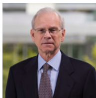
CROSSMARK
GLOBAL INVESTMENTS

# QUARTERLY UPDATE: 1Q 2021
# SMA STRATEGY COMMENTARIES

## ECONOMIC & MARKET
Commentary



written by
**Mel Cody**, Sr. Portfolio Manager

**Will an aggressive Fed and vaccine optimism keep the rally going?**

Equities ended 2020 on a very strong note, bouncing back from the fastest drop into bear market territory ever due to the COVID-related shutdowns ravaging the economy. The S&P 500 Index fell 35% over February and March of last year, ending the longest bull market in history. But optimism that the worst was behind us then fueled a 70% rebound through year-end, with the Index closing at an all-time high of 3,756. Given this performance, surely the market was due for a breather as we entered the first quarter of 2021. However, the growing success of the vaccine rollout is changing the game, acting as an additional major stimulus to economic growth as the country moves toward herd immunity. We also have the benefit of an aggressively loose Federal Reserve and an even looser Congress and Administration. Their message is clear – all will do whatever it takes to continue boosting the economy, so we saw the S&P 500 jump another 6.2% in the first quarter. The Index actually crossed the 4,000 level for the first time ever at the beginning of April. Anticipating a recovery, the smaller-cap S&P 1000 Index jumped an impressive 14.9% during the quarter. Some of these smaller companies are quite leveraged to ride an economic recovery.

**Reading the Data**

The economy appears to be coming back strong, just like the stock market. As Fed Chairman Powell recently noted, the recovery could accelerate "more quickly than it has in the past because it involves reopening the economy as opposed to stimulating aggregate demand and waiting for that to produce demand for workers." The data bear this out. For example, the recently released ISM March Manufacturing PMI posted a reading of 64.7, up from 60.8 in February and ahead of the 61.3 consensus. That was the highest reading since 1983, some 37 years ago (any reading above 50 indicates economic expansion). Keep in mind that the expansion is resuming from a lower level of output than before the pandemic. The ISM Non-Manufacturing Index for March also came on like gangbusters. At 63.7, this is its highest reading since the series began in 1997. All 18 component industries showed growth for the month, which is a notable feat. The vaccine rollout and the easing of certain state restrictions (and better weather) helped boost results for customer-facing businesses comprising the services survey.

**Promising News on Employment**

Employment numbers are also strong, with March nonfarm payrolls jumping by 916,000, well ahead of expectations of 675,000. The unemployment rate fell to 6.0% from 6.2%. The labor force participation rate rose to 61.5% but is still below the pre-pandemic (February 2020) level of 63.3%. Leisure and hospitality boasted the strongest gains with

# ECONOMIC & MARKET
Commentary (continued)

280,000 new jobs last month. With some schools reopening, education jumped by 190,000. Overall, it was a broad-based recovery across sectors. At the same time, January and February job numbers were revised upwards by 67,000 and 89,000, respectively. Demand for job seekers also looks excellent. In the most recent JOLTS (job openings) report for February, job openings jumped to a two-year high of 7.4 million (well ahead of the 7 million consensus). Still, there were 1.4 unemployed workers for every available job opening last month. This is well above the 0.82 number recorded just before the lockdowns started a year ago, so competition for positions will be tough.

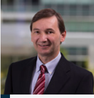
**Auto Sales and Stimulus Measures Should Boost GDP**
Auto sales appear to be on the rise after the pandemic-induced collapse one year ago. According to Bloomberg research, March's seasonally adjusted annualized sales jumped to 17.8 million units, a 56% increase over March of 2020 and a 4% increase over March 2019 (pre-pandemic). Fear of infection has translated into a greater desire for personal transportation (as opposed to mass transit or ride sharing), helping to boost demand for cars and trucks. With all this good news and the Biden Administration's recent $1.9 trillion stimulus package, we expect strong GDP growth in 2021. Some estimates for the first quarter are as high as 10%, a huge gain after 4.3% growth in the fourth quarter of last year. For 2021, growth could top 7% by some estimates, which would be the fastest since 1984 and a dramatic turnaround from the 3.5% contraction in 2020.

**Easy Comparisons for Corporate Earnings**
After getting slammed in 2020 by the pandemic, corporate earnings are rebounding nicely. Of course, the comparisons are fairly easy. Currently, positive guidance for S&P 500 companies in the first quarter is far outpacing negative guidance. Of the 95 companies issuing guidance so far, 61 have been positive (64%) - the five-year average is 35%. If this trend holds it will be the highest since FactSet began tracking this metric in 2006. The consensus year-over-year growth rate estimate for the first quarter is a stellar 23.8%, well above the five-year average of 3.8%. Nine of the eleven S&P 500 sectors are expected to show positive growth, led by Consumer Discretionary, while two sectors, Energy and Industrials, are expected to post negative growth. Sales also look solid with expected growth of 6.3% versus the five-year average of 3.5%. The second quarter is expected to be a corporate earnings blowout, up 52.5% compared to last year's second quarter plunge. For 2021, analysts are looking for earnings growth of 25.9% on revenue growth of 9.9%.

**Don't Fight the Fed (Says the Stock Market)**
Stocks have had a tremendous run since the March 2020 bottom, with the S&P 500 up over 80% through the end of the first quarter. Other indexes have done even better, with many at all-time highs (including the "advance-decline line"). The advance-decline line is a fairly reliable leading indicator of market strength and direction, as it usually gives several months warning if it peaks and starts to decline before the broad market follows suit. Of course, after a rebound like we have seen the last year valuations are getting stretched. At the end of the first quarter the S&P 500 was trading at a 12-month forward price/earnings ratio of 21.9X, according to FactSet. This is well above the five-year average P/E of 17.8X. So the market is certainly no bargain, but is it reasonably priced? We believe the valuation is reasonable given the current environment. First, the Federal Reserve has made it clear they will do whatever it takes to support the economy and our policy is always "don't fight the Fed." The rest of Washington D.C. is on board as well. We now have low inflation, low interest rates, an extremely accommodative Fed and a Congress and Administration throwing money at everything. This is about as good as it gets for stock valuations and it could push P/E ratios into the mid-20s or even higher. One canary in the coal mine, however, is that sentiment has gotten very bullish, so much so that it is considered a negative. And the volume of IPOs and SPACs, not to mention bitcoin and non-fungible token (NFT) speculation, is also flashing a warning light. Bottom line – we believe we are in a strong bull market that could use a breather for earnings to catch up to prices before resuming its move to the upside.

# GLOBAL EQUITY INCOME
## Commentary

Global Equity Income is a separately managed account investment strategy



written by
**John Wolf**, Managing Director

### Markets and Performance

Global equity markets carried considerable performance momentum into the first quarter, but not enough to outperform the Global Equity Income Strategy model. The strategy benchmarks (the S&P Global 1200 Index and the S&P 500 Index) ended the quarter with returns of 5.29% and 6.17%, respectively. Dividend stocks overall slightly outperformed the general equity market. For global dividend index comparison purposes, the MSCI World High Dividend Yield Index returned 6.12%. The Global Equity Income model portfolio outperformed both the S&P Global 1200 and the MSCI World High Dividend Yield Index for the first quarter, gaining 10.36%.

### Positive and Negative Contributors to Performance

Positive relative performance for the quarter was led by HP Inc. (2.10% of total net assets) which closed up 29.95%. Shares jumped as quarterly results were strong across the board. The ongoing work and learn from home environment has significantly increased PC demand as well as demand for consumer print hardware. Supply challenges appear to be the bottleneck as key hardware component shortages continue to constrain sales. However, the company has a record sales backlog. HP expects the current PC unit growth trend to continue through 2021. Shares of ViacomCBS (1.80% of total net assets) rose 21.35% as the company transitions from a traditional cable network to a significant player in the streaming market. The massive programming catalog on Paramount+, the recently launched subscription streaming service, is providing the base for the company to become a major competitor. Adding to the positive momentum was the recent televised interview with Prince Harry and Meghan Markle, which had blockbuster ratings and further boosted the price of the stock. Snap-on, Inc. (1.40% of total net assets) climbed 35.68% on a solid earnings report that beat analyst consensus on strong organic growth. The company engineers, manufactures, and markets tools, equipment, diagnostics, repair information and systems solutions for professional installers across multiple industries. The tools group was the standout segment with organic sales up nearly 20% year-over-year. Double-digit growth occurred in both the U.S. franchises as well as international operations.

Negative contributors to relative performance included Unilever PLC (1.60% of total net assets), which finished down 6.63%. Shares declined after the company reported earnings slightly lower than the forecast for the fiscal year. Sales were in-line with consensus estimates. Financial disclosures indicated that the company experienced a good level of organic growth (particularly in the Americas) but this came at a cost - it was offset by a disappointing contraction of operating margin. The company also reported it is raising its dividend by 4%. PepsiCo, Inc. (1.90% of total net assets) shares fell 3.86% despite fourth quarter results that beat both sales and earnings expectations along with a 5% dividend increase. The company also reported earnings guidance for 2021 that was in-line with its previous projections but slightly lower than analyst expectations. Other than the general COVID-related volatility affecting many large-cap companies , the only investor disappointment was related to a lack of buyback activity.

### Looking Ahead

With COVID vaccinations well underway, the growth to value rotation appears to be gathering momentum as local economies begin to open and more steps toward normalcy are taken. Value stocks, which dramatically underperformed during the pandemic last year, are now beginning to outperform their growth counterparts. This reflects investor expectations of a powerful economic rebound. With general equity market valuations currently at high levels, some investor caution may be warranted. This makes a good case for quality and dividend income stocks, which are well positioned to benefit from this type of equity market environment.

# COVERED CALL INCOME

## Commentary

Covered Call Income is a separately managed account investment strategy

written by

**Paul Townsen**, Managing Director – Head of Trading & Investment Operations

### Markets and Performance

The first quarter of 2021 is not looking much different from where we finished in 2020. U.S. equity markets experienced some volatility but for the most part continued to advance with cyclical stocks leading the way, building on outperformance that started with positive vaccine news last November. Market volatility from last month seemed to center around the potential for higher inflation, rising bond yields and the collapse of the investment firm Archegos Capital. The strategy benefitted from the rise in volatility by strategically executing trades on the option overlay to maximize income and limit as much risk as possible. By actively trading the option overlay, the Covered Call Income model generated just shy of 4% in income for the quarter between the sale of covered calls and dividends. The model put together an impressive quarter, outperforming its primary benchmark (the CBOE S&P 500 Buy/Write Index) by 236 basis points and also outperforming the S&P 500 by 194 basis points.

### Positive and Negative Contributors to Performance

Having a sector-neutral weighting towards the S&P 500 was a boost to performance last quarter, as was not owning the mega-cap darlings from 2020, names such as Amazon and Tesla. More specifically, there are several sectors and individual stocks worth highlighting. For the quarter, all S&P 500 sectors returned positive performance, but the strategy was led by strong returns from the energy, financial and industrial sectors. Several stocks the strategy owns in these sectors that performed well were Chevron (1.10% of total net assets), Bank of America (2.50% of total net assets), Capital One (2.70% of total net assets), Morgan Stanley (2.50% of total net assets), Delta Airlines (2.00% of total net assets), and Emerson Electric (2.00% of total net assets). The highest single-name contributor to relative outperformance for the quarter was Applied Materials (4.20% of total net assets). The strategy incurred a negative contribution to return by owning Apple, Inc. (3.90% of total net assets), which was down 7.80% for the first quarter.

### Looking Ahead

As we look ahead to the second quarter (April in particular), investors will be seeking solid evidence that the economic recovery is firmly in place. Earnings season will be in full swing in a few weeks with the street wanting to see a continuation of momentum from the fourth quarter of 2020. Historically, April has been the second strongest month for performance on average. Outside of earnings announcements, April could witness market-moving news coming from the COVID vaccine rollout and the reopening of the economy. The Crossmark team will continue to monitor volatility with the intent to trade the option overlay to maximize income and reduce market risk.

# LARGE CAP CORE GROWTH
Commentary

Large Cap Core Growth is a separately managed account investment strategy

written by
**Brent Lium, CFA®** Managing Director – Head of Equity Investments

**Markets and Performance**

While the Large Cap Core Growth Strategy model returned a healthy 4.31% in the first quarter of 2021, it lagged the S&P 500 by 1.86% as high-quality growth paused. The market seemed to become more excited about "reopening" stocks. After outperforming by over 6% in 2020, it was not surprising for large caps to give some of that back with the recovery of last year's underperformers in response to growing confidence in the rebounding economy throughout the quarter.

**Positive and Negative Contributors to Performance**

Our best performers were Deere, Lennar, and Intel (1.50%, 1.90% and 1.40% of total net assets). Deere returned 39.39% on solid earnings, excitement over the global reopening trade, and the potential for a large infrastructure bill from the new administration. The homebuilder Lennar was up 33.19% as demand for housing remained very strong. Intel rose 29.22% on very strong demand for semiconductors and the hopes that new management will get the large semiconductor maker back on track. Our underperformers were NVIDIA (1.20% of total net assets) which closed down 12.45% and Intuitive Surgical (1.80% of total net assets) which returned -9.68%. Both companies were very strong performers through the pandemic but suffered as the market moved towards "reopening" and "value" stocks. Not owning any energy stocks hurt us by 56 basis points and our overweight of technology hurt by 55 basis points during the quarter relative to the S&P 500 Index.

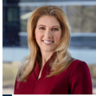
We used the pause in growth stock performance to increase our investments in companies with strong business models and exposure to long-term growth trends. We purchased NVIDIA, which makes high-end graphics cards and processors used in data centers, cloud computing, gaming, and AI applications. This company is the market leader in areas which are currently experiencing very strong growth. We funded the purchase by selling Cisco, which is seeing growth slow as products in their categories become more commoditized.

**Looking Ahead**

We expect to be able to make similar adjustments going forward as we have seen many growth companies pull back as the market rotates to reopening trades. However, we think the excitement over the reopening trade will fade as many of those stocks have returned to pre-pandemic levels despite their fundamentals being years away from warranting the lofty valuations.

# TAXABLE FIXED INCOME
Commentary

Core Fixed Income, Current Income Portfolio, Intermediate Fixed Income and Income Opportunities are separately managed account investment strategies



written by
Victoria Fernandez, CFA® Chief Market Strategist

## Markets and Performance

The first quarter of 2021 saw a jump in Treasury yields to levels many didn't expect to see until much later in the year. The quick pace of yield movement from around 0.92% on the 10-Year Treasury at the beginning of the year to around 1.70% at the end of the first quarter was a shock to many fixed income investors. It is not necessarily the level of 1.70% that makes people nervous, but rather the pace at which we moved approximately 80 basis points. This also led to volatility in the equity markets although we did not see a strong "flight-to-quality" move to the bond market that many times accompanies pullbacks in equity indices. The consolidation in the 1.60% to 1.70% range for the 10-Year Treasury, along with corporate spreads that seemed to suggest there were no credit concerns, helped support the fixed income market in general.

## Positive and Negative Contributors to Performance

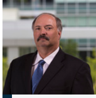
All Crossmark taxable fixed income model portfolios outperformed their respective benchmark indices for the first quarter of 2021. Our investment process led us to maintain shorter duration positioning during the quarter. This was the largest positive contributor to outperformance for all the model portfolios versus their respective indices, along with the effect of income generation. In addition, for all model portfolios except the Fixed Income Intermediate model, the yield curve positioning was also a positive contributor to performance. For the Current Income Portfolio and Income Opportunities model portfolios, the allocation to fixed-rate preferreds was a drag on performance due to their longer duration (mitigated somewhat by the income generated by the sector). The underweight to the Treasury sector was also a positive contributor to performance.

## Looking Ahead

As we move into the second quarter, we continue to extend duration across our taxable fixed income strategies. Our four-step investment process begins with the evaluation of many factors, including central bank actions and economic reports, to determine our duration target versus the comparable index. As yields have moved higher and our outlook for rates has this trend continuing in the coming quarter, we will maintain a shorter duration as compared to the index but will keep shifting that position closer to neutral. We maintain our focus on investment-grade securities that provide steady cash flow for the model portfolio which we see as a positive contribution to return over the coming quarter.

# MUNICIPAL FIXED INCOME
Commentary

Municipal Fixed Income is a separately managed account investment strategy



written by
**Patrick Garboden**, Sr. Portfolio Manager

**Markets and Performance**

The ratio of municipal bond yields to Treasury yields decoupled again in the first quarter. U.S. Treasury yields rose along most of the yield curve, while investment-grade municipal bond yields remained stubbornly close to year-end levels. Historically, the municipal bond yield ratio averages about 85% of comparable Treasuries, but the decoupling between 10-year municipal bonds and 10-year Treasuries began in January 2021 and accelerated through the middle of February when the ratio hit a historical low at 58%. This ratio has since moved to 64% to end the first quarter. While there was a rebound in municipal bond pricing in March, the benchmark remains in negative territory although outperforming other fixed income sectors. It is no surprise that even though municipal bond issuance was down 15% and 17% in January and February respectively, new issue volume for March was up 179% year-over-year due to very low levels at the beginning of the pandemic.

**Positive and Negative Contributors to Performance**

The Municipal Fixed Income model portfolio outperformed the Barclay's Quality Intermediate Municipal Index for the first quarter of 2021, returning +0.07% vs (0.45%) for the index. Lower quality credit names had more stabilization in pricing during the quarter, supported by investors searching those segments of the market for higher yields. Focusing on higher quality names was a mild negative for the model performance. However, with the rising interest rate environment we experienced during the quarter, having a shorter duration was a strong positive contributor to the outperformance of the model as compared to the index.

**Looking Ahead**

In the coming quarter, volatility could increase as concerns ranging from inflation, proposed tax changes, changes in the U.S. dollar, and declining credit ratings have the ability to push rates higher while the FOMC holds short-term rates low. As mentioned above, we saw municipal issuance increase during the month of March. Municipal bond supply could continue to increase during April and May with new issuance possibly outpacing the total amount of bonds being called or maturing during the same period. This could widen spreads throughout the quarter. Due to recent stimulus issuance, potential volatility, supply/demand issues and credit rating changes, another dislocation of the municipal bond sector from other fixed income sectors (similar to March 2020) is possible. With these factors in play, we continue to find value in the municipal secondary market. We favor bonds rated A or better by Moody's or S&P at time of purchase and involved with essential services like water, sewer, power, streets, highways, public school education and general obligations. We prefer maturities in the 8-year to 20-year range with call features between 2024 and 2027. The Crossmark Global Investments Municipal strategy will hold a shorter duration than the Barclay's Quality Intermediate Municipal Index with a focus on higher quality municipalities.

## Global Equity Income Top 10 Model Holdings [1]

| Holding | Weight |
|---|---|
| Texas Instruments, Inc. | 2.60% |
| Infosys Technologies Ltd | 2.50% |
| McDonald's Corp. | 2.40% |
| Taiwan Semiconductor Mfg Co. | 2.40% |
| Eli, Lilly & Company | 2.30% |
| Cummins Engine, Inc. | 2.10% |
| HP, Inc. | 2.10% |
| NetApp, Inc. | 2.10% |
| KB Home | 2.10% |
| Comcast Corp. | 2.10% |

% of Total Portfolio: 22.70%

## Covered Call Income Top 10 Model Holdings [1]

| Holding | Weight |
|---|---|
| Applied Materials, Inc. | 4.20% |
| Nike, Inc. | 4.20% |
| Apple, Inc. | 3.90% |
| Activision Blizzard, Inc. | 3.90% |
| Abbott Labs | 3.80% |
| Medtronic PLC | 3.80% |
| Oracle Systems Corp. | 3.70% |
| Micron Technology, Inc. | 3.70% |
| Starbucks Corp. | 3.50% |
| Microchip Technology, Inc. | 3.30% |

% of Total Portfolio: 38.00%

## Large Cap Core Growth Top 10 Model Holdings [1]

| Holding | Weight |
|---|---|
| Apple, Inc. | 9.50% |
| Microsoft Corp. | 7.90% |
| Amazon.com, Inc. | 6.60% |
| Alphabet – Class C | 5.10% |
| JP Morgan Chase & Co. | 3.20% |
| Mastercard, Inc. | 3.00% |
| UnitedHealth Group, Inc. | 3.00% |
| Abbott Labs | 2.60% |
| Nike, Inc. | 2.60% |
| Home Depot, Inc. | 2.60% |

% of Total Portfolio: 46.10%

[1] Model Portfolios are based on a hypothetical account managed during the current quarter. Actual characteristics and income may differ materially from model. As of 3/31/2021.

## Contact a member of our Advisor Solutions Team

advisorsolutions@crossmarkglobal.com | 888.845.6910

**Crossmark Global Investments, Inc. (Crossmark)** is an investment adviser registered with the Securities and Exchange Commission that provides discretionary investment management services to mutual funds, institutions, and individual clients. Investment advice can be provided only after the delivery of Crossmark's firm Brochure and Brochure Supplement Form ADV (Parts 2A and 2B) and Form CRS, and once a properly executed investment advisory agreement has been entered into by the client.

**All Investments are subject to risks, including the possible loss of principal. Past performance does not guarantee future results.** The Strategies may not achieve their objectives if the managers' expectations regarding particular securities or markets are not met.

Equity investments generally involve two principal risks—market risk and selection risk. The value of equity securities will rise and fall in response to general market and/or economic conditions (equity market risk). The value of any individual equity security will rise and fall in response to the market's perception of the issuer's revenues, earnings, balance sheet, credit worthiness, business plan, and overall perception of the viability of the issuer's business (selection risk).

Investments in securities of issuers in foreign countries involves additional risks not associated with domestic investments. These risks include, but are not limited to: (1) political and financial instability; (2) currency exchange rate fluctuations; (3) greater price volatility and less liquidity in particular securities and in certain foreign markets; (4) lack of uniform accounting, auditing, and financial reporting standards; (5) less government regulation and supervision of some foreign stock exchanges, brokers and listed companies; (6) delays in transaction settlement in certain foreign markets; (7) less availability of information; and (8) imposition of foreign withholding or other taxes.

Options are not suitable for every investor. Writing call options to generate income and to potentially hedge against market declines by generating option premiums involves risk. These risks include, but are not limited to, potential losses if equity markets or an individual equity security do not move as expected, and the potential for greater losses than if these techniques had not been used. If the market price of a security increases, a call option written against that security limits the gain that can be realized. And, there are significant differences between the securities and options markets that could result in an imperfect correlation between these markets, causing a given transaction not to achieve its objectives.

Fixed income investments generally involve three principal risks—interest rate risk, credit risk, and liquidity risk. Prices of fixed-income securities rise and fall in response to interest rate changes (interest rate risk). Generally, when interest rates rise, prices of fixed-income securities fall. The longer the duration of the security, the more sensitive the security is to this risk. There is also a risk that the issuer of a note or bond will be unable to pay agreed interest payments and may be unable to repay the principal upon maturity (credit risk). Lower-rated bonds, and bonds with longer final maturities, generally have higher credit risks. As interest rates rise and/or the credit risk associated with a particular issuer changes, bonds held within a portfolio may become difficult to liquidate without realizing a loss (liquidity risk).

Information and recommendations contained in market commentaries and writings are of a general nature and are not intended to be construed as investment, tax or legal advice. These materials reflect the opinion of Crossmark on the date of production and are subject to change at any time without notice. Where data is presented that was prepared by third parties, the source of the data will be cited, and we have determined these sources to be generally reliable. However, Crossmark does not warrant the accuracy of the information presented.

This content may not be reproduced, copied or made available to others without the express written consent of Crossmark.

**Crossmark Global Investments, Inc.**
15375 Memorial Drive, Suite 200, Houston, TX 77079
888.845.6910 advisorsolutions@crossmarkglobal.com
**crossmarkglobal.com**