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Second Quarter 2021 Market Summary

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Second Quarter 2021 Market Summary

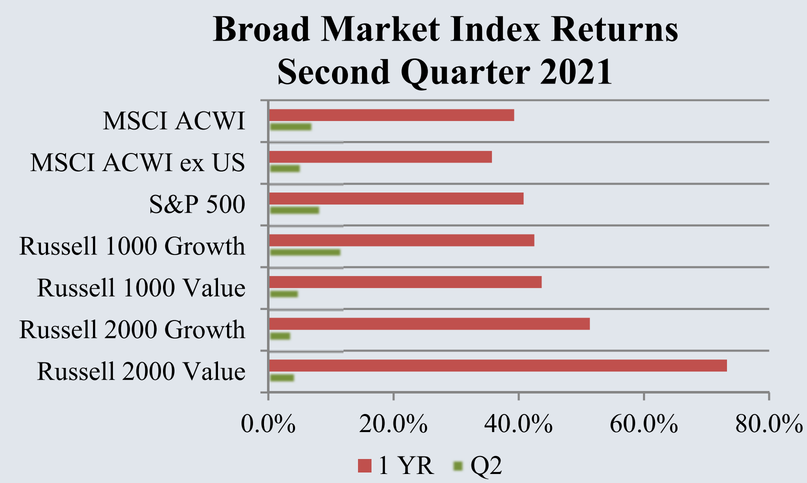
The second quarter was another strong quarter for virtually all asset classes, as investors have brushed aside many concerns and focused on a rebounding economy. School is out for the summer and the data is indicating social activity is nearing pre-pandemic levels as people are visiting restaurants and traveling. The quarter began with investors concerned about runaway inflation as commodity and housing prices marched higher, but inflation worries calmed down as the quarter progressed and we settled into summer, which historically is a less volatile period.

If you asked five pundits to describe the current state of the markets and global economy, you would likely get five different answers, depending on the lens they view it through. Many metrics indicate that the markets and economy are in the early part of the business cycle, with a rebounding economy, corporate earnings growing rapidly and high but declining unemployment. Other metrics such as rich valuations, aggressive underwriting and pockets of enthusiastic sentiment would indicate we are more late-cycle. So how do we reconcile these differences in perception?

Focusing on one side and cherry-picking certain data can create a clear picture that inspires confidence, but it is also an example of confirmation bias. The reality is that pieces of seemingly conflicting data can often both be accurate, thus leading to a hazy outlook. Valuations are high, but earnings are growing, and valuations will naturally decline, all else being equal. Consumer and business spending is strong, which has helped keep investor sentiment high, but the current high growth rates will settle over the coming quarters as growth normalizes. Labor markets continue to improve, but the pace has stalled. When assessing the macro environment and relating it to your personal financial strategy, it is important to balance these different dynamics and to also build flexibility in to the plan, allowing long-term investors to ignore prognostications about the market's near-future.

Equities tend to do well even when inflation is rising due to strong economic growth, which is what has transpired during the year. U.S. large company stocks, represented by the S&P 500 Index, were up 8.6% during the quarter. U.S. small company stocks, represented by the Russell 2000 Index, were up 4.3% during the quarter. As interest rates declined and inflation expectations became more subdued, "growth" style stocks, which had lagged the previous quarters, rallied relative to "value" style stocks. This pause in value's outperformance as stock prices catch up to higher earnings expectations is normal. For value to resume advancement, there will need to be continued evidence that strong global economic growth will be sustained into next year without the need for further stimulus.

International stocks, represented by the MSCI ACWI ex US Index, were up 5.5% during the quarter. International stocks were leading the U.S. indices during the quarter until June, when the market rotated back, as many international markets continue to be hampered by economic reopening difficulties.



The Bloomberg Barclays U.S. Aggregate Bond Index, which represents a broad basket of bonds, was up 1.8% during the quarter. Credit-oriented sectors such as corporates, high yield and emerging market debt continued their outperformance, driving credit spreads towards historically low levels. Bond yields peaked at the beginning of the quarter when inflation was rising and investors questioned the role of fixed income in a portfolio. Over the past three months, yields have fallen, with investors becoming more comfortable with slightly higher inflation. When bond yields fall it can indicate lowered expectations for sustainably higher inflation; thus the bond market is indicating that initial inflation fears may have been an illusion. The past quarter is a good reminder of why not to extrapolate short-term trends indefinitely and it also confirmed the role fixed income can play in a portfolio as a means of capital preservation, providing income and diversifying away from equity risk.

Second Quarter 2021 Market Summary (continued)

In June, the Fed left rates unchanged at 0% to 0.25%. Notably, the Fed is now anticipating two interest rate hikes by the end of 2023, which is faster than previous guidance. That decision was influenced by their increased estimates for growth and inflation over the next year. They did not allude to when they will begin tapering the Fed's balance sheet, but any announcement may cause market volatility. For now, the Fed continues to affirm their accommodative stance, but they also continue to point out their desire to be flexible in reaction to new data, particularly unemployment trends.

While there have been many positives over the past few months, there are still many unknowns in the market. Volatility may increase if expectations rise for higher inflation. Valuations in many of the equity and credit markets are not cheap, thus a decline in investor sentiment could rattle markets and lead to a correction. Additionally, market prices may be overpricing the near-term benefit of any future government stimulus. However, it is normal for pullbacks to occur in upward trending markets as the market pauses to digest the changing financial data. After exceptionally strong returns in 2019, 2020 and thus far in 2021, it is reasonable to assume that the second half of the year may be choppier and not quite as strong, as investors look ahead to solid but declining growth rates.

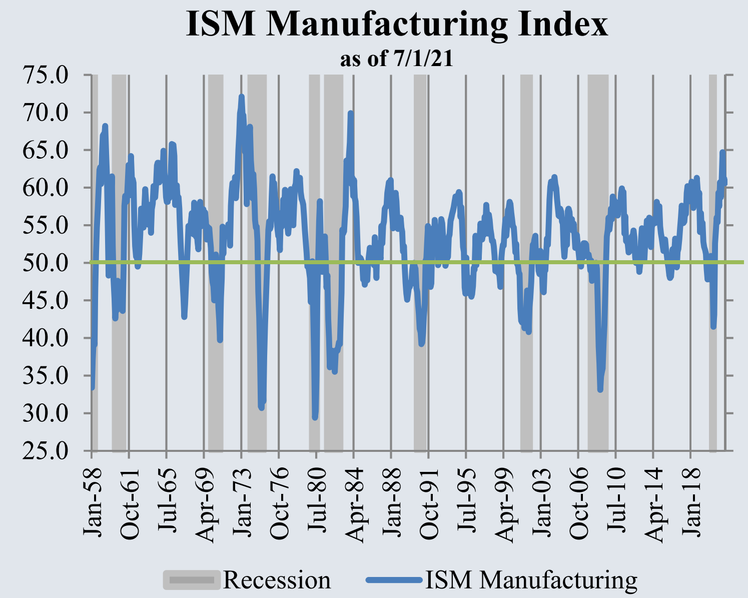
The way one perceives the current environment is likely a good insight into their risk tolerance and investor biases. Collectively, investors have many different views, strategies they implement, personal objectives and time-horizons. It is important to develop and execute your own financial plan and investment strategy and to "play your own game". A baseball player doesn't train like a gymnast, just as a long-term investor should not follow the advice from a short-term trader. A long-term plan may sound simple to execute and lead to expectations of smooth sailing into the sunset; however, an investor must develop the fortitude to overcome the waves of unpredictable short-term markets which can be quite distracting and challenging. A well-developed long-term investment strategy can make life feel like a day at the beach, though inevitably you'll have to deal with a little sand in your drink from time to time.

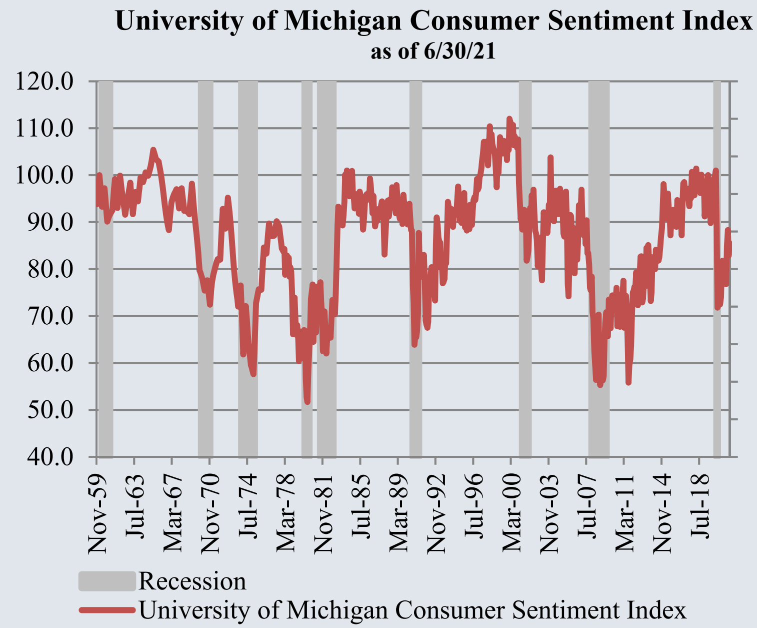
MACROECONOMICS

- The Bureau of Economic Analysis released the advanced estimate of second quarter 2021 real GDP, an annual rate increase of 6.5% from the preceding quarter. The increase in GDP was aided by strong growth of personal consumption expenditures, as many consumers were flush with cash and pent-up demand.
- GDP is expected to be about 7% in 2021 for the year.
- The ISM Manufacturing Index remained elevated during the quarter, finishing at 60.6 versus 64.7 in March. Typically, when the ISM Index is above 55 it is bullish and when it is below 45 it is bearish. The ISM Non-Manufacturing Index was also strong during the quarter and finished at 60.1 in June.
- In June, the Conference Board Leading Economic Index increased 0.7% month-over-month to 115.1. The index, which is a composite of leading employment, housing, manufacturing, and market indicators, continues to increase over the past year.
- The price of WTI Crude Oil was $73.52 at the end of June, which is 24.2% higher than $59.19 at the end of March. The price of Brent Crude Oil ended the quarter at $76.94, which is 21.1% higher than at the end of March. While oil prices went higher during the quarter, many other commodities such as lumber, copper, corn and soybeans saw prices peak in May and decline considerably thereafter.
- Inflation has increased over the past few months as the data reflects the weak prices from early 2020. In June, headline CPI increased 5.4% year-over-year, which was the highest level since 2008. Core CPI, which does not include food and energy, had a 4.5% increase. Used and new vehicles, airline fares, and energy prices have seen the highest increase in prices over the past year.

CONFIDENCE METRICS

- Consumer confidence has shown improvement with the vaccine rollout and the reopening of parts of the economy. Consumers continue to spend on home improvement related items and are expected to spend more on services such as vacations this summer.
- The University of Michigan Consumer Sentiment Index final reading for June was 85.5, which is higher than 84.9 in March. The graph on right shows the sentiment rebound.
- The Conference Board's Consumer Confidence Index June reading was 127.3, up from 114.9 in March.



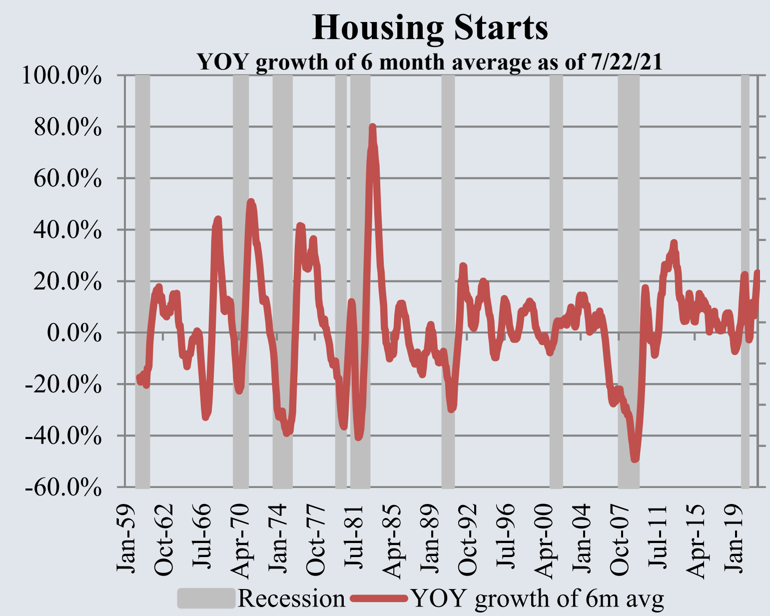


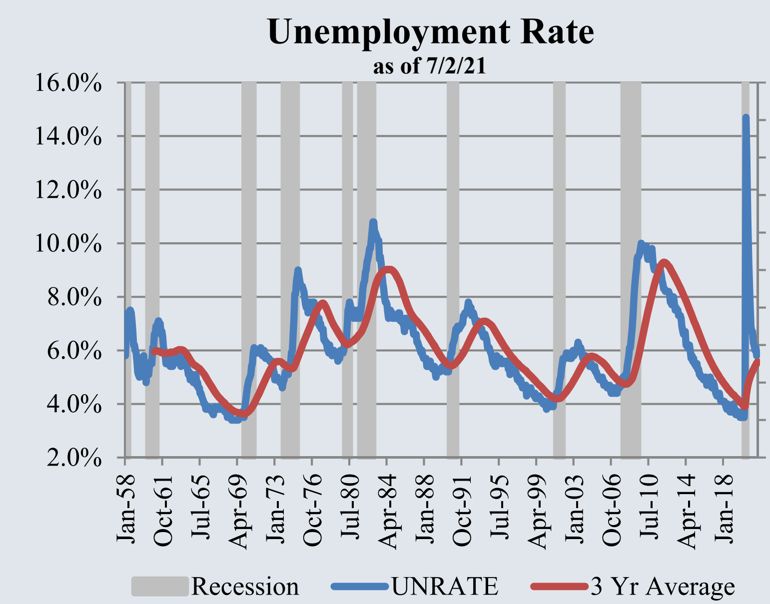
HOUSING

- The housing sector has been very strong over the past year, with pent-up demand fueled by low interest rates and low inventory levels. Low mortgage rates should continue to support the sector. However, home sale prices have soared, as have input costs, which will be a headwind for the housing sector going forward.
- Preliminary existing home sales decreased in the quarter, with a monthly average annualized rate of 5.83 million units, down from 6.30 million units in the first quarter. Unsold home supply remains at historic low levels.
- The preliminary existing home sale prices for the quarter were 23.4% higher than the levels of one year ago. Prices have accelerated higher this year as demand has greatly outstripped the constrained supply.
- New home sales were up slightly during the quarter on a year-over-year basis. Median new home prices were significantly higher during the quarter on a year-over-year basis.
- S&P Case-Shiller 20-City Home Price Index (seasonally adjusted) showed home prices rose over 16.9% year-over-year in May. Of the locations in the Index, home prices in many major cities in western states have risen the most over the past five years, while many major cities in eastern states have seen weaker growth. Housing trends will continue to shift as workforces become more mobile and millennials start buying homes.
- Housing starts continued to be strong to meet high demand. However, permits, which are a leading indicator, declined in June off very high levels in the first quarter. Higher input costs, higher home prices and a lack of labor may impact demand short-term.

EMPLOYMENT

- The labor market has seen mixed data but generally the trend has been positive. There is currently a mismatch of high labor demand and weaker labor supply, which continues to be effected by potential laborers' COVID concerns, need for child care and enhanced unemployment benefits.
- During the quarter, nonfarm payrolls averaged 567,000 jobs added per month. JOLTS Job Openings have risen considerably as employers are having trouble filling positions.
- The unemployment rate decreased during the quarter to 5.9% in June from 6.0% in March. Initial Jobless Claims have now declined to March 2020 levels. Many of the jobless claims are in the restaurant, leisure, retail and education sectors.





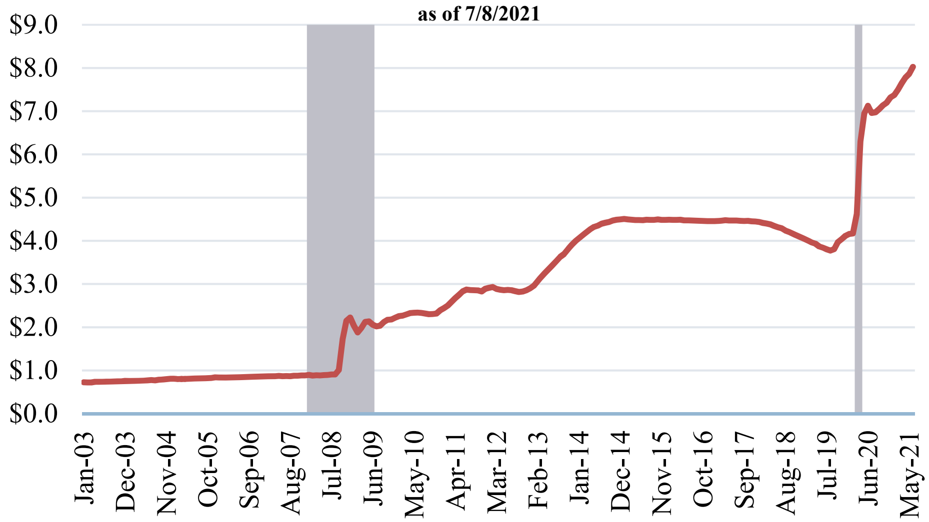
FED POLICY

- The Federal Open Market Committee (FOMC) kept the federal funds rate at a target range of 0.00% - 0.25% in June. However, the Fed altered their interest rate guidance as they are seeing higher growth and inflation, thus they are now forecasting two rate hikes by the end of 2023.
- The Fed did not make adjustments to their asset purchase commitment and they will continue "until substantial further progress has been made toward the Committee's maximum employment and price stability goals". This guidance indicates that the Fed will remain accommodative but they will be flexible based on data.

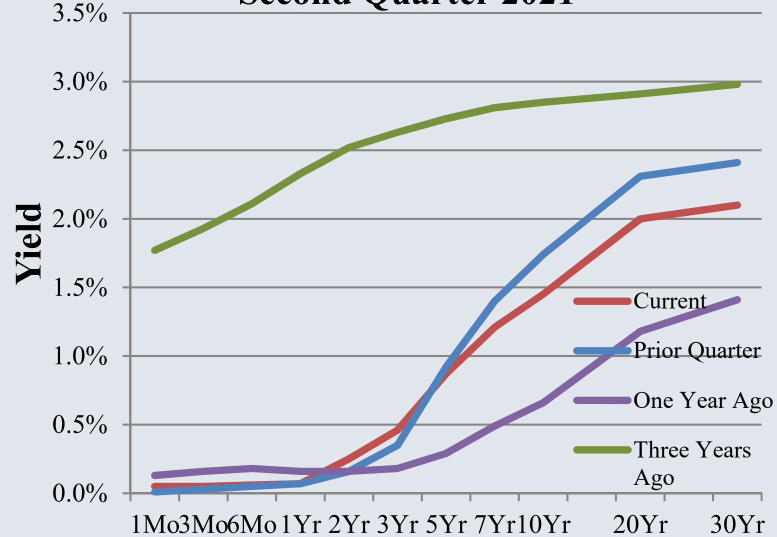
FIXED INCOME

- During the second quarter, U.S. Treasury yields slightly increased on the short-end of the curve, with an increased likelihood that Fed will raise rates sooner than previously expected. However, the yields on the intermediate and long-term parts of the curve fell reflecting the bond market's lowered expectations for future economic growth.
- Short-term interest rates are controlled or heavily influenced by central banks, whereas long term interest rates are controlled by market forces and economic growth.

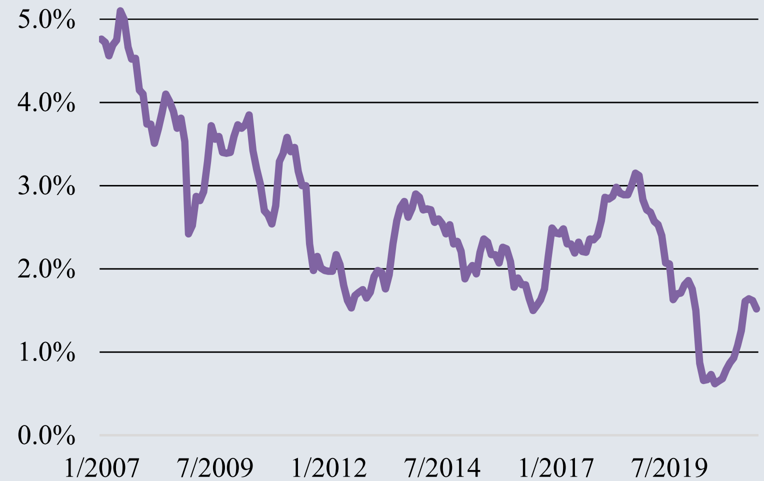
Federal Reserve Balance Sheet, assets in trillions $
as of 7/8/2021



U.S. Treasuries Yield Curve
Second Quarter 2021

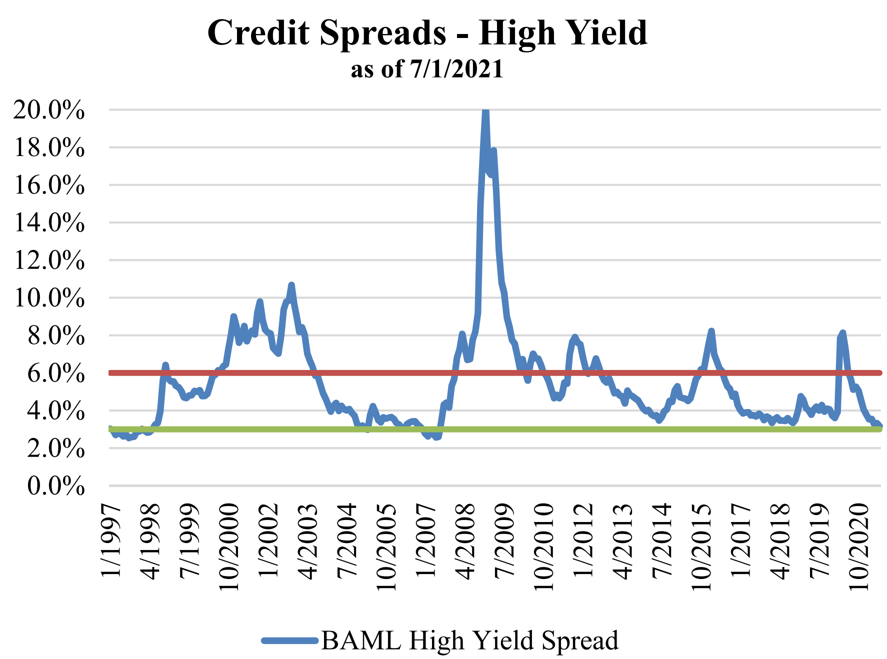


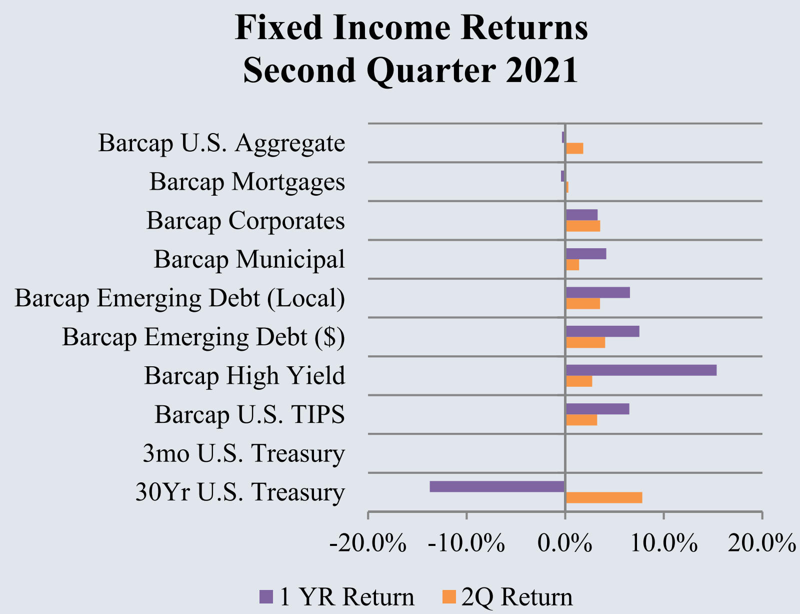
10-Year Treasury Yield
as of 7/1/2021

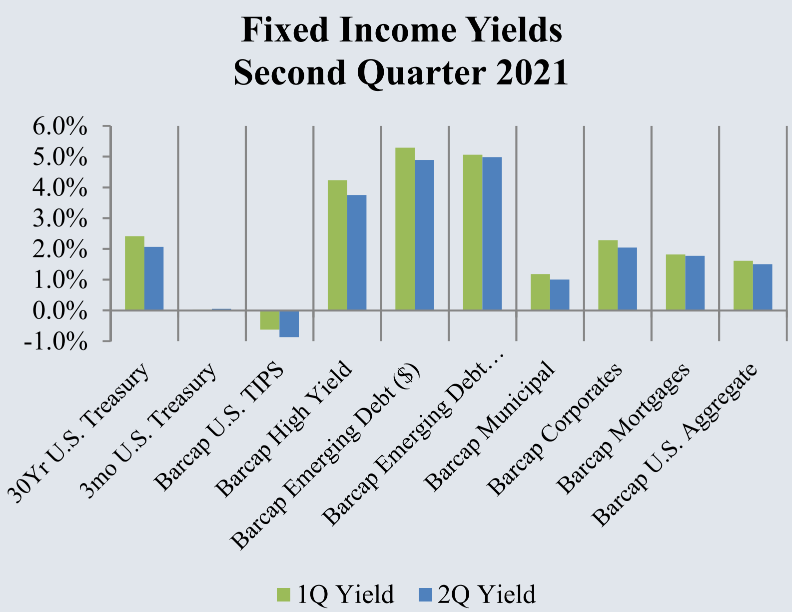


FIXED INCOME (continued)

- During the quarter, the Bloomberg Barclays U.S. Aggregate was up 1.83%, as interest rates decreased. Credit focused sectors, such as corporates, high yield, and emerging market debt continued their outperformance as credit spreads tightened.
- Mortgages were weak during the quarter as the market reacted to the disclosure that the Fed discussed tapering purchases in the June meeting.
- Municipals had another strong quarter as new federal support benefits state and local municipalities.
- Credit spreads are near their historic lows, indicating that a lot of the positive economic growth and earnings are baked in and there is not a lot of room to tighten further. Thus, returns in many fixed income sectors will be weaker over the next year relative to last year's returns.



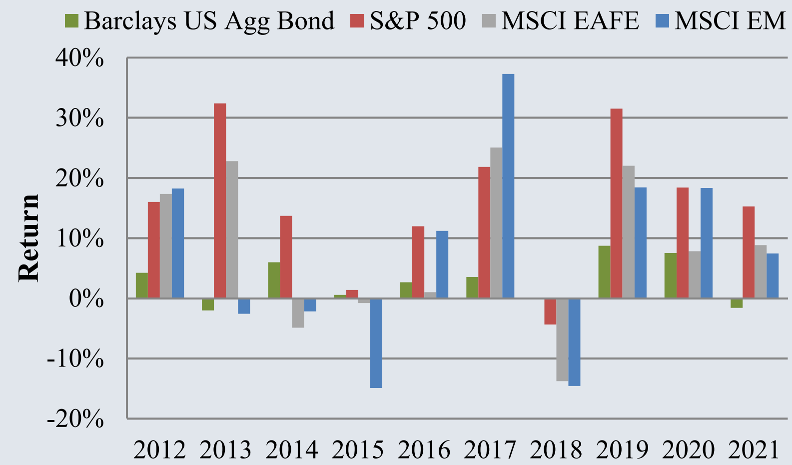




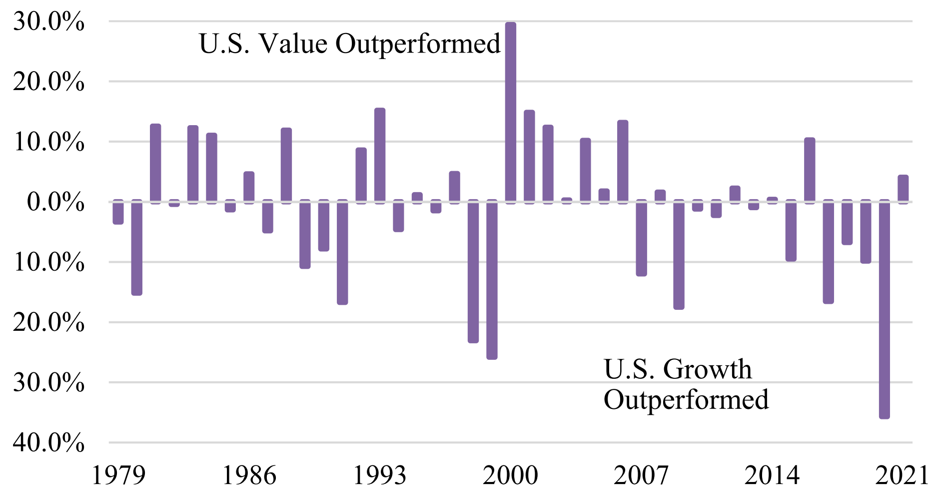
EQUITIES

- Equity markets had a very strong quarter as economic data has come in strong. There are many positives that are supporting the markets, including more fiscal stimulus coming, accommodative monetary policy, healthy consumer balance sheets and resilient consumer and business spending.
- Growth rebounded in the quarter and outperformed value stocks. Nonetheless, value has outperformed over the past nine months after years of underperformance.
- Global supply chains are still disrupted, which has caused an increase in prices in certain parts of the economy such as autos and commodities.
- Fiscal and monetary policy will likely continue to be drivers of asset returns in 2021. In addition, COVID variants are challenging the reopening of global economies and thus expected growth.

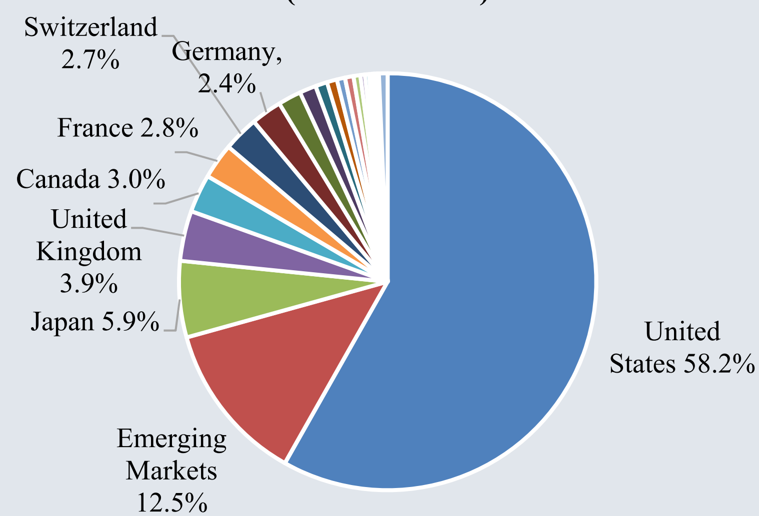
Equity & Fixed Income Market Annual Returns
(as of 6/30/2021)



U.S. Value vs. Growth Relative Equity Performance **(as of 6/30/21)**



Country Weighting in MSCI ACWI
(as of 6/30/2021)

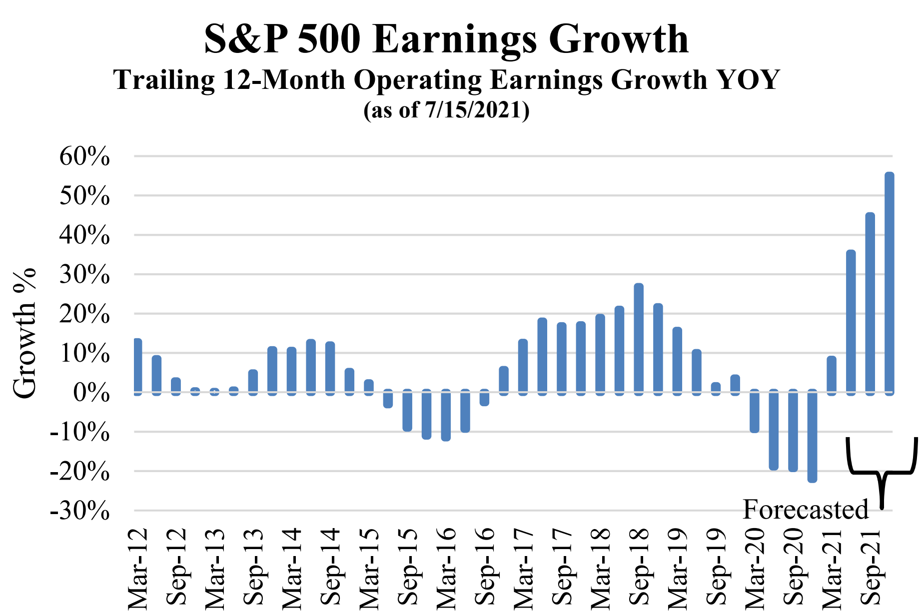


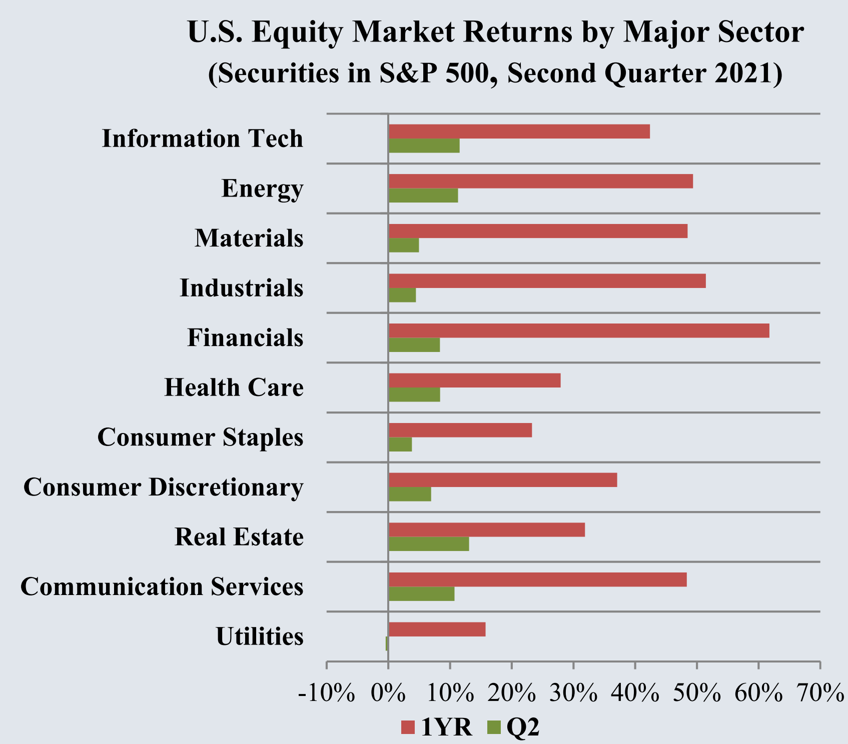
DOMESTIC EQUITIES

- The Russell 1000 Index, comprised of large and mid-capitalization stocks, posted a total return of 8.5% during the second quarter. This was the fifth quarter in a row with positive gains. All sectors were up during the quarter except Utilities. On a year-over-year basis, the Russell 1000 Index has increased 43.1%.
- Small capitalization stocks, as represented by the Russell 2000 Index, increased 4.3% during the second quarter. On a year-over-year basis, the index has increased 62.03%. Historically, small caps have led coming out of recessions.
- Corporate earnings are having an exceptionally strong year. While the growth rate will not be sustained, earnings are expected to be strong next year as well.
- Broad market valuations based on P/E have risen to highs last seen in the late 1990s, as markets have rebounded while earnings have just started to catch up. However, valuations across sectors and market caps are not uniform. Over the short-term, valuations tend to have little influence on returns, but over longer periods they tend to be more correlated.

Second Quarter 2021 Returns

	Value	Core	Growth
Mega Cap		10.1%	
Large Cap	5.2%	8.5%	11.9%
Mid Cap	5.7%	7.5%	11.1%
Small Cap	4.6%	4.3%	3.9%
Micro Cap	4.8%	4.1%	3.2%

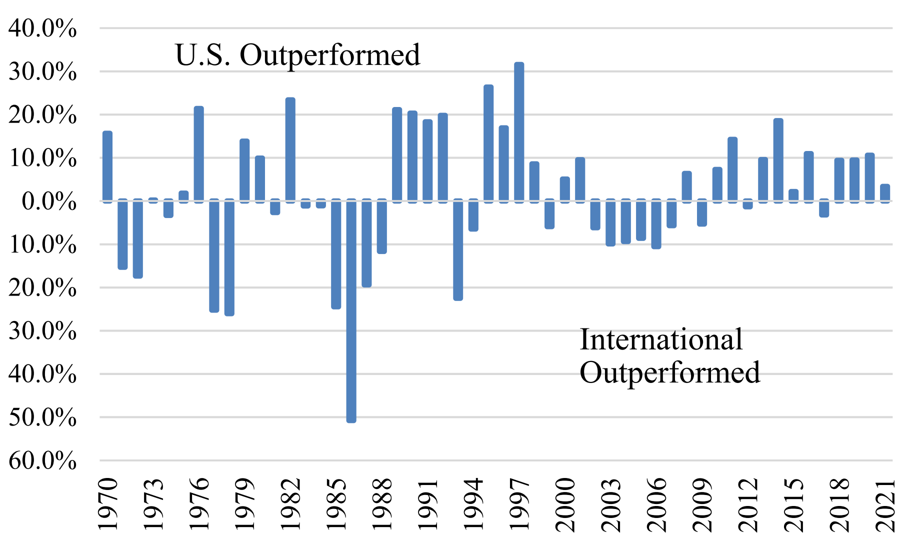




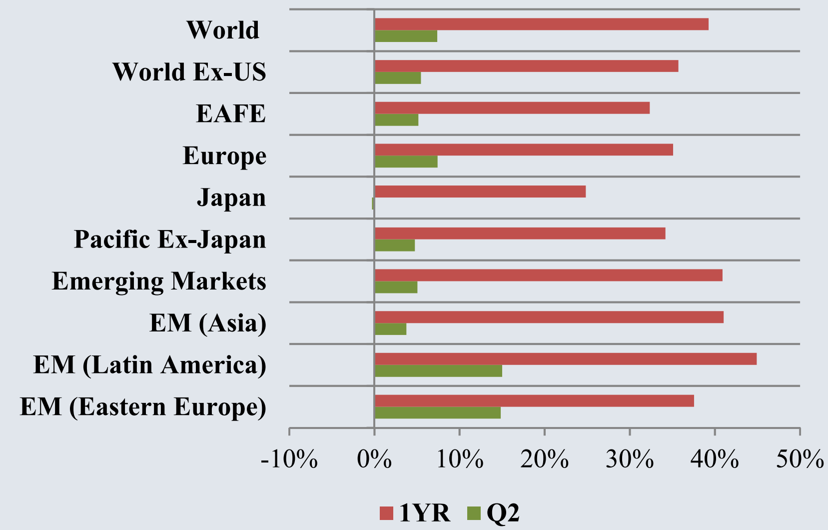
INTERNATIONAL EQUITIES

- Developed international stocks, as represented by the MSCI EAFE, were up 5.2% during the quarter. On a year-over-year basis, the EAFE is up 32.4%, performing worse than U.S. domestic equities.
- Emerging market stocks underperformed developed markets during the second quarter as the MSCI Emerging Markets Index rose 5.1%. On a year-over-year basis, emerging market stocks performed better than developed markets with a return of 40.9%.
- China's economic growth came in weaker than expected during the quarter. In addition, the Chinese government has been cracking down on regulatory oversight of major e-commerce companies.
- Japanese equity returns trailed their international peers during the quarter. Japan has had a slow rollout of vaccines compared to other nations as the Japanese government just recently approved foreign-produced vaccines.
- The past few years have seen the rise of populism and de-globalization pressures. Going forward, global asset diversification may provide more benefit than it has over the previous decade.

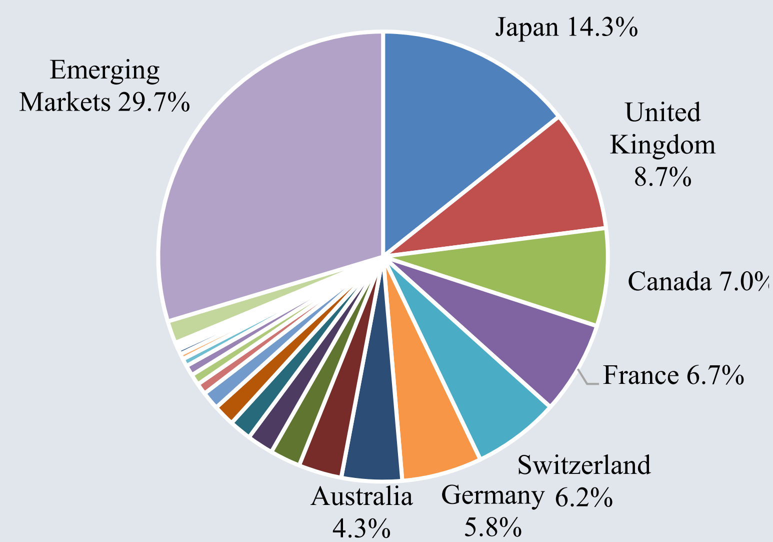
U.S. vs. International Equity Performance
(as of 6/30/21)



Non-U.S. Equity Market Returns
Second Quarter 2021



Country Weighting in MSCI ACWI ex US
(as of 6/30/2021)



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