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MARKET MATTERS

MONTHLY INVESTOR UPDATE

February 8, 2021

Executive Summary

- U.S. COVID-19 daily cases are down, vaccinations are up. Some states are relaxing restrictions.
- The U.S. Senate, on party lines, narrowly passed a budget plan for a $1.9 trillion COVID-19 stimulus package.
- The debate over the right size of a stimulus and the risk of inflation is heating up, with recent economic data providing support for both sides of the discussion.
- Reported earnings were up, small-cap equities outperformed large-cap equities, emerging markets were up.
- GameStop (NYSE: GSE) experienced high volatility as retail investors banded together to force a short squeeze.

COVID-19 Update: Vaccines, Roll Out

According to Johns Hopkins University's COVID-19 Dashboard, daily case counts have fallen precipitously in the U.S. while Europe is dealing with a resurgence in some areas. The U.S. still leads the global tally with over 25% of all confirmed cases and just under 20% of all deaths. Most restrictions remain in place; however, some states have begun to relax restrictions even in the face of new strains that appear to be more virulent than the original.

Progress in vaccine development and distribution remains slow but steady. China has conditional approval on the Sinovac vaccine, and several other vaccines have moved further into trials. Several vaccines have now reported efficacy rates that differ based upon region and the prevailing mutated strains. Overall, 67 new vaccines are in testing with 20 of them in the final stages and another 89 in preclinical trial stages, as reported by The New York Times' vaccine tracker.

The pace of vaccinations in the U.S. has increased to nearly one million doses per day and doubling that rate would not cause the country to fall short of distribution capacity or supply, The New York Times reported on January 22. President Joe Biden's goal of 100 million vaccines by his 100th day in office is no longer a lofty goal and appears to be quite achievable.

Economic Update: Stimulus Inflation

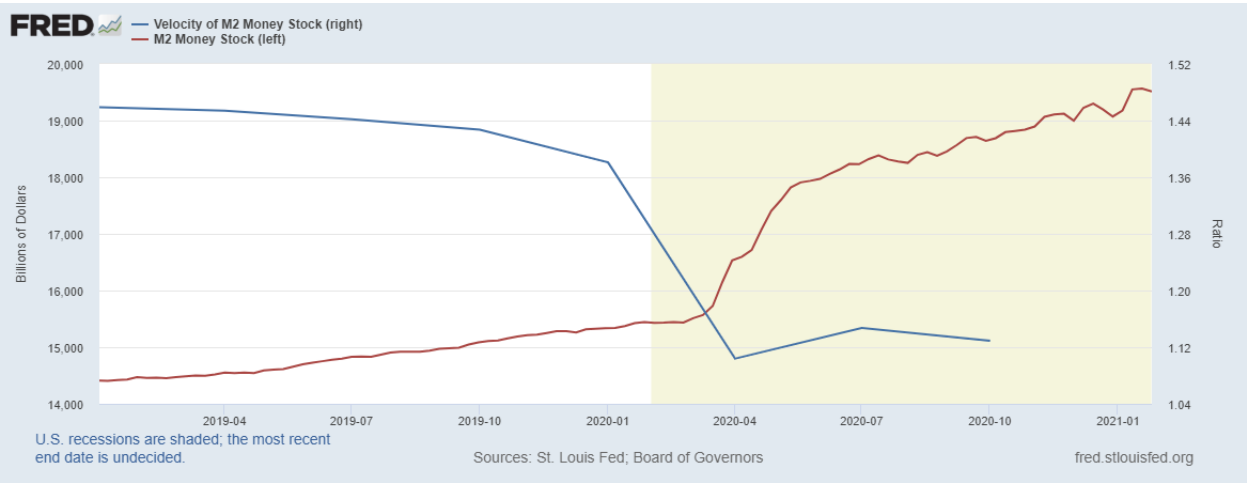
On February 5, the U.S. Senate narrowly approved on party lines (Vice President Kamala Harris cast the tie-breaking vote) a budget plan for a $1.9 trillion COVID-19 stimulus package. The

proposal must now be reconciled with the House of Representatives. A group of 10 Republicans offered support for a smaller $618 billion package.

The back and forth over the right size of a stimulus package in the face of an unprecedented pandemic is also heating the debate over inflation. Democrats fear a repeat of 2009, when an $800 billion stimulus package reduced the severity of the Great Recession but did not have the expected economic or inflationary boost thereafter, possibly because the stimulus was not large enough (assuming Keynesian economics). Republicans point to the fact that close to $4 billion has already been injected into the economy this time around.

Recent economic data offer fodder for both sides of the argument. In support of more stimulus: December job losses were revised up to 227,000; only 49,000 jobs were created in January; inflation remains stubbornly below the Federal Reserve's 2% target; while the Fed has drastically increased money supply, the velocity of money has declined (that is, people are saving their money when possible instead of spending it, which allows for families in need to spend stimulus checks without stoking inflation); positive economic data does not reflect the disproportionate impact of the recession on women and minorities.

In support of less stimulus: manufacturing and service activity continue to improve; the rollout of COVID-19 vaccinations is expanding; household income was up in 2020 despite the recession (and due to existing stimulus); the proposed stimulus package is six times larger than the projected 1.3% gap between actual and potential GDP; as pandemic-induced restrictions on economic activity are eased, the velocity of money will increase and rapidly fuel inflation due to the high level of money supply; Treasury rates have been increasing due to higher anticipated economic activity and inflation. See the graph below for a comparison of money supply and velocity.



For information on the stimulus and inflation debate, we referenced articles from the Brookings Institution, Bloomberg and the Economist dated May 23, 2016, August 24, 2020 and February 6, 2021, respectively.

Market Index Trailing Total Returns				
as of 1/31/2021	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500	-1.01%	-1.01%	17.25%	11.70%
Russell 2000	5.03%	5.03%	30.17%	11.11%
MSCI EAFE USD	-1.07%	-1.07%	8.94%	2.23%
MSCI Emerging Markets USD	3.07%	3.07%	27.90%	4.42%
Bloomberg Barclays U.S. Agg Bond	-0.72%	-0.72%	4.72%	5.49%
Bloomberg Barclays U.S. Corp High Yield	0.33%	0.33%	7.44%	6.14%
Bloomberg Barclays Global Agg Bond USD	-1.03%	-1.03%	8.16%	2.84%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

Market Update: Retail Clout

There was a lot to digest at the beginning of January with the Georgia Senate run-off results, the storming of the Capitol, and the likelihood of new policies under the Biden administration. As was the case for much of 2020, markets focused on the positive for the majority of January with major equity indices steadily increasing on further stimulus prospects and the beginnings of positive Q4 earnings reports. According to S&P Global, 81% of companies reporting as of the end of January had beat earnings estimates.

Bullish call option trading volume also reached record highs during the month. As reported by the Wall Street Journal on January 24, single contract trades made up almost 10% of recent activity, up from 2% three years ago. This trading activity is suggestive of retail traders since institutions trade in much larger quantities. The retail investor's growing market impact was another theme discussed for much of 2020 and it has undoubtedly continued this year.

Earlier gains in the month were erased during the last week of January after a couple days of broad declines, perhaps as the market became unnerved by the hectic trading events surrounding GameStop (NYSE: GME) and as some funds were selling long positions to cover shorts.

The S&P 600 small cap index returned 6.29%, outperforming large cap for the third month in a row. Consumer discretionary was the best performing small-cap sector, assisted by GameStop's massive monthly gain. At the end of the month, it was the largest issue in the index and more

than three times the size of the next largest issue, according to S&P Global. The S&P 500 ended the month of January down 1.11% (down 1.01% with dividends), with most sectors within the index declining as well.

Large Cap vs. Small Cap Trailing Total Returns				
as of 1/31/2021	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500 (large cap)	-1.01%	-1.01%	17.25%	11.70%
S&P 600 (small cap)	6.29%	6.29%	23.18%	9.04%
Russell 1000 (large cap)	-0.82%	-0.82%	19.84%	12.48%
Russell 2000 (small cap)	5.03%	5.03%	30.17%	11.11%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

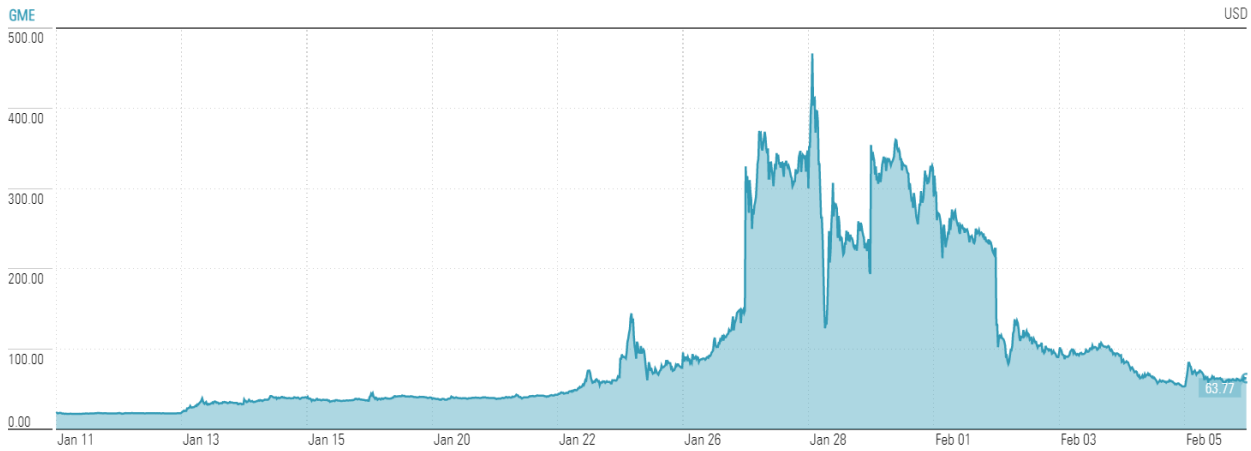
Broadly speaking, international developed markets fared about the same as the U.S. in terms of January total return. The MSCI EAFE return was negative 1.07%. Emerging markets performed better and many asset managers have a positive outlook for 2021. The MSCI Emerging Markets index gained 3.07% in January.

GameStop and the Anatomy of a Short Squeeze

A short squeeze occurs when the price of a heavily shorted stock rapidly appreciates. As market participants (often hedge funds) with short positions in that stock close out those positions to curb further losses, the price is driven even higher. This creates a domino effect as more and more traders close out short positions.

Taking a short position in a stock is a bet that the stock's price will decline. A short position involves selling borrowed shares of a stock. The short seller will eventually need to return those shares to the lender and does so by buying those shares at the then market price. If they are able to buy the shares at a lower price than they originally sold them for, the short seller makes a profit. The short seller loses money if the price of the stock has risen above what they originally sold it for.

What happened with GameStop last month was an example of a short squeeze as retail investors banded together to purchase the stock, which had been heavily shorted by hedge funds, in what some are calling a David vs. Goliath movement as hedge funds were forced to close out positions at a loss. In reality, professional investors likely took advantage of the market dislocation that was created and profited from the situation. This occurred with other stocks as well, such as AMC Entertainment (NYSE: AMC), but GameStop was the most prominent.



Source: Morningstar.com

As would be expected, the buying spree was temporary. After reaching a high of $483 per share, GameStop closed at $53.50 per share on February 4 (see chart above). Regulators have taken notice of the recent events. In a public statement on January 29, the SEC said, "the Commission is closely monitoring and evaluating the extreme price volatility of certain stocks' trading prices over the past several days," and "will closely review actions taken by regulated entities that may disadvantage investors or otherwise unduly inhibit their ability to trade certain securities." The latter part of that statement suggests that there will also be a review of actions taken by online brokerages such as Robinhood, which placed limitations on buy orders of those stocks earlier in the week.

There has been much speculation and anger over Robinhood's reasons for limiting trades in GameStop. While the answer has not been clarified, the simplest explanation is that Robinhood received a capital call, as is common in the brokerage industry, to cover for pending equity trades (trades take two days to settle), margin trades (leverage increases exposure) and option trades (options are a form of leverage). Robinhood opted to limit trading, as other brokerages also did, to limit growing exposure. As reported by Bloomberg on February 6, Robinhood should have been better prepared and questions remain over some of its practices and relationships, but the wild conspiracies are likely just that.

We are here to support you and navigate these times of uncertainty together. Knowledge is power, and we're committed to equipping you and your financial professional with the tools and information you need to weather this storm. We are continuing to watch market developments and are here to assist you with evaluating and understanding these economic changes. Please contact your financial professional to discuss your portfolio or should you have any questions or concerns.

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