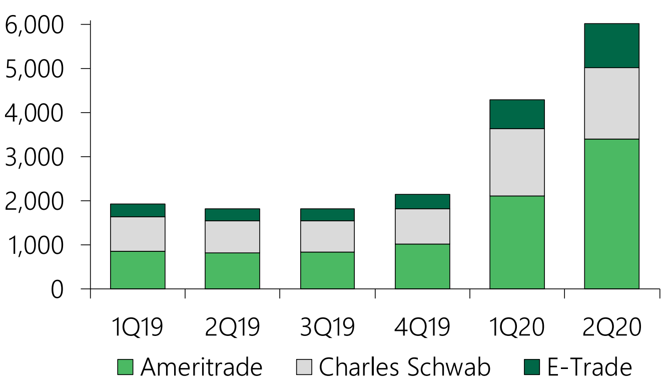
- **Ongoing Pandemic and Policy Uncertainties Temper Post-Lockdown Economic Growth**
- **Expected Global Expansion Underpinned by Huge Stimulus & Easy Financial Conditions**
- **The Federal Reserve's Commitment to Low Rates Helps Credit and Steepens Yield Curve**
- **Equity Market Gains Expected to Broaden Beyond Large Cap Tech as Economy Improves**

After its quickest ever -30 percent correction (22 trading days), the S&P 500 Index recouped losses in record time (126 trading days) with the rebound driven by huge global stimulus, Covid-19 vaccine optimism, positive economic surprises, investor confidence in the *Fed put*, the T.I.N.A. effect (i.e., **t**here **i**s **n**o **a**lternative), and a fear of missing out. It is also safe to assume part of the vast liquidity injected into the financial system made its way into the stock market. Other investment themes that crystalized this year include: 1) the concentration of stock market returns in a handful of large-capitalization tech stocks, 2) the sizable outperformance of equity growth indices across the market capitalization spectrum relative to value counterparts, and 3) the return of the day trader, which has lifted markets but also amplified individual stock volatility (Exhibit 1). For the first nine months of 2020, the so-called FAANG + M tech stocks (i.e., Facebook, Amazon, Apple, Netflix, Google, & Microsoft) have contributed 162 percent to the return of the S&P 500. We do not see this as symptomatic of a circa 2000 tech bubble given broad-based and sustainable growth drivers but recognize the historically high percentage of total market value that these stocks represent (≈25 percent of S&P 500) is a vulnerability.

After five consecutive months of gains, stocks modestly corrected in September as several risks developed to include signs of a downshift in global growth, a rise in coronavirus cases, a worsening of U.S.-China relations, and elevated policy uncertainty. The pullback in tech stocks was unsurprising and overdue, with signs of froth emerging in many of the most popular momentum stocks in August (Exhibit 2). We remain constructive on stocks over the intermediate and long term yet are mindful of the array of risks and uncertainties that will keep markets volatile. We expect the global economic recovery will be choppy post this initial bounce, with stocks following suit. We also anticipate participation in market gains will broaden beyond large-capitalization tech stocks as the pandemic comes under control and global economies normalize. Our investment focus remains on high-quality, fundamentally solid companies that can deliver above-average earnings growth, regardless of the economic backdrop. Tech remains a preferred sector, but we are becoming increasingly selective due to valuation concerns. We also believe health care, transportation, and select financial stocks offer an attractive combination of low valuations and earnings upside in an improving economy.

Exhibit 1: Retail Day Trading Back in Vogue

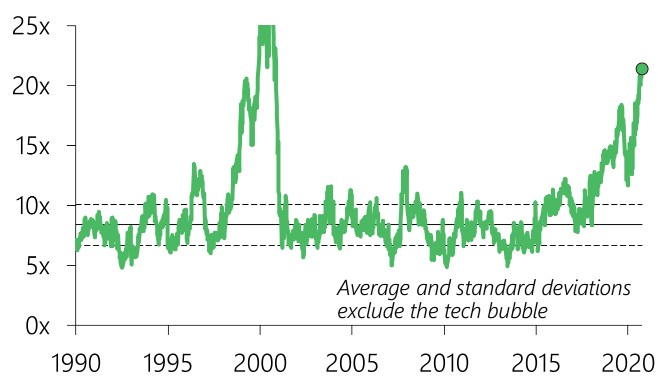
Daily Average Trades (000s)



Source: Ameritrade, Charles Schwab, E-Trade, 10/1/20

Exhibit 2: Near-Record Valuation Differentials

Top Quintile vs Bottom Quintile Forward PE



Source: Wolfe Research, 10/1/20

GLOBAL MACRO DEVELOPMENTS

Foundation for Sustained U.S. Recovery Forming but Economy Remains Hostage to Coronavirus

The post-lockdown economic recovery, fueled by extraordinary global stimulus, easy financial conditions, and pent-up demand, remains vulnerable to coronavirus-linked shocks and will likely require ongoing government intervention to achieve escape velocity and, in the event of another surge in new infections, thwart a possible double-dip recession. Due largely to policymakers' decisive actions, the economy averted a more dire possible outcome, leading to a spate of positive economic surprises and upward GDP revisions. Although pockets of economic strength persist, notably within single-family housing and durable goods, overall activity has moderated owing to stubbornly high new coronavirus cases (Exhibit 3). With a vaccine likely not widely available until mid-2021, another resurgence in the pandemic remains a major risk. Measures to contain the outbreak, and resultant economic downturn, have weakened public finances, triggered a spike in bankruptcies, and, at least in the near term, shifted consumer priorities. Even so, the foundation for a sustained recovery is forming: the job market is recuperating, manufacturing orders are growing, and confidence is on the upswing.

Much-Needed Economic Relief Legislation Stalled in Deeply Polarized Congress

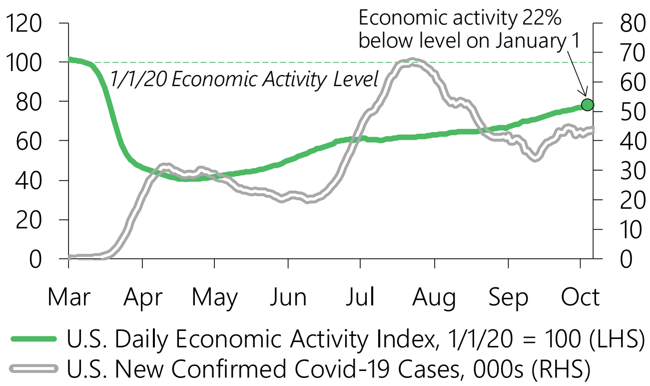
Congress has passed economic relief legislation totaling $4 trillion since March, with ≈60 percent disbursed or committed as of September 30. Combined with Federal Reserve and executive actions, total coronavirus-induced stimulus to date sums to over $11 trillion, or about 60 percent of GDP. However, a return to partisan divisions, deepened by election-year politicking and what is certain to be a highly contentious Supreme Court justice confirmation process, threatens to delay further passage of another economic relief bill. The House of Representatives approved a trimmed-down $2.2 trillion version of the Heroes Act on October 1 to bridge the gap with the White House's $1.6 trillion compromise package (Senate Republicans have balked at anything above $1.1 trillion since July). Still, it appears increasingly doubtful relief legislation will be agreed upon before the November 3 election. Without it, the U.S. economy will face a steep fiscal cliff, possibly causing growth to stall in the fourth quarter and beyond (Exhibit 4). Also, while Congress recently scraped together a stopgap funding bill to keep the federal government operating, another shutdown potentially looms in December.

Democratic Sweep Policy Could Boost Growth at the Expense of Already-Untenable Federal Debt

The near-term macro outlook is clouded further by the upcoming elections, the results of which could reshape legislative, policy, and spending priorities. Joe Biden now leads President Trump by roughly nine percentage points in national polls, with a tighter lead projected for key battleground states. Even so, the election result is far from certain, as Hillary Clinton maintained a sizable lead at this point in 2016. Biden's economic agenda entails approximately $7.2 trillion in new spending over ten years, offset by $3.9 trillion from higher taxes and other revenue. Under a Democratic sweep, Moody's Analytics projects full implementation of Biden's stated

Exhibit 3: Covid-19 Limiting Pace of Recovery

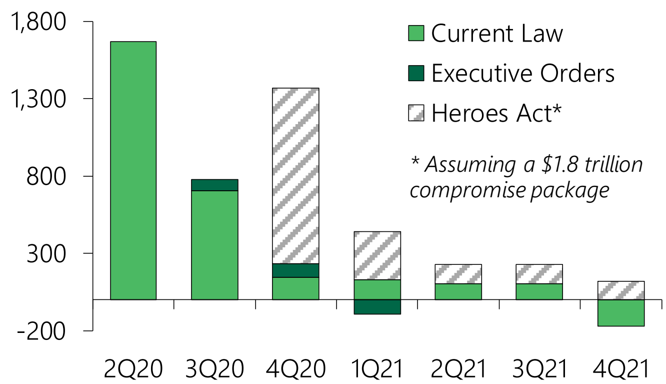
Daily Economic Activity Index vs New Covid-19 Cases



Source: Bloomberg, The COVID Tracking Project, 10/6/20

Exhibit 4: Possible Fiscal Cliff a Notable Risk

New U.S. Fiscal Stimulus per Quarter, $ Billion



Source: Cornerstone Macro, 10/5/20

agenda would result in average real GDP growth of +4.2 percent between 2020 and 2024 versus +3.2 percent under current policy. The added growth will likely come at the expense of a higher federal debt burden, with the CBO projecting beforehand debt held by the public will double to 200 percent of GDP by mid-century. With the prospect of higher taxes and re-regulation, a sweep may also dent business confidence and spark a wave of multinational firm relocations. However, a split Congress would likely temper significant policy shifts. Democrats need to pick up three Republican-held seats to control the Senate if Biden wins, four otherwise. Per oddsmakers, the implied probability of a Democratic sweep is now 38 percent and climbing (Exhibit 5).

Coronavirus Resurgence Will Push Out the European Recovery, Germany a Positive Outlier

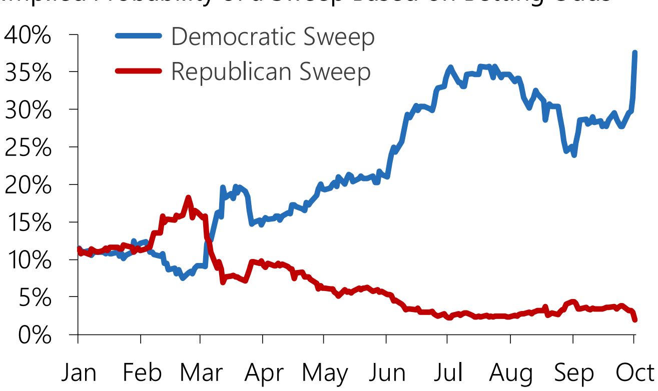
A resurgence in new coronavirus cases has dashed hopes for an uninterrupted economic recovery in the Euro Area and the United Kingdom. While the pandemic remains under control so far in Germany and Italy, new cases are again spiking in Spain, France, the United Kingdom, and elsewhere (Exhibit 6). Government support to blunt the economic fallout has come mainly in the form of furloughing schemes, direct loans to companies, and loan guarantees, but will likely now shift to tax cuts and spending to stimulate demand. After months of wrangling, the European Union (EU) also reached a deal on a €1.8 trillion budget for 2021-27, which includes a €750 billion stimulus plan to backstop harder-hit economies. In terms of monetary stimulus, the European Central Bank bought another €212.2 billion in financial assets during the third quarter, bringing total purchases to €567.2 billion under its €1.35 trillion Pandemic Emergency Purchase Program. Much like in the U.S., low expectations led to a recent wave of positive macro surprises, with export-reliant, industrial-centric Germany especially benefiting from China's recovery. Boosted by strong export demand, the Euro Area manufacturing PMI reached a 25-month high in September. Yet, a weak services sector remains a drag on overall growth. The ill-timed prospect of the UK exiting the EU at year end absent a trade deal is another lingering headwind.

Status Quo to Continue in Japan for Now Following Prime Minister Abe's Departure

The sudden resignation of Prime Minister Abe for health reasons, while unexpected, does little to alter our expectation for a continued uneven recovery in Japan. Economic activity has improved from the lows seen this spring, though the increase has hardly been robust. Confidence among consumers and businesses remains subdued and, by several measures, the recovery has lagged that of other developed markets. Newly appointed Prime Minister Yoshihide Suga, a long-time member of Mr. Abe's cabinet but a relative unknown to the broader electorate, has vowed a continuation of the policies which have fostered a steady, albeit far from dynamic, economy these last seven years. Along with a still accommodative Bank of Japan, this ensures much-needed certainty on the policy front, while a fresh fiscal stimulus package could provide additional support. However, this may prove fleeting as Mr. Suga, and with him, Mr. Abe's policies, will face a general election within the next year. Our expectation for an uneven recovery, along with potential policy uncertainty, reinforces our cautious view on the country's growth prospects.

Exhibit 5: Odds of a Democratic Sweep Rising

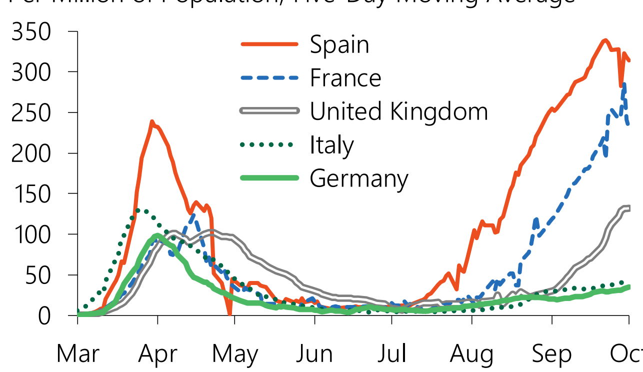
Implied Probability of a Sweep Based on Betting Odds



Source: PredictIt, 10/2/20

Exhibit 6: Covid-19 Surge Threatens Recovery

Incremental Confirmed Covid-19 Cases
Per Million of Population, Five-Day Moving Average



Source: Bloomberg, 10/2/20

China Will Achieve Positive Economic Growth This Year but Decoupling Challenges Ahead

China's economy is on track to deliver positive growth this year; the only major economy projected to do so. Barring a resurgence in the coronavirus, 2021 GDP growth may be in the high-single-digit range against easy year-over-year comparisons, before normalizing in 2022. Economic data show the recovery has been quicker than expected and is broadening. Export growth has been a notable bright spot owing to pandemic-related demand and the re-opening of global economies. While lagging, consumption seems to be catching up, with year-over-year retail sales growth turning positive for the first time this year in August. Despite the negative economic fallout, it is also clear the U.S.-China rivalry will persist regardless of who wins the U.S. presidential election. U.S. technology sanctions could expand from banning Chinese technology goods in the U.S. market to damaging the Chinese electronics industry to include preventing China from producing state-of-the-art goods for its own market. In response to an ever more adversarial international landscape, we expect China's 14th Five Year Plan, which will set key economic and political goals for 2021 through 2025 and be debated this month, to focus on its domestic market, technology independence, and opening up of the economy.

GLOBAL EQUITIES: ENVIRONMENT AND STRATEGY

With overall stock market valuations at "fair" levels, we expect a continued period of consolidation and uptick in volatility to prevail over the near term. We are now in a stock picker's environment where fundamentals must materialize to justify valuations and see additional stock appreciation. Improving economic conditions have helped provide encouraging visibility into "normalized" corporate earnings power when the economy fully recovers. As is usually the case during downturns, corporate cost reductions and efficiency gains increase prospects for positive earnings surprises as revenues normalize. Near-term forecasts, however, remain highly uncertain and dependent on several key factors, including the path of the coronavirus pandemic and the level (and specifics) of fiscal support. Election dynamics add to an already complicated backdrop.

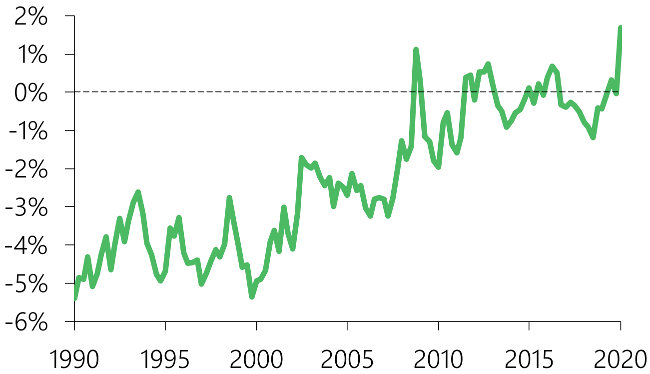
Diversification, growth, and quality remain key tenets of our investment strategy across all equity portfolios. We suspect leadership will vacillate as investors struggle with uncertainties around the path of the pandemic, fiscal stimulus, increasing debt, and the upcoming election. We continue to believe that a "barbell" investment strategy remains most appropriate, balancing secular growth sectors (e.g., technology and healthcare) with re-opening/reflation beneficiaries (e.g., transports, industrials, and select financials) that stand to gain the most from improving economic conditions. Despite recent volatility, and some clear signs of indiscriminate buying in certain instances, tech remains our preferred sector. We believe the onset of the coronavirus accelerated multifaceted growth trends for the sector, including cloud adoption, artificial intelligence, e-commerce, and the Internet of Things. One of the most promising investment opportunities is the deployment of the new wireless standard, 5G. This technology promises greater bandwidth, lower latency, and faster speeds which will enable countless new applications to be developed for the new "wireless Internet." Opportunities span a diverse set of industries, including service providers (Verizon), enabling infrastructure (American Tower, Ericsson), and handsets (Apple, Samsung). In addition, these complex systems require key components in order to function such as the RF subsystems for handsets (Skyworks, Avago, Qualcomm). We believe these stocks are compelling based on valuations and a visible, multiyear growth outlook.

Dividend-paying stocks have posted disappointing returns so far in 2020, due to a combination of investor enthusiasm for high growth tech stocks and lingering concerns that the severity of the economic decline has strained dividend sustainability for many companies. However, we expect these fears to diminish as dividend cuts are now largely behind us, with many dividend-paying stocks representing compelling values, particularly relative to bonds (Exhibit 7). As of September 30, we calculate that 77 percent of S&P 500 constituents now have dividend yields above the 10-year Treasury yield. We believe, however, that selectivity is critical, and our investment focus remains on firms with strong balance sheets, durable business models, and growth potential.

While there has been some volatility at the stock/industry levels ahead of the U.S. election, we are generally not taking "bets" on a particular outcome in the absence of clear valuation dislocations. Health care is a key

Exhibit 7: Dividend-Paying Stocks Attractive

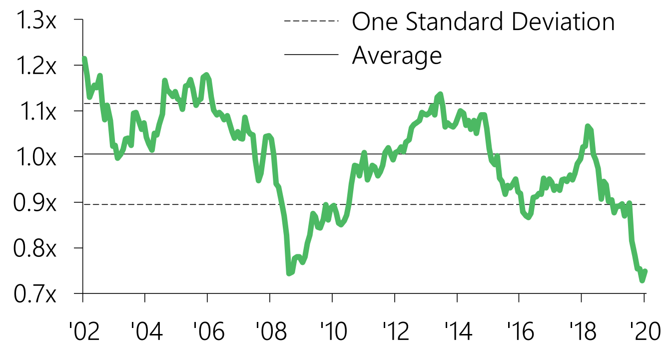
S&P 500 Dividend Yield Minus 10Y Treasury Yield



Source: FactSet, S&P Dow Jones, 10/1/20

Exhibit 8: Heath Care Valuations Also Attractive

Health Care Sector NTM Price-to-Earnings Ratio
Relative to the S&P 500 Index



Source: FactSet, 10/1/20

exception, as both pharmaceutical and health services stocks have sold off in recent weeks and valuations are now compelling (Exhibit 8). While regulatory changes represent an ongoing risk in this sector, the aging population remains a growth tailwind for innovative companies both in and outside the U.S. We have used price corrections to add to positions in most portfolios in recent weeks. Realistically, this election could have major implications for numerous sectors; a Democratic sweep could bring about major changes to the status quo. While health care, banks, energy, and defense are commonly cited as vulnerable to election outcomes, sweeping tax, trade, and regulatory policy changes could impact almost all companies. We expect significant volatility over the next few weeks and remain watchful for both opportunities and risks.

Within international mandates, we prefer exposure to investment opportunities in China, South Korea, and India. Despite the near-term pullback in Chinese stocks on profit taking, we are sticking with new economy sectors (e.g., e-commerce, IT) as our positive views on mid-to-long term growth prospects have not changed. In South Korea, holdings are skewed toward the technology, financial, consumer, and material sectors. The strong growth for information and communications technology products have been fueled by a shift in global demand towards products suited to working from home. Moreover, South Korea's 7.8 trillion won stimulus package for small businesses and households should be favorable for both consumers and banks. In India, added interest rate cuts, fiscal stimulus, and the re-opening of the economy should help economically sensitive stocks. Thus, we prefer exposure to consumer, financial, energy, information services, and industrial sectors.

FIXED INCOME: ENVIRONMENT AND STRATEGY

Taxable Bonds

Corporate Spread Tightening Continues

Investment-grade corporate bond spreads ground another 14 basis points tighter in the third quarter to close September at 136 basis points (Exhibit 9). Notably, investment-grade corporate yields hit an all-time low of 1.82 percent in early August as spreads set a new post-coronavirus low of 124 basis points. Spreads drifted modestly wider in September with the seasonal post-Labor Day supply wave, but the market continues to focus on the prospects for a vaccine and economic recovery rather than lament over recent poor economic and earnings data. We believe spreads will be a little more volatile heading into the election, but we also expect to see more momentum build behind the most vaccine-exposed credits and cyclical sectors that will be the largest beneficiaries of a successful vaccine and an eventual re-opening.

The Fed's Changes to Monetary Policy Framework

At the annual Jackson Hole Fed meeting in late August, the Federal Reserve announced a fundamental shift in policy to "inflation averaging." Essentially, this means the Fed will let inflation run above the 2.0 percent target, since it has been running well below that target for some time (Exhibit 10). Additionally, the Fed has shifted its stance on the maximum employment mandate to de-emphasize the traditional view of the inverse correlation between employment and inflation. Employment levels can run at or above maximum estimates without causing concerns of translating into higher inflation levels. These changes should put upward pressure on longer-term rates. The Fed has also communicated its intention to keep short rates near zero until at least 2023. These actions should result in a steeper yield curve with short rates anchored and longer-term rates moving higher.

Taxable Bond Strategy

The combination of massive market intervention by the Fed, record low interest rates, and a potential economic recovery after the tide of the pandemic turns will likely push interest rates higher and steepen the yield curve in the intermediate term. In the short run we are defensively keeping portfolio durations close to benchmark levels out of concern for a rise in coronavirus cases. We continue to be optimistic on a vaccine approval over the next few months and are overweight credit and underweight Treasuries where appropriate. We expect the eventual re-opening of the economy to be accompanied by a slowing of Fed market intervention, which will hurt Treasuries the most. We have maintained exposure to sectors that we expect to be positively leveraged to the end of the pandemic, including Treasury Inflation Protected Securities and collateralized airline industry debt. Housing activity continues to be strong. Low interest rates and favorable modification programs have helped alleviate delinquency and foreclosure fears. We remain constructive on securitized mortgage product, both in the agency and non-agency space and continue to execute our trading strategies opportunistically

Municipal Bonds

Yield Curve Steepens with Compression of Short-Term Rates

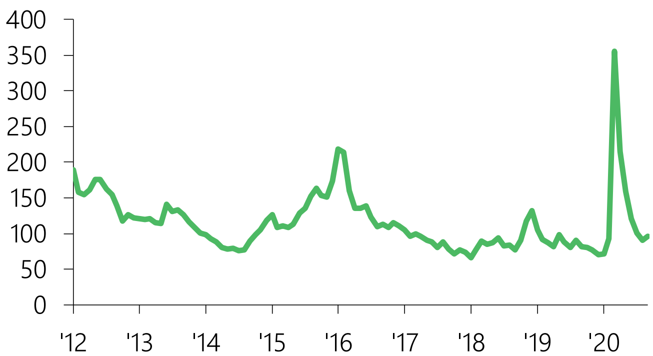
Intermediate and long-term high-grade tax-exempt yields closed the third quarter within a few basis points of their levels at the end of the previous quarter. However, short-term tax-exempt yields decreased to levels that are now also more consistent with U.S. Treasury yields. The result was a modestly steeper tax-exempt yield curve slope. In terms of absolute yields, high-grade tax-exempts of all maturity ranges remain low, with the Municipal Market Data (MMD) AAA GO Yield closing the quarter with a yield of 0.13 percent for the 2-year tenor and 1.62 percent for the 30-year tenor (Exhibit 11).

Credit Quality and Duration (Income) Drive Performance

Credit quality was the most significant factor driving performance for the quarter, with duration also contributing to results (Exhibit 12). Lower-quality bonds, mainly those rated BBB and below, including

Exhibit 9: Corporate Bond Spreads Normalized

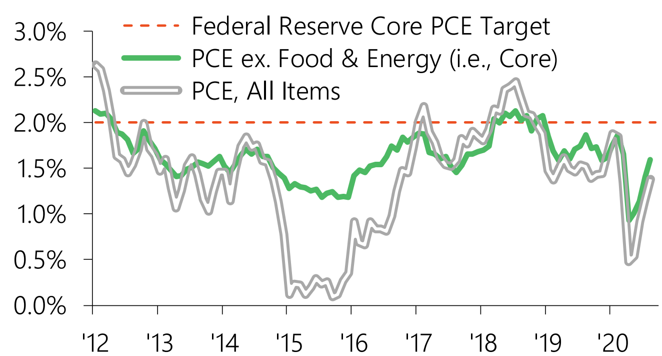
Bloomberg Barclays U.S. Aggregate Corporate IG OAS
Basis Points



Source: Bloomberg Barclays, 10/1/20

Exhibit 10: PCE Inflation Remains Below Target

Personal Consumption Expenditure (PCE) Price Index
Y/Y Percent



Source: U.S. Bureau of Economic Analysis, 10/1/20 non-rated bonds, outperformed higher-quality bonds. As a result, more credit-sensitive sectors also outperformed higher-quality sectors. The highest performing sectors in the Bloomberg Barclays Municipal Bond Index were tobacco, leasing, industrial development revenue/pollution control revenue (IDR/PCR), and hospitals. In terms of duration, longer duration tax-exempts outperformed shorter duration bonds during the quarter, although returns were more consistent across longer maturities. Generally, stable market yields for longer tax-exempt bonds led to income driving performance, particularly for high-quality bonds.

Municipal Issuance Strengthens but Increasingly Taxable

After sluggish issuance during March and April, year-to-date municipal issuance now totals nearly $342 billion, the highest on record for the first 9 months of any year. However, the absolute level of issuance is somewhat deceiving because taxable issuance is approximately thirty percent of total issuance, which is nearly as high as in 2010 when Build America Bonds were being issued. The higher proportion of taxable bonds as a percentage of total supply reduces the available supply for tax-exempt buyers. As such, year-to-date tax-exempt supply is approximately $239 billion, which would be modestly below the glide path when compared to the last five years. This lower amount of tax-exempt supply has been supportive in maintaining low absolute yields for tax-exempt bonds. Autumn is generally a period of increased municipal issuance. Should tax-exempt issuance rise this autumn, we could see a modest increase in tax-exempt yields.

Municipal Bond Strategy

The coronavirus's impact on state and local government budgets remains a concern for investors and other stakeholders. While it remains too accurately early to predict the magnitude of the impact, it is reasonable to say that municipalities will likely feel the effects through at least FY22. Rating agencies have taken a wait and see approach thus far, downgrading less than one percent of municipal issuers. While we do ultimately see a material increase in downgrades, the outlook for municipals remains positive. If state and local governments do not receive significant help from the federal government, they will either have to cut expenses, raise taxes, or both. If they raise taxes, it could increase the attractiveness of tax-exempt bonds. While we are not excited about the absolute level of yields, we continue to find relative value in housing and revenue bond issues and bond structures with attractive call or prepayment features. We expect to maintain duration near current levels and view diversification as a critical component of managing portfolio risk.

Exhibit 11: Municipal Bond Index Returns

	3Q20	YTD		3Q20	YTD
Muni Bond	1.23	3.33	GO Bond	0.92	3.92
3-Year	0.71	2.63	Revenue Bond	1.43	3.14
5-Year	1.28	3.49	Electric	1.18	4.01
7-Year	1.47	3.79	Hospital	2.09	3.24
10-Year	1.27	3.77	Housing	1.27	3.14
Long	1.41	3.14	IDR/PCR	2.25	3.42
			Transportation	1.24	2.29
AAA	0.80	4.24	Education	1.01	3.62
AA	0.96	3.71	Water & Sewer	0.99	4.38
A	1.45	2.83	Special Tax	1.03	2.71
BAA	3.11	0.99	Tobacco	2.48	4.04

Source: Bloomberg, 10/1/20

Exhibit 12: Municipal Bond Yields and Spreads

Yields	6/30/20	9/30/20	Chg. (bp)
2-Yr MMD AAA GO	0.27	0.13	-0.14
5-Yr MMD AAA GO	0.41	0.26	-0.15
10-Yr MMD AAA GO	0.90	0.87	-0.03
30-Yr MMD AAA GO	1.63	1.62	-0.01
2-10 MMD Spread	0.63	0.74	0.11
10-30 MMD Spread	0.73	0.75	0.02
2-30 MMD Spread	1.36	1.49	0.13
Bond Buyer 40 YTM	3.63	3.59	-0.04

Source: Bloomberg, 10/1/20