ITASCA BANK & TRUST
ECONOMIC OUTLOOK AND INVESTMENT POLICY

Q3 2021

ECONOMIC FACTORS	CURRENT OUTLOOK
U.S. GDP Growth	The median projection for 2021 U.S. GDP growth in a Bloomberg survey of economists rose to 6.6% in July from 6.2% in April with a range of 2.4% to 7.7%.
Federal Funds Rate	Market participants are pricing in the first 0.25% Fed rate hike by December 2022 and three hikes by December 2023 as implied from the U.S. OIS Curve.
Inflation	Expectations for average annual inflation over the next five years derived from U.S. TIPS breakevens declined to 2.50% after peaking at 2.77% in mid-May.
Employment	According to the NFIB's June survey, a record net 28% of U.S. small business owners reported plans to fill open positions over the next three months.
Consumer Confidence	The Conference Board's June survey of 3,000 U.S. households reached its highest level since February 2020 driven by consumers' assessment of labor conditions.
Oil	A failure between OPEC and its allies to reach a production agreement in early July could enable oil prices to continue grinding higher in the second half of 2021.
Housing	Limited supply, elevated home prices and raw material inflation are likely to at least partially offset robust housing market demand in coming quarters.
International Economies	The median projections for 2021 GDP growth in the euro zone, China and Japan, based on recent Bloomberg surveys of economists, are 4.5%, 5.6% and 2.6%, respectively.

FIXED INCOME

	MINIMUM		NEUTRAL		MAXIMUM
FIXED INCOME		●			
Core Bonds			●		
TIPS				●	
Non-Investment Grade				●	
International	●				

CURRENT OUTLOOK

We believe an underweight to fixed income in multi-asset class client portfolios remains appropriate. The total return prospects of high-quality bonds is likely to be capped over the next 6-12 months amid an environment of strong economic growth and the potential for periods of elevated inflation. Within core segments of fixed income allocations, we think a moderate duration underweight relative to benchmark is sensible given our base case of gradually higher government bond yields over the second half of 2021. Although they are not a perfect hedge for inflation, we believe an allocation to Treasury Inflation-Protected Securities (TIPS) should continue to help dampen the volatility of fixed income allocations compared to nominal U.S. Treasuries. Outside of core fixed income, we believe high yield bonds and preferred stocks will continue to benefit on a relative basis from of a benign credit environment and above-trend economic growth.

EQUITIES

	MINIMUM		NEUTRAL		MAXIMUM
EQUITIES				●	
Large Cap				●	
Mid Cap				●	
Small Cap				●	
Developed International		●			
Emerging Markets		●			

CURRENT OUTLOOK

Despite elevated valuations and concerns about the impact of inflation, we believe an overweight to equities relative to high-quality bonds and cash remains justified. Although the rate of change in policy support is decelerating, U.S. consumers are expressing increasing levels of confidence and their balance sheets are at their healthiest levels in a generation. Any improvements in the pace of the labor market recovery should further boost consumer sentiment. U.S. corporations have vastly improved their balance sheets over the last 12 months and are poised to generate strong profit growth in 2021 and 2022. Finally, another phase of the economic reopening could emerge in September as schools reopen, summer vacation season ends and pandemic-era supplementary unemployment benefits are set to expire. Within equity allocations, we favor increasing exposure to the most GDP-sensitive areas of the market including domestic mid cap, domestic small cap and emerging markets. These areas are more closely tied to the business cycle and should experience a disproportionately stronger boost to revenues and earnings than other areas of the market.

ALTERNATIVES*

	MINIMUM		NEUTRAL		MAXIMUM
ALTERNATIVES*				●	

	CAP PRES	IWSG	BAL	GWSI	GROWTH
Global Real Estate					
Global Infrastructure					
Gold		●	●	●	
Hedged Equity	●	●	●	●	●
Arbitrage	●	●	●		

CURRENT OUTLOOK

We believe an allocation to alternative asset classes and strategies remains appropriate despite expectations for above-trend economic growth in 2021. This is driven by our view that alternatives can be an effective portfolio diversification tool in an environment characterized by bouts of policy uncertainty and a low risk-free rate. Within an alternatives allocation, we believe an allocation to gold should help most client portfolios better navigate the next 6-12 months. This is largely based on our observation of gold's tendency to behave as a safe-haven asset in periods of market stress and the potential for it to benefit from U.S. dollar weakness and negative real (inflation-adjusted) interest rates. Our diversified alternatives portfolios, as seen in the table to the left, are designed to decrease the overall risk profile of our five investment objective-based portfolios (CAP PRES, IWSG, BAL, GWSI, and GROWTH).

The above minimum/neutral/maximum recommendations represent MainStreet Advisors' current positions relative to our Strategic Asset Allocation ranges. Views expressed have a six- to twelve-month horizon and are those of the MainStreet Advisors Investment Committee.

*Cap Pres: Capital preservation; IWSG: Income with some growth; Bal: Balanced; GWSI: Growth with some income

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