Holt Capital
Partners, L.P.

First Quarter Financial Market Commentary

"Ninety Days in Ninety Seconds"

March 31, 2021

Economic Boom and Consequences

- The underlying narrative for 2021 is the transition from economic recovery to expansion. The economy is being powered by fiscal stimulus, accommodative monetary policy and pent-up demand.

- Economic forecasts for Gross Domestic Product (GDP) in 2021 are as high as 8%, which would be the highest growth rate since 1951. A recent measure of factory output jumped in March to its best level since 1973, while the corresponding price index spiked to a 41-year high. The fact that the economy is beginning to boom is undoubtedly good news for Main Street businesses and jobless workers. Forecasts of this boom have been the fuel that has lit a fire under stock prices for the past several quarters. The risk to Wall Street for the balance of the year is that robust growth will lead to higher input costs, higher inflation, and higher interest rates.

- One of the unanswerable questions about the $1.9 trillion stimulus package is how this deficit-financed jolt will impact an economy that was already accelerating. Will an overheated economy ignite inflationary pressures? Will the economy remain in a Goldilocks environment that is not too hot and not too cold? While we are not complacent about these and other risks, we continue to be optimistic about the long term growth opportunities in the economy and the financial markets.

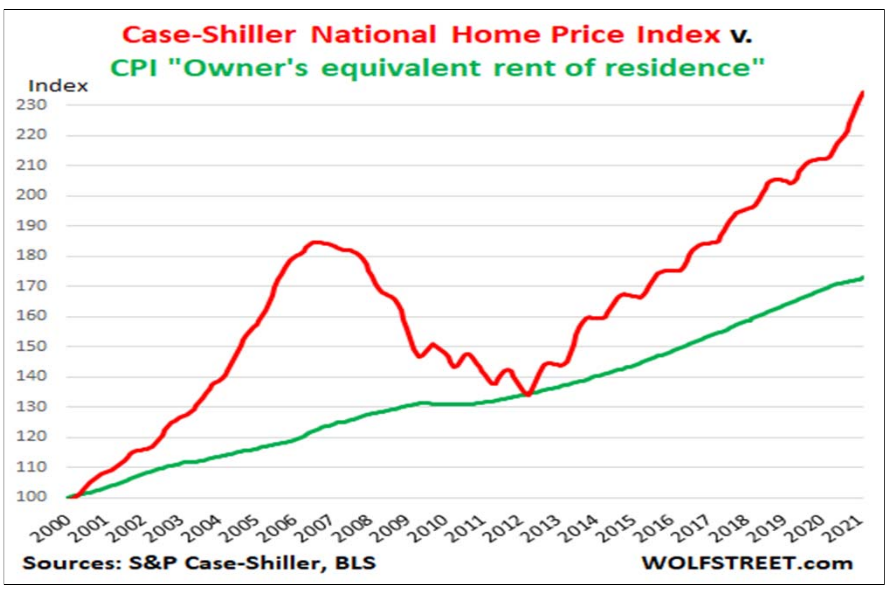
Stimulus Package: Excessive and Untargeted

- The $1.9 trillion economic stimulus bill is not simply $1,400 stimulus checks and extended unemployment benefits. It is the most far-reaching economic and social policy package in a generation. This deficit-financed shift toward bigger government is not only a reversal of Ronald Reagan's declaration that "government is the problem," but also of Bill Clinton's plan to "end welfare as we know it."

- From a macroeconomic perspective, this bill can best be described as too much, too late. A more thoughtful bill could have targeted those who were truly impacted by the pandemic. The economy was already set to boom from the confluence of vaccines, pent up consumer demand for goods and services, as well as the wealth effect of rising stock prices and home values. The risks of unintended consequences from this economic "sugar high" range from higher borrowing costs to a resurgence of inflation.

THE POTENTIAL FOR INFLATION

- Numerous signs point to an emerging inflationary spike in prices. Core producer prices rose 2.5% on a year-over-year basis in February, which was the largest jump in almost three years. At the consumer level, goods and services prices have diverged. Consumer goods prices have been boosted by stronger demand during the pandemic. However, the headline Consumer Price Index (CPI) number has been muted by the sharp declines in consumer services prices, i.e., lodging and travel. Inflation in the cost of services seems inevitable. The state of Texas, which has reopened earlier and more aggressively than most areas, recently reported a sharp jump in its index of general economic activity. The March increase was driven by significantly higher input costs and wages.
- Year-over-year price increases are likely to jump sharply over the next few months when compared to the weak pandemic-related price environment of 2020. The more important question revolves around inflation rates in the second half of the year as pent-up demand, higher commodity prices, and rising manufacturing costs potentially cause inflationary pressures to become more sustained.
- The best method for measuring housing costs has been debated by economists for years. The Bureau of Labor Statistics calculates "owner's equivalent rent of residence," which is the housing cost measure that is used in the monthly CPI. The divergence between home prices and housing costs in the CPI has reached new extremes. If home price data rather than equivalent rent data were used to calculate the CPI, the reported rate of inflation would have more than doubled.



REVENUES, MARGINS, EARNINGS

- Revenue growth for the S&P 500 in both 2021 and 2022 should be the strongest in a decade. Margins should also benefit from cost controls that companies put in place during the pandemic. This combination likely means that earnings growth for the S&P 500, which is forecasted to be +27% this year, still underestimates the potential increase in corporate profits.

SPECULATIVE BUBBLES

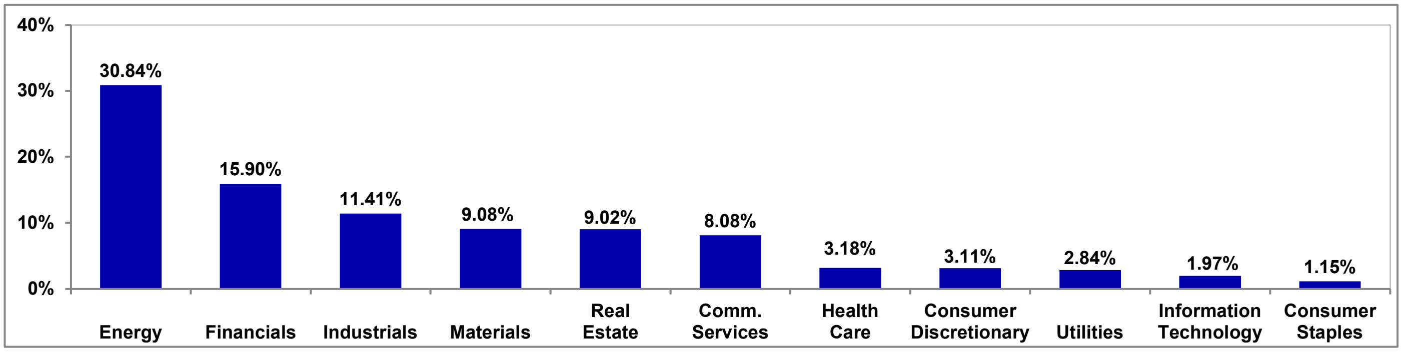
- In our fourth quarter market commentary we highlighted the risks of pockets of speculation in electric vehicles, green energy, work from home stocks, and SPACs. Most of these groups of stocks were weak first quarter performers. As the new year unfolded, Reddit, an information and communication site for individual traders has emerged as another source of trading in speculative stocks. Certain hedge funds also fell victim to aggressive trading strategies during the quarter. While these rather narrow segments within the market highlight speculative excesses, the potential for systemic market risk seems low.

CONCLUSION

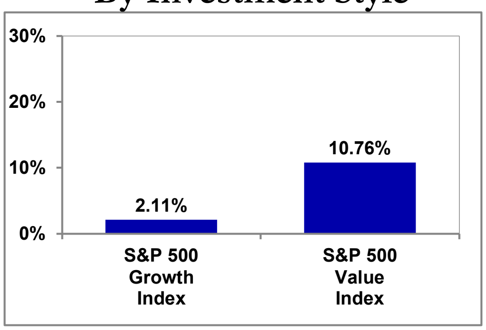
- The stock market price rally of 2020 continued into the first quarter of 2021. Since stock investors try to look out the proverbial "windshield" in order to forecast the future, this strength should not be surprising. The question is to what extent Wall Street has gotten ahead of Main Street. As the newly vaccinated consumer spends and travels, Main Street should thrive. It is quite possible that Wall Street will become more problematic over the balance of the year as Federal Reserve policy, inflation, and valuations potentially represent conflicting metrics.

First Quarter Investment Performance (including income)

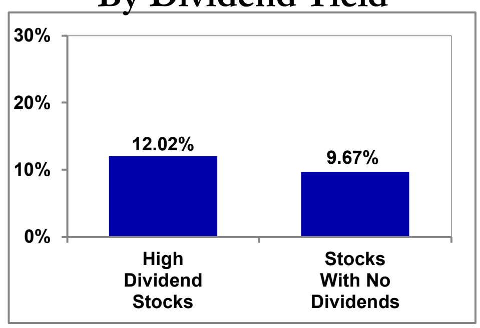
By Economic Sector



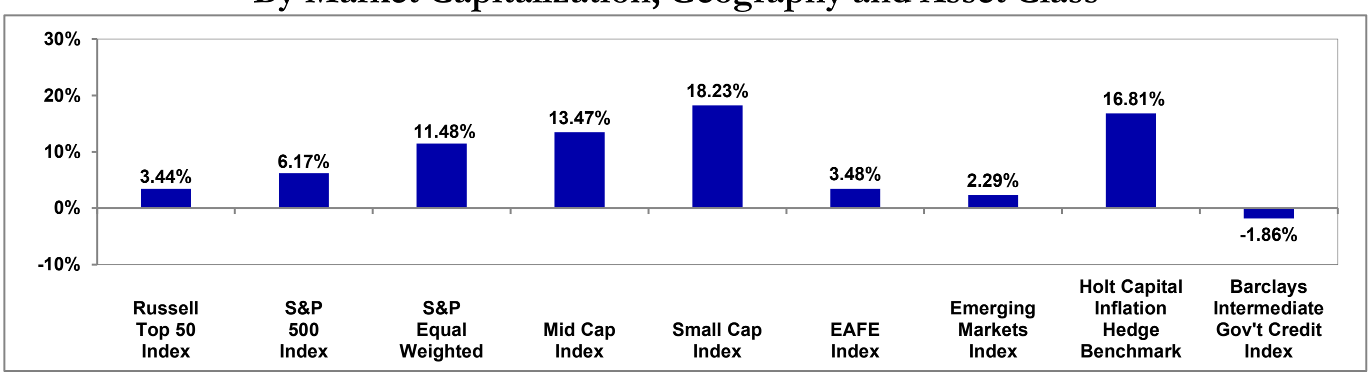
By Investment Style



By Dividend Yield



By Market Capitalization, Geography and Asset Class



- Companies that are perceived to be beneficiaries of the reopening of the economy provided market leadership during the first quarter. This group included cyclical sectors, such as energy, financials, industrials, and materials, as well as equal weighted indexes and value stocks. Small stocks, which tend to be more economically sensitive and domestically oriented, also rallied sharply.
- Many of the mega-cap tech stocks that drove the market higher in the first nine months of 2020 traded modestly lower. This can be seen in the relative performance of the Russell Top 50 Index, as well as the technology sector.
- Expectations for a strong economic recovery and fears of a spike in inflation pushed bond yields higher. This resulted in the total return from bonds being slightly negative for the quarter.