2020 Year-End Review & Outlook

■ Market Review

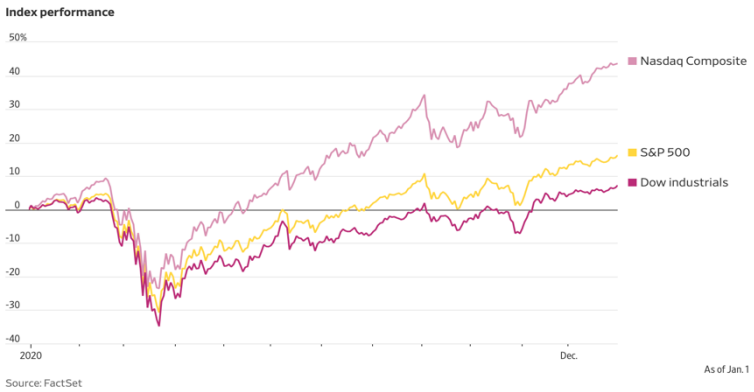
Equities

> [The pandemic] *put the U.S. economy and markets on the biggest bust-to-boom roller coaster we've seen.*
> — Jim Paulsen, Chief Investment Strategist for the Leuthold Group

U.S. stocks amazingly had a record-setting year after a bout of unprecedented destructive events only a clairvoyant would have predicted. It started with a global pandemic caused by a novel virus, a severe recession and high unemployment resulting from lockdowns, social unrest, numerous fires and hurricanes, and finally was capped off with a very contentious presidential election.

Worries about the rapidly spreading coronavirus in the first part of 2020 sent all types of securities tumbling —including stocks, commodities, real estate, and even bonds—triggering panic in markets worldwide. Then in moves not seen since the Great Recession, major central banks and governments in a coordinated effort promptly implemented massive stimulus packages, low borrowing rates, and market backstops to stem the deluge. Equity investors responded enthusiastically to the policies, sparking a second quarter rally. Then, news of an improving economy, effective Covid vaccines, and a controversial but eventual winner of the divisive presidential election, stoked a swelling enthusiasm for stocks.

So, after stocks plunged 34% into a bear market in March, a new bull equity market emerged that raced to new highs faster than ever seen before. The broad-market S&P 500 Index climbed out of its deep hole to end the year up an astounding 16.3%. The phoenix-like rise was fortified by a grassroots public enthusiasm for investing not seen in decades, as people across all ages and socioeconomic standing jumped into high-flying stocks and options contracts on innovative trading apps—at low account minimums and fees—to ride its upward wave. Caution by the end of 2020, however, was voiced by market analysts who noted that equity valuations were now high as a result of investor exuberance.



Fixed Income

Normally secure investment-grade bonds were not immune to losses during the onset of the pandemic. The virus roiled fixed-income markets in the first quarter of 2020, causing a far reaching sell-off in all debt securities; even stalwart U.S. Treasuries. Then, unprecedented Federal Reserve monetary policy paved the way for a rebound in fixed income prices, which improved throughout the remainder of the year. Government bond yields, which fall as prices rise, remained near all-time lows at year end. Meanwhile, corporate bond yields also dropped after the early-year turmoil, increasing prices.

With stocks rallying in the second quarter, emboldened investors sought out higher dividends within riskier fixed income assets, such as high-yield and emerging markets bonds, which led returns during the second half of 2020. That meant bond investors in

all sorts of debt securities ended the year with gains.

■ Global Market Performance

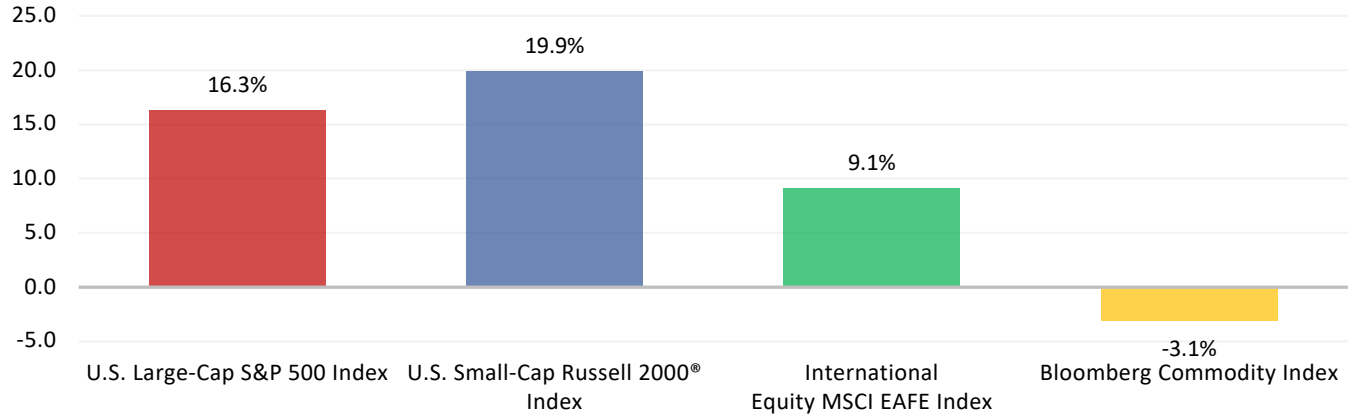
The benchmark S&P 500 Index finished with a gain of 16.3% for the year. The Dow Jones Industrial Average of the top thirty stocks ended up at 7.2%. The Nasdaq Composite Index, powered by growing Big Tech stocks, soared 43.6%. As signs for an improved economy appeared, investors became emboldened to take on riskier smaller companies that were undervalued compared to large-cap stocks. At year-end, small company stocks had its best quarter in three decades, finishing the year strong, gaining 19.9% for 2020, as measured by the Russell 2000 Index.

The best performing sectors for the year were Consumer Discretionary, Technology, and Communication Services, respectively. Lagging sectors were Energy, Real Estate, and Financials. Energy itself was down a substantial 33.7% for the year. For investment "styles," Growth outperformed Value the first half if the year, but then Value began to turn the tide in September as investors became more cautious ahead of a contentious U.S. presidential election, and gridlock on further government stimulus payments for unemployed citizens and challenged businesses amid increasing Covid-19 cases and deaths.

International developed country equities underperformed the U.S. stock market once more in 2020, but still recorded solid gains. Developed international markets were up 9.1%, while emerging markets jumped 18.1%. The emerging markets of Asia became the first to reopen its economies during the pandemic, thus were the quickest to recover equity losses. China had the best performing major country stock index; soaring 29.9% for 2020. International stock performance was also assisted by a weak U.S. dollar during the year.

Natural resources and other commodities fell 3.1% for 2020, as measured by the Bloomberg Commodity Index (BOMC). Energy was the major culprit in the BCOM's loss, with oil prices constantly under pressure as demand dried up when global economies shut down during the pandemic. In contrast, precious metals advanced as a perceived safe-haven during the 2020 storm. Gold jumped 25% and silver soared 46%, making precious metals among the top performing investments for 2020.

GLOBAL EQUITY AMD COMMODITY MARKETS CHART 2020

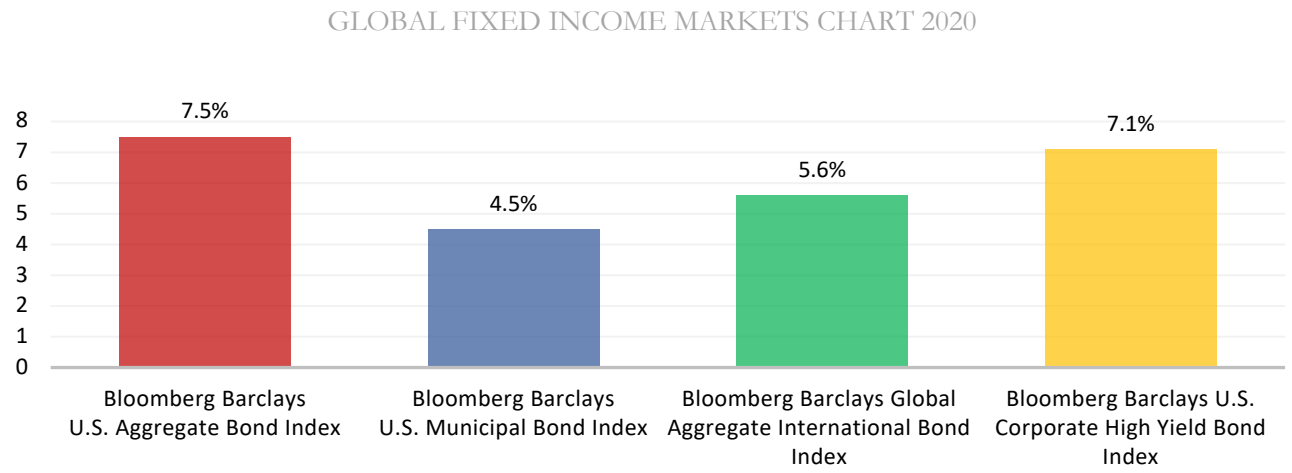


When coronavirus-related market turmoil gathered pace in March, and credit spreads blew out with liquidity drying up, the Federal Reserve took quick and decisive action. It cut the Fed-funds rate to near zero, reinstated large-scale quantitative easing last seen in the Great Recession, and launched an unprecedented number of bond-buying programs to support the smooth functioning of fixed income markets.

Federal Reserve actions, along with Congressional stimulus legislation, were successful in stabilizing fixed income markets. Nevertheless, this caused the Fed's balance sheet to skyrocket to over $7 trillion, and significantly raised the national debt for future generations to pay off.

The Federal Reserve continued its dovish tone throughout 2020, maintaining its bond purchases and indicating that rates will likely remain close to zero through at least the end of 2023. They also stated that if inflation picked up as a result of an economic recovery, the Fed was willing to let it rise above its two percent target; also a signal that rates will stay low for an extended period of time.

For 2020, the Bloomberg Barclays U.S. Aggregate Bond Index of high-quality government, mortgage and corporate bonds rose 7.5%. Non-investment grade or high-yield bonds rose 7.1% for the year, recovering losses from the beginning of the pandemic as fixed income investors took on more risk with the economy and stock market showing signs of recovery. State and local government municipal bonds gained 4.5% as high-earning investors sought tax-free income. Globally, bonds advanced 5.6% for the year aided by a weak dollar, as measured by the Bloomberg Barclays Capital Global Aggregate Bond Index.



■ Portfolio Review

Strategic Financial Concepts (SFC) Tactical Investment Strategies (TIS) Model Portfolios recorded solid gains for the year, despite the first quarter's stock market's descent due to the pandemic-caused economic shutdown and continued uncertainty. More importantly, our portfolios experienced less downside losses in the horrific first quarter, and in other less severe periods throughout the remainder of the year. This lower volatility was mainly the result of the alternative investments utilized. Still, while SFC TIS Model Portfolios' performance were ahead of the comparative category benchmarks for the first three quarters of the year, an extremely strong stock market in the fourth quarter pulled portfolio performance back to near-even compared to their respective assigned benchmark categories at year end. Most importantly, our model portfolios overall have outpaced the respective benchmarks over recent years and since inception going back to the early 2000s.

For 2020, our equity positions added strong gains (with U.S. investments beating the S&P 500 Index), along with our precious metals holding that surged 30%. Fixed income funds also added to gains, but slightly underperformed the bond benchmark. Alternative investments overall provided positive returns, but some holdings did not meet our expectations. Most significantly, our financial advisors' clients were very patient and exhibited confidence in our account management during a tumultuous 2020. We commend the vast majority that hung in there, and were rewarded for doing so!

We will continue to have portfolios well diversified in different asset classes, underweighted in stocks and bonds, with a bias toward high-quality securities. Alternative investments are being used as a substitute for a portion of our normal equity and fixed income holdings.

In the final month of 2020, we made portfolio adjustments to clients' accounts in anticipation of 2021 events. Along with evaluating current investment holdings'

performance, also considered were economic issues, equity and fixed income fundamentals; and other factors such as possible Biden administration political policies and the Covid outlook.

As a result, in constructing SFC TIS Portfolios for 2021, we were compelled to look at alternative investments even further as a complement to traditional stocks and bonds. From our in depth analysis, we swapped out several alternative investments for new holdings that provide better potential risk-adjusted returns. Such investments include stock and real estate funds that "hedged" for partial downside risk, and convertible bonds. We have kept our successful precious metals holding in the event that uncertainty or inflation spikes.

For stocks, we continue to overweight outperforming U.S. equities, underweight developed foreign stocks (due to a slower expected economic recovery there), and overweight emerging markets as they have already ramped up their economies with Covid more under control. Our bond positioning remains underweighted due to low expected returns.

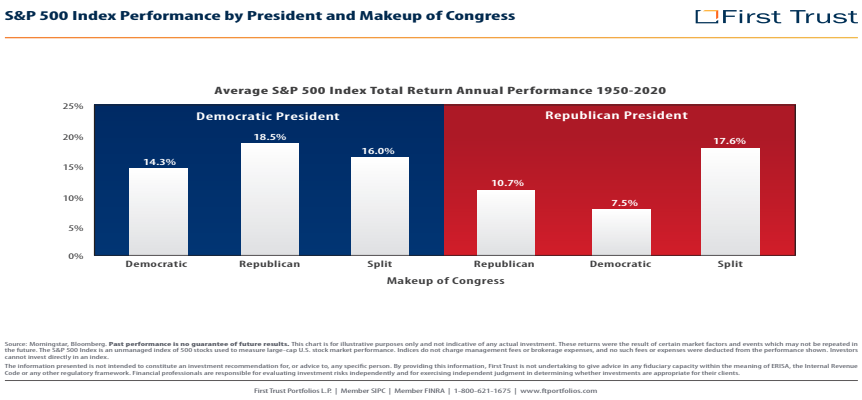
■ Market Outlook

> *What the long-term investor needs to think about is over the next year or next two years, is the economy going to grow? Are corporate earnings going to grow?*
>
> —Kelly Bogdanova; Vice President for RBC Wealth Management Portfolio Advisory Group

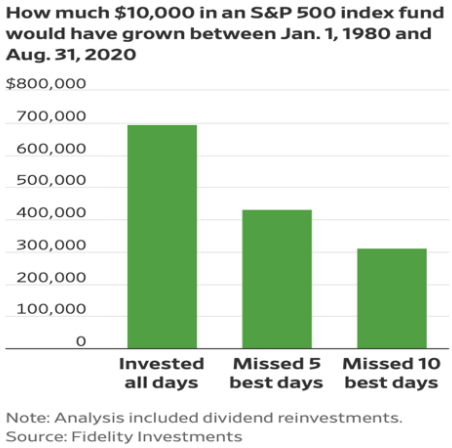
The prospects are favorable for a better economy in 2021 as Covid vaccines are distributed to our population, thus fully opening up businesses perhaps during the summer. The Federal Reserve (along with other major central banks) will continue to provide low borrowing rates, and Congress will enact further stimulus packages as needed. While gross domestic product (GDP) for 2020 will likely end down near 3%, estimated GDP for 2021 is expected to be up a strong 5%. Still, full employment will take longer to recover; economists say that may not occur until 2023-2024 due to economic scarring from the pandemic—especially in the leisure, travel, and hospitality sectors.

With the presidential election out of the way—with Democrats in a slight majority in the House and one vote lead in the Senate (with Vice President Harris casting any tied vote)—Democrats' agenda for higher taxes and new expensive federal programs may be difficult with a Republican filibuster and moderate Democrats threatening to thwart major Biden initiatives. Equity investors so far have shown favor to this outcome as stocks have rebounded further since the election. As you may know, stocks tend to rise regardless of which party is in power.

Nevertheless, equities are fully valued. And traditional bonds, with historically low dividend payments and high prices, are not expected to provide much in total return this year. As such, investment-grade bonds primarily provide portfolio "insurance" in cases when stocks slide. That's why we've underweighted both asset classes, and have added alternative investments to perhaps augment portfolio performance along with lowering account value instability.



If nothing else, 2020 once again proved that it's impossible to "time" the stock market. Facing both the pandemic and the financial crisis, those who sold on bad news and waited for the economy to recover before getting back into the stock market missed out on the bulk of stocks' upside. As emotionally harrowing as sizable selloffs may be, history shows that investors are better off not trying to hop in and out of the stock market.



With the pandemic toll resulting in economic and emotional hardships, racial tensions with social unrest, natural disasters, and citizens more divided on political lines than perhaps the Civil War era, 2020 was difficult for our nation to say the least. Still, the United States has not only survived, but will thrive despite these menacing issues, as we have done throughout our near 250 year-old history. And for investors, last year was surprisingly profitable, showing the importance of avoiding the "noise" and sticking to a long-term investment strategy to meet one's financial goals.

We congratulate clients who stuck with their assigned portfolios during a crazy 2020, and we appreciate your trust in our investment management services. As always, we are watching events closely and have the best industry resources available to make informed investment management decisions on your behalf. Reach out to us and your financial advisor for any questions or comments.

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Sources: **Sources**: Allianz Global Advisors, *2021 Outlook: Asset Class Views*, December 2020; American Century, *Investment Outlook Q1 2021*, January 2021; Charles Schwab, *Scar Tissue: Weak Jobs Report Emphasizes COVID's Scars*, January 11, 2021:; Fidelity Investments, *Quarterly Market Update: Four Quarter 2020*, January 2021; First Trust Advisors Monday Morning Outlook, *S&P 500 Index Performance by President and Makeup of Congress*, January, 2021; JP Morgan Asset Management, *Guide to the Markets*, Q1 2021; Marketfield Asset Management, *The Weekly Speculator*, January 7, 2021; Morningstar, *2020: The Year in Bond Funds*, January 4, 2021; State Street Global Advisors, *SPDR ETFs Chart Pack*, January 2021 Edition; The Wall Street Journal (multiple publications)