CIO View

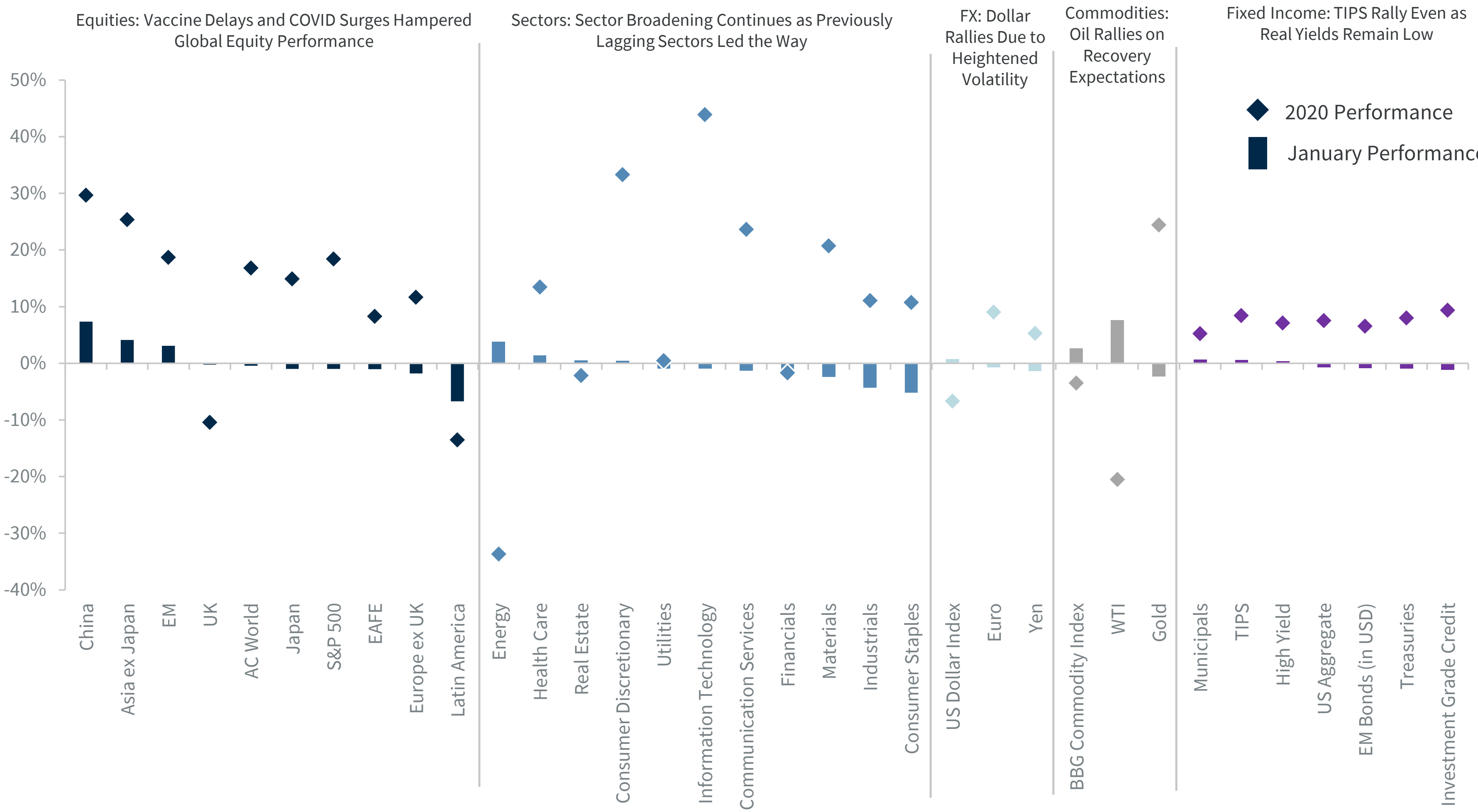
Monthly Strategy Snapshot

February 2021

Lawrence V. Adam III, CFA, CIMA®, CFP®
Chief Investment Officer

Returns By Asset Class | Month-to-Date and 2020 Returns

Returns by Asset Class



Data as of January 31, 2021. All international equity indices are MSCI indices and in USD. Diamonds represent the total returns for 2020 and bars represent monthly total returns.

Global Economy | Economic Recovery Softer Than Expected, But Should Gain Momentum in 2021

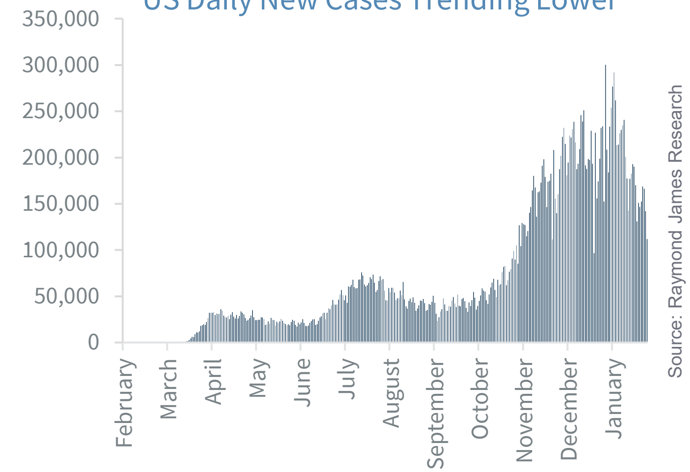
Global Economy | Recent Trends

- **While new daily COVID cases and hospitalizations hit record highs during January, both of these metrics declined sharply to end January.** As the pace of vaccinations continues to improve, we expect the pace of new daily cases to continue to decline and lockdown restrictions to ease.
- President Biden's goal of "100 million doses in 100 days" seems more than attainable, **with ~1.25 million doses per day administrated to end January**. According to Moderna and Pfizer, these two companies alone will be able to deliver enough vaccine to immunize the entire US population by October. This timeframe could be shortened if the JNJ single-shot vaccine, which was recently reported to have a 66% efficacy rate, is approved for distribution.
- Lockdowns weighed on economic growth in 4Q20, as **GDP rose less than expected** (4.0%) and remains down 2.5% from 4Q19 levels. While social distancing measures will continue to weigh on growth in the near term, **we expect a sharp rebound in the second half of 2021.**
- Consumer spending rose at a 2.5% annual rate, restrained by the pandemic's impact on holiday shopping. The Consumer Confidence Index showed **weaker evaluations of current conditions, but increased optimism for the future as the vaccine rollout continues in the US.**
- The Biden administration has announced its intent to pursue additional stimulus. In the near term, **the "rescue" plan would aim to provide $1.9 trillion for immediate aid**, though it is likely that negotiations will reduce the size and scope of such a package.

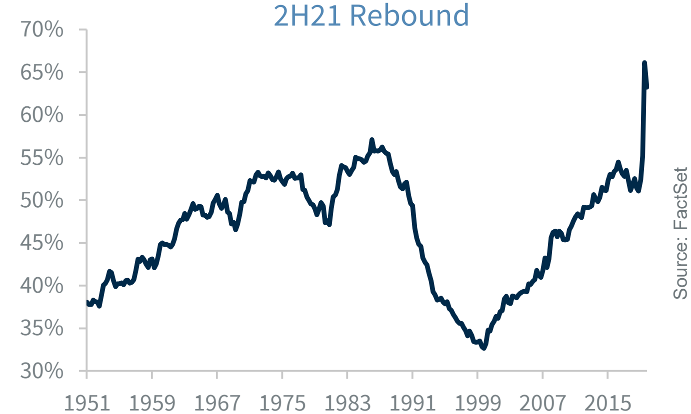
Global Economy | 2021 Outlook

- **Global economic momentum is likely to continue in 2021** as most G20 countries are likely to experience between 3% and 9% GDP growth for the year as social distancing measures wane and economies return to more normal activity. **The threat of COVID-19 remains a key risk** for the trajectory of economic growth (evident by the elevated levels of new cases internationally and new mutations) until an effective vaccine is widely distributed. Though wide-sweeping lockdowns like we saw in the spring are unlikely to return, several countries around the world continue to impose localized shutdowns in response to the recent case surge.
- Over the medium to longer term, continued **aggressive actions from policymakers (both from a fiscal and monetary perspective) will remain supportive of economic growth**. Globally, central bank balance sheets are increasing while governments continue to pursue additional fiscal stimulus. The Fed alone could reach $10 trillion by the end of 2021 (up from ~$7.4 trillion).
- As vaccines become more widely available in the second half of the year, **we expect spending on services to increase after the COVID-related decline in 2020.** As services make up ~66% of total US consumer spending, the increase will be a boost for economic growth going forward.

US Daily New Cases Trending Lower



Strong Consumer Balance Sheets Support 2H21 Rebound



Consumer Cash Balances (Checking Deposits + Time and Savings Deposits) as a % of Nominal GDP

Equities | Volatility Remains Elevated

Global Equities | Recent Trends

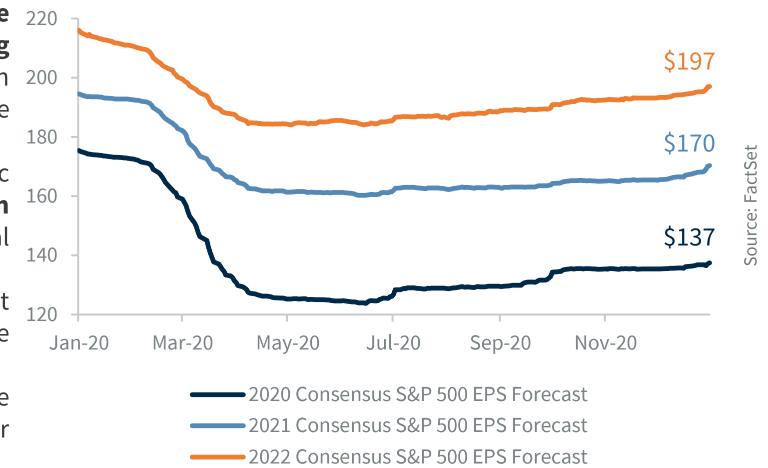
- While equity momentum carried into the new year as the S&P 500 posted five new record highs during the month of January, **volatility increased to end the month as the VIX rose to the highest level in three months.** Despite the strong start, the S&P 500 declined 1% for the month and only four out of 11 sectors were in positive territory.
- The month of February is a seasonally weak period of the year, as it is historically the third weakest month of the year on average dating back to 1950. Given stretched technicals (put/call ratios near record lows) and valuations (LTM P/E near the highest level since 2000), **the risk of additional pullbacks remains elevated.** We would **use pullbacks to add to our favorite sectors**: Info Tech, Comm. Services, Consumer Discretionary, Health Care and Industrials as these sectors should benefit from the economic recovery.
- 4Q20 earnings season is well underway with ~50% of the S&P 500 market cap having reported thus far. **81% of companies have beaten EPS estimates on aggregate by 13.5% on average, and 4Q20 EPS is forecast to have declined only 4% YoY (vs. estimates of -11% coming into the quarter).** Positive earnings growth will be needed to push equities higher from current levels, as we see limited room for further P/E expansion in 2021.
- Though we maintain our preference for US equities, we continue to favor emerging markets over developed international. The **MSCI EM Index returned ~4% in January**.

Global Equities | 12-Month Outlook

- While stretched technicals may lead to modest weakness in the near term, **we believe that equities will be higher over the next 12 months on the back of rebounding economic and earnings growth.** However, investors need to dial back their return expectations, as strong EPS growth ($175 2021 S&P 500 earnings forecast) will likely be offset by P/E multiple compression. Our year-end 2021 **S&P 500 price target is 4,025.**
- We remain biased to select cyclical sectors that should benefit from improving economic growth and stronger earnings growth. We favor **Technology, Comm. Services, Health Care, Consumer Discretionary and Industrials**—sectors that can benefit from additional fiscal stimulus, online shopping, the work-from-home trend and rising confidence.
- **We favor large cap relative to small cap in the near term** as large cap has more resilient earnings amidst the recent slowdown in economic activity. However, as vaccines are widely disseminated and the economy reopens, we will turn more optimistic on small cap.
- **We remain constructive longer term on global equities,** especially EM, due to the expected second half rebound in global economic growth, but prefer the US over other developed markets due to favorable sector exposure and more resilient economic growth.

Limited Room for Further PE Expansion

Annual EPS Estimates Trending Higher

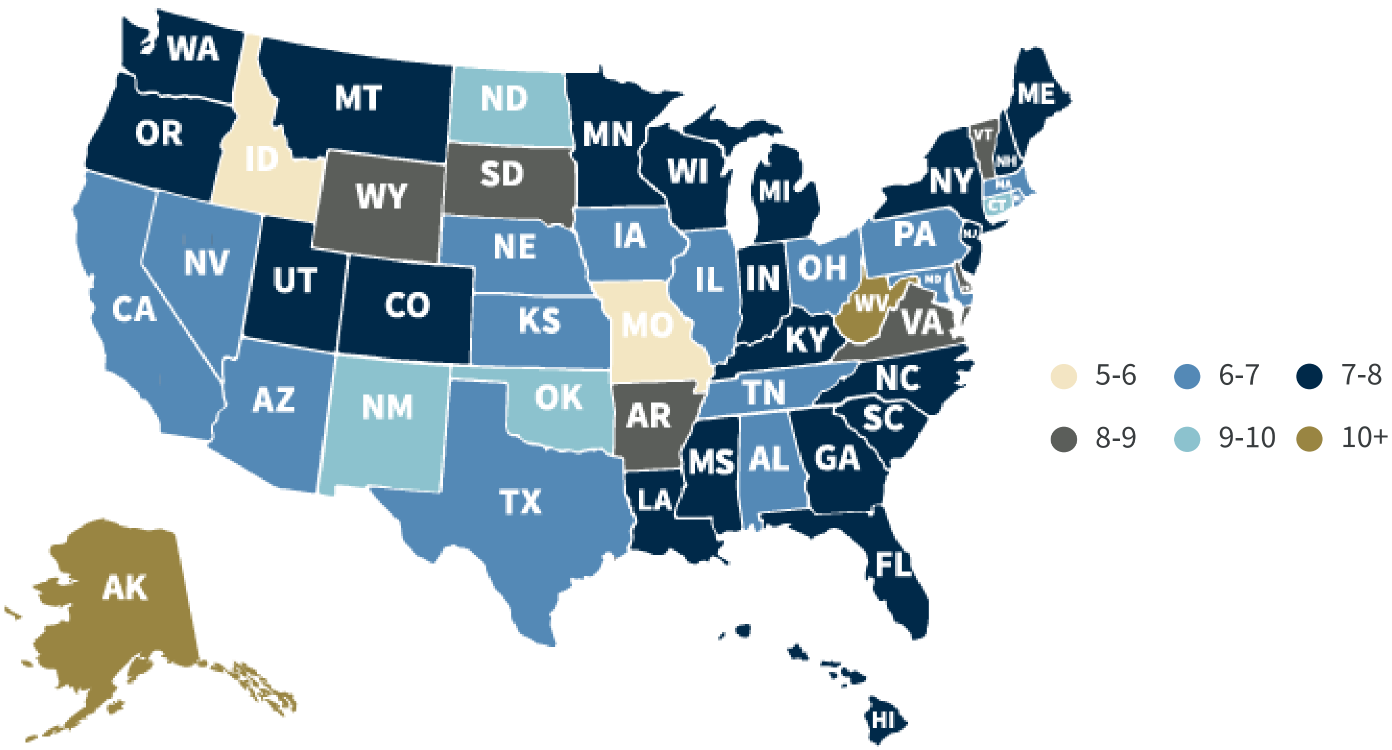


COVID-19 | Vaccine Dissemination

THE VACCINE ROLLOUT AND THE RETURN TO NORMAL

Over 1.25 million doses of the COVID vaccine were administrated per day during the last week of January. Moderna and Pfizer should be able to deliver enough vaccine to immunize the entire US population by October, but the possibility of additional vaccine manufacturers receiving approval could shorten this time frame.

People Vaccinated Per Hundred



Source: FactSet, as of 1/30/2021

Fixed Income | Treasurys' Rise Likely Contained

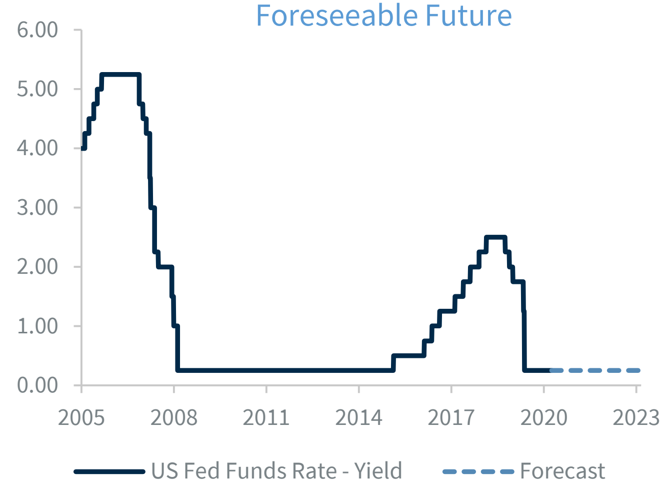
Global Bonds | Recent Trends

- **Longer-duration yields continued their recent move higher**, as the 10-year Treasury yield rose above 1% to its highest level intra-month (1.14%) since March 2020.
- Despite record levels of COVID cases and increased social distancing measures, Treasury yields moved higher on the back of **an additional $900 billion in fiscal stimulus** (and President Biden is seeking an additional $1.9 trillion in fiscal spending) and the **expectation for improving future economic activity**. **The rise in yields was driven by** increased inflation expectations, as breakeven rates rose to a two-year high.
- The Fed reiterated that it will remain accommodative for the foreseeable future, and will look through temporary increases in inflation. **Spreads between short and long-term Treasurys widened in January to the highest level since July 2017** as the market priced in the Fed remaining lower for longer while investors priced in a continuation of the economic rebound.
- Credit spreads (yield over Treasurys) moved lower during the month, **as both investment-grade and high-yield bond spreads** declined to the lowest level intra-month since March.
- Following Democrats taking control of the Senate, the **rally in municipal bonds has made the sector more expensive**, as the muni spread is back below historical averages.

Global Bonds | 12-Month Outlook

- As the market is pricing in continued economic recovery through 2021 and the potential for more stimulus following Democrats taking the Senate, **we forecast the 10-year Treasury yield to rise modestly from current levels to 1.5% by year-end 2021**. However, **we anticipate the rise in yields to be limited** due to acceptable inflation, continued buying from global central banks, increased demand from foreign investors and aging demographics.
- While our forecasted rise in yields will likely lead to **limited capital appreciation for bonds in 2021**, **fixed income remains an important piece within investors' portfolios** as they limit/hedge equity market risk and provide increased diversification.
- Given our expectation for a modest rise in longer-duration interest rates while the Fed is set to leave policy rates unchanged for the foreseeable future (keeping shorter-term rates low), **we recommend a shorter than benchmark duration for bond portfolios.**
- From a credit perspective, while spreads have narrowed dramatically from their post-crisis highs, **we expect spreads to continue to tighten to pre-COVID levels** in 2021. We would favor holding higher-quality bonds and therefore **favor investment grade over high-yield bonds**. In general, we would **prefer to add additional risk in the equity market over high yield** as we believe investors are better compensated for taking on risk in the equity market.

Fed Likely to Remain on Hold for Foreseeable Future



Source: FactSet

Municipal Valuations Now More Expensive

Source: FactSet

Commodities & Currencies | Commodity Rally Continues

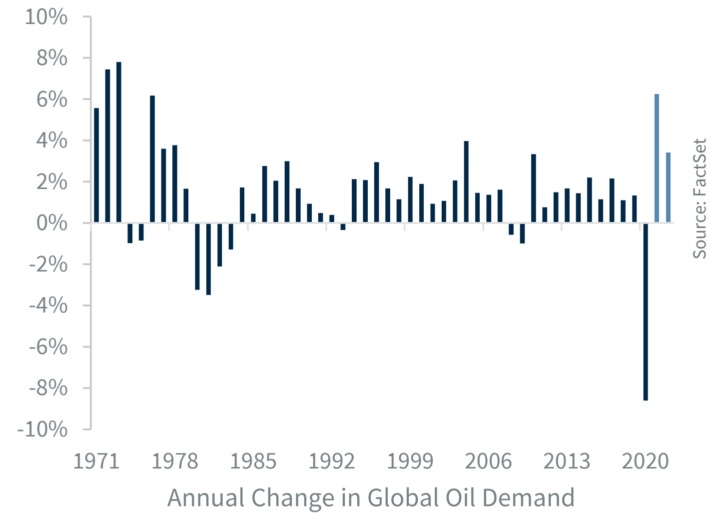
Commodities & Currencies | Recent Trends

- Despite increased social distancing measures to combat the record surge in global COVID cases and hospitalizations (although both new cases and hospitalizations declined to end the month), broad commodities continued to rally as **the Bloomberg Commodity Index rallied for the fourth consecutive month and rose to the highest level since April 2019.**
- While crude oil demand remains well off of its pre-COVID peak and the recovery in demand has stalled in recent weeks due to decreased mobility (motor gasoline demand remains near a seven-month low), **crude oil rallied to the highest level since February ($53/bbl)** on the back of further OPEC production cuts and the expectation for a recovery in future demand.
- Similar to crude oil, **industrial metals rallied for the ninth time in the last ten months and rose to the highest level since June 2018.** Copper was a standout within the sector, as the industrial metal rose to its highest level since 2013 and is now up ~70% off of the lows in March. This suggests that **investors are pricing in an ongoing improvement in global economic activity in 2021**, particularly in China and the emerging markets.
- While the continued risk-asset rally on the vaccine roll-out and improving economic growth pushed the dollar to the lowest level intra-month since April 2018, **increased volatility in the final days of month caused the dollar to strengthen.**

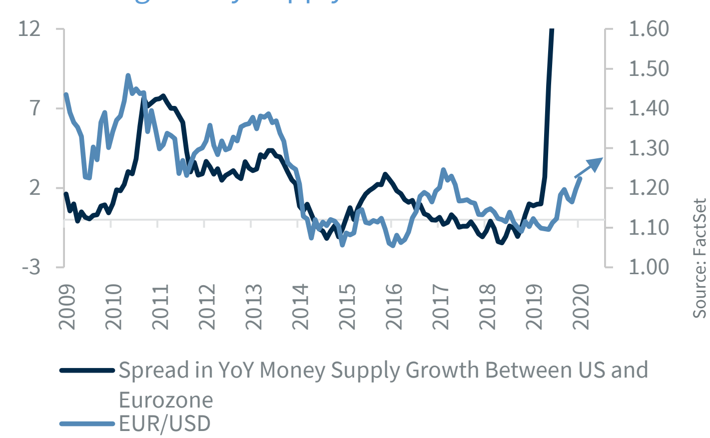
Commodities & Currencies | 12-Month Outlook

- As US economic activity recovers following the continued roll out of vaccines and reopening of the economy, **crude oil likely has further upside over the next 12 months (year-end 2021 WTI target: $60/barrel) due to improving global demand.**
- However longer term, as the price of crude oil is above current breakeven levels for US producers (thereby incentivizing more capital investment) **rising US crude oil production as well as increasing OPEC production will likely limit the rise in prices.**
- The US dollar typically moves in long-dated cycles. After a nine-year run, **the recent dollar bull market has likely come to an end**. Pressuring the dollar lower will be fundamental factors, as improving global economic activity and falling global economic policy uncertainty (due to the counter-cyclical nature of the USD) will likely reduce demand for the dollar. Additionally, **aggressive fiscal and monetary policy easing**, leading to rapid money supply growth and widening fiscal deficits will also likely lead to a weaker dollar.
- While gold has been a solid hedge for investors throughout the COVID-crisis, **the demand for gold will likely wane** as US economic activity improves as we move through 2021 and on the expectation that real interest rates move modestly higher from current levels.

Crude Oil Demand Set to Increase



Rising Money Supply a Headwind for the USD



Summary | Views and Key 2021 Year-End Targets

1 ECONOMY

2021 US GDP: ~4.0%

The US economy experienced its deepest and shortest recession ever due to the COVID-19 pandemic, but is already beginning to rebound. The rebound is likely to continue during 2021 especially if policymakers continue to exhibit a "by any means necessary" approach to defeat this virus.

2 BOND MARKET

2021 10-Year Treasury: 1.50%

We forecast that the 10-year Treasury yield will be 1.50% by year-end 2021, supported by improving economic activity and continued fiscal stimulus. As we prefer higher-quality bonds, we prefer investment grade over high yield. Municipals should benefit in a rising tax rate environment.

3 EQUITIES

2021 S&P 500: 4,025

Our expectation for a rebound in 2021 economic activity and stimulus from the Fed and Congress should support equities. In contrast to recent years, we expect positive returns to be driven by EPS growth rather than P/E expansion. Use pullbacks as buying opportunities within our favorite sectors (Info Tech, Health Care, Communication Services, Industrials and Consumer Discretionary).

4 DOLLAR DIRECTION

2021 EUR/USD: 1.25

Our expectation is that aggressive fiscal and monetary policy and a burgeoning budget deficit (~$3 trillion) may cause the dollar to modestly weaken throughout 2021. Separately, the easing of trade restrictions from the Biden presidential administration may weaken the dollar relative to other currencies. However, the potential for near-term volatility in riskier assets is likely to support the dollar.

5 OIL

2021 WTI: $60/bbl

Over the next 12 months, crude oil will be supported by the reduction in social distancing measures, increasing economic activity in 2021 and thereby improving demand. However, as prices rise above breakeven levels here in the US and OPEC raises production levels, the rise in oil prices will likely be limited.

6 ELEVATED VOLATILITY

Volatility: ↓

After a year of unpredictable events (e.g., COVID crisis, 2020 election) we expect the overall level of volatility to decrease in 2021 due to the continued roll out of vaccines, a more stable political environment in the US, improving global economic activity, still accommodative global central banks, and easing trade rhetoric (particularly between the US and Europe).

DISCLOSURES

Diversification does not ensure a profit or guarantee against a loss.

INTERNATIONAL INVESTING | International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.

SECTORS | Sector investments are companies engaged in business related to a specific economic sector and are presented herein for illustrative purposes only and should not be considered as the sole basis for an investment decision. Sectors are subject to fierce competition and their products and services may be subject to rapid obsolescence. There are additional risks associated with investing in an individual sector, including limited diversification.

OIL | Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors.

CURRENCIES | Currencies investing are generally considered speculative because of the significant potential for investment loss. Their markets are likely to be volatile and there may be sharp price fluctuations even during periods when prices overall are rising.

GOLD | Gold is subject to the special risks associated with investing in precious metals, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.

FIXED INCOME | Fixed-income securities (or “bonds”) are exposed to various risks including but not limited to credit (risk of default of principal and interest payments), market and liquidity, interest rate, reinvestment, legislative (changes to the tax code), and call risks. There is an inverse relationship between interest rate movements and fixed income prices. Generally, when interest rates rise, fixed income prices fall and when interest rates fall, fixed income prices generally rise.

US TREASURIES | US Treasury securities are guaranteed by the US government and, if held to maturity, generally offer a fixed rate of return and guaranteed principal value.

US DOLLAR | The US Dollar Index is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies,[1] often referred to as a basket of U.S. trade partners' currencies.[2] The Index goes up when the US dollar gains "strength" (value) when compared to other currencies.

DEFINITIONS

AGGREGATE BOND | **Bloomberg Barclays US Agg Bond Total Return Index:** The index is a measure of the investment grade, fixed-rate, taxable bond market of roughly 6,000 SEC-registered securities with intermediate maturities averaging approximately 10 years. The index includes bonds from the Treasury, Government-Related, Corporate, MBS, ABS, and CMBS sectors.

HIGH YIELD | **Bloomberg Barclays US Corporate High Yield Total Return Index:** The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below.

CREDIT | **Bloomberg Barclays US Credit Total Return Index:** The index measures the investment grade, US dollar-denominated, fixed-rate, taxable corporate and government related bond markets. It is composed of the US Corporate Index and a non-corporate component that includes foreign agencies, sovereigns, supranationals and local authorities.

MUNICIPAL | **Bloomberg Barclays Municipal Total Return Index:** The index is a measure of the long-term tax-exempt bond market with securities of investment grade (rated at least Baa by Moody’s Investors Service and BBB by Standard and Poor’s). This index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and prerefunded bonds.

BBG COMMODITY INDEX | Bloomberg Commodity Index is calculated on an excess return basis and reflects commodity futures price movements.

S&P 500 | The **S&P 500 Total Return Index:** The index is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

EMERGING MARKETS EASTERN EUROPE | **MSCI EM Eastern Europe Net Return Index:** The index captures large- and mid-cap representation across four Emerging Markets (EM) countries in Eastern Europe. With 50 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

ASIA EX JAPAN INDEX | **The MSCI AC Asia ex Japan** Index captures large and mid cap representation across 2 of 3 Developed Markets (DM) countries* (excluding Japan) and 9 Emerging Markets (EM) countries in Asia. With 983 constituents, the index covers approximately 85% of the free float adjusted market capitalization in each country.

AC WORLD INDEX | **The MSCI AC World** Index is a market capitalization weighted index designed to provide a broad measure of equity-market performance throughout the world. The MSCI ACWI is maintained by Morgan Stanley Capital International (MSCI) and is comprised of stocks from 23 developed countries and 24 emerging markets.

EMERGING MARKETS LATIN AMERICA | **MSCI EM Latin America Net Return Index:** The index captures large- and mid-cap representation across five Emerging Markets (EM) countries in Latin America. With 116 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

EMERGING MARKETS | **MSCI Emerging Markets Net Return Index:** This index consists of 23 countries representing 10% of world market capitalization. The index is available for a number of regions, market segments/sizes and covers approximately 85% of the free float-adjusted market capitalization in each of the 23 countries.

JAPAN | **MSCI Japan Net Return Index:** The index is designed to measure the performance of the large and mid cap segments of the Japanese market. With 319 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in Japan.

EUROPE EX UK | **MSCI Europe Ex UK Net Return Index:** The index captures large and mid cap representation across 14 Developed Markets (DM) countries in Europe. With 337 constituents, the index covers approximately 85% of the free float-adjusted market capitalization across European Developed Markets excluding the UK.

MSCI EAFE | The **MSCI EAFE** (Europe, Australasia, and Far East) is a free float-adjusted market capitalization index that is designed to measure developed market equity performance, excluding the United States & Canada. The EAFE consists of the country indices of 22 developed nations.

VIX | The **CBOE Volatility Index**, known by its ticker symbol VIX, is a popular measure of the stock market's expectation of volatility implied by S&P 500 index options.

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DATA SOURCES

FactSet as of 1/31/2021.

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INTERNATIONAL HEADQUARTERS: THE RAYMOND JAMES FINANCIAL CENTER
880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // 800.248.8863