Market Insights: Key Themes for 2021 and Beyond

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FOX Host: Gaby Griffin, Market Leader, Business Owners and Family Office Executives

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Today's Speakers

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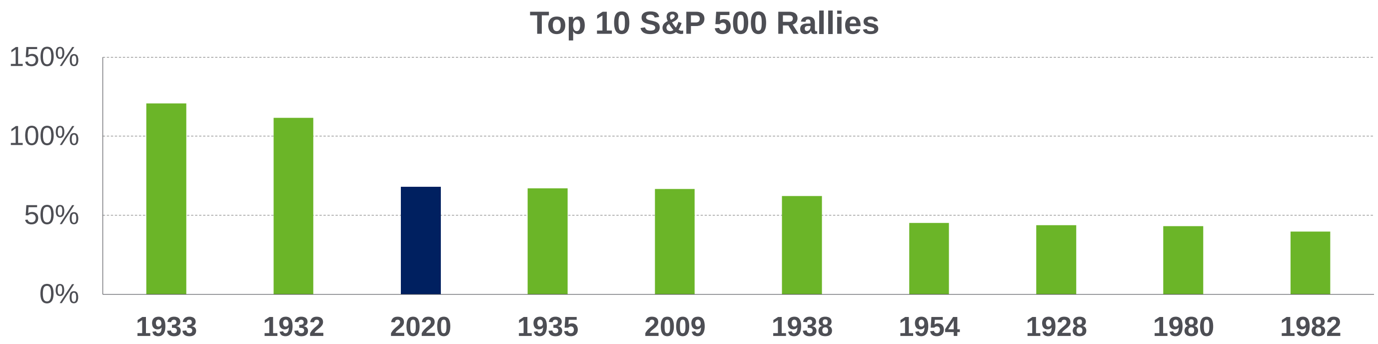
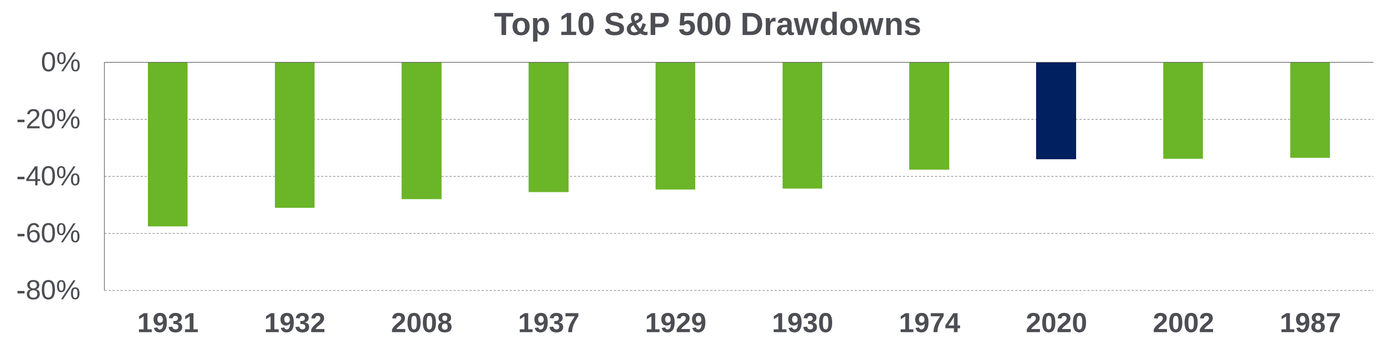
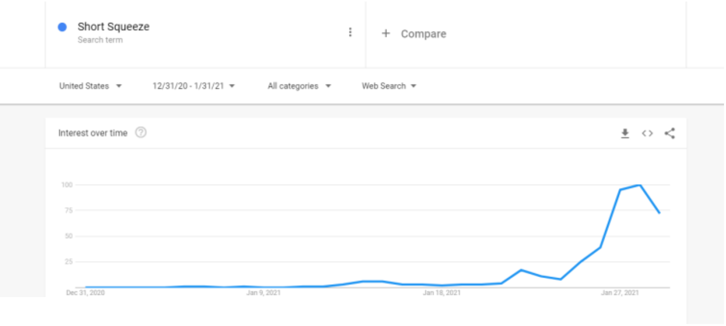
2020 was a momentous year





Source: S&P, FactSet
Rallies and drawdowns represent the largest trough-to-peak and peak-to-trough, respectively, within a calendar year

Wild Start for 2021




THE WALL STREET JOURNAL.

Keith Gill in his Boston suburb basement, where he streams his YouTube videos.

Keith Gill Drove the GameStop Reddit Mania. He Talked to the Journal.

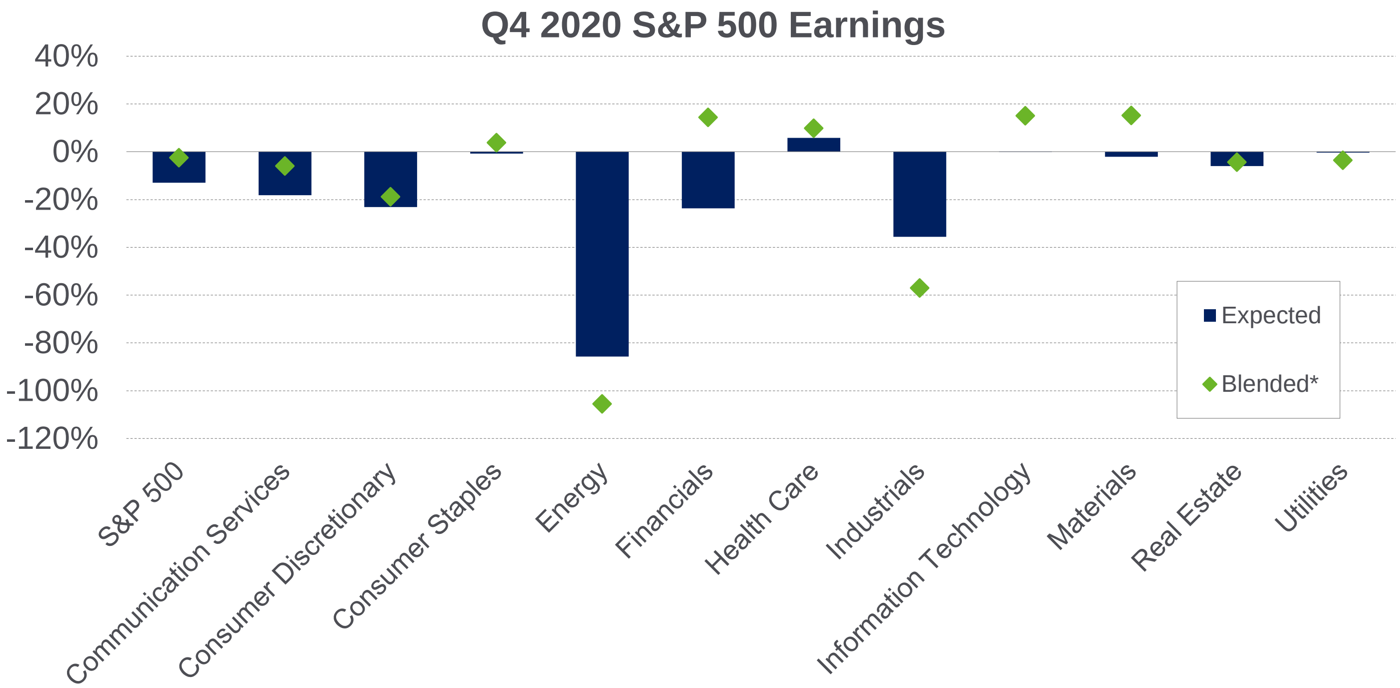
Source: Twitter, Google, Wall Street Journal

Bitcoin sets record levels

Family Office Exchange

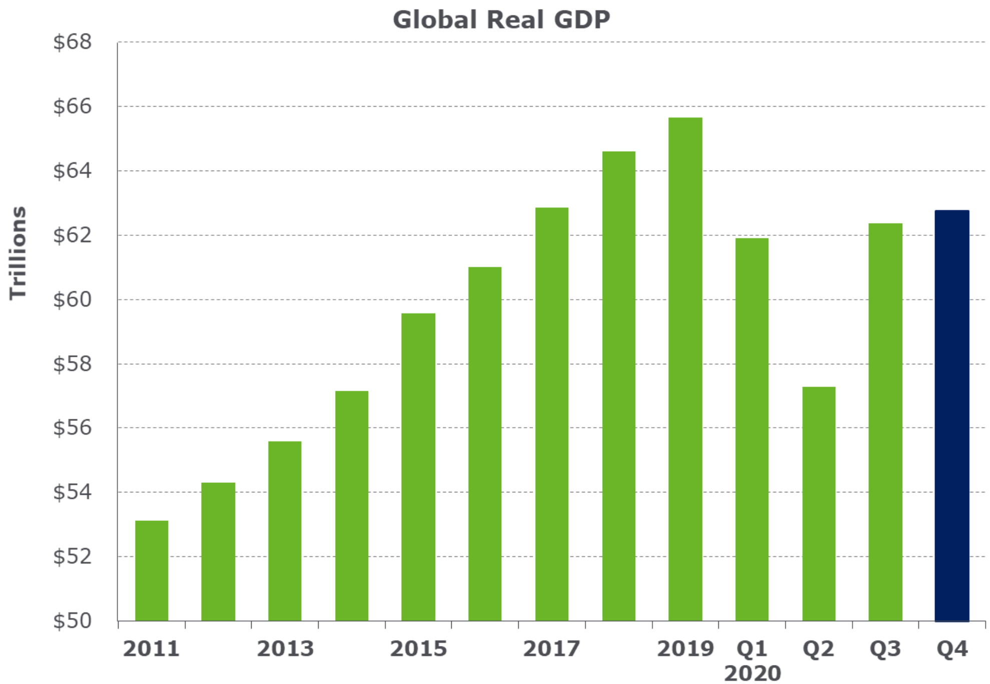
Source: FactSet

Positive earning surprise



Source: S&P, FactSet
Blended* earnings represents actual earnings reported for 187 companies and estimates for 318 companies that have not yet reported

The World Economy Shrank in 2020



Q4 2020 real GDP figure represents IMF forecast for 2020. GDP figures are seasonally adjusted and chained to 2005 dollars.
Source: IMF, FactSet

NEPC Key Market Themes

- Key Market Themes are factors that influence global markets and remain relevant for an extended period
- Themes may be disrupted and incite market volatility
- The conclusion of a theme may alter market dynamics and NEPC's long-term market outlook
- Our intent is for clients to be aware of these themes and understand their implications for the capital markets

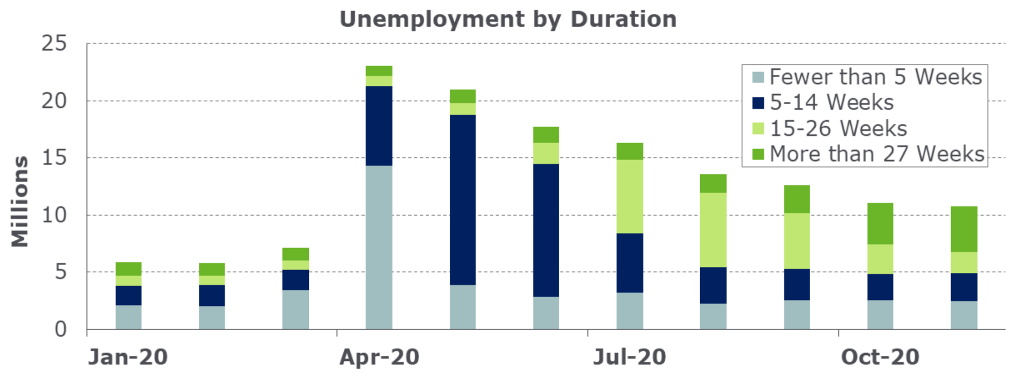
NEPC currently has four Key Market Themes:

1 Virus Trajectory	**2** Permanent Interventions
3 Globalization Backlash	**4** China Transitions

Key Market Theme: Virus Trajectory

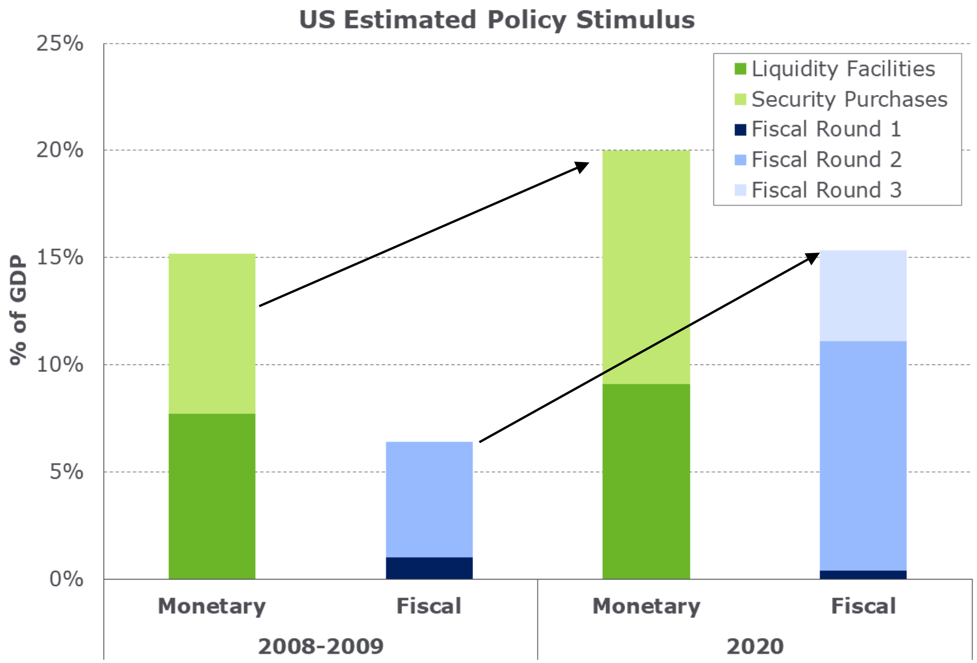
Thematic Macroeconomic Risks

- Economic dislocation from the pandemic is widespread
  - A rapid vaccine rollout can unleash economic exuberance aiding a rapid recovery and benefiting highly cyclical assets
- The lasting influence of the pandemic is uncertain as the extent of the economic scars have yet to be fully realized
  - Despite relative improvement in economic data, recent data points highlight lingering disruptions in businesses and the labor market



Source: Department of Labor, FactSet

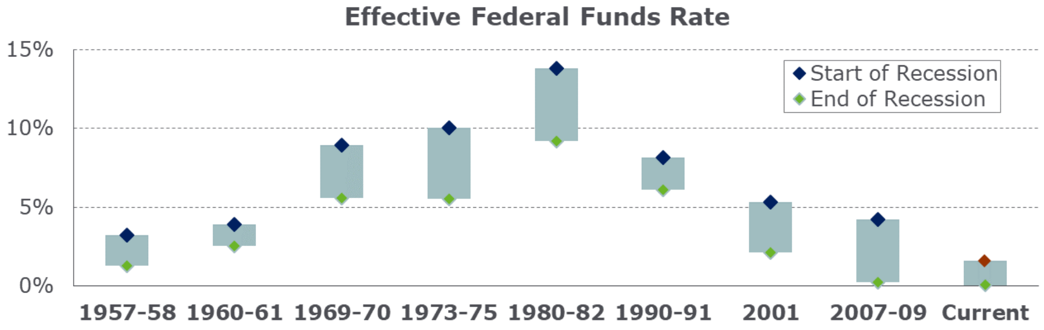
Elevated Permanent Interventions



Source: NEPC, Federal Reserve
Fiscal Rd 1: 2008 – Economic Stimulus Act ($152B); 2020 – CPRSA/Families First ($91B); Fiscal Rd 2: 2008 – Am. Recovery & Reinv. Act ($787B); 2020 – CARES Act ($2.3T); Fiscal Rd 3: 2020 – Consolidated Appropriations Act ($900B)

Thematic Macroeconomic Risks

- Market sentiment is now a key central bank policy pillar of equal standing to inflation and employment mandates
  - Without meaningful inflation pressures, the path of monetary policy does not normalize and an environment of low interest rates persists
- Permanent Interventions sustains high P/E multiples and equity valuations become a less potent market signal
  - Permanent Interventions gradually fuels tail-risks as moral hazard is absorbed into the financial system and markets nationalize losses
  - However, proactive tightening of monetary policy damages market sentiment and exposes the fragile nature of market dynamics



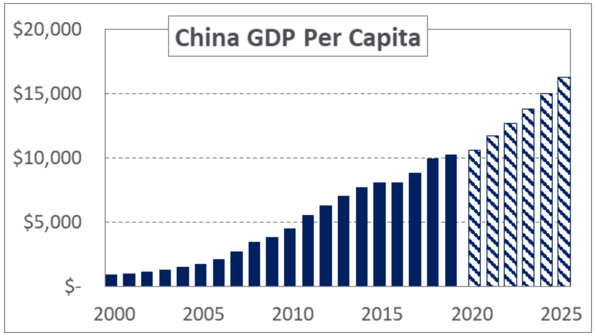
Source: FactSet, Federal Reserve

China Transitions

Expected Evolution

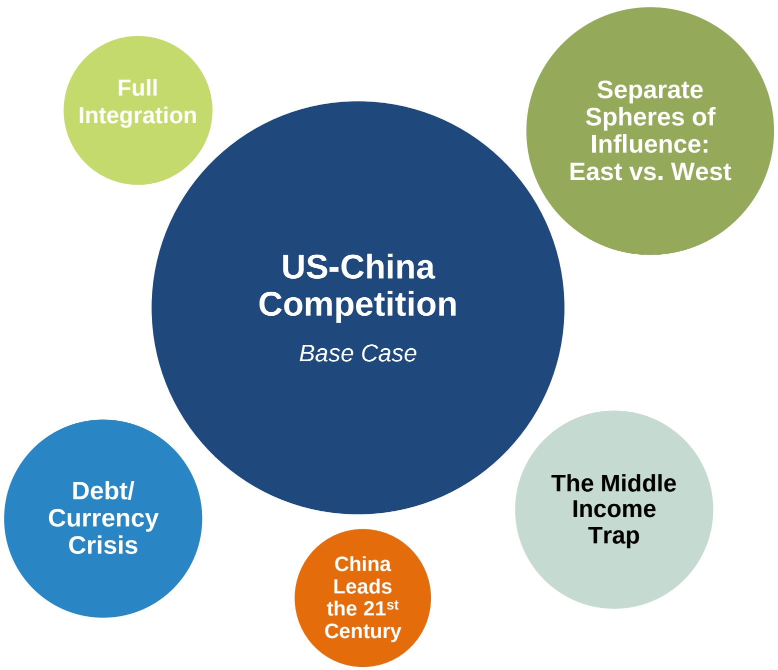
- China's growth will slow but its economy is expected to equal the size of the US economy within 15 years
  - Policymakers must continue to balance the goal of sustaining healthy economic growth rates and moderating credit growth
  - Recent data points highlight China's restraint, but an acceleration of credit growth and real estate development is a systemic risk

- Rising income levels and the rural to urban shift expand the demand for a range of consumer-oriented services
  - Despite the increases in GDP per capita, innovation and productivity advances are required for China to escape the middle income trap



Source: IMF

Potential Outcomes and implications



Size of bubble denotes expected likelihood of outcome

US-China Competition: Competition not confrontation characterizes the economic and geopolitical relationship for the US and China. China successfully transitions to a consumer-oriented economy with per-capita GDP in line with the developed world. Capital markets continue to liberalize but cycles of volatility reflects the ebb and flow of the competitive US-China relationship

US-China and Separate Spheres of Influence: Two separate economic, geopolitical, and financial systems exist with an ongoing confrontational relationship. This dynamic may impact foreign access to Chinese capital markets, with the potential to directly impact regional blocs aligned with China

The Middle Income Trap: Per-capita income growth stalls as innovation and productivity levels do not improve from current levels. China fails to achieve developed market status, implying an internal shift away from market-friendly reforms or an external force such as US policy pressure curtailing China's growth

Debt and Currency Crisis: Uncontrolled expansion of credit growth to drive short-term economic gain fuels capital misallocation and represents a systematic risk to the financial system and China's currency controls

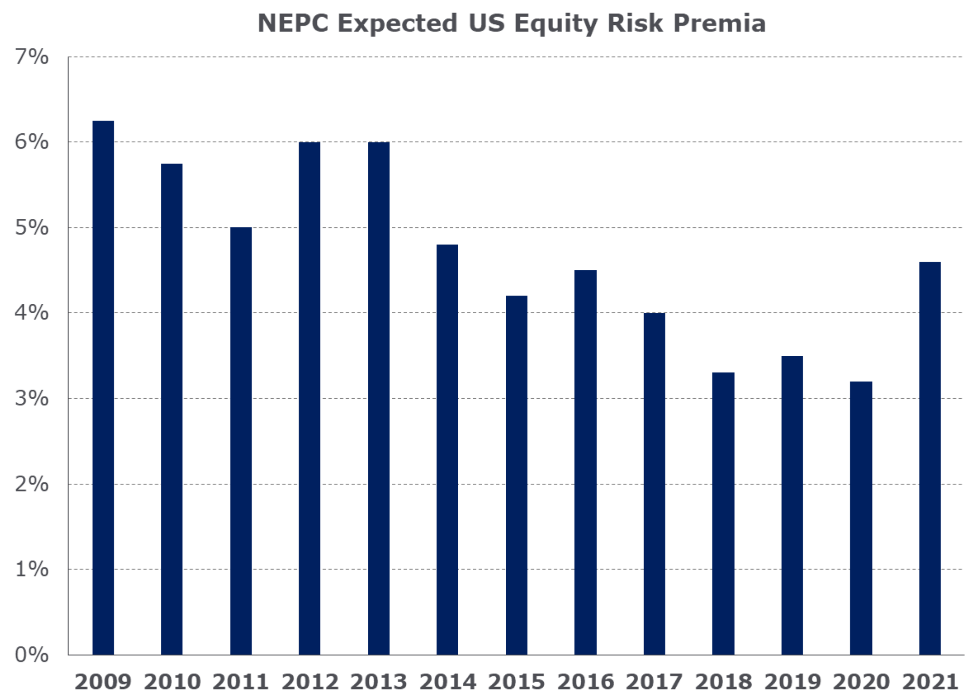
The 21st Century is Dominated by China: China becomes the dominant global power for this century. China assumes economic leadership and the yuan ascends to become a global reserve currency

Full Integration: Political and economic liberalization within China and complete integration in the established world order and the current geopolitical hierarchy

Asset Allocation Thoughts and Actions

- Permanent Interventions **sustains positive risk asset sentiment** and boosts our return outlook
- Consider **higher strategic equity targets** as the long-term return differential relative to fixed income is wide
- **Maintain adequate portfolio liquidity** levels as market stress can inject bouts of illiquidity across public assets
- The **wide range of outcomes** associated with COVID-19 place a greater focus on strategic beliefs
- Maintain a **strategic allocation to safe-haven fixed income** to serve as a source of liquidity and to provide downside protection

Consider Higher strategic equity targets



Source: NEPC
Represents the difference between 10-Year NEPC US Large-Cap and Cash Assumptions
*Prior to 2019, return assumption reflected a 5-7 year time horizon

Public Market Equity

Strategic views

- NEPC recommends US equity exposure be held at a target of 60% relative to overall global equity exposure
- We encourage a strategic bias to emerging market equities relative to the MSCI ACWI weight
  - The strategic overweight is designed to capture higher return expectations and growth potential in emerging Asia
- EAFE large cap is the recommended funding source for the US and emerging markets overweight
- Investor risk-tolerance and illiquidity risk inform the use of active investment strategies and private equity
- NEPC encourages a modest strategic bias to small-cap relative to exposure in the MSCI ACWI IMI

Private Equity Outlook

Private Markets Thoughts

- Despite the rebound in the public markets, many public and private companies are still experiencing significantly impacted fundamentals
- The longer business disruption continues, private companies will be more likely to need new infusions of private capital to sustain operations or capitalize on opportunities

Private Markets Actions

- Maintain new commitments to capture higher illiquid returns
- If you have to reduce your commitment size and don't drop high quality managers and risk losing access to their future funds
- Build growth exposure in regions that have better managed the pandemic and economic disruption

Private Market Equity

Strategy Outlook

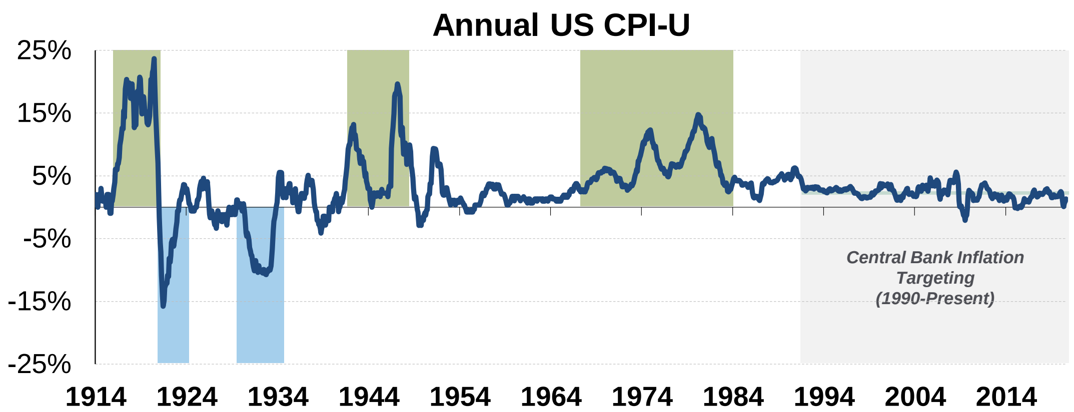
Key:

Green: Positive
Gray: Neutral
Red: Negative

Front: 2021 View Point
Back: 2020 View Point

Inflation Overview

- Inflation is a key risk for investors that can impact progress toward long-term goals and objectives
- Market expectations have anchored to a low inflation environment over the long-term
  - This dynamic makes an inflation surprise a key risk for asset pricing



Source: Bureau of Labor Statistics, FRED, FactSet, NEPC;
Data through 11/30/2020

Why Does Inflation Matter?

- **Determines Real Savings and Real Returns**
- **Impacts Borrowing and Lending Dynamics**
- **Informs Monetary and Fiscal Policy**
- **Effects Business Competitiveness**
- **Influences Investment Returns and Expectations**

Theoretical Causes of Higher Inflation

Fiscal and Monetary Stimulus

USD Devaluation

Vaccine

Globalization Backlash

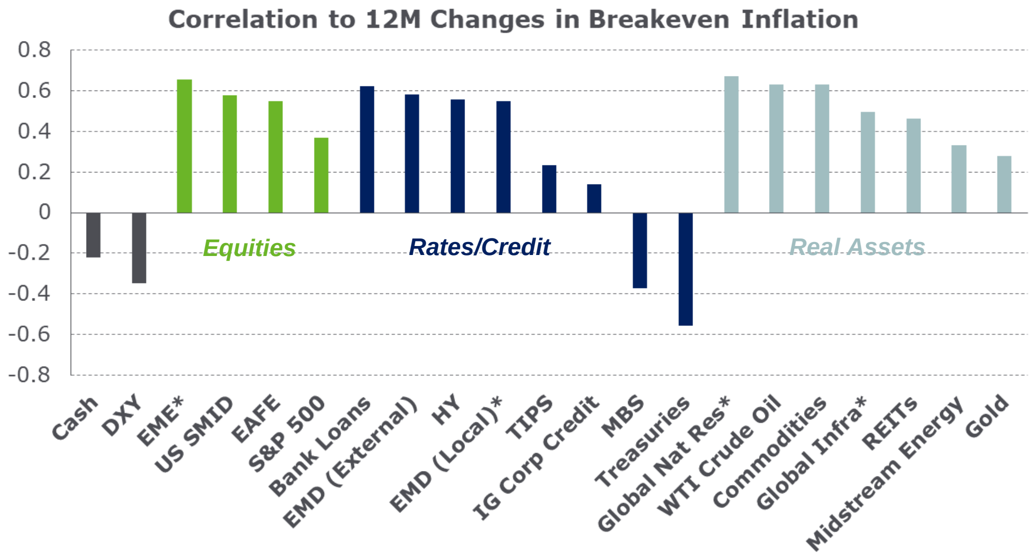
Energy Price Rally

Fed Inflation Framework Adjustment

“Healthy” Economic Inflation

Asset Class Inflation Sensitivity

- Most asset classes exhibit some sensitivity to inflation, though the magnitude of the price reaction will vary



Source: S&P, MSCI, JPM, Barclays, Alerian, FactSet, NEPC; correlations calculated 1997-2020
*Denotes shorter time frame for correlation calculation: EME 1999-2020; EMD (Local) 2002-2020; Global Infra 2001-2020; Global Nat Res 2002-2020

Analyzing Various Inflation Regimes

- There is no perfect inflation hedge as the growth, interest rate, and inflation backdrop dictate asset class behavior
- Economic regime changes are disruptive and unpredictable

Sharpe Ratios by Regime	US Large Cap	US Treasuries	TIPS	Commodities	Gold
Full Data Set (1970)	0.374	0.430	0.505	0.135	0.160
Defensive - Falling Inflation	-0.128	0.876	0.167	-0.544	0.228
Defensive - Rising Inflation	-0.827	-0.114	0.896	0.686	0.915
Neutral	0.483	0.438	0.360	0.087	-0.188
Growth - Falling Inflation	1.566	1.175	0.634	0.218	0.007
Growth - Rising Inflation	0.616	-0.272	0.448	0.515	0.280

Source: S&P, Barclays, FactSet, NEPC

Investment Implementation Thoughts

- NEPC's inflation path reflects higher inflation relative to market pricing, but does not call for "high" inflation
- Inflation exposure should be determined by an investor's risk tolerance and inflation vulnerability
  - There is no "perfect" inflation hedge that is suitable for all investors
- Resilient asset allocation should include exposures to both inflation-hedging assets and safe-haven assets
- Inflation can disrupt the Permanent Interventions theme and central bank support

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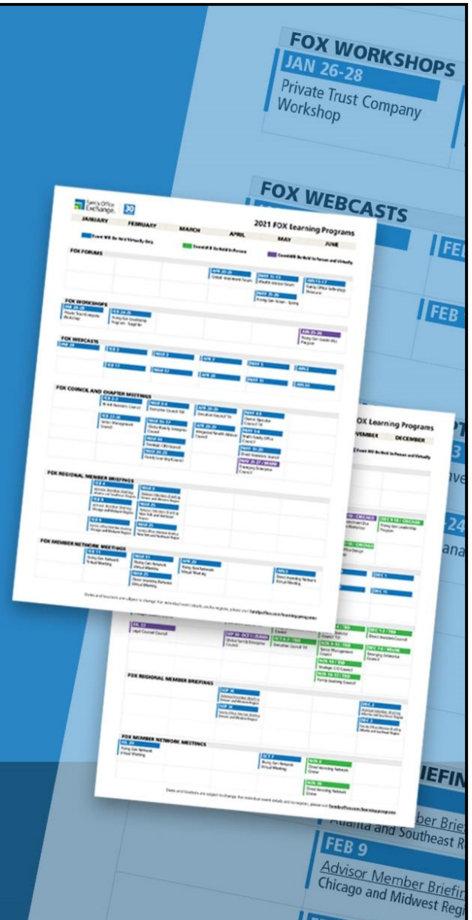

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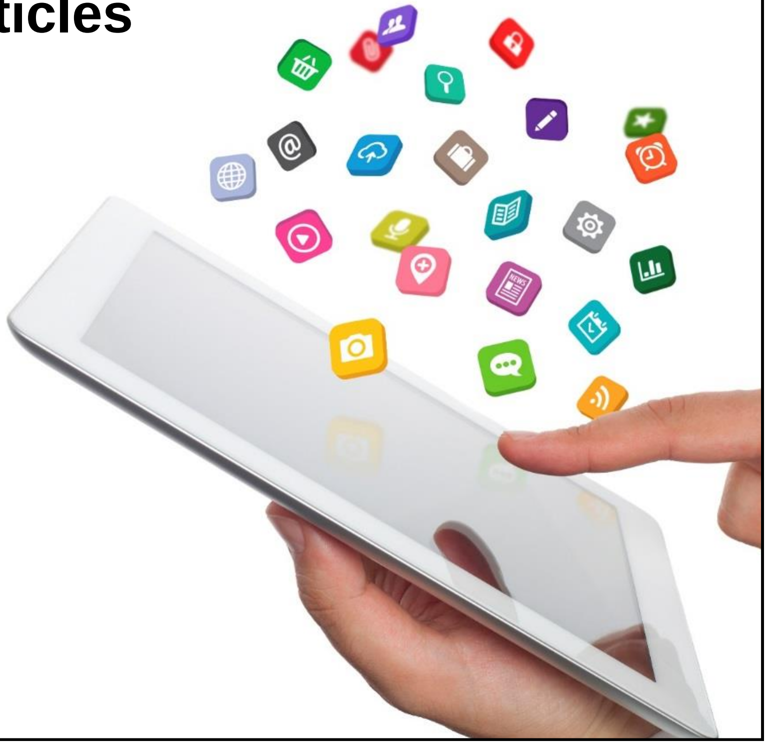

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