Review of Q1 2021 Economy and Current Capital Markets

May 17, 2021

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Contents

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Executive Summary

Capital Markets

- Equity markets appreciated 4.6% during Q1 2020 (ACWI Index) and have continued to rally post quarter-end through May 13th (up 7.2% YTD).
  - The pace of global vaccinations has accelerated rapidly (especially in the US), with most economies showing improving momentum as re-openings increase and progress towards normalization continues.
  - US markets have significantly outperformed international markets YTD (S&P 500 up 9.9% vs. 5.1% for Intl. stocks given a) faster pace of vaccinations and b) materially higher fiscal stimulus deployed leading to significantly higher-than-expected economic growth and activity.
- Corporate earnings continue to materially exceed expectations (especially in the US)
  - 86% of S&P 500 companies beat Q1 earnings forecast (the highest on record).
    - S&P 500 earnings grew 45% YOY and the magnitude of the earnings beats was also the highest recorded.
    - Analysts have been consistently upgrading earnings forecasts for 2021 and 2022 across most markets.
    - Credit default rates are also pacing well below expected levels thus far (although the potential for elevated defaults in 2022 or 2023 exist given the increase in "zombie" companies with temporary liquidity reprieves).
- However, equity valuations are elevated relative to historical averages
  - Equity market valuations are quite elevated based on NTM and 2022 earnings. Based on 2022 earnings, equity markets are trading at 10%-20% higher valuations vs. historical [NTM?] levels
    - *Relative* to Treasuries, valuations based on 2022 earnings appear reasonable.
  - Markets are already pricing in strong earnings growth in 2021 and 2022.
    - However, 2022 earnings forecasts appear more challenging to exceed. Near-term market risks include a) faster than anticipated inflation which could lead to faster-than-expected interest rate hikes or lower-than-expected profit margins, b) potential tax policy changes, c) geopolitical risks, and d) potential new COVID strains or disruptions in global vaccinations.

We are incorporating these views into portfolio positioning by:

- Increased allocations to alternatives with less correlation to public equities and credit
- Increasing allocations to private equity and other private strategies

Strategic Asset Allocation View (7-years)

- As equity valuations are elevated globally, <u>we now expect the low-end of mid-single digit nominal pre-tax equity returns (5.0%-6.0%) annually</u> over the next seven years.
  - As we flagged entering into 2021, the early year(s) in the forecast period may see outsized returns given the highly positive global re-opening momentum coupled with ample fiscal stimulus and easy monetary policy.
  - However, we anticipate increasing bouts of volatility over the next twelve months (surge in headline inflation, potential delays in vaccine distribution, tax policy uncertainty and potential mutations in COVID variants).
    - *We recommend investors maintain some dry powder and opportunistically add to risk assets at lower price levels.*
- <u>High-yield and leveraged loan credit spreads are now trading at pre-pandemic levels with absolute yields near historic lows</u>
- Relative to public markets, *we forecast significantly higher returns for risk assets across private market strategies* (i.e., private equity, stressed credit and real estate funds).

ASSET CLASS: STRATEGIC OUTLOOK (7-YEAR TIMEFRAME)	Negative ----- Neutral ----- Positive	Average Annual Return
EQUITIES		
US Large Cap (S&P 500)		Mid Single-Digit
US Small Cap (S&P 600)		
MSCI Intl. Developed Markets		
MSCI Emerging Markets		
FIXED INCOME		
US Treasury		Low Single-Digit
US Corp Investment Grade		
US Corp High Yield		Mid Single-Digit
US Corp Levered Loans		
ALTERNATIVES, PRIVATE EQUITY, & REAL ESTATE		
Real Estate Asset Level (Unlevered)		Upper Mid-Single-Digit
Hedge Funds		
Private Equity (Corp. + RE)		High-SD to Mid-Teens
Private Credit		

Tactical Allocation View

- From a shorter-term standpoint (next 6-12 months), we believe that equity markets' direction will be primarily driven by : a) corporate earnings trajectory vs. expectations, b) magnitude of any further stimulus packages, c) speed of vaccine rollout globally, d) potential tax or regulatory policy changes and *especially e) trajectory surrounding inflation*.
- Following the 90% rally since the March 2020 lows, equity markets valuations have become elevated by most measures with several risks mounting (especially in the US).
  - *Rapidly accelerating headline inflation* driven by large increases in commodity prices and shortages of key materials may spook markets going forward. While central banks currently view this surge in inflation as transitory, investors may hold different views especially if inflation prints significantly exceed expectations.
    - Sustained higher inflation may affect corporate earnings (rising costs that may not be able to be fully passed on) and may lead to a faster pace of interest rate hikes than currently forecast by central banks.
  - *Increases in corporate and personal tax rates* are highly likely in the US over the next 1-2 years.
  - Several regions within the world are still experiencing high levels of COVID cases or delayed vaccine rollouts. Additionally, newer COVID mutations are proving more contagious and potentially deadly.
- Public fixed income yields and spreads are at record lows, with unattractive risk / reward.
  - Elevated duration leads to high interest-rate risk for government bonds. Corporate bond spreads are now at pre-pandemic levels despite still uncertain credit fundamentals for Covid-affected issuers.
    - While slight near-term further spread compression may occur given Fed support and liquidity, risk / reward is increasingly asymmetric towards the downside.
- We believe compelling opportunities exist across private markets, especially among middle-market private equity strategies and private real estate strategies.
  - Better potential for lower entry valuations vs. public markets via proprietary-sourced deals.
  - Broader value creation opportunities via operational improvements, platform M&A and a wider range of exit options.
  - Mid-to-high-teens returns are achievable across several different middle-market private-equity strategies.
  - Class B Multifamily, select office and self-storage private equity real estate funds appear highly interesting.

Economic Activity

- <u>Major world economies largely experienced accelerating recovery during Q1</u>
  - US Real GDP increased at a 6.4% annualized rate Q/Q. China's GDP grew 18.3% YOY (but 0.6% Q/Q) as its economic recovery continued to accelerate. Japan's GDP growth is expected to accelerate 1.5% Q/Q driven by strong demand for its exports. Canada's GDP is forecast to grow 1.5% Q/Q as well. However, Eurozone GDP decreased 0.6% Q/Q in Q1 as Covid surges and delayed vaccine rollouts drove increased lockdowns.
    - The IMF is forecasting Global Real GDP growth of 6% in 2021 and 4.4% in 2022. These forecasts have been revised upwards as economic data have surprised to the upside.
  - Global PMI indexes are exhibiting healthy growth outlooks across both manufacturing and services indexes.
  - Retail sales have returned to sharply positive growth YOY across all major economies
- <u>Economic activity has continued to surprise to the upside.</u> Key factors include:
  - Significant consumer savings leading to pent-up demand (initially on high-ticket goods but now shifting to previously unavailable services).
  - Resumption in global trade growth leading to strong factory utilization and manufacturing activity.
  - Business inventory restocking given low inventory levels maintained during the pandemic.
- <u>However, inflation is beginning to increase rapidly throughout the supply chain</u>
  - Spot prices for copper, steel, lumber have more than doubled vs. pre-pandemic levels driven by a) rapidly escalating current demand, b) supply chain constraints and c) expectations of further demand driven by potential passage of broad-based infrastructure fiscal stimulus.
    - China factory gate prices (a harbinger for inputs used in global goods) increased by 6.8% YOY, the fastest level in four years
    - The global semiconductor shortage has shown no signs of abating
  - Central banks are presently viewing this surge in inflation as expected and as transitory
    - However, the US April CPI report exhibited a 0.8% MOM and 4.2% YOY increase (the largest in over 13 years).
    - Inflation skeptics point out that the headline figures were distorted by a) base-year-effects and b) sharp one-off spikes in items such as used cars (which only account for a small percentage of the inflation basket).
    - The trajectory of YOY inflation rates will be closely watched in H2 2021, especially as artificially low base-year effects are anniversaried.

Vaccines and Political Developments

- <u>Global Vaccination Progressing at Varying Rates Across Geographies</u>
  - The US and UK are much further along in vaccinating their populations vs. Continental Europe.
    - Vaccination rates (based on % of population receiving at least one shot) have exceeded 45% in the US and UK and 30% in Canada. However, vaccination rates vary substantially among European countries with Germany at roughly 30% whereas several other European countries are closer to 20%.
  - India has seen a staggering increase in daily new COVID cases since early March and has become the global hotspot for current COVID cases and deaths (after initially being hailed as a success story).
    - Daily new cases have increased to 375,000 from roughly 10,000-15,000 earlier this year.
    - Global health experts are closely watching whether the surge in Indian Covid cases is mirrored in countries that are geographically proximate to India or with links to India.
- <u>Large-Scale Governmental Policy Actions Increasing in the US</u>
  - The slim Democratic majority in Congress is enabling the Biden Administration to push forth an ambitious agenda focused on sharply increased governmental fiscal spending and addressing increasing wealth inequality.
    - Notable measures include the recent $1.9 trillion Stimulus package passed in January (controversial as the economy was already showing strong signs of improvement).
  - The Biden administration has also proposed a $2 trillion Infrastructure Bill to be funded through a combination of increases in corporate taxes and individual taxes (on income and capital gains).
    - As proposed, US corporate federal tax rates would increase from 21% currently to 28%. Additionally, the Administration has proposed additional taxes on income sourced from foreign countries.
    - Furthermore, Biden has proposed raising the marginal tax rate for the highest individual income bracket, introducing additional payroll taxes for higher earners and increasing capital gains tax rates from 20% to 40% for high-income individuals.
    - While these proposals may be modified (watered down) during negotiations, S&P earnings could decline by 5% (without offsets from potential growth) and the looming increase in capital gains taxes may trigger advanced selling of equities by high-income US individuals.

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Capital Markets Review

Equity Markets - Performance

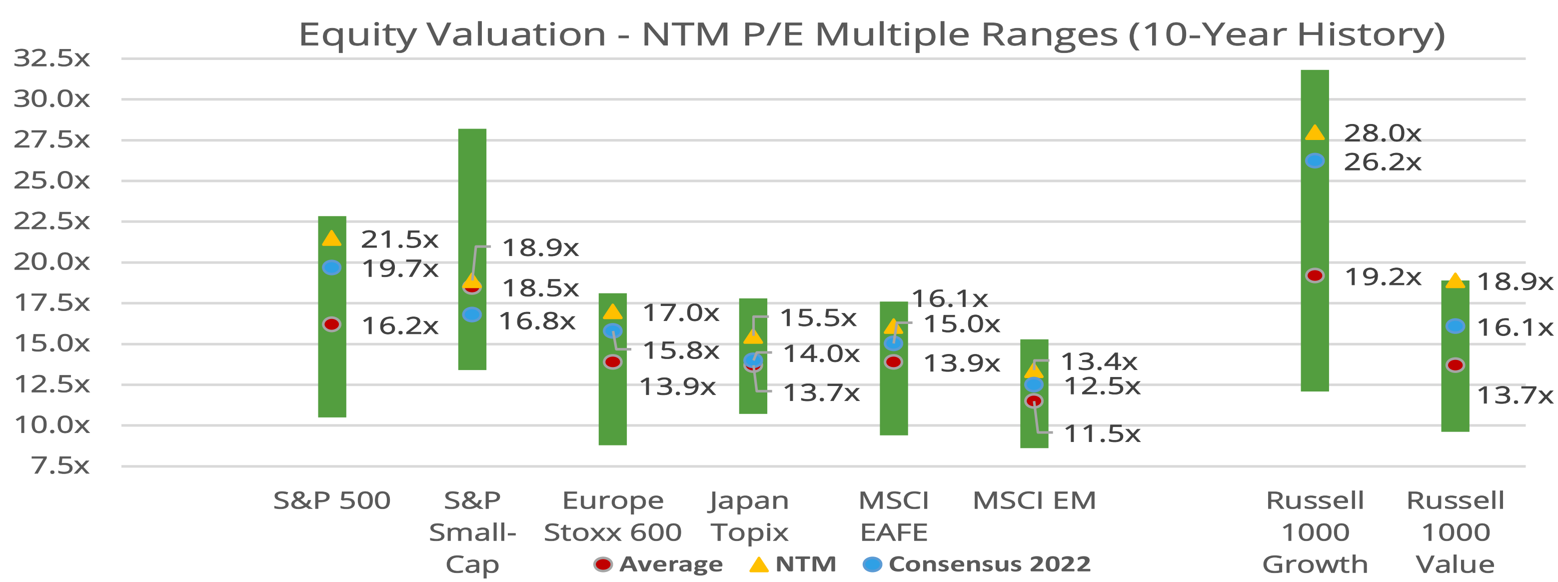
- Global equity markets appreciated 4.6% during Q1 (and another 2.5% post quarter end).
  - Since the beginning of the year (in USD terms), US stocks (+9.9%) have outperformed international stocks (+5.1%) driven by a) sharply better than anticipated corporate earnings, b) much higher fiscal stimulus measures adopted post New Year, and c) faster pace of population vaccination.
  - Value stocks in more cyclical sectors (financials, energy, materials) have outperformed growth stocks (high exposure to technology) as investors are anticipating rapidly improving financial prospects for companies more exposed to the global economic recovery.
    - Global value stocks have returned 13.3% YTD vs. 1.0% YTD for global growth stocks
- Over our 7-year forecast period, we continue to believe that stocks of high-quality companies will continue to outperform given their better business models, superior earnings growth and strong returns on capital.
  - However, as we have flagged over the last several months, we believe that current conditions may favor continued outperformance for more cyclical value stocks over a *shorter-term period of 12-18 months* (earnings inflections due to operating and financial leverage and accelerating rollout of vaccine distribution buoying investor sentiment).
  - We have already spoken with many of you about making tactical adjustments to your portfolios to increase exposure to value stocks where appropriate.

Equity Indices - (As of 05/13/2021)

	YTD Performance			Total Returns (%) - USD *				
	YTD 2021	2/19/20 3/23/20	3/23/20 - Present	March Qtr	Annualized Returns 1Y	3Y	5Y	7Y
US Large Cap (S&P 500)	9.9%	-33.8%	86.3%	6.1%	47.5%	16.1%	16.6%	13.2%
US Small Cap (Russell 2000)	10.3%	-40.7%	119.4%	12.7%	78.1%	12.0%	16.1%	11.4%
MSCI EAFE	6.2%	-32.7%	71.4%	3.5%	42.0%	5.8%	9.5%	4.9%
MSCI Emerging Markets	0.6%	-31.2%	74.5%	2.3%	45.2%	6.0%	12.8%	5.9%
MSCI ACWI	7.2%	-33.6%	82.8%	4.6%	46.7%	11.8%	14.0%	9.5%
Russell 1000 Growth	2.5%	-31.4%	89.6%	0.9%	44.8%	21.5%	21.8%	17.6%
Russell 1000 Value	16.6%	-38.0%	91.4%	11.3%	56.6%	11.8%	7.9%	9.9%

Equity Markets - Valuation

- Current equity valuations based upon next-twelve months "NTM" forward earnings appear high, but corporate earnings are still not fully normalized and are suppressed by pandemic effects.
  - Therefore, investors are looking past 2021 results and are focusing on 2022 earnings as the first "normal" year post COVID.
    - Multiples based upon 2022 earnings appear 10%-15% higher than historical averages.
    - Investors are clearly pricing in a strong global corporate earnings recovery with expectations continuing to increase. Should actual results disappoint lofty expectations, markets could be susceptible to pullbacks.
- With interest rates rising, equity market valuations now only appear fair relative to bonds.
  - The S&P 500 presently trades at 20x consensus 2022 earnings. If interest rates remain near present levels, this multiple may be justified vs. the 16x historical average.
    - These multiples are based upon a 350bps spread (average over the last 20 years) between S&P 500 earnings yield vs. 10-Year Treasury yields. We continue to monitor the recent rise in 10-Year Treasury yields (1.7% as of May 2021 vs. 0.7% nine months ago).



Fixed Income Markets - Performance

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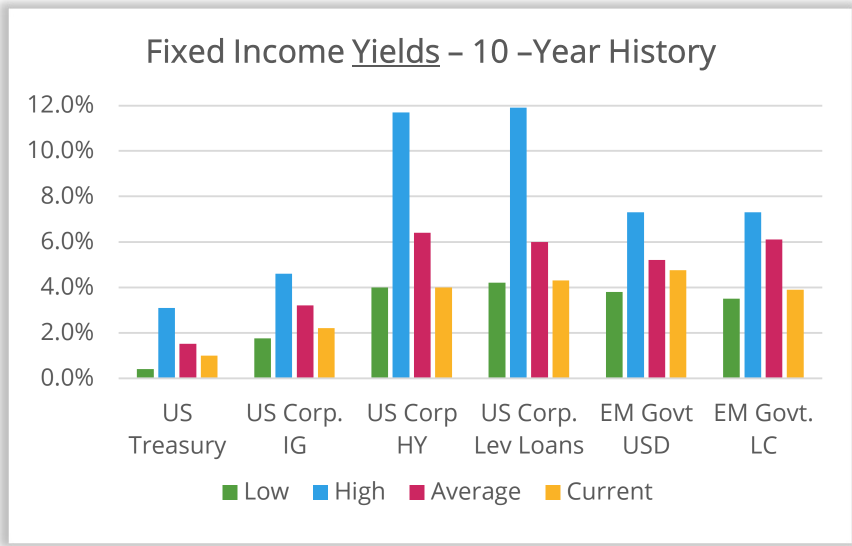
- Fixed income markets have bifurcated during Q1 and post quarter as well, with “safe” assets such as Treasuries and IG bonds underperforming riskier credit assets (high-yield and lev. loans).
  - US Treasuries and Investment Grade bonds declined 4.3% and 4.7% respectively during Q1 (have modestly appreciated post quarter). The declines were driven by increases in interest rates due to these bonds’ longer durations.
  - Riskier credit appreciated modestly during the quarter (+0.9% and +1.8% for high-yield and leveraged loans), with continued appreciation post quarter end.
    - Underlying corporate earnings have been significantly better than expected driven by better-than-expected demand and aggressive cost management. Additionally, high-yield bonds across COVID-affected sectors rallied alongside the pace of US vaccinations.
  - EM hard currency (USD) bonds declined by 4.5% during Q1 but have rallied by roughly 3% post-quarter end.
  - EM local currency bonds declined 6.5% in Q1 due largely due to currency depreciation driven by high COVID case counts and poor progress in terms of vaccinations across several large Latin American EM’s.
    - However, EM local currency bonds rallied 4% post quarter-end.

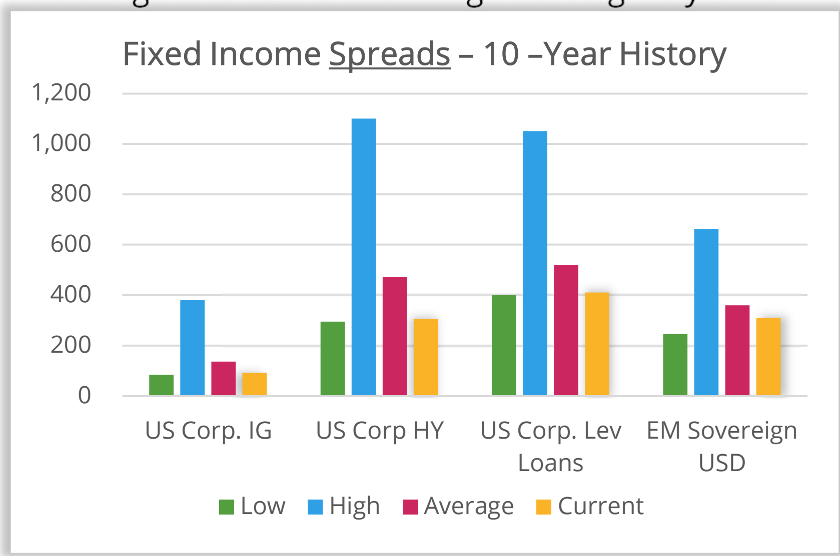
Fixed Income Indices - Characteristics and Performance in USD (as of 05/12/2021)

	Cum. Performance (%)			Mar Qtr.	Annualized Returns				Duration (yrs)
	YTD 2021	2/19/20 3/23/20	3/23/20 -Present		1Y	3Y	5Y	7Y	
US Treasury	-4.0	5.4	-3.8	-4.3	-4.4	4.5	2.2	2.6	6.9
US Corp. IG	-4.2	-12.3	17.0	-4.7	5.4	6.8	4.7	4.5	8.5
US Corp HY	1.9	-20.8	36.1	0.9	18.4	6.9	7.5	5.4	3.9
US Corp Lev. Loans	2.4	-20.6	32.1	1.8	15.2	4.2	5.0	4.0	NA
EM Sovereign USD	-2.3	-20.7	26.7	-4.5	13.1	5.7	5.1	5.0	8.7
EM Sovereign LC	-3.4	-18.0	23.0	-6.6	12.8	1.3	3.1	0.1	6.9
Barclays US Aggregate	-3.0	-0.9	3.2	-3.4	-0.2	5.1	3.1	3.2	6.5

Fixed Income Markets - Valuation

- Absolute yields are still well lower than historical averages across both government debt and corporate credit. Given high duration, the risks from movements in interest rates are tilted to the downside.
- Corporate spreads (investment grade and high yield) are near record tight levels
  - IG and HY spreads have both compressed to pre-pandemic levels
  - Abundant liquidity and generally improving economic data may buoy sentiment for investment-grade and high-yield bonds, leading to further spread compression in the near-term.
    - However, when looking at current yields combined with spreads, risk / reward is tilted towards the downside for publicly traded corporate credit (investment grade, high yield and leveraged loans) over a mid-term time-frame.
  - *Highly risky credit has rallied sharply* with high-yield for lower-quality (CCC) bonds now trading at spreads of only 650bps (versus over 1950bps in March 2020). Less than 5% of high-yield bonds and loans are presently trading at distressed levels (spreads of greater than 1,000bps), compared with over 25% in March 2020.
- We prefer credit exposure through *private* stressed credit and direct lending strategies.
  - These strategies can invest in smaller off-the-run restructurings and rescue financings with higher yields.





Alternatives and Currencies

- Hedge funds had a decent quarter with several major sub-strategies posting positive returns.
  - The HFRX Global Hedge Fund Index was up 1.3% during Q1 with modest appreciation post quarter.
  - Directionally-focused strategies such as long-short equities (+2.7%) and event-driven (+1.7%) performed especially well, while convert-arb also had another strong quarter (+2.2%).
- Private real estate (as measured by the NCREIF Index) increased by 1.7% during Q1 following a subpar year in 2020 (+1.6% as opposed to the 7%+ annual returns in years prior).
  - Performance driven by slight compression in cap-rates coupled with improving underlying NOI fundamentals.
- In Q1, private equity deal activity increased sequentially and more than two-fold vs. Q1 2020.
  - Underlying profit fundamentals generally improved across PE portfolio companies with most materially exceeding dire post-COVID budget plans.
  - Valuation markups also rebounded in Q1 for PE portfolio companies driven by improving underlying EBITDA and rising public and private comparable multiples.
- The USD strengthened in Q1 but has weakened measurably since then.
  - The Dollar Index strengthened in Q1 by 3.7% as US economic growth accelerated and US vaccination progress sharply eclipsed many other regions
    - However, post Q1, the Dollar Index has depreciated by 3.0%
  - The Dollar strengthened by 4.0% vs. the Euro during Q1 as the pace of Europe's vaccinations far lagged that of the US. However, post quarter, some of those gains have reversed.
  - The Canadian Dollar modestly appreciated vs. the USD in Q1 and has strengthened another 3% since then driven by continued appreciation in energy prices and Canada's strong economic recovery
  - EM currencies generally depreciated in Q1 (especially those outside of Asia) but have rallied since then.

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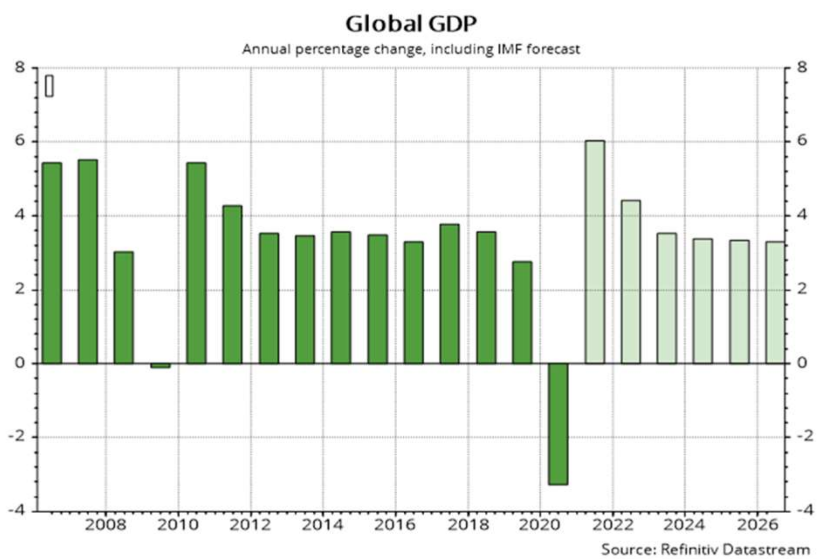
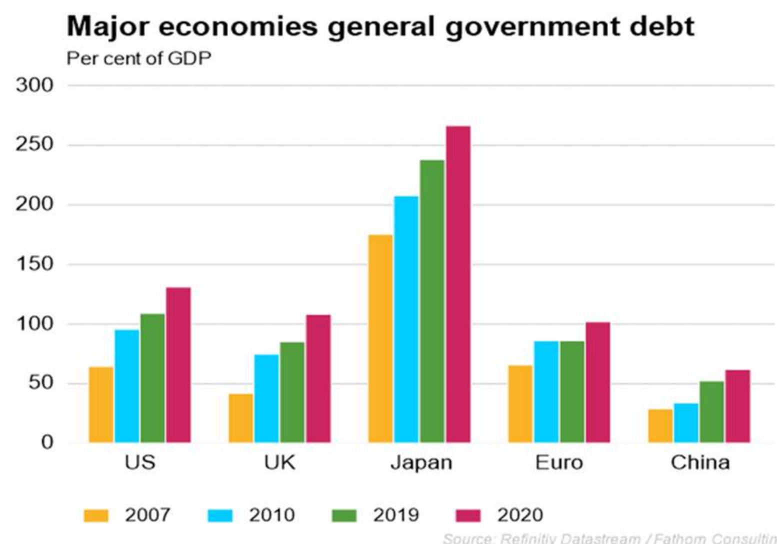
Economic Review

Global Real GDP Growth

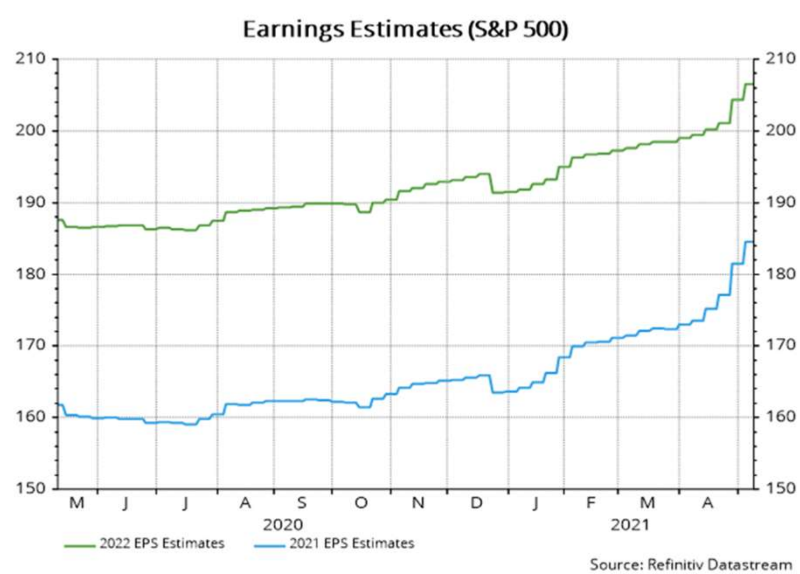
- 2020 represented the sharpest Real GDP decline in modern times (-3.3% vs. -0.3% in 2008 during the Global Financial Crisis).
- However, the IMF is forecasting synchronized global recovery (6.0% GDP growth forecast for 2021 and 4.4% for 2022). The IMF has consistently revised its forecasts upwards given the faster the anticipated pace of vaccine rollouts and still heavy fiscal stimulus programs.
  - Advanced economies are forecast to grow at 5.1% and 3.6% GDP growth rates for 2021 and 2022 while emerging economies are forecast to grow at 6.7% and 5.0% and respectively during those years.
- Governments have continued to rollout new stimulus programs to help economies recover from the pandemic.
  - These programs are causing government deficits to spike to historically high levels across various regions.
  - While debt service is currently manageable given ultra-low interest rates, the ability to reduce deficits post-pandemic and the long-term effects of such elevated debt levels remains unknown.

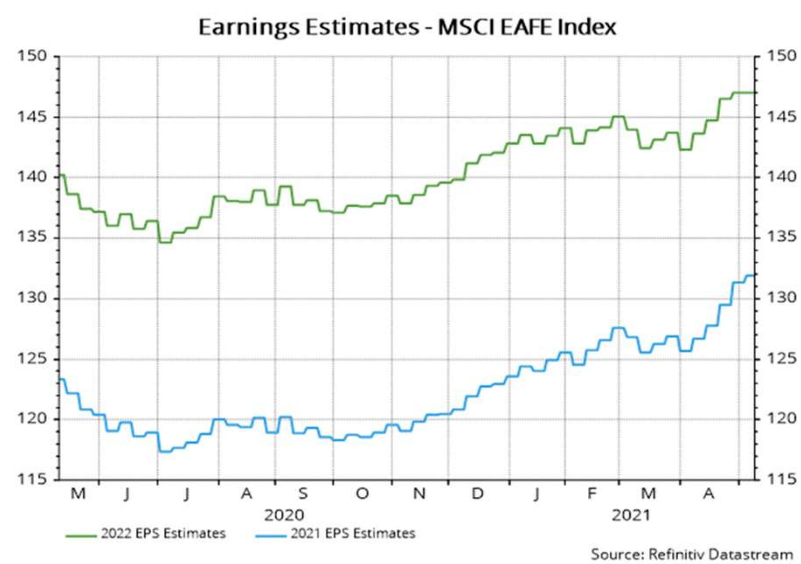




Global Corporate Profits

- Economic data and corporate earnings have been consistently surprising to the upside.
  - Analysts have been playing “catch-up” and sharply raising earnings’ forecasts for both 2021 and 2022.
  - Both S&P 500 and MSCI EAFE earnings forecasts for 2021 now exceed pre-pandemic 2020 earnings forecasts. Previously, analysts were forecasting a return to these levels by 2022.
- The competing dynamic between large-scale global pent-up demand vs. potential emerging inflation pressures will determine whether 2022 earnings forecasts are achievable.
  - The combination of significant pent-up consumer demand, massive stimulus, business inventory restocking, resumption in world trade growth and stringent cost controls augur well for continued strong economic and corporate earnings growth.
  - However, producer and supply-chain costs have risen rapidly over the past six to nine months (in some cases – commodity prices have tripled over the past year). Corporate profits may come under pressure if these inflationary costs cannot be passed on (without demand reduction).





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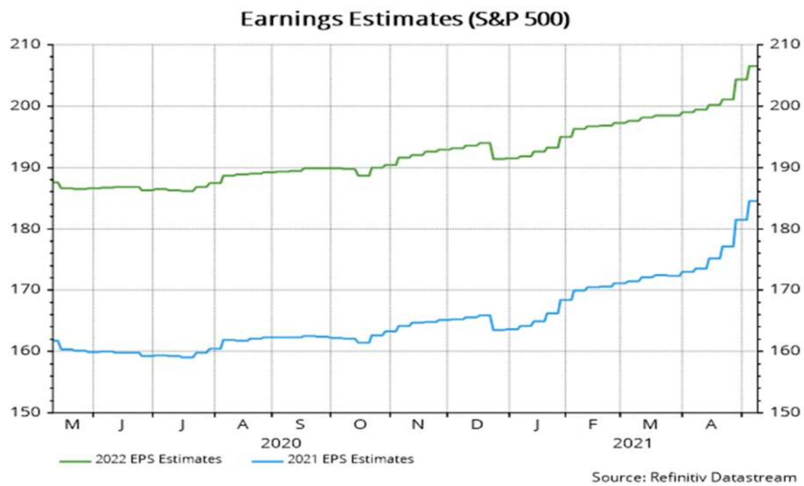

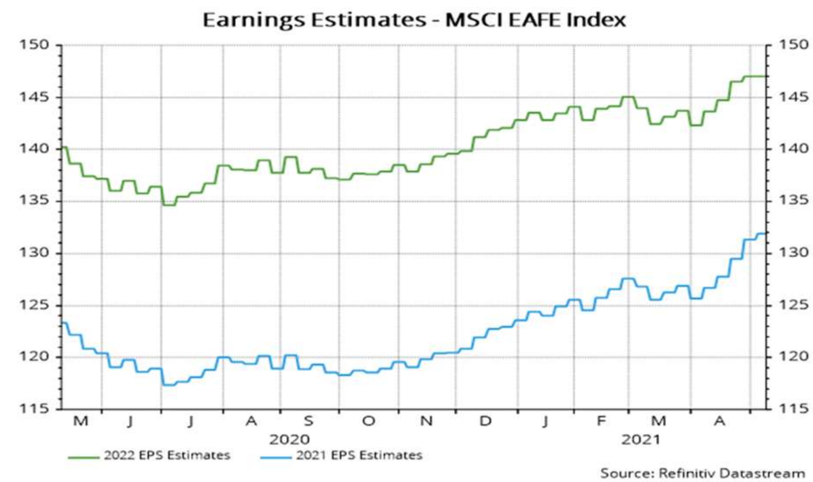

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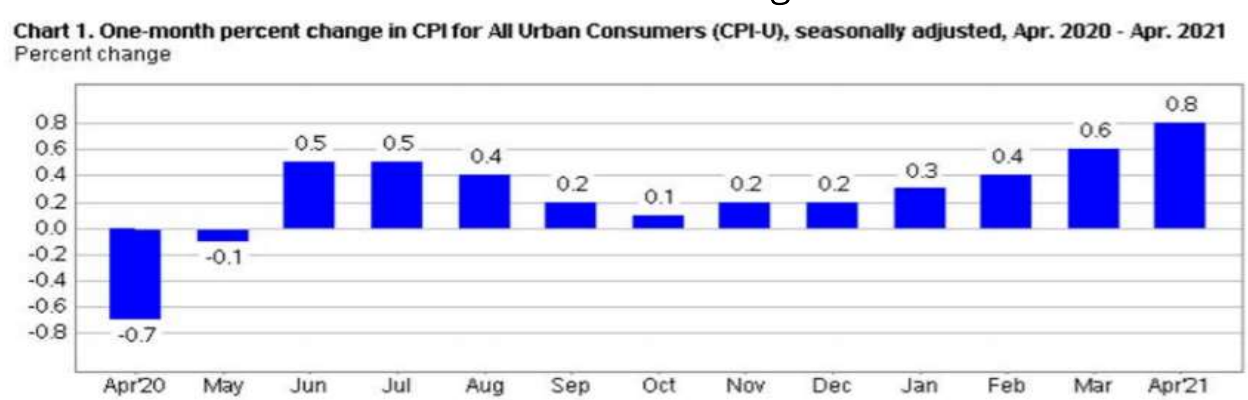
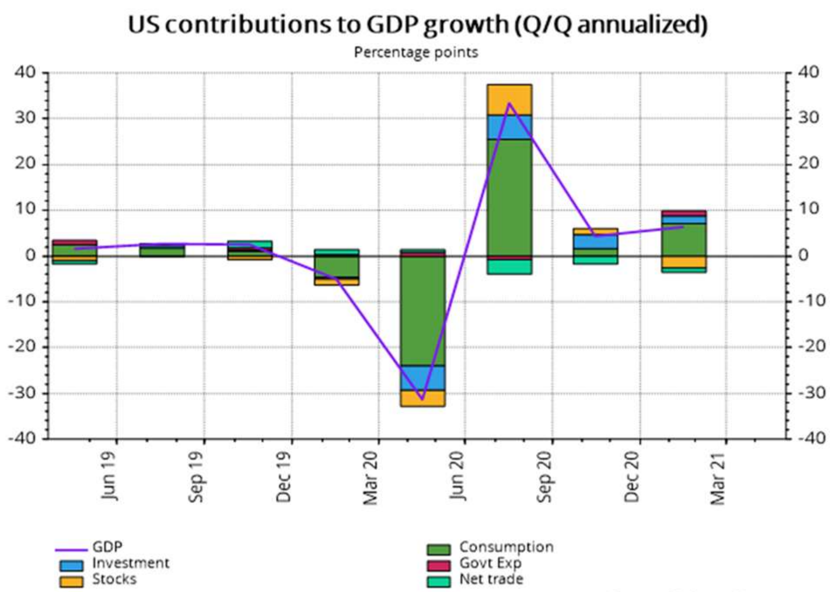
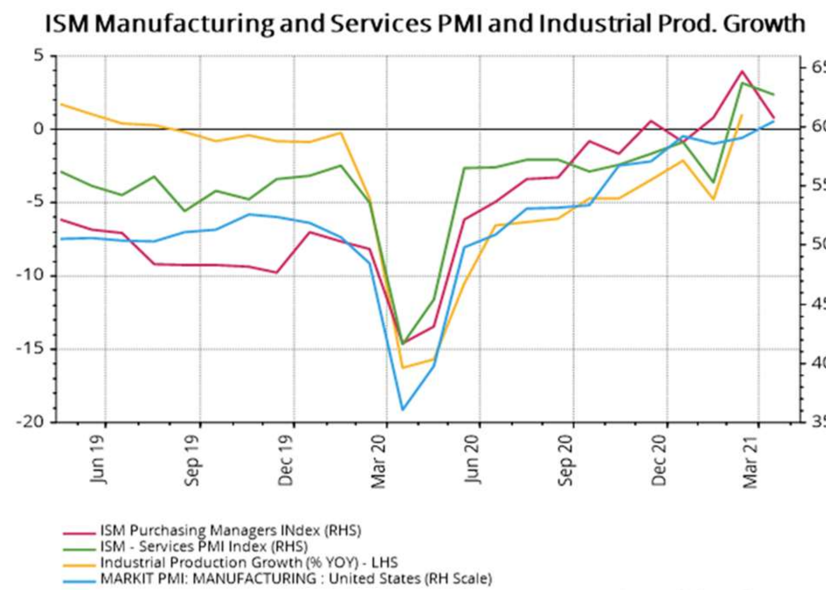


United States

- Real GDP grew by 6.4% Q/Q on an annualized basis in Q1 2021, with economists projecting 6.5% GDP growth in 2021 followed by a still healthy 3.7% growth in 2022.
  - The recovery has been pronounced across both the manufacturing and services sectors.
  - Recent additional stimulus ($1.9 trillion in January 2021) has furthered bolstered growth and a potential $2.3 trillion infrastructure spending package has the potential to turbo-charge economic growth if passed.
- Leading indicators such as Manufacturing and Services PMI Indexes have continued to rebound and are nearing record levels.
  - Economic data has consistently surpassed consensus expectations by wide margins, which contributed to much wider than normal upside to analysts' earnings forecasts. This is turn has led to the continued sharp rally across US equity markets (up 9.9% YTD through May 13, 2021).
  - There are clears signs of demand acceleration across several hard-hit COVID sectors including travel and lodging (based on near-term and future booking trends)



Source: Refinitiv Datastream



Source: Refinitiv Datastream

United States (Cont.)

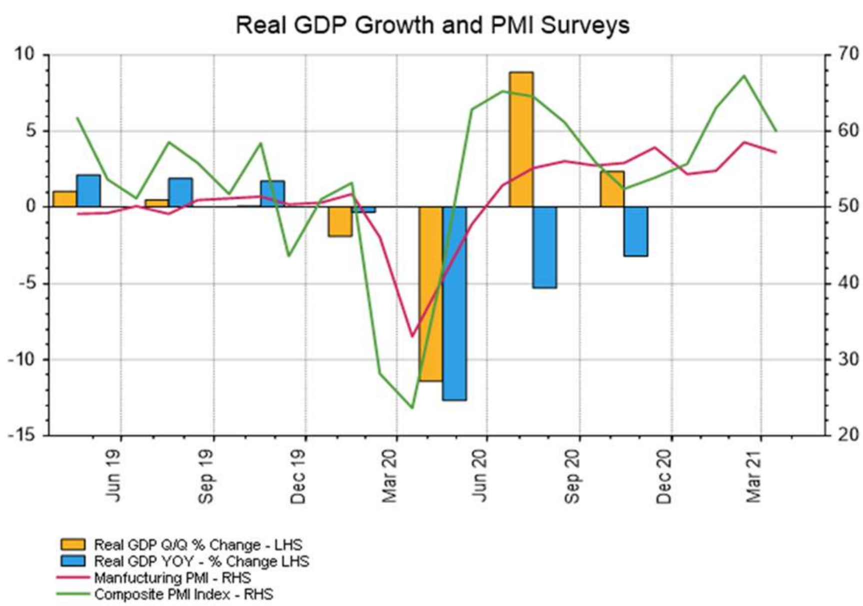
- <u>US employment levels continued to improve throughout Q1 with sharp increases in retail sales.</u>
  - The unemployment rate declined to 6.0% in March (although ticked up slightly in April to 6.1%)
    - The first three months of 2021 pointed to continued strong employment recovery with the unemployment rate continuing to decline to 6.0% from 6.7%
      - However, net job growth in April was only 266,000 vs. some bullish forecasts for nearly 1 million.
      - Interestingly, the number of job openings accelerated sharply indicating that many small businesses were having difficulty finding workers to fill vacancies. This apparent contrast has led to debate regarding whether current stimulus benefit policies are creating disincentives for workers to return to the workforce.
    - We continue to forecast further employment gains given a) accelerating vaccine availability and adoption and b) increased demand for COVID-affected activities (restaurants, lodging, etc.).
  - Consumer balance sheets are at extremely healthy levels following another significant tick-up in the consumer savings rates in March (following the January 2021 $1.9 trillion stimulus package).
    - These elevated personal savings rates are driving significant gains in consumption as evidenced by record retail sales growth and surging big-ticket expenditures (housing and auto sales).

Source: Refinitiv Datastream

Source: Refinitiv Datastream

Canada

- <u>Canada's economy likely experienced continued strong recovery in Q1 2021.</u>
  - Q1 GDP is expected to improve 1.5% Q/Q (6% annualized) with both manufacturing and services PMI's showing growth during the quarter.
    - 2021 GDP is now forecast to grow at 5.8% YOY with a recovery of 4.0% in 2022.
  - Following a sluggish start to the rollout of vaccines and a third wave of rising COVID cases, vaccinations have ramped up with most Canadians expected to be fully vaccinated by fall.
    - 33% of Canada's population have received at least one shot (well behind the US and UK but ahead of Europe).
  - The Canadian $ rallied heavily vs. the USD (presently at $1.22 vs. $1.27 at YE 2020 and $1.45 at March 2020).
  - Surging crude oil prices should also aid Canada's economic recovery throughout 2021 and is buoying strong business investment intentions.
    - According to the Bank of Canada's latest Business Outlook Survey, investment intentions were more favorable than in any previous month since tracking of the data began, dating back to 1998.



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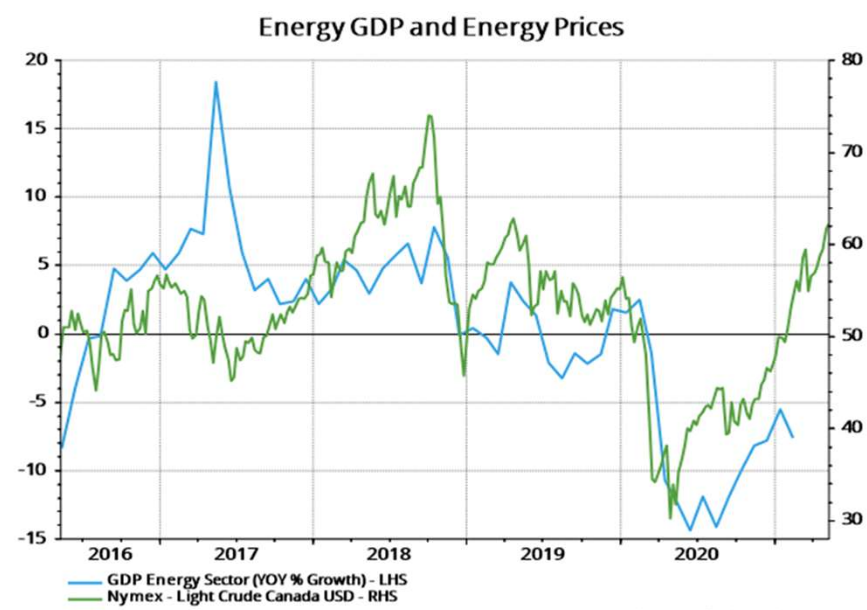
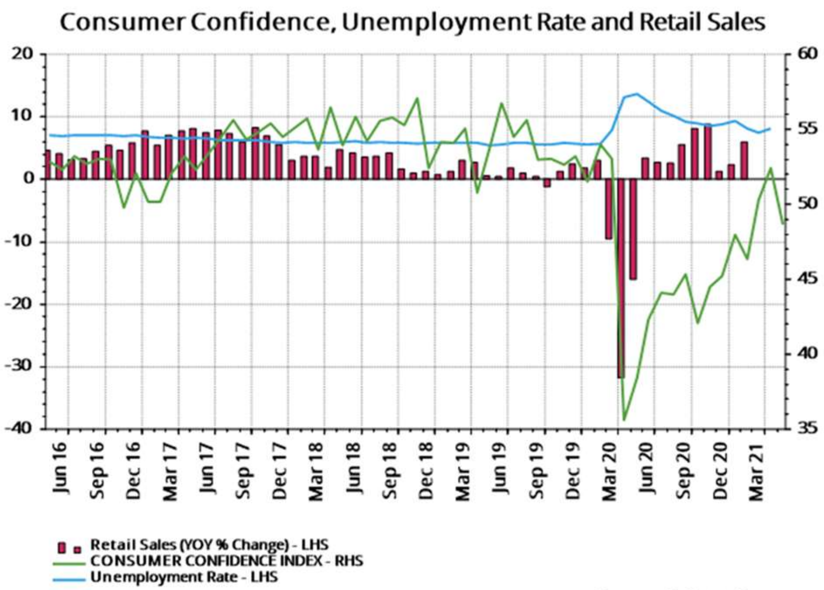


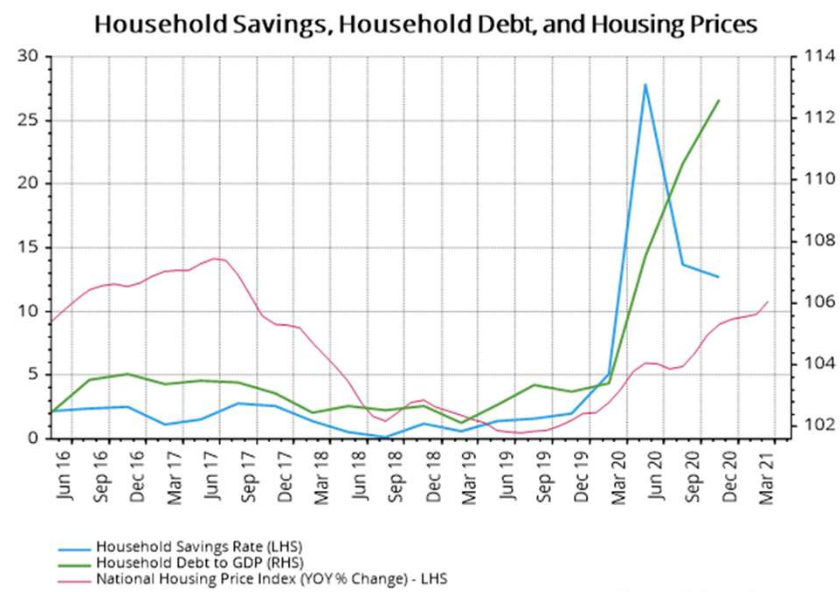
Source: Refinitiv Datastream

Canada (Cont.)

- <u>Canadian consumer and employment indicators remained highly positive in Q1 2021.</u>
  - Retail sales have shown continued positive YOY growth with economists projecting a large spike in YOY growth for March and April 2021 (vs. easy compares given the pandemic disruption).
  - Household savings rates remain elevated at near 15% indicating substantial capacity for pent-up demand.
    - As vaccinations ramp up through the summer and into the fall, consumer spending is expected to increase substantially (especially in COVID-affected sectors).
  - The Canadian government has aggressively provided benefit and wage support to unemployed workers through programs such as the Canada Emergency Wage Subsidy and the Canada Recovery Benefit.
  - The March employment report was much better than expected with employment surging in COVID-affected sectors. Full-time jobs were up an 11th straight month and are within 1% of their pre-pandemic peak.
    - The labor participation rate improved markedly to only 0.3% below that in February 2020 (pre-pandemic).
  - Housing activity remains robust with strong single-family home sales and home price appreciation reaching 10% YOY (trends mirroring those in the US).



Source: Refinitiv Datastream

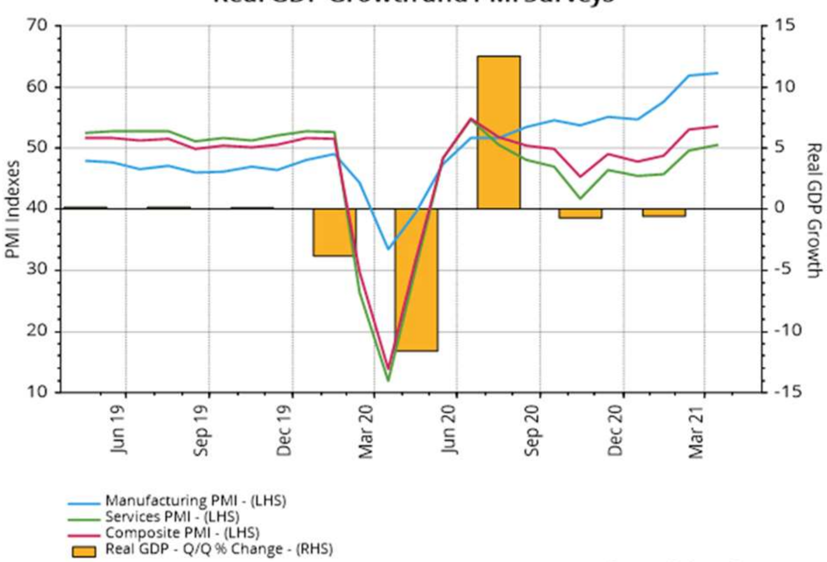


Source: Refinitiv Datastream

Eurozone

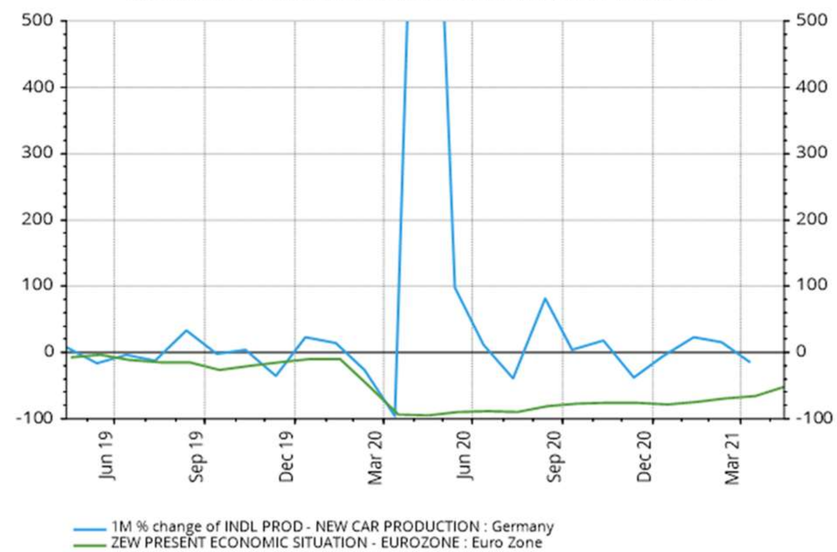
- <u>Eurozone (ex UK) GDP declined by 0.6% Q/Q in Q1 2021, a second consecutive quarterly decline.</u>
  - A sharp resurgence in COVID cases coupled with a highly delayed start to vaccine rollout has stymied the Eurozone economy, as strict lockdown restrictions were enacted by many European governments.
- However<u>, economists are relatively optimistic regarding the outlook for the Eurozone</u> over the second half of 2021.
  - Vaccination rollout efforts are ramping up significantly with Germany and France leading the pack.
    - The EU expects to have 70% of adult population vaccinated by this summer which should help Eurozone countries' tourism activities over the summer season.
  - Additionally, EU countries are due to start receiving EU-wide COVID support funds in the second half of 2021.
    - Compared to the over $5 trillion in stimulus deployed in US, the stimulus deployed at the EU-level has been relatively muted thus far.
  - Leading indicators such as PMI indexes have remained strong, especially for manufacturing indexes (with strong exports to China and the US helping buoy the manufacturing sector)

Real GDP Growth and PMI Surveys



Source: Refinitiv Datastream

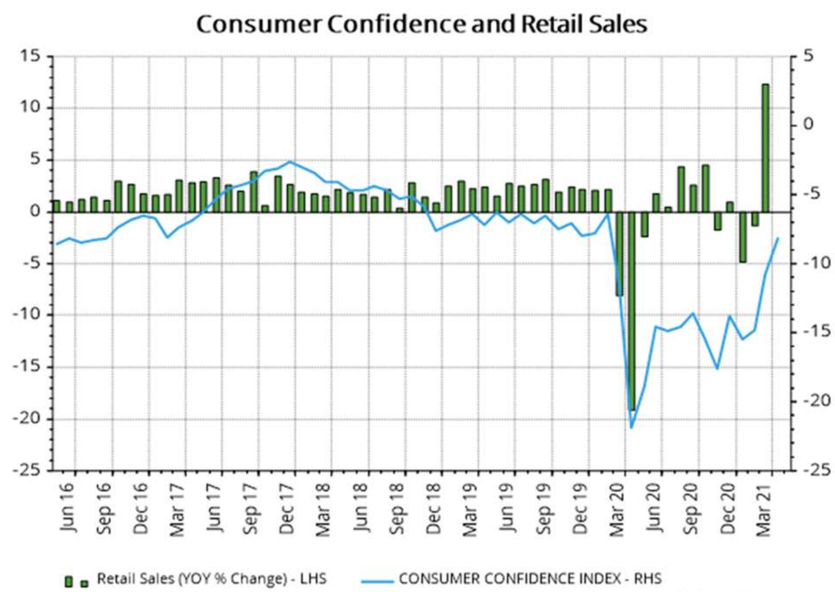
Economic Sentiment and German Auto Production



Source: Refinitiv Datastream

Eurozone (Cont.)

- <u>Consumer indicators have been mixed in 2021 since sharply recovering in fall 2020.</u>
  - YOY retail sales growth sequentially improved over the quarter.
    - However, the data is distorted by pandemic comparisons (Jan and Feb 2021 activity restricted due to lockdowns vs. no restrictions in 2020 and March 2021 data facing very easy compares).
  - Eurozone unemployment rates have declined modestly since an initial uptick occurred at the onset of the pandemic.
    - Unlike in the US and in Canada, unemployment swings in Europe have been much more muted.
    - Social protections and employee-friendly labor laws coupled with wage-replacement-based fiscal stimulus has thus far kept massive layoffs at bay.
  - Home price appreciation has remained steady and mortgage interest rates continue at rock-bottom levels.



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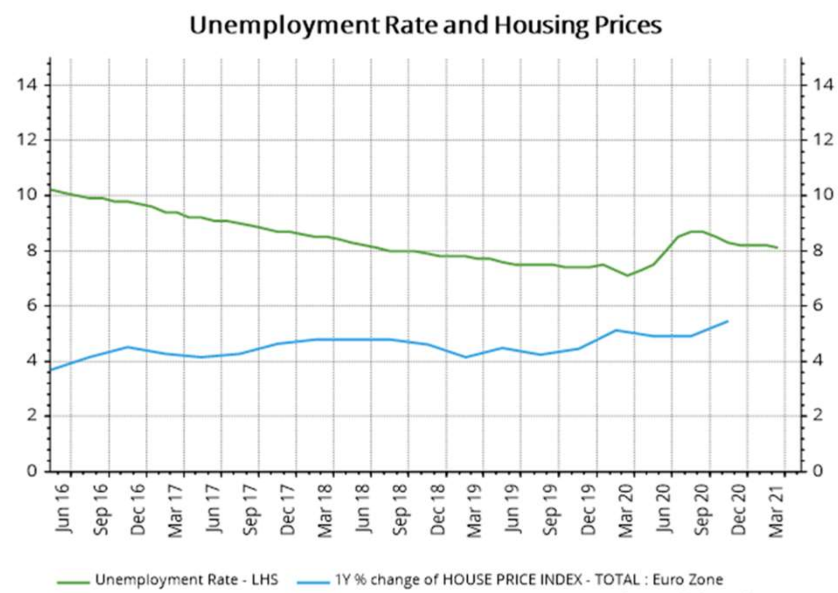
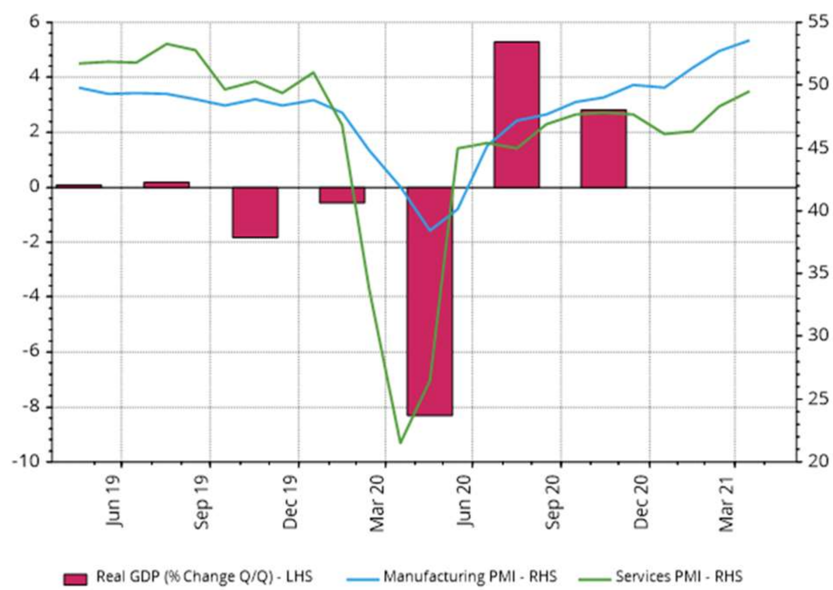


Source: Refinitiv Datastream

Japan

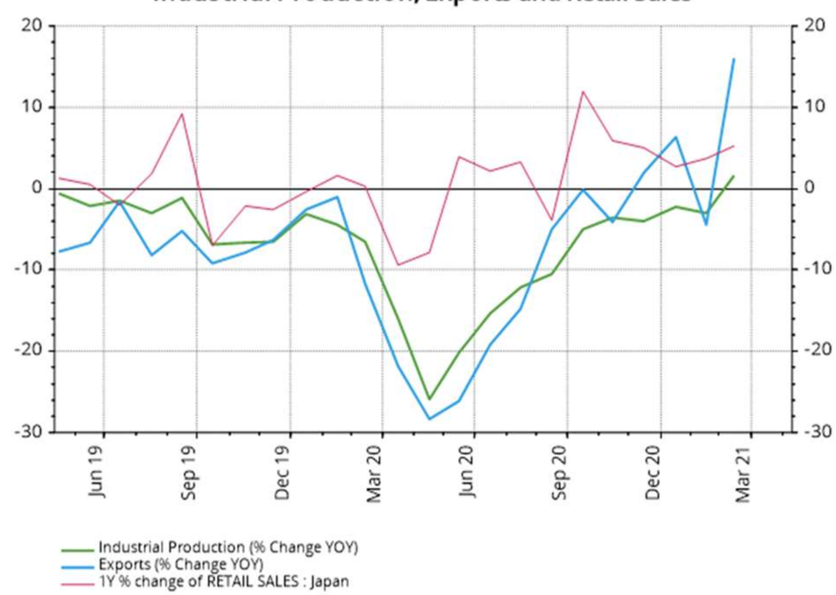
- <u>Japan's economy delivered mixed performance in Q1.</u>
  - Japan's exports rebounded sharply against easy compares driven by strong demand from its largest trading partners (the US and China). External demand for Japan's electronic exports has been very strong.
  - However, COVID cases have surged over the first three months with regions declaring various states of emergency. Domestic consumption has remained muted and any anticipated pickup from the Summer Olympics will be highly dependent on how the COVID cases evolve.
    - Japan's vaccination efforts have lagged other nations with only 2% of the population fully vaccinated.
  - Japan has deployed some of the most aggressive stimulus measures with fiscal measures taken amounting to 44% of GDP (16% in direct public spending and 28% in liquidity support).
  - Economists are forecasting healthy H2 2021 growth for Japan's economy driven by both continued strong demand for exports combined with increasing domestic consumption (as the vaccination effort gains steam).

Real GDP and PMI Indexes



Source: Refinitiv Datastream

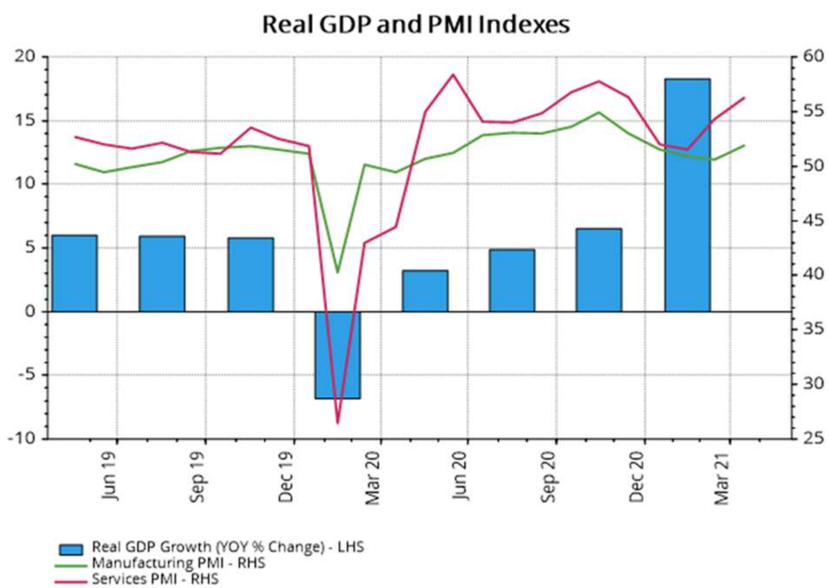
Industrial Production, Exports and Retail Sales



Source: Refinitiv Datastream

China

- <u>China's GDP Growth was mixed in Q1 2021.</u>
  - China achieved 18.3% YOY GDP growth but only 0.6% sequentially Q/Q (missing analyst expectations).
  - The IMF projects 8.4% Real GDP growth for 2021 and
  - China's exports grew 39% YOY during Q1 (due to easy compares as China had shuttered much of its factories during the early months of the pandemic in 2020). When comparing to pre-pandemic figures two years ago, China exports still grew robustly at 13.5%
    - Analysts expect the pace of export growth to wane (even on a two-year comp basis) as competition for exports increases as other nations fully re-open their economics.
    - However, economists expect domestic consumption to continue accelerating and help offset any manufacturing and export growth slowdown
  - Unlike in the US, China's fiscal stimulus has been less targeted towards direct benefits to consumers
    - As such, China has not seen the massive spikes in consumer spending vs. the US)



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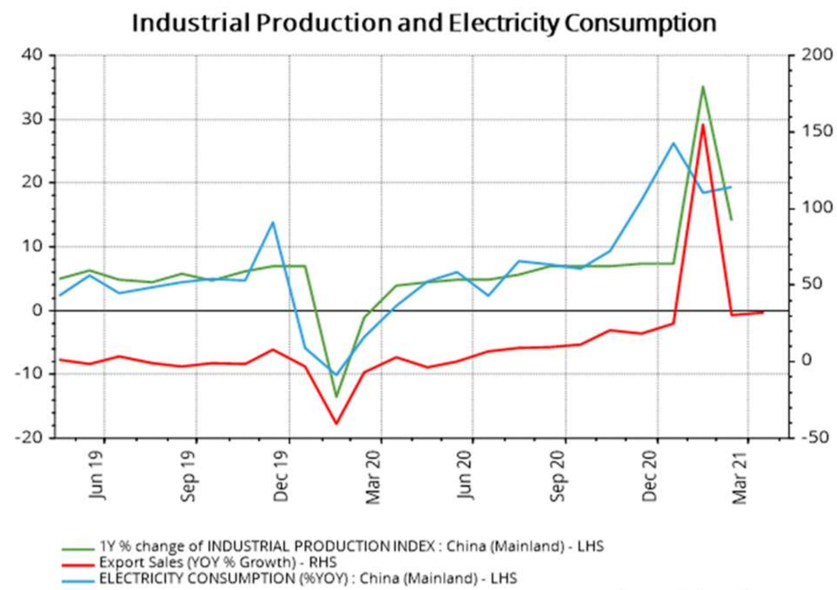
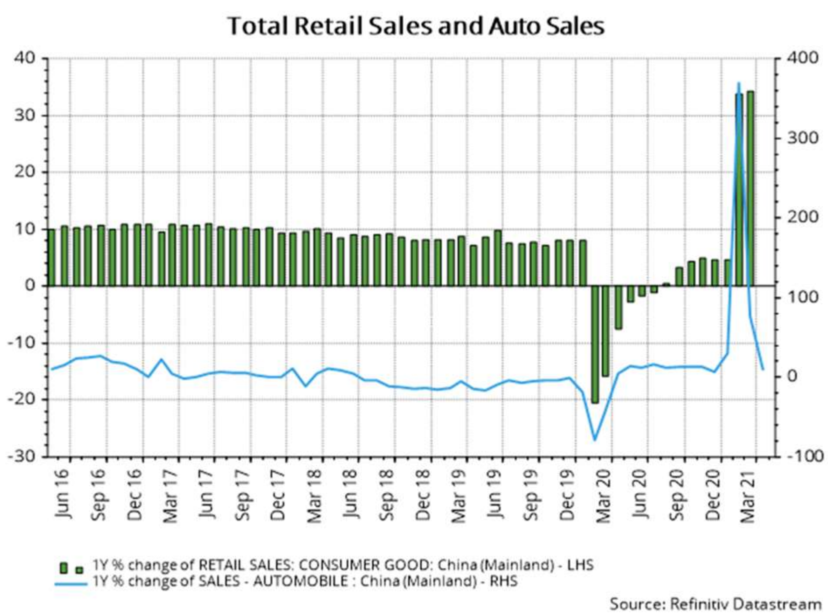
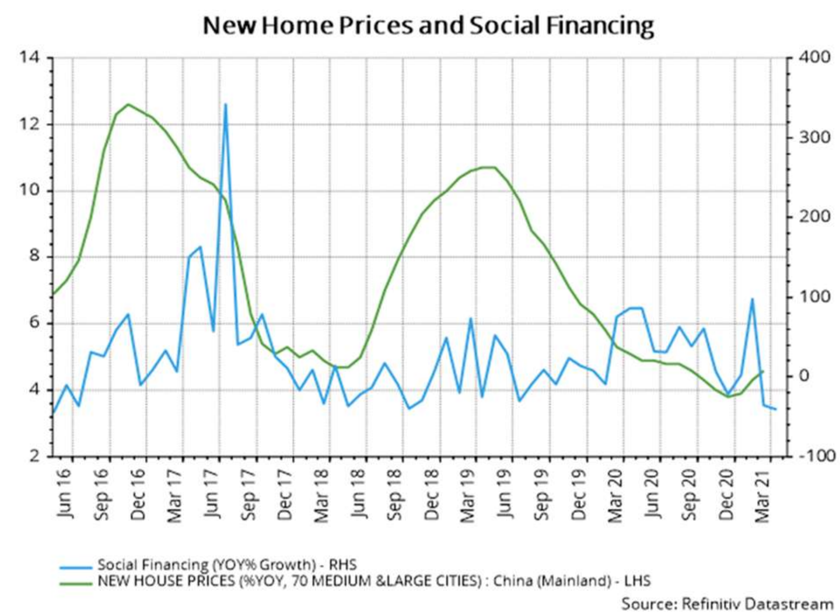


Source: Refinitiv Datastream

China (Cont.)

- <u>Chinese consumption is now recovering at a steady pace.</u>
  - Retail sales growth accelerated to 4.6% YOY in Q4 with all months showing YOY growth.
  - Imports jumped 38% YOY and the growth was relatively broad-based, indicating a surge in domestic consumption.
  - New home price appreciation has improved sequentially each month in 2021 with gains spreading across cities.
  - With the economy now firmly at or above trend, the government is taking steps to gently remove stimulus and financing
    - The Chinese central bank is focusing on cooling credit growth to help contain financial risks. Of particular concern has been the hot property market.
    - The government has asked banks to trim their loan books to help contain asset bubbles.

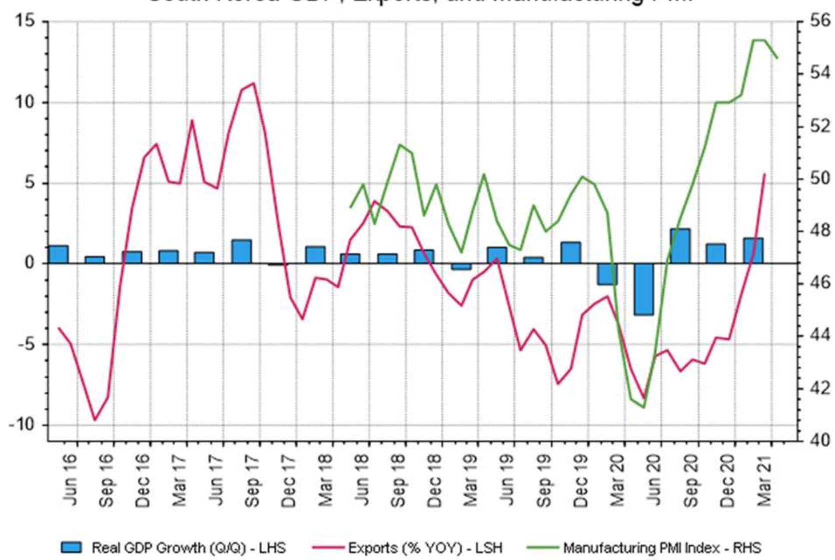




South Korea & Taiwan

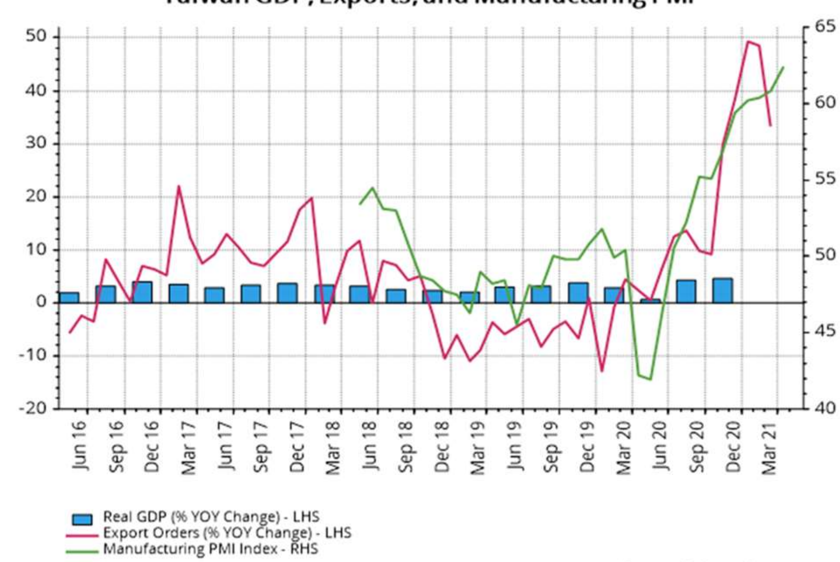
- South Korea and Taiwan's economies both grew robustly in Q1.
  - South Korea's GDP expanded 1.6% Q/Q (beating forecasts) after a 1.2% sequential increase in Q4. Economists are forecasting 3.5% GDP growth in 2021, the fastest growth in over a decade.
    - Exports (roughly 35% of GDP) fueled the bulk of the growth and briskly increased sequentially in Q1 (+1.9% Q/Q). Manufacturing PMIs spiked as factory activity surged to meet sharply increasing export orders.
    - Facility investment also increased substantially at 6.6% Q/Q.
  - Taiwan's economy is forecast to have grown at its fastest pace in more than a decade (8.2% YOY)
    - The "work-from-home" boom sparked strong global demand for the island's hi-tech exports. Export growth of electronic components was especially strong.
    - The global shortage of semiconductor chips has also bolstered demand for made-in-Taiwan semiconductors where leading producers such as TSMC are expanding capacity.
    - Economists are forecasting 8% annual GDP growth in 2021 buoyed by continued strong export growth and an uptick in domestic consumption.

South Korea GDP, Exports, and Manufacturing PMI



Source: Refinitiv Datastream

Taiwan GDP, Exports, and Manufacturing PMI



Source: Refinitiv Datastream

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Special Topic: SPACs

SPAC Overview – What Are SPACs?

SPACs are publicly-traded vehicles formed to raise "blank check" capital to acquire a single, public-market ready operating business

- Investors commit their capital for up to two years in exchange for **downside protection (redemption rights) and additional potential upside (share appreciation plus warrants)**
- IPO is **typically based on an investment thesis focused on a sector, geography** or a sponsor's experience
- Following the IPO, proceeds are placed into a trust account accruing interest in government securities, and the **SPAC has generally up to 24 months to identify and complete a merger** with a target company, called "de-SPACing"
- If the SPAC does not complete a merger within that time frame, in general the SPAC liquidates and IPO proceeds (with interest) are returned to shareholders
- Once a target company is identified and a merger is announced, the **SPAC's public shareholders individually have the option to vote in favor of or against the transaction and elect to redeem the amount in trust**

Diagram Source: Fortress Investment Group

SPAC Phases

- Investors can invest in SPACs at several points prior to a de-SPACing event:
  - At new issuance where the SPAC lists at a price equivalent to its guaranteed trust value (usually $10).
  - In the secondary market but prior-to-deal announcement (stock usually trades near cash trust value).
  - In the secondary market post-deal announcement but pre-acquisition or de-SPACing (stock generally trades above cash trust value).
- The diagram below illustrates the downside protection with upside potential.

PHASE I: PRE-ACQUISITION

Bond-like floor + call option

Pre-acquisition the SPAC trades like a zero coupon bond with a fraction of warrant

- 100% cash-in-escrow provides downside protection
- Option to participate in future acquisition

PHASE II: AT ANNOUNCEMENT

Bond-like floor + call option + potential equity upside

Between announcement of the acquisition and shareholder vote, investors have the option to monetize their shares while still maintaining downside protection

- Downside protection through the cash in trust ($10 + interest) due to the redemption right
- Potential upside in shares and warrants
- Opportunity to acquire a company at an attractive valuation

PHASE III: POST-ACQUISITION

Equity

After successful business combination, the SPAC will trade as a regular operating company with the shares and warrants providing additional upside potential

- No downside protection
- Trading in line with company fundamentals
- Additional upside potential from shares and warrants

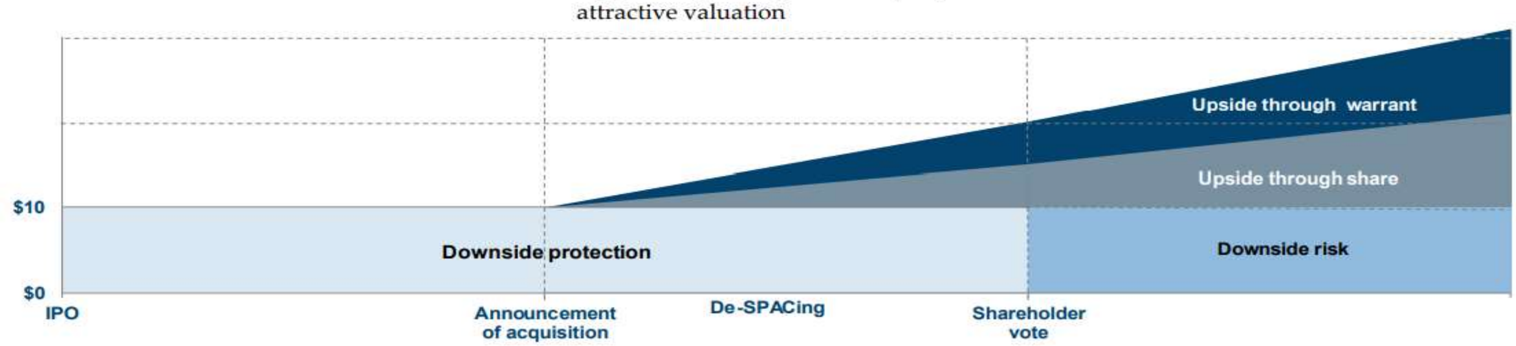

Diagram Source: Fortress Investment Group

SPACs – Evolution of Marketplace

- SPAC issuance has exploded since 2019 and SPACs are being viewed as a more mainstream and accepted path for private companies to access the public markets.
  - In 2020, SPAC issuance exceeded $80bln. Through April 2021, SPAC issuance has already reached $100bln, exceeding all of 2020.
    - These levels far exceed the sub $15bln annual issuance levels from 2010-2019.
  - SPAC mergers totaled $90bln in 2020 and $55bln in merger transactions have already been completed in 2021 (with another $220bln announced).
    - Presently, there are over 400 SPACs seeking merger targets with over $140bln in dry powder.
    - SPACs are becoming major players in the M&A market and are leading to a substantial increase in overall M&A deal volume.
- Prior to 2015, SPACs were viewed as non-mainstream
  - Several perceptions existed including a) lack of top-notch sponsors, b) lower-quality companies choosing the SPAC route, and c) target companies in "sleepy" traditional sectors such as industrial, energy, and financials.
- Over the last few years, SPAC perception changed substantially
  - Seasoned top-tier sponsors (Chamath Palihapitiya, Gores Brothers, Churchill Capital with Michael Klein, Bill Foley, etc.) have entered the space.
  - Several high-profile SPAC mergers have been completed in growth and new-economy sectors.
    - Many of these transactions appreciated over 200% in the 6 months post de-SPACing event. This rapid share price appreciation fueled other high-growth companies to pursue the SPAC route.
    - Prominent transactions include DraftKings (digital sports entertainment and gaming), QuantumScape (lithium batteries), Paysafe (digital payments) and Virgin Galactic (space travel).
  - SPAC IPOs and merger transactions have continued to increase in size.
    - In 2020, the average SPAC IPO had a trust value of $350 million (more than 2x the average the prior five years)
    - Similarly, the average SPAC merger transaction was close to $2 billion in enterprise value (again roughly 2x the average over the past five years).

SPACs – Why Are They Interesting Now?

- SPACs have several attractive investment attributes including:
  - SPAC IPOs are similar to fixed income instruments and have downside floors (cash trust value) but offer potentially compelling upside through participation in equity and warrants.
  - Large market with over $140 billion in active SPACs (dry powder in the form of SPAC IPOs that have yet to consummate transactions).
  - SPACs possess attractive duration and liquidity features.
    - Maximum duration of two years (most transactions announced under one year) and daily liquidity.
  - SPACs offer investors exposure to a wide range of industries and business models.
- SPACs offer compelling value propositions to target companies and investors.
  - Target companies have quicker paths to IPO with certainty of execution (combination of SPAC investors and sponsor / PIPE equity)
  - Unlike during the conventional IPO process, target companies can provide investors with projections for future revenue and cash flow growth.
    - One should note that the content of these projections are currently being reviewed by the SEC, who may issue regulations around the types of projections offered.
  - Investors can assess the merits of the transaction and choose to participate (assuming they believe upside potential is warranted) or decline and receive their principal back.
- However, given the explosion in SPAC issuance and SPAC mergers over the past 18 months, careful due diligence and active management is necessary.
  - SPACs vary in terms of sponsor quality
    - Sponsors need to be evaluated in terms of a) historical investing track record, b) SPAC transaction record for repeat issuers, c) industry focus and relationships, d) access to capital, and e) Equity market and M&A experience.
  - There is wide variability surrounding SPAC structures and thorough analysis of sponsor alignment with SPAC investors is critical.

SPACs – 2021 Developments

- The SPAC market had become extremely frothy early this year (especially in Jan. and Feb.)
  - Issuance of new SPACs exploded at the beginning of the year. Many of these were backed by unconventional sponsors such as athletes and celebrities (with no investing experience).
  - Simultaneously, institutional and retail participation increased significantly with competitions for allocations becoming extremely competitive.
  - SPAC trading also displayed unusual dynamics with low linkage to fundamentals.
    - SPACs often traded well above ($13+) cash-backed IPO price shortly after IPO and pre-transaction announcement. Generally, SPACs tend to trade around cash-trust value pre-transaction announcement.
    - Additionally, SPACs were rapidly appreciating to the high-teens levels post transaction announcement.
- In March, however, the market reversed and has weakened since.
  - Several prominent post-transaction SPAC stocks (DraftKings, Virgin Galactic, Quantum Scape) have declined more than 40% from recent peaks (in conjunction with the recent selloff in technology and growth stocks).
  - Pre-transaction SPACs began trading near or below cash trust value.
  - Many well-received transactions traded down below $11 post announcement (unusual as post-announcement SPACs tend to trade in the $11.00-$12.50 range as sponsors are given credit for value-creation abilities).
- We believe this correction in the SPAC market is healthy and that the SPAC market will continue to present many attractive avenues in which to participate.
- *BCA is exploring several options for ways to participate in the SPAC market including:*
  - Direct SPAC hedge funds (funds investing in SPAC IPOs).
  - Merger-Arb funds – as the SPACs are driving up M&A volumes and SPAC deals tend to trade at wider spreads.
  - Convertible-Bond Arbitrage Funds
  - High focus on risk-management and will look for funds investing in SPACs prior to de-SPACing event.
    - Pre-de-SPACing, SPAC's offer limited to no downside with potential significant upside potential.
    - The track record of SPAC stock price performance post de-SPACing event has been extremely volatile.

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