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Portfolio Comments
For the Quarter Ending March 31, 2021

March 23rd marked the one-year anniversary since last year's U.S. equity market low, which was brought about by the pandemic-induced selloff that dragged the S&P 500 down 34% in the space of about a month. Confronted by so many unknowns, and against the backdrop of economies being shut down worldwide, fear was a warranted response, and the markets reflected this. Yet here we are, a full year later, and the world has demonstrated that our collective resilience and ingenuity have allowed us to move forward in the face of that fear. COVID-19 is not eradicated, but large-scale vaccination programs are proving successful in mitigating its effects and spread. In addition, fiscal and monetary policy makers have stepped up on an extraordinary scale to ward off what could have spiraled into a worldwide economic catastrophe.

The recovery game isn't over, but there has already been a fair amount of Monday morning quarterbacking over the scale and distribution of spending measures. We too are not agnostic on these issues, but we echo Fed Chairman Jerome Powell's sentiment, that "now is not the time." Spending and balance sheet expansion cannot balloon ad infinitum, but growth and employment must be prioritized over premature curtailment of direct support if the recovery is to maintain its momentum. There is no doubt that decisions being made today will have lasting consequences, but reactionary measures are comprehensible in the face of extraordinary trials.

In any event, the markets are not complaining. The S&P 500 ended the first quarter of 2021 at 3,973, delivering a return of 6.18% for the year to date. The Dow Jones Industrial Average (DJIA) ended March at 32,982 for a first quarter return of 8.29%. Both indices weathered some interim pullbacks since the start of the year to achieve record closing highs going into the end of the quarter of 3,975 for the S&P 500 and 33,171 for the DJIA. Rebounding off last year's precipitous dip, the S&P 500 has just experienced its best 1-year return since the 1930's.

Indicative of a strong comeback for traditional sectors that were more severely impacted by global shutdowns, the industrial-heavy DJIA outperformed the broader S&P 500, which in turn finished well ahead of the tech-dominated Nasdaq Composite for the quarter. This current sector rotation took place as some of the heady valuations in some big

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tech names came under pressure, and optimism grew that vaccination efforts were well on track to spur reopenings. Still, on a yearly basis, the Nasdaq remains the clear winner among the three spectacularly recovered indices. Of particular note for the traditional value investing universe, the Energy Sector managed to rise from the ashes of being the worst performer in 2020 to the top gainer year-to-date through the week ending March 25th, and Financials placed second having ranked third from bottom in 2020. Quite the comebacks, although with the jarring drawdowns and recoveries witnessed over the past twelve months, the devil is in the detail of the time periods performance is measured over.

While good news and COVID-19 are unlikely bedfellows, we can at least say that the trend data is very positive in the U.S. Recent data indicates that hospitalizations are down over 70% from the early January peak and the CDC (Centers for Disease Control and Prevention) reports that the current 7-day moving average of new cases has decreased close to 80% compared with the highest peak on January 11th. The U.S. COVID-19 Vaccination Program began December 14th 2020 and, according to the CDC, as of March 24th, 130.5 million vaccine doses have been administered, with about 26% of the U.S. population, having received at least one dose of vaccine, with this figure rising significantly to 70% for people over 65 years old. In addition, 44% of the over 65's are fully vaccinated. All of these figures are good news for the population and the re-opening of the economy.

We entered this year with the Presidential election results still being questioned by some, and January 6th brought us shocking scenes of agitators storming the United States Capitol in Washington D.C. immediately following a nearby rally held by President Trump. Consequently, the inauguration of the 46th President, Joe Biden, alongside his Vice President Kamala Harris, took place on January 20th amid heightened security. Following January Senate runoff elections in Georgia, Democrats and Republicans now split the Senate 50-50 with the Vice President able to cast a tie-breaking vote. This presents an opportunity to the Democratic Party, which now controls both the White House and Congress. Even so, the administration inherits a weighty agenda, as we continue to navigate issues relating to the pandemic, a resetting of diplomatic alliances with foreign nations, and a wave of migrants straining capacity at our southern border, among other pressing issues.

We remain in the throes of unprecedented levels of fiscal and monetary stimulus. To further kick start the economy, and provide relief to people and organizations negatively affected by the impact of the virus, Congress recently passed a $1.9 Trillion relief bill with payouts for individuals, vaccine and testing efforts, school systems, state and local governments, as well as decimated industries. The bill included $1,400 payments to most Americans and enhanced unemployment benefits to offset the pandemic's effects on household incomes. As part of its next initiatives to spur recovery and growth, the Biden administration has proposed an infrastructure and economic package totaling around $2.3 trillion to be funded, at least in part, by selectively increased taxes, including those on corporate profits.

The most recent bill adds to the trillions of dollars in financial assistance that Congress and the White House have already provided in response to the pandemic. The U.S. national debt currently stands at over $28 trillion. According to the Congressional Budget Office (CBO), U.S. government budget deficits are forecast to raise the federal debt to 102.3% of gross domestic product (GDP) by the end of the current fiscal

year. By 2031, the CBO anticipates this figure will be at 107% of GDP.

Nevertheless, in a recent interview, Fed Chair Jerome Powell expressed confidence that the government could manage its current level of debt, but that steps should be taken to slow its rise once economic growth has gained a strong footing. Specifically, Mr. Powell said in a recent interview that: "Given the low level of interest rates, there is no issue about the United States being able to service its debt at this time or in the foreseeable future." Janet Yellen, the recently appointed Treasury Secretary and former Fed Chair, noted that the interest burden for the federal government is below that of 2007 levels despite the ratio of debt to GDP nearly tripling.

As anticipated, the Federal Reserve at its latest FOMC (Federal Open Market Committee) meeting, kept the Fed Funds rate unchanged at 0-0.25%, with the majority of Fed officials anticipating this will be maintained through 2023. Signaling its bullish outlook for economic recovery, the Fed increased its GDP growth estimate for 2021 to 6.5% (up from 4.2%) and for 2022 to 3.3% (from 3.2%). With the unemployment rate at 6.2% in February, employment is still 9.5 million below its pre-pandemic level (a metric that may understate the situation as it excludes those who have dropped out of the labor force or are underemployed). To further help the situation, the Federal Reserve has committed to maintain purchases of $120 billion / month in Treasury Debt and Mortgage-backed securities, bringing its expanding balance sheet to $7.72 trillion as of March 22nd.

Despite the Fed pinning the short end of the yield curve at zero, there has been some upward pressure on longer-dated interest rates, reflective of some expectation of rising inflation brought on by the sharp expansion in the money supply coupled with pent-up demand clashing with ongoing supply constraints. The benchmark 10-year Treasury rate has been on a relatively steady upward trend these past three months, beginning the year below 1% and rising close to 1.75% by the third week of March before falling back slightly to leave us around pre-pandemic level, which is still low by historic standards.

Rising rates contributed to some frothier growth stocks taking a dip with their valuations sensitive to discounted future earnings (the higher the applied interest rate, the lower the present value of future earnings). Perception of incoming inflation also tends to cause a rotation into cyclical / defensive stocks as well as commodities, namely investments better positioned to pass on higher pricing. That said, credit spreads (interest charged above the risk-free rate) remain low indicating both confidence in potential economic growth and a continued hunt for yield.

Inflation, by official measures, has yet to materialize in any meaningful way, although the Fed has reiterated that it is committed to achieving an average rate of 2% over time, a level that has not been achieved over the past decade, as well as pursuing its goal of maximum employment. According to the U.S. Bureau of Labor Statistics, The Consumer Price Index (CPI) rose by 1.7% for the twelve months to the end of February. Powell has been dismissive of concerns that stimulus spending could trigger an inflation overshoot, saying that discrete spending surges only lead to temporary price increases. A contrarian view is that we are already witnessing evidence of price inflation in the stock market and other asset prices, including home-price growth in America which accelerated to a 15-year high in January as inventory shrank to a new low. The S&P CoreLogic Case-Shiller National Home Price Index reported an 11.2% year-on-year increase in average home prices in major metropolitan areas to the end of January. In

related news, building supply prices are also rising, with lumber in particular approximately doubling in the past year.

Having been under pressure for much of the past year, the U.S. dollar has risen over the past month and is moving above its 200 DMA (Daily Moving Average) although still on a downward trend. There are various forces at play. America's economic strength has been bolstered by the relative success of its vaccine program, and the dollar remains the world reserve currency accounting for the vast majority of trade exchanges, but the concept of American hegemony continues to come under pressure as economies evolve and national alliances are subject to shift. The sharp increase in U.S. money supply – directly in response to the pandemic – may also be exerting pressure, but we have not been alone in deploying this tool.

As was to be expected, the rollout of COVID-19 vaccines worldwide has not followed a homogenous path. At this time pockets of virus spread, including variants, and various hindrances to rollout have resulted in new stay-at-home restrictions in Europe, which will put a dampener on the region's roadmap to full recovery. It is a harsh choice between deaths and economic recovery but nations are having to make it, at least now aided by vaccine options. America is leading the charge for worldwide growth, with our trade deficit already more than 50% higher than before the pandemic, as we absorb imports. In the coming months the U.S. may even outgrow China where there is tightening monetary policy and a stock market that has tumbled over 15% from its February highs.

Back at home, against a backdrop of improving fundamentals and economics, analysts are busy raising earnings estimates for 2021. Sector rotation will likely remain a dominant trend and the rate of recovery will eventually abate. Outsized gains in the stock market over the past twelve months were tied to the outsized dip that preceded. The upward revisions are greatest in the deep cyclical areas of Energy, Materials, and Financials with these, together with Industrials and Consumer Discretionary, leading the pack for overall EPS (Earnings Per Share) growth estimates for this year according to Raymond James. Technology, a major beneficiary of the stay-at-home era, may continue to post gains although inflation expectation jitters may dampen valuation optimism for this sector with outlooks for Utilities, Real Estate and Consumer Staples potentially weakening alongside.

'Don't Fight the Fed' is an old adage made popular by legendary Wall Street investor Marty Zweig and Jerome Powell recently attested: "At the Fed, we will continue to provide the economy the support that it needs for as long as it takes." This is historically music to the ears of corporations and equity holders who stand to benefit from a low interest rate environment. This is no time for complacency, however, and we continue to monitor the market for signs of fragility. A short-seller squeeze triggered by an uprising of small traders centered on a number of so-called 'meme stocks' (for enquiring minds, we didn't participate!), or the liquidation of a highly-leveraged fund that hit the news, do not necessarily denote market-defining moments, but where there are signs of liquidity-induced bubbles, we need to be wary of pins. This is why we stick to what we can research and form a reasoned opinion on. Value investing skews towards results over story. We like a good story, we just don't like overpaying for one.

Spring has sprung, and from an economic and market standpoint it is far rosier than the one we were faced with last year. We hope, for you personally it is a rosy one too in all aspects, and

we appreciate your continued confidence and support as always.

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