Trumbower Financial Advisors, LLC
4th Quarter 2020
Investment Market Commentary

Breaking Records in a Disaster

None of us went to med school so we won't pontificate on the efficacy or availability of vaccines, herd immunity or how many days to quarantine after exposure – even though the Covid virus profoundly influenced volatility within global financial markets last year. Mankind's ability to control and hopefully eradicate the virus will undoubtedly determine future economic health. Please keep in mind that our comments are intended to add perspective to your portfolio's past performance. Any predictive powers are coincidental.

As we huddled in our homes during the dark days of March who would have guessed 2020 would turn into a stock market record breaker. Last year offers a prime example of the dangers of market timing and a testament to our fundamental philosophy – be prepared to ride it out! Reflecting back, it is beyond surreal that investors regained their exuberance while virus related deaths top 1 million and counting, many business activities, travel and the daily commute ground to a halt and economies recessed. Naïvely optimistic or has the market priced in a robust post pandemic revival?

US household net worth hit a record high at the end of Q3 reflecting a surge in residential real estate prices, equity values and savings that would otherwise have paid for vacations, celebrations and fine dining. Just as a select group of stocks were fertilized by the dregs of Covid 19, rich folks have gotten richer but lower income families are still losing jobs and can't fall back on equity in homes or portfolios. Another wave of restrictions to curb infections along with expiring emergency benefits was evident in November's -1.1% decline in personal income and -$63 billion (-.4%) decline in consumption. US jobless claims headed in the right direction during December but are still extremely elevated and likely to worsen as we fight the pestilence by distancing.

Real GDP increased 33.4%, annualized, in Q3 making up for the horrific -31.4% decline in Q2. The Atlanta Fed forecasts Q4 GDP at 8.9%, annualized. The modest recent stimulus package is not likely to inject as much into US GDP as the first round. All bets are on the Biden

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Selected Benchmark and Category Average Total Returns

Large Cap Equity

*Benchmark Indx & Category Average**	4th Q 2020	12 Mos.
S&P 500 Index	12.15	18.40
Large Cap Blnd Avg	12.79	16.08
S&P 500 Growth	10.66	33.47
Large Cap Gr Avg	12.21	40.22
S&P 500 Value	14.49	1.36
Large Cap Val Avg	15.48	2.39

Mid Cap Equity

*Benchmark Indx & Category Average**	4th Q 2020	12 Mos.
S & P 400 Index	24.37	13.66
Mid Cap Blnd Avg	20.06	13.25
S&P MC 400 Growth	21.05	22.77
Mid Cap Gr Avg	19.90	40.44
S&P MC 400 Value	28.69	3.73
Mid Cap Val Avg	22.69	2.92

Small Cap Equity

*Benchmark Indx & Category Average**	4th Q 2020	12 Mos.
Russell 2000	31.37	19.96
Small Cap Blnd Avg	28.28	10.53
Russell 2000 Growth	29.61	34.63
Small Cap Gr Avg	27.35	40.64
Russell 2000 Value	33.36	4.63
Small Cap Val Avg	32.12	3.29

International Equity

*Benchmark Indx & Category Average**	4th Q 2020	12 Mos.
MSCI EAFE	15.75	5.43
Intl Equity Avg	15.56	9.12

* Category average calculated using *Morningstar Direct*. Fund universe screened to include funds that meet the following criteria:

A. M-Star Category consistent with designated asset class and management style.

B. M-Star Style Box consistent with designated management style.

C. Fund's Objective consistent with asset class.

D. Excludes Index Funds.

We have not independently verified *Morningstar* data.

Investing With a Conscience

ESG investing, short for Environmental, Social and Governance, is a hot topic but more than a fad. ESG or "sustainable" concepts aren't new but awareness and popularity intensified in recent years. The Wall Street Journal reported 31 ESG ETF launches in 2020, nearly double the number that debuted in 2019 and more than the previous records set in 2016/2017. $27 billion + poured into them in 2020.

ESG monikers include Impact, Socially Responsible or Green investing each encompassing a variety of permutations. Three principal sub-groups have evolved: SRI, Single Theme and Broad ESG. SRI sponsors employ negative screens to avoid "sin stocks." Single Theme strategies isolate companies displaying characteristics such as environment friendly or promoting gender diversity. The third variety is broadly diversified addressing multiple motifs and issues.

Major providers S&P, FTSE Russell and MSCI have established ESG research capabilities and constructed indices to represent various slices of the ESG pie. ESG judgments are intrinsically subjective despite appeals for standardized metrics. There are no auditable generally accepted principles leaving it up to users to assess the veracity of scores and rankings. How do investors know that their capital actually fosters the causes they deem most worthy? Professional managers dedicated to sustainable investing admit it is a challenge. We hope to unravel some of the mystery and provide useful guidelines.

ABC's of ESG

Melodies portraying "E," "S" and "G" rhyme but tones vary in meaningful ways. MSCI and FTSE Russell use ESG ratings that appear synchronized on the surface. For example, within Environmental they both measure impact on climate change, water and air pollution. MSCI adds green building and renewable energy use. For Social grading they both assess labor practices and health/safety records but MSCI adds community relations. Both evaluate Governance structures and tax transparency with FTSE attaching risk management to the checklist. Even when the substance they are gauging is similar, inconsistent terminology can be confusing.

The absence of standards has led to wide divergence among ESG marks assigned to companies. MIT researchers found the correlation of ESG ratings from five assessors was only .61. By comparison, credit ratings from S&P and Moody's are .99 correlated. The study concluded that roughly half of the variance arises from differences in the data points they consider. The other half is explained by variation in the weight assigned to criteria and the scope of their examinations. Raters' personal biases may show up in scores. If a company shines in a favored field, other areas may be viewed in a more positive light. To illustrate an extreme, Wells Fargo got a grade of 70% for Governance by one rater but landed (where it should have) in the bottom 5% by another!

In a recent white paper, *Research Affiliates* classifies 70 ESG rating providers into three distinct types. Most fall into the Comprehensive group. Using objective and subjective data, they employ their own methodologies for synthesizing public information, company interviews and proprietary analytics into scores. They supplement ratings with information about company-specific controversy and produce industry/country trend reports. There are 16 Specialists that evaluate one issue exclusively. They offer expertise to investors who want to tackle a particular concern. A handful of Fundamental firms aggregate and deliver public data to end users in a systematic fashion but do not score companies.

A major hurdle facing proponents of ESG is the lack of all-inclusive accurate source data. Does the absence of negative information assure the risk doesn't exist? Only one rating firm highlighted PG&E's safety record before fires related to faulty equipment forced the company into bankruptcy. Relying solely on company generated reports skews results in favor of large multinationals with the resources to document policies and highlight their best features.

Reporting standards are generally less stringent for companies domiciled in Emerging regions, and they tend to be less transparent about ESG factors. Europe gets higher marks than North America. The EU is implementing not only disclosure requirements for ESG index sponsors but criteria guidelines. The EU already requires large enterprises to report on their social/environmental footprints. The China Securities Regulatory Commission makes its listed issuers disclose ESG risks – but the SEC does not currently impose similar obligations. In efforts to appeal to the responsible investor, many companies voluntarily disseminate ESG data but without universal enforceable standards using it effectively will remain problematic. It took years of cooperation among accounting societies to standardize financial reporting for public companies. Organizations like the Global Reporting Initiative and the Sustainability Accounting Standards Board are supported by major rating providers in their endeavor to bring reliable, consistent information to conscience driven investors.

Performance With Conscience

Do portfolios constructed in line with ESG principles leave performance on the table? The track record is mixed but encouraging. We screened *Morningstar* for mutual funds and ETFs identified as sustainable; meaning ESG criteria are used at some point in the construction process. From this group of ~280 mutual funds and ~115 ETFs we isolated 320 that claim ESG factors are a priority in selection decisions. Whittling the list down we chose those that could be categorized as US Large Blend, Foreign Large Blend and World Large Stock for comparison to the S&P 500, MSCI EAFE and MSCI ACWI indices.

At first glance the US team is uninspiring. Average and median performance lagged the S&P 500 over the past 3, 5, 10 and 15 years ending 11/30/20. Only ~25% beat the benchmark over 5, 10 and 15 years. The average and median returns for Foreign ESG constituents beat the EAFE Index over all periods – keeping in mind there were only 5 with 15 years under their belts. 95% of the managers outperformed over the last 3 years and ~86% were ahead over 5 and 10 years. World Stock funds also topped their benchmark with 92% & 78% winning over 5 and 10 years.

Sustainable investment funds proved quite durable during the first quarter of 2020 when equities dove into a tailspin. Median divergence of US Large Blend ESG funds from the broad market is only -.05% over the last 3-years. Our Large Cap US ESG sample outperformed the S&P 500 in 2020 through November 30th by 1% on average and 65% of them beat the index. Those with the highest returns were heavily weighted in Apple, Microsoft, Facebook, Amazon, Alphabet, Tesla and not surprisingly avoided energy drag. 28.5% of the XTrackers S&P 500 ESG fund is comprised of the first five stocks vs 20% for the S&P 500 (Tesla joined in late 2020). The tech giants score highly on factors like low carbon, employment, data security and governance lending them prominence in ESG funds whose relative performance benefited from their widespread popularity. ESG portfolios within the Foreign and World asset classes sang a similar tune expanding their lead over relevant indexes to 5.18% and 4.73%, on average, during 2020. 96% of the Foreign ESG managers outpaced the EAFE. Apple, Tesla and Microsoft along with lots of biotech show up in these portfolios. Is superior recent ESG performance coincidental?

Fundamental ESG related factors may enhance profitability. On average, US and European companies highly regarded by ESG raters enjoy a lower cost of capital. Arguably, qualities contributing to more responsible corporate behavior also promote success. Management with heightened ESG awareness tends to allocate capital more effectively, incentivize productivity and better manage risks that could lead to expensive ESG snafus. Charts posted under the title "ESG Matters" on the January 2020 Harvard Law School Forum on Corporate Governance confirm that high ESG rankings have been well correlated with various measures of profitability. Commentators noted a self-fulfilling element – profitable companies have more resources to support ESG initiatives and dodge pitfalls.

Institutional Boards increasingly focus on ESG related mandates and these issues influence decisions made by 64% of younger investors. Not only do they want to support companies that impact the world positively, they believe it bodes well for future success. If capital continues to gravitate toward companies with more visible commitment to advancing ESG doctrines it makes sense that their stock prices will rise with demand. On the other hand, this could inflate valuations unless earnings growth and profitability follow suit. According to data compiled by BOA/Merrill Lynch, European companies with the highest MSCI ESG ratings have traded at an average 20% premium over the those with the lowest scores. The forward PE valuation premium for high ESG ranking stocks over the lowest among stocks in MSCI's Asia/Pacific group has risen from 1-2x to 5x since 2011. A preference rotation into sectors that do not generally boast proud ESG rankings could temper future performance expectations. It appears to us, however, that ESG minded investors do not necessarily have to sacrifice returns and a sustainable slant could have a positive effect on performance.

Sustainable Implementation

While it remains difficult to accurately assess a company's impact on ESG concerns, the range of securities available to investors who would like to support more sustainable enterprises has expanded exponentially. In the old days, one would have to construct a portfolio of individual equities using whatever data might be available to identify and screen out objectionable elements. We have helped clients eliminate exposure to undesirable industries while otherwise participating in an asset class using a selection of sector ETFs. Now there are scores of mutual fund and ETF vehicles available that consider ESG factors in one way or another. The resulting underlying line ups might not be perfect but a step in the right direction.

Before embarking on a more socially responsible investment program clients need to do some soul searching. Are there very specific products, behaviors or companies that you want to avoid? How far reaching is the aversion? For example, does an anti-tobacco theme trickle down to retail establishments that sell the products or movie production companies that feature cigarette toting protagonists? Do you want to support the environment by a sizeable commitment to solar or other alternative energy or do you want to eliminate fossil fuel producers? If so, what about fossil fuel consumers like utilities? Shunning firearms leaves Smith & Wesson out but what about sporting goods stores? Alternatively, you may want to overweight your portfolio with companies that are more highly rated in terms of overall ESG initiatives. We are happy to share general information that may help you formulate your goals.

Broad ESG indices are now available for those that do not have a very specific axe to grind. The S&P 500 ESG Index, for example, targets 75% of the market cap in each industry group while excluding tobacco, controversial weapons, companies not in compliance with the UN Global Compact and then those ranking in the bottom 25% of S&P Dow Jones' proprietary ESG score within their industry group. The resulting portfolio leaves out a couple of larger constituents like Alphabet, Berkshire Hathaway, Johnson & Johnson (overall scores not high enough). Ten large ETFs are available to fulfill the most common ESG target – climate change - with an explicit screen to carve out fossil fuel. They may fall short of expectations, however, as all but the Invesco Solar thematic fund retain some exposure as a result of the way exclusions are designed. As noted, we can now use *Morningstar* to extract mutual funds and ETFs with sustainable attributes within asset classes. There are fewer to choose from outside Large Cap US and Foreign but that is likely to change. Please let us know if you would like to discuss ways in which we can help you tilt your portfolio in a more responsible, sustainable direction.

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administration and fresh faces in Congress to ramp up relief. They may kick the cost further down the road for a while before they decide who pays the tab and how.

Governments are not the only ones who will emerge from this crisis laden with debt. When the current Federal eviction moratorium expires at the end of January, Americans are expected to owe $70 billion in unpaid rent and utility bills. Similarly, skipped mortgage installments under various forbearance programs must be repaid ultimately. Corporations took advantage of historically low interest rates floating record amounts of High Yield and Investment Grade bonds. The impact on balance sheets was muted as companies used some of the proceeds to retire short term and higher cost debt. Monthly issuance of municipal debt scored another record in October. The pace subsequently subdued and demand picked up strongly after the election dragging yields down and prices up. The spread between 2-year AAA munis and Treasuries is only 1 basis point (0.01%) – 12 bps for the 10 year. The good news is that state and local government revenues have been better than expected. The Federal government let scarcely used emergency municipal lending facilities expire at year end. Presumably, they can reinstate back-stop assistance if necessary.

Jacked up on vaccine headlines, equity markets dashed ahead 12% (S&P 500) to 31% (Russell 2000) during Q4. Small Cap US stocks delivered almost 20% in 2020. Tech heavy NASDAQ returned just under 45% during the year. Emerging International equities outpaced the S&P 500 in Q4 and both were up over 18.3% in 2020. Mid Cap US stocks managed a decent 13.7% annual return. Developed Foreign equities advanced over 15.7% in the quarter but only a measly 5.5% for the year.

Proudly flaunting "Risk On" attitudes investors scooped up $167 billion in shares of initial public offerings ("IPO") topping the previous record of $108 billion in 1999 at the height of the .COM era. IPO fever crested mid-December when Airbnb and DoorDash doubled in their first trading days – in spite of their failure to turn consistent profits. The frenzy is poised to continue into 2021 as a passel of billion-dollar deals queued up hoping to maximize opening prices instead of giving early trading gains to investors. Almost half of the capital raised in 2020 took the form of Special Purpose Acquisition Companies ("SPACs"). SPACs, aka "blank check" or "shell" companies, sound like the ultimate speculation – but that has not discouraged dauntless investors. They raise capital for the purpose of later purchasing or merging with a private company. They do not always have a target – in fact the idea is to buy into them before they have announced one. Contributors rely on the reputation of the founding sponsor and it may take years before a liquidating event occurs. SPACs used to be a means for very small start-up companies (many of whom did not survive long) to raise capital without the hassle and cost of an official IPO, but they are now becoming mainstream.

It is hard to avoid comparing 2020 to the period leading up to the 2000 equity market collapse when the price of 77 new public companies doubled in value on the first trading day. As was the case twenty years ago, swarms of individuals continue to chase "crowded" trades in popular individual equities. Passion for passive indexes remains intense further padding valuations among the largest constituents. Tesla's story is a classic example of the power of a position within an index that is replicated by hundreds of funds. Worth $408 billion when its admission to the S&P 500 was announced, its share price rose 70% in the ensuing five weeks. Yahoo put on 64% in December of 1999 ahead of its induction into the benchmark. Climbing another 46% through January 10th, Tesla is now worth more than all major automobile manufacturers combined. S&P 500 index construction is not a purely objective numbers game. Four consecutive profitable quarters are a pre-requisite that Tesla achieved in the 2nd quarter and when it was not admitted the price slid 21% in one day. Tesla supposedly met the milestone through tax credit sales and other revenues that are not part of its core business. The intricacies of index construction are beyond the scope of this essay, but suffice it to say resulting demand for dominant participants can distort stock prices.

Another bubble may be brewing in cryptocurrencies. The price of a Bitcoin tripled in 2020 to a record $29,000 up from ~$8,000 at the start of the year. Its utility as a payment medium is still limited by extreme volatility – it crashed 50% in 2017 after peaking at $19,000. While it has become easier to trade cryptocurrencies directly or through related securities, they are still not a generally accepted form of consideration. PayPal announced that they will begin allowing customers to use cryptocurrency to fund purchases in 2021 – but this feature is not yet enabled. Furthermore, that does not mean its 26 million vendors accept the virtual instruments. PayPal intends to convert crypto to US dollars collecting a margin (the difference between the exchange rate offered to customers and the rate it receives from its trading partner) – plus fees. Outside of the "dark economy" cryptocurrencies are generally only accepted by sellers of very high-end products, and they pass on fees of up to 2% paid to convert coins to dollars. There is definitely money to be made for those willing to absorb exchange risk. Don't forget US residents who want to spend their appreciated coins have to pay income tax on gains when tendered.

While virtual currency soared, our actual currency devalued against most others. It makes sense that the Fed's commitment to keep the lid on interest rates might have sent the dollar down to a 2-year low, except that yields on every other reserve quality currency are lower or negative. Interest rates do not tell the whole story. Trade tensions and a widening deficit coupled with inflationary concerns stemming from ongoing stimulus all tarnish demand for the greenback. Not a bad thing for Emerging market economies and other big commodity importers; a plus for US exporters and a boon for US investors in International stocks, but stability is generally more desirable – unless you are a FOREX trader.

Overseas economies were starting to show signs of recovery from initial pandemic shockwaves. Then the virus took control again. In spite of a last-minute Brexit deal, the UK is likely to slide into a multiyear recession as restrictions are imposed to grapple with an overtaxed health care system. Germany's unemployment rate has stayed relatively stable thanks to government subsidy and its manufacturing sector focus. Hopefully, the release of Eurozone emergency funds will help soften the double recessionary dip for others. All eyes will be watching to see how effectively the members deploy support, especially Italy where politicians are sparring about control over the funds.

In spite of the current administration's efforts, China generated a record trade surplus and all measures of business activity indicate ongoing robust recovery. Flaunting warnings from the US, the EU and China wrapped up seven years of negotiations on an investment accord. It has yet to be ratified and China's commitment to implement is questionable, but the agreement intends to open Chinese and EU markets while leveling the playing field, protecting technology rights and holding China to environmental standards. Just as China agrees its state-owned businesses will not discriminate between EU and domestic companies, the party is taking steps to give the government more control over private enterprises. State organizations gobbled up a record $20 billion of private companies in 2020. Citing the view that private entrepreneurs can't be trusted to serve the state's goals, they are using tactics like blocking access to capital (e.g. ANT Group IPO) and replacing executives and board members with government appointees.

Setting aside excesses like Tesla and Bitcoin, what may differentiate 2021 from 2000? Individual investors are probably bidding up prices indiscriminately but the IPOs coming to market these days are more mature, innovative companies that have been nurtured by private equity angels and have a fan base of customers who want to be investors. There are broad market segments suffering from Covid fatigue but otherwise financially sound and likely to become more profitable and popular when the virus is tamed. Global central banks have flooded economies with liquidity that should eventually stimulate productivity. Whether or not we approve of their methods, the Chinese are bringing the world's second largest economy back online – the rest of the world will eventually follow suit – according to stock market investors.