ELEMENT POINTE
ADVISORS

Market Outlook:
Top Ten Investment Themes for 2021

January 2021

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1. **The start of a new bull market:** Despite a challenging global health outlook for the next three months, we believe we are in the early stages of an economic expansion that will reward investors who endure through the inevitable bouts of volatility that await.
2. **Risk to our outlook:** The biggest risk to markets is higher-than-expected interest rates and inflation; however, we do not see this as a likely 2021 risk.
3. **The search for yield:** The Federal Reserve's unprecedented policy action in March created a low interest rate environment that is expected to persist for an extended period and poses a challenge for income-oriented investors .
4. **Growth vs. Value Debate:** Notwithstanding "value" stocks' outperformance in the fourth quarter, we believe that growth and disruptive technology will continue to lead the market higher in this cycle.
5. **A brighter outlook for emerging markets:** After a decade of lackluster results, we believe emerging market stocks, led by Asian companies, are set to outperform over the next decade.
6. **A Tale of Two Economies:** U.S. equities had a strong year in 2020 amid an economic contraction and sharp increase in unemployment. The disconnect is best explained by the market's growing leverage to high-growth companies that were able to adapt and thrive in this new environment.
7. **The world is awash in money:** While valuations are elevated, we believe the current liquidity backdrop will continue to support valuation multiples for the foreseeable future.
8. **U.S.-China relations:** Despite the Biden administration's new approach, the U.S.-China economic and technological rivalry will continue to escalate. However, expect a rapid shift towards normalizing relations with key allies and a more coordinated approach to tackling key issues like China and Iran national security threats, the coronavirus pandemic, and climate change.
9. **Brexit:** We anticipate the implications of Brexit to remain a key concern for investors in European markets for the near future, and the subsequent geopolitical and economic uncertainties pose a challenge for investors in European markets.
10. **The Robinhood Effect:** The emerging popularity of zero-cost, easy-to-use trading platforms, like Robinhood, has led to a democratization of markets, but consequently, has been a source of irrational price movements in small, speculative stocks. However, statistical evidence suggests this new wave of investors has yet to affect blue chip stocks, and we believe the emergence of the retail investor will not have a material impact on broader equity markets in 2021.

TOP 10 INVESTMENT THEMES FOR 2021

1. The start of a new bull market

Despite a challenging global health outlook for the next three months, we believe that we are in the early stages of an economic expansion that will reward investors who endure through the inevitable bouts of volatility that await. As we communicated during our third quarter update call, in our view, we are at the beginning of a new bull market that will take equity prices significantly higher as the cycle matures. The post-election rally has drawn many equity investors off the sidelines, causing positioning and sentiment to be a short-term risk for the market/ We see the likelihood of a correction in the coming months as high; however, if we are correct that a new, sustainable business cycle has begun, history suggests that this new bull market will continue to deliver attractive returns for an extended period.

We recognize that the next three months may be the most challenging of this pandemic from a health perspective. Coronavirus cases and hospitalizations are currently near records and worsening since the recent holiday period. The vaccination rollout has gotten off to a much slower start than expected, highlighting the logistical challenges of distributing the mRNA vaccines. According to the New York Times, less than three million people had received the vaccine as of the end of the year, falling far short of the administration's goal to have twenty million Americans vaccinated in 2020.[1] The winter season makes it difficult to keep outbreaks under control, but as the weather turns in the spring, we believe the warmer temperatures combined with the ongoing vaccination program, and perhaps the arrival of several other vaccine approvals, will significantly tame the health crisis, leading to the start of an enduring economic expansion.

Recognizing the renewed challenges posed by this latest coronavirus surge, Congress passed a new $900 billion relief package in December. Highlights of this relief bill include $600 direct payments to each qualifying individual, an additional $300 per week of unemployment assistance, $325 billion to support small businesses, funding for schools, COVID-19 testing and tracing efforts, vaccine distribution, and other targeted measures. Most of this money will be spent over the next six months, and we believe it will serve as an effective economic bridge until the vaccines are widely distributed. To put the size of this package in perspective, the U.S. government's entire fiscal response to the Great Financial Crisis was roughly $900 billion, and the economy is in much better shape today than it was in 2008. Relatively low bankruptcies, strong new business formations, and a rapidly declining unemployment rate all point to an economy that has suffered surprisingly limited long-term damage.

When we consider the lagged effects of the first stimulus bill, plus this new injection of frontloaded fiscal support, we believe the economy is close to entering a multi-year period of strong nominal growth that will act as a powerful tailwind for the equity market. So far, the U.S. government has done a great job of plugging the income hole created by the economic shutdown and ensuing recession. As Federal Reserve Vice Chairman Richard Clarida said in a speech in November, "This was the only downturn in my professional career in which disposable income actually went up in a deep recession, and a lot of that has been saved." With the exception of those most severely impacted by the pandemic, consumers have sharply increased savings and paid down debt. Experts suggest that this excess savings could drive $500 billion to $1 trillion dollars of additional consumer spending over the next 24 months.[2] If accurate, this represents up to 5% of GDP in pent-up demand waiting to be spent once economic restrictions are fully lifted.

We also expect a sharp increase in government spending once the new Biden administration takes power, especially now that the Democrats have control of the Senate. Major initiatives will focus on increasing direct payments to individuals, health care, education, state government aid, climate change, and infrastructure. Most of these are long overdue and should drive productivity gains that increase the growth potential of the economy. While we worry about the long-term side effects of the implied debt build-up, the shorter-term implications are positive for equity markets.

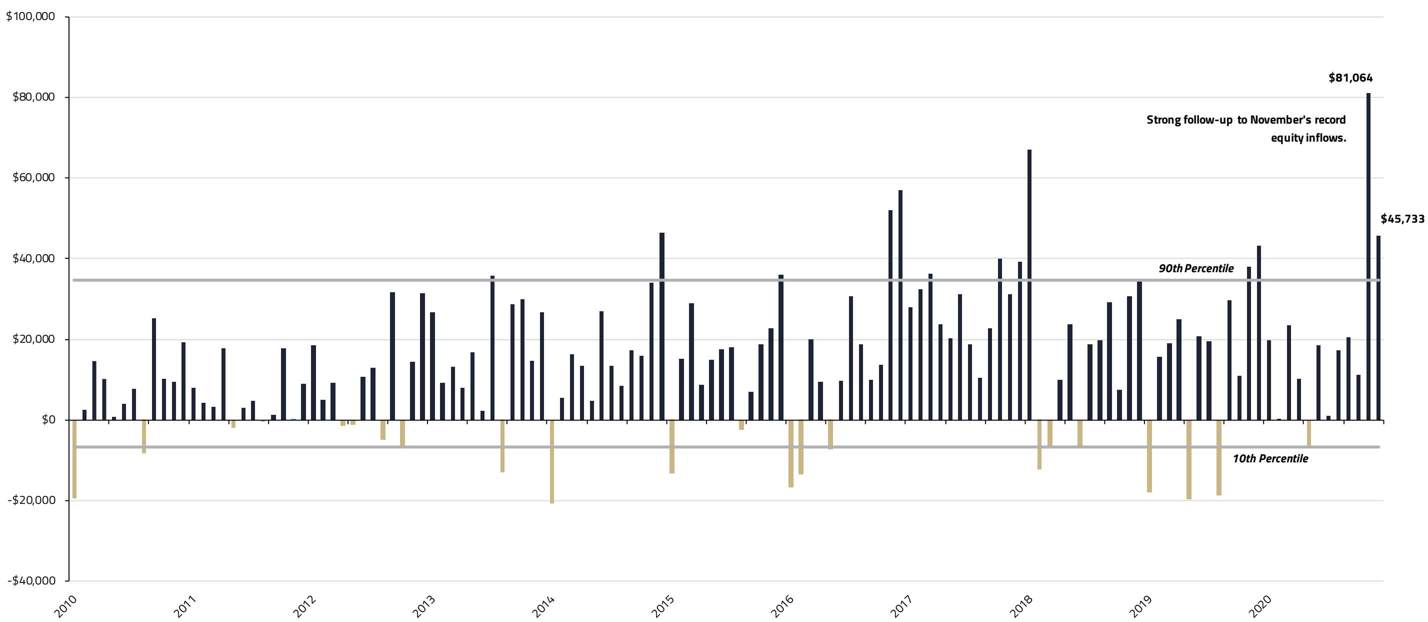
While this fiscal support is powerful, the Federal Reserve ("Fed") is central to our bullish thesis. It has made clear in numerous post-meeting communications and Chairman Powell press conferences, the Fed has promised to keep the federal funds rate near zero until the economy reaches full employment and inflation averages 2% over the cycle. This nuanced change to its inflation goal suggests that the Fed will likely keep interest rates near zero for at least the next few years. Chairman Powell also confirmed that the Fed will keep buying $80 billion in treasuries and $40 billion in mortgage bonds per month until the economy has made "substantial further progress." Expanding liquidity combined with low interest rates is a powerful recipe for further equity gains.

1. Rebecca Robbins, Frances Robles, and Tim Arango. "Here's Why Distribution of the Vaccine Is Taking Longer Than Expected." N.Y. Times. December 31, 2020.
2. KKR Global Macro & Asset Allocation Team. "2021: Another Voice." Volume 10.6. December 2020.

We are also encouraged by Janet Yellen's nomination to be the next Treasury Secretary. Yellen was the previous Fed Chair and has a longstanding working relationship with Chairman Powell. We believe her appointment portends increased coordination on important financial market backstops that helped quickly heal the capital markets back in March and April. We believe they will collaborate closely and promptly respond to any setbacks that may arise going forward, providing a safety net of sorts to the recovery. The unprecedented actions that the Fed and Treasury have taken to date have already created the most favorable financial conditions in the last decade, and the money supply is growing at an annual rate of 25%.[3] With Powell and Yellen in their respective posts, we believe these conditions will remain in place for years to come and act as a boon for risk assets.

Taken together, extraordinary fiscal and monetary support, virus-induced pent-up demand, the ongoing housing boom, low inflation, and the wealth effects of rising asset prices set the stage for an enduring economic expansion beginning this year that will likely drive strong corporate earnings growth and equity returns for years to come. That said, we recognize the immense challenge the coronavirus presents, including evidence that a more contagious variant is spreading in the U.S. We anticipate many periods of heightened volatility and sharp equity drawdowns as the world slowly recovers from the pandemic. We would not be surprised if we enter into such a period in the early part of 2021. The S&P 500 gained 11.5% from Election Day to year-end, and investors moved $127 billion into equity ETFs and mutual funds over that period (*See* Exhibit 1). This is an extraordinary amount of capital in a short time frame (November's inflow was an all-time record), which suggests that investor positioning and sentiment are short-term risks.

Exhibit 1: Monthly ETF Flows ($ Millions)



Source: Strategas

Bigger picture, markets in the U.S. and abroad have taken on a new complexion over the last few months. Market breadth and momentum statistics are reflective of what usually happens in the early stages of a bull market. Not only are all the major U.S. equity indexes at all-time highs, but similar patterns are emerging elsewhere. Markets in Korea, Taiwan, Sweden and New Zealand are making all-time highs while Japan makes a 29-year high. The pandemic created a global health crisis that caused a global recession, but the vaccines offer hope of a coordinated and powerful recovery that has begun to take shape. As we advised back in October, do not overthink this. Economic and political uncertainties are on the decline. Do not allow alarming coronavirus headlines or bouts of heightened market volatility to dissuade you. It is our opinion that we are in the early stages of a new bull market that promises to reward those who stay disciplined and optimistic.

3. Strategas. (January 4, 2021).

TOP 10 INVESTMENT THEMES FOR 2021

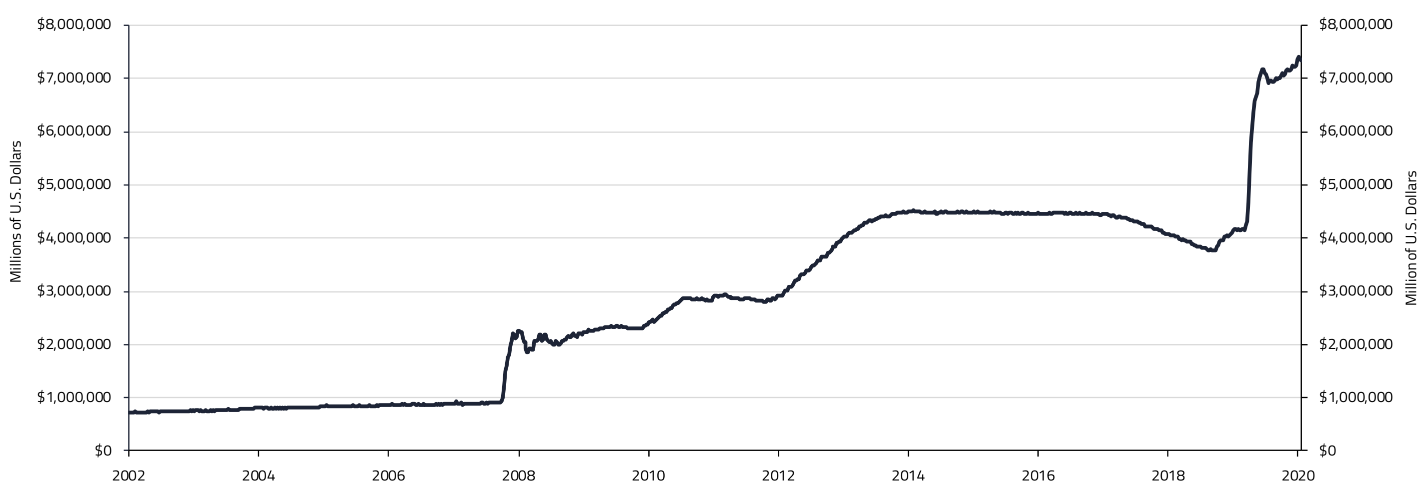
2. Risk to our outlook

In response to the Great Financial Crisis of 2008, the Federal Reserve, and many central banks throughout the world, adopted aggressive monetary stimulus measures in an effort to support credit markets and to stimulate economic growth. The Federal Reserve and other central banks reacted to the deepening crisis in the fall of 2008 not only by opening new emergency liquidity facilities, but also by reducing policy interest rates to close to zero and taking other steps to ease financial conditions. Such rapid and aggressive responses were expected to cushion the shock to the economy by reducing the cost of borrowing for households and businesses, thereby encouraging them to spend. These Fed measures came to be referred to as "Quantitative Easing."

Given the severity of the 2008 downturn, however, it soon became clear that lowering short-term policy rates and attempting to shape expectations would not be sufficient alone to counter the macroeconomic effects of the financial crisis. The Federal Reserve needed to use other methods to ease financial conditions. Thus, to reduce longer-term interest rates, the Federal Reserve initiated large-scale purchases of longer-term securities, specifically Treasury securities, agency mortgage-backed securities ("MBS"), and agency debt. Ultimately, in response to the Great Financial Crisis, the Federal Reserve purchased $300 billion of Treasury securities, about $175 billion of agency debt obligations, and $1.25 trillion of agency MBS.

In October 2014, the Fed announced the end of its bond-buying program. At that point in time, the Fed's balance sheet reached nearly $4.5 trillion (*See* Exhibit 2).

Exhibit 2: Total Fed Balance Sheet Assets (less elimination from consolidation)



Source: Board of Governors of the Federal Reserve System (US)

Later, in June 2017, the Fed announced that it would begin reducing the size of its balance sheet by letting bonds "run off" at maturity – in other words, by not reinvesting the proceeds of some of its maturing bonds. This gradual unwinding of the Fed's balance sheet was fairly short-lived; as in September 2019, interest rates for repurchase agreements spiked, thereby pushing the Fed's policy rate temporarily above the range that policymakers were targeting. The Fed responded to these technical issues in the money markets by purchasing Treasury bills and once again expanding the size of its balance sheet.

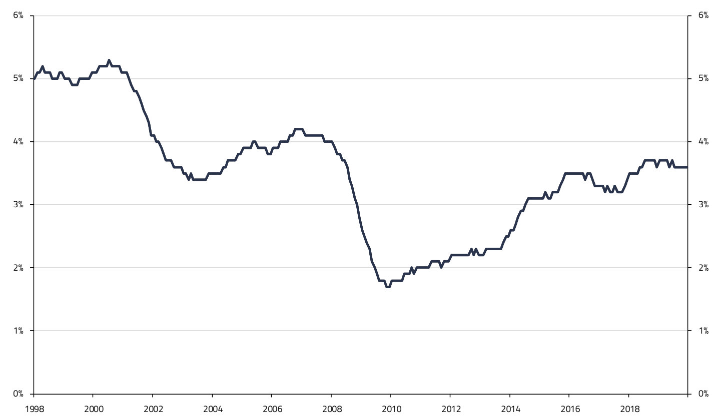
And then came COVID-19. In early March 2020, as COVID-19 spread throughout the U.S. and globally, it had devastating effects on global economic activity and caused tremendous human and economic hardship around the world. In response, the Fed once again enacted aggressive stimulus measures. During two unscheduled meetings on March 3 and March 15, the Federal Open Market Committee ("FOMC") voted to reduce the target range for the federal funds rate by a total of one and a half percentage points, dropping it to near zero, where it remains today. Further, the Fed ramped up its purchases of Treasury securities, buying $1.7 trillion of Treasuries between mid-March and the end of June. The Fed also introduced multiple temporary facilities to support various types of funding and credit markets, such as the Paycheck Protection Program Liquidity Facility and the Main Street Lending Program.

These aggressive stimulus measures had the effect of driving interest rates to all-time lows. In March 2020, in the midst of the COVID-19 pandemic, 10-year Treasury yields hit a new all-time low, briefly touching 0.318% intra-day on March 8. While rates have increased somewhat since the March 2020 lows, 10-year Treasury rates remain at just 1.02% as of January 6, 2021, lower than at any time in the history of the United States (other than 2020).

The aforementioned stimulus measures have had profound effects on financial markets. From the start of Quantitative Easing in 2008, many market prognosticators had opined that these aggressive stimulus measures would lead to runaway inflation, which would in turn drive interest rates higher in a vicious inflationary cycle. Thus far, these prognosticators have been wrong. Inflation has remained subdued for the past twelve years, despite the unprecedented level of central bank stimulus. While one could argue that there has been tremendous inflation in the value of risk assets (i.e., stocks, bonds, real estate), actual economic inflation has been tepid at best.

Yet, as the Fed has once again, in 2020, enacted aggressive stimulus measures in response to the global pandemic, many investors and market participants are understandably concerned about what effect these measures will have on the outlook for inflation and rates. While there is little doubt that the stimulus measures of the past decade are inflationary over the ***long-term*** (from an economic theory perspective), it is our view that the probability of inflation in the ***near-term*** is very low. The main historical drivers of inflation, wage inflation and a lack of slack (*slack* refers to the ability of an economy to ramp up production without reaching capacity) are simply not present (*See* Exhibits 3 and 4). Given the present unemployment rate, we view wage inflation as an unlikely 2021 event. As for economic slack, as shown in Exhibit 4, U.S. capacity utilization stood at a mere 73% of total capacity, as of November 2020. In the absence of these inflationary indicators, we believe it is unlikely that inflation will accelerate in the near-term.

Exhibit 3: Wage Growth Tracker



Sources: Current Population Survey, Bureau of Labor Statistics and author's calculations.

Exhibit 4: Capacity Utilization

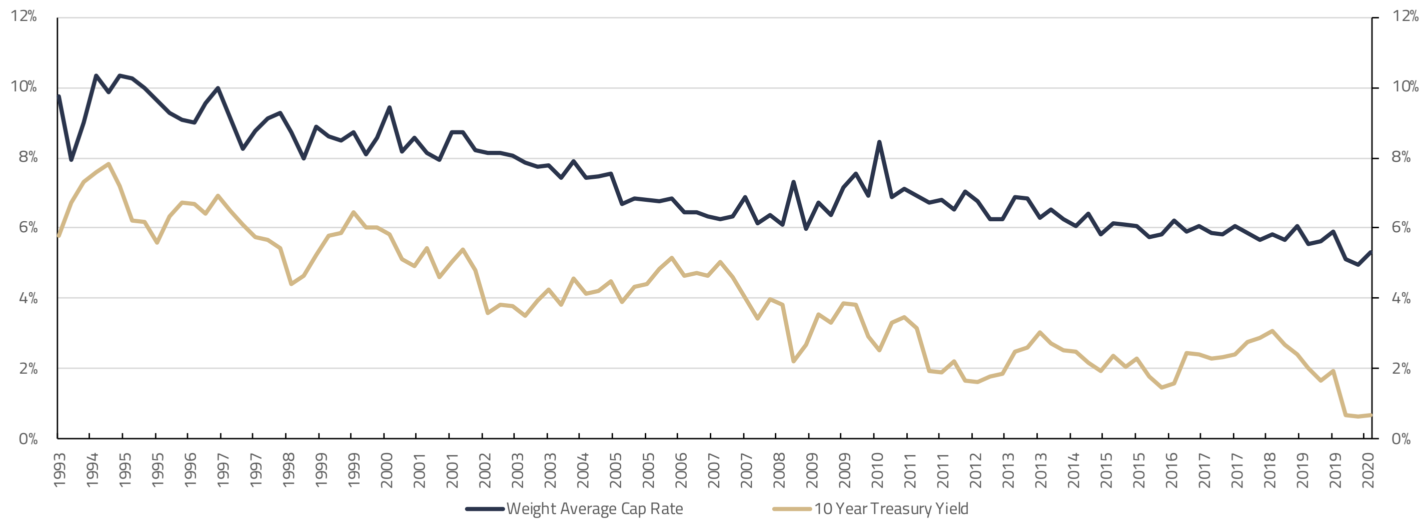
Source: Board of Governors of the Federal Reserve System (US)

TOP 10 INVESTMENT THEMES FOR 2021

3. The Search for Yield

As a result of the economic shutdown caused by the spread of the coronavirus in the United States, the Federal Reserve acted swiftly to provide stimulus to the economy by cutting the federal funds rate to a range of 0% - .25%, among other measures. The yields of most fixed-income securities have experienced downward pressure due to the Fed's stimulus actions, which has caused the overall yields of most fixed-income securities to fall below a suitable level for income-seeking investors. The search for yield has been a challenging puzzle for the investment community to solve. Some investors have chosen to increase the duration of their fixed-income portfolios or to move into lower credit-quality bonds that offer higher yields than their investment grade counterparts. We believe these actions do not properly compensate investors for the additional risk taken.

Exhibit 5: Wide spreads between Commercial Real Estate capitalization rates and 10-year Treasury yields



Weighted Average Cap Rate calculated using Bloomberg CMBS, 10 year yield calculated using Bloomberg generic 10 year government note.
Source: Bloomberg

The Fed's swift rate cuts caused mortgage rates to decline in tandem, providing attractive financing for real estate investors and creating additional demand in the market. Housing supply has not been able to keep up with this ramp-up in demand, which has caused a supply – demand mismatch that has served as a tailwind to underlying property values. Furthermore, the capitalization rates minus 10-year treasury yield spreads are reaching relative highs, which will benefit the cash-on-cash yields of income-producing real estate assets (*See* Exhibit 5). The capitalization rate of an asset is its net income divided by its current market value and serves as an estimation of the asset's potential return and a tool to analyze relative value. Because private real estate investment trusts ("REITs") utilize leverage when making investments, a larger spread between the capitalization rates and their financing costs should prove accretive towards the returns of income-producing real estate portfolios. Traditionally, real estate investments are made through direct purchases of single assets, a private real estate limited partnership structured vehicle, or through public REITs; however, these vehicles can expose investors to outsized concentration, liquidity, and market risk, respectively, that we find undesirable. The emergence of the private REIT structure has presented an investment opportunity that can grant investors exposure to a diversified portfolio of core real estate assets and moderate liquidity, while also providing a low correlation to U.S. equities. Private REITs can be an attractive vehicle to leverage the strong fundamentals of the real estate market and help provide investors with the potential for strong after-tax yields and lower volatility of returns.

The underlying assets of core and core-plus private REITs are designed to have high-quality tenants, strong levels of rent collection, low vacancy rates, and require minimal capital expenditure after purchase. This suggests that these real estate assets are more defensive than the assets found in opportunistic real estate funds. We would expect the bulk share of return from these vehicles to come from their income component. Private REITs have a higher correlation to equities than high-quality fixed income; however, their correlation is much lower relative to exchange-traded Public REITs. The net asset values ("NAV") of private REITs that invest in core and core-plus have shown little volatility since their inceptions, and many have been able to maintain a consistent distribution even amid the pandemic. The distributions of private REITs are tax advantageous, with a large portion of the monthly distribution classified as return of capital, leading to an even higher yield on a tax-equivalent basis. Overall, we believe the private REIT vehicles investing in core assets can help to provide an attractive way to generate strong, consistent cash flow without taking on excessive or inappropriate amounts of risk to obtain these higher yields.

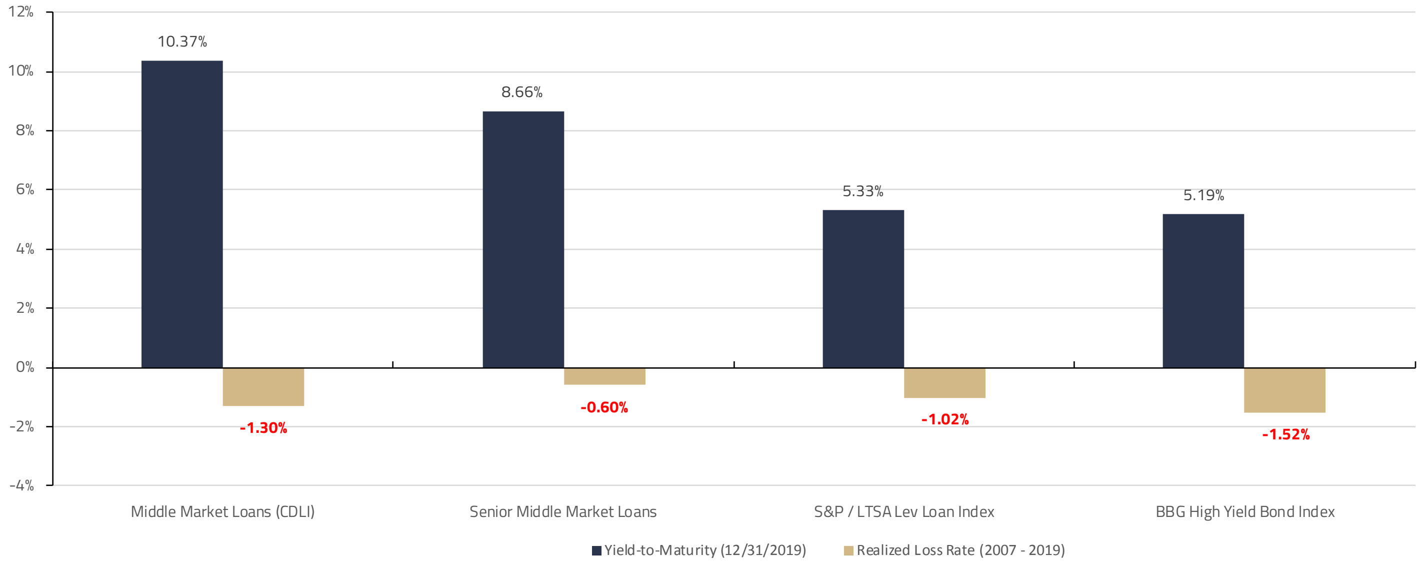
An important consideration when considering an investment in a private REIT is the sector allocation of the portfolio. Brick-and-mortar retail has been suffering headwinds as the growth of e-commerce has caused consumers to shop increasingly online. We believe this makes real estate investment in this space less favorable. However, the growth of e-commerce has led to an increase in demand for Industrial sector properties, particularly warehouses, as assets found near major supply lines have become increasingly valuable. Another real estate sector we find attractive is multifamily housing because the diversified rent roll provides operators the ability to increase rents, which we expect will increase the yield of these assets and help protect against inflation.

The location of real estate assets is an important consideration when evaluating managers. Gateway cities, such as New York and San Francisco, have experienced years of price appreciation, causing real estate in these cities to become expensive, and capitalization rates to compress drastically. The low capitalization rates of assets in gateway cities proves unattractive for investors seeking high quality investments with strong cash flows. Alternatively, there has been a migration of people and businesses away from traditional gateway cities towards cities in the Sunbelt regions, enticed by the lower cost of living and more favorable tax laws of these areas. The capitalization rates of real estate assets in these regions are higher than similar assets found in gateway cities, reflecting better yields and the opportunity for price appreciation. The expected population growth and business growth of these regions, coupled with strong relative value, as observed by capitalization rates, provide a strong fundamental investing environment for real estate assets.

The private credit market is another avenue that may be considered, in order to generate yield. Private credit is defined as debt that is not issued or traded on public markets and where the lender is not an affiliate of a bank. Private credit has been a rapidly growing asset class with non-bank lenders holding a larger share of the leveraged loan market than their bank counterparts do. Business Development Companies ("BDCs"), exchange-traded, closed-end funds that can provide investors exposure to the private credit market through a publicly-traded vehicle, have enticed income-orientated investors due to their higher dividend yields. However, BDCs generally charge hefty fees, and their considerable use of leverage makes them relatively high-risk investments.

Within the private credit asset class, we believe middle-market lending is an attractive area to consider for investors that desire to obtain yield on a risk-adjusted basis. Loans considered middle-market are those made to U.S. companies with Earnings Before Interest, Taxes, Depreciation, and Amortization ("EBITDA") of $10-$100 million. Generally, these loans have an average contractual life of five years and typically have a floating-rate structure. Exhibit 6 compares the risk-return profile of middle-market loans to the public leveraged loan and high-yield bond markets. The broad middle-market loan market, as defined by the Cliffwater Direct Lending Index ("CDLI"), shows higher yields with similar loss rates to the leveraged-loan and high-yield credit indexes. Senior middle-market loans that sit higher in the capital stack and have lower loan-to-value ratios than subordinated loans have experienced a significantly lower realized loss rate while still achieving yields higher than that of public market equivalents. The CDLI, the first published index tracking the performance of U.S. middle-market loans, has tracked over 6,800 individual loans since 2004, and has been adopted by prominent Wall Street firms. The CDLI has achieved an attractive risk-return profile since its inception to the end of 2019 by generating returns of 9.55% with a standard deviation of 3.4%. The CDLI has a near zero beta to the broader equity market with no meaningful correlation to rates over the same time period (*See* Exhibit 6).

Exhibit 6: The yields and loss rates of Middle-Market Lending vs. Public Market Credit Indexes



For senior middle market loans, the yield-to-maturity is represented by the CDLI-S and the Realized Loss Rate is represented by the average annual middle market senior loan default rate of 1.8% per "Fitch U.S. Leveraged Loan Default Insights" for 2007-2019 multiplied by (1 minus the recovery rate for senior secured loans of 67%) per "Moody's Annual Default Study" for 2007-2019.
Source: Cliffwater

In the wake of the Great Financial Crisis, an increasing number of private equity investors turned their attention towards the middle market, a trend we believe is beneficial for middle-market lenders because it creates the potential for downside protection during periods of temporary dislocation. Private equity sponsors have significant capital at risk behind senior loans with longer investment horizons that allow them to look past periods of short-term dislocation. Investors in middle-market lending believe it is likely for private equity sponsors to support borrowers in times of stress in order to preserve long-term equity value. In turn, we believe this should mitigate realized loss rates in loans made to sponsor-backed businesses, as private equity sponsors have incentives to prevent their portfolio companies from defaulting on their loans.

The interval fund structure is an interesting way to obtain broad, diversified exposure to middle-market lending while maintaining a better liquidity profile than traditional limited partner structured private credit funds that often require investors to lock up capital for years. Certain interval funds provide a daily NAV and generally allow for quarterly redemptions, subject to restrictions that only allow the repurchasing of a certain percentage of the funds' assets each quarter. Middle-market lending access vehicles traditionally come with large costs, and so, remaining cost conscious when evaluating possible investments in this space and prioritizing the appropriateness of the fee arrangement when vetting managers is necessary.

Private REITs and middle-market lending are two potential solutions towards the "search for yield" dilemma that has troubled the investment community during this period of falling interest rates and fixed income yields. Investments in income-generating assets, such as structured settlements, music royalties, and equipment leasing, are a few other options the investment community has been exploring to make up for the lost yield in portfolios. Investors will continue to develop ways to seek to generate income amid this period of deflated rates. Adapting to the ever-changing investment landscape will help investors reach their investment goals.

TOP 10 INVESTMENT THEMES FOR 2021

5. Growth vs. Value Debate

Notwithstanding "value" stocks' outperformance in the fourth quarter, we believe that growth and disruptive technology will continue to lead the market higher in this cycle. Many forecasters are calling for a rotation into value stocks now that the coronavirus vaccination rollout has begun and a potential return to normalcy is in sight. The argument rests on the fact that value stocks have underperformed the broader market for the last decade, including significantly underperforming growth stocks, and the belief that a meaningful reversion is likely as the economic recovery takes hold. It is a reasonable assumption because most value stocks are cyclical in nature, and thus, more economically sensitive. As economic growth accelerates, cyclical companies tend to deliver outsized earnings growth, leading to strong stock price performance. While we agree that value, cyclical, and small-cap stocks all tend to lead the market early in an economic cycle, we believe much of this outperformance has already taken place and will be short-lived due to the rapidly changing nature of today's digital economy and the disadvantageous position many of these companies find themselves in today.

Benjamin Graham and his student and legendary investor, Warren Buffett, made value investing famous over the last fifty years. Value investing was the perfect construct for outperforming the market in the industrial age. At its core, value investing advocates buying stocks with a "margin of safety" which translates to buying stocks that have low price-to-book ratios or low price-to-earnings ratios. Book value is a measure of a company's tangible assets, and in the industrial age, a company's tangible assets were highly correlated with the company's ability to grow and generate profits. Factories, machinery, equipment, stores, and branches were primarily the productive assets of the economy. Thus, buying companies with low price-to-book ratios proved to be a fruitful strategy that delivered market outperformance quite consistently for 60 years from 1950-2009 (*See* Exhibit 7).

Exhibit 7: Returns by Price-to-Book

	Value Stocks (Lowest P/BV)	Growth Stocks (Highest P/BV)	Differential
1950-59	25.06%	20.92%	4.14%
1960-69	13.23%	9.57%	3.66%
1970-79	17.05%	3.89%	13.16%
1980-89	24.48%	12.94%	11.54%
1990-99	20.17%	21.88%	-1.71%
2000-09	8.59%	-0.49%	9.08%
2010-19	11.27%	16.67%	-5.39%
2020	-33.29%	15.59%	-48.88%

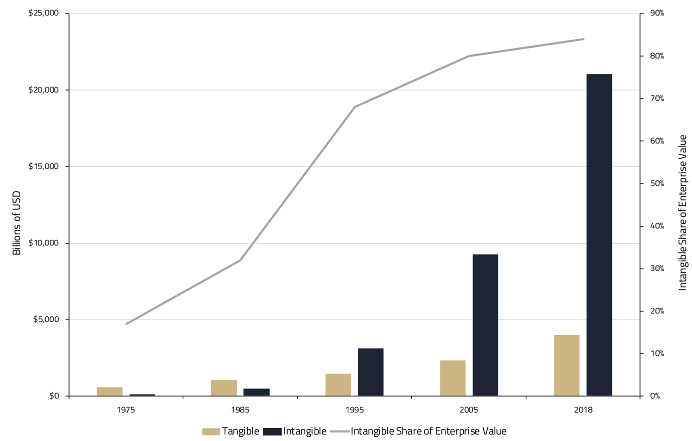
Source: Carlyle Analysis, CRSP Data, August 2020.

While many believe the market will revert to rewarding value stocks after a decade of underperformance, we believe that the economy has entered into a new digital age where growth and innovation shines brightest. In the digital age, tangible assets are often a competitive **disadvantage**. They carry a heightened risk of disintermediation and disruption. As an example, many retailers are struggling with the high cost of maintaining physical stores, and banks are closing branches due to decreasing utilization and high overhead. In the digital age, the most productive assets are software, ideas, data, algorithms, knowledge, culture, brands, and R&D. These are all intangible assets and are generally not accounted for on a company's balance sheet. What's more, annual spending on these items is often categorized as an expense on a company's income statement, resulting in understated earnings. A unique feature of intangible assets is that they usually enjoy increasing returns to scale. This leads to large network effects and companies that can grow much faster and larger, with less capital, than was capable in the industrial age. How else can we explain a company like Facebook with almost three billion global users or a company like TikTok that reached 700 million global users in less than three years.

4. Sherman, Alex. "TikTok reveals detailed user numbers for the first time." CNBC, https://www.cnbc.com/2020/08/24/tiktok-reveals-us-global-user-growth-numbers-for-first-time.html

We believe the market has done a good job of deciphering these changes and properly valuing the importance of intangible assets. Over the last twenty years, a sharp increase in intangible assets has been the primary driver of the growth in enterprise value of S&P 500 constituents (*See* Exhibit 8). This means that many companies now have high price-to-book ratios and are shunned by traditional "value" investors. However, we find that these same companies often make the better investments. They have stronger balance sheets, higher margins, better free cash flow conversion, and more attractive growth opportunities. Many of these asset-light companies have low fixed costs-to-sales ratios, making them more resilient in downturns and allowing for continuous investment in growth-expanding intangible assets. This high level of R&D and business reinvestment spend enhances their competitive moat and leads to enduring earnings growth. The last decade has proven the model with the emergence of mega-cap tech companies like Facebook, Apple, Amazon, Microsoft, and Google (also known as "FAAMG").

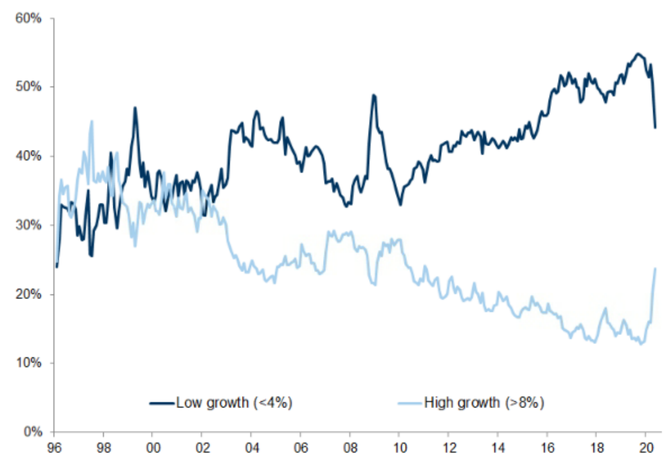
Exhibit 8: Enterprise Value of S&P 500 Constituents



Source: Carlyle

While we are bullish on growth and innovation, our viewpoint is not dependent on the continued leadership of FAAMG. These companies continue to be leaders in secular growth industries, but we recognize that they have gotten too powerful and are now in the crosshairs of regulators. Antitrust risks are escalating and, at a minimum, will increase costs and weigh on their growth and earnings over the next decade. We believe much of the growth and market outperformance for the next decade will happen outside of FAAMG. Other leaders are emerging in secular growth areas like digital payments, e-commerce, software-as-a-service, data analytics, cybersecurity, artificial intelligence, and genomics, to name a few. These areas offer fertile ground for compelling investments that we believe will outperform and potentially emerge as the mega-caps of tomorrow.,

Exhibit 9: The share of high growth companies has decreased



Source: Datastream, I/B/E/S, Goldman Sachs Global Investment Research

Notwithstanding the early stages of this economic recovery where nominal economic growth should be strong, aging demographics, high leverage ratios, and low interest rates all point to an economic cycle that will likely be characterized by below-trend nominal growth (much like the last cycle). In that environment, companies that can consistently grow their revenues and earnings will continue to be a scarce asset, and the market will reward those companies with valuation premiums and market outperformance (*See* Exhibit 9).

The investment community should no longer view "technology" as its own sector, but rather as a critical differentiator among companies in a given industry. The companies that embrace the digital age and new innovations are well-positioned to thrive, while old-economy stocks that fail to adapt, or are too dependent on capital-intensive assets, will continue to be left behind. The economy has changed and the way investors look at valuations needs to evolve with it. In a world where large "taxi" companies do not own cars, hospitality companies do not own physical assets, Apple, the world's largest company, does not manufacture any of its products, and Nvidia, the world's most valuable semiconductor company, does not manufacture any chips, ratios like price-to-book are deceiving. Today, companies that are undergoing massive disruption and struggling to adapt are heavily represented in traditional value indexes. While their valuations may look attractive using traditional metrics, we believe many will prove to be "value traps."

TOP 10 INVESTMENT THEMES FOR 2021

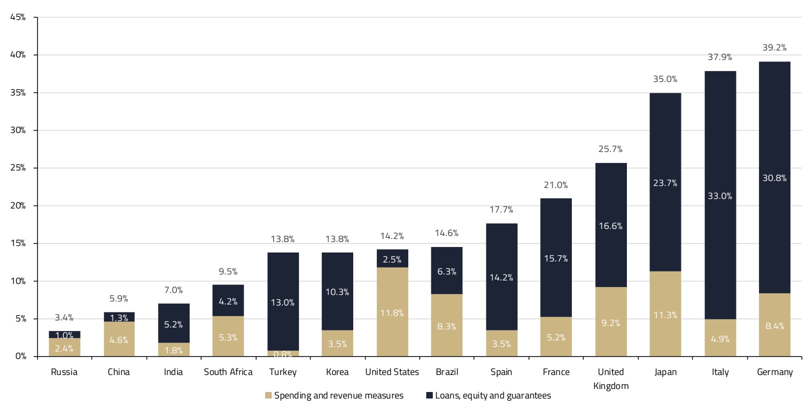
5. A BRIGHTER OUTLOOK FOR EMERGING MARKETS

After a decade of lackluster results, we believe emerging market stocks, led by Asian companies, are set to outperform over the next decade.[5] Several key reasons we believe this will be the case are: 1) most Asian countries controlled the spread of the coronavirus effectively and thus the damage to their respective economies has been more limited relative to the rest of the world; 2) emerging Asian countries addressed the pandemic with more restrained fiscal and monetary responses, allowing for much greater flexibility going forward; 3) the U.S. dollar looks like it may be entering an extended period of weakness, which would provide a boost to non-U.S. asset returns; and 4) Asia is rapidly becoming a leader in technology innovation and home to many of the world's fastest-growing technology companies.

Through a combination of aggressive testing, contact tracing, effective quarantining, and widespread adoption of mask-wearing, most Asian countries were able to quickly contain coronavirus outbreaks or avoid them all together. Many of these countries have experienced low per-capita case counts and minimal deaths. China, where COVID-19 first spread, was able to contain and quell the virus effectively, and its economy has recovered strongly. In fact, China is the only major economy expected to grow in 2021. Due to the pandemic, the Centre for Economics and Business Research (a U.K. think tank) believes that China's economy will overtake the U.S. economy as the world's largest by 2028, five years earlier than previously expected.[6] The ability to reopen quickly and avoid successive lockdowns has helped limit the economic damage caused by the pandemic. Indeed, this past month, China's trade surplus hit a new monthly high as the country is able to capitalize on supply constraints that other parts of the world are experiencing. With forward-looking economic data in Asia suggesting recovery is well under way, we believe growth in the region will be more stable and self-sustaining over the next decade, resulting in a nice tailwind for equity returns.

Contrary to the unprecedented fiscal and monetary stimulus unleashed by the U.S., Europe, Japan and the U.K., emerging Asian countries showed restraint in response to the pandemic (*See* Exhibit 10) . China stimulated its economy early on but has quickly changed its focus to containing excess and promoting financial stability. This is in direct contrast to its response after the Great Financial Crisis when it turbocharged its recovery with a massive expansion of debt-fueled infrastructure projects. The hangover from that debt binge proved long and complicated. China's economy experienced a sharp deceleration in growth as widespread misallocation of capital and projects of dubious merit created an environment of heightened financial risks and muted returns. China is keen not to make those same mistakes again, while the developed market economies are likely to face similar challenges and reduced financial flexibility in the decade ahead.

Exhibit 10: Fiscal response to COVID-19 (% of GDP)



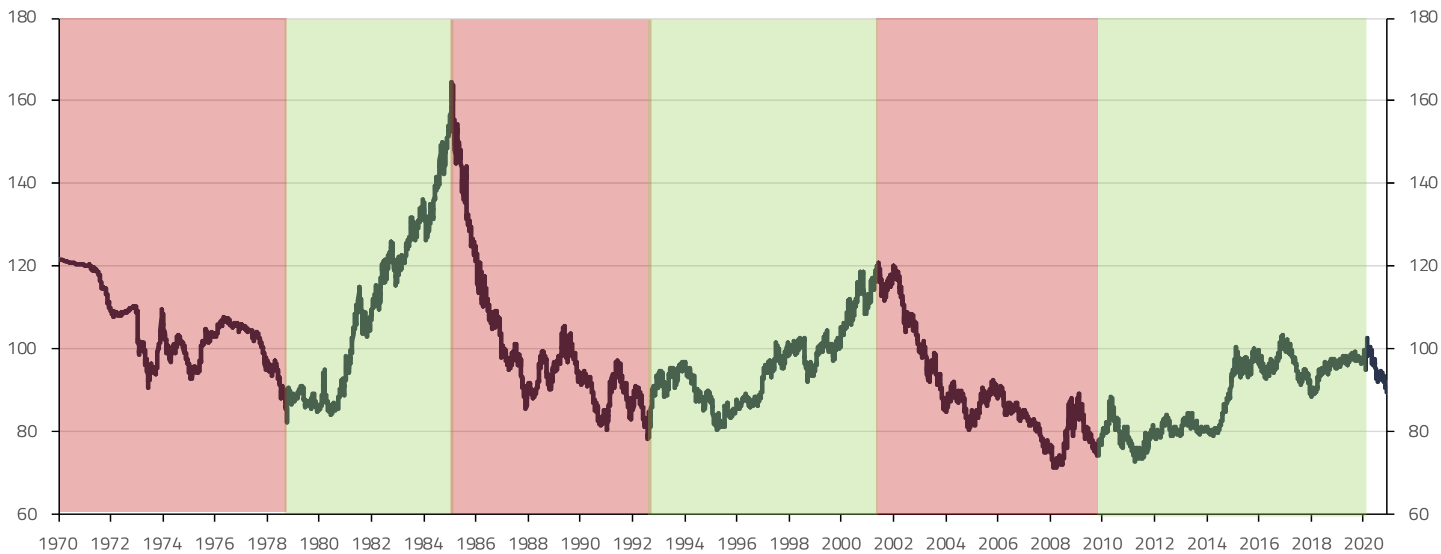
Fiscal measures are estimates from the IMF's October 2020 Fiscal Monitor.
U.S. Data are as of 12/31/2020.
Source: IMF Fiscal Monitor, J.P. Morgan Asset Management.

5.. MSCI Emerging Market Index returns are primarily driven by China (40% weighting) and broader Asia (75% weighting).

6. Burden, Lizzy. "China's Economy Set to Overtake U.S. Economy Earlier Due to Covid Fallout." Bloomberg, December 25, 2020, https://www.bloomberg.com/news/articles/2020-12-26/covid-fallout-means-china-to-overtake-u-s-economy-earlier

Historically, emerging market returns are stronger during periods of U.S. dollar depreciation. After a decade of strength, the U.S. dollar looks like it is at a turning point. The U.S. dollar tends to trend in long cycles, and we believe we are at the start of a new period of dollar weakness (*See* Exhibit 11). After peaking early in the pandemic, the U.S. Dollar Index has declined 13% and is now at its lowest level since 2018.[7] Despite this pullback, Goldman Sachs believes that the U.S. dollar remains as overvalued as it has been over the last fifteen years relative to a basket of emerging market currencies.[8] The catalysts for this expected weakness are plenty. The U.S. is running large twin deficits, and the Federal Reserve is committed to Quantitative Easing and keeping interest rates low for an extended period of time. Interest rate differentials, especially real interest rates, have sharply reduced the relative attractiveness of the USD. Fiscal discipline is passé in Washington, and modern monetary theory ("MMT") is quickly gaining adherents. The U.S. federal debt is ballooning to all-time highs as a percentage of GDP, and we expect it to remain elevated for a long time. Finally, many countries are seeking an alternative for the USD as the world's reserve currency. This will not happen anytime soon, but could add to pressure over time. While we do not expect a collapse in the dollar, we do forecast a period of extended weakness that would serve as a tailwind for emerging market returns.

Exhibit 11: The U.S. Dollar Exchange Rate Index (DXY) moves in long cycles



The DXY index averages the exchange rates betweeen the USD and major world currencies.
Source: Bloomberg

Lastly, the global economy has entered the digital age, and Asia has emerged as a strong rival to the U.S. in many leading areas of technology. Whereas emerging market returns used to be dominated by large, state-owned companies in the banking, energy and utility sectors, now tech companies have the most impact. The technology sector has the highest weighting in the MSCI EM Index today and the top eight holdings are essentially tech companies. Given our views on growth and innovation over the next decade, we believe this is a strong positive for expected returns. The region is home to many world-class companies that are leaders in e-commerce, digital payments, telecommunications infrastructure, social media, gaming, semiconductor manufacturing, and smartphones. The region is also quickly becoming a leader in electric vehicles and renewable energy technology. The budding tech war between the U.S. and China should serve to accelerate investment in these areas as China seeks leadership and self-sufficiency in leading technologies. With by far the largest concentration of digital-native millennials on the planet, we believe Asia is poised to be a leading source of innovation for decades to come.

The future for Asia is bright. After a decade of underperformance, its time has come. It is a dynamic, tech-forward region that has weathered the pandemic well and is emerging from the pandemic in a better competitive position. With favorable demographics, undervalued currencies, financial flexibility, and a history of technological excellence, we believe the region is poised to outperform over the coming years.

7. The U.S. Dollar Index (USDX) indicates the general international value of the USD. The USDX does this by averaging the exchange rates between the USD and major world currencies. Bloomberg.
8. *"Eye on the Market. 2021 Outlook",* Michael Cembalest, J.P. Morgan, January 1, 2021.

TOP 10 INVESTMENT THEMES FOR 2021

6. The Tale of two economies

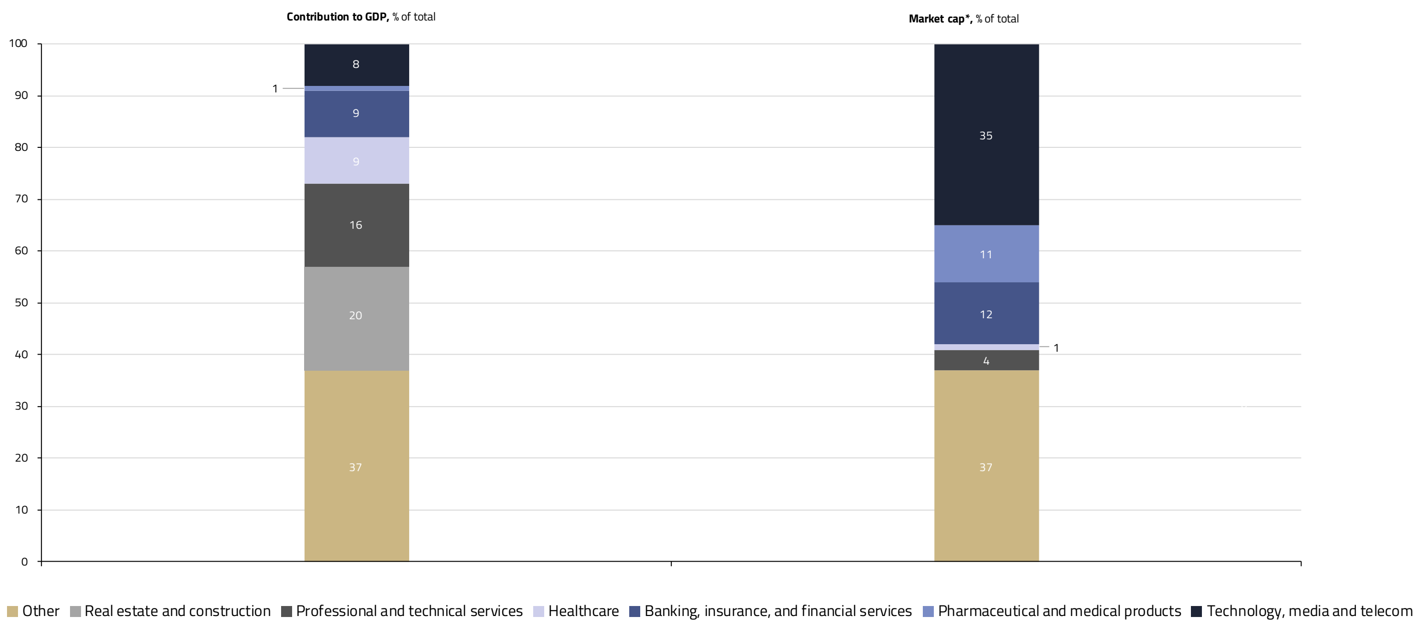
"It was the best of times; it was the worst of times." This fabled introduction from the Dicken's classic, *A Tale of Two Cities,* almost feels prognostic to the current economic environment in the United States. Service-sector businesses reliant on in-person contact have faced tremendous pressure, and a growing number of mom-&-pop stores have been forced to close their doors for good. Simultaneously, companies levered to remote work and cloud computing prospered, as a new, work-from-home environment increased demand for their products and services. The S&P 500 rallied from its March 23 low to end the year with a year-to-date total return of 18.4% at the same time that surging coronavirus cases prompted talks of further restrictions and Americans anticipated receipt of a second wave of stimulus checks.[9] It appears a schism has emerged in the U.S. economy, leading us to believe there is an opportunity for active management to generate significant alpha despite the resiliency of the broader market.

The economic disruption caused by national stay-at-home orders led to a quarter-over-quarter GDP contraction of 5% in the first quarter of 2020, with the following quarter posting a GDP contraction of 31.4%. Even with a strong third-quarter GDP rebound of 33.4% , due to increased consumer and business spending as lockdown restrictions eased, U.S. GDP still remained below pre-pandemic levels at the end of the third quarter.[10] Bloomberg consensus expectations for fourth quarter GDP growth are currently at 4.6%, implying a full-year GDP contraction of 3.5% for 2020. Meanwhile, U.S. equity markets were able to rebound quickly after the first quarter sell-off led the S&P 500 to bottom on March 23 at a level of 2,192, a decline of 34% from its peak on February 19, to close the year at 3,732. Historically, the price appreciation of the U.S. equity market has been correlated to economic growth. The resiliency of the stock market in the midst of a recession led many economists and investors to question whether economic fundamentals still influence the stock market. We argue that the composition of the public equity market and the forward-looking nature of investors explains the disconnect between the contraction of the economy and the performance of equity markets in 2020.

The lockdown restrictions forced service-sector businesses like restaurants, hotels, and transportation services to shut down operations and placed significant economic hardship upon these industries. These businesses continue to struggle financially during the lockdown despite help from government stimulus programs and gradual reopening, causing many businesses to declare bankruptcy. Meanwhile, businesses in sectors such as technology and communication services were able to swiftly transition to a remote-work environment mitigating lockdown-related disruption. Many economic indicators have rebounded since the lockdowns in the spring; however, unemployment data is far from pre-pandemic lows, suggesting that recession is still a reality for many Americans. The equity markets have performed strongly through this period of stunted economic growth and high unemployment, and we can partly attribute this performance to the composition of the market. The industries with larger weightings in equity markets were also the industries whose businesses were able to sustain operations and grow revenues despite economic lockdowns. Analysis published by McKinsey shows that as of September 15, 2020, the technology, media, and telecom sector made up 35% of the market cap of the 1,000 largest publicly-traded companies in the U.S. while only contributing 8% towards GDP (*See* Exhibit 12). Conversely, many businesses that provide large levels of employment, such as restaurants and gyms, are not listed on exchanges, meaning the job losses and economic contraction suffered by these industries were not reflected in the equity market. Further, the publicly listed companies experiencing high levels of job losses have been losing their market share in equity indexes to fast-growing technology companies for many years. Advances in technology have led to a boom in e-commerce, as well as, growing adoption of clean energy, which have pressured the equity prices of brick-and-mortar retailers and traditional energy companies. Both industries were sources for large job losses causing them to contribute to the spike in unemployment; however, their respective equity price declines had minimal impact on broader equity-market indexes. With equity markets increasingly levered to businesses that should be able to grow revenues and increase profitability in the near future, we believe the equity market can continue to perform well even as economic output and the job market work towards recovery (*See* Exhibit 12).

9. Strategas. January 4, 2021.
10. Id.

Exhibit 12: Contributions to GDP vs. Share of the Equity Market



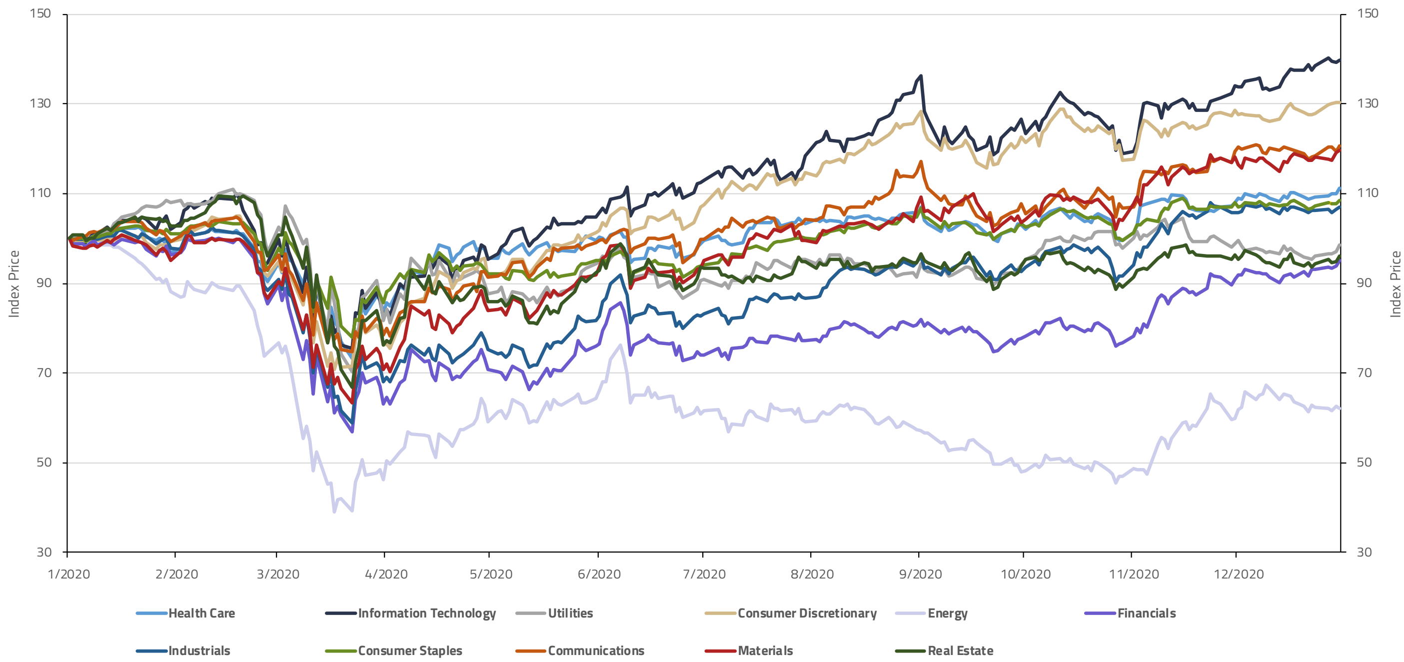
*Largest 1,000 US companies as of September 15, 2020
Source: S&P Global; Corporate Performance Analytics by Mckinsey

The equity market's ability to take a forward-looking view explains another reason why the market has been able to perform during a time of heightened unemployment and stunted economic growth. Corporate profits are projected to end the year well below 2019 levels; however, it is important to note that equity prices are based on expectations of future cash flows and are not a representation of current conditions. COVID-19 vaccine developments provide a path back to normalcy, and many businesses have proven their ability to adapt to the changing business landscape. Investors understand that these factors will eventually cause GDP and business profitability to return to normal levels, which allows them to overlook the near-term turbulence. We believe this longer-term outlook is supportive of increasing equity prices. The coronavirus pandemic accelerated the adoption of cloud computing, cybersecurity, and remote working that has bolstered the growth outlook for these businesses and created strong tailwinds for their stock prices. We believe that a unique opportunity to identify these areas of growth potential and leverage active management to generate alpha as the broader economy recovers continues to exist.

The tech-heavy NASDAQ index, which achieved a annual total return of 44.9%, trumped the strong performance of the S&P 500 in 2020. An analysis of the S&P 500 sector returns provides further evidence of the division of the market's outlook for the future growth potential across industries. The Technology sector posted the strongest 2020 total return of 43.9%, followed by the Consumer Discretionary and Communication Services sectors returning 33.3% and 23.6% respectively. Alternatively, the weakest sector was Energy with an annual total return of -33.7% and the Real Estate, Financials, and Utilities sectors also lagged the index significantly.[11] A more granular analysis of the S&P 500 reflects some constituents more than doubling their market cap over the year, as the effects of the pandemic helped catalyze revenue growth. At the same time, S&P 500 companies levered to travel, leisure, and energy lost more than half of their market cap over the year, as lockdown restrictions forced them to either operate at limited capacities or shut down completely. Within equity portfolios, we have expressed thematic views, inspired by our observations of compelling market trends, by complementing our beta exposure with single stocks and sector exchange traded funds. This strategy proved to be accretive towards the performance of equity portfolios in 2020. We believe challenges will persist for stock market constituents that were disrupted by the pandemic, and there is still a lot of uncertainty surrounding

11. Strategas. January 4, 2021.

Exhibit 13: GICS Sector 2020 Price Performance



Index prices normalized to 1/1/2020 value. 1/1/2020 value = 100.
Source: Bloomberg

the outlook of these companies, which may lead to longer-term headwinds for their equity performance. Alternatively, a sizable sample set of companies whose businesses should continue to experience growth catalysts exist because of the rapid change to the business environment, creating the potential for outsized returns for their shareholders. As we move into 2021, we continue to leverage active management and prudent stock selection to take advantage of the swiftly changing stock market environment, in hopes of generating alpha.

TOP 10 INVESTMENT THEMES FOR 2021

7. The World is Awash in Money

In March 2020, global central banks, including the Federal Reserve, took aggressive steps to stimulate the economy amidst the tumult caused by the COVID-19 pandemic. As noted in an earlier section of this publication, the Fed ramped up its purchases of Treasury securities, buying $1.7 trillion of Treasuries between mid-March and the end of June. The Fed also purchased approximately $562 billion of agency mortgage backed securities between March and August 2020, and nearly $300 billion in loans and other assets during this same period. By year end, the Fed's balance sheet had swelled to over $7.3 trillion, an increase of $3 trillion from its March 2020 level.

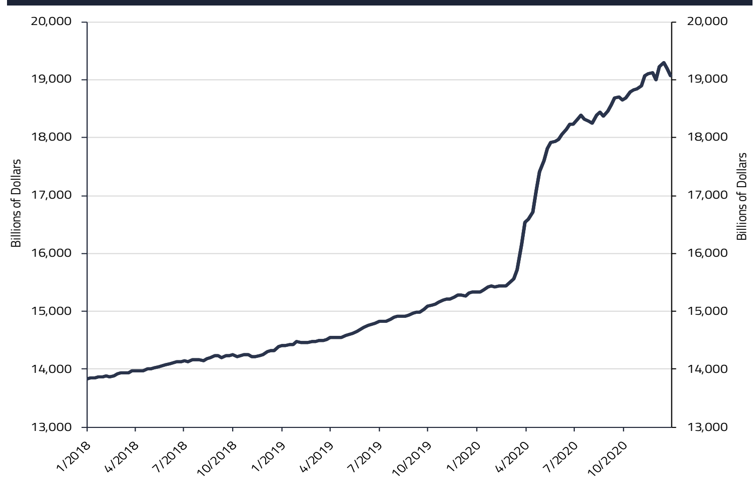
In addition to the aforementioned asset purchases, on March 15, the Federal Reserve reduced reserve requirement ratios to zero percent effective March 26, 2020. This action eliminated reserve requirements for all depository institutions. These collective actions by the Fed resulted in a dramatic increase in the U.S. money supply. Exhibit 14 highlights the dramatic increase in the money supply ("M2") from approximately $15.5 trillion in March 2020 to $19.1 trillion at year-end.

With the global financial system awash in money, it is no surprise that risk-asset values climbed in 2020. Exhibit 15 illustrates the dramatic increase in Price-to-Earning ("P/E") multiples of the S&P 500 from February 2020 (immediately prior to the March sell-off) through year-end. As highlighted in the chart, the mid-February P/E multiple on the S&P 500 was approximately 22x. Multiples collapsed to approximately 15x in March, as the market succumbed to worries about the COVID-19 virus. However, buoyed by the aggressive monetary response from central banks, and the equally aggressive fiscal response from governments around the world, the market rallied back with a vengeance, and S&P 500 P/E multiples ended the year at nearly 30x.

With multiples at elevated levels, many investors are asking whether U.S. equity markets are now overvalued. In our view, while valuations are certainly high, we nonetheless believe that the continued accommodative monetary policy and a rapidly expanded global money supply creates a backdrop against which valuation multiples could remain elevated for the foreseeable future. It is difficult to "fight the Fed," and the actions by the Fed and global central banks have created an enormous supply of money chasing a finite amount of investable assets, particularly public market assets.

For these reasons, we remain constructive on the outlook for U.S. equities in 2021. We continue to believe, however, that there are several sectors and themes that are better positioned for success over the next several years, and we remain highly selective in our over-weights to individuals stocks, sectors, and themes. Among the areas of particular interest are cloud software-as-a-service businesses, cybersecurity, 5G, streaming content services, life

Exhibit 14: M2 Money Stock



Source: Board of Governors of the Federal Reserve System (US)

Exhibit 15: S&P 500 P/E Multiples

Source: Bloomberg.

science technology, and alternative energy. Also on our radar is the homebuilder and home improvement value chain, as demographics in the U.S. create a tailwind for this sector in the next decade.

Overall, we view the outlook for equities as positive in 2021, but with valuations at elevated levels, we are tilting away from broad market exposure by adding stock and ETF over-weights to U.S. equity portfolios.

8. U.S.-China Relations

Despite the Biden administration's new approach, the US/China economic and technological rivalry will continue to escalate. However, expect a swift shift towards normalizing relations with key allies and a more coordinated approach to tackling key threats like China and Iran national security threats, the coronavirus pandemic, and climate change. We believe the Biden administration will take a multilateral approach to dealing with China's transgressions. In order to be more effective, President Biden will have to reset relations with our key allies. Look for him to have the U.S. quickly rejoin the Paris Climate Agreement, cancel our withdrawal from the World Health Organization ("WHO"), and reemphasize our commitment to the World Trade Organization ("WTO") and North Atlantic Treaty Organization ("NATO").

The relationship with our allies is strained, but not beyond repair. Two of the first things we expect Biden to do in office is to rejoin the Paris Climate Agreement and to end all trade wars with our allies. Climate change is an existential threat that affects the entire planet. Every leading economy in the world has committed to significant carbon reduction over the next thirty years, except the U.S. Europe has led the effort so far and welcomes U.S. support and leadership. This is one area where the U.S. can quickly rebuild trust and focus on common interests. The other area is trade. While trade between the U.S. and Europe is not perfect, the disagreements pale in comparison to those with China. Now that the U.K. has left the EU, both the U.K. and Europe should be eager to negotiate new agreements with the U.S. Strategically, we are much better off setting our minor differences aside and orchestrating a coordinated approach to China.

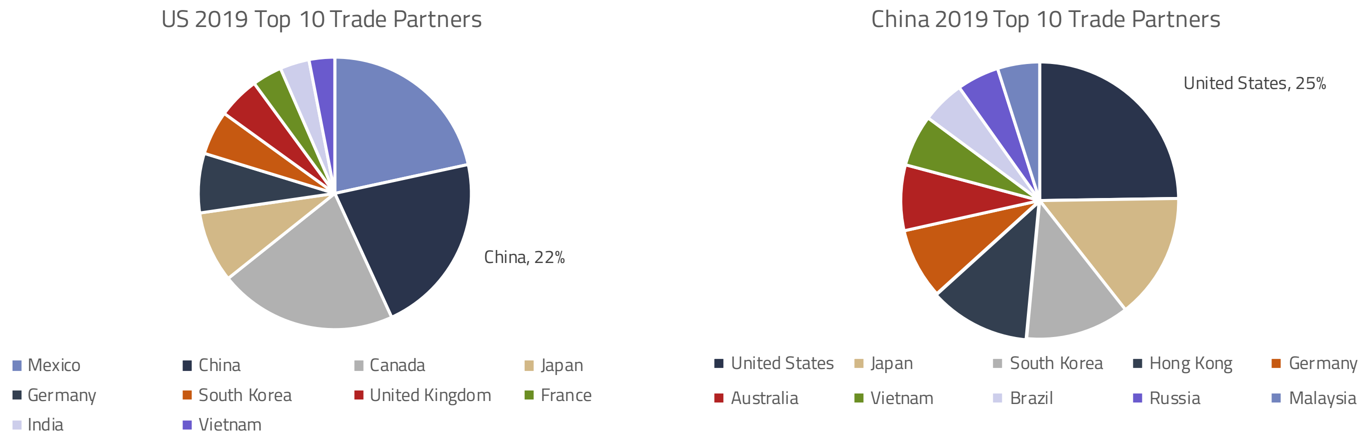
The U.S.'s relationship with China has fundamentally changed. Gone are the days when both political parties subscribed to the flawed theory that China would embrace democracy and free markets as the country prospered. The world has also become increasingly suspicious of China given the origins of COVID-19, its actions to thwart early investigations, and the advantageous position the country finds itself in now. Today, a tough and adversarial stance on China has bipartisan support.

Pre-pandemic, the Trump administration deserves credit for bringing many of China's transgressions to light and taking significant measures to combat them. Instead of using multi-lateral organizations and trade agreements like the WTO and the Trans-Pacific Partnership ("TPP"), Trump's preferred method of confronting and containing China was through bilateral negotiations and the extensive use of tariffs. The problem with tariffs were twofold: 1) they hurt consumers in the U.S. just as much as they hurt China; and 2) they mainly addressed our growing trade deficit with China without incenting changes to its abusive trading practices. While Trump's tariffs proved that the U.S. and global economy could withstand a trade war between the world's two largest economies, they were not effective in curbing China's economic and geopolitical rise or inducing better behavior. China simply rerouted goods to the U.S. through other Asian countries, and it substituted U.S. demand for its goods with demand from other trading partners. In fact, China's share of global trade and its surplus with the world has continued to grow despite a decline with the U.S.

Even though our trade deficit with China is shrinking, the U.S. cannot decouple completely without suffering severe economic damage. Unlike the Cold War with the Soviet Union, the U.S. and China have deep economic ties that will not be easy to unravel without unintended consequences. Trade between the countries is over $1 trillion annually, U.S. businesses get over $300 billion of sales in China, the Chinese Central Bank owns over $1 trillion in U.S. Treasuries, and bilateral foreign direct investment is substantial.[12] China is the world's second-largest economy and growing quickly. It is in each country's best interest, along with the rest of the world, that we agree on a system and set of rules aimed at leveling the playing field, rather than hostile confrontation (*See* Exhibit 16).

12. *"Eye on the Market. 2021 Outlook"*, Michael Cembalest, J.P. Morgan, January 1, 2021.

Exhibit 16: The U.S. and China have a deep trade linkage



Source: Bloomberg

With that in mind, we believe the Biden administration will work closely with Europe, Japan, India, and our Asian allies to create a new global trading system with rules updated to reflect commerce in the digital age. The WTO's charter and governance will be updated to reflect this new reality and enforcement measures will carry weight. The U.S. will also seek to revive multi-lateral trade agreements like the TPP, which had a geopolitical purpose of isolating China. With the combined heft of the alliance, China will have to choose between abiding by the new rules or risk losing access to a significant portion of the global economy. Together, the U.S. and its allies will send a strong message that intellectual property theft, forced technology transfer, unequal access to markets, unfair regulation, cyber-attacks, and human rights abuses will not be tolerated.

It will take a tough, coordinated approach to deter China off the path it is on currently. China sees the U.S.'s handling of the coronavirus pandemic as a sign of a deteriorating and vulnerable power at war with itself. The recent storming of the Capitol lends credence to this belief and bolsters China's conviction that its state-led economic and authoritarian political model is superior to ours. Further, while the U.S. spent the last four years withdrawing from international organizations and quarreling with our allies, China capitalized on an opportunity to advance its interests and influence around the world. We see continued evidence of this in its efforts to help many countries with their vaccination programs.

China seems to be holding a strong hand, but the U.S. holds a better hand if we play our cards right. Despite a new approach to our dealings with China, we expect the relationship will continue to be tense and adversarial.

TOP 10 INVESTMENT THEMES FOR 2021

9. Brexit

It seems hard to believe that four-and-a-half years after the Brexit referendum, Britain's withdrawal from the European Union ("EU") remains a major issue plaguing the European continent and its respective capital markets. In a last minute accord, the two sides were able to allay the worst-case scenario of Great Britain exiting without a withdrawal agreement, commonly referred to as a "Hard Brexit." While the deal has provided some clarity in regards to trade, travel, and the sharing of important security data, many key issues pertinent to Britain's exit from the bloc remain unresolved, with other conditions found in the agreement to expire in just a few years. Even with Britain's transition out of the European Union complete, the true political and economic effects of the divorce remain to be seen. We anticipate the implications of Brexit to remain a key concern for investors in European markets for the near future, and the subsequent geopolitical and economic uncertainty pose a challenge for investors in European markets. For that reason, we remain underweight European risk assets in client portfolios and prefer to invest in international markets with stronger fundamentals and higher growth potential.

The United Kingdom ("U.K.") officially exited the EU on January 31, 2020, commencing a transition period where both sides negotiated their future relationship after the expiration of the transition period on January 1, 2021. Prior economic, trade, and security relations between the two sides remained unchanged until the beginning of 2021, meaning many of the consequences of the separation have yet to manifest. As of the beginning of the year, the U.K. is no longer part of the EU's single market nor Customs Union. The EU single market requires a commitment towards the free movement of goods, services, capital, and labor between members of the bloc. The removal from the Customs Union will require regulatory checks for goods transferred between the two parties, which has the potential to cause logistical disruptions at key ports. The recent agreement was successful in establishing a free-trade deal that removes tariffs on trade with stipulations to encourage the U.K. to uphold EU standards towards labor, environmental issues, and government support for the private sector. The bloc aims to maintain a relative level playing field between companies under its domain and U.K. firms. The EU fears a drop in standards could provide an unfair advantage for U.K. firms, which maintain access to European markets pursuant to the free trade deal. The solution entitles the EU to respond appropriately in the event the U.K.'s standards fall behind the EU's by raising tariffs on trade goods.

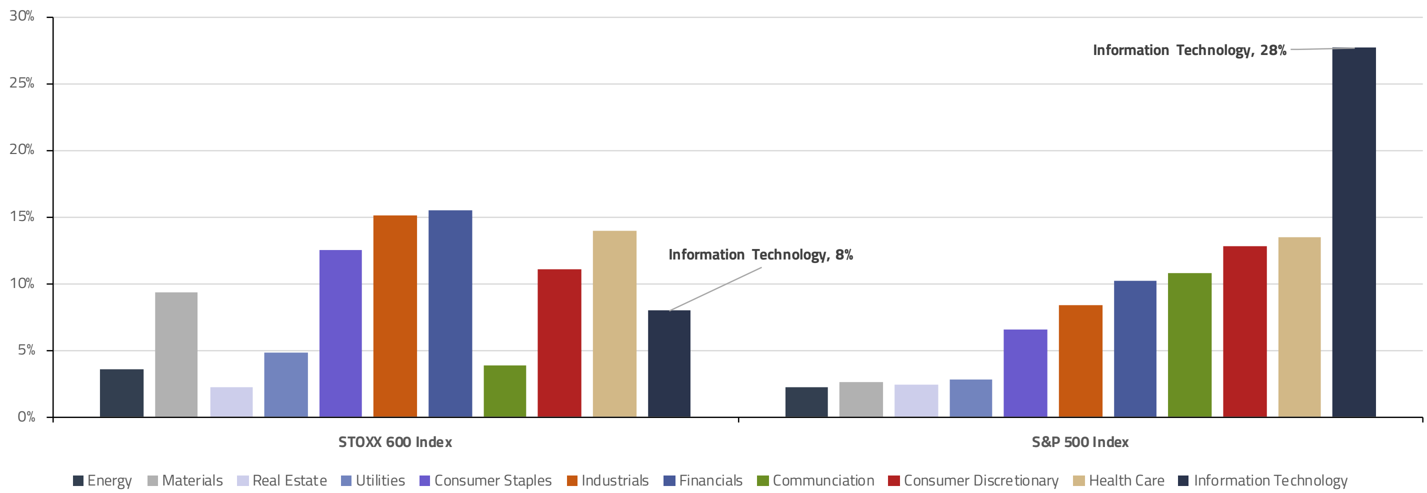
The agreement presents a rather complicated solution to the border issue in Ireland that has proven to be a major obstacle in earlier negotiations. The U.K. is comprised of England, Scotland, Wales, and Northern Ireland, while the Republic of Ireland remains a sovereign nation and member of the EU. The U.K.'s exit of the EU's single market and Customs Union would normally require the establishment of regulatory checkpoints at the Irish border. However, a troubled history of violence surrounding the once closed border between Ireland and Northern Ireland has led world leaders to demand that an open border remains in Ireland post Brexit. Recently, President-elect Joe Biden has voiced his support towards the 1998 Good Friday agreement, which opened the borders between Ireland and Northern Ireland and has proven successful in ending the terrorist activity of paramilitary organization seeking Irish unification. The solution keeps Northern Ireland within the EU's economic zone while remaining in the U.K.'s customs territory, which will require custom checks on goods traveling from Britain to Northern Ireland. Successful implementation of this strategy will be challenging and could very well be another factor that disrupts trade activity.

Another looming issue exists in Scotland, where the results of the referendum showed that the majority of Scottish citizens voted to remain in the EU. Despite a 2014 independence referendum that resulted in Scotland deciding to stay in the U.K., Brexit has caused support for Scottish independence to grow over the past few years. Britain has resisted suggestions for a second independence referendum, but growing support may serve as a harbinger for future geopolitical disruption on the isle.

Further, a successful Brexit may bring about additional geopolitical pressures within the EU. The stronger economic nations of the EU may be incentivized to follow the U.K.'s lead, if evidence emerges that the separation has proven favorable for the U.K. This presents another future risk for the EU, a union that relies on its more prosperous nations to support its weaker ones. We believe that talk of further separations would put pressure on European risk assets.

The decision to leave the European single market means that British financial services firms will now lose automatic access to EU markets; however, under the new arrangement, each side can unilaterally permit companies to conduct certain financial activities in their respective territories. This also means certain licenses and certifications may no longer be transferable for professionals doing business in both territories. This creates an unfavorable environment for financial services firms operating in the U.K. as either side can also unilaterally rescind this permission on short notice. This has led to companies relocating over 7,500 financial-services jobs out of the U.K. and challenges London's standing as the financial center of Europe. Ernst & Young estimates that $1.5 trillion of assets will leave the U.K. to continental Europe because of Brexit. While the impact of this mass migration is still unclear to financial-sector equities, the importance of the financial sector towards the performance of the FTSE 100 and the STOXX 600 should cause investors' concern, as the reshuffling of professionals across regions may present future obstacles (*See* Exhibit 17).

Exhibit 17: Global Industry Classification Sector Weightings of the STOXX 600 & S&P 500



Data as of 12/31/2020.
iShares STOXX Europe 600 UCITS ETF was used as a proxy for Stoxx 600 Index, iShares Core S&P 500 ETF was used as a proxy for the S&P500 Index.
Source: Bloomberg

It appears that the conclusion of the Brexit negotiations has left investors with more questions than answers. The consequences of Brexit still remain a looming uncertainty across European markets and likely serve as a headwind for the performance of equity markets in this region. When assessing the performances of international markets over the past year, both the FTSE 100 and STOXX 600 have proven to be laggards posting total returns of -11.45% and -1.44%, respectively (*See* Exhibit 18). European markets are more levered towards value sectors and have less exposure towards the industries we believe have the highest growth potential over the next few years. Recently, challenges in containing the coronavirus led the U.K. to announce its third lockdown, which should impede the country's economic recovery. Other European countries have faced the same issues that we believe will also serve as obstacles towards their respective economic rebounds. Political uncertainties, weak fundamentals, and persistent headwinds to economic growth have led us to underweight European risk assets in client portfolios, and this recent Brexit agreement does not change our viewpoint (*See* Exhibit 18).

Exhibit 18: 2020 Yearly Performance of World Equity Markets

Index prices normalized to 1/1/2020 value. 1/1/2020 value = 100.
Index Associations: United States = S&P 500 Index, Europe = STOXX 600 Index, United Kingdom = FTSE 100 Index, Emering Markets = MSCI Emerging Markets Index, World Equity Market = MSCI ACWI Index.
Source: Bloomberg

10. The Robinhood effect

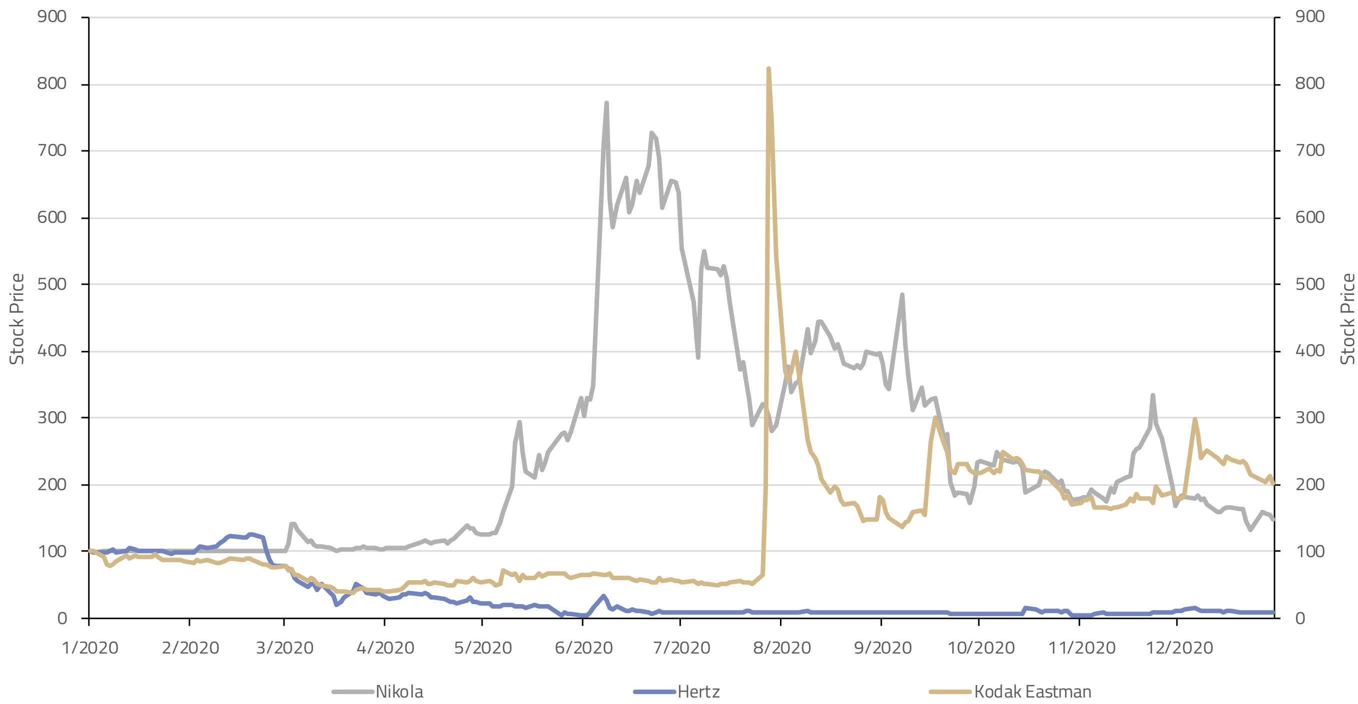
On March 11, 2020, NBA Commissioner Adam Silver announced that the league would halt operations indefinitely after Utah Jazz forward Rudy Gobert tested positive for the coronavirus. What ensued was a wave of similar actions by global organizations leading to mass cancelations of live events, the shutdown of businesses, and the implementation of stay-at-home orders, as the world made uniform efforts to flatten the curve. American citizens found themselves stuck at home, with many unable to work while quarantined. Financial markets saw a surge in retail trading as quarantined Americans looked towards stock trading as a way to occupy their time. One of the biggest beneficiaries was the Silicon Valley unicorn, Robinhood. Robinhood, the pioneer of zero-commission trading, saw over three million new accounts opened in the first four months of the year.[13] Many stocks began experiencing unusual behavior as amateur investors on Robinhood poured into names such as Nikola, Kodak, and Zoom Technologies with limited reasonable basis. The dislocation of these stocks' price movement from their underlying fundamentals led many industry veterans to criticize the behavior of these market participants and even to forebode that the growing market share of the retail investor could have negative impacts on the broader equity market. The irrational movement of stock prices as a result of retail trading, known as the “Robinhood Effect,” has been apparent in speculative names with smaller market caps. However, we have not found empirical evidence that would suggest that the activity of retail participants has been detrimental towards the broader equity market, and until evidence suggests otherwise, we maintain the view that retail activity will not have a material, negative effect upon equity markets going forward.

Robinhood’s name is an ode to the famous storybook character. The company’s mission is to provide the masses with access to financial markets that institutions and wealthy individuals have dominated for many years. Robinhood offers a zero-commission brokerage allowing investors the ability to invest in stocks, exchange traded funds, options, and cryptocurrencies. The platform has lifted many of the hurdles that have prevented the average citizen from accessing financial markets in the past. Robinhood tailors its service towards the less affluent by eliminating account minimums and allowing investors to purchase fractional shares in securities. Requirements to access derivative products and margin lending are less stringent than those of traditional brokerage firms, allowing the average citizen access to sophisticated financial instruments. The platform boasts a sleek, easy-to-use interface while also providing a mobile application that allows investors to conduct trades via their smart phones. Robinhood has lowered the barriers of entry into capital markets, which has led to the retail investor taking a larger market share over the course of the past year. According to a study from Citadel Securities, retail investors made up just 10% of stock market activity in 2019, but on peak days in 2020, that number jumped to 25%[14] This rapid growth spurred fears that retail investors could gain significant influence over the price movements of equity markets, to the detriment of seasoned investors. The price action in certain equities like Hertz, Nikola, and Kodak over the course of the year served to fan these fears (*See* Exhibit 19).

In late May, Hertz filed for bankruptcy after claiming that it could not meet its debt obligations. What followed defied the expectations of seasoned investors; retail investors on Robinhood piled into the stock, causing it to soar nearly 900% from the day of its bankruptcy filings.[15] Companies such as Nikola and Kodak, whose stock prices skyrocketed at points during the year only to fall back down afterwards, also experienced irrational investing behavior. Zoom Technologies saw a similar run up in price, in part, because investors confused the small Chinese technology company with the Silicon Valley video conferencing company expected to do well amid a surge in remote workers. The “Robinhood Effect” was apparent in the price movements of these stocks; however, some investors extrapolated this as a possible risk to the broader equity market. Retail traders served as convenient scapegoats for the sharp rebound in equity markets in March by seasoned investors who missed the buying opportunity. However, statistical analysis has been unable to prove that the retail investor has had a material impact on the broader equity market.

13. Posted September 1, 2020 by Nick Maggiulli. “No, Robinhood Traders Aren't Affecting the Stock Market.” Of Dollars And Data, 2 Sept. 2020, ofdollarsanddata.com/robinhood-trader/.
14. “Retail Traders Make up Nearly 25% of the Stock Market Following COVID-Driven Volatility, Citadel Securities Says.” Business Insider, Business Insider, markets.businessinsider.com/news/stocks/retail-investors-quarter-of-stock-market-coronavirus-volatility-trading-citadel-2020-7-1029382035#.
15. Smith, Kelly Anne. “Robinhood & Hertz: The Troubling Saga Of A Bankrupt Stock.” Forbes, Forbes Magazine, 16 Dec. 2020, www.forbes.com/advisor/investing/robinhood-bankrupt-hertz/.

Exhibit 19: The Robinhood Effect



Index prices normalized to 1/1/2020 value. 1/1/2020 value = 100.
Source: Bloomberg

In June of last year, researchers claimed that there was no clear relationship between Robinhood customer activity and S&P 500 index moves, discrediting the popular narrative at the time that new retail investors were driving the rebound rally.[16] Their analysis used the third party resource Robintrack, now disbanded, which provided data on stock ownership in Robinhood accounts. The analysis found that while many high-return stocks have had substantial increase in retail ownership, a similar amount of low-return stocks also had an increase in retail ownership. In fact, the analysis found that Robinhood picks were actually underperforming, stating, "More Robinhood customers moving into a stock has corresponded to lower returns rather than higher."[17] A similar study utilized holdings data from Robintrack to find the correlation between the one-day change in number of Robinhood users holding a stock and the one-day price return of that stock for the 200 most popular stocks on Robinhood. The analysis showed that the majority of stocks had low correlations between the change in Robinhood ownership and price return.[18] There were a few outliers to this dataset, such as Nikola and Hertz; however, larger stocks like Apple, Amazon, and Tesla that have significant influence on the large cap equity market indices, had correlations near zero. Media headlines may have hyperbolized the impact of the retail investor upon equity markets over the past year. We believe that retail investors will continue to impact speculative names as they have in the past, but larger companies that we typically hold in our portfolios should remain shielded from the "Robinhood Effect."

16. Mkmfitzgerald. "Robinhood Traders Are Not behind the Rally and Their Favorites Actually Underperform, Barclays Says." CNBC, CNBC, 12 June 2020, www.cnbc.com/2020/06/12/robinhood-traders-are-not-behind-the-rally-and-their-favorites-actually-underperform-barclays-says.html.
17. Id.
18. Posted September 1, 2020 by Nick Maggiulli. "No, Robinhood Traders Aren't Affecting the Stock Market." Of Dollars And Data, 2 Sept. 2020, ofdollarsanddata.com/robinhood-trader/.

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