

April 12, 2021

When looking through your results for the past twelve months, the sight of our **Growth Stocks** running up over 50% is literally breathtaking. The fact is that as good as it has been in compounding at this rate, the sunny outlook that promises to carry us even higher also reveals how far back (and down) lie more comfortable equity valuations. And as much as we can control your portfolio exposure from here, the market's direction depends much more on collective choices, and seldom yields to wishful thinking – especially our own.

If there is one thing we have repeatedly learned over the past 12 months, it is our awareness of “following the crowd” trade and its risks. Investors have long studied these as key to keeping a discreet distance, getting a step ahead, and securing their profits. Yet complacency, lack of alternatives, biases and sheer physics ultimately circumscribe success. What we see with the Federal Reserve and Treasury is that there is no such thing as an uncrowded trade — anywhere. And no matter our inclination, the “Re-Opening of the Economy Trade” expectation is vulnerable.

While we like the idea of centennial reprise for the Roaring 1920's, for our part, the sustainable path counsels a deliberate pace with a steady eye on the following:

- Vaccinations are up, but the path to global herd immunity looks to run long.
- Solid progress towards recovery faces supply constraints (shipping, chips, training and other logistics and resource limits) that slow the course.
- President Biden's sizable **Fiscal** stimuli (**Relief** and **Infrastructure**) along with the steady **Monetary Policy** will help fill the gap faster than the 2007-2009 Great Financial Crisis recovery track.
- **GDP** could run hot from 4% to 6%, lifting **Stocks** towards 10% for the year.
- Broad based **Infrastructure** could finally push the country faster into the 21<sup>st</sup> century.
- While structural **work force** deficiencies will make **Unemployment** sticky, **wage growth** won't embed a systematic 1970's-style inflation.
- **Consumer Prices** will see supply constraints, but not spur core price trends.
- **Interest rates** will rise proving more problematic for **Debt** costs.
- Though in general **Bond bearishness** is premature, targeted bond maturity ladders remains our strategy.
- Good news will push **Stock exposure** higher with earnings and the markets.
- Though **Cyclical** and **Value** stocks had good results in the 1<sup>st</sup> Quarter, their earnings reports remain vulnerable, and longer-term, proven **Growth** Stocks remain the best and the most sustainable way forward.

Overall, we expect an active, upbeat and generally steadier year with Investment Plan returns running in the 4% to 6% range depending on allocation. As always, we welcome the opportunity to discuss our expectations, your circumstances, and the track of your progress together during an Annual Review via Zoom Meeting or phone 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](http://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](http://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

“The bond market is broken, but more broadly, the equity markets are broken, too. In both, prices bear little resemblance to fundamental reality. I’m all for making them accessible to everyone. Unfortunately, the regulatory and educational structure hasn’t kept up. So what we’ve really done is empower people to do risky things without preparing them for the consequences.” John Maudlin, “Everything is Broken”, **Thoughts from the Frontline**, March 3rd.

“A privilege for a market historian lies in witnessing four major stock bubbles: Japan in 1989, Tech in 2000, Housing and Mortgages in 2008, and now the present. Mostly, you show up for work and do your job. But then, once in a long while, markets spiral away from fair value and reality, and investment advisors have a rare chance to really justify their existence. Requiring that you get the timing right is an overreach. If the hurdle for calling a bubble is set too high and you have to make a precise call, you’ll never try, and ride over the cliff instead.” Jeremy Grantham, “Waiting for the Last Dance”, **GMO**, January 5th.

“Of course, in between bubbles, the market does a decent job. The paradox is that the only times that really matter are these deviations from fair value. Sometimes, they’re on the downside when that market’s been crushed. My favorite letter was called ‘Reinvesting when Terrified.’ Published the day the market hit its low in 2009, we advised folks to drag themselves back into the market. Conditions were very bad, but I made the point that the rebound doesn’t start when the market sees light at the end of the tunnel, but turns when everything is still really black. Similarly at the top, the market won’t turn when something really bad happens, but on the second most optimistic day of the last 20 years. And it’s only slowly that you begin to realize the game has changed.” Robert Armstrong, “Interview with Jeremy Grantham: The Coming Stock Market Crash of 2021”, **Financial Times**, March 3rd.

“In the short run, a stock market correction is possible as Covid-19 comes under control. But it’s not much to worry about. Longer term, our economies would be less fragile if spending were less dependent on aggressive monetary policies and huge accumulations of private debt. Fixing this requires: 1) improved incentives for private investment; 2) high and sustained levels of productive public investment, and 3) greater redistribution of income from high-income savers to low-income spenders. We should also want an economy where nominal and real interest rates can rise sharply, as economies strengthen and inflation rises – if it’s all to turn out well. This may even be the world we live in. Time will tell.” Martin Wolf, “Economies Can Survive a Stock Market Crash”, **Financial Times**, March 16th.

“Biden’s infrastructure bill swerves away from let-the-market-handle-it approach, and harkens to government investments of the New Deal and the Eisenhower administration. In those decades, the U.S. extended its electric grid, created the Interstates, built the suburbs, upgraded and expanded universities and spent broadly on research. Biden looks to repeat that - adding a focus on climate change and racial inclusion. There’s risk in all changes in industrial policy, but with the successes of the earlier efforts to guide us, Biden isn’t so much charting a course into the unknown as tweaking a tried-and-true approach.” Noah Smith, “It’s Not Infrastructure: It’s Reimagining the US Economy”, **Bloomberg**, March 29th.

“A big reason investors are willing to fight the Fed is that Wall Street has become much more optimistic on economic growth than the Fed’s most recent estimate of real GDP at 4.2%. Goldman Sachs Group’s 8% projection doubles that, and many other Wall Street banks have boosted their outlooks to between 5% and 7% as well. Given the Fed’s [cautious language](#) and dovish policy, many investors find the central bank’s outlook is too conservative and expect policy makers to come around to the market’s view. Then they’ll pull forward the timing of raising interest rates.” Conor Sen, “A Dovish Fed Should Embrace the Market’s Optimism”, **Bloomberg**, March 16, 2021.

“We'd be better off with a Fed that had the simple instruction to try and maintain a steady increase in the money supply in relationship to the GDP - period. And all its fancy obligations are misplaced, mis-designed. And I have a simple experiment, which I love. It shows debt to GDP ratio in the US climbing back from post-World War II, slowly rising across the page imperceptibly until you reach Greenspan. There is simply no proof that debt increases growth. There is a convention that it does.” Robert Armstrong, “*Interview with Jeremy Grantham: The Coming Stock Market Crash of 2021*”, **Financial Times**, March 3rd.

“Spending has been spurred by a belief that as long as the federal government can borrow without a rise in low interest rates, no one really needs to pay. In case markets disagree, the rich can be taxed. Past experience suggests it will be hard to make the rich pay – they will oppose new taxes vigorously and avoid them if implemented. If the \$5TN of US spending so far enacted requires ordinary taxpayers to bear some burden, its lack of targeting or restraint will have adverse consequences.” Raghuram Rajan, “*A Riot of US Spending Spells Trouble for Future Generations*”, **Financial Times**, April 4th.

“Henry Kaufman casts a disapproving eye across the broad financial landscape; laments the deterioration of credit quality (from 61 triple-A corporate borrowers in the 1980's to only two today); the cartelization of the big banks (‘they’re quasi-public financial utilities’); and the hovering, insinuating presence of the Federal Reserve. ‘It seems clear to me that the combination of falling credit quality, elusive marketability and high financial concentration has moved the central bank from a lender of last resort to one of early resort.’ The old bear did not sugar-coat his conclusion. ‘With the federal government and the Fed firmly joined at the hip, the transformation of capitalism into statism is gaining perhaps irreversible momentum.’” James Grant, “*Chair Powell on the Beaches*”, **Grant’s Interest Rate Observer**, April 2nd.

“Last spring for the first time, the Fed bought corporate bonds. Scott MinerD pointed out, ‘We have now socialized credit risk, and forever changed the nature of our economy.’ The Fed’s standard cover of ‘promoting smooth market functioning’ is inconsistent with the far-reaching effects. Monetary laxity, fiscal profusion and zero-cost trading commissions have combined to raise up a SPAC boom, crush credit spreads, levitate meme stocks, infuse the cryptos, smile on the invention of non-fungible tokens, facilitate the issuance of trillions of dollars of low-cost public debt and train a youthful new cohort to speculate under the banner of ‘you only live once.’” James Grant, “*Chair Powell on the Beaches*”, **Grant’s Interest Rate Observer**, April 2nd.

“In a bid to attract ridiculous valuations, SPACs seek retail investors with glossy images and little in the way of hard numbers. This works if you can worry about due diligence later. But if a pumped up valuation requires an acquisition to generate supporting cash flows, the problem comes when the diamond-handed hodlers can’t be bothered with proxies let alone shareholder votes.” Jamie Powell, “*SPACs: Missing in Action*”, **Financial Times**, March 10<sup>th</sup>.

“The market for U.S. Treasuries has long been viewed as the world’s deepest and most liquid financial market. Yet it appears that with accelerating deficits, the market has outgrown trading capacity as revealed when heavy investor demands due to the Covid-19 crisis overwhelmed dealers and spiked rates, forcing the Fed to buy \$1 trillion over a three-week period to restore calm. Given expected deficits in the years ahead, the lack of a robust private-market should not be acceptable, and raises questions about the future safe haven status of these instruments, and the cost to taxpayers. Reform will prove expensive, but the outlook suggests that the expense is justified.” Darrell Duffie, “*Still the World’s Safe Haven?*” **Hutchins Center on Fiscal & Monetary Policy at Brookings**, June 2020.

## RESULTS

The **S&P 500 index** rose **6.2%** for the 1st Quarter and **56.35%** for the last 12 Months.

### Stocks:

*Size:* – Small and Medium Cap Stocks greatly outperformed Large Cap Stocks during the 1st Quarter and the last (12 Months).

**S&P 500 Large-Cap 6.2%** (53.7%), **S&P 400 Mid-Cap 13.5%** (+80.8%),  
**S&P 600 Small-Cap 17.9%** (+92.7%)

*U.S. Economic Sectors:* – **S&P 500 Index** Sectors with Ranges from: –

*1<sup>st</sup> Qtr.* - **Energy 29.3%** to **Consumer Staples 0.45%**

*Last 12 Months* - **Materials 74.7%** to **Utilities 15.4%**

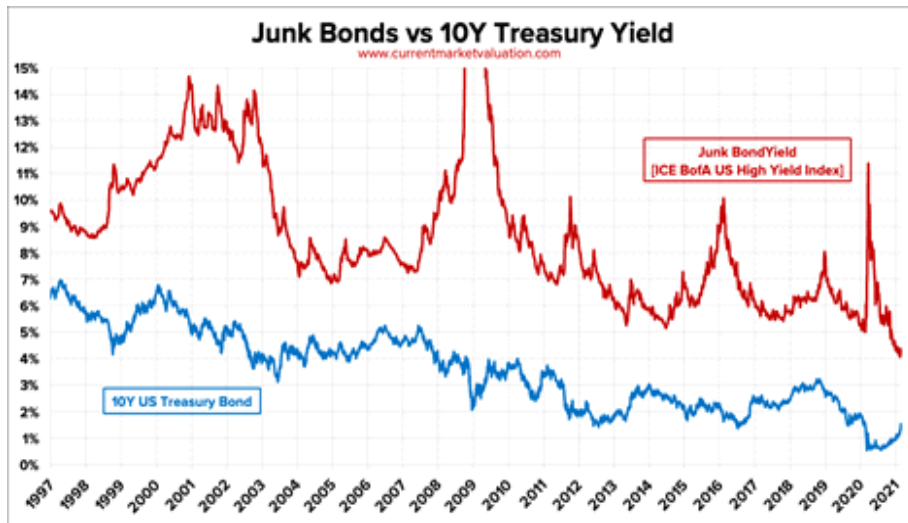
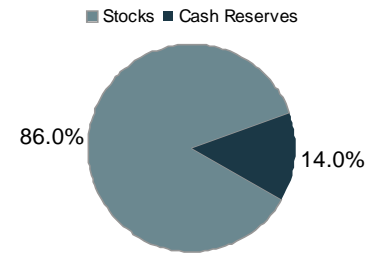
**Bonds** –High Yield Bonds outperformed Investment Grade Bonds for the period even as the Yield Curve steepened.

### Bond Indexes and Performance

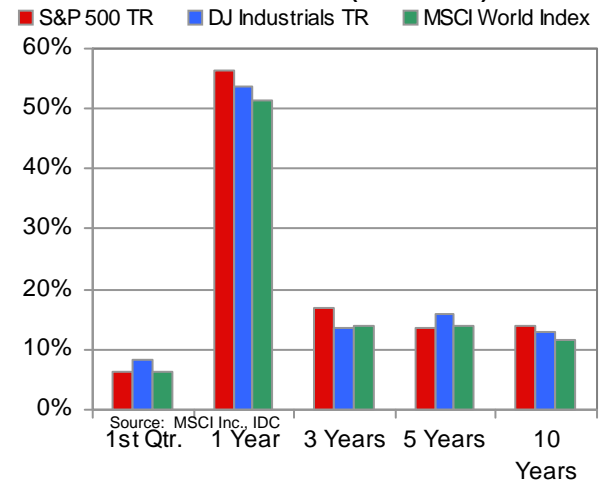
	1 <sup>st</sup> Qtr.	1 Yr.
➤ Lipper Short-Int. U.S. Govt. Index:	<b>-0.97%</b>	<b>0.77%</b>
➤ Lipper Short-Int. Municipals Index:	<b>-0.24%</b>	<b>4.17%</b>
➤ iShares iBoxx (LQD) Inv. Grade Corp. Bond Index:	<b>-5.47%</b>	<b>8.11%</b>
➤ iShares iBoxx (HYG) High Yield Corp. Index:	<b>0.58%</b>	<b>18.88%</b>

Source: Lipper, FactSet and Blackrock

### Carderock Equity Target Allocation



### Global Stock Market Annualized Performance (03/31/2021)



### Growth vs. Value Style Annualized Performance (3/31/2021)

