BROOKMONT
CAPITAL MANAGEMENT

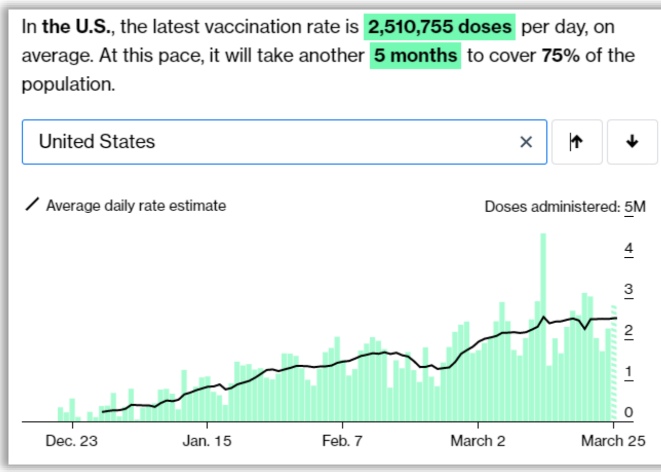
Speculative Assets Make News, Cyclicals Make Returns

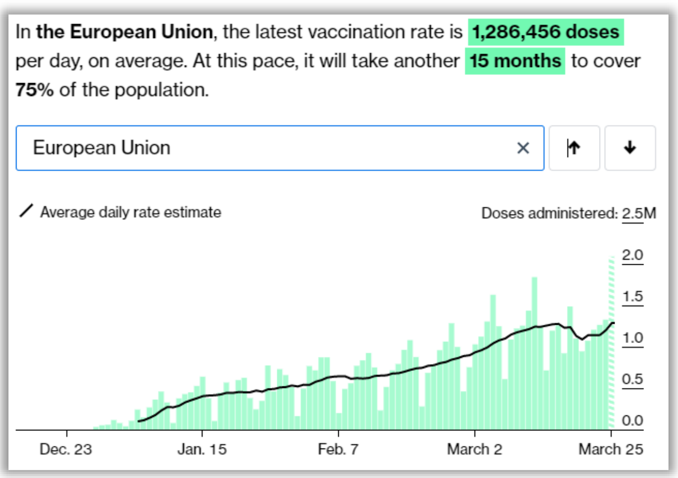
- S&P returned 7.36% in the 1st Quarter of 2021, while the Russell 1000 Value outperformed the Russell 1000 Growth by 10.32%
- Geographical discrepancies of the vaccine roll out will lead to an US economic recovery before the rest of the world
- Interest rate movements are causing a broad value rotation as the 10-year Treasury Rate rose 87%
- Negatively correlated sector specific volatility muted broad market volatility
- Are thousands of autonomous currencies backed by the full faith and credit of a person with a computer an investment?

COVID Vaccine update

The US continues to lead developed countries in vaccine deployment. At the current vaccination rate in the United States of ~2.8 million doses per day, herd immunity (75% of the population fully vaccinated) will be reached by July. In contrast, the European Union is only administering ~1.8 million doses per day; 35% fewer than the US on a gross basis and over 50% fewer on a per capita basis. At this pace, herd immunity will be reached by February 2022.

*Bloomberg

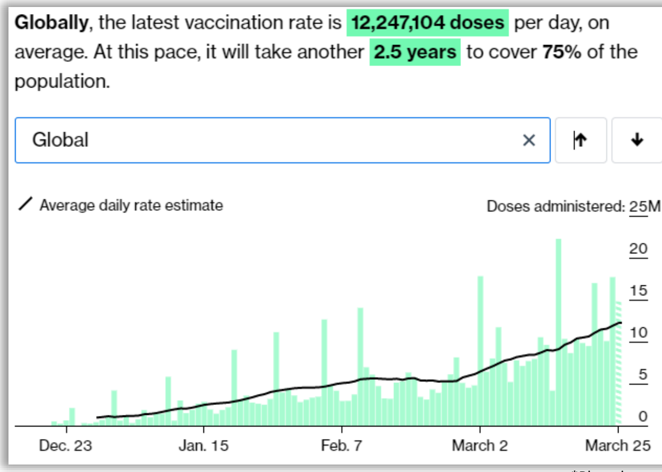




*Bloomberg

Looking only at COVID metrics, the US economy will recover faster than the EU, particularly in service-based industries. Further driving the divergence in economic recovery is the larger amount of stimulus that has been injected into the US economy. Businesses dependent upon reopening, such as airlines, hotels, and other leisure names, will vary in financial performance based on differences in geographic exposure, with increased US exposure driving outperformance over international industry peers.

Expanding to the global scope for vaccine progress, at the current pace, the 75% milestone will not be reached until March 2023 (24 months from present). Vaccine rollout in developing countries faces numerous challenges: lack of government leverage to negotiate supply agreements, affordability of doses, limitation of viable vaccine candidates due to scarcity of necessary refrigeration equipment, and far less funding available for government infrastructure and personnel required to deploy vaccines.



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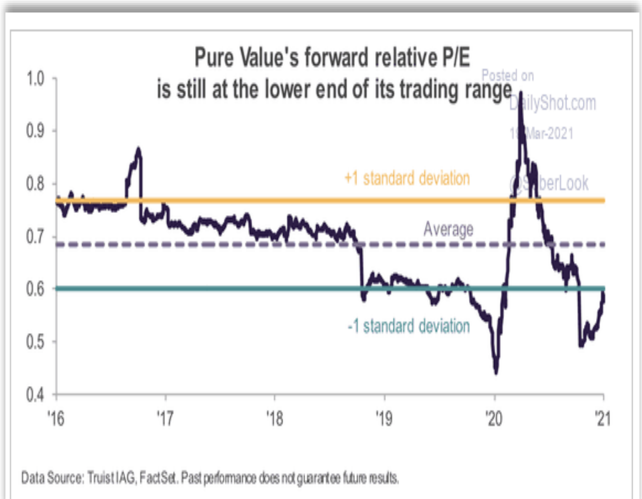
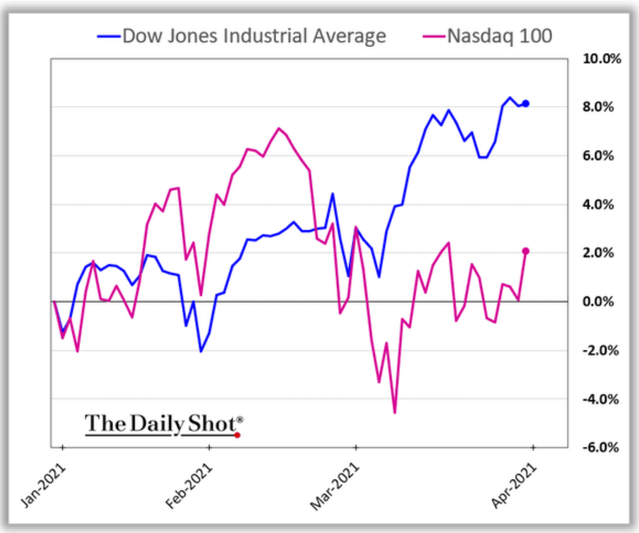
Interest Rate movement causing Value Rotation

In a rising rate environment, riskier assets are adversely affected as risk free assets become more attractive. This will lead to the continued "Great Value Rotation" that we wrote about in November 2020, as investors will chose to rotate from assets with high interest rate risk (growth stocks) and into the relatively undervalued stocks that are priced using near term cash flows (value stocks). As you can see in the graph on the side, value stocks' forward relative Price to Earnings ratio is still at the lower end of its trading range. With the reopening of the economy and summer approaching, there is potential for aggressive earnings growth from these securities.



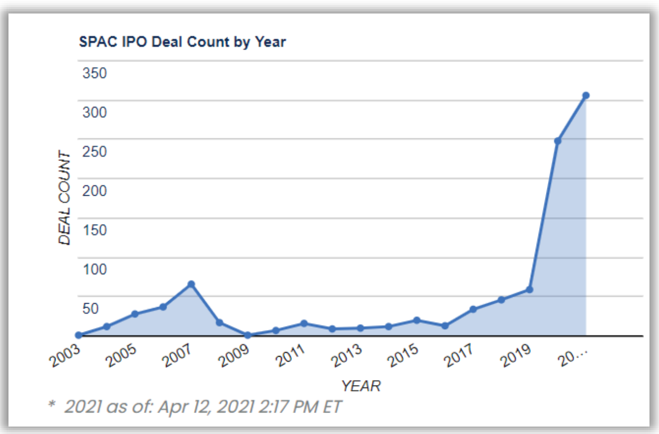


During the 1st quarter of 2021, the economy started to rebound as the lockdowns were lifted and vaccine distribution ramped up in the United States. This along with inflation fears resulting from more fiscal stimulus lead the 10-year treasury rate to increase 87%, from 0.93% to 1.74%. The increase in rates had a negative affect on long duration assets as the Dow Jones Industrial Average outpaced the tech heavy Nasdaq 100 by 4.69%. It is expected that the 10-year treasury is to remain at the current level or even increase to over 2% by the end of the year as the Federal Reserve has adopted a new "average inflation" policy which will allow the economy to run hotter than the previous "target inflation" policy.

Negatively Correlated Sector Specific Volatility Muting Broad Market Volatility

During the first quarter of 2021, the US equity market experienced a significant volatility. As shown in the graph to the side, the total value of market cap gains and losses in 1Q21 puts the S&P 500 on pace to reach a similar level of absolute volatility in 1H21 as in 1H20. It is crucial to differentiate this metric of absolute volatility from the VIX. The CBOE Volatility Index is based upon volatility expectations for the entire S&P 500 index; while this can accurately capture macroeconomic and market-wide sentiment, it fails to represent the amount of volatility in particular sectors and individual securities within the index. The inverse relationships of various sectors have resulted in low index volatility; for example, most days that the technology sector declined cyclical sectors increased. The recent negative correlation between cyclicals and tech can be primarily attributed to the impact of interest rates and inflation expectations on individual company valuations and growth prospects.

Are thousands of autonomous currencies backed by the full faith and credit of a person with a computer an investment?

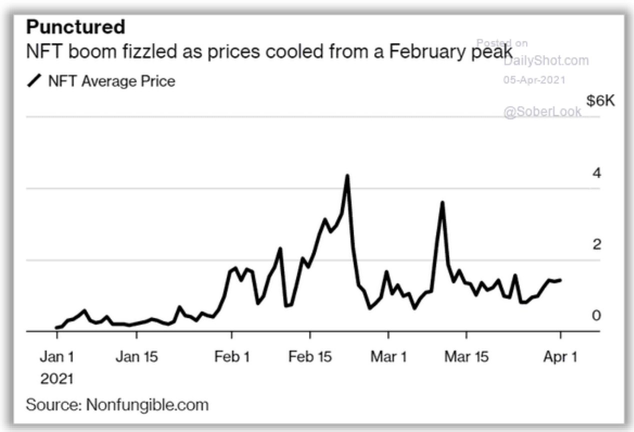


*Forbes

Markets have been focused on highly speculative securities and asset classes during the first quarter of 2021 this includes names such as GameStop, AMC, SPACs, and cryptocurrency.

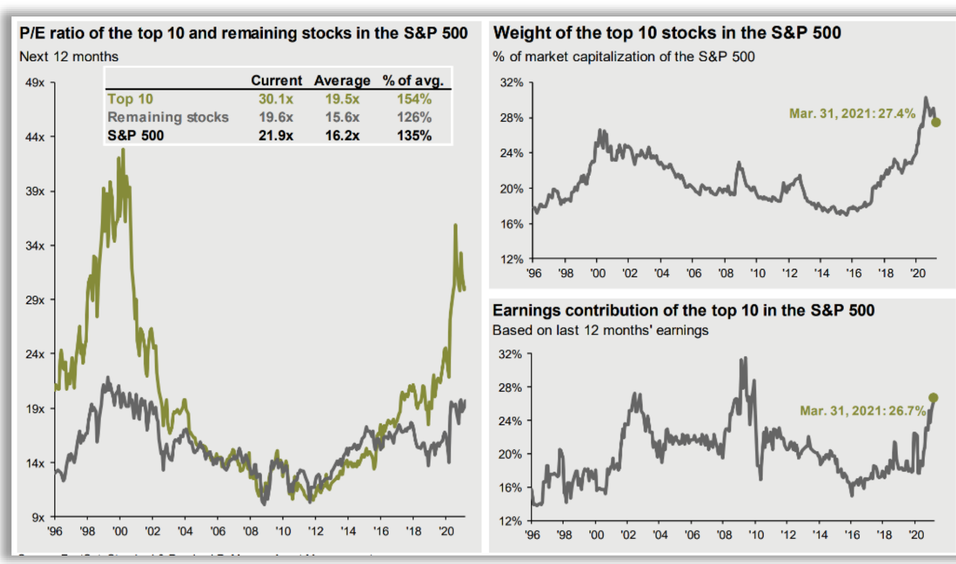
In some cases, such as GameStop and AMC secondary market trading dynamics were met with massive supply demand imbalances as short positions exceeded the supply of shares available resulting in companies having their valuations skewed based on trading dynamics and not the fundamentals underlying their businesses.

SPACs or blank check companies have gained in popularity for several reasons including the need for quick capital formation and deployment as our society and economy takes a sudden pivot due to the global pandemic. This has resulted in a need to funnel growth capital into smaller businesses to help effectuate growth in new segments of our economy that were small or nonexistent prior to the pandemic. However, the efficacy of a SPAC relies on the SPACs management team to source and diligence catalytic deals to expand businesses that will experience rapid and sustainable growth. Recently more attention has been placed on the SPACs secondary trading levels than the viability of the proposed transactions.



Crypto currency and Non-Fungible Tokens (NFTs) have gained traction as a popular asset for hyper appreciation. While blockchain technologies are interesting, it is hard to consider the value storer as an investment particularly given the lack of regulation and the idea that if and when it becomes a widely accepted legitimate currency alternative the global regulatory environment will squash speculation for a number of reasons including: inability to influence money supply and hence rates/inflation/economy, inability to track holders or transactions leading to more easily transacted illegal ventures, and inability to tax and economic destabilization due to susceptibility of market manipulation by private and public interests alike. The idea of thousands of autonomous currencies backed by the full faith and credit of a person with a computer does not feel like an investment and the massive unrealized gains discussed at the water cooler sounds like a speculative bubble.

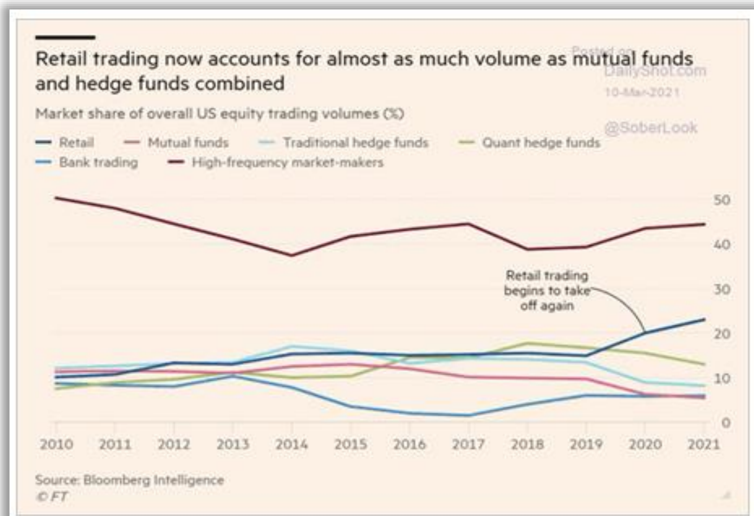
Finally, to a lesser extent the overbought growth stock market feels similarly frothy. As mentioned, the rotation from growth stocks to value stocks began in late 2020 due to relative value and rate fears. As of the First Quarter of 2021 the top ten stocks in the S&P 500 accounted for nearly 30% of the index and had a price to earnings ratio over



*JP Morgan Research

50% higher than the remaining 490 stocks in the index. The top seven of these names are all growth technology companies.

One of the drivers of these more speculative trades includes the continued growth of the retail trader. As the pandemic began, the retail trader at home has accumulated as much trading volume as mutual funds and hedge funds combined. The fear is that tactical traders selling in and out of securities create more volatility, particularly in the trendier growth stocks. Investing in the equity tranche of a company's capital structure has many intrinsic benefits that are not realized if the sole reason for your trade is to quickly sell it at a higher value.



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