COOK STREET CONSULTING

2021 | Q1 Market Brief

DISCLOSURE

I – DOMESTIC MARKETS OVERVIEW

U.S. Investors Maintain Risk-On Sentiment

Equity Market Recovery Continues Unabated

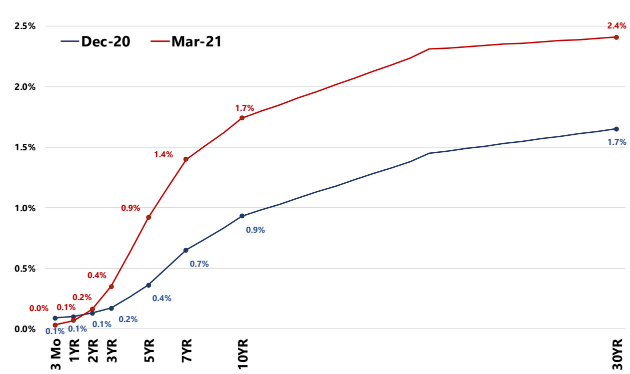
U.S. equity markets powered ahead over the first quarter of 2021, capping a remarkable 12-month recovery following the depths of a COVID-driven market panic over the first quarter of 2020 (Exhibit A). Stocks advanced as investors were buoyed by the mass rollout of vaccines across the country, a continued re-opening of the U.S. economy, and significant fiscal and monetary policy coordination and support from the U.S. government. The broad equity advance occurred somewhat under the radar, with the Presidential transition and otherwise unusual market developments (i.e. GameStop, SPACs, etc.) garnering many of the headlines over the quarter. U.S. large cap stocks (S&P 500 Q1 **+6.2%**; 1-Year **+56.4%**) posted another solid quarter, following a strong ending to 2020. All S&P 500 sectors experienced positive returns, with more economically sensitive sectors outpacing the broader market (S&P 500 Energy **+30.9%**; Financials **+16.0%**; Industrials **+11.4%**) in a continuation of what the market experienced over the back half of 2020. Similarly, small cap stocks strongly outpaced large cap stocks (Russell 2000 Q1 **+12.7%**; 1-Year **+94.8%**). The trailing one-year return for small cap stocks is the highest since 1983, highlighting the extent of the financial market recovery over the past twelve months and bringing into focus forward-looking valuations across sectors.

Exhibit A: **Trailing Asset Class Returns** *Source: Morningstar*
(Select Indices; through 3/31/2021)

Index	3-Month	YTD	12-Month	3-Year	5-Year
Capital Preservation (US 3-Month T-Bill Index)	0.01	0.01	0.10	1.38	1.16
U.S. Fixed Income (Barclays US Agg Bond Index)	(3.37)	(3.37)	0.71	4.65	3.10
U.S. Large Cap Equity (S&P 500 Index)	6.17	6.17	56.35	16.78	16.29
U.S. Small Cap Equity (Russell 2000 Index)	12.70	12.70	94.85	14.76	16.35
International Equity (MSCI ACWI Ex USA Index)	3.49	3.49	49.41	6.51	9.76
Global Real Estate (FTSE EPRA/NAREIT Developed Index)	5.80	5.80	34.65	5.06	3.86

Rising Treasury Yields Lead to Bond Selloff

Exhibit B: **Treasury Yield Curve** *Source: St. Louis Fed*
(Quarterly Change in Yield Curve)



Over the first three months of the year, domestic fixed income markets (Bloomberg Barclays U.S. Aggregate Bond Index Q1 **-3.4%**) were hurt by rising Treasury yields and a steepening yield curve (Exhibit B). The Index's quarterly decline was the worst since 1994, as yields on 10- and 30-Year Treasuries rose by 81 bps and 76 bps, respectively. Investors' risk-on sentiment, coupled with longer-term debt and inflationary concerns, precipitated the market selloff. While yields on government bonds rose, spreads on investment-grade corporate bonds narrowed somewhat (Bloomberg Barclays U.S. Credit Index **-4.5%**). Narrowing spreads aided returns for high yield bonds (ICE BofA High Yield Index **+0.9%**), while rising rates reduced prepayment risk on mortgages, leading mortgage-backed bonds to also outperform (Bloomberg Barclays U.S. MBS Index **-1.1%**). Additional fiscal stimulus and the possibility of a larger infrastructure package helped to send breakeven inflation rates higher, leading to outperformance from inflation-linked securities (Bloomberg Barclays U.S. Treasury U.S. TIPS Index **-1.5%**).

I – DOMESTIC MARKETS OVERVIEW (Cont.)

Vaccine Rollout, Stimulative Government Policy Poised to Boost Economic Recovery

Fed Remains Accommodative Amidst the Economic Recovery

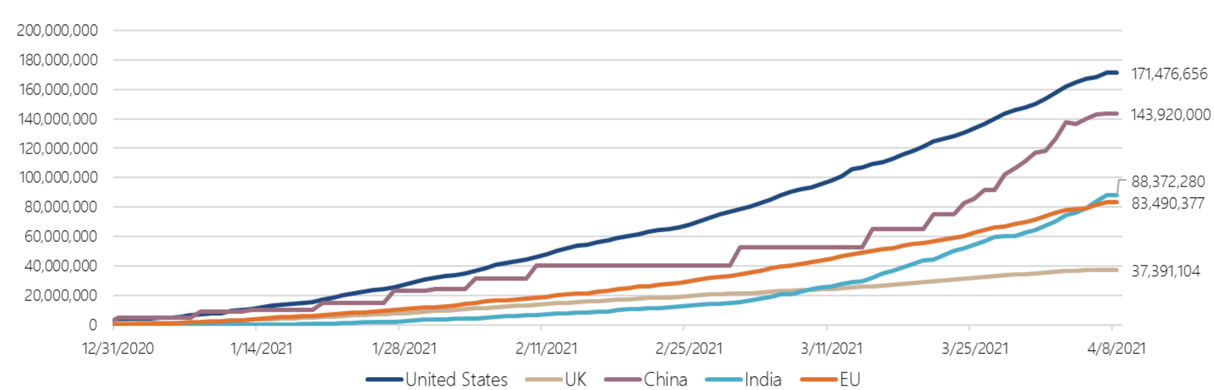
In March, the U.S. Federal Reserve signaled it would maintain its accommodative policy stance through 2021 and beyond (if necessary) in order to help meet its dual policy goals of full employment and a long-term inflation rate of 2%. The Fed kept its key Federal Funds Rate anchored at 0.00%-0.25% and indicated it would continue to pursue policies of quantitative easing (i.e., Treasury and mortgage bond buying program of at least $80 billion and $40 billion per month, respectively) for the foreseeable future. Based on the FOMC's interest rate projections, no interest rate increases are currently being projected by a majority of Fed governors until at least 2023. Additionally, the Fed maintained its guidance on inflation, indicating they would attempt to achieve near-term inflation higher than the long-term target of 2%, given that present inflation is running well below the intended target of 2%.

Economic Growth Projections Improve with Additional Fiscal Stimulus and Expedited Vaccine Rollout

In March, the U.S. government passed a $1.9 trillion fiscal stimulus and relief package to further combat the impacts of the COVID pandemic. Key provisions of the package included direct payments to most Americans, extended unemployment insurance, and additional funds for COVID testing and vaccine rollout. At the time of this report's publication, more than 700 million vaccine doses had been given worldwide, with over 170 million of those doses administered here in the United States (Exhibit C). The stimulus package and expedited vaccine rollout have led to an improvement in the expectations for economic growth over 2021. At its March meeting, the Fed revised its own GDP growth forecast for the U.S. from 4.2% to 6.5% for the year.

Labor markets have also improved in recent months as the U.S. economy has gradually opened up. Headline unemployment fell in March to 6%, while measures of underemployment (March U-6 Rate; 10.7%) have seen declines in recent months. Wage growth has also continued to outpace overall inflation. Nonetheless, initial jobless claims remain well above pre-pandemic averages, and the labor force participation rate remains depressed as fewer disaffected workers have attempted to re-enter the labor force, despite the recovery taking hold. After expanding at an annualized rate of 4.3% during the fourth quarter of 2020, investors and economists will be closely watching for the U.S. Bureau of Economic Analysis's first estimate on first quarter growth, expected during the latter part of April.

Exhibit C: **COVID Vaccine Rollout: Doses Administered by Select Countries** *Source: Bloomberg*

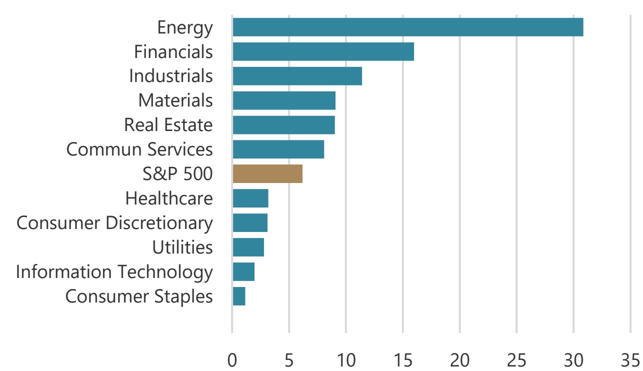


I – DOMESTIC MARKETS OVERVIEW (Cont.)

Market Contributors

Investor Optimism Continues

Exhibit D: **S&P 500 Sector Returns Q1** *Source: Morningstar*



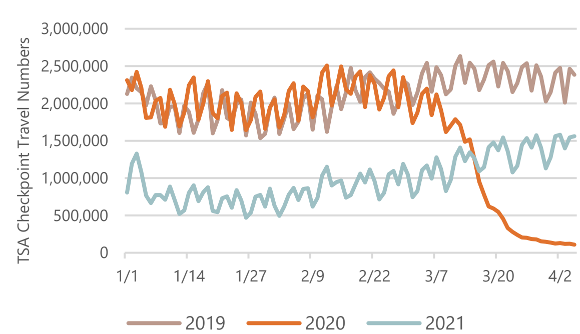
The same optimism that propelled equity markets to all-time highs at the end of 2020 continued into the first quarter of 2021, as all sectors delivered positive returns (Exhibit D). Like in the fourth quarter, cyclical areas of the market outperformed after trailing growth-oriented companies until the announcement of successful vaccine trials. The efficient rollout of vaccinations in the United States, strong consumer sentiment, the $1.9 trillion fiscal stimulus package signed into law, and the $2 trillion infrastructure bill proposed by the Biden administration all buoyed investor sentiment towards stocks that are expected to benefit from re-openings and the corresponding economic expansion.

Exhibit E: **WTI Crude Spot Prices** *Source: EIA*

After a difficult year in 2020 for the sector, energy companies in the S&P 500 index rebounded (30.9%) in the first quarter for the sector's best return on record. Reopening in the U.S. and strong growth in China, along with the OPEC oil cartel and allied countries agreeing to maintain production cuts, supported oil prices. West Texas Intermediate (WTI) crude oil traded below $40 a barrel for most of 2020 and ended the quarter at around $60 a barrel (Exhibit E).

The yield curve steepened, as the Federal Reserve revised upward its expectation for economic growth and committed to holding short-term rates near zero until 2023, leading the financial services sector to outperform. Companies in the industrials sector also thrived on the prospect of economic expansion. Airlines did particularly well over the first quarter, as air travel surged amid increases in vaccinations (Exhibit F). Commodities rose, which benefited the materials sector, led by steel producer Nucor and copper miner Freeport-McMoRan.

Exhibit F: **TSA Checkpoint Numbers** *Source: TSA*



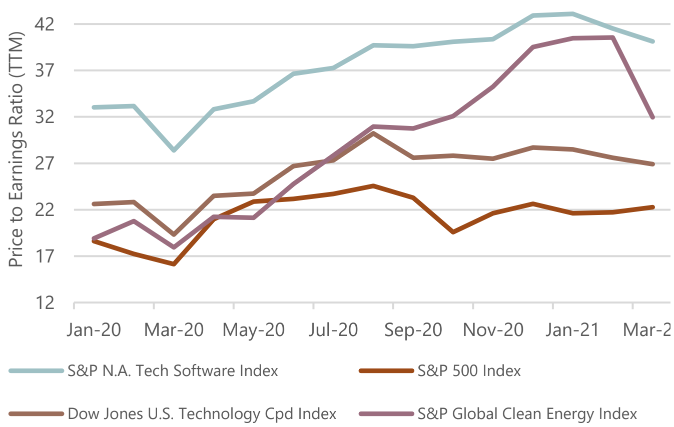
Although fixed income markets generally declined over the quarter, credit spreads narrowed, so leveraged loans and high yield bonds advanced. Short-term bonds were flat over the period, and although mortgage-backed securities lost value over the quarter, they outperformed duration-adjusted Treasuries and the broader market due to their higher coupon as mortgage rates have risen.

I – DOMESTIC MARKETS OVERVIEW (Cont.)

Market Detractors

Previous Top Performers Lose Their Luster

Exhibit G: **Investors Rotated Out of the Expensive Industries**
Source: Morningstar

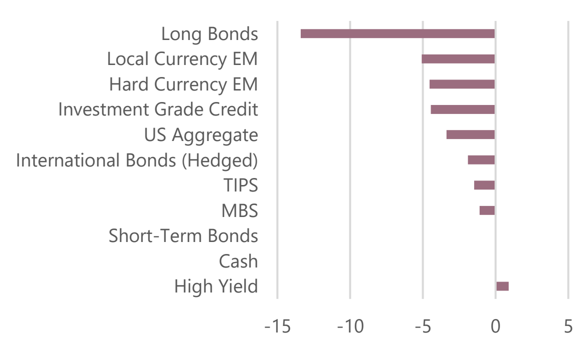


Investors rotated out of the stocks that had been favored until recently, including companies that saw huge run-ups in market value, like Apple, Amazon, and Tesla, all of which lost value over the quarter. In terms of sectors, defensive and technology stocks underperformed during the cyclical led advance over the first quarter after performing well through the early stages of the pandemic.

Consumer staples companies, which had benefited from homebound consumers, lagged the broader market as reopening stocks like retailers and resorts led the advance, and companies like Colgate-Palmolive, Walmart, and Clorox all underperformed the market. The utilities sector, another defensive area of the market, also underperformed. The sector similarly tends to underperform when interest rates rise, since utilities stocks are often purchased for their relatively high dividend yield. Although commodity prices generally rose over the quarter, safe havens like gold lost value, which negatively impacted gold miners.

Technology companies, which many investors favored last year for their ability to enhance productivity or for facilitating growth in emerging industries, also trailed the market. Both software companies, such as cloud service providers that facilitate remote work and semiconductor firms, which enable all online activity, lost value in the first quarter. Despite the Biden administration's proposed infrastructure plan and its emphasis on clean energy, solar and renewable energy companies were particularly hard hit this quarter too, as their valuations had dramatically appreciated over 2020 and pulled back in 2021 (Exhibit G).

Exhibit H: **Fixed Income Returns Q1:2021 (%)** *Source: Morningstar*



Fixed income generally lost value over the quarter, with the benchmark Bloomberg Aggregate Bond index declining 3.4%, as the yield curve steepened considerably. Consequently, long-term Treasury bonds were the worst performing sector (Exhibit H). The U.S. dollar also appreciated against foreign currencies, so unhedged international bonds underperformed U.S. bonds. Although high yield bonds outperformed due to narrowing credit spreads, investment grade bonds underperformed as companies took advantage of historically low rates last year by extending the maturity of their debt, making those bonds more sensitive to interest rate movements like those seen in the first quarter.

II – INTERNATIONAL MARKETS OVERVIEW

World View

Global Markets Recover, Start Year on Positive Note

One year after COVID-19 forced economies across the globe to implement lockdown measures, global markets are on the path to recovery. Countries across the globe rolled out mass distribution campaigns for vaccines during the first three months of the year, increasing consumer and investor optimism that economies would soon return to a new normal. While the rollout of vaccines has been relatively efficient across developed markets, European countries have lagged global counterparts. The region's vaccine campaign has been plagued by manufacturing delays and supply shortages. As a result, many European countries were forced to implement fresh lockdown measures during the quarter. Despite these struggles, the region continues to show signs of recovery. Underpinned by a record increase in manufacturing output, Eurozone PMI jumped from 48.8 in February to 53.2 in March (a reading above 50 signals expansion). While the improvement in activity was broadly seen across the Eurozone, growth in the region was led by Germany where a resurgent manufacturing economy drove the country's activity to a three-year high. The service sector in Europe, however, continues to struggle as the aforementioned lockdowns, coupled with continued travel restrictions, has held back consumer spending.

Exhibit I: **Global Equity Returns (%)**
Select Countries and Regions, Q1 2021. Source: Morningstar. Currency: USD.

Global Equity Returns		
Region / Country	Q1:21	Trailing 1-Year
MSCI Australia	3.4%	68.4%
MSCI Canada	9.6%	59.3%
MSCI China	-0.4%	43.6%
MSCI France	4.4%	50.0%
MSCI Germany	4.2%	59.3%
MSCI Italy	6.3%	53.0%
MSCI Japan	1.6%	39.7%
MSCI United Kingdom	6.2%	33.5%
MSCI USA	5.4%	58.6%
MSCI ACWI Ex USA	3.5%	49.4%
MSCI EAFE	3.5%	44.6%
MSCI EM	2.3%	58.4%
MSCI Asia Ex Japan	2.7%	57.3%
MSCI Asia Pacific	2.3%	51.8%
MSCI Europe	4.1%	45.0%
MSCI North America	5.6%	58.6%
MSCI World	4.9%	54.0%

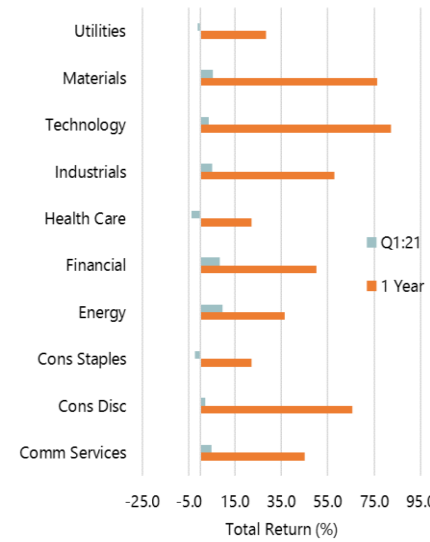
In Asian markets, China's recovery has been mixed. The country's vaccine campaign aided consumer spending in the services sector, which expanded at a stronger pace than anticipated in March (China Services PMI Mar: 54.3, Feb: 51.5), as overall activity and sales increased. Employment in the services sector also rose during the quarter as firms increased hiring to manage the capacity issues caused by the higher number of new orders. Manufacturing activity, however, has deteriorated over the quarter. The country's manufacturing PMI dropped to 50.6 in March, down from 51.3 in January, hitting an eleven-month low as both supply and demand within the sector slowed, and inflationary pressures increased. Global supply chain disruptions were a large contributor to this slowdown as heightened demand added pressure on suppliers, who are still trying to recover from the pandemic. The surge in global demand has not only increased the shortage in materials across the globe, but it has also created additional logistical problems, particularly in China. China is currently facing a critical shortage of shipping containers as the country is shipping out more orders to the U.S. and Europe. Additionally, supply chain issues were exacerbated when the Suez Canal was blocked for a week by a massive container ship. Approximately ten percent of global trade passes through the Suez Canal daily, the main water highway between Asia and Europe. The rapid increase in global demand, coupled with the issues supply chains are facing, also sent input and output costs higher for the ninth straight month, which additionally stifled China's manufacturing activity during the quarter.

II – INTERNATIONAL MARKETS OVERVIEW (cont.)

World View (Cont.)

Despite the economic recovery being mixed across the globe and increasing inflationary pressure, the vaccine rollout, coupled with continued government aid and pent-up consumer demand, has accelerated global growth with global GDP expected to grow at a record 6% in 2021.

Exhibit J: **Global Equity Sector Returns (%)**
Select Sectors, Q1 2021. Source: Morningstar



While generally underperforming the U.S. equity market, global equity markets kicked off the year in positive territory, with many market indices reaching fresh highs during the quarter (Exhibit J; MSCI USA Index Q1:+5.6%, MSCI World Index Q1:+4.9%). Additionally, one year after the pandemic, all sectors have seen double digit returns (Exhibit J). Given the surge in optimism regarding the post-pandemic economic recovery, investors shifted their assets into more cyclically sensitive sectors during the quarter. This shift led to value stocks outperforming growth stocks, and subsequently more defensive areas of the market underperforming. The energy and financial services sectors were the best performing sectors in the first quarter (MSCI ACWI ex USA Energy Index Q1:+9.6%, MSCI ACWI ex USA Financials Index Q1:+8.4%). After being the worst performing sector in 2020, the energy sector rebounded during the first quarter as oil prices increased. Performance in the financial services sector was generally aided by rising interest rates across globe and yield curves steepening. The health care sector was the worst performing sector during the first three months of 2021 (MSCI ACWI ex USA Health Care Index Q1:-3.8%) due to a sell-off in biotech stocks and investors rotating out of more defensive sectors. From a regional standpoint, Canadian equity markets (MSCI Canada Index Q1:+9.6%) were the best performing markets during the quarter. This was largely attributable to strong performance from underlying banks which benefited from rising rates and the steepening of the yield curve. Chinese stocks continued to underperform global equity markets in the first quarter (MSCI China Index Q1:-0.4%). This was largely attributable to the underperformance of internet retail companies as they continued to struggle to fulfil orders as a result supply chain disruptions.

Investors appeitie for risk, and inflationary concerns, led global fixed income markets to sell off, and sent yields rising, during the quarter. While regional fixed income performance was mixed, global fixed income generally underperformed the U.S. (Bloomberg Barclays Global Aggregate Bond Index Q1: -4.8%, Bloomberg Barclays U.S. Aggregate Bond Index Q1: -3.4%). The global bond sell-off, however, was muted across Emerging and European markets leading to their general outperformance during the quarter (Bloomberg Barclays Euro Aggregate Bond Index Q1: -1.9%; Bloomberg Barclays Emerging Markets Aggregate Index Q1: -3.5%). Investor sentiment remains risk-off for the regions as a result of rising Covid-19 cases, struggling vaccine campaigns, and continued lock-down measures. Risker areas of the fixed income market continued to outperform the broader global fixed income market. Increased investor optimism over the global recovery, coupled with spreads narrowing, led to the high yield sector outperforming during the quarter (Bloomberg Barclay Global High Yield Bond Index Q1: -1.0%). Global fixed income markets were also negatively impacted from a strengthening U.S. dollar during the quarter (Bloomberg Dollar Spot Index Q1:+2.9%).

III – LEADING ECONOMIC INDICATORS

Manufacturing and Industrial Output

Exhibit K: **Industrial Production and ISM PMI Indexes**
(Trailing 10-year)

Source: The Federal Reserve, Institute of Supply Management

ISM PMI Composite Index (U.S.) – The Institute for Supply Management (ISM) Purchasing Managers Index (PMI) combines five manufacturing indicators (new orders, production, employment, deliveries, and inventories) to create a composite view of national manufacturing activity. A PMI reading above 50 generally indicates manufacturing expansion.

Industrial Production Index (U.S.) – Calculated by the Federal Reserve, the Industrial Production Index measures real output for all facilities located in United States, including manufacturing, mining, electric utilities, and gas utilities.

Manufacturing Outlook Remains Positive while Winter Storm Uri Disrupts Industrial Production

The PMI Composite Index grew rapidly through March, recording its tenth consecutive month of expansionary readings, rising 23.0 percentage points from its low point in April 2020. After slowing in January, the pace of growth accelerated in February and March, with the Index rising 2.1 and 3.9 percentage points, respectively. The March reading of 64.7 is the highest the index has registered since reaching a peak of 69.9 in December of 1983. None of the 18 manufacturing industries reported contraction in March, though petroleum & coal products lagged other industries in their recovery from the Texas freeze. Textile mills, electrical equipment, and machinery led the advance.

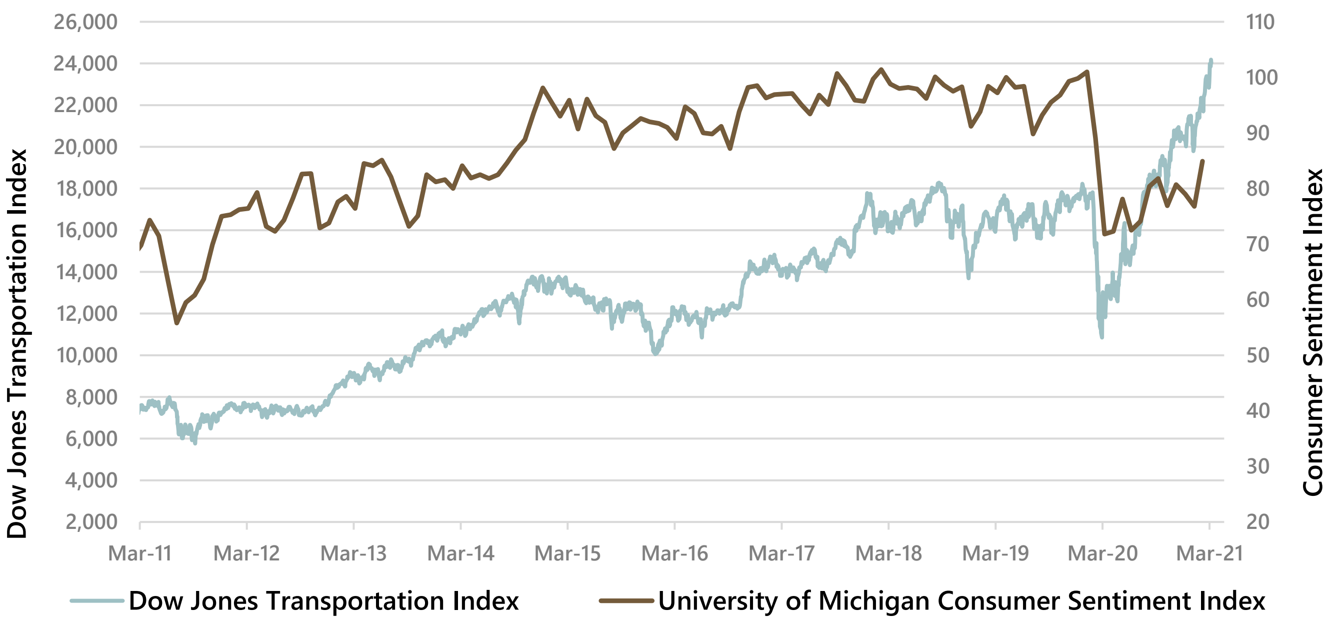
The Industrial Production Index fell sharply in February, due primarily to output and supply chain disruptions resulting from Winter Storm Uri. The storm damaged many refineries, petrochemical facilities, and plastic resin plants, which had a negative ripple effect on a variety of industries in the form of input shortages. The ongoing shortage of semiconductors also hindered motor vehicle output. On the other hand, utility output increased 7.4% due to increased heating demand from the cold weather. At 104.7, the composite Index remains below pre-pandemic levels, though it has recovered 14.7 from its low point in April 2020.

III - LEADING ECONOMIC INDICATORS (Cont.)

Commercial Activity

Exhibit L: **Transportation Index and Consumer Sentiment**
(Trailing 10-year)

Source: Morningstar, Thomson Reuters/University of Michigan



The Dow Jones Transportation Index – The Dow Jones Transportation Index represents the stock price movement of 20 of the nation's largest transportation firms, including trucking, airlines, and railroads. It is commonly used as a forward indicator for future commercial and industrial activity.

Consumer Sentiment Index – Conducted by the Survey Research Center under direction from the University of Michigan, this index reflects the personal and overall economic outlook of respondents. The survey is widely used as a proxy for future consumer spending expectations.

Transportation Index Reaches All-Time Highs, Consumer Sentiment Reaches Highest Level in a Year

The Dow Jones Transportation Average Index pushed to all-time highs, gaining 17.3% over the first quarter of the year. The ramp up of vaccination distribution along with subsiding cases of new COVID-19 infections powered all index constituents to positive returns for Q1 2021. Rental car and airline companies posted outsized gains (+49.9% and +31.6% respectively) as a surge in anticipated travel demand led to improved company forecasts. Marine shipping and domestic trucking companies also had a strong quarter as robust consumer spending continued to aid demand for transportation services.

The Consumer Sentiment Index bounced back in March (84.9), reaching its highest level over the trailing one-year period. Prior, the Index slipped over January (-2.1%) and February (-2.8%) due to political uncertainty, a rise in COVID-19 deaths, and lower future economic prospects. The Index's jump in March (+10.5%) was driven by distribution of the third COVID-19 relief checks and better than expected vaccination progress. Recent net jobs gains and strong consumer spending also attributed to growing economic optimism over the month.

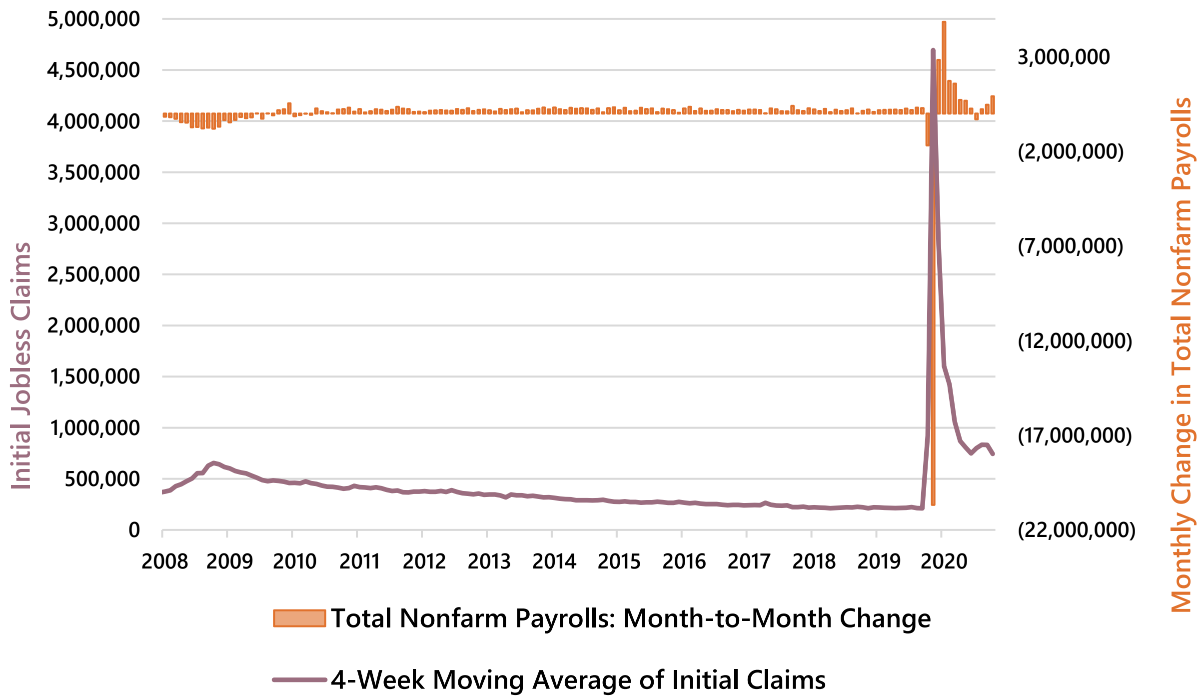
III - LEADING ECONOMIC INDICATORS (Cont.)

Labor Markets

Exhibit M: **Initial Jobless Claims and Total Nonfarm Payroll**

(monthly, seasonally adjusted, 2008-current)

Source: Federal Reserve Bank of St. Louis, BLS



Total U.S. Nonfarm Payrolls – U.S. Bureau of Labor Statistics statistical measure representing the total number of paid U.S. workers of any business, excluding: government employees, private household employees, employees of some nonprofit organizations, and farm employees.

Initial Jobless Claims (4-week moving average) – Initial Jobless Claims readings are issued by the U.S. Department of Labor. This indicator measures the number of unemployed who are filing for initial unemployment benefits. To smooth volatility, a 4-week moving average is utilized.

As COVID-19 Continues to Spread, the United States Economy Ends Seven Months of Job Growth

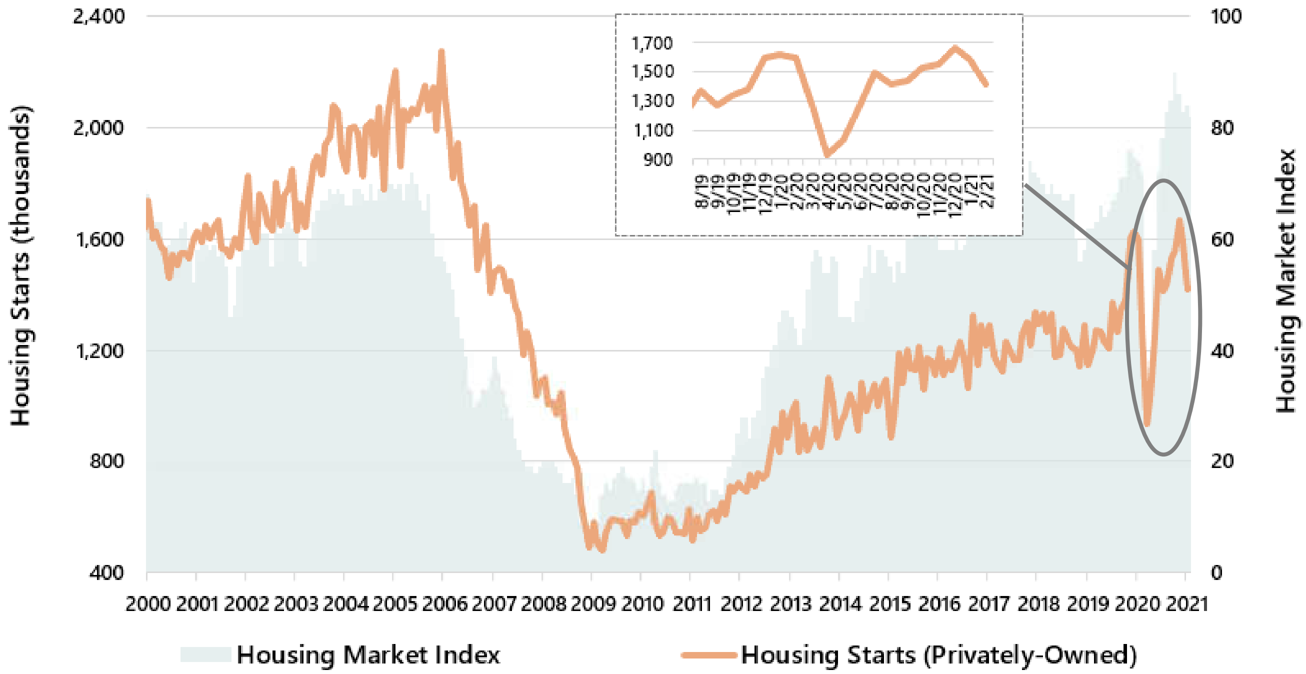
Now a year into the pandemic, labor market statistics have recovered, but remain elevated compared to pre-pandemic numbers. Job growth surged in early 2021 as more lost payrolls are recovered, but there remains a net job loss of about 8.4 million payrolls (over 4.2 million of which have now been unemployed for six months or longer. The 4-week average of initial jobless claims dropped to under 800,000, which is the lowest level since March 2020, yet is significantly above the average for the 2019 calendar year of 220,000 per month. While all sectors saw job growth in March, the majority of recent growth came from the Leisure and Hospitality sector (+280,000). The COVID-19 vaccine rollout has continued to accelerate across the United States, and many state governments have responded by loosening restrictions and lockdowns, allowing more restaurants and bars to open their doors and increase capacity. This sector suffered a disproportionate share of the job losses over the past year and has the most room for growth as lockdowns continue to loosen. Government (+136,000) also added jobs, specifically in the local and state education systems as schools resume in-person learning. There is optimism that the labor market can continue to recover more losses as vaccines become more available and all adults become eligible.

III - LEADING ECONOMIC INDICATORS (Cont.)

Housing

Exhibit N: **Housing Starts, Housing Market Index**
(2000 – current)

Source: Federal Reserve Bank of St. Louis, National Association of Home Builders, U.S. Department of Housing and Urban Development



Housing Market Index – Data compiled by National Association of Home Builders (NAHB) based on a monthly survey with a focus on single-family housing. The index is a weighted average of ratings from home builder surveys on market conditions for current and forecasted new home sales. The index ranges from 0 to 100, and a reading of 50 generally indicates positive sentiment in builders.

Builder Confidence Rebounds, and Housing Starts Begin Slow Road to Recovery

After reaching the 90 in November, the highest reading in the history of the index, the NAHB Housing Market Index fell slightly to a reading of 86 in December, and continued to fall to 83 in January of 2021. The index has fluctuated since January, with an increase to 84 in February and another slight decrease in the March preliminary numbers to 82. This quarter's readings indicate that there is still positive sentiment amongst builders. However, it has decreased slightly since November.

Privately-owned housing starts decreased 5.2% from an annualized rate of 1,670,000 in December to 1,584,000 in January. Housing starts continued to decrease at a greater rate of 10.3% to 1,421,000 in February. Housing starts missed expectations in both January and February, suggesting the housing market rebound is beginning to slow down. February housing starts for multi-family housing dropped 14.5% month-over-month, while single-family housing starts had a less severe decrease of 8.5%. Housing starts fell in every area of the country, except for the West, where housing starts rose by 17.6%, indicating more demand for housing in that region.