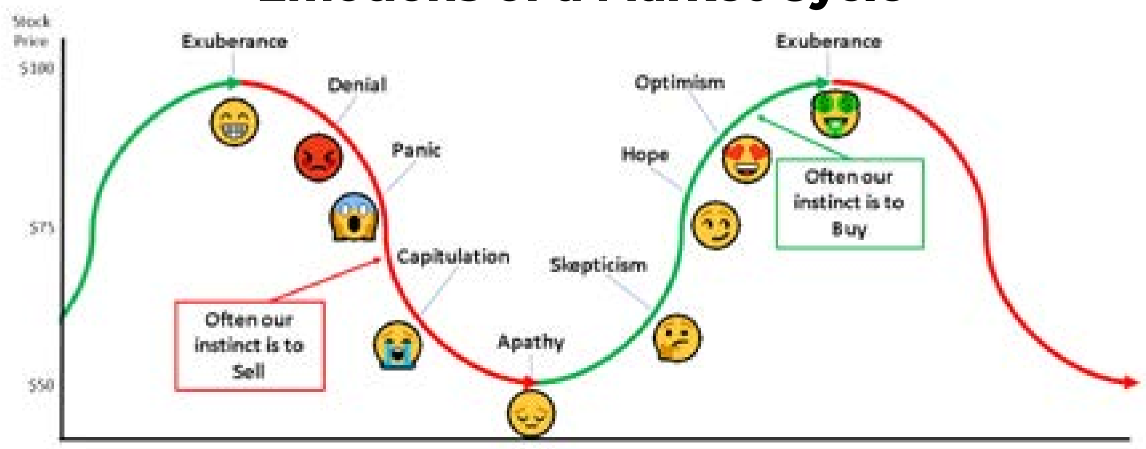
GHP Investment Advisors, Inc.

INVESTMENT INSIGHT

Emotions of a Market Cycle



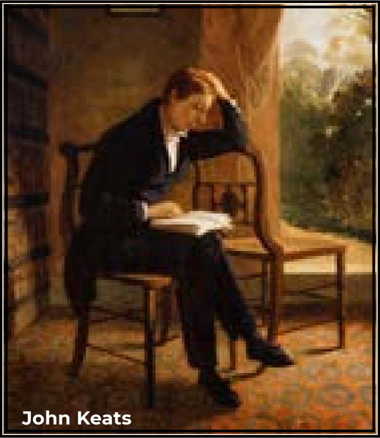
Negative Capability and the Emotions of a Market Cycle

By Mike Sullivan, CFP®, Vice President of Wealth Management

I want to begin our year-end letter by thanking all of you. Like my partners, I am a social person, and social distancing has played on my nerves. Nerves already rattled by the constant health concerns for my family, fires in our high country, racial tensions, and of course, the election cycle. Fortunately, your conversations, laughter, and debate with us throughout this stressful year helped to shorten that distance and ease those nerves.

In a *Wall Street Journal editorial* this November, Lance Morrow recalled the poet John Keats's term of "negative capability." Keats wrote in a letter to his brothers that negative capability "is when a man is capable of being in uncertainties, mysteries, doubts, without any irritable reach after fact and reason." To Morrow, that means "genius has the instinct sometimes to wait, and wait, and wait a little more, and allow the dust to settle, thoughts to mature, and truths to emerge. Hasty certainty tends to be a fool."

As your advisor, we must not only summon negative capability during panicked market selloffs, but also scale back and take profits in growth markets when exuberance and greed may impair our better judgment.


John Keats

Morrow's essay relates negative capability to 2020's political disputes, but it is also relevant to investing. As the year draws to a close, equity markets have recovered from the 35-40% losses encountered in mind-paralyzing speed this March. No one's negative capability went untested as the pandemic arrived. Wracked by countless doubts and uncertainties, even the steadiest investors experienced the full gamut of emotions in such a rapid market cycle.

More Inside...

Quarterly Market Summary: Page 4

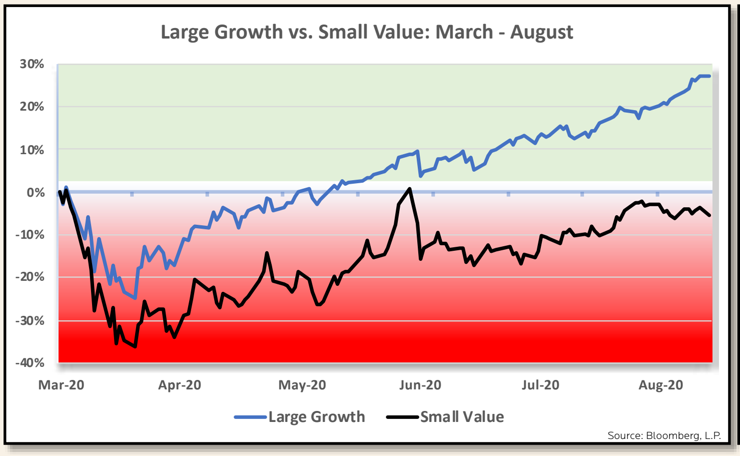
Prevailing over our most human fight-or-flight impulses in such harrowing circumstances requires the use of many tools in the advisory toolbox. Among these are three critical necessities that have been our guidelines this year: **Patience** with diversification, **Protecting** cash flow, and **Processing** information into context. This is my version of the 2020 PPP, so let us unpack each P to further understand how it can help us find strength in negative capability throughout the torrent of emotions in a market cycle.

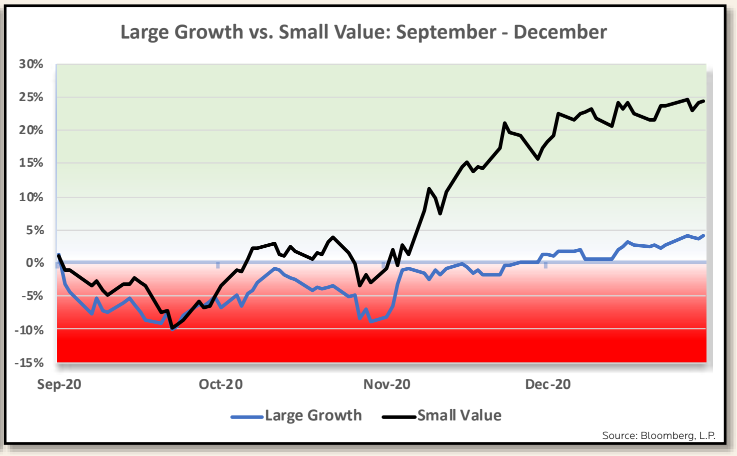
Patience with Diversification –

"Wait a little more and allow the dust to settle."

Yes, I know, we stress the importance of diversification until the cows come home. In Carin Wagner's 2nd Quarter letter, "*Fiscal Fitness: Why Diversification Matters*" she cited the dangerous risks of portfolio concentration in only a few sectors (such as technology stocks), which can be moderated by diversifying across a wide variety of reasonably valued and steadily profitable stock sectors. This year, however, economic lockdowns and social distancing measures allowed tech stocks to flourish while most other stock sectors slid toward oblivion, mightily testing our patience for diversification.

The encouraging vaccine announcements in the 4th quarter have rewarded us for our patience. As reports of the incredibly high rates of vaccine efficacy suggest a potential endgame to the pandemic in the year ahead, economically cyclical stocks have staged a healthy rebound over the past few weeks. For example, the charts below display the significant outperformance of the Large Growth Index (i.e. tech stocks) over the Small Cap Value Index (i.e. small banks, energy, and cyclical stocks) from March to August. Since September, however, Small Value stocks have surged, as opportunistic investors have seized on their far less expensive valuations relative to Large Growth stocks. While we still have a mountain to climb to return to economic normality, these last few months offered a clear example of the benefits of patient diversification





Protecting Cash Flow –

"Be capable of being in uncertainties."

Most of you have engaged in retirement modeling exercises with our financial planning team. During these comprehensive reviews, we gain a firm understanding of your cash flow needs. We seek to accurately quantify how much you will withdraw from your portfolio annually, and we then extrapolate your likely income and spending as closely as possible for the next decade.

In the example provided (see Insert), Keats and his muse Fanny expect to withdraw an average of $80,000 per year from their portfolio. While our portfolio strategies are tailored to each unique client, we generally advise clients to set aside a minimum of five years of their withdrawal needs in safe assets like cash, bank CDs, and short-term bonds. In this case, we advised that John and Fanny target eight years, or $640,000, for these highly conservative investments. The remainder of their portfolio ($1,860,000) is allocated towards growth assets in diversified stocks.

Itemized Cash Flow Projection for All

John Keats and Fanny Brawne

Financial Plan (2020)

Years	2020	2021	2022	2023	2024	2025	2026	2027
Age(s)	65/64	66/65	67/66	68/67	69/68	70/69	71/70	72/71
Cash Inflows								
Social Security								
Social Security Benefits (John)	30,480	31,090	31,711	32,346	32,993	33,652	34,325	35,012
Social Security Benefits (Fanny)	27,720	28,274	28,840	29,417	30,005	30,605	31,217	31,842
Subtotal	**58,200**	**59,364**	**60,551**	**61,762**	**62,998**	**64,258**	**65,543**	**66,854**
Liquidations – Joint GHPIA / Schwab	**76,253**	**78,142**	**80,898**	**83,766**	**86,766**	**89,893**	**74,081**	**72,804**
Total Cash Inflows	**134,453**	**137,506**	**141,449**	**145,529**	**149,763**	**154,151**	**139,624**	**139,657**
Cash Outflows								
Lifestyle Expenses								
Lifestyle Expenses (Joint)	72,000	74,520	77,128	79,828	82,622	85,513	88,506	91,604
Travel (Joint)	20,000	20,700	21,425	22,174	22,950	23,754	24,585	25,446
Gifting to Kids (Joint)	6,000	6,210	6,427	6,652	6,885	7,126	7,376	7,634
Mortgage (Joint)	20,400	20,400	20,400	20,400	20,400	20,400	4,467	0
Subtotal	**118,400**	**121,830**	**125,380**	**129,054**	**132,857**	**136,793**	**124,934**	**124,683**
Misc. Expenses - Charity	**8,000**	**8,280**	**8,570**	**8,870**	**9,180**	**9,501**	**9,834**	**10,178**
Federal & State Taxes	**8,053**	**7,396**	**7,499**	**7,605**	**7,726**	**7,856**	**4,856**	**4,796**
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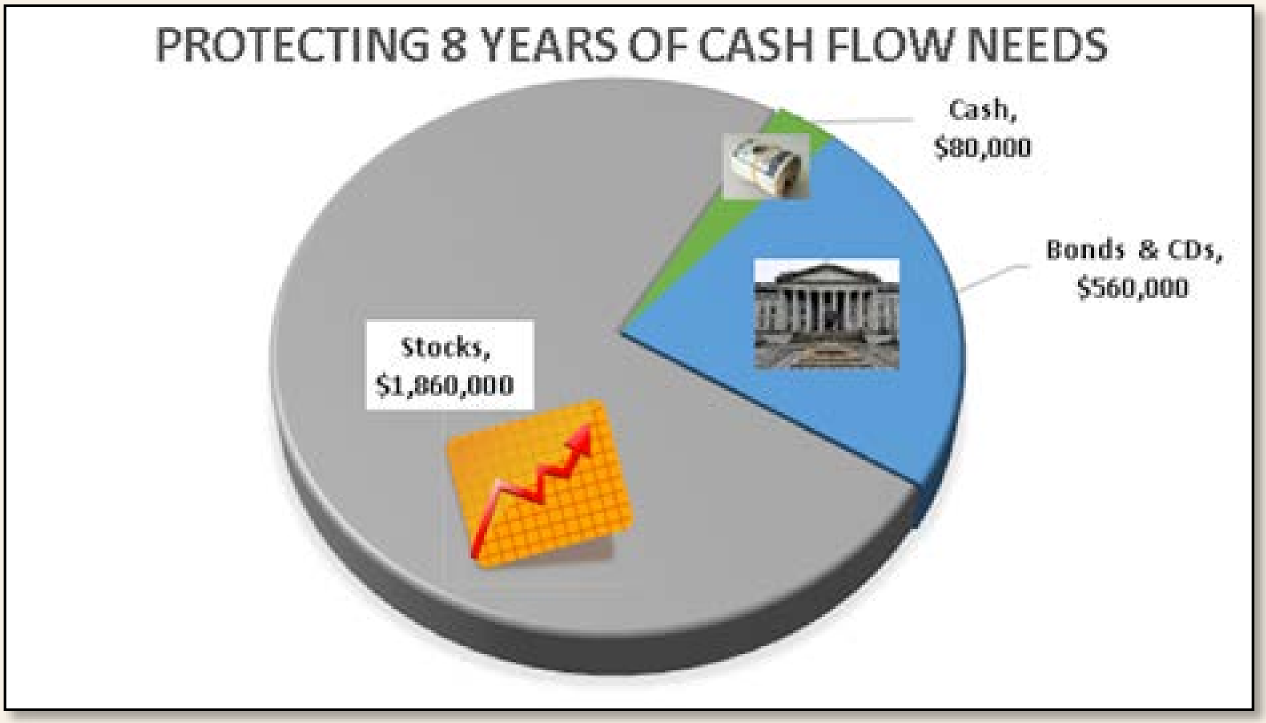

Put to the test in a year like 2020, as the stock portion of the Keatses' portfolio dropped 35-40% this spring, the safe side of the portfolio acted like a shock absorber. This buffer provided the psychological comfort from impulsive panic-selling, which allowed the stock portfolio to recover as this short yet very severe market cycle has played out. While the stock portfolio was only depressed for about eight months, the strategic design of this allocation protects cash flow for up to eight years.

Processing Information into Context –

"Have the instinct to let thoughts mature and truths emerge."

As we adjust to the Information Age, many of us are overwhelmed with the deluge of data and communication bombarding us daily. In a fast-moving and horrific year like this, it often feels impossible to make sense of the chaos. As your wealth advisors, one of the essential value propositions we extend is assisting in how to filter all this information and focus on context, on the bigger picture.

For example:

- Presidential elections trigger emotion and debate, but they do not exert significant influence on the success or failure of your stock portfolio over the long term.
- Electric and autonomous car technology is fascinating, but some opportunities in this space have been so hyped that investors piling in now face greater risk of disastrous outcomes.
- Unprecedented levels of fiscal and monetary stimulus in the U.S. and abroad have vastly increased the money supply, but that does not portend runaway inflation levels in the near term.
- The pandemic is tragic, and the ensuing recession has been brutal, but not every economic or health disaster precipitates long-term collapse for stocks.

During the GHPIA staff's regular Squawk Box and Investment Committee meetings (which in 2020 have moved to Zoom), we hold internal debates concerning these and other financial and economic trends. Our process establishes debate teams, and challenging our colleagues' assertions is encouraged. As analysts and advisors, we are constantly seeking to synthesize context from the minutia of data gleaned from our research so we can provide you with straightforward, considered, and actionable advice.

A Promising Conclusion to a Difficult Year –

"See how necessary a world of pains and troubles is to school an intelligence and make it a soul." – John Keats

I once saw Rodney Dangerfield in Las Vegas with my parents, and when he flubbed one of his jokes, he deftly recovered by stating, "I've gotta lotta bleeping jokes." We likewise have a lot of bleeping tools to keep your wealth goals on track despite the occasional portfolio flub or market setback. We employ a variety of safeguards beyond these highlighted PPP principles to allow our long-term portfolio management to withstand the punches taken in a bruising market cycle like 2020 and still be in the ring when investments begin to recover and flourish. As your advisor, we must not only summon negative capability during panicked market selloffs, but also scale back and take profits in growth markets when exuberance and greed may impair our better judgment. Excessive pessimism and unbridled optimism may be equally costly.

We appreciate your patience and fortitude throughout the nausea-inducing market cycle this year. As we embark on 2021 with uplifting news regarding initial vaccine efficacy, we wish you good health and prosperity, and we hope to be visiting with you in person again someday soon.

Market Summary

The GHPIA Equity Valuation Dashboard

Asset Class	Price/Earnings 2020:Q4	P/E Benchmark	Over/Under Valuation	Price/Book Value 2020:Q4	P/BV Benchmark	Over/Under Valuation	Price/Cash Flow 2020:Q4	P/CF Benchmark	Over/Under Valuation
Large-Cap Growth Stocks	38.3	27.0	41.7%	10.2	5.7	79.8%	24.3	17.5	39.0%
Large-Cap Value Stocks	24.0	20.2	18.9%	2.5	2.5	0.0%	11.8	13.1	-10.2%
Mid-Cap Growth Stocks	40.0	24.8	61.2%	4.6	4.5	2.0%	17.5	16.1	8.9%
Mid-Cap Value Stocks	26.3	19.1	37.5%	1.7	2.2	-21.6%	8.0	12.4	-35.1%
Small-Cap Growth Stocks	46.0	23.2	98.2%	3.6	3.5	3.2%	13.7	15.0	-9.0%
Small-Cap Value Stocks	82.9	18.2	355.6%	1.4	2.1	-32.1%	7.3	11.8	-37.7%

GHP Investment Advisors, Inc. benchmarks are based on proprietary models. P/E, P/BV and P/CF data are provided by Bloomberg L.P. as of 12/31/2020.

Returns by Index

Index	2020:Q4	YTD
DJIA Total Return*	10.73%	9.72%
S&P 500 Total Return*	12.15%	18.40%
S&P 500/Growth	10.40%	31.99%
S&P 500/Value	13.74%	-1.45%
S&P MidCap 400/Growth	20.79%	21.49%
S&P MidCap 400/Value	28.00%	1.30%
S&P SmallCap 600/Growth	29.49%	18.28%
S&P SmallCap 600/Value	32.33%	0.44%
MSCI EAFE	15.75%	5.43%

Source: Bloomberg L.P. as of 12/31/2020.
*Dividends reinvested.

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