NELSON CAPITAL

Quarterly Commentary

2021 | Q1

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Reopening Drives Valuations Higher

The lofty valuations we noted at the end of 2020 pushed even higher through the first quarter of this year, rising above the dot-com era valuations of 1999. Pockets of frothiness are still evident in some places such as the cryptocurrency market, the IPO market, and in so-called “meme stocks” like GameStop, which gained attention at the end of January. But overall market valuations appear to be based on this year’s anticipated reopening of the economy, along with the expected pent-up demand from consumers later this year as the vaccine rollout gains steam. President Biden has asked states to make all adults eligible for vaccination by May 1. As of this writing, CDC data show more than 121 million doses have already been administered, and roughly one in six American adults has been fully vaccinated.

Although the labor market has not yet recovered—the U.S. is still down almost 10 million jobs since the pandemic started—the expectation is that these jobs will return quickly upon reopening. The initial release of the first quarter Gross Domestic Product (GDP) data will occur on April 29 and is projected to be 4.7% quarter-over-quarter. Some economists are predicting that 2021 could usher in the highest U.S. GDP growth that we have seen since 1984.

Furthermore, the unprecedented fiscal and monetary stimulus that was injected into the system has increased U.S. money supply by 25%, the largest year-over-year growth on record. This begs the question: Will we see inflation rise? Although the latest Consumer Price Index (CPI) inflation data was underwhelming, we are seeing pressures build. Prices of raw materials (particularly lumber, steel, and copper) have risen substantially as the pandemic drove an unexpected wave of demand. When the pandemic first hit, many

Index Performance	Q1 '21	YTD
Dow Jones Industrials	8.29%	8.29%
Standard & Poor’s 500	6.17%	6.17%
EAFE (international stocks)	3.61%	3.61%
Russell 2000 (small stocks)	12.69%	12.69%
Barclays Interm. Gov/Credit	-1.83%	-1.83%
Barclays Municipal	-0.33%	-0.33%

We apply rigorous analysis in asset selection so you can focus on your passion

ECONOMIC OVERVIEW

Reopening Drives Valuations Higher (cont.)

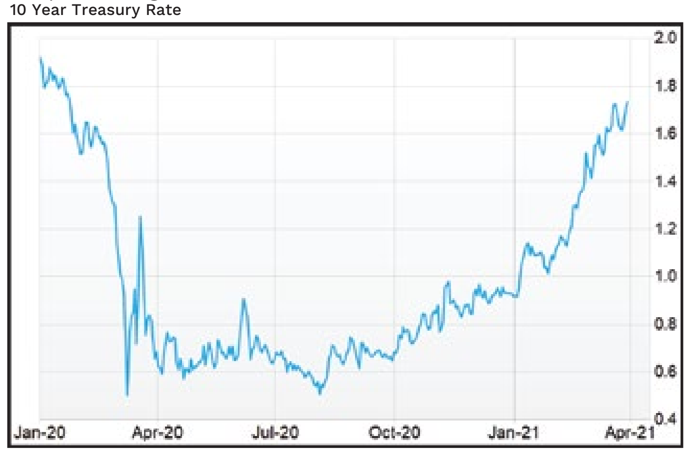
alongside increased demand, particularly as most supply has not come back online, with many rigs remaining idle. On recent earnings calls, CFOs have discussed using price increases to pass higher input costs on to consumers.

Moreover, we could see even more fiscal stimulus down the road. With its most recent $1.9 trillion coronavirus stimulus package passed, the Biden administration has turned its focus to infrastructure. Democrats passed the latest coronavirus stimulus through reconciliation, gaining no Republican support. Given the wide range of disagreement on size, scope, and funding source of a new infrastructure bill, it seems improbable that the two sides will reach a bipartisan agreement. The administration has mentioned possible corporate and wealthy individual tax increases, although it is difficult to imagine tax increases being passed while the economy is still recovering. Democrats also still need to contend with a razor-thin majority in Congress and some moderate-leaning members of the party.

Meanwhile, the yield on the 10-year U.S. Treasury has increased swiftly, from 0.93% at the beginning of the year to 1.75%. Some have pointed to this as a sign of elevated inflation expectations, while others have said this reflects growing confidence in the U.S. economic outlook, but the Federal Reserve has downplayed concerns, indicating that it does not plan to hike interest rates or ease its bond-buying program any time soon. In any case, increasing yields have shuffled the equity market and created new leaders. Growth and momentum stocks, such as Apple (tkr: AAPL), Netflix (tkr: NFLX), and Amazon (tkr: AMZN) which have outperformed dramatically over the past decade, have lagged so far in 2021. The best performing sectors year-to-date are financials and energy stocks, both considered value sectors that have trailed the broader market over the past several years and performed particularly poorly in 2020.

Looking ahead, we are evaluating our portfolio exposure across several themes: international (developed and emerging) vs. domestic, growth vs. value, large-cap vs. small-cap. The recent reshuffling of market leaders reminds us of the importance of having a diversified strategy and balanced exposure to a variety of sectors, regions, and styles. We think inflation fears will play a major role, even if we do not see actual inflation in the near term. We remain skeptical of growth and momentum valuations, which could be further challenged if rates really take off.

10 Year Treasury Rate



Source: YCharts

ASSET TRANSACTIONS

A Bustling Beginning

Nelson Capital stayed busy in the first quarter, making several adjustments within our core portfolio. In the communication services sector, we sold AT&T (tkr: T). Over the years, AT&T has made several poor acquisitions, especially in the content realm, leaving the company saddled with debt and unable to change directions. We further diversified our communication services sector by replacing AT&T with Comcast Corp (tkr: CMCSA), a media giant. Comcast is the largest cable provider in the U.S. and is the dominant Internet access provider in the markets it serves. Though Comcast will likely see further declines in cable subscriptions due to ongoing cord-cutting, it should be able to offset that lost revenue by growing Internet access customers and instituting higher pricing. The pandemic has increased the importance of a fast Internet connection, with more content streaming to homes at increasingly higher quality. Comcast made significant upgrades early on, allowing it to quickly deploy new technology and increase speeds to meet the evolving needs of its customers.

In the materials sector, we bought Danimer Scientific (tkr: DNMR), a next-generation bioplastics company offering completely biodegradable plastics that break down in virtually any environment. (See Featured Equity: Danimer Scientific).

We made another swap in the industrials sector, selling our position in Stericycle (tkr: SRCL) and replacing it with Xylem (tkr: XYL). Stericycle's medical waste business was not performing well in the middle of a pandemic, partly because people have put off routine care and elective procedures. Additionally, disruptive new competition emerged with the development of in-office appliances that heat up medical waste using high temperatures that kill pathogens and shred sharps. The remains can be disposed of in regular trash after treatment. Lastly, despite a new management team and the offloading of lagging businesses, Stericycle's performance still underwhelmed and we decided to seek better opportunities within the industrials sector. Xylem is one of the leading water technology companies in the world, with about half of its revenues derived from outside the U.S. Its portfolio spans a wide range of equipment and solutions for the water industry, including the transport, treatment, testing and efficient use of water for public utilities as well as industrial, commercial, and residential customers.

In the energy sector, we bought a position in Chevron (tkr: CVX). As interest rates have increased, we have witnessed a rotation out of growth and momentum stocks and into value stocks. We think this trend could continue, which would be advantageous for Chevron. Additionally, we anticipate an uptick in oil and gas demand as more people get vaccinated and air travel picks up. Higher oil prices coupled with increased demand should lead to better earnings results for Chevron, which will enable it to support (or perhaps grow) its large 5% dividend.

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FIRM UPDATES

As the broad vaccine rollout continues, the team at Nelson Capital is making progress internally, with nearly half of our employees fully vaccinated and the rest expected to be vaccinated by the end of May.

FIXED INCOME

Is Inflation on the Horizon?

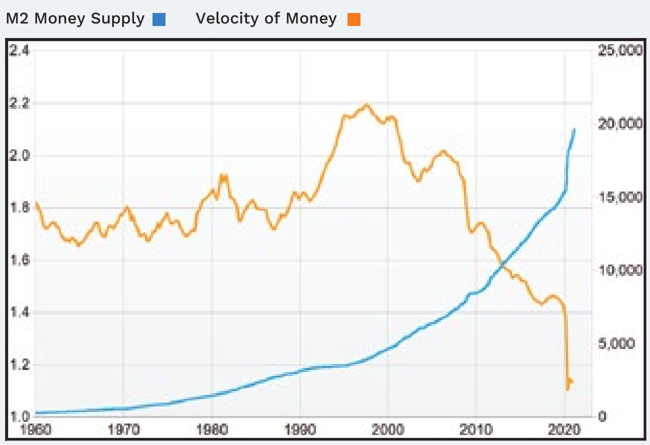
In response to the pandemic, the U.S. government provided massive amounts of fiscal stimulus. Beginning with the CARES Act passed in 2020, and followed by the more recent $1.9 trillion American Rescue Plan Act of 2021, the total amount of stimulus passed in the last 12 months stands at about $5.3 trillion or nearly 25% of GDP. Attention has now turned toward yet another stimulus package (aimed at supporting infrastructure) that could be worth $3 trillion. Taken together, this wave of stimulus has sparked concerns that the U.S. could be on the path toward high inflation. As the economy opens back up and consumers are eager to spend, we could be facing a scenario where too many dollars are chasing too few goods and services. History has shown that inflation can have a significant impact on stocks and bonds, but predicting it is very difficult.

Fears of inflation have gone unrealized for years. Despite the large stimulus programs launched in response to the financial crisis in 2008-2009, over the last decade, the U.S. has seen slow economic growth and inflation below the Federal Reserve's target level of 2%. Inflation has not been a real problem since the 1970s when easy monetary policy, energy shortages and government price controls led to double-digit inflation.

Is this time different?

Since February 2020, the quantity of money in the U.S. economy, measured by M2 Money Supply, has increased by $4 trillion or 25%. This is the largest increase since the 1940s when the government was forced to print money to fund its WWII efforts.

Although money supply has increased, the velocity of money has dropped at almost an equally staggering rate. The velocity of money is defined as the rate at which money is exchanged in the economy. During inflationary periods, velocity generally rises as consumers spend more rapidly in anticipation that future prices will be higher, and today's dollars will lose value tomorrow. In the decade since the financial crisis, the velocity of money has slowed as regulations have forced banks to hold more cash and consumers have been staying home and saving money.



Source: FactSet

An increase in money supply alone will not cause inflation. Money creation must stimulate lending and spending for prices to be pushed higher. We compared the current U.S. money supply increase to German money supply levels during the 1920s when the country experienced hyperinflation. We are orders of magnitude away from the increase in German money supply levels post-WWI.

We believe that the record drop in the velocity of money supports the view that surging money supply will not lead to rising prices in the short-term. Significant slack in the economy with high unemployment and advances in technology lead us to believe that it will take time before inflation picks up.

FEATURED EQUITY

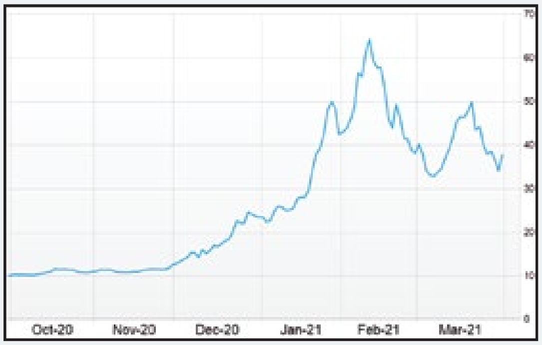
Danimer Scientific

While essential to modern life, plastic products are an ongoing environmental concern due to their longevity and therefore the pollution that results. Despite nationwide efforts to recycle plastics, only 8.5% of plastics waste in the U.S. is being recycled, according to a study by the U.S. Environmental Protection Agency.

Danimer Scientific (tkr: DNMR) has developed a method to make plastic products that are 100% biodegradable and compostable without compromising on functionality. The company sells its PHA-based plastics under the brand name Nodax and is currently the only viable commercial-scale offering.

Danimer uses canola oil to create 100% biodegradable and compostable biopolymer, PHA, through a completely waste-free process. PHA biodegrades in both anaerobic (without oxygen) and aerobic (with oxygen) environments, and unlike other biodegradable plastics, it does not need heat, moisture, or an industrial composting plant to break down. PHA-based plastics can effectively biodegrade in a waste treatment facility, the ocean, or even in home compost piles within 12-18 weeks after the product is discarded.

Danimer Scientific



Source: FactSet

PHA plastics are versatile, adaptable and heat- and UV-resistant. They have been FDA approved for food contact and are comparable in functionality to many products produced using petrochemicals. The formula can be customized to create many types of plastic resins for a multitude of purposes. The range of applications for products made with PHA is enormous and includes straws, cups, lids, bottles, produce bags, shopping bags, utensils, diaper linings, plates, wipes, toys, trash bags, seals, labels, glues and much more.

With an impressive customer base, including PepsiCo, WinCup, Walmart and Nestle, and several strategic partnerships with other well-known companies, Danimer's Nodax could soon become a staple for consumer-packaged goods. Danimer is working with PepsiCo to design, develop, manufacture, and evaluate PHA-based resins for individual layers suitable for flexible food packaging. Nestle and Danimer are developing a biodegradable water bottle for Nestle's PureLife brand. Bacardi teamed up with Danimer to create biodegradable spirits bottles which should fully degrade within 18 months. Most recently, Mars Wrigley, the snack giant, announced a two-year partnership with Danimer Scientific to advance home compostable packaging. Mars Wrigley said it will soon introduce Skittles candy packaged in Danimer's Nodax material in U.S. stores.

Danimer went public in late 2020 via Special Purpose Acquisition Company (SPAC). As a newly public company, Danimer's stock price tends to be rather volatile, but we bought a small position for the long-term opportunities it offers. Demand for PHA plastics is likely to accelerate over the next several years as corporations and the public become increasingly concerned about the environmental impact of wrappers from consumer-packaged goods. More government regulation of single-use plastics has pressured large corporations to adapt. Additionally, the Biden administration has a strong emphasis on climate change and sustainability which will provide a near- to mid-term tailwind for Danimer. As the leading PHA innovator with over 125 patents across 20 countries, Danimer is well-positioned to benefit from these trends.

(The preceding information regarding the featured equity should not be construed as a recommendation to purchase the security. It should not be assumed that future returns will be profitable or will equal the historical performance. Please contact us for a complete list of holdings.)

TOP 15 HOLDINGS

- AMAZON.COM INC.
- MICROSOFT CORP.
- VANGUARD DEVELOPED MARKET ETF
- ISHARES S&P SMALL-CAP ETF
- ALPHABET INC.
- APPLE INC.
- WALT DISNEY CO.
- COSTCO WHOLESALE CORP.
- FIRST REPUBLIC BANK
- TRANE TECHNOLOGIES
- ILLUMINA INC.
- HOME DEPOT INC.
- LINDE PLC
- MEDTRONIC PLC
- QUALCOMM INC.

OUR TEAM

Brooks Nelson, CFA
Steve Philpott, CFP®, MBA
Ann Oglesby, MD, MBA
Darcy Nelson Smoot, CFA
Evan Nelson, CFP®
Erin Rodriguez
Chrissy Domingo
Marissa Wisniewski
Tiffany Young

SPECIAL TOPIC:

Life After the Pandemic

The anniversary of the advent of the pandemic has caused Nelson Capital to reflect on the challenges and changes we have endured in the last year. The loss of life has been catastrophic with over 2.6 million (and counting) recorded deaths. The emotional and physical toll on healthcare and essential workers has been palpable. The jolt to our economy resulted in record unemployment rates and unprecedented volatility in capital markets. We are social creatures that have been denied the ability to see friends, family, and loved ones for over a year, in many cases missing or postponing the celebration of important milestones.

Despite these hardships, there are silver linings. We were able to successfully transition to remote work and keep our employees healthy while maintaining a high level of service and productivity. Today's technology has enabled us to communicate and collaborate remotely in ways which were not possible decades ago. We feel fortunate that we can stay in touch with our clients with Zoom meetings and share ideas through video presentation updates. But one year in, it is abundantly clear that Zoom fatigue is real. What started as a fun way to do virtual happy hours with friends has morphed into an all-consuming schedule of video calls. Furthermore, the grid of webcam squares does not compare to the natural setting of an in-person meeting, and it has even created anxiety for some. We prefer the visceral experience of a face-to-face meeting with our clients and cannot wait until we can travel and share a meal again.

With the weather beginning to warm and promises that a vaccine will be available for any willing adult by May, we are hopeful this will be sooner rather than later. However, virus variants bring the chilling realization that COVID-19 may never fully go away and there may be some fundamental changes to our behaviors for the foreseeable future. How long will it be before we are comfortable hugging a loved one outside our bubble? Or shaking a stranger's hand? If we are just as productive working from home, then do we need to be in the office 40 hours a week?

Some companies have proclaimed the death of the office and are allowing employees to work from home indefinitely. We have proven tools exist to make this possible, however, this severely discounts the benefits of in-person communication and apprenticeship. We envision a hybrid approach with collaborative workspaces and areas to host client meetings, integrated with a more flexible work schedule that allows employees to have a proper work-life balance and focus on emotional wellbeing. Until this time comes, we remind you to not let your guard down and stay safe in the final stretch. The light at the end of the tunnel is brightening.

NELSON CAPITAL

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