



MANAGER
COMMENTARY

Fourth Quarter 2020

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MARKET REVIEW

Did 2020 really just happen?! Despite U.S. equities getting absolutely demolished during the four weeks following February 2020 (the most rapid bull-to-bear transition in history), we finished the year about 20% higher for most main indices. This strangest of years did not disappoint during Q4, either; the stocks with the most volatile profiles led the market sharply higher, propelled both by the notion of more fiscal stimulus enabled by a possible blue wave and announcement of an effective COVID vaccine. Yes, 2020 really did happen - and none of us is likely to soon forget.

Russell 3000

The Russell 3000 Index recorded a 14.7% advance during Q4, and ended the calendar year with a heady 20.9% gain.

Size/Style

- Small-caps posted a massive performance edge over both mid and large-caps during the final quarter of 2020. Ultimately, performance across the cap spectrum was consistently about 20% for the year.
- From a style perspective, value performed nicely to close the year – but came nowhere near undoing prior damage relative to growth stocks. For all of 2020, the Russell 3000 Growth Index posted a 35% advantage over the 3000 Value Index.

Russell 3000 Sectors

Cyclicals surged to the top of the relative performance list, with a mix of late-stage and hyper-cyclicals reflecting the extreme bullish sentiment:

- After posting a narrow decline during Q3, the Energy sector soared 29.2% during the final quarter. Remarkably, the sector was still 32.4% lower for the year. Financials, Producer Durables, and Materials & Processing sectors followed during Q4. On the year, Tech and Consumer Discretionary paced the Russell 3000, with gains of 45.2% and 40.9%, respectively.
- Defensive sectors lagged in this environment - yet still posted solid gains. Utilities performed worst, but added 7.96%. Consumer Staples were next lowest at 7.1%.

FOURTH QUARTER ATTRIBUTION

The AllCap strategy advanced a solid 12.3% during the quarter, yet trailed the benchmark Russell 3000 Index's 14.7% advance. The table on the following page breaks down the contributions from sector positioning and stock selection.

In total, sector positioning had no impact on active return:

- Underweighting the Consumer Staples sector added 25bps, as the sector underperformed the benchmark by nearly 8% during the quarter.
- Underweighting the Financials sector detracted 47bps from active performance, as the sector topped the Russell 3000 Index by 10%.

Stock selection within the respective sectors detracted 2.35% from active return.

MARKET OUTLOOK

Not-so-bold Prediction: 2019 – 2021 will go down in history as one of the more unique periods for U.S. equities. From an incredibly swift bear-to-bull transition to start 2019, to the Fed easing and injecting liquidity at the end of a long economic expansion in late summer 2019, to COVID/shelter-in-place/#WFH, to unprecedented monetary response, to the most surreal of Presidential races, to a COVID vaccine, and finally a change in control of the Senate decided in a run-off some 2 months after



FOURTH QUARTER ATTRIBUTION

SECTOR	GLA WEIGHTING	R3000 WEIGHTING	% ACTIVE	GLA RETURN	R3000 RETURN	% ADDED	SECTOR ALLOCATION	STOCK SELECTION	ACTIVE CONTRIBUTION
Comm. Services	8.63	9.91	-1.29	24.76	15.41	9.36	-0.11	0.93	0.82
Consumer Disc.	20.45	12.28	8.17	11.24	14.39	-3.15	-0.01	-0.71	-0.72
Consumer Staples	3.15	6.10	-2.95	17.36	7.11	10.25	0.25	0.26	0.51
Energy	2.30	2.05	0.25	28.95	29.16	-0.21	-0.06	-0.11	-0.17
Financials	5.60	10.39	-4.79	23.26	24.77	-1.51	-0.47	-0.11	-0.58
Health Care	9.05	14.22	-5.16	10.18	10.29	-0.11	0.24	0.13	0.38
Industrials	13.78	9.28	4.51	12.07	18.32	-6.25	0.23	-0.89	-0.66
Technology	24.87	26.85	-1.98	11.32	13.82	-2.50	-0.09	-0.56	-0.65
Materials	5.31	2.81	2.50	3.09	17.37	-14.28	0.07	-0.77	-0.71
Real Estate	6.86	3.26	3.59	1.70	9.31	-7.61	-0.23	-0.52	-0.75
Utilities	0.00	2.85	-2.85	0.00	7.96	-7.96	0.19	0.00	0.19
Total	100	100		12.32	14.67	-2.35	0.00	-2.35	-2.35

Source: GLA and Bloomberg. Performance numbers are gross of fees.

the general election. This latter combination means a shift in balance from monetary to fiscal stimulus to carry us through to the light at the end of the COVID tunnel. Let's just hope that light isn't from an oncoming inflation train.

On balance, economic news looks quite good, although time will tell whether this is simply Red Bull economics.* Leading Economic Indicators are recovering to break-even, and corporate profits have rebounded swiftly to pre-COVID levels, with strong profit margins.

Credit markets are rich, but well-behaved. Easy credit conditions, plus the aforementioned expected forthcoming spike in fiscal stimulus, plus the developing herd immunity is resulting in a shift toward more economically-sensitive cyclical and small cap stocks. We are concurrently at a risk for rising yields, which would likely have the impact of an improving outlook for Banks as the curve steepens, a rotation toward beleaguered value stocks, and an eventual compression of P/E ratios.

Prices are well-contained at the turn of 2021, but year-over-year comps will lead to a spike in inflation numbers. This one-time impact may be further boosted as consumers release pent-up demand, given their robust collective balance sheet. Outside of this, the economy has plenty of excess capacity which should keep underlying price pressure from building to exorbitant levels. Unemployment levels, while improving nicely, should stay above prior cyclical lows, as we sort through the permanent damage on small services businesses caused by sheltering in place.

A particular highlight for 2020 is the robust housing market. All indicators are at record highs: permits, starts, sales (new and existing), and prices. Affordability, however, is consequently suffering. Any meaningful rise in rates can take the air out of this segment quickly – this will be key to watch as we hit the summer and

fall of 2021 – with summer and fall being seasonally weak regardless.

Something else to watch for is the dramatically weakened U.S. Dollar. This means foreign goods become more expensive to U.S. consumers – but can also be a boon to the U.S. manufacturing industry.

Typically, we'd look to prevailing valuation levels and the economic outlook to inform market outlook. However, any metrics using trailing sales, earnings, cash flow, etc. are invalid in the current situation. Instead, the strength of the rebound will determine whether or not the market is fairly priced at present. At a minimum, we expect the aforementioned rotations. And if yields rise as expected, this may undercut both multiples and the relative attractiveness of stocks versus bonds. As always:

"I know a lot of people have very strong and definite plans that they've worked out on all kinds of things, but we're subject to a tremendous number of outside influences and the vast majority of them cannot be predicted. So my idea is to stay flexible."

- Henry Singleton, longtime CEO of Teledyne

Positioning:

The AllCap models are demonstrating increased risk appetite. Positive biases include Volatility, Earnings Variability, Growth, and Liquidity. Negative biases include Earnings Yield, Dividend Yield, and Size. In the style box breakdown, a strong growth bias has evolved into more of a positive bias toward large-cap stock versus mega-caps.

Defensive sectors Consumer Staples and Utilities are now out of favor, along with Industrials. The Tech sector has also swung out of favor, paced by the Internet industry group. Financials have turned



positive, propelled by Financial Services and Banks.

From a return-driver perspective, we again see large changes from 3 months ago. Risk/Volatility metrics have swung decidedly favorable, while momentum and Growth measures have fallen to neutral. Valuation metrics remain mixed.

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*Coined by Bob Rodriguez, the longtime stalwart manager of FPA Crescent Fund, Red Bull economics is an economy juiced by outsized monetary and/or fiscal stimulus.

The data in the attribution table represent the returns for each sector and for the gross returns for a representative composite account for one quarter ending the current calendar quarter. Individual account returns may vary.

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