GALECKI FINANCIAL SENSE

GALECKI FINANCIAL MANAGEMENT

	LAST MONTH	LAST 3 MONTHS	YTD
S & P 500 Index	3.84%	12.15%	18.40%
Russell Midcap Index	4.68%	19.91%	17.10%
Russell 2000 Index	8.65%	31.37%	19.96%
Dow Jones Industrial Average	4.20%	13.75%	20.40%
Morgan Stanley EAFE Index	4.65%	16.05%	7.82%
DJ US Real Estate Index	2.53%	7.72%	-5.29%
S&P Commodity Index	5.97%	14.49%	-23.72%
Barclays Aggregate Bond Index	0.14%	0.67%	7.51%

INDEX RETURNS

Equities staged a powerful rally in the final three months of the year. The S&P 500 increased 12.15% in the quarter and finished the year up 18%. Mid-cap stocks and small-cap stocks did even better in the fourth quarter. The Russell Mid-cap Index was up more than 19% in the quarter and the Russell 2000 advanced by more than 31%. This is creating a short-term valuation problem for U.S. equities.

International stocks also grew nicely in the fourth quarter. The MSCI EAFE Index was up 16.05% in the quarter, and ended the year up 7.82%. Emerging Market stocks had a great run in the final quarter, advancing 19.7% to finish the year with a gain of 18.31%. International equities continue to look attractive at these levels.

The Barclays Aggregate Bond index had a very quiet quarter with a gain of 0.14%. High Yield bonds were up 5.87% in the fourth quarter and finished the year with a gain of 4.66%. Global bonds also rallied in the fourth quarter by 6.12% pushing their annual return to 5.77%.

ECONOMIC REVIEW AND OUTLOOK

The U.S. economy fell by a 31.4% annualized rate in the second quarter of 2020 and rebounded by 33.4% in the third quarter. The National Bureau of Economic Research (NBER) declared that we entered a recession in February. Early estimates for the fourth quarter are in the 4-5% range. This means that NBER will probably declare that the recession ended in the third quarter. Given the recent COVID-19 surge in the U.S. and abroad, we think January and February could see slower growth. This would then set us up for significantly faster growth in the final three quarters of 2021 as people begin to do things they have been putting off.

The Leading Economic Index was up 0.6% in November to 109.1. This follows the 0.8% increase in October and the 0.7% increase in September. Industrial Production rose 0.4% in November for the eighth consecutive month of growth. This is still roughly 5% below the pre-pandemic level in February. The Capacity Utilization rate (which measures how much slack is in the economy) was at 73.3 percent in November which is 6.5% below the long-term average.

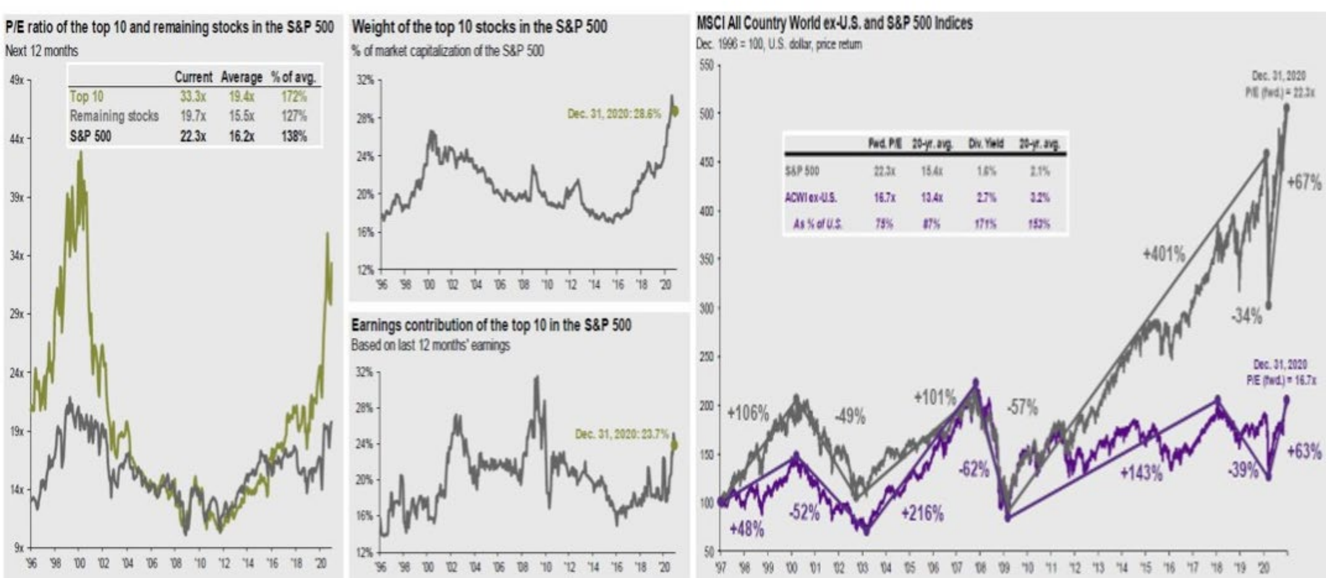
Non-farm payrolls rose by 245,000 in November. The unemployment rate declined to 6.7%. This is down 8% from the high in April. Initial weekly unemployment claims were 787,000 for the week ending January 2, 2021. The four-week moving average has dropped by about 18,000 over the last week.

Manufacturing increased to 60.7% on the ISM PMI index in December. This was an increase of 3.2% from November. The New Orders Index came in at 67.9 percent which was an increase of 2.8 percent from November. The ISM Services index was at 55.9% in November which was a drop of 0.7% from October but still represents expansion. This marks the 6th straight month of growth for the services sector. The Business Activity Index came in at 58.0 percent which was a drop of 3.2% from October, but also still represents expansion.

Global economies are also experiencing economic recoveries. The JPM Global Manufacturing PMI was at 53.7 in November which is up from 53 in October. This marks the fifth straight month of expansion and the index is at a 33-month high. Of the 30 territories covered by the survey, 19 recorded PMI readings indicative of growth. The top five countries are Brazil, Germany, Taiwan, USA and India.

EQUITY AND BOND MARKETS

Equities had a remarkable fourth quarter. Prices moved up swiftly while earnings have been slow to follow. The P/E ratio in the S&P 500 is now around 22.3%. The unique characteristic about the markets in 2020 is the performance of the top 10 stocks in the S&P 500. Those 10 companies now make up about 28% of the entire market value of the index. This means the remaining 490 companies share the other 72%. Because prices of the top ten stocks appreciated so much in 2020, it has created a valuation discrepancy. The top 10 stocks have a P/E ratio of around 33.3 times earnings while the other 490 stocks have an average P/E of only 19.7 (Bottom left).



International equites appear more attractive than domestic equities form a valuation perspective. The ACWI ex-US index has a P/E ratio of 16.7 times earnings versus a 20-year average of 13.4. In addition, the dividend yield for this index is at 2.7%. Compare that international income yield to the S&P 500 of only 1.6% and the 10-year

Treasury yield of 0.9% and international stocks continue to look attractive. In addition, the dollar weakened in 2020 due to our rising debt and annual deficit. If this trend continues in 2021, look for international equities to continue their solid performance.

The unemployment rate has dropped to 6.7%. We expect January and February to be difficult months for the economy due to surging COVID-19 cases in the U.S. and abroad. This could lead to further economic restrictions and a difficult earnings picture for the first quarter. However, the remaining three quarters of the year could be quite strong. Much of our population could get the vaccine, which would enable us to get closer to "herd-immunity". Once this occurs, people will resume travel, eating out, attending events, and just doing things that they were not able to do for the last year.

Bonds still maintain an important place in a diversified portfolio. While they are expensive from a historical perspective, they do provide principal protection. Investors should maintain their long-term allocation targets.

PORTFOLIO MANAGEMENT

The Investment Committee has been working on removing some of the Innovator ETFs from the portfolio. These ETFs provided nice downside protection in early 2020. However, we believe that the second half of 2021 could be good for equity returns, so we don't want the funds capped.

As mentioned in the prior section, we are concerned about the next few months as we navigate a new regime in Washington, deal with potential further economic restrictions due to COVID-19, and work through short-term elevated prices in domestic equities. As we move into summer, we believe that the economy will pick up steam, jobs will be recovered, and earnings will improve. This should lead to solid equity returns in the second half of the year. It will be important to keep a long-term perspective on equities when volatility rises.

The bond market could be challenging in 2021. The Federal Reserve has stated that they intend to keep rates low until 2023. This should at least provide some stability in the fixed income market. However, it is going to be very important to have diversified bond holdings in 2021. We believe high yield bonds, convertible bonds, and global bonds will all benefit from the current economic environment this year, so we are maintaining our allocation.

FINANCIAL PLANNING

In late December, Congress passed an additional Coronavirus Relief Package as a part of the Consolidated Appropriations Act of 2021. Here are some of the highlights.

Stimulus Checks/2020 Tax Credits

Taxpayers will be receiving another round of stimulus payments. The amount will be $600 per person and $600 for each child under age 17. Taxpayers begin to be phased out of receiving checks if their 2019 Adjusted Gross Income (AGI) is above $75,000 for Single Filers, $150,000 for Joint Filers, and $112,500 for Head of Household Filers.

For example, a Married Couple Filing Jointly with 2 children is eligible to receive $2,400. They will receive the full $2,400 if their AGI is below $150,000. If their AGI is above that figure, they lose $5 for every $100 their income is above the limit.

As is the case with the stimulus checks that were distributed back in April, this is actually an advanced credit that is being paid based on taxpayers 2020 tax returns. If your income was above the limit in 2019, but won't be in 2020, you'll receive the stimulus funds when you file your 2020 tax return. If your income was under the limit in 2019, but will be above the limit in 2020, you will not have to pay back any stimulus funds you received.

Paycheck Protection Program (PPP) Guidance and Additional Round

Businesses who received a PPP loan finally have guidance on the taxability of their forgiven loans. All forgiven loans are still not subject to income tax. Congress also cleared up that any qualified expenses paid by the loan proceeds are still deductible in 2020.

There are new additional expenses that the loans can be used for: operations expenditures (software that assists with the operations of the business), property damage costs (related to vandalism or looting that occurred in 2020), supplier costs (payments to suppliers of essential goods), and worker protection expenditures (costs associated with meeting CDC guidelines such as masks, sneeze guards, etc.).

If a business missed out on the initial round of PPP loans, additional funds have been allocated to the program and applications should hopefully be processed the week of January 11th.

A second round of PPP loans are available to businesses that have already received and spent the first round. The caveat with the second round of PPP is the business must have experienced a drop in revenue of more than 25% in any quarter of 2020 compared to that same quarter in 2019. This second round is also only available to businesses with less than 300 employees (down from 500 employees in round one).

Miscellaneous Items

A few other quick highlights:

- The hurdle to deduct medical expenses is now “permanently” 7.5% of Adjusted Gross Income (AGI).
- A $300 above-the-line tax deduction is available for cash donations given to charity in 2020. This is extended into 2021 with the deduction increasing to $600 for Married Filing Joint taxpayers.
- Taxpayers may deduct up to 100% of their AGI for cash donations given to charity in 2020 and 2021. Previously this cap was 60% of AGI.
- As a way to revitalize the restaurants industry, in 2021 and 2022, businesses are able to deduct 100% of the cost of “food or beverages provided by a restaurant.” This appears to include eating in a restaurant and takeout dining. Additional guidance still needs to be provided on exactly what qualifies as a restaurant.
- Funds remaining in a Flexible Spending Account (FSA) at the end of 2020 can be rolled over into 2021 and 2022. Usually, the amount remaining at the end of the calendar year is forfeited. Employers must elect this for their employees.

Company News

Like so many people, our normal Galecki holiday festivities were canceled this year. However, we were still able to spend time together as a team, online shopping and wrapping gifts for families less fortunate this holiday season. We look forward to continuing this tradition for years to come.

2020 was a difficult year for many individuals and families. It was also a year that gave us perspective on what is important and what we should all be thankful for. Happy 2021 from all of us at Galecki Financial Management.

- Galecki Financial Management Investment Committee

Special Note: If you would like to schedule an appointment with a Certified Financial Planner™ Professional, please visit www.galecki.com