Independent Investment Advisory

GKV Capital Management

Quarterly Update

Fourth Quarter 2020

Fourth Quarter Review

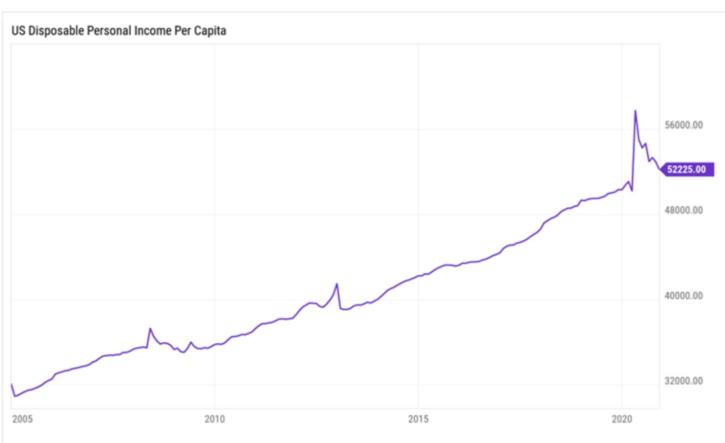
Post Pandemic Healing

Opening Thoughts

2020 is in the history books but it will not be one that we soon forget. Despite the pandemic, population lockdowns, forced closure of whole industries, global climate change induced natural disasters, demonstrations and riots, a contentious national election capped with a storming of the Capitol, the equity markets moved significantly higher.
Last year reminded us that the stock market is a poor proxy for the general state of the world. The pandemic, with its forced government shutdowns worldwide caused massive economic disruption as consumers changed their behavior. These changes crippled certain industries while benefitting others. But most importantly for the broad economy and the stock market, salaries and wages fell far less than we (and other economists) anticipated. Total employee compensation in the U.S. declined only 0.5% for the nine months from March to November 2020 versus the prior year. There are millions of lost jobs, however, most of the jobs lost are lower paying. The unemployment rate ended December at 6.7%, nearly double the number of people looking for work in December 2019 when the rate was 3.6%. But for many of these out of work employees, the massive stimulus in the CARES act, particularly the $600 weekly supplement to jobless benefits, enabled household income to remain stable and even increase in 2020. Total unemployment insurance programs paid out $500 billion more in 2020 than in 2019 and the $1,200 check paid to most Americans contributed an additional $276 billion. Including all the various stimulus programs, personal income increased 8% or $1.03 trillion from March to November 2020 over the same period in 2019.

Despite the rise in income, Americans were not able to spend all the additional income in 2020. Spending on services including restaurants, travel and entertainment fell by nearly $600 billion. Personal savings grew $1.56 trillion higher from March to November 2020. Extra cash in consumers' pockets, or their brokerage accounts is good for the outlook for the economy. It is also good for the price of cult stocks and Bitcoin.

Even with worrisome unemployment, the consumer generally is in great shape and there is pent-up demand to go spend in the post-pandemic. Broad new stimulus may not be necessary but is likely to come anyway which will lead to a further acceleration in economic activity. We expect the disruptions of the pandemic to wane by June with the continued rollout of effective vaccines. We are always looking for potential pitfalls, but we see good reasons to be optimistic.



4Q20 Data Points

DJIA YTD	**7.3%**
S&P 500 YTD	**16.3%**
NASDAQ YTD	**43.6%**
US Bond YTD	**7.5%**
10-Year Treasury Yield	**0.93%**
S&P 500 LTM Dividend Yield	**1.55%**
S&P 500 EPS Next 12-MTH	**$164.41**
S&P 500 P/E	**23x**

Fourth Quarter Review

The stock market is forward looking. As difficult as the recent past or even the current economic situation may be, investors are discounting future cash flows. The success of multiple vaccines has enabled the market to forecast an end to the pandemic. The outlook for recovery looks compelling. Despite the upheavals of the pandemic, consumers are generally in good shape. Meanwhile, a new administration promises additional stimulus and spending while the Federal Reserve keeps interest rates low and capital flowing.

Stocks rose sharply in 2020, although the gains were very uneven across industry sectors and even across the broad market indexes. The Dow Jones Industrial Average, which we discount as being representative of the market overall, gained 7.3%, the S&P 500, which we view as the most representative broad index gained 16.3%. The heavily technology influenced Nasdaq Composite gained 43.6% for the year. Smaller companies, as represented by the Russell 2000 index, lagged much of the year, but picked up sharply in the second half to close up 18.4%.

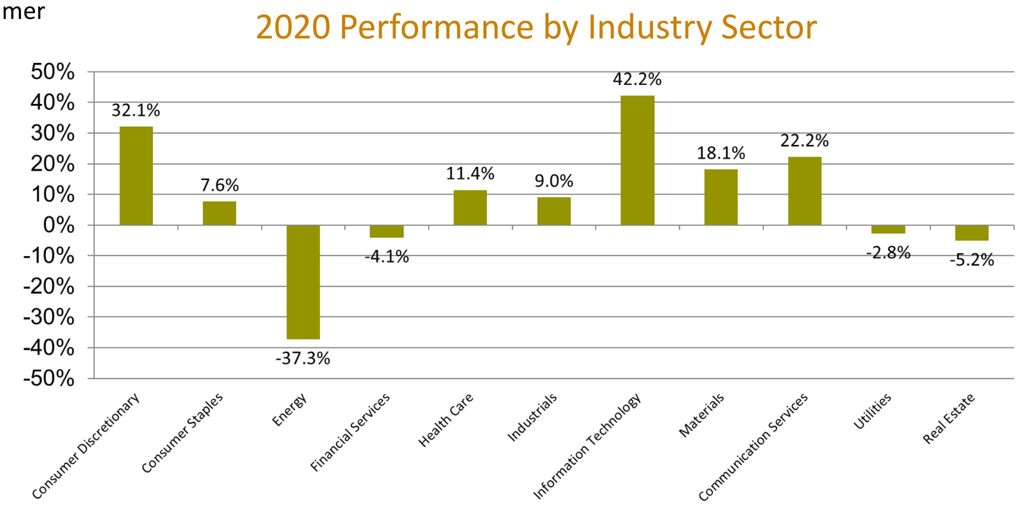
Dislocation among industry sectors was tremendous. Sectors that were relatively unaffected by the pandemic and the economic shutdowns predictably soared while areas exposed negatively to the forced changes in consumer behavior declined precipitously. Energy lost more than 37% in 2020 followed by Real Estate (driven by weak commercial values) down 5% and financial services down 4%. Technology soared 42% as many companies benefitted from workers stuck at home and consumption moving online. The consumer discretionary sector gained 32%. This sector includes retail computer and electronics sales as well as home improvement, appliances, and importantly, both Amazon and Tesla. Consumer discretionary does include hard hit hotels, resorts and cruise lines, which pared losses substantially to end the year down only 26%. Internet and direct marketing retail gained 68% in 2020 driven largely by Amazon.

Estimates for earnings of the companies in the S&P 500 began the year at a cumulative $183.37, representing 18% growth over the $155.84 recorded in 2019. With the pandemic, estimates for 2020 were slashed with analysts forecasting $109.06 for the year back on June 30th. With reopening and an improving economic outlook, the current forecast is for earnings to be $120.25 in 2020. While this is still a far cry from the old $184 estimate, the revisions are getting better rather than worse. The current forecast for 2021 is for earnings to reach $164 per share, which would put us slightly ahead of 2019.

The U.S. equity markets generally outperformed global equity markets, although all markets staged significant recoveries in the fourth quarter as a 2021 end to the pandemic became apparent. The MSCI EAFE (Europe, Australia, Far East) closed the year up 5.4%, Europe gained 8.3%, and emerging markets closed the year up 16%. Global GDP growth is expected to have shrunk 4.4% in 2020 due to the pandemic but is expected to rebound sharply by 5.2% in 2021.

Unemployment spiked to 14.7% in April and has subsequently declined to 6.7% by year end. For context, following the 2008 recession, the high point for unemployment was just over 10% in October of 2009. Consumer spending has remained positive due in part to the significant stimulus. This includes payments made to individuals, extra unemployment checks and payments to small businesses.

Interest rates around the world have been slashed largely to zero in an effort to encourage borrowing and bolster economic growth. The dramatic decline in interest rates has had a positive impact on fixed income investments. The 10-year U.S. Treasury yield ended the year at 0.93%. The Barclays Global Bond Index closed the year with a gain of 9.2% while the U.S. Bond Index gained 7.5%.



Post Pandemic Healing

"In the middle of a difficulty lies opportunity."

- Albert Einstein (1879-1955)

Chaos, turmoil, the unpredictable, sadness, prosperity and despair coupled with the tribulation of disoriented and disconnected lives affected by existential variables has become the remembrance of the past twelve months. The inequality of personal misfortune was illuminated more clearly than ever in 2020. In the Gospel according to Matthew there is the verse: "For to everyone who has will more be given, and he will have abundance; but from him who has not, even what he has will be taken away." Ignoring religious interpretation and context, in the past year the verse has been very applicable to the corporeal, secular world in which we live. The stock market soared, real estate values rose dramatically, technology and its workers generally prospered but the bottom 60% of the economic strata in our country in varying degrees suffered disproportionately. Much of the economic and personal inequality is a factor of the interaction of the myriad tentacles of government policy, primarily Federal Reserve policy. Since 1987, the country's central bank has correctly, in our opinion, supported financial markets with significant monetary stimulus when confronted with the possible occurrence of a national and worldwide collapse of our financial institutions. The Federal Reserve has repeatedly guaranteed large groups of financial assets during crises, thereby placing a floor against any collapse in the country's financial institutions and markets. It has also resulted in greater risk taking in financial assets under the umbrella of the Federal Reserve's guarantee of support. The Federal Reserve's policy decisions and legislated mandate are to preserve our complex financial markets. In 2020 it issued over $7 trillion of monetary stimulus and supported almost all areas of the capital markets, including real estate. The rise in real estate values is directly attributable to a Federal Reserve policy of almost zero interest rates and the constant monthly purchase of $120 billion of mortgage-backed bonds. It supports home purchases by enabling low-cost financing and an abundance of funds to finance the purchase of real estate assets. Its monetary stimulus was also the primary driving force in the significant rise in common stock prices in 2020. It is important to understand that the largess of money from the Federal Reserve goes toward the financial structure of our country and not to the local restaurant and business owner. It flows to the large corporations which can tap the capital markets for funds and not to the small local entrepreneur. In time the vast monetary stimulus provided by the Federal Reserve does get to the people, the economically bottom 60%, but it does not arrive immediately. It takes a considerable amount of time for the benefits of the Fed's monetary stimulus to positively affect the general populace. However, it works quickly for the financial markets, their institutions and large corporations with access to the capital markets. Most of the financial assets and real estate in the U.S. are owned by a minority of the country's population. This minority represents the top 20% economically. Financially it prospered during the pandemic and economic collapse caused by the lockdown. Because of the disruption of normal business, the large pools of money created by the Federal Reserve found their way into assets such as stocks and bonds. In those two categories we had asset value inflation.

Fiscal stimulus issued by Congress is the best mechanism to get money quickly into the hands of the people. The Cares Act passed by Congress in the spring of 2020 sent immediate financial relief of over $2 trillion to the general populace. The distribution of this money was somewhat imperfect in its implementation and suffered some abuse, but checks and government loans were quickly disseminated to all eligible parties. These funds helped the economy begin a recovery from its deep economic collapse in the second quarter of 2020. However, more fiscal stimulus from Congress was needed in the second half of last year but it became a victim of polarized politics and a Presidential election. The absence of this second stimulus package in the fall of 2020 caused the general economy to again relapse in the fourth quarter in the face of a resurging COVID-19 pandemic. Consequently, we ended last year with exceedingly large gains in asset values such as stocks, bonds and real estate, complements of the Federal Reserve, but the general economy as represented by Main Street was still suffering. The second needed fiscal stimulus package was mired in political stagnation.

In our opinion, the outlook for 2021 is very favorable. Many investors mistakenly fixate on politics in formulating their investment strategy. Many devoted Republicans forecast a bleak two- or four-year future for the country with a U.S. government controlled by Democrats. Many Democrats always predict the same for a U.S. government (Congress and Presidency) controlled by Republicans. The truth is far different from these preconceived, biased and ingrained misconceptions.

Financial markets are moved by the forecast of future economic conditions. The Federal Reserve is the primary variable. As we have said repeatedly politics and which political party is in power is a secondary variable at best. The political party controlling Congress and the Presidency has considerable power over issues such as judicial nominees, trade tariffs, trade agreements, social entitlements, such as social security and Medicare benefits, immigration and regulations but these are all tangential variables affecting the future growth of the economy. The Federal Reserve and its ever-present monetary stimulus in conjunction with fiscal spending by Congress are the issues of importance, not which political party controls the White House and Congress.

The investment performance of the stock market as measured by the Dow Jones Industrial Average since WWII has been almost the same during time periods when either the Republican or Democratic party controlled both Congress and the White House. When the Democrats controlled both houses of Congress and the White House the average gain was an above average growth of 15.7%. During time periods when both houses of Congress and the White House were controlled by Republicans, the investment performance results were almost the same with an average gain of 16.3%. Concerns over which party controlled all the branches of government are historically without merit regarding domestic economic growth and stock market investment performance.

Policy emphasis is different between the Democratic and Republican political parties. The incoming Democratic Party will alter some of the previous Administration's policies but the biggest economic event for 2021 will be the much greater emphasis on enlarged fiscal stimulus than was the case under the previous Senate and President. The inequality between the haves and have nots will be more immediately and effectively addressed under the new administration than was the case for the outgoing leadership. The gap between Main Street and Wall Street will lessen but remain large. With greater emphasis on corralling the COVID-19 pandemic and getting more money directly to the bottom 60% of the people, we should see the American economy steadily rebounding from its poor performance of 2020. By 2022 we are confident the U.S. economy will be at its level of economic output experienced in 2019, the latest year unaffected by the pandemic. It is likely that growth in 2022 will exceed the levels of 2019.

In 2021 GDP growth will probably exceed 4% for the first time in a decade. If the inoculations of the COVID-19 vaccine become quickly widespread allowing people to resume a more normal life, GDP projections for this year may be too low. Such accelerating growth may make current stock market valuations look reasonable. Annual GDP growth during the Obama and Trump years was usually 2%.

Corporate earnings growth this year may equal and exceed their peaks in 2019. We said earlier that the stock market did so well last year because the Federal Reserve was so expansive in its money supply growth, creating a huge demand for assets such as stocks, bonds and real estate. The Federal Reserve will not alter this stimulative policy in 2021 and it will be partnered with extensive fiscal largess by Congress and encouraged by the Biden administration. The result will be an economy which is robust and more effectively firing on all cylinders since 2007. A result of the government's expansionary policies will be strong corporate earnings growth this year. Wall Street since the election is anticipating the positive dual effects of consistent Federal Reserve policy this year and greater fiscal stimulus from a Democratic Party controlled government. These two expectations have driven the stock market steadily higher since November 3. Price/earnings ratios for companies, in the light of more predictable, reinvigorated corporate earnings growth this year, do not look quite so excessive as a couple of months ago. Very low interest rates for 2021, large amounts of monetary liquidity, greater fiscal stimulus and more prosperity on Main Street than last year will generate a more normal economy and should translate into additional decent asset price growth in 2021.

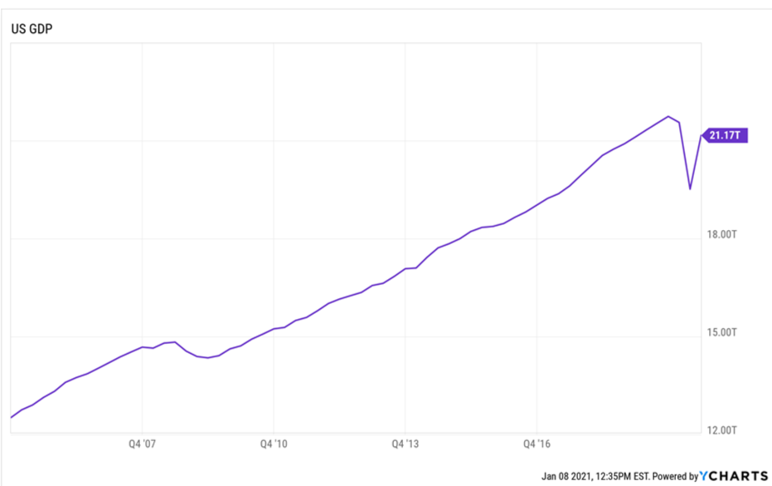
It is expected that the Biden administration will increase personal and corporate tax rates by 2022. This kind of legislation takes time, so any increases through formal legislation will not occur before 2022. Traditionally Republicans have been against federal deficits and Democrats have been more prone to deficit spending. During the last four years both political parties have completely embraced deficit spending. And the Federal Reserve is committed to monetizing all government deficits. Ironically, under the current Biden administration, its proposed tax increases will help to slow the growth in our federal deficit, but it will certainly continue to expand for the next four years. The proposed tax increases under the Biden administration will primarily affect the wealthiest 1% in the country and wage earners with annual incomes in excess of approximately $500,000 if married and filing jointly. The proposed top individual tax rate will return to its former 39.6%, up from the present 37%. These tax law changes, if enacted, should prove to be a boon for the tax-free municipal bond market. Of greater concern for the stock market, a rise in corporate tax rates will impede corporate earnings growth modestly. Also, ordinary income tax rates on dividends and capital gains, if passed, may have a negative effect on stock prices, but this is not certain. A large percentage of stocks are owned by tax free retirement funds. A change in the capital gains tax rate may result in less stock trading and alter psychology more toward longer-term investing. The individual public reentered the stock market in a big way during the pandemic last year. This increase in individual participation in the stock market clearly helped drive stock prices higher. Speculation increased broadly. As the pandemic hopefully subsides this year, the individual investor may not be as involved in speculating on prices and day to day investing for themselves. Perhaps we will see a little less volatility in the stock market especially in the more speculative small capitalization companies as the public returns to a more historically normal use of its time.

As a result of the pandemic, productivity in the country increased significantly above its usual trend line. The volume of goods consumed per worker has increased substantially in 2020 as a result of significantly greater online purchasing. It requires fewer employees, produces greater efficiency and less expensive real estate assets. The offset is that employment is probably in a long-term secular decline in consumer distribution industries. The rise in productivity in conjunction with rising wealth for a large percentage of Americans due to the rise in savings, increasing home values and higher stock prices coupled with the large cash balances held by major corporations augurs well for the maintenance of present stock market valuations and their further advance this year. In 2021 we expect unemployment caused by the pandemic to continue to decline from the levels of last summer, but it will take into 2022 to approximate the levels of 2019.

We anticipate changes in the regulatory environment. The Trump administration significantly reduced industry and environmental regulations. The impact on corporate profitability was small but positive. Over the next few years, we anticipate an increase in government regulations both for individual industry components and the environment. The Biden Administration will rejoin the Paris Climate Accord abandoned by Trump. Also, in his pre-election speeches Biden has gone on record as an advocate of renewable energy and the creation of a "green new deal." Scientific analysis, data and research will again be the predominate variable in determining our path toward self-sustaining energy, the greening of the environment, the reduction in industrial pollution and harnessing climate change. The new administration's employment projections within the next 10 years from innovative renewable industries is optimistic but growth in these areas will be steady and pronounced. Just as technology has disrupted traditional industries and has been life altering in the last 25 years, renewed government and private industry interest in the "greening" of America will again disrupt many conventional industries, create new industries and change our life patterns in ancillary ways. This movement became muted during the last four years but is again recognized as essential and will be reinvigorated. The present oil and auto industries are on the cutting edge of being severely disrupted from their traditional present operations in the next ten years.

Regardless of political affiliation, the last four years have been politically chaotic. No long-term economic plan or strategy was ever formulated. Government economic policies were always ad hoc inspirations of primarily one man and were subject to frequent changes. The chaotic political season is winding down. Business will again begin to see some consistency to government policy. We will again see the country's economic direction move to support continuing globalization with some significant modifications. Factories and the relocation of American jobs will not be moved to foreign nations. International trade, however, will reaccelerate and tariffs will be removed to pre-2016 levels or eliminated. A modified doctrine of utilizing "comparative advantage" will again find its footing in international commerce. "America first" in general will no longer be the guiding economic policy. However, the pandemic and China friction has altered the pre 2016 concept of globalization. Some domestic industries are correctly seen as vital to the country's welfare and cannot be hollowed-out. The country needs to be able to provide for the basic welfare of its citizenry from domestic production before creating a dependency on foreign sources. China is now recognized as an adversary to the U.S. in many ways. It has engaged in the theft of American intellectual property, it has pursued xenophobic unfair business practices and closed or restricted many of its markets to Western companies. Trade and business by the U.S. and Europe with China will probably increase over the coming decade but it will occur under the auspices of much more regulation and government guidance. Look for the United States in the next four years to advocate and join more international trade agreements. The United States will dismember its isolationist policies of the past four years and renew its commitment to world cohesion.

In assessing the government and Federal Reserve's responses to the pandemic in 2020 and the proposed responses in 2021, an objective analysis of these policies will recognize the rising threat of increased inflation as a result of the flood of monetary stimulus and deficit spending. There also exists the possibility that pent-up demand will outrun the production of goods once the pandemic is under control. The consumer has larger than usual amounts of cash and savings available for spending as we enter 2021, while production capabilities have been reduced in response to the pandemic restrictions. For a short time, we may find demand outrunning supply, causing an acceleration in inflation. It is very possible that inflation may approach 3% this year, exceeding the Federal Reserve's 2% goal. Until the economic recovery is complete, and unemployment is reduced to 2019 levels, it is doubtful the Fed will change its stated monetary policy in 2021. But in 2022 we may see the Federal Reserve remove its support of the mortgage market and allow an increase in interest rates within a range of 1 to 2%. The housing industry would be negatively affected quickly in this new environment, while benefiting financial institutions such as banks and insurance companies. Also, the "there is no alternative" to stocks argument which has persisted correctly for the last 4 years, will come under pressure as interest rates rise, making bonds an increasingly attractive alternative. Rising interest rates into the 1.5% to 2.0% range as measured by 10-year U.S. Treasury bonds should start to compress stock price/earnings ratios and possibly impede capital appreciation potential. We do not foresee this eventuality before the last half of 2021, and it may not happen. Inflation, like interest rates, is extremely hard to predict.



Some investors fear massive government deficit spending under the new administration and argue that the country will move too far toward the left in its economic policies. We argue that the Democratic Party does not have the political capital to effect sweeping changes in our economic system. Instead, we think we will see a more centrist approach to economic policy proposals. Although the new Senate is controlled by the slimmest of margins by the Democrats, we may see that the real power for future legislation during the next four years rests in the hands of the three senators who are not attached to either party. They are all moderates, so compromise and serious negotiation may emerge once again in Congress versus the polarization and outright rebuking of contrary ideas which has existed for the past six years. A new more reasoned tone in the dialogue in Congress should be viewed optimistically, in our opinion. In this legislative environment it is very doubtful regulatory overkill will happen. We expect to see a major infrastructure bill pass Congress this year as moderates prevail over previously polarized political thinking regarding such legislation.

As this year progresses, we will see not only stronger corporate earning versus 2020 but also strong revenue growth. These two all-important determinates of stock prices will compare favorably with the poor performance of 2020 and will probably exceed 2019 levels. There are myriad variables which affect stock prices and some rise in importance for short periods of time and then recede, but earnings and revenue growth are always the constant critical variables in determining the future direction of the stock market. Right now, both variables will perform well in 2021. Furthermore, as the Federal Reserve and Congress keep the monetary stimulus flowing, optimism will prevail, and investor psychology will remain in a "risk-on" attitude.

In 2020 we experienced a unique year. We witnessed both a massive bear market and a massive bull market. No market forecaster made this prediction. This has never happened before. The pandemic created unique circumstances. But now we are looking forward to a more normal investment environment for the next few years. Risks and rewards will exist, but within the pattern of greater stability, greater predictability and fewer unknowns.

As we move further into this decade the large gap between the "haves" and "have nots" will remain but lessen as the economy returns to a more stable trajectory. This will be viewed as a positive event for stability and should increase confidence in our economic policies. Right now, inequality cuts across all data metrics: economic wealth, investment opportunity, demographics, age, health, living environment and personal rights. Regardless of changes in how we work and live, we forecast a slow but healthy reduction in the present inequality which has grown larger for decades. With more personal economic reward and satisfaction with one's life and with a greater belief that government is including all peoples in its policies, we think we will be in an environment more tranquil and conducive to investment. Reflecting on the words in the Gospel of Matthew, perhaps in this decade we will see those who have will receive more and those who have not will again participate more fully in the wealth of the nation. The past decade was filled with political and domestic discord. Perhaps the nation's people are tired of the disharmony and wish to move forward toward a better environment.

Southern California
299 W Hillcrest Dr.
Suite 119
Thousand Oaks, CA 91360

Northern California
1350 Treat Boulevard
Suite 260
Walnut Creek, CA 94597

Phone: 805-497-2616
www.gkvcapital.com
E-mail: greg@gkvcapital.com

Independent Investment Advisory

GKV Capital Management is an independent investment advisory firm registered with the Securities and Exchange Commission since 1975. We provide portfolio management services for our clients which include individuals, families, charitable trusts, corporations and retirement plans. We are an independent, fee-only advisor. We do not receive commissions and we do not sell any financial products. We have a fiduciary responsibility to put our clients' interest first.

Client accounts are separately managed and tailored to meet the specific needs, including risk tolerance, investment objectives, and tax consequences of each client. Client assets are held at an unaffiliated brokerage firm.

With extensive expertise in security analysis, we make direct investments on behalf of our clients buying individual securities. This eliminates costly mutual fund fees and increases the flexibility to manage volatility. We actively allocate capital to take advantage of investment opportunities altering exposure to individual companies, industry sectors, and asset classes in anticipation of the changing investment and economic environment.

We are transparent in all facets of our asset management practice and believe it is important for our clients to know what they own, why, what their performance is, and what they are paying in fees.

We build comprehensive portfolios for our clients with a goal of reducing volatility and producing prudent growth. We protect and build wealth at GKV Capital.

GKV Capital Management

Build Your Wealth to Fund Your Passions