First Quarter 2021 Investor Update

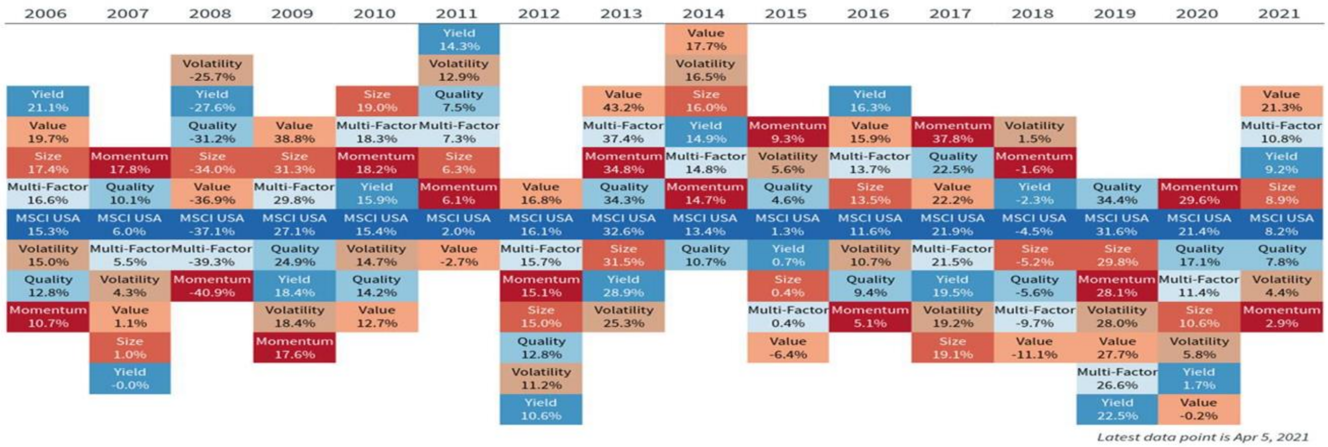
Welcome back value investing. For years we have been writing to you talking about how the market was not including stock valuation a primary driver of performance. Future growth prospects have been dominating the determination of stock performance, along with a stock's market capitalization ranking in the ever-growing S&P 500 stock index. The first quarter of 2021 saw the tables turn and stocks with compelling valuations ruled the day. The performance showed up in spades in the CWC portfolios. The CWC Large Cap portfolio gained 11.47% for the quarter vs. a return of 6.17% for the S&P 500. The markets also saw a rotation into the relatively undervalued small cap stocks. The CWC small cap portfolio returned 20.65% in Q1 vs. the Russell 2000 who returned 12.70%.

The biggest factor effecting the changing leadership in the market was the move in long-term interest rates. When a Wall Street analyst calculates a future price target for growth stocks, they estimate the potential earnings which will be produced far into the future. Those future earnings are then discounted back to present value. Typically, analysts use current interest rates as the discount rate to value these companies. Interest rates have been historically low for many years; in fact, interest rates have been approaching zero. In our opinion, one of major problems with the valuations placed on the largest growth companies has been the implicit assumption that interest rates will stay at historically low levels in perpetuity (or at least until the end of the earnings stream being discounted). As the interest rate paid on ten-year U.S. treasuries increased from 0.55% to 1.72% today, the interest rate used by analysts to discount future earnings has increased. Mathematically, this makes the current value of the future earnings decline.

There are several other factors at work helping to create this rotation from growth to value and from large to small, but in our opinion, the move in interest rates is the largest contributor. As you can see from the "factors chart" below, stocks considered "value" stocks, were the top performing group by a wide margin in Q1 2021. One can also see that value stocks have been at or near the bottom performers for the past three years.

Factors Relative to U.S. Stocks

MSCI USA Factor Index Returns

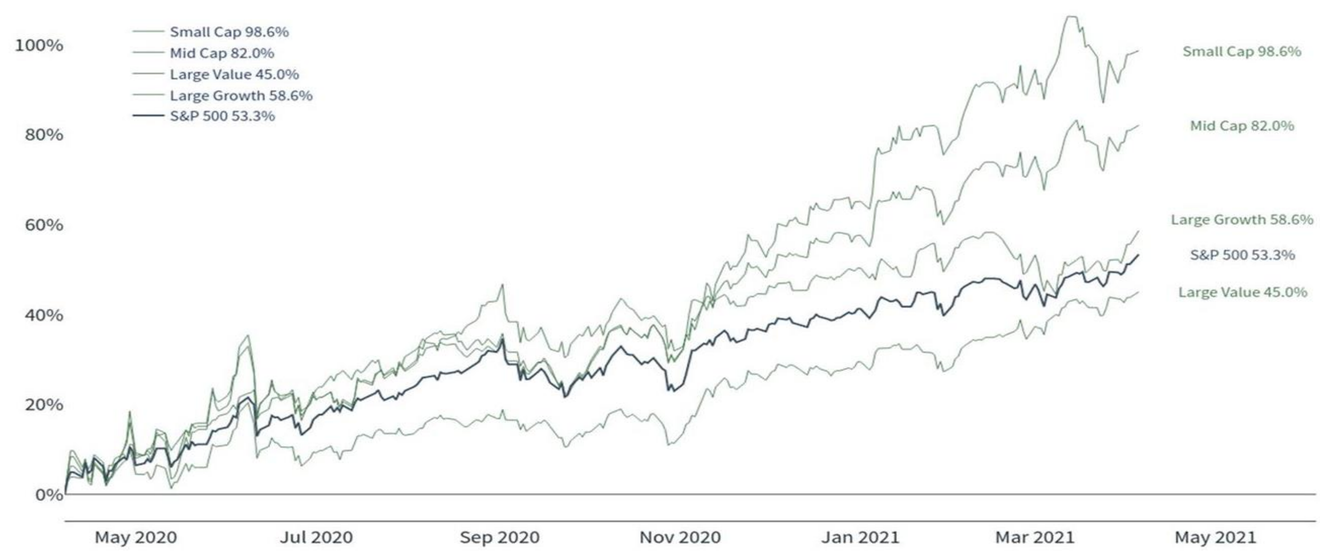


Source: MSCI, Refinitiv

The following chart demonstrates the move from large cap stocks to small cap stocks. Prior to the last year, large cap stocks dominated performance over small caps.

Size and Style Returns - Year over Year

Large, mid and small caps are the S&P 500, S&P 600 and S&P 400, respectively

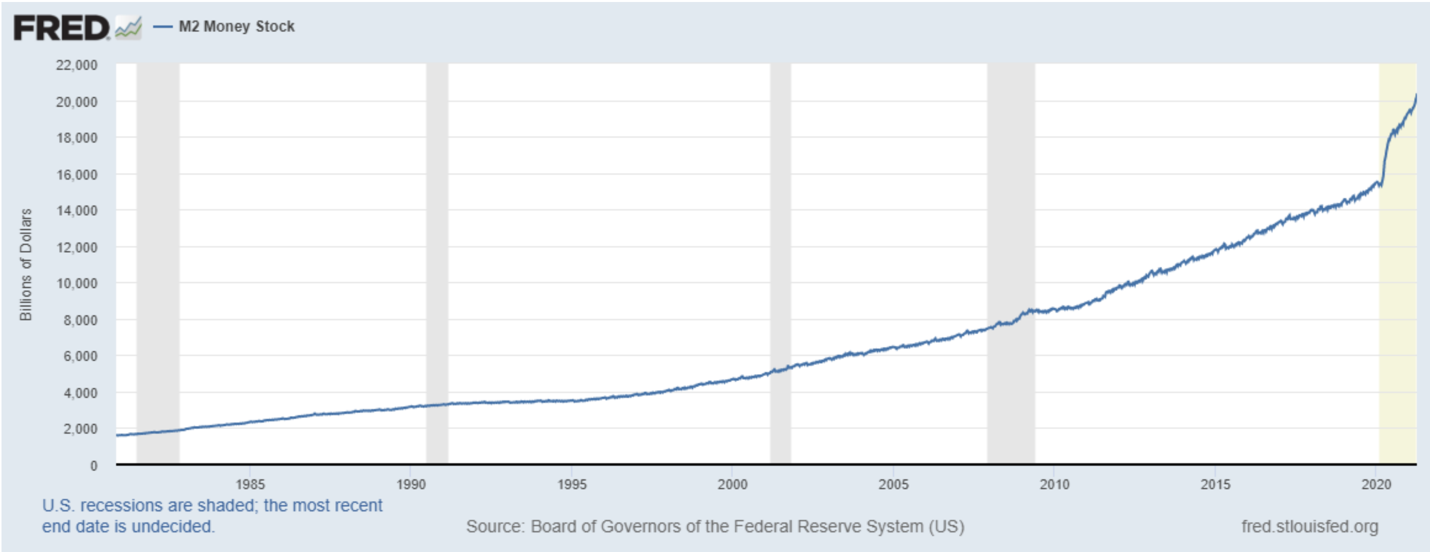


Latest data point is Apr 5, 2021

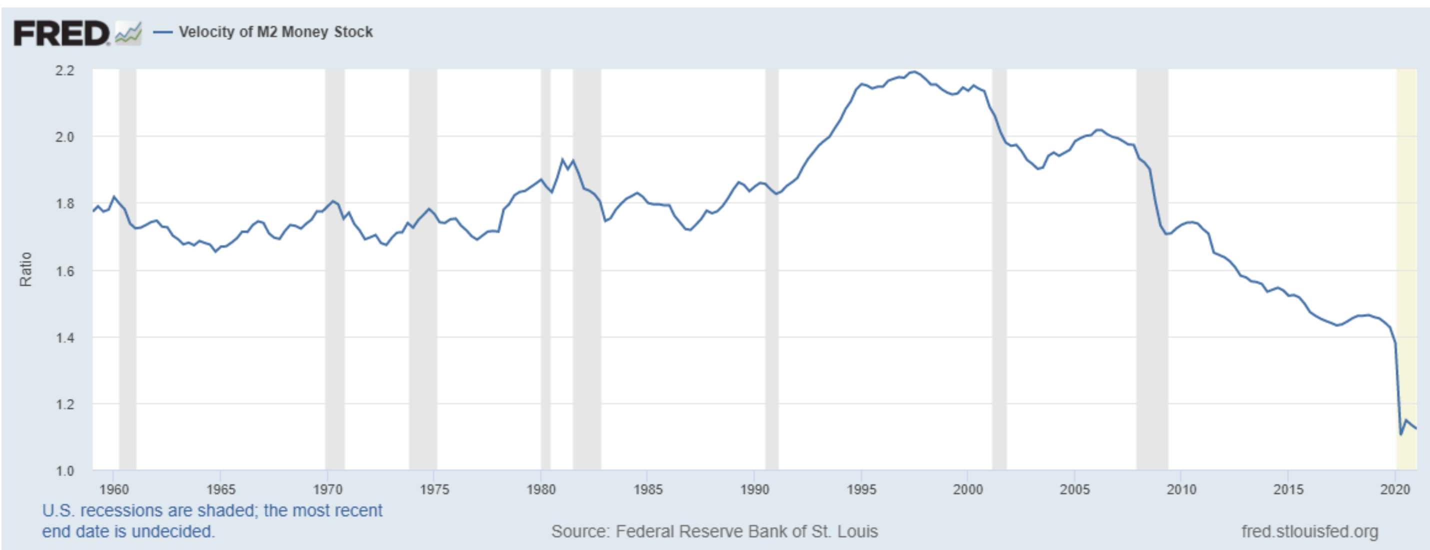
Source: Refinitiv, Standard & Poor's

Nobody knows how long these trends will continue, but conditions are in place that could support a long period of small cap and value outperformance.

Inflation has become the preeminent risk in the minds of investor over the past few quarters. Aggressive government reaction to the economic shutdown caused by the Covid-19 pandemic has increased the supply of money substantially over the past 12 months.



Typically, an increase in money supply leads to an increase in inflation. There are some differences this time around. The velocity of money is the critical statistic when gauging the likelihood of inflation. Velocity is the number of times a dollar is spent over the course of a year. If the velocity of money is 2, then each dollar created get spent twice over the course of a year and has double the stimulative effect if the velocity were 1. You can see from this chart below; we are in an unprecedented time of low velocity.



Velocity has slowed for several reasons. First, banks are reluctant to lend money for anything other than conventional mortgages. Lending standards remain tight for any loans other than the most basic, safe borrowers. Second, consumers have been cautious through the pandemic and in general have used stimulus (and other excess cash flows) to pay down debt. That is wonderful for financial safety, but detrimental to money velocity and therefore the resulting stimulus to the economy.

We feel even with the ballooning of the federal stimulus, inflation is not a foregone conclusion. We will continue to watch carefully as inflation is still a possibility, just not inevitable.

Many prices have gone up recently. Lumber, gasoline, food, housing to name a few. You may point to that as "inflation" and you are partially correct. Systemic inflation is a long-term (sometimes permanent) rise in prices of goods and services. The current rise in gasoline, lumber, and most food products are a result of production slow down caused by the pandemic causing a transitory (not permanent) supply/demand imbalance that will correct itself when the effects of the pandemic subside.

There will be a balancing act to decrease easy monetary policy as the velocity of money increase back to normalized levels to avoid inflation, but at this point we do not see an imminent inflation problem.

As always, we thank you for trusting us with your assets and we will continue to manage them with the utmost diligence and care. We wish you and your loved ones a happy and health 2021.