

ClearBridge

Investments

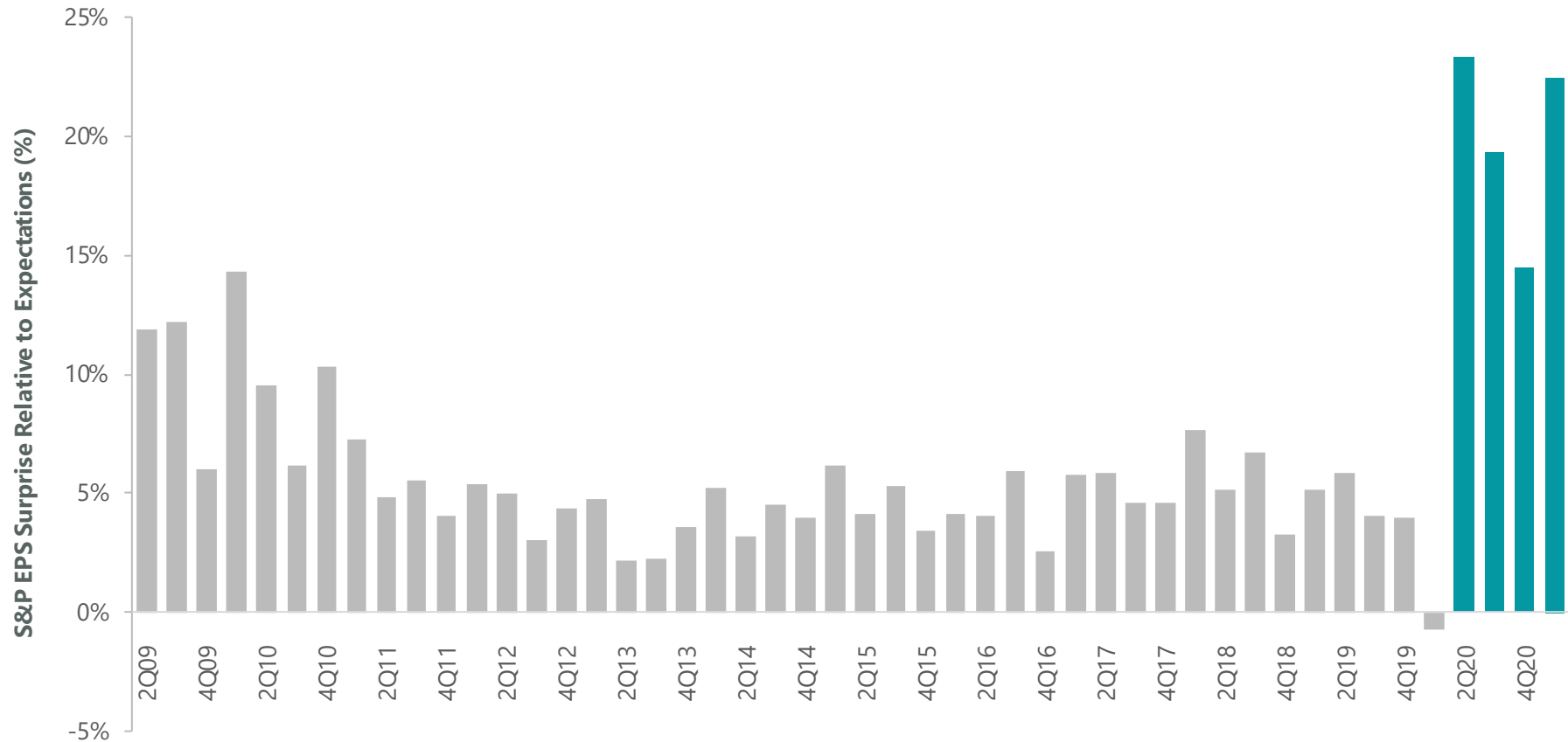
Economic and Market Outlook

Third Quarter 2021

Past performance is no guarantee of future results. Financial term and index definitions are available in the appendix.

Historic Earnings Surprise

Earnings Beats over the Last Year Have Been Extremely Strong



- ▶ Earnings have handily beat expectations and helped power the market's rally.
- ▶ 87% of S&P 500 companies beat earnings estimates last quarter, the best on record.

U.S. Recession Risk Indicators

- 12 variables have historically foreshadowed a looming recession
- No recession signals are flashing risk right now

	June 30, 2021	March 31, 2021	December 31, 2020
Consumer	Housing Permits	↑	↑
	Job Sentiment	↑	×
	Jobless Claims	↑	●
	Retail Sales	↑	↑
	Wage Growth	↑	×
Business Activity	Commodities	↑	↑
	ISM New Orders	↑	↑
	Profit Margins	↑	●
	Truck Shipments	↑	●
Financial	Credit Spreads	↑	↑
	Money Supply	↑	↑
	Yield Curve	↑	↑
Overall Signal	↑	↑	↑

↑ Expansion ● Caution × Recession

U.S. Recession Risk Indicators

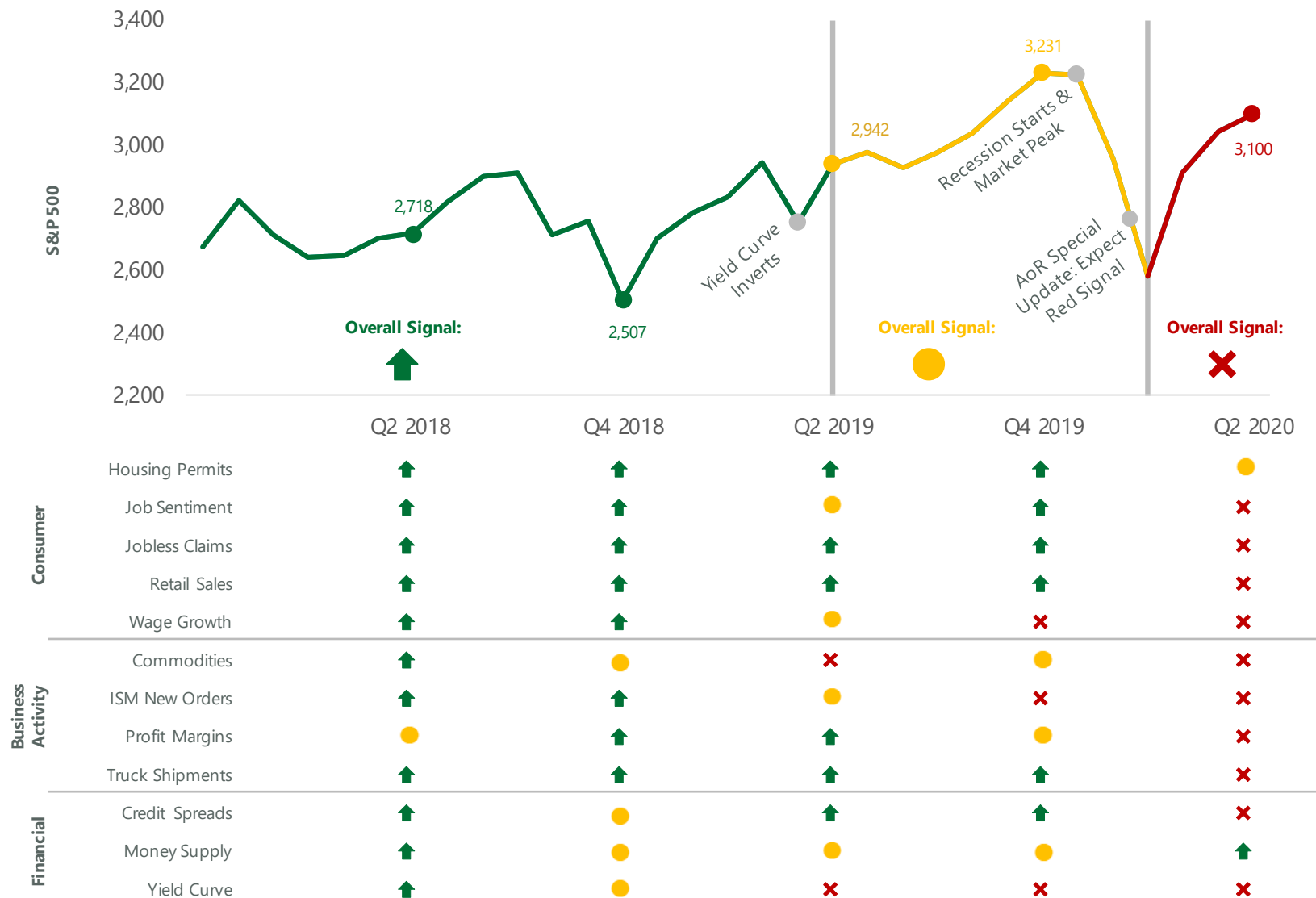
- 12 variables have historically foreshadowed a looming recession
- No recession signals are flashing risk right now

	Current	2020	2007-2009	2001	1990-1991	1981-1982	1980	1973-1975	1969-1970
Consumer	Housing Permits	↑	↑	×	●	×	×	×	×
	Job Sentiment	↑	●	×	×	×	●	●	●
	Jobless Claims	↑	↑	●	×	×	×	↑	×
	Retail Sales	↑	↑	×	×	×	×	●	×
	Wage Growth	↑	×	×	×	×	×	×	×
Business Activity	Commodities	↑	↑	×	×	×	●	●	●
	ISM New Orders	↑	●	×	×	×	×	×	×
	Profit Margins	↑	×	×	×	×	×	●	×
	Truck Shipments	↑	↑	●	×	×	×	n/a	n/a
Financial	Credit Spreads	↑	↑	×	×	×	×	↑	●
	Money Supply	↑	↑	×	×	×	×	×	×
	Yield Curve	↑	×	×	×	×	×	×	×
Overall Signal	↑	●	×	×	×	×	●	×	

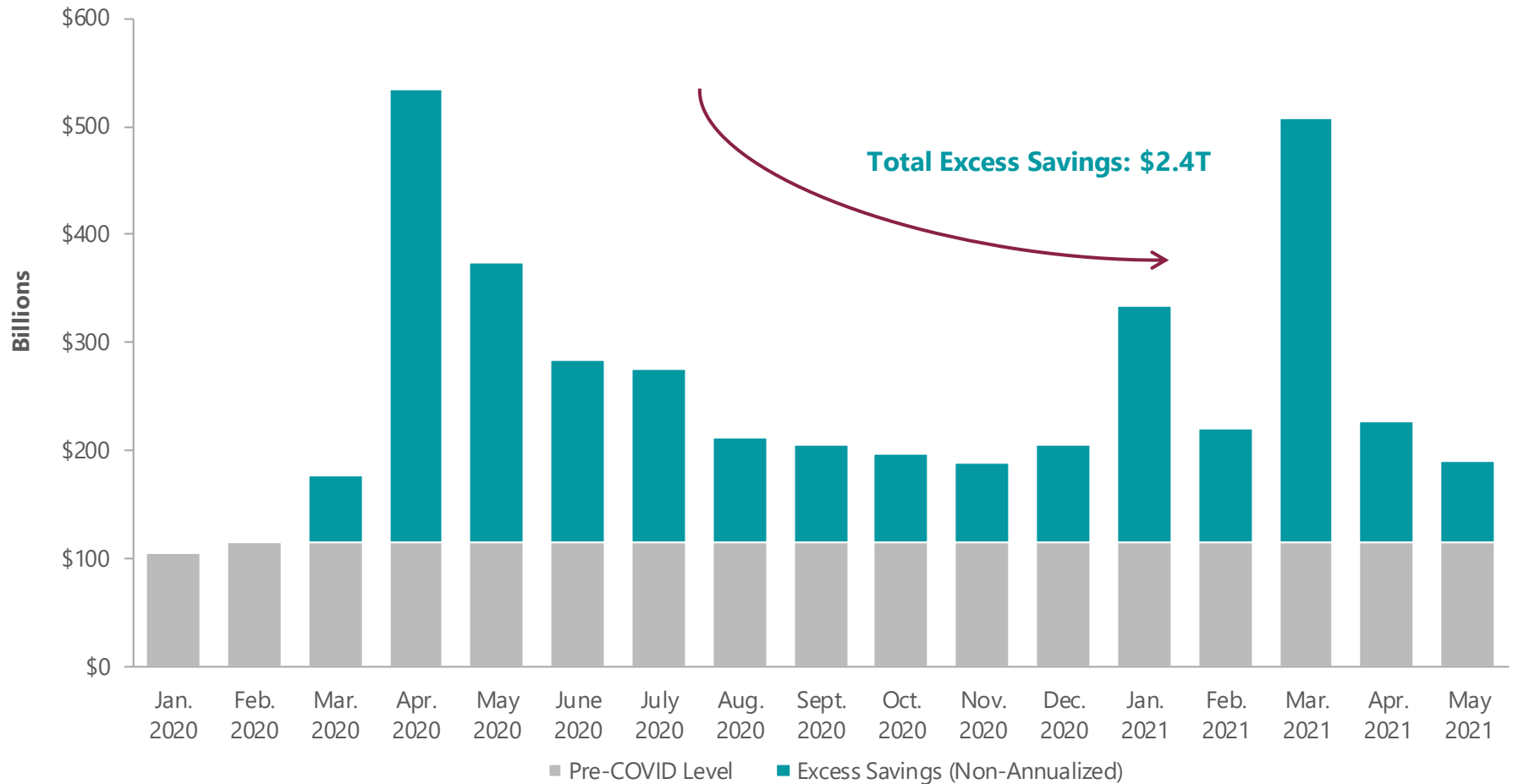
↑ Expansion ● Improvement × Recession

U.S. Recession Risk Dashboard

Case Study: 2018-2020

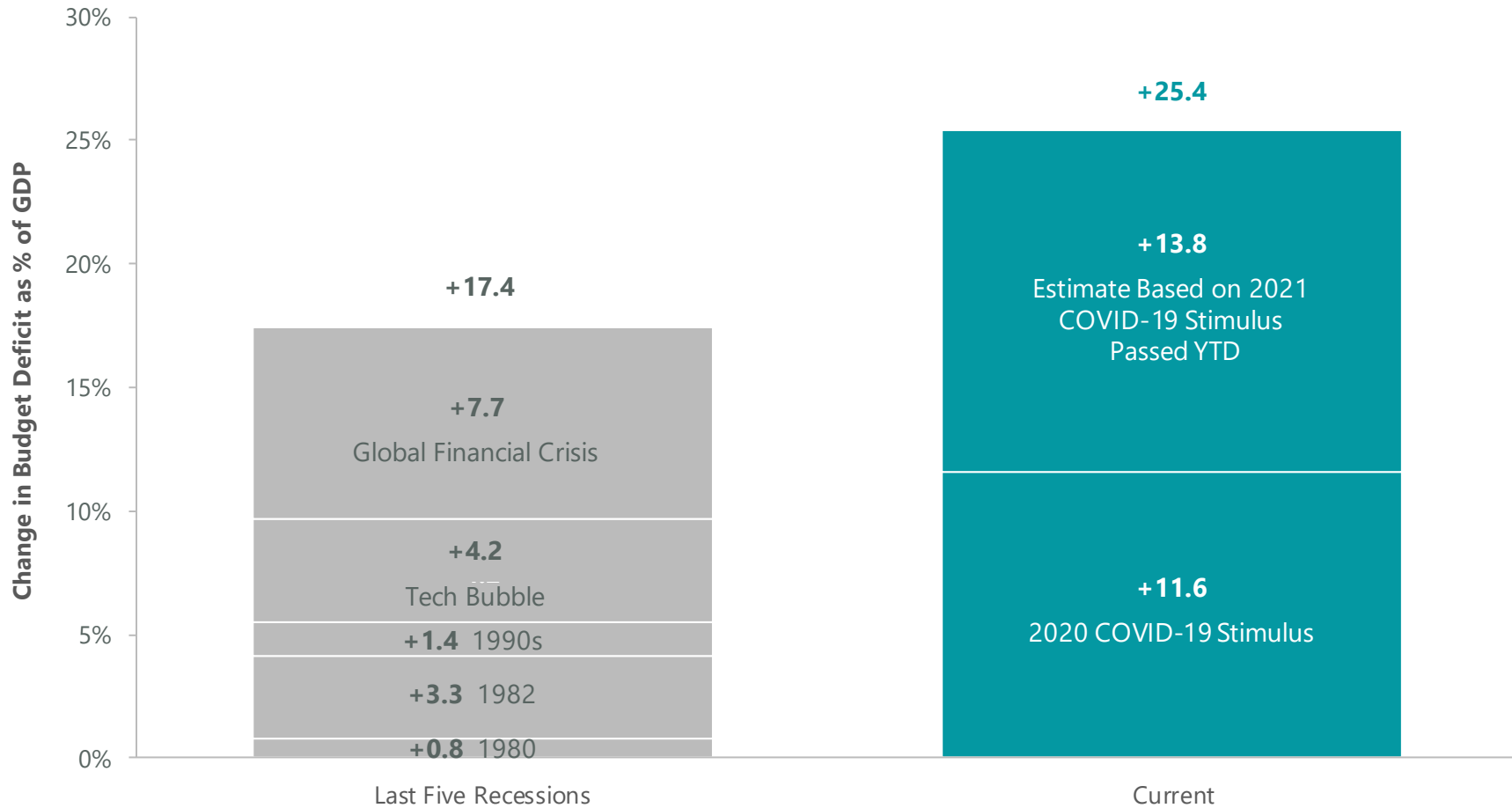


Consumer Balance Sheets Flush



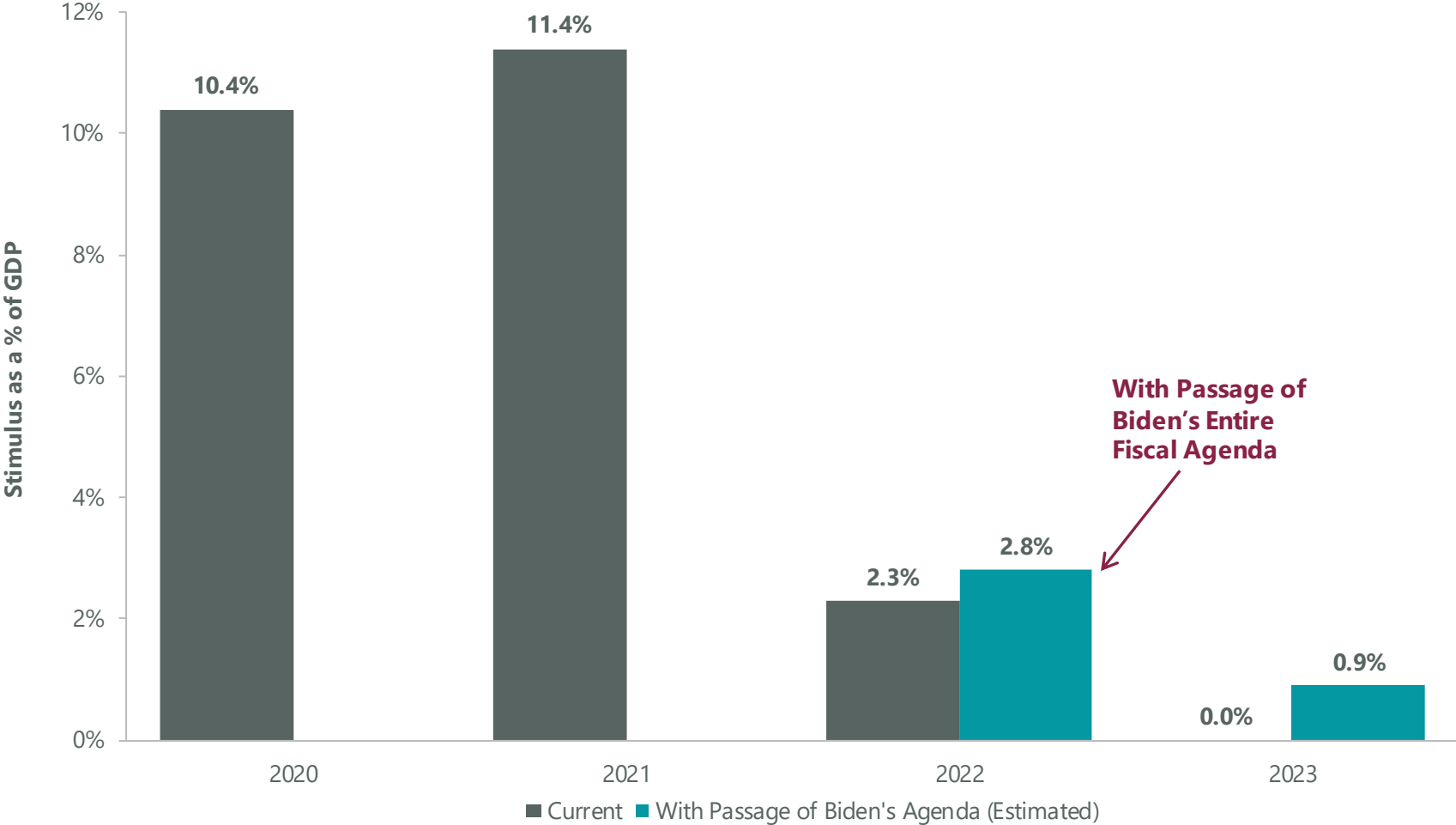
- ▶ **The inability to spend and government transfer payments have resulted in an abundance of consumer savings.**
- ▶ **As the economy renormalizes, some of these reserves will be drawn which should further fuel the recovery.**

Stimulus Tidal Wave



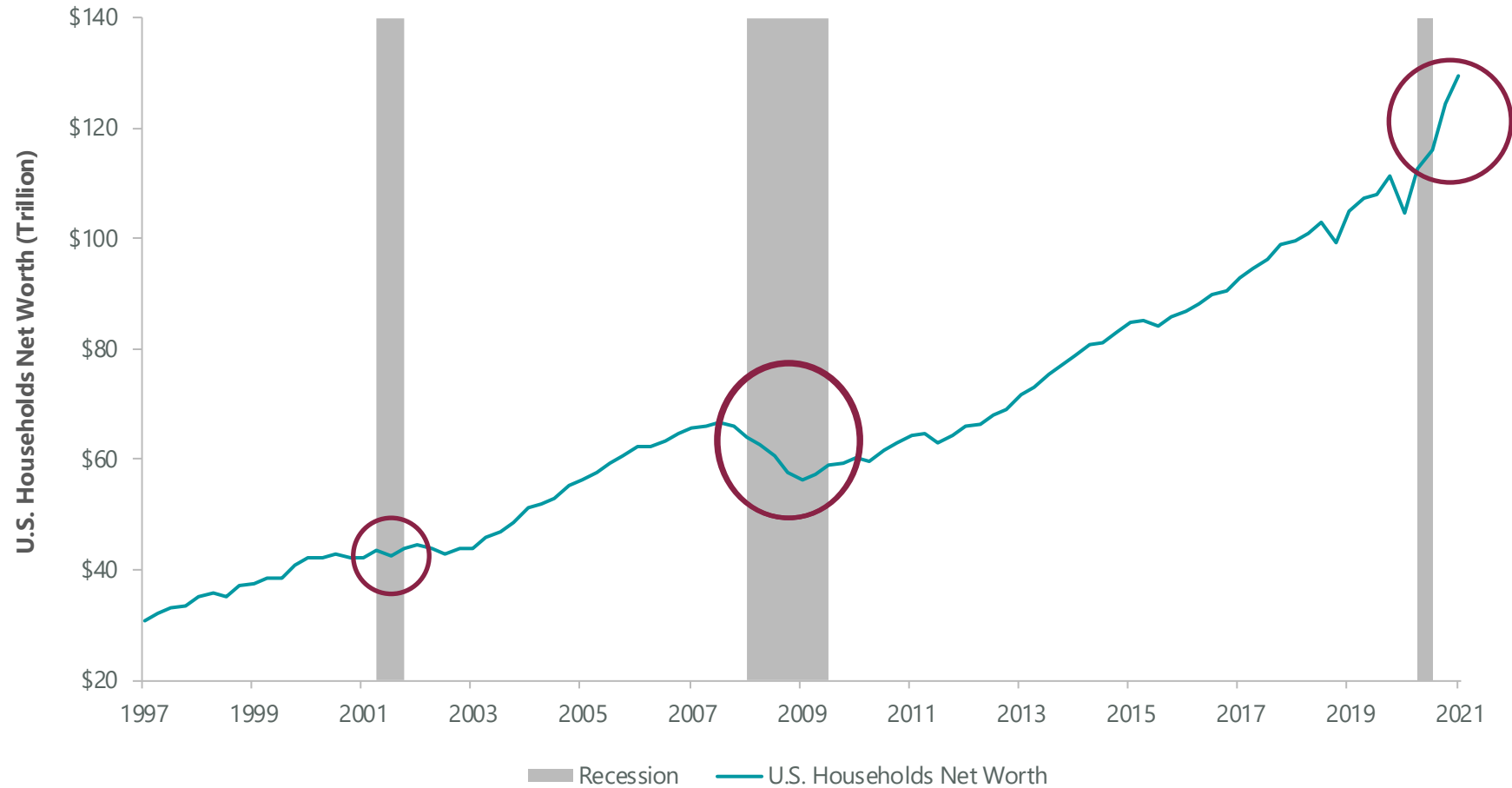
▶ **The fiscal policy response to COVID-19 has far surpassed the total response to the past five recessions.**

Fiscal Cliff?



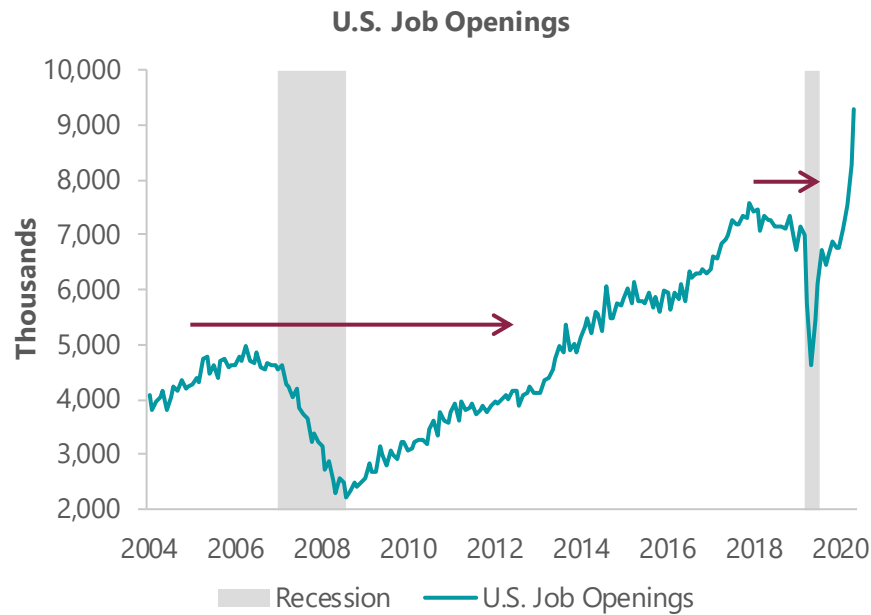
▶ **Although stimulus is set to wane in the coming years, higher compensation and healthy job creation should support consumption and blunt the fiscal drag.**

Aren't Recessions Supposed to be Painful?

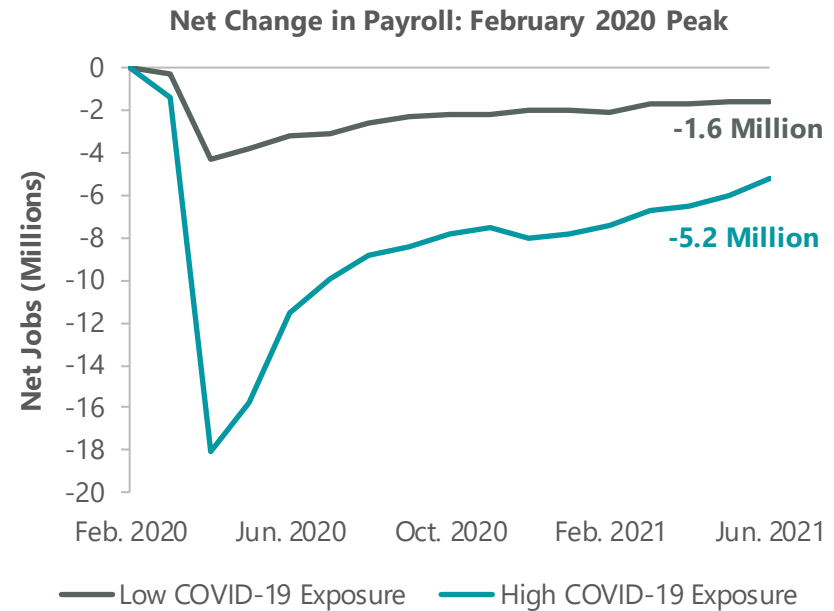


- ▶ **Historically, recessions have put a dent in household net worth.**
- ▶ **Since the end of 2019 (pre-COVID), U.S. household net worth has increased by \$25 trillion (23.8%).**

Not The Global Financial Crisis: Labor



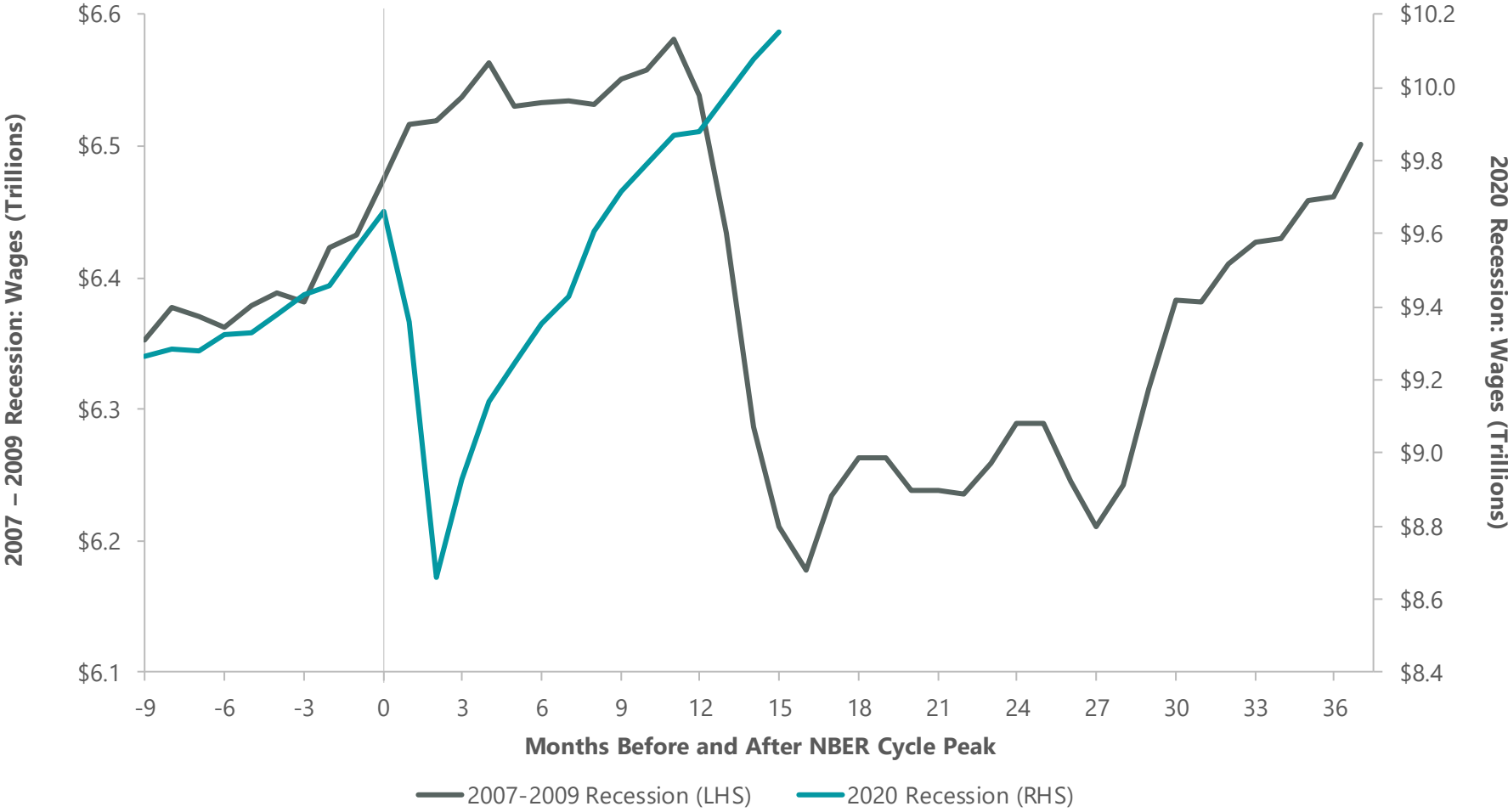
Source: DOL, FactSet.



Source: Bloomberg, BLS, INET Oxford.

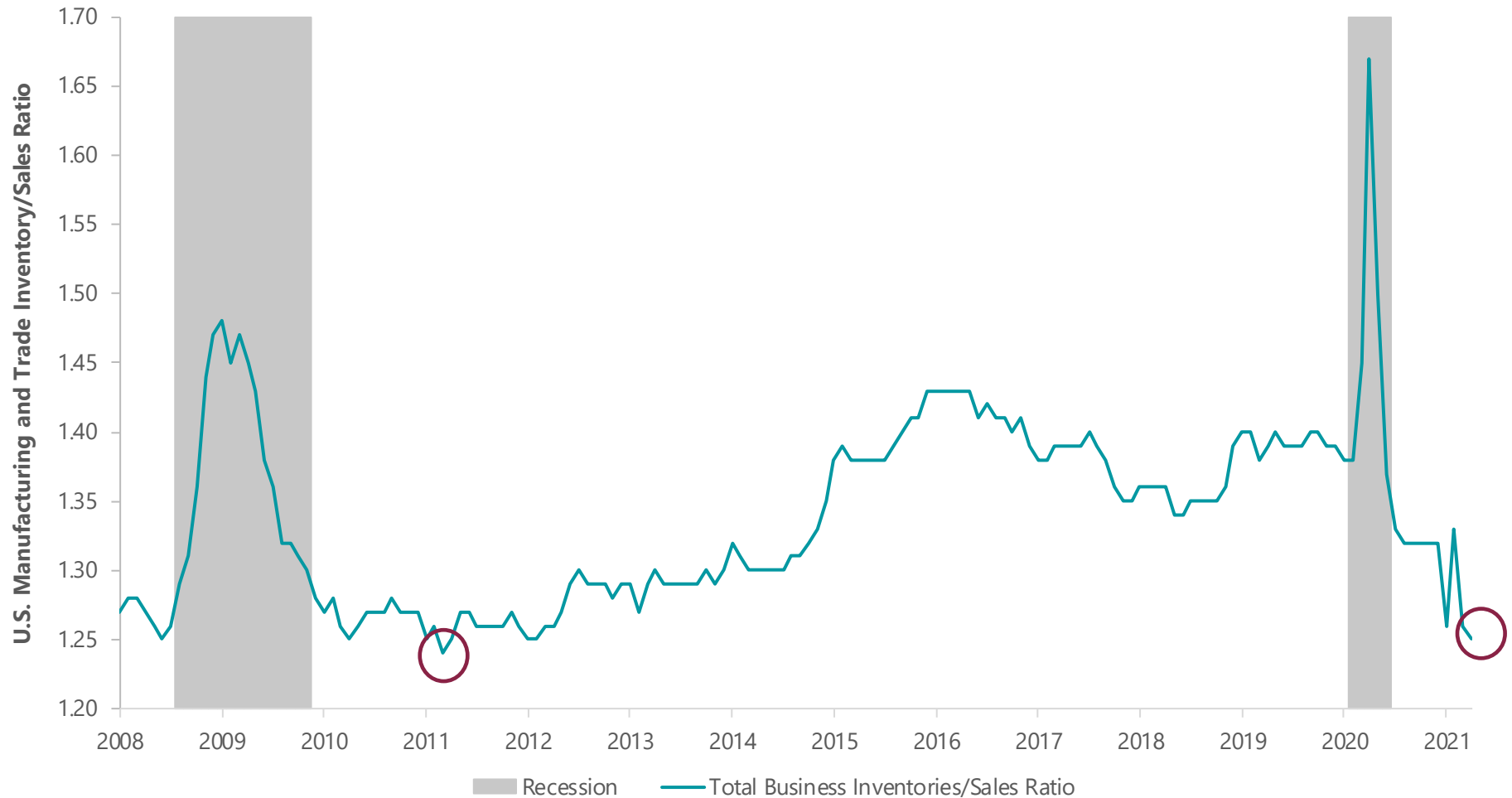
- ▶ **Post-GFC, it took until 2014 for the labor market to recover to pre-crisis levels.**
- ▶ **The majority of job losses have been in COVID-19 sensitive industries, which suggests a faster pace of job creation as the economy normalizes.**

Not the Global Financial Crisis: Wages



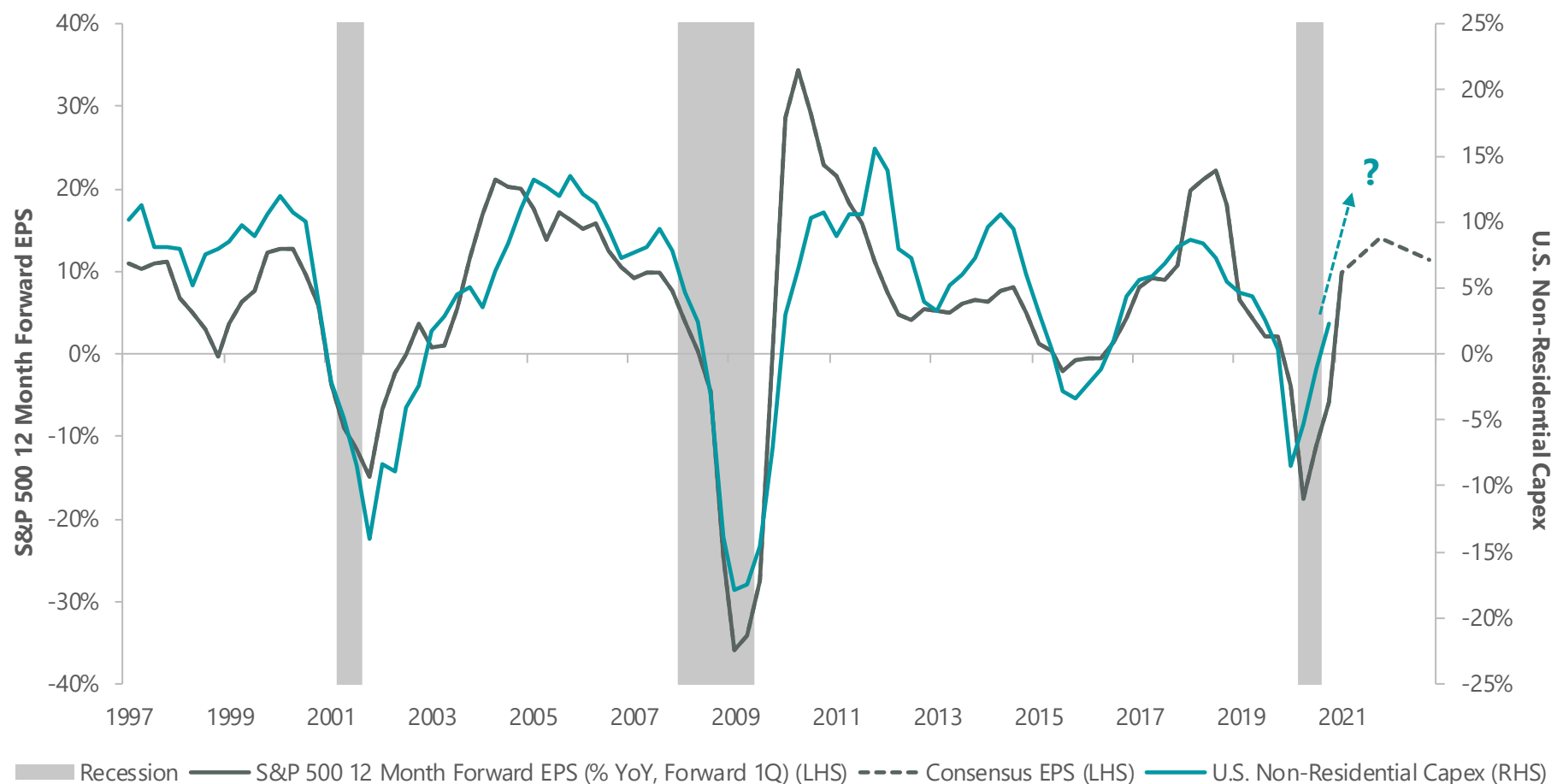
- ▶ **Wages have rapidly recovered from the COVID-19 crisis compared to the ~3-year recovery following the GFC.**
- ▶ **This should be a key support for a faster economic rebound.**

Inventory Rebuild, Economic Tailwind?



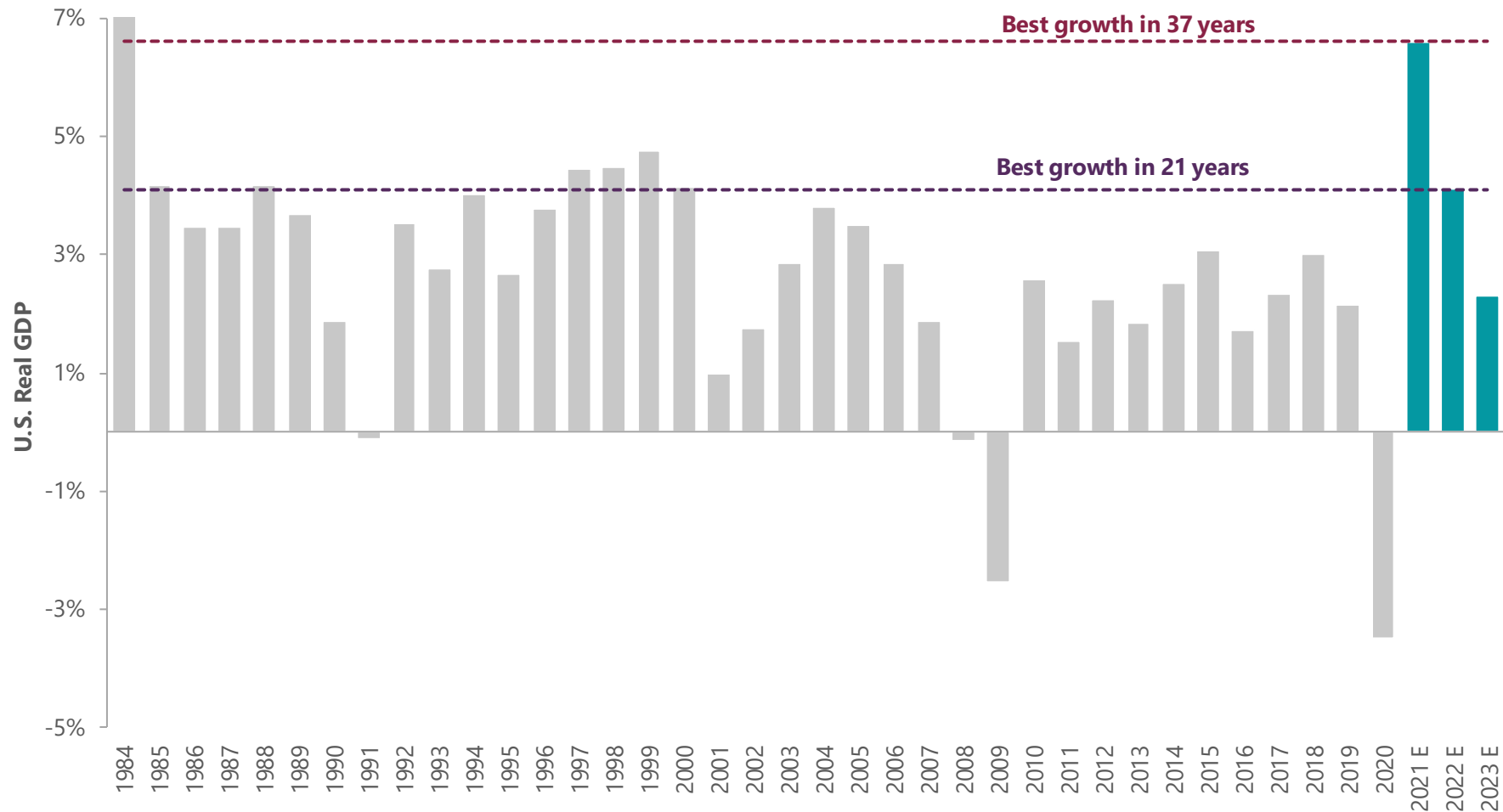
- ▶ **Inventory levels relative to sales have not been this depleted since 2011.**
- ▶ **Businesses will likely re-stock inventories in anticipation of growing demand, providing further economic upside in 2021.**

Capex Takes the Baton



- ▶ **Capital expenditures typically follow earnings growth, as companies reinvest profits back into their business.**
- ▶ **The robust growth backdrop suggests a coming pickup in capital spending, which should drive the next leg of economic growth.**

The New (Old) Normal?



- ▶ **Following the COVID-19 GDP collapse, 2021 is expected to see the strongest growth in 37 years.**
- ▶ **This strength is currently expected to persist into 2022 with the best GDP growth since 2000.**

The Stock Market is Not the Economy

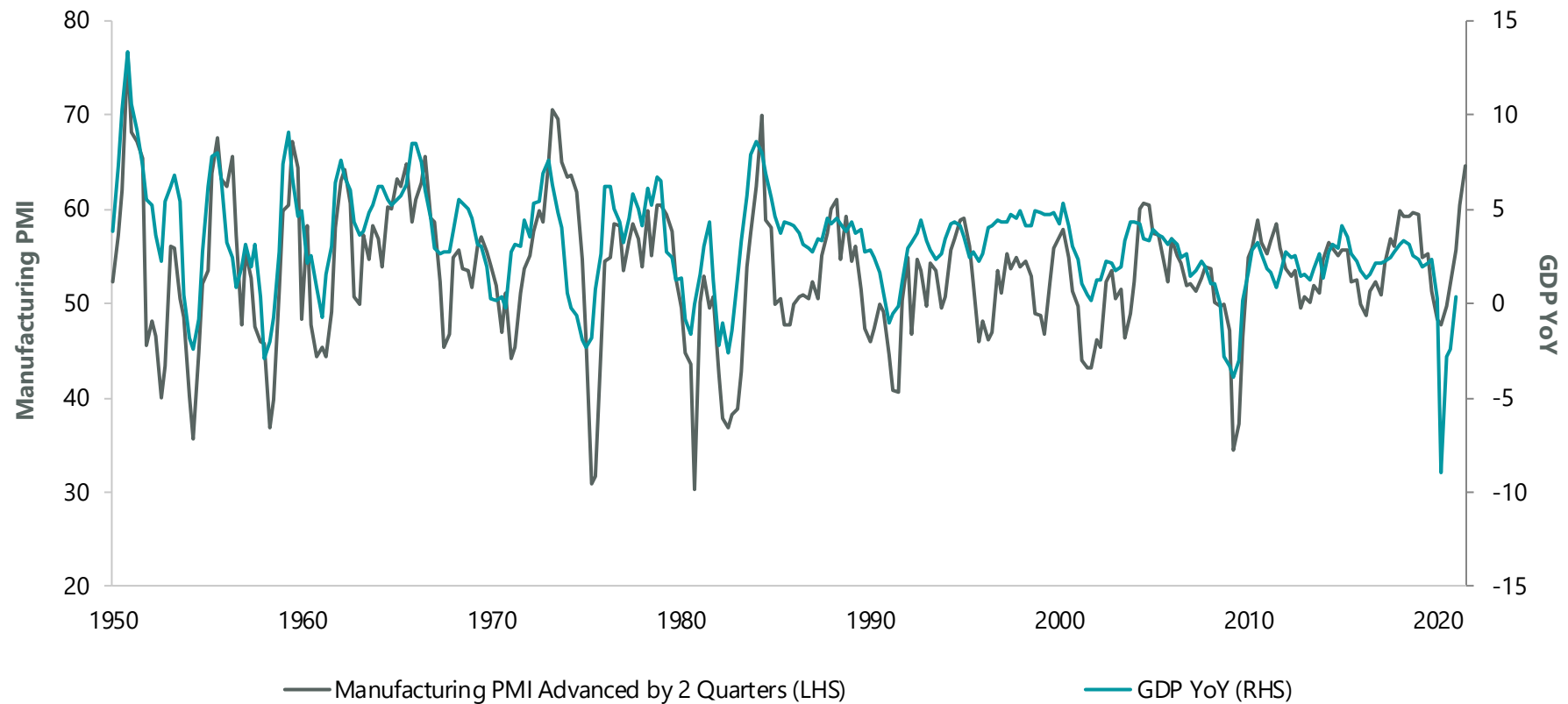
Best 10 Years U.S. Real GDP Growth Since 1950

Year	Real GDP YoY	S&P 500 Return	Max Drawdown
1950	8.7%	31.5%	-14.0%
1951	8.1%	24.0%	-9.0%
1955	7.1%	12.0%	-9.0%
1959	6.9%	-8.7%	-26.8%
1962	6.1%	-10.0%	-22.2%
1964	5.8%	-14.7%	-23.4%
1965	6.5%	12.5%	9.9%
1966	6.6%	16.4%	-3.2%
1973	5.6%	6.2%	-12.6%
1984	7.3%	31.4%	-10.6%
Average:		10.1%	-12.1%

- ▶ **During periods of exceptionally strong economic growth, stock returns tend to be above average but varied.**

Twin Peaks: Economy I

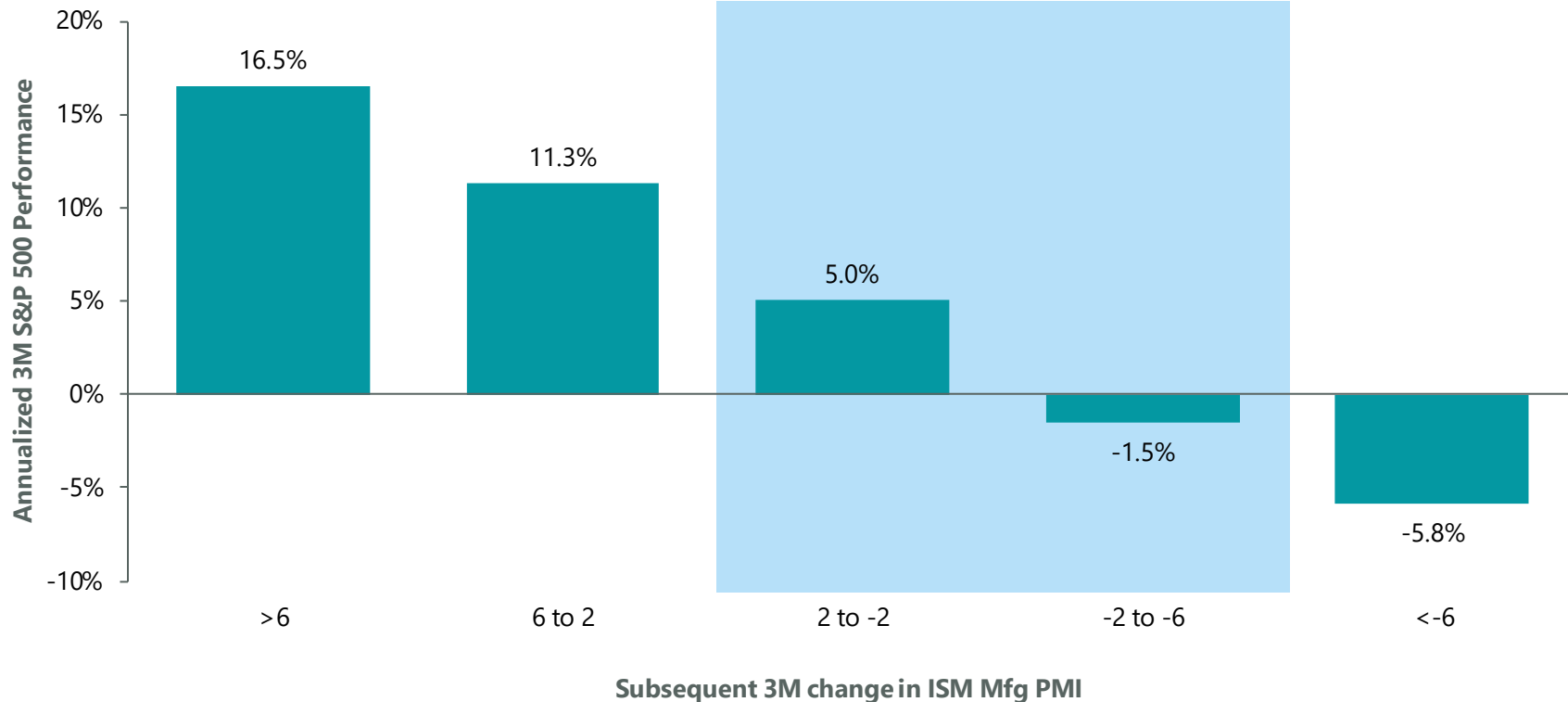
Manufacturing PMI vs. GDP YoY Since 1950



- ▶ **Historically, GDP growth has followed the ISM Manufacturing PMI survey by 2 quarters.**
- ▶ **This relationship foreshadows strong economic activity in the coming quarters.**

Twin Peaks: Economy II

S&P 500 Annualized 3M Return Based on 3M ISM Mfg Change from Levels ≥ 60 since 1950



- ▶ **Historically, only substantial declines in the ISM survey from high levels have led to meaningful market declines.**
- ▶ **If the ISM survey remains elevated or even slips modestly, history suggests the market should remain buoyant.**

Twin Peaks: Earnings

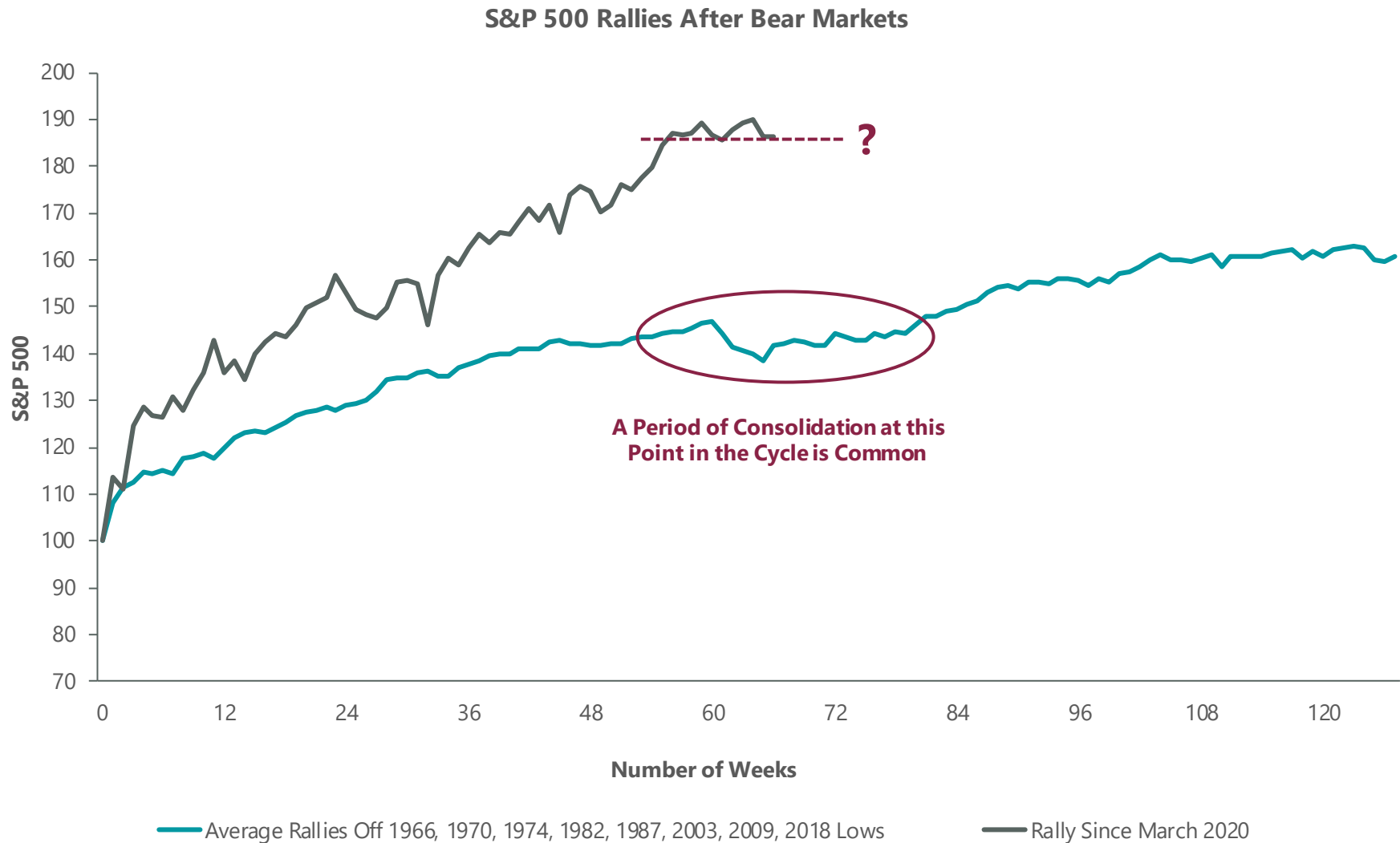
S&P 500 Returns Following Peak EPS Growth Since 1962

EPS Peak (S&P 500)	EPS Growth + 1 Year	Return (Next 6 Months)	Return (Next 12 Months)
3Q62	12.2%	18.3%	27.4%
1Q66	2.1%	-14.2%	1.1%
4Q68	0.3%	-5.9%	-11.4%
4Q73	8.9%	-11.8%	-29.7%
4Q76	9.9%	-6.5%	-11.5%
3Q79	0.1%	-6.6%	14.8%
3Q81	-11.2%	-3.4%	3.6%
2Q84	-3.6%	9.2%	25.2%
2Q88	16.4%	1.5%	16.3%
3Q93	20.0%	-2.9%	-3.2%
2Q95	9.9%	13.1%	23.1%
1Q97	1.2%	25.1%	45.5%
1Q00	-12.6%	-2.9%	-11.9%
3Q02	17.8%	4.0%	22.2%
1Q04	12.9%	-1.0%	4.8%
3Q06	-2.6%	6.4%	14.3%
4Q10	27.9%	5.0%	0.0%
2Q14	0.3%	5.0%	5.2%
3Q18	6.0%	-2.7%	2.2%
2Q21*	22.0%	??	??

Average Returns Post EPS Growth Peak		
EPS Growth + 1 Year	Return (Next 6 Months)	Return (Next 12 Months)
All Periods	1.6%	7.3%
<10%	0.4%	5.4%
>10%	4.2%	11.2%

▶ **Where earnings settle following peak growth has historically been an important barometer for forward 12 month returns.**

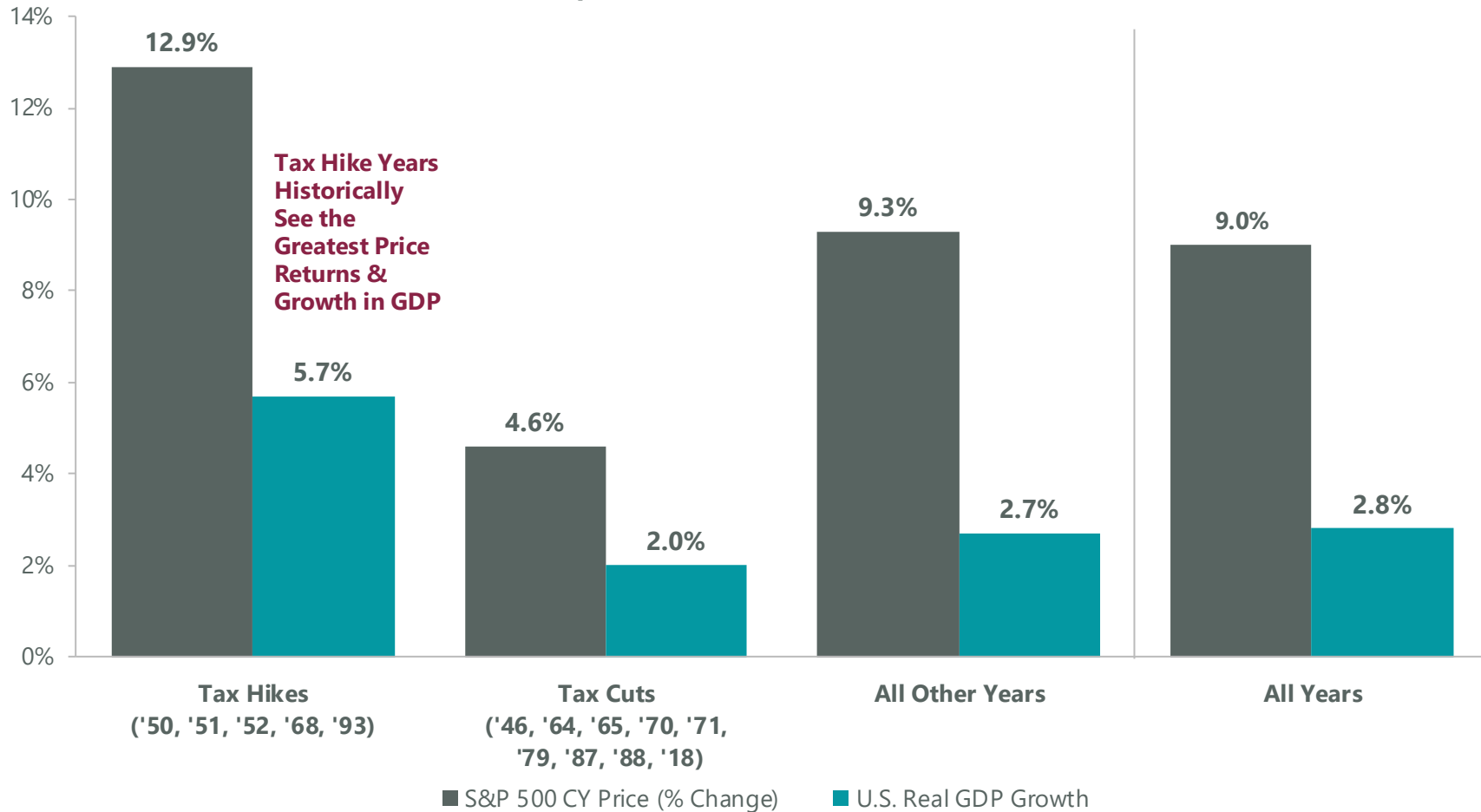
Early Gains Need Digesting



- ▶ **Following a substantial rally from the lows, equities typically experience lackluster returns as the handoff from early to mid-cycle occurs.**

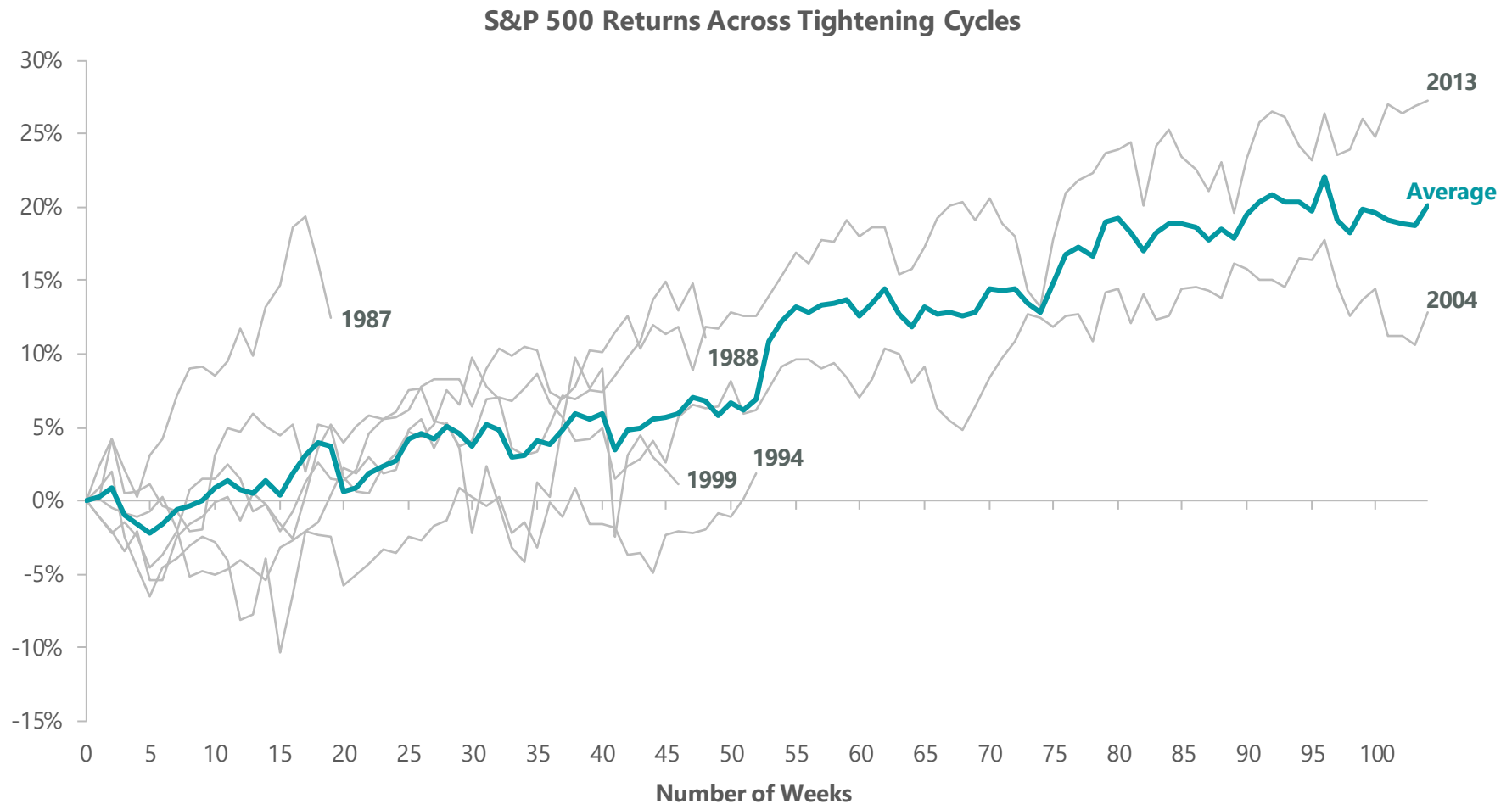
Higher Taxes, Higher Returns?

S&P 500 Average Calendar Year Price Returns & Annual U.S. Real GDP Growth
Based on Corporate Tax Rate Hikes/Cuts (Since 1945)



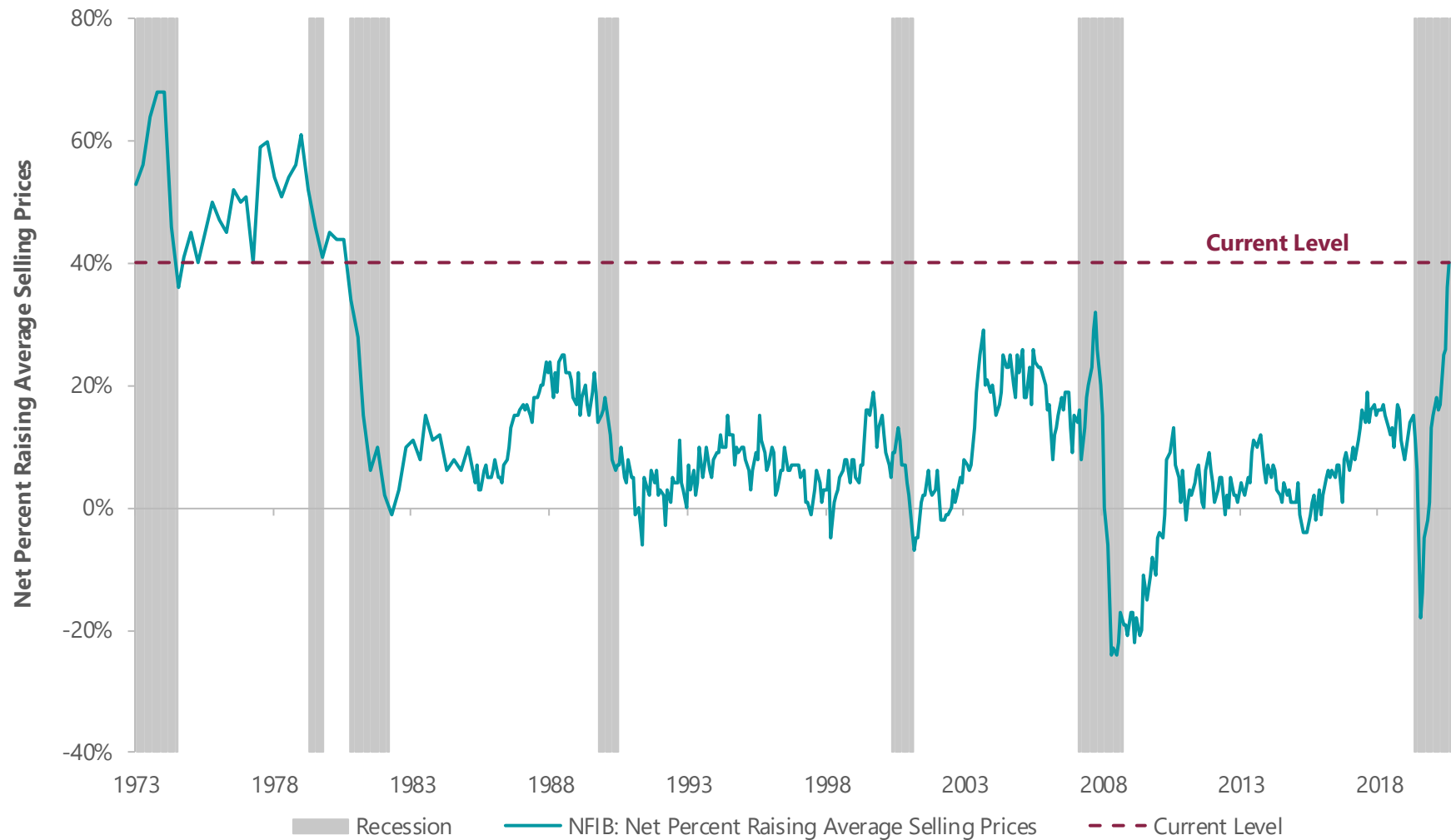
- ▶ **Although many investors fear corporate tax hikes, history suggests they tend to occur during periods of strong economic growth. This typically offsets the potential drag on equity markets.**

Fed Liftoff, Brief Pullbacks



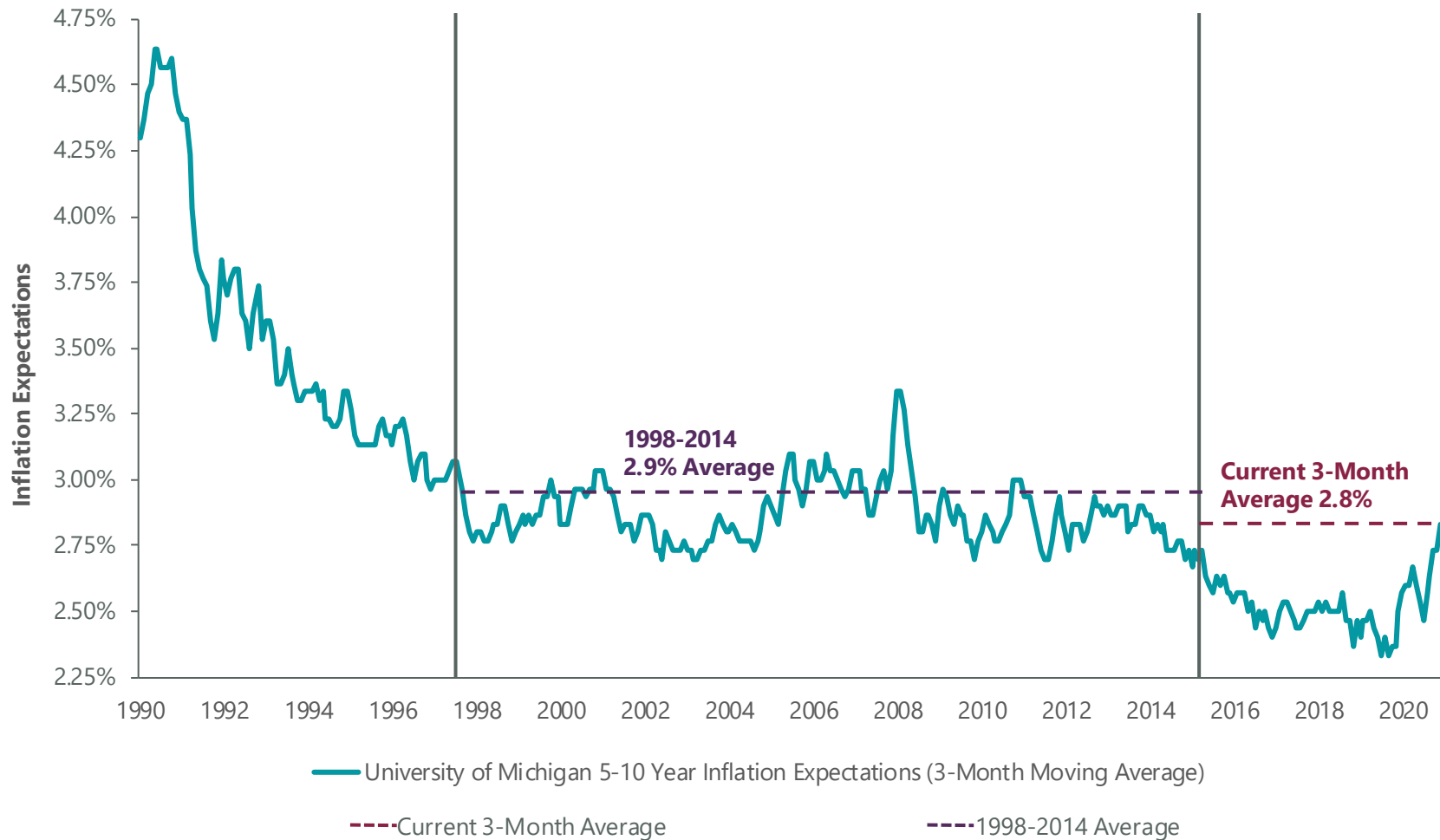
- ▶ **The beginning of a monetary tightening cycle has historically led to a brief (< 2 months) stock market sell-off.**
- ▶ **These have historically proved to be good buying opportunities for long-term investors.**

Summer 2021: Hotter Temps & Inflation?



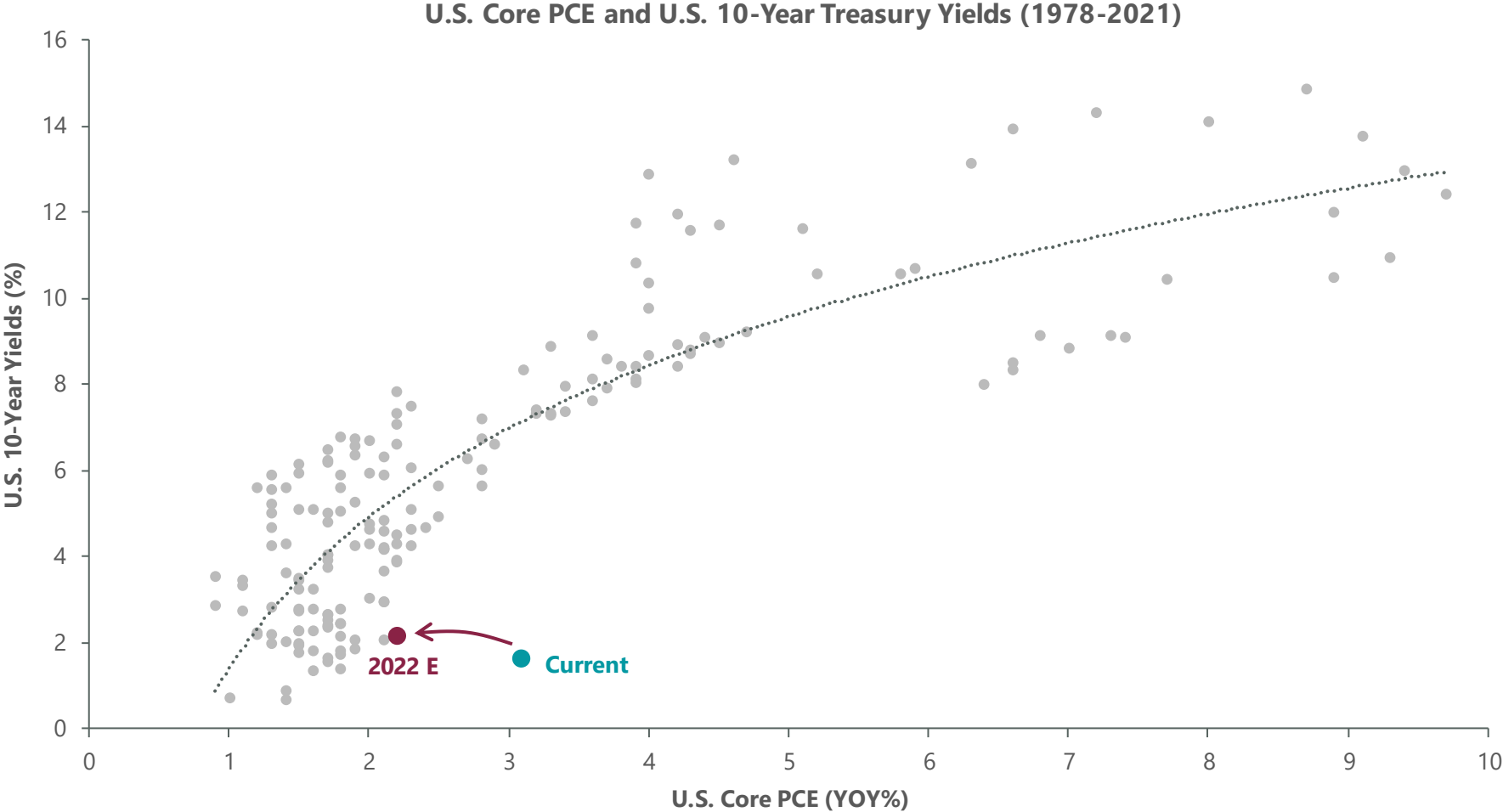
- ▶ **The proportion of small businesses increasing prices is at the highest level in four decades.**
- ▶ **This suggests that inflation could heat up beyond current expectations this summer.**

Rampant Inflation or the Old Normal?



- ▶ **Despite fears of runaway inflation and a sharp move higher from the lows, current expectations are still slightly below the average level seen between 1998 and 2014.**

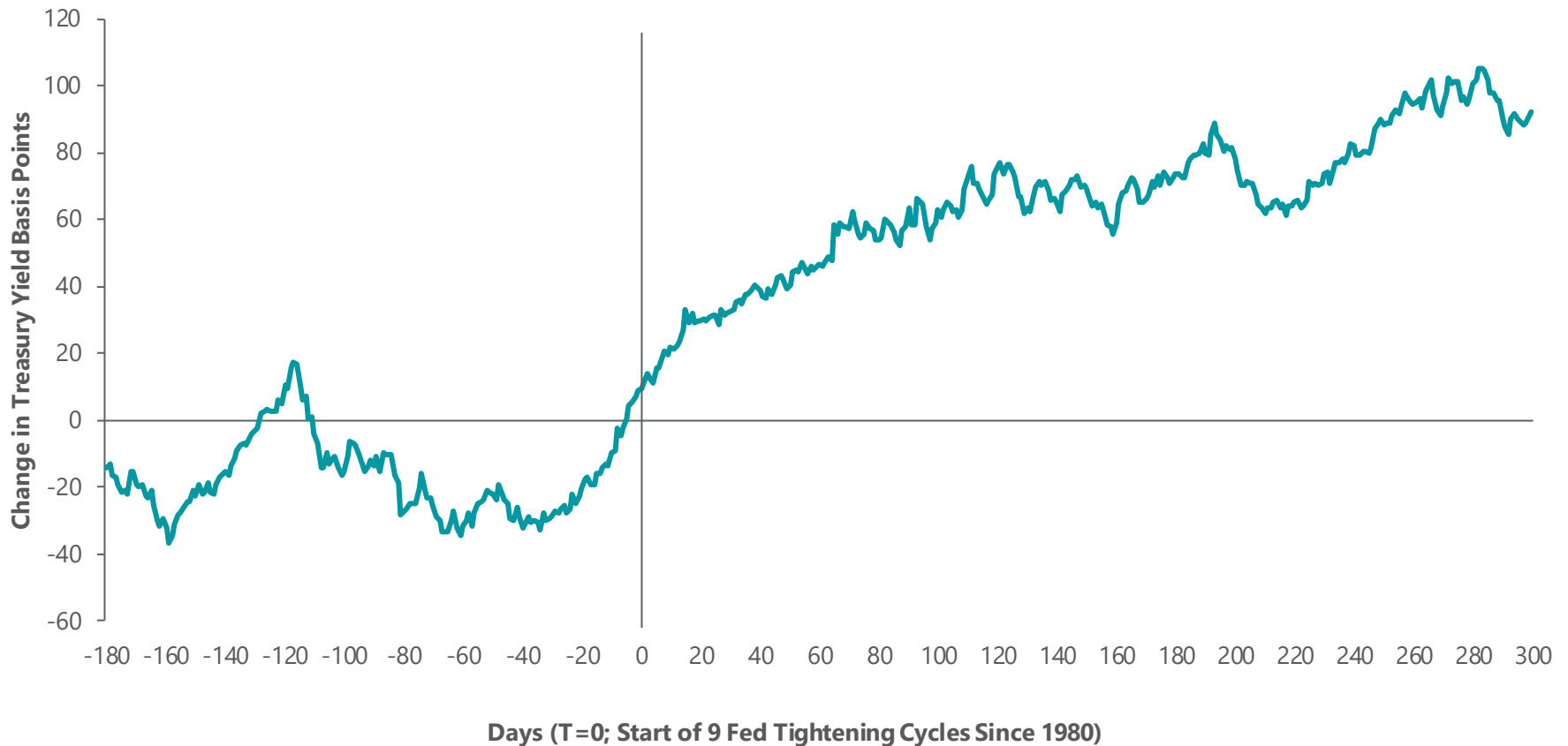
Bond Market Unfazed by Inflation



- ▶ **Historically, higher inflation tends to go hand-in-hand with higher interest rates.**
- ▶ **10-Year Treasury yields are well below the levels typically associated with both current and future expected inflation.**

Rates Bottom Ahead of Tightening Cycles

10-Year U.S. Treasury Yield Change Around the Start of Fed Tightening Cycles



- ▶ **Since 1980, rates have typically bottomed 1-2 months before the start of Fed tightening cycles.**
- ▶ **With tapering likely to commence in the next 2-3 quarters, rates may follow a similar path.**

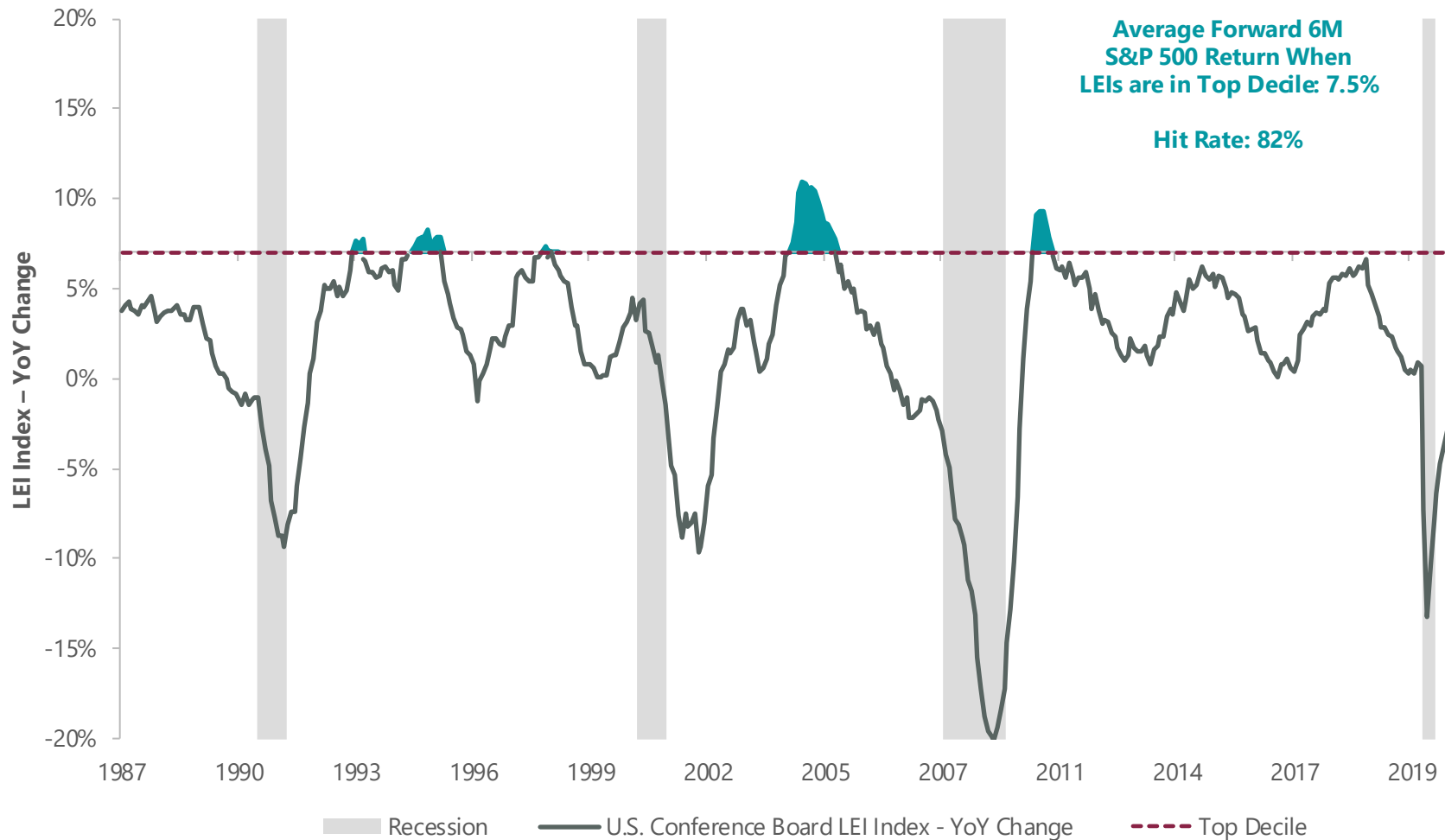
Higher Rates, Higher Equities

Stock Returns During Historical Rising Rate Environments (10-Year Yield Change > 1.5%)

Rising Rates Start Date	Rising Rates End Date	Duration (Months)	Change in 10-Year Treasury Yield	S&P 500 Gain/Loss (Annualized)	Russell 2000 Gain/Loss (Annualized)
Dec. 1962	Aug. 1966	45	1.7%	8.1%	-
March 1967	Dec. 1969	34	3.6%	3.6%	-
March 1971	Sept. 1975	55	3.2%	-0.9%	-
Dec. 1976	Sept. 1981	58	9.0%	7.3%	-
May 1983	May 1984	13	3.9%	-3.5%	-11.8%
Aug. 1986	Oct. 1987	14	3.3%	13.6%	5.9%
Oct. 1993	Nov. 1994	13	2.9%	1.5%	-3.1%
Jan. 1996	July 1996	6	1.5%	6.7%	10.1%
Oct. 1998	Jan. 2000	16	2.6%	35.5%	44.5%
June 2003	June 2006	37	2.1%	9.8%	16.3%
Dec. 2008	April 2010	15	1.9%	28.5%	35.7%
July 2012	Dec. 2013	18	1.6%	28.0%	35.5%
July 2016	Oct. 2018	27	1.9%	16.8%	17.2%
Average:		27	3.0%	11.9%	16.7%
% Positive:			100%	84.6%	77.8%

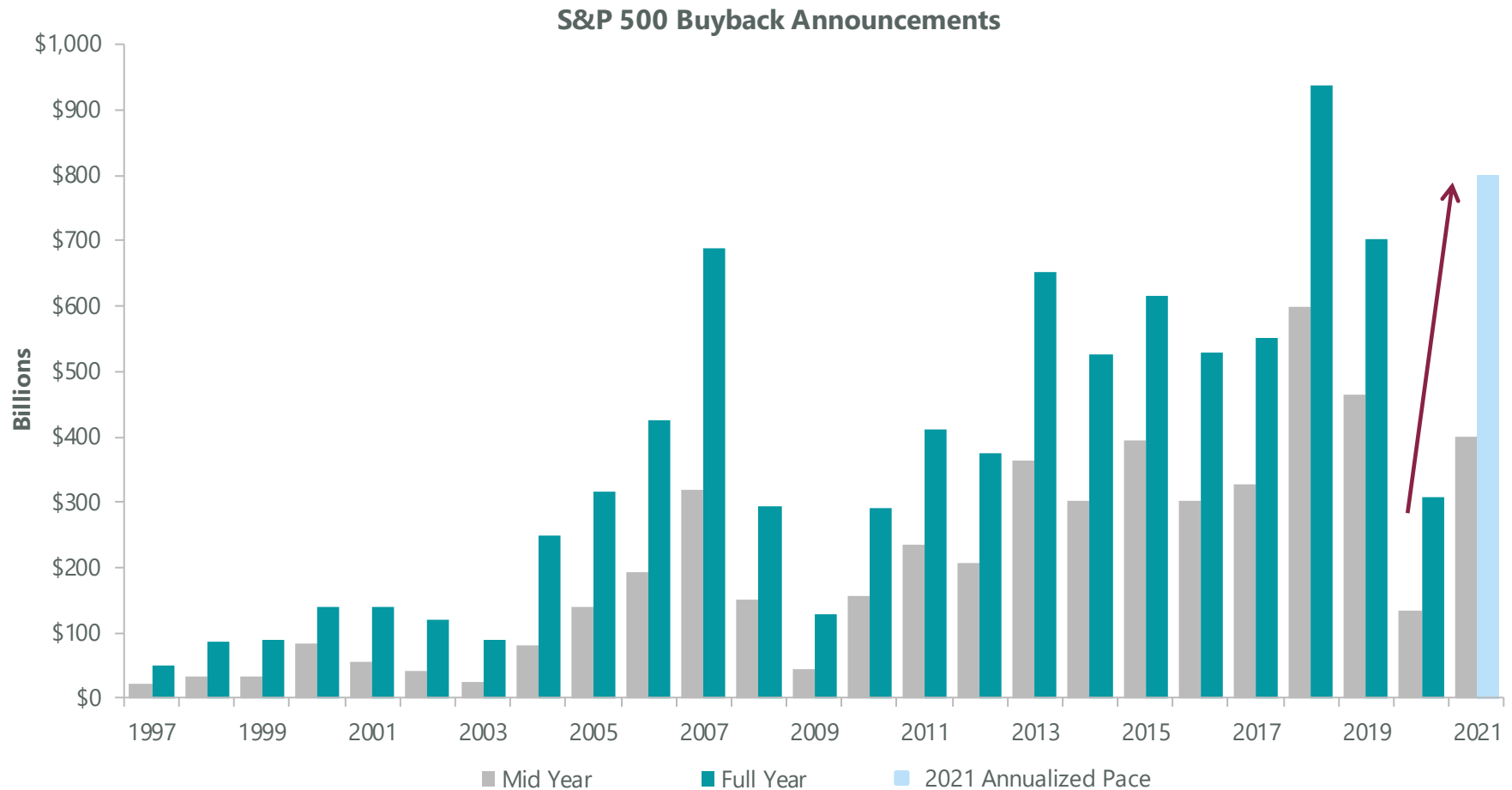
- ▶ **During periods of rising rates, equities have delivered above-average returns with particular strength in small cap stocks.**

Leading Indicators, Positive Omen



▶ **When leading economic indicators are at their strongest, stock returns over the subsequent six months tend to be well above average.**

Corporate Stimulus Just Getting Started



- ▶ **Buyback announcements have rebounded sharply from 2020 lows on the back of strong earnings and outsized corporate cash reserves.**
- ▶ **If the second half of 2021 maintains the pace seen so far, this year will be the second strongest on record for share repurchase announcements.**

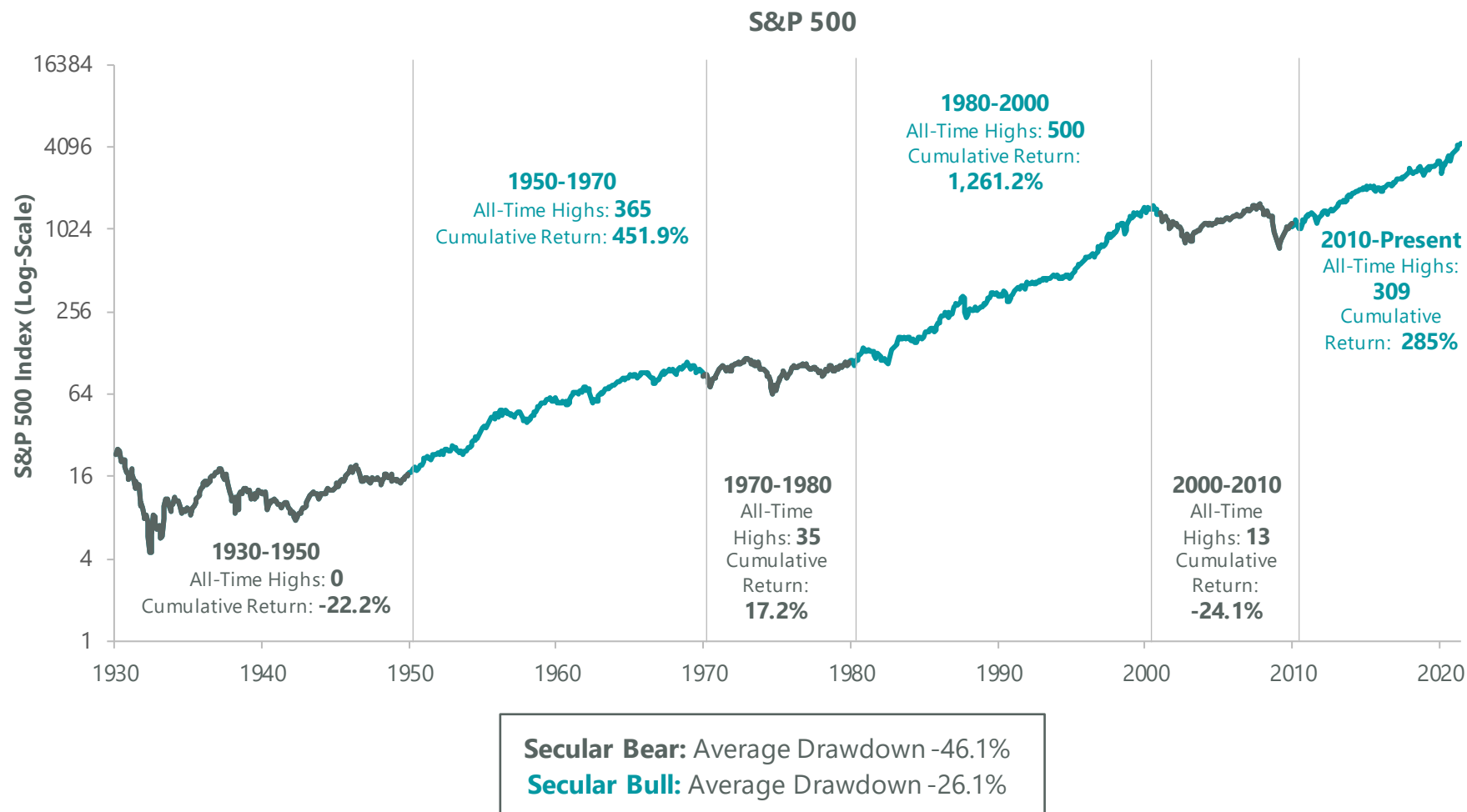
The Terrible Twos?

S&P 500 Performance 1st & 2nd Year Following Bear Market Low

Bear Market Low	Selloff	1st Year Off Low	2nd Year Off Low	2nd Year Max Drawdown
Jun. 1949	29.6%	42.1%	11.9%	-13.4%
Oct. 1957	21.6%	31.0%	9.7%	-9.2%
Jun. 1962	28.0%	32.7%	17.4%	-6.5%
Oct. 1966	22.2%	32.9%	6.6%	-10.0%
May 1970	36.1%	43.7%	11.1%	-11.0%
Oct. 1974	48.2%	38.0%	21.2%	-5.1%
Aug. 1982	27.1%	58.3%	2.0%	-14.7%
Dec. 1987	33.5%	21.4%	29.3%	-9.2%
Oct. 1990	19.9%	29.1%	5.6%	-6.8%
Oct. 2002	49.1%	33.7%	8.0%	-8.8%
Mar. 2009	56.8%	68.6%	15.7%	-17.1%
Mar. 2020	33.9%	74.8%	?	?
Average (All Periods):		42.2%	12.6%	-10.2%
% Positive (All Periods):		100%	100%	
Average (30%+ Selloffs):		41.1%	17.1%	-10.2%
% Positive (30%+ Selloffs):		100%	100%	

- ▶ **The first year of a new bull market typically sees strong equity performance despite economic malaise.**
- ▶ **The second year often sees robust economic growth but a more volatile (but higher) equity market, particularly following larger selloffs.**

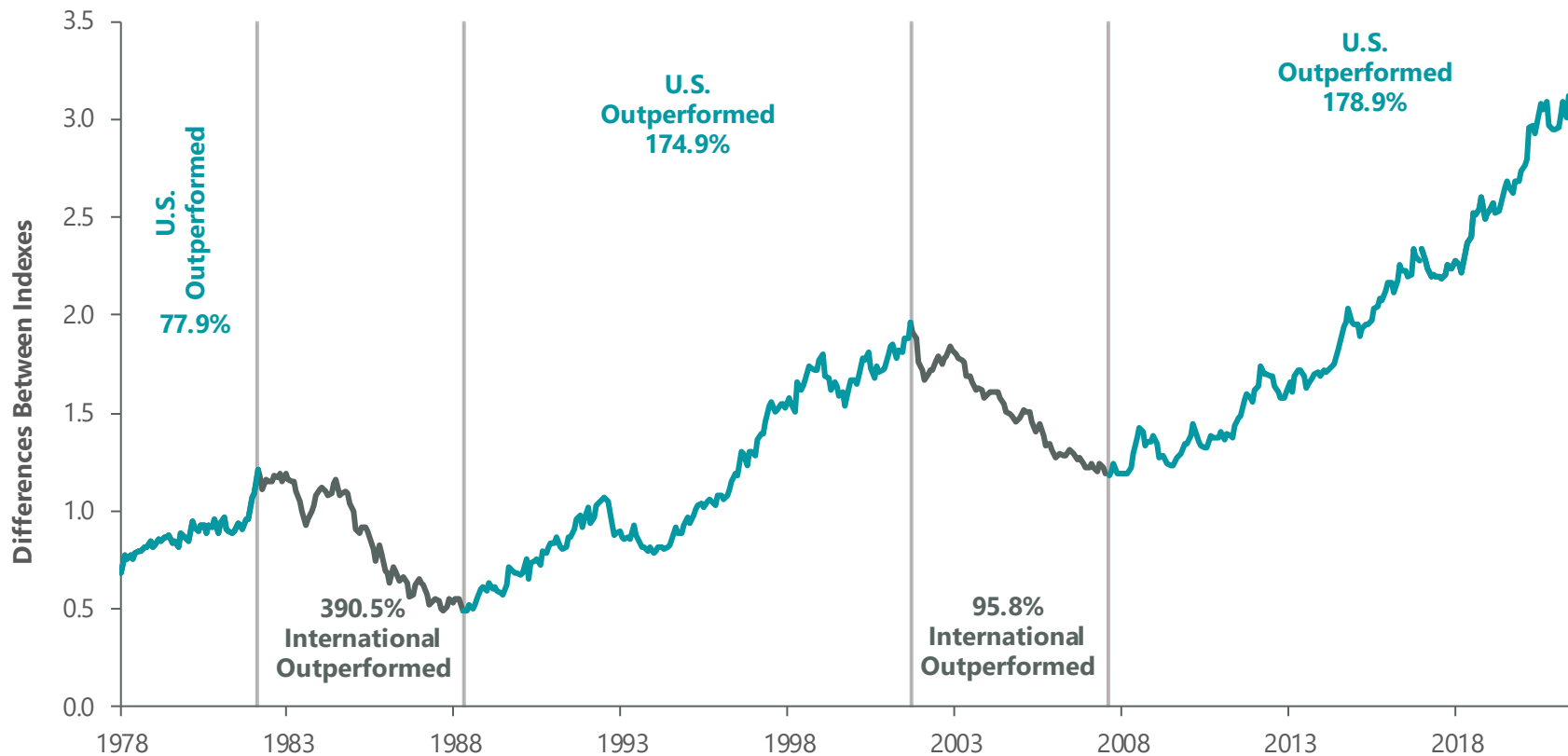
New Secular Bull Market?



► **In the 12 months following an all-time high, stocks have historically been up 8.6% on average with positive returns 71% of the time.**

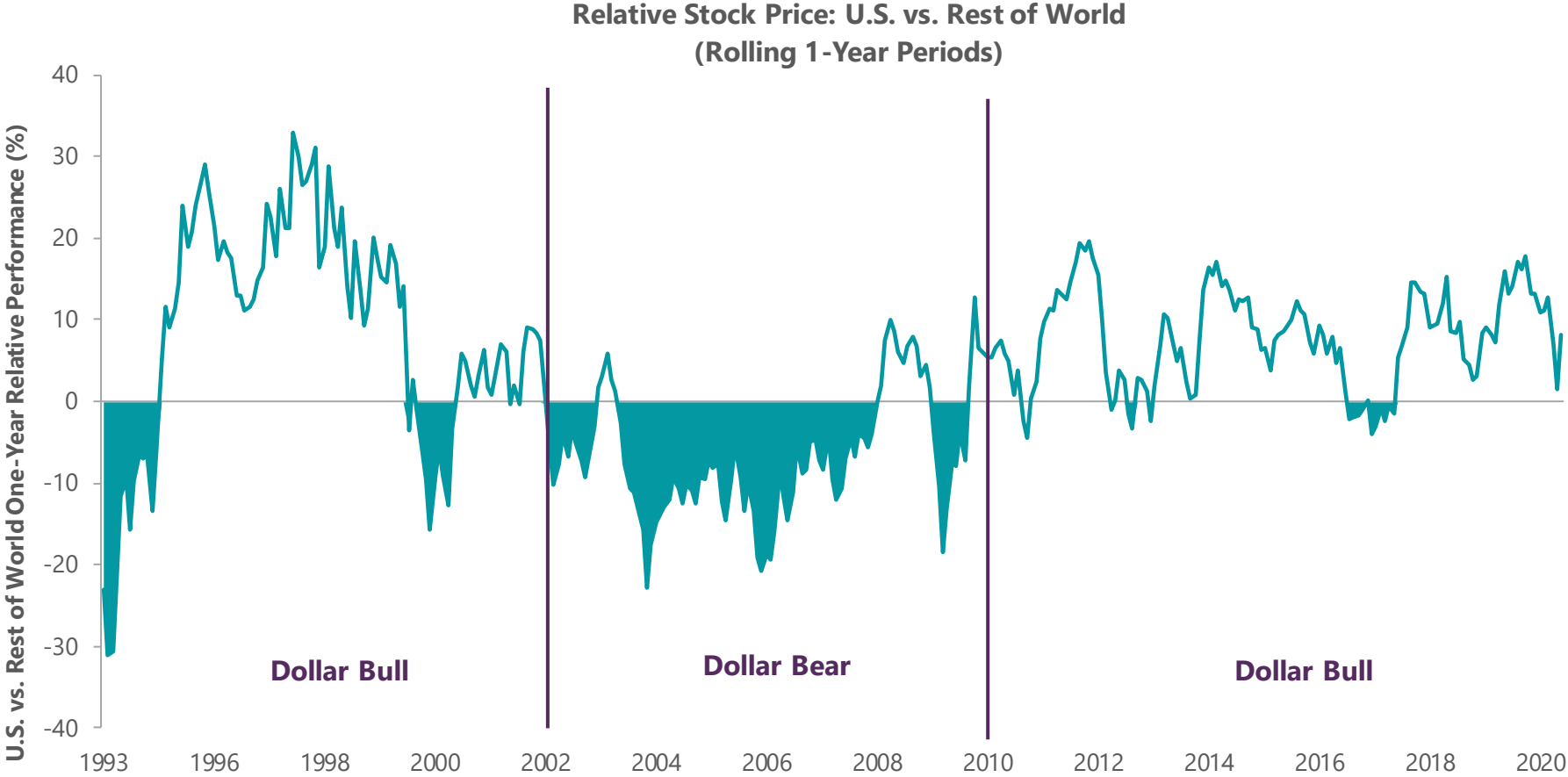
International Outlook

U.S. vs. International Equity Performance



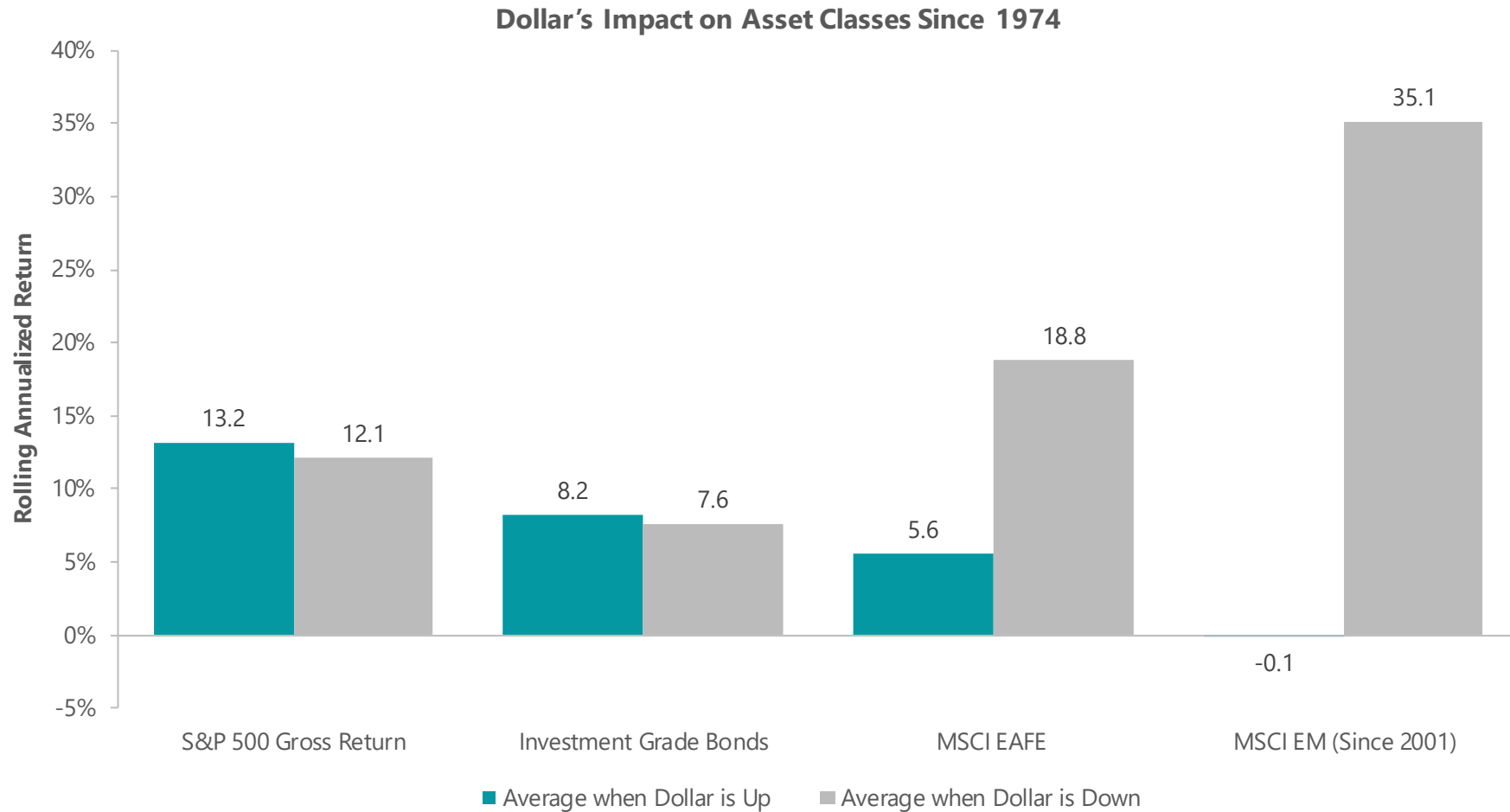
► **Geographic leadership tends to persist for multiple years.**

Dollar Regimes Coincide With Global Equity Leadership



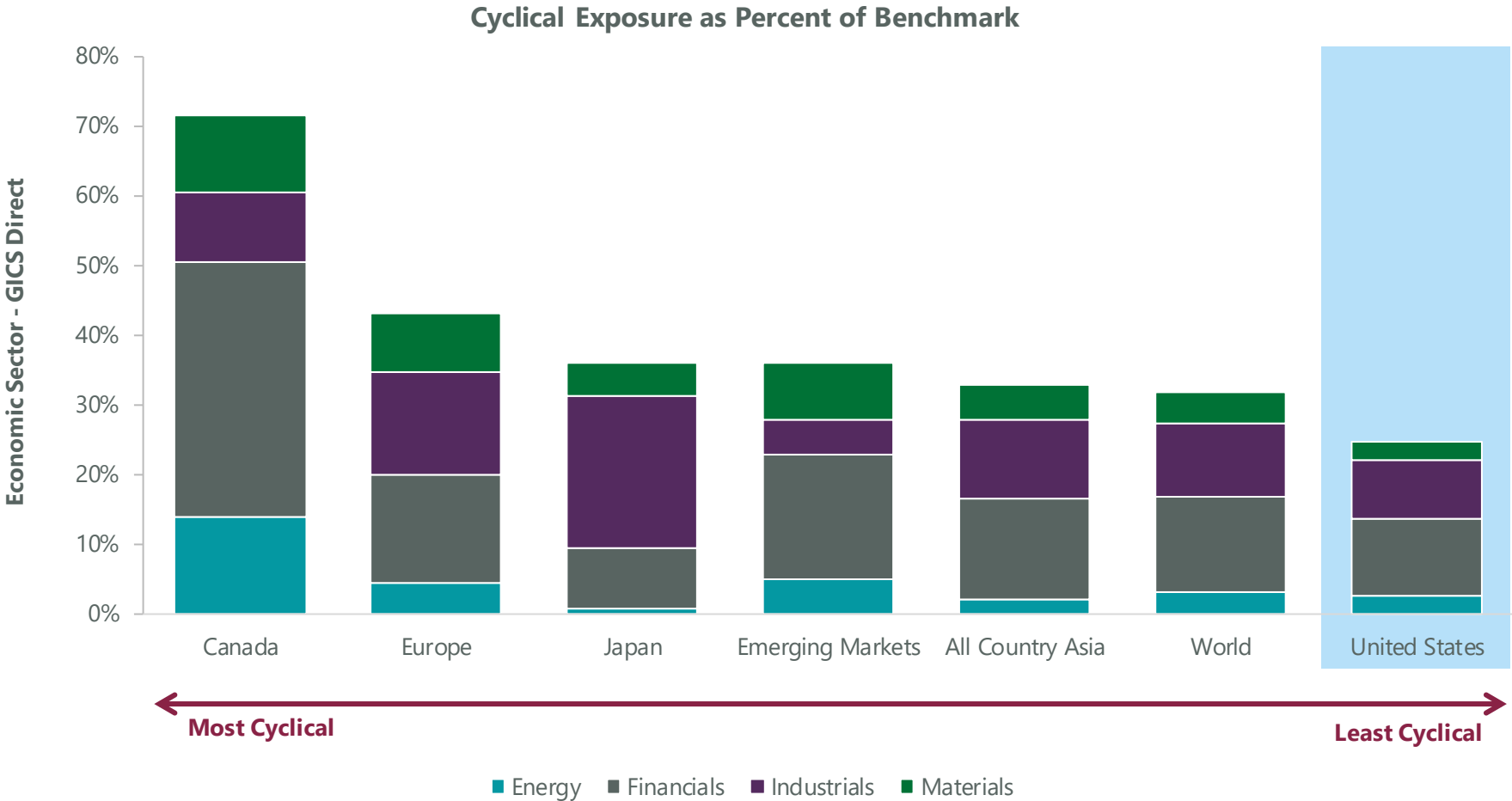
- ▶ **Periods of sustained dollar strength have aligned with U.S. equity outperformance.**
- ▶ **Dollar weakness could lead to a shift in global equity market leadership.**

Weaker Dollar Supercharges Non-U.S. Stocks



▶ **International equities tend to outperform during periods of dollar weakness.**

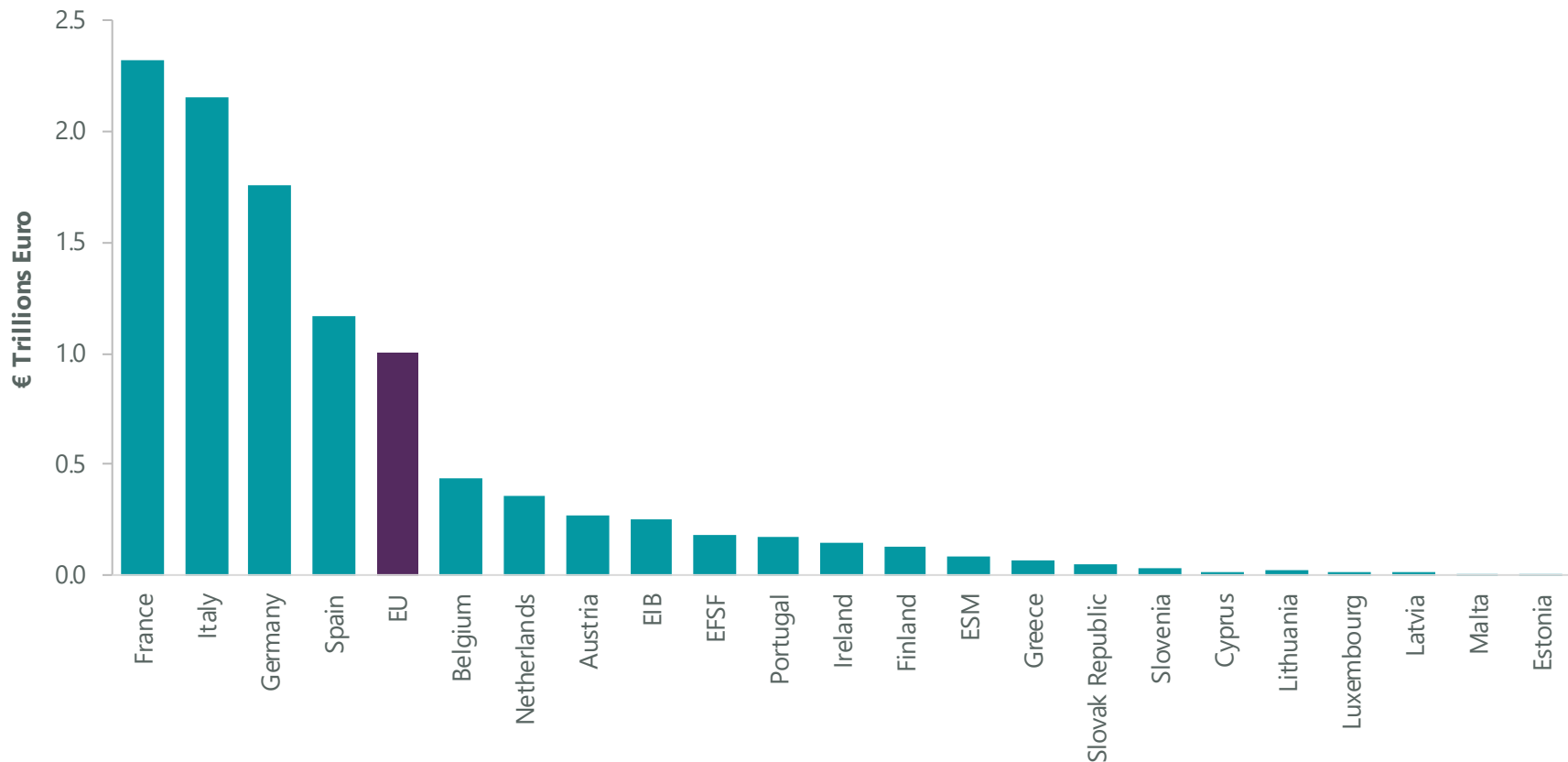
Global Markets More Cyclical



▶ **In periods of accelerating economic growth, non-U.S. markets tend to lead given greater cyclical exposure.**

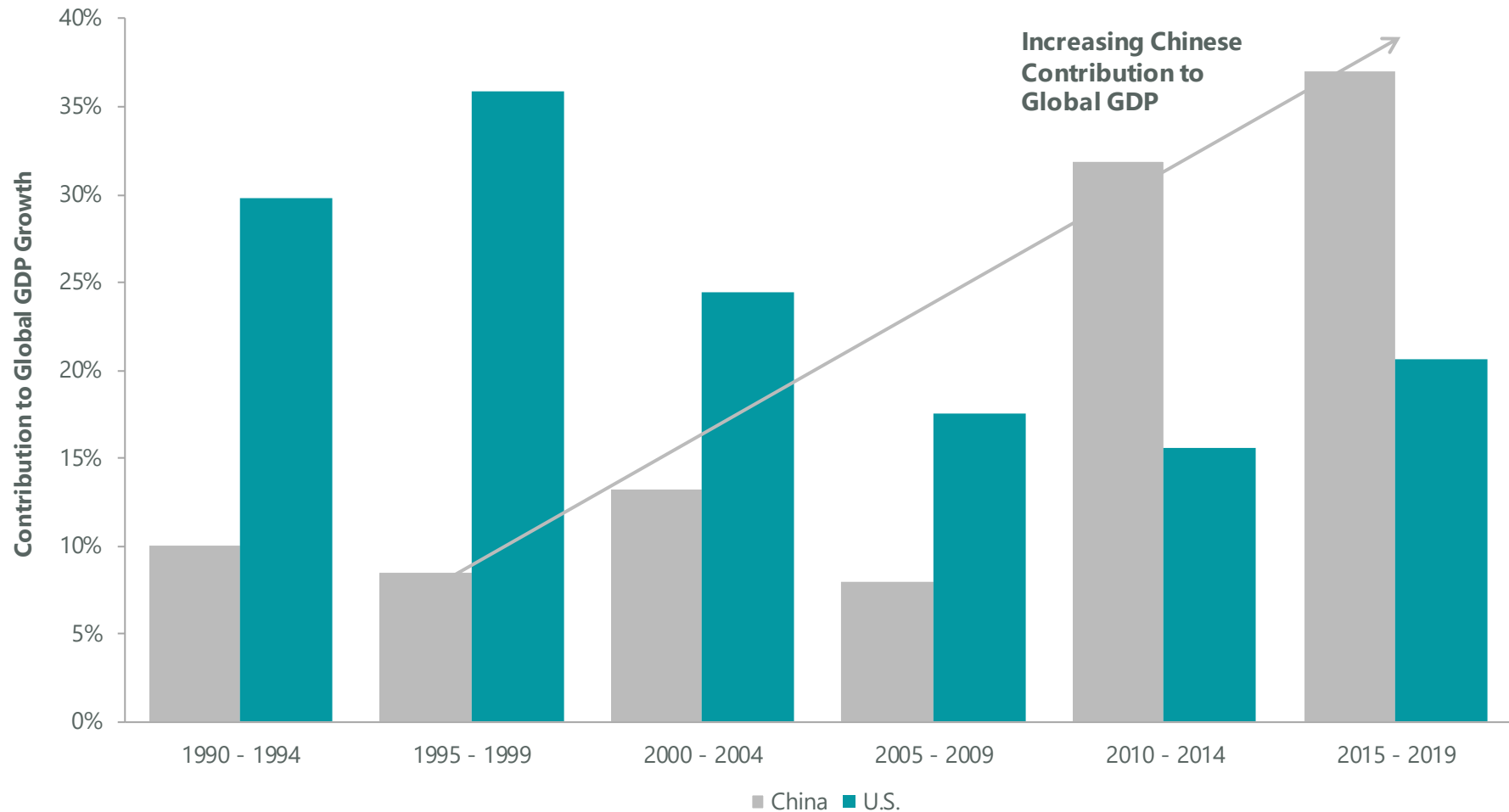
Tighter Fiscal Union, Less Risk

Outstanding Euro-Denominated Bonds



- ▶ **Projected joint issuance of Eurozone debt creates a more integrated fiscal union which bodes well for the Euro's long-term prospects.**
- ▶ **This milestone could act as a catalyst for European assets to embed lower risk premiums going forward.**

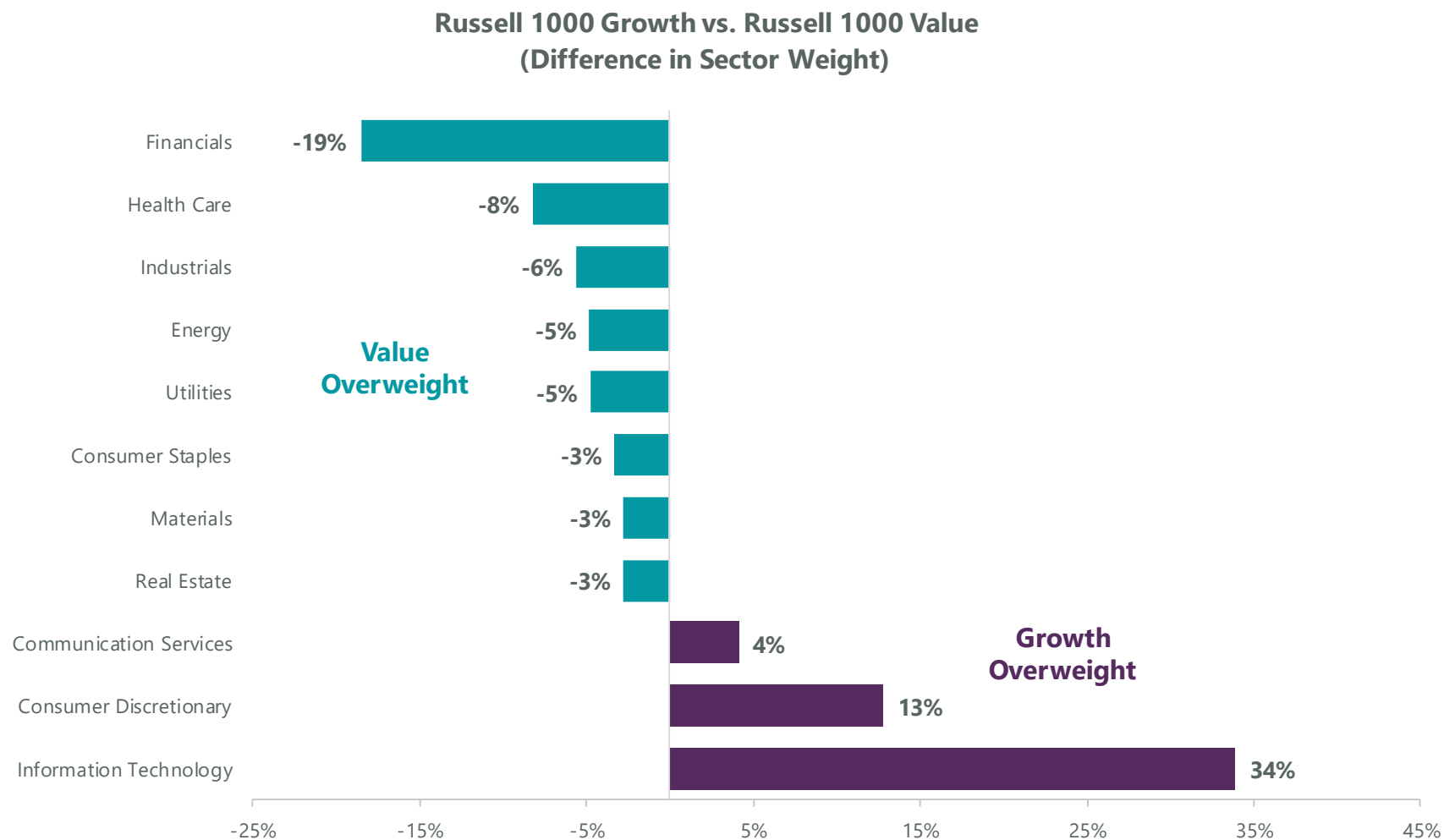
The Rise of China



- ▶ **Over the last 25 years, China has become an increasingly important driver of global growth while the U.S. has become less integral.**
- ▶ **In 1995, China had two Fortune 500 companies compared to the U.S.'s 148. Today, China is home to 124 versus 121 for the U.S.**

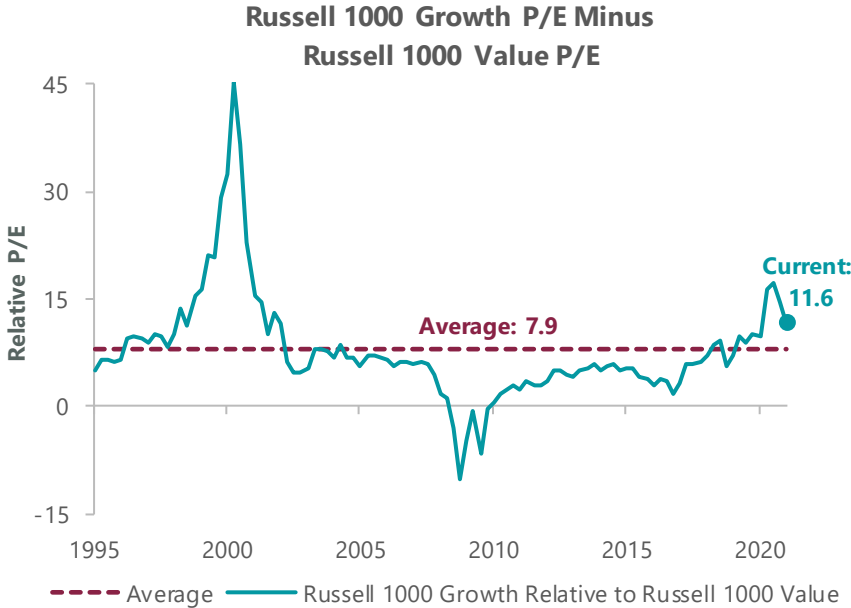
Market Leadership

Sector Mix Explains Leadership

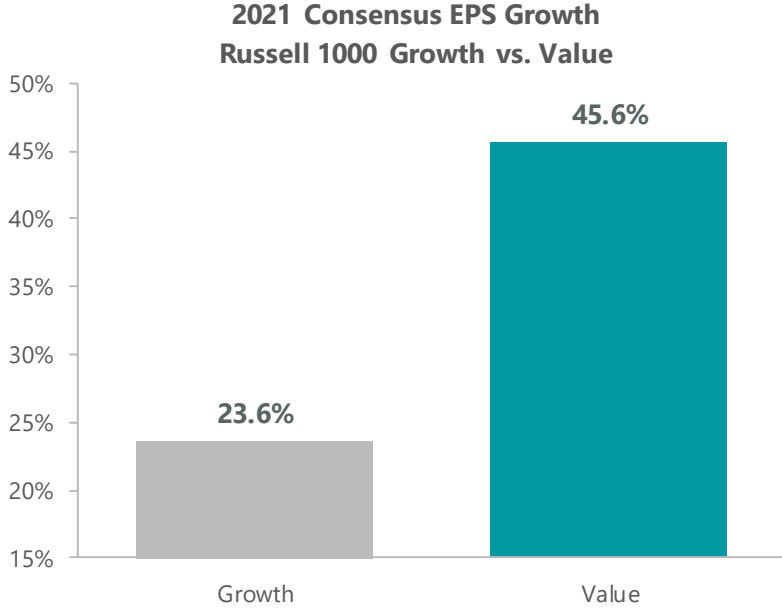


► **The performance of Financials, Health Care, and Industrials relative to Technology and Discretionary explains a large share of Growth/Value leadership.**

Fundamentals Favor Value



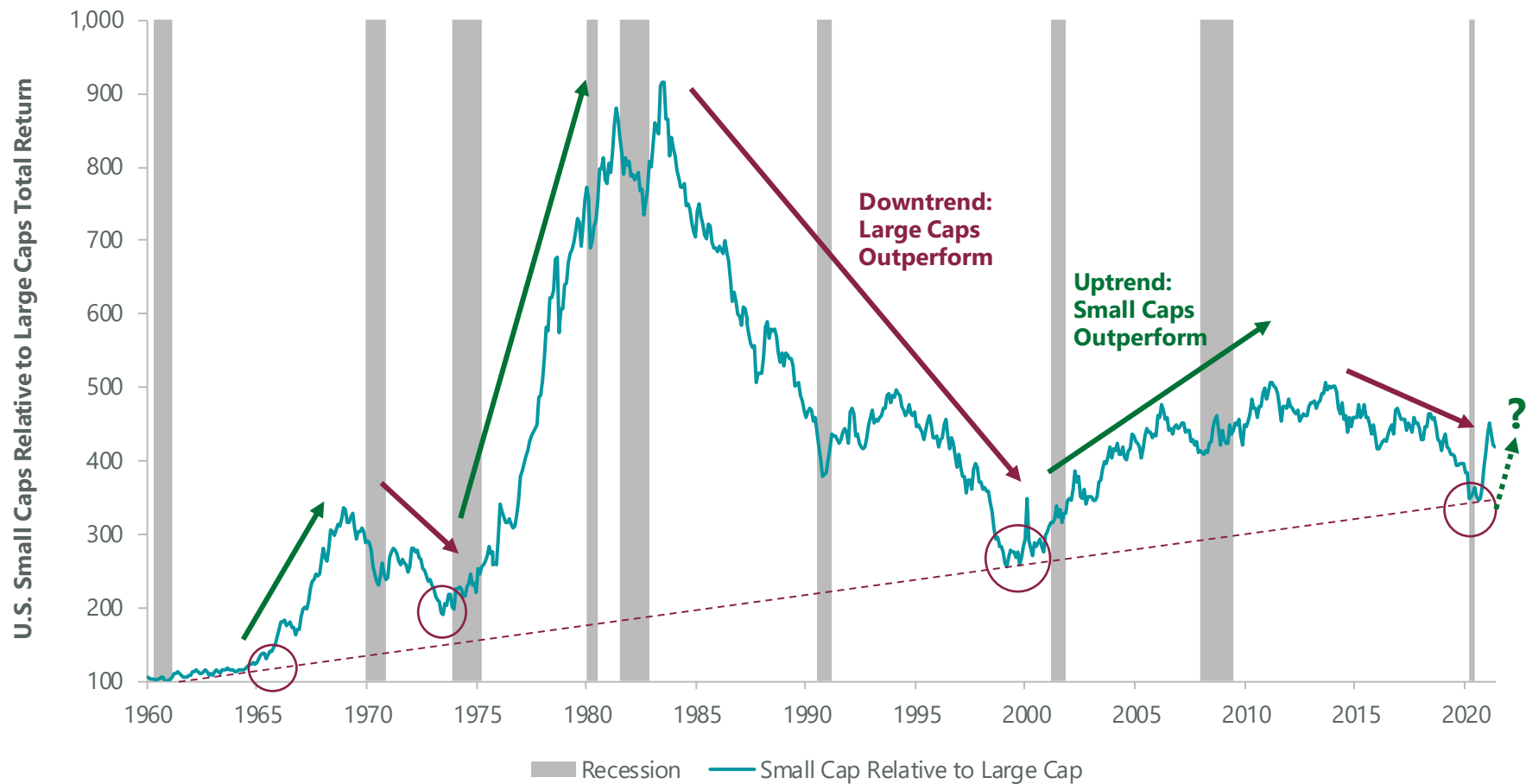
Source: Bloomberg.



Source: FactSet, Russell.

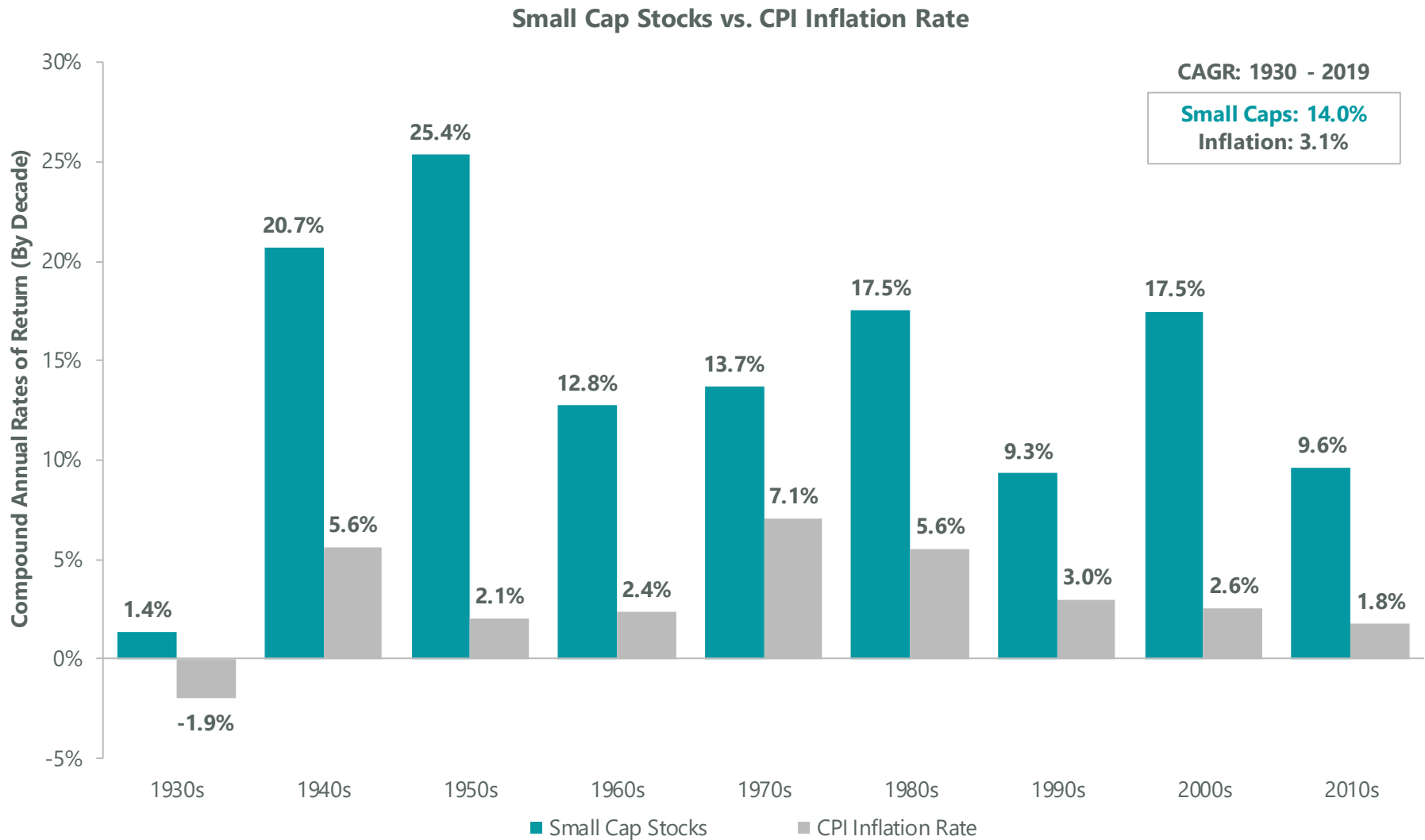
- ▶ **Relative P/E and EPS Growth point to further upside for Value stocks relative to Growth.**
- ▶ **Each multiple point of relative P/E equates to 4-5% of relative performance between Growth and Value.**

Time for Small Caps to Shine?



- ▶ **Over the last 60 years, markets have experienced three full Small Cap cycles.**
- ▶ **Recent Small Cap outperformance following the COVID-19 recession could be the start of a new cycle.**

Small Caps Unfazed by Inflation



▶ **Since the 1930s, Small Cap stocks are the only major asset class to outperform inflation in each decade.**

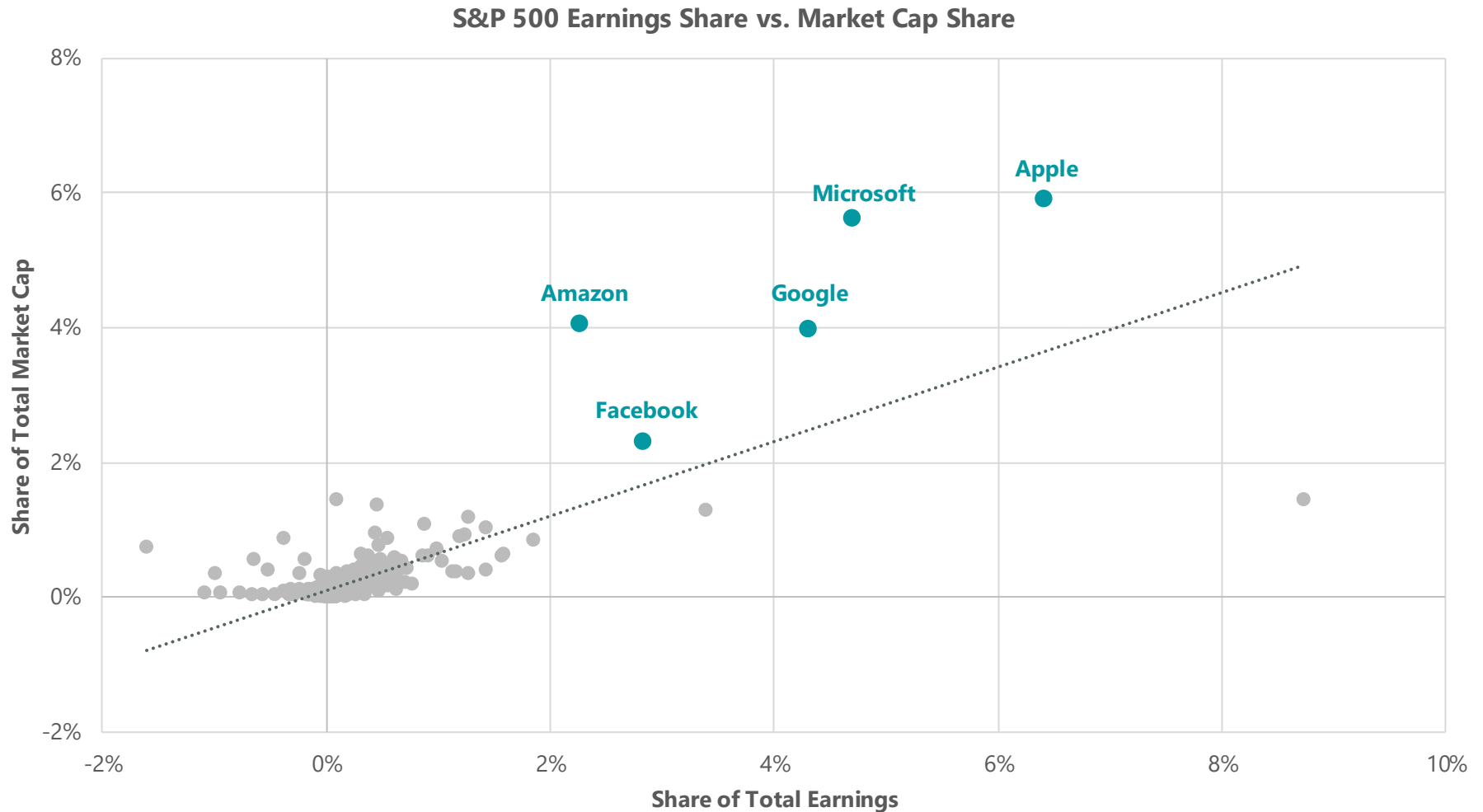
Is FAANGM a Bubble?

Leader Valuations Get Extreme During Manias

December 1972		March 2000		Current	
Nifty Fifty	P/E*	Dot-Com Darlings	NTM P/E	FAANGM	NTM P/E
Coca-Cola	46.4	Intel	44.3	Facebook	24.5
McDonald's	71.0	Cisco	126.3	Amazon	53.5
Texas Instruments	39.5	EMC	80.0	Apple	26.0
IBM	35.5	Microsoft	57.1	Netflix	44.9
Xerox	45.8	Oracle	107.2	Google	26.7
Polaroid	94.8	Nortel	92.0	Microsoft	32.4
Average	55.5	Average	84.5	Average	34.7
S&P 500	18.9	S&P 500	23.8	S&P 500	21.3

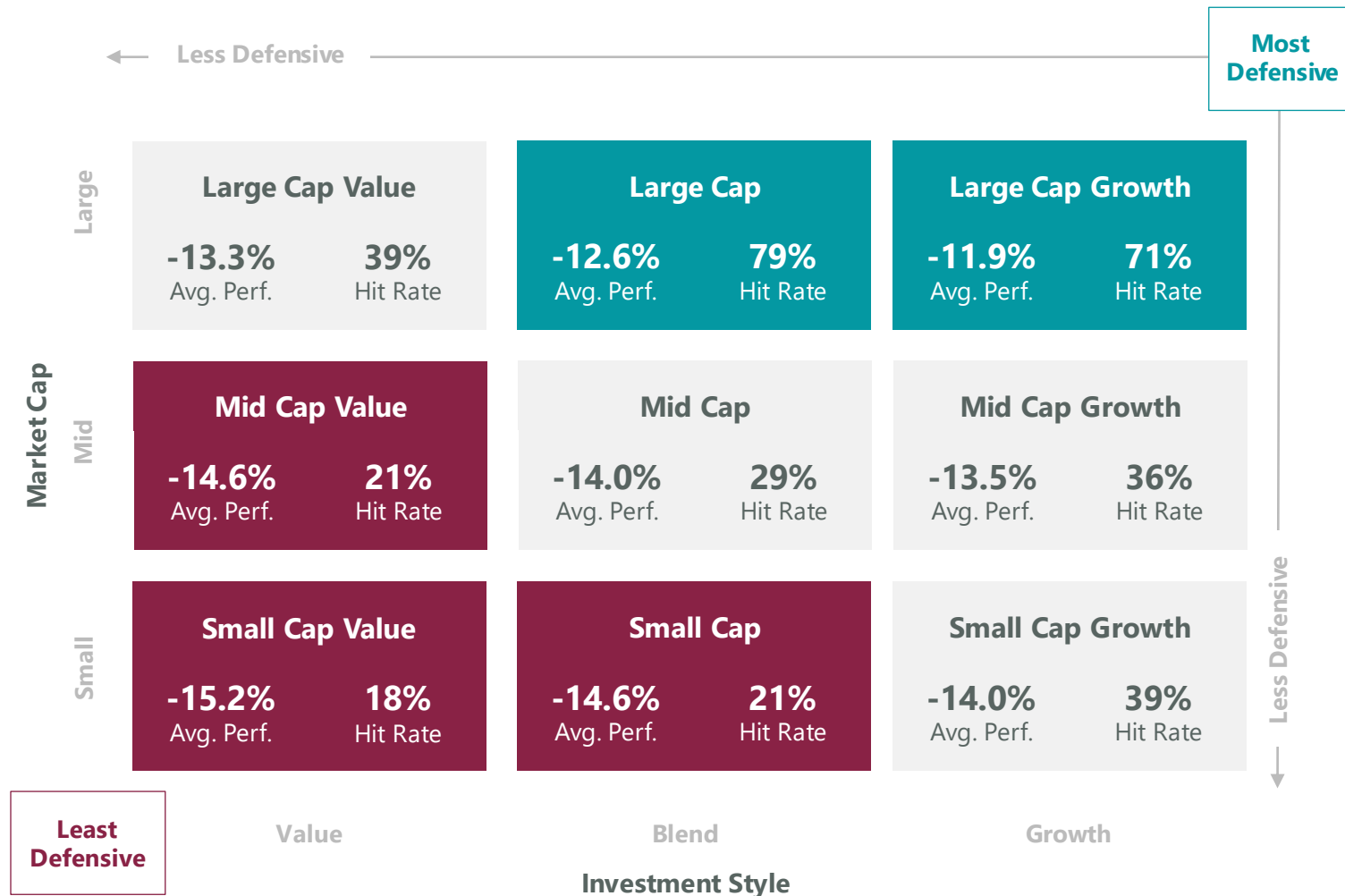
- ▶ **Although FAANGM trades at a large premium to the market, past bubbles have seen even more inflated valuations.**

Are Valuations Justified by Earnings?



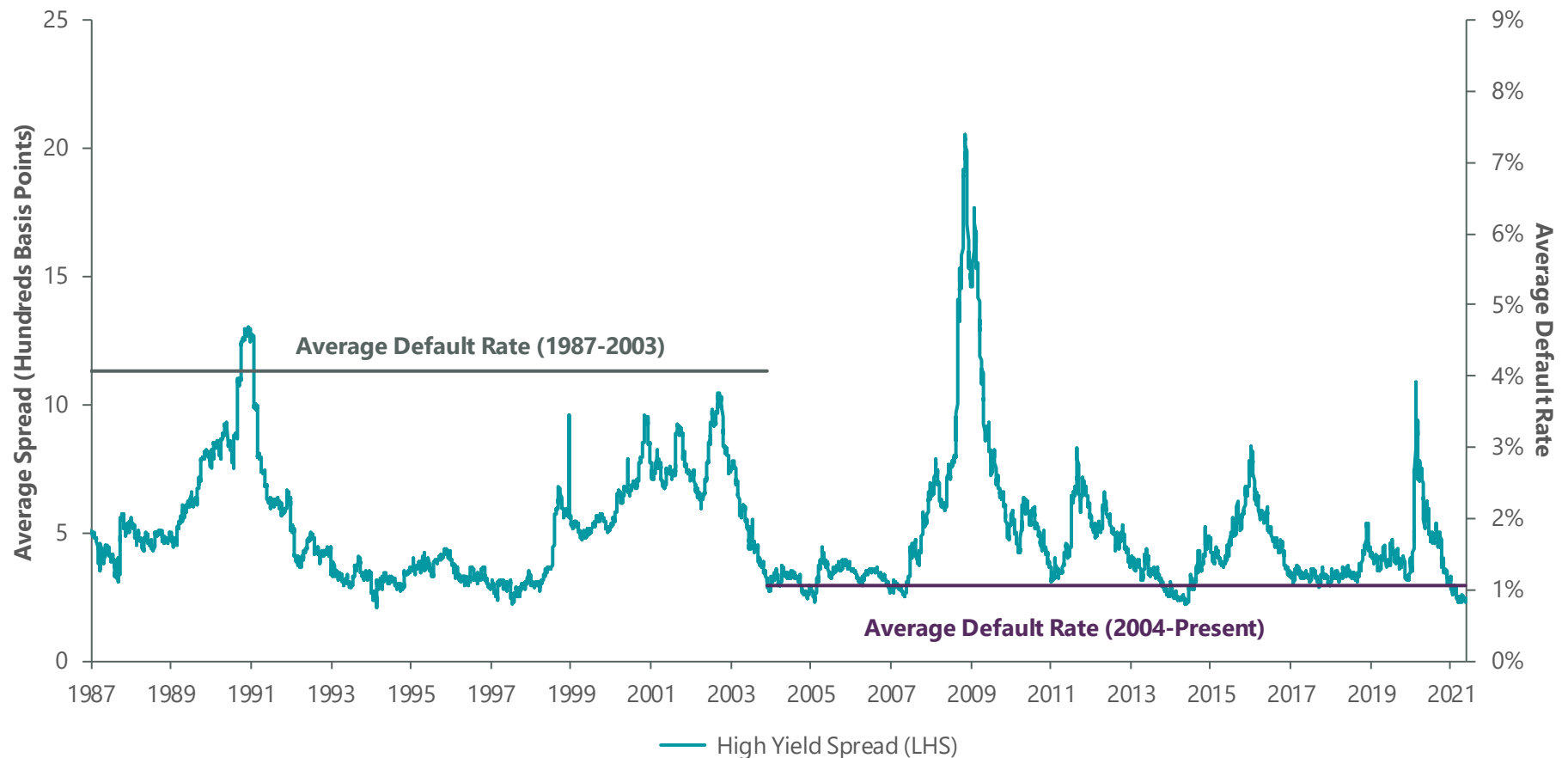
- ▶ **The 5 largest stocks are expected to account for 21% of 2021 earnings.**
- ▶ **The top 5 contribute more income than market cap.**

Typical Market Leadership in a Downturn



Note: Average performance: average performance during selloffs of 5% or more, Hit Rate: Hit rate of outperformance during 5%+ selloffs, 2005 – present. Benchmarks used: Large Value: S&P 500 Value, Large Blend: S&P 500, Large Growth: S&P 500 Growth; Mid Value: S&P 400 Value, Mid Blend: S&P 400, Mid Growth: S&P 400 Growth; Small Value: S&P 600 Value, Small Blend: S&P 600, Small Growth: S&P 600 Growth. Outperformance frequency calculated relative to S&P 1500 index. Source: S&P, Bloomberg. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

Could Spreads Go Even Lower?



- ▶ **While credit spreads are near the low end of their historical range, default rates have been substantially lower since 2004.**
- ▶ **Lower default rates mean investors may demand less compensation in order to take credit risk.**

Glossary of Terms

BEA: Bureau of Economic Analysis

Bloomberg Barclays US Corporate Investment Grade Bond Index: an unmanaged index of U.S. investment-grade corporate bond securities

Capex (Capital expenditures): corporate spending on productive assets (such as buildings, machinery and equipment, vehicles) intended to increase capacity or efficiency for more than one accounting period.

EPS (Earnings per Share): the portion of a company's profit allocated to each outstanding share of common stock.

GDP: Gross Domestic Product

GFC (Great Financial Crisis): the severe economic and market downturn experienced in 2007-2008.

LEI Index: Conference Board Leading Economic Indicators index.

MSCI All Country World Index: unmanaged index of large- and mid-cap stocks in developed and emerging markets.

MSCI EM Index: unmanaged index of large- and mid-cap stocks in 27 emerging market countries.

MSCI EAFE Index: unmanaged index of equity securities from developed countries in Western Europe, the Far East, and Australasia.

MSCI USA Index: unmanaged index of US large- and mid-cap equity securities.

NFIB (National Federation of Independent Business): a U.S. small business advocacy association, representing over 350,000 small and independent business owners.

NFIB Small Business Optimism Index: measure of small business sentiment produced by the National Federation of Independent Business based on its monthly survey of small business owners.

P/E Ratio: Price/Earnings ratio

PMI: Purchasing Manager's Index

Quantitative easing (QE): Monetary policy implemented by a central bank in which it increases the excess reserves of the banking system through the direct purchase of debt securities.

Russell 2000 Index: unmanaged index of small-cap stocks.

Shibor: Shanghai Interbank Offered Rate

S&P 500 Index: Unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the U.S.

VIX: VIX is the ticker symbol and the popular name for the Chicago Board Options Exchange's CBOE Volatility Index, a popular measure of the stock market's expectation of volatility based on S&P 500 index options.

Yield Curve: Comparison of interest rates at a point in time of bonds with equal credit quality but different maturity dates.

YoY: Year Over Year

U.S. Treasuries: Direct debt obligations issued and backed by the "full faith and credit" of the U.S. government. The U.S. government guarantees the principal and interest payments on U.S. Treasuries when the securities are held to maturity. Unlike U.S. Treasury securities, debt securities issued by the federal agencies and instrumentalities and related investments may or may not be backed by the full faith and credit of the U.S. government. Even when the U.S. government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting from declines in the market value of these securities.

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