COLORADO FINANCIAL MANAGEMENT®

Economic & Market Review

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Partner & Chief Investment Officer

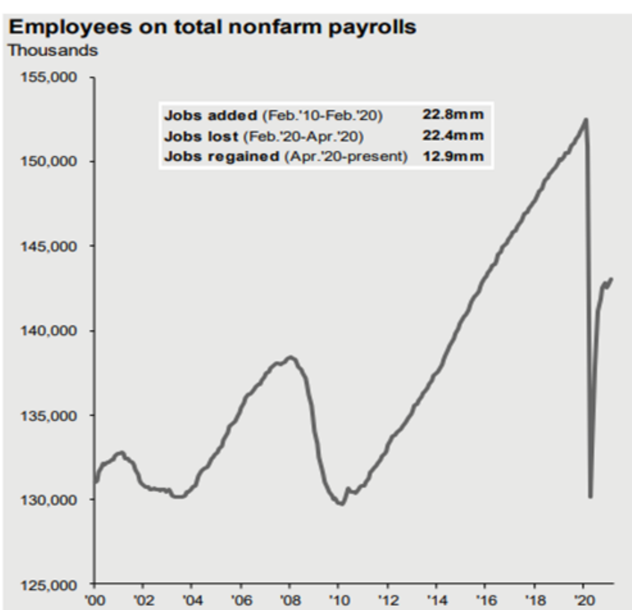
April 2021

As Of 03/31/2021	Year to Date	Last 12 Months	Last 5 Years (Annual)
60/40 Balanced World Index (VSMGX)	1.4%	30.9%	12.2%
World Equity Index (ACWI)	4.6%	54.8%	17.2%
U.S. Large Cap Equities (S&P 500)	6.2%	56.1%	20.6%
U.S. Small Cap Equities (Russell 2000)	7.8%	97.9%	21.9%
Foreign Equities (ACWI-ex U.S.)	3.5%	49.4%	12.2%
U.S. Bonds (AGG)	-3.4%	0.7%	4.6%
Global Bond Index (BNDX)	-2.9%	1.8%	4.1%
Cash & Equivalents (VMFXX)	0.0%	0.1%	1.0%

Dear Clients and Friends,

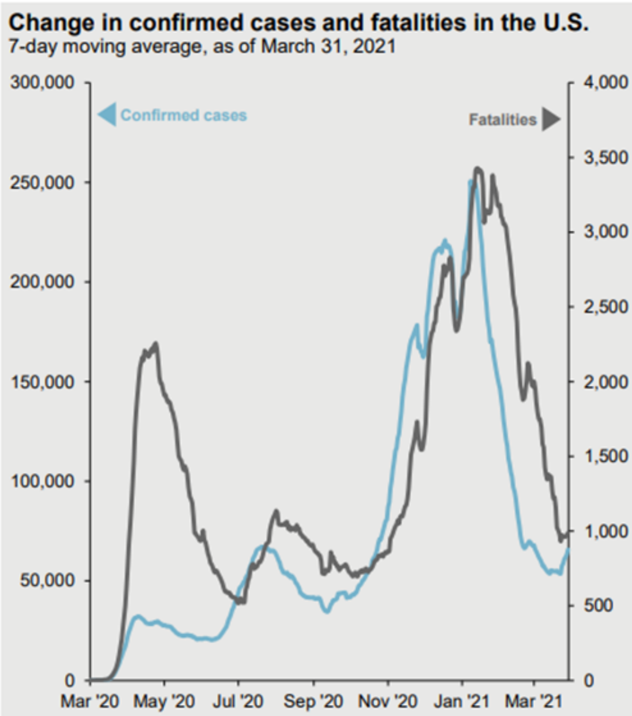
Those are eye-popping numbers! It is worth pointing out that the 12 month returns are from the depths of the correction, but even the 5 year returns are above average.

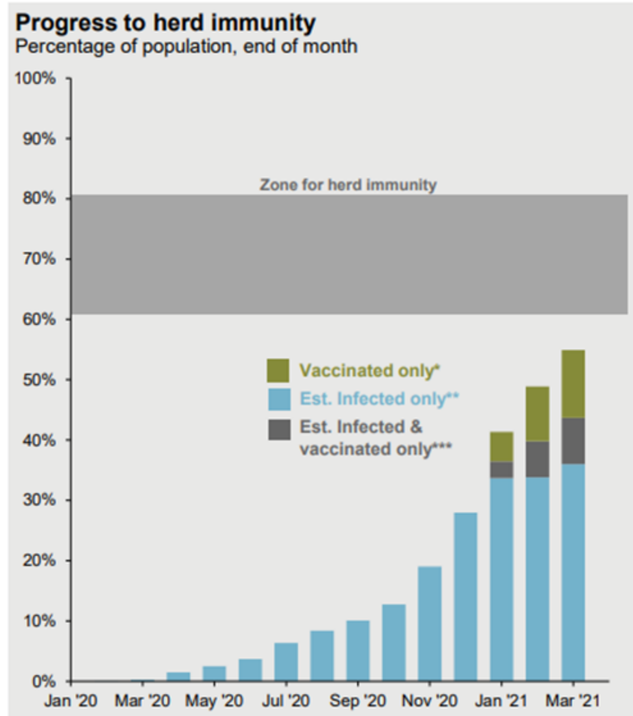
Let us try to explain the why behind the past numbers and provide a little insight into what to expect as we go forward. When COVID-19 began last March, we went through an unprecedented shut down of the economy – exemplified by the drop in employment. The stock market plunged at the same pace.



Source: Bureau of Labor Statistics, J.P. Morgan Asset Management.
Guide to the Markets – U.S. Data are as of March 31, 2021.

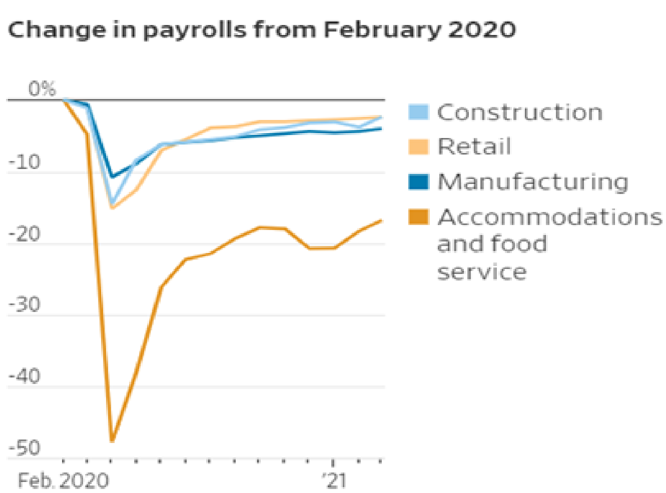
This was a new and unexpected crisis. But almost as quickly as it began, investors realized it would be a temporary phenomenon. We didn't know how it would be resolved, but we were confident it would be. Arguably, the market got ahead of the fundamentals by September, and last October through November there was a pause in the market's trajectory. At the same time, we faced a surge in cases as shown below.





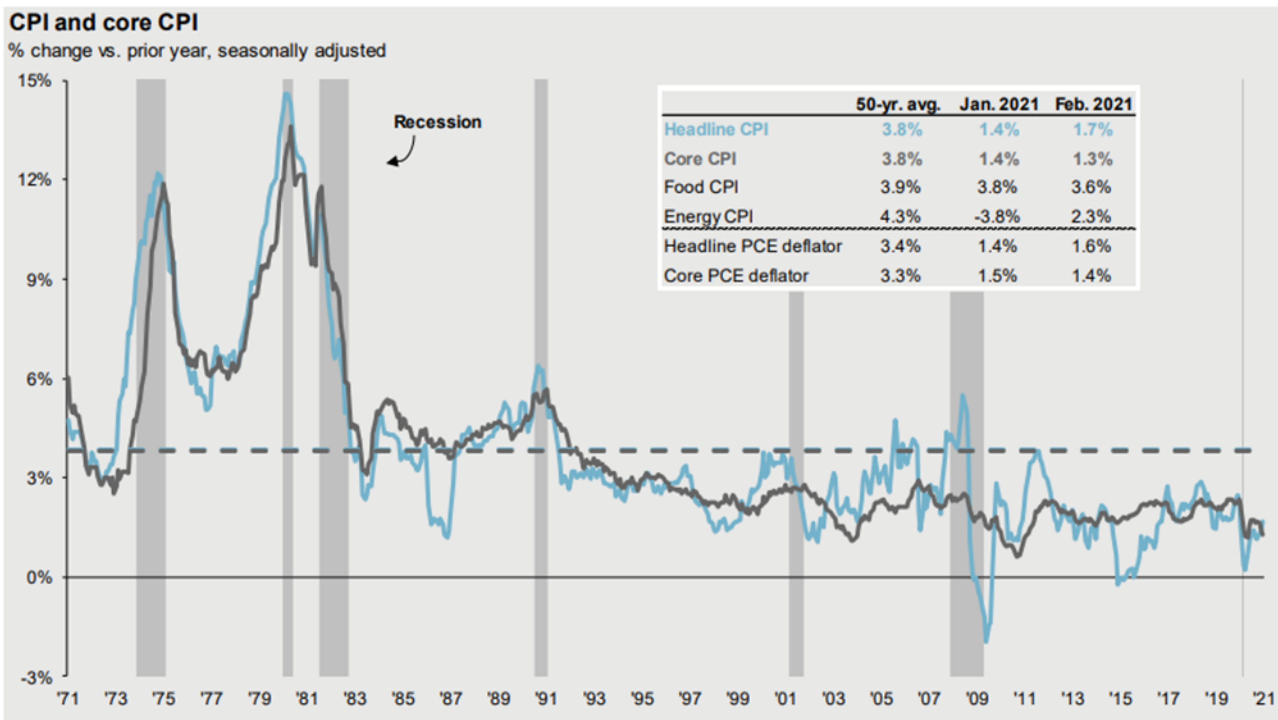
The surge peaked in January and we are now approaching the zone of herd immunity that we need to move past this crisis. As everyone knows, however, it is a race against time since new COVID variants are coming fast and we can not be sure how effective the vaccines are against them. I would hope and expect the fatality numbers to continue to fall since we have focused on vaccinating the most vulnerable in our society. In fact, yesterday (April 4th) just 222 deaths were reported in the USA – the fewest since March 23, 2020.

We cannot say for certain there will not be another surge, but it certainly looks like we are fast approaching something like a more normal environment. Last month we added 916,000 jobs in the USA and the unemployment rate fell to 6%. There are still 8.4 million fewer jobs than in February 2020, but we are clearly headed in the right direction. This strength in the economy comes even



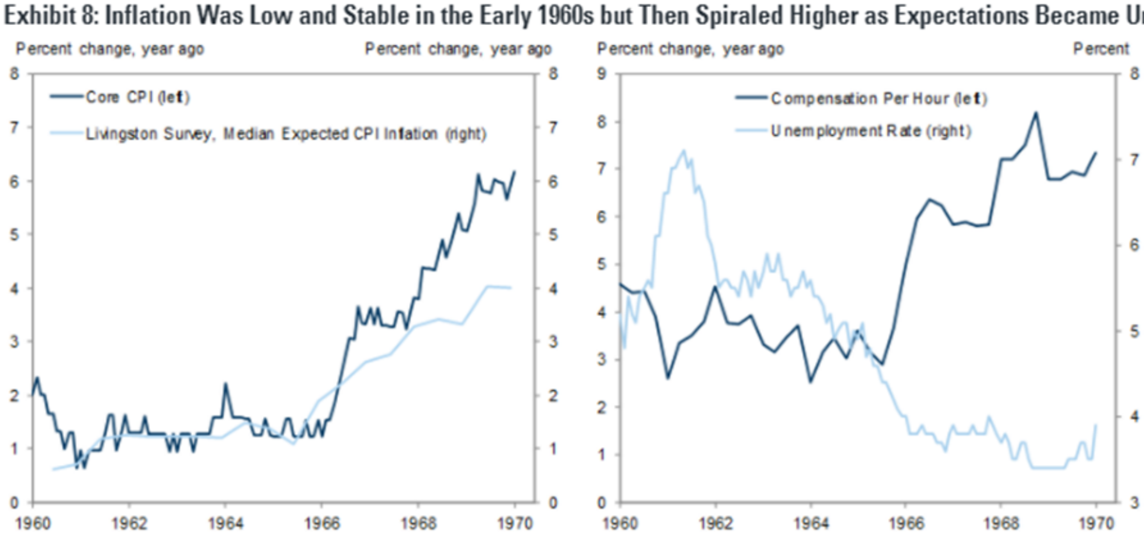
before the government's stimulus program has taken effect, so we can expect even stronger growth as we go forward.

With economic growth estimated to possibly reach 7% this year and 4% or better next year, some economists are beginning to worry about inflation. We continue to believe that inflation is anchored by long term structural factors. As shown in this chart, inflation has not been consistently above 3% since the 1980s.



What would it take to see inflation rise like it did in the 1970s? It would require a combination of labor costs <u>consistently</u> rising, and inflation expectations rising. Shown below are charts of how those factors got out of hand in the 1960s.

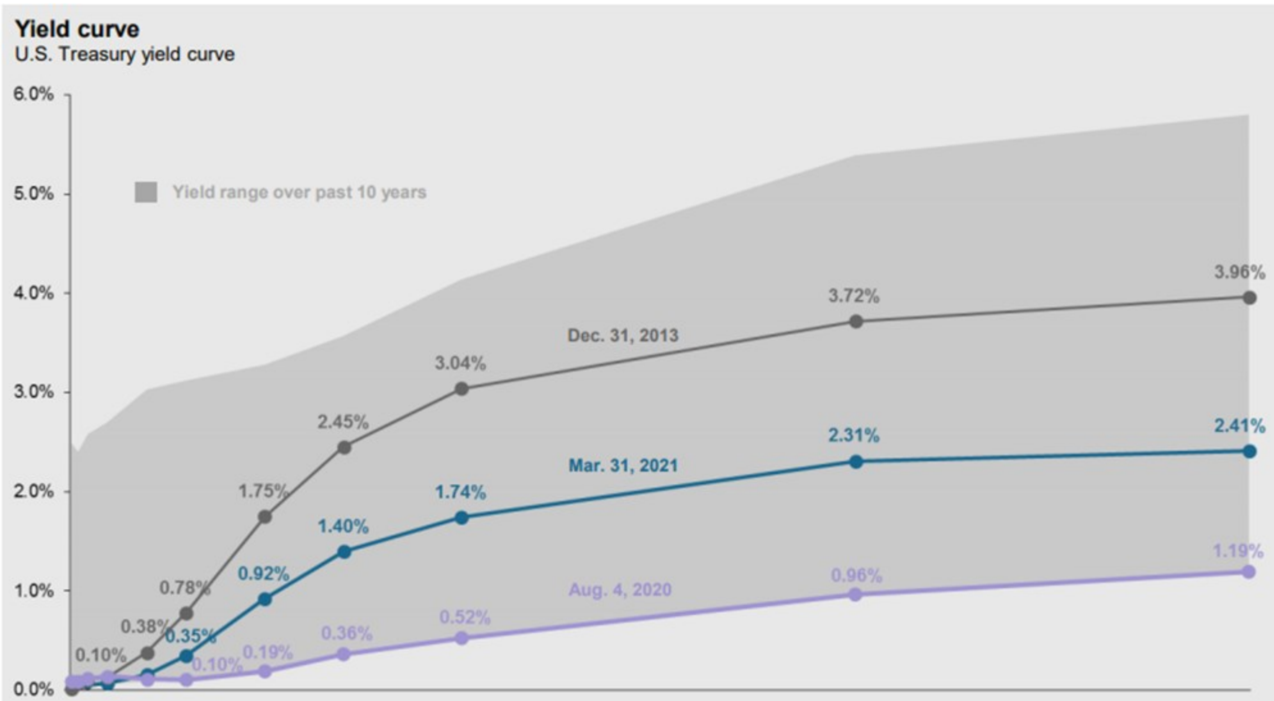
Exhibit 8: Inflation Was Low and Stable in the Early 1960s but Then Spiraled Higher as Expectations Became Unanchored



Source: Department of Labor, Department of Commerce, Haver Analytics, Goldman Sachs Global Investment Research

The Fed made a series of policy blunders in the 1960s and 1970s that arose from both conceptual errors and political pressure. Today, having learned from past mistakes, the Fed now sees keeping long-term inflation expectations anchored at 2% as a paramount goal. There is no guarantee they won't blunder again, but economists and the institution of the Fed have learned from prior mistakes.

However, while they want expectations anchored at 2%, the Fed has been telling us for some time now that they want to see inflation rise to a little above 2% to offset a decade of below 2% inflation. Already, longer term interest rates have increased to reflect this. Since last August, the benchmark 10 year Treasury yield has risen from 0.52% to 1.74%.



This is still a low rate if inflation rises to 2% - 2.5%. It means there continues to be a negative inflation adjusted yield. I don't expect rates to rise to the 2013 levels as shown above, but it would be surprising if they don't rise to at least the level of inflation. This means continued low returns on Treasury bonds unless the circumstances change.

S&P 500 earnings and valuation

	Goldman Sachs Portfolio Strategy		Consensus Bottom-Up	
	2021E	2022E	2021E	2022E
EPS	$181	$197	$175	$202
Growth	27 %	9 %	23 %	15 %
	NTM	2022E	NTM	2022E
P/E	21.2x	19.8x	22.3x	19.4x

Source: I/B/E/S, FirstCall, Goldman Sachs Investment Research

Turning to stocks, as the economy recovers so do corporate earnings. Estimated earnings growth this year is as high as 27% with another 10% possible next year. We do not argue the market is cheap, but at 19x – 21x forward earnings, and interest rates as low as they are, we do not think valuation is going to drive the market lower. It probably will act as something of a speed bump, and if there are negative surprises there could be a correction since positive expectations are priced into the stock market.

Reluctantly, let's take a look at the political debate today – at least the one regarding taxes and infrastructure spending. There is little question that the USA's infrastructure needs updating. We have roads and bridges dating back a century or more. We have no high-speed railway. A water main breaks every two minutes wasting 6 billion gallons of water each day. Our airports were underfunded by $111 billion as of 2019. Transmission lines are inadequate as proven in Texas this winter. One in five school aged children lack high speed internet needed for stay-at-home school.

In contrast, China has over 23,000 miles of high-speed rail… enough to link New York and Los Angeles more than eight times.

But here, once again, the debate has taken its usual form. According to polls, polarization remains but is worse in Washington than in the country at large. Some politicians are against any form of tax increases to pay for increased spending. Other politicians want absurd levels of spending with no plan for paying for it. The Federal gasoline tax, which goes to pay for infrastructure is 18.5 cents per gallon. It hasn't been increased since 1993. Common sense says it should be indexed to inflation. And, what are we going to do when most cars are electric? The need for roads and bridges won't go away, but the tax revenue to pay for them will.

So far, the only tax increase that has been proposed is one on corporations from 21% to 28% and to impose some kind of minimum corporate tax. There is talk of other taxes to come, but so far this is the only proposal. There is no point in commenting on tax changes that haven't been proposed yet. We will review them when they are. The previous law had a top corporate rate of 35%, but companies could get credit for foreign taxes and other expenses. Few companies (if any) pay anything close to the top marginal rate.

Infrastructure spending is economically friendly. Increases in taxes are generally not. With all the stimulus in the system, tax increases are unlikely to slow down economic growth. There will be winners and losers from tax changes, but it is too early to identify them and taxes are only one factor and rarely the most important. This is really the most important point to remember. Taxes are but one factor in our very complicated economy, in the profitability of a given corporation, or even in the motivations of an individual. If you Google 'taxes and economic growth', you will find an article to prove either side of the argument you wish. I would argue based on almost 40 years of experience and a dose of common sense:

- The Reagan tax reform of the 1980s was the only tax reform in the last 40 years that made a real difference (in my opinion). In that change, rates were slashed but so were deductions.
  - At the same time, breaking the inflation cycle and bringing interest rates down was ultimately more important.
- The effective tax rate on corporations before the recent reduction was 27.7%. The average of rich countries was 27.2%[1]. The effective rate is total taxes divided by total income.
- The tax cuts under the Bush and Trump administrations had little effect on longer term economic growth. Other factors had a much larger impact, and in the end all we had was a larger deficit and a lot more debt.
- There have been a number of tax increases over the last 40 years (Bush 1, Clinton, Obama) that were underwhelming in their effect on the economy. It used to be that there was great concern over the annual deficit that drove bi-partisan efforts to control it. Today, there is no concern about the deficit.
- Congress gives hundreds of billions in tax breaks to a variety of industries. The largest is probably real estate, but there are also giveaways to liquor producers, motorsports, electric vehicles, and others. Tax rates are not the only factor.

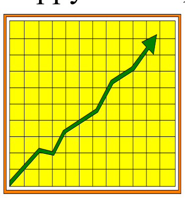
I don't like taxes. Nobody does. But could we stop pretending that we can have everything and never pay for anything? And could we stop pretending we don't need government? Government pays for roads, bridges, defense, police and fire departments, schools, social security, health care for the elderly and the poor, and much more. Our society depends on these things.

[1] Economic Policy Institute, June 4, 2013, Corporate tax rates and economic growth since 1947

Finally, the market trend is still bullish and sentiment is still too optimistic. So far this year we have had a correction of only 4% that lasted a couple of weeks. As always, be prepared for 10% correction any time, but we continue to believe the weight of evidence says maintain our current policies… slightly overweight stocks, underweight bonds and cash.

Thank you for your continued confidence.

Happy returns,



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And Your Entire Colorado Financial Mgmt. Team

Index Definitions & Disclosures:

Standard and Poor's Index

- **S&P 500:** The S&P 500® is an unmanaged index that is widely regarded as the best single gauge of large-cap U.S. equities. The index includes 500 leading companies and captures approximately 80% coverage of available US market capitalization.
- **60/40 Global Balanced Growth Index:** The index is rebalanced in March and October and is comprised exclusively of exchange-traded funds (ETFs) from a list of eligible ETFS. The determination of the weights of the instruments representing the various asset classes is done based on a review of the relative market capitalization of certain benchmark indices as of the rebalancing reference date. For equities, 60% of the index is comprised of any or all of the following ETFs: iShares Core S&P 500 ETF, iShares Core S&P Mid-Cap ETF, iShares Core S&P Small-Cap ETF, iShares Core MSCI Intl Developed Markets ETF, iShares Core MSCI Emerging Markets ETF. For Fixed income, 40% is comprised of any or all of the following ETFs:iShares Core Total USD Bond Market ETF and iShares Core International Aggregate Bond ETF.

Morgan Stanley Capital International (MSCI)

- **MSCI All Country World Index:** The MSCI ACWI Index is designed to represent performance of the full opportunity set of large- and mid-cap stocks across 23 developed and 24 emerging markets. As of September 2018, it covers more than 2,700 constituents across 11 sectors and approximately 85% of the free float-adjusted market capitalization in each market. The index is often used as a benchmark for global equity portfolios. Investments in international and emerging markets include exposure to risks such as currency fluctuations, foreign taxes and regulations, and the potential for illiquid markets and political instability.
- **MSCI All Country World Index Ex US:** The All Country World Index Ex-U.S. (MSCI ACWI Ex-U.S.) is a market-capitalization-weighted. It is designed to provide a broad measure of stock performance throughout the world, apart from U.S.-based companies. The MSCI All Country World Index Ex-U.S. includes both developed and emerging markets. For investors who benchmark their U.S. and international stocks separately, this index provides a way to monitor international exposure apart from U.S. investments.

Bloomberg Barclays Indices

- **Bloomberg Barclays Global-Aggregate Total Return Index (Hedged):** The Bloomberg Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging markets issuers.
- **Bloomberg Barclays U.S. Aggregate Bond Index:** The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency).
- **Barclays Capital 1-3 Month U.S. Treasury Bill Index:** The Barclays Capital 1-3 Month US Treasury Bill Index includes all publicly issued zero-coupon U.S. Treasury Bills that have a remaining maturity of less than 3 months and more than 1 month, are rated investment grade, and have $250 million or more of outstanding face value. In addition, the securities must be denominated in U.S. dollars and must be fixed rate and nonconvertible.

Other Indices

- **Russell 2000® Index:** The Russell 2000® Index measures the performance of the small-cap segment of the US equity universe. It includes approximately 2,000 of the smallest securities based on a combination of their market cap and current index membership. The Russell 2000® is constructed to provide a comprehensive and unbiased small-cap barometer and is completely reconstituted annually to ensure larger stocks do not distort the performance and characteristics of the true small-cap opportunity set
- **Vanguard Federal Money Market Fund** invests at least 99.5% of its total assets in cash, government securities, and/or repurchase agreements that are collateralized solely by government securities or cash (collectively, government securities). As government agency securities, the fund's holdings have very high credit quality, although most are not backed by the full faith and credit of the U.S. government. The average maturity typically ranges from 30–60 days, and the fund maintains a dollar-weighted average maturity of 60 days or less, and a dollar-weighted average life of 120 days or less.
- **Vanguard Total World Bond ETF** seeks to track the performance of a broad, market-weighted index that measures the investment return of investment-grade U.S. bonds and investment-grade non-U.S. dollar-denominated bonds.

Performance Calculation Disclosures: a) Time weighted returns are used; b) Cash and equivalents are included in the balanced composite, but not in the equity or fixed income composite; c) Gross figures do not reflect the deduction of investment advisory fees for all clients. Therefore the return would be reduced by the advisory fees in some cases. d) Returns are not GIPS compliant; e) Total return includes the reinvestment of dividends and capital gains.

Past performance is not to be construed as a guarantee of future performance. Returns are presented for the period shown and may differ for future time periods. Composite is a broad reflection of performance. Prospective clients should recognize that each client's account is customized and performance can vary widely.

References to specific investments should not be construed as a recommendation by Colorado Financial Management to buy or sell securities.

Past performance is not an indication of future results, and as is the case with all investment advisors that concentrate on equity investments, future performance may result in a loss. Portfolio holdings and weightings are subject to change at any time due to ongoing portfolio management. Portfolio returns given are after trading costs but not after fees. Returns do not reflect the holding of cash in the account, if any. This report is for informational purposes only.

Colorado Financial Management, LLC (CFM) succeeds registration as Sargent Bickham Lagudis, LLC. Sargent Bickham Lagudis, LLC (SBL) succeeds registration as Sargent and Company. SBL's registration was effective March 8, 1999. Sargent & Company's registration was effective in 1988. Sargent Bickham Lagudis merged with Colorado Financial Management effective January 1st, 2016. For the year 2016 and after, the composite performance will include both firm's households for each asset class. For returns before 2016, only returns from legacy Sargent Bickham Lagudis will be included in the composite.

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