Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS	1st Qtr. 2021	1-Year	3-Year	5-Year
Equities				
S&P 500	6.2%	56.4%	16.8%	16.3%
MSCI EAFE	3.5%	44.6%	6.0%	8.8%
MSCI Emerging Markets	2.3%	58.4%	6.5%	12.1%
Fixed Income				
Barclays Capital US Aggregate	-3.4%	0.7%	4.7%	3.1%
Barclays Capital US Corp. Inv. Grade	-4.7%	8.7%	6.2%	4.9%
Barclays Capital Emerging Market	-3.5%	13.6%	4.8%	5.2%
Other Assets				
MSCI US Reit Index	8.8%	37.7%	9.5%	5.3%
S&P GSCI	13.5%	50.2%	-4.9%	1.2%
ICE WTI Crude Oil	21.9%	188.9%	-3.1%	9.1%
Comex Gold	-9.5%	7.5%	9.0%	6.7%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity-

Markets performed as expected for an economy healing from the pandemic and supported by continued stimulus. U.S. equities outperformed global stocks, posting 6.2% returns in the first quarter. Value stocks and small cap stocks performed even better, posting double digit returns for the quarter. Industrial metals and oil surged. Against this backdrop of robust growth and the prospect of more inflation on the horizon, bonds posted negative returns for the quarter, as yields expanded sharply (pushing prices down).

Economic Activity-

The U.S. economy continued its rebound from the April 2020 bottom, yet more improvement is needed to fully reclaim its prior peak. Real GDP (Gross Domestic Product) peaked at $19.3 trillion (on a seasonally adjusted annual basis) in Q4 2019 and most recently registered $18.8 trillion in Q4 2020. While the virus is still inflicting harm on the population and the economy, we expect above average growth in both 2021 and 2022, as we may be on the cusp of one of the strongest economies since the early 1980's. According to BCA Research, fiscal stimulus and restricted spending have produced an excess savings pile of $1.9 trillion on consumer balance sheets. While some of this money will be saved, some will pay down debt, and some will be invested, the majority is likely to be spent. Signs are already present that pent-up demand is being unleashed. After starting the year down 60% from 2019 levels, the number of seated diners reported by OpenTable has markedly improved with some states - Florida, Nevada, Oklahoma, and Texas -showing

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more diners than in similar periods in 2019. So, go the airlines – American, United, and Delta have all recently commented that their businesses are quickly improving. Delta Airlines commented that bookings beyond 60 days are almost back to even with 2019 levels. Strong bookings far in advance suggest the consumer expects the virus to soon be under control.

Around the world, some regions are lagging the U.S., while others are leading. Economic prospects are largely tied to vaccination efforts. Israel and the United Kingdom are two countries that vaccinated their populations quickly. The European Union and emerging markets are lagging in their virus fight, with recent lockdowns in Germany and France providing evidence of this point. We do not expect the uneven pace of vaccinations to materially derail the global recovery and expansion.

Monetary & Fiscal Policy-

The U.S. continued to expand fiscal support in the first quarter of 2021 with the $1.9 trillion American Rescue Plan being passed in mid-March. More recently, the administration has shifted energies to other priorities – infrastructure, healthcare, child-care, and education - with infrastructure tackled first. The administration has presented a $2.3 trillion proposal (to be spent over 8 years) with the next move in the hands of Congress. Tax changes are being contemplated to help pay for this ambitious plan. Given narrow majorities, what tax policy emerges is still uncertain. Higher taxes on corporations and capital gains could be mild headwinds to equities.

To the Fed's credit, their message to the market has been incredibly consistent – they will provide maximum accommodation until the economy is on a firmer footing, inflation exceeds its target, and inflation is expected to persist. We don't expect to hear a different message from the Fed for some time – perhaps a discussion on asset purchases by the end of the year, and no rise in rates until the end of 2022. The market is forecasting a faster rate hike cadence than the Federal Reserve itself. By the end 2023, the market (as implied by overnight index swaps) is assuming a Fed funds rate of 1.00%, while Fed internal projections believe the rate will still be at 0%. We believe the market is likely to be proven correct.

Valuation and Sentiment –

In past writings when discussing valuation, we have focused on valuation multiples, more specifically the P/E ratio – which compares the Price of an index or security against expected Earnings of the security. While the multiple for the S&P 500 has been stretched since last summer, and the media may tend to focus on the price of assets (the P in P/E), our view is this is an important time to pay close attention to the "E" in the equation.

In December 2019, analysts were forecasting 2021 S&P 500 Earnings of $197 per share (EPS). The emergence of the pandemic resulted in a large downward adjustment to this outlook. However, analyst's initial adjustments were too harsh for the reality that played out. The 2021 EPS estimate has rebounded from $163 in June 2020 to $175 by the end of Q1 2021. Worth noting is that, historically, estimates start high and come down. However, this year has seen the opposite occur, with data and fundamentals positively surprising analysts, resulting in upward revisions. Earnings surprises (actual EPS reported by companies compared to the expected EPS) have been similar in number, but the magnitude is abnormally large. In Q4 2020, reported EPS figures were 14.5% ahead of estimates, historically surprises have been 6.3%.

To summarize, while stocks may be considered expensive based on standard metrics, they will appear less so if the trend of upward revisions in revenues and profits continues in the months and years ahead.

INVESTMENT OUTLOOK & STRATEGY

The basic trend for the stock market is higher in sync with increasing economic activity and corporate profits, albeit with elevated investment risk. Topics worthy of mention are the virus, and our expectations for the economy, Fed policy, and the stock market.

COVID-19: While certain states and regions are experiencing an increase in virus cases, according to former FDA (Food and Drug Administration) Commissioner Dr. Scott Gottlieb, these increases are due to school re-openings, and higher levels of travel and mobility. Given the accelerating increase in the number of people being vaccinated, Dr. Gottlieb views a fourth wave as unlikely. Our view remains that we will reach herd immunity during the summer months (July to September).

The Economy: Expectations for economic growth to accelerate are fueled by the Fed, who remains committed to keeping short term interest rates pegged near zero for two to three years, and the federal government which, as they dole out trillions of dollars from past legislation, seeks more funds for other objectives. From an economic perspective, the stimulus from our government and central bank were required in 2020 to allow time for global economies to absorb and deal with the devastating shock inflicted by the COVID-19 virus. Our sense and concerns are that the spigots may stay open too long. When you consider that the economy was in a solid growth mode Pre-Covid with record low unemployment, if additional stimulus proves excessive then economic imbalances and inflation pressures are likely. This would put the Fed in a box, as too much of a good thing may not be a good thing.

The Stock Market: The primary factor impacting stock prices is the Fed's low interest rate policies and actions. Interest rates are the bloodline for economies and the Fed has consistently conveyed the message that the spigots will remain open for another two or so years. At a higher level, global economies have huge sums of capital seeking rates of return and shares of companies that grow and reward stakeholders during these ever-changing times are attractive. Stated differently, stocks continue to compare favorably to securities and funds with low single digit returns and, in some countries, negative interest rates.

While we are true believers that owning shares of leading companies provides the best way of growing capital and protecting purchasing power, bonds have a definite place in portfolio management. Fixed income securities provide safety of assets, known rates of return, and ballast to client portfolios. While stock returns generally exceed fixed income investments over longer periods of time, stocks are only appropriate for risk capital that can withstand inevitable periods of market weakness.

Periodically, we remind ourselves of the math on investment returns – if the price of an asset declines by 20% then it requires a return of 25% to get back to even; if the decline is 50% then a return of 100% only gets one back to even. The main reasons against allocating more than normal amounts to stocks are that valuations are elevated and there are many developments that can cause a rapid repricing of assets lower. Putting it all together, we continue to manage accounts with a neutral asset allocation.

Common 2020 Tax Questions

Changing tax rules are never easy, and when done during a pandemic it is not surprising that many people have questions on how to file their 2020 income tax returns. To give taxpayers and their advisors ample time, the IRS has delayed the federal tax deadline to Monday, May 17. Does this mean your state tax return is delayed until May? It depends on where you live, as New Hampshire, Arizona and Hawaii have yet to push their deadline past April 15th (note that this may change). Below are some additional points that may provide clarity.

Does the date change apply to retirement account contributions? Yes, the IRS and most states adopted May 17 for contributions to IRA's, health savings accounts (HSAs), Archer Medical Savings Accounts, and Coverdell ESA's.

Does the new deadline apply to estimated tax payments for 2021? No, estimated taxes remain due by April 15, June 15, September 15, and January 22 (Jan 15th is a Saturday; Monday is a holiday).

If you received stimulus checks, note that it is not considered taxable income. These checks were considered an advance on the 2020 tax credit with eligibility based on income reported on your most recent tax return. If you had less income in 2020 than in 2019, you may want to file your taxes sooner to receive your stimulus check under President Biden's American Rescue Plan, otherwise you may have to wait until Q4 2021 to receive it.

If you received unemployment income in 2020, you may benefit from President Biden's relief package. While unemployment benefits are normally considered taxable income, the package exempts the first $10,200 for those with AGI (Adjusted Gross Income) less than $150,000. Note that some states, such as Rhode Island, consider all benefit amounts received as taxable income.

Withdrawals from your retirement accounts changed in 2020. Required Minimum Distributions were not required and, if taken, could be put back. If you were under age 59.5 and took a withdrawal for a hardship purpose, the 10% penalty was waived. The amount withdrawn must be includable in your taxable income over a three-year period (versus in the year withdrawn); further, the amount withdrawn may be repaid over the three-year period. There has no similar guidance given for 2021 thus far.

Lastly, if you are over the age of 65, the IRS has a separate tax filing form called the 1040-SR. This form is easier to read and complete then the 1040 used by younger filers.

Please note that, while we factor tax considerations into our financial planning and asset management services, we recommend consulting your tax advisor for specific tax advice. Please feel free to contact us with any related questions or if we may be of assistance in any manner.