Capital Markets Review and Outlook

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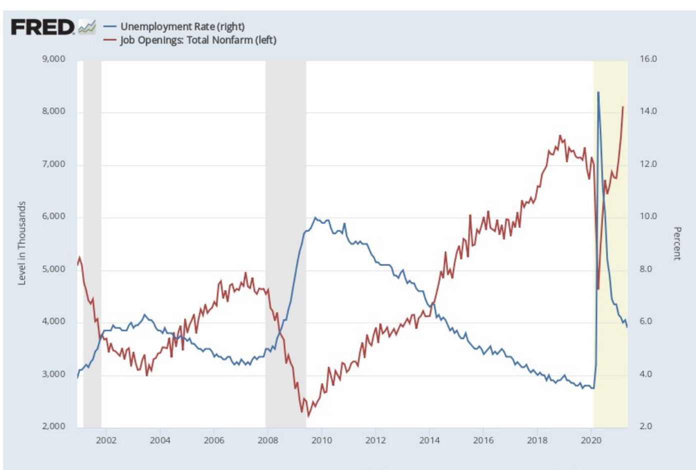
Economy and Outlook

The tide is beginning to turn in the fight against the coronavirus pandemic. Daily infections in the United States have now declined to the lowest levels since March 2020 as more than half the population has received at least one vaccine dose, and over 40% are fully vaccinated. While the U.S. is further along than other countries in combating the pandemic, progress is also taking place worldwide. In hard-hit countries such as India where daily infections were almost 900,000 a few weeks ago, the daily infection rate has declined below 200,000. Worldwide, over 1.6 billion vaccine doses have been administered and the pace is quickening. Economies are opening up in response to the positive news on the pandemic as well as from the vast governmental fiscal stimulus programs and accommodative monetary policies that continue unabated. As part of the $2.2 trillion CARES Act enacted in the U.S. last year, more than 8 million businesses have now received almost $800 billion in forgivable loans, the largest business bailout in U.S. history. In addition, three rounds of direct payments to U.S. taxpayers totaled to a sum even greater than the business loans. As a result, the economy is gaining momentum. Although employment is rising, as seen in the more than half a million job gains for the month of May, the labor market still has 7.6 million fewer jobs compared to February 2020. However, as shown in the chart on the left, while the latest unemployment rate of 5.8% (right y-axis) is still above the pre-pandemic low of 3.5%, the number of available jobs (red line, left y-axis) is at the highest level since the labor market began tracking this statistic more than 20 years ago. The phasing out of enhanced unemployment benefits may help to further drive down the unemployment rate. Economic stimulus programs are ramping up in other countries as well. The economy of Brazil, one of the hardest hit countries by the pandemic, is back to pre-pandemic levels boosted by the biggest stimulus program in emerging markets as the government spent the equivalent of 8% of GDP mostly in individual cash payments.



An increasing concern with the speed of the economic recovery that is unfolding is that as demand continues to outpace supply, inflation may become more entrenched. Central banks currently view the widespread rise in prices as transitory. However, the minutes of a recent Federal Reserve policy-making meeting indicates that several participants are saying that it might be appropriate at upcoming meetings to begin discussing a plan for adjusting the pace of the Fed's asset purchase program (Quantitative Easing) if the economy continues to make rapid progress. Therefore, the extraordinary monetary policies that have been a major support for risk markets may come to an end sooner than expected.

Equity Markets

After three consecutive months of strong gains, equity markets had a more muted rise in May with the broad domestic equity market represented by the Russell 3000 index gaining +0.5% for the month. This still left the index up a strong +12.3% for the first five months of the year. Performance differentiation by capitalization was mixed in May with Mid Cap outperforming both Large Cap and Small Cap. Performance by style reversed yet again with Value outperforming Growth across all capitalizations. In fact, performance for the Growth style lost an average of -1.9% for the month. Year-to-date, Value has outperformed Growth across all capitalizations by a massive margin of +12.1% to +23.4%. Sector performance was mixed in May. While Cyclicals such as Consumer Discretionary (with the worst performance of -3.8%) and Technology (-0.9%) lagged, other Cyclicals such as Materials (+5.2%) posted strong gains. Energy (+5.8%) and Financials (+4.8%) were also strong performers for the month. The second consecutive monthly decline in the U.S. dollar together with an increase in the pace of Covid-19 vaccinations buoyed international equity markets. The Developed Markets index, MSCI EAFE rose +3.3% in May bringing its return for the year-to-date to +10.1%. Canada (+5.4%), Italy (+6.4%), and the United Kingdom (+4%) were among the strong performers for the Developed Markets. Japan was a notable laggard as the Japanese economy contracted -1.3% in the first quarter of this year. The Japanese yen was also the only major currency that declined against the U.S. dollar. While other developed market equity indices had double digit gains for the first five months of the year, the Japanese equity market was up just +1.6%. The MSCI Emerging Markets index rose +2.3% in May. The strengths in Brazil (+9.6%) and India (+8.7%) were offset by the more subdued returns in China (+0.8%) and Korea (+0.4%) and the -1.7% decline in Taiwan. Year-to-date, the Developed Markets index with a gain of +10.1% has widened its lead over the Emerging Markets index which rose +7.3% for the same period.

Fixed Income Markets

Treasury yields declined for the second consecutive month in May. The belly of the Treasury yield curve (5-year and 10-year Treasuries) declined the most as yields dropped by 7 bp, while 2-year and 30-year year Treasury yields declined by 2 bp and 4 bp respectively. The 10-year Treasury yield closed the month at 1.58%. While the intermediate part of the Treasury yield curve flattened in May, as the 2-year/10-year spread narrowed by 5 bp to +144 bp, the longer part of the yield curve steepened with the 10-year/30-year spread widening by 3 bp to end the month at +68 bp. The investment grade credit sector continued to rally in May with the credit index option-adjusted spread (OAS) tightening by 6 bp to +79 bp resulting in +43 bp of outperformance over duration-matched Treasuries. After steepening in April, the corporate quality and credit curves both flattened in May. The BBB sector outperformed the Single-A sector by +17 bp in excess return, while the long maturity credit sector outperformed short and intermediate issues by an average of +48 bp. The best performing sectors were energy-related with Oil Field Services (+156 bp), Midstream (+131 bp) and Independent Energy (+112 bp), while Cable Satellite (-4 bp), Supermarkets (-3 bp) and Consumer Cyclical Services (+2 bp) were the underperformers. New issuance of investment grade bonds continues at a brisk pace with $835 billion issued in the first five months of this year. For the month of May, the investment grade credit index posted a total return of +0.7% helping narrow the year-to-date decline to -2.7%. Unlike the investment grade sector, the high yield sector gave up some gains in May as the Bloomberg Barclays High Yield index OAS widened by 5 bp to end the month at +296 bp. Despite the spread widening, the higher coupon and the decline in Treasury yields enabled the sector to post a total return of +0.3% for the month and +2.3% year-to-date. Like its investment grade counterpart, the best performers in the high yield sector were energy-related with Oil Field Services (+2.4%) and Independent Energy (+0.9%). The worst performers include Pharmaceuticals (-2.2%) and Wirelines (-0.4%). Although bond yields in international developed markets declined by less than U.S. Treasury yields in May, the broad decline in the U.S. dollar against most currencies, except for the Japanese yen, led to an outperformance of the FTSE non-US World Government Bond Index (WGBI) which rose +1.2% for the month versus +0.3% for the U.S. government bond index. As a result, the U.S. government bond market's year-to-date lead over the international government bond index has narrowed, -3.1% versus -4.0%.

			Returns as of 5/31/21 (In %)				
		Month	QTD	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	0.5	5.6	12.3	43.9	18.0	17.4
Russell 1000®	US Large Cap Equity	0.5	5.9	12.1	42.7	18.4	17.5
Russell 1000® Growth	US Large Cap Growth	-1.4	5.3	6.3	39.9	23.0	22.1
Russell 1000® Value	US Large Cap Value	2.3	6.4	18.4	44.4	12.9	12.3
Russell Midcap®	US Mid Cap Equity	0.8	5.9	14.6	50.3	16.1	15.4
Russell Midcap® Growth	US Mid Cap Growth	-1.5	4.0	3.4	37.8	19.9	18.9
Russell Midcap® Value	US Mid Cap Value	2.0	6.9	20.9	56.6	12.6	12.3
Russell 2000®	US Small Cap Equity	0.2	2.3	15.3	64.6	13.1	16.0
Russell 2000® Growth	US Small Cap Growth	-2.9	-0.7	4.1	50.1	14.5	17.6
Russell 2000® Value	US Small Cap Value	3.1	5.2	27.5	79.4	10.7	13.8
MSCI ACWI ex-US	Global Equity ex-US	3.1	6.2	9.9	42.8	8.9	10.9
MSCI EAFE	Global Developed Mkts Equity	3.3	6.4	10.1	38.4	8.2	9.8
MSCI EM	Emerging Mkts Equity	2.3	4.9	7.3	51.0	9.6	13.9
Bloomberg/Barclays US Agg	US Core Fixed Income	0.3	1.1	-2.3	-0.4	5.1	3.2
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	0.2	0.7	-0.9	0.4	4.4	2.8
Bloomberg/Barclays US Credit	US Corporate Bonds	0.7	1.8	-2.7	3.3	6.7	4.8
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	-0.2	0.4	-0.7	-0.5	3.8	2.4
Bloomberg/Barclays US Corp HY	US High Yield	0.3	1.4	2.2	15.0	7.1	7.4
FTSE Non-US WGBI	Global Fixed Income ex-US	1.2	2.6	-4.0	6.3	3.4	2.6

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