Q1 2021

Maclura Investments

Quarterly Report

Clay Brethour, CFA

The Rally of the Left Behinds

The first quarter US stock market performance can best be summed up as the "rally of the left behinds." After years of underperforming the growth sector, the pro-cyclical rally helped elevate the value stocks during the first quarter as growth stocks diverged from value stocks mid-February to finish relatively flat for the quarter. The Morningstar US Market Index was in between the two investment styles, finishing up 6.01% for the quarter (the S&P 500 Index returned 5.77%), while the Morningstar US Value Index was up 12.49% and the Morningstar US Growth Index finished at 0.61%.

Sectors having the most upside during the quarter were those most exposed to a resurgence in the world's economy; such as energy, consumer cyclical, and industrials, with the financial sector rising on hopes of higher interest rates. To put the "rally of the left behinds" into perspective, of the top five performing stocks in each sector for the quarter (excluding utilities and telecommunications), the vast majority of the stocks (93%) have underperformed the S&P 500 for the past five years. When looking at the bottom five performers for the quarter by sectors, and adding energy to the exclusion list (since every stock in the energy sector underperformed the S&P 500 for the past five years), 93% of the stocks had beaten the S&P 500 for the past five years.

	Morningstar Index Market Returns	2015	2016	2017	2018	2019	2020	2021 1Qtr
Growth	U.S. Growth	5.54%	3.16%	29.52%	0.78%	35.90%	44.65%	0.61%
	Large Growth	7.71%	1.79%	31.15%	2.94%	33.81%	38.86%	-0.73%
	Mid Growth	-0.71%	6.46%	25.67%	-3.16%	36.01%	46.17%	-1.62%
	Small Growth	-0.18%	9.61%	23.77%	-5.67%	27.60%	43.52%	-0.42%
Value	U.S. Value	-2.16%	20.79%	14.23%	-7.51%	25.09%	-1.31%	12.49%
	Large Value	-1.43%	18.91%	15.09%	-5.90%	25.70%	-0.62%	10.13%
	Mid Value	-2.57%	25.21%	13.02%	-10.63%	24.81%	-3.76%	17.21%
	Small Value	-8.65%	27.96%	8.40%	-16.61%	19.96%	1.01%	21.41%

Often, investing pundits talk about a reversion to the mean, or a broadening of the market that lifts all stocks, and this past quarter was a great example of that type of market. Regardless of the first quarter leadership change in the market, once the valuation rerating of the "left behind" companies has run its course, in order for those stocks to continue to work, they must show revenue and earnings growth, something that most have failed to do over the past decade with a backdrop of an extremely easy monetary policy fueling the economy. But if Covid has done one thing throughout the world, it has loosened the purse strings of fiscal stimulus everywhere.

While most of us are more aware of the $1.9 trillion relief package recently passed by Congress, the United States isn't alone in trying to jumpstart the economy. To date, there has been $16 trillion in global government aid that has helped sustain companies and consumers during the global Covid lockdowns. Recently, the International Monetary Fund (IMF) upgraded its forecast for 2021 global growth to a record 6%, the fastest expansion for the global economy in IMF records dating back to 1980. As we discussed in our 2021 outlook, this should not surprise anyone. The amount of cash in the system is mind-boggling, and this particular time period will be coined as the greatest experiment of all time because the strength of the economy was particularly strong when the world mandated a shutdown last spring. The health of an economy ebbs and flows naturally, but history will render the final judgement as to if the excessive stimulus was a successful investment or not.

Decades of moving towards a just-in-time inventory management process and the globalization of manufacturing and the supply chain to the most cost-effective geography has been an economic benefit for all, except for when it no longer is. While the closing of the Suez Canal in March due to an accident created a worldwide traffic jam for cargo traveling between the Mediterranean and Indian Ocean, it was just one of the bottlenecks impacting global trade. There is an availability shortage of items from construction materials, semiconductors, transportation containers, and raw materials, that are having an impact on the economy and business's abilities to provide finished goods and render services. This "hiccup" in the global supply chain throughout the world is potentially the greatest risk to the sustainability of the world's unfolding robust economic recovery.

During early February, Ford announced that it would cut production at two US plants where it builds the popular F-150 because of the ongoing shortage of semiconductors, expecting a $2.5 billion hit to its earnings. It's a simple dilemma; if companies can't get necessary products, raw materials, adequate staffing, etc., the ability to generate revenue from manufacturing or providing services is hampered, not only negatively impacting future revenues and earnings but resulting in a negative impact on the economy.

Nonetheless, the global supply network will normalize at some point in the future, but it will take time. There are a number of ways investors can participate in the structure change that is coming for the supply chain. North America stands to benefit significantly from the nearshoring trend of US manufacturers after the finalization of the USMCA trade agreement. The likelihood of a US and China phase 2 trade agreement getting finalized is slim, as well as compliance to the original phase I agreement agreed to in 2019. The announcement by Intel (INTC) in late March to invest $20 billion into two new chipmaking facilities in the U.S. is significant news to help diversify the semiconductor manufacturing away from reliance in Asia. This will benefit a number of companies within client portfolios having semiconductor exposure, such as KLA Corp (KLAC) and Entegris (ENTG).

During the quarter, Kansas City Southern (KSU) and Canadian Pacific (CP) announced a merger that will create the first connected Canada-United States-Mexico railroad system, closing the transaction sometime in 2022. When it comes to U.S. Trade, Mexico and Canada are the largest exporting destinations for U.S. goods and in the top three importing partners. This combination of the two smallest class I railroads will make a powerhouse for transporting goods throughout North America. While China often gets cited as a great region for investment, for all practical purposes, it is still a third world country with significant long-term challenges. At Maclura Investments, we believe that North America is the prime real estate in the world and provides the greatest long-term investment opportunities for investors.

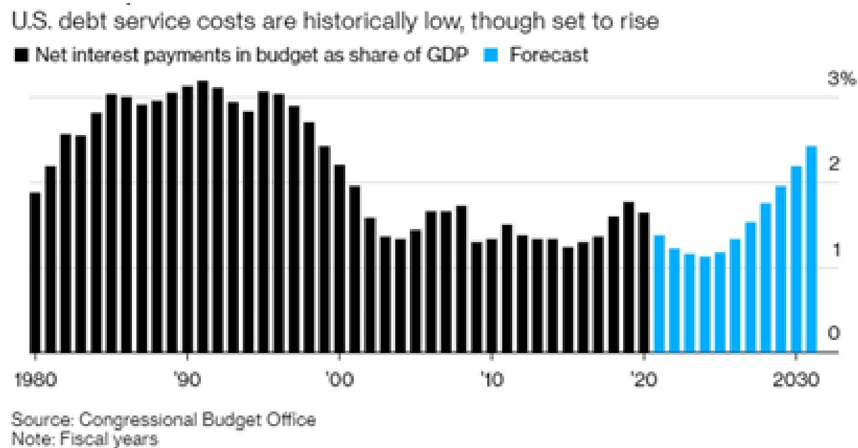
Brick-and-mortar retail and the restaurant industry have had a difficult time adjusting to the new operating norm that Covid brought to the industry. The pandemic quickened the movement of commerce to a more “omni-channel” experience, as consumers are wanting a seamless transaction whether they are shopping online from a mobile device, a laptop or in a brick-and-mortar store. Businesses that want to excel in that environment will need to adjust to the new normal. Lightspeed POS (LSPD) has been aggressively building out its global footprint to be the market leader in complex retailer and restaurant POS (Point of Sale) software. The company focuses on complex retail stores by providing cloud-based solutions to better manage all aspects of the business including procurement from suppliers, inventory management, payment processing, and ecommerce support. The Company is also building a supplier network to increase visibility to the end markets and providing better visibility on what is selling and how the suppliers can increase their manufacturing efficiency, supplying product to the end markets quicker and more efficiently, providing value-added capabilities to all ecosystem participants.

Short supplies are increasing prices of raw materials after years of lack of reinvestment to maintain or improve production. The recent price action on copper is a good example of what is going on throughout the world. In March 2020, the COMEX copper price hit a low of $2.10 but has been increasing since then. It ended the year at $3.50 a pound (67% off its low), and reached $4.30 in February. Cleantech and renewables projects, infrastructure investments, recovering economies, and inflation all play a role in copper prices. Encore Wire (WIRE) is a beneficiary of rising copper prices. The company is the low-cost manufacturer of wiring and is centrally located in the United States in Dallas, Texas. In building custom equity portfolios for clients, it is important to make sure a portfolio has exposure to all areas to ensure adequate diversification. Seldom do all holdings in a portfolio work in concert together, but over the long-term, positioning assets to help offset others as market leadership changes is a prudent endeavor. Encore Wire is a rather unique company with no public comparisons and no debt on its balance sheet. Having worked in Dallas in the 90s, I've been familiar with the company for quite some time and am confident that it is a good investment as an inflationary hedge.

Within the healthcare sector, the most notable news coming out of the quarter was Insulet Corp's (PODD) long-awaited results from the Omnipod 5 pivotal study, and in summary, the data was impressive. Insulet is an insulin drug delivery company that, with its Omnipod 5 offering, is a differentiated platform that is tubeless, disposable, flexible (set point personalization), easy-to-use, and easier to access through the pharmacy with no upfront, out-of-pocket costs or 4-year binding contract requirements of other insulin pump providers. Treatment for individuals with diabetes has changed drastically over the past several years, and Maclura clients have multiple investments providing innovative solutions in this area.

There is much to be excited about as an investor in the market today, but along with the supply chain uncertainty, the second wildcard that could impact the market short-term is rising interest rates. During March, the Federal Reserve Chairman Powell emphasized in his press conference that he thinks any post-Covid increase in inflation will prove "transient," thereby rendering any discussion of future policy tightening premature at the very least. The Fed wants to see substantial progress towards both its inflation and employment goals before beginning to reduce the pace of asset purchases. During the press conference, Chairman Powell repeatedly made the point that the Fed needs to see real progress in the data. He does not believe that the pandemic is over yet, and he thinks that the new variants pose unquantifiable risks. The Federal forecast continues to show no rate hikes through 2023, with seven officials now looking for a rate hike in 2023.

While the Fed will wait for the data to provide the confirmation before it moves the interest rates higher, the market doesn't wait. The market usually anticipates movement before confirmation. For investors relying on fixed income, higher rates would be welcomed, but for those already holding long duration bonds, as rates move higher, the price of the existing bonds moves lower and vice versa. There will come a time to move capital into fixed income for those needing that asset class, but our opinion is that it is premature at this time to do so. With the headlines pointing attention to the massive amounts of fiscal borrowing, most aren't aware that the cost of the U.S. debt continues to drop to historical levels. The government is essentially refinancing debt that it issued years ago when borrowing costs (interest rates) were much higher. The health of the borrowing status of a government entity is the size of the interest payments compared to its share of the economy, the Gross Domestic Production (GDP), or it could be thought of as its taxable revenue source. The Congressional Budget Office (CBO) doesn't anticipate that borrowing costs for the government will increase until after 2025, but those estimates are based on assumptions that the 10-year interest rates only have a modest annual rise. If they rise faster, those expectations will be wrong, and that is what will cause the stock market to exhibit volatility as seen so far this year. As it stands now, this assumption is why the Fed continues to forecast lower rates for longer time versus the market.



In our 2021 outlook at the beginning of the year, we guided to an expectation that the market would return in the double-digits for the year. Two factors will influence the achievability of that outcome: the normalization of the supply-chain and the movement of interest rates, particularly long-term rates. The markets discount six months into the future, so as companies report first quarter financial results over the next several weeks and give future guidance, we would expect a continuation of volatility in the market but a continued upward movement in stock prices over the long term.

Maclura Investments, LLC is a registered investment advisor. Maclura Investments utilizes direct investing to build customized equity portfolios for individuals. For more info, go to MacluraInvestments.com

Disclosure: This material is intended for information purposes only, and does not constitute investment advice, a recommendation or an offer or solicitation to purchase or sell any securities to any person in any jurisdiction. The opinions expressed are as of April 11, 2021, and are subject to change without notice. Investing in equities involves risk and past performance is not indicative of future results.