PrivateWealth Partners, LLC

FOURTH QUARTER 2020 REVIEW

"To be an investor, you must be a believer in a better tomorrow."

-BENJAMIN GRAHAM

Dear Friend, January 13, 2021

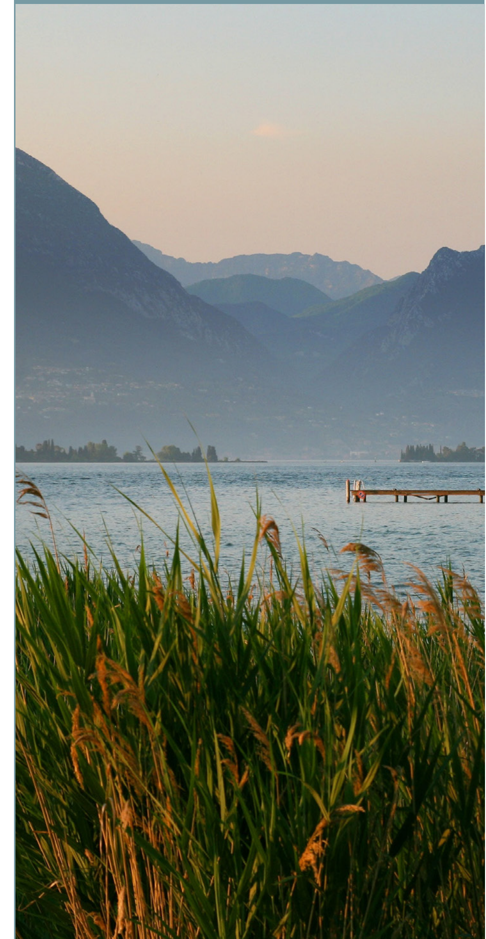
2020 was a remarkable year everyone will remember in different ways, but mostly for its challenges, hardships, and persistent uncertainties. We are looking forward to the new year.

Much like everything that took place in 2020, the stock market also seemingly defied norms and reality. As noted in a November *Bloomberg* article, "*punishment has been swift for almost any skeptical [investment] instinct in 2020. Views that seem logical on their face – that the election would sow pain, that a recession would kill the rally, that the pandemic would ruin the economy – immediately became money losers.*"

Indeed, the S&P 500 index disregarded the mood of the country and advanced +18.4% for the year, following a solid +31.5% return in 2019. While the S&P 500 posted a two-year compounded return of +55.3%, the equity portion of Private Wealth Partners' strategy performed even better. Our thematic approach to investing—which in 2020 focused on leading health care and digital economy beneficiaries—has helped drive portfolio performance.

AN INTRA-YEAR BEAR MARKET DID NOT PREVENT THE S&P 500 FROM REACHING NEW HIGHS

Source: Strategas Research



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Technology was the best performing sector for the year (+43.9%), and Private Wealth Partners' overweight throughout the year helped drive our strong relative performance. Consumer Discretionary (+33.3%), and Communication Services (which is also tech-heavy, +23.6%) were also among the top performers last year. The worst performers in 2020 were Energy (-33.7%), Real Estate (-2.2%), and Financials (-1.7%). The tide did not lift all boats. 2020 created an environment that rewarded active management.

Financials have been dragged by rock-bottom interest rates and a flattish yield curve, but we think some upward pressure on the long end of the yield curve could improve the profit picture for major banks in 2021. The 10-year U.S. Treasury has been moving higher and just crossed 1% for the first time since March 2020. For reasons explained later in this review, we think interest rates could be pressured even higher throughout 2021 and perhaps beyond. Well-capitalized and earnings-generating banks could benefit.

2020 presented an odd dynamic for stocks: a seemingly chaotic and uncertain world, underpinned by a resilient and rallying stock market. While this disconnect may seem logic-defying, it is actually a defining feature of stock market history. The stock market has no emotional connection to the world's events 'in the moment.' Markets are always forward-looking. In 2021, we think the market sees large increases in vaccine uptake, a growth rebound, and a wall of liquidity.

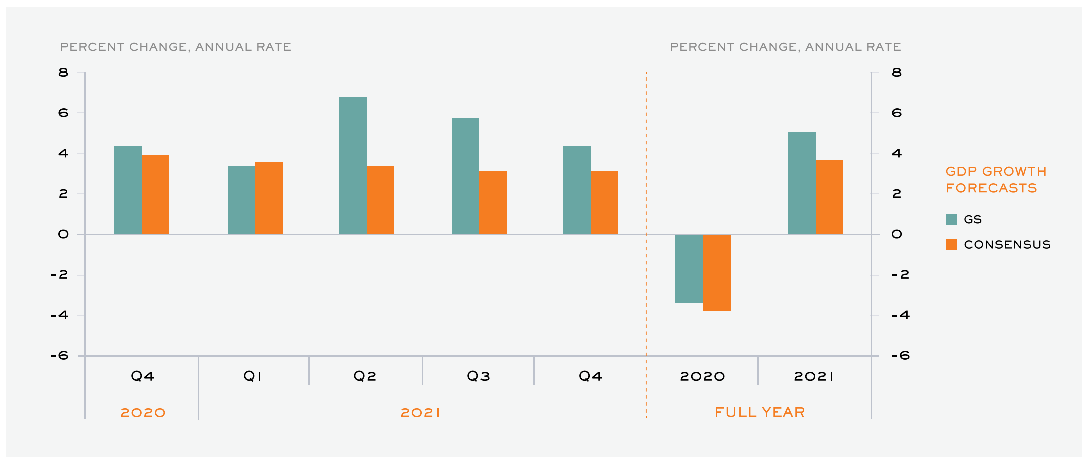
Uncertainties persist in the new year. But we urge investors to remember the importance of separating emotion and/or political views from the investment decision-making process. Every new war, pandemic, or crisis is a 'first of its kind' event, and adversities often feel insurmountable in the moment. But history reminds us that these events are nothing new to the U.S. economy. The Spanish flu, World War II, Kennedy's assassination, Vietnam, the Global Financial Crisis, this latest episode in the U.S. Capitol—the economic engine does not give up that easily. 2021 will be no exception, in our view. That said, we expect more market volatility in the new year.

2021 U.S. ECONOMIC AND MARKET OUTLOOK

Nuveen's Chief Equity Strategist, Robert Doll, notes that "stocks should get a boost from an economic recovery combined with continued hyper-accommodative monetary policy, fiscal support for households and businesses, and negative real returns on government bonds."

From an economic recovery standpoint, mass immunization is likely to fuel a mid- to late year upswing in economic activity, in what Goldman Sachs referred to as "a virtuous cycle of increasing consumer and business confidence [that] should boost GDP and provide for strong corporate profit growth." Expectations are for better-than-expected full year 2021 growth for the U.S. economy, as pent-up demand and excess liquidity drive spending and investment higher in the second half of the year. The vaccine has been proven to work effectively—now it is just a matter of getting it broadly distributed.

GOLDMAN SACHS PREDICTS HIGHER-THAN-CONSENSUS GDP GROWTH IN 2021

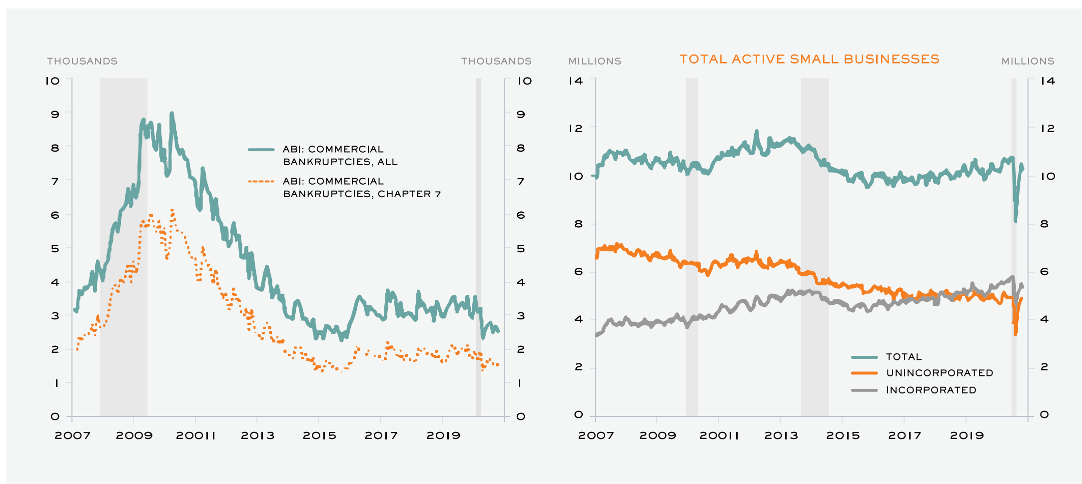


Source: Goldman Sachs

Today, jobless claims remain elevated with about 750,000 Americans applying for unemployment benefits each week, a number that has remained fairly steady since October. In December, U.S. employers shed 140,000 jobs, the first employment decline since April 2020. The services sector is also notably suffering, as the pandemic continues to restrict in-person economic activity.

Current economic fundamentals are by no means rosy. But the toll on businesses has not been nearly as bad as one would expect, as commercial bankruptcy filings (left side of chart below) are actually running below pre-pandemic trends. Small businesses fared far worse (right side of chart below), but snapped back considerably well in the second half of 2020 thanks in large part to PPP loans, the ability to cut costs during the worst of the pandemic, and a sharp rebound in business revenues. An accelerating pandemic coupled with a disorganized vaccine rollout pose a major risk in Q1 and Q2, but more fiscal stimulus may help businesses bridge the time needed for mass immunization.

BUSINESS BANKRUPTCIES HAVE BEEN SURPRISINGLY LIMITED

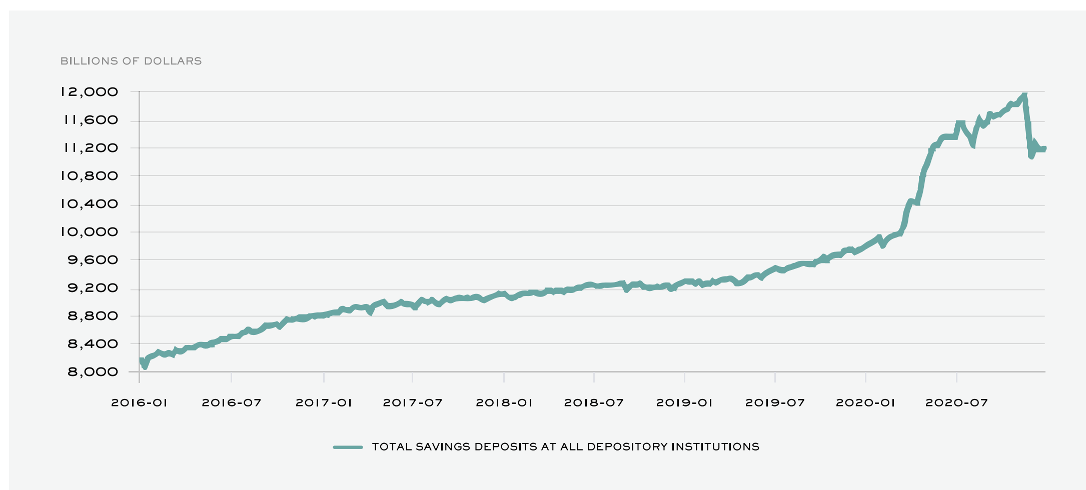


Source: Goldman Sachs

The latest fiscal stimulus package, signed into law on December 27, has the federal government spending another $900 billion, or roughly 4.3% of GDP. Part of the bill includes $600 direct payments to lower and middle income Americans, as well as providing more runway for boosted unemployment benefits ($300/week). President-elect Biden has stated that more stimulus is on the way, and the 50/50 split in the Senate will make another short-term spending package all but assured.

From a macroeconomic perspective, it would seem that direct injection of money into the U.S. economy is designed to offset the pandemic's toll on personal savings. But American households are not dipping into savings—they are adding to them. Americans who can work remotely, spend less, invest in the stock market, and hold hard assets like real estate have actually increased their net worth during this time.

TOTAL SAVINGS DEPOSITS HAVE SOARED OVER THE LAST YEAR



Source: Federal Reserve Bank of St. Louis

By some estimates, households have added $1.7 trillion in savings deposits since last February, thanks largely to stimulus payments and to the savings accrued by services sector closures. By spring, according to Pantheon Macroeconomics, savings will likely top $2 trillion —an unprecedented surge. These accrued savings are likely to drive a spending surge later in the year, in our view—a liquidity cannon aimed at 2021.

THE FEDERAL RESERVE, INTEREST RATES, AND INFLATION

Many analysts were worried about inflation in the aftermath of the 2008-2009 Global Financial Crisis. Central banks around the world were implementing hyper-accommodative quantitative easing programs, and balance sheets were expanding by the trillions. But runaway inflation never arrived. In fact, inflation has been mostly benign.

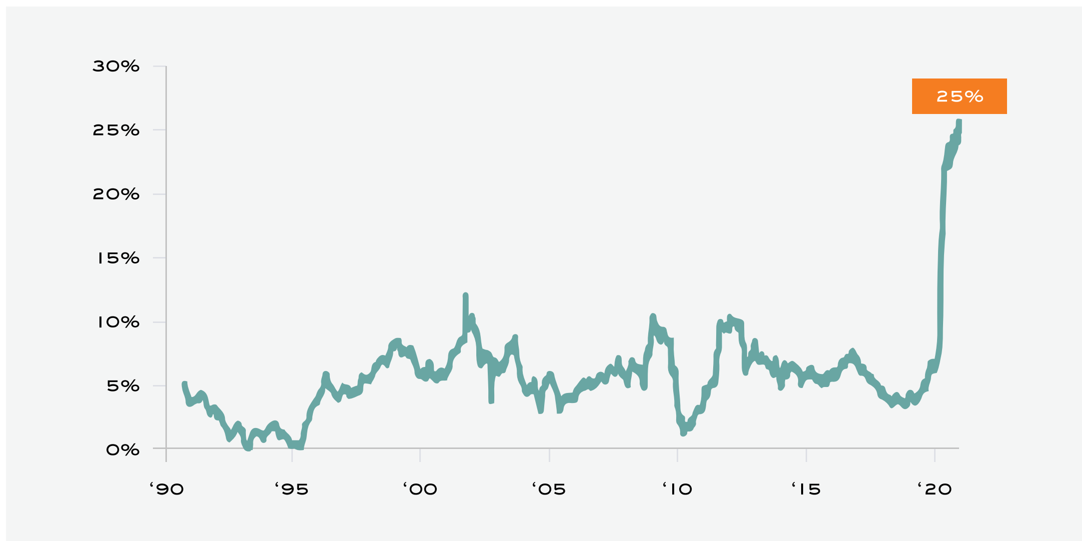
The reason is that, going back to 2009, QE and other liquidity programs just served to recapitalize banks after the devastation of the crisis. Banks needed capital reserves, and

Dodd-Frank legislation required them to reach certain thresholds (Tier 1 capital ratios). When the Federal Reserve unleashed QE, most of the new liquidity ended up parked in bank reserves. There is a good argument that excess, cheap liquidity combined with ultra-low interest rates led to asset price inflation (surging stock market) in the last decade, but not to consumer price inflation. In order to trigger the latter, dollars need to move around in the real economy.

Fast-forward to 2020, where banks were already well-capitalized heading into the crisis and the deflationary shock hit consumers, small businesses, and generally speaking, Main Street versus Wall Street. As laid out by the financial writer Lyn Alden, *"instead, this time, fiscal authorities (Congress and the President) spent trillions of dollars into the real non-bank economy, sending folks stimulus checks, boosting unemployment benefits by an extra $600/week (which is $2,400/month for several months for folks who received it), financing banks to give small businesses PPP loans that mostly turn into grants, and partially bailing out some of the hardest-hit corporate industries with fresh capital injections. It was a much larger stimulus than anything from 2008/2009."*

The end result is that the M2 money supply is rising at an unprecedented 25% year-over-year rate, which is much faster than during the inflationary period of the 1970s:

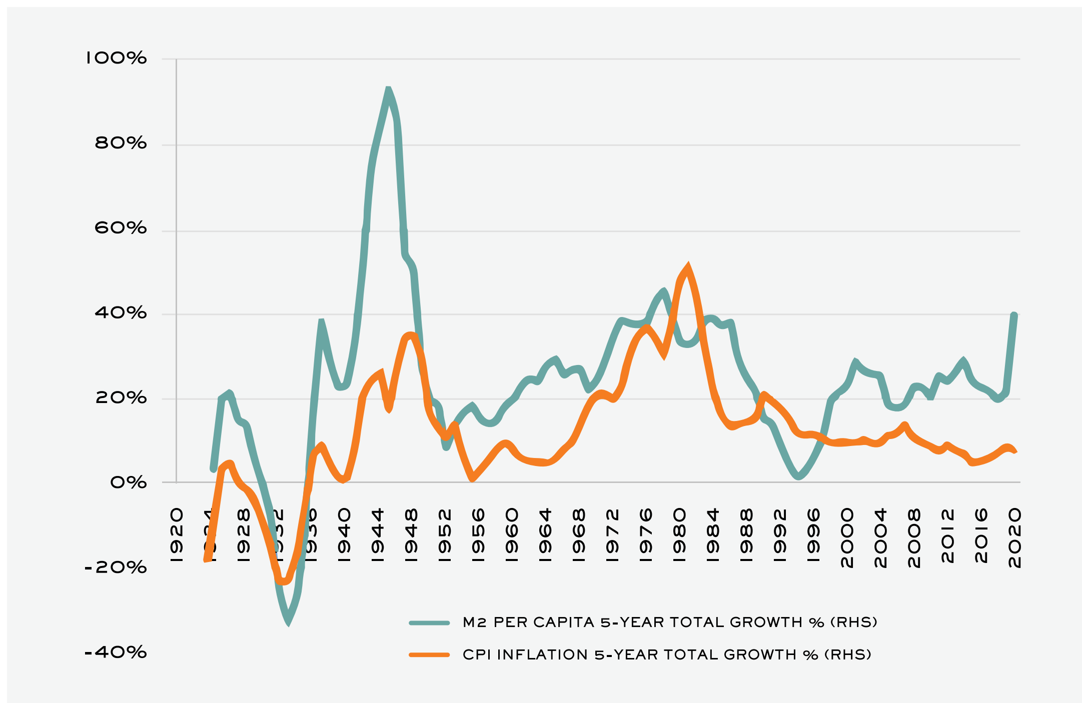
U.S. FEDERAL RESERVE M2 MONEY SUPPLY



Source: Strategas Research

The implication is that rising M2 money supply could give way to inflation in the not-too-distant future, which could start placing upward pressure on interest rates. As seen in the chart on the next page, there is a fairly tight historical correlation between M2 money supply and inflation:

HISTORICAL U.S. M2 PER-CAPITA GROWTH AND INFLATION



Source: Federal Reserve

Upward pressure on inflation may eventually put some pressure on the Federal Reserve to tighten monetary policy, though probably not in the form of raising interest rates in 2021. Recent history with the equity market's "taper tantrums" reminds us that dialing back accommodative monetary policy can give way to volatility, which is especially prevalent in a stock market with a relatively high P/E.

In 2021, the interplay between inflation and interest rates will be a key fundamental to track. To the extent inflation drives interest rates higher, we may reasonably expect a reality check for high valuation sectors, like Technology.

PRIVATE WEALTH PARTNERS UPDATES

Private Wealth Partners is pleased to announce we are now offering comprehensive financial planning services to current and prospective clients. We now have the resources, tools, and personnel in place to help you structure a long-term financial plan designed to help you reach your goals.

If you are interested in learning more, the client services team can work with you and your portfolio manager to evaluate your consolidated assets, liabilities, cash flow needs, and long-term objectives using our robust financial planning software. In addition to determining the best strategy for your assets, our team can assist you in refinancing of debt, creating tax-efficient strategies, and coordinating with your estate attorney to develop a long-term estate plan.

Financial planning is a process, but the end goal is to put a plan in place to help you pursue your long-term goals. We can also adjust your plan over time, as your needs or financial situation change. Please contact Elise by phone at 415-464-2122 or by email to learn more: egottschalk@pwpart.com.

We also would like to update you on privacy and security, which we take very seriously. Cybersecurity is a major concern these days, and news stories of data breaches occur frequently. Most recently, the Treasury, Commerce and Energy Departments, and other government agencies were infiltrated in a wide-ranging hack attributed to Russia. It is ever-important to have safeguards in place.

We wanted to share with clients some of the wide-ranging security measures put in place by Charles Schwab:

- MULTI-LAYERED TECHNOLOGY
  The Charles Schwab sites feature encryption and risk-based security technology. These controls, combined with automated alerts, an identity verification process and rigorous monitoring, help defend against unauthorized account access.

- HIGHLY-TRAINED SPECIALISTS
  Employees who handle sensitive information are trained in privacy and security. Schwab's commitment to the privacy of your personal and financial information can be found here: https://www.schwab.com/legal/privacy.

- SECURE PROCESS AND PROCEDURES
  Whether you call, visit a branch or go online, your identity will be verified before any sensitive information is discussed. Also, you will receive an alert when money is moved, or your personal information is changed.

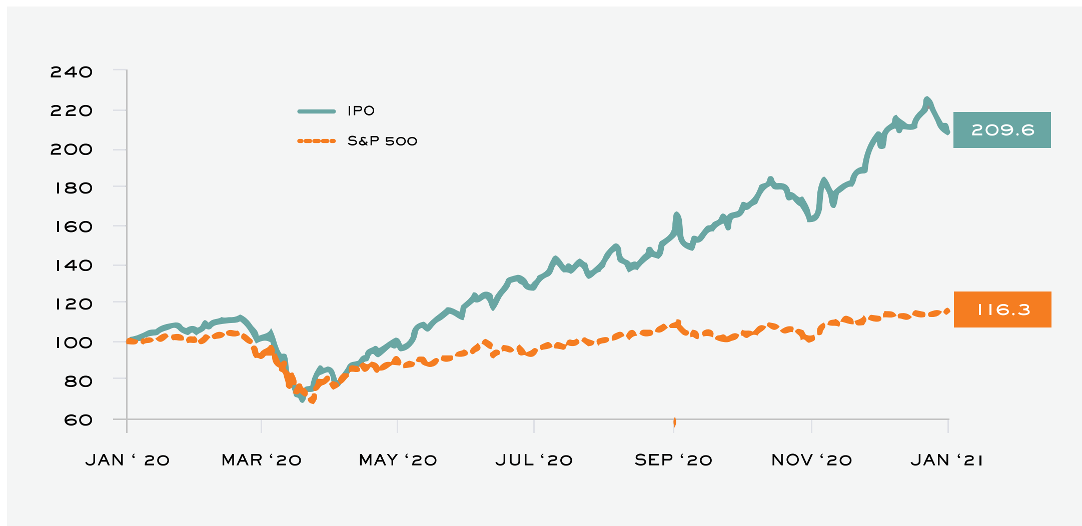
We encourage clients to read more about security measures being put in place by Schwab. Learn more here: https://schwab.com/schwabsafe.

CONCLUSION

There is little doubt the U.S. economy will stage an economic recovery in the second half of the year, but a few questions remain: will the economic recovery exceed or fall short of expectations? Will the high savings rate and 'wall of liquidity' in the real economy create inflationary pressures? And finally, how much of the economic recovery may already be priced-into stocks?

Investors are showing signs of growing optimism and risk-taking, which is usually a cautionary sign. An example of this increase in risk taking was the public listing of Airbnb and DoorDash last year. Both stocks were massively oversubscribed in what appeared to be major buy-in from the retail trading community. IPOs in general widely outperformed the S&P 500 in 2020:

IPO INDEX VS. S&P 500 INDEX



Source: Strategas Research

"Risk-on" sentiment also ended the year with somewhat of a bang – investors borrowed a record $722.1 billion on margin through November 2020, and individual investors opened more than 10 million new brokerage accounts in 2020 (a record). The parabolic rise of bitcoin and stories of 100+% gains are flooding the airwaves. *The Wall Street Journal* also reported that the online trading platform Robinhood, which targets millennials and younger investors, saw 500,000 downloads in December alone. As optimism grows, we might reasonably expect also more frequent bouts of volatility and the possibility of a correction in the short-term.

As Robert Doll pointed out, however, hyper-accommodative monetary policy (including Fed financed fiscal stimulus), direct payments to Americans, massive liquidity and savings, and a "v-shaped" services recovery tied to mass immunization should drive the next sustainable equity rally.

On the political side, Democrats now control the White House, Senate (50/50 with the vice president casting the tiebreaker vote) and a narrow margin in the House. In 2001, Republicans had a 50-50 Senate, a similarly thin majority in the House, and were still able to pass a $1.3 trillion tax cut, No Child Left Behind, and a big boost to the Defense budget. Early appointments indicate that President-elect Biden is staying close to the 'center,' but regardless, Democrats are poised to make some changes. It is too early to weigh too deeply into policy implications today, but we will have more analysis in our Q1 2021 letter.

We truly believe the outlook for the economy and public health are positive looking ahead to the second half of the year. The vaccine roll-out has been underwhelming so far, but will improve with time. We are confident the vaccine will become widely distributed enough to normalize the economy and strongly support growth in the second half.

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. Keep safe and healthy this winter, and stay constructive about the future.

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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