2021 Mid-Year Update

NORTHEAST SEQUOIA
PRIVATE CLIENT GROUP

Simply Unprecedented

June 30, 2021

Overview

- Our 2021 Outlook, entitled "Hope Over Despair," outlined our prologue for a post-COVID world. And thus far through 2021, our optimistic stance has triumphed over our doubts and fears.
- While quite a few of our prognostications are coming to fruition, we were surprised about how several economic and capital market trends evolved. In hindsight, the unprecedented circumstances surrounding a global pandemic changed our present and future in unexpected ways.
- Our optimistic view supporting market resilience, in our opinion, is based on a capital market and economic outlook dynamic that relies on four key trends including:
  - ❑ The global economy is only mid-way through a re-opening trade, and several economies are at the precipice of a new economic cycle. Positive COVID trends, a lull in geopolitical uncertainty, and unprecedented fiscal and monetary stimulus have combined to help support risk assets.
  - ❑ Inflation prospects will remain transitory through 2023.
  - ❑ Interest rates will rise only modestly and at a predictable rate.
  - ❑ Stripped-down versions of President Biden's tax reform and "Build Back Better" recovery plan gains bipartisan support, including support for infrastructure investment.
- We are increasing our near-term S&P 500 expectation driven by our earnings-yield framework. Based on an earnings expectation of $205 per share and an assumed multiple of 21.7x, we believe there could be as much as 18% upside in the S&P for 2021, albeit not without modest and healthy corrective moves over the next few months.
- Still, risks remain, which may cause some near-term volatility and a modest retracement in the equity markets, which we view as a buying opportunity**.** The greatest risk, in our opinion, is the negative impact of QE tapering, which should become more apparent following the next FOMC meeting (late July).

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Executive Summary

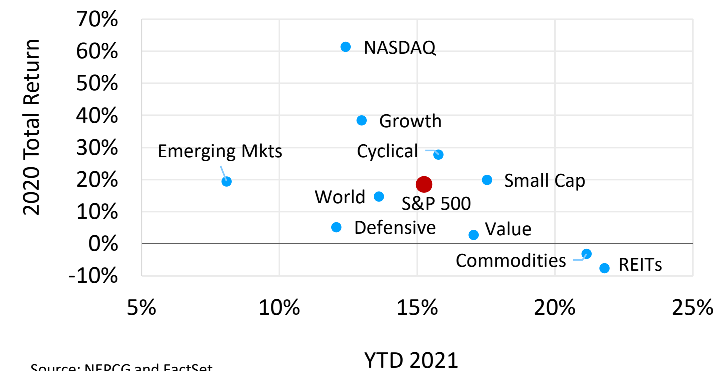
- The S&P closed on June 30, 2021, at $4,297, representing a total return of 12.6% year-to-date, roughly 5% higher than our original 2021 expectation.
- While our expectation for Value and REITs to outperform came true YTD, we were surprised at how robust Commodities performed. However, a fierce re-boot of global supply chains, combined with low interest rates, drove the demand for manufacturing goods, particularly housing and housing-related goods.
- Our 2021 Outlook suggested that bond investors should consider buying credit risk over interest rate (duration) risk, a prognostication that came true thus far through 2021. However, over the last three months, duration has outperformed credit as investors may be siding with the Fed's view of transitory inflation. Hence, the probability of higher interest rates is diminishing.
- Like many institutions and individual investors, we underestimated the unprecedented use of fiscal and monetary stimulus to stem the disruption resulting from COVID-19. As a result, several economic data exhibited a "V" recovery, which supports equity and fixed-income markets to this day.
- We believe the U.S. economy is at the precipice of a new economic cycle, supported by pent-up consumer demand, a recovering job market, an outsized savings rate, positive vaccination/therapeutic trends, and unprecedented fiscal and monetary stimulus.
- As we pointed out in our November 20, 2020, note entitled, "*One Step Up And Two Steps Back*," we suggested that based on research gathered by the Milken Institute, it was a matter of when not if COVID will be defeated. As of July 4, 2021, according to Our World In Data, roughly 25% of the world's population have received at least one vaccination, and approximately 55% of U.S. citizens have received one vaccination.
- We anticipate overall geopolitical and U.S. policy risks to remain in check for the remainder of 2021, which could help to limit equity volatility and support stock and bond valuations.
- The FOMC publicly acknowledged the presence of inflation, which is hard to ignore given the recent trend in the Fed's preferred inflation measure, Core PCE. Still, the FOMC continues to state inflation prospects are transitory and will recede.
- One of the most significant risks, in our opinion, is a policy mistake by the Federal Reserve. However, about 65% of the FOMC voting members for 2021 are "dovish," followed by 55% in 2022. As a result, we believe the "fix is in," thus limiting the magnitude of rate increases.
- Corporate earnings proved to be surprisingly resilient during the recent global recession. Compared to the Great Financial Crisis (GFC) of 2007-2009, S&P 500 earnings contracted less, helping support a robust equity recovery.
- The disruptive nature of COVID dislocated historical equity style/sector relationships. Extraordinarily low interest rates and the persistent purchase of mortgage-backed securities (MBS) by the FOMC helped drive housing prices higher. Combined with a re-boot of the global economy, we can now fully rationalize the outperformance of typically Bear Flattener sectors and styles such as Energy, Real Estate, and Commodities.
- We are increasing our near-term S&P 500 expectation driven by our earnings-yield framework, and now believe there could be as much as 18% of upside in 2021 albeit not without modest and healthy corrective moves over the next few months.
- Still risks remain, including a Federal Reserve policy mistake, the resurgence in COVID cases/variants globally, an increase in geopolicital uncertainty, higher than expected taxes and disappointing and/or a lack of bipartisan legislation.

Performance Review

Hindsight Is 20/20 Or 42/97 Thus Far In 2021

- On June 30, 2021, the S&P closed at $4,297, representing a year-to-date (YTD) total return of 12.6%.
- Our 2021 Outlook called for the roughly 8% of compound growth in 2021 and 2022.
- In hindsight, the rebound in equities is understandable as an unprecedented level of monetary and fiscal stimulus unleashed across the globe has caused investors to increase their appetite for risk assets.
- Top-performing asset classes thus far through 2021 include REITs (+22%), Commodities (+21%), Small-Cap stocks (18%) and Value stocks (+17%).
- In our 2021 Outlook, we suggested that REITs could surprise investors as a valuation beneficiary associated with workers returning to urban office buildings, apartment renters returning to major cities and, a rebound in the travel and tourism industry.
- Over the last three months, REITs and Commodities have continued to outperform. However, we have noticed that Growth and Technology have rotated back in favor. We believe this rotation was due to investors siding with the Fed's expectation for transitory inflation. Hence, the probability of higher interest rates may be diminishing.

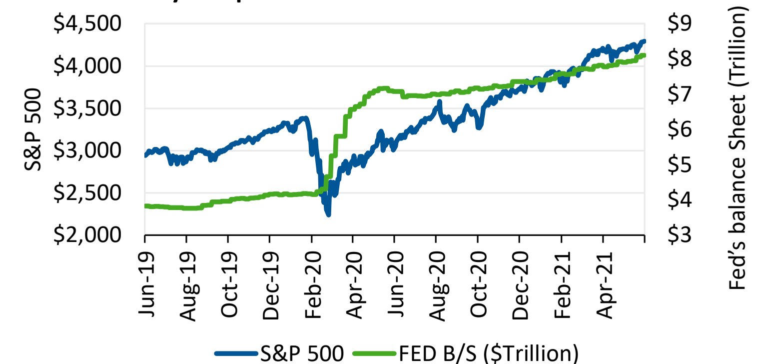
YTD 2021 vs 2020



Source: NEPCG and FactSet

While our expectation for Value and REITs to outperform came true YTD, we were surprised at how robust Commodities performed. However, a fierce re-boot of global supply chains, combined with low interest rates, drove the demand for manufacturing goods, particularly housing and housing-related goods.

Monetary Expansion & S&P 500

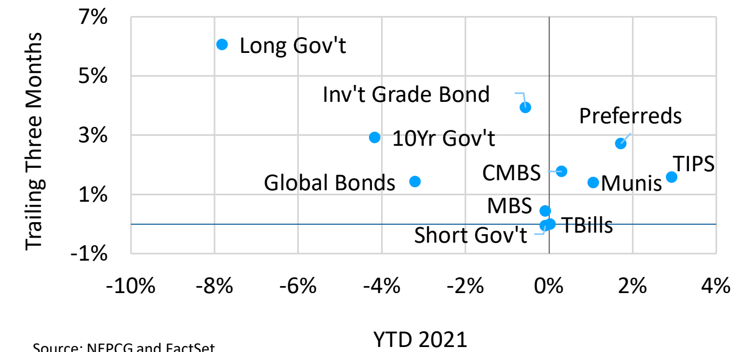


Source: NEPCG and FactSet

Performance Review

Credit Outperforming Duration

- Interest rate risk, or duration risk, represents the vulnerability of a bond's price to changes in interest rates.
- Credit risk, on the other hand, represents a bond's vulnerability to default, or the chance that some (or all) of the principal and interest will not return to investors.
- Bonds with more interest rate (duration) risk tend to perform well as interest rates fall, but they tend to underperform as interest rates rise.
- Bonds with greater credit risk generally do well as the underlying financial strength of their issuer improves but typically weakens when underlying finances, business fundamentals, or the broader economy deteriorates.
- In our 2021 Outlook, we suggested to fixed-income investors that credit risk could outperform duration, a prognostication that came true thus far through 2021. However, over the last three months, duration has outperformed credit.
- In our opinion, The recent rotation from credit to duration was driven by a combination of factors. First, investors may be siding with the Fed's view regarding transitory inflation. Secondly, a resurgence of COVID variants and speedbumps related to vaccination rollout resulted in a flight to higher-quality fixed-income securities. And lastly, some investors may be questioning the sustainability of the economic recovery.



Source: NEPCG and FactSet

In our 2021 Outlook, we suggested to fixed-income investors that credit risk could outperform duration, a prognostication that came true thus far through 2021. However, over the last three months, duration has outperformed credit. One reason could be that investors may be siding with the Fed's view regarding transitory inflation. Hence, the probability of higher interest rates could be diminishing.

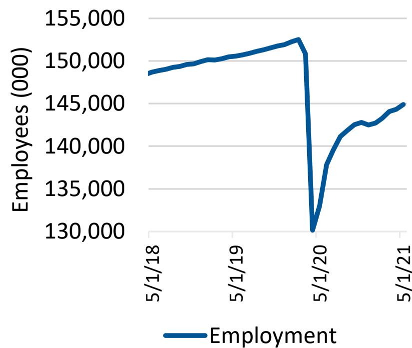
Economic Review

V Is For Victory…Over Covid

Winston's Churchill's V for Victory sign is perhaps one the most iconic of the Second World War. V stood for far more than Victory, it stood for solidarity, resistance and never giving up. – Imperial War Museum (UK)

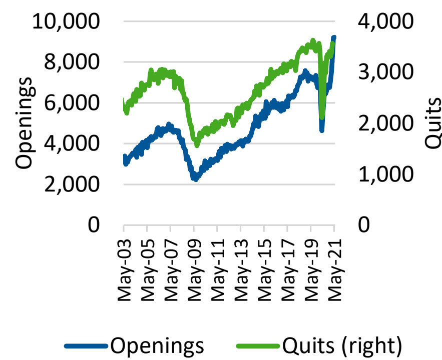
- We believe the level of disruption caused by COVID was, and remains, unprecedented, forcing economies to adapt rapidly.
- We, like many, underestimated the unprecedented actions by central banks and lawmakers to stem the disruption through monetary and fiscal stimulus.
- **As a result, several economic data exhibited a "V" recovery, which continues to support equity markets to this day.**

US Job Market



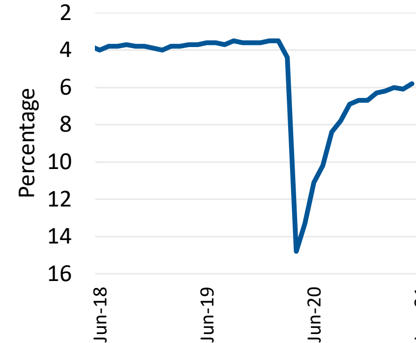
Source: NEPCG and Bureau of Labor Statistics

Openings and Quits



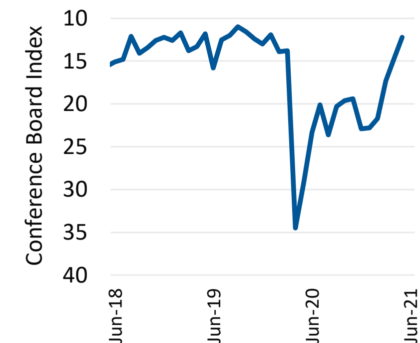
Source: NEPCG and Bureau of Labor Statistics

Unemployment Rate



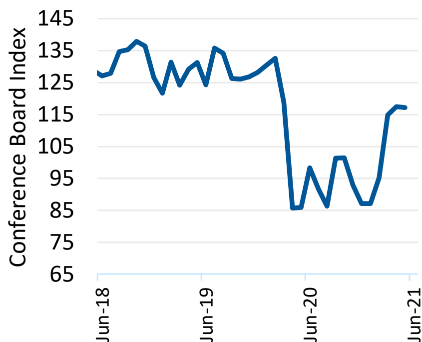
Source: NEPCG and Bureau of Labor Statistics

Jobs Hard To Get



Source: NEPCG and The Conference Board

Consumer Confidence



Source: NEPCG and The Conference Board

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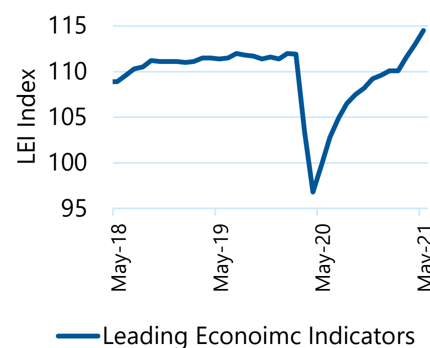
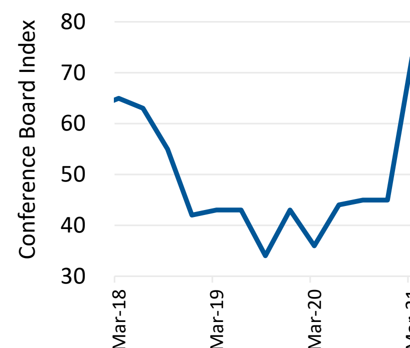


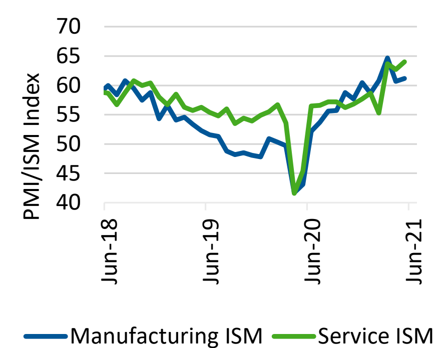
Source: NEPCG and The Conference Board

CEO Confidence



Source: NEPCG and The Conference Board

Purchasing Managers



Source: NEPCG and The Conference Board

Second Half Play Book

COVID Accelerated the US Into A New Economic Cycle

- COVID 19 and the ensuing global recession ended the 129th consecutive month of economic expansion here in the U.S. and the 132nd month of an equity bull market.
- We believe we are on the precipice of a new cycle, supported by pent-up consumer demand, positive vaccination/therapeutic trends, unprecedented fiscal and monetary stimulus.

We believe the US economy is on the precipice of a new economic cycle, characterized by rising inflation, increasing interest rates, a recovering job market, and easy/expanding credit.

Economic Cycle

Peak
* Top-line revenue begins to decelerate
* Financial conditions (credit) begin to tighten
* Earnings growth slows as margins are squeezed
* Confidence/ consumer comfort peaks
* Inflation registers highest level in the cycle
* Credit spreads trough and start to hook up

Decline
* Housing demand falling
* Federal Reserve turning dovish
* Inflation is MIA
* Corporate earnings/ profits decline
* Overall business activity is falling
* Job growth tops out and turns negative
* Consumer confidence declining

Trough
* Activity rebounds
* Credit begins grow
* Profit growth resumes
* Interest rates low/falling
* Confidence bottoms
* Inflation MIA

Expansion
* Job growth begins to meaningfully expand
* Credit/ lending growth begins to slow
* Profit margins expanding driven by lower costs
* Interest rates begin to increase more rapidly
* Confidence is rebounding in a material way
* Inflation begins to percolate, but not out of control

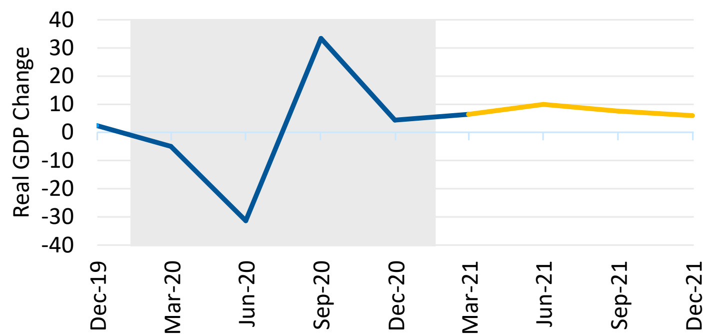
Source: NEPCG

Second Half Play Book

GDP Growth

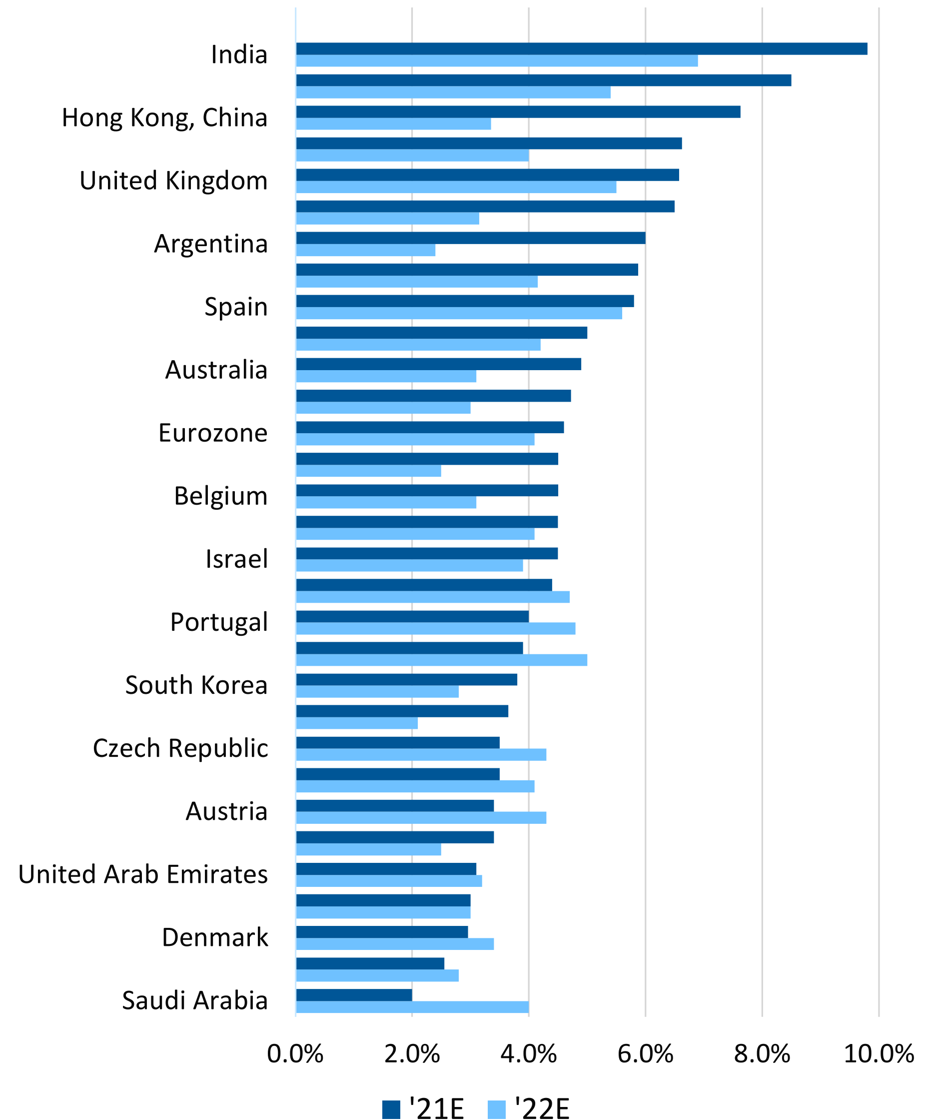
- The global economy is only mid-way through a re-opening trade, and several economies are at the precipice of a new economic cycle.
- According to FactSet, the median year-over-year growth rate in Real GDP for 2021 is roughly 4.8% for the countries we analyzed.
- While Developed economies will show solid growth, we find that emerging economies may exhibit even more significant growth. According to the International Monetary Fund, the average growth rate in Real GDP for Emerging economies is forecast to be 6.7% in 2021, while Developed economies are forecast to grow 5.1%.
- Among major investment banks, the average expected quarterly change for 2Q21, 3Q21, and 4Q21 are 9.9%, 7.6%, and 6.0%, respectively.

U.S. GDP Quarterly Changes



Source: Goldman Sachs, Wells Fargo, Citigroup and NEPCG

Full Year Global GDP Comparison



Source: NEPCG and FactSet

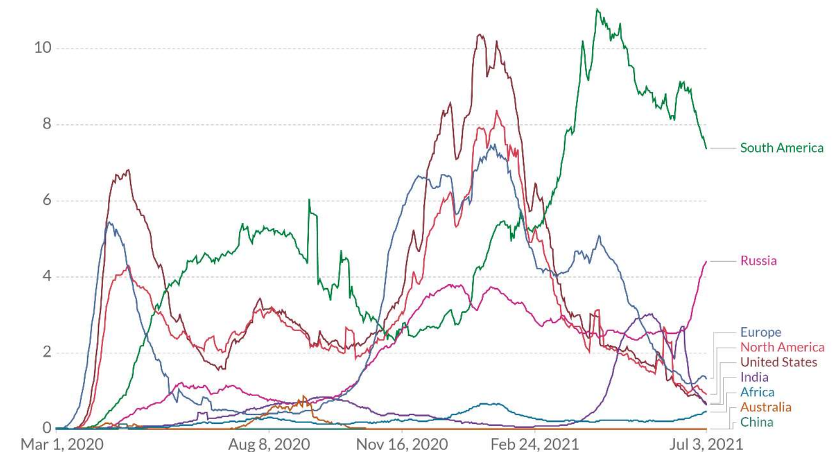
Second Half Play Book

COVID Update

- According to Johns Hopkins Corona Virus Research Center, there have been almost 4 million deaths and 185 million cases globally as of July 4, 2021.
- As we pointed out in our November 20, 2020 note entitled, "One Step Up And Two Steps Back," we suggested that based on research data provided by the Milken Institute, it was a matter of when, not if, COVID will be defeated.
- As of July 4, 2021, according to Our World In Data, roughly 25% of the world's population have received at least one vaccination, while roughly 55% of U.S. citizens have received one vaccination.
- One rising concern and risk to our outlook is the prevalence of the delta variant among new cases, especially in countries with rapidly receding cases.

Daily new confirmed COVID-19 deaths per million people

Shown is the rolling 7-day average. Limited testing and challenges in the attribution of the cause of death means that the number of confirmed deaths may not be an accurate count of the true number of deaths from COVID-19.



Source: Johns Hopkins University CSSE COVID-19 Data

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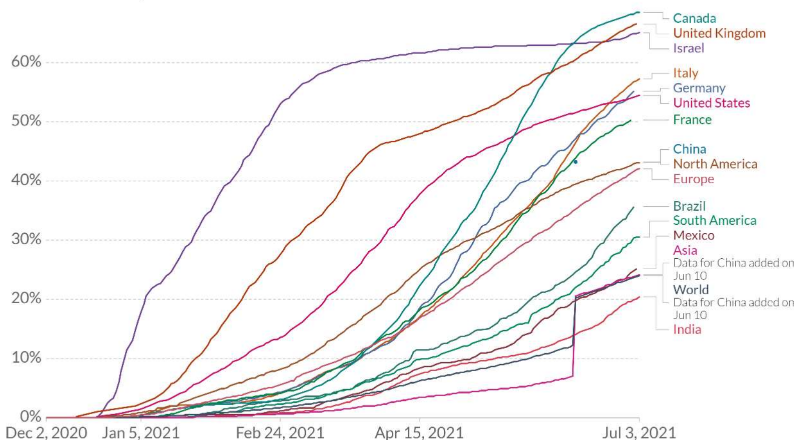
Share of people who received at least one dose of COVID-19 vaccine

Share of the total population that received at least one vaccine dose. This may not equal the share that are fully vaccinated if the vaccine requires two doses. This data is only available for countries which report the breakdown of doses administered by first and second doses.



Source: Official data collated by Our World in Data

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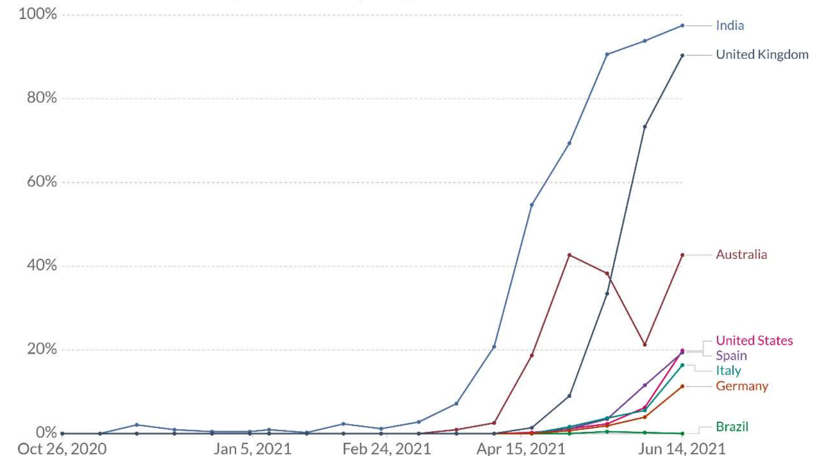
Share of COVID sequences that are the delta variant

Shown is the delta variant's share of total analyzed sequences. This does not necessarily reflect its share of total confirmed cases because not all samples receive DNA sequencing.



Source: CoVariants.org and GISAID – Last updated 3 July 2021, 01:20 (London time)

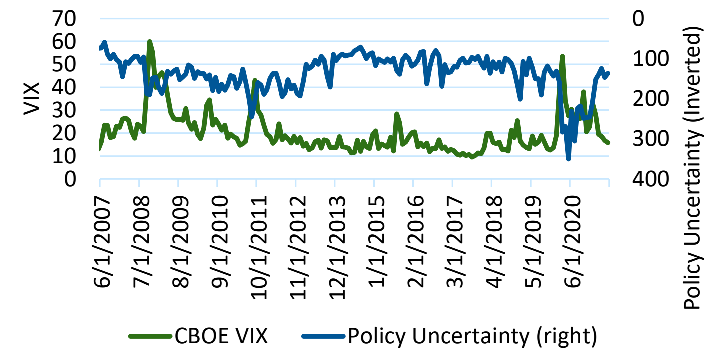
OurWorldInData.org/coronavirus • CC BY

Second Half Play Book

Subsiding Uncertainty Amid Unprecedented Liquidity

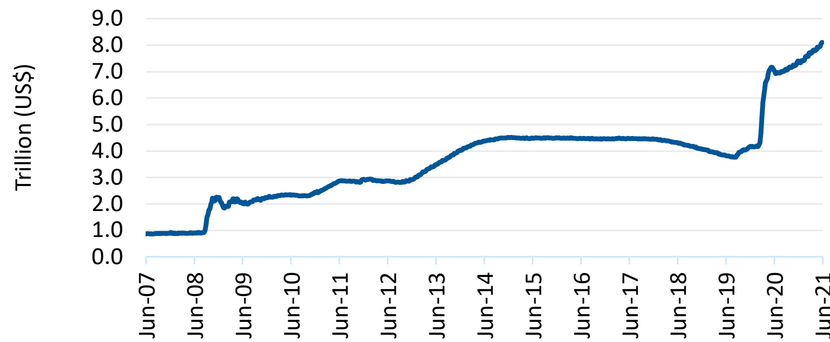
- Our 2021 Outlook suggested that the level and magnitude of geopolitical and event risk will be subdued in 2021.
- Based on data provided by policyuncertainty.com, this prognostication also came true, as the overall level of U.S. policy uncertainty is close to 2019 lows.
- **Since the beginning of the pandemic, the Fed's balance sheet has increased by roughly $4 trillion to over $8 trillion. With a lull in policy uncertainty, this unprecedented excess liquidity has supported a strong economic recovery and robust equity market price gains**.
- Unless derailed by another idiosyncratic or black-swan event, we believe equity markets will continue to find support over the intermediate-term.
- **We would not be surprised to observe modest retracements over the next 90 days. Still, we believe these pull-backs should be viewed as buying opportunities for equity investors.**

Policy Uncertainty vs VIX



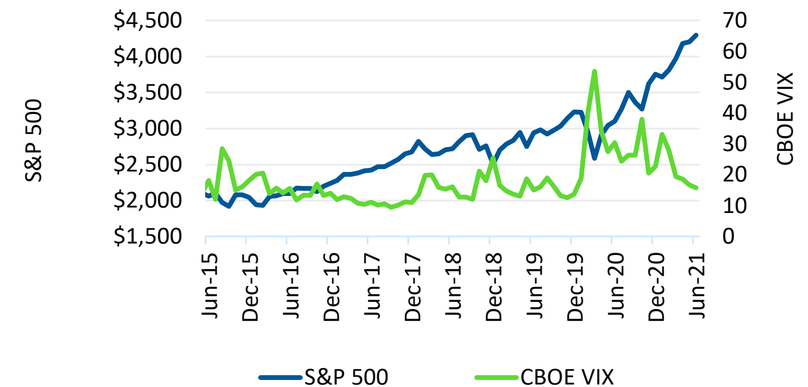
We anticipate geopolitical and policy risks to remain in check, which could help to limit equity volatility and support equity valuations.

Federal Reserve Balance Sheet



Source: NEPCG and Federal Reserve

CBOE VIX vs S&P 500

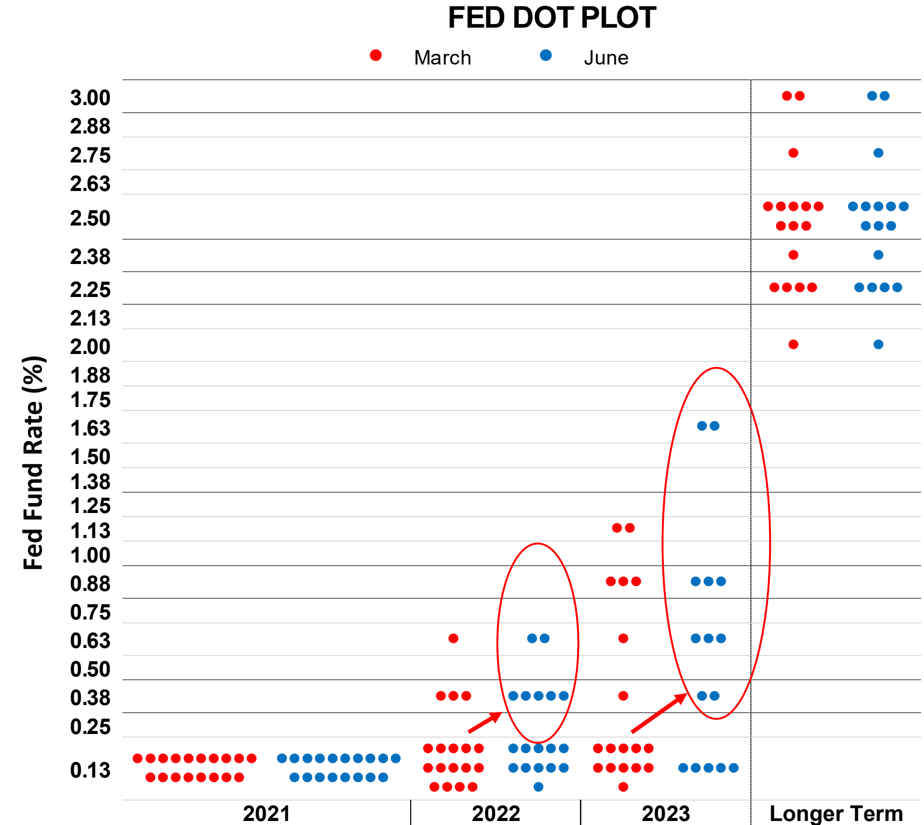


Source: NEPCG and FactSet

Second Half Play Book

FOMC: Lost In Transition

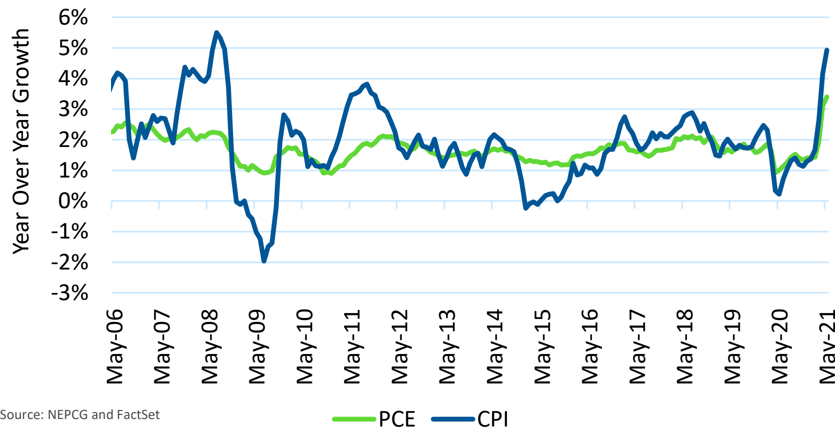
- We believe the FOMC is walking a tight-rope between easing market anxiety regarding pervasive inflation prospects and the impact higher interest rates would have on the economy and capital markets.
- At the Fed's most recent meeting, the FOMC published its "dot-plot" forecast, which is meant to signal its expectations of future interest rate changes, both in timing and magnitude.
- While all 18 forecasts signaled no Fed-Funds rate hike in 2021, three (3) additional Fed Governors now expect a rate hike in 2022, and six (6) additional now expect a rate hike in 2023.
- The FOMC publicly acknowledged the presence of inflation, which is hard to ignore given the recent trend in the Fed's preferred inflation measure, Core PCE. Still, the FOMC continues to officially state inflation prospects are transitory and will recede..



Source: NEPCG and United States Federal Reserve meetings as of March 15, 2021, and June 16, 2021

One of the biggest risks, in our opinion, is a policy mistake on behalf of the Federal Reserve as it is hard to ignore the back-up of inflation prospects.

Inflation Trends



Source: NEPCG and FactSet

Second Half Play Book

FOMC: The Fix Is In

- In our opinion, the Doves hold all the cards regarding driving and realizing the “transitory” narrative surrounding the inflation debate.
- Based on our research, over 60% of the voting Governors for 2021 are in the Dovish camp. For 2022, roughly 55% of the voting Governors are Dovish, a statistic that moves back to almost 65% in 2023.
- While we continue to hear “Hawkish” commentary and interviews from certain Federal Reserve Governors, these are typically from those with limited voting weight (George, Bullard and Kaplan) over the next three (3) voting cycles.
- Therefore, we believe rates will tend to remain low.
- As a result, risk assets (equities) could continue to find support and Commodities could rebound if investors believe the Fed is on the sideline with respect to raising rates.

FOMC - Hawk/Dove Analysis InTouch Capital Markets

Last Update: 24 June 2021

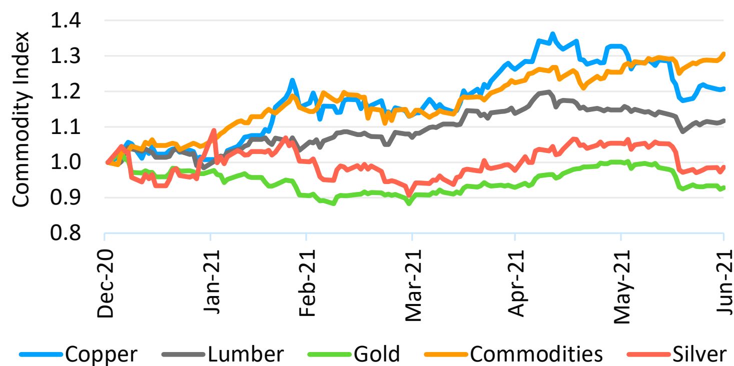
Name	Position	Hawk Scale	Voter? 2021	2022	2023
Most Dovish					
Kashkari	Minneapolis		✗	✗	✓
Brainard	**Board**		✓	✓	✓
Daly	**San Francisco**		✓	✗	✗
Clarida	**Vice Chair**		✓	✓	✓
Powell	**Chairman**		✓	✓	✓
Williams	**New York**		✓	✓	✓
Evans	**Chicago**		✓	✗	✓
Bowman	**Board**		✓	✓	✓
Mester	Cleveland		✗	✓	✗
Quarles	**Board**		✓	✓	✓
Waller	**Board**		✓	✓	✓
Rosengren	Boston		✗	✓	✗
Barkin	**Richmond**		✓	✗	✗
George	Kansas City		✗	✓	✗
Bostic	**Atlanta**		✓	✗	✗
Harker	Philadelphia		✗	✗	✓
Bullard	St Louis		✗	✓	✗
Kaplan	Dallas		✗	✗	✓
Most Hawkish					

Notes

2021 Voting members in bold

Source: NEPCG and InTouch Capital Markets

Commodity Index



Source: NEPCG and Federal Reserve

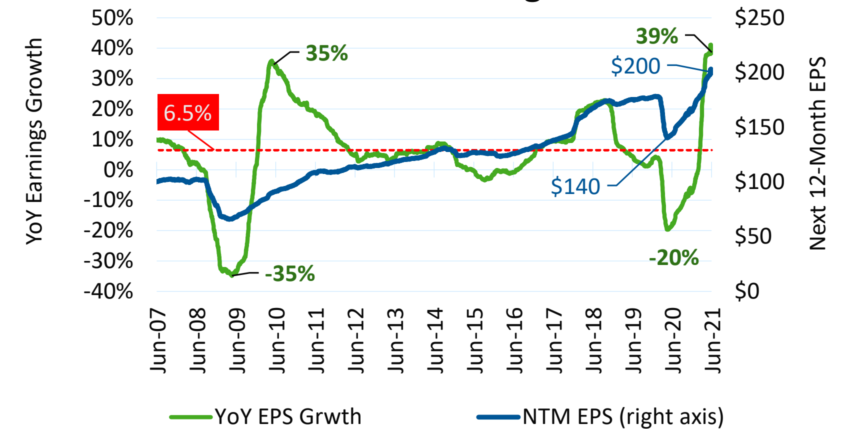
One of the most significant risks, in our opinion, is a policy mistake by the Federal Reserve. However, we believe the “fix is in” given about 65% of the FOMC voting members for 2021 are “dovish,” followed by 55% in 2022.

Note: The Copper Index is represented by the US Copper Index ETF (ticker: CP), the Timber Index is represented by the Invesco MSCI Global Timber ETF (CUT), the Gold Index is represented by the SPDR Gold Shares ETF (GLD), the Commodities Index is represented by iShares S&P GSCI Commodity Indexed Trust (GLD), and the Silver Index is represented by the iShares Silver Trust ETF (SLV)

Second Half Play Book

Corporate Earnings Look Supportive

- Unlike the 2007 Great Financial Crisis (GFC), the 2020 recession was caused by a global pandemic and not necessarily financial excesses.
- Like most things during this period, the rate at which the global economy was shut down and turned on was unprecedented.
- While several industries were devastated (airlines, travel/leisure, real estate), others benefited (technology, communication services)..
- Further, while global GDP plummeted at rates more than those witnessed during previous recessions (and Great Depression), corporate earnings proved to be more resilient..



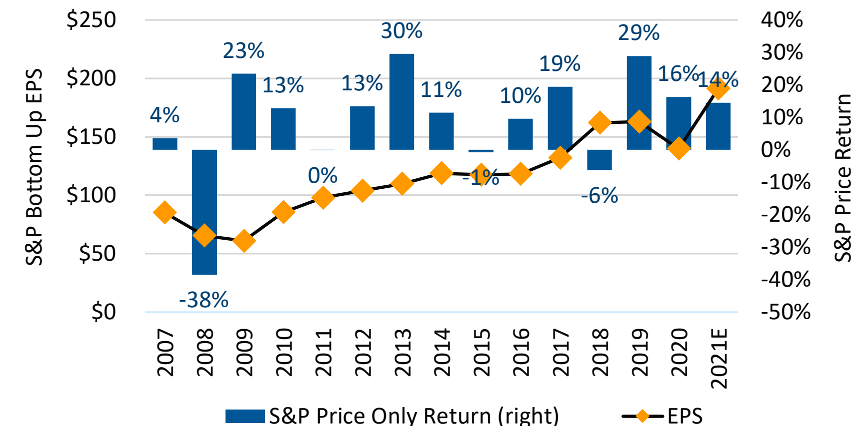
Source: NEPCG and FactSet

S&P EPS Growth

	EPS	Earnings Growth YoY	2Y CAGR
2007	$85		
2008	$65	-23%	
2009	$61	-7%	-15%
2010	$85	40%	14%
2011	$98	15%	27%
2012	$104	6%	10%
2013	$110	6%	6%
2014	$119	8%	7%
2015	$117	-1%	3%
2016	$118	1%	0%
2017	$132	12%	6%
2018	$162	23%	17%
2019	$163	1%	11%
2020	$140	-14%	-7%
2021E	$191	37%	8%
2022E	$232	21%	29%
2023E	$233	1%	10%

Source: NEPCG and I/B/E/S

Corporate earnings proved to be surprisingly resilient during the recent global recession. Compared to the GFC of 2007-2009, S&P 500 earnings contracted less, helping support a robust recovery in equities.

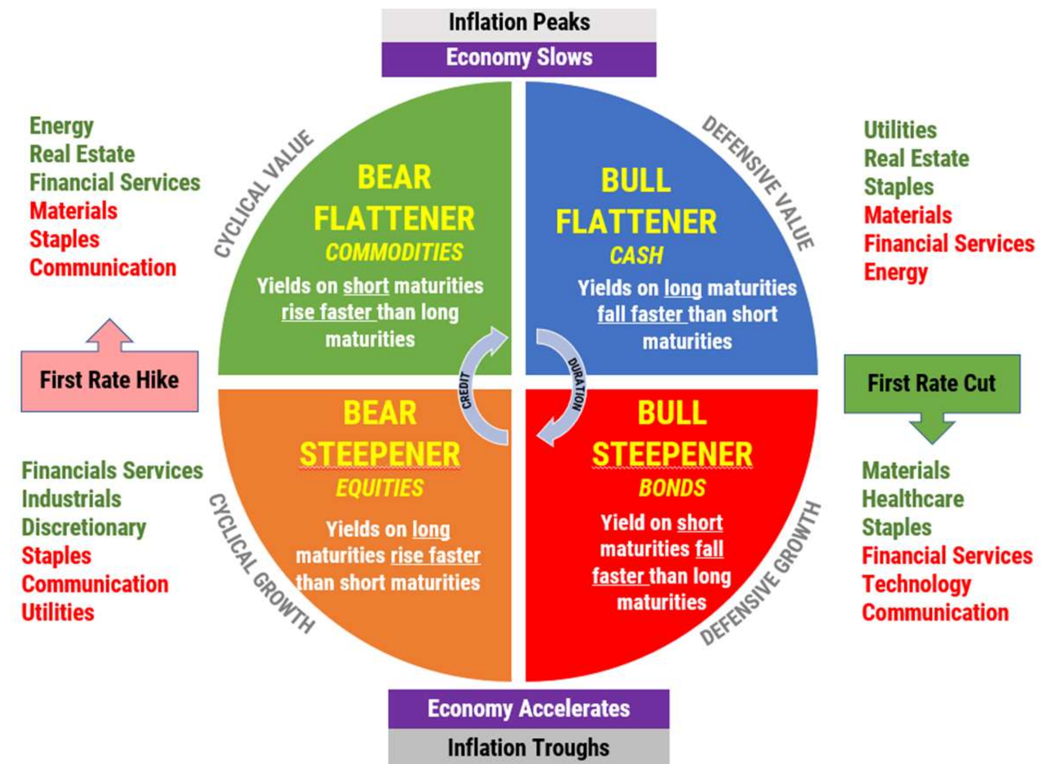


Source: NEPCG and FactSet

Second Half Play Book

Interest Rate Regime Rotation

- We introduced our Interest Rate Regime framework in our 2020 Outlook report entitled "What Goes Up."
- We intended to help investors triangulate the impact of monetary policy, yield curve dynamics, and equity sector returns.
- At the time, we suggested the U.S. capital market was somewhere between the end of a Bull Steepener (red shaded area) and the beginning of a Bear Steepener (orange shaded area) regime, following a series of Fed rate cuts and commensurate with an economy showing signs of topping.
- In our 2021 Outlook entitled, "Hope Over Despair," we suggested the U.S. capital market was firmly within a Bear Steepener regime. But we also introduced a notion that given the disruptive nature of COVID, certain historical yield curve/sector relationships may be dislocated. Still, we surmised that Value-oriented sectors, beneficiaries of an economic re-boot, would outperform.
- Fast-forward six months, and this prognostication also came true, as not only did Financials and Industrials outperform, but the disruption associated with COVID accelerated the demand for certain styles, such as Commodities, and specific sectors such as Energy and Real Estate.



Source: NEPCG and FactSet

The disruptive nature of COVID dislocated historical style/sector relationships. Extraordinarily low interest rates and a consistent bid for mortgage-backed securities (aka Quantitative Easing, "QE") by the FOMC helped drive housing prices. Combined with a re-boot of the global economy, we can now fully rationalize the outperformance of typically Bear Flattener sectors and styles such as Energy, Real Estate, and Commodities.

Second Half Play Book

It Is Different This Time Because There Was No Last Time

- In our 2021 Outlook, we suggested to investors to "Flip The Script And Buy The Dip," suggesting that despite seeming over-valued from a multiple perspective, the S&P 500 was undervalued from an earnings-yield perspective, given how low interest rates were. Remember, the earnings yield of any stock or equity index is nothing more than the reciprocal of its P/E multiple**.**

- We are increasing our near-term S&P 500 expectation driven by our earnings-yield framework, and now believe there could be as much as 18% of upside in 2021 albeit not without modest and healthy corrective moves over the next few months.

- Key assumptions that drive this expectations are:

  - ❑ The 10-Year Treasury Note trades no higher than 1.75%, implying a forward earnings multiple of 21.7x, and

  - ❑ Forward four-quarter earnings per share (EPS) for the S&P from 4Q21 through 3Q22 totals $205.

How Do We Get There?

(A)	Forward S&P Earnings Assumption	$205
(B)	Forward 10Yr Assumption	1.75%
(C)	Historical Earnings Yield Spread	**2.85%**
(D)=(B)+(C)	S&P Earnings Yield Imputed	4.60%
(E)=1/(D)	Implied "Spread" Multiple	21.7
(F)=(A)x(E)	Imputed S&P Price-Only Target	4,457
(G)	Price on 12/31/2020	3,756
(H)=(F)/(G)-1	Potetnial % Upside	18.6%

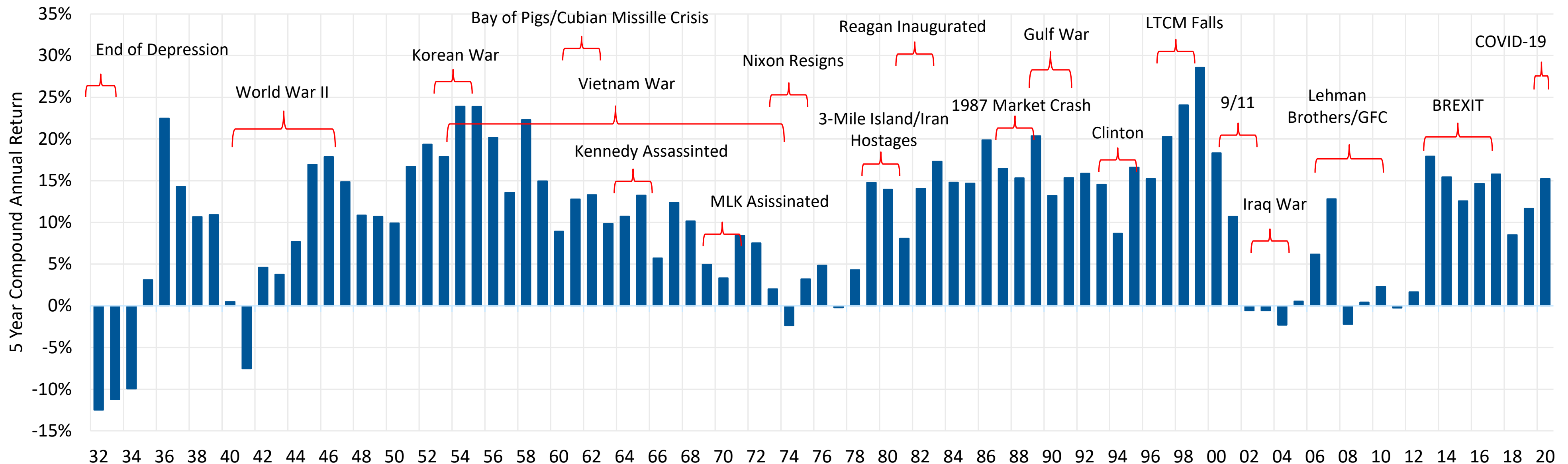
Source: NEPCG and FactSet

Second Half Play Book

You Need To Be In It, To Win It

- We believe equity investors should consider remaining invested to obtain the returns that accompany the risks.
- **Despite our more optimistic outlook, NOT EVERY INVESTOR should be overweight equities.**
- Every investor's circumstances, investment time horizon, goals, and constraints are different.
- In the exhibit below, we analyze the long-term return of the S&P 500 in increments of 5 years and overlay specific events of historical relevance.
- For investors with the risk appetite to invest in equity securities, we illustrate the notion that there have been only 11 instances over the last 88 years whereby a 5-year look back has produced a negative total return**.**

S&P 500 | 5-Year Compound Annual Growth



Source: NEPCG and FactSet

Second Half Play Book

Risks Remain…If They Didn't This Would Be Easy

- Despite our relatively positive outlook for the U.S. economy and increased market expectations, our forecasts have several risks. Here are just a few.

  - ❑ While the FOMC seems steadfast in keeping rates lower for longer, QE tapering suggestions, specifically concerning mortgage-backed security purchases, could cause interest rates to increase and home prices to drop. This may be a significant risk. According to the Congressional Research Service, close to 18% of annual GDP is accounted for through direct residential investment or housing-related services.

  - ❑ A resurgence in COVID cases globally, and spikes in new variants, could temper economic growth and corporate earnings.

  - ❑ Geopolitical uncertainty could return commensurate with emboldened confidence of economic and military rivals of the United States.

  - ❑ Some investors are concerned about slowing economic growth, despite continued re-openings across the globe.

  - ❑ A bipartisan infrastructure bill could grossly disappoint more progressive factions of the Democratic Party. Conversely, excessive spending measures and reconciliation proposals could increase corporate and/or individual taxes greater than expected could stifle growth.

  - ❑ We believe many of these risks will manifest over the next 30-90 days, adding to the typical summer/early fall volatility markets encounter. But given our analysis, we view any sell-off as a buying opportunity.

Wealth Management Process

We Are There, Even When We Aren't There.

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