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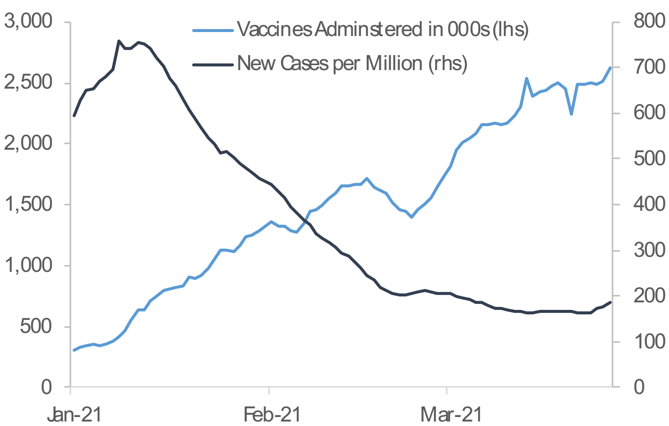
First Quarter 2021 Recap & Second Quarter Outlook

Pandemic Passes One-Year Anniversary Mark

One-year after the pandemic first struck, the U.S. is making positive progress in battling the virus. Vaccination efforts are in full swing, with the U.S. administering nearly 2.5 million vaccine doses per day in the second half of March. Daily new confirmed cases are down from their early 2021 spike. The data is encouraging and signals the pandemic's loosening grip.

FIGURE 1

COVID-19 Update — Vaccine Doses vs New Cases



Source: MarketDesk Research, Our World in Data. Note: 7 day moving averages

Positive progress on vaccinations and new cases is allowing public officials to ease restrictions. States are removing capacity restrictions on restaurants and bars and allowing public venues to reopen. However, restriction easing comes as virus variants are emerging and new daily confirmed cases are ticking higher. The risk is new cases counts increase in the months ahead.

Congress & Federal Reserve Remain Supportive

The federal government and Federal Reserve both remain committed to supporting the economic recovery. In March, Congress passed the Biden administration's $1.9 trillion fiscal relief package, which distributed $1,400 checks to individuals and extended unemployment benefits. The relief comes despite improving virus trends as the Biden administration and Treasury Secretary Janet Yellen reiterate the biggest risk is not acting big enough.

Looking ahead, the Biden administration is drafting a $3 trillion infrastructure and jobs package. The infrastructure portion is expected to focus on repairing the nation's roads, bridges, waterways, and rails and tackling climate change. A domestic priorities bill focused on education and childcare is expected to follow. The bills' expensive price tags are prompting questions about funding, with the Biden administration considering corporate and individual tax increases to offset some of the spending.

The Federal Reserve held interest rates and bond purchases steady in the first quarter. The central bank is walking a tightrope by maintaining its current policy. Its own internal projections point to stronger growth and higher inflation ahead. However, Chairman Jay Powell reiterated it will take time to reach the bank's goals of maximum employment and 2% sustained inflation. He added the Fed wants to see actual progress, not forecast progress, before removing support. As a result, the Fed does not expect to raise interest rates until 2023.

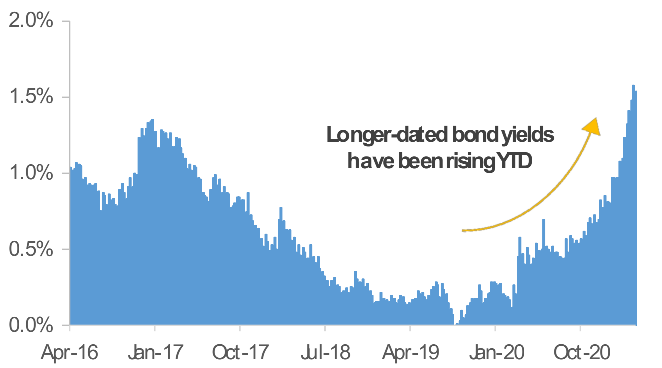
Markets Forecast a Reflationary Period

The combination of positive virus progress and more fiscal and monetary stimulus drove the first quarter's reflationary narrative. Reflation is defined as a period of price increases when the economy is striving to achieve full employment and growth. The market is betting the combination of positive vaccination momentum, fiscal stimulus, and low interest rates will supercharge 2021 economic growth.

One of the first quarter's big stories was the Treasury yield curve's steepening, which occurs when the yield gap between two bonds widens. Figure 2 charts the spread between the yield on the 10-year Treasury and the 2-year Treasury, or the 10-2Y spread. Markets track the 10-2Y spread for signals about future economic expectations. A steeper or widening spread signals expectations for stronger growth, higher inflation, and/or interest rate increases. A flatter or tightening spread suggests markets are concerned about the economy. Recent spread movement indicates the market is gaining confidence as the economy prepares to reopen with significant fiscal stimulus and monetary policy support.

FIGURE 2

Interest Rate Spreads — 10 Year vs 2 Year U.S. Treasury Bonds



Source: MarketDesk Research, Federal Reserve

Market Rotates into Cheaper Cyclical Stocks

The reflationary environment impacted equity returns. Performance was volatile at times as the market rushed to buy companies and sectors that benefit from stronger economic growth. Cyclical sectors, such as Energy, Financials, Industrials, and Materials, outperformed, while defensive sectors, such as Health Care, Utilities, and Consumer Staples, underperformed. The Russell 2000 Index, which tracks small-cap domestic stocks, returned 12.9% during the first quarter, while the S&P 500 Index, which tracks large cap stocks, returned 6.3%.

The steeper 10-2Y spread also created a speed bump for growth stocks during the first quarter. The Russell 1000 Growth Index returned 0.9% during the first quarter. However, high-flying growth companies, such as Tesla, Zoom, and Snowflake, traded lower as the market questioned the group's expensive valuations. In contrast, the Russell 1000 Value Index returned 11.3% as investors rotated into cheaper cyclical stocks.

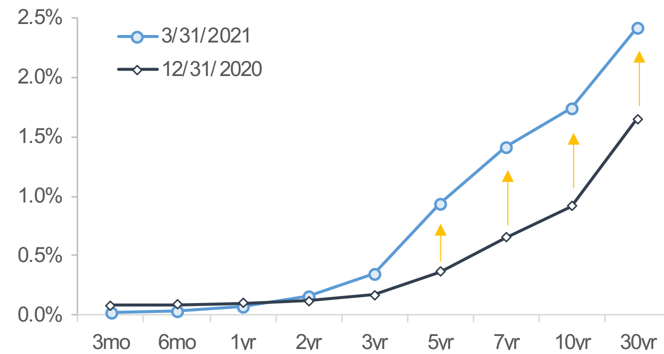
Credit Returns Hurt by Rising Interest Rates

The bond market struggled as interest rates rose during the first quarter. Figure 3 compares the Treasury yield curve at the end of March against the yield curve at the end of 2020. It shows yields on longer maturity bonds rose the most as the market priced in stronger economic growth and higher inflation expectations. Rising interest rates lead to lower bond prices. As a result, longer maturity bonds broadly underperformed to start 2021.

Rising interest rates also hurt investment grade corporate debt. In contrast, lower quality high yield corporate bonds were less impacted by rising rates. Demand for high yield debt remains strong as investors hunt for income. The market's growing risk appetite allowed companies to issue a record $140 billion in junk bonds during the first quarter.

FIGURE 3

U.S. Treasury Bond Yield Curve — Today vs the End of 2020



Source: MarketDesk Research, Federal Reserve

2021 Outlook – Did the Market Get Ahead of Itself?

The economic outlook brightened significantly in the first quarter due to positive vaccination efforts, declining COVID case counts, and strong stimulus efforts. Real-time data, including TSA security screenings and OpenTable reservations, is already rebounding. The market expects the economy to strengthen further in the coming months. As an example, the Federal Reserve recently increased its 2021 GDP growth estimate to 6.5% from 4.2% in December 2020. The economy has not expanded that fast since growing 7.2% year-over-year in 1984.

FIGURE 4

Economic Activity — Year over Year Change

Source: MarketDesk Research, TSA, OpenTable. ***Note:*** *7-day rolling averages.*

The question is: how much future economic growth is already priced into the stock market? February economic data was messy, and investors are questioning if cold weather or a slowing recovery is to blame. The result is an unsettled market trying to figure out what happens next. One thing is certain -- the economy has big expectations to meet in the coming months.

THIS QUARTER IN NUMBERS

FIGURE 5

U.S. Style Returns (1Q 2021 in %)

	Value	Blend	Growth
Large	11.3	6.3	0.9
Mid	13.1	8.1	-0.5
Small	21.3	12.9	5.0

Data Reflects Most Recently Available As of 3/31/2021

FIGURE 6

U.S. Sector Returns (1Q 2021 in %)

Data Reflects Most Recently Available As of 3/31/2021

FIGURE 7

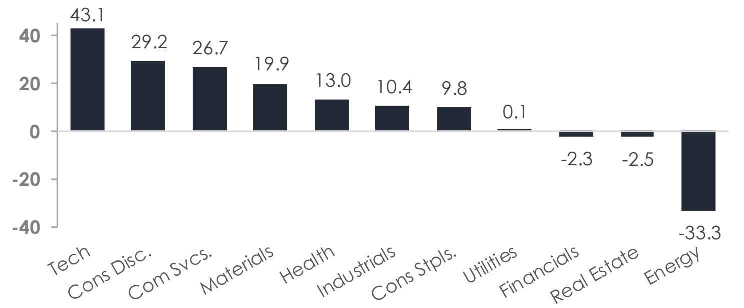
U.S. Style Returns (2020 in %)

	Value	Blend	Growth
Large	2.2	17.9	38.0
Mid	4.2	16.4	35.1
Small	4.1	19.6	34.4

Data Reflects Most Recently Available As of 12/31/2020

FIGURE 8

U.S. Sector Returns (2020 in %)



Data Reflects Most Recently Available As of 12/31/2020

FIGURE 9

Market Data Center

Stocks	Level	1 month	3 months	YTD	1 year	3 years	Dividend Yield	NTM P/E	P/B
S&P 500	3,973	4.5%	6.3%	6.3%	55.9%	56.9%	1.39%	21.8x	4.1x
Dow Jones	32,982	6.9%	8.4%	8.4%	53.2%	43.8%	1.68%	20.5x	4.8x
Russell 2000	5,519	1.4%	12.9%	12.9%	94.8%	49.5%	0.90%	30.5x	2.6x
Russell 1000 Growth	1,617	1.8%	0.9%	0.9%	62.3%	82.2%	0.62%	28.8x	11.3x
Russell 1000 Value	922	6.0%	11.3%	11.3%	55.4%	33.9%	1.72%	18.3x	2.5x
M SCI EAFE	1,255	2.5%	4.0%	4.0%	44.8%	17.1%	2.02%	17.2x	1.8x
M SCI EM	74,289	-0.7%	3.2%	3.2%	58.5%	16.4%	1.39%	14.9x	2.1x
NASDAQ	13,247	1.7%	1.8%	1.8%	68.5%	102.3%	0.55%	28.1x	8.0x

Fixed Income	Yield	1 month	3 months	YTD	1 year	3 years
U.S. Aggregate	2.13%	-1.1%	-3.4%	-3.4%	0.8%	13.9%
U.S. Corporates	2.70%	-1.5%	-5.5%	-5.5%	8.1%	20.9%
Municipals (10 yr)	2.08%	0.6%	-0.7%	-0.7%	4.8%	13.8%
High Yield	4.76%	1.2%	0.6%	0.6%	18.5%	17.1%

Key Rates	3/31/2021	2/28/2021	12/31/2020	9/30/2020	3/31/2020	3/31/2018
3 yr Treasuries	0.34%	0.31%	0.17%	0.16%	0.27%	2.38%
10 yr Treasuries	1.74%	1.46%	0.92%	0.68%	0.68%	2.74%
30 yr Treasuries	2.42%	2.19%	1.65%	1.45%	1.32%	2.97%
30 yr Fixed Mortgage	3.25%	3.25%	2.87%	3.08%	3.86%	4.27%
Prime Rate	3.25%	3.25%	3.25%	3.25%	3.25%	4.75%

Commodities	Level	1 month	YTD
Oil (WTI)	59.16	-3.8%	21.9%
Gasoline	1.94	8.0%	41.9%
Natural Gas	2.61	-7.2%	3.2%
Propane	0.92	1.1%	43.1%
Ethanol	1.79	7.2%	43.2%
Gold	1,716	-0.8%	-9.5%
Silver	24.53	-7.2%	-7.1%
Copper	4.00	-2.2%	13.9%
Steel	1,348	6.6%	40.0%
Corn	5.64	3.1%	16.6%
Soybeans	14.44	2.6%	10.2%

Data Reflects Most Recently Available As of 3/31/2021