Colorado Capital
MANAGEMENT

QUARTERLY MARKET UPDATE / APRIL 2021

Economic Outlook

Overview

January began with protestors storming the U.S. Capitol in an attempt to disrupt the certification of the presidential election. Ultimately, Joe Biden was sworn into the nation's highest office less than two weeks later.

By the end of the first quarter, he had signed a new $1.9 trillion stimulus package into law, proposed a $2.3 trillion infrastructure plan, and raised his target for COVID vaccinations administered in his first 100 days in office from 100 million doses to 200 million.

Both business and consumer confidence improved sharply. Oil prices surged, interest rates rose, and inflation concerns escalated. The S&P 500 index gained over 6%, closing the quarter near a new peak. Relative to historical norms, it continued to trade at a high multiple of projected earnings.

CCM Key Economic Indicators

Indicator	3.31.21	12.31.20	3.31.20
US Economy			
Quarterly GDP Growth	Est. 5-6%	4.3%	-5.0%
Unemployment Rate	6.2%	6.7%	4.4%
U.S. CPI (Core)	1.28%	1.61%	2.09%
Interest Rates			
Fed Funds Rate	0.00%	0.00%	0.00%
10-Year Treasury Rate	1.61%	0.93%	.87%
Currency & Commodities			
Crude Oil (WTI)	$ 59.19	$ 48.35	$ 20.51
Gold Price	$ 1,685	$ 1,891	$ 1,624
Trade Weighted Dollar Index	113.6	112.2	121.3
Confidence			
Consumer Confidence Index	109.7	88.6	118.8
ISM Purchasing Managers Index	64.7	60.5	49.7
Stock Prices--12/31/20			
Dow Jones Industrial Average	32,982	30,410	21,917
S&P 500 Forward P/E ratio	21.9	22.3	15.4

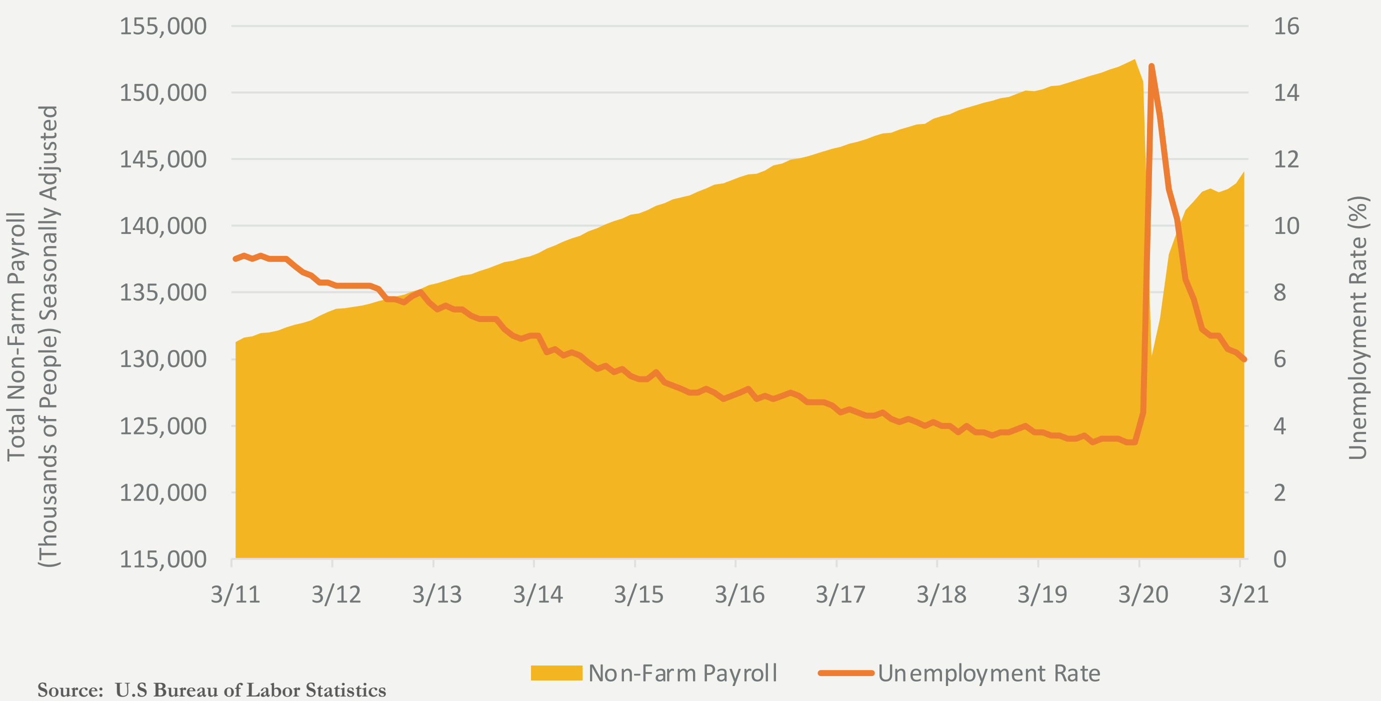
Gross Domestic Product (GDP)

During the first quarter of 2021, the number of daily new COVID cases and COVID related hospitalizations in the US fell dramatically. This allowed an easing of government restrictions and the reopening of many businesses. Together with the new government stimulus program, this led to a surge in consumer spending and estimated growth in 1st quarter real GDP of 5% to 6% on an annualized basis (which is about the twice the normal pace). Many expect growth to continue at this pace throughout the year, which would be the fastest annual growth rate in decades.

Employment

Hiring accelerated in the first quarter as restaurants and other hospitality businesses reopened and coronavirus cases eased. U.S. employers added 379,000 jobs in February—the largest monthly increase since October. While the U.S. unemployment rate ticked down to 6.2%, it still remains elevated. This figure actually understates the magnitude of job losses as labor market participation is still well below pre-pandemic levels. Overall, the U.S. had 9.5 million fewer jobs than a year earlier.

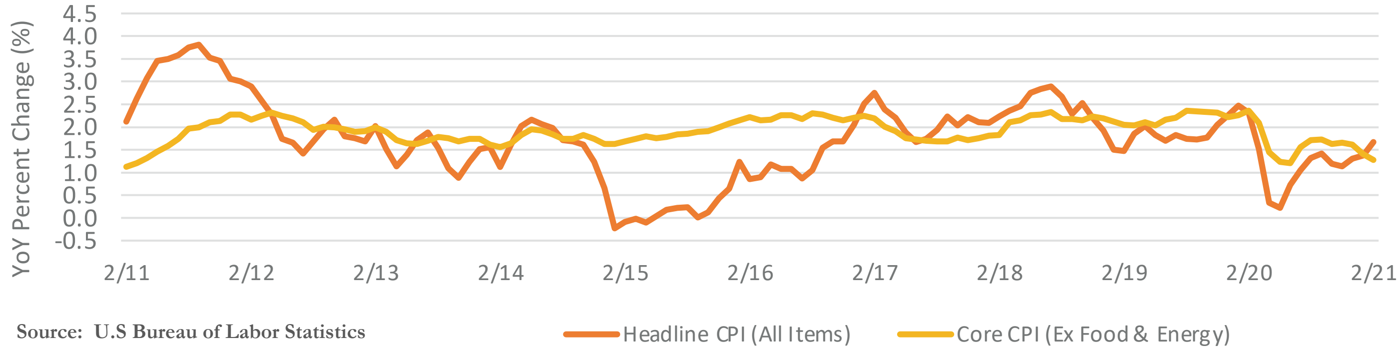
Total Non-Farm Payrolls and Unemployment Rate



Source: U.S Bureau of Labor Statistics

Inflation

Inflation (Consumer Price Index)



Source: U.S Bureau of Labor Statistics

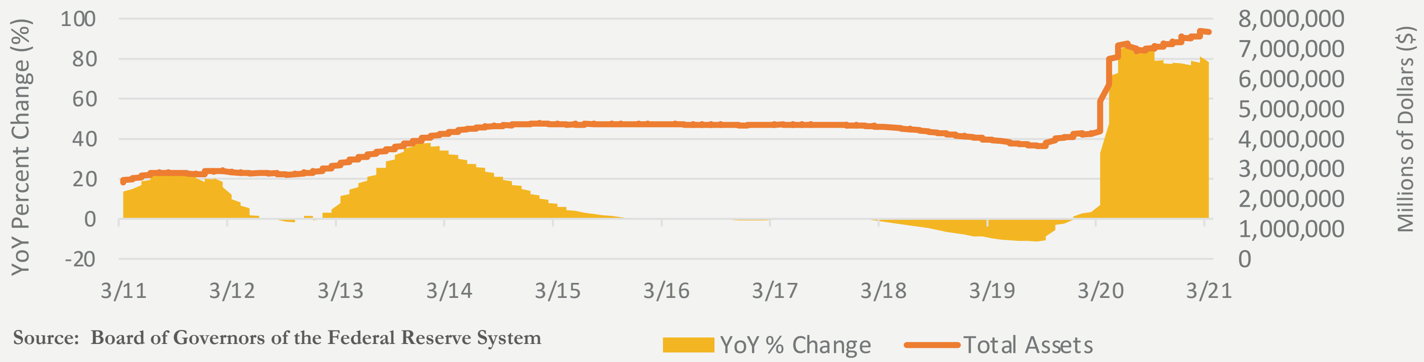
The average inflation level of 1.73% for the past decade is the second lowest 10-year trailing average witnessed over the last 50 years. Annual inflation has been below the Federal Reserve target of 2% for each of the last six years, but this may be changing. While the usual conditions for rising inflation - tight job markets and public expectations of rising prices - have been glaringly absent, unprecedented stimulus spending and rising long-term interest rates have alarmed many investors about the prospects of rising inflation.

In the near term, plentiful unused capacity and decades of habits are likely to keep inflation low. However, resurgent economic growth and a burst of demand for consumer goods have heaped pressure on already strained supply chains. In the longer term, a shifting political climate is likely to be more tolerant of inflation rising well past 2%. After years of undershooting 2%, the Federal Reserve would like inflation to slightly overshoot in the hopes of banishing the specter of deflation and stagnation that has persisted for the last decade. The Fed's pursuit of annual inflation of 2% or more, President Biden's $1.9 trillion stimulus plan, and new goals for infrastructure spending and narrowing racial economic disparities should reduce the priority that policymakers place on controlling inflation.

Interest Rates

The Fed will likely continue to hold its short term interest rate near zero until labor market conditions have returned to full employment and inflation has reached or exceeded its target 2% level for some time. Also, the Fed will continue to purchase $120 billion in bonds per month, a policy meant to keep credit cheap and help the economy rebound until substantial further progress has been made toward their employment and inflation goals. These substantial bond purchases, and the associated dramatic increase in the Federal Reserve's balance sheet, have materially eased financial conditions and provided substantial support to the economy.

Federal Reserve Banks: Total Assets

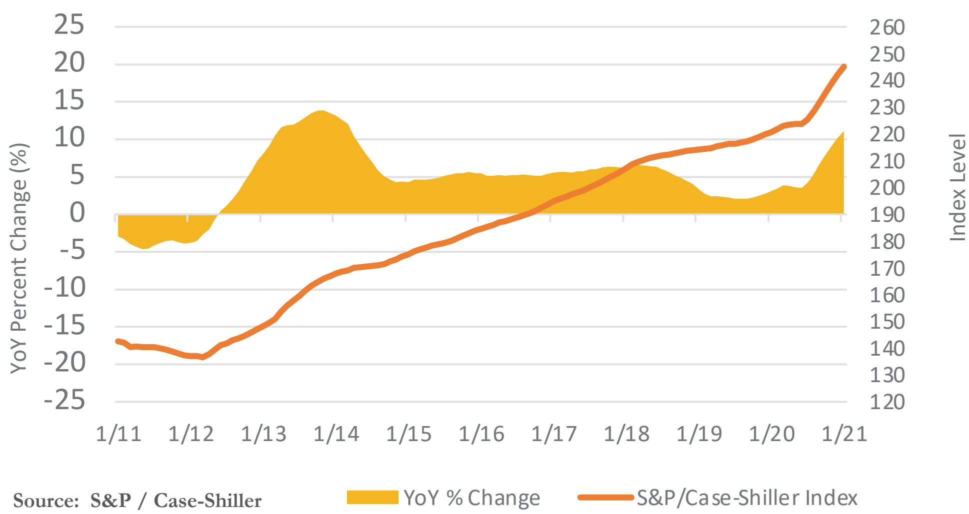


Source: Board of Governors of the Federal Reserve System

Housing

New housing starts got off to a slow start in 2021, partly due to builder concerns about rising interest rates and rising material costs. Existing home sales were also slow, mostly due to a lack of inventory. Inclement weather may have also played a role in certain regions of the country. As the economy and labor market recover in 2021, the housing market is expected to remain strong, but home price growth is expected to slow from its current double-digit pace as affordability is eroded by higher mortgage rates.

S&P Case-Shiller 20-City Home Price Index

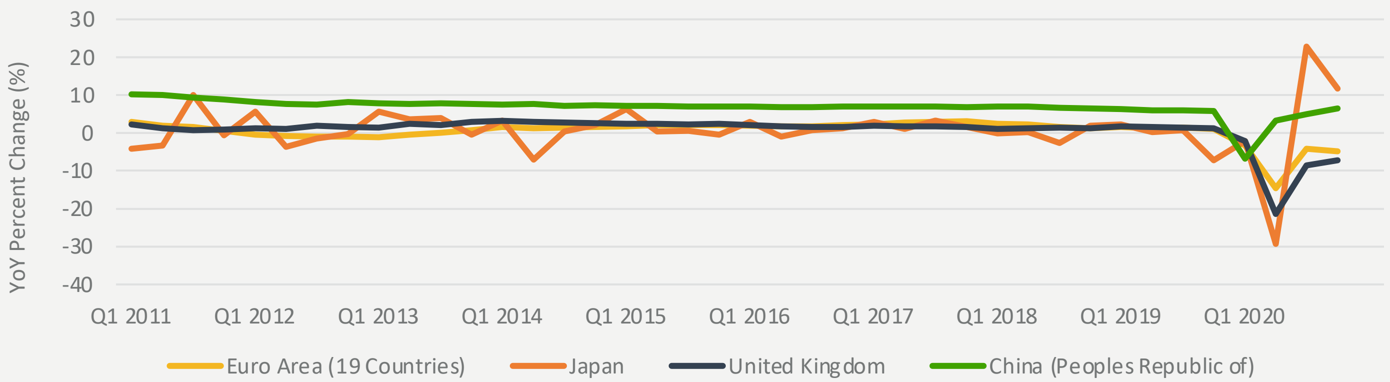


Source: S&P / Case-Shiller

Global Growth

The economic effects of COVID have reverberated around the world, but have affected countries differently. In Europe, it is estimated that real GDP declined 7% in 2020 and that it will grow 3.5% in 2021. In the U.S., comparable figures are a 3.5% contraction followed by 4% to 6% growth. In China, despite a rough first quarter, November GDP was up 7% from the prior year and appears to be accelerating. In terms of global trade, exports from China have already surpassed pre-pandemic levels, while they are still down 2.6% in the Eurozone and 9% in the U.S.

Real GDP Growth



Source: Eurostat, Economic and Social Research Institute Japan, UK Office for National Statistics, National Bureau of Statistics of China

In the Eurozone, the economy showed better than expected resilience in the 4th quarter of last year, but is expected to have contracted in the first quarter of this year due to continuing COVID-related restrictions. Relatively sound household finances should underpin a recovery, particularly as more of the population gets vaccinated.

China's economy has recovered relatively quickly from the initial outbreak and ended up with 2.3% growth for the year. It was the only major world economy to grow in 2020. It is targeting 6% GDP growth this year. With growth momentum now at pre-virus levels, Beijing policymakers have signaled that they plan to gradually withdraw stimulus measures and focus instead on reining in debt and heading off an emerging bubble in the real estate market.

Outlook

The recent headway made in the U.S. on vaccine development, government fiscal support, and personal and business adaptability has been nothing short of tremendous. Strong economic growth and job gains are expected to continue, and full recovery to be achieved over the next 1 to 2 years. The unemployment rate is expected to drop below 5.0% before the end of 2021.

As the economy reopens, the potential release of pent-up demand could drive stronger growth in 2021 than seen in decades. U.S. real GDP may grow by 6% or even more in 2021. This would be the fastest annual GDP growth in the US in the last 35 years, and would likely surpass the growth rates of all other developed countries during the year.

Inflation represents the clearest and most present danger to the U.S. economic outlook, but it is not expected to get out of hand. Due to a combination of economic growth, massive stimulus spending and pent up demand, year over year inflation measures may rise to the 2.5% level before year end.

Market Commentary—Recap

US Equity Markets

US Equity markets rose during the first quarter as COVID-19 vaccines reached more people and fourth quarter corporate earnings exceeded expectations. Building on the trend that was established in the final quarter of 2020, value stocks again outperformed growth names. During Q1, the Russell 3000 Value index gained 11.9% while its growth counterpart rose a more modest 1.2%. Through the end of the first quarter, the best performing sector was energy with a return of 30.9%. In contrast, some of 2020's top producing sectors, including technology and consumer discretionary, delivered only low single-digit returns. Small-cap stocks continued the strong run that began during Q4 2020 when the quarterly return was more than 31%. Finally, March 23, 2021 marked the one-year anniversary of the 2020 COVID driven market bottom. As of quarter end, the S&P 500 had bounced back more than 77% from this 2020 low. For the quarter, the S&P 500 rose 6.2%.

International Equity Markets

International equity markets produced positive gains but underperformed their U.S. counter-parts. This was largely driven by these markets lagging the U.S. in vaccine delivery and thus being more susceptible to the newer, more contagious COVID variants. The MSCI EAFE Index gained 3.5% for the quarter while the MSCI Emerging Markets Index increased by 2.3%. Following their strongest quarterly return in more than a decade during Q4 2020, emerging market stocks continued to climb higher, but at a much more modest pace. Amongst the BRICs (the largest developing economies) Brazil and China were negative for the quarter while Russia and India were up solidly.

Fixed Income

Fixed income markets produced broadly negative returns. The Barclays U.S. Aggregate Bond Index lost 3.4% while the Barclays Global Aggregate ex US Bond Index fell 5.3%. The first quarter was a difficult period for fixed income investors. Bond yields rose sharply amid expectation of significant U.S. stimulus. The yield curve steepened as the 10-year U.S. Treasury yield increased from 0.93% to 1.74% while the 2-year yield rose only modestly. Given the rise in interest rates, Q1 was the second worst quarter since 1980 for U.S. Treasuries. Higher risk bonds generally held up better during this “risk-on” period.

Market Commentary—Outlook

U.S. Equity Market

In the U.S. equity market valuations appear rich. However, the expectation for relatively low interest rates at least partially justifies elevated valuation metrics. In addition, the rebounding economy and accompanying rising corporate earnings should help bring elevated price-earnings multiples to less extreme levels. For those who are overweight mega-cap growth stocks, now may be an appropriate time to rebalance and add more value oriented stocks. Compared to long-term averages, value is cheap relative to growth, and the latest round of stimulus and the broader reopening from lockdowns should boost the earnings growth of cyclical sectors such as materials and industrials, which have greater representation in the value index. Also poised for solid relative returns are small-cap names as this asset class has historically shown strength during the recovery phase of the cycle.

International Equity Markets

Developed international equities also appear attractive. The MSCI All Country World index (excluding the U.S.) is trading at a forward price-to-earnings ratio that is 26% lower than that of the S&P 500. If the post-coronavirus economic recovery favors undervalued cyclical value stocks over expensive technology and growth stocks, developed international equities should perform well as major foreign stock indexes are overweight cyclical value stocks, relative to the U.S.

Emerging Market Stocks

Emerging market stocks also have their merits. They have historically done well when global growth accelerates, interest rates rise, and commodity prices increase as the world economy strengthens. The asset class will also benefit if the U.S. dollar remains weak. All 27 emerging market countries in the MSCI index are expected to deliver positive real GDP growth in 2021 for the first time since the global financial crisis, and the recovery of developed market economies should be good news for emerging market exports. The EM asset class is a complex one which includes many markets with disparate characteristics. Many emerging market nations face structural growth challenges and rising debt levels.

Fixed Income Market

The fixed income market is a challenging one for investors. The combination of very accommodative monetary policy and a recessionary environment drove 10-year Treasury yields to less than 1% at the start of the year. Although yields have since risen, they remain at very low levels. Furthermore, the Fed's bond buying programs have led to compressed credit spreads, meaning that the additional yield offered by higher risk bonds is lower than usual. The low interest rate and narrow spread environment limits the income potential of bonds going forward and increases the risk of capital loss when the Fed becomes less accommodative. On a positive note, improving fundamentals are supportive and investor demand remains strong, especially from Europe and Asia where U.S. corporate yields remain attractive. Investors should be careful not to take too much personal risk on long-duration bonds as the level of risk may not be adequately compensated.

Sources: Capital Market Consultants, Department of Labor, Department of Commerce, European Central Bank, Bloomberg, Morningstar, China's National Bureau of Statistics, Bloomberg, Morningstar, Johns Hopkins University

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