QUARTERLY REPORT

INVESTMENT PERSPECTIVE

31 December 2020

The recovery in financial markets continued in Q4 2020 with the S&P 500 and Russell 2000 Value rising 12.2% and 33.4%, respectively. For the year, the S&P 500 and Russell 2000 Value rose 18.4% and 4.6%, respectively. Positive vaccine data, combined with election results that indicated further stimulus is expected, were the impetus for the strong fourth quarter rally. The equity market rally materially boosted valuation multiples indicating a portion of the 2021 earnings recovery has already been discounted. As the economy continues to recover, additional policy support may be needed to offset the damage that occurred to key service sectors and the commercial real estate market.

U.S. and International economies remain buoyed by the continued strong recovery in the industrial sector as global supply chains are busy rebuilding inventories and preparing for a post COVID-19 normalization of activity. The recovery in the services side of the economy continues at a modest pace as renewed lock downs have presented headwinds in the fourth quarter. One of the brightest spots in the U.S. economy has been the strength in housing. The rapid increase in demand has pushed home prices materially higher. Higher home prices represent a near term headwind but are a harbinger of increased economic activity as additional supply is brought to market to balance supply and demand.

A key driver of the recovery has been the weaker U.S. dollar, which boosted commodity prices and eased the debt service burden of foreign borrowers. However, the falling U.S. dollar and supply chain disruptions are leading to domestic price increases which will likely cause headline inflation to exceed the Federal Reserve's 2% target during the first half of 2021. Should this increase in inflationary pressure prove transitory, and there are no material shifts in real yields, then we would not expect a material impact to risk assets. To the extent higher inflation expectations become more entrenched, or real yields move higher, a broader repricing of risk assets across sectors and asset classes is expected.

The Bloomberg Barclays Aggregate Index returned 7.5% in 2020. The best sector within the Index was Corporates. The investment grade sector returned 9.9%, while Treasuries rose 8.0%. Treasuries performed well during the year as the Federal Reserve cut interest rates 150bps and launched a new round of quantitative easing to support the economy.

Credit spreads began the year at +92 basis points over Treasury yields and widened to +340 basis points during the March 2020 correction. From March through the end of the year, credit spreads tightened in response to the COVID-19 stimulus packages, Fed actions, and the better-than-expected economic data. Credit spreads finished the year right where they started at +92 basis points over Treasuries.

Fixed income returns in 2021 will have a difficult time matching last year, but we continue to see opportunities to generate alpha within spread sectors and opportunistic duration shifts. While we remain overweight the Corporate bond sector, we will continue to focus on higher quality credits and maintain a shorter duration relative to the benchmark with Treasury yields at historic low levels.

The municipal markets also recorded good returns in 2020, with the ICE BofA AAA-A Municipal Index returning 3.8%, which is 6.0% on a taxable equivalent basis. With demand expected to outpace supply again in 2021 and with the U.S. economy recovering, we expect another good year for the tax-exempt market.

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