FORUTH QUARTER,
DECEMBER 31, 2020

MARKET COMMENTARY

In investing, as in life, you can't know what you don't know. Too often, it's the things you don't know (and couldn't have known) that throw a monkey wrench into your plans. And we can't know everything. As investment managers, there is a forward-looking aspect to what we do. We are expected to somehow be able to predict the future. But the truth of the matter is that predicting the future is impossible. When asked what the New Year might bring, the truest answer an investment manager can give is, "I don't know."

2020 proves our point. This time last year, investment firms across the globe went through the annual ritual of publishing their 2020 market outlooks. Countless research hours were collectively spent on these endeavors, and, for all of their heterogeneity, not a single outlook predicted a global pandemic. Rather, the focus was on risks that were mostly knowable, such as Brexit, trade tensions with China, elections, and a slowing global economy. In retrospect, these concerns were mundane against the backdrop of COVID-19.

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To compound matters, not only was COVID-19 unknowable, but the market's behavior in 2020 was unexpected, if not equally unpredictable. Traditional defensive stocks were eschewed in favor of a new breed of defensive, work-from-home stocks. In the first half of the year, we witnessed both the fastest decline and the fastest recovery in stock market history. Investors hoping for a pause and an opportunity to get their bearings were afforded no such luxury. While economists and epidemiologists were debating whether we might see a "W" or "L" shaped future, the stock market, looking past the crisis, moved into full-on "V" mode. In the face of massive, unprecedented volatility, the best course of action was simply to hold on. Those who sold in the face of fear paid a high price, whereas those who held on were rewarded.

For our part, we didn't get everything right. For example, going into the crisis, we had an overexposure to traditional defensive investments, because, at the time, we viewed the market as ripe for a more normal, end-of-cycle correction. It turned out that work-from-home stocks, like Zoom Video Communications, were the true defensive stocks in this particular crisis, and, while we did have some work-from-home exposure, we could have had more.

That said, we were able to add value in several key ways. First, by keeping client portfolios fully invested throughout the volatility, we avoided the costly error of selling low. During a period when markets were swinging up and down by 10% per day, this was easier said than done. Second, by purchasing equities at the margin in March and April, we were able to snatch up deals and add incremental value. Again, during a period when markets were swinging up and down by 10%, this was easier said than done. Third, by making a number of tactical moves on the fixed income side of things, such as temporarily extending duration before the crisis and moving a bit more into credit opportunities during the worst of the crisis, we were able to drive additional return.

As the year progressed, we worked hard to find pockets of opportunity in a market that was quickly becoming expensive. Come November, with some much needed certainty provided by the elections and two vaccine approvals, the work-from-home trade gave way to value stocks, cyclical stocks, small cap stocks, and emerging market stocks. During this period, client portfolios benefitted significantly and largely outperformed. By the end of the year, our stock portfolios had outpaced the S&P 500 Index despite having had less relative exposure to FAANGM and work-from-home stocks, and client accounts were worth more than at the start of the year – in some cases significantly so. On the whole, we were pleased with this result, and we consider ourselves fortunate given the challenges and heartbreak that COVID-19 brought to the world.

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Again, we do not (and cannot) know what 2021 will bring. We hope it is a better year than the outgoing one. That said, 2020 was a good year for investors, and we face particular challenges in 2021 that have only been exacerbated over the past twelve months. Key themes for the New Year include:

1. Stocks are expensive in aggregate, there's no way around it. The S&P 500 Index trades at a higher price-to-sales ratio than it did at the height of the Dot-Com bubble. If one considers price-to-earnings, then stocks are below peak Dot-Com valuations but still expensive in a historical context. While it is our opinion that the stock market overall is not in a bubble, we've seen evidence of bubbles in certain stocks and industries. Certainly, investor euphoria and speculation are at levels not seen since the Dot-Com days, and this has led to completely wacky behavior in stocks like Tesla and Hertz, plus the cryptocurrency, Bitcoin. To what degree this euphoria poses a threat to the broad market remains to be seen.

2. That said, portions of the market are still attractively priced, assuming we see an economic recovery take shape toward the back half of the year. Banking stocks, energy stocks, and certain consumer discretionary stocks, particularly in the hospitality and leisure categories, look mostly cheap. In fact, after a decade long slump in value stocks, the spread between growth and value is about the widest it has ever been. Therefore, it is entirely possible that the stock market continues to climb on the backs of the previously unloved if a meaningful rotation into value stocks takes place. At the same time, investor euphoria could also continue to drive multiple expansion in growth stocks. We cannot say with certainty that the recent rotation from growth into value will persist or that it is time to reduce growth exposure.

3. The relative attractiveness of international stocks versus U.S. stocks tends to come in waves. The 2000's were a decade marked by international outperformance, while the 2010's were marked by domestic outperformance. Because international stocks, by and large, look more attractively priced than U.S. stocks, it is possible that 2021 could mark the beginning of the next wave in this cycle. Domestic instability could quicken this process.

4. Stocks might be expensive, but bonds are too. Yields are low, which means investors cannot avoid stocks and expect to get any type of meaningful return in the bond market. We see this dynamic continuing for some time, as the Federal Reserve has made clear its intention to keep rates low until sometime in 2022 or 2023. Even then, the Fed has expressed a willingness to let inflation rise above its 2% target in any given year, focusing instead on an average rate of inflation over time. Rates are so low that it makes little sense to extend duration in the search for yield. Today, the 10-year Treasury yields just 0.96%, a rate that practically ensures a negative real return after inflation. The 30-year Treasury yields 1.71%! In 2021, investors are likely to be better served by keeping duration limited while taking on more credit risk, but even that opportunity has lessened as spreads have tightened. Investors looking for safety and low duration will have to resign themselves to very low, if any, return.

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As one might expect, we have positioned portfolios in light of our views on the above dynamics. However, our outlook and our positioning continually evolve as events change and as more information becomes available. Our guiding light is not some market outlook written at the start of the year based on static information. Rather, we are continually reminding ourselves to be prepared for what is unknown and unknowable, as much as what is known or thought to be known. To this end, our guiding light is asset allocation, which is steeped in each client's goals and risk tolerance. A properly formulated, long-term investment strategy should account for both known and unknown risks. When markets are at their most volatile, and when markets are at their most frothy, and when markets are at their most benign, sticking to your investment strategy will see you through. We saw this throughout 2020, and we'll surely see it again in 2021.

Until next time, may you and yours have a happy and healthy start to the New Year!

PLANNING CORNER

Balance

We hear the word used often – balance in pursuits, balance in diet, balance in life generally. One area that doesn't get a lot of attention is the need for balance within your savings strategies. We hear a lot about maximizing 401(k) and IRA contributions but little about the need to balance those savings vehicles with contributions to taxable accounts and methods for funding Roth IRAs when you are in a high-income bracket.

Tax planning is a key piece of any investment strategy, but it is just that - a piece. Although it seems intuitive that paying the least amount of taxes currently is the wisest choice, in the long run that may be short-sighted. Deferring salary to pre-tax vehicles such as Traditional IRA, 401(k) and other ERISA plans is part of a comprehensive strategy for saving and investing over a lifetime. Amounts deferred to such accounts are sheltered from current taxation. You should always contribute at least that amount that is matched by employer contributions, otherwise you are leaving free money on the table. A good rule of thumb is to contribute 15% of your income to any employer sponsored plan. Calculation of that 15% should include the amount contributed by your employer. For example, if your salary is $100,000 you should contribute $15,000 to your plan. If your employer offers a match up to 5% of your salary, you should defer 10% of your salary to the plan. However, Uncle Sam will get his due when the time for required minimum distributions (RMD) arrives – currently when you turn 72. All RMDs are taxable income to the recipient at their then current ordinary income tax rate. Tax rates are scheduled to return to pre-2017 rates when the Tax Cuts and Jobs Act (TCJA) expires in 2025; additionally, the incoming Biden administration plans to increase taxes for those earning more than $400,000 annually. To throw one more wrench into the works, keep in mind that up to 85% of your social security income can be taxable when your income reaches quite low thresholds: $34,000 for individuals and $44,000 for married, filing joint. Those income amounts INCLUDE one-half of your social security income. So, although tax-deferred savings are attractive on the surface, it is important to weigh your expected income and what tax rates may be during your retirement.

Another consideration when funding ERISA plans is that withdrawal of funds from the plan may be subject to a 10% penalty if you access them prior to reaching age 59½. That means that a married couple residing in the State of Maine with taxable income of $100,000 would pay a whopping 39.15% in taxes and penalties to withdraw funds from an ERISA plan before turning 59½. Early withdrawals from retirement accounts are never encouraged but if your savings strategy does not include currently taxable accounts, you may have no option when faced with an emergency.

A last thought on retirement accounts is the impact to non-spouse beneficiaries. The 2019 SECURE Act eliminated the "stretch" IRA which allowed non-spouse beneficiaries to take the RMD over their lifetime. Non-spouse beneficiary Inherited IRAs must now be fully distributed within ten years of the original owner's date of death. This could have significant tax consequences for beneficiaries and is cause to rethink that part of your estate planning strategy.

Enter a balanced investment strategy that, while still focusing on retirement needs, gives you flexibility to access funds in case of emergency but more importantly provides you with income that may result in lower or no tax cost. The first investment vehicle to consider is a Roth IRA or, if available, a Roth 401(k). While contributions to either vehicle do not lower your current tax burden, qualified distributions from Roth accounts are non-taxable (or partly so) in most situations even if you are not yet 59½. Roth IRA contributions are technically not available to high income earners. However, there is an option known as a "back-door" Roth IRA. Funding of a "back-door" Roth IRA is accomplished through use of a non-deductible IRA and a resulting Roth conversion of some or all of your IRA. While there is no current tax savings, a "back-door" Roth is subject to the same rules as a Roth IRA – qualified distributions are generally non-taxable events.

The next piece of a balanced investment strategy would be a taxable investment account. Counterintuitively, there are possible tax advantages associated with this type of account. While distributions from retirement accounts are taxable to you as

SOUNDBYTES

Congratulations to Tyler Hoxie and Kylie Peacock, who married this past October in a lovely seaside ceremony. May your years together be filled with love, happiness, and blessings!

Lucie Estabrook, CEO, moderated the Olympia Snowe Women's Leadership Institute CEO Panel. Panelists included Carol Epstein of Epstein Commercial Real Estate; Deanna Sherman of Dead River Company; Bob Montgomery-Rice of Bangor Savings Bank; and Larry Shaw of MMG Insurance. Since 2015, the Olympia Snowe Women's Leadership Institute has delivered a unique program rooted in the themes: My Values, My Voice, and My Vision. It has grown from 45 girls in the seven schools serving Androscoggin County to 540 girls from 36 schools across all of Maine's sixteen counties.

Jennifer Eastman, COO and Chief Compliance Officer, attended the National Regulatory Services Fall 2020 Virtual Compliance Conference. This annual event provides a comprehensive view of the current regulatory landscape affecting the investment industry.

Lucie Estabrook attended the virtual Schwab Impact Conference, one of the investment advisory industry's most widely respected educational events. This year's featured speakers included renowned journalist and news anchor Katie Couric, Harvard Professor and bestselling author David C. Brooks, and David B. Agus, MD, Professor of Medicine and Engineering Lawrence J. Ellison Institute for Transformative Medicine, University of Southern California.

Jenifer Butler successfully completed the National Social Security Advisor® certificate program. Administered by Premier Social Security Consulting, the program is designed to enable advisors to provide thoughtful, strategic advice regarding maximization of Social Security filings.

ordinary income, a taxable investment account could give you flexibility around distributions from pre-tax retirement accounts. You will, of course, be subject to the RMD but if you need supplemental income beyond the RMD amount, after-tax accounts could decrease the amount of your overall tax bill. In the case of taxable brokerage accounts (and Roth accounts), there is no requirement to take distributions and growth can continue uninterrupted. Investments sold in taxable accounts are subject to capital gains tax, but the timing of such taxes is in the hands of the investor.

> Taxable accounts allow you to apply investment gains to any goal you choose, over any time horizon.

Income paid in the form of interest and dividends in a brokerage account are usually taxable, depending on security type and the classification of the distribution. This is one downside of brokerage accounts relative to retirement accounts. Taxable income can be managed by holding securities that pass through less income to shareholders, such as Exchange-Traded Funds (ETFs). More broadly, you may choose to hold only growth-focused equities or equity funds in this type of account while keeping income-generating investments like bonds in your tax-shielded accounts.

Taxable accounts can also be useful for short-term financial goals. You may have a plan to buy a new car in five years, for example. While retirement accounts allow for penalty-free distributions prior to retirement in limited circumstances (such as a down-payment on a first-time home purchase in the case of a Roth IRA), typically they are designed to incentivize long-term investing. Taxable accounts allow you to apply investment gains to any goal you choose, over any time horizon. Current tax laws allow a step-up in cost basis for inherited assets. This means that the cost basis for assets you hold at your death becomes the value of that asset on your date of death. Stepped-up basis can be a significant advantage for your estate beneficiaries.

Even if you have no goal in mind beyond investment growth and supplemental retirement income, a taxable account can allow for easier and more tax-friendly access to funds if an unexpected need arises. Capital gains and income taxes apply, but penalties do not. Additionally, retirement accounts best serve their primary purpose when compounding can continue uninterrupted. We recommend clients maintain a cash reserve as a first line of defense against having to tap into retirement funds, but taxable brokerage accounts can be an additional source of security.

In a word, taxable brokerage accounts provide flexibility. As much as we embrace strategies to avoid, defer, and mitigate tax bills, the tax man generally attaches a string to any advantage he offers and will not long be put off from receiving his due. While government will always need some of your dollars to fund its goals, a balanced investment strategy will help you achieve yours.

PORTFOLIO CHANGES

We made relatively few changes to portfolio positions throughout the quarter, opting instead to ride decisions made in prior quarters. One change of note, however, was a switch in our preferred choice for passive international developed market equity exposure. We started to incorporate the Vanguard FTSE Developed Market ETF (VEA) in place of the Schwab International Index Fund (SWISX). Like SWISX, VEA provides ultra-low cost exposure to developed market equities, with a particular focus on Europe and Japan. Unlike SWISX, however, the fund includes exposure to South Korea and Poland, due to a slight difference in the composition of its underlying index. Additionally, the fund is a bit more tax-friendly, thanks to its ETF structure. VEA is a highly liquid fund with good tradability. Its primary role is to provide core international developed market equity exposure in client accounts.

In addition to the above, we also started incorporating the Parnassus Core Equity Fund (PRLBX) and the Boston Trust Walden Small Cap Fund (BOSOX) into our Environmental, Social, and Governance (ESG) portfolios. We have held these funds, which adhere to ESG guidelines per their prospectuses, in our traditional portfolios already for some time. Because we continue to like and use these funds, it made sense to integrate them into our ESG models. The addition of these funds brings an active management component to our ESG portfolios, which were previously limited to passive funds in these areas.

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