JURIKA · MILLS & KEIFER
Private Wealth Management

Quarterly Investment Commentary

January 2021

Forward

In fairness to 2021, the new year was set up with unreasonably high expectations, as if somehow all the problems that beset 2020 would magically disappear at the stroke of midnight on December 31st.

Unfortunately, problems are not beholden to a calendar. With the pandemic still raging and extreme political division threatening the very stability and sanctity of our Republic, the year is already off to a rocky start.

The entire world is aching to get out and move *forward*: to shuffle off the constraining coils of Covid and to return to a more normal life. This will happen in time, as more and more people are vaccinated and the Virus is finally vanquished. Between now and then however, things will likely get grimmer first.

In the United States, most people are also aching for a return to greater political stability and governmental competence. We believe this will also happen, sooner than later. We are hopeful that January 6th was both a wake-up call and turning point; where politicians realize the danger of their division and rediscover the virtue of coming together in common purpose. This may be naively hopeful, but there are real problems to be solved and it is amazing how much more progress you can make when you stop shooting yourself in the foot.

2020 underscored the importance of taking a long view with respect to investing and not trying to second-guess markets based on near-term events. Despite a pandemic, global recession, and breathtaking sell-off in most financial markets earlier in the year, most stock and bond markets ended the year strongly in positive territory.

Given the enormous hardship that Covid has caused around the world, it seems a bit surreal that markets and client portfolios ultimately performed so well. It certainly is preferable to the alternative, at least for owners of financial assets, but also underscores the very uneven and inequitable way that the pandemic has impacted people, businesses, and markets for better or worse.

The global economy offers a very dynamic and uneven playing field, marked by areas of secular growth, decline, disruption and flux. In 2020, we saw a wide gulf created between economic winners and losers. Covid forced people to adapt their behavior and accelerated many trends that were already underway. While cyclical sectors should bounce back sharply as the economy opens back up, other industries face more permanent changes. More people will use technology to work, shop, connect and learn online with long-lasting implications for retail and commercial real estate, logistics, healthcare, education and government.

We think that it is always important to invest with a forward-looking point-of-view and framework for thinking about the world which identifies areas of secular and accelerating growth, as well as areas of long-term adversity. Put simply, we want to look for areas of secular growth and get in the way of them and look for areas of secular decline or long-term adversity and avoid them.

Although we want to be very intentional about how and where we invest, we also believe in being very diversified within an area of focus – akin to owning the racetrack rather than betting on individual horses. This way, if our insights about a particular area are correct, we know that we will benefit, regardless of how well or poorly any individual company might do.

We frame these longer-term ideas in the context of shaping forces and current conditions to produce a set of investable outcomes.

Finally, we balance investments actively targeted at areas of higher growth and opportunity with more defensive investments to offset risk.

This framework helps to clarify thinking and cut through the near-term ebbs and flows of markets and investor sentiment. It acts as a set of navigational stars by which to invest portfolios for long-term success.

As we look forward into the New Year and beyond, we thought it would be helpful to outline our current strategic framework and investment outlook.

Major Trends: Areas of secular and accelerating growth

Technology and Innovation: The scope of technological innovation is expanding and transforming broad parts of the global economy at an accelerating rate. This includes broadband internet and 5G mobile technology, cloud computing, connected devices, artificial intelligence, cyber security, autonomous vehicles, social media, gaming, virtual reality, robotics and 3-D printing.

As noted above, technology is transforming the way we shop, work, connect and communicate, bank, pay for things, learn and are entertained. New industries are being created and existing industries are being disrupted and transformed.

The move from 4G to 5G technology represents an exponential leap forward in technology and capability versus the leap from 3G to 4G and involves an exponential increase in the future demand for semiconductors, software, and connected devices.

Electric cars will rapidly displace traditional gas-powered cars in the coming years. They represent a superior technology in almost every way. Self-driving technology will also transform how we use cars.

At the same time the trend towards increasing use of alternative and clean energy sources will only grow while marginal demand for fossil fuels should decline.

Not all this innovation and change is for the better. As industries and practices are displaced, many traditional jobs are being eliminated and many unskilled workers are having trouble finding new jobs that pay a liveable wage.

Social media has shown itself to be a very mixed blessing. It has allowed people to connect easily around common interests and relationships. It has allowed people to share valuable information, to collaborate on projects, and to create and publish content with ease. It has also become the primary way that many people get their news and information, which frames their view of the world. Unfortunately, its algorithms tend to create feedback loops which facilitate and amplify the virulent spread of misinformation. This has resulted in an ever more divided country where large groups of people believe things that are objectively false, and some are incited to acts of violence. Social media, like food and nutrition, needs to be responsibly regulated or the results can be deadly.

Healthcare – Medical Technology and Life Sciences

The population of the developed world is aging. This includes the United States, Europe, Japan and China. As we age, we have more healthcare issues and those issues tend to become more complicated and expensive to treat.

In addition, the healthcare system around the world is much in need of improvement and ripe for innovation and disruption. This seems to be especially true in the U.S. The Pandemic has only underscored the inadequacy of our current system to deal with a major healthcare shock on a national level.

It has also led to remarkable advancements in genetic research, vaccine development and the treatment of disease, as well as the use of new technologies to connect patients and doctors and medical information.

We are confident that significantly more resources will be devoted to healthcare and wellness in the next five years than in the past, and want to have exposure to the areas of greatest innovation and growth including life-sciences and medical technology.

Developing World – Growth of developing world consumer and technology.

When many investors speak of “Emerging Markets,” they treat them as if they are monolithic, when in fact there are large differences between countries and regions, as well as the nature of their respective economies, political systems, business climate and capital markets.

As a whole, the developing world comprises just over 6.7 billion people, representing 84% of the World’s almost 8 billion people and more than half of global GDP. In addition, the developing world is expected to drive the majority of future global GDP growth.

China, which 10 years ago had a GDP of $7.5 Trillion, now has a GDP of $14 Trillion and is expected to surpass that of the United States by 2028. Over the past four years, the U.S. has withdrawn from global alliances and treaties and relinquished much of its leadership role and China has moved in to fill the void.

We are particularly focused on the growth of the developing world consumer, especially in Asia, as well as the many consumer and technology-oriented companies that cater to them. The current middle class in China is over 400 million people, larger than the entire population of the United States and China now accounts for 40% of all global e-commerce transactions. Some of the world’s largest companies today are Chinese or Indian companies that didn’t exist 10 to 15 years ago. If we look forward 10 to 15 years, we expect substantially more of the world’s leading companies to come from Asia and India and enormous value to be created.

Debt:

The developed and much of the developing world is awash in government debt as deficits and government borrowing soars, and central banks engage in various extraordinary measures (meaning printing money) to keep interest rates low. In the United States, total government debt has mushroomed to over 100% of GDP, and a ten-year Treasury bond yields a meager 1%. In the Euro zone, government debt to GDP is also about 100% and 10-year government bonds basically yield nothing at all. In Japan, government debt to GDP is over 230% and a 10-year bond also yields nothing. Even in China, debt to GDP is close to 60%.

Political leaders, whether liberals or fiscal conservatives, have learned the time-honored lesson that it is easier to get reelected by giving people money – either with benefits or tax cuts - than through fiscal austerity and propriety. It is hard to see that this genie will ever go back into the bottle.

We don't know how this all plays out. In general, higher levels of government debt should crowd out private sector investment and impede economic growth. It also leads to a steady reduction in the intrinsic value of government bonds and currencies, which should ultimately result in higher interest and inflation rates down the road.

In the U.S., over the past 40 years, bonds have been a very attractive asset class, offering income and defensive balance in client portfolios. They also benefitted from a secular decline in interest rates from close to 20% to close to 0%. As interest rates decline, the value of bonds increases. In the rear-view-mirror, bonds have produced stellar returns and look like an attractive asset class. Looking forward, they offer high risk and little return.

In the coming years, it is hard to see how rates could go much lower and easy to see how they could increase significantly, creating a very challenging environment for bonds and bond holders. Short-term bonds can act as a safe place to park money but generate little or no yield, and medium and longer-term bonds don't pay much either and will lose significant value should interest rates rise.

Shaping Forces:

Secular trends, even powerful ones, are influenced by external factors - we call them "Shaping Forces" - which can affect how the trends play out, for better or worse. Government investment and regulations, trade and tax policy, monetary policy, demographics, geopolitics, climate, disease, and social media are all examples of shaping forces.

Shaping forces tend to be medium to longer-term in duration. Government policies can change significantly from administration to administration depending on priorities. Climate change is likely to shape and influence these secular trends for decades to come. Health issues like Covid, are significant but shorter-term in nature, but may have lasting impact on work and lifestyle habits.

In the United States, with a closely divided Congress, it will be hard to affect major changes but we would assume that there will be additional fiscal stimulus to help support the economy and those people and institutions most impacted by Covid. We also expect to see a dedicated infrastructure spending bill as a way to provide additional economic stimulus. There will also likely be a more coordinated effort to get people vaccinated. Finally, we will likely see a reversal in climate policy with a renewed focus on clean energy investment and rejoining the Paris climate accords. We do not expect any major changes to tax policies as the priority for the Biden Administration will be on healing the economy.

In Europe, the near-term focus will be on vanquishing Covid and returning the Continent back to normal. Great Britain will also be wrestling with life after Brexit, which is likely to create some headwinds for economic growth in the U.K.

By contrast, China - where Covid originated - has been much more successful in battling the disease. Chinese economic growth has returned to pre-Covid levels and the Chinese economy seems poised for additional growth as Europe and the U.S. start to recover.

Current Conditions:

Current conditions overlap with shaping forces but are more short-term in nature. They also influence how trends might play as well as the absolute and relative attractiveness of owning investments impacted by them. Current conditions can include valuation levels, interest rates, monetary policy, politics, disease and weather.

Our current outlook is for improving weather conditions and partly sunny skies to come. The combination of effective vaccination, more stable political leadership, pent-up demand for goods and services, large pools of cash and savings on the sidelines, additional fiscal stimulus and supportive monetary policy should provide fertile environment for economic recovery and growth.

Overall asset prices are high, but markets are not uniformly valued. Underneath the hood of the broad stock market, there are wide disparities between regions, sectors, and types of companies.

As a group, the technology sector looks over-owned and overvalued. Other sectors, like healthcare look more reasonably valued and financials and small company stocks are inexpensive.

International and emerging market stocks look attractive relative to U.S. stocks and should benefit as the global economy revives.

Bonds, and especially longer-term government bonds are very expensive. Short term bonds offer little or no yield but can still serve as a defensive store of value. Municipal bonds offer more attractive yields for taxable investors and the Biden administration will likely be more supportive of state and local governments. Corporate bonds look expensive, but improving economic conditions should help to limit default risk.

Investable Outcomes and Current Strategy:

2020 was a year when our targeted growth investments focused on technology and innovation, biotechnology and emerging markets all performed exceptionally well. These areas all tended to benefit from the economic shifts that Covid produced and investors piled into them, driving prices and valuations ever higher. Although we have long-term conviction in these areas, we get nervous when everybody is at the same party at the same time and therefore pruned them last fall.

We reinvested some of the proceeds in areas that offer more attractive valuations and we think should do better as the world economy stabilizes and improves. In particular, we added to smaller capitalization positions and bank stocks within the U.S. and increased our overall exposure to international stocks.

We are also maintaining an allocation to gold in client portfolios. With an improving economy and trillions of dollars of stimulus in the system, we might start to finally see higher rates of inflation. In addition, with governments borrowing and printing money like never before, the intrinsic value of government bonds and paper money should inevitably deteriorate over time. Gold, along with other precious metals and even crypto-currencies, can provide a valuable hedge against this deterioration.

We hold bonds primarily as a defensive investment in client portfolios, with a focus on municipal bonds in taxable portfolios and shorter-duration bonds in non-taxable portfolios. They offer less attractive yields but are also much less vulnerable to a sudden increase in interest rates.

We continue to invest with a global focus; balancing investments targeted at areas of long-term growth and innovation with more defensive equity, alternative and fixed income strategies aimed at mitigating volatility and risk.

As always, please let us know if you have any questions and/or if there is anything we can help you with relating to your financial life. And, if we can ever be of any help to a family member or friend, we always welcome referrals from our clients.

Jurika, Mills & Keifer

Based in the San Francisco Bay Area, Jurika, Mills & Keifer provides wealth management, planning and advisory services to a limited number of individuals, families and foundations.

We combine a forward-looking view of the world with a deep understanding of our client's needs and aspirations to build and preserve wealth and financial well-being over time.

Over the years, we have built a reputation for independent thinking, sound judgement, and a high level of individualized advice and service.

We welcome the opportunity to discuss your financial goals and priorities and how we can help you achieve them.

Jurika, Mills & Keifer, LLC
Private Wealth Management

Main Office
3595 Mount Diablo Blvd, Suite 300
Lafayette, California 94549

San Francisco Office
Four Embarcadero Center, Suite 1400
San Francisco, California 94111

415-677-5430 Phone
info@jmkadvisors.com

jmkadvisors.com

Important Disclosures

Opinions expressed are those of Jurika, Mills & Keifer, LLC, and are subject to change.

Source for Data: Bloomberg, Morningstar, Congressional Budget Office, UK Center for Economics and Business Research (CEBR), World Bank, International Monetary Fund, Brookings Institute, General Accounting Office, St. Louis Federal Reserve, Eurostat, Wall Street Journal.

Investments in securities involve the risk of loss. There can be no assurance that investment strategies referenced will be successful, or that investment objectives will be achieved. Past performance is no guarantee of future results. One cannot invest in an index.

This communication is neither an offer to sell nor the solicitation of an offer to buy a security or advisory services, which can only be made by the appropriate offering document.

Jurika, Mills & Keifer is registered with the U.S. Securities and Exchange Commission.

v. 1-2021b