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AMG National Trust

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Three-Year (2021 to 2023)

Economic Outlook

A look at probable economic scenarios and asset class expected return projections

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Introduction to the Scenarios

With the world reawakening from the Great Shutdown due to COVID-19 and uncertainty around the path of recovery still elevated, now more than ever, prudent investors should be aware of possible alternative developments for the economy and financial markets as they revisit their portfolios. To this end, AMG has developed seven scenarios to illustrate different paths that the economy may take over the 2021-23 period. Our Base Case, or most likely scenario, is *More Fiscal Stimulus*. Summaries and highlights of each scenario are presented on the next few pages. Each scenario's three-year economic and two-year asset class performance projections provide the estimated expected return information required for the formulation of a client's efficient frontier.

Economic Backdrop for Scenarios

AMG constructs several comprehensive economic scenarios in order to project the most likely central tendencies of investment results for various classes of assets. The multi-scenario approach allows an examination of the probable effects (both good and bad) of the most prominent known risks that may lie on the path of the economy and investment returns.

The Great Shutdown has made forecasting the course of the economy even more difficult than under normal circumstances. Still, it is likely that economic growth will trend upward over the 2021-23 period as the output gap created by the COVID-19 pandemic is eliminated. AMG's Base Case projects growth that, on average, well exceeds the growth of the sustainable economic capacity of the economy. Judging by historical experience, the path of growth will not be smooth. Although both growth and investment returns have upside potential, volatility should be anticipated as the path to eradicate COVID-19 evolves with each day.

Results for each scenario depend on its starting point, so it is appropriate to summarize broad economic conditions in early 2021. The domestic economy entered 2020 in a structurally enviable form only to be stress-tested by a pandemic. Before COVID-19 avalanched through the global economy, in the U.S. jobs were being created, inflation was well anchored, and steady increases in productivity offset declining labor participation. Household leverage had fallen to pre-Great Recession levels and household debt service—relative to disposable income—was near three-decade lows.

Two months into the shutdown—roughly in the middle of 2020—total economic output was collapsing at an unprecedented rate and few forecasters ventured a guess as to the decline's end. Consumer spending and housing activity screeched to a halt, with service sectors pummeled particularly hard by mandates to socially distance. The spread of the novel coronavirus escalated across the country and suppressed economic activity before a vaccine could change the trajectory's course. With a new spike in COVID-19 cases pushing the number of infections significantly above previous peaks in early 2021, some states are reintroducing moderate containment policies, including social distancing restrictions and work-from-home advisories as of this writing.

No way around it: COVID-19 has not exited the economic stage quite yet. At the same time, fiscal and monetary policies remain largely supportive for continued economic recovery. In spite of early 2021 weakness, the broad labor market has made significant improvement since the pandemic's worst days, and on the whole the economy has continued to recover.

Overview of 2021-2023 Economic Scenarios

★ **More Fiscal Stimulus.** (AMG's Base Case.) As multiple effective vaccines are rolled out and the pandemic wanes, the domestic economy continues its recovery and total production of goods and services (real GDP) expands faster than its sustainable, long-term growth rate. The economy returns to its pre-pandemic level of output in late 2021 and potential output in early 2024. Federal fiscal stimulus on the order of $2.5 to $3 trillion is passed by Congress in 2021. The corporate tax rate is lifted to 28%, liberal 2017 capital write-off rules are allowed to phase out, individual tax rates on income over $400,000 revert back to pre-2017 levels, capital gains tax rates move to 25%, and dividends are taxed as ordinary income. Inflation advances moderately but do not surpass the Federal Reserve's (Fed) 2% target by more than 0.5 percentage points for any three consecutive quarters. The Fed's policy rate remains on hold throughout the period. Long-term Treasury rates begin to inch up in 2021 as term premiums start to normalize and inflation expectations rise.

- **Fiscal Crowding Out.** Although domestic economic output expands at above-potential growth rates in 2021, economic policy uncertainty increases and weighs on hiring and business investment, motivating a large, debt-funded federal fiscal stimulus. Congress passes an assortment of programs on the order of $3.5 to $4 trillion over the course of 2021. The regulatory burden on the economy increases as Congress expands the federal bureaucracy and charges it with enforcing additional mandates on the private sector; these structural changes adversely impact potential real GDP and its growth. The size of budget deficits persuades Congress to agree to higher tax rates in late 2021. The Tax Cuts and Jobs Act of 2017 is completely repealed, and all other elements of the tax plan proposed by the Biden administration during the presidential campaign are implemented. Inflation advances steadily but do not surpass Fed's 2% target by more than 0.5 percentage points for any three consecutive quarters. The Fed's policy rate remains on hold throughout the period.

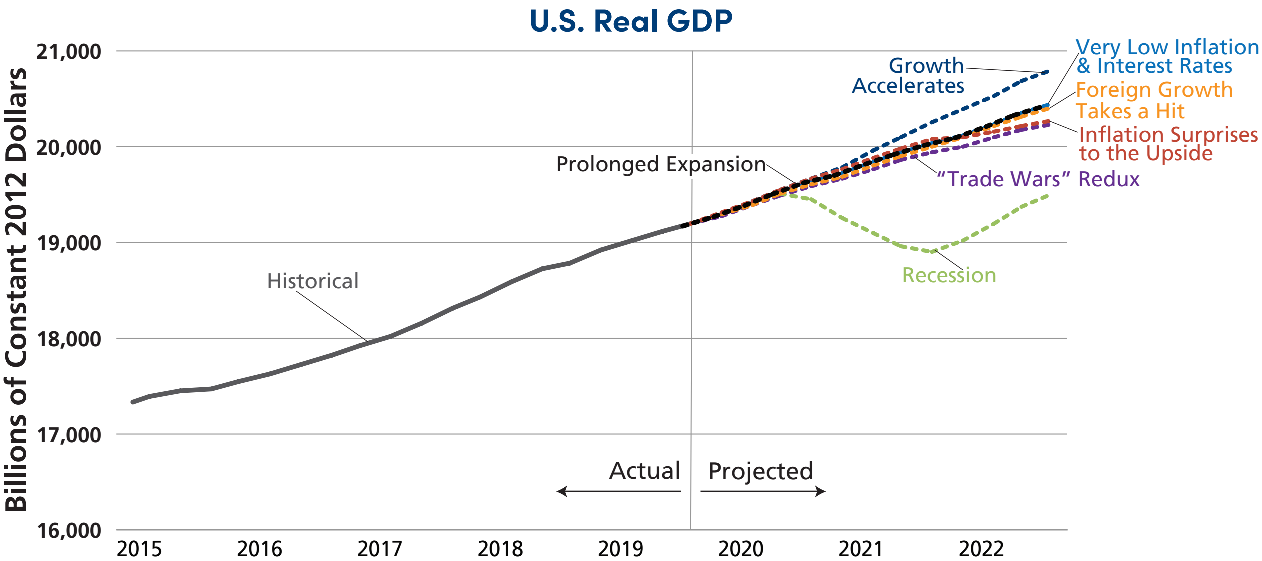
- **Accelerated Recovery.** A combination of vaccines and strategic, targeted lockdowns set up an unexpectedly robust recovery in the U.S. service sector as pent-up demand boosts growth across the board. Domestic economic output expands at well-above-potential growth rates throughout the forecast period. Federal fiscal stimulus on the order of $0.75 to $1.25 trillion is passed by Congress in 2021. Growth in business fixed investment is strong due to robust product demand and profits growth. As global demand stabilizes and supply adjustments lag slightly, commodity prices— including energy—advance but not sufficiently to accelerate inflation, which does not surpass the Fed's 2% target by more than 0.3 percentage points for any three consecutive quarters. The yield curve steepens moderately throughout the projection period.

- **Grinding Upward.** The domestic economy continues its recovery with real GDP expanding at a rate above its sustainable, long-term trend. The economy returns to its pre-pandemic level of output in late 2021 and potential output in late 2024. Fiscal stimulus on the order of $1.25 to $1.75 trillion is passed by Congress in 2021; no additional pandemic-related fiscal spending packages occur thereafter. Although a higher regulatory burden subtracts a couple of basis points from economic growth, it is not material when compared to the post-pandemic bounce-back. Tax rates on individual and corporate incomes increase modestly. Inflation creeps up, but it does not surpass the Fed's 2% target by more than 0.3 percentage points for any two consecutive quarters. The Fed maintains interest rates near zero. Long-term Treasury rates begin to inch up in 2021 as term premiums start to normalize.

- **Global Economic Boom.** Domestic economic output expands at well-above-potential growth rates during 2021 through 2023. Aggressive fiscal and monetary stimulus programs in Europe and emerging markets help foreign economies emerge from the COVID-19 pandemic with 1) sizeable pent-up demand and 2) consumers and businesses with the financial wherewithal to support that demand on the world's markets. Rebound in global trade helps fuel the global recovery. Labor markets tighten around the globe. Global demand growth materially outpaces supply; commodity prices—including energy—advance, putting upward pressure on inflation. Growth in business fixed investment is strong due to robust product demand and profits growth. Short-term bottlenecks become a problem. The dollar weakens notably as capital is attracted to rapidly improving business conditions outside of the United States. Global inflation and inflation expectations move up, but U.S. inflation does not materially surpass the Fed's 2% target. As prospects for growth significantly improve, the real federal funds rate approaches neutral by the end of 2023. Yield curves steepen nearly everywhere.

- **Mild Recession.** The COVID-19 pandemic's effects persist longer than expected, leading to additional shutdowns and business interruptions well into 2021 and provoking a mild recession during the first half of the year. Political squabbling forestalls Congressional action on a federal fiscal stimulus until the reality of recession hits. In mid-2021 a package on the order of $1.5 to $2.0 trillion is passed. As demand weakens during the recession, commodity prices—including energy—along with prices of manufactured products soften notably. Inflation falls below 1.0%. Long-term Treasury rates remain low. The yield curve only begins to steepen slightly toward the end of 2022.

- **Emerging Markets & Europe Struggle to Recover.** As the U.S. economy powers ahead and heals from the Great Shutdown, output returns to pre-pandemic level in late 2021. In contrast, emerging markets struggle to cope with the COVID-19 pandemic while Europe grapples with both COVID-19 and adjustments to the negotiated Brexit. Both regions experience anemic growth that is not enough to meaningfully offset their cumulative economic output gaps. Fiscal packages are relatively timid and late. Poor global economic conditions support a stronger U.S. dollar, but imply weak global profits, weak U.S. exports, and weak global inflationary pressures. As global demand fails to close the gap between demand and capacity, commodity prices initially slip downward before stabilizing. Weak global capital investment and demand for debt funding suppresses long-term interest rates.



Calculating Expected Total Return Estimates

Estimates of expected returns for the 19 asset classes used by AMG to develop clients' strategic investment plans are provided for each economic scenario. These estimates for the aggregate of investment in each asset class were obtained using the following procedure.

- Identify key economic indicators—the most prominent of these are growth in real GDP, consumer price inflation, long-term interest rates (10-year Treasury bond yields), short-term interest rates (90-day Treasury bill rates), oil prices, and changes in the foreign-exchange value of the dollar (trade-weighted index).
- Develop projections for the numerical values of the various economic indicators that are consistent with each scenario.
- Enter the projected indicator values, together with certain other data, in AMG's proprietary investment-return models.
- Apply the extensive judgment and experience of AMG's research staff to analyze and adjust the results obtained from the investment-return models to calculate expected return estimates.

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