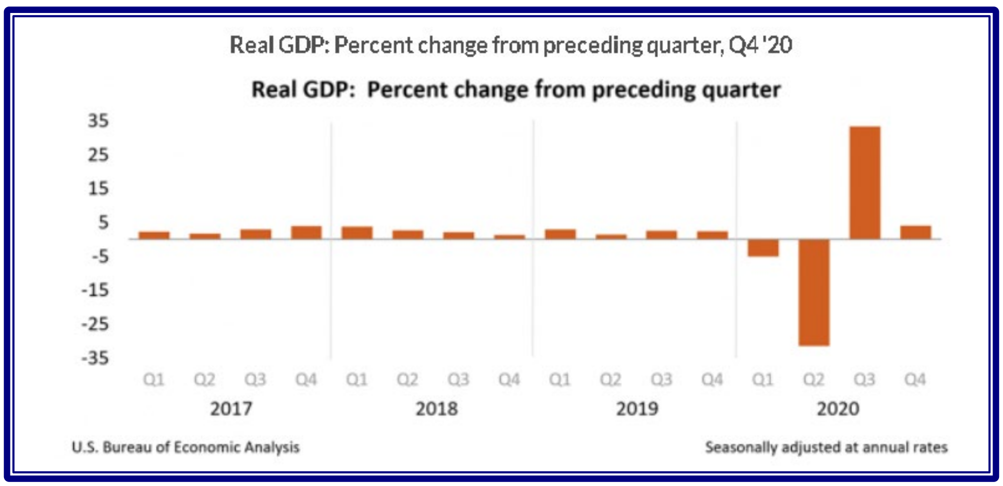
ALTMAN
INVESTMENT MANAGEMENT

EQUITY STRATEGY FOCUS

JANUARY, 2021

IN VIEW: The Economic Landscape

The first estimate of gross domestic product (GDP) increased 4% in Q4 after rebounding 33.4% in Q3, and declining -31.4% in Q2. For the year, GDP declined 3.5%. This comes as the economy continues to reopen and activity resumes in various stages across the nation. GDP in Q4 was supported by personal consumption expenditures in services, exports, non-residential and residential fixed investments. This boost was partially offset by declines in government spending and an increase in imports which is a negative for net exports.



Also, in response to continued re-openings plus fiscal stimulus, gross domestic income advanced 25.8% while corporate profits climbed 27.4%. Personal incomes declined -1.1% in November reflecting the run off of the Paycheck Protection Program along with reductions in other supplemental assistance programs. One bright spot was an increase in wages and salaries within the services sector.

Unemployment was reported at 6.7% for December with 10.7 million people unemployed. These figures remain nearly double pre-pandemic levels. Not included in labor force calculations are an additional 7.3 million people who want a job, but are currently not actively looking for employment or are otherwise unable to take a job. This number stood at 5 million before the pandemic. Initial jobless claims jumped to 965,000 in the latest report, its highest level since August. This primarily reflects the ongoing stress the pandemic has had on employment, but also is due in part to the recent $300 in supplementary unemployment benefits. The bump in weekly payment incentivizes registration for benefits. Continuing claims, which run a week behind initial claims, also ticked up to 5.3 million. Total unemployed persons receiving benefits, which lags by an additional week, fell by 800k to 18.4 million, a significant increase off the prior year. Payrolls fell by 140,000 in December mainly in areas of hospitality and leisure and private education sector, reflecting a second surge in Covid-19 cases. The employment picture is a sign the economy is off to a sluggish start, as it eagerly awaits wide spread vaccinations to ignite growth.

The December Consumer Price Index (CPI) report came in at up 0.4% due mostly in part to the rise in gasoline prices. The annualized number of 1.4% for year end is down from the prior year's jump of 2.3%. The current rate is below that of the 10-year average illustrating the impact Covid-19 has had on the economy thus far. Producer prices also ticked up 0.3% in December for an annualized rate of 0.8%. Most economists believe the prospects of greater fiscal stimulus and higher growth expectations for the second half of the year indicate higher price levels are on the horizon over the long term. But for now, with 10.7 million people unemployed in the U.S., it will be difficult for producers to pass-through higher prices to end consumers at least until some slack is taken out of the labor market.

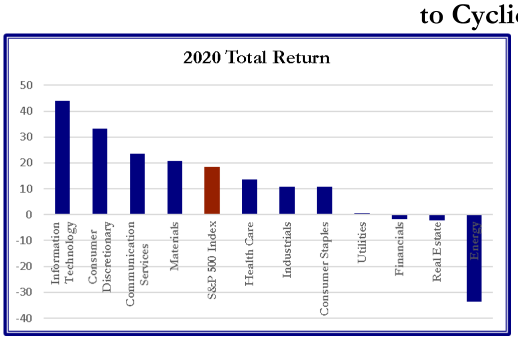
With the leadership change at the Federal level, there is now a greater likelihood of additional fiscal stimulus in the weeks to come extending to state and local governments, plus extended unemployment benefits and additional stimulus checks. The Fed's posture on low interest rates will likely be supported by Janet Yellen, the newly appointed Treasury Secretary who tends to be somewhat dovish leaning. For these reasons we believe the U.S. dollar level may remain under pressure in the near term, but as growth stabilizes, we can expect the U.S. dollar will begin to strengthen once again. Additionally, the Fed's current position of lower rates for longer will inevitably start to unwind. Growth likely bottomed in Q2 and we are learning to operate within a new "normal". As this process becomes more efficient or we reach the post COVID era, economic growth should rebound from its annualized 2020 decline providing room for higher rates in the future. The Democratic sweep also raises the likelihood of higher taxes at some point in the future to combat a ballooning deficit. Addressing the deficit in this way will raise confidence in U.S. liquidity and thus lend support for the dollar.

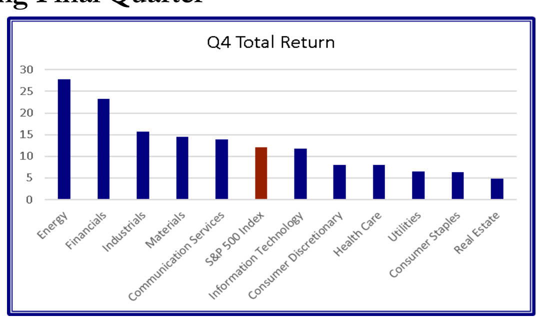
CLOSE-UP: Equity Investment Overview

Market Performance & Earnings:

The stock market finished the year up 18.4% as measured by the S&P 500 benchmark index. Information Technology was the leading market sector, carried by Apple and Microsoft. Consumer Discretionary stocks were the next best performers, followed by Communication Services. The worst performing sectors were Financials, Real Estate, and Energy, each ending the year in negative territory.

Sector Performance Shifts
to Cyclicals During Final Quarter



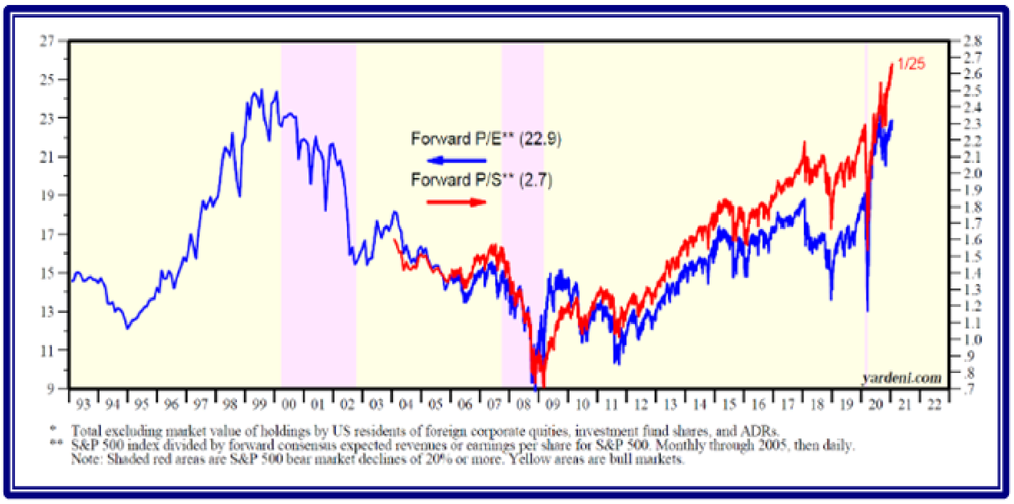


Source: Bloomberg and Altman Investment Management, LLC

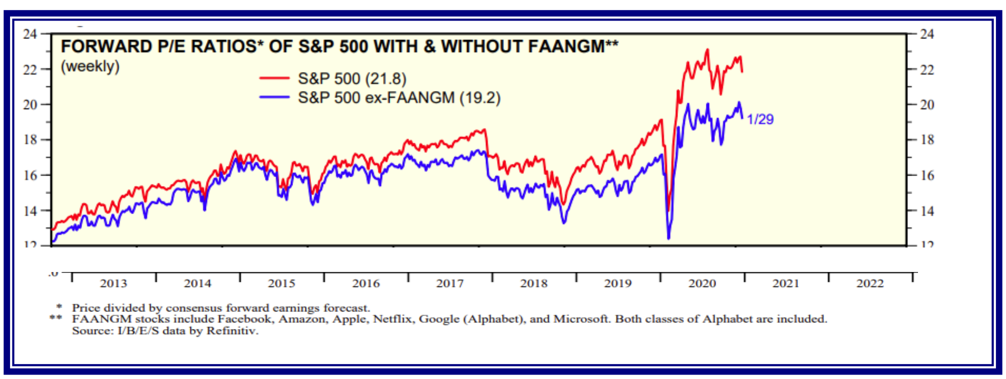
The market broadened significantly in Q4, as Energy and Financials took the lead. The election results gave markets reason to believe additional stimulus is on the horizon. The promise of multiple vaccines and the start of distributions further aided in lifting the market outlook. Another noteworthy observation is that the FAANGM stocks dropped in influence over the index in Q4, accounting for only 18% of the index return as compared to 58% of the market return over the entire year.

The forward price to earnings multiple of the S&P 500 expanded 20.6% during the last year, representing investor optimism of future growth. With the exception of Consumer Staples and Utilities, most market sectors participated in the expansion. Cyclical sectors, such as Energy, Consumer Discretionary and Industrial sectors saw the largest move up, even surpassing the Information Technology sector. Admittedly, a few sectors like Energy and Utilities experienced an expansion on the backs of depressed earnings, but the general take away from this broad-based upward trend is positive. To put the overall market valuation in a historical perspective, its current multiple of 21.8x is still lower than 25.7x reached during the height of the tech bubble. Excluding the FAANGM stocks (the 6 most popular and best performing stocks that make up 25% of the benchmark index), that multiple drops to 19.2x.

Market Forward Multiples Remain Below Tech Bubble Level



A Comparison: S&P 500 Forward Multiples
Including and Excluding FAANGM Stocks



Nevertheless, the absolute level of the price to earnings ratio does deserve some pause to consider the possibility of a bubble. Quite simply, we believe the stock market has room to grow from current levels and could end the year up high single digits or low double digits. The 10-year yield, at approximately 1.16%, provides much heeded incentive in support of stocks offering higher yields by comparison. Inflation is also subdued at a mere 1.4% annualized rate reported in December. Lower interest rates stimulate growth by providing for cheap access to cash for investments. The surrounding data does not suggest the environment is in a danger of over stimulating growth and thus provoking inflationary pressures. We of course will continue to monitor any developments and stand ready to make any necessary adjustments should the backdrop change.

As of the 4th week into the earnings season, just over 75% of companies have reported. The positive surprises for both S&P 500 revenues and earnings per share have been much greater over the past three quarters of the Great Virus Crisis (GVC) than they were coming out of the Great Financial Crisis (GFC), according to Yardeni Research. The S&P 500 Net Earnings Revisions Index also has rebounded into positive territory faster during the GVC than the GFC. The big difference is that the GFC involved a severe recession caused by a prolonged credit crunch. The GVC could have played out the same way - but for the unprecedentedly massive liquidity provided by monetary and fiscal policies around the world.

Earnings growth is up 4.7% year over year and sales grew by 0.8%. So far, 7 of the 11 market sectors reported an uptick in growth led by Materials, Financials and Technology on a bottom-line earnings basis. The weaker U.S. dollar was additive to top line sales. Companies that beat on both top and bottom lines did not receive much reward, if any at all, as the average performance was -.2%to -1.4% in the first week following the reports. Upon initial analysis, one may conclude that the uptick in earnings was already priced in. However, seeing as though stocks that missed on both metrics saw similar sells offs, it appears that investors have their eye on capex spending which improved slightly but remains in negative territory at -10% (excluding Amazon which alone skewed capex into positive territory). The shadow of Covid-19 still hangs over corporate willingness to make any long term or significant decisions. A resolution to the timing and amount of fiscal stimulus should help provide some visibility.

We have revised our earnings outlook for this year at $175 - and held our estimates for next year at $195 - as the likelihood of higher corporate tax rates effective in 2022 will begin to take shape. This puts our forecasted earnings for 2021 at a forward P/E around 22.5 price-to-earnings ratio and next year at 20.2X. If for some reason the corporate tax rate isn't raised, we think that the profit margin could rise to a new record high as technological innovations boost output and the trend in the five-year growth rate of productivity remains solidly to the upside.

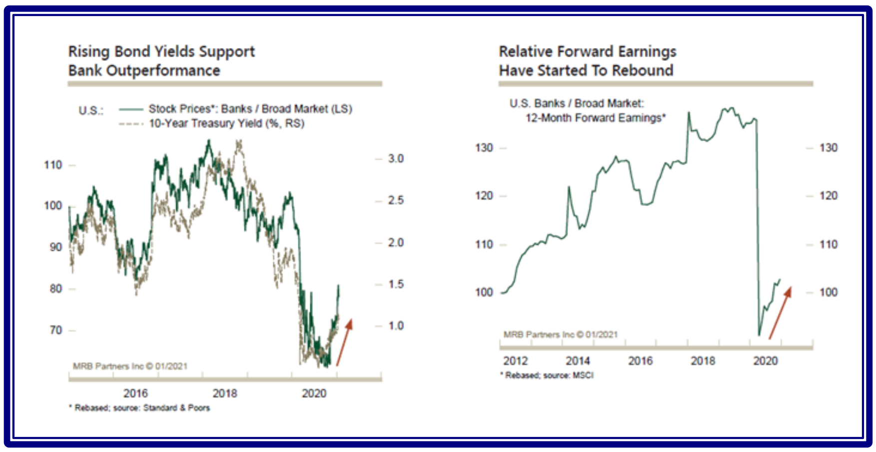
The stock market continues to melt up this year, as it has since it bottomed last year on March 23rd. U.S. equity valuations now stand in their 10th decile, indicating equities have been cheaper at least 90% of the time, according to Goldman Sachs Research. However, we stress that valuations must be considered in the context of the prevailing macroeconomic environment. Periods of low and stable inflation - such as the one the U.S. has been in since 1996 – has provided investors greater confidence in future cash flows and have expanded valuations that are currently by some estimates 35% above the post WWII median. While current valuations stand above those levels, interest rates remain considerably lower than in similar periods of the past. All else being equal, a lower discount rate applied to future cash flows increases their value. Although pockets of bubble-like behavior do exist, defined by stocks with earnings yields lower than that of the 10-year Treasury bond, these stocks only account for an estimated 12% of the market cap today versus 80% at the peak of the dot-com bubble in 2000. Because these valuations are not pervasive, with the expensive stocks' share of the S&P 500 market cap much smaller today versus the tech bubble, we conclude that these overvalued stocks are not enough to undermine the broader market.

Equity Strategy:

We anticipate the cyclical recovery that began in Q4 is likely to continue throughout 2021, as vaccines are distributed and the economy continues to reopen. Infrastructure and clean energy spending as well as climate and social justice-based initiatives are policies supported by the new administration. The pursuit of these initiatives lends support to sectors such as Energy, Industrials and other cyclicals broadening the performance of the market. These coordinated efforts coupled with rising expectations for growth as the economy emerges from the virus, should trigger the unwinding of pent-up demand in service industries such as recreation, entertainment, transportation, and hospitality. The velocity of a cyclical shift is less predictable at the moment but should become clearer as global vaccination plans progress and a time frame to reach post-pandemic economic normalcy can be established.

As cyclicals advanced broadening market performance in the fourth quarter, the AIM composite portfolio outpaced the S&P. Our overweight position and individual stock selection in Financials and Energy were additive to performance. Stock selection in Technology shares across traditional industries of semiconductors, hardware & equipment and services also contributed as well as Communications Services and Materials. Admittedly, the abrupt change in leadership lends to the potential for a brief pause or short-term reversal as the fundamentals catch up to expectations. In the long run, however, a sustainable recovery is indeed in the cards. As the economy reopens further, cyclical sectors most impacted by the event-driven recession should thrive alongside the release of pent-up demand.

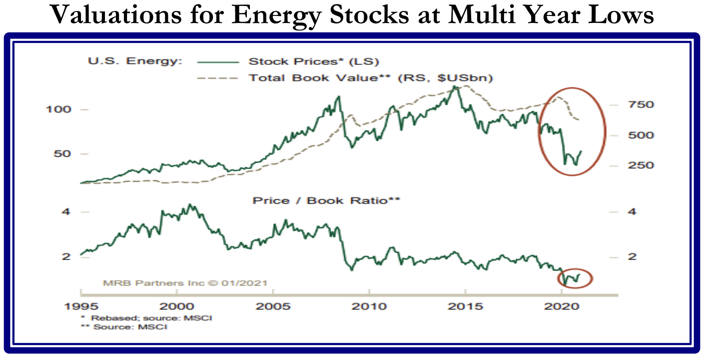
The steep rally in U.S. bank stocks may be due for a pause, but the cyclical outlook is positive. Relative valuations are attractive and there is plenty of room for a meaningful re-rating as credit risks diminish and underlying fundamentals improve. The rebound in bank relative earnings will initially be mostly driven by the release of loan loss reserves and ongoing solid performance of non-interest income. As the economic recovery progresses, loan demand should gradually reaccelerate and contribute tailwinds to bank revenues and earnings. The steepening of the yield curve will help marginally improve net interest margins (NIMs). A more meaningful expansion of NIMs, however, is incumbent on a rise in short-term interest rates, which will only develop after the economic recovery becomes much more entrenched. U.S. bank stocks remain overweight in our portfolios and a significant way to play the economic recovery - and we are bullish on the group overall but emphasize the prospects for the sub-group and anticipate adding to exposure on price weakness.



Source: MRB Partners, Inc.

Following a sustained rally in oil prices, OPEC+ members agreed to modestly increase output by .5 mb/d, with the goal being to gradually return 2 mb/d to production. This came as a surprise to many analysts who anticipated an extension of the current output reduction level to carry forward into the spring. This most recent infusion adjusts production reductions levels from the current 7.7 mb/d to 7.2 mb/d. A gradual return to more normalized production levels in conjunction with higher demand should provide support for prices if shocks to the supply/demand balance are avoided.

Valuations for Energy Stocks at Multi Year Lows



The Energy sector of the AIM composite portfolio climbed in Q4, contributing to relative performance. Even after the recent rally, valuations remain historically low. The price to book ratio reflects more pessimism than depressed ROE's levels suggest. Our overweight in the sector underscores our expectation for Energy stocks to outperform as the demand for oil rebounds with a resumption in economic growth.

Industrial stocks have a relatively highly correlation with sentiment and should perform alongside economic growth. Management's reluctance to make commitments amongst uncertain times has depressed capital expenditures, which are likely bottoming here. Industrial production advanced in 5 of the past 6 months, a trend that bodes well for Industrials. Capacity utilization recovered to nearly 3% of pre-pandemic levels, reflecting the return of idling demand. Our positioning in Industrials centers around over-weights in aerospace and defense, building materials, diversified manufacturing and electrical products. Q4 earnings should bring about greater visibility to earnings, cap ex, and overall strategy. Valuations overall remain elevated making stock selection key going forward. The potential for a resumption in capex alongside inventory re-stocking this year are key themes moving forward. Overall valuations are relatively high compared to other sectors, highlighting stock selection as another important strategy while we remain focused on fundamentals and industry drivers.

The composite portfolio is underweight Technology by comparison to the S&P 500 benchmark index due to heightened valuations. Technology is a direct beneficiary of the pandemic that prompted a shift towards telecommuting and remote learning. This was evident in performance which outpaced the overall market by over 2500 basis points last year. Applied Materials, Oracle, Accenture, and Cisco had a strong relative fourth quarter rally and are positioned well for future growth. The landscape does not warrant a significant reduction in exposure here, but some profit taking may occur as opportunities arise throughout the year.

Healthcare stocks are overweight in the composite portfolio due to their desirable valuations and defensive nature in the face of a pandemic. We are overweight pharmaceuticals, healthcare equipment/services, and healthcare products/services with a particular emphasis on large cap pharma. The Biden administration plans to expand and reform the Affordable Care Act and Medicaid. This will benefit big pharma as well as managed care by expanding coverage. While Biden is committed to lowering drug prices, an overall negative for drug companies, he has suggested establishing review boards to negotiate prices which would allow manufacturers a voice in discussions. At reasonable valuations, healthcare stocks provide much needed balance to round out diversified portfolios, providing some defensiveness and stability.

IN CONCLUSION:

The proposed stimulus injection on top of an accommodative Fed policy, are on track to provide a stable base for earnings and GDP growth in 2021. A rebound in consumption trends and the labor market in the second half preceded, by a peak in Covid-19 infections and a successful vaccination distribution plan, could open the way for a resumption in GDP growth upwards of 5% in 2021. We will be focusing on Q4 earnings for corporate guidance heading into the new year. Initial consensus estimates anticipate a strong rebound in earnings this year (+24%) off of a depressed earnings comparison last year of an estimated decline of -15.9%. We believe the worst is behind us, as markets continue to price in forward expectations.

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Any performance reference represents a hypothetical composite compiled from actual equity, fixed income or balanced client portfolios and includes cash. These three composites reflect aggregated returns that address differing objectives. As such, the performance of each composite does not reflect the actual total portfolio returns earned by our clients. The investment performance records are compiled from a capital weighted average of the equity, bond and cash components of a broadly representative group of discretionary accounts that meet certain minimum size thresholds.

No gross performance returns that are referenced that are calculated after brokerage commissions but before investment counsel fees are presented without the comparable net performance figures after both commissions, investment counseling fees and other custodial charges. The net counseling fees are the actual average counseling fee calculated across all the portfolios included in the composite. All performance figures are presented on a time-weighted total return basis and assume all income is reinvested. The investment advisory fees are disclosed in Part II-A of the Investment Form ADV. Some clients may benefit from available discounting in the management fee schedule associated with the overall size of the portfolio. Management fees will reduce overall returns to the client.

The composites were created in 2001 and the inception dates start on August 17th, 2001.The composites include only discretionary fee-paying accounts managed in the strategies, and additional information associated with the composites are available such as: dispersion in individual portfolio results as well as the % of the firms AUM in the strategy. All performance calculations are presented within the GIPS® guidelines of the CFA Institute. The CFA institute does not endorse or promote this organization nor does it warrant the accuracy of the content herein.

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