KLS
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2021 Second Quarter Commentary and Outlook

U.S. equity markets rose sharply again in the second quarter of 2021, spurred on by a robust economic recovery driven by both fiscal stimulus and the COVD-19 vaccine rollout. During the quarter, 87% of S&P 500 companies reported a positive Q1 earnings surprise and better-than-expected revenues, and the University of Michigan's Consumer Sentiment Index, which measures consumer confidence, reached its highest levels since before the onset of the pandemic. Consumer spending increased by 11.8%, helping propel estimated GDP to an annualized 6.5%. For the quarter, the S&P 500 gained over 8.5%, its fifth consecutive positive quarter, the longest run of quarterly gains since 2017. Global equities, as measured by the MSCI All Country World Index, rose by nearly 7.4%.

Index / Market	Q2 2021	YTD 2020
Dow Jones Industrial Average	5.08%	13.79%
S&P 500	8.55%	15.25%
S&P 400 (Mid Cap)	3.64%	17.59%
NASDAQ	9.68%	12.92%
Wilshire 5000	8.42%	15.45%
Russell 2000 (Small Cap)	4.29%	17.54%
MSCI Europe	7.42%	11.80%
MSCI EAFE	5.17%	8.83%
MSCI Emerging Markets	5.05%	7.45%
MSCI All Country World	7.39%	12.30%
MSCI All Country World ex USA	5.48%	9.16%

U.S. equity performance in the second quarter continued to be broad-based, with all sectors except utilities having positive returns for the period. As the economic recovery continued to gain momentum, cyclical sectors were among the strongest performers, with real estate and energy up 13.1% and 11.3%, respectively for the quarter. Year-to-date through the end of the second quarter, energy has been the best performing sector having risen 45.6%, while utilities have been the worst, gaining just 2.4%.

The market rotation seen in previous quarters reversed itself during the quarter, with large capitalization stocks outperforming small and mid-caps, and growth-oriented companies beating value stocks. The technology sector in particular benefitted from the move back into growth, finishing the quarter 11.6% higher. Through the midpoint of 2021, value continues to have the lead over growth (17.1% for the Russell 1000 Value vs. 13.0% for the Russell 1000 Growth), and small and mid-caps remain ahead of their large-cap counterparts (23.6% and 17.6% for the S&P Small Cap 600 and Mid Cap indices, respectively, as compared to 15.3% for the S&P 500).

Equity market valuations remained at near-record highs, with the S&P 500's forward 12-month P/E ratio finishing the quarter at 21.1, below the 21.8 value recorded at the end of the first quarter, but still well above the 5-year (18.1) and 10-year (16.2) averages.

Fixed income markets experienced positive performance in the second quarter, with the Bloomberg Barclays U.S. Aggregate Bond Index returning 1.8%. This index remains negative for the first half of the year, however, as do investment grade corporate bond index returns. The benchmark U.S. Treasury 10 year yield fell from 1.74% to 1.45%, but remains meaningfully higher than the 0.93% level where it began the year. Municipal bonds returns are now positive for the year.

Index / Market	**Q2 2021**	**YTD 2020**
Bloomberg Barclays U.S. Aggregate Index	1.83%	-1.60%
Bloomberg Barclays U.S. Corporate Bond Index	3.55%	-1.27%
Bloomberg Barclays U.S. High Yield Index	2.74%	3.62%
Bloomberg Barclays U.S. Treasury Index	1.75%	-2.58%
Bloomberg Barclays U.S. Municipal Bond Index	1.42%	1.06%

Outlook

Our positive outlook on the U.S. economy and equity markets remains, bolstered by the sharp increase in U.S. economic growth as measured by GDP. However, the emergence of the Delta coronavirus variant has increased the risk of a slowdown in the resumption of economic activity. New COVID concerns and high equity valuations add to the risk of market volatility for the remainder of the year.

Monetary Policy & Inflation

The end-of-quarter Core PCE inflation reading, which is the Federal Reserve's primary inflation gauge, increased by 3.5% year-over-year in June, the highest level since 1991. The Fed acknowledged that recent inflation data has been higher than expected, but stated that these inflationary pressures are likely "transitory" and primarily due to pandemic-related supply constraints. The Fed estimates that in 2022 inflation likely will level out around 2%, its stated average inflation target. While there remains debate as to the Fed's view that inflation will not be persistent over the long-term, there were indications late in the second quarter that inflationary pressures might be peaking, such as the sharp decline of lumber prices from record highs as sawmills ramped up production. The shortage in semiconductor chips has disrupted new car manufacturing and caused used car prices to spike during the quarter, contributing about one-third of the June inflation number. This supply constraint, which also is causing consumer electronics prices to rise, eventually will turn around, but perhaps not for 12-18 months. The Fed has signaled that it will taper its monthly bond purchases once "substantial further progress" has been made towards its inflation and maximum employment goals. Such reduced purchases are expected as early as the fourth quarter of this year, while an interest rate increase is more likely in late 2023. However, should the Fed see longer-term inflation expectations move persistently above its 2 percent goal, it is prepared to adjust its accommodative policy more quickly, which could lead to a short-term challenge for equity markets. Given our constructive view on the American economy, we are inclined to maintain our exposure to U.S. equities through any sentiment-driven drawdowns.

U.S. Government: Fiscal Stimulus and Tax Policy Changes
Infrastructure was at the center of President Biden's second quarter agenda. As discussed in our last letter, the President's plans include both traditional infrastructure spending and investments in human capital. An additional $550 million of physical infrastructure spending beyond what Congress already intended to spend has moved forward with bipartisan support. The Democrats simultaneously are moving a $3.5 trillion human infrastructure package through the budget reconciliation process. That plan, for which legislation has not yet been written, includes spending for child care, health care, education, and climate initiatives, paid for by an increase in corporate taxes and taxes on wealthy individuals. These proposals will be at the center of Washington's fall calendar, and we will continue to monitor the impact on our clients' tax bills and on corporate profitability, which may have knock-on effects on equity markets.

Labor Markets
The U.S. economy continued to add jobs throughout the second quarter, culminating with an addition of 938,000 positions in June. This was followed by a gain of an additional 943,000 jobs in July. Through July the unemployment rate fell to 5.4%, the lowest level since the beginning of the pandemic. Overall employment is still 5.7 million jobs below the pre-pandemic level of February 2020 when the unemployment rate was 3.5 percent. The Fed anticipates that factors relating to the pandemic which have weighed on employment growth, namely caregiving needs, virus fears and Federal extended unemployment benefits, should wane in coming months, leading to further job gains. The Fed's commitment to maintaining its accommodative stance on interest rates until maximum employment is achieved bodes well for further economic growth.

Corporate Earnings & Consumer Spending
As the economic reopening rapidly accelerated in the second quarter, corporate earnings soared. All eleven sectors are reporting year-over-year earnings growth. Consumer spending increased by 11.8% during the quarter, which followed an increase of 11.4% for the first three months of the year. The Bureau of Economic Analysis reported that the personal savings rate fell from 26.9% in March 2021 to 9.4% in June, demonstrating that Americans are spending more. A common theme in recent earnings reports is that companies have maintained margins by passing through higher input costs to consumers. This was possible as consumers had savings from stimulus payments and pent-up desire to spend. Continuing supply constraints may lead to sustained price increases, but no further stimulus checks are planned and it is unclear whether wage increases will keep up with prices. Eventually corporate pricing power and earnings may come under pressure. As the economy moves towards maximum employment strong consumer spending should continue, although sentiment has tempered since the end of the quarter due to the spread of the Delta variant. Optimism should return if COVID can be controlled and economic activity continues to expand.

Portfolio Construction

Our conviction in maintaining a substantial weighting to U.S. equities was further bolstered in the second quarter as we witnessed better-than-expected growth of the U.S. economy and another period of outperformance by domestic companies. Within client portfolios we believe in broad diversification to capture expanding economic activity and the possibility for retrenchment. We maintain a tilt towards technology and growth-oriented stocks, as we believe that these companies are well positioned to succeed in the continually evolving economy. Furthermore, if we see the emergence and spread of coronavirus variants, these companies should hold up well as they did during the most challenging days of the pandemic in 2020.

While bond markets recovered slightly during the past quarter, our view remains that the risk-reward proposition in fixed income is challenging. With this in mind, the KLS Investment Committee continues to look for investment opportunities that can provide meaningful income with low correlation to equity markets. We have done significant research in the real estate space and expect to add exposure to this asset class to client portfolios, where appropriate, throughout the second half of this year.

Merger with SVB

Boston Private's merger with Silicon Valley Bank was completed on July 1, 2021. We are excited to join a larger organization with talented colleagues and more resources. Your KLS advisor can answer any merger-related questions and discuss the economic landscape or your specific circumstances. We remain enormously appreciative of your confidence in KLS and wish you a wonderful end of the summer. Be well and be safe.

August 26, 2021

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