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# The Anatomy of a Recession: What to Look for and Where We're Headed

Third Quarter 2021

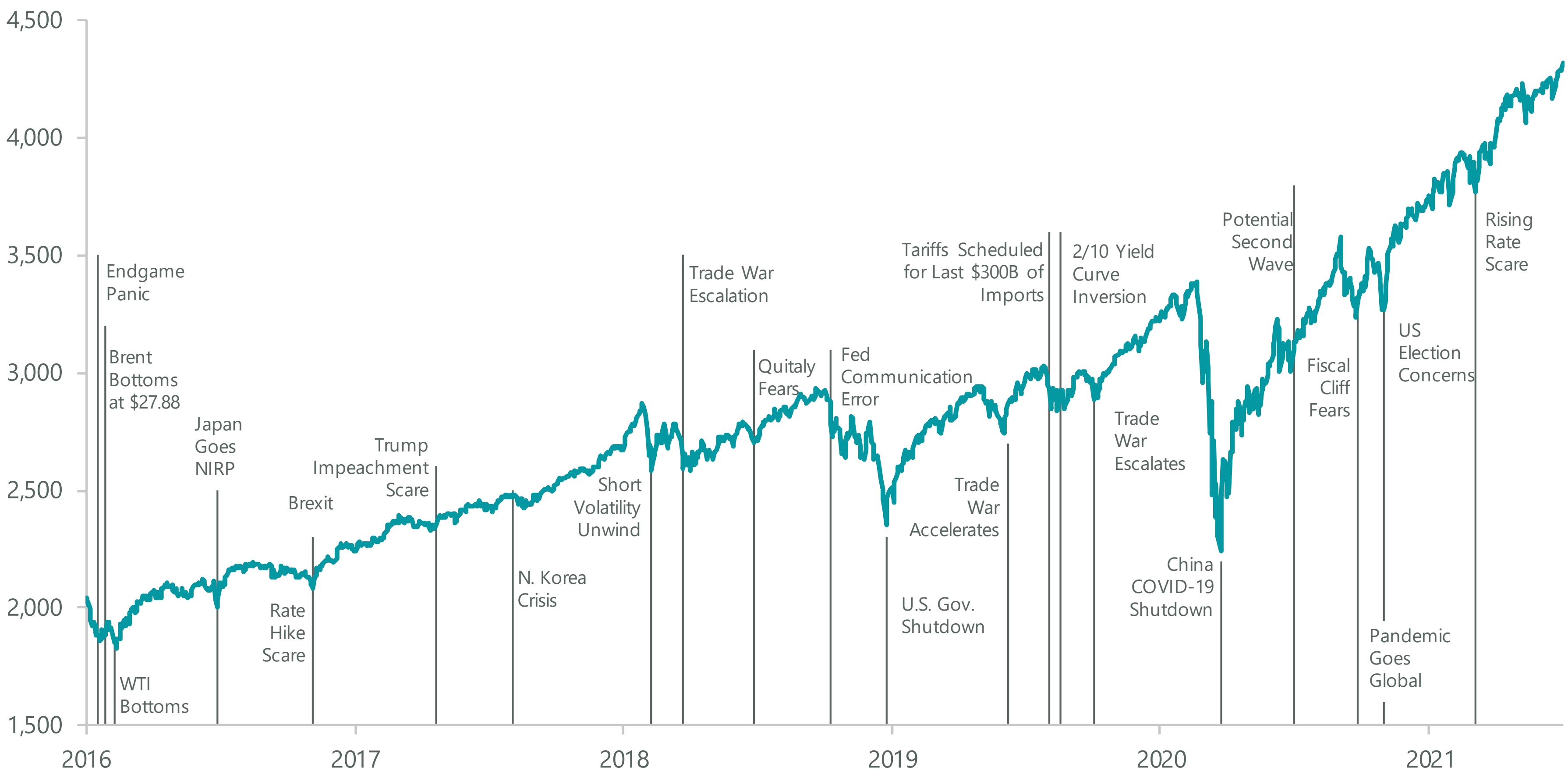
Past performance is no guarantee of future results. Financial term and index definitions are available in the appendix.

# Probabilities vs. Possibilities

The Wall of Worry

Equity Valuations
Fed Policy Error
Civil Unrest
Trade Wars
North Korea Escalation
Dollar Debasement
COVID-19
Sovereign Debt Crisis
Taper Tantrum
Inflation
Corporate Leverage
China Over-Tightening
Populism
EM Problems Intensify

# S&P 500 & Panic Attacks




**"The definition of insanity is doing the same thing over and over again and expecting a different result."**
- Attributed to Albert Einstein

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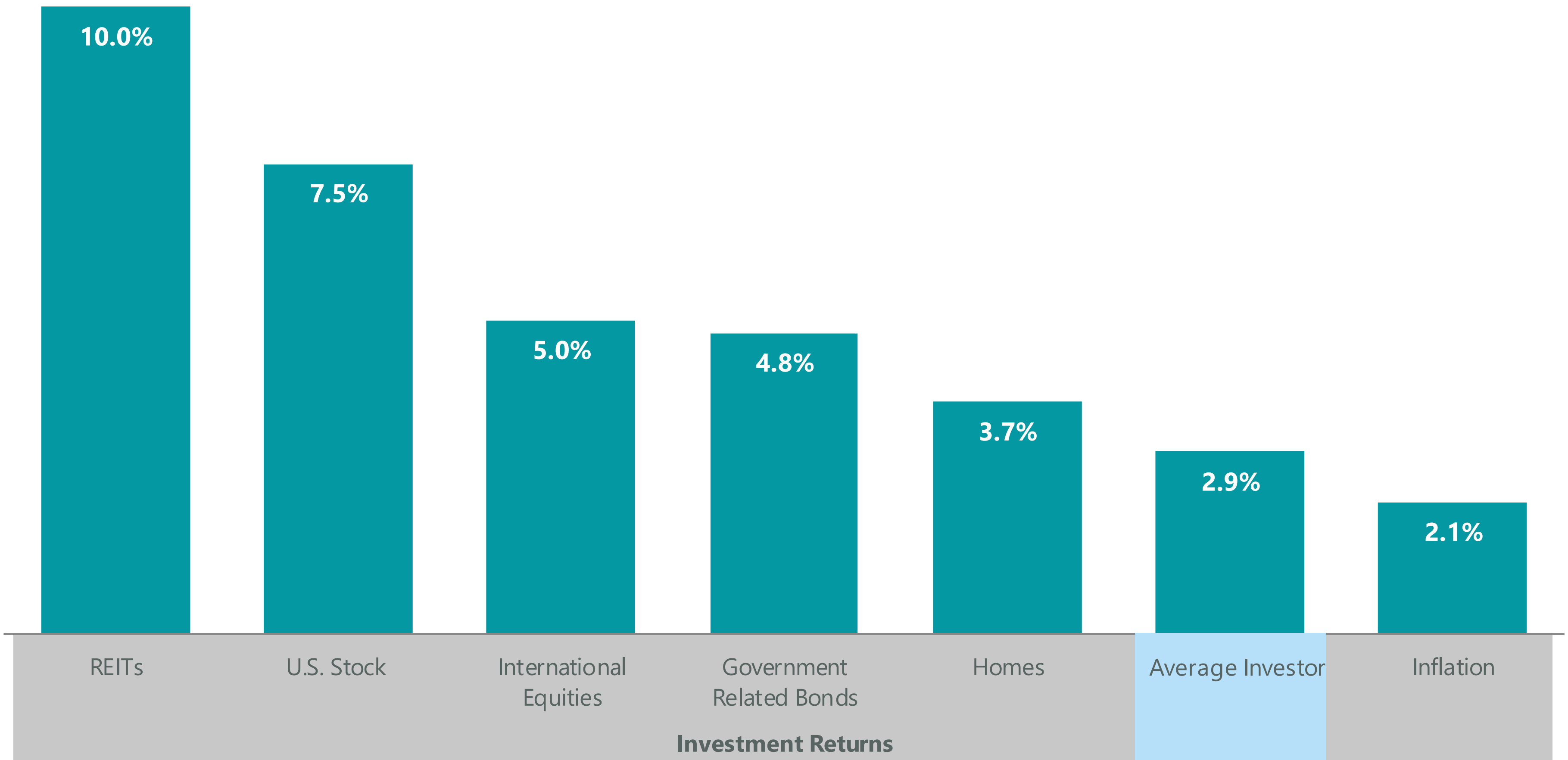
Data as of June. 30, 2021. Source: Standard & Poor's. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Effects of Panic Attacks on Average Investors

20 Years Annualized Returns (2001-2020)




Source: Bloomberg, June 30, 2021. Average asset allocation investor return is based on an analysis by DALBAR, Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Indices shown are as follows: REITs are represented by the NAREIT Equity REIT Index, U.S. Stocks are represented by the S&P 500 Index, International Equities are represented by the MSCI EAFE Index, Government-Related Bonds are represented by the Bloomberg Barclays U.S. Aggregate Bond Index, Homes are represented by U.S. existing home sales median price, Inflation is represented by the Consumer Price Index. Indices are unmanaged and cannot be purchased directly by investors. Index performance is shown for illustrative purposes only and does not predict or depict the performance of any investment. **Past performance is no guarantee of future results.**

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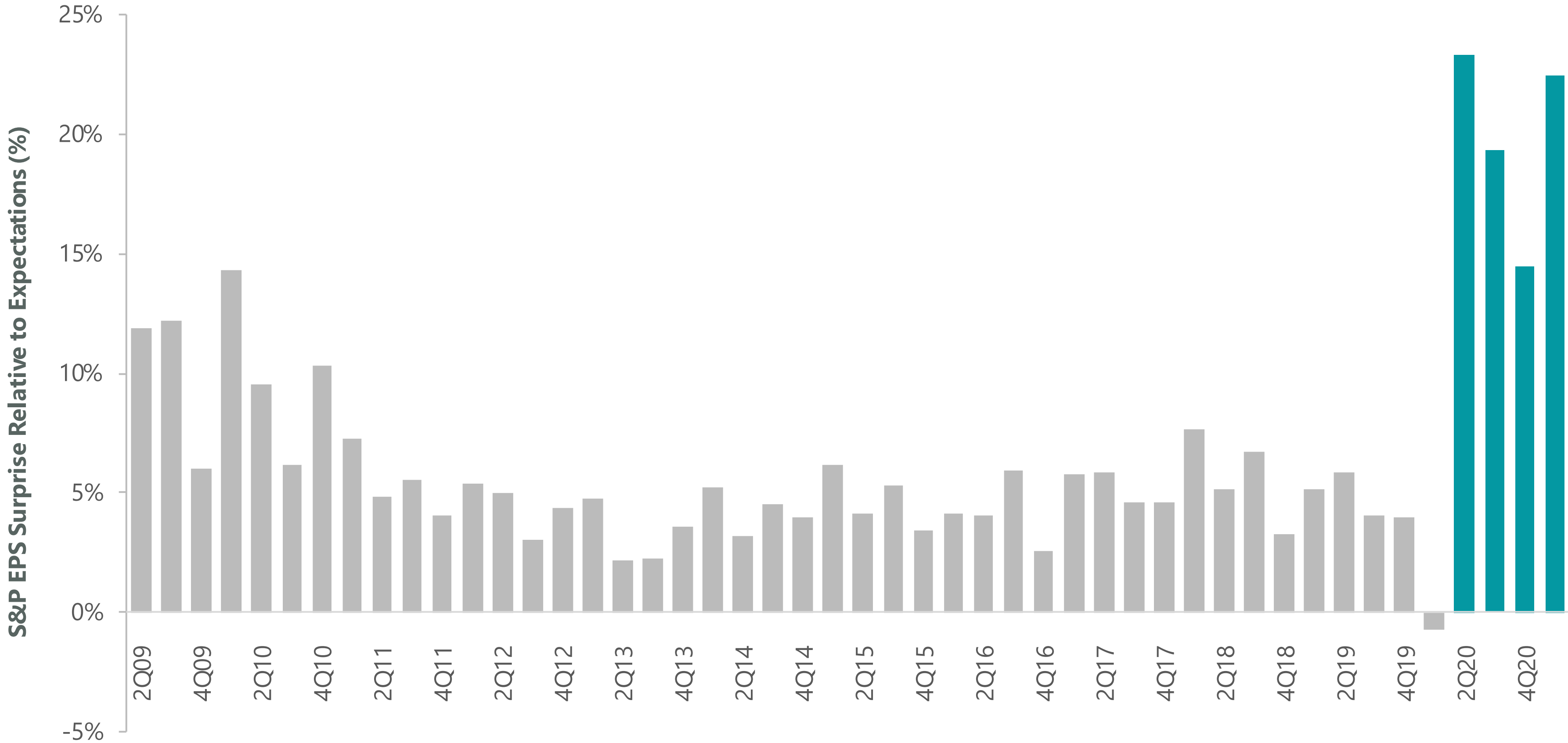
# Historic Earnings Surprise

## 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.**

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Data as of March 31, 2021, latest available as of June 30, 2021. Source: FactSet. 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.

# 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

Data as of June 30, 2021. Source: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

# 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** | ⬆ | ● | ✖ | ✖ | ✖ | ✖ | ✖ | ● | ✖ |

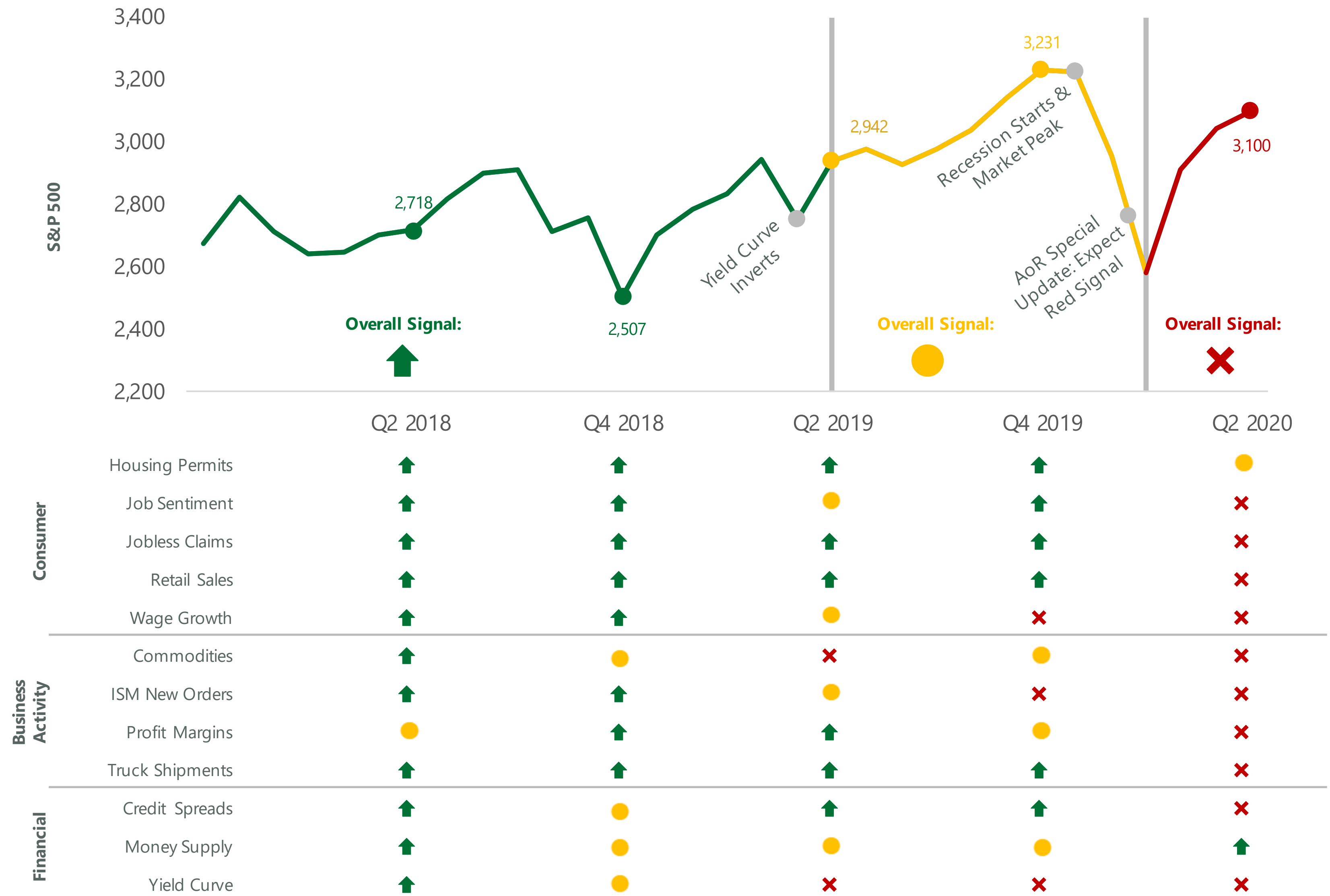
⬆ Expansion ● Improvement ✖ Recession

ClearBridge Investments

Data as of June 30, 2021. Source: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

# U.S. Recession Risk Dashboard

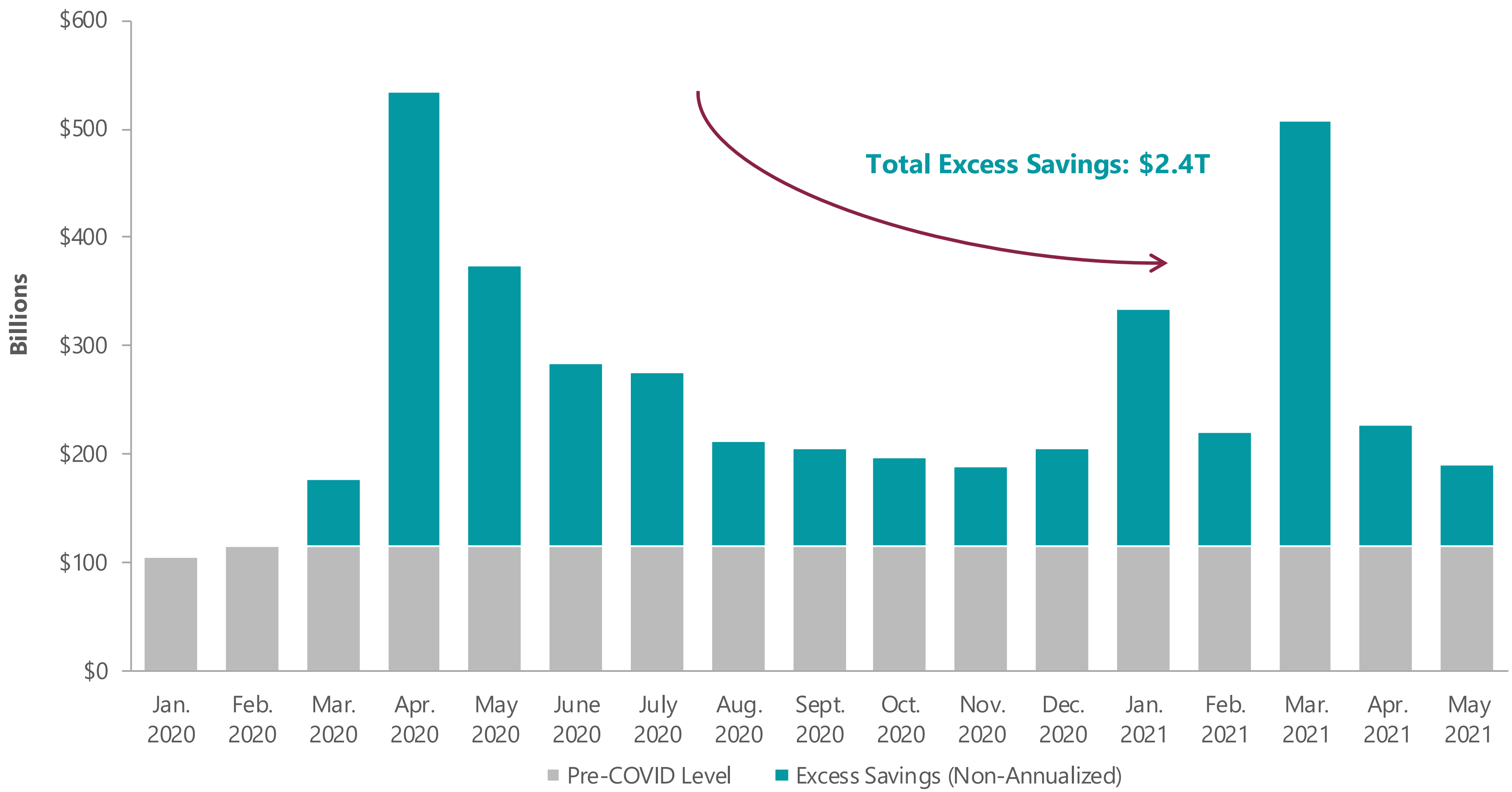
## Case Study: 2018-2020




ClearBridge Investments

Source: BLS, Federal Reserve, Census Bureau, ISM, BEA, American Chemistry Council, American Trucking Association, Conference Board, and Bloomberg. The ClearBridge Recession Risk Dashboard was created in January 2016. References to the signals it would have sent in the years prior to January 2016 are based on how the underlying data was reflected in the component indicators at the time.

# 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.**

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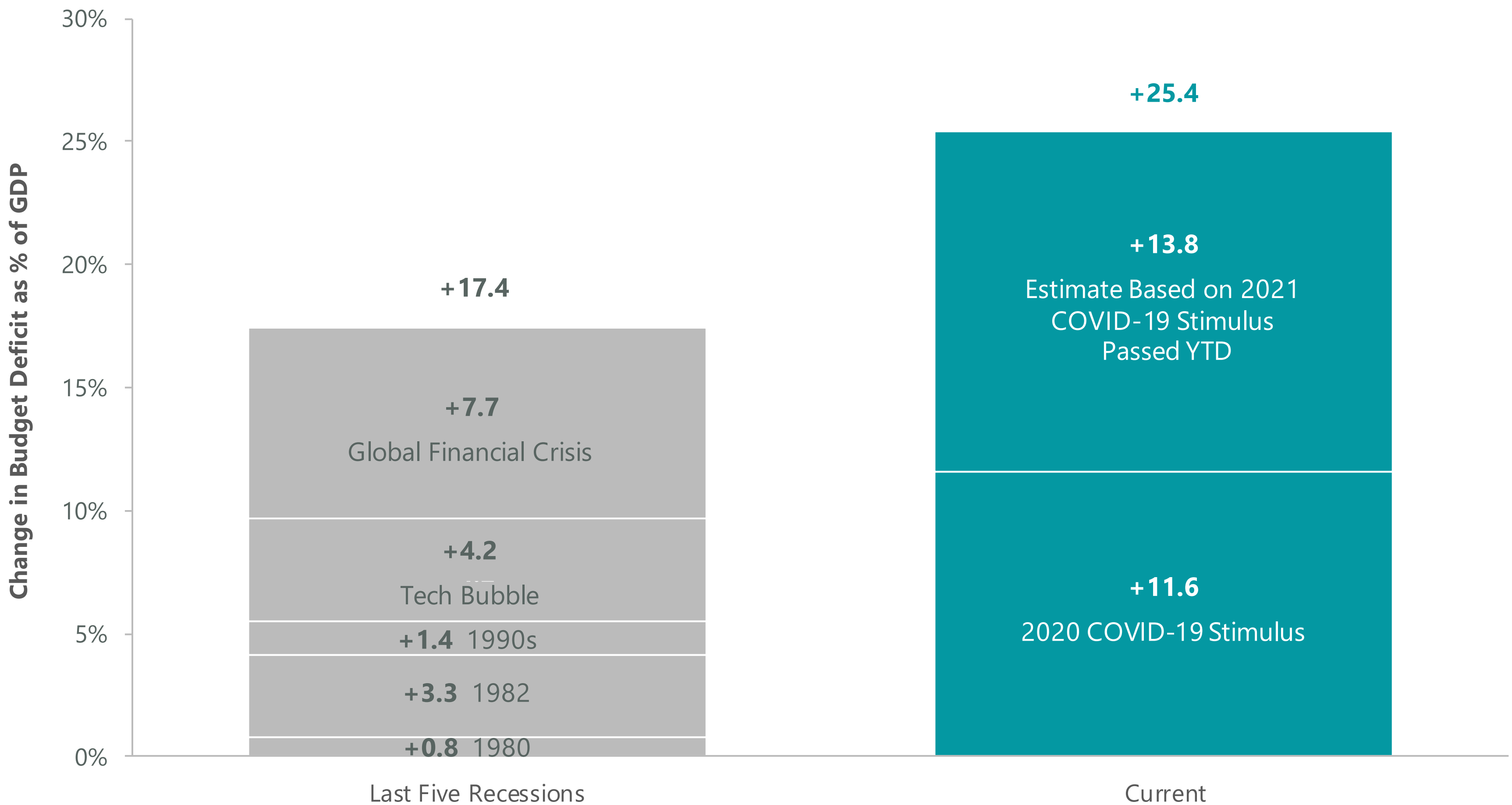
Data as of May 31, 2021, latest available as of June 30, 2021. Source: Bureau of Economic Analysis. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

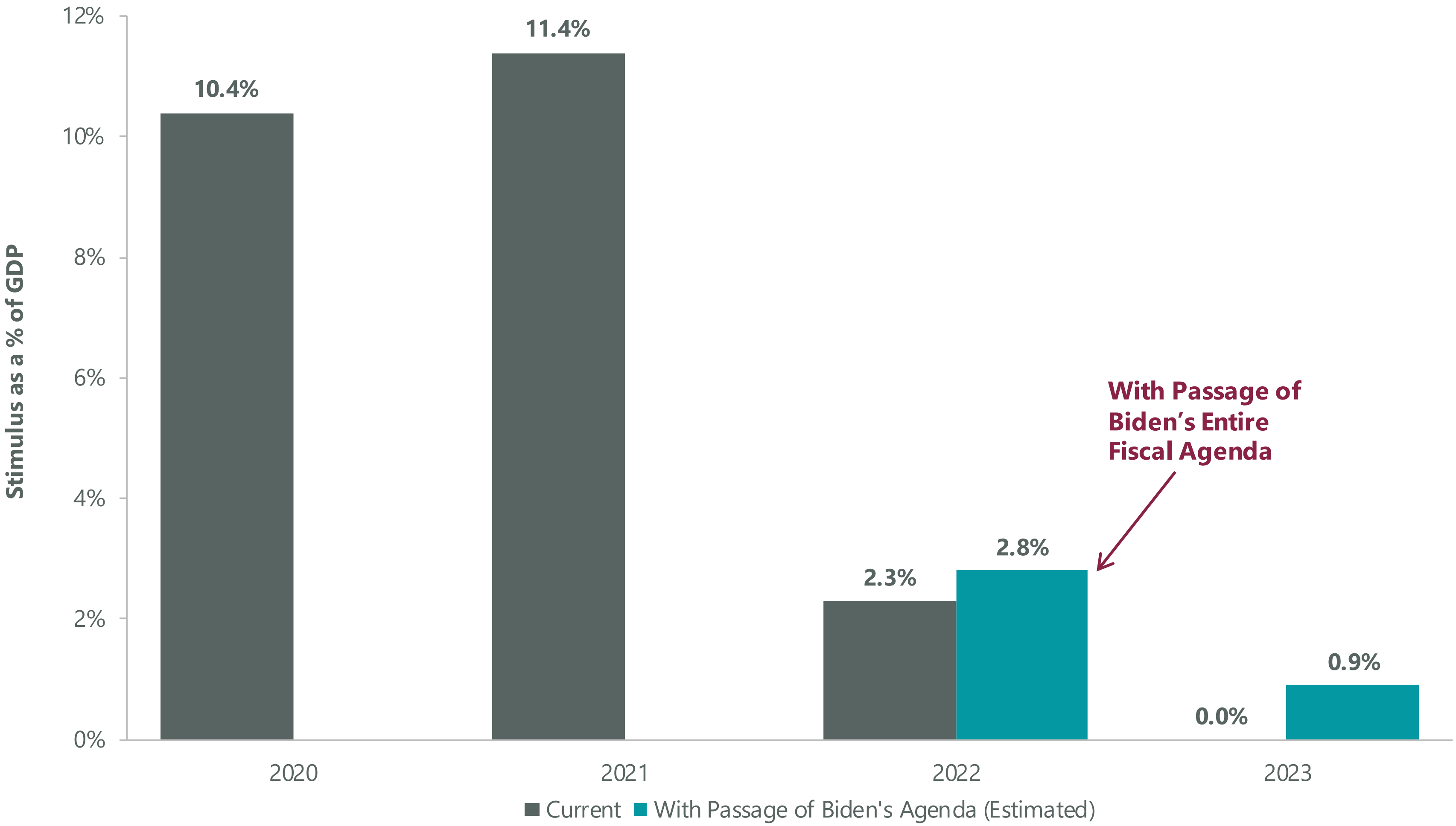
# Stimulus Tidal Wave




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

Change in budget deficit as % of GDP from the start of recession to 1-year after the end of the recession. Data as of June 30, 2021. Source: BEA, Bloomberg, U.S Treasury. 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.

# 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.**

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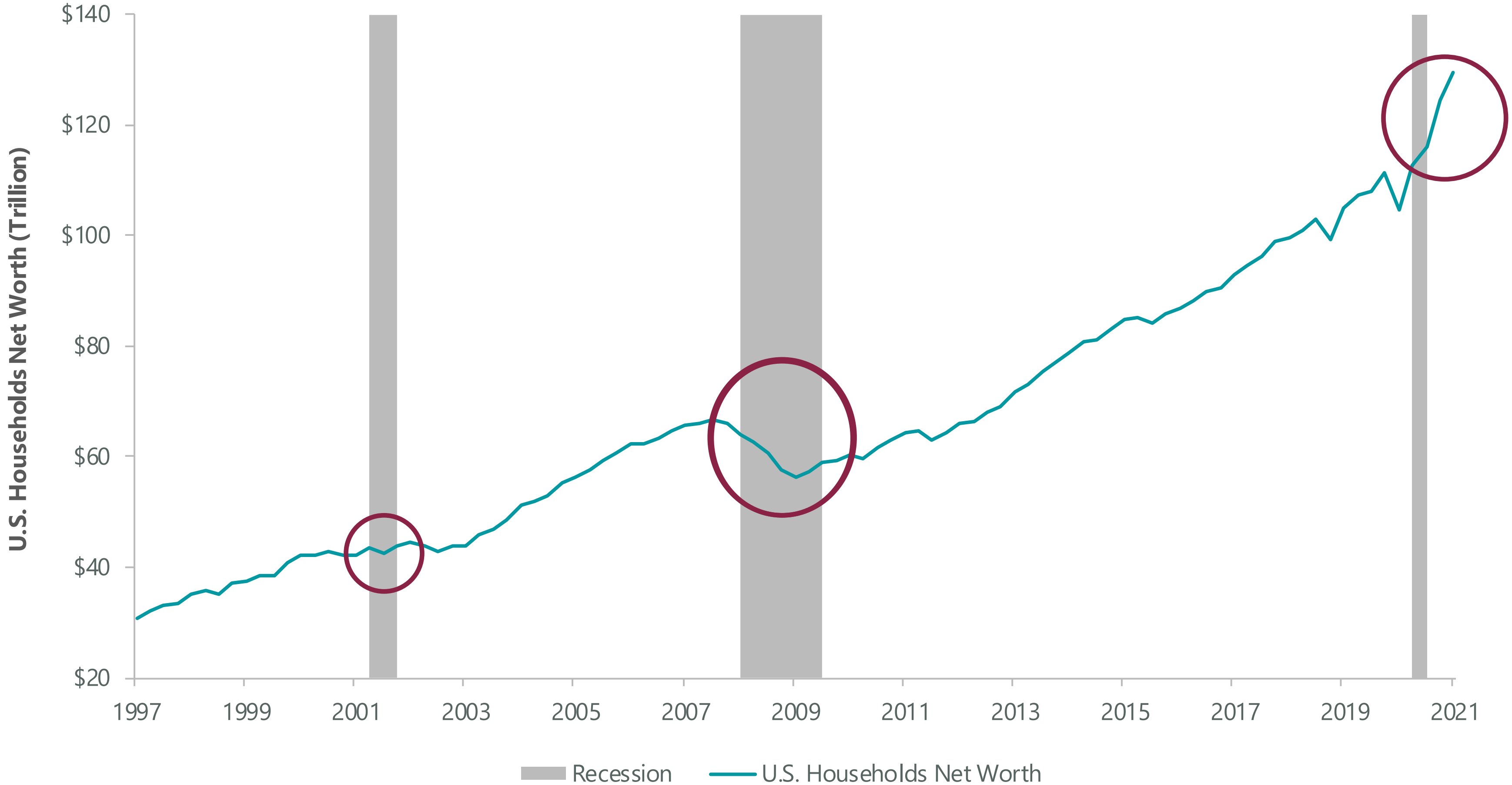
Source: Strategas. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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%).**

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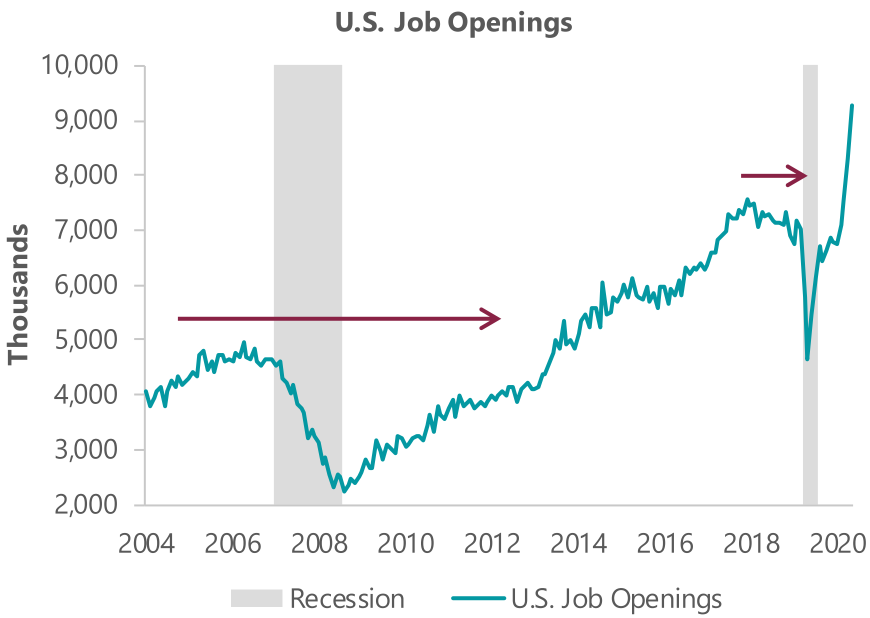
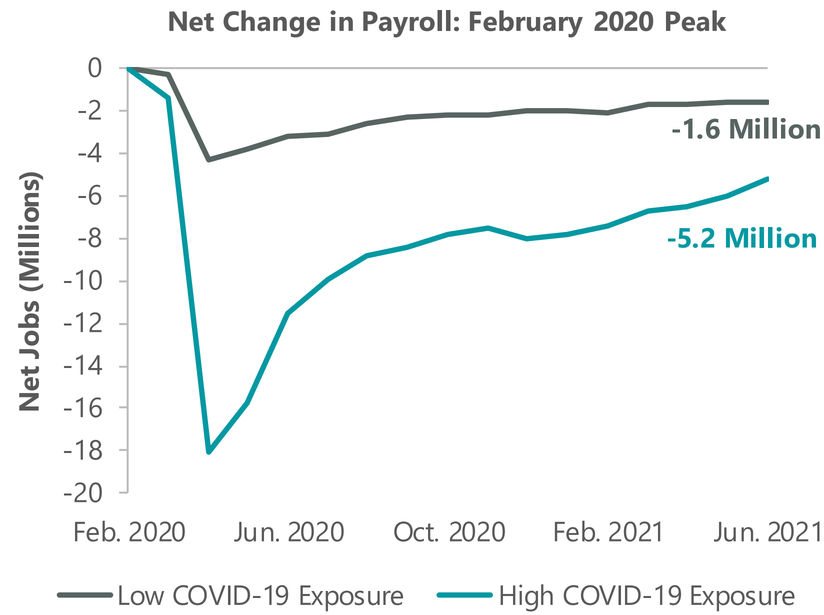
Data as of Jan. 1, 2021, latest available as of June 30, 2021. Source: Federal Reserve Bank of St. Louis. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

High and low COVID-19 exposure is based on industry-level data measuring data including the ability to work remotely, essential vs. non-essential status, and supply/demand shocks resulting from the COVID-19 pandemic. Aggregate net change in payroll employment in these industries is measured relative to February 2020 peak employment levels. High COVID-19 exposure industries account for ~60% of pre-pandemic total non-farm payroll employment; Low COVID-19 exposure industries account for ~40% of pre-pandemic total non-farm payroll employment. Data as of June 30, 2021. 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.

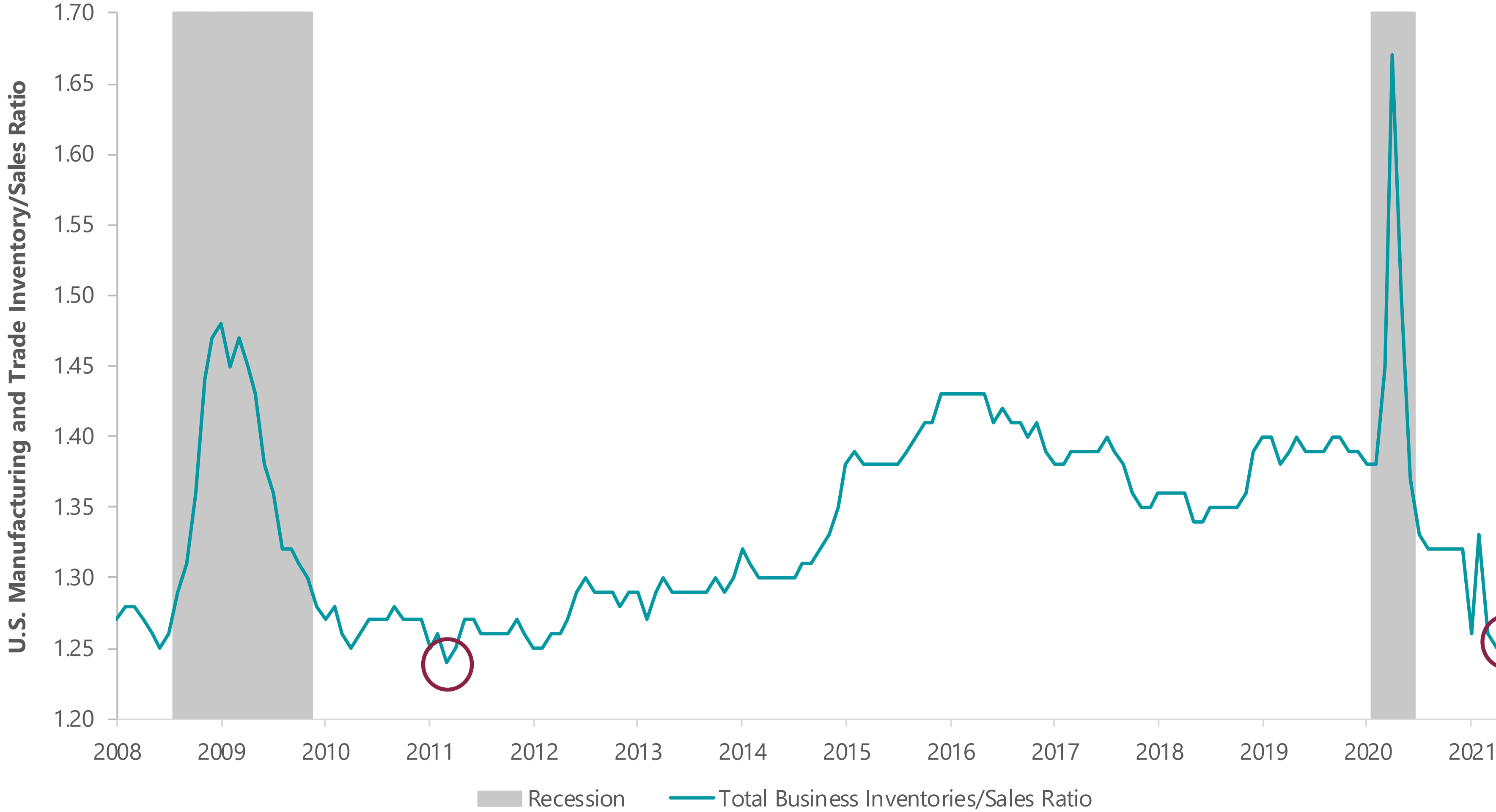
# Not the Global Financial Crisis: Wages


- **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.**



Data as of May 30, 2021, latest available as of June 30, 2021. Source: FRED, Federal Reserve Bank of St. Louis. 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.

# 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.**

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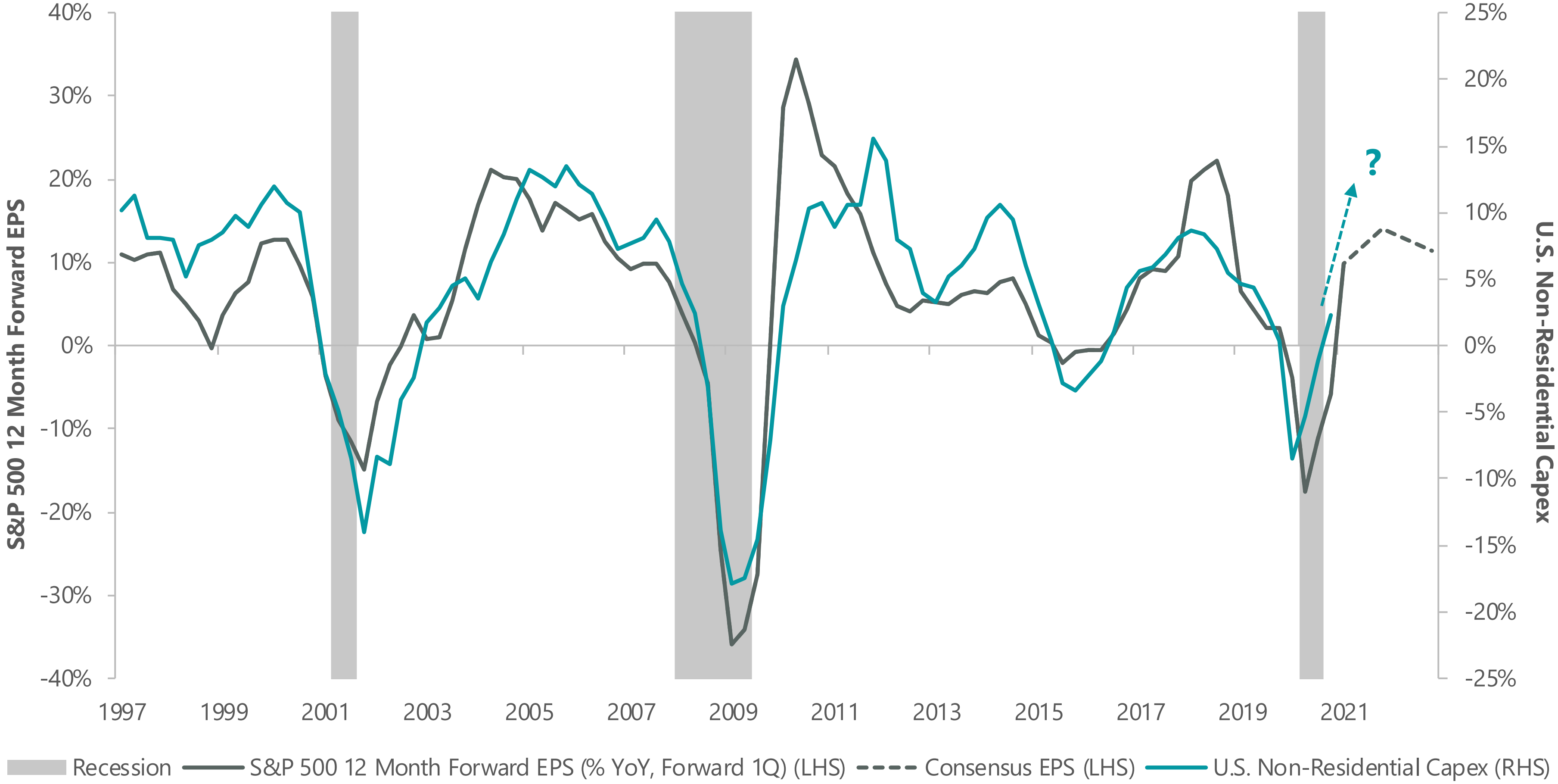
Data as of April 30, 2021. Source: U.S. Census Bureau, FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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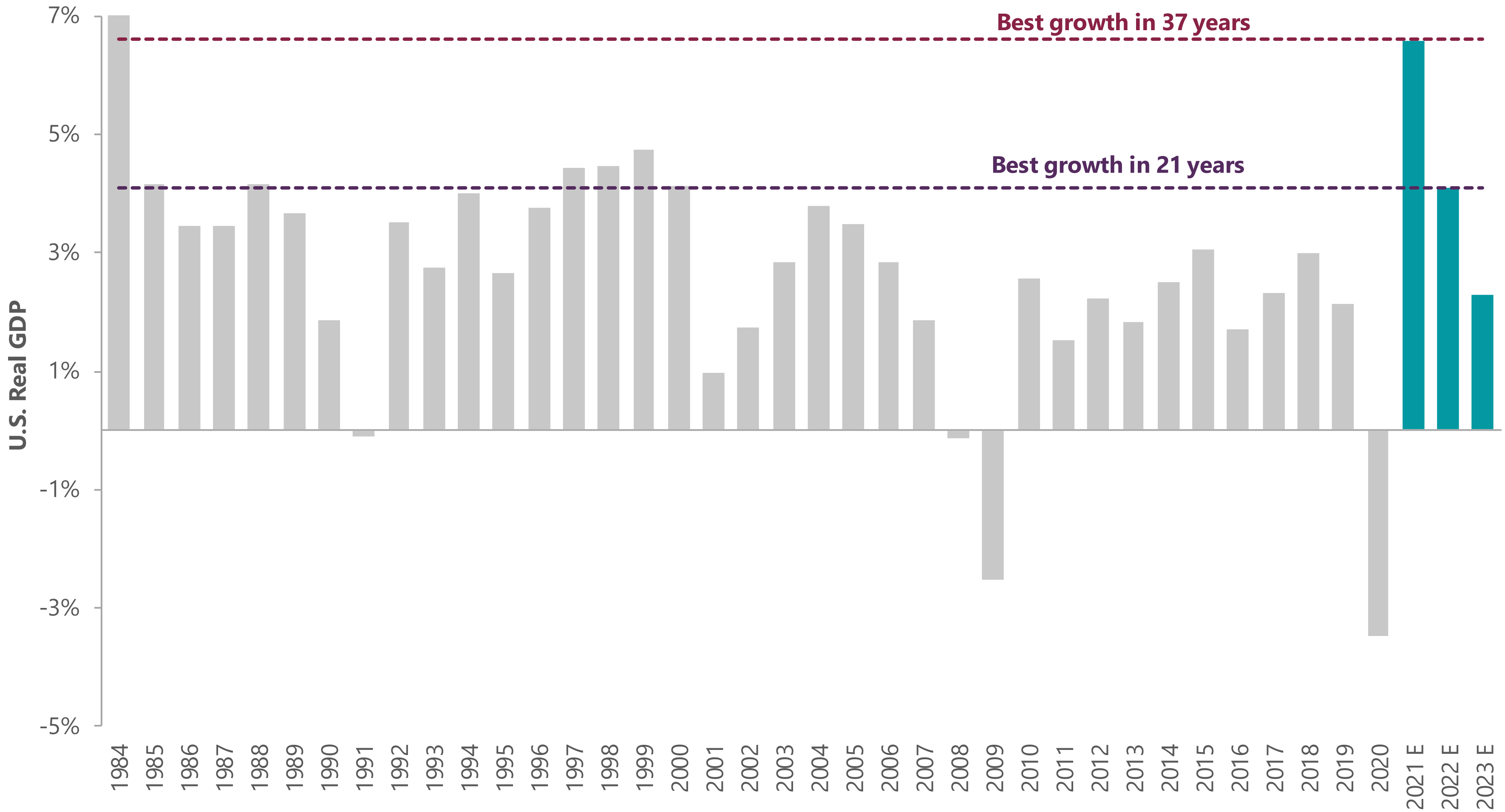
Data as of March 31, 2021. Source: Bloomberg, Factset, Federal Reserve System. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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Data as of Dec, 31, 2020, latest available as of June 30, 2021. Source: BEA, FactSet. 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.

# 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.**

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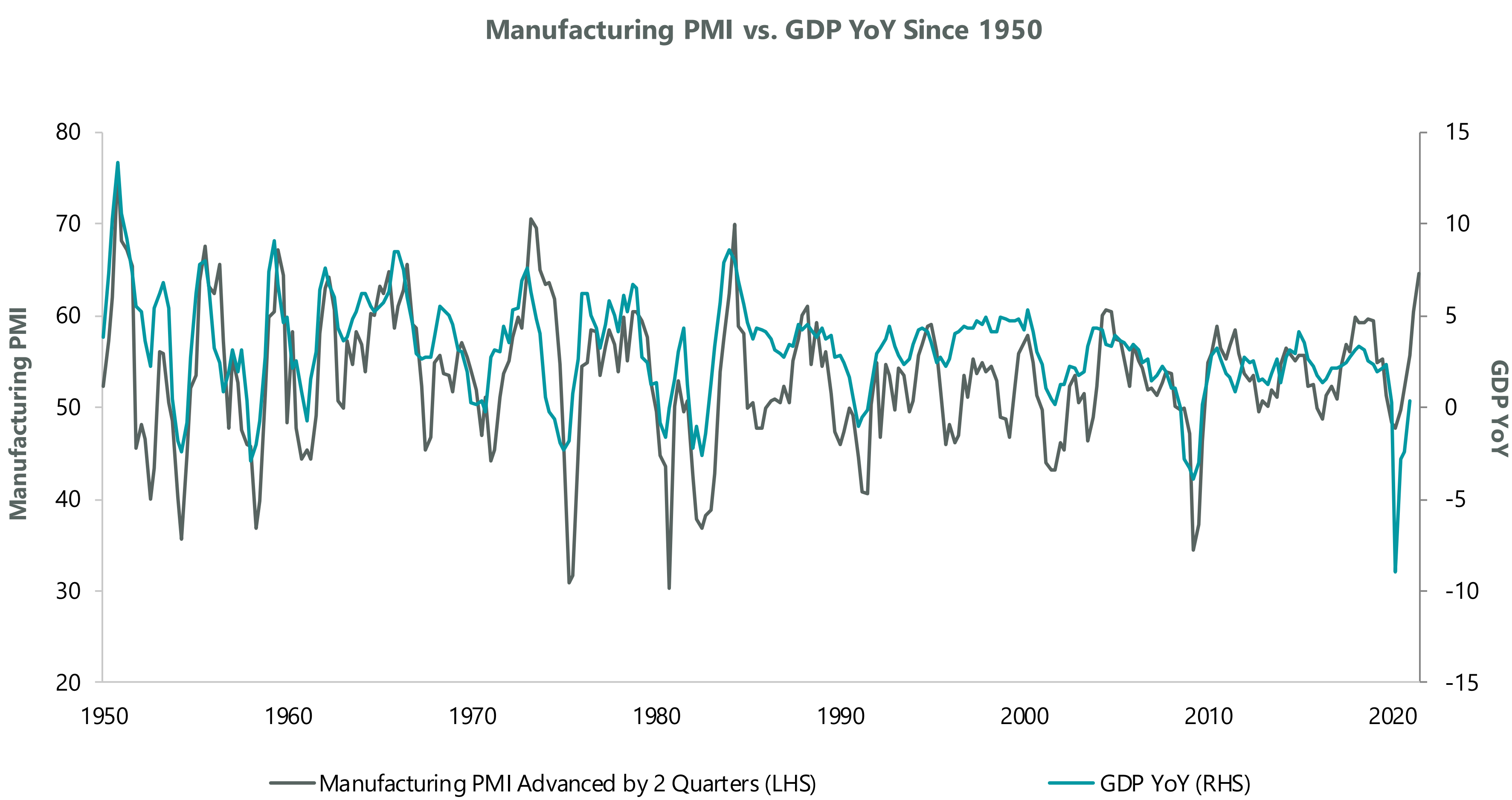
Source: Bloomberg, FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Twin Peaks: Economy I




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

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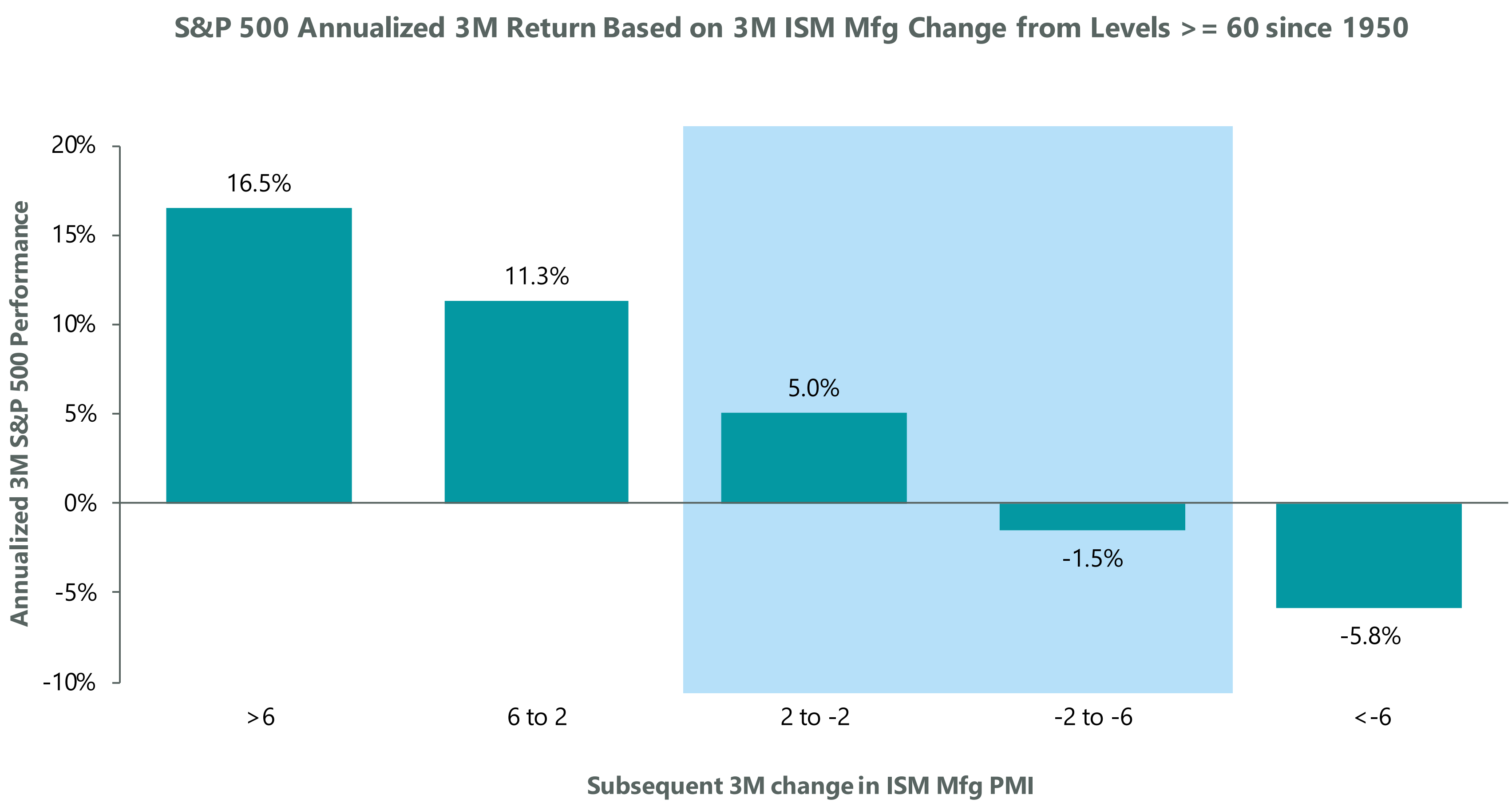
Data as of June 30, 2021. Source: ISM, BEA, and Bloomberg. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Twin Peaks: Economy II




- **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.**

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Data as of June 30, 2021. Source: ISM, S&P, and Bloomberg. S&P 500 annualized return based on starting ISM level (when over 60) based on change in ISM over next 3 months also looking at next 3 months S&P return (then annualized), 1950– present. 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.

# 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.**

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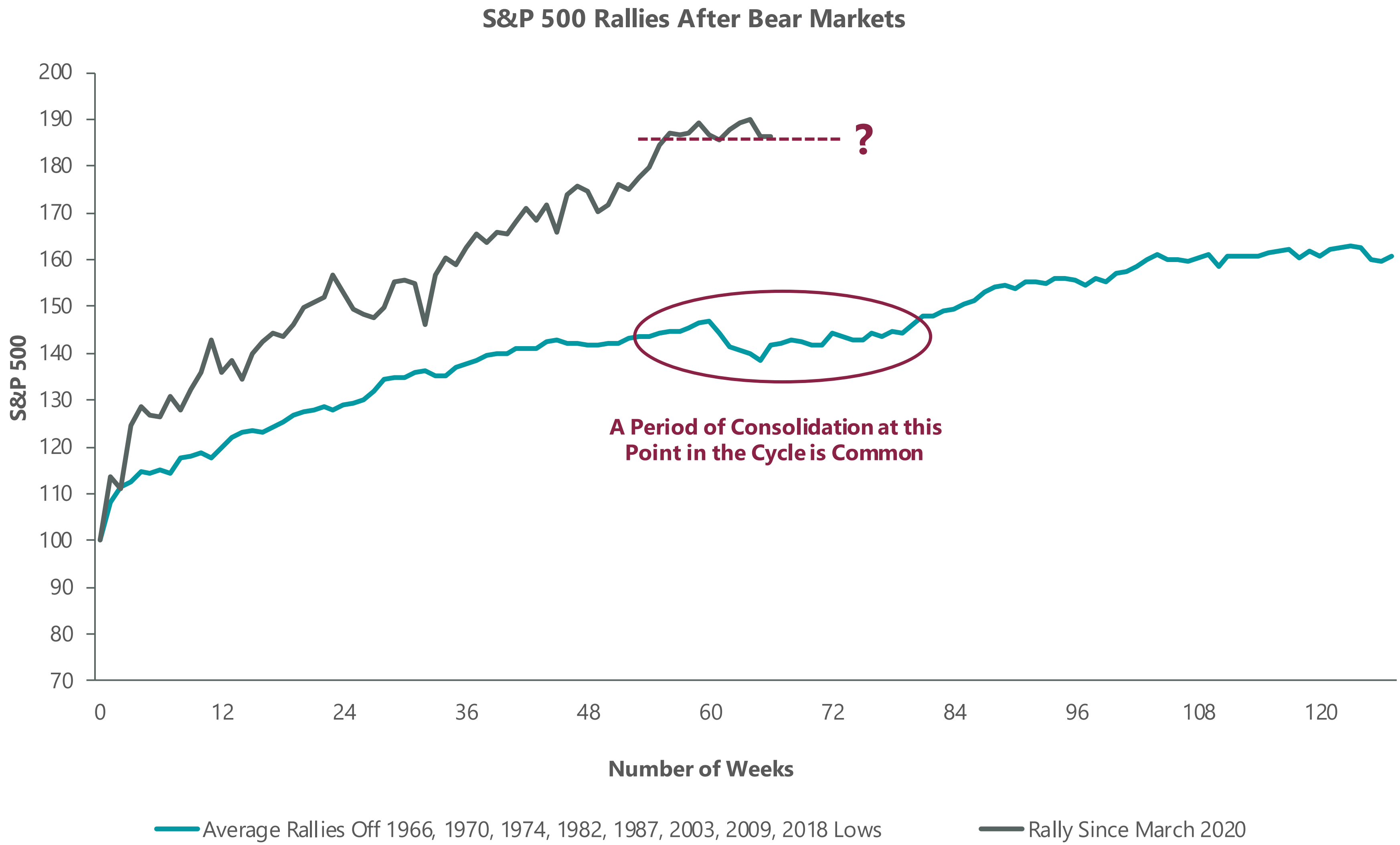
Note: *Expected EPS growth. Peak EPS based on YoY trailing EPS growth. Source: Haver, S&P, Bloomberg. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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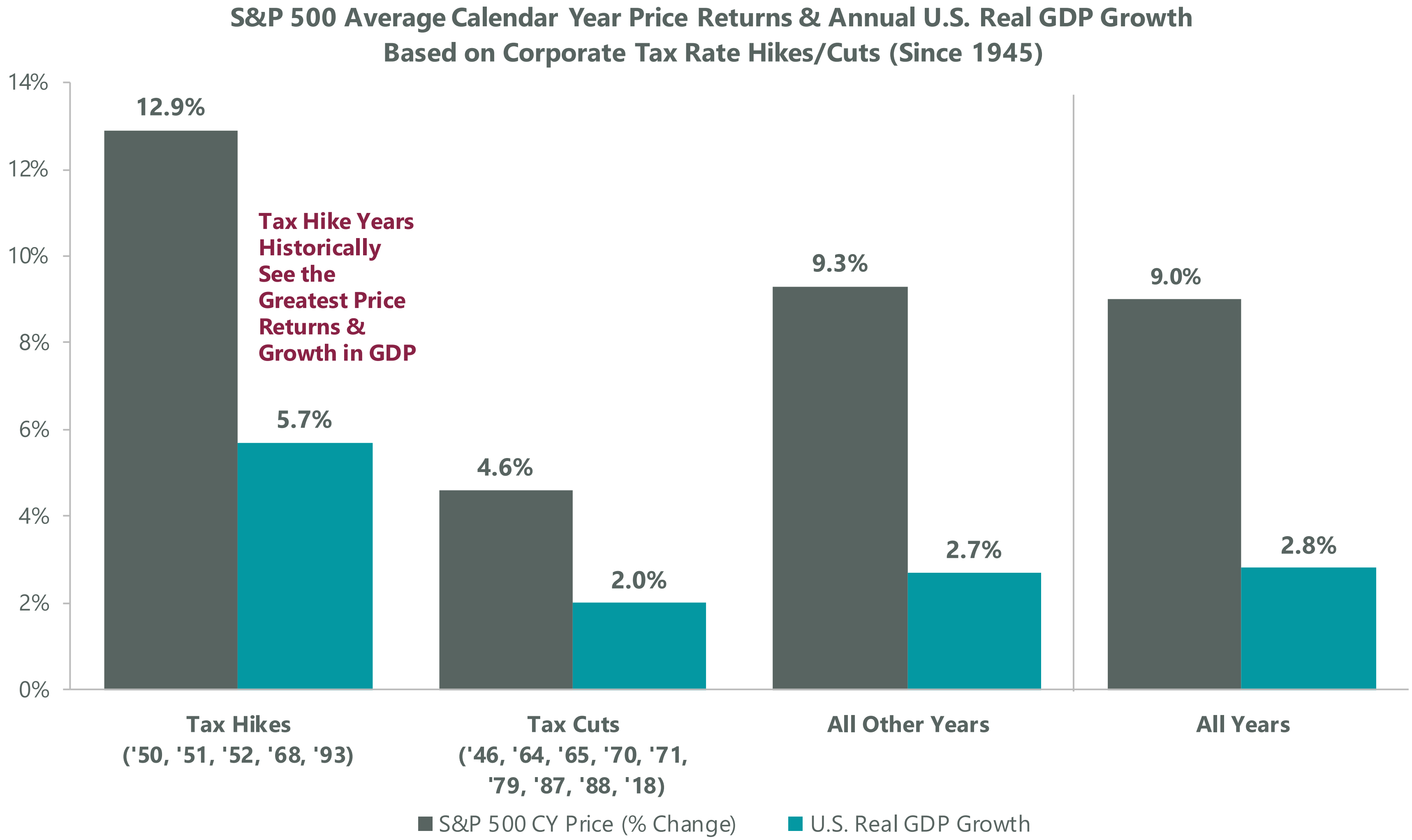
Data as of June 23, 2021. Source: FactSet, S&P Global. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Higher Taxes, Higher Returns?




- **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.**

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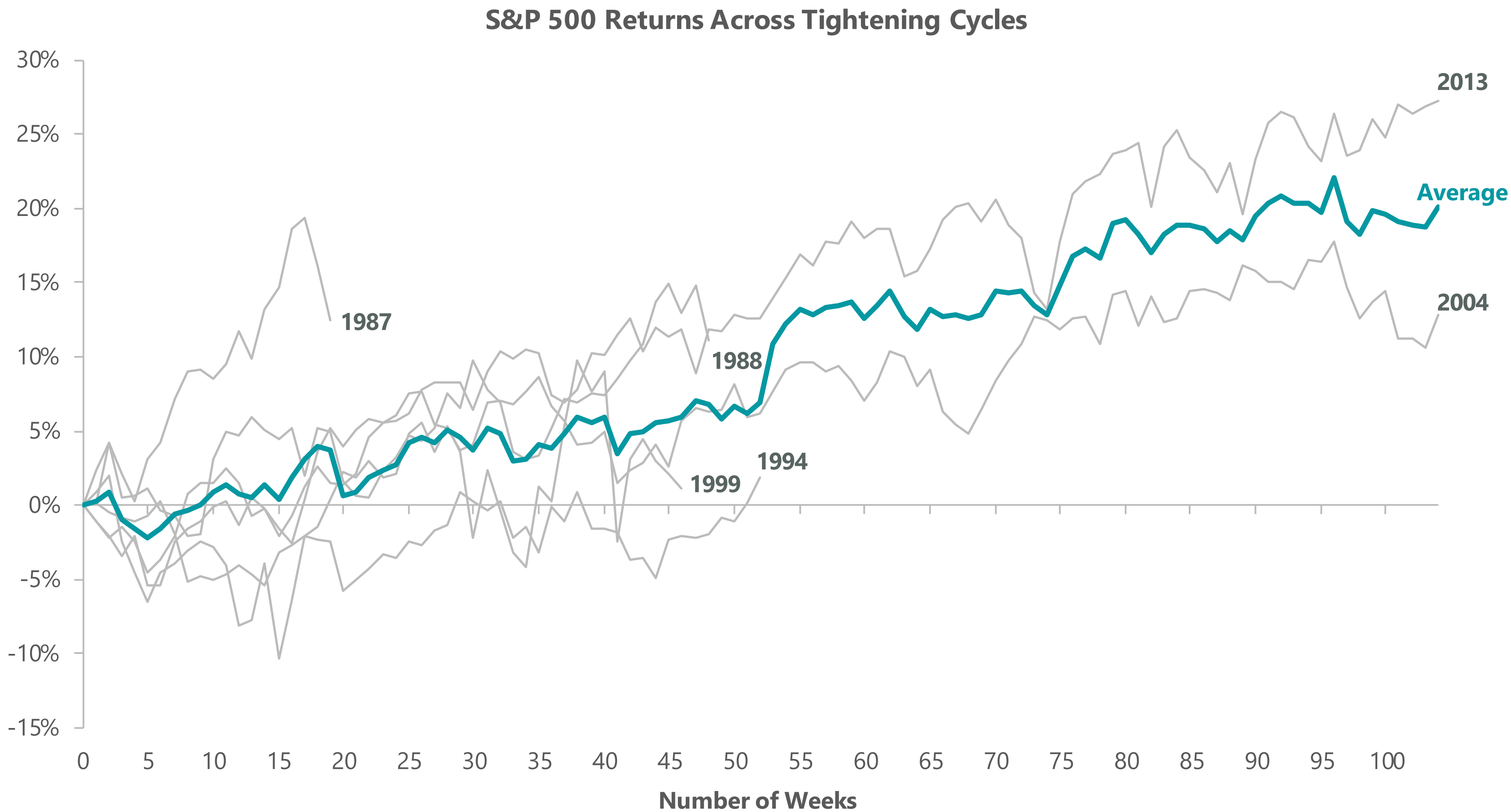
Source: FactSet Standardized Economics, FRED. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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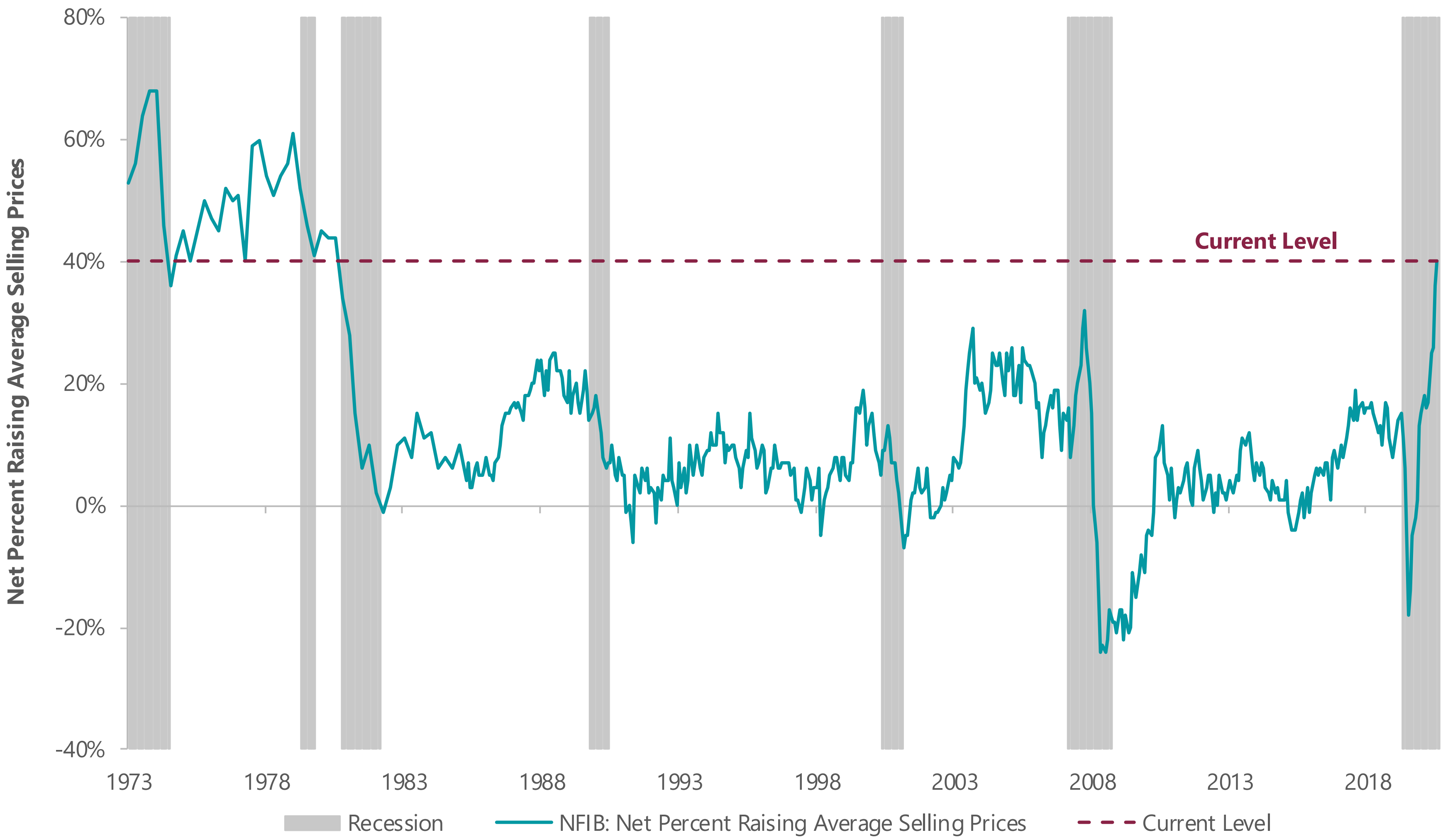
Data as of June 18, 2021. Source: Factset, S&P Global. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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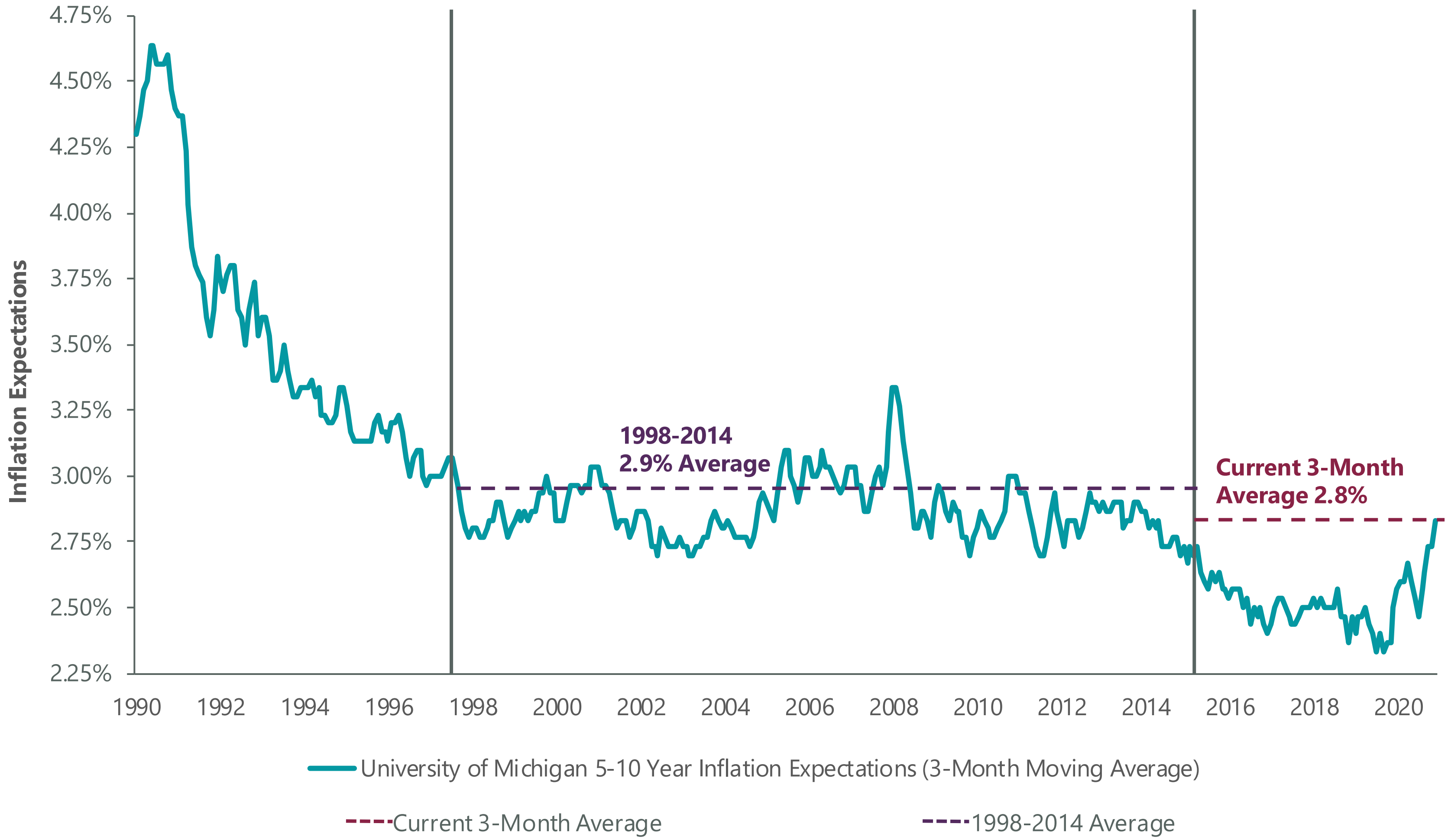
Data as of May 31, 2021, latest available as of June 30, 2021. Source: NFIB – National Federation of Independent Business. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.**

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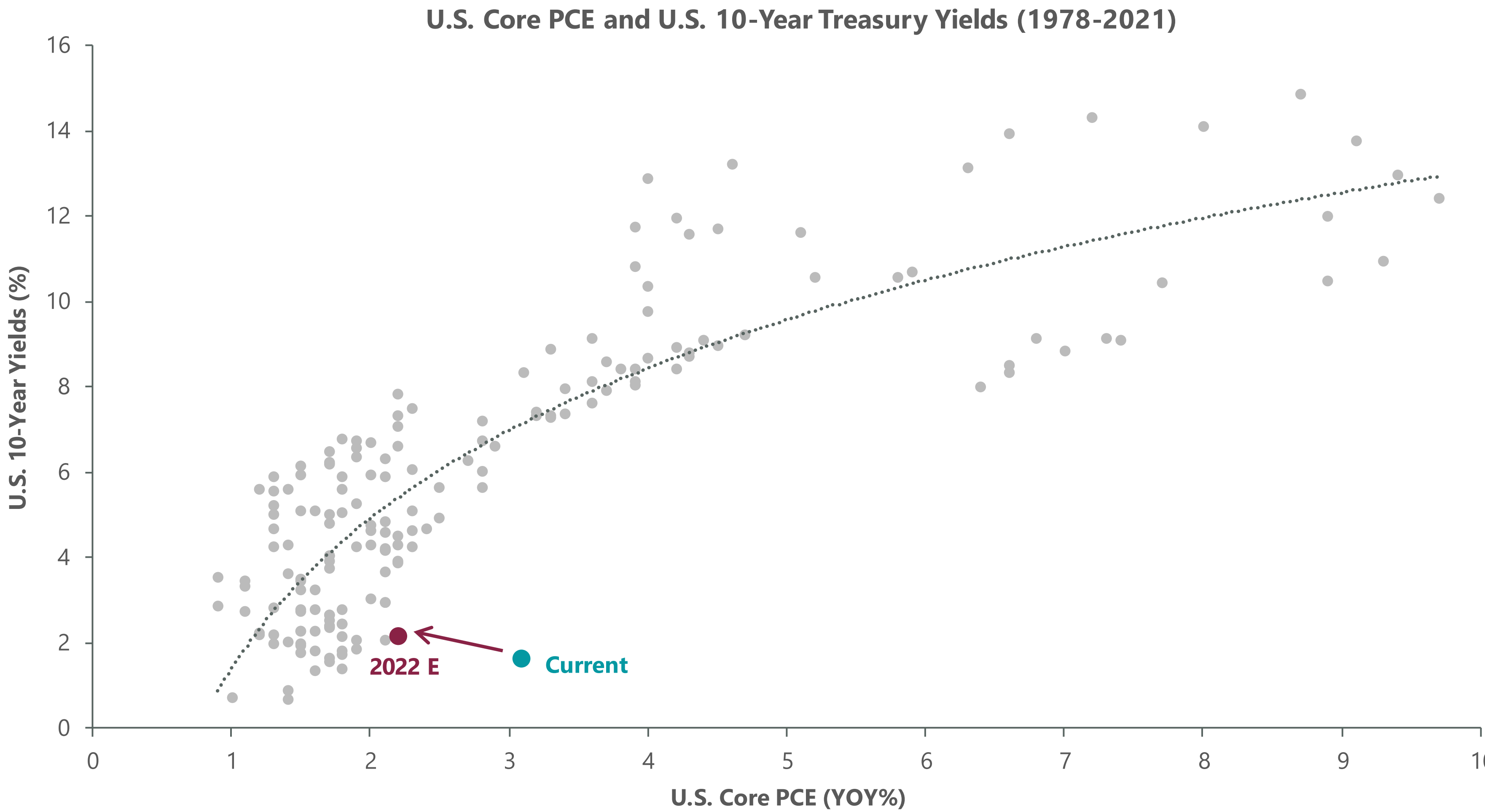
Data as of May 31, 2021. Source: University of Michigan. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# 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.

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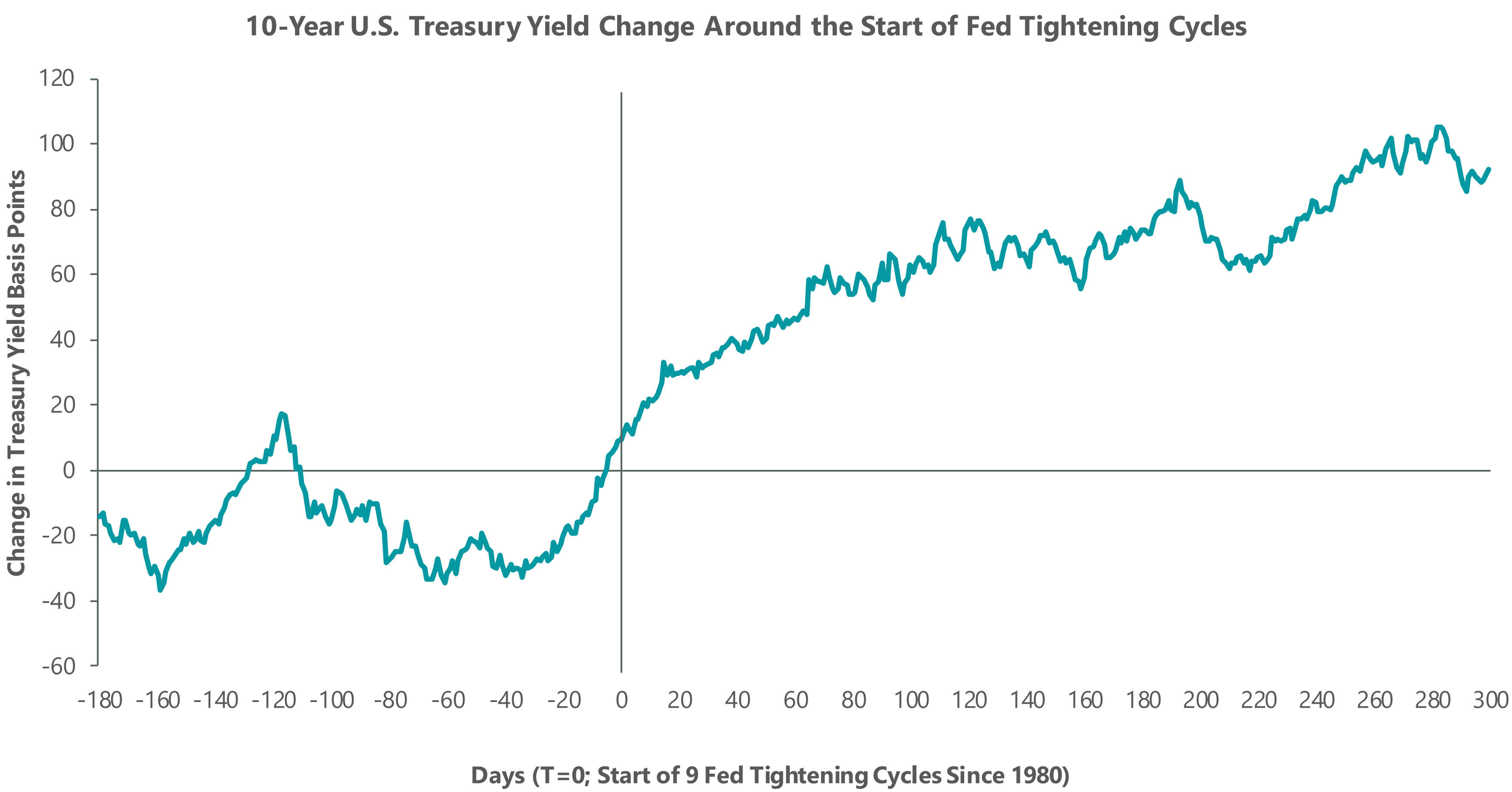
Data as of April 30, 2021. Source: Bloomberg, U.S. Treasury, FRED, Bureau of Economic Analysis, FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Rates Bottom Ahead of 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.**

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Data as of June 21, 2021. Fed Tightening Cycle includes December 2013 communication of Fed Taper. Source: FactSet Standardized Economics. 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.

# Higher Rates, Higher Equities

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

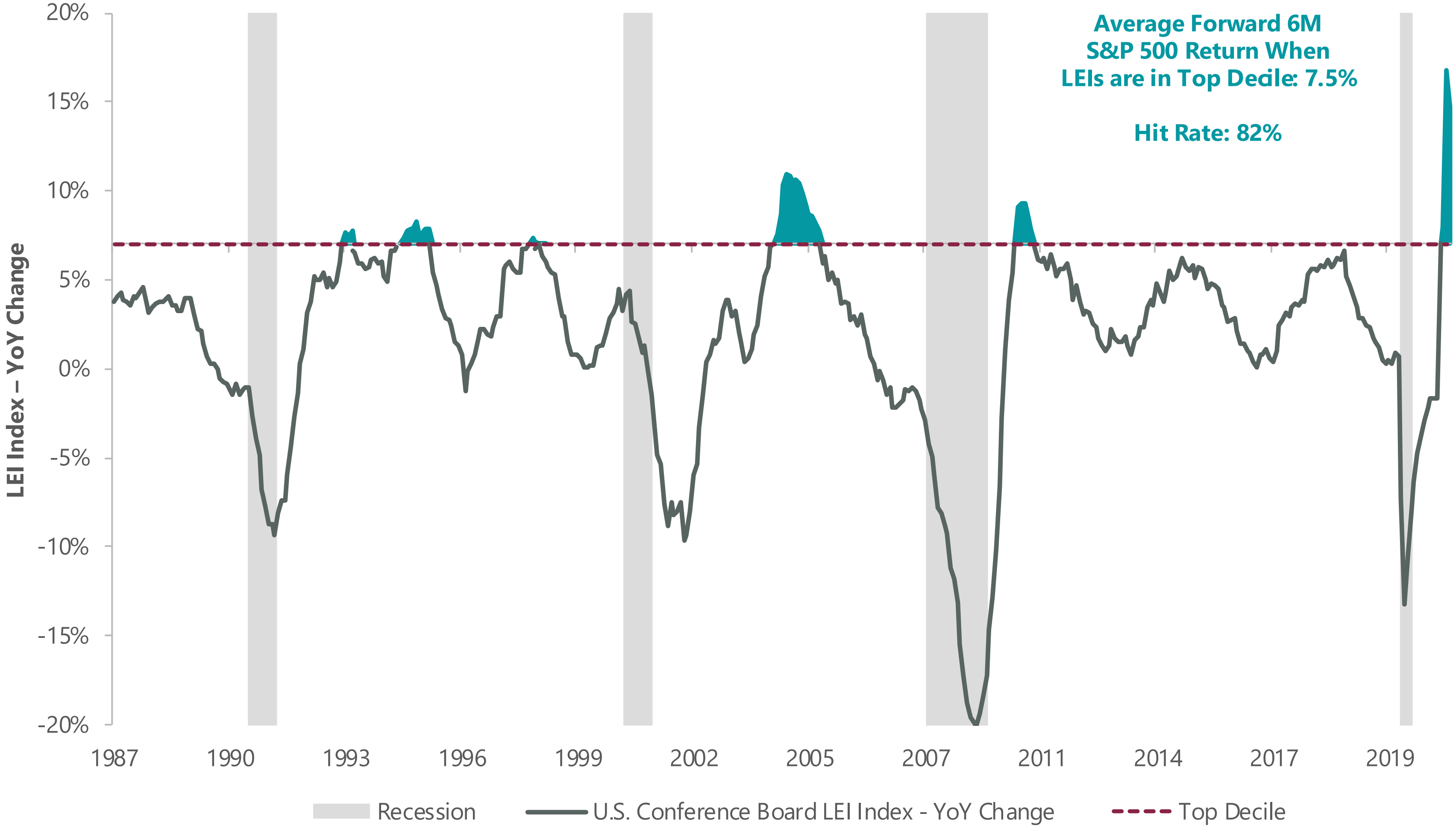
| Rising Rates Start Date | Rising Rates End Date | Duration (Months) | Change in 10-Year Treasury Yield | S&P 500 Gain/Loss (Annualized) | Russell 2000 Gain/Loss (Annualized) |
|---|---|---|---|---|---|
| Dec. 1962 | Aug. 1966 | 45 | 1.7% | 8.1% | - |
| March 1967 | Dec. 1969 | 34 | 3.6% | 3.6% | - |
| 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.**

ClearBridge Investments

Source: FactSet. 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.

# Leading Indicators, Positive Omen

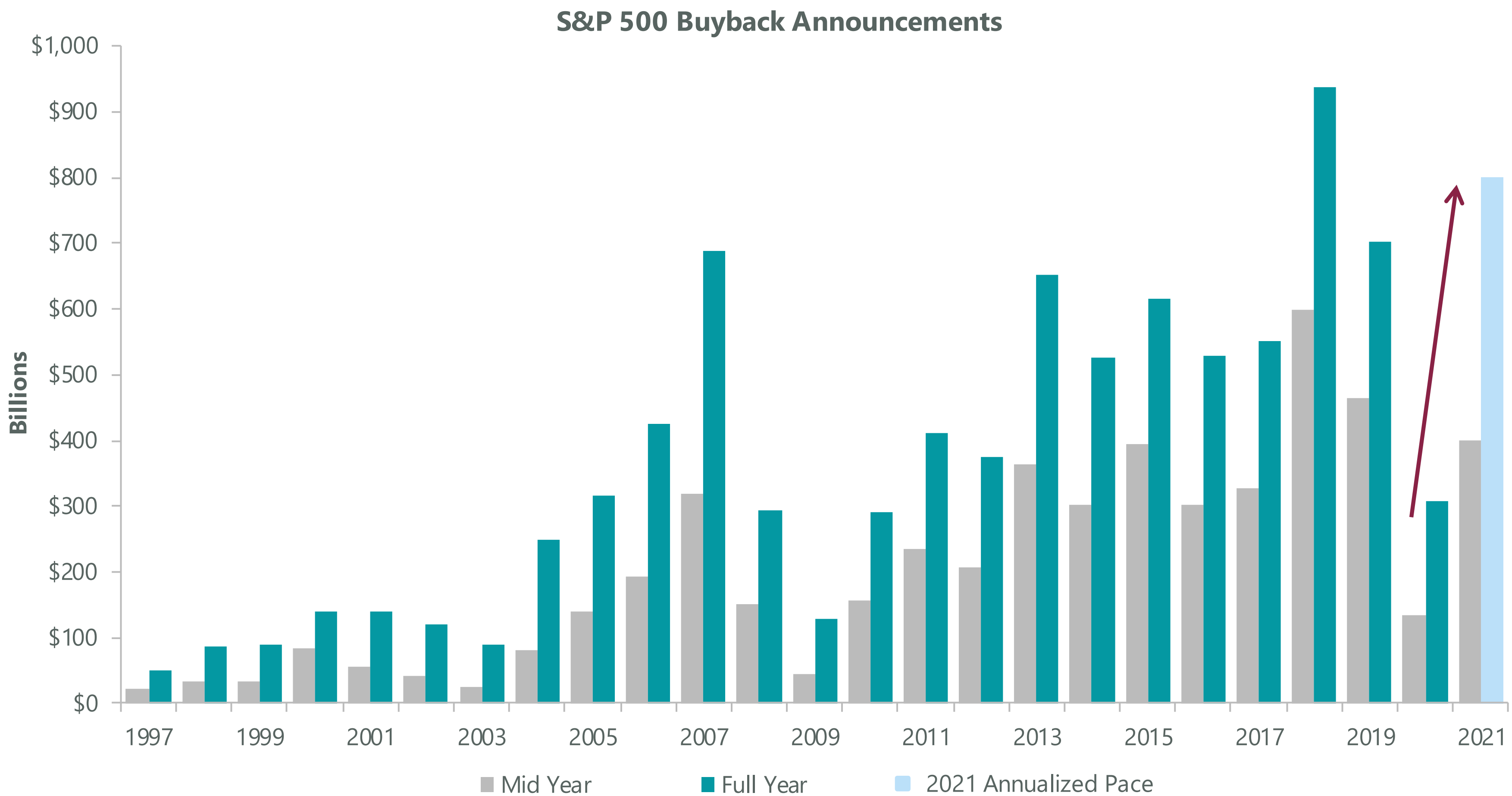



- **When leading economic indicators are at their strongest, stock returns over the subsequent six months tend to be well above average.**

ClearBridge Investments

Data as of June 18, 2021. Source: Conference Board, FactSet. 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.

# 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.**

ClearBridge Investments

Full year for 2021 is YTD annualized. Data as of June 30, 2021. Source: JP Morgan. 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.

# The Terrible Twos?

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

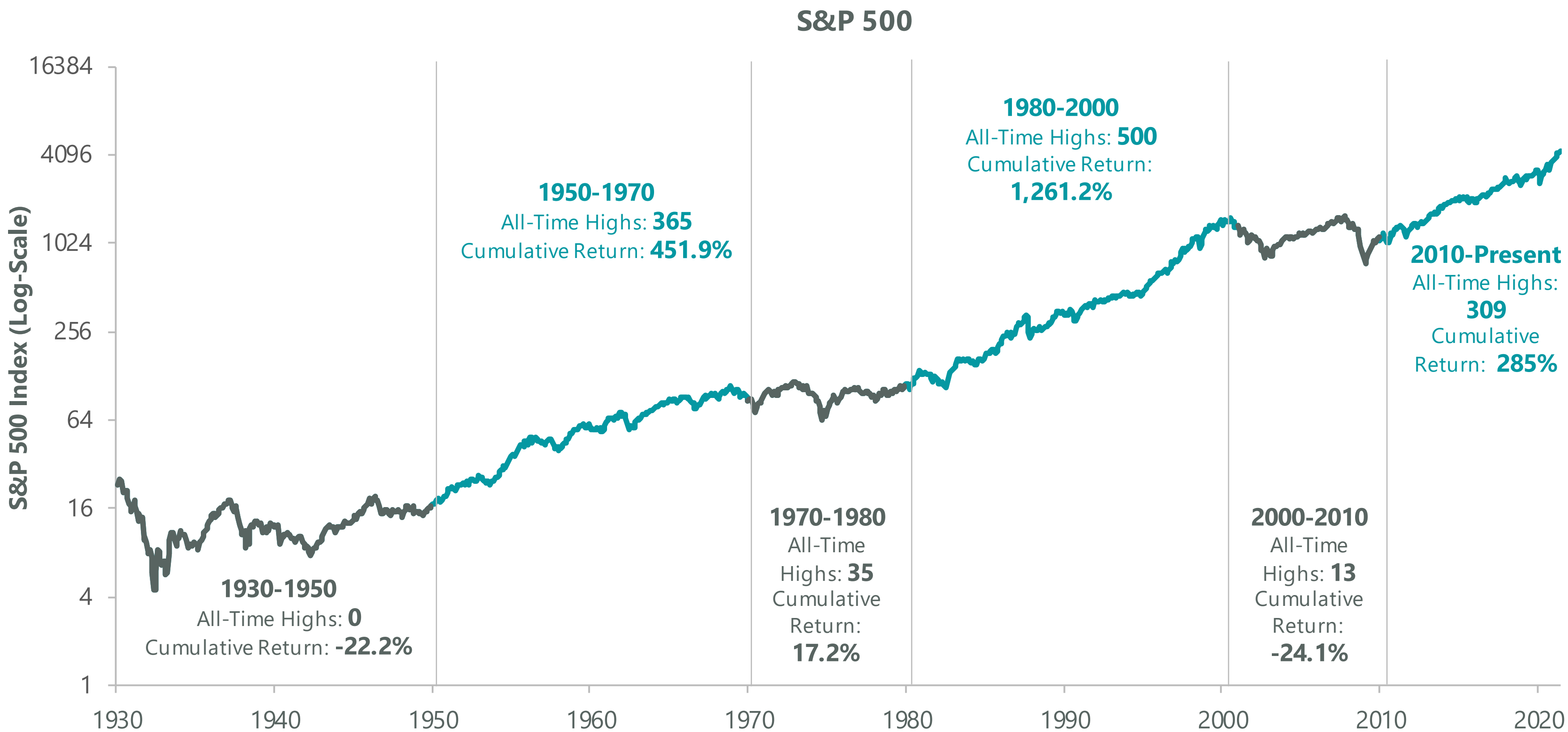
| Bear Market Low | Selloff | 1st Year Off Low | 2nd Year Off Low | 2nd Year Max Drawdown |
|---|---|---|---|---|
| Jun. 1949 | 29.6% | 42.1% | 11.9% | -13.4% |
| Oct. 1957 | 21.6% | 31.0% | 9.7% | -9.2% |
| Jun. 1962 | 28.0% | 32.7% | 17.4% | -6.5% |
| Oct. 1966 | 22.2% | 32.9% | 6.6% | -10.0% |
| May 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.**

ClearBridge Investments

Source: FactSet.
Data as of June 30, 2021. 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.

# New Secular Bull Market?




**Secular Bear:** Average Drawdown -46.1%
**Secular Bull:** Average Drawdown -26.1%

- **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.**

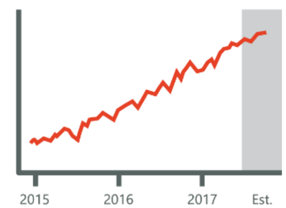
ClearBridge Investments

Secular bear market average drawdown includes selloff beginning September 1929. Data as of June 30, 2021. Source: Bloomberg, FactSet. 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.

# One Year Outlook

## Themes That Will Drive the Market Over the Next 12 Months

**Inflation**




**Valuations**

**Market Leadership**

**International**

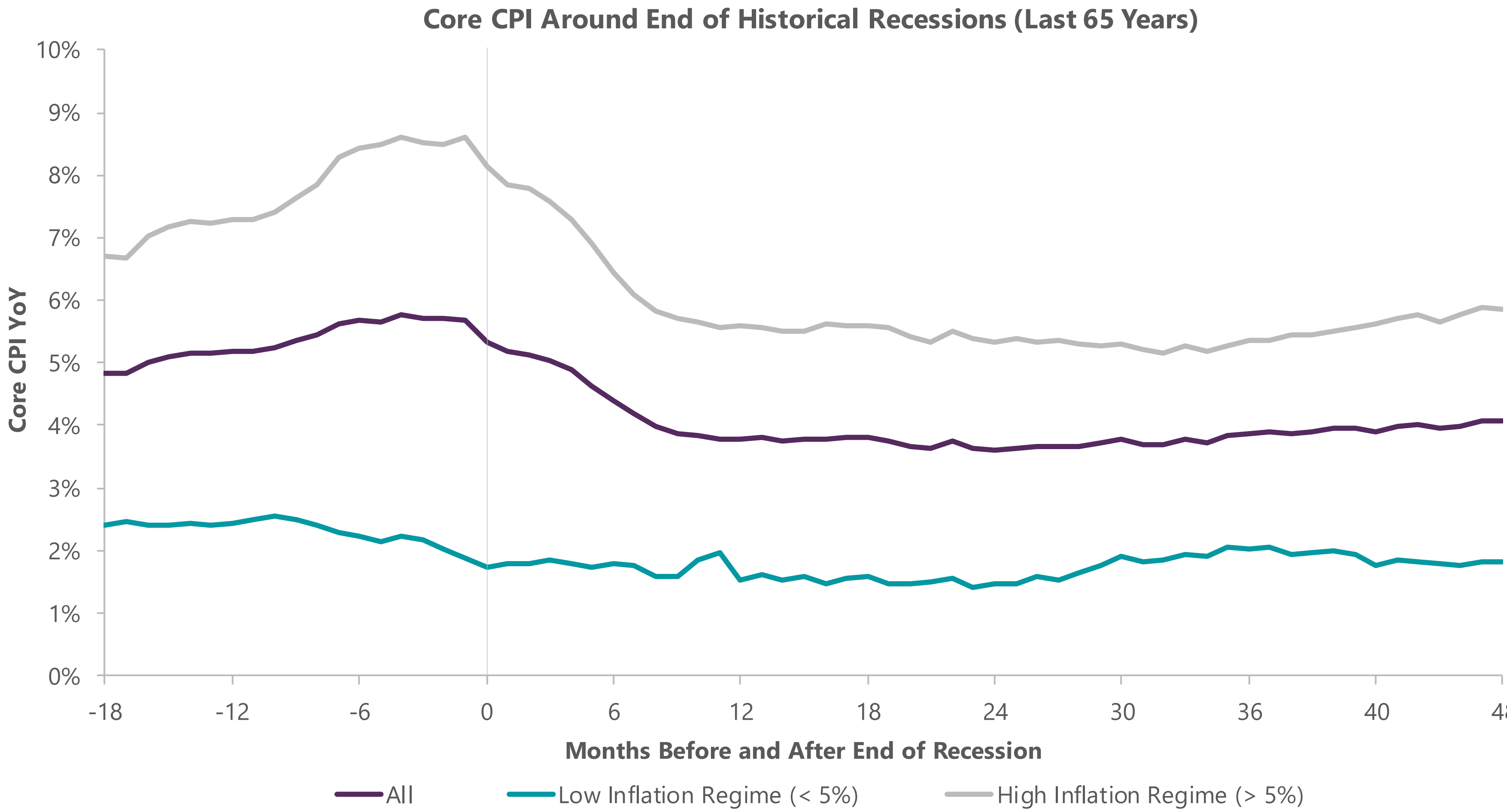
**Demographics**

**Volatility**

ClearBridge Investments

## Inflation

# Inflation Rare Early Cycle

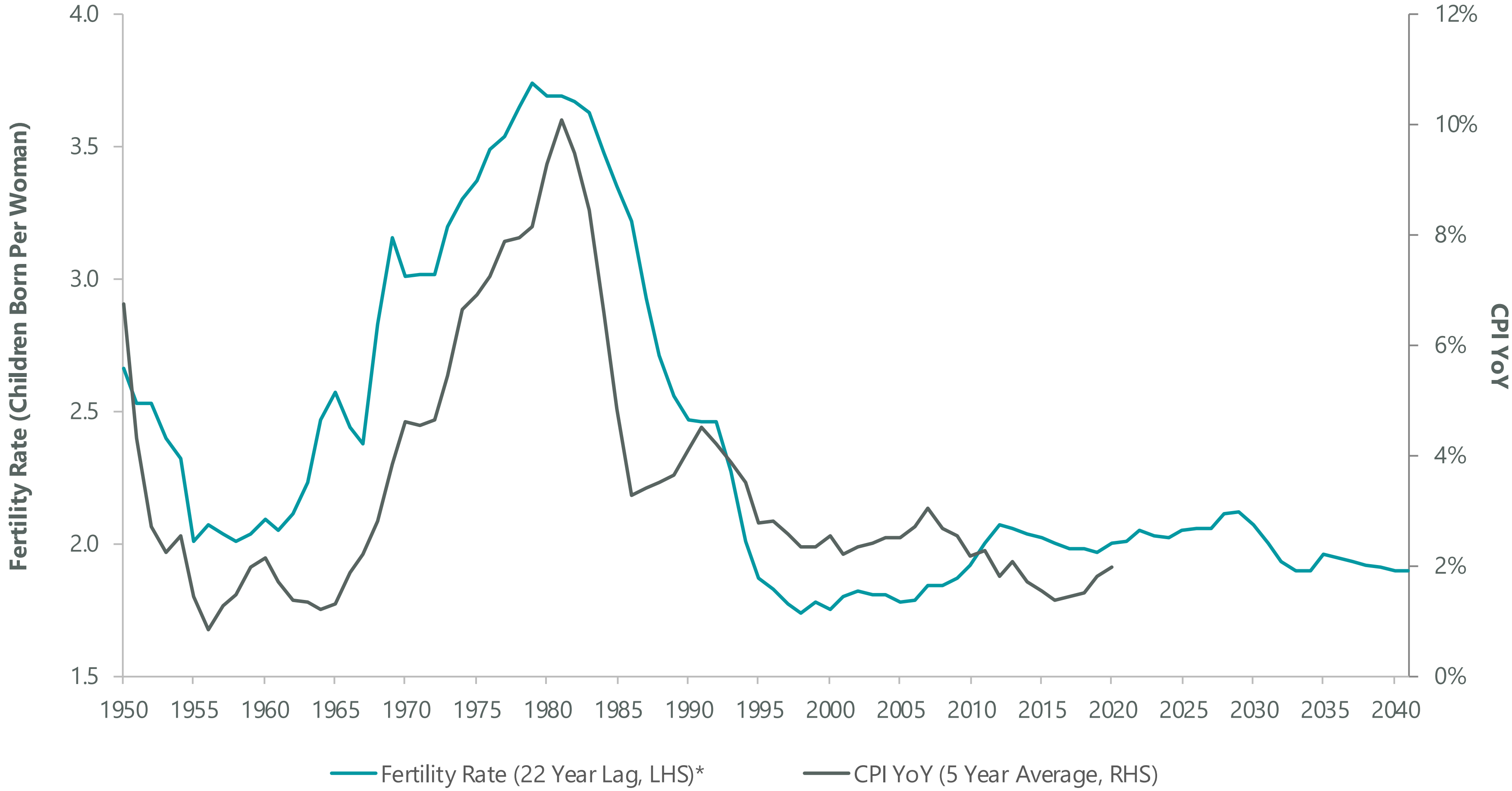



- **Historically, inflation does not tend to pose a problem in the first two to three years of a new expansion due to ample spare capacity.**
- **This same dynamic has historically played out in both high and low inflationary environments.**

ClearBridge Investments

Note: High/Low Inflation Regime based on Inflation Over/Under 5% at End of Recession. Data as of June 30, 2021. Source: BEA, NBER, 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.

# U.S. Demographics Point to Muted Inflation

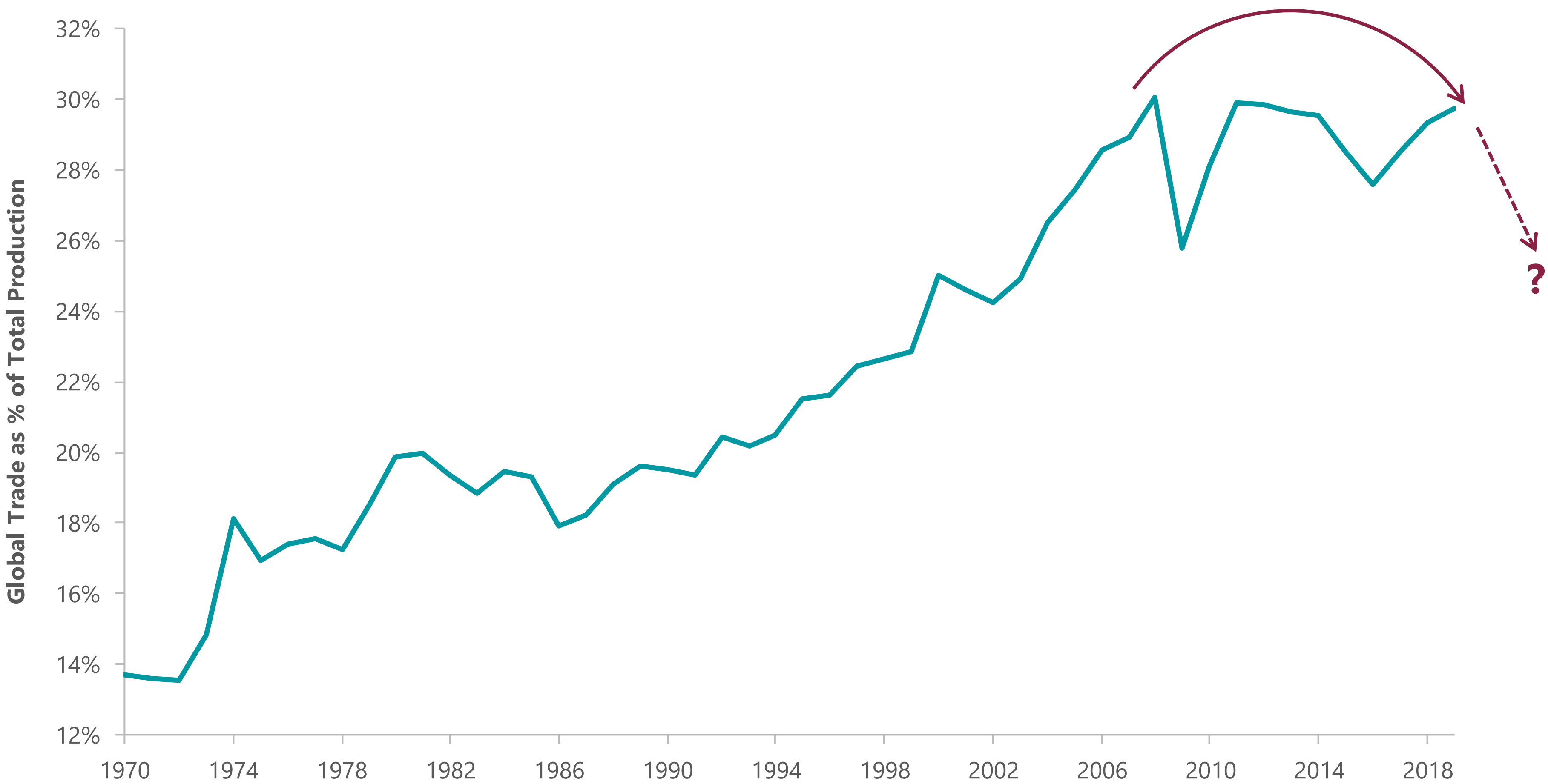



- **Demographics tend to lead inflationary pressures by 22 years, historically.**
- **This relationship suggests inflation should remain muted in the U.S. in the coming decade(s).**

ClearBridge Investments

*Shown is the 'Total Fertility Rate' which measures the number of children that would be born to a woman if she were to live to the end of her childbearing years and bear children in accordance with the age-specific fertility rates of the specific year.
Data as of Dec. 31, 2019, latest available as of June 30, 2021. Source: Our World in Data, FactSet. 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.

# A New Paradigm: De-Globalization?

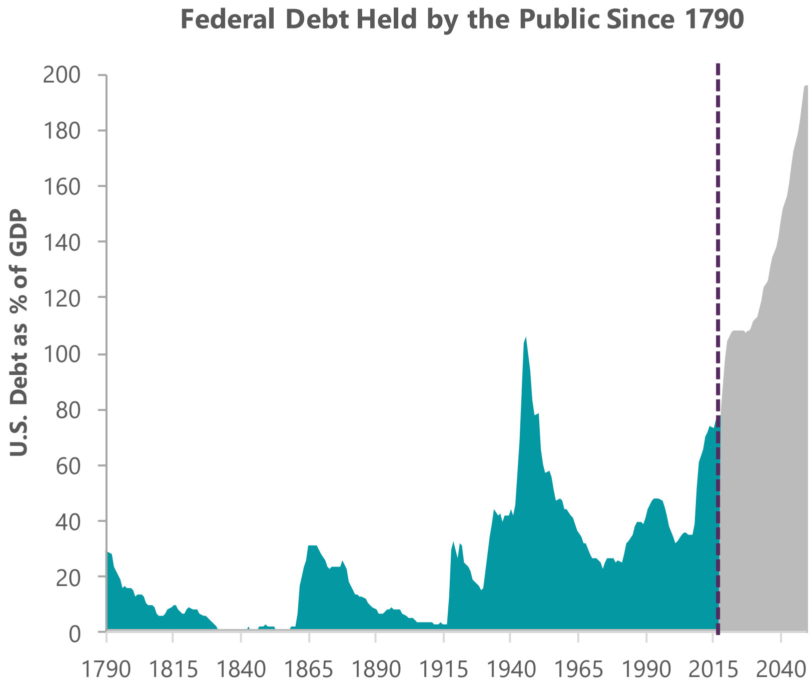


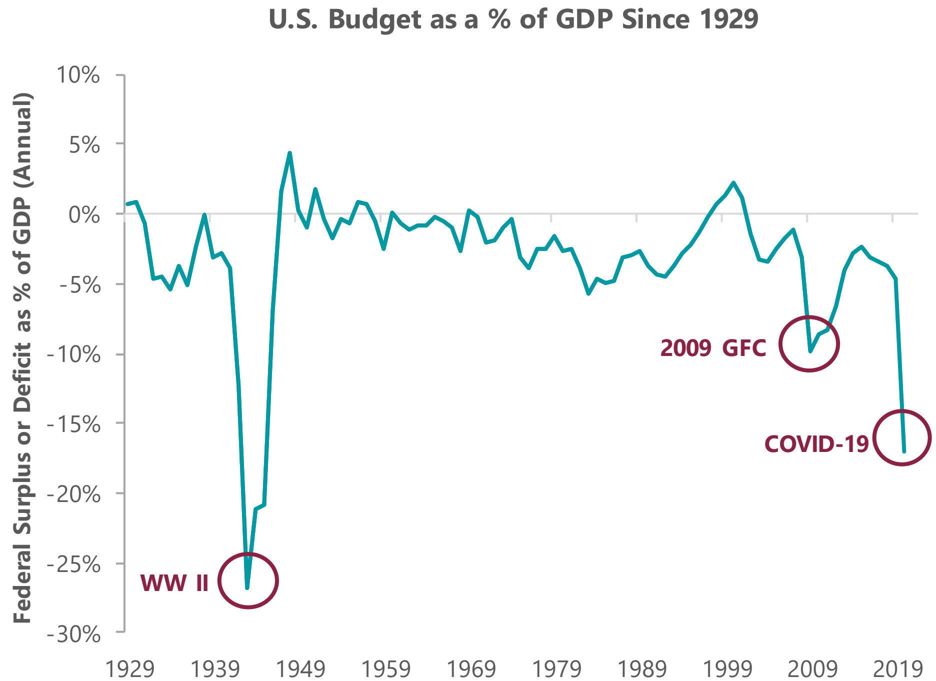

- **The multi-decade trend of globalization appears to be stalling which could lead to greater inflationary pressures resulting from re-shoring.**
- **Further, the working age in China has peaked which could lead to greater global wage pressure in the coming years.**

ClearBridge Investments

Data as of Dec. 31, 2020, latest available as of June 30, 2021. Source: World Bank. 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.

# U.S. Debt Levels Set to Rise Higher



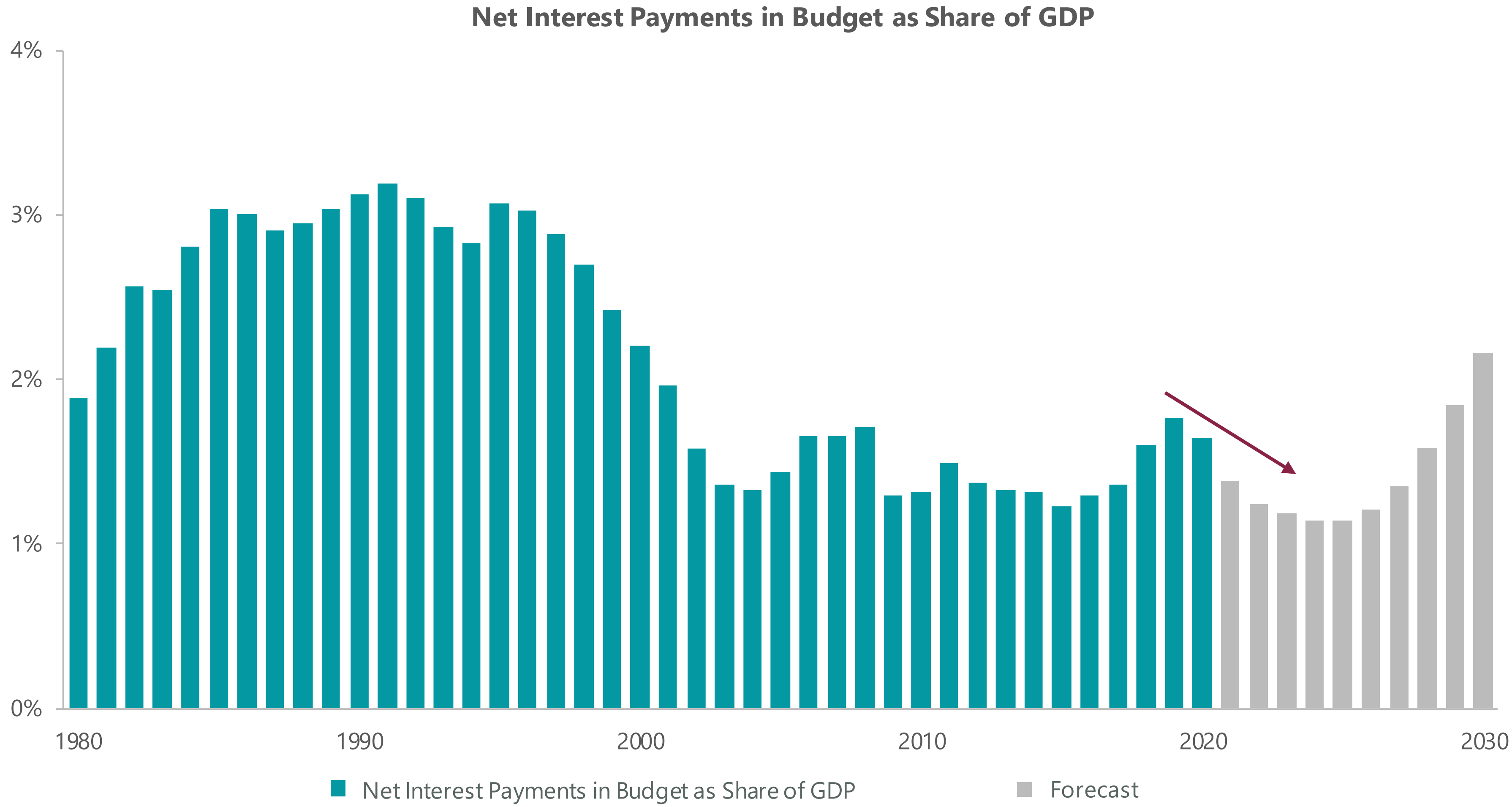




▶ **Barring a change in spending, U.S. debt levels will grow substantially in the coming decades.**

ClearBridge Investments

Budget as % of GDP data as of June 30, 2020, latest available as of June 30, 2021. Source: Bloomberg, CBO, Deutsche Bank, FRED. Future debt levels are based on a Congressional Budget Office forecast. 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.

# Is U.S. Debt Really an Issue?

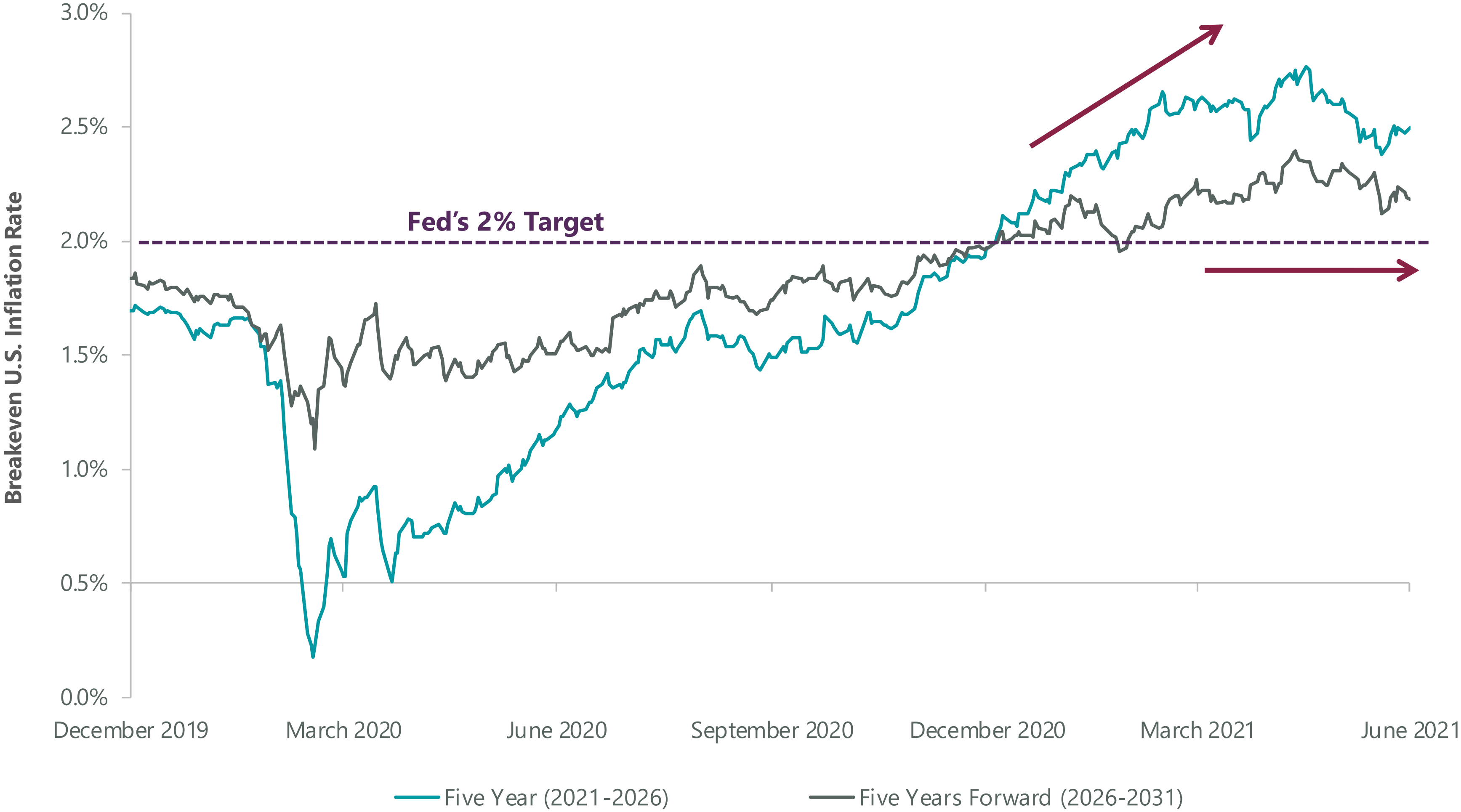



- **Despite a dramatic increase in government debt outstanding, total debt servicing costs as a percent of GDP have declined due to falling rates.**
- **While this could become a risk in the next decade, the intermediate-term outlook appears less troubling.**

ClearBridge Investments

Source: Congressional Budget Office. 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.

# Long-Term Inflation Not a Concern

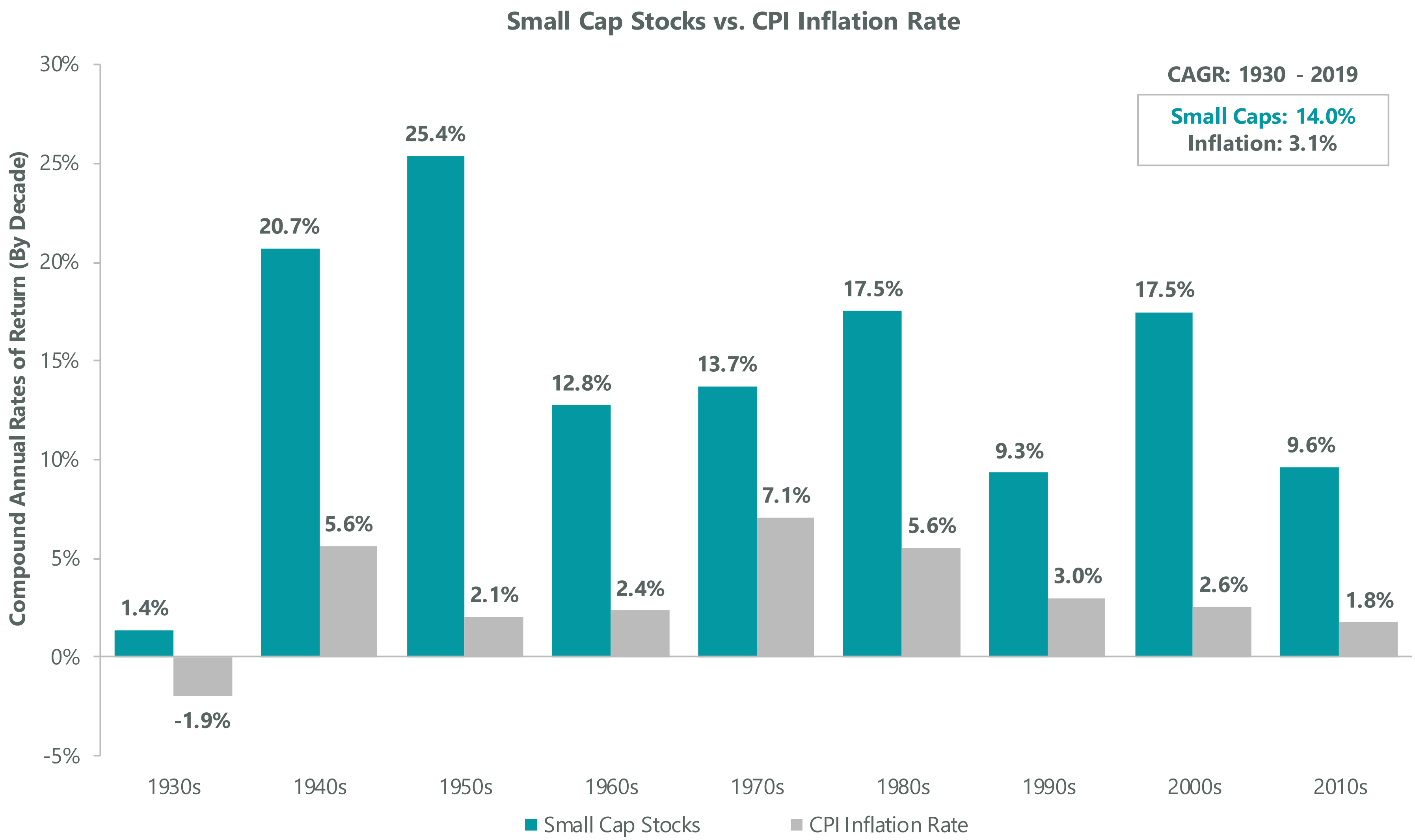



- **Investors are pricing a period of above-target inflation in the coming years.**
- **However, these pressures are not expected to persist over the back half of the decade.**

ClearBridge Investments

Five year period represents period from April 2021 –April 2026; five years forward represents period from April 2026 –April 2031. Data as of June 30, 2021. Source: FactSet. 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.

# Small Caps Unfazed by Inflation

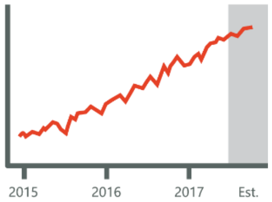



**Since the 1930s, Small Cap stocks are the only major asset class to outperform inflation in each decade.**

ClearBridge Investments

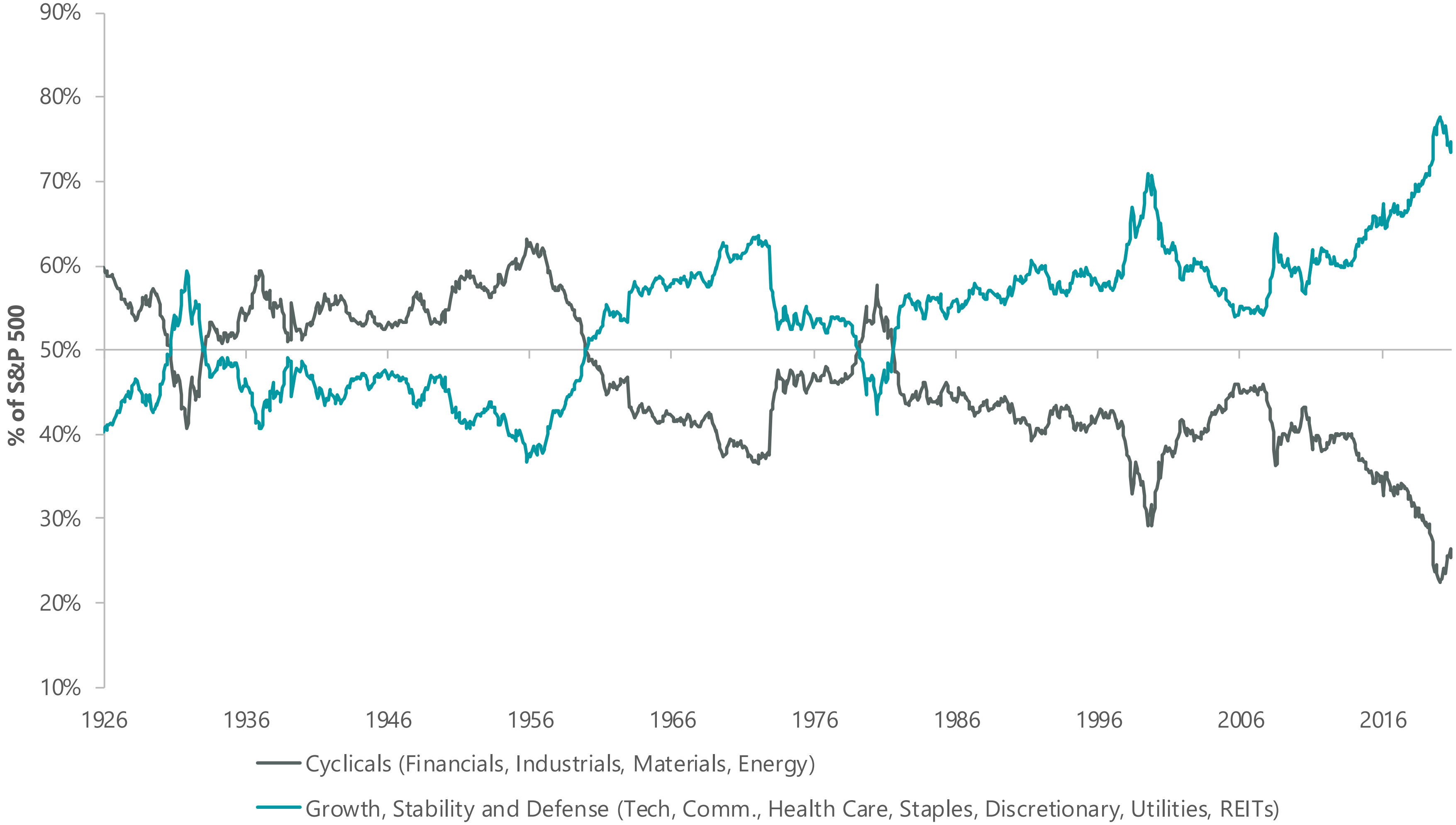
Source: Ibbotson Small Cap Index-Morningstar, Bureau Labor Statistics. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Valuations



# Index Composition Supports Higher P/Es

## Cyclical Sector Representation is Near a 100-Year Low

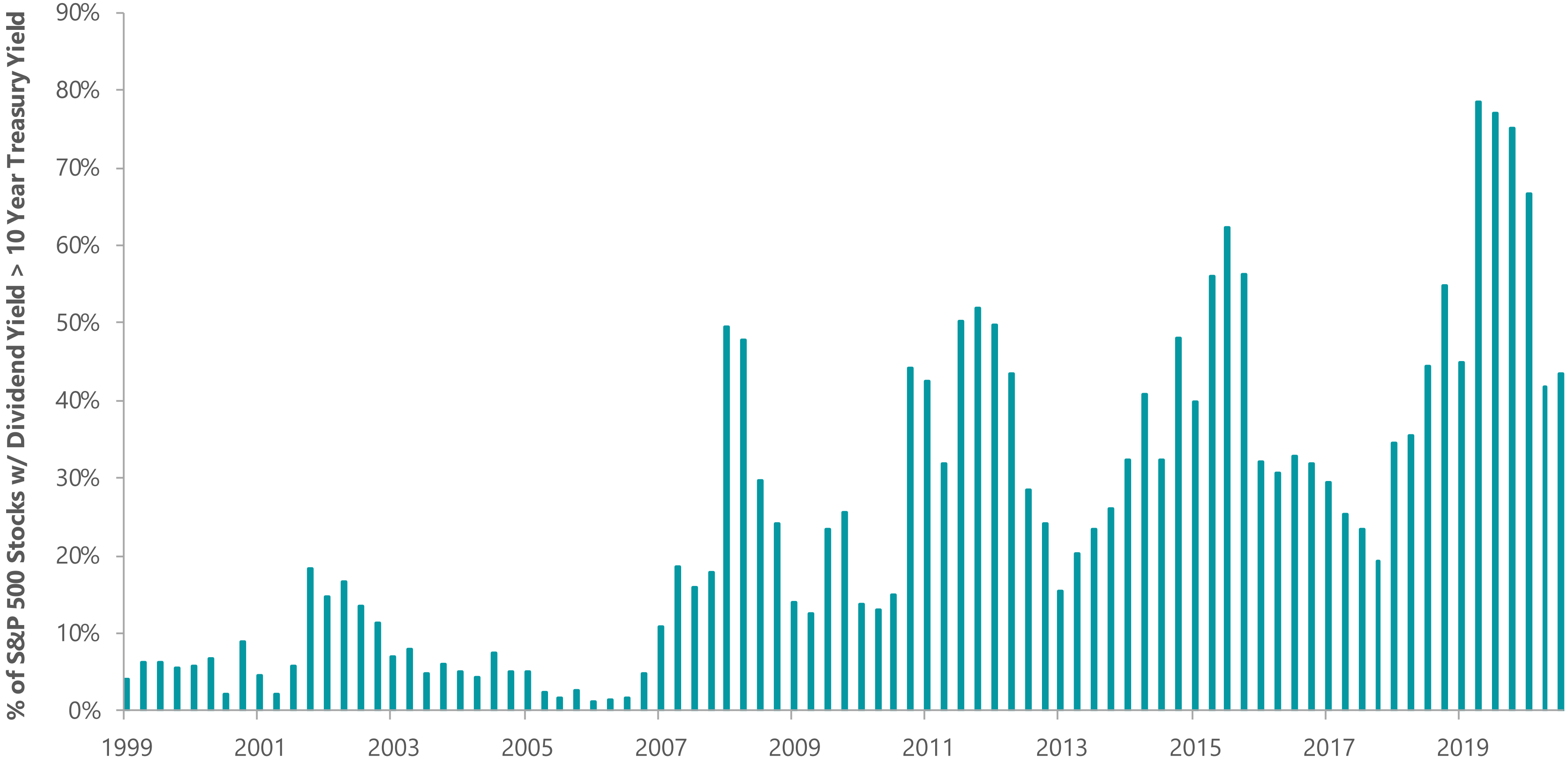



- **Less-volatile sectors are typically rewarded with higher multiples. These groups make up a near-record share of the S&P 500 today.**

ClearBridge Investments

As of June 30, 2021. Source: Cornerstone Macro. 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.

# Dividend-Paying Equities Attractive

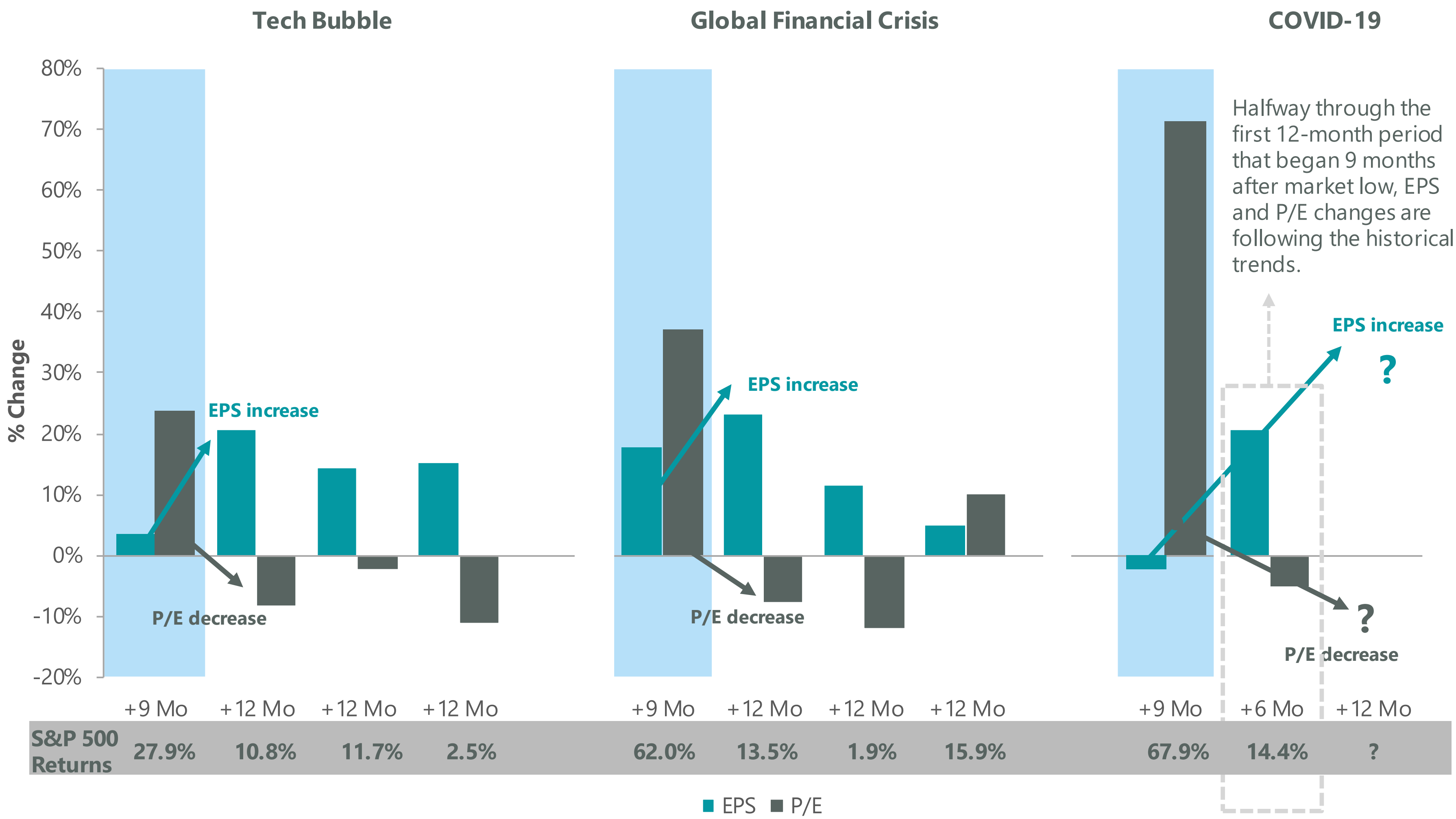



▶ **44% of S&P stocks now have a dividend yield greater than the 10-year Treasury.**

ClearBridge Investments

As of June 30, 2021. Source: FactSet. 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.

# Earnings to Take the Baton

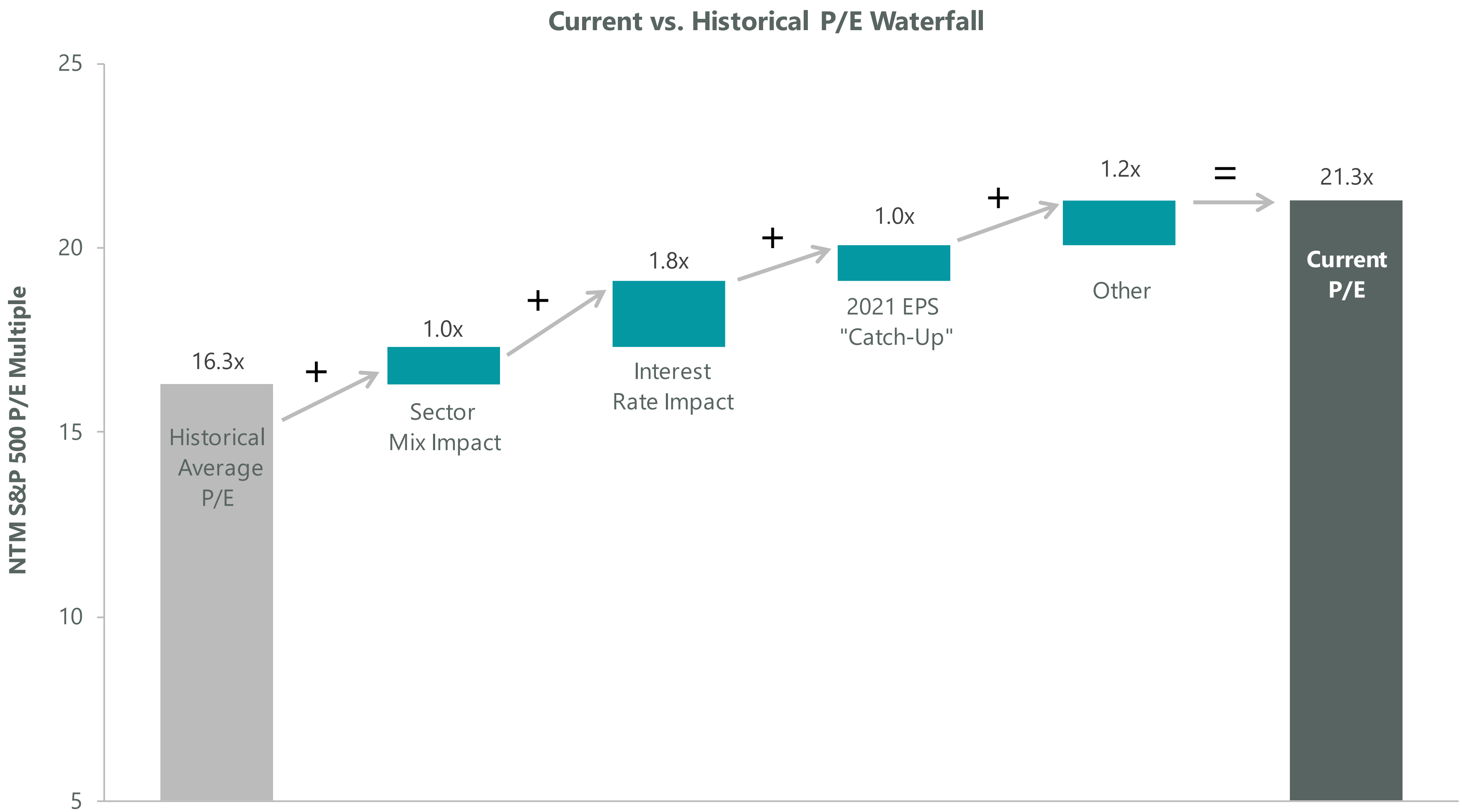



- **In the nine months following recessionary troughs, multiple expansion has been an outsized contributor to returns.**
- **As the recovery matures, earnings typically drive stock upside as multiples contract.**

ClearBridge Investments

Data as of June 30, 2021. Source: FactSet, S&P. 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.

# Just How Stretched are Valuations?



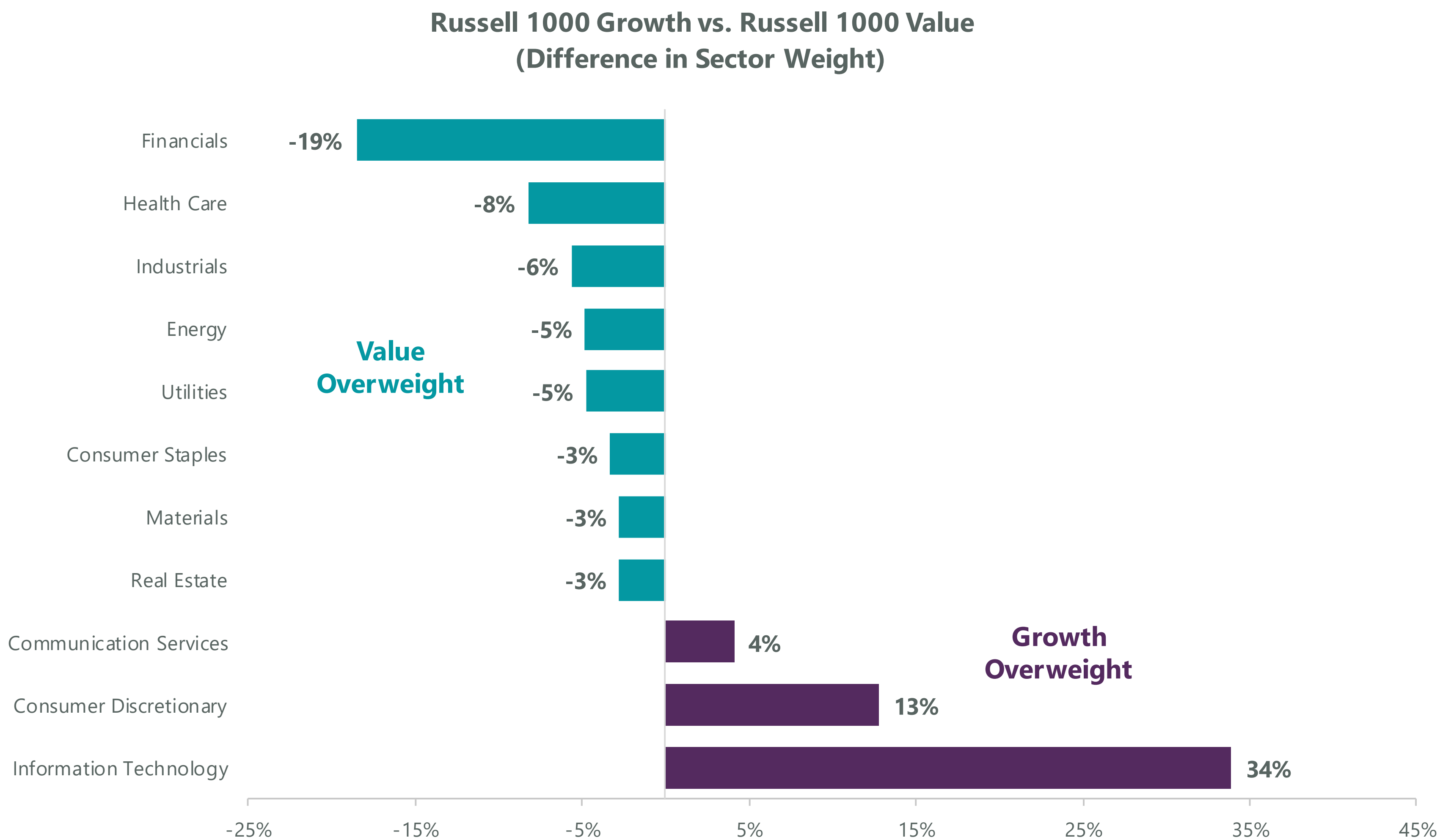

- **Current valuations appear rich relative to history. Much of this can be explained by sector mix differences, lower interest rates, and an expected earnings "catch-up" in 2021.**

ClearBridge Investments

Data as of June 30, 2021. Source: Bloomberg, FactSet, Federal Reserve, Moody's, and S&P. Note: NTM = next twelve months; Historical Average P/E represents 1995-present. 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.

# Market Leadership

# Sector Mix Explains Leadership

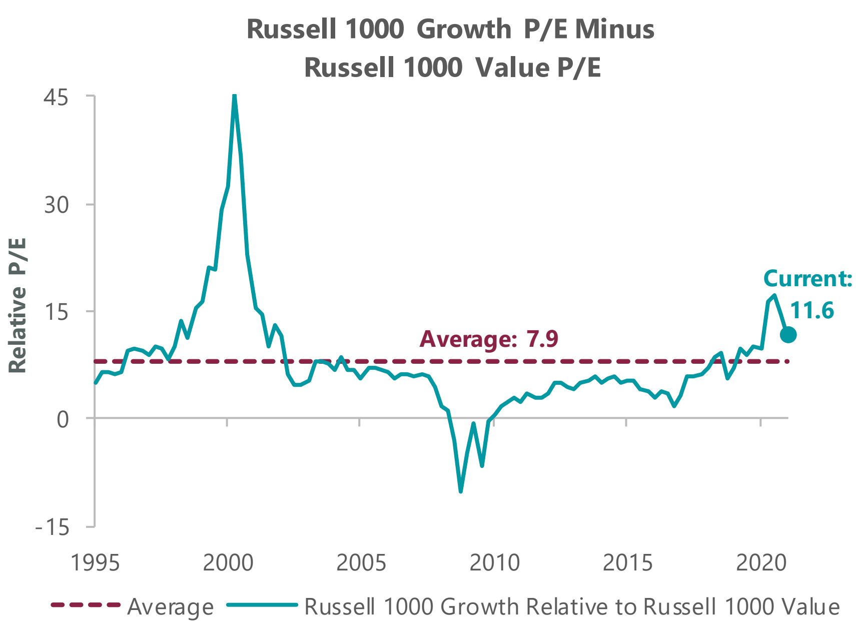



- **The performance of Financials, Health Care, and Industrials relative to Technology and Discretionary explains a large share of Growth/Value leadership.**

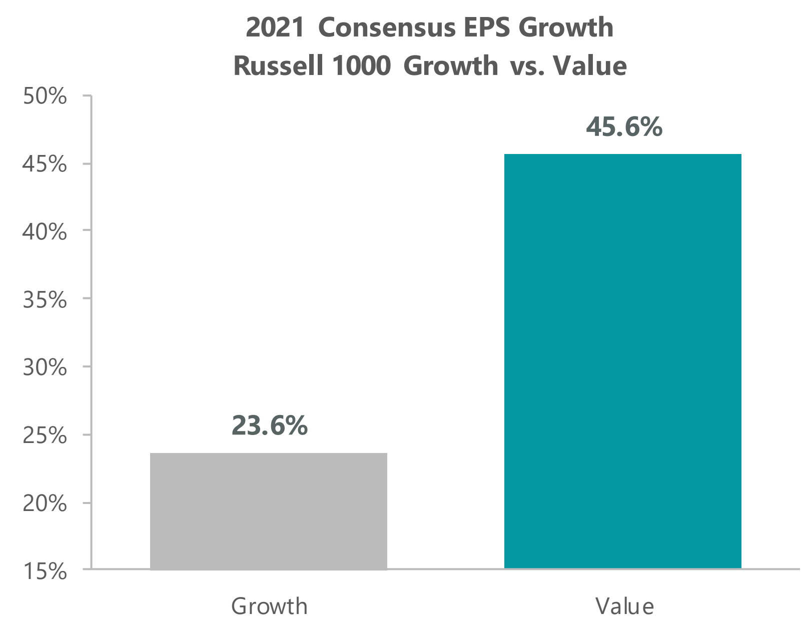
ClearBridge Investments

Data as of June 30, 2021. Source: FactSet. 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.

# Fundamentals Favor Value




Source: Bloomberg.



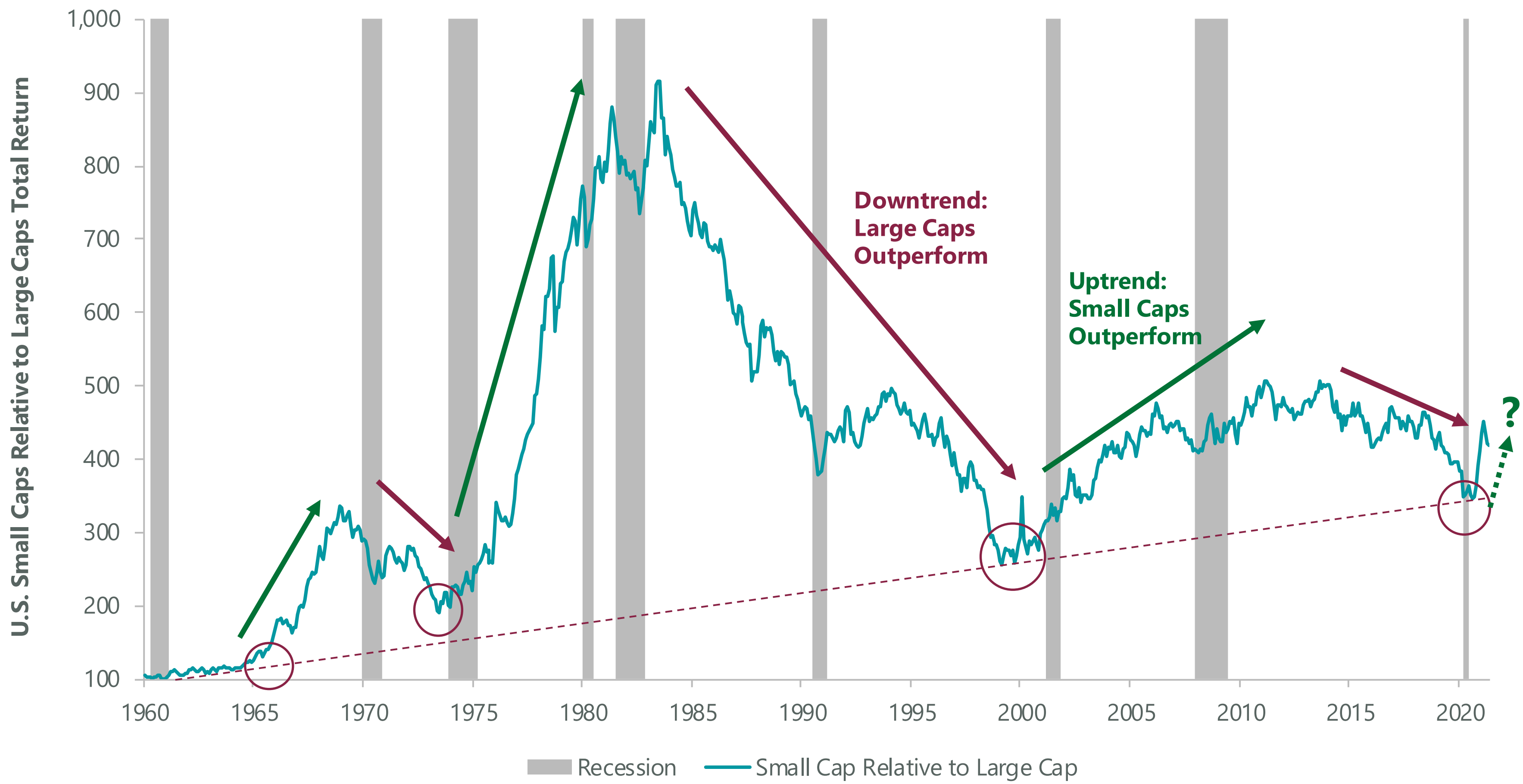

Source: FactSet, Russell.

- **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.**

ClearBridge Investments

Data as of June 21, 2021. 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.

# 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.**

ClearBridge Investments

Data as of May 31, 2021. Source: Morningstar, Bloomberg. Ibbotson Small Cap from 1960 to 1978, then Russell 2000. 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.

# Is FAANGM a Bubble?

## Leader Valuations Get Extreme During Manias

**December 1972**

| Nifty Fifty | P/E* |
|---|---|
| Coca-Cola | 46.4 |
| McDonald's | 71.0 |
| Texas Instruments | 39.5 |
| IBM | 35.5 |
| Xerox | 45.8 |
| Polaroid | 94.8 |
| **Average** | **55.5** |
| **S&P 500** | **18.9** |

**March 2000**

| Dot-Com Darlings | NTM P/E |
|---|---|
| Intel | 44.3 |
| Cisco | 126.3 |
| EMC | 80.0 |
| Microsoft | 57.1 |
| Oracle | 107.2 |
| Nortel | 92.0 |
| **Average** | **84.5** |
| **S&P 500** | **23.8** |

**Current**

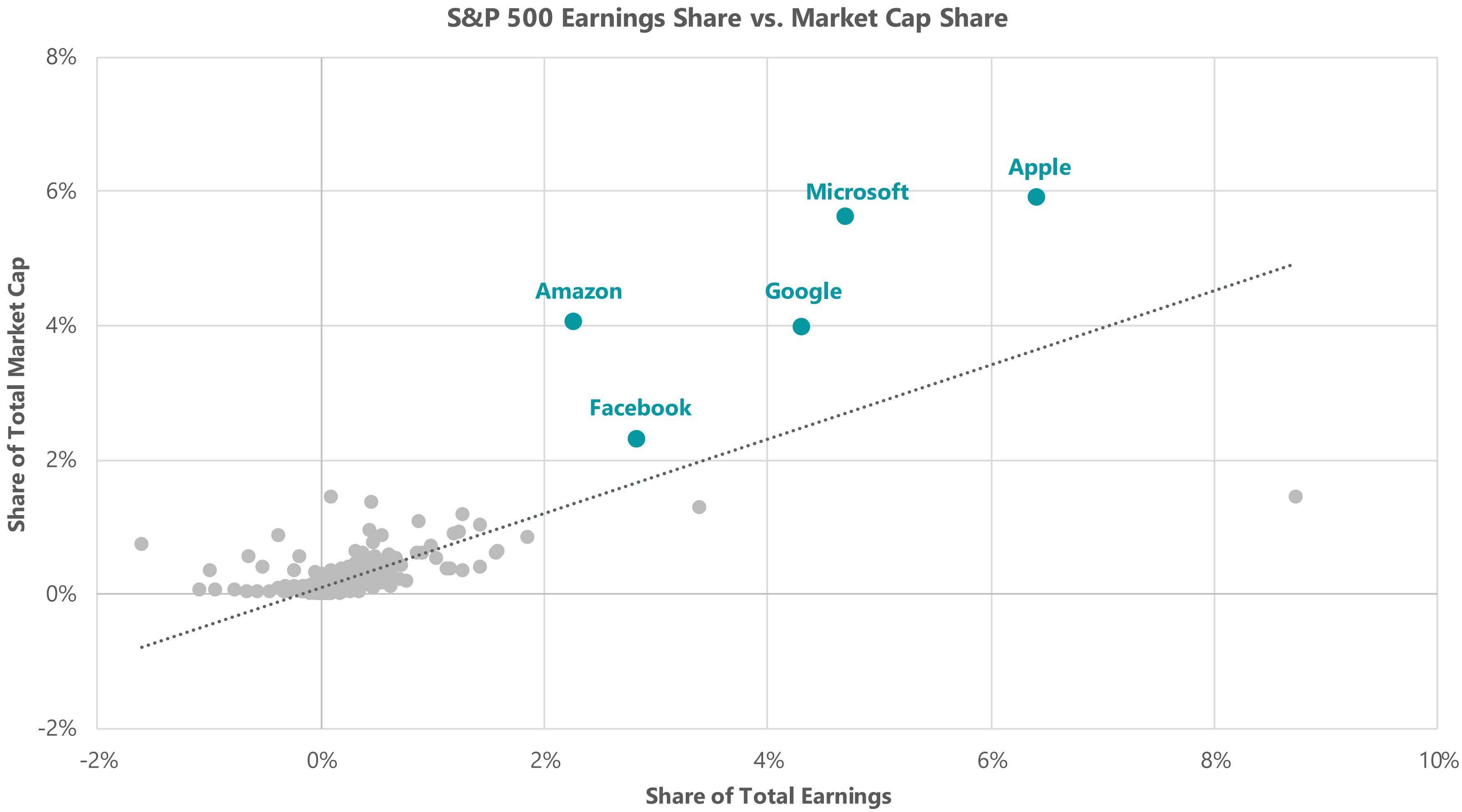
| FAANGM | NTM P/E |
|---|---|
| Facebook | 24.5 |
| Amazon | 53.5 |
| Apple | 26.0 |
| Netflix | 44.9 |
| Google | 26.7 |
| Microsoft | 32.4 |
| **Average** | **34.7** |
| **S&P 500** | **21.3** |

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

ClearBridge Investments

*Actual P/E ratios; forward P/Es unavailable for this period. NTM = next twelve months. Data as of June 30, 2021. Source: FactSet; "Valuing Growth Stocks: Revisiting the Nifty Fifty" by Jeremy Siegel, AAII Journal, October 1998. 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. Not a recommendation to buy or sell any security.

# Are Valuations Justified by Earnings?

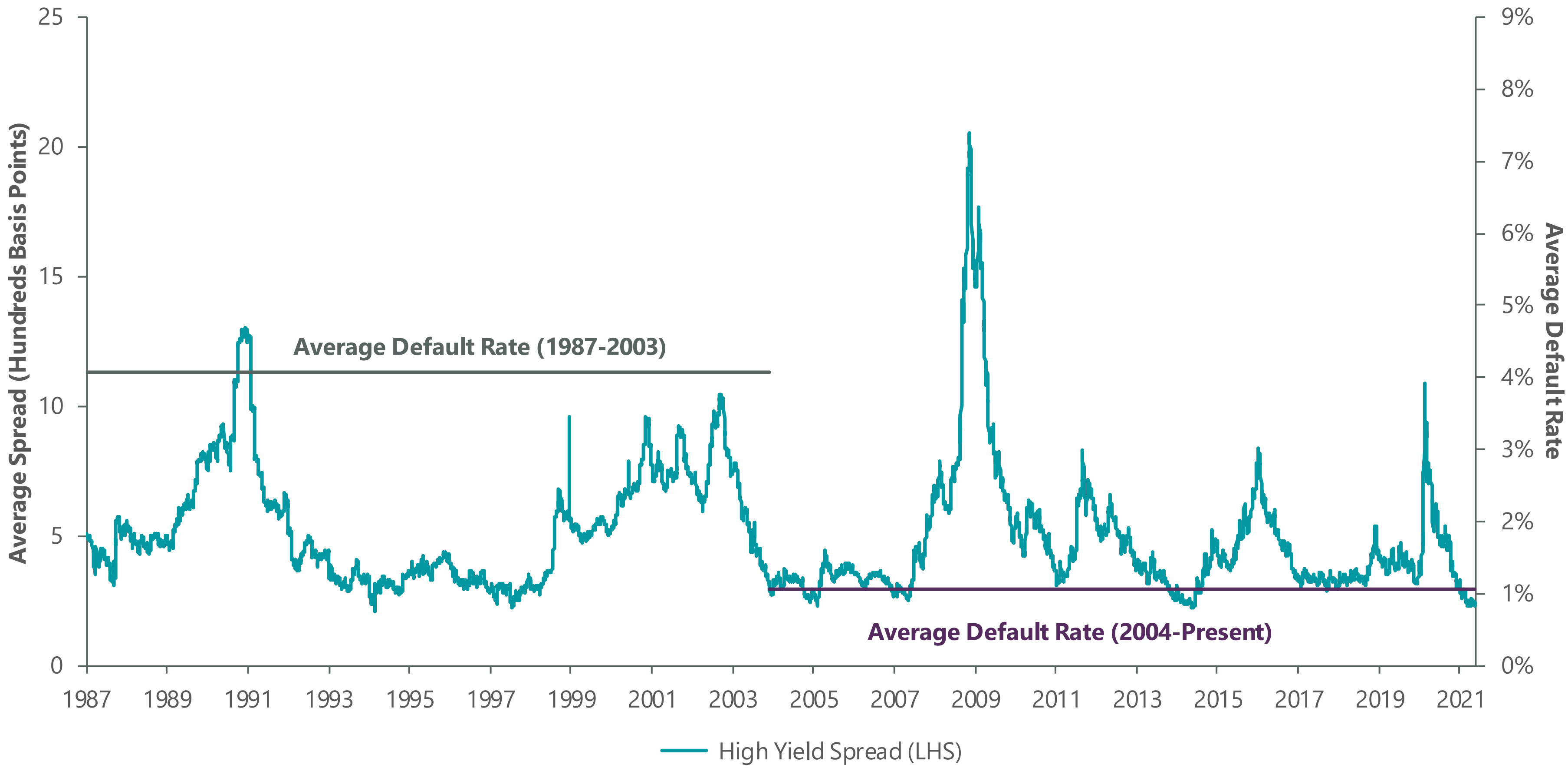



- **The 5 largest stocks are expected to account for 21% of 2021 earnings.**
- **The top 5 contribute more income than market cap.**

ClearBridge Investments

Data as of June 30, 2021. Source: FactSet. 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. Not a recommendation to buy or sell any security.

# 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.**

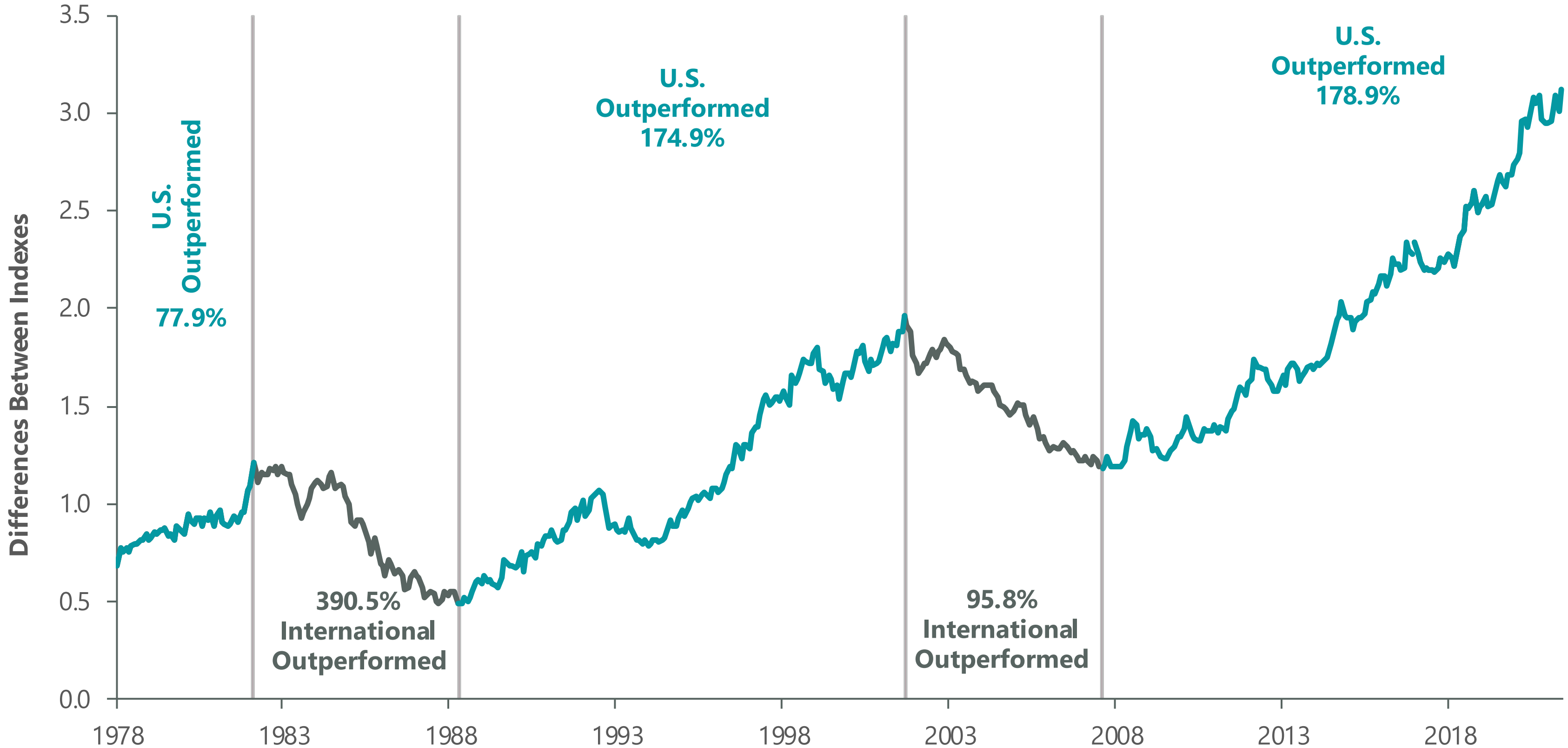
ClearBridge Investments

Data as of June 18, 2021. Source: Federal Reserve Bank of St. Louis, FactSet. 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.

# International

International investments are subject to special risks, including currency fluctuations and social, economic and political uncertainties, which could increase volatility. These risks are magnified in emerging markets.

# U.S. vs. International Equity Performance

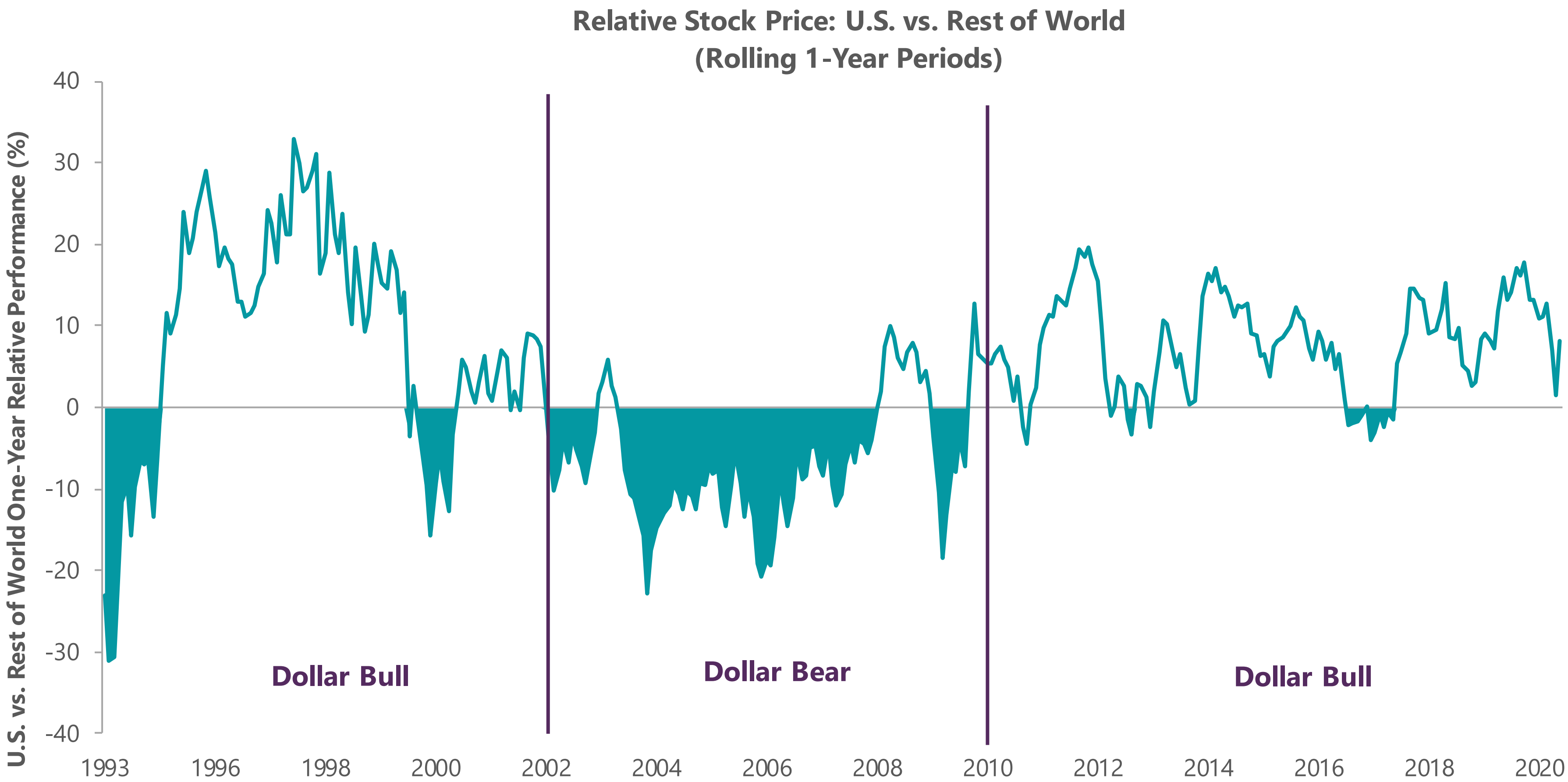



**Geographic leadership tends to persist for multiple years.**

ClearBridge Investments

S&P 500 vs. MSCI EAFE. Data as of June 30, 2021. Source: FactSet. 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.

# Dollar Regimes Coincide With Global Equity Leadership

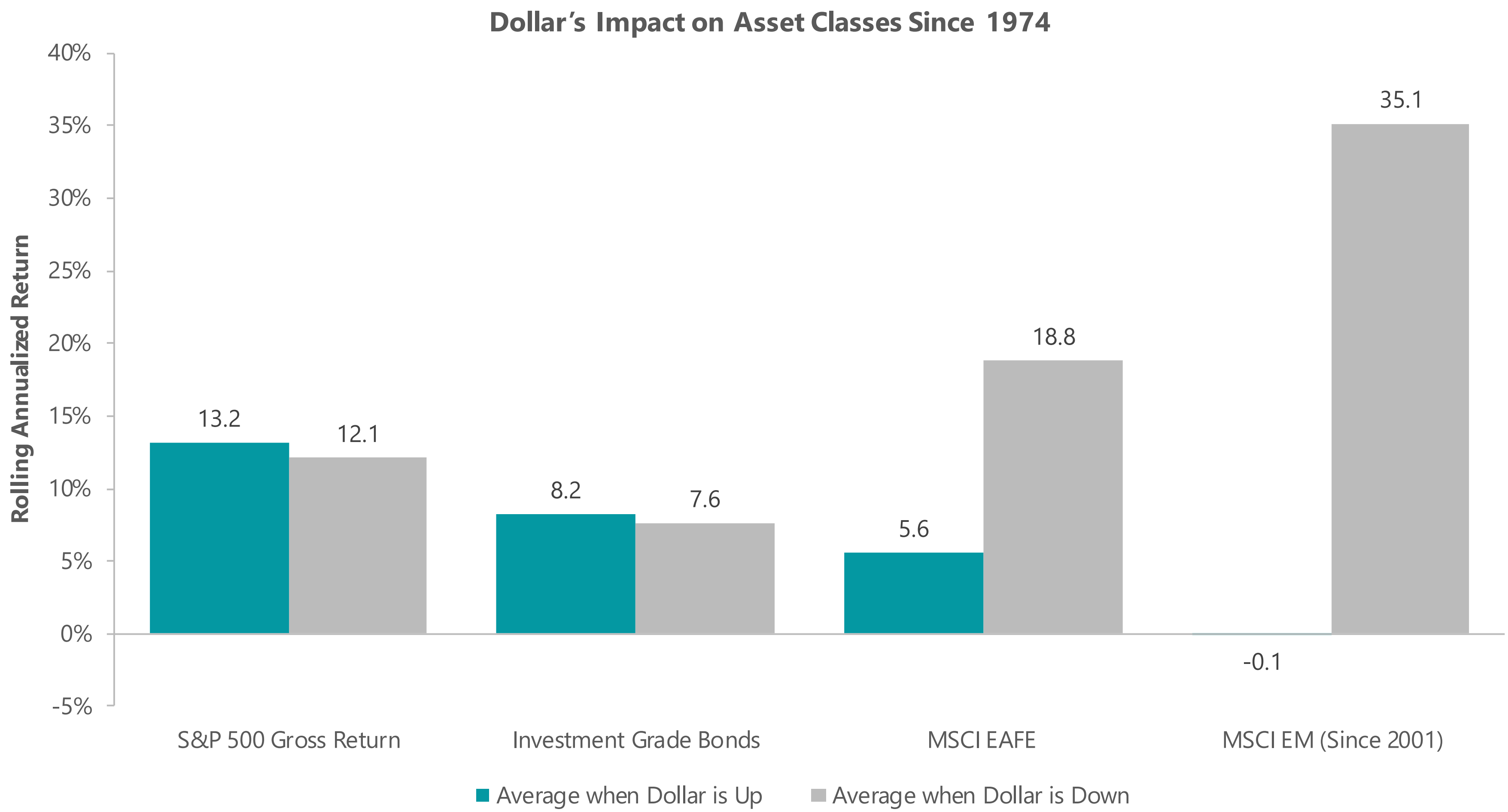



- **Periods of sustained dollar strength have aligned with U.S. equity outperformance.**
- **Dollar weakness could lead to a shift in global equity market leadership.**

ClearBridge Investments

Data as of June 30, 2021. MSCI U.S. Index vs. MSCI All Country World ex-U.S. Index in U.S. dollar terms. One year rolling periods. Source: FactSet. 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.

# Weaker Dollar Supercharges Non-U.S. Stocks

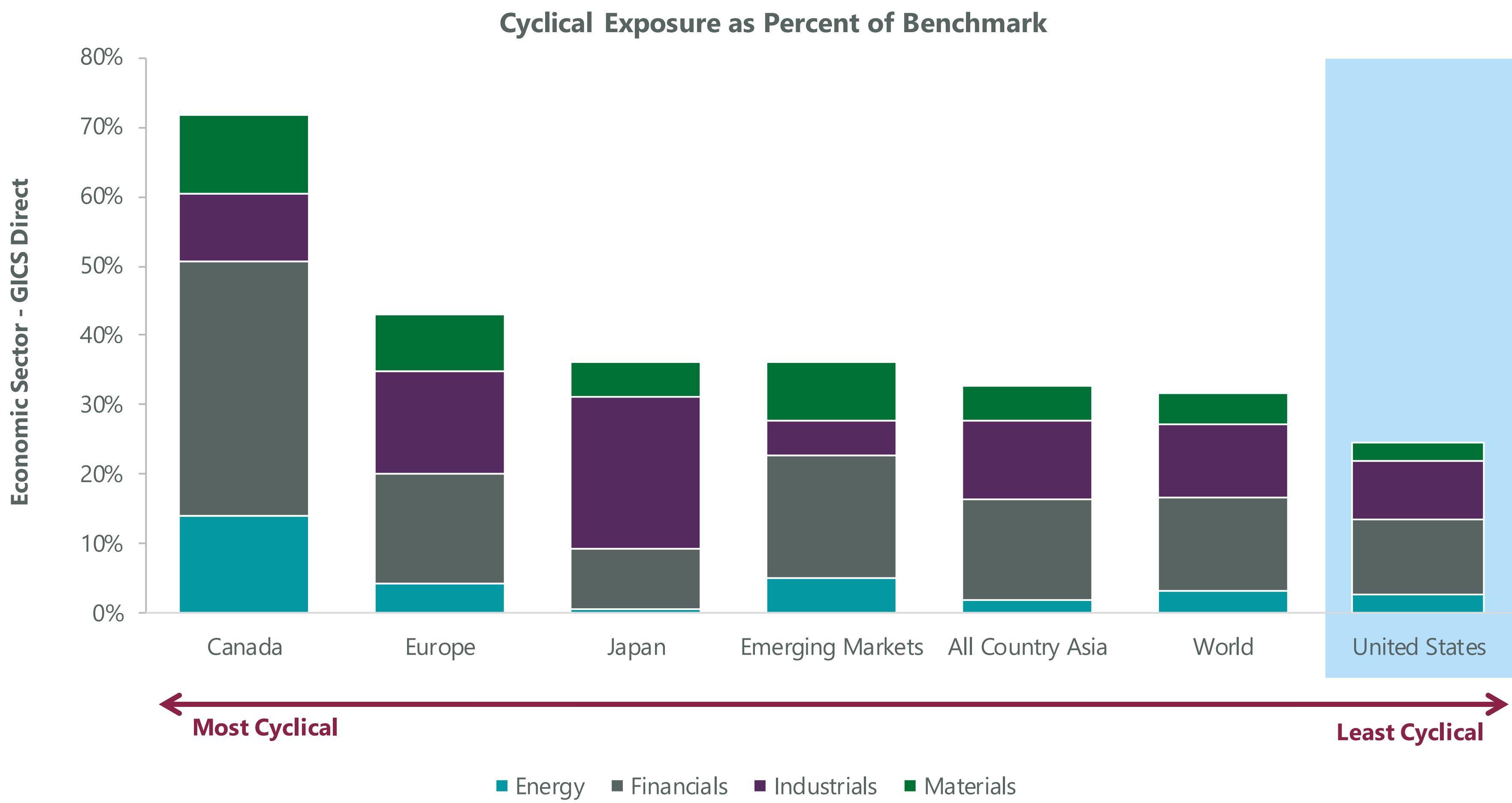



**International equities tend to outperform during periods of dollar weakness.**

ClearBridge Investments

Data as of June 30, 2021. MSCI EAFE and MSCI EM are net returns; MSCI EM data starts in 2001. Investment Grade Bonds refers to the Bloomberg Barclays U.S. Corporate Investment Grade Bond Index. Source: FactSet. 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.

# Global Markets More Cyclical

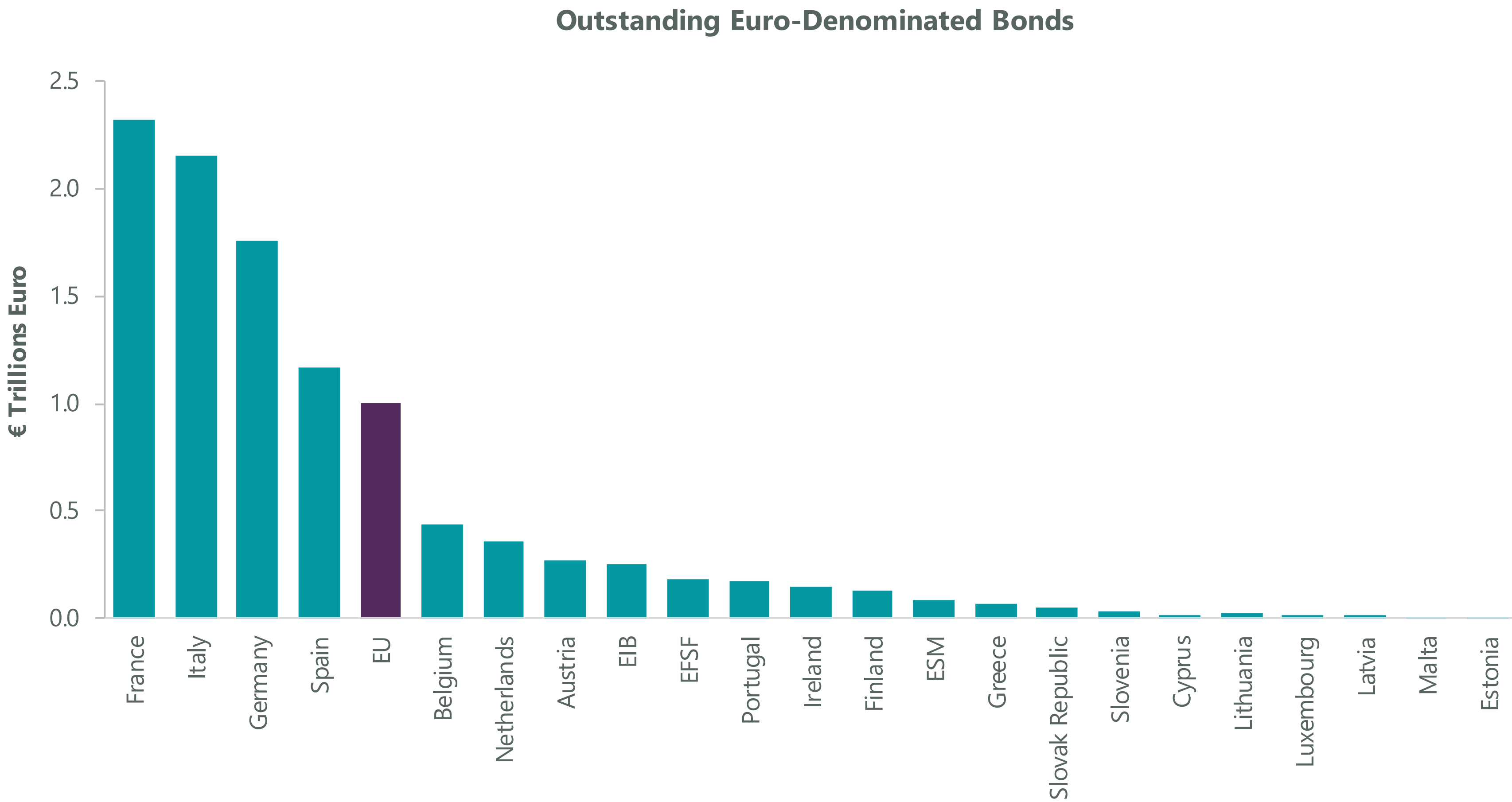



- **In periods of accelerating economic growth, non-U.S. markets tend to lead given greater cyclical exposure.**

ClearBridge Investments

Cyclical sectors: Financials, Materials, Industrials, Energy. Cyclical exposure by MSCI Region. Data as of June 30, 2021. Source: FactSet. 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.

# Tighter Fiscal Union, Less Risk

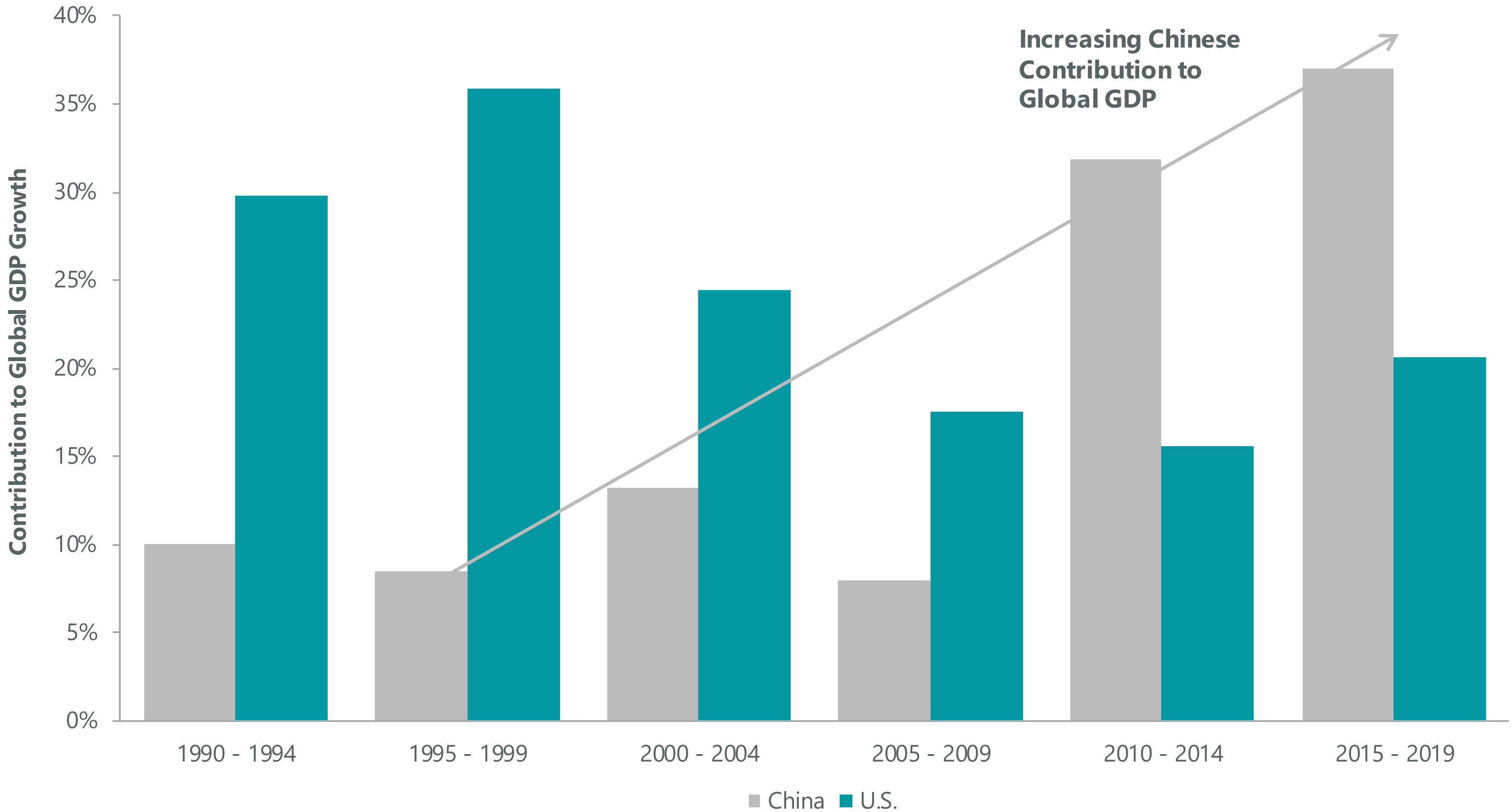



- **Projected joint issuance of Eurozone debt creates a more integrated fiscal union which bodes well for the Euro's long-term prospects.**
- **This milestone could act as a catalyst for European assets to embed lower risk premiums going forward.**

ClearBridge Investments

Includes planned issuance. EIB = European Investment Bank,; EFSF = European Financial Stability Facility; ESM = European Stability Mechanism. Data as of Dec. 31, 2020., latest available as of June 30, 2021. Source: FactSet, Eurostat. 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.

# 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.**

ClearBridge Investments

Data as of Dec. 31, 2019, latest available as of June 30, 2021. Source: World Bank. 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.

# Demographics

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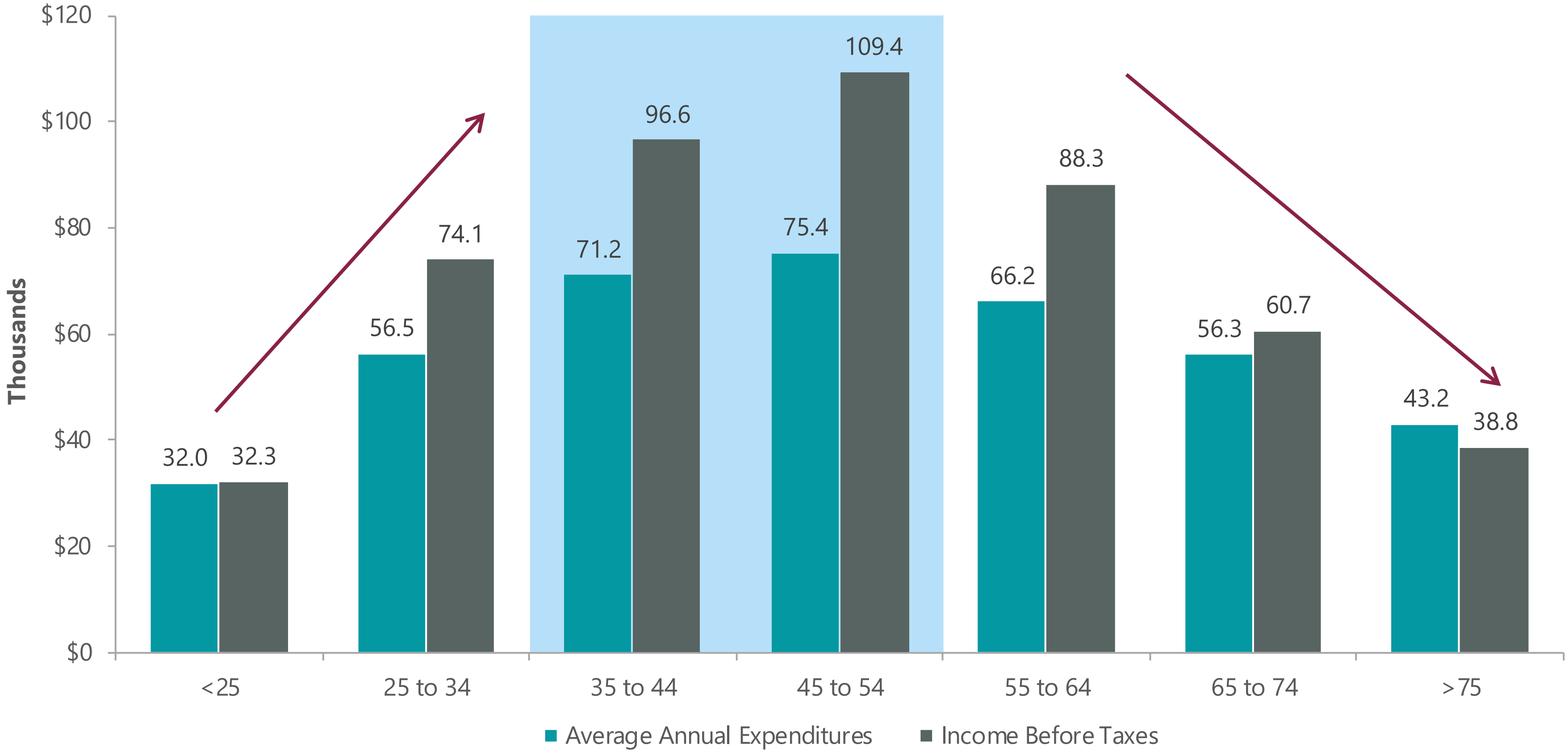
# The Earnings and Spending Lifecycle

## U.S. Consumption by Age (2018)

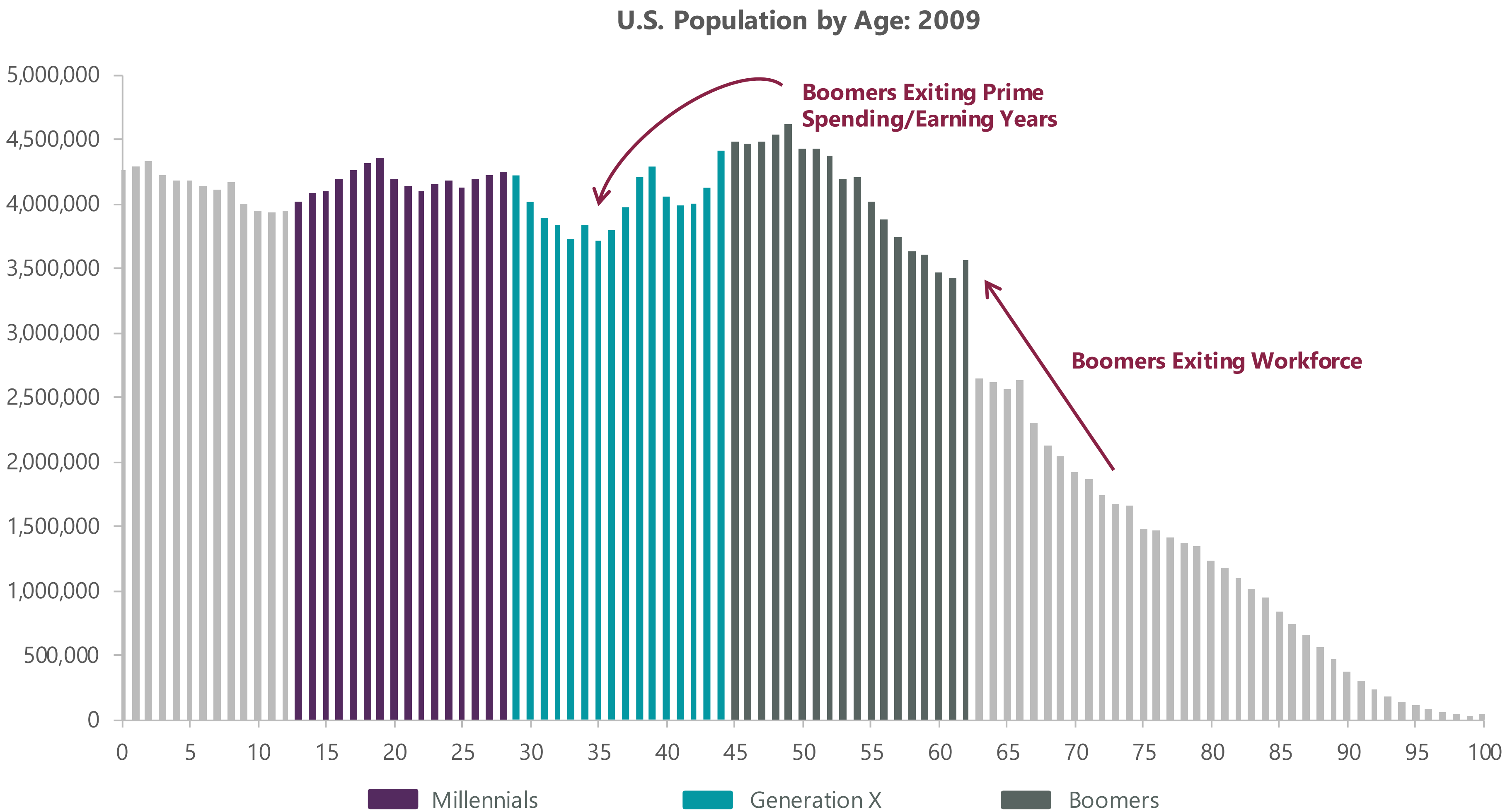



- **Individuals typically reach their peak earnings and spending years between the ages of 35 and 54.**
- **As a result, the share of the population in this age range has a strong influence on economic growth and financial markets.**



Data as of Sept. 2019. Source: Consumer Expenditure Survey, U.S. Bureau of Labor Statistics. 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.

# 2009 Demographic Headwind

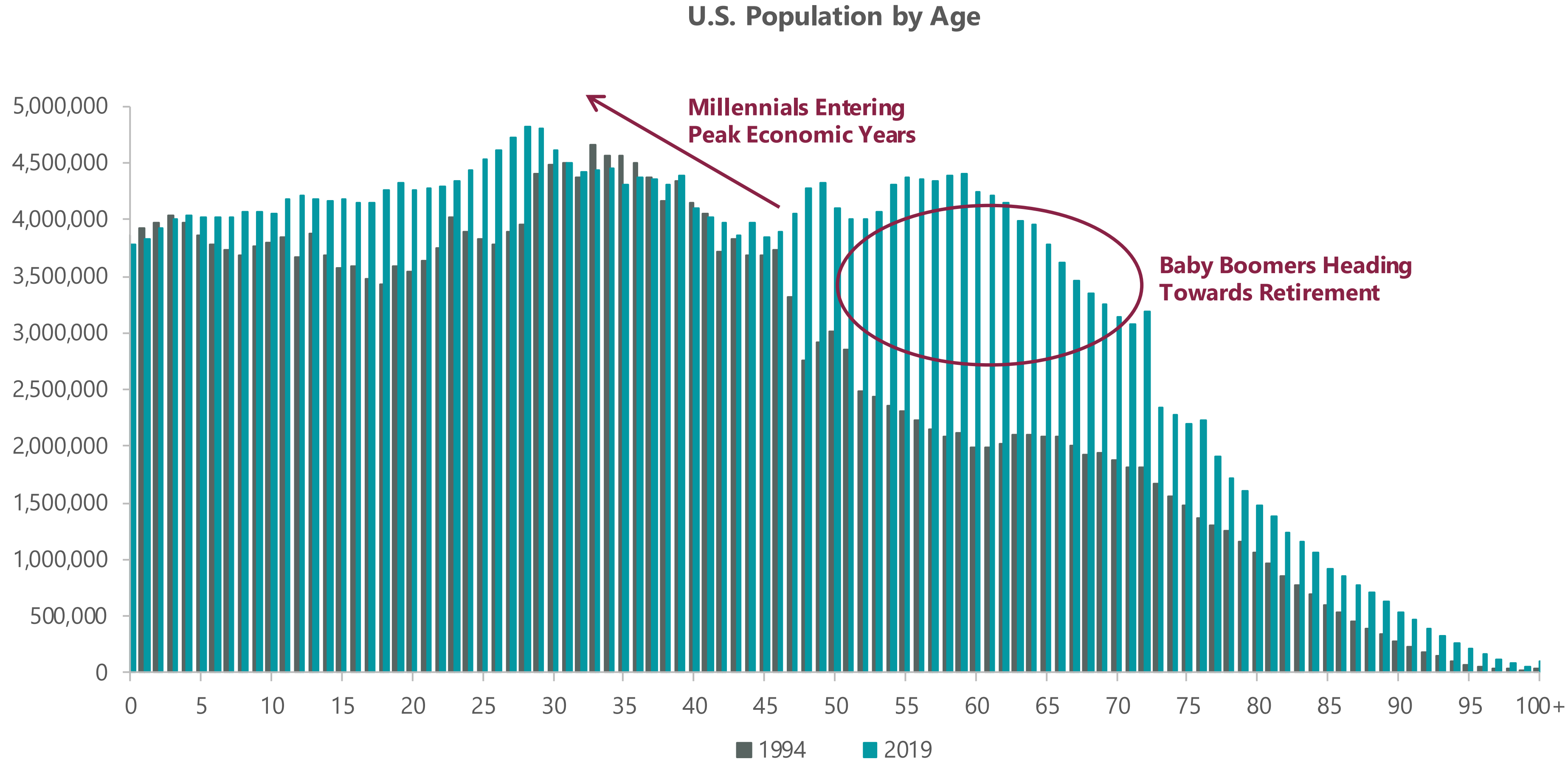



- **In the wake of the GFC, poor demographic trends were a headwind to economic growth as the Baby Boomers aged out of the workforce.**
- **The smaller size of Gen X meant fewer individuals in their prime spending and earning years.**

ClearBridge Investments

Source: U.S. Census Bureau. 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.

# 2019 Demographic Tailwind Similar to 1994

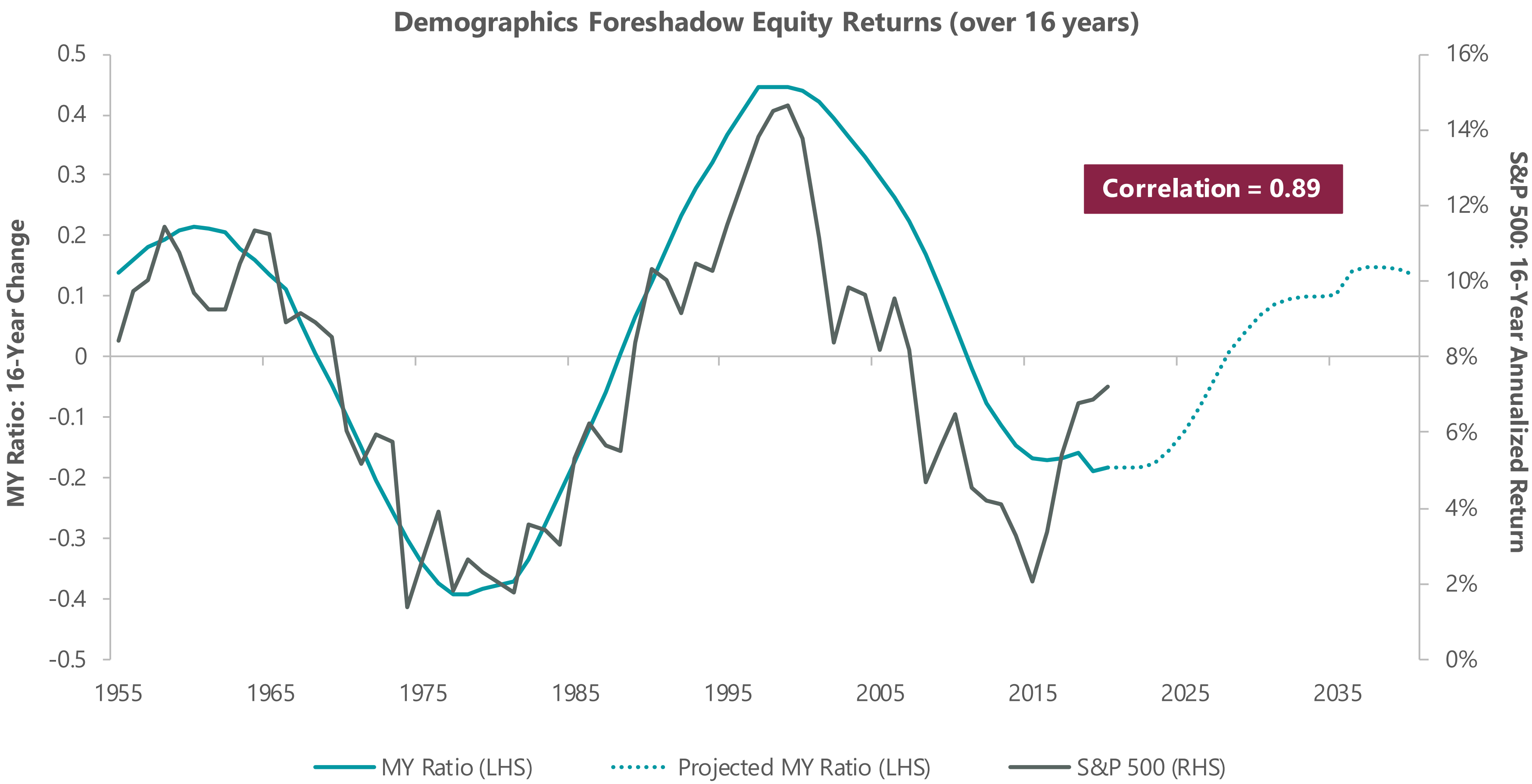



- Similar to the mid-1990s, demographics should be a tailwind for economic growth as the Millennials enter their prime earning and spending years.
- This impulse should be somewhat dampened compared to 1994 due to the larger cohort of retirees today.

ClearBridge Investments

Source: U.S. Census Bureau. 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.

# Middle vs. Young (MY) Ratio




- **A growing share of middle-age (35-49), relative to younger (20-34), workers has historically coincided with stronger equity market returns.**
- **The demographic profile of the U.S. suggests a healthy environment for stocks well into the 2030s.**

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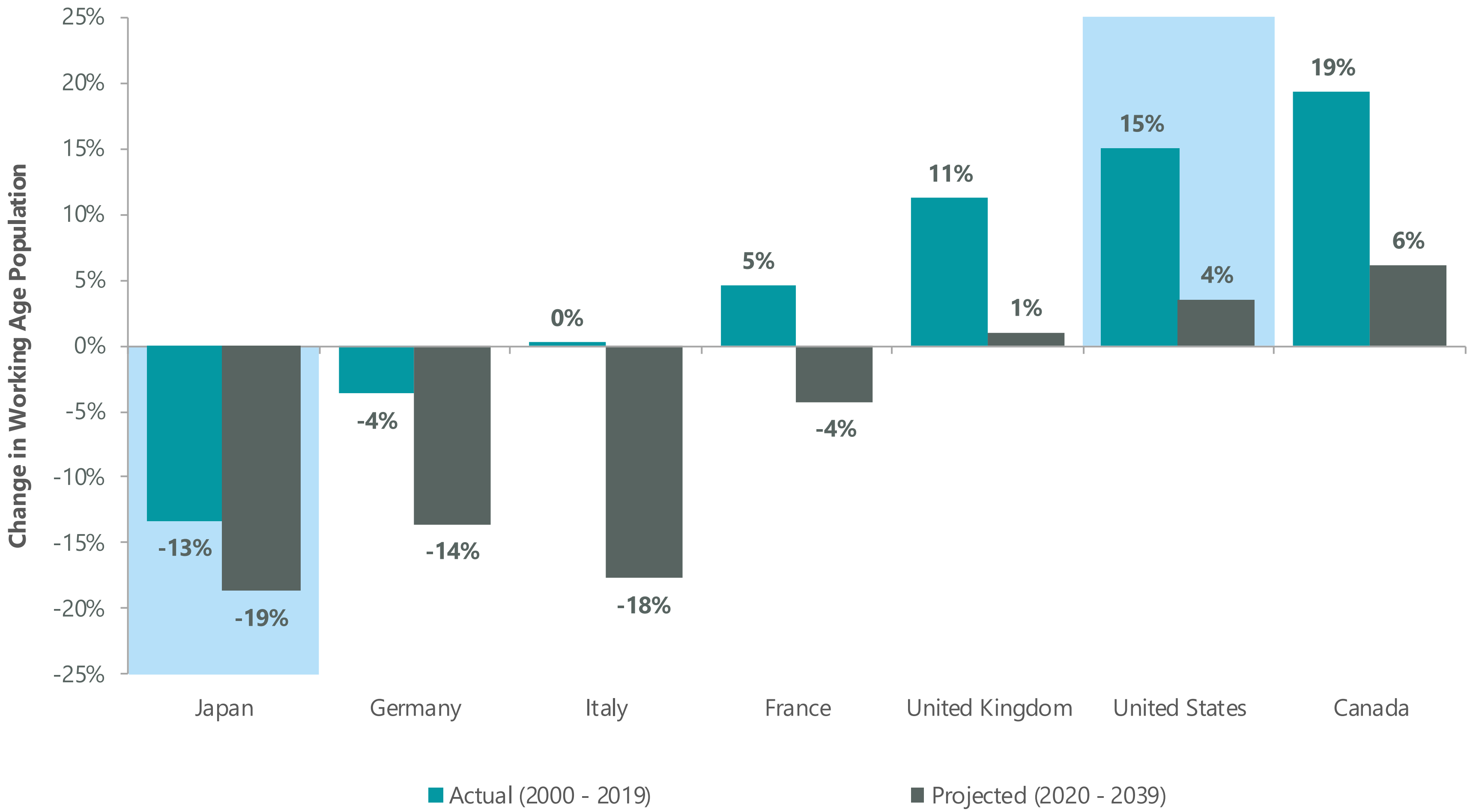
Source: Census Bureau, S&P, and Bloomberg. Note: Census Bureau Forecast is based on 2017 National Population Projections. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# U.S. Demographic Profile Among Developed World's Best




- **Fear of "Japanification" in the U.S. may be overblown due to a more favorable demographic profile.**

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Data as of Dec. 18, 2020, most recent as of June 30, 2021. Source: World Bank. 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.

## Volatility

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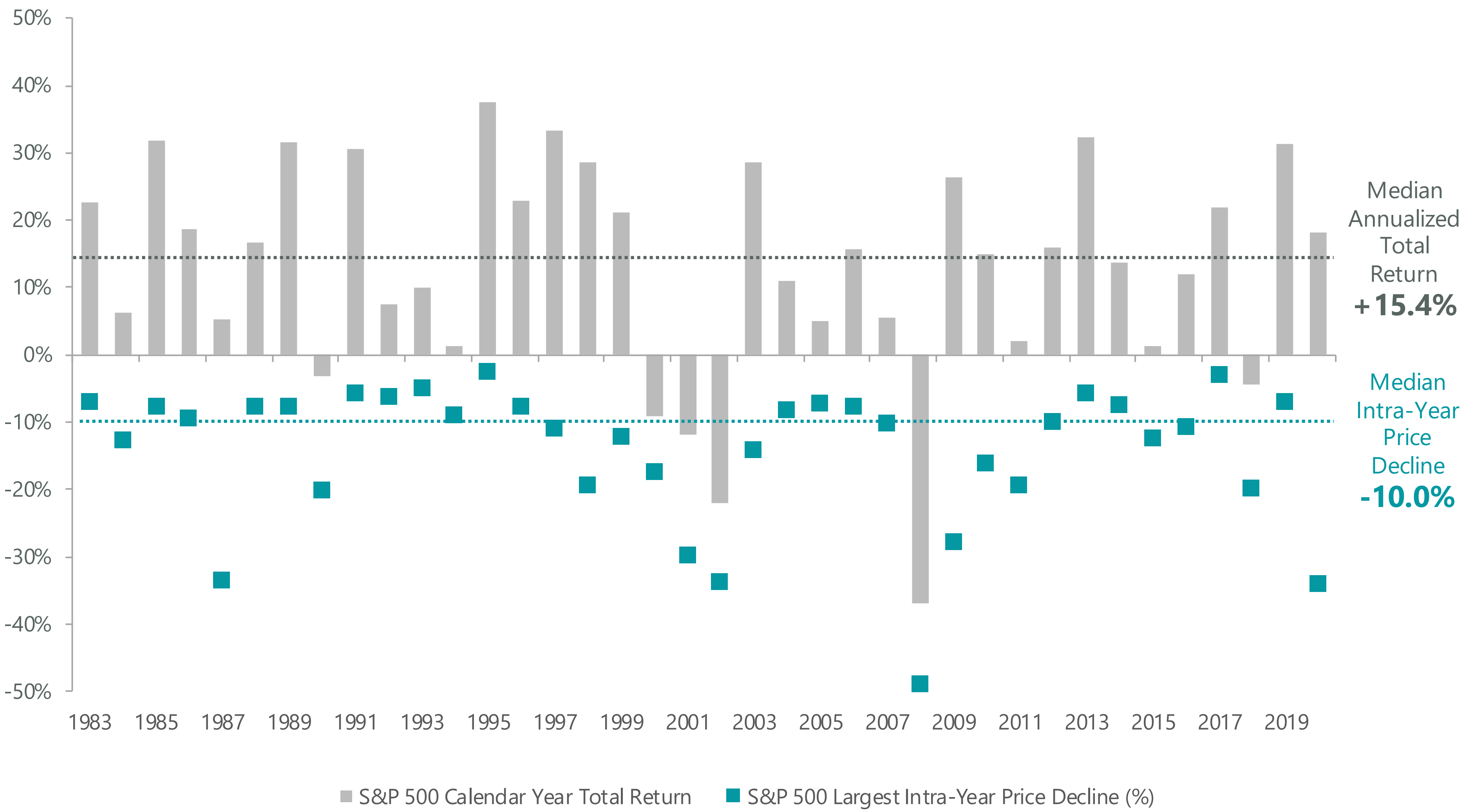
# Volatility Does Not Equal a Financial Loss Unless You Sell

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As of Dec. 31, 2020. Source: FactSet. 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.

# Missing the Best Days Can Drastically Reduce Returns

| | Cumulative | | Annualized | |
|---|---|---|---|---|
| **Decade** | **Price Return** | **Excluding 10 Best Days Per Decade** | **Price Return** | **Excluding 10 Best Days Per Decade** |
| 1930 | -42% | -79% | -5% | -15% |
| 1940 | 35% | -14% | 3% | -2% |
| 1950 | 257% | 167% | 14% | 11% |
| 1960 | 54% | 14% | 4% | 1% |
| 1970 | 17% | -20% | 2% | -2% |
| 1980 | 227% | 108% | 13% | 8% |
| 1990 | 316% | 186% | 15% | 12% |
| 2000 | -24% | -62% | -3% | -10% |
| 2010 | 190% | 95% | 11% | 7% |
| **Average Since 1930** | **114%** | **44%** | **6%** | **1%** |

- **Investors that missed the 10 best days in a given decade would have seen 70% lower returns over the course of that decade on average.**
- **28% of the best days (5% or more) took place in the first two months of a bull market.**

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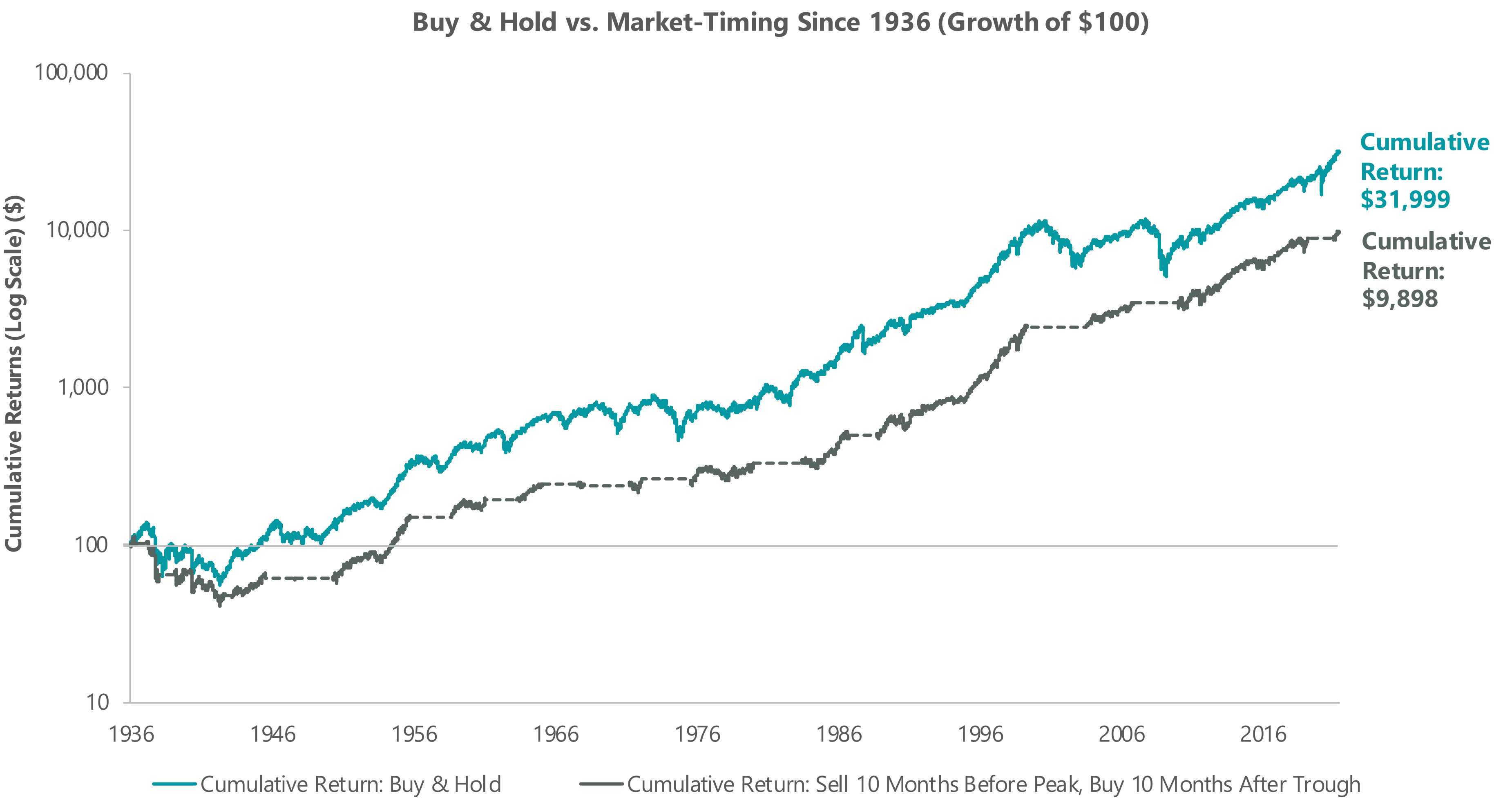
Data as of March 31, 2020. Source: FactSet. Past performance is not a guarantee of future results. Investors cannot invest directly in an index, and unmanaged index returns do not reflect any fees, expenses or sales charges.

# Can You Time the Market?




- **Since 1936, an investor that consistently sold 10 months prior to a market peak and bought back 10 months after the trough was worse overall than a buy and hold investor.**



Data as of June 30, 2021. Source: Yardeni Research. 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.

# Typical Market Leadership in a Downturn

← Less Defensive — **Most Defensive**

| Market Cap | Value | Blend | Growth |
|---|---|---|---|
| Large | **Large Cap Value**<br>-13.3% Avg. Perf.<br>39% Hit Rate | **Large Cap**<br>-12.6% Avg. Perf.<br>79% Hit Rate | **Large Cap Growth**<br>-11.9% Avg. Perf.<br>71% Hit Rate |
| Mid | **Mid Cap Value**<br>-14.6% Avg. Perf.<br>21% Hit Rate | **Mid Cap**<br>-14.0% Avg. Perf.<br>29% Hit Rate | **Mid Cap Growth**<br>-13.5% Avg. Perf.<br>36% Hit Rate |
| Small | **Small Cap Value**<br>-15.2% Avg. Perf.<br>18% Hit Rate | **Small Cap**<br>-14.6% Avg. Perf.<br>21% Hit Rate | **Small Cap Growth**<br>-14.0% Avg. Perf.<br>39% Hit Rate |

Less Defensive ↓

**Least Defensive**

**Investment Style**

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.

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# Glossary of Terms

**BEA:** Bureau of Economic Analysis

**Bloomberg Barclays US Aggregate Bond Index:** an unmanaged index of U.S. investment-grade fixed-income securities.

**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.

**CPI (Consumer Price Index):** measure of the average change in U.S. consumer prices over time in a fixed market basket of goods and services as determined by U.S. Bureau of Labor Statistics.

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

**FAANGM:** Shorthand term for a group of leading technology stocks including Facebook, Apple, Amazon, Netflix, Google/Alphabet, and Microsoft.

**GDP:** Gross Domestic Product

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

**Fed (Federal Reserve Board):** the U.S. central bank, responsible for policies designed to promote full economic growth, full employment, and price stability.

**LEI Index:** Conference Board Leading Economic Indicators index.

**Mortgage Bankers Association (MBA) Purchase Index:** measure of relative change over time in mortgage applications for property purchases

**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.

**NAREIT All-Equity REITS Total Return Index:** free-float-adjusted market capitalization weighted index that includes all tax qualified REITS listed in the NYSE, AMEX and NASDAQ National Markets.

**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

# Glossary of Terms

**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 1000 Growth Index:** unmanaged index of large-cap stocks chosen for their growth orientation.

**Russell 1000 Value Index:** unmanaged index of large-cap stocks chosen for their value orientation.

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

**Shibor:** Shanghai Interbank Offered Rate

**S&P MidCap 400 Index:** unmanaged index of 400 US mid-cap stocks

**S&P 400 Growth Index:** unmanaged index of mid-cap stocks having higher price-to-book ratios relative to the S&P 400 MidCap as a whole.

**S&P 400 Value Index:** unmanaged index of mid-cap stocks having lower price-to-book ratios relative to the S&P 400 MidCap as a whole.

**S&P 500 Growth Index:** unmanaged index of large-cap stocks selected based on sales growth, the ratio of earnings change to price and momentum.

**S&P 500 Value Index:** unmanaged index of large-cap stocks selected based on the ratios of book value, earnings, and sales to price.

**S&P 600 Index:** unmanaged index of 600 US small-cap stocks

**S&P 600 Growth Index:** unmanaged index of US small-cap growth stocks, selected based on sales growth, the ratio of earnings change to price, and momentum.

**S&P 600 Value Index:** unmanaged index of US small-cap value stocks, selected based on ratios of book value, earnings, and sales to price.

**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. Treasurys:** 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 US. government. Even when the U.S. government guarantees principal and interest payments on securities, this guarantee does not apply to losses resulting fom declines in the market value of these securities.

# Biographies

| Name and Position | Industry Experience | ClearBridge Tenure | Education, Experience and Professional Designations |
|---|---|---|---|
|  **Josh Jamner CFA**<br>Vice President, Investment Strategy Analyst | 12 years | • Joined ClearBridge in 2017 | • Member of the CFA Institute<br>• RBC Capital Markets - Assistant Vice President, Associate Strategist - U.S. Equity<br>• Bessemer Trust - Assistant Vice President, Client Portfolio Analyst<br>• BA in Government from Colby College |
|  **Jeffrey Schulze CFA**<br>Director, Investment Strategist | 16 years | • Joined ClearBridge in 2014 | • Member of the CFA Institute<br>• Lord Abbett & Co., LLC – Portfolio Specialist<br>• BS in Finance from Rutgers University |

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