Northwestern Mutual Wealth Management Company

Asset Allocation Focus Update

December 2020

In this publication for advisors and their clients, Northwestern Mutual Wealth Management Company's (NMWMC) investment professionals provide views and commentary on the current marketplace. This information is designed to complement the long-term strategic view on asset allocation that is reflected in the model allocations shown in most clients' investment policy statements. We believe that these standard model asset allocations continue to be prudent and suitable for most long-term investors. The strategic viewpoint represented in the chart below illustrates our views based on the relative attractiveness of different asset classes over the next 12 to 18 months. Keep in mind that this viewpoint can and will change as valuations and economic variables evolve. Because our advisory programs provide different levels of investment flexibility, our strategic viewpoint may not be implemented in our home office-managed programs or may be implemented only in certain programs.

Inside:

Equities	Unfavorable		Neutral	Favorable*	
U.S. Large Cap				■	
U.S. Mid Cap				■	
U.S. Small Cap				■	
Intl Developed			■		
Emerging Markets				■	
Fixed Income	**Unfavorable**		**Neutral**	**Favorable***	
Duration				■	
Government Securities				■	
Investment Grade			■		
High Yield		■			
Non-U.S.		■			
TIPS					■
Municipal Bonds				■	
Real Assets	**Unfavorable**		**Neutral**	**Favorable***	
Real Estate	■				
Commodities			■		

*The colors indicate the level of unfavorablility and favorability within the asset class, starting from neutral. The more favorable or unfavorable, the color will extend to the far right or left.

Outlook 2021: Contemplating COVID-19's diminishing economic and market impact

With vaccines, stimulus and easy monetary policy, economic growth is poised to push higher in 2021. But as the recovery broadens, we expect market leadership will also change. In this edition of the Asset Allocation Focus, Northwestern Mutual's investment committee digs into the rotation happening in markets and what that means for next year.

When investors examine historical stock market returns to inform their future outlook, 2020 will need an asterisk. As of mid-December, nearly all U.S. equity asset classes sport high single- to mid-double-digit returns. Just another normal year, right? Of course, those who experienced 2020 will always remember it was anything but normal — it was an extreme roller coaster ride.

Take the harrowing fall from record highs that carved a deep economic and market valley in late Q1 and early Q2. Extreme pessimism and uncertainty prevailed at the time, but we remained optimistic that markets and the economy could push higher so long as two key conditions could be met: first, monetary and fiscal policymakers acted quickly and forcefully

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to fill the valley; and second, economic and scientific innovation would shrink the valley's width.

Heading into 2021, that's largely what's occurred. Although economic output fell, policymakers flooded the U.S. economy with relief that pushed U.S. personal incomes well above year-end 2019 levels. To put this in context, it took more than *two years* into the Great Recession for incomes to surpass their 2008 peak — it took just *one month* for personal incomes to reach new highs in 2020. The economy's uncanny ability to adapt (think teleconferencing, ecommerce, deliveries) has fostered growth and reduced the width of the economic valley, even while the virus pulses around the globe. Most importantly, science also came to the rescue, developing three very effective vaccines in rapid fashion. Those vaccines have essentially put a mid-2021 end date to COVID-19's impact on the U.S. economy.

> As we look ahead to 2021, we forecast a U.S. and global economy operating on all cylinders of growth for the first time since 2017 and into early 2018.

As we look ahead to 2021, we forecast a U.S. and global economy operating on all cylinders of growth for the first time since 2017 and into early 2018. The U.S. will ride several tailwinds, including additional fiscal stimulus, continued monetary policy easing and the virus ending its impact on economic growth. Wholesale inventories need to be rebuilt (bullish for manufacturing), and there is pent-up demand in many sectors of the economy that were hamstrung by COVID-19 (think leisure, travel, dining, live events). All signs point to continuing economic growth next year.

Given this backdrop, we believe equity markets can also move higher in 2021, but different sectors and asset classes will lead the way. Indeed, the rotation we've been positioning for arrived in Q4 2020, and we believe it will continue into 2021. We continue to advise investors to nudge their portfolios toward parts of the market that rely more on broader economic growth vs. more defensive parts of the market that have carried the water for much of the past three years. Think about more cyclical stocks and asset classes, such as U.S. Small- and Mid-Cap stocks that are leveraged to broadening economic growth, rather than stocks that benefit from us staying at home and have dominated the recovery in 2020.

Economic and market broadening continues

Economic growth came screaming back after dipping 5 percent (seasonally adjusted annualized rate) and a -31.4 percent plunge in Q2. This was followed by a sharp, V-shaped recovery — up 33.1 percent in Q3. This does not bely the reality that COVID-19 has been a severe headwind to some industries and sectors, but let's not forget that it's been a major tailwind for other parts of the economy. What's more, COVID-19 is impacting a steadily shrinking slice of the overall economy with each passing month.

Just look at U.S. consumer spending, which comprises roughly 70 percent of annual U.S. economic growth. After falling at an annualized rate of nearly 20 percent in April 2020, spending was only 1.6 percent (annualized) below its pre-pandemic high by the end of October. Looking deeper, we find that COVID-19 shifted spending, as well. Spending on goods, both of durables (think home furnishings and household equipment) and non-durables (think food and beverage for off-premise consumption, or grocery stores), has been aided from our stay-at-home environment — those figures are 7.5 percent higher than pre-COVID. On the other hand, services spending (think recreation and leisure, hotels, airlines) is 6.1 percent lower. This is the slice of the U.S. economy that is still being impacted, but even here the situation is improving.

Let us drive home this theme of broadening economic growth using data from the Institute for Supply Management (ISM) Manufacturing and Services Purchasing Manager Survey (PMI). These monthly surveys paint a real-time, all-inclusive picture of the U.S. economy. Currently, both reside in expansion mode and show heightened new orders against a backdrop of low inventories, which bodes well for future production. Again, there's more to this story.

Combined, the services and manufacturing ISMs represent 36 different industries. In November, 30 of the 36 represented industries reported growth. In April, just 4 of 36 industries were growing. That rose to 27 by the end of Q2 and to 31 by the end of Q3. Evidence for broadening economic growth couldn't be clearer.

And while COVID-19 has surged over the past few months, it's notable that the total number of ISM industries reporting growth slipped by just one — from 31 to 30 of 36. Manufacturing hit a high of 16 out of 18 industries expanding, while services have fallen back to 14 (which ties into spending, above). And it contrasts with manufacturing during the trade war. The segments in decline are Arts, Entertainment &

Recreation; Other Services; Real Estate, Rental & Leasing; and Educational Services.

Here's how this all impacts our market outlook. Think about the beginning of the pandemic, when a narrow group of U.S. Large Cap growth stocks drove the market higher. These largely technology-related names were relatively unscathed by lockdowns and the decline of an "in-person" economy. Many rode a massive tailwind from COVID-19 as years of adoption trends condensed to just a few weeks. While other companies saw growth stall, earnings growth from these tech names was the only game in town. But as the recovery has broadened, other more economically sensitive companies, industries and asset classes are returning to growth.

Look at economically sensitive U.S. Small-Cap stocks, which saw their aggregate earnings fall from nearly $9 a share in Q4 2019 to -$8 in Q1 and $0 in Q2 as measured by the S&P Small Cap 600 Index. However, by Q3 they were back to nearly $11 per share and are forecasted to grow earnings 73 percent year-over-year in 2021. Other economically sensitive sectors, such as energy, financials and industrials (value stocks, more broadly), are also expected to see sharp earnings growth in 2021. We are not saying that U.S. Large Cap growth stocks are a bad investment but rather that investors will likely find other areas more attractive in 2021.

Putting the past into perspective

We realize the bar is high to convince many investors to nudge away from Tech and Large-Cap growth stocks after their compelling performance over the past years. And why not? Three-year returns through September 2020 show U.S. Large Caps (the S&P 500) up 13 percent per annum, driven by Large-Cap growth stocks' dizzying 19 percent annualized returns. Large-Cap value advanced a more modest 4 percent. Similarly, U.S. Mid-Cap stocks were up a paltry 2.9 percent, while U.S. Small Caps declined 0.33 percent per year. Across the pond, returns were similarly weak, with Emerging Markets advancing 2.4 percent and International Developed markets returning a whopping 0.62 percent per year.

We think the tables are turning, but they've been quietly turning for some time. We believe the start date for this narrow vs. broad economic growth environment actually dates back to late 2017 and early 2018. Back then, the U.S. economic growth was similarly broad, based on ISM measures, and the global economy was also accelerating. Quite frankly, at that time the world was beginning to look more normal, and market performance both in the U.S. and overseas was inclusive. But it shifted when the world was introduced to a trade war that robbed the more export-driven global economy of growth and severely hampered the manufacturing side of the U.S. economy. Put in the context of our earlier comments, global growth stalled, U.S. growth narrowed, and the market rewarded U.S. Large-Cap growth stocks.

As the trade war subsided in Q4 2019, economic and market performance began broadening. Then, COVID-19 stunted growth. As we look into 2021, we see a return to broad U.S. and global growth as economies begin hitting on multiple cylinders. This, we believe, is the backdrop for markets that will continue shaking up leadership in 2021 while pushing higher.

Current portfolio positioning

In April 2020, in the heat of the market decline, we upped our overall equity allocation and increased exposure to more economically sensitive, relatively cheap U.S. Mid-Cap stocks. In late August, we recommended investors shift some of their U.S. Large-Cap allocation, which we noted was increasingly dependent on the performance of a few growth stocks, toward more economically sensitive value stocks. We expressed our belief that these stocks would benefit as the U.S. economic recovery broadened. Since then, both shifts have paid performance dividends, and we expect this to continue into 2021. We acknowledge that the current virus surge and regional lockdowns could cause market consternation, but we forecast markets will look past short-term headwinds and instead focus on the day vaccines are widely distributed and COVID-19's impact on the economy diminishes.

Overall, we enter 2021 with an overweight recommendation to equities relative to fixed income given our intermediate-term outlook and time horizon.

Overall, we enter 2021 with an overweight recommendation to equities relative to fixed income given our intermediate-term outlook and time horizon. We are overweight the U.S. equity market, and our three most recent moves have been to increase the cyclicality of the portfolio by adding to U.S. Small Caps at the end of 2019, U.S. Mid-Caps in April 2020 and U.S. Large Cap value stocks in late August 2020. We remain max underweight U.S. Real Estate Investment Trusts (REITs), are neutral International Developed and are overweight Emerging Markets, which stand to benefit from rising global growth and persistent low U.S. interest rates and accommodative monetary policy.

Equity View

U.S. Large Cap

2020 has been an active year managing the U.S. Equity allocation in our nine asset class models. We rebalanced the allocation amid the March dislocation, added to U.S. Mid-Caps in early April and most recently redeployed our U.S. Large Cap overweight allocation into U.S. value exposure at the end of August. Our central thesis has been guided throughout this year by our four milestone markers, with the last marker, a vaccine, now guiding asset class and style leadership in the financial markets.

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Our portfolios were well positioned for this step change, as market leadership has broadened and shifted firmly in favor of cyclicality. Since our recommendation to shift towards value in late August, the MSCI USA Enhanced Value Index has handily outperformed the broad S&P 500 index. We remain committed to this implementation over the intermediate term, as the spread between the most expensive parts of the market and the cheapest areas remains very wide, with the business cycle still in its early innings and a Federal Reserve that has no desire to tighten policy anytime soon. We remain overweight U.S. Large Cap in aggregate but continue our recommendation that investors nudge that overweight toward value-focused strategies.

U.S. Mid Cap

As market leadership has shifted in our favor to start the fourth quarter, U.S. Mid-Caps have shined. Quarter to date, U.S. Mid-Caps are the second best-performing asset class in our nine asset class portfolios, trailing only U.S. Small Caps. We believe the reason for this is centered on the relative value proposition for asset classes outside traditional U.S. Large Cap as well as higher levels of optimism for a broader macroeconomic recovery with the announcement of the vaccine. This higher level of optimism has increased consensus estimates for next year's earnings for U.S. Mid-Caps at a faster rate than U.S. Large Caps, which has been a tailwind to relative performance. We remain overweight based on both a favorable relative valuation setup and stronger macroeconomic tailwinds.

U.S. Small Cap

After a rough start to 2020, U.S. Small Caps are firmly in pole position within capital markets. Since the March 23 low, U.S. Small Caps have led an impressive equity market recovery, with particular relative performance acceleration following the announcement of successful vaccines. Earnings expectations for 2021 and 2022 have accelerated faster than any other equity asset class, as the earnings base of U.S. Small Caps tend to be the most economically sensitive. Looking forward, we think the recovery has room to run based on the vaccine's efficacy along with persistently accommodative monetary policy. We remain overweight.

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International Developed

International Developed markets have recently been slowed by a second wave of COVID-19. Mobility restrictions returned to previous levels and remain relatively tight as of this writing. Reflecting the virus roller coaster, the Markit Eurozone composite Purchasing Managers Index (PMI) went from 51 in February to 13 in April, only to have peaked at 54 in July (a read above 50 indicates expansion). The current reading of 45 reflects strong manufacturing output (53.8) but weak services (41.7) due to the aforementioned restrictions impacting the in-person and travel parts of the economy. But we expect as vaccines are released that cases will decline and a substantial relaxation of restrictions will provide a broad and meaningful boost to economic activity by the second half of next year. In the interim, international developed economies will continue to weather the crisis with the support of social payments and a national health care system. However, we remind again that in the intermediate to longer term, the international developed economies will be impacted by demographic issues and lower overall growth.

In addition, the United Kingdom (UK) and the European Union (EU) are still negotiating Brexit, and that could have near- and long-term implications for their economies and markets. The UK's membership in the EU ceased in January, but the UK has agreed to follow EU rules until the end of 2020 while new trade arrangements are solidified. This has proven to be a difficult task, with talks stuck over the same issues that stalled talks back in spring. Both sides need to reach new trade arrangements and rectify them in their respective parliaments before the end of the year. Failure to achieve that could lead to a no-deal scenario — higher costs and barriers for exporters on both sides.

European monetary policy has been proactive through large asset purchases. The Pandemic Emergency Purchase Programme (PEPP) launched with €750 billion and has almost doubled to €1.35 trillion. The timeline of easing is currently June 30, 2021. However, the European Central Bank has strongly indicated that it will "recalibrate" its instruments and signaled it is prepared to revise QE rules "to the extent necessary to make [our] action proportionate to the risk that we face" at its Dec. 10 meeting. Even with monetary and fiscal stimulus, Eurozone inflation has declined and is currently in negative territory.

Japan's recent economic recovery has been more modest than Europe's, in part because its decline in the first phase of the virus was smaller. The country is also easing restrictions following a reduction in virus infections. Recent news in Japan has been dominated by the election of the new prime minister, former Chief Cabinet Secretary Yoshihide Suga. Prime Minister Suga is expected to continue current policies with a strong commitment to an economic reform agenda focused on improving productivity and industrial production. Inflation has trended below expectations despite easing monetary policies and strengthened fiscal stimulus.

The international developed markets have performed in line recently as the dollar depreciated and traditional value stocks caught more bids. Valuations are relatively attractive and give International Developed equities potential for competitive returns in the intermediate term. The MSCI EAFE index is mostly weighted to European, Japanese and UK equities. While we believe these markets have potential for attractive future returns, we await an economic catalyst. Therefore, we have focused our attention on other asset classes that we believe possess better near-term economic and virus fundamentals and keep a neutral rating on the International Developed asset class. Put differently, we have focused our current attention and international overweight toward Emerging Markets.

Emerging Markets

In our last Asset Allocation Focus, we discussed Emerging Market stocks' strong historical negative correlation to the U.S. dollar. A weaker dollar is generally helpful to developing countries, as it makes it easier to service dollar-denominated debt. In November, the dollar (as compared against a broad basket of currencies) hit lows that we haven't seen since mid-2018, when the trade war began (see our opening discussion). Against emerging-market currencies, the month of November was the worst month for the dollar in about two years. We believe dollar weakness will continue into 2021, providing a positive tailwind for Emerging Market equities.

Notably, the Chinese Yuan maintained its strength against the dollar, as the Chinese economy has now recovered to pre-COVID-19 levels. Strength in the world's second-largest economy is important to the Emerging Market asset class as a whole. Recent factory data shows continued strong expansion, with profit growth at industrial firms in October the fastest since early 2017. While we have seen U.S. equities outperform over the last decade, remember that 2017 bucked that trend and was a year of outperformance for Emerging Market equities (again, reiterating our thesis of a broadening recovery). The backdrop now (currency strength, economic expansion, attractive valuations) reminds us of 2017 and continues to support our positive view.

We are constructive on Emerging Markets on a relative basis versus much of the developed world for several additional reasons. Importantly, in the intermediate-term economic growth in the developing world is anticipated to grow at least at double the pace of the developed world, and demographics are generally more favorable in emerging markets relative to developed markets. In the nearer term, while we believe the incoming Biden administration will continue to take a tough tact toward China, we do not believe the weapon of choice will be tariffs.

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Easy monetary policy is likely to continue in the U.S., which affords central banks in developing nations the ability to remain easy and stimulative. Not only has China's central bank been easing, but most central banks in developing countries have moved from tightening to easing over the past year. The Chinese were successful in containing the virus and appear to be the only major economy to have full-year 2020 economic growth. As we look to 2021, we don't believe the People's Bank of China is in any rush to tighten policy. Inflation is muted, and the stimulus of 2020 will continue to trickle into the economy. When we sum up all these factors and add in Emerging Market equities' attractive relative valuations, we continue to recommend an overweight toward the asset class as we move into 2021.

Fixed Income

For much of the past few years, we've stated our belief that the Federal Reserve was shifting from the Paul Volcker-led Fed, which fought inflation and moral hazard each step of the way, to the Janet Yellen/Jerome Powell Fed, which attempts to enhance inflation and let the economy and markets run hot. This forecast has become reality over the past few months and is now written into the Fed's operating model. That means even if inflation ticks higher, the Fed has no intention of even gradually raising interest rates. If interest rates don't behave and actually push higher, the Fed may be compelled to cap their advance and allow the economy to run at a faster pace for much longer.

The interesting addition to this story is the incoming Biden administration and new Treasury Secretary Janet Yellen. To say the former Fed Chair is qualified for the job is an understatement, but the possibility for greater monetary and fiscal policy coordination is notable. While this coordination may reap near- term benefits, it could create inflation pressures at some point in the intermediate to longer term.

We believe it is likely that bond yields remain low in the nearer term, even if the economy and inflation pick up. While this backdrop lessens the risk of a bond market decline, we believe current low yields place a governor on future "real" bond market returns. Even with subdued inflation, Treasury yields across the curve remain below inflation — in other words, real interest rates remain negative. Given this backdrop, we continue to believe there are more attractive intermediate, real-return opportunities in equity markets.

We also strongly note our preference to help guard against the risk of rising future inflation with an allocation to Treasury Inflation Protection Securities (TIPS) based on our view that inflation is an underpriced eventuality.

We again remind — with heavy emphasis added — that the above commentary does not imply that bonds are no longer important in portfolio construction. Given our desire to tilt our portfolios toward equity-risk exposure, we maintain our conservative stance toward our fixed-income holdings. We continue to recommend high-quality, moderate-duration fixed income as a ballast in a diversified portfolio during a period of still elevated volatility. We also strongly note our preference to help guard against the risk of rising future inflation with an allocation to Treasury Inflation Protection Securities (TIPS) based on our view that inflation is an underpriced eventuality.

Duration

Duration is something we encourage most of the time, and you may wonder why. Predicting the direction of interest rates over shorter time frames (say two to five years) can prove challenging for fixed-income managers. While we may be right from time to time, the math almost always favors having some minor excess duration relative to the benchmark we are tracking. Put the opposite way, it costs too much to be short duration. Using the Treasury curve from today, if we buy a 3-year Treasury at 22 basis points and a 7-year treasury at 69 basis points and nothing happens over the next year (rates don't move), the 3-year underperforms the 7-year by 120 basis points. That's why we maintain modest, high-quality duration.

Government Securities

Some people are changing their thinking about fixed income in 2020. Modern monetary theory (MMT) has picked up traction, and many policymakers seem to favor massive fiscal spending, even as monetary policy is nearing traditional limits. Does that mean government bonds are effectively worthless? No, it just means we may be dealing with negative real rates for a long time; and the silent thief of all investments, inflation, may eat into suppressed fixed-income returns (along with all asset classes). That's why we strongly favor TIPS, callable agencies, agency CMOs and taxable municipal bonds for clients who can use them.

Credit

As we approach the end of the year, credit spreads are near or approaching the lows of the year, while rates are starting to perk up. Credit can be a conundrum, as improving economic conditions can help credit but also cause rates to rise, which can ultimately hurt individual companies by increasing their financing rates at some tipping point (see 2018). Until then credit is fine, but after that point it gets messy. We are most likely quite a way from that point, but we need to know what we own.

TIPS

TIPS are the trade. We like TIPS and breakevens here. Even with breakevens well off the lows of the year, we believe some inflation is on the horizon, and the way to benefit from that is TIPS because nominals or coupon-bearing Treasurys may be suppressed for a while. We own TIPS and still buy them with new money (according to our allocation) and will likely continue doing so until the Fed starts talking more.

Municipal Bonds

Traditionally, municipals would love a Democratic presidency. And while they are doing just fine, they are starting from a spot of being, at best, reasonably priced. They are rate and term structure sensitive, like anything else. While there will certainly be questions about municipal credit pressure, as there have been all year — and we can see some places having some issues — we believe they will be limited to "special situations," as even in some of the most high-profile municipalities, ad valorem tax revenue has increased this year.

Real Assets

Throughout this document we have described the headwinds and tailwinds that COVID-19 has presented the U.S. economy. While those headwinds are shrinking, we believe REITs remain the most COVID-19 impacted. Put directly, REITs have the most structural issues to sort out in the intermediate to longer term from COVID-19. However, one could argue that this is reflected in their current price, and while we maintain our max underweight the asset class, we are beginning to warm to its income-producing potential.

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We continue to hold a neutral allocation in Commodities, primarily due to their diversification benefits and correlation to unexpected inflation. Building portfolios is about hedging risks: While risks are diminishing from early this year, they are certainly still high and may be evolving to more commodity-favorable inflationary risks. While recent history has not been kind to Commodities, perhaps the future will be. We are not throwing in the towel on an asset class that may provide future diversification benefits as policymakers around the globe pull out all the stimulus levers to help their respective economies climb out of their COVID-19 economic valleys.

Within Commodities we recommend investors "tilt" some of their broad exposure toward gold. If broad commodities are a call on future economic growth and inflation, gold can hedge against too little or even too much growth. Given this straddle and our desire to further diversify our portfolio, we continue to recommend targeted gold exposure within our commodity allocation. We'd also point out that if inflation does rise and the Fed tries to suppress its impact on interest rates, gold will likely provide portfolios with a pressure relief valve given its propensity to be positively impacted with negative real interest rates.

> We believe monetary and fiscal policy levers are going to be aggressively employed to stem any economic or equity market downturn in the future.

For those still not inclined to own Commodities or gold due to their recent performance, we offer the following commentary. We believe monetary and fiscal policy levers are going to be aggressively employed to stem any economic or equity market downturn in the future. Long-term readers will know this has been a substantial basis for our equity overweight of the past few years. As we have said (repeatedly), this doesn't mean there won't be shocks and downturns but rather that any such events will likely be shorter because policymakers — especially the Fed — need markets to move higher to guide the economy and inflation higher. One needs to look no further than the recent COVID-19 economic and market displacement.

Overall, this aggressive and quick use of monetary and fiscal policy as an economic and market backstop remains our central forecast. And why not? Currently there is no apparent "cost" on the other side to contemplate. Indeed, this remains our central forecast until there is a cost to contemplate in the form of an inflation surprise, a rising interest rate market that doesn't cooperate or a dollar collapse. We believe this means Commodities and gold play an important role in guarding against these unexpected events, which could derail both the stock and bond markets. Given this backdrop we continue to recommend that investors "spend" a small portion of their portfolio hedging against what could be a future market disruption.

Real Estate

We've written for some time that the price of real estate is directly influenced by macroeconomic factors such as household formation, job growth, wage gains and real interest rates. The events stemming from the outbreak of COVID-19 and the worldwide response have negatively affected all these factors and will undoubtedly put pressure on many areas of the REIT markets for some time into the future.

The low interest rate environment of the past few years drove income-seeking investors to REITs with their relatively attractive yields compared to traditional fixed-income securities. After the market began pricing in the likely impact of the economic slowdown in the later part of Q1, long-term bond yields retreated, which would normally make REITs look more attractive as income-producing assets. However, with mounting job losses nationwide and an uncertain economic backdrop, we believe the current valuation of REITs leaves them vulnerable to any stabilization or push higher in yields, especially REITs exposed to corporate, retail and entertainment sectors post-COVID-19. We have been saying it for a while, but we believe there are still better parts of the equity market from a relative performance perspective in the coming months. In fact, structural changes in how Americans work, shop, seek entertainment and go about their daily lives may have serious implications for many areas of the REIT market, especially commercial, retail and hospitality.

To reflect our negative view on this asset class, we moved to a maximum underweight position, as the confluence of both fundamental and macroeconomic factors warrant extra caution. We will closely watch for signs of improvement in real estate markets and evaluate potential attractive valuation levels to reestablish a more constructive stance.

Commodities

The Bloomberg Commodity Index posted strong gains through the fall, continuing its advance after sharp COVID-19-induced declines earlier in the year. The rebound is notable given that the pandemic temporarily impaired the outlook on both the supply and demand side of commodity markets. Governments, along with their central banks, pledged to support economic growth through various monetary and fiscal policies. As a result, financial markets stabilized, and global growth has since resumed, increasing the prices of economically sensitive assets like Commodities. The stimulus measures also played a part in a weaker U.S. dollar, which further supported commodity prices.

The three primary components of the Bloomberg Commodity Index are energy, metals (both industrial and precious) and agriculture. The benchmark is composed of around one-third from each sector, which means it is broadly diversified across the commodity spectrum and ensures that no single commodity has an outsized impact on overall risk and return. The individual components of the commodity benchmark all have unique characteristics and prices that are determined by different supply and demand drivers within individual markets. However, inflation, economic growth and the direction of the U.S. dollar are the largest drivers for overall commodity prices.

The pandemic's effects were dramatic, particularly for energy. Oil prices showed weakness in January, and prices reached historic lows in April, with the benchmark West Texas Intermediate crude price briefly turning negative. Oil prices rebounded sharply over the summer and were relatively stable through the fall. Although OPEC softened production cuts in July, the cartel has signaled its commitment to help maintain the crude oil supply/demand balance at least through the end of 2020.

Agricultural goods were the big driver of recent returns, with wheat, soybeans and hogs posting big gains. Industrial metals like zinc, copper, aluminum and nickel also posted strong gains. A primary factor impacting commodity prices has been U.S.–China relations, which remain tense. This has caused concern about commodity trade between the two countries. However, China continued to import more U.S. crops, helping it fulfill its obligations set forth in the partial trade agreement signed in January 2020. An African swine fever outbreak in Germany also improved demand prospects for U.S. pork products.

Gold prices have been a bright spot in 2020, but gains paused in August and the precious metal has pulled back somewhat since. Gold and silver rose as a weaker U.S. dollar increased the attractiveness of these metals as alternative stores of wealth. Gold serves as a haven for investors looking to avoid volatility in risk assets, particularly in an environment with real interest rates near zero or negative.

> As we look forward, our forecast is for both global growth and inflation to strengthen in the intermediate term. This would be a plus for commodity prices.

We acknowledge that market forces have resulted in historic levels of commodity price volatility, and the asset class has yet to fully recover losses from earlier in the year. As we look forward, our forecast is for both global growth and inflation to strengthen in the intermediate term. This would be a plus for commodity prices.

It is also important to remember that Commodities are very sensitive to unexpected inflation. Over the past 30 years, Commodities have exhibited the highest positive correlation to inflation of all the major asset classes. In today's environment where the market expects continued low inflation, we think it is important to have some exposure to Commodities within a portfolio. In an era of seemingly unlimited central bank accommodation, Commodities are the one asset class that can respond well if inflation unexpectedly returns.

The bottom line

Focus on the "big picture"

To this point, we have yet to touch upon the harrowing and emotional ride that investors were put through in 2020. As always, the ways people dealt with the turbulence determined their outcome in 2020. We've always held a belief that investment managers and investment strategy committees are defined by how they behave when times get tough. To say the least, the surprise arrival of COVID-19 in early 2020 was a strong punch to the gut that tested our committee's mettle. It was something different than any of us had experienced in our extensive collective years of managing money.

While our outlook shifted, and we needed to adapt to the new realities of COIVD-19, our investment philosophy and process remained steady. Put bluntly, we did not react emotionally or fall prey to believe "this time was different," nor did we shift our time horizon. Instead, we calmly factored COVID-19 into our decision-making process, and that approach has added value.

At a minimum, we hope our actions and commentary have provided context and guidance for you through this difficult time. Our "tilts and tweaks" are important and have been an additive to performance, but let's not lose sight of the biggest determinant of financial success: Did you stick to the plan during this difficult time, or did you abandon ship and miss the explosive recovery that has occurred over the past few quarters?

Through the pandemic, our communications articulated a clear belief that emotional time periods like the one we are still navigating are times when financial futures are earned and kept. Anyone can stick to the plan and own stocks when times are good, but that mettle is tested during periods of distress. These are the times when emotions can drive many to hit the sell button. We once again advise you to think about your willingness to stick to the plan when markets fall again. Will you be able to stay the course? If you are questioning that resolve, it's time to have an honest discussion with your advisor now, when markets are in a good place, rather than waiting until a market plunge precipitates a conversation.

> We once again advise you to think about your willingness to stick to the plan when markets fall again. Will you be able to stay the course?

Let us offer one more tangent to this tale: Please don't assume that because one asset class has dominated returns for years that it will continue into the future. Diversification remains a core tenet of our approach. Our research shows that a recession has historically been an impetus for changing leadership from the past cycle. This time period reminds us a lot of 1999, when the world similarly believed that one asset class – Large-Cap growth — was set to continue leading. Those who were in markets back then know it did not pan out as expected.

We'll close by wishing you happy holidays and a prosperous, healthy 2021.

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Please remember that all investments carry some level of risk, including the potential loss of principal invested. Indexes and/or benchmarks are unmanaged and cannot be invested in directly. Returns represent past performance, are not a guarantee of future performance and are not indicative of any specific investment. Diversification and strategic asset allocation do not assure profit or protect against loss. With fixed income securities and bonds, when interest rates rise, bond prices usually fall because an investor may earn a higher yield with another bond. Moreover, the longer the maturity of a bond the greater the risk. When interest rates are at low levels, there is a risk that a significant rise in interest rates can occur in a short period of time and cause losses to the market value of any bonds that you own. At maturity, the issuer of the bond is obligated to return the principal (original investment) to the investor. High-yield bonds present greater credit risk than bonds of higher quality. Bond investors should carefully consider risks such as interest rate risk, credit risk, liquidity risk, securities lending risk, repurchase and reverse repurchase transaction risk.

All index references and performance calculations are based on information provided through Bloomberg. Bloomberg is a provider of real-time and archived financial and market data, pricing, trading, analytics and news.

Although stocks have historically outperformed bonds, they also have historically been more volatile. Investors should carefully consider their ability to invest during volatile periods in the market.

Investors should be aware of the risks of investments in foreign securities, particularly investments in securities of companies in developing nations. These include the risks of currency fluctuation, of political and economic instability and of less well-developed government supervision and regulation of business and industry practices, as well as differences in accounting standards.

Specific sector investing such as real estate can be subject to different and greater risks than more diversified investments. Declines in the value of real estate, economic conditions, property taxes, tax laws and interest rates all present potential risks to real estate investments.

Commodity prices fluctuate more than other asset prices with the potential for large losses and may be affected by market events, weather, regulatory or political developments, worldwide competition and economic conditions. Investment can be made directly in physical assets or commodity-linked derivative instruments, such as commodity swap agreements or futures contracts.

Standard & Poor’s 500 Index (S&P 500) is a capitalization-weighted index of 500 stocks. The index is designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Treasury Inflation-Protected Securities (TIPS) are securities indexed to inflation in order to protect investors from the negative effects of inflation.

The Consumer Price Index (CPI) examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care.

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