OUT OF THE BOX

INVESTMENT COMMITTEE UPDATE

2021 Q1

Faith | Trust | Excellence | Care

Our Mission is to help people with complex financial needs experience an **EXCEPTIONAL** life.

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Our Investment Committee

Each quarter our Investment Committee meets to review the markets and economy. At this meeting, three voting members review significant market data and hear from current advisors and appropriate support staff. When necessary the Committee adjusts the model portfolios managed by the firm. Our quarterly newsletter represents the Committee's general thoughts behind any adjustments.

Our Team

This month a group from our team was able to help pack food with **Feed My Starving Children**. Several members of the our team were able to get together and serve many who still need daily meals around the world—especially during these challenging times. For information on this organization and their ministry, please visit www.fmsc.org.

LIGHT AT THE END OF THE TUNNEL

Car rides traveling through long tunnels really fascinated me. On bright sunny days, the car would get instantly dark upon entering the tunnel. It takes a while for the eyes to adjust to the darkness of the tunnel creating the eerie feeling that comes from being in a tube without seeing an exit on the other side. We started 2020 like a nice joy ride. We were enjoying bright sunny days with the strongest economy on record when, suddenly, we were thrown into a dark tunnel with twists and turns marked by gripping drama and harrowing dread of recession. The seemingly never-ending chaos over the summer and political upheavals of the fall only added to the drama. Even though 2020 is behind us, we are still in the dark tunnel, but we believe we are starting to see a light at the end of the tunnel.

ECONOMIC COMMENTARY

A look at What **Was**, What **Is**, and What **Could Be**

What Was

In our last paper, we left readers keeping an eye out for spikes in COVID-19, potential stimulus packages, and inflation. Winter brought flu season and a spike of COVID-19 cases. This led to increased protocols in Minnesota and states all over the U.S. Because of this, we have seen continued struggles in the services and entertainment sectors to keep their doors open while revenues have been put on pause. The good news for those industries is our legislative branches were able to pass another round of stimulus and another round of potentially forgivable loans for companies which were struggling. We were pleasantly surprised to see they were able to come to a deal, even though we did not expect it to be passed before the transition in administration had taken place.

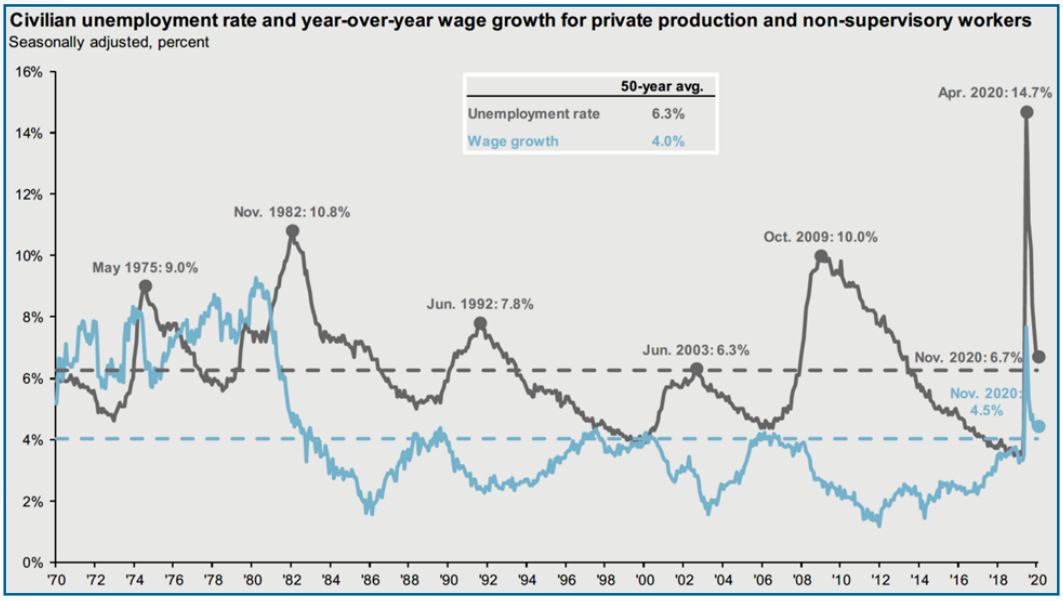
Lastly, we have yet to see inflation pick up. The core inflation numbers coming in for the month of December were 1.6% compared to September's reading of 1.7%. We are still confident inflation will begin to pick up, although, it is hard to imagine seeing inflation begin to rise without people being able to spend their money in a more open economy. Unfortunately, when inflation is greater than the current interest rate for "safe" assets such as bank accounts, it can be challenging for households. That is what we call negative real yields.

What Is

Things continue to feel like we are moving towards the light at the end of the tunnel. In Minnesota and all over the country, restaurants are beginning to open again, and schools are having conversations about bringing children back on location. As much as the vaccine news has had a positive impact on our economy, effectively treating and managing the virus will bring about the sustained confidence needed to get back to life as usual.

Consumers continue to have very healthy balance sheets. According to JP Morgan, wage growth has increased to 5.2%, which is above the long-term average of 4%. For the 93.3% of the nation who are employed, the wage growth has helped households feel stable through these trying times. For the unemployed, increased government stimulus has helped keep income levels afloat as they work through these rocky times. Additionally, households are only paying 9.1% of their disposable income towards household debt. For comparison, in the 4th quarter of 2007, the average American household had 13.2% of their disposable income paying off debt (JP Morgan). We believe this excess in cash flow from increased wages and decreased debt means consumers are primed to spend when the economy gets the green light. This is one of the factors that could lead to inflation as accelerated spending could increase the price of goods.

Lastly, we are currently in a world of a weakening dollar. This is due to many factors, but a significant reason could be that the federal reserve has remained very accommodating to a world of low interest rates. We expect this to be a theme moving forward as the dollar tends to move in very long cycles.



What Could Be

We expect 2021 to consist of a continued growth escalation with some small pull backs as the recovery from the severe declines we saw in 2020 continue. We also see the new political administration having a hand on the recovery's trajectory. Earnings have struggled since COVID-19 arrived on US soil, causing a downturn of 31%

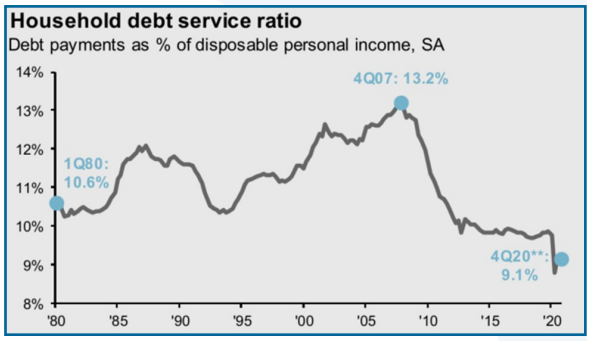
Economic Commentary, Cont.

in the 2nd quarter of 2020 (Cetera Investment Management). It will take some time to recover from this kind of loss. Cetera Investment Management's commentary projects a 45% gain in earnings in the second quarter of 2021. If they are correct that would only put our earnings levels back to where we were in the 1st quarter of 2020.

We also foresee US GDP to be close to 4%-6% growth for 2021. Much of this prediction is from the economy pushing play after being on pause for so long and the pent-up demand expected, not to mention the trillions in stimulus already spent with a proposed $2 trillion additional expected. Aside from demand and stimulus innovations resulting from COVID-19, such as the adoption of e-commerce and digital payments, virtual medicine and health care tracking, work from home, and shopping logistics should also contribute to this growth. Sectors hit the hardest should be seeing the biggest bounces. These would include leisure, travel, lodging, and restaurants to name a few.

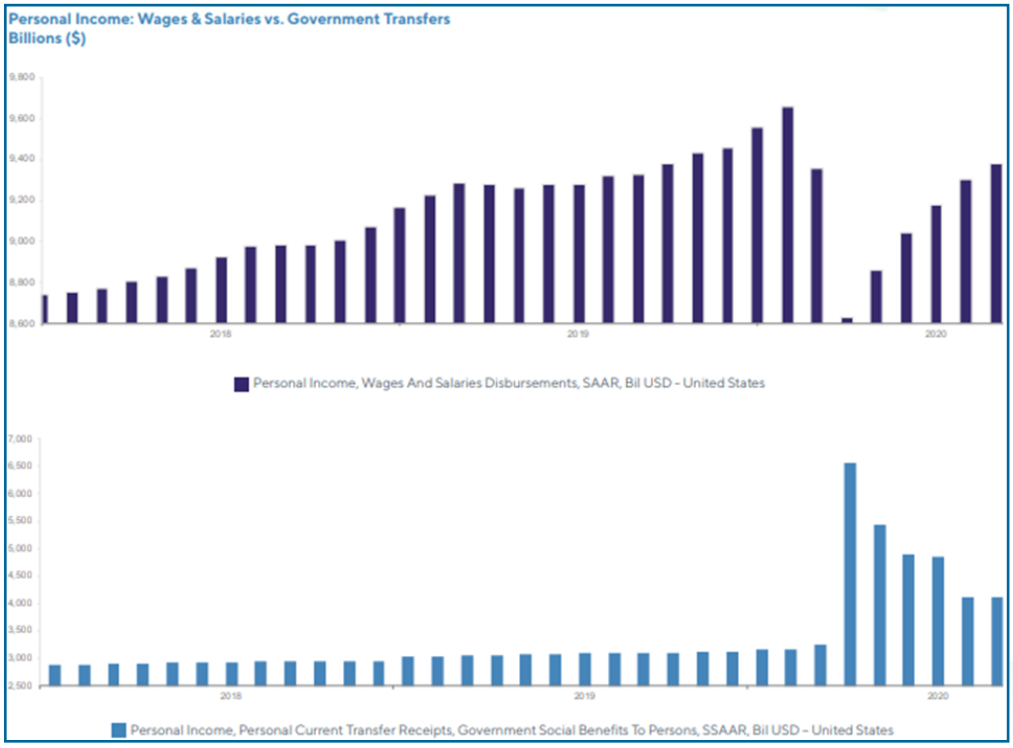
Overseas, we are mainly watching China, as they were the first to experience COVID-19, and they have been first to paint a picture of what recovery could look like. As an economy, they have already pushed the play button and are on track for 8% GDP growth this year. China will most likely have to strike a perfect balance between easing off the stimulus accelerator to avoid too much growth too rapidly and derailing their economy by abandoning monetary stimulus measures too quickly.

US GDP returning to healthy growth rates will be great for the US economy, but for the everyday US consumer, we will be paying much more attention to the 10-year treasury interest rate. This number normally affects everything from mortgages to business loans to personal loans, and it is the most tracked number for economic activity. For December 2020 & January 2021, 10-year treasury yield has hung around 1%. We would expect a robust economy to push past the 1%, but we do not expect to see 2% in the immediate future. This seems most plausible as we could reach a more stabilized low unemployment number and inflation due to increased stimulus from a more accommodating administration.



The sweep of all three political wings has many implications for the United States, but we look at it from the investing standpoint and prepare for how we effectively manage portfolios in the anticipated environment. We expect more stimulus. Yes, we just passed another round of PPP, $600/person to many families, and increased unemployment benefits, but there are continued talks of passing even another bill in due time. We also see increased investment into infrastructure and renewable energy as these initiatives have been large parts of the Biden campaign.

We also expect changes to tax policy, and at this point that is really all we can say. There is a lot of talk about changes to many different aspects of the tax code, but until we see a bill that is being worked through, anything is possible. While the House and



Senate are controlled by the Democratic party, many political analysts have suggested that any bills being passed through legislature will need to appeal to the moderate members of both major parties to pass because of the razor thin margins. We expect to hear a lot of conversation about aggressive new tax policies, but we also expect deals to be much more moderate than many of the initial suggestions.

Final Thoughts

We all know 2020 was maybe the strangest year in any recent memory, marked by COVID-19, government mandated economic shutdowns, leisure travel cancelled, sports without fans, record sudden unemployment, seemingly never-ending unrest, the bizarre Presidential election, and the worst sudden recession since the Great Depression. The good news is 2020 is gone, but the future of global economic growth, earnings, inflation and markets will feel 2020's impact for years to come.

Although we are watching the pace of this recovery and it may continue to grow by fits and starts for the first half of the year, we are carefully watching the signs of its growth with earnings.

So, what does 2021 have in store? Will the recovery continue? Can stocks climb from here? Is inflation a worry? While 2020 was a year unlike any other, there are reasons for optimism in 2021. A potential broad array of additional stimulus should continue to provide an economic safety net, and vaccine availability offers the possibility of a return to normalcy which could ignite the global economy.

On car trips, we never know exactly what the trip will be like, and when we pass through an unexpected dark tunnel, the only thing we can do is keep moving through the tunnel while looking for the light at the other end. As COVID's grip on our lives begins to subside, the other impediments to our travel through the tunnel seem small as we get closer to the light.

MARKETS

The 2020 US Stock market had an emphatic rebound after the March lows with the S&P 500 ending positively at 18.4%. With this rebound, we saw valuations move to above average levels.

As a reminder, valuations are based on earnings, and earnings have been depressed due to COVID-19. We expect earnings growth to rebound sharply in 2021 which should bring P/E levels to historic norms.

We are also paying attention to the breakdown of market performance. Cetera Investment Management's commentary has done research and found that the S&P 500 valuation levels are 2.6 standard deviations above the 15 year mean, but the mid cap 400 is only .9 standard deviations above its mean, and small cap 600 is 0.2 below its 15-year mean. Yes, large cap stocks have performed well — especially in the tech space. But small and mid-size companies still seem fairly valued and have the potential for continued growth in a post-COVID world.

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