Hemenway
Trust Company LLC

Winter 2021 Investment Report

It's hard not to be optimistic about 2021 after a chaotic 2020 – which saw US employment decline by almost 10 million jobs, a tumultuous election cycle and over 400,000 lives lost to COVID-19 in the US. We expect a strong recovery in the economy in 2021 as the majority of adults are vaccinated this year and look forward to resuming client meetings across a table versus in front of a screen!

We are not alone in our optimism.
Even as COVID-19 cases ramped up in Q4, markets focused on the positive vaccine news, more stimulus from governments and a conclusion to the US presidential election. US large cap stocks, which had led equity markets (due to a heavy tech focus), rallied another 12% in Q4 2020. However, virtually all equity asset classes saw strong returns in 2020, with US small cap stocks up 30%+ and emerging markets up 20%. Equity analysts have continued to increase their expectations and now project S&P 500 companies will see sales grow by 9% in 2021 and earnings grow by 23%.

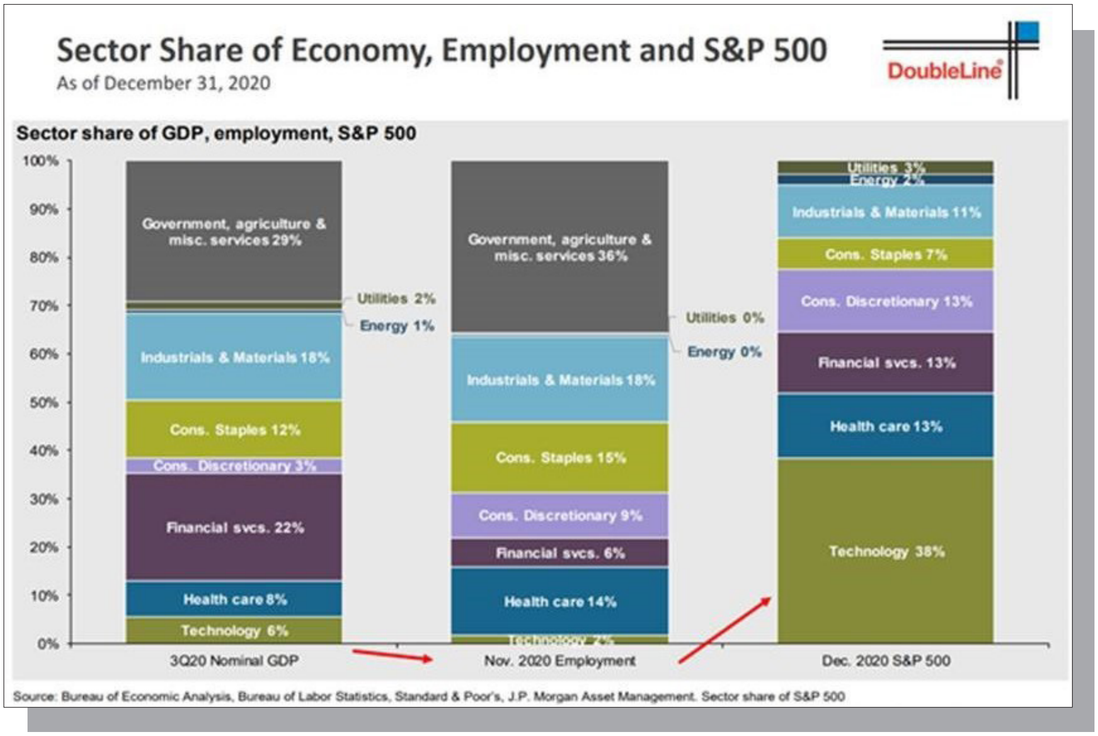
The energy, industrial, retail and financial sectors should see the largest growth, as these sectors were most-negatively impacted in 2020. Our portfolios had been underweight in these cyclical sectors for the past several years, but as valuations began to come down, we added to some of these sectors in 2020 and we expect to add more exposure in 2021.

Will the Biden Administration be good or bad for stocks?
While it's still early in the new administration, the Biden team has laid out some broad economic initiatives for the next four years. They include more direct payments to families, small businesses, and local governments hit by the pandemic; bringing back jobs to the US; and increasing investment in infrastructure (with an emphasis on green energy). These programs all have worthy aims, but have large price tags. Under Biden's plan, these will be partially paid for by increasing tax rates and lowering deductions for higher income households and corporations. While these proposed tax increases would clearly reduce disposable income for some individuals and net profits for companies, we expect the final spending plan and tax hikes to be more modest without meaningful impact to the overall growth trajectory of the country.

As for stocks, we expect the technology large stocks to see the highest increase in tax rates, given the level of profitability seen in the sector. Again, we do not think this will have a significant impact on their ability to grow earnings or job creation. As you can see in the chart on page two, while technology now represents 38% of the S&P 500 stock index, these companies only represent 6% of GDP and 2% of US employment.

Are we in a Bubble?
The price of any goods and services is based on a balance of supply and demand of that item. Bubbles form when demand rises so sharply that even sellers, who know the asset they hold is overvalued, do not want to sell, hoping that prices will go even higher. Over our careers, we've seen many bubbles – in housing, commodities and individual stock and/or broad sectors. Over the past couple weeks, we've seen a small group of stocks with poor fundamentals, see their share price soar after a mass of retail investors crowded as one into these names. These moves have led to many

"institutional" investors, who use a momentum trading strategy, to follow the trend and bid prices higher. While these bubbles are a natural part of the market, fortunately (or unfortunately!) they have had virtually no impact on our portfolio companies. We all know how this story will end, with some timing an exit strategy well and others not. However, as stewards of our clients assets, we will continue to watch this one from the sidelines.



As we've discussed in the past, the trillions of dollars of economic stimulus programs over the last year have reduced the level of economic pain, but have also led to asset price inflation. While rising asset prices could be viewed as a sign of a growing economy, when stock values grow at a faster pace than earnings and the corresponding growth in the real economy, that dynamic will reduce expected returns on stocks going forward.

Now is a good time to review your long-term investment goals.
With the start of a new year and potential changes to tax laws, now is a good time to review your long-term investment goals. Our office phone numbers and emails continue to be the best way to reach us, while many of us continue to work remotely. Our contact information is on our website.

See "Tax Planning After the 2020 Election… and 2021 Runoffs" prepared by Hemenway & Barnes LLP for an overview of tax planning strategies to consider now before changes are made to tax laws.