Third Quarter 2021

Market Outlook

Outlook Summary

The first half of 2021 largely continued the optimism that characterized the end of 2020, as hopes for a successful conclusion to the pandemic increased and drove most risk asset categories higher. Looking forward to the second half of 2021, we believe several topics will take center stage: increased scrutiny on the U.S. Federal Reserve and potential changes to the path for interest rates and quantitative easing, supply chain disruptions and the potential for increased inflation, the ongoing global recovery from Covid-19, and possible tax hikes out of Washington, D.C. While we believe economic and corporate fundamentals will continue to improve in 2021 and beyond, we are mindful that the emergence of unknown risks often have the largest impacts on financial markets.

For the fifth consecutive quarter since bottoming in March 2020, global equities posted strong gains as the world continued its recovery from the Covid-19 pandemic. For the first half of the year, the S&P 500 Index gained +15.3%,, developed international markets (MSCI ACWI ex-U.S.) increased +9.4%, and emerging market stocks added +7.6%.

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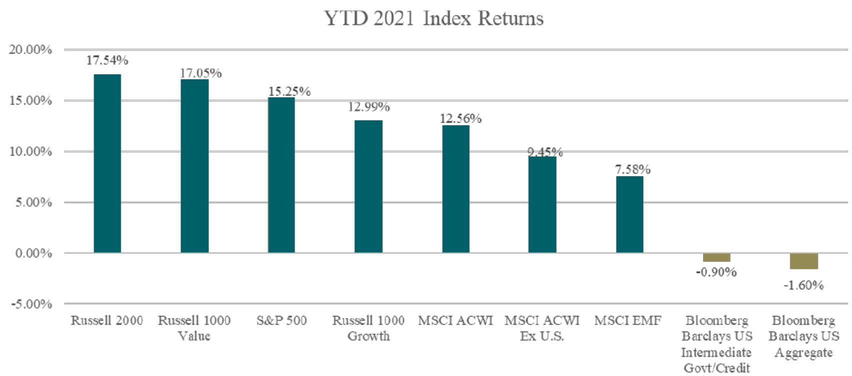


Source: FactSet 6.30.21

Despite underperforming larger counterparts in the second quarter, smaller U.S. stocks continue to lead on a year-to-date basis. For the first half of 2021, the U.S. S&P 400 mid cap index advanced +17.6%, and the small cap Russell 2000 added +17.5%. Similarly, growth stocks outperformed value counterparts in the second quarter, but the Russell 1000 Value Index maintained its 2021 outperformance, gaining +17.1% in the first half of the year versus +13.0% for the Russell 1000 Growth Index.

As U.S. Treasury rates drifted lower during the second quarter, total returns were broadly positive across fixed income for the period. However, on a year-to-date basis, fixed income indices largely remained negative. The benchmark Bloomberg Barclays U.S. Aggregate Bond Index declined -1.6% for the first half of the year with the Bloomberg Barclays U.S. Intermediate Govt. Index down -0.9% and the U.S. Corporate Investment-Grade Index down -1.3% over the same period. The High Yield Bond Index increased +3.6%, and U.S. Preferreds rose +4.3% during the first six months of 2021.

In other asset classes, Commodities continued their torrid pace, as the Bloomberg Commodity Index gained +21.2% in the first half of the year. Likewise, Real Estate equities performed strongly, advancing +14.3% on a year-to-date basis.

In equities, continued success with vaccine distribution and administration, aided by fiscal and monetary policy support, is driving corporate earnings growth acceleration – a key to additional upside for global stock markets. For full-years 2021 and 2022, consensus, bottom-up S&P 500 estimates have moved significantly higher and imply a broad overall economic recovery. For the second half of 2021, we expect higher volatility to accompany the ongoing economic recovery, as risks including supply chain disruptions, inflation, U.S./China geopolitical tensions, and tax increases potentially challenge equity valuations. However, we remain constructive overall on the global equity environment.

While the potential for a period of elevated inflation has increased, we still favor several areas of the fixed income universe. Within corporate credit, we continue to find investment grade corporates attractive relative to low government bond yields, preferring select BBB rated credits due to the appealing yield pickup and leverage to the economic recovery. We also remain constructive on collateralized loan obligations (CLOs), non-agency mortgage-backed securities (MBS), and bank-issued preferred securities.

ECONOMICS

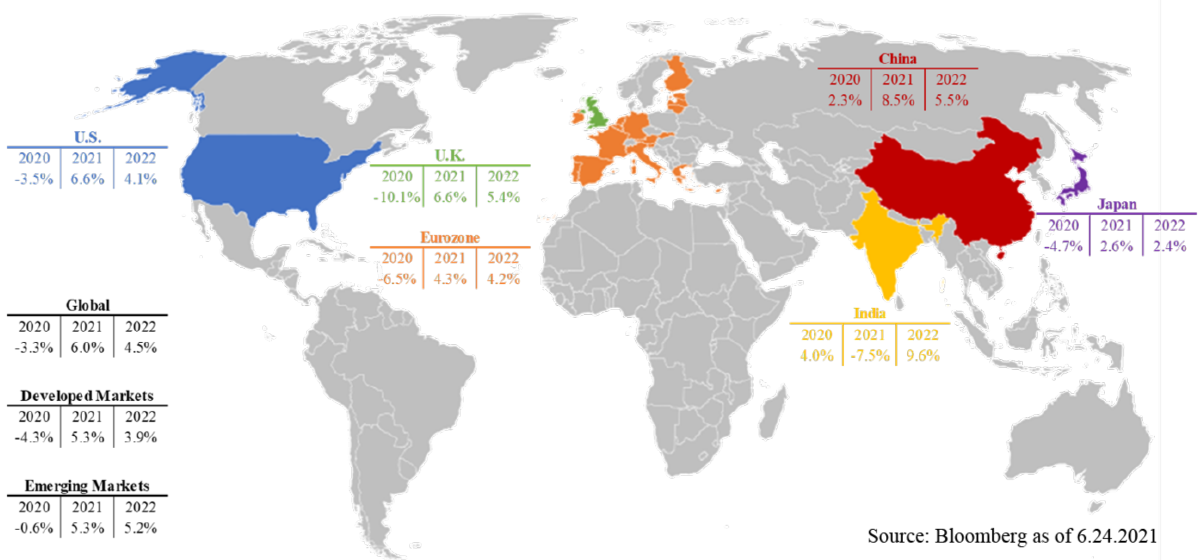
In the U.S., stimulus and vaccine progress have driven robust economic growth. As of June 30, over 47% of Americans have been fully vaccinated against Covid-19, resulting in steady declines in cases and subsequently allowing for an easing of mobility and social distancing restrictions. The reopening of the economy has been met with a surge in demand for goods, and, more recently, for services powered by U.S. household savings rates, which are at record levels. High frequency data, such as the sharp increase in airline passengers, highlights the desire of consumers to return to pre-pandemic activities.

Tied to the reopening of the economy has been a spike in inflation. Temporary shortages of materials, transportation (shipping) and supply chain disruptions, and labor shortages have all put upward pressure on inflation readings. Our base case remains for inflation to settle back to a more subdued rate, which is in line with its longer-term trend, towards the end of this year. Many of the structural headwinds, such as demographics, high debt levels, and the impact of technology remain in place and, in certain cases, have become even more pronounced as a result of the pandemic.

The strength of the labor market is key to the economic expansion, and, thus far, the recovery in employment has been relatively sluggish. While the economy has recovered around 14.8 million jobs, payrolls are still more than 7.5 million shy of pre-pandemic levels. A variety of labor market indicators point to challenges employers are having in finding workers. There appears to be a confluence of factors, including generous unemployment benefits, childcare obligations, and lingering health concerns, which have resulted in the shortage of workers. However, these hurdles should fade as the summer progresses with supplemental unemployment benefits scheduled to expire on Labor Day (some states have elected to end it sooner) and a decline in cases allowing schools to reopen, alleviating fears around the virus.

Overall, U.S. growth looks to be significantly above trend in 2021, driven by vaccinations, falling business restrictions, abundant household savings, and continued supportive fiscal and monetary policy. For the full year, the majority of participants in Bloomberg's survey of economists have revised their growth estimates higher, with a median forecast of 6.6% in the June survey, up from 5.7% in the March survey. Economic growth of 5.5%, or above, would be the highest growth rate since 1984.

Global GDP Forecasts



Source: Bloomberg as of 6.24.2021

After a slow start, the pace of vaccine distribution in Europe has improved meaningfully, and many restrictions on mobility and travel are now being relaxed. As the European economy continues to reopen, activity should see a meaningful boost with consumer spending supported by pent-up demand and accumulated excess savings. Economic growth in the second half of the year will be further supported by fiscal policy both at the country and European Union level. Longer term, the question is whether or not Europe will be able to exceed its sluggish growth rate of the past decade. While demographics will continue to weigh on economic growth, there is optimism that private and public investment may result in moderately higher growth rates.

Japan's state of emergency has been effective in reducing the number of new virus cases and provided some time to ramp up vaccinations. However, it also has set the country on course for a second consecutive quarterly contraction in economic activity. An additional lockdown has had a meaningful impact on private consumption, which has declined sharply during the first half of the year. The strength of external demand has been a bright spot, with machinery orders showing a sizeable increase. Growth should pick up in the second half of the year as the vaccine rollout finally appears to be gaining momentum.

Thanks to effective containment measures, the Chinese economy recovered swiftly from the pandemic and has largely returned to its trend growth rate. The manufacturing sector has been the driver of growth and has benefitted from strong export demand. However, sequential economic growth has likely peaked and will continue to slow over the remainder of the year. A key factor for Chinese growth will be the extent to which the rotation in demand from goods to services (travel, leisure, etc.) in the developed markets will weigh on global trade. Beijing's policy normalization will also become less of a tailwind to growth.

The economic recovery in emerging markets (ex-China) continues to lag as vaccination rates remain low. However, the outlook is far from uniform. India and Brazil were both forced to place restrictions on mobility – negatively impacting economic growth – due to severe virus outbreaks during the first half of the year. Conversely, other emerging markets experienced robust economic activity, significantly benefiting from a global recovery. The stimulus-fueled boom in U.S. demand has supported parts of Asia. Meanwhile, commodity exporting countries have had the tailwind of higher prices.

Overall, the global economy appears to be on track for above-trend growth as it rebounds from the pandemic, with the median forecast for 6% (global) growth this year. So far, the U.S. and China have played outsized roles in the recovery. However, over the remainder of the year, the expectation is for the recovery to become more broad-based, with Europe and a growing number of emerging markets countries re-opening and experiencing subsequent rebounds in growth.

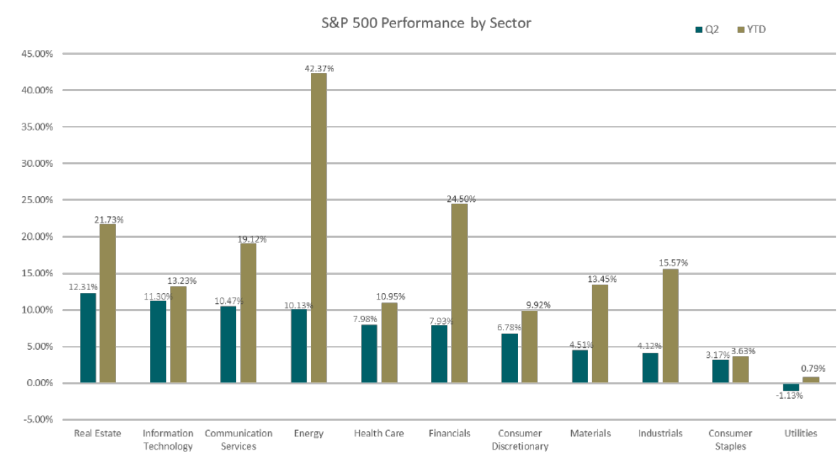
As the pandemic reminded us, the future is uncertain, and risks always exist. As we look ahead, the most obvious risks are related to the virus. At the current vaccination pace, it will take years to achieve a significant global immunity level, raising the potential for virus variants to render the vaccines less effective. Other risks that we are closely monitoring include the potential for a sustained period of higher inflation, a policy and/or miscommunication error from the Fed, cyberattacks, and China-U.S. tensions. We are also aware that there are many unknown risks, and it is often the emergence of these risks that have the largest impact on financial markets. Therefore, we remain vigilant to the changing macro environment and evaluate these evolving factors to understand their impact on financial markets and investment portfolios.

EQUITY MARKET OUTLOOK

The benchmark S&P 500 gained +8.5% in the second quarter of 2021, the fifth consecutive quarter of positive performance and the continuation of a +96.1% rally from the index's pandemic-fueled low on March 23, 2020. Smaller U.S. stocks trailed their larger counterparts during the period but still delivered gains, as the mid cap S&P 400 and small cap Russell 2000 gained +3.6% and +4.3%, respectively. International stocks also participated in the move higher; the MSCI ACWI ex-U.S. index gained +5.6% for the second quarter, while the MSCI Emerging Market Index was up +5.1%. The Chinese Shenzhen A Share Index and Brazilian Bovespa led major international markets, while the Japanese Nikkei 225 and German DAX indices were the laggards.

Ten of eleven S&P 500 sectors posted positive returns during the second quarter (Utilities was the exception), and, once again, performance varied significantly. The well-worn "growth versus value" theme continued to linger as a popular discussion topic amongst financial press, and while the Russell 1000 Growth Index (+11.9% for the June quarter) outperformed the Russell 1000 Value counterpart (+5.2%), there was a broadening of performance that did not always follow conventional wisdom. Although traditionally growth-dominated sectors such as Technology (+11.6%) and Communication Services (+10.7%) delivered better performance than the broader benchmark, so too did Real Estate (+13.1%) and Energy (+11.3%), which are generally more cyclically sensitive. Two of the three largest holdings in the S&P 500, Apple and Amazon, both underperformed the S&P 500, another indicator of widening performance driving stock indices higher.

The actively managed FSP equity strategies are concentrated large-cap strategies, all benchmarked to the S&P 500, with a variety of style tilts as well as risk, return, and income profiles. Our investment process is anchored by identifying businesses in all sectors with sustainable structural, competitive, and/or economic advantages with attractive valuations and does not focus on a simple "growth versus value" framework. We are opportunistic when there are dislocations in the market. For example, during the beginning of the 2020 downturn, we added a number of companies with limited short-term fundamental visibility but had a strong history of successfully navigating downturns and investing in their businesses to emerge as stronger



Source: FactSet 6.30.2021

competitors. Subsequently, we added a few additional companies with more economic sensitivity to the recovery. Most recently, we have incrementally added a few "direct recovery" and "expansion phase" beneficiaries to portfolios; these include businesses that should see a direct lift in revenues and earnings from consumer and corporate activity during the reopening phase of the global expansion. Importantly, these are all companies that meet our definition of an advantaged business and, in several cases, were owned prior to the pandemic.

What to Expect Going Forward in 2021

Since the winter of 2020, the single most important determinant to global economic growth and corporate profitability has been the path of the Covid-19 pandemic and its eventual resolution. Dangerous conditions remain in some parts of the world, as the more-infectious Delta variant has led to noteworthy rises in cases and deaths, particularly in geographies such as India, Brazil, and Indonesia where vaccine distribution and administration rates have lagged.

However, the situation is far different in the U.S., U.K., and much of Western Europe, where vaccination rates have trended much higher. According to Bloomberg, as of the end of the second quarter, more than 3 billion doses had been administered across 180 countries at a then-current rate of 36.6 million doses a day. An estimated 55% of the U.S. population has received at least one dose, and 47% can be considered "fully vaccinated." Other developed peers are quickly moving to similar levels – the U.K. has 51% of its population fully vaccinated with the broader European Union at 36%. Evidence of the impact on vaccinations and reopening can be viewed in economic data – those areas with higher vaccination rates are forecasted to grow GDP faster than many emerging markets. In addition, higher frequency data such as commercial airline passengers, restaurant reservation bookings, and ride-hailing activity suggest that the pent-up consumer demand has indeed materialized. We continue to believe successful implementation and administration of Covid-19 vaccines remains the key to the end of the pandemic and the return to coordinated global economic growth.

Similar to the forecasts for economic growth and consumer spending, expectations for corporate profitability continue to improve at a stunning rate. According to FactSet, a record 86% of S&P 500 companies reported better-than-expected EPS in the first quarter of 2021 with 76% reporting higher-than-expected revenue results. A record number of companies have issued positive EPS guidance for the second quarter of 2021. For full-year 2021, the consensus, bottom-up estimate S&P 500 EPS has moved from $165 to begin the year to over $189 as of the end of the second quarter. For 2022, the consensus estimate continues to rise as well, up from $193 on December 31 to over $211 on June 30. Importantly, earnings estimates for most S&P 500 sectors are moving higher, indicating a broad overall recovery. While the average P/E multiple on next-twelve-month S&P 500 EPS (21.5x) remains elevated versus its longer-term average of 16.7x, we believe the combination of the absolute low levels of U.S. Treasury yields and historically improving U.S. earnings growth justifies above-average valuations at the current time.

Unfortunately, the rising threat of inflation has accompanied the progress to move beyond the Covid-19 experience. Never before in modern times has the U.S. or a majority of the developed world voluntarily shut down much of its economic output and overall activity to deal with the fallout from a global pandemic. With the reopening process in or near full bloom in many of those geographies, inflation worries have grown in several areas. Supply chains remain stretched in many areas; for example, semiconductor shortages have impacted production of items ranging from automobiles to washing machines. Commodity prices have spiked in a variety of items including copper, lumber, crude oil, and more. Container ship congestion around the globe has led to exporters and importers scrambling for increasingly scarce vessels. Finally, wage inflation has emerged in the U.S. due to a variety of factors, including greatly extended federal unemployment benefits. We believe a majority of these inflation pressures are largely transitory in nature rather than structural; however, we will be watching closely for signs that any of these inflationary forces prove more permanent and potentially compress corporate profit margins and reduce consumer spending.

We continue to monitor other risks to both economic growth and equity market strength. U.S./China geopolitical tensions continue to simmer, as President Joe Biden recently signed an executive order expanding previous bans on U.S. investment in Chinese companies with links to China's military. Earlier this year, the U.S. Securities and Exchange Commission adopted the Holding Foreign Companies Accountable Act that requires auditing by a U.S. "watchdog" and the submission of documents to establish that companies are not owned or controlled by a government entity in a foreign jurisdiction. China answered back with an "anti-foreign sanctions law" that attempts to force companies with operations in both markets to choose between complying with either country's sanctions. Finally, concerns over Taiwan will continue to linger given the fundamental disagreement over the island's long-term status.

Another potential headwind for U.S. stocks could be in the form of higher corporate and individual taxes. In late March, President Biden announced the "American Jobs Plan," an ambitious effort that targets improving the nation's infrastructure. In order to fund the $2 trillion package, the administration intends to raise taxes – namely, moving the corporate tax rate from 21% to 28%, adding a global minimum tax of 21% on multinational income overseas, and ending existing tax deductions for fossil fuels companies. On the individual side, the Biden proposal's most notable change, among many, would be a potentially significant increase in capital gains taxation, including raising the top long-term capital gains tax to 39.6% from 20% for Americans earning more than $1 million.

FSP Asset Allocation and Internal Equity Strategies

During the second quarter of 2021, the FSP Investment Policy Committee made no significant changes to the firm's asset allocations. However, we did prudently rebalance client portfolios, which involves selling asset classes that have outperformed and buying underperformers toward longer-term strategic targets. These are incremental steps, taken carefully as liquidity allows.

Within FSP, we actively manage five primary large cap equity strategies with a range of return and risk objectives that represent style tilts to the S&P 500 benchmark – Strategic Growth, Partners Advantaged, Equity Income, Growth & Income, and Sustainable, Responsible Equity. Growth & Income uses a barbell approach, combining stocks from our core growth-oriented strategy (Strategic Growth) with our core value conservative strategy (Equity Income); and Sustainable, Responsible strategy is a thematic environmental, social, and governance (ESG) approach to our Partners strategy.

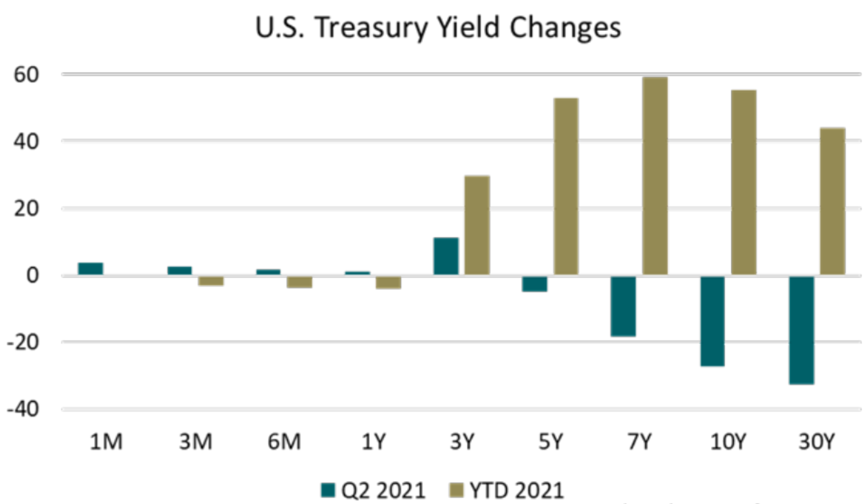
In the actively managed, internal equity strategies, we continue to focus on companies with distinct advantaged business models and longer-term secular opportunities, making changes in accordance with the style, risk, and reward objectives for each individual strategy. We continue to favor advantaged companies with secular growth opportunities, strong balance sheets, high free cash flow generation, and capital flexibility, strongly believing that advantaged businesses are uniquely positioned to emerge as stronger competitors over the longer term. We remain mindful that early-cycle beneficiaries are likely to continue to outperform growth sectors over the next few quarters due to extreme year-over-year expansion in depressed revenue and earnings over 2020 levels. However, we are not making wholesale changes to portfolio holdings and will be looking for attractive entry opportunities into growth companies in which longer-term secular growth trends are very compelling.

FIXED INCOME OUTLOOK

As the economy continues to reopen and strengthen in the midst of fiscal stimulus and historically accommodative monetary policies, the Fed's actions and communications become even more important for the assessment of financial conditions and the outlook for inflation, as investors look for any signals that the Fed may be closer to either raising rates or reducing its balance sheet. At the June FOMC meeting, the committee left rates unchanged at a range of 0-0.25%. However, the Fed delivered a surprise in its Summary of Economic Projections (SEP), with the median projected path for the policy rate now forecasting two hikes in 2023, compared to an expectation for no hikes following the March meeting.

This change in outlook suggests that the committee is putting more emphasis on the upside inflation surprises rather than on the downside surprises in employment. Interestingly, despite the more hawkish outlook for the policy rate, the SEP showed almost no change in 2023 core inflation projections. The shift suggests the FOMC is taking a more backward-looking approach to average inflation targeting than most market participants assumed. The SEP showed substantially higher median projections for 2021, with GDP growth up 0.5% to 7.0%, core inflation up 0.8% to 3.0%, and headline inflation up 1.0% to 3.4%. In terms of balance sheet reduction, Chairman Powell acknowledged that the FOMC had been "talking about talking about" tapering at the June meeting. We expect more details on tapering to come over the course of the fall but for the actual tapering of asset purchases to not begin until next year.

After increasing by 83 bps during the first quarter, U.S. Treasury rates have drifted lower during the second quarter, with the 10-year yield up by less than 60 bps year-to-date. In 2018, a yield of 3% on the 10-year Treasury note was the maximum sustainable rate level, in part due to government debt levels. The massive debt expansion due to Covid relief packages suggests that the maximum sustainable debt level has likely dropped to below 3%.



Source: Bloomberg as of 6.30.21

Fixed income investors are keeping a watchful eye on inflation as they position for the second half of 2021 and beyond. We believe elevated inflation – driven by supply-chain bottlenecks, labor shortages, and related supply/demand imbalances – will ultimately prove transitory, especially as fiscal stimulus begins to wind down. However, we acknowledge that the potential for a more prolonged period of elevated inflation has increased. The drivers of this view are the prospects for more persistent fiscal stimulus, a reset higher of inflation expectations, and the shift towards ESG considerations by companies and governments, which could result in more fiscal stimulus to implement changes, and, in turn, result in higher costs for certain assets and services.

Investment grade (IG) spreads continued to compress during the quarter. The sector has been supported by a strong economy, fiscal and monetary stimulus, and demand from overseas investors. In addition, company fundamentals and credit rating trends have also improved, adding further support. However, current valuations have already priced in much of the good news. On an absolute basis, credit spreads are already at the tightest levels since 2007, and valuations appear even more stretched after adjusting for the longer duration and lower credit quality metrics of the market today compared to 2007. While valuations are not in themselves a correction catalyst, they do frame the risk-return skew.

Overall, we continue to find IG corporates relatively attractive in the context of very low global government bond yields. At an asset-class level, additional spread compression will be limited and, therefore, the majority of returns will come from coupon income. However, at a more granular level, we do continue to find pockets of opportunities in certain sectors and issuers that possess the potential for additional spread tightening. At a ratings level, the yield pickup in BBB rated bonds is still attractive relative to higher-rated bonds. In addition to the appealing yield pickup, BBB rated companies will be more levered to the economic recovery and will be less likely to pursue shareholder-friendly activities.

The reach-for-yield theme should also benefit the high yield (HY) market. While high yield spreads are at their lowest level since 2007, lower interest rates should continue to create demand for the asset class; however, valuations are elevated, and many HY bonds trade at or above their call price, meaning that the majority of returns, on aggregate, will come from income.

Year to date, collateralized loan obligations (CLOs) have been among the best-performing sectors across fixed income. The sector has benefitted from price appreciation as spreads have tightened and total returns have not been impacted by the rise in long-term Treasury yields due to their floating-rate structure. While the scope for additional spread tightening in the near term appears limited, we continue to think CLOs offer attractive relative value, given their attractive yields and low interest rate risk.

Municipal bond valuations remain historically rich, with 10Y AAA yields at only 67% of U.S. Treasury yields. However, fundamentals for the asset class remain sound. The U.S. Treasury recently began to disburse a portion of the $350 billion in federal aid to state and local governments under the American Rescue Plan. These funds will provide a significant boost to state budgets and will increase infrastructure investment over this year and next. Technicals in the municipal bond market also remain strong with the market benefitting from robust demand for tax shelters (which could increase) and a large net-negative supply environment in which reinvestment income – calls, coupons, and maturities – outpace new issuance. Within the muni market, our focus remains on high-quality, general obligation bonds, which benefit from the taxing power of the municipality and essential service revenue bond sectors – those backed by utilities, such as water and sewer.

Mortgage fundamentals continue to strengthen as national home prices were up over 13% over the past year, fueled by record-low mortgage rates and historically low housing supply. We continue to view non-agency mortgages as offering one of the most attractive risk-adjusted return profiles within the fixed income market. However, the Fed's asset purchase program and strong demand from banks has pushed valuations in the agency residential and commercial mortgage sectors to very expensive valuations, making these sectors unattractive.

Year-to-date, preferreds have been one of been one of the best-performing sectors across fixed income markets. Net supply in the preferred market has been essentially zero, with issuance driven almost entirely by refinancing activity as banks have called high-cost preferreds and issued new lower-coupon preferreds, reflecting the low rate environment and tight credit spreads. Call activity has also allowed banks to redeem preferreds that had floating-rate components tied to Libor, which will not be reported after June 2023. The floating-rate component (if there is one) on newly issued preferreds are now most commonly being tied to 5-year Constant Maturity Treasury (CMT).

Bank fundamentals continue to be robust, which remains supportive of moving down the capital structure. Banks more than doubled their loan loss reserves in 2020, in anticipation of higher losses that never materialized, and capital ratios remain near all-time highs. Relative to BB rated high yield bond, preferreds offer an attractive pick-up in yield, lower interest-rate sensitivity, and are issued by companies with strong balance sheets.

A matter we are following closely is what impact tax reform may have on the preferred market. The proposed tax plan would effectively eliminate the lower qualified dividend income (QDI) tax rate, which could lead to lower demand for preferreds from investors in high tax brackets. The outcome of tax reform remains highly uncertain, but all else equal, we would expect any changes to QDI rules to more adversely impact the $25 par preferred market relative to the $1,000 par market.

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