LOOK AHEAD

Q2 2021

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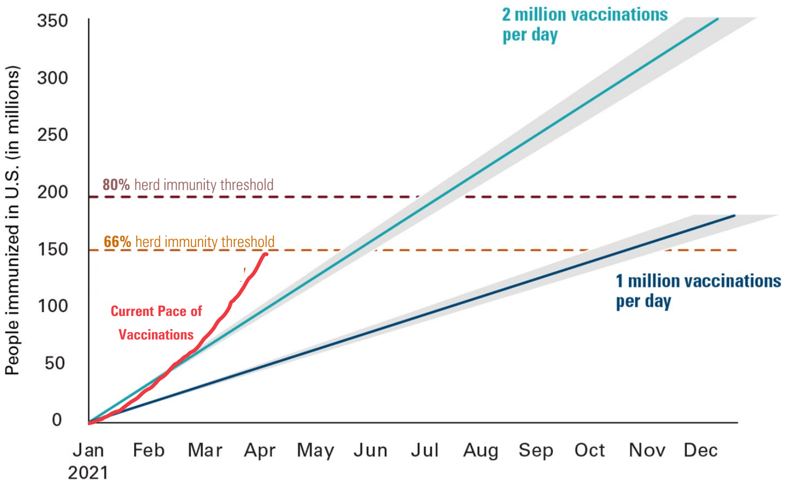
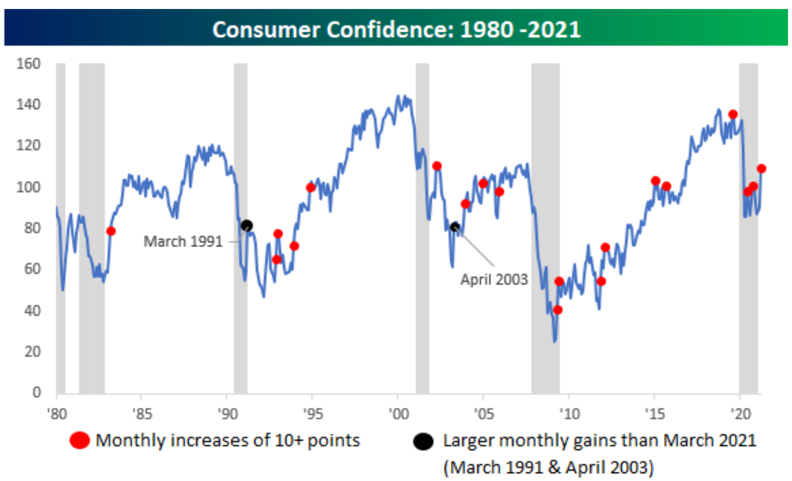
Consumer Strength – Close to Liftoff

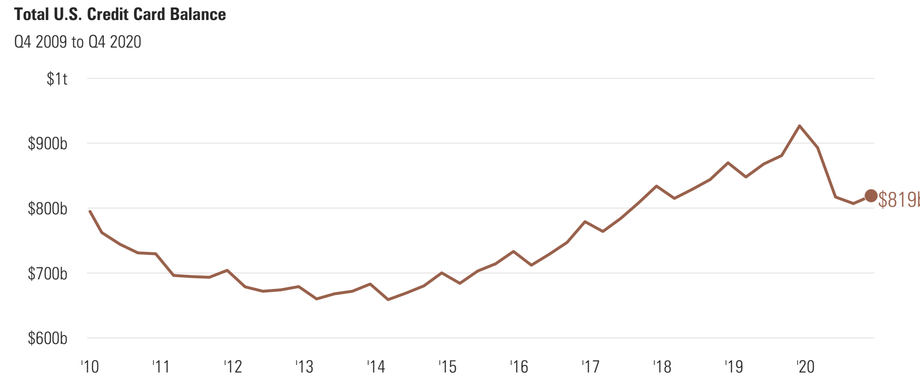
Vaccinations rate will determine pace of spending and resurgence in consumer services (restaurants, hotels, entertainment)





Consumers still need to spend and for them to do that on any sustained basis they need to have two things: jobs and confidence. With so much fiscal support for the consumer, confidence will matter most in the coming quarter.

After paying down their credit cards throughout 2020, consumers have begun reinflating their balances



Balances have declined 11.7% from a peak of $927 billion in December 2019 to $819 billion at the end of December 2020.

If consumers reinflate their credit card spending back to pre-pandemic levels, that could add another $108 billion, 0.49%, back to GDP in 2021.

Even in the midst of the pandemic, consumer debt to disposable income is still at multi-decade lows.

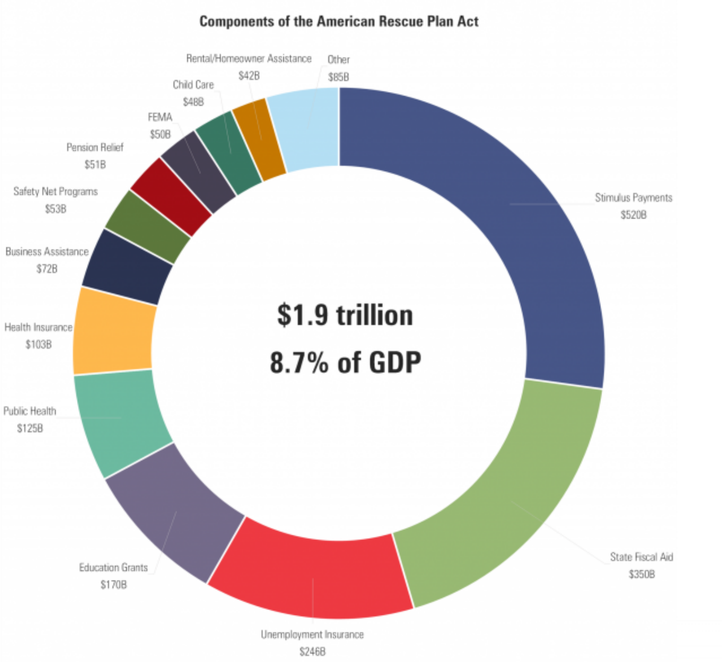
In our estimation, it's really about what they pay to service the debt that matters most.

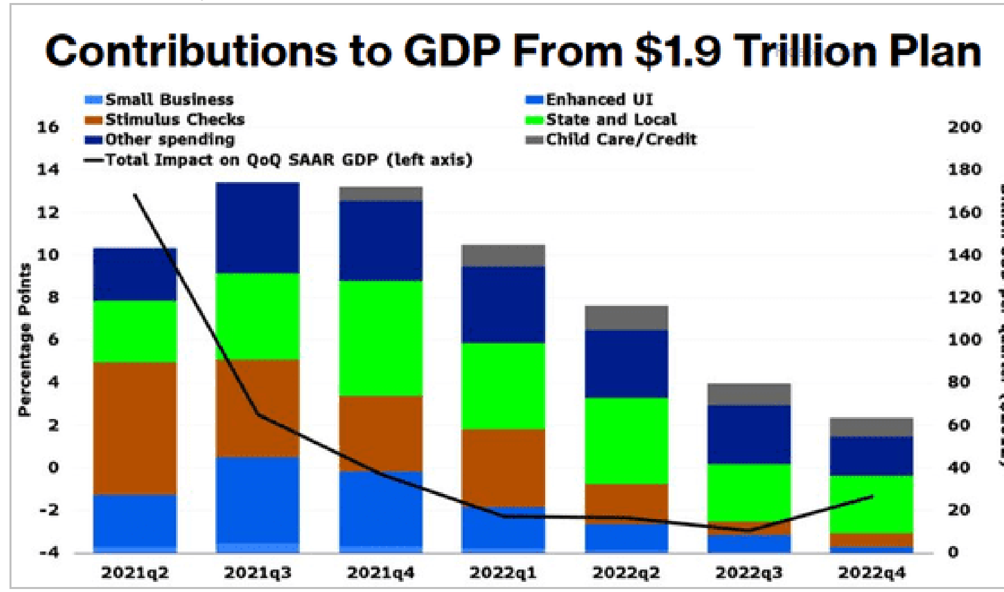
If consumers returned to prior peak levels of debt service, it could total $2.03 trillion or 9.7% of GDP.

Data Sources: Bloomberg, Federal Reserve Bank of St. Louis, Bespoke Investment

Triple Play: The Fiscal – A New Policy Tool

With the passage of the $1.9 trillion American Rescue Plan Act, congress and the President will continue to fuel extensive stimulus to the American economy.





The $300/week in extra federal unemployment benefits will create an implicit increase in the current minimum wage

$474/week Average State Unemployment Benefits + **$300/week** Federal Unemployment Benefits = **$774/week** Total Unemployment Benefits ÷ **40** hours per week = **$19.35/hour** Implied Minimum Wage

To get those currently unemployed back to work, the American employer will need to match that wage between now and September when we wean off the supplemental benefits.

Remember, wages, once earned, are rarely ever taken away.

Data Sources: Congressional Budget Office, Bloomberg News, Phillips & Co. estimates

Triple Play: The Personal

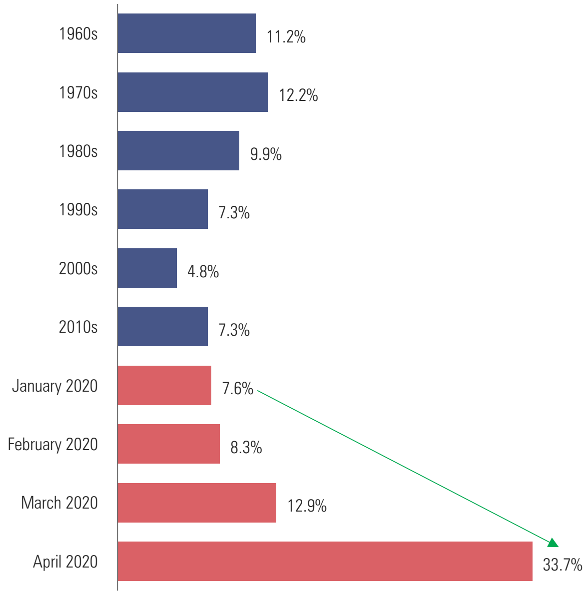
The U.S. consumer has been sitting on a pile of cash. Personal savings rates were immediately elevated after the passage of the CARES Act in March 2020.

It's fair to extrapolate that the spend-down rate was around 13.8% per month during the critical lockdown months of April through November.

Moving forward we should see another massive boost to savings from the recent passage of the $1.9 trillion American Rescue Plan, with $520 billion of that in the form of direct payments.

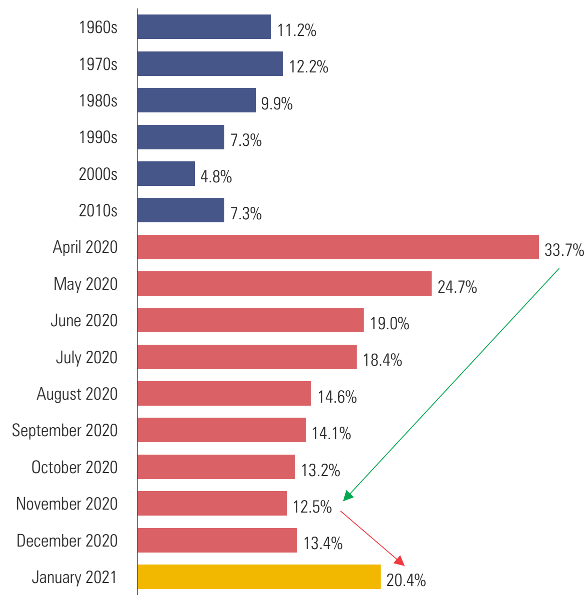
Pandemic Spike in Personal Savings

Savings rate as a % of disposable income



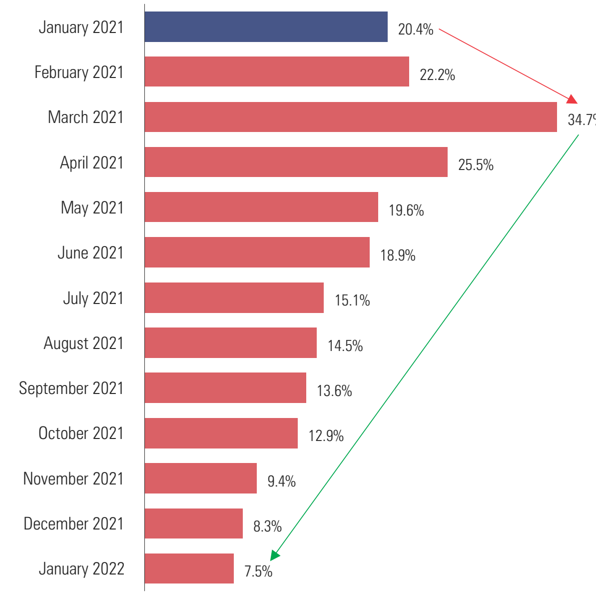
Personal Savings Return to May-June 2020 Levels

Savings rate as a % of disposable income



Potential Spend Down of Personal Savings

Savings rate as a % of disposable income



The passage of the $900 billion second stimulus package in December boosted personal savings back up to the levels last seen in May and June.

It is not hard to imagine that the extra boost to savings will become less precautionary and more opportunistic spending. Following a similar trajectory to the CARES Act, we could expect the monthly spend down to look like the chart above.

The overall boost to economy could be $2.65 trillion or 12.1% of GDP

Data Sources: Federal Reserve Bank of St. Louis, Phillips & Co. estimates

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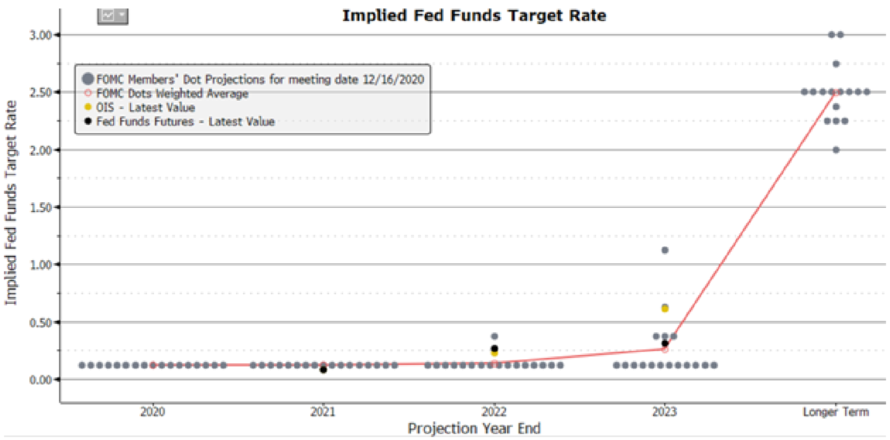
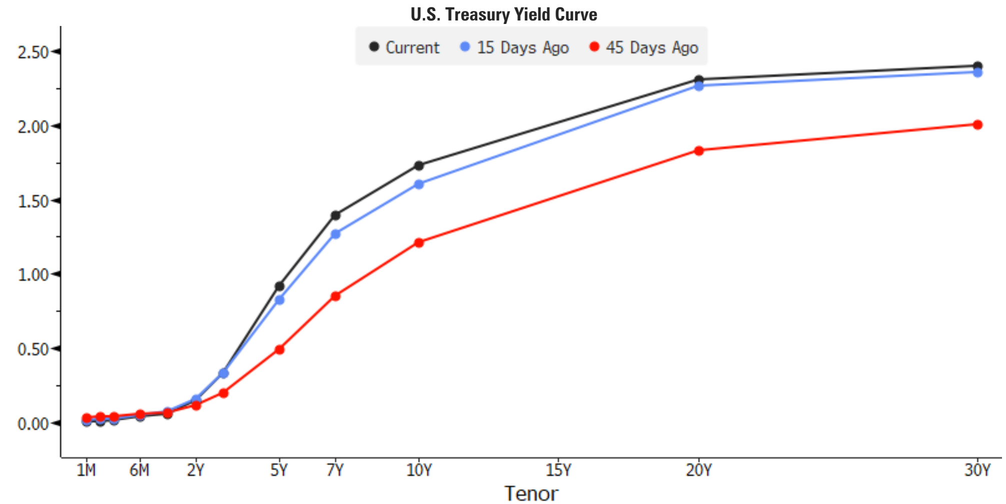
Triple Play: The Monetary

The Federal Reserve adds to this incredible triple play by continuing to promise to keep interest rates lower for longer.



It's clear the Fed wants to do their part to lift wages on the lower end of the income spectrum. However, they will need to balance the increase in long-term interest rates within the real economy against an ongoing economic expansion.



The general expectation is that the Fed will be on hold regarding interest rates until 2023, even with slightly higher inflation expectations based upon the 5-year inflation breakeven rate over 2%.

Fed's 5-Year Forward Breakeven Inflation Rate

We expect the Fed to manage the long-end of the yield curve through the purchase of additional longer-dated treasuries, pushing down interest rates.

This could occur when mortgage rates spike above 4.25%.

Average 30-Year Fixed Mortgage Rate

Data Sources: Board of Governors of the Federal Reserve System, Bloomberg, Federal Reserve Bank of St. Louis

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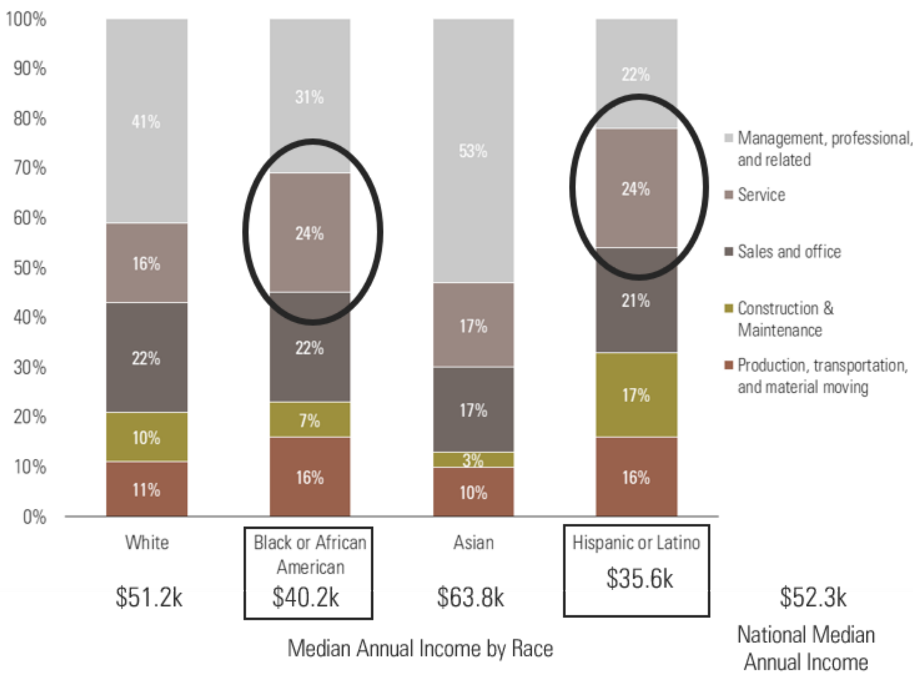
Interest Rates & the Fed

Keeping rates low, allowing wages to rise and inflation to drift above 2%

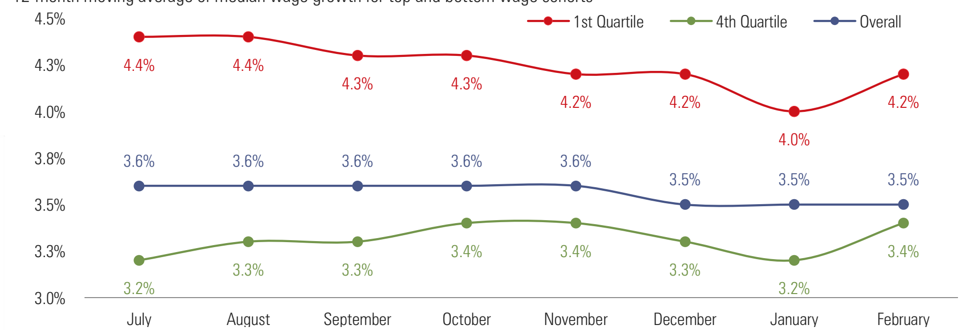
"Inflation that is persistently low can pose risks…The result can be worse economic outcomes in…both employment and price stability…with the costs likely falling hardest on those least able to bear them." —Jerome Powell

Employed Persons in Industries Most Affected by COVID-19 by Race



Wage Growth Tracker by Wage Level

12-month moving average of median wage growth for top and bottom wage cohorts



Despite transitory inflation, wages at the low-end have made some progress in catching up to the overall wage increase.

The tacit "get off the couch" minimum wage increase will make substantial progress towards closing the gap.

Labor Force Participation May Be the Trigger vs. Other Inflation Inputs

The Fed is keenly attuned to the labor force participation rate rather than unemployment.
The participation rate will likely drive forward guidance from the Fed.

Data Sources: Bureau of Labor Statistics, Federal Reserve Bank of Atlanta, Federal Reserve Bank of St. Louis

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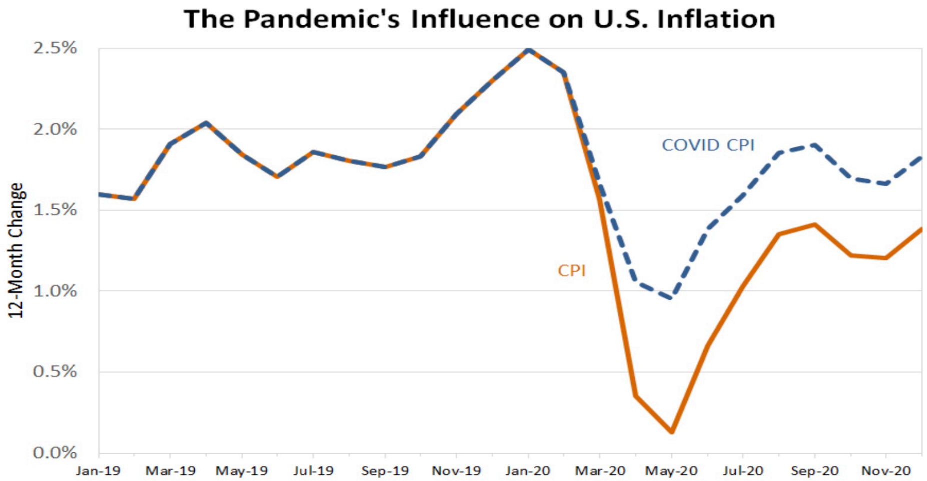
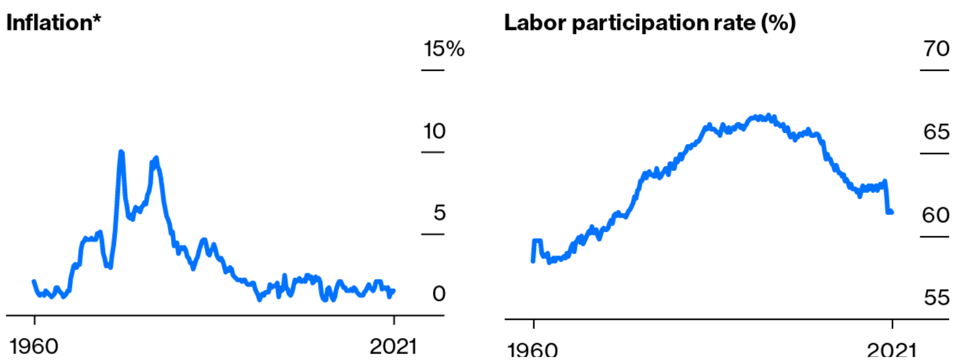
Inflation is Transitory

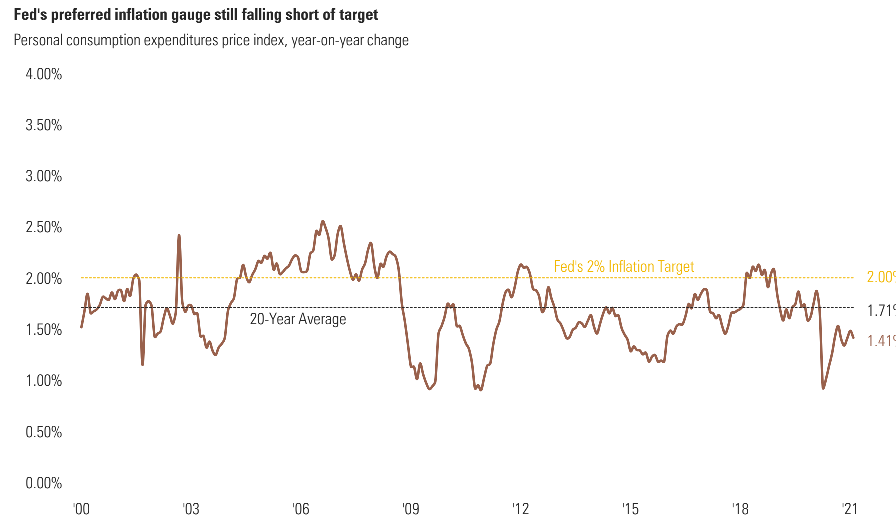
Certain measures of CPI were higher driven by Covid supply chain disruptions and adjustments to the pricing cycle.

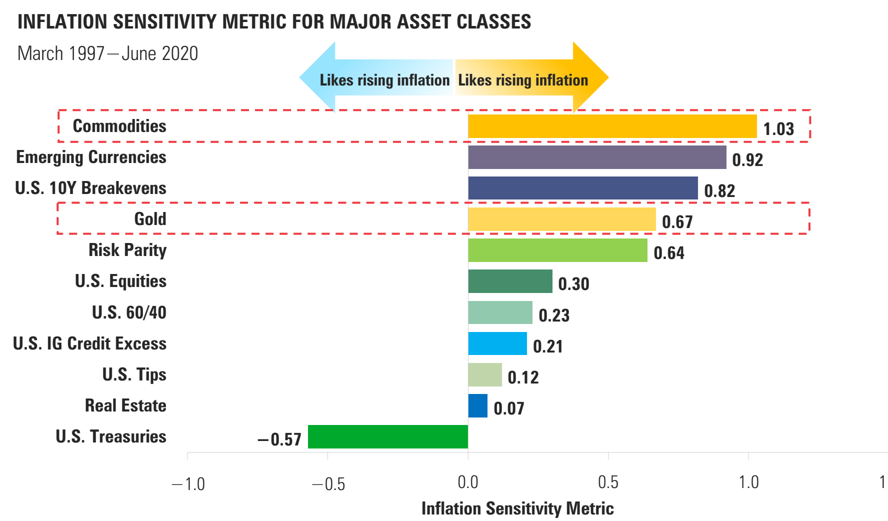


Inflation and higher wages will pull more people from the sideline and provide a small dampener to exposing wages.

It's harder for inflation to surge when workers are readily available.







Data Sources: IMF, Federal Reserve Bank of St. Louis, Bloomberg

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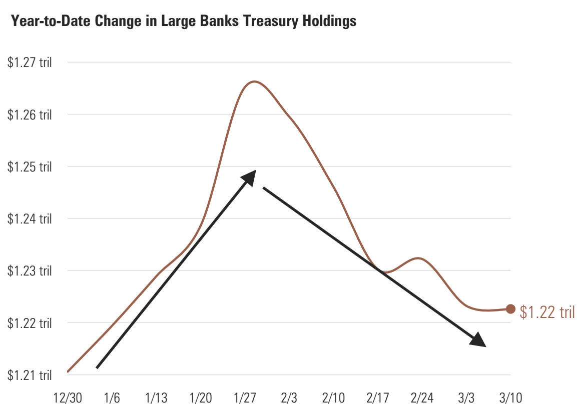
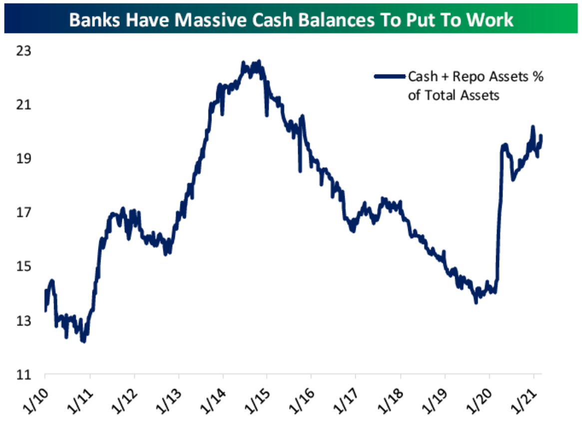
Fixed Income – A Tough Year Ahead

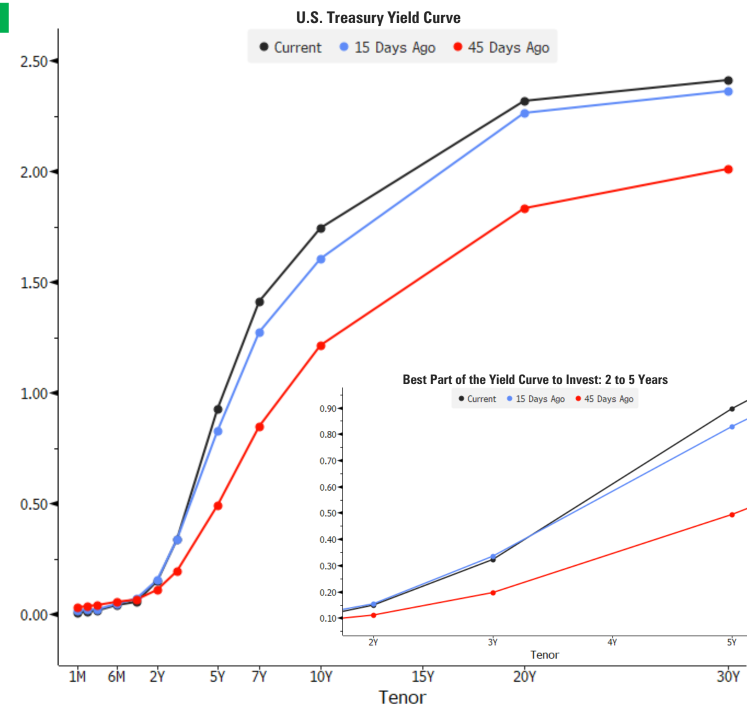




- Banks have large cash balances and are selling U.S. Treasuries to meet new regulatory capital requirements, leading to steep year-to-date declines for longer-dated Treasury ETFs.

Hardest Hit Areas of Fixed Income Year-to-Date

Ticker	Name	Price	Yield (%)	YTD TR (%)
EDV	Extended Duration Treasury Bonds	125.41	2.47	-16.66
TLT	20+ Year Treasury Bonds	135.85	1.52	-13.87
TLH	10-20 Year Treasury Bonds	140.15	1.23	-11.98
BLV	Long-Term Bonds	97.64	2.90	-10.94
VCLT	Long-Term Corporate Bonds	100.43	2.97	-9.58
LQD	Investment Grade Corporate Bonds	129.36	2.50	-6.35
EMB	Emerging Markets Bonds	108.53	3.88	-6.37
IEF	7-10 Year Treasury Bonds	113.00	0.74	-5.79
BIV	Intermediate-Term Bonds	88.62	1.87	-4.56
BND	Total Bond Market	84.63	1.83	-4.04
AGG	Core U.S. Aggregate Bonds	113.70	2.00	-3.80



- Yield chasing will increase exposure to companies who may be at higher risk of default or downgrades by credit rating agencies.

- The least risky part of the yield curve currently looks to be in the 2-to-5-year range. This should press down on income returns and mitigate the risk reduction advantages fixed income can provide.

Data Sources: Federal Reserve Bank of St. Louis, Bespoke, Bloomberg

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The Base Effect – Earnings Forecasts

Valuations on U.S. equites are extremely elevated. Current valuations run the risk of much higher volatility as events unfold in the coming quarter.

S&P 500 Forward Price-to-Earnings (Next Twelve Months Estimates)

With current earnings growth expectations at 24.9%, the go forward adjustment in price could be -8.1%.

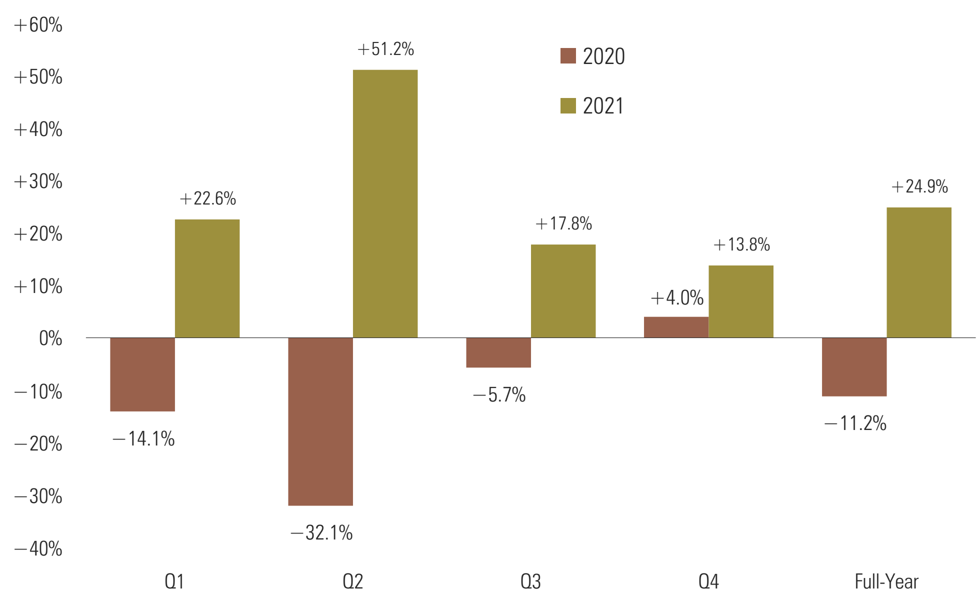
	CURRENT LEVEL	IMPLIED 2021 GROWTH RATE	IMPLIED YEAR-END 2021 GROWTH RATE
S&P 500 Price	3,957.25	-8.1%	3,634.91
S&P EPS	180.76	24.9%	225.77
P/E Ratio	**21.9x**		**16.1x**

Another way to normalize valuations back to historical averages this year would be to see the S&P 500 fall by 26.1% from current levels.

	CURRENT LEVEL	IMPLIED 2021 GROWTH RATE	IMPLIED YEAR-END 2021 GROWTH RATE
S&P 500 Price	3,940.59	-26.1%	2,910.25
S&P EPS	180.76	0.0%	180.76
P/E Ratio	**21.8x**		**16.1x**

The base effect of having such a terrible 2020 in corporate earnings provides for some pretty easy 2021 comps.

S&P 500 Earnings Growth: 2020 vs. 2021



Lots of **E** (earnings) and very little **P** (price) appreciation.

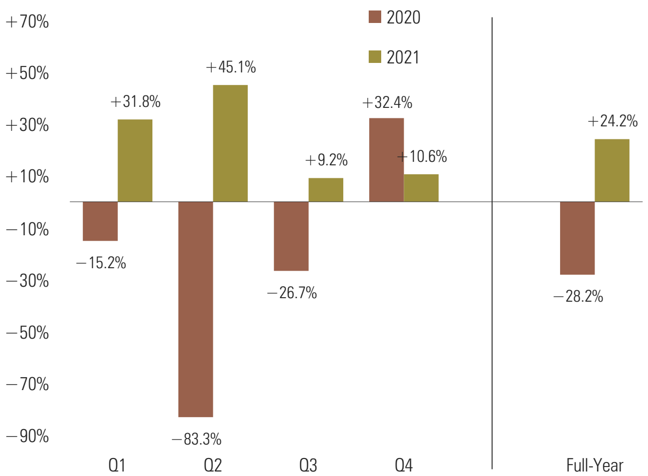
While there is an expectation for strong earnings growth in 2021, perhaps those earnings will be reflected in moderating valuations versus price appreciation.

Data Sources: Bloomberg, FactSet

Developed Markets

While a return to earnings growth is still anticipated in 2021, the pace of the recovery in Developed Markets is expected to lag Emerging economies while valuations remain elevated on a relative basis.

MSCI EAFE Earnings Growth: 2020 vs. 2021

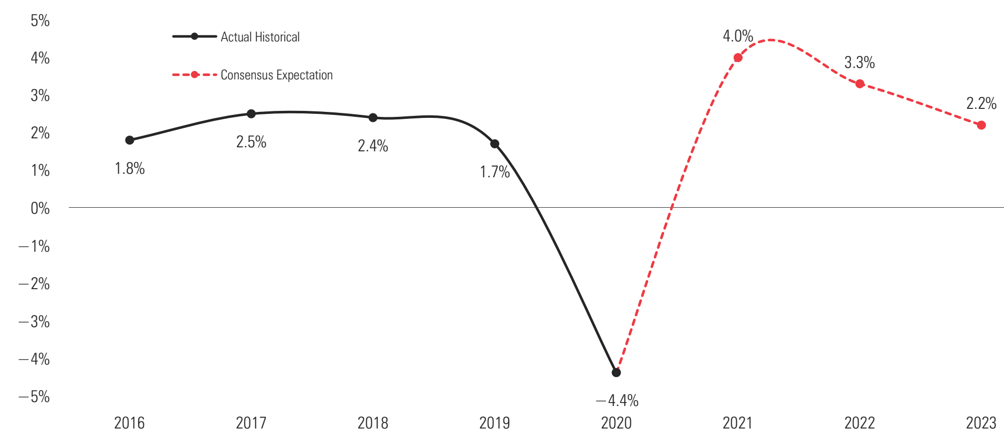


Historical CAPE Ratio Developed Markets & Emerging Markets

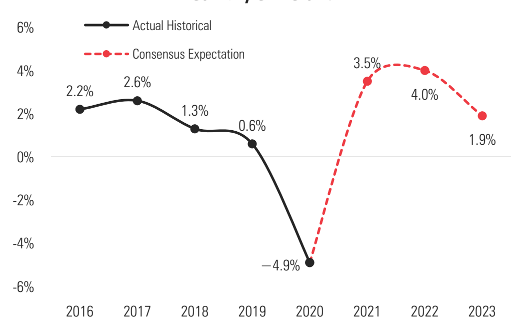
With an average of 11% of GDP and 17% of employment tied to tourism, an economic recovery in the Developed Markets is highly dependent on the timing of reopening.

Economic activity remains subdued heading into Q2 due to tight national restrictions and limited internal mobility across Western Europe.

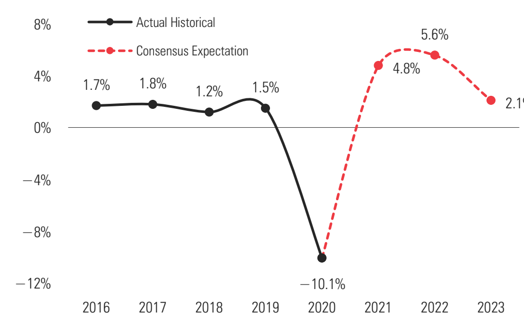
EAFE GDP Growth



Germany GDP Growth



United Kingdom GDP Growth



Data Sources: Bloomberg, Barclays

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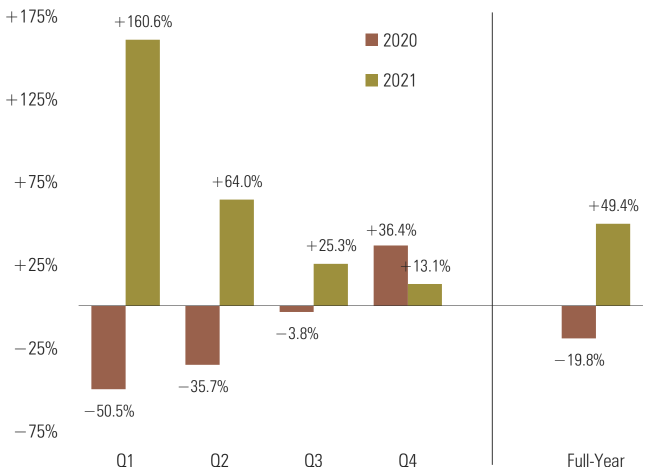
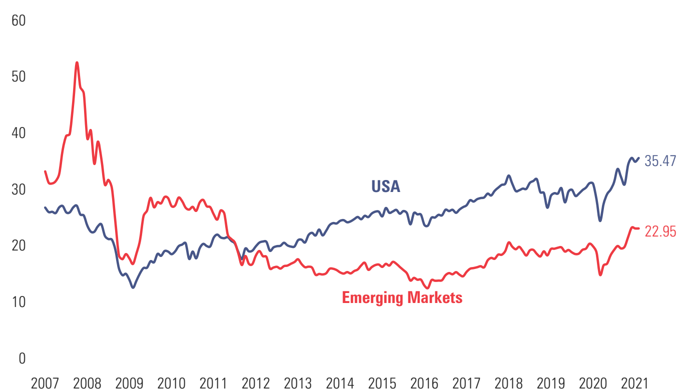
Emerging Markets

From an earnings growth and valuation perspective, Emerging Markets remain the favorite within the broad spectrum of equity investing.

MSCI Emerging Markets Earnings Growth: 2020 vs. 2021



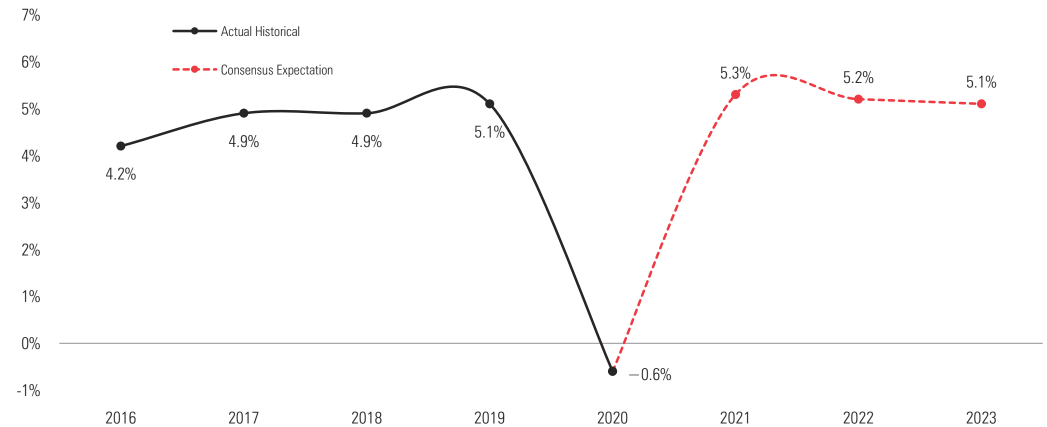
Historical CAPE Ratio United States & Emerging Markets



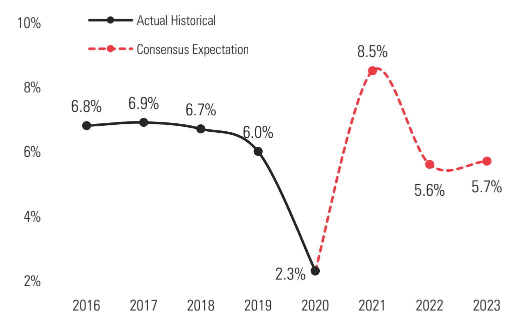
With Emerging Market valuations trading at 35% discount to the U.S. and 2021 EPS expected to grow at 24.5% above the U.S. EPS growth rate, Emerging Markets present a clear opportunity.

We anticipate a sharp recovery in annual growth rates, driven by further easing of COVID lockdowns combined with the support provided by fiscal and monetary policy.

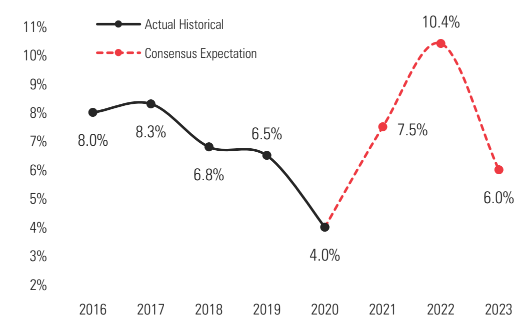
Emerging Markets GDP Growth



China GDP Growth



India GDP Growth



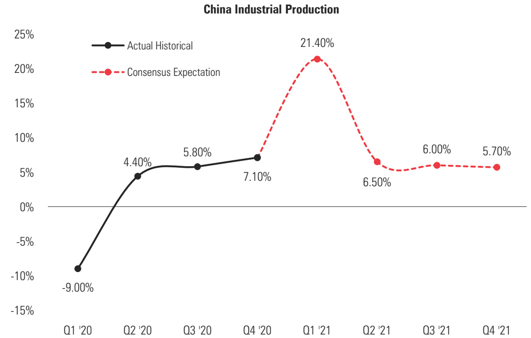
Data Sources: Bloomberg, Barclays

China – Crossing Over

Bouncing back

Comparing China's 2020 economic goals and results with 2021 targets

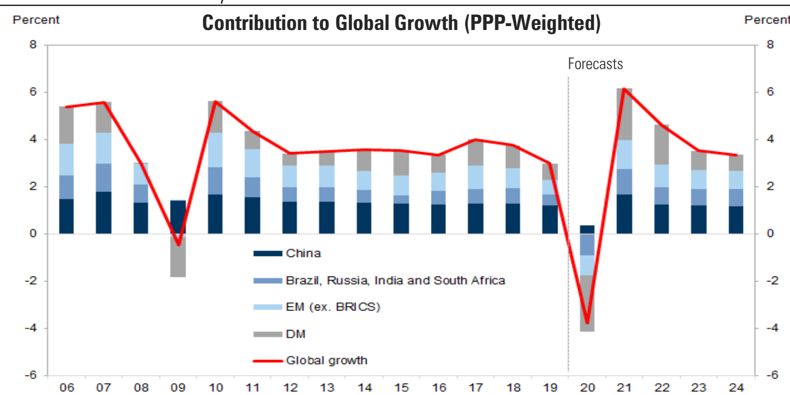
	Target 2020	Actual 2020	Target 2021
GDP	No target	2.3%	>6%
CPI	~3.50%	2.5%	~3%
M2	Significantly higher than the 8.7%	10.1%	In line with nominal GDP growth
Fiscal deficit	3.60%	3.7%	3.2%
Special treasury bond	1 tr yuan	1 tr yuan	None
Local government special-purpose bond	3.75 tr yuan	3.6019 tr yuan	3.65 trillion yuan
Urban employment	Up 9 million	Up 11.86 million	Up 11 million
Surveyed unemployment rate	6%	5.60%	5.50%



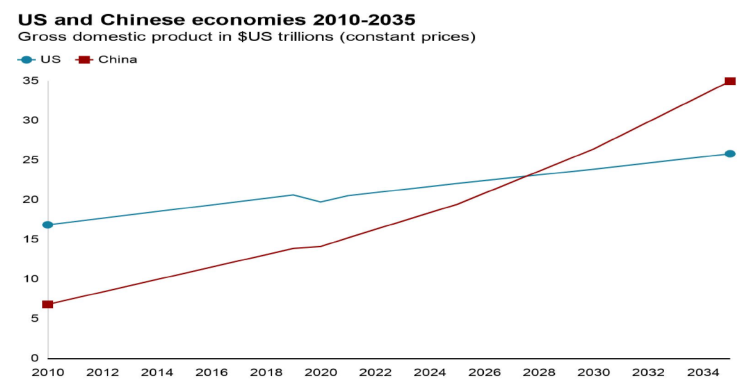
- China's economy is operating close to, if not above, pre-pandemic levels across a wide array of metrics; increasing net exports as the rest of the world opens up could provide upside to official 2021 economic targets.
- The Chinese economy has rebounded sharply after successfully controlling the spread of COVID-19, effectively closing their output gap in February.
- China's 14th Five-Year Plan shows that the government is tackling domestic issues and working toward high-quality growth in a more practical way (i.e., setting realistic/flexible targets) while focusing on new strategic priorities such as de-carbonization and security.

Key Economic & Social Development Indicators from China's 14th Five-Year Plan

	EXPLICIT GOAL 2020	EXPLICIT GOAL 2025	IMPLICIT GOAL
Economic Development			
GDP Growth	2.3%	–	Within a reasonable interval
Urbanization Rate	60.6%	65.0%	
Innovation			
Growth in R&D spending	–	–	Growth >7%
Number of innovation patents per 10k people	6.3	12	
Digital economy share of GDP	7.8%	10.0%	
People's Wellbeing			
Growth in disposable income	2.1%	–	In line with GDP
Urban unemployment rate	5.2%	<5.5%	
Green Ecology			
Reduction in energy consumption per unit of GDP (%)	–	–	–13.5%
Reduction CO_2 emissions per unit of GDP	–	–	–18.0%
Security/Safety			
Comprehensive grain production capacity	–	–	>650 million tons
Comprehensive energy production capacity	–	–	>4.6 billion tons of coal



- Chinese growth may be the biggest driver of global growth over the next decade as it accounts for a bigger portion than ever before.
- China's total output will account for approximately 1% of total global GDP growth, which is targeted at 4%. Put another way, China will represent about 25% of global growth while the United States will only count for around 15% according to World Bank estimates.



- Based on future projections for GDP growth in 2021, China's output would total ~$15.5 trillion compared to the U.S. at $21.4 trillion in 2021.
- If the United States returns to normal pre-COVID growth (2.5%) along with China (5%), **the crossover point for China to become the largest economy in the world is estimated to be 2028 as shown above.**

Data Sources: Centre for Economics & Business Research, China Briefing, Goldman Sachs, World Bank

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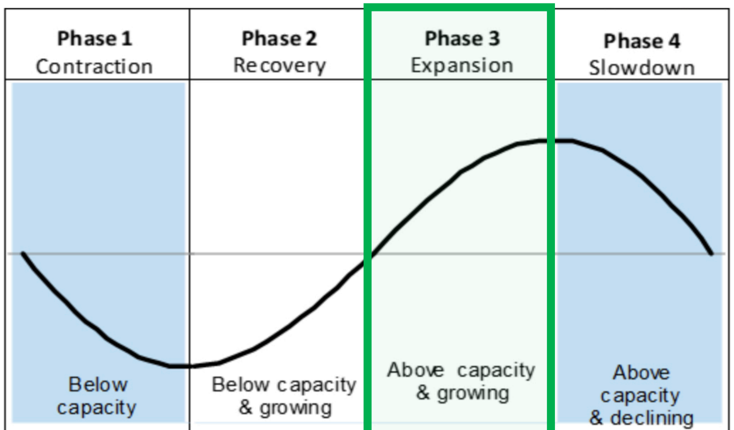
Commodity Cycle – Cyclical or Secular?

Commodities and wages grow fastest during late cycle expansions



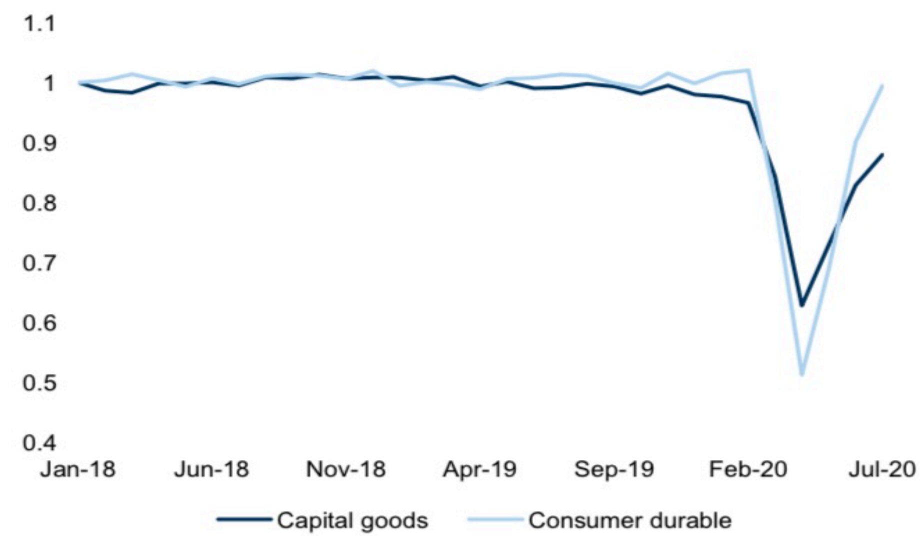
Relative Ranking of Assets (average return by phase, annualized)							
Bonds	12.2%	Equities	19.1%	Commodities	29.7%	Bonds	14.3%
Equities	10.6%	Bonds	4.4%	Equities	15.5%	Cash	5.6%
Cash	2.9%	Commodities	4.0%	Bonds	5.8%	Commodities	3.4%
Commodities	0.0%	Cash	3.0%	Cash	5.1%	Equities	-12.4%
Quintile Income Growth							
Lowest Income	3.0%	Poorest Quintile	1.6%	Poorest Quintile	3.1%	Poorest Quintile	5.6%
2nd	1.7%	2nd	1.6%	2nd	1.9%	2nd	4.4%
3rd	2.4%	3rd	1.9%	3rd	1.7%	3rd	4.2%
4th	2.9%	4th	2.4%	4th	1.6%	4th	4.6%
Highest Income	3.1%	Highest Income	3.6%	Highest Income	4.2%	Highest Income	1.6%
Core CPI	2.7%	Core CPI	2.3%	Core CPI	2.8%	Core CPI	3.4%

We could be entering a long-dated Phase 3 that supports commodities and provides a boost to the poorest wage earners.

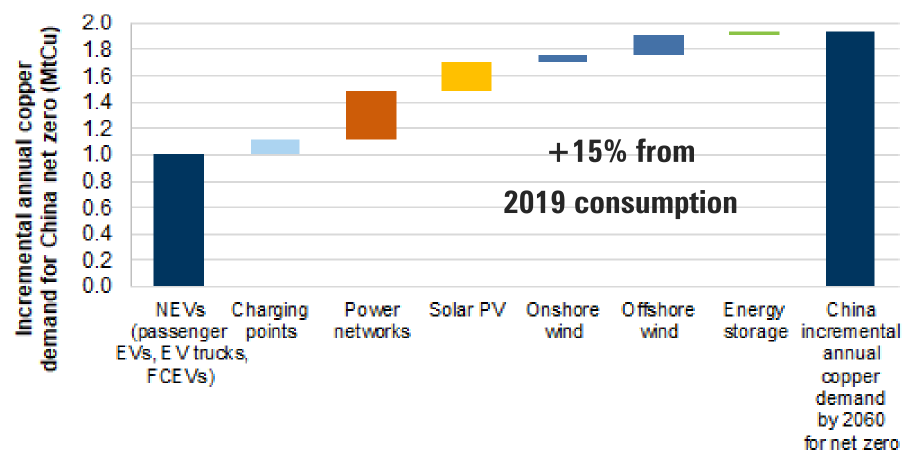
Catalysts for a secular bull market in commodities

Recovery in Western metals demand fueled by resurgence in Industrial Production

Capital Goods and Consumer Durables Industrial Production, US, index (Jan18=1)



Incremental copper demand in 2060 for China net zero



Data Sources: Bloomberg, Goldman Sachs

Mean Reversion Dashboard

Style Forward P/E as a % of 20-Year Average

Size	Value	Blend	Growth
Large	132.6%	140.3%	159.5%
Mid	129.2%	139.0%	173.2%
Small	117.1%	143.1%	243.7%

Regions & Countries Forward P/E as a % of 20-Year Average

Regions

World	Developed Markets	Emerging Markets
131.7%	116.3%	100.8%

Countries

United States	Germany	United Kingdom	China	Brazil	India	Russia
150.0%	108.8%	91.6%	107.0%	66.5%	147.1%	52.1%

Sector Forward P/E as a % of 20-Year Average

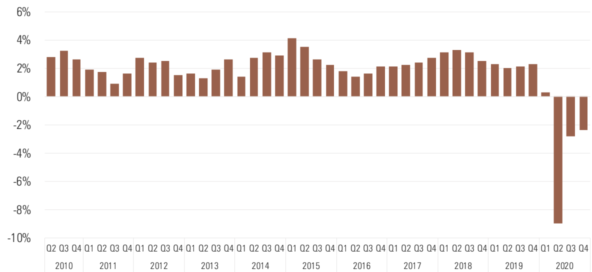
Sectors

Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
107.5%	101.1%	131.1%	168.9%	105.5%	82.8%	77.3%	130.0%	112.0%	91.8%	267.5%

Data Source: Bloomberg

Economic Dashboard

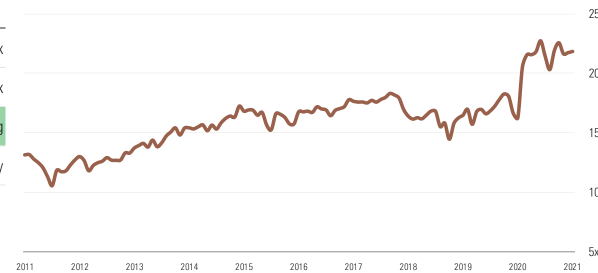
U.S. GDP Growth (YoY %)	
Latest Level	-2.40
Change from Prior Quarter	0.40
Latest Direction	Expanding
Frequency	Quarterly



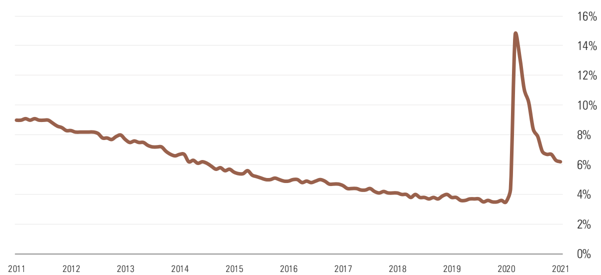
U.S. Treasury Spread (10 Yr vs. 2 Yr)	
Latest Level (basis points)	158
Change from Prior Month	30
Latest Direction	Steepening
Frequency	Monthly

U.S. Inflation (YoY %)	
Latest Level	1.70
Change from Prior Month	0.30
Latest Direction	Rising
Frequency	Monthly

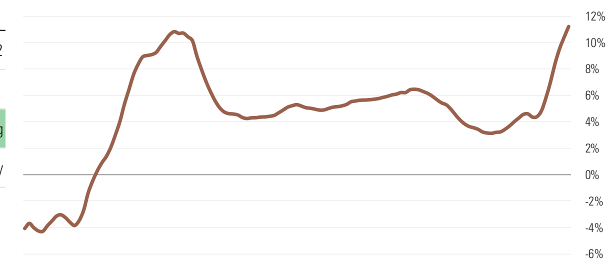
S&P 500 Forward P/E Ratio	
Latest Level	21.8x
Change from Prior Month	0.1x
Latest Direction	Increasing
Frequency	Monthly



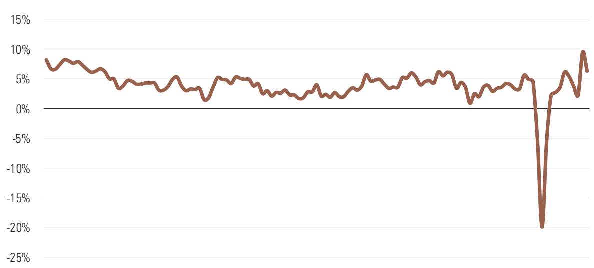
U.S. Unemployment (YoY %)	
Latest Level	6.20
Change from Prior Month	-0.10
Latest Direction	Falling
Frequency	Monthly



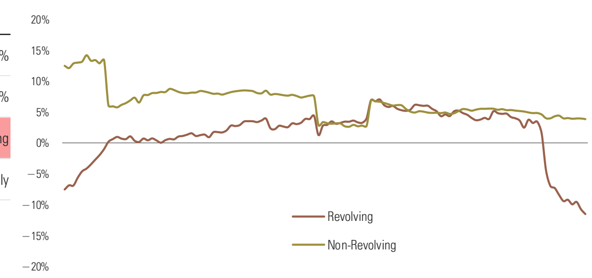
Case-Shiller Home Prices (YoY %)	
Latest Level	11.22
Change from Prior Month	0.81
Latest Direction	Increasing
Frequency	Monthly



Retail Sales (YoY %)	
Latest Level	6.30
Change from Prior Month	-3.20
Latest Direction	Decreasing
Frequency	Monthly



Consumer Credit (YoY %)	
Latest Levels	−11.6% | +3.8%
Change from Prior Month	−0.8% | −0.1%
Latest Direction	Decreasing
Frequency	Monthly



Data Source: Bloomberg

Phillips & Company
Wealth Strategies | Vested

Our View & Recommendations

Our View

- Much of the recovery in corporate earnings are priced into U.S. equities
- Vaccine implementation should help bolster economic recovery this coming quarter
- The Federal Reserve continues to institutionalize lower rates as a way to lift lower income Americans' wages, including racial minorities.
- China is continuing to increase their global presence through major trade alliances and vaccine diplomacy in Africa, Latin America, Southeast Asia, and the Middle East
- Emerging Markets present the most attractive valuations
- President Biden will focus on infrastructure and reorganizing tax policy
- Possible start to a secular bull market in base metals

Recommendations

- Maintain policy weightings to U.S. equities with a balancing of U.S. Large Cap Growth and Quality/Value
- Continue to actively manage fixed income, as yield chasers increase, defaults across the credit markets will have greater impact
- Overweight Emerging Markets as a best global price to growth opportunity
- Specific overweight to China domestic equities
- Consider some exposure to industrial commodities as a weak dollar and recovering global economies will push prices and profits higher

Strategy Update

- Review our discussion with award-winning financial author Morgan Housel about his book, *"The Psychology of Money"*

Link to Morgan Housel interview: **https://youtu.be/lBEF-okhAEE**

THANK YOU

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Data Sources

Slide 2	**Consumer Strength – Close to Liftoff** Bloomberg terminal https://fred.stlouisfed.org/series/CCLACBW027SBOG https://fred.stlouisfed.org/series/TDSP https://www.bespokepremium.com/interactive/research/think-big-blog/
Slide 3	**Triple Play: The Fiscal – A New Policy Tool** https://www.congress.gov/bill/117th-congress/house-bill/1319/text https://news.bloombergtax.com/daily-tax-report-state/house-sends-stimulus-bill-to-biden-checks-to-u-s-pocketbooks
Slide 4	**Triple Play: The Personal** https://fred.stlouisfed.org/series/PSAVERT
Slide 5	**Triple Play: The Monetary** https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20201216.pdf https://fred.stlouisfed.org/series/T5YIE https://fred.stlouisfed.org/series/MORTGAGE30US
Slide 6	**Interest Rates & the Fed** https://www.bls.gov/data/tools.htm https://www.frbatlanta.org/chcs/wage-growth-tracker https://fred.stlouisfed.org/series/CIVPART
Slide 7	**Inflation is Transitory** https://blogs.imf.org/2020/11/10/data-disruption-the-impact-of-covid-19-on-inflation-measurement/ Bloomberg terminal
Slide 8	**Fixed Income – A Tough Year Ahead** https://fred.stlouisfed.org/series/TASLCBW027SBOG https://www.bespokepremium.com/interactive/research/think-big-blog/ Bloomberg terminal
Slide 9	**The Base Effect – Earnings Forecasts** Bloomberg terminal https://insight.factset.com/topic/earnings
Slide 10	**Developed Markets** Bloomberg terminal https://indices.barclays/IM/21/en/indices/static/shiller.app
Slide 11	**Emerging Markets** Bloomberg terminal https://indices.barclays/IM/21/en/indices/static/shiller.app
Slide 12	**China – Crossing Over** https://cebr.com/reports/world-economic-league-table-2021/ https://www.china-briefing.com/ https://research.gs.com/ https://www.worldbank.org/en/publication/global-economic-prospects
Slide 13	**Commodity Cycle – Cyclical or Secular?** Bloomberg terminal https://research.gs.com/
Slide 14	**Mean Reversion Dashboard** Bloomberg terminal
Slide 15	**Economic Dashboard** Bloomberg terminal