CROWELL WEEDON ASSET MANAGEMENT
MONTECITO INVESTMENT PORTFOLIOS

2Q 2021

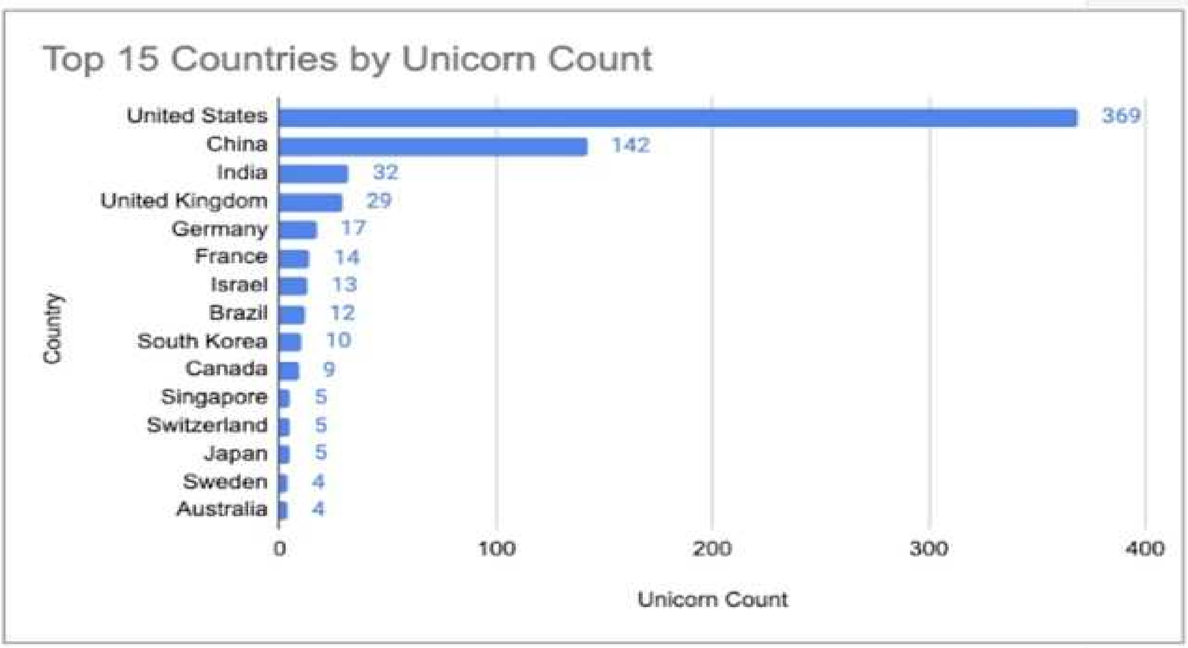
Dear Fellow Investors,

It's hard to believe that we're halfway through 2021. Maybe it's the altering of our daily routines. Perhaps it's simply the fact that we aren't getting any younger - whatever the reason, time seems to be passing faster than ever. In a world obsessed with "now" it's vital to pause every once in a while, reflect on where we've been, and remain steadfast on the long-term.

Please recall our Main Message from this year's annual letter: *Welcome to the Roaring 2.0's*. We predicted a decade similar to the 1920's when innovation flourished and optimism grew - a generational shift, led by a great reset of thought regarding where we work, what is truly important in life, and what we can accomplish going forward. This is not a comparatively minor change to tax rates, health care, or social security benefits. This is far, far more lasting change that will reshape beliefs about the employee-employer relationship, big city life, customer experiences, and our work-life balance as connectivity enables us to be productive from anywhere in the world. This has sparked a renewed sense of optimism that we see growing throughout this decade. We will see old replaced by new, slow replaced by fast, and inefficient replaced by efficient.

As long-term investors that think in years and not months, it's probably not too surprising that 6 months after releasing our long-term outlook, this outlook remains unchanged. We are witnessing a great human reconnection. Even from your living room you can almost feel the energy from the return of fans at sporting events and concerts. Flights are packed, restaurants are booked, and party destinations like Las Vegas are basically fully reopened. Human ingenuity has brought us back together far faster than many had initially feared and for the most part, people are grateful to see a return to normal.

Innovation continues its amazing progress. Perhaps underappreciated or merely unrecognized is just how vibrant our start-up scene is in the United States. This remains the greatest place on Earth to turn your idea into reality. As long as it's legal, there are very few roadblocks to stop you from trying. Heck, we've even made a television show (Shark Tank) about this as it's proven to be rather entertaining. If your idea is good, funding and business guidance are readily available. You are allowed the opportunity to compete. Success is not guaranteed, but if you happen to fail, it's not the end of the world – we have a framework (bankruptcy laws) in place for you to pick yourself up, dust yourself off, and try again. To shine some light on just how well this system continues to thrive even after 245 years of operation, let's take a look at a recent study done by Elad Gil on the number of private companies that have reached Unicorn status (a $1 Billion valuation). As the following graph shows, the U.S. continues its dominance, with not only the highest number of companies, but with the largest, most valuable companies as well. Of the 6 largest companies reaching this status, Space X, Stripe, and Instacart were formed here in the U.S. by founders born in other countries. China, for all of their focus on technological investment, remains a distant second. In our eyes this is proof that some of the greatest minds in the world continue to view the United States as the preferred location to pursue their dreams.



While our Roaring 2.0's outlook remains intact, we would be remiss to not mention the major fear of today – Inflation. While we have indeed witnessed price increases for items such as lumber and copper we do believe a great deal of the initial price spikes were related to supply chain issues and will indeed prove to be "transitory". We warned during COVID lockdowns that the economy is not a light switch. Although somewhat simple to flick off, it cannot be flicked back on with the same ease. It will take some time to rebuild, but we are confident that many of the recent price spikes will settle into long-term equilibrium 6 – 18 months from now (many commodities are already seeing significant declines from recent spikes). Long-term, we will continue to have some significant forces fighting each other. On one side we have massive money supply growth (nearly 20% of all dollars were created in 2020), countries with a renewed appreciation for domestic production, and companies across numerous industries raising wages. All of this would tend to be inflationary. On the other side we have technological innovation allowing us to do far more with far less decimating layers and layers of embedded costs. Rising productivity and technological advancement tends to be deflationary.

When all is said and done, we believe technological innovation will prove to be the dominant force. As referenced in our annual letter, technologies such as autonomous transportation, advanced robotics, and deep learning could prove to be revolutionary. Further, the checks and balances of our political system are working as designed. Initial concerns about dramatic changes to taxes and spending appear to be moderating. Work continues on a bipartisan infrastructure package that is a fraction of initial cost estimates and appears to be gaining momentum. Although $1.2 Trillion may give some sticker shock, the proposed spending will take place over 8 years and involve $579 billion in new spending. The bipartisan proposal was refreshing to see and might signal a thawing of partisan tensions that have gripped our country for some time now. Remember, it's quite easy to get caught up in all of the negative concerns and fears of the day. We've been through difficult times in the past and will experience more in the future. However, focusing on the fears and not appreciating the freedom, choice, creativity, and opportunity for prosperity that the American framework provides, is not the answer. The "American Tailwind" remains alive and well.

FORECASTS

As we're half way through 2021, let's check in on our forecasts for the year**.** Our forecasts from the beginning of the year are in **bold** with current updates in *italics*.

- **Economy: by the end of Q3 the economy will surpass the output of 2019 –** *We're on track for this to happen as the broad reopening is taking place as quickly as we anticipated. We now must rebuild supply chains as demand is outstripping supply.*
- **S&P 500: more index turnover, more growth companies, 4,200 target by year-end –** *Our target price has substantially been achieved. We feel that the appreciation from here will be led by earnings, a continuation of lower-for-longer yields, and further technological disruptions to various industries.*
- **Short-term rates**: **unchanged throughout the year** – *Correct so far. Perhaps first rate hike will be sometime in 2022 or 2023.*
- **Long-term rates**: **slight steepening of the yield curve, 10 year near 1.5% by year-end –** *1.5% has been achieved and we continue to see rates slowly climbing. As we approach 2022 – 2023 and assuming the economy remains strong, we may continue to see the yield curve steepen a bit.*
- **Oil prices**: **range-bound, no longer a core, long-term investment asset –** *Prices hit the upper-end of our range at $70 a barrel. The Biden administration is not going to make new areas of Federal land available for drilling. Production growth should come from the reopening of shut-in wells and continued development of existing resources. Our energy independence could come*

into question if we can't replace declining oil production with alternative energy sources fast enough. Long-term, we believe investors have spoken. On the same day, Exxon, Chevron, and Royal Dutch Shell were dealt blows demanding they do more to reduce greenhouse gas emissions.

- **Inflation**: **remains benign but growth of money supply provides potential fuel –** *As previously discussed, some of the price increases are related to supply chain disruptions we view as transitory. The growth of money supply has increased the potential for financial inflation but if it's not accompanied by faster velocity it might not materialize. For proof that velocity is lacking look no further than some banks asking some corporate clients to either spend their cash on their business or move it elsewhere.*
- **Commercial real estate**: **a continuation of trends we saw for 2020 only further accelerated by COVID** - *The sectors that we believe investors will favor most, remains unchanged. The ability of REITs to raise their dividends on an annual basis will become important in the future to maintain their share prices, as interest rates on alternative investment vehicles potentially rise.*
- **Residential real estate**: **overall gains with low-cost areas outpacing high-cost areas –** *Pent-up demand for houses, a decline in building during COVID, and supply disruptions of building materials has led to a "seller's market" in residential real estate. Data shows people are indeed moving from high-tax, more expensive areas to lower-tax, more affordable areas as remote / hybrid work offerings will remain in place for many.*
- **2021 sees the launch of an autonomous rideshare service -** *Driverless delivery is being tested in several cities with pizza delivery one of the first uses. While widespread rideshare services are just around the corner, this year they may largely be contained to specific geographic locations.*
- **Advancement in healthcare is led by gene editing, mRNA, and AI –** *Obviously, the COVID vaccinations have been evidence of this trend.*
- **Space exploration starts to be seen as a reality for mankind -** *China is manning their own space station, test flights for "tourists" into sub-orbit continue, a flight with Jeff Bezos on his Blue Origin rocket fetched $28 million and is scheduled to take place next month, NASA continues with project Artemis, and Elon Musk and the Space X team continue their quest to get to Mars.*

As always, we welcome your feedback and would love to talk about these and other topics that may be important to you. We thank you for your continued confidence and the opportunity to manage your investments. We take very seriously our responsibility. ***Montecito Investment Portfolio's Mission: To provide diversified, disciplined long term investment solutions, service and guidance to help our clients achieve, and maintain, their "Financial Independence".***

Sincerely,

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