BOYD WATTERSON
ASSET MANAGEMENT

January 2021

Investment Outlook

Our Firm:

Boyd Watterson Asset Management, LLC is an SEC-registered investment advisory firm with approximately $13.8 billion of assets under management.[1] Over the last 90+ years, Boyd Watterson and its predecessor companies have successfully managed a broad range of fixed income and real estate strategies for institutions and individuals alike.

With a focus on the management of money and a dedication to the satisfaction of our clients' expectations, we offer the benefits of a boutique firm but with the resources usually attributable to a much larger asset management firm.

[1]Including gross real estate assets under management and advisory-only unified managed accounts. SEC registration does not constitute an endorsement of the Firm by the SEC nor does it indicate that the Firm has a particular level of skill or ability.

For information about Boyd Watterson's investment strategies, insights, philosophy and teams, please visit our new website, www.boydwatterson.com

Check out our blog:
www.boydwatterson.com/insights/

Our Offices:

Headquarters

Cleveland, OH	1301 East 9th Street Suite 2900 Cleveland, OH 44114
Main Phone	(216) 771-3450
Advisor Channel	(866) 771-2693
Chicago, IL	Real Estate Advisory Group One North Wacker Drive Suite 4025 Chicago, IL 60606
Bloomfield Hills, MI	121 West Long Lake Road Suite 350 Bloomfield Hills, MI 48304
Brandon, FL	607-A W. Bloomington Avenue Brandon, FL 33511
Denver, CO	1675 Larimer Street Suite 830 Denver, CO 80202
Washington, DC	905 16th Street, NW Suite 450 Washington, DC 20006

The Macro View

The end of a year is typically a time for reflection on the events that shaped the year and how those events impacted the financial markets. However, we suspect most people would prefer to forget this past year and focus their thoughts on the gradual return to normalcy that is believed to be on the horizon. If investors were to look purely at equity and bond market returns, it would be easy to conclude this past year was a normal year with solid asset class performance; yet 2020 was anything but normal. It is doubtful a global health pandemic was on the minds of most as news of a novel virus in China became known and began to spread around the globe. The pandemic has touched people's lives in a multitude of ways, and after nearly a year of battling the virus, many believe we are now at the beginning of the end of the pandemic.

The government's Operation Warp Speed program supported the rapid development of multiple vaccine candidates to combat the pandemic. Historically, vaccines have taken many years to develop and test. However, in the case of COVID-19, two vaccines were developed, clinically tested, and received emergency use approval in less than one year. There are several additional vaccine candidates in various phases of clinical trial, which, if subsequently approved, will likely further expedite efforts to achieve herd immunity in the U.S. It is widely anticipated that additional vaccines may become approved in the first quarter while production and distribution of those already approved simultaneously ramps up, just as the U.S. is experiencing its third major surge in COVID-19 cases.

Financial markets have been anticipating vaccine approvals for several months, driving equity markets higher and credit spreads tighter. Yet, the vaccine news was not the only good news to impact the financial markets this past year. As the year ended, a BREXIT deal was finally reached between the EU and the U.K. after years of negotiations, and politicians in Washington agreed on an additional COVID-19 stimulus package and a government funding bill, the latter averting a shutdown. As a result, investors can now focus their attention squarely on the economy, President-Elect Biden's fiscal agenda, and what the return to normal will eventually look like.

Performance for Periods Ending December 31, 2020

	QTD	YTD	3-Yr	5-Yr
2-Year Treasury	0.06	3.03	2.67	1.76
10-Year Treasury	-1.91	10.58	6.38	4.17
Bloomberg Barclays Aggregate	0.67	7.51	5.34	4.44
Corporate Investment Grade	2.99	9.81	7.03	6.71
Corporate High Yield	6.45	6.21	5.90	8.41
Leveraged Loans	3.64	2.78	3.99	5.19
Mortgage Backed Securities	0.33	4.09	3.84	3.12
S&P 500	12.15	18.40	14.18	15.22
MSCI EAFE	16.05	7.81	4.28	7.45

Source: Interactive Data, Credit Suisse, Bank of America/Merrill Lynch/Bloomberg.

The views expressed herein are presented for informational purposes only and are subject to change without warning. This material is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance.

The economic carnage from the pandemic is well documented and the K-shaped recovery, while somewhat stronger than we originally expected, remains uneven with some parts of the economy benefiting more than others. The recent surge in cases has resulted in additional restrictions on activities and services in many parts of the country and may dampen economic activity somewhat over the near-term. We believe the combination of increased vaccine distribution/administration and the additional fiscal stimulus package will provide relief to the areas most affected, bridging the gap to more robust economic activity as we navigate through 2021. Our expectation is for increasing demand in leisure travel, dining, entertainment, etc. in the second half of the year, resulting in stronger employment gains and spending in those areas that have been most impacted. Following this surge in activity, we anticipate the U.S. economy will return to its pre-pandemic growth trajectory in the two percent area as normalization flattens out beyond 2021. Additionally, we may see an uptick in core inflation as economic activity increases throughout 2021 coupled with higher commodity prices and a weaker U.S. dollar. However, we do not see this as a long-term trend and expect core inflation to remain below the Fed's two percent target over the medium term. The current Bloomberg consensus estimates for 2021 GDP and core PCE inflation are 3.9% and 1.7%, respectively.

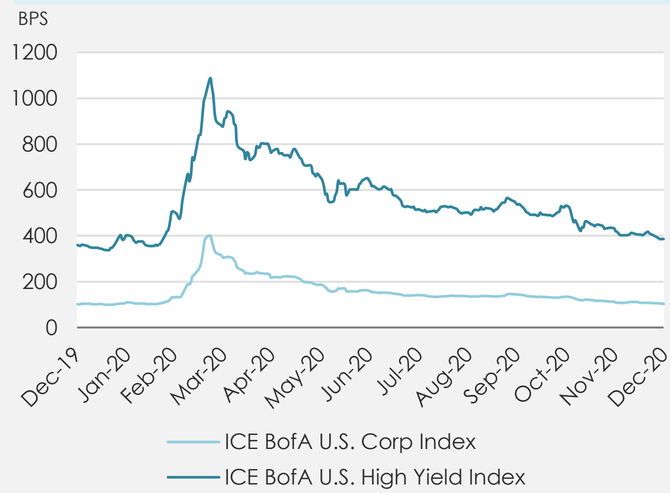
Undoubtedly, the powerful combination of fiscal and monetary policy stimulus enacted this year successfully averted an economic depression. With another round of fiscal stimulus just signed into law, direct checks to qualifying Americans, additional unemployment assistance and a second round of paycheck protection loans to small businesses are on the way. While the Trump Administration required some of the Federal Reserve's pandemic-related programs to expire at year-end, Fed Chair Powell remained steadfast in his message that the Fed remained both willing and able to provide additional support to the economic recovery if necessary. This was evidenced by the Federal Open Market Committee's (FOMC) statement at its December meeting regarding the quantitative easing program and their policy objectives. The FOMC stated they will continue their purchases of Treasury and agency mortgage-backed securities at their current monthly pace "until substantial further progress has been made toward the Committee's maximum employment and price stability goals," further strengthening the Committee's forward guidance. We believe the FOMC remains committed to altering the size and duration of this program if conditions warrant, while simultaneously indicating that short term interest rates are likely to remain at their current low levels for the next couple years.

While we are cautiously optimistic, we also recognize the transition back to life as we knew it is not without risks. The approval of vaccines is great news, but the public's willingness to receive the vaccine will determine how quickly large-scale immunity can be achieved. Distribution and administration of the vaccine is a massive undertaking and will likely take more time than currently anticipated and there is always the risk of unknown side effects that could slow the public's uptake. Additionally, questions that remain unanswered include: how much of the changes in consumer and corporate behavior may become permanent; will corporate travel return to pre-pandemic levels; to what degree will working from home become permanent and what effects will this have on metropolitan areas; and will the surge in online demand for services permanently replace certain in-person activities? While the long-term economic impact will take years to play out, we are confident that fiscal and monetary policy will continue to support this transition back and businesses and consumers alike will adapt and innovate just as they have through prior crises.

Fixed Income

The last twelve months treated investors to extreme financial market volatility which included the economic highs and lows typically experienced over a full market cycle. While financial markets have recovered with equity markets at or near record highs and risk sectors of the fixed income market at or near pre-pandemic levels, portions of the economy are far from where they began 2020. For fixed income investors, this risk-reward set up of tight credit spreads and very low yields presents a challenging starting point for the New Year. While we do expect the recovery to continue throughout 2021, we also expect it to be somewhat uneven, requiring a more nimble approach to managing fixed income portfolios.

2020 Credit Index OAS Trend

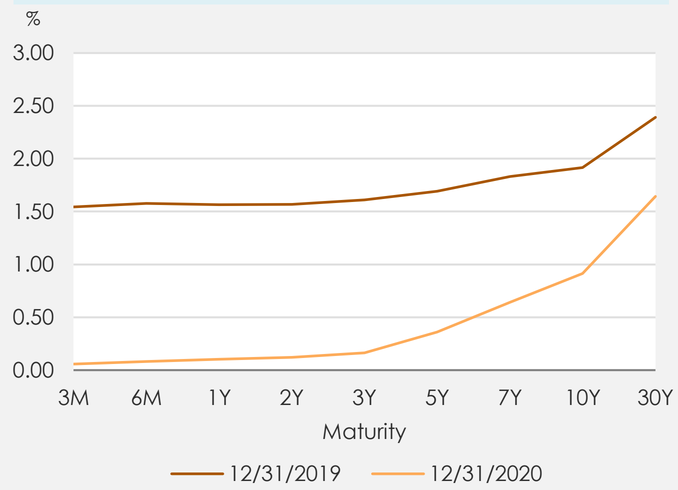


Source: Bloomberg.

The powerful and rapid response of fiscal and monetary policy support at the outset of the pandemic set the stage for the massive risk rally that occurred over the last nine months. The Federal Reserve's dramatic rate cuts, twice in a period of two weeks in March, brought short-term Treasury yields down nearly 150 basis points and the 10-year Treasury yield down

100 basis points in 2020. The Federal Reserve backstopped many areas of the financial markets and economy, driving investment grade and high yield credit spreads nearly back to year-end 2019 levels. This backstop opened the issuance spigot, resulting in record corporate bond issuance for the year. Similarly, the multiple rounds of fiscal stimulus have resulted in large increases in Treasury issuance, further expanding the national debt. This, combined with the Fed's commitment to keep short-term interest rates at their current low levels for the foreseeable future, resulted in a steeper yield curve over the course of the year. The yield spread between 2-year and 30-year Treasuries increased 70 basis points, to 1.52 percent. Given the low rate and tight spread environment to start 2021, we expect fixed income returns to likely be significantly lower than what was realized in 2020.

U.S. Treasury Yield Curve



Source: Bloomberg.

Our portfolio positioning reflects our cautiously optimistic outlook on the recovery. We have shortened portfolio durations based on our expectation for intermediate and long-term interest rates to gradually rise in 2021. The combination of additional fiscal stimulus, a broadening economic recovery, and prospects for higher near-term inflation support this positioning. Given our expectation for a steeper yield curve, we have maintained our bulleted maturity structure, favoring bonds in the middle of the curve within each respective strategy. Additionally, with central banks committing to keep interest rates low, coupled with more than $17 trillion of negative yielding debt globally, fixed income investors will be forced to take on more risk in their quest for income. We believe this will support risk sectors of the fixed income markets over the first half of 2021. As a result, we are repositioning our investment grade and high yield credit exposure with a rotation out of lower beta credit winners of 2020 and into credits that have not yet fully participated in the recovery. Cyclical industries, such as energy, leisure and transportation will be areas of focus as we try to take advantage of the recovery theme. We believe, given low rates and tight risk premiums, a focus on sector allocation and security selection will likely give us the best opportunity to outperform in the year ahead.

Real Estate

Now that a vaccine has been approved and distribution has begun to frontline workers, the commercial real estate sector has turned its eyes towards the end of the pandemic and what its impact will be in the long-term. Some of the trends caused by the pandemic are likely to remain, but many will likely reverse themselves to varying extents. Ultimately, these trends will dictate which areas are attractive for investment and where capital is allocated in the future within commercial real estate.

The primary trend investors are watching is how and when workers will return to their offices. Office physical occupancy has remained around 20% this winter after rising a bit in the fall and then falling as the pandemic's most recent wave has hit. As the largest asset class within real estate, office investors are obviously concerned that the demand for office space will be negatively impacted if the number of workers working remotely remains elevated. Though not showing up in official statistics for vacancy yet, there is a significant overhang of sublease space that has hit the market which will likely pressure rents lower. Whether or not companies will reverse their positions on shrinking their footprint once a return to the office is safe is unknown. The return to the office is also critical for downtown retail which is supported by office workers. Without this critical foot traffic, these retailers are likely to close, creating a hollowed out downtown that will make urban locations even less desirable. For that reason, rapid distribution of the vaccine and a quick return to the office will be critical for maintaining the dynamism of downtowns.

In a similar vein, another trend being closely monitored is people's willingness and desire to return to live in big urban centers versus the recent flight to suburbia and smaller, more affordable cities once the pandemic is over. Cities such as New York, San Francisco and Chicago have seen big shifts of people moving to suburban or less expensive locales. When the country is fully reopened, it will remain to be seen if people will still find cities as desirable places to live, with restaurants, cultural institutions and street life available again, or if they will prefer the greater space afforded by the suburbs and cheaper locales. Much will likely depend on how flexible their employers are with remote work and if companies come back to offices. This will all likely have a big impact on housing markets and, in particular, apartment owners in densely populated cities. It is our opinion that most workers will return to offices, and that residents, particularly the young and well educated, will follow their jobs into cities because they want to live close to work and also experience city life.

A trend critical to the hotel and retail industries (particularly restaurants) will be the return of the business travel industry. Tourists have largely returned to beach and outdoor

The views expressed herein are presented for informational purposes only and are subject to change without warning. This material is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance.

destinations but have stayed away from city destinations. Likewise, the business travel industry has largely remained dormant, with major conferences non-existent. These travelers drive the hotel industries in many cities, including Las Vegas, Orlando, Chicago, New York, San Francisco, and many others. Without the return of the business traveler, we will see many hotels and restaurants shut their doors. Our position is that business travel will resume by the summer and that conferences will become common again in late 2021, but many short, face-to-face meetings that once took place in person will now take place virtually, which will have a long-term impact on hotels in particular.

Lastly, we are continuing to keep an eye on how people shop. The pandemic has accelerated the already-occurring trend of shifting shopping from in-person to online, which has driven tremendous growth in industrial distribution space to handle the additional shipment of goods. This has been to the detriment of brick-and-mortar retailers, causing numerous bankruptcies and the shuttering of many stores. Retail landlords are hopeful that in-person shopping will resume at its pre-COVID levels once the pandemic subsides, but we are of the opinion that in-person shopping will likely never return to quite the same level as it once was, and that industrial real estate will be the primary beneficiary.

Boyd Watterson's focus on government-leased real estate primarily located in suburban locations has largely insulated it from many of the negative trends caused by the pandemic. We will closely be monitoring the impact of remote work on the office market since the great majority of our portfolio is office space. However, we believe that the mission-critical focus of the great majority of our tenants will limit the impact of remote work on our existing properties.

Equities

The year ended with the Dow and S&P 500 indices closing at record highs, while the NASDAQ was within 11 points of its all-time high. The S&P 500 Index ended the year up 18.40% and was up 67.88% from its 2020 low hit in late March. Federal Reserve support of the financial markets coupled with low interest rates for the foreseeable future, and a rollout of two vaccines led investors to look forward with the expectation for revenue and earnings growth returning in 2021. On a valuation basis, the market looks very rich as the P/E ratio based on 2021 earnings is at 27 times. Low interest rates often drive P/E ratios higher, but the market is clearly expecting positive earnings surprises as the economy continues to recover.

Growth stocks were the clear winner versus value stocks, with the S&P 500 Growth Index up 33.14% versus only 1.15% for the S&P 500 Value Index. From a market capitalization perspective, large-cap stocks outperformed mid-caps and mid-caps outperformed small-caps. Lastly, there was a big diversion between the different industries that make up the composition of the S&P 500 Index. Technology related industries were the best performers, up anywhere from 50 to 75 percent for the year. Energy, hotels, airlines, and REITS were the weakest performing industries and ended the year with negative returns. We do expect a rotation to take hold as we move through 2021 and see the economic growth fueled more from the services industries rather than the goods producing industries. This should result in better relative performance for many of those industries that underperformed in 2020 as pent-up demand gradually returns more broadly across the economy.

The views expressed herein are presented for informational purposes only and are subject to change without warning. This material is not intended as a recommendation to invest in any particular asset class or strategy or as a promise of future performance.