Commentary
Charitable Asset Management

Q1 2021

Q1 Tactical & Market Summary

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The 1st quarter started off quite stable with the macroeconomic picture looking attractive for growth assets despite some near-term headwinds. Weaker labor data, a drop in some mobility trends and slight softening of global PMIs suggested economic growth momentum may have slowed with the start of the year. However, a myriad of factors suggested the recovery was on solid footing and the current reflation trade had further room to run.

COVID cases, both new infections and hospitalizations, had been improving and despite some hiccups in vaccine rollout, countries were making good progress administering treatments and containing the virus while also loosening mobility restrictions. Despite a soft patch, the global economy is showing resilience as evidenced by supportive PMIs, which have softened a bit, but are generally improving and signal healthy levels of activity, especially in the US. Elsewhere, another round of stimulus was expected in the US and all indications pointed to a large and more targeted package that would sustain consumer demand. Corporate profits continued to rebound as measured by the S&P 500 with about 81% of reporting companies beating expectations and a projected growth rate of +1.7%, which would be the first positive quarterly year-over-year growth since 4Q 2019. This improvement, coupled with ultra-low rates, opened the door for increased dividends and buybacks, potentially providing an additional tailwind for equities. Lastly, the Fed re-committed to staying accommodative and quelling any concerns about a repeat taper tantrum similar to 2013.

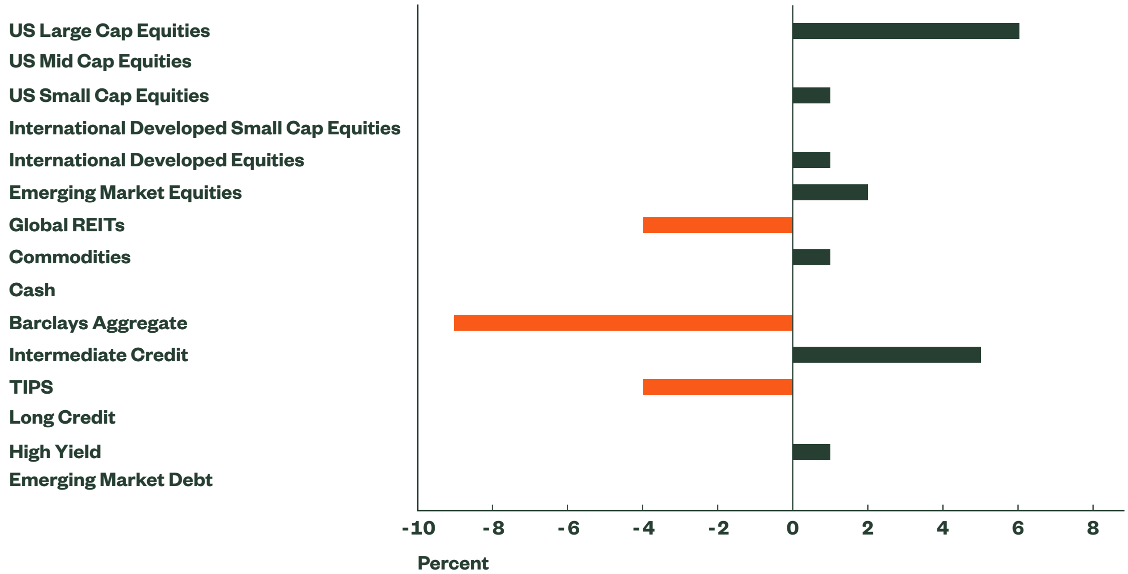
Overall, we chose to continue to deploy our risk budget towards equities and broad commodities, while tilting our fixed income portfolio towards credit, both investment grade and high yield. Core bonds and REITs continue to look unattractive and remain our largest underweights.

Overview

We continue to hold a diversified equity position and have made a minor adjustment within our relative value equity positions to better capture the re-opening momentum. The US remains our preferred region while we also have a modest overweight to developed markets and emerging market equities. The US continues to exhibit strong price momentum and robust earnings and sales estimates, which offset poor valuations.

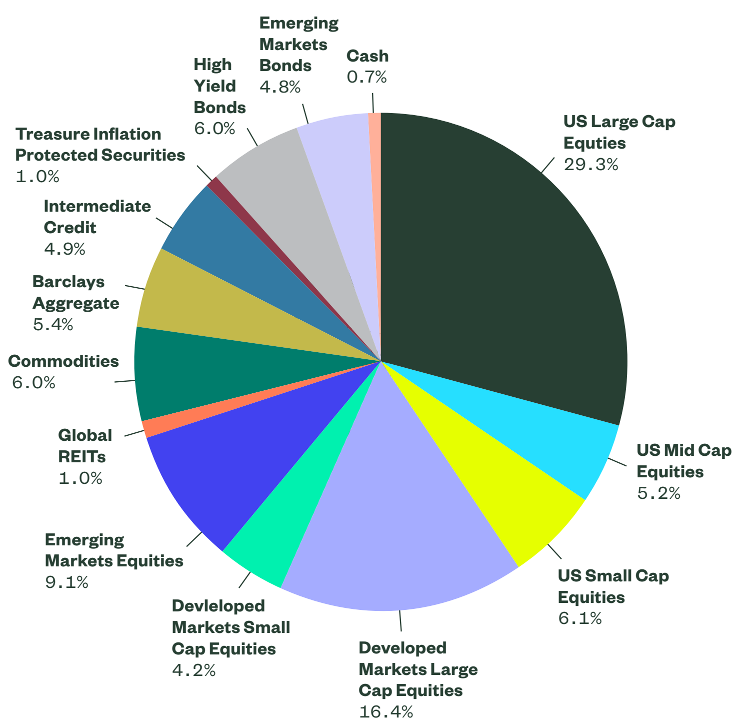
Valuations have remained attractive for European equities, but a recent rebound in earnings sentiment suggests an improving outlook. Further, the region is poised to benefit from re-opening momentum as the pace of vaccine rollouts increases and mobility restrictions are eased.

Figure 1
Tactical Portfolio Positions for 70/30 Portfolio
Asset Class Overweights/Underweights



Source: State Street Global Advisors, as of 03/31/2021. Weights are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

Figure 2
Allocation for 70/30 Trust Portfolio



Source: State Street Global Advisors, as of 03/31/2021. Allocations are as of the date indicated, are subject to change, and should not be relied upon as current thereafter.

With the expectation for a return to positive global economic growth in 2021 and supportive quantitative forecasts, we continue to hold a diversified equity overweight with the US remaining our favorite region.

We chose to maintain our slight overweight to both developed market equities and emerging market equities. In the developed markets, the buoyant outlook for Pacific equities continues driven by strong and improving sentiment associated with earnings and sales prospects in the region. Additionally, positive valuations and supportive quality scores reinforce the more optimistic forecast. In emerging markets, the we've seen improved PMI's, a weaker US dollar and improved sentiment bares well for the asset class in the near term.

Within fixed income, we continue to prefer credit exposure. Our forecasts for a steeper yield curve imply positive future economic conditions which advocates further spread tightening. Elsewhere, favorable seasonality and advantageous equity volatility readings also promote tighter spreads. Although higher government interest rates may result in more expensive financing costs, we continue to see momentum in credit spreads and a sturdy economic backdrop amidst recent curve steepening. Notwithstanding the fact that yields and spreads are relatively tight (much like valuations for most assets), the environment for credit still looks attractive. The rotation within investment grade credit allows us to pick up additional yield while the duration impact on the portfolios is de minimis.

During the quarter, we chose to move further underweight to TIPS given the current environment for inflation, and we deployed that to the equity side.

1st Quarter Market Commentary

Economic recovery gathered pace in the first quarter on the back of widespread vaccination, renewed fiscal stimulus and continued monetary policy support. Although manufacturing continued to expand strongly across regions, services growth improved only in the United States (US) and the United Kingdom (UK) and lagged in rest of Europe. Emergence of new variants of Coronavirus and a pick-up in inflation caused by cost pressures across supply chains remained key risks to growth momentum.

Risk assets continued to rally in the first quarter with cyclical and value assets outperforming growth sectors that saw outsized returns in 2020. Commodities registered modest gains and oil prices rallied sharply on optimism that demand would rebound even as OPEC+ countries kept a tight rein on additional supplies. The US dollar registered its best quarterly performance since 2018 amid rising expectations of a strong US economic recovery. The yield on the US 10-year Treasury note rose to 1.75% versus 0.9% at the start of the year but remained lower than the 1.9% level registered at the end of 2019. Strong economic recovery and a potential rise in inflation as a result of fiscal spending played crucial roles in yields rising in Q1.

On the fiscal front, the US Congress passed a third major stimulus package in the form of a US$1.9 trillion American Rescue Plan backed by US President Joe Biden. A new plan for stimulus in the form of an infrastructure package further raised growth prospects. Elsewhere, in Europe, a German constitutional court's adverse order cast new doubts on the timely implementation of the European recovery fund. In the UK, Finance Minister Rishi Sunak pledged an additional £65 billion stimulus in the budget plan. In Japan, parliament cleared a record US$1 trillion budget for the next fiscal year, raising hopes of further stimulus spending.

On the monetary policy front, despite markets pricing in higher growth and inflation being at the long end of the curve, the US Fed reiterated its accommodative monetary policy stance and did not expect to raise interest rates in near future. The Fed remains focused on restoring the economy to full employment. In Europe, the European Central Bank (ECB) responded to the rise in bond yields by committing to significantly increase its purchase of bonds over the next quarter while re-iterating that its Pandemic Emergency Purchase Program would run at least until March 2022. In Japan, the Bank of Japan (BoJ) made changes to its framework to continue with monetary easing more sustainably and effectively. The BoJ would maintain yield curve control but would allow more fluctuations around yield levels.

On the economic front, manufacturing continued to show sustained resilience globally with the US ISM Manufacturing Purchasing Managers' Index (PMI) soaring to 64.7, its highest reading since the 1980s. The Euro Area Manufacturing PMI was at 62.5. Services activity also rose toward the quarter end in the US with March PMI at 63.7, strongly exceeding consensus estimates of 59. China's March services PMI was also higher than expected. However, Europe continued to lag in services with March PMIs remaining in the contractionary zone due to extended lockdowns. Job growth accelerated in the US in March as total payrolls soared by 916,000 against consensus estimates of 660,000. In Japan, the BoJ's Tankan survey of business conditions improved again in the first quarter reflecting diverging conditions in manufacturing and services. The survey implied potential upside for the former.

Global Equities

Equity markets performed well registering positive growth during the quarter as the MSCI All Country World Index rose by 4.68%. The performance was dominated by developed market equities as measured by the MSCI World Index, which returned 5.04% during the quarter. Emerging market equities posted modest positive returns of 2.34% but lagged behind developed market equities.

The quarter started off by overcoming concerns regarding potential virus-driven restrictions as a successful roll out of vaccinations and the promise of a fiscal and monetary stimuli lifted investor sentiments. However, the subsequent slow pace of vaccine distribution and concerns around a longer-than-anticipated timeline for economic recovery led to global markets stumbling for a short period. The sell-offs were short lived as stocks regained some upside momentum on news of strong manufacturing data, firmer oil prices and hopes for additional fiscal stimuli. With majority of adults receiving at least one dose of the vaccine and the number of people being hospitalized with COVID-19 being much lower than at the start of the year, the continued rally was a signal of investors looking ahead to a sustainable reopening of economies.

The Chicago Board Options Exchange's CBOE Volatility Index (VIX) posted negative returns of -14.72% over the quarter, indicating reduced market volatility. However, there was a spike in the volatility toward the end of January as concerns around a delayed economic recovery led to market sell-offs.

North American Equities

In the US, the Democratic Party's victory in Georgia at the start of the year paved way for further stimulus measures, resulting in the S&P 500 Index gaining 6.17% during the quarter. In addition, the infection rate continued to trend down and the vaccine rollout accelerated during the period with the vaccination goal being raised from 100 million to 200 million. President Biden also announced a stimulus package worth 9% of US GDP leading to upgrades in consensus forecasts for US growth this year. The stimulus package, which includes unemployment benefits, is likely to accelerate consumption. However, there were concerns that the size of the US stimulus, combined with pent-up savings, could lead to a pickup in inflation, potentially leading the US Fed to tighten policy to an extent that could be damaging for equity markets.

The quarter closed with the Fed indicating that there would be no rate hikes before 2024. Energy (30.85%) and financials (15.99%) were the best performing sectors while information technology (1.97%) and consumer staples (1.15%) languished at the bottom.

Mid- and small-cap companies, which tend to be more domestically focused, delivered better gains compared with their larger counterparts with the S&P Midcap 400 Index rising by 13.47% and the Russell 2000 Index gaining 12.70%.

European Equities

In Europe, there were delays in vaccine rollout and many countries extended their lockdowns. Within the region, Italian markets performed the best as the new government announced an effective vaccination plan, new support to prevent COVID-19 related layoffs and its intentions to efficiently use the resources of the European Recovery Fund. A go-ahead was given to the Recovery and Resiliency Plan by the European Parliament, which is expected to attract investors' attention. Business surveys indicated strong manufacturing expansion in Europe and the UK. However, Europe started to see an increase in cases by the quarter end, which could put a damper on domestic recovery.

In the UK, Prime Minister Boris Johnson announced a target to vaccinate the country's adult population by July. The vaccination campaign was progressing well with approximately 58% of adults having received at least one dose. The UK service sector witnessed a notable improvement as businesses experienced improving consumer confidence and there were signs of pent-up demand.

MSCI Europe returned 4.21% in the quarter in US dollar terms. Energy (10.83%) and financials (9.77%) were the best performing sectors while utilities (-3.83%) and real estate (-5.95%) were the worst performing.

Asia Pacific Equities

MSCI Pacific performed in line with global indices during the quarter and rose by 2.63% in US dollar terms. With gains of 8.88% and 7.26%, respectively, MSCI Singapore and MSCI Hong Kong were the top performers. MSCI Australia and MSCI Japan also had moderate gains of 3.44% and 1.70%, respectively. MSCI New Zealand was the only laggard with a negative return of -10.54%. Japanese equities were supported by a strong rebound in global goods demand and fewer COVID-19 cases despite the low vaccination rate.

Emerging Market Equities

In China, new cases were registered in the northern provinces, which lead to tighter restrictions being extended up to the lunar year season. Chinese equities had a sell-off during the quarter over policy tightening. Despite a strong start to the quarter, the region had a difficult time due to concerns around rising COVID-19 cases in some parts of the region.

The MSCI Emerging Markets Index, the broad measure of the performance of emerging markets, was up by 2.34% for the quarter in USD terms. At the country level, the top-performing markets included MSCI Chile (17.08%) and MSCI Saudi Arabia (16.50%). The markets that were ranked at the bottom were MSCI Colombia (-17.22%) and MSCI Turkey (-20.17%).

Global Fixed Income

Global bonds (Bloomberg Barclays Global Aggregate Bond Index — USD Hedged) saw negative returns (-2.47%) in 1Q21. Even though spreads tightened overall by 4 bp over the quarter, underlying rates returns were negative. Large bear steepening moves were witnessed in most government bond markets, particularly in the US, where 5-year and 10-year Treasury yields rose by 58 and 83 bp, respectively, leading to a pickup in volatility across risk assets. Progress in COVID-19 vaccination, the move higher in commodity prices suggesting a better demand backdrop and the signing of the third stimulus package in the US had all led to markets expecting a reflationary environment, which in turn saw the return of long-suppressed term premia in government bond markets.

US Credit

Investment grade (IG) spreads (Bloomberg Barclays U.S. Aggregate Corporate Index) tightened by 5 bp to end the quarter at 91 bp over Treasuries. The Fed sent a dovish message at the March Federal Open Market Committee meeting, stating the policy will react to actual, rather than expected, improvement in economic data. The willingness in particular to let inflation run above 2% for an extended period of time led to some near-term respite for credit spreads as rising US rates reflecting growth optimism is not bad for credit per se. This is especially so with broad monetary conditions still remaining highly accommodative. Q1 US IG issuance totaled US$523.7 bn on a gross basis and US$216.5 bn on a net basis as per Barclays. Rates volatility is still elevated and the expectation of even higher rates going forward could force some issuers to frontload issuances, especially those involved in large pending M&A deals that are expected close around mid-year.

High yield (HY) spreads (Bloomberg Barclays U.S. HY 2% Issuer Cap Index) tightened by 50 bp to end the quarter at 311 bp. CCCs (+3.81%) outperformed Single B bonds (+1.60%) and BB bonds (-0.26%) in an environment of rebounding growth trends, indicative of a more supportive earnings environment. 1Q21's US$158.6 bn in HY issuance was a new record, surpassing 2Q20's prior high of US$145.5 bn, even though US$36.4 bn of non-refinancing related issuance was a fraction of 2Q20's record of US$75.5 bn. The par-weighted US HY default rate at the end of March stood at 4.80%. Continued improvement in vaccinations across the globe, wide open primary markets and oil prices hovering around US$60/barrel led to a decline in default rates year to date.

Treasury Inflation Protected Securities (TIPS)

Market-based inflation expectations for the US, measured by five-year break-evens, sharply increased by 63 bp over Q1, ending at a multi-year high of 2.60%. Vaccine distribution and optimism, improving global growth trends, rising commodity prices, expected further drop in COVID-19 infections and a US$1.9 trillion fiscal package all stoked inflation expectations. Both TIPS and nominal treasury bonds gave out negative returns over the quarter, with nominals significantly underperforming TIPS bonds of similar maturities.

Commodities

Commodities (as measured by the Bloomberg Commodities Total Return Index) registered their fourth straight quarterly gains. Optimism regarding economic recovery, supply dislocations and a weakened US dollar assisted in fueling a rally in commodities. Despite giving up some recent gains in March, the index rose 6.9% for the quarter with energy being the best performing index component as oil prices continued to pick up.

- The Energy sector advanced 17.3% with West Texas Intermediate (WTI) crude oil returning over 22% for the quarter. Crude prices rose in Q1 as overall expectations for a global recovery supported a brighter demand outlook. Nevertheless, optimism regarding a recovery faded in March as a resurgence in coronavirus cases curtailed fuel demand. OPEC+ countries reduced output by approximately 7 million barrels per day to support prices and reduce their surplus. The Bloomberg Natural Gas Sub-Index fell 7.2% in March but managed a positive return for the quarter.

- The industrial metals index rose 7.5% for the quarter. Prices for copper rose to their highest level in almost 10 years on the heels of growing optimism over a widespread economic recovery. Higher Chinese demand amid concerns that demand will outstrip near-term supplies also supported metal prices. However, most industrial metals fell in March with Nickel faring the worst. The precious metals sub-index fell further in March extending the year-to-date loss to 9.3%. Optimism about an economic recovery weighed on haven assets like gold and silver, which were also hurt by rising bond yields. Gold was down by about 9% while silver lost approximately 7% for the quarter.

- The agriculture sector gained 6.8% in Q1 driven higher by strong performance from soybeans and corn. Dwindling stockpiles of US grains along with strong demand from Asia lifted prices of row crops. The U.S. Agriculture Department (USDA) released its annual survey of planting intentions in March, which suggested that the farmers' growing plans fell below earlier expectations, especially for soybean and corn.

Real Estate Investment Trusts (REITs)

Real estate investment trusts (REITs) as indicated by the FTSE EPRA Nareit Global Real Estate Index gained 6.0% in Q1, while Dow Jones US Select REIT returned 10% for the quarter. Nearly all property sectors posted positive returns during the quarter. The sectors that were negatively impacted by the pandemic in 2020 continued their strong performance in 2021 with retail REITs returning 18.1% so far this year and lodging/resorts returning 18.0%.

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* This figure is presented as of March 31, 2021 and includes approximately $60.33 billion of assets with respect to SPDR products for which State Street Global Advisors Funds Distributors, LLC (SSGA FD) acts solely as the marketing agent. SSGA FD and State Street Global Advisors are affiliated.

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Sources: Bloomberg, FactSet, J.P. Morgan, Barclays, Morgan Stanley, Wall Street Journal, and MSCI, as of March 30, 2021.

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