# Madison Commentary Report - December 31, 2020

If in the depths of the Covid-19 market sell-off in March we had been told that 2020 would end with record market highs there would have been only one logical conclusion: by some miracle, the Covid-19 pandemic had been averted. Yet here we are at the end of the year seeing both U.S. stock market and infection highs. We've remarked on this seeming paradoxical coupling for a couple of quarters. Now, with a little more time and perspective, the reasons behind it are becoming clearer. And with that clarity comes some potential insights for the kind of investment environment likely in 2021.

But first a review of the fourth quarter and the year past. The stock market continued on the upward trajectory which began in April, with the S&P 500® Index rising 3.8% in December, for a quarterly return of 12.1%, bringing the return for the calendar year to a robust 18.4%. Digging a little deeper behind these benign numbers reveals some of the turmoil that was 2020. The Technology Sector soared 43.9% for the year, while Energy was the laggard, dipping -33.4. Powering much of the fourth quarter rally was the prospect of further fiscal stimulus from Washington along with unexpectedly welcome news regarding the speed of vaccine development and its efficacy.


Interest rates had dropped precipitously in March as investors fled to safety and as the Federal Reserve (Fed) stepped in by dropping its target rate close to zero. In the end this produced a solid year for bond investors. While the fourth quarter return for the U.S. Aggregate Bond Index was a modest 0.75%, the annual return was 7.36%, far higher than would have been expected given the relative low yields at the beginning of the year. Yields on the 10-year Treasury finished 2020 at 0.9%, a level below anything seen prior to this year.

An early analysis of 2020 income and spending patterns sheds quite a bit of light on the stock market resilience. While lost jobs have been potentially devastating to those affected, the stimulus checks, expanded unemployment benefits and job retention engineered by PPP grants have made a huge difference. Keep in mind that most of the lost jobs have been on the lower-wage spectrum with initial estimates showing a Covid-19 loss of some $43 billion in payroll in 2020, a significant amount, yet one that is dwarfed by the $276 billion in stimulus checks and $499 billion in CARES Act unemployment benefits. The end result of the stimulus has added up to close to a $1 trillion increase in disposable personal income. On top of this massive stimulus, consider the shifts in discretionary spending as travel and leisure activities have been stymied. Together with the fiscal stimulus this has pushed monthly U.S. savings rates up to an unprecedented high of 30+%. In the absence of attractive alternatives, money has flowed into stocks.

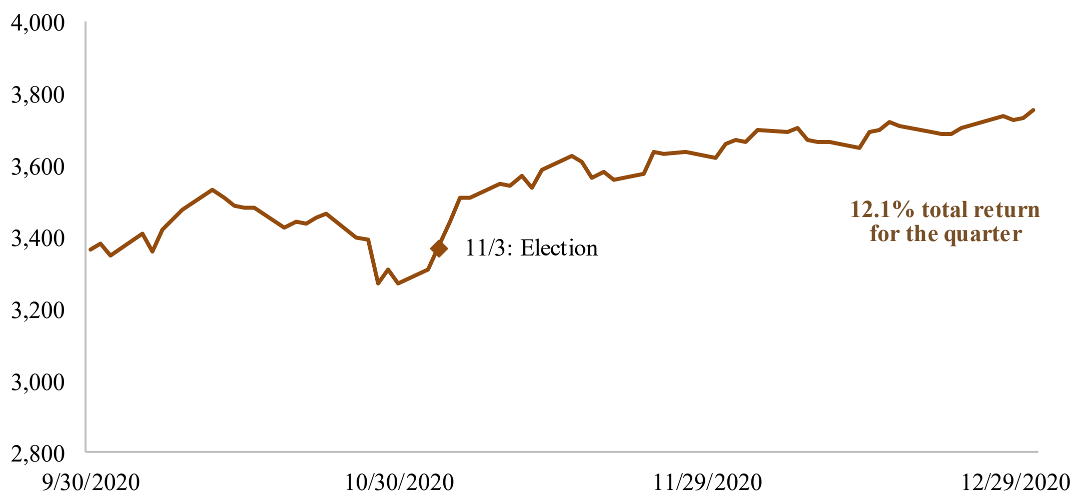
Given this unusual scenario, what should investors be prepared for in 2021? We trust the Fed's commitment to keep rates low for 2021 and well beyond. Easy money will incent corporations to be active in capital spending and in pursuing mergers and acquisitions as well as maintaining the currently robust housing market. The latest round of $900 billion in fiscal stimulus should keep the economy bounding and push more money into investable assets. However, with valuations already stretched, risk of a stumble also rises.

As the new administration takes control we have the prospect of higher taxes, increased regulation and additional spending. The economic fundamentals including rising Federal debt suggest future inflationary pressure. It's been a long time since the U.S. economy has had to deal with significant inflation and with the Fed bound to low rates inflation could be a longer-term issue even if high unemployment dampens the prospect for 2021. Still, inflation deserves close attention and we will be watching out for a weaker dollar, while keeping an eye of the expanding money supply, employment, wage expansion and overall GDP growth.

While initial vaccination deployment has been slower than hoped, the market is clearly focused on a post-Covid-19 economy in 2021. Even as we are fervent cheerleaders for this possibility, we are also aware that a market priced for perfection may not have the patience required should the vaccination effort take more time than expected or produce less than anticipated impact on the economy. This matches our general concerns over valuations. It had been our experience that overheated markets often overlook companies with the strongest fundamentals. In line with our belief that this low-yield environment is no time to add risk to bond portfolios, we are constantly monitoring stock holdings for downside risk, knowing that while bull markets can rise beyond expectations, they can reset in a heartbeat, often with the highest fliers taking the biggest dives.

# EQUITY MARKETS CONTINUED TO RISE IN THE FOURTH QUARTER

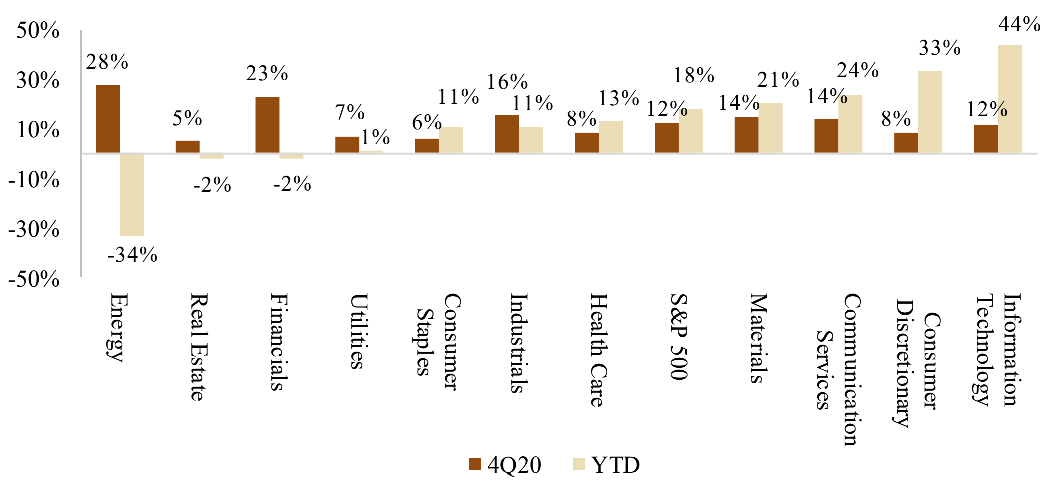
S&P 500® - Fourth Quarter 2020




## Quarter Highlights

- Equity markets continued to move higher in the fourth quarter with the S&P 500 posting a total return of 12.1%. For 2020, the S&P 500 finished up 18.4%.
- The election outcome, emergency use authorization of two Covid-19 vaccines and the likely passage of a second Covid-19 relief package supported the markets.
- The Federal Reserve reiterated its accommodative monetary policies with ongoing purchases of Treasury and agency bonds and commented that it will not raise rates until 2023.
- The economy rebounded in the third and fourth quarters. GDP growth in the third quarter increased 33.4% and fourth quarter GDP growth is expected to increase 4.6%.
- Unemployment has recovered with the unemployment rate now at 6.7% at the end of November.

S&P 500® Sectors - Fourth Quarter & YTD Performance



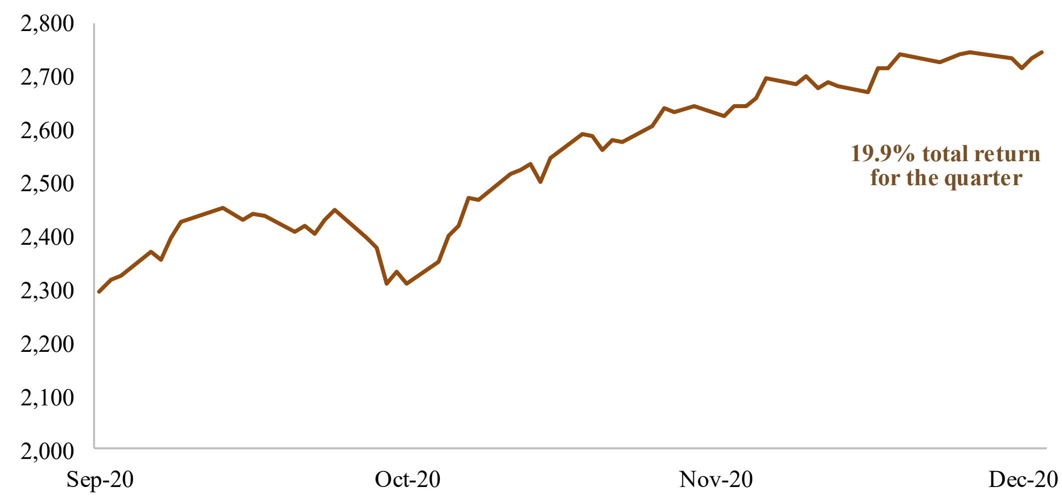

## Sector Snapshot

- All sectors saw positive returns in the fourth quarter. The positive vaccine data and ultimate approval of both the Pfizer/ BioNTech and Moderna vaccines gave the market support for an economic recovery in 2021 and beyond driving a cyclical rally.
- Cyclicals led the market with Energy up 28%, Financials up 23% and Industrials up 16%. Defensive sectors were also up but underperformed the broader market with Real Estate up 4.9%, Consumer Staples up 6.4%, and Utilities up 6.6%.
- For the full year, the Technology (44%) and Consumer Discretionary (33%) sectors continued to lead the market but Communications Services (23.6%), Materials (20.7%), Healthcare (13.4%), Industrials (11.8%) and Consumer Staples (10.7%) also posted double digit returns for the full year.

Source: FactSet

# U.S. EQUITY MARKETS SOARED AGAIN IN THE FOURTH QUARTER

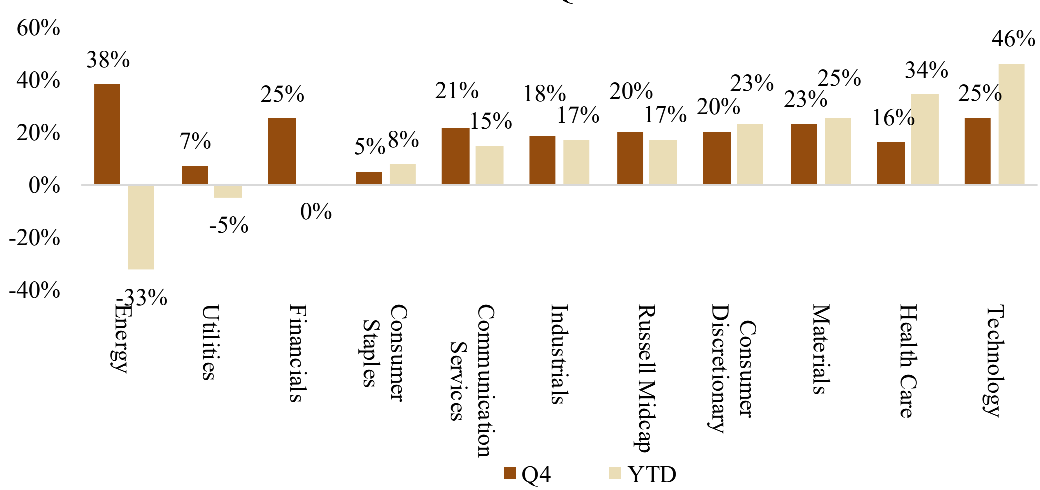
Russell Mid Cap - Fourth Quarter 2020




Quarter Highlights

- Equity markets continued to move higher in the fourth quarter with the Russell Midcap posting a total return of 19.9%. For 2020, the Russell Midcap finished up 17.1%.
- The election outcome, emergency use authorization of two Covid-19 vaccines and the likely passage of a second Covid-19 relief package supported the markets.
- The Federal Reserve reiterated its accommodative monetary policies with ongoing purchases of Treasury and agency bonds and commented that it will not raise rates until 2023.
- The economy rebounded in the third and fourth quarters. GDP growth in the third quarter increased 33.4% and fourth quarter GDP growth is expected to increase 4.6%.

Russell Mid Sectors - Fourth Quarter and YTD Performance



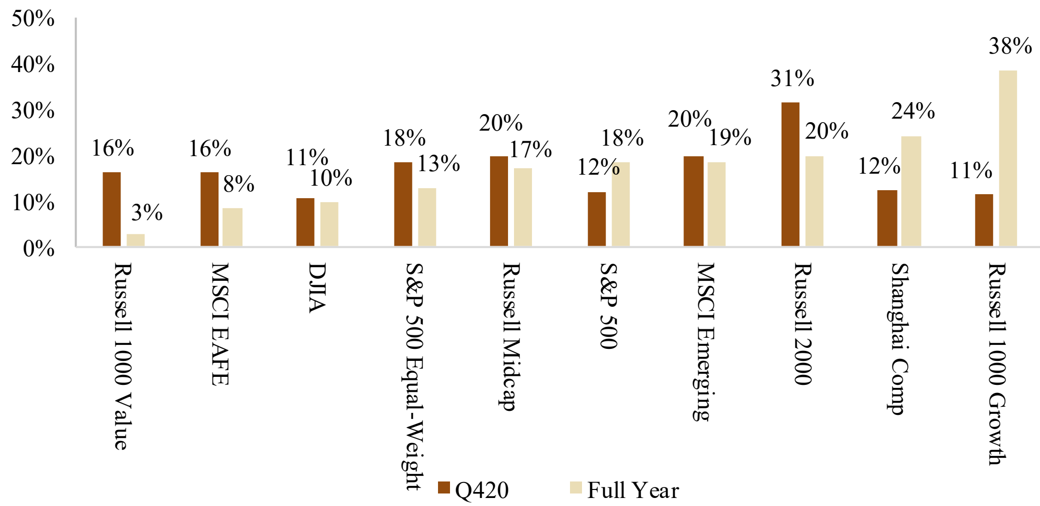

Source: FactSet

Sector Snapshot

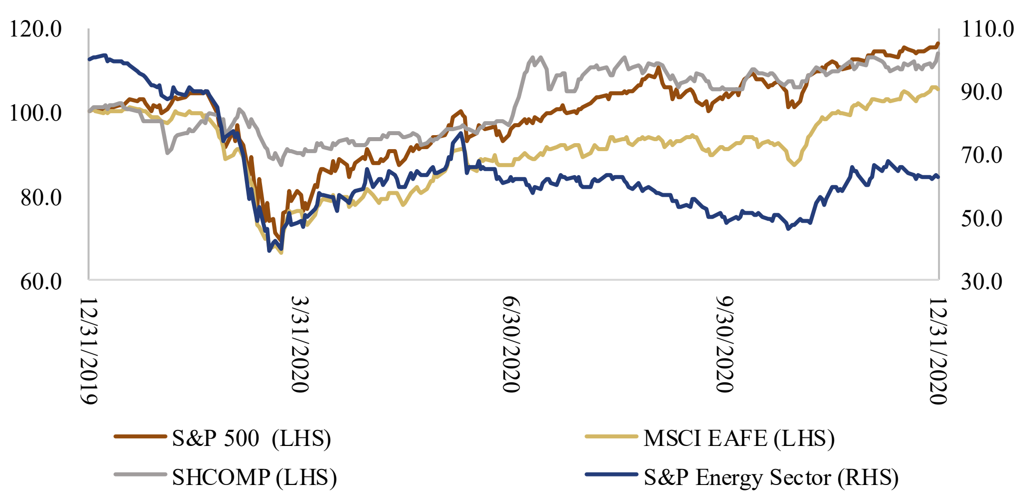
- All sectors saw positive returns in the fourth quarter. The positive vaccine data and ultimate approval of both the Pfizer/BioNTech and Moderna vaccines gave the market support for an economic recovery in 2021 and beyond, driving a cyclical rally.
- Cyclicals led the market with Energy up 41%, Financials up 27% and Materials up 26%. Defensive sectors were also up but underperformed the broader market with Consumer Staples and Utilities up 6%.
- For the full year, the Technology (48%) and Healthcare (37%) sectors lead Midcap stocks but Materials (27%), Consumer Discretionary (19%), and Industrials (17) also posted double digit returns for the full year.

# WHAT A YEAR! STRONG EQUITY MARKETS ALMOST EVERYWHERE

Various Equity Market Returns: Size, Geography and Style




2020 Was a Volatile Year: Global Relative Returns

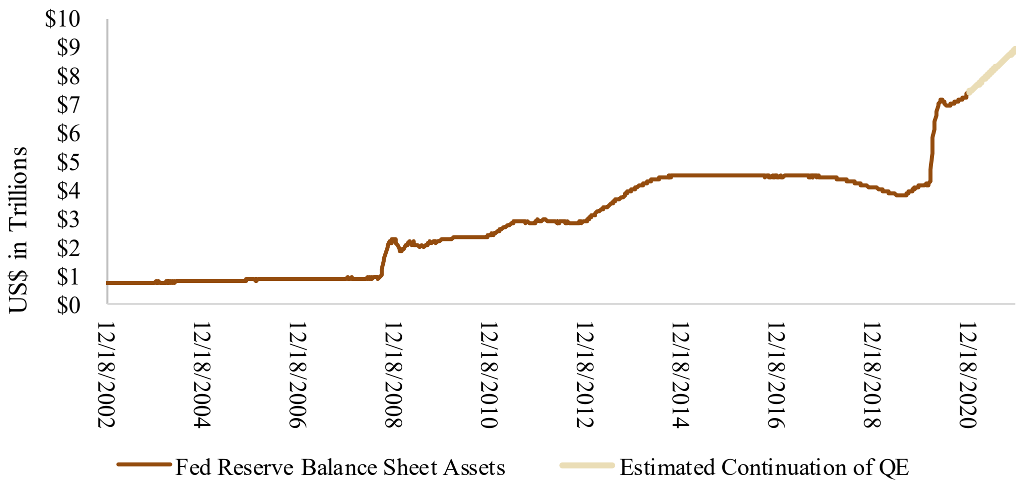



Sources: Factset, Bloomberg

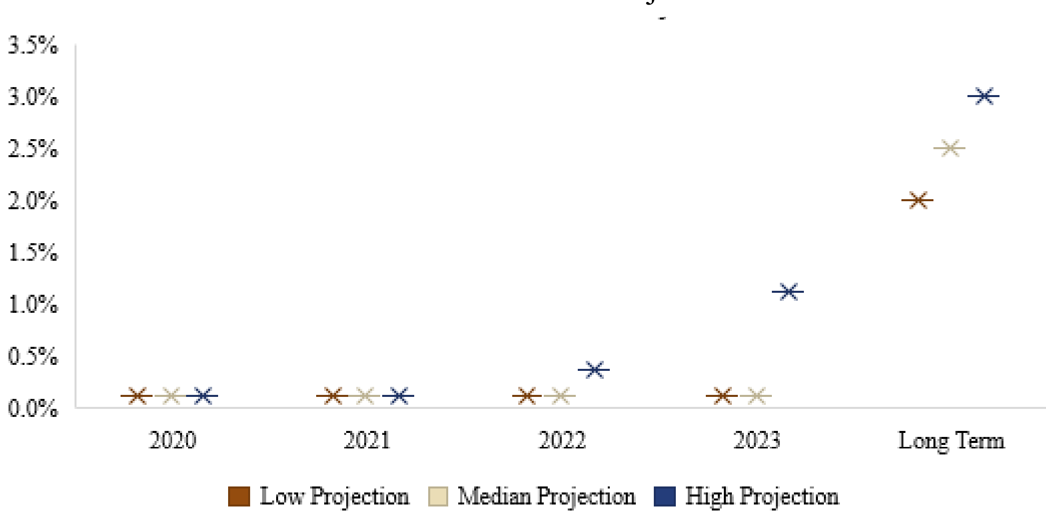
- Equity markets continued to move higher in the fourth quarter as confidence in an economic recovery took hold with positive vaccine data and subsequent emergency use authorizations. Additionally, the outcome of an uncontested election spurred markets higher.
- **(Top)** The fourth quarter provided a strong finish to the year with strength across the board. Small capitalization stocks (+31%) led during the fourth quarter after lagging all year as the economy started re-opening more broadly. Midcap and Value stocks also had a strong quarter after weak performance earlier in the year. For the full year, most regions, capitalizations and styles did well with Value stocks standing out as the weakest performer. Growth stocks, driven by Technology and Consumer Discretionary stocks led the markets in 2020. We also saw double digit returns in Chinese stocks, small and midcap stocks as well as Emerging markets for the full year.
- **(Bottom)** As the Covid-19 Crisis led to shutdowns and economic paralysis, equity markets sold off abruptly in the early part of the year in both the U.S. and across the developed world. As central banks stepped in with liquidity measures and governments opened their coffers to support those most impacted by the pandemic, equity markets started recovering. The markets started discounting an eventual re-opening with hopes for vaccine approvals with ongoing monetary and fiscal support along the way.
- The Energy sector was most impacted by the pandemic due to the steep decline in global travel and work-from-home mandates as the demand for oil came to a near stop. Oil prices declined from $61 per barrel at the beginning of the year to less than $10. As a result, energy related companies have been the slowest to recover coming out of the pandemic.
- The Shanghai Composite was less volatile in 2020 but its peak Covid-19 crisis was earlier than the developed world and China dealt with containment of the pandemic quickly and aggressively.

# EASY MONEY CONTINUES

Federal Reserve Balance Sheet with Continuation of QE



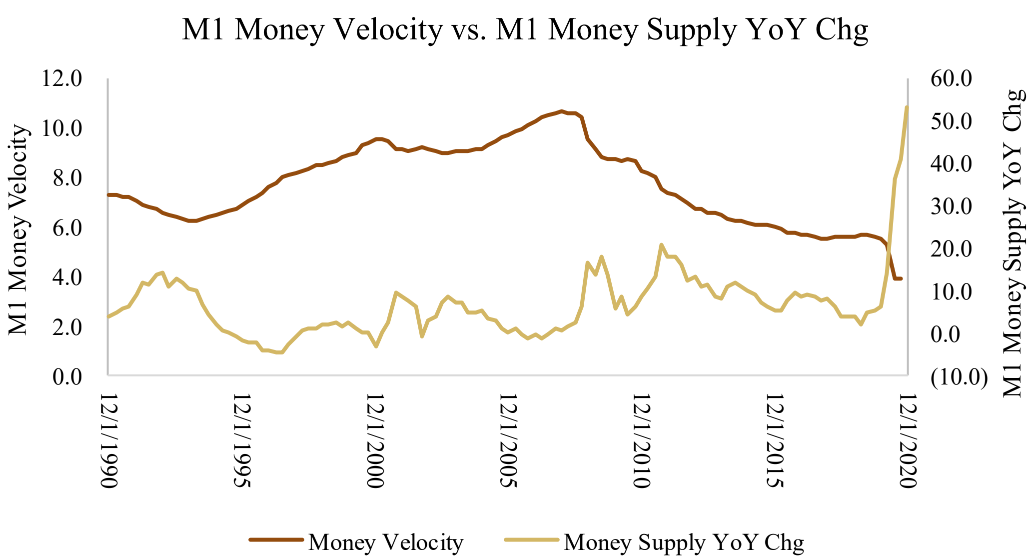

FOMC Fed Funds Rate Projections

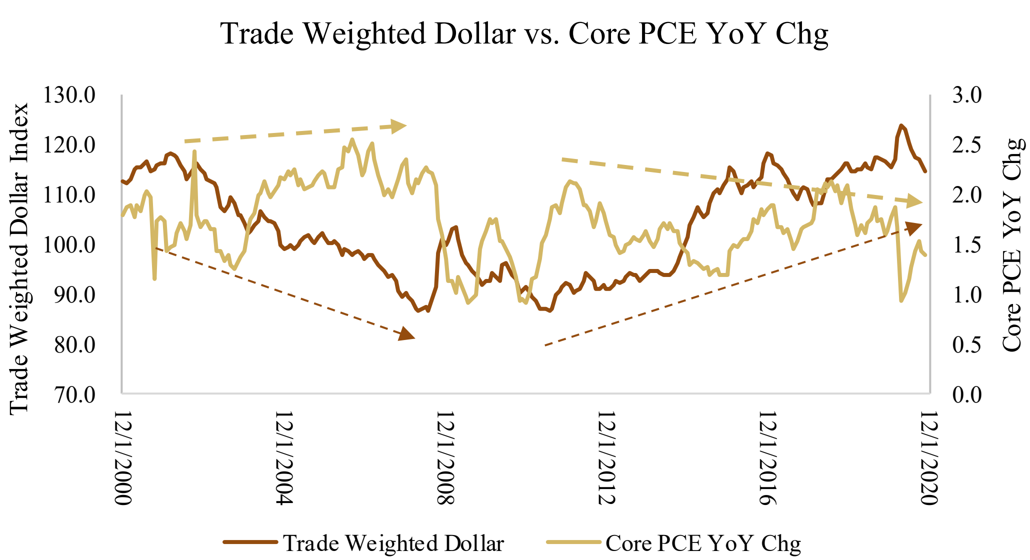



Source: Factset, Bloomberg

- Monetary policy remained accommodative through the end of the year to provide liquidity to the credit markets as the economic recovery remains uneven with still high unemployment and sectors of the economy yet to re-open. During its last meeting of the year, the Fed stated that it would remain accommodative by continuing its bond purchase programs well into 2021.
- **(Top)** Before the end of 2019, the Fed was in the process of reducing its balance sheet and was raising rates. In order to prevent a credit crisis as economies were being shut down to deal with the coronavirus, the Fed announced new bond buying programs that have increased the Fed's balance sheet by 75% from $4 trillion to more than $7 trillion in assets.
- The Fed has indicated that they intend to continue to provide liquidity through continued implementation of quantitative easing (QE). The tan section of the line on the top chart represents the estimated level of the Fed's balance sheet through next year, with purchases of $120 billion of securities a month.
- **(Bottom)** In addition to the expansion of its balance sheet, one policy that the Federal Reserve emphasized during its meetings in 2020 is that it will not raise rates before 2023 implying that short term interest rates will remain at historic lows as the economy requires more time to heal.
- The Fed may have raised rates too quickly in past recoveries as inflation started increasing towards or slightly above its long term target of 2%. The message from the Fed during this recovery is that it will not raise rates preemptively and will allow inflation to run above 2% for some time. In addition, it is looking for unemployment to return to maximum employment levels (presumably to 3.5% as seen pre-Covid-19) before considering tightening financial conditions with rate increases.

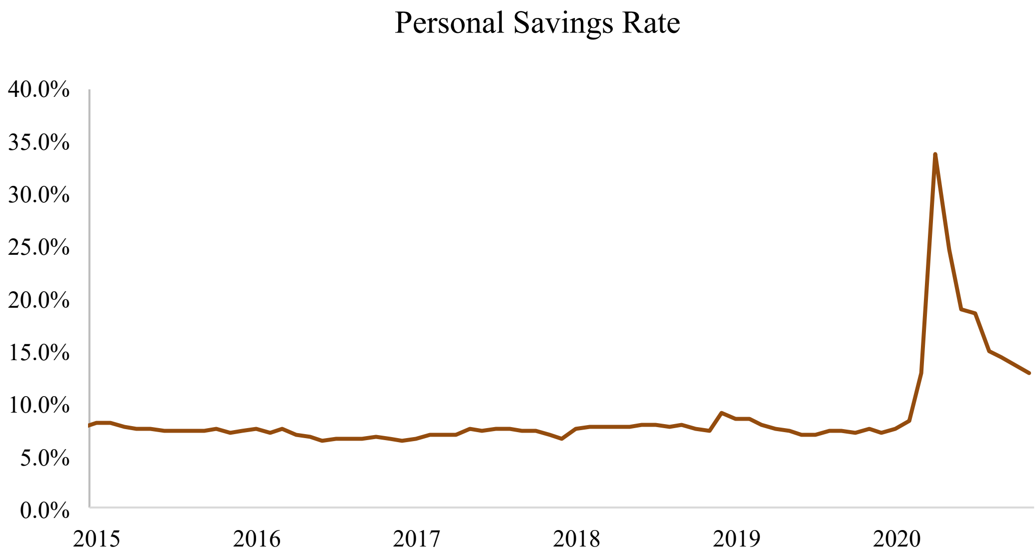
Madison INVESTMENTS

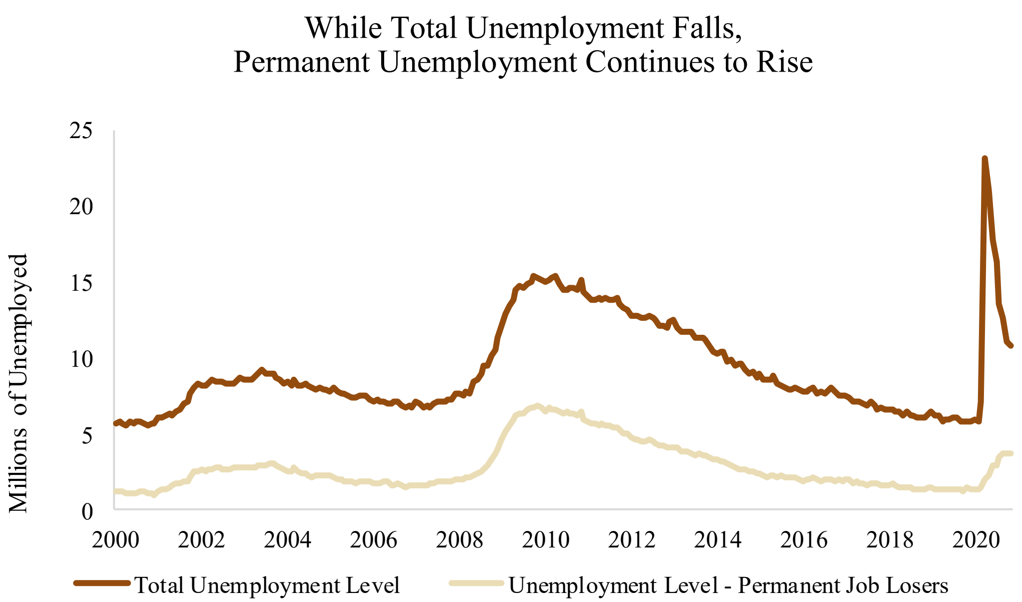



Source: Madison, Bloomberg

- With very low interest rates and abundant liquidity in financial markets, inflation could be in our future. However, for inflation to rise and sustain, there are many conditions that would need to occur. To see sustained inflation, we would need i) sustained growth in both the money supply and GDP growth; ii) the economy would need to be running at much higher utilization; iii) employment would need to be near full employment; and iv) the U.S. Dollar would need to weaken further resulting in higher commodity prices.
- **(Top)** The Federal Reserve responded to the pandemic with a quick and aggressive bond buying program and other lending facilities to ensure that the credit markets would operate smoothly as global economies were being shut down. As a result, the money supply increased by over 50% from early March through the end of the year. The money supply will continue to increase, albeit at a lower rate, as the Fed is committed to purchasing $120 billion in Treasury and agency debt per month for the time being. The growth in the supply of money is a necessary but not sufficient condition to drive inflation higher, as mentioned above. But we believe this growth is unprecedented and heeds close attention. The use of Quantitative Easing as a monetary policy tool since the Financial Crisis and now with the Covid-19 Crisis has reduced the velocity of money, suppressing bond yields globally and has been disinflationary.
- **(Bottom)** In the early part of the 21st century, the Trade Weighted U.S. Dollar declined by 25% which in part drove accelerating inflation. The Trade Weighted U.S. Dollar strengthened as economic growth started improving post the GFC and the Federal Reserve signaled that it would start raising rates. The impact was that core inflation stayed well below 2%. Sustained dollar weakness may push inflation higher but the dollar would need to weaken considerably, perhaps over 20%, to drive inflation back above 2%.
- The Chinese economy and the Yuan will also play a role in the Trade Weighted Dollar. China's economy has stabilized so perhaps we will see less appreciation of the Yuan in 2021 which would bode well for inflation in the U.S..



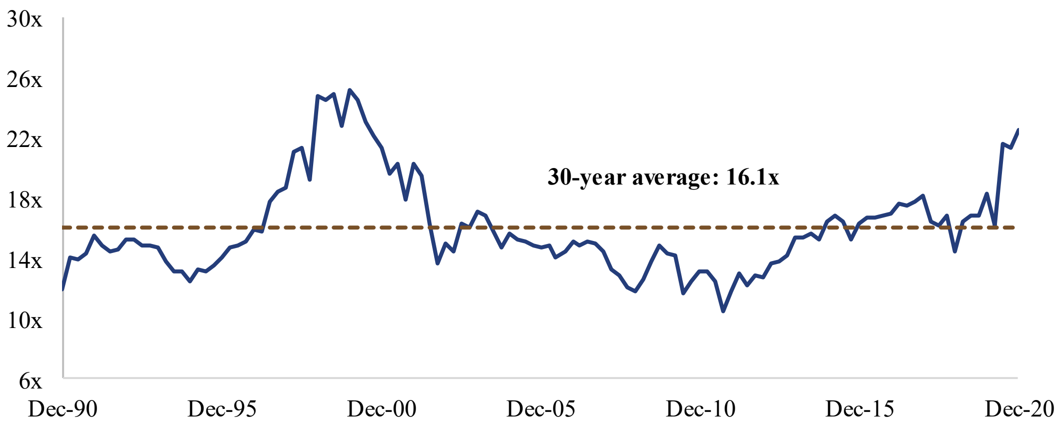

Sources: Factset

- The leisure and hospitality sectors of the U.S. and global economies had partially re-opened only to be closed again as the number of Covid-19 cases surged towards the end of the year. Many white collar workers have kept their jobs and have been able to work from home with no impact to their income levels. We expect unemployment rates will continue to fall as restaurants re-open and consumers and businesses feel more confident that they can travel again but it will take time to return to pre-Covid-19 levels.
- **(Top)** For the first time in history personal income increased while unemployment levels accelerated higher. Increased government transfers combined with less spending by consumers on items such as travel and dining out helped push the savings rate to record levels, putting many consumers in stronger financial positions today than at the start of 2020. Vaccination of the U.S. population should allow for a broader reopening of the economy and pent-up demand from consumers should contribute to a recovery of economic growth in 2021.
- **(Bottom)** As the overall level of unemployment continues to fall, the level of permanent job loses is growing. Illustrated in the bottom chart, previous employment cycles have seen both of these levels move in tandem, but today they are moving towards each other. With unemployment remaining elevated and the level of permanent job loses continuing to rise, the economic recovery will look very different for many consumers, depending upon the industry they work in.

# THE MARKET IS LOOKING TO THE RECOVERY

Madison INVESTMENTS

S&P 500 Index Forward P/E Multiple
(based on next 12 months expected earnings)




S&P 500 Level Implied by Price to Earnings Combinations

| | | | Price/Earnings Multiple | | | | |
|---|---|---|---|---|---|---|---|
| | | | 12x | 14x | 16x | 18x | 20x |
| | $ | 195 | 2,340 | 2,730 | 3,120 | 3,510 | 3,900 |
| | $ | 190 | 2,280 | 2,660 | 3,040 | 3,420 | 3,800 |
| | $ | 180 | 2,160 | 2,520 | 2,880 | 3,240 | 3,600 |
| **S&P 500** | $ | 170 | 2,040 | 2,380 | 2,720 | 3,060 | 3,400 |
| **Earnings** | $ | 160 | 1,920 | 2,240 | 2,560 | 2,880 | 3,200 |
| **per Share** | $ | 150 | 1,800 | 2,100 | 2,400 | 2,700 | 3,000 |
| | $ | 140 | 1,680 | 1,960 | 2,240 | 2,520 | 2,800 |

| **S&P 500 Top Down Estimates** | | |
|---|---|---|
| | Mean | |
| **2019A** | $ | 164.60 |
| **2020E** | $ | 136.97 |
| **2021E** | $ | 167.25 |
| **2022E** | $ | 195.22 |

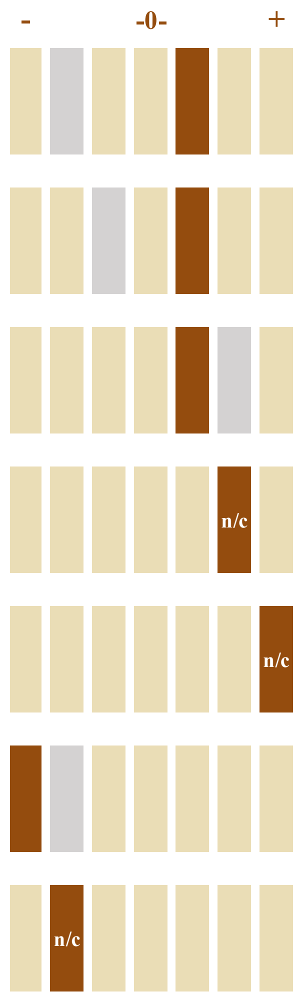
Source: Factset, Bloomberg

- **(Top)** As the economy and earnings recover, we will be looking at more normal levels of earnings yet the market remains expensive compared to the 30-year historical average. Monetary and fiscal support will continue in 2021 along with a rebounding global economy which should continue to support equity markets.
- **(Bottom)** With the economy recovering and vaccines being distributed, we have seen earnings for 2021 and 2022 continue to rise. Expectations are now for earnings of $167 in 2021, up 22% for the year and then, to $195 in 2022, an increase of 17%. With unemployment at 6.7% and another Covid-19 relief package to get Americans through the next few months, we expect consumer spending to continue to increase.
- With low interest rates and modest yields, despite looking expensive, equities are more attractive than bonds. With earnings growth accelerating in 2021 and again, in 2022, equities could continue to move higher. With Democrats leading the Government, spending will increase which could add to the tailwinds in 2021 but we would expect headwinds from taxes and regulatory changes to be more present in 2022.

# MACROECONOMIC SCORECARD: DECEMBER 31, 2020

Supported by unprecedented levels of fiscal stimulus, ongoing global central bank accommodation, quickly recovering corporate profits, and encouraging news on the COVID-19 vaccine front, risk assets continued their steady and impressive ascent since first putting in their pandemic-related panic lows this past March.

## Potential Influence on Stock Market




| | |
|---|---|
| U.S. Economy | Economic visibility has improved dramatically. Most importantly, two newly approved COVID-19 vaccines are being administered throughout the U.S.; herd immunity is now a realistic target by the 3rd quarter of 2021. To bridge the economic gap until the pandemic is brought under control, significant additional fiscal support was also recently approved. |
| Corporate Profits | Earnings expectations for 2021 have rebounded sharply and now exceed those levels previously reached in 2019. This rapid restoration in the corporate profit outlook provides solid support for a still recovering economy. |
| Inflationary Pressures | Despite unprecedented levels of both fiscal and monetary stimulus, inflationary pressures remain surprisingly low. Given the extreme and sustained degree of easing in financial conditions, inflationary risks are likely to build. |
| Interest Rates | Fed messaging remains clear, short-term rates are on hold for years to come; a period of above target (2.0%) inflation will also be tolerated. Conversely, longer-term U.S. interest rates may rise further if U.S. Dollar weakness persists. |
| Liquidity | The Fed remains committed to providing unprecedented liquidity to improve financial conditions; even elevated asset prices, per Fed Chair Powell, won't deter the Fed from holding back its support of financial markets. |
| Sentiment | With massive liquidity support from the Fed, investor sentiment is now historically elevated. Price-insensitive, momentum-based retail trading remains a growing concern, with dubious implications for equity markets. |
| Valuation | Stocks remain richly valued. Ordinarily, valuations would be improving with an earnings recovery underway. However, equities have re-rated significantly higher over the past nine months. Discipline is key for investors. |

- Negative for Stocks
+ Positive for Stocks

■ - Current ■ Prior n/c - No change

## News Influencing Markets

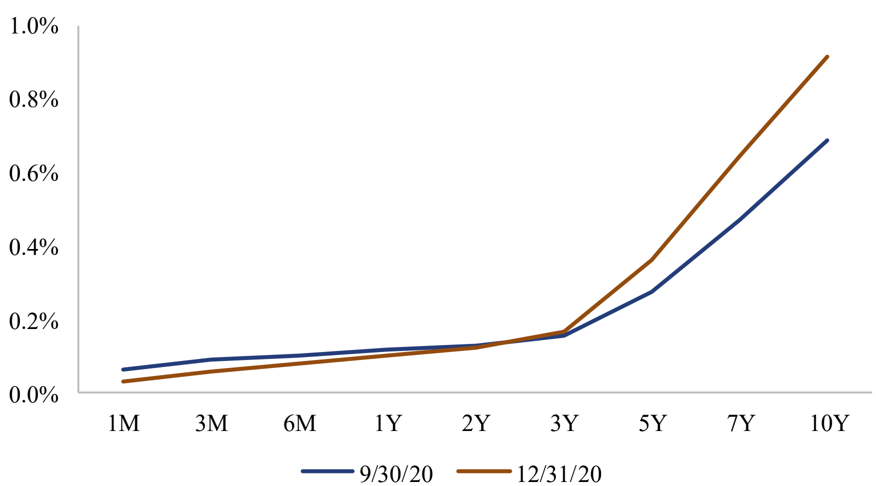
Potentially Positive for Bond Returns

+ Aggressive Federal Reserve policy favoring lower interest rates remains a powerful deterrent against rising interest rates.
+ The effectiveness of vaccine administration, public confidence in those vaccines and virus mutation could lengthen lockdowns, thereby dampening growth and inflation expectations.
+ Uncertainty over potential changes in tax and regulatory policy could shift investor preferences from risk assets to safe-haven Treasuries and pressure rates lower.

Potentially Negative for Bond Returns

– With two approved vaccines being administered economic reopening is likely to take hold with more vigor leading to higher rates.
– Rising inflation expectations and explicit Fed policy supporting higher levels of inflation could also pressure rates higher.
– The declining value of the U.S. dollar as the global economy recovers could reduce (risk-related hedging) foreign demand for Treasuries at a time of expanding federal deficits.

### Treasury Yield Curve Comparison




## Fixed Income Scorecard

Potential Influence on Bond Returns

| | - | | | -0- | | | + |
|---|---|---|---|---|---|---|---|
| **U.S. Macroeconomics** | | | | | | | |
| Economic Growth | | | | n/c | | | |
| Employment | | | | n/c | | | |
| Inflationary Pressures | | | | n/c | | | |
| **U.S. Policy** | | | | | | | |
| Monetary (Fed) | | | | n/c | | | |
| Fiscal (Congress) | | | n/c | | | | |
| Regulatory / Tax | | | Current | Prior | | | |
| **Global** | | | | | | | |
| Foreign Macroeconomics | | | | | n/c | | |
| Geopolitical tensions | | | | n/c | | | |
| Central Bank Policies | | | | | n/c | | |
| **U.S. Corporates** | | | | | | | |
| Credit Fundamentals | | | n/c | | | | |
| Risk Premiums | | | n/c | | | | |
| Liquidity | | | | n/c | | | |
| **U.S. Treasury Market** | | | | | | | |
| Interest Rates | | | n/c | | | | |
| Sentiment | | | | n/c | | | |

- Negative for Bonds
+ Positive for Bonds

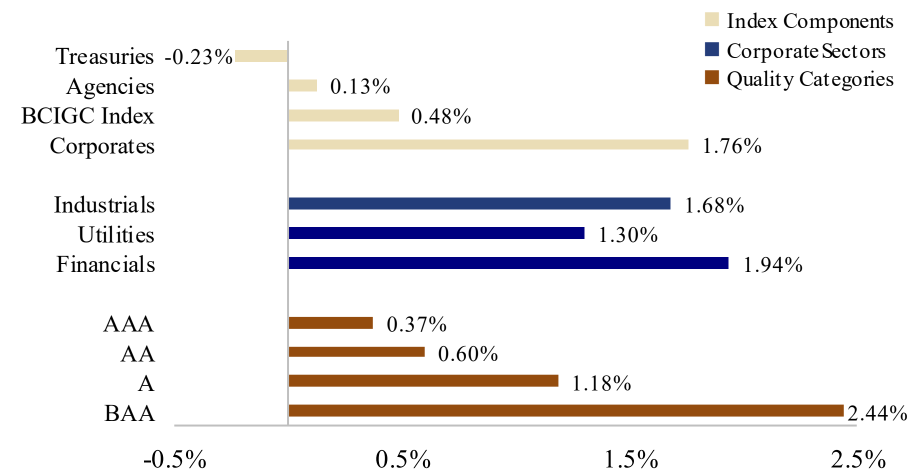
- Current
- Prior
n/c - No change

Sources: Bloomberg, Madison

# PERFORMANCE UPDATE FOR THE FOURTH QUARTER 2020

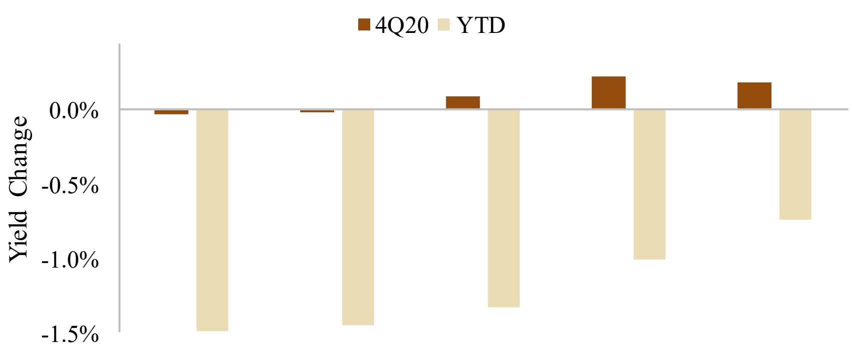
| Asset Class | Market Sector | 4Q20 | YTD |
|---|---|---|---|
| Money Market | 3-month Tbill | 0.0% | 0.7% |
| Fixed Income | Intermediate Gov/Credit | 0.5% | 6.4% |
| | US Aggregate (1-30 yr) | 0.7% | 7.5% |
| | TIPS (1-10 year) | 1.6% | 8.4% |
| | Municipal Bonds (1-30 yr) | 1.8% | 5.2% |
| | EM Aggregate | 4.5% | 6.5% |
| | US High Yield | 6.5% | 7.1% |
| Equities | S&P 500 Index | 12.1% | 18.4% |
| | Russell 3000 Index | 14.7% | 20.9% |
| Int'l Equities | MSCI Europe, Asia, Far East | 16.1% | 8.4% |
| | MSCI Emerging Markets | 19.6% | 18.5% |
| Commodities | Gold | -0.4% | 20.9% |
| | Commodities | 10.2% | -3.5% |
| | Crude Oil (Brent) | 19.4% | -31.5% |

Total Rate of Return Comparison
Fourth Quarter 2020




Source: Bloomberg

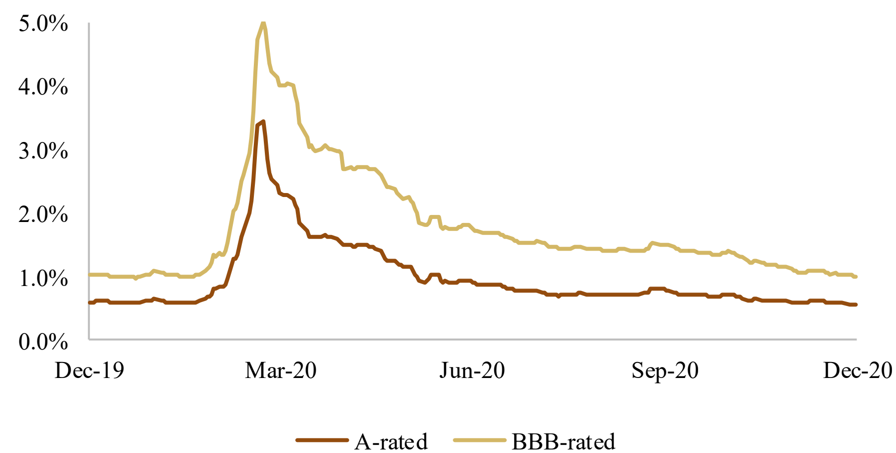
U.S. Treasury Curve
Yield Change (bars) and Period Returns (bottom data table)




| Returns | 3-mth | 2-yr | 5-yr | 10-yr | 30-yr |
|---|---|---|---|---|---|
| 4Q20 | 0.03% | 0.04% | -0.22% | -1.91% | -4.18% |
| YTD | 0.67% | 3.07% | 7.26% | 10.61% | 18.72% |

Source: Bloomberg

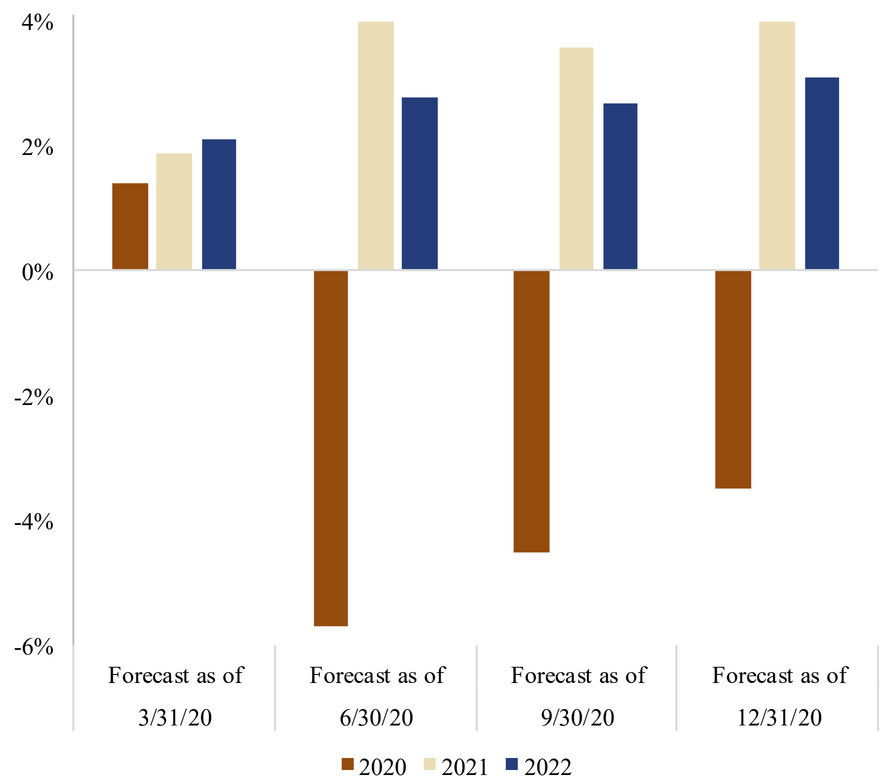
Comparison of Intermediate Corporate Spread
by Credit Quality




Source: ICE Data Indices

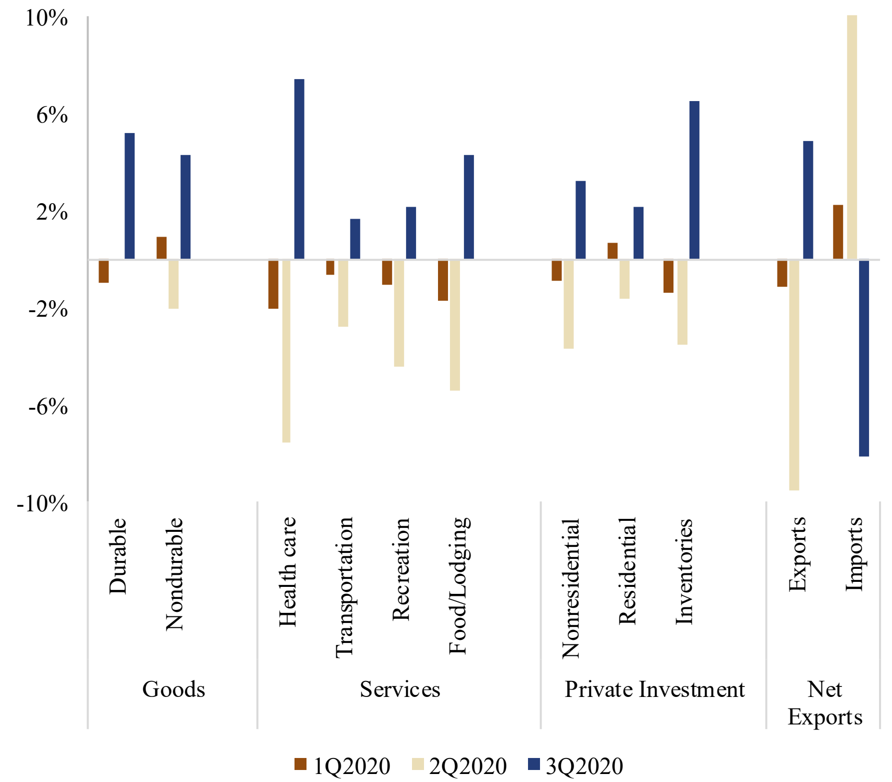
# ECONOMIC GROWTH EXPECTED TO CONTINUE AS MANY INDUSTRIES SHOW IMPROVEMENT

Estimated Annual GDP
(as of date specified)




Sources: Bloomberg

Major Parts of the Service Economy
are Facing an Uphill Battle



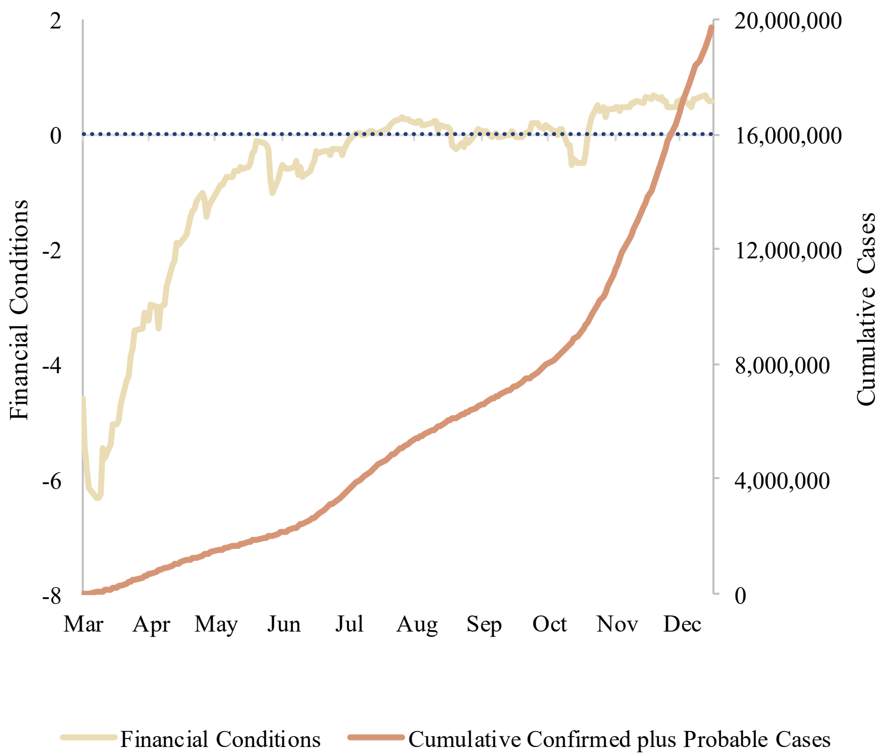

Sources: Bureau of Economic Analysis

- Many economists continue to revise their GDP forecasts upward in response to signs the U.S. economy may be able to sustain its rebound after the pandemic-induced recession began in early 2020.
- Recent growth estimates compiled by Bloomberg suggest the economy will expand by 4% in 2021 and just over 3% in 2022.

- Third quarter GDP details indicate the major contributors to growth have been economically sensitive industries within the Goods and Services sectors, especially Durable Goods, Health Care, and Food/Lodging.
- Private Investment was a source of growth, particularly Nonresidential and Residential Construction as well as corporations building up inventories.
- Lastly, exports rebounded significantly during the quarter while imports decreased substantially offsetting the substantial second quarter increase.

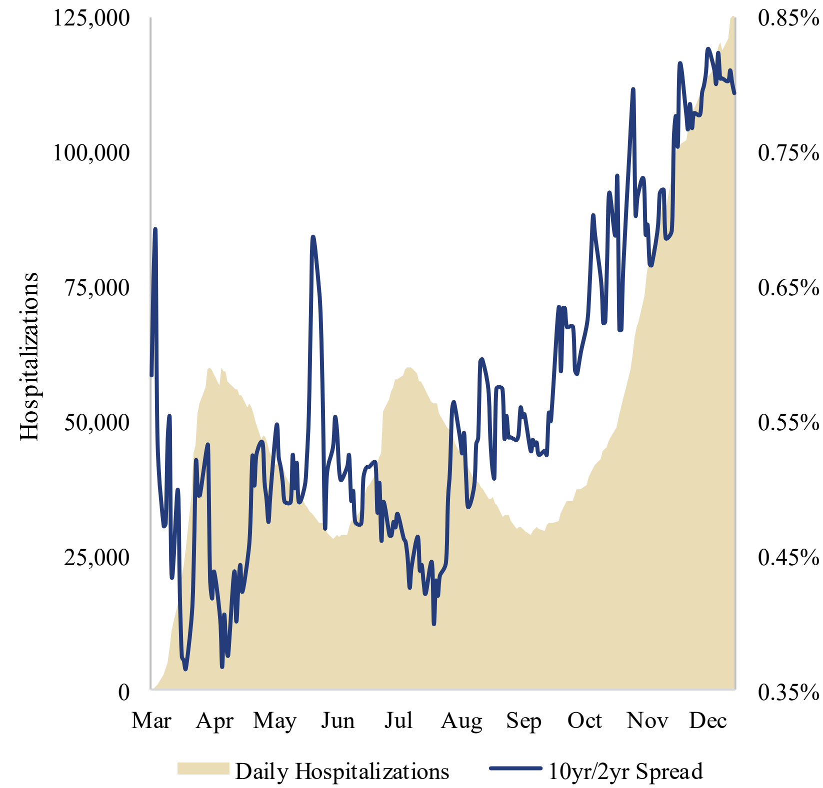
# FINANCIAL CONDITIONS HAVE BECOME MORE ACCOMMODATIVE WHILE LONGER-TERM RATES RISE

Financial Conditions versus Cumulative Covid-19 Cases




Sources: Bloomberg, CovidTracking.com

Daily Covid-19 Hospitalizations versus Spread between 10-year and 2-year Treasuries

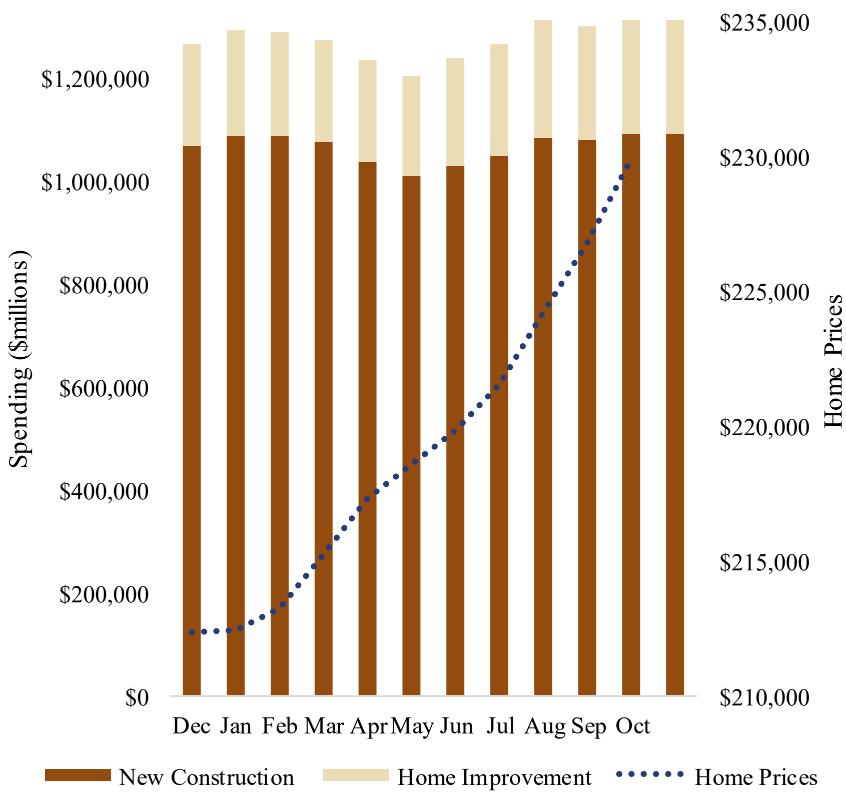



Sources: Bloomberg, CovidTracking.com

- According to Bloomberg, U.S. financial conditions have become increasingly accommodative during the past few months.
- This measure tracks the overall level of financial stress in the U.S. money market, bond, and equity markets to help assess the availability and cost of credit.
- Despite the spike in confirmed/probable coronavirus cases and increased threat of a potential lockdown, companies appear to have ready access to capital at a reasonable cost.
- The yield difference between 10-year and 2-year Treasuries widened as bond investors adjusted intermediate maturity Treasury valuations in anticipation of a step towards more normal economic conditions.
- This reshaping of the yield curve comes as no surprise given longer term rates tend to rise during early stages of an economic recovery as bond investors await a reversal of Fed policy (e.g. short-term rates begin to rise) and revise their inflation outlooks.

# HOUSING REMAINS A BRIGHT SPOT SUPPORTED BY LOW MORTGAGE RATES

Spending on New Construction and Home Improvements versus Average National Home Prices




Sources: Bloomberg

Home Mortgage Rates


Sources: Bloomberg

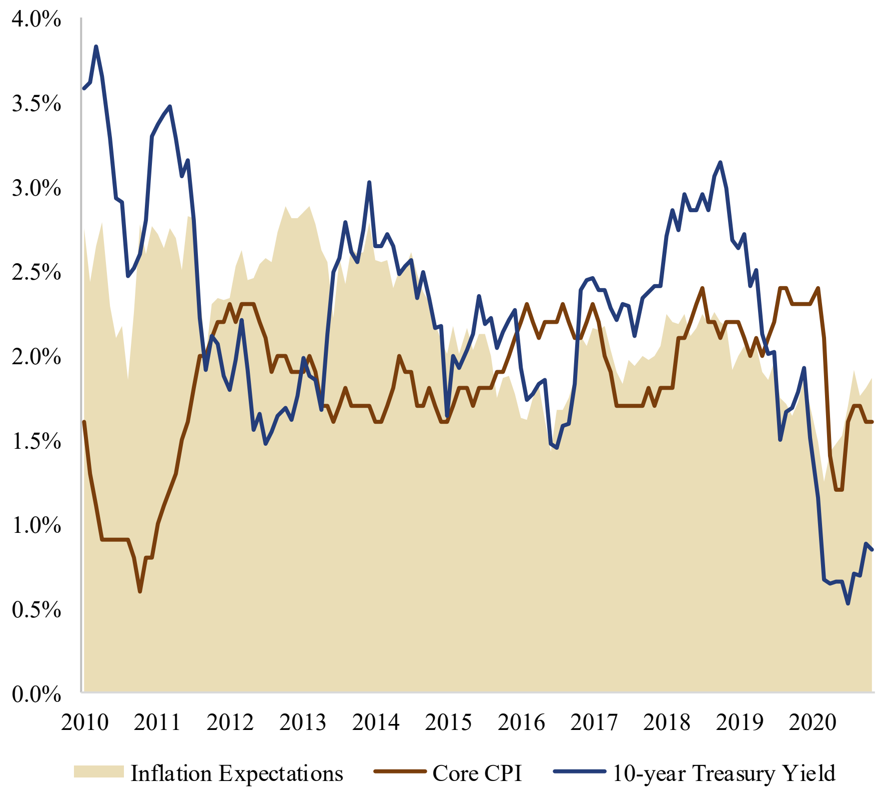
- Housing-related spending remained resilient in 2020 as consumers splurged on new construction and home improvements.
- Home prices also rose steadily during the year, in large part due to the dwindling supply of homes available for sale.

- Home prices have also been supported by lower mortgage rates which makes owning a house more affordable. Similarly, low rates prompt home improvement projects as homeowners borrow home equity (e.g. home equity loans or lines of credit).
- Mortgage rates have fallen in response to both lower 10-year Treasury rates and lower risk premiums stemming from investor demand for yield which is attainable via mortgage-backed securities.

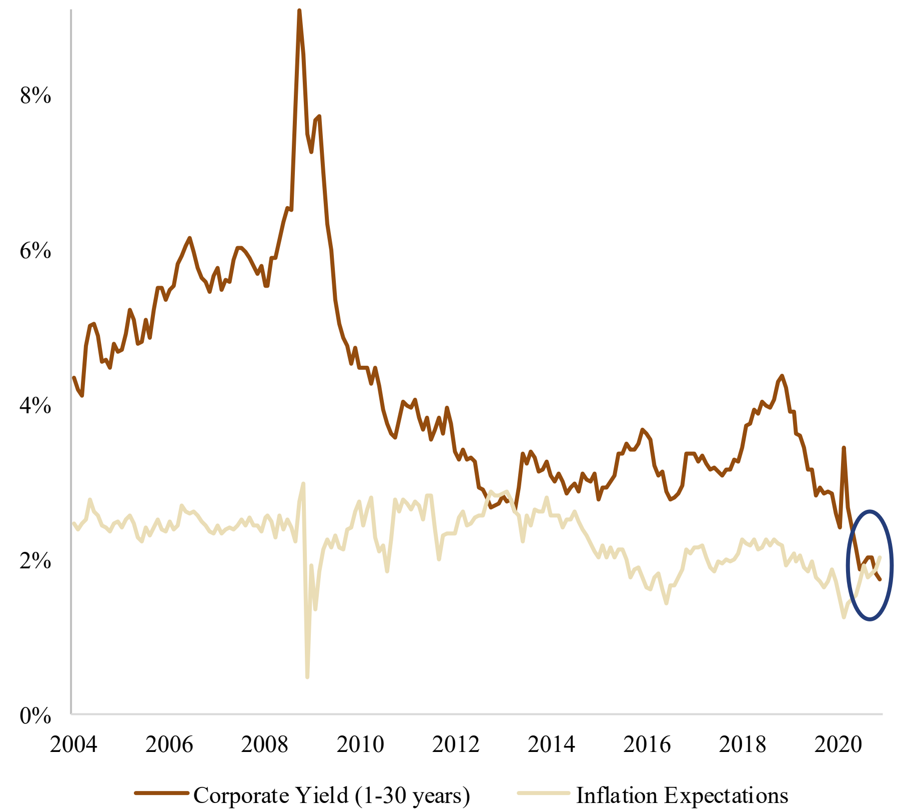
# BOND YIELDS HAVE NOT FULLY ADJUSTED FOR HIGHER INFLATION EXPECTATIONS

Madison INVESTMENTS

Inflation Expectations are Slowly Rising Yet Interest Rates Remain Low




Corporate Yields Fall Below Inflation Expectations



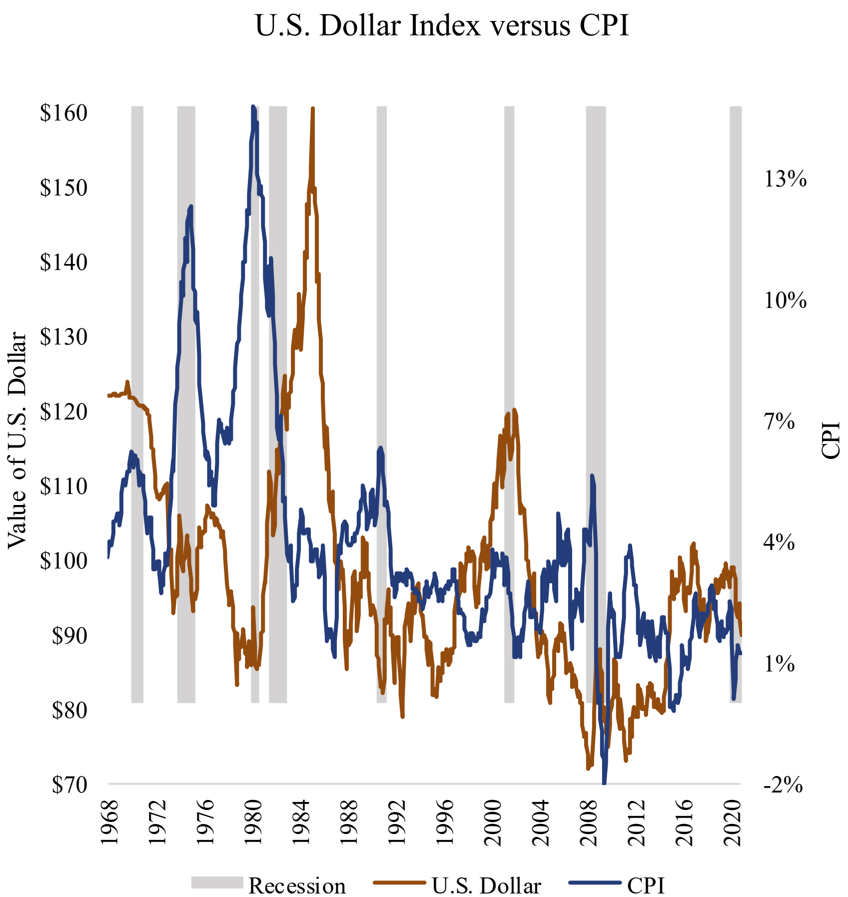

Sources: Bloomberg,

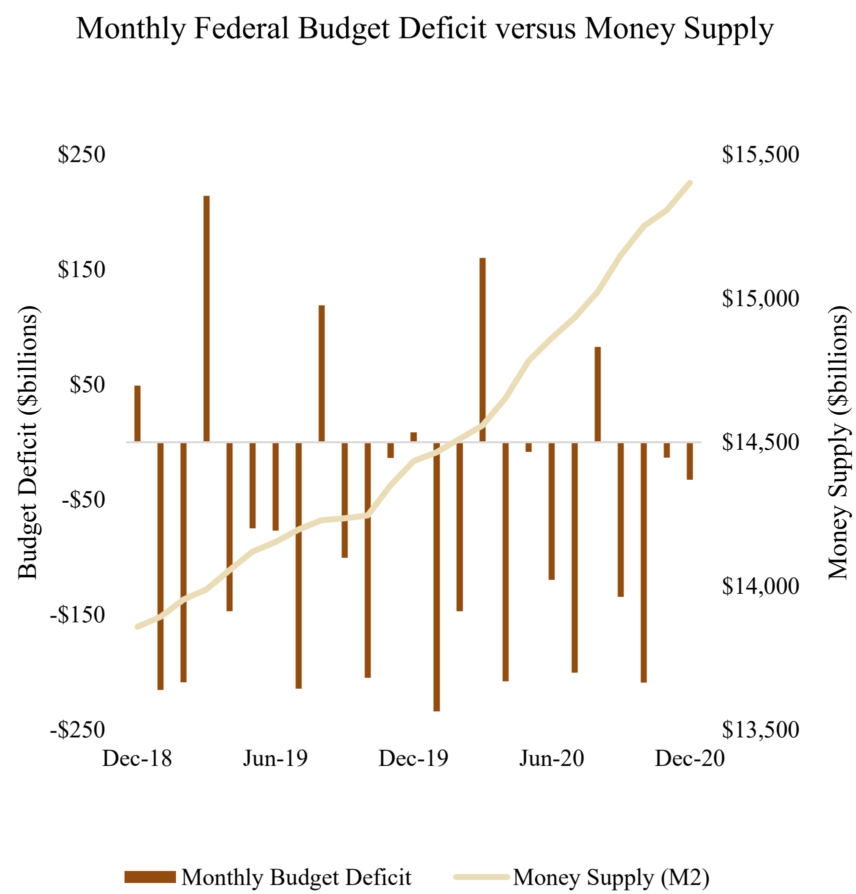
- Many economists expect the inflation rate will exceed 2% should economic growth continue to accelerate.
- During the past decade, expectations for higher inflation have not materialized as core prices remained near or below 2%. The Fed is concerned about low inflation and stated its intention to abandon the central bank's 2% inflation target for the foreseeable future.
- As investors, we're uneasy about interest rates staying below the inflation rate for an extended period. Therefore, we are positioning for Treasury rates to adjust to higher levels.

- We are also troubled by corporate yields which recently fell to levels below the rate of inflation. In other words, real corporate yields are negative.
- Importantly, this does not mean investors should avoid corporate bonds, especially given the nominal yield advantage offered by corporates. Rather, investors are encouraged to consider how best to position corporate bonds given some issuers may increase the size of their capital structure, thereby elevating potential downgrade risk.
- We believe it appropriate to position high quality issuers within industries less prone to market volatility while considering each issuer's credit curve (e.g. risk premiums at different points on the yield curve).

# U.S. DOLLAR CONTINUES TO DEPRECIATE WHILE THE FEDERAL BUDGET DEFICIT AND NATION'S MONEY SUPPLY INCREASE

Madison INVESTMENTS



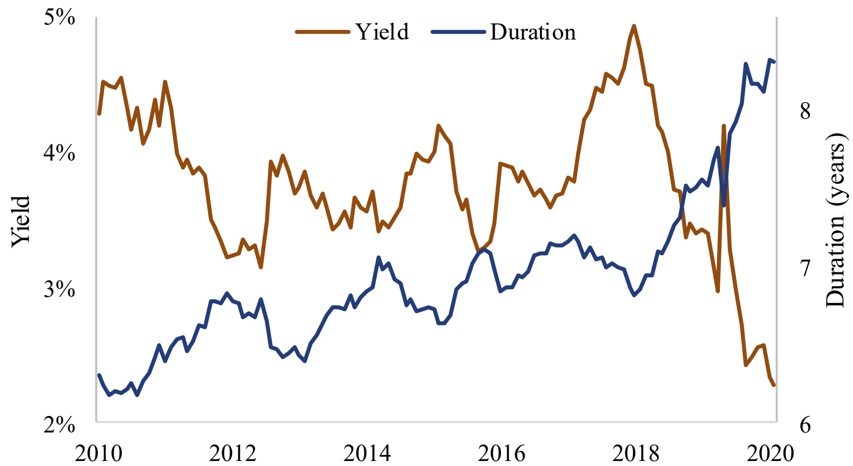




Sources: Bloomberg

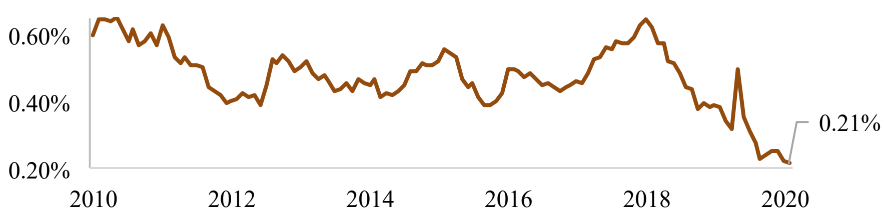
- Some investors believe the recent decline in the U.S. dollar's value relative to other currencies will lead to inflation as the dollar price of imported goods and services rise.
- However, other investors deem a depreciating dollar to contribute towards a transitory price shock that does not lead to a persistent increase in the general level of prices nor promote an upward spiral of wages.
- Although we agree currency depreciation doesn't automatically result in higher inflation, we actively monitor the U.S. dollar for hints about how currency declines may effect foreign demand for U.S. Treasuries.
- In response to lackluster economic growth caused by the pandemic, the federal government continues to pursue deficit spending initiatives as a means to stabilize the weakened U.S. economy.
- A potential consequence of incremental Treasury issuance necessary to finance deficit spending is the sizable increase in the nation's money supply. This may also be a contributing factor toward the nation's currency depreciation, although the Fed absorbed about 40% of the newly created money by buying Treasuries.
- Over the longer term, interest rates are likely to adjust upward to attract a larger buyer base for Treasury bonds.

# CORPORATE BONDS REMAIN A VIABLE INVESTMENT ALTHOUGH RISK HAS INCREASED

Corporate Bonds: Risk has Increased

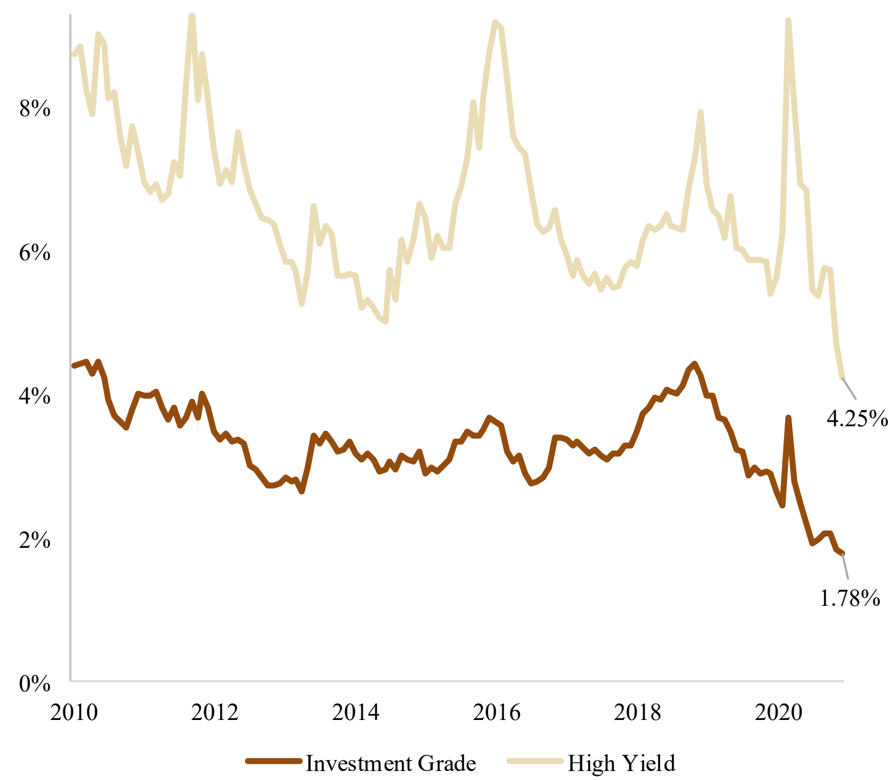



Break-Even Yield
(yield/duration)




Sources: Bloomberg

Bond Yields Have Reached Record Lows
(Average yield on 1-year to 30-year maturities)




Sources: Bloomberg

- Risk within the corporate bond market has increased substantially since March as yields moved towards record lows while sensitivity to yield changes (as measure by duration) moved notably higher.
- At the close of 2020, the breakeven yield (i.e. calculated as yield / duration) for corporate bonds was a mere 21 basis points versus an average of about 30 basis points during the entire year.

- During the fourth quarter, corporate bonds yields reached historic lows as interest rates declined. At the close of 2020, investment grade (IG) bonds yielded 1.78% and high yield (HY) bonds yielded 4.25%.
- Year-end spreads on IG and HY bonds were 0.98% and 3.90% respectively. Although risk premiums on average ended the year where they began 2020, risk premiums in both markets collapsed considerably from their peak levels on March 23 of 3.97% for IG and 10.82% for HY.
- We think the yield pickup relative to similar maturity Treasuries makes corporate bonds an attractive investment as long as the underlying issuers possesses sound credit fundamentals.

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All investments contain risk and may lose value. Equities may decline in value due to both real and perceived general market, economic and industry conditions. Investing in foreign-denominated and/or -domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets.

The S&P 500® is an unmanaged index of large companies, and is widely regarded as a standard for measuring large-cap and mid-cap U.S. stock-market performance. Results assume the reinvestment of all capital gain and dividend distributions. An investment cannot be made directly into an index.

The Dow Jones Industrial Average® (The Dow®), is a price-weighted measure of 30 U.S. blue-chip companies. The index covers all industries except transportation and utilities.

The MSCI Emerging Markets Index captures large and mid cap representation across 24 Emerging Markets (EM) countries. With 1,138 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI EAFE (Europe, Australasia & Far East) Index is a free-float adjusted market capitalization index that is designed to measure developed market equity performance, excluding the U.S. and Canada. These indices are unmanaged. They are shown for illustrative purposes only, and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance.

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.

The Bloomberg Barclays Emerging Markets Local Currency Government Index measures the performance of local currency Emerging Markets (EM) debt.

Bloomberg Barclays U.S. Government/Credit Bond Index includes securities in the Government and Corporate Indices. Specifically, the Government Index includes treasuries (i.e., public obligations of the U.S. Treasury that have remaining maturities of more than one year) and agencies (i.e., publicly issued debt of U.S. Government agencies, quasi-federal corporations, and corporate or foreign debt guaranteed by the U.S. Government).

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, mortgage backed securities, asset-backed securities and corporate securities, with maturities greater than one year.

The Bloomberg Barclays Global Aggregate Bond Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.

The Bloomberg Barclays Intermediate Govt/Credit Bond Unmanaged index that tracks the performance of intermediate term US government and corporate bonds.

The Bloomberg Barclays US Treasury Inflation-Linked Bond Index measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.

# DISCLOSURES

The Russell Midcap® Index measures the performance of the mid-cap segment of the U.S. equity universe. The Russell Midcap® Index is a subset of the Russell 1000® Index. It includes approximately 800 of the smallest securities based on a combination of their market cap and current index membership.

RUSSELL MIDCAP® GROWTH: The Russell MidCap® Growth Index is designed to track those securities within the broader Russell MidCap Index that FTSE Russell has determined exhibit growth characteristics.

RUSSELL MIDCAP® VALUE: The Russell MidCap® Value Index is designed to track those securities within the broader Russell MidCap Index that FTSE Russell has determined exhibit value characteristics.

RUSSELL 2000®: Russell 2000®Index measures the performance of the 2,000 smallest companies in the Russell 3000® Index, which represents approximately 11% of the total market capitalization of the Russell 3000® Index.

The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are reflected.

RUSSELL 1000®: Russell 1000® Index measures the performance of the 1,000 largest companies in the Russell 3000® Index, which represents approximately 89% of the total market capitalization of the Russell 3000 Index.

RUSSELL 1000® GROWTH: Russell 1000® Growth Index is designed to track those securities within the broader Russell 1000 Index that FTSE Russell has determined exhibit growth characteristics.

RUSSELL 1000® VALUE: Russell 1000® Value Index is designed to track those securities within the broader Russell 1000 Index that FTSE Russell has determined exhibit value

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Bloomberg Barclays US Corporate Bond Index measures the investment grade, fixed-rate, taxable corporate bond market.

The VIX Index is a calculation designed to produce a measure of constant, 30-day expected volatility of the U.S. stock market, derived from real-time, mid-quote prices of S&P 500® Index (SPXSM) call and put options.

January 15, 2021