Economic & Market Perspectives
April 2021

March Madness is back!

We are referring, of course, to one of the most exciting and popular events in sports, the NCAA Men's Basketball Tournament, which takes place during the last three weeks of March and first week of April. But we could just as easily be talking about what we are seeing in the economy and markets, especially during the first quarter of 2021.

The Tournament, aka March Madness, was cancelled last year for the first time since 1939 on concerns about the novel coronavirus (Covid-19) and its spread. The Tournament reopened this year, albeit in a somewhat limited capacity, which is symbolic of the controlled reopening we are beginning to see in the United States and across the globe.

The excitement associated with March Madness and its single-elimination format, resulting in both expected and unexpected outcomes, has spawned several well-known phrases such as *survive and advance*, *bracket-buster*, and *Cinderella story*, to name a few, all of which could be used in some way to characterize recent economic and market activity.

The Economy

In March Madness parlance, *survive and advance* means focusing on the challenge at hand, getting through it, and advancing to the next round. There is no better example of surviving and advancing than the U.S. economy over the past 12 months.

For the better part of the past year, the Federal Reserve has indicated that "the path of the economy will depend significantly on the course of the virus, including progress on vaccinations". In terms of policy support, Fed Chair Jerome Powell has pointed out that only "our elected officials" have the power to tax and spend, not the Fed.

It was just a year ago, March 2020, that the World Health Organization (WHO) declared the Covid-19 outbreak a global pandemic, and sadly, the U.S. reached a grim milestone in February 2021 as deaths caused by Covid-19 surpassed 500,000.

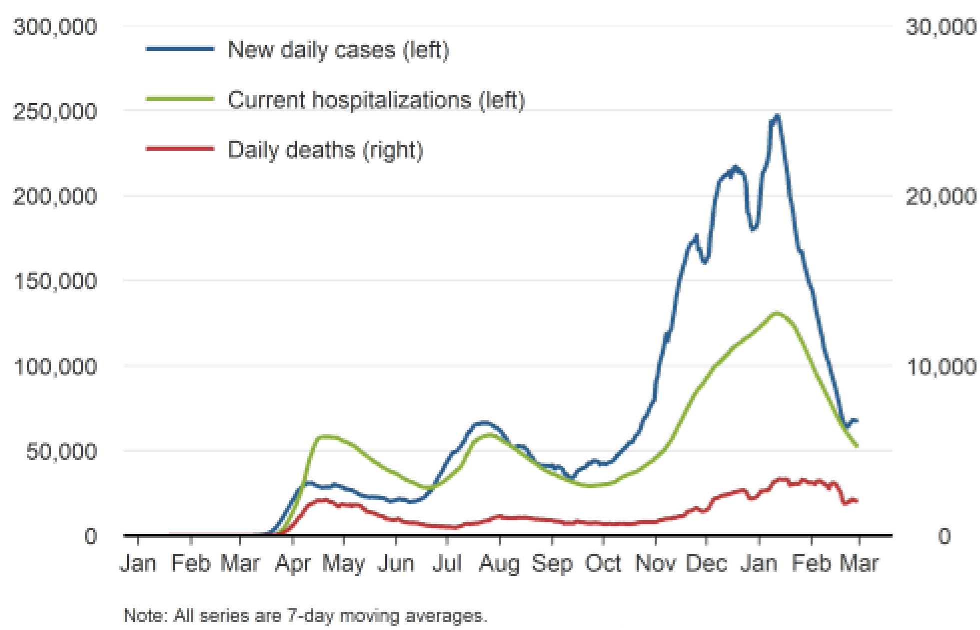
Federal and state officials have taken extraordinary measures, including restrictions and closures, to control the spread, which resulted in a significant decline in economic activity in the second quarter of 2020. Real GDP bounced back in the third and fourth quarters of last year and declined by 3.5% for the year, which was better than earlier forecasts, and the outlook for economic growth is improving.

According to the Organization for Economic Cooperation and Development (OECD), a strong surge in U.S. growth will help drive a sharp rebound in the world economy, which is expected to grow by around

6% this year, the fastest rate in almost half a century. In mid-March, the Federal Reserve revised upward its projection for U.S. real GDP in 2021 to 6.5% (from 4.2% in December). The U.S.'s economic surge is being bolstered by a successful Covid-19 vaccine rollout, a $1.9 trillion fiscal spending package, a very accommodative Federal Reserve, and pent-up demand.

Covid-19 trends are very encouraging. The numbers of Covid-19 cases, hospitalizations, and deaths have dropped significantly since peaking in January – see Figure 1. According to the Centers for Disease Control and Prevention (CDC), newly reported Covid-19 cases have decreased 77%, hospitalizations are down 72%, and deaths have declined 72% from their peak levels in January (based on 7-day averages through March 24, 2021).

Figure 1 – U.S. Covid-19 new daily cases, hospitalizations, and deaths are improving



Source: Federal Reserve Bank of San Francisco; Worldometer, data through Feb, 28, 2021 and the Covid Tracking Project

There has been significant progress with Covid-19 vaccinations. The Johnson & Johnson/Janssen Covid-19 vaccine received Food and Drug Administration Emergency Use Authorization (EUA) in February 2021. The U.S. now has three safe and effective vaccines, including the Pfizer/BioNTech and Moderna vaccines, which received FDA EUA in December 2020. The J&J vaccine has advantages over the other two vaccines in that it only requires a single dose (as opposed to two) and it has less restrictive storage requirements. President Biden has promised vaccines for U.S. adults by May 31 and at the current rate of over 2.4 million vaccinations being delivered daily, experts project the U.S. will reach herd immunity, which is critical to stopping community spread, by mid-summer of this year.

The federal government has provided extraordinary fiscal policy support in the form of various relief packages. After passing nearly $2.8 trillion in support, including the CARES act, in March-April of 2020, Congress passed a $900 billion relief bill in December 2020 and followed that with the $1.9 trillion American Rescue Plan, signed into law on March 11, 2021. And there is talk of a $3 trillion spending proposal, focusing on infrastructure, education, and poverty. Treasury Secretary Janet Yellen has indicated that the U.S has the capacity to borrow to fund deficit spending, given historically low interest rates. However, in order to support more permanent spending in the longer run, the government will have to raise revenue through higher taxes.

The Federal Reserve also remains very supportive. At its most recent meeting in March, the central bank reiterated its commitment to an easy money policy, maintaining ultra-low interest rates and continuing asset purchases, until substantial further progress has been made toward its employment and inflation goals.

The labor market is still under stress despite unprecedented levels of fiscal and monetary support. The U.S. economy has only regained a little more than half of the close to 23 million jobs lost last year at the onset of the pandemic-related slowdown. Weekly jobless claims have remained persistently high and only recently dipped below the pre-pandemic high of 695,000 and approximately 4.1 million Americans or 41.5% of all the unemployed have been out of a job for more than six months. However, the Fed projects that the economy will return to full employment (that is, at or below their longer run unemployment rate of 4%) by 2022.

Inflation fears, based on stronger economic growth prospects, have driven bond yields higher since the beginning of the year. The Fed recently upped its inflation projections to 2.4% in 2021 and 2.0% in 2022. The Fed believes that any short-term spikes in inflation will be transitory. Markets appear to be supporting the Fed's view with shorter term inflation expectations recently coming in higher than longer term as measured by 5- and 10-year breakeven inflation rates.

Markets

Rising bond yields have been a *bracket buster* for markets in the first quarter of 2021, upending long-time favorites: investment grade bonds and growth stocks (dominated by technology shares).

Bond yields rose in the first quarter on higher economic growth and inflation expectations. The yield on the benchmark 10-year Treasury note has risen from 0.92% at the beginning of the year to a high of 1.77% during the first quarter – bond yields rise when the price of bonds falls. Investors have been concerned by both the magnitude of the increase as well as the rate of change. There is also concern about supply as the government finances its increasingly high levels of deficit spending.

Rising bond yields slowed U.S. stock market momentum as investors rotated out of big technology shares which thrived in last year's stay-at-home environment, and into cyclical sectors (such as financials, energy and industrials) that tend to perform better in a recovering economy.

After flying high for most of 2021, the tech-heavy Nasdaq Composite fell into correction territory on March 8 as the selloff in bonds weakened demand for growth stocks, which include big tech companies. The Nasdaq declined more than 10% from its record high on February 12 to March 8.

Value stocks have also been a *bracket buster* as the rotation out of growth into value stocks (such as financial and energy companies) that began last November continued in the first quarter of this year. For the quarter, the Russell 1000 Value Index rose 11% and the Russell 1000 Growth Index gained 1%. That gap is one of the largest leads for value stocks in almost two decades according to Dow Jones Market Data. At this point last year, during the coronavirus-induced downturn, growth stocks held a wide lead.

There were a few *Cinderella stories* in the first quarter. The Russell 2000 index of small-cap stocks, which tend to perform well when the economy is strengthening, have advanced 12.4% year to date (as of Mar 31). Although, the small cap index has retreated 6% from its mid-March record close. Another *Cinderella story* involved the "short squeeze" trading frenzy around video game retailer GameStop (GME), which saw its share price run up by close to 20x its starting point at the beginning of January. GME has since pulled back by around 50% from its January closing high of just under $348.

Bitcoin has also been a *Cinderella story* not only for the first quarter but well beyond. As the crypto-currency garners greater acceptance from institutional investors and the financial industry, the price of bitcoin continues to surge, up over 100% in the first quarter of this year and up close to 800% for one year. That story continues to unfold. For additional commentary on Bitcoin, see below.

Overall, stocks performed well in the first quarter, and despite having historically high valuations, the outlook for equities remains positive. According to FactSet, analysts expect earnings growth of 25% in 2021 and project a 14% increase in price for S&P 500 over the next 12 months. Although, rising bond yields could put downward price-pressure on stocks.

For select asset and asset class returns, see Figure 2.

Figure 2 – Select Asset and Asset Class Returns
Many asset classes have had positive returns in the past 3 months bolstered by additional fiscal relief and the successful vaccination rollout.

10-Yr Treasury Yield 0.84*	Bitcoin 99.5%	Bloomberg Barclays U.S Aggregate Bond Index -3.4%	Cboe Volatility Index (VIX) -14.7%
Dow Jones Industrial Average 7.8%	Gold (per troy ounce) -9.5%	MSCI Emerging Markets Index 1.9%	Nasdaq Composite 2.8%
Nikkei 225 6.3%	Refinitiv/CoreCommodity CRB Index 10.2%	Russell 2000 12.4%	S&P 500 5.8%
STOXX Europe 600 7.7%	Shanghai Composite -0.9%	U.S. Dollar Index 3.6%	WTI Crude oil (per barrel) 24.3%

1/1/21 - 3/31/21 *Change in percentage points

Sources: Bloomberg, MarketWatch, The Wall Street Journal

Investment Strategy

"Cautiously optimistic" is perhaps one of the more overused phases in the investment industry, but nevertheless, it most accurately describes our current outlook. We are optimistic given the tailwinds of unprecedented monetary and fiscal policy, outlook for improving global economies and earnings growth, and "game-changing" impact of vaccines and progress on vaccinations. However, we remain somewhat cautious given potential risks including the size and timing of additional fiscal response, impact of coronavirus variants, challenges around distribution of vaccines, and the effect of rising bond yields on stock valuations.

The tailwinds mentioned above are supportive of our above-neutral allocation to equities. We favor U.S. over non-U.S. stocks. We have recently added to our large cap value exposure and are close to an equal-weight allocation to value, core, and growth within our strategies. We have an above-neutral allocation to U.S. mid and small cap as well as REITS. For non-U.S. equities, we favor emerging markets and recently added an allocation to international small cap.

The Fed is committed to keeping interest rates "lower, for longer" but bond yields have ticked up with higher growth and inflation expectations. As a result, we have a below-neutral allocation to fixed income and are underweight core bonds relative to our neutral target. With a bias towards shorter duration and higher credit risk, we have added allocations to high yield bonds, inflation protected securities, floating rate bonds, and preferred securities.

Low short-term interest rates and higher inflation expectations make cash returns unattractive and our allocation to cash across our strategies is minimal.

We recently added an allocation to commodities, which could benefit from the following drivers: the post-pandemic recovery, fiscal stimulus and accommodative monetary policy, potential for higher inflation, weaker U.S. dollar, and more aggressive environmental policy.

Please see our asset class views on the next page.

Bitcoin

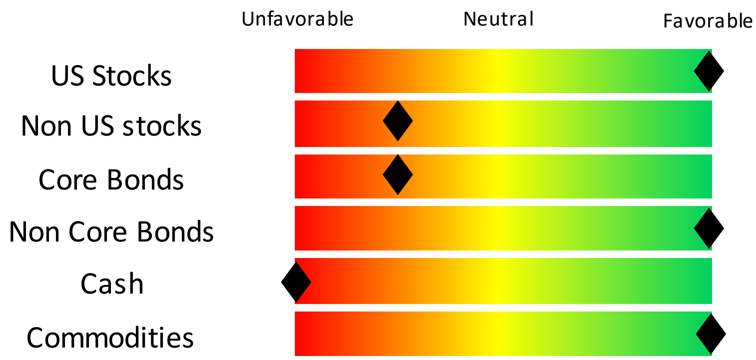
In closing, we would like to comment on bitcoin. The price action in bitcoin has been nothing short of phenomenal. It certainly has been and will remain an attractive trade for those who are able to purchase it at a lower price than they are able to sell it. Whether bitcoin, and more generally cryptocurrency, ultimately plays an important role in commerce remains to be seen, but earlier indications are that it will. Our concern with using bitcoin as a diversifying asset in investment strategies centers on its volatility and the ability to value it.

The price of Bitcoin is highly volatile, and unlike more traditional assets like stocks and bonds, there are no future earnings, cash flows, or interest payments which can be used to determine a discounted present value. Bitcoin is not a real asset although it has been referred to as "digital gold" nor is it a currency widely used in transactions. The fact that it is not a currency backed by a government that can "print money" has been part of its appeal.

In addition to the volatility and valuation risk noted above, we are also concerned about regulatory risk. Treasury Secretary (and former Federal Reserve Chairwoman) Janet Yellen recently expressed concerns about bitcoin's use for illegal transactions and hinted that more government regulation is likely.

As long as there are willing buyers and sellers and there is demand to own bitcoin, it will remain a *Cinderella story*. That reason alone, in light of the risks noted above, is not enough of an investment thesis for us to consider including it as a diversifying asset or asset class in our investment strategies.

PeopleBank Wealth Management
Asset Class Views



Asset class views are as of 3/23/2021 and subject to change without notice

Investment Process

PeoplesBank Wealth Management's asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic recommendations are based upon how the Investment Strategy Committee believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. The tactical recommendations are meant to highlight opportunities over the next one to two years where the Committee sees either increased opportunity or risk.

The Wealth Management Investment Strategy Committee (ISC) is responsible for establishing and updating both the strategic (long-term) and tactical (short-term) asset allocation for Wealth Management's investment management and trust relationships. The committee is comprised of the senior members of the Wealth Management team. The committee is also responsible for monitoring and updating strategies, managers, and funds within client portfolios. The ISC meets monthly. If you have any questions or would like to discuss PeoplesBank Wealth Management's outlook further, please call or send an email to your relationship or investment officer.

Sources: Barron's, Bloomberg, Centers for Disease Control and Prevention (CDC), FactSet, MarketWatch, The Federal Reserve Board of San Francisco, and The Wall Street Journal.