NorthCoast
Asset Management

Quarterly Client Update

Q4 2020

December 31, 2020

"When I started counting my blessings,
my whole life turned around."

~ Willie Nelson

The events of the first week of 2021 have made moving past 2020 and the upside down effect it had on our lives difficult. For me, one of the lasting memories will be the effort it took to stay level-headed in the face of intense national events. Even as I write this, the shock and sadness of watching a standoff at the doors of the House chamber has been replaced by pride and hopefulness in watching Congress reconvene. Not sure about you, but I feel like a metronome bouncing back and forth between optimism and anxiety. It was a year in which all of us had to contend with the same terrible things – canceled family gatherings, family and friends falling ill with the virus, businesses failing, and perhaps even the death of a loved one.

As an optimist, I often see the positive in situations. However there were moments in 2020 that could knock anyone on their heels and it was during those times that the above quote (which used to hang in my high school teacher's classroom) would inspire me. So before some thoughts on the market, I first would like to recognize some professional blessings:

- To our operations and trading teams, thank you. My estimate is that you processed over 2 million transactions across more than 4,000 clients last year. In the face of office closings, extreme volatility, and heightened demands, I didn't hear from a single client that a trade, check or transfer wasn't handled as promised.

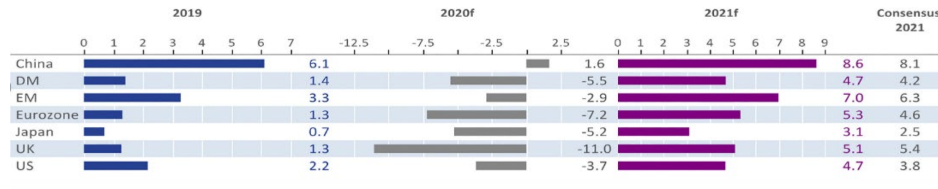
- To our portfolio management team, thank you. We believe in engineering investment solutions based on data and discipline. But what happens to any model when you introduce unprecedented data? You have to grab the wheel and adjust. And that's what you did. Our hedged portfolios did their job, our growth and ETF portfolios performed as expected, and all the while you productively adjusted parameters for our concentrated stock clients.

- To our client advisory and marketing teams, thank you. Shoot, move, and communicate is the mantra espoused by Special Forces teams, and you did this so well this year with one additional element -- care. You advised, guided, and communicated all while keeping our client's best interests front and center. I received more client compliments and "thank you" notes than ever in 2020 and that is a testament to you.

- Finally, to our clients, thank you. We work for you and we are so grateful for the trust you place in us. Our collaboration went above and beyond this year – whether it was a strategy change, a Roth conversion, or a portfolio review, we thoughtfully worked through it together. We set a new record with over 360 financial plans executed as you strategically looked ahead despite the pressure of the here and now. We launched four new products all based on your feedback, and we welcomed more new clients this year than in the previous five years – fruits of our strong partnership.

So with that said, we look ahead to 2021 and focus on what's ahead. We believe taking advantage of opportunities will require careful and timely asset allocation, fundamentally driven security selection and active management of market risk. We have a positive macro and market outlook for 2021 underpinned by the discovery of effective vaccines against Covid-19. The path of the virus and efforts to control it have been the principal driver of the global economy, greatly ameliorated – but not cured – by unprecedented fiscal and monetary policy support. An effective vaccine brings the return to 'normal' and a full economic recovery within much closer reach. We believe a broad-based and sustained global recovery will be mirrored by a rotation in market leadership.

Global Growth Forecast (annual % change)



Source: Consensus forecast as reported by Bloomberg; BlueBay Asset Management forecasts, as of December 1, 2020.

It was a health crisis that plunged the global economy into its deepest recession in modern history, rather than unsustainable private-sector imbalances or excessive tightening of financial conditions by central banks, as has been the case in previous downturns. The policy response was similarly unprecedented in terms of the scale of interventions by central banks and governments, providing a financial bridge for households and companies to the other side of the pandemic.

Fresh on the heels of last week's $935 billion stimulus package, we assume over $1.4 trillion in additional aid will flow following the outcome of last week's Senate runoffs in Georgia. Meanwhile, trade in Asia continues to build on the global manufacturing cycle and investment to lay the ground for stronger growth in the second half of 2021. The pandemic of 1918 gave way to the roaring 20s. There are strong reasons to believe this analogy is fitting for today's world.

To begin, the Fed has expanded money supply (M2) at an unprecedented pace and appears poised to spike it further through at least June 2021. In the 3rd quarter of 2020, the U.S. economy recovered 95% of its output from 2019 because M2 exploded 25-30% higher. Consumer net worth is at record levels. Corporate balance sheets are pristine. In a nutshell, monetary and fiscal policy act with a lag, but mass inoculation could lift the only brake on the economy by the beginning of summer.

Though concern about a unified government under President Biden bringing about higher personal and corporate taxes is warranted, there isn't great evidence historically that those types of administrations negatively impact markets. Below we can see the impact of a unified government from the Great Depression until last year. Further, we can break down election years and the year immediately following under unified vs. divided governments.

S&P 500 Price Returns by Government Control (1928-2020)

Unified	9.3%
Divided	6.1%
All	7.7%

Year	Government Control		Election Type	S&P 500 Return	
	Pre-Election	Post-Election		Election Year	Next Year
2020	Divided	Democrats	Presidential	16.3%	???
2016	Divided	Republicans	Presidential	9.5%	19.4%
2008	Divided	Democrats	Presidential	-38.5%	23.5%
2002	Divided	Republicans	Midterm	-23.4%	26.4%
1992	Divided	Democrats	Presidential	4.5%	7.1%
1976	Divided	Democrats	Presidential	19.1%	-11.5%
1960	Divided	Democrats	Presidential	-3.0%	23.1%
1948	Divided	Democrats	Presidential	-0.7%	10.5%
1932	Divided	Democrats	Presidential	-14.8%	44.1%
			Average (1928-2019)	**-5.9%**	**17.8%**
			% Positive	**37.5%**	**87.5%**
			All Years Average (1928-2019)	**7.7%**	
			% Positive	**66.3%**	

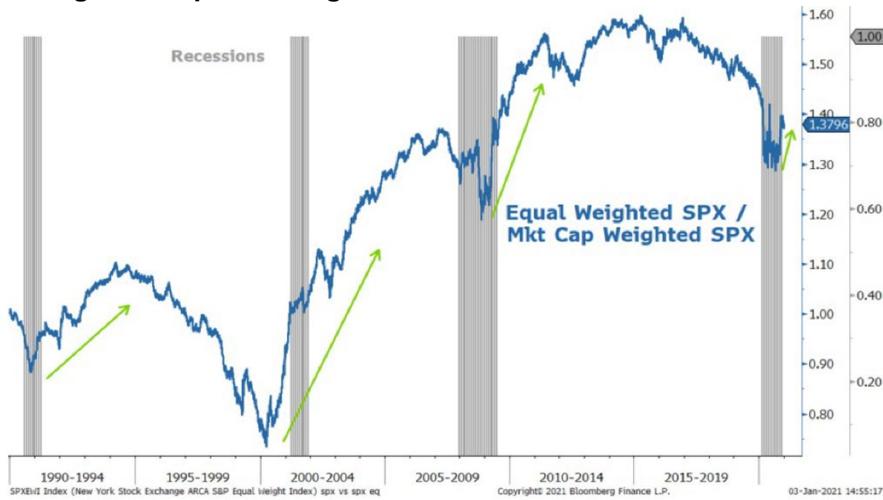
Source: Bloomberg, BTIG Research

This improving breadth is typical coming out of any recession and we see no reason for it to be different this time. It also syncs with our view that policy is likely to favor the little guy for a change.

With regard to stocks, the above-mentioned factors could drive inflation and nominal GDP to surprisingly high levels, spiking interest rates and potentially upending the Technology/Growth leadership. Why? The dividend discount model: **Stock Price** = (Dividend/(Cost of Equity Capital – Growth rate)) or P=(D/(R-G)). When the risk-free rate drops, this decline by itself reduces the cost of equity capital. However, many mature companies experience stock price declines because the decline in interest rates signals weakening economic activity, which is the largest driver of the growth rate in mature industries. The slower growth rate reduces margins and free cash flow, depleting the credit profile. These adverse impacts to the cost of capital more than offset the decline in the risk-free rate for mature industries. However, structural growth companies are immune to the economic outlook. As a result, a drop in

the risk-free rate drives growth stocks higher, as the decline in interest rates combines with resilient growth expectations. This phenomenon reverses dramatically if rates begin to rise. Given the crowding in growth, the adjustment could be severe. We believe the recession last year is the beginning of a shift in this narrative whereby the average stock performs better than the broader indices.

2020 saw the beginning of several new trends including the average stock performing better



Source: Bloomberg, Morgan Stanley Research.

So with that thankfulness and optimism for 2021, let's kick 2020 to the curb and embrace the new year. Once again, thank you for your trust and your business. Sending best wishes to you and your family for a happy, healthy, and profitable 2021.

Warm regards,

Dan Kraninger
President & CEO

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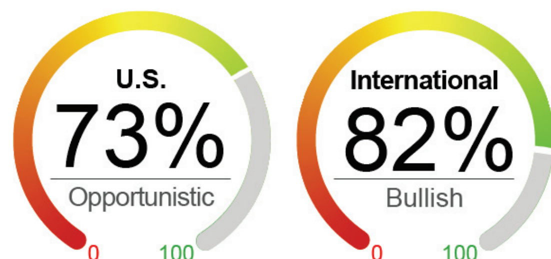
The NorthCoast Navigator is a market barometer displaying current equity outlook. The aggregate metric is determined by multiple data points across four broad dimensions including macroeconomic, sentiment, technical and valuation indicators. The daily result determines equity exposure in our tactical strategies. As of 12/31/2020. Data provided by Bloomberg, NorthCoast Asset Management.



An Election and a Bullwhip

There were a number of remarkable market events in 2020, the most well-known of which was the S&P 500's rally from its record selloff in March. After losing nearly a third of its value in the spring, the S&P 500 rose almost 70% by year end from its March lows, and notched a gain of almost 18% for the year. The S&P was not alone in its record run - the Dow Jones Industrial Average and Nasdaq both had equally remarkable runs. Together, these three major indexes recorded 100 record closes during the year. For context, that is the most record closes since 2017, a banner year for equities with certainly no pandemic to contend with. Such positive market action was not exclusive to equities however, and it is almost easy to forget that some oil futures traded below $0/barrel in April, having since rallied back to around $50/barrel. The driver of such widespread investor optimism was largely faith in governments and central banks to prop up economic activity through accommodative monetary policy (low interest rates) and fiscal stimulus. Both of these actions did come to fruition with central banks committing to as supportive policies as necessary and governments passing major stimulus bills. The most recent stimulus bill in the U.S. was confirmed last month. These actions were critical to maintaining optimism throughout markets.

The end of 2020, particularly December, was somewhat of an inflection point for what had been driving the markets higher. Investors are moving from optimism about governmental intervention to confidence that vaccines will bring more economic recovery and eventually restore a high level of activity. The Chinese economy has substantiated this belief since it has essentially recovered, now functioning at a high level since the country largely controlled the pandemic's outbreak. Other countries are dependent on the vaccines and their rollouts going smoothly, which does have the inherent risks of a major logistical undertaking.

The country as a whole has been very optimistic about the end of 2020 and the start of a new year. Of course, little has changed since last week but there is the expectation that in this year the country will be able to return to normal activity. To achieve that, the rollout will have to move smoothly. We are certainly wary of potential issues with the vaccine distribution and believe there will be some sustained push-pull between rising cases and vaccine distribution in the coming months. Similarly, we expect some back and forth between politics, stimulus and economic activity. We are also aware that much of the optimism surrounding equities is warranted, but that exuberance can significantly inflate prices to unsustainable levels. Currently, some investors are seeking a very high level of risk that we do not see as sustainable. The Georgia senate race runoff will have some market implications in the short-term as it determines control of the senate. A democratic victory might cause some investors to worry about tax increases, though chances of hikes seem slim for the time being. We currently sit 73% invested in our U.S. tactical flagship strategy and 82% invested in tactical international strategy.

Macroeconomic

Economic figures showed some signs of strength as the year drew to a close. Manufacturing was a bright spot as compared to services, which were hurt by recent lockdown restrictions. The resilience of manufacturing amid increasing lockdowns is a very positive sign moving into 2021.

Sentiment

Sentiment improved in December with the passage of another stimulus bill as both investors and consumers appear more optimistic about current and future economic conditions. The University of Michigan consumer sentiment survey jumped higher from November to December, but is still well below Dec 2019.

Technical

Market momentum is currently very positive thanks to so much upward price movement. For the same reason, reversal indicators are slightly red. Still, technical indicators are overwhelmingly positive and the S&P 500 sits significantly above its most common moving averages. .

Valuation

With such a strong year for equities, it is easy to ignore that the economy is still recovering from last Spring's dip in productivity. The gap between equity prices and company earnings is severe. Valuations are still strongly negative in the U.S.

2020: An Unforgettable Year Ends With Resounding Stock Gains

The year saw the fastest bear market and fastest recovery, as the coronavirus transformed the economy. Gains since Jan. 1, 2020, are charted below.