FALL 2020 | VOL. 28 | NO. 4
QUARTERLY PERSPECTIVE

DVI
DAVID VAUGHAN INVESTMENTS

Will Williams *Chairman, President & CEO*

OPERATING WITHOUT AN "ALL CLEAR" NOTIFICATION

If you have not come to this realization by now, it is becoming quite apparent we are living through a historic time in our nation's economic history. Even though nearly eight months have passed since the first patient in the U.S. was confirmed with the COVID-19 virus, the healthcare crisis that was the primary catalyst for the economic crisis is unfortunately still alive and kicking. It is almost becoming common place for investment analysts to use words such as "unprecedented", "unparalleled", and "extraordinary" as they attempt to describe many of the economic and market related developments since the onset of the COVID-19 pandemic. In the past, we have done our very best to thoughtfully manage through the challenges caused by economic disruptions. It just seems that this time around, everywhere we turn the facts and circumstances appear to be at historic extremes.

Economic Fundamentals

Core Data

- Gross Domestic Product (GDP) through the end of the 2nd Quarter of 2020 declined 9% year-over-year and over 31% quarter-over-quarter. According to the National Bureau of Economic Research, the economic recession technically began in the month of February.
- Twenty-two million jobs were lost in March and April, and we have regained approximately half of those jobs to present date.

Economic Stimulus

- Washington has enacted the largest economic stimulus packages in U.S. history with over $3 trillion in coronavirus aid. The most recent Trump Administration proposal would call for an additional $1.6 trillion in additional relief.
- The Fed's Balance Sheet through quantitative easing has increased by approximately $3 trillion since March.
- Interest Rates have been pushed to all-time lows, with 10-Year U.S. Treasuries trading at .69%. Real (inflation adjusted) interest rates are now in negative territory.

Equity Market Statistics

Rise & Fall

- The market decline from its February high to March Low (-35.41% in 23 trading days) was the fastest bear market decline in history.
- The 50-Day rally from the March Low (+39.6%) was the largest 50-Day Gain in market history.

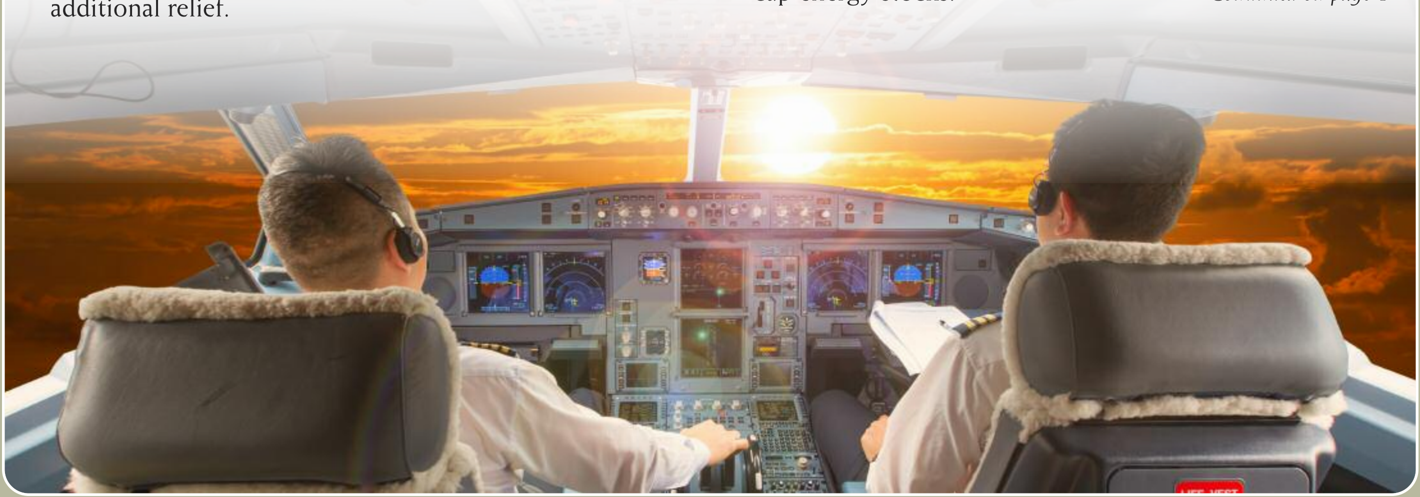
Market Composition

- Just five stocks (Facebook, Apple, Amazon, Alphabet, Microsoft) held in the S&P 500 Index represent 23% of the total index and only ten stocks comprised nearly 30%.
- Of the 434 stocks held in the Russell 1000 Growth Index, a mere five stocks represented 37% of the index and ten stocks represented nearly 50% of the index. This is the highest concentration on record.

Equity Performance

- Despite achieving new highs, as of mid-September over 50% of the stocks held in the S&P 500 Index were trading more than 15% below their 52-week high.
- There was a 42% performance difference between large cap growth stocks and large cap value stocks over the past 12 months.
- At the sector level, there was a 92% performance difference between large cap technology stocks and large cap energy stocks.

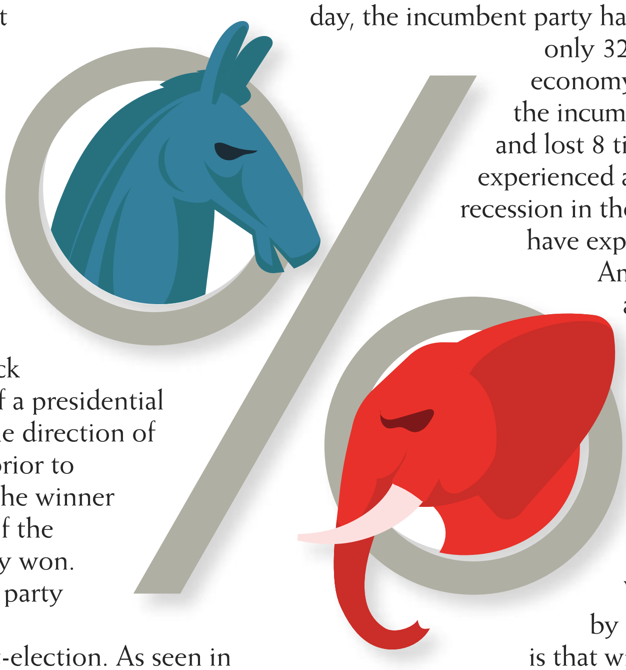
Continued on page 4



Brian Christensen, CFA
Senior Vice President & CIO

ELECTIONS AND MARKETS

2020…Ouch! We are weathering a pandemic, hopefully survived a recession, experienced both a bear market and bull market in very short order, and now we get to witness probably the most contentious election in history. While the long-term consequences of the pandemic will not be known for some time, history gives us guidance as to the impact an election may have on financial markets.

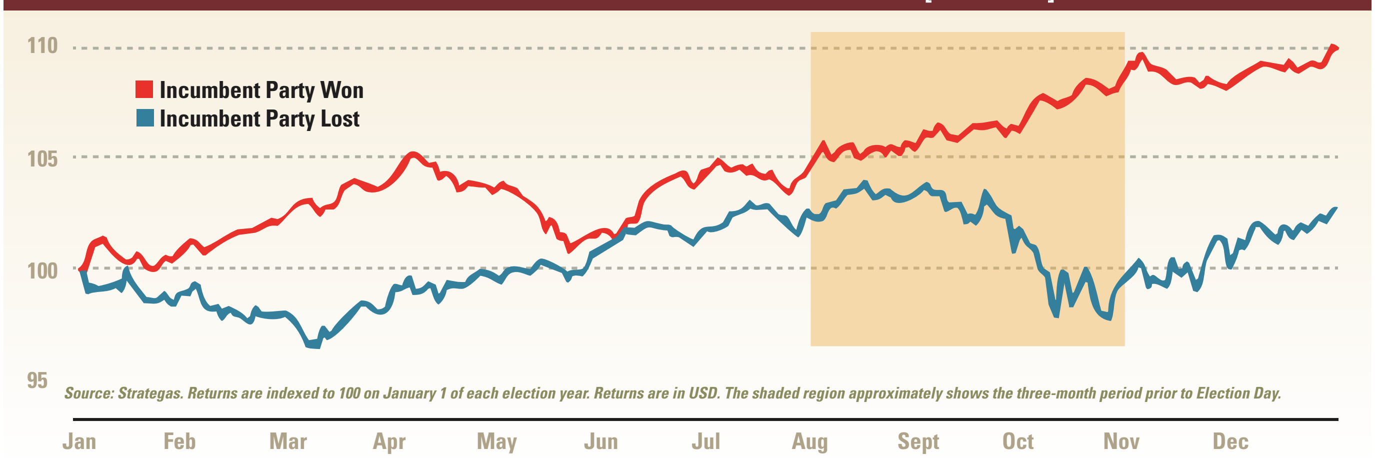


The stock market has a solid track record for predicting the winner of a presidential election. Looking back to 1936, the direction of the S&P 500 in the three months prior to election day has correctly picked the winner in 20 of 23 presidential elections. If the market is up, the incumbent usually won. If markets are down, the opposing party won. Perhaps more interesting, however, is the market's trend post-election. As seen in the following chart, the trend was generally higher regardless the winner.

Presidential election results and recessions have history as well. When the economy is in a recession on election day, the incumbent party has lost 80% of the time, but only 32% of the time when the economy is in expansion. Since 1900, the incumbent party has won 3 times and lost 8 times when either the market experienced a 20% decline or there was a recession in the election year. In 2020, we have experienced both.

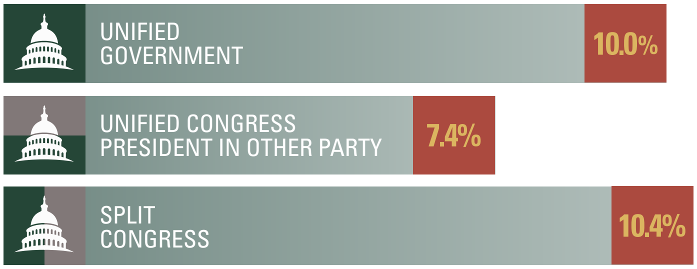
Among the debates as we approach the election, is the probability of a Democratic sweep thereby gaining control of both the White House and Congress. Many believe the stock market prefers gridlock. That is, an environment where Congress and the White House are controlled by competing parties. The logic is that with gridlock the status quo remains, limiting the uncertainty for financial markets. The data suggests otherwise.

S&P 500 AVERAGE RETURNS DURING ELECTION YEARS [1936-2016]



Source: Strategas. Returns are indexed to 100 on January 1 of each election year. Returns are in USD. The shaded region approximately shows the three-month period prior to Election Day.

S&P 500 INDEX AVERAGE ANNUAL RETURN [1933-2019]



As seen in the chart to the left, average annual stock market return was 10% in years where one party controlled the government. This has occurred in 42 years going back to 1933, almost 50% of the time.

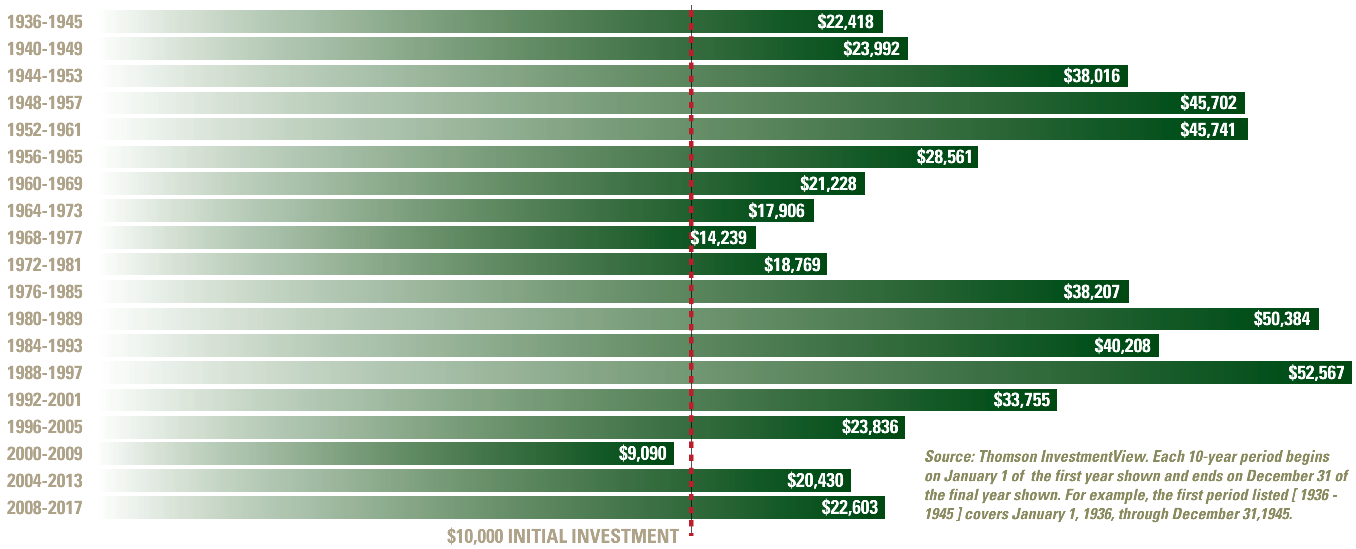
In general, as we head into an election, the best decision for investors has been to maintain portfolios, stay the course and avoid the temptation to time markets. Capital Group analyzed stock performance for 10-year periods beginning with the start of each presidential election year going back to 1936. The results are shown on the top of page 3.

Source: Capital Group, Strategas. As of 12/31/19. Unified government indicates White House, House and Senate are controlled by the same political party. Unified Congress indicates House and Senate are controlled by the same party, but the White House is controlled by a different party. Split Congress indicates House and Senate are controlled by different parties, regardless of the White House control.

CONTINUED FROM PAGE 2

GROWTH OF HYPOTHETICAL $10,000 INVESTMENT MADE AT THE BEGINNING OF AN ELECTION YEAR

S&P 500 total ending value 10 years after the start of the presidential election year



Source: Thomson InvestmentView. Each 10-year period begins on January 1 of the first year shown and ends on December 31 of the final year shown. For example, the first period listed [1936 - 1945] covers January 1, 1936, through December 31,1945.

In only one of the 10-year periods measured, 2000 – 2009, did the S&P 500 lose money. During that decade, we experienced the end of the dot-com bubble and the 2008 global financial collapse.

A pandemic, market volatility, economic uncertainty, social unrest, and an election filled with divisive issues. I cannot imagine an environment that would be more challenging for one's emotions. But, as Big David would frequently remind us, "we're still drinking Diet Coke, pounding on the bottom of Heinz ketchup bottles, and the electricity is still running." As for me, and just as I did at the end of 2008, I suggest we all "Stick to the Plan".

HOW DO THE REPUBLICAN & DEMOCRATIC TAX PLANS DIFFER?

With the presidential election only weeks away, many people are beginning to pay closer attention to each candidate's positions on such issues as the COVID-19 pandemic, health care, the environment and taxes.

Among their many differences, President Donald Trump and former Vice President Joe Biden have widely divergent tax proposals. Their stances could have a major impact on the amount of taxes you'll owe in the future. Here's an overview of each candidate's tax proposals for individuals:

Trump's tax proposals for individuals

The GOP-backed Tax Cuts and Jobs Act (TCJA) was signed into law in December 2017. It included a number of temporary federal tax cuts and breaks for individuals and families for 2018 through 2025. President Trump has indicated support for preserving tax reforms under the TCJA — and possibly providing additional breaks for individuals and families.

The White House budget document for the government's 2021 fiscal year which started on October 1, 2020 indicates support for extending these TCJA individual tax provisions beyond 2025:

- Current federal income tax and estate tax regimes
- Expanded child and dependent tax credits
- Increased standard deduction amounts
- More favorable alternative minimum tax (AMT) rules
- Continued limitations on itemized deductions for home mortgage interest and state and local taxes (SALT)

In August, Trump promised that, if reelected, he'll find a way to forgive federal payroll taxes that were temporarily deferred for certain employees from September 1, 2020, through December 31, 2020 by an executive action issued on August 8. He has also mentioned permanent federal payroll tax cuts, without providing details. And if reelected, Trump is unlikely to sign any legislation that calls for major federal tax increases for individuals.

Biden's tax proposals for individuals

If former Vice President Joe Biden is elected, he has expressed support for major federal tax law changes. The Biden plan would raise the top individual rate on ordinary income and net short-term capital gains back to 39.6%. Biden has also promised not to increase taxes for those who make under $400,000. However, it's unclear whether that limit refers to taxable income, gross income or adjusted gross income — or whether it would apply equally to singles, heads of households and married joint-filing couples.

Other elements of Biden's plan that would affect individual taxpayers include:

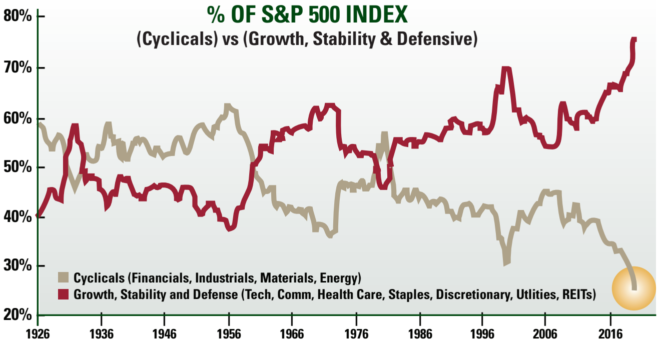
- Limits on itemized deductions

  For upper-income individuals, Biden would reinstate the pre-TCJA rule that reduces total allowable itemized

Continued on page 4

CONTINUED FROM PAGE 1

- Stock categorized as cyclical stocks -- financials, industrials, materials and energy -- are now at a 100-year low as a percentage of the S&P 500 Index market capitalization *(See chart below)*



Source: ClearBridge Investments as of June 30, 2020

With this as the operating backdrop, we want to emphasize a handful of themes that we believe are as important today as ever. Success for DVI is providing our clients a logical path to be able to ride out these tough times and be able to prosper when conditions return to more "normal".

- Now is not the time to become an emotional investor; maintaining a level head today is as important as ever. Do not panic. Reacting to negative news headlines is once again going to be a recipe for disappointing results. Reassess your need for financial liquidity and the appropriateness of your current financial plan. Both practices will lead to greater sleep quotient during these turbulent times.

- We believe it is a fundamental mistake to translate current market trends and behavior as the new normal and the permanent future state. Especially considering the extreme conditions that exist today in the financial markets and the global economy. At DVI, we have always attempted to apply a fact-based approach and a long-term perspective to our investment process. A key component driving our decision-making is the firm belief that markets tend to move from statistical extremes or outliers back to long-term relationship averages. This is called the mean reversion theory. We think it is as logical today as it has been in the past that financial markets tend to shift back towards their long-term established equilibrium.

- Sometimes simply being prepared is the key to success. There is lots of speculation as to what the Tax and Estate Tax regime will look like after the upcoming election. I am not sure anyone really knows for sure. However, scheduling a brief call with your attorney and accountant to determine areas of greatest vulnerability would be both prudent and wise. Beginning to think through an actionable plan might help you avoid the inevitable bottleneck if changes need to be implemented prior to year-end.

I count my blessings during times like this that we have such an abundance of investment experience and expertise participating on the DVI Investment Committee. I recently shared with others that managing money in this environment is like flying an airplane through a storm without fully functioning flight instruments. You do not know that you made it through until you finally break through the clouds and see the welcome sunshine on the other end. And along the way, you are forced to make critical, life-changing decisions based upon past experiences and professional intuition. I eagerly await the "all clear" notification on this economic storm.

CONTINUED FROM PAGE 3

deductions above an applicable income threshold.

- Relief for certain homeowners
  Biden is calling for the elimination of the TCJA's $10,000 cap on itemized SALT deductions. His plan also would create a new refundable tax credit of up to $15,000 for eligible first-time homebuyers that would be collected when a home is purchased, rather than later at tax-return filing time.
- Expanded breaks for eligible families
  Biden's plan includes a refundable federal tax credit of up to half of a family's costs to care for children under the age of 13 and other disabled dependents. He would like the maximum credit to be $8,000 for one qualifying child or $16,000 for two or more qualifying children, with partial credit for household income above $125,000.
- Higher maximum rate on long-term capital gains
  Net long-term gains (and presumably dividends) collected by those with incomes above $1 million would be taxed at the same 39.6% maximum rate that he would apply to ordinary income and net short-term capital gains. With the 3.8% net investment income tax (NIIT) add-on, the maximum effective rate on net long-term gains would be 43.4%.
- Elimination of basis step-up for inherited assets
  Under current law, the federal income tax basis of an inherited capital-gain asset is the stepped up fair market value as of the deceased's date of death. The Biden plan would eliminate this tax-saving provision.

Looking ahead

More details regarding the two candidates' tax plans may be revealed during interviews, ads and debates in the coming weeks. No matter who wins the presidency, we can help you implement planning strategies to keep your tax bill as low as possible.