Q1 Market Summary:

- **Summary**
    - US equities rallied in Q1 with the four major indexes up for a fourth straight quarter.**Energy** put in the best performance as a combination of under-ownership and rebound in oil provided it with some of the best leverage to the pro-cyclical rotation.**Financials** also fared well as banks founded added support from a bearish steepening of the yield curve with the BKX +22.7%.**Materials** outperformed with upside leadership from industrial metals. **Industrials** beat the tape with some of the best gains in airlines, machinery and building materials.**Communications services** did well as both GOOGL +17.7% and FB +7.8% bucked the broader tech underperformance. **Consumer staples** lagged with weakness in at-home leveraged retailers like WMT (5.8%) and COST (6.5%), along with HPCs. **Consumer discretionary** upside was limited by AMZN (5.0%) though reopening plays like department stores, apparel retail, casual dining, casinos and OTAs fared well. Homebuilders also rallied with XHB +22.1% despite the higher rate backdrop. **Tech** lagged despite another strong quarter for the semis with the SOX +11.8%. AAPL (7.9%) weighed while growth software also came under scrutiny. **Treasuries** came under pressure with 10-year yields rising ~80 bp to 1.74%. The **dollar index** gained 3.7%. **Bitcoin**jumped 103.3%. **Gold** lost 9.5%. **WTI crude**gained nearly 22%.

- **What happened?:**
    - The big story for Q1 revolved around a continuation of the pro-cyclical rotation with reopening plays outperforming the pandemic winners. Value outperformed growth by more than 800 bp. Heightened fiscal stimulus expectations following the Democrats' surprise victory in the Georgia runoffs were a key driver. In addition, coronavirus trends saw a meaningful improvement after peaking in mid-January and the vaccine rollout gained significant momentum with a third shot approved for emergency use and the US exiting the quarter with ~150M doses already administered. The central bank liquidity tailwind remained in focus as the Fed set a high bar for both tapering and liftoff. However, this dynamic also seemed to exacerbate the big backup in bond yields. The earnings calendar was another relative bright spot for risk sentiment as Q4 earnings growth unexpectedly turned positive, Q1 estimates moved higher and corporate commentary leaned positive. Some of the other high-profile headlines for Q1 revolved around supply chain disruptions and related input price pressures, FOMO, record equity inflows, buy-the-dip, potential bubble-like conditions in some pockets of the market, and the influence of retail investors.

- **Bullish themes and potential risks:**
    - The bullish narrative dominated for the better part of Q1. The central bank liquidity tailwind continued to be viewed as one of the most powerful forces for risk assets. BofA noted global central banks have purchased $1B+ of assets every hour since March 2020 and JPMorgan put the aggregate G5 central bank balance sheet at ~$30T. Massive fiscal stimulus was another key tenet with the total US government response to the coronavirus crisis near 25% of GDP vs the ~10% decline in the economy at the height of the pandemic. The US averaged nearly 2.5M coronavirus vaccine doses per day late in the quarter while a combination of vaccine progress and improving case and hospitalization trends drove a pickup in high-frequency indicators in March, particularly surrounding the consumer. US economic growth estimates ramped higher with some of the more optimistic firms looking for 7%-8% GDP growth in 2021. In addition, the Street is looking for S&P 500 earnings growth of nearly 25% this year. Multiple compression from higher

yields, taper tantrum, central bank policy mistake, new coronavirus variants, higher taxes and margin pressure from higher input costs were some of the more widely discussed risks.

- **Democrats go it alone on $1.9T coronavirus relief package, infrastructure stimulus next:**
  - Congress passed a $1.9T coronavirus relief package along party lines that President Biden signed into law in early March. The package included $1,400 stimulus checks, $350B for state and local governments and $300 in supplemental unemployment benefits through early September, but not a $15 minimum wage. Even before the latest coronavirus relief package was finalized, the focus had already begun to shift to the next economic plan. It is expected to be broken into two parts. The first, which President Biden previewed at the end of March, will revolve around infrastructure and be worth $2.25B+ over an eight-year period. The second will focus on family issues, education and healthcare. The two packages could total ~$4T with ~$3T in new taxes, including an increase in the corporate tax rate to 28% from 21%. Some firms downplayed tax risks for equities. Goldman Sachs and UBS discussed the likelihood of a 25% rate vs the 28% favored by the White House, while JPMorgan noted prior hikes in capital gains tax rates only had a limited, short-term impact. The path to additional stimulus is expected to be complicated, particularly with Democrats once again likely to have to use reconciliation in the Senate.

- **Fed sets high bar for tapering and liftoff:**
  - There were several moving pieces surrounding the Fed in Q1 though its $7.7B+ balance sheet still seemed to be a key tailwind for broader risk sentiment. BofA pointed out that the Fed's balance sheet is now more than 35% of GDP, well above the 3% for WWI, 11% for WWII and 15% seen after the global financial crisis. Fed leadership was fairly quick to push back against some of the speculation that heated up in January about a potential tapering later this year. Fed Chair Powell said that the Fed needs to be very careful about communicating on asset purchases given the real sensitivity the market has with regards to such policy support. Powell and other Fed officials repeatedly stressed that it would be some time before the Fed achieved "substantial further progress" toward its employment and inflation goals. They also repeatedly highlighted the importance of looking though transitory inflation pressures. In addition, while a combination of fiscal stimulus and improving coronavirus trends drove a notable pickup in near-term growth and inflation expectations in the March Summary of Economic Projections (SEP), it was not enough to shift the median dot, which implied a Fed still on hold at the ZLB for the next three years.

- **Coronavirus trends improve, vaccine distribution ramps up:**
  - Coronavirus case and hospitalization trends improved throughout much of the quarter before climbing again at the end of March. However, the bigger story from a risk sentiment perspective was the ramp in vaccine distribution. The US exited the quarter with ~150M doses already administered and a seven-day average of nearly 2.5M doses per day. In late March, President Biden doubled his administration's first 100-day vaccine goal to 200M doses. He also said that 90% of adults will be eligible to receive the vaccine by mid-April. The combination of improving coronavirus trends, the vaccine ramp and stimulus played into the reopening momentum theme. This was particularly evident late in the quarter as economists highlighted the improvement in high-frequency indicators surrounding mobility, air travel, vacations, retail visits, dining out, gas demand and the labor market. Reports also discussed how consumers are starting to replenish their wardrobes with workwear, dresses and even tuxedos Goldman Sachs noted that the Composite Score that underlies its Reopening Scale hit 75 at the end of March for the

first time since the pandemic, while the Reopening Scale (1-10, lockdown to fully open) itself edged closer to 6.

- **Big bond yield backup on reflation theme traction, Fed willingness to let things run hot:**
    - One of the biggest stories of Q1 revolved around the speed and magnitude of the backup in bond yields. There were a number of different drivers behind the move, including some catch-up to a reflation trade that had already been at work in equities since November. Democratic control of the Senate and the accompanying pickup in fiscal stimulus expectations (and supply headwinds) was another widely cited factor. There was also a good deal of focus on the extent of the Fed's embrace of last year's policy framework shift to average inflation targeting. In addition, unlike some other central banks, the Fed seemed comfortable with the higher rate backdrop as the likes of Powell and Brainard only said they would be concerned about disorderly market conditions or a persistent tightening of financial conditions that impeded progress toward its goals. While the speed of the move at times weighed on equity sentiment, particularly for the more crowded growth and momentum names, strategists noted the ~100+ bp backup in yields since August was by no means unprecedented. They also repeatedly discussed how rates and stocks can move higher in tandem and highlighted further support for the pro-cyclical rotation

- **Q4 earnings growth swings into positive territory, Q1 estimates move higher:**
    - S&P 500 earnings increased nearly 4% in Q4 vs expectations for a nearly 9% decline at the start of earnings season in mid-January. Upside surprises were driven by the usual suspects, including overly aggressive estimate cuts earlier in the pandemic, the resilient macro backdrop and elevated margins. Thematic takeaways revolved around WFH/LFH tailwinds, accelerated e-commerce shifts, accelerated digital transformations, strong semi demand, resilient credit quality, pent-up savings, residential construction boom, renewed capital return, supply chain disruptions, rising input costs, pricing power, and the lingering coronavirus drag on epicenter industries. Sell-side strategists also highlighted largely upbeat corporate commentary, including on reopening green shoots. In addition, estimates bucked the trend for a third straight quarter and moved higher during the first three months of 2021. The bottom-up S&P 500 EPS increased by 5.7% compared to the 4.2% five- and ten-year average decline over the course of a quarter. According to FactSet, the Street is looking for S&P 500 earnings to increase 23.3% y/y in Q1, which would mark the highest growth rate since the 26.1% seen in Q3 2018.

- **Retail frenzy and bubble talk:**
    - One of the big stories of Q1 revolved around a late January rally in popular message board stocks such as GME +907.5%, AMC +381.6%, BBBY +64.1%, EXPR +341.8% and KOSS +553.8%. Many of these moves were meaningfully exacerbated by high levels of short interest and the use of out-of-the-money options. They also drove big losses for a select group of hedge funds and the largest hedge fund de-grossing episode in the final week of January since February 2009. The retail frenzy was chalked up to a number of factors that have been percolating for a while, including free trading on online brokerage platforms, the video gamification of trading, the heightened influence of narrative-driven investing, more time at home, government stimulus checks, income inequality and a broader fear of missing out (FOMO). Elevated retail participation, particularly in weak balance sheet and earnings names, fit with bubble concerns that popped up elsewhere surrounding equity valuations not seen since the early 2000s, a two-decade low in the put-call ratio bullish options activity, the SPAC/IPO/secondary boom and surging

cryptocurrencies. However, some of the froth did come off later in the quarter with the upward pressure on yields.

- **S&P 500 Sector Performance:**
  - **Outperformers:** Energy +29.27%, Financials +15.35%, Industrials +11.00%, Materials +8.56%, REITs +7.88%, Communications Svcs. +7.82%
  - **Underperformers:** Consumer Spls. +0.45%, Tech +1.74%, Utilities +1.94%, Healthcare +2.74%, Consumer Disc. +2.94%

Source: IA Solutions, Canaccord Genuity