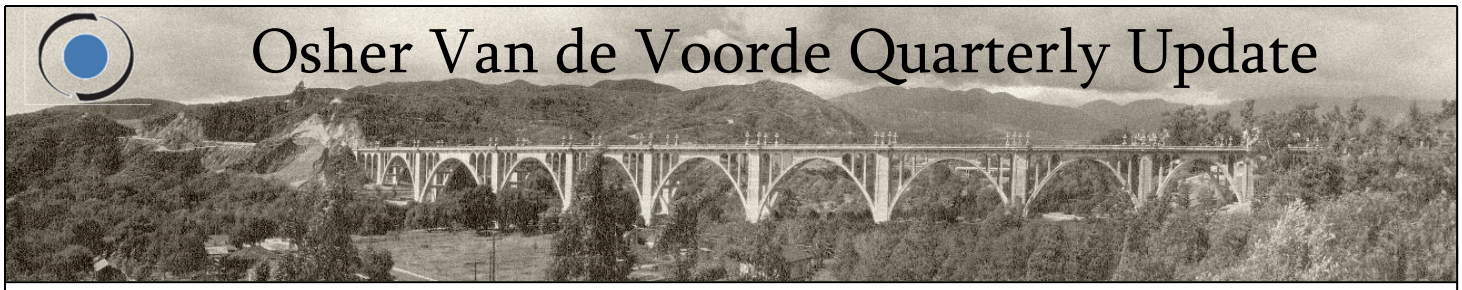


A New Gov Put?

October 2020

Led by the continued sharp rebound in technology shares, the stock market rally off the March pandemic-panic lows continued in the third quarter with the S&P 500 and NASDAQ Composite up 4.09% and 24.46% respectively for the year. By contrast, the Dow Jones Industrial Average is down -2.65% through the end of September, reflecting its more value-oriented mix of companies and underrepresentation in the high-flying technology sector.

Indeed, the technology sector dominated by market cap giants Apple ($2.1 trillion) and Microsoft ($1.7 trillion) now represents 28.2% of the S&P 500. Meanwhile, the Amazon-led ($1.7 trillion) consumer discretionary sector and Google-Facebook-led ($1.1 trillion and $800 billion) communication services sector comprise 11.6% and 10.8% of the S&P 500 respectively. Together, these tech-tilted sectors make up a remarkable 50.6% of the S&P 500 market capitalization.

As we wait for the eventual approval of a vaccine, available treatments and testing capacity for coronavirus continue to improve. As shown with President Trump's recent bout with COVID, those infected and most at-risk are recovering more quickly when treated with the latest steroid, antibody cocktail and anti-viral therapy. Advanced COVID testing technology now allows for various at-home test kits, multiple serological tests and even an antigen test that costs $5 and offers results within 15 minutes. Similar to this good news on the virus front, economic news continues to improve with unemployment down from the April peak of 14.7% to 7.9%, both ISM Manufacturing and ISM Services Indices registering solid economic expansion and the market for residential suburban housing red-hot.

Arguably the most important piece of news during the quarter came from Fed Chief Jerome Powell who announced a significant shift in how the Federal Reserve will set interest rates. Instead of targeting 2% inflation, Fed policy will now aim for inflation *averaging* 2% over time, thereby allowing periods of shortfall where inflation runs below 2% to be offset by periods where inflation runs "moderately above 2%." This revamp is intended to address the "reality of a quite difficult macroeconomic context of low interest rates, low inflation, relatively low productivity and slow growth." Powell went on to say that "we've got to work to find every scrap of leverage in helping stabilize the economy." With the Fed's preferred measure of inflation (core Personal Consumption Expenditure or core PCE) consistently falling short of the Fed's 2% target, the futures market doesn't expect the Fed to raise its target range for federal funds from the current 0% to 0.25% range until late 2024. Former Fed Chief Ben Bernanke opined that this strategic shift "will increase the accommodative power of policy" with "markets expecting a longer period of easier policy that will increase the amount of effective stimulus."

With interest rates essentially pegged at zero for the foreseeable future and the Fed's newfound intention to ignite moderately higher inflation, investments such as dividend-hiking blue-chips and real estate, asset classes that have performed historically well as hedges to inflation, should continue to receive additional favor. Indeed, financial markets in general are likely to be buoyed by the implicit expansion of the so-called "Fed put", in which the U.S. central bank is seen as rescuing the economy and markets during periods of distress. Bond investors may have the most to lose and big borrowers the most to win as this new Fed policy takes shape.

Speaking of big borrowers, the federal deficit was running at a pace of approximately $1 trillion even before the pandemic and is now projected to total $3.7 trillion for this fiscal year. With the ability to borrow at under 1% for all but the longest maturities, the burgeoning U.S. debt load is much easier to finance and makes Uncle Sam the biggest beneficiary of all. U.S. debt as a percentage of GDP is expected to surpass 100% in the coming fiscal year for the first full year since 1946, when the U.S. debt level exceeded economic output by 6% after years of financing military operations to help end World War II.

Expectations are mounting for a November sweep of the White House and both houses of Congress by Joe Biden and the Democrats that is widely expected to usher in higher income, estate and capital gains taxes in the years ahead. Indeed, a prominent election forecasting model now predicts Vice President Biden's odds of winning the election and popular vote at 82.8% and 92.5% respectively. With the stock market hovering near all-time highs, it is worth pondering why the stock market seems unfazed by the prospects of higher taxes induced by a potential "blue wave."

We believe the answer may lie in the massive fiscal stimulus expected to be enacted by a Biden White House and supported by the House and Senate. The Federal Reserve has been telegraphing that the economy needs additional fiscal stimulus and that monetary policy alone is incapable of bringing unemployment back to previous low levels in the wake of the pandemic. To say nothing about the potential for additional coronavirus relief, the Biden campaign seems committed to massive infrastructure spending (only partially offset by higher taxes and requiring massive issuance of additional debt) which would be highly stimulative for jobs and the economy. Together with the Fed's historic shift, a Biden Presidency may usher in an era of big government previously unseen and give rise to a new "gov put" that dwarfs today's "Fed put." The caveat of course is that polls are famously wrong and elections have the propensity to surprise.

While we are concerned about the long-term implications of big government and the Japan-like balance sheet (230% debt to GDP) we seem destined to pursue, the short-term implications may benefit the stock market. Well-regarded and oft-quoted academic studies illustrate how economic growth begins to slow markedly once debt to GDP ratios surpass 90%. With growth more challenged, interest rates are likely to remain subdued for an even longer period; and companies that can deliver both earnings and dividend growth, hallmarks of the Osher Van de Voorde investment discipline, are more scarce and valuable to own.

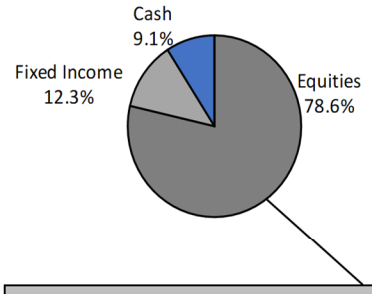
For perspective, chief market strategist Keith Lerner at SunTrust recently cited the Rule of 72 (divide 72 by the assumed rate of return) to calculate how long it will take for an investment to double given a fixed annual rate of return. Using a 5% annualized return, it takes equity investors about 14 years to double their money. At today's paltry rates on 10-year Treasuries, it would take 100 years to double one's investment. And it would take 900 years to double one's investment in cash at current money market rates! With returns on bonds and cash so dismally low and the Fed on a path to ignite higher inflation, these asset classes at best offer investors a means to lose money safely.

With current earnings expectations for 2021 at $166.21, the S&P 500 currently trades at 21x forward earnings. This may seem historically rich, but the very low level of interest rates leads us to believe that the propensity will continue for investors to buy the dips. As a source of dry powder for stocks, there remains over $4 trillion on the sidelines in money market funds and trillions more earning next-to-nothing in bonds. With the Fed's recent paradigm shift and rising potential for a blue wave sweep, the government put may make investors even more confident to buy stocks when the markets go through inevitable bouts of volatility, volatility that we see increasing as government-induced asset inflation leads to increasing odds for speculative pricing.

Investment Strategy Summary

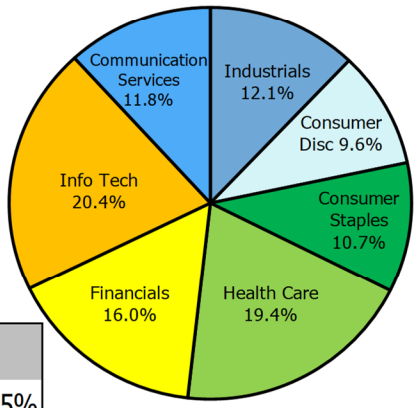
As of September 30, 2020

Firmwide Asset Allocation



OVIM Equity Composition	
International Core	10.5%
U.S. Core	89.5%

Equity Sector Allocation

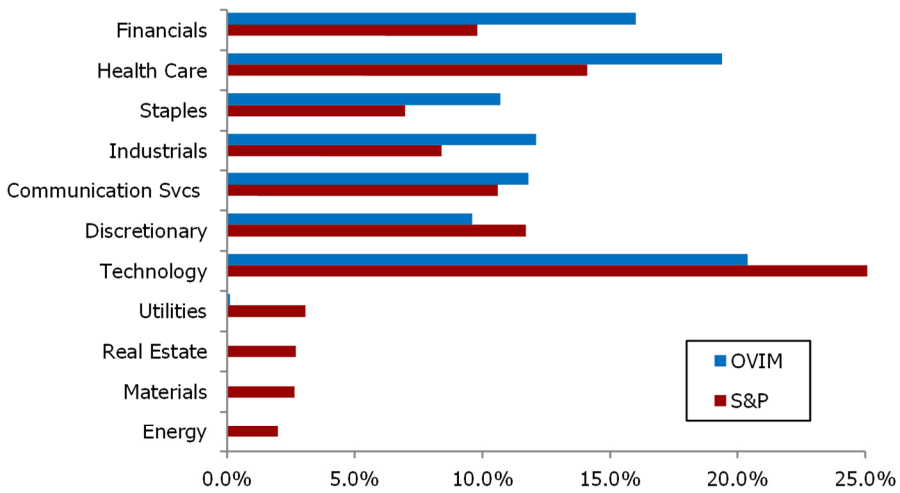


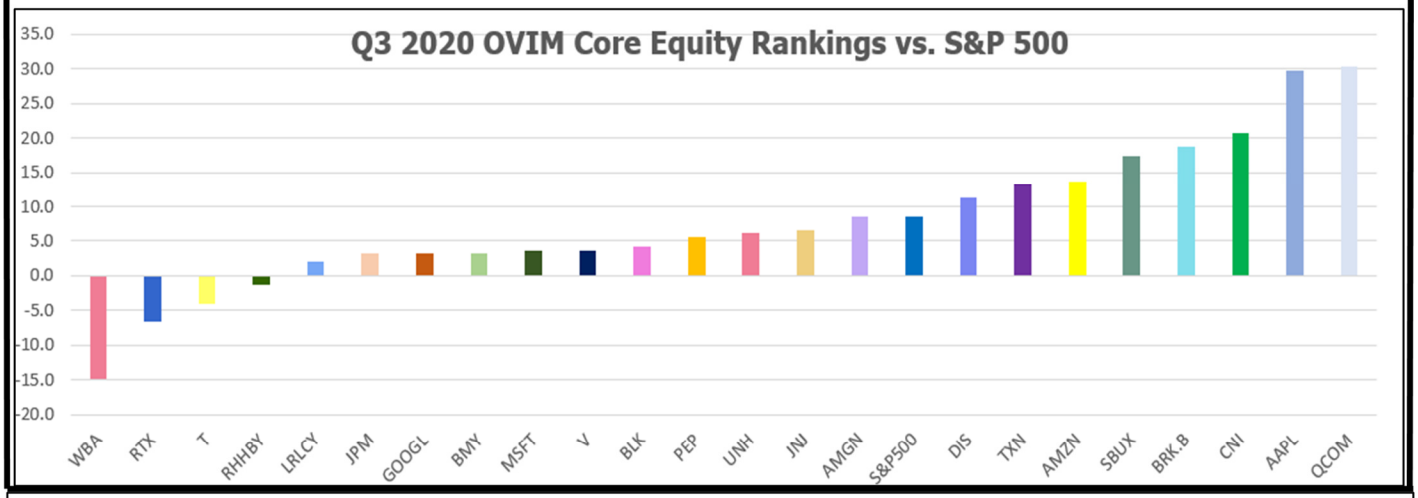
Top Core Global Equity Holdings

United Parcel Service Inc.	UPS
Amazon.com Inc.	AMZN
BlackRock Inc.	BLK
Qualcomm, Inc.	QCOM
Alphabet Inc. Class A	GOOGL
Starbucks Corp.	SBUX
Berkshire Hathaway Inc. "B"	BRKB
Apple Inc.	AAPL
Amgen Inc.	AMGN
Texas Instruments Inc.	TXN
Pepsico Inc.	PEP
Bristol-Myers Squibb Co.	BMY
UnitedHealth Group Inc.	UNH
Walt Disney Co.	DIS
Microsoft Corp.	MSFT
Charles Schwab Corp.	SCHW
Johnson & Johnson	JNJ
Visa Inc.	V
Roche Holding AG	RHHBY
Canadian National Railway	CNI
JP Morgan Chase & Co.	JPM
AT&T Inc.	T
L'Oreal ADR	LRLCY
Walgreens Boots Alliance Inc.	WBA
Raytheon Technologies Com.	RTX

Sector Weightings Relative to S&P 500

Ranked by Largest Overweight

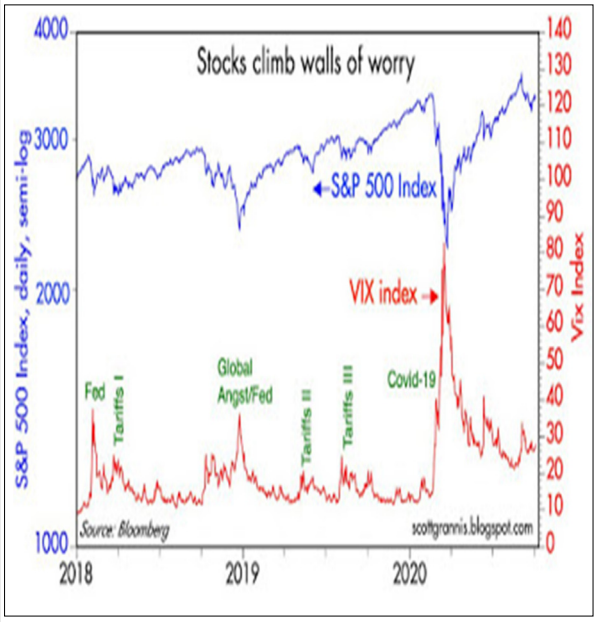


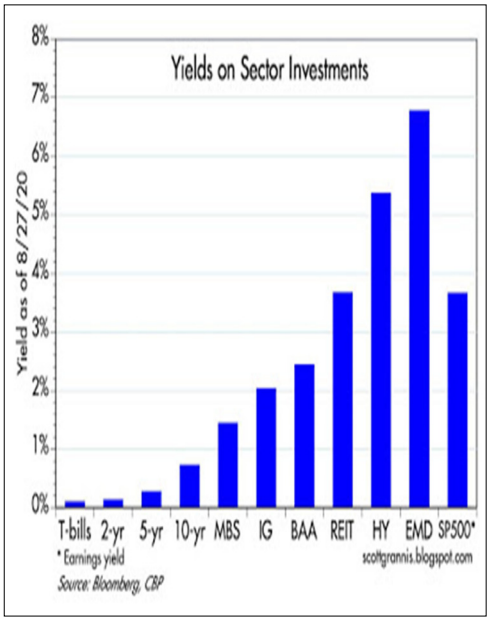


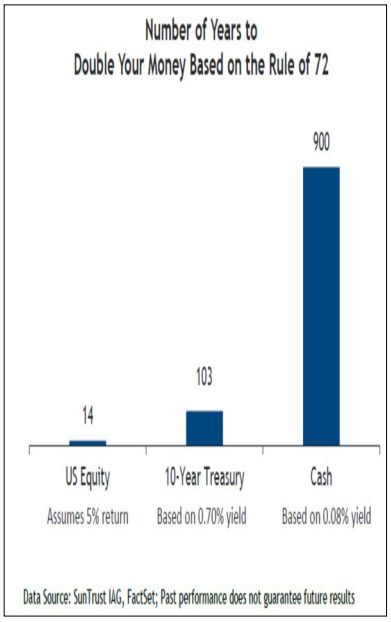
This presentation is solely for informational purposes. Data is pulled from sources believed to be reliable, but not independently verified. Past performance is no guarantee of future returns. Investing involves risk and possible loss of principal capital. No advice may be rendered by Osher Van de Voorde Investment Management unless a client service agreement is in place. Please contact us at your earliest convenience with any questions regarding the content of this presentation and how it may be the right strategy for you. This data is representative of all equity securities held across Osher Van de Voorde's client accounts, however portfolios are tailored to meet specific client objectives and actual client holdings will vary.

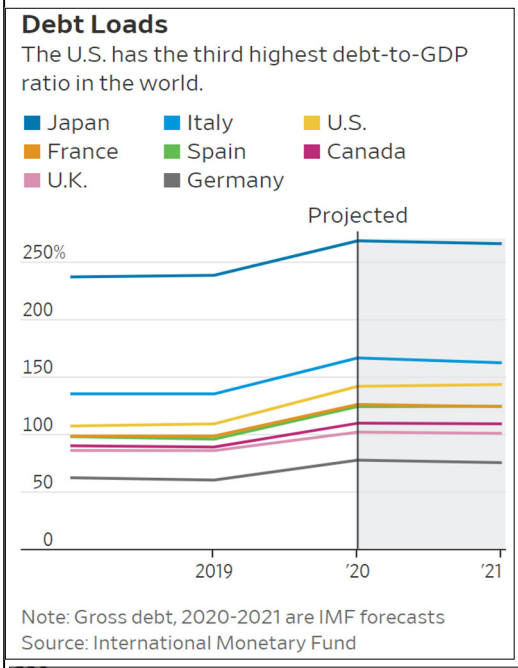
The S&P 500 Index or the Standard & Poor's 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies. The S&P 500 is a float-weighted index, meaning company market capitalizations are adjusted by the number of shares available for public trading. Note: Investors cannot invest directly in an index. These unmanaged indices do not reflect management fees and transaction costs that are associated with most investments.

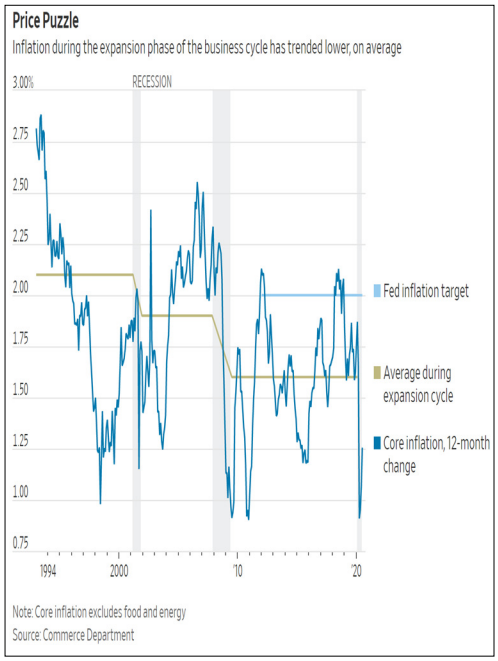
Charting the Markets

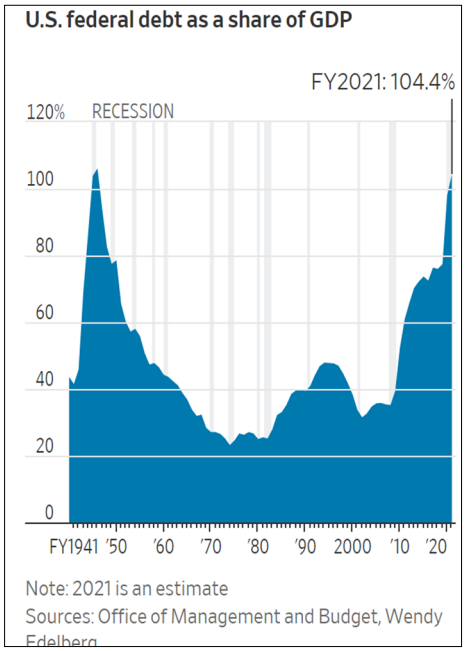


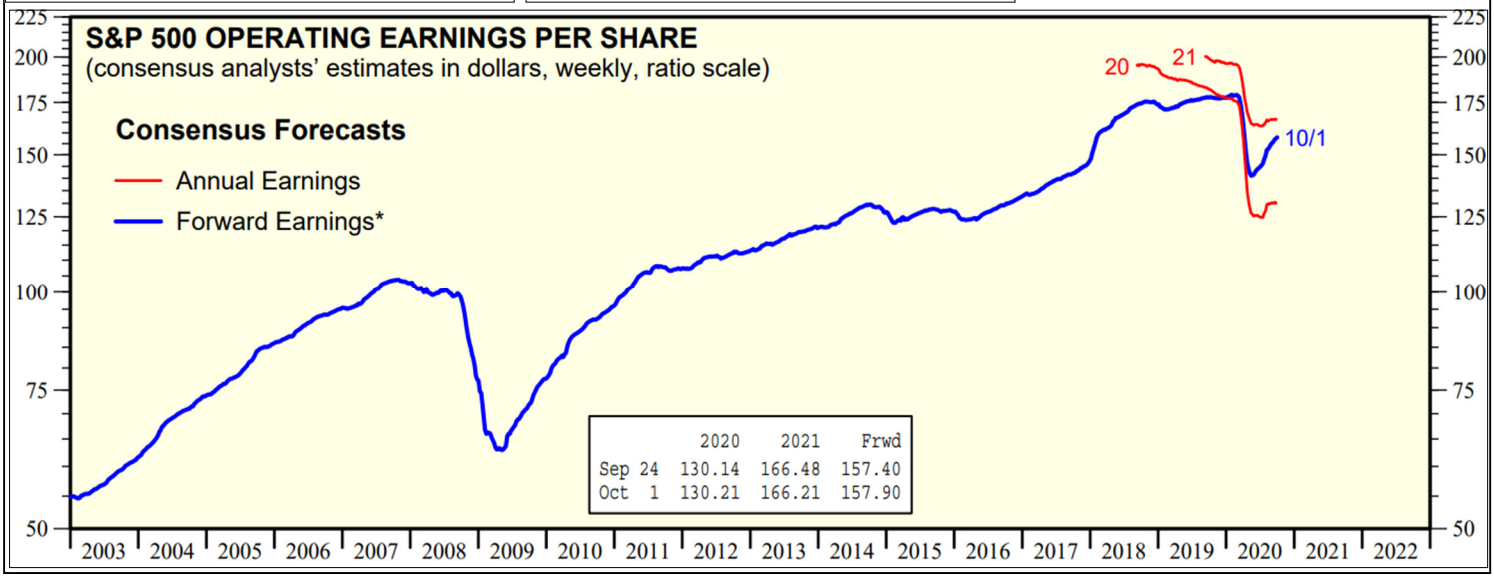












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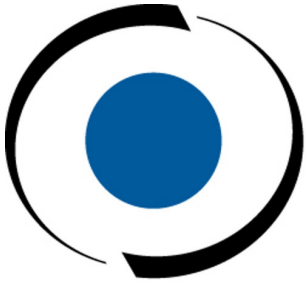

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Year-End Financial Planning Ideas

With just a couple months left in 2020, now is a great time to consider some year-end financial planning ideas that may improve your wealth.

Charitable Giving: The CARES Act, passed into law on March 27, 2020, includes a new $300 per individual, $600 per married couple, above-the-line charitable deduction available to taxpayers who do not itemize. The above-the-line contribution is deducted from income before calculating the taxpayer's adjusted gross income (AGI) and donations to a donor advised fund (DAF) do not qualify. In addition, the CARES Act increases available charitable deductions on qualified charitable contributions up to 100% of AGI in 2020 for taxpayers who itemize, up from 60% of AGI. The increased AGI limit applies to cash contributions made to a qualified charity and the higher deduction for a contribution directly to a DAF does not qualify.

Maximize Contributions to Tax-Deferred Retirement Plans: Consider maximizing contributions to your IRA, 401(k) or other tax-deferred retirement plan. Contributions, subject to annual contribution limits, result in an immediate tax deduction and grow tax free, while future distributions from the plan are taxed as ordinary income.

Tax-Loss Harvesting: Consider using unrealized capital losses in your portfolio to offset realized capital gains, thereby reducing 2020 capital gains taxes. While the highest federal marginal tax rate in 2020 is 37%, the highest tax rate applied to long-term capital gains is 20%. Capital gains are also included in the calculation of the 3.8% net investment income tax. For taxpayers who believe that capital gains tax rates may be increasing in the future, it may be an advantage to defer realized capital losses to future years, when losses will be deemed more valuable.

2020 Coronavirus Related Distribution: The CARES Act provides favorable tax treatment and distribution options for IRAs and retirement plans. Distributions up to $100,000 to qualified individuals taken from eligible retirement plans from January 1, 2020 to December 30, 2020 are not subject to the 10% early distribution tax, may be included in taxable income over a three-year period and may be repaid to an eligible retirement plan within three years of the date of distribution. Taxes paid on distributions that are later recontributed to the plan can be reclaimed by filing an amended tax return.

Forgo your RMD in 2020: The CARES Act waived Required Minimum Distributions (RMDs) in 2020, including those for beneficiaries with Inherited IRAs. Forgoing unwanted RMDs in 2020 lowers taxable income. However, the RMD waiver in 2020 does not apply to defined-benefit plans.

Contributions to a Health Savings Account (HSA): If you qualify to contribute to an HSA by owning a High Deductible Health Plan (HDHP), contributions to the HSA are deductible from current year's taxable income, can be invested to grow tax-free and feature tax-free qualified withdrawals resulting in a triple tax advantage. In 2020, the tax-deductible contributions to an HSA are limited to $3,550 for individuals and $7,100 for families. If you obtain age 55 by the end of the year, you may contribute an additional $1,000 in 2020.

Consider a ROTH Conversion: The CARES Act waiver of the 2020 RMD creates an ideal time to consider converting your IRA to a ROTH as funds otherwise distributed would be qualified for tax-free ROTH distributions. In a ROTH conversion, you are paying tax now to avoid paying tax in the future. As such, a ROTH conversion may make sense if you expect higher tax rates in future years.

Review Liabilities: With interest rates at historic lows, now is a good time to review existing loans on mortgages, automobiles and credit cards for the possibility of refinancing at a lower interest rate.

Estate Planning: Historically low interest rates make now an ideal time to consider implementing certain wealth transfer techniques that reduce potential estate tax exposure. The section 7520 interest rate, published monthly by the IRS, is used to value interests in certain trusts, annuity payments and remainder interest values. The section 7520 rate of 0.4% in October 2020, compared to 2.0% in January 2020, is at historic lows and a lower rate may result in greater tax savings for certain planning techniques. Such wealth transfer strategies should be discussed with a trusted estate attorney or CPA tax advisor.

Review Estate Planning Documents: Having an estate plan in place, naming trusted people to help make financial and health decisions during incapacity, takes on greater importance during the pandemic. Now is a great time to be sure your affairs are in order. A complete estate plan may include a revocable living trust, financial and health care powers of attorney and a living will which details your wishes for end of life treatment.