January 2021

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MARKET SUMMARY

Equities

MSCI AC World	646.3
Price / Earnings	24.5x
Dividend Yield	1.9%
S&P 500	3,756
Price / Earnings	27.0x
Dividend Yield	1.5%

US Interest Rates

2 Year Treasury	0.1%
10 Year Treasury	0.9%
30 Year Treasury	1.6%
Bloomberg US Agg.	1.1%

US Corporate Spreads

Investment Grade	1.1%
High Yield	4.4%

Equity Volatility

CBOE SPX Volatility	22.8

US Economic Figures

GDP Growth 3Q20	+33.4%
Unemployment	6.7%
Inflation (core)	1.6%
Fed Funds Rate (mid)	0.1%
3 Month LIBOR	0.2%

Commodities

Oil (Brent)	$51.80
Natural Gas	$2.54
Copper ($/lb.)	$3.52
Gold ($/oz.)	$1,898

Foreign Exchange

Euro	$/€	1.22
Japanese Yen	¥/$	103
Chinese Yuan	元/$	6.50

Market summary data as of:
December 31, 2020

Light Shines Through

Necessity is indeed the mother of invention. After many months in the fight against COVID-19, successful vaccine trials and government approvals were announced in December. It’s quite an achievement to develop effective vaccines in only 10 months – work which normally takes several years and a testament to human ingenuity and international collaboration. Along with antibody treatments, the vaccines mark the beginning of the end of the pandemic – light at the end of the proverbial tunnel.

They’ve arrived not a moment too soon. A global surge of infections, spurred by “precaution fatigue”, year-end holiday gatherings, and the emergence of more contagious strains of the virus, is setting back the progress in economic recovery of the prior six months. Several countries and some areas in the US have reinstated lockdowns and travel restrictions.

Exhibit 1: Global COVID Surge

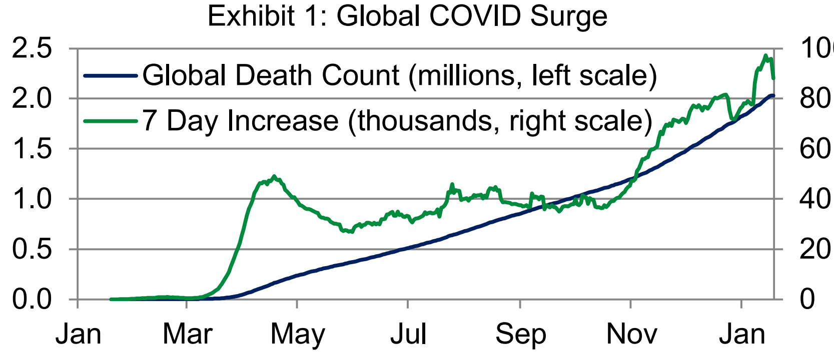
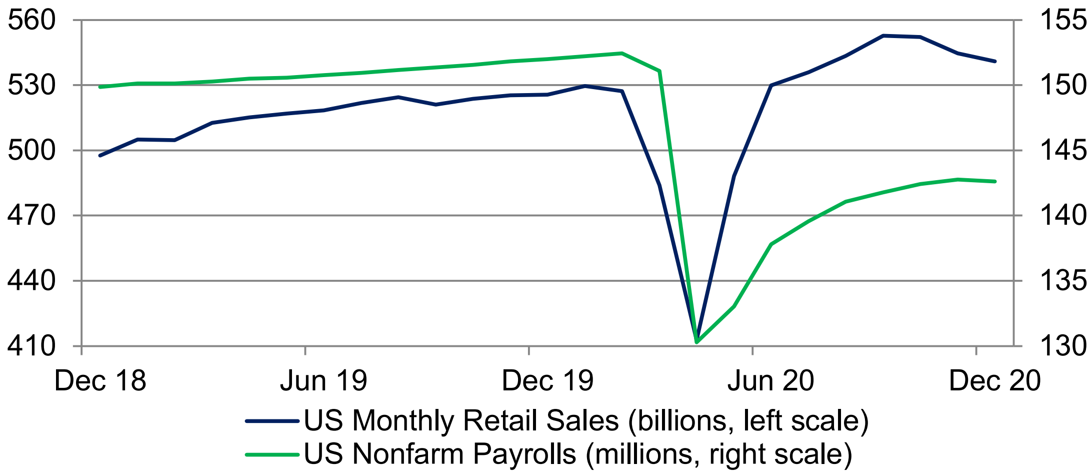


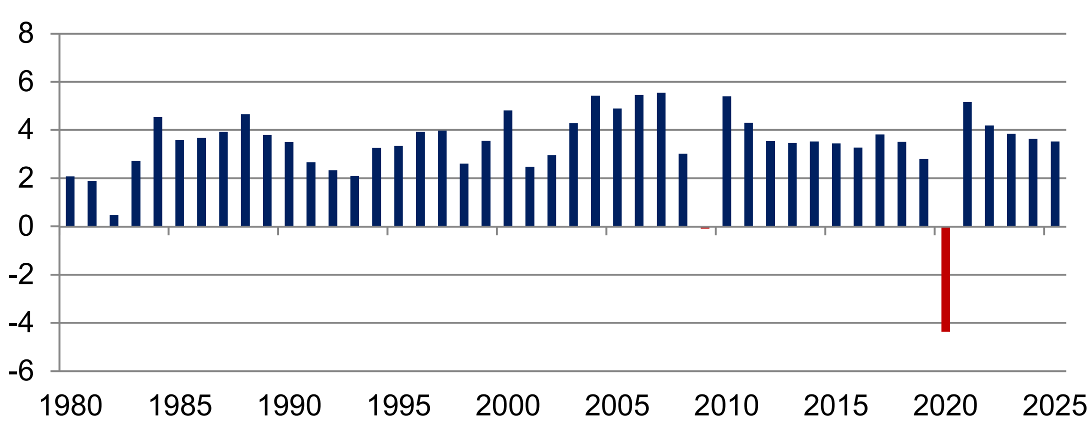
Exhibit 2: Recent Weakening in Retail Sales and Employment



Economic data such as retail sales and employment reveal the stiffening headwind from the pandemic's "third wave". Moreover, the Centers for Disease Control and Prevention estimates that a new strain of the virus (B.1.1.7), first detected in the US in recent weeks and 50% more contagious, will be the predominant strain in the country by March and will require a higher level of population immunity (80%) for the pandemic to be brought under control. This tough reality highlights the need for speed in identifying additional vaccines and in the manufacturing and distribution of vaccines and treatments known to be effective.

Acknowledging today's worstening infection trends and slower than planned vaccinations, we expect improvement as the year progresses. Vaccine and antibody manufacturers are boosting production, and the initially maladroit logistics around mass inoculations can only get better. As such, we continue to expect 2021 to offer broad, if occasionally stuttering, improvement from 2020. A rising immune proportion of the population should pave the way for a normalization of activity, particularly in hard-hit sectors like restaurants, hospitality, travel, and entertainment. A bounce back in such labor-intensive service industries can help bring employment back toward pre-pandemic levels. We may even see a catch up in pent up demand as people seek experiences denied for many months. Speaking personally, we're keen to eventually travel to see family, dine in a restaurant, catch a movie on the big screen, and take in a concert!

Exhibit 3: International Monetary Fund Global GDP Forecast – Recovery in 2021



Financial markets reflect expectations for further economic recovery, particularly after gains in the final months of last year. Moreover, investors are not just seeing past the current pandemic challenges toward improved conditions. They're also banking on persistent low interest rates and enduring monetary and fiscal stimulus for an economy that may soon need less government life support. In that regard, valuations and speculative behavior tell a story of great, and possibly excessive, enthusiasm.

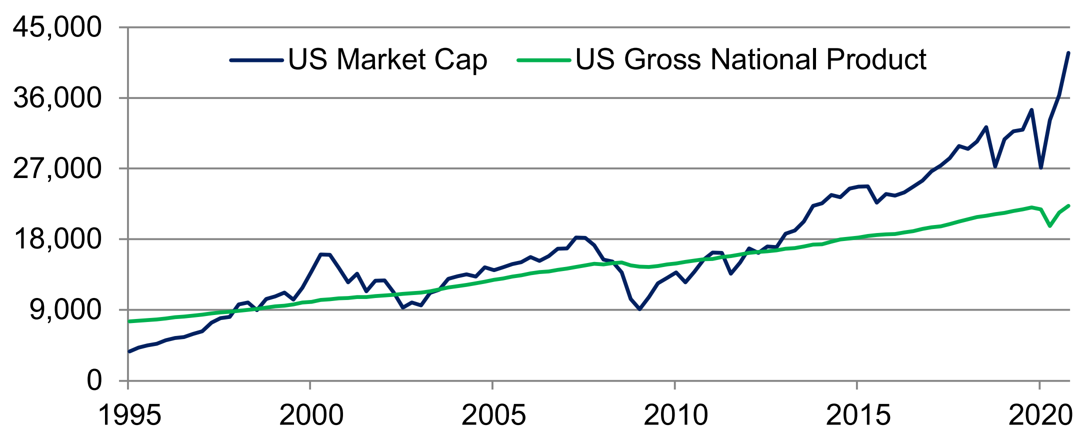
Stock prices and corporate earnings expectations have markedly diverged. In contrast to earnings expectations for this year that fell by 13% domestically and 15% internationally over the last twelve months, stock prices rose by 19% in the US and by 8% outside the US. Resulting price-to-earnings and price-to-cash-flow valuations are very well above historical average, especially in the US where they have reached an all-time high.

Exhibit 4: 2021 Fundamentals & Market Prices

	Prior 12 Months Change		Price / Earnings		Price / Cash Flow	
	Estimated Earnings	Stock Prices	Current Valuation	15 Year Average	Current Valuation	15 Year Average
USA	-13.4%	+19.2%	27.3	16.6	17.3	10.6
International	-14.9%	+8.2%	21.6	14.0	12.2	8.8

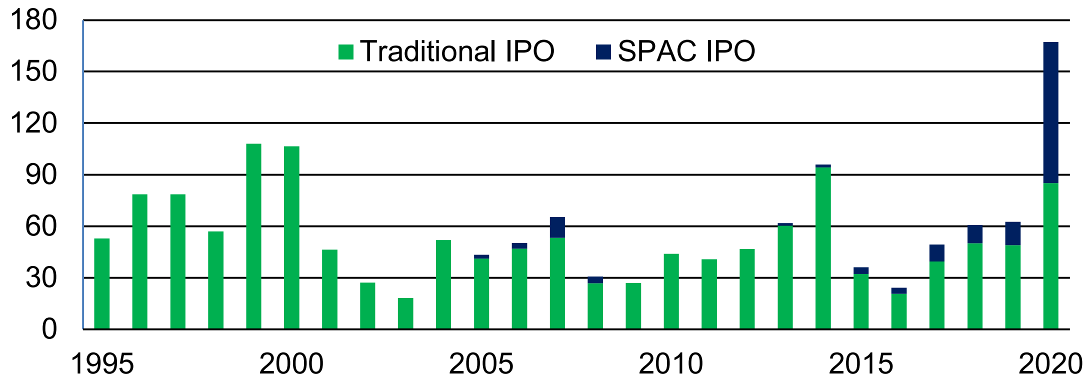
Another indicator of stock prices relative to underlying fundamentals is the so-called "Buffet Yardstick", a comparison of total stock market capitalization with gross national product that the famed investor calls "the best single measure of where valuations stand at any given moment". It's a rough gauge that's more conceptual than precise, but it supports the notion that US stocks are now quite highly valued versus history.

Exhibit 5: "Buffet Yardstick" ($ Billions)



Investors, meanwhile, are showing much more willingness to speculate. Mobile phone based stock trading apps have become popular for buying shares of companies whose businesses often catch more imagination than earnings. The value of initial public offerings (IPOs), historically a barometer of market exuberance, soared last year more than 50% higher than the prior record. More so, nearly half of IPO value was for SPACs (Special Purpose Acquisition Companies), which give the issuer a blank check to take an unspecified company public by acquiring it. Every major stock market has regulations requiring a company issuing publicly-traded shares to disclose detailed information about its business, financial situation, management, and risks to inform investors and protect them from fraud. SPACs circumvent these rules and provide a “back door” to going public with no disclosures.

Exhibit 6: Annual Value of US Initial Public Offerings ($ Billions)



Very high valuations and speculative fervor signal risk in financial markets which we try to manage on behalf of clients. Favoring securities with lower relative valuations while avoiding areas that appear to be priced too high versus earnings or yield is part of that process. We’ve discussed in prior letters the high market capitalization of “growth at any price” stocks, some of which have no profit, and bonds with yields well below inflation as presenting potentially lower-than-normal forward returns and higher-than-normal risk.

Ironically, higher interest rates spurred by economic improvement could correct some of the excesses we’re seeing in markets. Large portions of the economy, such as consumer spending and manufacturing, have recovered substantially from the acute contraction of the second quarter. Further improvement through 2021, especially if we see recovery in service sector employment and release of pent up demand, could put upward pressure on inflation and yields. Democratic Party control of the presidency and both houses of congress sets the stage for more

Exhibit 7: Long-Term Yields Unusually Low Versus Economic Momentum

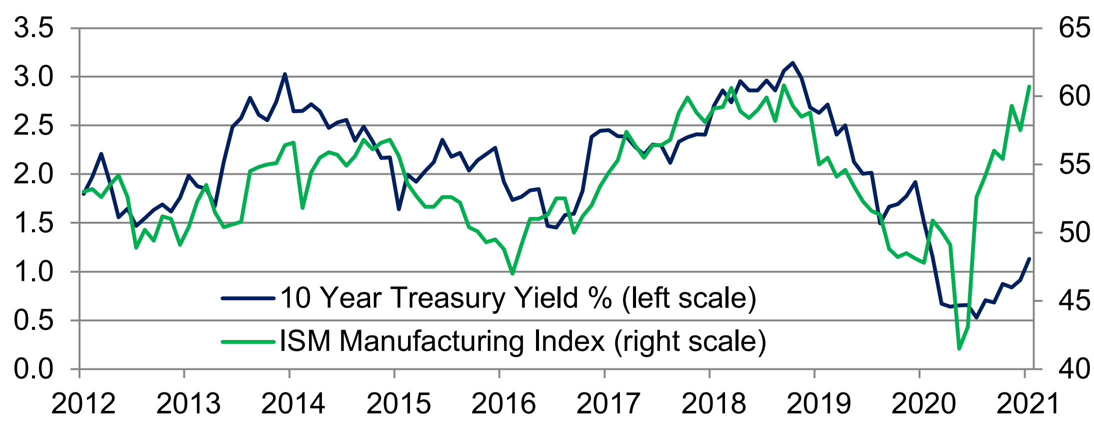
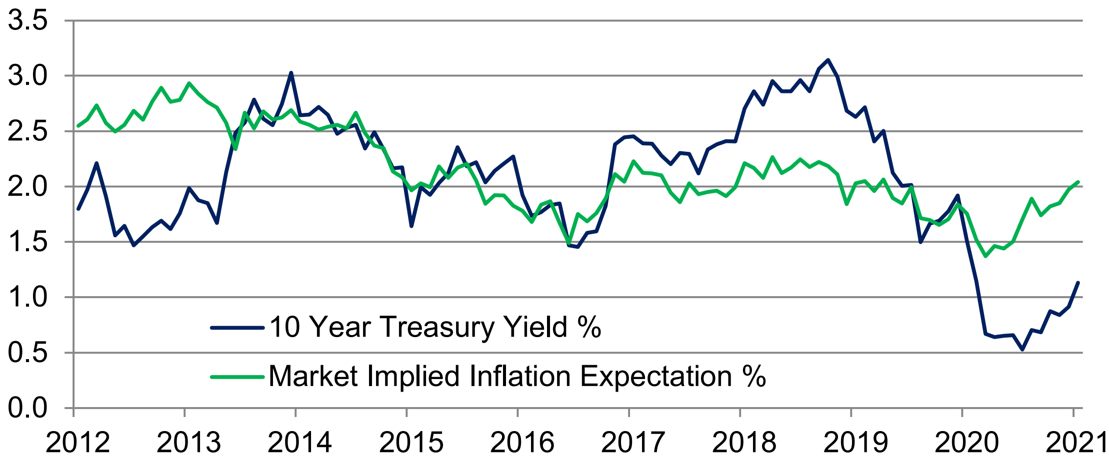


Exhibit 8: Long-Term Yields Below Inflation Expectations



government spending in the name of COVID relief and a possible short-term bump up in the economy that is already poised to see an above-trend pace of recovery.

If 2021 proves to be a year of returning to normal and catching up from activity that was missed in 2020, a change of market leadership is in order. Stocks trading at very high valuations versus earnings, especially those of companies that benefitted most from people staying at home, could be pressured if long-term rates rise and make future profits worth less today and if consumers resume prior habits. Bonds with lengthy maturities could see price declines based on higher rates. Relative performance of those winners of 2020 could give way to leadership by stocks with more cyclical, value, and international characteristics and by bonds with shorter maturities and exposure to an improving credit cycle. Client portfolios are positioned in these areas to benefit from a return to economic and market normalcy while protecting capital from extreme valuations.

We hope this review of the economy and markets helps inform you on how we're managing the capital you've entrusted to us, and we would be pleased to have a discussion with you via phone or video call. We hope the best for you in the new year and are grateful for the opportunity to work with you.

With best regards and wishes to your health and safety,

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