GRANT STREET ASSET MANAGEMENT, INC.
QUARTERLY LETTER
1st QUARTER 2021
MARCH 31, 2021

We have now surpassed the one-year mark from when the world shut down as a result of COVID-19. Fortunately, the outlook for this year is much brighter, both economically and as we begin to return to more familiar ways of life. Vaccine doses have rolled out globally, with over 165 million doses provided in the U.S., 138 million in China, and 115 million in Europe/U.K. so far this year. While we have not yet reached herd immunity levels, and we have some learning to do regarding the longevity of the vaccines' protections, we expect the success or failure of each nation's vaccination rollout will make or break their economic recovery over the next 12-24 months.

To that end, the U.S. recovery looks promising, and it appears that all Americans wishing to receive the vaccine will be able to do so within weeks. Consumer and business optimism has been further supported with yet another round of fiscal stimulus. With the recent passing of the $1.9 trillion dollar package, the U.S. government has now dedicated over $5 trillion to propping up the U.S. economy during this unusual time. There is no question that government aid was required on some level to avoid a much more significant and dire recession, but there is some political controversy around this level of spending and whether it may have some unintended long-term consequences we do not yet understand. However, in the short-term, investors have welcomed the stimulus. Equity markets have rewarded, and economic data has improved dramatically. It is worth noting that the technology-heavy Nasdaq that has dominated returns over the past several years has paused its outperformance in the first quarter of 2021. We believe this is due to both the recent rise in interest rates as well as full valuations following years of strong performance from these stocks.

Equity Index	**1Q 2021**	**2020**
S&P 500 (Large Companies)	6.2%	18.4%
Nasdaq (Technology-heavy)	1.8%	48.9%
S&P 400 (Mid-sized Companies)	13.5%	13.7%
Russell 2000 (Small-sized Companies)	12.7%	20.0%
MSCI EAFE (Europe, Australia & Far East)	3.5%	7.8%
MSCI Emerging Markets	2.3%	18.3%
MSCI ACWI (All Country World Index)	5.2%	16.3%

Economically speaking, nearly every leading indicator that we track is flashing green, which suggests we may expect robust economic growth throughout 2021 and into 2022. In fact, economists are expecting U.S. GDP growth to be nearly 7% this year, a rate not achieved since 1984.

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U.S. manufacturing orders have increased sharply for both consumers and more expensive durable goods, and consumer confidence recently registered its largest one-month increase (The Conference Board) since April 2003, reaching a new one-year high in March. Housing in the U.S. was also a bright spot throughout 2020, and it continues to post strong growth in 2021. Year-over-year median home prices increased an impressive 13.7% through February. As the work-from-home shift has led to a permanent change in lifestyle for many, demand for larger homes has driven inventories to all-time lows and prices higher. Fortunately, interest rates have remained historically low to maintain affordability for now.

The employment picture has likewise improved, with unemployment now at 6%, down from a post-WWII high of more than 14% reached last April. Also of importance in the most recent jobs report, job growth was widespread in March, led by gains in leisure and hospitality, public and private education, and construction. Broad job growth across industries serves as a signal that economic activity continues to improve across those sectors that struggled in 2020.

One economic area of concern that is worth mentioning is potentially higher inflation. The Federal Reserve has a long-term inflation target of approximately 2%, but it also considers unemployment when factoring whether or not to put the brakes on the economy, and therefore a lid on rising inflation through short-term rate hikes. It is expected that the Fed will allow inflation to run above its 2% target while we return to full employment. We have already witnessed significant commodity price inflation and notable wholesale price inflation so far this year. However, we have not yet witnessed all of these price increases being passed on to the consumer, as broad market inflation still sits at 1.6% as measured by the Fed's preferred PCE metric. We believe that we are likely to experience a spike in overall inflation in the first half of 2021 followed by a decline and stabilization. Most economists see this spike as a result of a temporary imbalance between supply, which was shut down or disrupted for much of 2020, and demand, which has rapidly rebounded to levels that cannot be met by the sluggish supply-chain reaction. We are less worried about higher levels of inflation into the future due to slack in employment (i.e., wage inflation is unlikely any time soon), interest rates remaining low (as messaged by the Fed) and increased productivity, automation and digitization creating cost savings.

The fixed income markets have reflected some of these inflation fears so far this year.

Fixed Income Index	**1Q 2021**	**2020**
Bloomberg Barclays U.S. Aggregate Bond	-3.4%	7.5%
U.S. 10-year Treasury	-5.7%	10.0%
Bloomberg Barclays 1-3 yr. U.S. Treasury	-0.1%	3.2%
U.S. 3-month T-Bills	0.0%	0.7%
Bloomberg Barclays U.S. Corp. High Yield	0.8%	7.1%
Bloomberg Barclays Municipal Bond	-0.4%	5.2%

While the Federal Reserve has not moved short-term rates higher, investors have steepened the yield curve in anticipation of higher inflation. When interest rates rise, bond values fall. The 10-year U.S. Treasury yield began the year at 0.93% and rapidly increased to 1.74% by quarter end, leading to negative returns for most traditional bond sectors for 2021. We expect the 10-year to remain in a range of 1.5% to 2.5% over the next 12 months, but do not expect significantly higher rates.

These interest rate considerations are important because we are likely to remain in a low-rate environment for years to come. For client portfolios with balanced and conservative guidelines, we are focused on the challenge of managing the defensive side of the portfolio to generate returns above the modest 1-2% yields offered by traditional high-quality bonds. We continue to shift the make-up of the defensive side of portfolios to include unique strategies (buffered equity structures, multi-asset class strategies, direct real estate, etc.) that will provide us higher total return with low correlation to stocks.

Within equities, we see opportunity despite the new market highs reported on the news regularly. While technology and healthcare stocks shone last year during the pandemic lockdown, many of those companies look fully valued today, and we are finding more upside potential in value segments like financials, industrials, and energy, which took a beating last year. Likewise, foreign equities in both emerging and developed countries continue to trade at 20-year lows in terms of valuations relative to the large-cap U.S. market. We are currently active in several searches to add managed strategies in small cap, emerging markets and large cap U.S. value equities. We have already added a U.S. large cap value index ETF during the quarter to initiate more value exposure. While the largest companies in the U.S. indexes may appear fully valued, there are many opportunities in other sectors with runway left for higher returns. We expect equity markets overall to remain resilient given strong economic growth and the impact of recent stimulus.

Finally, it is worth noting that we believe the driving force behind portfolio returns moving forward will be equities and not the defensive side of portfolios. Historically, balanced investors have not been very disadvantaged relative to more growth-oriented equity investors in terms of absolute returns because the fixed income (defensive) side of portfolios consistently produced 7-9% per year returns to complement equity returns. As interest rates have fallen to historic lows, we do not see that trend continuing, and we expect a wider range of returns between growth-oriented and conservative investors. Balancing return expectations with each client's level of acceptable risk is more of an art than a science. We are having conversations with clients about portfolio investment guidelines and whether any guideline adjustments are appropriate in the current yield environment.

GSAM Updates:

<u>Return to Office Plan</u>

While a limited number of staff members have been in the office over much of the past year, we are planning for our full staff to return to the office in early May. Given the success of our team serving clients regardless of work location, we expect that some flexibility for ongoing remote work will continue for employees. We also wish to thank you for being open to meeting and connecting in new ways, whether via phone, video conference or outdoor meetings. As we have all become more familiar with virtual meetings over the past year, we intend to continue leveraging this excellent technology to connect with clients in the future. We are also beginning to meet with clients in person again, so our ways of connecting continue to improve.

<u>Digital Documents and Signatures</u>

The past year has increased the pace of adoption of receiving digital documents, and most of our clients are now receiving their quarterly reports exclusively through our GSAM client portal. We are very pleased with the positive feedback we have received. Likewise, our asset custodians (Schwab and Fidelity) are also promoting the use of digital delivery. Your monthly statements, trade confirmations and tax reports are all available for digital delivery if you choose, but paper mail continues to remain an option as well. Digitally processing the forms to open new accounts, change addresses, link bank accounts, transfer assets, etc. is faster and more efficient than mailing paper applications and this method is preferred by our custodians. While we will continue to provide paper forms as requested by clients, we wish to communicate to you our plan to continue to digitize as much client account paperwork as possible. Digital signatures (DocuSign) and delivery of paperwork is becoming the standard in our industry, and fortunately it is also more secure than forms passing through mail and even email. We appreciate your transition with us, and we are available to assist you in this process.

As always, we value your trust and confidence and look forward to what lies ahead in 2021.

Sincerely,

Michael M. Evans
Executive Chairman

Kristen E. Jackson, CFA
President & Chief Executive Officer

Michael C. Loch
Vice President/Director of Research

John S. Ferraro
Senior Vice President

Patrick T. Evans
Sr. Financial Advisor/Portfolio Manager

Scott P. Dolson, CAIA
Financial Advisor

Enclosures