C Y P R E S S

Asset Management, Inc.

MARKET COMMENTARY **January, 2021**

Despite the US Economy contracting by about 3.5% and S&P 500 earnings falling almost 15%, the S&P 500 finished 2020 at an all-time high, returning 18% on the year, and stocks are now up 56% in two years. A raging pandemic, economic shutdowns, and political turmoil have not been able to sink the market largely because these factors have been outweighed by unprecedented monetary and fiscal policy. An $8 trillion monetary and fiscal response from the Federal Reserve and Congress thus far represents almost 40% of total US nominal GDP which stood at $21.4 trillion in 2021. With hyper liquidity flowing through the system, significant portions of which remained shut down and out of work in 2020, much of it is finding its way into assets. Financial assets have been the prime beneficiary but longer-term assets are inflating across the board: equities, home prices (particularly higher end), gold hit record highs in the late summer while bitcoin and cryptocurrencies continue to soar, now other commodities are rising too with oil back above the $50 level and copper at a 7-year high.

Global Economic Outlook & S&P Earnings - January 2021 (S&P 500 @ 3,748)	2013	2014	2015	2016	2017	2018	2019	2020e	2021e
Global Real GDP Growth (y/y rate)	3.3%	3.4%	3.1%	3.0%	*3.7%*	3.8%	**3.1%**	***-3.5%***	***5.4%***
U.S.	2.2	2.4	2.4	1.6	*2.3*	2.9	**2.3**	***-3.5***	***4.8***
Euro Area	-0.4	0.8	1.5	1.8	*2.4*	1.9	**1.2**	***-7.0***	***3.9***
Japan	1.5	0.0	0.6	1.0	*1.8*	0.3	**0.7**	***-5.2***	***2.4***
Developing Asia	6.6	6.4	6.2	6.2	*6.4*	6.1	**5.2**	***-1.1***	***7.7***
China	7.7	7.3	6.9	6.7	*6.8*	6.8	**6.1**	***1.8***	***8.5***
Latin America	2.5	1.0	-0.5	-1.2	*1.2*	1.7	**0.8**	***-7.2***	***3.9***
Emerging Market & Developing Economies	4.7	4.6	4.2	4.1	*4.7*	4.7	**3.7**	***-3.1***	***3.4***
S&P 500 Aggregate EPS	109	118	117	118	*131*	162	**165**	***140***	***175***
Earnings (y/y rate)	12.6%	8.3%	-0.8%	0.9%	*11.0%*	*23.7%*	*1.9%*	*-15.2%*	*25.0%*
PE Ratio (January 2021 price @ 3,748)						15.5	19.6	26.8	*21.4*

Sources: IMF, ISI Group, BAML

Rational Exuberance

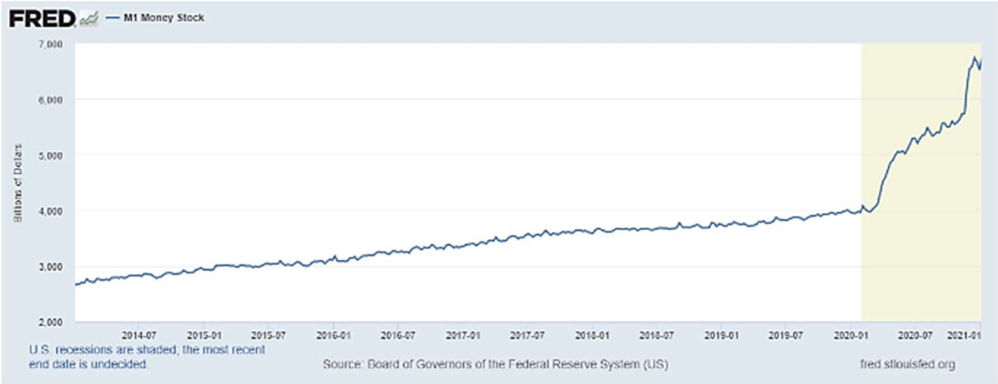
On a certain level this can be viewed as "rational exuberance" since policy makers have indicated they will continue to provide ample liquidity for the foreseeable future. Many respected market strategists like David Zervos remain bullish, saying that the Fed has your back, having promised not to raise rates until absolutely necessary and inflation moves well above target. With interest rates this low and fiscal spending also now in overdrive (President Biden has proposed to spend another $2 trillion out of the gate), treasury bonds no longer offer an effective market hedge according to Zervos: "the Fed is your backstop", your only backstop.

One reason that we are not seeing much inflation yet is that conditions remain difficult on Main Street for small and mid-sized businesses and for middle and lower-income Americans. The pandemic has widened the wealth disparity gap and further tilted the playing field in favor of Big Tech and Big Corporations. As the vaccine rolls out in the first half of 2021 and the recovery broadens, pent up demand will be released and people will start spending their money and we could see a surge in economic growth and activity and a pickup in inflation. We have seen a stock market boom, 2021 could see an economic boom.

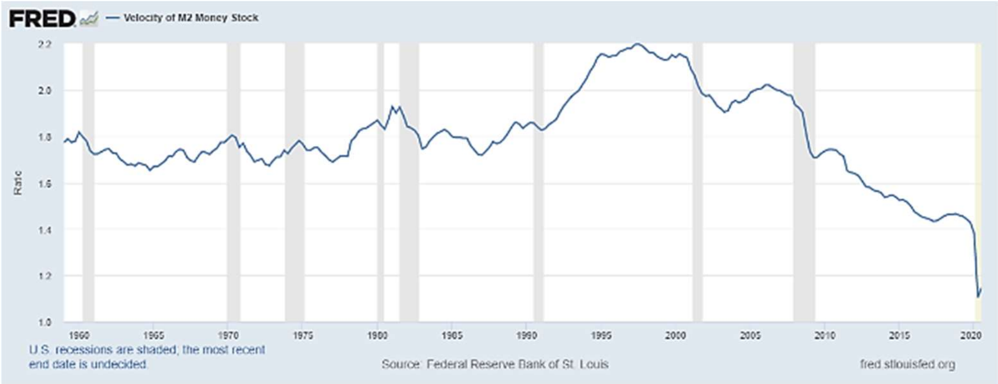
The biggest risks to the market are valuations and an unexpected rise in longer term interest rates. In the words of Goldman Sachs strategist Abby Cohen: *"The valuation of the US equity market is dependent, not just this year* *but next, on low interest rates. Almost all valuation measures are in unattractive territory, with the exception of those linked to interest rates ... "* The Fed has moved in early 2021 to tamp down talk of a "tapering off" in bond purchases this year. Recall that when this occurred back in 2013, 10-year treasury bond yields surged from 1.7% to over 3%. This set off a "taper tantrum" in the market which has chastened the Fed ever since. Such a surge in bond yields late in 2021 would be a big deal for equity and bond markets and poses a risk. Other risks include higher taxes and more regulation, but we think these risks pose nowhere near the threat of inflation and higher rates.

Those who see a significant pickup in inflation point to ballooning deficits, a declining dollar, strengthening commodity prices, and still another round of fiscal stimulus even as the newly launched corona virus vaccine and pent-up demand has buoyed confidence in a strong and broadening recovery. 2021 could be a boom year and that carries a risk that it also brings significant inflation. One of the reasons that inflation has not moved higher is that people aren't spending their dollars, as reflected in the declining velocity of money. "Velocity" is a key concept in monetary economics and is a measurement of the rate at which consumers and businesses in an economy spend money. As confidence and velocity pick up in 2021, it could have a big and unexpected impact on growth and inflation.

M1 Money Supply (Billions)



Velocity of M2 Money Supply



It can also be argued that many stocks are trading at reasonable valuations, particularly given the low interest rate environment. There are pockets of extreme bubble-like valuation in med tech, software as a service and cloud software, internet retailers with unproven profitability, electric vehicles and batteries, streaming companies, environmental/clean energy, SPACS and a surging IPO market, and perhaps bonds themselves. In contrast, well-established blue-chip stocks in health care, consumer staples and discretionary, industrials, financial services, and traditional tech are largely valued at reasonable levels not too dissimilar from historical norms. This is reminiscent of the environment in the late 1990s. Given near zero interest rates and expectations that rates will remain low for the foreseeable future, massive monetary and fiscal stimulus moving through the system, and coronavirus vaccines being rolled out across the country, it's hard not to be constructive on the market in the near term.

The Roaring 20's

ISI has written that consensus estimates of around 5% GDP growth in 2021 look too low, and that growth and earnings may surprise significantly on the upside. Its economic indicators are pointing to GDP growth at *twice* that level and record S&P 500 earnings well in excess of $180 (as a reference 2019 S&P earnings were $165). It is not yet comfortable publishing estimates so far out of consensus but bases the potential for a boom year on the following:

1) additional fiscal stimulus passed late 2020 and prospects for another $1 trillion or more in 2021
2) Massive monetary stimulus in the system
3) Vaccine related reopening of the economy in the second half and significant pent-up demand
4) A declining dollar (a lift to corporate earnings)
5) A declining savings rate in 2021 – see above, pent-up demand and impact on consumer spending
6) Inventory rebuilding
7) A booming housing market
8) Surging consumer net worth
9) Synchronized global growth

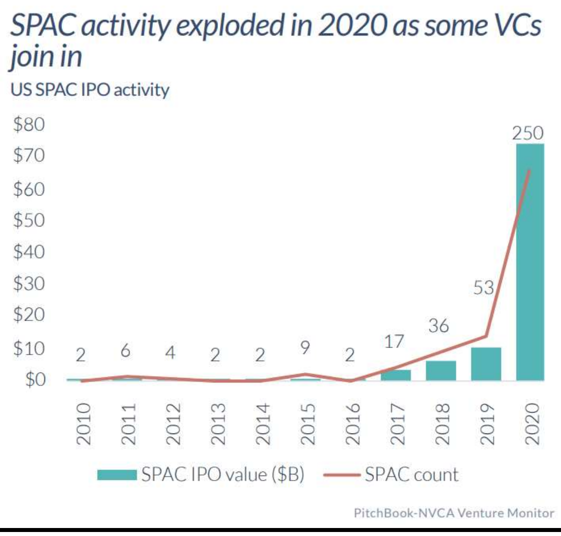
It is difficult to understand how after WW1 and the Spanish Flu in 1919, the US economy could move so quickly into the Roaring 20's. The proponents of a Roaring 20's style boom point to the idea of "pent-upness" – the potential for a generational consumer boom bursting out of a horrendous experience. Given all the monetary and fiscal stimulus already in the system and being added in 2021, it is also hard not to worry about unintended consequences down the road.

Alternative Assets Go Mainstream: Bitcoin and SPACs

There is a lot of money out there. Money is finding its way into every asset corner, propping up values, creating historical asset inflation and valuation high water marks. One phenomenon is the unprecedented growth in alternative investments. This includes both venture capital and more outlier assets, widely considered hedges, like gold and bitcoin. Bitcoin, one of several novel alternative forms of exchange, akin to currency, had explosive growth in 2020, up from around $7,000 a bitcoin at year end 2019 to about $32,000 a bitcoin on January 1, 2021. Bitcoin, like gold which is among the oldest stores of value, is considered a hedge against inflation and geopolitical risk. The volatility of hedges like gold and bitcoin is renowned and predictably unpredictable. Bears warn that Bitcoin is a crowded trade and bulls like Bill Miller claim that the more crowded the trade the better due to the "networking effects" of bitcoin ownership and usage.

Bitcoin's growth ultimately hinges on acceptability in the population at large and with investors in particular. While there have been examples of new sources of acceptance – PayPal has moved to accept bitcoin as a method of payment – bitcoin transactions remain a still relatively insignificant niche market. As for investing in bitcoin, there are two funds, a crypto index fund and a publicly traded trust that hold physical bitcoins. Finally, there are ways for individuals to hold "coins" directly. To date, the SEC has rejected any filings of ETF's related to bitcoins. There currently is another attempt at an ETF that will hold bitcoins in cold storage and price the coins via a benchmark rate. So, acceptance remains an elusive issue with bitcoin as does the specter of the coins as a competitor to any fiat currency. There will always remain the risk that any government, uncomfortable with the risk of competition that bitcoin presents to the nation's fiat currency, simply outlaws the use of the coins.

Another asset class, venture capital, had a record year as well. US venture deal activity topped $150 billion for the first time ever. Investors deployed $156 billion into startups, liquidated $290 billion of value via exits and closed on $73 billion in traditional venture capital funds, all historical records. 321 mega deals closed in 2020, up from 2019. For perspective, in 2011, just 46 mega deals closed. The most interesting feature in 2020 fund raising was the SPAC, Special Purpose Acquisition Corporation, a publicly held fundraising vehicle with an indefinite purpose – money raised for the purpose of literally doing "something"- raised over $70 billion in funds in 250 vehicles. For perspective, ten years ago, 2 SPACs went public.



Twelve Month Price Chart