Pinney & Scofield

Building long-term relationships with long-term investors

April 15, 2021

Dear Client,

The markets reward long-term investors – this is a phrase we have stated many times over the years. It was not easy to stay the course when the markets were collapsing a year ago, but you will see the payoff when you look at your enclosed reports. Think of these results as Exhibit A of the benefits of staying invested with a long-term, disciplined process.

One year ago today, in our April 2020 quarterly letter, we referenced a quote from investor Shelby Davis – "You make most of your money in a bear market, you just don't realize it at the time." Your reports show how a disciplined investment process validates this statement so let's look at the data.

The S&P 500 fell over 30% in the first quarter of 2020 ending a 10-year bull market. Since then, it is up 56.35%. Sound good? Then you will love this: the Russell 2000 and Russell 2000 Value, which both track small US companies, returned 94.85% and 97.05% respectively! The EAFE Small Cap and EAFE Emerging Markets indices, which measure international small cap stocks and emerging markets stocks, returned 61.98% and 58.39% respectively also besting the S&P for the twelve-month period. Twelve-month returns have not been this strong since the financial crisis recovery in 2010.

We include these asset classes in our diversified approach so you captured these phenomenal returns. While we do not recall anyone predicting these results in March and April of 2020, that was when we were buying within our disciplined rebalancing process which calls for action when asset classes fluctuate outside parameters. Many investors who let emotions take over their decision making were not so fortunate.

Maintaining a long-term investment strategy during times like the past year is not easy. Short periods like the first quarter of 2020 are not signals of future performance, but reminders of just how hard being a long-term investor can be. No one knew we would have such a strong bull market, but we did know we had to stay invested to capture the returns when they eventually showed up. It just turns out the recovery was much sooner and quicker than anyone expected.

The lesson is twofold. Not only do you need to stay invested, but you also need to stay disciplined in what you invest in and not chase returns. Your portfolio has exposure to both growth and value stocks. Over the last decade, growth stocks, fueled by a handful of high-flying tech stocks, as we've discussed a few times in recent letters, have outperformed value stocks by a good margin, particularly through the first half of 2020. We have not seen growth beat value by this much and for this long since the dot-com era. However, as we discussed in our last letter, starting in the second half of 2020 the tide has changed, at least in the short term, with value outperforming growth since June 30, 2020

22 Hilliard Street, Cambridge, MA 02138 • (617) 492-6223 • Fax (617) 492-8025 • www.pinneyandscofield.com

by 36.57% (Russell 1000 Value) to 27.30% (Russell 1000 Growth). Historical data shows that the value asset class does better than growth over the long-term, but its strong performance is sporadic. We will need to wait to see if value continues to make up ground on growth in this upward market.

No one can predict the future so we don't know if this trend will continue amidst competing data points. On one side, strong markets show no signs of slowing down as Congress has passed stimulus bills pouring over $5 trillion into the economy and the Federal Reserve continues to hold interest rates at historic lows. Simultaneously, the number of vaccinations is rising rapidly bringing the economy closer to reopening. Add on that Biden is trying to pass a $2.25 trillion infrastructure plan and all the cash floating around has many predicting a booming market could continue for the next few years. However, on the other side, potential changes in tax policy and the nascent rise in inflation measures adds uncertainty to the mix.

What we've seen recently, though, is that optimism is prevailing in the markets causing many to experience FOMO – Fear Of Missing Out. There was a record-breaking number of new investment brokerage accounts opened in 2020. Young, inexperienced market participants with cash from the stimulus checks in their pocket, unable to spend and earning next to zero in interest at the bank, looked at the rising markets and jumped in. The amount of day trading is nearing what we saw in the late 1990's. We all saw what impact this had on dramatic plays like GameStop.

Which begs the question, how does market FOMO impact your portfolio? In the case of GameStop, Dimensional Fund Advisors (DFA), who manages many of the funds we use, held $60M worth of GameStop shares in their small company funds at the beginning of 2021. When the price skyrocketed as it was being gamed, the stock no longer fit the profile of a small company so DFA sold all their shares netting roughly $1 billion. Not a bad profit. The benefit of DFA's discipline was passed directly on to you because this helped their small company fund outperform the index over the last twelve months and highlights the benefits of their flexibility. An index fund is required to hold on for as long as a stock is part of the index so where DFA could capitalize, a pure index fund could not.

Speaking of DFA, there are two developments on the horizon that will impact you. First, they began the process to convert six of their tax-advantaged mutual funds to Exchange Traded Funds (ETFs). These funds attempt to minimize incurring taxes and DFA has done a good job meeting this objective. Converting to an ETF structure will enhance this tax efficiency even further. The conversion of the US funds will occur in June and the international funds will be in the fall. An added benefit is there will no longer be any transactions costs at Schwab because ETFs trade like stocks which means they will fall under Schwab's zero commission structure. The conversion is a non-taxable event, and your holding period and cost basis will remain the same. Not all our clients own the funds being converted so we will reach out to those who will be impacted with more details.

Second, DFA has announced an additional reduction in their management fees for many of their other mutual funds. You may recall they had reduced their fees this time last year as well. The average fee for their funds is now 0.28%. This is great news.

Each year we are required by law to remind you that a copy of our most recent form ADV, our registration with the Security and Exchange Commission, remains available on our website along with our form CRS and Privacy Notice. The link is https://www.pinneyandscofield.com/resources. Should you wish a copy in paper please call or email us and we will be glad to send it to you.

Jim, John, Richard, Mary and Ryan