QUARTERLY MARKET REVIEW

FOURTH QUARTER 2020

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JANUARY 25, 2021

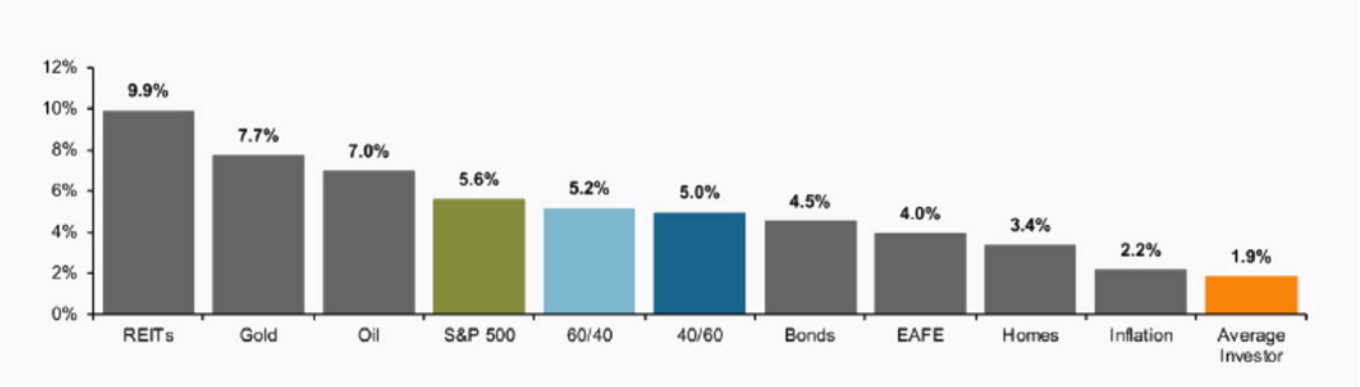
Dear Investors,

After a record, and generally steady year in 2019, we assumed potential volatility in 2020, although we never could have anticipated the extent of it. Between the Coronavirus (which is obviously far from over), the ensuing economic shutdowns, social injustice & unrest, and political stress, 2020 was one of the more challenging calendar years we have ever experienced. That said, taken in its entirety, 2020 was ironically another terrific year for the equity markets. Following the shocking 33.47% decline from February highs to March lows, the S&P 500 rallied an equally impressive 65.19% through the remaining nine months of the year to finish up 18.40%.[1]

Three very important core principles of investing were reinforced throughout this black swan year: 1) the market is an anticipatory organism, easily capable of looking out 6 to 12 months into the future 2) attempting to time the market can lead to impairment of capital that may be extremely difficult from which to recover 3) maintaining one's discipline and commitment to a longer term plan is imperative during periods of volatility.

Regarding the market's ability to look to the future, we saw this in March 2009 when the economy was shedding over 700k jobs a month, reminiscent of 1929, and again in March of this year.[2] Often when the environment on Main Street seems as though everything is going wrong, that is when Wall Street is preparing for better times ahead. It is during these periods that removing the emotion from one's investment decisions is most difficult, while at the same time most important. The following graphic is telling. The reason "average investors" tend to underperform is not because they consistently select losing investments; rather, their underperformance is driven by attempts at market timing fueled by emotion.

20-YEAR ANNUALIZED RETURNS BY ASSET CLASS (1999–2018)



Source: J.P. Morgan Asset Management; Barclays, Bloomberg, FactSet, Standard & Poor's

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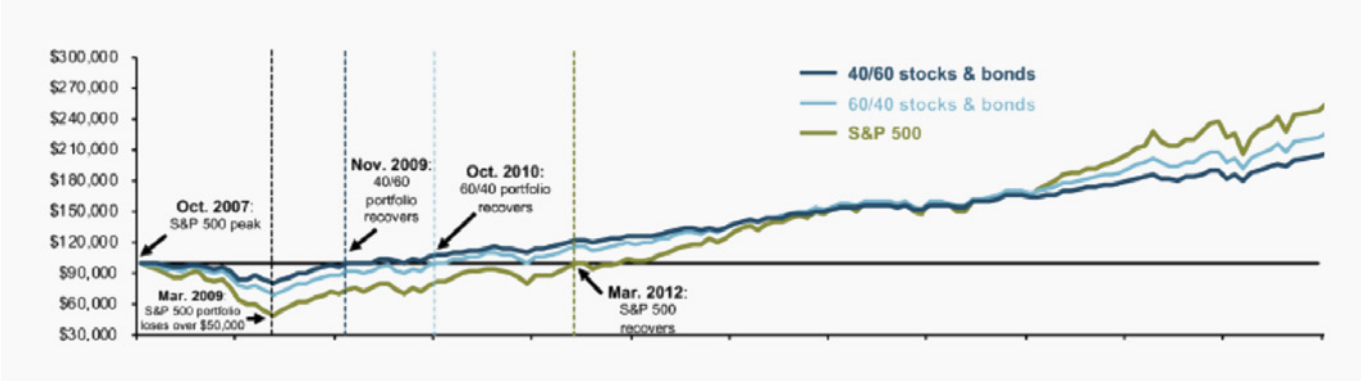
The most effective way to take emotion out of the decision-making process is to have a well-defined, balanced plan to believe in. 2020 being a case in point, none of us are able to predict unknowns to come, although we can be prepared for them by understanding how various investments may interact given potential market environments. We do not suggest diversifying for the sake of diversification, nor would we suggest exposure to an asset class because modern portfolio theory says we should. We do spend a lot of time and resources sourcing and studying investments designed to interact and perform together through varying market conditions. In order to remain calm and confident during periods of market weakness, we must have confidence in our investments that are structured to preserve capital. Likewise, during periods of growth we must not get tempted to abandon these same investments to chase performance. As you can see below, balanced portfolios outperformed the S&P from 2007 to sometime in 2015 due to market volatility. It was not until five years in, to the longest bull market in history that the S&P was able to catch up.

PORTFOLIO RETURNS: EQUITIES VS. EQUITY AND FIXED INCOME BLEND



**Source: J.P. Morgan Asset Management; Principles for successful longterm investing, pp. 8*

Many of our clients, as well as other investors, are concerned about the prospects for economic growth as this would affect corporate earnings and, consequently, the financial markets. Over the medium and long term the economy's growth is largely determined by the increase in labor force and productivity growth. As long term investors, it is important to be attentive to trends in the latter. Productivity growth is what allows our economy to produce more with the resources we have, and thereby improve our standard of living. That is what powered U.S. growth over the last century as the percentage of our workforce employed in agriculture fell from 41 percent in 1900 to 1.9 percent in 2000. This has allowed for the release of resources to other sectors of the economy, even while agricultural output still rose sharply. [3]

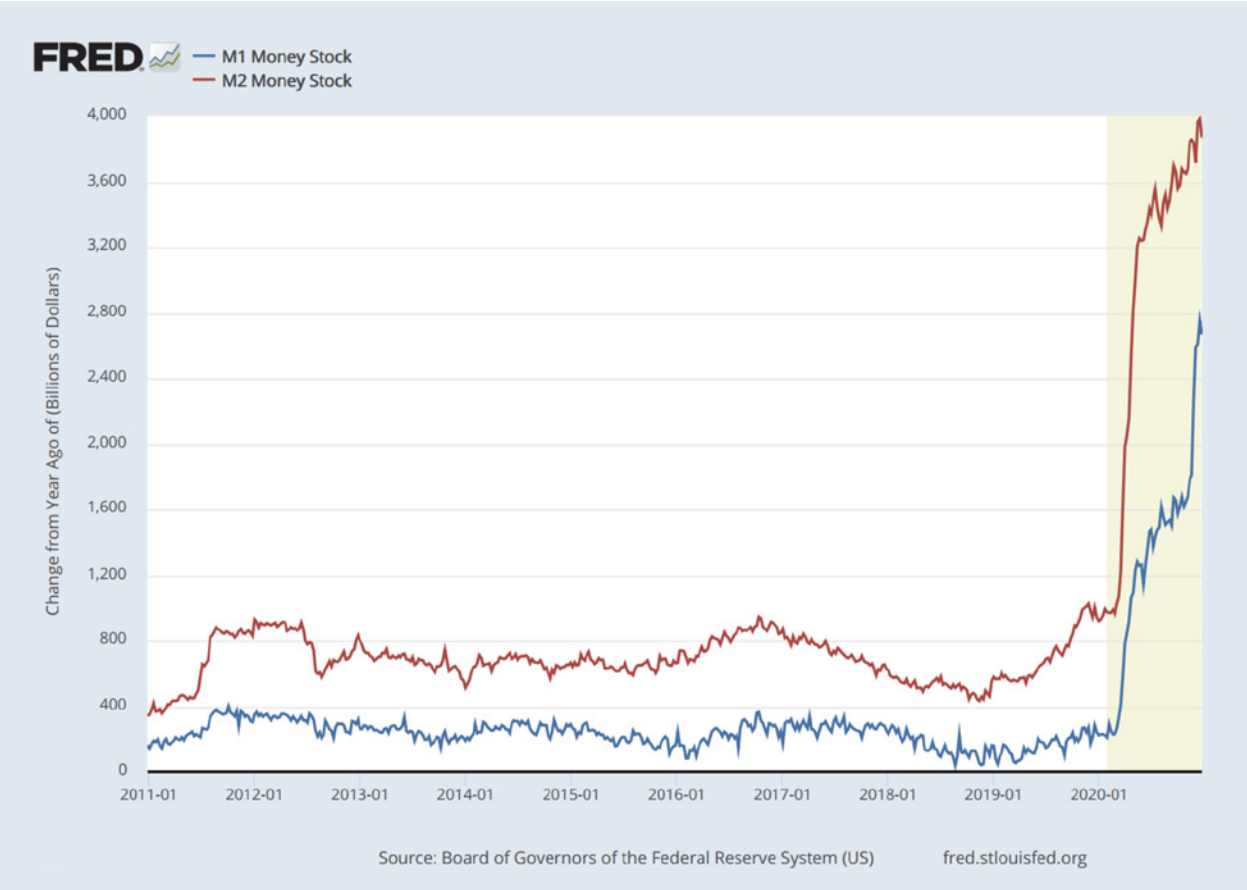
As we are all aware, we are witnessing important technological changes in virtually all aspects of our lives and which may have similarly dramatic effects across our economy. It should be acknowledged that there is a dark side to productivity growth as workers are temporarily displaced, firms go out of business, and some sectors of the economy decline in importance. However, on the other side of these changes, per capita income and living standards usually rise as resources are reallocated to more productive sectors of the economy.

The most recent downturn early last year set up important opportunities for productivity growth. Goldman Sachs estimates that trends observed in 2020, induced by the recession and the pandemic, may add about 1.3% annually to productivity growth over the next 3 years. While this may not sound like a lot, this increase would nearly double

the rate of productivity growth of 1.4% observed from 2010 to 2019. Among the contributors to this acceleration are reductions in costs, after a very long expansion during which firms lacked the urgency to tackle costs, cutbacks in office space, travel, and entertainment (some of which may be permanent), and inroads made by ecommerce at the corporate as well as at the consumer level. A recent and unique phenomena is the repurposing of the household sector's capital stock to the production of goods and services; that is, the use of private autos by Uber and Lyft to provide transportation services, the use of home computers for business purposes for those working at home, and the adaptation of home space for productive purposes — all contributing to output without additional corporate investment.[4]

Assuming the projected acceleration in productivity growth materializes, it should not only result in higher economic growth, it will also likely restrain inflation thereby improving the chances for a longer expansion. Both have positive implications for financial markets over the medium and long term.

The critical support provided by the Government spending and the increase in liquidity injected by the Fed were major factors in the equity market's resilience, although are now becoming a potential cause for concern. The recent explosion in Government debt, and in the money supply, could leave the economy vulnerable to higher interest rates driven by a pick-up in inflation. The following chart illustrates the magnitude of the expansion in money supply over the last 12 months:



Although we remain constructive on the economy, considering the amount of money that has been pumped into the system (M1 was increased by approx. 67.47% in the last 12 months), the debt that has been created, as well as the eventual possibility for inflation, we would recommend maintaining ballast in all portfolios.[5]

As always, navigating the financial markets remains a balancing act between many known and unknown inputs. The amount of unknowns are always heightened during a change of administration, especially during a transition like this one. We certainly hope for continued progress on vaccine production and distribution, while we continue to diligently study inputs, the reactions of our investments and the balance of your portfolios.

Here is to a healthier year ahead!

Warm Regards,

Chris

CHRISTOPHER SARGENT
Principal

Ricardo

RICARDO ROSENBERG
Principal

Brian

BRIAN McGREGOR
Principal

P.S. One regulatory housekeeping item; with the recent additions to our team we have updated our ADV Part 2B, which we have included herein.

Important Considerations:
The views and opinions expressed are for informational purposes only as of the date of writing and may change at any time based on market or other conditions and may not come to pass. This material is not intended to be relied upon as investment advice or recommendations to buy or sell securities. The information provided is taken from sources we believe to be reliable but it has not been independently verified. All investments carry a certain degree of risk and there is no assurance that an investment will provide positive performance over any period of time. Past performance is not a guarantee of future results.

[1] *Source: Orion Advisor Solutions*
[2] *Tappe, Anneken, and Annalyn Kurtz. "The US Economy Lost 701,000 Jobs in March - Worst Report since 2009." CNN, Cable News Network, 3 Apr. 2020*
[3] *Source: Compiled by Economic Research Service, USDA. Share of workforce employed in agriculture, for 1900–1970, Historical Statistics of the United States; for 2000, calculated using data from Census of Population; agricultural GDP as part of total GDP, calculated using data from the Bureau of Economic Analysis.*
[4] *Goldman Sachs. "US Daily: The Work-from-Home Windfall: A Productivity Update (Hill)" 23 Dec. 2020, pp. 1–2.*
[5] *Board of Governors of the Federal Reserve System (US), M1 Money Stock [M1], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/M1, January 7, 2021.*

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