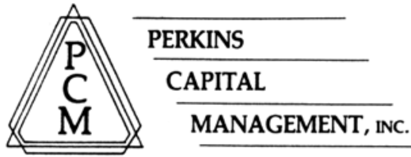

May 12, 2021

Dear PCM Clients and Friends:

We hope this letter continues to find you and your family safe and healthy as we optimistically begin to leave what has been an unprecedented time.

Winter is now officially over and spring has started in Minnesota! Within the past week here in Minnesota, the trees are leafing out and the early flowers, the tulips and daffodils, which have been in bloom where the warm sun hits, are bringing a renewed feeling that the enjoyable summer months are finally approaching. This time of the year is always an optimistic renewal. A time for getting outdoors and making adventurous plans. For doing.

Especially so this year, as we have all wanted to believe that we could and will put COVID behind us. More than to just "get out and about." We think everyone has been yearning for a clear vision that we truly are moving into a post-COVID environment. We believe we can now see that within the country and from an investment perspective, a post-COVID era is clearly shaping up.

These first several months of 2021 have been marked by much more than just continued COVID concerns. The first surprise of 2021 came on January 6 when during confirmation by Congress of the Electoral College votes from the November 2020 presidential election, protestors stormed the U.S. Capitol causing a temporary delay to the election certification and marking a historically tragic day in the U.S. democratic process. After confirmation the newly elected Democratic-controlled government immediately began steps to pass another massive economic stimulus bill. This helped stocks rally in early February. Also in February, vaccine distribution meaningfully accelerated throughout the U.S. That increased distribution, combined with the authorization of a single-dose Johnson & Johnson COVID-19 vaccine, helped investors embrace the idea that the end of the pandemic was now possibly just months away. This sentiment helped stocks rally further.

Markets continued to rally in early March as investors began to price in more economic recovery following passage of the massive $1.9 trillion economic stimulus bill on March 11. That new stimulus, combined with COVID-19 vaccine distribution reaching 2.5 million doses/day, resulted in growing expectations for a full economic reopening and recovery in the coming months.

The first quarter of 2021 at times reminded investors of the volatility and unpredictable nature of markets that we all witnessed in 2020; however, just like markets proved resilient last year, stocks overcame multiple surprises during the first quarter to provide another positive quarterly return.

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THE MARKET SCOREBOARD

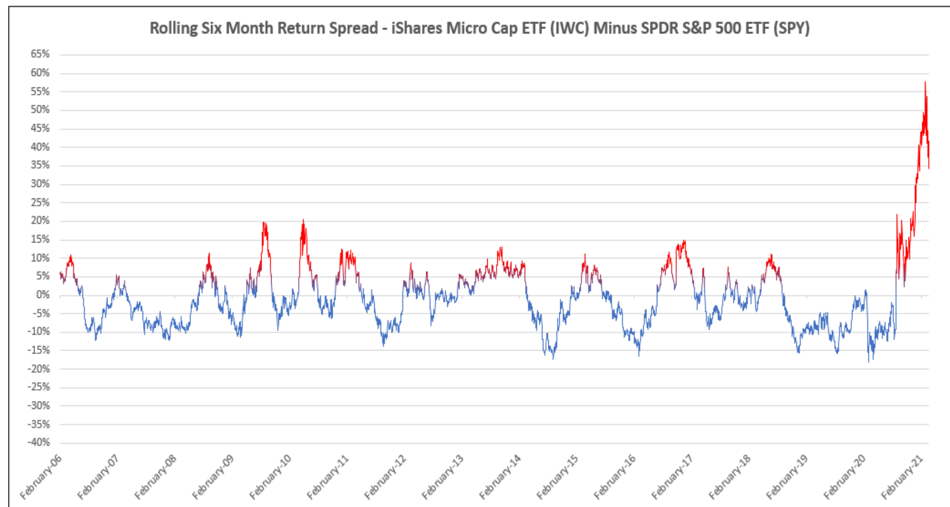
Expectations of a post-COVID-19 economic recovery drove market performance in the first quarter, as the Dow Jones Industrial Average outperformed both the S&P 500 and the Nasdaq Composite due to the underperformance of technology shares.

By market capitalization, small-cap stocks, which are historically more sensitive to changes in economic growth, outperformed large-cap stocks as COVID-19 cases declined and numerous states partially or fully reopened their economies, leading investors to expect a broad acceleration in future economic activity.

Ranked by Q1 Return Indexes	% Return Q1 2021
Dow Jones U S Micro-Cap	25.60
Dow Jones Industrial Average	7.76
NYSE Composite	7.41
S&P 500 Total Return	6.17
Wilshire 5000	5.79
NASDAQ Composite	2.78

All eleven S&P 500 sectors finished the first quarter with positive returns. For the second straight quarter the sector leaders included energy, financials, and the cyclical industrial and materials sectors. As mentioned, expectations of an acceleration in future economic growth again, mainly a product of stimulus and COVID-19 vaccine distribution, drove these "cyclical sectors" to outperformance in the first quarter. Traditionally defensive sectors such as utilities, health care, and consumer staple companies underperformed. The biggest sector laggards in the first quarter were in several of the technology groups.

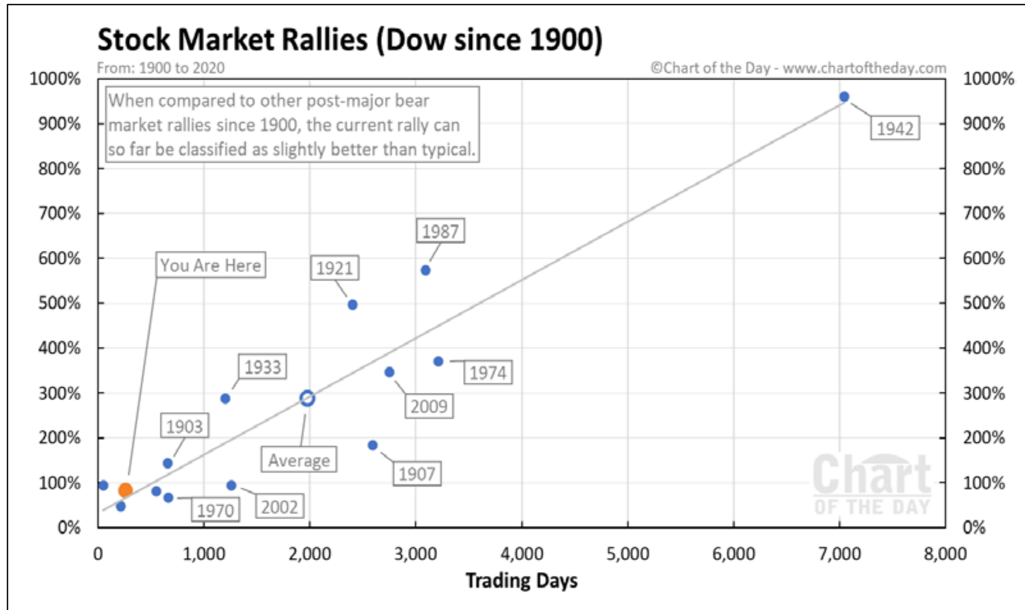
Within the first quarter there was a notable outperformance by small-cap equities over large-cap equities; with micro-cap stocks handily outperforming all-caps. In fact, this extra performance between micro-cap and large-cap hit their highest levels in at least fifteen years, as reflected in the chart below which compares the six-month performance difference or "spread" in returns between a popular micro-cap ETF and an S&P 500 ETF. This difference is normally +/- 15% one way or the other; but in the first quarter it peaked at a 15-year record difference of 55%. We did some significant "trimming" in a number of our micro-cap investments, to take advantage of the spike in their prices during the quarter, for you. In the second quarter we will likely see a reversion back toward the mean.



STOCK MARKET OBSERVATIONS

How does the current stock market rally compare to rallies over the past 120 years?

The chart below from *Chart of The Day* answers that question by presenting the performance of the current rally (the orange dot) compared to other post-major bear market rallies since 1900. The first quarter of last year was the quickest bear market on record when the market was gripped by the COVID-19 virus and fell in 33 days by an unprecedented 34%. This decline was then followed by last year's second quarter which was a mirror image of the first quarter and contained 50 of the best continuous market days within a quarter in history. The rally from the low was the fastest recovery from a 30% decline on record. It took only 6 months to return to a new high on August 18, 2020, recovering the decline from the February 19, 2020 high. As dramatic as the past year has been, now that the current stock market rally has been in existence for a little over a year, which for market rallies is a short amount of time, relative to prior rallies the current rally can be considered so far only slightly better than typical (since it is above the gray regression line). It is worth noting that all but three of the rallies (or 77%) since 1900 ultimately gained more than the current rally has so far. So, despite anticipated corrections along the way, compared to prior market recoveries, this current market could have more life ahead. The average stock market rally on the chart is the larger blue circle and lies at the intersection of 2,000 trading days and a 300% increase.



Now that we are moving into a post-COVID environment, we still believe the three factors we have outlined in our quarterly letters over the past year – the need for an effective vaccine, an accommodative Fed, and the positive effect of effective fiscal stimulus – are still important and will materially affect the market during the balance of this year and into 2022. Fortunately, for all of us, the vaccine rollout continues its success story. Though no longer referred to as Operation Warp Speed, it is because of this success that we are where we are at today in our fight against the COVID-19 virus.

The unprecedented Fed policy action continues. No surprises came from the recent FOMC (Fed Open Market Committee) two-day policy meeting. The target federal funds rate remains in the range of 0.00 to 0.25 percent and asset purchases will continue at about $120 billion per month. The Fed committed to maintaining a zero-rate policy and indicated economic activity has strengthened. Powell said he believed the higher inflation is due to transitory factors and that the inflationary pressures building in the economy will be temporary. One analyst we read noted that though the Fed was on point at their news conference that investors should not expect any changes in their accommodative policy for the foreseeable future, there was a change in the tone and direction of the questions being asked. The analyst felt the economic reporters seemed incredulous to the need for the Fed's policies to remain in crisis mode given the strong trend in recent economic releases.

Economic trends and announced corporate profit growth are both better than investors might have expected earlier in 2021. This historic recovery is becoming global as we reopen from the 2020 pandemic shutdown. Corporate earnings are better than expected with over two-thirds of S&P companies reporting a median sales growth of 8% and EPS growth of 24%. This level of EPS growth is the highest growth rate since 2010.

There are other positive factors which are all working together at the same time. Personal saving was up dramatically during the shutdown with about $3 trillion in excess savings that has not yet been spent and re-openings are accelerating. Disposable personal income is rising, employment is improving, and consumer confidence is up. Since last year, the money supply has increased over $4 trillion, consumer net worth is up $27 trillion, and fiscal stimulus has totaled $5 trillion. There is the possibility of even more fiscal stimulus. All of this along with low interest rates will lead to strong economic growth through 2023; perhaps beyond.

Clearly, the economy is poised for rapid growth as it continues to open up. Yet, there are challenges. Labor shortages are by far the toughest. *The Kiplinger Letter* recently pointed out that "after so many workers lost their jobs last year, and with the unemployment rate still fairly high, it seems like there should be plenty of people to hire as employers see business improve. But it turns out that workers aren't nearly as abundant as expected. Many workers prefer government aid to a regular paycheck right now." *Kiplinger* suggested these labor woes will not end until late August when unemployment benefits have expired.

Due to the shutdown, there are shortages of critical materials and parts for many industries. There are also reopening and other logistical bottlenecks. As people are out spending more money there are consumer goods shortages - as mundane as shirts and swimsuits.

Low interest rates have continued to fuel the demand for homes causing house prices to soar across the country rising 11% in a 20-city index versus a year earlier and creating a severe shortage of For Sale home inventory, despite higher prices.

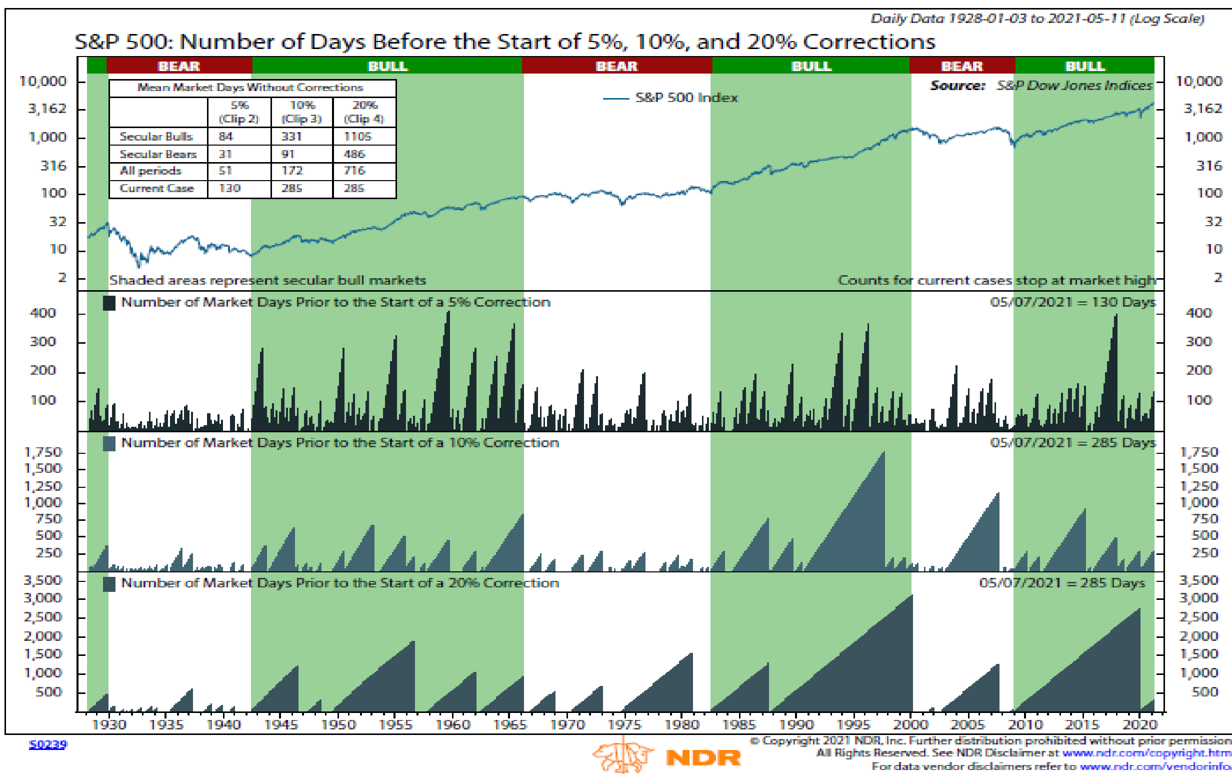
There are even higher prices at the grocery store where just about everything costs more. A *Bloomberg* article wrote that new data from Nielsen IQ revealed that 50 of 52 categories tracked by them were more expensive than a year ago. Rising commodity costs are partially

to blame; but more to the point: "Everyone is looking to offset higher transportation costs, higher labor costs, and higher input costs. And that flows through the whole chain all the way to the consumer."

The incredible levels of liquidity and pent-up demand are, perhaps somewhat irrationally, making investors concerned that "things are too good"; causing the rebirth of persistent inflation. This had been the "news spark", the reason given, for a well needed but never looked forward to or "dreaded" correction in the stock market averages.

What should we expect in terms of a correction in stock prices?

The answer is that we should always expect corrections in the market every year. Ups and downs are just part of investing. Corrections of 5% are common and corrections of 5% to 10% occur each year. Below on this page is a chart from Ned Davis Research which, though complex and requires some study, details the number of market days before the start of 5%, 10%, and 20% corrections in the S&P 500 from 1928 through today. The first important information is in the box in the upper left-hand corner. This reveals the Mean Market Days Without a Correction. In bull markets 5% corrections come along every 84 days on average (3 or 4 a year), 10% corrections occur every 331 days (every year), and 20% corrections every 1105 days (every 4 years - the economic cycle). The current market is overdue for a correction. As seen in the Current Case bottom row in the box there has not been a 5% correction for 130 days, a 10% correction for 285 days, or a 20% correction since the 2020 COVID correction ended 285 days ago. In the body of the chart there are four rows of chart information. The top area of the chart shows the S&P 500 index's ups and downs from the



start of 1928 through yesterday May 11, 2021. Every wiggle is there, but as we have written before, on a chart like this all of the dramatic ups and downs in the markets over all of these years don't look like much compared to what we have lived through as investors. The trend is clearly up. Each spike in the bottom three sections show a correction. Lots of 5% spikes and fewer 10% spikes. The Y-axis in the bottom three sections is days between corrections for each correction - interesting to study. The bottom line is we are due for a 5% to 10% correction.

What will the current correction be in terms of a percentage? This is not predictable in advance with any degree of accurate honesty. No one knows; but everyone looks to history as a guide. We also often review charts of the indexes for areas of price support.

As investors we know corrections are to be expected. The big worry and the big question everyone asks is, essentially: Will it be a big one? Each week John Stoltzfus, Chief Investment Strategist for Oppenheimer Asset Management writes a piece called the *The Market Strategy Radar Screen*. Quite often in this piece, he has the table below which details S&P 500 Maximum Drawdowns (or market corrections) since 1990 with each year's maximum decline or "drawdown". We think the table is quite interesting. What it reveals is since 1990, during the past 30 years, there have been five years with 25% or greater corrections: the 2020 COVID correction at -33.92%, the two years around the banking crisis of 2008 and 2009 at -27.19% in '09 and -47.71% in '08, and the top of the market in 2001 and 2002.

Maximum Drawdowns Since 1990

Year	Maximum Drawdown	Drawdown Start Date	Drawdown End Date	Drawdown Recovery Date	Annual Price Return	Average Fed Funds Rate	Avg. 10-Year Treas. Yield
2020	(33.92%)	2/19/2020	3/23/2020	8/18/2020	16.26%	0.37%	0.90%
2019	(6.84%)	4/30/2019	6/3/2019	6/20/2019	28.88%	2.50%	2.38%
2018	(19.78%)	9/20/2018	12/24/2018	4/23/2019	(7.03%)	2.25%	3.06%
2017	(2.58%)	3/2/2017	4/13/2017	5/2/2017	19.40%	0.93%	2.44%
2016	(10.27%)	1/1/2016	2/11/2016	3/17/2016	9.54%	0.50%	1.99%
2015	(12.04%)	7/21/2015	8/25/2015	7/8/2016	(0.73%)	0.25%	2.19%
2014	(7.28%)	9/19/2014	10/15/2014	10/31/2014	11.39%	0.25%	2.42%
2013	(5.58%)	5/22/2013	6/24/2013	7/11/2013	29.60%	0.25%	2.19%
2012	(9.58%)	4/3/2012	6/1/2012	8/16/2012	13.41%	0.25%	1.79%
2011	(18.64%)	5/2/2011	10/3/2011	2/17/2012	(0.00%)	0.25%	2.66%
2010	(15.63%)	4/26/2010	7/2/2010	11/4/2010	12.78%	0.25%	3.32%
2009	(27.19%)	1/7/2009	3/9/2009	5/8/2009	23.45%	0.25%	2.71%
2008	(47.71%)	1/1/2008	11/20/2008	1/10/2013	(38.49%)	2.25%	3.78%
2007	(9.87%)	10/10/2007	11/26/2007	3/14/2013	3.53%	4.62%	4.34%
2006	(7.46%)	5/8/2006	6/13/2006	9/13/2006	13.62%	4.98%	5.07%
2005	(7.01%)	3/8/2005	4/20/2005	7/11/2005	3.00%	2.67%	4.46%
2004	(7.43%)	3/8/2004	8/12/2004	11/4/2004	8.99%	1.08%	4.41%
2003	(13.78%)	1/15/2003	3/11/2003	5/2/2003	26.38%	1.25%	3.87%
2002	(33.01%)	3/20/2002	10/9/2002	10/16/2006	(23.37%)	1.75%	4.65%
2001	(29.09%)	1/31/2001	9/21/2001	10/16/2006	(13.04%)	4.34%	5.10%
2000	(16.56%)	9/4/2000	12/20/2000	5/18/2007	(10.14%)	6.50%	5.66%
1999	(11.80%)	7/19/1999	10/15/1999	11/16/1999	19.53%	5.15%	5.92%
1998	(19.19%)	7/20/1998	8/31/1998	11/23/1998	26.67%	5.50%	5.37%
1997	(10.80%)	10/7/1997	10/27/1997	12/5/1997	31.01%	5.46%	6.35%
1996	(7.60%)	6/5/1996	7/23/1996	9/13/1996	20.26%	5.30%	6.44%
1995	(2.53%)	12/13/1995	12/20/1995	1/29/1996	34.11%	5.83%	6.57%
1994	(8.94%)	2/2/1994	4/4/1994	2/3/1995	(1.54%)	4.21%	7.07%
1993	(4.99%)	3/10/1993	4/26/1993	8/20/1993	7.06%	3.02%	5.85%
1992	(6.24%)	1/15/1992	4/8/1992	7/28/1992	4.46%	3.52%	7.00%
1991	(5.60%)	4/17/1991	5/15/1991	5/31/1991	26.31%	5.69%	7.86%
1990	(19.92%)	7/16/1990	10/11/1990	2/11/1991	(6.56%)	8.10%	8.54%
Average (1990-2020):	(14.16%)				9.31%	2.89%	4.40%
Average (1998-2020):	(16.18%)				7.55%	2.10%	3.51%

Source: Bloomberg. OAM Research calculations. Interest rates are average for the period from the drawdown start date until its end date. These results cannot and should not be used

There were no 20% to 25% corrections; but four years were just below, essentially at 20%. These years were 1990 at -19.92%, 1998 at -19.19%, 2011 at -18.64%, and 2018 at -19.78%. During the 30 years of the table there were nine years with "drawdowns" of essentially 20% or greater.

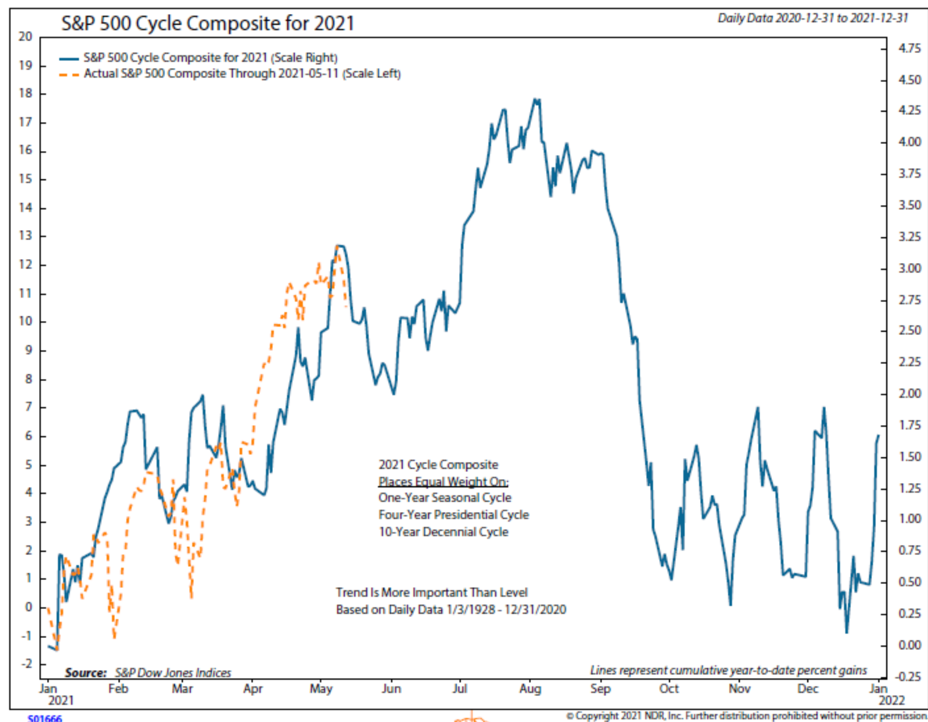
There were two years with about a 15% correction: 2000, which was the beginning of the 2001 and 2002 correction, with a -16.56% correction and 2010, which was part of 2008 and 2009 with a -15.63% correction. There were three "drawdowns" of between 10% and 12% in 1999, 2015, and 2016. Half of the years, fifteen years, had a

"drawdown" or correction of 10% or less with the greatest number being six corrections of around 7%.

On the right side of the table are three columns which show the annual price return of the S&P 500 as well as a short-term and a long-term interest rate. During the 30 years of the table there were 9 "red" years where the return was negative. Scanning from the bottom of the interest rate columns to their top one can see the dramatic decrease in interest rates since 1990.

In summary, corrections are expected every year and since 1990 about a third of the time they have been significant; though only in the 2000 to 2002 time period and in 2008 was the return significantly negative for the year. I think most of us at this time last year would not have predicted the 2020 recovery would end as positively as it did.

In our October 2020 letter we printed the Four-Year Presidential Cycle from Ned Davis Research for the previous four years from 2017 through 2020 to date. In our February 2021 letter we included a prospective Four-Year Presidential Cycle for 2021 through 2024. Later this year we will include more information on what we expect for market cycles during the next several years. On this page is the one-year 2021 S&P 500 Cycle Composite for 2021 updated through 5-11-21 from Ned Davis Research. The orange line is the actual YTD S&P 500 Composite and the blue line is the Ned Davis Research Cycle Composite for 2021. We have included their cycle work for many years because, though not perfect, it is often quite accurate in its form and has proven itself to be useful. The 2021 cycle calls for a top about now with a correction into June then a continuation of a "honeymoon" period for the new President until fall when we have our normal year-end correction period.



It is our feeling that with the amount of liquidity in the system, increasing corporate earnings, strong consumer confidence, the reopening, Fed

policy, and fiscal stimulus that market corrections will be more about correcting overvaluations than broad economic distress.

Though mortgage rates are still at their lows making homes more affordable, many young people are challenged buyers as homes go on the market and sell immediately or are just not available in certain neighborhoods at this time. In the cartoon even Snoopy agrees.

As always, if you have any questions about your investment accounts or any of the specific investments in them, please give us a call. Or call in and ask to schedule a time for a more formal review or to have a longer updating talk at a specific time.

We close this letter with the hope that you continue to be safe and healthy as we move through 2021 into a post-COVID time.

Sincerely,

Richard C. Perkins, C.F.A.
President
Portfolio Manager

Daniel S. Perkins, C.F.A.
Chief Operating Officer
Portfolio Manager

RCP:DSP/jah

TWO LITTLE BOYS

Two little boys, ages eight and ten, were excessively mischievous, they were always getting into trouble. If any mischief occurred in their town, the two boys were probably involved.

The boys' mother heard that a preacher in town had been successful in disciplining children, so she asked if he would speak with her boys.

The preacher agreed, but he asked to see them individually. So, the mother sent the 8-year-old first, in the morning, with the older boy to see the preacher in the afternoon.

The preacher, a huge man with a booming voice, sat the younger boy down and asked him sternly, "Do you know where God is, Son?"

The boy's mouth dropped open, but he made no response, sitting there wide-eyed with his mouth hanging open.

So, the preacher repeated the question in an even sterner tone, "Where is God?"

Again, the boy made no attempt to answer. The preacher raised his voice even more and shook his finger in the boy's face and bellowed, "Where is God?"

The boy screamed and bolted from the room, ran directly home and dove into his closet, slamming the door behind him.

When his older brother found him in the closet, he asked, "What happened?"

The younger brother, gasping for breath, replied, "We are in BIG trouble this time," "GOD is missing, and they think we did it!"

FIRST FOOTBALL GAME

Eddie took his new girlfriend to her first football game. They had great seats right behind their team's bench. After the game, he asked her how she liked the experience. "It was great, especially the tight pants and all the big muscles," she said. "But I just can't understand why they were killing each other over 25 cents." "What do you mean?" Eddie asked, dumbfounded. "Well, I saw them flip a coin, and one team got it," she explained. "And then for the rest of the game, all they kept screaming was, 'Get the quarterback! Get the quarterback!' Hel-loll! It's only 25 cents."

TOO EXPENSIVE

A very frugal man was looking for a gift for a friend. Everything was very expensive, except for a broken glass vase, which he could purchase for almost nothing. He asked the store clerk to package and send it to his friend, hoping that his friend would think it had been broken in transit.

In due time, the man received a thank you note from his friend.

"Thanks for the vase," it read. "it was so thoughtful of you to wrap each piece separately."

THE FLOOD

One night, a torrential rain soaked northwestern Minnesota. The next morning the resulting floodwaters came up about six feet into most of the homes.

Mrs. Johnson was sitting on her roof with her neighbor, Lena, waiting for help to come. She noticed a baseball cap floating near the house. Then she saw it float far out into the front yard, then it floated back to the house; it kept floating away from the house, then back towards the house. Her curiosity got the best of her, so she asked Lena, “Do yew see dat der baseball cap a floatin avay from da house, den back again?”

Lena said, “Oh ya, dat’s my husband Ole; I tole dat lazy bum he vas gonna cut da grass today, come hell or high vater.”

PRAISE THE LORD

Lars was so happy. The preacher had just sold his horse to him and he was so excited! The good preacher took the time to explain to Lars that he trained the horse well.

“Ya, Lars,” he said, “To get da horse to go, all yew have to do is say, “Praise da Lord! And vhen yew vant him to stop yust say, Amen.”

“Vell, ya, Pastor John, that’s vhat I will do,” said Lars.

Later that day Lars jumped on the horse and said “Giddy-up.” The horse didn’t move. Then Lars remembered, and he said “Praise da Lord” and the horse took off at a gallop.

“Vhoa, Vhoa!” yelled Lars, but the horse wouldn’t stop. The horse was about to go over a cliff, and Lars figured that he was going to die and go to heaven, so he said, Amen!”

At that, the horse skidded to a stop just two feet from the edge of the ridge. Lars looked down at the jagged rocks far below. Happy that his life had been spared, he yelled, “Praise da Lord!”

SAY IT WITH FLOWERS

Ole walked into a floral shop that displayed a large neon sign that read, “Say it with flowers.” Ole asked the florist to “Wrap up vun rose.” “Only one?” the florist asked.

“Uff-da, ya,” said Ole. “I’m a man of few vords!”

LITTLE OLE’S REPORT CARD

Little Ole came home from school with his report card. His parents, Ole and Lena, were just shocked! “Ole!” gasped Lena. “Dis report card is yust awful! Vhy, deese grades couldn’t be any vorse!” “Vell, I agree, Lena.” said Ole.

“Vell, so do I,” chimed in Little Ole. “But vhat da yew attribute it to? Heredity or environment?”