ASSET ALLOCATION UPDATE

March 2021

REFLATION, RISING RATES, AND AN EQUITY MARKET ROTATION

After reviewing the economic and market environment, FSA Investment Group and Highland offer the following comments on the current landscape:

Reflections on a Turbulent Year

Twelve months ago, domestic confirmed COVID cases still numbered in the hundreds. Outbreaks in China and Italy felt frightening, but remote.

That complacency was punctured on March 11, 2020, when the NBA paused its regular season. That freeze, in response to Utah Jazz center Rudy Gobert testing positive for COVID-19, was one of the first big foreshocks presaging the disruptive impact the pandemic would have on all of our lives. Two weeks later businesses were closed, schools were shut down, and lockdowns were ramping up.

Today, with vaccination campaigns representing a clear light at the end of the tunnel, we're taking this anniversary as a prompt to look back on a very turbulent year.

While we're generally constructive on return to normal and reopening themes, we're also monitoring the lasting impacts of this pandemic: From the accelerated adoption of working from home to the ongoing sea change in Congress's approach to fiscal stimulus, we think some of the macro and market effects of the last 12 months could have staying power. Unpacking the investment implications of those shifts could be a key focus for our team long after vaccination campaigns are complete.

Macro Outlook and HDI Update

Our market outlook is increasingly favorable. This is consistent with the Highland Diffusion Index (HDI) framework, which shows the following:

- Monetary policy remains accommodative.
- The yield curve remains upward sloping across its term structure, indicating the market is pricing in future growth.
- Credit spread tightening and equity market momentum remain positive as investors remain hungry for the return from risk assets.
- While economic indicators including labor market conditions deteriorated due to worsening outbreaks earlier this winter, those challenges could prove short-lived.

Moreover, recent news on the fiscal and public health fronts supports our constructive outlook:

- The pandemic is waning. The number of COVID patients being treated in U.S. hospitals has plunged from over 130,000 at its January peak to roughly 50,000 in late February.
- This trend could accelerate as vaccine production increases. Here in the U.S., we're optimistic vaccination campaigns will support a widespread reopening this summer.

- *Investment Services*
- *Reporting Services*
- *Consulting Services*

ABOUT OUR FIRM

We are dedicated to providing investment management and strategic wealth planning to Indian tribes and high net worth individuals. Simply put, we strive to be our client's trusted advisor. As a financial advisory firm, our primary focus is to provide unbiased opinions that are designed to achieve long term investment results. FSA Investment Group does this with the highest levels of trust, integrity and respect while always collaborating using a team approach. We are dedicated to professionally supporting, educating, and providing informed direction to each and every client.

FSA INVESTMENT GROUP
212 SOUTH ALCANIZ STREET
PENSACOLA, FLORIDA 32502

Telephone: 850.696.1550
Fax: 251.459.6918
Email: info@fsa-ig.com

- Congress has enacted a ~$1.9T stimulus package which includes $1400 economic impact payments, extended pandemic unemployment assistance, and state fiscal aid. Funding from that package has already started to flow out to households.

This combination of renewed fiscal support and falling case counts could put the economic recovery back on track over the next couple months, supporting our reflationary growth outlook.

Reflation and Rising Rates

U.S. equity markets have long priced in a healthy recovery. However, treasury markets have been slower to reflect that outlook. Today, treasury markets are starting to play catch-up with equities and other risk assets.

Interest rates accelerated higher last month: 10-year treasury yields have climbed from ~1.1% in late January to ~1.6% in early March. The recent treasury sell-off was a testament to investors' growing confidence that vaccination campaigns and fiscal stimulus could propel a rapid economic recovery, and a relatively quick liftoff from the zero-lower bound.

We came into February well positioned for rising rates:

- We reduced Treasury Inflation-Protected Securities (TIPS) exposure, while adding to listed real estate (REITs) in January. That shift away from TIPS was additive as real rates sold off last month.
- We took off our core fixed income over enhanced cash tilt last March, when 10-year yields first fell below 0.6%. That decision to reduce duration has helped protect portfolios from rising rates.

As rates rise, we will continue to monitor duration exposure. We're also positioning around these trends in clients' equity portfolios.

Positioning for a Rotation in Equity Leadership

Last month we highlighted our decision to close out our domestic equity tilt and spoke to our growing focus on small and mid-cap managers here in the U.S. Today, we're continuing to shift equity exposure by favoring emerging market (EM) equities – including Chinese, South Korean, and Brazilian stocks – over developed market (DM) equities.

We're constructive on emerging markets for three reasons:

- EMs should benefit from synchronized early cycle growth and a recovery in global trade. Rebounding commodity prices could also be positive for EM equities.
- Low valuations and attractive economic fundamentals should drive healthy returns for EM allocators over a strategic horizon.
- Our momentum-based relative strength indicator framework increasingly favors EM equities.

Moreover, currency effects could contribute to EM returns near term, as the dollar tends to weaken relative to EM currencies in early cycle environments. Any loosening of U.S. trade policies under the Biden administration could also bolster EM growth prospects.

Meanwhile, here in the U.S., we're still finding opportunities with small and mid-cap managers.

Our focus on small and mid-cap U.S. managers ties into broadening leadership and reflation themes. If the U.S. recovery accelerates, less loved styles and sectors could continue to see tailwinds, while recent winners could lag.

That focus also dovetails with recent rising rate trends. Large-growth stocks are more sensitive to shifts in the discount rates used to value their future cash flows than smaller, more cycle exposed value stocks. That sensitivity has been on display recently, as growth skewed indices like the NASDAQ 100 have underperformed during stretches of rising rates. If rates continue to rise, tilting away from large-growth stocks could be rewarded.

Over the next couple months, we'll continue to look for ways to capitalize on this prevailing market environment.

IMPORTANT DISCLOSURES: Highland Associates, Inc. ("Highland") and FSA Investment Group, LLC ("FSA-IG") have entered into an agreement whereby Highland will support FSA-IG in the areas of asset allocation, capital market research and manager research. Highland and FSA-IG will collaborate in the construction of model portfolios for FSA-IG's clients. FSA-IG is solely responsible for the consulting services and discretionary management of their client portfolios as set forth in the Investment Advisory Agreement by and between FSA Investment Group, LLC and Highland Associates, Inc.

The information contained herein is provided as of the date first set forth and are the views and opinions of Highland Associates, Inc. While Highland has tried to provide accurate and timely information, there may be inadvertent technical or factual inaccuracies or typographical errors. Highland assumes no duty to update any such information for subsequent changes of any kind. This information is confidential and may not be disseminated without prior written consent from Highland Associates, Inc.

Receipt of this report is intended for FSA Investment Group's investors and/or their representatives; it is for informational purposes only, and should not be construed as investment advice or a recommendation by FSA Investment Group, LLC or Highland Associates, Inc. to purchase or sell any securities or any other financial instrument. Investing involves a high degree of risk, and all investors should carefully consider their investment objective and the suitability of any investment program. Forward looking statements are based upon assumptions which may differ materially from actual events. This information should not be relied upon in making an investment decision.

This portfolio commentary is provided for informational purposes only and may contain forward-looking statements that may not come to pass. All information is subject to change without notice and should not be relied upon for any investment decision. This writing is provided for the sole use of its intended recipient and may not be distributed to any unauthorized third parties without the prior written approval of FSA Investment Group. Investing involves the risk of loss, including the potential loss of principal, and past performance may not be indicative of future results. There can be no assurance that any investment strategy will provide profitable or that any asset class will achieve the return expectations set forth above. Please contact FSA Investment Group if you have questions about this commentary and refer to the account statements generated by your custodian for official account data.

PAST PERFORMANCE IS NOT INDICATIVE OF FUTURE RESULTS.

212 SOUTH ALCANIZ STREET
PENSACOLA, FLORIDA 32502

Telephone: 850.696.1550
Fax: 251.459.6918
Email: info@fsa-ig.com