Q1
21 QUARTERLY INVESTMENT LETTER

Opus CAPITAL MANAGEMENT

The Reflation Trade

Quick Look

- Optimism abounds in regards to COVID-19 as hospitalizations have fallen to six month lows and one-third of U.S. adults have received at least one dose of a vaccine.
- From the March 23, 2020 market bottom, the S&P 500 Index gained an astounding 76% one year later! The variability of one-year returns is a lot wider than many investors realize.
- Since news of the vaccine development in November, markets have thematically moved on to the reflation trade. Stocks that benefited during the lockdowns have fallen out of favor in exchange for cyclical stocks that benefit from an economic rebound.
- U.S. small cap value stocks, which are not as well capitalized and thus more dependent on an economic rebound, have outpaced U.S large cap growth stocks by 50% over the past two quarters.
- Investor psychology has also flipped in the past year from a fear of losing money to a fear of missing out.
- Fiscal aid to consumers is occurring at an unprecedented level. Once pent-up demand can safely be unleashed, the U.S. economy is set to rip higher. The economic outlook, at least in the near term, is extremely positive.
- On a relative basis, our portfolio positioning has capitalized on this reflation trade period. Our factor tilts towards small and value stocks helped boost returns this quarter, while our shorter duration and modest allocation to high-yield bonds helped soften the losses within bond allocations.

Contacts

KEVIN P. WHELAN, CFA
Principal and Portfolio Manager
kwhelan@opusinc.com

NATHAN A. BISHOP, CFA
Principal and Portfolio Manager
nbishop@opusinc.com

NATHAN M. BAILEY, CFA, CFP®
Principal and Portfolio Manager
nbailey@opusinc.com

221 East Fourth Street, Suite 2850
Cincinnati, Ohio 45202
P (513) 621-6787

www.opusinc.com

Follow Us:

About Opus Capital Management

Opus Capital is an evidenced-based investment advisory firm driven by our overriding mission to help people. We believe the marriage of comprehensive financial planning + statistically proven investment principles creates the clearest roadmap to long-term success.

We are independent and transparent in all aspects of investment management decision making and financial planning. We selectively partner with like-minded individuals and families, endowments, foundations, and 401(k) plans in 30 states.

Quarterly Investment Letter, Q1 2021

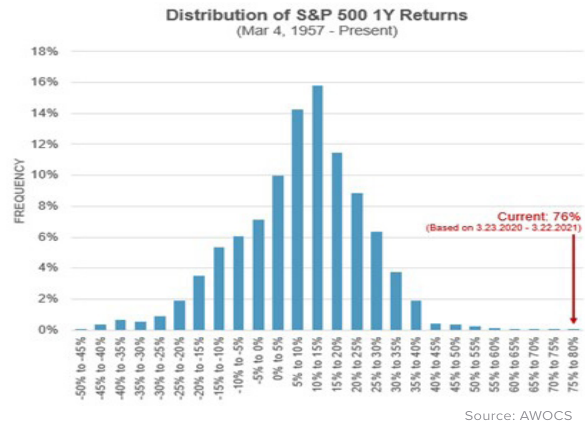
The arrival of spring always ushers in a sense of optimism once flowers begin to bloom, temperatures rise, and the days are suddenly longer. This year has added enthusiasm thanks to the progress made in regards to COVID-19. Over the past 90 days, hospitalizations have fallen to six month lows, and one-third of U.S. adults have received at least one dose of a vaccine. Schools, restaurants, theaters, and theme parks are all reopening, and there is a sense that herd immunity will be reached sooner than previously expected. Optimism abounds.

It's hard to overstate just how bleak the picture looked a year ago, with the nation in full lockdown and struggling to come to grips with the largest health crisis of our lifetimes. On March 23 of last year, the S&P 500 Index reached a 34% drawdown from its February 19, 2020 high, making it one of the five largest drawdowns since World War II. Our client letter from last spring highlighted that large drawdowns are often accompanied by above-average forward investment returns. We included in that client letter the chart below, which looked at the worst quarters in S&P 500 Index history since 1940 and the associated forward performance. The purpose was to highlight the evidence that over the long-term, purchases at meaningful drawdown levels often become highly profitable investment lots. While it was impossible at the time to know that the market had already bottomed, one-year forward performance overshot even the most optimistic of expectations.

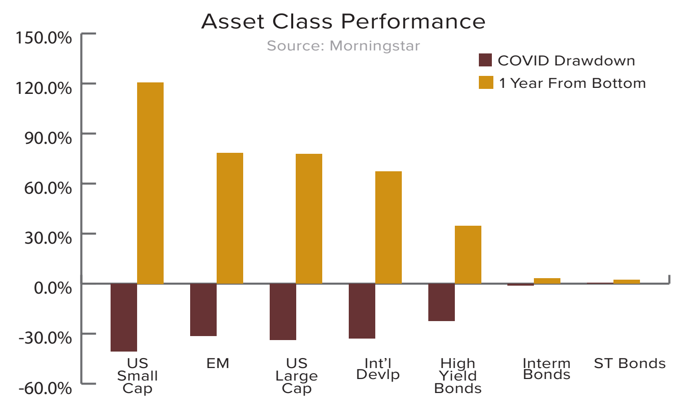
S&P 500 Worst Quarters Since 1940			Forward Performance		
Year	Quarter	Performance	1 Year	3 Years	5 Years
1962	Q2	-20.6%	31.2%	69.2%	94.8%
1974	Q3	-25.2%	38.1%	72.7%	117.5%
1987	Q4	-22.6%	16.8%	48.8%	109.0%
2008	Q4	-21.9%	26.5%	48.6%	128.2%
2020	Q1	-19.6%	56.4%	?	?
Average		-22.6%	28.1%	59.8%	112.4%

Source: AWOCS

In that same letter, we also discussed that the variability of one-year equity returns is a lot wider than many investors realize. We stressed that while the average annualized stock return is 10%, any one-year returns between -8% and 28% were to be considered normal, and any returns between -26% and 46% should be considered in play. From the March 23, 2020 market bottom, the S&P 500 Index gained an astounding 76%! As you can see in the next chart, this set a new data point in the right tail of distribution return possibilities, and at the risk of hyperbole, could very well wind up being the best rolling one-year return of our investing lifetimes.



The first leg of the recovery saw U.S. stocks resume all-time highs in less than six months, but those returns were primarily carried by the large technology companies. The breadth of the recovery finally occurred with the news of the vaccine development in November. Since that time, markets have thematically moved on to the reflation trade. Stocks that benefited during the lockdowns have fallen out of favor in exchange for cyclical stocks that benefit from an economic rebound. The best example is that U.S. small cap value stocks, which are not as well capitalized and thus more dependent on an economic rebound, have outpaced U.S large cap growth stocks by 50% over the past two quarters. This quarter, traditional value sectors Energy (up 29%) and Financials (up 15%) thrived, while last year's darling Technology mostly stood in place (up 2%).



U.S. EQUITY RETURNS (%)

As of 03/31/21	Q1 2021	1-Year	3-Year	5-Year	10-Year
S&P 500	6.2	56.4	16.8	16.3	13.9
Russell 1000 (Large Cap) Growth	0.9	62.7	22.8	21.1	16.6
Russell 1000 (Large Cap) Value	11.3	56.1	11.0	11.7	11.0
Russell 2000	12.7	94.9	14.8	16.4	11.7
Russell 2000 (Small Cap) Growth	4.9	90.2	17.2	18.6	13.0
Russell 2000 (Small Cap) Value	21.2	97.1	11.6	13.6	10.1

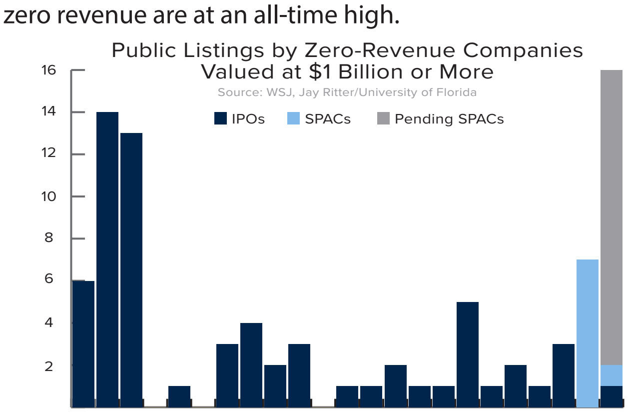
Source: Morningstar

Continued from page 2 . . .

To The Moon

Investor psychology has flipped in the past year from a fear of losing money to a fear of missing out. The general public's interest in stock market trading is arguably at its highest level since the dot-com boom two decades ago. New brokerage accounts have exploded, and according to a survey by Deutsche Bank, more than half of online investors 45 and younger have under two years of investing experience. The use of both stock options and margin has noticeably increased, as has the frequency of trading, propelled by the decision of RobinHood and other online brokerage platforms to move to zero commission trading. The surge in shares of brick-and-mortar video game retailer GameStop made national headlines as its shares inexplicably jumped from $20 to $483 and then fell back below $50 in a span of four weeks, prompting a mostly theatrical Congressional hearing featuring the CEOs of RobinHood and Citadel and a retail trader known by the pseudonym Roaring Kitty. Other retail favorites this quarter were AMC, Macy's, and Bed Bath & Beyond, all of which were deep value retail stocks whose price skyrocketed above their pre-pandemic highs diverging drastically from fundamental valuations.

The reflation trade is not just limited to the stock market. Investor enthusiasm for cryptocurrencies is extremely strong. Since the vaccine announcement, the price of Bitcoin has gone parabolic, jumping from $15,000 to over $60,000 per coin. Dogecoin, which was created as a joke and has infinite supply, is up 10x since the start of the year. Non-fungible tokens, which are digital tokens distributed on a blockchain and tied to assets such as digital artwork, music, and sports collectibles, became a thing this quarter. Special Purpose Acquisition Corporations (i.e. SPAC's) are investments in a blank check shell company that must complete an acquisition within 24 months. SPAC acquisitions hit an all-time annual high by February of this year and have become an alternative way for private companies to go public without incurring the costs, due diligence, or regulatory requirements that come with the traditional IPO process. Thanks to the boom in SPAC capital raising, public listings of companies valued over $1 billion dollars that produce zero revenue are at an all-time high.

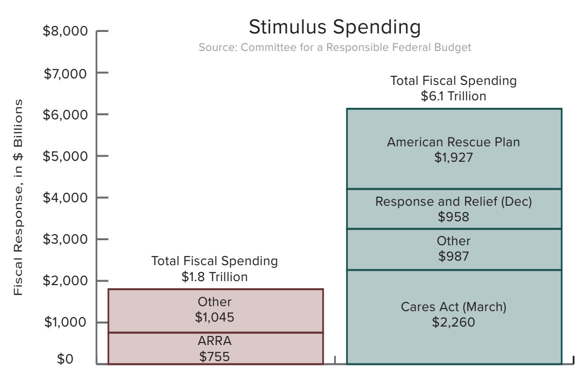


In reality, we believe these are outlier examples of pockets of irrationality that are more noise rather than material impact to the overall market. Equity valuations are indeed trading above historic averages, but some allowance should be made for the impact of interest rates, which are on the rise but still far below any level of historic normalcy. The current earnings yield of 4.5% looks overvalued in absolute terms, but when compared to a 1.7% 10-year U.S. Treasury, the equity risk premium is 2.8%, which is close to the 20-year average.

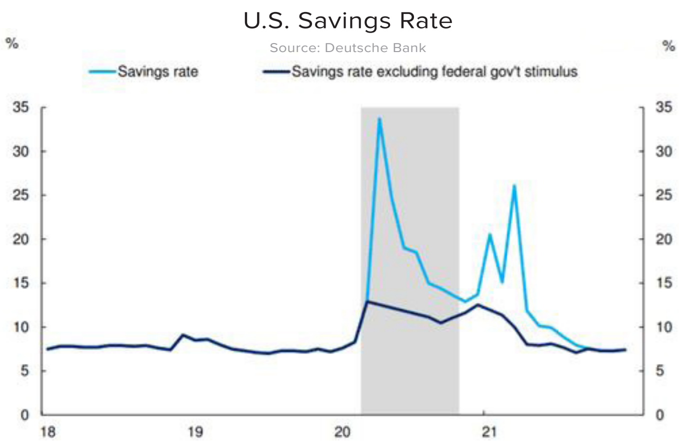
In a low-rate world, investors are persuaded to increase risk when safe assets pay so little, and there is simply a lot of capital sloshing around right now. This is yet another example of what has made the COVID-caused recession atypical of normal market cycles. Most recessions are accompanied by a credit crunch and starvation of capital, but thanks primarily to the Fed's aggressive action to backstop the markets, we saw record debt issuance last year in both investment grade and high yield credit. Regardless of balance sheet quality, companies have been able to access capital, and it has kept default rates far below where expectations were at the onset of the crisis. AMC avoided bankruptcy by taking advantage of the Reddit board WallStreetBets' sudden enthusiasm in the stock to more than quadruple its number of shares outstanding, raising more than $1 billion as investors overlooked the massive equity dilution to embrace the social media rally to #saveAMC.

The aggregate consumer is flush with cash, and once pent-up demand can safely be unleashed, the U.S. economy is set to rip higher. While we know that the cruel nature of the pandemic has had an adverse financial impact on many (particularly those less fortunate), in aggregate, the consumer coffers are presently well funded. U.S. bank deposits are up more than $3 trillion from a year ago, while credit card balances are down 12% over the past year. Cash-out refinances were at their highest level since the mid-2000's housing peak, and home values are up 11% over the past year.

Fiscal aid to consumers is occurring at an unprecedented level. The Democratic sweep of the Georgia primaries paved the way for the passage of the American Relief Act, which at $1.9 trillion was likely double the expected spending level had Republicans held the Senate. From the new bill, $1.2 trillion is expected to be distributed over the next two months. $700



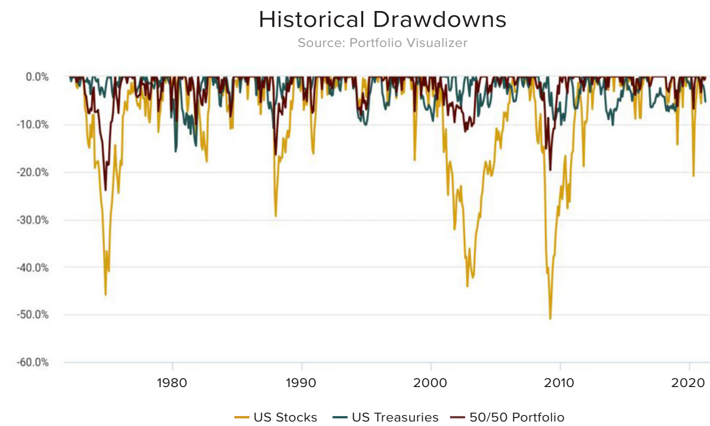
billion of that is going directly to consumers, highlighted by the $1,400 checks per person under $75K in income that were sent out at quarter-end. This is on top of the $900 billion relief plan that was passed just after Christmas and the $2.2 trillion relief bill last March. Retail sales jumped 5% and the savings rate surged to 20% after the January checks; the magnitude from the recent Aid Bill should be far larger in scale. Full year GDP for 2021 is poised to exceed 5% for the first time in more than 35 years.



Reflation Moving Forward

The economic outlook, at least in the near term, is extremely positive. Only time will tell how much is already baked into asset prices, but historically speaking, the second year of a bull market has generally been good for investors, and economically speaking, we are just starting the reopening phase. It is worth noting that the summation of these events should in theory be inflationary. We will see what transpires; the Fed seems intent on letting it run hot after a decade of failing to reach its 2% target.

Not all assets have benefited during this reflation trade period. The rising expectations for both economic growth and inflation resulted in rising Treasury rates, as the 10-year jumped 80 basis points to 1.7%, leading to a very poor quarter for bonds. The Barclays Aggregate Index has declined 4% since August, during which time the spread between 2-year and 10-year Treasurys has increased by nearly 125 basis points. Historically speaking, spreads have a pattern of steepening above 250 basis points during the expansionary portion of an economic cycle before reaching resistance. Should this be the case, the current bond drawdown likely has more to go. That said, we would encourage investors to maintain current bond allocations. Firstly, the historic drawdown of bonds pales in comparison to equity drawdown potential. Secondly, bonds remain the best ballast to an equity market slump, and the continuation of rising rates is far from a certainty. Thirdly, our portfolios have been well positioned to mitigate interest rate risk; our portfolios' fixed income allocations captured less than half of this quarter's drawdown in bonds.



On a relative basis, our portfolio positioning has capitalized on the reflation trade that began in November. Our factor tilts towards Small and Value stocks helped boost returns this quarter, while our shorter duration and modest allocation to high-yield bonds helped soften the losses within bond allocations. In fairness, this positioning had seemed evident to us for some time, even as both the Small and Value factors spent the better part of 2020 getting thumped by Large Growth stocks. In our fall letter, we noted that the Value premium had fallen to its 100th percentile readings across any rolling time period. The Small and Value factors had become a sprung coil just needing a catalyst to mean revert, and it appears the vaccine development was the event. Their outperformance helped send many of our portfolios above their maximum equity range, necessitating a rebalance back to strategic asset allocations.

As always, please contact us to discuss in further detail. We appreciate your confidence in our firm and value your partnership. Markets aside, optimism abounds of a return to normalcy in the very near future!

INTERNATIONAL RETURNS (%)

As of 03/31/21	Q1 2021	1-Year	3-Year	5-Year	10-Year
Int'l Developed ex US	3.5	44.6	6.0	8.9	5.5
Emerging Markets	2.3	58.4	6.5	12.1	3.7

Source: Morningstar

FIXED INCOME RETURNS (%)

As of 03/31/21	Q1 2021	1-Year	3-Year	5-Year	10-Year
Aggregate Bond	-3.4	0.7	4.7	3.1	3.4
Muni Bonds	-0.2	5.8	4.3	2.9	3.8
Int'l Bonds	-3.6	10.2	2.1	2.8	1.9
High-Yield Bonds	1.1	21.9	5.4	6.6	5.3
Short-Term Bonds	-0.1	6.2	3.3	2.5	2.1
90-Day T-Bill	0.0	0.1	1.4	1.2	0.6

Source: Morningstar

Opus CAPITAL MANAGEMENT
Opus Capital Management
221 East Fourth Street, Suite 2850
Cincinnati, OH 45202
(513) 621-6787 • www.opusinc.com