KEIM ASSET MANAGEMENT, LLC
Preserving Your Lifestyle

January 13, 2021

A TOUGH YEAR

Dear Investor:

It's pretty clear there have been two major stories that dominated 2020. They are the recent elections and the COVID-19 pandemic. I generally refrain from discussing the political scene in my letters as that's not my purpose, and in deference to the fact that I have clients on both sides of the aisle with their own viewpoints. Obviously, government policies have a substantial effect on the economy and our portfolios. Working hard to understand their possible impact is an important part of our decision-making process when managing our clients' money.

Fortunately, the US economy is continuing to recover from the steep decline in the second quarter of this year. The growth rate for the third quarter was a big bounce back of over 33%. This was expected due to the huge amount of relief provided by the Government and the Fed. When I wrote my last letter, the forecast was in a range of 14% to 30%, so we came in over the high end of expectations. At the time, projections for the fourth quarter of this year were around 5%. That still looks reasonable, as the current forecasts are running from 2.2% to 8.7%. Regardless, our economy contracted well over $600 billion dollars in 2020. It will take at least 3% growth in 2021 to get back to where we were in December 2019. Thus, you could say we've lost at least two years of possible growth. As a brief sidenote, the total world economy at over $87.5 trillion in 2019, was down close to $4 trillion dollars for 2020. This is primarily a direct result of COVID-19 damage.

One of the big issues we are still facing is high unemployment. As I'm writing this letter, we just posted the highest weekly gain in unemployment since the pandemic started last March with 965,000 new applications. As I'm sure you know, there has been a strong surge in coronavirus cases coming off of the recent holiday season. We are at an all-time high in many regions. This has led to layoffs and business restrictions once again. The December jobs report showed a drop of 140,000 jobs after seven months of gains. The sectors that were hurt the most were restaurants, hotels, and the leisure industry. Many other sectors are recovering and are adding jobs. This is why we are still expecting solid growth in the fourth quarter. It's a mixed picture, but the bottom line is that the job gains since March are greater than the losses, and the economy is growing again.

The relief package of $900 billion that was just passed after the holidays will provide stimulus checks for many families and increased unemployment benefits for others. The financial effects of this will likely be seen in the early part of this year. The incoming Biden administration has plans for substantial additional relief. They are proposing a package in the range of

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$1.9 trillion. How it will all play out is not known, but it's certainly realistic to think that even more government help is coming fairly soon. The Fed has also made it very clear they don't expect to raise interest rates until the employment picture is much better than it is now. With all this in mind, what might 2021 look like?

Some US GDP Estimates for 2021 are as follows:

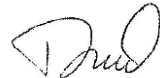
International Monetary Fund (IMF) +3.9%
Fed Open Market Committee (FOMC) +4.2%
Morgan Stanley +5.1%
Goldman Sachs +6.4%

This is an encouraging outlook, but realize these are not guarantees of future growth. They are simply intelligent projections of what could happen if we stay on our current path with no big surprises. We also have every reason to believe that as more and more people get vaccinated, there is the potential for growth to accelerate. This is what everyone is expecting, and it seems to make sense.

Turning to the stock market, we are looking at a different situation. At the beginning of the year, earnings for the SP500 were expected to be somewhere in the range of $178, an increase of $15 from the 2019 earnings of $163. As we know, this isn't going to happen due to the virus. Current estimates for 2020 are now $137, a drop of $26, or 16%. The question that comes to mind is why does the market appear to be doing so well if this year's earnings are going to be down around 16%? This has been a big issue all year, and I know I've mentioned it before. The answer is that there has been a very large expansion in the P/E ratio. Investors are willing to pay much more for the future earnings of the companies they own. This is not without controversy, as it has brought us into a very high-priced environment for shares. The biggest reason for this is Federal Reserve policy. Rates are expected to be low for a very long time. This makes stock market earnings more valuable as there are very few places for investors to get possible high returns on their money. The low interest rates that most other investments pay are barely adequate to keep up with inflation, if that. The danger that we face in this environment is if the situation changes in a relatively short period of time, and rates go up quickly, we can expect a sharp and painful market correction. We've been through several of these in the last decade and while it's no fun, we can get through it. When the time comes to increase rates, we always hope for a very gradual timetable. This would allow the P/E ratio to come down gradually and lead to what we call a soft landing. Current expectations are for the SP500 to end this year at over 4,000. As you know, this is not guaranteed. With growth reaccelerating due to the vaccine, it seems reasonable to think that stocks could continue to move up.

Thank you for working with us in 2020. Please contact us anytime to discuss your portfolio.

Best Regards,



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