



Market Review
First Quarter 2021

The first quarter marked the anniversary of the global coronavirus pandemic, evoking memories of the initial shock, confusion, and contradiction. Encouragingly, it also demonstrated the country's best success in resisting the disease to date.

The primary cause for optimism has been accelerating traction in the nationwide vaccination program. In the U.S., over 100 million people have received at least one dose of COVID-19 vaccine. Recent messaging is that every adult in the country will be eligible to be vaccinated by April 19, 2021.

At the same time, the economy (and stock market) continues to benefit from extreme fiscal and monetary stimulus. This includes the effects of two relief packages, totaling \$2.8 trillion, that have been approved in the past four months and are working their way through the system.

The combination has provided the reopening momentum with a running start that most investors believe signs the beginning of a robust expansion. It has also changed the narrative in financial markets in numerous and important ways.

Financially, the most significant development was a sharp rise in the 10-year U.S. Treasury bond yield. After bottoming at record low levels, the benchmark yield increased 24 basis points in the fourth quarter and another 82 basis points in the first quarter, with the bulk of the move occurring in February and March. The principal factor behind the rise is the increasing optimism about the U.S. economy, coupled with the possibility of higher inflation, which was borne out in recent reports. The March ISM Manufacturing Index achieved the highest level since 1983, but also indicated rising input prices and low customer inventories; the combination paints the picture of an economy straining to shift into a higher gear.

After buckling initially, the stock market has rallied in response to the improving outlook, and despite higher yields. In the first quarter, the S&P 500 and Russell 2000 indices gained 6.17% and 12.70% respectively, both on a path to record highs. Unlike in previous periods, however, the gains were broader based. The S&P 500 Equal Weight index returned 11.49%, which cut into a 10-year deficit against the capitalization-weighted benchmark. The Nasdaq Composite lagged, returning 2.78%. Value also trounced Growth on both ends of the market cap spectrum with the Russell 2000 Value Index up 21.17% while the Russell 2000 Growth Index increased 4.88%.

Notably, all of the most significant divergences occurred in February and March as interest rates spiked, reflecting investors' impulse to increase cyclical exposure amid rising Wall Street GDP forecasts and earnings estimates. At the same time, the higher discount rate (finally) increased scrutiny on excessive valuations in the protracted aggressive growth leadership.

Thus far, the Federal Reserve has been content to let long-duration interest rates rise, which marks another departure from the past. One interpretation is that policy authorities are more willing to cater to "Main Street" than "Wall Street" with a Democratic administration and a former Fed Chair serving as Secretary of the Treasury. Having said this, it is clear that the governing body is committed to staying accommodative and is (preemptively) labeling increases in inflationary pressure as transitory. What is less clear is to what extent a country running post-war high deficits can afford higher rates.

That said, we are very encouraged by the reopening momentum, which improves the prospects for our valuation-based process. We have always cast a wide net in our search for growth and accelerating earnings, and fare better in broader markets than in the narrow high-octane advance of the past two years (i.e., health care and technology). We believe that a recovery across sectors will refocus investors on the bottom line, and most importantly on earnings and cash flow valuation metrics. Ultimately, valuation matters.



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Sources: FactSet, GICS Sector Classification, Forbes, Institute for Supply Management

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The ISM Manufacturing Index, also known as the purchasing managers' index (PMI), is a monthly indicator of U.S. economic activity based on a survey of purchasing managers at more than 300 manufacturing firms. It is considered to be a key indicator of the state of the U.S. economy. It is a composite index that gives equal weighting to new orders, production, employment, supplier deliveries, and inventories. Each factor is seasonally adjusted.

S&P 500 Index is widely regarded as the best single gauge of the U.S. equities market, this world-renowned index includes 500 leading companies in leading industries of the U.S. economy. Although the S&P 500 focuses on the large cap segment of the market, with approximately 75% coverage of U.S. equities, it is also an ideal proxy for the total market. S&P 500 is part of a series of S&P U.S. indices that can be used as building blocks for portfolio construction.

The Russell 2000® Index measures the performance of the small-cap segment of the U.S. equity universe. The Russell 2000 Index is a subset of the Russell 3000® Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000 is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set.

The Nasdaq Composite Index is the market capitalization-weighted index of over 2,500 common equities listed on the Nasdaq stock exchange. The types of securities in the index include American depositary receipts, common stocks, real estate investment trusts (REITs) and tracking stocks, as well as limited partnership interests. The index includes all Nasdaq-listed stocks that are not derivatives, preferred shares, funds, exchange-traded funds (ETFs) or debenture securities.

The Russell 2000® Value Index measures the performance of the small cap value segment of the US equity market. The index is constructed to provide a comprehensive and unbiased barometer for this market segment, and it is completely reconstituted annually to ensure accurate representation.

The Russell 2000® Growth Index measures the performance of the small-cap growth segment of the U.S. equity universe. It includes those Russell 2000 companies with higher price-to-value ratios and higher forecasted growth values. The Russell 2000 Growth Index is constructed to provide a comprehensive and unbiased barometer for the small-cap growth segment. The Index is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set and that the represented companies continue to reflect growth characteristics.

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Index Definition Sources: Standard & Poor's, FTSE Russell, Investopedia

Mutual fund investing involves risk including the possible loss of principal. There are specific risks inherent in small cap investing, such as greater share volatility as compared to other funds that invest in stocks of companies with larger and potentially more stable market capitalizations. Products of technology and biotech companies may be subject to severe competition and rapid obsolescence.

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