

LOOK AHEAD

Q1 2021

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Wall Street Parlor Tricks

Market Comparison: 2020 Predictions to Present

	S&P 500 Level	S&P 500 Price Return	U.S. GDP Growth	10-Year Treasury Yield
Average Estimate (December 2019)	3,280	+1.52%	+1.80%	1.97%
Actual	3,756	+16.26%	-2.80%	0.94%

Wall Street's 2021 Market Predictions

Firm	Year-End S&P 500	% Chg thru Year-End
Bank of America	3,800	+1.17%
Citigroup	3,800	+1.17%
Société Générale	3,800	+1.17%
Wells Fargo	3,850	+2.50%
Morgan Stanley	3,900	+3.83%
Ned Davis Research	3,900	+3.83%
Scotiabank	3,900	+3.83%
Deutsche Bank	3,950	+5.16%
Barclays	4,000	+6.49%
Credit Suisse	4,050	+7.83%
Evercore ISI	4,050	+7.83%
UBS	4,100	+9.16%
Bank of Montreal	4,200	+11.82%
Jefferies	4,200	+11.82%
Goldman Sachs	4,300	+14.48%
Cantor Fitzgerald	4,400	+17.14%
JPMorgan	4,400	+17.14%
Average	4,035	+7.43%
Current S&P 500	3,756	

- Last year's predictions underestimated market returns by 970%
- GDP growth came in below analyst estimates by 255%

2021 Predictions

2021 Projected GDP Growth

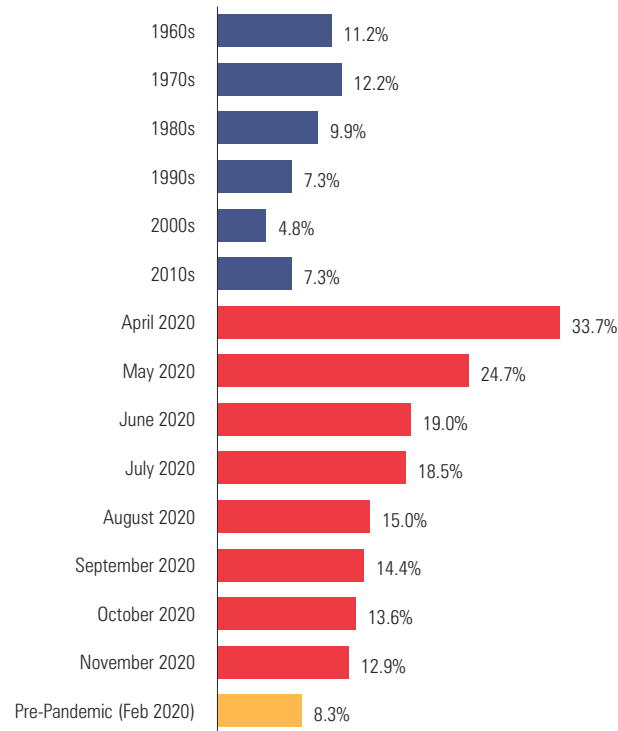
	United States	China	Japan	Euro Area	Global
U.S. Federal Reserve	+4.20%	—	—	—	—
IMF	+3.08%	+8.24%	+2.32%	+5.15%	+5.15%
World Bank	+4.00%	+6.90%	+2.50%	+4.50%	+4.20%

Consumption & Investment Rocket Fuel

Pandemic-driven consumer caution was certainly a major theme for 2020, with consumers building up precautionary savings – mainly from fiscal support – throughout the year

Rainy Day?

Savings rate as a % of disposable income



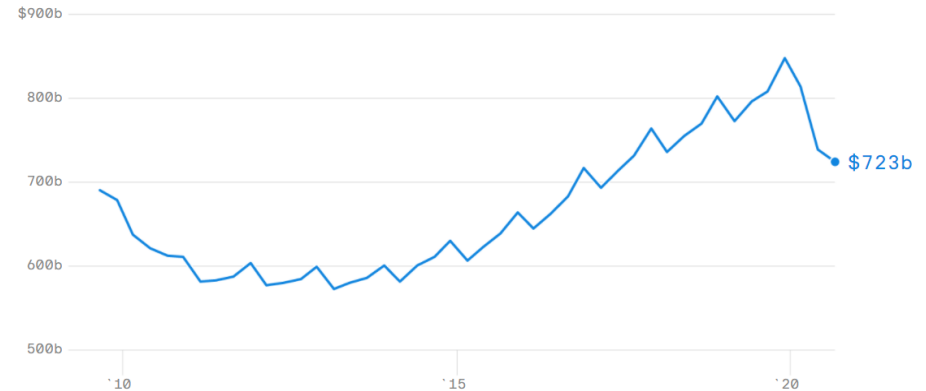
If the consumers feel safe with their jobs and health, we could see an epic return of their animal spirits in 2021

That could be equivalent to about \$1.1 trillion, or 5.4%, added back to GDP if they return to pre-pandemic savings levels

Consumers also paid down their credit cards, as shown by the steady decline of credit card balances throughout the year

Total U.S. credit card balance

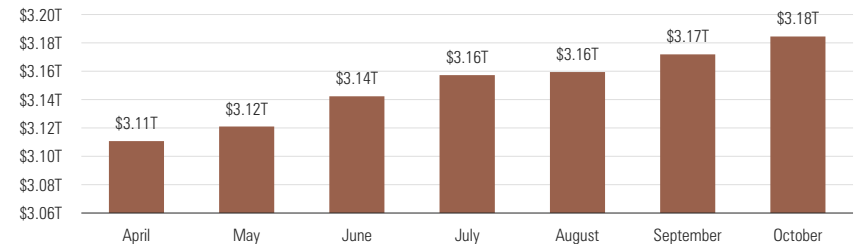
Q3 2009 to Q3 2020



Balances have declined 13.6% from a peak of \$847 billion in December 2019 to \$732 billion at the end of September

If consumers reflate their discretionary credit card spending back to pre-pandemic levels, that could add another \$115 billion, 0.55%, back to GDP in 2021

Non-Revolving Credit Outstanding (\$ trillions)

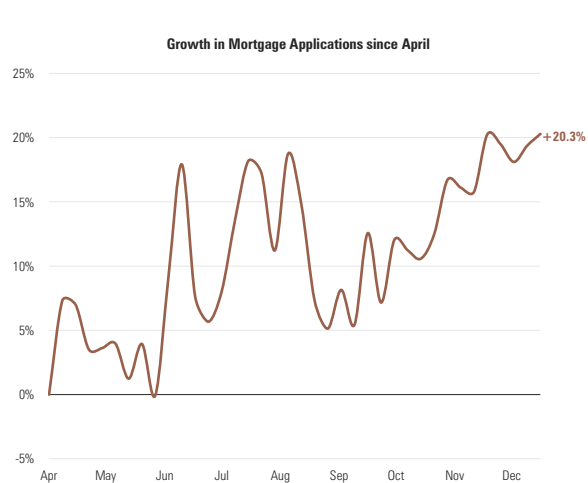


Non-revolving credit (like mortgages) has been expanding during the COVID-19 pandemic

All the consumption rocket fuel provided by fiscal stimulus has encouraged the consumer to use credit

Will They Spend?

In fact, new mortgage applications have risen 20.3% since April



U.S. Household Debt Service to Disposable Income Ratio



Even in the midst of the pandemic, consumer debt to disposable income is still at multi-decade lows

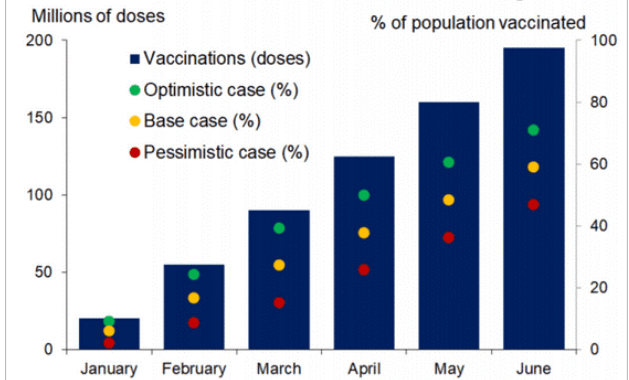
In my estimation, it's really about what they pay to service the debt that matters most

If consumers returned to prior peak levels of debt service, it could total \$2.03 trillion or 9.7% of GDP

Vaccinations rate will determine pace of spending and resurgence in consumer services (restaurants, hotels, entertainment)

Figure 2: A gradual vaccine diffusion across North America

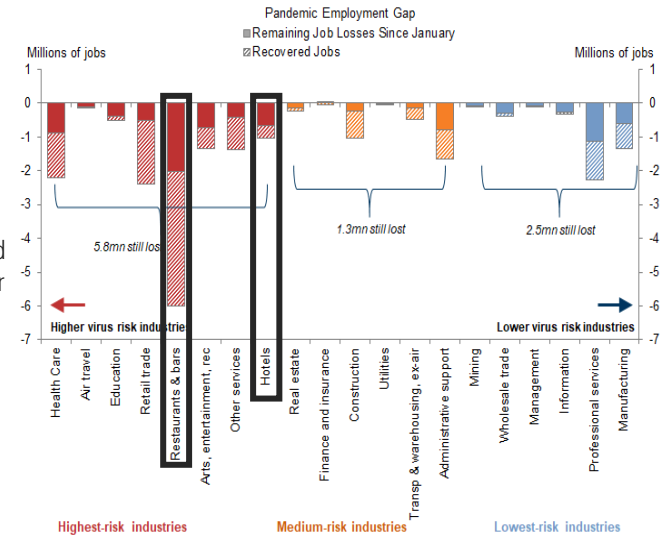
US: Estimated vaccine distribution



Adding it all up could be a jaw-dropping \$2.1 trillion flooding our economy and approximately 10.2% of GDP

	Amount (\$ billions)	% of GDP
Precautionary savings spend down	\$1,123	5.37%
Revolving credit card consumption	\$115	0.55%
Fiscal Support	\$900	4.31%
Total	\$2,138	10.23%

In just three industries hit hardest by the pandemic (Restaurants, Hotels, Airlines), "missing" wages from jobs lost since February would total approximately \$73.1 billion, or 0.60% of 2020 GDP



Data Sources: Mortgage Bankers Association, Federal Reserve Bank of St. Louis, Goldman Sachs, The Daily Shot

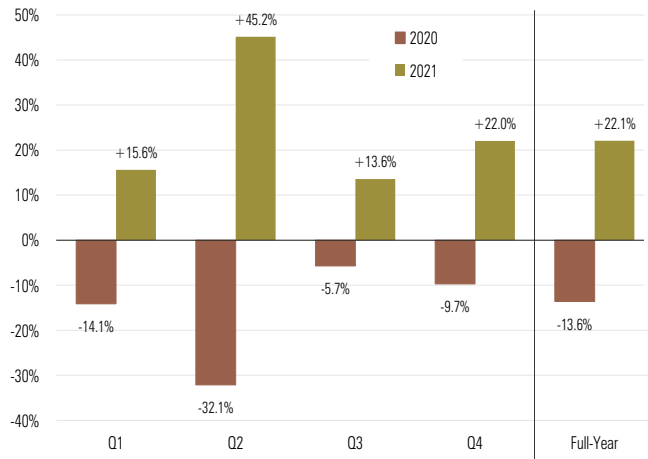
Small Hurdles – A lot of “E” and Maybe no “P”

The base effect of having such a terrible 2020 in corporate earnings provides for some pretty easy 2021 comps

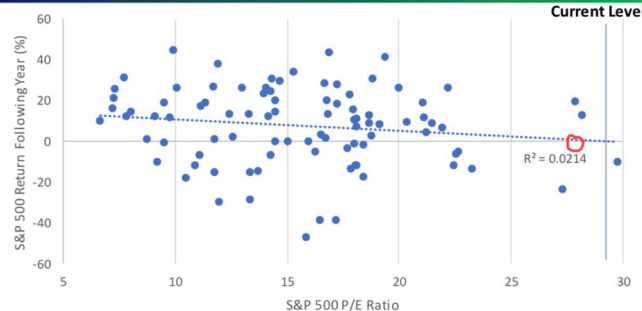
Market prognosticators are calling for strong 2021 returns, however current valuations project that muted returns are likely

Another way to cut the valuation data is to look at similar periods to 2020 from a valuation perspective

S&P 500 Earnings Growth 2020 vs. 2021



S&P 500 P/E Ratio vs Forward 1-Year Return: 1929 - 2020



S&P 500 Years With P/Es Most Similar to 2020*

Year	P/E Ratio		S&P 500 Performance
	Level	Direction	Following Year (%)
1999	29.8	Rising	-10.1
2020	29.4	Rising	
2009	28.2	Rising	12.8
1998	27.9	Rising	19.5
2001	27.3	Rising	-23.4
1933	22.7	Rising	-4.7
2017	22.5	Rising	-6.2
1961	22.4	Rising	-11.8
1997	22.2	Rising	26.7
1992	21.9	Rising	7.1
2003	21.5	Rising	9.0
1991	21.2	Rising	4.5
2019	21.1	Rising	12.0
2016	21.1	Rising	19.4
2015	20.3	Rising	9.5

Average	4.6
Median	8.0
% Positive	64.3
All Other Years	
Average	8.6
Median	12.0
% Positive	68.4

*P/E Ratio above 20 and higher vs prior year.

The average return is just over 4.5% not the whopping average 7.4% Wall Street experts are forecasting

Lots of E (earnings) and very little P (price) appreciation

While there is an expectation for strong earnings growth in 2021, perhaps those earnings will be reflected in moderating valuations versus price appreciation

Mean reversion towards historical P/E ratios could imply muted or no growth in S&P 500 prices during 2021

	2020 Level	Implied 2021 Growth Rate	Implied 2021 Level
S&P 500 Price	3,756.07	0.0%	3,756.07
S&P EPS	139.55	22.1%	170.39
P/E Ratio	26.9x		22.0x

Central Banks – Coordinated?

Major Central Bank Policy Rate Forecasts

	Current	2021 Estimate	2022 Estimate
U.S. Fed	0.25%	0.25%	0.30%
Bank of England	0.10%	0.10%	0.20%
European Central Bank	0.00%	0.05%	0.08%
Bank of Japan	-0.10%	-0.10%	0.00%

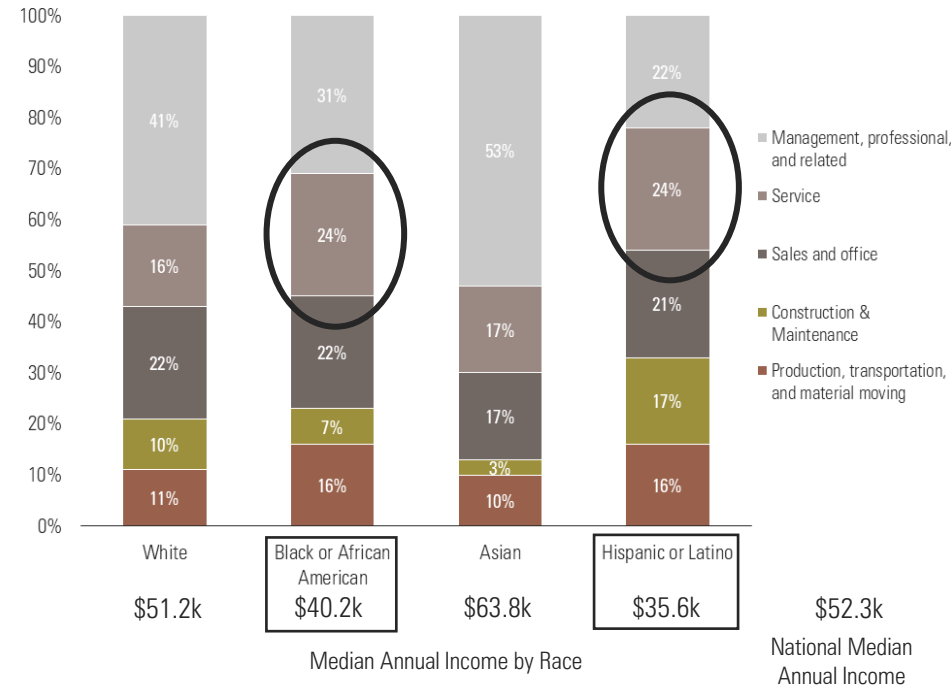
Labor Force Participation May Be the Trigger vs. Other Inflation Inputs



Keeping rates low, allowing wages to rise and inflation to drift above 2%

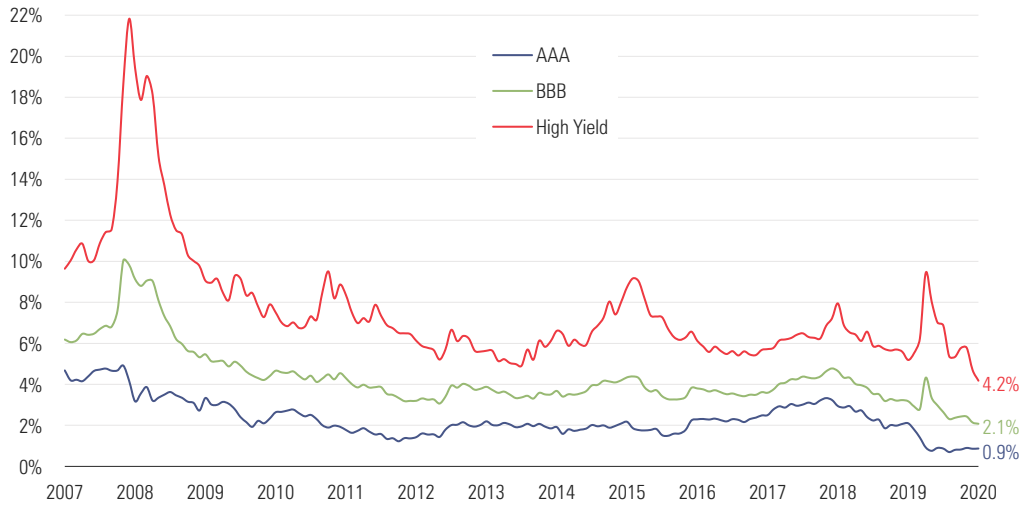
"Inflation that is persistently low can pose risks... The result can be worse economic outcomes in... both employment and price stability... with the costs likely falling hardest on those least able to bear them." —Jerome Powell

Employed Persons in Industries Most Affected by COVID-19 by Race



Fixed Income – A Tough Year Ahead

U.S. Corporate Bond Yields



Fixed Income Sectors 2021 Expected Returns

Sector	2021 Return	Annualized Volatility
U.S. Intermediate Treasuries	1.50%	2.83%
U.S. Long Treasuries	0.40%	11.38%
TIPS	1.50%	5.29%
U.S. Aggregate Bonds	2.10%	3.43%
U.S. Securitized	2.40%	2.37%
U.S. Short Duration Government/Credit	1.70%	1.50%
U.S. Long Duration Government/Credit	1.60%	9.24%
U.S. Investment Grade Corporates	2.50%	6.22%
U.S. Long Corporates	2.10%	10.21%
U.S. High Yield Corporates	4.80%	8.33%
U.S. Leveraged Loans	5.10%	7.91%
World ex-U.S. Government Bonds	1.80%	7.77%
Emerging Markets Debt	5.20%	12.27%
Emerging Markets Corporates	4.70%	8.52%
U.S. Municipals	1.90%	3.28%
U.S. Municipals High Yield	4.60%	7.68%

Yield Dispersion Across Investment Grade & High Yield Corporates



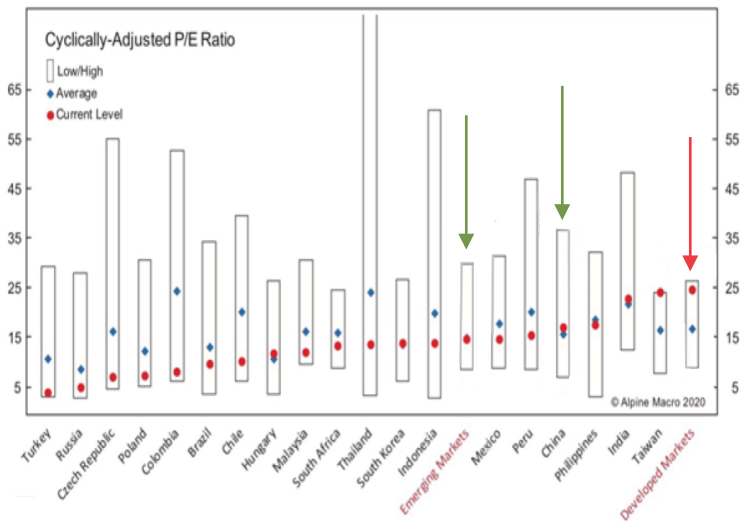
Average Credit Quality

	IG	HY
Energy	A3/BAA1	BA3/B1
Basic Materials	BAA1/BAA2	BA3/B1
Industrials	A3/BAA1	BA3/B1
Consumer Discretionary	A2/A3	BA3/B1
Consumer Staples	A3/BAA1	B1/B2
Health Care	A3/BAA1	B2/B3
Financials	A3/BAA1	BA2/BA3
Technology	A2/A3	BA3/B1
Communication Services	BAA1/BAA2	BA3/B1
Utilities	A3/BAA1	BA1/BA2
Real Estate	BAA1/BAA2	BA2/BA3

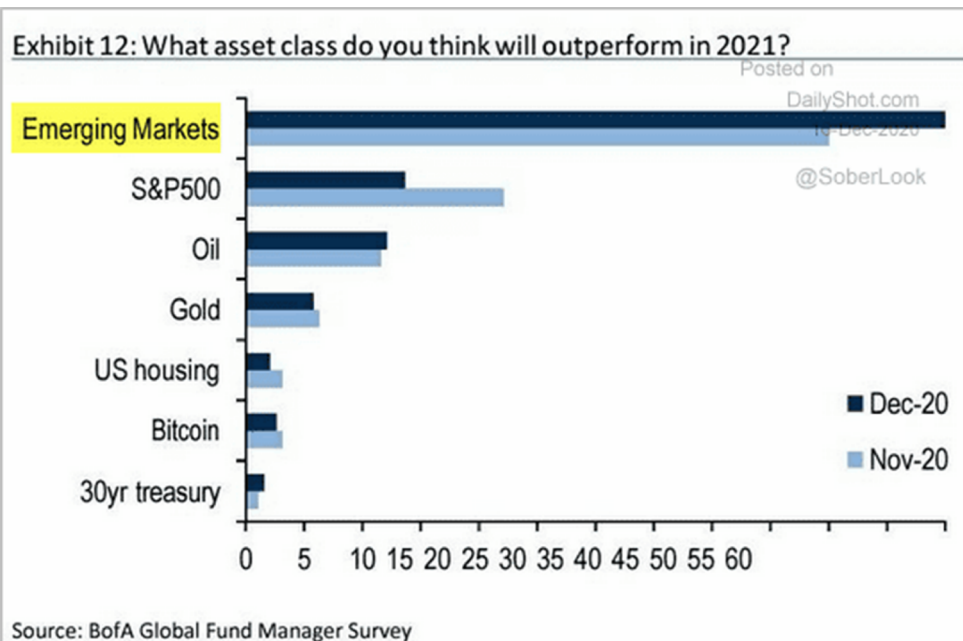
- Yield chasing will increase exposure to companies who may be at higher risk of default or downgrades by credit rating agencies

Emerging Markets

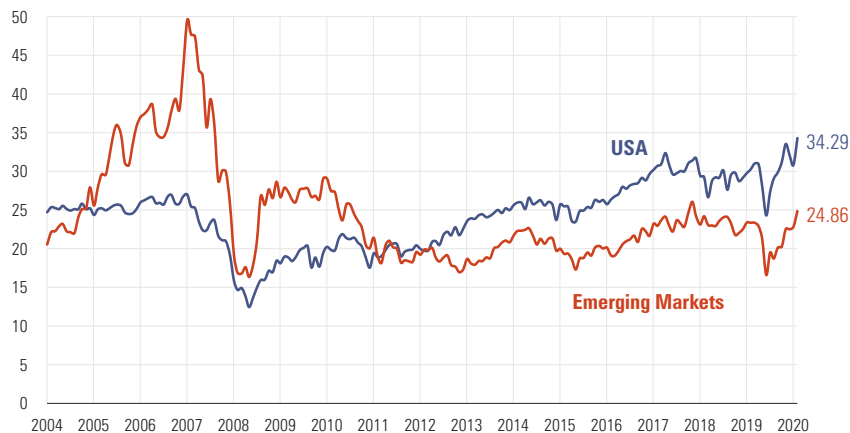
As we approach 2021, it is becoming abundantly clear that, from a valuation perspective, Emerging Markets are the favorite within the broad spectrum of equity investing



No wonder a recent fund manager survey by Bank of America shows an ever-growing drumbeat for Emerging Markets outperformance in 2021



Historical CAPE Ratios United States and Emerging Markets



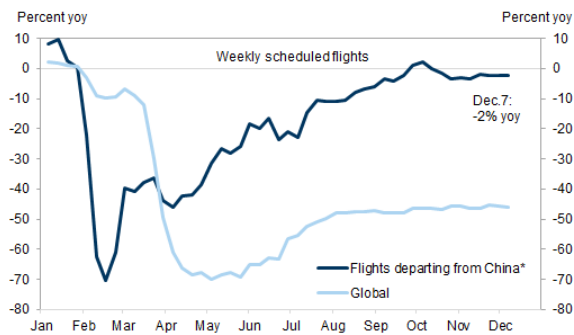
Data Sources: Alpine Macro, Barclays, Bank of America Merrill Lynch

China – Crossing Over

“Isn't it true that the Chinese Government is a counting-house for our foreign masters?” – Mao Tse-tung, 1923

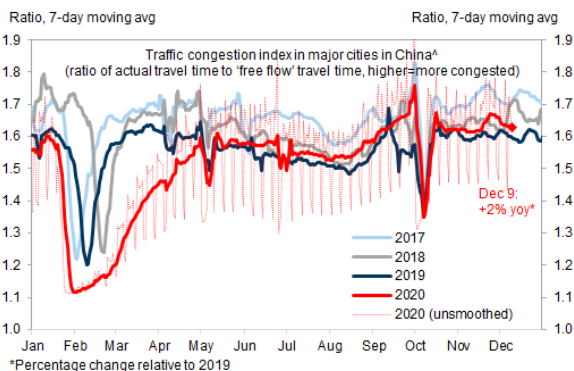
Return to Normal Indicators

Flights departing from China are only 2% below 2019 levels



*Both domestic and international flights are included

Intra-city traffic congestion remains above 2019 levels



Regional Comprehensive Economic Partnership

- On November 15th, China formed the Regional Comprehensive Economic Partnership, or RCEP, the largest trade bloc in history
- 15 countries
- 30% of World GDP
- 27% of global merchandise

So Who's in & Who's Out?



- You can see there are some compelling member nations including those that have been at odds with each other over trade for many years. Japan, China, and South Korea are strange bedfellows yet, they formed a powerful trade alliance

EU-China Comprehensive Investment Agreement

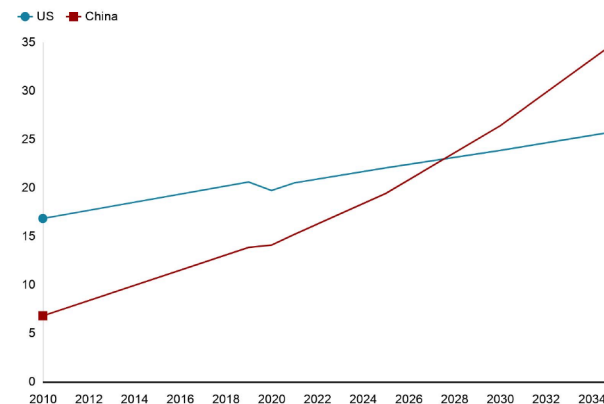
- On December 30th, the European Union and China announced the political approval of an agreement to open the Chinese market further to EU investors
- 27 countries
- \$650 billion in 2019 bilateral trade
- The agreement removes barriers to foreign investments in China for certain EU industries, such as new energy vehicles, cloud computing services, financial services and health care

Where's the United States?

- As you can see, the U.S. was out on both of these massive trade agreements
- The United States' non-participation will only support China's further growth and gives them a very strong strategic advantage over the United States
- Based on future projections for GDP growth in 2021, China's output would total ~\$15.5 trillion compared to the U.S. at \$21.4 trillion in 2021
- If the United States returns to normal pre-COVID growth (2.5%) along with China (5%), **the crossover point for China to become the largest economy in the world is estimated to be 2028 as shown to the right**

US and Chinese economies 2010-2035

Gross domestic product in \$US trillions (constant prices)



Developed Markets

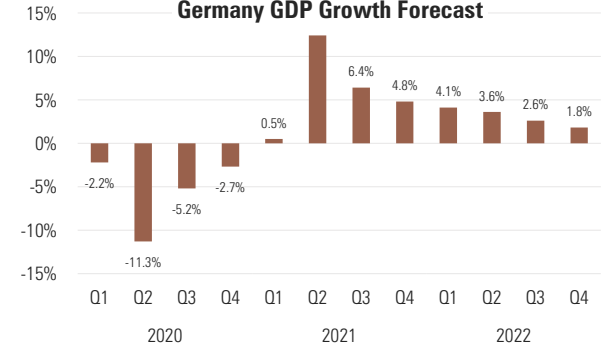
MSCI Germany Forward Price-to-Earnings



Germany Earnings Growth Forecast



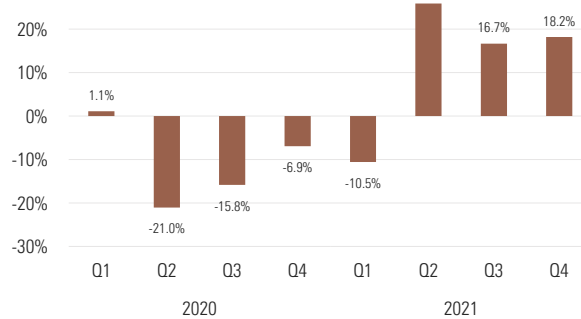
Germany GDP Growth Forecast



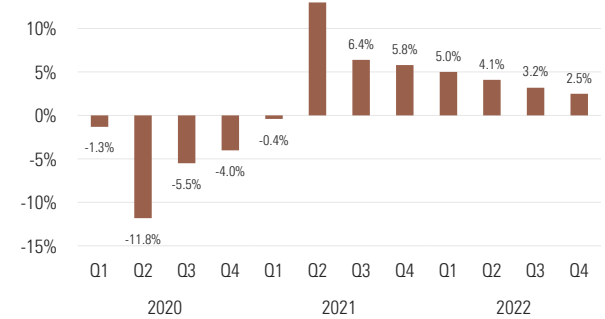
MSCI Developed Markets Forward Price-to-Earnings



Developed Markets Earnings Growth Forecast



Developed Markets GDP Growth Forecast

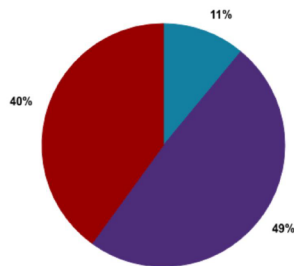


- Resurgence of COVID cases is impeding the recovery in Europe

Where does the UK trade?

% of total UK trade in 2018

■ Countries with EU trade agreements ■ The EU ■ Rest of the world



Brexit Comments

- The EU is the UK's closest and largest trading partner, their recent trade deals means no tariffs or quotas will be introduced
- The UK has made deals to continue existing trading policies with 60 other countries
- Free movement of Services ended December 31st, Services make up close to 80% of the UK economy

Biden Presidency

Biden's ambitious campaign proposals below now look less likely given the probability that Republicans keep the Senate majority. This may lead the administration to focus more on areas where executive action can make an impact, including trade, environmental policy, labor, and health care regulation

Personal Tax

- Increase top individual tax rate for taxpayers with incomes above \$400K to 39.6% from 37

Trade

- Increase federal spending on goods made by US workers by \$400 billion
- Take aggressive enforcement actions against China and rally US allies to pressure China and other trade abusers

Labor

- Raise federal minimum wage to \$15/hour and index to the median hourly wage

Healthcare

- Provide individuals with the ability to purchase a public health insurance option like Medicare

Corporate Tax

- Increase the corporate income tax rate from 21% to 28%

Estate Tax

- Revert estate transfer exemptions to the 2009 level of \$3.5 million per person, eliminate cost basis step-up at death

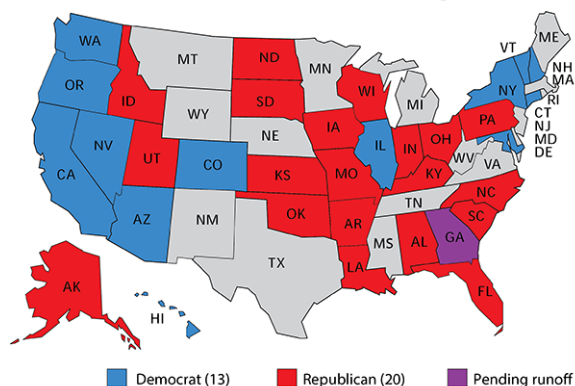
Infrastructure

- Create a \$2 trillion clean energy and infrastructure fund to be deployed during the first term with a focus on transportation funding

Energy

- Rejoin the Paris Climate Accord and rally other nations to increase their emissions reduction targets

2022 Senate Races Map



Senate 2022: An Early Look

PROBABLY COMPETITIVE – 3 Republican, 3 Democrat, 1 Undecided

- Arizona, Georgia, Nevada, New Hampshire, North Carolina, Pennsylvania, and Wisconsin

POTENTIALLY COMPETITIVE – 2 Republican, 1 Democrat

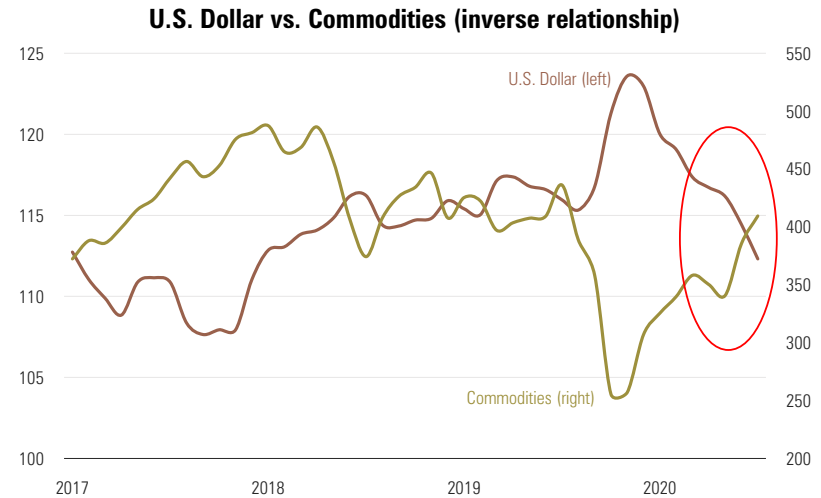
- Colorado, Florida, Ohio

NOT COMPETITIVE – 15 Republican, 9 Democrat

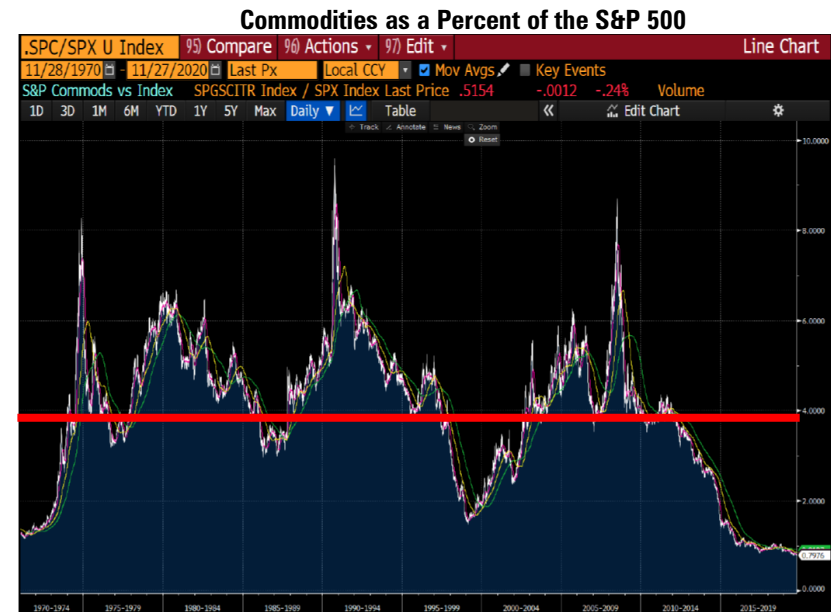
- Alabama, Alaska, Arkansas, California, Connecticut, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Missouri, New York, North Dakota, Oklahoma, Oregon, South Carolina, South Dakota, Utah, Vermont, Washington

Commodity Cycle

- As most commodities are priced in U.S. Dollars there is a strong inverse relationship between the strength of the U.S. Dollar and the pricing of commodities
- The recent decline in the dollar combined with a global economic recovery could create a lift in commodities prices in 2021



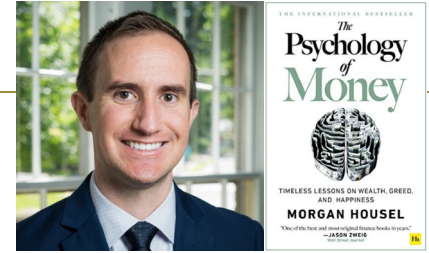
- Commodities are at a 50-year low as a percentage of equities
 - Currently commodities are trading at just 0.8x of the S&P 500
 - The historical average, shown in red, is approximately 3.8x
 - The highs are about 8x
- Look to industrial commodities, like copper and aluminum, to take advantage of this mispricing



How to Think About Risk

Morgan Housel, author of *"The Psychology of Money"*

Morgan Housel encourages people to focus on Real Risks versus risks people are talking about



Here's our take on the Real Risks

Risks People Are Talking About

1. Tech War with China
2. Green New Deal
3. Future Pandemics
4. Inflation & Rising Interest Rates
5. Higher Taxes
6. Systemic Unemployment
7. Social Unrest

Real Risks

1. China Invades Taiwan to Secure Prior Treaties and Technology Access
2. Global Single Point of Failure with Taiwan Semiconductor and 5G
3. Embedded Precautionary Savings Becomes Permanent
4. Limited Durability of the COVID Vaccine
5. Inept Global Central Banks
6. U.S. Credit Rating Downgrade

[Review our discussion with Morgan Housel about his book, *"The Psychology of Money"*](#)

Mean Reversion Dashboard

Style Forward P/E as a % of 20-Year Average

		Style		
		Value	Blend	Growth
Size	Large	128.8%	142.2%	170.5%
	Mid	123.5%	139.0%	194.2%
	Small	109.5%	144.3%	254.3%

Regions & Countries Forward P/E as a % of 20-Year Average

Regions		
World	Developed Markets	Emerging Markets
136.2%	119.7%	104.3%

Countries						
United States	Germany	United Kingdom	China	Brazil	India	Russia
152.2%	110.1%	97.6%	107.0%	87.3%	157.2%	60.1%

Sector Forward P/E as a % of 20-Year Average

Sectors										
Energy	Materials	Industrials	Consumer Discretionary	Consumer Staples	Health Care	Financials	Technology	Telecom	Utilities	Real Estate
160.1%	106.5%	119.4%	173.2%	105.1%	82.4%	74.1%	137.9%	112.3%	88.2%	235.5%

Our View & Recommendations

Our View

- Much of the recovery in corporate earnings are priced into U.S. equities
- Vaccine implementation should help bolster economic recovery, but may take several quarters
- The Federal Reserve continues to institutionalize lower rates as a way to lift lower income Americans' wages, including racial minorities.
- China is continuing to increase their global presence through major trade alliances
- Emerging Markets present the most attractive valuations
- President Biden likely to face political gridlock as he comes into office. Will focus on items that can be accomplished through executive order
- Weakening dollar could strengthen commodities

Recommendations

- Maintain policy weightings to U.S. equities with a balancing of U.S. Large Cap Growth and Quality/Value
- Continue to actively manage fixed income, as yield chasers increase defaults across the credit markets will have greater impact
- Overweight Emerging Markets as a best global price to growth opportunity
- Specific overweight to China domestic equities
- Consider some exposure to industrial commodities as a weak dollar and recovering global economies will push prices and profits higher

Strategy Update

- Review [our discussion with award-winning financial author Morgan Housel](#) about his book, "*The Psychology of Money*"

Link to Morgan Housel interview: <https://youtu.be/IBEF-okhAEE>

THANK YOU

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Data Sources

Slide 2	Wall Street Parlor Tricks https://www.bespokepremium.com/interactive/research/think-big-blog/ https://www.imf.org/en/Data https://datacatalog.worldbank.org/dataset/global-economic-prospects https://www.federalreserve.gov/monetarypolicy/fomcprojtabl20201216.htm
Slide 3	Consumption & Investment Rocket Fuel https://fred.stlouisfed.org/series/PSAVERT https://fred.stlouisfed.org/series/NONREVS1 https://www.axios.com/credit-card-balances-recession-spending-0d3ea967-1258-4f71-b02f-b9364d3f443c.html
Slide 4	Will They Spend? https://www.mba.org/ https://fred.stlouisfed.org/series/TDSP https://research.gs.com/ https://thedailyshot.com/
Slide 5	Small Hurdles – A lot of “E” and Maybe no “P” https://insight.factset.com/topic/earnings https://www.bespokepremium.com/interactive/research/think-big-blog/
Slide 6	Central Banks – Coordinated? https://www.bls.gov/data/tools.htm Bloomberg terminal
Slide 7	Fixed Income – A Tough Year Ahead https://am.jpmorgan.com/us/en/asset-management/adv/ Bloomberg terminal
Slide 8	Emerging Markets https://alpinemacro.com/ https://www.bofaml.com/en-us/content/global-research-about.html https://indices.barclays/IM/21/en/indices/static/shiller.app
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Slide 13	How to Think About Risk https://youtu.be/lBEF-okhAEE
Slide 14	Mean Reversion Dashboard Bloomberg terminal
Slide 15	Economic Dashboard Bloomberg terminal