Year-in-Review: A Look Back on 2020 Market Activity and Key Areas of Focus for 2021

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Greetings GVA Friends, Happy Holidays! I hope this note finds you well and in good health. As we near the end of 2020, I wanted to share some thoughts with you on what has been one of the most dynamic and challenging years, not only in the investing world but in our daily lives. The way I see it, 2020 was a "one-hundred-year storm" and looking ahead to 2021, I see the beginning of a new year, a new era and quite simply a new start for all of us. So let's push the rest button and look ahead to 2021!

In addition to my thoughts below, we have all kinds of information posted to the Valor Library on the GVA portal on Salesforce. For example, we recently posted two new "Valor Views" documents that provide additional thoughts, data and commentary on the market and economy along with changes we made to the Valor models for 4th quarter 2020. We also have our normal position reports for all Valor models and the latest performance posted out there.

Thank you and I wish you all the best during this holiday season.

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"The Year of Everything"

Advisors in the Great Valley Advisor (GVA) network know I have referred to 2020 as "The Year of Everything", a lighthearted moniker for one of the most challenging and dynamic years we have ever seen. The events of 2020 have not only thrown a wrench in our daily lives, but also brought unprecedented uncertainty in the markets which led to wild swings all year long. From the economic fallout at the beginning of the year to the election at the end of the year, 2020 has been a constant blur of "Everything". Words like "vaccine", "stimulus", "shutdown", "social distance", "PPP", "new norm", "recession" and "recovery" have become a part of everyday conversation. And they have highlighted a rapidly evolving news cycle that has taken a life of its own day in and day out as new information becomes available.

Quite simply, there has been a lot of noise for investors to sift through this year. This noise has led to extremes in the market we have not seen in a very long time. Perhaps ever. The US Government and The Fed made several moves during the year to help temper these extremes. These moves were not only historic, but they were necessary to help stimulate the economy. But all of this led to a very uncertain backdrop as investors assessed their investment strategy in 2020. And we know from studying behavioral finance that investors are inclined to let outside factors influence their investment decision-making process. That certainly rang true this year, but the flipside to that for investors is to try and look beyond the noise and try to focus on the quality and defensive oriented investments the market can offer to help provide ballast to their portfolios. This sentiment has become increasingly important in the current environment.

To that point, at Valor, we not only stayed true to our investment discipline and process throughout the year, but we added new steps and new checks to our modeling process to help improve our decision making. For example, we introduced a stress testing methodology to test all of our models for another COVID type scenario. That gave us a nice range of confidence between upside and downside expectations in the event the market takes another turn. We not only used that for our own models but passed that information on to the GVA network to help equip our advisors with the data, information and insight they needed to help with their modeling needs. This not only educated our advisors but also helped them facilitate meaningful conversations with their clients. All of this was meant to drill down to the core positions of our models and focus on the factors that could affect performance, especially on the downside. This approach was in keeping with the principals rooted in our Valor investment philosophy: keep it simple, focus on the fundamentals, block out the noise and manage risk through diversification. Now that we are at year-end, this presents an opportunity for us to look back on the year, assess wins and losses, reflect on lessons learned, and look ahead to the new year.

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A Look Back on 2020

Back in January, investors welcomed a new year without any warning of what was truly in store. 2019 was a record year for the markets; the S&P 500 was up over 28%, the Dow was up 22% and the tech-led Nasdaq was up 35%. Investors, including myself, largely expected to enjoy the extended bull market. Early market performance indeed showed that as gains continued, and in February all indices reached then-peak levels.

In mid-March, everything changed as the coronavirus pandemic took hold and completely altered the nation's way of life. The global health crisis prompted an emergency response, with a swift market correction fueled by staggering unemployment and the start of a recession. In April, we contemplated the "shape" of the recovery, reopening timelines and prospects for stimulus. We now have much more clarity on these issues, and we have since seen the markets make a so-called "V-shaped" recovery, breaking and setting new record highs in the S&P 500 and the Dow. As if that hasn't been enough, we also saw a highly contested election in November which we are still feeling the aftereffects of, and there is still one more election to go with the Georgia runoff on January 5th, 2021 which has huge implications.

Volatility Reinforces the Importance of Diversification and Downside Protection

Pandemic-driven market volatility coupled with mounting political concerns, civil unrest and other events this year have left investors on edge about their portfolios. At Valor, we certainly did not expect everything that happened this year ("murder hornets"?) but we did prepare for a possible downturn at the beginning of the year after we saw record performance in 2019. Then when the pandemic hit, we saw unprecedented volatility which caused all asset classes to rapidly decline. Quite simply, there was no place to hide. After that, we stayed true to the Valor investment philosophy by continuing to invest in quality companies and managers with a competitive advantage, strong balance sheets and solid fundamentals. But we also sharpened our pencils and began shifting exposures to asset classes and companies that had a defensive and "COVID type" element to their business. For example, the "stay at home" trade complemented our models very well this year and it kept us diversified to help us manage risk and downside protection.

Speaking of risk, we expanded our thinking this year on this very important concept, which is sometimes overlooked by clients who typically focus on the upside. But the downside is just as important, if not more, because as we saw in early 2020, a sudden drop in the market can be a drag on your portfolio and can eliminate long felt gains in one fell swoop. To help prepare for that possible scenario again, we stress tested all of the Valor models and focused on minimizing downside capture for the level of risk each model would take. Now, like I said, there was no hiding in March and April, and we bounced out of it, but going forward we prepared ourselves for downside protection with diversification and sensible investments on both the equity and fixed income side to help dampen volatility when/if it happens again.

How the Valor Models are Positioned Going Forward

The pandemic will continue to be a significant concern for investors as we head into 2021. Even though a vaccine will soon be available nationwide with the first shots just given on Monday 12/14, the distribution and effectiveness may be cause for concern. There are also concerns about new spikes in case counts across the country which is prompting many states to shut down again. We have seen this in recent jobs reports where jobless claims are rising again. But it is my expectation that the measures being taken now across the country, along with a successful vaccine rollout, will lead to a positive outcome in 2021 and beyond. But it will take time. The economy will follow suit but again it will take time and be a slow recovery as jobs slowly come back.

The political landscape is also creating some cause for concern. The January 5th, 2021 Georgia runoff election will also have potential downside implications on the market if the Senate flips from Republican to Democrat. Both Democratic candidates will have to win on order for that to happen, but current polls show a tight race.

With all of that in mind, we feel it is important to maintain a focus on quality and downside at this time. On the equity side, that means a continuation of our current thinking by investing in a combination of what we

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call our "core" companies/asset classes that offer quality and strong fundamentals along with defensively themed names. On the fixed income side, that also means staying with a defensive theme by maintaining increased exposures to government bonds, investment grade corporate bonds and global bonds, all of which perform better in a volatile market. We also shifted out of real estate and into gold which is a benchmark for stability but also has an inflation-hedging component which should pick up slowly in 2021 and beyond (we invest in gold through the miners who have better margins).

Key Areas to Watch in 2021

Many of the same themes we were watching earlier this year are still very relevant as we head into year end. But as we look ahead, here are our primary areas of focus:

1. **Vaccine Optimism Balanced with Ongoing Risk from the Pandemic**
   The coronavirus pandemic remains a top concern among investors, with the CDC reporting over 12 million cases in the United States, and numbers currently rising. The best news we received was when the Pfizer vaccine got approved by the FDA for emergency use. But this will create an interesting dynamic in the markets going forward which I view as a pendulum shifting in investors' minds between "fear of loss" if something goes wrong and "fear of missing out" if science does prevail. The markets will be sensitive to this and all news surrounding the vaccine, distribution plans, side-effects and effectiveness. In the end, I expect the vaccine to be a success, but the rollout will be slow and there will probably be some setbacks as the population receives treatment. But we should all expect a methodological rollout with some potential setbacks.

2. **New Stimulus Package**
   Record levels of stimulus have already been circulated throughout the economy this year and on Sunday, Congress agreed to a new $900B round of stimulus. It will now go up for an official vote but assuming it passes into law, this will certainly be a welcome sign for the economy. Especially as we enter the winter months. I had expected a new package to be delivered to the American people but wasn't sure it would get done before the end of the year so it's nice to see this happening now. The resulting cash infusion, new PPP loans and enhanced unemployment benefits should continue to spur the consumer and businesses alike. But as with all packages like this, it will not come with unlimited funds and unlimited relief. In the long run, the economy will have to eventually support itself. If not, another round of stimulus may be necessary. If that happens, investors should expect new debates and new negotiations, all with a new Congress in 2021. This is certainly a developing story and one the market will continue to monitor very closely as time goes on. But I've always believed "something is better than nothing" and with this new package, the economy will have renewed hope and the support it needs to stay in check.

3. **The Georgia Runoff and Potential for More Volatility**
   We closely monitor the Chicago Board Options Exchange Volatility Index (the "VIX") for indications on future market volatility. We expect volatility to be driven by continued political uncertainty, specifically the Georgia runoff election in January and its potential to significantly impact the legislative landscape.

4. **Corporate Profits and Opportunity**
   The pandemic is fueling areas of opportunity and we can already see this as the markets have broadened a strong momentum-based rally as we end the year. This is a signal inferring equity valuations are attractive and the market expects a recovery next year. But the question lies where and in what sectors? For one, it will be sectors that benefit from an economic expansion which will ultimately drive corporate profits and favorable results going forward. Some sectors to consider in this environment are consumer discretionary, financials, technology and healthcare. Consumer spending is expected to remain strong, particularly if inflation picks up, and the technology sector is working quickly to meet the needs of the new digital lifestyle. Healthcare remains strong as testing increases, demand heightens for medical supplies and vaccine trials and distribution progress.

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5. **The Economy - Key Economic Data Will Take Center Stage**
   GDP reached a record growth rate in the third quarter and investors will be watching to see if growth is sustainable. Other key indicators, including unemployment numbers and housing starts, will stay in focus as data suggests a recovery. Momentum in these areas needs to stay on course for positive change to occur.

Final Thoughts

The events of 2020 have been unprecedented. The related market, consumer, government and economic response has been unprecedented as well. While these challenges were all new, our country has adjusted to a new way of life and a new way of doing business and that has led to many bright spots this year too. I do see light at the end of the tunnel, and I have been especially encouraged by the rally we saw over the summer which wiped out the bear market returns we experienced when the pandemic hit. I am even more encouraged by the broadening rally we are now seeing as we close out the year. To me, both of those trends indicate ongoing signs of recovery and progress. And quite simply I don't think America would have it any other way. We continue to maintain a focus on the long-term by investing in companies with a competitive advantage, strong fundamentals, resilient performance and growing cash flows.

Thank you for your time reading this note and please check out all of our materials posted in the library section of the GVA portal on Salesforce. We not only post regular market updates like this but also all Valor model allocations, all the positions and all the performance information. And please connect with us on LinkedIn and Twitter for our latest insights and team updates.

Disclosures

1. Content in this material is for general information only and not intended to provide specific advice or recommendations for any individual. All performance referenced is historical and is no guarantee of future results. Value will fluctuate with market conditions and investments/portfolios may not achieve its investment objective. No strategy assures success or protects against loss. Investing involves risk including loss of principal.
2. Consult your financial advisor prior to making any investment decision.
3. ***Investors should consider the investment objectives, risks, charges and expenses of the investment company carefully before investing. The prospectus and, if available, the summary prospectus, contain this and other important information about the investment company. You can obtain a prospectus and summary prospectus from your financial representative. Read carefully before investing.***
4. Asset allocation does not ensure a profit or protect against a loss. All investing involves risk, including the risk of loss.
5. Rebalancing a portfolio may cause investors to incur tax liabilities and/or transaction costs and does not assure a profit or protect against a loss.
6. The prices of small and mid-cap stocks are generally more volatile than large cap stocks.
7. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. These risks are often heightened for investments in emerging markets.
8. Long positions may decline as short positions rise, thereby accelerating potential losses to the investor.
9. Bonds are units of corporate debt issued by companies and securitized as tradeable assets. A bond is referred to as a fixed income instrument since bonds traditionally pay a fixed interest rate (coupon) to debtholders. Variable or floating interest rates are also now quite common. Bond prices are inversely correlated with interest rates: when rates go up, bond prices fall and vice-versa. Bonds have maturity dates at which point the principal amount must be paid back in full or risk default. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond yields are subject to change. Certain call or special redemption features may exist which could impact yield.
10. Corporate bonds are debt obligations issued by corporations to fund capital improvements, expansions, debt refinancing, or acquisitions. Interest is subject to federal, state, and local taxes. The market value of corporate bonds will fluctuate, and if the bond is sold prior to maturity, the investor's yield may differ from the advertised yield.
11. Investment grade bonds are those rated BBB and above by Standard & Poor's or Baa and above by Moody's
12. Municipal bonds are bonds issued by state and local governments to help fund large, expensive and long-lived capital projects in the communities they serve (like a bridge, toll road, school or airport). They are subject to availability and change in price. They are also subject to market and interest rate risk if sold prior to maturity. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply. If sold prior to maturity, capital gains tax could apply.
13. High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.
14. Preferred stocks are "hybrid" investments, sharing characteristics of both stocks and bonds. Like a stock they are generally paid after a bond, but like a bond they offer a fixed rate of payment and par value upon maturity/redemption. Risks can include interest rate risk, longer duration, lower credit ratings, and sector concentration, etc.
15. Convertible bonds are a type of debt security that can be converted to a fixed number of shares of the issuer's common stock.

16. The fast price swings in commodities and currencies will result in significant volatility in an investor's holdings. Precious metal investing involves greater fluctuation and potential for losses.
17. Alternatives are investments that don't fall into traditional investment categories—namely long-only stocks, bonds, or cash. Alternative investment managers can invest long or short, across multiple asset classes, aren't constrained to an investment style, and aren't entirely dependent on the markets going up to achieve positive results. Examples are hedge funds, private equity, event driven, long/short, hedged equity or "multi-strategy" which is a combination of the various alternative strategies.
18. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.
19. Dividend yield refers to a stock's annual dividend payments to shareholders, expressed as a percentage of the stock's current price.
20. An investment in Exchange Traded Funds (ETF), structured as a mutual fund or unit investment trust, involves the risk of losing money and should be considered as part of an overall program, not a complete investment program. An investment in ETFs involves additional risks such as not diversified, price volatility, competitive industry pressure, international political and economic developments, possible trading halts, and index tracking errors.
21. Because of their narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.
22. Cash flow is the net amount of cash and cash-equivalents being transferred into and out of a business. At the most fundamental level, a company's ability to create value for shareholders is determined by its ability to generate positive cash flows, or more specifically, maximize long-term free cash flow (FCF).
23. Market capitalization is a measurement of the size of a company, interpreted as the market's total valuation of the company, obtained by multiplying the number of shares outstanding by the current price per share.
24. The S&P 500 Index (the "S&P 500") is a stock market index that measures the stock performance of 500 United States based companies listed on stock exchanges in the United States. It is a "market capitalization-weighted" index meaning the index is calculated by weighting the respective market capitalization of each constituent (calculated by multiplying the current price of the stock by the total shares outstanding). The S&P 500 is often used as a proxy for the U.S. stock market.
25. The Dow Jones Industrial Average Index (the "DJIA" or "Dow") is a stock market index composed of 30 United States based companies found on the New York Stock Exchange, with only a handful of Nasdaq-listed stocks such as Apple (AAPL), Intel (INTC), Cisco (CSCO), and Microsoft (MSFT). Along with the S&P 500 Index and the Nasdaq Composite Index, the Dow is one of the three most-followed stock market indices in the United States. The Dow is a price-weighted index, meaning its value is derived from the price per share for each stock divided by a common divisor. The term "Dow" comes from its founder Charles Dow.
26. The Nasdaq Composite Index (the "Nasdaq") is a stock market index that includes all the companies listed on the Nasdaq stock exchange. It is roughly 3,300 stocks. The term "Nasdaq" refers to the National Association of Securities Dealers Automated Quotations exchange, the first electronic exchange that allowed investors to buy and sell stock on a computerized, speedy, and transparent system, without the need for a physical trading floor. The Nasdaq is heavily weighted towards companies in the information technology sector ("tech" or "internet" companies) but there are financial, consumer, biotech, and industrial companies as well. Just like the S&P 500, it is a market capitalization-weighted index where its price is calculated by weighting the sum products of the closing price of each stock by their respective shares outstanding.
27. The "VIX" is a popular name and ticker symbol for the Chicago Board Options Exchange's CBOE Volatility Index. It is a real-time market index that represents the market's expectation of 30-day forward-looking volatility ("implied volatility") and is based on the prices of call and put options on the S&P 500 index that are traded daily.