

MARKET LETTER

A QUARTERLY PUBLICATION of
FERGUSON WELLMAN CAPITAL MANAGEMENT
& WEST BEARING INVESTMENTS



(I CAN'T GET NO) SATISFACTION

GEORGE HOSFIELD, CFA
Director, Chief Investment Officer

MARKET LETTER
FOURTH QUARTER 2020

IN THIS PUBLICATION

- Market Perspective..... I
- Weapons of Reason II
- Investment Strategies.....IV

Founded in 1975, Ferguson Wellman is a privately owned registered investment advisory firm, established in the Pacific Northwest. As of January 1, 2020, the firm manages over \$5.96 billion for more than 848 clients that include individuals and families; Taft-Hartley and corporate retirement plans; and endowments and foundations with portfolios of \$3 million or more.

West Bearing Investments, a division of Ferguson Wellman, serves clients with assets starting at \$750,000.

INVESTMENT EXCELLENCE
LIFELONG RELATIONSHIPS



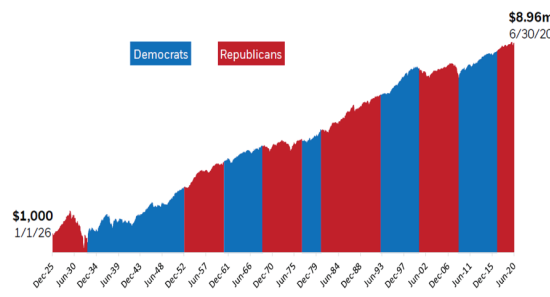
DESPITE THE TECHNOLOGY-LED GAINS

of U.S. equities so far this year, uneasiness abounds as the world adjusts to life with COVID-19. While roughly half the jobs lost

to this year's steep and short recession have already been recouped, many investors fear the day when the bill for massive stimulus comes due. We acknowledge these fears, but recognize the underlying issues are set to play out over a long time in the future and have little impact on today's capital markets.

Speaking of the future, current equity prices are discounting a return to a "normal" level of economic activity by mid-2021. After the pandemic-induced plunge in second quarter GDP, the economy has exited recession and is now expanding. To that end, the U.S. job market is healing expeditiously, having already achieved single-digit levels of unemployment few foresaw even by year-end. Furthermore, retail sales have experienced a "V-shaped" rebound that is now eclipsing pre-pandemic levels and amid ongoing quantitative easing, low mortgage rates are providing a significant boost to housing and the economy writ large. Meanwhile, monetary policy remains highly supportive as the Federal Reserve

Stocks Have Continued Higher Regardless of Presidential Party



Source: Morningstar

has signaled that zero-interest rate policy is likely to continue for years to come. As such, we expect that interest rates will remain low on a secular basis.

What sustained impact will the election have on the capital markets? If history is any guide, not a lot. As the accompanying chart demonstrates, equities have risen over time regardless of which party holds office. While some adjustments to sectors or individual stocks may occur, we do not anticipate making election-based changes to asset allocation. Having reinvested proceeds from bond sales earlier this year into cyclical industries within the U.S. market, we maintain our overweight to large cap U.S. equities and alternatives while retaining a material underweight to fixed income where yield has become scarce.

Everything we hear is an opinion, not a fact. Everything we see is a perspective, not the truth. – MARCUS AURELIUS



THAT THING WE DO

DEAN DORDEVIC

Director, Alternative Assets and Portfolio Management



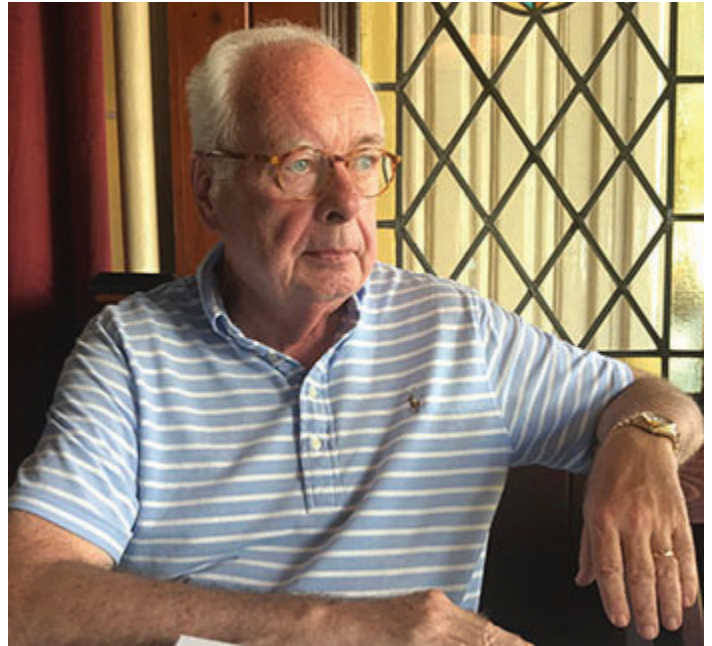
IN THE FALL OF 1983, I left my first job on Wall Street with E.F. Hutton & Co. for what would prove to be a much better opportunity with Kidder, Peabody & Co. At the time, I considered myself extremely fortunate to be hired on, especially so for a kid from Brooklyn lacking an Ivy

League pedigree. Kidder was an old-line, “white-shoe” private partnership, perhaps the best ownership model that ever existed on Wall Street. It’s one where the partners put their *personal capital* at risk every day.

My new job was in their asset management division, which at the time was called Webster Management. Kidder was founded in 1865, but by 1931 in the lee of the Great Depression the venerable firm was hard on the skids. A senior partner, by the name of Edwin Sibley Webster, helped to arrange the logistics of a rescue during the depths of the Depression.¹ Decades later this division was named in his honor.

The early 1980s were an interesting time to be new to Wall Street. Roughly a decade and a half earlier, in January 1966, the Dow reached the 1,000-level intraday for the first time ever. In the intervening years, largely due to rampant hyperinflation and sky-high interest rates, the Dow went *absolutely nowhere*. In fact, a dollar invested in the Dow in January of 1966, and withdrawn in November of 1982, had an annualized compound return of 0.3 percent annually. However, the so-called real return (i.e., after-inflation) was *minus 6.2 percent per year*. With dividends reinvested, this (real) return was a bit better at *minus 1.8 percent annually*. This loss of purchasing power was second only to the havoc wrought during the Great Depression itself.

The 80s were also a time that was both strange and wonderful. In the spring of 1983, the market began to move quite sharply. Little did we know that the seeds were being sown for what was to become an epic advance. The problem was that we



Nick Murray
Source: nickmurray.com

just didn’t know it at the time. Every naysayer worth his salt was a bear. Retail and institutional investors alike were so incredibly skeptical of this push into uncharted waters that the atmosphere was anything but giddy.

After a good, solid nearly five-year run, and just as investors’ sea legs were finally returning, in October of 1987 the market would experience a horrific crash. It would erase any and all traces of

what little investor exuberance had accrued. The naysayers had a field day. I recall a meeting in the weeks following the crash with economist Gary Shilling. Not to let a good crisis go to waste, Shilling quickly penned a thin new book with the title, *“What Next, Recession or Depression?”*

“Human nature is a failed investor.”

- NICK MURRAY

It was also a time of what in hindsight were sky-high trading commissions. Large, so-called “soft dollar” research budgets accompanied them. Investment management firms could not then, and cannot now, benefit in any way from the trades they execute on the behalf of their clients. They can, however, give away these trades and their associated commissions to brokers on The Street. These brokers would compete for these trades with the overall quality of their research effort, and hopefully fruitful ideas that distill from this process.

As a byproduct of this paradigm, the so-called “idea lunch” came about. All of the large firms had institutional salespeople, who would *telephone* their portfolio manager clients on a daily basis. This usually occurred in the early morning before the start of the trading day. There were, of course, no computers or cell phones and the internet, as we know it, *didn't yet exist*. Everyone invited to the lunch was charged with bringing an idea to the group and being prepared to defend it. Needless to say, there were many more knives in the room than just those on the table. These lunches were great sources of information, networking and even career development. They were great fun, too. Eventually these *salons* died a slow death as trading commissions all but evaporated.

At Webster, we had offices in both Los Angeles and Boston, in addition to our New York office. Every Monday morning, we would host a conference call with all three. There was a fellow in our Boston office by the name of Gerald “Gerry” Curtis. A born-and-bred Bostonian, Gerry was part of what was perhaps the best idea lunch group of this era. This since one of the portfolio managers in his group was none other than Peter Lynch.

Peter Lynch was the manager of the Fidelity Magellan Fund. Between 1977 and 1990, Lynch averaged a 29.2 percent annual return. Consistently more than double that of the S&P 500 and in its day The Magellan Fund was the best-performing mutual fund in the world. During his tenure, the assets under his management increased from \$18 million to \$14 billion.²

One morning, our colleague Gerry told us of a fascinating story that Lynch had shared at one of their lunches. He said that Lynch had come to the conclusion that while he was earning these extraordinary returns for his clients, he became convinced that they were not actually getting the returns he was generating. Why? Because he said he would get piles of ... *new money after the market had run up* and get an equally large number of *fund redemptions* after the market had gone down. In other words, inside of the best-performing equity mutual fund in the world at the time his clients were *market timing*.

So perplexed was Lynch that Fidelity commissioned an internal study to see if his hunch was correct. Lynch guessed that his clients' returns might be somewhere between the quite robust market returns at the time, and the vastly superior return he was generating. That proved to be hugely off the mark. In fact, the study showed that the median investor had *actually lost money*.³ Astonishingly, all an investor had to do to earn the terrific returns generated by Lynch was to simply sit still and *stay invested*.

Which brings me to Nick Murray. You've probably never heard of him. I was only introduced to his writings very recently by a colleague. But Murray is not an economist, strategist, or a TV pundit. He's not a CNBC talking head with zero skin in the game, a very large ego and an outsized opinion. He's a writer, author and lecturer, but most importantly, he's one of us. That is, he's a practitioner. More likely than not he's on the phone right now, talking an investor off the ledge. Nick's quote is at the top of this piece, and it was penned to preface this ...

“If you asked me to state in one sentence the pure essence of everything I've learned about being an investment advisor, that would be the sentence. It perfectly captures both the challenge and the opportunity in what we do. The challenge is that we will always be required to stand steadfastly against the investor's instincts — that we will forever be advocating for what he ought to do, which will almost always be the perfect opposite of what he desperately wishes to do. The transcendent opportunity, of course, is that it is functionally impossible for him to achieve lifetime success without us. Which means that, particularly at market extremes, our advice is priceless.”⁴

It's our job to help our clients navigate the perpetual rivers of both change and uncertainty. This while steadfastly maintaining focus on *their* long-term goals. But market cycles come and go, and at the end of the day, human nature and psychology are dependably, and remarkably, *predictable*. With this in mind, and perhaps most importantly, we live and breathe *The Hippocratic Oath* every day. That is first, do no harm.

It's ... that thing we do.

Weapons of Reason Footnotes and Sources:

1. Miller, Steven, “Energetic Salesman Became a Power on Wall Street.” *Wall Street Journal*, May 2, 2009.
2. Wikipedia Contributors. “Peter Lynch,” Wikipedia. Page was last updated September 15, 2020.
3. Chisholm, Kirk, “Why Are Individual Investors So Bad at Investing?” *IAG Wealth Management*, April 2, 2019.
4. Murray, Nick, August 2020 Newsletter, Volume 20, Issue 8, NMI/Nick Murray Interactive, August 2020.



IS VALUE DEAD?

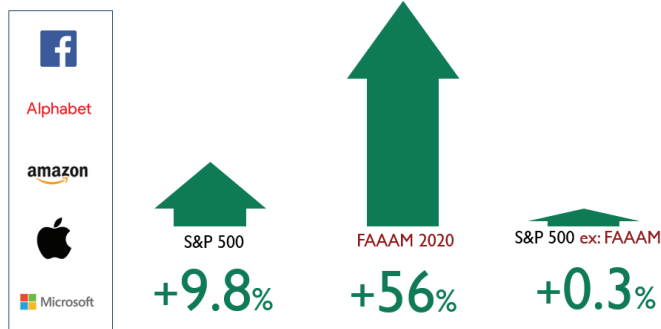
JASON NORRIS, CFA
Executive Vice President, Research and Portfolio Management



2020 HAS BEEN A TOUGH YEAR for the value investor. Growth stocks have outperformed their value peers by over 30 percent and investors have started to hear the comparisons to the Internet Bubble of 1999-2000. This culminated with the IPO of Snowflake, a software company, with a valuation of 175x revenue. Historically, these trends reverse themselves, but timing a bubble's burst can be difficult as markets can go to extremes in both directions.

As Mark Twain once said, "History doesn't repeat itself, but it often rhymes." While the performance of the growth technology stocks may be similar to 1999, the fundamentals of tech companies are meaningfully better this time. Regardless, one cannot argue the impact these large-cap technology companies have had on the S&P 500 index return this year. The accompanying chart highlights the outsized performance of the five largest names in the S&P 500, which are all "growth" companies. While the S&P 500 was up 9.8 percent through August 31, without those five names, the other 495 stocks in the index were roughly flat.

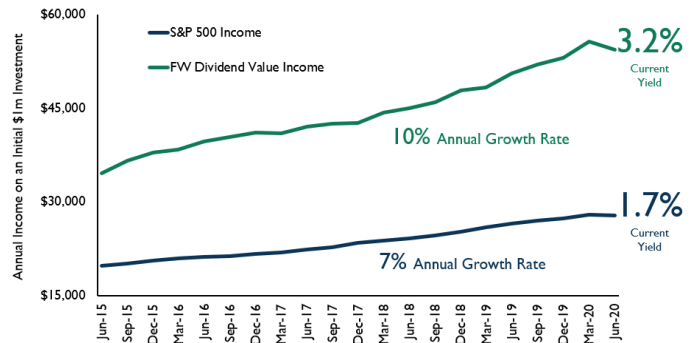
Top Stocks in S&P 500 Performance



*Facebook, Alphabet, Amazon, Apple, Microsoft

Source: FactSet

Dividend Value Growth vs. S&P 500



Source: Ferguson Wellman

This dramatic trend toward growth has been a headwind for all value-based strategies, including Ferguson Wellman's *Dividend Value*. This strategy invests only in dividend-paying companies, thus will have limited exposure to the growth, technology companies that have been driving the market. This has resulted in the strategy lagging the S&P 500 throughout 2020. A key attribute of *Dividend Value* strategy is the growth of income. *Dividend Value* has consistently grown its income stream faster than the overall market, and has produced a higher dividend as highlighted by the chart above.

This stream of income growth is even more important to clients when considering that interest rates are at historic lows and we expect them to remain low for an extended period of time. As such, going forward, clients in need of income may have to allocate fewer assets to fixed income securities in order to satisfy their long-term investment objectives. *Dividend Value* would be an ideal strategy for this reason.

Our logo features a bronze coin of Marcus Aurelius Antonius, Emperor of Rome from A.D. 161 to 180. According to historian Edward Gibbon, he was the only person in history in which "the happiness of a great people was the sole object of government." Marcus Aurelius was the author of meditations that reveal a mind of great humanity, natural humility and wisdom.