RIVERVIEW QUARTERLY INSIGHTS

RIVERVIEW trust company

THE EVERYTHING RALLY

Writing about the stock market at this point in history seems like a fool's errand. The same year that saw a pandemic kill over 1.9 million people worldwide and brought the global economy to its knees also saw the Dow and S&P 500 close at record high levels by the end of that year. Those bare facts, at first glance, defy explanation. But since stopping there would make for a pretty boring article, we'll try to do a little explaining anyway.

To fully appreciate how far we've come, let's recap the journey that investors have been on for the last year. From its peak on February 19, 2020, the S&P 500 fell 34% in just 33 days - the fastest drop and the shortest Bear Market on record for the index. What followed has been nothing less than astonishing. Referred to as an "Everything Rally" by the Wall Street Journal, most segments of the financial markets, from crypto-currency to emerging markets, have increased dramatically in value since the bottom on March 23, 2020. As we discussed in our Q2 2020 newsletter, this rally has been driven in large part by actions of the Federal Reserve. Their short-term interest rate policy and bond buying programs have pushed interest rates so low that fixed income and cash are unattractive investments, driving investors into stocks.

This "Everything Rally" did not happen all at once, however. Instead, it transitioned its way through industries and different sized companies. The first to recover were large technology stocks, as investors realized that retail was shifting online and that remote working would be in place for the foreseeable future. Small US stocks, on the other hand, stayed at a level about 10% below their pre-pandemic peak through November. From November through year end, however, small company stocks gained a whopping 27%.

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In addition to small cap stocks, "value" stocks (companies that have a low price relative to their earnings), which had underperformed "growth" stocks for most of the past 10 years, had their biggest one-day gain in history (over 6%) on November 9, the day the Pfizer vaccine was announced. Since then, value stocks outperformed growth in all but two weeks during the fourth quarter. This is probably due, at least in part, to the anticipation that banks, energy companies and traditional retail companies will start to recover as the vaccine is more widely distributed.

When stocks from economically sensitive industries (like those just mentioned) increase in value, it generally means that the market is anticipating a significant economic recovery (often referred to as a "reflation trade"). It could be the first sign of stronger results in manufacturing, technology, and retail. On the other hand, it also means that investors have already priced in such a recovery, which means in turn that stock prices could drop if such a recovery doesn't materialize or if it is weaker than anticipated. What the latter statement illustrates is that economic data describes what is, while stock prices describe what might be. Current events matter to stock prices only to the extent that they provide clues as to what might happen later. Right now, market investors are looking at a significant recovery in the coming year. Economists at Goldman Sachs, for instance, recently raised their forecast for U.S. economic growth to 8%, based in part on the additional $1.9 trillion stimulus from the new Democratic administration and Congress.

Can any conclusions be drawn from this information? An intelligent investor should consider the following:

- **Ignore predictions**. This is the season when every investment advisor will give their opinions about where the market is headed, which sectors will outperform others, which stocks to buy or sell. Such opinions are like posteriors; everyone has one. No one knows what will happen in the coming year and anyone who invests based on predictions about it is simply gambling, not investing.

- **Don't time the market**. We say this over and over again, but in this environment it bears repeating. A Wall Street Journal article from January 4 (citing research from Fidelity) points out that a hypothetical investor who put $10,000 into an S&P 500 index fund at the start of 1980, and who missed the best five days of the market through the end of August 2020, would have generated a return that was 38% lower than the returns of someone who stayed invested during the entire period. Miss five days, lose 38%. Crazy stuff will happen this year. We don't know what it will be, but it will make you nervous. Maybe very nervous. Remember these statistics when that nervousness makes you want to get out of the market.

- **Don't pick individual stocks or sectors**. Put your investment dollars into broadly diversified funds, rather than trying to bet on particular stocks or industry sectors. Have technology stocks gone as high as they can go? Will value stocks continue to outperform growth? Will emerging market companies take off? The answers to all of these questions are unknowable, because they depend upon events that we can only guess at. And guessing is simply gambling.

- **Check your cash**. As you decide on how much you think you can invest, make sure you are not dipping into your emergency funds (and certainly don't engage in margin investing). Instead, be sure to keep enough cash on hand to weather any market downturns, particularly if you are retired.

Sure, this is the same advice we've been giving forever. But despite the awful times we are living through, such advice is all that is reliable. And it provides some small measure of comfort to know that it still works in bad times as well as good.

SPOTLIGHT ON PLANNING

AMERICAN RESCUE PLAN ACT PROVIDES RELIEF TO INDIVIDUALS AND BUSINESSES

On Thursday, March 11, 2021, the American Rescue Plan Act of 2021 (ARPA 2021) was signed into law. This is a $1.9 trillion emergency relief package that includes payments to individuals and funding for federal programs, vaccines and testing, state and local governments, and schools. It is intended to assist individuals and businesses during the ongoing coronavirus pandemic and accompanying economic crisis. Major relief provisions are summarized here, including some tax provisions.

Recovery rebates (stimulus checks)

Many individuals will receive another direct payment from the federal government. Technically a 2021 refundable income tax credit, the rebate amount will be calculated based on 2019 tax returns filed (or on 2020 tax returns if filed and processed by the IRS at the time of determination) and sent automatically via check, direct deposit, or debit card to qualifying individuals. To qualify for a payment, individuals generally must have a Social Security number and must not qualify as the dependent of another individual.

The amount of the recovery rebate is $1,400 ($2,800 if married filing a joint return) plus $1,400 for each dependent. Recovery rebates start to phase out for those with an adjusted gross income (AGI) exceeding $75,000 ($150,000 if married filing a joint return, $112,500 for those filing as head of household). Recovery rebates are completely phased out for those with an AGI of $80,000 ($160,000 if married filing a joint return, $120,000 for those filing as head of household).

Unemployment provisions

The legislation extends unemployment benefit assistance:

- An additional $300 weekly benefit to those collecting unemployment benefits, through September 6, 2021
- An additional 29-week extension of federally funded unemployment benefits for individuals who exhaust their state unemployment benefits
- Targeted federal reimbursement of state unemployment compensation designed to eliminate state one-week delays in providing benefits (allowing individuals to receive a maximum 79 weeks of benefits)
- Unemployment benefits through September 6, 2021, for many who would not otherwise qualify, including independent contractors and part-time workers

For 2020, the legislation also makes the first $10,200 (per spouse for joint returns) of unemployment benefits nontaxable if the taxpayer's modified adjusted gross income is less than $150,000. If a 2020 tax return has already been filed, an amended return may be needed.

Business relief

- The employee retention tax credit has been extended through December 31, 2021. It is available to employers that were significantly impacted by the crisis and is applied to offset Social Security payroll taxes. As in the previous extension, the credit is increased to 70% of qualified wages, up to a certain maximum per quarter.
- The employer tax credits for providing emergency sick and family leave have been extended through September 30, 2021.
- Eligible small businesses can receive targeted economic injury disaster loan advances from the Small Business Administration. The advances are not included in taxable income. Furthermore, no deduction or basis increase is denied, and no tax attribute is reduced by reason of the exclusion from income.
- Eligible restaurants can receive restaurant revitalization grants from the Small Business Administration. The grants are not included in taxable income. Furthermore, no deduction or basis increase is denied, and no tax attribute is reduced by reason of the exclusion from income.

Housing relief

- The legislation allocates additional funds to state and local governments to provide emergency rental and utility assistance through December 31, 2021.
- The legislation allocates funds to help homeowners with mortgage payments and utility bills.
- The legislation also allocates funds to help the homeless.

Health insurance relief

- For those who lost a job and qualify for health insurance under the federal COBRA continuation coverage program, the federal government will generally pay the entire COBRA premium for health insurance from April 1, 2021, through September 30, 2021.
- For 2021, if a taxpayer receives unemployment compensation, the taxpayer is treated as an applicable taxpayer for purposes of the premium tax credit, and the household income of the taxpayer is favorably treated for purposes of determining the amount of the credit.
- Persons who bought their own health insurance through a government exchange may qualify for a lower cost through December 31, 2022.

Student loan tax relief

For student loans forgiven or cancelled between January 1, 2021, and December 31, 2025, discharged amounts are not included in taxable income.

Child tax credit

- For 2021, the credit amount increases from $2,000 to $3,000 per qualifying child ($3,600 for qualifying children under age 6), subject to phaseout based on modified adjusted gross income. The legislation also makes 17-year-olds eligible as qualifying children in 2021.
- For most individuals, the credit is fully refundable for 2021 if it exceeds tax liability.
- The Treasury Department is expected to send out periodic advance payments (to be worked out by the Treasury) for up to one-half of the credit during 2021.

Child and dependent care tax credit

- For 2021, the legislation increases the maximum credit up to $4,000 for one qualifying individual and up to $8,000 for two or more (based on an increased applicable percentage of 50% of costs paid and increased dollar limits).
- Most taxpayers will not have the applicable percentage reduced (can be reduced from 50% to 20% if AGI exceeds a substantially increased $125,000) in 2021. However, the applicable percentage can now also be reduced from 20% down to 0% if the taxpayer's AGI exceeds $400,000 in 2021.
- For most individuals, the credit is fully refundable for 2021 if it exceeds tax liability.

Earned income tax credit

For 2021 only:

- The legislation generally increases the credit available for individuals with no qualifying children (bringing it closer to the amounts for individuals with one, two, or three or more children which were already much higher).
- For individuals with no qualifying children, the minimum age at which the credit can be claimed is generally lowered from 25 to 19 (24 for certain full-time students) and the maximum age limit of 64 is eliminated (there are no similar age limits for individuals with qualifying children).
- To determine the credit amount, taxpayers can elect to use their 2019 earned income if it is more than their 2021 earned income.

For 2021 and later years:

- Taxpayers otherwise eligible for the credit except that their children do not have Social Security numbers (and were previously prohibited from claiming any credit) can now claim the credit for individuals with no qualifying children.
- The credit is now available to certain separated spouses who do not file a joint tax return.
- The level of investment income at which a taxpayer is disqualified from claiming the credit is increased from $3,650 (as previously indexed for 2021) to $10,000 in 2021 (indexed for inflation in future years).

MARKET SNAPSHOT

MARKET SUMMARY – Short- and Long-Term Index Returns

Stocks had very strong fourth quarter performance as a result of positive developments on the Covid-19 vaccine, leading investors to begin anticipating the broader reopening of the economy in 2021.

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate	US Bond Market	Global Bond Market ex US
4Q 2020	**STOCKS**				**BONDS**	
	14.68%	15.85%	19.70%	12.55%	0.67%	0.94%
1 Year						
	20.89%	7.59%	18.31%	-9.09%	7.51%	3.94%
5 Years						
	15.43%	7.64%	12.81%	3.66%	4.44%	4.40%
10 Years						
	13.79%	5.19%	3.63%	6.14%	3.84%	4.35%

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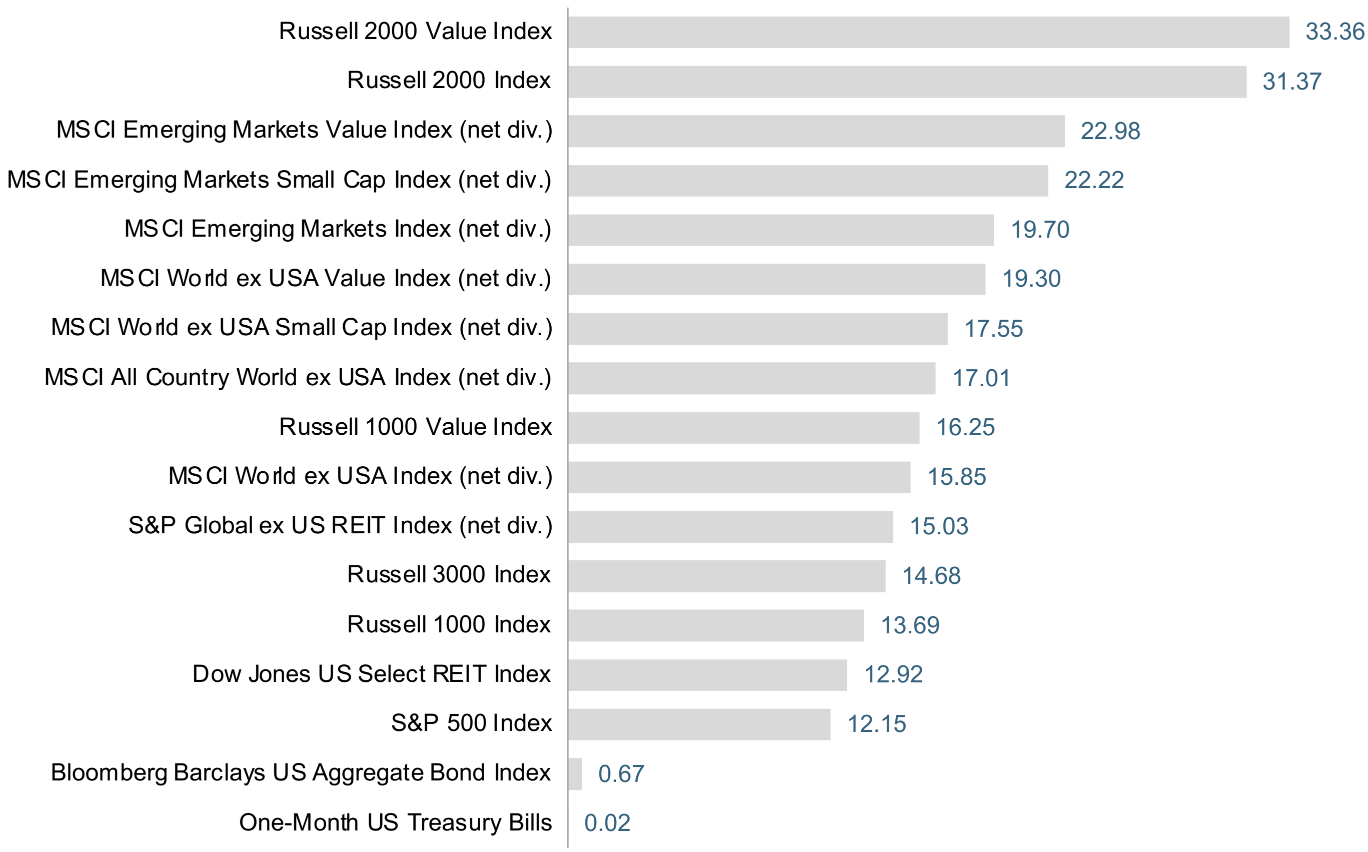
GLOBAL MARKETS - Fourth Quarter 2020 Index Returns (%)

Equity markets around the globe posted positive returns in the fourth quarter. Looking at broad market indices, emerging markets outperformed non-US developed markets and US equities.

Value outperformed growth across regions. Small caps outperformed large caps across regions as well.

REIT indices underperformed equity market indices in both the US and non-US developed markets.



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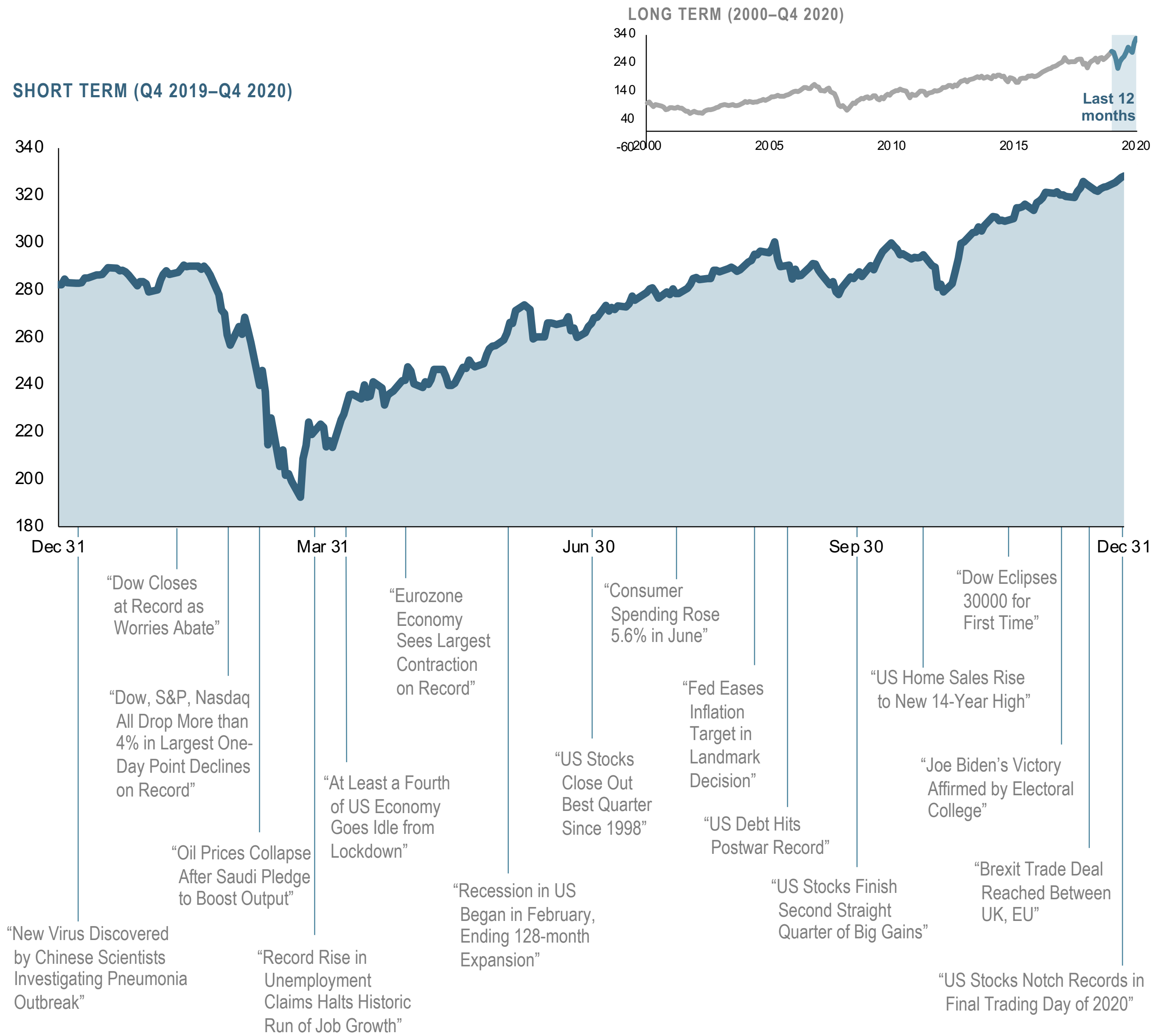
WORLD STOCK MARKET PERFORMANCE

MSCI All Country World Index with selected headlines from past 12 months

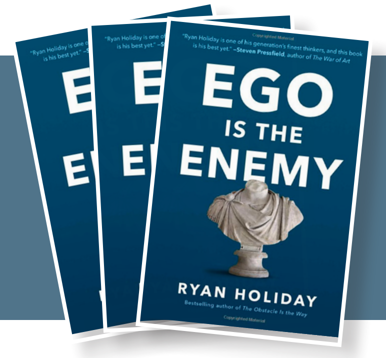
These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.



Graph Source: MSCI ACWI Index [net div.]. MSCI data © MSCI 2020, all rights reserved. It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

See Important Disclosure Information.

BOOK REVIEW



EGO IS THE ENEMY

Ryan Holiday

As you know, we follow the writings of Jason Zweig from The Wall Street Journal pretty closely. Last year, he reported in one of his columns that young men were using low-cost online trading platforms to make "investments" that were really more akin to gambling. Following the initial economic carnage of the pandemic, these people would place large bets on stocks (often in the travel and entertainment businesses) that were in financial distress. They would then brag online to their friends about their outsized results, whether positive or negative. It didn't seem to matter whether they had large gains or large losses, as long as they were large. Such ego-driven behavior may have artificially inflated stock prices for a time.

I had Zweig's column in mind when I read Ego is the Enemy, a 2016 book from Ryan Holiday. In it, Holiday explored the ill effects of ego on himself, his friends and colleagues, and on important figures throughout history. Holiday uses the term "ego" not in the Freudian sense but rather as the "unhealthy belief in our own importance." In other words, arrogance and self-centered ambition. Ego is the enemy of mastering a craft, of working well with others, of achieving real creative insight. Although a problem throughout history, our culture in particular "fans the flames of ego."

The book looks at historical figures who have either succumbed to or have overcome ego. What these examples demonstrate is that,

> [w]hen we remove ego, we are left with what is real. What replaces ego is humility, yes – but rock-hard humility and confidence. Whereas ego is artificial, this type of confidence can hold weight. Ego is stolen. Confidence is earned. Ego is self-appointed, its swagger is artifice. One is girding yourself, the other gaslighting. It's the difference between potent and poisonous.

It is arranged in three sections: Aspiration, Success and Failure. Its goals are to help us be "humble in our aspirations, gracious in our success, resilient in our failures."

Rather than paraphrase Holiday's insights, this review will provide some of his best insights directly, organized in those three sections.

I. Aspiration.

Historically, our greatest thinkers have promoted being ruled by principle. However, our current cultural values make us dependent on validation, entitled, and ruled by our emotions. We are inspired, encouraged and assured by society that we can do whatever we want. We create our aspirations accordingly.

But the ability to evaluate our own ability is the most important skill of all for implementing those aspirations, because without it, improvement is not possible. Ego makes such self-evaluation difficult "every step of the way." It leads us to talk about things rather than do them; and social media encourages us to tell the world how wonderful we are. "The only relationship between work and chatter is that one kills the other." Ego leads us to want to "be," rather than to "do." Holiday recommends asking of ourselves "what is it that I want to accomplish in life," rather than "who do I want to be in life?"

Similarly, ego leads us to promote how good we already are, rather than how much better we might be through study; “the pretense of knowledge is our most dangerous vice, because it prevents us from getting any better. Studious self-assessment is the antidote.” Put another way, “you will not find the answers if you’re too conceited and self-assured to ask the questions. You cannot get better if you’re convinced you are the best.” If we are to fulfill our aspirations, we must learn not only to take harsh feedback but to actively solicit it. This is something that the ego will work hard to avoid.

Holiday recommends not being passionate, a sentiment that runs counter to our cultural imperative of finding our passion. “Passion typically masks the weakness. Its breathlessness and impetuousness and franticness are poor substitutes for discipline, for mastery, for strength and purpose and perseverance.” Passionate people “can tell you all the things they’re going to do, or have even begun, but they cannot show you their progress. Because there rarely is any.” Holiday recommends purpose and realism instead of passion. “Purpose, you could say, is like passion with boundaries. Realism is detachment and perspective.” Put another way, passion “is form over function. Purpose is function, function, function.”

As you pursue your aspirations, you also must exercise restraint. “When someone doesn’t reckon you with the seriousness that you’d like, the impulse is to correct them. (As we all wish to say: do you know who I am?!). You want to remind them of what they’ve forgotten; your ego screams for you to indulge it. But you can’t react. Instead, when someone doesn’t value you as you think you should be, “[t]ake it. Eat it until you’re sick. Endure it. Quietly brush it off and work harder. Play the game. Ignore the noise; for the love of God, do not let it distract you.” It is a “timeless fact of life that the up-and-coming must endure the abuses of the entrenched.”

One area that needs particular restraint is pride. “Pride blunts the very instrument we need to own in order to succeed: our mind. Our ability to learn, to adapt, to be flexible, to build relationships, all of this is dulled by pride. Most dangerously, this tends to happen either early in life or in the process – when we’re flushed with beginner’s conceit.” Instead, it should be about the work alone. “Our ego wants the ideas and the fact that we aspire to do something about them to be enough. Wants the hours we spent planning and attending conferences or chatting with impressed friends to count toward the tally that success seems to require. It wants to be paid well for its time and it wants to do the fun stuff – the stuff that gets attention, credit, or glory.” In other words, “to get where we want to go isn’t about brilliance, but continual effort.”

In conclusion, as we address our aspirations, we can face what Ira Glass calls the “Taste/Talent Gap,” which occurs when your ability to conceive of a great idea is not matched by your ability to execute on it, so that the end product is “really not that great.” Whereas ego wants us to avoid facing this harsh truth, “we can face our shortcomings honestly and put the time in. We can let this humble us, see clearly where we are talented and where we need to improve, and then put in the work to bridge that gap.”

II. Success.

If we find ourselves able to work hard and achieve the things to which we aspire, we start to gain some measure of success. However, this is success can simply plant the seeds for our next challenge: “as we first succeed, we will find ourselves in new situations, facing new problems. The freshly promoted soldier must learn the art of politics. The salesman, how to manage. The founder how to delegate. The writer how to edit others.” Each advancement bumps you into situations you’ve never encountered before. “With accomplishment comes a growing pressure to pretend that we know more than we do. To pretend we already know everything.”

As you face these new challenges, ego can tempt you to focus on “some grand division or power trip” rather than "instilling excellence." The story that you build out of your own success can delude you. "Narrative is when you look back at an improbable or unlikely path to your success and say: I knew it all along. Instead of: I hoped. I worked. I got some good breaks. Or even: I thought this could happen." This shows itself in the narratives of investment managers whose claims about what they're doing in the market are not really to be trusted. "The founding of a company, making money in the market, or the formation of an idea is messy. Reducing it to a narrative retroactively creates a clarity that never was and never will be there."

One way to avoid self-congratulating narratives is to stay on our own path "without getting distracted by all the others that intersect it. In other words, it's not about beating the other guy. It's not about having more than the others. It's about being what you are, and being as good as possible at it, without succumbing to all the things that draw you away from it." Importantly for our purposes, "[t]his is especially true with money. If you don't know how much you need, the default easily becomes: more. And so without thinking, critical energy is diverted from a person's calling and toward filling a bank account."

Indeed, an ego-driven success narrative created after the fact can lead a person to entitlement, a need for control and in the end paranoia. "Entitlement assumes: This is mine. I've earned it. At the same time, entitlement nickels and dimes other people because it can't conceive of valuing another person's time as highly as its own." Control says that everything must be done my way, "even inconsequential things. It can become paralyzing perfection or a million pointless battles fought merely for the sake of exerting its say." Finally, paranoia kicks in when the successful person believes that he or she can't trust anyone. "It says, focusing on my work, my obligations, myself is not enough. I also have to be orchestrating various machinations behind the scenes – to get them before they get me; to get them back for the slides I perceive."

Again, the key to avoiding these pitfalls is to avoid being driven by ego. Let your confidence be more important than honors or recognition. "Ego needs honors in order to be validated. Confidence, on the other hand, is able to wait and focus on the task at hand regardless of external recognition." Easy to say, but very difficult to achieve after reaching some level of success.

III. Failure.

No one succeeds forever. Even the most successful people have faced major setbacks in their journey. So properly handling failure involves managing the ego. Adam Smith said that "It is because mankind are disposed to sympathize more entirely with our joy and with our sorrow, that we make parade of our riches, and conceal our poverty." The ego-driven narrative can only tolerate a successful storyline. It can't handle the notion that life isn't fair. So instead, ego "loves this notion, the idea that something is 'fair' or not. Psychologists call it narcissistic injury when we take personally totally indifferent and objective events."

This leads the egotist to wallow in "dead time," under which problems are simply not dealt with. "That's what so many of us do when we fail or get ourselves into trouble. Lacking the ability to examine ourselves, we reinvest our energy into exactly the patterns of behavior that caused our problems to begin with. It comes in many forms. Idly dreaming about the future. Plotting revenge. Finding refuge and distraction. Refusing to consider that our choices are a reflection of our character. We'd rather do basically anything else." In short, dead time occurs when we are controlled by ego.

The solution to dead time is to do the right thing, regardless of outcome. "In life, there will be times when we do everything right, perhaps even perfectly. Yet the results will somehow be negative: failure, disrespect, jealousy, or even a resounding yawn from the world." We must face the question "[w]ill we invest time and energy even if an outcome is not guaranteed? With the right motives we are willing to proceed. With ego, were not." To handle failure in a healthy way, doing good work in itself must be sufficient. "In other words, the less attached we are to outcomes the better. When fulfilling our own standards is what fills us with pride and self-respect. When the effort – not the results, good or bad – is enough."

And when doing the work is enough, failure won't last. "Most trouble is temporary . . . Unless you make that not so. Recovery is not grand, it's one step in front of the other. Unless your cure is more of the disease. Only ego thinks embarrassment or failure are more than what they are. History is full of people who suffered abject humiliations yet recovered to have a long and impressive careers."

Put another way, the internal scoreboard rather than the external one is what sees us through difficult times. Ego can only see what's going well, not what isn't. "Your potential, the absolute best you're capable of – that's the metric to measure yourself against. Your standards are. Winning is not enough. People can get lucky and win. People can be assholes and win. Anyone can win. But not everyone is the best possible version of themselves."

IV. Epilogue.

Holiday concludes with the thought that "it's admirable to want to be better businessmen or businesswomen, better athletes, better conquerors. We should want to be better informed, better off financially . . . We should want, as I've said a few times in this book, to do great things. I know that I do.

"But no less impressive an accomplishment: being better people, being happier people, being balanced people, being content people, being humble and selfless people. Or better yet, all of these traits together."

* * * * *

As always, the books we review have (we hope) a connection to our clients' financial lives, to their views about money, and to the ways we try to hone our craft. Good investment choices involve studiously examining data, testing your own assumptions, not giving into superficial and retrospective narratives, self-discipline. Bad investment choices almost always result from ego. This book tells us so much that we already know, and yet always seem to ignore.

IMPORTANT DISCLOSURE INFORMATION

Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citi WGBI ex USA 1-30 Years [Hedged to USD]).

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