

2020 Year End Market Update

Over the holiday break, as I was sitting on my couch with nothing to do as I have been most weekends in 2020; I happened to be scrolling through my phone where I stumbled upon one of my favorite pictures of my family – our last visit to Disneyland in October of 2019. My now 4 year-old Tytan was only 2 and change (He wasn't going to turn 3 until November) and although I wouldn't advise taking most 2 year old children on Space Mountain, Tytan met the height requirement ... so we were doing it. Parent of the year... probably not – BUT not only did Tytan rush Space Mountain like a BOSS, but he wanted to go on it again right away!



Content

2020 Roller
Coaster

Bubble = Ride
The Wave

2021 Portfolio
Positioning

Final Thoughts

2020's Markets reminded me a little of Space Mountain – they moved very quickly and we were all in the dark trying to figure out what twist and turn was coming next from Covid 19. Like Tytan, our eyes all got pretty big when the Volatility Index often referred to as the VIX plumbed levels above 80 ... to put this in context we've only seen volatility like this during the depths of 2008 and the 1929 stock market crash ... yes, it was historic. We all know how the story ended, the Fed borrowed 3 trillion dollars and bought anything that was for sale in the bond market and the Federal Govt. rushed in with PPP Loans and helicopters full of money dropping 1200 checks on the public. The market bottomed, sprung up like it was on a trampoline and made new all-time highs before we even got to December. Party like 1999 baby... oh wait that didn't end well. Which brings me to my next point – the only thing that I can compare this time period (2019 & 2020) to... drum roll.... is...the late 90s. If we can roll back the tape to 1997... we would remember the words of Fed Chairman Alan Greenspan talking about "Irrational Exuberance". Markets were too frothy... so the Fed hiked rates aggressively which then ran smack dab into the blow up of Long Term Capital Management and the Asian currency crisis in 1998.

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The Fed then had to totally reverse course and cut rates aggressively that year ... which then set the table for the Nasdaq to triple in 1999 right before the roller coaster ride peaked in March of 2000 and investors had to puke up a lot of their gains till October of 2002 (Literally the month I started in this business). 2019 feels a lot like 1997 and 2020 feels a lot like 1998... so does that mean 2021 is going to be the mother of all blow off tops and we have massive gains coming over the next 12 months like 1999???? Maybe.... Honestly, I have no idea, what I do know however is we're in an asset bubble no doubt about it. All you have to do is look at all time high values in so many things and the parabolic moves of stocks like Tesla or curiosities like Bitcoin (Yes, I called it a curiosity). There's an old Wall Street adage... "When the ducks are quacking... feed them". There has been such an insatiable demand for the next hot stock idea, that we have famous investors creating SPACs (Special Purpose Acquisition Companies) raising billions of dollars in the market from investors to fund these vehicles before they even invest in a target company. These SPACs are referred to as "Blank Check Companies"... what?... yes ... Blank Check Companies. If you want to know what manias look like... this is it. So, the biggest question is what to do about it?! Our view at Koa, with our Hawaiian roots, is to tell our clients to continue to ride this sweet wave. Be mindful that the ride will end and there's probably sharp coral beneath you ready to cut you up if you lose your focus, but let the wave tell you when you need to bail.

This year we'll continue to watch interest rates, how the markets digests the gains from 2020 and a host of other indicators we follow to tell us when we need to start de-risking our portfolios. Our strategy of focusing on the equity market and real estate as primary drivers of returns over bonds hasn't changed from 2020. Our allocation in each of our major asset buckets has. In our stock portfolios we still have a healthy dose of tech, healthcare and consumer stocks that fared well in 2020 and we expect will still be positive contributors to returns in 2021. However, we think companies that derive more of their income from outside the US may see a nice additional tailwind to their earnings vs. more US centric names. In addition, we have moved more of our US equity allocation overseas into Global as well as Emerging Market stocks (With more of a focus on the EM consumer). The US dollar peaked in March and has been falling against EM currencies since, what we've learned over the years, is if this is the beginning of a multi-year move lower in the US dollar, then we could see big gains coming in Emerging Market Stocks ala the early to mid 2000s. In our real estate portfolio, we are staying invested in our "Core" cash flowing assets, but we are adding investment for our Qualified Purchasers (QPs – Households with 5 million + liquid assets) in Distressed Real Estate. Covid 19 has created stress in the real estate market and we think there's opportunity to be a provider of liquidity during the next couple of years. In our bond portfolio, we probably have the lowest allocation that we've had in bonds – maybe ever. We don't see these assets as drivers of returns but rather just additional buckets of liquidity outside of stocks and real estate that help us contain risk and give us some diversification. Frankly, bonds present A-symmetric risk... you could lose more if things go wrong vs. make a little if things go right. We continue to hold the municipals bonds that are in our ladders, but at this juncture all of our corporate and treasury Bonds have matured out in our qualified account bond ladders. Rather than sitting in cash or T-bills earning next to nothing in interest, we are opting to allocate to HY Munis in our taxable accounts and strategic bond managers in our taxable and qualified accounts. The idea being, states that have terrible budgets (Many of them blue states) are going to get bailed out by the Federal Govt. so we think HY munis could continue to rally here in 2021 as default risk continues to fall. In regards to the strategic bond managers... when we're not sure where the market is going, we opt to bring in the hired guns, managers that when grouped together historically have managed through periods like this with index-beating returns.

Happy New Year everyone, we are blessed to be alive and in a position to guide you through another campaign in the markets -- Mahalo

Michael Souza,
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