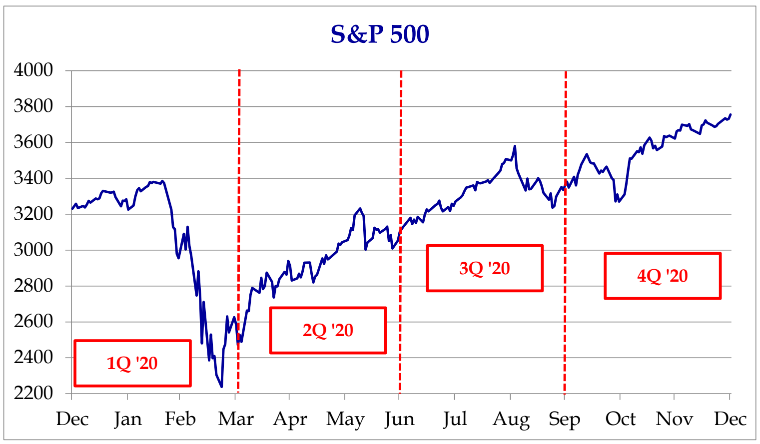
FOURTH QUARTER 2020 REVIEW AND 2021 OUTLOOK
ECONOMIC RECOVERY IS ON THE HORIZON

Chart I



Source: Strategas

Stock market historians are likely to record 2020 as one of the most unusual years in its long history. Beginning with strong economic and employment trends, the market collapsed in the beginning of March from a Covid-induced economic freefall that is still hampering global progress as we enter the new year. Concurrent with a global and domestic lockdown of economic activity, the federal government and global central banks injected substantial new fiscal and monetary stimulus programs aimed at reducing the economic damage. Corporate America also responded with massive employment reductions and dramatic cutbacks to capital spending programs. With this as the economic backdrop, would anyone have predicted that the S&P 500 would end up 18% in such a year (Chart I)?

The uniquely strong equity market reflected a number of factors:

- Unprecedented fiscal stimulus programs totaling over $4 trillion, including $1,800 directly to middle to lower-income households through two cash payments.
- The Federal Reserve aggressively pushing interest rates lower and flooding the economy with monetary stimulus (see Charts II and III).

Chart II

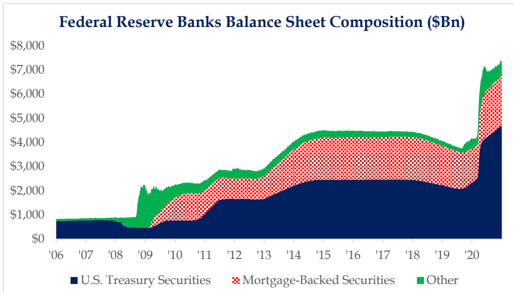
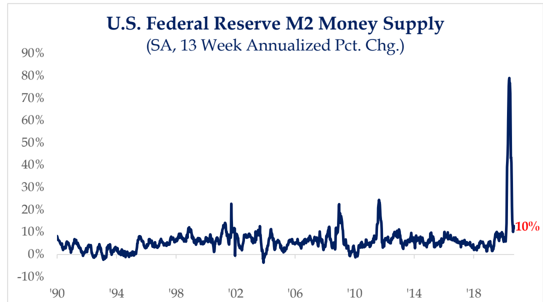


Chart III



Source: Strategas

- Swift corporate actions to reduce the workforce and preserve cash flow thus preventing possible bond defaults.
- Federal government loans to small to medium-sized businesses.
- State and local governments delaying tax payments and delaying possible bank foreclosures on homeowners and protecting renters from eviction, etc.
- Dramatic shift in investor focus to companies with a high degree of digital exposure.

Perhaps the most important factor pushing the market higher was the willingness of equity investors to look through this difficult earnings period. This was reflected in rewarding companies with rapidly expanding digital revenue. In the latter months, as announcements pertaining to possible vaccines were released, companies that would benefit from an economic recovery began to rally. This created a significant broadening out of the equity markets and is generally a very bullish signal. This broadening continues today. Overall, the stock market ended on a strong note as investors focused on the expected economic recovery in 2021. As 2020 came to an end, S&P 500 earnings declined to approximately $140 a share; only an 11% decline from the prior year earnings of $158 a share.

With a Democratic controlled House of Representatives, Presidency and Senate, expectations are now for more aggressive stimulus programs than originally expected. Offsetting these positive trends are likely to be corporate and individual tax increases. At this juncture, we believe that the economy will begin to significantly recover by the second half of the year as the majority of the U.S. population would have already received the vaccine treatment. Most economists forecast a 6% increase in GDP leading to an approximate 20% increase in S&P 500 earnings (~$160-$180 share). At current prices, this would place the S&P 500 at a relatively high 22-23x P/E multiple on projected recovery earnings.

The timing of future stimulus programs and the expectation of higher taxation is likely to be a critical variable for equity prices during the latter part of 2021 and all of 2022. While history is

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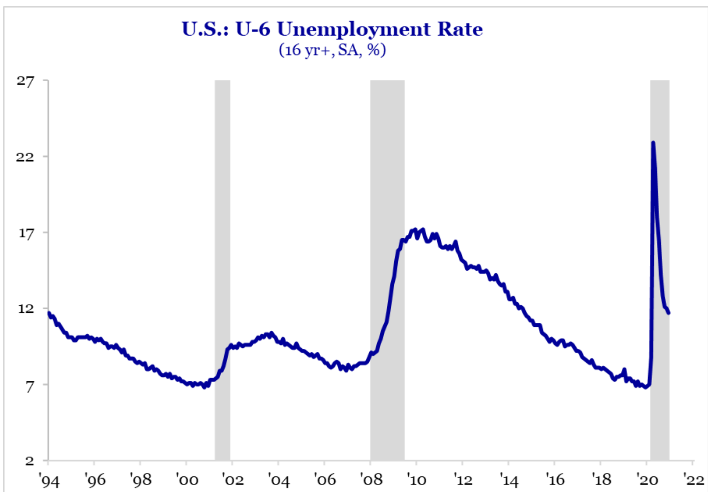
clear that rising corporate and personal taxes can slow the degree of GDP growth, it is less clear that any increase would necessarily inhibit stock market gains during this period. The relative improvement in the Federal debt levels and/or pressure on interest rates and inflation tend to be more important to overall equity valuations. Thus, most strategists expect the equity markets to rise approximately 5-10% in 2021 and still have the ability to continue upward in 2022. Any prospect of a significant pullback or bear market (exclusive of another outbreak in Covid-19) is more likely to reflect a sharp rise in interest rates over and above the expectation of 1%-1.5% yield in benchmark 10-year Treasury bonds. Should inflation and interest rates remain benign (and the Federal Reserve is vocal on trying to keep rates low), the overall equity markets should continue to move upward.

Chart IV



Source: Strategas

The vitality of the recovery may also be dependent on the speed of business to open and rehire laid off workers (Chart IV). This will be most apparent in the leisure, restaurant and travel industries. We expect big corporations to rehire but at a much slower pace than what we will see in the industries mentioned above.

THEMATIC INVESTING

In the last few years, we introduced "thematic investing" as an overlay to our quantitative and fundamental detailed analysis. Our first theme was "5G," which we introduced some years ago. We then introduced the theme of "The Digital World" reflecting our focus on the investment opportunities in the expanding cloud-based orientation that many companies adopted. About eighteen months ago, we introduced our third theme of renewable energy. Indeed, we not only invested in a number of equities in this space but also reduced our exposure to the traditional fossil fuel industry.

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Today, we introduce another theme which we call "Investing in Recovery." While this may be of shorter duration than our first three secular investment themes, it is timely and should lead us into a number of good, long-term investments. Two such investments recently added to our dividend/ growth portfolio were Morgan Stanley and The Blackstone Group Inc. Morgan Stanley is a financial giant and is rapidly shifting its business model toward mutual fund and money management and away from more traditional broker dealer activities. This should help valuation move to a higher level as this shift takes place.

The Blackstone Group is one of the biggest and most successful alternative investment firms in the financial industry. We expect it to continue to benefit from harvesting its earlier investments in private companies as well as expand its position in real estate, which is its largest area of operation.

INVESTING IN EQUITIES – BELIEVE IT OR NOT – IT IS STILL GOING THE WRONG WAY!

Chart V

Net Flows into Mutual Funds + ETFs ($BN)						
	Domestic Equity		International Equity		Bond	Money Mkt
Year	MF	ETF	MF	ETF		
2009	($27.6)	$30.9	$29.6	$39.6	$417.2	($539.1)
2010	($81.1)	$46.7	$56.7	$41.5	$262.0	($525.1)
2011	($133.3)	$47.3	$4.1	$24.3	$163.7	($124.1)
2012	($159.1)	$80.9	$6.4	$51.9	$358.5	($0.2)
2013	$18.1	$104.1	$141.4	$62.8	($59.0)	$15.0
2014	($60.2)	$141.5	$85.4	$46.6	$94.5	$6.2
2015	($170.8)	$65.4	$93.9	$109.7	$29.4	$21.5
2016	($235.4)	$167.6	($24.5)	$20.1	$190.1	($30.3)
2017	($236.0)	$186.0	$76.7	$159.8	$381.1	$106.9
2018	($253.2)	$139.1	($7.3)	$70.3	$103.0	$158.8
2019	($302.2)	$132.7	($59.8)	$29.8	$458.5	$552.7
2020 YTD	($401.6)	$112.7	($130.6)	$14.9	$309.0	$714.1
TOTAL	($2,042.2)	$1,254.9	$272.0	$671.3	$2,708.0	$356.3

Source: Strategas

For the last three years (2018-2020) investors have sold equities and purchased bonds (Chart V) as global interest rates have fallen to almost record low levels. In fact, the sale of equities accelerated in 2020! We also note that while investors have aggressively sold domestic mutual funds since 2015, the amount of money shifting into domestic and foreign index equity exchange traded funds (ETFs) has progressively slowed. As a result, concurrent with the decline in the number of stocks available to trade, it is not a big surprise to see money flow into so many "Hot Growth" stories; many of which have little or no earnings. **Currently some 54% of the Russell 2000 growth stocks do not generate a profit**. The historical average for the Russell 2000 is 28%. The sharp jump in SPACs (Special Purpose Acquisition Company) going public is another example of signs of speculative excess. These are blank check companies looking to buy an ongoing business yet to be identified.

Despite these speculative signs, we believe that current valuations are likely to be maintained as long as four things occur:

1. Covid-19 outbreaks are contained and vaccines become widely available during the early months in 2020.
2. Corporate profits continue to rise on the heels of a good economic recovery.
3. Interest rates remain around current levels with a band of about 1.0-1.5% for the 10-year government bond.
4. Inflation remains relatively benign. Importantly, the Fed has said it is willing to see the economy run hot for a period of time with inflation above its 2% target before tightening interest rates.

<u>THE VALUATION OF THE MARKET LOOKS ELEVATED</u>

By almost any historical metric, the S&P 500 is close to fully valued. In many ways, comparing it against the peak of the technology bubble in 2000 is a good way to view current valuations relative to that peak period in time (see Chart VI).

Chart VI

S&P 500 Historical and Current Valuation

	March 2000	February 2020	Current	20-Yr Avg	Current vs. Pre-Covid
Trailing P/E (S&P)	29.6	21.6	31.1	18.9	1.44
Forward Consensus P/E	24.4	19.0	22.5	15.7	1.18
Trailing Normalized P/E	46.5	30.7	32.2	23.8	1.05
Shiller P/E	43.2	30.7	33.4	25.5	1.09
Price/Book Value	5.1	3.5	3.4	2.7	0.97
EV/EBITDA	15.7	15.6	16.7	12.6	1.07
Trailing PEG *	NA	1.8	2.2	1.5	1.25
Forward PEG *	NA	1.7	1.8	1.4	1.11
P/OCF	20.4	13.5	14.7	12.9	1.09
P/FCF	73.0	20.5	21.9	27.3	1.07
EV/Sales	2.9	2.7	2.6	2.1	0.96
S&P 500 in WTI Terms	54.5	63.3	77.4	31.9	1.22
S&P 500 in Gold Terms	5.4	2.1	2.0	2.0	0.94
ERP (bps)	-262.3	285.0	241.2	226.2	0.85
Normalized ERP (bps)	-390.5	158.9	230.3	111.2	1.45

*Trailing & Forward PEG use 10-Year Average

Source: Strategas

Excluding the uniquely depressed trailing 12-month P/E ratios, the equity markets are at about 22-23x estimated earnings versus the 2000 peak of 24x estimated earnings. On an EV/EBITDA basis (valuation relative to peak adjusted operating income), market valuation is at a peak of 16.7x. However, a major difference and perhaps the most positive trend is that both price to operating cash flow and (more importantly) free cash flow are well below the 2000 peak. This suggests that profit margins and productivity are very strong. As fundamentalists, return on invested capital (assets) relative to cost of assets is a key metric that we use to properly gauge investment attractiveness. Nevertheless, looking at a different set of valuation variables, we also find the U.S. equity market close to historic highs (see Chart VII).

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Chart VII

Average Inflation, Treasury Yields, Valuation, Tax Rates & Nominal GDP by Decade

	CPI Y/Y % Change	S&P 500 Operating P/E	10 Year Treasury Yield	Dividend Tax Rate	Capital Gains Tax Rate	Nominal GDP
1950s	2.1%	12.6	3.0%	91.0%	25.0%	7.1%
1960s	2.3%	18.1	4.7%	80.3%	25.4%	7.0%
1970s	7.1%	12.5	7.5%	70.2%	36.0%	10.2%
1980s	5.6%	11.7	10.6%	48.4%	23.6%	7.8%
1990s	3.0%	19.5	6.6%	37.0%	26.0%	5.6%
2000s	2.6%	20.1	4.4%	23.4%	16.8%	4.0%
2010s	1.8%	17.7	2.4%	21.2%	21.2%	4.1%
Average	**3.5%**	**16.X**	**5.6%**	**53.1%**	**24.9%**	**6.6%**
Current	**1.2%**	**31.1X**	**0.9%**	**23.8%**	**23.8%**	**38.0%**

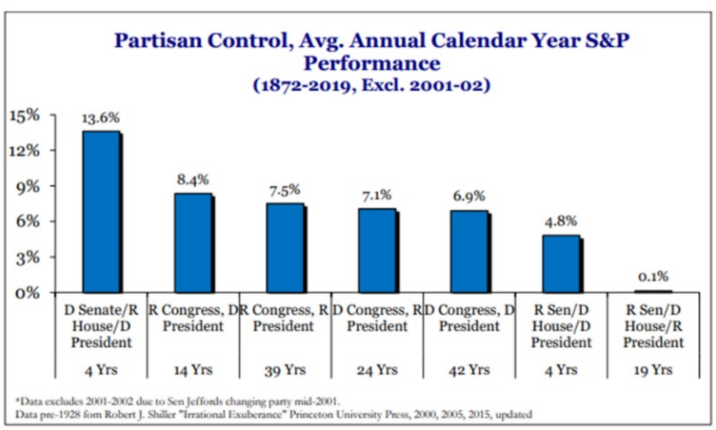
Source: Strategas

While historical metrics suggest the S&P 500 has little upside, our investment focus is not index-based. Indeed, during periods in which indices offer limited returns, individual stock selection still offers positive potential returns. With the Federal Reserve's effort to keep interest rates at near historic lows, coupled with a backdrop of low inflation, companies fitting within our thematic approaches should continue to outperform.

THE DEMOCRATIC SWEEP – INVESTMENT IMPLICATIONS

Many investors believe that an all-Democrat federal government is negative for the equity markets. However, statistics suggest that this is not true. As Chart VIII indicates, the average stock market returns (over 42 years) for all-Democrat administrations have averaged a gain of 6.9% compared to all-Republican administrations (over 39 years) which generated a 7.5% gain. Years with Democrat/Republican combinations had gains averaging about 5-8%.

Chart VIII



Source: Strategas

Of more significance is the pending changes in tax rates for corporations and individuals. The following is a general view of these potential changes:

- The Biden administration has advocated for a corporate tax rate of 28% from the current 21%. The current rate was cut from 36% under the Trump administration. We expect that Congress may settle on a 25-28% rate going forward. Given the need to help job growth recover, our guess is that the increase may take effect in 2022 forward. This increase does not suggest a down year in the equity markets. Many years have seen a rise in corporate tax rates and a rise in the equity markets. This was particularly true under the Clinton administration. If some of this increase in tax revenue is used for infrastructure spending, it may well be stimulative to economic growth. President Biden has plans to discuss tax increases and infrastructure spending in his February address to the nation.
- Secondly, the liquidity programs to fight the Covid crisis have dramatically increased the federal deficit. Any improvement in deficit spending will probably be viewed as a positive.
- Finally, the significant tax cut under the Trump administration dramatically increased the federal debt but had little impact in accelerating GDP. Most corporations did not accelerate capital expenditures and many used the cash for share repurchase and/or acquisition.
- Individual tax rate increases are also anticipated. If the focus of the increase is aimed at individual earnings well above average income (as is suggested), the impact should only have a minor impact on the economy. Some believe that certain tax deductions which were cut under the Trump administration may be reinstated or partially restored.

While we have read many opinions from experts about the economic impact on the economy of tax increases, the consensus at this juncture assumes a 0.5% (half of 1% percent) reduction to GDP growth in 2022 forward. Current consensus expectations assume a 4-5% growth in GDP in 2022 with an increased tax rate base. Needless to say, this assumes a continued recovery in job growth and moderate expansion in the global economies.

KINGS POINT IS GROWING

KPCM is happy to announce the addition of Lauryn Lafferty to the Brentwood, TN office. With over five years industry experience, Lauryn joins the Operations team as a Client Service Representative and will be working closely with clients across the firm. Please join us in welcoming Lauryn to the firm.

As always, we request that each client provide us with written notice about any changes to their investment needs, goals, objectives, risk tolerances, or investment restrictions to our advisory team. Should you have any questions, please contact us at your earliest convenience.

Jack L. Salzman Senior Managing Partner	Jeffrey P. Bates Managing Partner	Jake A. Marshall, IV CFA, CFP® Partner
Jason D. Beaird, CFA Director	Ken Lynn VP, Investment Advisor	Andres Fernandez VP, Investment Advisor

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