February 3, 2021

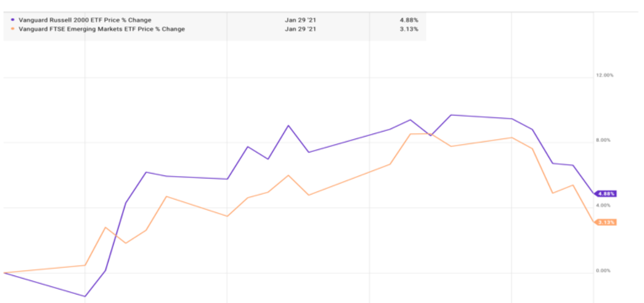
Overview

January offered a mixed picture for equity markets in general. The S&P's 500 dropped **1.01%** on a total return basis while the Nasdaq Composite was up **1.44%** and the Russell 2000 (Small US Caps) rose **5.03%,** continuing on its strong year-end trend.

Internationally, the broad EPAC BMI (developed economies) was down **.88%** but the MSCI EM (emerging markets) rose **3.07%.** Unusually when small US capitalization stocks and emerging market equities rally, the USD rose by about 1.33% against a basket of diversified trading partners' currencies.

These somewhat inconsistent market developments may be a consequence of a general risk-on environment and of heightened volatility caused by the unstable political environment in the US and the unusual activity generated by retail investors around Gamestop and other heavily shorted stocks. In my view, the larger and longer trend remains nevertheless supportive of equity markets.

The chart below illustrates the performance of emerging markets (VWO-Orange line) and Small Caps (VTWO-Purple line) during the month:



VWO was up **3.13%** in January. VTWO was up **4.28%.** This is not a market ready to give up. This does not mean that prudence should not be exercised. While I believe that the next 6-12 months environment remains favorable to equities, bumps along the way are likely.

In January, our client portfolios dropped between **.26%** and **.94%.** Over the same period, a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy) declined **.53%.**

As a reminder, the equity allocation in our clients' portfolios ranges currently from 40% to 70%, depending on risk profiles.

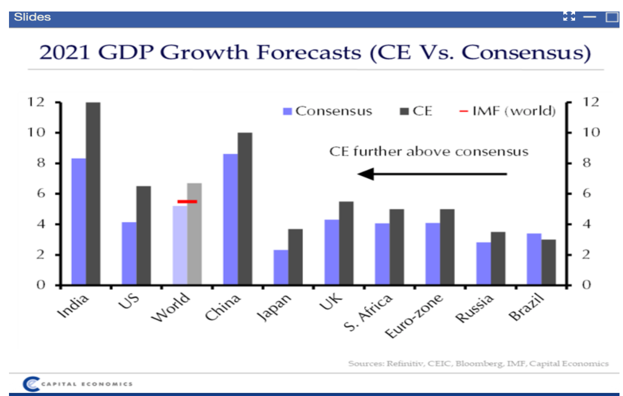
Market developments

On January 6, prompted by two months of election denial rhetoric from the White House, a mob stormed the US Capitol. Given the momentous nature of this event, I am not sure what to make of the resilience of the stock market as the storm passed. Is it just that investors do not really care much about politics or that many do not measure accurately the potential implications? I will take my cue from them though and assume that the benign market reaction portends the prompt dissipation of this moment.

While the performance of equity markets was uneven in January, the overall environment remains constructive, even if obstacles related to the fight against Covid 19 remain and could set us back a few weeks or months.

Below is a chart of the expected performance of several major countries and economic blocs in 2021. CE stands for "Capital Economics", my go-to economic service.

The relatively robust growth pictured here should provide good support to equities worldwide.



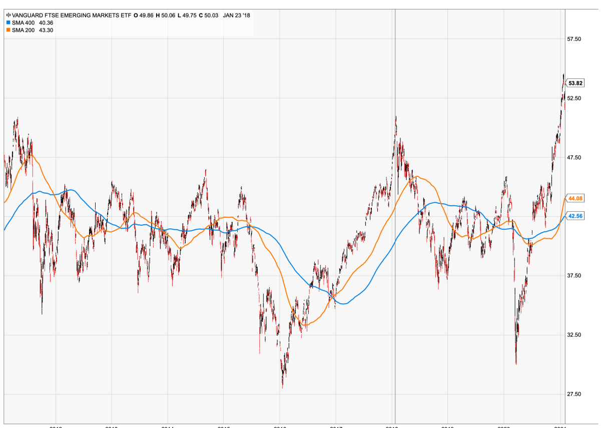
The US economy is expected to grow at a meaningful 6% in 2021, mostly as a result of a strong jump in consumption concurrent with a gradual return to normal, as the economic and human costs of Covid dissipate. Vaccination efforts should start yielding measurable results by the end of June and bring about a re-opening of the US economy and major developed economies.

Granted, vaccine production and delivery issues, as well as new Covid 19 variants could stretch the recovery farther out into the future. Nevertheless, a stronger and better organized Federal response should eventually get us out of the rut. Markets are betting on this, with surprising equanimity.

Tilts and Allocations

In mid-January, I cut our US equity exposure by 10%. This is a significant reduction that I did not entertain lightly. My concern about an anticipated resurgence of Covid cases in February and March in connection with the new UK variant prompted me to do so. Equity markets do not seem to have taken this eventuality into consideration, choosing instead to focus on the stimulus package currently discussed in Congress. It is hard to say whether this deterioration will come to pass. I hope it does not. If it does however, markets should decline and give us opportunities to re-invest at lower levels. My intention is to get back to our initial equity allocation by mid-March or earlier.

During the month I cut our VWO investment (emerging market equities) in half after this ETF reached key historical levels, as illustrated in the chart below:



This is the 10-year chart for VWO. The vertical line marks the previous peak attained in January 2018, at about $50. The prior peak over that 10-year period was reached in early 2011, also around $50.

In early January, I sold half of our investments in VWO at about $51.50 in spite of a still supportive environment. At those elevated levels, I felt it was time to take some profits and possibly re-deploy our cash on other emerging markets investment vehicles that have not yet pushed higher so significantly.

ILF, the Latin American Equity ETF, is one such investment vehicle. It is an extremely volatile security, as most Latin American investments are, and I am proceeding with caution.

Conclusion

With a new and sizeable stimulus program eventually passed in Congress over the next two months, it is hard to see anything other than a rather positive environment for the stock market over the coming months. That said, it is possible that our fight against Covid 19 encounters unexpected bumps.

Should this happen, markets may decline enough and give us opportunities to re-enter them at lower levels. I have prepared for this eventuality.

Thank you for your continued trust.

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