TC Wealth Partners LLC
Trust Company of Illinois

MATTERS OF TRUST

From the desks of William M. Giffin, CEO (left) and Kevin Rice, Senior Investment Strategist (right)

WHAT'S HEATING UP

Summer is here, and a good chunk of the country is absolutely baking.

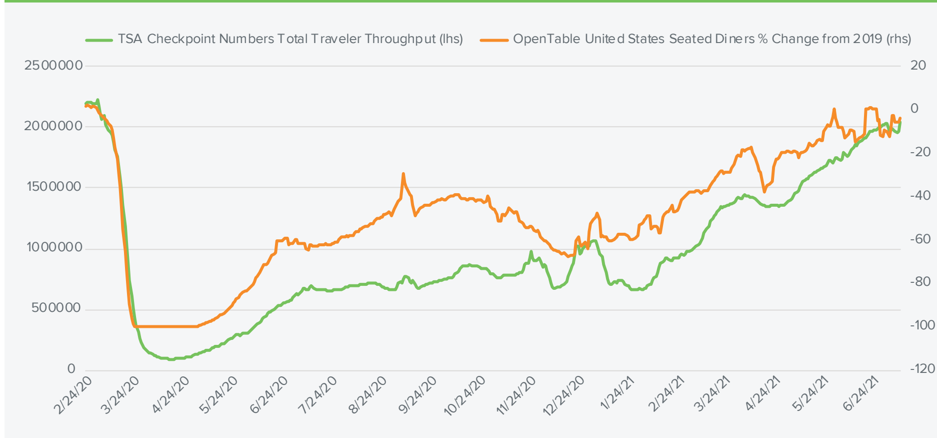
The record-hot temperatures combined with drought levels out West, in some cases extreme, are ominously setting the table for a potentially devastating wildfire season. The 2020 wildfires set records in the U.S., but the tinderbox conditions this summer are worse. We trust that the temperatures will start to cool and the fires abate.

As the masks come off (the great "unmasking"), another kind of heat is rising, the red-hot economy.

Inflation jitters that spooked the market in May have cooled, with most investors agreeing with the Fed that the inflation pressures that persist are largely temporary. The U.S. is blazing the global trail towards post-COVID normalcy, but supply chain disruptions emanating from countries not as far along continue to create pockets of inflation.

As we cross the halfway point of the year, markets have been extremely strong across the board except for fixed income. Robust corporate earnings along with a trend of upward revisions are helping to fuel the positive performance. As we wait for cooler temperatures, let us also hope that the inflation we are seeing fades out a bit, lest the Fed pours some cold water on this market.

EXHIBIT 1: REOPENING DATA



Source: TC Wealth Partners, Bloomberg.

COVID

The United States missed President Biden's goal of having 70% of Americans receiving at least one dose of COVID-19 vaccine by July 4.

At the end of the first week of July, about 182 million Americans (64% of the population age 12 or older) had received at least one dose of a COVID-19 vaccine, and 157 million were fully vaccinated (55% of the population age 12 or older), per the Centers for Disease Control and Prevention. The new Delta variant of the COVID-19 virus, however, has become the dominant strain in the U.S., representing over 50% of cases across the country.

Several health experts said they do not expect the new variant to cause a nationwide surge in the U.S. like the one that occurred last winter, but they do anticipate localized outbreaks in places where vaccination rates remain low.

▶ *Our View*

We do not expect the Delta variant to derail the recovery in the U.S. thanks to existing vaccination levels. We continue to believe that an end to the COVID-19 crisis in the U.S. now appears to be in sight, but the path to a full recovery depends on the vaccination rate and the emergence of new variants.

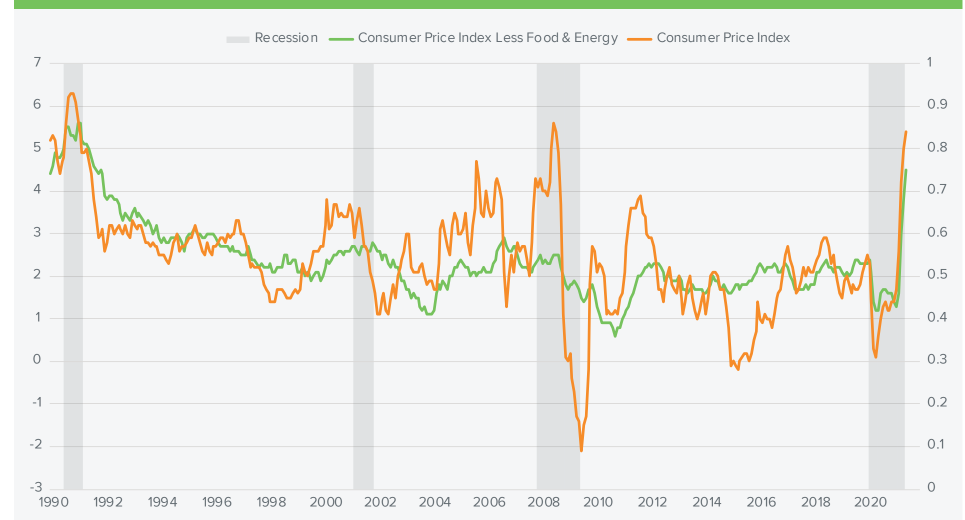
As the number of people who have gotten vaccinated has increased, restrictions are being relaxed and more people are traveling and eating out at restaurants (See Exhibit 1). Over the Fourth of July holiday weekend the number of passengers cleared through TSA airport-security checkpoints surpassed the totals back in 2019. AAA predicted overall road-trips would be back to 2019 levels. We believe that as we move throughout the second half of this year things will begin to return to "normal".

INFLATION

The consumer price index rose 5% in May on a year-over-year basis, the highest since the summer of 2008 when oil prices were skyrocketing (See Exhibit 2).

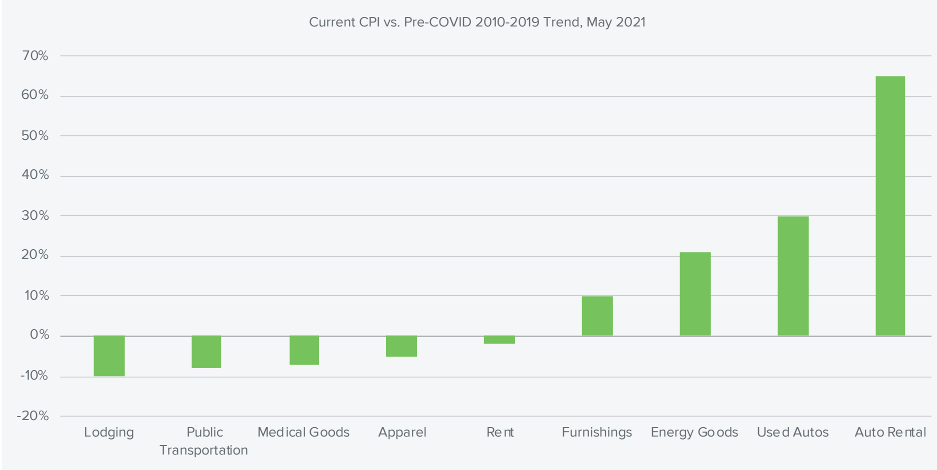
Excluding food and energy, core CPI rose 3.8% year over year, the highest pace since 1992. A third of the increase was attributed to a sharp 7.3% increase in used car and truck prices. While the surge in used car and truck prices was headline grabbing, other larger components of CPI such as shelter and medical care posted much more modest increases.

EXHIBIT 2: CONSUMER PRICE INDEX (YEAR OVER YEAR CHANGE)



Source: TC Wealth Partners, Bloomberg.

EXHIBIT 3: CPI DEVIATION FROM TREND



Source: TC Wealth Partners, U.S. Department of Labor and Bloomberg

The year-over-year readings were expected to rise sharply since the global economy was essentially shut down a year ago.

▶ *Our View*

The key question facing the Fed and investors is whether the pickup in inflation is sustainable or transitory.

We believe that the Fed is correct in its temporary view, but we believe inflation will continue to increase modestly into next year because the price level for some categories that were impacted by social distancing remain below levels predicted by their pre-COVID trends (See Exhibit 3). We will continue to watch consumer expectations and wage growth to gauge how long price pressures will persist (See Exhibit 4).

If consumers believe that prices will continue to rise at a fast pace, then those expectations can become a self-fulfilling prophecy.

The latest University of Michigan inflation expectations survey showed that consumers expect prices to rise by 4.6% per year over the next five to ten years, which is the fastest pace in a decade. Prices for food and gasoline tend to heavily influence this measure, so we believe any easing of pressures in these two areas would help make this spike temporary, as in 2011.

We are also monitoring wage growth because it has the potential to drive long-term inflation trends higher, a dynamic that is typically seen during periods of tight labor markets. The current signal from wages is not worrisome at the moment as wages have held steady despite the slack in the labor market.

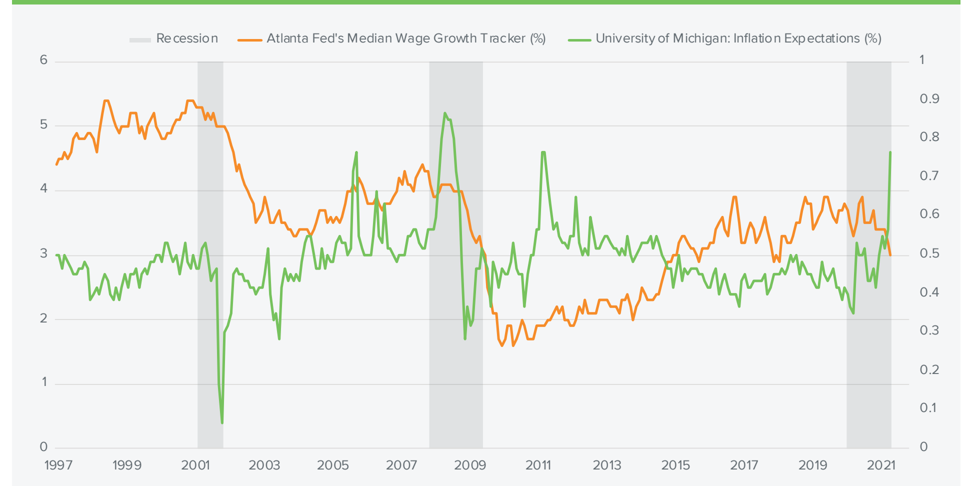
FEDERAL RESERVE

At the June meeting, the Federal Open Market Committee (FOMC) signaled a more hawkish stance towards its monetary policy outlook driven by a materially stronger growth and inflation outlook in the medium term.

The committee voted not to change interest rates and reaffirmed its commitment to $120 billion in asset purchases per month, until the committee feels “substantial further progress” has been made towards its inflation and employment goals. The FOMC signaled they now expect two interest rate increases by the end of 2023, a more hawkish projection relative to this past March.

The committee’s quarterly projections

EXHIBIT 4: INFLATION DATA WATCH



Source: TC Wealth Partners, Federal Reserve Bank of St. Louis and Bloomberg

now show 13 of 18 FOMC officials favoring at least one rate hike by the end of 2023. There are now eleven FOMC officials expecting at least two hikes by the end of 2023.

▶ *Our View*

In terms of tapering its asset purchases, our sense is that the Fed opted to leave out the taper talk to support consistency with its view that this recent spike in inflation is temporary.

Moreover, we suspect Chairman Powell is keenly aware of the market's 2013 "Taper Tantrum" and intends to be as clear as possible about the Fed's expectations to avoid mixed messages. With the rate hike now likely in 2023, we believe investors can take comfort in the fact that, historically, periods leading up to the initial policy-rate increase are traditionally favorable for equities (See Exhibit 5).

Since 1990, U.S. large-cap equities have averaged a total return of 18.1% during the two years preceding the initial rate hike from the Fed. U.S. equities outperformed bonds by an average of nearly 6% during those periods. International equities also performed well, with developed-market large-caps gaining an average of 16.4% and emerging markets outperforming.

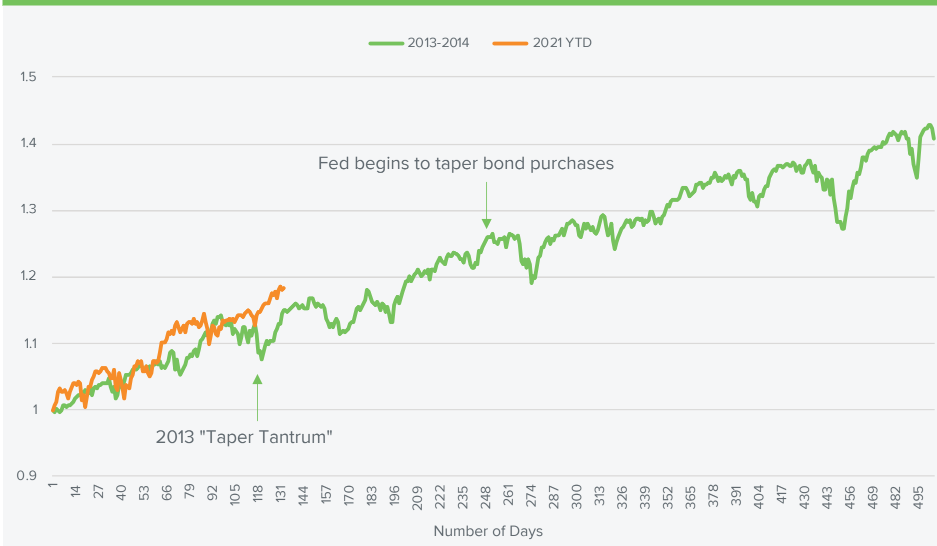
ECONOMIC GROWTH

U.S. economic growth for Q2 is on track to strengthen to around 9.0% annualized growth.

The economy continues to be supported by the fiscal stimulus approved in the first quarter of 2021 and the unleashing of pent-up demand, with most states removing their COVID-19 restrictions as more than half of the country is vaccinated.

First quarter growth was driven by solid contributions from consumption expenditure, business investment spending and residential investment, each of which posted double-digit growth. U.S. GDP growth in Q2 continues to be underpinned by robust consumption expenditure and business investment spending.

EXHIBIT 5: S&P 500 PERFORMANCE AMID TAPER TALKS



Source: TC Wealth Partners, Bloomberg.

Consumption spending is being fueled by pent-up demand for services as steady labor income and excess savings boost spending.

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▶ *Our View*

We think above-average growth this year will be sparked by the vaccine-driven reopening, boosted by ongoing monetary and fiscal stimulus, and sustained by ongoing improvement in the labor market. We believe that the speed of the economic recovery will be defined by how the labor market grows, how spending drives inflation and how the Federal Reserve signals its plan to phase out their crisis-era policies.

UNEMPLOYMENT

Payroll employment jumped by 850,000 in June, boosted by strong job gains in leisure and hospitality.

The unemployment rate edged up to 5.9% because more people voluntarily left their jobs and the number of job

seekers rose. Even with the latest advance, U.S. payrolls are still 6.76 million below their pre-pandemic level.

Demand for labor remains robust as employers strive to keep pace with the expanding economy, fueled by the lifting of restrictions on business and social activity, mass vaccinations and trillions of dollars in federal relief. At the same time, a limited supply of labor continues to plague employers as COVID concerns, child-care responsibilities and expanded unemployment benefits are all likely contributing to the record number of unfilled positions which currently stands at 9.2 million positions (See Exhibit 6).

▶ *Our View*

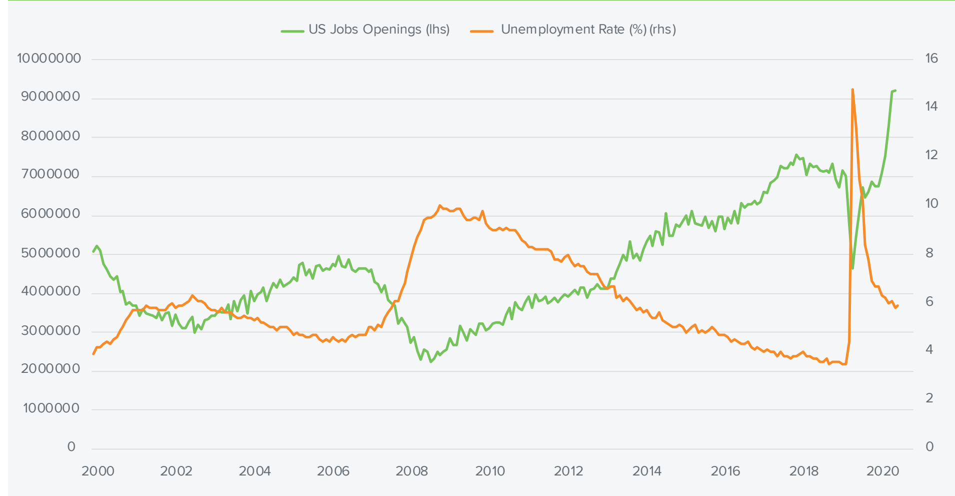
The economy has made a remarkable recovery from the COVID pandemic, but the public health crisis has left a lot of scars.

Many people are still afraid to go back to work.

Some cannot return to their old jobs because they have disappeared, and others still lack options for the care of their kids or elderly relatives. Extra unemployment benefits are also getting some blame. Whatever the case, the unemployment benefits are set to expire in all states in September. By then, schools, day-care centers and senior-care facilities are likely to be fully open and allow most people to go back to work.

We expect a further easing in labor supply constraints in the coming months resulting in additional large gains in employment.

EXHIBIT 6: UNEMPLOYMENT DATA



Source: TC Wealth Partners, Bloomberg.

EARNINGS

A powerful earnings recovery has been underway for nearly a year and analysts expect profits to continue to surge at least through 2022.

Exhibit 7 plots S&P 500 earnings per share (EPS) on a 12-month trailing basis, with the shaded area representing future estimates. Despite the economy having fallen into its deepest recession since the 1930s Great Depression, profits have rebounded incredibly fast and are expected to surpass their pre-COVID peak by the second quarter of 2021.

▶ *Our View*

Unlike the previous three quarters when the better-than-projected results were primarily a function of low expectations, the fast-rising first-quarter earnings reflected broad economic strength.

We believe that the pace of blistering earnings growth is expected to continue as S&P 500 earnings are projected to grow double-digits for the remaining three quarters of 2021. However, expect that the second quarter growth will likely mark the peak for earnings. The expected deceleration in earnings growth will simply reflect the return to a more normal, steady state for the economy.

Improving corporate fundamentals will drive a sustained upward trajectory in stocks.

DOMESTIC EQUITIES

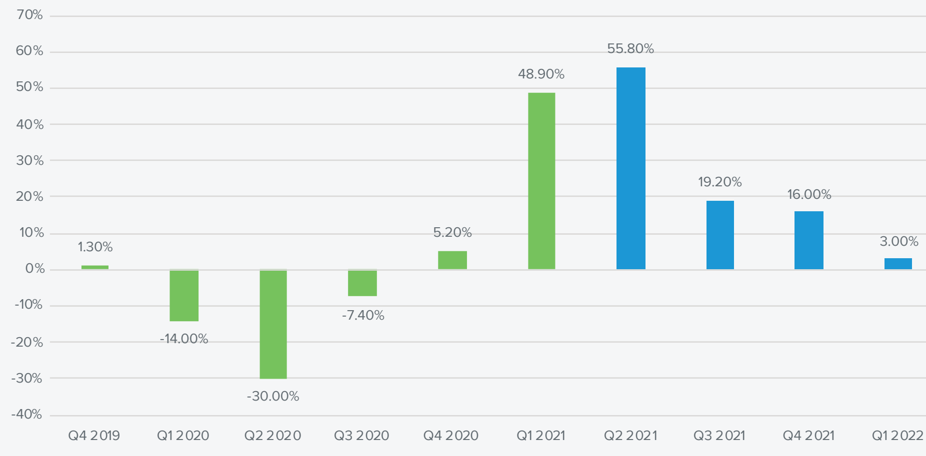
U.S. equity benchmarks closed the first half of 2021 at or near record highs as the economy continues its reopening and more and more people are returning to work.

Historic fiscal and monetary stimulus has provided a consistent tailwind since the Spring of 2020.

There is little evidence those efforts will be removed anytime soon.

After stumbling out of the gate in January, the S&P 500 has strung

EXHIBIT 7: ACTUAL AND FORECASTED S&P 500 QUARTERLY EARNINGS



Source: TC Wealth Partners, Bloomberg.

together five consecutive monthly gains and finished the first half of 2021 with a total return of 15.2%. Smaller caps have outperformed, with the Russell 2000 returning +17.53%. The Nasdaq has underperformed both with a relatively modest gain of 12.92% YTD (See Exhibit 9).

▶ *Our View*

We think the fundamental outlook continues to be favorable, making a positive case for domestic equities.

Outside the double-dip recession of the early 1980s – when inflation was at double digits – no recession in the last 75 years has begun when unemployment was at current levels and falling. We think the combination of strong GDP growth, rising corporate profits and still-low interest rates will support an enduring bull market.

Throughout the second half of the year, we expect fears of inflation will be enough to stoke volatility in stocks, even amid Fed assurances of continued accommodation. Similarly, tax policy may become a volatility trigger as lawmakers debate the proposals.

INTERNATIONAL EQUITIES

Developed International equities (+5.35%) lagged U.S. equities as measured by the MSCI EAFE Index for the three-month period.

The underperformance can be attributed to the fact that economic prospects are improving more slowly outside the U.S. due to a slower pace of vaccinations, and the policy mix is less skewed toward fiscal stimulus. Emerging markets (+6.18%), according to the MSCI EM Index, also underperformed and can point to similar issues as well as a stronger U.S. Dollar during the latter part of the quarter which created a headwind for emerging market companies.

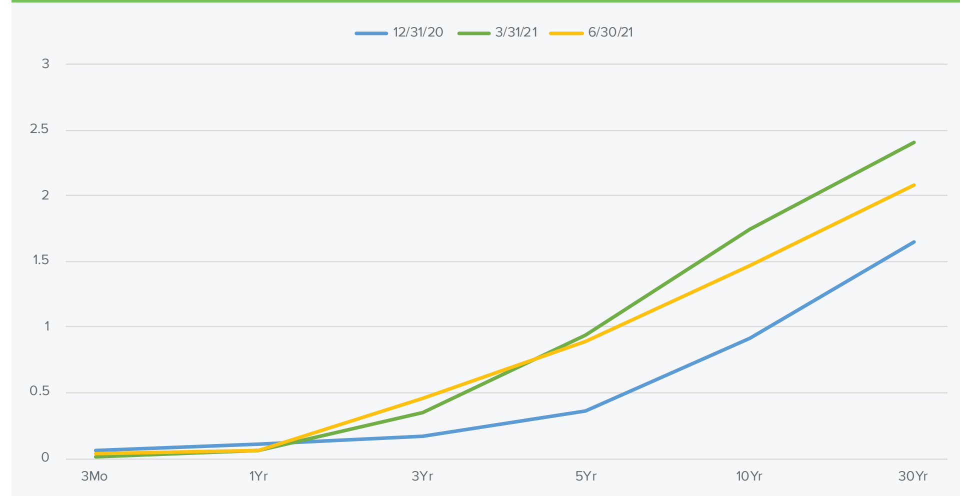
▶ *Our View*

Developed markets outside the U.S. trade at a discount, but we believe it is warranted and reflective of weaker growth expectations.

Corporate earnings in developed markets are forecast to grow 34% in 2021 and 13% in 2022. Central banks across the globe are providing accommodative monetary conditions and risk assets have responded favorably.

While this is a supportive backdrop for further equity market gains, we believe COVID/vaccine headlines will

EXHIBIT 8: U.S. TREASURY CURVE



Source: TC Wealth Partners, Bloomberg.

EXHIBIT 9: MARKET PERFORMANCE

S&P 500 SECTORS	Q2-2021	YTD	1Yr	3Yr	5Yr	10Yr
Utilities	-0.41%	2.38%	15.82%	10.50%	7.41%	10.56%
Real Estate	13.09%	23.30%	31.88%	14.69%	9.42%	9.23%
Materials	4.97%	14.50%	48.51%	14.85%	14.58%	10.08%
Information Technology	11.56%	13.76%	42.39%	30.27%	31.19%	21.97%
Industrials	4.48%	16.40%	51.43%	14.97%	14.37%	12.76%
Health Care	8.40%	11.85%	27.92%	17.02%	14.06%	15.65%
Financials	8.36%	25.60%	61.60%	13.89%	16.98%	13.65%
Energy	11.29%	45.61%	49.34%	-6.09%	-0.81%	-0.03%
Consumer Staples	3.83%	5.02%	23.29%	14.12%	8.04%	11.48%
Consumer Discretionary	6.95%	10.27%	37.08%	19.34%	19.67%	17.88%
Communication Services	10.72%	19.67%	48.38%	23.25%	10.89%	11.29%
DOMESTIC EQUITY INDEXES	**Q2-2021**	**YTD**	**1Yr**	**3Yr**	**5Yr**	**10Yr**
Russell 2000	4.29%	17.53%	62.00%	13.47%	16.43%	12.32%
Russell Midcap	7.50%	16.25%	49.79%	16.42%	15.60%	13.22%
Russell 1000 Growth	11.93%	12.98%	42.49%	25.12%	23.64%	17.85%
Russell 1000 Value	5.21%	17.04%	43.66%	12.39%	11.85%	11.59%
NASDAQ	9.68%	12.92%	45.29%	25.76%	25.85%	19.41%
S&P 500	8.55%	15.24%	40.77%	18.64%	17.62%	14.82%
FIXED INCOME INDEXES	**Q2-2021**	**YTD**	**1Yr**	**3Yr**	**5Yr**	**10Yr**
Global Aggregate ex. US	0.92%	-4.42%	4.60%	3.12%	1.63%	0.99%
US Aggregate	1.83%	-1.60%	-0.33%	5.34%	3.02%	3.39%
Treasury	1.75%	-2.58%	-3.22%	4.65%	2.15%	2.84%
High Yield	2.74%	3.62%	15.37%	7.44%	7.48%	6.65%
TIPs	3.25%	1.73%	6.51%	6.53%	4.17%	3.40%
Municipals	1.42%	1.06%	4.17%	5.10%	3.25%	4.28%
Asset Backed Securities	0.34%	0.18%	1.34%	3.65%	2.39%	2.36%
Mortgage Backed Securities	0.33%	-0.77%	-0.42%	3.78%	2.27%	2.63%
Commercial Mortgage Backed Securities	1.92%	-0.22%	2.94%	5.91%	3.51%	4.07%
INTERNATIONAL EQUITY MARKETS	**Q2-2021**	**YTD**	**1Yr**	**3Yr**	**5Yr**	**10Yr**
MSCI World	7.88%	13.33%	39.71%	15.61%	15.47%	11.29%
MSCI ACWI	7.51%	12.55%	39.89%	15.15%	15.22%	10.51%
MSCI ACWI ex US	5.62%	9.42%	36.34%	9.93%	11.65%	5.99%
MSCI EAFE	5.35%	9.21%	33.04%	8.87%	10.88%	6.48%
MSCI EM	6.18%	15.81%	31.10%	8.68%	10.97%	8.30%
MSCI Europe	6.74%	15.81%	28.63%	8.70%	9.51%	8.31%
MSCI Asia Pacific	2.63%	5.11%	34.83%	10.79%	13.09%	7.48%
MSCI North America	8.96%	15.15%	42.71%	19.04%	17.80%	14.29%
MSCI EM Asia	3.79%	5.96%	41.41%	13.38%	15.60%	7.36%
MSCI EM Latin America	15.11%	9.05%	45.28%	5.37%	6.22%	-2.19%
MSCI EM Europe & ME	7.46%	16.18%	37.85%	6.09%	7.56%	0.04%

Source: TC Wealth Partners, Bloomberg.

continue to drive equity prices. The large amount of stimulus in the U.S. should provide a boost to emerging market stocks, though some countries will benefit from strong fundamentals growth while others continue to face challenges dealing with COVID.

FIXED INCOME

U.S. fixed-income assets gained during the second quarter, partially recovering from broad declines in the first quarter.

Amid faster than expected growth and rising inflation readings, investors increasingly fixated on shifts in the Fed policies. The Treasury yield curve flattened, driven by both a steepening in the front end and moderating inflation expectations (See Exhibit 8). Long-term Treasuries led all other sectors during the period, with the 10-Year U.S. Treasury yield ending June at 1.45%, down 0.29% from the previous quarter.

Nearly all major fixed-income sectors finished the quarter with gains (See Exhibit 9).

▶ *Our View*

With yields already very low in other major developed markets, U.S. bond yields are attractive on a relative basis, drawing in foreign investors.

We see room for bond yields to move up in the second half of the year. We believe that short-term interest rates should remain anchored near zero by Fed policy. However, we expect the 10-year Treasury yield to rise from its current level. We continue to believe that active management is crucial right now in fixed income because yields remain very low.

CONCLUSION

All of us at TC Wealth Partners/ Trust Company of Illinois are so appreciative to serve you through this unprecedented time in the history of our country and the world. We will continue to keep you updated with our views as new events unfold. We urge you to keep a long-term perspective, review your financial plan and have conversations with your advisor about plotting your course.

Please take care and be safe! ■

NOTEWORTHY

WELCOME

CHRISTIE MITTLESTAEDT
Account Executive
June 2021

CONGRATULATIONS

JENNI ENGSTROM
Series 65 License

ATTENDED

NANCY T. BELL
US SIF (The Forum for Sustainable and Responsible Investment)
Annual (Virtual) Conference
June 2021

TAMI BOWMAN
Wolters Kluwer Ethics Webinar
April 2021

TAMI BOWMAN
ASPPA (American Society of Pension Professionals and Actuaries)
Spring (Virtual) Conference
April 2021

TAMI BOWMAN
TIMOTHY H. HATTENDORF
FIS (Fidelity) Great Lakes User Group (GLUG)
Partial Plan Termination Webinar
June 2021

DEBRA L. GREGORASH
SHANIQUA JEFFERSON
BNY Mellon's Pershing
INSITE (Virtual) Conference
June 2021

TIMOTHY H. HATTENDORF
Wolters Kluwer Form 550 Webinar
May 2021

SHANNON L. STEVENS
IICLE (IL Institute for Continuing Legal Education)
Estate Planning Course
May 2021

SPONSORSHIPS

MARKLUND 39TH ANNUAL GOLF CLASSIC
Cog Hill Golf & Country Club
June 2021

OUTREACH COMMUNITY MINISTRIES
Golf, Food & Wine Experience
Butterfield Country Club
June 2021

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