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Capital Markets Review and Outlook

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Economy and Outlook

The first month of the new year unfolded on both a somber and a hopeful note. The coronavirus pandemic continued to spread and exact its toll on the world in January. Globally, the number of confirmed infections has surpassed a previously unimaginable number of 100 million; and this is just one year after the first reported cases of Covid-19. Fatalities from the disease have now exceeded 2 million worldwide. In the United States, the number of confirmed cases has crossed 2 million, and the number of people who have succumbed to the disease is fast approaching 450,000. Further compounding the health crisis, new variants of the disease have now emerged. On the positive front, the pace of vaccinations has accelerated. In the last week of January, more than one million people per day have been vaccinated in the United States. Additionally, vaccines from more companies are in the process of receiving regulatory approval which will help further increase the number of daily vaccinations. While the vaccines may not be fully effective against some of the new mutations of Covid-19, they are likely to help prevent severe outcomes that require hospitalizations. Also, the pharmaceutical companies developing the vaccines are confident that they will be able to develop booster vaccines which will help more fully mitigate new mutations.

The economy continues to recover in a mixed manner. While millions of Americans remain unemployed due to business closures or low levels of activity in several service industries such as restaurants, hotels, leisure and travel, there has been a pickup in the manufacturing sector with a key index, the IHS Markit Manufacturing Index rising to 59.2 in January, its highest level in more than a decade. In Europe, however, more severe lockdowns were instituted due to rapidly rising Covid-19 cases resulting in a weaker economic recovery relative to the United States. On the other hand, the global economy has benefitted from the strength of China's economy. With GDP growth of +2.3% for 2020, China was the only major economy to report positive growth. In contrast, the World Bank's predictions for the U.S. and the eurozone are economic contractions of -3.6% and -7.4% respectively for all of 2020. With the inauguration of President Joseph Biden this month, the new administration has placed a heightened emphasis on getting the pandemic under control, providing further stimulus measures for economic momentum, and renewing a focus on globally important issues such as climate change. Additional spending in the trillions of dollars will likely be required for the administration's agenda. Record-low interest rates due to monetary policy actions undertaken as a result of the pandemic have been integral in enabling massive government spending. The U.S. federal debt, which was $5.1 trillion in 2007, has exploded

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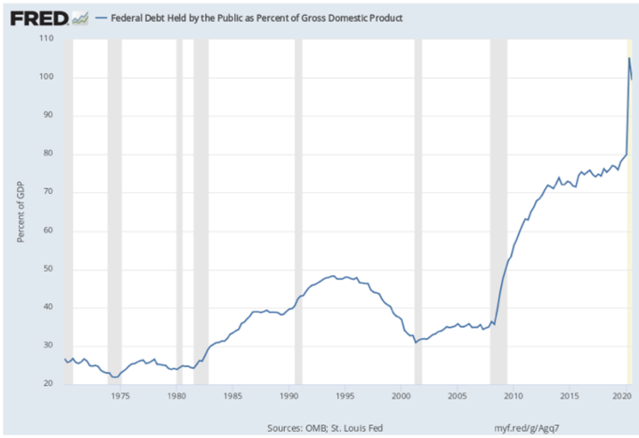

to over $21 trillion at the end of last year. As the chart on the left shows, this debt level as a percentage of the economy may become unsustainable. As of the end of 2020, the U.S. federal debt held by the public as a percentage of GDP was very close to 100%, the highest ratio in more than 70 years. This year, the ratio is likely to exceed 100% even with positive economic growth. The risk is that with an accelerating vaccination program, the negative effects from the pandemic may be curtailed sooner than expected. To put this in perspective, in less than two months more people have been vaccinated in the United States. than the total number of people infected since the start of the virus one year ago. Higher interest rates could then ensue to offset the more than sufficient economic stimulus programs by that time. The cost of servicing the massive debt would then require a larger share of the federal budget leading to a potentially vicious cycle of rising budget deficits.

Equity Markets

After the spectacular rebound last year following the 1st quarter's swoon, and the resulting stellar performance for the full year, the equity markets took a breather in the first month of 2021. The broad domestic equity market represented by the Russell 3000 Index lost -0.4% in January. While Large Cap and Mid Cap declined -0.8% and -0.3% respectively, investor optimism for a strong economic rebound this year boosted Small Cap by +5%. The Style differential from last year played out again with Growth outperforming Value modestly for Large Cap. However, for both Mid Cap and Small Cap, Value outperformed Growth by +10 bp and +44 bp respectively. Sector performance was mixed in January. The -5.2% decline for Consumer Staples compared to the +0.4% gain for Consumer Discretionary might suggest a month when Cyclicals outperformed Defensives. However, Industrials (-4.3%) and Materials (-2.4%) were the 2nd and 3rd worst performers, while Health Care (+1.4%) and Real Estate (+0.5%) had positive returns for the month. Technology (-0.9%) and Financials (-1.7%) also lost ground. Energy was the best performer for the month with a return of +3.8% as oil prices (WTI) broke back and stayed above $50 in January, the first close above $50 per barrel in almost one year. In international markets, the Developed Markets Index, MSCI EAFE, declined -1.1% in January. An increasing number of coronavirus cases which led to more lockdowns in Europe weighed on the Eurozone equity markets. A reversal in the U.S. dollar's decline also added to international equity market losses as the dollar gained +1.3% against the euro. The equity markets in Italy and France were among the worst performers with declines of -4% and -3.1% respectively. The dollar's +1.4% gain against the Japanese yen contributed to the -1% decline in the Japanese equity market. While developed markets lagged, the MSCI Emerging Markets

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Index rose +3.1% in January building on its strong performance from the 2nd half of 2020. Steep losses in Brazil (-7.8%) were more than offset by the robust +5.4% gain in the largest emerging market (China), and the +5.2% gain in Taiwan.

Fixed Income Markets

Despite the decline in equity markets in January, intermediate and long maturity Treasury yields rose for the month as investors anticipated a ramp-up in stimulus programs by the new administration in Washington. Short maturity yields remained anchored by the Fed's reiteration of its accommodative monetary policy. The yield on the 2-year Treasury note declined by 2 bp in January to 0.11%, while yields on 5-year, 10-year and 30-year Treasuries rose by 9 to 22 bp with the 30-year bond's yield closing the month at 1.87%. By the end of the first month of the new year, the Treasury yield curve steepened sharply as the 2-year/30-year spread widened by 24 bp to +176 bp. Just 7 months ago, in July 2020, the spread was +109 bp. Investment grade corporate bond spreads were unchanged in January leading to +6 bp of outperformance over duration-matched Treasuries. However, on a total return basis, the Bloomberg Barclays Investment Grade Credit Index declined -1.2% due to the sharp rise in Treasury yields. Although the investment grade option-adjusted spread (OAS) remained unchanged at +92 bp in January, the quality curve and the credit curve both flattened for the month. BBB-rated bonds outperformed Single-A rated issues by +25 bp in excess return, while long maturity corporate bonds outperformed short to intermediate bonds by +9 bp. The best sector performers in January in terms of excess return include Airlines (+182 bp), Building Materials (+75 bp) and Healthcare (+65 bp), while Communications (-25 bp) and Technology (-24 bp) lagged. Although the High Yield OAS widened by 2 bp in January, the Bloomberg Barclays US High Yield Index still generated excess returns of +62 bp despite the rise in Treasury yields. Similar to the investment grade sector, the High Yield quality curve flattened as Caa-rated bonds outperformed Single-B bonds by +129 bp in total return. However, the High Yield credit curve steepened with short maturity bonds outperforming intermediate issues by an average of +34 bp. The best performing sectors in January were Oil Field Services (+6%), Airlines (+1.7%) and Retailers (+1.3%). The worst-performing sectors included Lodging (-62 bp), Supermarkets (-55 bp) and Restaurants (-35 bp). For the month, the High Yield sector generated a total return of +0.33%. Although government bond yields in developed markets rose by less than the corresponding yield rise in the U.S. Treasury market, the rebound in the U.S. dollar weighed on the returns in the international bond markets. After the dollar index's (DXY) steep decline last year to its first close below 90 in almost three year, the dollar index gained +0.9% in January. The gains against major currencies were even stronger with the dollar rising versus the euro and the Japanese yen by +1.3% and +1.4% respectively. As a result, the FTSE non-US World Government Bond Index (WGBI) dropped -1.4% in January underperforming by -50 bp the U.S. government bond index which declined -0.9% for the same period.

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			Returns as of 1/31/21 (In %)		
		Month	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-0.4	20.5	12.4	16.7
Russell 1000®	US Large Cap Equity	-0.8	19.8	12.5	16.7
Russell 1000® Growth	US Large Cap Growth	-0.7	34.5	19.9	22.2
Russell 1000® Value	US Large Cap Value	-0.9	4.1	4.4	10.7
Russell Midcap®	US Mid Cap Equity	-0.3	17.7	10.1	14.9
Russell Midcap® Growth	US Mid Cap Growth	-0.3	33.9	18.2	20.5
Russell Midcap® Value	US Mid Cap Value	-0.2	6.8	4.5	10.9
Russell 2000®	US Small Cap Equity	5.0	30.2	11.1	16.5
Russell 2000® Growth	US Small Cap Growth	4.8	42.7	16.5	20.2
Russell 2000® Value	US Small Cap Value	5.3	16.4	5.1	12.3
MSCI ACWI ex-US	Global Equity ex-US	0.2	14.0	3.1	10.5
MSCI EAFE	Global Developed Mkts Equity	-1.1	8.9	2.2	8.8
MSCI EM	Emerging Mkts Equity	3.1	27.9	4.4	15.0
Bloomberg/Barclays US Agg	US Core Fixed Income	-0.7	4.7	5.5	4.0
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.1	4.2	4.7	3.2
Bloomberg/Barclays US Credit	US Corporate Bonds	-1.2	5.6	6.7	6.1
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.1	3.2	4.2	2.8
Bloomberg/Barclays US Corp HY	US High Yield	0.3	7.4	6.1	9.0
FTSE Non-US WGBI	Global Fixed Income ex-US	-1.4	8.0	3.0	4.7