Kayne Anderson Rudnick
Investment Management

Market Review

Equities are off to a solid start through the first quarter of 2021 with the S&P 500 returning 6.17%. For the first time in many years, value stocks dramatically outpaced growth stocks returning 11.26% and 0.94% as measured by the Russell 1000 Value and Russell 1000 Growth indices, respectively, for the quarter. Small-capitalization stocks returned 12.70% as measured by the Russell 2000 Index, outperforming large-capitalization stocks for the second quarter in a row. Small-cap value stocks were the standout performer during the quarter gaining 21.17% as measured by the Russell 2000 Value Index. International and emerging markets continued to lag the U.S. with the MSCI EAFE Index up 3.48% and the MSCI Emerging Markets Index up 2.29% in the first quarter.

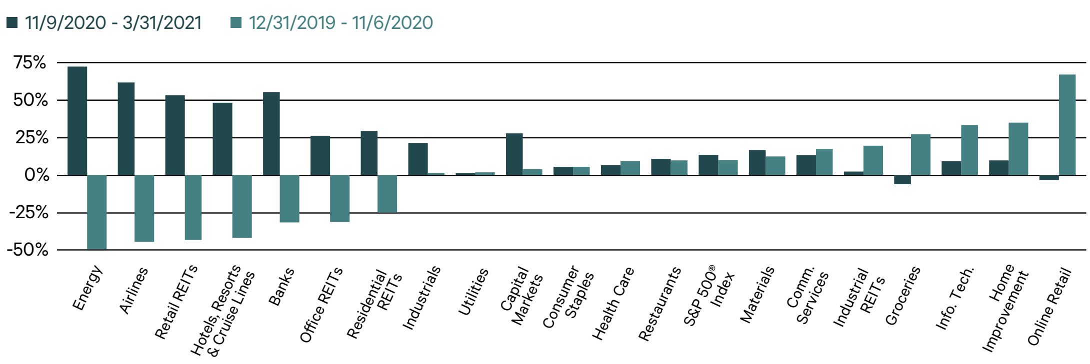
In response to improving economic conditions throughout the quarter, the 10-year U.S. Treasury yield rose from 0.92% to 1.74%. This increase resulted in the U.S. Bloomberg Barclays U.S. Aggregate Bond Index declining 3.37% during the quarter. Credit-sensitive or spread-based fixed income fared better with high yield up 0.90% as measured by the ICE BofA U.S. High Yield (USD Unhedged) and municipal bonds down 0.35% as measured by the Bloomberg Barclays Municipal Bond Index. Emerging market debt was hit hard in the quarter declining 4.74% as measured by the JP Morgan EMBI Global (Local) Index.

MEANINGFUL ROTATION?

The approval of several vaccines in early November of last year has generated a “game changing” rotation from growth to value stocks. We are five months into this rotation driven by an early stage economic recovery scenario that we believe the stock market is starting to discount.

FIGURE 1: SECTOR LEADERSHIP THROUGH THE PANDEMIC

Total Returns by Sector and Industry Before and After November 6, 2020

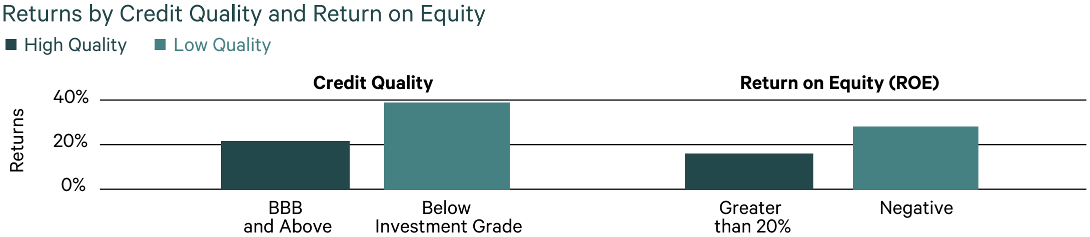


Data is obtained from FactSet Research Systems, Standard & Poor’s and J.P. Morgan Asset Management and is assumed to be reliable. November 6, 2020 chosen as the last business day before vaccine candidate is revealed to have more than 90% efficacy against the COVID-19 virus in global trials. The company referenced is for illustrative purposes only. ***Past performance is no guarantee of future results.***

We agree that the 2021/2022 economic outlook is becoming increasingly robust given significant pent-up consumer demand combined with record net worth, several trillion dollars of federal stimulus being distributed this year, vaccinations, and declining COVID-19 hospitalizations, all of which are improving consumer confidence. In a rapidly accelerating economic growth environment, low quality stocks tend to outperform high quality businesses as investors seek out companies with more operating and financial leverage. This is precisely what has been happening since the vaccine approvals.

FIGURE 2: PERFORMANCE OF HIGH QUALITY VERSUS LOW QUALITY

Returns by Credit Quality and Return on Equity



Data presented is for the five months ending March 31, 2021 and is based upon the Russell 3000 Index. Data is obtained from FactSet Research Systems and is assumed to be reliable. Return on equity (ROE) is a measure of financial performance calculated by dividing net income by shareholders’ equity. ***Past performance is no guarantee of future results.***

AUTHOR

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Chief Investment Officer

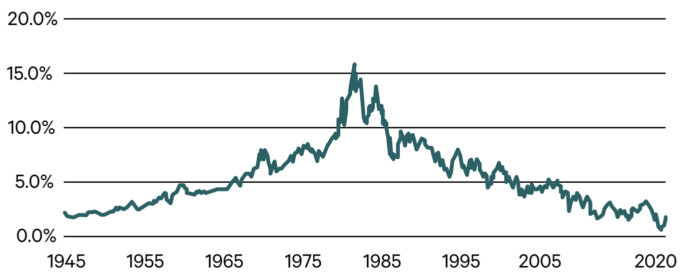
Douglas S. Foreman, CFA is Chief Investment Officer, Portfolio Manager, and a member of the Executive Management Committee. He has approximately 35 years of investment experience.

In our experience, equity markets are often 6 to 12 months ahead in assessing the business and economic environment. Once the acceleration in GDP starts to stabilize, we expect the relative performance of high-quality stocks will start to improve.

INFLATION AND INTEREST RATES?

The 10-year U.S. Treasury yield is climbing due to improving economic conditions. The Federal Reserve has continued to focus on reducing unemployment more than worrying about a rise in inflationary expectations. Therefore, short-term interest rates have continued to hover around zero. The Fed has made it clear that they have no intention of raising interest rates over the short term and potentially derailing the impending economic recovery.

FIGURE 3: 10-YEAR U.S. TREASURY YIELD



Data presented is for the period ending March 31, 2021. Data is obtained from Strategas and is assumed to be reliable. ***Past performance is no guarantee of future results.***

However, as longer-term rates have adjusted upward, credit spreads have remained tight at historically low levels and inflation expectations are fairly modest. It is likely that we may experience a short-term increase in inflation due to a robust economy, global supply disruptions and some product shortages. However, we believe an increase in inflation is likely to be temporary as structural headwinds to inflation (significant global competition, innovation creating faster, cheaper and improved productivity) seem to be very much intact.

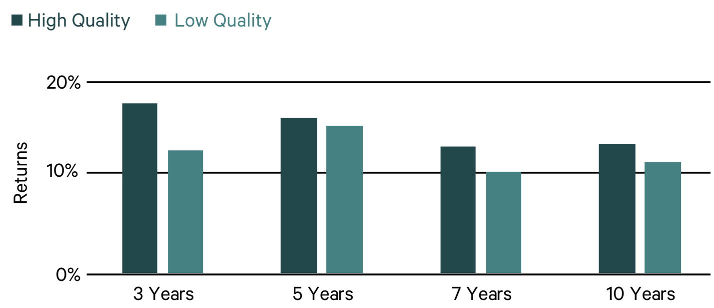
If the economy continues to improve as expected, we think the 10-year U.S. Treasury yield will likely move in the 2.0% to 2.5% range over the next year. A rise in interest rates can trigger sustainable earnings growth fears if the Fed has to start fighting inflation with rising short–term rates, but we seem to be a long way from that type of environment and policy. As long as earnings growth is outpacing interest rate increases, we believe the equity market can perform fairly well.

Price/earnings ratios are higher than normal, but this is not unusual at the bottom of an economic recession. As the recovery unfolds, earnings should recover and multiples will typically decline somewhat as earnings recover to more normalized levels. In this second year of recovery from the COVID shock, we think equity returns should be more modest than last year.

DO WE DO ANYTHING DIFFERENTLY IN THIS ENVIRONMENT?

We are quality investors. We seek to purchase high quality businesses regardless of the current economic outlook. We strongly believe that quality investments produce strong risk-adjusted returns over a full business cycle. We think competitive protections and differentiation are the key investment metrics that matter the most over any reasonable time period. Typically, low quality rallies last 6 to 12 months and then run out of steam as economic growth starts to stabilize. We will continue to invest as we always have in high quality businesses for the long term.

FIGURE 4: HIGH QUALITY HAS OUTPERFORMED OVER THE LONG TERM | Russell 3000® Index Quality Returns



Data presented is as of March 31, 2021. Data is obtained from Factset and is assumed to be reliable. High Quality is represented by S&P Quality Rankings of B+ and above. Low Quality is represented by S&P Quality Ranking of B and below. ***Past performance is no guarantee of future results.***

We thank you for your continued trust and confidence in managing your assets.

Large-capitalization stocks are represented by the S&P 500® Index which is a market capitalization weighted index which includes 500 of the largest companies in leading industries of the U.S. economy. Growth stocks are represented by the Russell 1000® Growth Index which is a market capitalization-weighted index of growth-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Value stocks are represented by the Russell 1000® Value Index which is a market capitalization-weighted index of value-oriented stocks of the 1,000 largest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Small-capitalization stocks are represented by the Russell 2000® Index which is a market capitalization-weighted index of the 2,000 smallest companies in the Russell Universe, which comprises the 3,000 largest U.S. companies. Small-cap value stocks are represented by The Russell 2000® Value Index, which measures the performance of small-cap value segment of the US equity universe, and includes those Russell 2000® companies with lower price-to-book ratios and lower forecasted growth values. Developed international markets are represented by the MSCI® EAFE Index which is a free float-adjusted market capitalization index that measures developed foreign market equity performance, excluding the U.S. and Canada. Emerging markets are represented by the MSCI® Emerging Markets (EM) Index which is a free float-adjusted market capitalization index tracking the equity performance of global emerging markets. The J.P. Morgan Emerging Markets Bond Index Global (EMBI Global) is a benchmark index for measuring the total return performance of international government bonds issued by emerging market countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements. Included in the EMBI Global are U.S.-dollar-denominated Brady bonds, Eurobonds, traded loans, and local market debt instruments issued by sovereign and quasi-sovereign entities. The Bloomberg Barclays U.S. Aggregate Bond Index is a market value weighted index that tracks the daily price, coupon, pay downs and total return performance of fixed-rate, publicly placed, dollar-denominated and non-convertible investment grade debt issues with at least $250 million par amount outstanding with at least one year to final maturity. Performance is calculated on a total return basis with dividends reinvested. The ICE BofAML U.S. High Yield Index tracks the performance of U.S. dollar denominated below-investment-grade corporate debt publicly issued in the U.S. domestic market. The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prefunded bonds. This report is based on the assumptions and analysis made and believed to be reasonable by Advisor. However, no assurance can be given that Advisor's opinions or expectations will be correct. This report is intended for informational purposes only and should not be considered a recommendation or solicitation to purchase securities. ***Past performance is no guarantee of future results.***