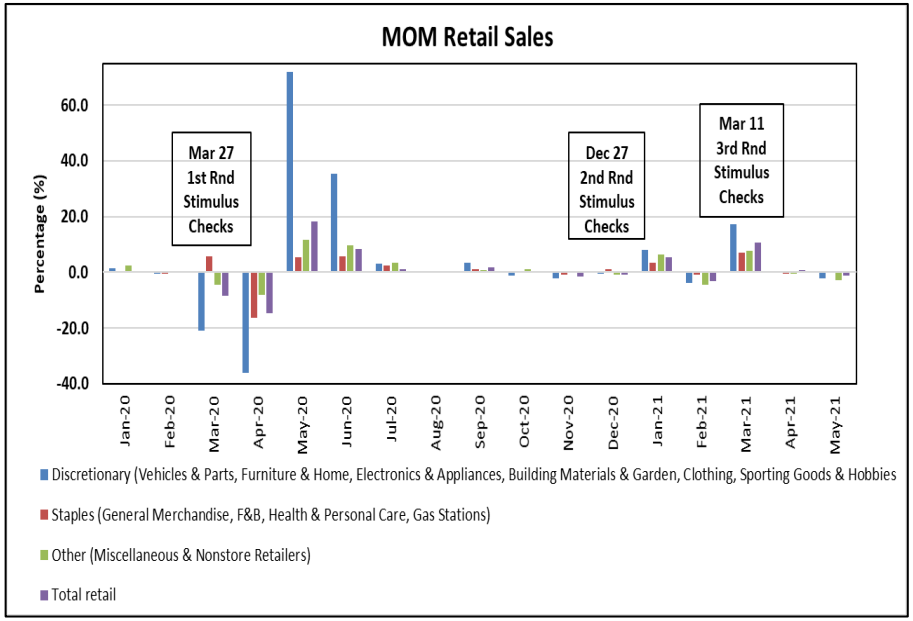
Economic Environment

Retail Sales – June 2021

- Spending on discretionary items followed closely in-line with stimulus payments, proving much more volatile than any other grouped category.
- Month-over-month data shows a pull back in retail sales over the past two months, suggesting we have reached a "now what" moment. Reports over the next few months will reveal whether consumption accelerates or begins to stagnate compared to pre-pandemic levels.
- The significant YOY comparisons due to base level comparisons will soon roll off.





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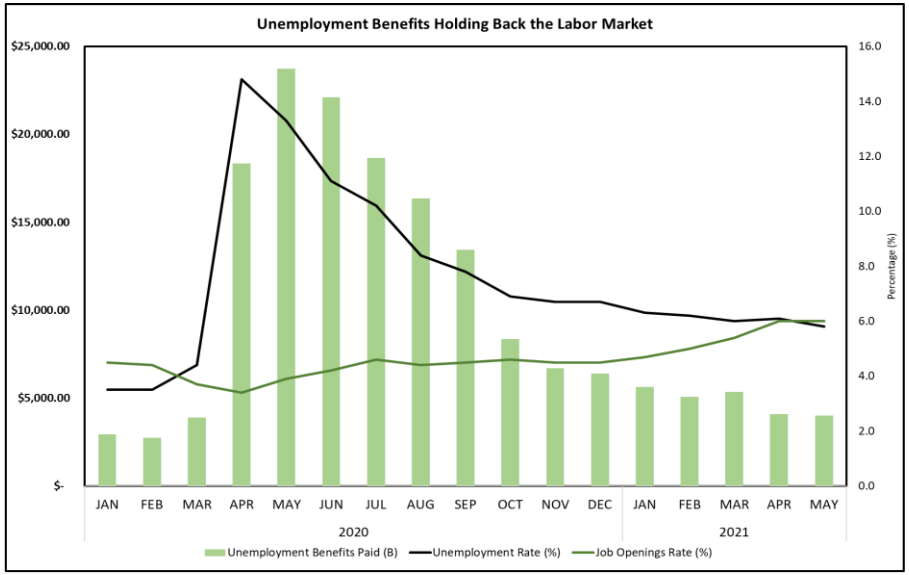
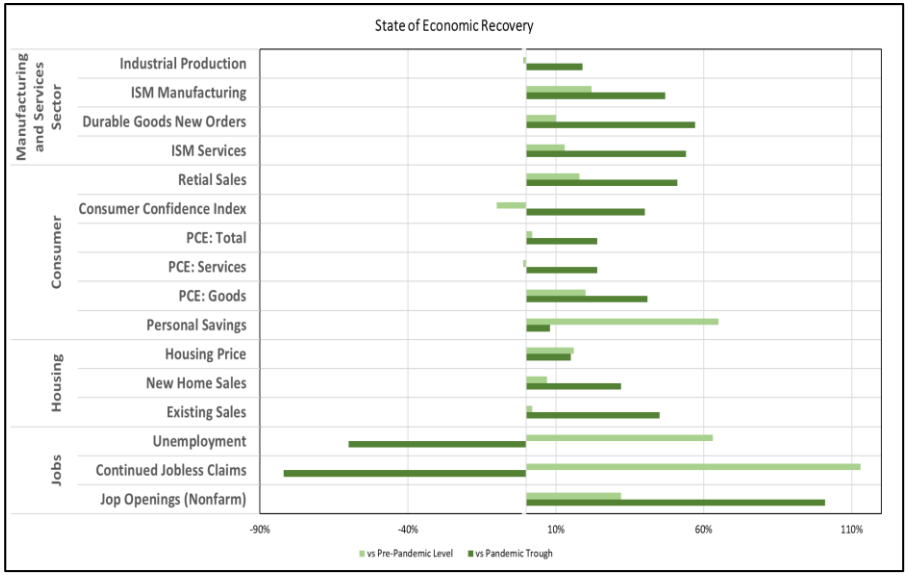
Economic Environment

Employment and Inflation – June 2021

- Despite many job openings, the unemployment rate remains stubbornly high. We expect the September deadline to end enhanced unemployment benefits will finally force people back to work.
- Supply chain issues and lingering COVID-19 fears explain why industrial production and PCE services lag pre-pandemic levels, while the remainder of the economy has recovered.
- Current inflationary pressures seem to be driven by housing prices and consumption on goods, both of which have accelerated past pre-pandemic levels. Low inventory is curbing home sales and boosting prices.





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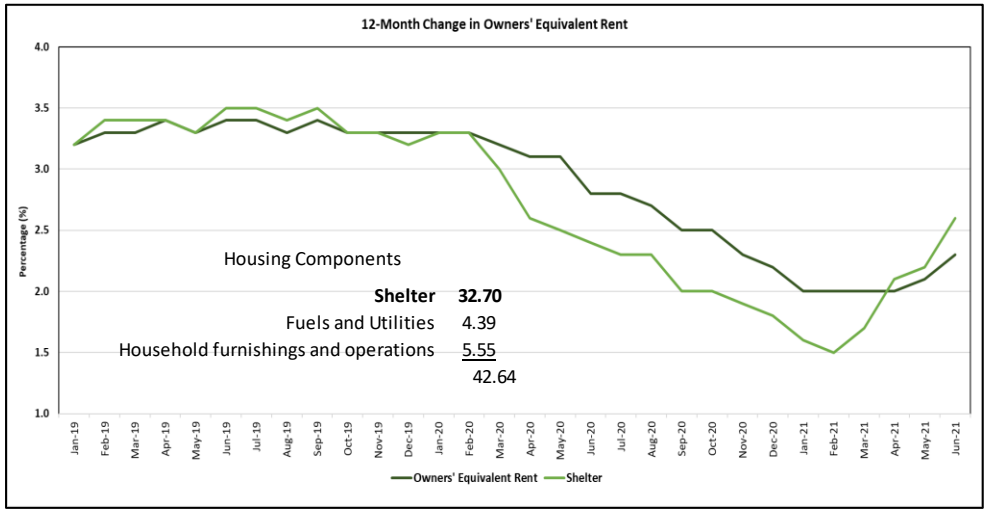
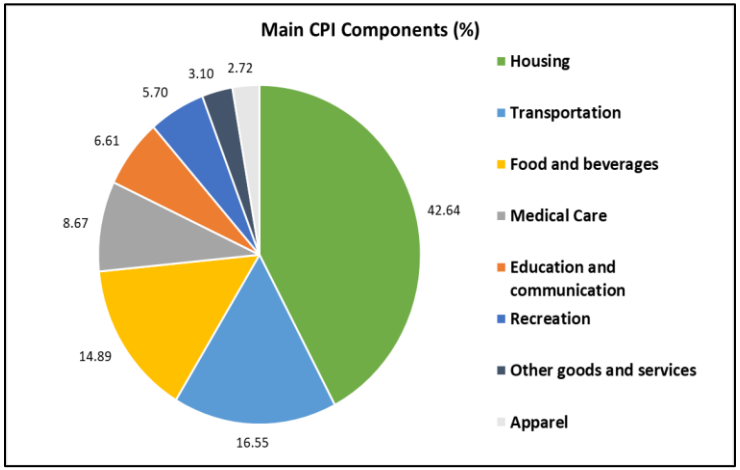
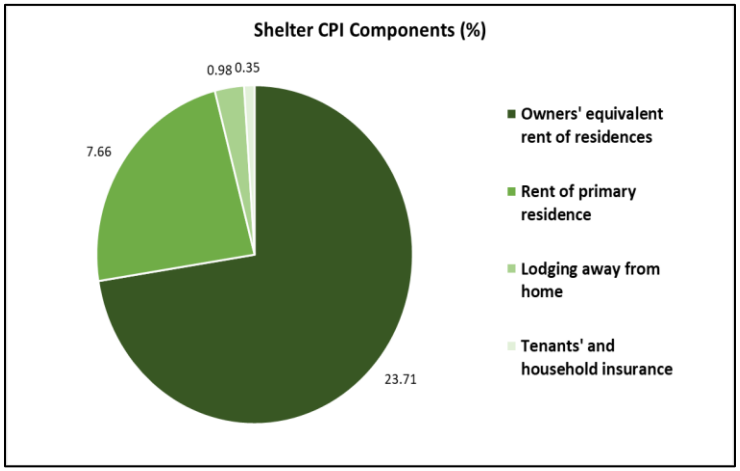
Economic Environment

Inflation and Housing – June 2021

- The housing market greatly impacts inflation as housing accounts for about 43% of the CPI.
- After declining considerably since March 2020, the shelter CPI component has been accelerating since February of this year, contributing to the recent rise in inflation.







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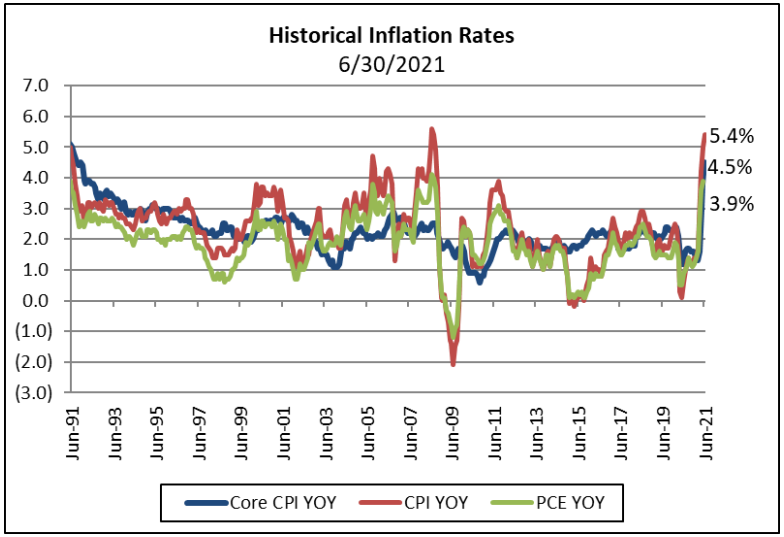
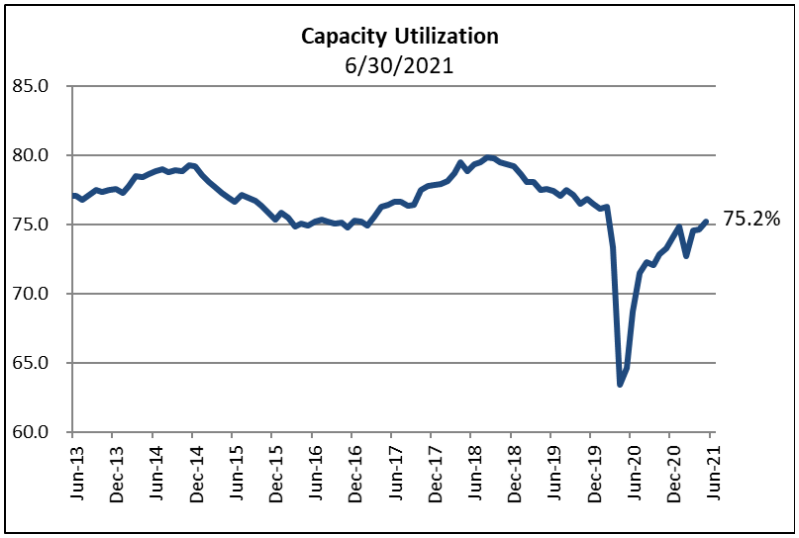
Economic Environment

Employment and Inflation – June 2021

- Inflation levels continue to rise amid resurgence of growth and supply disruptions.
- Expectations of inflation are increasing as the realization of the increased costs associated with working, living, and operating in a post-pandemic world with increased health and safety measures.
- Capacity utilization has retracted as factories face significant supply chain issues and are having trouble sourcing materials, such as the chip shortage limiting auto production.





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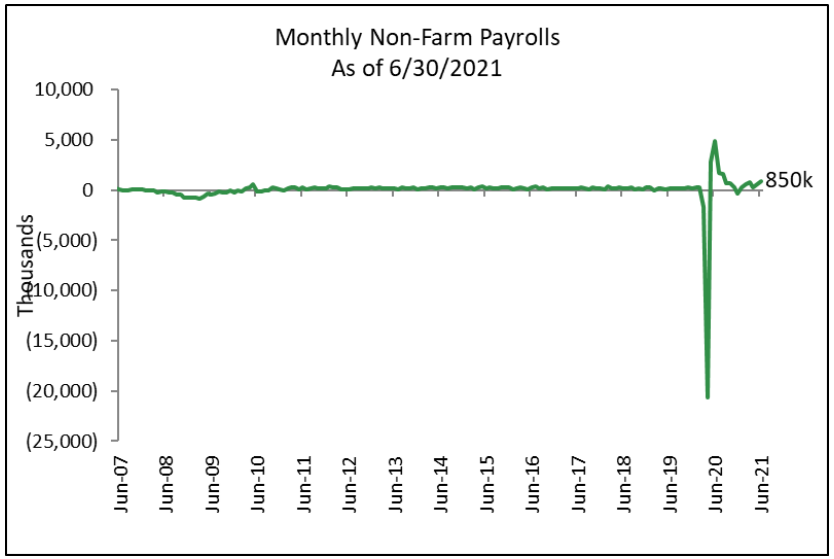
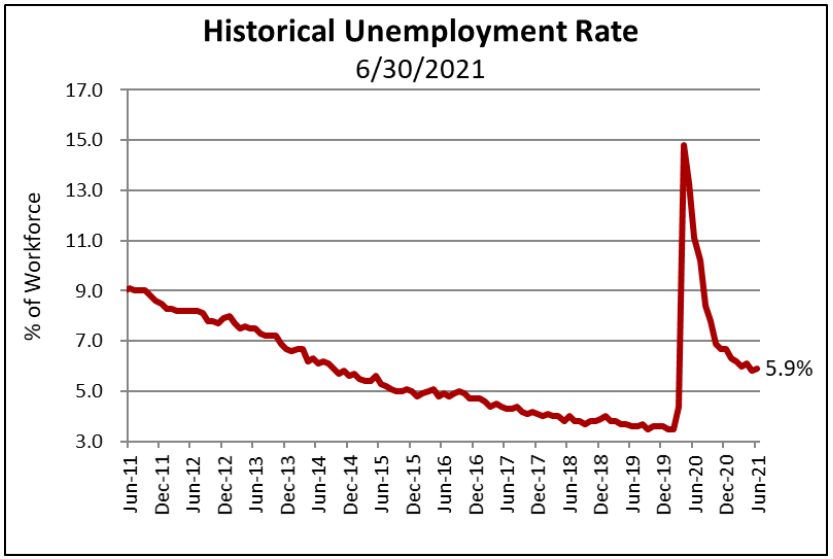
Economic Environment

Employment – Monthly Payrolls – June 2021

- Monthly Payrolls has not been as robust as expected, but may begin to accelerate as services like hospitality fully open and unemployment benefits run out.
- The unemployment rate has fallen and stabilized around the 6% zone. The US has recovered about half the jobs lost during the pandemic.





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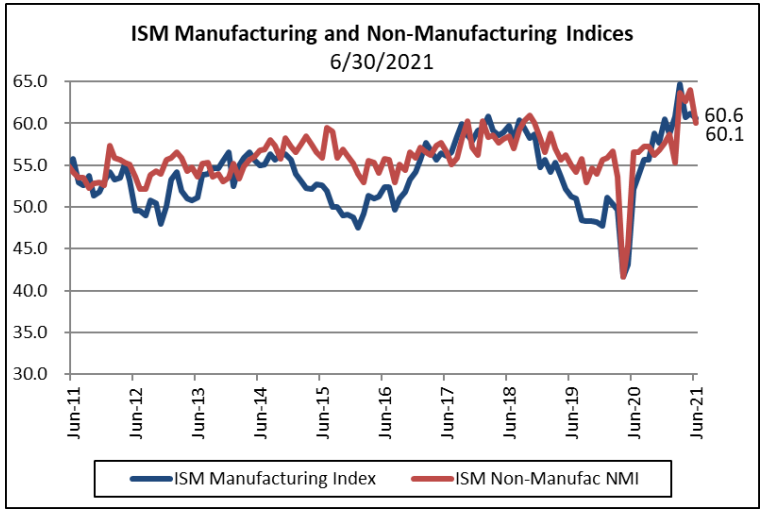
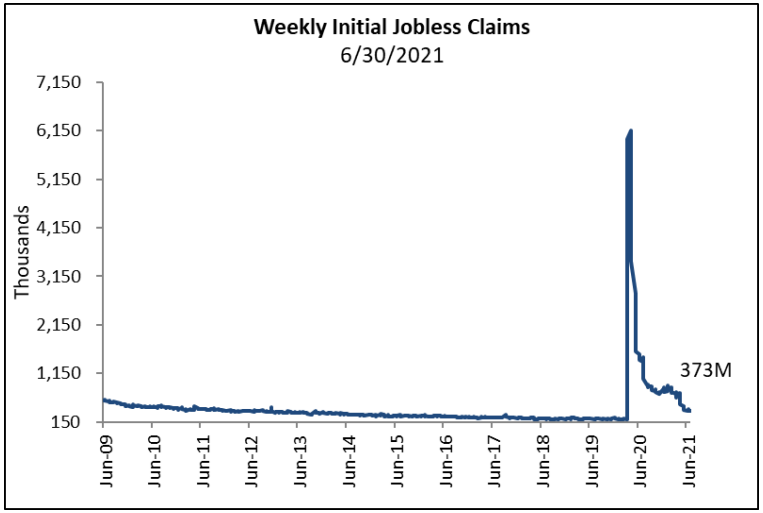
Economic Environment

Employment – Monthly Payrolls – June 2021

- The manufacturing sector, as measured by the manufacturing purchasing manager index continues to rebound as factories bring people back in and restart production.
- The Non-Manufacturing index has also accelerated amid reopening of the service sector.
- Initial claims for unemployment have come down, however remain stubbornly high showing continued high level of layoffs in some industries against the tide growth and reopening in others.





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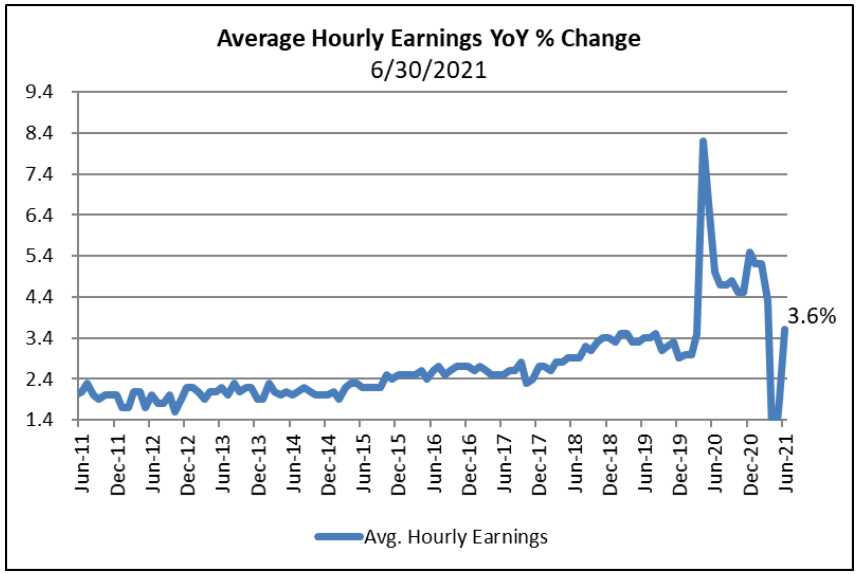
Economic Environment

Employment and Inflation – June 2021

- The prime working age participation rate has leveled out after its initial recovery but may begin to accelerate as the economy reopens.
- Workers in several industries have left the work force as jobs have disappeared while other newer growth industries are having a hard time finding workers.
- Average hourly earnings have risen amid the need to provide incentive to bring people into the workforce.



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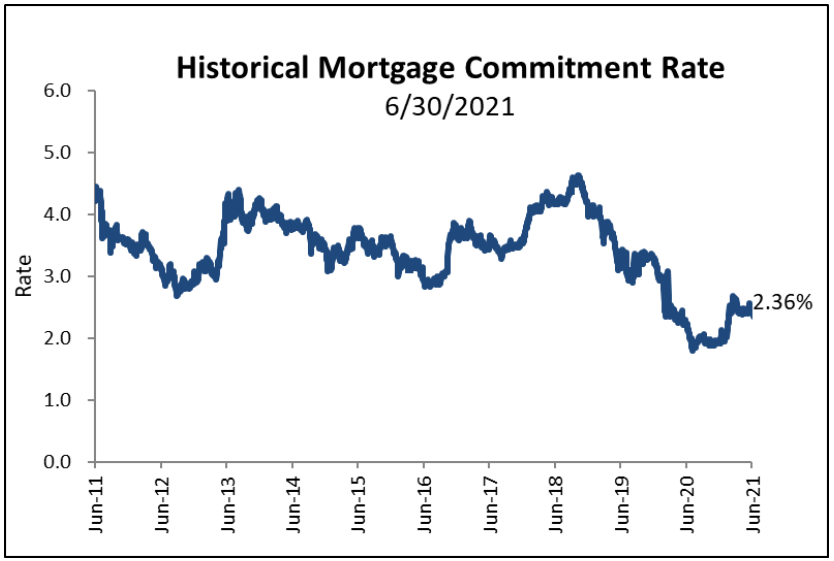
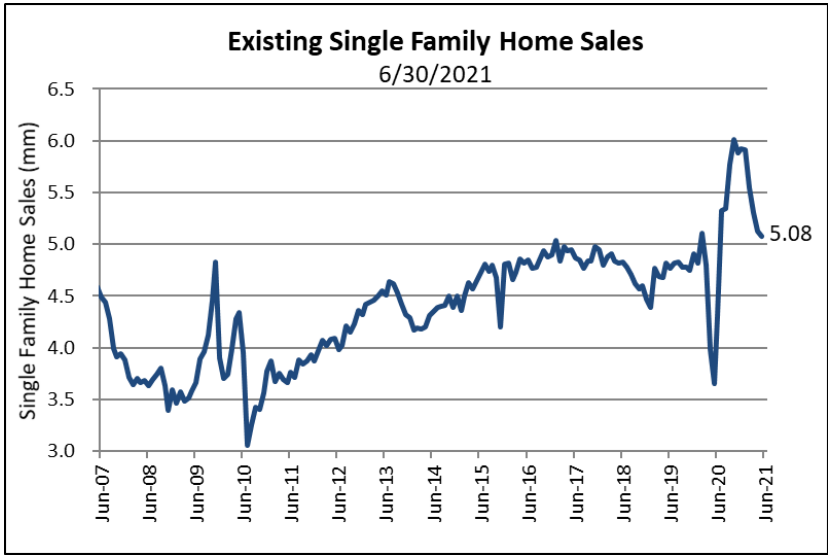
Economic Environment

Mortgage Rates and Housing – June 2021

- The drop in interest rates over the past year has brought mortgage rates down with it, more than 1% from their highs of last year and 2% lower than 2018. The recent rise has not yet curbed activity.
- Lower mortgage rates have supported home sales to some degree, but the significant migration to suburbs from cities has been a driving factor, which has also pushed housing prices higher.
- The slowdown in home sales is due to lack of supply.





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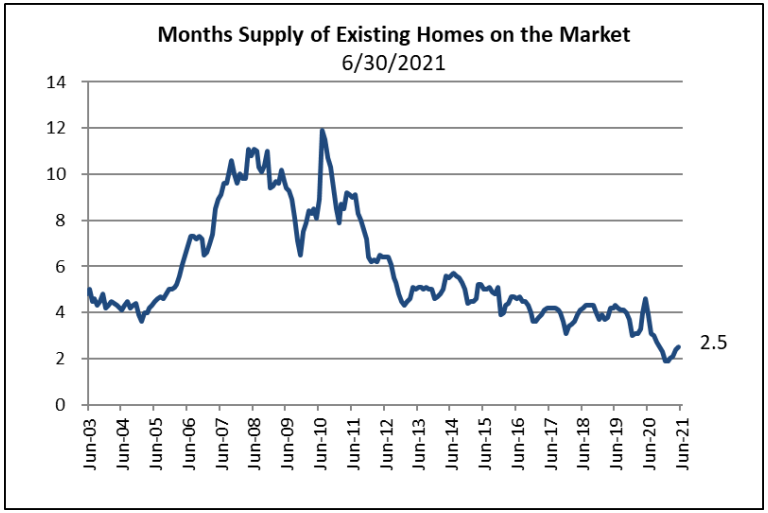
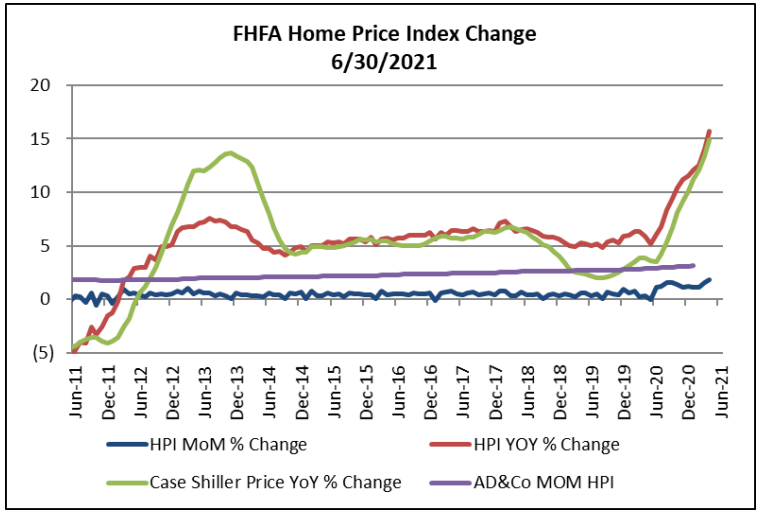
Economic Environment

Mortgage Rates and Housing – June 2021

- The high level of activity in the housing market with fewer new homes build has taken inventory of homes on the market to historically low levels.
- The high demand for housing has also pushed home prices up over 15% vs. year ago levels. The pace of home purchases and price gains has been broad based.
- There continues to be elevated mortgage prepayment activity from both housing turnover and refinancing.





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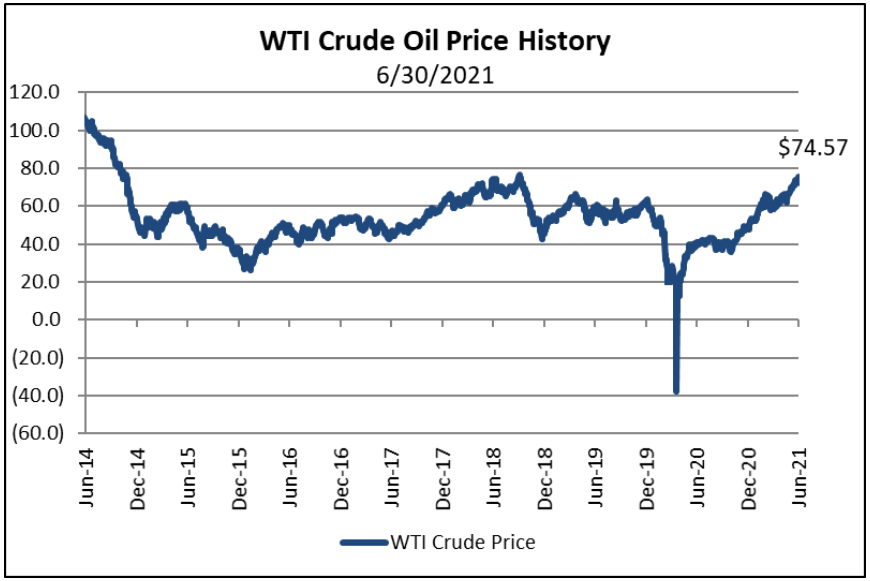
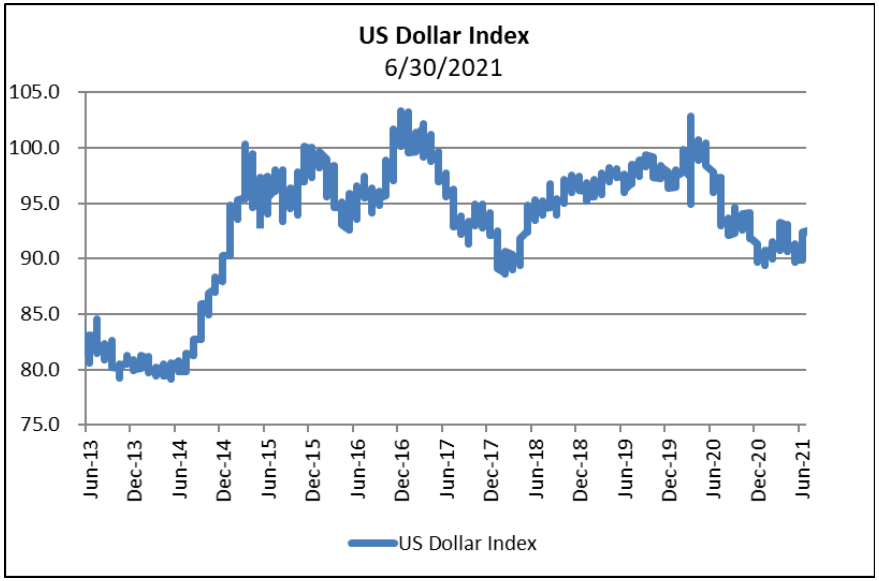
Economic Environment
June 2021

- As economies come back online, oil has rebounded and stabilized above $70. Much of the supply glut from last year has been worked off amid production cuts and increased demand from factories coming back on line and expected increased demand as economies reopen..
- The Dollar has strengthened off its lows last year and may continue to do so as the US economy is the global leader of economic recovery.





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