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MARKET REVIEW

› 1st QUARTER 2021

EXECUTIVE SUMMARY

- Equities continued to rally for the fourth straight quarter, with US Small returning +95% over the past 12 months.
- US Small stocks were the strongest equity performer YTD, with the overall US market slightly outperforming international.
- Value companies outperformed YTD, while lagging in the previous 12-month returns.
- The Federal Reserve reinforced their plan to fully support this economy by keeping rates near zero.

Quarterly Market Review

First Quarter 2021

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Equities have had positive returns for four consecutive quarters from the market bottom of the March 23, 2020 low. All equities, especially small and value companies, have recovered exceptionally well coming out of the downturn. US small companies have returned +95% over the last 12 months, and small value companies returned +21% quarter-to-date with increased enthusiasm for a strong economic recovery in the coming year. This optimistic outlook has also increased interest rates, resulting in a slightly negative quarter for fixed income overall. Inflation concerns have been priced into the bond markets; however, the primary inflation gauge followed by United States Federal Reserve has not moved meaningfully. In March, Chairman Powell described the Federal Reserve policy stance as continuing to be accommodative, meaning continued low rates.

What's All This Enthusiasm About?

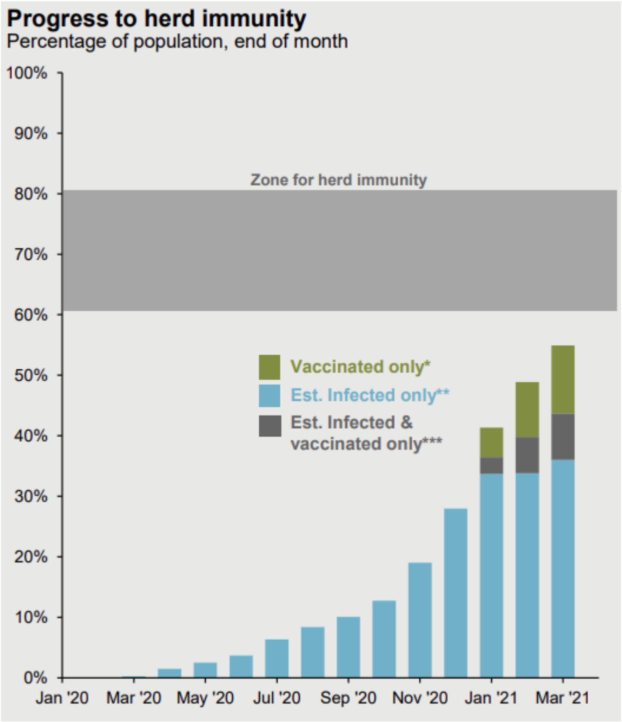
After a challenging year and corresponding rough start to 2021, there is finally light at the end of the tunnel. As we've mentioned in previous commentaries, the market is forward-looking – meaning today's market prices are incorporating anticipated economic performance (plus six months ahead). With that said, the market is looking at two main surges.

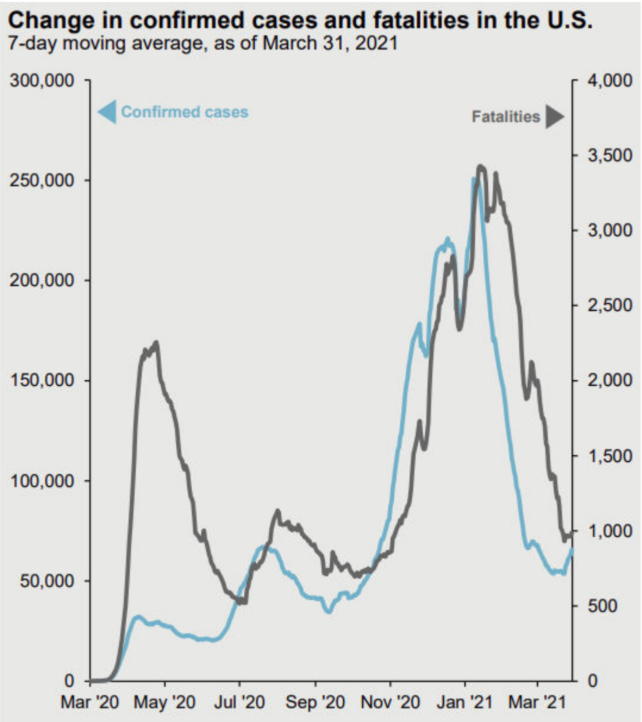
- Overview:

First, a vaccine surge. With over 100 million vaccines provided and over three million administered per day, the United States is quickly approaching the benefits of herd immunity. Generally, herd immunity is achieved when 60-80% of the population has some or full immunity against a virus. This includes those who have either had COVID-19 or have had at least one vaccine dosage. Today, 50% of the US has some form of immunity. Additionally, cases have been dropping dramatically from the start of the year, going from 250,000 cases per day (7-day average) to 50,000 cases per day.

With these two tailwinds and pent-up demand, the market is anticipating earnings to reach all-time highs later in the year.

Second, a fiscal surge. Trillion is the new billion. The $1.9T American Rescue Plan is expected to provide a meaningful stimulus to the economy, with $1.2T of the $1.9T being deployed in the next six months and a majority going to low/middle-income individuals who typically have a higher propensity to spend. In addition, the recently proposed $2T infrastructure plan (if passed) would provide additional tailwinds to the economy. This multi-year plan would target infrastructure, research and development, manufacturing, and environmentally friendly policies. The Biden administration plans to fully fund this effort by way of increased taxes on corporations and higher-income individuals; however, with thin party lines between the US Senate and House, there is a reasonable likelihood that, at least in the short term, any tax increase would be modest.





Quarterly Market Review

Portfolio Update

Here at HFG, we continue to evaluate and reevaluate the soundness of our portfolios. As mentioned in previous commentaries, we've made meaningful updates in the portfolio over the last 12 months; primarily mentioned was the incorporation of private real estate and reinsurance as alternatives for increased income and overall reduced portfolio volatility. One update that didn't get much attention in the middle of last year was our incorporation of bonds that provide protection (ie: increase in value) specifically from unexpected increases in inflation – we like to think of this as a form of insurance. In the absence of a crystal ball, we decided to take the calculated position that, with expected inflation being priced so low, the opportunity for increased inflation substantially outweighed the limited downside of inflation being lower than expectations.

Gamestop, YOLO, Short Squeeze: What's Your Investment Style?

You only live once! Social media investors have banded together on unconventional platforms to drive up the prices of a handful of "meme stocks," seemingly without traditional evaluation of investment risks and rewards. They made headlines with their "short squeeze" of GameStop (GME) and, as they garner media attention, their tactics continue. While it's not the intended victim of the YOLO traders, will the efficient market hypothesis be a casualty of these events? The answer depends a lot on your definition of efficient markets. Perhaps long-term investors would be better served questioning the potential impact on their investment philosophy.

Nobel laureate and professor of Finance at the University of Chicago Booth School of Business, Dr. Eugene Fama (1970), defines the efficient market hypothesis (EMH) to be the simple statement that prices reflect all available information. The rub is that it doesn't say how investors should use this information. EMH is silent on the "correct" ways investors should use information and apply it to portfolio construction. To be testable, EMH needs a companion model: a hypothesis for how markets and investors should behave. This leaves a lot of room for interpretation. Should asset prices be set by rational investors whose only concerns are systematic risk[1] and expected returns? It seems implausible to link recent meme-stock price movements to economic risks. Rather, they seem fueled by investor demand to be part of a social movement, hopes of striking it rich with a lucky stock pick, or plain old schadenfreude.

From individuals investing in their own accounts to governments and corporations investing on behalf of thousands, there is a vast ecosystem of investors. Ask investors why they invest the way they do, and you'll likely get a range of goals and approaches just as diverse. It's this complex system that generates the *demand* for stocks. Another complex system fuels the *supply* of stocks, and supply and demand meet at the market price. People may contend that the market is not always efficient or rational, but the stock market is always in equilibrium. Every trade has two sides, with a seller for every buyer and a profit for every loss.

There are plenty of well-studied examples that show supply and demand at work. The huge increase in demand for stocks added to a well-tracked index often creates a run-up in the stock price. Some of this price increase can be temporary and reversed once the tremendous liquidity demands at index reconstitution[2] are met. Index reconstitution is just one example; instances of liquidity-driven price movements happen all the time. It is well documented that liquidity demands can produce temporary price movements.[3] Investors may wonder if temporary price dislocations motivated by users of r/WallStreetBets differ from those caused by changes to an index. A lot of buying puts temporary upward pressure on prices, which later fall back to "fundamental value" – it sounds familiar. The more relevant observation may be that markets are complex systems well adapted to facilitate the supply and demand of numerous market participants.

There are numerous reasons people may be willing to hold different stocks at different expected returns. Can all those differences be explained by risks? Doubtful. To quote Professor Fama, "The point is not that markets are efficient. They're not. It's just a model."[4] EMH can be a very useful model to inform how investors should behave. We believe investing as if markets are efficient is a good philosophy for building long-term wealth. Likewise, trying to outguess markets might be a quick way to destroy it.

It's true, you only live once. The good news is that investors can look to market prices, not internet fads, to pursue higher expected returns. Theoretical and empirical research indicate that higher expected returns come from lower relative prices and higher future cash flows to investors. Long-run investors can be better served by using markets, rather than chatrooms, for information on expected returns.

1. Systematic risk is the possibility of an investor experiencing losses due to factors that affect the overall performance of the financial markets in which he or she is involved.
2. Reconstitution involves the re-evaluation of a market index. The process involves sorting, adding, and removing stocks to ensure that the index reflects up-to-date market capitalization and style.
3. For example, see "Tesla's Charge Reveals Weak Points of Indexing" (Dimensional, 2021)
4. "Are markets efficient?" – Interview between Eugene Fama and Richard Thaler (June 30, 2016)

World Stock Market Performance

MSCI All Country World Index with selected headlines from Q1 2021

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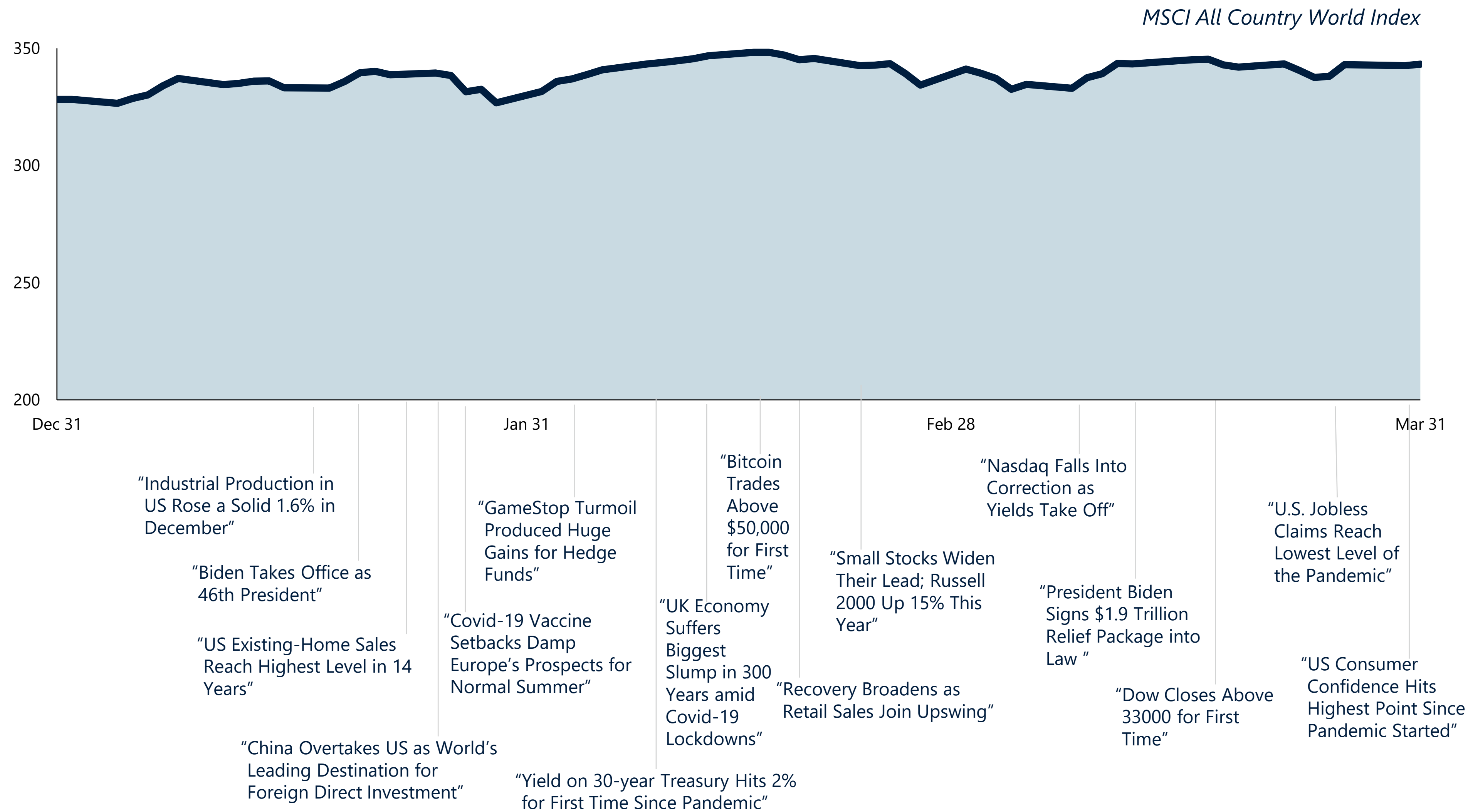


These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

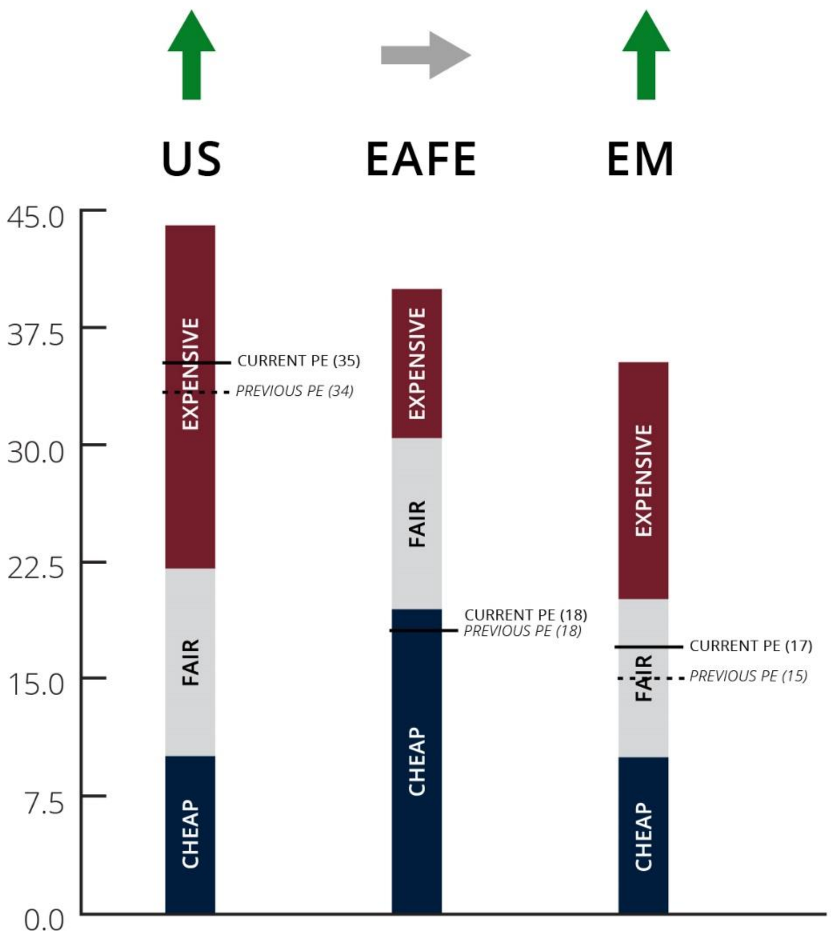
Graph Source: MSCI ACWI Index [net div.].

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. **Past performance is not a guarantee of future results.**

Global Valuations

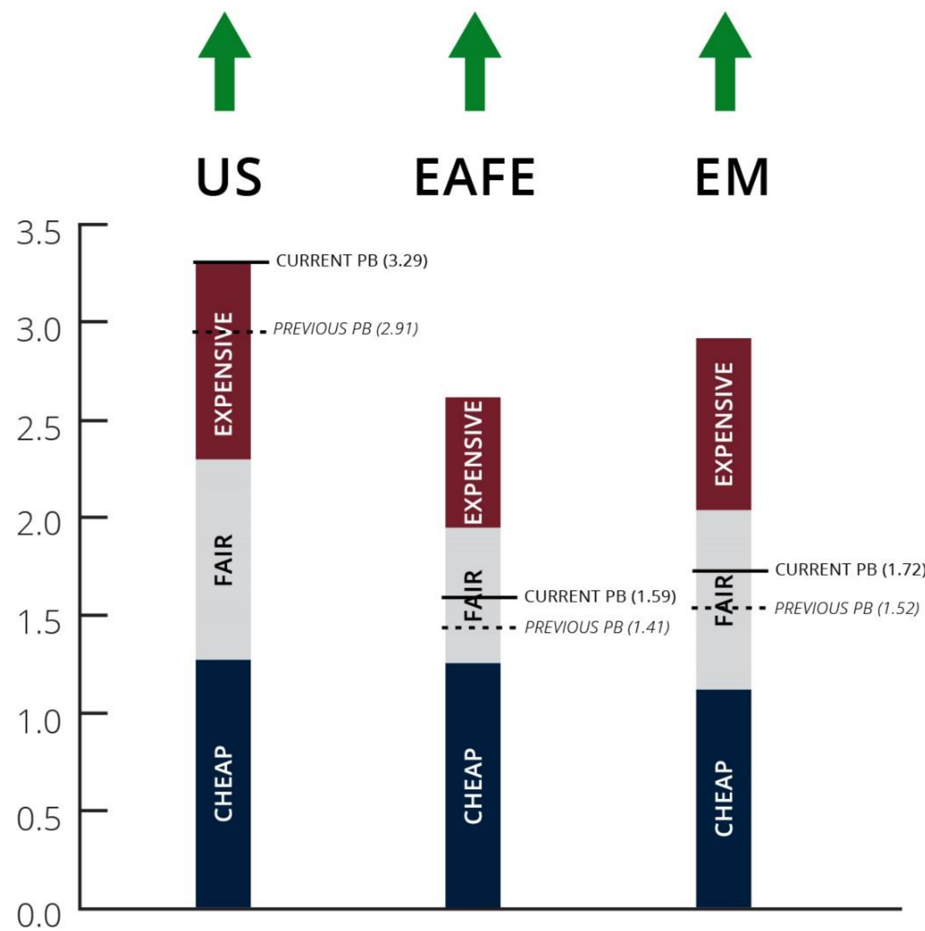
What is the Investment Climate?

Price-to-Earnings (CAPE)



As of 03/31/2021

Price-to-Book Value



As of 03/31/2021

Cyclically Adjusted Price-to-Earnings or "CAPE" is a valuation metric, where the current market price is divided by the last ten years of average earnings (adjusted for inflation). The price you pay is what you get, and by utilizing average earnings over a longer period (10 years), we can put into perspective whether the current market price is trending toward expensive, undervalued, or fairly valued historically.

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Quarterly Market Summary

Index Returns

1Q 2021	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
	STOCKS				BONDS	
	6.35%	4.04%	2.29%	6.22%	-3.37%	-1.90%

Since Jan. 2001	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
Avg. Quarterly Return	2.4%	1.6%	3.0%	2.5%	1.1%	1.1%
Best Quarter	22.0%	25.9%	34.7%	32.3%	4.6%	4.6%
	2020 Q2	2009 Q2	2009 Q2	2009 Q3	2001 Q3	2008 Q4
Worst Quarter	-22.8%	-23.3%	-27.6%	-36.1%	-3.4%	-2.7%
	2008 Q4	2020 Q1	2008 Q4	2008 Q4	2021 Q1	2015 Q2

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

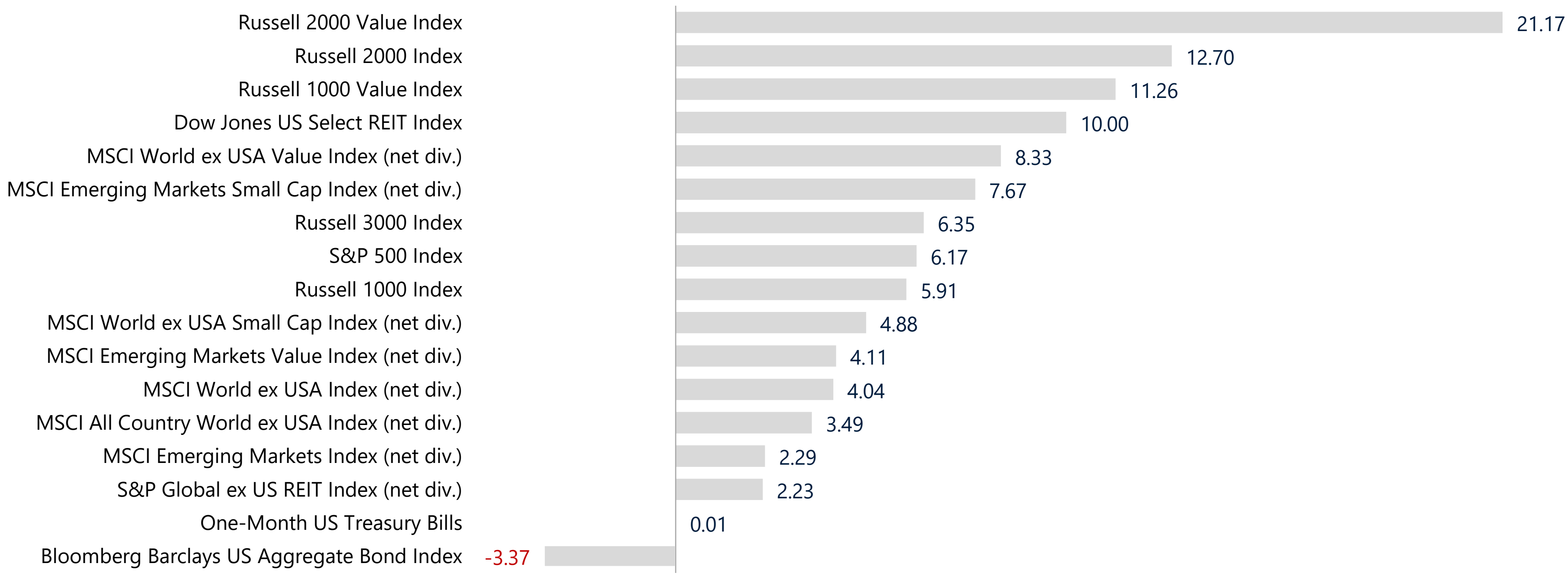
World Asset Classes

First Quarter 2021 Index Returns (%)

Equity markets around the globe posted positive returns in the first quarter. Looking at broad market indices, US and non-US developed markets outperformed emerging markets.

Value outperformed growth across regions. Small caps outperformed large caps across regions as well.

REIT indices outperformed equity market indices in the US and underperformed in non-US developed markets.



US Stocks

First Quarter 2021 Index Returns (%)

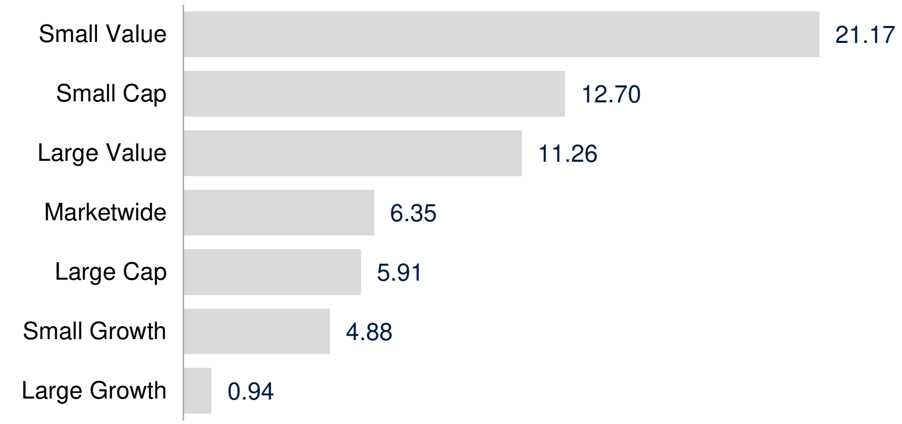
The US equity market posted positive returns for the quarter and outperformed non-US developed markets and emerging markets.

Value outperformed growth across large and small cap stocks.

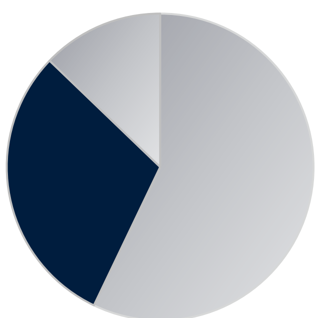
Small caps outperformed large caps.

REIT indices outperformed equity market indices.

Ranked Returns (%)



World Market Capitalization—US



57%

US Market
$40.3 trillion

Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Small Value	21.17	97.05	11.57	13.56	10.06
Small Cap	12.70	94.85	14.76	16.35	11.68
Large Value	11.26	56.09	10.96	11.74	10.99
Marketwide	6.35	62.53	17.12	16.64	13.79
Large Cap	5.91	60.59	17.31	16.66	13.97
Small Growth	4.88	90.20	17.16	18.61	13.02
Large Growth	0.94	62.74	22.80	21.05	16.63

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International Developed Stocks

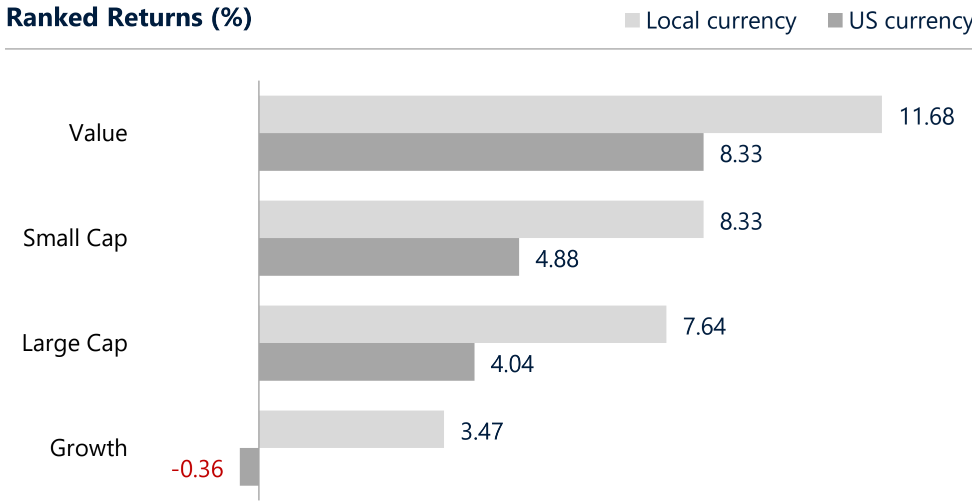
First Quarter 2021 Index Returns (%)

Developed markets outside the US posted positive returns for the quarter, underperforming US equities but outperforming emerging markets.

Value outperformed growth.

Small caps outperformed large caps.

Ranked Returns (%)

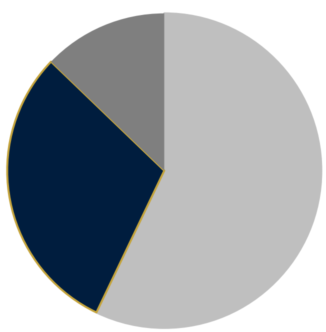


World Market Capitalization—International Developed

30%

International Developed Market

$21.2 trillion



Period Returns (%)

** Annualized*

	YTD	1 Year	3 Years*	5 Years*	10 Years*
Value	8.33	47.17	2.25	6.81	3.54
Small Cap	4.88	65.17	6.89	10.55	7.14
Large Cap	4.04	45.86	6.34	8.92	5.21
Growth	-0.36	43.55	10.02	10.72	6.69

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Emerging Markets Stocks

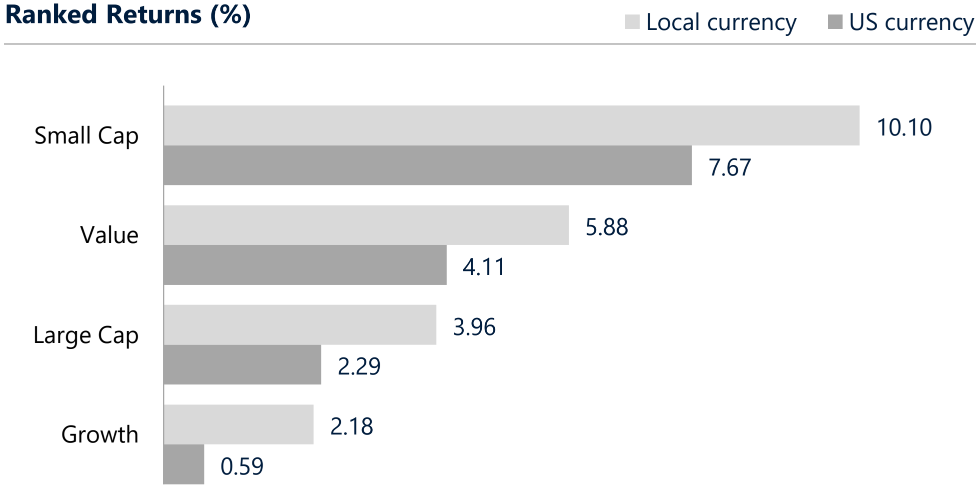
First Quarter 2021 Index Returns (%)

Emerging markets posted positive returns for the quarter, underperforming the US and developed ex US equity markets.

Value outperformed growth.

Small caps outperformed large caps.

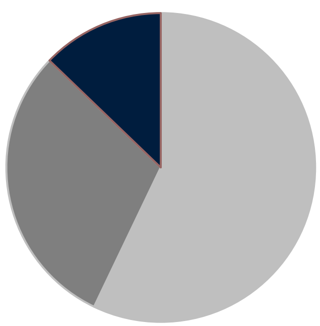
Ranked Returns (%)



World Market Capitalization—Emerging Markets

13%

Emerging Markets
$9.0 trillion



Period Returns (%)

** Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Small Cap	7.67	87.13	5.19	9.59	3.33
Value	4.11	52.53	2.60	8.42	1.03
Large Cap	2.29	58.39	6.48	12.07	3.65
Growth	0.59	63.78	10.10	15.53	6.15

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Fixed Income

First Quarter 2021 Index Returns (%)

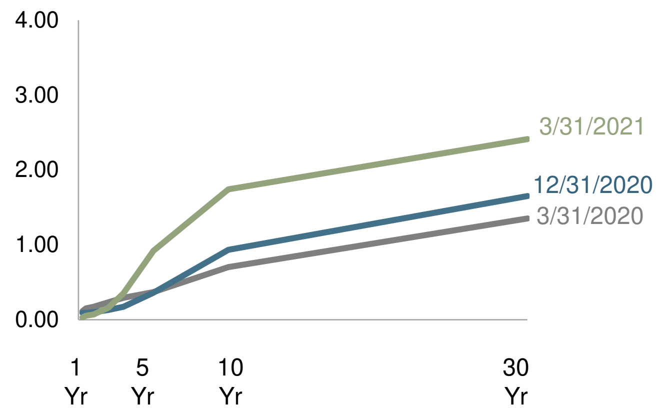
Interest rates generally increased in the US Treasury fixed income market during the first quarter. The yield on the 5-Year US Treasury note rose 56 basis points (bps), ending at 0.95%. The yield on the 10-Year T-note increased 81 bps to 1.74%. The 30-Year Treasury bond yield increased 75 bps to 2.39%.

On the short end of the curve, the 1-Month US Treasury bill yield decreased 3 bps to 0.05%, and the 1-Year T-bill yield fell 5 bps to 0.08%. The yield on the 2-Year US Treasury note climbed 6 bps to end at 0.15%.

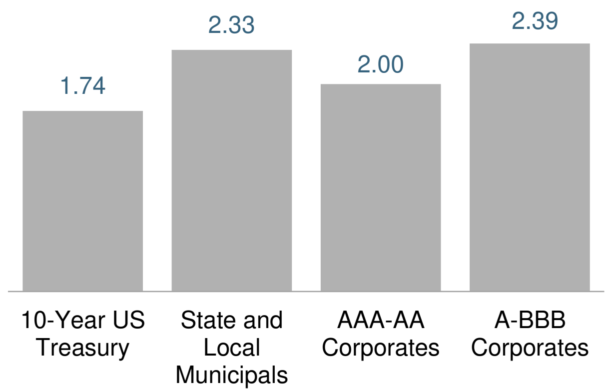
In terms of total returns, short-term corporate bonds declined 0.59%. Intermediate-term corporate bonds returned 2.19%.

The total return for short-term municipal bonds was flat, while intermediate-term municipal bonds lost 0.52%. Revenue bonds outperformed general obligation bonds.

US Treasury Yield Curve (%)



Bond Yield across Issuers (%)



Period Returns (%)

*A

	Asset Class	QTR	1 Year	3 Years*	5 Years*
6	Bloomberg Barclays US High Yield Corporate Bond Index	0.85	23.72	6.84	8.06
7	ICE BofA 1-Year US Treasury Note Index	0.07	0.17	2.14	1.52
8	ICE BofA US 3-Month Treasury Bill Index	0.03	0.12	1.49	1.19
1	Bloomberg Barclays Municipal Bond Index	-0.35	5.51	4.91	3.49
2	FTSE World Government Bond Index 1-5 Years (hedged to USD)	-0.36	0.57	2.88	2.05
3	Bloomberg Barclays US TIPS Index	-1.47	7.54	5.68	3.86
4	FTSE World Government Bond Index 1-5 Years	-2.39	3.20	1.29	1.43
5	Bloomberg Barclays US Aggregate Bond Index	-3.37	0.71	4.65	3.10
	Bloomberg Barclays US Government Bond Index Long	-13.39	-15.60	5.84	3.17

One basis point (bps) equals 0.01%. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Yield curve data from Federal Reserve. State and local bonds are from the S&P National AMT-Free Municipal Bond Index. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the ICE BofA Corporates, BBB-A rated. Bloomberg Barclays data provided by Bloomberg. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

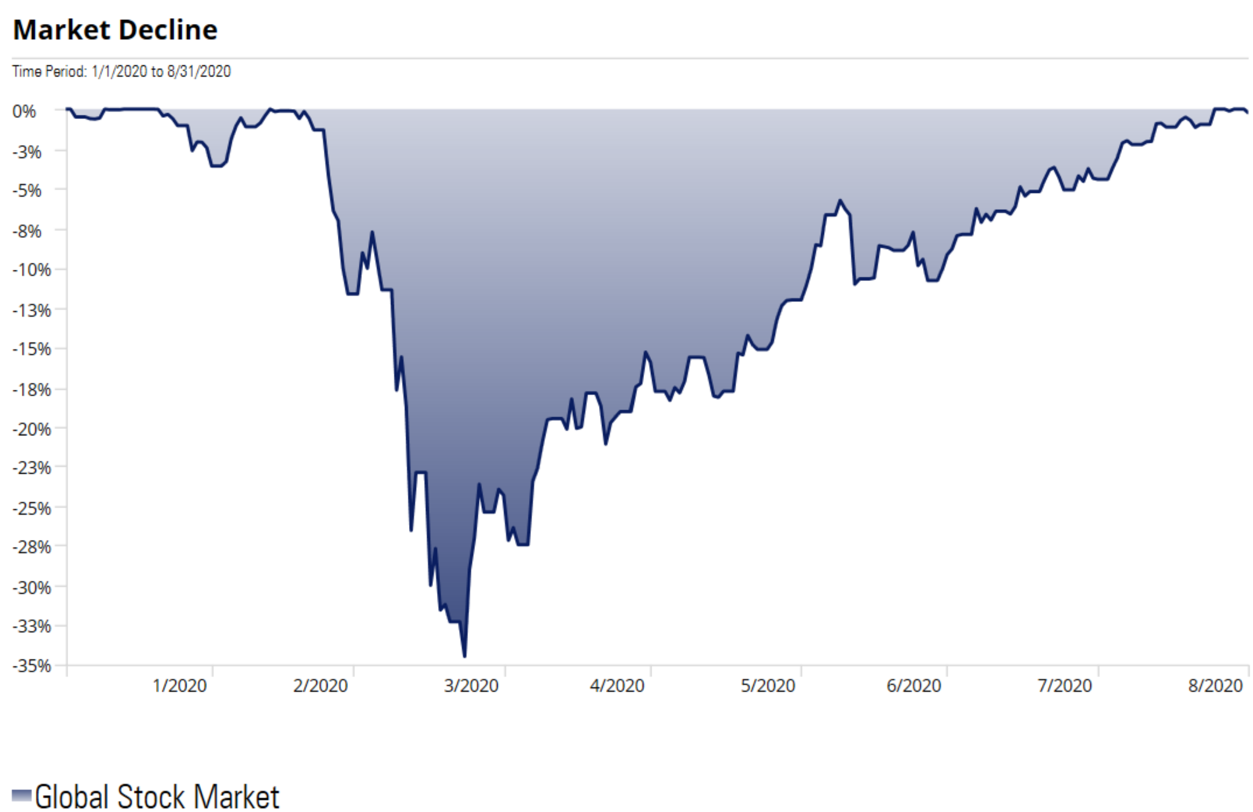
Quarterly Market Review

One Year After the March 2020 "Market Bottom"

The last twelve months have been interesting, to say the least: lockdowns, a freefalling economy and market, and the awkward handshake/fist-bump/friendly wave. With all that has happened, I think it's worthwhile to reflect on the lessons we've learned since March of 2020.

Stay invested in the market and don't invest based on emotions. At one time or another last year, the thought of "this time's different" or "should I sell out and salvage what I can?" crossed every investor's mind. With a global market decline of 35% from February to the market low on March 23, and a lockdown of the global economy with no end in sight, I would be hard-pressed to find an investor who didn't ruminate on these thoughts for at least a moment or two.

Here at HFG Trust, we were struggling with the same questions and emotions. We had no crystal ball to peer into the future, but regardless of the investment climate, we try to practice what we preach: *Invest in an appropriate portfolio based on your financial plan, stay invested for the long term, and don't make investment decisions based on emotion*. With this philosophy in hand, we decided to rebalance portfolios during the drawdown, generally purchasing equities from fixed income. With the exceptional rebound in market returns over the last twelve months, in retrospect it seems like an easy decision; but at the time, it was gut-wrenching.

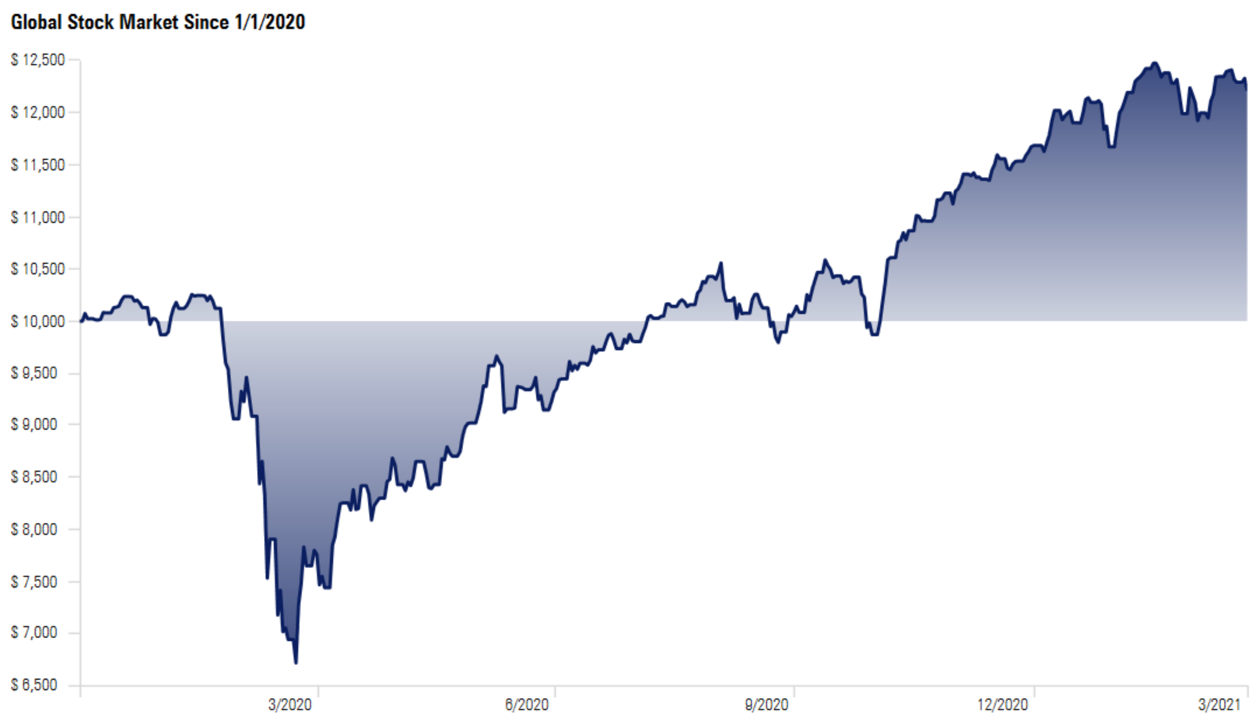


4. "Are markets efficient?" – Interview between Eugene Fama and Richard Thaler (June 30, 2016)

Quarterly Market Review

One Year After the March 2020 "Market Bottom"

Some investors and pundits on TV looked like heroes as they sold on the way down. However, a majority of these investors are now still waiting for the "right time" to reinvest in the market, resulting in being underweighted in their portfolio and missing out on a large portion of the 80% increase from market lows led by US Small Value companies returning +120%.



Ultimately, no crisis or pandemic will look the same. When some say, "this time it's different," they are correct. However, the market and economies are resilient overall; and the adaptability of companies and people results in responses that are both different and meaningful. This doesn't mean there won't be short-term volatility, but over time, investors are rewarded by staying disciplined.