GIA PARTNERS

2nd Quarter 2021

Highlights

- **Surprisingly, interest rates declined despite robust economic growth. Spreads continued to narrow and higher risk sectors outperformed benefiting our portfolios;**
- **The second quarter will likely be the fastest growing of 2021. Reductions in stimulus and a pause in consumption may lower future growth, although the reopening momentum will likely continue;**
- **The government spent generously to confront the pandemic leading to a massive increase in debt. More is proposed by the current Administration, can the country afford it?**

Markets

		Returns (%)			
GIA*	Average Quality	2Q21 Gross	2Q21 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**2.72**	**2.63**	**5.05**	**4.68**
Global Investment Grade	**(A-)**	**3.52**	**3.42**	**4.60**	**4.18**
Global Credit Plus Composite	**(BBB+)**	**3.09**	**2.96**	**6.14**	**5.61**
High Yield Composite	**(BB-)**	**3.37**	**3.22**	**19.67**	**19.02**
Emerging Market Corporate Debt Composite	**(BB)**	**3.47**	**3.31**	**15.05**	**14.36**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	1.83		-0.33	
Treasury	(AAA)	1.75		-3.22	
Corporate	(A-)	3.55		3.30	
Mortgage	(AAA)	0.33		-0.42	
Government/Credit	(AA)	2.42		-0.39	
ICE BofA U.S. Corporate & Yankees	(A-)	3.34		3.28	
ICE BofA U.S. Corporate	(A-)	3.60		3.63	
ICE BofA U.S. High Yield	(B+)	2.77		15.62	
ICE BofA EM Corporate Plus	(BBB)	1.90		7.11	
ICE BofA Global Gov't ex-US	(AA-)	0.10		-0.98	
JPM Emerging Markets EMBI GD	(BB+)	4.06		7.53	
JPM CEMBI Broad Diversified	(BBB-)	2.10		8.67	
JPM GBI-EM Global Diversified	(BBB+)	3.54		6.57	
Benchmark Equities					
S&P 500	NA	8.17		38.62	
Nasdaq Composite	NA	9.49		44.19	
Russell 2000	NA	4.05		60.30	
MSCI EAFE	NA	4.37		29.45	
MSCI Europe	NA	6.31		31.87	
MSCI Japan	NA	-0.44		22.44	
MSCI Emerging Markets Equity	NA	4.42		38.14	

* Please refer to the respective factsheets for the long-term composite and benchmark returns for each strategy.

Markets

Predictably, financial markets began to question a few firmly held assumptions as the second quarter unfolded. The "reopening" was more vigorous than most expected leading to very strong economic performance. With explosive consumer demand came visible inflationary pressures, product shortages and a race to make up for lost time. An entrenched assumption had the Fed playing a supportive role into 2023 and fiscal policy throwing copious sums of money at the economy. With the economy likely to grow at a rate exceeding 9.0% annualized, the justification for abundant monetary and fiscal support fades. Ironically, the labor market failed to keep pace with the rest of the economy, leading economists, strategists and investors to conclude the authorities would continue with their relentless stimulus. Wrapped in this security blanked, financial markets had an excellent quarter, with the S&P 500 returning 8.2% for the quarter, 14.4% year-to-date and closing at a record high. Global equity markets enjoyed similar returns even though even though the Covid exit remains elusive for many countries. European stocks returned 6.3% for the quarter and 10.1% year-to-date, while emerging markets equity returned 4.4% and 6.5% respectively. Remarkably, concerns over further increases in interest rates were allayed by the tepid labor market bringing 10-year rates lower from 1.74% to 1.47% during the quarter. Other economically sensitive markets like commodities in general and oil, in particular, responded to demand signals climbing to 13.3% and 24.9% gains respectively. (Bloomberg Commodity Index and September 2021 Oil futures contract)

Investment grade credit had another good quarter with further spread narrowing and a price boost from declining interest rates. Excellent corporate profitability and ongoing government stimulus boosted creditworthiness and facilitated market access. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was up 3.6% during the quarter and down -1.1% year-to-date. By comparison, the U.S. treasury index returned -2.0% for the quarter and -2.7% year-to-date. Corporate option adjusted spreads (OAS) narrowed by 14 b.p. to 82 b.p., while the yield to worst of the index decreased from 2.27% to 2.04%. Investment grade issuance continued at a robust pace with $453.1 billion for the quarter and $976.9 billion through mid-year. While this pace exceeds most first half historical borrowings, it is nearly $400 billion below last year's record issuance.

The high yield market continued to lead most fixed income asset classes as the combination of abundant liquidity, profitability and government support kept investors involved. In addition, recoveries in Covid-ravaged industries led to a modest default rate and expectations for higher credit ratings. The ICE BofA U.S High Yield Index (H0A0) was up 2.8% for the quarter and 3.7% year-to-date, which compared very favorably with the negative YTD returns for higher quality fixed income securities. Energy, the largest industry in the index, continued to recover posting a 6.1% return for the quarter and a 10.2% return year-to-date. Spreads to worst narrowed further by 34 b.p. from 346 b.p. to 312 b.p., while the yield to worst decreased from 4.16% to 3.77%. Surprisingly, high yield retail investors withdrew $3.2 billion from funds adding to the $10.3 billion withdrawal during the first quarter, much of which came from ETFs. The default rate including distressed exchanges decreased to 1.87% in June from 5.37% in March marking the lowest first half default rate on record. The decline in the default volume resulted from supportive reopening conditions, and the decline in the rate was aided by dropping the large volume of defaults that occurred in June 2020 from the calculation. Even with withdrawals from retail investors, high yield companies issued record amounts in the new issue market. For the quarter there were $140.5 billion the third highest quarterly volume on record. Year-to-date, the volume was $299.1 billion a record for the first half of the year.

Emerging markets bonds also had a strong quarter aided by the U.S. reopening, abundant liquidity and a jump in global demand for commodities. While many countries remain behind in the battle with the pandemic, investors believe similar trajectories to the U.S. and Europe are forthcoming. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was up 4.1% bringing the year-to-date result to -0.7%. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) returned 2.1% for the quarter and 1.3% for the first half of the year. JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index rose 3.5% for the quarter cutting year-to-date losses to -3.4%.

Economy

During the last year, economic forecasting has been challenging. Everyone successfully predicted the direction of each quarter's output, but measuring magnitude became virtually impossible. Revisions were common due to the severe alterations in consumer behavior. It looks like 3Q and 4Q 2021 will be no different. In December 2020, the WSJ Economic Survey respondents forecast an average growth rate of 4.2% for the second quarter and 4.3% for the third. By April, those forecasts were raised to 8.1% and 6.9% respectively, and as we closed the second quarter, economists lifted their forecasts again with many expecting 2Q to turn in an impressive 10% or better growth rate and 3Q to come in above 7%.

After successful vaccinations and decisive reopening across the country, it is likely 2Q will prove to be the fastest growth quarter of 2021. An accumulation of savings during the lockdowns fueled a euphoric consumption boom which caught many companies by surprise. Residual COVID-related bottlenecks entangled supply chains and exacerbated product shortages. Prices rose and manufacturers were forced to pass these through to consumers. Producer and consumer prices had their highest increases in decades in May and June. While the Fed and a few economists deemed the price moves transitory, pressure on wages and margins suggests otherwise.

A review of industries suggests the economy is returning to its pre-COVID state faster than most expected. Data on fuel and electricity demand, transportation carloads, refinery utilization rates, shipping prices, auto sales, air travel and restaurant bookings all suggest consumers are spending in an effort to return to normal. Some industries like lodging, cruising and international travel remain constrained because other countries lag the U.S. in vaccinations and reopening. While stubborn infections and more aggressive virus variants are raising concern, it is not likely these will lead to a new period of lockdowns. The antidote for the virus is well known and countries are racing to vaccinate their populations.

One troubling element of an otherwise rosy recovery forecast is the labor market. The unemployment rate, labor participation rate and payroll data do not match the abundant demand for labor. One of the factors contributing to the conundrum is the generous unemployment benefits that were attached to the government relief packages. These are scheduled to expire in September likely providing some relief to worker-starved industries.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing about 6.0% at an annual rate in 3Q, and then slowing to a 4.0% rate in 4Q 2021. After a booming consumption driven second quarter, we believe consumers will pause and retain some of the savings they built up. The Biden Administration pandemic relief bill was approved in March and will not provide a further boost in 3Q. In addition, combating the Delta and other virus variants will require some caution and perhaps a delay in activities like international travel, large gatherings and full restoration of social activities. Nevertheless, the momentum will still provide for a healthy third quarter. PROBABILITY 65%

2. A second scenario has the economy expanding at an even faster pace of 7.0% to 8.0% at an annual rate in the third quarter. Despite the absence pandemic relief, the Administration is proposing an infrastructure and a social spending package that could add to the momentum the economy already has. In addition, the vaccination campaign may successfully quell the threatening variants adding to consumer confidence. In this scenario inflationary pressures may become more prevalent. PROBABILITY 20%

3. A third scenario has the economy stalling at a positive, but substantially slower rate of growth. This scenario could take hold with a third wave of infections and an unsuccessful vaccination campaign. The influence of slow-to-exit countries on the global fight against the pandemic becomes larger causing a decline in consumer

confidence. With most countries already “spent” in their fight, the new variants are allowed to run their course with damaging economic implications. PROBABILITY 15%

Market Outlook

In a contradiction to the robust economic performance in 2Q, interest rates declined suggesting market concerns with the momentum and continuity of growth. The Fed attempted to allay fears by signaling their continued support. As we begin the second half of 2021, markets will likely pay attention to countervailing forces like increasing inflation with an accommodative Fed, robust consumer demand with product shortages and labor shortages with an expiring unemployment benefit. Relatively high valuations across asset classes add to investor concerns. For now, the Fed’s presence, strong and improving corporate earnings and a world still directionally on a path to control the pandemic, suggest holding exposure to spread product makes sense. We believe investors may become more cautious as the quarter progresses but will still bias their exposures to reflect the benefits of a healthy economy.

July 15, 2021

Important Information

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Index Definitions

Bloomberg Barclays U.S. Aggregate Index

The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Bloomberg Barclays U.S. Treasury Index

This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Bloomberg Barclays U.S. Government/Credit Index

The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Bloomberg Barclays U.S. Credit Index

This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Bloomberg Barclays U.S. Mortgage Backed Securities Index

This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

ICE BofA U.S. Corporate & Yankees Index

The ICE BofA U.S. Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

ICE BofA U.S. Corporate Index

The ICE BofA U.S. Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

ICE BofA U.S. High Yield Index
The ICE BofA U.S. High Yield Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

ICE BofA Global Government Excluding the U.S. Index (N0G1)
The ICE BofA Global Government Excluding the U.S. Index tracks the performance of publicly issued investment grade sovereign debt denominated in the issuer's own domestic currency. N0G1 excludes U.S. government bonds.

JP Morgan Corporate Emerging Markets Bond Index Broad Diversified (CEMBI Broad Diversified)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. The CEMBI Broad Diversified limits the weights of those index countries with larger corporate debt stocks by only including a specified portion of these countries' eligible current face amounts of debt outstanding.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI Europe Index
The index is a free-float weighted equity index measuring the performance of Europe Developed Markets.
MSCI Japan Index

The index is a The MSCI Japan Index is a free-float weighted equity JPY index.

MSCI Emerging Markets Equity

The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.