JULY 2021

Investment Review and Outlook

KEY TAKEAWAYS

- The US is steadily emerging from the worst of the pandemic, and the economic recovery resulting from the reopening has been robust with the equity market surging to new heights.
- Inflationary expectations still rattle the markets, although the Federal Reserve continues to view inflation as a transitory issue.
- Changes in tax policy may be on the horizon with the potential to impact charitable giving and multi-generational estate planning.

Total Returns & Values As Of 6/30/21

	QTD Return	YTD Return	Price/ Value
Dow Jones Industrial Average	5.1%	13.8%	34,503
S&P 500 Index	8.5	15.3	4,298
Russell 2000 Index	4.3	17.5	2,311
MSCI EAFE Index	5.4	9.2	2,305
MSCI EM (Emerging Markets)	5.1	7.6	1,375
Bloomberg Barclays US Aggregate	1.8	-1.6	106
Bloomberg Barclays Municipal Bond	1.4	1.1	115
Gold (NYM $/ozt) Continuous	3.3	-6.5	$1,771.60
Crude Oil WTI (NYM $/bbl) Continuous	24.2	51.4	$73.47

Source: FactSet

THE ECONOMY

The US Emerges From The Pandemic

The progress of the vaccine rollout in the US is encouraging, and our hope is that vaccine efficacy continues to hold, despite emerging variants. Globally, the pandemic is far from over. However, the US is steadily emerging from the worst of the pandemic from both a health and an economic perspective. The announcement of a new vaccine from Novavax adds to the ample supply available domestically from Moderna, Pfizer-BioNTech, and Johnson & Johnson. The US has more than enough doses of vaccines to finish vaccinating the entire American population, and currently, 54% of the US population has had at least one dose, according to the Centers for Disease Control and Prevention. The fact that the US has made such significant progress has enabled the reopening of the economy and businesses, although the impact of the pandemic will be felt for some time to come and new virus variants may cause pockets of disruption as the year progresses.

Quelling the pandemic globally is extremely important for a sustainable recovery around the world. Notably, the Novavax vaccine does not require special handling and may be part of a supply the US contributes to COVAX, the World Health Organization-backed immunization program. This will help in places such as India, where the virus is rapidly circulating, and potent variants are emerging. The development and rollout of vaccines in such record-breaking time make a strong statement about the US healthcare system's research and development capabilities, which are paramount to our economy.

The Implications Of Tax Hikes On The Horizon

The potential for changes in tax policy is on our radar. The Biden Administration's recently released *General Explanations of the Administration's Fiscal Year 2022 Revenue Proposals*, also known as the "Green Book," provides more details on the proposals, including potential tax increases and changes to the treatment of capital gains.

These proposals include:

- Increasing the top tax rate on ordinary income to 39.6% for individual income above $452,700.
- Increasing tax rates on capital gains and qualified dividends for individuals with adjusted gross incomes above $1 million (but with a lower income threshold for trusts and estates).
- Eliminating the tax-free step-up in the cost basis of assets by taxing capital gains at death.

There is a deep dive into the details of these tax proposals in our latest whitepaper: *Planning Strategies, Update on Possible Tax Changes in 2021*. *Click here to view.*

The Constrained Labor Landscape

As we emerge from the pandemic, unemployment levels and labor shortages in the US are key considerations. Many American workers, particularly women, juggled the demands of childcare, online schooling, eldercare, and employment during the pandemic. More than three million women dropped out of the workforce. For many American workers, layoffs, both temporary and permanent, presented significant challenges. Early retirements during the pandemic further reduced the labor supply.

However, as the economic recovery proceeds, vaccinated workers should feel more comfortable returning to the workforce, schools will reopen in the fall, and unemployment benefits will revert to pre-pandemic levels, resulting in greater labor force participation. For now, however, many service-based businesses in the hospitality, retail, and restaurant industries are desperate for workers and are offering higher wages and sign-on bonuses in order to attract talent.

Stimulus & Spending

Unprecedented stimulus, including enhanced unemployment benefits during the worst of the pandemic, helped many Americans meet their basic needs. Those individuals who did not necessarily need such aid directed the excess dollars to their savings. As the reopening continues, the question remains as to how much of that pent-up savings will be spent.

For now, a robust level of consumer spending is underway, as measured by the average of Visa's and Mastercard's March 2021 quarterly results showing US dollar spending volume up 19% from the June 2020 quarter pandemic lows. Perhaps even more impressive is that US dollar spending volumes also are up from pre-pandemic levels by an average of 18% from the March 2019 quarter. With the consumer in good shape, the biggest impediment to growth seems to stem from supply bottlenecks, which we view as temporary for the most part. States and schools, also beneficiaries of fiscal stimulus, have significant funds available to spend, which we hope they will allocate in a productive manner.

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Inflation & The Fed

Inflation expectations have made headlines, periodically sparking market volatility due to concerns about the potential for the Fed to have to raise rates if expectations become reality. During the Fed's June 16th meeting, it increased its 2021 expectations for inflation to 3.4% from 2.4% while still describing inflationary pressures as "transitory," forecasting a tame 2.1% pace for inflation in 2022.

The Fed did bring forward the time frame for when it will next raise interest rates, likely in 2023. It did not indicate when it will begin cutting back on its aggressive bond-buying program but stated it will continue to monitor economic progress and provide ample notice of any tapering. As expected, the Federal Open Market Committee left its benchmark short-term borrowing rate near zero. The Committee sees inflation subsiding, reverting to its 2% goal over the long run, and raised GDP expectations for 2021 to 7% from 6.5%, maintaining its 3.3% projection for 2022. Its unemployment estimate remained unchanged at 4.5% for 2021 and was reduced to 3.8% from 3.9% for 2022.

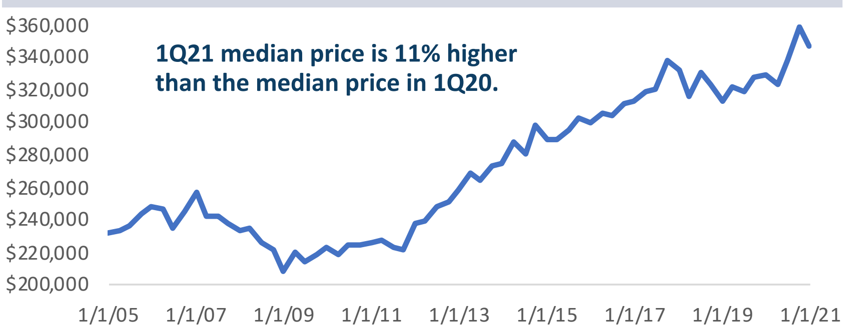
According to the Fed, "Indicators of economic activity and employment have strengthened. The sectors most adversely affected by the pandemic remain weak but have shown improvement." In the Fed's post-meeting conference call, Chairman Powell reiterated the Fed's commitment to providing "powerful support to the economy until the recovery is complete."

We also believe inflationary pressures currently at play will remain transitory, despite being compounded by supply shortages and wage-price spikes as businesses seek to replenish their labor pools. Multiple demands on consumers' finances, from student loan payment resumption to the end of rent or mortgage payment forbearance, also should serve to dampen consumer demand, further reducing inflationary pressures.

You Paid How Much For That House?

The housing market continues to be extremely supply-constrained. It is an environment wherein home builders and sellers are receiving bids well above asking prices. The 1Q21 median price is 11% higher than the median price in 1Q20. However, buyer's regret may be setting in for some as they realize they not only overpaid for homes but also now have ongoing maintenance costs they had not anticipated.

Median Sales Price Of US Houses Climbs Rapidly



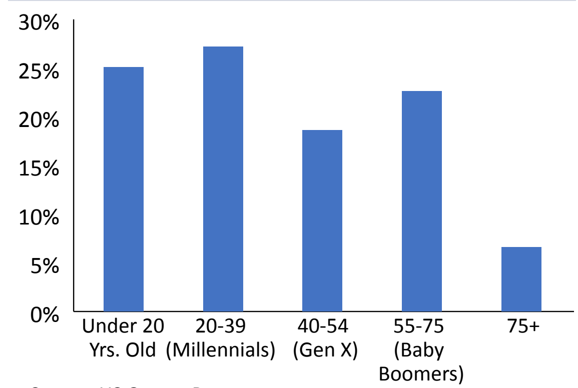
Source: Federal Reserve Bank of St. Louis

As some companies require workers to return to offices, we may see a change in the areas where housing demand has been most robust. Workers in companies that encourage ongoing remote work versus those required to be on-site may alter the relocation trends of Americans who were able to work from any location during the pandemic. In addition, given the high level of housing prices, if interest rates start to rise, the housing market naturally should cool, which may negatively impact home builders and other housing-related companies.

The Increasing Impact Of Millennials

Millennials (recognized as individuals born primarily between 1981-1996) are now the largest generation in the American population and workforce, comprising one-third of US workers, according to the US Census Bureau. How they choose to spend their money appears to be more tightly aligned with their values than in past generations. Often millennials let their wallets do the talking, supporting companies that align with their values and ending relationships when they disagree with a company's business practices. This values-based approach has sparked a growing interest in socially responsible investing and consumption of sustainable products.

Millennials - The Largest Generation



Source: US Census Bureau

Millennials may increasingly drive economic trends, as baby boomers, previously the largest demographic cohort, have done over the past several decades. During the pandemic, we have seen millennials adopt the typical American playbook of moving out of urban areas for a house with a yard and more space. However, if the cost of owning a home makes up a larger part of their household budget, it will significantly impact their consumption of other items, similar to the burden of student loan debt, which plagues many in this cohort.

The Transition To A Lower Carbon Economy

The transition to a less carbon-centric US economy clearly is underway. Globally, there is a movement towards lower fossil fuel usage and a recognition of the importance of renewable energy as a long-term solution. Nonetheless, we still live in a world that increasingly consumes fossil fuels, particularly in developing economies. It is estimated that the global demand for fossil fuels will not peak until 2030.

At the same time, there has been a significant pullback in capital expenditures related to fossil fuel exploration, which has led to higher prices for oil and gas. This scenario makes renewable energy even more attractive from a cost perspective. We discussed many of these dynamics at our 2021 Intellectual Capital Conference, including the shift from a linear carbon economy, focused on the extraction and burning of fossil fuels/carbon, to a circular carbon economy that can reduce, reuse, recycle, and remove greenhouse gases associated with fossil fuels. We encourage you to read the insights from our expert speakers *here*.

THE EQUITY MARKET

Cyclical Leadership As The Economy Reopened

Cyclical stocks led the equity market in the early stage of the recovery. A cyclical company's stock price typically is affected by macroeconomic changes in the overall economy. Most cyclical companies sell products or provide services that consumers and businesses buy more of during a booming economy but pullback on as economic growth declines.

Financial Services is a cyclical sector that has seen significant traction year-to-date and has benefited from being attractively valued in a rapidly-recovering American economy. Banks are poised to benefit from net interest margin expansion should interest rates rise, while release of loan loss reserve should boost profits.

During the peak of the pandemic, we estimate 10% to 12% of commercial and consumer loans were in forbearance or deferral. This has since dropped to an average of 1%, which speaks to the support provided by fiscal stimulus, including the government's Paycheck Protection Program. Currently, ample liquidity is negatively affecting loan growth, but this should change as businesses reopen and stimulus funds are depleted.

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Trading exchanges, a financial subsector, benefit from the growth of fee income when periodic market volatility drives heightened trading volumes. The property and casualty insurance market also should benefit from strong demand and has experienced the highest level of price increases since 2003.

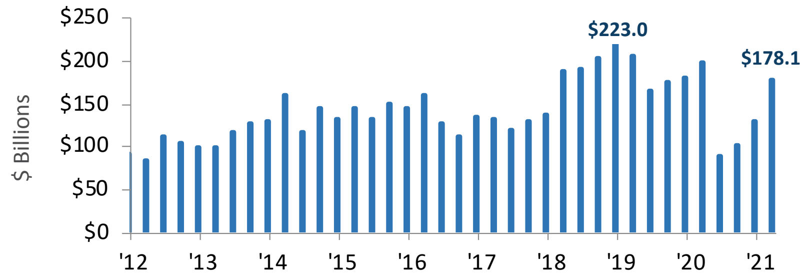
Spooked By The Fed

Recently, after Fed officials signaled that they plan to gradually pull back the monetary policies that have helped propel markets to record highs, enthusiasm for cyclical stocks has dampened, sparking renewed interest in less-cyclical sectors such as technology. While these shifts between cyclical and more-secular growth stocks may continue, we remain focused on investing in high-quality businesses with strong underlying fundamentals with the potential for attractive long-term growth.

Valuation Driven By Household & Corporate Demand

Low interest rates and high cash balances have driven individuals to allocate more of their savings to equity investments. Recent data indicate that households currently allocate 44% of their financial assets to equities which is slightly below the all-time high of 46% reached in 2000. At the same time that households are adding to equity holdings, companies are increasing share buybacks again, supported by a sharp recovery in revenues and earnings.

S&P 500: Quarterly Share Buybacks



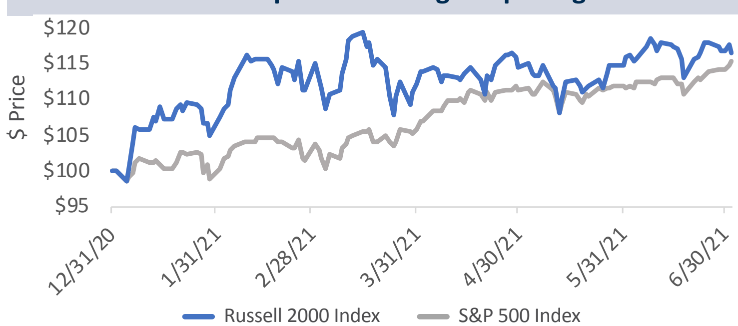
Source: Strategas

Stocks in the S&P 500 currently trade at 22x expected earnings for this year and 20x the forecast for 2022. It is helpful to convert these valuations into an equivalent yield, given the low interest rate environment. The S&P 500 earnings yield (earnings per share/stock price) for 2021 and 2022 stands at 4.6% and 5%, respectively, compared to a 10-year US Treasury yielding 1.44%. As investors face the ongoing problem of little yield from bonds, stocks with growing earnings and dividends remain compelling, even at elevated valuations.

Small-Cap Stocks Also Outperform

Small-cap stocks, typically tied to the domestic economy, have outperformed large-cap stocks as investors focused on companies poised to benefit from the rapid economic recovery.

Small-Caps Soar During Reopening



Source: FactSet. The Russell 2000 and S&P 500 indices shown represent small-cap and large-cap stocks, respectively.

The question remains whether this robust economic expansion persists or if we quickly revert to pre-pandemic growth levels. Regardless, in a yield-starved environment, investors likely will return to the stocks of companies positioned to deliver growth in all economic cycles, such as those in the Technology sector.

Household Wealth Grows For Equity Investors & Homeowners

Driven by the robust stock and housing markets, US household net worth reached new highs this year, ending the first quarter of 2021 at $136.9 trillion, an increase of 23.6% year-over-year. At the same time, the economic downturn during the pandemic has severely impacted lower-income workers who are not homeowners or investors, further widening the already significant wealth gap.

Our Expectations For Market Volatility

Market volatility may intensify in the latter half of 2021 as more extensive economic reopening data regarding the pace of normalization, wage pressures, employment, and consumer spending become available. By the fourth quarter, we will know the impact of reduced unemployment benefits and reopened workplaces and schools. The disparity between expectations and actual results may lead to economic surprises resulting in increased market volatility, which may be further exacerbated by any upward movement in interest rates.

The gamification trend of short-term trading of stocks also continues to bedevil the equity markets. Disconnections between the fundamental value of certain companies and their elevated stock prices have been driven by eager social media-led crowds. This trend is disruptive, and we believe eventually may result in losses for a group of speculative investors.

Equity investors often chase what has been working rather than what will work. We believe it is important to maintain a disciplined and consistent approach that looks beyond the next quarter or two and considers sustainable growth of earnings and cash flow, as a path to long-term growth of capital.

THE FIXED INCOME MARKET

Higher Rates On The Horizon

We may yet see slightly higher rates as a result of rising inflation expectations. As usual, the path of inflation, both actual and expected, is the biggest determinate of the course of bond yields. The Fed's flexible inflation-targeting approach, using actual data over a period of time, versus a preemptive approach relying on forecasts, is a game-changer. As a reminder, the Fed has “dual mandate” goals of maximum employment and stable prices. Following the high inflation rates of the 1970s, the Fed traditionally would tighten policy preemptively in order to prevent an inflation overshoot, since policy changes impact the economy with a lag of about 18 months. This new approach entails a tolerance by the Fed of above-target inflation (defined as a 2% annual rate) in order to focus on the employment side of the dual mandate.

The Committee is willing to let the actual inflation rate run above 2% for a period of time in order to make up for persistent shortfalls below that level since the credit crisis a decade ago. Should actual readings on inflationary pressures prove sustained and non-transitory, we expect the Fed will have to change course, reducing its bond purchases and eventually raising short-term interest rates. The recent Fed meeting indicates it is beginning to map out the timing of reduced policy accommodation, as both growth and inflation are exceeding previous expectations. As a result, we expect yields will move modestly higher in the coming quarters.

Still Overweight Corporate Bonds

Although spreads of corporate bond yields to US Treasury yields remain tighter than historical averages, we still favor corporate bonds for the additional yield and because of our outlook for a limited widening of spreads. If the stock market moves higher and valuations become more extended, some institutional investors may continue to lock in profits and redirect cash proceeds into corporate bonds, which would further tighten spreads. Lower new issuance for the year also is supportive of limiting the amount of spread widening that could occur should the Fed move rates sooner than expected.

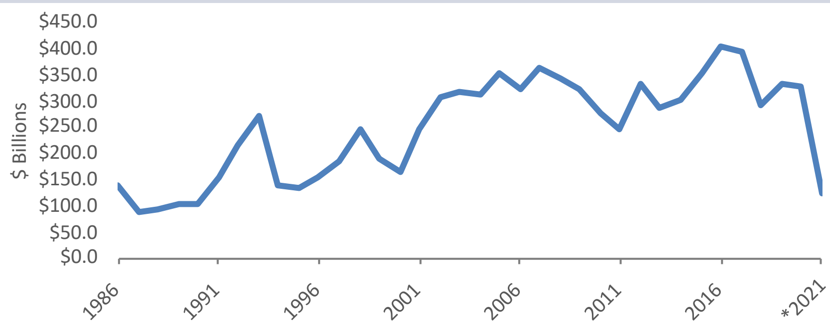
Opportunities for yield in the mortgage market are few and far between. This area is heavily distorted by the Fed's monetary policy and monthly purchases of $40 billion in mortgage securities and $80 billion in Treasuries. The Fed’s Treasury purchases are keeping those yields low, despite heavy issuance post-pandemic with potentially more to come, depending on the shape and size of the infrastructure package.

Healthy Appetite For Municipal Bonds

Although yields remain low, the municipal bond market has attracted historically-high inflows in 2021. Concerns about rising taxes, a search for relative yield, and the idea that states and municipalities will benefit from the Biden administration's infrastructure bill have fueled investor interest in municipal obligations.

Many states have benefited from fiscal stimulus, reopenings are underway, and with President Biden's proposal, local and state government bonds are expected to help fund the revitalization of the country's infrastructure. From old-economy roads and bridges to new initiatives bolstering internet access and renewable energy sources, the bill's objectives should be a catalyst for new municipal bond issuance in what has been a supply-constrained environment.

Recent Years Have Seen Lackluster Municipal Bond Issuance



Source: The Bond Buyer. 2021 data is through 5/31/2021.

The volume of bond sales suffered following the 2017 Tax Cuts and Jobs Act, which eliminated the popular practice of issuing new bonds to refund higher-yielding debt. The pandemic response further aggravated the situation, as few municipalities were eager to borrow in the middle of a deep recession with federal support that was uncertain for much of the election cycle. More recently, the ongoing debate about the form, size, and timing of the infrastructure bill is keeping projects on the shelf, since federal funds may diminish the borrowing needs for coming capital projects. With greater clarity on the last two obstacles, we expect volume to increase accordingly.

LOOKING FORWARD

Inflation uncertainty, a highly-valued equity market, yield-starved investors, and emerging COVID-19 variants are giving investors plenty to consider for the remainder of the year.

The impact of these 18 months of the pandemic on how we live, work, educate, spend, and travel is still unfolding. Surely, some of the digital transformations and healthcare innovations accelerated during the pandemic will transform the ways we live for some time to come.

The equity market, although highly valued, will continue to be supported by massive liquidity and low rates, although periods of volatility should be expected as the recovery progresses in fits and starts. As we have recently written, the above-average valuation for equities likely will lead to a period of below-average returns, which is consistent with previous periods of elevated valuations. Additionally, bond prices which have benefited from exceptionally low interest rates for quite some time, will experience weakness as the economy and Fed policy returns to pre-pandemic conditions.

The views expressed are subject to change. Any data cited herein have been obtained from sources believed to be reliable. The accuracy and completeness of data cannot be guaranteed.