# Research Review

## Q1 2021

*The continued rollout of COVID-19 vaccinations and the associated resumption of global economic activity helped send risky asset prices, high-quality sovereign interest rates, and inflationary expectations significantly higher in the first quarter of 2021, with U.S.-based assets generally outperforming those internationally domiciled. While some incoming U.S. economic data continued to appear spotty—notably a beleaguered, albeit improving, labor market—numerous survey-based measures of economic activity have improved to secularly high levels. Global equity performance in the first quarter of 2021 was strongly positive, with certain ongoing trend reversals appearing to take shape, such as small and micro cap outperformance versus large cap and the outperformance of the value equity style over the growth style. On the fixed income front, Treasury interest rates—both nominal and, to a lesser degree, inflation-adjusted (i.e., real)—rose materially, reflecting rising investor fears of positive near-term inflation surprises and serving as a tailwind behind the recent increase in the slope of the Treasury yield curve. Below investment grade credit performance was positive for the quarter, particularly for the floating-rate bank loan sector, which outperformed high yield credit. Real asset returns, outside of the safe haven precious metals sector, were strongly positive, with energy-related corners generating outsized performance amid percolating inflationary sentiment and an ongoing rebound in overall economic activity.*

### INSIDE THIS ISSUE



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# Economic Update

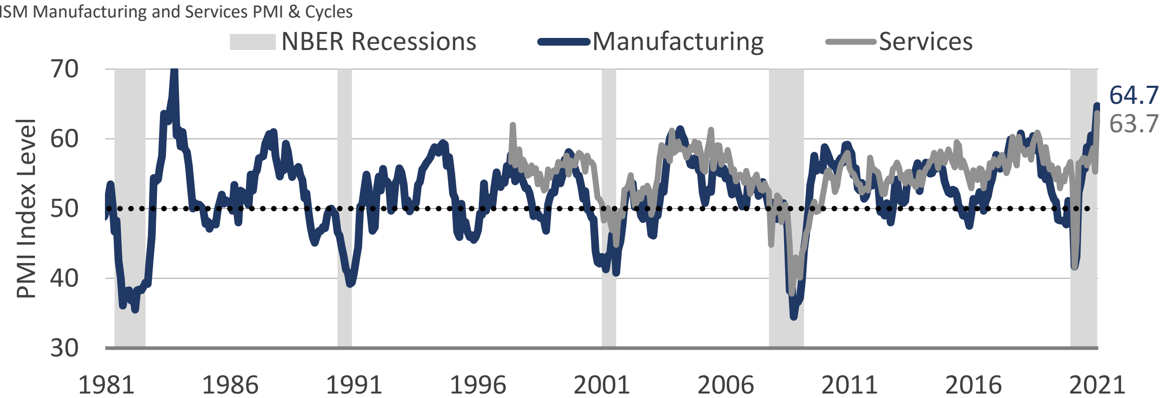
## U.S. Economy Gathers Momentum as Risk Assets Push to New Highs

The first quarter of 2021 marked the 1-year anniversary of the global equity market's spring 2020 drawdown, with most major domestic indices establishing lows on March 23, 2020. From that low point and through March 31, 2021, U.S. large cap equities (S&P 500) generated a handsome 80.7% holding period total return, small cap (Russell 2000) experienced even greater performance with a 124.3% return, and micro cap (Russell Micro Cap) had an astonishing 151.6% gain.

Continued tailwinds in the way of ultra-accommodative monetary and fiscal programs, paired with gradually improving economic conditions, have sent major global equity indices to record high levels. In March, some survey-based composites that seek to capture general business activity sentiment, such as the Institute for Supply Management's (ISM) Purchasing Manager Index (PMI) composites, increased to multi-decade highs to round out the quarter.

MANUFACTURING AND SERVICES PMI MEASURES SPIKE

ISM Manufacturing and Services PMI & Cycles




*Data sources: ISM, NBER, Bloomberg, L.P.*

Through March, sentiment across the manufacturing base, as reflected by the ISM's Manufacturing PMI, improved to the highest level since December 1983, while the broader and more economically critical Services PMI increased to at least the highest level since July 1997 when the index series began.

A key pillar behind the broad rebound across economic activity and inflationary sentiment since spring 2020 has been large-scale expansion of fiscal accommodation, including the recent passage of the $1.85 trillion *American Rescue Plan Act of 2021* in mid-March, which represented the third fiscal package signed into law in the past year.

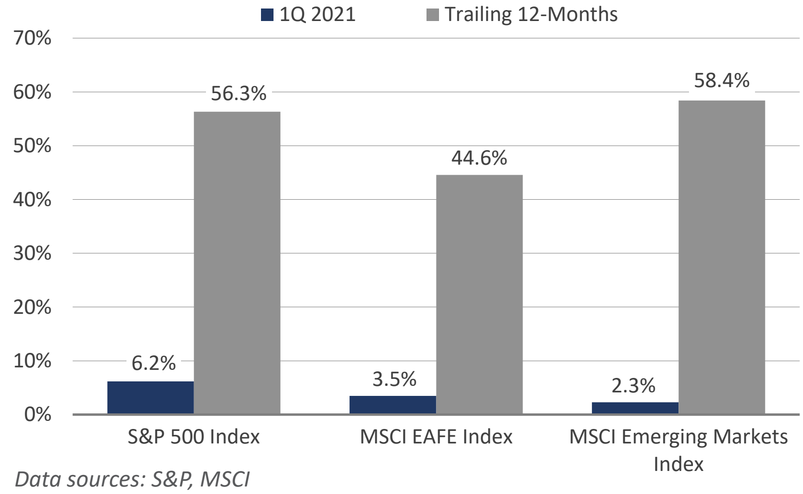
A critical component of these fiscal packages has included direct payments in the form of stimulus checks to millions of Americans, which has led to a revival of consumption growth while also sending the share of government transfer payments as a ratio of total personal income to a historical high.

# Global Equity

- Global equity markets rallied during the first quarter of 2021 due to the ramp-up in vaccine distribution in many parts of the world and improvement in global trade activity. In the U.S., widespread vaccinations and a third significant fiscal stimulus package contributed to investor optimism.
- The volatility during the quarter could be attributed primarily to targeted stock trading by retail investors, a rise in interest rates, and inflationary pressures, despite the Federal Reserve's (Fed's) assurance that inflation is likely to undershoot.
- Within large cap equities, sectors that had lagged during prior periods of peak COVID-19 stress were the best performers, with energy, financials, and industrials achieving the best performance.
- The rotation of demand for large cap and growth stocks into small cap and value stocks, which began in fourth quarter of 2020, continued its trend throughout the first quarter. The Russell 1000 Value Index (+10.7%) posted its largest outperformance over the Russell 1000 Growth Index (+0.7%) in two decades.
- Equities in the UK rallied as the service sector and the manufacturing purchasing manager's index (PMI) showed signs of a rebound due to significant strides in vaccination rates and easing lockdown measures. Previously hard-hit economically sensitive areas of the market, such as materials, energy, and financials posted strong returns.
- While European equities shared a similar story, markets remained cautious about rising COVID-19 infection rates and localized lockdown measures in some EU member states. The supply shortfall for vaccines raised tension between the EU and UK as vaccines continued to be exported from the EU.
- Japanese equity returns were positive, as signs of recovery in corporate profits improved and value stocks rallied, but weakness of the yen weighed on returns for U.S. investors. Taiwan and Singapore were the strongest performers in the MSCI Asia ex-Japan index as Taiwan continued to reflect strong returns aided by gains in internet and semiconductor stocks. Additionally, the rally in financials across the globe positively impacted the three largest banks in Singapore.

**U.S. EQUITIES OUTPERFORM AMID REOPENING**

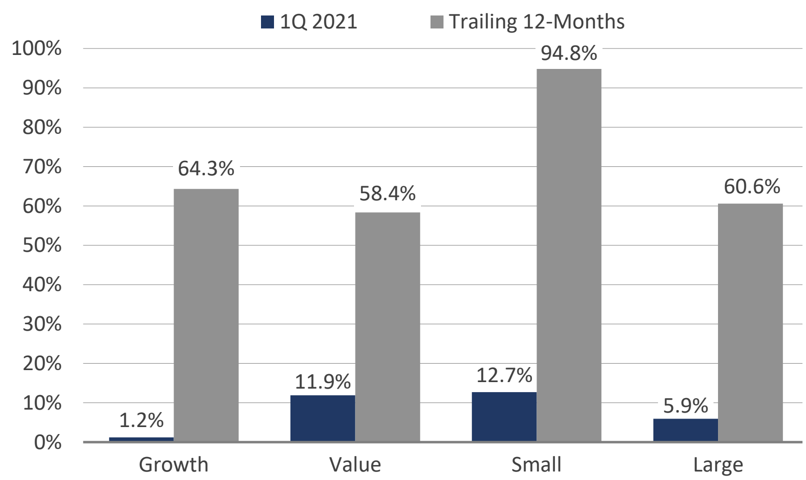
Equity Indices Performance (Returns in U.S. Dollars)




*Data sources: S&P, MSCI*

**VALUE OUTPERFORMS GROWTH; SMALL CAP OUTPERFORMS LARGE CAP**

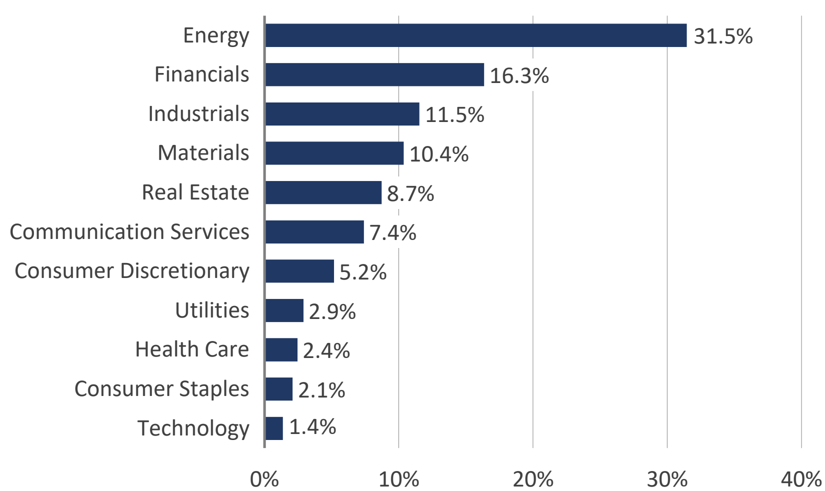
U.S. Russell Index Performance




*Data source: FTSE Russell*

**PREVIOUS LAGGARDS OUTPERFORM**

Russell 3000 Sector Returns




*Data source: FTSE Russell*

- The total face value of high yield bonds trading at “distressed” levels (OAS above 1000 bps) declined by more than 30% to$41 billion, marking the lowest supply of distressed bonds since 2011.

# Real Assets

## Real Estate

- U.S. REITs gained 8.3% with property type performance continuing to be characterized by increasing demand for more economically sensitive sectors expected to benefit from the vaccine rollout.

- Those property sectors most negatively impacted by the pandemic—malls and hotels—rebounded sharply. Meanwhile, property types which outperformed in 2020 and have favorable long-term growth prospects—infrastructure and data centers—lagged the market. U.S. REITs, which include a larger allocation to technology real estate, underperformed global benchmarks, which have larger tilts towards residential, retail, and lodging.

- In March, Blackstone Group and Starwood Capital announced an agreement to purchase Extended Stay America—a mid-priced hotel chain—for $6 billion. This represents the largest transaction in the hotel sector since the start of the pandemic. More importantly, the deal demonstrates an appetite for hotel assets from institutional investors.

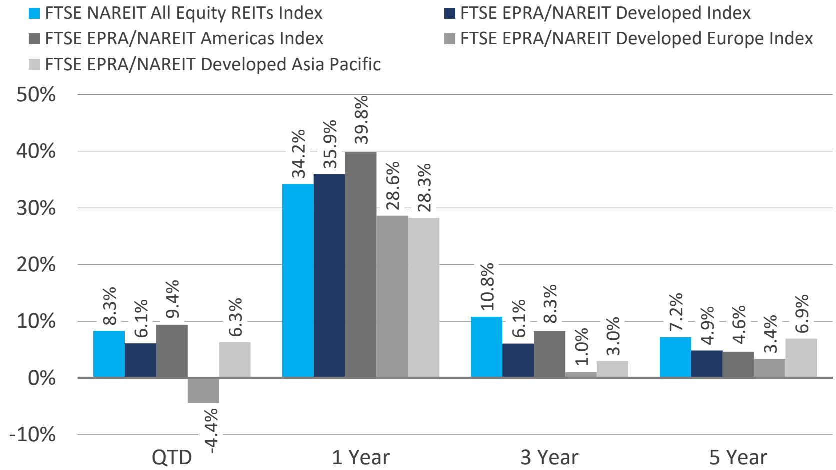
## Natural Resources

- Oil prices continued to strengthen, with the front month contract increasing 22% to close the quarter at almost $60 per barrel. Oil was supported by an improving supply/demand outlook driven by increased travel as economies reopened. However, further price increases may be limited by OPEC’s production targets. OPEC is currently cutting about 7 million barrels per day, with Saudi Arabia cutting an additional 1 million barrels per day.

- Warmer weather forecasts for April led to lower natural gas demand expectations and pushed gas contract prices down in late March. This was slightly offset by continued supply constraints in California and Texas.

### REITs POST POSITIVE RETURNS WITH VACCINE ROLLOUT

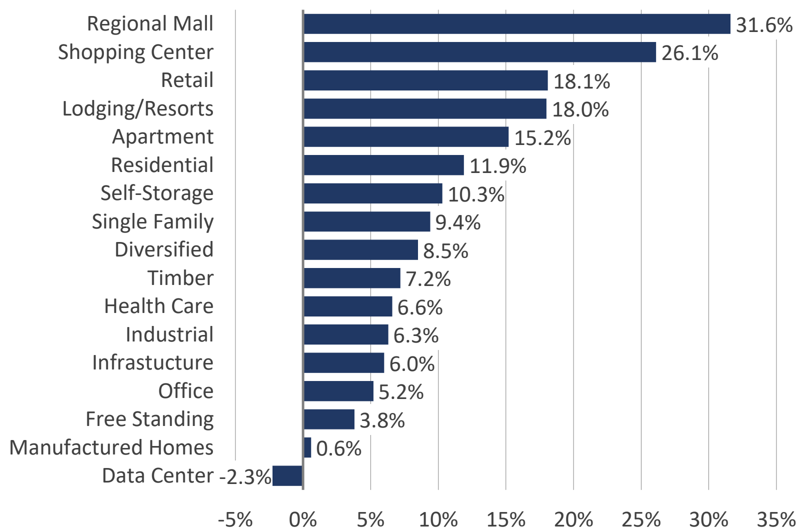
Public Real Estate Index Trailing Returns




*Data source: NAREIT*

### RETAIL AND LODGING REBOUND

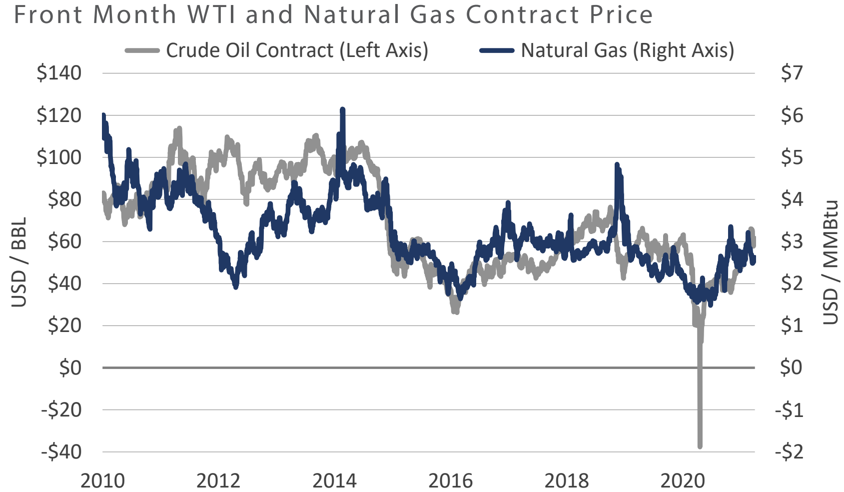
NAREIT Sector QTD Performance




*Data source: Russell*

### OIL PRICE JUMPS TO NEAR $60 PER BARREL

Front Month WTI and Natural Gas Contract Price




*Data source: Bloomberg, L.P.*

- Commodity prices showed positive per-formance from energy and lumber and negative performance from precious metals and select agriculture.

## Infrastructure

- Midstream energy infrastructure's strong performance is attributable to gains in energy commodities and strength in the broader energy sector. The financial position of most midstream energy companies continued to improve, as evidenced by share buybacks and deleveraging of balance sheets.

- Listed infrastructure sectors with high sensitivity to COVID-19, such as passenger transportation, toll roads, airports, and passenger rail, continue to outperform as global economic activity recovers from the downturn of 2020.

- After strong performance in 2020, renewable energy stocks, as tracked by the Nasdaq Renewable Energy Generation index, experienced a weak first quarter 2021, leaving them flat at month-end.

# Diversifying Strategies

- Hedge funds ended the quarter with positive returns, supported by sector dislocations in global equity markets, as well as continued uncertainty surrounding international vaccination efforts.

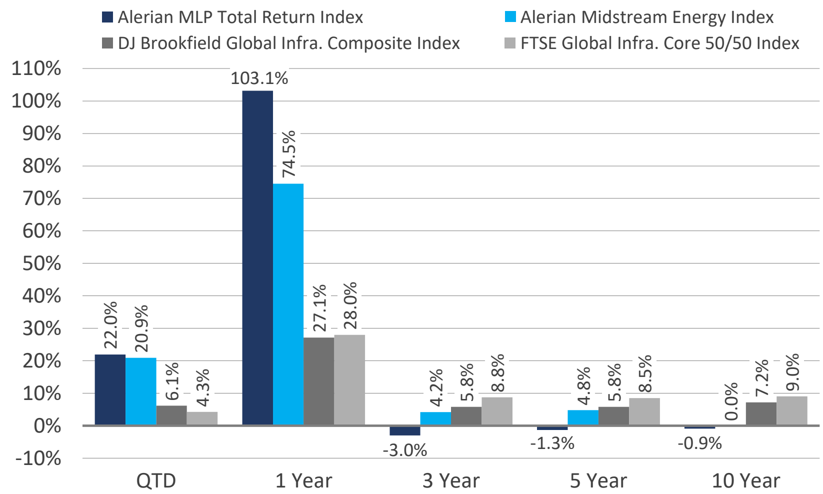
- Equity hedge managers' strong per-formance was predominantly driven by the continuation of retail investor trading. Early in the quarter, performance was hindered by retail trading. Later in the quarter, an array of unwinding positions in single-name equities, triggered by prime brokerage margin calls on a large family-office investor, buoyed returns.

- Event-driven managers posted the strongest performance, which came primarily from distressed/restructuring and special situations managers, as broader equity and credit markets responded to positive vaccination efforts.

- Global macro and relative value manager returns were both positive for the quarter, with dislocations in commodity and foreign exchange markets driving positive performance for dislocation strategies, although negatively impacting concentrated long-biased managers.

**ONE YEAR RETURNS REFLECT GAINS FROM THE TROUGH**

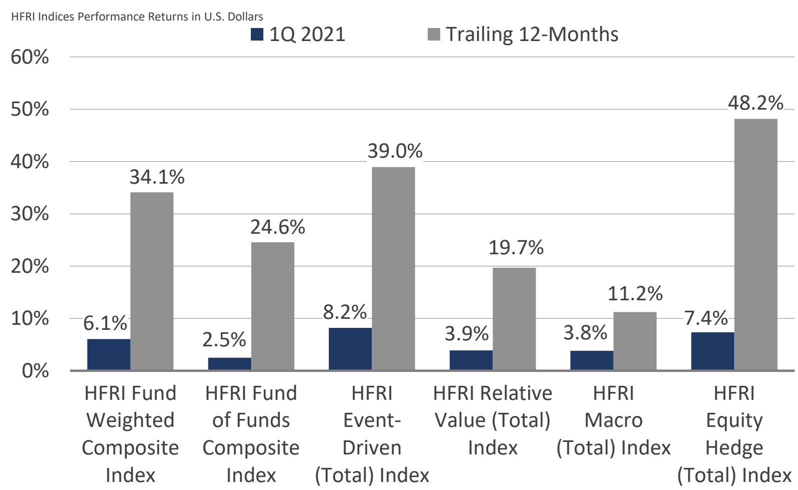
Trailing Infrastructure Returns




*Data source: Bloomberg, L.P.*

**HEDGE FUND RETURNS SOLIDLY POSITIVE**

HFRI Indices Performance Returns (U.S. Dollars)




*Data source: HedgeFund Research*

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All data is as of March 31, 2021 unless otherwise noted.

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