January 2021
Market Commentary

First Affirmative
Financial Network, LLC

Stay the Course

By Theresa Gusman, Alexander Cote, Kaitlyn Mitchell
January 20, 2021

Overview

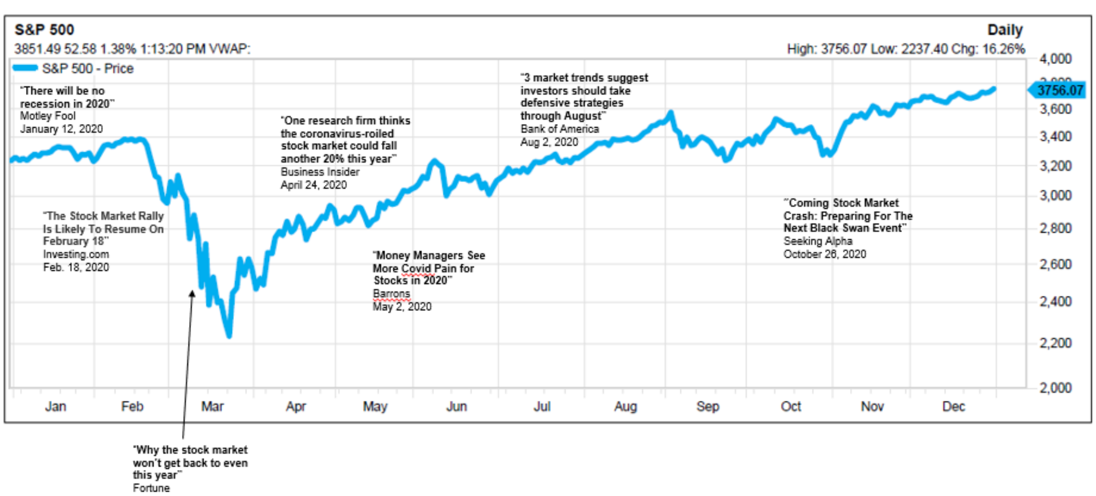
- As volatility reigned amid COVID-19, fiscal and monetary stimulus, political wrangling, and social unrest, the S&P 500 advanced 18.4% in 2020, following a 31.5% gain in 2019.

- US stocks continued to outperform non-US, growth continued to outperformed value, large capitalization continued to outperform small, and technology continued to dominate in 2020. These trends reversed in the fourth quarter, with non-US equities, small value, and energy at the top of the leader board.

- The shift into sustainable, responsible, and impact (SRI) investments accelerated in 2020 driven by the global pandemic – along with rising climate risk awareness, social unrest, and growing recognition that financial and impact objectives can be achieved simultaneously. From January 1, 2020 to September 30, 2020, $203 billion flowed into ESG funds, and the MSCI KLD 400 Social Index outperformed the S&P500.

- Interest rates, inflation, and a return to normal economic activity—whatever that looks like in a post-pandemic world—will determine the trajectory of the markets this year. Like 2020, investors who stay the course amid market volatility and conflicting prognostications will continue to be rewarded.

Figure 1. S&P 500 Performance and Prognostications, 12/31/19-12/31/20



Source: FactSet, First Affirmative

Fourth Quarter and 2020 Market Review

Global equity markets advanced sharply in the fourth quarter as predictions of fourth quarter COVID-19 vaccine availability became reality. The increase was particularly strong for US dollar investors (see Figure 2). The S&P 500 rose 12.1% in the fourth quarter, boosting the gain for the year to 18.4%.

Figure 2. Global Equity Market Performance, 12/31/19-12/[i]31/20

	December 2020		4Q 2020		YTD 2020	
Equity index returns (%)	U.S. dollar	Local currency	U.S. dollar	Local currency	U.S. dollar	Local currency
S&P 500	3.8	3.8	12.1	12.1	18.4	18.4
MSCI ACWI	4.6	3.8	14.7	12.8	16.3	14.2
MSCI ACWI ex USA	5.4	3.5	17.0	12.6	10.7	6.0
MSCI World	4.2	3.5	14.0	12.4	15.9	13.5
MSCI Emerging Markets IMI	7.4	6.1	19.9	16.1	18.4	19.2
MSCI EAFE	4.6	2.5	16.0	11.4	7.8	0.8
MSCI Europe	4.7	2.2	15.6	10.3	5.4	–2.2
MSCI Pacific	4.5	2.8	16.7	13.2	11.9	6.2

Source: RIMES

For the first time in a long time, non-US equity market returns (+17.0%) exceeded US market returns (+12.1%) in the fourth quarter reflecting US dollar weakness. The AUD appreciated 7.7% against the dollar, the GBP 5.7%, the CAD and EUR more than 4% (see Figure 3). In local currency terms, US equities continued to outperform other developed markets, particularly in Europe, where both economies and markets remain in the doldrums.

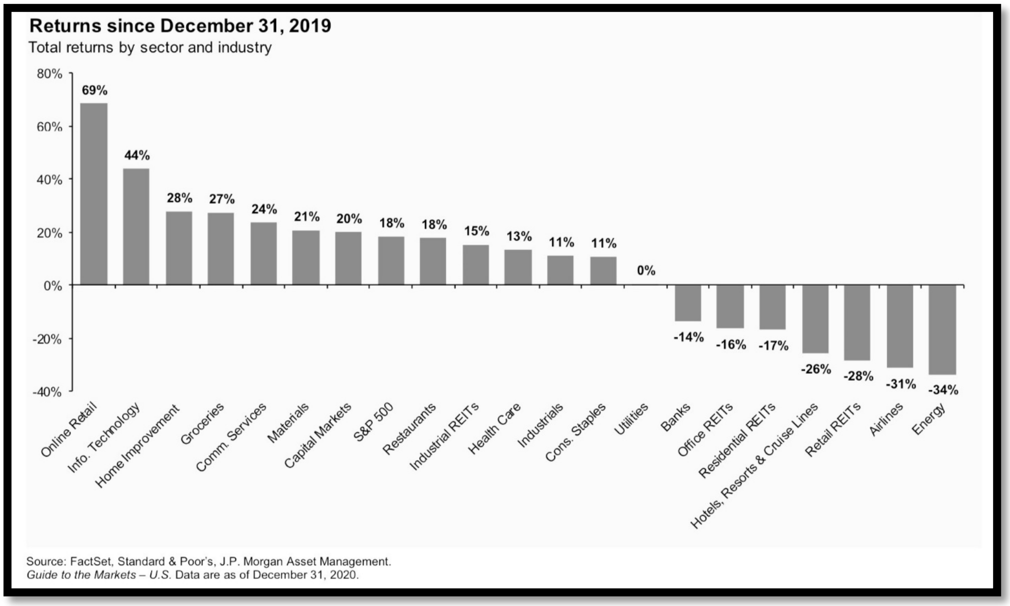
Figure 3. Exchange Rates Relative to the USD, 12/31/19-12/31/20

Exchange rates (% change vs. USD)	Dec 2020	4Q 2020	YTD 2020
Euro	2.3	4.3	9.0
Japanese yen	1.0	2.2	5.3
British pound	2.4	5.7	3.2
Canadian dollar	1.7	4.8	1.8
Australian dollar	4.7	7.7	9.8
Swiss franc	2.4	3.9	9.5

Source: RIMES

Energy and financial stocks led the fourth quarter rally as investors moved into sectors that had suffered the biggest losses earlier in the year. Industrials and materials stocks also rose sharply amid expectations of a robust economic rebound in 2021. Consumer staples and health care stocks lagged the overall market as cyclical sectors took center stage. As shown in Figure 4, fourth quarter sector performance was precisely the opposite of full-year 2020 performance.

Figure 4. Total Returns by Sector and Industry, 12/31/19-12/31/20



Like geographic and sector performance, style performance reversed in the fourth quarter. According to Morningstar, US Small Value Funds advanced 30.9%, compared with a 12.5% return for US Large Growth Funds. Despite the fourth-quarter surge, value-stock fund strategies suffered one of their worst years on record relative to growth funds in 2020. Large-growth funds returned an average of 34.8% in 2020, 32.0 percentage points ahead of the average large-value fund. That exceeded the gap registered in calendar-year 1999 (i.e., the dot.com bubble), when growth beat value by 30.7 percentage points.

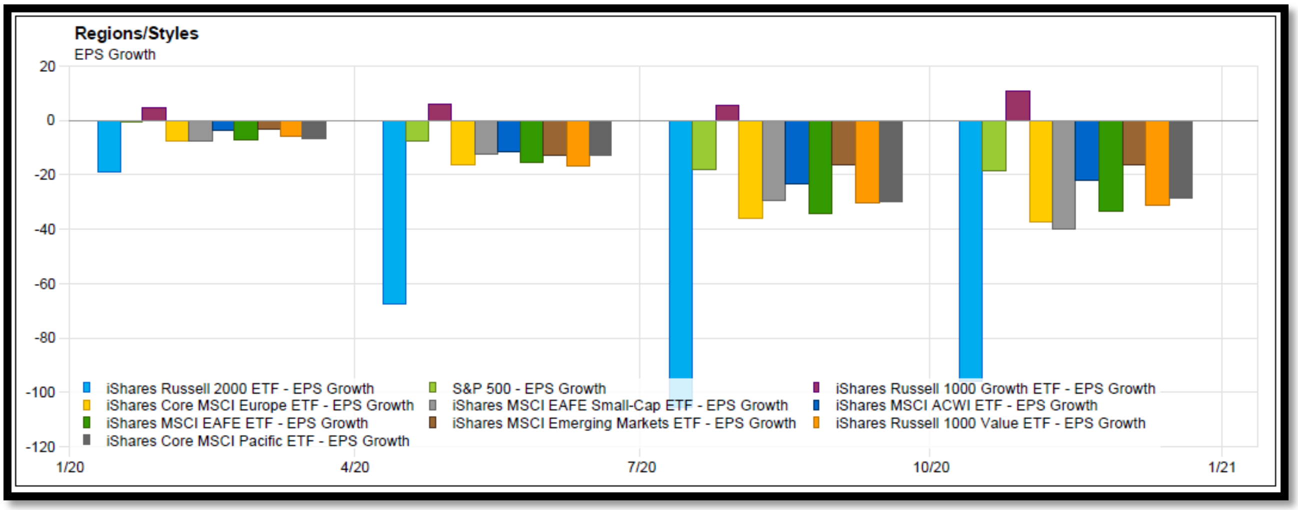
Figure 5. Mutual Fund Performance Value versus Growth, 1/1/11-12/31/20

	1-Year (1/1/2020-12/31/2020)	3-Year (1/1/2018-12/31/2020)	5-Year (1/1/2016-12/31/2020)	10-Year (1/1/2011-12/31/2020)
Large Value	2.68	5.46	9.30	9.40
Large Growth	34.84	20.22	18.04	14.66
Value Underperformance:	-32.15	-14.75	-8.74	-5.26
Mid-Cap Value	2.84	3.81	8.37	8.87
Mid-Cap Growth	37.32	19.25	17.43	13.27
Value Underperformance:	-34.48	-15.45	-9.06	-4.40
Small Value	3.84	2.13	7.88	7.81
Small Growth	36.91	18.01	17.31	13.06
Value Underperformance:	-33.06	-15.89	-9.43	-5.25

Source: Morningstar Direct. Returns are annualized.

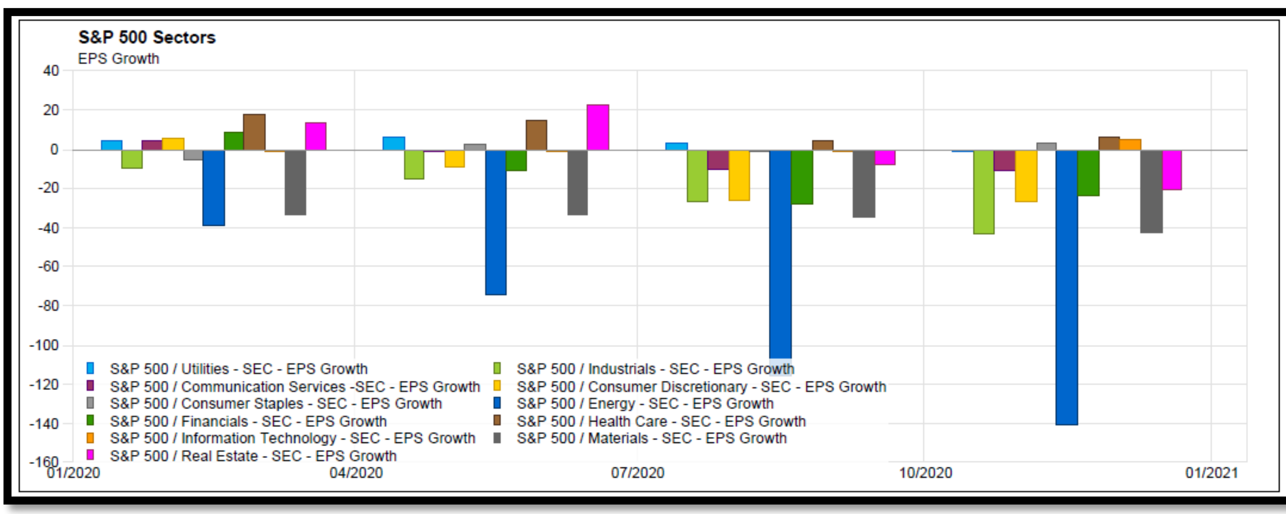
Earnings projections fell rapidly during 2020, as earnings projections for winners (Online Retail, Technology) and losers (Airlines, Energy) diverged. Keeping in mind that earnings projections are changing as rapidly as adjustments are being made to economic forecasts, current earnings projections by regions, styles, and sectors are presented in Figures 6 and 7.

Figure 6. Corporate Earnings Growth, Styles 1Q20-4Q20



Source: FactSet as of 12/31/2020; Displayed here is 2020 Q1-Q4
EPS growth is the % change YoY relative to EPS a year prior.

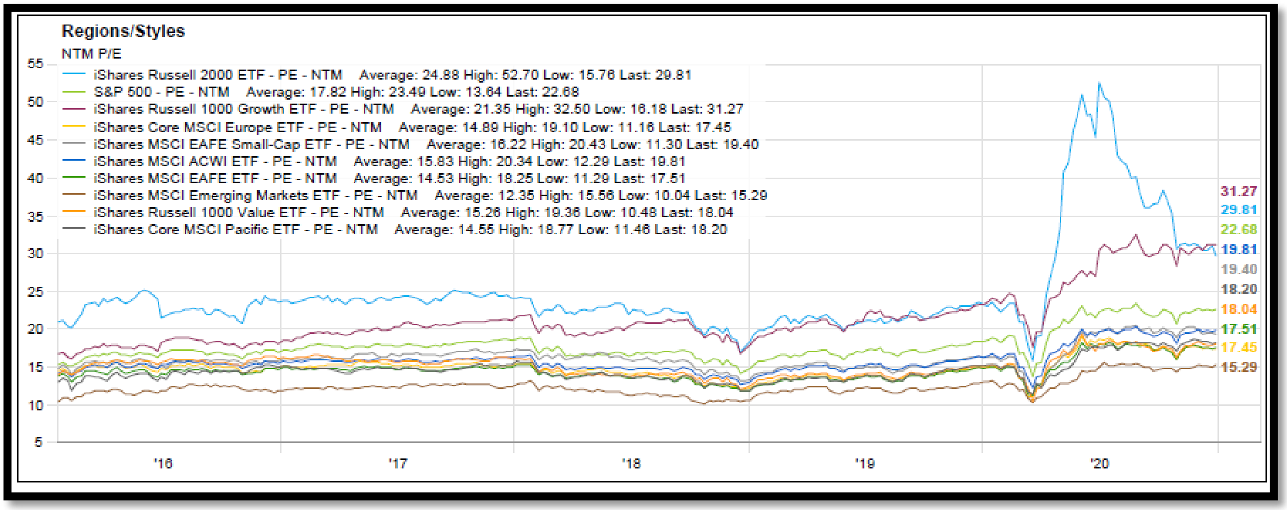
Figure 7. Corporate Earnings Growth, S&P 500 Sectors 4Q19-2Q20



Source: FactSet as of 12/31/2020; Displayed here is 2020 Q1-Q4
EPS growth is the % change YoY relative to EPS a year prior.

Equity valuations remain well above their 10-year averages – which is typical for the start of a recovery. Earnings estimate cuts and PE blow outs are typical as economic growth bottoms. As we enter 2021, the Russell 2000 and Russell 1000 Growth indices remain at the highest valuations relative to their historic averages. Emerging Markets, Europe, and EAFE are least expensive, although earnings remain suspect.

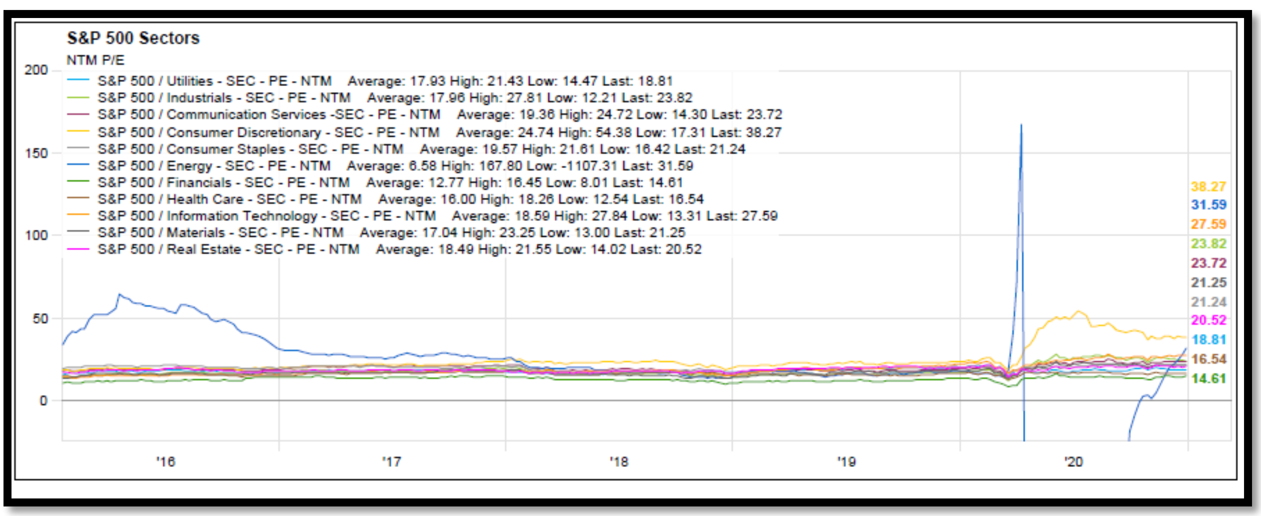
Figure 8. Equity Valuation Analysis, Regions/Styles, 6/30/20



Source: FactSet as of 12/31/2020
NTM P/E is market price per share divided by expected earnings per share over the next twelve months.

Sector valuations look equally stretched – with (not surprisingly) the cyclicals at the most expensive end of the spectrum.

Figure 9. Equity Valuation Analysis, S&P 500 Sectors, 12/31/20



Source: FactSet as of 12/31/2020

NTM P/E is market price per share divided by expected earnings per share over the next twelve months.

Outlook – Don't fight the Fed…or the new administration

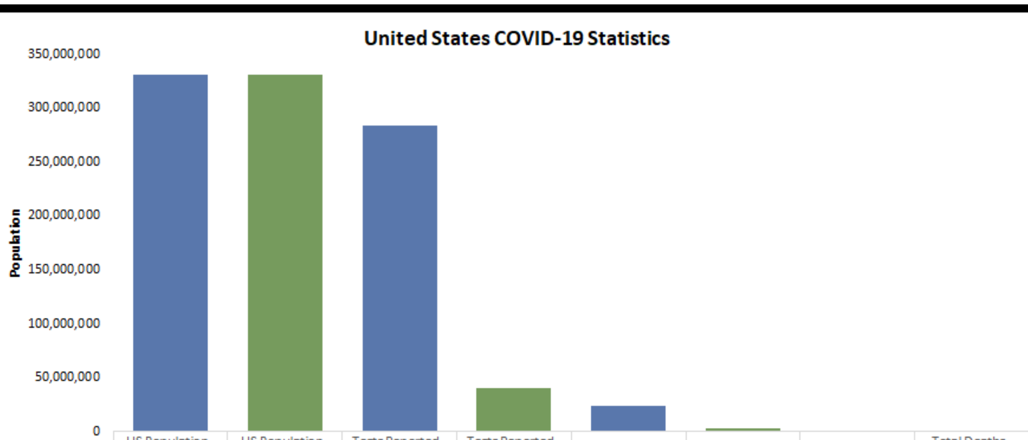
Interest rates, inflation, and a return to normal economic activity—whatever that looks like in a post-pandemic world—will determine the trajectory of the markets this year. Like 2020, investors who stay the course amid market volatility and conflicting prognostications, maintaining well-diversified portfolios geared toward achieving their long-term objectives, will continue to be rewarded.

In the near-term, the "blue sweep" of the White House and Congress could usher in greater fiscal stimulus to aid the coronavirus-ravaged economy. This bodes well for equity markets, particularly combined steady monetary policy and the roll-out of the COVID-19 vaccine. Nonetheless, we anticipate continued volatility in the coming months – in an upward trend – as the vaccine is rolled-out and new cases surge simultaneously.

We published the July figures shown in Figure 9 in our mid-year Market Commentary. In it, we noted, "As horrific as the pandemic has been, it has infected only a small fraction of the US population. COVID-19 has infected less than 1% of the US population and 0.04% of Americans have died from coronavirus-related complications, and according to a July 13th USA Today headline, two-thirds of Americans do not know anyone who has had COVID-19. The relatively small number of coronavirus cases, combined with the personal and collective difficulties caused by economic closures and social distancing, have resulted in quarantine fatigue."

We have now seen the calamitous consequences of our collective attempt to return to "normal" – particularly over the holidays – and we have little doubt the statistics will get significantly worse before they get better, particularly as new, more transmittable strains of the virus evolve. As of January 18, 2021, more than 7% of Americans had tested positive for coronavirus, and 400,000 had died through January 19th. The question we face now is: Will the markets and public officials continue to look beyond the surge, or does another shutdown – and the resultant economic consequences – loom?

Figure 10. US Coronavirus Data as of January 18, 2021



	US Population - Jan	US Population - July	Tests Reported - Jan	Tests Reported - July	Total Cases - Jan	Total Cases - July	Total Deaths - Jan	Total Deaths - July
Population	331,002,651	331,002,651	283,985,954	40,045,940	23,778,275	3,047,671	390,262	132,056
%	100.00%	100.00%	85.80%	12.10%	7.18%	0.92%	0.12%	0.04%

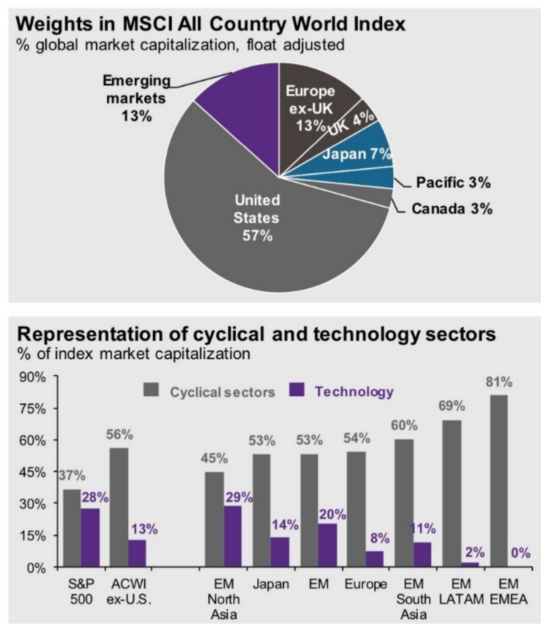
Cases as a percent of Total Tests: 8.4%
Deaths as a percent of Total Cases: 1.6%
Date: January 18, 2021. Source: COVID-19 Data, The Atlantic; US Population Data, UN.

The blue sweep will pave the way for President Biden to push through a more aggressive policy agenda, including greater corporate regulation and higher taxes. Although this reversal from the Trump agenda could constrain corporate profits, the new administration has promised that new tax increases will not be implemented before 2022. President Biden is also promising a significant rise in government spending, which could benefit renewable energy and industrials. At the same time, pharmaceutical companies and big tech could suffer from increased government regulation.

As we move forward, we recommend that advisors work with their clients to ensure portfolios are aligned with financial objectives and remain well-diversified across asset classes, geographies, market capitalizations, and styles. Although we do not anticipate a reversal in the major trends that have emerged in recent years (see figure 10), we believe the COVID-recovery is more likely to "lift all ships" – not favoring the US over the rest of the world, growth over value, or large cap over small.

Figure 11. Global Equity Market Performance and Composition

Returns	2020		2019		15-years	
	Local	USD	Local	USD	Ann.	Beta
Regions						
U.S. (S&P 500)	-	18.4	-	31.5	9.9	0.89
AC World ex-U.S.	6.5	11.1	21.4	22.1	5.4	1.08
EAFE	1.3	8.3	22.3	22.7	5.0	1.04
Europe ex-UK	2.1	11.6	27.5	25.9	5.9	1.18
Emerging markets	19.5	18.7	18.5	18.9	7.0	1.19
Selected Countries						
United Kingdom	-13.2	-10.4	16.5	21.1	2.9	1.02
France	-3.9	4.7	29.3	27.0	5.5	1.22
Germany	3.0	12.3	23.9	21.7	6.5	1.31
Japan	9.2	14.9	18.9	20.1	3.7	0.73
China	28.3	29.7	23.3	23.7	11.9	1.12
India	18.6	15.9	10.0	7.6	8.0	1.28
Brazil	4.8	-18.9	31.5	26.7	4.8	1.51
Russia	3.4	-11.6	38.8	52.7	2.7	1.51



Source: FactSet, Federal Reserve, MSCI, Standard & Poor's, J.P. Morgan Asset Management.
All return values are MSCI Gross Index (official) data. 15-year history based on U.S. dollar returns. 15-year return and beta figures are calculated for the time period 12/31/05 to 12/31/20. Beta is for monthly returns relative to the MSCI AC World Index. Annualized volatility is calculated as the standard deviation of quarterly returns multiplied by the square root of 4. Chart is for illustrative purposes only. Please see disclosure page for index definitions. Past performance is not a reliable indicator of current and future results. Sector breakdown includes the following aggregates: Tec (Information Technology) and cyclicals (Consumer Discretionary, Financials, Industrials, Energy and Materials). EM North Asia includes China, Taiwan and South Korea. EM South Asia includes India, Indonesia, Malaysia, Pakistan, Philippines, Taiwan and Thailand.
Guide to the Markets – U.S. Data are as of December 31, 2020.

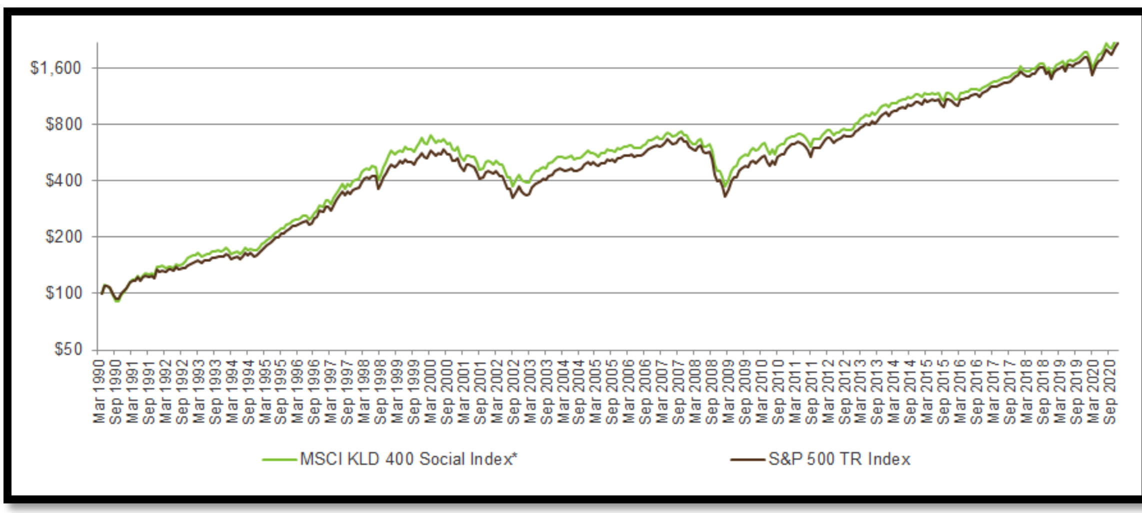
Achieving Long-Term Investment and Impact Objectives

The shift into sustainable, responsible, and impact (SRI) investments accelerated in 2020 driven by the global pandemic – along with rising climate risk awareness, social unrest, and growing recognition that financial and impact objectives can be achieved simultaneously. As shown in Figure 11, the MSCI KLD 400 index outperformed the S&P 500 index in 2020. The sustained, consistent performance of this standard SRI/ESG benchmark over time and recent outperformance support our view that strategies incorporating

environmental, social and governance (ESG) factors – with an eye toward making the world a better place – and mainstream financial returns are not mutually exclusive.
According to US SIF, "total US-domiciled under management (AUM) using environmental, social, and governance (ESG) strategies grew from $12.0 trillion at the start of 2018 to $17.1 trillion at the start of 2020, a 42% increase. This represents 33% of the total US assets under professional management". Growth continued in 2020, as $203 billion flowed into ESG funds through September 30, 2020 – and will remain strong as the new administration implements more ESG-friendly policies.

As always, everything we do at First Affirmative is driven by our dedication to enabling advisors to deliver financial results to clients and belief in the power of capital to bring about lasting environmental and social change. Our three Sustainable Investment Solutions – Custom, Multi-Manager, and Managed Mutual Fund – are built to enable clients to achieve their financial goals over the long term, along with their individual environmental, social, governance, ethical, and values-based objectives. Each portfolio is carefully constructed to be well diversified across assets, sectors, geographies, securities, and management styles –– and designed to weather periods of uncertainty and volatility.

Figure 12. MSCI KLD 400 vs S&P 500 Indices, 12/31/20



	MSCI KLD 400 Social Index*	S&P 500 TR Index
Annualized Return Since 5/1/90:	10.96%	10.54%

Source: Morningstar. *Data prior to 9/1/2010 is that of the MSCI KLD 400 Social Index GR, while data since 9/1/2010 is that of the MSCI KLD 400 Social Index NR. Indexes are unmanaged groups of securities. Index performance does not include the impact of cash, fees, or transaction costs. Investors cannot invest directly in indexes but may purchase mutual funds or other investment products designed to track the performance of various indices.

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WASMER SCHROEDER STRATEGIES

Quarterly Bond Market Overview

December 31, 2020

How Bad Can It Get??
Happy 2021, and good riddance, 2020.
By: Tom Richmond, Co-Head of Wasmer Schroeder Taxable Bond Strategies

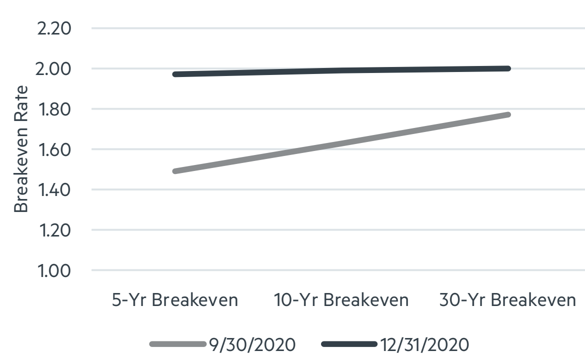
As the New Year gets started, things look very much the same, with pandemic-related and geopolitical headlines still very much setting the tone. Vaccinations are taking place around the globe, but for now case counts, social lockdowns, and economic and human suffering still cast a pall over the proceedings. That said, continuing monetary and fiscal support from central banks and governments continue to keep economies from collapse, and prospects for achieving some sort of "normalcy" later this year seem to be giving people, generally, and financial markets, specifically, cause for optimism.

This combination of policy accommodation, deficit spending, money creation, and prospects for future GDP growth has many in our world—rightfully so—wondering about the prospects for and likelihood of higher inflation, and with it, higher long term interest rates. The Federal Reserve's pivot last fall to an "average inflation" regime—letting inflation alternatively run higher and lower than its 2% goal—has clearly been taken to heart by the US Treasury market. Inflation expectations, as implied by the Treasury Inflation-Protected Securities (TIPs) market, are within a few basis points of that 2% target in virtually every tenor beyond five years. For now, this has taken real rates further into negative territory more than it has taken nominal rates higher, but if the recovery does indeed pick up steam, it would stand to reason that long nominals would have to move up.

Could this happen? Of course, and the market seems to be counting on it to some extent. For the next few months, as pandemic-induced readings on all data series start to skew year-over-year numbers, it seems highly likely that headline inflation will increase for some number of months. Certain items and price categories will probably see more persistent pressure as the long processes of inventory rebuilding and supply chain repair play out. Other categories, however, will likely still be dealing with the same technology-driven and demographic disinflationary pressures that were in play pre-pandemic. In the end, rates and the shape of global yield curves will be driven by the "transient or permanent" decisions made by the world's central banks, and the policy moves that will or will not be taken in response.

Until we get more clarity, however, it bears repeating that bond investors must be careful to not pre-suppose anything when making asset allocation decisions. Yes, higher rates would be beneficial over time, vis-à-vis higher yielding reinvestment opportunities, despite short-term mark-to-market losses, but there are no guarantees as to when or if these rates will arrive. Given unemployment still hovering near 7%, and the Fed's well-telegraphed desire for low rates, any increases will likely be gradual. Finally, even longer dated, high quality credit assets have a built-in buffer in the form of their risk spread if rates rise in the face of a stronger economy. Despite the yield on the 10-year US Treasury rising 23 basis points in the fourth quarter, for example, Apple's benchmark 10-year issue had a positive total return thanks to its starting yield advantage and to 21 basis points of tightening. So, at least for now, even as rates rise, it is not too bad.

US Breakeven Rates



12/31/2020; Source: Bloomberg

Tax Exempt Market

By: Jason Diefenthaler, Head of Wasmer Schroeder Municipal Bond Strategies

Municipal bonds continued their recovery from the turbulence of March and April 2020 as supply/demand technicals and attractive valuations relative to US Treasuries drove the market to strong fourth quarter performance.

The Bloomberg Barclays Municipal Bond Index posted its third consecutive quarter of positive performance for the three months ended December 31, with a total return of 1.82%. The long end of the yield curve continued to lead returns as the slope of the tax exempt yield curve bull flattened—yields inside of 5-year maturities were lower by one-to-seven basis points while 10- to 30-year yields fell by 16-21 basis points. Lower-rated credits also delivered another strong quarter, as the BBB Muni Index outperformed the AAA Muni Index by 231 basis points (fun fact: BBBs also outperformed AAAs by 231 basis points in the third quarter). New Jersey and Illinois credits represented 41% of the BBB Index, and were the primary drivers of the outperformance in that rating category with returns of 3.95% and 5.68%, respectively. The New York Index also had a performance rebound during the quarter with a 2.46% return. This was driven primarily by the rally in bonds issued by the Metropolitan Transportation Authority (MTA), which saw an average total return of 8.41%. The Bloomberg Barclays Municipal High Yield Index also produced a notable quarter of performance with a total return of 4.54%. The rally in the high yield sector was driven by the larger, more liquid names in the market—Puerto Rico Sales Tax Financing Corp (COFINA), Buckeye Tobacco Settlement, and Delta Airlines contributed almost 30% of the Muni High Yield Index's total return during the quarter.

A large part of the 4Q 2020 rally can be attributed to the combination of strong investor demand and a relatively light supply of tax exempt issuance. Refinitiv Lipper reported that municipal bond mutual funds saw positive net weekly inflows in 12 of the 13 weeks during the period, totaling $12.7 billion. This demand is being met by tepid tax exempt new issuance as the low-yield environment has resulted in a surge of taxable refundings, which was the case for most of 2020. As Bloomberg notes, taxable municipal issuance doubled last year to $140 billion while tax exempt issuance shrank by 8% to just $315 billion.[1] The issuance outlook will likely persist through much of the first quarter of 2021 as the "January Effect" of seasonally-light supply takes hold. The Bloomberg 30-Day Visible Supply Index ended December at just $4.5 billion, confirming expectations for a slow start to the new year. Absent a significant pullback in investor demand or materially higher issuance, we expect technicals to remain supportive of current valuations in the market.

As we discussed in last quarter's commentary, our focus continues to be on the fast-developing credit trends that we believe will continue to materialize in 2021. While some financial disclosures are expected to be better than expected—such as California announcing an unexpected $15 billion budget surplus—there will certainly be some negative developments that the market will have to rationalize in the coming quarters. From a positive perspective, the prospects for additional and perhaps substantial, Federal stimulus at the state- and local-government levels have improved materially since the Presidential election. Still, the relatively limited visibility across the market continues to support the up-in-quality theme that we implemented across the Wasmer Schroeder Strategies throughout 2020. For example, we have been strategically reducing exposure to credits such as the New York Metropolitan Transportation Agency, the State of Illinois general obligation debt, and bonds back by the City of Chicago's general obligation pledge. We anticipate that the goal of moving higher in credit quality will remain in place throughout 2021, depending on prevailing market conditions.

Taxable Market

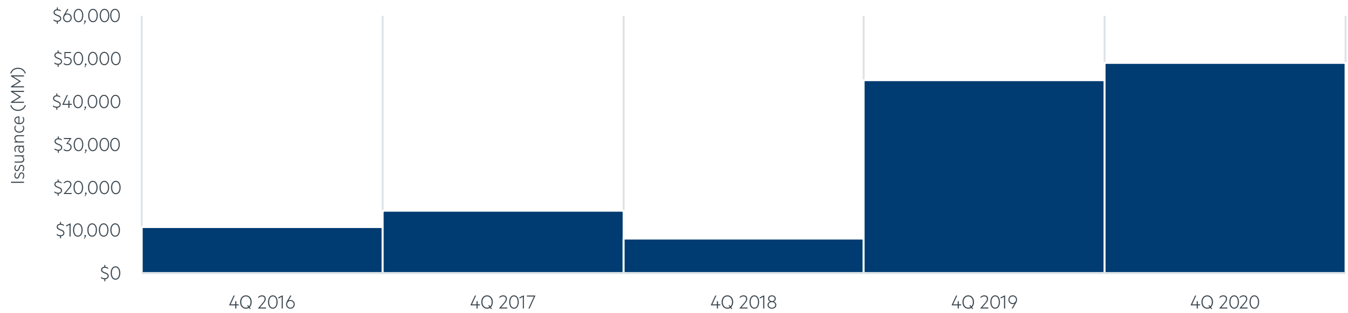
By: Christopher E. Sheehan, Senior Portfolio Manager

An ongoing succession of headlines and low volatility—reflective of the success of the fiscal and monetary policies being enacted—characterized the fixed income markets in 4Q 2020. Most investors thought the period would be considerably more volatile with the COVID-19 virus still surging, and the country heading toward the end of an incredibly contentious election season. When the Bloomberg Barclays US Corporate Index ultimately finished the quarter, it was at a +96 option adjusted spread (OAS)—40 bps better than when the period started. Corporate bond spreads reflected investors' belief that the Fed stands ready to do more, if needed, despite the expiration of some of its programs. Spreads also indicated optimism that the rollout of the Covid-19 vaccines would be successful, and that there would continue to be stimulus policies to help compensate for an economy that is still limited by the virus.

Issuance in taxable municipal bonds continued to run significantly ahead of historical averages, with approximately $50 billion coming to market during the year's fourth quarter. The increased supply was welcomed with open arms, and levels improved throughout the quarter. Better levels were seen across the risk spectrum; however, levels that were even more notable were attained by some lower-rated issuers in sectors that were more affected by the COVID-19 pandemic. Investors continued to search for any additional yield that could be found, and these "back-to-normal" issuers appeared to be a good way to express that view.

[1] Bloomberg, "Bond Market Tax Haven Shrinks as Corporate-Style Munis Surge" 1/11/21; https://www.bloomberg.com/news/articles/2021-01-11/bond-market-tax-haven-shrinks-as-corporate-style-munis-surge.

Taxable Municipal Issuance



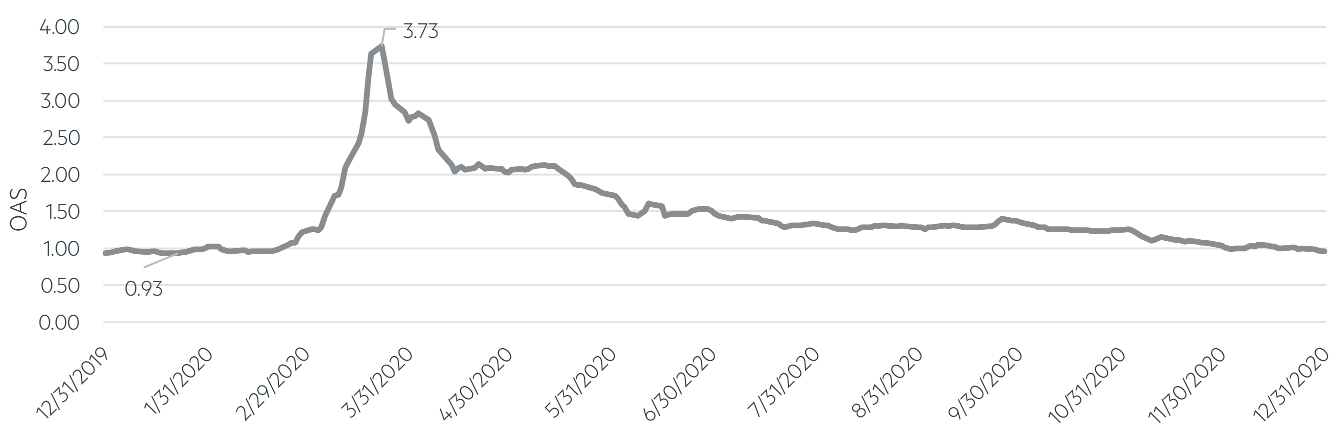
12/31/2016– 12/31/2020; Source: Bloomberg

The Fed continued to renew its commitment to keeping mortgage rates low as a way to stimulate the economy. The Central Bank grew its balance sheet by $630 billion, an approximate increase of 45%, year-over-year. Both 15 and 30 year mortgage rates hit all-time lows during the fourth quarter as a result of the Fed's purchases, leading to an increase in mortgage pre-payments. This had an adverse effect on existing mortgage pools by offsetting their existing price increases, and resulting in mortgages having a slightly-negative performance for the year.

Golfer's often use the phrase "there are no pictures on a scorecard" when talking about an untraditional way to reach a low score—but they could just as easily be referring to the corporate bond market in 2020. Looking just at the numbers, the Bloomberg Barclays US Corporate Index started 2020 at +93 OAS and finished the year at +96 OAS.

Those numbers simply do not do justice to how wild a ride 2020 was for the US financial markets. We saw record corporate issuance, a virus that shut down many portions of the economy, significant monetary and fiscal policy accommodations, an unprecedented election season, development of vaccines in record time—and despite all that, the stock market closed at record highs and corporate bond spreads were near the tightest levels in recent memory. In our opinion, though, financial markets remaining at these levels depends on the speed and success of the vaccines, as well as the continuation of stimulus packages, until the economy gets to a more traditionally-normal place. There are a lot of potential pitfalls to navigate, and moving forward it would seem that at some point we will have to pay the piper for all that has happened. The question is, "Can all this be navigated as well in 2021 as it was in 2020?"

Bloomberg Barclays Corporate Option-Adjusted Spread (OAS)



12/31/2019 – 12/31/2020; Source: Bloomberg

Thomas N. Richmond Jr.
Co-Head of Wasmer Schroeder Taxable Bond Strategies

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Tom earned his B.S in Computer Science and his M.S. in Applied Mathematics from Rensselaer Polytechnic Institute, where he also minored in Economics and Management.

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Christopher E. Sheehan
Senior Portfolio Manager

Chris Sheehan is a Senior Portfolio Manager, and he is responsible for co-managing taxable Wasmer Schroeder Strategies at Charles Schwab Investment Management, Inc. (CSIM). Mr. Sheehan earned his BA in Business Administration from Washington & Jefferson College and his MBA from Cleveland State University.

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