AUREUS
ASSET MANAGEMENT

January 2021

2021 Global Asset Allocation Review

Introduction

The Aureus annual asset allocation review evaluates the risks and opportunities available in global financial markets and their potential impact on the investment portfolios of our clients. Our Asset Allocation Policy describes our positioning for the coming year and may be adjusted as market conditions evolve.

Beyond this annual perspective on global allocation, Aureus also develops a customized investment policy for each client based on their specific goals and objectives.

Summary

The Aureus 2021 global asset allocation review combines critical interpretations of global market factors with a focus on the following:

2021 Analysis			
Market Factors	▪ US Economy ▪ Global Economy ▪ Corporate Profitability ▪ Interest Rates & Inflation ▪ Geopolitics	**Asset Classes**	▪ Cash ▪ Fixed Income ▪ US Equities ▪ International Equities ▪ Alternative Assets

This year we have modified the format of the allocation to group asset classes by three risk categories: Lower, Moderate and Higher. The allocation presented below represents a 'base case' composite for portfolios. In practice, each client is adjusted based on risk and return factors specific to their investment objectives.

2021 Asset Allocation Summary

Risk Category & Asset Class	Risk Level	2021 Allocation	Δ vs. 2020	2020 Allocation	2019 Allocation	2018 Allocation	2017 Allocation
Lower Risk		**23%**	↓	**26%**	**28%**	**27%**	**25%**
Cash	Low	4%	↓	6%	7%	5%	5%
Absolute Return	Lower	15%	↑	13%	13%	12%	10%
High Quality Bonds	Lower	4%	↓	7%	8%	10%	10%
Moderate Risk		**8%**	↑	**6%**	**6%**	**9%**	**11%**
Directional Strategies	Moderate	8%	↑	6%	6%	9%	8%
High Yield Bonds	Moderate	0%	=	0%	0%	0%	3%
Higher Risk		**69%**	↑	**68%**	**66%**	**64%**	**64%**
US Equities	High	46%	=	46%	46%	44%	46%
Int'l Developed Equities	High	11%	=	22%	20%	20%	18%
Int'l Emerging Equities	High	12%	↑				
Total		**100%**		**100%**	**100%**	**100%**	**100%**

2021 Asset Class Commentary

This year's asset allocation reflects the following adjustments compared to 2020.

Lower Risk: Lower risk assets are decreased to 23%, compared to 26% in 2020.

After starting 2020 at 1.5%, Treasury Bill yields are now 0.1%, rendering them very unattractive from a return perspective. In response to the pandemic, the Fed reduced short-term rates to essentially zero and intends to maintain a "lower for longer" posture to aid the economic recovery. However, some measure of cash is helpful to reduce volatility, provide for distributions if needed, and serve as a reserve for adding to equities in the event of a market correction. Cash allocation is 4% for 2021, down from 6% in 2020.

Absolute Return investments are designed to provide a 5-7% return, or inflation plus 2-3%, with less volatility than equities and a lower correlation to interest rates than other fixed income. Given these characteristics, and our lower cash allocation, we are slightly increasing our weighting to 15% for 2021. We currently think of Absolute Return as a replacement for fixed income in many cases.

The return on high quality fixed income investments increased in 2020 given the decline in interest rates. However, coupon rates for intermediate maturity (5-7 years) government bonds are currently less than 1%. With inflation estimated at 2%, the real return for quality bonds is projected to be negative. Because of huge spending by governments worldwide, we expect interest rates should rise modestly over the next 12 months. We would continue to underweight quality fixed income and have lowered the allocation to 4% of a diversified portfolio, down from 7% last year.

Moderate Risk: Moderate risk assets are increased slightly to 8%, compared to 6% in 2020.

Our allocation in this risk category is 8% to Directional Strategies. In general, these strategies are "hedged" meaning they should participate in periods when equity markets move higher and protect on the downside when equity markets correct. Given our positive investment outlook for global equities, we have only modestly increased our weight to these strategies, preferring to have exposure to long-only equities in this environment.

High yield bonds continue to have no allocation in 2021. Spreads for these bonds are very narrow and do not fully address the credit risk with many of the issuers in this market.

Higher Risk: Higher risk assets are moderately increased to 69%, compared to 68% in 2020.

US Equities remain a 46% allocation, despite surprisingly strong performance in 2020. Although the trailing 5- and 10-year annualized returns for the S&P 500 are materially above their long-term averages and valuations are high historically, we believe that the combination of a supportive Fed and additional fiscal stimulus should bode well for economic growth over the next few years. In addition, consumer demand is expected to be strong through 2021.

Returns for some international equity markets, particularly emerging markets, were competitive with US equity returns. In 2021 we have split our international allocation into a developed market and emerging market allocation to provide additional specificity. We are positive on both, and modestly favor emerging markets as a global economic recovery should benefit these economies. Developed markets, particularly in Europe, underperformed the US. For 2021, our overall international equity allocation is up slightly to 23% with 12% allocated to emerging markets and 11% allocated to developed markets.

2020 – Year in Review

Investment Return Summary

Asset Class/Index	Asset	Calendar Year 2020	2019	2018	2017	2016	Annualized 3 Year	5 Year	10 Year
Cash									
BofA ML U.S. Treasury Bills	Treasury Bills	0.7	2.3	1.9	0.8	0.4	1.6	1.2	0.7
Fixed Income									
Barclays US Aggregate	US Fixed Income	7.5	8.7	0.0	3.5	2.7	5.3	4.4	3.8
Barclays US Intermediate Agg.	US Fixed Income	5.6	6.7	0.9	2.3	2.0	4.4	3.5	3.1
BofA ML High Yield	US High Yield Bonds	6.2	14.4	-2.3	7.5	17.5	5.9	8.4	6.6
Global Equities									
S&P 500	US Large Cap	18.4	31.5	-4.4	21.8	12.0	14.2	15.2	13.9
Russell 2000	US Small Cap	20.0	25.5	-11.0	14.7	21.3	10.3	13.3	11.2
MSCI EAFE	Developed International	7.8	22.0	-13.8	25.0	1.0	4.3	7.5	5.5
MSCI EMF	Emerging International	18.3	18.4	-14.6	37.3	11.2	6.2	12.8	3.6
Alternatives									
HFRX Equity Hedge	Equity Hedge Funds	4.6	10.7	-9.4	10.0	0.1	1.6	2.9	0.8
HFRX Global Hedge Fund	Hedge Funds	2.5	8.6	-6.7	6.0	2.5	2.7	3.3	1.3
S&P GSCI	Commodities	-23.7	17.6	-13.8	5.8	11.4	-8.2	-1.9	-8.8
S&P GSCI Gold	Gold	21.0	18.0	-2.8	12.8	7.8	11.5	11.0	2.1
Inflation									
CPI-U (Less Food and Energy)	Inflation	1.9 e	2.3	2.2	1.8	2.2	2.1	2.0	2.0

Best performing   Worst performing

The chart of returns above hardly does justice to our investment experience in 2020. If we can set aside the pandemic-induced humanitarian crisis experienced by all, understandably hard to do, and look at the investment landscape that unfolded, it was a remarkable year. The year brought a global pandemic, recession, and bear market – and that was just the first four months. Following that, we witnessed a global economic and societal shutdown, a widespread healthcare crisis, massive stimulus plans, and a bull market. As the stock market climbed, we saw civil unrest, vaccine approvals, and a new president elected.

Unlike 2019, this past year was characterized by upheaval in the market. The S&P 500 lost 34% of its value in 21 trading days from mid-February to mid-March. After that, it advanced nearly 70% by year end. Short-term interest rates, which started the year at 1.6% went to “zero” in May and remain there today. Similarly, 10-year Treasury yields dropped from 1.9% at the beginning of the year to 0.5%, before ending 2020 at 0.9%.

Equities led the performance table again in 2020 with US (both large and small cap) and emerging markets posting nearly 20% returns for the year. With declining interest rates, bonds returned more than their coupon with total returns in the 6-8% range. Alternative asset class returns were positive in 2020 but again failed to keep up with equity market returns.

Several sections of this review look back at economic factors at play in 2020 and 2021 so we will defer discussion of economic numbers to later.

2020 Model Factors

Model Factor 1 - Fundamentals

Key considerations include economic prospects, inflation expectations, and the corporate earnings outlook.

Economic Overview

A Global Pandemic

A discussion of the fundamentals of the global economy must start with the unprecedented impact caused by the COVID-19 pandemic. When we published this piece one year ago, none of us could possibly have predicted the coronavirus's devastating impact on virtually every aspect of the world.

As shown in the table below, no economies were immune from the impact to Real GDP.

	Annualized % Change in Real GDP from Prior Quarter									
Country/Region	Q1 2019	Q2 2019	Q3 2019	Q4 2019	2019 y/y	Q1 2020	Q2 2020	Q3 2020	Q4 2020E	2020 y/y
United States	2.9	1.5	2.6	2.4	2.2	-5.0	-31.4	33.1	1.2	-3.7
China	--	--	--	--	6.1	--	--	--	--	6.5
Japan	2.8	1.6	0.1	-7.0	0.7	-2.2	-28.6	21.4	3.6	-1.3
Germany	2.5	-2.0	1.2	-0.1	0.6	-7.4	-33.8	38.5	-3.2	-5.5
United Kingdom	2.2	-0.1	1.3	0.6	1.3	-9.7	-58.7	78.0	-9.2	-11.2
France	2.1	1.2	0.6	-0.7	1.5	-21.6	-44.8	98.3	-16.6	-9.1
OECD Total	***2.5***	***1.6***	***1.7***	***0.8***	***1.6***	***-7.2***	***-36.0***	***40.1***	***-2.5***	***-5.5***

Source: OECD

Except for China, GDP growth rates from major developed countries were a modest 0-2% in 2019. The onset of the pandemic proved devastating starting with the source, China, with a year over year quarterly decline of -9.7% in Q1 and Q2 recovery of +11.6%. The impact to developed countries began in Q1 and continued through Q2, with the first quarter contracting in a range of -9% to -22%, followed by an even worse second quarter with GDP contracting between -28% and -58%. The recovery was mostly very strong in Q3, with 2020 overall seeing a -5.5% global decline in GDP.

If the worst has passed, 2020 will have been the deepest and shortest recession most economies have ever experienced, thanks, largely, to the massive stimulus efforts from governments. However, economies cannot return to pre-pandemic levels until populations are vaccinated and achieve herd immunity.

We hope and believe that by the fall of 2021, we will return to a more "normal" environment whereby the ability to interact in person, return to offices, travel, attend concerts and plays, and walk into a store maskless is restored. Only then will the service economy begin to bring back the millions of lost jobs.

We will be watching for signs of recovery across the country and monitoring for any longer-lasting impact – schools, business closures, occupancy levels of urban real-estate, hotels, housing markets, and remote/office work.

A New Administration

For the past four years, Trump policies featured a tough attitude towards China and other international trading partners, new tariffs, tax cuts, and an 'America First' attitude. The new Biden administration is expected to be cautious of China and more wary of Russia, especially since the hacking attack of late 2020 on sensitive government offices. It will also try to repair our alliances with European and Asian trading partners. As for tariffs, we expect a gradual rollback of many of those that impacted US consumers.

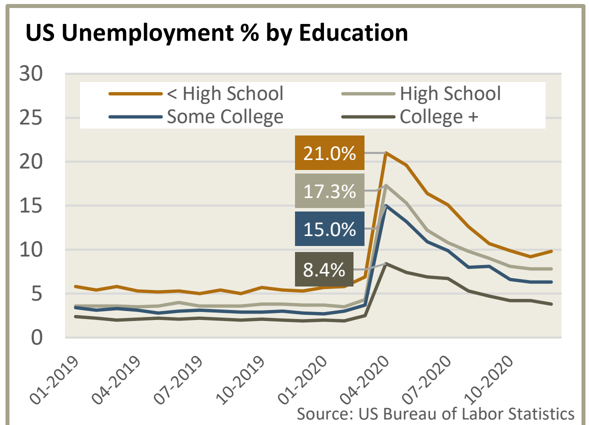
Domestically, with a Democratic majority in the Senate, we expect a substantial number of measures to pass quickly, including another round of stimulus and possible bills targeted at housing, infrastructure, climate change, and education. The Biden administration is likely to target reversal of the 2017 corporate and personal tax cuts, to help fund these new initiatives.

While the Federal Reserve successfully stabilized the economy by slashing interest rates, that tactic has likely run its logical course. Stimulus funds will promote spending and allow businesses to pay their bills. Beyond the economy, the new administration faces the enormous challenges of widespread and effective vaccinations, as well as mending the partisan and social divides.

Consumer Economy

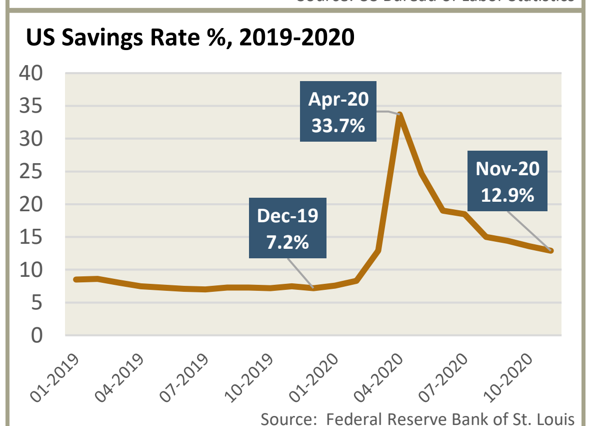
Unemployment

The national unemployment rate spiked to 14.7% and then rapidly began falling before finishing the year at 6.7%. The impact of COVID has been disproportionately felt by individuals in lower-paying jobs, often with less education, especially in the service industries. Employment at hotels, restaurants, casinos, and all types of personal services (hair salons, for example) has been decimated, while white collar and professional jobs have been mostly immune to the pandemic. Jobs for these people will only return once we control the virus.



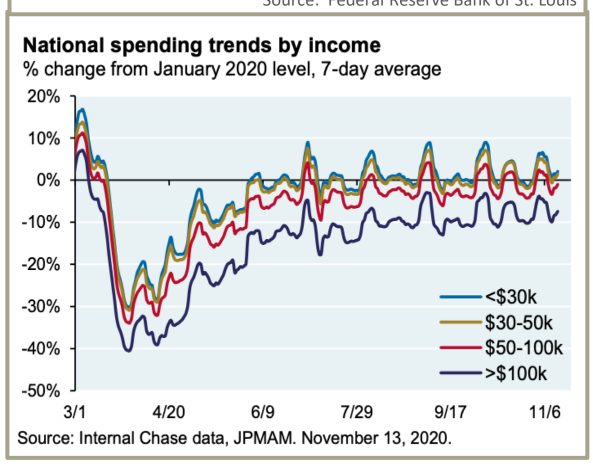
Savings

In late March, Congress passed the CARES Act, which included stimulus checks to individuals and PPP (Payment Protection Program) for businesses depressed by the pandemic, allowing them to retain employees. Wealthy individuals had fewer opportunities to spend money, and the overall savings rate spiked from ~7.5% to over 33%. Some of these savings have helped fuel the stock market rally. Now back in the 13% range, we expect the consumers to resume historic savings levels once the economy fully can reopen.



Spending

Consumer spending by lower income cohorts, which is mostly required rather than discretionary, proved remarkably resilient during 2020 thanks to the disbursement of stimulus checks and enhanced unemployment benefits. Households with incomes over $100K per year, with fewer leisure experiences available, continue to spend roughly 10% less than in the prior year, as reflected in the elevated national savings rate. We expect this type of discretionary spending to resume post-vaccines.



Global Monetary Policies

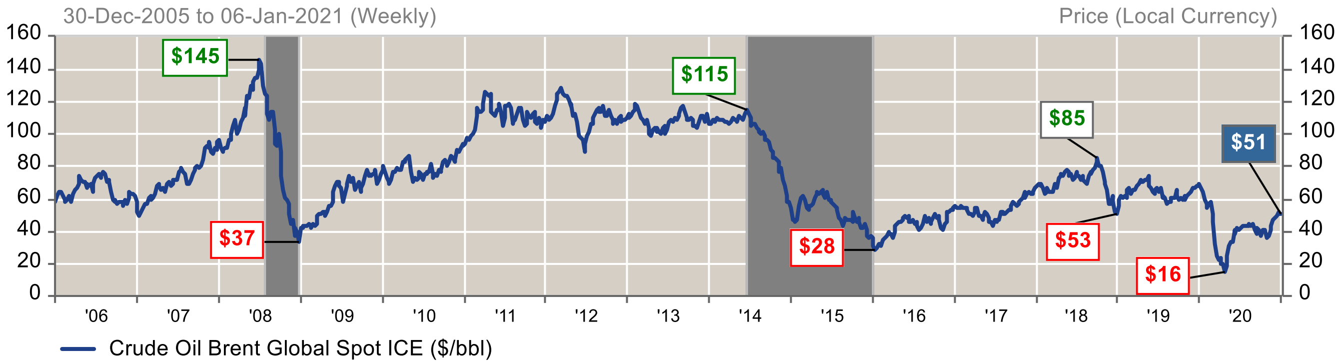
2020 was marked by unprecedented central bank efforts to provide easy money, leading to negative yields on over one-third of world sovereign bonds and massive money supply infusions.

As immunization proceeds, central banks will need to adjust their policies to the course of the economic recovery, reining back easy money and eventually raising interest rates. Yet we believe that the chances for a major rise in inflation remain low, as there is substantial unused capacity in the world's labor markets and in most manufacturing sectors. Therefore, bond yields should still stay low on a historical basis.

Oil Prices

As economic activity ground to a standstill in early 2020, oil prices fell to $16 per barrel and actually traded below $10 in April before recovering to the $40 level during the summer. Recently, anticipation of improved economic activity has helped push prices back above the $50 level.

2006-2020 Crude Oil Prices



Source: FactSet Prices

Interest Rates and Inflation

The modest growth experienced in the long economic, pre-pandemic expansion has kept inflation in check for many years. Commodity prices rose 20% in the fourth quarter of 2020 and are approaching 2019 levels. A global economic recovery and the massive debt/deficits accumulated by governments may put upward pressure on inflation in coming years. The offset to this is the commitment of the Fed to keep short-term rates "lower for longer" and to use inflation as a measure for future rate increases. Coming out of the recession and anticipating a reopening of the economy, we expect interest rates to move modestly higher in 2021, toward levels experienced in 2020, in the range of 1.5%-2.0% on the 10-year US Treasury note.

Corporate Earnings

Not all economic sectors experienced equal damage during the 2020 recession. Some sectors were surprise beneficiaries, while others were unfortunate casualties. Healthcare and Information Technology are expected to post earnings growth >5% for the year. In the case of Info Tech many companies benefitted from the virtual/online environment necessitated by a closed economy. Others, like Consumer Staples were unchanged as these products are needed regardless of economic conditions. On the other side, Consumer Discretionary and Industrials will experience >40% reduction in 2020 earnings. Energy, with oil prices spending much of the year in the sub-$40 range, will see earnings drop 100% from 2019 levels.

S&P 500 earnings for 2020 are expected to be down 15-20% to around $135 (from $165 in 2019) per share. We expect a 20% increase in 2021 back to the $165 level and, based on current information, could see another 10-15% increase in 2022 to $185 in earnings. Given the historically high relative valuation of equities, this level of earnings growth will be necessary to deliver positive returns for investors.

Economic Growth

United States:

Economists are expecting real GDP growth over 4% in 2021, with some estimates as high as 6% in a bull case scenario. Ultimately, control of the spread of the virus, vaccine efficacy, and the pace of reopening will determine the magnitude of GDP growth. We are experiencing a health crisis, and while monetary and fiscal stimulus can help, this crisis requires a health solution.

Factors	Influence
▪ Rising COVID infection rates	-
▪ Government spending/income support	+
▪ Consumer savings rate/pent-up demand	+
▪ Trade and tariff concerns	=
▪ Unemployment rate	-
▪ Fed commitment to lower for longer ST rates	+

Europe and Japan:

Central banks acted quickly and forcefully to address the pandemic impact. However, more is needed in the form of fiscal stimulus to change the longer-term trajectory of economies. Brexit implementation will be difficult, time consuming, and may well limit growth for specific countries (including the UK). Japan appears to be the farthest along in recovery, given better COVID response (lower infection and death rates).

Factors	Influence
▪ Post-pandemic improving economic growth	+
▪ Supportive central banks	+
▪ Political uncertainty in several countries	-
▪ Brexit implementation	-
▪ Trade and China Impact	+

Emerging Markets:

China bucked global trends in 2020 by taking dramatic measures to curb the spread of COVID. The first COVID-hit country, China was also the first out, and we expect growth to continue at an above average pace. We expect other EM countries to lag China's recovery but still benefit from synchronized global economic growth.

Factors	Influence
▪ Post-pandemic global growth recovery	+
▪ More reasonable equity valuations	+
▪ China continues to gain economic influence	+
▪ US trade policy	+
▪ Dollar Weakness	+

Model Factor 2 - Valuation

Key considerations are valuation and yields, viewed historically, in absolute and relative terms.

Equities

Global Equity Valuation Comparison

	10 Year P/E Ratio			Jan.	Jan.	10 Year Price/Book Ratio			Jan.	Jan.
Country/Region	High	Low	Avg.	2021	2020	High	Low	Avg.	2021	2020
US	23.9	10.0	15.9	22.7	18.3	3.9	1.6	2.7	3.9	3.4
Europe	22.1	8.3	13.9	17.4	14.4	1.8	1.0	1.4	1.7	1.7
Japan	19.3	10.9	14.1	18.7	15.0	1.5	0.8	1.2	1.3	1.2
Emerging Markets	18.9	9.6	13.6	17.8	14.0	2.3	1.4	1.7	2.2	1.8

Source: FactSet, January 2020. Forward P/E and P/B ratios.

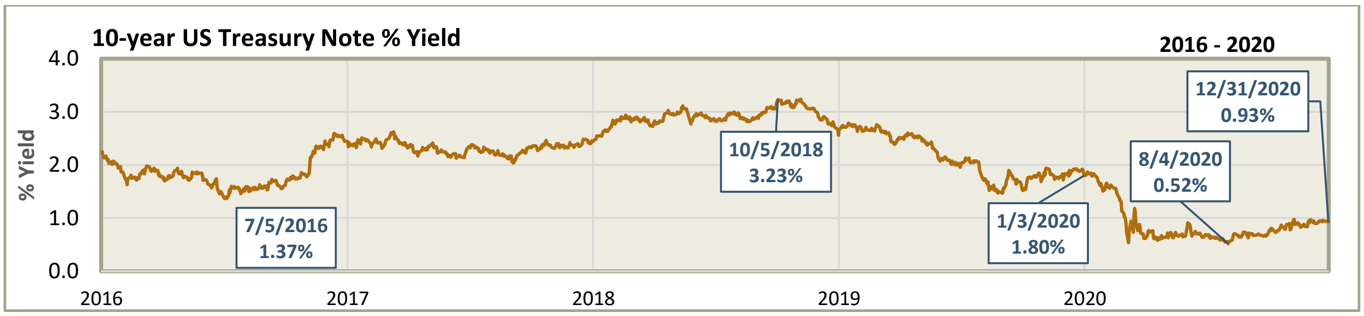
The US market now sells for around 22x next year's earnings, at the high end of the historic range. With earnings multiples near historic highs, it is difficult to argue that the market is attractively valued, and we would certainly agree that discretion is warranted. However, there are two counterweights to consider. The first is that we expect to see accelerated earnings growth off currently depressed levels, which makes multiples on 2022 earnings more palatable. The second is that interest rates remain near historic lows. Low interest rates support higher equity valuations, and relative to fixed income and other asset classes, equity valuations still appear attractive.

Based on the price/earnings ratio, valuations in Europe, Japan, and emerging markets are near the high-end of their 10-year averages, but multiples remain well below the US, which has been true for many years. The post-pandemic economic recovery should help all international markets with emerging markets seeing the best outlook as global growth recovers.

Bonds

As described above, the Fed reduced short-term rates, effectively, to zero in March and the Treasury provided unprecedented liquidity for fixed income markets. The 10-year Treasury Note began 2020 at 1.80%, fell to 0.53% in August before rising to 0.93% to close the year. While the Fed has committed to keeping short-term rates low, longer bond yields have recently been rising in response to an improving economic outlook, concerns of rising inflation, and massive government deficits. At current levels, we believe bonds offer very little in terms of competitive return.

Developed market bonds outside the US continue to have rates at or below 0% reflecting the attempts of global monetary authorities to stimulate economic growth.



Model Factor 3 - Geopolitical

Key considerations are government and political conditions in specific geographies that may impact economies and investment markets.

United States

President Biden will have to restore respect for government and our democratic system. In addition, he has identified, as a key goal, improving foreign relations with many traditional allies. He most likely will ease the tariff war with China, but maintain a firm stand with both China and Russia.

Europe

With Brexit a fait accompli, the UK and the Continent will struggle to implement a positive path forward. COVID has been severe in much of Europe, as well as Great Britain, and pulling out of the pandemic will be a huge hurdle in 2021, particularly for those countries in which tourism plays a larger role.

Asia ex China

Much of this area, including South Korea, Taiwan, Japan, Australia, and New Zealand, benefited from a fast and mostly effective containment of COVID. Therefore, their economies should post reasonably good growth this year. However, these countries now look much more cautiously on China's assertive policies, which may mean an opportunity for the US to mend fences with their leaders.

China

The world will remember a two-faced approach to COVID — a month of denial, then severe lockdowns which, accompanied by scientific progress, brought China back to better economic growth. But the shutdown of dissent and freedoms in Hong Kong may cause other Asian countries to be more wary of their relationships with their powerful neighbor .

Model Factors – Summary Table:

Region	Economic Fundamentals	Valuation & Risk	Geopolitical
US	▪ Dismal winter followed by strong recovery in summer and fall assuming vaccination success ▪ More stimulus expected in first quarter ▪ Fed will maintain easy money and low rates until signs of recovery underway ▪ Possible tax increase late in year or in 2022	▪ Price-earnings multiples are high, bond valuations even more stretched ▪ Anticipated snapback in corporate earnings later in 2021 should help to prop stocks ▪ Bonds are vulnerable to an eventual change in Fed's easy money policy	▪ Biden administration faces challenge of restoring faith in government while calming political tensions ▪ Expect much more attention to domestic priorities of education, healthcare, infrastructure ▪ Biden will rebuild alliances with traditional allies, to face threats from Russia and China
Developed Markets	▪ Brexit poses questions about adjustment of both UK and EU, with potential negative impact on growth near-term ▪ Japan to keep to slow growth, very low inflation ▪ Central bank policies will remain stimulative until late in the year	▪ Bonds seem especially exposed when, and if, monetary policies adjust to better growth expectations ▪ Fairly low equity valuations offset by sluggish growth prospects	▪ Post-Brexit the UK will need to reach trade deals with the US, the EU, and the rest of the world ▪ Greater caution on the part of EU re Russia ▪ China to continue to pursue EU and rest of Asia
Emerging Markets	▪ China will continue to recover from COVID faster than EU or US ▪ China's demand for commodities and services will help other emerging countries	▪ Demand for Chinese equities and debt should stay strong ▪ Commodity price recoveries should help a number of countries	▪ Fears about Chinese domination are rising ▪ Chinese actions in Hong Kong show rigid policy of requiring all citizens to conform to official government postions

Expected Returns

2021 Asset Allocation: Expected Returns

Asset Class	Risk Level	Expected Nominal Return	2021 Allocation	Expected Nominal Return Attribution
Cash	Low	0.0% – 1.0%	4%	0.0% – 0.0%
Fixed Income	Low	1.0% – 2.0%	4%	0.0% – 0.1%
Absolute Return	Low	4.0% – 6.0%	14%	0.6% – 0.8%
Directional Alternatives	Moderate	3.0% – 7.0%	7%	0.2% – 0.5%
US Equities	High	4.0% – 8.0%	47%	1.9% – 3.8%
International Developed Equities	High	5.0% – 9.0%	11%	0.6% – 1.0%
International Emerging Equities	High	5.0% – 11.0%	13%	0.7% – 1.4%
Total Portfolio Nominal Return			100%	**3.9% – 7.6%**
Less Expected Inflation				(2.0%)
Total Portfolio Real Return				**1.9% – 5.6%**

Calculating expected returns is mainly a quantitative exercise to establish a range of returns for both asset classes and an overall "average" portfolio. History has shown that rarely will these asset classes deliver these expected returns during any one calendar year given the cyclicality and volatility of individual asset classes. For example, US equities returned -4.4% in 2018, followed by 31.5% in 2019 and 18.4% in 2020 delivering a three-year annualized return of 14.2%. Over longer periods these more volatile one-year returns are smoothed and returns generally move toward longer term asset-class averages. The expected nominal returns in the table above incorporate factors specific to our view of the current market environment and allow us to express our assumptions and apply them to a client's portfolio.

For 2021, we expect better returns to come from US equities and International equities. However, the range of returns are lower for equity assets given higher valuations than a year ago. In a base-case portfolio implementation, we would expect a diversified portfolio to generate expected nominal returns in the 3.9% to 7.6% range, with the overweight to global equities providing the bulk of the return contribution.

As always, we remain diligent in our approach to the financial markets and the management of our clients' investment portfolios. As new information becomes available, we will update our models and, when market conditions warrant, adjust our allocations.

We appreciate the opportunity to share our views and welcome your questions and comments.