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Capital Markets Review and Outlook

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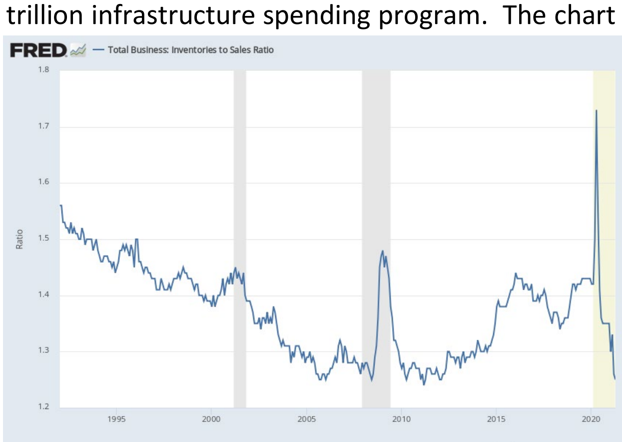
Economy and Outlook

The positive news on the coronavirus pandemic-front continued to build momentum in June. While the cumulative statistics paint a grim picture with over 182 million confirmed cases world-wide and almost 4 million deaths, the number of confirmed cases on a weekly basis has dropped below 2 million, less than half the rate from just a month ago. Additionally, almost 3 billion vaccine doses have been administered which is close to double the number from last month. In the United States, more than half of the total population has received at least one dose of the vaccine, and the percentage fully vaccinated is approaching 50%. The current vaccines have also been found to be fairly effective against emerging highly contagious Covid-19 variants. These positive developments together with the continuation of fiscal and monetary stimulus programs have led to a further opening up of economies. In the United States, 850,000 jobs were added in the month of June, the largest gain in 10 months. In another sign of the recovery in the labor markets, weekly jobless claims fell to the lowest level since the pandemic began. Although the total level of employment (nonfarm payrolls) is still 6.5 million lower than January 2020, wages are increasing at a brisk pace reflecting strong demand for workers. For private sector workers, wages rose 3.6% compared to the prior year. Estimates for economic growth this year have been ramped up following the signing of the $1.9 trillion Covid-19 relief package. The Congressional Budget Office (CBO) now expects fourth quarter real GDP this year to increase by 7.4% compared to last year, twice the rate anticipated in February. Stronger than expected economic growth and price pressures are occurring even before the potential effects from the White House's proposed $1+ trillion infrastructure spending program. The chart on the left shows that the total business inventory to sales ratio is near its lowest level in almost 30 years. This is another sign of price pressures in the economy. A big question for investors is whether the expected acceleration in inflation is transitory as the Federal Reserve believes or will the Fed find itself behind the curve which would have serious implications for investors.



Equity Markets

The major domestic equity market indices made all-time highs in June bolstered by the accelerating pace of Covid-19 vaccinations, continued fiscal and monetary stimulus, and a surging economy. The broad domestic equity market represented by the Russell 3000 index gained +2.5% for the month, and +8.2% for the 2nd quarter. For the 1st half of 2021, the index rose a strong +15.1%. Performance differentiation by capitalization was mixed in June with both Large Cap (+2.5%) and Small Cap (+1.9%) outperforming Mid Cap (+1.5%). There was a strong reversal in performance by style as Growth outperformed Value across all capitalizations. For the broad equity market, Growth's return of +6.2% is in stark contrast to Value's loss of -1.1% in June. The dominance of Growth over Value persisted for the 2nd quarter for Large Cap and Mid Cap. However, Small Cap Value outperformed Growth by +64 bp for the three months. For the 1st half of 2021, Value maintained its sizeable lead ranging from +4.1% to +17.7% over Growth across all capitalizations. Sector performance was mixed for the second consecutive month. While Technology (+7%) was the best performer in June, other Cyclicals such as Materials (-5.3%) and Industrials (-2.2%) were among the worst performers. Financials (-3%) lost ground as the Treasury yield curve flattened significantly in June. Energy (+4.6%) continued to power higher as oil prices (WTI) broke above $70 a barrel. For the 1st half of the year, the Energy sector is up a sizzling +45.6%. The foreign exchange markets played a dominant role in international equity markets returns in June. Confounding the pundits who have had bearish views on the U.S. dollar, the dollar index (DXY) rocketed higher by +2.7% for the month. The dollar gained across a wide swathe of currencies in both developed and emerging markets; a notable exception was Brazil where the Brazilian real rose +4.7% against the dollar. The Developed Markets index, MSCI EAFE lost -1.1% in June trimming its return for the 1st half of the year to +8.8%. Italy (-3.1%) and the United Kingdom (-2.4%) were among the laggards for the Developed Markets. Canada was flat as the decline in the currency was offset by the strong rise in oil prices. The MSCI Emerging Markets index (+0.2%) was barely changed in June. The strength in Brazil (+5.3%) was offset by the -0.7% decline in India and the flat return in China (+0.1). For the 2nd quarter of 2021, the Developed Markets index (+5.2%) and the Emerging markets (+5%) had similar returns. Year-to-date, the Developed Markets index (+8.8%) has a +140 bp advantage over its counterpart.

Fixed Income Markets

Volatility in Treasury yields rose sharply in June on indications that Federal Reserve officials were discussing tapering the central bank's quantitative easing (QE) program. Short and intermediate Treasury yields spiked higher, while longer maturity yields plunged. The difference in yield changes caused a significant flattening in the Treasury yield curve. Two-year and 5-year Treasury yields rose by 11 bp and 8 bp respectively to 0.25% and 0.87%. Conversely, the yield on the 30-year Treasury bond dropped 20 bp to end the month at 2.07%, while 10-year Treasury yields declined 13 bp to 1.45%. The 2-year/30-year spread differential narrowed by a massive 31 bp to +181 bp. At the beginning of the 2nd quarter, this spread was +225 bp. The investment grade credit sector continued to rally in June with the credit index option-adjusted spread (OAS) tightening by 2 bp to +77 bp resulting in +43 bp of outperformance over duration-matched Treasuries. For the second consecutive month, the corporate quality and credit curves both flattened. The BBB sector outperformed the Single-A sector by +26 bp in excess return, while the long maturity credit sector outperformed short and intermediate issues by an average of +52 bp. The best performing sectors were Media Entertainment (+107 bp) and Airlines (+91 bp), while Sovereigns (-16 bp) and Supranationals (+3 bp) lagged. For the 1st half of 2021, new issuance of investment grade bonds came in at just under $1 trillion. Prior to the pandemic, this would represent the volume of new issuance for an entire year. For the month of June, the investment grade credit index posted a total return of +1.5% helping narrow the year-to-date decline to -1.3%. The high yield sector posted strong gains in June with the Bloomberg Barclays High Yield index OAS narrowing by 28 bp to end the month at +268 bp. This, in turn, led to excess returns of +122 bp. Performance by quality was mixed in June. While the Ba-rated index gained +1.5% on a total return basis and the Single-B index was up +1%, the Caa index rose +1.5% and distressed issuers rated Ca and below gained +6.2%. The best performers in the high yield sector were energy-related with Oil Field Services (+4.7%) and Independent Energy (+3.3%). The worst performers include Refining (-1%) and Banking (+0.5%). For the month, the high yield index produced a total return of +1.3% which increased the index's 1st half return for the year to +3.6%. While short maturity government yields in international developed markets did not rise as much as similar maturity Treasury yields, long maturity international government yields declined by less than long maturity Treasury yields. In addition, the U.S. dollar rallied strongly against developed market currencies. As a result, the FTSE non-US World Government Bond Index (WGBI) lost -2.1% in June versus the +0.6% gain for the U.S. government bond index. For the 1st half of the year, the U.S. government bond market with a return of -2.5% continues to lead the international government bond index (-6%) by +350 bp.

			Returns as of 6/30/21 (In %)				
		Month	Q2	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	2.5	8.2	15.1	44.2	18.7	17.9
Russell 1000®	US Large Cap Equity	2.5	8.5	15.0	43.1	19.2	18.0
Russell 1000® Growth	US Large Cap Growth	6.3	11.9	13.0	42.5	25.1	23.7
Russell 1000® Value	US Large Cap Value	-1.1	5.2	17.0	43.7	12.4	11.9
Russell Midcap®	US Mid Cap Equity	1.5	7.5	16.2	49.8	16.4	15.6
Russell Midcap® Growth	US Mid Cap Growth	6.8	11.1	10.4	43.8	22.4	20.5
Russell Midcap® Value	US Mid Cap Value	-1.2	5.7	19.5	53.1	11.9	11.8
Russell 2000®	US Small Cap Equity	1.9	4.3	17.5	62.0	13.5	16.5
Russell 2000® Growth	US Small Cap Growth	4.7	3.9	9.0	51.4	15.9	18.8
Russell 2000® Value	US Small Cap Value	-0.6	4.6	26.7	73.3	10.3	13.6
MSCI ACWI ex-US	Global Equity ex-US	-0.6	5.5	9.2	35.7	9.4	11.1
MSCI EAFE	Global Developed Mkts Equity	-1.1	5.2	8.8	32.4	8.3	10.3
MSCI EM	Emerging Mkts Equity	0.2	5.0	7.4	40.9	11.3	13.0
Bloomberg/Barclays US Agg	US Core Fixed Income	0.7	1.8	-1.6	-0.3	5.3	3.0
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.0	0.8	-0.8	0.1	4.4	2.5
Bloomberg/Barclays US Credit	US Corporate Bonds	1.5	3.3	-1.3	3.0	7.4	4.6
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.0	0.3	-0.8	-0.4	3.8	2.3
Bloomberg/Barclays US Corp HY	US High Yield	1.3	2.7	3.6	15.4	7.4	7.5
FTSE Non-US WGBI	Global Fixed Income ex-US	-2.1	0.5	-6.0	3.1	2.8	1.3

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