NEW REPUBLIC PARTNERS

MARKET COMMENTARY

2Q 2021

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Market Monitor 2021	Q2%	YTD%
MSCI ACWI Index	7.4	12.3
S&P 500 Total Return Index	8.5	15.3
Bloomberg Barclays Agg. Bond Index	1.8	-1.6

Performance is not correlated to portfolio holding period.

Market Trends in Early 2021

Interest rate gyrations and inflation worries drove market trends in the first half of the year.

- Interest rates were a dominant macro driver of equity returns.
- The inflation debate raged between Central Banks and market participants.
- Record inflows into global equities funds were fueled in part by new highs in retail investing.

Interest rates were a dominant macro driver of equity returns over the first half of 2021. The U.S. 10-year treasury yield peaked at 1.74% at the end of March, only to fall back to 1.4% by quarter-end. These interest rate gyrations were reflected in the rotation of value stocks outperforming growth stocks early in the year. However, this trend reversed in the last six weeks of the quarter. In sympathy with rates, the market also favored short-duration stocks (+28%) vs. long-duration stocks (+5%).*

The “transitory or not” debate on inflation between the Fed and market participants raged on through the 2nd quarter. Palpable pressure on supply chains continued as bottlenecks created by Covid-19 and its aftereffects interrupted both transportation and manufacturing. Both sectors struggled to meet demand while also dealing with ongoing shortages in skilled workers and supplies such as micro-chips.

Inflation was also evident in re-opening sectors such as airlines, car rentals, lodging and used cars. Inflation even reached decade highs in spots around the globe, partly due to base effects, and continued to be reflected in longer-term break-even rates.

*Source: Goldman Sachs

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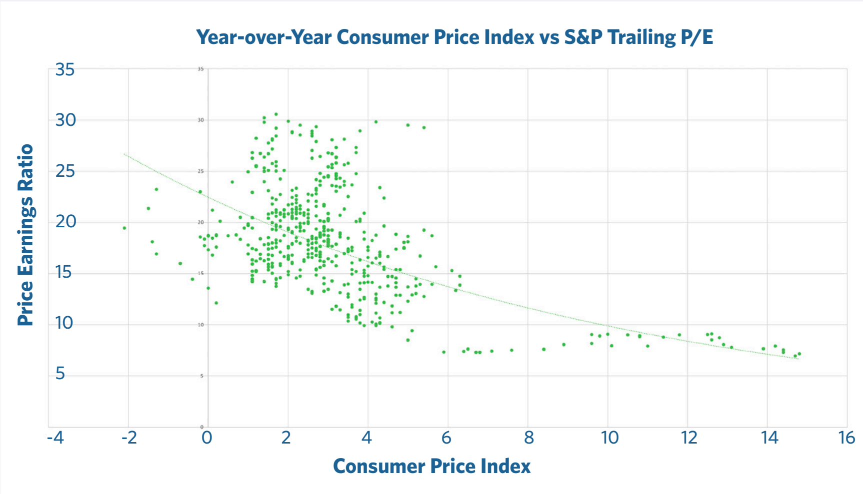
Market Trends in Early 2021 continued

The specter of inflation was great enough to prompt Central Banks—led by the Federal Reserve—to disseminate a more hawkish tone in 2Q than in prior quarters. For equity investors, accelerating inflation is worth paying attention to as high inflation limits multiple expansion based on market history as highlighted below.

A less widely publicized point during the quarter was that after a multi-year period of outflows from global equity funds, the first half of 2021 saw record inflows. Global equity fund inflows in the first half of 2021 completely retraced cumulative outflows since 2018, as investors increased risk in their portfolios alongside accelerating global activity and bullish sentiment.

Notably, the make-up of the U.S. investor base has changed as retail investing now comprises roughly 20% of U.S. equity trading volumes—a doubling since 2010. One needs only to look at the dramatic user growth of retail trading platforms such as Robinhood for evidence. Many active managers view this as an opportunity as dispersion often increases in a retail-driven market, but hedge fund managers remain wary of being on the other side of the next retail-driven meme stock.

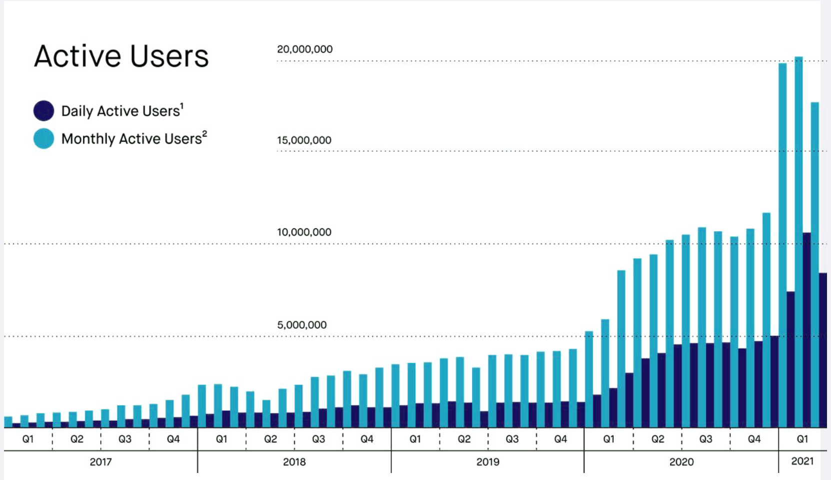
Inflation vs. Market Multiples



Source: New Republic Partners Chart, Data from Bloomberg

Growth in Retail Investing

Robinhood Active Users



Source: Robinhood Markets, Inc.

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Standout Themes

Despite the noisy macro data around the economic re-opening and value/growth rotations, a few big topics stand out to us:

The Market Remains a Discounting Mechanism

Ultimately, the market is a weighing machine over the long run, which means that earnings growth should still tilt the scales. Beyond 3-year holding periods, earnings growth has been 80-90% correlated with stock market returns.

- Estimated 2Q year-over-year earnings growth is 65% after earnings grew 50% in the first quarter. Logic then leads to the question of whether earnings growth is peaking. It is difficult to say "yes" definitively when the number of companies issuing positive earnings per share guidance is almost two times the 5-year average.
- What does seem clear is that we are moving from early-cycle, strong economic growth to a slower, longer phase of the economic cycle. With that shift, stock dispersion should be on the rise from one of its lowest points in the past 30 years, as quality and earnings power differences emerge. After a muted first half of the year, we believe hedged equity managers should benefit from such an environment.

The Earnings Recovery is Global

- The current earnings recovery is not only a U.S. phenomenon, but it is apparent in EAFE and EM countries. With delayed re-openings and vaccine rollouts, the economic and reflation momentum is arguably stronger outside of the U.S. than within.
- Furthermore, cyclicals comprise a higher proportion of the equity markets in Europe (54%), Japan (55%) and EM countries (44%) vs. the U.S. (33%).
- P/E multiples in international markets are closer to long-term averages than in the U.S. and below in the case of Japan.

In our view, these earnings recovery trends underscore the need for global diversification in a long-only equity exposure, despite U.S. equity markets outperforming international markets over the past decade.

Active management takes on a greater role in international investing, particularly in emerging markets where the equity investor base is evolving and a shareholder culture is developing. Thus, we favor investment managers who have offices or are headquartered in the country where they are investing.

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Standout Themes continued

Prospects for a "Traditional Portfolio" are Bleak

Whether one believes the near-term risks are more disinflationary than inflationary, or that U.S. rates are headed towards 1.25% or 2%, the asset allocator problem remains: the traditional 60/40 equity/bond allocation is challenged.

- Traditional fixed income provides little yield and little protection at current levels and would suffer pain should the economy and markets continue to run hot.
- Alternative assets are needed to replace the typical diversifiers for those inflationary, and even disinflationary, risks to portfolios—namely private credit, real assets, and absolute-return-oriented hedge fund strategies.

Thus, we believe the integration of alternative assets into investment portfolios is critical at this juncture.

- The breadth and complexity of alternative investments require expertise to select appropriate solutions for investors.
- Building an alternatives portfolio requires a balance of liquidity, risk tolerance, and access to top investment talent and opportunities.

We believe the extra effort is warranted in today's environment, as the future is not what it used to be.

Investment Committee

Thomas K. Hoops, CFA | **Samuel B. Bowles** | **Michael P. Phipps, CAIA** | **J. Keith Benedict**

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Disclosure

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704.626.1526

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