PrivateWealth Partners, LLC

FIRST QUARTER 2021 REVIEW

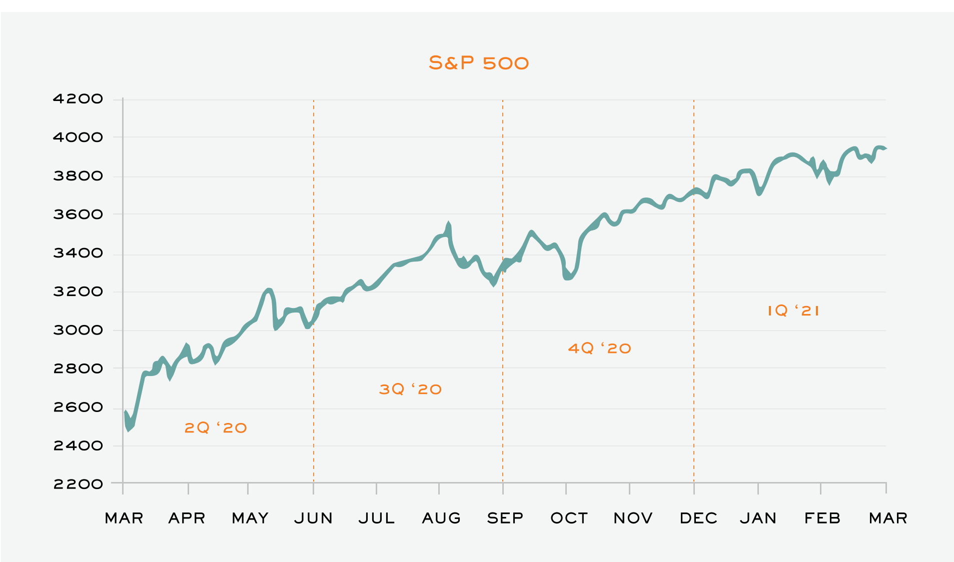
Dear Friend, April 15, 2021

U.S. stocks marched higher in the first quarter, with the S&P 500 pushing through 17 new highs and reaching 4,000 for the first time. "Risk-on" sentiment is being driven by what investors and consumers see as the long-awaited economic reopening, improving and accelerating economic data, and arguably the greatest fiscal stimulus experiment in the country's history. The latest stimulus installment, at $1.9 trillion, amounts to a staggering 9% of GDP.

The first quarter also saw surging U.S. Treasury bond yields, with the 10-year nearly doubling and posting the third largest quarterly increase in over a decade. In a sense, long-term interest rates in Q1 were telling us what stocks have been telling us for almost a year now—that the economy is accelerating its growth trajectory. In past years, strong fundamental economic growth has provided a constructive backdrop for equity market performance.

A positive economic outlook has given way to the "reopening trade," which has driven an accelerated rotation into cyclical stocks, favored value over growth, small-cap over large-cap, and helped boost shares in sectors most impacted by the 2020 shutdown, like Energy and Financials. We wrote last quarter that we expected 2021 to deliver large increases in vaccine uptake, a growth rebound, and impacts from a "wall of liquidity." So far, we think each factor has played a key role in driving asset prices higher.

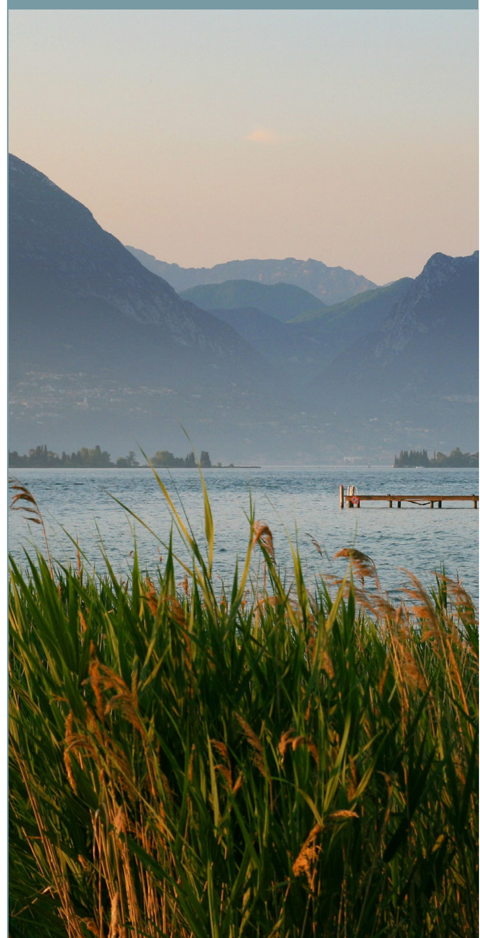
THE S&P 500 HAS POSTED STEADY GAINS OVER THE LAST YEAR



Source: Strategas Research

"Uncertainty actually is the friend of the buyer of long-term values."

-WARREN BUFFETT



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Excess liquidity in the markets, coupled with growing optimism, has also led to overt risk-taking in asset classes like cryptocurrencies, SPACs, and in individual stocks like GameStop. Historically, these trends have been harbingers of bubbles and crashes. We think it prudent not only to avoid these 'heat chasing' categories, but also to be mindful of excessive risk taking in other areas of the equity market. We continue to focus on quality and earnings.

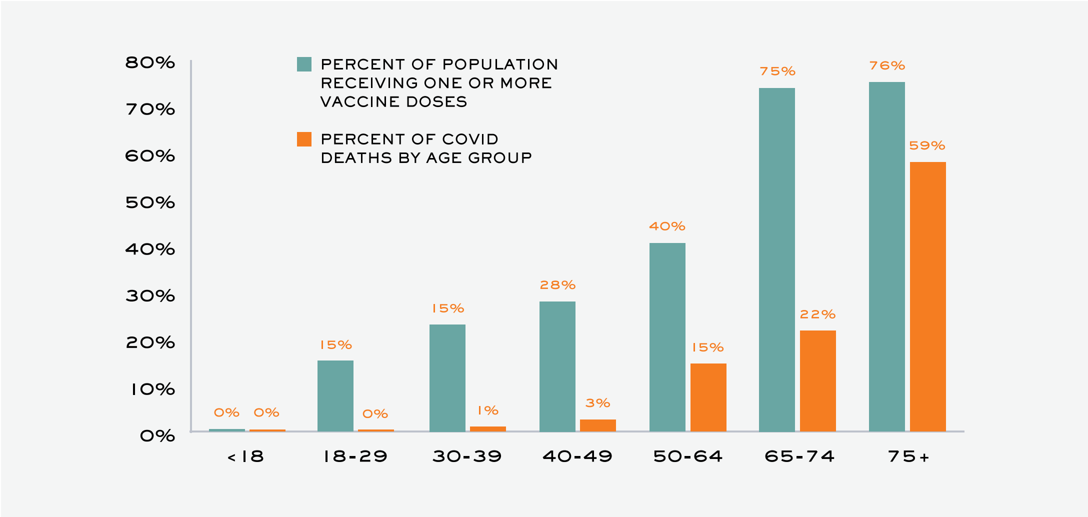
From a sector perspective, capital rotation was most evident in Energy and Financials. In 2020, Energy was the worst performing sector in the S&P 500, posting a -33.7% decline. Financials was near the bottom of the pack as well, falling -1.7% last year. In Q1 2021, however, Energy and Financials were the two top performers, rising +30.9% and +16%, respectively. Energy is benefitting from a demand resurgence in the global economy, and Financials have been helped by rising rates and a steepening yield curve.

We have written before that rising interest rates could put pressure on tech/growth stocks. We saw this dynamic play out in Q1, with a fairly tight correlation between rising yields on the 10-year U.S. Treasury and selling pressure in growth, tech, and other high valuation categories. Given Technology's surge in 2020 and strong performance in years prior, we view the current rotation as normal and healthy. We still believe Technology will drive secular growth in years ahead.

The "reopening trade" was most evident in the growth versus value category. Some of the biggest gainers in 2020 were companies providing services in the 'digital economy' (generally growth stocks), while the last few months have seen a leadership shift to companies that benefit from a fully reopened economy (generally value stocks). This rotation is a healthy sign, in our view—it is meaningful that overvalued areas of the market are not being bid-up to even higher extremes.

We ended our note last quarter striking an optimistic tone, writing that we "truly believe the outlook for the economy and public health are positive looking ahead to the second half of the year," and "we are confident the vaccine will become widely distributed enough to normalize the economy and strongly support growth." The vaccination campaign so far has been a success, with the nation administering 3 million shots a day mostly to older, more vulnerable Americans. The vaccine should be available to all adults by April 16.

PERCENT OF POPULATION RECEIVING ONE OR MORE VACCINE DOSES BY AGE VS. PERCENT OF TOTAL DEATHS BY AGE



Source: Strategas Research

Interestingly enough, one of Private Wealth Partners investment themes—digital enterprise technology—is responsible for many of the vaccine campaign's successes. Booking online appointments, checking-in patients when they arrive at a facility, running identity verification and eligibility, recording same-day health checks, and maintaining vaccination records are all examples of digital enterprise technology at work. There is also the matter of logistics in sending vaccines around the country and collecting data on shots given. If you have ever marveled at how we can access precise vaccine data – how many shots have been given in each state, for example – you are actually impressed by the capabilities of digital enterprise technology.

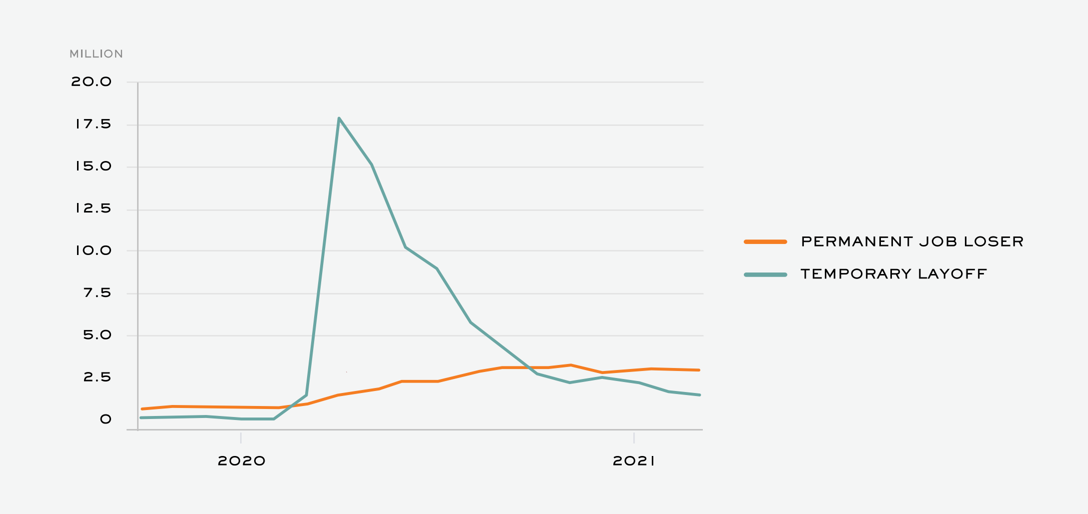
Some of the critical tools at work are cloud computing and cloud-based management software platforms, being run online and via tablets and laptops at vaccination facilities. By drawing computing power and capacity from the cloud – instead of from a hospital's data center – facilities can set up anywhere. Hence, convention center vaccination sites, stadiums, shopping malls, etc. This type of technology is driving innovation not only in vaccine administration but also across the economy, and we believe will be a key driver of secular growth for decades to come.

ECONOMIC GROWTH ON THE HORIZON

Almost every key labor market indicator flipped green in March. Overall hiring accelerated for the month, with U.S. employers adding a seasonally adjusted 916,000 jobs—the strongest gains since August 2020 and well above economist expectations. Most sectors in the U.S. economy saw growth—led by leisure and hospitality (+280,000)—which also likely provided fuel for the aforementioned 'reopening trade.' More job seekers are entering the labor market and more job postings are coming available, a good sign the recovery is gaining momentum. The unemployment rate fell to 6.0%.

The data is trending in the right direction, but the economy still has 8.4 million fewer jobs than it did a year ago, and the number of permanent job losses has risen steadily over the last year. This trend tells us that reaching broad-based full employment will be a multi-year process.

UNEMPLOYED PERSONS BY REASON FOR UNEMPLOYMENT



Note: Seasonally adjusted | *Source: Labor Department*

Demand is clearly returning to the global economy at a faster pace than many expected. Factories around the world are struggling to keep up with orders, creating supply chain bottlenecks and delaying inventory restocks. According to the ISM, the index of factory activity, which accounts for new orders, production, inventory levels, and commodity prices rose to its highest level in over 37 years. Rising demand is broad-based and affecting every major industry, but it is also causing supply shortages which puts pressure on costs. The most recent US PMI data showed manufacturing input prices rising to levels last seen in 2009, with manufacturer delivery speeds at their lowest levels since 2007.

Perhaps the most acute shortages are being seen in the supply of semiconductors, which seems to stem in part from a global movement to buy new computers and other electronics for home office setups. Semiconductors are also used in cars, and several major automakers—Ford, Toyota, Honda—have been forced to halt or slow production of various makes and models due to lack of essential components. The end result is that factories are reporting the sharpest rise in prices for inputs in nearly 10 years, which could add to inflationary pressures this year.

Given these supply chain issues are a bi-product of soaring demand, these all amount to 'good problems' for the economic recovery. At the same time, however, the ability of companies to pass through rising input costs to consumers will likely be a key determinant of the trajectory of S&P 500 profit margins.

INTEREST RATES AND VALUATIONS

The 10-year U.S. Treasury bond yield started 2021 at 0.93% and finished Q1 at 1.74%. Goldman Sachs sees the 10-year yield at 1.9% by the end of 2021, driven higher by rising inflation expectations and accelerating economic growth.

We have long expected interest rate 'normalization' as the economy shifted back into growth mode, so rising rates do not necessarily send off any alarm bells. Rates are still very low in a historical context. The speed of the adjustment in rates may create temporary consternation in markets, as certain over-leveraged investors and speculators have to adjust their positioning. To the extent higher rates take excessive froth out of the market, however, we ultimately view the volatility as a good outcome.

Rising bond yields may drive downside volatility in certain high valuation multiple stocks, but for stocks in general, rising rates have not necessarily been a bad omen, historically. LPL Research crunched the numbers. Over the last ~60 years, the S&P 500 rose an average of +17% during periods of rising bond yields, which lasted an average of 25.8 months.

HIGHER RATES ARE USUALLY BULLISH FOR STOCKS

S&P 500 Index Returns Under A Higher 10-Year Yield

RISING RATES START DATE	RISING RATES END DATE	DURATION (MONTHS)	CHANGE IN 10-YEAR TREASURY YIELD	S&P 500 GAIN/LOSS
12/26/1962	8/29/1966	44.7	1.7%	18.3%
3/16/1967	12/29/1969	34.0	3.6%	1.3%
3/23/1971	9/16/1975	54.6	3.2%	-18.1%
12/30/1976	9/30/1981	57.8	9.0%	8.7%
5/4/1983	5/30/1984	13.1	3.9%	-7.9%
8/29/1986	10/16/1987	13.8	3.3%	11.8%
10/15/1993	11/7/1994	12.9	2.9%	-1.4%
1/19/1996	7/8/1996	5.7	1.5%	6.7%
10/5/1998	1/21/2000	15.8	2.6%	45.8%
6/13/2003	6/28/2006	37.0	2.1%	26.0%
12/30/2008	4/5/2010	15.4	1.9%	33.3%
7/24/2012	12/31/2013	17.5	1.6%	38.1%
7/8/2016	10/5/2018	27.3	1.9%	35.5%
3/9/2020	2/25/2021	11.8	1.0%	39.4%
Average		25.8	2.9%	17.0%
Median		16.6	2.4%	15.0%
% Positive			100.0%	78.6%

Source: LPL Research, FactSet 03/03/21

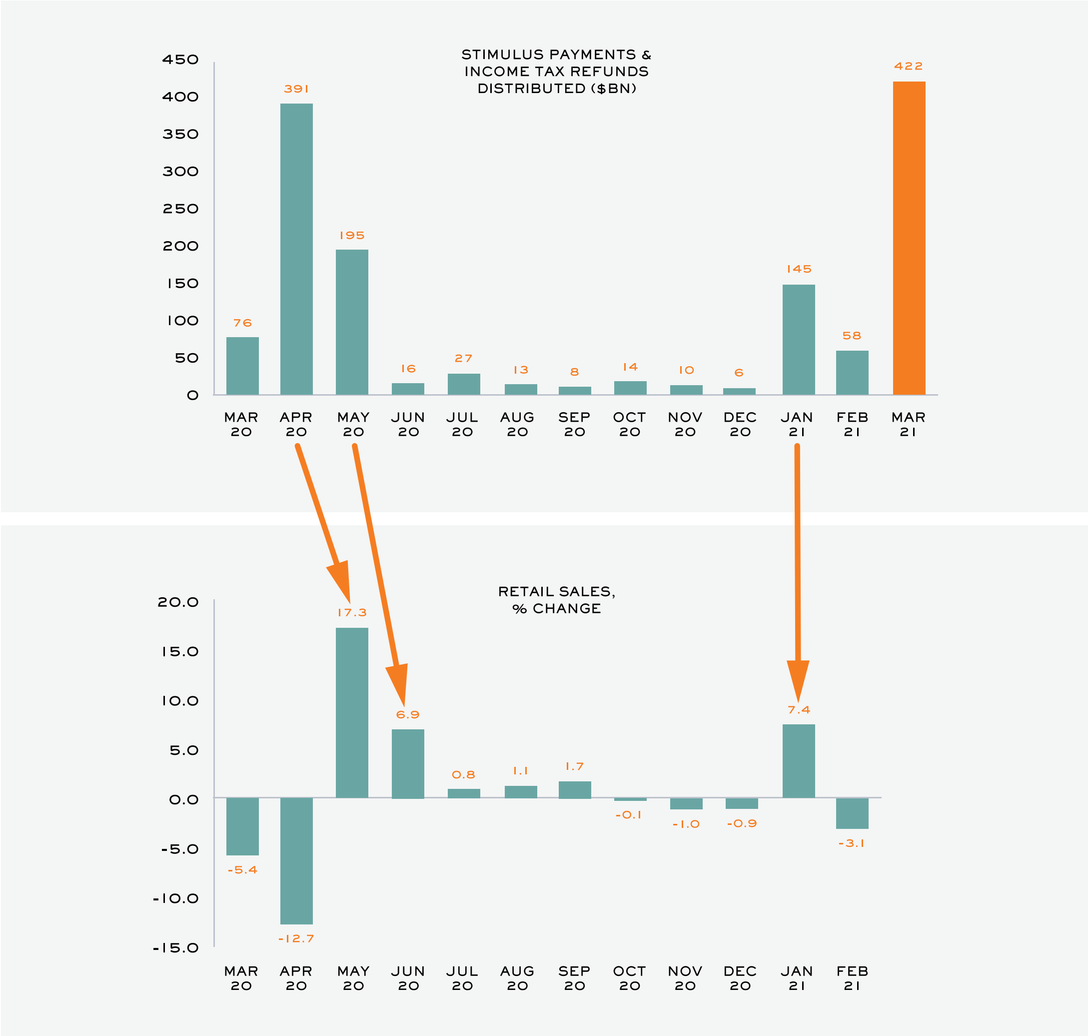
Here is Goldman Sachs's take on the issue: *"We believe equity valuations should be able to digest 10-year yields of roughly 2% without much difficulty. A 10-year yield of 2% and a constant S&P 500 forward EPS yield of 4.5% (the inverse of a 22x P/E multiple) would reduce the yield gap between stocks and bonds to approximately its 45-year average of 250 bp."* In other words, rising rates in 2021 and beyond may be problematic for overpriced pockets of the market, but not necessarily for the market at-large.

FISCAL STIMULUS OVER MONETARY STIMULUS

President Biden signed the $1.9 trillion 'American Rescue Plan' into law on March 11. The bill included direct payments to most American households, a significant expansion to the child tax credit, an extra $300/week in unemployment benefits through September 6, and billions of dollars across state and local education, Covid-related public health measures, and additional business loans.

There is plenty more in the bill. To appreciate the scope of direct payments, consider a young, middle income family with three kids. By qualifying for the stimulus checks and the child tax credits, they could receive somewhere in the neighborhood of $15,000 from the federal government in 2021. In short, the bill is massive, and a majority of dollars are making their way into the real economy. The chart on the next page demonstrates the clear impact that income tax refunds and stimulus payments have on retail sales.

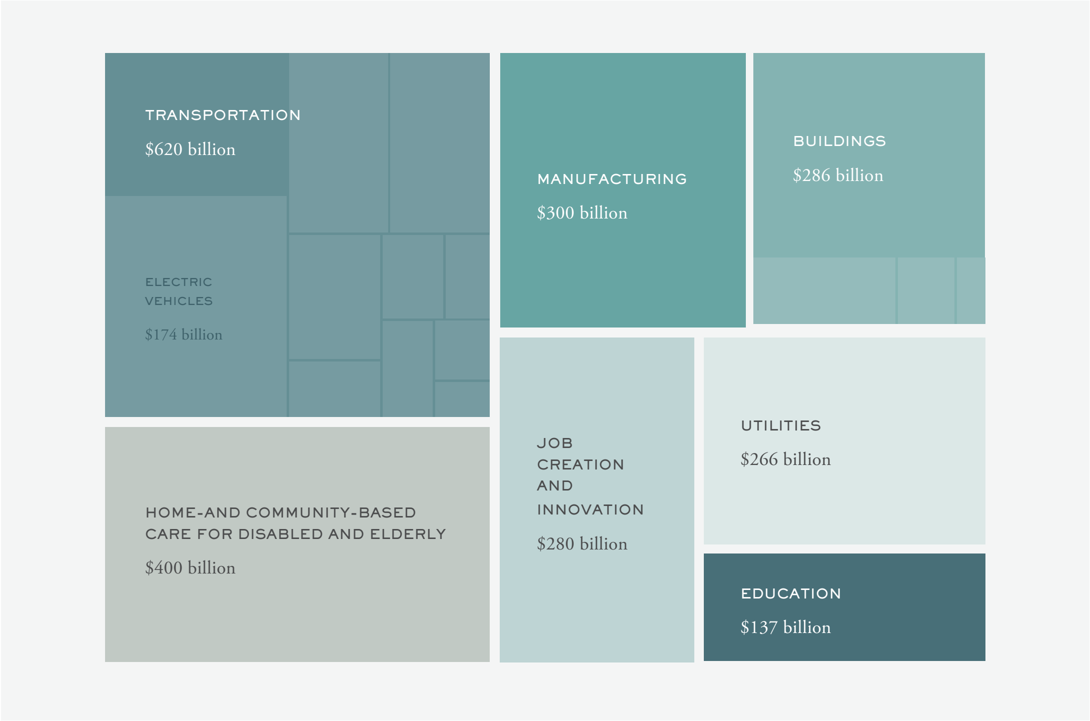
FISCAL STIMULUS MAKING ITS WAY INTO THE REAL ECONOMY



Source: Strategas Research

Biden's $1.9 trillion stimulus—and the $3.3 trillion in government spending that came before it—have driven savings higher and boosted the economy with (arguably short-term) demand-side stimulus. The proposed $2.3 trillion infrastructure bill is more supply-sided, with the administration attempting to invest in physical and human capital as a means to increase the economy's productive potential. The administration is, in effect, proposing to raise taxes on corporations while also picking the winners for its new investment and spending plans. Trillions of dollars of new spending will no doubt drive growth in targeted sectors and industries, but it seems less likely to lift growth across all sectors and industries. It depends on where the funding ultimately goes.

BREAKDOWN OF BIDEN'S INFRASTRUCTURE PLAN

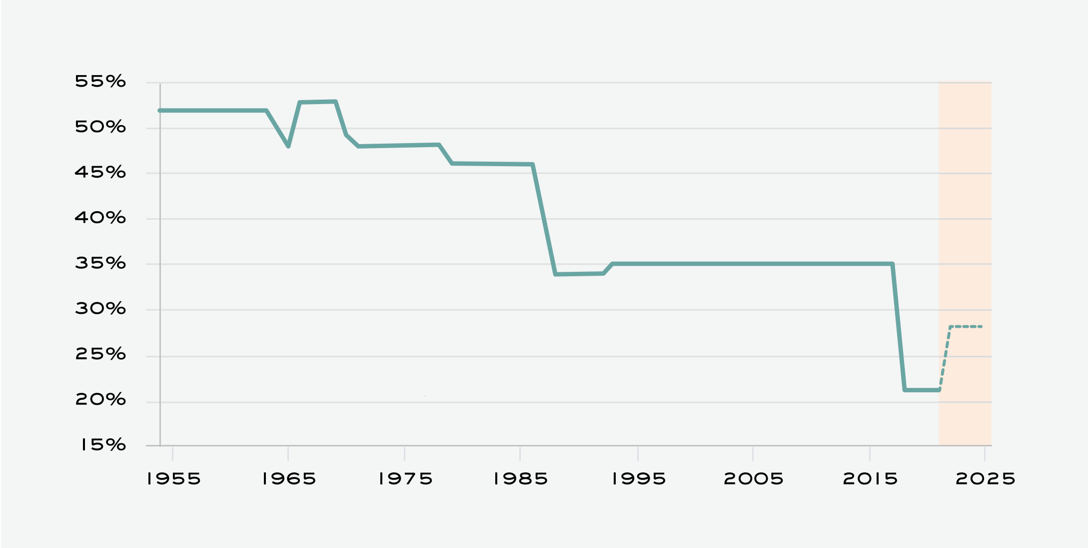


Note: Totals are rounded estimates | *Source: The White House*

Funding for the projects would be spent over eight years, which implies a steady stream of investment from the federal government to sectors like Industrials, Materials, Communication and Technology.

In order to pay for the plan, the administration is proposing to raise the corporate tax rate from 21% to 28%. Of note is that the Trump administration cut the corporate tax rate from 35% to 21%, so Biden's aim for 28% may indicate a new, lower benchmark for the corporate tax relative to previous decades. Prior to the 2017 Tax Cut and Jobs Act, the corporate tax rate had been above 30% since World War II.

U.S. STATUTORY CORPORATE TAX RATE*



*Rate for top tax bracket, federal taxes only | Sources: IRS, White House

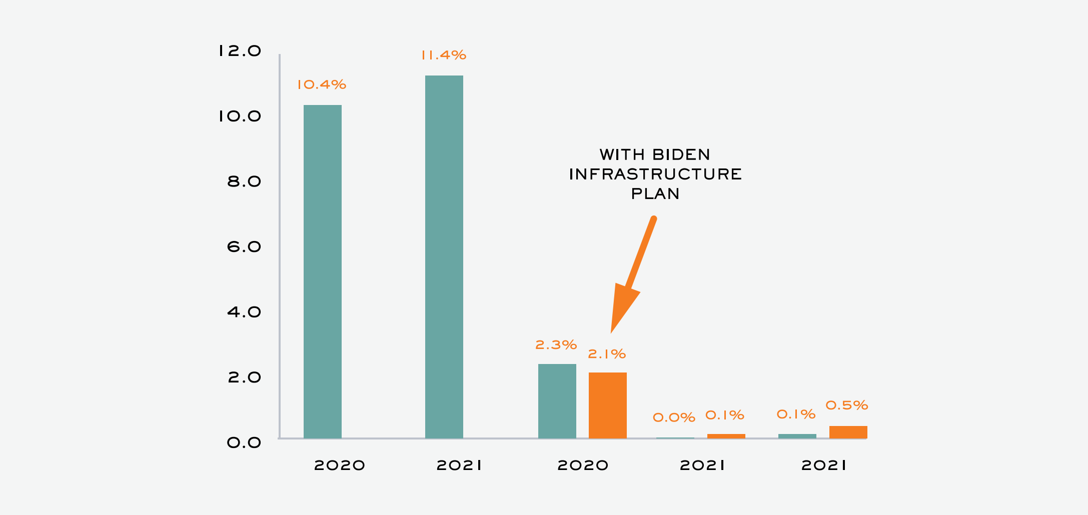
The bill is very far from becoming law, and even moderate Democrats have reservations. Senator Joe Manchin has said he only supports an increase in the corporate tax rate to 25%. The Biden administration is not likely to get everything they want in the bill. It is also important to consider how different the proposals would be under a Warren or Sanders presidency, or if Democrats had more Senate seats. Even still, the Biden administration appears to be throwing most of its political capital behind this plan, raising the chances that some form of the bill gets passed eventually—perhaps through the budget reconciliation maneuver that does not require Republican support.

CONCLUSION

Over the next few months, growth is likely to be driven higher by vaccination uptake combined with economic reopening. The $1.9 trillion stimulus plan will almost certainly boost spending over the short-term as well.

We would also note, however, that the demand-driven 'boom' of additional government spending will be somewhat temporary in nature, and we can expect fiscal tightening starting in 2022 (see chart on the next page).

FISCAL POLICY STIMULUS, % OF GDP, FISCAL YEAR



Source: Federal Reserve Bank of St. Louis

A risk we see is that the equity market could start discounting decelerating growth once the fiscal boost runs its course. We do not necessarily see this as a Q2 2021 issue, but it is a factor to keep in mind for the second half of the year and beyond.

There is a reasonably good argument that the compressed nature of the recession—coupled with extraordinary stimulus measures—could give way to a compressed recovery, with many of the gains front-end loaded into the next few quarters. Time will tell, but in the meantime the U.S. economy remains in a strong position to deliver significant growth in 2021.

If you have any questions about this review or would like to speak to us more about our outlook or portfolio strategy, please do not hesitate to contact us. We hope you have a lovely spring season and enjoy more time outdoors. As always, thank you for your continued confidence.

Sincerely,

Kenneth F. Siebel
Peter K. Maier
William F. Dagley
David P. Wong
Richard G. Kuchen
James Lenczowski
Jason M. Saxon
Chris Greene
Katrina Sutherland
Elyse Gottschalk
Vickie Marinovich

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