SYMONS® CAPITAL MANAGEMENT

QUARTERLY INVESTMENT LETTER
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SEEKING TO PROTECT DURABLE WEALTH AND FINANCIAL SECURITY IN AN EXPENSIVE MARKET

2020 REVIEW AND THE BIG PICTURE

2020 was a truly one-of-a-kind year in many ways. Focusing on the financial markets, a lockdown-created recession met a record-breaking stimulus. At least for 2020, stimulus won. The unprecedented flood of liquidity by central banks (the Fed doubled its asset holdings) and governments (the U.S. government generated previously unmatched deficit spending and stimulus payouts), when coupled with the historically low interest rates created a frenzy of asset buying, particularly in more speculative stocks. The popular belief that Fed asset purchases and government stimulus will bail out all of us forever has made this appear to be a "no risk" market. But history suggests there is no connection between such beliefs and economic reality. What won in 2020 does not make much sense as a viable investment strategy. While we continue to see a lot of optimistic stories to justify the expensive stock market, the hard data for the past several years show little growth in corporate revenues or earnings, a slowing economy, a struggling jobs market, and, most disappointing of all, a lot of stressed and struggling people around the world.

The periodic recurrence of stock speculation is a given, but at some point it looks to be a bit too risky. Should you really buy a company that hasn't made money for a decade and has no prospects of making money? If you are OK with that type of investment because you like the story and dismiss the data, you should be really confident you won't be the person left holding the bag when the story encounters the end game of continuing earnings losses. It has happened before. History suggests that selling often appears only after the investor psychology of greed turns to fear; after investor risk indifference turns to risk aversion. No one knows when that might happen, but you actually don't have to know if you consistently manage risk.

When should an "investment" be classified as "speculation?" One of the classic examples of speculation was investment in tulips in the Netherlands in 1636. Certainly tulips had some modest value. But what made the soaring tulip prices speculation was people buying in the hope of making a quick profit by selling to another "investor" with the same quick profit motivation, most of who were also buying on credit. Once prices started to drop buyers disappeared because the intrinsic value of a tulip bulb was still modest. Classifying something as an "investment" tends to be more focused on using it as a "store of value" and being willing to hold it for an indefinite period of time without worrying about interim price changes, due to the judgment that the investment has sustainable value and a fundamentally sensible purchase price because of the underlying products or services it offers.

THE ECONOMY AND INVESTMENT MARKETS

Eventually, the economy matters greatly to the success of the stock market. With all the debt and interventions, the U.S. economy is looking more and more like Japan, as are the European Area countries and the United Kingdom. More debt and less growth. Inflation remains low because of unused worldwide productive resources and weak economies. Because Japan and others have even greater debt burdens than the U.S., at least until recently the dollar's relative strength has limited our inflationary pressures. But potential problems are surfacing involving inflation, higher interest rates, and debt. Government money printing unsupported by economic growth suggests the potential for inflation, as more money chases the same amount of goods and services. Then the appearance of inflation eventually results in higher interest rates. But the Fed and government can only allow interest rates to rise modestly because higher rates increase the burden of debt. It is a difficult, delicate balance.

There are various ways to deal with debt burdens growing faster than GDP. But none is easy or pleasant. As a result, we really haven't tried any of them. One way is to save and repay. But today's politicians don't like austerity because they are afraid they won't be reelected. Another is to create real economic growth, which over time can reduce the percentage of revenue allocated to debt repayments. Unfortunately that hasn't worked for multiple decades because cheap money tends to go toward speculation rather than productive investment. Two more realistic, but still difficult, possibilities are either getting rid of bad debt by restructuring or default, or by inflation, which historically is the favorite of governments. Overall, the difficulties of resolving debt problems are enormous, as are the risks of inflation and higher interest rates.

More specifically, we don't know what will alter the current euphoria of the stock market versus the weak economy. Is the economy going to surge back because we have a vaccine? Or is there ongoing damage from stopping the economic machine? The most important thing is that we are reasonably prepared for alternative future outcomes. Speculative investors can be unnerved by increased market volatility, or by a rotation from growth to value. But such unexpected market changes can create opportunities. Positive vaccine news in the fourth quarter caused some consumer staples stocks to briefly drop 8% – 10%, which gave us an opportunity to put some cash to work at a more attractive price point. We constantly look for relatively low-risk opportunities like that.

How about the new year? The current popular consensus for 2021 is for another great year for the stock market. We're not saying a great year can't happen, but we would point out that the 2021 stimulus and central bank asset purchase numbers that are being bandied about are notably lower than the numbers we saw in 2020, and the economy seems to be stabilizing at a lower level than where it was at the start of 2020. We've now had 12 years that have largely been about the Fed constantly intervening in financial markets to protect and inflate financial asset prices. Could the interventions slow soon? Wall Street is confident that won't happen, but we don't want to be around the epicenter of the expensive mega-cap stocks should they be wrong. When that happened in the 2000 tech bubble, a lot of junk tech went down 90% or more, and many totally disappeared, including big names such as Lucent, Sun Micro, and Nortel.

For 2021, we see an expensive stock market and a burdened economy. Is our forward looking market thinking always perfect? No. In 2020 we stayed

cautious because we are always trying to be responsible with the money clients have entrusted to us. Honestly, responsible behavior paid poorly in 2020. We saw too much risk in the massive increases in asset purchases, money printing and debt as a serious policy game. We consistently try to be prepared for what we see as realistic risks in a market where it is hard to find realistic rewards.

INVESTMENT STRATEGIES AND PORTFOLIO MANAGEMENT

Taking outsize risks can set you back a decade or more. Believe it or not, from its 2000 peak, it took the S&P 500® Index about 10 years to get back to even. And from its 2000 peak it took the Nasdaq index about 15 years to get back to even. Today, 20 years after the 2000 market peaks, investment psychology is carrying virtually all indices to new heights and new historically stretched valuations. Is there a limit to how much you are willing to pay for a future stream of projected probable income? If you look at annualized returns from March 2000 to the end of 2020, the S&P 500 has annualized returns of about 5%, and Nasdaq of about 4%. So the indices have beaten inflation by a bit, but the indices also are now back to valuations levels quite similar to those we saw at the 2000 peak. Could we be looking at a similar multi-year trip to nowhere? The moral of the story is pretty clear. Be patient. In 2000 few investors considered the possibilities that, not too far in the future, energy stock prices would be materially higher and technology stock prices would be materially lower. Perhaps history really can give us some insights to inform our thinking about the future.

We are comfortable holding cash when it makes sense. Does holding cash have any value in a market that is expensive, but continues to reach new highs? We think the answer is Yes. In a market where there are limited attractive risk/reward opportunities, the downside risk differential between cash and stocks with little earnings often makes cash a more attractive choice. And, if investor psychology changes to risk aversion, cash becomes an even more attractive asset because increasingly attractive risk/reward opportunities appear in a market downturn. Today the principal objection to holding any cash is the belief that the Fed will protect everyone from every market downturn. Just as we did in 2000 and 2008 we prefer to navigate the investment world without trusting in the Fed to save us. While the Fed has been with us since 1913, time and again it has proven to be essential for investors to manage their portfolios with a margin of safety. Holding cash, and waiting to see what happens, often gives investors much better investment choices as the future unfolds in frequently unexpected ways. As a result, if we can't find anything attractive to invest in today, it makes sense to hold cash and retain the option to invest in something that becomes unexpectedly attractive tomorrow. When the market is expensive, the value of cash is at its highest. When a downturn makes the market cheap, as numerous attractive risk/reward opportunities appear the reasons for holding cash recede.

There are still some reasonably priced stocks to buy. They're an increasingly small minority of available stocks, but they're still out there. So, in general we are buying, but buying slowly. We particularly like precious metals stocks, even recognizing they can be volatile for a variety of reasons. In the second half of 2020 they attracted a lot of momentum investors, who usually are principally focused on big tech. That sent the precious metals stocks soaring. But precious metals stocks are not nearly as liquid as big tech, and so when the positive vaccine news spurred a rotation out of momentum into cyclical value it hurt the precious metals stocks due to their lesser liquidity. We can live with such short term price moves in stocks that we believe have long-term attractions. The latest earnings from the miners were great, and we don't really expect that to change. We recognize that mining stocks would be affected if the economy came roaring back and interest rates soared. But both of those possibilities seem unlikely to us, particularly the idea of higher interest rates. In any case, we currently find precious metals stocks to be one of the more attractive investments.

CONCLUSION

We view the current disparities between the economy and the stock market as dramatic, unsustainable and a poor risk/reward proposition. We don't know when it will change, but ultimately economic data like GDP and asset prices will reconnect and then decent investment opportunities will again appear. Investing is not about going after the last dollar of hoped-for gain. It is about first protecting what you have accumulated, and then building it in a way that doesn't risk setting you back by a decade or more.

Very few ideas about the future of the financial markets, or anything else, are completely certain. In fact the supposed certainty of science is actually founded on dealing with uncertainties, or on questioning supposed certainties. Otherwise, how else could science or any other area of inquiry advance? One of the greatest scientists in U.S. history was Richard Feynman. He made dramatic scientific advances in particle physics, quantum mechanics, quantum computing, and nanotechnology, and won the Nobel Prize in Physics. (If you have never heard of Feynman, we suggest you read *Surely You're Joking Mr. Feynman! (Adventures of a Curious Character).*) Feynman repeatedly said that "Scientific knowledge is a body of statements of varying degrees of certainty — some most unsure, some nearly sure, but none absolutely certain." Wall Street likes to tell us stories about the next sure thing that you can't pass up. As Feynman said — while a story may have some basis in fact, it is not certain — whether it be tulips or Tesla.

Today, we frequently hear that growth stocks should be the focus of investors. If you pay attention to risk/reward, the core of our Intelligent Risk Management approach, perhaps it makes more sense to think in terms of trying to buy "growth" stocks at "value" prices. There are no certain definitions of growth or value. The basic concept of "growth" is that earnings are expected to grow at a faster rate than earnings of "value" stocks. Few growth stocks have significant dividends. Between the uncertainties of actual future earnings growth and low dividends, the fundamentals suggest a more concerning risk profile. The basic concept of "value" is that you are seeking stocks that are trading at a low price relative to their long-term fundamentals, such as low price-to-sales. In such a case, the probabilities of the uncertainties are more on your side. Such stocks may have above market dividends, and more broadly buying an asset at a discounted price should reduce your risk. Bottom line, while Symons Capital is often classified as a value manager, we view our work as being focused on risk/reward analysis, on seeking to buy stocks that we believe have more attractive futures than does the market consensus for those stocks. By doing so, in 1998-2000 we may have lost the battle, but ultimately we won the war, as was also true in 2006-2008. That is how we seek to build durable wealth and help clients develop financial security.

Today's economy has little organic growth. What growth we have is based on debt, and the burden of debt slows future economic growth. While speculation has been rampant over the past several years due to the moral hazard of continuing Fed and government interventions in the markets, we prefer to look for relatively reliable investments in stocks that have stable revenues, cash flows, and earnings, along with manageable debt. Why? Because we are again seeking to win the war and the preservation of capital is paramount to long-term success.

Yours sincerely,

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Chairman & Founder	Chief Investment Officer

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