Colorado Capital
MANAGEMENT

QUARTERLY MARKET UPDATE / JANUARY 2021

Economic Outlook

Overview

During the fourth quarter of 2020 there were major political, public health, and economic developments.

In November, the Biden/Harris ticket won the U.S. presidential race, making Biden the oldest president elect and Harris the first woman, Black American, and Asian American to be elected vice president. Democrats also won control of both the House and the Senate.

President Trump and his allies made unsubstantiated claims that the election was stolen. The election was certified by Congress in early January, but not before there was a shocking and violent invasion of the Capitol building by protestors.

By year end, over 20 million Americans had been infected with COVID 19, roughly 350,000 had died, and daily new cases were near record highs. The first COVID vaccines from Pfizer and Moderna were approved by the U.S. in December.

Optimism about the new vaccines, the end of election uncertainty, and additional government stimulus legislation all served to give the stock market a significant year-end boost, particularly those sectors that had lagged earlier in the pandemic.

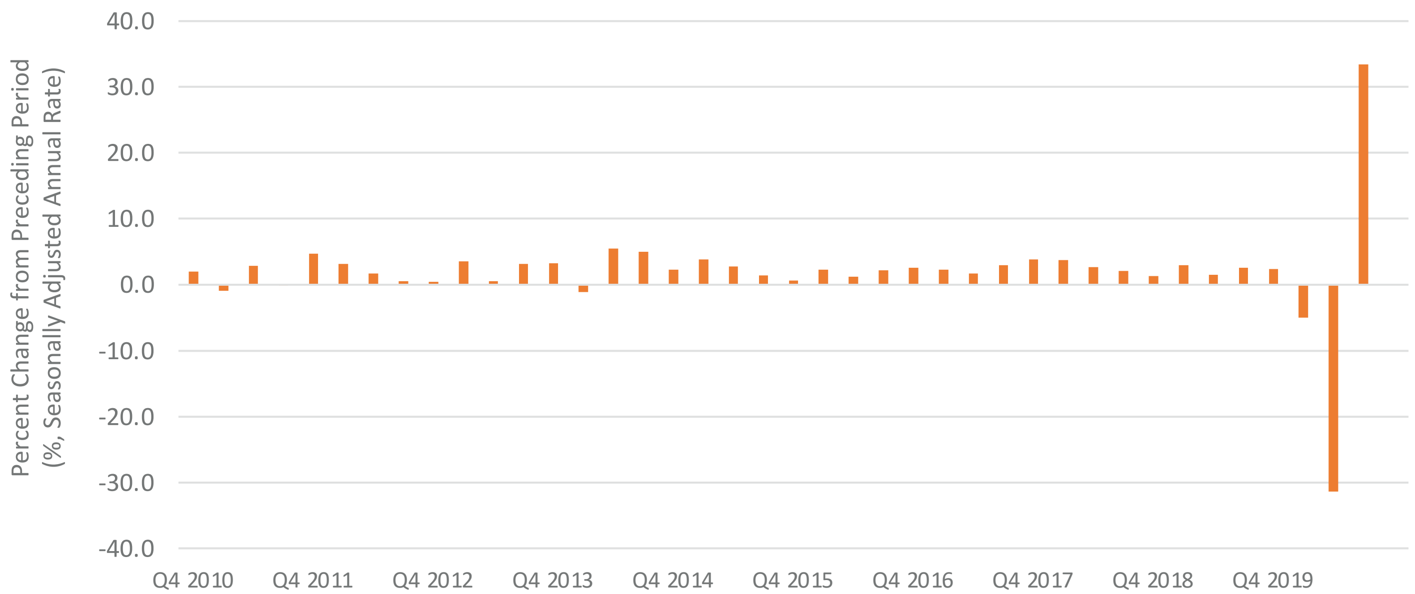
CCM Key Economic Indicators

Indicator	12.31.20	9.30.20	12.31.19
US Economy			
Quarterly GDP Growth	Est. 5-10%	33.1%	2.4%
Unemployment Rate	6.7%	7.9%	3.5%
U.S. CPI (Core)	1.7%	1.7%	22%
Interest Rates			
Fed Funds Rate	0.00%	0.00%	1.50%
10-Year Treasury Rate	0.93%	0.68%	1.86%
Currency & Commodities			
Crude Oil (WTI)	$ 48.35	$ 40.05	$ 61.14
Gold Price	$ 1,891	$ 1,883	$ 1,523
Trade Weighted Dollar	112.2	116.7	116.0
Confidence			
Consumer Confidence Index	88.6	101.8	126.5
ISM Purchasing Managers Index	60.7	55.4	47.8
Stock Prices--12/31/20			
Dow Jones Industrial Average	30,405	27,782	28,538
S&P 500 Forward P/E ratio	22.3	21.5	18.2

Gross Domestic Product (GDP)

The 4th quarter of 2020 capped a pandemic-driven rollercoaster of a year that many are glad to see come to an end. Gross Domestic Product (GDP), the value of all goods and services produced, swung wildly as many workplaces were forced to close for months. Real GDP declined at a record-smashing annualized rate of 31% in the second quarter, only to dramatically recover at a similarly eye-popping record pace of 33% in the third quarter. Fourth quarter GDP is estimated to have grown at a slower, but still strong, 5% to 10% rate, which is well above historical norms.

Real GDP Growth: U.S.



Source: U.S. Bureau of Economic Analysis

The recession that began in March brought an abrupt halt to the longest economic expansion in U.S. history. With the help of over $2 trillion of government stimulus programs, the economic recovery is well underway, but the economy is not expected to reach its pre-pandemic size until sometime in the second half of this year. While growth in 2021 is expected to be moderate, it is still projected to come in at a robust 4% to 5%, and will likely be supported by additional government stimulus spending.

Employment

The changes in GDP were closely tied to employment, which followed a similar up and down pattern during the year. Unemployment rates began the year at 3.5% and peaked at close to 15% in April before falling 11.1% in June and 6.7% by year-end. While unemployment has improved, job growth cooled in November. Robust job gains in late spring and early summer largely reflected businesses adding back staff after lockdowns were lifted. But many businesses have continued to operate below capacity. Some state and local governments implemented new restrictions as coronavirus cases surged in the fall.

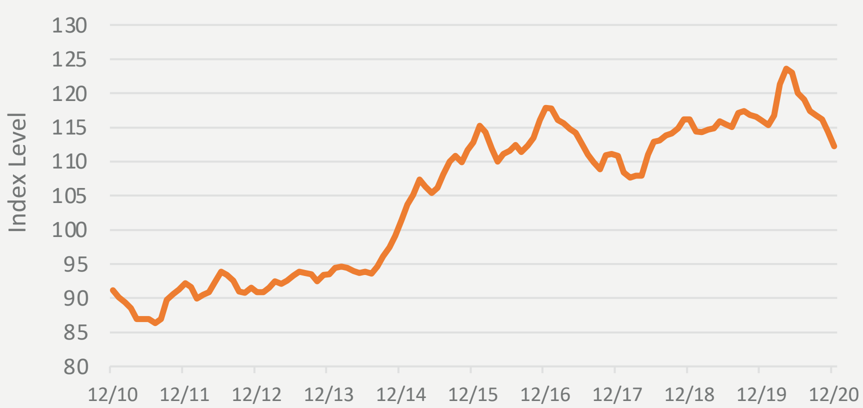
Interest Rates, Inflation and Commodity Prices

Interest rates remain at very low levels. At the onset of the Pandemic, the Federal Reserve cut its benchmark overnight interest rate from 1.5% to 0% and has indicated it plans to keep the rate near zero through at least the end of 2022. The longer-term 10-year Treasury bond rate declined from 1.9% at the beginning of the year to 0.7% in September, but ticked up modestly during the fourth quarter. These rates are well below the rate of inflation, as indicated by the core CPI (consumer price index) level, which rose at a modest 1.65% over the last year. When food and energy are included in the index, it rose only 1.2%, as oil prices, which fell precipitously at the beginning of the pandemic, ended the year down more than 20%.

Currency Rates

The U.S. dollar hit its lowest levels against a basket of foreign currencies in more than two years and is expected to continue to fall. The dollar is down 4% for the quarter, and nearly 13% from its March peak. The dollar strengthened markedly early in the pandemic as investors sought safety. That pattern has since reversed, particularly as the promise of new vaccines has supported the outlook for a global economic recovery. Factors including low U.S. interest rates and high stimulus spending, together with the prospect of strong stock market performance abroad and an uneven recovery in the US, have all contributed to the decline.

U.S. Dollar Trade-Weighted Index



Source: Board of Governors of the Federal Reserve System

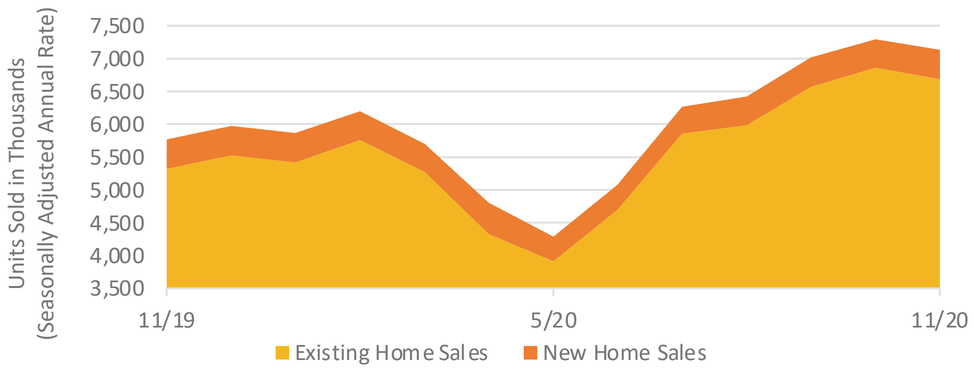
Consumer and Business Confidence

Overall consumer spending continued to increase during the quarter, but more slowly than over the summer. Recent economic data suggests further slowing, as retail sales fell 1.1% in November. Consumer confidence, as measured by the Conference Board, improved modestly from the six-year low recorded in August, but was down sharply for the quarter. For the year as a whole, the index dropped 30%. In contrast, business confidence, as indicated by the Purchasing Managers Index, is up sharply for the both the quarter and the year, suggesting that businesses are more optimistic about future.

Housing

Home sales have been a surprising bright spot in the economy, with prices rising steadily and monthly unit sales jumping an impressive 12% over the last quarter and 25% over the past year.

Home Sales: New and Existing



Source: U.S Bureau of the Census, National Association of Realtors

The strength in the housing market can be explained by a combination of factors including: 1) higher-income households, which tend to be homeowners, have fared relatively well on the employment front, 2), government support programs and working from home have contributed to increased household savings for this same demographic, 3), low-interest rates have been a massive boost to affordability, and 4), the virus has increased the desire for people to move out of dense urban areas into less-dense suburbs, thus raising demand for single-family homes.

The inventory of homes for sale is now at a historic low. The imbalance of supply and demand has led to home prices rising so quickly that the gain in affordability from lower interest rates has been erased.

Global Growth

The economic effects of COVID have reverberated around the world, but have affected countries differently. In Europe, it is estimated that real GDP declined 7% in 2020 and that it will grow 3.5% in 2021. In the U.S., comparable figures are a 3.5% contraction followed by 4% growth. In China, despite a rough first quarter, November GDP was up 7% from the prior year and appears to be accelerating. In terms of global trade, exports from China have already surpassed pre-pandemic levels, while they are still down 2.6% in the Eurozone and 9% in the U.S.

The Chinese economy, where the pandemic originated, contracted 10% during the first quarter of 2020. But China has largely been successful in subsequent months in combatting the spread of the virus, and the country has reported negligible numbers of new cases in recent months. Most other developing countries had much weaker economies to start with and have not been as successful in containing the virus.

Economic Forecast

The new year is starting on tenuous footing. While about two-thirds of the economy's lost output has been recovered, reclaiming the remaining ground will be slower going forward. Real GDP growth is likely to sputter during the early part of 2021 before taking off when widespread vaccination greatly reduces the need for social distance. Longer-term, the picture looks much brighter. Effective and rapid vaccination should help bring the return of most in-person and indoor activities by early summer. Additional government stimulus legislation could help, particularly as the recently passed bill was about ½ the size of the original $2 trillion CARES Act.

An untenable surge in COVID cases continues to be a major downside risk to the outlook, but the relationship between virus cases and the economy has weakened since the onset of the pandemic. Businesses and the public sector are adapting as we learn more about the virus, and households appear to have a higher risk tolerance for contracting the virus and general fatigue over mitigation efforts.

The wide availability of vaccinations in the second half of 2021 should help life and business return to some semblance of "normal." Yet the pandemic's effects on spending, the labor market, and monetary policy are unlikely to fully dissipate. Recovery, measured by the level of real GDP, should be complete by the third quarter of 2021, but the economy will still be smaller than it would have been in the absence of the pandemic. Furthermore, not all businesses or households will be back to where they were at the end of 2019.

Successful vaccines, coupled with expectations of a less antagonistic trade policy from a Joe Biden White House, should drive global growth and encourage investors to step back from the relative safety of U.S. assets and invest in stocks, bonds, and currencies outside the U.S. This all adds credence to the view that the dollar will undergo a bearish cycle with the Federal Reserve keeping rates low for years. This may be inflationary over the long term, but probably not in the short-run.

Market Commentary

Overview

Driven by U.S. election results and positive developments surrounding potential COVID-19 vaccines, equity markets continued to rally during the fourth quarter. Small-cap stocks led the way with a quarterly return of more than 31%. This represents a significant shift as for much of 2020 small-caps significantly underperformed their large-cap counterparts. Cyclical stocks were also strong performers during Q4 and value stocks turned in their best quarter since 2009. Representing another shift away from recent trends, growth stocks lagged the broader market. For the calendar year, however, growth maintained its relative strength by a large margin.

The positive quarter for stocks came despite rising COVID-19 infection rates, particularly in the U.S. and Europe, and the corresponding implementation of new lockdown measures. The November announcements of promising new vaccines provided hope that an end to the COVID-19 pandemic is in sight.

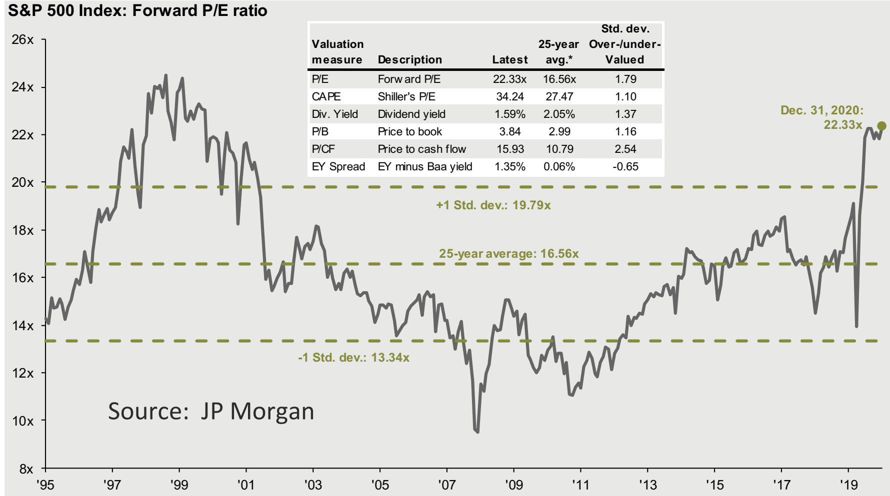
For the quarter, the S&P 500 rose 12.1%. Overseas, the MSCI EAFE Index gained 16.1%, and the MSCI Emerging Markets Index increased by 19.7%. Fixed income markets also produced positive returns with the Barclays U.S. Aggregate Bond Index gaining 0.67%.

U.S. Equities

Highlights of the fourth quarter included promising developments regarding a COVID-19 vaccine, Joe Biden's win in the U.S. presidential election, and a $2.3 trillion combined coronavirus relief and government funding package that was signed into law in late December. Further boosting markets, the Federal Reserve reinforced its supportive message, stating it will continue with current levels of quantitative easing. With the Biden victory came the prospect of a less confrontational presidency and more predictable trade policies. The prospect of a safe and effective vaccine, along with a successful rollout, also drove forward-looking equity markets higher. The Dow Jones Industrial Average crossed the 30,000 level for the first time during the quarter, and both the Dow and the S&P 500 ended the year at all-time closing highs.

This chart illustrating the historical price to earnings ratio of the S&P 500 index shows that the index is currently priced well above historical norms. To return to more normal levels, earnings must grow, or prices must fall, or some combination of the two.

S&P 500 Index: Forward P/E ratio



Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	22.33x	16.56x	1.79
CAPE	Shiller's P/E	34.24	27.47	1.10
Div. Yield	Dividend yield	1.59%	2.05%	1.37
P/B	Price to book	3.84	2.99	1.16
P/CF	Price to cash flow	15.93	10.79	2.54
EY Spread	EY minus Baa yield	1.35%	0.06%	-0.65

Source: JP Morgan

International Equities

Overseas, equity markets produced strong gains for the quarter and outperformed their U.S. counterparts. In Europe, markets were up sharply on vaccine-related news and despite rising infection rates that led to renewed restrictions and lockdowns. EU leaders approved a €1.8 trillion budget that included a €750 billion recovery fund. Significantly, the European Union agreed to a Brexit trade deal with the UK. In Japan, equities rallied, driven by vaccine-related news and the result of the U.S. presidential election. Emerging market equities produced their strongest quarterly return in more than a decade. Currency strength relative to the U.S. dollar provided a boost while rising commodity prices drove markets representing net oil-exporting countries higher. Chinese stocks rose but lagged the broader emerging market index as escalating tensions with the U.S. proved to be a drag on sentiment.

Fixed Income

The risk-on environment driven by COVID-19 vaccine news along with fiscal relief efforts boosted non-Treasury sectors. U.S. government bonds finished negative for the quarter as the 10-year Treasury yield rose 25 basis points. U.S. corporate bonds, on the other hand, turned in a strong quarter. High yield bonds led the way as credit spreads fell about 150 basis points during the quarter. International bonds, aided by currency strength, sharply outpaced U.S. issues. The U.S. Federal Reserve affirmed its dovish stance at its December meeting, maintaining asset purchases at least at the current level for the foreseeable future.

Market Outlook

The victory of President-elect Joe Biden may create a positive backdrop for U.S. markets. In the U.S., improving economic conditions are likely to boost business and consumer confidence which, in turn, should drive significant corporate earnings growth in 2021. Equity markets were primarily driven by shifts in valuations in 2020. Going forward, we expect corporate earnings to play a larger role. Increased fiscal spending, accommodative monetary policies, and less contentious trade policies may prove to be profit tailwinds.

Volatility is expected to remain elevated into the new year for at least as long as the duration and impact of COVID-19 remain uncertain. If vaccines prove to be safe and effective and the U.S. economy continues to recover, early cycle outperformers should be in favor. Smaller companies typically lead coming out of a recession, and additional fiscal measures should be supportive of this asset class. High-quality cyclicals, including financials, materials, and segments hit hard by COVID-19 lockdowns such as travel and leisure, are also expected to lead in the early cycle environment.

Developed international equities should also perform well as major foreign stock indexes are overweight cyclical value stocks, relative to the U.S. In Europe, equity markets are poised for a strong post-vaccine recovery. The European economy suffered a big hit from the pandemic, thus there is an opportunity to rebound from a low base.

Emerging markets should benefit from yield-starved investors seeking higher income than that provided by bonds in developed countries. Developing nations should also benefit from an uptick in cyclical global growth in 2021, more predictable U.S. trade policies under a Biden administration, and a weaker dollar.

Along with the tailwinds, emerging markets also face significant challenges exacerbated by the coronavirus pandemic. Many emerging market nations face structural growth challenges and rising debt levels. While exposure to emerging markets remains attractive, significant risks remain and caution is prudent.

The fixed income market is characterized by record supply, historically unique monetary policies, and government deficit spending. These trends are likely to continue through at least the first half of 2021. Assuming stimulus for states is forthcoming, municipal bonds will benefit. Volatility is expected to remain elevated, and interest rates are generally projected to remain at low levels for the foreseeable future. Given the low yield environment, investors may want to consider expanding non-traditional options. Yet broadly speaking, fixed income should continue to play a useful role in managing overall portfolio risk.

Sources: Department of Commerce, Department of Labor, Federal Reserve Bank of Chicago, Morningstar, Bloomberg, National Bureau of Statistics of China, European Central Bank, JP Morgan, and Capital Market Consultants.

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