Broadleaf Partners, LLC

Our 2021 Playbook January 15, 2021

Each year, we look back at the prior year's Investment Playbook to assess what we got right, what we got wrong, and what we learned in the process. We then turn to the coming year, putting our dominant ideas in writing, with hopes of gaining greater clarity on the factors that might drive our investment returns going forward.

This piece isn't meant to be detailed or comprehensive. Our hope, rather, is that it may help you gain a better understanding of the primary influences that could drive our investment decisions in the coming year. How we react to changes and new information is a fluid exercise subject to our discretion, but always made with a longer term perspective in mind and the intent to drive superior returns over time.

Thank you for your continued confidence in our approach and interest in our work!

Looking Back

In our *2020 Investment Playbook*, we followed the pattern of several previous years where we provided general observations on the economy, the financial markets and politics in general.

As we all know, 2020 started off in typical fashion, but ended up being one of the most disruptive years for most human beings alive today. The pandemic has not only taken lives, but has contributed to social unrest and political dysfunction at levels I have never experienced in my five plus decades on Earth.

I would say that overall, our primary views on the economy, the markets and politics for 2020 weren't that poor, all things considered, but had you told me about the freight train that was coming down the tracks, I might have changed my mind.

The Economy

With respect to the economy, we felt that overall GDP growth wouldn't exceed 3% and might likely be slower, in the 2's. We stated, *"Growth will remain slow for as far as the eyes can see as whole swaths of the economy continue to be remade by technological and societal change." We also believed that the Fed would remain on hold for most of the year and that an additional cut might be more likely than further hikes.*

Obviously the pandemic not only brought about a severe recession, but the Fed quickly took rates to zero with little intent of raising them for at least a couple of years. The pandemic and its

9 Aurora Street, Suite 5
Hudson, Ohio 44236
Phone: 330-650-0921
www.broadleafpartners.com

effects is only affirming our notion of an economy being remade by pervasive and accelerating rates of technological and societal change.

The Markets

With respect to the markets for 2020, we stated that "*in a slow growth economy, we believe investors will be best served by investing in companies that can grow "in spite of it all." Barring a recession, we remained constructive, believing that 2020 would generate positive returns.*

Oddly, these views were accurate and the markets did enjoy positive returns for the full year, particularly from those companies that could grow "in spite of it all". Well, no one needs me to tell them that there was a great deal of "in spite of it all" in 2020, including a deep and severe recession. The markets did do surprisingly well for the full year, posting double digit returns for most indices, but only after plunging 30% and more as the economy fully shut down last spring. Time in the market, they say, is more important than timing the market, and once again, that thesis bore out for the full year.

Politics

With respect to politics, we stated in last year's playbook that, "*the election will likely be Donald Trump's to lose given record lows in unemployment and a solid, albeit slow-growth economy.*" Donald Trump lost the election as we all know, or at least I hope so by now, in the face of the pandemic, its impact on the economy, and massive social unrest. The fiscal and monetary response to the crisis, in my opinion, has actually been decent considering the political dysfunction, but that is purely from the vantage point of Wall Street and not Main Street, where the observation could be far more varied and debatable.

Looking Forward – Our 2021 Playbook

As we turn to our Playbook for the coming year, we'll stick with the format we've been using and discuss our views on the economy, the markets, and politics for the year ahead.

The Economy

In general, we believe the economy will continue to recover in 2021 as distribution of the vaccine broadens and as individuals slowly return to more typical routines. Given the severe downturn of the past year, we suspect that growth in GDP for 2021 will be above the 2-3% likely long term averages, largely as a function of the easier year over year comps and reopening economic activity.

While we continue to believe innovation will drive economic activity, we suspect the cyclical effects of a broader reopening may drive outsized, measurable impacts to GDP growth in 2021. Market based interest rates may rise on the longer end of the curve, but a Fed committed to keeping rates near zero for the next few years will likely anchor them below levels seen just prior to the pandemic.

Longer term, beyond 2021, we continue to expect subdued GDP growth in the 2-3% range given the deflationary impacts of the pandemic and the now accelerated shift in industry wide disruption enabled by technology that is becoming increasingly pervasive and productive throughout society.

The Markets

Given the strong two year run for the markets, and particularly off the lows of last spring, we wouldn't be surprised to see the market consolidate its gains in 2021. This doesn't mean to imply that certain areas of the market won't do well, just that the overall indices may tread water as a function of greater underlying volatility among economic sectors and factor components.

We've long held to a proprietary investment approach which postulates that three cycles determine overall value creation in the stock market. These three cycles include: *the Economic Cycle, the Innovation Cycle and the Credit Cycle.*

Historically speaking, *the Economic Cycle* – the economy's natural movement from recession to recovery to expansion - has tended to have the greatest impact on market returns in any given year. Given the likelihood of increased reopening activity within the economy coupled with the severity of the recession in 2020, we wouldn't be surprised if the more economically sensitive areas of the market outperform in 2021. Value stocks, in particular, may shine on a relative basis, at least for a time.

This general trend started to manifest itself in the fourth quarter of 2020 and may likely continue to do so as 2021 progresses. Consistent with this thinking, for much of 2020, the few new positions we have added to in the portfolio have reflected a desire to capture greater cyclical characteristics in addition to the long term imperative of being an innovation leader and adopter.

Longer term, meaning more than a year out, we believe *the Innovation Cycle* will continue to be the dominant generator of alpha for growth portfolios, particularly in a low growth environment. The pandemic has only accelerated efforts in corporate America to achieve greater productivity gains and fixed costs continue to be turned into variable costs as the sharing economy proliferates and overall economic cyclicality is reduced. We will go back to some semblance of normal as a society, but that normal will be permanently changed not only due to the availability of technology but now it's more broad based cultural acceptance.

With respect to *the Credit Cycle*, we continue to believe the Fed will remain on hold, not likely raising rates until late 2023 unless inflation becomes downright unruly, which we do not expect at this time.

Given this low rate environment, financial asset bubbles in some areas of the market will continue to take form and longer term investors, including ourselves, will need to exercise discipline in balancing the desire to participate in today's returns with the risks of a more severe bubble popping down the road. As a tech investor during the early 2000's, I will say that I've never "felt" more sobering parallels to that environment than I do today, twenty years later.

Politics

I'm hopeful that President Elect Biden will seek to unite rather than further divide the country as expressed in his recent speeches and campaign promises. With the recent Georgia senate elections now going in the Democrats favor, he has a green light to enacting a more progressive agenda than may have otherwise been the case just a few weeks ago. Whether he can unite the country by being more progressive than he might have otherwise been will depend a great deal on the breadth of the success of such measures across party lines.

Regardless of which way you lean politically, we have always said that it is best to check one's politics at the door when it comes to investing or not investing in the stock market. Over the years, we've witnessed far too many investors be derailed by allowing their political emotions to rule their financial decisions.

Since the dawn of time, commerce, trade and the prospect of a win-win have always managed to bring people together when they've seemed so far apart economically, culturally or politically.

But you have to come to the party. You have to stay involved.

We'll close our 2021 Playbook as we have always done, by reminding investors that our business is never easy, as 2020 clearly showed, but it's always an intellectual challenge worth pursuing.

May God bless you abundantly in the coming year, even if it comes in ways you don't expect!

Kindest Regards,

Doug
Doug MacKay
CEO & CIO
dmackay@broadleafpartners.com

Bill
Bill Hoover
President
bhoover@broadleafpartners.com