January 5, 2021

Dear Clients and Friends:

It is fashionable to gratefully bid adieu to 2020, thinking it among the worst years in history. This is typical of our self-absorbed society, thinking that everything we experience is somehow unique or without precedent. While 2020 was an unusually difficult year by recent standards, a cursory review of history would not rank it particularly significant even in the last 100 years or so. Yet in years far more tumultuous, humanity somehow managed to not only survive, but thrive. We will no doubt do the same, and while 2021 may be better for most of us in many ways, it may be anything but that for those whose livelihoods depend on the financial markets.

We wrote back in March that our focus had shifted away from the extreme level of volatility in financial markets to the substantially greater risk that we saw looming toward the end of the year. That forecast has proven to be eerily prescient, as the current environment is essentially as we predicted and a significantly riskier one than we faced in March. In the early days of the panic, we saw, as we often do, indiscriminate selling with prices deviating wildly from underlying fundamentals. Forward looking rates of return exploded and provided more than adequate compensation for risks taken. This is almost always true of panics, which is why we enjoy them so very much. If you can keep your head about you while those around you are losing theirs, then as Kipling would say, the Earth is yours. Well maybe not the Earth, but we believe our clients have been justly rewarded for the risks we took on their behalf, and we believe we acquitted ourselves and our process very well. But that was then and not today.

Today unfortunately, our world looks, well, pretty much as we feared. Behold a landscape bereft of any meaningful return and a future that, while as unknowable as any, has or seems to have a variety of rather unpleasant outcomes high on the list of possible. Watch now as investors who once scorned securities with high yields and low risk fight amongst themselves for the same securities, which now have yields almost too small to matter. Sadly, this is all too common. With the yield on the overall market (Bloomberg Barclays Aggregate as of December 31, 2020) at 1.12% and investment grade credit at close to the richest levels in history, it is a justifiable question to ask if fixed income makes any sense at all. What is the point of fixed income if there is essentially no income?

This is where most investors fall down and fall apart. Obsessed with beating an index or their peer group rankings, they will forecast this and that, or talk about their ability to extract blood from stones and all sorts of silly things, to enhance returns relative to an index. No one knows what 2021 and beyond will bring, and it is foolish to waste time in such discourse even though we all enjoy opining on the future.

What we do know is that returns on broad market indices are likely to be muted going forward, and taking significant incremental risk will not improve that much at all. This is simple math, like 8th grade math. It is important to ask yourself why you have an allocation to fixed income in the first place. Yield, which is the raw material of return, is close to zero and while we do not like that, it is a fact. So the focus needs to be on the other reasons you have an allocation to fixed income, which are just as valid today as they ever were, and maybe even more so. The ideas of capital preservation and equity diversification remain extremely important, especially with equity valuations stretched to an even greater degree than usual. Valuations also provide a warning against amping up risk in pursuit of return and increasing the correlation between stocks and bonds. Such actions will surely lead to disappointment when the inevitable equity market correction takes place, a correction that may not be waved away by machinations of the Federal Reserve.

We enter 2021 guided by fundamental principles of investing and not by our ability to render a forecast. We are hewing toward the principles of capital preservation and diversification of equity risk, as well as providing a source of liquidity if needed. Should 2021 prove to be a smooth experience in all ways relevant, then we will seek to provide a return commensurate with the market, hopefully a bit more, possibly a bit less. In the more likely scenario where markets are surprised and we experience a bout of volatility, we will fulfill our critical mission and, as we saw in 2020, perhaps place ourselves in a position to benefit on your behalf.

As always, we thank you for placing your trust in our organization. We will continue to strive each day, to the best of our abilities, to help you achieve your investment goals.

Sincerely,

Mark M. Egan, CFA
Managing Director