GIA PARTNERS

3rd Quarter 2021

Highlights

- **A resurgence of the virus via the Delta variant imposed new constraints on the economy and markets. Interest rates rose and spreads widened which held back our performance;**
- **Conditions are in place for ongoing economic growth, even in the face of possible Fed tapering. Consumer savings will likely be spent over the next year or two;**
- **The pandemic distorted both economic activity and people's lives. Some of the distortions may take longer than expected to iron out.**

Markets

		Returns (%)			
GIA*	Average Quality	3Q21 Gross	3Q21 Net	12 Months Gross	12 Months Net
Core Plus Composite	**(A)**	**0.17**	**0.09**	**3.18**	**2.81**
Global Investment Grade	**(A-)**	**0.09**	**-0.01**	**2.28**	**1.87**
Global Credit Plus Composite	**(BBB)**	**0.47**	**0.35**	**4.00**	**3.48**
High Yield Composite	**(BB-)**	**0.89**	**0.75**	**15.65**	**15.02**
Emerging Market Corporate Debt Composite	**(BB)**	**0.60**	**0.45**	**11.46**	**10.79**
Benchmark Bonds					
Bloomberg Barclay's U.S. Agg. Index	(AA+)	0.05		-0.90	
Treasury	(AAA)	0.09		-3.30	
Corporate	(A-)	-0.00		1.74	
Mortgage	(AAA)	0.10		-0.43	
Government/Credit	(AA)	0.04		-1.13	
ICE BofA U.S. Corporate & Yankees	(A-)	-0.09		1.51	
ICE BofA U.S. Corporate	(A-)	-0.06		1.84	
ICE BofA U.S. High Yield	(B+)	0.94		11.46	
ICE BofA EM Corporate Plus	(BBB)	-0.58		3.64	
ICE BofA Global Gov't ex-US	(AA-)	-0.18		-1.81	
JPM Emerging Markets EMBI GD	(BB+)	-0.70		4.36	
JPM CEMBI Broad Diversified	(BBB-)	0.25		6.03	
JPM GBI-EM Global Diversified	(BBB+)	-3.10		2.63	
Benchmark Equities					
S&P 500	NA	0.23		28.09	
Nasdaq Composite	NA	-0.38		29.38	
Russell 2000	NA	-4.60		46.21	
MSCI EAFE	NA	-1.03		22.96	
MSCI Europe	NA	-2.02		24.33	
MSCI Japan	NA	4.03		20.06	
MSCI Emerging Markets Equity	NA	-8.84		15.81	

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

Markets

The virus' resurgence during the third quarter disrupted the 2021 reopening and seemed to crush the optimistic "return to normal" narrative. Just three months ago, markets were euphoric. Upon reflection, the optimism may have been premature given the life-altering nature of the pandemic. Invariably, the distortions thrust upon societies by draconian lockdowns and highly inhibiting mandates were bound to have consequences. Labor shortages, supply chain jams, inflation and altered priorities became more visible as the world tried to come back. Understandably, investors paused to reassess economic prospects and the likely path of government policies. The S&P 500 rose through August, but then retraced in September leading to a paltry 0.23% return for the quarter. European stocks looked similar in local currency, although they underperformed in U.S. dollars, and emerging markets equities declined about 8.8%. In fixed income, investors took note of the inflationary threat to push yields higher and erode returns in most sectors. Away from stocks and bonds, commodities rose on continued consumer demand and product shortages, while the Fed's acknowledgement a taper was prudent helped boost the U.S. dollar.

Investment grade credit declined in absolute terms, performing in line with U.S. government bonds which declined in price as yields rose. The "wall of liquidity" that was built from personal savings and Fed stimulus kept demand for corporate bonds elevated. The investment grade corporate bond index, the ICE BofA U.S. Corporate Index (C0A0), was down -0.06% during the quarter and down -1.12% year-to-date. By comparison, the U.S. treasury index (G0Q0) returned -0.03% for the quarter and -2.71% year-to-date. Corporate option adjusted spreads (OAS) widened by 6 b.p. to 88 b.p., while the yield to worst of the index increased from 2.04% to 2.12%. Investment grade issuance continued at a robust pace with $373.7 billion for the quarter and $1.35 trillion year-to-date. Through September, issuance exceeded every prior year, except for 2020.

Despite slightly wider spreads and higher absolute yields, the high yield market continued to deliver good relative returns. The combination of improved creditworthiness, negligible defaults and abundant liquidity helped support the sector. The ICE BofA U.S High Yield Index (H0A0) was up 0.94% for the quarter and 4.67% year-to-date. Continued outperformance by Covid-affected industries contributed. Energy, the largest industry in the index, returned 1.72% for the quarter and 12.10% year-to-date. Spreads to worst widened by 13 b.p. from 312 b.p. to 325 b.p., while the yield to worst rose from 3.77% to 4.00%. High yield retail investors turned more positive as they added $1.9 billion during the quarter, reducing the year-to-date outflow to $12.0 billion. The default rate including distressed exchanges decreased to 0.99% in September from1.87% in June. Reflective of ample liquidity and strong economic performance, the default volume was down 5.77% through September. The new issue market remained "hot" with $108.5 billion pricing during the quarter and $409.7 billion borrowed year-to-date. Through September, issuance was 17% ahead of last year's pace.

Emerging markets bonds had a mixed quarter as successful vaccination programs were offset by disruptive factors like rising inflation, pockets of infection and mounting China related factors. In general, spreads widened and currencies weakened, although global financial conditions remained favorable and rising commodity prices provided ample support. In China, various policy pronouncements deflated technology and housing-related securities. Within housing, Evergrande, the largest homebuilder, became stressed causing the entire industry to suffer. For the quarter, the JPM Emerging Market Bond Index – Global Diversified (EMBIGD), a dollar denominated sovereign index, was down -0.7% bringing the year-to-date result to -1.36%. The JPM Corporate Emerging Markets Broad Diversified Index (CEMBI BD) bucked the sector's negative trend returning 0.25% for the quarter and 1.53% through September. JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, suffered from both rising rates and currency depreciation to decline -3.10% for the quarter and -6.38% year-to-date.

Economy

Growth in the second quarter of 2021 came in well below many economists' forecasts for reasons that suggest the underlying growth trajectory was as strong as the optimists expected. However, the resurgence of the virus, and its related disruptions, held the economy back. Specifically, reductions in inventories (due to supply chain disruptions), government (due to the end of Covid relief programs) and an increase in imports (due to healthy consumer demand) detracted from an otherwise stellar quarter. Globally, the Delta variant intervened to slow the reopening and, in effect, defer growth as vaccination programs were accelerated. In that vein, the U.S. appears to have experienced peak Delta cases at the beginning of September, which coincided with schools reopening and many businesses attempting to return to their offices.

With ample liquidity from government relief programs and reduced spending during the pandemic, consumers have approximately $2.4 trillion in excess savings and appear poised to spend. By the end of the quarter, many service businesses were open and expanding their patron capacity. While travel restrictions remained for many countries, improving news on cases and vaccinations triggered to a jump in bookings for airlines, hotels, and restaurants. The foundation is in place for an optimistic economic outlook, although the economy is not fully unchained. In addition to supply-chain related impediments, inflation has gained traction threatening consumer confidence and financial markets.

Also, the labor market remains dislocated and a constraint for most businesses. Despite more job openings than unemployed, labor market data has been sluggish. Of significant concern, the labor force participation rate has remained stubbornly low and filings for unemployment too high. With the expiration of enhanced unemployment benefits and the end of prohibitions on foreclosures, the availability of labor should improve. However, the cost of labor and raw material shortages still threatens company's efforts to maximize efficiency. As the quarter ended, many consumer product companies complained about raw material inflation and manufacturing challenges. Altogether, the global picture shows financially healthy consumers eager to purchase goods and services which cannot be supplied in the desired quantities because of the pandemic-related distortions.

Some economists believe the inflationary threat will be resolved by a recovery in productivity. One of the consequences of the pandemic was the resumption of capital investment. Backed by plentiful orders, companies began to invest. Technological enhancements along with labor supply constraints may indeed drive a boost in productivity that keeps the lid on inflation and helps address some of the economy's constraints.

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 4Q, and then slowing to a 5.0% rate in 1Q 2022. Third quarter growth likely softened compared to 2Q, although the key elements behind continued economic optimism remain in place. With consumer savings near all-time highs, corporate cash flow at comfortable levels and the Fed still in stimulus mode, liquidity remains abundant. As the Delta variant subsides, we believe pent-up demand for services will boost Covid constrained industries like travel, dining, entertainment, and leisure. Even if there is a demand shift from goods to services, the effect on economic activity should still be positive. A constraint will likely come from the slower-than-expected normalization of supply chains, leading to manufacturing delays and possibly price increases. PROBABILITY 65%

2. A second scenario has the economy expanding at an even faster pace of 7.5% at an annual rate in 4Q. Accelerated vaccinations and declining Covid cases globally could encourage additional spending during the holiday quarter. Also, venues still operating with reduced capacity may ease all limitations allowing for a full restoration of pre-Covid activity. With plenty to spend, consumers may celebrate. PROBABILITY 20%

3. A third scenario has the economy stalling at a positive, but substantially slower rate of growth. This scenario could take hold if a new variant emerges, or vaccinations stall. Furthermore, some of the current impediments like energy shortages and supply chain disruptions may become more acute leading to empty shelves and hoarding. In this scenario, inflation may become a challenge for both consumers and global central banks. PROBABILITY 15%

Market Outlook

While we believe elements are in place for a constructive outlook for financial markets, numerous factors support a cautionary stance. Most asset classes continue to be highly valued for good reasons, including excellent performance and a wall of liquidity providing support. The impediments to further improvement do not likely have enough weight individually to derail the underlying pillars of the economy, but together they might unsettle investors. Specifically, government policy adjustments and economic management in China have important implications for the world. Similarly, energy shortages affect both global inflation and the world's shift away from hydrocarbons. And finally, the smooth flow of materials and components is essential for efficient manufacturing and the timely delivery of goods. Should all of these become worse instead of better, the favorable economic backdrop may not matter to financial markets. For fixed income, the pressures of inflation, central bank tapering, and additional government spending portend higher rates. We believe credit markets will continue to deliver excess returns, although the best policy remains to upgrade quality without making a meaningful statement on the likely direction of interest rates.

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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.