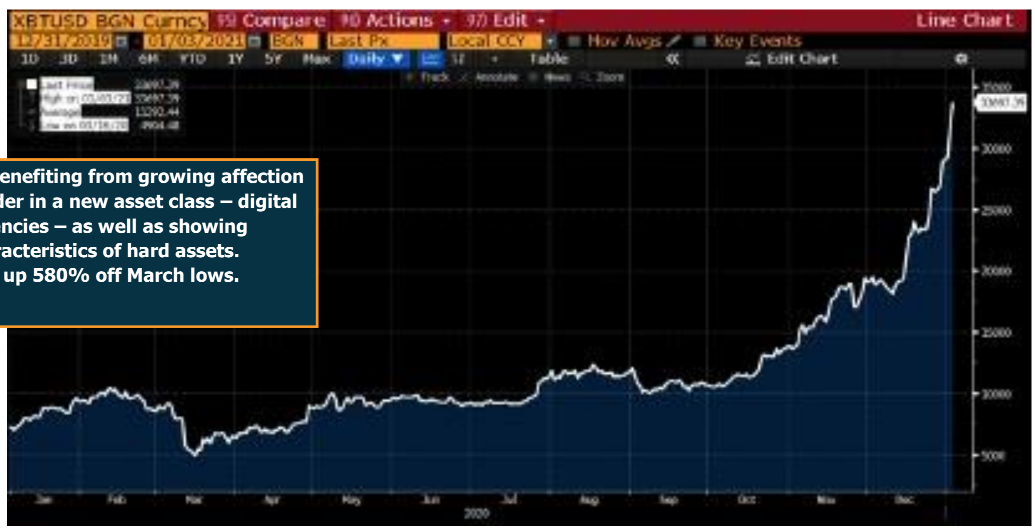
CHART & GRAPH REVIEW OF 2020 & 2021 PREVIEW

JANUARY 2021

It was a wild ride but the S&P 500 was up 16.6% in 2020.

Source: Bloomberg/Star Capital Inc.

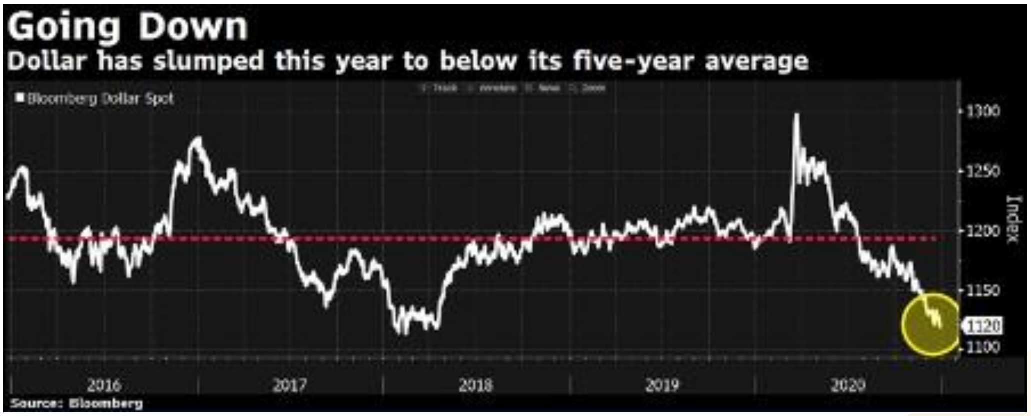
As you can see from the chart above, the S&P performance was above average last year and strings together a two-year annual run. Ironically, the stock market wasn't the top performing asset class though. Silver was up over 47%, gold up 24%, and…Bitcoin up an impressive 370% year-to-date (ending January 3rd, 2021).



Bitcoin is benefiting from growing affection as the leader in a new asset class – digital currencies – as well as showing characteristics of hard assets. BTC up 580% off March lows.

Source: Bloomberg/Star Capital Inc.

Price action in these assets tells us investors are reacting to the unprecedented moves of the U.S. Federal Reserve with an expectation these programs will continue. As later charts will illustrate, the Fed was significantly more aggressive in reacting to COVID than the Great Financial Crisis. As the Fed prints and injects money into the economy, hard assets benefit as investors seek to avoid U.S. dollar dilution and gain from potential inflationary pressures. These same forces drove the value of U.S. dollar down to 5-year lows.

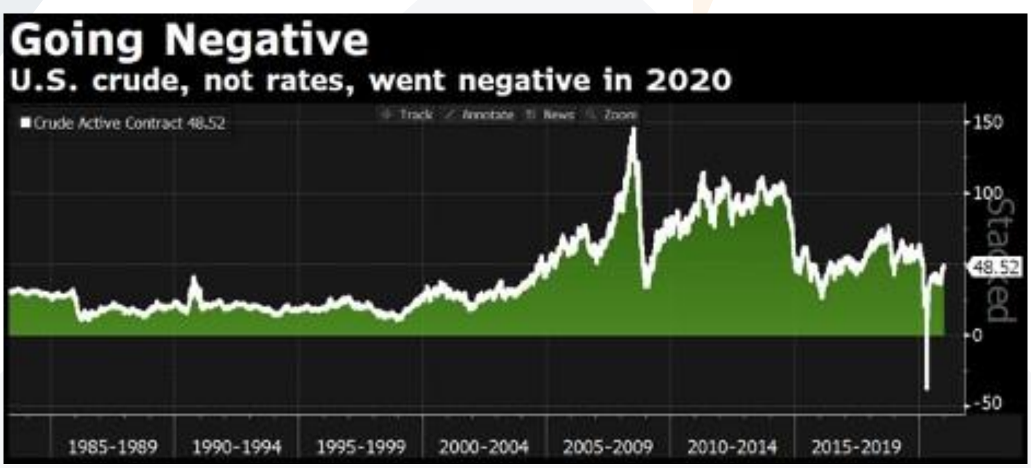


Source: Bloomberg/Star Capital Inc.

Since commodities generally have an inverse relationship with the price of the U.S. Dollar, it is not surprising to see this asset class perk up.

Source: Bloomberg/Star Capital Inc.

The year 2020 marked "a first" for the energy sector – negative spot prices – as lockdowns swiftly eroded demand and speculators maneuvered to avoid storage costs.



Source: Bloomberg/Star Capital Inc.

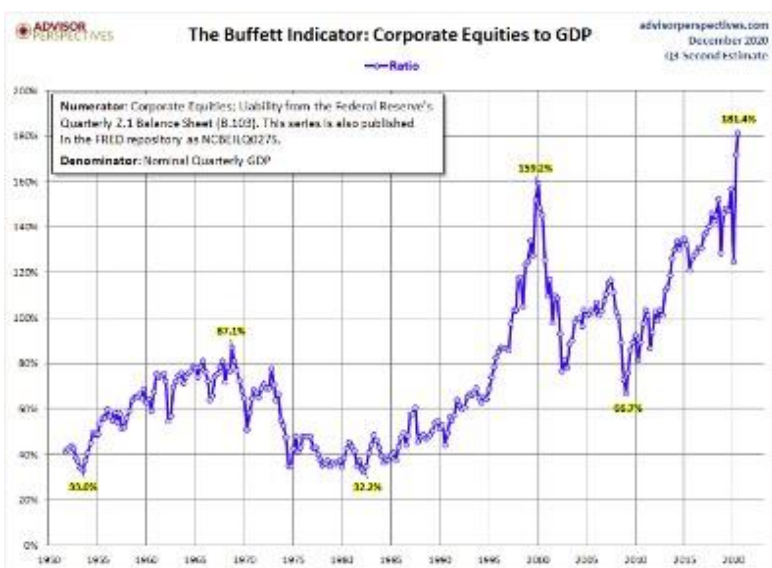
For the second year in a row, the technology sector led the stock market advance.

Source: Bloomberg/Star Capital Inc.

Technology outperformance once again drove "growth" over "value" styled investing. The second half of the year demonstrated some hints that this trend may reverse though. The slope of the recovery will dictate any sustainable performance of the "value" class of companies.

Source: Bloomberg/Star Capital Inc.

Where does the stock market valuation stand as we begin 2021? Stretched.



Source: [https://www.advisorperspectives.com/dshort/updates/2021/01/05/market-cap-to-gdp-an-updated-look-at- the-buffett-valuation-indicator](https://www.advisorperspectives.com/dshort/updates/2021/01/05/market-cap-to-gdp-an-updated-look-at-the-buffett-valuation-indicator)

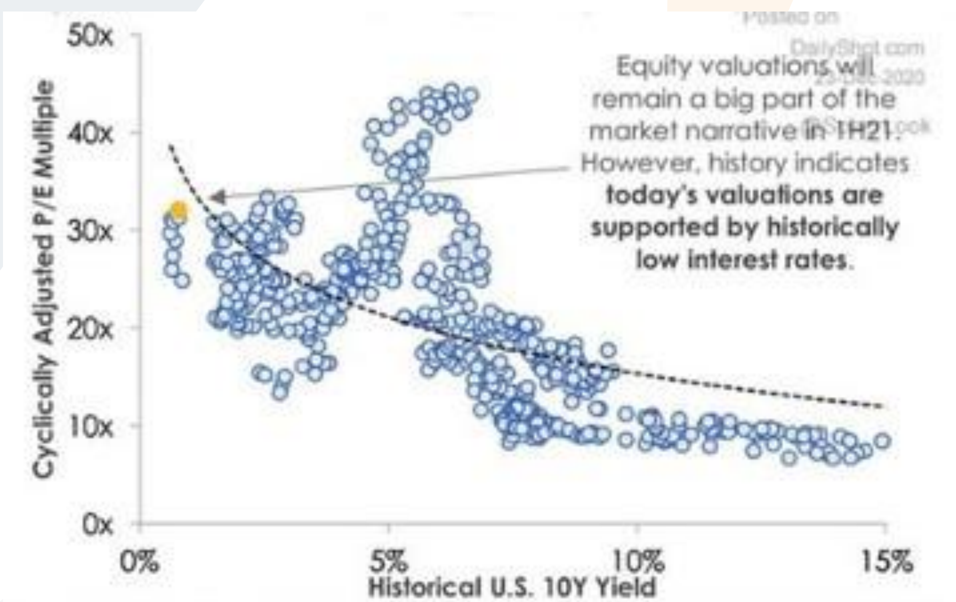
One of the big picture valuation indicators rumored to be favored by Warren Buffet is the market cap of the U.S. stock market versus our GDP. As you can see that ratio reached all- time highs last year.

Also, the market's price to sales ratio (total market cap divided by total company revenues) hit a level last seen in the ".com" era.

The market's Price to Sales ratio is back to ".com" era levels...but one can argue lower interest rates are justified in driving higher valuations. The US 10yr rate is 1% versus 6% plus in 2000.

Source: Datastream/Pictet Asset Management

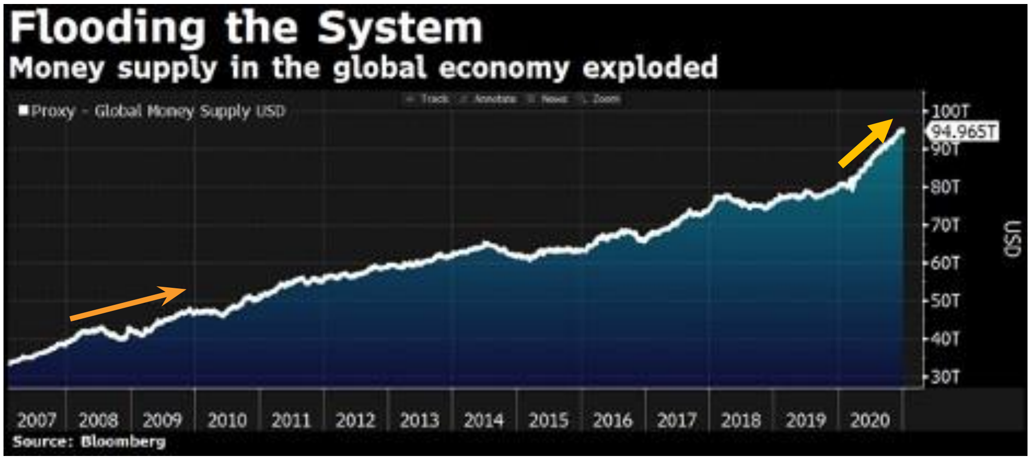
On a price to earnings (p/e) basis, the market is expensive, but less so when factoring for low interest rates. This chart suggests an inverse relationship – lower rates equal higher p/e multiples and vice versa.



Source: MarketDesk Research, Yale/Robert Shiller

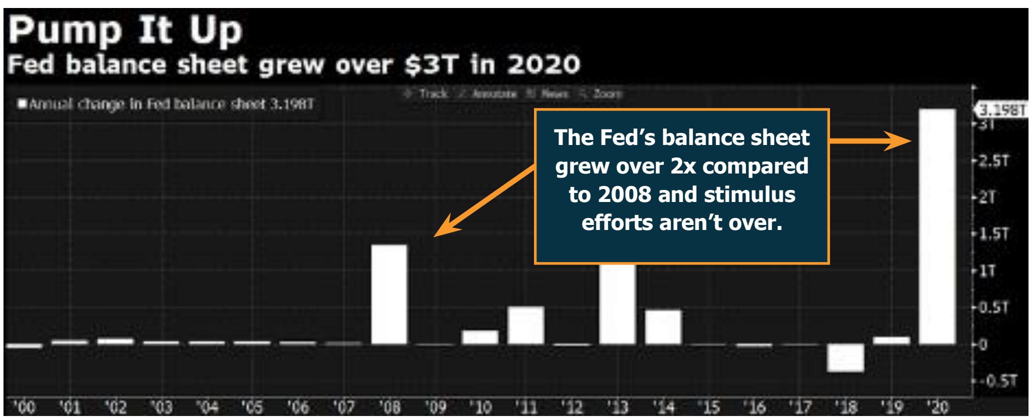
The key with this valuation metric will be the direction of interest rates. Investor sentiment on future rates can change fast but recent comments from Jeremy Powell, chairman of the Federal Reserve, indicate their expectation is to keep rates low until the labor market improves and inflation sustains above a target of 2%.

By injecting money into the financial system, the Fed grew money supply at a staggering level. Look at the slope of the curve in money supply growth compared to the Financial Crisis of '08.



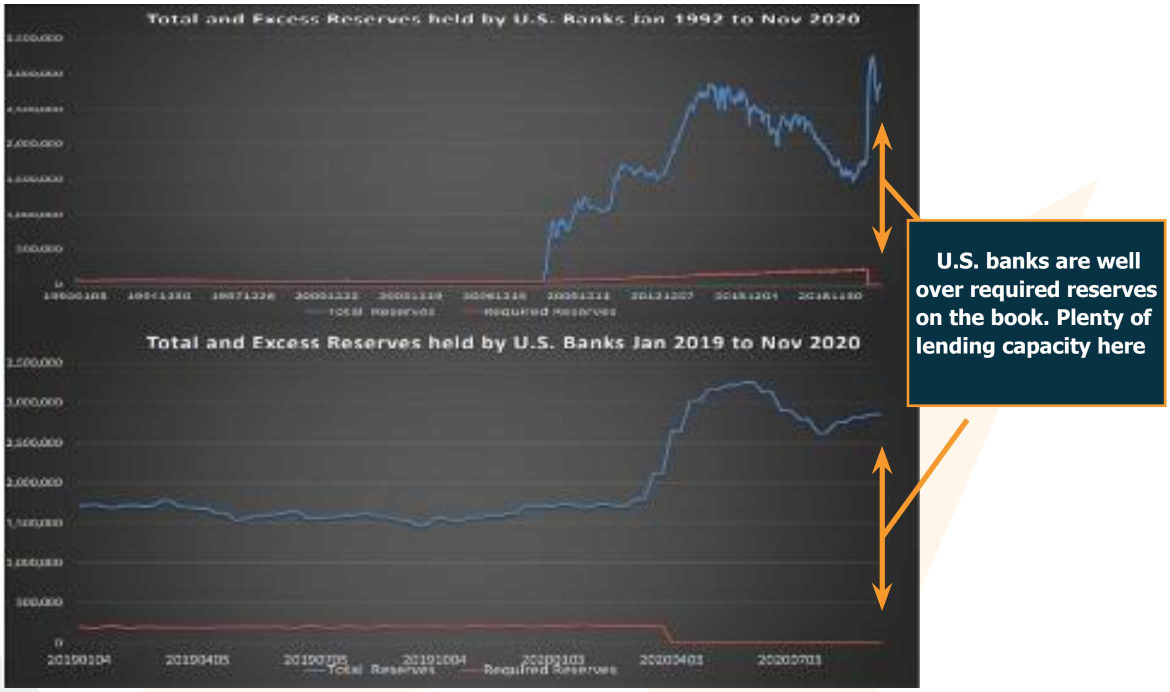
Source: Bloomberg/Star Capital Inc.

These actions drove significant growth in the Fed's balance sheet (they take on debt to put money into the economy and buy debt issued by the government). Again, unprecedented moves even relative to 2008 – the largest financial crisis since the Great Depression.



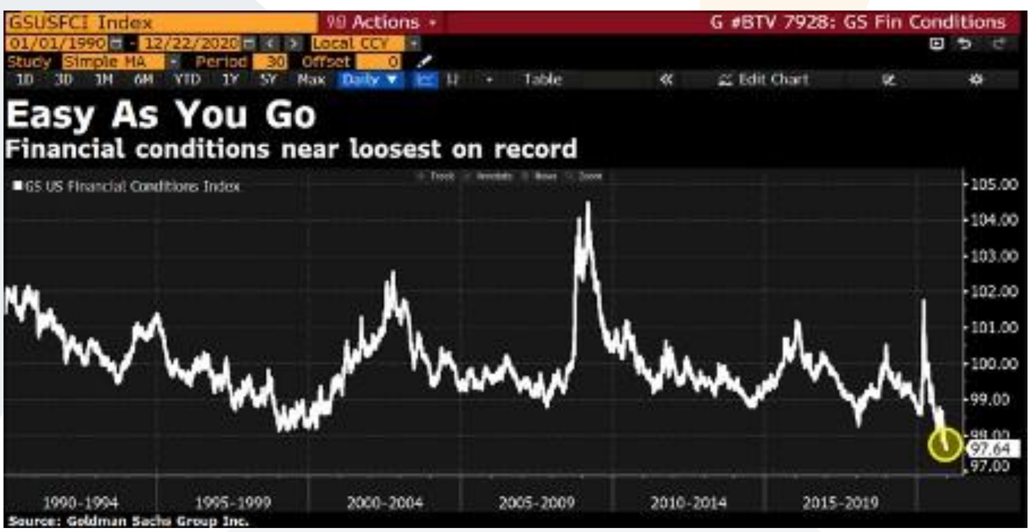
Source: Bloomberg/Star Capital Inc.

The economy is not short on liquidity. Most financial institutions are well above reserve requirements and in a position to boast lending.



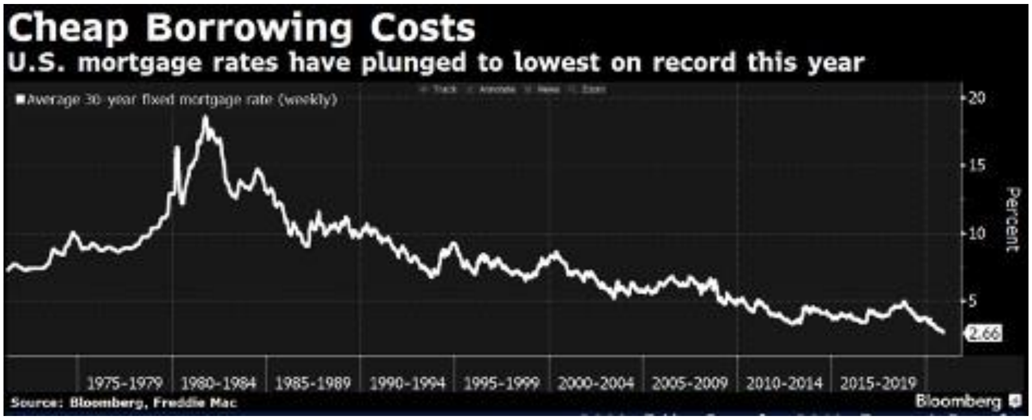
Source: Federal Reserve/SISR

All these actions of the Fed have resulted in the most attractive and loose financial conditions ever!



Source: Bloomberg/Goldman Sachs

Mortgage rates are at the lowest level ever. On the other hand, affordability has pinched home buyers as prices have escalated due to enhanced borrowing capacity. This induced "asset inflation" is one of the criticisms of central banks.



Source: Bloomberg/Freddie Mac

The monetary theory tells us as assets appreciate, a "wealth effect" is created for consumers. They feel wealthier and start spending money into the economy. It is this target where the Fed and other central banks are actually failing miserably.

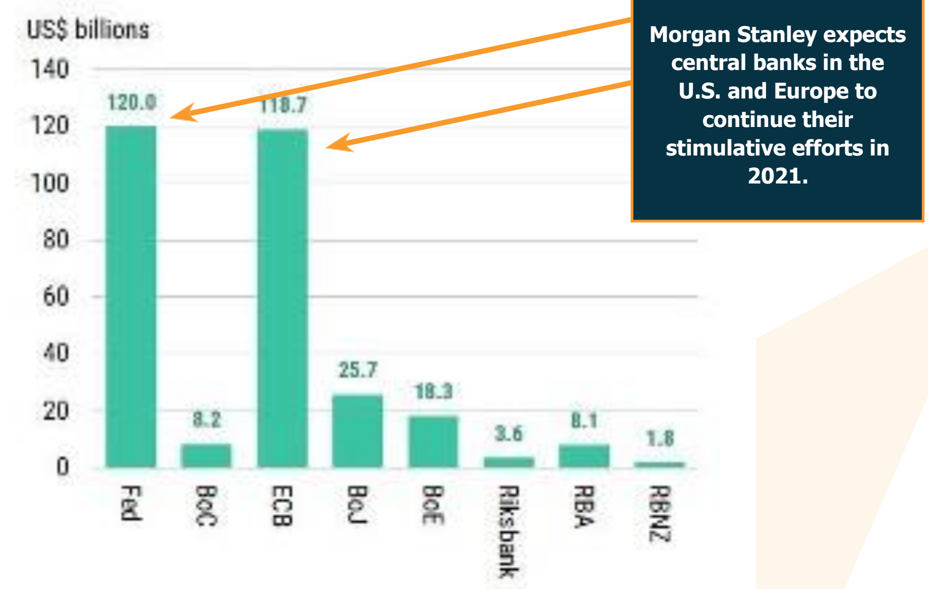
Underneath the surface, eroding velocity of money (measure of the rate of spending) has been a consistent drag on improving economic growth.

Source: Federal Reserve Bank of St. Louis

The goal is to increase the velocity of money. Velocity of money is the rate at which money is being spent in the economy. This downward trend has only accelerated with COVID. We would argue part of this downward force is just straight demographics - an aging population where baby boomers are over the peak spending age of 46 years while millennials are too early in their earnings cycle. Consumers still have a cautious mindset and continue right-sizing their balance sheets as memories of the housing crisis are slow to age.

We do not see the Federal Reserve changing course anytime soon. As the chart at the top of the following page plots, the Fed is expected to keep the money train going. Is it the right thing to do in the long run? No, in our opinion, but we don't make the rules. This fact should provide a favorable monetary back drop for stocks and other assets going into 2021.

Exhibit 8: G10 central bank expected average monthly QE pace in 2021, in USD



Source: Morgan Stanley Research, National Central Banks, Bloomberg

Despite monetary efforts, we expect there to be volatility as risks loom while our sentiment indicators, on balance, indicate fairly optimistic expectations.

It is the state of debt markets that concerns us most. As our ***Star Capital Inc. Debt Series*** research report concluded over a year ago, the world is awash in significant amounts of debt where risks are mispriced. Request a copy of the report from your financial advisor if you would like more detail.

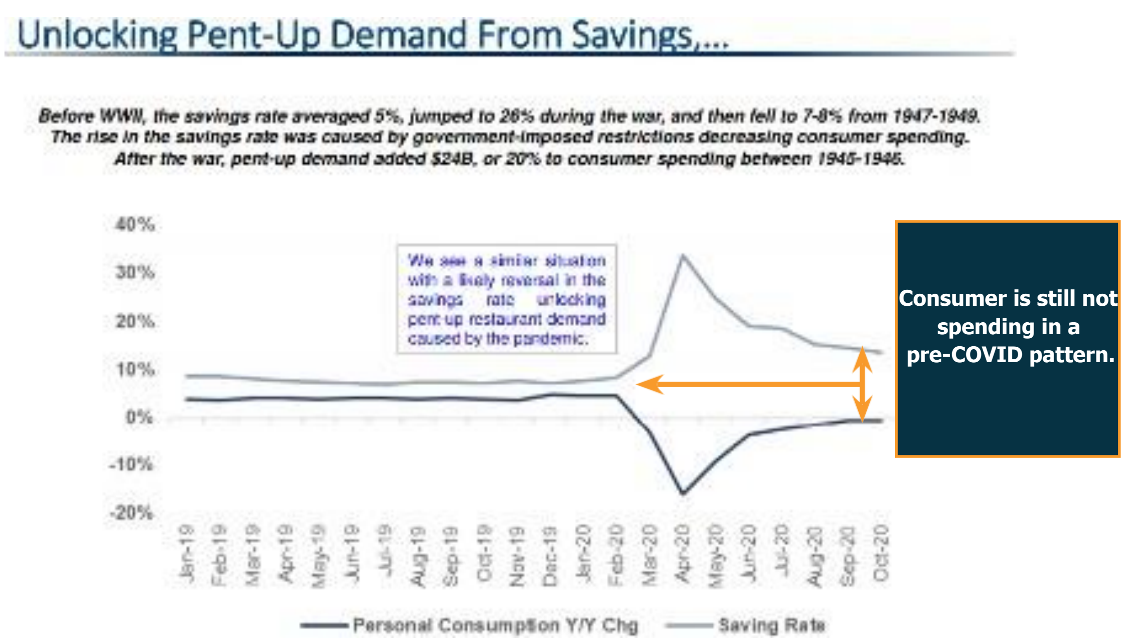
Source: Bloomberg/Star Capital Inc.

You are not reading this chart incorrectly. Seventeen trillion dollars of debt in the world is in the class where bond holders pay the issuer. It sounds crazy but this is the case. Had the Federal Reserve not intervened by buying bonds directly in March 2020, the debt market would have frozen similar to the financial crisis, in our opinion.

While bankruptcies are off the peak, this trend needs to be monitored closely. A reversal due to continued slow recovery could negatively trigger the bond market.

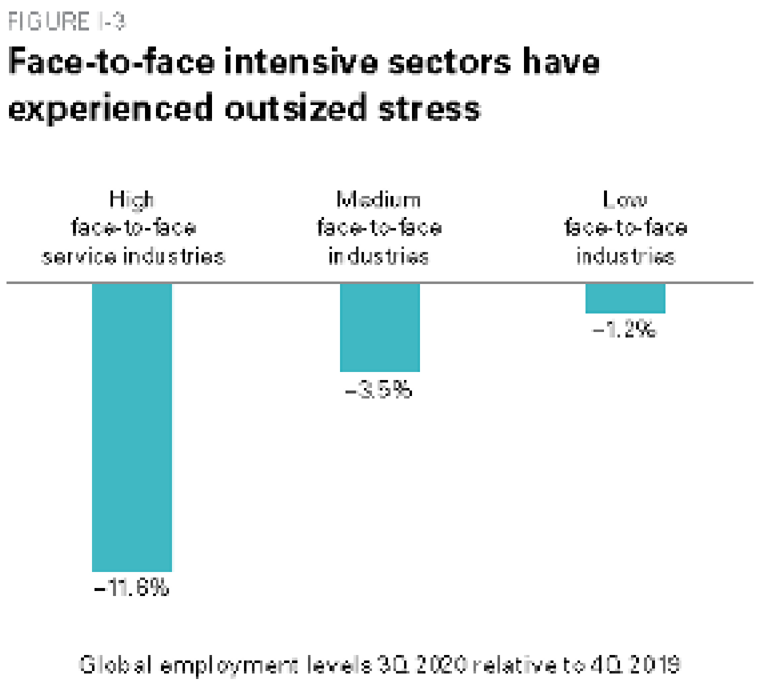
Source: Bloomberg/Star Capital Inc.

A potential positive dynamic, as the excerpt from a Stifel research report below depicts, is consumers stopped spending and saved during the heart of the crisis. The return to a typical pattern would be positive for main street businesses.



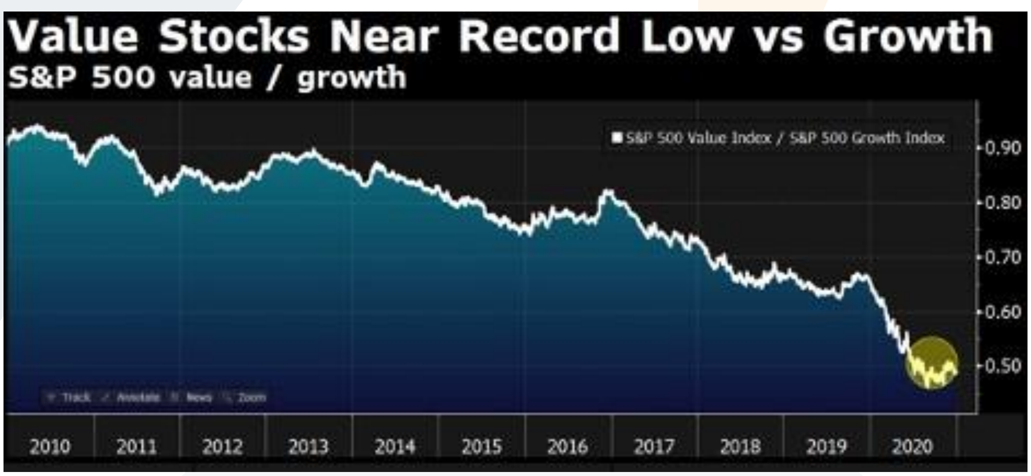
Source: Bureau of Economic Analysis, Stifel Analysis

The high “face-to-face” (F2F) businesses were hardest hit during the crisis and may offer investors an opportunity to find less exploited investments in a normalizing world.



Source: Vanguard economic and market outlook for 2021: Approaching the dawn, December 2020

A recovery in these front-line industries could trigger a sustainable reversal in the “growth” versus “value”, in our opinion. As the chart below shows, this reversal has been a long time in coming.



Source: Bloomberg/Star Capital Inc.

We will be monitoring changes in initiatives as President-elect Biden and his team enters office. Some of the obvious topics we'll be following include impact of escalating tax rates, especially related to capital gains rates; deficit spending and infrastructure investment; changing energy priorities; potential tapering or reversal in monetary stimulus; and student loan forgiveness and college assistance.

We will continually monitor, assess, and adapt to the ever-changing environment. Please feel free to contact us with any questions or interest in additional thoughts. We appreciate your trust and confidence.

THANK YOU

Star Capital Inc.