July 15, 2020

In communicating your quarterly reports, we are again emphasizing brevity and deferring more detailed remarks for mid-quarter. Much as this approach constrains our views to a few words, we're finding a two-stage process less disruptive, and more congruent with the rest of our incremental style of management. We believe more timely, efficient communication works for all of us.

For now, we have the pleasure of reporting that your stocks continue their strong rebound:

- Your Stocks were up 21% on average for the quarter, and 12.6% over the last 12 months.
- Accounts stand even to fractionally ahead year-to-date.
- Volatility remains high, skewed favorably, but is trending lower.
- With 6 months to go, Stocks could deliver full-year results approaching 10%.

Though neutral and cautious in our last report, we have since adopted a more constructive stance:

- Stock Cash Reserves at 18%'s trended lower through purchases and rising valuations.
- Stock **BUYS** topped **SALES** nearly 2:1 in the quarter, completely flipping the 12-month ratio.
- Trimming Stock positions to make room for Buys means you should check your Capital Gains.
- Bond **BUYS** beat calls and maturities extending the struggle to generate fixed incomes.

Our positive outlook based on recovering trends for the balance of the year is not without risks:

- COVID-19 may produce temporary setbacks, but broader economic activity is now heading up.
- The market direction set by Fiscal and Monetary interventions matters more than value metrics.
- The new Rust Belt sectors (Hospitality, Travel, and Retail) will constrain the rebound and risk overvaluation in stronger sectors (Tech, Meds, and Internet).

In sum, current events will likely accelerate shifts in the economy that have long been in the offing. Rushed together by the pandemic, their breadth could drag in ways unseen since the stagnation of the 1970's. Change in the Investment Climate on this scale warrants revision to our Investment Plan projections – a review currently underway. Key for now is that we expect to see higher returns for Stocks, lower for Bonds and more volatility for both. While overall the changes may seem nominal, combined volatility could make progress less consistent, and harder to keep.

At least that's the way we see it for now. As always, should you wish to discuss the specifics of your portfolio or review your progress, please feel free to call.

Warmest Regards,

James W. Mersereau, CFA, CIC
President

Daniel A. Kane, CFA, CIC
Managing Director

In compliance with Rule 204-2(a) of the Investment Advisors Act of 1940, we hereby offer our current Form ADV Part II as filed with the Securities and Exchange Commission through notice of its public posting on our website (www.carderockcapital.com). The Securities Exchange Commission's Investment Adviser Public Disclosure database can be accessed at their website (www.adviserinfo.sec.gov/IAPD/Content/Search/iapd_Search.aspx). With reference to Rule 206(4)-2 Carderock urges you to compare the information on your statement with the statements received from your custodian. Please call if you have any questions.

Random Gleanings

"Bond holdings are no longer a risk-reducer, and may not only increase risk, but be positively correlated with stocks. Nor may equities afford the inflation protection they once did. Today's mighty oligopolies (Microsoft, Apple, Amazon, Alphabet and Facebook) have scant leverage against rising prices. Inflation is at least a plausible and latent danger given the natural experiment the Fed and the Treasury have conducted by expanding M-3 Money Supply at an annual rate of 87.6% and public debt by $2.5 trillion." James Grant, "*Money Gusher*", **Grant's Interest Rate Observer**, June 12th.

"The Fed's buying of corporate bonds is quietly one of the wildest stories of 2020. Announcing their willingness to do 'whatever it takes' - this alone immediately solved the problem. Everyone said, 'The Fed is backstopping the investment-grade market? We're good now,' and enthusiastically bought bonds. Rates fell to record lows and issuance ran at a record pace, but the Fed actually bought nothing. As Hank Paulsen once said, 'If you've got a bazooka, and people know you've got it, you may not have to take it out.'" Matt Levine, "*Money Stuff: Banks Are Managing Their Stress*", **Bloomberg**, June 29th.

"Despite national riots, an upcoming presidential election, Chinese relations, and an ongoing pandemic – the stock market is focused solely on restarting the U.S. and global economies. With a worldwide, synchronized bounce afoot and news poised to improve, the shape of the recovery is less important than its persistence. Even if the economy remains anemic, the better bet has more room to the upside than the downside. So, don't fade the bounce." James Paulsen, "*Don't Fade the 'Economic' Bounce*", **The Leuthold Group**, June 3rd.

"A lesson we should have learned from the GFC and slow expansion that followed is that budget deficits, growth in the national debt and monetary expansion didn't lead to the sort of runaway inflation or dollar debasement the pessimists feared. And thus there is scope for both fiscal and monetary policy to assertively support labor and the economy." Conor Sen, "*The U.S. Can't Wait Half a Decade for a Jobs Recovery*", **Bloomberg**, July 7th.

"A boom in solar projects is under way across Texas, the US oil and gas capital, that is now building a quarter of the industrial-scale solar capacity to be installed this year – much of that in the Permian Basin, the center of a US shale oil industry. Shift to renewables closed many coal-fired powerplants and looks set to challenge the primacy of natural gas as solar prices keep falling. Even oil companies have begun to embrace solar despite the threat it represents to their sales." Gregory Meyer, "*Texas: How the Home of US Oil and Gas Fell in Love with Solar Power*", **Financial Times**, April 7th.

"The outlook for productivity is negative and thus the capacity to expand the supply side of the economy as well. Further, a significant share of the capital stock is stranded and uneconomical. The airline industry is a good example. Going forward, regulations will keep the middle row seats empty, implying that the capital stock has lost significant value. To break even, airlines will have to raise the price of fares between 45% and 55% on most routes. The same applies to restaurants, hotels and cinemas that have to change their practices in response to COVID-19." The Bank Credit Analyst, **BCA Research**, June.

"As for the Fed itself, it doesn't appear to be overly concerned with lofty valuations. St. Louis Federal Reserve President James Bullard said he isn't seeing risks on par with those of the tech bubble of 1998-2000 or the mid-2005 runup to the greatest financial crisis outside of the Great Depression. Not that the Fed spotted either bubble. Feel better yet?" James Grant, **Grant's Interest Rate Observer**, June 26th.

"In Q1, the S&P500 slumped exactly 20% in price, accompanied by all sizes, styles, and sectors, with the defensive groups demonstrating relative leadership. In the second quarter, the S&P500 also jumped 20% again joined by all sizes, styles and sectors, and led by the cyclical groups. As a result, some are calling this a 'bizarro' market and asking what happens next following such polar-opposite quarterly returns. There have been four presidential-election years since 1960 that saw the S&P500 decline in price in Q1 and the rise in Q2 (1960, 1968, 1980 and 1992). In those years, the S&P500 posted second half gains all four times, averaging 8%." Sam Stovall, "*Investment Strategy, S&P Investment Policy Committee*", **MarketScope Advisor**, July 1st.