FINANCIAL MARKETS COMMENTARY

FIRST QUARTER, 2021

TELEMUS®

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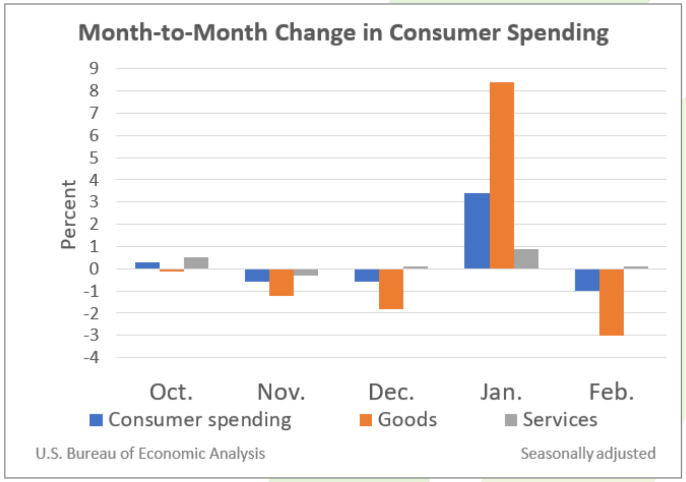
ECONOMY

The U.S. economy continued to rebound during the first quarter and is positioned to be exceptionally strong heading into the second quarter. A $900 billion fiscal stimulus package passed in late December of 2020 provided fuel to start the year. The stimulus package, combined with a decline in COVID-19 cases and gradual progress on vaccinations, provided added reason for increased business and consumer confidence. The passage of an additional $1.9 trillion stimulus package initiated by President Biden only furthered the optimism on the economy through the remainder of 2021.

The second round of stimulus checks issued in January started the quarter off on sound footing, as consumer spending grew +3.4% in January. This positive trend reversed in February due to cold weather across the U.S., although the overall trend in spending during the quarter was positive.

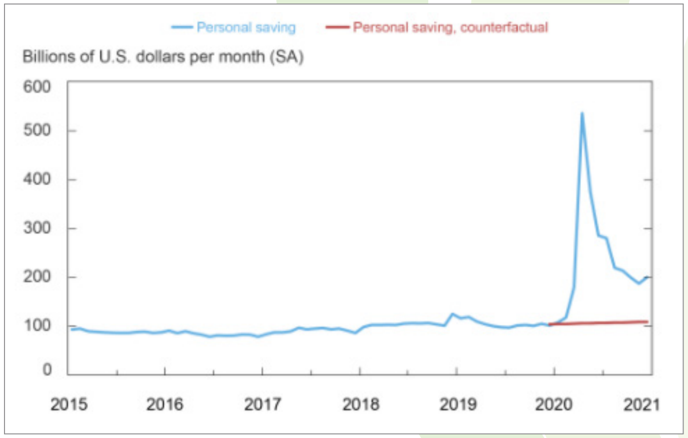
Personal savings rates experienced an inflection higher during January, hitting 20%, as a portion of the second round of stimulus payments was saved. Savings reverted back toward late 2020 levels in February, although they remain at levels nearly double the pre-pandemic trend. In the chart to the right, the New York Federal Reserve highlights personal savings levels, with the red line highlighting what savings rates were forecasted to be given the pre-pandemic trend. The significant excess savings, now estimated to be roughly $1.7 trillion (prior to the most recent stimulus package), offers significant ammunition for the economy going forward.

CONSUMER SPENDING



Source: U.S. Bureau of Economic Analysis

PERSONAL SAVINGS RATE



Source: New York Federal Reserve Liberty Street Economics, Bureau of Economic Analysis, accessed through FRED

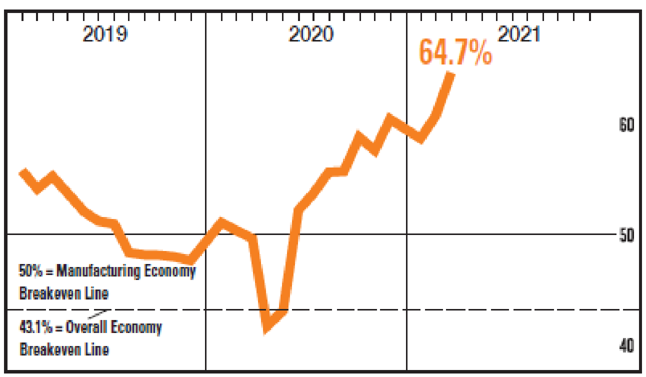
ECONOMY

As we look ahead, a question we and many are trying to ascertain is the pace that savings will be spent, if at all, as COVID-related restrictions are lifted and consumers feel comfortable returning to pre-pandemic spending patterns. One indicator is consumer confidence. At quarter's end, the Conference Board's Consumer Confidence index surged, indicating optimism around purchasing intentions. Another positive indicator is consumer debt coverage. Debt as a percentage of disposable income is now at the lowest level since the 1990's. This added cushion should provide consumers with extra discretionary funds in their monthly budgets.

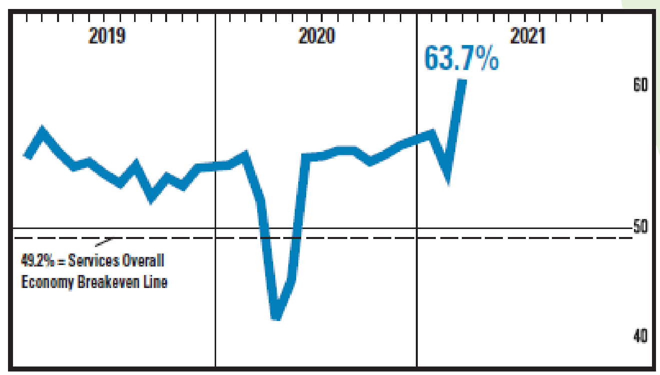
Manufacturing activity continued to expand throughout the quarter. The charts below highlight the ISM Manufacturing and ISM Services indices. The ISM Manufacturing index finished the quarter at its highest level since December of 1983. Manufacturing activity has also grown for ten consecutive months. While conditions are significantly positive, we remain optimistic about the sustainability of industrial activity given that customer inventories are at levels not seen since the Great Financial Crisis, and new orders continue to trend higher. This is a positive indicator that manufacturing activity is likely to be sustained for the foreseeable future.

Activity levels for services grew at the fastest pace on record during March. Service businesses have lagged manufacturing activity in the recovery, but a lifting of restrictions related to COVID-19 helped spur consumption as there had been pent up demand for services.

MANUFACTURING PMI



SERVICES PMI

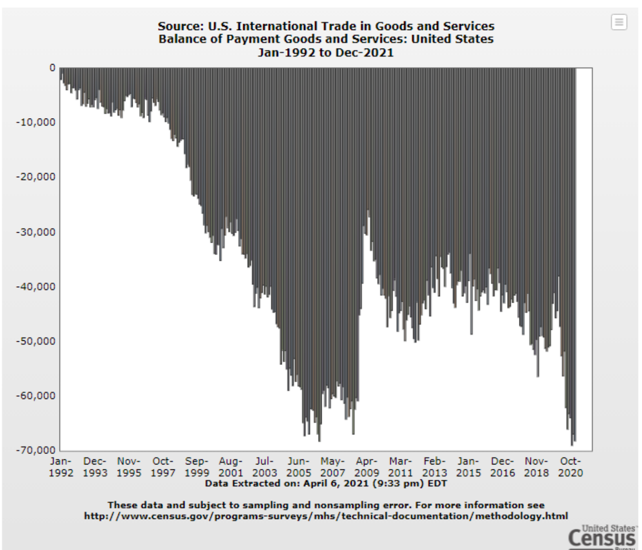


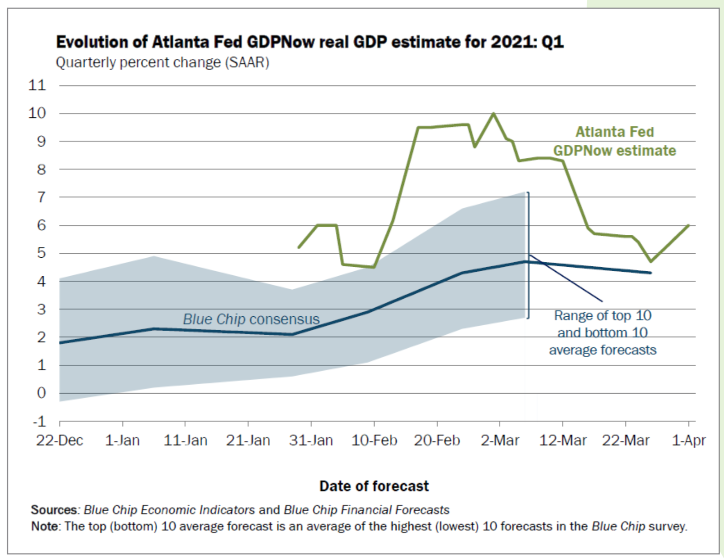
Source: Institute of Supply Management, March 2021 reportonbusiness

ECONOMY

A negative for the U.S. economy has been trade. Trade activity during the quarter neared the record trade deficit hit late last year. Strong demand for goods, coupled with supply chain shortages, have led to a high level of imports. While the dollar appreciated during the quarter, a weaker dollar earlier in the quarter did not seem to impact the demand for U.S. goods and spur higher exports. The chart to the right from the US Census Bureau depicts the U.S. trade deficit.

As we amass this information, it appears the U.S. economy will grow at a solid pace in the first quarter, with expectations for a stimulus-infused economy to grow even faster in the second quarter. The Atlanta Federal Reserve has begun publishing a real-time GDP forecast, the Atlanta Fed GDPNow estimate. This estimate, shown in the green line in the chart below, seeks to use data as it's released to estimate economic growth. Based on this forecast, first quarter GDP is trending near 6%.





Source: Atlanta Federal Reserve

ECONOMY

We expect a hot economy for much of 2021. Growing off this strong base could be a challenge in 2022, with the wildcard being how quickly consumers return to prior spending habits and how quickly savings and stimulus payments are put back into the economy. If consumers were to choose to slowly allocate their savings, this could help to stretch economic growth well beyond 2021. Given that we have not experienced this level of fiscal stimulus before, this is unchartered territory and what transpires will be a learning experience for all economists.

A measure we will be keeping our eye on is inflation. Through the first quarter, inflation readings remain subdued. As we begin to lapse the challenging economic conditions that occurred during the spring of 2020, year-over-year inflation calculations will likely see a jump higher. The Federal Reserve has openly referred to these as base effects. Therefore, higher inflation readings are expected in the coming months and will not be indicative of the economy hitting a high inflation regime. These base effects are likely to wear out by the third quarter.

What is becoming more widely debated is what may transpire out of inflation readings in the back half of 2021. Supply chain disruptions and low inventories are leading to higher prices in some goods, such as appliances and semiconductors. Commodity prices have also soared, leading to higher production costs. Moreover, there have recently been signs of increasing pressure to increase wages. All of these factors could lead to higher inflation, an outcome we are closely monitoring.

ECONOMY

PERSPECTIVE

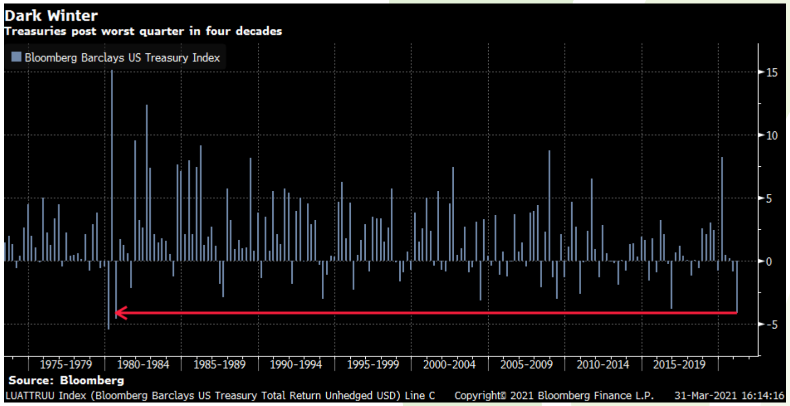
The economy is in strong shape and is setting up to be one of the strongest economies we have experienced in some time. The fact that the economy has been stoked by fiscal and monetary stimulus leaves questions on the ability for the fire to sustain itself, or whether it will fizzle. It seems unlikely that pent up demand will be consumed all at once. For example, we all may want to return to traveling, but for most there is not unlimited time to travel. In addition, unemployment levels are likely to gradually decline, as employers will look for signs of stability before they hire in earnest. Business investment will be another key to sustaining economic momentum. We are seeing some indications of an increased appetite for greater capital expenditures, although higher spend may be more gradual in nature. All of these factors would indicate to us that there will be legs to the current economic expansion, although mathematically it will be hard to sustain the level of growth we are likely to see in 2021.

FIXED INCOME

Rising long-term interest rates were the storyline for the bond market in the first quarter. The yield on the 10-year Treasury advanced 80 basis points, or 0.8%, during the first three months of the year. Given that prices move opposite interest rates, this proved challenging for returns. Shorter maturities, which did not experience much movement in rates, along with high yield bonds, whose higher coupons helped to offset the impact of rising rates, were the best performers.

The Bloomberg Barclays U.S. Aggregate index lost -3.4% during the first quarter. There were few places to hide from price declines, with Treasury returns negative across maturities. In fact, as the chart below highlights, it was the worst quarterly return for Treasury bonds since the early 1980's. The impact was most prevalent among long dated maturities, which not only experienced the brunt of rate increases but whose prices are also the most sensitive to a shift in rates.

INDEX	Q1 2021
Bloomberg Barclays U.S. Aggregate	-3.4%
Bloomberg Barclays Intermediate Corporate	-2.2%
Bloomberg Barclays High Yield	0.9%
Bloomberg Barclays US Mortgage Backed Securities	-1.1%
FTSE World Government Bond	-5.7%
Bloomberg Barclays Municipal Bond Index	-0.4%



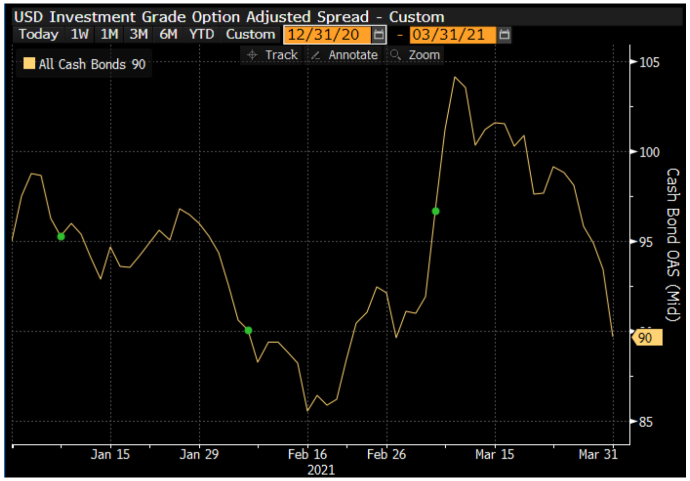
FIXED INCOME

Interest rates are often quoted as nominal yields, or yields that combine inflation expectations with the real yield (yield net of inflation). During the quarter, the increase in nominal yields was nearly a 50/50 split between higher inflation expectations and higher real yields. As of March 31st, the nominal 10-year Treasury yield of 1.74% incorporated a 2.37% expected inflation rate and a -0.63% real yield.

Investment grade corporate bonds had comparable returns to Treasuries, as long rates proved to be a headwind, while the spread, or difference in yield between corporate bonds and Treasuries, contracted slightly (highlighted below). Mortgage-backed securities experienced modest price compression, declining -1.1%, outpacing the broader bond market.

High yield bonds benefited from continued tightening of spreads (highlighted below). Going into the quarter, the yield advantage of high yield bonds over Treasuries was nearly four percentage points. By quarter's end, that had fallen to 3.4 percentage points.

INVESTMENT GRADE BOND SPREADS

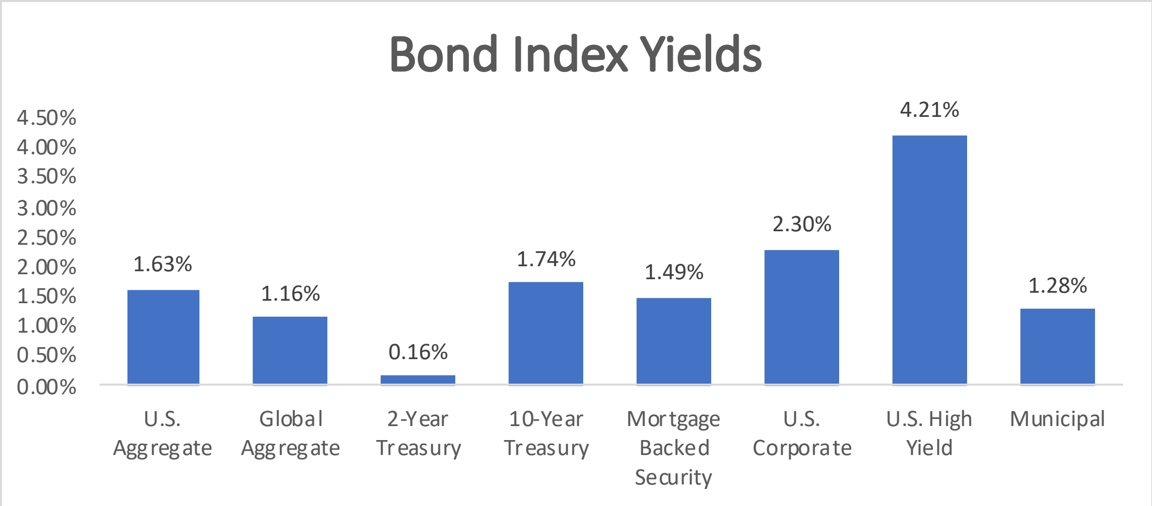


HIGH YIELD BOND SPREADS

Source: Bloomberg

FIXED INCOME

The absolute level of yields has become a challenge for fixed income investors. In fact, the yield (measured as Yield to Worst) on the Bloomberg Barclays U.S. Aggregate Index finished the quarter at 1.6%. This compares to a dividend yield of 1.4% on the S&P 500. In aggregate, investors are not being compensated with a great deal more income in the bond market, with the attraction for bonds increasingly becoming the less volatile nature of the asset class. Some bond investors are also having to accept greater risk as they clamor for yield. Strong returns for high yield, despite challenges elsewhere in the bond market, is evidence of strong demand for lower quality credits. The chart below plots yields (as measured by yield to worst) across key segments of the bond market.



Source: Bloomberg. Yield to Worst, as of 3/31/21, calculated for the Bloomberg Barclays U.S. Aggregate, Bloomberg Barclays Global Aggregate, active 2-year Treasury and 10-year Treasury, Bloomberg Barclays U.S. Mortgage Backed Security, Bloomberg Barclays U.S. Corporate, Bloomberg Barclays High Yield, and Bloomberg Barclays Municipal Index.

FIXED INCOME

Within the municipal bond market, the theme of rising rates also resonated, but not to the same degree. Rate changes among municipals tend to lag those of their taxable peers. In addition, long-dated muni yields increased at roughly half the level they did among Treasury bonds. As a result, the broader municipal market finished the quarter down marginally. What is noteworthy is that municipal bonds are now trading at yields that are at historic lows relative to Treasuries. As of quarter end, AAA rated municipal bonds traded at 62% of Treasuries. Levels this low make the tax-free yield of muni's nearly equivalent to the after-tax yield of taxable bonds; hence at the moment taxable investors see less attraction for muni bonds over taxable bonds. Within the municipal bond market, however, there are variations in pricing and opportunities to add yield outside of those depicted by these broad market averages.

As we look ahead, movements in interest rates are likely to remain a headline throughout 2021. The Federal Reserve maintains a dovish posture, with its rhetoric stating that rates will remain low for some time as they await data confirming inflation is trending above its 2% target and unemployment rates are much lower. Given the strength of the economy and expectations for an acceleration in the second quarter, Fed Fund futures are now pricing in an interest rate increase by the end of 2022, despite Fed projections indicating rates will not rise through at least 2023. Long dated maturities have not historically been in the purview of the Fed. However, central bank asset purchases are now a tool the Fed can use to target specific maturities and attempt to manage yields if necessary. With the 10-year Treasury yielding 1.74% at quarter's end, the Fed does not appear interested in influencing rates at this level. However, should rates continue to spike higher, many market participants would expect the Fed to become more active in managing its balance sheet to target lower yields on longer maturities.

EQUITIES

The first quarter of 2021 was anything but a normal market environment. However, in the end, conditions tended to normalize out and stocks continued their march higher. The big difference was a shift in preferences with some of 2020's worst performers leading the way in the quarter, while some of last year's better performers were lagging.

Early on in the quarter there were a number of growth stocks that shot higher. In late January the prices of select stocks that were heavily shorted, such as GameStop and Blackberry, went up 10-20 fold as social media posts on the companies drew insatiable investor interest. So much so that on some days the trading volume on these stocks was over 100% of their shares outstanding. SPACs, or Specialty Acquisition Corporations, garnered significant investor interest in the quarter as well. These unique structures are blank check companies looking to acquire a company and take it public. Trading activity in SPACs skyrocketed during parts of January and February while at the same time the number of new SPACs going public increased at an exponential rate. Based on our analysis, there were 593 listed SPACs as of mid-March. This compared with 161 a year ago. At one point during the quarter, many of these stocks traded well in advance of their trust, or book value, as some investors chose to speculate on which companies will soon be announcing value additive deals.

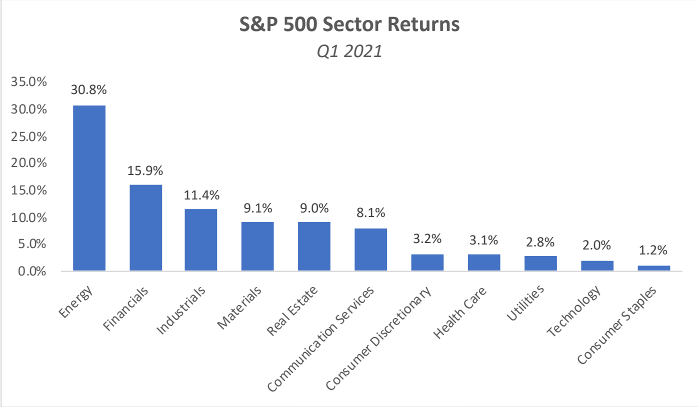
When we look at broader market trends, the quarter had very distinct months. During January, riskier segments of the market, such as small caps and emerging markets, were favored. There was a notable shift in mid-February, where returns to small caps started to revert and value stocks handily outpaced their growth counterparts. As we moved into March there was a rotation into more stable quality businesses such as utilities and consumer staples. As this transition occurred, small cap and emerging markets sold off.

	Q1 2021
S&P 500	6.2%
NASDAQ	3.0%
Dow Jones Industrial Average	8.3%
Russell 2000	12.7%
Russell 1000 Growth	0.9%
Russell 1000 Value	11.3%
MSCI EAFE	3.5%
MSCI Emerging Markets	2.3%

EQUITIES

Collectively, this led to a market that favored small cap and value stocks over growth and emerging markets. Rising interest rates and strong economic data served as fuel for this transition.

From a sector standpoint, economic cyclicals stood out. Energy, which was 2020's worst performing sector, was far and away the best performer, up nearly 31%. Financials, industrials and materials also experienced strong returns. Consumer staples lagged the most, while technology, 2020's best performer, lagged behind the S&P by over 4 percentage points.



An interesting segment of the market was emerging markets. Emerging markets were up nearly 12% by mid-February, but sold off by 10% in the back half of the quarter to finish up 2.3%. Returns were varied across emerging counties. China, which represents approximately 40% of the MSCI Emerging Market index, was down -0.4%, having declined -6.3% in March alone. Brazil's negative returns of -9.9% were a function of accelerating inflation in the country along with a spike in COVID-19 cases. Alternatively, Taiwan, India, Russia and Mexico all outpaced the broader EM index. The table to the right highlights the wide dispersion in returns across EM countries.

	MARCH	Q1 2020	TRAILING 1-YEAR
Brazil	4.3%	-9.9%	46.7%
China	-6.3%	-0.4%	43.8%
MSCI Emerging Market	-1.5%	2.3%	58.9%
Mexico	8.4%	4.2%	58.8%
Russia	5.2%	5.0%	45.7%
India	2.3%	5.2%	77.0%
Taiwan	-0.4%	11.0%	94.6%

As we look forward, the market is battling dueling forces of strong earnings results and improving expectations, while at the same time digesting above-average valuations. Earnings results for the fourth quarter of 2020 resulted in 79% of companies beating expectations, as earnings grew a healthy 3.8% over prior year levels. Forecasts for 2021 earnings expectations have also been trending higher. We expect the added backdrop of the $1.9 trillion stimulus package to drive earnings expectations even higher as the year progresses.

REAL ASSETS

Real assets generally produced positive returns. Pipelines and commodities stood out as positive performers, while the price of gold fell.

	Q1 2021
Bloomberg Commodity	6.9%
ICE U.S. Dollar Spot Index	3.7%
Alerian MLP	22.0%
Philadelphia Stock Exchange Gold/Silver	-6.8%
MSCI World Real Estate	6.0%

COMMODITIES

Improving economic sentiment, low inventory levels and supply chain challenges have all contributed to strong gains for commodities. The Bloomberg Commodity index rose 6.9%. There was strength across agriculture and industrial metals. Softness in the price of gold, which is the largest component of the index, kept the return in check. The standout was the price of lumber, which was up 57.1%; this on top of lumber prices doubling during 2020.

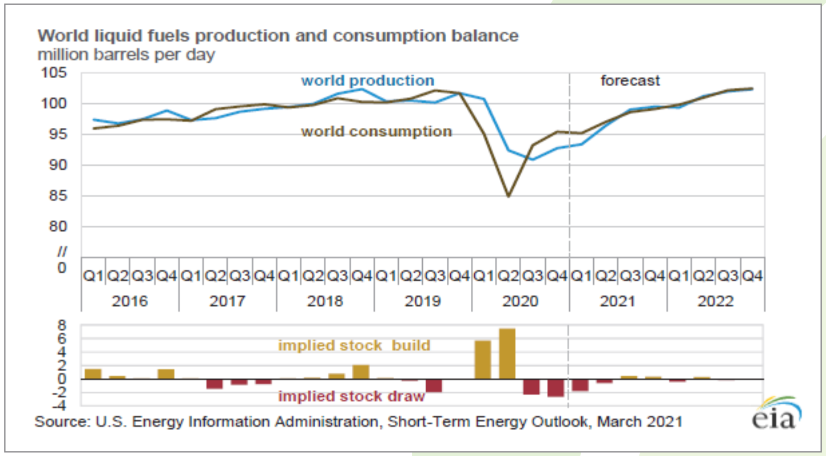
The chart below depicts returns of key commodities during the quarter.

	Q1 2021
Corn	16.8%
Soybeans	10.0%
Lumber	57.1%
Copper	13.4%
Iron Ore	10.2%

REAL ASSETS

OIL

Oil prices rose 22.5% during the quarter, closing the quarter just below $60 a barrel. The price of oil has now returned to early 2020 levels. Prices had retreated last year as there was an oversupply of crude. As production levels have slowed, and demand has continued to gradually improve, supply and demand are beginning to balance. Forecasts from the U.S. Energy Information Administration project supply and demand coming into equilibrium during the second quarter of 2021. However, the level of oil demand, at under 100 million barrels a day, is expected to remain below the pre-pandemic level until 2022.



GOLD

After surging during the middle of 2020, the price of gold has started to stall and sold off -9.8% in the first quarter. Gold prices touched a technical support level twice during the quarter, before bouncing off to finish near $1,7000/oz. The Philadelphia Gold/Silver index finished down -6.8% thanks to slightly better performance out of silver.

CURRENCY

Having depreciated throughout the second half of 2020, the dollar returned to favor. During the quarter it appreciated against a wide array of currencies globally, both developed and emerging. Strong economic readings helped to provide support for the currency. Interest gained as long-term rates moved higher. With the U.S. yield curve looking more attractive, on a relative basis, versus other government bonds, demand for U.S. dollars has been spurred by foreign investors seeking to buy Treasuries for the added yield.

LOOKING AHEAD

We are poised for an exceptionally strong economy as we look toward exiting the COVID-19 pandemic. There will be an element of a K-shaped recovery where some consumers and businesses will not be able to return to pre-pandemic financial conditions, while others will. The averages, however, point to many coming out of the pandemic in better financial shape. The combination of lower discretionary spending during the pandemic, higher savings rates and additional income from stimulus payments are all helping to drive consumer balance sheets that are in the best shape in decades, if not ever.

Strong financial conditions will fuel a strong recovery in 2021, with varying expectations on the longevity of that. We are in the camp that we will see the economic expansion extend beyond 2021, albeit at a slower rate of growth since the economy cannot keep up a sprinters pace in perpetuity.

Strong economic fundamentals provide a solid backdrop for stocks. In addition, significant liquidity and personal savings should provide a floor as investors seem willing to 'buy the dip' on recent pullbacks. These favorable conditions are balanced by what will be a gradual shift in focus on the economy's ability to sustain momentum in 2022 and beyond. Moreover, the rising interest rate trend and potential for higher corporate tax rates are likely to keep multiples in check.

There remains an insatiable search for yield within the bond market. While fundamentals for sectors such as high yield are generally positive, ignoring risk and chasing yield has generally not been a good long-term investment strategy. Therefore, we continue to see a need for balance in bond portfolios and having a prudent understanding of the inherent interest rate risk in portfolios.

In general, we view the market environment shifting in its preferences as the end of the pandemic appears to be insight. At the same, the ramifications of the unprecedented level of stimulus continue to be digested. We expect the fallout from this once in a lifetime occurrence to create distortions in markets, along with opportunities. This should mean that 2021 will be anything but ordinary, and it sure wasn't in the first quarter. Staying disciplined and remaining focused on the long-term remain key tenants, but, at the margin, being willing to be contrarian may be prudent as well.

On behalf of the entire team at Telemus, we want to express our gratitude to our clients. To those of you who might not yet be clients of Telemus, please feel free to contact us.

Telemus Investment Committee

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