

The Essex Exchange

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Don't Despair the Wall of Worry!

By: Stephen D. Cutler - President and Senior Portfolio Manager

Here we are in 2020 entering a new decade after 10+ years of a bull market. It has not been a particularly smooth ride as the market had to climb that Wall of Worry with some unsettling declines that were actually buying opportunities.

“Wall of Worry”

- The ongoing trade/tariff drama
- Loss of confidence in our Government
- A slower rate of earnings growth
- The growing Federal deficit
- Impeachment implications
- An Immigration solution
- Populism/Growing Inequality
- Is Capitalism Broken?
- Presidential Election Dynamics
- And of course, ongoing geopolitical problems

These worries have only grown over the years and have led to a number of contradictory reports from different respected sources some of whom were voted #1 Economist and #1 Strategist in Wall Street Journal Polls. Most investors when analyzing the stock market search for help in economic surveys and monetary reports to support their stock selections.

Note the following examples:

Positive:

- “Signs US Economy’s bottoming”
- “Global Rebound is already underway”
- “Global slump is ending”
- “Trade and tariff discussions will end positive for U.S. and China and rest of the world”

Negative:

- “Global growth enters synchronized slowdown”
- “Political uncertainty is causing concern”
- “Sluggish 2020 as stimulus loses oomph”

And to Top it Off:

- Is the yield curve a good predictor of recession:

Yes – every recession is preceded by an inverted curve
 No – lead times are variable and some times very long
 Net - Can't rely on it

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The bottom line is that no one can reliably predict the future and these contradictory opinions which are usually short term oriented and subject to frequent changes do not serve the long-term investor well. And even if you knew the economic future it does not mean your stock selection would follow suit. For example, the growth in earnings in 2018 was over 20% yet the stock market was down. And in 2019 the estimate of earnings is up only 7% yet the stock market is up over 20%.

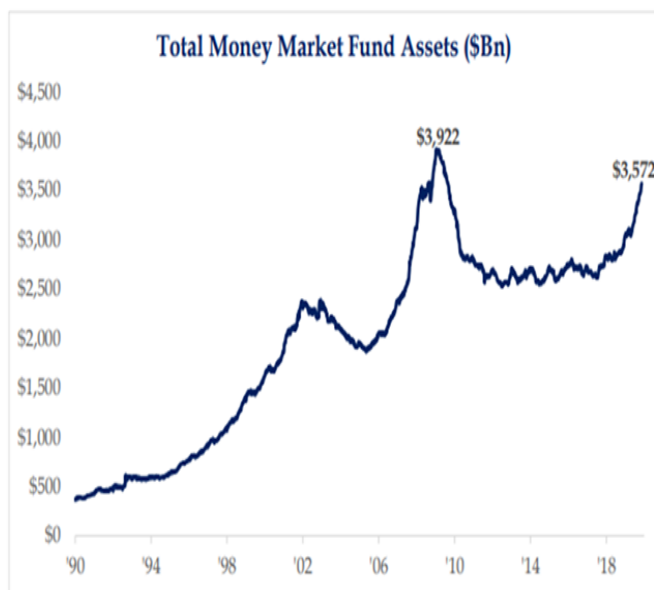
However, despite mixed economic data, the economic recovery, while slower than we thought a few months ago, is not at risk.

Our approach is to not ignore some of conflicting commentary as seen above, but to rely on our historic process of anticipating long term structural change in areas and selecting the best stocks within those areas.

Thematic changes that influence our stock selection:

- Demographics
 - Impact of increased numbers of millennials*
 - Aging population – Health Care*
 - Fewer younger workers – Robotics*
- Deteriorating infrastructure
 - Construction and aggregates*
- New Technology
 - 5 G and Blockchain*
 - Virtual Reality*
 - Gene Therapy*
- Income Inequality
- Market share winners/disruptors
- Climate Change
- Policy Changes
 - Marijuana*
 - Sports Betting*

But the Question People Ask is Where Do We Go from Here?



And despite the rally in the stock market this year there has not been a surge in equity flows chasing the market as seen by the following chart. In fact, Larry Fink from Blackrock, the largest manager of ETF products, said “what we are seeing worldwide are clients just struggling in putting their money to work. We still saw, as an industry and at Blackrock, outflows in equities and this is one of the reasons why I believe the market is getting set up for huge inflows into equities.” Because of that, the amount of money in the money market fund assets have almost reached the peak when the stock market bottomed in 2009!

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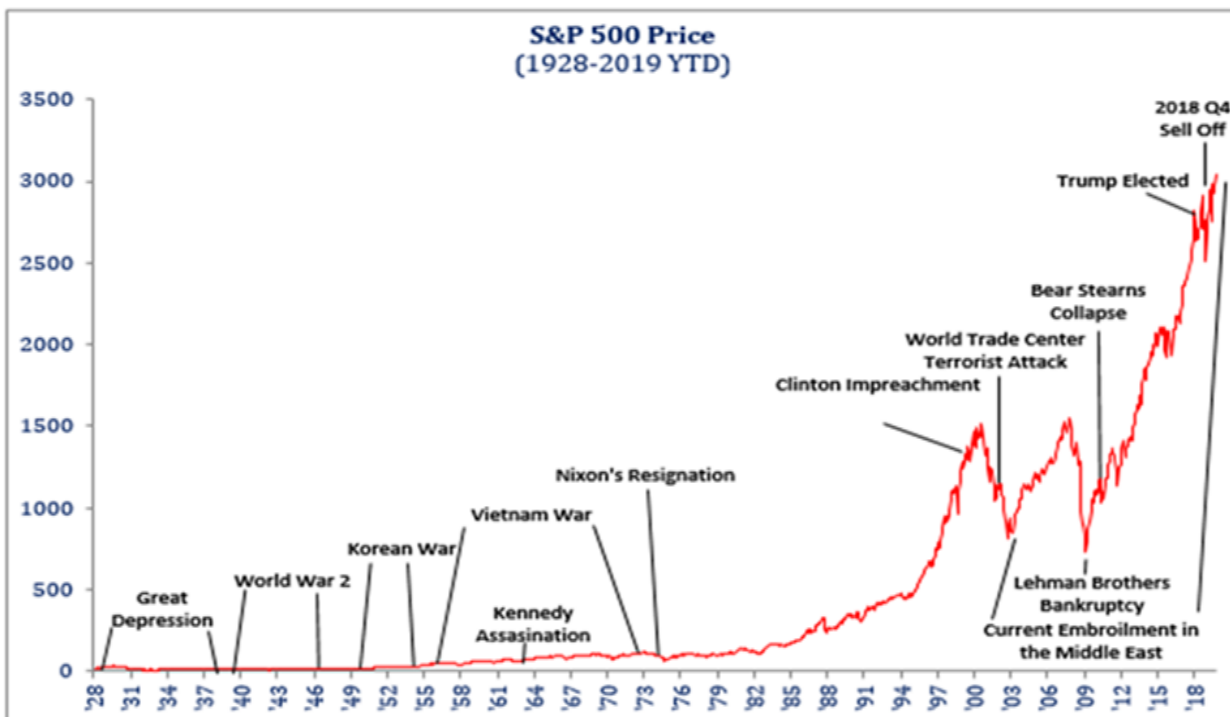
And this view is further supported by Barron's Magazine's Big Money Poll showed just 27% of market pros surveyed were bullish on the prospects for the market over the next 12 months. This was the least optimistic since the data began in 1999. The median return a year after the prior 10 lowest readings was 11.4%.

And this is buttressed by the low level of yields, contributed to by the low inflation number that results in the willingness to pay a higher price to earnings for stocks. This has historically provided a reason to buy equities as "there is no alternative."

While recognizing the "Wall of Worry" concerns we believe there is a cushion to the stock market which lie in the aforementioned comments.

We sometimes forget, given the current domestic political and geopolitical turmoil, the United States and the stock market have survived many crises in the past as noted in the following chart which long term investors should not ignore.

And as we continue to focus on those thematic changes mentioned earlier and the companies that would benefit from those changes, our process should bring positive long term results to our clients.



Source: Essex, December 2019

ESSEX INVESTMENT MANAGEMENT COMPANY, LLC

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Essex Strategies

The Essex Micro Cap Growth, Small Growth and SMID Cap Growth strategies each share a common investment philosophy and process. Our all women Evanston, Illinois investment team is focused exclusively on managing long-only small growth strategies and has worked together for more than 15 years.

Micro Cap Growth Strategy: We look for under-followed, under-owned, under-appreciated companies & industries in early stages of acceleration.

Small Growth Strategy: The process focuses on identifying companies in an inefficient sector of the market at an inflection point where their growth rate is improving.

Small/Mid (SMID) Cap Growth Strategy: Our approach is to execute a systematic, fundamental process to find companies whose future growth prospects are not fully reflected in the price of the stock.

Global Environmental Opportunities Strategy (GEOS) operates at the nexus of environment and finance, investing in companies that enable greater natural resource and energy efficiency. GEOS is a listed-equity, global, all-cap strategy investing across nine environmental technology themes in long-only fashion with about 40 holdings. GEOS is clean technology and energy infrastructure-focused, with companies that exhibit generally-high growth rates.

Essex Research Strategy is co-managed by a team of investment professionals seeking growth equity opportunities across an all-cap universe. By employing fundamental top down economic and sector analysis with bottom-up stock picking skills, the strategy provides the investment team a wide framework in which to identify growth candidates regardless of market capitalization restraint. Individual client portfolios are offered in two profiles: aggressive growth or growth and income.

Essex Evolution Long/Short strategy is an aggressive All-Cap equity strategy that aims to maximize returns by utilizing both fundamental and technical analysis with an emphasis on thematic investing and tactical market positioning. Specifically, we aim to understand key themes within dynamic sectors to capture the growth in those trends and utilize short positions to both hedge portfolio risk and exploit specific stock mispricing's.

Essex Evolution Long Only is an aggressive All-cap strategy which primarily aims to uncover small and mid-sized companies that exhibit the potential for meaningful growth over time. Seeks to maximize returns by utilizing both fundamental and technical analysis with an emphasis on thematic investing and tactical market positioning. The Strategy is concentrated within 40-70 names and is sector agnostic.

Growth Equity is an All-Cap strategy designed to provide investors with exposure to growth companies in a market capitalization range of \$100 million and up. The strategy is a concentrated portfolio of 50-70 companies diversified across domestic industry sectors that show accelerating earnings and sustainable revenue growth. Individual client portfolios are offered in two profiles: aggressive growth or growth and income.

Please refer to our firm's website at www.essexinvest.com for more information about Essex, the strategies we manage and important disclosures.