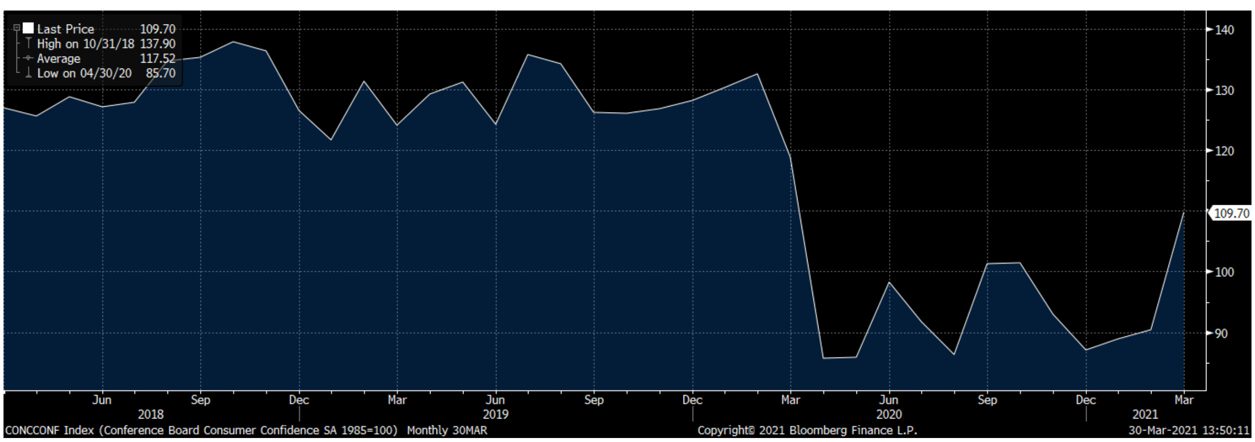
VANDERBILT Ave.
ASSET MANAGEMENT

1st Quarter 2021

There are several **stimulus programs** that will propel economic growth in the near-term. Biden's recently enacted $1.9 trillion fiscal program is his first significant economic policy. The size of the program comes from the perspective that too much is better than falling short in providing funds to the economy given the severity of the pandemic induced economic dislocations. The program was as much, if not more, a relief program versus a traditional fiscal stimulus program. In addition to the stimulus program, is the unfolding of the vaccine rollout, which will also contribute to the economic rebound. The sooner the population is vaccinated, and herd immunity is achieved, the quicker will be the return to normalcy. Another important economic stimulus is a very accommodative Federal Reserve monetary policy. The Fed is committed to fostering a jobs recovery and will not begin a gradual withdrawal of monetary stimulus until inflation is at a **sustained** level above their 2% target.

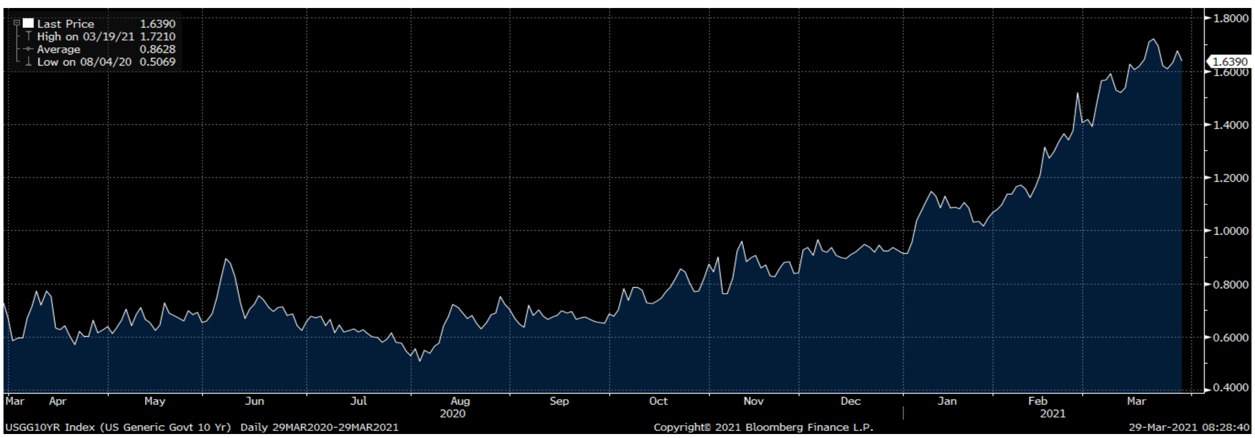
VAAM's **economic growth** outlook is above consensus estimates. We are looking for annualized real GDP growth of 7%-8% for the next several quarters. This growth will be led by the consumer sector- approximately two-thirds of overall GDP. Consumer spending has rebounded because of fiscal and monetary stimulus and pent-up demand established during the lockdown. There are already signs that demand is beginning to pick up. Private-sector data on restaurant visits, hotel bookings and airline travel all show a pickup in spending in recent weeks. Consumer sentiment continued to rise in late March, reaching its highest level in a year due to the third disbursement of relief checks and better than anticipated vaccination progress. The consumer balance sheet is in good shape. U.S. consumers are sitting on $2.4 trillion of excess savings, the equivalent of 18% of GDP. In addition, debt payments as a percent of income have significantly dropped.



We do not attribute any growth for the next several quarters coming from the approximate $2.3 trillion **infrastructure proposal**. We think it is likely there will ultimately be some form of an infrastructure program; however, the specifics remain unknown. Without a looming deadline like expiring unemployment aid, which helped to quickly mobilize Democrats on the $1.9 trillion relief measure, the process for passing another major bill could take months. Lawmakers will need to work out the scope of the package, how to raise taxes to fund at least part of the program, how to address procedural limitations on the legislation, and whether to tailor it so it receives some Republican support. There is fairly broad agreement that the nation's infrastructure is in need of investment. The expenditures would be spread over approximately 10 years and could be funded at historically low interest rates.

VAAM's **inflation outlook** is also above consensus expectations for the near term. However, we do not think inflation will interfere with consumer spending and the increase will be of a transitory nature. We think the inflation rate will slowdown and stabilize after the V shaped economic rebound of this year. The transitory nature of the inflation uptick is due to the March-April price declines from last year as the pandemic spread and lockdowns took effect. Once we move into the fourth quarter, this transitory impact should subside.

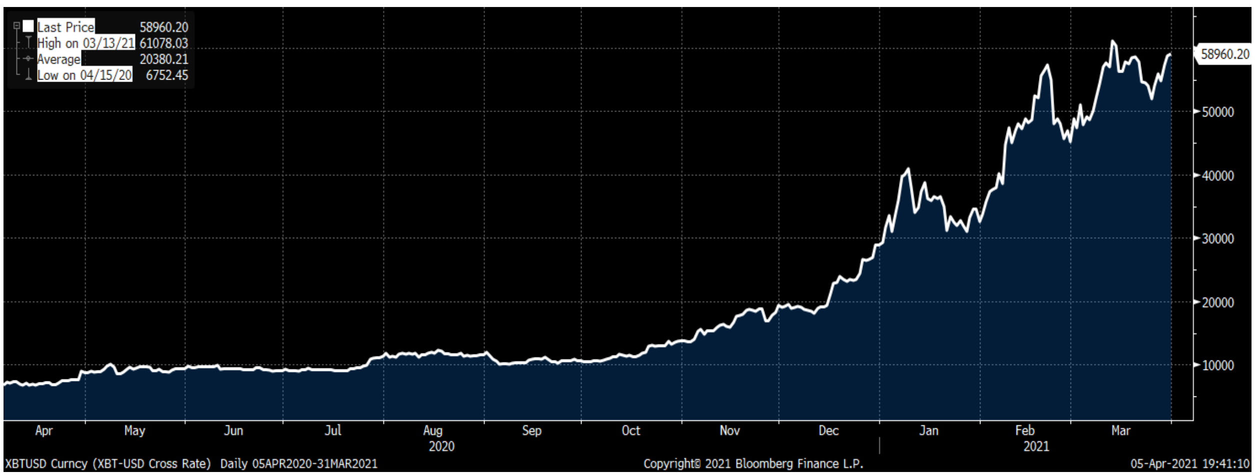
The combination of pent-up spending, the stimulus programs and the Fed's willingness to let inflation accelerate, has made investors nervous and has had an impact on the **markets**. While the Fed has maintained short rates at very low levels (e.g. the two-year U.S. Treasury remains at 0.15%) the longer end of the yield curve has seen rising interest rates. This is depicted below which graphs 10-year U.S. Treasury yield levels over the last year.



The 10-year yield has risen from 0.50% last August to 0.90% beginning this year and to 1.65% currently. While these are still historically low interest rate levels, the rapid nature of the increase since the beginning of the year has had ramifications across investment markets. In addition to higher interest rate levels, **the yield curve is steeper and credit spreads remain narrow**.

Higher rates have also had an impact on the equity market. Value stocks, which remain cheap to growth stocks, have begun to gain increased attention. Value stocks typically trade at lower valuation levels than growth stocks and they should benefit as more cyclical earnings get a boost from the recovering economy. In addition, higher interest rates have raised the discount factor used to present value growth stock cash flows thereby resulting in lower present values. Higher rates have also had an impact on specific sectors. A good case in point is the banking group. While lagging in performance last year they are amongst the leaders this year. A steeper yield curve affords banks the opportunity to invest and lend at higher interest rate levels thereby widening the net interest margin between what they pay on deposits and earn on their investments and loans. Furthermore, a growing economy will stimulate loan demand and improve the quality of the loan portfolio. The banks are in significantly better financial condition than they were coming out of the 2008-2009 financial implosion. The Fed has said that subject to passing their stress tests the banks will be allowed to raise dividends and reinstate shareholder buybacks.

Bitcoin has gained more than 200% in 2020. The strong performance was the result of several factors. During last summer, the pace of Bitcoin issuance declined from 3.6% to 1.8%. Secondly, Bitcoin was helped by the rapid monetary response by the Federal Reserve and the fiscal stimulus.
The monetary and fiscal response to the pandemic caused the money supply (M2) to explode by 24% in 2020 to just over $19 trillion according to the St Louis Federal Reserve. An increase of $4 trillion in one year. By contrast, the total market value of Bitcoin is $700 billion. Bitcoin issuance does not respond to increases or decreases in the crypto currencies value regardless of the magnitude or direction of the change in market value. Bitcoin also has a stipulation set forth in its source code that it must have a limited and finite supply. For this reason, there will only ever be 21 million bitcoins ever produced. On average, these bitcoins are introduced to the Bitcoin supply at a fixed rate of one block every ten minutes. In addition, the number of bitcoins released in each of these blocks is reduced by 50% every four years. This is unique to Bitcoin. Every other commodity traded in the world today, would expand or contract in supply based on changes in price. Bitcoin has a **fixed supply** associated to it and does not have a price response to changes in its supply. However, there are also negatives when it comes to bitcoin: as a store of value, it is impaired given the high volatility of its price, there is a large amount of electricity used to mine bitcoin through computers and thefts from exchanges have occurred. Furthermore, there is the threat of regulatory oversight as cryptocurrency becomes a larger share of the money supply and illegal transactions (such as money laundering) become more common and much harder to detect.



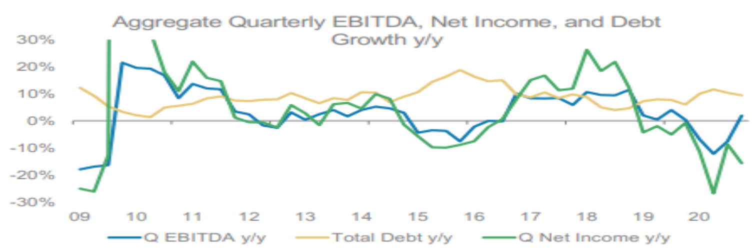
Corporate Review
1st Quarter 2021

The rise in U.S. Treasury interest rates drove Investment Grade Corporate prices lower during the first quarter. For instance, the Intermediate Corporate Index total return was a negative 2.19%. The 1-3 Year Corporate Index was down just 0.02% as short-term interest rates were significantly more stable than longer dated rates during the period. The new year has seen reduced volatility in Investment Grade Corporate Bond spreads versus comparable U.S. Treasury securities. Both Intermediate Corporate and the 1-3 Year Corporate securities offset the negative impact of the wider spreads from the higher income earned as compared to U.S. Treasuries. (See table next page, YTD Excess Return).

	12/31/2020	3/31/2021
Inter. Corporate Total Return		-2.19%
Inter. Corporate Spread	0.67%	0.69%
YTD Spread Change		+0.02%
YTD Excess Return		+0.03%
1-3 Corporate Total Return		
1-3 Corporate Spread	0.34%	0.39%
YTD Spread Change		+0.05%
YTD Excess Return		+0.05%

Spreads & Excess Returns are from the Bloomberg Barclays Corporate Intermediate or 1-3 Corporate index

Your portfolio has remained overweight to the Corporate sector as the re-opening of the economy has gradually begun and the financial performance of Corporate America has started to bounce back. The large fiscal packages passed over the last year and the Federal Reserve monetary actions have been successful in mitigating the worst case outcomes for the economy and businesses. Corporate financial fundamentals improvement can already be seen and should continue to improve throughout the remainder of the year. For instance, 77% of companies reported sales that exceeded analyst estimates in the fourth quarter of 2020, which is significantly higher than historical results. During the period, earnings were in line or better for 79% of the companies, which is around historical norms. EBITDA (a measure of cash flow) was modestly higher, approximately 2%, during the 4th quarter of 2020 as compared to the quarter a year earlier. As shown in the graph below EBITDA has been more resilient than net income.



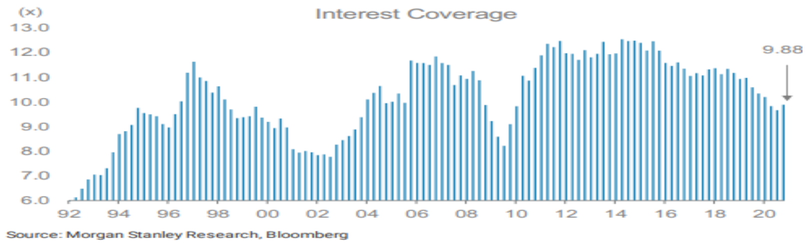
Source: Morgan Stanley Research, Bloomberg

Companies continued to hold onto their cash as the Cash/Debt reached 28% for the universe of Investment Grade Issuers. As the economy recovers the key question for corporate quality is how this cash is utilized. Lower rated companies are expected to focus on debt reduction over the coming months while higher rated companies may begin to increase share buybacks and Merger & Acquisitions, which have remained subdued since the beginning of the pandemic.

The improvement in EBITDA during the prior quarter resulted in gross leverage (Gross Debt/EBITDA) falling to 2.66x, an improvement of 0.2x from its peak last year. The ratio, however, remains approximately 0.3x times year over year. Net Leverage (Gross Debt-Cash/EBITDA) also continued to improve due to the combination of the improvement in EBITDA and the increase in cash balances. Median Net Leverage was at 1.84x at quarter end. This was down 0.14x quarter over quarter and just 0.04x year over year. The difference between it and gross leverage was at 0.82x, a high-water mark. (See graph below)

Source: Morgan Stanley Research, Bloomberg

Interest Coverages (EBITDA/Interest) showed a modest improvement during the quarter due to the improved EBITDA and the low coupon rate of new debt. The 9.88x coverage was up 0.22x for the quarter but remains below year ago levels. Though EBITDA performed well during the quarter, EBITDA margin did show some cost pressures. Given concerns over future inflation levels cost pressures may increase over the coming months, slowing the recovery in corporate financial fundamentals.



The economy is expected to grow significantly during the next several quarters and financial fundamentals should continue to improve. The largest risks to the Corporate bond sector are a too "hot" economy that drives inflation significantly higher, and corporations taking advantage of low interest rates and liquidity to significantly increase buybacks and M&A activity. Either could short circuit the needed improvement in credit fundamentals for lower rated companies. Therefore, though overweight to the sector, we remain cautious on the lowest rated issuers that continue to have fundamentals significantly below investment grade levels. Your portfolio remains underweight to the lowest investment grade rating (Baa3/BBB-) with only a modest allocation in highly selective names such as General Motors.