KADES & CHEIFETZ LLC

# INVESTMENT OVERVIEW

for the quarter ending December 31, 2020

## Equities in Review

US stocks recorded robust gains in the fourth quarter, with all of the major indexes reaching record high levels. Foreign and small cap stocks outperformed large cap stocks, while value-oriented companies came back into favor after significantly trailing growth-oriented holdings—many of which benefitted from the stay-at-home economy during the first three quarters of the year.

While positive developments in the COVID-19 vaccine rollout seemed to drive investor confidence during the quarter, the toll of the pandemic continued to weigh on consumers, as retail sales and household income fell sharply. In December, weekly jobless claims hit their highest level in months.

Investors seemed to shrug off bad economic data and remain optimistic on the potential success of the vaccines and the anticipated impact of the expected future fiscal stimulus packages.

Following are the quarterly, year-to-date, and 5-year average returns for the six equity indexes that we track:

| INDEX | DESCRIPTION | Quarter | Year-to-Date | 5-Year Avg. |
|---|---|---|---|---|
| DJ Industrial Average | Large cap stocks | +10.7% | +9.7% | +14.7% |
| MSCI EAFE | Foreign stocks of developed nations | +16.1% | +7.8% | +7.5% |
| MSCI Emerging Markets | Foreign stocks of emerging nations | +11.6% | +15.4% | +9.0% |
| NASDAQ Composite | Growth-oriented large cap stocks | +15.6% | +44.9% | +22.1% |
| Russell 2000 | Small cap stocks | +31.4% | +20.0% | +13.2% |
| S&P 500 | Large cap stocks | +12.2% | +18.4% | +15.2% |
| Weighted Index Benchmark* | Diversified Equities | +16.8% | +20.9% | +14.7% |

**The Index weighting is 20% each: DJ Industrial Average, Nasdaq Composite, S&P 500, and Russell 2000; and 10% each: MSCI EAFE and MSCI Emerging Markets.*

## Other Important Data

For the twelve months ending December 31, 2020, inflation as measured by the CPI increased 1.4%. This rate continued the trend of increasing inflation which began in September, and was notably larger than the 0.6% increase for the 12 months ending June 30.

The spread on the yield curve (the difference in yield between the 1-Year and 30-Year Treasury bond) has often been a reliable leading indicator of the likelihood of recession. During the fourth quarter, the spread widened to 1.55% (and stands at 1.75% as of January 22). This spread, which is high by recent standards, is primarily driven by the Fed cutting short term rates to near zero as one of the several steps they took to provide liquidity to the market. The Federal Reserve announced late in the third quarter that it would allow inflation to drive above its 2% target as part of an inflation averaging program designed to promote low unemployment.

- December 31, 2020 1.55%
- September 30, 2020 1.34%
- June 30, 2020 1.25%
- March 31, 2019 1.18%
- December 31, 2019 0.80%

# Equities Looking Forward

As we noted in our September 30 Overview, valuations in the value stocks appeared more attractive than growth stock valuations. We maintain this view despite the fourth quarter reversal of the powerful trend towards growth stocks. A more normal cyclical recovery could continue to boost value stocks relative to their growth-oriented counterparts. Further, a return toward pre-pandemic consumer spending patterns could bode well for financial stocks and energy stocks, which suffered significant losses during the pandemic while tech stocks generally soared.

We are optimistic about a strong economic recovery in 2021. However, because of the equity market performance in the face of weak economic data during the second half of 2020, we are less optimistic about how much equity price growth will correlate with the strong economy as many stocks are currently priced -- on the basis of price relative to earnings (i.e. P/E ratio) as if the economy has already recovered.

# Hybrid and Hedging Assets

We believe that the Morningstar Moderate Risk Target Index offers the best benchmarks for hybrid and hedging assets. Returns are as follows:

| INDEX | DESCRIPTION | Quarter | Year-to-Date | 5-Year Avg. |
|---|---|---|---|---|
| Morningstar Moderate Risk | Hybrid (bonds and stocks) | +10.2% | +12.8% | +9.8% |

Since the hybrid assets we own in our portfolios invest in a combination of securities including, but not limited to, bonds and stocks, the hybrid assets typically produce returns close to the average of the bond and stock index returns. This is the case for the quarter and for the annualized returns of the past five years.

Hedging assets like commodities or alternative strategies generally move with little, zero, or negative correlation to the bond and stock markets. We believe hedging assets should play a role in diversified portfolios because over the long-term, their limited or inverse correlation to bonds and stocks should reduce the volatility of overall portfolio returns.

# Bonds in Review

Bond prices continued to rise in fourth quarter as low interest rates and a continuing flight to the safety of cash and bonds provided a comfortable environment for fixed income investors. However, yields began to rise as federal stimulus and economic growth expectations make interest rate risk a growing issue going forward. Since bond prices and bond yields move in opposite directions, the 10-Year US Treasury yield dropped from 1.92% at the end of 2019 to 0.69% on September 30 and then topped out at 1.15% in mid-January. We will continue to monitor bond yields as we believe they are a strong leading indicator of market movements. It seems reasonable to expect somewhat muted returns from bonds going forward given the current low yields, as compared to recent history.

The quarterly and historical results for the bond indexes that we track are as follows:

| INDEX | DESCRIPTION | Quarter | Year-to-Date | 5-Year Avg. |
|---|---|---|---|---|
| Barclays Municipal Bond | I-T US Municipality Issues | +2.1% | +5.6% | +4.2% |
| Barclays US Aggregate Bond | I-T US Gov't and Corporate Issues | +0.7% | +7.5% | +4.4% |
| Morningstar TIPS | Inflation Protected Gov't Issues | +2.8% | +10.4% | +4.9% |
| Average of the Indexes | Diversified Fixed Income | +1.9% | +7.8% | +4.5% |

As with stocks, the recent gains in bond prices lead to our belief that most bond categories are overvalued in the short-term. However, it is important to remember the following, even when we feel bonds are overvalued:

- The prices of overvalued investments often go higher. This is especially true of bonds if the move is in response to a flight to safety amidst equity selling.
- Bonds always have a place in diversified portfolios to reduce volatility, preserve principal, and provide income.

# Our Asset Allocation Philosophy

It is our philosophy that investors with long-term time horizons are best served by using a disciplined, diversified asset allocation approach (investing in bonds, hybrid and other hedging assets and stocks) rather than trying to time the markets. It is important to periodically review your asset allocation and your target allocation and to rebalance your assets among the classes to keep the allocation close to the target. We will address the issues specific to you when we review your situation in the coming months. In the interim, if you would like to discuss these issues, please contact us at howard@kadescheifetz.com or steve@kadescheifetz.com.

# Reminders

Please contact Kades & Cheifetz LLC if there are any changes in your financial situation or investment objectives, or if you wish to impose, add or modify any reasonable restrictions to the management of your account. Our current disclosure statement is set forth on Parts 2A and 2B of Form ADV and is available for your review upon request.

Kades & Cheifetz LLC has provided this overview for internal use and for use by our clients. We have prepared it using sources believed to be reliable. We do not guarantee the accuracy of the sources. We reserve the right to change our opinions (expressed above) without notice.

You should be receiving statements at least quarterly from your custodian. If you are not receiving these statements, or you need another copy of a statement, please call us and we will provide one to you. Clients are encouraged to review the information on the statements, especially the amount of fees deducted, and compare that information with any information provided by Kades & Cheifetz LLC. If there are any questions or discrepancies, please contact us as soon as possible.

<u>Important Disclosure Information</u>

*Please remember that past performance may not be indicative of future results. Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product (including the investments and/or investment strategies recommended or undertaken by Kades & Cheifetz, LLC ("Kades & Cheifetz"), or any non-investment related content, made reference to directly or indirectly in this commentary will be profitable, equal any corresponding indicated historical performance level(s), be suitable for your portfolio or individual situation, or prove successful. Due to various factors, including changing market conditions and/or applicable laws, the content may no longer be reflective of current opinions or positions. Moreover, you should not assume that any discussion or information contained in this commentary serves as the receipt of, or as a substitute for, personalized investment advice from Kades & Cheifetz.*

*Additionally, please remember to contact Kades & Cheifetz, **in writing**, if there are any changes in your personal/financial situation or investment objectives for the purpose of reviewing or evaluating or revising our previous recommendations and/or services, or if you want to impose, add, to modify any reasonable restrictions to our investment advisory services. Kades & Cheifetz shall continue to rely on the accuracy of information that you have provided. **Please Note:** unless you advise, in writing, to the contrary, we will assume that there are no restrictions on our services, other than to manage the account in accordance with your designated investment objective.*

*Historical performance results for investment indices, benchmarks, and/or categories have been provided for general informational/comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results. It should not be assumed that your Kades & Cheifetz account holdings correspond directly to any comparative indices or categories. <u>Please Also Note</u>: (1) performance results do not reflect the impact of taxes; (2) comparative benchmarks/indices may be more or less volatile than your Kades & Cheifetz accounts; and, (3) a description of each comparative benchmark is available upon request.*



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