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INVESTMENTS

THE TENGLER REPORT

December 17, 2020

The Outlook for Equities

From Nancy Tengler, Portfolio Manager and Chief Investment Officer

2020: The Year of Firsts

"The noblest pleasure is the joy of understanding." Leonardo da Vinci

We've heard about it all year: 2020 brought the shortest and most dramatic bear market in history, followed by the quickest recovery and the start of a new bull market in a matter of months. A global pandemic unlike any we've seen for one hundred years, then the ensuing unprecedented economic lockdown. An epic plummet in GDP, an equally epic moonshot in jobless claims. Political divisiveness, Operation Warp Speed, and a stock market that continues to hit new highs.

Huh?

I had the pleasure to spend a weekend with a dear friend a few months back. Bev is 90 years old, and during our visit she shared with me her newly constructed five-year plan. (I have no doubt she will execute on it, by the way.) I considered her plan over the subsequent weeks and realized Bev's behavior is similar to the stock market (See how I did that? Everything comes back to investing!). She is looking forward, setting objectives, and then moving toward them, deliberately and determinedly. Not relying on her 90 plus years of triumphs or limited by disappointing defeats, she is strategic and optimistic—"one foot in front of the other" as she so often says.

This year of firsts has presented individuals and investors with plenty of challenges, and it is almost impossible not to extrapolate those difficulties out to infinity and run for the proverbial hills. I am frequently asked why the market is going up in the midst of economic lock down and high unemployment (future growth), has it gone up too quickly (undoubtedly—it usually does) and should I sell (almost never!)? Because you see: the market, too, has a five-year plan. The gyrations are not haphazard, nor terminal, nor even terribly insightful from day to day.

This is not to say there are not obvious hurdles to overcome. The vaccine needs to be widely distributed, kids need to return to school, and their parents to work. Bars and restaurants must reopen; theatres, theme parks and sports arenas, too. Folks need to begin flying and cruising and recreating. In short, we need to return the economy to "normal".

Though we expect continued volatility, we believe selloffs and the inevitable correction are an opportunity to add to high-quality holdings rather than a reason to flee stocks. Here's why:

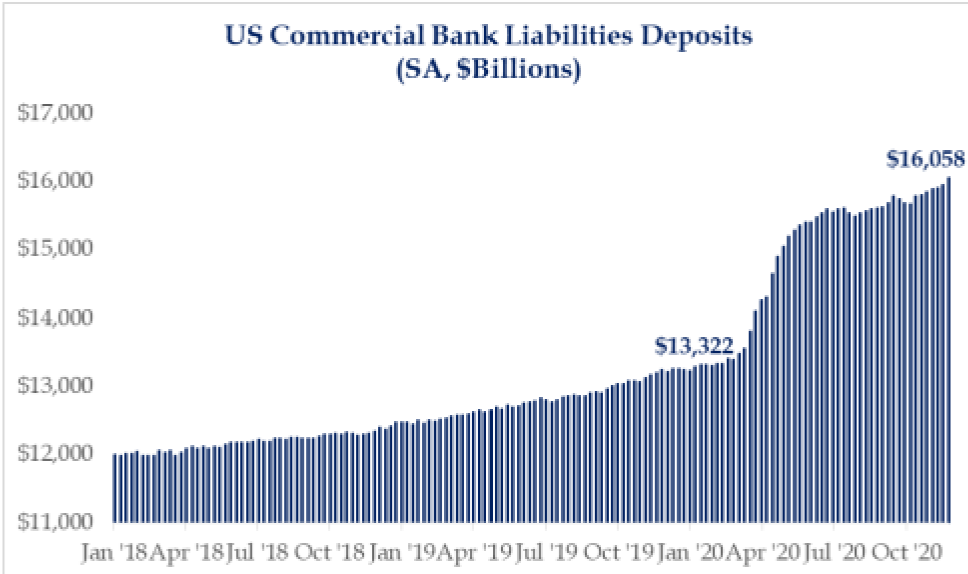
Unprecedented stimulus and equity flows: Nancy Lazar of Cornerstone Macro compiled the table below, which outlines global monetary and fiscal stimulus. As you can see below, the U.S. put in place stimulus to the tune of 49% of GDP and global stimulus is equal to 32% of global GDP. It is important to note that the benefits of stimulus take time to trickle through the economy (12- 18 months is a good rule of thumb). So, we have yet to see the full effect in GDP growth.

Global Monetary And Fiscal Stimulus To Fight COVID-19 Impact 2020 Feb to Dec (CSM)

	Potential Central Bank Liquidity Injection		Potential Fiscal Stimulus		Central Bank Liquidity Injection and Fiscal Stimulus	
	$ Tln	% GDP	$ Tln	% GDP	$ Tln	% GDP
U.S.***	$6.21	29.0%	$4.20	19.6%	$10.41	48.6%
Eurozone	$2.38	17.9%	$4.27	32.0%	$6.65	49.9%
Japan**	$1.03	20.0%	$2.22	43.1%	$3.25	63.1%
U.K.	$0.57	20.7%	$0.59	21.6%	$1.16	42.3%
China****	$1.43	10.0%	$1.22	8.4%	$2.64	18.4%
Others*	$0.94		$2.85		$3.79	
Global	$12.56	14.5%	$15.35	17.7%	$27.91	32.2%

Source: Cornerstone Macro, December 10, 2020

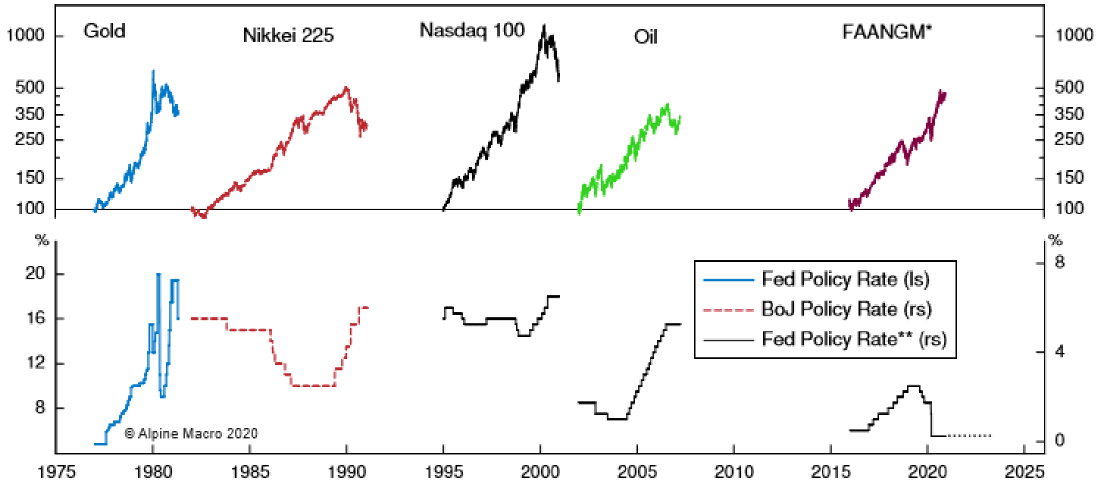
And excess liquidity tends to find its way into risk assets. Though equity flows have been muted when compared to bond flows in 2020, they have improved. Still, flows are well off the historic highs hit in late 2017, which leaves room for money on the sidelines to move into equities. Additionally, commercial bank deposits have increased dramatically. In investment parlance, we call that pent-up demand for goods and services and stocks.



Source: Strategas Research Partners, December 9, 2020

Low interest rates for the foreseeable future: Chairman Powell of the Federal Reserve has told us that the Fed is "not even thinking about thinking about raising rates." Low rates are good for consumer borrowing, companies who need to issue debt to stay solvent during a crisis like the one we are facing, and low rates tend to be bullish for risk assets, like stocks.

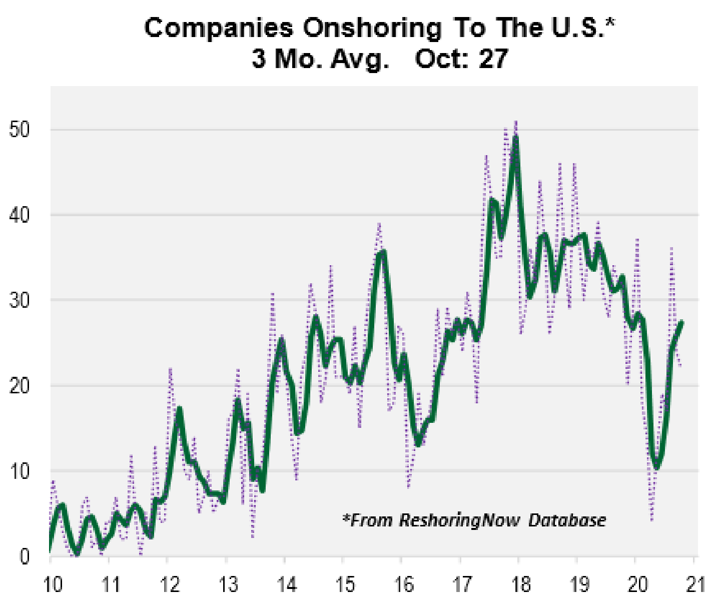
The following chart from Alpine Macro shows previous assets "bubbles" and the Fed policy rate. You can see that enthusiasm (and therefore prices) waned when the Fed tightened monetary policy. That said, we are not unmindful of the risks in stocks and, particularly, some of the growthier names we hold. We have been scaling back on our winners and building positions in attractive alternatives. When the market takes a breather, we will opportunistically and discriminatingly step in the gap.



Note: All series in the top panel are rebased to 100 at the starting point
*Market-cap weighted average of Facebook, Amazon, Apple, Netflix, Google and Microsoft
**Dotted line is a projection

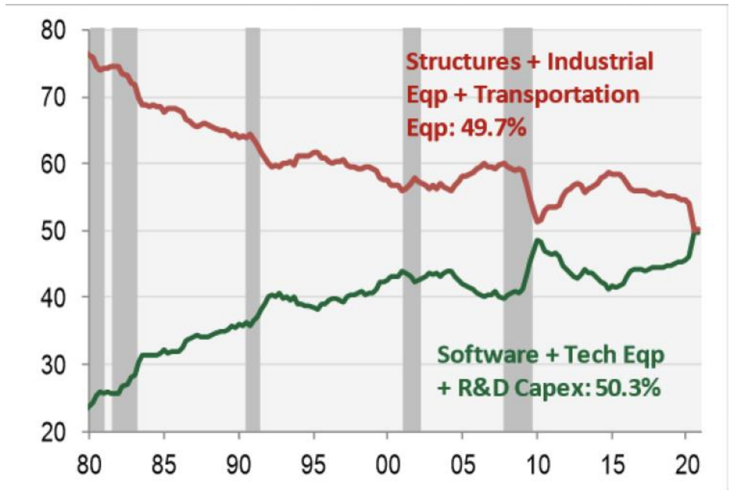
Rising corporate profits will drive capex which will drive productivity improvements: We have been preaching, ad nauseum I fear, that technology will continue to drive improving productivity and growth. And by technology, we don't necessarily mean FAANGM. We are painting our technology holdings with a much broader brush. We are focused on companies that build the cloud and data pipes, companies that help old economy companies digitize and become part of the tech/productivity boom. The trend is firmly in place, catalyzed by the many ways American consumers and businesses adapted to the shutdown.

Importantly, companies are moving manufacturing to the U.S.



Source: Cornerstone Macro, December 11, 2020

The last expansion (prior to COVID) real capex growth averaged 4% annually. The driver was tech capex (we have written about this exhaustively over the last year) growing double the overall annual rate. Tech as a percent of capex breached 50% of total capex spend last year for the first time ever. This bodes well for productivity improvements, which will mute inflation in the near term as Americans get back to work and wages rise. We do expect cyclical inflation in 2022 as the economy takes off.



Source: Cornerstone Macro, December 3, 2020

So, in summary, we remain bullish over the mid- to long-term, but cautious in the near term. The Georgia senate races are still not in the books and markets—on average—experience a decline after a change in party in the White House but since there is nothing normal about this year, we will wait and see. But make no mistake. We will be jumping in to pick off high quality names on sale just as we did in March and April of this year.

We appreciate your support during this difficult year and are looking forward to a prosperous new year.

Concentrated

From Nancy Tengler, Portfolio Manager and Chief Investment Officer and David Jeffress, Portfolio Manager

As has always been our thesis (supported by the research), optimal portfolio diversification is twelve holdings. The reason most people don't do it? It's very hard to do. A concentrated portfolio of "best ideas" will outperform its more diversified counterparts, and 2020 proved this to be the case once again. In keeping with our strategy, we held the number of names constant at 12 and took advantage of price appreciation in many of the names to raise capital to direct towards names we felt had underperformed and were due for a rally.

We took profits from names like Apple (AAPL) and Walmart (WMT) and replaced names we felt no longer qualified as "best ideas" like Alphabet (GOOGL) and Chevron (CVX) with names we see significant upside in, such as Microsoft (MSFT) and Palo Alto Networks (PANW). Other portfolio changes include selling proceeds from a spin-off, Otis (OTIS) and Carrier Global (CARR), and adding FedEx (FDX) as a new addition.

The Concentrated portfolio continues to outperform the S&P, with very little turnover, and we anticipate these 12 names will continue to lead in 2021.

Equity Growth

From Nancy Tengler, Portfolio Manager and Chief Investment Officer and David Jeffress, Portfolio Manager

Despite falling nearly 34% from its peak in February to its March low, the S&P 500 has gained 13.4% for the year through December 9th. However, this remarkable rebound and subsequent rally to an all-time high has not always been felt evenly. Not all stocks in the S&P 500 shared in this recovery throughout the year, and at times the market's gains have been highly concentrated in just a handful of names. In February, only 26 names in the S&P 500 were positive for the month; in March, the number was 41.

Companies such as Apple (AAPL), Alphabet (GOOGL), Facebook (FB), Microsoft (MSFT), salesforce.com (CRM), and ServiceNow (NOW) are among the top 20 drivers for the entire S&P 500 index for 2020 and are core holdings for Equity Growth. By being in these market drivers early, Equity Growth was able to fully participate in the market's recovery, and as the number of names that participated in the market's gains widened in November to 464, our "growth at a reasonable price" mindset has continued to be a driver of outperformance.

Equity Income

From Nancy Tengler, Portfolio Manager and Chief Investment Officer and David Jeffress, Portfolio Manager

From January 2000 until the last trading day of 2010, the Russell 1000 Value Index increased by 12.38%, while the Russell 1000 Growth Index fell by 31.39%. Conversely, from 2010 until today, December 9th, value rose by 135.92%, while Growth appreciated by 366.45%. The inevitable question of growth versus value predictably comes down to the time-period one chooses to measure, and the past few years have been difficult for those on the hunt for value in a growth-oriented marketplace.

In our Equity Income strategy, we persistently maintained our discipline and continued to seek out and acquire shares in large-cap value stocks with an attractive dividend yield that we view as high-quality, resilient companies that were nevertheless exposed to market pressures due to this year's health crisis.

Despite value's underperformance relative to its growthier peers, we are confident that owning high-quality stocks that pay their investors an attractive yield coupled with reasonable capital appreciation will continue to pay-off in 2021 and beyond.

Convertible Securities

From Stan Rogers, Portfolio Manager

2020 Review

The convertible market has had an exceptional year on several fronts: outstanding performance, new issuance is approaching $100 billion, the highest since 2001, and the asset class's market value is close to historical highs. Returns were boosted by low interest rates and a strong equity market. Despite the difficulty experienced during the first quarter, LTI Convertibles produced competitive returns. Diversification within the portfolio helped returns, including names that benefitted from the stay-at-home theme (technology, software) and positions that were not susceptible to earnings uncertainty (utilities).

2021 Outlook
With multiple potential volatility triggers (virus, new administration and policy direction, vaccine usage), the convertible portfolio is positioned to dampen volatility while maintaining an attractive underlying equity sensitivity profile. We also look for continued robust new issuance.

Bonds & Fixed Income

From Jason Weaver, Head Trader & Portfolio Manager

Fixed Income's "boring" reputation of late was certainly upended in 2020 as a dramatic peak in risk assets preceded a pandemic-driven selloff and recovery, only to be later punctuated by a contentious presidential election season. LTI's strategy in FI has always been one driven by a need for capital preservation above all, and our disciplined approach allowed us to proactively reduce risk going into the crisis and later, to position ourselves opportunistically for the recovery with added assurances of Fed and Treasury support. Looking to 2021, we are maintaining this discipline and while we could see potential volatility on the horizon, we remain positioned for a continued recovery and are continuously screening for the most promising risk/reward exposures across the fixed income landscape.

Global Equity

From Arthur B. Laffer, Jr., Portfolio Manager

The pandemic of 2020 caused quite a shift in investment returns and economic performance by country. Those countries that moved fastest to reopen their economies after dealing with the initial COVID impact recovered the fastest and performed the best. The Asia region overall had the fastest economic recovery and some of the lowest COVID infection rates globally.

The global strategy shifted allocations from some of the more exposed economies to those with the most potential for recovery and growth. Post pandemic, positions were added in China, Taiwan and Japan. The US was reduced to a single weight. Switzerland and Israel were removed.

Dynamic U.S. Inflation Strategy

From Arthur B. Laffer, Jr., Portfolio Manager

Over the course of 2020, inflation continued to stay well below the US Federal Reserve Bank's target, prompting no major changes in the strategy other than tactical assets shifts.

As a result of the COVID induced change in economic expectations, combined with the trajectory of interest rates to a "new low" paradigm, the following changes were made to the strategy.

High yield credit exposure was removed from the strategy due to the weak economic performance and also the significant exposure it had to the energy sector.

Mortgage backed security exposure was also curtailed due to very strong performance and a lack of reasonable upside potential going forward. Positions were increased to investment grade corporate bonds and a position was added to investment grade preferred stocks. The preferred stocks met two criteria for the strategy. They added a very competitive yield replacement for the high yield bond allocations that were removed, and they kept the overall quality of the strategy focused on investment grade credit quality.

Dividend Growth

From Steven Shepich, Portfolio Manager

COVID created unusual challenges for the strategy in 2020. We had to reanalyze every business owned and determine the potential COVID impact, not only over the short-term but three years out. We also placed heavy emphasis on sustainability of dividends, balance sheet quality, and credit quality and availability. We had to make some difficult decisions by exiting quality businesses with declining fundamentals by no fault of their own. In the end, our hard work paid off as we were able to enhance portfolio quality, and not a single business in the strategy reduced or eliminated its dividend, while the vast majority continued to provide dividend increases.

Equity Hedging

From David Jeffress, Portfolio Manager

The pursuit of an effective equity hedge in 2020 was an exciting and exacting challenge. We initially began to explore ways to hedge equity exposure in late 2019 as we witnessed levels of volatility significantly below historical norms, coupled with ever-appreciating equity valuations.

We began buying protection in February of 2020, and as markets started to sell-off in the wake of the coronavirus fallout, we were able to capitalize on market turmoil that would have been unthinkable just a few short months before. Following that initial trade, we have continued to strategically hedge our risk quarter after quarter. Although we are constantly refining our option strategy as markets change and as we gather new information, we are resolute in our belief that equity markets will continue to climb higher in 2021, but we can do so with a little more confidence knowing we have some protection in place for any bumps along the way.

Nancy Tengler's Recent USA Today Articles

After the Dow Jones Industry Average Hit 30K, What's Next? (Dec 6)
What 401(k) Moves Should You Make Now that the Election is Over? (Nov 10)
3 Reasons Stocks Will Probably Rise No Matter Who Wins the Election (Oct 11)

Nancy Tengler's Recent Media Appearances

Apple is Doing a Lot of Things Right Now with its Fitness Subscription App (CNBC, Dec 15)
How to Prepare Your Investing Strategy for 2021 (Fox Business, Dec 11)
Walmart is a Solid Bet as Rally Presses Pause (CNBC, Dec 7)
Emerging Markets Near Three Year High (CNBC, Dec 7)
AstraZeneca Vaccine News Boosts Stocks Despite Surging Covid Infections (CNBC, Nov 23)
This Is An 'Early Stage Bull Market', Stocks Continue to Outperform (Fox Business, Nov 16)
Energy's Best Week Ever – Two Experts on Whether It Can Continue (CNBC, Nov 13)
Some of 2020's Hottest Stocks Just Had an Awful Week (CNBC, Nov 13)

Pfizer's Vaccine Propelling Stocks (Fox Business, Nov 10)
Stock Market Investment Strategy Based on 2020 Election Results (Invest Diva, Nov 6)
I Think You Sit Back and Don't Take on Additional Risk (CNBC, Nov 3)
Activision Blizzard, Take-Two Earnings (CNBC, Oct 29)
These Shares Have Rocketed Off the March Lows (CNBC, Oct 26)
'Enough Already', Says Investor After Latest Quarterly Disappointment (CNBC, Oct 26)
Intel Falls After Reporting Data Center Weakness (CNBC, Oct 23)
Stealth Consumer Stocks: These Shares Have Rocketed Off the March Lows (CNBC, Oct 23)
One Underdog Sector is Beating the Market This Month (CNBC, Oct 19)
A Chipmaker and Railroad Stock: Traders Share the Top Earnings Reports (CNBC, Oct 16)
What's Next for the Utilities Sector, According to these Investors (CNBC, Oct 16)

THE LAFFER TENGLER INVESTMENTS DISCIPLINE

Discipline is key to sustainable long-term total returns:

- At Laffer Tengler Investments we use two, time-proven stock valuation metrics (both pioneered by our team) that are consistent and robust indicators of value: Relative Dividend Yield (RDY) and Relative-Price-to-Sales Ratio (RPSR).

- Why not use earnings like almost everyone else? Because earnings are often an unreliable indicator of value. In May of 2016, I published the following:

Earnings reported by corporations have always been subject to the vagaries of accounting gimmickry. You don't have to be a novice to scratch your head at the way managements (or governments for that matter!) account for various items.

A recent case in point: The Wall Street Journal (Thursday, February 25, 2016) reported that according to FactSet, pro forma earnings for S&P 500 companies rose 0.4% in 2015. Using generally accepted accounting principles or GAAP, earnings per share actually fell 12.7% in 2015 (this according to S&P Dow Jones Indices). The author's point is that according to GAAP earnings, investors are paying a great deal more for stocks than they think. The price-to-earnings ratio (P/E) on pro forma earnings (which is the most commonly accepted method) is 17x 2015 earnings. But when GAAP earnings are considered, the P/E jumps to more than 21x.

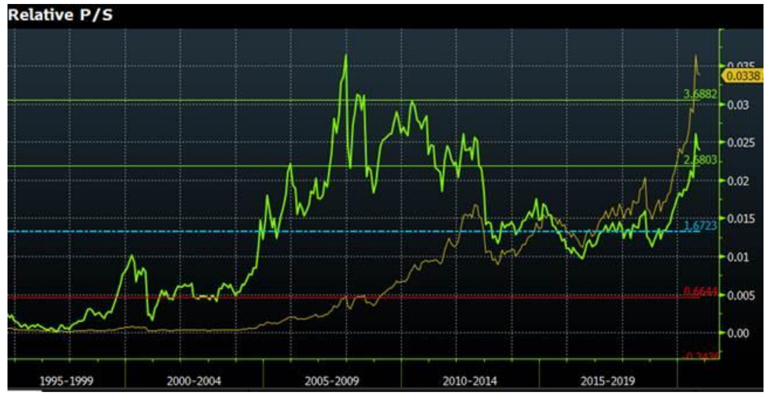
It is important to remember that the P/E ratio for any given stock is only as good as the price input (a fact) and the reported earnings input (apparently not a fact at all).

- **RDY** measures the yield of a particular stock compared to the yield on the S&P 500 and does so over long periods of time. Since a stock's relative yield and relative price are inverse, we can generally conclude that as a stock's yield is rising, its price is declining—similar to a bond. Consequently, a rising RDY provides an opportunity for investors to at least consider an underperforming, cheaply valued stock for purchase.

- Company managements and boards of directors pay the dividend out of free cash flow, not earnings. In maturing U.S. companies these seasoned professionals often operate within a "dividend paying culture" and set the dividend as a portion of long-term, sustainable real earnings power because management teams are loathed to cut dividends.

- The relative nature of the RDY metric is also important because it measures the relative attractiveness of a stock compared to its own history and compared to the S&P 500. (In 1992, I co-authored Relative Dividend Yield, Common Stock Investing for Income and Appreciation with Tony Spare)

- RPSR: In fallen-angel growth companies where the dividend is less of a factor in management's calculus, we look at sales—a fact. Rarely are sales manipulated and when they are someone usually goes to jail. The price-to-sales ratio measures how much investors are paying for a unit of sales, the relative price-to-sales ratio reveals what investors have historically paid for a particular company's sales compared to what they are paying for the sales of all the companies in the S&P 500. In 2003, I authored New Era Value Investing, John Wiley & Sons where I outline the benefits of RPSR in stock selection.



- Discipline, in summary, is the only way to navigate volatile markets. We remain disciplined and over time that consistency generates excess return.

Fundamental Research reduces the ownership of terminally cheap companies:
Meet the 12 Fundamental Factors.
Our proprietary research approach analyzes fundamental qualitative and quantitative factors.

- Qualitative Factors: Catalyst for Outperformance, Franchise Value & Market Growth, Top Management/Board of Directors.
- Quantitative Factors: Sales Growth, Operating Margins, Relative P/E, Positive Free Cash Flow, Dividend Coverage/Growth, Asset Turnover Ratio, Use of Cash (buyback, debt, div.), Leverage, Financial Risk.

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There is no assurance that a portfolio will achieve its investment objective.

Definitions and Indices

The S&P 500 Index is a stock market index based on the market capitalization of 500 leading companies publicly traded in the U.S. stock market, as determined by Standard & Poor's.
Unless otherwise noted, index returns reflect the reinvestment of income dividends and capital gains, if any, but do not reflect fees, brokerage commissions, or other expenses of investing. Investors cannot make direct investments into any index.

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