J.W. Burns & Company
Investment Counsel
Quarterly Update and 2021 Outlook - January 2021

Strong Returns During Turbulent Times

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness, it was the epoch of belief, it was the epoch of incredulity…"
- Charles Dickens, A Tale of Two Cities

Dear Clients and Friends,

On a personal level, 2020 was, for almost everyone, an extraordinarily painful and difficult year. On a financial level, however, investors in high-quality stocks had a good, if not excellent year. Overall, the S&P 500 Index finished the year up 18.4%, driven primarily by technology stocks; the Dow Jones Industrial Average finished the year up 9.7%, and international stocks, as measured by MSCI EAFE Index, were up 7.8%.

Overall, our performance was quite strong as we had our clients positioned in the right stocks in the right sectors. Most importantly, we did not sell out at a most inopportune time during the March stock market panic.

We end 2020 proud of our stewardship in managing our clients' money successfully during these incredibly tumultuous times. As a firm, we just crossed over $700 million in assets under management – with no dedicated marketing staff/sales. We continue to grow, as we always have, through prudent investing and word of mouth referrals. Rest assured, we remain vigilant and will continue to work relentlessly to grow and preserve your wealth.

"The greatest single edge an investor can have is a long-term orientation."

- Seth Klarman

The year 2020 was by far the most remarkable and extreme year in my now 34-year career. Unimaginable events that included: a global pandemic that swept onto America's shores in early February, followed by one of the quickest and most violent market crashes in history, which was then followed by an almost as quick stock market recovery. Last year also featured western wildfires, tornadoes, business closures, job losses, and civil unrest.[1] Add to that one of the most divisive and bizarre presidential elections in American history… you get the idea.

It was, indeed, an immensely challenging year for society, the economy, and investors.

Through it all, we remained focused on serving our clients by staying invested in superb, growing businesses for the long term. As legendary investor, Seth Klarman, correctly stated: ***"The greatest single edge an investor can have is a long-term orientation."***

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The fuel driving the stock market's strong performance in 2020 remains firmly in place heading into 2021: namely, supportive liquidity injected into the financial system by the Federal Reserve, near 0% interest rates, high levels of investor cash on the sideline looking for solid long-term returns (that will not be found in bonds or cash), earnings results that were significantly better than expected, and an improving economic recovery that is expected to continue through this year. A successful vaccine rollout will also allow investors to anticipate a return to something more normal with much less uncertainty in the global economy.

These are significant positives, but they are also, at least to some extent, already priced into markets.

<u>Risks:</u>

It seems to me that with stocks on a roll, there are many experts in the financial media who are not worried about the risks equity investors face in 2021. We believe there are many.

First and foremost, equities are not cheap, selling at about 23 times forward earnings. Even with a mere 1.03% on the 10-year Treasury, the current market levels are priced such that they are expecting – almost demanding – a robust economic recovery which may or may not keep pace with expectations.

There is also rampant speculation in various segments of the financial markets including Bitcoin, which recently surpassed over $40,000, up from around $13,000 back in November! Small and mid-cap emerging technology companies with no earnings and questionable business models have also experienced parabolic increases in 2020. These speculative market conditions can be a warning sign that a correction or even a temporary bear market may be close at hand, ***which we must always be prepared for.***

Most important is the trajectory of COVID-19. If for some reason there is a significant lag time in getting the new vaccines distributed, or if a new mutation takes hold that is resistant to the present vaccines, then all bets are off; equities would surely experience a significant decline.

Finally, although we left many of the headline risks behind in 2020 – a COVID vaccine, Brexit, and the elections – 2021 is sure to have some surprises of its own; volatility nearly always comes from shocks and events no one is anticipating.[2]

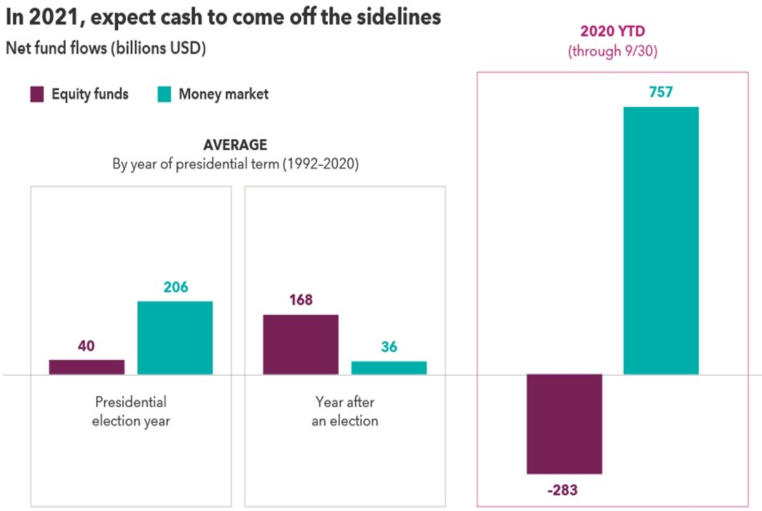
<u>Our Base Case For 2021:</u>

Despite the risks, and the fact that markets have priced in a lot of good news, our base case is that stocks can have a solid year that will probably mirror both the vaccine rollout and the ensuing "economic reopening recovery." This process will undoubtedly be uneven, unpredictable, and full of highs and lows. COVID-19 has already brought about massive changes in the economy and in our personal lives. As an example, 25% of small businesses are now closed that were open only a year ago. This is beyond unfortunate and very sad. As such, volatility should be expected as a new and uncertain economic paradigm settles in.

"Our base case is that we remain bullish on stocks and believe a high single-digit rate of return for 2021 is a reasonable assumption."

Nevertheless, it is vital that we keep our eyes focused on the long term. ***Remember, the Federal Reserve has explicitly stated that interest rates will remain ultra low until at least 2023. That gives equity investors confidence that there will be little competition for stocks over the next few years.*** Although there is speculation in certain segments of the market, consider this statistic: according to Fund Strat's Tom Lee, since 2008, a whopping 94% of the $3.1 trillion retail investor inflows have gone into bonds and cash. Only $183 billion has gone into stocks even as we have experienced one of the most powerful bull markets in history.[3] In short, there remains ample levels of dry powder that is earning – after inflation and taxes – a negative rate of return.

It is hard to imagine that a sizeable shift to equities will not take place over the next few years. Hence, our base case is that we remain bullish on stocks and believe a high single-digit rate of return for 2021 is a reasonable assumption.



Source: Morningstar U.S. Includes mutual funds and ETFs. Values based on USD. Equity funds include U.S. and international equity funds. 2020 is year-to-date through 9/30/20.

Where are the Opportunities?

As we have mentioned in previous client letters, "growth" stocks have outperformed "value" stocks by a historically wide margin over the last 12 years. Growth stocks are primarily found in the technology, bio-pharmaceutical, medical devices industries, and cutting-edge companies with big long-term growth potential. Value stocks, on the other hand, are found in old economy businesses such as industrials, basic materials, banks, and energy.

Also of note, U.S. stocks have run laps around their international counterparts over the last 10 years.

Both these trends are likely to revert, at least some degree, over the next few years, especially if inflation starts to tick up. So, expect to see us make some adjustments in 2021, looking for opportunities in these areas using exchange traded funds for emerging markets and small-cap value along with high-quality individual stocks in some of these "old economy" sectors.

We see ample opportunities, and if you have extra money to invest, you know exactly who to put it with. 😉

Along these lines, I thought you might find this snippet of interest. Many investors are always worried about investing in the market near its highs. Our view is this thinking is a form of market timing and should be avoided. See the following from Haverford:

"…it's not rational to be fearful of market highs. In fact, during the last 70 years, the markets have spent nearly half their time within 5% of an all-time high. Like shark attacks compared to a regular day at the beach, we tend to remember major market declines with superb salinity, while the steady march upward in asset prices just blends into the background…

…a recent post on Of Dollars and Data, provides a significant amount of data on this topic. This table sums it up nicely:

S&P 500 – 1950-2019

	Average Future 1-Year Return	Future 3-Year Annual Return
Near ATH	8.2%	8.2%
Off ATH	9.3%	7.4%

Near ATH is anytime the index is less than 5% from its all-time high.
Off ATH is anytime the index is more than 5% from its all-time high.
Source: Haverford January 4th Market Commentary

This data suggests that the fear of a market crash following all-time highs is often overblown."[4]

What About the Chaos in Washington?

In my lifetime, I have not seen a time where this country is as divided as it is today. Politics aside, the riots that occurred in the Capitol earlier this month were very disturbing. Some clients are wondering why markets have not reacted negatively to these events. Relative to the political landscape, keep this point in mind: financial markets are focused almost exclusively on three factors – interest rates, the economy, and corporate earnings. Broadly speaking, if investors believe that this crisis/event will be resolved over the short run, they are not going to be selling off stocks in response, however serious and discouraging the event might be.

As I mentioned in our October Client Letter, do not let drama in Washington affect your long-term investment plan. I know these are very unsettling times, but it is usually best to tune out the news, and stay focused on moving our lives forward.

To close, I believe that 2021 is going to be a better year for all of us. While a repeat of 2020's investment performance would be very pleasant indeed, I believe we should expect positive but more muted returns this year.

I will finish with two points: 1) the backdrop for stocks remains favorable heading into 2021 and 2) you continue to work with a premier investment counselor who is focused on your best interests and is committed to continually improving the economic profile of your portfolio.

Happy New Year, and thank you for your continued confidence.

Best Wishes,

Jim

James C. Burns, CFA
President & Chief Investment Officer

<u>P.S.</u> - As we start 2021, I thought this would be an opportunity to share another employee highlight. Thad Malley is a valued portfolio manager and analyst who joined J.W. Burns & Company in the summer of 2006.

Interesting note on his hire: I had put an ad for a portfolio manager position in a national investment journal. I was inundated with, literally, hundreds of applications. However, I ended up hiring then young Thad after he impressively came to our office to submit his resume in person. I interviewed him the next morning and hired him on the spot! He's been with us ever since. We just can't seem to get rid of him! LOL.

Thad plays a vital role in all processes of our investment work. I like to call him a renaissance man, as Thad also rides a Harley, does improv comedy, photography, is an avid world traveler and is an Adjunct Professor at the Whitman School of Management at Syracuse University.

Perhaps most importantly, Thad is a man of the highest integrity and has a pleasant and kind demeanor. We are proud to have him on our team and look forward to him continuing the tradition of investment management excellence here at J.W. Burns & Company.

Thad lives with his wife Lisa in Fayetteville and their dog, Gracie.

J.W. BURNS & COMPANY, INC.

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1 Fisher Investment, Market Outlook
2 Jeff Gundlach, CNBC Halftime Report, January 2021
3 Thomas Lee, Fundstrat, January 2021
4 Haverford Trust Company, Market Commentary, January 2021