Gore Capital Management

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It seems that every year begins, to some extent, with a degree of hope and optimism about the next 12 months. It's in our nature to be hopeful (otherwise, what are we all doing here?). But 2021 feels a little different; the level of hope, optimism, and sheer desperation to return to normal has the entire planet rooting for these vaccines to be effective and to allow us all to get back to our regularly scheduled programming. You'll see this sense of optimism appear throughout our newsletter this quarter, but we'll also try to keep things level by examining the reasons that a degree of caution may still be warranted.

First, to COVID trends. Vaccination rollout has gotten off to a shaky start with some states handling the process better than others. However, we're starting to see new case counts dropping, indicating that the vaccines are indeed working. Raymond James's health care policy analyst Chris Meekins believes a new positive case rate of 5% or less (it's currently about 8% after a mid-January peak of about 12%) will signal that we are finally getting this thing under control. Hospitalizations and deaths are also down significantly from January, suggesting that not only are we slowing the spread of the virus, but we're also handling the resulting illness better too. It's important to note that, while the trends are improving, there's still a great deal of work to be done. We've seen how quickly the trajectory can change, so this is no time to stop being vigilant. (All data from Raymond James "Putting the Pieces Together" webinar, 2/8/21)

Next, a brief update from Washington policy analyst Ed Mills. It's Ed's belief that lawmakers will spend most of the year focused on stimulus and recovery efforts to bring the nation's economy back on line. He believes there's a high probability of a large $1-2 trillion package by the end of March with further legislation in the second half of 2021 focused on infrastructure spending and sustaining the economic recovery. He also thinks significant changes to the tax code are unlikely until the country can get back on its feet, with Congress more likely to focus on tax reform in 2022. Of course, Congress could make a small change to the code this year (like raising income tax rates on the top tier) before working on more comprehensive reform next year. We'll just have to wait and see. (From "Putting the Pieces Together," 2/8/21)

Fourth quarter earnings season has been much better than expected, with blended earnings growth of 1.7% versus an expected earnings decline of –9.3%. This is the first quarter of positive earnings growth since the end of 2019. Leading sectors included Financials (17.2% growth), Materials (16.7%), Technology (15.6%), and Healthcare (12.5%). Underperforming sectors were Utilities (-3.5%), Real Estate (-3.9%), Industrials (-54.8%) and Energy (-101.7%). Importantly the positive trend is not just reflected in earnings (which can be subject to some creative accounting) but also top-line revenues. The blended revenue growth rate for 4Q 2020 was 2.7%, also the first positive quarter in about a year. (All data from Factset, 2/5/21)

Looking forward, analyst expectations for 2021 earnings are lofty. According to Factset, the average year-over-year expected earnings growth rate for the full calendar year is 23.4%, with the bulk of that growth occurring during the second quarter. If you think back to last year, the April-June period saw the strictest lockdowns and weakest economic

Market Statistics	YTD (as of 1/312021)	2020	3-Year Annl.	5-Year Annl.
S&P 500	-1.04%	17.75%	11.06%	15.47%
Dow Jones Ind. Avg.	-1.98%	8.98%	6.38%	14.64%
Russell 2000 (Small Cap)	5.02%	19.50%	10.67%	16.03%
MSCI EAFE (Foreign)	-1.07%	7.82%	2.23%	8.84%
MSCI ACWI (Global)	-0.45%	16.25%	7.90%	13.56%
MSCI Emerg. Mkts. Equity	3.07%	18.31%	4.42%	15.03%
Barclay's Aggregate Bond	-0.72%	7.51%	5.49%	4.00%
S&P GSCI Gold (Spot)	-2.36%	24.42%	11.27%	10.63%

Source: Morningstar

activity, so it's no surprise that the same period this year is expected to have the best recovery.

The price-to-earnings ratio for the S&P, often used as a rough guideline for how "fairly valued" the market is, is 22. This is well above the 5-year (17.6) and 10-year (15.8) historical averages, indicating that market participants are very enthusiastic about earnings expectations for the coming year. When everybody is only focused on the good news, potential bad news (a slowdown in vaccinations, new strains of COVID which are vaccine-resistant, and so forth) is usually not well-received.

In addition to earnings, many analysts will forecast a price target for the S&P 500 for the coming year. CNBC polled 15 strategists from major investment firms at the beginning of the year and found the average 2021 year-end price target was around 4,080 points. For context, the S&P opened on January 4th (the first trading day of 2021) at about 3,765. Should the forecast be accurate, a rise of 315 points represents a price increase of about 8%. (Source: CNBC)

You will note that the expected return of 8% is considerably less than the expected earnings growth rate of 23.4% we quoted from Factset on the previous page. Many analysts, Raymond James's included, believe it is crucial for companies to print strong earnings growth numbers this year not only to justify current market prices, but also to set a foundation for future growth potential. Think of it this way: if earnings growth exceeds the increase in price, the price-to-earnings ratio will drop. A drop in P/E towards longer-term historical levels is an indication that the market may not be as overvalued as some of us may fear, and it also suggests that market prices can continue to rise as long as earnings can follow suit.

It's easy to imagine someone wondering, "if earnings are expected to be strong and analysts are forecasting a positive return for stocks, it must be time to pile in!" Not so fast, friend. As of this writing the S&P 500 is currently trading around 3,900. Assuming we're sticking with the same price target, the difference between 4,080 and 3,900 only amounts to an increase of a few percentage points from today's levels. It's still very early in the year; quite a bit can happen between now and December 31st, and it's hard for us to believe the market won't see some kind of pause or pullback as the year unfolds and some piece of bad news (even a minor one) scuttles the momentum. While we are "cautiously optimistic," we think that taking advantage of these pullbacks by buying (or reallocating) when prices are reduced represents a more prudent strategy than simply buying stocks indiscriminately today.

To that point, Raymond James's Chief Investment Officer Larry Adam implores investors to stick with their asset allocation strategies in 2021. Asset allocation can be a frustrating exercise—especially when markets only seem to rise—but, as you've heard us say many times, patient investors have historically been rewarded for maintaining diversified portfolios over the long-term.

Warm wishes for a warm spring!

Peter, Ben & Keri

SIX FUNDAMENTAL REASONS WE ARE OPTIMISTIC ON EQUITIES LONGER TERM

WHILE MARKETS ARE NEAR RECORD HIGHS, THERE ARE SIX FUNDAMENTAL REASONS WE ARE OPTIMISTIC LONG TERM

1. Year **1** of Current Bull Market
   Bull markets typically last ~6 years on average
2. S&P 500 Dividend Yield of **2%**
   ~61% of S&P 500 companies have dividend yields > 10-YR Treasury
3. Fed to Leave Rates on Hold for **3** More Years (Through 2023)
   Low interest rates will continue to be supportive of equity markets
4. **~4%** GDP Growth for 2021
   2021 expected to be best year of GDP growth since 2000
5. **$5** Trillion in Fiscal Stimulus Passed
   Additional round of fiscal stimulus will push total relief above $5 trillion
6. **6** Months Until Inoculation
   Reopening the economy will be a boost for economic activity and risk assets

This is a slide from RJ's equity portfolio strategist Mike Gibbs, presented during the "Putting the Pieces Together" webinar on 2/8/21

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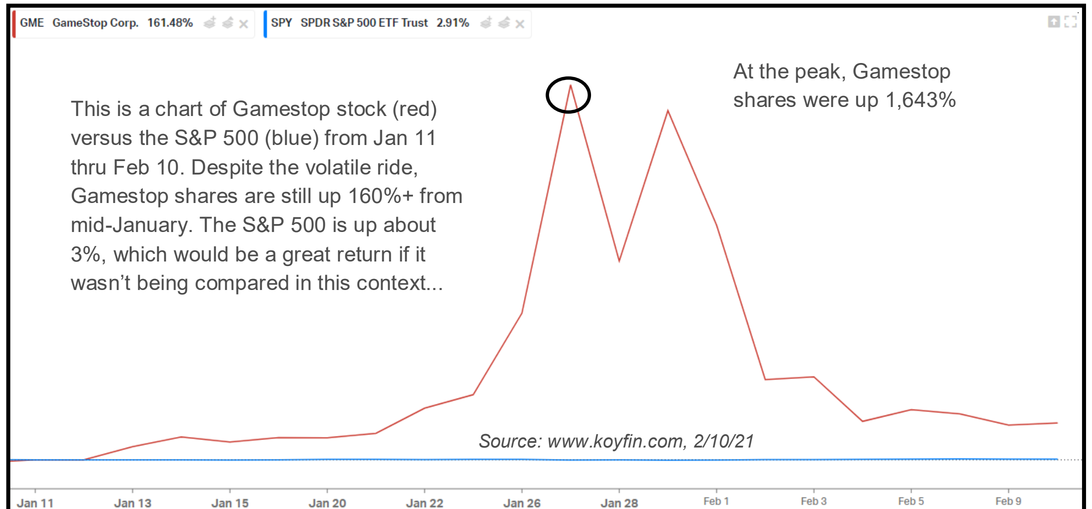
Ben's Corner

Whether you follow the financial press closely or not, you've likely heard the recent hullabaloo over Gamestop stock. I've noticed, though, that most of the stories making headlines are opinion pieces (usually extreme opinions at that) with a distinct lack of basic fundamental explanation of what really happened behind the scenes. That, then, is my objective in this short column.



Wall Street analysts have held a negative view of Gamestop for several years with a very simple thesis: video game sales have transitioned away from physical media towards digital. Gamestop has not figured out a way to stay competitive amid this change in consumer behavior and technology. COVID lockdowns will be the final nail in the coffin for the struggling retailer.

How does an investor express a negative opinion of a stock? Most of us just simply avoid buying it, but some (usually large institutions) might engage in short selling. This is the act of borrowing shares of stock from one investor and selling them to another. In theory, you can buy back the shares you borrowed at a lower price, give them back to the institution from whom you borrowed them, and pocket the difference between what you originally sold them for and the price at which you bought them back. For the sake of brevity, we'll ignore the philosophical question of whether short selling is a productive and useful investment practice. Suffice it to say that some large institutional investors were shorting Gamestop shares as a way of expressing their negative viewpoint.

Meanwhile, a user of the popular financial internet forum WallStreetBets performed his own analysis of the company. He published his research (a compelling piece, I may add), arguing that Gamestop was undervalued by analysts because the company's balance sheet was reasonably strong and they had just recruited a new board member with experience in e-commerce. This user put his money where his mouth was, posting a screenshot of his personal investment account with a large holding of recently-purchased Gamestop stock.

As 2020 came to a close, some other members of WallStreetBets noticed sentiment around Gamestop was so negative that some hedge funds had managed to sell short more than 100% of Gamestop's shares, an action that is technically illegal and should be impossible anyway. They posited that, if they could begin to buy up shares en masse, they could "squeeze" the short sellers into buying the borrowed shares back at astronomical prices (making money for themselves while causing huge losses for the short sellers). A similar thing happened to Volkswagen about 15 years ago which briefly made VW the most valuable company in the world as VW stock rose from €210 to over €1,000 in about two days.

As the short squeeze began and Gamestop shares climbed, more and more amateur investors jumped on the bandwagon, pushing the price of the stock from about $20 to nearly $500 (for a brief minute) in a matter of weeks. The pressure was so extreme that some brokerage firms had to temporarily bar their customers from buying Gamestop shares because they couldn't meet collateral requirements, something I don't think has ever been witnessed in financial history.

There are now rumors circulating that the hedge funds have covered their short positions (one fund was down 53% in the month of January), and it seems as though the air is finally being let out of the balloon. Shares of Gamestop are now trading in the $50s with a downward trajectory. That doesn't mean the story is over, though; lots of questions remain. Did WallStreetBets users and/or hedge funds violate securities laws? Did brokerage firms manipulate the market by preventing their customers from trading specific securities? Will short selling practices receive enhanced scrutiny going forward? Will anyone be held accountable, or will this whole thing just fade away?

News is now crossing the wire that the DOJ has subpoenaed information from Robinhood as part of their investigation. It will be interesting to watch this one unfold. I will be sure to bring you any highlights in future editorials.

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