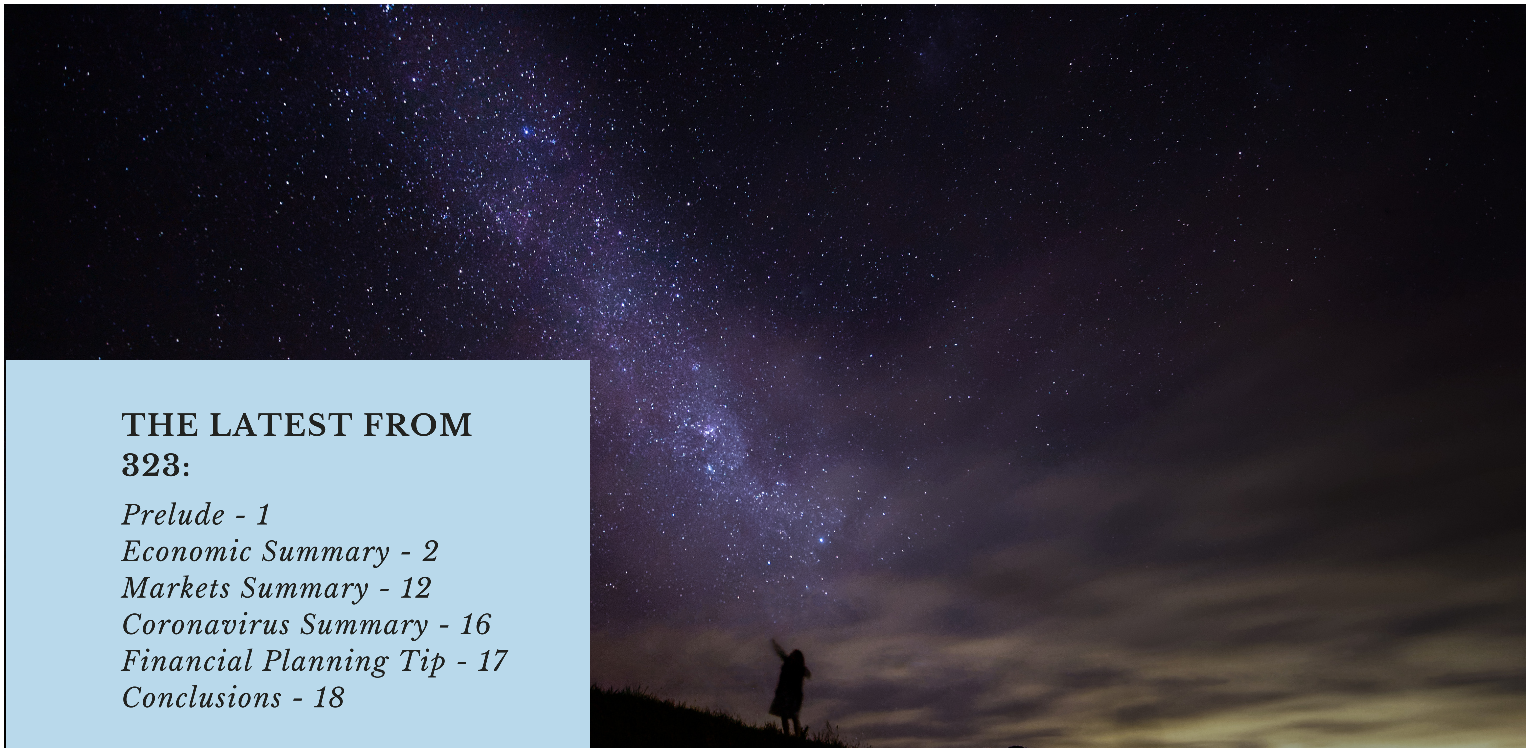
April 8, 2021

323 QUARTERLY UPDATE

The Newsletter of 323 Wealth Management LLC



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PRELUDE

Story by Greg Wilson, CFA, CFP, MBA

For the first quarter of 2021, the season of chaos continued. There were continued election issues, a massive winter storm, and meme stocks. However, if you take a step back and look through the chaos, the undercurrent is relatively positive. Ok, fair enough, you might have to take a few steps back.

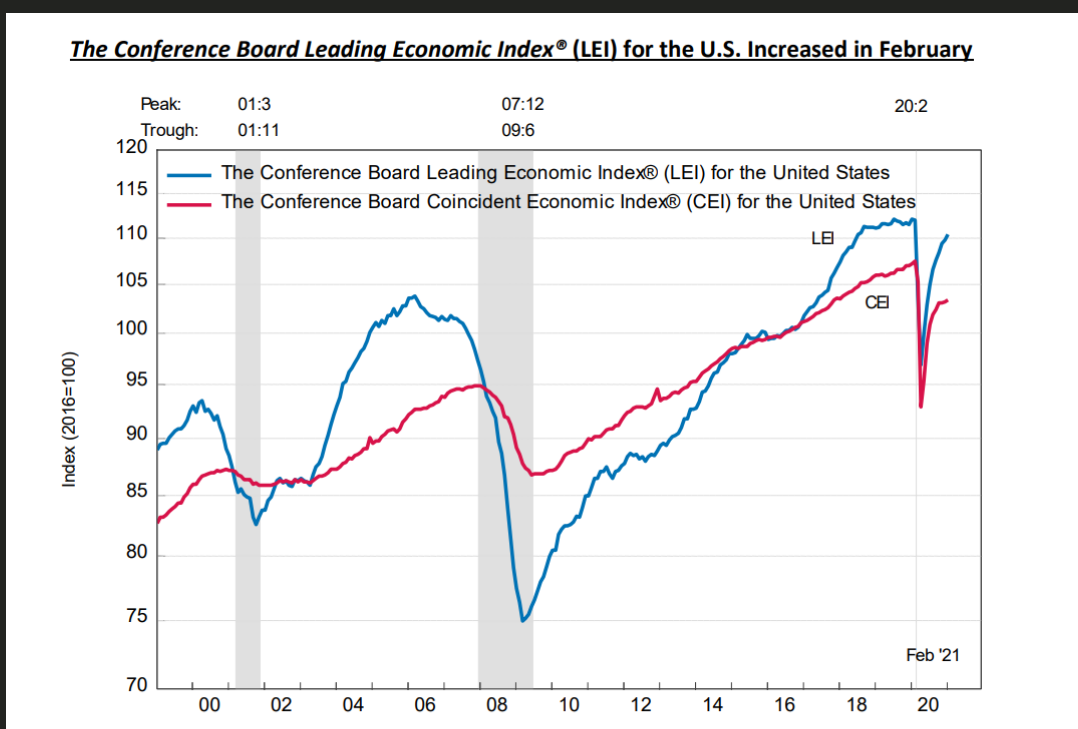
For investors, the first quarter of 2021 was robust. The economic rebound continued and there was more optimism on the pandemic front. There is still a long ways to go. The economic recovery is far from complete. There are many areas of the economy and many businesses that will continue to struggle for quite some time, for instance, businesses associated with travel and leisure. There are investor concerns such as valuations, rising interest rates, and potentially higher corporate income tax rates that prudent investors must address and manage. I will unpack all of this over the course of this update.

Understanding the economy is one of the first steps to understanding investing.

ECONOMICS SUMMARY

Continued V-shaped Recovery

I have discussed the LEI previously. The index continues to recover and is approaching a level last seen prior to the pandemic. This is an encouraging sign, but some of the other fundamentals need to catch up.



Source: https://www.conference-board.org/us/

ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued V-shaped Recovery

The U.S. economic data continues to recover. Unemployment is down. House prices are up. GDP is recovering, although not back to its pre-pandemic level. Most economists were predicting a long road to recovery for corporate profits (earnings), but I was more optimistic. The American consumer has proven time and time again that they have a propensity to spend. Once the initial shock and fear of the pandemic wore off, this trend continued (see the chart below). Couple this momentum with unprecedented fiscal stimulus and you get a recipe for recovery.

Source: https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Continued V-shaped Recovery

Understanding the economy is one of the first steps to understanding investing.

The unemployment rate continues to trend downward and I expect this trend to continue as more and more regional economies open up.

Source: https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Continued V-shaped Recovery

Home prices continue to climb as the long-term trend in mortgage rates continues to decline or stay lower. Please note that the home price graph is a year-over-year percentage change in prices.

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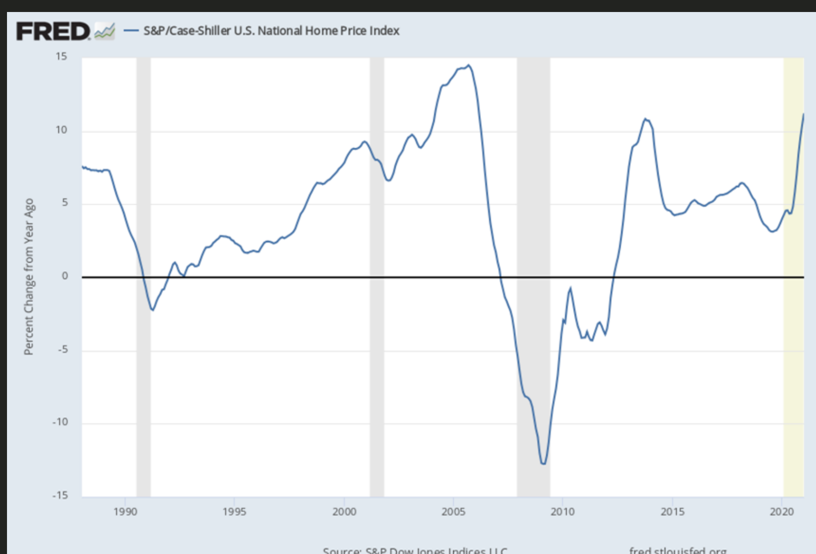
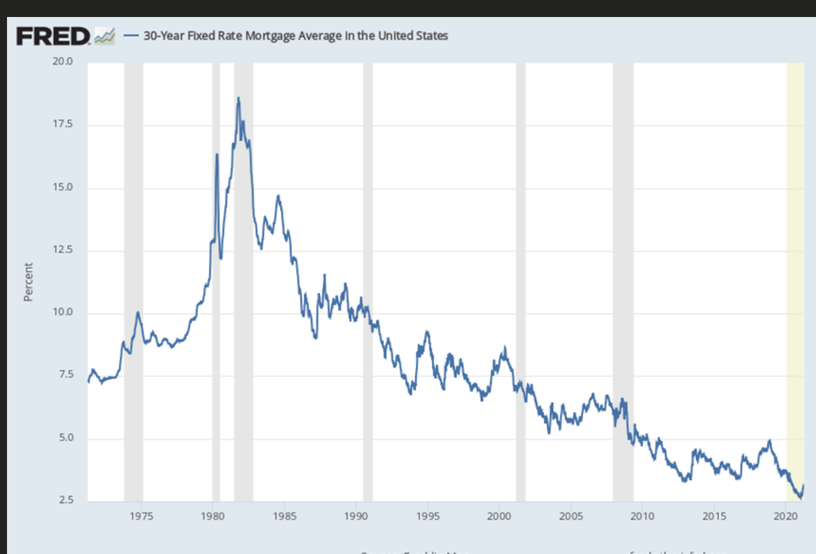




Source:
https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Continued V-shaped Recovery

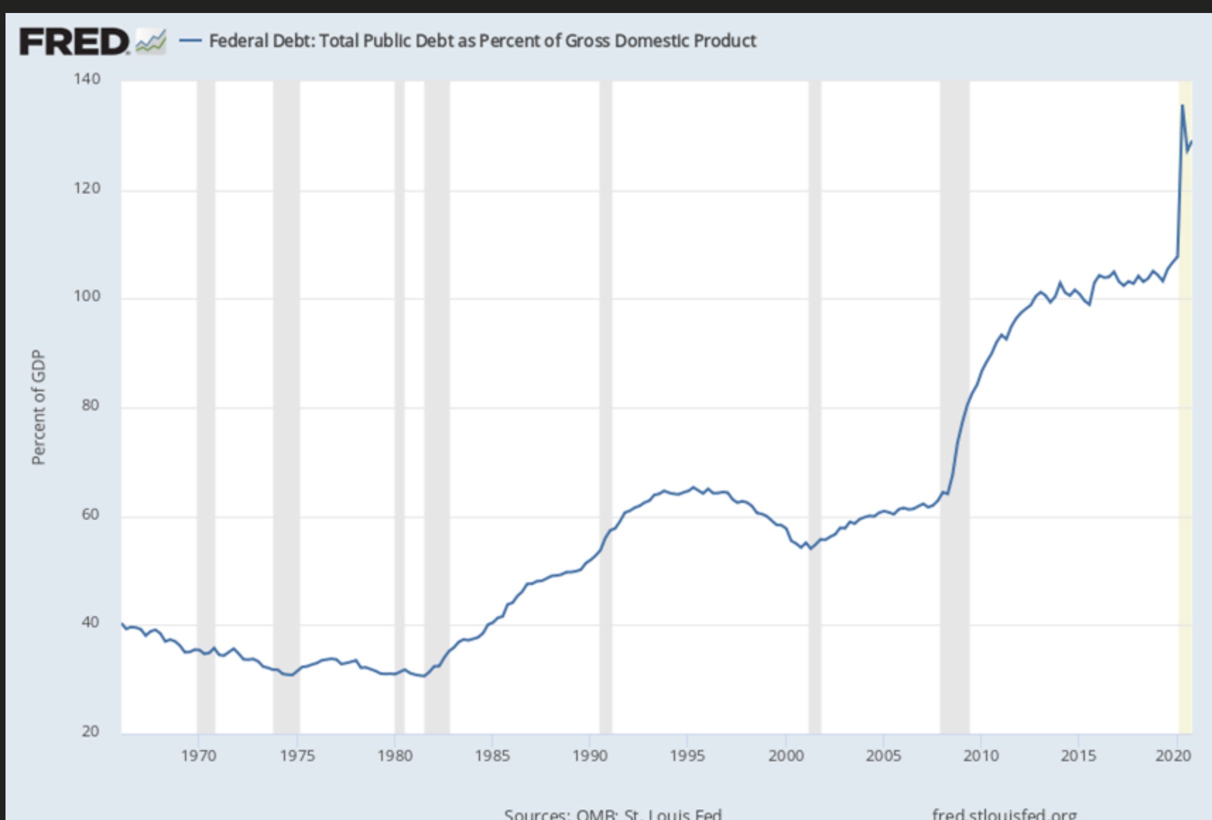
Understanding the economy is one of the first steps to understanding investing.

While I think there are plenty of economic undercurrents to be optimistic about, it is not all blue skies and rainbows. The U.S. federal debt as a percentage of GDP has ballooned to over 120% (see the chart on the next page). While I am not a fan of measuring the federal debt in this manner, it is a popular way to view this metric. I prefer to look at all funded and unfunded liabilities in absolute terms, but that seems to be too scary, so most economists avoid it. As a secondary way to view this data series, I like to look at it in terms of a interest coverage ratio. An interest coverage ratio compares a company's earnings per year to it's interest costs on it's debt per year. It's simply a measure of how many times over that company can cover the interest payments on it's debt. I have yet to see anyone who looks at the federal debt interest cost this way, but they should. As interest rates rise, this debt interest cost will rise which will cause greater budget deficits and thus greater borrowing to cover those deficits. This is an exponential equation with a feedback loop. In other words, it can get out of hand very quickly. I am not sounding the alarm. I am just making a few observations. I could be wrong, but I think at some point, the price will need to be paid for the expansion of the federal debt and constant deficits. Having studied thousands of years of financial history, this scenario typically has 4 potential outcomes and often times a combination of the 4. 1) Lower currency valuation; 2) Monetization of debt which is already occurring via the Federal Reserve's electronically printing of more money to buy the extra debt being issued; 3) Higher interest rates; and 4) Inflation. Prudent investors need to understand the economic landscape, both now and in the future. This is what I continue to do for my clients.

ECONOMICS SUMMARY (CONT.)

Continued V-shaped Recovery

Understanding the economy is one of the first steps to understanding investing.



Source:
https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued V-shaped Recovery

As you can see from the chart below, Corporate Profits have rebounded back above their pre-pandemic level. Most economists were predicting several years for this type of recovery. As I previously mentioned, I have been more optimistic than most and I remain so.

Source: https://research.stlouisfed.org/

ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued V-shaped Recovery

Let's talk about interest rates. I hear a lot of talk from the talking heads on TV about rising interest rates. I understand their job is to driver viewership. But, my job is to guide my clients and protect their financial futures, so let's clarify a few things. "Rising" interest rates are not to be feared. In fact, I would push back on the entire rising interest rate theme which is why I put the word "Rising" in quotation marks. The graph below shows the 10 year U.S. Treasury Bond Rate for the last year. This is known as the benchmark rate for interest rates. I think that is an oversimplification, but let's go with it. Looking at this graph and, in particular, the red arrow, it appears that interest rates are, in fact, rising. Let's take a look at the next page and graph.

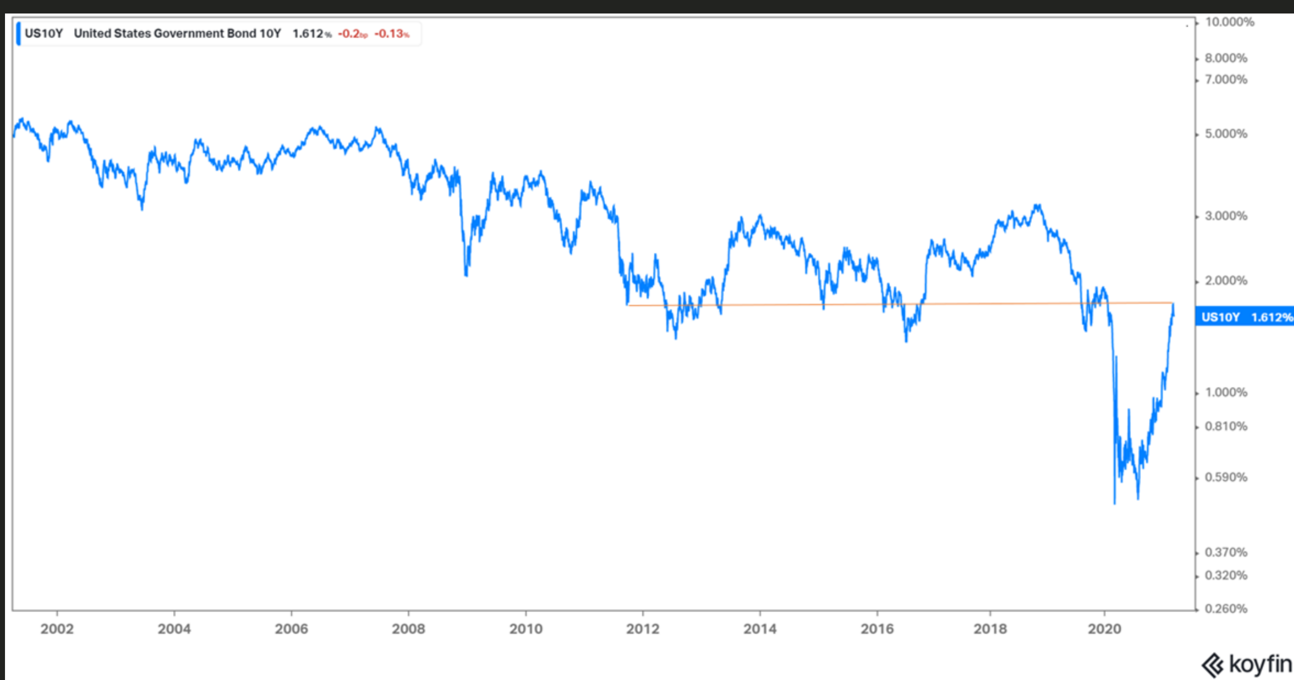
Source: www.koyfin.com

ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued V-shaped Recovery

This graph represents the same 10 year U.S. Treasury Bond Rate, but for the last 20 years. As you can see, interest rates may be "rising", but they are simply back to their pre-pandemic level. In fact, they have further to run in my estimation. I would not be surprised to see the 10 year U.S. Treasury Bond Rate climb to 2.5%-3% by the end of summer. I would consider that a return to a healthier level.



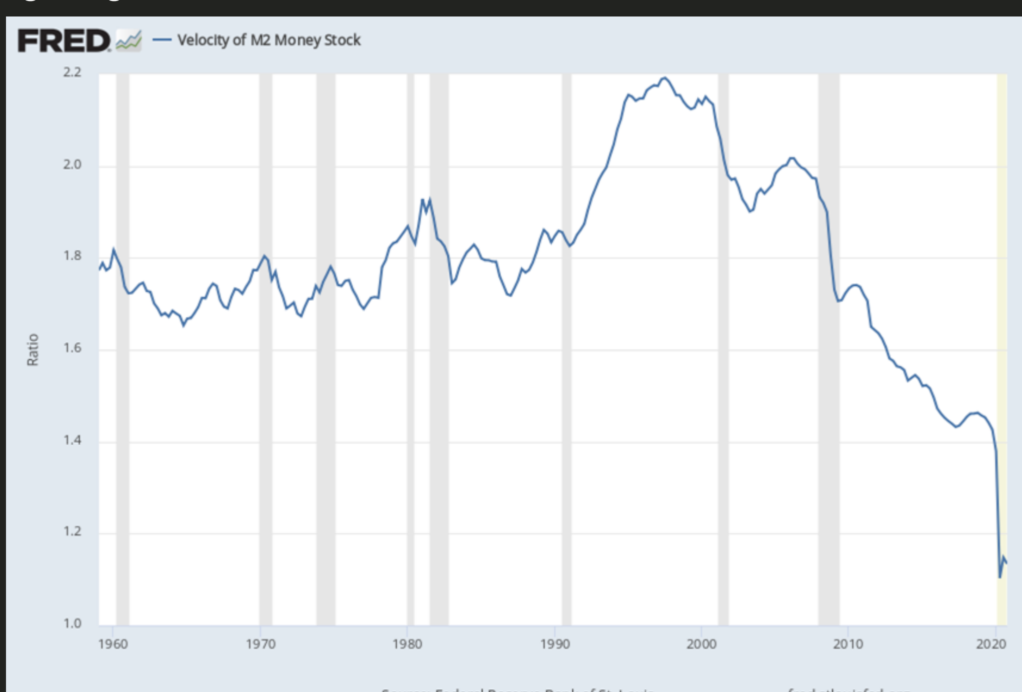
Source: www.koyfin.com

ECONOMICS SUMMARY (CONT.)

Understanding the economy is one of the first steps to understanding investing.

Continued V-shaped Recovery

Ok, the next topic is fairly technical, so feel free to skip to the next page if you prefer. I think it is an important topic, but I also understand how boring it can be. The velocity of money is how fast money moves through the economic/financial system. The higher the velocity, the more times a dollar changes hands and the greater the impact on economic growth. As you can see from the graph below, the velocity of money has plummeted, most notably from the Financial Crisis of 2008-2009. Some of the potential causes are more stringent bank capital requirements in the wake of the subprime mortgage crisis along with changes in consumer spending and savings patterns. In addition, corporate spending slowed tremendously following the Financial Crisis. The reason I bring this up is not to scare anyone. It's actually the opposite. In my estimation, there is room to run on the upside if we can get the velocity moving. Visualize a coiled spring being released.



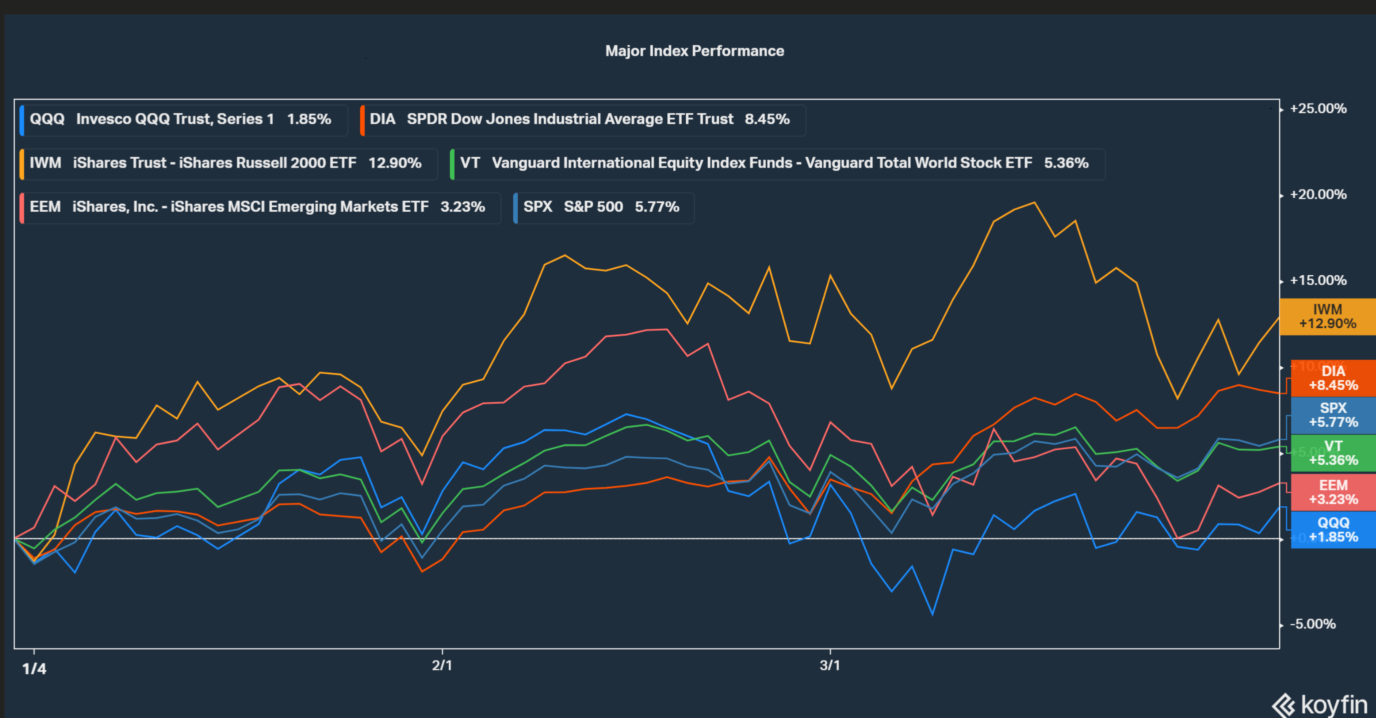
Source:
https://research.stlouisfed.org/

MARKET SUMMARY

Continued momentum

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.

The U.S. stock market continues to climb to all-time highs (please see the graph below). Small Caps (IWM) led the way while the Nasdaq (QQQ) took a backseat. While there are continued spikes in volatility, the overall trend has been down for the last 12 months and for this first quarter.



Source: www.koyfin.com

MARKET SUMMARY (CONT.)

Sectors

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.

I wrote extensively about valuations in my 2020 annual update. You can review that topic here https://323wm.com/archive. Let's talk about sectors first. The Energy sector had, by far, the best performance of Q1 2021. But, even with that robust performance, the sector is still negative since the market peak of last year. In addition, it's P/E (Price to Earnings ratio) looks stretched compared to most of the other sectors. When you combine those fundamental metrics and the historical volatility of the sector, the risk/reward dynamic does not appear encouraging at this time.

Returns and valuations by sector

GTM – U.S. | 15

Equities

	Energy	Materials	Financials	Industrials	Cons. Discr.	Technology	Comm. Services*	Real Estate	Health Care	Cons. Staples	Utilities	S&P 500 Index	
S&P weight	**2.9%**	**2.7%**	**11.3%**	**8.8%**	**12.4%**	**26.6%**	**11.1%**	**2.5%**	**13.0%**	**6.1%**	**2.7%**	**100.0%**	Weight
Russell Growth weight	0.1%	0.8%	1.9%	4.7%	16.5%	44.2%	11.9%	1.7%	13.7%	4.5%	0.0%	100.0%	
Russell Value weight	5.2%	4.7%	20.6%	13.7%	7.7%	9.4%	9.5%	4.4%	12.6%	7.1%	5.0%	100.0%	
QTD	31.1	6.1	13.5	7.7	0.5	-0.5	7.4	6.7	1.2	-1.0	0.6	3.9	Return (%)
YTD	31.1	6.1	13.5	7.7	0.5	-0.5	7.4	6.7	1.2	-1.0	0.6	3.9	
Since market peak (February 2020)	-4.6	30.0	10.3	15.9	25.9	27.7	24.7	-2.1	12.4	6.9	-6.9	17.1	
Since market low (March 2020)	116.5	103.5	93.3	98.7	84.4	85.5	74.6	57.1	55.9	40.7	44.6	76.8	
Beta to S&P 500	1.55	1.18	1.23	1.16	1.11	1.07	0.98*	0.73	0.78	0.60	0.28	1.00	β
Correl. to Treas. yields	0.55	0.50	0.66	0.55	0.33	0.36	0.50*	0.17	0.23	0.18	0.03	0.47	ρ
Foreign % of sales	51.3	56.8	30.1	43.8	34.0	58.2	44.7	-	38.5	32.7	-	42.9	%
NTM earnings growth	839.7%	29.0%	21.2%	71.9%	40.3%	16.0%	14.0%	3.9%	11.5%	6.9%	4.1%	22.1%	EPS
20-yr avg.	**69.3%**	**18.6%**	**21.9%**	**11.8%**	**15.6%**	**13.6%**	**9.5%***	**7.4%****	**9.2%**	**8.2%**	**4.4%**	**11.2%**	
Forward P/E ratio	22.7x	19.7x	14.9x	25.1x	35.1x	25.4x	22.9x	21.4x	16.0x	20.1x	18.7x	21.5x	P/E
20-yr avg.	**13.8x**	**14.6x**	**12.4x**	**16.1x**	**18.6x**	**18.8x**	**19.0x***	**15.9x**	**15.6x**	**16.9x**	**14.6x**	**15.4x**	
Buyback yield	0.9%	0.9%	2.9%	0.8%	0.3%	2.0%	1.9%	-1.1%	0.9%	0.7%	-1.1%	1.4%	Bbk
20-yr avg.	**1.6%**	**0.7%**	**0.1%**	**2.1%**	**2.4%**	**2.8%**	**1.2%**	**-1.1%**	**1.9%**	**1.8%**	**-1.0%**	**1.6%**	
Dividend yield	4.4%	2.0%	1.9%	1.5%	0.7%	1.0%	1.0%	2.9%	1.7%	2.8%	3.4%	1.5%	Div
20-yr avg.	**2.6%**	**2.5%**	**2.3%**	**2.2%**	**1.4%**	**1.1%**	**1.4%***	**4.2%**	**1.9%**	**2.8%**	**3.9%**	**2.1%**	

Source: FactSet, Russell Investment Group, Standard & Poor's, J.P. Morgan Asset Management. All calculations are cumulative total return, not annualized, including dividends for the stated period. Since market peak represents period from February 19, 2020 to March 24, 2021. Since market low represents period from March 23, 2020 to March 24, 2021. Correlation to Treasury yields are trailing 2-year monthly correlations between S&P 500 sector price returns and 10-year Treasury yield movements. Foreign percent of sales is from Standard & Poor's, S&P 500 2018: Global Sales report as of August 2019. Real Estate and Comm. Services foreign sales are not included due to lack of availability. Next 12 months (NTM) earnings growth is the percent change in next 12-months earnings estimates compared to last 12-months earnings provided by brokers. Forward P/E ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Buyback yield is net of share issuance and is calculated as last 12-months net buybacks divided by market cap. Dividend yield is calculated as the next 12-months consensus dividend divided by most recent price. Beta calculations are based on 10-years of monthly price returns for the S&P 500 and its sub-indices. *Communication Services (formerly Telecom) averages and beta are based on 5-years of backtested data by JPMAM. **Real estate NTM earnings growth is a 15-year average due to data availability. Past performance is not indicative of future returns.
Guide to the Markets – U.S. Data are as of March 24, 2021.

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J.P.Morgan
Asset Management

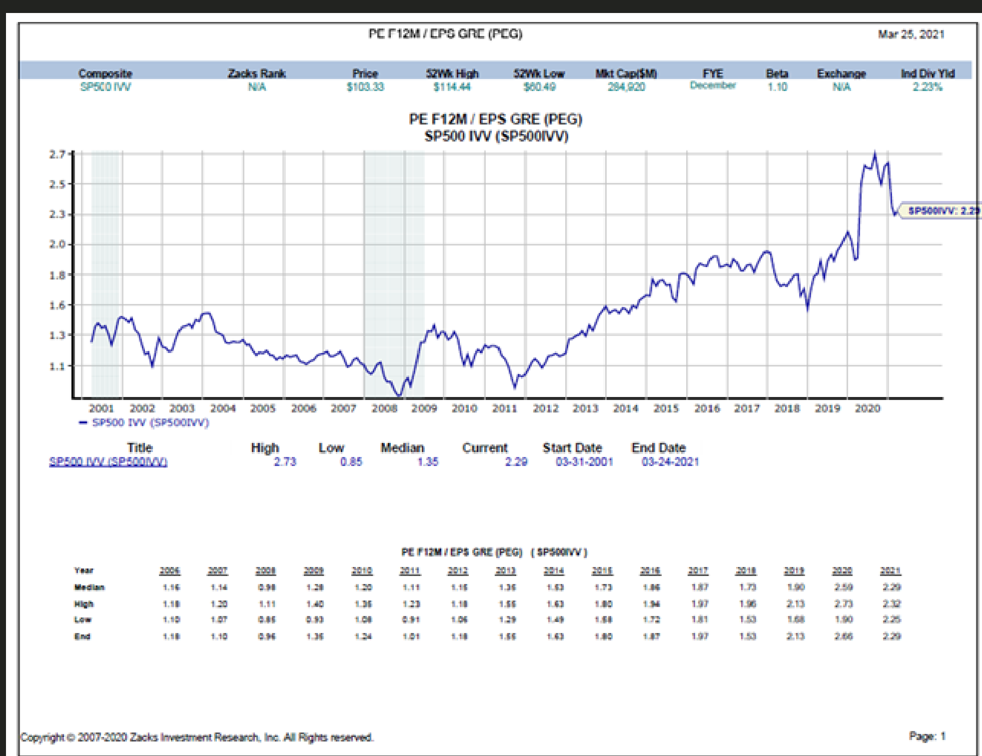
Source: https://am.jpmorgan.com/us/en/asset-management/adv/insights/market-insights/guide-to-the-markets/m

MARKET SUMMARY (CONT.)

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.

PEG Ratio

Since we discussed the PE ratio, let's discuss the next iteration of that metric which is the PEG ratio. The PEG ratio is the PE ratio divided by the expected earnings growth of the referenced data series. The PEG ratio is designed to tell you that a fairly priced security would measure at 1. An overpriced security would be > 1 and vice versa. As you can see from the graph below, the market (SP500IVV) is at 2.29 which is no where near 1. So, does that mean the market is overvalued? Possibly, but I think it's more complex than that. The graph tells an interesting story. The data hovers around 1 from the beginning of the chart up until around 2012. Then, the data starts to climb and has yet to return to that range. What happened around 2012? Well, the 10 year U.S. Treasury Bond Rate dropped to below 3% and stayed there. Technically, it rose above 3% towards the end of 2018, but it retreated quickly in the beginning of 2019. Lower interest rates means lower borrowing rates, which means more spending and lower costs. That could help to explain why the PEG ratio has stayed higher. I do not think this metric can rise indefinitely, but I do think it can stay above 1 and the overall market can still be relatively healthy.



Composite	Zacks Rank	Price	52Wk High	52Wk Low	Mkt Cap($M)	FYE	Beta	Exchange	Ind Div Yld
SP500 IVV	N/A	$103.33	$114.44	$60.49	284,920	December	1.10	N/A	2.23%

Title	High	Low	Median	Current	Start Date	End Date
SP500 IVV (SP500IVV)	2.73	0.85	1.35	2.29	03-31-2001	03-24-2021

PE F12M / EPS GRE (PEG) (SP500IVV)

Year	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Median	1.16	1.14	0.98	1.28	1.20	1.11	1.15	1.36	1.63	1.73	1.86	1.87	1.73	1.90	2.59	2.29
High	1.18	1.20	1.11	1.40	1.35	1.23	1.18	1.55	1.63	1.80	1.94	1.97	1.96	2.13	2.73	2.32
Low	1.10	1.07	0.85	0.93	1.08	0.91	1.06	1.29	1.49	1.58	1.72	1.81	1.53	1.68	1.90	2.25
End	1.18	1.10	0.96	1.36	1.24	1.01	1.18	1.55	1.63	1.80	1.87	1.97	1.53	2.13	2.66	2.29

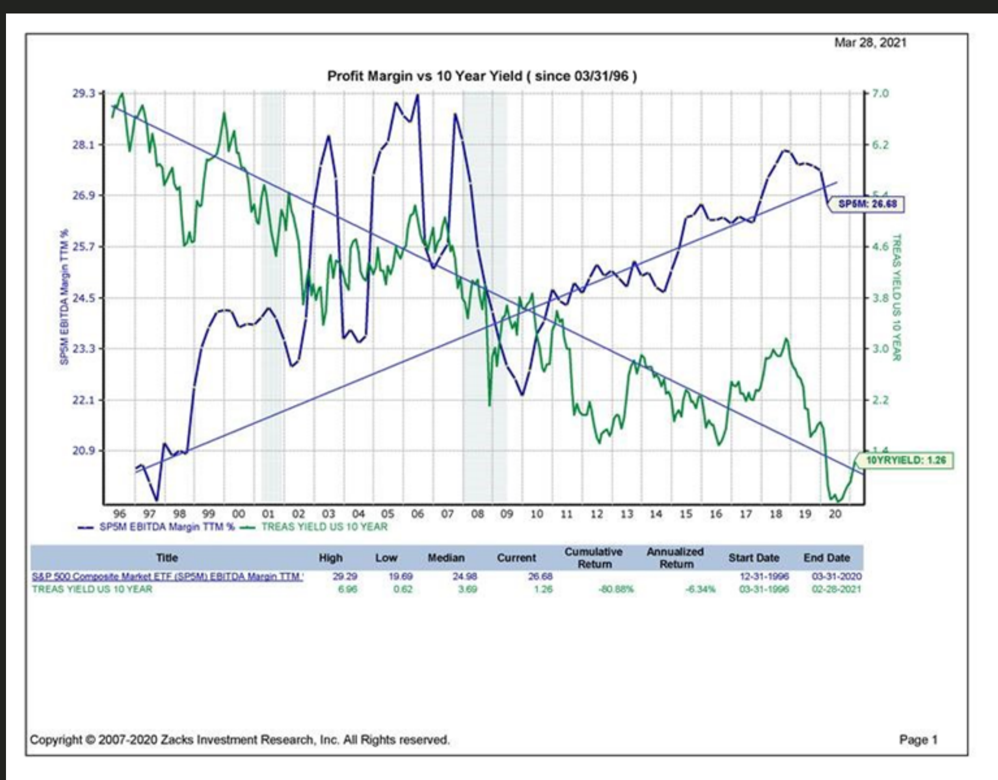
Source: Zacks Investment Research

MARKET SUMMARY (CONT.)

Understanding the markets can help us build a better plan for our financial futures AND sleep easier at night.

Interest Rates versus Profit Margins

Ok, here is the last financial nerd graph, I promise. In an attempt to better explain market valuations, I compared the U.S. 10 year Treasury Bond Rate to the S&P 500 Index Profit Margin over the last 25 years. The Profit Margin data series is in blue. The Treasury Rate data series is in green. The data is definitely choppy, but there is a trend. In fact, there is what is known as an "inverse correlation" between the two data series, which means one goes up while the other goes down. Now, correlation does not equal causation, which means we cannot know for sure if one of these is causing the other, but it does make intuitive financial sense. If you lower borrowing costs (interest rates) for long enough, then companies will adjust and use those lower costs to expand their profit margins. Another component that is not being displayed is the continued incorporation of technology into ALL businesses. Technology, provides enhancements to top-line revenue and helps reduce costs. Both of those help to expand profit margins. I think some of these gains in profit margins are likely to stay, but they could be sector and company specific, which means it will be more important to know "what you own" and "why you own it".



Title	High	Low	Median	Current	Cumulative Return	Annualized Return	Start Date	End Date
S&P 500 Composite Market ETF (SP5M) EBITDA Margin TTM '	29.29	19.69	24.98	26.68			12-31-1996	03-31-2020
TREAS YIELD US 10 YEAR	6.96	0.62	3.69	1.26	-80.88%	-6.34%	03-31-1996	02-28-2021

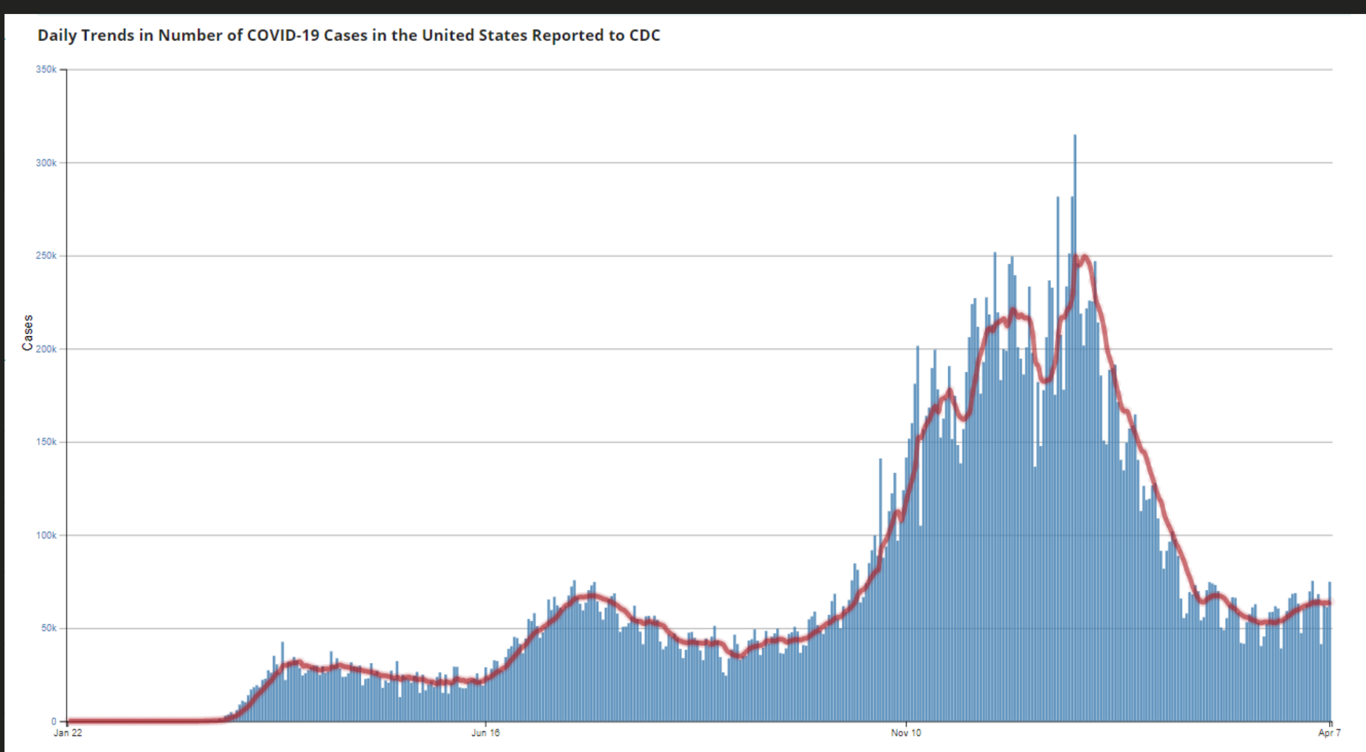
Page 1

Source: Zacks Investment Research

CORONAVIRUS UPDATE

After a challenging fourth quarter in 2020, there has been tremendous improvement on the pandemic front.

Keeping up to date on the pandemic will hopefully help you plan your finances as well as your life.



Source: https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases

FINANCIAL PLANNING UPDATE

Are you a DIY tax preparer?

Financial planning is an ongoing process that evolves with your life's changing circumstances.

If so, here is an short article for you.

https://centsai.com/save-money/financial-planning/diy-tax-prep-can-cost-you-big-time

CONCLUSION

What's next?

Moving forward, investors should be more focused on fundamentals. Earnings should start to matter more and policy response should matter less. I think the rising tide lifts all boats theme is dissipating. The Federal Reserve has been very clear that they expect to hold interest rates at their lower bound for another couple of years. That could always change, but it should not be feared and a rise in rates would almost certainly be because economic and market conditions have improved tremendously.

If you have questions and/or concerns, please give us a call. We are here to help. If this update has been forwarded to you and you would like to be included on future emails, please subscribe at our website at www.323wm.com.

Thank you very much for your time.

DISCLOSURES