Q1 MARKET INSIGHTS

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Spring 2021

Spring is a special time of the year. Spring brings new life, rejuvenation, renewal, resurrection, regrowth, and here in New England, optimism for the upcoming Red Sox season. During the first quarter, investors displayed their optimism for an economic renewal as equity markets advanced in hopes of a post-COVID-19 recovery. Additional economic stimulus, combined with accelerating COVID-19 vaccine distribution plans and a decline in Coronavirus cases helped push stocks higher as the S&P 500® Index posted a 6.17% return for the quarter. Foreign markets also saw positive returns due to initial signs of a global economic recovery, driven by progress in vaccine distribution and lower infection rates. For the quarter, foreign developed markets, represented by the MSCI EAFE Index, registered a solid 3.61% return, while emerging markets, as represented by the MSCI Emerging Markets Index, were up 2.21%. Switching to fixed-income markets, quarterly returns for most bond classes were negative for the first time in more than two years. The U.S. bond market has only posted negative quarterly returns 30 times over the past 50 years with the worst period being the early 1980's when Federal Reserve (the "Fed") Chairman Paul Volcker was sharply raising interest rates to combat a double-digit inflation rate. The first quarter of 2021 proved to be the worst quarter for the Bloomberg Barclays U.S. Aggregate Bond Index since 1981 as growth expectations resulted in a surge in inflation estimates (pushing yields higher). For the quarter, this fixed income index was down 3.37%.

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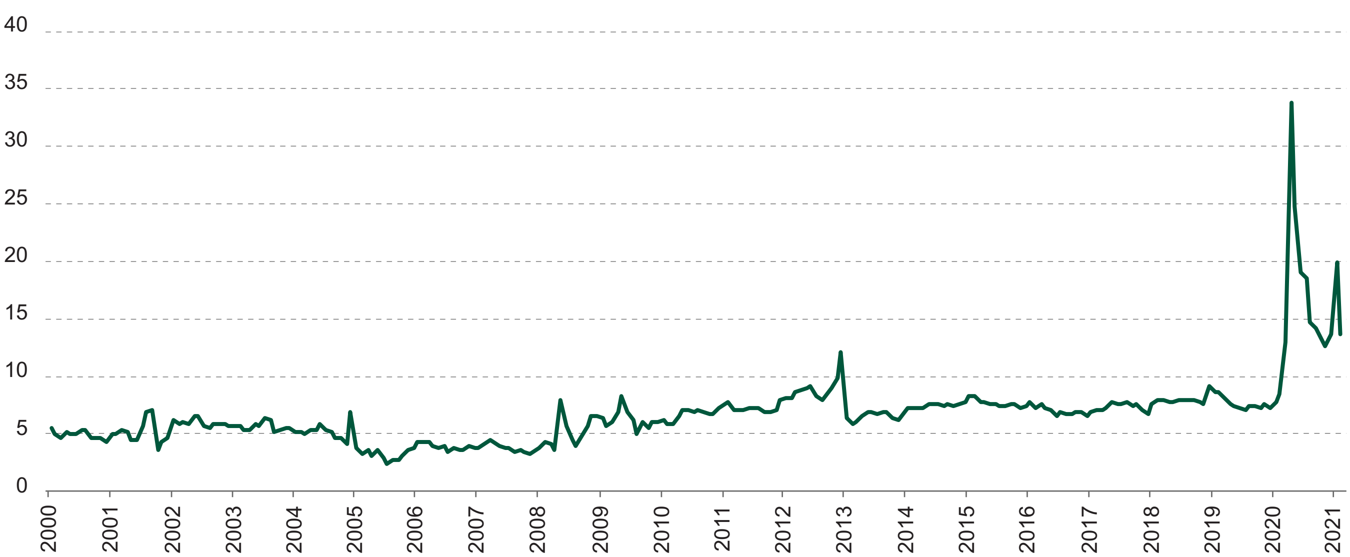
Elevated Household Savings Could Fuel a Burst of Spending

U.S. Personal Savings as a Percentage of Disposable Income
Monthly (Jan 2000 - Feb 2021)



Source: Bloomberg, U.S. Bureau of Economic Analysis

As we begin the second quarter, the outlook for the economy remains broadly positive, with consumers expected to shake off lingering pandemic related uncertainty and go on a spending spree. Monies from the massive $1.9 trillion economic stimulus bill that was passed by Congress are now entering the economy, and those funds should help spur economic growth in the months ahead. Personal consumption, which represents 70% of the U.S. economy, is expected to increase rapidly. U.S. households currently hold more cash than almost any time on record. Analysts expect the personal savings rate to rise back above 30% in April as the stimulus checks come through (see the chart on the previous page). This pent-up demand, combined with accelerating vaccine distribution (with President Biden declaring that all American adults be eligible for the vaccine by April 19th) has some Wall Street analysts predicting 2021 Gross Domestic Product (GDP) growth of 8% . This would be the highest rate of economic growth in the U.S. since 1951.

ROBUST CONSUMER SPENDING EXPECTED TO DRIVE CORPORATE PROFIT

In light of this strength, we anticipate that the stock market should continue to advance. The stimulus background alone might be a solid argument for strong corporate earnings growth in 2021, but there are other factors that argue for a substantial upturn in the profit cycle. First, earnings in 2021 will have very easy comparisons to 2020's pandemic-depressed earnings. Second, in addition to higher revenues driven by robust consumer spending, many corporations should see their earnings grow through increased operating leverage. Companies try very hard to control costs, and the pandemic has forced businesses to aggressively reduce costs over the past year. Many companies hit hard by COVID-19 have restructured – cutting jobs and other expenses – and these changes should flow right to the bottom line (more revenues + lower expenses = more profit). This was already evident during the fourth quarter of 2020 when the net profit margin of the S&P 500 was higher than the margin during the same period in 2019 (11% vs. 10.9%). According to Factset, analysts are expecting the S&P 500 to earn $176 per share in 2021. We would not be surprised if these estimates are revised upward later this year, helping valuations and further supporting equity prices.

The initial increase that we expect in consumer spending will likely contribute to short-term inflationary pressures. The rise in inflation expectations is one of the main reasons why bonds did so poorly in the first three months of the year as the yield on the 10-year U.S. Treasury note increased by 0.83% (from 0.91% to 1.74%) during the first quarter (note that when interest rates go up, bond prices go down). Bond yields tend to rise in an inflationary environment because inflation erodes the value of money. For example, when an investor owns a bond, inflation reduces the purchasing power of every dollar that an investor receives in future interest payments. Since those interest payments are now less valuable as inflation rises, your bond is worth less (which causes the price to drop). Despite these inflation pressures, the Fed has signaled its intention to remain very stimulative and to keep interest rates close to zero for the foreseeable future. This is a marked change from the past when the Fed would tighten monetary policy and raise short-term interest rates to avoid having the economy overheat. According to the Fed, these inflationary pressures are "transitory" and will only last a few quarters before eventually subsiding. We generally agree with that view, as over the next several months we believe we will witness a multi-month price level adjustment, which will feel like an uptick in inflation. However, in the latter part of 2021, as the economy further normalizes, sequential growth in real economic activity and prices may slow, potentially bringing down the year-over-year growth rate in headline inflation.

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BALANCING RATES & INFLATION

The Fed currently faces a difficult challenge in trying to balance market expectations for both inflation and interest rates. Rising rates are not good for an indebted economy, as higher rates could cause an economic slowdown. Total U.S. credit market debt outstanding (which includes household debt, corporate debt, local and state government debt, as well as federal government debt) stands at 389% of GDP (see chart below for perspective). Given the historically high level of debt outstanding, any increase in rates could result in higher interest payments for consumers, corporations, and the federal government and could increase the risk of defaults (especially at the consumer and corporate levels). While the Fed has control over short-term interest rates, market forces determine longer-term rates. So, while the Fed seems committed to keeping short-term rates close to zero for the foreseeable future, they are likely keeping a close watch on longer-term rates (10 years and longer). Again, the yield on the 10-year U.S. Treasury note rose to 1.74% during the quarter, and if this trend continues, rates could rise to a point where they may cause an economic slowdown. If rates do rise to a level that causes an issue in the debt markets, the Fed may be forced to step in and implement yield curve control ("YCC"). YCC is a form of monetary policy that involves targeting longer-term interest rates. Under YCC, the Fed would set target rates for U.S. Treasury bond yields and pledge to buy enough bonds to keep the rates from rising above their targets. This policy has been used by the Fed in the past, specifically between 1942 and 1951 when they targeted long-term rates at 2.5%. Initially, to establish these interest rate targets, the Fed purchased large quantities of Treasuries (of all maturities), which made the monetary base double from 1942 to 1945. Current Fed Chairman, Jerome Powell, has previously stated that the Fed has discussed using YCC as one of their policy tools should it be required. YCC is simply an additional form of quantitative easing whereby instead of purchasing a set quantity of bonds, it focuses on prices of bonds (meaning the actual amount of bonds to be repurchased is unconstrained).

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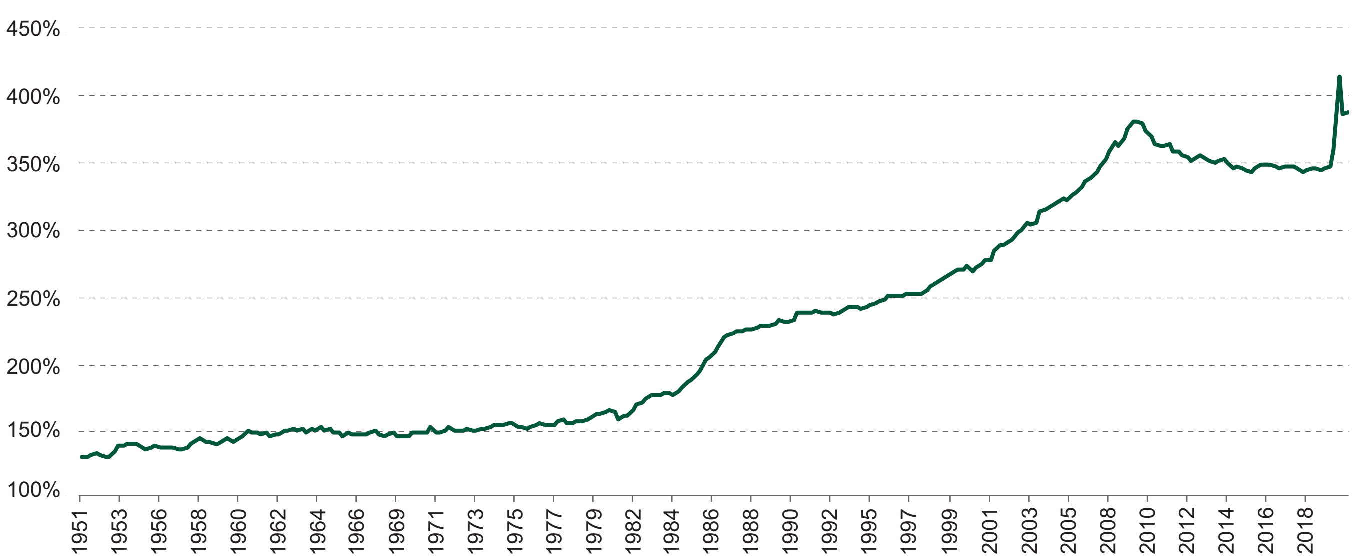
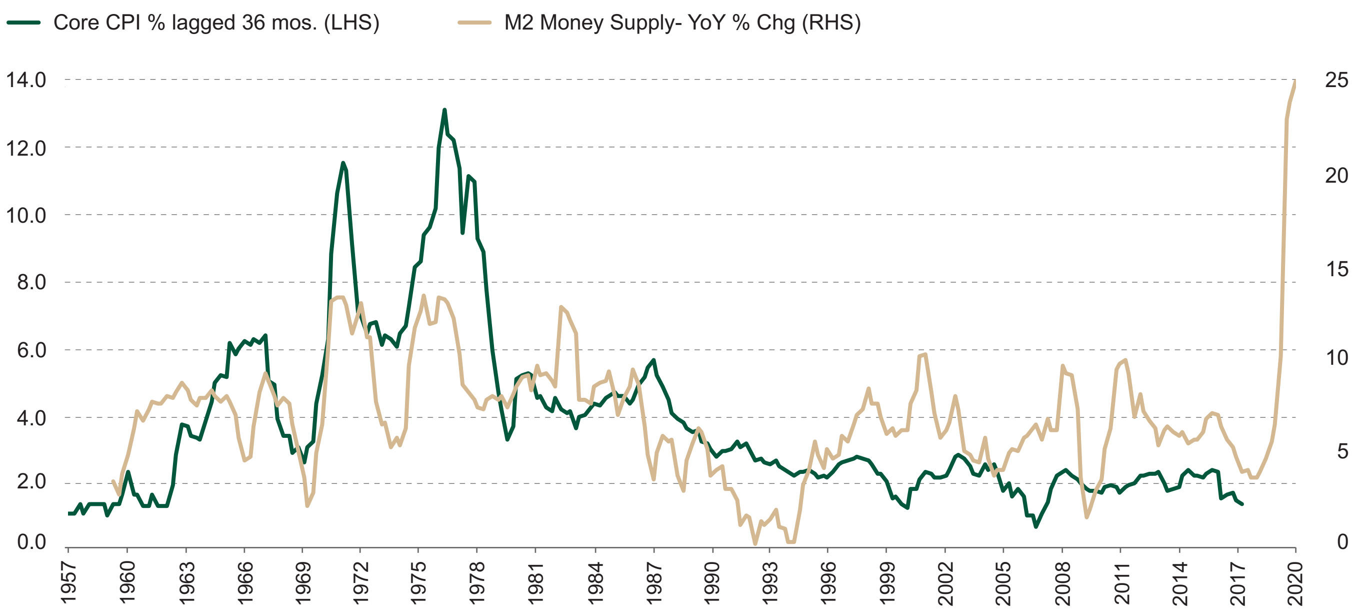
While the Fed may or may not need to implement YCC policy, we do believe the threat of inflation is possible. It is likely that we will see a temporary increase in headline inflation as a result of increased consumer demand, but we expect it to be short-lived. However, the longer-term impact of the rapid growth of the money supply and credit (as a result of the unprecedented fiscal and monetary expansion

Higher Rates Could Impact an Overleveraged Economy



Source: U.S. Bureau of Economic Analysis

Will Fed Policy Bring Higher Inflation?



Source: Bloomberg, U.S. Bureau of Labor Statistics, Board of Governors of the Federal Reserve System

being deployed) may have longer-term repercussions on inflation. So far, the fiscal response to the pandemic (which includes the CARES Act, the Consolidated Appropriations Act, and the American Rescue Plan) has dwarfed prior rescue packages by pumping $5 trillion, or 25% of GDP, into the economy over the past year. This has caused a staggering increase in national debt and federal deficits. This does not even account for President Biden's recent introduction of a $2.25 trillion plan to upgrade the nation's infrastructure, which could lead to further increases in the deficit. In order to fund these deficits, excess debt issued by the U.S. Treasury is being purchased by the Fed. To do this, the Fed creates U.S. Dollars (sometimes referred to as "money printing") to purchase the debt issued by the U.S. Treasury. M2, a measure of the U.S. money supply, has grown by 27% in the past year alone. In the past, the rapid growth of the money supply has coincided with meaningfully higher inflation rates, as more U.S. dollars are available to purchase the same amount of goods and services. The chart above highlights the relationship between growth in the M2 Money supply and the core consumer price index ("CPI") here in the U.S. (please note that the Core CPI is lagged by 36 months to allow for the impact of the increase in money supply on the economy). As you can see, the increase in money supply growth has historically contributed to higher inflation (especially in the 1970s).

Again, our outlook for equities given the crosscurrents of higher Treasury yields, an expected jump in consumer spending combined with massive amounts of fiscal stimulus, and easy monetary policy remain positive. While an adverse economic event caused by rising long-term interest rates may initially cause equity markets to fall, we believe the Fed would likely implement some sort of YCC policy, which should ultimately have a positive effect on equities as it would cause the Fed's balance sheet to expand further (as you may recall, there is a chart that we have shown many times in the past highlighting the relationship between the increase in the Fed's balance sheet and positive returns for the S&P 500). Ultimately, we believe the market is underpricing the longer-term inflationary risks associated with the current monetary policy combined with the possibility of YCC. Therefore, we think investors can be served well to protect their purchasing power by having an allocation to real assets, bitcoin, and other alternative assets where appropriate in their portfolios. Despite moving higher in the past several months, interest rates remain low and are unlikely to compensate investors adequately for growing inflation risks. In our opinion, fixed income still offers diversification and correlation benefits relative to equities and still merit ownership, however, on a reduced basis.

THE AMERICAN JOBS PLAN

At the end of the quarter, President Biden introduced a $2.25 trillion plan to overhaul and upgrade the nation's infrastructure. The plan includes spending on traditional transportation infrastructure as well as funding for electric vehicles, clean water, expanding coverage of 5G, and many other items including an increase in Medicaid spending. In order to pay for the various plans, President Biden is proposing an increase in the corporate tax rate from 21% to 28%, as well as eliminating certain tax credits. Given the slim majority in the Senate (with Vice President Kamala Harris providing the tie-breaking vote), it is likely that tax rates will only rise to maybe 25% as some centrist Democrats may balk at raising corporate tax rates to 28%. As such, we would expect the White House to propose some other tax increases, like an increase in the long-term capital gains rate and a higher top marginal rate for individuals. While this will likely have an impact on equities, it is still too early to quantify the ultimate impact. For now, these potential risks do not outweigh the actual positive influences that we have outlined for stocks. Again, we have highlighted several times that whoever controls the White House and/or Congress ultimately has very little impact on equity markets. This is evident with this past election. Prior to the pandemic, the former administration looked poised to retain the White House as the economy was humming along and a resolution on the trade war with China seemed forthcoming. However, the spread of COVID-19 changed everything. Surprisingly though, this major shift in the political landscape barely registered with the U.S. stock market. When looking at the performance of the stock market on a historical basis, the change in Washington is hard to discern. That being said, with the possibility of some changes to individual tax rates, it may make sense to consider ways to mitigate the impact.

ROTH IRA CONSIDERATION

As mentioned above, President Biden and members of Congress have recently put forth several tax policy proposals, all of which suggest that individual income tax rates are likely to go up for the wealthiest Americans to help pay for the economic stimulus packages and proposed infrastructure investments. Given the likelihood of rising personal income tax rates, it may be prudent for some individuals to consider contributing to a Roth IRA or Roth 401(K) account (if available). Another potential approach is to convert a portion of an existing IRA account to a Roth IRA. While this creates taxable income in the year of conversion, the amount converted into a Roth IRA can grow without ever being taxed for the rest of your life. A Roth IRA can also be left to heirs, again without ever being subject to income tax. Therefore, depending upon the facts and circumstances, it may be beneficial to consider utilizing some of the benefits associated with Roth IRAs.

IN CLOSING

In a year overshadowed by the virus, it is important to acknowledge how we have collectively navigated the various challenges and proven that the human spirit is truly indomitable. 2021 has brought fresh hope in the form of vaccines and a sharper, stronger than expected economic recovery. In addition, policymakers, perhaps recalling inadequate responses during past crises, have kept fiscal and monetary support in high gear. It is against this backdrop that we look to maintain an investment plan to help you meet your long-term investment goals.

We remain committed to working with you to establish a personal investment allocation appropriate for your financial position, risk tolerance, and investment timeline.

We thank you for your ongoing confidence and trust. Please rest assured that our entire team will remain dedicated to helping you successfully navigate this challenging market environment.

Happy Spring!

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Definitions:

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The MSCI EAFE Index is a stock market index that is designed to measure the equity market performance of developed markets (Europe, Australasia, Far East), excluding the US & Canada. The MSCI EAFE Index is an equity index which captures large and mid-cap representation across Developed Markets countries around the world, excluding the US and Canada. With 913 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Indices are not managed and do not incur fees or expenses. Performance numbers for the index are total return with dividends reinvested in the index.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (EM) countries*. With 838 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. Performance numbers for the index are total return with dividends reinvested in the index.

The Bloomberg Barclays US Aggregate Bond Index provides a measure of the total return performance of the U.S. dollar denominated investment grade bond market, which includes investment grade government bonds, investment grade corporate bonds, mortgage pass through securities, commercial mortgage backed securities and asset backed securities that are publicly for sale in the United States.

Gross domestic product (GDP) is calculated by the Bureau of Economic Analysis that serves as a measure of total market value of the goods and services produced (output) in the U.S. GDP is the sum of consumer spending, investments made by industry, the excess of Exports over Imports and Government Spending.

Quantitative easing (QE) is defined as large scale purchases of securities, typically fixed income, by a monetary authority such as the Federal Reserve. In theory, the result is an increase in demand for those securities, putting upward pressure on their prices and pushing yields down. Quantitative easing allows a monetary authority the ability to influence longer duration securities, while traditional monetary tools can only directly influence shorter duration securities.