VWG WEALTH MANAGEMENT
A Hightower Company

4th Quarter and 2020 Year-End Review

Executive Summary

• Large U.S. stocks, as measured by the S&P 500 Index, rose 12.1% for the quarter, and increased an astonishing 18.4% this year. This optimism was countered by the massive damage COVID-19 inflicted on health, employment and the global economy. It belied the pandemic's spread which closed the year by recording highs in new U.S. cases, hospitalizations and deaths. Volatility expected from a highly contentious U.S. presidential election failed to materialize.

• The 4th quarter's sharp rebound in small U.S. stocks reflected optimism for global economic recovery, ending a "brutal 3-year stretch for the average stock." High yield bonds, and economically sensitive commodities copper and oil rose in tandem.

• Near-zero interest rates and over $17 trillion globally in negative-yielding debt make stocks and many other assets relatively attractive.

• Some signs of market excess and froth are evident; however the U.S. stock market is bifurcated. Many industry sectors and smaller stocks are reasonably valued.

• The world is awash in liquidity. Considering global highly accommodative fiscal and monetary policies, and of the approval and distribution of highly efficacious vaccines, investors cannot be too negative.

• VWG currently recommends diversified, moderately positioned portfolios for long-term investors. We are optimistic on specific public and private equity, debt and real estate managers and strategies. We do expect to see a transition to choppier and at times more volatile asset prices than those we've enjoyed the past six months. Holding adequate reserves for future needs and a psychological 'margin of safety' is required.

Review of the Markets

The fourth quarter capped off a most puzzling and remarkable year for U.S. stocks, as the S&P 500 Index gained 12.1%. It was the benchmark's best 4th quarter since 1999. The strength was fueled in part by the approval of two highly efficacious vaccines against the COVID-19 virus. This belied the diseases' demoralizing spread as December marked the pandemic's worst month in new U.S. cases, hospitalizations and deaths. Market volatility expected to emerge from the highly contentious presidential election was nowhere to be seen.

For the full year the S&P 500 Index returned 18.4%. This positivity occurred despite the pandemic's massive shock to the U.S. economy, employment, and corporate earnings. The year was marked by a sickening 23-day, 33.9% plunge that culminated on March 23. From there it rose steadily, witnessing only two mild pauses in September and October. The stock market ended the year enjoying extremely strong breadth, with 90% S&P 500 stocks trading above their 200-day moving average. Breadth is widely considered a sign of market health.

Small U.S. stocks roared back in the 4th quarter, as hopeful signs for economic recovery began to emerge. The Russell 2000 Index rose 31.3%, the best quarter in its history. It is now trading at its highest-ever margin above its 200-

day moving average. 2020's full-year benchmark index return was 20.0%, the first time it outperformed the S&P 500 since 2016.

International stocks outperformed large U.S. stocks in the 4th quarter. The MSCI EAFE Index, a benchmark for stocks of companies domiciled in developed economies, increased 15.7%. It gained 7.6% for the year. Quite notable were Japanese stocks. The Nikkei 225 broke out to levels not seen since the early 1990's. Emerging markets were also a bright spot as many Asian economies combatted the pandemic with greater success than the Eurozone and U.S. The MSCI Emerging Markets Index rose 18.4% in the 4th quarter and improved 17.0% the full year.

Bonds did not echo equities "risk-on and economic recovery" theme in the 4thquarter. Large flows continued into bonds and bond exchange-traded funds. These, along with ongoing asset purchase programs by global central banks, kept yields low despite the optimism of other asset markets. The U.S. 10-year Treasury ended the year with a paltry yield of 0.92%. That put 2019's close of 1.92% quite attractive in comparison. Putting the global near-zero yields into perspective, Strategas' Jason Trennert cited that stocks and other assets including residential real estate were attractive relative to bonds. For the quarter the Barclays Aggregate Bond Index improved 0.7%. Its full-year return was 7.5%.

High yield bonds reversed course from a very difficult year in the 4th quarter. Following small U.S. stocks' 'economic recovery' theme, high yield bond spreads (against investment grade bonds) finished the year near their tightest levels since the pandemic. This a sign considered to be positive confirmation for a 'risk-taking' environment. The Barclays High Yield Very Liquid Bond Index rose 6.2% for the quarter, but still dropped 4.9% for the year. The S&P National Municipal Bond Index returned 1.8% in the quarter and earned 5.1% for the year.

Economically sensitive copper and crude oil also reflected 4th quarters' forward optimism toward eventual recovery from the pandemic-driven crisis. The NYMEX High Grade continuous futures contract increased 16.5%. The NYMEX West Texas Intermediate Crude Oil continuous futures contract gained 20.4%. For the year commodities suffered losses, reflecting the damaging effects on the global economy. From a wider perspective, commodities as an asset class underperformed equities for the 10th straight year. Gold was a bright spot, as the U.S. dollar slipped in value against the currencies of most developed countries. The NYMEX Gold continuous futures contract gained 24.8% for the year.

Observations Looking Back, and Looking Forward

What a tumultuous, gut wrenching year it has been – for families, our health care system and its dedicated work force, for businesses and for investor psyches. Looking back a year ago, no one could have predicted how it would all unfold – from the virus' outbreak and its spread, widespread panic and lockdowns, the global tidal waves of fiscal and monetary stimulus, novel responses by small businesses and entrepreneurs, the impact on the U.S. presidential election, the unprecedented mobilization of the scientific community in developing vaccines, and the dramatic unexpected response by markets.

Much has been said, and there will be plenty more to be said, as the hopeful containment of the virus develops. From an investment perspective, here are some observations:

Risk is rarely where you look for it.

Morgan Housel of the Collaborative Fund writes:

"The biggest economic risk is the one no one's talking about, because (they will then be ill-prepared for it, and when it arrives) its damage will be amplified . . . .

Paying attention to known risks is smart. But we should acknowledge that what we can't see, aren't talking about, and aren't prepared for will likely be more consequential than all the known risks combined . . . .

We are bad at forecasting the economy (and markets). But that's not (just) because we can't analyze the impacts of an event or series of event. We can't analyze events we haven't begun to consider. ***Risk is what you don't see***."

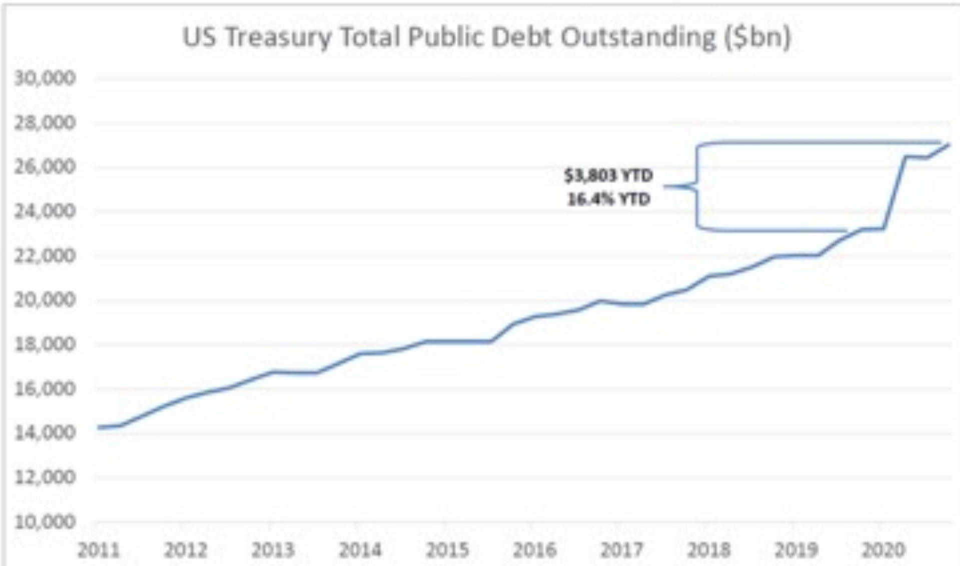
Staying on course is difficult.

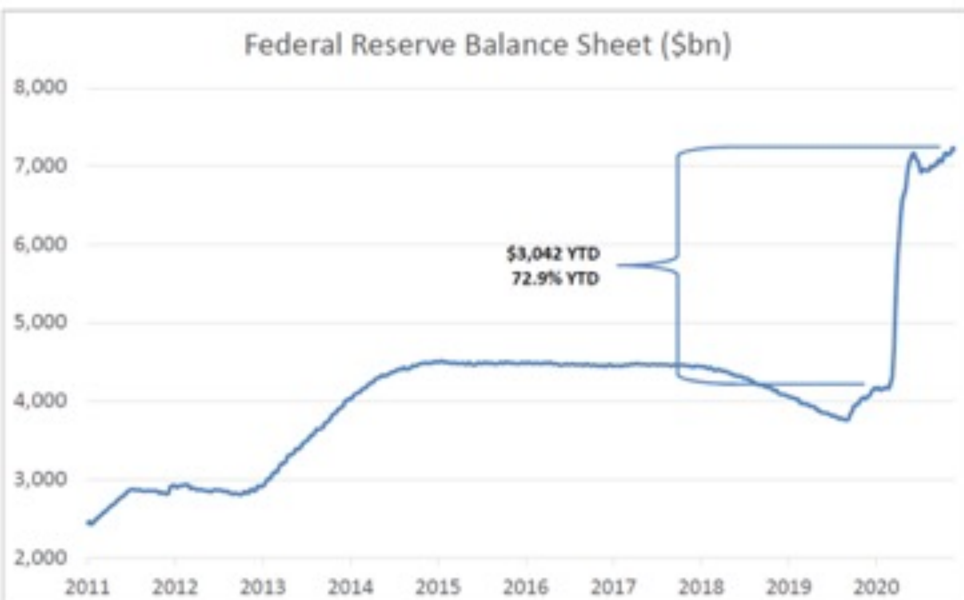
Panics force us to challenge our beliefs and expectations for the future. The COVID-19 pandemic did that with a vengeance, turning our world upside down. Our strategy of planning for uncertainty in advance with a custom long-term financial plan, combined with a diversified portfolio constructed to meet the plan's needs, helped assuage client concerns during this stressful time. It helped to maintain proper perspective, and to reduce the instinct of making abrupt, knee-jerk reactions. Asset mispricing during extreme volatility created opportunities for VWG to implement tax-loss harvesting strategies.

By taking these steps, we helped our clients address one of their greatest *known*risks. This is the risk to their long-term financial viability, threatened by getting thrown off their plan, and our shared investment process. 2020 proved how planning ahead, and keeping a long-term focus, is critical for investment success. The wise sage Charlie Munger, vice chairman of Berkshire Hathaway, states this another way, *"The first rule of compounding: Never interrupt it unnecessarily."*

The world is awash in liquidity.

The size and speed of fiscal and monetary response to the COVID-19 pandemic has been simply massive. U.S. lawmakers passed four pieces of legislation costing approximately $2.6 trillion. More is likely on the way. The Federal Reserve has expanded its balance sheet by $2.3 trillion, which continues to grow monthly. Other aggressive actions directed at easing financial conditions have been taken, and more are promised if necessary. Global governments and central banks have followed in suit. In this backdrop, investors cannot be too negative on stocks, private equity, and many types of real estate and other investments. Near-zero interest rates in the U.S. and over $17 trillion globally in negative-yielding debt makes bonds less appealing at the margins.





Charts courtesy of Bloomberg, Chatham Asset Management

Valuations are historically high. Some signs of froth are evident.

The S&P 500 Index has rebounded 63% from its March bottom with hardly a tremor. On both a trailing and forward basis, the index's price/earnings ratio is historically high. Signs of speculative froth are evident – in the explosion of single stock options activity, trading in recently released headline IPOs, and the issuance and valuation surge of special purpose acquisition companies (SPACs).

Chart courtesy of Bespoke Investment Group

Valuations in public markets are highly bifurcated.

VWG favors managers who invest in the equity and debt of businesses, not in "the markets." A deeper look beyond indexes and 'the market' is illuminating. If we remove the largest 5 stocks and look at the S&P 500, valuations are more reasonable.

Chart courtesy of Goldman Sachs

Drilling down into 2020's stock performance by market capitalization provides a different picture. Atlanta Capital shows the distinct outperformance of the largest quintile of U.S. stocks this year (through September 30). They also point out that 2020's best performance of large and small stocks came from those of 'low quality, low-or-no earnings companies.' The bulk of U.S. public companies are still trading at reasonable values. Strategas Research Partners' Chris Verrone states that with the 4th quarter's resurgence in the Russell 2000 index, "the brutal three-year stretch for the 'average' stock is over." Chatham Asset Management reveals that aggregate S&P 500 cash balances as a percentage of their total assets are at thirty-year highs. This cash could be fuel for capital expenditures and stock buybacks once a recovery is underway. Similar themes are evident in many international equity markets. There is opportunity ahead for active management.

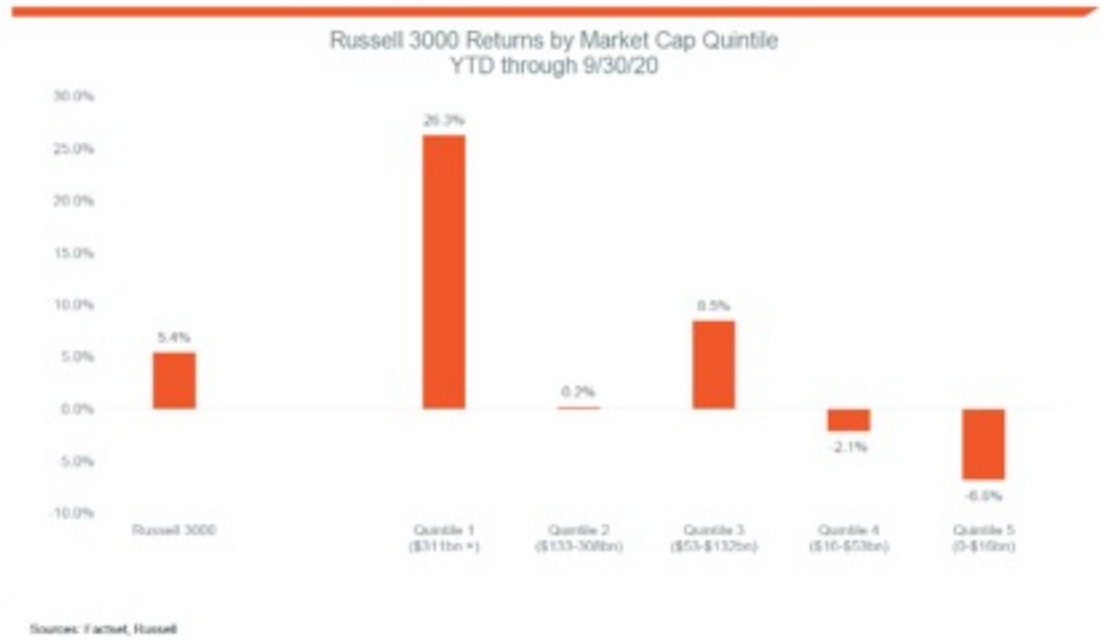


Chart courtesy of Atlanta Capital Management

It’s too early to know how the COVID-19 pandemic and its economic effects will fully play out.

Investors cannot be too negative. The prospects of a positive end to the crisis are being heavily bolstered by three strong legs of stimulus: fiscal policies, monetary measures and tools, and two approved highly efficacious vaccines with more on the way.

Yet the precise path to recovery is uncertain. We don’t know how much of the healing thesis is already priced into assets. 2020’s events have accelerated trends, both of growth and decay, that were already in place. Highlights include flexible workplaces, migration of families from some high price dense urban areas, entrenchment of smartphones, full embrace of e-commerce (and decline of brick-and-mortar retail), mobilization of novel medical technology, explosion of cloud computing, and the purported ‘peak globalization.’ Engaging narratives abound. Someday we’ll look back at these and conclude that some were overly conservative, and some were preposterous.

Sadly, a lot of damage has been done. Worldwide, small businesses and household savings have taken a major hit, some irreparably. Physical and mental health has suffered, some which will have lasting consequences. Social and political revolt has been unleashed. It will take a long time, quite possibly years, for parts of the economy to return to 'normal.' There will be financial and societal costs to all of this. The road ahead will not be smooth.

Portfolio Strategy and Asset Positioning

VWG is currently recommending diversified, moderately positioned portfolios for long-term investors. We are optimistic on several disciplined public and private equity strategies. We are positive on the prospects for several asset-constrained strategies in defined niches within equity, debt and real estate. VWG is cautiously allocating to fixed income with an eye on liquidity and capital preservation. It is hard to see a strong case for income and total return in most fixed income sectors. Duration must be kept low with yields at record lows and with over $17 trillion in global bonds trading at negative yields.

VWG expects to see a transition to choppier and at times more volatile asset prices than those we've enjoyed the past six months. Market analogues support such a pattern. 2009-2010's recovery out of the great financial crisis, and the typical first year of a U.S. president whose political party differs from that of his predecessor, are examples noted by market technicians and strategists.

As always, a prudent amount of cash and quality, liquid short-term bonds are called for. The exact amount of these should be sized to your temperament and the requirements of your personal financial plan. This liquidity can be deployed to fund unexpected needs, to provide emotional and financial support should further risks emerge, and to deploy opportunistically.

The personal, family and business challenges and war stories from 2020 are numerous. We have all suffered, some much more than others. We have all been subjected to swift and often unwelcomed life changes. Here's a toast, hoping that 2021's narrative of the COVID-19 pandemic brightens. The one thing that has not changed – VWG's unwavering commitment and deep gratitude in serving you and your families.   Having such a wonderful group of clients and their families only further steels our resolve in the face of trouble and turmoil. In 2021 you can count on us to continue our relentless efforts to protect you from risks, both seen and unseen, and to uncover sensible opportunities.

To further help digest the events of 2020, and to evaluate the environment facing us in 2021,

VWG's Ponderings and Musings LIVE webinar series continues next month.

Please Save the Date – "Winter Wonders" – February 4 @ 12:00pm EST

With COVID vaccine nearing national distribution, a new presidential administration and congress and an uncertain economy ahead, we find ourselves in an extended period of transition to our new normal. During this webinar, our VWG advisors will tackle the "wonders" that face all of us during this unsettling time. What have we learned from 2020? What changes does VWG expect? What are we still watching?

This event will also include a Q&A session to answer any other questions you have for our team. Online registration link to follow.

Regards,

VWG Wealth Management

Suzanne, Ashley, Rashmi, Kay, Lynette, Ona, Michelle, Ryan, Ryan, Susan, Marnie, Justin, Elana, Patricia, John, Rick and Jeff

Who we are

** Index Data and Charts Sourced from FactSet Research, Morningstar, Bloomberg, Goldman Sachs, Chatham Asset Management, Atlanta Capital Management*

Please reach out to us if you have any questions or comments.

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Disclosures

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