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Investment Committee Perspective

First Quarter 2021

Our Investment Committee meets no less than quarterly to evaluate asset class performance, analyze macroeconomic data and trends, and review asset class valuations and risks in order to refine our market outlook and tactical portfolio positioning. This letter is intended to summarize the topics discussed during those investment committee meetings and provide guidance on our outlook and corresponding tactical investment strategy.

Reflection on the Market & Economy in 2020

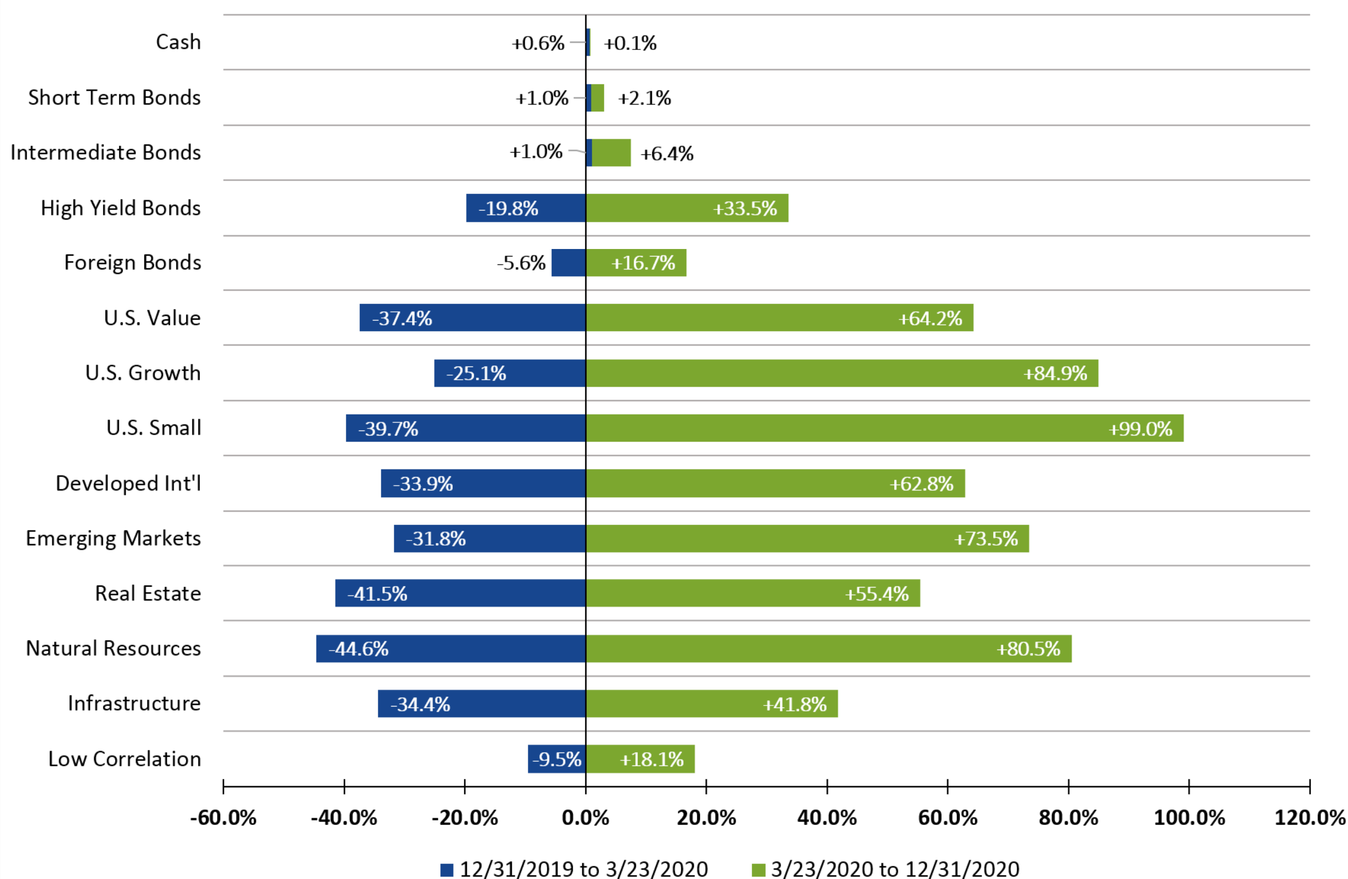
What a year. We entered 2020 conservatively positioned, tactically managing portfolios close to our long-term strategic asset allocation targets with a sizeable amount of U.S. Treasury bonds, as a means of mitigating risk to protect against a potential recession and equity market drawdown. In our first quarter 2020 letter sent only one year ago, although it feels like it has been a decade, we contended that the risk of a recession was elevated despite very strong 2019 market performance. One investment committee member aptly described it as we were "waiting for a glacier to melt". We all agreed that a recession was imminent but we had no idea that a virus pandemic, the likes of which haven't seen in over 100 years, was going to be the catalyst. The fact that few people were alive or old enough to remember the impact of those events makes it difficult to draw on past experience for wisdom or comfort. However, as history has repeatedly shown, both the stock market and humankind find ways to adapt and overcome.

One quarter later, we were living through an unprecedented pandemic that will go down in the history books for many reasons. We subsequently noted in our second quarter 2020 letter, while in the midst of the fastest equity market sell-off in history, that during all prior recessions since World War II that stocks tend to bottom on average six months *before* the end of the recession. Equity markets have a history as forward-looking, discounting mechanisms and we expected this time to be no different. We also noted that the historical 'playbook' for investing in bear markets and recessions is clear – to stay the course – while also selectively taking advantage of tactical opportunities where appropriate and maintaining a steadfast focus on your long-term investing objectives while not letting short-term behavioral instincts derail your plan.

As we look back on 2020, it is both remarkable and unsettling to reflect on the events that we all endured from a personal, societal, and economic perspective. Financially, we witnessed the most rapid stock market decline in U.S. history (-34% in 22 trading days) followed by the swiftest market recovery in U.S. history (+70% since the March 2020 lows). Global economies have made significant progress but are not yet back to their pre-pandemic levels and likely won't be for another year or two.

Together, we did just that. The stock market is prone to dramatic mood swings, and during recessions often exhibit whipsaw sentiment. During the course of many "emergency" investment committee meetings, and many understandably worried client conversations, we communicated the importance of being disciplined, focusing on the long-term, and "staying the course". While it is certainly an overused cliché in the investment industry, it proved once again to be the right course of action.

In the face of an incredibly challenging year for the markets, we were pleased to see client portfolios finish the year with above-average returns. Although the velocity of the market decline in the first quarter was unsettling, our decision in late-March to increase exposure to global equities proved beneficial as equities surmounted an incredible recovery and have rallied over 50% from March through the end of the year. To illustrate the magnitude and speed of the market decline and equally rapid and dramatic recovery, the chart below shows the first quarter (12/31/2019 – 03/23/2020) declines and subsequent recoveries (3/23/2020 – 12/31/2020) across all of the asset classes we manage in client portfolios. There exist numerous historical academic and scientific studies which indicate many unguided investors, due to behavioral instincts, unfortunately end up selling their long-term investments near market bottoms and then have no choice but to reenter markets after they had fully recovered which has proven to have a detrimental impact to their long-term returns. This substantial market downturn, and second largest U.S. recession in history, further reinforces the importance of staying invested.



Source: Tamarac | Envestnet, Causey Demgen & Moore P.C.

This quarter, we reflect briefly on the past year while focusing more on our outlook for 2021 and beyond. While risks certainly remain, the effective vaccines, promises of continued policy stimulus, and signs of a sustainable economic recovery are providing a reassuring light at the end of a dark tunnel. There is no question that economic and market conditions have improved markedly throughout 2020 and our expectation is they will continue to improve in 2021.

2020 Asset Class Performance Recap

While this past year was both devastating and turbulent, global equity markets were, miraculously, up 16.3% for the year. The surprisingly positive equity returns do not provide justice for the incredible level of market volatility and fear that investors faced through the year. Global equity markets were down anywhere from -30% - 40% during the first quarter. In March, when equity markets were in free fall, virus pandemic fears rampant, and global economies were seemingly falling off a cliff nobody (including us) predicted the markets would end the year even positive, let alone with above-average returns.

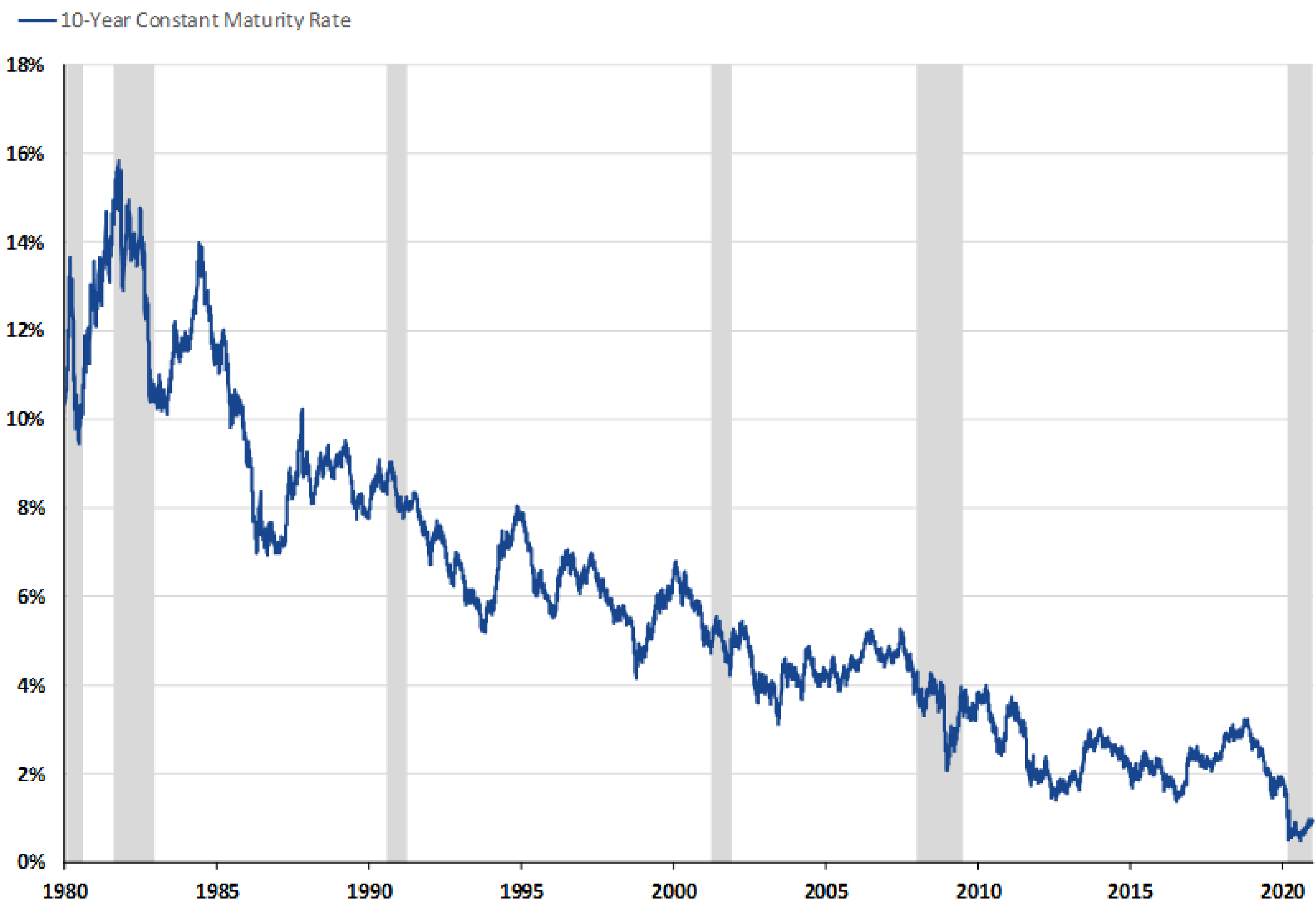
Equities weren't the only asset class that saw above-average gains for the year. In fixed-income, core bonds returned an impressive return of +7.5% for the year. Within Fixed Income, Short-term bonds were up +3.1%, Intermediate-term bonds were up +7.5%, High Yield bonds were up +7.1%, and Foreign bonds were up +10.1%. These are remarkable returns for fixed-income and we unfortunately do not anticipate returns anywhere close to these levels for years to come. In fact, due to both rising inflation expectations and interest rates, we are likely facing low single digit returns as interest rates gradually normalize.

Equities drove the charge through the market recovery. Performance was led by U.S. growth stocks, namely those companies which were poised to benefit from the pivot to remote working/learning/living. U.S. growth stocks were up 38.5%, while U.S. value stocks barely eked out a gain of +2.8%. We expect U.S. Value and U.S. Small-cap stocks to begin outperforming as we move along the economic recovery curve and are repositioning portfolios accordingly. U.S. small-cap stocks were up +20.0%, International Developed stocks were up +7.6%, and Emerging Markets were up +18.3% for the year.

The disinflationary shock, as a result of the coronavirus, showed the greatest impact on Alternative assets, which historically perform best during periods of rising inflation. Real Estate fell -9.1% and Natural Resources ended the year flat at -0.1%, Infrastructure struggled and lost -7.0% and Low Correlation assets were the sole positive performer up +6.8%. The Alternative asset class continues to play a critical role in portfolios despite its underperformance in 2020. We widely anticipate it will play an even more important role in 2021 and beyond and, as such, are now overweighting most sectors within Alternatives.

The first leg of the market recovery was driven by the unprecedented fiscal stimulus measures taken by Governments all over the world and the equally unprecedented monetary policy stimulus of the global Central Banks. These enormous and simultaneous policy actions unequivocally stabilized the financial markets and prevented the economic crises from being a more cataclysmic event akin to that seen during the Great Depression event of the 1920's. The joint efforts of fiscal and monetary stimulus have traditionally been referred to as a twin-bazookas, but the scale, speed, and magnitude of the efforts to combat the devastating impact of the coronavirus is more akin to a B-2 Bomber. The second leg of the market recovery was driven by the positive vaccine trials and efficacy outcomes which created a light at the end of the tunnel for the markets.

Of course, every action has an equal and opposite reaction and the monetary stimulus has driven interest rates to all time low yields. While this has been a longer-term (40 year) trend, it has accelerated this past year. The extremely low interest rates we face today create unique challenges for investors, particularly retirees that tend to be more reliant on Fixed Income as a percentage of their retirement assets. Interest rates are so low that near-term return expectations for core fixed-income are very low, and likely negative, after accounting for inflation as 1) nominal core fixed income yields are currently below expected inflation and 2) as nominal interest rates normalize (further driven by increasing inflation) to higher levels. The chart below illustrates just how long and how low interest rates have fallen since 1980.



Source: Board of Governors of the Federal Reserve System (US), Causey Demgen & Moore P.C.

While it has been a great past 40 years for Fixed Income returns, as bond prices rise when interest rates fall, it is likely we have seen the end of this long-term bull market for bonds. As interest rates normalize, and head higher, it is a dire outlook for core Fixed Income investments. In addition to the challenges that core Fixed Income present, the trillions of dollars spent and printed on building a bridge to the other side of the coronavirus pandemic is not free. We have spent trillions of dollars - albeit necessary given the circumstances - that we simply don't have. The implications of such will take years, perhaps decades, to fully realize but two very likely impacts are going to be higher taxes and higher inflation. Of the two, we are most confident that taxes are going to increase across the board – individual, corporate, capital gains, and estate taxes. While we don't anticipate tax legislation to occur in 2021, due to the negative effect raising taxes would have on the still recovering economy, it is likely we see tax legislation passed in 2022, probably retroactive to January 1, 2022. As such, this year will be a good year to prepare for higher taxes by revisiting your estate planning and reviewing your tax-efficient investments (and the location of those investments) from a tax perspective.

The 2020 Federal deficit is estimated to be $3.3 trillion while the 2021 Federal deficit is estimated to be $4.0 trillion adding to our ever growing national debt which is now at $28 trillion and climbing (https://www.usdebtclock.org/). The CBO projects the national debt will swell to an unfathomable $35.3 trillion by 2031. At some point, although we recognize pundits have been saying this for decades, we will have to pay this back. We have borrowed from the future and it is likely going to be a debt that our children, and likely their children, will have to face. In the meantime, politicians will continue to kick the can down the road until that road turns into a cliff. The cliff to watch out for may be less than a decade away when our Entitlement programs (Medicare and Social Security) are projected to become insolvent. At its current pace, Medicare will be bankrupt in 2030 and Social Security will go bankrupt in 2033. While there are ways to salvage our entitlement programs, none of the options are popular so it is likely our government we will wait until the very last minute to deal with these issues and by that point it may just be too late.

A more meaningful increase in inflation is the other risk and potential byproduct of the trillions of monetary stimulus that we unleashed to stabilize the financial markets. Further, U.S. consumers have saved almost $2 trillion dollars during the pandemic as a result of everyone staying at home that is likely to be unleashed once the pandemic ends. In addition, we are seeing substantial supply side constraints as global supply chains were dismantled as a result of the pandemic along with the rise in nationalism and general retreat from globalization. Add on trillions more in fiscal stimulus, along with a spike in raw materials (oil, steel, lumber, copper), and we are likely to see a meaningful increase in inflation. Adding exposure to asset classes (Equities, Natural Resources, Precious Metals, and Infrastructure) that have historically done well during periods of rising inflation is going to be an important inflation-hedging portfolio diversifier in 2021.

Tactical Market & Economic Outlook

Even as we face extraordinary longer-term secular risks and fiscal deficit/debt mountains to climb, there are reasons to be optimistic for the economy and the markets in 2021. The increasing pace of widespread vaccine distribution supports the case for a continued economic recovery for the remainder of the year and into 2022. Global central bank monetary policy will remain accommodative for the next few years and fiscal policy, by all accounts, is also likely to continue to be stimulative, as evidenced by the recent passage of the $1.9 trillion economic stimulus. This monetary and fiscal stimulus backdrop will prove supportive to equities and other risk assets in 2021.

While U.S. stocks are trading at very high absolute valuations they look fair value-to-cheap relative to Fixed Income which has been driven by all-time low bond yields. International Developed and Emerging Market equity markets, Emerging in particular, have much more attractive valuations than U.S. stocks. We remain meaningfully underweight U.S. stocks and overweight International markets, and Emerging Markets specifically, for that reason. Foreign exchange (currency) is another potential tailwind for foreign stocks over U.S. stocks. As the global economic recovery continues along with the continued expansion of U.S. Fiscal and Monetary stimulus, the U.S. twin deficits are likely to continue to put downward pressure on the U.S. dollar. When the U.S. dollar declines, U.S. investors benefit as foreign stocks earn a positive currency return on top of the Foreign equity return.

The most significant challenge we face today is Fixed Income. While core bonds are still an important ballast in client portfolios and will still benefit portfolios during economic shocks, yields, both Treasuries and Corporate bonds, are the lowest they've ever been. Even a modest increase in interest rates will lead to negative short-term returns for most Fixed Income. In fact, this is exactly what we have seen over the past few months as the 10-year Treasury yield has tripled from 0.5% to 1.5%. We are tactically reducing Fixed Income in client portfolios due to these concerns.

In 2019, we added meaningful U.S. Treasury bond exposure to client portfolios in anticipation of a recession (not knowing it would be a global virus pandemic that would cause it). The Treasury bonds we added in 2019 performed admirably in 2020, returning, on average, 10% - 12% in client portfolios. However, looking forward over the next few years, due to the current level of incredibly low interest rates, we expect Treasuries will return low single-digits (before inflation) and possibly worse. Therefore, during the second half of 2020, we sold all of our clients' Treasury bonds exposures.

To replace core fixed-income (i.e. Treasury bonds), within our Intermediate bonds, we have increased our allocations to actively managed multi-sector strategies that have higher expected returns and lower interest rate risk. Within High Yield, we are adding back Senior Loans that are floating (not fixed) bonds. Senior Loans, which we owned in portfolios during the last period of rising interest rates, from 2015 – 2018, have floating interest rates that fluctuate according to the London Interbank Offered Rate (LIBOR). The interest rate/coupon on Senior Loans resets monthly or quarterly and therefore benefits (relative to traditional "fixed" bonds) during periods of increasing interest rates. This "floating" rate is the yield that investors will make on their investment. This floating rate aspect provides investors with protection against rising interest rates, and as a protection against inflation, which we believe will be an important portfolio benefit within Fixed Income in the coming years.

We are committed to retaining a meaningful allocation to strategies that will continue to serve as a stabilizer in portfolios to protect on the downside when markets fall while providing similar diversification benefits of Treasury bonds but without the interest rate risk. Therefore, we have increased our allocation to Low Correlation investment strategies. As a reminder, Low Correlation strategies are intended to do well regardless of what happens to Fixed Income or Equities. They are often referred to as absolute return strategies intended to generate low-to-mid-single digit returns through an economic cycle, even during periods of market volatility/sell-offs. We have tactically increased our allocations to these strategies in the face of rising interest rates which will negatively impact Fixed Income returns and the possibility of equity market sell-offs due to elevated U.S. stock valuations. The other significant tactical change that we're making is to increase our inflation-hedging investments within Alternatives, in particular, Natural Resources and Infrastructure, which have proven over time to do well during periods of rising inflation. Keep in mind that Equities have also historically performed well during periods of rising inflation as long as inflation doesn't turn into hyperinflation which is not our base case.

We believe our client portfolios are well positioned for a continued cyclical recovery as we heal from the pandemic. We also believe that if interest rates continue to rise and if inflation picks up our underweight tactical positions to Fixed Income along with the addition of floating rate bonds and our tactical overweight to Natural Resources and Infrastructure, respectively, position client portfolios very well to face those headwinds. If a less sanguine outcome should occur, we have investments in the portfolio that will offer downside protection via Low Correlation strategies and we are prepared to prudently, albeit opportunistically, respond as events unfold as we did in 2020. Please find at the end of this letter the specific details of our *three-to-five year Tactical Asset Allocation outlook* and *Asset Class Return Expectations* that guide our current portfolio management.

As we happily close out 2020, we are pleased to announce we have completed a three-year project to transition our portfolio accounting, investment reporting, and portfolio trading to an industry-leading, state-of-the-art institutional system. Clients have seen the benefits of our upgraded quarterly investment reports and in 2021 we are excited to be rolling out an online client portal. Along with the recently upgraded quarterly investment reports, our new reporting software enables us to provide clients with a portal where clients can view all of the same familiar quarterly investment reporting graphs and tables, but updated in real-time, in a secure online portal. In addition, the portal comes equipped with document sharing functionality known as the vault. The vault allows us to share and permanently store all quarterly investment reports, invoices, chartbooks, Investment Committee perspective letters, and other pertinent financial documents. The portal can serve as a one-stop-shop allowing clients to view the detailed performance of their portfolios at any time and store or retrieve all historical investment and financial documents. Over the course of the coming quarters, we hope to roll this portal out to all clients.

The experience of 2020 was one we hope to not have to repeat again in our lifetimes. As we welcome a hopefully brighter 2021, we wish you and yours a healthier and happier year in 2021. As always, we believe it is important to meet or teleconference with our clients regularly to address any questions about portfolio performance or longer-term investment and financial planning. Please don't hesitate to contact our office to schedule a review meeting or time to talk.

Cordially,

Causey Demgen & Moore Investment Committee
- Robb Stone, Nathanael Koch, Stephen Warren, Paul Demgen and John Connell

Three-to-Five Year Tactical Asset Allocation Outlook

Please find below our Tactical Asset Allocation outlook as of December 31, 2020 and below that our three-to-five year asset class return expectations. Looking out over a three-to-five year tactical horizon, the major risks we are watching are elevated U.S. stock valuations, in particular U.S. growth stocks, rising interest rates, and increasing inflation.

Below is a summary of the tactical asset allocation changes we are making in client portfolios as a result of our January 2021 Investment Committee meeting. Please also find attached to this e-mail our Q4 2020 chartbook that highlights these tactical changes (p.4) along with supporting slides (p. 8, 20, 21, 26, and 27):

	Underweight					Overweight			
	- - - -	- - -	- -	-	Strategic	+	+ +	+ + +	+ + + +
OVERALL POSITION									
Cash	●								
Fixed Income			●	◈					
Equities						●			
Alternatives					◈	●			
FIXED INCOME									
Short Bond			●		◈				
Intermediate Bond		●	◈						
High Yield Bond					◈		●		
Foreign Bond				●					
EQUITIES									
US Value					●				
US Growth			●	◈					
US Small Cap						◈			●
Developed Int'l						●			
Emerging Markets						◈	●		
ALTERNATIVES									
Real Estate				●	◈				
Natural Resources							◈		●
Infrastructure									●
Low Correlation			◈				●		

Current Outlook	●
Prior Outlook	◈

In short, we are:

Selling "core" Fixed Income (i.e. Treasury bonds) due to our outlook and concern for rising interest rates and allocating to active, dynamic, multi-sector bond strategies.
Buying Senior Loans/Floating Rate bonds (within High Yield) as their interest rates/coupons reset monthly or quarterly and are therefore not negatively impacted by rising interest rates.
Selling U.S. Growth stocks as their valuations are extremely elevated (back to "tech bubble" valuations for many of them).
Buying U.S. Small-cap stocks as they look relatively cheap (compared to U.S. growth stocks) and are poised to outperform as the economy continues to recover.
Buying Emerging Market stocks as they look relatively cheap (compared to U.S. stocks broadly) and are well positioned to also outperform as the global economy recovers.
Buying Natural Resources as an inflation-hedge due to the unprecedented amount of Fiscal and Monetary stimulus.
Buying Low Correlation strategies to replace "core" fixed income for safety ("ballast") as their absolute return strategies should do well regardless of how Fixed Income (rising interest rates) or Equities (expensive valuations) perform.

Three-to-Five Year Tactical Asset Class Return Expectations

Cash/Money Markets: Very low single-digits (0.0 - 1.5%). We maintain our maximum underweight to cash. Short-term U.S. interest rates are hovering around 0.00 – 0.25%. In March of 2020, the Federal Reserve lowered its benchmark interest rate to 0.0 to 0.25% (from 1.0 – 1.25%) and in June further reinforced that it will hold its benchmark interest rate near zero through the end of 2022. A more rapid and non-transient uptick of inflation expectations may force the Federal Reserve to raise rates sooner but it is unlikely for the next couple of years. Unfortunately, cash and money market yields are going to remain well below historical levels, and also well below inflation, for the foreseeable future making holding cash a losing proposition.

Fixed Income: Low single digits (1.5 - 3.0%). We are tactically underweight Fixed Income overall. Rising interest rates are a major headwind to core fixed-income returns in the near-term. In 2020, we removed exposure to U.S. Treasury bonds and replaced those Treasury positions with active, flexible, multi-sector bond strategies within the Short-term and Intermediate Fixed Income sectors. Within High Yield bonds, which we have moved to a tactical overweight, we have added back Senior Loans to client portfolios for their floating rate benefits in the face of rising interest rates. We are slightly underweight Foreign bonds due to most International Developed interest rates that are lower or even negative relative to U.S. interest rates (with the exception of Emerging Market bonds that we are overweight).

Equities: Mid-to-high-single digits (6.0 - 8.0%). Equities will continue to offer the best asset class performance albeit with the greatest amount of risk. Equities, like hard assets, have historically permed well during periods of rising inflation. Furthermore, we think International equities, in particular Emerging Markets, due to their relatively attractive valuations (to U.S. stocks) will outperform most other asset classes with the support of a U.S. dollar remaining under pressure.

Alternatives: Low-to-mid-single digits (3.0 - 6.0%). Alternatives will continue to offer inflation-hedging and uncorrelated diversification benefits in client portfolios. As inflation expectations increase, we believe hard assets – real estate, natural resources, and infrastructure – will provide solid mid-to-high single digit returns. Low Correlation, absolute-return strategies will continue to provide low-to-mid-single digit returns while offering meaningful risk mitigation diversification benefits to replace core Fixed Income to help mitigate downside risk during equity market corrections.