HAVERFORD

QUALITY INVESTING

JULY 2021

Global Economic and Market Commentary

Summary:

- In the US economic cycle, we are at or near "peak everything," but we expect growth to remain strong through year end. Economic reopening and pent up demand should counterbalance waning fiscal stimulus and monetary policy should remain accommodative despite recent inflation data. Globally, Europe and Asia should lead growth in 2H 2021. We foresee manufacturing and trade to accelerate, bottlenecks to ease and central banks to maintain their current dovish stance. We expect 6.0+% global GDP growth in 2021, the strongest in decades.

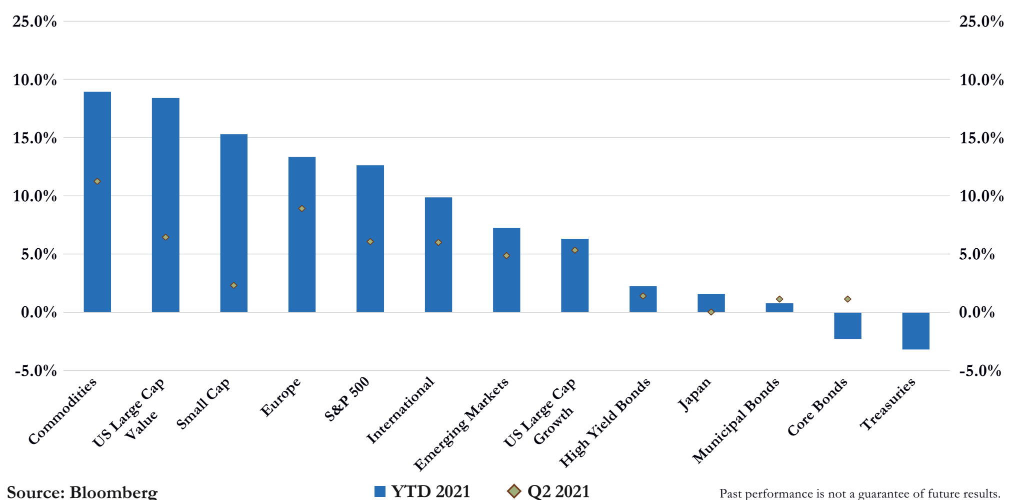
- Global equities are attractive compared to bonds despite higher than average valuations. Earnings growth and potential upside surprises should offset a modest decline in valuations. Additionally, equities tend to perform well during periods of moderate inflation. In the US, corporate tax rate increases would hurt earnings modestly, but this would likely take effect in 2022.

- In international equities, developed markets are likely to lead through year end. Europe and Japan are both accelerating vaccine delivery and lockdowns have eased. Emerging Markets (EM) may lag due to Chinese GDP and credit growth slowing. Long term, we believe EM, specifically Asia are the most attractive non-US equity markets.

- Investment grade bonds remain unattractive relative to equities due to low absolute yields, but we maintain an allocation as a risk offset and source of liquidity. High yield spreads are tight and do not offer attractive returns.

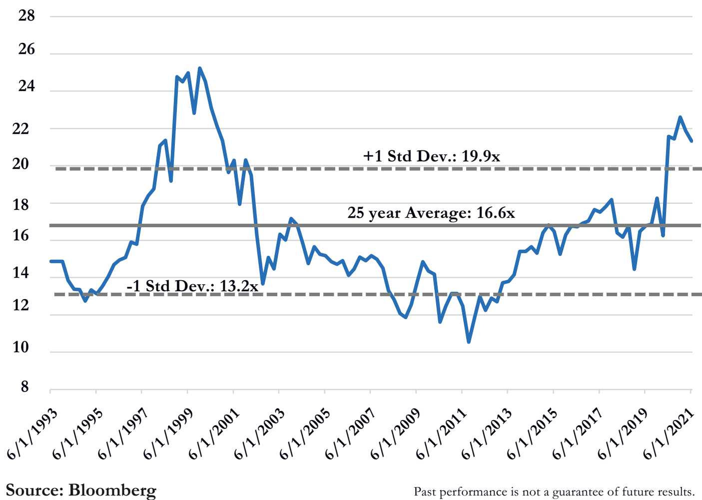
- Current inflationary pressures are likely to be largely transitory once demand and supply reach equilibrium. We believe the inflation rate will be higher than the post Great Recession period but will not warrant extreme monetary policy. Long term interest rates are likely to move higher into 2022.

Exhibit 1: Q1 2021 Asset Class Returns through June 30, 2021

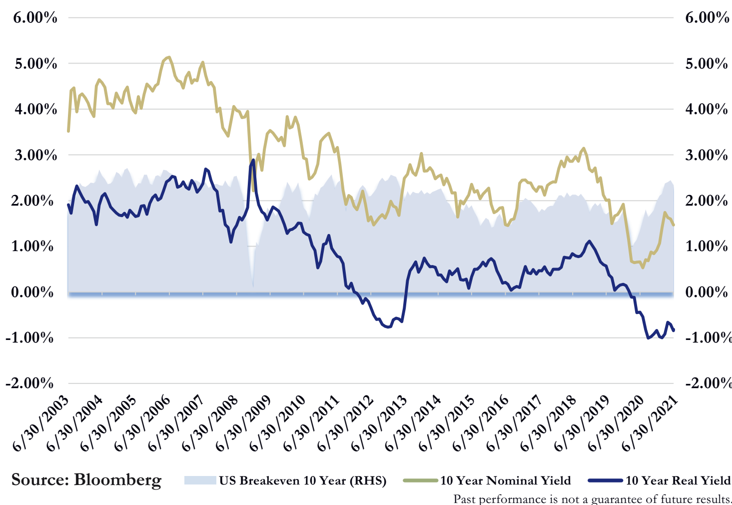


Source: Bloomberg

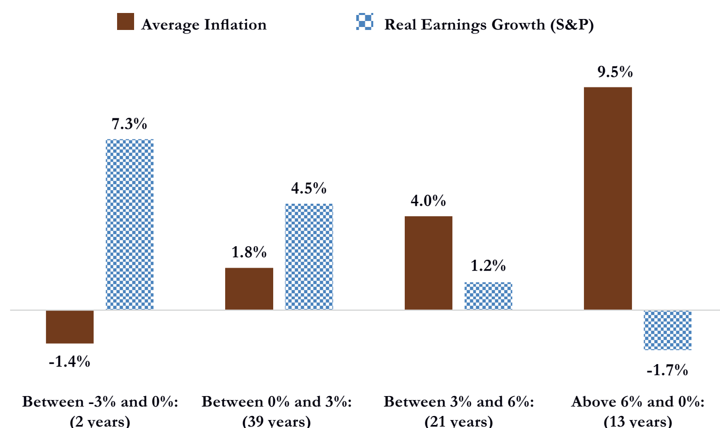
Past performance is not a guarantee of future results.



- Equity valuations have contracted despite strong year to date returns. Earnings growth has surprised to the upside. We foresee further contraction through year end, especially if interest rates move higher.
- The equity risk premium (ERP) for the S&P 500 is not at an extreme, making equities attractive to bonds. The ERP has compressed for small cap companies and cyclicals making these recent outperformers less likely to lead markets in 2H 2021.
- We foresee a shift into higher quality value companies as the US economy exits the early cycle recovery. These companies have lagged, offer predictable forward earnings and can withstand an increase in input prices. A full economic reopening should benefit these companies due to their relatively lower valuations and higher earnings growth.



- US Treasury yields dropped in Q2 as inflation expectations peaked and the size of the proposed infrastructure package declined. Real yields declined in the quarter.
- Accelerating growth in Europe and the UK should facilitate inflation, albeit lower than the US. While the ECB and BOE's reaction functions are likely less sensitive than the Fed, upward pressure on Bund and Gilt yields should translate into higher nominal and real yields in the US in 2022.
- High yield and investment grade credit spreads declined in the quarter and remain near historical lows.



- Historically, when inflation is lower than 6%, companies in the S&P 500 have been able to grow earnings after inflation. Once inflation exceeds 6%, it has been more difficult to grow real earnings.
- Since 1946, annual inflation has resided between 0-6% for 60 of 75 years. In the years with 0-3% inflation, companies in the S&P 500 grew earnings 4.5% after inflation. In years with 3-6% inflation, earnings growth was 1.2% after inflation.
- There is no perfect inflation hedge, but historically, US large cap equities have provided protection relative to most asset classes.

Regional Outlook

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Economic data in the US is peaking, but strong GDP growth is likely in 2H 2021. The Fed will be watching inflation data vigilantly and adjusting their reaction function accordingly.

The European Recovery Plan (NGEU) was passed. Coupled with previous fiscal stimulus, the supportive policy measures should reduce potential economic downturns, especially in peripheral countries.

Chinese growth is likely to slow, but will likely lead major economies and grow between 8-9% in 2021.

The Japanese economy contracted in Q2 amidst shutdowns and automotive supply issues. Growth should improve and accelerate into year end.

The delta variant has led to shutdowns and economic contraction in India. Vaccination efforts should enable the economy to reopen in Q3.

U.S.

- Leading indicators have likely peaked but remain at historically elevated levels. Waning stimulus and base effects will likely lead to a moderation of economic data in 2H 2021.
- The Fed will likely announce tapering in Q4 and begin hiking rates in late 2022.
- The GS Financial Conditions Index is at historically easy levels due to further credit spread compression and equity market appreciation.

Japan

- Japanese vaccination rates are among the lowest of developed countries. Japan will likely reach a 50+% vaccination rate in Q4.
- Easing of supply/ input constraints should improve manufacturing and export growth but growth will lag most developed economies.
- Monetary policy is unlikely to change due to low inflation expectations and sluggish growth.

Europe & UK

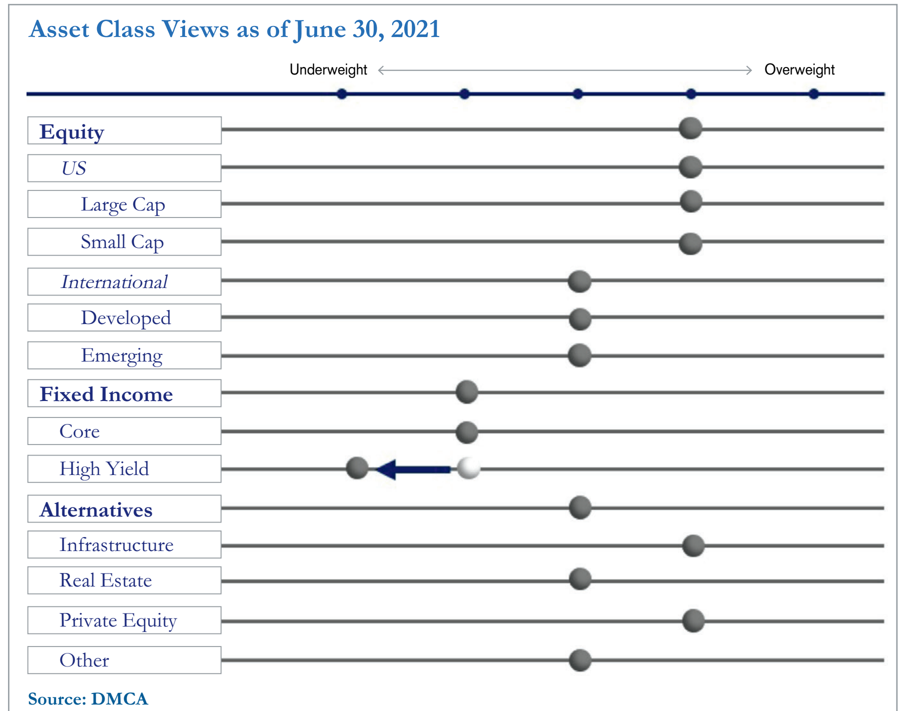
- Vaccine deployment has progressed over Q2 opening the path for many European economies to reopen by the late summer or fall.
- Pent up demand and excess household savings should boost consumption in Europe and the UK.
- The ECB and BOE are expected to extend asset purchase programs. We don't foresee inflation reaching central bank targets in the UK or EU in 2021.

China and EM

- Chinese government credit impulse has waned and consumption has slowed from early 2021.
- Asian economies have led the recovery but are taking a pause. Indian GDP growth will likely contract significantly in Q2 but rebound in Q3.
- Growth forecasts for Latin American economies have been upgraded amidst rising commodity prices, more stimulative policy and higher vaccination rates. Cyclical Latin American companies should perform well into Q4.

Domestic Equities

- We maintain our recommendation for an overweight to US equities in 2021 relative to bonds. Despite strong performance YTD, multiples have actually contracted modestly due to strong earnings growth.
- The US is moving out of the early cycle recovery. Growth companies outperformed in Q2 as interest rates declined. We believe the outperformance of value that occurred in the first quarter will reemerge in Q3 and Q4, but higher quality value companies look more attractive relative to "recovery stocks."
- Earnings growth should be the driver of performance in 2H 2021 and into 2022 and multiples should decline further.



International Equities

- Non-US developed markets, particularly Europe, have accelerated vaccine delivery after lagging in March and April. With fiscal support, lack of inflation and accommodative policy, many large non-US DM economies should experience strong growth through year end and into 2022. Revenue and earnings growth should follow as both Japanese and European indices have higher weightings of cyclical companies than the US. Earnings levered to global GDP growth, lower starting valuations, and increasing investor flows make non-US DMs more attractive than prior years.
- The delta variant and slowing Chinese economic activity have weighed on EM equities relative to developed markets. Latin America has benefited from strong commodity demand and the increase in global trade. We continue to prefer an overweight to Asia to in our emerging markets allocation due to an attractive long term growth profile relative to most regions. Once supply chain disruptions recede and developed markets GDP growth moves back toward long term trend levels, we believe EM Asia will resume its outperformance.

Fixed Income

- The recent move lower in Treasury yields and further compression in investment grade corporate bond spreads have reinforced our stance to maintain a shorter duration than benchmark indices. We will likely add to duration once yields move above 2.5% and we are increasing the quality of our portfolios. We remain overweight investment grade corporate credit, but primarily in maturities less than 7 years. We expect a negative total return for 2021 for taxable fixed income and modestly positive return from municipal bonds.
- We remain overweight securitized credit in our fixed income allocation through active managers, but will likely be decreasing this allocation due to price appreciation. High yield is unattractive at current spread levels.
- Liquidity remains a key feature in our allocations.

Alternatives/ Real Assets

- Valuations in the private credit and real estate markets have increased alongside other asset classes. While private credit strategies offer attractive yields relative to liquid strategies we are cognizant of embedded leverage, illiquidity and terms that are less friendly to lenders. We continue to prefer asset-based lending to cash flow lending.
- The valuation gap between private equity and public markets remains wide.

Important Information

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The opinions expressed in this Global Economic and Market Commentary are those of Haverford, as of June 30, 2021. Views and security holdings are subject to change at any time based on market and other conditions. This Global Economic and Market Commentary is for informational purposes only and should not be construed as investment advice or recommendations with respect to any information or specific securities presented. Each individual investor's circumstance is unique and you should consult with your investment professional prior to any portfolio decisions. Some of the information presented in thisGlobal Economic and Market Commentary may contain forward-looking statements. These statements are only forecasts, based on our opinions. No forecasts are guaranteed, and past performance is not a guarantee of future results.

Commodities: Bloomberg Commodity Index is made up for 22 exchange-traded futures on commodities that represent 20 commodities. These commodities are weighted to account for economic significance and market liquidity.

US Large Cap Value: Russell 1000 Value Index measures the performance of the large-cap value segment of the U.S. equity universe. It includes those Russell 1000 companies with lower price-to-book ratios and lower expected and historical growth rates.

Small Cap: Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 index.

Europe: The Euro Stoxx Total Market Index covers 95% of the free-float market cap of the stocks in Europe.

S&P 500: S&P 500 Index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

International: MSCI ACWI ex US Index is a stock market index that is designed to measure the equity market performance of all equity markets excluding the US.

Emerging Markets: MSCI Emerging Markets Index is a stock market index that is designed to measure the equity market performance of emerging markets outside developed markets, markets such as Brazil, China, Russia, etc.

US Large Cap Growth: Russell 1000 Growth Index measures the performance of the Russell 1000's growth segment, which is defined to include firms whose share prices have higher price-to-book ratios and higher expected earnings growth rates

High Yield Bonds: Barclays US Corporate High Yield Index covers the universe of fixed rate, non-investment grade debt. Eurobonds and debt issues from countries designated as emerging markets (sovereign rating of Baa1/BBB+/BBB+ and below using the middle of Moody's, S&P, and Fitch) are excluded, but Canadian and global bonds (SEC registered) of issuers in non-EMG countries are included.

Japan: The TOPIX Net Total Return Index includes the stocks traded on the Tokyo Stock Exchange. It has approximately 1700 companies.

Municipal Bonds: Barclays Municipal Index is an unmanaged index that is considered representative of the broad market for investment grade, tax-exempt bonds with a maturity of at least one year.

Core Bonds: Barclays US Aggregate Bond Index, which used to be called the "Lehman Aggregate Bond Index," is a broad base index, maintained by Barclays Capital, represents investment grade bonds being traded in United States.

Treasuries: Barclays US Agg Total Treasury is a subset of the Barclays Aggregate US Bond Index and consists of most US Treasury bonds with a maturity of one year or more. It excludes TIPS and STRIPS.

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