TRAPHAGEN
CPAs & WEALTH ADVISORS

2020 Market Review & 2021 Outlook

2020 Economic & Market Review/Comments

This past year was like no other in terms of the impact it has had on the country and the world. 2020 started out as most other years, with the biggest news headlines concerning the newly inked 'Phase 1 China Deal', who the democratic presidential nominee would be, and the continued stock market rally. However, by the dawn of 2021, after the worst pandemic in 100 years, the first bear market and recession in 10 years, an election cycle like no other, a change of government, and US social/civil unrest not seen since the 1960s, we are now living in a different world.

We know many of our clients have had a difficult year either in terms of health, family concerns, financial struggles, or other challenges. Your Traphagen advisors are here to help and we remain focused on the financial market aspect of the events of 2020 / 2021. This newsletter will address the investment/financial issues and look at how these external events impacted the financial markets, client portfolios, and your long-term retirement/financial planning goals.

Select 2020 Asset Class Returns	
US Large Cap Stocks (IVV)	+ 18.4%
Emerging Market Equity (IEMG)	+ 17.8%
US Small Cap Stocks (IJR)	+ 11.3%
Investment Grade Bonds (LQD)	+ 11.0%
Alternative Lending (LENDX)	+ 10.2%
Mid/Long Treasury Bonds (IEF)	+ 10.0%
Middle Market Lending (CCLFX)	+ 8.3%
Foreign Developed Equity (IEFA)	+ 8.2%
Insurance Securities (XILSX/SHRMX)	+ 7.0%
Municipal Bonds (MUB)	+ 5.1%
High Yield Bonds (HYG)	+ 4.5%
Diversified Real Assets (VCRRX)	+ 1.4%
Private Real Estate (TIPWX)	+ 1.3%
Pipeline Companies (TPYP)	- 21.4%

- *GPB, Mosaic, KKR, & Blackstone performance discussed in detail on page 6/7*

Despite the myriad of reasons for fear, 2020 was a good year in terms of financial market returns. Investment performance for almost every asset class including stocks, bonds, and alternatives were positive with many materially so.

Both the US and Emerging stock markets performed especially well in 2020, with total returns right around 18%. Foreign developed stocks, although still showing positive returns, was a notable laggard with about an 8% return. This performance occurred due to 'multiple expansion' rather than earnings growth. In fact, the SP500 is expected to see corporate earnings drop around 30% in 2020 vs. 2019 despite stock price increases.

On the bond side, between a historic decrease in interest rates (both in terms of timeframe & percentage decrease), record low absolute rates, and explicit government support, most high-quality bonds had an excellent year as well. In 2020 mid/long term Treasury, TIPS, and investment grade bonds all returned around 10%.

Below: ***10 Year Treasury Interest Rate over past 5 years.*** *After dropping from 3.3% to 1.9% in early 2020; rates plummeted from that 1.9% level to record lows near 0.5% in March 2020.*

To round out the portfolio investment overview, all alternative/private investments had a positive return during 2020 with less volatility and significantly better portfolio protection in March 2020 vs. any other asset outside of Treasury bonds.

Symbol	Asset Class	YTD Return	2020 Max Drawdown
SRRIX	Insurance	6.7%	- 2.3%
SHRMX	Insurance	6.6%	- 1.5%
XILSX	Insurance	7.2%	- 1.8%
LENDX	Consumer Lending	10.3%	- 4.5%
CCLFX	Middle Market Lending	8.4%	- 2.5%
VCRRX	Infrastructure/Farmland/Timber	1.2%	- 4.6%
TIPWX	Private Real Estate Equity	1.4%	- 2.7%
MREC*	Private Real Estate Credit	7.3%*	0.0%
BREIT	Private Real Estate Equity	6.9%	- 8.2%
KKR*	Private Equity	10.5%*	- 7.0%
GPB Fund II	Private Equity	6.7%	0.0%

Above: *Spreadsheet of all 2020 private/alternative investment returns and max 'drawdown' for each fund. 'Drawdown' is the largest percentage drop from high to low wtihin a period of time. In 2020 the SP500 had a drawdown of 35%, Investment Grade bonds 20%, and Municipal bonds 13%. * = estimated return.*

Major Issues That impacted the markets & client portfolios in 2020:

COVID-19 Pandemic & Lockdowns: The COVID-19 pandemic and the worldwide lockdowns put in place in March 2020 – May 2020 and again from November 2020 through the current time have caused economic disruption and slowdowns not seen since the great depression. Initially this caused almost all companies to suffer in terms of revenue/profit declines, forced layoffs, tighter credit, significant liquidity issues, and much lower stock prices. This resulted in the 35% 'bear market' in stocks during the spring of 2020. As time progressed, a historic stimulus/relief package was passed and the FED lowered interest rates to zero. At that point, a clear separation of performance occurred among different sectors and sized businesses. In general, larger companies, technology, healthcare, and consumer stocks did well. At the same time, smaller businesses, restaurants, energy, financial, and real estate companies were hit very hard. Overall, the pandemic and the government lockdowns caused US corporate earnings to fall about 30% vs. 2019, unemployment to briefly spike to near 15%, and the US government to spend more than $5 Trillion in relief efforts. As the vaccine is now being distributed and cases start to decline across the country from elevated levels, we are confident the worst of the pandemic is behind us on both the health and economic front.

Unprecedented Government Stimulus/Spending: Due to the pandemic and a dramatic collapse in economic activity around the world, global governments responded in a manner we have never seen before in history both on the monetary and fiscal side.

Above: *Chart of US Money Supply (amount of USD circulation); the money supply increased around $3.6T over the past 9 months.*

In addition to the above increase in money supply, the US (and many other global governments) deployed a multitude of tools in an attempt to calm financial markets and help the economy starting in February 2020. The actions taken are highlighted below.

- Reduced short term interest rates to 0%
- Initiated the purchase of government bonds, investment grade corporate bonds, high yield bonds, bond ETFs, and mortgage backed bonds
- Signaled a policy of allowing the economy to 'run hot'; allowing inflation to run above their target 2% for a period of time. In addition, they stated they would not raise short term rates for at least a year
- Began a program of lending to businesses and significant support for the PPP program spearheaded by the Treasury

When all these Fed actions are combined with the two fiscal stimulus packages already passed by Congress and the Trump Administration there has been more support and money supply added into the economy over the past 9 months than there has been between 1981 and 2001. The Biden administration is already planning another $1.9T stimulus package on top of the existing stimulus which would include further unemployment support, stimulus payments, small business support, and possibly infrastructure build out.

The ultimate implications of these actions are unknown, however to this point they have proved positive for equities. As risk managers and asset allocators we continue to take actions to guard client portfolios from the uncertainty these historic actions present. We have invested in a wide range of infrastructure and select real estate assets that should provide protection if inflation and interest rates rise in the future. In addition, we have limited exposure to Treasury and investment grade bonds which would be hit hard by rising interest rates.

2020 US Election Outcome & possible Future Legislation: Now that President Biden has officially taken office and the make up of Congress is known, much uncertainty is behind us. What remains unclear is exactly how much of Biden's legislative plans will be actually enacted with very tight majorities in Congress. Below you will find an outline of the major focal points of the Biden administration's legislative agenda. Red indicates an economic negative, yellow; near neutral, and green would be positive in our view.

Increase corporate tax rate from 21% to 28% & add a 'Corporate AMT Tax'
Increase capital gains & dividend income tax rates for $1M+ earners
Additional payroll/Social Security taxes for those who earn more than $400k per year
Decrease the estate tax exemption by 50%
Increase top individual rate to 39.6% from 37%
Step-up in cost basis on assets upon death would be eliminated
Extensive support and subsidies for Renewable Energy/Carbon Reduction
$5,000 child tax credit increase
Deferment/Forgiveness of Student Loan Debt
Large Infrastructure Program (Cyber, COVID, transportation, etc.)
Additional Fiscal Stimulus (Unemployment, COVID relief, PPP, Stim Payments)

Traphagen believes some, but not all, of these initiatives will be enacted over the next 1-2 years. We are of the opinion that bipartisan negotiation will take place on many of these stated goals and the end result will be some tax increases (although most likely not all listed), corporate rates will increase, but at a lower level than 28%, additional stimulus will pass, support for renewable energy will come, and some form of an infrastructure bill will be enacted.

In aggregate, if this thesis is correct, we think the financial markets are correct in predicting fairly benign/positive legislative impacts over the next couple years, but do recognize risk and uncertainty remain. We have adjusted portfolios in anticipation of these changes and will make further adjustments as we get more policy clarity through 2021.

Traphagen 2020 Portfolio Comments & 2021 Changes

Although 2020 was a difficult year, this type of market behavior offers the biggest financial opportunities if you have a diversified portfolio and the discipline to 'buy low' despite panic and fear reigning supreme. Below you will find an overview of the tactical trades Traphagen made throughout the year. Most clients will not own all the below investments, as specific client allocations are determined through risk tolerance, tax status, and other variables. In addition, the performance reflects a broad average across all client accounts, actual returns will differ for each client.

Below: List of tactical 'offensive' trades and investments made in March/April 2020.

Addition to large cap technology *Strong Balance Sheets, Strong Growth, Limited COV-19 Impact*	**IGM (2)**	**+ 60.0%** *to* **+ 70.0%**
Purchase of high yield debt *Market dislocations & very wide corporate to Treasury spreads*	**ANGL (2)**	**+ 35.0%** *to* **45.0%**
Purchase of public real estate *Cheapest valuations since 2011, 4.5% dividend, Cell Towers/Data/Residential*	**FREL**	**+ 12.0%** *to* **+ 14.0%**
Purchase of Utility companies *Cheapest valuations since 2016, 4.0% dividend, defensive cash flows*	**FUTY**	**+ 18.0%** *to* **+ 25.0%**
Addition to natural gas/oil pipeline companies *Cheapest valuations since 2009, 8.0% dividend, defensive cash flows*	**TPYP**	**+ 15.0%** *to* **+ 16.5%**
Addition to high yield municipal bonds *Deep discount to actual value of up to 13%; 6% tax free yield*	**HYMB**	**+ 10.0% to + 12.5%**

Below: List of investments made from May-December of 2020.

Addition to higher quality/fundamentally screened IG Bonds *Higher quality corporate bonds in time of stress, ~ 3% yield*	**GIGB**	**+ 2.5% to + 3.5%**
Allocation to Foreign Developed Growth Stocks *Reasonably priced (vs. US) growth stocks in Europe, Japan, etc.; 2% yield*	**EFG**	**+ 13.5% to 14.5%**
Allocation to Technology/Telecom Related Real Estate *Cell Tower/Data Center, higher growth & largely recession proof; 1.6% yield*	**SRVR**	**+ 4.0% to + 5.5%**
Disruptive 'Long Horizon' Technology Active ETF *Genomics, Crypto, AI, Robotics, Autonomous Transportation, etc.*	**ARKK**	**+ 75.0% to + 77.5%**
Disruptive 'Genomics' ETF *Genomic and other disruptive healthcare companies*	**ARKG**	**+ 38% to 40.5%**
Small/Medium Sized US Dividend Stocks *Value/Dividend Exposure through US Small/Mid Cap Stocks*	**DON**	**+ 15% to + 20%**

Private Investment Update *(for $1M+ Traphagen/Accredited clients only)*

Private Equity (GPB Fund II): GPB Fund II had a materially improved year with positive operational results despite the recession/pandemic, with a 6.7% return in the form of a dividend, and their fund's audit is now complete. Per GPB's late 2020 update call, the fund's automotive dealership division (Prime Auto) had a record year with roughly 19% year over year growth. The healthcare/IT division was largely unaffected by the pandemic with near flat performance, while their physical therapy was the most impacted with year over year declines. Looking ahead through 2021, they are expecting to see an increase in valuation as of the 12/31/2020 mark, continued improvement/growth across the three major operational divisions, and additional dividends/distributions (most likely later in the year).

Private Real Estate Credit (Mosaic): We remain very pleased with Mosaic. Through 2018 and 2019 the fund retuned an annualized 9.4%. Despite the pandemic, recession, and overall difficult environment for real estate in 2020, the fund has not recorded a negative quarter since its 2015 inception and will post a 2020 total return of around + 7.3%. Approximately 17% of their total portfolio is currently deemed 'non-performing'; this is not uncommon during recessionary periods. One of the reasons we invested within Mosaic is their focus on investor capital protection. When a loan becomes non-performing, Mosaic can either renegotiate the loan, take possession of the property and sell, or take possession and retain for a time for rental income/value improvement. Mosaic is working through these properties, utilizing all three of these methods, and at this point they do not expect any markdowns on any of the properties within the portfolio. Mosaic believes 2021 will be another solid year, with returns in the mid single digits.

Private Equity (Altegris KKR Private Equity Fund): This well diversified private equity fund performed well during a tough 2020. The fund had a maximum drawdown of about 8% (relative to 35% for the public stock market) and should return around + 10.5% for the year. The fund owns hundreds of private companies with concentrations in technology, healthcare, and consumer companies worldwide.

Private Real Estate Equity (Blackstone BREIT): While public real estate indexes suffered a 40% maximum drawdown and a 2020 return of around negative 6%, Blackstone's private real estate fund did very well. The fund is mainly invested within industrial/warehouse and residential real estate (avoiding the hard hit retail and office sectors). After volatility in March, the fund has fully recovered and returned + 6.9% in 2020, beating public real estate markets by 13%. We continue to like this investment for their superior sector selection, 5.7% yearly rental income (paid monthly), and relatively low volatility.

2021 Portfolio & Economic Commentary

After the very challenging but financially rewarding past year, it is now time to look ahead through 2021 and expect to a return to some level of 'normalcy' as the vaccine is rolled out.

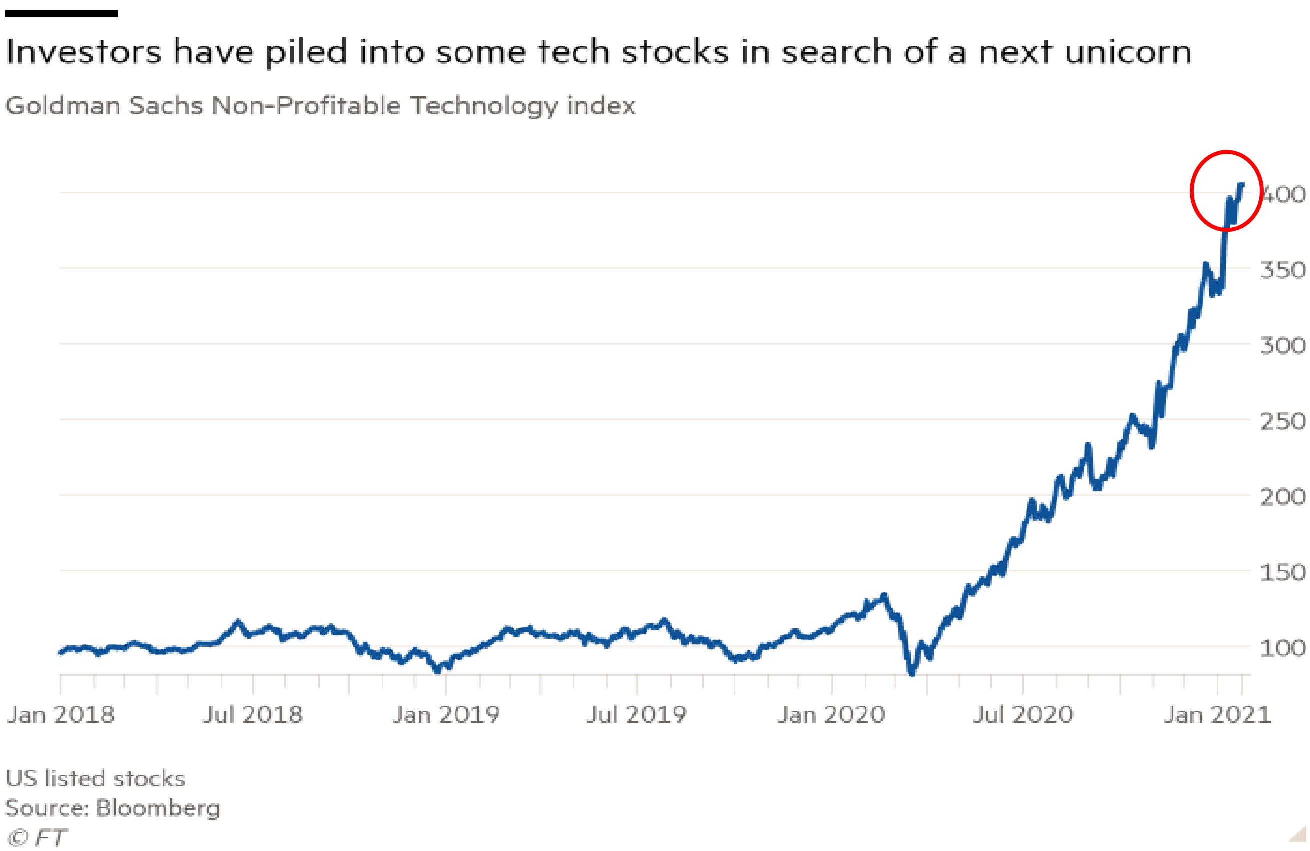
2021 Portfolio Changes
Gradual trim/sale of Mosaic for some clients
Purchase of Blackstone BREIT for some clients
Purchase of a renewable infrastructure/energy fund
Continued trim of Treasury/corporate bonds
Purchase of a US Stock fund which adjusts stock allocations for certain accounting metrics
Trim of some technology stocks after recent strong run
Increase in allocation to alternative/middle market lending

In making the above portfolio changes we have taken many factors into account. These include the likelihood of higher inflation/interest rates, a 20 – 30 year growth opportunity in renewable energy and infrastructure, the incoming administration's legislative agenda, and current stock valuations.

The economic and market outlook for 2021 is quite bright as we exit the recession of 2020, the combination of vaccine distribution, existing/past infection, and seasonality puts the worst of the pandemic behind us, we get closer to a full 're-open' of the economy, and further fiscal stimulus is on its way. As an additional backstop to all these positives, the FED has promised continued extensive support in the form of near zero interest rates and liquidity.

We expect US corporate earnings to rapidly recover from depressed 2020 levels and after the worst period for small businesses in many decades, a more gradual rebound is expected there as well. With the recovery and the gradual reopening, we expect unemployment to remain stable through roughly March/April, then gradually decline to 5.5% to 6.0% by the end of the year.

One risk we are planning around is the potential that some parts of the stock market have become 'frothy'. We are actively avoiding these areas and trimming some positions in which we already have large profits. We would use any 10%+ correction (which we would view as healthy) to reestablish longer term positions where we see growth.



Above: *Goldman Sachs 'non-profitable' technology stock index price level 2014 – Current. The incredible increase in price (488%) since March 2020 we attribute largely to very high speculation/risk-taking among investors and the historic amount of liquidity/stimulus introduced into the system by the FED.*

Below we have highlighted what we feel are the major risks for the markets in 2021

2021 Stock Market/Economic Risks
Materially higher interest rates/inflation
Generally high valuations/stock speculation
Higher Corporate Tax Rates/Regulation
Slower exit from the COVID-19 Pandemic

Traphagen feels the backdrop for the economy, corporate earnings, unemployment, and financial markets are quite positive. Somewhat of a counterbalance to this, we have relatively high valuations in most assets, some areas of excess speculation, and the risks listed above.

We have positioned the portfolios to produce returns through a generally positive period, while at the same time providing protection from volatility, inflation, and rising interest rates. This was accomplished through limited bond exposure and meaningful allocations to renewable energy/infrastructure, select real estate assets, several alternative/private investments, and stocks we feel offer 'growth at a reasonable price'.

After correctly predicting a heightened chance of a recession in mid/late 2019 (reaching levels of around 60%) our Traphagen recession index (TRI) currently sits at around 24%, which indicates a very low change of recession over the next 12 months, giving us further confidence in the recovery.

As we put 2020 behind us and look forward to an improved 2021, we wish all our clients and their families the best. Again, as you concentrate on staying safe, maintaining personal relationships, and working hard to maintain your businesses or careers we always remain focused on ensuring your retirement or other long term financial goals remain on track. We appreciate the continued confidence and trust you have placed with us during this time and look forward to spring and summer when the long awaited return to normal will hopefully be underway.

Best regards,

Your Traphagen Investment Team