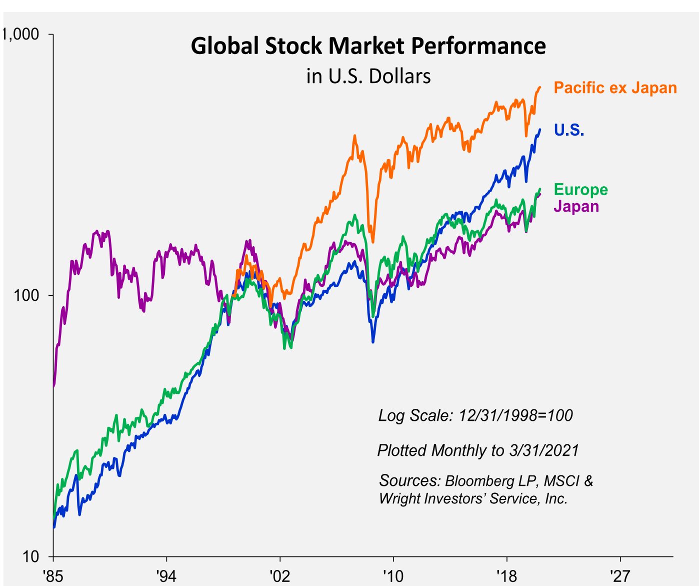
Quarterly Investment Report

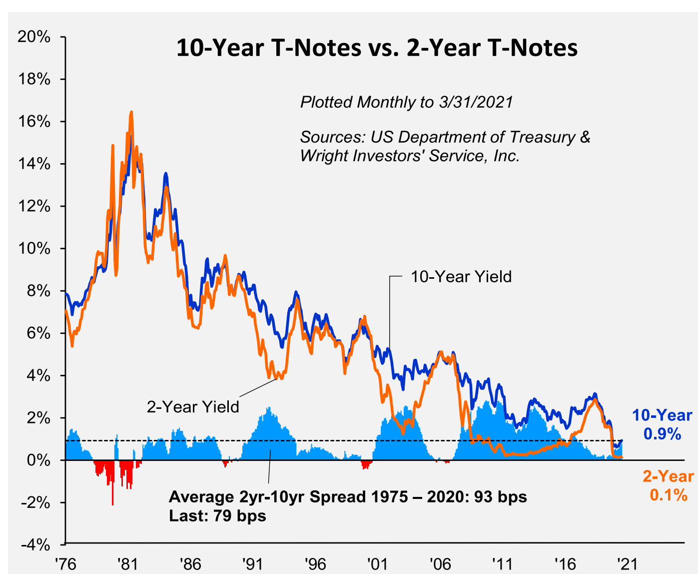
April 2021

SUMMARY: ***Global stocks had strong positive returns in the first quarter as the recovery kicked into higher gear, led by the U.S., where a V-shaped rebound is gaining steam, powered by fiscal and monetary stimulus and a vast rollout of COVID-19 vaccines. Returns lagged in Europe, where vaccine distribution has been slower. Bonds had negative returns as yields on U.S. Treasuries rose in anticipation of higher inflation fueled by stronger GDP growth and growing federal debt. The financial markets continued to be supported by the Federal Reserve, which reiterated its pledge to keep monetary policy accommodative and interest rates low to anchor the recovery, possibly until 2024.***

U.S. stocks rose sharply in the first quarter, with the major equity indexes ending March at or near record levels. The Dow Jones Industrial Average was the best performer among the big cap indexes, returning 8.3% for the quarter after gaining 6.8% in March. The S&P 500 returned 6.2% for the quarter following March's 4.4% gain before powering past 4000 for the first time ever on April 1. NASDAQ continued to trail those two benchmarks as market sentiment rotated away from tech stocks that benefited from the COVID-19 lockdowns, but the index still ended the quarter up 3.0% after gaining 0.5% last month. Small cap stocks, which underperformed last year, continued to outperform in the new year. The S&P 400 Small-Cap Index returned 18.2% for the quarter after gaining another 3.3% in March, while the S&P 400 Mid-Cap Index increased 13.5% in the quarter, including March's 4.7% rise.

All 11 sectors in the S&P 500 had positive returns for both the month and the quarter, led by those sectors most likely to benefit from the reopening economy. Energy stocks were the best performers in the first quarter with a 30.9% return as oil prices surged more than 21% and unleaded gasoline jumped by nearly twice that. Financial stocks returned 16.0% on the strength of rising interest rates, which improve lending margins, and reduced charges for bad debt. Banks have also been given the green light by the Federal Reserve to restart





dividend payment and share buybacks. Industrials (+11.4%) and materials (+9.1%) stand to benefit as more traditional sectors of the economy participate in the rebounding economy. The beaten-down real estate sector gained 9.0% as more companies are likely to bring employees back to the office as the pandemic recedes, refilling vacant office space and resuming rent payments.

Stocks outside the U.S. also had positive returns although they slightly underperformed their U.S. counterparts, largely due to a stronger dollar and a weaker reopening due to a slower vaccine rollout. Eurozone stocks gained 3.5% for the quarter while U.K. stocks returned 6.2% in dollar terms as the greenback advanced 4.1% against the euro while weakening 0.8% against the pound. Japanese stocks returned 1.6% in dollar terms as the dollar jumped 7.2% against the yen. Emerging market stocks gained 2.3%. Chinese stocks, among last year's best performs, continued to trail global markets this year, losing 0.4% in dollar terms.

Bonds had mostly negative returns as interest rates spiked on fears of renewed inflation stemming from government stimulus and a rebounding economy. The Bloomberg Barclays U.S. Aggregate lost 3.4% in the quarter as the yield on the benchmark 10-year U.S. Treasury note jumped 83 basis points to close March at 1.74%, its highest level since before the economic shutdown a year earlier. Corporate bonds, as measured by the Bloomberg Barclays U.S. Credit index, lost 4.5%. But high-yield bonds managed to return a positive 0.8%. Outside the U.S., the Bloomberg Barclays Global Aggregate ex-U.S. index lost 5.3%.

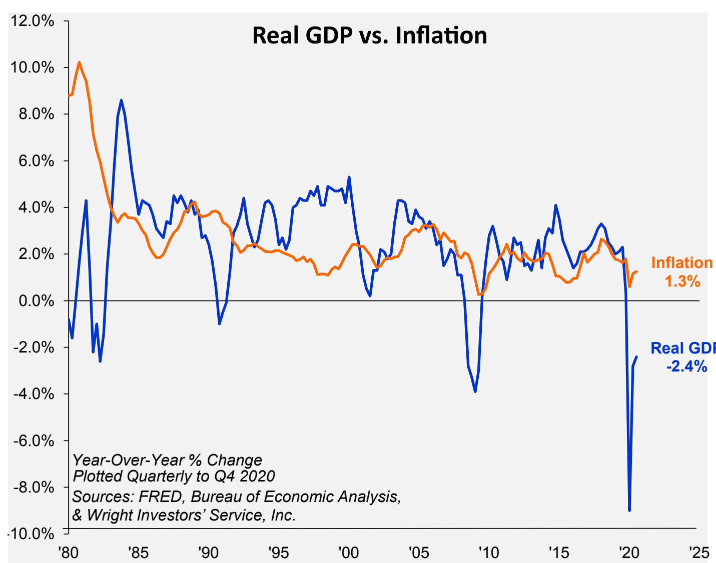
THE U.S. ECONOMY

A strong post-pandemic bounce-back has already begun and promises to grow stronger as all sectors of the economy gradually reopen as COVID-19 cases decline amid the rollout of vaccines and massive government fiscal and monetary stimulus. The Fed's latest GDP forecast calls for 6.5% growth this year, up sharply from its December estimate of 4.2%. The Conference Board forecasts 5.5% growth this year, beginning with 3.0% annualized growth in the first quarter; that would follow the fourth quarter's 4.3% pace. Much of that growth will likely be powered by consumer spending, largely due to what we believe is strong pent-up demand, especially for those sectors of the economy that have yet to enjoy the benefits of the reopening, such as travel and entertainment. Already, airline bookings are rising, and movie theatres and entertainment venues are reopening their doors to more people. The Conference Board's consumer confidence index soared 19.3 points in March to 109.7, its highest level since the pandemic forced economic shutdowns a year ago, "an indication that economic growth is likely to strengthen further in the coming months," the group said.

Global Investment Returns
In U.S. Dollars

	Q1 2021		Trailing 12 Months	
	Stocks	Bonds	Stocks	Bonds
U.S.	**5.4%**	**-3.4%**	**58.6%**	**0.7%**
Canada	9.6%	-2.8%	59.3%	10.3%
Mexico	4.2%	-5.0%	58.5%	22.5%
Japan	**1.6%**	**-6.9%**	**39.7%**	**-3.2%**
Pacific ex Japan	4.6%	-2.7%	54.0%	16.8%
Australia	3.4%	-5.4%	68.4%	19.5%
China	-0.4%	0.7%	43.6%	7.7%
Hong Kong	7.3%	N/A	37.3%	N/A
Europe	**4.1%**	**-5.8%**	**44.9%**	**10.6%**
France	4.4%	-3.4%	50.0%	15.5%
Germany	4.2%	-6.3%	59.3%	5.4%
Italy	6.3%	-1.5%	53.0%	24.4%
Netherlands	11.2%	-6.8%	74.0%	6.1%
Spain	1.0%	-2.4%	36.9%	N/A
Switzerland	-2.0%	-7.4%	23.7%	4.8%
U.K.	6.2%	-5.7%	33.5%	8.8%
World	**4.9%**	**-4.5%**	**54.0%**	**4.7%**
World ex U.S.	4.0%	-5.3%	45.9%	7.2%

Sources: MSCI Stock & Bloomberg Barclays Bond Indexes as of 3/31/2021



That survey followed the third – and biggest – installment of government stimulus checks that hit most Americans' bank accounts last month. Of course, those checks did not show up in February's retail sales, which dropped 3.0% after jumping 7.6% the prior month following the disbursement of December's second tranche of "helicopter money." Personal consumption expenditures were also down, by 1.0%, as personal incomes fell 7.1% after climbing 10.1% in January. While consumers probably should not expect any more direct payments from the U.S. Treasury, fiscal stimulus will likely continue in other ways, such as President Biden's proposed 10-year, $2 trillion infrastructure spending plan unveiled late last month. That should help further boost employment levels that are already starting to rise. In March, the economy added 916,000 jobs, nearly double February's upwardly revised total of 468,000 jobs. The unemployment rate fell to 6.0%, which is down from last April's lockdown peak of 14.8%. The Fed now expects the unemployment rate to fall to 4.5% by the end of this year before receding further to 3.9% next year and 3.5% in 2023; by way of comparison, the U.S. jobless rate was at a 50-year low of 3.5% in February 2020, just before the shutdown. The Institute for Supply Management's manufacturing index jumped nearly four points in March to 64.7, a 38-year high, indicating further job gains.

The strong housing market experienced a hiccup in February. Sales of existing homes fell 6.6% from the previous month to an annual rate of 6.22 million, although they remained 9.1% higher than a year earlier. More concerning, pending home sales – a forward indicator of actual closings – dropped 10.6% versus the previous month and 0.5% versus a year earlier, the first year-over-year decline in eight months. The problem is a big shortage of homes for sale, which fell to a record low of about one million units, down a record 29.5% over the previous year. That is boosting the price of homes beyond the reach of many people. In February, the median price of an existing home rose to $313,000, nearly 16% higher than a year earlier, as all regions of the country posted double-digit price gains for the second straight quarter. While that would normally present an opportunity for current homeowners to cash in by putting their own homes on the market, many are reluctant to do so because of the difficulty of finding their next home at a reasonable price. As a result, many homeowners are simply staying put, further reducing the available supply. But that also means they are continuing to build home equity wealth. The market for newly-built homes is similarly price-constrained. Sales of new homes dropped 18.2% in February, although that was 8.2% above the prior year's level. The median price of a new home rose to $349,400, up from $331,800 a year earlier, while the average price rose to $416,000. Prices are rising not just due to high demand but also the soaring price of lumber and other materials. While interest rates remain at historically low levels, it is likely they will start to rise as the economy heats up, which would further add to the cost of homeownership. Lenders are also starting to tighten borrower requirements, according to media reports.

Inflation – or the threat of it – has once again resurfaced on the radar screens of policy makers and bond investors as government fiscal stimulus and deficits soar, but so far there is not much to be alarmed about. The headline consumer price index for February showed a modest year-over-year rise of just 1.7%, despite a 6.4% increase in gasoline prices, while the core rate, which excludes food and energy prices, was even lower, at 1.3%. The personal consumer expenditures index, the Fed's preferred inflation index, was equally subdued, rising at year-on-year rates of 1.6% and 1.4%, respectively. While the Fed has stated repeatedly that it is willing to let inflation run hotter than its target rate of 2.0% – which the economy has failed to achieve since the global financial crisis of 2008 – Fed chair Jerome Powell downplayed the possible resurgence of rising prices. "We might see some upward pressure on prices," he said in his congressional testimony last month. "Our best view is that the effect on inflation will be neither particularly large nor persistent."

INVESTMENT OUTLOOK

If and when the Fed starts to tighten monetary policy as the recovery progresses remains a big issue on investors' minds, but if Fed officials can be believed, that day is likely well off into the future. "The recovery has progressed more quickly than generally expected and looks to be strengthening," Powell told Congress. "But the recovery is far from complete, so, at the Fed, we will continue to provide the economy the support that it needs for as long as it takes." That view was reiterated by several other Fed officials. "I suspect that it might be 2024 before we actually raise the interest rate target," Chicago Fed President Charles Evans said. "We can really be patient, and absolutely make sure, we get inflation expectations up to a point where they can much more sustainably support 2% inflation." The Fed is currently predicting core PCE inflation this year of 2.2%, receding to 2.0% next year and 2.1% in 2023. San Francisco Fed President Mary Daly promised that "we won't be preemptively taking the punchbowl away. That's something that worked maybe in the past, definitely doesn't work now, and we're committed to leaving that punchbowl or monetary policy accommodation in place until the job is fully and truly done."

While we are not terribly worried about a sudden reversal in Fed policy, we are a little concerned about President Biden's intention to raise taxes to pay for his big infrastructure program. The proposed corporate tax increases look like they may reverse much of the cuts enacted under President Trump, which had a big positive impact on corporate earnings – and stock prices – the past few years. Some of the benefit from them also found their way to shareholders in the form of increased dividends and stock buybacks. The package also calls for increases in individual income and capital gains taxes that may also discourage stock buying. On the plus side, plowing more government money into much-needed infrastructure improvements should generate job growth and business investment, which may override any disadvantages of the bill. For now, it is too early to know what the final bill will look like. All in all, we remain optimistic about the economy and the markets. While it is premature to declare total victory against the pandemic, clearly the world is returning to normal quickly, some quicker than others, and the lessons and technologies we learned over the past year will continue to benefit people long into the future.

The U.S. Economy 2019–2022

			% Change In			End of Period Rates	
			Real GDP*	PCE Core Deflator*	Profits from Operations#	90-Day T-Bills	10-Year T-Notes
2019	Q1		2.9%	1.2%	14.7%	2.4%	2.4%
	Q2		1.5%	2.1%	8.7%	2.1%	2.0%
	Q3		2.6%	1.9%	1.2%	1.8%	1.7%
	Q4		2.4%	1.3%	1.0%	1.5%	1.9%
2020	Q1		-5.0%	1.6%	-4.5%	0.1%	0.7%
	Q2		-31.4%	-0.8%	-14.3%	0.1%	0.7%
	Q3		33.4%	3.4%	-15.7%	0.1%	0.7%
	Q4	e	4.3%	1.3%	-18.0%	0.1%	0.9%
2021	Q1	e	4.7%	1.5%	-7.9%	0.0%	1.7%
	Q2	e	7.0%	2.1%	19.4%	0.2%	1.6%
	Q3	e	6.9%	1.8%	46.3%	0.2%	1.6%
	Q4	e	4.5%	1.9%	57.9%	0.3%	1.7%
2022	Q1	e	3.3%	1.9%	39.7%	0.3%	1.8%
	Q2	e	2.9%	1.9%	-10.1%	0.4%	1.9%
	Q3	e	2.5%	2.0%	-12.5%	0.4%	2.0%
	Q4	e	1.3%	N/A	-17.6%	0.4%	2.0%

e: Bloomberg Consensus Estimates; *: Annual Rates; #: Year-Over-Year Change in S&P500 EPS Sources: Bloomberg LP, Wright Investors' Service, Inc.