Hillegas Advisory Services
FAMILY WEALTH MANAGEMENT

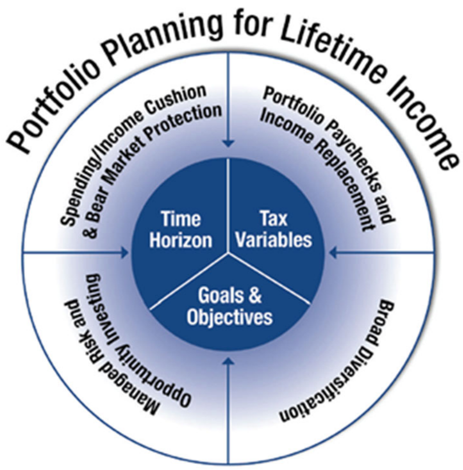
Winter 2021

Twenty-eight Years of Service (1993—2021)

It would be almost impossible to imagine a stranger year for U.S. financial markets than 2020. It was a year that defied logic. At the beginning, who could have forecast that a global pandemic would engulf every aspect of our lives? Or that it would persist in the United States – the wealthiest country in the world – more than anywhere else?

Diversity and Inclusion: Your Best Approach to 2021

At HAS we apply multiple strategies so clients may be more assured of the success they desire – **money for life**. These strategies include Portfolio Paychecks, a spending/income cushion, risk-opportunity investing and broad diversification.



Our portfolio management decisions are backed by research and designed to strike a balance between upside participation in a recovery and downside protection against declines. Thus far, we have successfully navigated three "once-in-a lifetime" calamities -- in just the past two decades: the dot.com bubble, followed by the Financial Crisis and now the pandemic. As for the later, we remain cautiously optimistic and elaborate on key ingredients for economic recovery further below.

Broad diversification means complimentary investments across the risk-reward spectrum: bonds, other income-generating investments, risk-managed investments, U.S. and international equities. To further mitigate risk, we favor specialist institutional managers who have demonstrated success in a variety of market environments, including investments that are available to HAS clients but not the general public. Our largest positions have seasoned managers at the helm, including those who successfully navigated the 2008 financial crisis.

We highlight some adjustments from 2020 and continue to make incremental investments in keeping with the following themes:

- Thanks to aggressive action by the Federal Reserve, interest rates are at rock bottom. 5-year Treasury bonds yield just 0.41% and 5-year municipal bonds provide a meager 0.23% a year. In this environment, alternative sources of income are essential.

- Generate "all-weather" income, via our proprietary Portfolio Paychecks™, which offer a predictable and steady stream of cash, regardless of whether the market is rising or falling. Cashflow for our high-income ETFs (Exchange Traded Funds) is in the 7 to 9% range.

- Capture tailwinds from turbulent markets. These investments are designed to capture rewards from increased volatility – in effect, collecting commensurately higher income as market volatility increases (current cashflow ranges from 8 to 11 percent).

- Diversify, with moderate risk investments that complement bonds while also protecting against downside market risk.

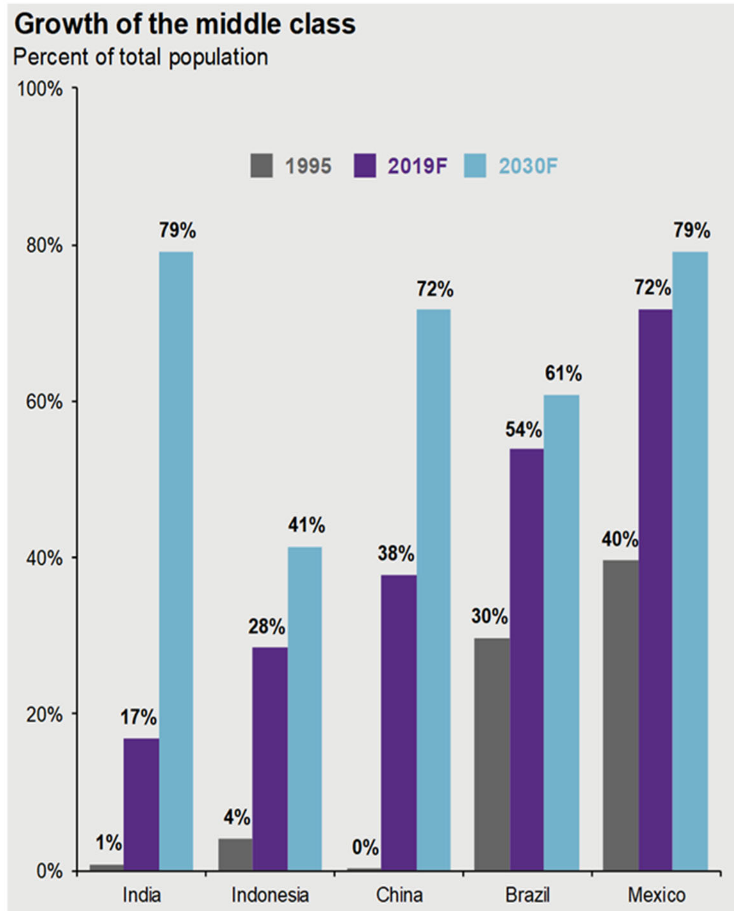
- Add to international equities, for both diversification benefits and exposure to faster growing markets. We have been especially pleased with newer international investments for their performance and for these reasons outlined below.

Discovering Value Overseas

Relative to their U.S. counterparts, both emerging market and developed country stocks are on sale, with valuations not seen in 20 years. This, along with the potential for a strong global post-pandemic economic rebound, lower trade tensions and the prospect of a lower dollar all bolster the case to increase exposure to international equities.

Other factors that may further boost overseas growth include Asia's much more successful handling of the pandemic and also the resolution of the longstanding UK-EU Brexit standoff, which should lead to more fiscal integration in Europe.

Additionally, demographic research (See chart to the right) also points to exceptional growth opportunities. In the next 11 years, for example, 1.3 billion people are expected to be lifted out of poverty and join the middle class in just two countries alone: India and China. China is forecast to overtake the U.S. as the world's largest economy by 2027. As anticipated, many global corporations that provide goods and services to these markets are experiencing explosive growth.



Cautious Optimism

For the U.S. economy to be able to recover from the tumultuous 2020, it's necessary to take into account the course of COVID-19 and a number of forward-looking variables. It is likely that companies will be 'asked' to make more vaccine, all paid for by U.S. Government and that our trajectory for national coverage of immunity for those who want vaccine, is now more likely to be late spring/early summer, unless something new comes up (which could be the case should vaccines require modifying to account for new virus variants). Below we share an excerpt from Strategic Economic Decisions, noted for their technical expertise and thought leadership. They include six ingredients for a more robust, sustainable economic recovery:

Case for Optimism: If the vaccine rollout goes smoothly; if there are no new strains of the virus that cannot be immunized by vaccines; if significant new fiscal stimulus is provided soon; if Biden is 70% successful in raising the $1.9 trillion he says he needs; and if as a result of all this public confidence about the future is restored and huge pent-up demand translates into catch-up spending – then we could expect a significant increase in GDP starting in April. Growth between April 2021 and January 2022 could average 4.5% - 5.5%. We could even witness a few quarters of 6% or 7% growth. April could be the turnaround month because that is when the success of the vaccines will be apparent, and will boost consumer confidence and spending.

Case for Pessimism: If half of the above 6 preconditions for recovery do not materialize, then growth will stagnate during the same period at about 1.5%. If none of these preconditions are met, then the nation could be in for a long 2-3 year recession with negative growth. In this latter case, it will be the extent of ongoing fiscal stimulus that will largely determine GDP growth. Our conclusions here result from an intensive study of the forecasts of many different analysts, and we believe these forecasts to be unbiased by policy *preferences* – a different matter altogether. There is, of course, a critical *caveat*: We have never experienced a service-sector-led catastrophe like this one, so all forecasts must be taken with a grain of salt.

Hindsight 2020

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After the dramatic market collapse that began on February 20, and saw a 13% drop in the month of March. The second-quarter saw a 32.9% annualized decline in the U.S. GDP, followed by a steep recession, record unemployment and three waves of a pandemic.

Against all these hurricane force headwinds, U.S. stocks – initially led by Big Tech – not only recovered, but sailed to new heights with the large company S&P 500 Index gaining 16.26%. These returns are both cause for celebration and alarm, as many stocks have become so expensive they are now vulnerable.

At the other end of the risk-reward spectrum, bond yields have plummeted as a result of extraordinary government intervention. Presently 5-year Treasury bonds yield just 0.41% while 5-year municipal bonds provide a meager 0.23% a year. With interest rates and bond yields at rock bottom, many have decided that stocks are the only way to make money in their investment portfolios, regardless of the risk.

Large tech stocks are particularly at risk. Since late last year, governments in the U.S., China and Europe separately began investigating whether Big Tech is too big. The answer is apparently yes. These companies face increased regulatory scrutiny and potential antitrust lawsuits. It's worth mentioning here that after the dot.com bubble burst in early 2000, it took more than 15 years for the Nasdaq Top 100 (QQQ) to recover.

Across the pond, companies in developed foreign economies gained 15.75 percent in Q4, as measured by the broad-based EAFE index, or 5.43 percent in dollar terms. In emerging markets, stocks of less-developed countries, as measured by the EAFE EM index, were up 15.84 percent (in dollar terms) for the year.

Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a 10.62% gain during the year's final quarter, but it finished the year with a 7.90% loss. The S&P GSCI index, which measures commodities returns, gained 14.49% in the 4th quarter, but ended the year down 23.72%.

Few would argue that U.S. stocks are cheap right now. By one measure, the Price/Earnings ratio of the S&P 500 index is 33.83, which is about 72% above the modern-era market average of 19.6. With interest rates and bond yields at rock bottom, some have decided that stocks are the only way to make money in their investment portfolios. However, the current U.S. valuations suggest that we be cautious about return expectations. Most people realize that the underlying economic fundamentals are shaky at best; the unemployment rate of 6.7% feels like an undercount since millions of service workers in the restaurant industry are sitting at home and weekly unemployment claims are approaching a million once again. Nobody yet knows the damage that the pandemic is causing America's public companies as they limp along with remote workforces, and we may not know the full extent until late in the year – if then.

Nobody can predict when or how the bull market will end, how deep the inevitable (sooner or later) bear market will be, or, really, anything other than the fact that all past downturns were followed by upturns which took the markets and the economy to new heights. We have already seen that dynamic in microcosm during the 2020 year of surprises.

Recognition: HAS' Five Star Service Streak Continues

For the seventh time, Craig Hillegas has been named a **Five Star Wealth Manager**. The rigorous selection process includes regulatory and consumer reviews, peer input and other objective criteria associated with the wealth management profession.

The award recognizes not only Craig's but also Team HAS's hard work, dedication and commitment to provide quality services to all their clients. The Five Star Wealth Manager program is the largest and most widely published wealth management accolade in North America.

Footnotes and References

JP Morgan Guide to Markets

SED Strategic Economic Decisions – January Issue

Inside Information – Bob Veres

Financial data: Morningstar, Bloomberg and cefconnect.com

https://www.bloomberg.com/markets/rates-bonds/government-bonds/us

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