QUARTERLY COMMENTARIES

STOCK AND BOND MARKETS DIVERGE AS ECONOMY REOPENS

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The first quarter of 2021 delivered strong results for equity investors and presented some challenges for fixed income investors. The U.S. economy (along with some foreign ones) proved resilient to the government-enforced shutdowns of 2020, and pent-up demand began to weave its way through economic indicators en route to corporate bottom lines. Massive liquidity injections into the financial system by the Federal Reserve played a role, as did the continued direct and indirect government stimulus. Corporate managers kept their eyes on the ball, used the downturn as an opportunity to trim some of the fat that had accumulated in the pre-Covid expansion, and emerged prepared to respond to rekindled demand. The Dow Jones Industrial Average, S&P 500 and NASDAQ Composite indexes, including dividends, returned 8.3%, 6.2% and 3.0%, respectively. Foreign equities, represented by the MSCI EAFE and MSCI Emerging

Market indexes, produced total returns of 3.6% and 2.2%, respectively, in U.S. dollar terms.

We've spoken at some length in written commentaries and in webinars about the potential for a resurgence of inflation in this country in response to deficit-financed government intervention in our economy, so we won't dive further into this topic here except to reiterate that weakening currency and rising interest rates are two classic market reactions. In the first quarter of 2021, the dollar index remained relatively stable against most major currencies, but the yield on the 10-year Treasury note rose substantially, from 0.87% on December 31, 2020 to 1.70% on March 31, 2020. Since bond prices move inversely to interest rates, bond prices declined. The Barclay's Aggregate Bond index, a broad measure of the investment-grade bond markets, fell by –3.4% in the quarter. Please note that interest rates are one important factor in the valuation of bonds, but that bond prices are also impacted by other factors, including but not limited to credit quality, coupon and time to maturity. We have our eyes on inflation and interest rates, as well as these other factors, when investing your wealth in bonds.

In last quarter's letter, we highlighted the fact that the five largest companies in the S&P 500 had produced a return in 2020 of 53% while the remaining 495 companies delivered an average return of only 12%. Because of the heavy weighting ascribed to those five companies in computing overall S&P 500 index returns, the broad market returned over 18%. Keeping pace with that kind of return was obviously a challenge for any diversified portfolio. We also described the positive feedback loop that can drive markets, and segments of the market, through cycles in ways that seem to defy logic. We know that these kinds of cycles are a natural and important feature of markets, so a period of underperformance is very often followed by a period of outperformance. So it has been in the early months of 2021, when previously out-of-favor sectors have delivered some of the market's best returns. An investor doesn't need to be positioned in the market's "sweet spot" all the time to produce strong returns over time because the pendulum swings both ways, driven by a wide range of factors, some of which can be anticipated, but most of which can be explained only with hindsight. We've not concerned ourselves with periodic underperformance (or periodic outperformance) versus broader indexes, but rather have built a portfolio that we can expect, based on the strength of the underlying businesses and a discipline with respect to prices we pay, will perform well over a market cycle.

Today, equity and debt markets are trading at elevated valuations, and with that comes some added risk, to be sure. We believe we can manage this additional risk, since the market pendulum alluded to above produces opportunities among individual securities, or within sectors of the market, regardless the valuation of the broad markets. To illustrate, we highlight recent transactions that we executed in our Core accounts later in this letter.

The drumbeat is growing louder for corporate and individual tax increases. These will be needed to finance burgeoning government spending to combat Covid, rebuild aging U.S. infrastructure and set in motion policies that will increase government's future role

in our economy. As with the general populace, our views across the firm on the virtues and costs of these policies vary widely. We don't think our job is to wade into political waters and present a particular viewpoint, but rather it is to evaluate the landscape as it evolves and make judgments on your behalf that are designed to protect the purchasing power of your wealth and secure your financial futures. With respect to corporate taxes, the impact of a potential increase on your specific stockholdings would vary depending on the business. Some of the increased tax expense will be passed through to customers, some will be offset by other changes in our firms' cost structures, and some will be borne by shareholders. It is difficult to know precisely before the new rules, if they are enacted at all, are drafted and debated in Congress, but we have considered some of these impacts in our valuation models. In no case has it changed our view as to whether or not to own a particular company in your portfolio.

Q1 Portfolio Changes

Please keep in mind, these commentaries should not be construed as a recommendation to buy or sell the securities discussed. Such decisions are made only within the context of the market environment as we perceive it at the time of the decisions and the structure of the diversified portfolio of which the securities are a component. ***

During the quarter we initiated new positions in Dollar General, Salesforce, and Northrop Grumman and exited our position in Fox Corporation.

<u>Dollar General</u>

Dollar General is one of the largest low-price retailers in the country. The company competes in the retail space by offering convenience and value to customers. Most of the stores are in rural areas, which isolates them from many competitors. Low-cost operations, driven by significant scale in sourcing low-value items, provides additional advantages over online and traditional retailers.

Dollar General is a growing business. The company is set to grow its store base by a healthy clip over the next five years. In addition, Dollar General has been increasing product assortment, accelerated efforts to remodel older stores, and has launched several other initiatives aimed to increase customer wallet share and store traffic.

Retail is detail and to get the details right you need strong leadership. We think Dollar General has one of the best management teams in retail. Management exhibited excellent operational and capital allocation skills and is focused on driving investment returns for owners.

We have been following Dollar General for several years, monitoring its progress and building our conviction. Last quarter, the risk-reward appeared attractive enough to initiate a new position in this exceptional name.

Northrop Grumman

Long term clients will recognize Northrop Grumman from their past statements. We purchased the stock in 2013, after concerns about the defense budget created an attractive investment opportunity. We think a similar opportunity exists today.

Northrop Grumman is a prime defense contractor with leading positions in aerospace and cyber security. After years of consolidation, the defense industry is comprised of several large players, which means very few bidders vie for most defense programs. The limited competition supports pricing discipline and attractive returns on capital for Northrop.

We were big fans of former CEO Wes Bush, so naturally, we were thrilled when in 2019 Kathy Warden was appointed as his successor. Warden has proven to be an effective leader. We are confident that she will preserve the outstanding capital allocation culture and superb execution that benefited owners over the years.

Concerns about decreased defense spending under the Biden administration, combined with company-specific margin headwinds, have pressured shares over the past year. While these are valid concerns, they are short-term in nature. Northrop provides essential solutions for our nation's defense. Any reduction in the defense budget isn't likely to have a material impact on demand for Northrop's products or the earnings power of the business. This setup creates an attractive opportunity in the stock.

Salesforce

Corporations around the world use Salesforce software platforms to manage important business functions such as customer service, sales, marketing, ecommerce, and business analytics. The business is very attractive because the products tend to be very sticky. Once a customer adopts one of the platforms, it becomes very hard to replace it because it's integrated with other software and businesses processes. As a result, revenue is recurring in nature and customer retention is very high.

Software is eating the world, cloud computing is gobbling on-premises computing infrastructure, and ecommerce is displacing brick and mortar retail. These powerful trends are changing the world and Salesforce is extremely well positioned to benefit from all of them.

Recent concerns regarding the pending acquisition of Slack Technologies led to weakness in the stock. This created a unique opportunity to buy this competitively advantaged business at a discount to its true worth.

Fox Corporation

Fox is a prominent player in the media space with dominant positions in news and sports. When we initiated the position in 2019, our thesis was that Fox benefitted from

untapped pricing power. We assumed Fox would raise affiliate fees to offset declines in the number of subscribers due to cord cutting.

So far, this dynamic has played out as expected. However, the number of subscribers declined faster than what we had originally estimated. This eroded our confidence in the company's ability to keep raising prices to offset future subscriber losses. Since any acceleration in cord cutting was a major risk to our thesis, given the evidence that such acceleration has occurred, we decided to exit the position.

New to the team

Notwithstanding the challenges of operating our business remotely, we again expanded the Summitry team in the first quarter. We look forward to introducing you to our two newest associates, Emily Hazelroth and Chintan Pabari, who joined Summitry on February 8th and March 8th, respectively. We look forward to meeting them ourselves for the first time "in the flesh" soon, as it appears that San Mateo County restrictions are slowly being lifted.

Emily Hazelroth, CFP® comes to us after six years in financial advisory roles at TIAA and Fidelity Investments, and serves within our Private Client Group as a Financial Advisor. Prior to entering our industry, Emily earned a B.S. degree in Neuroscience from University of Saint Thomas in her native Minnesota, and worked as an analyst and project manager for an environmental chemistry laboratory. We were drawn to the blending of these experiences, and as she described it, her two primary personality traits: data-driven and extroverted.

Chintan Pabari has also joined Summitry's Private Client Group, serving as a Financial Planning Associate. Chintan graduated from the University of Calcutta with a Bachelor of Commerce in Accounting and Finance, began his professional career in the securities industry in his native India, and enrolled at Golden Gate University to earn a Master's of Science in Taxation. He chose to remain in the United States and held positions at accounting firm Ernst & Young and wealth management firm Chequers Financial Management. We're pleased and grateful for the new perspective that he brings the team in the area of personal taxation. As a bonus, we will add Hindi, Bengali and Gujarati to the languages spoken at Summitry.

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