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Sound Investments Inc.

4th Quarter 2020

DJIA 30606 S&P 500 3756 Nasdaq 12850

Summary

The Case for Optimism

Economist see several reasons for optimism outlined as follows:

1. Both President Biden and the Federal Reserve Bank are in favor of supporting the economy by pumping more money in.

2. Americans have stashed away more than a trillion dollars of additional savings last year. Pent up demand for services, travel and live entertainment, combined with stimulus cash will add up to record spending in 2021's second half of the year.

3. As if to confirm the case for optimism, Goldman Sachs expects the U.S. economy to grow at 5.8% in 2021 after contracting 3.5% in 2020. Moody's expects 4% growth

This investment letter is mailed quarterly to our clients and friends.

Unexpected Gains

One of the wildest years in history brought plunges, improbable rebounds, and human tragedy. Predictions from forecasters and pundits proved to be inaccurate. I entered 50% more trades this year than last as I sold some in Jan /Feb then rebought in the spring / summer. It was a busy year. The main thing I did was to hang on and we were rewarded as stocks climbed to an all time high and ended the year with strong gains.

Here's what happened for the year: the S&P 500 was up 18.4%, the Dow Jones gained 9.8% and the tech-forced Nasdaq rose an astonishing 41%. Small stocks lagged most of the year but a strong 4th quarter rally, led by the Russell 2000 index, posted a 20% gain. The lower U.S. dollar helped emerging markets ring in a gain of 17% for the year.

Stock Boom Should Follow A Tough Winter

It's a new year and Covid-19 still has a grip on the country but there is a bright light at the end of the tunnel. We think there is a strong case for optimism which is outlined on the next page. Meanwhile, Covid-19 deaths continue to set records.(see chart on Page 2) This has caused consumers to pull back and has resulted in a higher unemployment rate of 6.7%, twice as high as the pre pandemic level. Employers cut 140,000 workers in December, the first decline since the virus hit.(see chart page 2) Also, retail sales fell for the last 3 months due to an upswing in Covid-19 cases. Congress will try to pass a $1.9 trillion stimulus package, which works out to approx. 7% of gross national product, so it is significant.

Stock Rotation

Throughout most of 2020 large technology companies like Microsoft , Apple, Google etc., or the so called "stay at home stocks" dominated the market. In October, the market sensed a reopening of the economy and value stocks started to move up. This was a major change as growth stocks had outperformed for a number of years. In November, both value stocks and small cap were moving higher, fueled by post election relief and positive vaccine announcements.

Prices Set To Increase As Crisis Fades

The things that have kept inflation low during the Covid-19 crisis are a lot different than the ones that used to keep it low. A whipsawing of prices when the pandemic passes is something to look out for.

The Labor Department on Wednesday reported that U.S. consumer prices rose 0.4% in December from November, putting them 1.4% above their year-earlier level. Core prices, which exclude food and energy items to better capture inflation's trend, rose 0.1% from November, and were up 1.6% on the year.

The Federal Reserve's aim is for 2% inflation, and the consumer-price measures it follows run cooler than the Labor Department's.

Under inflation's hood, though, there are some big shifts. Prices for food at home—groceries and the like—remain elevated as a result of the pandemic, and were up 3.9% in December from a year earlier. Meanwhile, prices for lodging at hotels and the like were down 11.2%.

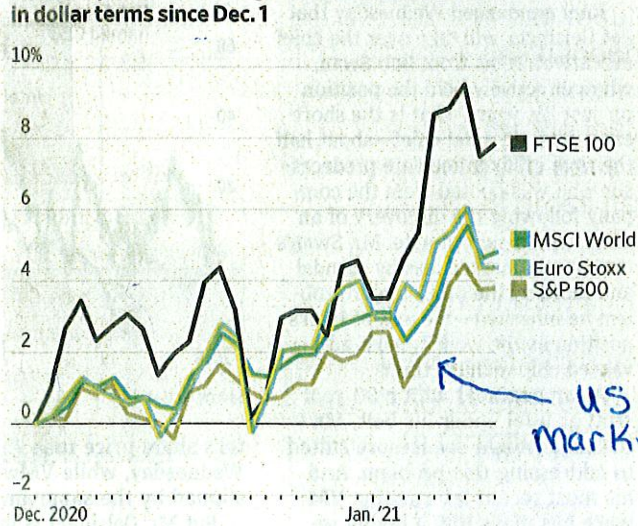
Those are reflections of a broader trend in which goods prices have risen on the back of stronger demand during the pandemic while services inflation has cooled substantially. Core goods prices were up 1.7% on the year last month, which compared with a December 2019 gain of 0.1%. Core services prices were up 1.6%, which compared with a December 2019 gain of 3%.

The last time core goods inflation exceeded core services inflation was in 2011. With vaccinations now under way, raising the prospect of life returning to some semblance of normal later this year, it is worth thinking about how the goods and services inflation dynamic might play out.

Prices for services might come back with a vengeance, particularly in areas where supply can't easily meet rising demand. When everybody feels comfortable finally getting on a plane to see family, deals on flights could be hard to come by. And goods inflation might not ease up all that much, given that the economy will be in better shape as Covid concerns pass than it is now.

The resulting price gyrations would likely be in large part temporary, but interpreting what is going on in the moment could be hard. The best inflation forecast right now might be that it is about to get confusing. —*Justin Lahart*

Relative performance of global stock indexes in dollar terms since Dec. 1



US Market

Note: Through Tuesday

Source: FactSet

Since Dec. 2020, International Funds have outperformed indicating a possible shift in the market.

Interest rates have remained remarkably low with the 10 year government bond yielding less than 1%. On page 4, there is an article entitled, "Prices Set to Increase as Crisis Fades." It reviews how the last year was a goods based economy(i.e. computers desk and chairs etc) while the recovery will focus on services.(travel, eating out, shopping etc.) This change in demand will push prices up.

I subscribe to a number of investment letters and most of them have concerns about inflation. They don't see hyper-inflation but foresee it moving into the 2 to 3% range. Even through the Federal Reserve Bank controls short term interest rates, longer term rates could go up from their historic lows. This will affect different parts of the market differently. For instance, higher rates will help banks as it will increase their margin on their loans. Higher rates will hurt utilities and property companies, who normally carry higher debts and higher interest rates will decrease their profits.

The Case for Optimism

As the pandemic drags on into the new year, however, economists see several reasons for optimism outlined as follows:

1. Both President Biden and the Federal Reserve Bank are in favor of supporting the economy by pumping more money into it.

2. With much of the service sector hobbled by the virus, Americans have been saving an unusually high part of their income since spring, when the pandemic first restricted activities. (see chart on page 2). Americans have stashed away more than a trillion dollars of additional savings last year. Pent up demand for services, travel and live entertainment, combined with stimulus cash will add up to record spending in 2021's second half of the year.

3. Borrowing costs are low and Federal Reserve officials expect the Central Bank will hold short term rates near zero through the next year or so.

4. As if to confirm the case for optimism, Goldman Sachs expects the U.S. economy to grow at 5.8% in 2021 after contracting 3.5% in 2020. Moody's Investors Service expects 4.2% growth.

Conclusion

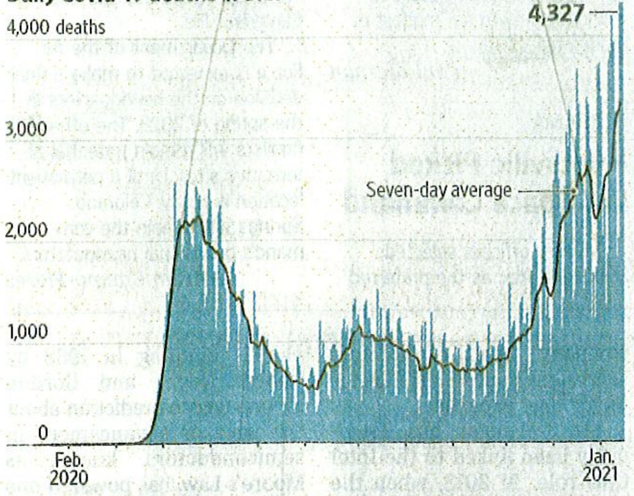
We think investors should retain a healthy weighting in stocks of companies likely to do well as the economy recovers as 2021 begins. Our sense is that the economy will continue to recover even with a few missteps, and is likely to remain on an uneven growth track. That is a tough combination to beat, even if high P/E ratios (particularly in the tech group) suggest a greater degree of caution is now in order. In sum, despite the risks, we still believe a normal weighting in equities is warranted. We plan to keep a close eye on the possible market rotation into value and international equities and make changes along the way.

We welcome your calls

U.S. Covid Deaths Set Record

The U.S. reported 4,327 Covid-19 deaths on Tuesday, the nation's highest daily death toll of the pandemic. **A3**

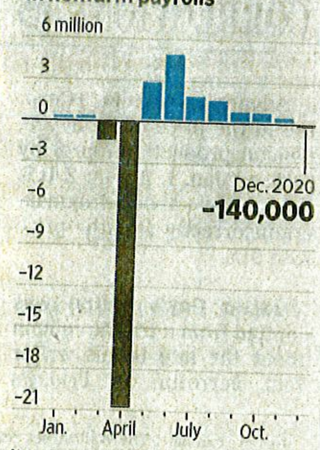
Daily Covid-19 deaths in U.S.



Source: Johns Hopkins University

Death tolls continue to set records. The recent uptick has slowed the economy.

Monthly change in nonfarm payrolls

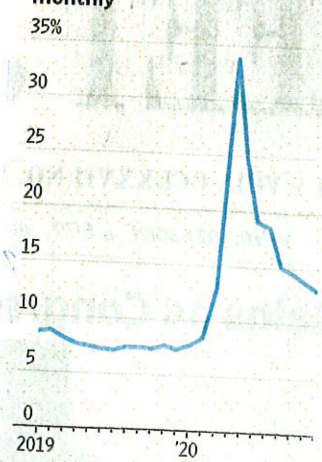


Note: Seasonally adjusted
Source: Labor Department

Job rebound loses steam.

After a rebound, job growth has declined. Applications for unemployment insurance have increased as well.

Personal saving as a share of personal disposable income, monthly



Note: Seasonally adjusted annual rate
Source: Commerce Department via the St. Louis Fed

Additional savings have ballooned to over 1 trillion. This will finance pent up demand for services when the pandemic ends.