First Quarter 2021
Market Outlook

Outlook Summary

Following an outstanding 2019 for global risk assets, 2020 began in a similarly encouraging fashion. Unfortunately, the entire tenor of 2020 changed in late February and early March, as the Covid-19 pandemic began to wreak havoc on all aspects of global life. As a result, financial markets entered one of the most volatile periods in history, dropping precipitously through late March, then roaring back in the second quarter and advancing much of the remainder of the year. Market-shaping events occurred regularly – from historic levels of stimulus from both central banks and fiscal authorities to support global economic recovery, to a U.S. presidential election season that provided countless surprises, to the astonishing accomplishment of Covid-19 vaccine development in such a short period. "Unprecedented" is a term employed far too often, but given the economic and market experiences of the past year, it appears to be an accurate descriptor of 2020.

Despite a global pandemic that thrust much of the world into economic recession, a hypothetical globally-diversified 60/40 portfolio returned

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approximately +15.4% for 2020[1]. Risk assets rebounded throughout the second half of the year, led by large cap growth equities. The Russell 1000 Growth Index gained 38.2%, followed by the small cap Russell 2000 return of +19.8%, the MSCI Emerging Market Index at +18.5%, and the benchmark S&P 500 up +18.3% for the year.

Fixed income assets also enjoyed a strong year. For 2020, the benchmark Bloomberg Barclays U.S. Aggregate Bond Index added +7.5%. Real Estate equities were one of the few asset classes with a negative return for 2020 at -9.1%. Gold was the leading asset class for the year, advancing +20.8%.

As 2021 dawns, the ongoing Covid-19 pandemic remains the overwhelming dynamic driving both macroeconomic conditions and equity market performance. Even as much of the world remains in some level of lockdown, optimism for a sustained global recovery continues to drive both bond yields and equity prices higher to begin the year. Overall, we believe the successful distribution and application of Covid-19 vaccines will be the key factor to a return to global synchronized economic growth as the year

Source: FactSet 12.31.20

progresses, along with added stimulus from fiscal authorities and additional policy support from global central banks. While we do not expect the ongoing recovery to occur in a coordinated, linear fashion, we believe the potent combination of successful vaccine implementation and continued fiscal and monetary support will lead to accelerating economic and corporate fundamentals in both 2021 and beyond.

We strongly believe in the effectiveness of longer-term thinking and investing. Once again, past experience provides a valuable lesson – market timing is simply not a strategy worth pursuing. We are active investors. We focus where we can make a real difference for our clients – to help them achieve their long-term

[1] Source: Bloomberg as of 12/31/2020. The globally-diversified portfolio comprised the following asset classes, weights and proxies: U.S. large cap stocks 40% (S&P 500 Index), U.S. small cap 10% (Russell 2000 Index), International stocks 10% (MSCI AWCI ex U.S. Index) and bonds 40% (Bloomberg Barclays U.S. Aggregate Index). This hypothetical portfolio is provided only to illustrate historical market trends. Indices are unmanaged, may not include reinvestment of income or short positions and do not incur management fees. An investor is unable to invest directly in an index.

investment goals. From an asset allocation perspective, prudent rebalancing to preserve a client's risk and return objectives in the current volatile environment is the first call to action. Given the increased market volatility and the wider-than-normal range of potential economic outcomes, the investment committee is meeting more frequently to review and, if necessary, adjust asset allocation and portfolio positioning.

We remain constructive on equities, particularly given current levels of interest rates, as investors turn their attention toward improving corporate fundamentals in 2021 and into 2022. In terms of market leadership, traditional cyclical themes have outperformed early in 2021, buoyed by hopes of sustained economic expansion and momentum trading; however, we anticipate growth stocks will participate in any market upside as well. In fixed income, we continue to position portfolios with neutral duration relative to the applicable benchmark. From a category perspective, we prefer BBB-rated corporates from issuers with improving balance sheets and strong cash flow, non-agency residential mortgage-backed securities (RMBS), and preferred securities.

ECONOMICS

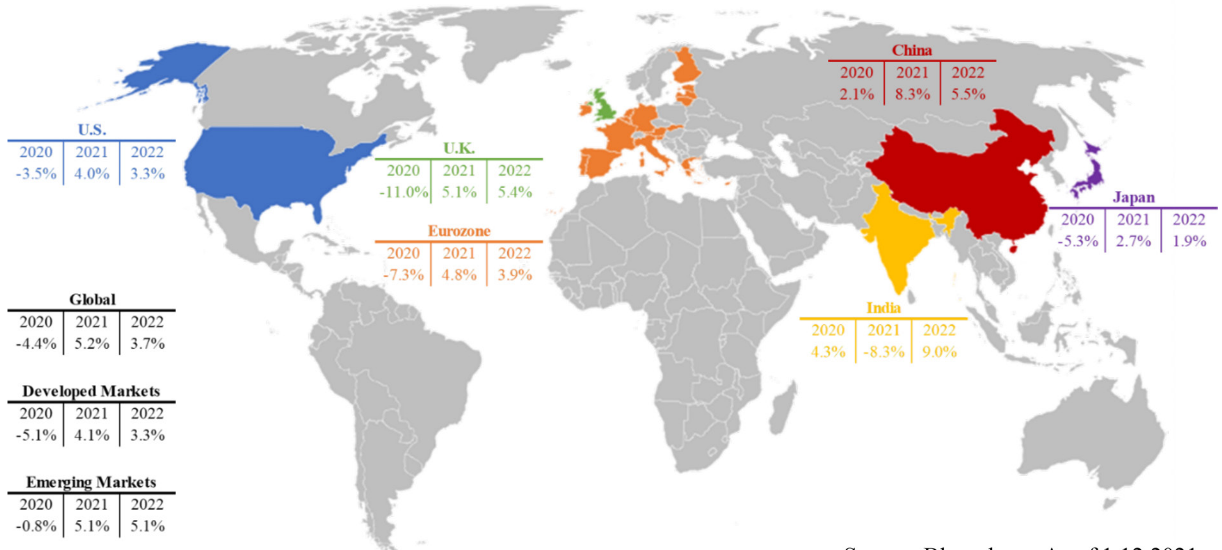
The catastrophic impact of Covid-19 has been unprecedented, with lives and businesses tragically lost. As the virus circled the globe during the first quarter, governments were forced to implement broad-based "lockdowns" to slow its spread, resulting in record-breaking declines in economic activity. GDP in the developed world contracted by an annualized 33% in the second quarter. Governments and central banks acted swiftly, providing unparalleled fiscal and monetary support to economies and financial markets. Global economic activity rebounded strongly in the third quarter, as the easing of Covid-related restrictions unleashed significant pent-up demand. Unfortunately, a resurgence of the virus in the U.S. and Europe during the fourth quarter is resulting in further measures to limit social mobility. Governments are focused on balancing public and economic health to minimize repeating devastating effects of the March/April lockdowns on their economies.

However, promising news on effective vaccines emerged in November, a truly remarkable development since vaccine development has historically taken close to 10 years. As of the second week of 2021, nine vaccines have achieved regulatory authorization or approval in one geography or more. The two vaccines approved in the U.S., Pfizer/BioNTech and Moderna, are ahead in the process with both reporting efficacy in excess of 94.5%; this figure exceeds initial targets and compares favorably with the efficacy of the flu vaccine, generally 60-70%. Current expectations are that 55-

70% of the population need vaccination to reach "herd immunity" that would allow a full exit from current lockdowns; any delay or disruption to this process would likely result in downward revisions for economic growth.

After contracting by -5% percent in the first quarter and -31% – a record level of decline – in the second quarter, the U.S. economy posted record-breaking growth of 33% in the third quarter, which significantly exceeded expectations.

Global GDP Forecasts



Source: Bloomberg. As of 1.12.2021

The recent resurgence of Covid infections and the subsequent implications of mandated and/or self-imposed lockdowns is likely to have created headwind for growth in the fourth quarter as well as in the first quarter of 2021. Against this backdrop, economists have responded by trimming their forecasts for economic growth during this period. However, the impact to economic output is likely to be modest compared to that experienced in March and April, as lockdowns are less stringent and businesses are much better prepared than during the first wave.

OVERALL, WE EXPECT THREE MAIN FACTORS TO DICTATE ECONOMIC GROWTH IN 2021:

The Path of the Virus: The recent surge in cases and hospitalizations will create a drag on economic activity during the first quarter. The success of producing and distributing a vaccine will determine, in large part, the speed of economic growth over the remainder of the year. Given the high efficacy of the vaccines, big data analytics firm Airfinity estimates that the U.S. will be able to achieve herd immunity against Covid by the early summer. Achieving this milestone will allow sectors (such as travel, leisure and restaurants) to reopen and operate in an economically efficient manner, helping reduce the unemployment rate.

Monetary and Fiscal Support: The Fed appears set to continue to provide support to the economy – through financial markets – for the foreseeable future through a combination of holding short-term interest rates near zero and asset purchase programs (known as quantitative easing (QE)). The long-winded 2020 elections concluded on January 6 with a Democratic sweep of two critical Georgia Senate seats, giving the Democrats control of the Senate by a narrow margin. Markets now expect more fiscal spending with additional Covid-19 relief in the near term and the potential for additional spending on infrastructure and healthcare longer term. Many economists suggest that fiscal policy is particularly important in the wake of the pandemic, as fiscal policy can be more targeted than monetary policy to certain areas of the economy; this is especially important during this crisis that has impacted some sectors (hospitality, travel, leisure) much more than others. Second, monetary policy can only offer loans, not grants. Loans add to private sector debt and weigh on spending and, in turn, the scale of the recovery.

Consumer Confidence and Spending: The household savings rate has increased substantially during the pandemic. Part of the buildup was involuntary (sizable fiscal stimulus and consumers staying home rather than shopping or traveling) and part was due to voluntary decisions – saving more due to the increased uncertainty about the future. Given the importance of the consumer to economic growth in the U.S. – accounting for ~68% of GDP – the speed at which consumers feel comfortable spending will be critical to the velocity of the economic recovery. However, the distribution of savings balances is heavily skewed towards higher-income households, which have been able to continue to work while saving a large portion of their budget previously spent on restaurants and travel. These households may be less likely to run down their savings following the pandemic. Overall, we expect the savings rate to continue to decline, but remain elevated to its pre-pandemic level, which is typical in the years following recessions.

Similar to other developed economies, the U.K. experienced a record decline in economic activity in the second quarter. While the economy did enjoy a sizable rebound in the third quarter, a recent spike in virus cases has resulted in the introduction of new lockdown measures, which could potentially remain in place through the first quarter of 2021. In addition to the pandemic, the Brexit saga dragged throughout 2020 when both sides came to an agreement on December 24. However, even with a deal struck between the U.K. and EU, a great deal of uncertainty still remains; this continues to create a negative overhang on business and consumer confidence, and, along with the effects of the pandemic, suggests that the U.K. could see further economic contraction through the first quarter.

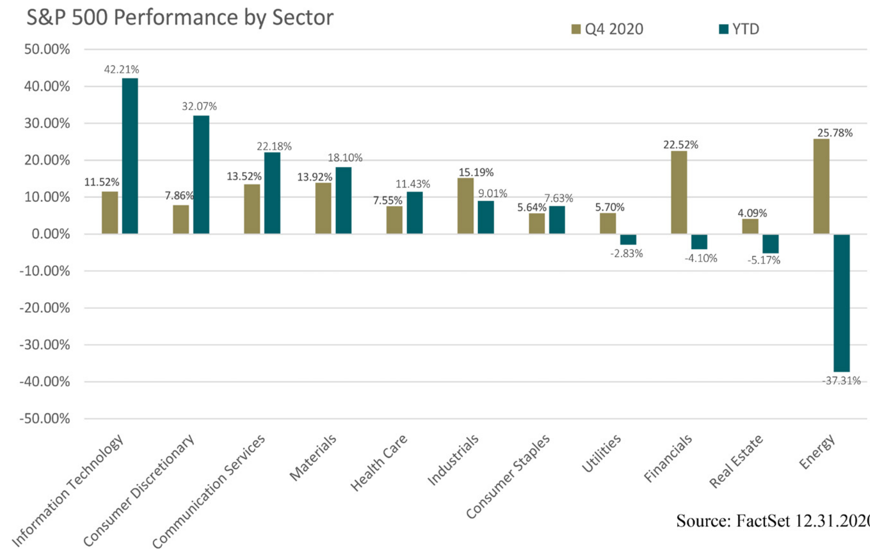
After the economy contracted by over 15% in the first half of the year, Europe experienced a strong, but partial, rebound during the third quarter. However, the recent resurgence in virus cases has forced governments in the region to implement a series of shutdown measures. While these current restrictions on mobility and economic activity are less severe than those deployed during the first wave of the pandemic, they will probably remain in place throughout the winter. Against this backdrop, economists now forecast that the European economy will contract in the fourth quarter and the first quarter of 2021. Beyond the first quarter, the outlook is more favorable, as a combination of fiscal support through the EU recovery fund, distribution of the vaccine, warmer weather, and potentially a more favorable relationship with the new U.S. administration should all provide tailwinds to economic activity.

While "emerging markets" are frequently discussed as one sector, it is important to remember that it is actually a very heterogeneous set of individual countries. As such, the impact of the pandemic has varied by country and region. Areas where economic activity is heavily comprised of technology-related sectors, such as Taiwan, have performed relatively well. Conversely, countries in South America and the Middle East, where growth is dependent on cyclical sectors, such as energy and materials, have been more severely impacted. China, the world's second largest economy, appears to have managed the pandemic – and additional 'waves' – better than most regions of the world, with growth already surpassing its pre-Covid trend.

EQUITY MARKET OUTLOOK

Equity Market Recap

For 2020, the benchmark S&P 500 delivered a total return of +18.4%, well ahead of its +10.8% average annual return since expanding to 500 companies in March 1957. The path of 2020's return was remarkable in itself; the S&P 500 entered a bear market from peak levels faster than at any point in history, dropping more than -35% from its February 19 peak to its intraday trough on March 23. The average daily move in the S&P 500 was 5.0% in March, and equity markets



Source: FactSet 12.31.2020

were characterized by indiscriminate selling with overnight futures hitting "limit up" and "limit down" levels on multiple occasions. For the first quarter, the S&P 500 posted a loss of -20.0%, the index's worst quarter of performance since the fourth quarter of 2008 and the worst first quarter in history. Smaller U.S. stocks struggled even more, as the as the S&P 400 Mid Cap and small cap Russell 2000 lost -30.0% and -30.9%, respectively.

However, global equities roared back beginning in late March, fueled by a needed snapback from oversold conditions, optimism over reopening the U.S. economy and a potential Covid-19 vaccine, and the simple idea of "don't fight the Fed" when both monetary and fiscal policy were committed to supporting the domestic economy through the pandemic and on the path to recovery. The S&P 500 gained +20.5% in the second quarter, the fourth best calendar quarter since World War II. With an additional +8.9% return in the third quarter, the benchmark had its best two quarter performance since 2009. Better-than-expected corporate earnings reports and the announcement of two promising Covid-19 vaccine candidates in November provided additional fuel for stocks in the fourth quarter. As of December 31, the S&P 500 had gained an astonishing +70.2% from its March 23 low in fewer than 200 trading days.

On a full-year basis, growth stocks continued their long-running outperformance relative to value counterparts, as the Russell 1000 Growth provided a +38.3% gain versus +2.8% for the Russell 1000 Value Index.

The discussion over "growth versus value" remains a popular topic. The gap in performance has been significant, with growth stocks outperforming value starting at end of the second quarter of 2013. The Russell 1000 Growth Index has recorded a cumulative total return of +265.2% versus +96.0% for the Russell 1000 Value Index and +172.2% for the S&P 500. International markets followed similar patterns to U.S. stocks – weakness in the first quarter gave way to strong performance in the second half. The MSCI ACWI ex-U.S. Index gained +10.4% while the MSCI Emerging Market Index was up +17.0% for the year.

The Winners and Losers of 2020

Throughout the year, much was written about the concentration of performance in a relatively small number of stocks, and terms like "FAANG" and the "Big 5" became well known parts of the investment lexicon. As of the end of 2020, the five largest names in the S&P 500 Index were Apple, Microsoft, Amazon, Alphabet (Google), and Facebook. Collectively, these five companies comprised nearly 24% of the index's total market value; this compares with 11.6%

at the end of 2013 and represents the highest level of concentration in five companies since 1977 (IBM, General Electric, General Motors, AT&T, Exxon). Impressively, the five companies contributed nearly all of the S&P 500's return for 2020. While we are mindful of the dangers of excessively consensus thinking, we are not concerned by the idea of large positions, as by our own design, we actively manage high conviction and/or concentrated equity strategies.

Despite the overhang of Covid-19, the "Big 5" were not the only stocks to enjoy a truly successful 2020. A number of ongoing secular growth themes – financial technology and digitalization, public and private cloud storage and optimization, software as a service, among others – accelerated in the pandemic environment. In most instances, these trends were already prevalent, but the pandemic accelerated the adoption. We believe companies such as PayPal (PYPL) and Nvidia (NVDA) are longer-term advantaged businesses that are uniquely positioned to emerge as stronger competitors over the longer term as well as navigate severe economic challenges. In addition to the aforementioned themes, several new themes entered the lexicon, none more so than "Work/Play from Home." The pandemic introduced an entirely new way of life from the workplace to recreation, and newer companies such as Zoom Video Communications (ZM) and Peleton Interactive (PTON) became universally known in short order. More established standbys like Lululemon Athletica (LULU), Lowe's (LOW), and Activision Blizzard (ATVI) also thrived during 2020, as consumers adjusted behaviors to invest in fitness, home improvement, and gaming entertainment.

On a year-to-date basis, several sectors underperformed the broader market, none more so than Energy. The sector's overall importance has waned in recent years for a variety of reasons, and comprised a mere 2.4% of the S&P 500 as of mid-December versus 12.0% at the end of 2010. Energy's path during the second quarter was particularly interesting; on April 20, the front month West Texas Intermediate (WTI, the benchmark U.S. grade of crude oil) oil futures contract settled at -$37.63 per barrel, a previously unthinkable situation driven by a short-term imbalance of supply and demand. By the end of the second quarter, benchmark WTI had traded back to over $39 per barrel and stood at $48.52 as of the end of the year.

In our opinion, 2020 provided yet another example of the fallacy of "market timing." According to J.P. Morgan, an investor who missed only the ten best days in S&P 500 performance from the beginning of 2000 to the end of 2019 resulted in an annualized return of +2.4% over that period, compared with an annualized return of +6.1% for someone fully invested over the entire period. Over that same 2000-2019 period, six of the best ten days in the S&P 500 occurred within two weeks of the ten worst days. Not surprisingly, a similar pattern emerged in 2020. The S&P 500 experienced its third worst day in history on March 16 (-11.9%) but followed that up with its eighth best day ever on March 24 (+9.4%). We strongly believe in the effectiveness of longer-term thinking and investing. Once again, past experience provides a valuable lesson – market timing is simply not a strategy worth pursuing.

What to Expect Going Forward in 2021

Even with the turn of the calendar, the resolution timeline for the Covid-19 pandemic clearly remains the largest determinant of equity performance due to its impacts on both global economic growth and corporate profitability. Despite December being the deadliest month of the pandemic thus far, optimism continues to grow for an eventual end to the pandemic and the return of sustained economic expansion. Fueling this optimism has been the successful development of multiple Covid-19 vaccines with initial distribution and implementation of vaccines during the upcoming year, with an eye towards achieving an "all clear" date in late 2021.

There are also other topics worth monitoring in 2021: the new presidential administration and Congress' ability to deliver additional Covid-19 related fiscal support and stimulus, and additional accommodation in monetary policy from global central banks. These two factors, combined with the effect of distribution and implementation of Covid-19 vaccines, will have vast effects on the drive toward coordinated global economic growth.

The range of estimates on corporate earnings was wide and volatile in 2020; S&P 500 estimates moved from $176 to begin the year, to $125 at the end of the second quarter, to $136 on December 31. 2021 S&P 500 estimates of $166 represent a +22% increase on a year-over-year basis. Importantly for market sentiment, the 2021 estimate is above the $161 earned in 2019. Given the potential for FY22 to represent the first full year of "normalized" economic activity, investors are already turning to FY22 earnings estimates to anchor equity valuations. Current 2022 estimated earnings for the S&P 500 stand at $194, a growth rate of +16.3% over 2021's estimate. The S&P 500 benchmark is trading at a 19.6x forward P/E multiple of FY22 earnings estimates.

In addition to various earnings outcomes, we must contemplate a wider range of valuation considerations. Over the last twenty-five years, the average P/E multiple on next-twelve-month S&P 500 EPS has been 16.6x. While the current P/E multiple of 2021 estimated earnings currently stands well above average, it is important to consider that stock prices are ultimately a function of future earnings and interest rates, and the absolute low levels of U.S. Treasury rates suggest a higher P/E multiple is justified. Ten-year yields should remain around 1% until investors have more confidence in the outlook for immunity; however, additional positive developments, such as the success of the JNJ trial, could provide a clearer path to an increase in 10-year yields. If yields breakout, Value stocks will continue to move higher relative to Growth, as has been the case over the past 3 months, but stock picking and broader themes would then replace factor trends.

In the actively managed internal equity strategies, we continue to focus on companies with distinct advantaged business models and longer-term secular opportunities, making changes in accordance with the style, risk, and reward objectives for each individual strategy. We continue to favor advantaged companies with secular growth opportunities, strong balance sheets, high free cash flow generation, and capital flexibility. Advantaged businesses are uniquely positioned to emerge as stronger competitors over the longer term as well as weather severe economic challenges. We believe 2021 will be another year where active management and stock selection become important differentiators.

FIXED INCOME OUTLOOK

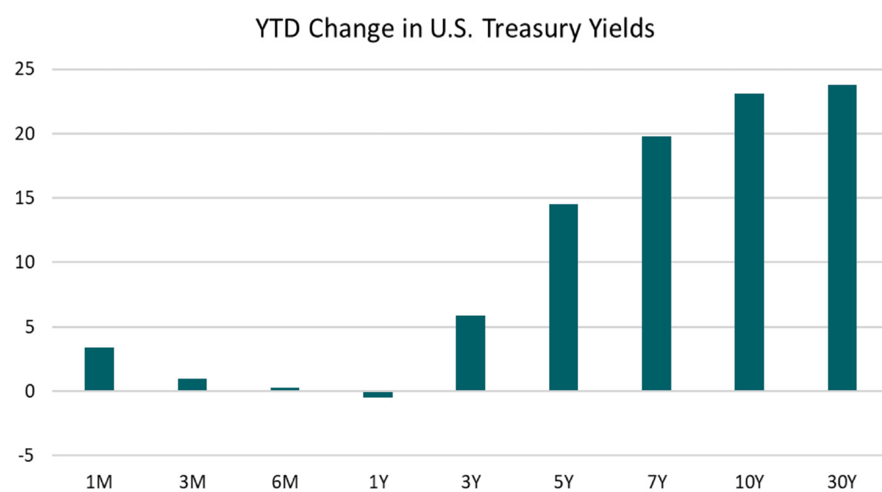
While the pandemic was clearly unprecedented, the monetary policy response from central banks was also extraordinary. Globally, central banks cut policy rates over 150 times (net) during the course of the year, and a number of QE programs were either implemented or increased. In the U.S., the Federal Reserve cut its policy rate to near zero and signaled its intention to keep interest rates low for an extended period of time. It also reintroduced purchases of U.S. Treasury bonds and agency mortgages as well as introduced new programs which would allow the purchase of corporate and municipal bonds. This policy supernova supported the liquidity and function of financial markets and laid the groundwork for the significant rally.

In August, the Fed announced a new policy framework, suggesting it will not increase its policy rate until inflation exceeds 2% for a period of time and the shortfall from full employment is eliminated. The main impact of these changes has been to solidify expectations that the policy rate will remain in its current 0-0.25% range through 2023. While we agree with the outlook that the Fed will remain accommodative, this is very much the consensus forecast, and markets are heavily priced for this outcome. This one-sided positioning increases the fallout that can result from a communication error by the Fed that either changes expectations for the timing of rate hikes or the pace of asset purchases.

Mounting debt loads and extraordinarily easy monetary policy have led to concerns about inflation. While we expect a bounce in inflation readings next spring, the higher reading will be driven by the low-base effect this past spring as a result of the collapse in prices (particularly oil) as the global economy shutdown. Despite a potential bounce, our base case remains that inflation remains modest due to a combination trends that were already in place before the pandemic – aging demographics and technological advancements – as well as elevated unemployment and other structural economic slack caused by the pandemic. There is a risk that investors confuse a higher inflation reading as the start of a more pronounced move, resulting in a risk-off move, with the market pulling rate-hike expectations forward and long-dated yields repricing higher. We would view such a selloff as temporary and an opportunity to take advantage of dislocations that are created.

Portfolio Positioning: We continue to see a steepening trend in the yield curve, with the 3m/10y curve increasing by more than 20 basis points over the first two weeks of the year. With the Fed anchoring short-dated yields by maintaining very accommodative policy rates over the next several years, there is scope for the yield curve to continue to steepen. While our expectation is for an improving economic environment, uncertainties remain, and periods of volatility are possible. Even with U.S. Treasury yields at low levels, we believe they continue to offer protection and, importantly, provide a source of liquidity during risk-off periods that can be used to take advantage of market dislocations. We believe the intermediate-maturity (5-7 year) portion of the curve is the most attractive.

Investment grade corporate bonds have staged a remarkable rally since the low point in March. The initial rally was sparked by the announcement that the Federal Reserve was taking a number of actions to support financial markets. By the end of December, the credit risk premium for owning corporate bonds



Source: Bloomberg as of 1.12.21

(known as 'spread') had returned to nearly exactly the same level as last December 2019. Over the coming year, a rebound in economic growth, supportive monetary policy, lighter issuance, and strong demand from overseas investors should be supportive of corporate bonds.

The U.S. investment grade market is one of the few places in the global bond market where investors are able to find a positive yield. Interestingly, for many foreign investors, the yield on U.S. corporate bonds is currently higher than it was at the end of 2019, largely due to the sizeable decline in currency hedging costs. On the other hand, current valuations have already priced in a lot of good news, and corporate fundamentals have weakened since the end of last year. Combined, these factors have created a gap between fundamental credit risk and the risk premium investors are receiving.

On aggregate, we expect the risk premium, or credit spread, to grind tighter; however, the vast majority of the performance for the sector is expected to come from income and roll down, since Treasury yields are already very low. Our focus remains on companies with sound – and ideally improving – balance sheets and the ability to generate strong free-cash-flow. As we emerge from the pandemic, we are watching for shareholder friendly and/or M&A activity from this year's best performing sectors, such as technology and healthcare. The risk is a tradeoff of balance sheet deterioration at a time when these issuers may be trading at expensive valuations. Conversely, as investor confidence grows about the ability of the economy to reopen, the large valuation gap between the broader market and the sectors most disrupted by the virus should gradually close. From a ratings perspective, we expect the BBB-rated portion of the market to outperform, driven by improving fundamentals and a reach for yield. The reach-for-yield theme should also benefit the high yield market. The fact that many bonds within the market already trade at their call price means that price appreciation will be limited. The majority of returns will be driven by the coupon income.

Municipal (muni) bonds moved into the spotlight in March, as the pandemic essentially severely impacted state and local revenues and lead some market commentators to warn of dire outcomes for the sector. While investor concerns did result in price declines in March and April, the underlying credit quality of most issuers remained strong. This resiliency was largely due to the sizable 'rainy day' funds many state and local governments built following several years of conservative budgeting. The combination of the Fed's Municipal Liquidity Facility (MLF), which provided a liquidity backstop for issuers, and fiscal stimulus support provided through the CARES Act, eased investor concerns and helped spark a significant recovery during the summer.

The performance of the tax-exempt muni market was further supported by the lack of new supply as issuers tapped the taxable municipal market instead. The preference to utilize the taxable market was due to changes in the tax code in the 2017 Tax Cut and Jobs Act, which limited the ability to advance-refund debt in the tax-exempt market. Muni bond markets will be more impacted by the negotiations in Washington than other sectors of the bond market, particularly around future fiscal stimulus programs. We expect the news that the U.S. Treasury would not extend the MLF beyond the end of 2020 will have a very limited impact on the market. While the MLF did initially provide a key backstop to the market, only two issuers (the State of Illinois and the New York Metropolitan Transportation Authority) accessed the facility. The current strength in tax collections and the lack of utilization signal that the muni market has been able to provide sufficient liquidity without assistance from this program.

Our focus remains on high-quality general obligation bonds that benefit from the taxing power of the municipality and essential service revenue bond sectors – those backed by utilities, such as water and sewer. Most utilities tend to have significant liquidity, the ability to raise rates, and strong operational and financial performance throughout the business cycle. This is due to the fact that their services are 'essential' and their structures are monopolistic. Similar to corporate bonds, we expect the majority of returns in 2021 to come from income and roll down. Municipal valuations have returned to a level where they are now more expensive than their long-term averages as a percentage of U.S. Treasury yields.

The non-agency mortgage market experienced three significant shocks during the year. The first was the fallout from economic lockdown measures and financial market volatility. As the unemployment rate spiked sharply, investors became concerned whether housing would experience losses similar to the financial crisis. However, the backdrop in 2020 is significantly different than during the 2007-08 period. Second, the market volatility during March forced several highly-leveraged mortgage REITs to sell securities to meet margin calls. This compelled selling activity in an asset class with a more limited buyer base resulted in a sharp decline in prices. Finally, the sector was not included in any of the Fed's asset purchase programs. The absence of Fed support, in combination with the fact that the sector naturally has a smaller number of activity participants (due to the complexities of accessing the underlying mortgage pools), has meant the sector has lagged the sharp recoveries experienced by other areas of the bond markets. Looking forward, we believe non-agency MBS offer one of the most compelling valuations across the fixed income market.

Unlike non-agency mortgages, agency commercial mortgage-backed securities (CMBS) have been one of the best performing sectors, benefitting from healthy fundamentals and support from the Fed. Our focus within agency CMBS is on the senior tranches of multi-family (apartment) housing. These securities receive a full faith and credit guarantee of the issuing agency (either Fannie Mae or Freddie Mac) and offer an attractive source of yield and diversification from corporate credit. While valuations are less compelling than they were at the start of the year, limited new-issue supply, combined with the search for high-quality sources of yield, will continue to support the sector.

Despite the challenging economic backdrop in 2020, most U.S. banks have remained profitable and have also built sizable reserves against potential future loan losses. Regulatory actions have helped improve already strong fundamentals, as the ability to return capital to shareholders (in the form of dividends or share buybacks) has been curtailed. Supply and demand technicals are also solid as most banks have already met capital requirements. Although there will be new issuance as legacy securities are called, we expect net new supply to remain low. This trend, coupled with strong demand from yield-seeking investors, implies a supportive technical backdrop. Lastly, valuations have recovered substantially from the lows in March, including a strong rally in the fourth quarter. The current yield spread over U.S. Treasurys, and most other sectors of fixed income, is now close to fair value.

Our view for emerging market debt has become more favorable, as we believe the sector will benefit from stronger global growth, easy global monetary policy, and more predictable U.S. trade policies. In addition, the combination of less demand for safe-haven assets, such as the U.S. dollar, as economic growth improves and the reduction in interest rate differentials between the U.S. and other countries suggests a weaker U.S. dollar, which is beneficial for emerging market debt.

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