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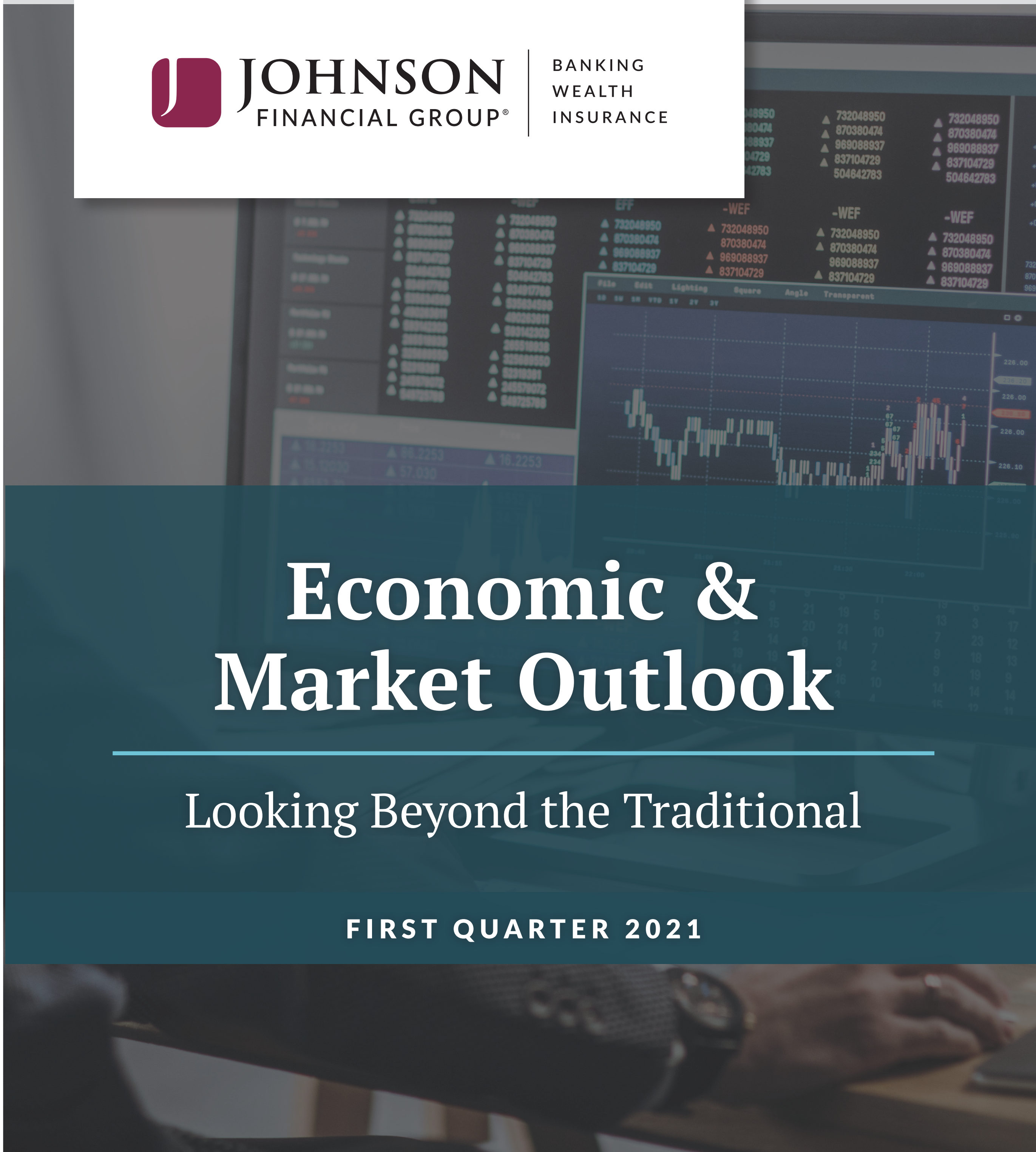

Economic & Market Outlook

Looking Beyond the Traditional

FIRST QUARTER 2021

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Executive Summary

In a year that offered a pandemic and an election as reasons for investors to bail on risky assets, 2020 turned out to be a great year for those that stayed the course. A 60/40 portfolio of diversified stocks and bonds increased by a double-digit percentage, exceeding what would be expected on a historical basis even without a pandemic crippling the global economy.

Looking through the asset classes shown in [Exhibit 1], one would be hard pressed to find "doom and gloom" in returns for the most recent quarter or the full year. Even real estate and commodities bounced back in the fourth quarter. Most dramatically—and most optimistically—small caps' fourth-quarter performance catapulted them in front of large caps for the year taken as a whole.

As we look forward to 2021, we see a favorable backdrop for markets. We expect a synchronized recovery in the global economy, sales and earnings are expected to grow in all sectors and monetary and fiscal policy are expected to remain supportive. However, markets reflect a lot of this good news already, so returns in 2021 may not keep up with the improvement in the economy as prices tend to reflect future data with a six to nine-month lead time.

Looking longer term, investors are facing a challenging investment environment. Intermediate-term bonds are yielding about 1% and stocks trade at valuations that imply low to mid-single-digit annual returns over the next 10 years. As a result, investors are looking beyond the traditional 60/40 stock/bond portfolio to successfully meet their income and return goals.

Looking Beyond the Traditional 60/40 Portfolio

- Allocate to complementary investments as substitutes for bonds and/or stocks to manage risk and/or enhance returns.
- When the risk is justified, tactically allocate to non-traditional bond strategies such as high yield and emerging market bonds, which offer the opportunity for higher returns.
- Employ opportunistic portfolio rebalancing to capture gains in stocks when sentiment runs hot, so portfolios have the capacity to reinvest when pessimism returns.
- Stress-test estate plans and financial plans for the below-average returns that may occur over the next 10-15 years.

Economy

- While we expect a bumpy start given the high level of virus cases, consensus expects 4% real GDP growth in 2021. Upside of 6% may be possible with the recently passed stimulus package and a successful rollout of the vaccine.
- Problems with the vaccine rollout, dramatic changes in taxes or government regulation, and geopolitical turmoil are just a sample of issues that could impact the recovery.

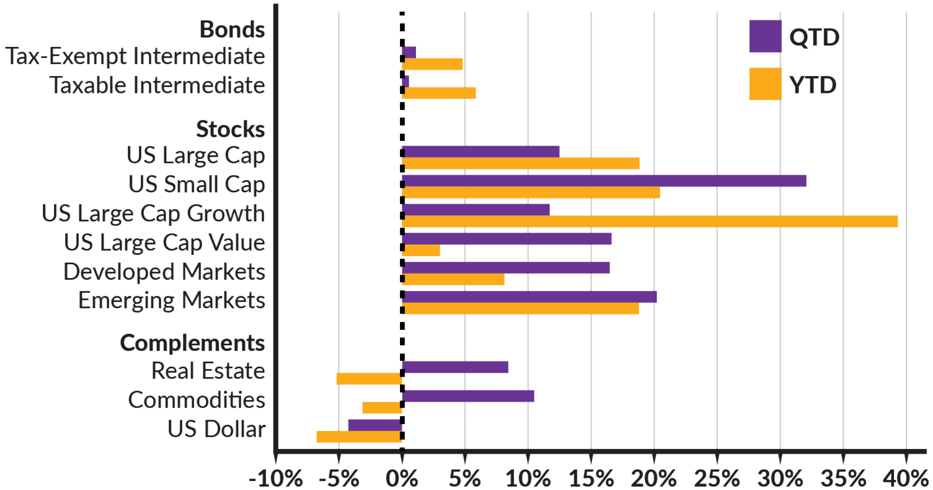
Politics

- The immediate focus of the Biden administration will be on addressing the pandemic: the rollout of vaccines, nationwide mask policies, and additional assistance to aid the economic recovery.
- With Democratic control of all branches of government we can expect higher taxes, infrastructure spending focused on green initiatives and drug price regulation. However, the magnitude of change may be limited given a slim majority.

Exhibit 1

3 Month & Year-to-Date Performance

As of December 31, 2020



Index List: Tax-Exempt Intermediate: ICE BofAML 2-12 US Muni Index, Taxable Intermediate: BBgBarc US Ag Intermediate Index, U.S. Large Cap: S&P 500 Index, U.S. Small Cap: Russell 2000 Index, U.S. Large Cap Growth: Russell 1000 Growth Index, U.s. Large Cap Value: Russell 1000 Value Index, Developed Markets: MSCI EAFE Index, Emerging Markets: MSCI Emerging Markets Index, Real Estate: FTSE NAREIT All Equity REIT Index, Commodities: Bloomberg Commodity Index, U.S. Dollar: U.S. Dollar Index.

Source: Morningstar Direct

Equities

- We expect positive returns from stocks in 2021, but gains will not likely keep up with expected earnings growth, which has risen to 23%, as sentiment and prices have shifted from a cautious to an optimistic outlook.
- We expect the cyclical market leadership that started in the fourth quarter to continue into 2021. However, we do not expect the performance gap between sectors to be as wide as in 2020.
- While we have an overweight to cyclical sectors, we believe that it is important to stay diversified. A setback to the recovery could lead to a rapid change in leadership back to defensive or "stay at home" stocks.

Fixed Income

- Return expectations should be tempered as we expect interest rates and inflation to move higher in 2021. However, we expect no hikes from the Federal Reserve until late 2022 at the earliest.
- The positive economic backdrop favors corporate bonds and non-traditional fixed income investments like emerging market bonds.
- While yields are low, bonds still have a place in the portfolio as a ballast when risk markets decline.

We expect a synchronized recovery in the global economy, sales & earnings are expected to grow in all sectors and monetary & fiscal policy are expected to remain supportive.

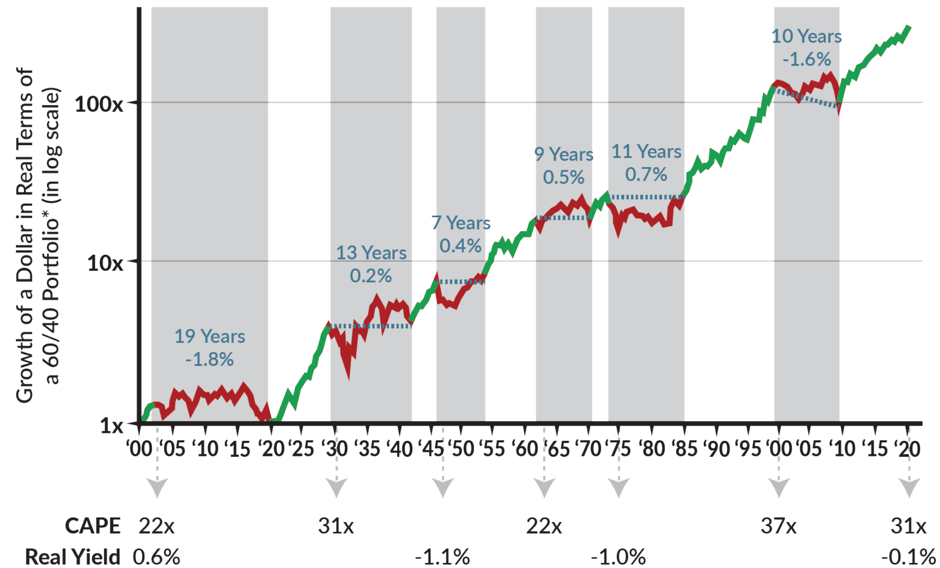
Looking Beyond The Traditional

Much has been written in recent years about the death of the traditional 60/40 stock/bond portfolio. The rationale for the 60/40 portfolio is that it has historically produced a reliable stream of income and a mid to upper-single-digit total return with a moderate level of risk that most investors could stomach.

Unfortunately, we are facing an environment in which the yield on bonds is near 1%, far from the 5% level seen just 15 years ago, and the valuation on stocks implies low to mid-single digit average annual returns over the next 10 years as opposed to the long-term average of 10%.

Exhibit 2

The 60/40 Lost Decades
1900-2020



*60% U.S. Equities (S&P 500), 40% U.S. Bonds (U.S. Treasuries) rebalanced monthly. Past performance is not indicative of future results.

Source: As of 9/30/20 GMO, Bloomberg, Global Financial Data (early history), Factset, J.P. Morgan, Shiller data; real yields are the yield on the 10-Year U.S. Treasury minus the 12-month trailing CPI.

[Exhibit 2] illustrates the "lost decades" in which investors have endured long periods with flat returns. These periods started with high valuations in the stock market (CAPE = Cyclically Adjusted Price Earnings ratio) and/or low real yields in the bond market (Real Yield = Nominal Yield minus the rate of inflation).

Complements: The Fourth Asset Class

While there are some things that can be done within the equity and fixed income sleeves of the portfolio to boost returns or manage risk, we believe we can get the biggest impact by adding alternative assets to portfolios when appropriate. We also refer to alternatives as "complements" due to their attractive risk/reward characteristics that can provide diversified sources of return or yield to complement a traditional stock/bond portfolio.

There is a wide range of alternative assets to consider, each with its own benefits and risks. At a high level, alternative investment options include real estate, commodities (including precious metals), private equity, hedge funds, and private credit. Alternative assets can be broadly grouped into "diversifiers" and "return enhancers" and can be accessed via the public markets (i.e., mutual funds) as well as private placements. [Exhibit 3] summarizes the benefits of various alternative asset classes.

The amount to allocate to alternatives depends on several factors, including the investment objective, time horizon, and the ability to tolerate the lower liquidity that characterizes some of them. In the first quarter of 2020, we increased our recommended allocation to complements from 10% to 15%, based on an optimization analysis of forward-looking capital market assumptions.

The 15% allocation is funded one-third from the equity allocation and two-thirds from the fixed income allocation. The primary driver behind the increase was the Federal Reserve policy to lower interest rates in response to the pandemic's effect on the economy.

Exhibit 3

Benefits of Alternative Asset Classes

	Diversifiers		Return Enhancers	
	Hedge Funds	Real Assets	Private Credit	Private Equity
Description	Various strategies including long/short investing in public markets	Private investments in real estate, transportation and infrastructure	Providing borrowers with capital in various forms	Investing in private companies
Portfolio Diversification	✓	✓		
Volatility Mitigation	✓	✓		
Current Yield		✓	✓	
Inflation Protection		✓	✓	
Return Enhancement			✓	✓

Source: JP Morgan Asset Management

The following four investment strategies comprise the 15% allocation when employing publicly traded funds:

2% Private Credit – We added a publicly traded business development company (BDC) in July. BDCs lend money to middle-market companies with a floating interest rate at a spread of 500 to 800 basis points above a short-term index such as LIBOR. These loans are generally secured and have taken the place of traditional bank lending recently. The current yield on this investment is approximately 9.5%, which is paid quarterly. We view private credit as an alternative to traditional fixed income.

3% Real Estate – We are currently using two real estate funds. One invests solely in real estate investment trusts (REITs), and the other is a mutual fund invested in a mix of private real estate and REITs. The types of real estate properties include apartments, office, industrial, retail and self-storage. In addition to appreciation potential, the other main attraction of real estate is income. The annual income from real estate investing ranges between 2% and 6% today. We view real estate as a hybrid of equity and fixed income investments, with less volatility than equity and similar income as investment grade bonds.

3% Real Assets – Real assets include infrastructure (toll roads, communication towers, renewable power and utilities), commodities, farmland and timberland. Real asset investments generally have an income component that is tied to an inflation escalator, which can provide downside protection in the event of higher inflation. We view real assets primarily as a diversifier of risk when added to a traditional investment portfolio.

7% Hedge Funds – We are using a global macro fund focused on trading "volatility" in the public equity and currency markets. The fund is expected to generate positive returns in all market environments and protect capital in highly volatile times. In March of 2020, when the economies around the world were shutting down to combat the virus spread, this fund returned +7%, compared to equity returns of -10% to -20%. The fund has historically exhibited little correlation to either the equity or fixed income markets. For this reason, we view the fund primarily as a risk diversifier.

Please contact your Johnson Financial Group advisor for information on "private" alternative investments.

Economic Outlook

While the global economy will get off to a bumpy start given the increase in virus cases, the latest fiscal stimulus package should provide the "shot in the arm" that the U.S. economy needs to weather the remainder of the COVID-19 storm. The combination of stimulus checks, additional unemployment benefits, and small business support come as the vaccine is on the front end of widespread distribution.

Real GDP is expected to decline -3.5% in 2020 and rebound in 2021 with growth near 4%. While estimates vary, the approximate boost to GDP in 2021 from the roughly $900 billion fiscal stimulus package is in the 2.5% range. Assuming a successful rollout of the vaccine through the first half of 2021, GDP may grow nearly 6%, which would represent the strongest annual economic recovery in four decades [Exhibit 4].

The combination of COVID-related shutdowns and the series of stimulus packages has significantly impacted the personal savings rate in the U.S., which has already soared to over 13% at the end of 2020 [Exhibit 5]. The latest package is expected to push that figure even higher, to the 16% range. To put this into perspective, this is the highest personal savings rate in the country since World War II. A higher savings rate is a sign that consumers can weather the storm, and in this case it may indicate pent-up demand to spend in the second half of the year.

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Exhibit 4

U.S. Real GDP

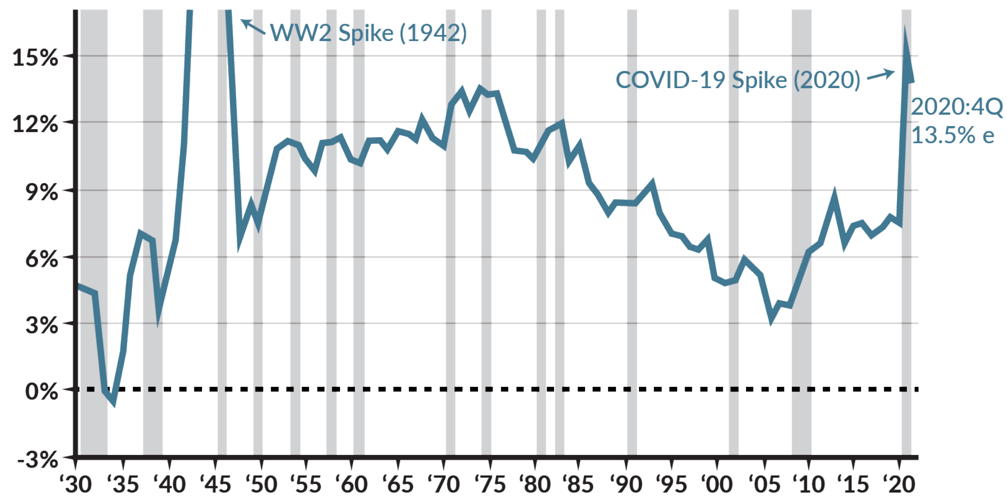
2021	1Q e	2Q e	3Q e	4Q e
Q/Q % A.R.	5.0%	7.0%	6.0%	6.0%
Y/Y%	0.6%	12.5%	6.2%	6.0%

Source: Cornerstone Macro

Exhibit 5

U.S. Saving Rate

December 2020: 16.0% expected

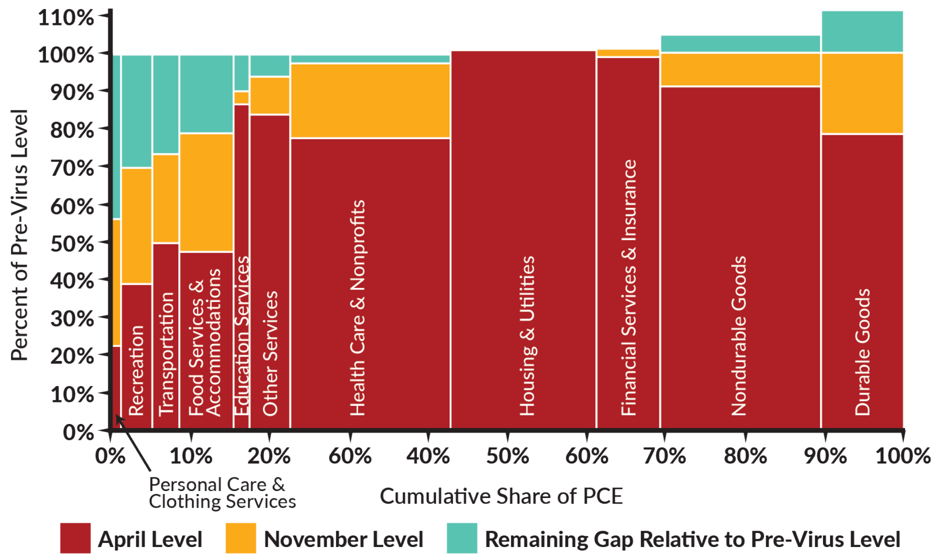


Source: Cornerstone Macro

Exhibit 6

Consumption By Sector During Pandemic

Still a gap to get back to pre-virus levels

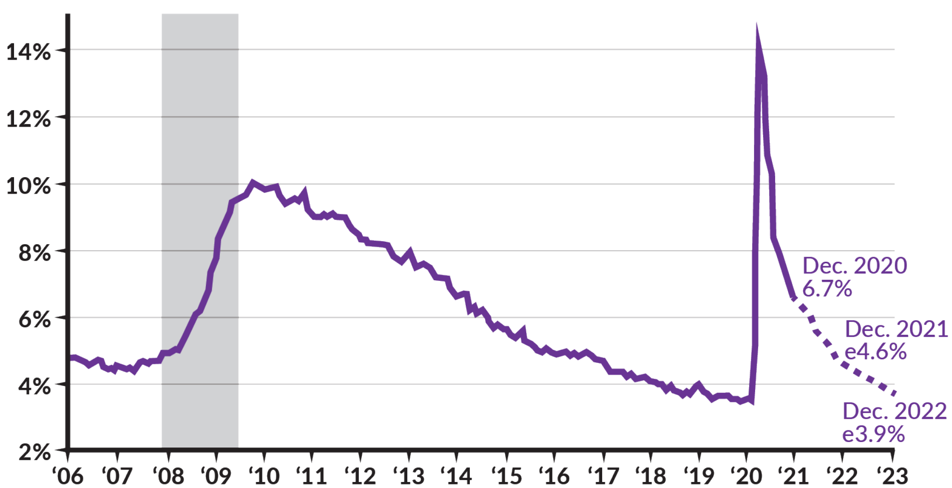


Source: Bureau of Economic Analysis, Goldman Sachs Global Investment Research

Exhibit 7

U.S. Unemployment Rate

December 6.7%



Source: Cornerstone Macro

The clear beneficiary of this savings "cushion" will be those sectors of the economy that have been most effected by the COVID shutdowns. [Exhibit 6] illustrates the level of consumption in April, the rebound as of November and the remaining gap to get back to pre-virus levels. Transportation, food service and recreation are among those sectors that are still tracking well below pre-virus levels in terms of consumer spending. The expected rebounds in these virus-sensitive areas are a key driver to the strong expected growth in GDP in 2021.

For the recovery to be sustained, the job market needs to recover as well. The December unemployment rate in the U.S. stands at 6.7%, which by historic standards represents a very fast recovery from the peak level in early 2020 near 15% [Exhibit 7]. At this point in the recovery, it appears that much of the early layoffs are temporary in nature, and labor demand has already strengthened significantly. When considering the expected recovery in the most virus-sensitive sectors, the labor market could return to pre-virus levels much faster than would have been anticipated earlier this year.

The unemployment rate is also important to monitor because it is one of the key metrics the Federal Reserve will use to determine the timing of future rate hikes. The Federal Reserve has communicated it wants to see a full recovery before raising rates, which would put the first rate hike in late 2022 or 2023 at the earliest.

While the base case is that the economy is poised for a strong recovery in 2021, there are, as always, risks to the outlook. Problems with the vaccine rollout are of primary concern given the direct impact on economic growth. Dramatic changes in taxes or government regulation and geopolitical turmoil are other risks we are monitoring. For now, we're optimistic that better times are ahead following the unprecedented experiences of 2020.

Politics

New Administration, New Legislative Priorities

The election of Joe Biden as the 46th President of the United States will bring new legislative priorities to Washington. While different policy agendas can impact the investment landscape, history shows that over the long term, market performance is not closely correlated with the political party in control of the White House. Throughout history, companies have had to navigate through regulatory and legislative changes under various political mixes and have still managed to grow and post share price gains.

Investors often look to the policy agenda of an incoming administration to try to identify which segments of the market will perform the best. President Trump's recent term is a good reminder of the challenges of making forecasts based solely on this metric.

With the rollback of regulations in the energy and financial sectors, these were market sectors that were perceived to be the biggest beneficiaries of a Trump Administration, whereas they ultimately proved to be two of the worst sectors over the past four years as falling interest rates and low oil prices proved to be more important. This is a good reminder that political leadership is only one of many factors that impact financial market performance.

The immediate focus of the Biden Administration will be on addressing the pandemic: the rollout of vaccines, nationwide mask policies, and additional assistance to aid the economic recovery. The first item on the legislative agenda will likely be an infrastructure bill, which could potentially be attached to additional economic stimulus to aid in the recovery from the pandemic. Ultimately, the Biden agenda includes more support for the Affordable Care Act (ACA), clean energy subsidies, increased payments to low income Americans, efforts to control prescription drug prices and higher taxes to partially offset the spending. [Exhibit 8] summarizes Biden's potential policy priorities.

While tax increases are part of Biden's policy agenda, significant tax rate increases are unlikely given the tight margin in the Senate including a number of relatively moderate Democrats who would likely oppose Biden's more progressive proposals. The Biden Administration would like to reverse the changes from the Tax Cut and Jobs Act (TCJA), which are set to expire in 2025. The corporate income tax rate, which was reduced from 35% to 21%, may be raised to 25% or 28%. Individual tax increases will be targeted toward upper-income taxpayers. For example, the top marginal rate could move back to 39.6% from the current 37% level. Additionally, capital gains taxes may increase, though it is not expected that they would be retroactive to the beginning of the year.

Major changes to health care policy are unlikely, with Biden looking to build upon the Affordable Care Act (ACA). It may be challenging to rebuild and expand the ACA given the makeup of Congress; however, the Biden Administration may be able to support the ACA without Congress by reinstating the budget for advertising and enrollment assistance, which would likely increase enrollment in the ACA exchanges. Drug price regulation has bipartisan support but may have near-term challenges given the pharmaceutical industry's strong response to the pandemic.

Financial stocks, which have been laggards, may see some upside as market participants have been comforted by the nomination of Janet Yellen for U.S. Treasury Secretary. This has been viewed as being far more market favorable relative to other potential rumored candidates such as Elizabeth Warren. Yellen has served as both the Chair of the Federal Reserve and the Chair of the White House Council of Economic Advisors. She has tended to advocate for more dovish policies and can play a key support role between the Treasury Department and the Fed as fiscal and monetary stimulus measures are developed.

Exhibit 8

Policy Options in 2021 & 2022

Policy Changes	Narrow Dem Sweep
Tax	Most of what Biden wants on individual side (but no payroll and less on cap gains and dividends), 25% corporate rate & double GILTI. No TCJA extensions.
Labor	Biden's broader labor agenda not possible. May seek bipartisan minimum wage deal. Executive actions for fed contracts, overtime & joint employer rules, etc.
Health Care	Expand ACA and onshoring drugs/PPE. No real chance of public option, but major drug price controls likely.
Antitrust	No changes in law, tech still under microscope from FTC & DOJ. More aggressive regulators confirmed.
Tech	Potential sec. 230 reforms (Twitter, Facebook, Google) and federal tech privacy law.
Traditional Energy	Targeted energy tax hikes (~$20bn) & regulatory actions to limit drilling, methane emissions, rejoin Paris, strict fuel efficiency standards.
Green Energy	Generous subsidies for green energy production, transportation, and homes. Carbon pricing considered.
Infrastructure	A bipartisan deal is possible, but something as high as $1 trillion infrastructure package done in reconciliation (like HR 2), with most of the money not going to traditional infrastructure.
Safety Net	Federalize UI & boost automatic stabilizers, create paid leave program, big refundable credit expansions (CTCEITC) possible.
Education	Executive action to forgive student loans. More funds for HBCUs and public schools.

Source: Cornerstone Macro

We expect a more multilateral approach to foreign policy under a Biden administration with more globalization, not less. This will provide a rebound to global trade, potentially buoying international markets. We expect a commitment to rejoining the Paris Climate Accord agreement and more engagement with the World Trade Organization and United Nations. Defense spending may remain flat with a greater emphasis on diplomacy.

Candidate Biden's more progressive policies are unlikely to move forward with such narrow control of the Senate. With the makeup of Congress potentially constraining major fiscal initiatives, the Biden Administration may turn to the use of executive orders and regulatory policy to advance its goals. This approach will have a more modest impact.

While we are watching political developments, it is important to remember that stock market performance has historically been relatively consistent across different mixes of political leadership. Making long-term allocation changes based on the outcome of any single election is not advised. We remain focused on the long-term strategies that provide the best likelihood of successful client outcomes while also remaining nimble enough to make any adjustments to portfolio positioning that may be warranted.

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Equity Markets

Markets ≠ Economy

Equity returns in 2020 serve as a good reminder that returns in the stock market do not equal the growth rate of the economy. U.S. equities increased 18%, which is in stark contrast to the -3.5% contraction forecast for the U.S. economy. The disconnect can be traced to the actions of the central banks, governments and the healthcare industry, which helped build investor confidence. These actions allowed investors to look beyond the pandemic and erase the 34% plunge in the S&P 500 within six months.

Reflecting on the stock market in 2020, the year can be broken into four phases that closely match the calendar quarters [Exhibit 9]. Leadership changed based on the outlook and risks at hand. Thanks to the discovery of vaccines, we expect a broader variety of stock sectors to lead in 2021 rather than the narrow group of "stay at home" winners that led in 2020.

1Q | Economic Shutdown: all risk assets declined with defensive sectors fairing best

2Q | Policy Response: all risk assets increased led by the hardest hit sectors

3Q | Restricted Reopening: "stay at home" winners emerged

4Q | Vaccine Announcements: cyclicals staged a comeback

Exhibit 9

S&P 500 Index Total Return

S&P 500 Sectors	1Q20	2Q20	3Q20	4Q20	2020 YTD
Consumer Discretionary	-19.3%	32.9%	15.1%	8.0%	33.3%
Financials	-31.9%	12.2%	4.5%	23.2%	-1.7%
Health Care	-12.7%	13.6%	5.9%	8.0%	13.5%
Technology	-11.9%	30.5%	12.0%	11.8%	43.9%
Consumer Staples	-12.7%	8.1%	10.4%	6.4%	10.8%
Industrials	-27.1%	17.0%	12.5%	15.7%	11.1%
Materials	-26.1%	26.0%	13.3%	14.5%	20.7%
Energy	-50.5%	30.5%	-19.7%	27.8%	-33.7%
Utilities	-13.5%	2.7%	6.1%	6.5%	0.5%
Real Estates	-19.2%	13.2%	1.9%	4.9%	-2.2%
Communications	-17.0%	20.0%	8.9%	13.8%	23.6%
Index Total Return	**-19.6%**	**20.5%**	**8.9%**	**12.2%**	**18.4%**

Source: Morningstar Direct as of 12.31.20

Earnings Rebound on the Horizon

The outlook for stocks in 2021 is supported by expectations of a globally synchronized economic recovery and a continuation of monetary and fiscal support. Earnings are expected to follow suit and surpass pre-pandemic levels by the end of 2021, with potential further upside if newfound efficiencies prove durable.

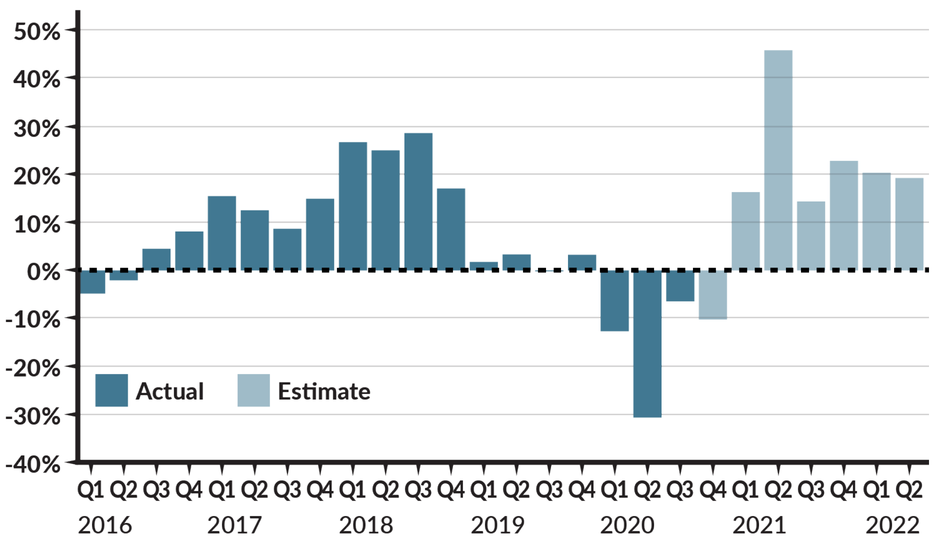
While earnings for the S&P 500 are expected to increase 23% in 2021, stocks are unlikely to keep pace as today's prices already incorporate much of this good news with stocks tending to anticipate future data with a six to nine-month lead time. For example, in 2020 stock prices gained 18% despite earnings declining -15%, and in 2018 stocks fell 6% despite a 23% increase in earnings [Exhibit 10].

While the "stay at home" stocks led the Technology (Apple, Microsoft), Consumer Discretionary (Amazon) and Communications (Alphabet, Facebook, Netflix) sectors in 2020, we expect returns to be more evenly distributed in 2021.

With only four of the 11 S&P 500 sectors posting positive earnings growth in 2020, all 11 sectors are expected to grow earnings in 2021 [Exhibit 11]. The Energy, Industrials, Materials and Financial sectors are expected to report large earnings rebounds from depressed levels, which we expect will balance the enthusiasm investors have shown for the secular disruptors within technology that drove markets in 2020. Given their exposure to more economically sensitive sectors, a market led by cyclical sectors is expected to benefit international and value style strategies relative to defensive and growth strategies.

Exhibit 10

S&P 500 Operating Earnings Growth



Source: I/B/E/S data from Refinitiv as of 12.29.20

A Note of Caution

We expect stock prices will be higher in 2021. However, sentiment has moved from cautious to optimistic, as reflected by the large gains in the fourth quarter. As a result, stock prices will not likely keep pace with the 23% earnings growth expected. Bullish sentiment also

Exhibit 11

Estimated Earnings Growth

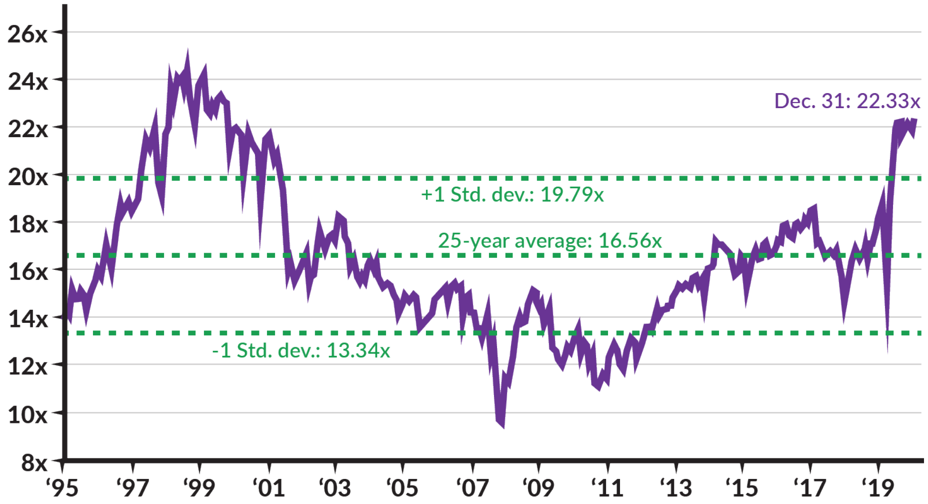
S&P 500 Sectors	2020 e	2021 e
Consumer Discretionary	-34.8%	61.2%
Financials	-24.2%	21.3%
Health Care	7.3%	11.6%
Technology	6.6%	14.4%
Consumer Staples	2.1%	6.4%
Industrials	-55.3%	81.8%
Materials	-9.7%	30.9%
Energy	-108.2%	668.3%
Utilities	1.5%	4.8%
Real Estates	-11.2%	7.8%
Communications	-6.8%	15.9%
Index Total Return	**-15.3%**	**23.3%**

Source: I/B/E/S data from Refinitiv as of 12.29.20

Exhibit 12

S&P 500 Index

Forward PE Ratio

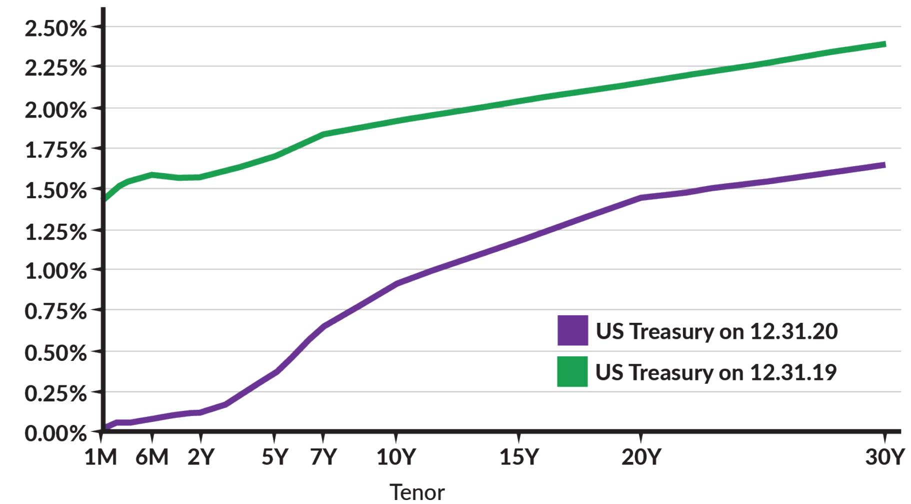


Source: FactSet, FRB, Thomson Reuters, JP Morgan Asset Management 12.31.20

Exhibit 13

U.S. Treasury Rates

Steeper Yield Curve as Treasury Rates Declined



Source: Bloomberg; U.S. Treasury Yield Curve as of 12.31.19 and 12.31.20

sets the stage for a market decline should we get a disappointment on the vaccine rollout, earnings or a change from the Biden Administration. While we are always monitoring the risks, we expect a multi-year growth cycle, which will make corrections attractive buying opportunities similar to the selloff ahead of the U.S. election in late October.

The valuation level of the S&P 500 Index has climbed to 22x forward 12-month earnings, which is high compared to the 16x average over the past 25 years [Exhibit 12]. This valuation level suggests that returns expectations should be in the low to mid-single digits over the next 10 years. While a 3-5% return may look not be as attractive as the long-term average of 10%, it does look more attractive than a bond paying 1% for investors willing to stomach the higher level of risk.

Sentiment has moved from cautious to optimistic, as reflected by the large gains in the fourth quarter.

Fixed Income

Unexpected Bounty

Bond investors received an unexpected bounty in 2020 as the Federal Reserve cut the federal funds rate to a range of 0-0.25% and dramatically increased the size of its balance sheet through bond purchases designed to combat the economic effects of the pandemic.

On December 31, 2019 the yield on a 1-month T-Bill, a near proxy for cash, was nearly 1.5%, roughly 0.50% greater than the 10-year Treasury yield as we begin 2021. Today, investor cash earns close to zero while yields have dropped across the entire Treasury curve [Exhibit 13]. Short-term rates fell more than long-term rates in 2020, leaving the yield curve steeper than it began the year and requiring investors to lend for longer terms or look beyond the safety of government bonds to achieve their income objectives.

After widening dramatically in March, credit spreads narrowed through the remainder of the year as investor fears were allayed by Fed intervention and fiscal stimulus. Investment grade corporate bond yields shot to over 4% and high yield issues briefly exceeded 10% before finishing the year lower than where they began [Exhibit 14]. Indeed, although the excess yield of corporate bonds versus Treasury bonds remains higher than pre-pandemic, total yields are already at or near all-time lows.

Bond prices rise as yields fall, and this translated into strong total returns in excess of coupon income. The Bloomberg Barclay's Intermediate Aggregate Index rose 5.6%, and tax-exempt municipal bonds gained 4.6% thanks largely to a year-end rally as areas of the municipal market most affected by the pandemic saw increased investor appetite.

Emerging market debt and high yield bonds also performed well, but the greatest rewards were reaped by opportunistic investors. We added to both sectors while spreads were historically wide and benefited from price increases as markets recovered. More recently, we pared our exposure to below investment grade issues, taking profits as valuations grew less compelling.

Investment grade corporate bond yields shot to over 4% and high yield issues briefly exceeded 10% before finishing the year lower than where they began.

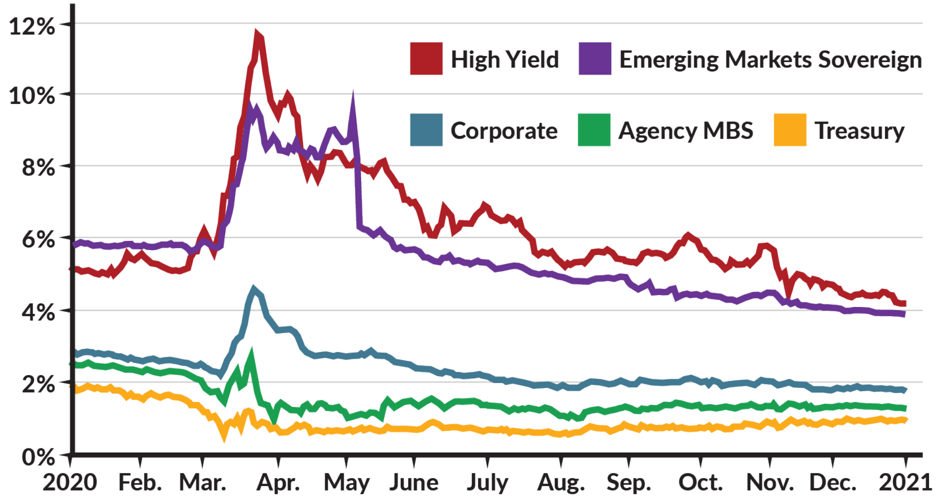
Bond Math

2021 looks more challenging. Our fair value model suggests that the 10-year Treasury yield should trade in a range of 0.30%-1.30%; however, we think GDP growth could surprise to the upside as additional fiscal stimulus makes its way through the economy and a broader vaccine rollout brings more people back into the workforce.

A recovering economy could see the yield curve steepen further as growth and inflation expectations rise and push long-term yields up even as Fed policy keeps short-term rates near zero. We see limited upside to bond prices in this scenario, although we

Exhibit 14

Bond Yields are Lower



Source: Bloomberg; Bloomberg Barclays U.S. Index Yields through 12.31.20

believe rate hikes remain years into the future, limiting the scope for interest rates to rise dramatically. A 10-year Treasury yield at the top end of our fair value range, 0.80%-1.30%, is consistent with this outlook.

We believe corporate credit remains relatively attractive even as yields are somewhat less compelling following strong recent performance, and we continue to favor emerging market debt due to higher yields relative to other fixed-income sectors and a favorable long-term outlook.

The challenge for fixed-income investors today is simple bond math. Bond returns are primarily a function of coupon income, or yield, and changes in interest rates. Low starting yields limit the income stream provided by bonds and its ability to offset the negative bond price impact of a rise in interest rates. And since the Fed has so far shown no appetite for implementing European-style negative policy rates, interest rates have little room to fall before reaching zero. In this environment, we believe it is important to emphasize capital preservation rather than reaching for yield, while seeking to add to returns by investing opportunistically.

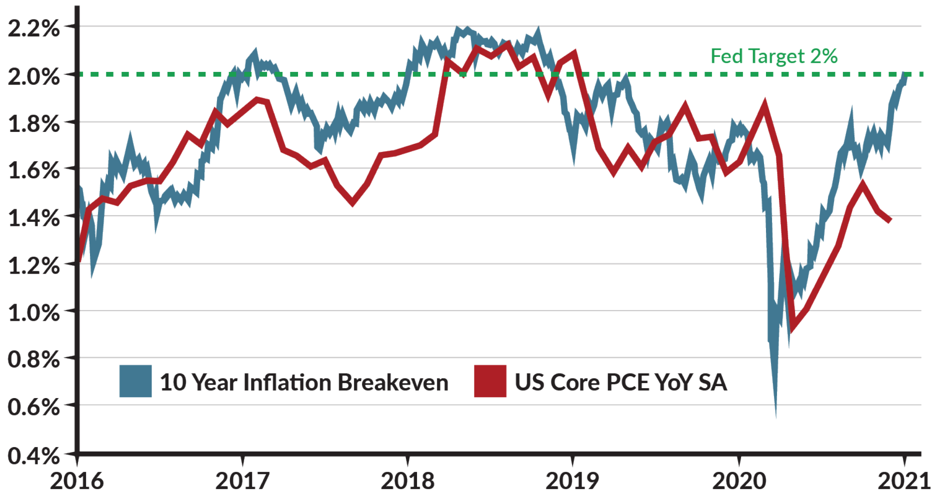
Invisible Enemies

COVID-19 has been one of the most destructive invisible enemies in modern history, but wise investors have long understood that the invisible enemy of inflation is one of the most insidious impediments to wealth accumulation. The gradual loss of purchasing power from higher inflation is scary not only to senior citizens on a fixed income but also to younger investors saving for college, a house, or simply a better future. With government spending exploding in response to the pandemic, it is no wonder that inflation is on investors' minds.

[Exhibit 15] plots the 10-year breakeven inflation rate, which reflects market participants' inflation expectations over the next 10 years, compared to actual reported inflation as measured by the year over year change in Core PCE, the Fed's preferred measure of inflation in the economy. The market has just begun to project inflation above the Fed's 2% target after forecasting materially lower inflation over the past two years. Our view is that while inflation is likely to rise early in the year, it is likely to moderate in the second half of 2021, and Fed action to combat temporary inflation is unlikely this year.

Exhibit 15

Reported Inflation Expected to Rise



Source: Bloomberg; U.S. Treasury Inflation-Protected Securities (TIPS) breakeven inflation through 12.31.20; Fed's preferred inflation measure, U.S. Core PCE, through 11.30.20; consensus estimate of 2020 Q4 U.S. Core PCE is 1.5%

Investors must recognize that we are in a new age where income is likely to remain scarce and future fixed-income returns are unlikely to bear much resemblance to the past.

Reported inflation will likely rise to the Fed's 2% average target in the first half of 2021 due to comparisons with sharply negative inflation in March and April 2020. However, with GDP still well below both pre-pandemic levels and levels that are consistent with the economy's full potential, inflationary pressures should remain subdued.

With the Fed's adoption of average inflation targeting in August 2019, and its December pledge to maintain its current level of asset purchases until "substantial further progress" has been made in achieving both its inflation target and maximum employment, we see little chance that the Fed takes its foot off the gas in 2021, which should help limit the rise in bond yields.

Past Performance and Future Returns

Every investor has seen the disclaimer "Past Performance Is No Guarantee of Future Results." And yet, for most of us, we invest in stocks and bonds because we expect the future to at least resemble the growth and income that financial markets have bestowed upon disciplined investors for generations.

Over the past 40 years, bond investors have enjoyed a tailwind of high and declining interest rates that produced a profitable combination of coupon income and price appreciation (bond prices rise as their yields decline). But with 10-year Treasury yields having declined from over 15% in the early 1980's to 1% today, investors must recognize that we are in a new age where income is likely to remain scarce and future fixed-income returns are unlikely to bear much resemblance to the past.

Does this challenged outlook mean that investors should jettison bonds from their portfolios altogether? We don't think so.

Bonds serve two main roles in investor portfolios: income generation and risk management. While the income portion of that equation is increasingly challenged, 2020 showed that bonds continued to provide a source of stability amid extreme equity market volatility. [Exhibit 16] shows that when the S&P 500 index plummeted 30% in March, an index composed of U.S. Government bonds and investment-grade corporate bonds held its value, and in fact increased.

To be sure this reflects the Fed intervention we have already noted, but it also demonstrates that investors still view high quality bonds as a haven during equity market stress.

Investors should not eschew bonds then but recognize that achieving the fixed income returns of yesteryear is not possible in today's low-rate world without some tradeoffs. Income investors will need to consider niche areas of the fixed income markets or consider alternative asset classes and private markets to meet those objectives, while total return investors will need to be nimble and responsive to market dislocation that may only last days.

Conclusion

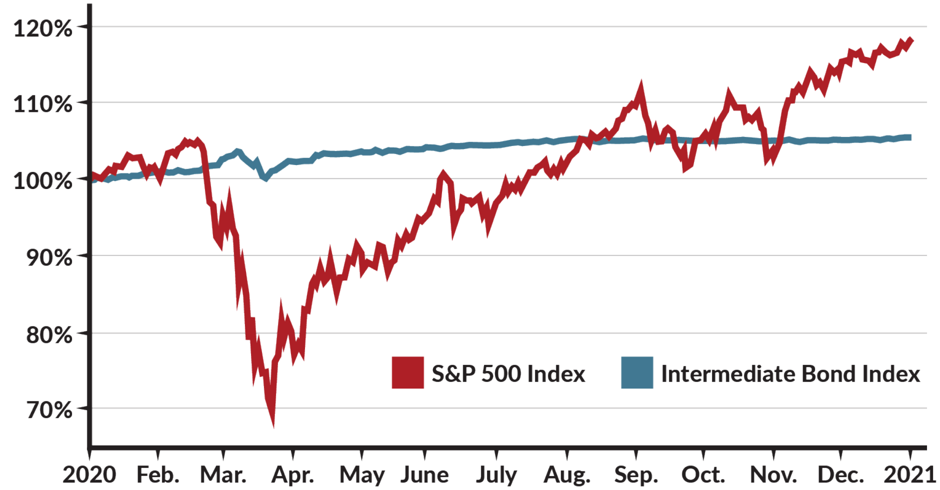
Not one of us has ever experienced a year like 2020—and surely there is no one who wants to repeat it. Yet from the standpoint of markets, 2020 was a "good" or even "great" year.

So, from an investment standpoint, 2020 stands as a touchstone year in illustrating the importance of charting a risk-aware course and staying with it. As we welcome the promise and challenges of a new year, that's one lesson to keep front of mind.

Strategies may change over time—such as through enhancements to a traditional 60/40 allocation. What doesn't change is our focus on helping clients achieve long-term success. We thank you for the privilege of joining you on that journey.

Exhibit 16

Bonds Continue to Offer Diversification



Source: Bloomberg; Bloomberg Barclays U.S. Aggregate Intermediate Index as of 12.31.20