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Capital Markets Review and Outlook

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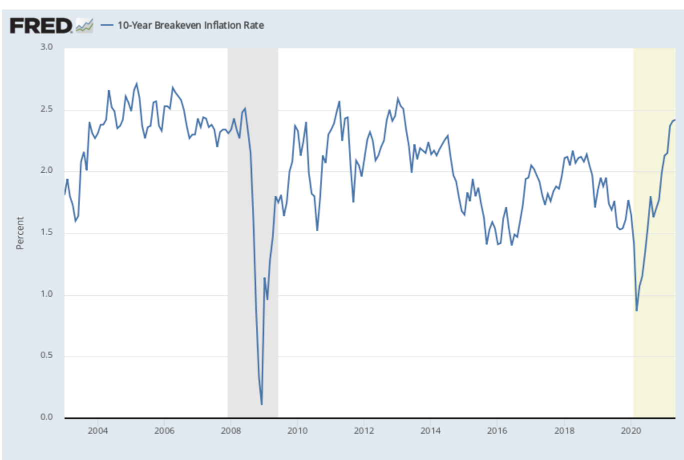
Economy and Outlook

The light at the end of the Covid-19 tunnel in the United States grew brighter as the month of April came to a close. As of the writing of this commentary, almost 150 million Americans, representing 45% of the total population have received at least one dose of the coronavirus vaccination, while 106 million (one-third of the population) have been fully vaccinated. The number of new daily infections and fatalities have both progressively declined as well. Other developed regions of the world have also seen progress. After a slow start, a quarter of the European Union's population has now received at least one vaccine dose. On the other hand, major developing countries, such as India and Brazil, have seen a resurgence in Covid-19 infections as well as the emergence of virus mutations. India became the second country in the world to surpass 20 million reported coronavirus cases. While mutations are a concern and pose a threat to the global containment of the virus, progress is also being made in the development of next-generation vaccines which will provide broader and more lasting virus protection.



Despite the increasingly positive news on the virus-front, accommodative monetary and fiscal policies world-wide continue unabated. In the United States, this has resulted in the massive growth in household and corporate balance sheets amounting in the trillions of dollars. This has, in turn, led to a sharp economic rebound. At the end of April, the Commerce department reported that the U.S. economy grew at an annualized rate of 6.4% for the first quarter of 2021, significantly higher than estimates at the beginning of the year. This follows a 4.3% increase in real GDP for the fourth quarter of 2020. Even state governments' finances have improved significantly. Last year, the state of California was anticipating a $54 billion budget shortfall which would have led to severe cuts in spending. Instead, the state is now expecting a $15 billion budget surplus for the next fiscal year. Sharply higher levels of economic growth are taking place even before the Biden administration's next proposed spending of almost $2 trillion. In addition to the trillions of dollars in fiscal spending, the Federal Reserve continues to buy $120 billion in

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government securities each month and continues to maintain the overnight interest rate at near-zero levels. There is somewhat of a disconnect between the extraordinarily low levels of interest rates and a surging economy. Commodity prices across the board are at multi-year highs. While supply chain disruptions may explain some of the price increases, strong demand appears to be a primary catalyst. The Federal Reserve remains sanguine about the risks for inflation from the unprecedented levels of fiscal and monetary stimulus. However, a key segment of the interest rate markets, Treasury Inflation Protected Securities (TIPS), that focuses on future inflation is indicating concern. The chart on page 1 shows that the 10-year breakeven inflation rate is now just 33 bp from the peak reached even before the Great Financial Crisis. A renormalization of interest rates may likely be an inevitable outcome of the policies enacted to mitigate the economic fallout from the coronavirus pandemic.

Equity Markets

Positive news on the increasing number of Covid-19 vaccinations and proposals for additional fiscal stimulus led to further strong gains in the equity markets in April. For the month, the broad domestic equity market represented by the Russell 3000 Index rose +5.2%. For the first four months of 2021, the index is up +11.8%. For the second consecutive month, Large Cap (+5.4%) outperformed both Mid Cap and Small Cap by +30 bp and +330 bp respectively. Year-to-date, however, Large Cap's return continues to trail both Mid and Small Cap following its significant outperformance in 2020. In April, there was a reversal in performance by style as Growth outperformed Value across all capitalizations for the first time this year. Value, however, continues to dominate Growth by a substantial margin year-to-date, a reversal from 2020. For the second consecutive month, all 11 S&P 500 sectors had positive returns. Cyclicals mostly outperformed Defensives in April. The best performing sector was Real Estate (+8.3%) with Communications Services (+7.8%) and Consumer Discretionary (+7.1%) also among the top performers for the month. Laggards include Energy (+0.6%) and Consumer Staples (+2.1%). Despite a decline in Treasury yields and a flattening of the yield curve, the Financials sector continued its strong performance rising +6.6% in April which brought the year-to-date return for the sector to +23.6%. Although the U.S. dollar index (DXY) declined -2% in April, the gains in international equity markets lagged the U.S. markets as the slower pace of Covid-19 vaccinations was reflected in slower economic growth. The Developed Markets index, MSCI EAFE rose +3% for the month and 6.6% year-to-date. While France (+6.2%), Australia (+4.9%) and Canada (+4.4%) were strong performers for the month, Japan (-1.5%) and Italy (+0.5%) were detractors. Emerging markets underperformed Developed Markets for the third consecutive month. The MSCI Emerging Markets index was up +2.5% in April. The strong gains in Brazil (+6.4%) and Taiwan (+8.5%) were dampened by the weakness in India (-0.9%) and the more subdued +1.4% rise in China. Year-to-date, the Developed Markets index is up +6.6% compared to +4.8% for its Emerging Markets counterpart.

Fixed Income Markets

After the sharp rise in Treasury yields through the first quarter of the year, interest rates declined modestly in April. While 2-year Treasury yields were unchanged at 0.16%, yields

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further out the curve dropped by 6 to 11 bp with the yield on the 30-year Treasury bond closing the month at 2.3%. The Treasury yield curve flattened as the 2-year/30-year spread narrowed by 11 bp to +214 bp. However, the yield curve is +62 bp steeper since the beginning of the year. Despite the strong rally in equity markets, the gains in the investment grade credit sector were more muted. The credit index's option-adjusted spread (OAS) tightened by 2 bp to 83 bp leading to +12 bp of outperformance over duration-matched Treasuries. For the first time in several months, the corporate quality and credit curves both steepened. The Single-A sector outperformed the BBB sector by 3 bp, while short and intermediate issues outperformed the long maturity sector by 20 bp. The best performing sectors in April were REITs (+66 bp) and Finance Companies (+48 bp), while Health Insurance (-44 bp) and Pharmaceuticals (-41 bp) lagged. For the month of April, the investment grade credit index posted a total return of +1.1% helping narrow the year-to-date decline to -3.4%. The High Yield sector performed better (and more in line with the equity markets) in April as the Bloomberg Barclays High Yield index OAS tightened by 19 bp pushing the OAS below 300 bp to close the month at +291 bp. This led to +70 bp of outperformance over Treasuries. The best performing sectors include Oil Field Services (+3.8%) and Independent Energy (+2.7%), while similar to the investment grade sector, Pharmaceuticals (+17 bp) and Health Insurance (+26 bp) were the underperformers. In April, the High Yield sector posted a total return of +1.1% which brought its return for the first four months of 2021 to 2%. Although bond yields in international developed markets rose or declined by less than U.S. Treasury yields in April, the 2% decline in the dollar index (DXY) led to an outperformance of the FTSE non-US World Government Bond Index (WGBI) which rose +1.4% for the month, twice the return for the U.S. government bond index. Year-to-date, however, the U.S. government bond market with a decline of -3.4% continues to outperform the -5.2% loss for the international bond index.

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			Returns as of 4/30/21 (In %)				
		Month	YTD	1 Year	3 Years	5 Years	
Russell 3000®	US AllCap Equity	5.2	11.8	50.9	18.9	17.7	
Russell 1000®	US Large Cap Equity	5.4	11.6	49.5	19.2	17.8	
Russell 1000® Growth	US Large Cap Growth	6.8	7.8	51.4	25.4	22.9	
Russell 1000® Value	US Large Cap Value	4.0	15.7	45.9	12.3	12.2	
Russell Midcap®	US Mid Cap Equity	5.1	13.7	59.6	16.7	15.6	
Russell Midcap® Growth	US Mid Cap Growth	5.6	5.0	54.0	22.0	19.7	
Russell Midcap® Value	US Mid Cap Value	4.8	18.5	60.7	12.3	12.2	
Russell 2000®	US Small Cap Equity	2.1	15.1	74.9	15.2	16.5	
Russell 2000® Growth	US Small Cap Growth	2.2	7.2	69.2	18.0	18.9	
Russell 2000® Value	US Small Cap Value	2.0	23.6	79.0	11.7	13.5	
MSCI ACWI ex-US	Global Equity ex-US	2.9	6.5	43.0	7.0	9.8	
MSCI EAFE	Global Developed Mkts Equity	3.0	6.6	39.9	6.3	8.9	
MSCI EM	Emerging Mkts Equity	2.5	4.8	48.7	7.5	12.5	
Bloomberg/Barclays US Agg	US Core Fixed Income	0.8	-2.6	-0.3	5.2	3.2	
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.5	-1.1	0.8	4.5	2.7	
Bloomberg/Barclays US Credit	US Corporate Bonds	1.1	-3.4	4.3	6.6	4.6	
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.6	-0.6	-0.2	4.1	2.5	
Bloomberg/Barclays US Corp HY	US High Yield	1.1	1.9	19.7	7.0	7.5	
FTSE Non-US WGBI	Global Fixed Income ex-US	1.4	-5.2	5.5	2.2	1.9	

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