BCN ADVANTAGE: 2020 ANNUAL REPORT

February 2021	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	15.16% [1,2,3]	21.16% [1,2]	11.59% [1,2]	1.00% [1,2]
Jan ' 97 = $100,000 [4]	$1,045,528	$818,151	$437,000	$165,504
Beta (2020):	0.71	1.00	0.50	0.00
Risk Adjusted Return:	14.04%	21.16%	11.59%	1.00%

1 Performance results are based on the T. Rowe Price Mid-Cap Growth Fund (24.2% for 2020), the Vanguard Index 500 Fund (18.3% for 2020), the Fidelity Diversified International Fund (18.9% for 2020) and an average money market return of 1.02%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.
2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.
3 Performance results are net of BCN Financial management fees.
4 BCN Financial Inc. is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2020 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2020	75%	25%
2	02/01/2020	75%	25%
3	05/01/2020	75%	25%
4	08/01/2020	75%	25%
5	11/01/2020	75%	25%
6	11/20/2020	40%	60%
7	12/31/2020	40%	60%
	Present	40%	60%

A Year Unlike Any Other

For 2020, the S&P 500 gained +16.3% to 3,756, the Nasdaq +43.6% to 12,888, and the Dow +7.2% to 30,607. These are extraordinary gains coming in the midst of a global pandemic that precipitated economic devastation in the U.S and worldwide.

What cannot be underestimated is the power of fiscal and monetary stimulus to lift asset prices, especially in the tech heavy Nasdaq. Since the Fed reversed course in January 2019, the Nasdaq has nearly doubled, up 94% from its December 2018 level of 6,635. The Fed's balance sheet (the sum total of years of "quantitative easing") increased by more than $3.25 trillion since February 2020, once the ravages of COVID became fully apparent. Add to that $2 trillion authorized under the March 2020 CARES Act, the $900 billion supplement in December 2020, and the current Biden proposal for another $1.9 trillion, and the total fiscal and monetary response to the pandemic will be more than $8 trillion – roughly equivalent to 37% of the entire $21.5 trillion U.S. economy, and nearly 3-times the response seen during the 2008 Great Recession.

The Ultimate V-Recovery

The U.S. economy was humming along in mid-February 2020, with unemployment at 50-year lows and the S&P 500 rising to 3,386. There were only 15 reported COVID cases in the U.S. and as yet no deaths from this mysterious novel virus. Less than 5 weeks later, with reported cases approaching half a million and deaths nearing 700, the S&P 500 had plummeted 33.9% before bottoming at 2,237 on March 23rd. In the early days of the decline, we issued a series of notices urging our clients not to sell. "From long experience, we know that stock markets usually recover quickly from panic selloffs, especially in circumstances like we're experiencing today, when the U.S. economy was on strong footing prior to the crisis." By mid-August, in the face of continuing lockdowns and no real end in sight to the global pandemic, the major indexes had fully recovered and kept powering ahead despite more than 20 million reported COVID cases and 355,000 deaths in the U.S. by year-end.

Economic Damage Wrought by COVID

At its worst point, GDP from April - June sank by 31.4% on an annualized basis, more than 3-times the previous pandemic-era record contraction of 10.0% in 1958. Helped by stimulus and a slow rollback of virus-related restrictions, the U.S. economy grew at an annualized record 33.4% the following quarter, but overall economic output remains well below pre-pandemic levels.

The labor market will likely require years to fully recover, even as COVID vaccines become widely distributed and a longer-lasting economic reopening takes place. The U.S. economy lost a record 20.8 million jobs in April alone, after shedding nearly 1.4 million in March. The worst drop in payrolls during the global financial crisis was 800,000 in March 2009. The unemployment rate surged to 14.7% in April, a record in Labor Department data going back to 1948, though it did avoid reaching Great Depression-era levels, when the jobless rate peaked at an estimated 25% in 1933.

As of December, the economy is still 9.8 million jobs short of where it was in February before the pandemic, and more than 20 million Americans are still claiming unemployment benefits. At 6.7%, the unemployment rate remains nearly double its pre-pandemic level, and the labor force participation rate, at just 61.5%, has sunk nearly two percentage points below pre-pandemic levels. Federal Reserve forecasts show the labor market not returning to 3.7% unemployment until the end of 2023.

Fed Policy Continues to Drive Stocks

The central bank has maintained its interest rate target at near-zero and reiterated its commitment to at least $120 billion a month in asset purchases until “substantial further progress” is made on the recovery. “Any time we feel like the economy could use stronger accommodation, we would be prepared to provide it,” Powell said on December 16th. The imprecise language, however, will keep Fed watchers and investors guessing on where inflation and unemployment will have to land before quantitative easing is pared back, but any tapering would likely begin no earlier than the fourth quarter of 2021. A new policy adopted in August would allow inflation “moderately” above the Fed’s 2% target, meaning that reflation in a possible second half recovery would not trigger an interest rate hike. Core personal consumption expenditures, the Fed’s preferred measure of inflation, clocked in at just 1.4% in November.

Headwinds Still Confront the Markets

Markets are showing visible signs of excess speculation, with a record $272 billion flowing into stocks over the past 12 weeks. The S&P 500 is trading at a forward 12-month price-to-earnings (P/E) ratio of 22.9, well above both its five-year average of 17.6 and 10-year average of 15.8. Fund managers are underweight cash for the first time since May 2013. With cash levels so low, much of the expected growth has already been "priced to perfection”. As expectations rise, so do the opportunities for disappointment.

Higher interest rates and inflation are key risks. Ultra-low rates support companies by reducing borrowing costs and motivate investors to keep piling into stocks amid a hunt for yield. The huge injection of liquidity (both fiscal and monetary), the Fed’s expressed tolerance of higher inflation and massive government debt (currently $27 trillion and counting) pose a structural threat of inflation greater than at any time since the 70’s. The negative impact of higher interest rates on corporate earnings, stock price multiples (P/E) and many quantitative strategies (back tested in a mostly low inflation environment) would be severe.

Since the 2008 financial crisis, corporate share repurchases, or "stock buybacks," have accounted for nearly all buying in the market. The total amount of stock bought back by companies even exceeds the Fed's bonds purchases over the same period as part of quantitative easing. Now, companies are hoarding cash and markedly decreasing share buybacks from 2015-2019 levels, at the same time they have increased outstanding shares. Notably, over the last 20 years, the only two previous periods where corporations increased shares outstanding were during the 2000 and 2008 recessions.

The Biden administration could substantially raise taxes on many U.S. corporations that have benefited from lower rates, which have in turn improved U.S. corporate competitiveness globally, increased profitability, encouraged innovation, strengthened balance sheets, and contributed to job growth. An increase in the capital gains tax might also put pressure on the markets. And even with targeted support, vulnerable sectors such as travel, hospitality and leisure could remain hard-hit by the outbreak, giving rise to the notion of a “K-shaped” recovery. Global tourism fell 72% in the year through October. A quarter of business trips could disappear forever as meetings move online. With vacations upended and mass events like festivals and concerts called off, the trend among consumers to favor “experiences” over goods has been disrupted. And when activities do resume, they may not be the same.

The situation won’t improve meaningfully until COVID containment measures are lifted. While the vaccination program is starting to gain traction there is a window of extreme vulnerability as the number of cases and hospitalizations rise. Should the new, more transmissible variant of COVID gain a foothold here then this would increase the threat of more near-term containment measures, which would undoubtedly come at a severe economic cost.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.