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SECOR Asset Management

Macroeconomic, Equity and Credit Updates

April 12, 2021

Macroeconomy: Brief Update

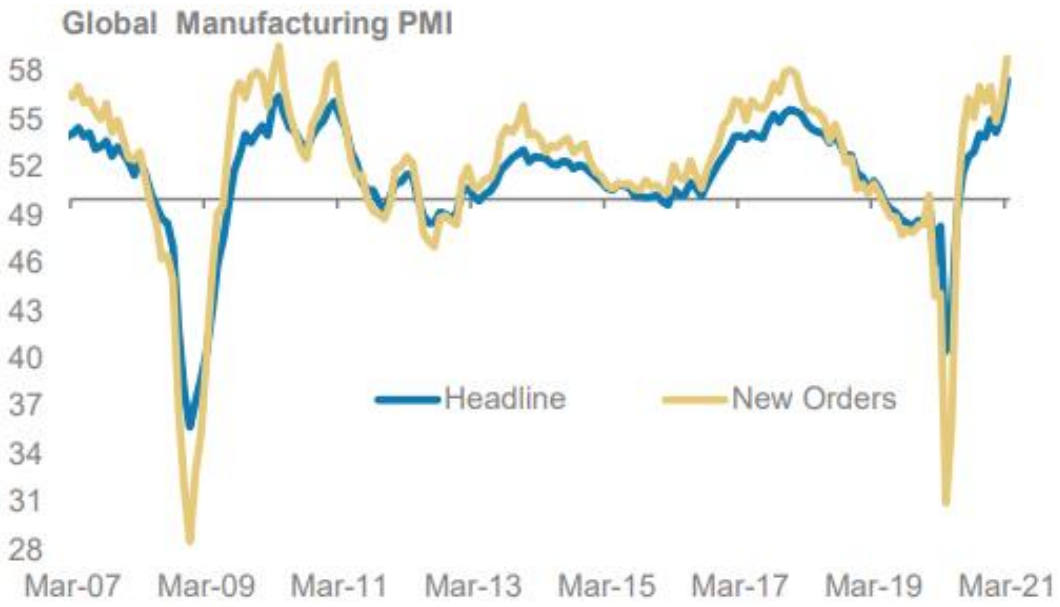
- **Latest Data/Increasing Stimulus/Vaccine Availability…**
  - Prompting IMF, OECD, private forecasters to raise their cyclical outlook
  - This year's Global GDP growth now forecast in 6% - 7% range - roughly double the long-term trend
- **Major Developed Markets, China and India Expected to Participate in Current Surge**
  - US growth accelerating sharply in response to extortionary stimulus
  - Euro area expected to regain momentum, following drags from renewed lockdowns
  - UK gradually easing lockdowns, poised to surge in current quarter
- **Some Concerns Being Raised about Reflation and Debt Sustainability But…**
  - Few question global economy's exceptional near-term strength
- **Biden's Corporate Tax Proposal Generating Considerable Discussion**
  - "Usual Suspects" supporting and opposing raising corporate rate to 28% - hit to S&P 500 earnings estimated at 5+%[1]
  - Prominent members of global community seemingly agree on international proposals in principle[2]
    - Minimum corporate rate fine but: Is 21% acceptable? Will Ireland agree?
    - Giving other countries power to tax slice of profits based on sales in their countries fine but…
    - Will they agree to limit provisions to only ~100 mega corporations? What will be the rate?

1. Capital Economics estimate
2. Mario Draghi and Hans Vijibrief of the Netherlands support a minimum corporate tax

Macroeconomic Backdrop

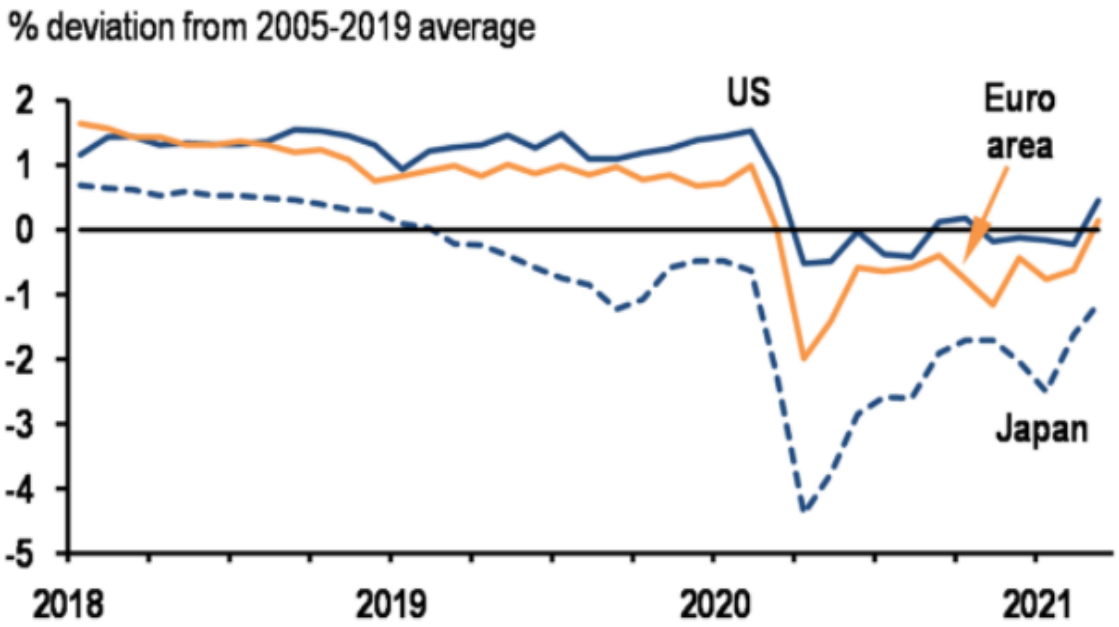
- Global manufacturing PMI reached new high in March
- Demand (new orders) continuing to increase, despite constrained global supply chains

Global Manufacturing



- Consumer confidence improved across major DMs in March but…
- Still below pre-pandemic levels, particularly in Japan

G-3 Consumer Confidence



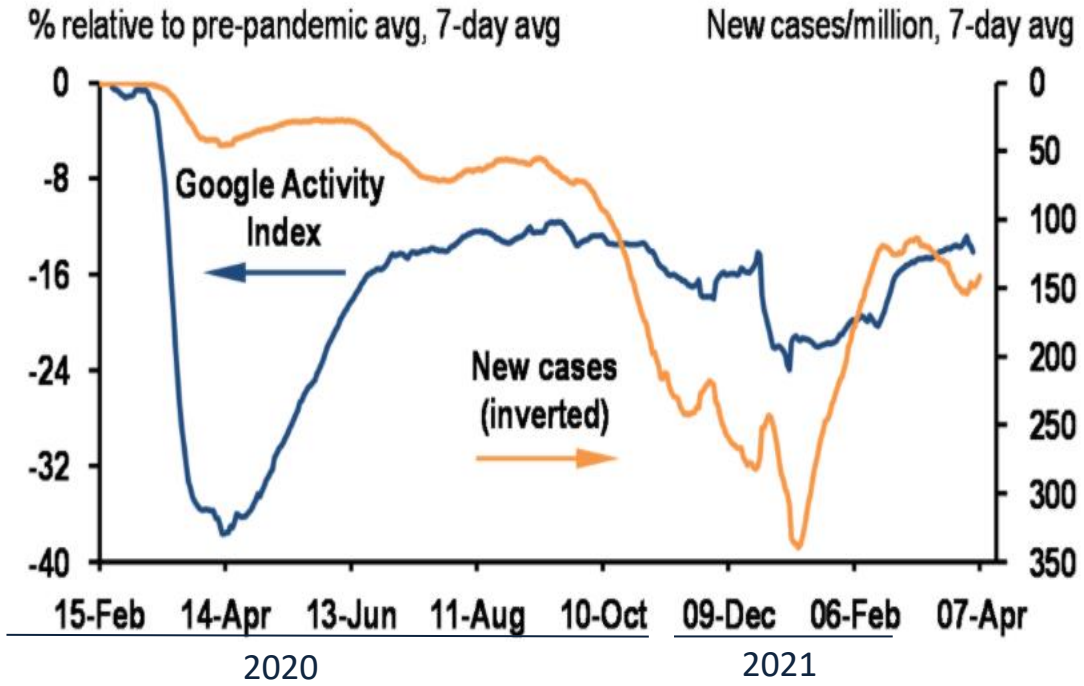
Source: Markit, Haver Analytics, MS, J P Morgan

Covid-19 Update

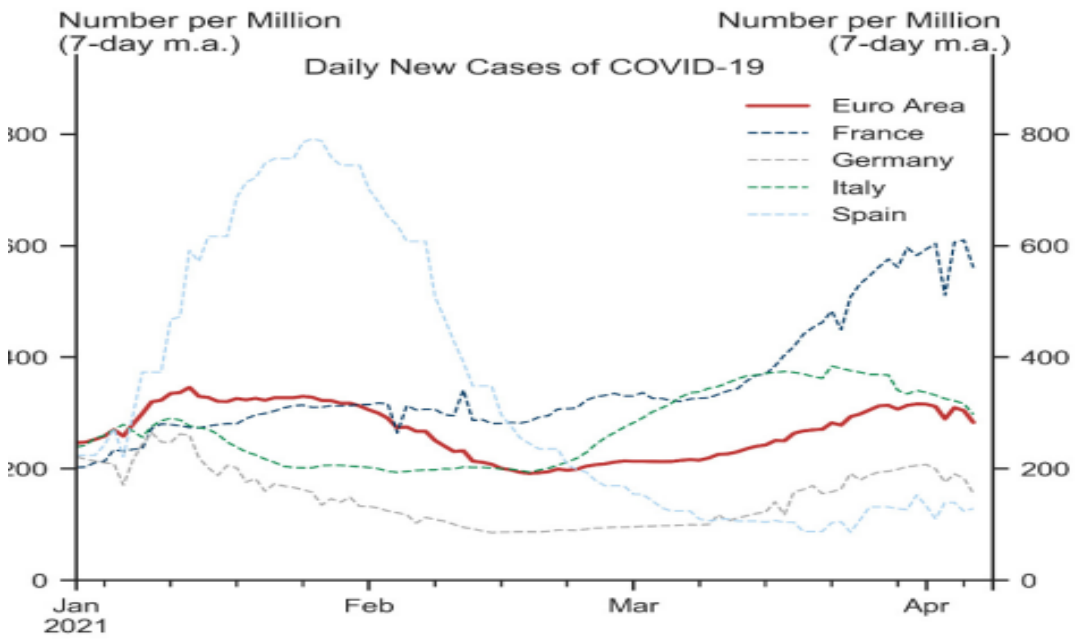
- New global Covid-19 cases still at high level but…
- Mobility up from levels earlier in year

- Recent surge in Europe appears to be attenuating with…
- Lockdowns and vaccinations seemingly containing virus in April
- Vaccinations expected to reach 50% of population in July

Global Mobility & New Cases (per mil.)



New Cases in Euro Area Countries

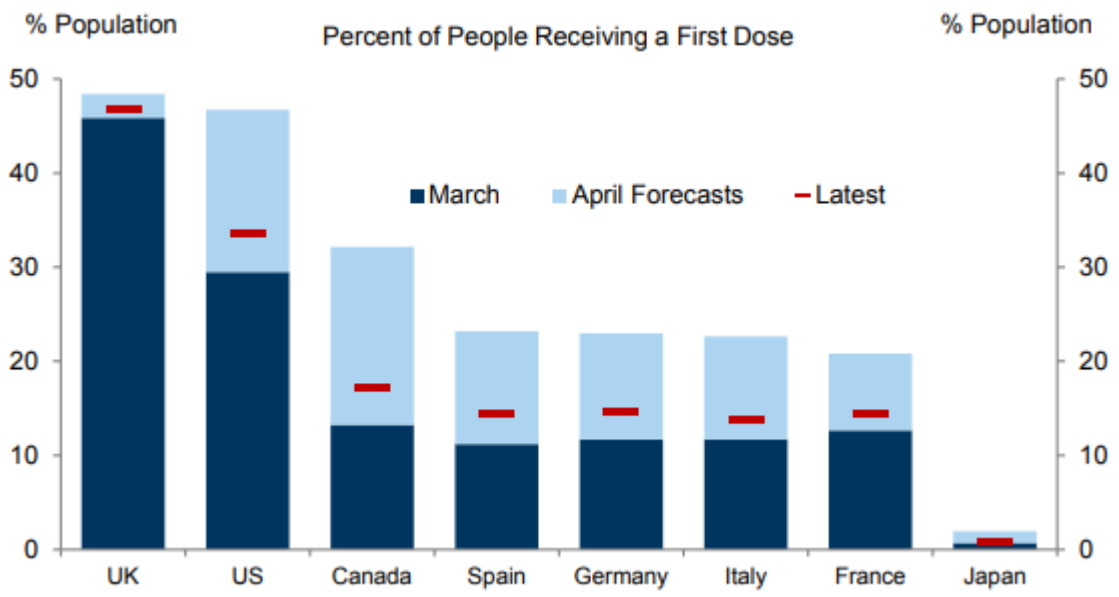


Source: J P Morgan, Our World Data, GS

Covid-19 Vaccine Rollout

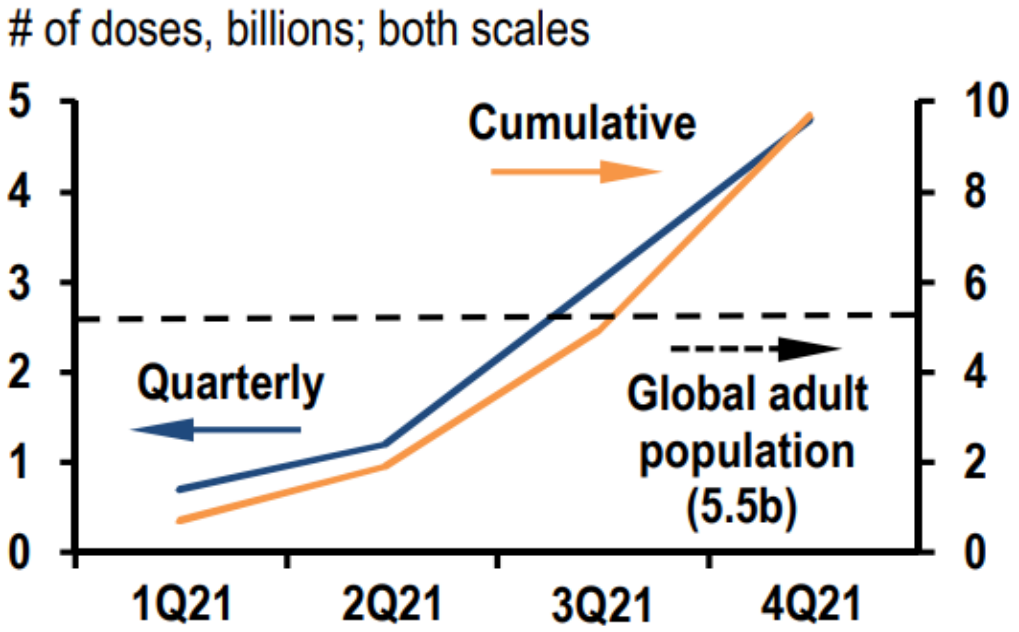
- US and UK leading among major Developed Markets in vaccine rollout
- Supply should accelerate in April with expanded Pfizer-BioNTech, Moderna and J&J output
- Countries with large contracts to these suppliers - - US, EU and Canada - - should benefit

% of Population Receiving 1st Dose



- Global vaccine production expected to provide 10 billion doses by yearend, sufficient to vaccinate world's entire adult population
- Distribution across EMs likely to be uneven and trail global output

Global Vaccine Production



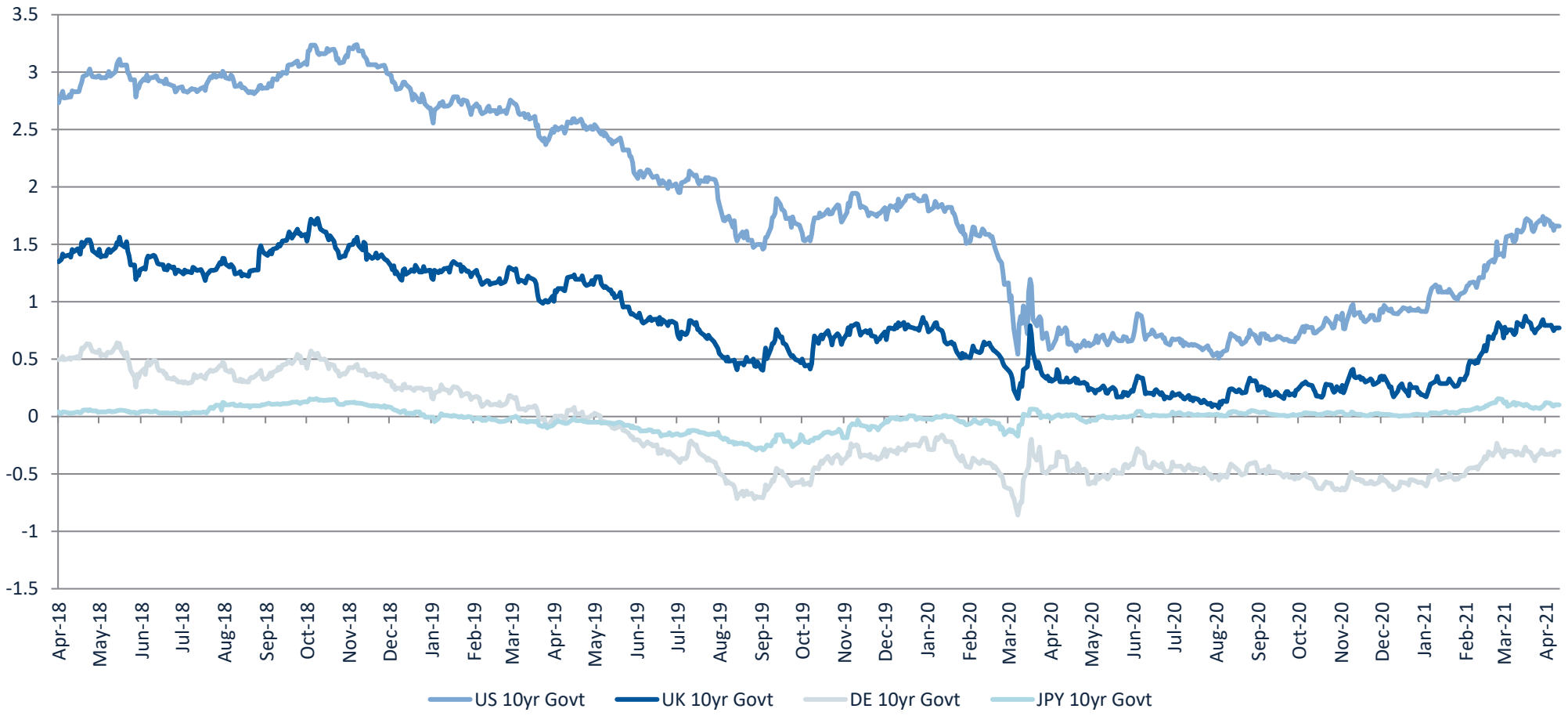
Source: Our World in Data, GS, J P Morgan

Market Performance

(USD)	Since 3/5	YTD	2020	2019	2018
Equities					
MSCI ACWI	5.87%	7.94%	16.26%	26.60%	-9.42%
MSCI EAFE	5.39%	6.09%	7.82%	22.01%	-13.79%
MSCI EM	-0.49%	3.40%	18.31%	18.42%	-14.57%
MSCI US	7.58%	9.63%	20.73%	30.88%	-5.04%
Fixed Income					
BarCap Global Agg Total Return (Hedged)	0.07%	-2.20%	5.58%	8.22%	1.76%
Citi US 10+ Govt Bond Index	-0.73%	-12.25%	17.72%	14.89%	-1.89%
BarCap US High Yield Total Return (Unhedged)	1.02%	1.57%	7.05%	14.32%	-2.08%
Oil					
WTI Crude	-10.01%	21.83%	-10.99%	8.90%	-4.16%
Brent Crude	-8.34%	21.85%	-13.04%	4.34%	-1.74%
Currency					
USD/EUR	0.17%	2.90%	-8.25%	1.86%	7.00%
USD/GBP	0.68%	-0.46%	-3.07%	-3.76%	6.16%
USD/JPY	1.25%	6.15%	-4.99%	-1.00%	-2.54%
USD/CNH	0.59%	0.93%	-6.73%	1.38%	5.53%
USD/TRY	8.33%	10.17%	24.88%	11.93%	40.19%
USD/ARS	2.29%	9.85%	40.55%	58.95%	100.07%

Source: Bloomberg, data as at April 9, 2021

Sovereign Bond Yields

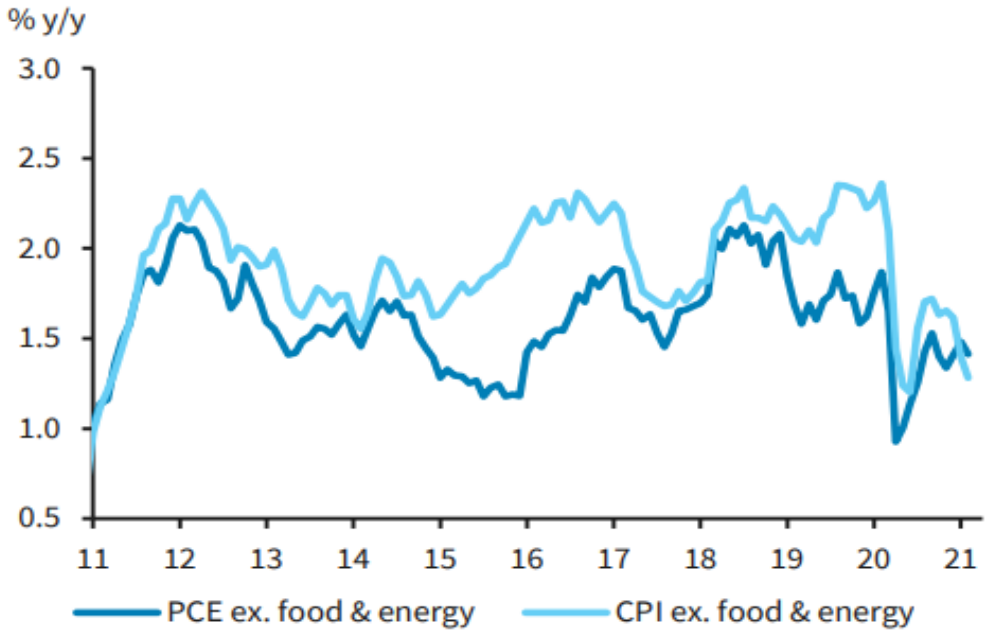


Source: Bloomberg

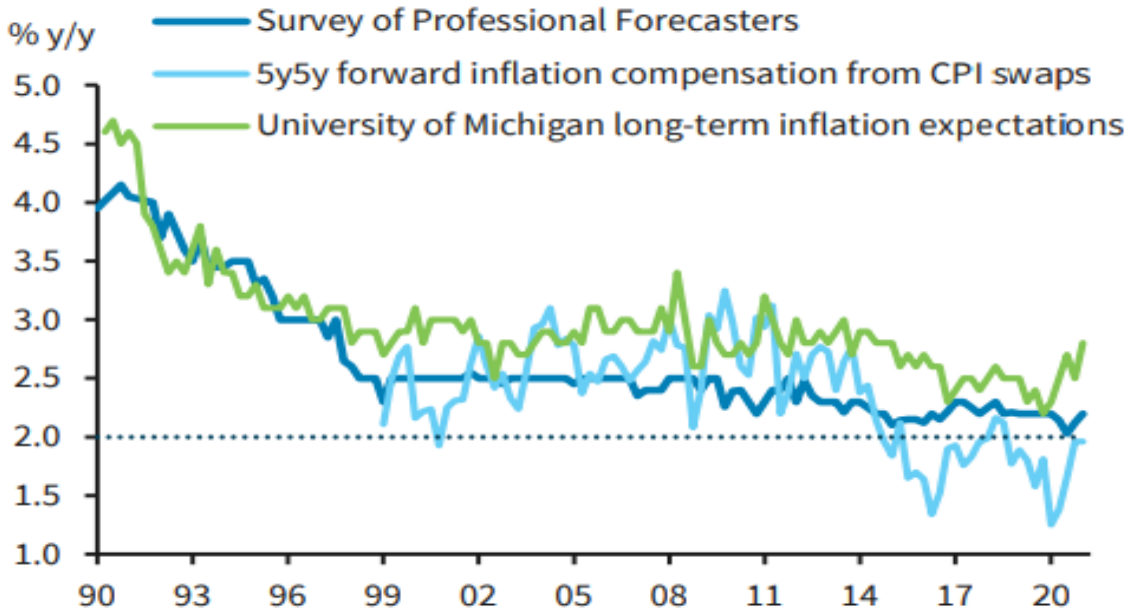
US Inflation Still Contained Based on Most of Recent Reports

- Core still contained, even though headline inflation may rise above 2% in coming months due to:
  - Base effects, higher commodity prices, and supply chain bottlenecks
- Inflation expectations up from recent lows but roughly in line with 20-year average
- Market-based measure of inflation expectations ~2% currently

Core Consumer Inflation Currently ~1.5%[1]



Inflation Expectations



1. **Fed's latest median projections for core PCE inflation: 2.2% ('21), 2.0% ('22)**

Source: BLS, BEA, Barclays, FRB, U Mich, Haver Analytics

Reflation Debate

- **Concerns About Overheating Largely US Phenomenon for Now, at Least Among Major DMs**
  - Unprecedented fiscal stimulus[1] /High vaccination rates/Recoveries in other major DMs starting from deeper holes[2]
- **Mainstream Economists[3] - - $1.9 Trillion Stimulus Package Passed in March Raising Concerns**
  - Unemployment rate declining when latest stimulus enacted
    - Sending $1,400 checks to millions of Americans financed by new debt when $1.5- $2 trillion of excess savings also available…
  - Risks creating spending boom that will more than close output gap and could…
    - De-anchor inflation expectations and shift Phillips curve[4]
- **Case for US Core Inflation Not Rising Materially Above 2% Over Cyclical Horizon**
  - Slack in economy much greater than widely used metrics imply
    - Effective unemployment rate ~10%, not 6%[5]/estimated output gap ~6%, not 3%[6]
  - Much of stimulus temporary and one-off payments
    - Unemployment benefits will expire or scale down/fiscal stimulus expected to decelerate to 5% next year[7]
  - Only roughly two-fifths of core PCE very responsive to cyclical factors
    - Affordable Care Act has made health care disinflationary

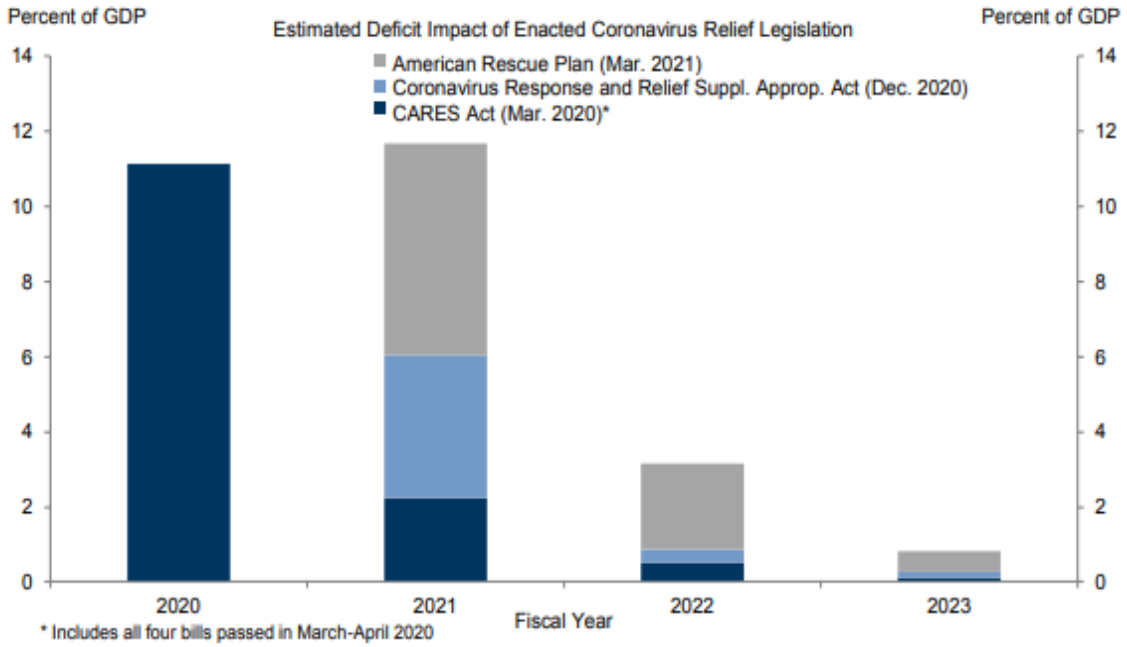
1. US fiscal stimulus since April 2020 has totaled $5.3 trillion
2. Real GDP was down 2.4% yoy in US in late 2020 vs 5% in Europe and 8% in the UK
3. Former Treasury Secretary Larry Summers and former Chief IMF economist Olivier Blanchard
4. Blanchard points out that in early 1960s when inflation started to rise (from 1% to ~3%) expectations remained anchored but in 1967 when inflation edge up further they adjusted rapidly
5. Janet Yellen: because 4 million people have dropped out of labor force because of child-care responsibilities during pandemic, effective unemployment rate is close to 10%
6. GS economists content CBO estimated output gap (3% at YE 2020) is too low. CBO showed economy running above potential in two years before pandemic while inflation remained below target
7. Infrastructure and other fiscal measures totaling ~$3 trillion likely to be spread over 10-yer period and be partially offset by higher taxes

$5 Trillion US Fiscal Response to Pandemic/DM Output Gap Narrowing

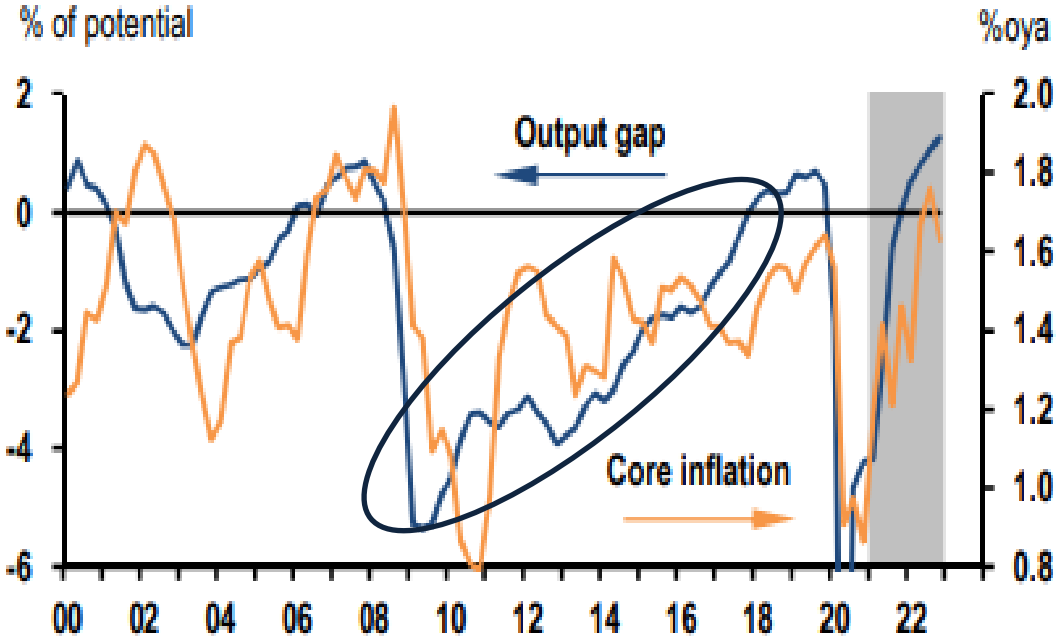
- Congress has passed three major Covid-19 relief measures in the past year
- Roughly $4 trillion of these relief allocations expected to be spent by the end of this year before dropping sharply in subsequent years

- Output gap difficult to measure and questions remain concerning its size
- Virtual agreement closing much faster than post Global Financial Crisis

Covid-19 Relief Measures



DM Output & Core Inflation



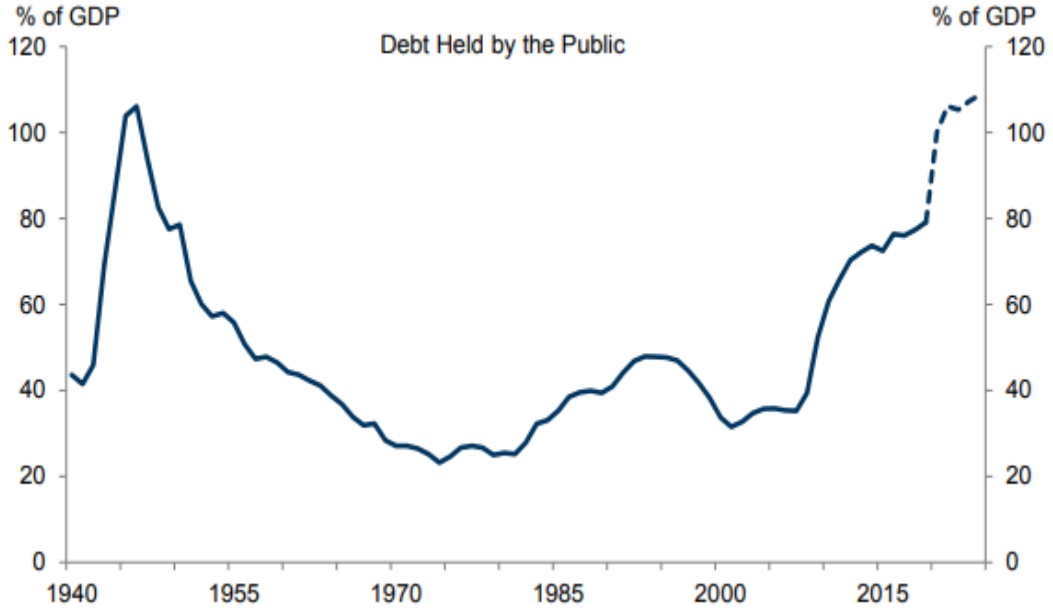
Source: Congressional Budget Office, GS, J P Morgan

Record Debt Levels/Low Rates: Generating New Thinking re Seeming Sustainability [1]

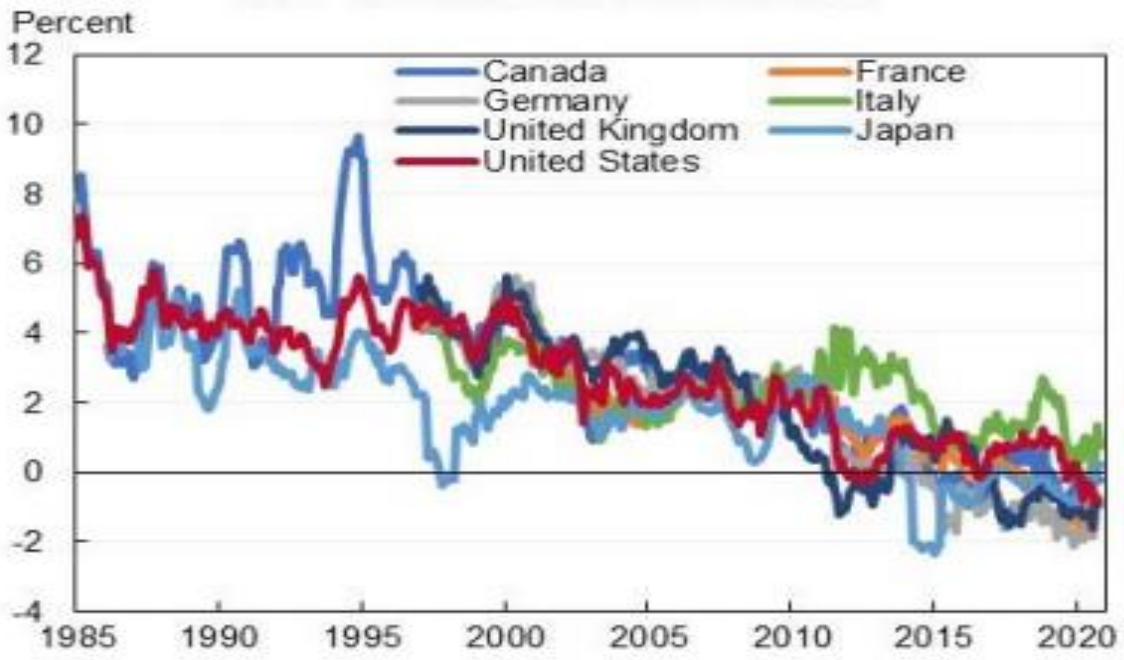
- Ratio of US federal debt to GDP rose above 100% last year
- Will soon surpass World War II peak, reaching highest level in US history

- Global rates near historic lows
- Some argue current low rates make fiscal expansion affordable and perhaps attractive

US Federal Debt to GDP Ratio



Real Ten-Year Benchmark Rate



1. **Key inputs: Panel discussion at Brookings Institute (December 2020), Furman/Summer paper (Nov 2020)** Source: Office of Management and Budget, GS

Source: Office of Management and Budget, GS, Various Central Banks, Furnman Summer

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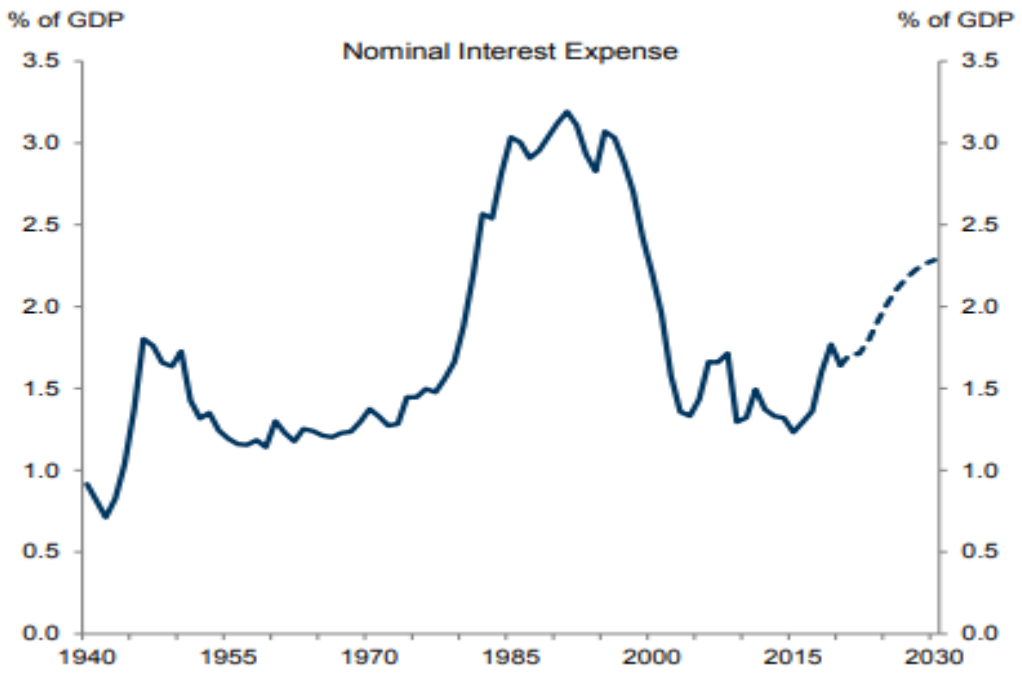
Debt Servicing Costs: Principal Factor Generating New Thinking

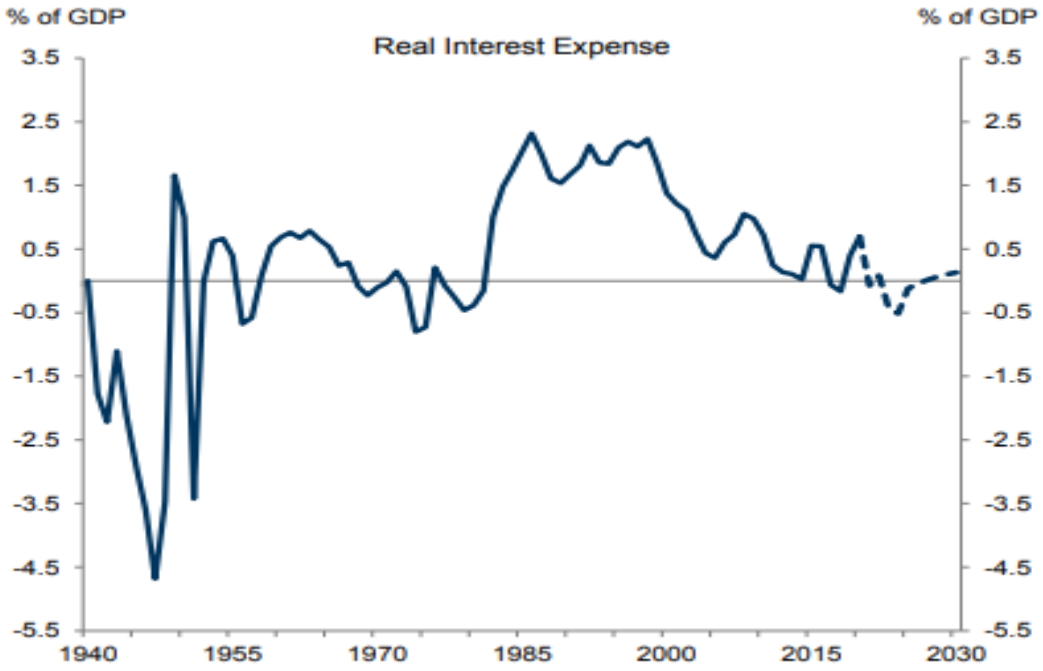
- Debt servicing costs far below recent peaks
- Even with some further modest increases in rates[1] over the decade ahead, servicing costs expected to remain manageable

- If the impact of inflation on debt levels and interest costs taken into account …[2]
- Possible to argue real servicing costs could edge down from ~1% to ~0% by 2030

Interest Expense as % of GDP



Real Interest Expenses % of GDP



1. **GS expects policy rate to return to Fed's long-run normal ~2.5% over the course of the decade**
2. **Furman and Summers recommend subtracting the stock of debt that is "inflated away" each year from interest payments**

Source: Office of Management and Budget, GS

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Some Caveats Re Sustainability of US Public Debt Servicing Costs

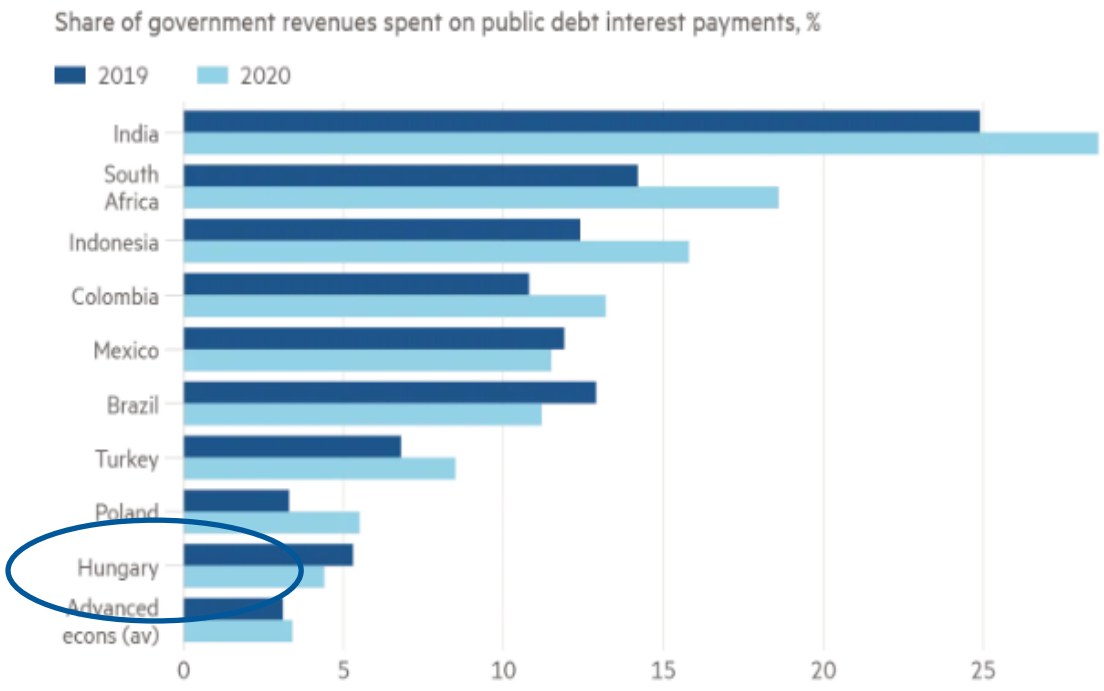
- **Current Estimates Do Not Include Possible Increases to Meet Promised ”Entitlements”**
  - Medicare Insurance Trust Fund is expected to be depleted in 5 years[1]
  - Social Security Trust Fund not expected to be able to pay full benefits beyond 2032[2]
  - Policymakers will face difficult choices of raising taxes and/or reducing benefits
- **Estimates Assume Policy Rate Gradually Moves to Fed’s Neutral Rate (~2.5%)**
  - Service costs estimates vulnerable to higher rates
- ***“Longer Current Policies Proceed as if Limits Don’t Exist, the More Likely They Will Hit Them”[3]***

1. Bipartisan Policy Center of AEI (March 2021). Based on current estimates without raising taxes Medicare would be able to cover only 89% of hospital and insurance payment in 2026.
2. Social Security trust fund is expected to be no longer able to pay full benefits starting in 2032 based on estimates from Wharton School study.
3. Paraphrased quote from Greg Ip’s article in April 8, 2021 WSJ.

Debt Servicing More Challenging for EMs

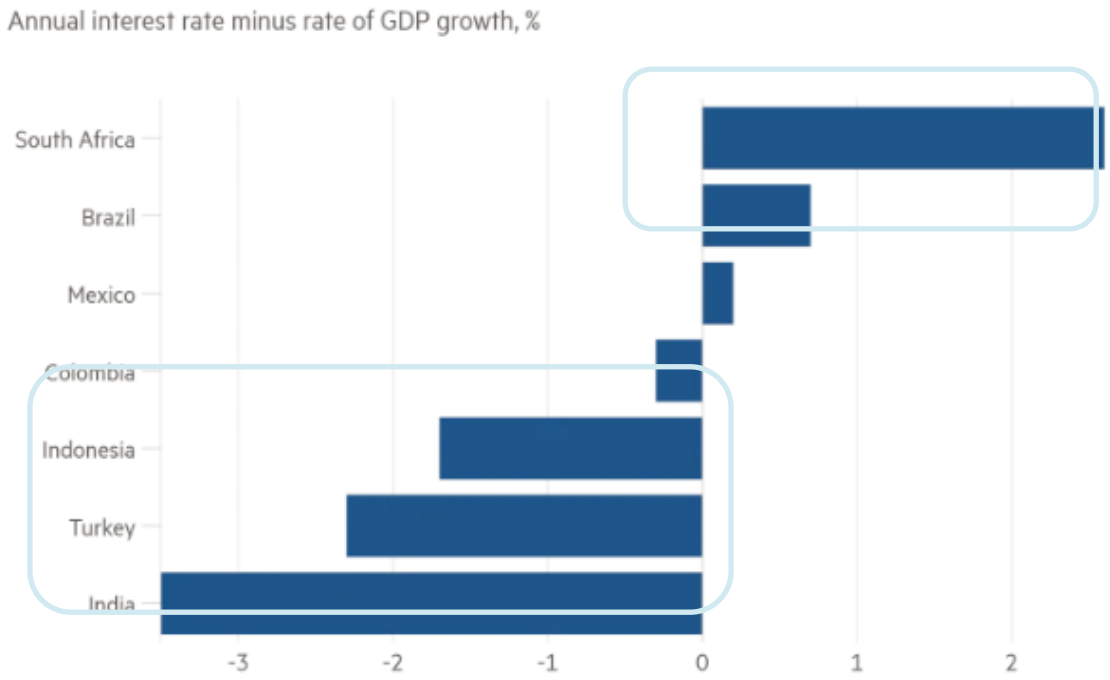
- Developed Markets average share of government revenue spent on servicing public debt 3.3% in 2020
- In contrast, Emerging Markets average share of government revenue spent on servicing public debt 10.4% in 2020

Debt Servicing Costs: EMs vs DM Avg.



- Servicing costs seemingly manageable for high growth Emerging Markets such as India
- But more challenging for moderate growth EMs such as South Africa and Brazil

Growth & Interest Rates

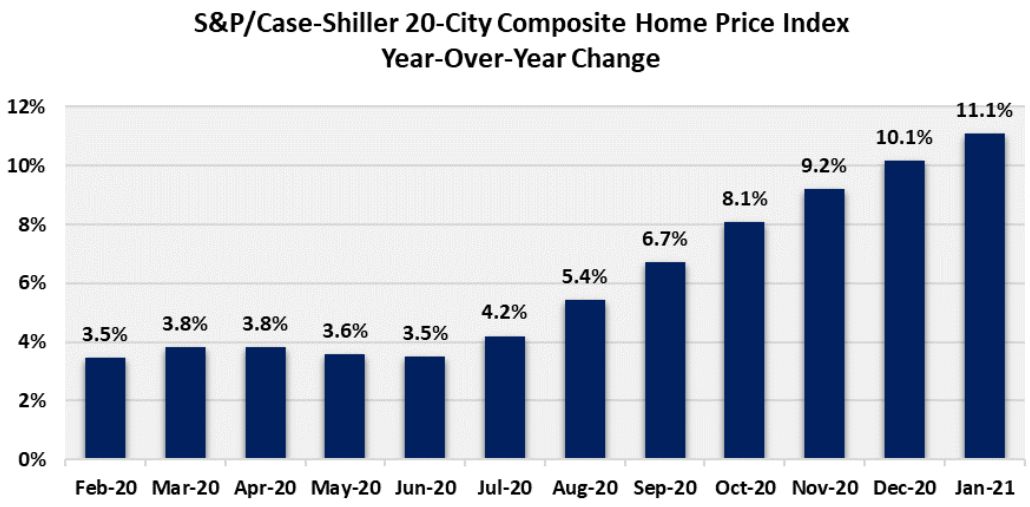


Source: Fitch, IIF

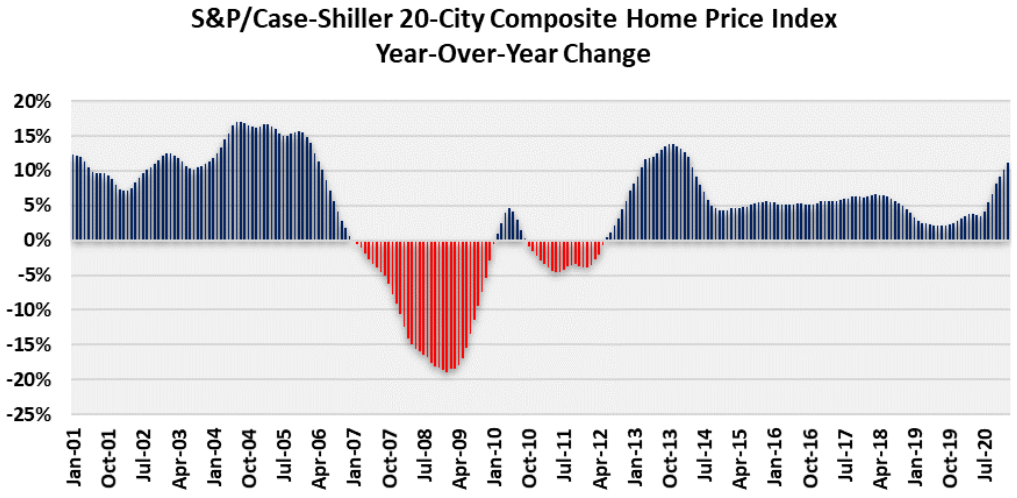
Equity Update

Another Housing Bubble?

- The residential real estate market in the US has started to heat up.
  - Home prices increased by 11.1% YoY in January 2021; February and March data are forthcoming but likely continued the rally.



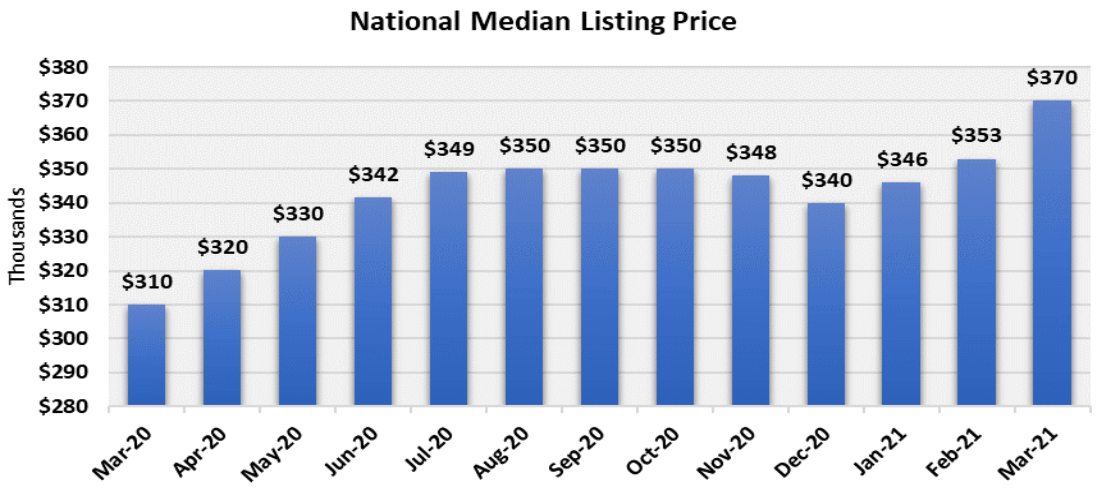
- This recent rise in home prices has raised concerns of a repeat of the first decade of the 2000s.



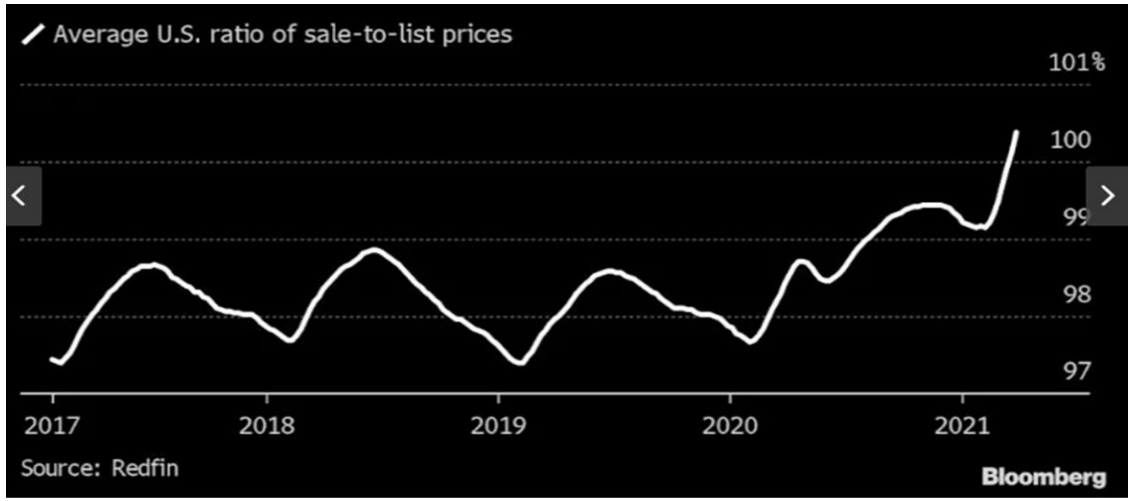
Sources: Federal Reserve Economic Data.

Another Housing Bubble?

- The median listing price has also seen a big jump recently.
  - The median listing price was up 19% YoY in March 2021.



- Despite this, the average house in the US is now selling at a premium to its list price.
  - 36% of all homes sold above list in Feb 2021 vs 22% in Feb 2020.



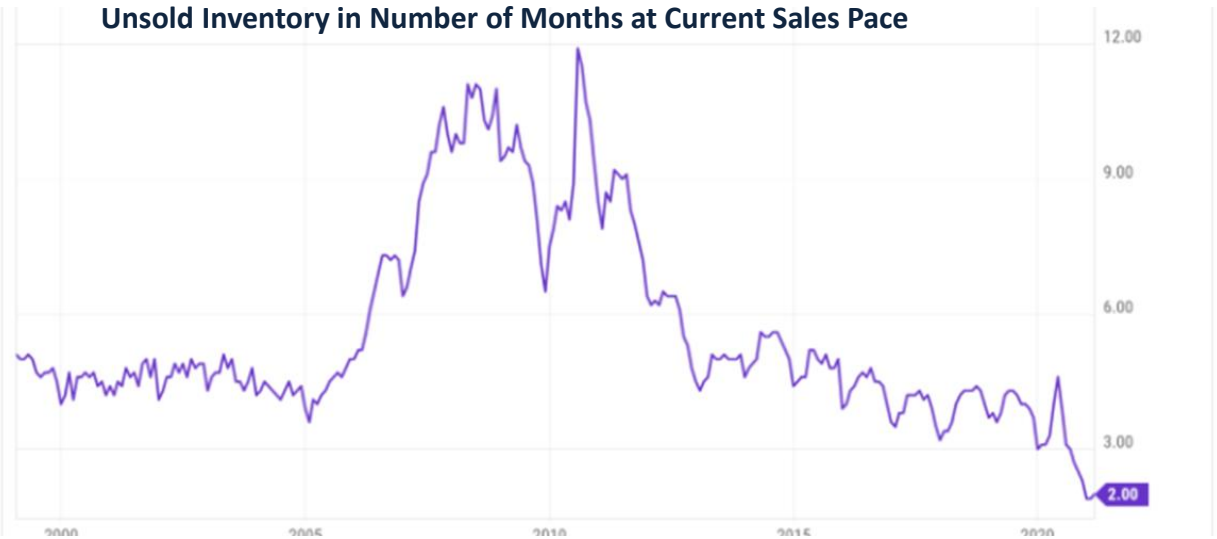
Sources: Realtor.com, Redfin, Bloomberg.

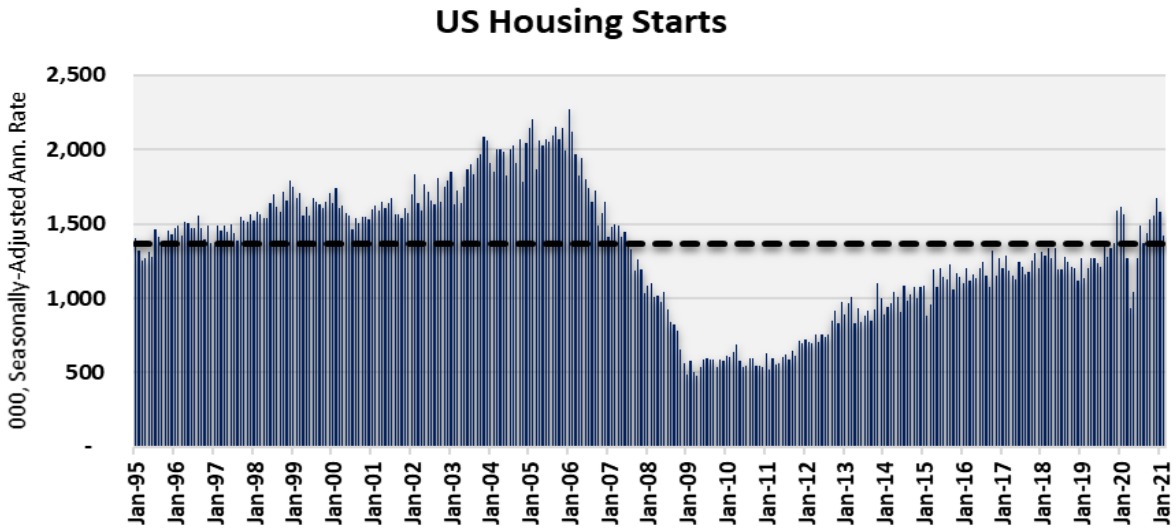
Constrained Housing Supply

- The current supply of homes on the market (2 months of inventory) is extremely low versus history, but it has been constrained by the pandemic and seller's reluctance to have strangers going through their homes.

- And by homebuilders being more cautious after the last boom and bust cycle.

  – February starts were just slightly above median for the last 25 years and 40% below 2006's peak.

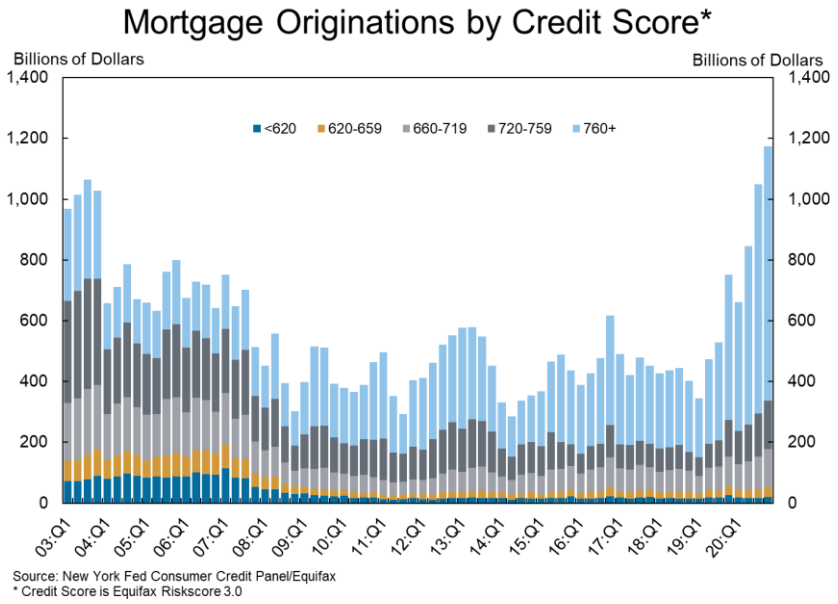


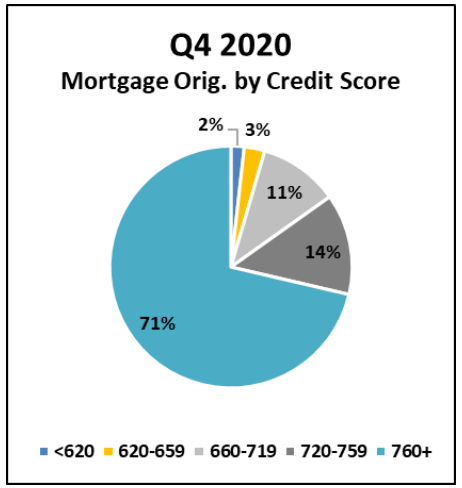


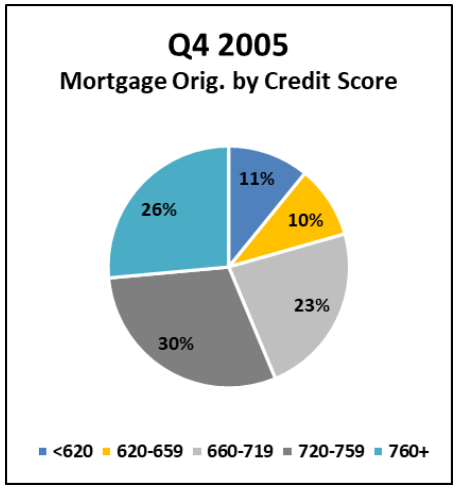
Sources: Y!Charts, Federal Reserve Economic Data.

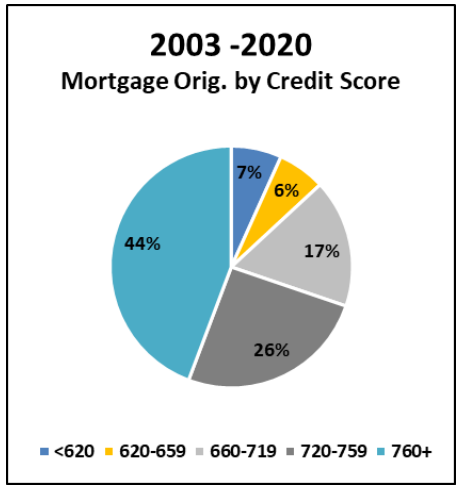
Improved Borrower Credit Quality

- Borrowers today are more creditworthy than at any time in recent history.
  - 71% of mortgages originated in Q4 2020 were to borrowers with a credit rating of Excellent (Equifax score 760 or above), versus only 26% in Q4 2005 and an average of 44% since 2003.
  - Only 5% of originations in Q4 2020 were to those with a rating of Fair or worse (659 or below) versus 21% in Q4 2005 and a 13% average since 2003.







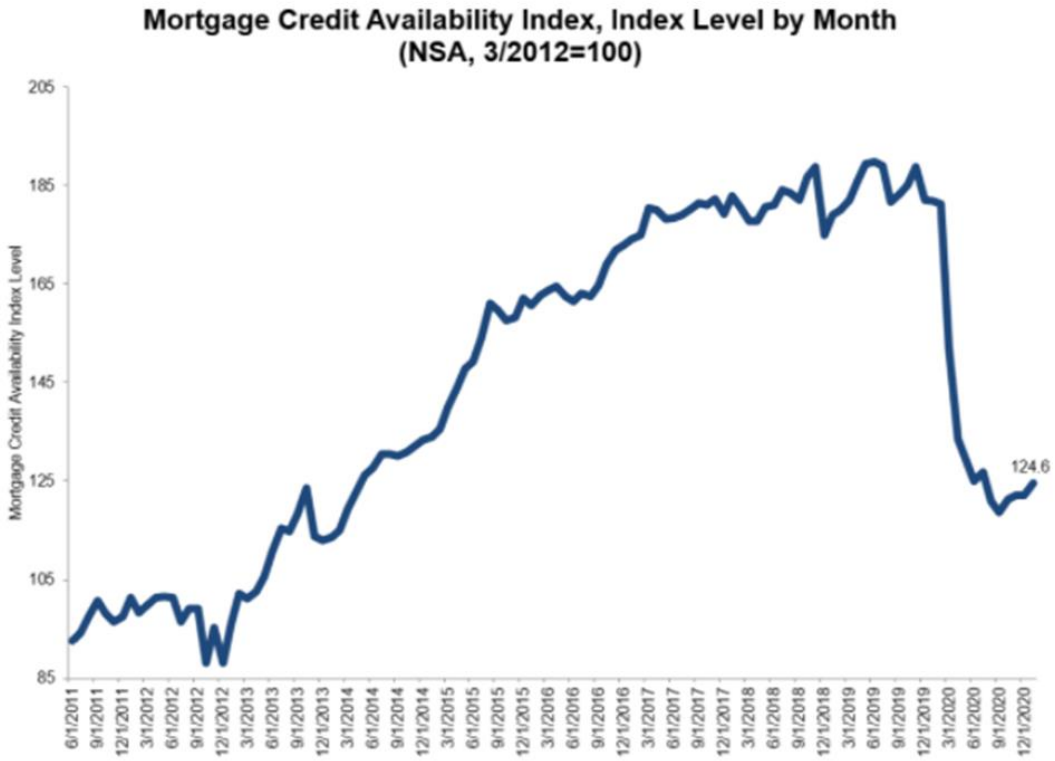


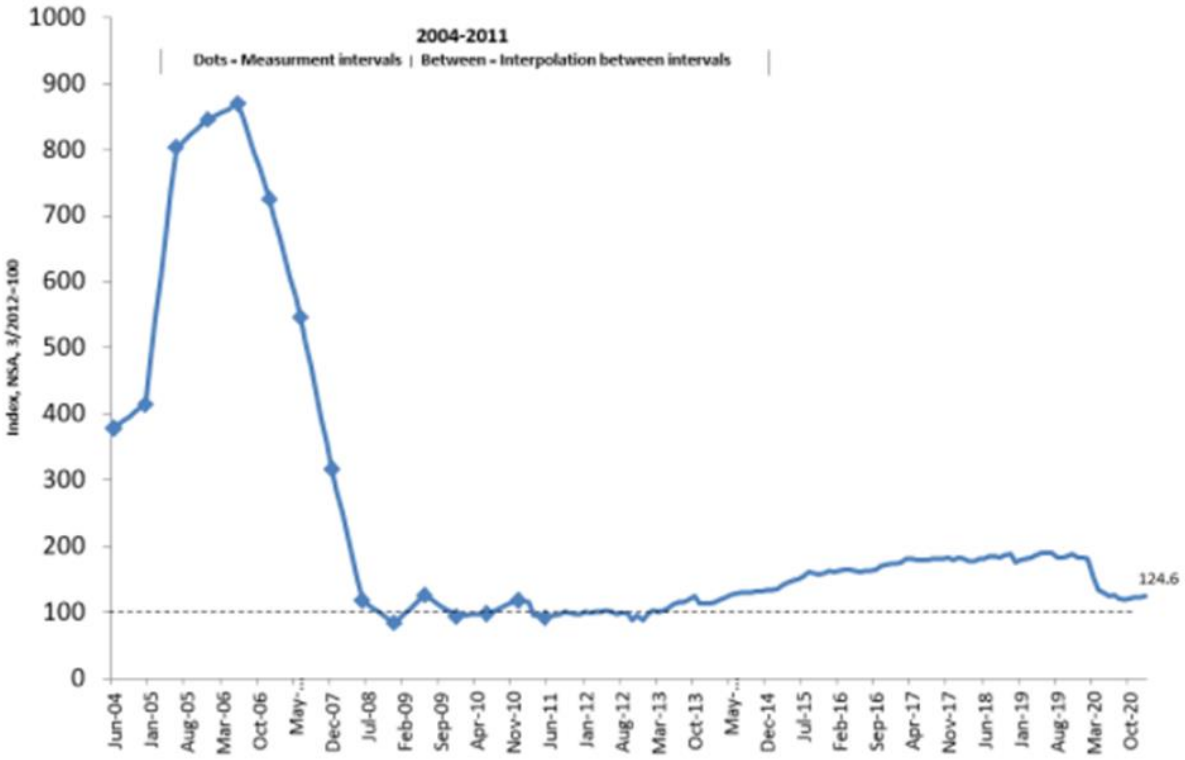
Source: Federal Reserve Bank of New York.

Mortgage Availability

- Lenders have become much more cautious, with mortgage availability only ticking up in recent months after pulling back more than 30% during the pandemic.

- And in the longer-term context that includes the GFC, mortgage availability today is only a fraction of its mid-2000s peak.

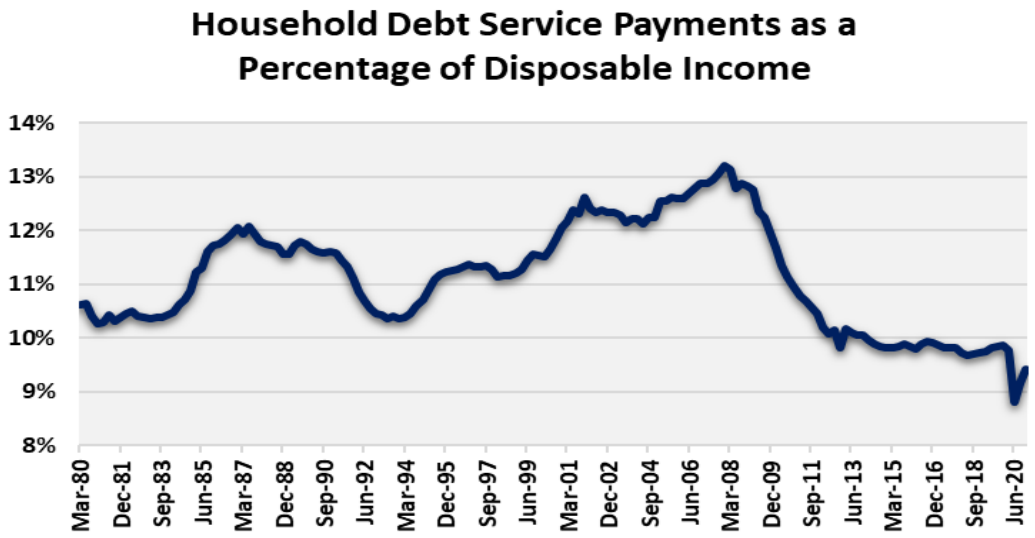




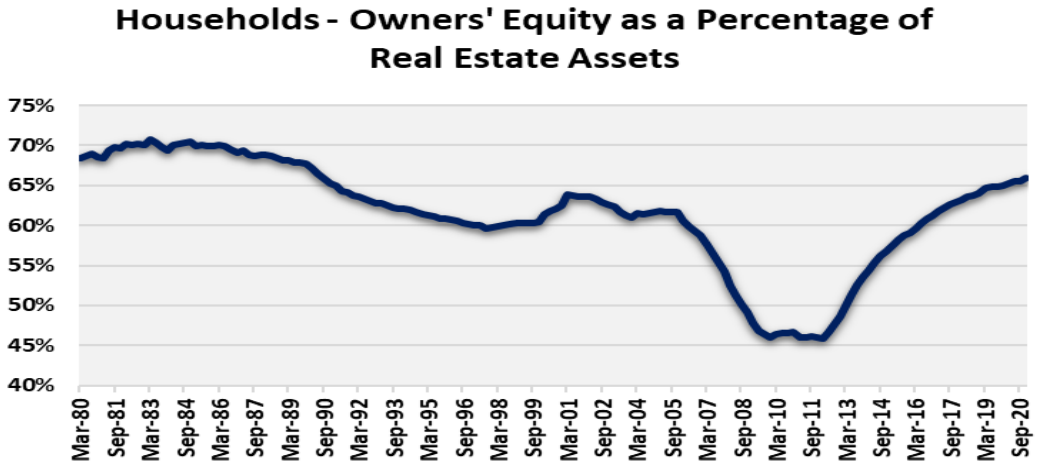
Source: Mortgage Bankers Association.

Consumer Balance Sheet

- A combination of lower rates, some consumer trepidation after the GFC & during the pandemic, as well as recent stimulus payments has left the US consumer debt payments at a low level as a percentage of disposable income.



- And homeowner's equity in their homes is as high as it has been since 1990 after bottoming a decade ago.

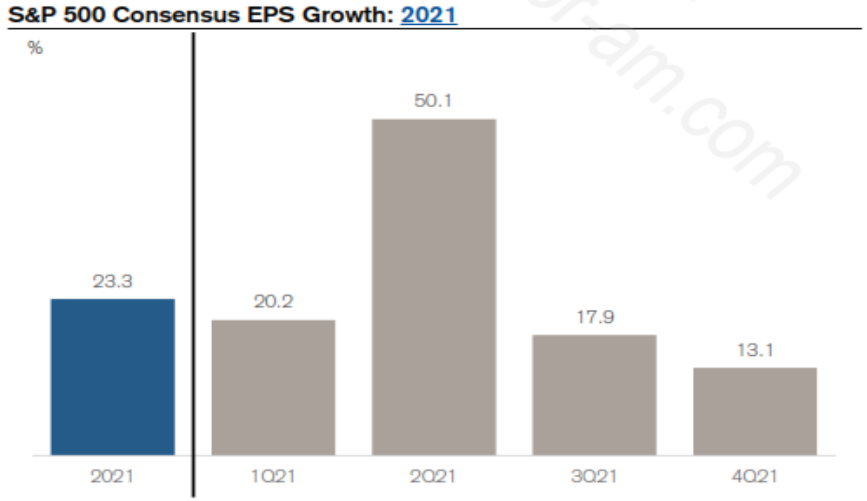


Sources: Federal Reserve Economic Data.

Q1 Earnings

- Q1 earnings season kicks off in the US this week after a surprisingly strong 2020 in the US.
  - Earnings fell by 13.5% in 2020 but analyst expectations were too conservative during the pandemic.

- Consensus expectation is for Q1 earnings to grow by 20.2% YoY (Sales growth +5%, net margin expansion of 66 bps to 9.9%).
  - 2021 consensus is for 23.3% EPS growth.



Sources: Credit Suisse, Standard & Poor's, Refinitiv, FactSet, Goldman Sachs Global Research.

Emerging Market Debt (EMD) and High Yield (HY) Updates

EMD Update

YTD Returns (as of 31 March 2021)

Hard Currency EMD	EMBI Global Div	-4.5%
Local Currency EMD	GBI-EM Global Div	-6.7%
EMD Corporates	CEMBI Broad Div	-0.8%

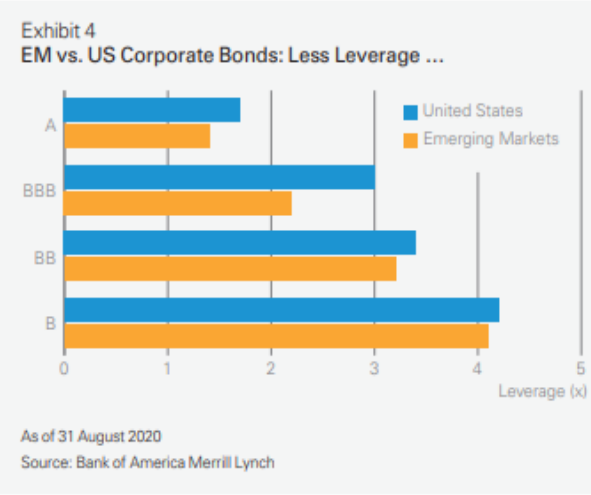
- Negative returns across EMD sectors YTD
  - Rising US Treasury yields
    - Initially, nominal yields rose while real yields remained low; in February real rates began to rise
  - Stronger than expected US fiscal stimulus package, paired with better than anticipated data → upward revisions for US growth forecast and a narrowing of US-EM growth differential

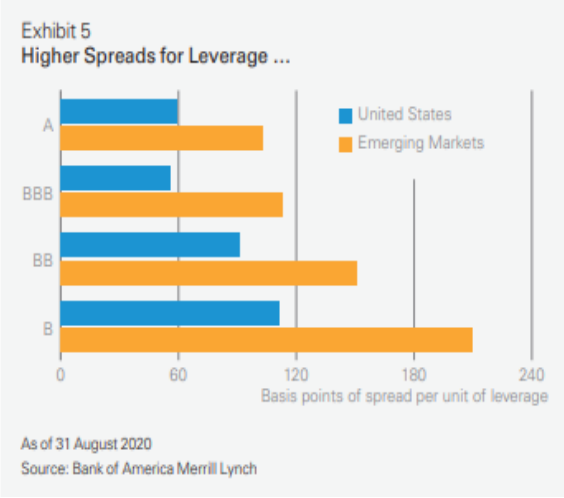
- EMD Corporates have been outperformed
  - Lower duration & solid fundamentals

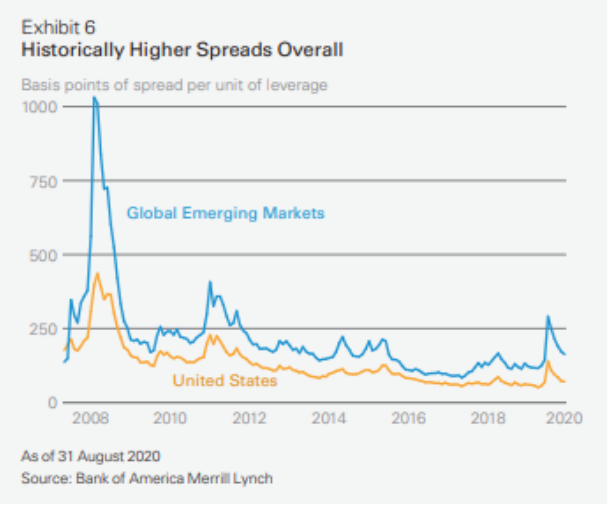
Source: SHIP

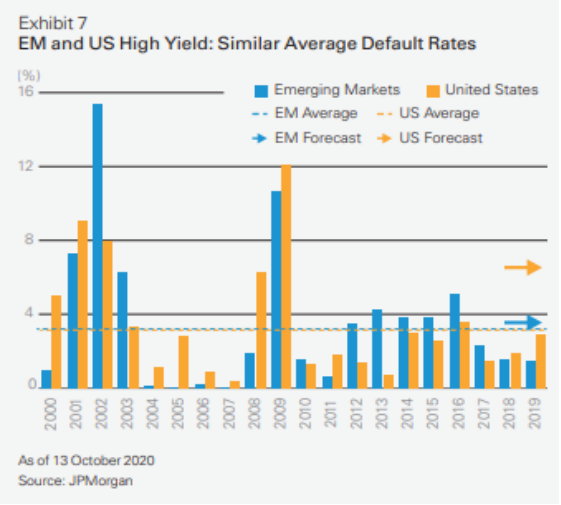
EMD Corporates

- Traditionally viewed as being riskier than EMD Sovereigns, but demonstrated significantly less volatility during pandemic
- Well diversified
  - 700 issuers from 57 countries
- EM issuers typically issue debt abroad to fund growth (due to scarcity of local capital) – in comparison to DM corporate borrowers (particularly in HY) where leverage is often used to increase equity return or fund M&A activity
  - More creditor friendly
- Higher yield without a commensurate decrease in credit quality
  - Lower net leverage than US corporates at every credit rating









Source: Lazard

EMD Corporates

- The main concern around EMD Corporates is liquidity
  - However, bid-ask spreads are similar to US HY, and this argues more against high turnover/short-term strategies than a longer-term allocation
- Some technical concerns
  - Only 5% of EMD Corporate debt indices is held by dedicated investors; remaining 95% is crossover/opportunistic capital, and thus more susceptible to sell-offs

Source: Lazard

EMD – March Performance Update

EMBI Global Diversified

Country	Mar 2021 Return %	YTD 2021 Return (%)
Bahrain	-0.74	-1.83
Brazil	-1.08	-6.24
Chile	-0.22	-5.90
China	-0.51	-1.21
Colombia	-0.48	-7.89
Dom. Republic	0.10	-6.46
Egypt	-2.43	-6.48
Indonesia	-0.13	-4.15
Kazakhstan	-0.57	-5.44
Malaysia	-1.02	-5.58
Mexico	-0.18	-5.59
Oman	0.38	1.70
Panama	-0.61	-8.81
Peru	-1.75	-9.43
Philippines	-0.92	-5.44
Qatar	-0.52	-5.80
Russia	-1.88	-5.40
Saudi Arabia	-0.94	-4.41
South Africa	0.03	-3.05
Turkey	-6.05	-7.74
Ukraine	-0.20	-3.22
Uruguay	0.34	-7.41
Total	**-0.96**	**-4.54**

GBI-EM Global Diversified

Country	Mar 2021 Return %	YTD 2021 Return (%)
Brazil	-2.89	-12.89
Chile	-2.07	-6.04
China	-0.93	0.30
Colombia	-5.69	-12.42
Czech Republic	-4.56	-7.09
Dom. Republic	2.87	5.19
Hungary	-2.87	-5.97
Indonesia	-1.73	-5.43
Malaysia	-3.21	-5.38
Mexico	-0.72	-7.36
Peru	-6.64	-11.44
Philippines	-2.61	-1.80
Poland	-5.48	-6.40
Romania	-2.84	-4.02
Russia	-1.94	-5.38
South Africa	0.08	-2.34
Thailand	-3.71	-8.36
Turkey	-20.58	-20.00
Uruguay	-3.00	-2.93
Total	**-3.07**	**-6.68**

Source: J.P. Morgan. Excluded countries with <2% allocation from EMBI Global table. GBI-EM returns are unhedged in $

HY – March Performance Update

Sector	Mar 2021	YTD 2021
Automotive	0.07	0.70
Banking	-0.04	-0.35
Basic Industry	-0.02	0.61
Capital Goods	0.90	1.19
Consumer Goods	-0.77	-0.05
Energy	0.00	3.88
Financial Services	0.23	0.41
Healthcare	0.06	0.13
Insurance	1.15	0.75
Leisure	0.88	2.41
Media	0.26	-0.38
Real Estate	-0.15	0.20
Retail	0.35	1.03
Services	0.87	1.05
Technology	-0.04	0.03
Telecommunications	0.10	-0.39
Transportation	1.18	3.70
Utility	-0.97	-1.59
Total	**0.18**	**0.91**

Rating	Mar 2021	YTD 2021
BB	-0.28	-0.23
B	0.53	1.18
CCC	1.16	4.16
CC	1.12	16.05
C	1.25	58.85
D	0.0	35.06
Total	**0.18**	**0.91**

Source: NCRAM

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