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Quarterly Review and Outlook

The latest three-month period provided ample examples and evidence of factors impacting investor attitudes and expectations for the rest of 2021 and beyond. While the balance of these items was generally seen to be positive and supportive for equities, the outlook for fixed income securities was less clear. Not surprisingly, investor focus has been centered on the new Biden administration and the flurry of policy moves and the possible future actions by our Federal Reserve and U.S. Treasury. While the laborious process of enacting new legislation can be frustrating, the alternative of independent executive orders can lead to overuse and a risk to public confidence and support for such actions.

The effectiveness, thus far, of the various anti-covid vaccines in allowing the return to normalcy in the U.S. leads the list of positive economic and structural forces. If these vaccines prove effective to the new covid variants, the public vaccination rates should increase further and allow sustained economic expansion. The earlier prolonged hiatus in economic activity has led to numerous supply chain bottlenecks in many important industrial and consumer sectors globally. These are now showing signs of easing which will reduce the upside price pressures on many key raw materials and finished goods and services. The substantial payroll relief and family support programs had the desired effect of supporting many sectors, but with the unintended effect of dampening the return to productive employment of individuals in many critical industries. These support programs are currently reaching their expiration dates, and the number of open job opportunities are being gradually filled.

As employment achieves more normal levels, we expect to see steady improvement in demand for goods and services bolstered by the strong balance sheets in all consumer sectors and met with the available capacity positions in corporate manufacturing suppliers. These are constructive factors supporting an outlook for continued positive equity returns for the next eighteen months, but the recent upward spike in inflation has raised some doubts and worries about the "official" Federal Reserve policies of significant supportive and benign monetary actions. The price reaction in both stocks and bonds in the U.S. was volatile to the downside, but short-lived, as Fed Chairman Powell stated firmly his belief that the sharp upticks in prices in most sectors was transitory and not reasons for altered current policies. Nevertheless, investors and businesses are now alert to any nuances in statements by Fed members since everyone knows or should realize that the next policy or tactical move by the Fed will most certainly be seen as a beginning gambit in a new range of policies and monetary targets.

The latest quarter also gave evidence that the domestic economy is moving beyond the healing stage and into a more balanced growth cycle. Recent data shows that the critical item of industrial productivity is rising at a sustainable rate and that corporate infrastructure spending is steadily improving as an indicator that corporate confidence is widening. The individual and private household measures of consumer confidence are stronger as employment opportunities are abundant and wages are bouncing back. But, as is often the case, the equity and bond markets during the last several weeks have been churning in contrast to the rather rosy economic picture which is developing.

The likely reasons for the markets resting or marking time are difficult to discern decisively, but valuations and uncertainties about future Fed policy changes seem likely to be at the top of investor concerns. The issue of valuation is centered on the factors of both actual and relative measures corresponding to often questionable or changeable guideposts. As long-term growth investors in the equity arena, we are most comfortable with comparing three year likely growth in revenues and earnings relative to those same areas for the broad market and the respective industry projections and will consider making portfolio adjustments when fundamentals seem clear. Our Federal Reserve is a more difficult variant to pin down with clarity and certainty. The makeup of the Fed voting participants changes with scheduled regularity, and the frequency of voting and non-voting members making public statements does not lend confidence or reliable insights as to future policy actions.

Another subject of concern could soon be added to the prior list. The subject of taxes, both corporate and individual, to pay for the infrastructure programs which have been under discussion for several weeks is looming. While there is widespread agreement as to the need and urgency of many of these projects, the bills put forward thus far have been seen as wide of the mark as to the inclusion of items which strain the definition of capital infrastructure. In addition, taxes are levied initially, while most projects have a prolonged period to complete and often entail higher than planned costs. While most programs have worthy objectives, most businesses and their leaders and investors value certainty and a commitment to responsibility and consistency. The potential for future higher taxes erodes that confidence.

In previous letters, we have outlined the likely factors supporting a positive outlook in U.S. economic expansion for the next two years. This forecast is still intact and contingent on prospects for employment gains, increasing productive efficiencies, and no significant alterations in monetary accommodations and global tax policies. The short-term probability of GDP growth averaging in the +5% zone is not guaranteed, but still probable. We are also careful to list areas of risks related to politics, military and security threats, and unexpected changes in monetary and fiscal policies. Now, we need to include the unpredictable potential for a recurrence of covid disruptions related to new virus variants. As some savant reportedly said: **"**history may not exactly repeat itself, but it often seems to rhyme.**"**

In terms of investment strategy, we are analyzing how well our client accounts are structured and should be altered, if necessary, to benefit from the improving key economic supports and the ever-present changing political and societal actions. The tenor of our banking sectors is paramount and currently is steady. The consumer and corporate business segments are healthy and balance sheets are sound. Leading industrial firms are well capitalized and are making significant

investments in a variety of newer technologies to augment their competitive market positions and to expand into new areas of opportunity. The broad health care and services sector is managing well to offset political pressures and to achieve greater productivity in critical areas of science and technology. Energy in broad terms is proving to be a challenging sector as the "green" construct continues to offer rising public interest and erratic governmental initiatives and support along with the unpredictable make up of OPEC.

A relatively new area of investor and corporate involvement is cybersecurity, where the threats to essential industrial operations and national and military interests have shown the ever-present vulnerabilities. An essential element for outside investors in many of these sectors is a forward-looking management team which is committed to the belief that the long-term individual company success is now inexorably tied to involving technology in varied aspects of company operations. This tenet has been a touchstone for us in the past several months as we added new positions in the broadly composed cyclical value sectors.

Our asset allocation for accounts is basically unchanged. We believe that well-chosen equities offer the best potential for long-term appreciation of capital, and that bonds do not seem appealing now for new money seeking growth of capital. We will continue to hold short-term cash substitutes to moderate volatility, on a client-by-client comfort basis. We would be remiss if we did not acknowledge the still-serious threats to the current investment markets from the new covid variants and possible shutdowns affecting economic activities and capital markets. Also, our domestic political backdrop is less sanguine, and the fractures are increasing again over policy differences ranging from immigration to domestic tax policies and nascent discussions regarding international tax treaties. The fact that these are well known, as are the simmering relations with China, Russia, and the Middle East, should not mean they are discounted in the markets. Unless, and until, we are convinced that the strong domestic economic and financial underpinnings are compromised by some combination of known and unforeseen events, we believe the equity markets have momentum, sustainability**,** and attractive potential for investors.

While it would be easy to relax and enjoy the broadening impact of the continuing reopening and recovery of our domestic economy, we intend to maintain a watchful and unblinking eye on the myriad factors of change and challenge which are always present. We will keep the lines of communication open, and we encourage our clients to stay in touch with any questions or concerns as to your portfolios or our policies and actions. We pledge vigilance and responsiveness!

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