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December 10, 2020

The Monthly Letter covers two topics this month. First, recent vaccine announcements indicate a coming end to the Global Pandemic, with vaccines starting to roll out before year end. Unlike 2008, the US and Europe possess an intact Banking System, ready to lend as opportunities open up. With Consumers sprouting strong balance sheets and Corporate Profits now above their Q4 2019 peak, the fuel for a Global Economic Boom awaits the spark to set off a blazing inferno. Second, with technology continuing to drive down the cost of Wind Power, Wind Power's economics became more and more attractive compared to traditional forms of producing power, such as natural gas, over the past decade. However, with numerous communities opposing the erection of windmills that scar the landscape, kill birds, and impact real estate values, wind farms faced rising opposition to locate and operate on land. To address this NIMBY issue, the industry developed offshore windmills that can sit in the ocean and deliver power back to land. Given the political support for green energy production, new wind farms are being constructed at a rapid pace in Europe and elsewhere. And, with an explosion in orders over the past few years, Offshore Wind Power should grow dramatically, meeting a significant portion of the growth in power demand. And Third, as always, we close with Views From The Stream.

This Time Is Different:
Consumers, Corporations, and Banks,
& The Coming Economic Boom

> "*But nothing of this is true in the world in which we live. Here every economic force is constantly changing its action, under the influence of other forces which are acting around it. Here changes in the volume of production, in its methods, and in its cost are ever mutually modifying one another; they are always affecting and being affected by the character and the extent of demand. Further all these mutual influences take time to work themselves out, and, as a rule, no two influences move at equal pace. In this world therefore every plain and simple doctrine as to the relations between cost of production, demand, and value is necessarily false: and the greater the appearance of lucidity which is given to it by skillful exposition, the more mischievous it is. A man is likely to be a better economist if he trusts to his common sense, and practical instincts, than if he professes to study the theory of value and is resolved to find it easy.*"

Chapter V, Equilibrium of Normal Demand and Supply, Continued
Book V, General Relations of Demand, Supply, and Value
Principles of Economics, 8th Edition
By Sir Alfred Marshall, 1890

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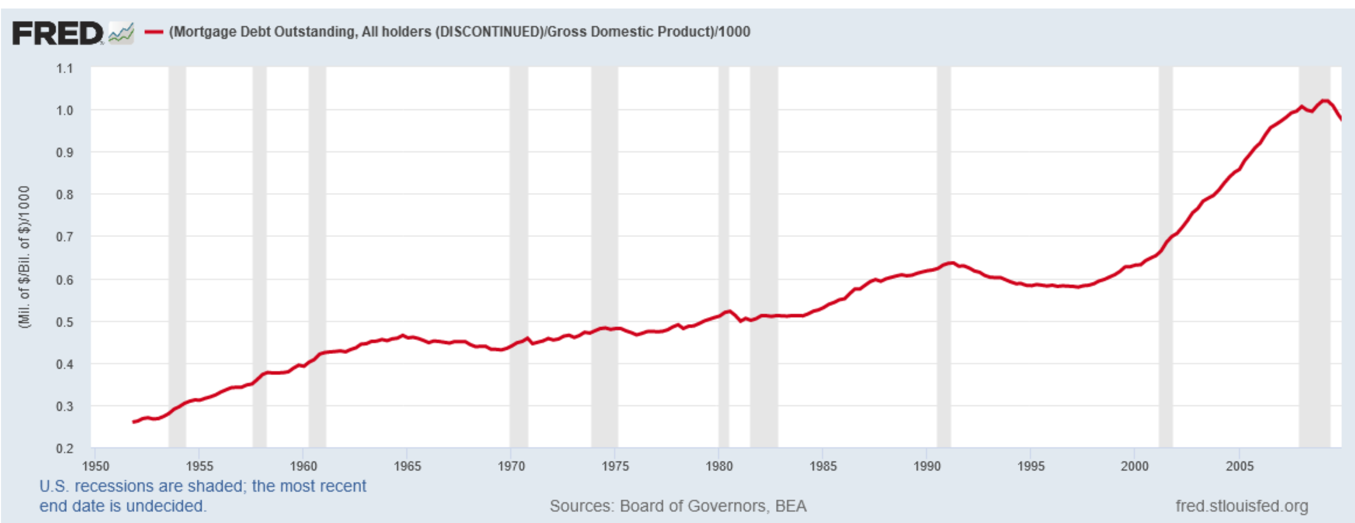
Numerous economists and politicians worry about a slow recovery similar to that seen after the 2008 – 2009 Recession. They remember the difficulty the economy had gaining altitude from 2009 – 2012. And they believe a repeat of that experience is at hand. However, there needs to be remembered that these are the same experts who predicted the economy would grow 3.5%+ per annum exiting that recession. And while the economy did endure a deep recession in 2020, in some ways deeper than that in 2008 – 2009, the causes of the 2020 Recession differ markedly from 2008 – 2009, as do the economic conditions prior to the recession. As such, a markedly different outcome appears likely this time with much stronger growth exiting the recession and for the intermediate term.

In 2009, the economy faced a bankrupt banking sector, an overbuilt housing stock, an overextended consumer, and a collapse in state and local revenues which depleted state treasuries. Alas, such a setup typically takes years to correct due to the nature of the problems. As well documented across numerous nations, banking crises that require recapitalizing the banking system tend to lead to 4 – 5 years of subpar growth for an economy as the banking sector addresses the bad assets and rebuilds its balance sheet. Only after that time frame, does growth typically return to normal. In addition, after any sector of the economy sees gross overinvestment, leading to a massive overbuilding of the capital stock in that sector and a collapse in returns and asset values, it takes years to absorb the capital stock put in place such that asset values and returns recover to such a level that new investment is justified. One need only look at commercial real estate after the late 1980s boom, technology after the late 1990s boom, and housing after the 2004 – 2007 boom. In each case, it took the sector years to recover. In addition, consumer debt and debt service stood through the roof, literally. Debt to income and assets hit new highs. The following chart of Mortgage Debt to US GDP illustrates the setup entering the last recession:



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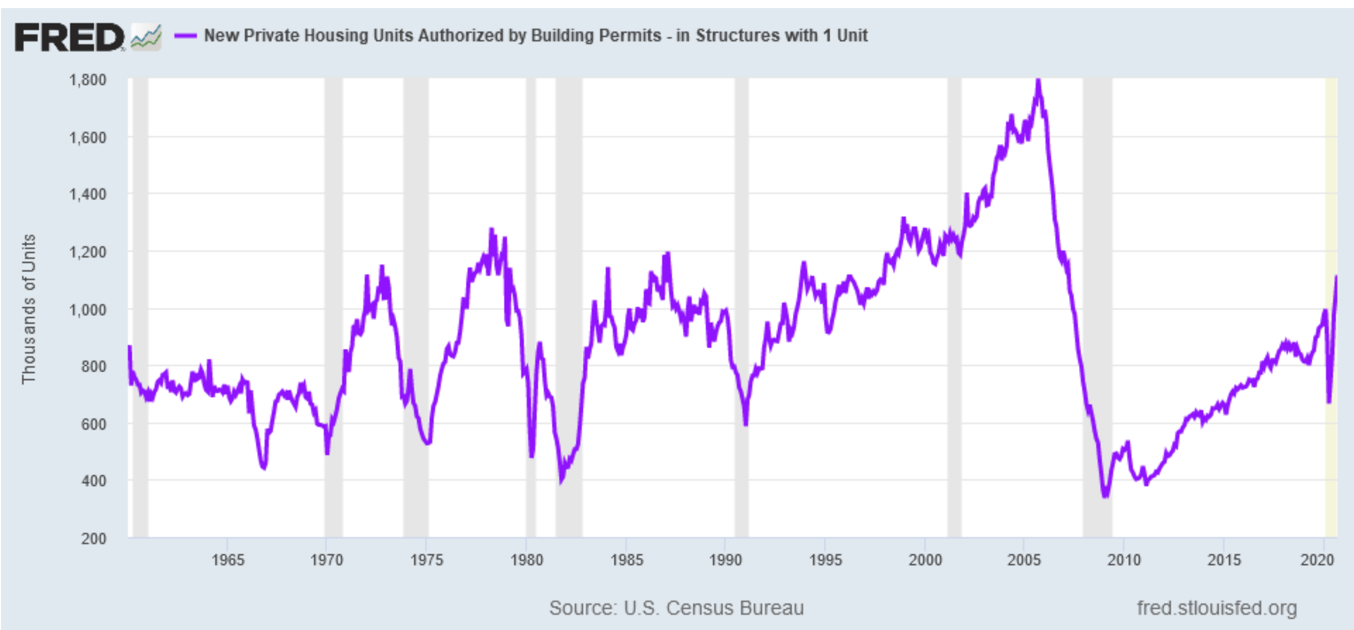
With Mortgage Debt to GDP rising more than 4% from 2001 to 2008, millions of homeowners walked away from their homes, defaulting on their mortgages and declaring bankruptcy. And with home sales collapsing and real estate values sinking to new lows, local tax revenue, which depended on a healthy real estate market, dropped through the floor, literally. And, of course, with home values collapsing, the collateral behind many mortgages no longer stood above the value of the debt. As a result, the banking system collapsed, with only a bailout from Congress preventing an entire destruction of the US financial system. Not a pretty picture.

In 2020, by contrast, each one of these economic statistics stands at almost the opposite extreme. The banking system, due to Dodd Frank, possess significant equity capital able to withstand even a downturn of the magnitude of 2009 – 2011 and still provide the lending the economy needs. The Housing Stock remains within normal bounds and new construction stands at levels similar to during the 1990s, avoiding the overbuilding that occurred from 2004 – 2008 and only back to levels seen in the 1980s and 1990s:



The Consumer remains in good financial shape. Mortgage Debt to GDP, despite the rise in Home Prices, remains at reasonable levels:

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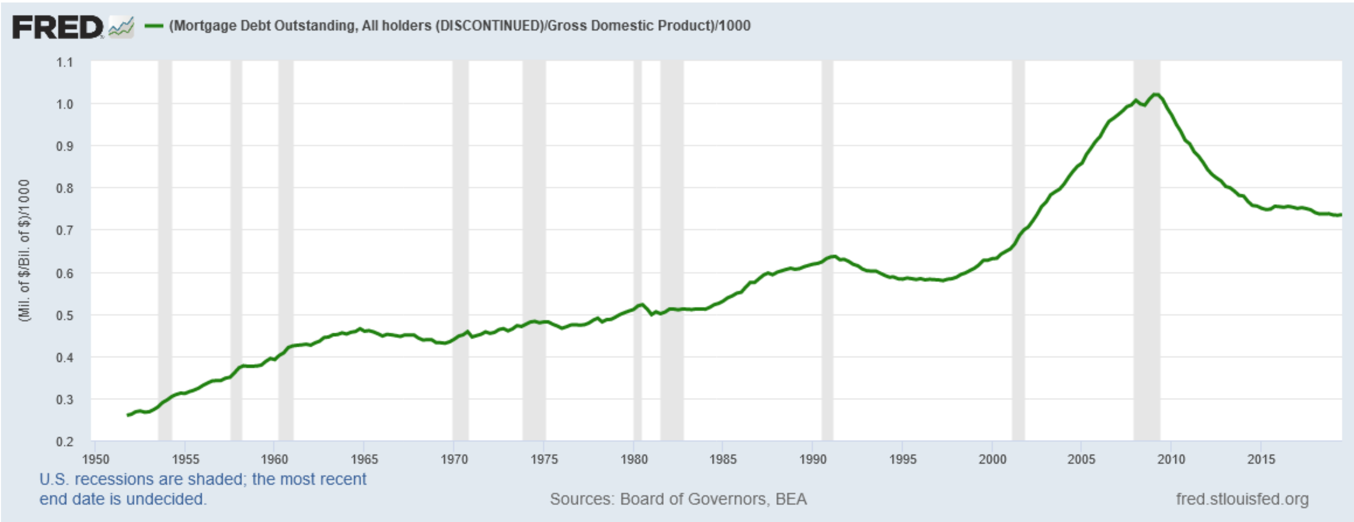
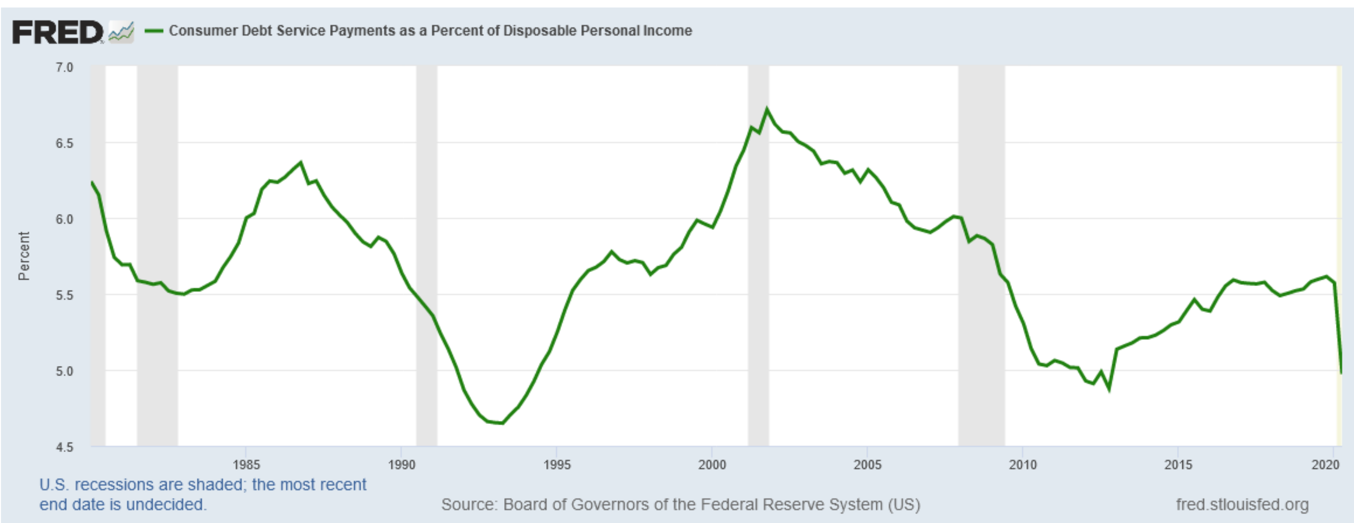


And Consumer Debt Service to Disposable Personal Income now sits at levels that existed right before the 1990s economic boom:



And, while the struggles of particular cities, such as New York City or Chicago, and of individual states, such as New Jersey or California, make the front page of the newspaper and the nightly news, the overall fiscal picture appears strong. State and Local Tax Revenue remains close to its peak prior to the

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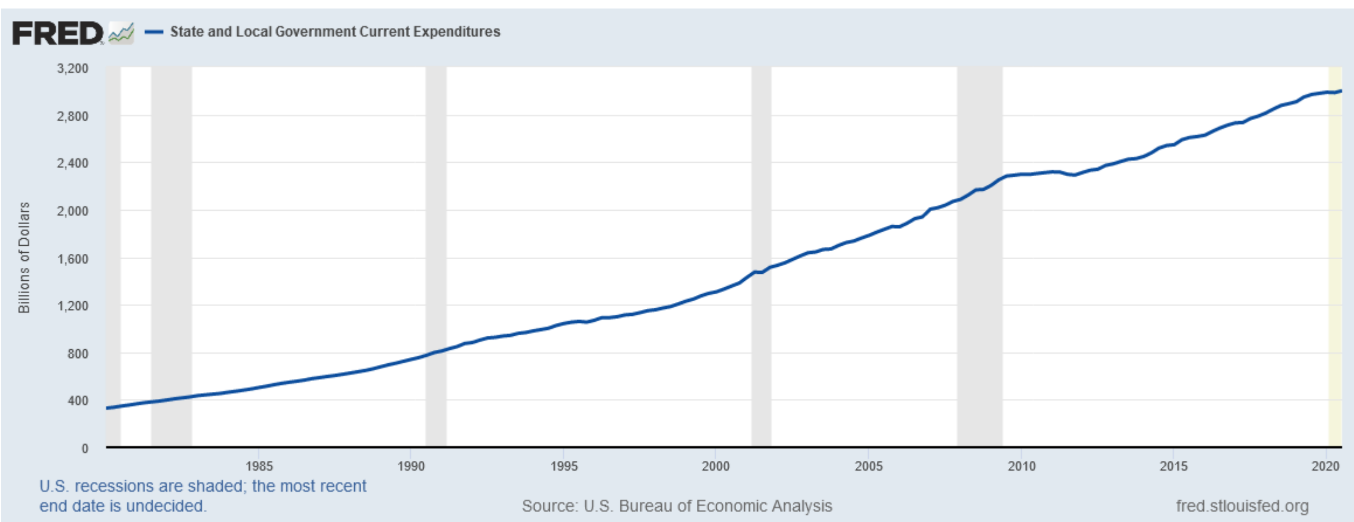
recession. This stands in marked contrast to the prior recession when it took almost 3 ½ years to get back to breakeven on revenue:

With these revenues, in aggregate, above their Q4 2019 levels and less than 1% below their peak in Q1, spending should not experience the massive cuts that occurred after the last recession. In fact, spending stands at record levels:



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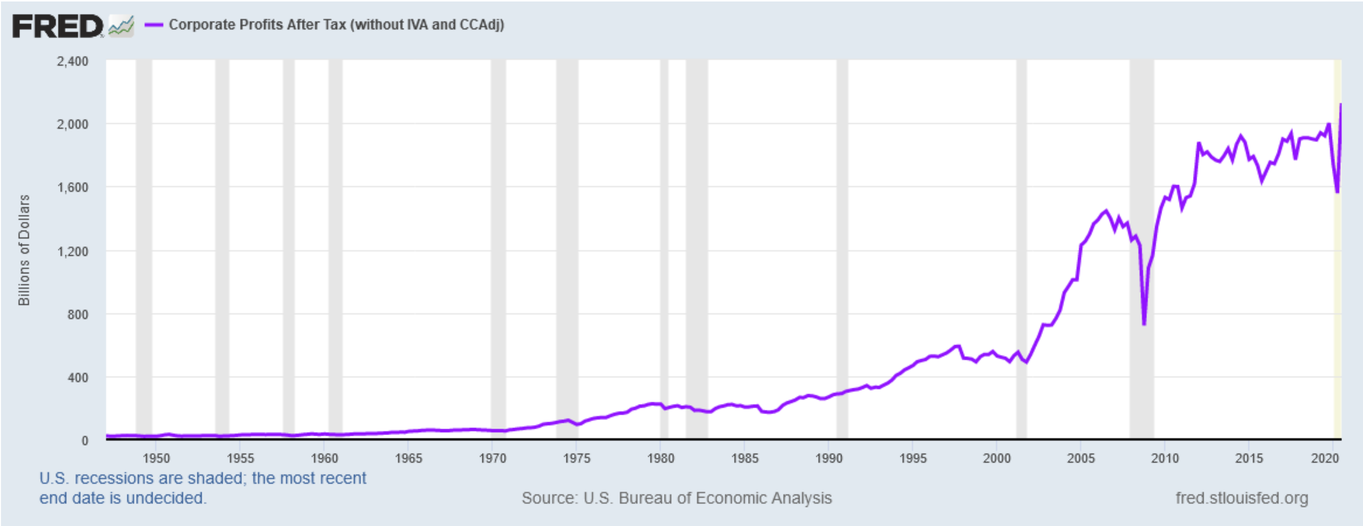
This contrasts with the last recession whereby it took 4 years for State & Local Spending to sustainably recover and exceed peak levels heading into the recovery. And if one examines the Corporate side of the ledger, a bright picture emerges there too. Corporate Profits stand at record levels, as the following chart demonstrates:



And with Corporate Profits making new heights, hiring and capital spending should follow, as has occurred after every past recession.

Lastly, US GDP appears set to grow strongly in Q4 2020. According to the Atlanta Fed's GDP Now, the US economy will grow at an 11.2% rate in Q4 or ~2.7% in absolute terms. With Q3 2020 Real GDP at $18,584 billion SAAR (Statistically Adjusted Annual Rate), according to the Bureau of Economic Analysis, this would put Q4 GDP at $19,084 billion or less than 1% below its Q4 2019 peak of $19,254 billion. With the 8%+ of the economy related to travel, tourism, and leisure activities, such as restaurants, hotels, movie theaters, amusement parks, and other places requiring a physical presence, operating at less than 50% of capacity, as the Pandemic wanes, this area of the economy should exhibit strong growth, driving GDP to new heights. And, of course, transportation areas, such as airlines, trains, and buses that enable consumers and business to reach these destinations, will further add to this sharp recovery.

While the Pollyannas continue to look in the rearview mirror, the US continues to move down the highway. Unlike 2009, where a broke banking system coupled with depleted treasuries at the Local and State levels along with a collapse in Housing led to a long road to recovery, recovery already appears strongly underway. Consumers, Corporations, and Banks entered this recession in a solid financial

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position and, with Federal Government support, exited the recession in solid financial shape. With the Pandemic exiting as 2021 progresses, the shackles on the economy will disappear, allowing the engine to open full throttle, underpinning The Coming Economic Boom. And with the economy racing down the highway with the potential for a massive government infrastructure program ahead, It Is Different This Time. (Data from the Federal Reserve, Census Bureau, and Bureau of Economic Analysis coupled with Green Drake Advisors analysis.)

Blowing In The Wind: The Coming Explosion in Offshore Wind Power

"*The answer, my friend, is blowin' in the wind,*
The answer is blowin' in the wind."

Blowin' In The Wind
Music and Lyrics by Bob Dylan, 1963

For those in favor of Green Energy, Wind Power always possessed a long attraction as did Solar Power. Both generate power by harnessing a free resource, the wind or the sun. And they turn those into energy that can be utilized in a myriad of ways. Of the two, Wind Power stands as one of the oldest forms of energy production. It dates back to the 3rd Century when the Byzantine Empire used it for grist milling. But it did not really see a major expansion into the standard, when running water was not available, until the 10th Century. It's role as an alternative to water power is most well known for the famous windmills in The Netherlands in Europe, where there still exist Windmills from the 1400's. Nevertheless, with the advent of the steam engine in the 1800s, the economics of the windmill faded until the last 30 years.

Since the 1990s, new developments in technology enabled Windmills, with tax credits, to become competitive with standard forms of power. Thus, the initial Wind Farms came into existence, demonstrating how a Green Alternative could compete with traditional power produced via coal or natural gas. With continuous development of the technology, Windmills saw increasing use across the world, as an individual Windmill which could only produce 2 MW of power in 2001 can produce 9.5 MW today. This production will continue to grow such that an individual Windmill will produce almost 14 MW by 2025. However, especially in places such as Europe and the US, opposition arose as they scarred the landscape, killed birds, and lowered property values. As a result, approvals became more difficult, took longer, and cost more money. Based on recent data from Wood Mackenzie, the global energy consulting firm, installations of Onshore Wind Capacity, outside of China, will peak in 2021, then enter decline, falling 19% in 2022 and an additional 10% in 2023. (Please see the following link

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for the report: https://www.woodmac.com/press-releases/over-$16-billion-of-wind-turbine-capacity-ordered-in-q2-2020/ .)

Offshore Windmills appear poised to fill the void and enable overall Wind Power to continue its growth. When positioned offshore, these Windmills avoid many of the NIMBY issues that face onshore installations. And, with standard undersea power cables, these installations can easily hook up to the local grid. As a result, Offshore Wind Power installations will rise from 6.8 GW in 2020 to a projected 9.8 GW next year, growing almost 45%. They will then gather steam, rising to 11.5 GW in 2023 before leaping to 19.2 GW in 2025. All in all, Offshore Wind Power installations will grow over 180% from 2020 to 2025 or at a 23% Compound Annual Growth Rate. This will make Offshore Wind Power one of the fastest growing major industries in the world.

While finding new Windmills on land may become a rarer and rarer sight and older Wind Farms may get decommissioned, the economics of the technology, coupled with the policy goal to reduce carbon emissions, will continue to underpin their use. As a result, annual installations offshore will continue to accelerate throughout the 2020s, reaching 25 – 30 GW per year by 2030, potentially 4x their level in 2020. With Wind Power continuing to assert its role in the energy grid of the future, The Answer, My Friend, Is Blowin' In The Wind, The Answer Is Blowin' In The Wind. (Data from Wood Mackenzie, JP Morgan, and Jefferies LLC coupled with Green Drake Advisors analysis.)

Views From the Stream:
Country Road, The Great Frontier, and Getting Personal

Finally, we close with brief comments Country Road, The Great Frontier, and Getting Personal. First, According to industry data, RV sales continue to skyrocket. With hotels remaining a difficult option and quarantines galore, Americans have resorted to the RV as a mobile hotel. In October, industry shipments rose 21%, the latest month for which statistics are available. With Americans taking to the road in droves with their RVs, we see the call of the great Country Road. Second, new technology continues to drive into the Space Industry. Relativity Space applied 3D manufacturing to build rockets for the major satellite and defense companies. They can fabricate a whole rocket in just 60 days using their 3D printing technology. As a side benefit, this reduces the number of parts 100x. With technology continuing to forge ahead, The Great Frontier beckons closer and closer. And Third, Gilead Sciences recently announced results for their Phase 2 trial of Yescarta. Yescarta is their leading CAR-T therapy for cancer. CAR-T stands for Chimeric Antigen Receptor T-Cell. In this therapy, a person's T Cells are primed to lock onto the cancer in their body. This is being tested on uncurable cancers. In the Phase II study, Yescarta achieved 80% complete remission and 94% response rate in follicular lymphoma and

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60% complete remission and 85% response rate in marginal zone lymphoma. With these promising early results, we see medicine Getting Personal and curing hitherto uncurable diseases.

In Closing

Should you have any questions on how the above issues or the items discussed in our accompanying cover letter impact your family's financial position or your business's future as well as the potential actions you could take in response, please do not hesitate to contact us. We welcome the opportunity to discuss this with you.

Yours Truly,

Paul L. Sloate
Chief Executive Officer
& Senior Advisor

Steve Rodia
President
& Senior Advisor