consequent capital management

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Capital Markets Review and Outlook

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Economy and Outlook

The coronavirus-induced shroud of darkness and gloom that has engulfed the world for over a year lifted further as the month of March ended. While the number of new Covid-19 infections in the United States remains elevated at 60,000 per day, the vaccination rate has ramped up significantly with over 3 million vaccinations administered per day. More than 100 million Americans have received at least one vaccine dose, and 18% of the adult population is now fully vaccinated. With President Biden well ahead of his original vaccination goal, he recently doubled it to 200 million vaccinations in his first 100 days in office. Globally, the vaccination program has also picked up speed. While fully vaccinated percentages are still in the single digits for most countries, except for a few such as Israel (53%), Chile (20%) and the United States (18%), over 17 million vaccinations per day are now being administered worldwide. This rate will quickly ramp up as vaccine manufacturers increase supply and new vaccines become available.

In addition to the optimistic picture that is developing on the vaccination-front, the economy is also building momentum. The U.S. March employment report showed non-farm payrolls increased by over 900,000 helping drive down the unemployment rate to 6%, less than half its peak last year as shown in the chart on the left. Although total nonfarm employment is still lower by over 8 million compared to its pre-pandemic peak in February 2020, there are emerging signs of labor market tightness. For example, the National Federation of Independent Business (NFIB) recently reported that the number of small businesses that are having difficulty filling jobs is at a record high. Consumer confidence hit a pandemic peak with the Conference Board index rising for the third consecutive month and reaching 109.7 in March, its highest reading since April 2020. The U.S. household sector ended 2020 with $14.1 trillion combined in checking and savings accounts according to the Federal Reserve. This figure is $2.7 trillion higher than the end of 2019 despite the economic impact of the pandemic and reflects the massive fiscal and monetary stimulus programs unleashed to combat the economic fallout

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from the pandemic. The slower pace of vaccinations in Europe has cast a shadow on the speed of economic recovery in the eurozone. As a result, the European Central Bank (ECB) has signaled that while the €1.85 trillion allocated to combat the effects of the pandemic will remain unchanged, the bank will buy bonds at a significantly higher pace this year to help offset the slower economic recovery.

The more upbeat economic picture in the United States has been unfolding even before the recently passed $1.9 trillion American Rescue Plan, which amounts to 8% of U.S. GDP. Much of this new stimulus will make its way through the economy this year providing a further uplift to economic growth. At the same time, the Federal Reserve, as well as foreign central banks, are staying the course on monetary policy accommodation. The cost, of course, is widening budget deficits. For the first 6 months of its fiscal year, the U.S. budget deficit has already crossed $1 trillion which does not include the cost of the latest stimulus program. Risks remain elevated for higher interest rates, especially in the near-term, together with a concomitant rise in risk assets volatility.

Equity Markets

The equity markets ended March on a strong note with some of the major domestic equity market indices making record highs on the buoyant outlook for both the pandemic and the economy. The broad domestic equity market represented by the Russell 3000 Index rose +3.6% in March bringing its return for the 1st quarter of 2021 to a strong +6.4%, a sharp contrast to last year's first quarter loss of -20.9%. Performance differentiation by capitalization reversed from the first two months as Large Cap (+3.8%) outperformed both Mid Cap and Small Cap by +110 bp and +280 bp respectively. However, for the first quarter, Large Cap's return trails Mid and Small Cap following its significant outperformance in 2020. From a style perspective, Value continued its trend this year of outperforming Growth across all capitalizations. In March, Value outperformed Growth by an average of +6.5%, widening its lead year-to-date to +13.4%. Positive sector performance across the board generally favors Cyclicals over Defensives. However, although all 11 S&P 500 sectors had positive returns in March, the top performers were Defensives – Utilities (+10.5%) and Consumer Staples (+8.2%). The laggards were Technology (+1.7%) and Communications Services (+3.1%). For the first quarter of the year, Energy was the winner with a gain of +30.9% on the heels of the sharp rise in oil prices with the price for benchmark WTI closing just below $60 a barrel by quarter-end. Financials came in second with a return of +16% as the Treasury yield curve (2-year/30-year Treasury yield spread) steepened sharply by 73 bp to +225 bp. International developed equity markets also registered gains in March despite the strength in the U.S. dollar. The Developed Markets index, MSCI EAFE added +2.3% for the month helped by the strong performance in Germany (+4.1%) and Italy (+4.7%). However, the MSCI Emerging Markets index lost -1.5% in March primarily due to the sharp -6.3% decline in China. For the first quarter of the year, the Emerging Markets index is still up +2.3%, while the Developed Markets index gained +3.5%.

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<u>Fixed Income Markets</u>

Concerns about a widening federal budget deficit, increased supply in Treasuries, and another large stimulus program during an economic recovery that is increasingly V-shaped, weighed on the Treasury market. Treasury yields climbed higher with 10-year maturities facing the most pressure as the 10-year Treasury yield rocketed by 30 bp to 1.74%. 5-year and 30-year Treasury yields increased by 17 bp and 24 bp respectively. The yield on 2-year Treasuries went up only 2 bp to 0.16% as the Federal Reserve maintained its monetary policy accommodation. The differences in yield changes resulted in a 28 bp steepening in the 2-year/10-year yield curve, while the 10-year/30-year curve flattened by 6 bp. Despite the strong rally in equity markets, the Bloomberg Barclays investment grade credit option-adjusted spread (OAS) was unchanged at +86 bp in March which led to +34 bp of outperformance over duration matched Treasuries. However, on a total return basis, the investment grade index had a negative return of -1.6% due to the sharp rise in Treasury yields. For the first quarter of the year, the credit index lost -4.4%. The corporate quality curve and the credit curve both flattened for the month as the BBB-rated sector outperformed the Single-A sector by +46 bp in excess return, while long maturity corporates outperformed short and intermediate issues by +135 bp. The best performing sectors in March include Communications (+112 bp), Energy (+69 bp) and Consumer NonCyclicals (+59 bp), while Financials (-15 bp) and Utilities (-3 bp) were among the laggards. After the record-breaking net issuance of over $1 trillion for investment grade corporates in 2020, net issuance continued on a strong pace in 2021. In the first quarter, net issuance of investment grade corporates was $217 billion. In contrast, the average **annual** net issuance for the three years prior to 2020 was $434 billion. Unlike the Investment Grade index, the Bloomberg Barclays High Yield index OAS tightened by 16 bp in March to +310 bp. As a result, on a total return basis, the High Yield index generated a positive return of +0.2% for the month despite the significant drag from sharply higher Treasury yields. For the first quarter of the year, the High Yield index posted a total return of +0.9% as the index's high coupon return (+1.4%) dominated the price drag (-0.5%) from the spike in Treasury yields. Similar to the Investment Grade sector, the High Yield quality curve flattened in March as the Single-B sector outperformed the higher quality BB sector by +73 bp. For the month, sector performance was mixed. The best performing sectors include Aerospace/Defense (+2.1%), Airlines (+1.7%), and Leisure (+1.2%), while Utilities (-0.9%) and Home Construction (-0.6%) lagged. Although international government bond yields in developed markets rose by less than the corresponding large yield increases in U.S. Treasuries, the sharp appreciation in the U.S. dollar (+2.7% for the dollar index, DXY) in March more than offset the wider government yield differentials. As a result, the FTSE non-US World Government Bond Index (WGBI) declined -2.6% in March underperforming by -110 bp the U.S. government bond index which declined -1.5% for the same period. For the first quarter of the year, the U.S. government bond market's return was -4.1% compared to -6.4% for the non-U.S. government bond market.

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			Returns as of 3/31/21 (In %)				
		Month	1st Qtr	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	3.6	6.3	62.5	17.1	16.6
Russell 1000®	US Large Cap Equity	3.8	5.9	60.6	17.3	16.7
Russell 1000® Growth	US Large Cap Growth	1.7	0.9	62.7	22.8	21.0
Russell 1000® Value	US Large Cap Value	5.9	11.3	56.1	11.0	11.7
Russell Midcap®	US Mid Cap Equity	2.7	8.1	73.6	14.7	14.7
Russell Midcap® Growth	US Mid Cap Growth	-1.9	-0.6	68.6	19.4	18.4
Russell Midcap® Value	US Mid Cap Value	5.2	13.1	73.8	10.7	11.6
Russell 2000®	US Small Cap Equity	1.0	12.7	94.8	14.8	16.4
Russell 2000® Growth	US Small Cap Growth	-3.1	4.9	90.2	17.2	18.6
Russell 2000® Value	US Small Cap Value	5.2	21.2	97.1	11.6	13.6
MSCI ACWI ex-US	Global Equity ex-US	1.3	3.5	49.4	6.5	9.8
MSCI EAFE	Global Developed Mkts Equity	2.3	3.5	44.6	6.0	8.8
MSCI EM	Emerging Mkts Equity	-1.5	2.3	58.4	6.5	12.1
Bloomberg/Barclays US Agg	US Core Fixed Income	-1.2	-3.4	0.7	4.7	3.1
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.7	-1.6	1.4	4.2	2.7
Bloomberg/Barclays US Credit	US Corporate Bonds	-1.6	-4.5	7.9	5.9	4.7
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-0.5	-1.1	-0.1	3.7	2.4
Bloomberg/Barclays US Corp HY	US High Yield	0.1	0.8	23.7	6.8	8.1
FTSE Non-US WGBI	Global Fixed Income ex-US	-2.6	-6.4	5.7	0.9	2.0