Grant Street Asset Management, Inc.

INVESTMENT ADVISORS

GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
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As the rollout of COVID vaccinations spread around the globe in the second quarter, economic activity roared back to life, and consumers and business eagerly returned to business as usual. At long last, restaurants reopened, airports were packed, and we even saw the first cruise ship in a year set sail from American shores at the end of June. All these positive developments have resulted in a U.S. economy that has rebounded and now exceeded pre-pandemic GDP levels. While there are risks on the horizon that we will address later in this letter, the U.S. and rest of the world appear poised for continued momentum and solid economic growth in the second half of 2021.

The $1.9 trillion stimulus package passed in the U.S. at the end of the first quarter was widely expected to benefit consumer spending and investment/financial assets, and we have seen evidence of that occurring. Consumer spending surged in April with a 0.9% increase over the month of March. Although spending in May was flat, economists attribute that to the shortage in supply of certain consumer goods (autos or consumer electronics) and expect this to be temporary. Once supply chain kinks are smoothed over, we expect consumer spending to continue with above average growth. Adding momentum to that spending will be the new child tax credits set to begin in July, a high savings rate among consumers over the past year, and pent-up demand for goods and services set aside for much of 2020.

As for financial assets, equity exchange-traded funds (ETFs) were also the recipient of some of the dollars looking for a home in the second quarter. Investors added $66.5 billion to their U.S.-listed ETF holdings just during the month of May, bringing year-to-date inflows up to $394.8 billion—well ahead of the $121.1 billion seen at this same time a year ago. As a result of these strong flows during the second quarter, major domestic and international equity markets saw additional growth, including an impressive rally back from the tech sector and continued preference for large cap U.S. stocks as can be seen in the performance table below.

Equity Index	1Q 2021	2Q 2021	Year-to-Date
S&P 500 (Large Companies)	6.2%	8.6%	15.3%
Nasdaq 100 (Technology-heavy Growth Cos.)	1.8%	11.4%	13.3%
Russell 1000 Value (Large Value Cos.)	11.3%	5.2%	17.1%
S&P 400 (Mid-sized Cos.)	13.5%	3.6%	17.6%
Russell 2000 (Small-sized Cos.)	12.7%	4.3%	17.5%
MSCI EAFE (Europe, Australia & Far East)	3.5%	5.2%	8.8%
MSCI Emerging Markets	2.3%	5.1%	7.5%
MSCI ACWI (All Country World Index)	5.2%	7.2%	12.8%

Second quarter U.S. GDP is estimated to have grown over 10%, a truly historic figure. For the year, economists are forecasting 7% overall growth, nearly 3x the rate we have experienced over the past decade. In addition to strong consumer spending, local and federal government spending and a rebuilding of depleted inventories will fuel strong growth this year. U.S. manufacturing and service activity has also fully rebounded, and the rest of the world is following the U.S. lead as vaccines roll out at a delayed pace.

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A continued focus for investors over the last year has been the level of employment in the U.S., and this quarter was no exception. With significant vaccine penetration (over 150 million people fully immunized in U.S.) along with most lockdown restrictions being lifted, we have seen a flurry of consumer activity that has sent job openings soaring to meet the rebound in demand. Despite this, we saw mixed employment progress in the second quarter as both April & May nonfarm payrolls were below estimates (266K vs 1M for April and 559K vs 671K for May). However, June numbers were the strongest in over 10 months and exceeded expectations (850K vs 720K). We saw continued improvement across industries severely impacted from lockdowns, with leisure and hospitality alone making up 40% of the employment gains in June. In spite of recent gains, unemployment remains at 5.9%, nearly flat from the 1st quarter, and total employment remains 7.13 million jobs below pre-pandemic levels. There is room for continued improvement in U.S. employment.

Despite higher unemployment, a record 9.3 million job openings currently remain unfilled, and filling these roles is proving difficult. As a result, many businesses have begun to offer signing bonuses and/or raise wages to attract applicants and retain talent. In rapid fashion, wages have spiked 3.6% year over year, a significant increase which many refer to when citing concerns about overall inflation. We also believe enhanced unemployment benefits are a contributing factor to the recent spike in wage inflation, and this influence may continue.

The Federal Reserve continues to express its view that inflation will be transitory, but recent comments are beginning to hint otherwise. The Fed has suggested that it may begin to taper monthly bond purchases as early as 4Q2021 and may consider raising interest rates in late 2022 or early 2023. Tapering bond purchases would serve as an indirect method of pushing long-term treasury rates higher. The recent reference to tapering by the Fed marks a shift in sentiment that occurred after we saw the 13th straight month of increasing prices in the manufacturing sector and strong wage growth during the first half of the year. To be fair, commodity prices have moderated recently, most notably for lumber, which dropped 40% in the month of June. However, most commodities have not seen that volatility just yet, and the question remains how quickly supply chains will catch up to help ease inflation.

To that end, inflation expectations built into the fixed income markets appear to reflect a "wait and see" approach, as yields have fallen slightly in the quarter. The pull back in rates resulted in positive returns for fixed income in the second quarter.

Fixed Income Index	1Q 2021	2Q 2021	Year-to-Date
Bloomberg Barclays U.S. Aggregate Bond	-3.4%	1.8%	-1.6%
U.S. 10-year Treasury	-7.0%	3.0%	-4.1%
Bloomberg Barclays 1-3 yr. U.S. Treasury	-0.1%	0.0%	-0.1%
U.S. 3-month T-Bills	0.0%	0.0%	0.0%
Bloomberg Barclays U.S. Corp. High Yield	0.8%	2.7%	3.6%
Bloomberg Barclays Municipal Bond	-0.4%	1.4%	1.1%

One additional area of the economy worth commenting on is the white-hot housing market. Median home prices rose nearly 25% year over year in May. We believe there are a number of factors driving price increases: raw materials have increased dramatically (i.e., lumber), the work-from-home shift is changing where people live, low mortgage rates make borrowing affordable, and finally, the U.S. never fully reached sufficient supply levels following the 2008-2009 housing crisis. The U.S. was already operating in a tight supply market for housing before COVID-related factors came into play. While the recent surge in home values may feel uncomfortably like the period leading up to the housing correction of 2008-2009, we do not foresee a similar outcome. A primary difference today is that the consumer debt picture is much healthier and bank underwriting standards are much stricter. That said, we believe the Federal Reserve may consider the asset appreciation in housing as a factor in its rate decisions to avoid a significant asset bubble. An increase in rates may begin to slow the climb in prices by making borrowing more expensive. This is an area we are keeping a close watch on given how much housing impacts the consumer and therefore overall GDP growth trajectory.

With respect to portfolio positioning, we continue to be constructive on equities over the long term. We have observed that volatility has fallen back to pre-pandemic levels, suggesting investors may be starting to get complacent. We are overdue for a healthy 5-10% pullback within equities, and we would welcome that as a sign of a well-functioning market environment as equities are likely to climb higher from here. As such, we are looking for pockets of opportunity within the equity market at reasonable valuations and trimming back on those areas that are at historically high levels. Specific to equities, in the second quarter we completed searches for both the U.S. small cap core and emerging markets equity asset classes. In both cases, our research led us to the conclusion that dedicated actively managed strategies (i.e., not indexes) were appropriate for most clients given the relative inefficiencies of these markets. For clients holding fixed income, we remain focused on structuring investments that remain protective in a falling stock market, are resilient in a rising rate environment, and provide higher-than-inflation returns over time.

We believe equities will continue to be the growth engine within portfolios, and historically they have provided strong returns during periods of low and rising inflation. Even if the Federal Reserve begins to tighten markets earlier than expected, interest rates are likely to remain historically low for a period of time. Cash savings on the sidelines will not only forgo opportunity for returns, but those dollars will lose purchasing power as returns on cash and bonds are well below current inflation rates. We are having more conversations with clients on how to better leverage their cash-reserves savings in the current environment.

While the year ahead leaves us optimistic, we are closely monitoring fundamentals for signs of additional opportunity as well as risks on the horizon. As always, growing and preserving your wealth remains our primary objective, and we thank you for your trust and confidence in that effort.