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July 2021

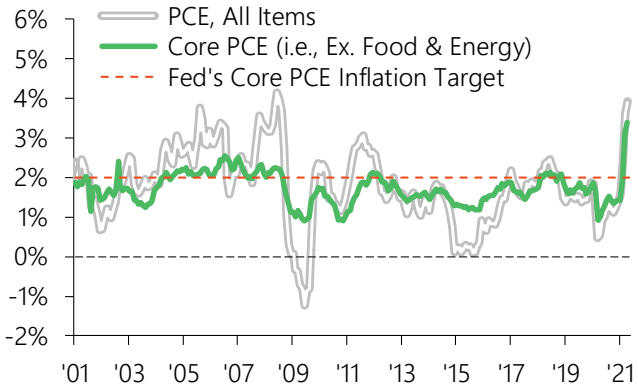
GLOBAL INVESTMENT OUTLOOK AND STRATEGY

- **U.S. Economy Shifts into High Gear; More Fiscal Stimulus Expected**
- **Market Volatility Likely to Rise on Inflation, Delta Variant, & Tax Fears**
- **Inflation is a Top Investor Concern but We Believe It Is Transitory**
- **Fed Pivots to a Less Dovish Stance, Flattening Bond Yield Curve**
- **Focus Will Likely Shift to Quality Growth Stocks as Momentum Peaks**

Inflation Should Moderate as Labor Markets, Supply Chains, & Commodity Costs Normalize

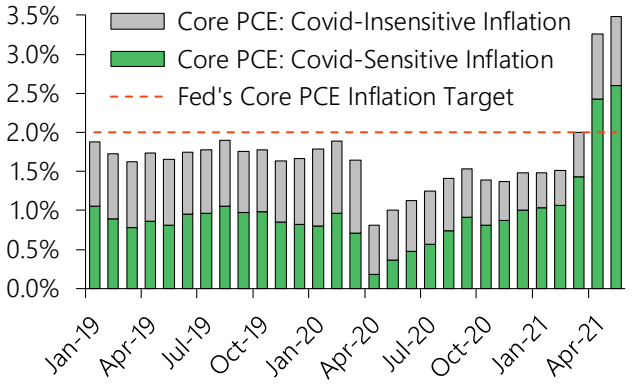
PCE Inflation Up Against Easy Y/Y Compares

U.S. PCE Price Index
Y/Y Percent



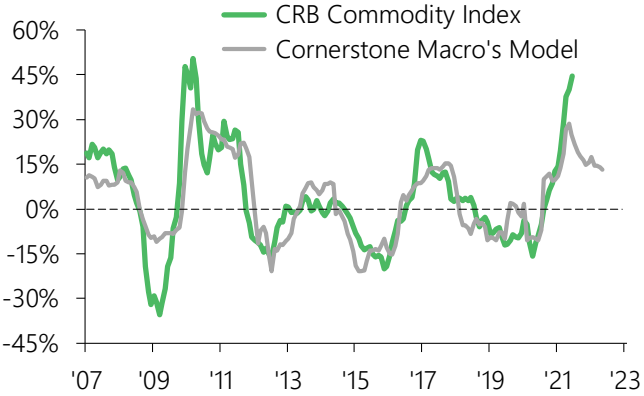
PCE Prices Driven by Covid-Sensitive Items

U.S. Core PCE Price Index
Contribution to Y/Y Percent Change



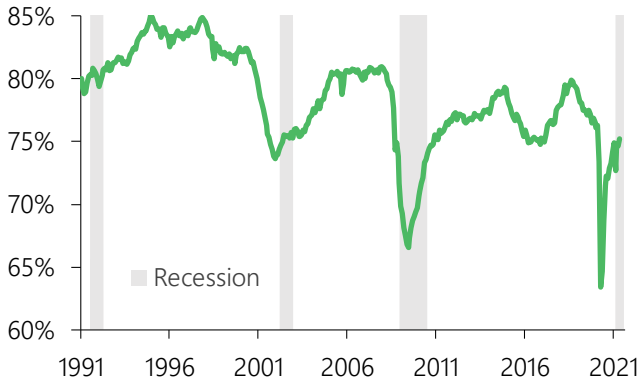
Commodity Inflation Projected to Moderate

Commodity Research Bureau Index
Y/Y Percent



Spare Capacity Should Contain Inflation

U.S. Capacity Utilization
Percent



Sources: Bureau of Economic Analysis, Federal Reserve Bank of San Francisco, Cornerstone Macro, Department of Labor, 6/30/21

We Believe Inflationary Pressures Will Persist Short-Term, But Prove Transitory

A multitude of interlinked factors is contributing to a transitory surge in inflation, including a post-lockdown rebound in demand, a backup in global supply chains, massive federal stimulus, a weaker U.S. dollar, and rising commodity prices. The recent upshift in consumer inflation is almost entirely due to a spike in so-called *flexible* prices (respond quickly to market conditions) against especially easy year-over-year comparisons (Exhibit 1). In contrast, *sticky* inflation, which is historically a much better gauge of inflation expectations, remains benign. We believe many of the global supply chain issues currently plaguing producers, and driving costs higher, will be largely ironed out by late 2021 or early 2022. Excess savings has also begun to abate, implying demand may diminish some after the stimulus-induced surge (Exhibit 2). Moreover, the froth has begun to come off some commodities, with slowing growth in China and mending U.S. dollar being headwinds for prices. Higher services, especially hospitality and leisure, and shelter inflation could take up some of the slack. However, we forecast core PCE inflation will moderate to the low +2 percent range by yearend, giving the Federal Reserve the flexibility to stay accommodative. The Fed pivoted to a somewhat less dovish stance in June, signaling the possibility of tapering asset purchases (perhaps this year) and two rate increases in 2023. Still, it must proceed extremely carefully or risk unwinding the economic gains achieved thus far.

Global Recovery Now Led by the U.S. & Europe as China Gradually Tightens Policy

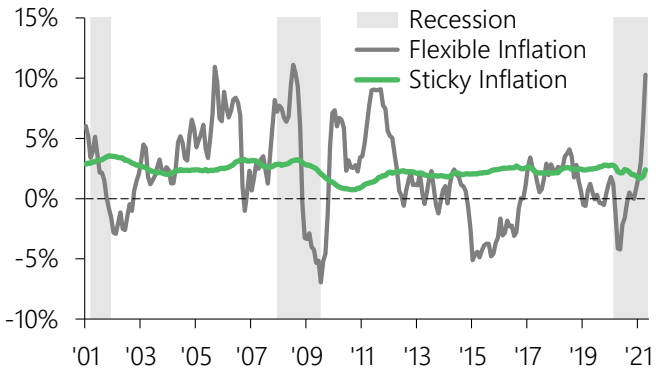
At last count, almost $ 31 trillion (or over 35 percent of world GDP) in global pandemic-related stimulus has accrued since spring 2020. The U.S. accounts for two-fifths of this amount and, if the Biden administration has anything to say about it, more is on the come. Accommodative government policies helped global economies avert potential crises in 2020 and, in concurrence with rising Covid-19 vaccination rates, is now underwriting the recovery. Still, unprecedented central bank liquidity, especially when joined with enormous fiscal stimulus and global supply chain logjams, is contributing to a spike in asset values and prices worldwide. Even so, we think most of the current uptick in inflation will be transitory and ease as excess demand is satiated, supply chains get unsnarled, and year-over-year comparisons normalize. Another widespread Covid-19 outbreak aside, we estimate global real GDP will expand at least +5.5 percent in 2021 against the -3.5 percent drop in 2020. The World Bank projects a broad-based recovery, with advanced and emerging economies expanding +5.4 and +6.0 percent, respectively, this year. There is mounting evidence economic momentum is moderating in China, peaking in the U.S., and rising in Europe (lifted restrictions later) – emerging markets are a mixed bag. Yet, leading indicators continue to confirm expectations for robust, albeit slower, global growth in 2022.

U.S. GDP Shifts into High Gear; Temporary Supply & Labor Issues Restrain Upside

U.S. real GDP is on pace to expand +6.5 percent in 2021, its highest annual growth rate since

Exhibit 1: Flexible vs Sticky Consumer Inflation

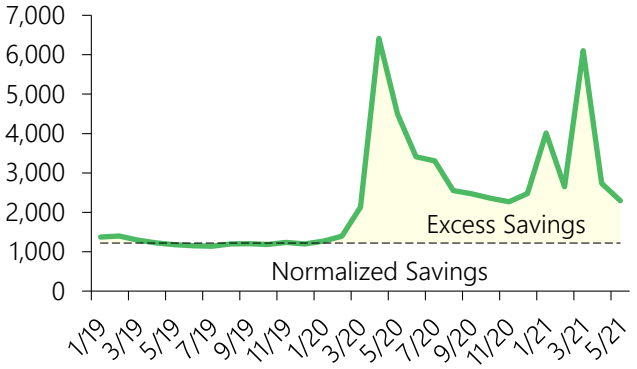
U.S. Consumer Price Index (Y/Y %)



Source: Federal Reserve Bank of Atlanta, 6/10/21

Exhibit 2: U.S. Personal Savings

SAAR, $ Billions

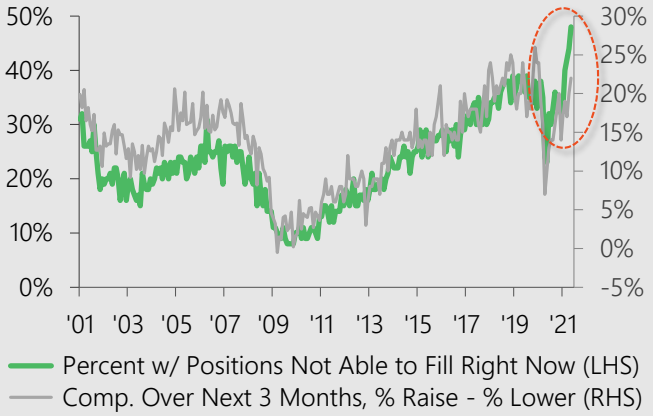


Source: U.S. Bureau of Economic Analysis, 6/30/21

U.S. Inflation: Other Notable Data Points

Businesses Unable to Fill Some Positions

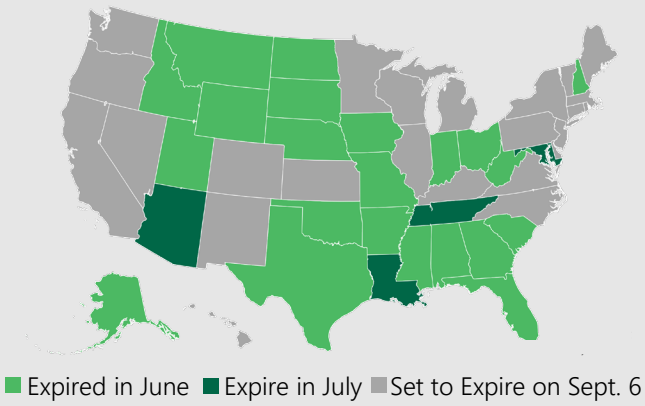
Small Business Job Openings & Compensation



Source: National Federation of Independent Business, 6/8/21

But Workers Likely to Come Off the Sidelines

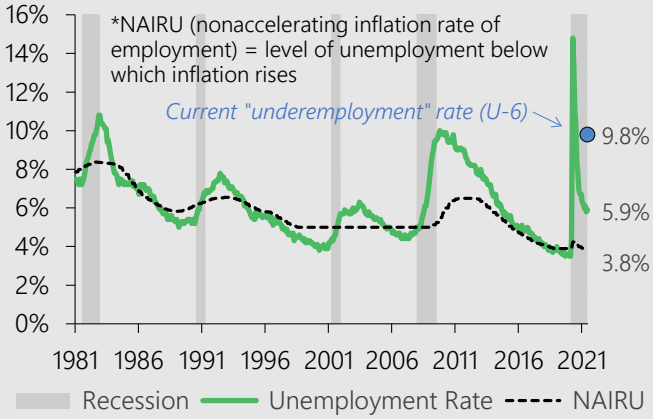
Expiration of Enhanced Unemployment Benefits



Source: CNET, 7/5/21

There is Still Sufficient Labor Market Slack

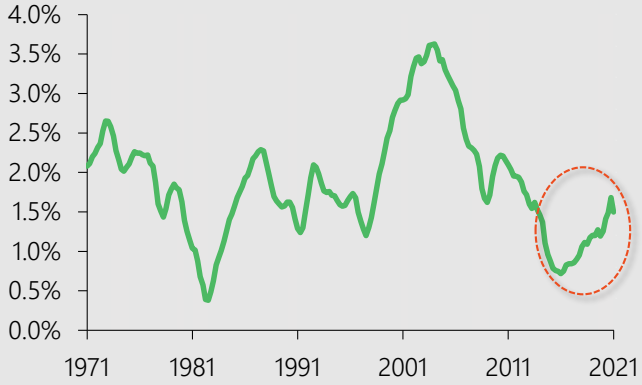
U.S. Unemployment Rate (U-3) vs NAIRU*



Source: U.S. Department of Labor, Oxford Economics, 7/2/21

Higher Productivity Can Allay Wage Inflation

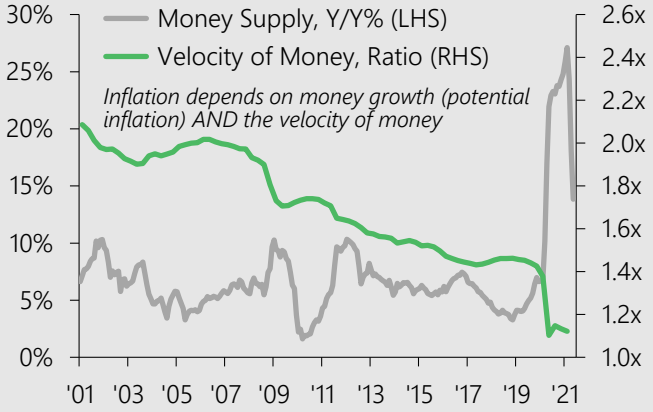
U.S. Productivity: Nonfarm Output per Hour
Five-Year Moving Average, Y/Y Percent



Source: U.S. Department of Labor, 6/30/21

The Velocity of Money Remains Muted

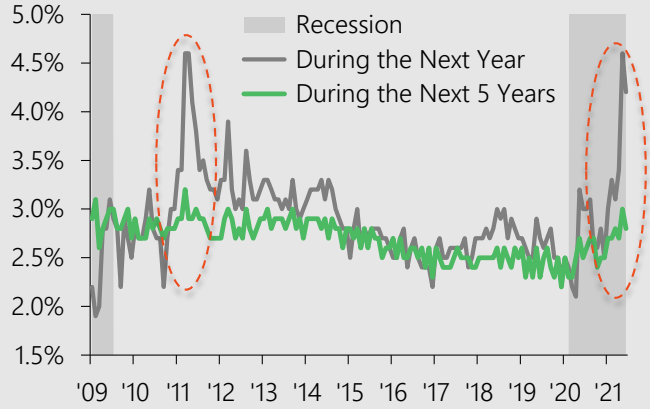
U.S. Money Supply (M2) vs Velocity



Source: U.S. Federal Reserve, 6/30/21

Consumer 5-Year Inflation Expectations Benign

U.S. Consumer Inflation Expectations



Source: University of Michigan, 6/30/21

1984, as the economy rebounds and achieves new heights. We estimate real GDP will increase +10 percent in the June quarter but moderate in subsequent quarters as comparisons become more challenging. The Conference Board's Leading Economic Index bested its pre-pandemic peak and is now at an all-time high (Exhibit 3). Therefore, we believe above-trendline growth will persist through at least 2022, supported by pent-up demand, employment gains, inventory restocking, fixed investment, and favorable government policies. Supply chain constraints and temporary labor availability issues are tempering growth potential near term. However, there is still plenty of labor slack to grow the economy and lessen inflationary pressures as enhanced unemployment benefits end and pandemic risks fade. Even though there are sizable disparities in labor conditions across states and sectors, investments in automation are rising and should ultimately improve both productivity (offsetting wage inflation) and GDP potential. A recovery in services, which represents about 75 percent of GDP and near 85 percent of nonfarm private employment, is poised to sustain the next stage of the expansion. Risks to our outlook include a prolonged uptick in inflation, potential policy missteps, and the spread of Covid-19 variants.

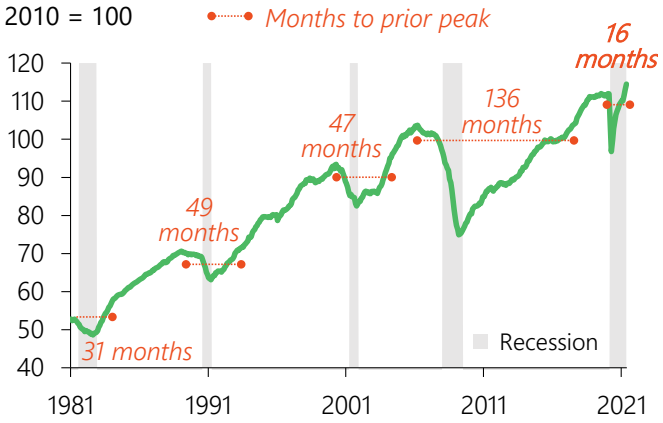
Delta Variant a Significant Risk; Any Future Surges in Infections Likely Localized

The worst of the Covid-19 pandemic is likely over for many developed nations as vaccination rates improve (Exhibit 4). However, given still-high vaccine hesitancy, the emergence of more transmissible variants may cause headaches for policymakers, dent confidence, prevent people from re-entering the workforce (or engaging in other activities), or require localized lockdowns. The Delta variant of the Covid-19 virus is the most significant risk to date for increased global infection rates, even among fully vaccinated people. The CDC reports the latest Covid-19 strain is over 60 percent more contagious than the original strain and now accounts for 50 percent of new cases in the U.S. The variant has been detected in 92 nations so far, forcing authorities in several places, including the U.K, Australia, and Israel, to reinstate some restrictions to combat its transmission. It also appears vaccine effectiveness is lower against the Delta variant – the Pfizer-BioNTech vaccine is purportedly 88 percent effective in preventing symptomatic disease from the Delta variant compared to 93 percent for the Alpha strain. Given still-low vaccination rates globally, the risk of even more contagious variants taking hold is high. While U.S. vaccine hesitancy rates dropped to 30 percent in June from 51 percent in January, according to KFF, the high level of holdouts leaves the country vulnerable to another surge in infections. Only 21 states reached President Biden's goal to partially vaccinate 70 percent of U.S. adults by July 4.

Growth Baton Passed to Euro Area, But Delta Variant Risks Renewed Lockdowns

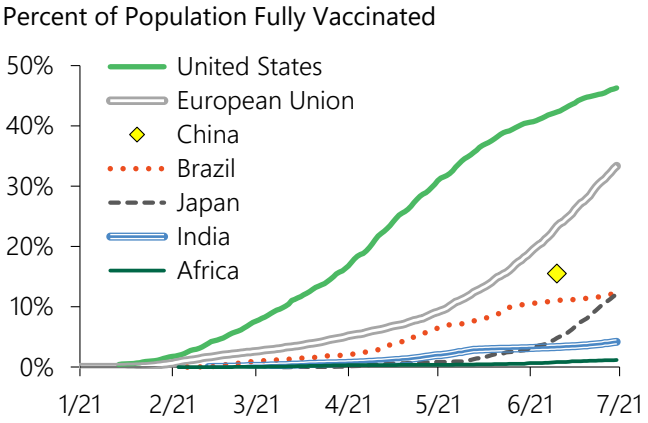
The Euro Area's services-heavy economies are swiftly gathering steam as the pandemic ebbs, vaccinations accelerate, and authorities ease restrictions. A coinciding rebound in demand for services joined an already booming manufacturing sector to lift the Euro Area Composite PMI to a 15-year high in June. Pent-up demand, excess savings, rising exports, recovering tourism, easing credit, and supportive government policies underlie continued economic growth. Thus, we forecast Euro Area real GDP will grow +4.5 percent in 2021 but not return to pre-pandemic

Exhibit 3: U.S. Leading Economic Index



Source: The Conference Board, 6/17/21

Exhibit 4: Global Covid-19 Vaccination Rates



Source: Our World in Data, 6/30/21

levels until mid-2022, given the delayed reopening of economies. Despite increasing inflation, the European Central Bank will remain accommodative and likely let the economy run hot. As a result, the Euro Area is well-positioned to achieve GDP growth of +4.0 percent or more in 2022. Still, another surge in Covid-19 infections or policy missteps could dampen or further delay the expansion. Over 50 percent of Euro Area residents have received at least one dose of the Covid-19 vaccine. However, the Delta variant has already taken hold in the U.K, and Euro Area officials project the variant will account for 90 percent of new infections in the region by August. Renewed lockdowns would forestall the nascent services recovery and be especially harmful to nations reliant on tourism (≈10 to 15 percent of GDP in Spain and Italy).

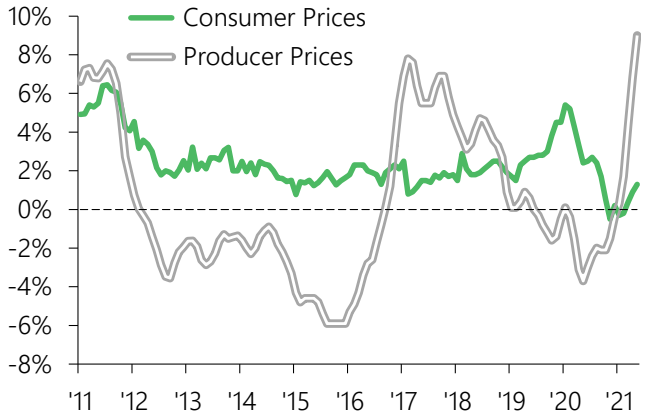
China GDP Growth Moderating from High Levels; Inflation Not a Major Concern

We lowered our 2021 real GDP growth forecast a tad to +8.5 percent based on disappointing May economic data but remain positive on China's outlook. Consumer spending was sluggish amid localized Covid-19 outbreaks, while a rebound in manufacturing capital spending partly offset a slowdown in infrastructure investment. Export growth, though robust, moderated due partly to temporary Covid-related shutdowns at some of the busiest shipping ports. However, China is on track to achieve a 70 percent vaccination rate in 2H21, boosting prospects for a gradual recovery in consumption. Although growth rates have likely peaked, export demand should also remain solid. Moreover, after tightening in 1H21, fiscal policy should offer support in 2H21 on rising bond issuance and a widening fiscal deficit. Prudent monetary policy is likely to stay, though the sharpest deceleration in credit growth may be behind us. Finally, soaring commodity prices have pushed producer prices to a 13-year high, but with little evidence of pass-through (Exhibit 5). Therefore, we expect consumer prices to rise incrementally with the broader recovery in services but remain benign and not a major concern for policymakers.

Vaccinations Support a Second Half Reopening for Japan, Though Risks Remain

Overall, Japan's economic outlook has improved in recent months as the vaccination effort has gathered pace, though crosscurrents remain. The economy stumbled at the beginning of the year, hobbled by a virus resurgence, and return of emergency restrictions. However, a quicker than expected vaccine rollout may enable a broader reopening of the economy. The country is on pace to inoculate one-half of its adult population by fall, providing a much-needed boost for the struggling services sector – though the recent emergence of the Delta variant could delay full recovery. The manufacturing industry has been Japan's lone bright spot as robust overseas demand has buoyed exports (Exhibit 6). Recent data suggests some waning as challenges from component shortages mount and demand from key trade partner China moderates. However, firming demand in other markets, a competitive yen, and pent-up domestic corporate demand suggest a supportive backdrop looking forward. Altogether, we continue to expect real GDP to grow +2.5 percent in calendar 2021, as a slower start to the year is countered by an improved outlook for the second half. However, downside risks remain; for instance, cancellation of the Olympics alone would be a -0.2 percent drag on 2021 growth.

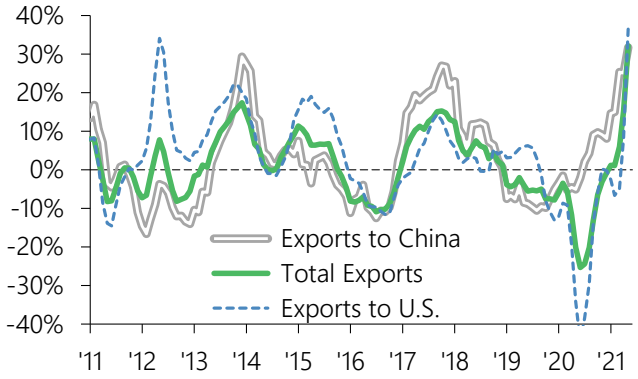
Exhibit 5: China Inflation Metrics, Y/Y Percent



Source: National Bureau of Statistics of China, 6/30/21

Exhibit 6: Japan Foreign Exports, Y/Y Percent

Three-Month Moving Average



Source: Japan Customs, 6/30/21

The Powell Pivot – Easy Monetary Policy May Have a Shorter Lifespan

The Federal Reserve (Fed) remains positive on the employment and economic outlook. It also acknowledges the inflation *threat* while simultaneously, and somewhat vexingly, understating current inflationary pressures. Higher prices have become commonplace as global economies emerge from pandemic-induced recessions, as notably evidenced by surging home prices and rental rates (Exhibit 7). Fed Chair Jerome Powell still contends many of the factors influencing the recent upsurge in inflation will prove transient and dissipate as the economy enters a more stable post-Covid environment. Given the low base from last year, much of the rise in inflation was a mathematical certainty. However, the debate is shifting to other aspects. For example, how long will transitory inflation persist, and what are the effects of an effective *tax* (i.e., higher inflation) on consumers? At its June meeting, the Fed moved forward the timing of potential rate hikes to two in 2023. While there is not much historical precedent for an anticipated rate increase two years out, it was not the change investors expected, as evidenced by the dramatic flattening of the yield curve (Exhibit 8). The present level of bond yields is still very low and is not necessarily reflective of the current inflationary and growth environment. The Fed is still buying bonds to the tune of $120 billion per month, but also hinted at discussing future tapering of purchases (which will put upward pressure on interest rates).

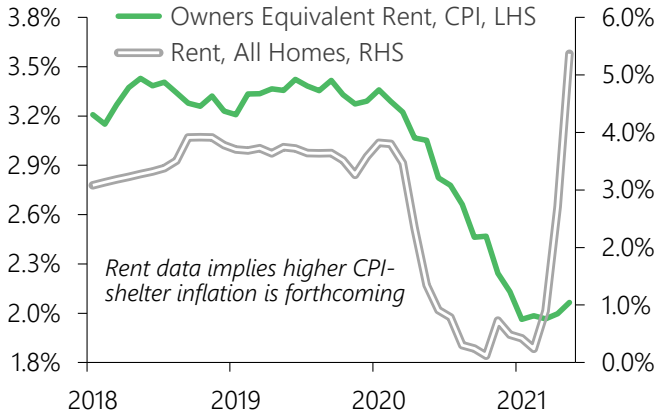
Remote Work is Changing the Employment Landscape for the Better

The pandemic's shadow will likely continue to impact the recovery longer than most would like. While domestic travel may benefit from heightened interest, international travel may lag. Current inflation metrics are the highest we have experienced in decades. Much of the inflation will decline over time, as we have already seen some relief in some commodities. However, the transitory effects may still be felt for longer than anticipated as supply chains are still working through backlogs, and other inflation items may counter some of the expected decline. While the labor market is strengthening, we expect some friction as elevated unemployment aid continues and childcare remains an issue until fall. The increase in the quits rate has shown that workers are on the move. Many workers postponed job or career changes until after the pandemic and are now taking advantage of a strong labor market to facilitate the move. After months of working from home, many employees are wary of a full return to the office environment. The ability to work remotely has led many to rethink the concept of work-life balance. We feel these changes will ultimately result in a stronger labor force overall.

Taxable Fixed Income Strategy

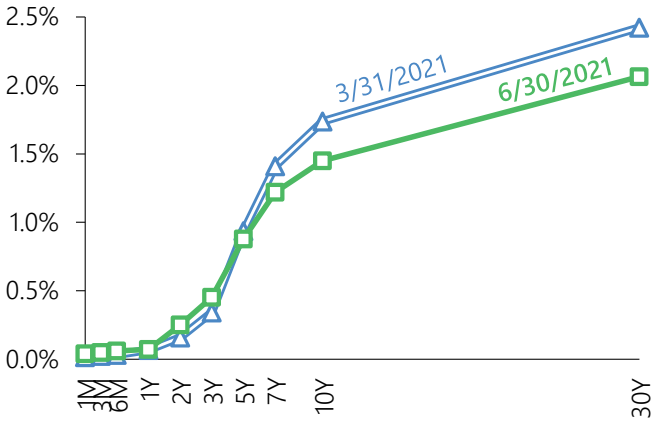
We believe confusion surrounding the flattening and twisting of the yield curve is providing attractive investment opportunities. Thus, we continue to favor a contrarian trading approach and look to take advantage of any dislocations. We see interest rates trending higher over the

Exhibit 7: Shelter Inflation (OER) vs Rent



Source: U.S. Department of Labor, Zillow, 6/30/21

Exhibit 8: U.S. Treasury Yield Curve



Source: FactSet, 6/30/21

medium term and are opportunistically adding to inflation trades. We have maintained an emphasis on providing a significant yield advantage, which represents the best source of return to offset potential price losses from rising interest rates. We have also positioned portfolios with durations below benchmarks, with an emphasis on lower quality and cyclical securities where appropriate that should out-perform in an economic rebound. Furthermore, we utilize inflation protected securities and are avoiding bonds in the long end of the yield curve.

Strong Demand, Moderate Supply Drives Municipal Bond Performance

Tax exempt municipal bonds did not outperform U.S. Treasuries and corporate bonds in the second quarter but still lead all other fixed income markets for returns in the first half of 2021 according to the Bloomberg Barclays Municipal Bond Index (Exhibit 9). The ratios of yields on tax-exempt municipal bonds to U.S. Treasury bonds remained at historically low levels throughout the quarter, signifying a fully valued market. Average yields of municipal bonds in the Barclays Index reached all-time lows. Lower rated and non-rated municipal bonds significantly outperformed high-grade municipal bonds as investors sought extra yield. Demand continued to be fueled by an unprecedented influx of cash into municipal bond funds.

Taxable Municipal Issuance Reduces Tax Exempt Bond Supply in 2Q21

The supply of tax-exempt municipal bonds has not kept pace with investor demand; tax-exempt bond issuance in 2Q21 was 2 percent lower than in 2Q20. One reason for this has been the shift of issuance from the tax-exempt bond market into the taxable bond market. In 2021, 25 percent of new municipal bond issues have been subject to federal income tax (Exhibit 10). Over half of recent taxable municipal bonds have been issued to refund existing tax-exempt bonds, prompted by changes to the federal tax code effective in 2018. However, those changes may be reversed within an infrastructure or budget reconciliation package now under negotiation. If that occurs, it could mean increased supply of tax-exempt bonds, alleviating supply pressures in the tax-exempt market to a degree, although bond refunding opportunities are starting to wane. Both tax-exempt and taxable municipal bond issuance might also benefit from legislation to finance infrastructure spending using municipal bonds.

Tax-Exempt Fixed Income Strategy

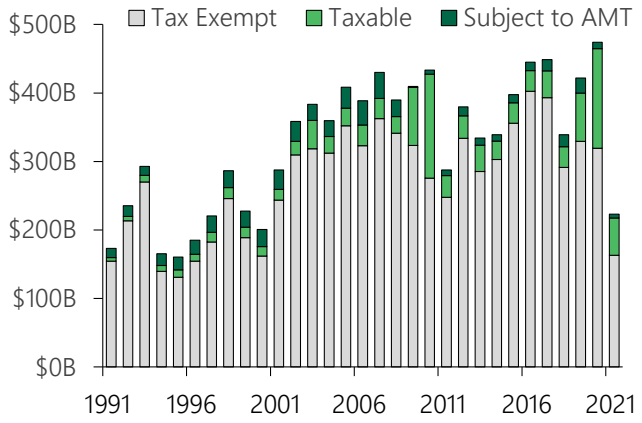
Notwithstanding potential supply shifts, the Administration's plans to increase corporate and individual federal tax rates (and sharply raise taxes on capital gains) should drive investor demand for tax-exempt income. Concerns over state and local government budgetary distress have also largely dissipated following the passage of over $600 billion of emergency federal aid in March. Along with the re-opening of the economy, this has been caused widespread improvement in recent months to outlooks for municipal bond credits. Thus, the foremost headwind to the current municipal bond outlook is from a general rise in interest rates over the intermediate term. We believe that our emphasis on tax exempt income over short-term gains and defensive portfolio positioning will differentiate our performance.

Exhibit 9: Municipal Bond Index Returns

	2Q21	YTD		2Q21	YTD
Muni Bond	1.42	1.06	GO Bond	1.09	0.55
3-Year	0.27	0.41	Revenue Bond	1.66	1.36
5-Year	0.48	0.17	Electric	1.03	0.47
7-Year	0.72	0.18	Hospital	2.07	2.15
10-Year	1.14	0.57	Housing	0.92	0.68
Long	2.82	2.33	IDR/PCR	1.51	1.21
			Transportation	1.89	1.93
AAA	0.97	0.06	Education	1.70	1.13
AA	1.17	0.51	Water & Sewer	1.14	0.34
A	1.78	1.84	Special Tax	1.77	1.11
BAA	2.60	3.91	Tobacco	1.87	1.69
Muni High Yld	3.93	6.13	Minnesota	1.07	0.54

Source: Bloomberg, 7/1/21

Exhibit 10: Municipal Bond New Issues



Source: Thompson Reuters, Sit Investment Associates, 7/1/21

Earnings Revisions Driving Robust Stock Market Gains on Stable Valuations

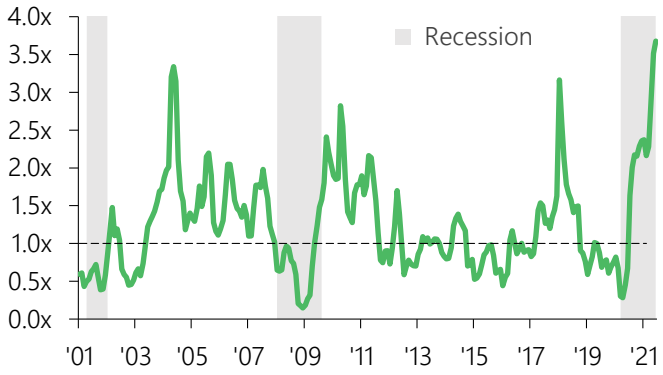
The S&P 500 Index posted its second best first-half gain since 1998, producing a total return of +15.3 percent for the first six months of 2021 (vs +18.5 percent in 2019 and +17.7 percent in 1998). Against a stable price-to-earnings multiple, rising earnings projections drove all the S&P 500's first-half performance. Over 85 percent of S&P 500 constituents beat the consensus EPS expectation for the March quarter, the largest percentage in at least the past two decades. The highest percentage of companies surpassing EPS projections were in the financial, energy, and information technology sectors. Due to the exceptional March quarter reports, bottom-up earnings for the S&P 500 are now estimated to grow +37 percent year over year in 2021, up from +26 percent at the end of March. Consensus estimates also imply approximately +12 percent earnings growth in 2022, but those forecasts do not yet include the potential drag from higher corporate taxes. The ratio of S&P 500 upward earnings revisions to downward revisions is at an historic high of 3.7 times (Exhibit 11), as sell-side analysts who underestimated the strength of the recovery play catch up. We expect another round of robust corporate earnings reports for the June quarter, but think the magnitude and scope of S&P 500 upward earnings revisions may have peaked. Thus, the focus of investors will likely shift back to earnings quality and sustainability as the U.S. economy enters the next, slower growth, stage of the expansion.

Investor Focus Will Likely Shift to Quality Growth as Economic Momentum Peaks

The U.S. economy is booming, confidence is rebounding, government policies are stimulating, leading indicators are rising, and interest rates are near record lows – can it get much better? Probably not. At least not from a rate of change perspective. The economic expansion may be far from over, but momentum is probably peaking, at least for perhaps the next 12-24 months (depending on when the next economic catalysts emerge). Even though decelerating economic growth does not signal an end to the equity bull market, it typically denotes an inflection point in sector and style performance. For instance, cyclicals tend to outperform defensives equities as the manufacturing PMI is accelerating but underperform as it decelerates (even if the PMI is still expansionary). We do not necessarily believe a declining manufacturing PMI is the end of the line for cyclical stocks (especially those exposed to favorable themes). Nonetheless, we think investors will be more discerning and focus on companies with specific revenue growth drivers, pricing power, margin enhancement opportunities, and solid balance sheets. In other words, investors are apt to gravitate to quality growth stocks and away from value, particularly with year-over-year comparisons in earning growth about to become more challenging. Rising excess liquidity and falling interest rates lifted equity price-to-earnings multiples (Exhibit 12). However, excess liquidity has begun to slow, and the bias is for rates to go higher eventually. As a result, we believe picking quality stocks with strong earnings growth that can more than offset potential multiple contraction will be crucial for outperformance.

Exhibit 11: S&P 500 Earnings Revision Ratio

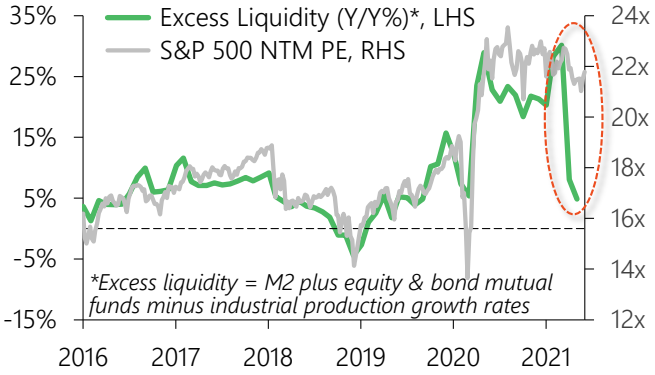
Number of Up Revisions ÷ Number of Down Revisions



Source: FactSet, 6/30/21

Exhibit 12: S&P PE Multiple vs Excess Liquidity

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



Source: FactSet, Federal Reserve, ICI, 6/30/21

Dividend Strategies Poised to Return to Favor as Price Returns Moderate

We believe dividend-paying stocks remain compelling. While dividend payers benefitted from the broadening stock market that began late last summer, the more defensive *lower beta* stocks within the dividend-paying universe have lagged. This subsection of dividend payers includes companies in the consumer staples, pharma, aerospace/defense, utilities, and telecom sectors. As shown in Exhibit 13, the overall weighting of defensive sectors in the S&P 500 Index is at an historic low, and we see the potential for mean reversion in the months ahead. We also expect sentiment to improve for stable, *low vol* stocks as market volatility increases. Moreover, dividend-paying stocks offer downside protection if the stock market pulls back after posting robust gains in recent quarters. As year-over-year comparisons become increasingly difficult for higher beta cyclical companies and the global economy normalizes, we expect better relative earnings growth and growing dividends to ignite investor enthusiasm for stable dividend-paying growth stocks. Current high stock market valuations, already low interest rates, and peaking economic growth imply a somewhat muted outlook for equity returns, raising the appeal of total return strategies. Our dividend investments emphasize attractively valued, high-quality growth companies that are committed to returning capital to shareholders. While the current yields of our dividend-based portfolios are already well above benchmark yields, we anticipate double-digit dividend growth in 2021 for each of our dividend growth strategies.

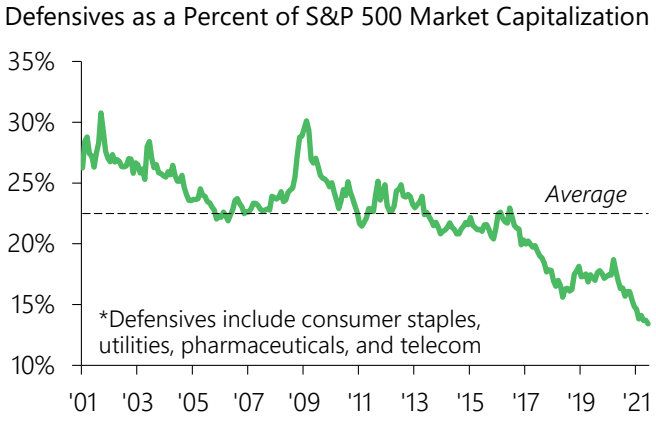
Investors Complacent About Mounting Risks; Margin Calls Will Amplify Pullbacks

Albeit off the record high achieved earlier this year, the Citi Panic-Euphoria Model (a measure of investor sentiment) is at a euphoria level not seen since the height of the technology bubble in 2000. Investors continue to pour money into stocks, with U.S. equity inflows growing at their fastest pace since 2015 and first half 2021 global equity inflows its largest on record. Aside from the rebound in earnings, a bevy of factors underpin positive equity flows, including central bank liquidity injections, fiscal stimulus, the T.I.N.A.-effect (i.e., there is no alternative), the fear of missing out, the return of the day trader, and improving Covid-19 vaccination rates. Increasing capital returns via dividends and share buybacks, and record M&A activity, are also sustaining investor enthusiasm. We are constructive on stocks, but investor euphoria remains a source of concern near term. Although the *Fed put* (monetary intervention during times of market stress) is firmly in place, investors appear complacent about gathering risks, including impending tax hikes, Covid-19 variants, inflationary/margin pressures, policy tightening, and rocketing debt. The S&P 500 Index is currently *overbought* on a technical basis and about +12 percent above its 200-day moving average, implying it is vulnerable to negative headlines. U.S. margin debt has ballooned to $862 billion and is at historic highs even when normalized for both GDP and total stock market capitalization (Exhibit 14). Buying stocks on margin has boosted prices, but margin calls could make a market pullback correspondingly more severe.

Global Equity Strategy

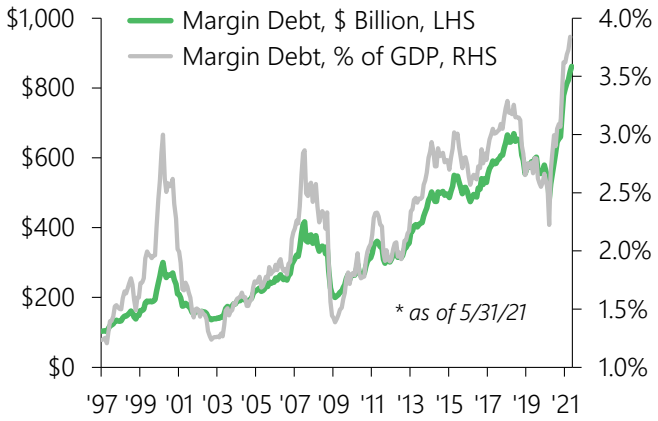
With equity valuations *fair* across most sectors and the market overall, we believe identifying

Exhibit 13: Defensives as a Percent of S&P 500



Source: FactSet, 6/20/21

Exhibit 14: Debit Balances in Margin Accounts



Source: FINRA, Bureau of Economic Analysis, 6/16/21

companies that can sustain growth beyond easy pandemic-impacted comparisons will lead to continued stock price appreciation. From a sector standpoint, we advocate a *barbell* strategy through investments in a combination of traditional and cyclical growth stocks levered to the reflationary economic backdrop. Based on current stock valuations, we think technology and financial stocks offer the most compelling investment opportunities on each side of the barbell.

Sector rotation out of technology and into cyclical stocks began in late 2020, catalyzed by the snapback in economic activity and a subsequent broadening in earnings growth expectations. Technology valuation multiples have contracted in many cases as strong earnings growth has lagged underlying equity prices, presenting attractive investment opportunities throughout the sector. The semiconductor industry is a preferred investment area based on high demand and constrained supply, leading to extended forward visibility on revenue, pricing, and margins. Semiconductor content is growing in many end markets, including 5G, artificial intelligence, Internet of Things, data center, automotive, and industrial. Many segments are also receiving an added boost from a broader pickup in capital spending. Global supply chain vulnerabilities exposed by the pandemic and geopolitical tensions have also resulted in some de-globalization and redundant supply sources – this will incrementally drive demand higher for a wide range of goods, including semiconductors. We also continue to add selectively to software holdings that benefit from several secular growth themes, including digital transformation, e-commerce, online payments, digital advertising, and the post-pandemic shift to *work from anywhere*.

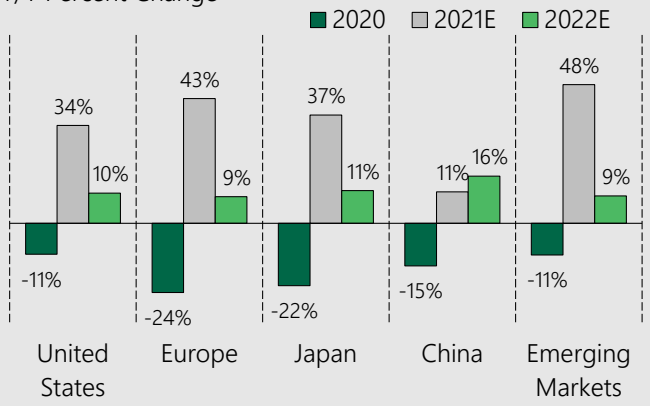
On the other side of the barbell, the financial sector remains the most attractively valued cyclical group and offers a critical *hedge* should higher interest rates upend the broader equity market. Banking fundamentals and investor sentiment have benefited from a rebound in interest rates and a sharp improvement in the credit picture owing to monetary stimulus and an improving labor market. Loan growth is also poised to reaccelerate as businesses and consumers rebuild leverage. Moreover, earnings and capital returns will benefit significantly from the release of excess credit reserves and the reduction of excess capital levels. Rising interest rates, including an eventual move by the Federal Reserve to boost short-term rates, is the key variable that will drive investor sentiment. Notably, earnings projections do not yet embed higher interest rates, and valuations are depressed compared to the overall market. The outlook for the property-casualty sector is also highly attractive as the combination of Covid-19 claims and several years of catastrophe losses have led to the most robust commercial pricing cycle in many years.

In international portfolios, we prefer equities in China, South Korea, India, and Europe. While emerging market central banks will tighten to counter rising inflation, we do not believe policy will become overly restrictive. Moreover, despite a resurgence in the coronavirus outbreak, we expect the pace of vaccinations to accelerate, leading to the easing of pandemic restrictions. We remain somewhat cautious on Chinese equities near term given weakening earnings revisions and the government crackdown on monopolistic behavior. However, MSCI China earnings are expected to grow double digits in 2021 amid a post-Covid recovery, making a sharp market decline less likely. Furthermore, with China's desire to be a world leader, the government will likely allow and facilitate the prosperity of new economy and international Chinese companies. We believe a balanced allocation between growth and cyclical stocks provides an optimal risk-reward profile near term. Longer term, we remain optimistic on structural trends such as consumption and digitization of the economy. In South Korea, we own a broad portfolio of stocks in technology, financials, ecommerce, and electric vehicle battery manufacturers. India holdings focus on the consumer, financial, energy, information services, and industrial sectors. We are also positive on materials such as iron ore and copper given China's robust steel production and a probable U.S. infrastructure package.

Global Equities: Other Notable Data Points

Robust Global EPS Growth vs Easy Compares

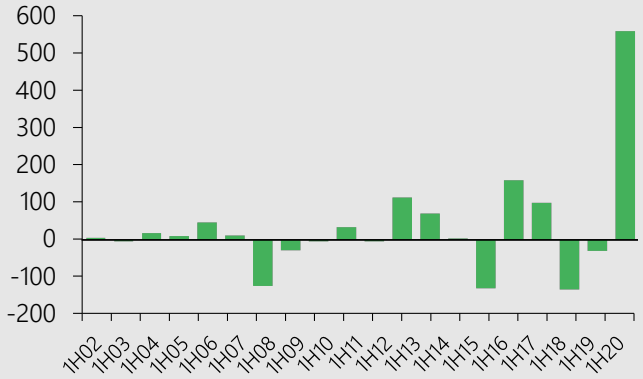
Bottom-Up EPS Estimates for MSCI Indices
Y/Y Percent Change



Source: FactSet, 6/30/21

Record-Breaking First Half Global Equity Inflows

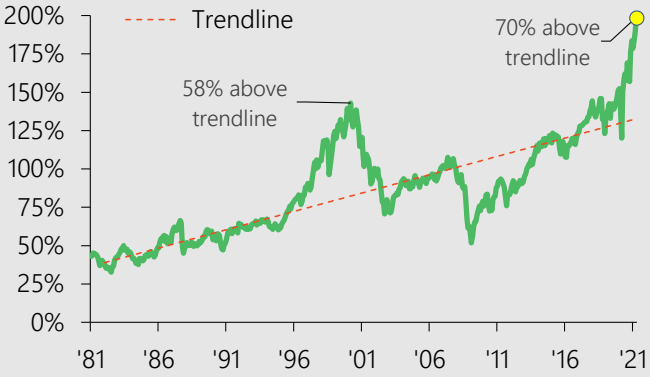
Global Equity Fund Flows
First Half, $Billion



Source: BofA Global Research, 7/1/21

Buffett Indicator Infers Total Market Stretched

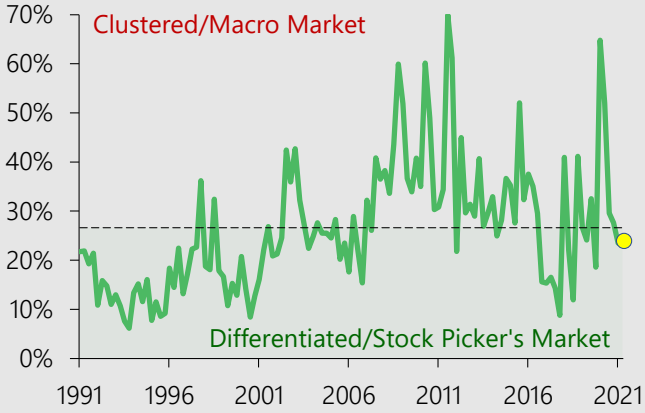
U.S. Equity Market Capitalization to GDP
Wilshire 5000 Total Market Index as a % of Nominal GDP



Source: FactSet, 6/30/21

Good Stock Picking Vital for Outperformance

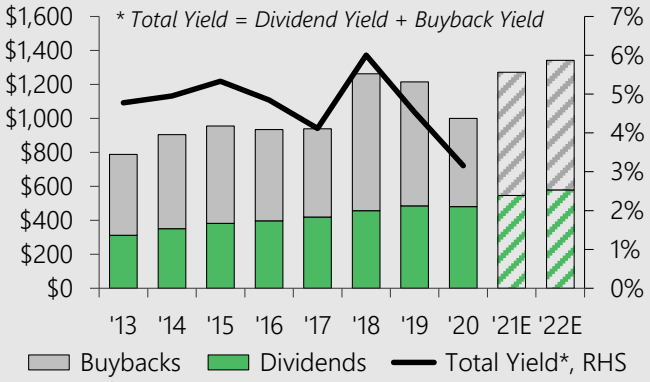
Avg. Pair-Wise Correlations of S&P 500 Stock Combos



Source: BofA Global Research, 7/6/21

Dividends & Share Buybacks Back on the Rise

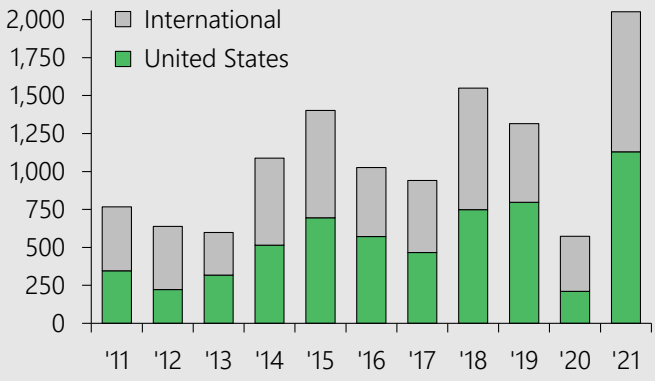
S&P 500 Share Buybacks and Dividends
Billions of U.S. Dollars



Source: S&P Global, Goldman Sachs, 6/30/21

M&A Fueled by Massive Liquidity & Low Rates

Global M&A Transactions, First Half
Total Deal Value, $ Billion



Source: FactSet, 6/30/21