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Nauset Market Commentary
First Quarter 2021

Market Performance Recap: **Stocks Up, Bonds Down**

Accelerating vaccinations, diminishing economic restrictions and a $2 trillion stimulus led to a strong 2021 opening quarter for the stock market. However, those same elements also drove up Treasury yields, causing concerns about bonds and the tech sector. The good news drove the Russell 1000 up +5.9% in the quarter led by economically-sensitive materials, energy, financials and industrials sectors. US small cap stocks were the best performer for the quarter with a gain of +12.7%. International stocks posted smaller gains of +3.5% for EAFE and +2.2% for Emerging Markets index. Higher yields hurt bond returns, which posted their first quarterly loss in three years at -1.9% per the Barclays Intermediate Gov't/Credit bond index.

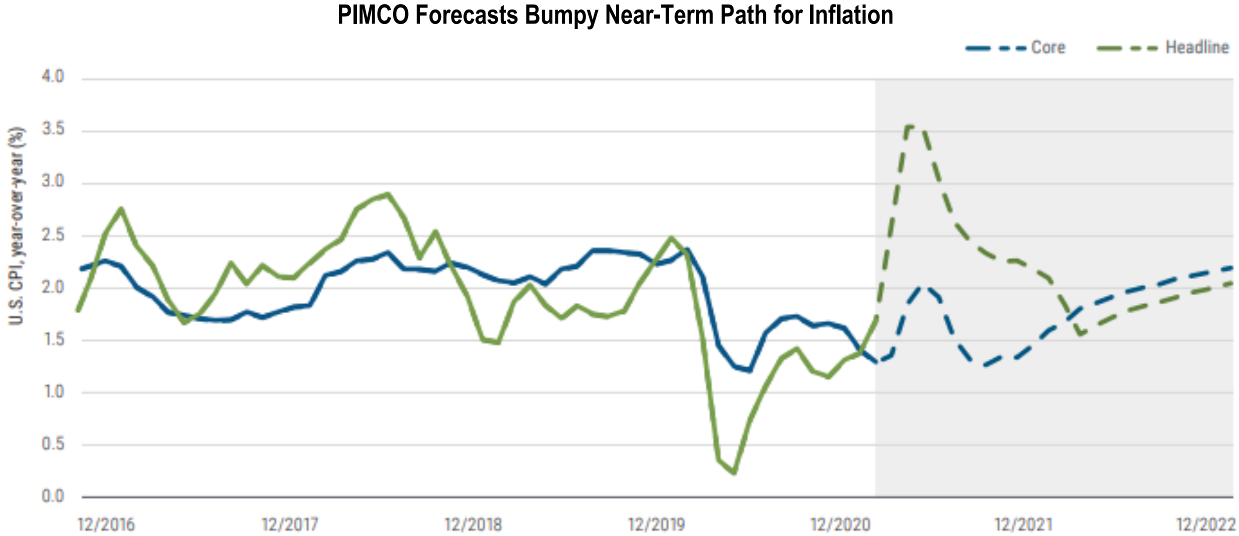
Economic & Market Discussion: **Inflation Fear Factor**

Most agree we are in an unusual economic cycle featuring a global pandemic, economic lockdowns and massive monetary and fiscal support. As such, there is a large degree of uncertainty regarding the recovery phase, particularly how the upcoming cyclical boom will affect inflation. The fear is that an overheating economy boosts inflation and leads the Federal Reserve to raise rates and thus choke off a nascent recovery. Let's look at the inflation issue more closely.

- Boom Time – The US and most major global economies are poised to exit the most severe elements of the global recession later this year. Low borrowing rates and powerful stimulus packages across most developed countries will likely ignite a roaring recovery unlike any we have experienced in over 30 years. Current forecasts point to 2021 US GDP growth exceeding 6%. With rapid growth comes a scramble for resources, goods and services that will most likely lead to price increases. The question is what level of inflation might we expect and for how long?

- Temporary Spike? – We agree that US consumer prices will rise as demand for goods and services surges later this year. However, we also agree with PIMCO's forecast (chart below) that the rise in US inflation will be temporary. Here's why: While consumer prices will most certainly rise, we believe full employment will prove elusive as companies incorporate more automation and digitization into their processes. We expect that will dampen inflation following a temporary price run-up. Moreover, the chances of the Fed raising rates quickly to combat even a temporary inflation spike are unlikely as they have stated they will let core inflation run above 2% for at least a year before any rate increases.

PIMCO Forecasts Bumpy Near-Term Path for Inflation



Source: U.S. Bureau of Labor Statistics data through 28 February 2021; PIMCO forecasts from 31 March 2021 through 31 December 2022. Data and forecasts shown are year-over-year % change for core and headline U.S. consumer price index (CPI).

- New Opportunity Set – While we don't foresee a new higher level of inflation persisting into 2022 and beyond, financial markets will likely focus on elevated inflation fears in 2021 and thus create volatility in the bond and equity sectors most sensitive to rate risks. We will look for new opportunities amid this anticipated volatility to add to our favored positions across the portfolio. At the same time, we are mindful that inflation risks can persist and central banks can make policy mistakes. So, we will monitor the inflation situation closely as the economy ramps up in the next several quarters.

Portfolio Strategy: **Base Policy Changes**

Our current investment strategy is based on our view that easy money policies and positive earnings growth will continue to support stocks in 2021 despite volatility and full valuations. Within this strategy, we are favoring specific classes and sectors that we believe will benefit from the recovery growth scenario.

- Overweight Mid & Small Cap Stocks – In a shift from 2020, we believe the economic recovery will have a relatively larger positive impact on mid and small cap stocks over large caps. Therefore, we have increased our equity weighting toward mid and small caps in most portfolios.
- Sectors Focus – We added equity exposure to the financial sector in the first quarter. Along with the industrials sector, we feel these two economically-sensitive areas will benefit as the expected recovery accelerates. We continue to hold tech and healthcare overweights in this environment. Even though these sectors may not enjoy a short-term advantage, we believe both provide attractive long-term value.
- Staying in Balance – Investors have focused on high flying stocks during the past year. While we share that view, we have kept portfolios balanced with allocations to bond, real assets and alternative investments to create diversified sources of return and to help manage overall portfolio risk.

Market Performance **% Change for Periods Ended 3/31/2021**

Market Index	First Quarter	2021 YTD	1-Year	3-Year Annual.	5-Year Annual.
Russell 1000	5.19	5.19	60.59	17.31	16.66
MSCI EAFE – Non-US	3.48	3.48	44.57	6.02	8.85
Russell 2000	12.70	12.70	94.85	14.76	16.35
MSCI Emerging Markets Equity	2.29	2.29	58.39	6.48	12.07
DJ US Real Estate	7.70	7.70	34.90	10.28	7.23
NASDAQ Composite	2.95	2.95	73.40	24.54	23.44
Barclays Gov't/Credit Interm. Bond	-1.86	-1.86	2.01	4.36	2.75
Wilshire Liquid Alternative	2.17	2.17	15.21	2.84	3.00
3-Month T-Bill	0.02	0.02	0.21	1.45	1.15