February 10, 2021

Market Update

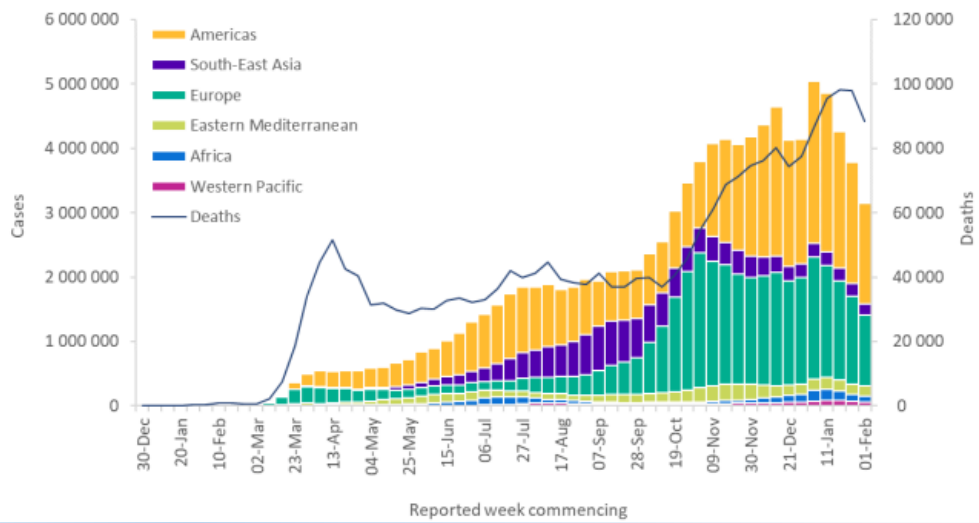
Source: Bloomberg

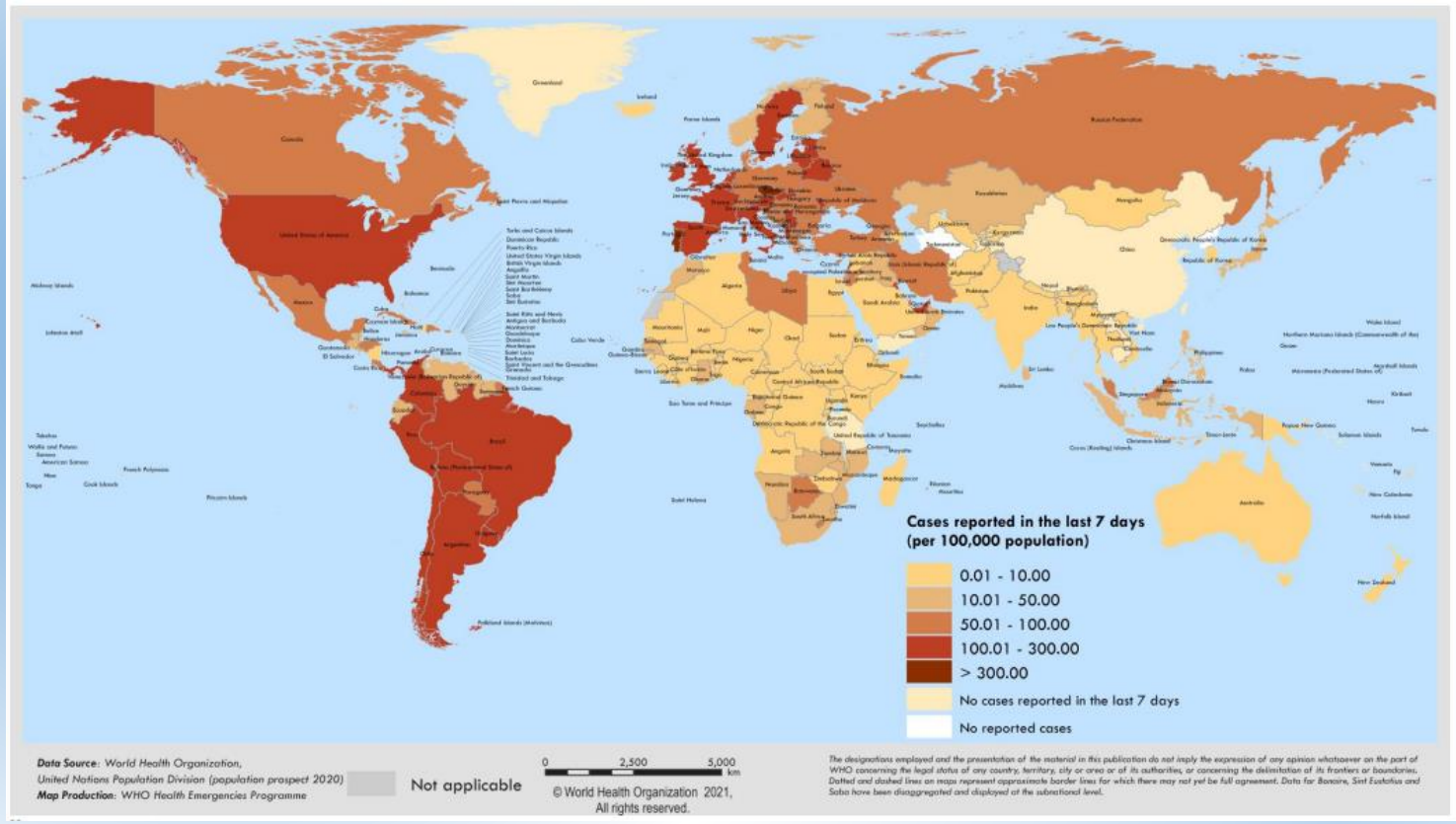
COVID-19 Pandemic

From the latest Situation Report by the World Health Organization, the number of new cases and deaths has continued to fall significantly. Is the decline due to vaccinations, herd immunity or social distancing measures? The answer will significantly affect the global economy. Only time will tell us the answer.

WHO Region	New cases in last 7 days (%)	Change in new cases in last 7 days *	Cumulative cases (%)	New deaths in last 7 days (%)	Change in new deaths in last 7 days *	Cumulative deaths (%)
Americas	1 568 167 (50%)	-17%	46 913 218 (44%)	45 350 (51%)	-4%	1 092 521 (47%)
Europe	1 102 953 (35%)	-19%	35 515 952 (34%)	33 169 (38%)	-13%	781 242 (34%)
South-East Asia	177 074 (6%)	-12%	13 033 797 (12%)	2 560 (3%)	-21%	200 267 (9%)
Eastern Mediterranean	158 625 (5%)	-2%	5 828 565 (6%)	2 761 (3%)	-16%	136 950 (6%)
Africa	84 842 (3%)	-22%	2 655 316 (3%)	3 232 (4%)	-30%	65 736 (3%)
Western Pacific	61 765 (2%)	-14%	1 481 789 (1%)	1 297 (1%)	1%	25 885 (1%)
Global	**3 153 426 (100%)**	**-17%**	**105 429 382 (100%)**	**88 369 (100%)**	**-10%**	**2 302 614 (100%)**

*Percent change in the number of newly confirmed cases/deaths in past seven days, compared to seven days prior. Regional percentages rounded to the nearest whole number, global totals may not equal 100%.

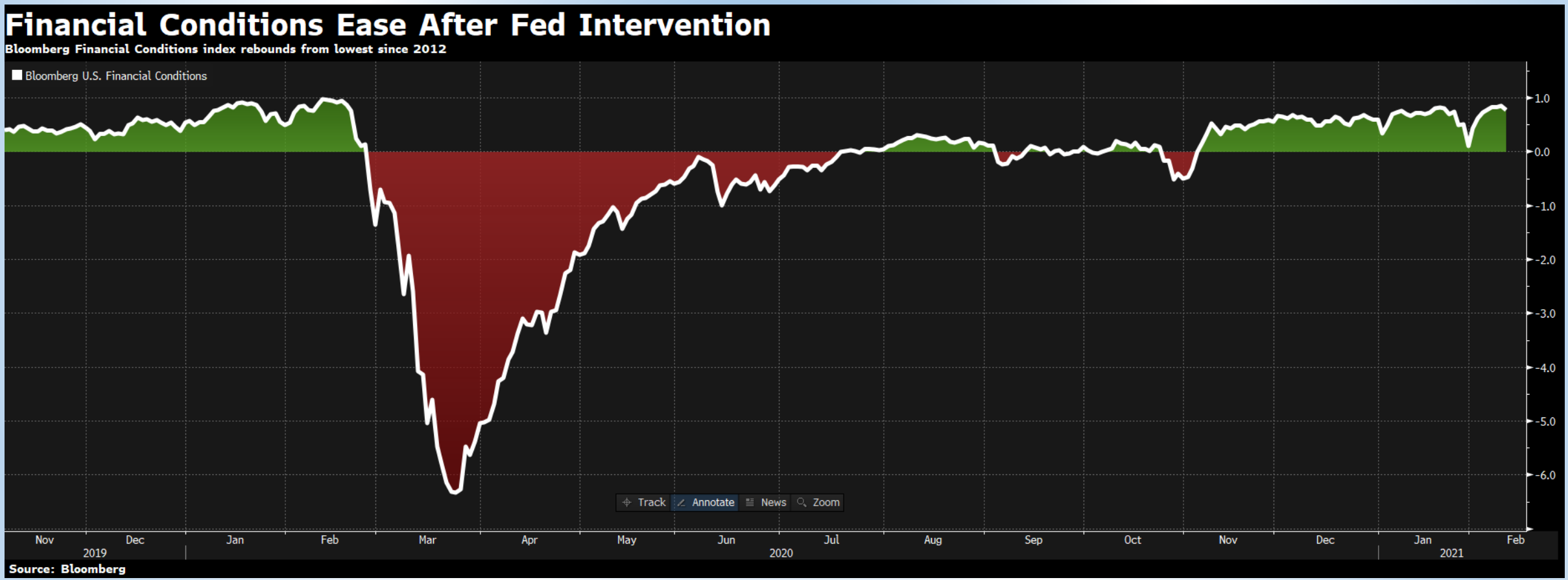




Source: Bloomberg

Are Investors Complacent?

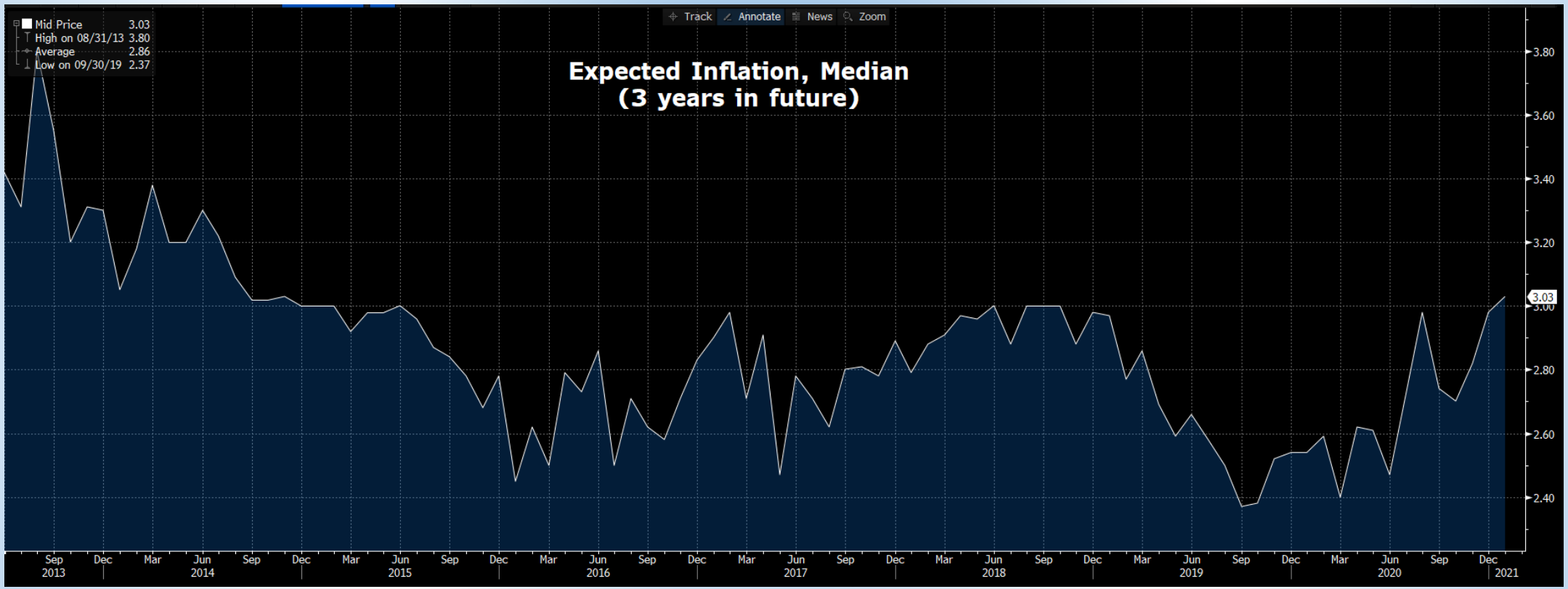
Financial Conditions continue to be "easy". We expect that the liquidity will remain plentiful as the Federal Reserve & Congress continue to underpin the economy and the workers harmed by the pandemic.



Source: Bloomberg

Expected Inflation

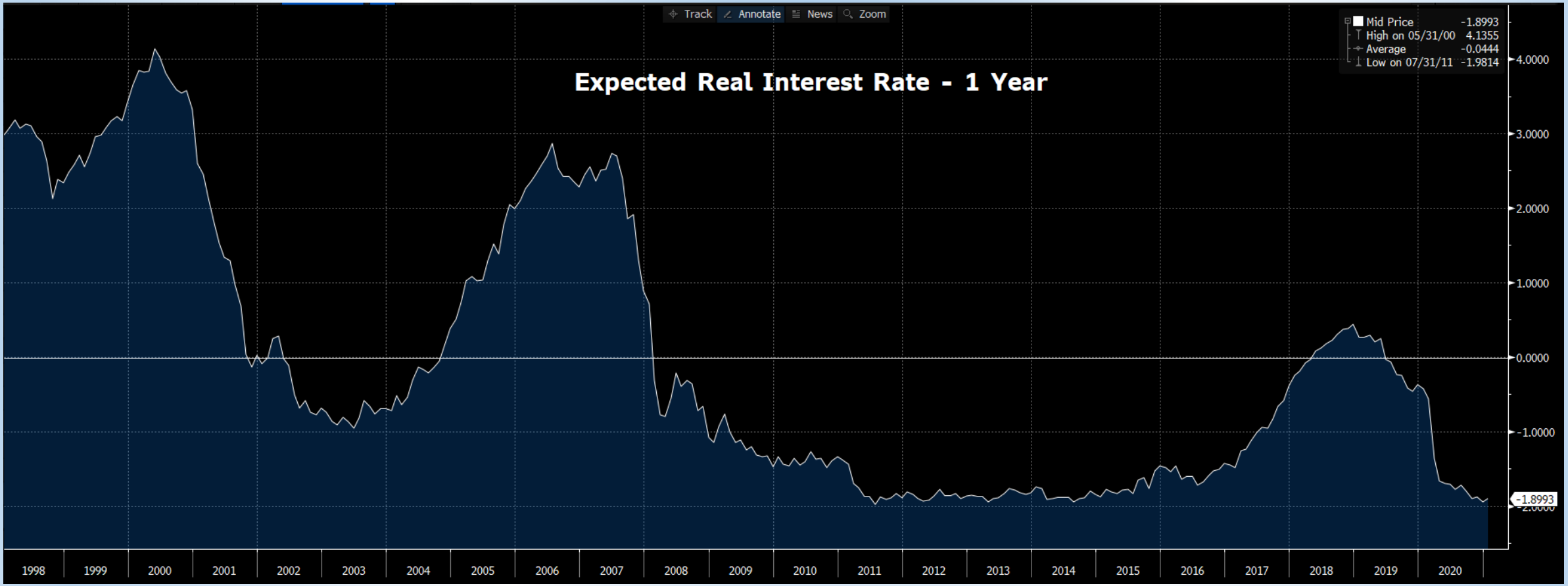
With the ample liquidity in the economy, many investors and consumers have been discussing the possibility of higher inflation. As shown below, expected inflation beginning in three years have increased to approximately 3%. This is a positive for most investors and consumers. We need to monitor the situation as the economy reopens.



Source: Bloomberg

US Expected Real Interest Rate

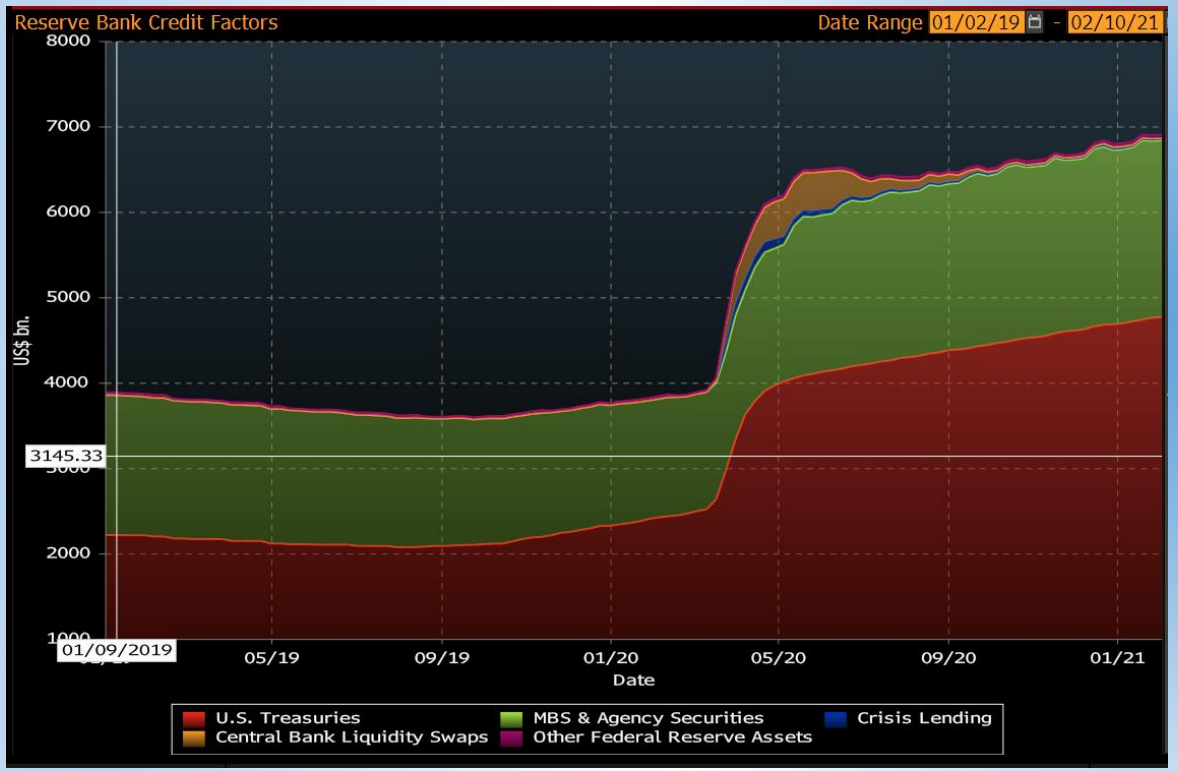
The real interest rate in the US is the nominal rate adjusted for expected inflation. Since 1997, the highest real interest rate was 4.1% and the low was -1.98%. We are currently -1.89%. This essentially tells investors that the cost of debt is negative since inflation offsets the interest rates. This low cost of funding should continue to support business and consumer spending.

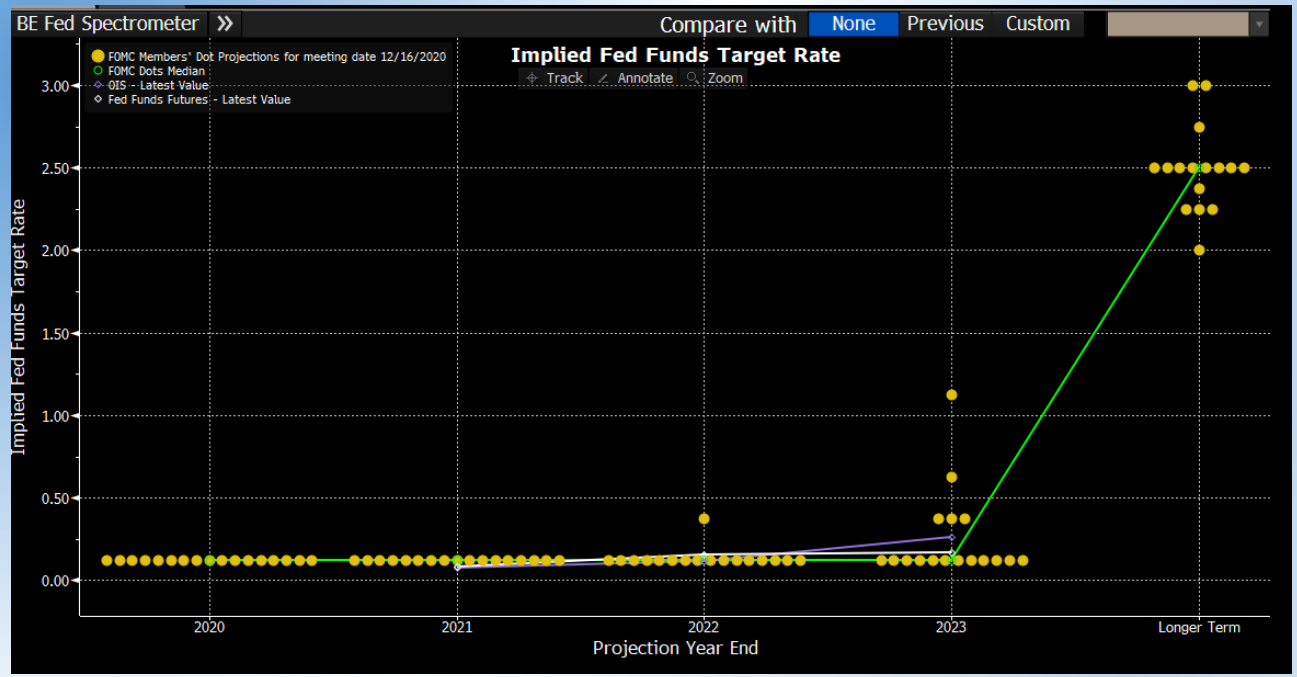


Source: Bloomberg

Fed Reactions?

One of the risks to the equity market is the potential for the Federal Reserve to begin to taper its asset purchases and/or raise interest rates. They have indicated the FOMC will remain on hold until inflation becomes problematic. We still have yet to see inflation, but if we see higher persistent inflation, we could see the Fed act earlier than many investors expect. This earlier action would put the equity and bond market rallies at risk.

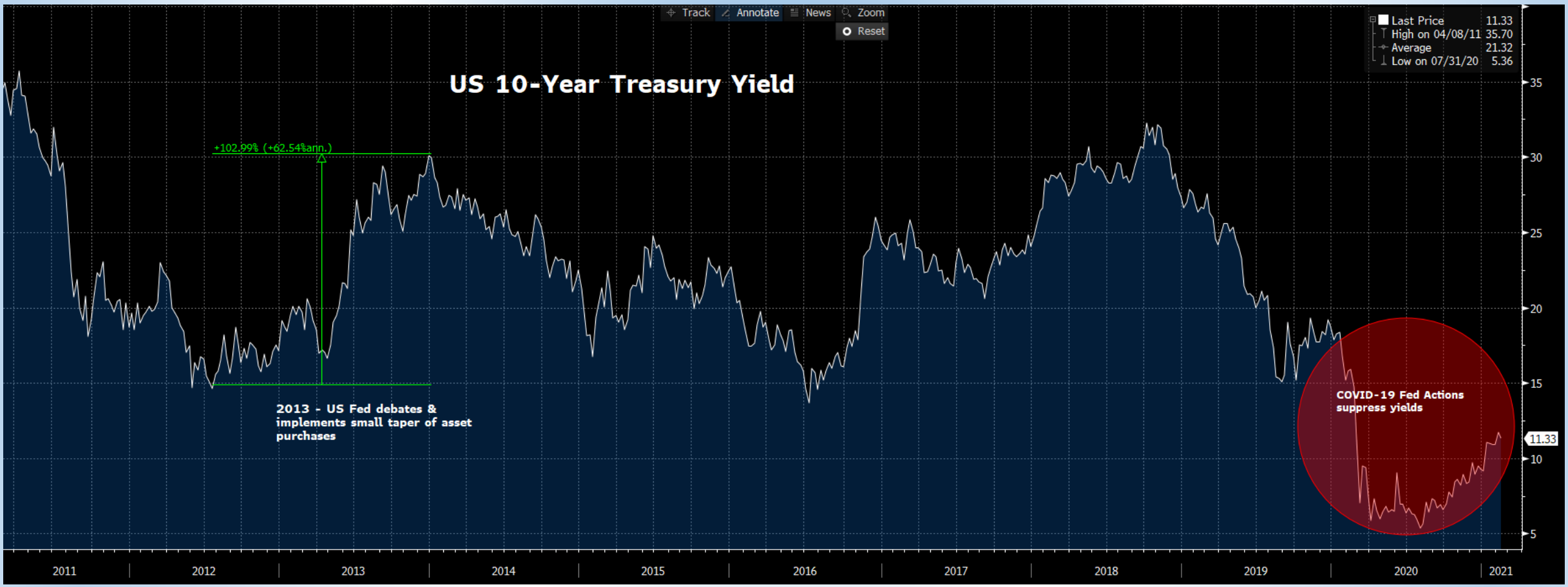




Source: Bloomberg

Taper Tantrum?

Given the backdrop of plentiful liquidity causing negative real yields on bonds and the potential for future inflation, we need to vigilant to the Federal Reserve's intention for future action. As shown below, the Federal Reserve can cause significant volatility in the fixed income markets when they announced their intent to begin to taper. In Dec 2013, they initiated the taper. As you can see, the 10-year US Treasury yield doubled from its low rate in 2012. The potential for bond yields to react negatively to Fed actions is important for investors to keep in mind. It would also become a headwind for most equities.



Source: Bloomberg

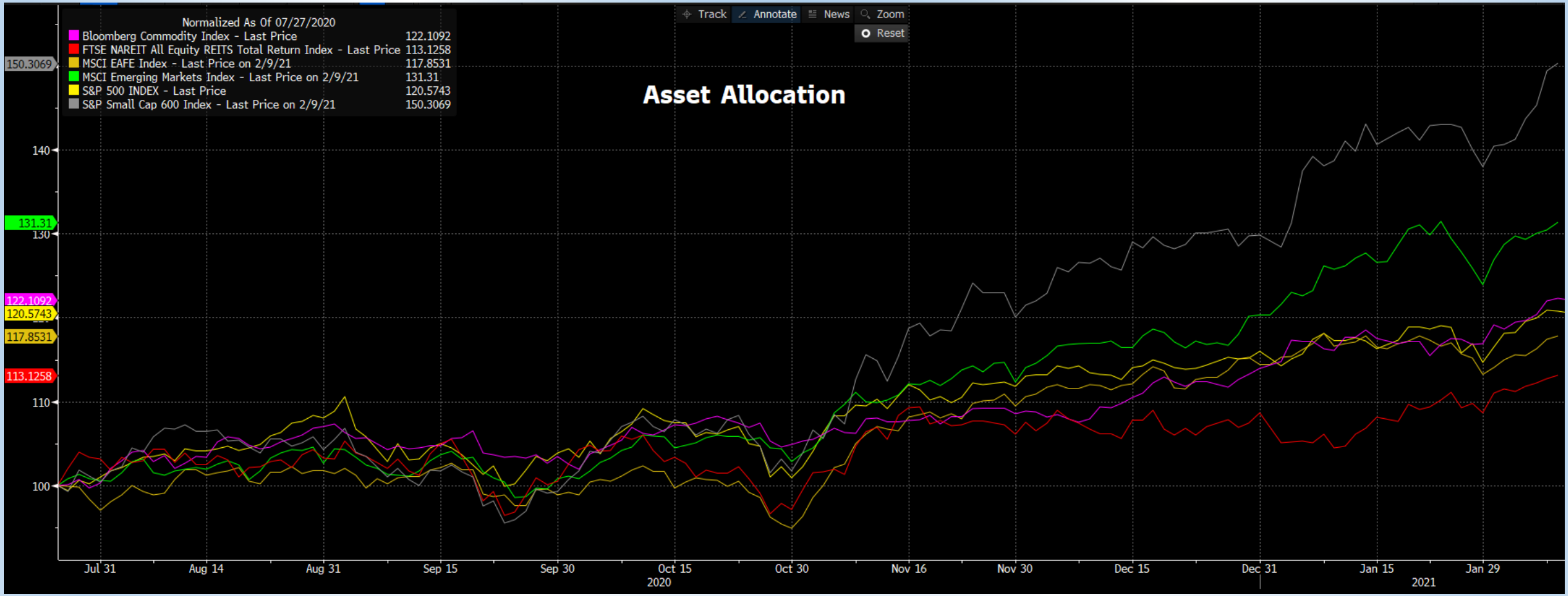
US Dollar

The USD has dropped since the beginning of 2020 as record amounts of stimulus were pumped into the economy. With the continued monetary support and potential federal stimulus, we expect the USD to remain under pressure and, possibly, to continue to move lower. A weakening USD may provide support for International/Emerging Market assets and Commodities to outperform.

Source: Bloomberg

How should we be positioned?

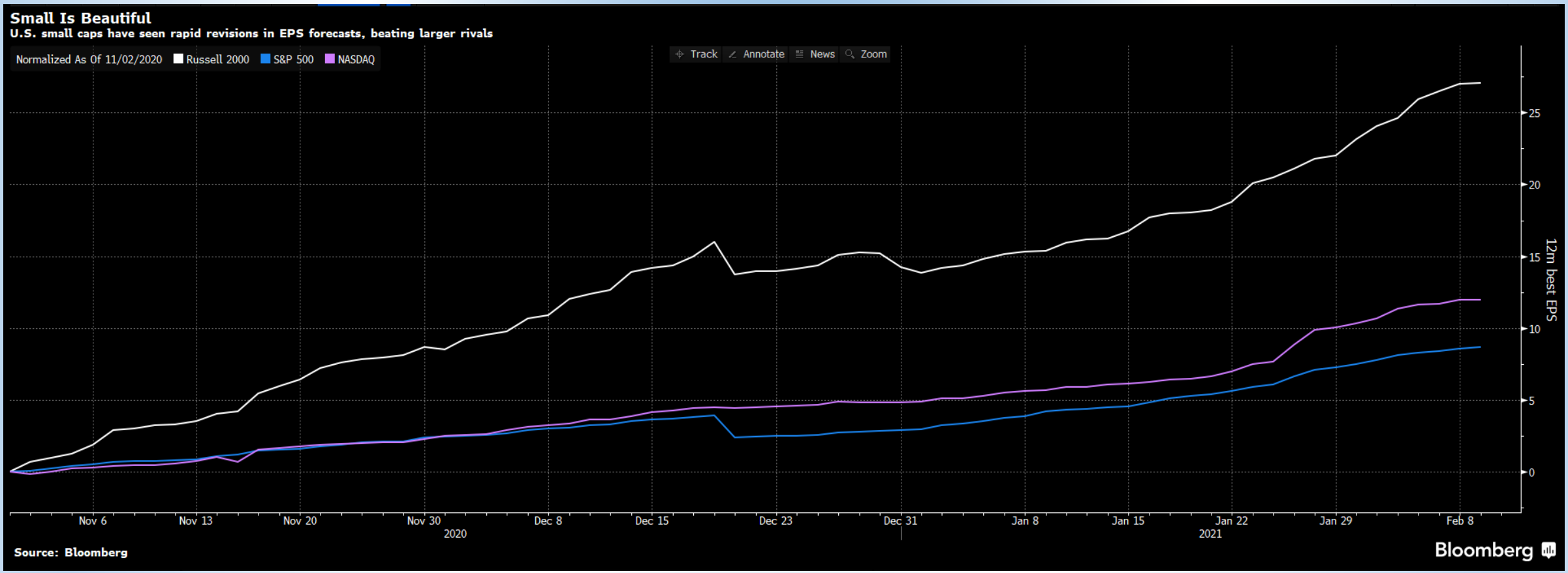
Small Cap is continuing to lead since Oct 2020. This is an important development since small businesses are the ones most impacted by lockdowns. We are maintaining our small cap overweight until we see changes in liquidity in the markets.



Source: Bloomberg

Earnings Growth

Small cap companies are outperforming their large cap counterparts significantly year to date. One of the reasons is because earnings for small companies suffered more than large companies last year. This year, small companies are expected to return to earnings growth as analysts revise their earnings estimates higher.



Source: Bloomberg

How should we be positioned?

Below are a few of the charts we follow to see the shifts in certain equity markets. In the top chart, Emerging Market stocks are outperforming US large cap companies. Developed Markets (MSCI EAFE) are slowly beginning to gain some outperformance after years of underperformance.

Source: Bloomberg

How should we be positioned?

Value has moderated somewhat versus Growth but has a long way to go before increasing our exposure is considered prudent.

Source: Bloomberg

JUNCTURE
WEALTH STRATEGIES

Summary

- **The Fed has stabilized the financial markets via substantial liquidity interventions.**
- **Interest rates should remain low for longer underpinning support for equity and short-term bond markets.**
- **Negative real yields will encourage international investors to invest in assets denominated in other currencies causing the US Dollar to struggle.**
- **Fiscal stabilization packages will be needed in the short term until vaccines and/or herd immunity can be reached.**
- **Earnings are expected to growth significantly over the next two years with Small Cap & Emerging Markets continuing their leadership role.**
- **Begin to look for inflation to slowly build in second half of 2021 into 2022.**

Action Plans

- **Overweight Small Cap companies relative to Large Cap.**
- **Begin to gain exposure to cyclically-sensitive sectors and companies.**
- **Begin to build positions in International and Emerging Market equities and fixed income.**
- **Increase exposure to Commodities.**
- **Employ a hedging strategy to moderate downside risk, if necessary.**

Source: Bloomberg