Hancock Whitney Asset Management

Special Edition – 2Q 2021 Review

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Summary

DAVID LUNDGREN
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Index Return Summary as of 06-30-21									
Index Name	**Q2 2021**	**April**	**May**	**June**	**Q1 2021**	**Year to Date**	**Last 12 Months**	**Last 3 Years**	**Last 5 Years**
Equity									
S&P 500	**8.55%**	5.34%	0.70%	2.33%	6.17%	15.25%	40.79%	18.67%	17.65%
Dow Jones Industrial Average	**5.08%**	2.78%	2.21%	0.02%	8.29%	13.79%	36.34%	15.01%	16.67%
S&P MidCap 400	**3.64%**	4.50%	0.20%	-1.02%	13.47%	17.59%	53.24%	13.16%	14.30%
S&P SmallCap 600	**4.51%**	2.04%	2.08%	0.33%	18.24%	23.56%	67.40%	12.20%	15.83%
MSCI Europe, Australasia and the Far East (EAFE)	**5.17%**	3.01%	3.26%	-1.13%	3.48%	8.83%	32.35%	8.27%	10.28%
MSCI All Country World Index (ACWI)	**7.39%**	4.37%	1.56%	1.32%	4.57%	12.30%	39.26%	14.56%	14.62%
Equity Satellites									
MSCI Emerging Markets (EM)	**5.05%**	2.49%	2.32%	0.17%	2.29%	7.45%	40.90%	11.27%	13.03%
MSCI World Ex USA Small Cap	**4.95%**	4.19%	2.31%	-1.54%	4.97%	10.17%	42.80%	9.34%	12.31%
MSCI Frontier Markets	**14.10%**	6.84%	4.01%	2.67%	0.80%	15.01%	38.50%	8.88%	9.37%
Bloomberg Commodity	**13.30%**	8.29%	2.73%	1.85%	6.92%	21.15%	45.61%	3.90%	2.40%
MSCI US Real Estate Investment Trusts (REIT)	**12.00%**	8.05%	0.93%	2.69%	8.76%	21.80%	38.05%	10.13%	6.32%
Alerian Master Limited Partnership (MLP) Infrastructure	**22.35%**	7.47%	7.16%	6.24%	21.85%	49.08%	65.60%	-0.80%	-1.79%
Fixed Income									
FTSE World Government Bond Index (WGBI)	**0.45%**	1.36%	1.23%	-2.10%	-6.42%	-6.00%	3.06%	2.81%	1.28%
Bloomberg Barclays U.S. Intermediate Aggregate Bond	**0.78%**	0.52%	0.22%	0.04%	-1.61%	-0.84%	0.05%	4.41%	2.53%
Bloomberg Barclays Municipal 1-10Y Blend 1-12Y	**0.62%**	0.48%	0.07%	0.07%	-0.26%	0.36%	2.43%	3.91%	2.48%
Bloomberg Barclays US Corporate High Yield	**2.74%**	1.09%	0.30%	1.34%	0.85%	3.62%	15.37%	7.44%	7.48%
Bloomberg Barclays US Universal	**1.96%**	0.84%	0.38%	0.73%	-3.05%	-1.15%	1.12%	5.64%	3.48%
JPMorgan Emerging Market Bond Index (EMBI)	**4.06%**	2.22%	1.06%	0.73%	-4.54%	-0.66%	7.53%	6.71%	4.86%
Source: Morningstar									

The most notable event of the quarter is that COVID has slowly faded to the background in the U.S. As business restrictions were lifted, economic growth rapidly accelerated with expectations for above average growth likely to continue for the remainder of 2021. Unprecedented amounts of fiscal and monetary stimulus have left many consumers flush with savings. After being ‘locked up’ for the better part of a year, many were excited to put their cash to work and the recent economic data confirms their enthusiasm. Equity markets also continued to celebrate the reopening as the S&P 500 closed the quarter at all-time highs. The significant market selloff of 2020 seems more and more distant as stocks continue their advance. Further advance for stocks looks promising, but stretched valuations may warrant a more cautious approach. During the quarter, progress was made on an Infrastructure deal and for now, it appears moderates from both parties have the upper hand. A bipartisan deal on Infrastructure and possibly limited or no tax changes looks like a real possibility at least for 2021. Obviously much can change on that front as the negotiations continue to evolve. The Federal Reserve also finds itself at a crossroads regarding policy. Chairman Powell acknowledged that the Fed had greatly underestimated the pace of the economic rebound and the resulting pickup in inflation. As a result, Powell stated that the committee was now formally beginning discussions about how and when to begin tapering asset purchases (QE). Fed comments also indicate an increase in short term rates may occur sooner than anticipated to slow the economy and avoid runaway inflation. Since the Pandemic began, the Fed and legislation have played a critical role in the economic and market rebound. The wildcards for markets and the economy going forward involves Washington DC and the Federal Reserve and the pace in which they step away from policies enacted during the pandemic.

Below are additional highlights of the quarter and in the pages to follow the Hancock Whitney Asset Management team discusses several other noteworthy events in more detail. We hope you enjoy this review and as always please reach out to any Hancock Whitney associate to discuss your personal financial situation.

- **Economy** – Fiscal and monetary stimulus combined with easing of pandemic related restrictions supercharged a wave of pent-up demand that produced a 6.4% annual rate of Q/Q Real GDP growth in 1Q21, which is still accelerating in 2Q21 and expected to clock in at 8-9% growth. The U.S. economy is experiencing the strongest sustained growth since the early 1980s with strength evident in personal consumption, capital investment, manufacturing output and resurgent hiring.

- **Equity Markets** – Equity price increases accelerated in the second quarter of 2021, compared to the first. And although it was not without a brief, but healthy, interruption, sentiment and conviction among equity investors grew stronger as the market was barraged with good news on multiple fronts. From pandemic news to economic news to corporate earnings reports, the case for higher stock prices was bolstered throughout the quarter.

- **Fixed Income Markets** – The U.S. bond markets staged a surprising reversal in Q2 2021 wherein longer term interest rates declined for 3 consecutive months. The rally lifted bond prices and allowed the major bond indices to recoup almost half of the negative returns suffered during the interest rate spike of Q1 2021. While multiple factors contributed to the sea change in bond investor sentiment, it was mostly the simple fact that interest rates had risen to a level that bond investors found attractive again given their outlook for inflation, the economy and the Federal Reserve.

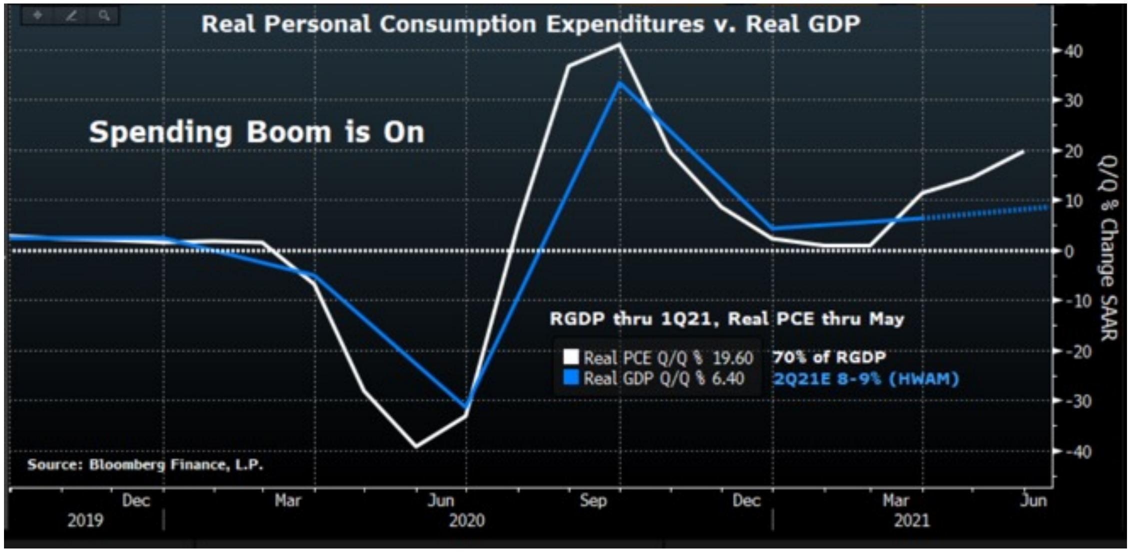
- **Politics and Policy** – Almost certainly, the most-watched policy story of the second quarter has been the ongoing proposals and counterproposals around a potential infrastructure spend. Having proposed his roughly $1.9 trillion American Jobs Plan in the waning days of the first quarter, President Joe Biden followed up in late April with the American Families Plan which proposed roughly $2.2 trillion in spending over the next eight years. Promoted as a paired set, the plans ranged the gamut from traditional infrastructure like bridges and roads to manufacturing and research support to funding for education, healthcare and eldercare. The American Jobs Plan called for several reforms to the corporate tax structure to offset the additional spending while the American Families Plan focused on taxes on wealthy and high-income households alongside increased tax enforcement. While negotiations are ongoing, it appears scaled down plans of each proposal likely have better chances of passage.

Economy[1,2]

Pent-up Demand Supercharges the U.S. Economy

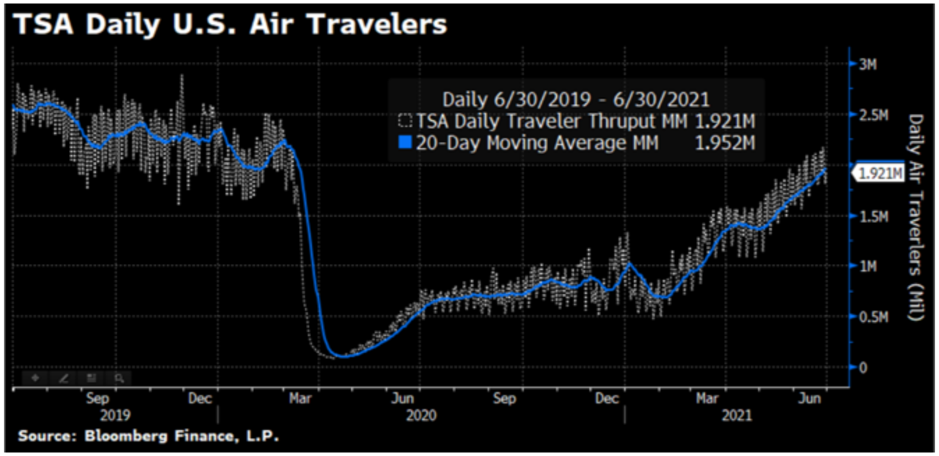
PAUL TETEN, CFA
SVP, CHIEF INVESTMENT STRATEGIST & INVESTMENT DIRECTOR

The most notable drivers of the economic acceleration occurring this year made their mark in the first quarter. The rollout of the coronavirus vaccines, which looked a bit chaotic early on, has been a great success with the decentralized distribution proving highly effective. Operation Warp Speed was a phenomenal achievement, driving dramatically diminished COVID metrics and facilitating widespread re-opening of the U.S. economy. And on the fiscal side of policy, COVID relief including $600 checks distributed to households in early January, was followed by the American Rescue Plan which included additional $1400 checks widely distributed in March. That stimulus and other features of the packages supercharged a wave of pent-up demand that produced a 6.4% annual rate of Q/Q Real GDP growth in 1Q21, which is still accelerating in 2Q21 and expected to clock in at 8-9% growth. The U.S. economy is experiencing the strongest sustained growth since the early 1980s with strength evident in personal consumption, capital investment, manufacturing output and resurgent hiring.



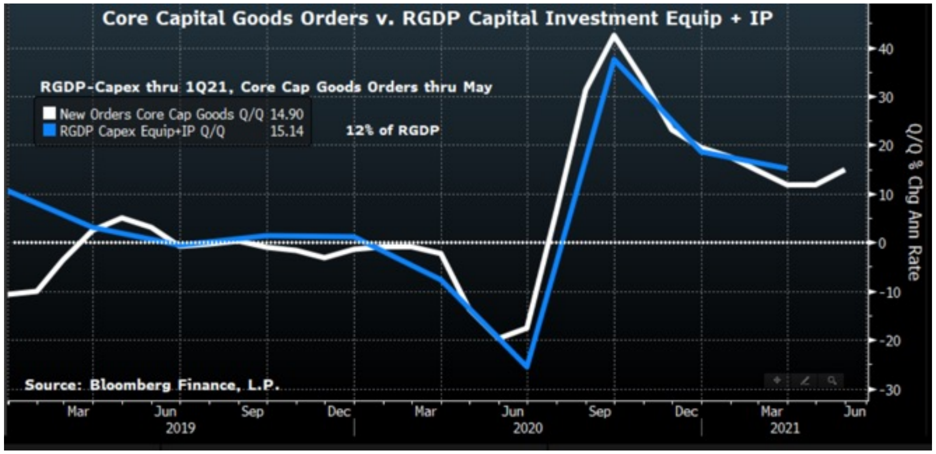
Personal Consumption Expenditures

While the sugar high from the first quarter's money shower has dissipated somewhat in 2Q21, the U.S. economy has gained sustainable traction and is experiencing another strong quarter of personal spending. Even with continued moderation in household spending in June, to be reported late July, our scenario analysis indicates that Real PCE is likely to show 10-11% growth on a Q/Q annual rate basis in 2Q21. The Q/Q rate is likely to recede further in 3Q21 but our assessment is that personal spending will continue briskly this summer. Air travel has regained normal traffic levels, employment has rebounded substantially and anecdotal reports proliferate that the U.S. is experiencing widespread internal tourism as pandemic restrictions are lifted.



Capital Investment

Real GDP components that capture capital spending on equipment and software, as opposed to structures, are Gross Private Domestic Investment in Equipment and Information Processing. Spending in these categories grew at 15% Q/Q annual rates in 1Q21 following a very strong rebound last fall, and monthly data for new orders for such equipment indicate continued strength through the summer. Part of this investment surge can be attributed to the pandemic induced paradigm shift toward more digital and virtual commerce. And it also seems likely that the demand surge that is far outpacing manufacturing capacity in many industries and may be driving factory demand for productivity enhancing equipment.

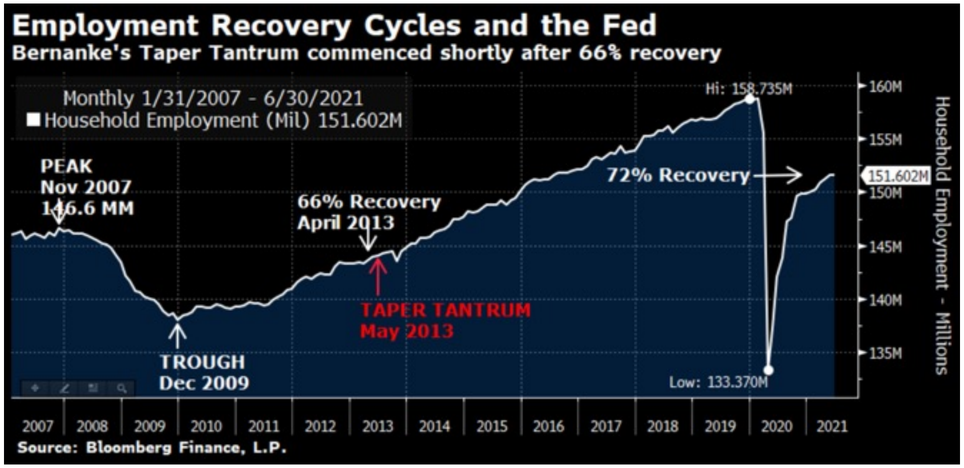


Manufacturing Output

Factory output has been accelerating sharply but has not kept pace with final demand, resulting in an inventory drawdown that subtracted 2.7% from 1Q21 Real GDP's Q/Q annual rate. Manufacturing output has accelerated in 2Q21 and minimizing further inventory depletion is a key component of our expectation as GDP accelerates beyond the 1Q21 6.4% rate in the second quarter. Signals from purchasing managers surveys, while modestly lower than the March peak, remain at a higher level than those seen in the 2017-18 manufacturing resurgence. Continued high optimism toward robust manufacturing conditions from the operations managers has driven prices for raw industrial commodities to the highest levels in a decade, reflecting strong demand for industrial inputs. The outlook for U.S. manufacturing is bright for the rest of the year.

Employment Conditions

Monthly additions to non-farm payrolls have been lumpy this year, with seasonal adjustments seemingly out of sync with recovery patterns and severe winter disruptions, but nevertheless the U.S. added 1.56 million jobs in 1Q21, strong jobs growth by any standard, and bettered that with 1.7 million jobs added in 2Q21. Leisure and hospitality industries accounted for 49% of those first half job gains, rehires in the main, as the economy re-opened and the pandemic faded. There were a few clues in the June labor report that the elimination of supplemental federal unemployment benefits by a number of states may have contributed to the strong 850,000 increase in June non-farm payroll gain, namely the sharp decline in the U6 comprehensive unemployment rate from 10.2% in May to 9.8% in June and an increase in the labor force that pushed the standard U3 unemployment rate up a notch to 5.9%. Analysts will examine whether states that eliminated benefits contributed inordinately to June jobs growth when the state data is released later this month. A dozen states terminated those benefits in June, another dozen plan to in July and the benefits are scheduled to expire for all states in September. The unemployment rate was 6.7% in December and dropped to 5.9% in June, inching closer to one of the Fed's favorite and more notorious theoretical constructs, the non-accelerating-inflation rate of unemployment (NAIRU), generally estimated at 5.0%, purported to be the lowest unemployment rate feasible without triggering an acceleration in inflation. We only need examine the years leading up to the pandemic, when the unemployment rate was 3.5% and inflation rates languished around 1.5%, to question the validity of the NAIRU concept in the era of globalization. Deflationary global conditions were the more dominant condition than high labor utilization. However, the post-pandemic economy has its own idiosyncrasies, primarily a substantial expansion of federal safety net and other support programs, elevating uncertainty as to whether we will see a 3.5% unemployment rate again. Previously noted strong investment in productivity-enhancing equipment (including robotics) is also a plausible impediment to achieving the super low unemployment rates seen in 2019. To the point, we've noticed that self-checkout has become the norm in most retail outlets in the last year. These characteristics of the post-pandemic economy point to the likelihood that wage pressures will build at a significantly higher unemployment rate than the previous cycle low of 3.5% The chart below illustrates that household employment has already recovered more than the point in 2013 at which the Fed moved to taper quantitative easing, currently 72%, a signal we have advised previously is likely to pressure the current Fed similarly. The Fed acknowledged as much last month and tapering is now officially on the table.

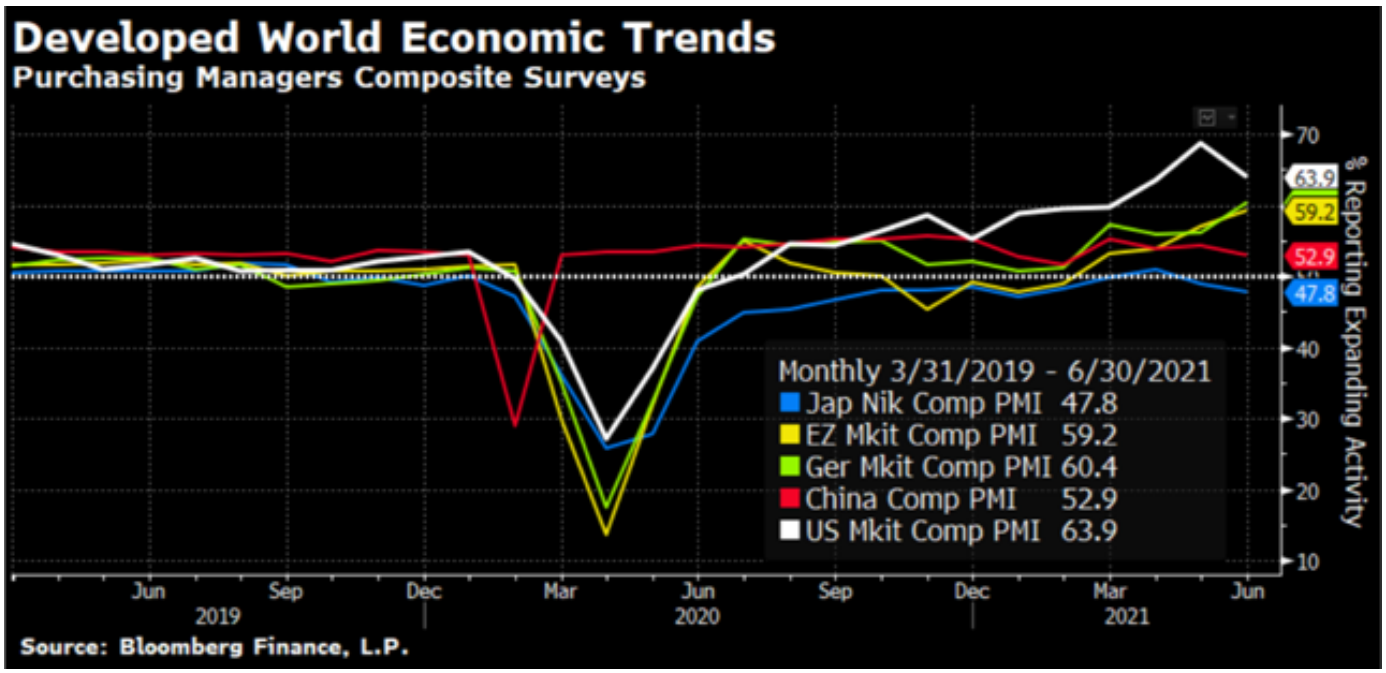


Inflation

Since last Fall we have noted regularly that the strength of the U.S. economic recovery was accelerating rapidly and pulling forward the point at which the rate of inflation-adjusted economic output would exceed the 2019 peak of $19.3 trillion. Last Fall we estimated Spring 2022 would be that point but by January it was evident that the initial rebound was significantly stronger than expected and, combined with the CARES Act stimulus and the American Rescue Plan proposal, we re-estimated the U.S. would surpass 2019 output in Summer 2021. It's now apparent that Real GDP will exceed the 2019 peak in 2Q21, which timed out last week. The fast-forwarding of clearing the previous peak of national output essentially represents an astounding surge of final demand that has created supply bottlenecks in many industries as factories struggle to catch up. The list is long and prominently includes a semi-conductor shortage that is impairing auto production, airfare escalation as the carriers race to redeploy equipment into service, lumber and home furnishings price spikes in response to brisk home demand as young families yearn for back yards and an exodus from urbanization. Rental car fleets have been cannibalized, the first wave from the lockdowns and the rest due to soaring prices for used cars. Americans are driving their own cars around the country as necessary and hotel vacancies are scarce. The result is that the Fed's desire to see higher inflation has been abruptly realized and it is now under pressure from the opposite direction. Our assessment is that the inflation surge is likely to be transitory, much as the Fed insists, and that many supply bottlenecks will dissipate in the coming months. Inflation expectations, reflected in the chart below, are beginning to mirror the transitory theme. Nevertheless, the longer higher inflation is a news item, the hotter the Fed's seat will get, and in addition to QE tapering, the lift-off of short-term interest rates will edge into policy deliberations.

What's Wrong with this Picture?

Apart from the startling price spikes which surfaced suddenly in 2Q21, which we expect to moderate as the year progresses, there are several indications that the U.S. recovery is not uniform across all sectors and other signals that the global recovery is not well synchronized. Residential investment is a relatively small component of Real GDP at 4% but has been a solid contributor to growth during the rebound that commenced last summer. However, explosive home price appreciation now constitutes a significant headwind to growth and housing investment is likely to stagnate for the remainder of the year, at least. The retrenchment in commercial and office construction which was intense in the wake of the pandemic appears to be stabilizing, and should be relatively inconsequential for the near-term growth outlook, however fundamental demand for office space has likely changed in a lasting way. Many companies will never return to commercial space to the extent they leased in 2019. The U.S. runs a chronic trade deficit and the reality of surging personal consumption is that imports spike as a result. The U.S. trade deficit subtracted 1.5% from Q/Q annual rate Real GDP growth in recent quarters. The silver lining though is that the U.S. is performing its historical role as locomotive of the global economy, exporting demand to our trading partners and giving their recoveries a boost. The chart below spotlights the uneven global recovery so far, with China and Japan lagging behind more vigorous economies in the U.S. and Europe.



Geopolitical Risks Abound but our Outlook Remains Constructive

Several adversaries are currently testing the Biden Administration and economic blowback risks are on the rise. While the U.S. engages Iran to limit nuclear weapons research, dangling reduced sanctions as a carrot, escalating conflict in Syria between the U.S. and Iranian militias underscores the precarious balance of power in the region that is a key energy source for most developed economies. Russia is probing in Ukraine and may be wondering if signals of political correctness from U.S. military leaders indicate a reticence to engage. Recent ransomware attacks connected to Russia that have disrupted key U.S. infrastructure components are beyond annoying and constitute an unacceptable pattern that will inevitably lead to retribution of some nature if they persist. China's behavior toward the U.S. has been reserved lately but on the occasions in which they have engaged diplomatically, their messaging has been unusually hostile. Chinese patterns of political aggression and repression in Hong Kong and Xinjiang bode poorly for Taiwan, one of the industrial world's most important sources of semiconductor chips. Chinese ambitions for global technological dominance may ineluctably lead to interference in Taiwan's independence, possibly entailing U.S. military countermeasures. Our expectation is that these concerns will accelerate U.S. on-shoring of critical technology production and strengthen U.S. leadership in confronting Chinese hegemony. Our assessment is that these are not significant near-term risks to the U.S. economic recovery, however the Biden Administration will likely face recurring challenges on these fronts and face pressure to respond to them.

Equity Markets [3]
Positive News Lead Stocks to New Highs

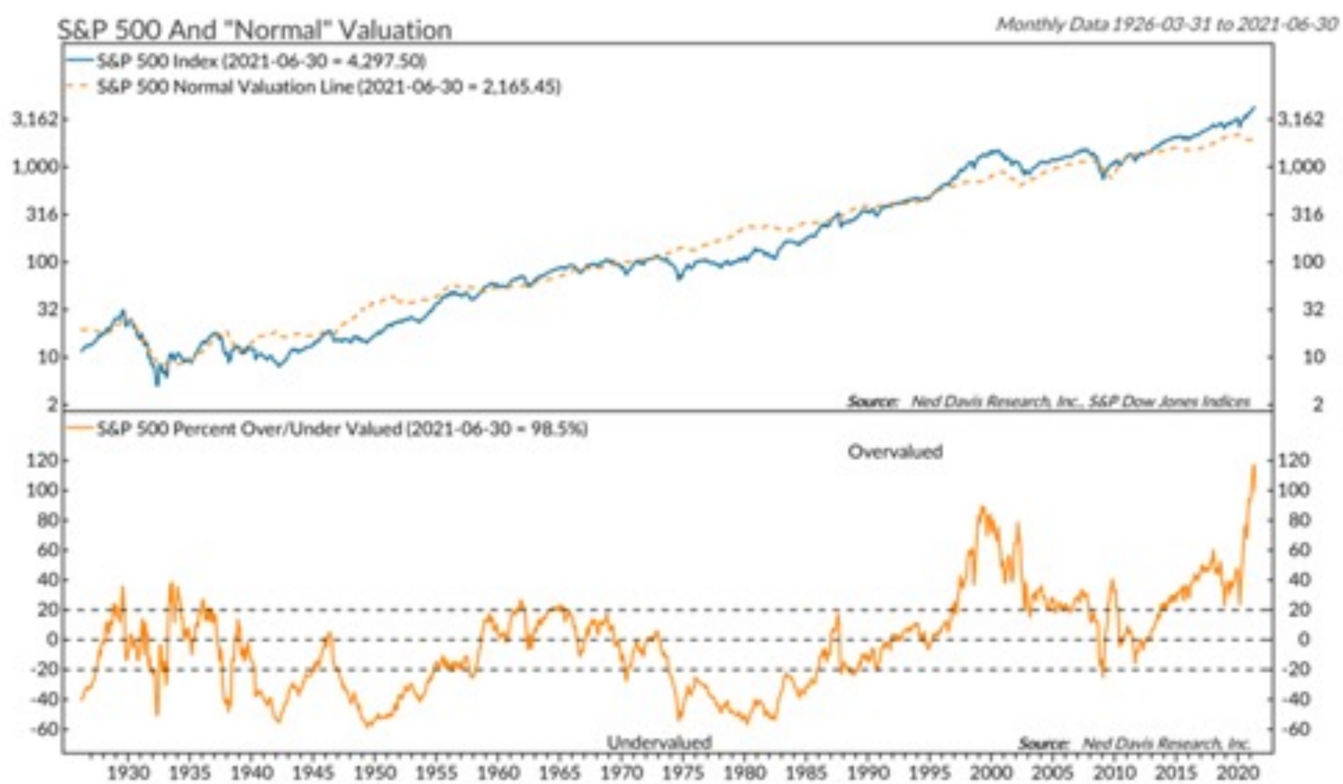
MARTIN SIRERA, CFA
EQUITY PRODUCT MANAGEMENT & INVESTMENT DIRECTOR

- Equity price increases accelerated in the second quarter of 2021, compared to the first. And although it was not without a brief, but healthy, interruption, sentiment and conviction among equity investors grew stronger as the market was barraged with good news on multiple fronts. From pandemic news to economic news to corporate earnings reports, the case for higher stock prices was bolstered throughout the quarter. The S&P 500 posted a very healthy 8.5% return in 2Q21. The quarter saw the return of some themes that dominated the market prior to the brief but deep selloff in early 2020: Large Cap U.S. Growth stocks dominated almost all other equity sub-categories. The S&P 500 Growth Index was up 11.9%, while the S&P 500 Value Index rose a healthy, yet comparatively paltry, 5.0%.

- Among smaller company indexes, returns trailed Large Cap returns. The S&P Mid Cap 400 Index rose 3.6% and the S&P Small Cap 600 Index rose 4.5%. Value and Growth returns in Mid and Small Cap companies did not show the same patterns as in the Large Cap space. In fact, the S&P Small Cap 600 Value Index actually outperformed its Growth counterpart, 5.2% to 3.8%. Non-U.S. Equity markets, as represented by broad indexes, largely trailed the S&P 500. European Equities came close, while Asia Equities trailed. The MSCI Europe Index, which contains European developed market countries whether they are in the EMU or not, rose 7.3%. The MSCI Asia Index rose only 2.2% and the MSCI EAFE Index rose 5.2%.

- As the economy continues to emerge from the depressing effects of the pandemic shutdown in 2020, growth, as measured by many different metrics, has been resoundingly strong. While this is in a big way due to favorable comparisons to recession lows, recent organic growth trends have been impressive. These strong reports include very strong corporate earnings announcements. Equity analysts, in the aggregate, currently estimate that S&P 500 Earnings Per Share grew over 63% in the second quarter of 2021 compared to the second quarter of 2020. That estimate is a good bit higher than it was at both the beginning of the second quarter (+52%) and at the beginning of 2021 (+45%). Top Line Sales growth is also estimated to have grown substantially compared to 2Q20. S&P 500 Sales are currently estimated to have grown almost 20%, and that estimate is up from 16% on March 31, 2021, and 14% on December 31, 2020. As has been noted earlier in 2021, the combination of strong growth, with rising expectations for future growth, which themselves are then exceeded when the actual results come in, is a powerful driver of equity asset prices. The good returns in 2021 have come on the back of strong fundamental growth.

- The strength of the growth of earnings has caused equity valuations to improve a bit over the last few months. Make no mistake however equity valuations are extended. It is not an exaggeration to describe them as extreme. The current trailing P/E on the S&P 500 is 27, down from approximately 30 in the beginning of May or 29 in mid-February. This level was exceeded in the last 30 years only in the late 1999/early 2000 period. Other measures of valuation (P/Sales, P/Book Value, etc.), all paint the same picture. The chart, courtesy of Ned Davis Research, attempts to describe "Normal" valuation over time by combining a number of measures into a single number. It presents a stark picture of how far off the current level is from a very long-term average. It is worth noting that while that very long-term "Normal" valuation level held for a good bit of the 20th century, it has not held for much of the last thirty years. Valuation in this period has revolved around a much higher "Normal". Yet even noting this, today's level is extremely high.



- Outside of Core Equity Categories, the situation is not much different. All such residual-claim assets (i.e., those that get what's left after the high level debt service is addressed), are benefitting from the global monetary and fiscal stimulation that has been amped up over the last 18 months. Some categories have posted better results than U.S. equities so far in 2021 (for example, broad commodity indexes and MLP indexes have performed extremely well on the strength of the price of oil and rising activity in the energy sector), while others have trailed yet still delivered solid returns (Emerging and Frontier markets).

- The environment for cryptocurrency assets has grown extremely volatile of late. One could be tempted to describe the most recent action in crypto assets as a crash. Bitcoin, for example, traded close to the $65,000 level in April and is now approximately $33,000, a decline of almost 50%. On the other hand, today's general price level is more than 3 times higher than last summer's and it is still up about 14% in 2021. This extreme volatility lately can be attributed to any number of things – increased scrutiny by global regulatory entities (like the US Fed or the Chinese Central Bank), high speculation by recent unsophisticated retail investors, the general new-ness that is still the case with the asset class and its underlying technology. Mainly however, volatility in this category is due mostly to the lack of any sort of historical reference for valuation. Both cryptocurrencies as well as the blockchain technology that underpins them, have some purchase in modern finance. It is almost certain that they will be important parts of the landscape for the foreseeable future. Yet with a lack of a reference point for valuation, it is purely speculation driven supply and demand that determines the price and that will always lead to the extreme volatility seen recently.

- Looking ahead, it is important to note the underlying trends which seem to bode well for equity assets – strong growth, solid liquidity support, increasing investing activity by business (e.g., capex, or M&A), and a population driven by "pent-up demand" just to list a few. Risks are growing. Inflation could threaten corporate gross profit margins. Higher regulations and higher taxes can burden profitability. Excess money-creation and sovereign debt issuance can place a damper on future aggregate growth. Additionally as 2021 rolls into 2022, the general economic environment will see the return to the type of and sources of growth that existed before the virus emerged from Wuhan, China and into the lives of the whole world. Growth rates will decelerate rapidly back to the "new normal." In this environment, the world will be burdened with the weight of all the measures put into place in order to offset the self-imposed limitations on economic activity. Even though the second quarter of 2021 was stronger than the first, almost 2/3 of the strong result posted by the S&P 500 Index were achieved in the first full week of the quarter and the last full week. For the rest of the time equity markets mostly meandered sideways seeking answers to the questions about what that post-recovery future will look like. While the immediate future looks clear, with Valuations extended and long-term risks growing, equity investors should maintain caution in their outlooks; stay invested at long-term targets, and remain vigilant for changes to underlying trends.

Fixed Income Markets [3]

Bond Market Rallies

JEFFERY TANGUIS
DIRECTOR OF FIXED INCOME & INVESTMENT DIRECTOR

The U.S. bond markets staged a surprising reversal in Q2 2021 wherein longer term interest rates declined for 3 consecutive months. The rally lifted bond prices and allowed the major bond indices to recoup almost half of the negative returns suffered during the interest rate spike of Q1 2021. For the quarter the Bloomberg Barclays Intermediate Aggregate Bond Index generated a positive quarterly total return of 0.78% versus -1.61% in Q1 2021.

The Stage Was Set

- After relentless waves of bond market selling in the month of March right up to the quarter end closing bell, all the pieces were in place for a textbook market reversal on day one of the second quarter. The bond markets were extremely oversold on a technical basis, short interest was high and the bond market selloff had driven the Treasury 10 year note yield up from a paltry 0.91% on Jan 1st to a respectable closing yield of 1.74% on March 31st. And while multiple factors contributed to the sea change in bond investor sentiment on midnight of March 31st, it was mostly the simple fact that interest rates had risen to a level that bond investors found attractive again given their outlook for inflation, the economy and the Federal Reserve. In many respects the factors driving the bond market rally in second quarter were mirror images of those concerns found in the first quarter. Whereas inflation expectations rose dramatically in the first quarter, they declined in the second quarter. The historically reliable "Copper/Gold Ratio" interest rate indicator signaled rate stabilization in Q2 after rising sharply in the first quarter. Concerns around an overheating economy in the first quarter cooled in the second quarter with back to back employment reports for April and May coming in below expectations. And finally plans for more multi trillion dollar Treasury debt fueled spending in Washington D.C. seemed to hit an air pocket in the second quarter with the more moderate Democrats voicing reluctance. By quarter's end bond investors were gravitating to the view that much but certainly not all of their worries were related to the post pandemic reopening of the economy and likely "transitory" in nature.
- For the quarter the bellwether Treasury 10 year note yield declined -27 basis points to close at +1.47%. The U.S. Treasury 30 year bond yield finished the quarter down -33 basis points to close at +2.09%. On the shorter end of the curve the U.S. Treasury 2 year note yield rose +9 basis points to close the quarter at 0.25%. The U.S. Treasury yield curve as evidenced by the U.S. Treasury 2 yr./10 yr. yield spread flattened by -36 basis points to +122 basis points. Investor inflation expectations cooled during the quarter with market based intermediate term (5 year) inflation expectations trending lower by -10 basis points to 2.50% annualized.

Federal Reserve

- The Federal Reserve policy making committee met twice in the second quarter only to leave its official interest rate policy unchanged. Chairman Powell did finally acknowledged after the June meeting that which everyone already knew. The Fed had greatly underestimated the pace of the economic rebound, the extent supply chain bottlenecks would elevate the prices of available goods and the resulting pickup in inflation. It was a mea culpa of sorts but also a signal the Fed had corrected course and was now fully engaged. Powell also acknowledged that the committee was now formally beginning discussions about how and when to begin tapering asset purchases (quantitative easing). And finally the blockbuster news of the June meeting was the Fed committee member "Dot Plot" survey on year end fed funds target rate expectations. The survey indicated the majority of the committee members had pulled forward their rate hike expectations to 2023 with 7 of 18 even predicting 1 rate hike by the end of 2022. Previous survey's as well as Chairman Powell's commentary had signaled no rate hikes likely until 2024. The revelation caught the bond markets by surprise and sent short term interest rates higher and longer term interest rates lower on the logic that the Fed will raise short term rates sooner than anticipated to slow the economy and avoid runaway inflation.

U.S. Credit

- The corporate bond markets rallied back hard in the second quarter of 2021 after a very challenging first quarter. The Bloomberg Barclays Intermediate Investment Grade Corporate Bond Index was the top performing sector in the intermediate maturity range with a total return of +1.70% for the second quarter. Corporations continued to issue record amounts of bonds to seemingly insatiable investor demand. The strong demand drove credit spreads to 30 year lows. Intermediate term investment grade corporate bond spreads narrowed during the quarter -12 basis points to +58 basis points and remain at 24 year lows. High yield corporate bond spreads dropped -42 basis points during the quarter to +268 basis points over Treasury securities.

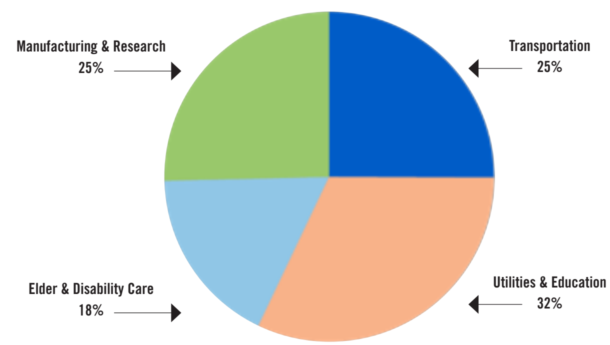
Politics and Policy [4,5,6,7,8]
Has Bipartisanship Returned?

STEVE MORGAN
WEALTH PORTFOLIO MANAGEMENT & INVESTMENT DIRECTOR

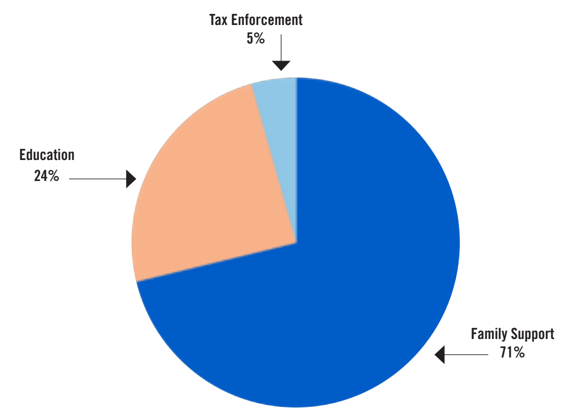
- Almost certainly, the most-watched policy story of the second quarter has been the ongoing proposals and counterproposals around a potential infrastructure spend. Having proposed his roughly $1.9 trillion American Jobs Plan in the waning days of the first quarter, President Joe Biden followed up in late April with the American Families Plan which proposed roughly $2.2 trillion in spending over the next eight years. Promoted as a paired set, the plans ranged the gamut from traditional infrastructure like bridges and roads to manufacturing and research support to funding for education, healthcare and eldercare (which the administration positioned as "human infrastructure"). The American Jobs Plan called for several reforms to the corporate tax structure to offset the additional spending while the American Families Plan focused on taxes on wealthy and high-income households alongside increased tax enforcement. (See our recorded commentaries for more details on the two proposals.)

- Republicans, as expected, opposed the broad scope of the plans, particularly the tax increases to support the increased spend, leaving two general paths forward: Either find a scaled-back infrastructure plan that could garner enough Republican support to avoid a filibuster in the evenly-split Senate or create a version that could gather the support of essentially all Democrats in Congress in order to push through a measure through budget reconciliation which is not subject to filibuster. At this point, the Democratic strategy appears to be "both". After several round of negotiation with different groups, President Biden announced in late June that he had reached an agreement for the framework of an infrastructure bill with a bipartisan group of senators including Republican Mitt Romney of Utah and Democrat Joe Manchin of West Virginia. However, he also called for the Democratic congressional caucus to work on a separate piece of legislation focused on other priorities laid out in the American Jobs and Families Plans that can be passed on a party-line vote via budget reconciliation. The size and contents of such a supplemental plan are unclear as of this writing. Both House Speaker Nancy Pelosi and Senate Majority Leader Chuck Schumer have said they will tie the legislative fate of the bipartisan plan to clear progress on the additional spending, viewed as critical to gain the votes of the more progressive wing of the party.

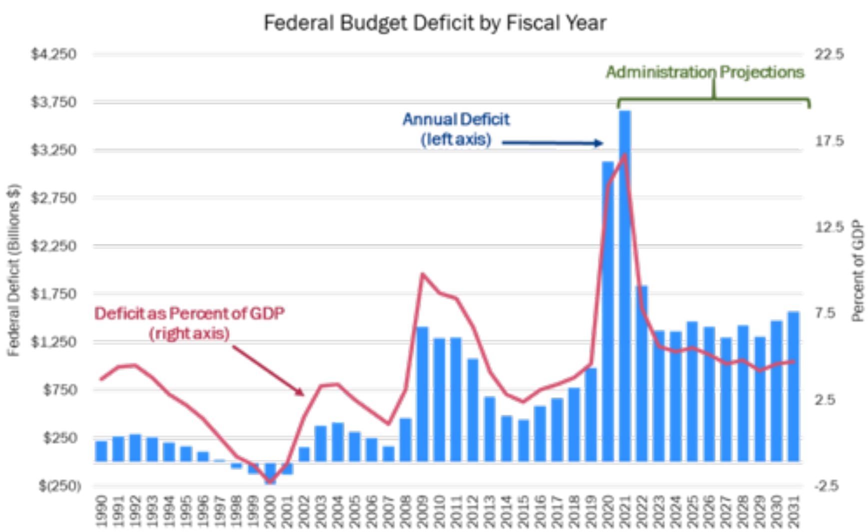
AMERICAN JOBS PLAN SPENDING



AMERICAN FAMILIES PLAN SPENDING



- The bipartisan plan authorizes $579 billion in new spending (for a total of about $1.2 billion in planned infrastructure spend over the next eight years) focused on traditional infrastructure priorities – transportation, water, power and information infrastructure. It does include about $15 billion for electric vehicle infrastructure – far short of the President's original ask of $174 billion for electric vehicle expansion. Most of the new spending will be funded by unused funds from the COVID-19 response, though there has been discussion of minor additional taxation to fill any gaps.
- Both houses of Congress have now restored earmarks, a process by which individual members of either houses can insert favored projects into larger legislation. The restoration comes with several requirements designed to prevent the abuse that led to Congress abandoning them a decade ago. Earmarks may make it easier to get some infrastructure and other spending measures through Congress.



- In mid-May, the Biden administration released its 2022 budget request for Congress, outlining the President's proposal for just over $5.7 trillion in spending in the fiscal year (a bit more than $4 trillion of which is for mandatory spending programs like Social Security and interest on the Federal debt) as well as estimates for future years. The proposal incorporated the full set of features of both The American Jobs and Families Plans. The proposal projects a budget deficit of just over $1.8 trillion for FY 2022 (which is down from FY 2021's record deficit which included substantial COVID-related spending and tax-loss) and a total deficit of $14.5 trillion for the 2022 – 2031 fiscal years, representing about 5.2% of GDP over period. This is a higher percentage than the U.S. has historically incurred outside of wartime or significant economic slowdown. Administration officials have emphasized that interest rates are at abnormal lows, presenting an opportunity to borrow for additional investment. Of particular interest to some investors, the Treasury's accompanying Green Book outlining revenue projections assumed that changes proposed in the capital gains tax rate would be effective as of the date of the American Families Plan announcement in April 2021, a departure from past experience in which capital gains increases only become effective at or after the passage of actual legislation.

- Two Federal COVID responses came under particular scrutiny during the quarter. Many policymakers claim that the first – the Federal Unemployment Insurance program that gave an additional $300 per week above state programs to qualifying recipients – was impeding economic recovery by incentivizing potential workers to stay out of the workforce. This prompted President Biden to clarify in comments that those turning down a suitable job offer would not qualify for further Federal unemployment insurance. Leaders at the state level have also moved decisively with 26 states announcing that they would leave the program prior to its planned September 6 expiration. Of these, 22 exited during the quarter. The remaining states have all announced exit dates in July.

- The second of the two policies is a ban on certain residential evictions that the Centers for Disease Control had initially issued in September 2020 and had extended in steps until July 31, 2021. In early May, U.S. District Court Judge Dabney Friedrich ruled that the CDC had no authority to impose the moratorium and therefore it could not be enforced. At that time, she also put a temporary hold on her ruling to provide an opportunity for appeal. The coalition of landlords that brought the suit had asked the Supreme Court to lift the hold which would allow evictions to begin immediately. In late June, however, the Supreme Court in a 5-4 vote that included justices from both the liberal and conservative sides of the court decided to leave the ban in place until July 31. Justice Brett Kavanaugh in his concurring opinion cited the brief additional time frame and the (now hurried) efforts to coordinate mitigating activities such as distribution of emergency rental assistance as authorized by Congress. Although Justice Kavanaugh in his opinion concurred with Judge Friedrich' original ruling, the Court did not formally rule on the matter.

- As we had predicted, the Biden administration is pursuing greater engagement with the United States' traditional partners in matters including trade but is proceeding hesitantly in fully restoring free trade. In mid-June, U.S. Trade Representative Katherine Tai reached an agreement with European officials regarding a longstanding dispute concerning the aerospace industry, clearing the way for retaliatory tariffs tied to the dispute to be lifted. No such agreement, however, has been reached in a dispute over the steel and aluminum trades where the administration appears to be more willing to extend protections for domestic producers and workers. In another signal of the U.S. rapprochement with traditional partners, the G-7 announced a plan to promote infrastructure projects in the developing world. Designed to compete with China's "Belt and Road Initiative", the plan is dubbed "Build Back Better for the World", a phrase echoing a campaign slogan of President Biden.

- Beyond this infrastructure plan, the U.S. appears to be willing to confront international rivals. In response to cyberattacks, election interference and threats against U.S. soldiers in Afghanistan, the White imposed sanctions on Russia. Among other measures, the sanctions prohibit U.S. financial institutions from buying Russian sovereign debt at its initial issue. Meanwhile, the Senate in early June passed the U.S. Innovation and Competition Act in early June. Beyond providing support for U.S. companies in critical technologies including semiconductors, the bill would authorize several provisions which directly target China including providing support for militaries in the Indo-Pacific region to contain Chinese influence.

COVID-19 Update

Vaccine Pace in U.S. Improves Significantly - Back to 'Normal' Closer

RICHARD CHAUVIN, CFA
MANAGER OF DUE DILIGENCE & ASSET ALLOCATION & INVESTMENT DIRECTOR

- As the second quarter of 2021 ends, a sense of relief is warranted when reviewing the tremendous progress made not only in the United States, but globally in containing the spread of COVID-19.

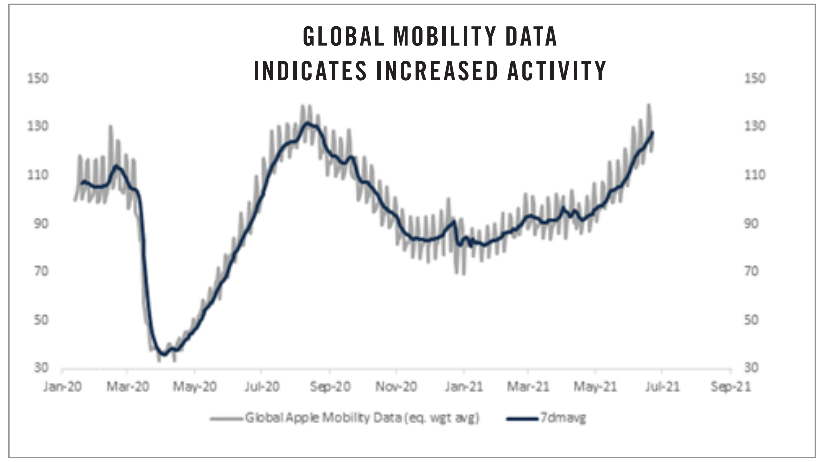
- In the U.S., the 7-day moving average of reported cases plummeted from a peak rate on April 14 of 72,544 to 13,061 on June 30, an 82% decline. Worldwide, a similar but less dramatic decline occurred. The 7-day average of new daily cases peaked at 826,700 on April 28, and proceeded to drop almost 55% to 372,974 at the end of June.[10]

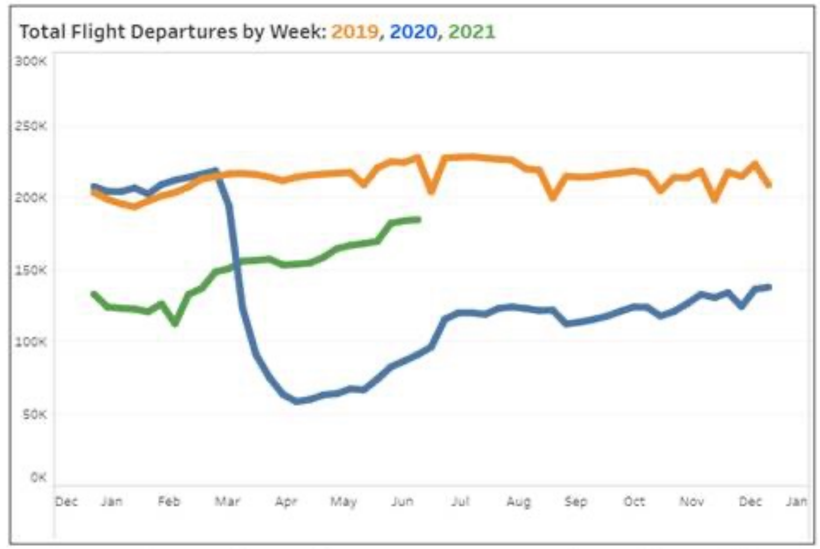
- The 7-day average of new daily fatalities in The U.S. was in a sustained downtrend for the entire quarter, beginning at 969 deaths per day and ending the quarter at 257 per day. Around the globe, there has also been progress in reducing fatalities, though many public health officials have expressed disappointment that more was not achieved. Worldwide reported daily deaths peaked on May 3 at 13,998 and have declined to 10,249 on June 30, a 27 percent decline.[10]

Two major virus-related concerns at quarter-end are:

- The failure to stay on track to meet the original goal of the COVAX program, which was to deliver 2 billion vaccine doses to countries in need by the end of 2021. This target was set in order to cover 20 percent of their populations. At the recent Group of Seven summit, the participants pledged an additional 870 million doses to COVAX bringing the total commitment to 1 billion doses by the end of 2021. The lack of adequate vaccine supplies in middle and low-income countries presents a threat of more outbreaks of COVID-19 and more opportunities for the virus to mutate.[11]
- The spread of the highly transmittable Delta variant that was first discovered in India and has become the dominant strain in the UK. The strain is believed to represent about 10 percent of cases in the U.S. and has been found in 77 countries. Delta has sparked new concerns among some public health officials. In Los Angeles County, the public health department now recommends that everyone - even vaccinated individuals - wear masks again in indoor public places due to risk of transmission of the variant. The CDC has countered that this is not necessary because vaccination protects individuals from the known virus variants. However, the CDC states that the public should heed local officials' guidelines based on local conditions.[2]

- Despite these concerns, the populations of developed nations as well as their governments are unlikely to return to restrictive social distancing measures when they see the risks of serious illness and death declining to demonstrably low levels. Population mobility data are bearing this out. The Apple mobility data in the chart to the right shows that the mobility of the global population of Apple device users is at the highest level since the pandemic began.[12]
- Likewise, the chart shows a significant increase in airline flight departures per week in 2021, as compared with 2020 when the amount of airline traffic plummeted and then began a slow recovery.[13]
- The outlook for continued economic expansion appears to be bright, largely due to the public having become well informed about COVID-19 infection risk and, after some early setbacks, the success of the vaccine development and distribution program in the U.S. and many developed countries.





Vaccine Update

- The regional disparities in vaccination rates continue to cause concerns that future outbreaks of COVID-19 will occur. There are 17 states with full vaccination rates over 50 percent of their populations, with Vermont leading at 65.6%. The states with the worst coverage are mostly located in the South and West, led by Mississippi at 29.8% and Alabama at 32.5%. Fifteen states have full vaccination rates under 40%, and in six of these states more than 60% of the people have not received their first shot. Some states are seeking ways, such as holding lotteries, to encourage the vaccine-hesitant to get their shots. If vaccination rates remain low in some areas, new outbreaks are possible, but may not have outcomes as severe as prior surges since there is a potentially significant percentage of the unvaccinated population who are protected due to a prior Covid-19 infection.

About Our Authors

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Sources: [1]Bloomberg Finance, L.P., [2]Wall Street Journal, [3]Factset, [4]thehill.com, [5]AP, [6]Reuters, [7]whitehouse.gov, [8]congress.gov, [9]CDC.gov, [10]Worldometers, [11]World Health Organization, [12]Evercore ISI, [13]Bureau of Transportation Statistics