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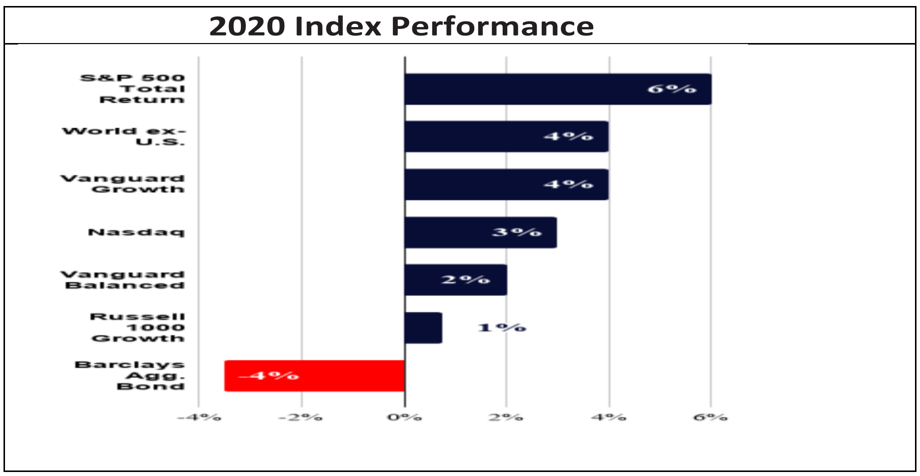
FIRST QUARTER 2021 MARKET COMMENTARY

INDEX PERFORMANCE AND ANALYSIS

The post-COVID bull market extended its run through the first quarter. The stock market's first quarter rise was not without its hiccups as there were constant leadership changes among the varied asset classes. The market's underlying equity components were trendless. Bonds across the board fell as investors positioned their portfolios for an expansionary business cycle. The stock market is rising as a consequence of the explosion of government spending, an easy money Federal Reserve, and an economic recovery set to unleash a year's worth of pent-up demand. We are therefore bullish on stocks through the rest of the year though we remain abundantly aware of the new challenges to be faced in the months ahead: a trendless market in transition, rising inflation, and unchecked federal spending.



Trendless and in Transition

Quarterly performance numbers take into account only two days' worth of market movement—the first and last days of the quarter. What happened between these two dates is too often ignored by observers focused solely on the broadest of market trends. In order to understand markets, it is essential to observe their daily fluctuations and the presence of any trends. This was especially the case in the first quarter.

2021's stock market so far has strategies may end up taking the middle ground. This is because trendless assets, by definition, will advance and decline in short order.

Changes in Market Leadership

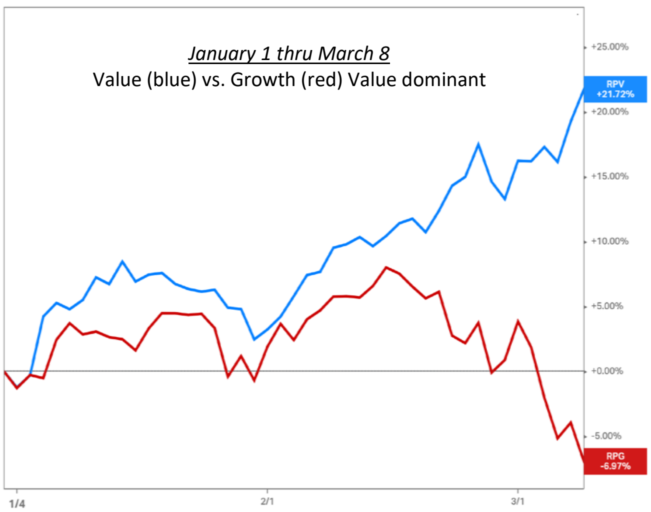
The first quarter's stock market saw a continuous battle for leadership between two distinct market segments: large growth stocks (big companies with high potential for future growth; mostly technology stocks) vs. cyclical stocks (these are companies that stand to outperform at the beginning stages of an economic expansion cycle; they include small companies, inexpensive value stocks, financials and industrials).

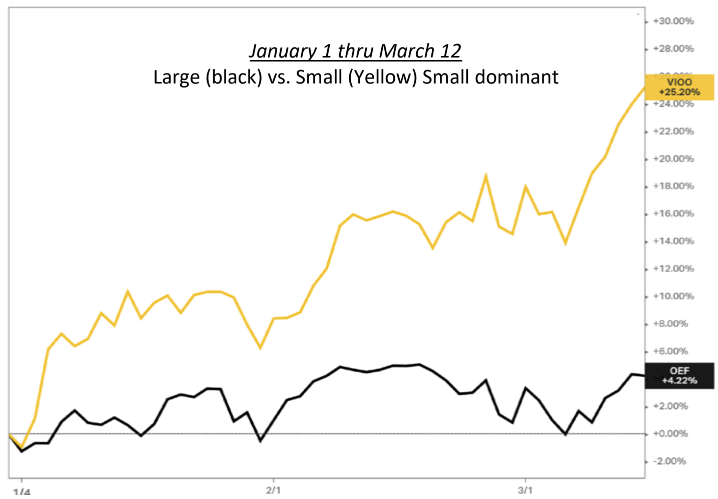
Optimism about the coming end of the pandemic helped to fuel the positioning into cyclical stocks. Expectations were that economic growth coming out of last year's brief recession (a contraction of economic growth for two consecutive quarters) would be fast and furious and so we saw assets flood into cyclicals to capture that opportunity. But this was not a complete rotation from growth to cyclicals—growth stocks *also* rose from the fourth quarter through mid-first quarter.

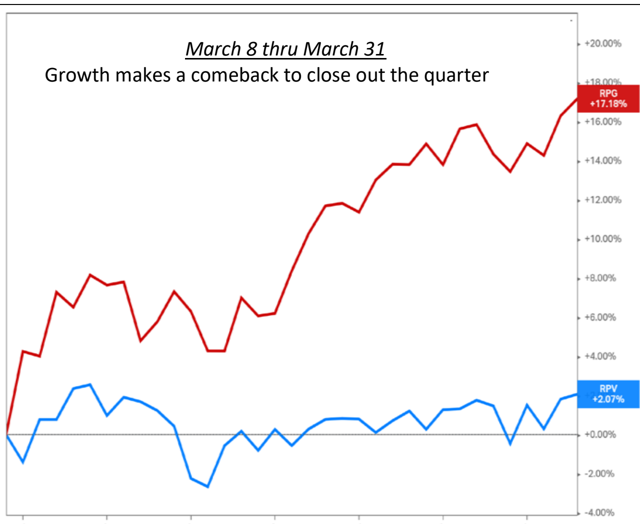
Midway through the first quarter, last year's predominant growth investment finally faced some competition. From mid-February until mid-March investors exited these positions and reassessed the market environment going forward. And just three weeks later leadership swapped *again* as growth stocks led the market through to the end of the quarter. See the stark shifts in the charts below.

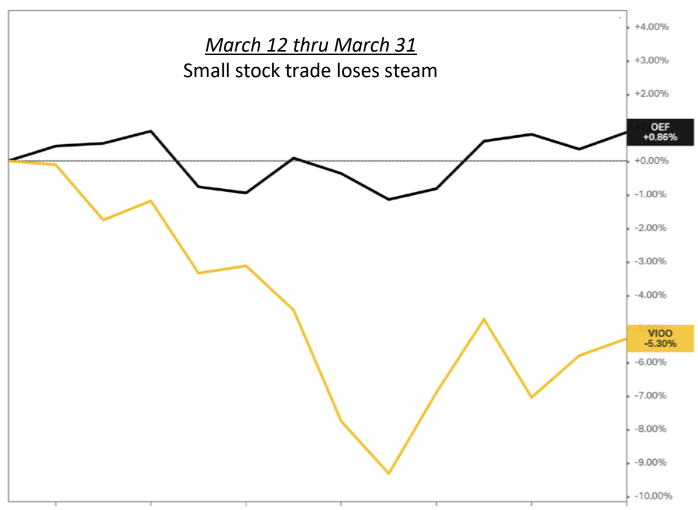
Shifting Leadership

Value vs. Growth Stocks	Large vs. Small Stocks









This is a market in transition. The overarching narrative is the continuing recovery from the lockdown recession though the pace and strength of the recovery remain open questions. This lingering uncertainty has caused the market to become emotion-driven. Shifts in leadership are spurred by relatively minor occurrences causing confusion in the market and erratic performance for the market's leaders from one day to the next. These transitional markets are temporary and so tactical asset allocation strategies are able to respond and identify longer-term trends as they emerge through the rest of the year.

Improving Economy & Market Catalysts

As ever, the question for investors, for us, is where do we go from here? The market has come so far so fast that, in our attempts to anticipate the future, we often fail to appreciate the depths from which we've risen and the lessons we can learn. These lessons can give us clues as to the health of the recovery and the potential catalysts for the next leg up—or down—in the market.

March marked the one-year anniversary of the pandemic year. The stock market bottomed on the 23rd of that month and we experienced a -31% contraction in gross domestic product growth (GDP, this is just the total value of all goods and services produced in the country) as the entire country went on lockdown. The unemployment rate peaked at 14.8% and weekly unemployment claims topped 6 million Americans out of work. What a difference a year makes:

Indicator	Trough	Recent
GDP	-31%	+33.4% (Q3) +4.3% (Q4) +6.4% (Q1)
Unemployment	14.8%	6% (March)
Jobless Claims	6.1 million	547,000

These numbers reveal several important facts. First, that the economy was on firm footing pre-pandemic. This enabled growth to recover as quickly as it has. Second, the government's rapid response to the pandemic undoubtedly prevented a prolonged recession and proved that targeted legislation on short notice can ably confront once-in-a-century devastation. Third, and most crucially, the speedy recovery serves as substantial evidence of the resilience of the American people.

Rapid rise in yields coincides with expectations of fast economic growth; start of business cycle

The stock market corrected and shook out all of the unnecessary leverage and speculation that had accumulated in the decade-plus bull market run. We didn't see a collapse; we saw an opportunity. We believe this opportunity still exists for markets and that is why we are bullish on stocks through the end of the year. Consumer confidence across the board remains below pre-pandemic levels and the Gallup economic confidence index only turned positive just this past month. All of the pent-up demand caused by the lockdown will be unleashed as we embark on the great reopening this summer. Too much of a good thing, however, can cause an economy to overheat. Thus, have arisen fresh worries about long-dormant inflation.

Inflation on Horizon?

Inflation is simply too many dollars chasing too few goods. Consensus opinion is that the rate of inflation will be higher this year than year's past. When the federal government injects nearly $5 trillion directly into the economy you can be assured that there will be upward pressure on prices for goods and services. Consumers surprised producers as retail sales recovered in record time. This is to say nothing of the booming housing market and simultaneously skyrocketing commodities prices. Though inflation indexes have stayed mild so far this year, its prospect alone is already making waves in markets.

First, bond yields have risen significantly. The so-called "risk free" U.S. Treasury bonds suffered their worst quarterly performance since 1980 as the yield on the 10-year climbed as high as 1.72% (it started the year at 0.93%). Prices fall as yields rise so, as Warren Buffett stated in last year's Berkshire Hathaway shareholder letter, bond investors worldwide face a bleak future. Whether inflation persists or if it will be, in the Federal Reserve's preferred adjective, *transitory*, yields are going to rise along with our growing economy.

10-Year Treasury Bond Yield

Looming inflation and higher yields will also affect the stock market. As discussed above, cyclical stocks will tend to outperform along with our growing economy. Meanwhile, growth stocks, whose argument for investor dollars *now* is for growth and earnings at some point in the *future*, may be shunned in favor of currently outperforming cyclicals and other currently higher yielding asset classes.

Should it rear its head, then, inflation's effects on securities markets will be felt most acutely in bonds. Instead of providing sought-after lower-risk ballast for portfolios, bond allocations will only introduce a different kind of risk. Bond prices, though not volatile, will gradually diminish in proportion to the rise in yields. On the other hand, even with the prospect of inflation, our tactical portfolios will enable us to allocate to whichever segment of the stock market stands to outperform.

The New Administration

Investors are also paying close attention to politics as the new administration in Washington seeks to reintroduce a more active, generously spending federal government. The president clearly wants his term to be transformational; his priorities and accomplishments these first months in office are indicating what could be the most progressive presidential administration since Lyndon Johnson's. As we stated in these pages last quarter, Wall Street expected the razor-thin majorities in the Senate (50-50) and the House (a six-seat majority) to restrain the appetite for bold legislation. That hasn't happened.

Out of the gate, Congress passed and the president signed a massive $1.9 trillion COVID relief bill. The president followed this up with an infrastructure proposal, a jobs plan, and a plan to expand the social safety net. In all President Biden's plans come to $6 trillion in spending through the next decade.

Much of the administration's plans for spending and funding were expected and so have been baked into the stock market's prices. The president made no secret of his tax plans, though the speed and forcefulness of the legislative push has taken some by surprise. Overall, the effects of the new legislation on markets this year will likely be both positive and negative; all of the spending will act as a sugar high for stocks while the proposed tax hikes (corporate and capital gains especially) will eat into earnings and could discourage investment.

We are mindful of the enormity of this past year's federal spending. With our recovery economy in the near-term, however, we think the excess cash will be a further catalyst for positive market movement.

Looking Ahead

We are optimistic about securities markets through the rest of the year. While we believe the overall market is rising on the recovery's solid foundations, it is important to remember that risk is inherent in investing. And as the pronounced movement underlying the first quarter's returns tells us, this market is fluid and in transition. Volatility thrives in such circumstances. Recall that, since 1980, the S&P 500 experiences an average intra-year decline of -14%. So far this year the S&P's biggest drop has been just -4%.

Our portfolios attempt to mitigate risk, manage volatility, and capture gains through tactical asset allocations. Because we can no longer rely on most bonds for ballast, we have transitioned to higher quality, shorter duration bonds for our most conservative portfolios. To maximize opportunity for gains, we have also expanded the selection of equity security styles and sizes given this year's volatile leadership changes.

Portfolio allocations are made with our software according only to current price movement and without regard to emotion or trying to forecast the future. While this year's market has been trendless, we note that such trendless markets are often precursors to great market opportunities.

Performance Disclaimer

No investment strategy or methodology can guarantee profits or protect against losses. Investment risk is inherent in every individual portfolio and no computer model or modeling program used or relied upon in making investment choices for a portfolio can eliminate risk.

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