ADKINS SEALE CAPITAL MANAGEMENT, LLC
Investment Commentary
January 7, 2021

Dear Clients:
Recent events bring to mind the aspirational words of Buzz Lightyear from the movie Toy Story – "To infinity and beyond." Abundant (if not infinite) optimism is in full force across the world's investment securities markets despite daily news reports of pandemic calamity, unprecedented political turmoil in the United States, and continued geo-political tensions between democratic and autocratic regimes around the globe. The relative calm of voters and markets following the election of Joe Biden in November was an encouraging sign with some uncertainty surrounding the balance of power in the US Senate. Market action since the Senate runoff election in Georgia and the ugly pro-Trump assault on Congressional hearings certifying the 2020 election results shows no sign of concern from those events.

The case for optimism is well supported by simply taking a look at the long-term progression of humanity. A long-time investor friend recently sent us a book with the audacious title – Ten Global Trends Every Smart Person Should Know. Actually, the book describes seventy-eight trends over the preceding decades and centuries which highlight geometric improvements in health, income, literacy, mortality, resource availability and safety from natural disasters and armed conflicts. Unsurprisingly, most of the parabolic improvements have occurred in the last 100 years as innovation in technology and science created massive positive change in society.

The most recent poster child for equity optimism is the trend in the common stock of Tesla Inc., a vertically integrated manufacturer of fully electric vehicles and energy generation and storage equipment. The stock ended 2019 at a share price of about $90; today, the share price is slightly over $800 having doubled since September 30, 2020. Earnings per share estimates over the next twelve months are in the range of $2.50 to $3.00 or a historically astronomical PE ratio of 300+. As Buzz so eloquently alludes to the mathematical attributes of a zero denominator, any number divided by zero is by definition infinity. In modern finance, we know that $1 received thirty years in the future has a present value of $0.06 when discounted at a 10% interest rate, whereas, that same $1 is worth $1 if the discount rate is 0%. In all likelihood, the current price for Tesla stock reflects an expectation for much higher earnings in the distant future, discounted at a very low interest rate. The valuation approaches we rely on suggest a possible fair value of around $300 per Tesla share, so the current quote seems to be based on some combination of much higher earnings in the future discounted at very low interest rates. Time will tell whether this current example of optimistic valuation will prove out or a downward recalibration of the share price will follow a more modest earnings outlook valued at a higher interest rate. Of note, Tesla's common stock was recently added to the S&P 500 Index and currently has a 2.1% weighting, which facilitates the opportunity to go along with the ride without having to bet the farm on the realization of earnings forecast for a single stock.

Investors always face the prospect of unfavorable return outcomes over the near term, say over the next five years. Uncertainty with respect to future economic conditions including enterprise earnings and interest rates and the wide range of highs and lows for such variables make forecasts highly unreliable. Fortunately, over the longer term (10+ years), history suggests a more favorable expectation for those able to hold a diversified portfolio of reasonably structured, high quality securities. On with the dance, let optimism reign but with an eye on potential near term risks.

Investment Market Returns as of December 31, 2020
Investment returns remained robust through the fourth quarter despite headline concerns about the economy and national elections. The broad US equity market generated a total return including dividends of 14.7% for the recent quarter and finished the year with a total gain of 21%, an astonishing outcome given the depth of the market decline experienced in the first quarter. Perhaps signifying a return to historical norms, the performance of US mid and small cap stocks exceeded 30% in the fourth quarter to finish the year only slightly behind their large cap brethren. Returns from non-US stocks also improved in the later part of the year, up 17% for the quarter and 10.7% for the full year.

Bond returns continued to benefit from low interest yields. The broad US investment grade taxable bond index returned 0.7% for the quarter and 7.5% for the full year. The average yield for this index was 0.3% for the quarter and 1.5% for the year. The return on the non-US bond index used by our firm was even stronger with returns for the quarter and full year of 4.3% and 9.6%, respectively. Foreign bond returns benefitted both from falling yields and a decline in the exchange rate for the US dollar.

Trend following and option based hedge strategies were a mixed bag for the quarter and full year. Trend following managed futures broke even for the both periods, while option based strategies were positive but lagged equity returns by more than half. Commodities and precious metals generated offsetting returns with outperformance by commodities during the fourth quarter and by gold over the full year.

Cash returns remain essentially zero, acting only as a store of "dry powder" to deploy if stock and bond prices fall.

Our Look Forward

We continue to expect mid-single digit annual returns from US large cap stocks and upper single digit annual returns from mid to small cap US stocks and non-US stocks over the next ten years. We remain skeptical of the "straight up" trajectory of equity returns since the end of March 2020 and counsel our clients to not be surprised by near term volatility. Investor sentiment can change dramatically with little notice; with price multiples at historically high levels, significant volatility in account values remains likely. Bond yields remain at abnormally low levels as a consequence of aggressive central bank money creation. To date these policies have not resulted in adverse increase in price inflation, but that outcome remains a considerable risk to the valuation for long duration assets such stocks and long dated bonds.

The margin of safety in the current prices of marketable securities remains low, which subjects account valuations to higher volatility should investor sentiment turn more bearish. The recipe for achieving higher portfolio returns calls for greater equity allocation and a smaller bond allocation with a short duration profile. At the risk of sounding redundant, investors and our clients in particular may well look to using higher equity allocations to achieve desired portfolio returns. Such an approach makes sense where the client has an appropriate time horizon and emotional construct to "stomach" the volatility in market prices and an ability to adjust periodic withdrawals in periods where market values decline significantly.

In Closing

We look forward to visiting with each of you about your investment results and expectations for the future and to make sure your portfolios are aligned with your specific circumstances. We greatly appreciate the opportunity to serve as your investment adviser and pledge our best efforts to meet your expectations.

P. Michael Adkins, CFA
mikeadkins@ascm-llc.com

J. Richard Seale, CFA
dickseale@ascm-llc.com

Jay K. Binderim, CFA
jaybinderim@ascm-llc.com

333 Texas Street, Suite 2235 Shreveport, LA 71101 • 318-703-3641 • 800-304-6588 • www.ascm-llc.com