Sit Investment Associates

April 2021

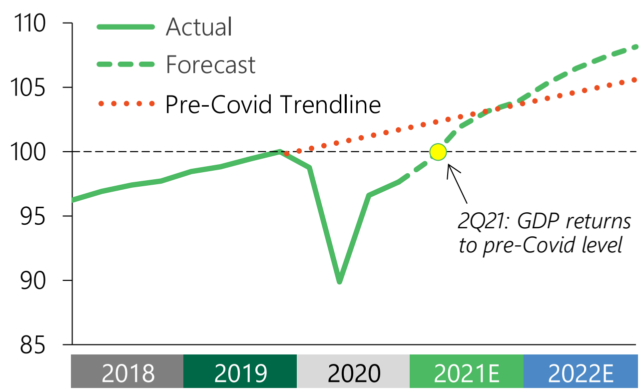
Global Investment Outlook and Strategy

- **Much-Improved U.S. Outlook with Fresh Stimulus & Vaccine Progress**
- **Inflation Pressures Will Intensify Short Term but Prove Transitory**
- **Global Economic Prospects Diverging on Vaccine & Policy Disparities**
- **Historic Shift in Treasury Yields on Anticipated Economic Rebound**
- **Attractive Opportunities in Both Secular and Cyclical Growth Stocks**

Rapid Shift in Economic Growth Backdrop as Earnings Become Key to Equity Market Gains

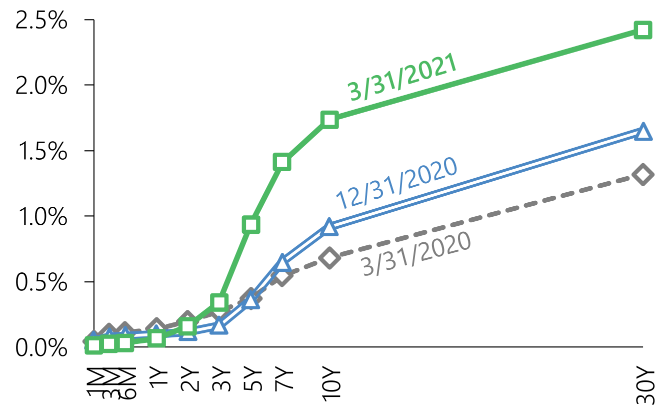
1 Extraordinary Stimulus Lifting GDP Trajectory

U.S. Real GDP
Indexed, 4Q19 = 100



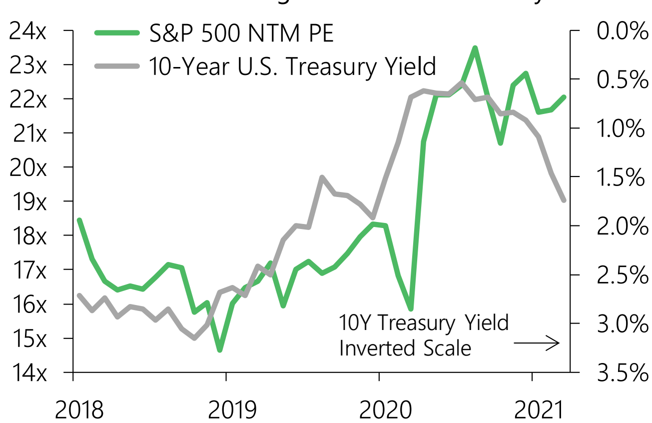
2 Leading to U.S. Treasury Curve Steepening

U.S. Treasury Yield Curve



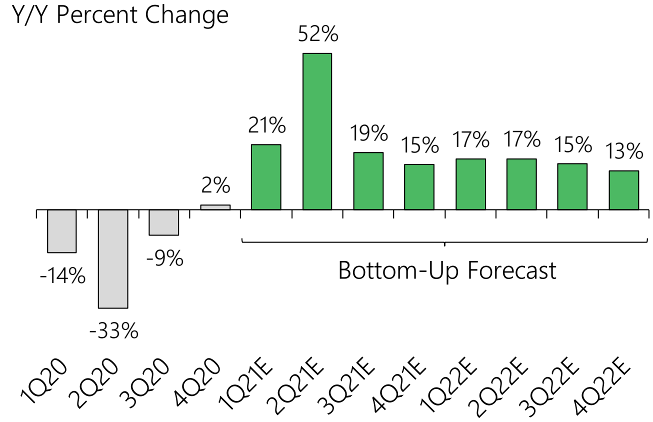
3 Higher Yields May Pressure Equity PEs

S&P 500 Price-to-Earnings Ratio vs U.S. Treasury Yield



4 But Shifting to an EPS-Driven Equity Market

S&P 500 Bottom-Up EPS Growth
Y/Y Percent Change



Source: Bureau of Economic Analysis, FactSet, Sit Investment Associates 4/8/21

Accumulating Stimulus Boosting U.S. (and Global) Economic Growth Outlook

The recently passed $1.9 trillion American Rescue Plan Act, which brings total potential Covid-related U.S. fiscal and monetary stimulus to date to a staggering $12.8 trillion, has contributed to a much-improved economic outlook. The near doubling of weekly doses available following the FDA's late February approval of J&J's Covid-19 vaccine will also likely accelerate the path to herd immunity and a full reopening of the domestic economy. Consequently, we now project U.S. real GDP will rise +6.6 percent year over year in calendar 2021, up from our +4.4 percent estimate in January. This rebound comes after a -3.5 percent contraction in 2020 but would still be the economy's highest annual growth in nearly four decades. Led by job gains in leisure and hospitality, the labor market is gathering steam post the autumn 2020 surge in new Covid cases. Moreover, with over $2 trillion in excess savings, a large percentage of which is thanks to Uncle Sam's stimulus checks, consumers have the extra wherewithal to drive a robust upturn in spending (Exhibit 1). Increasingly confident and flush with cash, businesses are also hiking capital expenditures. On top of it all, the newly revealed $2.3 trillion American Jobs Plan (AJP) could lift baseline 2022 GDP growth by 50 to 100 basis points if passed by yearend. Near-term risks tied to Covid-19 include another surge, a new variant, or public resistance to the vaccine.

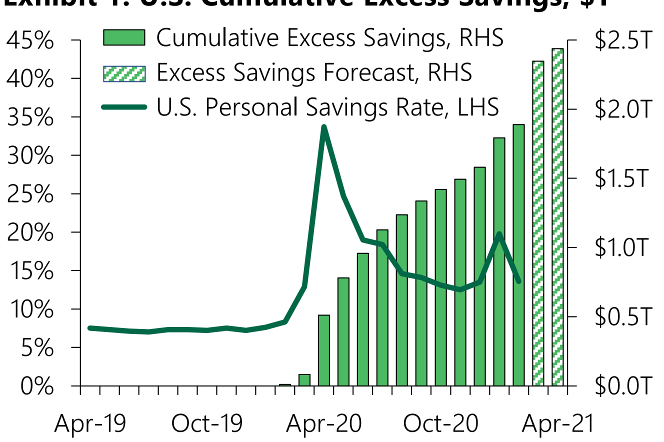
Reflation Hopes Turned to Inflation Fears, but Cost Pressures Likely Transitory

The strength of factory orders driven by ever-mounting global stimulus and pent-up demand caught many producers, suppliers, and shippers flat-footed. Pandemic-linked disruptions have rippled across worldwide supply chains, leading to depleted inventories, stretched lead times, and increased costs. One-offs such as the recent fire at a Japanese chip maker and Suez Canal logjam are other near-term impediments. A weaker U.S. dollar and spiking commodity prices are also putting upward pressure on input and freight costs, with the ISM Manufacturing Prices Paid Index soaring to a 10-year high. The services sector is seeing higher costs as well, mostly by way of commodities exposure. We project U.S. consumer prices will rise +1.5 percent year over year in the first quarter of 2021 but leap +2.7 percent in the second against easy year-ago comparisons (Exhibit 2). Inflationary pressures will persist, and likely modestly intensify, into 2022 as the economy reopens and spending accelerates. However, the spike in inflation should be largely transitory and eased by ample economic slack, giving the Federal Reserve the needed flexibility to stay accommodative. The supposed $3 to $4 trillion of fresh stimulus in the works, counting the AJP, raises the risk the economy will overheat. Yet, any further spending bills will likely be watered down (if even enacted), offset with higher taxes, and spread over many years.

Nearer-Term U.S. Dollar Reversal Should Help Take Edge Off Rising Prices

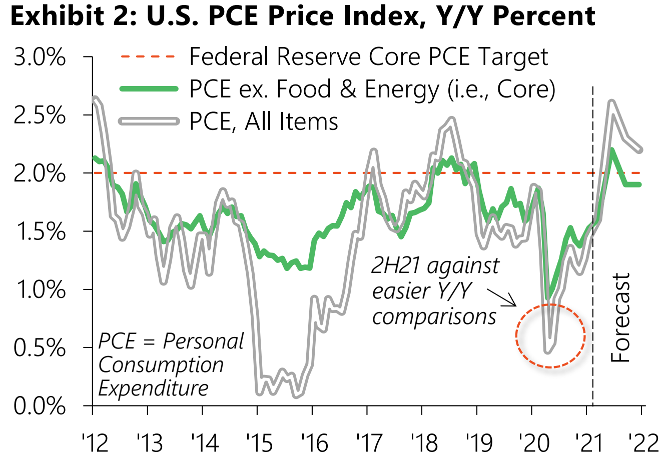
The U.S. dollar is generally countercyclical – that is, the trade-weighted dollar tends to weaken as global economic growth strengthens and vice versa. The lower relative cyclicality of the U.S.

Exhibit 1: U.S. Cumulative Excess Savings, $T



Source: Bureau of Economic Analysis, Oxford Economics, 4/3/21

Exhibit 2: U.S. PCE Price Index, Y/Y Percent



Source: Bureau of Economic Analysis, Sit Investment, 4/5/21 economy by virtue of a smaller manufacturing base helps explain this dynamic. Thus, the U.S. dollar fell -12 percent against a broad group of currencies from April 2020 to yearend as global growth prospects improved, contributing to higher import and commodity prices. Yet, rising fiscal stimulus and a comparatively faster Covid-19 vaccine rollout have since positioned the U.S. economy to decidedly outperform global peers in 2021. We now project U.S. GDP growth will outpace that of other developed nations by an average of 150 basis points this year. The Dollar Smile Theory suggests the U.S. dollar will strengthen during global recessions, weaken when international GDP growth outpaces that of the U.S., and strengthen when U.S. growth outperforms (Exhibit 3). A stronger U.S. dollar (up +2 percent year to date), while unlikely to surpass peak March 2020 levels, will pose a sequential headwind for U.S. exporters, U.S.-based multinationals, and emerging markets but also likely tamp down input and commodity prices. Nonetheless, historically high U.S. twin deficits (i.e., current account and federal budget) and a proactive Federal Reserve will likely cap dollar strength and contribute to another downward reversal in late 2021or early 2022 when international economies are on a more solid footing.

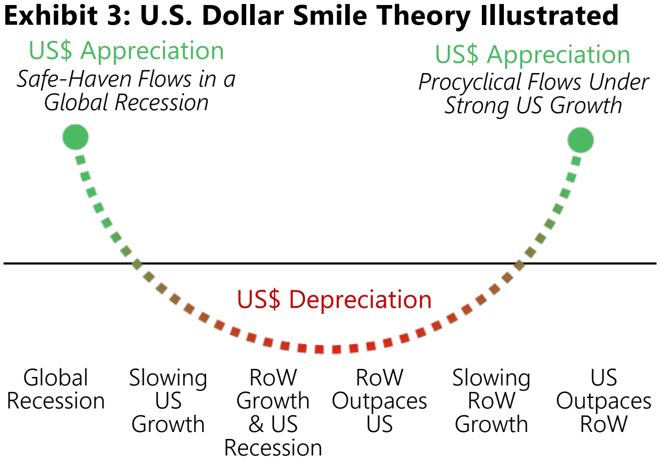
Vaccine & Policy Disparities Contributing to Diverging Global Economic Prospects

Led by massive global stimulus and economic strength in China and the U.S., we now estimate real global GDP will surpass the pre-pandemic level by midyear and expand about +5.0 percent in 2021. U.S. stimulus has not only improved the domestic growth outlook markedly, but the economic spillover will also increase international output. The OECD projects a 50 to 120 basis point lift to major U.S. trading partners' baseline GDP growth rates in the first full year of the $1.9 trillion American Rescue Plan. In all, $31 trillion in global stimulus (≈36 percent of global GDP) has amassed since early 2020. Along with a shift in consumer spending to home-related and leisure goods and growing capacity/tech investment, the stimulus has helped lift the global manufacturing PMI to a 10-year high. However, as manufacturing surges upward, the services sector remains hamstrung by Covid-19 containment measures. Economic divergences among nations are also becoming increasingly evident based on success in keeping the virus in check, the pace of vaccinations, and policy support level (Exhibit 4). For some, securing an adequate Covid-19 vaccine supply is the holdup, while deployment missteps have plagued others. A somewhat staggered global recovery is not necessarily undesirable as it should forestall added inflationary pressures and, in turn, allow central banks to remain accommodative.

Recovery in European Services Sector Pushed Out by Slower Vaccine Deployment

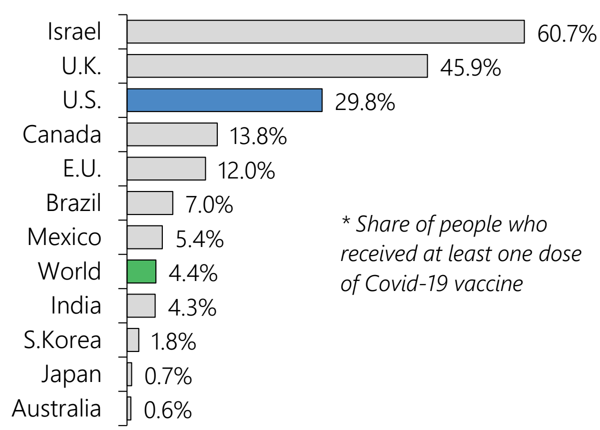
Manufacturing activity is booming throughout Europe, with Germany's manufacturing PMI at a record high in March (survey started in 1996), Italy's at a 21-year high, France's at a 20-year high, Spain's at a 14-year high, and the U.K.'s at a 10-year high. Robust demand from the U.S. and China as well as domestic preparations for loosening Covid-related restrictions underpin the strength. The European Central Bank also continues to underwrite the nascent recovery, injecting near €500 billion of new liquidity into the financial system in the first quarter of 2021. In the last year, it has expanded its balance sheet +48 percent to €7.5 trillion. Nonetheless, the

Exhibit 3: U.S. Dollar Smile Theory Illustrated



Source: Vanda Research, Sit Investment, 3/31/21

Exhibit 4: Percent of Population Vaccinated*



Source: Our World in Data, 3/31/21

services sector continues to contract under the weight of rolling Covid lockdowns (Exhibit 5). The U.K. is considerably outpacing continental Europe in terms of the percent of the population vaccinated against Covid-19, setting the economy up for a full reopening. Deployment snafus and safety concerns tied to the AstraZeneca vaccine have materially slowed the vaccine rollout across much of the rest of Europe. With services representing over two-thirds of GDP, the late rollout dampens the near-term outlook for the Euro Area. We now forecast real GDP will grow +4.0 percent in 2021 (down -50 basis points versus prior estimate). Aided by a favorable base effect and rapid vaccine deployment, we still project U.K. GDP will rise +5.0 percent this year. However, the Euro Area and the U.K. may not return to pre-Covid GDP levels until early 2022.

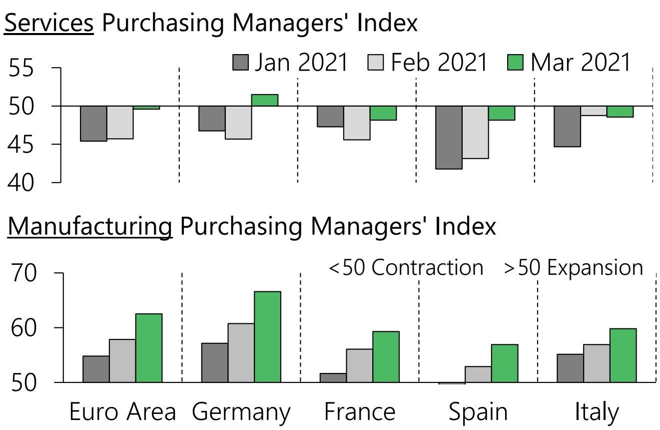
Mixed Outlook for EMs but Most Will Benefit from Stronger U.S. Economy

Emerging market economies are confronting a strengthening U.S. economy, rising U.S. dollar, higher commodity prices, and slower vaccination of its population, all of which have a mixed impact on the various nations. Stronger U.S. economic growth and currency should boost U.S. imports and support emerging market exports and commodities of oil, copper, and iron ore. Thus, emerging market economies will benefit from improving trade. However, a stronger U.S. dollar would also hurt countries with high U.S. dollar-denominated debt. For example, Brazil's consolidated gross government debt is 89 percent of GDP, and its interest expense to fiscal revenues ratio could deteriorate to 15.2 percent of GDP by 2022, up from 12.5 percent in 2020. Higher commodity prices will also contribute to inflationary pressures, especially in oil importers, such as India. Although annual headline inflation has remained relatively stable in most emerging markets, low base effects from last year should lead to a near-term acceleration. Finally, many emerging markets are lagging in terms of vaccination, which will delay economic recovery and a return to pre-Covid GDP levels. China is targeting to vaccinate 40 percent of its population by mid-year, while most other emerging markets will be about five percent.

China to Focus on Quality Growth and Long-Term Sustainability

China's macro data was better than expected in January and February. Industrial production growth accelerated on export strength and additional working days in February. Conversely, private consumption growth, which was negatively affected by the January Covid-19 outbreak and subsequent Lunar New Year travel controls, continued to lag. At the same time, the pace of policy normalization has been mild as expected. Our forecast of high teen real GDP growth in the first quarter of 2021 and high single-digit growth for the entire year remains unchanged. In mid-March, China released its 14th Five-Year Plan for 2021-2025. Against the backdrop of challenging U.S.-China relations and a global pandemic, the blueprint emphasized innovation and the need to stabilize the manufacturing share of GDP. The plan also elevated new strategic priorities for green development and food and energy security (Exhibit 6). In our view, while lacking forceful changes on lifting household income and consumption, the plan, if executed well, should still help China achieve quality, sustainable growth.

Exhibit 5: Services and Manufacturing PMIs



Source: Markit Economics, 4/7/21

Exhibit 6: China's Five-Year Plan – Key Targets

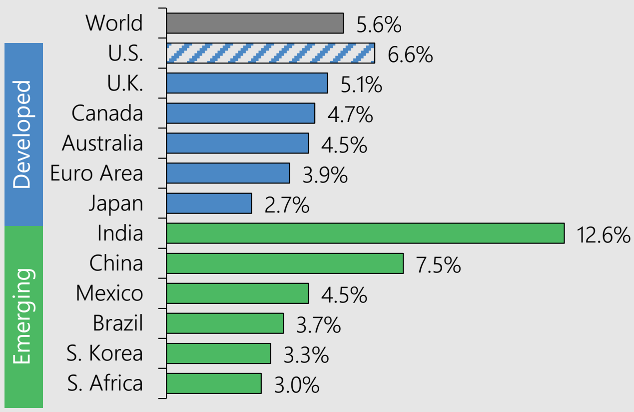
Indicator	FYP Target	2020
GDP Growth, %	Set appropriate annual targets	2.3
Labor productivity growth, %	>GDP growth	2.5
Urbanization rate, %	65	60.6
R&D spending growth per year, %	7	10.3
High-value patents per 10k population	12	6.3
Digital economy value add, % of GDP	10	7.8
Avg. disposable income growth, %	as fast as GDP	-
Unemployment rate, %	<5.5	5.2

Source: Deutsche Bank Research, 3/17/21

Global Macro: Notable Data Points

U.S. Expansion to Outpace Global Growth in '21

2021 Real GDP Growth, Y/Y Percent



Source: OECD, Sit Investment, 3/31/21

GDP Lift From Possible AJP Limited by ↑Taxes

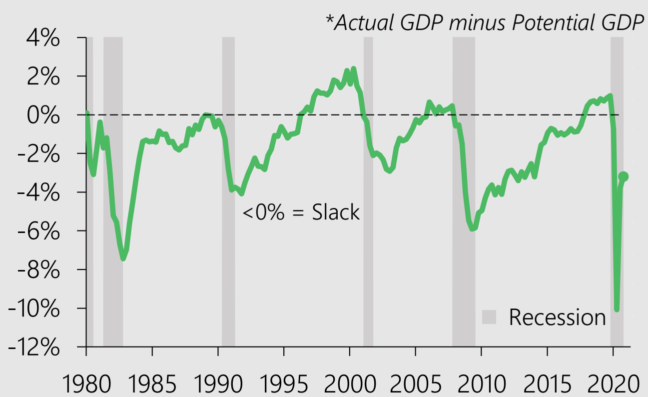
American Jobs Plan, Key Provisions*	10 Yrs	15 Yrs
Invest in Transportation Infrastructure	$621B	
Invest in Domestic Manufacturing, R&D, & Job Training Initiative	590	
Expand Home Care Services & Provide Additional Support for Care Workers	400	
Improve Housing Stock, Modernize Schools & Child Care Facilities, & Upgrade VA Hospitals & Federal Buildings	328	
Invest in Broadband, Electrical Grid, & Clean Drinking Water	311	
Total New Spending	$2,250B	$2,250B
Total New Taxes	$1,750B	$2,750B
Total Deficit Increase (+)	$500B	-$500B

** Excludes $400b in clean energy tax credits that bring cost to $2.65T*

Source: Committee for a Responsible Federal Budget, 4/2/21

Ample Economic Slack Should Ease Inflation

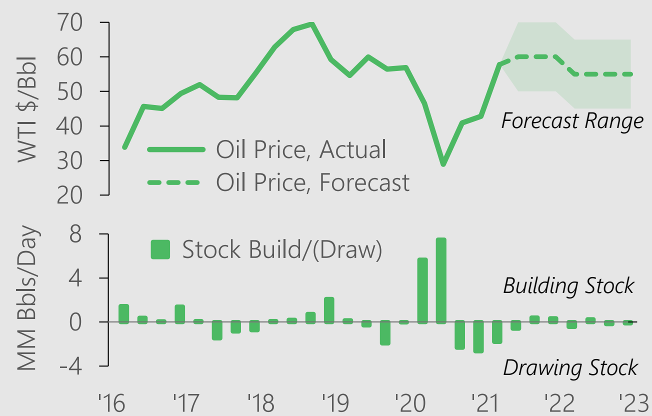
U.S. Output Gap*
Percent of Potential GDP



Source: Bureau of Economic Analysis, CBO, 3/31/21

Oil Prices Likely Plateaued as Stock Normalizes

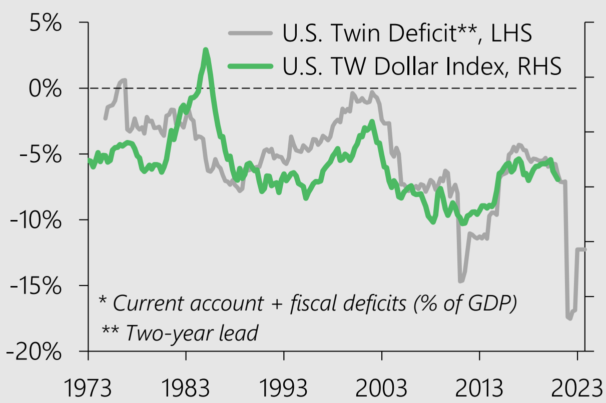
Oil Prices and Global Oil Stock Build-Draw



Source: EIA, FactSet, Sit Investment, 3/31/21

Twin Deficits Will Cap Recent US$ Strength

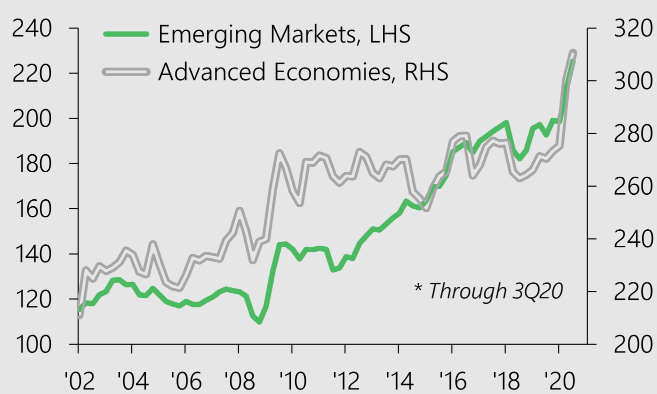
U.S. Twin Deficit* vs Trade-Weighted Dollar



Source: Federal Reserve, U.S. Census, CBO, 3/31/21

Global Debt on an Unsustainable Trajectory

Total Credit to the Non-Financial Sector*
Percent of GDP



Source: Bank for International Settlements, 3/31/21

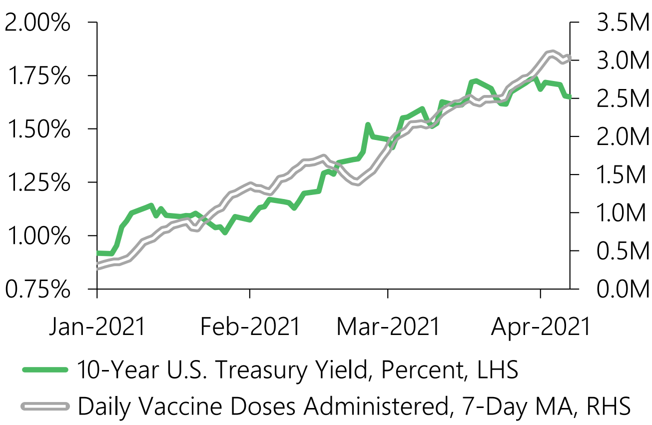
Higher Bond Yields on the Horizon

The first quarter of 2021 has seen an increase in vaccine deployment and a rise in U.S. Treasury yields (Exhibit 7). We anticipate both trends to continue. Interest rates are being driven higher by improving economic growth, rising inflationary pressures, and anticipated Treasury market imbalances (Exhibit 8). The rapid pace of vaccinations and the reopening of the economy are contributing to improved economic activity, with pent-up demand fueling robust growth on a global scale. We already see increased pricing pressures in services and manufacturing data. Supply chain issues and bottlenecks will likely worsen and continue to contribute to upward pricing issues in the coming months. Moreover, year-over-year inflation metrics will be biased upward as the depressed figures from the pandemic's onset provide a low base for upcoming comparisons. Many of the factors influencing inflation will likely prove transient and dissipate in 12-18 months as the economy enters a more stable post-Covid environment. The massive amount of fiscal stimulus the government has provided ($6.8 trillion so far), along with future proposed spending initiatives, will eventually need to be funded by increased Treasury issuance (projected to be $3 trillion). This increase in supply is coming when market participants speculate the Federal Reserve (Fed), which is buying $120 billion in securities per month, may be looking to begin winding down its asset purchase program. This anticipated supply-demand imbalance is also pressuring yields higher. The rise in interest rates may slow as the proposed infrastructure bill and corresponding tax hike may be perceived as a net negative on domestic economic growth.

Taxable Fixed Income Strategy

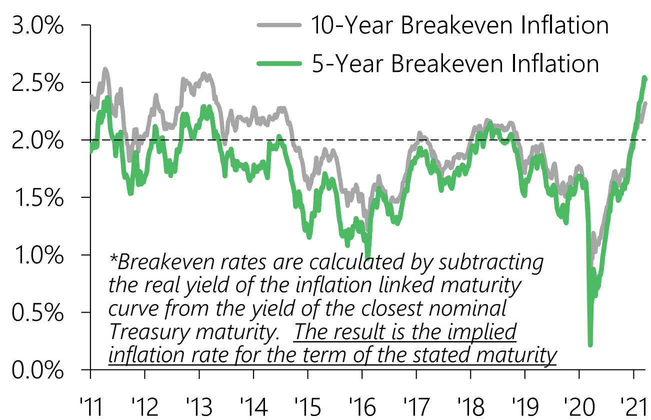
Although the pandemic's economic drag will likely end sooner than previously forecasted, the Fed has reiterated it will remain accommodative, and enormous fiscal stimulus continues to accumulate. As a result, we believe the economic recovery will likely be large, occur soon, and drive a spike in inflation against easy year-over-year comparisons. A synchronized global economic rebound is already causing difficulties for firms trying to restock in preparation for the end of lockdowns, exemplified by soaring shipping costs/delays and container shortages at West Coast ports. The Fed's commitment to keep short-term interest rates low until 2023-2024, coupled with inflationary pressures, are driving up longer-term rates and will steepen the yield curve over the intermediate term. Our emphasis remains on providing a significant yield advantage, which represents the best source of return to offset potential price losses from rising rates. We positioned portfolios with durations below benchmarks that should outperform in an economic rebound, emphasizing lower-quality and cyclical securities where appropriate. We are also using inflation-protected securities and avoiding bonds at the long end of the yield curve. We intend to capitalize on tactical trading opportunities as the economic recovery takes hold.

Exhibit 7: U.S. Treasury Yield vs Vaccine Doses



Source: CDC, FactSet, 4/8/21

Exhibit 8: Treasury Breakeven Inflation Rates



Source: Federal Reserve Bank of St. Louis, 3/31/21

Municipal Yield Curve Steepens to Lesser Extent than Treasuries

The reflation and recovery investment themes were evident in the first quarter. The tax-exempt yield curve steepened, although to a lesser extent than like-maturity U.S. Treasuries. As shown in Exhibit 9, short-term Municipal Market Data (MMD) AAA general obligation (G.O.) yields were unchanged at low absolute levels, while longer-term MMD AAA GO yields rose nearly 40 basis points. Intermediate- and long-term municipal yield ratios, or MMD AAA GO yields as a percentage of like-maturity U.S. Treasuries, fell during the first quarter as investor demand for tax-exempt income led to less steepening in the municipal yield curve than the Treasury yield curve (Exhibit 10). In a reversal from last quarter, shorter bonds largely outperformed longer bonds due to the rising interest rate environment (Exhibit 11). Investors continued to reach for yield, leading to lower quality bonds outperforming higher quality ones.

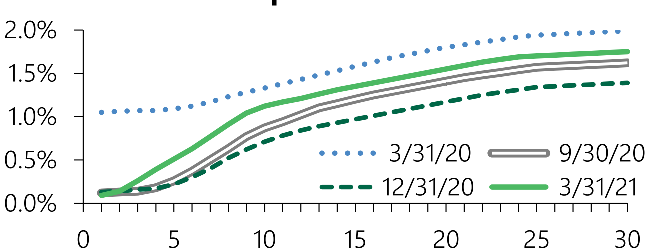
American Rescue Plan Strengthens Already Improving Credit Quality

The newly enacted $1.9 trillion American Rescue Plan (ARP) included over $600 billion in municipal entities' funding (Exhibit 12). Many state and local governments cut spending early last year to anticipate declining revenues and pandemic response spending. On balance, state and local government revenues were far more resilient than expected, and little has changed over the last year. Still, some state and local government entities, such as transportation-related issuers, have been more negatively impacted than others. Yet, on balance, the additional funding in the ARP far outweighs any negative budget impacts of Covid-19 and strengthens credit quality for many municipal issuers over the short term.

Tax-Exempt Fixed Income Strategy

Intermediate and long-term U.S. Treasury rates have increased rather markedly from the low levels at yearend and may increase further. While tax-exempt interest rates have not increased as quickly as U.S. Treasury rates thus far in 2021, at least some of the gap may begin to close. That being said, the Biden administration's plan to increase corporate and some individual federal tax rates is likely to maintain investor demand for tax-exempt income. Similarly, the significant funding to municipal entities from the American Rescue Plan may decrease their need to issue debt over the short run. While credit spreads could tighten further, we believe most of the tightening has likely already occurred. We plan to maintain duration near current levels and, as always, view diversification as a vital component of managing portfolio risk.

Exhibit 9: Tax-Exempt Yield Curve



Source: Thomson Reuters, 3/31/21

Exhibit 10: Municipal to Treasury Yield Ratios

Ratios	12/31/19	12/31/20	3/31/21
5-Yr MMD/UST Ratio	64.4%	60.8%	54.3%
10-Yr MMD/UST Ratio	75.0%	77.5%	64.3%
30-Yr MMD/UST Ratio	87.4%	84.4%	72.5%

Source: Bloomberg, Thomson Reuters, 3/31/21

Exhibit 11: Bloomberg Municipal Bond Indices

	YTD		YTD
Muni Bond	-0.35	GO Bond Index	-0.54
3-Year	0.15	Revenue Bond Index	-0.29
5-Year	-0.31	Electric	-0.55
7-Year	-0.54	Hospital	0.07
10-Year	-0.57	Housing	-0.24
Long	-0.47	IDR/PCR	-0.30
AAA	-0.90	Tranportation	0.04
AA	-0.65	Education	-0.57
A	0.06	Water & Sewer	-0.79
BAA	1.28	Resource Recovery	-0.32

Source: Bloomberg, 3/31/21

Exhibit 12: Municipal Funding in ARP ($M)

Sector	Total Potential Aid	Shared	Exclusive
Total	**649,631**	-	-
States	408,046	178,696	229,350
Locals	181,890	51,690	130,200
Community based orgs	-	-	-
Not for Profits	80	80	-
Healthcare	13,350	5,710	7,640
Primary/sec edu	137,005	136,155	850
Higher edu	39,969	330	39,639
Airports	11,000	-	11,000
Surface transit	-	-	-
Mass transit	30,000	-	30,000
Other Transportation	1,666	-	1,666
Housing	39,011	34,011	5,000

Source: U.S. Congress, JP Morgan, 3/31/21

Cyclical Growth, Value, and Small Caps Outperform in Classic Early Cycle Fashion

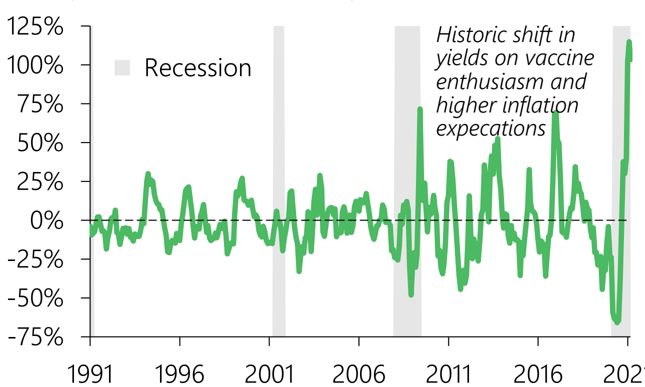
A +22 percent upswing in crude oil spot prices in the quarter, an +82-basis point surge in the 10-year U.S. Treasury bond yield, and rising investor confidence in a global economic rebound fueled robust first quarter 2021 gains in the energy (+31 percent), financial (+16 percent), and industrial (+11 percent) components of the S&P 500 Index. The overall Index returned +6.2 percent, with positive performance across all eleven primary GICS sectors. Given the energy, financial, and industrial sectors generally comprise a larger percentage of value indices, those measures outperformed growth counterparts across the market capitalization spectrum for the quarter. Small-capitalization indices also continued to outperform large peers and have almost closed the considerable performance gap that expanded over the previous three years. While cyclical growth and value stocks continued to outperform in March, market leadership shifted back to large capitalization. As the recovery matures and the rate of change in economic growth decelerates, we expect a rotation back to secular growth stocks from cyclical growth and value. In terms of international stocks, developed markets generally outperformed emerging markets (which outperformed in 2020) in the first quarter, with solid performance throughout much of Europe. The MSCI Taiwan and MSCI South Africa significantly outperformed other emerging market indices on strong technology and commodity demand, respectively.

Rising Bond Yields Are Not the End of the Road for Equities; Not Even Close

The 10-year U.S. Treasury yield shot up +82 basis points to +1.74 percent in the first quarter and is now +124 basis points above its March 2020 low. Driven by a new $1.9 trillion stimulus package and faster-than-expected vaccine deployment, the speed and scale of the swing in the 10-year yield is unprecedented (Exhibit 13). Restrained by Federal Reserve policy, and maybe skeptical bond investors, yields were late to discount the favorable economic outlook and rising inflationary pressures. Increasing bond yields and the so-called *duration effect*, however, have negatively impacted higher valuation, momentum stocks (generally secular growth tech). As secular growth companies generate high rates of cash flow over many years, as compared to a cyclical that may only realize two or three years of robust growth, valuations are more sensitive to changes in discount (or interest) rates. Otherwise, while caught off guard and a bit spooked initially by the spike in bond yields, equity investors continue to push stocks higher on positive fundamentals. Excess liquidity has helped offset the drag from rising yields on equity valuation multiples. However, a continued increase in yields will eventually catch up with equity market multiples as the pace of excess liquidity decelerates. Still, we expect double-digit year-over-year earnings growth for the S&P 500 in 2021 and 2022 to more than offset contraction in the overall market multiple and drive positive equity returns in 2021, and perhaps beyond as the economic upturn endures. Equities have historically done well when inflation and yields are rising at a moderate pace, as it is usually indicative of a positive macro backdrop (Exhibit 14).

Exhibit 13: 10-Year U.S. Treasury Bond Yield

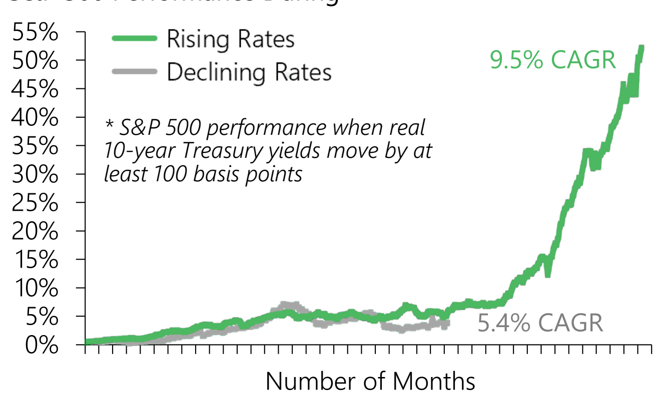
Rolling 6-Month Percent Change in Yield



Source: Tullett Prebon, 3/31/21

Exhibit 14: S&P Performance vs Rate Backdrop

S&P 500 Performance During*



Source: BCA Research, 3/15/21

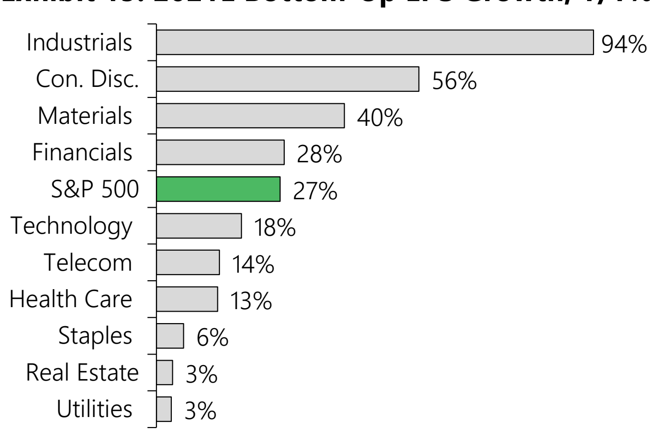
Expect Broad-Based Earnings Recovery, But Higher Costs and Taxes Are Risks

Bottom-up earnings for the S&P 500 are currently projected to grow by +27 percent year over year in 2021 and by +15 percent in 2022. The ratio of upward earnings revisions to downward revisions have plateaued at a high level of 2.4 times but largely indicate continued momentum upward in forward estimates. The earnings upturn is broad-based, though the more cyclical/economically sensitive sectors (e.g., industrials, consumer discretionary, materials, financials) have the highest projected growth in 2021 (Exhibit 15). As international markets account for ≈40 percent of S&P 500 revenue, the weaker U.S. dollar vis-à-vis a year ago has boosted the export demand and translated foreign profits of U.S.-based multinational constituents. At the same time, the ISM Manufacturing Prices Paid Index has risen to a 10-year high on increased import, commodity, and freight costs. The ratio of prices paid to prices received for regional manufacturing PMI surveys shows companies have only partially passed along higher costs. The S&P 500 operating margin has recovered from its March 2020 quarter low of 5.9 percent, rising to 10.4 percent in the December quarter thanks to improved financials and technology profitability. Still, while a nearer-term reversal in the U.S. dollar may provide some cost relief, inflationary pressures are likely to remain a source of earnings risk over at least the next several quarters. Also, President Biden has proposed several changes to corporate tax codes, including raising the corporate income tax rate from 21 to 28 percent, to offset new spending initiatives. Though much can change in the interim, Wolfe Research estimates the proposed tax changes are a possible $15 headwind (-7 percent) to current 2022 S&P 500 EPS estimates (Exhibit 16).

Increased Equity Market Volatility Likely as Risks/Uncertainties Accumulate

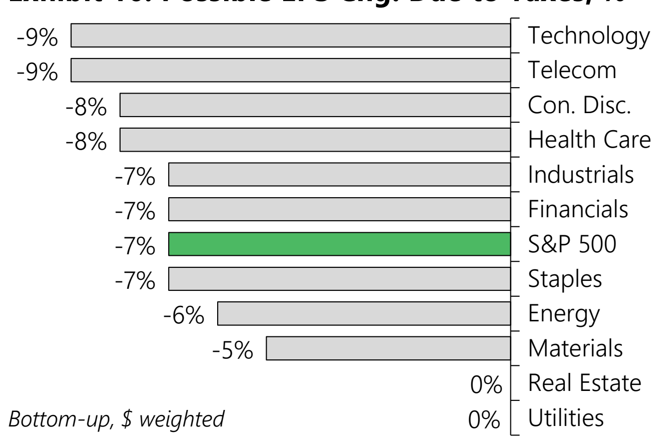
Ultra-low short-term interest rates and the unprecedented amounts of excess liquidity central banks continue to inject into the global financial system have led to speculation, extreme risk-taking, and asset bubbles. Signs of froth include a record number of special purpose acquisition companies (SPACs) formed, an almost +400 percent surge in the value of Bitcoin in the last six months, and a +1,250 percent rise in ARK (disruptive themed) ETF assets under management in the past year. Flows in and out of ARK ETFs have contributed to price swings and valuation distortions for larger fund holdings. The forced unwinding of significant leverage at Archegos Capital in March also resulted in extreme volatility in several stocks. In what amounted to the largest margin call on record, brokers who provided leverage to the manager rapidly liquidated positions in equities owned by Archegos, resulting in significant losses for Archegos, the other holders of the liquidated assets, and several brokerage firms providing the leverage. Although losses taken were sizable, in isolation, it does not appear comparable to the Long-Term Capital Management (1998) or Lehman (2008) events. The day trader's return has also lifted markets and amplified stock volatility, with GameStop's year-to-date price action a good example of this phenomenon. The CBOE Volatility Index (VIX) had three major swings in the last year and remains above its historical average. Currently at a one-year low after the strong market move, the VIX will likely trend upward on several risks, including inflation/rates, re-escalating U.S.-China tensions, and looming antitrust actions against dominant technology companies.

Exhibit 15: 2021E Bottom-Up EPS Growth, Y/Y%



Source: FactSet, 3/31/21

Exhibit 16: Possible EPS Chg. Due to Taxes, %



Source: Wolfe Research, 3/31/21

Global Equity Strategy

We continue to position portfolios toward traditional growth sectors as well as those most levered to the surge in economic growth we expect over the next several quarters. We continue to emphasize semiconductors within technology as a broad-based acceleration in demand is outpacing supply in many end markets. Despite the strong recent performance, valuations for many semiconductor companies remain attractive and do not yet reflect the combination of secular (e.g., wireless, cloud) and cyclical (e.g., auto, consumer electronics) growth drivers. Industrial and transportation stocks also remain attractive as a broad-based capital spending rebound is underway and should be further augmented by a U.S. infrastructure bill (although the timing of passage remains uncertain). Finally, the reflationary backdrop has created a strong tailwind for financial stocks, with bank earnings accelerating due to a combination of improving credit trends, robust capital markets activity, and an uptick in net interest margins. In addition to banks, we are also overweight the property-casualty insurance industry, where a combination of Covid-related losses and elevated catastrophes have led to the strongest pricing environment in many years.

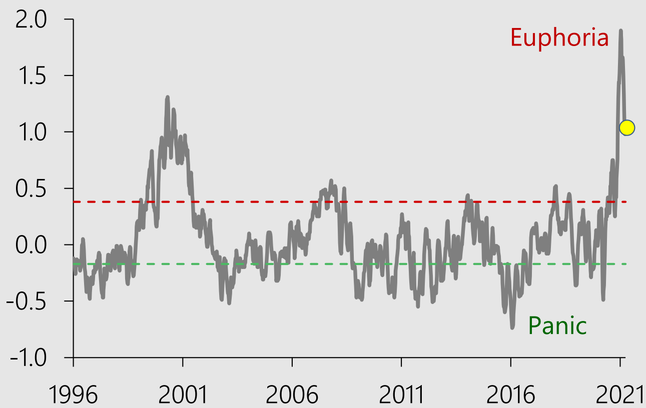
While we expect many cyclical areas of the economy to rebound strongly over the near term, we recognize that this is now largely a consensus view. As is typically the case in front of an economic recovery, investors have rushed in to virtually all cyclical or depressed areas of the market in anticipation of a rebound. Along with initially depressed valuations, an improved backdrop for cyclical stocks underpins the recent strong *value* performance relative to the *growth* style, which began in earnest last August. However, we believe valuations for many traditional value groups now fully reflect near-term earnings rebound. In addition, we believe secular headwinds prevailing over the past several years (resulting in years of underperformance) for many groups will reassert themselves once outsized growth from "easy comparisons" come and go. This applies to many companies within retail, energy, technology hardware, commercial real estate, and media. Given our valuation discipline and focus on long-term growth, portfolios remain underweighted across these structurally challenged groups.

In the international portfolios, we remain positive on China, South Korea, Singapore, and India equities. We expect total emerging market real GDP growth of +5.3 percent in calendar 2021, up from -0.6 percent in 2020. Weighed down by the rising U.S. Treasury yields, re-escalating U.S.-China tensions, and lingering Chinese policy tightening concerns, the MSCI China Index has declined almost -15 percent since the middle of February and has underperformed most other major indices in the first quarter of 2021. After the recent correction, the MSCI China Index is trading at roughly 15.6 times forward earnings, which is still at the higher end of its historical range. While cautious near term, we are reluctant to turn pessimistic on the market. We believe the positive macro backdrop and earnings recovery could outweigh the negatives from geopolitical events and rising U.S. Treasury yields. We are sticking with internet names despite recent underperformance as their mid-to-long term growth prospects remain solid. We also increased exposure to the reopening beneficiaries during the quarter. In addition, we are positive on the outlook for materials (especially iron ore and copper) given strong steel production in China and potential U.S. fiscal stimulus on infrastructure. We like South Korean exporters, sectors exposed to consumer spending, financials, and electric vehicle batteries. Our Singapore holdings are concentrated in financials, gaming, ecommerce, and technology. In India, we like consumer, financials, energy, information services, and industrial companies.

Global Equities: Notable Data Points

Investor Euphoria Remains a Near-Term Risk

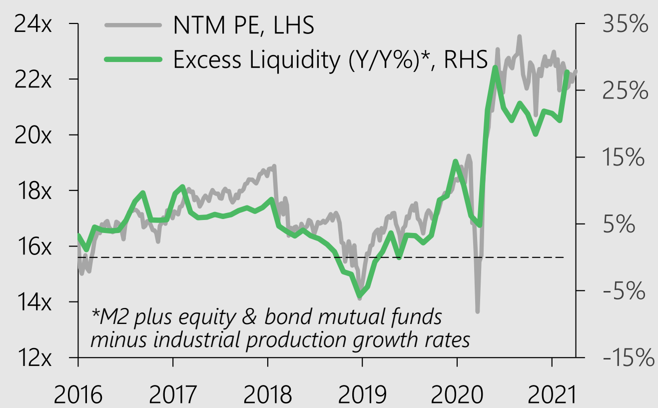
Citi Panic-Euphoria Model



Source: Citi Research, 4/2/21

Impact of ↑ Rates Offset by Excess Liquidity

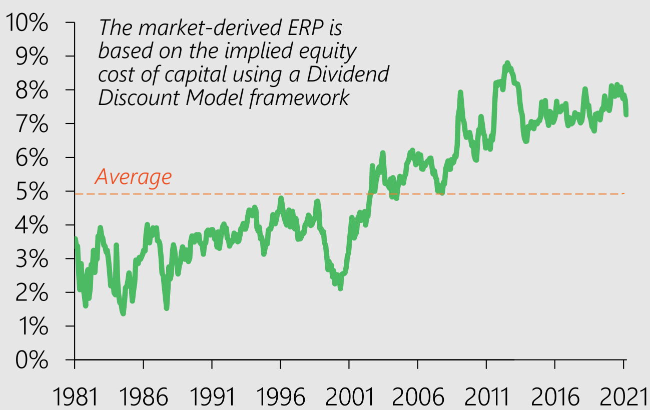
S&P 500 Price-to-Earnings Ratio vs Excess Liquidity



Source: Federal Reserve, ICI, FactSet, 3/31/21

Decline in ERP Could Also Offset Higher Rates

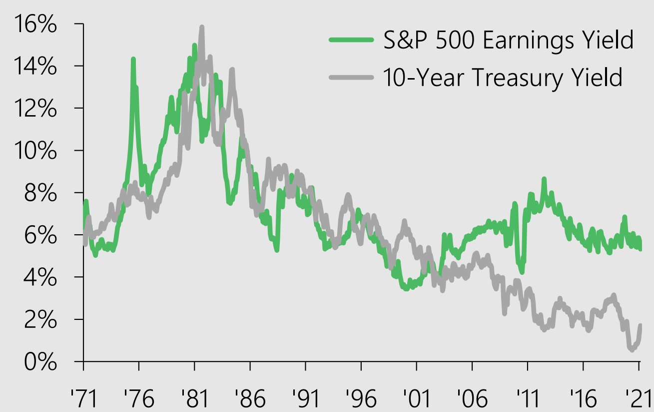
Market-Derived U.S. Equity Risk Premium



Source: BofA/Merrill Lynch, 4/7/21

Equities Remain Attractive Relative to Bonds

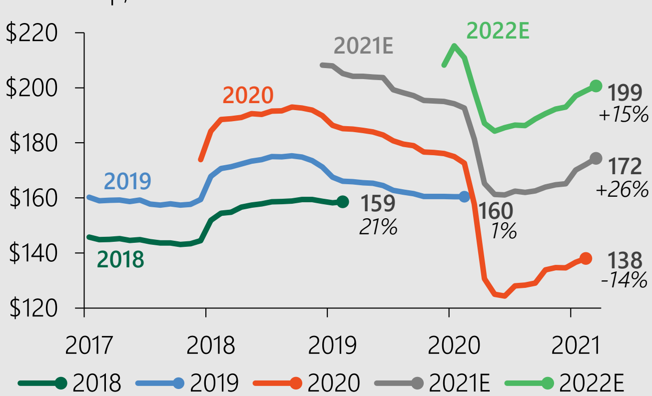
S&P 500 Earnings Yield vs 10-Year U.S. Treasury Yield



Source: FactSet, 3/31/21

Forward EPS Estimates Remain on the Upswing

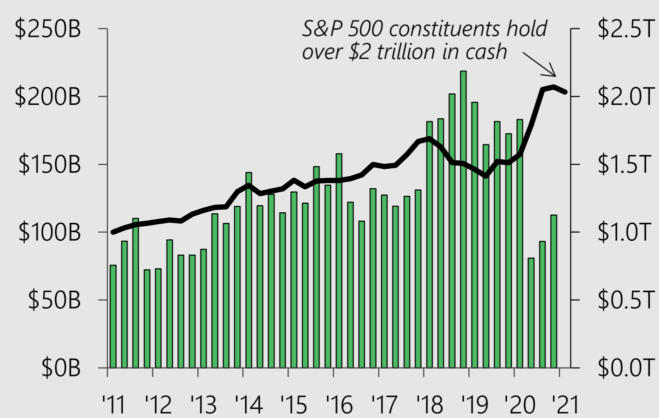
S&P 500 Consensus EPS Estimates
Bottom-Up, Calendar Year



Source: FactSet, 3/31/21

U.S. Buyback Activity Poised for Rebound

S&P 500 Share Buybacks vs Cash Holdings



Source: FactSet, 3/31/21