BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY, JANUARY 2021

Happy New Year. We hope your holidays brought you much joy. 2020 was remarkable in many ways and while we endured numerous challenges, we also have many reasons to be thankful.

Our economy is making headway despite very significant issues facing policymakers, the Fed, corporate boardrooms, and consumers. In defiance to the 30% selloff in equities in March, stock markets finished the year with a bang, capping an extraordinary recovery, even with Covid cases growing globally.

A key concern to Blue Granite is the significant differential between the robust stock and bond market performance amid anemic economic growth. Historically, similarly correlated circumstances have led to sell-offs as equities shed speculative excesses. Investment markets tend to focus on the future, and investor optimism points to better days ahead in 2021 and beyond. In the near-to-medium term, the stock market may reflect confidence that economic growth, employment, and the general business environment will improve. While we are optimistic over the long-haul, we are a bit more restrained in our outlook than those calling for a healthy economy by the spring or summer of this year.

Hopeful expectations surrounding Covid vaccines have also bolstered confidence in the economic outlook. That opinion is debatable with the prospect of the Covid virus accelerating. One overlooked issue is that current data shows that while over 33 million vaccine doses have been delivered, approximately 66% have yet to be administered. A new virus strain and the risk of further shutdowns lead us to our cautious view regarding a full economic recovery by the end of this year. While equities enjoyed a great run for the last 2 years during less-than-ideal conditions, it appears that a return to sustained economic growth, full employment, and the benefits of massive government stimulus are largely reflected in current equities values. In our view, this level of optimism invites heightened scrutiny when we are considering stock valuations.

A critical question is whether equities remain at all attractively valued. Those quite bullish on stocks suggest that continuing stimulus efforts and hopes for better times ahead provide equities with a long runway. That stock dividend yields exceed bond yields, offering substantively better total returns than bonds, support this thesis only to a degree. However, Blue Granite does not view this as a zero-sum, ‘stock vs bonds’ debate. The bond strategy deployed in your portfolio is about building and maintaining a solid investment foundation to mitigate risk and to smooth volatility, and your portfolio’s bond position serves as a ‘rudder’ for directional stability, rather than solely an income source. During particularly turbulent markets, a broad investor ‘flight to quality’ (into bonds) tends to lift the value of short to intermediate fixed income holdings in your portfolio.

Looking deeper into equities valuations, Blue Granite views stocks as expensive across several financial metrics, so careful selection is imperative. A clear positive to us is the broadening market rally beyond the exclusive club of ‘work-from-home’ (WFH) and technology stocks. Nevertheless, speculative investors appear smitten with technology and the WFH names (e.g., Zoom & Peloton) despite exceedingly high valuations, and they appear willing to buy these at stocks at any price. Time will tell if their share prices have moved too far and too fast, as we suspect more than a few have. Instead, we observe quantifiable long-term benefits to your portfolio because we diligently hunt for value with appropriate diversification. We are very pleased with our absolute and relative performance in 2020, which was achieved with muted risk.

It is estimated that corporate earnings will grow approximately 5-10% this year. This is a reasonable growth rate, though it will not fully make up for the losses and slower growth exhibited in 2020. A complete and sustainable recovery will take time and is directly correlated with a full reopening of the economy and getting the millions of unemployed back to full time work. Also of concern is the long-term impact on our economy resulting from the vast and escalating government deficit which has been exacerbated by current stimulus packages.

For some, ‘hope springs eternal’ while others suggest that ‘hope isn’t a strategy’. We believe in the former over the longer-term and the latter near term. We see moderate improvement during 2021 while remaining mindful that unpredictable events and pressing Covid issues could linger well into the year mitigating the scope of a recovery. Please be assured, we monitor all events and issues constantly to provide prudent risk management for your investments.

We wish you the best for the coming year and please call us should you have any questions or concerns.

Best regards,

Scott, John, Dave & Richard