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Letter from the Chief Investment Officer

The Ten Themes for 2021—Seeking the Thrill of Victory

We wish you a safe, healthy, and prosperous New Year! These words are even more meaningful given the most deadly and economically crippling 'Black Swan' event that we have experienced in the last century—COVID-19. After unprecedented fiscal and monetary stimulus, the record-setting development of multiple effective vaccines has elevated optimism that we will experience the 'thrill of victory' over this nemesis in the upcoming year. The first-ever postponement of the Summer Olympics, scheduled to take place last July in Tokyo, Japan, exemplifies the depths of disruption this pandemic has caused. However, the concept of the torch is associated with hope, light, and strength, an excellent metaphor for the rescheduled start date—July 23, 2021—likely coinciding with the sustainable reopening of many parts of the world. In fact, in the US, optimistically, more than 50% of the population (the majority of which are among the most vulnerable) could be inoculated from the virus by the opening ceremonies. After more than a year of social distancing, the athletic events are the quintessential celebration for the world coming together once again. As a salute to everyone that has done their part to make this happen—from scientists to frontline workers to the athletes themselves—and to set our sights on a more uplifting time period, we have chosen the Summer Games as the backdrop for our Ten Themes for 2021.

#1: Global Synchronized Economic Recovery – Rowing In The Same Direction

Nineteen of the twenty largest economies in the world experienced a contraction in growth in 2020, but we expect the entire 'crew' to rebound and see positive growth in 2021. The 'coxswain' of the recovery will continue to be global central banks, led by the Federal Reserve (Fed), as its decisions to keep interest rates low and liquidity robust will ultimately dictate the power and pace of the global economic recovery. With short-term interest rates at or below zero for the foreseeable future and global central banks having the stamina to allow inflation to overshoot temporarily, economies should have a favorable glide path to recovery. Given that monetary and fiscal stimulus actions have a lagging economic impact, we expect all these economic oarsmen to experience a 'swing,' or synchronized forward motion, by midyear.

#2: US Economic Recovery Taking On A Triathlon

While our overall expectation is that the US economy will return to healthy, positive economic growth on an annual basis (2021 US GDP forecast: ~4%), the recovery will be defined by transitional periods with varying paces throughout the year. At the onset, worsening COVID trends and paused reopening processes will prove to be a challenge. Analogous to swimming, the first leg of the triathlon, the pace will be slower than that of the biking and running legs, and the waters may be choppy. However, by the spring, economic growth will accelerate as the dissemination of vaccines 'push the pedal' for more businesses to safely reopen. Pent-up demand, especially for services, a rebuild of depleted inventories, an improving labor market and a resurgent global economy should help the economy notch its 'top speed' through the summer and early fall. However, toward the end of the year, we expect the US economy to reach a steadier 'stride,' finishing at a slower, but more sustainable pace.

Investment Strategy Quarterly is intended to communicate current economic and capital market information along with the informed perspectives of our investment professionals. You may contact your financial advisor to discuss the content of this publication in the context of your own unique circumstances. Published 1/11/2021. Material prepared by Raymond James as a resource for its financial advisors.

> “With pullbacks still a natural occurrence for the equity market, it is critical that investors have a strategy in place for when the times get ‘rough’ so that emotionally-driven decisions don’t lead portfolios into ‘hazards.’”

#3: Fixed Income – Keeping Portfolios En Garde Despite Low Yields

Fencing is a sport that requires agility, coordination, balance, and timing – the same skill set global central banks displayed when adjusting interest rates in light of the COVID-19 pandemic. At the beginning of 2020, the 10-year Treasury yield was ‘targeting’ the 2% level, but the global health crisis led the Fed to ‘sabre’ yields to record lows, resulting in the yield ‘striking’ a historic low of 0.50% last March. This year, our envisioned acceleration in economic growth should ‘thrust’ the yield back to the 1.50% level by year end; but low inflation, central bank buying, strong foreign demand and the growing economic sensitivity to higher yields will ‘parry’ yields from returning to levels near 2% on a sustainable basis. With the Fed pledging to keep interest rates low until at least 2023, the yield curve will likely steepen, and therefore we encourage investors to limit longer duration bonds. The opportunities for yield will remain restricted, and rather than ‘lunging’ at lower-quality bonds in pursuit of yield, investors should allow bonds to serve their more traditional role in portfolios. In the year ahead, we expect bonds to offset the potential for equity volatility rather than produce the robust capital appreciation returns we have grown accustomed to over the last several years.

#4: Equity Market – Earnings Will Do The Heavy Lifting

In 2020, for the second consecutive year, equity market returns were ‘lifted’ by P/E expansion, as optimism surrounding the eventual economic recovery drove the equity market to record highs in the midst of the outbreak. We remain positive on equities over the next 12 months, but it will be a ‘powerful’ earnings rebound (20% plus EPS growth in 2021) that will ‘raise the bar’. Earnings are often revised higher in the period following a recession, so when combined with tailwinds such as multiple vaccines and additional fiscal stimulus, the S&P 500 is likely to reach 4,025 by year end. We continue to favor the large-cap growth space at this stage of the recovery; however, value and small-cap equities may ‘out-muscle’ the space later this year as the economy fully reopens.

#5: Info Tech – Hitting The Bullseye Of Our Sector Target

The sport of archery incorporates both accuracy and precision, the same qualities we ‘aim’ to possess as we determine our preferred sectors. The Information Technology sector has been the top performing sector for three of the last four years, and we believe the rollout of 5G and the manner in which the pandemic altered the way companies conduct business will be additional ‘arrows’ in the sector’s ‘quiver.’ The COVID-19 outbreak forced businesses to establish an online presence and to reconfigure operations in an effort to meet safety guidelines. It also revealed several efficiencies in the way we live our everyday lives (e.g., e-commerce, streaming, telehealth), and has permeated industries not typically associated with tech due to ongoing innovations related to artificial intelligence (e.g., the use of drones in agriculture). Elevated tech investment has placed the sector at the center of our allocation ‘target,’ but given the tech-based adaptations in other industries, we believe investors can still ‘score points’ with the Health Care, Consumer Discretionary, Communication Services, and Industrials sectors.

#6: ESG – Wave Of Socially Responsible Investment Not About To Break

The sport of surfing began prior to 1770, but it will make its debut in the upcoming games this year! Similarly, the principals of environmental, social, and corporate governance investing have been

Letter from the Chief Investment Officer *(cont.)*

practiced for decades, but between the Biden administration and the lingering impacts of the COVID-19 pandemic, the ESG 'wave' is expected to grow. Throughout his campaign, Biden emphasized the importance of 'clean technology' and his appointment of a climate czar is an early sign that he will follow through on his promise. While affirmative action will be undertaken by the federal government, we expect companies will continue to 'ride the wave' of setting, adhering, and disclosing their ESG-related goals and principles. Whether it be through an exclusion, thematic, or impact approach, we expect investors to have heightened awareness of the sectors better aligned with positive environmental and societal outcomes.

#7: International – Exposure Abroad Will Be A Balancing Act

The 'uneven bars' are one of the four events for female gymnasts, but they are also prevalent in our equity allocation preferences, as our bias toward US equities remains intact. The broad-based global economic recovery would typically lead us to be more 'flexible' with our international exposure, but the sector allocation in Europe (e.g., overweight Financials in the low-rate environment) has garnered the region a few 'deductions.' However, our expectation for a weakening dollar, attractive valuations and our bias toward Info Tech, Communication Services, Consumer Discretionary, and Industrials present a favorable outlook for emerging market equities, as these sectors combine for more than half of the Emerging Markets Index.

#8: US Dollar Will Not Have The Inside Track

The COVID-19 pandemic sparked demand for safe-haven assets, causing the dollar to 'clear a jump' to the highest level since January 2017. However, once the panic associated with the start of the outbreak was subdued, the dollar weakened to its lowest level in two years. The global economy's recovery, ongoing aggressive fiscal and monetary policy action, a growing budget deficit, and more likely than not easing trading restrictions with China and our allies will all serve as 'hurdles' in the dollar's path, preventing it from moving higher. Ultimately, the weakening of the dollar may 'pass the baton' to emerging market equities, emerging market bonds, commodities and US multinational companies.

#9: Oil Demand To Catch The Crosswind Of Economic Activity

2020 was anything but 'smooth sailing' for the oil industry, as the Saudi-Russia oil price war (excess supply) combined with the virus-induced lockdowns (weak demand) weighed heavily on oil prices. As we look ahead to 2021, a sustainable return to normality is expected to cause the best rebound in global oil demand since 1973. The gradual rise in oil prices (WTI Crude $60/bbl year-end target) should put 'wind in the sails' of the industry's lagging recovery, but there may be more 'elements' to face. With the environment a top campaign issue for Biden, a renewable energy 'storm' is on the horizon. The consumption of renewable energy has tripled over the last 20 years, and additional regulatory shifts under the new administration could cause the Energy sector to 'sail' in a new direction.

#10: Keeping Asset Allocation Parameters On The Fairway

Fortunately for investors, our expectation is for overall market volatility to be more palatable in the year ahead, driven by the gradual reopening of the economy, more stable monetary policy and less political risk. But just because volatility won't be 'on par' with that of 2020, does not make adherence to asset allocation parameters of any less importance. With pullbacks still a natural occurrence for the equity market, it is critical that investors have a strategy in place for when the times get 'rough' so that emotionally-driven investment decisions don't lead portfolios into 'hazards.' With valuations stretched from a historical perspective, selectivity will be key in 2021, and we expect that active managers will serve as 'caddies,' having insights into potential areas for opportunity.

After a tumultuous 2020, the words spoken by tennis legend and four-time gold medalist Serena Williams—"I've grown most not from victories, but setbacks"—are arguably just as true for investors as they are for athletes. The year reminded investors of the importance of a well-crafted 'game plan,' one that prepares for potential challenges ahead. While your advisor can offer in-depth insights more specific to your situation, we hope that our views on the economy and various asset classes serve as a reliable, integral part of this plan, and that our timely commentary throughout the year can help guide your portfolio to the top of the podium.

Again, we wish you all the best for a wonderful 2021! Go U-S-A!

Lawrence V. Adam, III, CFA, CIMA®, CFP®
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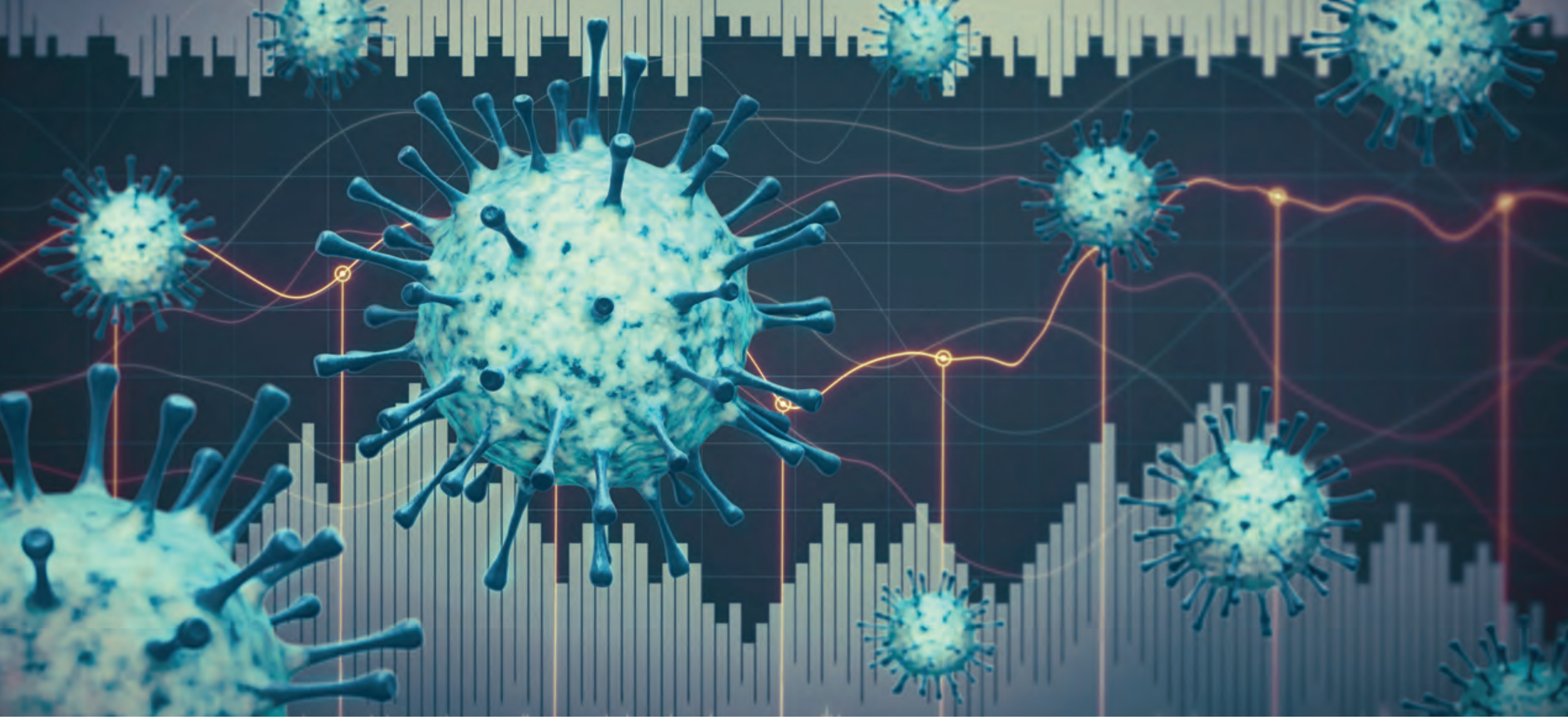

COVID-19: An Unprecedented Year

Chris Meekins, *Director, Healthcare Policy Analyst,* Equity Research

COVID-19 has made this year nothing short of 'unprecedented.' The pandemic has put Americans to the test as we have been forced to rapidly adapt to new ways of life. Changes span virtually all areas of life: how we work, how we socialize, how we cope, and how our children learn, to name a few. With over 23 million identified cases and over 350,000 identified deaths attributable to the coronavirus in the US alone, COVID fatigue is running rampant as individuals grow weary of the 'new normal.'

There is hope as Americans get the first doses of the coronavirus vaccines. The virus spread rapidly, yet there was also unprecedented speed in developing vaccines. 2021 is likely to look quite different than 2020 and we believe a return toward normality is likely. As high risk populations receive the vaccines, there will likely be a major drop off in the number of fatalities from the virus. Hospitalizations will also likely drop notably, but only after we see a continued surge through January. The drop off in fatalities, even if cases remain elevated, will likely lead more individuals and policymakers to begin returning to normal behaviors. In fact, if the portion of the population limiting their activities the most is vaccinated in the first half of 2021, we could see the pent-up demand for interacting with others explode.

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While there are encouraging signs heading into 2021, there are also some 'known unknowns' – any of which could hamper the positive outlook.

FIRST QUARTER 2021

The first quarter of 2021 should look similar to what we see today, but the loosening of restrictions is likely. The incoming Biden administration is likely to ramp up the public health messaging. In his inaugural address in mid-January, we expect Biden to ask every American to wear a mask for 100 days. This sets up an artificial deadline in the mind of Americans that all restrictions should be able to be lifted by early May. The strategy behind the 100 day request is that by that time a large portion of the population should have access to a vaccine. The messaging

KEY CONSIDERATIONS FOR 2021

Hospitals are likely to be overwhelmed in the first half of 2021.

Expect a '100 Days of Mask Wearing' push from President-elect Biden.

President-elect Biden plans to tackle our nation's testing problem.

Expect top-down messaging to sound much different than current messaging.

Vaccines could change the game by the second half of the year.

Even with vaccines, many mitigation measures are likely to continue for some time.

Many flexibilities are likely to stick around for good.

Expect the unexpected.

will also focus heavily on reassuring the public that the vaccines are safe and effective. We expect that in the first quarter, states will continue to make their own decisions on how to proceed with restrictions and reopenings. While there may be requests from the Biden administration for the nation to impose greater restrictions depending on just how bad things get following the holidays, Republican governors can largely ignore what the federal government is requesting. We expect most Republican governors to do just that. Democratic governors are likely to align themselves with what the Biden administration requests. One benefit of this is that the Democratic governors are more likely to trust what the Biden administration requests and could be more likely to reopen sooner than they would under a Trump administration. By the end of the first quarter, vaccines should be available to more than 125 million Americans. This can cover the most at-risk populations and therefore lead to dramatically lower hospitalizations and fatalities. Concern that hospitals are becoming overwhelmed has led to most restrictions by local and state leaders. Releasing some of the pressure from hospitals will likely help lead to more individuals willing to return to normal activities.

SECOND QUARTER 2021

The second quarter of 2021 will likely be a continuation of what we are seeing at the end of the first quarter with a ramp up of vaccinations leading to the loosening of restrictions at the state and local level and more individuals returning to normal activities. By Memorial Day, we anticipate a vaccine will be available to every American who is willing to get one. While reaching herd immunity likely will require at least 70% of the population to receive the vaccine (or to have been infected), we believe life can return to normal prior to reaching that point. As more people get vaccinated, cases, hospitalizations, and fatalities should drop precipitously. The decrease will take COVID-19 off the front page and we anticipate this will lead to increasing numbers of Americans returning to pre-COVID activities. In fact, we would anticipate a major increase in vacation travel by the end of the second quarter. However, we think businesses will be reluctant to have their employees return to the office too quickly. In the second quarter we expect an increasing number of businesses to let employees return in greater numbers, but it is unlikely in our view that a majority will require a return to office.

SECOND HALF 2021

The second half of 2021 is likely to lead largely to a return to normal. Every American who wants a vaccine should have received both doses by this point. We expect most Americans will no longer feel the need to wear masks and governments will

> "By Memorial Day, we anticipate a vaccine will be available to every American who is willing to get one."

not be mandating them. While some restrictions on crowd sizes could remain, the vast majority will likely be removed. We also anticipate a large pent-up demand for interacting with others to be released. We would expect COVID to largely be in the rearview mirror for most Americans and businesses. Proof of vaccinations could become a prerequisite for business-related meetings in person and conference attendance.

MANY FLEXIBILITIES ARE LIKELY TO STICK AROUND FOR GOOD

If we were to think of a silver lining from the pandemic, it would be how quickly we have adopted technologies that provide more flexibilities to healthcare, careers, and everyday life. For example, the Trump administration broadly allowed fee-for-service Medicare to cover telehealth visits and services amid the onset of the public health emergency. On December 1, Centers for Medicare & Medicaid Services (CMS) announced some telehealth services for which coverage will become permanent, such as group psychotherapy and established patient home visits. In the coming year, we anticipate additional COVID-era flexibilities will remain, even after we hopefully have a green light to return to our normal routines.

KNOWN UNKNOWNS

While we see a pretty straightforward roadmap for how things should unfold in the months ahead, there are certain things we know we do not know. We do not know what portion of the population will choose not to get vaccinated. We also do not know if the virus will mutate to the point of making the vaccines ineffective. The duration of the immunity of the vaccine is also an unknown. Will the vaccine protect for six months, a year, two years? We just do not know. Will production delays occur, thus leading to fewer vaccines being available than expected? Lawsuits are likely to be filed against businesses for how they handled the care of their employees and we do not know how that will impact businesses' willingness to return to normal. While there are many things that could delay the return to normal, we think these are relatively low-probability events.

KEY TAKEAWAYS:

- There is hope as Americans get the first doses of the coronavirus vaccines. The virus spread rapidly, yet there was also unprecedented speed in developing vaccines. 2021 is likely to look quite different than 2020 and we believe a return toward normality is likely.
- The incoming Biden administration is likely to ramp up the public health messaging. The messaging will also focus heavily on reassuring the public that the vaccines are safe and effective.
- By Memorial Day, we anticipate a vaccine will be available to every American who is willing to get one. The second half of 2021 is likely to lead largely to a return to normal.
- If we were to think of a silver lining from the pandemic, it would be how quickly we have adopted technologies that provide more flexibilities to healthcare, careers, and everyday life.

An Effective Vaccine Has Arrived (Actually, Two)!

Steve Seedhouse, *Director, Biotechnology Analyst,* Equity Research

In December, the FDA granted emergency use authorizations (EUAs) in the United States for two COVID-19 vaccines in people over 16 years old (Pfizer vaccine) and people over 18 years old (Moderna vaccine). Both vaccines are currently being distributed and administered by priority, starting with healthcare personnel and long-term care facility residents.

TRIAL RESULTS

Moderna's vaccine was 94.1% efficacious in a 30,000-patient Phase 3 study, whereas Pfizer's was 95% efficacious in a ~44,000-patient study (i.e., efficacy is indistinguishable). Importantly, *severe* COVID-19 cases were also reduced (0 in vaccine vs. 30 in placebo group for Moderna, 1 vs. 9 for Pfizer). Generally speaking, this level of efficacy exceeded our, and most experts', expectations. For context, vaccines for polio (99%), measles (97%), and rubella (>95%) are slightly more effective, but chickenpox (92%) and mumps (88%) are actually less effective. In any given year, seasonal flu vaccines are 40% to 60% effective.

There are no concerning acute safety signals in the completed studies (although detailed safety data from the large Phase 3 studies have not been published). However, the speed of development and high 'attack rate' (i.e., rate at which people got COVID-19 in the Phase 3 study, leading to quick completion of primary efficacy analysis) mean *long-term* safety data are simply not available. No patient that enrolled in any study phase is more than one year out from their first vaccination. That said, based on the good acute safety profile, the large nature of the Phase 3 studies, and historical knowledge of safety for other vaccines (very rarely, if ever, do safety issues emerge beyond ~ two months post vaccination), we do not expect any safety issues. Tolerability is different than safety and it should be noted that there are tolerability side effects of these vaccines (e.g., fatigue, chills, muscle pain, fever, and more).

> This level of efficacy exceeded our, and most experts', expectations.

Although no vaccine has previously been developed in less than a year, as is the case for these new COVID-19 vaccines, ~95% efficacy and clean safety profiles were demonstrated in gold standard, placebo-controlled, large Phase 3 trials. Thus, we expect public health officials, the FDA, CDC, and community physicians will be major advocates for widespread vaccination in virtually everyone except children (until more data are available). So far, adults over the age of 18 have been the subjects enrolled in clinical trials although Pfizer and Moderna are now testing in children as young as 12 years old.

AstraZeneca recently reported data from Phase 3 trials conducted outside the US (UK, Brazil) for its viral vector-based COVID-19 vaccine. Although the vaccine was ~70% efficacious in the studies, a dosing error that resulted in less than 3,000 patients receiving half the intended 'prime' dose of the vaccine followed by a full boost dose a month later resulted in ~90% efficacy. AstraZeneca is planning to relaunch a new Phase 3 US-based study with this half/full dose regimen to explore if the 90% efficacy result is real and reproducible and our understanding is US authorization would not occur until the new Phase 3 is completed. Separately, we expect Johnson & Johnson to complete Phase 3 of its single-shot, viral vector vaccine around January 2021, and Novavax to complete Phase 3 of its recombinant, adjuvanted vaccine around the first quarter of 2021. Both should work and supplement the vaccine supply in the US.

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MANUFACTURING AND DISTRIBUTION

It will be very important to closely monitor manufacturing and distribution to track whether Moderna and Pfizer are hitting their targets in 2020 and 2021. Moderna expects 20M doses ready to ship in the US in 2020 and fully 500M-1B doses (250-500M people) in 2021. Operation Warp Speed in the US has already secured the first 100M doses for $1.5B, expected to be delivered before the end of the first quarter. Separately, Pfizer expects current production capacity of ~20M doses/month to provide ~50M total doses for worldwide distribution in 2020 and 1.3B doses (650M people) in 2021, comprising:

- 200M doses for the EU in 2020-2021 + 100M option
- 120M doses for Japan, first half of 2021
- 100M doses for the US 2020-2021 (by March) + 500M option
- 30M doses for the UK in 2020-2021
- Undisclosed number for Canada plus 22 preliminary contracts (term sheets) and another 30 countries and supranational organizations in discussion.

Long-term storage of Pfizer's vaccine requires -80°C freezers (commercially available freezers commonly used in research labs and hospitals). Vaccine vials can be stored in this way for about six months. However, Pfizer's vaccine can be stored or shipped on dry ice for up to 15 days and then refrigerated up to five days at the points of use. The compressed gas industry indicates it expects sufficient dry ice supply to meet the demand and FedEx and UPS should be able to handle vaccine delivery with no problem. Moderna's vaccine is even easier to store, requiring -20°C long-term storage (standard kitchen freezer) and refrigeration up to 30 days, or room temperature up to 12 hours.

ROLL OUT

On December 1, the CDC's Advisory Committee on Immunization Practices (ACIP) met to discuss priority for vaccine allocation upon EUA. The committee members were asked to vote on a motion for the following proposed interim recommendation:

> *"When a COVID-19 vaccine is authorized by FDA and recommended by ACIP, vaccination in the initial phase of the COVID-19 vaccination program (Phase 1a) should be offered to both 1) health care personnel and 2) residents of long-term care facilities."*

The motion passed 13 to 1 in favor of the interim recommendation, and ACIP indicated that they will not be meeting again until shortly after the December 10 VRBPAC meeting (i.e., EUA for Pfizer's vaccine). The one dissenting vote seemed to be based on not having access to Phase 3 data and lack of data specifically pertaining to use in long-term care facility residents (a reasonable dissent in our view but overwhelmingly outnumbered).

There are ~21M healthcare personnel and ~3M residents of long-term care facilities in the US, thus we expect advancement to Phase 1b ('essential workers') within 1Q21. The ACIP identified ~87M 'essential workers' in the US, which could comprise Phase 1b (through ~April 2021) including teachers, firefighters, police, food service and agriculture workers, transportation, and more. Phase 1c would comprise people with risk factors (e.g., obesity, diabetes, cancer) and people over 65 years old, followed in Phase 2 by healthy adults.

APPROVAL

The UK approved Pfizer's vaccine in early December, becoming the first country to approve a COVID-19 vaccine. Canada, the US, the UK, Australia, the EU, and Japan are the only countries that have procured a full two doses per capita (i.e., enough vaccine to vaccinate their entire populations). Thus, competition for limited vaccine supply in other countries will be intense in 2021.

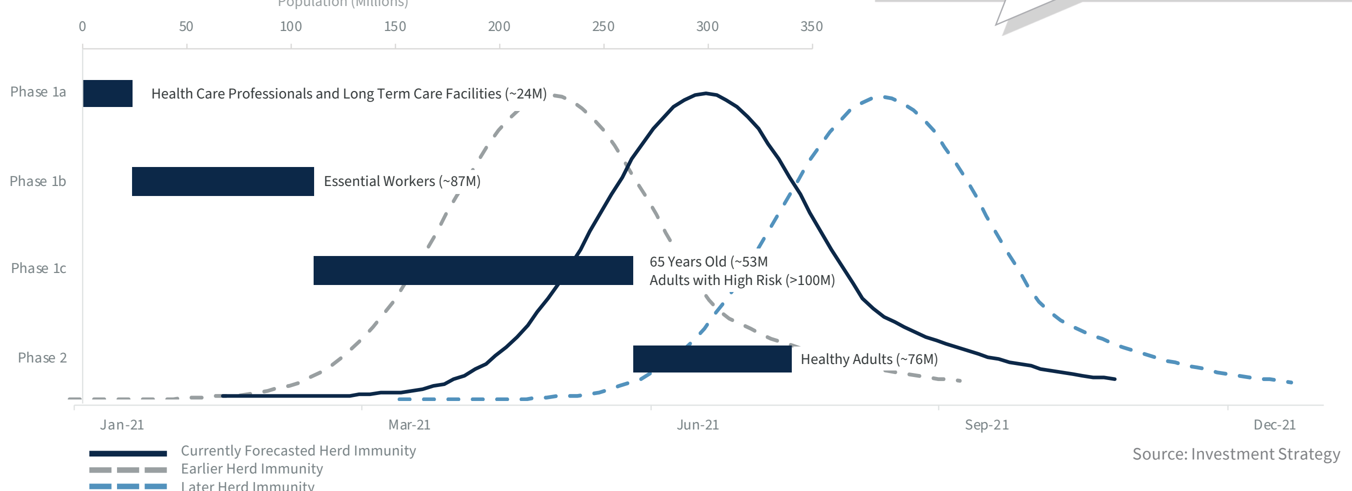
Putting it all together, given the wide availability of effective vaccines ramping to hundreds of millions of doses distributed in the US and available on a gradual basis to different population subgroups combined with the weather turning and regional mitigation measures after what will prove to be a devastating

Reasons why it could be sooner:

> Additional vaccines in the pipeline
> Single dose
> Less arduous logistics and storage
> Lower cost /financial incentives for participating
> Widespread availability (local pharmacies versus hospitals)

Reasons why it could be later:

> Unwillingness to get vaccinated
> No additional vaccines
> Difficulties with raw materials, production, logistics
> Storage and delivery problems
> Discovery of adverse side effects
> Excessive cost
> Scarce availability (few facilities per city)



Source: Investment Strategy

winter in terms of hospitalizations and deaths, we anticipate 'herd immunity' and a full return to normal within the US (i.e., excluding international travel to countries where a vaccine is not as widely available) by the second half of 2021, so long as vaccine manufacturers hit their target dose goals and the public sufficiently uses the vaccine.

KEY TAKEAWAYS:

- Based on the good acute safety profile, the large nature of the Phase 3 studies, and historical knowledge of safety for other vaccines (very rarely, if ever, do safety issues emerge beyond ~ two months post vaccination), we do not expect any safety issues.
- Moderna expects 20M doses ready to ship in the US in 2020 and fully 500M-1B doses (250-500M people) in 2021. Separately, Pfizer expects current production capacity of ~20M doses/month to provide ~50M total doses for worldwide distribution in 2020 and 1.3B doses (650M people) in 2021.
- We expect Johnson & Johnson to complete Phase 3 of its single-shot, viral vector vaccine around January 2021, and Novavax to complete Phase 3 of its recombinant, adjuvented vaccine around first quarter 2021. Both should work and supplement the vaccine supply in the US.
- We anticipate 'herd immunity' and a full return to normal within the US (i.e., excluding international travel to countries where a vaccine is not as widely available) by the second half of 2021, so long as vaccine manufacturers hit their target dose goals and the public sufficiently uses the vaccine.

2021 Economic Outlook: A Return to Normal?

Scott J. Brown, PhD, *Chief Economist,* Raymond James

Pandemics have often played a significant role in world history – 2020 added another chapter. In past episodes, including the 1918 influenza outbreak, government officials fought over wearing masks and public health guidelines. Some things never change.

> The worst of the pandemic was met by the best in monetary and fiscal policy.

IMPACT OF COVID-19

The COVID-19 pandemic had mixed effects on households. Job losses were more concentrated in low-wage service industries. About 40% of those in the bottom 20% of income earners lost jobs in April and May. White collar workers were more easily able to work from home and experienced a more V-shaped recovery in jobs. Consumer spending fell sharply amid the spring lockdowns, but self-imposed isolation (on health concerns) appears to have had a greater impact. Most of the hit was to consumer services, including leisure and hospitality, tourism, spectator events, and restaurants. With a limited ability to spend on these services, spending on durable goods rose above pre-pandemic levels. However, while spending on consumer services picked up off the April lows, activity remained depressed into the fourth quarter.

There is a trade-off between economic activity and efforts to contain the virus. Locking things down to prevent the spread reduces activity. Conversely, opening up the economy allows the virus to spread more widely. The harsh lockdowns in April and May were critical in preventing hospital overload, allowing time to increase hospital capacity, to distribute personal protection equipment, and to develop treatments. As restrictions were eased, infections increased in the summer months, but mostly for young (healthier) adults. The third wave has hit those aged 60 and above (those more susceptible). This surge has led state and local governments to reimpose restrictions on in-person services, which will dampen the pace of economic improvement in early 2021.

Luckily, vaccines are on the way. The effectiveness of potential vaccines was very good in early trials. Their distribution should lead to better improvement in the economy in the second half of the year. However, many people may not accept a vaccine. Others may be reluctant to resume social contact even after being vaccinated. However, savings of mid- and upper-income households

increased during the pandemic and people will be eager to travel, to go to music and sporting events, and to resume their previous lifestyles. Most likely, the level of GDP will match the fourth quarter 2019 level by the middle of 2021, but that will still leave us below trend (that is, without the pandemic, output would have been growing due to population growth and productivity gains).

> “There is a trade-off between economic activity and efforts to contain the virus. Locking things down to prevent the spread reduces activity. Conversely, opening up the economy allows the virus to spread more widely.”

POLICYMAKER RESPONSE

The worst of the pandemic was met by the best in monetary and fiscal policy. The Federal Reserve (Fed) quickly lowered short-term interest rates to near 0%, restarted lending facilities that it had employed during the financial crisis and created some new ones along the way. It also expanded the balance sheet (from $4 trillion to $7 trillion) to ensure that there was more than adequate liquidity in the financial system. Lawmakers in Washington passed massive fiscal support, funding healthcare, extending unemployment benefits, offering loans and grants to small business, and aiding state and local governments.

Most Federal Reserve officials expect to keep short-term interest rates low through 2023. The Fed revised its monetary policy goals and strategies in 2020 and signaled that it intends to follow periods where inflation (as measured by the PCE Price Index) is below the 2% target with periods of inflation above 2%. This is no mathematic formula; monetary policy will remain a judgment call. However, it does signal a greater tolerance for somewhat higher inflation. The Fed's employment goal has been made 'broad-based and inclusive.' Low unemployment significantly benefits low-income communities. The Fed will no longer tighten because unemployment falls to a certain level. A key takeaway from the pre-pandemic years is that there is a lot more slack in the labor market than the official figures would suggest. This isn't a major change from the way the Fed has conducted monetary policy in recent years, but writing it down was an important signal for the financial markets.

A key issue for the Fed in 2021 will be deciding when and how much to reduce monthly asset purchases. The financial markets (especially the stock market) have been sensitive to changes in the Fed's balance sheet. As the economy recovers, the Fed should return focus to maintaining an adequate level of reserves in the banking system.

FISCAL SUPPORT VERSUS AUSTERITY

Fiscal support was critical in offsetting the worst of the pandemic, but it added to the federal budget deficit, which had been trending at $1 trillion per year before the pandemic. The government has no problem borrowing and the Fed has placed much of the increased debt on its balance sheet. Interest rates are low and even with the added borrowing, interest payments on the debt over the next decade are projected to be lower than before the pandemic. The real danger with fiscal policy is not doing enough to support growth and removing support too soon. Austerity may be an individual virtue, but the government is not a household. The debt does not need to be paid off. At some point, lawmakers should work to have federal debt rising no faster than nominal GDP, keeping the debt to GDP ratio stable or declining over time; however, now is not the time. Tax increases or spending cuts in an economic recovery make that recovery weaker.

As with any economic downturn, there is generally downward pressure on inflation, reflecting increased slack in resource markets. Some prices fell sharply during the lockdown phase and rebounded sharply as the economy reopened, but have since moderated. Input cost pressures related to the supply chain disruptions have been noticeable, but firms generally have difficulty in passing such costs along to the consumer. Strong demand for durable goods added some pressure, but inflation in consumer services has slowed. The shift to working from home has led to strong housing demand and the supply of available homes for sale has been limited. However, high housing price inflation does not show up in the Consumer Price Index. A house has two functions: it's an asset and it provides shelter. The Bureau of Labor Statistics seeks to measure the price of shelter, not the asset value, and so considers the rental equivalent – and rents have generally risen more slowly in the pandemic.

The labor market is the widest channel for inflation pressure. Average hourly earnings surged during the lockdown, but this was a byproduct of arithmetic. Job losses were concentrated in lower-paying industries and in lower-paying positions within individual firms, which increased the average. For the private sector, the Employment Cost Index (ECI), which is not affected by compo-

> "The Fed's employment goal has been made 'broad-based and inclusive.' Low unemployment significantly benefits low-income communities. The Fed will no longer tighten because unemployment falls to a certain level."

sitional changes and includes benefit costs, rose 2.4% over the 12 months ending in September, vs. 2.7% in the year before. Productivity figures have also been distorted by the loss of low-wage, low-productivity jobs, but assuming a moderate underlying trend of 1.0-1.5% implies little inflation pressure from labor costs.

The incoming administration will likely focus on healthcare issues, preventing the spread of the virus and distributing vaccines. Economic policy efforts beyond that will depend on the makeup of Congress, but we are unlikely to see major tax increases or big spending plans (other than immediate pandemic-related support). If, as expected, social distancing remains elevated in early 2021, economic growth will be weaker. Federal aid should focus on supporting the long-term unemployed and small businesses.

Federal support will also be important for state and local governments, helping to ease budget strains from lost revenue. These strains were a significant issue in the 2008 financial crisis, despite federal aid in that recession, and dampened the pace of growth in the early years of the economic recovery. State and local governments employ about seven times as many workers as the federal government. In the recovery from the financial crisis, we lost teachers, police and fire personnel, and had only reached the pre-crisis level of state and government payrolls in the year before the pandemic.

The Biden administration will have a longer-term focus on issues such as climate change, income inequality, and antitrust regulation. Trade policy was a major issue in the Trump administration. Tariffs are paid by US consumers and businesses. They raise costs, invite retaliation, disrupt supply chains, and add uncertainty, dampening business investment. Tariffs may be rolled back, but bashing China plays well politically, and the folks in Washington will look ahead to the 2022 mid-term and 2024 elections. Still, we should see more cooperation on the world stage.

LESSON LEARNED

The study of past pandemics shows that economic activity eventually recovers after the crisis has passed. Importantly, we should be better prepared for the next one.

KEY TAKEAWAYS:

- Most likely, the level of GDP will match the fourth quarter of 2019 level by the middle of 2021, but that will still leave us below trend (that is, without the pandemic, output would have been growing due to population growth and productivity gains).
- Fiscal support was critical in offsetting the worst of the pandemic, but it added to the federal budget deficit, which had been trending at $1 trillion per year before the pandemic.
- At some point, lawmakers should work to have federal debt rising no faster than nominal GDP, keeping the debt to GDP ratio stable or declining over time; however, now is not the time.
- Federal aid should focus on supporting the long-term unemployed and small businesses. Federal support will also be important for state and local governments, helping to ease budget strains from lost revenue.

2021 Washington Outlook: The Impact of the Biden Administration on the Market

Ed Mills, *Managing Director, Washington Policy Analyst,* Equity Research

Democrats are in position to control the White House, Senate (pending final vote certification as of this writing), and the House of Representatives, completing a Democratic sweep and ushering in a new set of priorities, bound to have an impact on both the economy and market. The policy outlook for the next year, while dominated by the COVID-19 response, will also look to advance a Biden administration's economic priorities in the areas of energy and the environment, manufacturing, trade, and consumer protections with the associated market impact. The very thin Democratic majority margins in the House and Senate will effectively moderate the direction of policy changes, but Democrats do have tools to enact impactful policies in the areas of taxation and spending.

In the near term, policy uncertainty may elevate volatility, but heightened expectations in the longer term of recovery-supporting measures and an increase in federal spending will continue to support positive market sentiment. Thematically, we could see Consumer Discretionary and Financials be two of the best positioned sectors. Technology, on greater antitrust regulations and tax changes, could see weakness, but we believe the sector remains well positioned for the future in a unified Democratic government.

In the near term, policy uncertainty may elevate volatility, but heightened expectations in the longer term of recovery-supporting measures and an increase in federal spending will continue to support positive market sentiment.

BIDEN WITH A DEMOCRATIC CONGRESS: THE FIRST 100 DAYS AND BEYOND

With a 50-50 tie in the Senate, control of the chamber goes to the party of the vice president, which will be Kamala Harris, making a 50-50 Senate a Democratic majority. Senator Chuck Schumer (D-NY) would serve as Senate Majority Leader and would be in control over which bills and nominees receive a vote in the Senate. The Democratic agenda will lead with additional fiscal stimulus and the confirmation of key Biden appointees. Later this year we expect a budget reconciliation bill to pass and include tax changes. The key debate we have observed is a belief that Dems

> “Aside from the immediate focus on COVID-19 mitigation and recovery, we expect the bulk of Biden’s executive actions to be focused on climate and foreign policy.”

may transition any tax changes and focus on the economic items (market positive) before tax and regulatory changes (market negative). We believe that there is some truth to this assumption and the Democratic agenda will not be as robust than if they had won 53-55 Senate seats in the November election, but it is important not to understate how impactful having control of the Senate will be for control of the Senate agenda.

We expect Democrats to use budget reconciliation in 2021 to enact tax changes and implement other portions of their agenda (i.e., paid sick leave, child care, and/or infrastructure spending). Budget reconciliation is allowed once per budget and only requires a simple majority vote in the House and Senate (no filibuster). It is generally subject to revenue (taxes and spending), but it has limits (current rules do not allow changes to Social Security). With a narrow House majority and the need to get every Senator on board before passage, this debate is likely to have false starts and breakdowns in negotiations. However, with reconciliation the only pathway for legislation with a simple majority, we expect Democrats to do everything possible to find a final compromise.

The filibuster (the 60-vote threshold for votes in the Senate) is not expected to be eliminated for legislation. Changing the filibuster is a change to Senate rules, which only requires a simple majority, so it is within their power to change the threshold, if they have unanimous support. Currently they do not have the support to change the filibuster, but we will be watching to see if there are incremental changes that place more requirements on the minority to sustain a filibuster or eliminate the filibuster for appropriations bills. Pressure may build on Democratic lawmakers to change the filibuster if it is effectively used to block key agenda items.

As is typical with discussions on increasing spending, there will also be negotiation on how to pay for it. This is where we expect tax adjustment considerations to come into play, and a Biden administration supported by Democratic lawmakers has a clearer path to raise certain taxes through the budget reconciliation process. Biden’s tax plan broadly calls for raising the corporate tax rate to 28% and tightening tax rules on overseas income, which we expect could be paired with extending middle class tax cuts on the personal side on a permanent basis. There is a big debate in DC over timing on any potential tax changes. Legislation is not allowed to be retroactive, with the exception of tax law, which can be retroactive to January 1 of the year passed. We believe that Democrats would take a staggered approach, if given the opportunity, but some changes would begin in 2021. As highlighted earlier, compromise will be necessary to achieve this goal and with zero margin for error, we can expect false starts and potential breakdowns in the process – further heightening policy uncertainty.

EXECUTIVE ACTION IN A BIDEN ADMINISTRATION: EXPECT CLIMATE AND FOREIGN POLICY AS THE FOCUS

A very thin majority Congress elevates the prominence of executive action as a driver of policy change in the Biden administration. Aside from the immediate focus on COVID-19 mitigation and recovery, we expect the bulk of Biden’s executive actions to be focused on climate and foreign policy. Specifically, we expect a Biden administration to use executive authority to drive a clean energy transition in the federal government through procurement and modernization of federal facilities toward increased energy efficiency. Biden’s newly-created White House Climate Coordinator position, to be held by former Obama EPA administrator Gina McCarthy, is a clear sign of executive climate action as a key priority for 2021. A longer-term area to watch is the Biden trade agenda, especially the direction of economic ties with China. Biden has signaled there will be no quick action on Trump-era China tariffs, but we ultimately expect the administration could explore tariff adjustments for widely-available goods or goods tied to climate policy objectives as a further economic boost.

AS FOR THE REGULATORY AGENDA, PERSONNEL IS POLICY

Biden’s picks to lead regulatory agencies are another factor impacted by the Georgia Senate outcome flipping Senate control

to Democrats. Biden has largely avoided polarizing picks, however, there are still key positions without a nominee. Democrats would have control over setting confirmation votes and would ensure many more of Biden's picks receive a confirmation vote. This likely alters some of the individuals that Biden nominates to the final key positions and will have a significant impact on the agencies with boards. Senate rules still allow delays in confirmation votes, which were used effectively by Democrats in the minority to slow the confirmation process during the Trump administration.

Generally speaking, Biden's cabinet picks to date have signaled a prioritization of economic recovery and growth over a robust regulatory rulemaking agenda. However, a Biden administration will have significant regulatory levers at its disposal – even before nominees are confirmed by the Senate.

We expect a significant focus in the early part of 2021 will be on an agenda of consumer protection. The Biden administration's authority in this area is greater following the Supreme Court's ruling in the *Seila Law v. Consumer Financial Protection Bureau (CFPB)* which gives the president immediate authority to fire and replace the Consumer Financial Protection Bureau Director at will. We expect this will be one of the earliest opportunities for the Biden administration to demonstrate a consumer protection focus to progressive lawmakers.

THE 2022 MIDTERMS ARE OFFICIALLY UNDERWAY

It's never too early to look to the next election. We expect a further moderating factor in terms of policy will be the greater than expected losses suffered by Democrats in the House in the 2020 cycle. Republicans are now within striking distance of taking back the majority in 2022 – requiring five net seats gained to flip the chamber. To conclude, while a Democratic sweep may raise fears of sweeping policy changes, we expect moderate policy adjustments with a focus on economic recovery that supports markets over the long term.

KEY TAKEAWAYS:

- The policy outlook for the next year, while dominated by the COVID-19 response, will also look to advance a Biden administration's economic priorities in the areas of energy and the environment, manufacturing, trade, and consumer protections with the associated market impact.
- With a 50-50 tie in the Senate, control of the chamber goes to the party of the vice president, which will be Kamala Harris, making a 50-50 Senate a Democratic majority. Senator Chuck Schumer (D-NY) would serve as Senate Majority Leader and would be in control over which bills and nominees receive a vote in the Senate.
- Generally speaking, Biden's cabinet picks to date have signaled a prioritization of economic recovery and growth over a robust regulatory rulemaking agenda.
- While a Democratic sweep may raise fears of sweeping policy changes, we expect moderate policy adjustments with a focus on economic recovery that supports markets over the long term.

2021 Equity Outlook: Turning the Page

J. Michael Gibbs, *Managing Director,* Equity Portfolio & Technical Strategy
Joey Madere, CFA, *Senior Portfolio Analyst,* Equity Portfolio & Technical Strategy

As the calendar turns to 2021, we maintain a positive view on the equity markets. This stance stems from our expectation for an economic recovery, fueled by the likelihood of at least three vaccines with stated 90% plus efficacy rates. This increases the chances that enough of the population (essential workers and those most at risk) gets vaccinated to allow for an economic reopening as 2021 progresses in our quest for a return to normality. Economic data and corporate earnings have recovered well above feared expectations from six to nine months ago, momentum that we believe will continue over the intermediate term. We also believe the Federal Reserve (Fed) will remain accommodative and on hand to support the economic recovery as needed.

The Democratic sweep raises the odds of higher fiscal stimulus and spending, however it is also likely that Democrats will want to pay for this stimulus with higher taxes down the road. The slim majority may temper the ability for the full agenda to be completed and may make the battles tougher, but we do believe the majority of President-elect Biden's agenda ultimately gets accomplished. The result is a net positive for potential economic growth this year, and consequently enhances the reflation trade already underway on vaccine optimism. However, while the short-term outlook (six to twelve months) is bolstered due to the likelihood of increased stimulus, the longer-term outlook (beyond six to twelve months) is murkier given the potential for higher taxes, higher interest rates, and lower valuations. The prospect of higher taxes will be a headwind to earnings growth in 2022 and 2023 in our view. This will also likely be a headwind to valuation multiples later this year, as investors position over time for the coming changes.

"Economic data and corporate earnings have recovered well above feared expectations from six to nine months ago, momentum that we believe will continue …."

> “ ... we maintain a positive view on the equity markets. This stance stems from our expectation for an economic recovery ....”

Additionally, questions remain about the ongoing virus surge, vaccine capacity and distribution, timing and size of stimulus, and the pace of the economic recovery. So while we are positive on equities over the next 12 months, we would not be surprised for the road to be bumpy along the way.

S&P 500 TARGETS (BASE/BULL/BEAR CASE SCENARIOS)

Our base case S&P 500 target for 2021 is 4,025 ($175 EPS, 23x P/E). We use $175 in earnings, above the current consensus estimate of $166, due to our positive expectation on the economic and fundamental recovery in the year ahead. It is also normal for estimates to be revised higher coming out of recessions, as analysts historically set the bar too low in dire economic times. This is the exact opposite of normal times when analysts typically set estimates too high and have to revise lower into the actual results. For example, coming out of the last two recessions, S&P 500 earnings estimates for the following year (2004 and 2010) trended higher from the bear market low to year end by 3-5% and continued in the following year by another 8-10%. In the current timeframe, 2021 estimates have been revised higher by 4% so far (in line with those previous periods), and our earnings estimate of $175 reflects just a 4.5% further move upward. This $175 estimate is a 27% snap-back in growth from 2020’s pandemic-depressed earnings (and 9% above 2019 earnings).

2021 Year-End Outlook

S&P 500	EPS ESTIMATE	P/E	PRICE
Bull Case	$190	22x	4,180
Base Case	$175	23x	4,025
Bear Case	$160	20x	3,200

Source: Raymond James Equity Portfolio & Technical Strategy

We also believe valuation multiples can remain elevated given the low inflationary and interest rate environment. The current S&P 500 P/E of 27.5x is well above the historical average of 16.5x. However, when taken in conjunction with still low interest rates, the current valuation is more reasonable in our view. For example, the equity risk premium (S&P 500 earnings yield vs. US 10-year Treasury yield) is currently 2.6%. This remains well above the long-term average of 0.6% (since 1954) and just marginally below its pre-pandemic level last January. Moreover, the S&P 500 dividend yield of 1.5% is 0.5% higher than the US 10-year Treasury yield. Despite equities being at all-time highs, this is still in line with the highest spreads on record prior to COVID-19- reflecting a still attractive environment for equities versus bonds in our opinion. It is also normal for valuations to elevate coming out of recessions due to depressed earnings as investors discount the eventual recovery. As earnings rebound in 2021, we expect the S&P 500 P/E multiple to contract. However, the Fed has stated its intent to keep interest rates lower for longer in order to support the economic recovery, which also supports above-average multiples in our view. Therefore, we use a 23x P/E in our base case 2021 scenario which, combined with our $175 earnings estimate, produces a S&P 500 target of 4,025.

In a bull case scenario, we believe the S&P 500 can trade to 4,180. In the event that the virus spread subsides and COVID-19 vaccinations allow a quicker reopening process (in conjunction with fiscal stimulus) that results in upside to growth expectations throughout 2021 (i.e., GDP growth is closer to ~6.5% than ~4.5%), we believe S&P 500 earnings could potentially reach $190. With this stronger growth backdrop, it is likely that inflation and interest rates are marginally higher than under our base case scenario, resulting in a slightly lower valuation assumption. We use a 22x P/E in this scenario as valuation also normalizes at a quicker rate. Applying this 22x P/E to $190 earnings results in a bull case S&P 500 target of 4,180.

In a bear case scenario, we see the S&P 500 downside at 3,200. If virus concerns linger for longer and hamper the reopening process and pace of economic recovery (i.e., GDP growth is closer to 3% in 2021), we believe earnings revisions could break from their historical upward trend out of recessions and finish near $160. In this scenario, tax increases also become an overarching theme for the longer-term outlook and outweigh the benefits of spending increases. As investors discount the impact from these tax changes to 2022 earnings, the result is a lower P/E. We use a 20x P/E, over 10% lower than our base case P/E assumption of 23x, in this scenario- resulting in a S&P 500 bear case target of 3,200.

PORTFOLIO POSITIONING

At the sector level, the pandemic created a bifurcated market in which roughly half of companies saw positive earnings growth this year (i.e., Technology-oriented, Health Care, Consumer Staples), while the other half saw their fundamentals decline substantially (i.e., small caps, Energy, Industrials, Financials, and select consumer areas). Also, this spread was wide with a median earnings growth rate of 10% for the 'winners' and a median earnings contraction of 19% for the 'losers.' As the economic reopening gains momentum in 2021, the more economically-sensitive areas that were beaten up the most by the pandemic should generally see the greatest upside. Many of these areas have seen sharp outperformance since early November on vaccine and stimulus optimism, so from current levels we recommend a pragmatic approach to portfolio repositioning.

For this reason, we believe it is important to maintain a healthy allocation to the areas operating best through the pandemic while also accumulating areas with the greatest leverage to the economic recovery. Thus, our current overweight sector recommendations — Technology, Communication Services, Health Care, Consumer Discretionary, and Industrials — reflect a combination of this strategy. We maintain equal weight recommendations to the also cyclical Financials and Materials sectors, and continue to under-

> "… leads us to a constructive view on small caps as they have more leverage to the economic recovery that we believe will transpire in 2021."

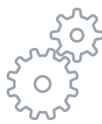
Sector Views

OVERWEIGHT:

Technology

Health Care

Consumer Discretionary


Industrials

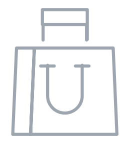
Communication Services

EQUAL WEIGHT:

Financials

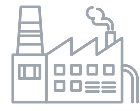
Materials

UNDERWEIGHT:

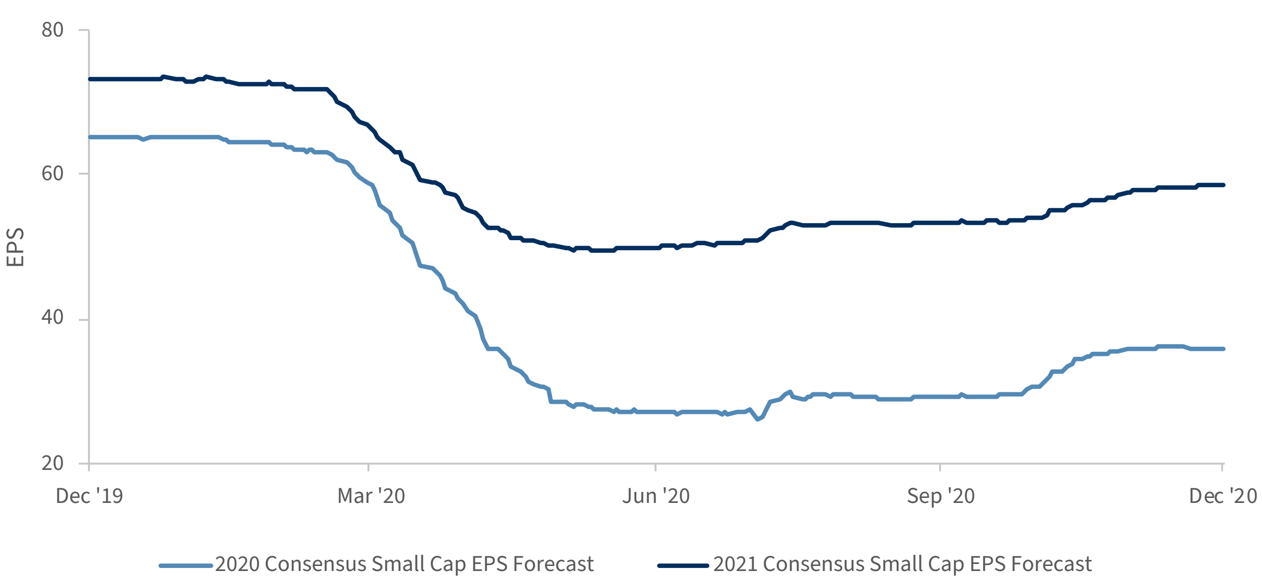

Consumer Staples

Utilities

Real Estate


Energy

Source: Raymond James Equity Portfolio & Technical Strategy as of 12/28/2020



Source: Investment Strategy, as of 12/28/2020

weight Energy for now. We also recommend underweight exposure to the more defensive Consumer Staples, Utilities, and Real Estate sectors given our positive stance on the recovery in 2021.

This thinking also leads us to a constructive view on the small caps as they have more leverage to the economic recovery that we believe will transpire in 2021. After underperforming in 2020 due to the economic shutdown (resulting in a 40% earnings contraction), valuation is fairly attractive with respect to an expected snap-back of earnings growth in 2021. The group trades in line with its 15-year average relative P/E (vs. the S&P 500) despite much stronger growth expectations in 2021- resulting in a P/E to Growth ratio of just 0.5x. However, markets do not often move in straight lines. Following an enormous 34% move since October, we recommend building your allocation to the small caps over time from current levels, taking advantage of consolidations or pullback periods. In sum, we recommend pro-cyclical exposure to portfolios, and would stick with fundamental leaders while accumulating the recovery areas.

KEY TAKEAWAYS:

- Our base case S&P 500 target for 2021 is 4,025 ($175 EPS, 23x P/E).
- We believe it is important to maintain a healthy allocation to the areas operating best through the pandemic while also accumulating areas with the greatest leverage to the economic recovery. Thus, our current overweight sector recommendations — Technology, Communication Services, Health Care, Consumer Discretionary, and Industrials — reflect a combination of this strategy.
- Following an enormous 34% move since October, we recommend building your allocation to the small caps over time from current levels, taking advantage of consolidations or pullback periods.

All investments are subject to risk, including loss. Past performance may not be indicative of future results. The performance noted does not include fees and charges which an investor would incur. Investing in international securities involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Small cap securities generally involve greater risks and are not suitable for all investors. Companies engaged in businesses related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. Asset allocation does not guarantee a profit nor protect against loss. Dividends are not guaranteed and will fluctuate.

2021 International Outlook: Younger Economies Catching Up

Giampiero Fuentes, *Investment Strategy Manager,* Investment Strategy

The blackest of ‘Black Swan’ events — COVID-19 has dominated the 2021 global equity market narrative. However, despite negative earnings growth across the globe, equity markets have rebounded from their early-year lows and rallied into positive territory. Aggressive policy actions and optimism over effective vaccines have catapulted the equity market higher.

So what will the next year hold for global equity investors? Global equities should remain well supported by a significant rebound in economic growth around the globe. Fostering economic growth is continued aggressive policy action. For example, in Europe, the European Central Bank has confirmed that it will persist with its asset purchase program until at least March 2022, and agreed to a €750 billion emergency relief package forming part of the forthcoming seven-year, region-wide €1.8 trillion budget package.

So does that mean that Europe will outperform the US for the first time since 2015? We believe that remains an uphill battle on three fronts. First, our favorite sectors favor US equities. In fact, one of the more heavily weighted sectors in European indices is Financials (currently neutral), which tend to be negatively impacted by negative interest rates that are expected to persist. Similarly, Europe has little exposure to sectors that benefit from the current environment, such as Technology and Communication Services. These sectors combined have over 25% more exposure in the S&P 500. Second, a strengthening euro could potentially hamper earnings growth as many of the largest companies in Europe are reliant on exports. Third, politics remain a threat to the European economic recovery. Elections in both Germany and Italy in 2021, and in France in 2022 will likely increase volatility in the euro zone.

Can emerging markets outperform in the upcoming year? Assuming the global pandemic fades and the global economy accelerates, emerging market equities could be a big beneficiary. Asian equities have been the best performing regional equity market in 2020 as they were impacted by the pandemic earlier in the year, and dealt with it in a remarkable way that allowed both their economies and equity markets to promptly rebound. Asian emerging markets offer great opportunities as the region has over two-thirds of its market capitalization in our favourite sectors which, together with our expectation of a declining dollar and secular trends such as demographics (younger population, wealth creation), should propel their equities higher. Commodity-based emerging markets could benefit as well if commodities such as oil and industrial metals continue to move higher.

Ultimately, we continue to favour the US over international, but emerging market Asia seems to be the clear runner up.

International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

2021 Fixed Income Outlook: Lower for Longer

Doug Drabik, *Managing Director,* Fixed Income Research
Nick Goetze, *Managing Director,* Fixed Income Services

Thirty-nine plus years of general interest rate decline, twenty-three years of moderate inflation, five recessions, and the longest expansionary period ever preceded 2020's pandemic-triggered recession, unprecedented central bank intervention, and historically low interest rates. Fixed income total returns have benefitted for years (if not decades) from general interest rate decline. There is an inverse relationship between rates and price. As rates decline, prices increase. The year 2020 was no exception as Treasury, corporate and municipal bonds all boasted solid total returns.

MARKET CONDITIONS

Just as all corners of the world have been impacted by the global pandemic, so have all corners of the fixed income market as spreads, volatility, and rate levels have been affected. The pandemic-induced recession officially began in February and prompted significant central bank (Federal Reserve (Fed)) and government response through fiscal and monetary actions. The Fed's balance sheet, which had begun the year with ~$4.1 trillion in asset size, has ballooned to over $7.2 trillion via implemented emergency lending facilities, bond purchase programs, and other stimulus-related bills. Treasury yields have declined 30% on the long end and over 90% on the short end of the Treasury curve, creating an even flatter sloped curve during 2020.

Just as all corners of the world have been impacted by the global pandemic, so have all corners of the fixed income market as spreads, volatility, and rate levels have been affected.

Pre-pandemic market conditions included record low unemployment along with moderate growth, and although poor economic conditions did not trigger the recession, isolation, slowed consumer confidence and outright business shutdowns initiated an economic ambush pushing 20+ million job losses, small business collapses and a general sense of fear and uncertainty. The reliability and sureness of a COVID-19 vaccine may largely dictate the pace of the recovery and the level of consumer confidence that leads us back to measurable growth.

LOOKING FORWARD

The variables are numerous and atypical thereby challenging forecasts on how the markets emerge in 2021. The base case sce-

nario presumes that the vaccine is indeed effective and, equally as important, easy to quickly disseminate. This will initiate a rise in consumer confidence and allow businesses to gravitate toward their normal and intended business plans. Assuming much of the recovery begins taking shape in the second half of the year, the intermediate and longer end of the curve will push higher in yield. The 10-year Treasury, which will likely end 2020 around 1.00%, will creep higher in yield in 2021 to ~1.50%. The shorter end of the curve is directly influenced by the Fed. The implied Fed funds target rate is projected to keep its lower band at 0.00% through 2023, thus influencing 2021 where the 2-year Treasury rate projection will remain relatively low at around 0.25%. These combined moves point to a slight steepening of the yield curve over the course of 2021.

We believe a more bullish scenario also exists for bonds (prices higher/yields lower). The world's central banks (including the Fed) have clearly taken the helm in controlling rates and driving economies. Four primary central banks (Federal Reserve, European Central Bank, Bank of Japan, People's Bank of China) have ballooned their balance sheets from a combined total assets of ~$6 trillion before the Great Recession (2008-2009) to over $27 trillion today. This year alone, they have increased their combined asset size over 36%. The flood of money has helped to keep rates down. Increasing domestic debt, which comes with higher interest expense, is an incentive for the Fed and the government to keep interest rates down. In addition, world interest rates continue to exhibit great disparity versus US rates, which are significantly higher than many European and Asian rate environments. There is over $17.1 trillion of negative yielding debt worldwide. This helps to drive demand for higher quality, higher yielding US securities, thus contributing as a headwind to higher rates. The thought that the US would ever enter the world of negative interest rates has shifted from 'never' to 'conceivable' as global rates continue to drift apart. The Fed and government are likely to continue with additional stimulus packages and persistence in keeping Fed funds at zero. In addition, there is a possibility that the COVID-19 vaccine takes much longer to distribute and the hangover effects that have crushed certain businesses take much longer to recover. Under these circumstances, we see a bullish scenario that could keep the 2-year closer to 0.00%, the 10-year Treasury lower to ~0.50% and higher stock and bond prices.

Spreads have tightened across many product areas including investment-grade and high-yield securities. We anticipate that any recovery will not begin until the second half of 2021 and we anticipate spreads to remain tight. It is worth noting that spread widening, and recovery in general, is likely to be segmented. There are many businesses and corporations that have actually benefitted from COVID-19 consequences. These include companies like Amazon and FedEx, which speaks to the increase in at-home shopping while consumers self-restricted their outside activities. There are an equal number of industries that the pandemic trampled on regarding employment and revenue numbers, such as airlines, entertainment, transportation and health clubs. This supports an argument for a more fragmented recovery.

World Bond Markets

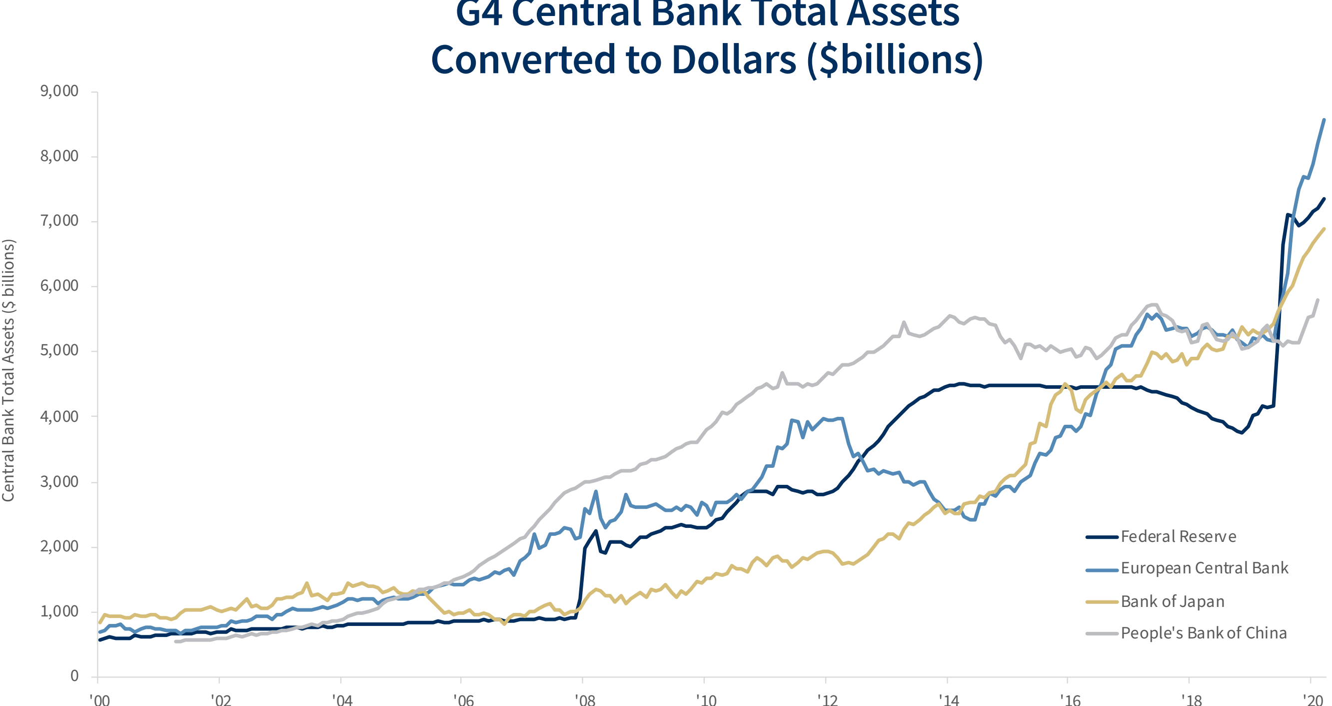
	2-Year	5-Year	10-Year	30-Year
United States	0.119	0.354	0.923	1.659
Canada	0.221	0.432	0.721	1.264
France	-0.707	-0.648	-0.331	0.377
Germany	-0.705	-0.732	-0.565	-0.156
Greece		0.107	0.651	
Ireland		-0.609	-0.294	0.313
Italy	-0.421	-0.017	0.539	1.408
Japan	-0.119	-0.112	0.025	0.647
Netherlands	-0.690	-0.700	-0.482	-0.087
Spain	-0.625	-0.410	0.050	0.862
Sweden	-0.364	-0.293	0.038	
United Kingdom	-0.123	-0.046	0.257	0.829

Source: Bloomberg LP, Raymond James: as of 12/28/2020

OPPORTUNITIES IN FIXED INCOME

The emerging market space may experience a slower recovery. The logistics for vaccine distribution include very specific temperature controls, a technology that may not be easily met for simple distributions in less high-tech equipped countries. That being said, emerging markets that are strongly positioned possess an opportunity to benefit greatly from a pandemic turnaround. Flows will likely remain very strong as investors seek opportunities to add any kind of yield in an overall low-rate environment. Emerging market oil companies may be one of the few sectors where spreads could still narrow, creating a positive total return chance. Higher risks will accompany 2021 emerging market opportunities and, although there will be pockets of dislocation, opportunities will exist for more aggressive investors to capture higher yields, especially relative to the low interest rate strapped high-quality bond alternatives.

Although fixed income total return prospects will be muted due to historically low interest rates with lessening bullish prospects, many of our investors allocate to individual bond positions to meet the primary purpose of principal preservation. Nothing changes here and this component remains a vital allocation to continue to protect hard earned wealth. Municipal and corporate issuance will likely remain robust as corporations and municipalities take advantage of leveraging a low rate environment. The Fed has allowed a view into the future with their proclamation of a zero interest rate policy through 2023. High demand for quality



Source: Raymond James: as of 12/28/2020

securities of the shortest maturities will continue to present the opportunity to reinvest those short maturities prior to their actual maturity. A modest extension into the steeper part of the municipal and/or corporate curves can provide modest yield increases. At the same time, we suggest that overall durations be kept in check. To meet cash flow needs, look to buy premium high-coupon bonds, which will also perform better in a rising rate environment. Avoid chasing minimal increases in yield through significant maturity extensions or excessive credit risk. The market is not rewarding investors to take on these excessive risks. 2021 will be a year to upgrade credit quality and keep durations in check, a sort of holding period in anticipation of better positioning for an eventual economic turnaround. Reduce market risk (long duration) and solidify credit risk, but also take advantage of the information the Fed is providing (move to the four to ten year part of the curve).

KEY TAKEAWAYS:

- Assuming much of the recovery begins taking shape in the second half of the year, the intermediate and longer end of the curve will push higher in yield. The 10-year Treasury, which will likely end 2020 around 1.00%, will creep higher in yield in 2021 to ~1.50%.
- The implied Fed funds target rate is projected to keep its lower band at 0.00% through 2023, thus influencing 2021 where the 2-year Treasury rate projection will remain relatively low at around 0.25%.
- Emerging markets that are strongly positioned possess an opportunity to benefit greatly from a pandemic turnaround.
- 2021 will be a year to upgrade credit quality and keep durations in check, a sort of holding period in anticipation of better positioning for an eventual economic turnaround.

The value of fixed income securities fluctuates and investors may receive more or less than their original investments if sold prior to maturity. They are subject to price change and availability. Risks include, but are not limited to, changes in interest rates, liquidity, credit quality, volatility, and duration. Past performance may not be indicative of future results. Investing in international securities involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets. Companies engaged in businesses related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence. Asset allocation does not guarantee a profit nor protect against loss.

2021 Energy Outlook: Oil Market Recovery in 2021 Will Follow Vaccine Ramp-Up – And in the Meantime, Global Energy Transition Is Accelerating

Pavel Molchanov, *Director, Energy Analyst,* Equity Research

It is not often that we reference the World Health Organization when writing about oil, but this is one of those times. The past year's epic oil market crash was precipitated by the most severe fall-off in global oil demand in modern history. This was a direct result of the COVID-19 pandemic and ensuing lockdowns.

For oil demand to get back to the pre-pandemic run-rate of 100 million barrels per day – which implies a more than 5% rebound from year-end 2020 levels – there must be overall economic normalization, and that depends on widespread vaccine availability for the general population: billions of people around the world.

Because the pace of vaccine production and distribution remains uncertain at this early stage in the process, it is impossible to put a precise timetable on when, for example, schools will be open across the board, or large in-person events and entertainment venues can resume. Broadly speaking, we anticipate that, after the tough wintertime period with the return of numerous lockdowns in Europe and elsewhere, demand recovery should resume in the spring and summer of 2021. While some segments of the oil market (notably aviation) are unlikely to fully recover until 2023 at the earliest, there is a plausible scenario of overall demand reaching 100 million barrels per day in 2022.

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> "… the most important structural underlying trend in the energy sector is a shift away from petroleum and other fossil fuels."

SUPPLY AND DEMAND

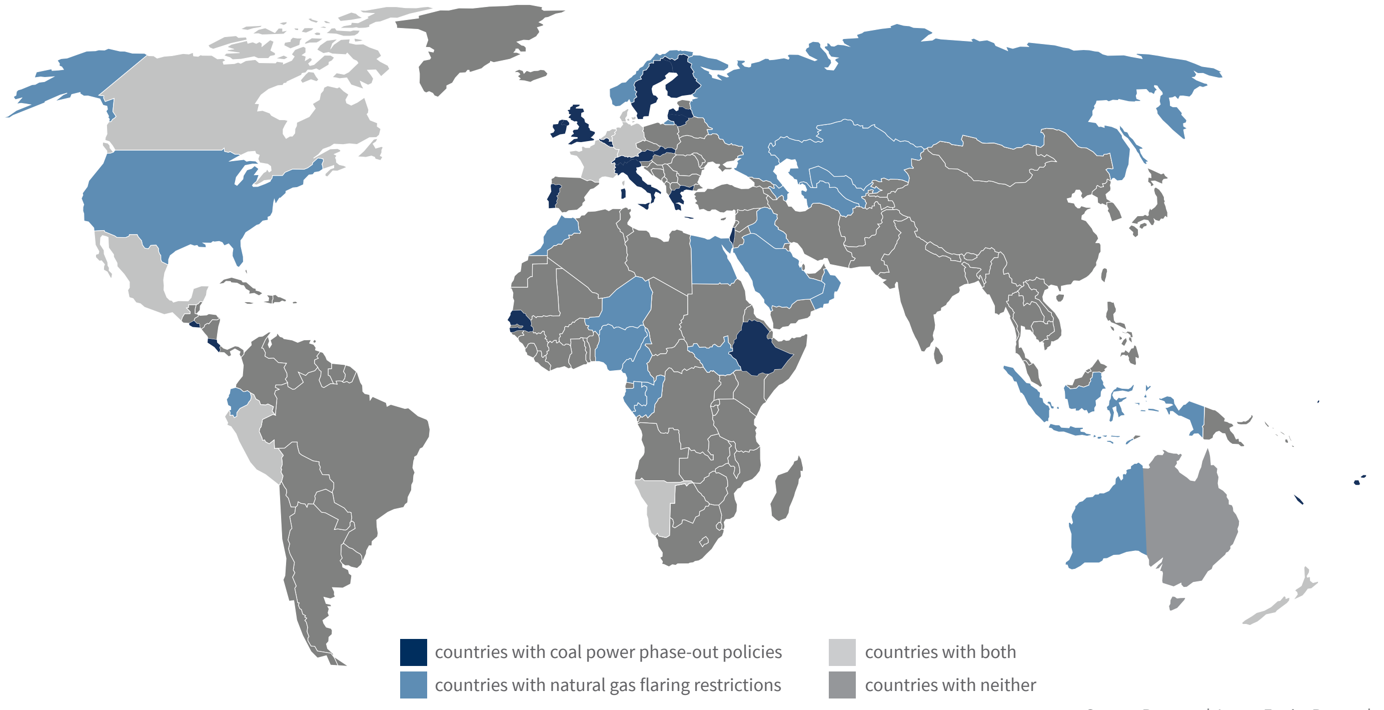
Public health developments will drive the demand side of the oil market equation, whereas supply will be influenced by more 'standard' variables with which energy investors have long been familiar. Having slashed production in the early days of the pandemic, OPEC and Russia can be expected to gradually move toward higher output levels, in parallel with demand recovery. US production, on the other hand, would continue to trend lower on the assumption of pricing in line with commodity futures (West Texas Intermediate (WTI) crude in the $45 to $50 per barrel range), and the same applies to some other non-OPEC countries such as China, Mexico, and Colombia. Because demand and supply are heading in opposite directions, we forecast hefty global inventory drawdowns in both 2021 and 2022 – which, by definition, is bullish for prices. The bottom line is that the industry will ultimately need prices much higher than what the commodity market is signaling. Specifically, we forecast WTI ending 2021 upwards of $60, which implies an average of more than $50 for the year.

GLOBAL ENERGY TRANSITION

Oil market recovery is an important energy story to track in 2021, but by no means the only one. From a very long-term perspective, in fact, the most important structural underlying trend in the energy sector is a shift away from petroleum and other fossil fuels. This is what's referred to as the global energy transition. Reflecting a potent combination of economic/technological factors and political/regulatory support, the energy transition is accelerating. Examples of technological innovation include more scalable wind turbines, more efficient solar panels, electric cars and buses with longer battery range, and energy-efficient building materials. This spurs plenty of demand, independent of government policy. For example, more than 250 multinational companies, ranging from banks to automakers, have committed to source 100% of their electricity from renewable sources – and dozens have already achieved this target. Even more impactful, a dozen of the top-tier oil and gas producers have committed to reorient

Renewable Resources

Growing demand for sustainable energy sources such as solar panels and wind turbines is driven by the increased utilization of clean energy by governments, corporations, and individuals.



Source: Raymond James Equity Research

their operations toward renewable and low-carbon energy over the next 20 to 30 years. To clarify, these companies are doing it **not** because they are forced to by governments, but rather because they see it as good business and advantageous for Environmental, Social and Governance (ESG) ratings, thus increasing interest from a growing portion of investors.

The role of governments in the energy transition varies a great deal from country to country, and even within countries. For example, this past December the European Union approved the European Climate Law, thereby becoming the world's largest carbon emitter to impose a legally binding mandate for net zero CO_2 emissions by 2050. To clarify, net zero does **not** mean literally zero, but all emissions will need to be captured and sequestered, or offset via projects such as forestry. President-elect Joe Biden has proposed the same policy for the US, but the ultra-divided, 50/50 Senate makes it highly unlikely that such transformative legislation would be able to pass. The Biden administration will need to use executive action to incrementally boost decarbonization. In the meantime, politically progressive states such as California and New York will continue their own climate reforms, which are more ambitious than what Congress is willing to do. Other examples of relevant policies include coal power phase-outs (in 34 countries, including Germany and the UK) and natural gas flaring restrictions (in 31 countries, including the US, Russia, and Saudi Arabia).

KEY TAKEAWAYS:

- For oil demand to get back to the pre-pandemic run-rate of 100 million barrels per day – which implies a 5% rebound from year-end 2020 levels – there must be overall economic normalization, and that depends on widespread vaccine availability for the general population: billions of people around the world.
- Because demand and supply are heading in opposite directions, we forecast hefty global inventory drawdowns in both 2021 and 2022 – which, by definition, is bullish for prices.
- Specifically, we forecast WTI ending 2021 upwards of $60, which implies an average of more than $50 for the year.
- From a very long-term perspective, in fact, the most important structural underlying trend in the energy sector is a shift away from petroleum and other fossil fuels.

Investing in the energy sector involves risks and is not suitable for all investors. Past performance may not be indicative of future results. Companies engaged in businesses related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

Economic Snapshot

The surge in COVID-19 cases is expected to result in slower growth into early 2021. However, the distribution of vaccines should lead to a sharper pace of recovery in the second half of the year. Spending on consumer durables may moderate as spending on consumer services improves, but services account for a much larger portion of consumer spending. The Federal Reserve has signaled that it will be more tolerant of higher inflation, but inflation is likely to remain low until the economy more fully recovers.

DR. SCOTT BROWN
Chief Economist

	ECONOMIC INDICATOR	COMMENTARY
FAVORABLE	GROWTH	GDP growth in the first part of 2021 is expected to be moderate, reflecting the recent surge in COVID-19 cases, but activity should pick up in the second half of the year.
	EMPLOYMENT	Job growth in early 2021 is expected to be lackluster, but we should see a sharper recovery in the second half of the year.
	CONSUMER SPENDING	Some pandemic-related weakness in the near term. As vaccines become more widely distributed we should see a strong recovery in consumer services, with some moderation in spending on consumer durables.
	MANUFACTURING	Manufacturing operations adapted to the pandemic, but global demand weakened. A pickup in global growth should help in 2021, but more so in the second half of the year.
	HOUSING AND RESIDENTIAL CONSTRUCTION	Low mortgage rates and a shift to work-from-home have boosted housing demand in 2020 and that should continue into 2021. Supply constraints will continue to lift home prices, reducing affordability.
	MONETARY POLICY	Fed officials expect short-term interest rates to remain low through 2023. The monthly pace of asset purchases is likely to be reduced at some point in 2021, but monetary policy remains very accommodative.
	LONG-TERM INTEREST RATES	Bond yields normally rise in an economic recovery. However, Fed asset purchases should prevent long-term interest rates from rising much and inflation is expected to remain low.
	REST OF THE WORLD	A mixed bag. Vaccines should help advanced economies rebound. The outlook for emerging economies is mixed – some did a better job handling the pandemic, others will see vaccines arrive later.
NEUTRAL	BUSINESS INVESTMENT	Business spending on equipment is expected to pick up as the global economy recovers from the pandemic. However, investment in business structures, especially commercial real estate, is likely to remain weak.
	INFLATION	Pandemics are disinflationary (inflation-reducing). Rents have slowed, dominating the CPI. Inflation may pick up as the economy strengthens, but that is more likely in 2022. There will still be a lot of slack in the economy in 2021.
	FISCAL POLICY	Even with additional fiscal support in 2021, the economic impact will be negative (as 2020 support was much larger). However, that drag should be easily offset by private sector gains.
	THE DOLLAR	The trade deficit has widened, putting some downward pressure on the dollar. Central bank polices are expected to remain accommodative here and abroad, but a reduction in Fed asset purchases may be a slight negative.

Sector Snapshot

J. MICHAEL GIBBS
Managing Director of Equity Portfolio & Technical Strategy

This report is intended to highlight the dynamics underlying the 11 S&P 500 sectors, with a goal of providing a timely assessment to be used in developing your personal portfolio strategy. Our time horizon for the sector weightings is not meant to be short-term oriented. Our goal is to look for trends that can be sustainable for several quarters; yet given the dynamic nature of financial markets, our opinion could change as market conditions dictate.

Most investors should seek diversity to balance risk versus reward. For this reason, even the least-favored sectors may be appropriate for portfolios seeking a more balanced equity allocation. Those investors seeking a more aggressive investment style may choose to overweight the preferred sectors and entirely avoid the least favored sectors. Investors should consult their financial advisors to formulate a strategy customized to their preferences, needs, and goals.

These recommendations will be displayed as such:

Overweight: favored areas to look for ideas, as we expect relative outperformance

Equal Weight: expect in-line relative performance

Underweight: unattractive expectations relative to the other sectors; exposure might be needed for diversification

For a complete discussion of the sectors, please ask your financial advisor for a copy of *Portfolio Strategy: Sector Analysis.*

	SECTOR	S&P WEIGHT	COMMENTARY
OVERWEIGHT	INFORMATION TECHNOLOGY	28.0%	We remain Overweight the Technology sector. After achieving positive earnings growth during the recessionary 2020 year, projections suggest a healthy encore with double-digit growth in 2021. Valuation is at a premium; therefore, upside earnings are likely necessary to allow the sector to outperform. As investors focus on a progression to economic normality later in 2021 and into 2022, the smaller to mid-cap tech stocks are likely to continue the recent relative strength outperformance vs. the mega-cap tech stocks.
OVERWEIGHT	HEALTH CARE	13.7%	We remain Overweight the Health Care sector. The sector checks the positive factor boxes in many of the most relevant (long-term) investment areas. Secular trends are positive, given annual spending on health care with an aging population. The fundamental momentum is healthy, with projections calling for double-digit earnings growth in 2021 after a 8% gain in 2020. Despite the overall equity market trading at an all-time high, the Health Care sector trades at some of the lowest relative valuations seen over the past 15 years. Despite all the positives, the cap-weighted and equal-weight indexes continue to lose relative strength. A combination of an uncertain political environment for the sector and the overall positioning in more pro-cyclical areas are the catalysts for the underperformance. Nonetheless, the broad diversity in the sector provides ample opportunity for stock pickers.
OVERWEIGHT	CONSUMER DISCRETIONARY	11.3%	Investors should take advantage of diverse investment opportunities within the Consumer Discretionary sector. Numerous companies are prime beneficiaries of trends created by the pandemic, while others will be prime beneficiaries of an eventual return to normal. Additionally, the record fiscal response leaves the consumer much better positioned in recessionary conditions for many industries than normal. The government's fiscal support, along with consumers' large savings balances, provides a bridge to normality. With the vaccines rolling out and fiscal stimulus passed, we feel the average consumer stock will continue the recent positive momentum reflected by the equal-weight index.
OVERWEIGHT	COMMUNICATION SERVICES	11.0%	We continue to Overweight the Communications Services sector. The diversified sector offers investors attractive valuation, fundamental and technical trends. The sector also provides a combination of stocks less impacted by the pandemic lockdown and others offering upside from the eventual reopening. Although the sector is not a concentrated investment bet on either side, shutdown or reopen, it does provide a healthy balance between the two.
OVERWEIGHT	INDUSTRIALS	8.6%	We recently moved Industrials to an Overweight. We favor Industrials as a way to play the eventual reopening of the global economy. The sector's tight correlation to global manufacturing is a plus as manufacturing is only likely to momentarily pause (if at all) due to the recent resurgence of the COVID-19 virus worldwide as businesses push to restock inventories depleted during the initial shutdown period. After a horrendous year for earnings in 2020, projections suggest a rapid recovery in 2021. The global stimulus (still brisk in 2021) should provide additional rapid earnings gains in 2022 (current consensus estimates 27% 2022 growth). Technical momentum is attractive, with a positive uptrend firmly in place for both the equal-weight and cap-weighted indexes.
EQUAL WEIGHT	FINANCIALS	10.4%	We maintain our Equal Weight recommendation for the Financials. Rising interest rates and loosening capital restraints by the Fed are two favorable tailwinds building for the banks. Despite the improving environment, meaningful headwinds remain. Although rates have moved up slightly off the low, net interest margins remain challenging with rates very low by historical standards. With the Fed messaging lower rates for longer, the slim net interest margins may remain. With business slowing due to the virus spread, credit losses, which for now seem manageable, remain uncertain. Price momentum is improving. However, we prefer to wait for improving relative trends.
EQUAL WEIGHT	MATERIALS	2.7%	We remain Equal Weight in the Materials sector. Attractive valuation, a likely bounce back in earnings growth, potential higher commodity prices as the world gradually returns to normal, along with a buyable technical momentum trend piques our interest in this reopen sector. Nonetheless, we remain Equal Weight given the current global virus surge.

Continued on the next page

UNDERWEIGHT			
	CONSUMER STAPLES	6.7%	We remain Underweight Consumer Staples as we see better relative opportunity in other areas. As the world moves to normality later in 2021 and into 2022, investors are likely to seek more risk-on cyclical sectors than the defensive Consumer Staples.
	UTILITIES	2.8%	We remain Underweight Utilities. Slow earnings growth along with a likely desire of investors to position in risk-on sectors raise the odds that the sectors will continue to lag others.
	REAL ESTATE	2.5%	We maintain an Underweight to the Real Estate sector. The sector is a reopen area investors are shunning thus far. The uncertain environment for commercial real estate is justifiably the reason. Office buildings will likely suffer as companies allow work-from-home options, and the population flees large cities. Likewise, the pandemic sped up the adoption of e-commerce, raising questions regarding the amount of needed retail real estate space. Additionally, many small businesses will not survive the pandemic, idling countless square feet of real estate.
	ENERGY	2.4%	We maintain an Underweight to Energy. Energy is an area to watch, given the upside potential if it eventually catches up with the overall market. However, headwinds remain in place for now, with potential demand destruction likely from renewed shutdowns globally. For this reason, we remain Underweight. Technically, the impressive rally is a potential trend turning event as prices finally moved above the 200-day moving average. But, for now, it is too early to determine if the new uptrend is sustainable.

Disclosure

All expressions of opinion reflect the judgment of the aurthors and are subject to change. Past performance may not be indicative of future results. There is no assurance any of the trends mentioned will continue or forecasts will occur. The performance mentioned does not include fees and charges which would reduce an investor's return. Dividends are not guaranteed and will fluctuate. Investing involves risk including the possible loss of capital. Asset allocation and diversification do not guarantee a profit nor protect against loss. Investing in certain sectors may involve additional risks and may not be appropriate for all investors.

International investing involves special risks, including currency fluctuations, different financial accounting standards, and possible political and economic volatility. Investing in emerging and frontier markets can be riskier than investing in well-established foreign markets.

Investing in small- and mid-cap stocks generally involves greater risks, and therefore, may not be appropriate for every investor.

There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices rise.

US government bonds and Treasury bills are guaranteed by the US government and, if held to maturity, offer a fixed rate of return and guaranteed principal value. US government bonds are issued and guaranteed as to the timely payment of principal and interest by the federal government. Treasury bills are certificates reflecting short-term obligations of the US government.

While interest on municipal bonds is generally exempt from federal income tax, they may be subject to the federal alternative minimum tax, or state or local taxes. In addition, certain municipal bonds (such as Build America Bonds) are issued without a federal tax exemption, which subjects the related interest income to federal income tax. Municipal bonds may be subject to capital gains taxes if sold or redeemed at a profit.

If bonds are sold prior to maturity, the proceeds may be more or less than original cost. A credit rating of a security is not a recommendation to buy, sell or hold securities and may be subject to review, revisions, suspension, reduction or withdrawal at any time by the assigning rating agency.

Commodities and currencies are generally considered speculative because of the significant potential for investment loss. They are volatile investments and should only form a small part of a diversified portfolio. Markets for precious metals and other commodities are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

Investing in REITs can be subject to declines in the value of real estate. Economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

High-yield bonds are not suitable for all investors. The risk of default may increase due to changes in the issuer's credit quality. Price changes may occur due to changes in interest rates and the liquidity of the bond. When appropriate, these bonds should only comprise a modest portion of your portfolio.

Beta compares volatility of a security with an index. Alpha is a measure of performance on a risk-adjusted basis.

The process of rebalancing may result in tax consequences.

Alternative investments involve specific risks that may be greater than those associated with traditional investments and may be offered only to clients who meet specific suitability requirements, including minimum net worth tests. Investors should consider the special risks with alternative investments including limited liquidity, tax considerations, incentive fee structures, potentially speculative investment strategies, and different regulatory and reporting requirements. Investors should only invest in hedge funds, managed futures, distressed credit or other similar strategies if they do not require a liquid investment and can bear the risk of substantial losses. There can be no assurance that any investment will meet its performance objectives or that substantial losses will be avoided.

The companies engaged in business related to a specific sector are subject to fierce competition and their products and services may be subject to rapid obsolescence.

The indexes are unmanaged and an investment cannot be made directly into them. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The NASDAQ Composite Index is an unmanaged index of all stocks traded on the NASDAQ over-the-counter market. The S&P 500 is an unmanaged index of 500 widely held securities. The Shanghai Composite Index tracks the daily price performance of all A-shares and B-shares listed on the Shanghai Stock Exchange.

The VIX is the Chicago Board Options Exchange (CBOE) Volatility Index, which shows the market's expectation of 30-day volatility.

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