OPUS INVESTMENT MANAGEMENT

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Quarterly Commentary

June 30, 2021

Executive Summary

ANN TRIPP
President

MARKET COMMENTARY

Throughout the spring, estimates of quarterly GDP growth were continually revised upwards and ended the period at 10%. If these estimates prove to be accurate, this would be the second-highest quarterly increase in over 40 years. With states lifting their remaining COVID-related restrictions as the population of fully vaccinated citizens grows, rising optimism surrounding economic recovery is becoming the consensus. Against a backdrop of fiscal stimulus and accommodative monetary policy, the S&P 500 returned 8.55% during the quarter, while the Bloomberg Barclays U.S. Aggregate Bond Index reversed some of the sell-off from the first quarter, returning 1.83%. The conversation has shifted to an economy running near capacity, with inflation running above the long-term Federal Reserve target. There is speculation regarding whether this spike in prices will prove to be transitory or whether changes to monetary policy will occur sooner than expected.

In May, the Federal Reserve’s preferred measure of inflation, core personal consumption expenditures (PCE), rose to 3.4% year-over-year, the highest level in nearly two decades. This increase was largely driven by supply chain disruptions and extreme base effects resulting from declines at the start of the pandemic. When looking at average inflation over the last two years, inflation appears to be much closer to the Federal Reserve’s long-term 2% target and could be the basis for much of their wait-and-see policy. While significant improvement has been made toward the FOMC’s second mandate, full employment, there still appears to be significant slack as we have nearly 7 million fewer employed than pre-pandemic.

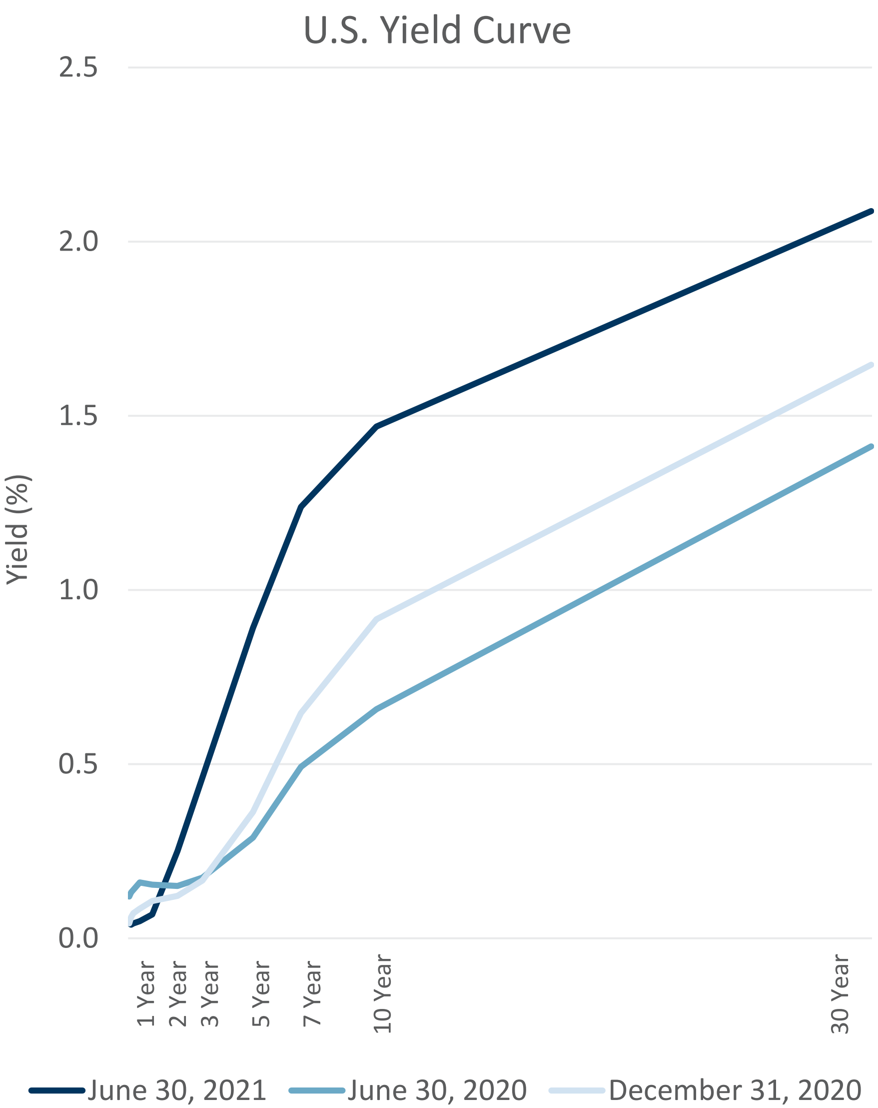
The recent FOMC “dot plot” shifted the expectation of lift-off from 2024 to sometime in 2023. However, it is interesting to note the high dispersion between the forecasts, with a few members predicting an overnight rate over 1.5%. Additional focus has been on the Federal Reserve’s asset purchase program and when “tapering” of the current program could occur. Chairman Powell has been clear that tapering will be well-telegraphed to the market and that we still need significant improvement before we can move away from these supportive policies. However, other Federal Reserve policy makers have recently opined that tapering could start later this year with mortgage-backed securities, especially given the run-up in housing valuations.

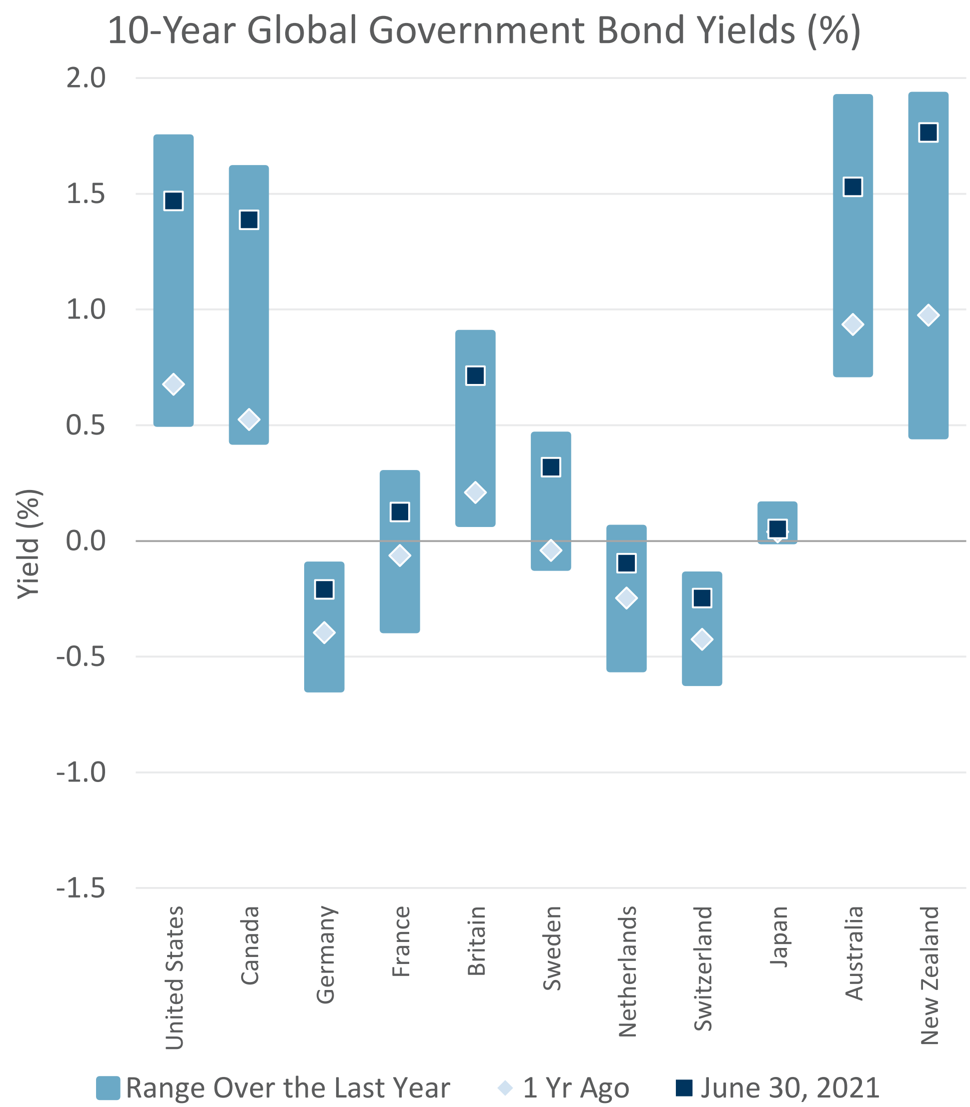
Investors’ risk appetite remained insatiable throughout the quarter, driving equity markets to repeated new all-time highs and driving spreads on fixed income securities lower. The yield differential between U.S. Treasuries and investment grade corporate bonds decreased to 80 basis points, which is only a few basis points above pre-Great Financial Crisis lows seen in 2005. The quest for yield has spilled over into the below investment grade (high yield) market with issuance expected to hit a record high this year, as all-in-yields remain close to historically low levels. Despite valuations that seem to be priced for perfection, we believe spreads could push marginally lower due to a robust economic recovery, additional fiscal stimulus, and monetary policy, which for the time being remains accommodative.

Ann

Economic Outlook

Sovereign yields near one-year highs as global growth and inflation expectations increase

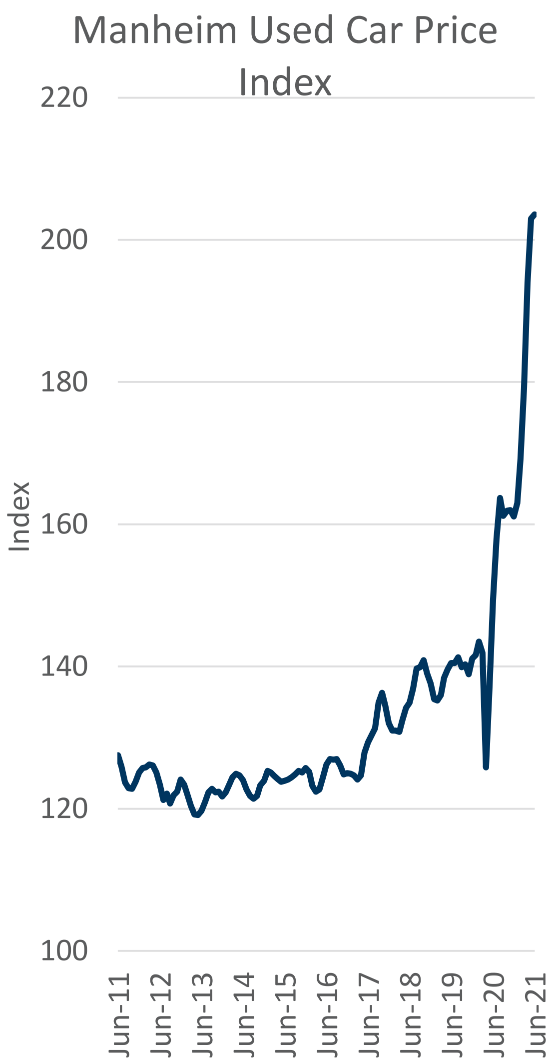


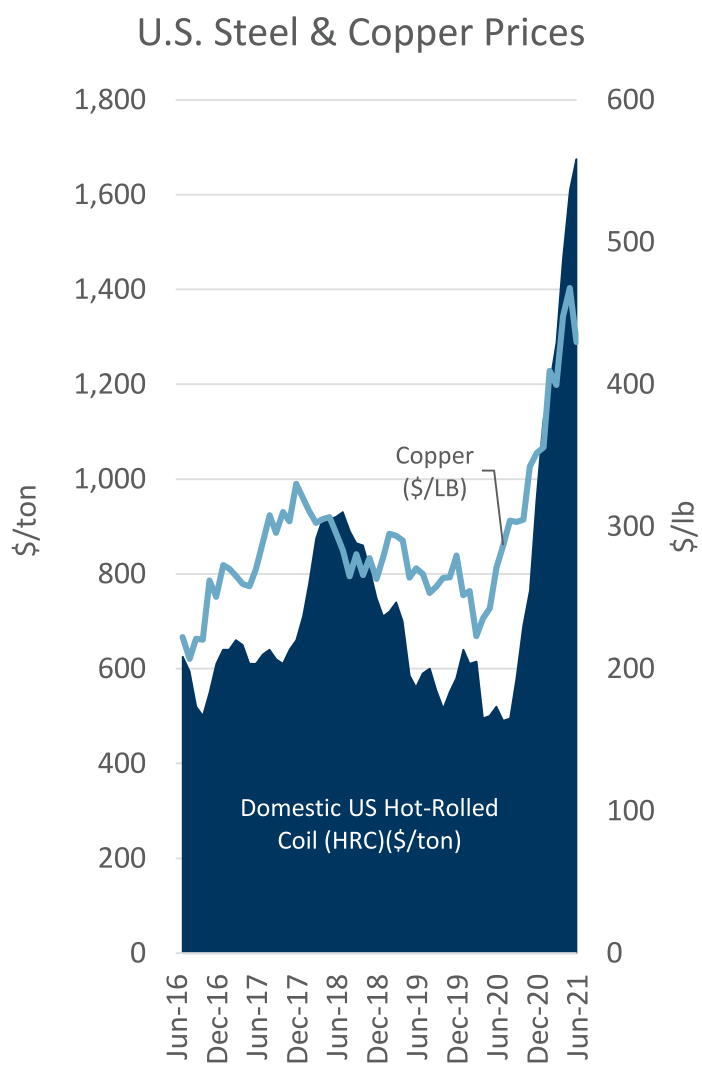


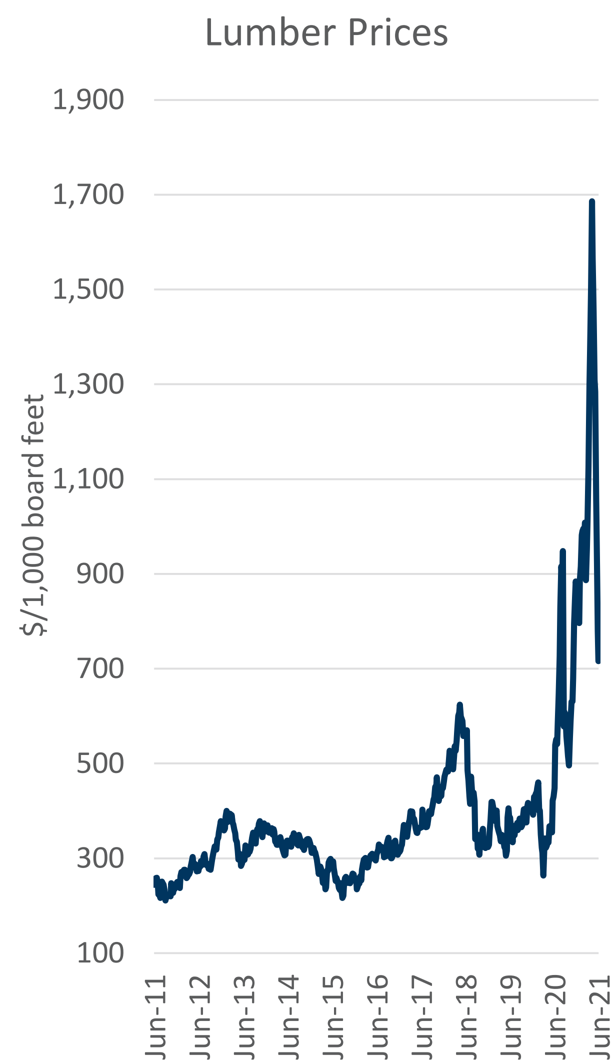
Source: Opus, Bloomberg

Economic Outlook

Supply chain issues and tight inventory combined with pent up demand have influenced inflation



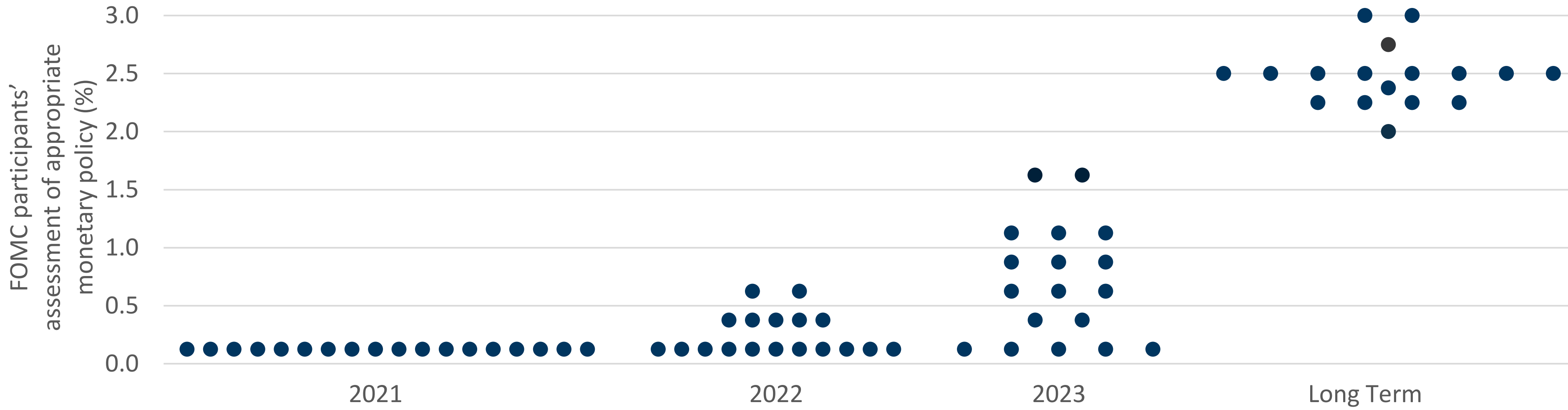


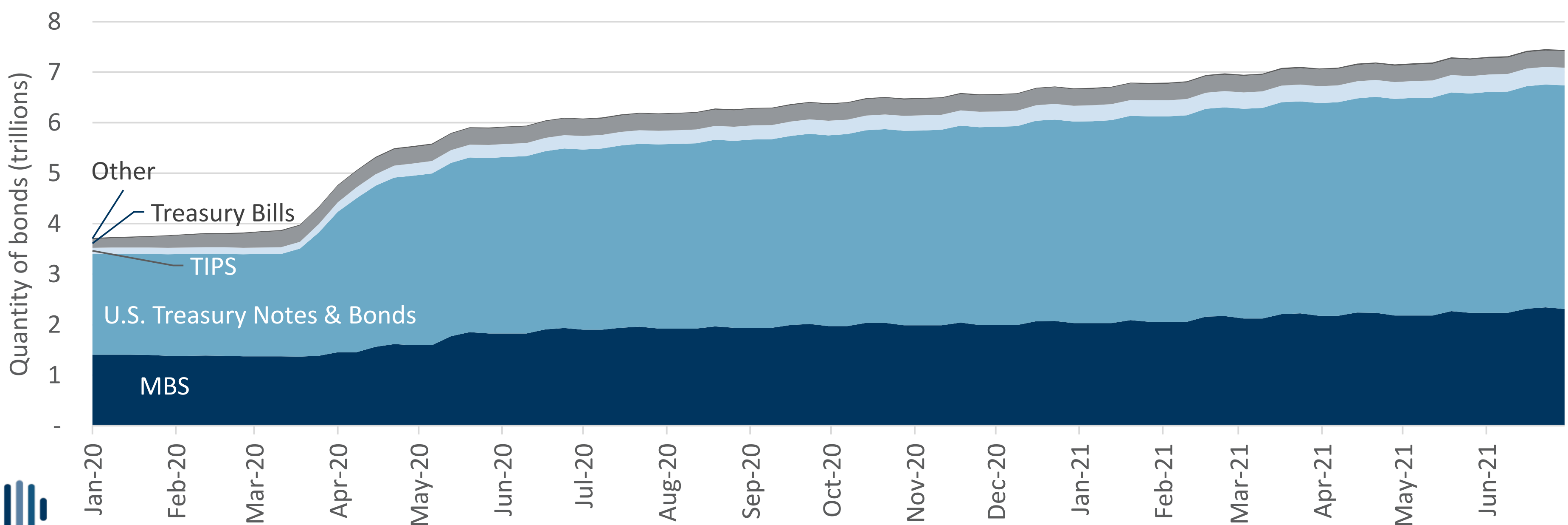


Source: Opus, Bloomberg, Manheim Auctions, Bureau of Labor Statistics

Economic Outlook

Federal Reserve "Dot Plot" suggests first rate hike in 2023, however tapering likely to occur first

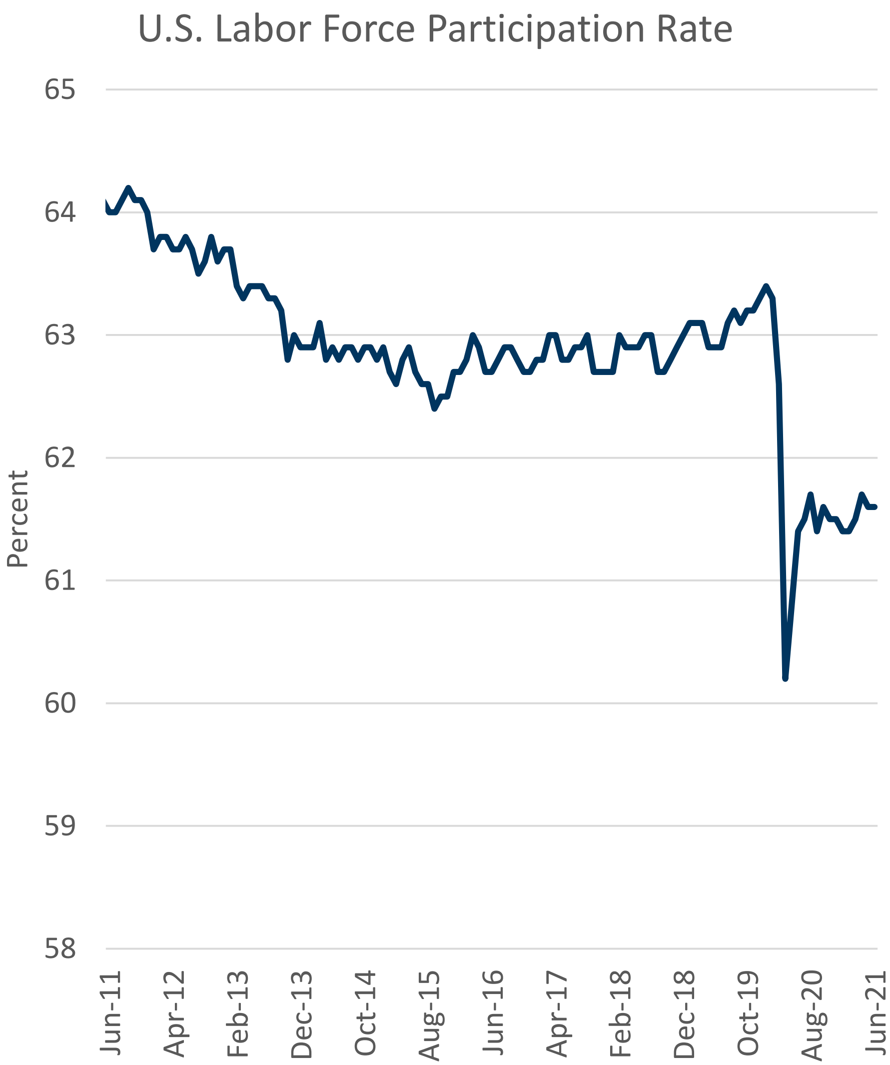


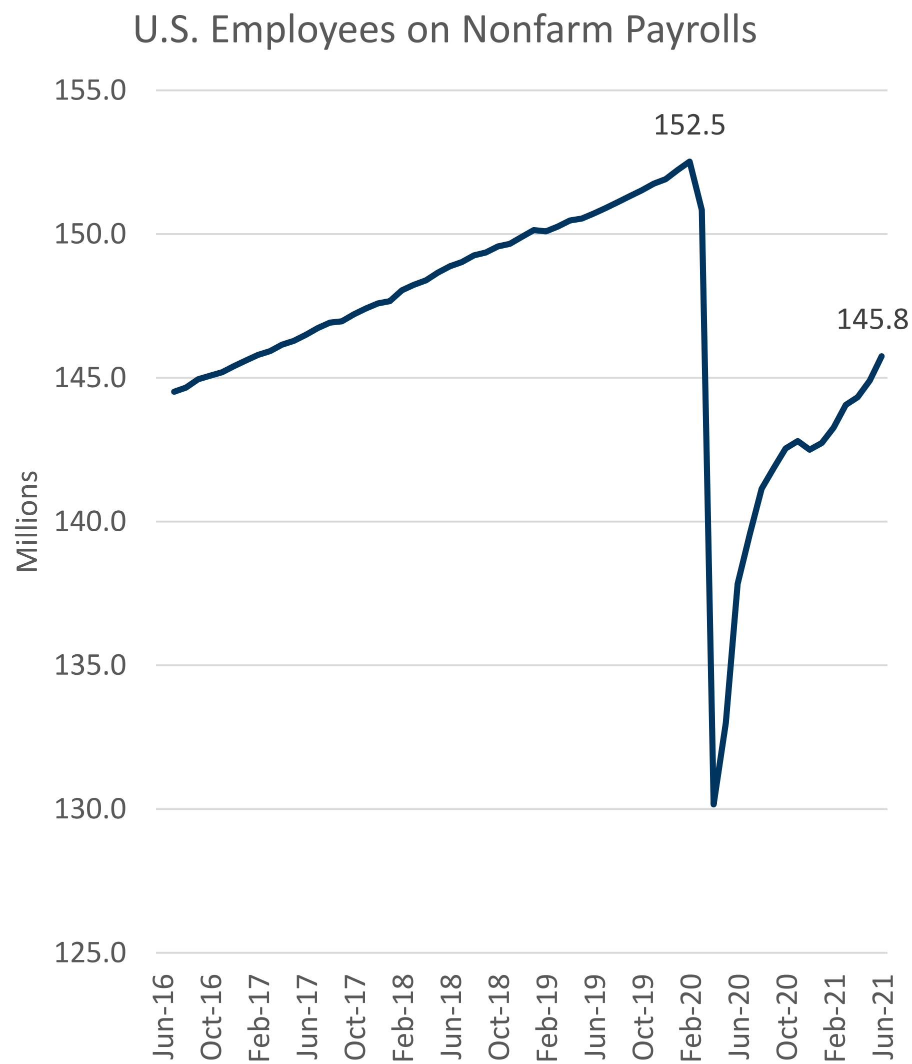


Source: Opus, Bloomberg, Federal Reserve

Economic Outlook

Even with a strong June employment report, there is still significant slack in the labor market





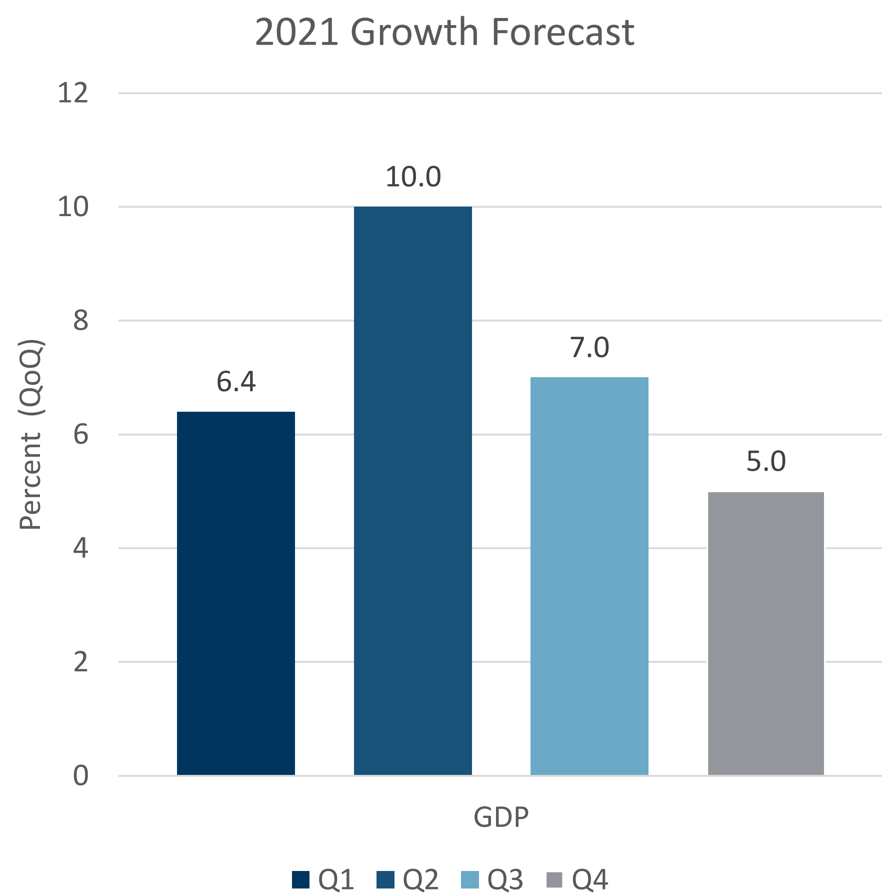
Source: Opus, Bloomberg, Bureau of Labor Statistics

Economic Outlook

Q1 GDP at 6.4%, with second quarter growth forecast at 10% as economic recovery expected to continue throughout 2021, supported by fiscal and monetary policy

(YoY%)	2020	2021	2022	2023
Real GDP	-3.5	6.6	4.1	2.3
Consumer Spending	-3.9	8.0	4.1	2.4
Government Spending	1.1	2.0	2.0	1.1
Private Investment	-5.2	10.4	6.2	3.5
Exports	-12.9	5.4	6.2	5.0
Imports	-9.3	13.5	5.2	3.6

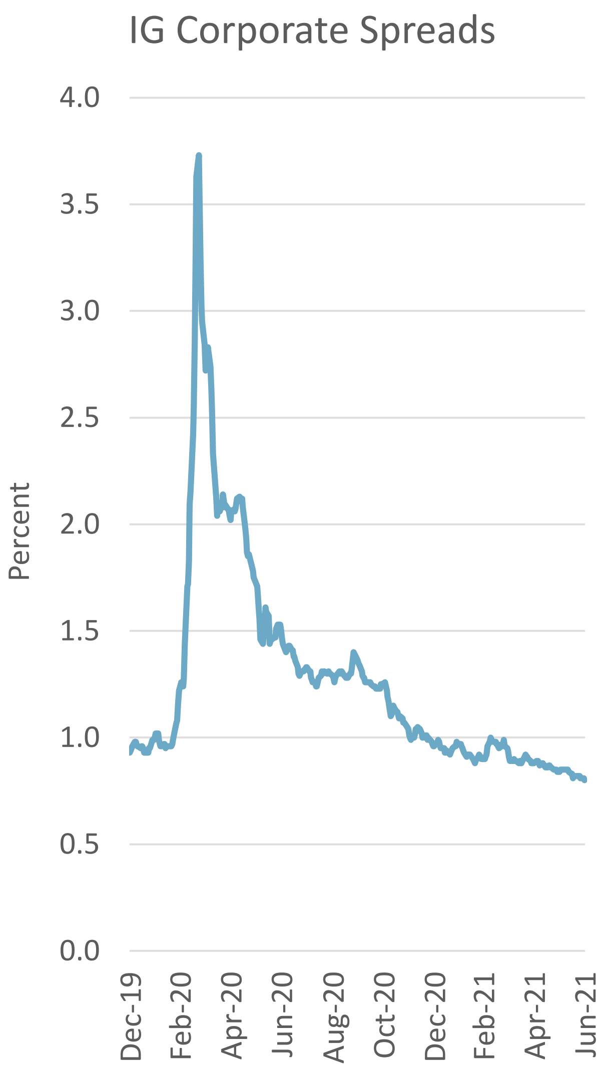
Bloomberg Consensus growth outlook

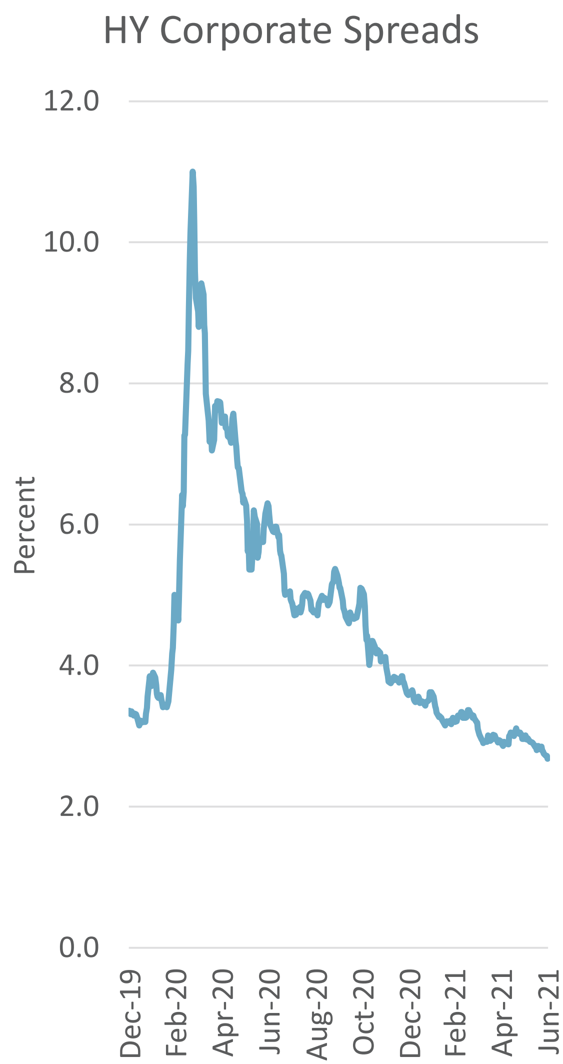


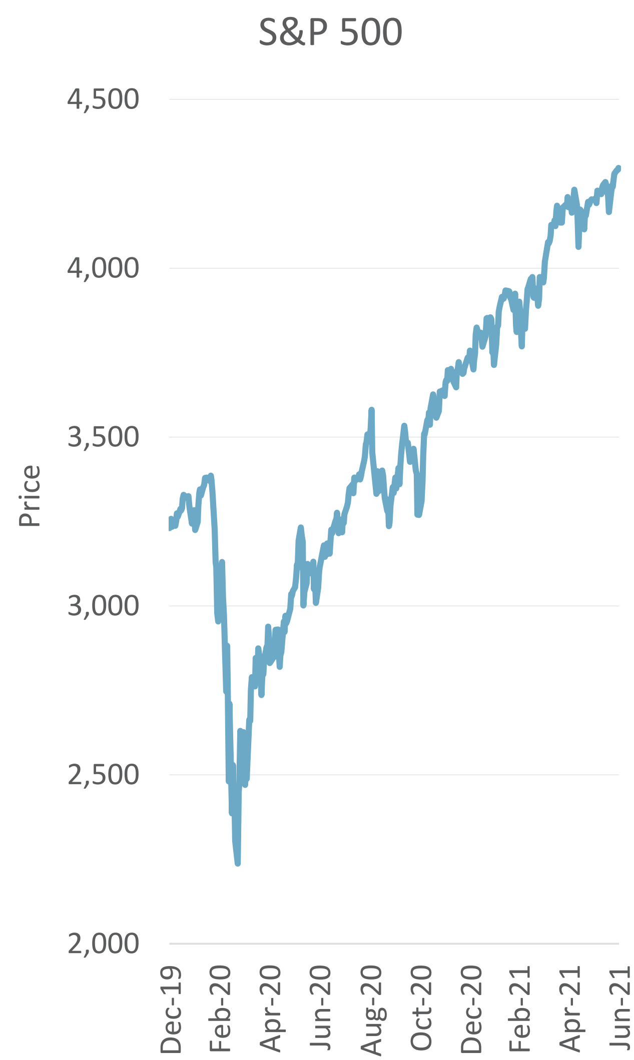
Source: Opus, Bloomberg, Bureau of Economic Analysis

Economic Outlook

Valuations of fixed income challenged, while equity market hits all-time price highs







Source: Opus, Bloomberg

Economic Outlook

All eyes on the Fed and any potential change to current policy

Monetary and fiscal stimulus likely to continue

- Fed's target rate expected to remain near zero into 2023 before first projected rate hike. Global central banks continue QE programs.
- The pace of quantitative easing policy in the U.S. could change with a potential tapering of mortgage-backed securities beginning as early as this year.
- Fiscal stimulus is expected to continue, including infrastructure spending.

Resulting in higher expected growth

- Positive vaccine momentum coupled with improved forecasted earnings has resulted in the S&P 500 hitting a new all-time high in June.
- Growth of 6.4% in first quarter, 10% growth forecast for second quarter, with inflation above Fed target, could put upward pressure on Treasury yields.
- Spreads on risk assets remain near historic lows.

How will monetary policy adjust?

- Increased growth expectations, rising inflation and additional stimulus are pressuring FOMC accommodative stance.
- Timing and transparency of Fed policy likely to be key to keep markets from experiencing significant volatility as they did in 2013.
- Uncertainty regarding fiscal policy changes remains, including tax reform, which could be a risk to long-term growth.

Source: Opus, Bloomberg

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