

There are three tenets of managing money that we live by at Doxa Capital:

- 1) The most powerful thing in investing is **compounding**.
e.g., Invest in good businesses with great management and long tailwinds.
- 2) The most important thing about investing is **planning**.
e.g., Don't have FOMO. Stick to the strategy and exert discipline.
- 3) The most difficult thing in investing is **selling**.
e.g., If you sell too early, you may violate rule 1. If you sell irrationally, you may violate rule 2.

Use compounding, plan and be disciplined, try not to sell. Those are our rules for investing. But these rules aren't new to us or our clients and fellow investors, we've been following them for a long while. These mantras are all over books and articles, Charlie Munger has preached them along with Howard Marks and many other legend investors all in their own way. So why bring them up now? Because, if there was ever a year that a strong rules-based framework was needed, it was 2020.

We've all lived it so there's no need to venture off into a lengthy recap, but in short there were a slew of unknown unknowns and unknown knowns thrown at us consistently from all angles. In other words, there was no forecast or clear insight before COVID-19 (*unknown unknown*) or even after COVID-19 (*unknown known*) that could have guided you accurately through this year's market. As a colleague put it to me, "there's no person that had both the severity of the virus and the strength of the markets correct all in the same forecast." In the roller coaster of 2020, rules win – and at Doxa we are very grateful that we followed them to turn a crazy year into a really good one.

2021 Outlook, Executive Summary

2020 saw the biggest market drawdown and economic recession since 2008 due to the effects of COVID-19. This dealt the final blow to an economy that had been slowing since 2018.

All cycles begin and end in recessions; this time is no different. A new cycle has begun and the recovery is underway. In fact, we expect to see a big economic recovery in 2021 – *but that doesn't necessarily mean the same for markets*. **Markets always live in the future**, so the gains had this year were in anticipation of a solid recovery next year. This should temper some expectations for a big market gain in 2021. *Think of it more as a pause to let the economy catch up.*

Did COVID-19 change our long-term themes? No, it accelerated them. Big exogenous shocks rarely upend existing trends - they simply fast-forward the existing ones. Good businesses are still good, and bad businesses get bad faster. **All of our themes are still on track.**

Rules in Action

Every year we include a '*what we got right/wrong*' section about our prior year's forecast. Well, it's safe to say that a global pandemic doesn't treat prior forecasts very well (although we were very right in our housing outlook, absent the 'virus-induced panic buying' part). In a year with a massive exogenous shock, it's not the old forecast that matters – it's how you *change* the forecast under pressure. Managing portfolios and financial planning is about guiding a ship through a storm no one saw coming. We don't just talk about discipline and long-term investing; we execute on it. So, this is how 2020 unfolded at Doxa Capital from the *real-time* viewpoint of our notes:



December 2019: We've always focused on good businesses with great management teams. In our annual outlook, [The Next Decade](#), we identified tailwinds for the long-term: *demographic trends, housing, electrification, and beneficiaries from the deployment phase.*

March 2020: *Things got real.* Markets were in a liquidity crisis. States were closing, office buildings shuttered, and the NBA shut down overnight. Honestly, no one knew much. At Doxa, three things were paramount: **help clients, discard emotion, act with discipline.** This spawned arguably our best note to date, [This Time is Different](#), in the heat of the crisis.

April 2020: We were starting to get a better picture of how things were playing out economically, but the severity was still relatively unknown. In [This Time is Different, Part 2](#), we began to paint the optimistic picture that we believed was in the cards.

July 2020: This is when our '**optimistic, but allow for setbacks**' theme was born, which still holds true today. At this point, we had a clear vision of the next cycle beginning and how to position appropriately for it. The focus needed to be on the [Psychology of COVID-19](#), not the virus itself.

Did we follow the three rules of investing?

Compounding: We aren't renters of stock; we own them for the long term. Therefore, our portfolios are compiled of very well-run businesses with big tailwinds. This is most appreciated during periods of stress like this past spring. Although market prices can move quickly, we were able to remain very confident our companies would make it through the COVID-19 crisis well.

Planning: When emotions run high, planning and discipline come to the rescue. Every client has a portfolio, every portfolio has a plan, and every plan has to be followed – no matter what. Doxa's allocation discipline and long-term framework took hold and proved successful in the subsequent market snap back.

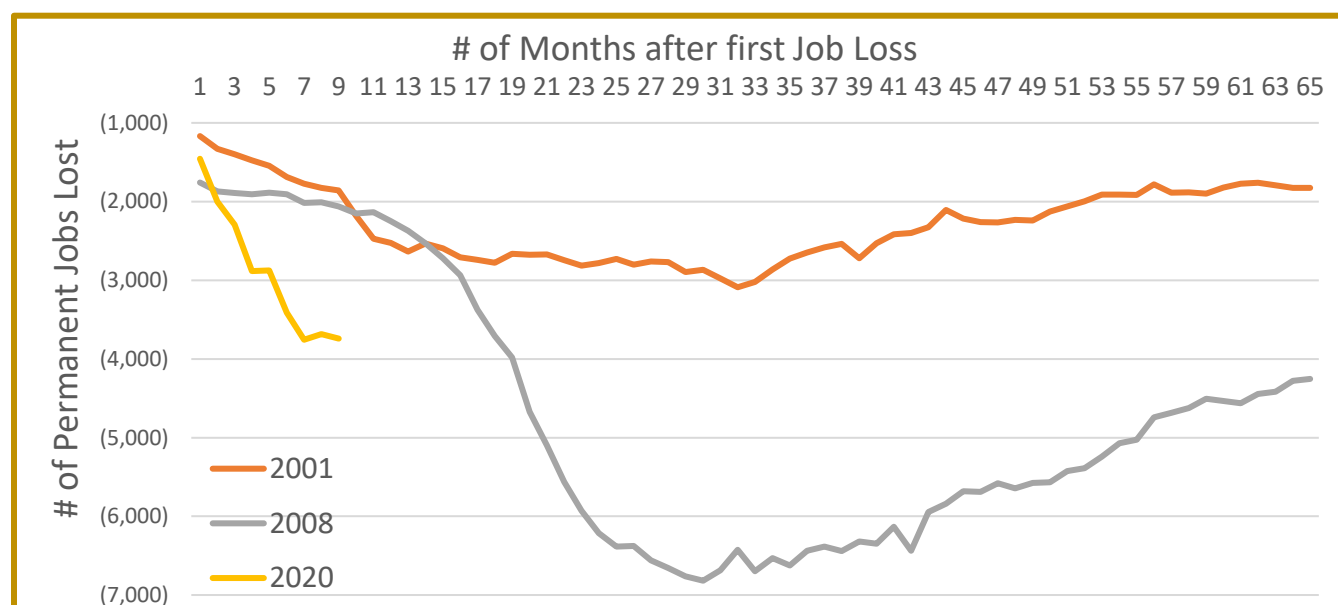
Selling: In the most volatile year in recent memory, we exited 3 positions out of roughly 26. Of the three, one saw its thesis be successfully achieved and the other two saw their stories change too much for us to remain comfortable. This is exactly what we'd like to see and it means that rules 1 and 2 were executed to plan.

The Beginning of a New Cycle

This most important assertion in our outlook over the next few years is that we have begun a new economic cycle. We don't see the 2020 recession as a mere hiccup in the old cycle, nor do we view the COVID recession as much different than any other vanilla recession at this point. It **could have** been, absolutely. But it's not. Let's dive in.

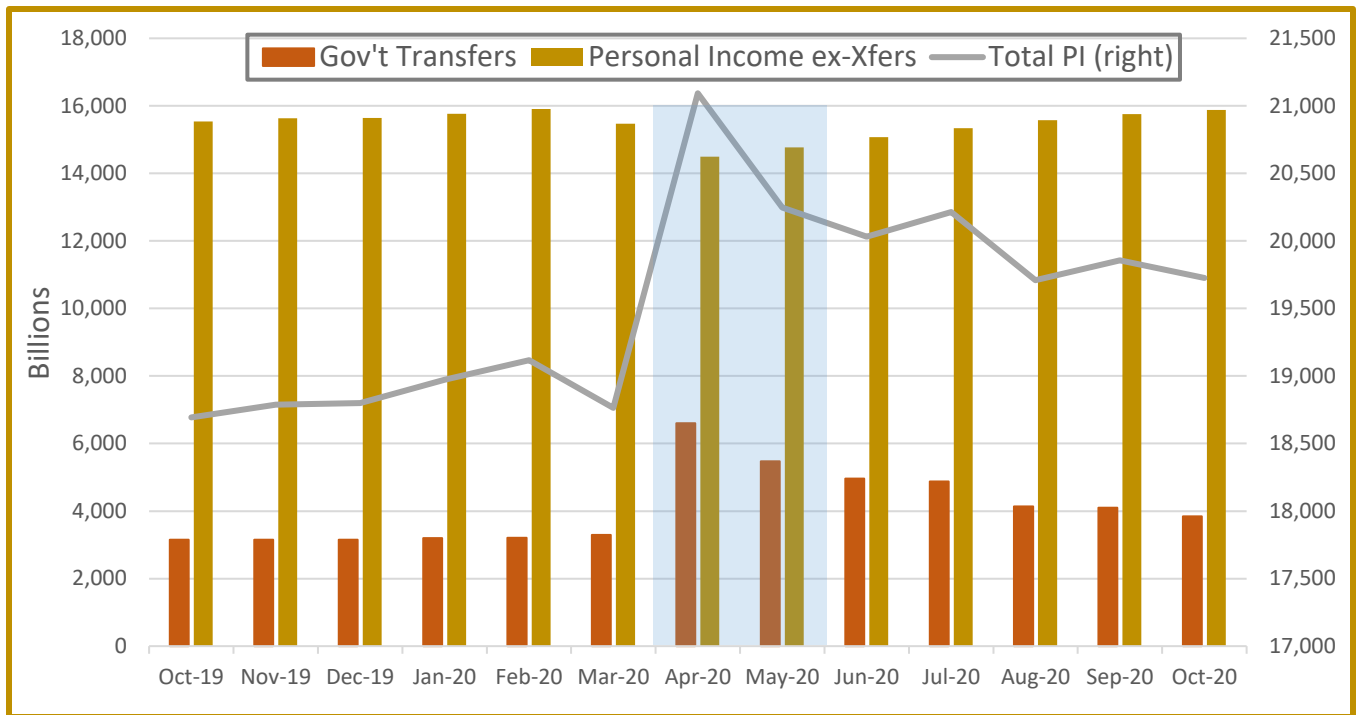
For simplicity's sake, a new cycle begins when a combination of most of these variables is met:

1. **Low consumer confidence: Check.** This one is rather obvious - consumers don't feel as confident as they did pre-pandemic. ([Chart here](#))
2. **Low Inventories: Check.** Supply chain disruptions across the globe and COVID-19 uncertainties created a pretty decent inventory drawdown that needs to be restocked.
3. **High Unemployment: Check.** This is the most painful indicator and the one that can do the most damage. The nature of the COVID shutdowns has produced a lot of noise around unemployment, but we are focused on the 'permanent unemployed' for now – seen as compared to the past two recessions below.



Clearly, we have seen a much swifter decline than in the past, but we contend that the end of the COVID-19 crisis is closer than the beginning. The labor market should provide a recovery tailwind for the foreseeable future.

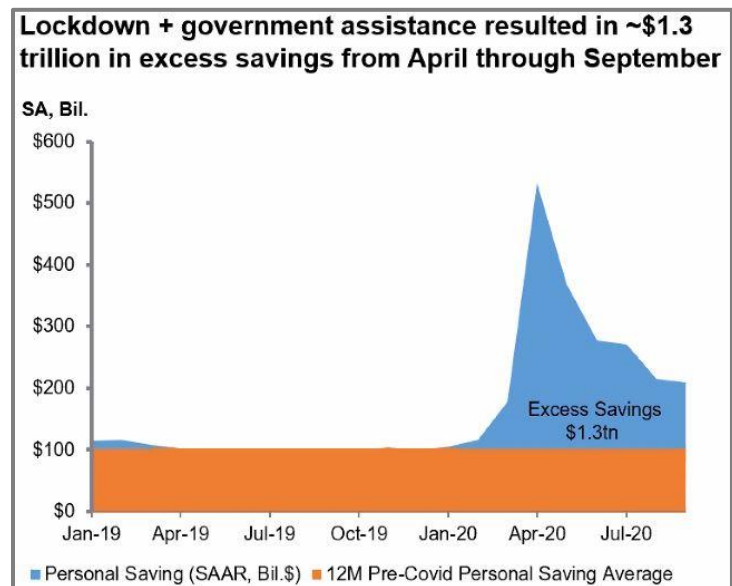
4. **High Savings Rate: Check.** If consumer confidence is low and jobs are being lost readily, it makes sense that spending goes down and savings goes up, right? Absolutely, but it's not just about going up or down. The magnitude of income lost + savings made can give us a hint at the severity of recession we are facing. This is also where you can see policy in action, e.g., the CARES act and the massive fiscal package in Europe. I'll let the chart explain on the next page. →



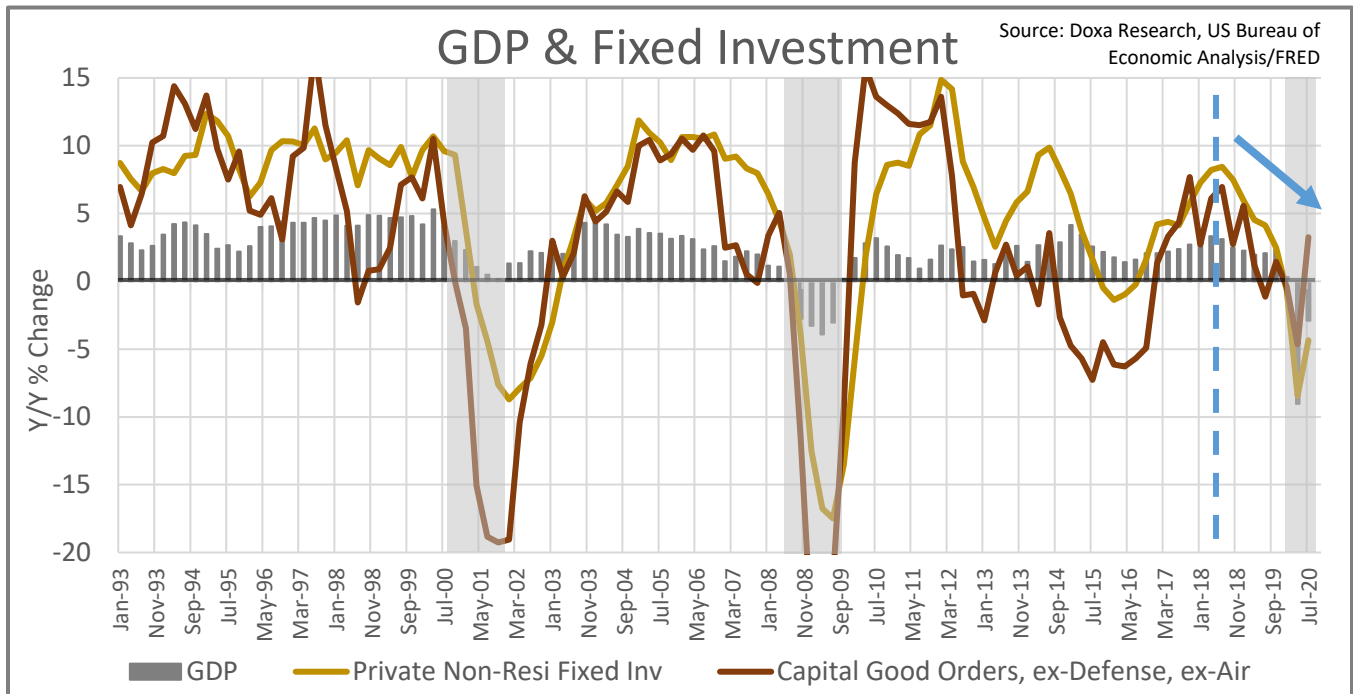
Government transfers can be social security payments, unemployment, stimulus checks, etc., while personal income (PI) is the sum of all income a person receives. PI ex-Xfers is just that, personal income minus government transfers. This chart is the **most important** of the COVID recession and is the reason why it will be one of the shortest in history. The simple reason: Congress and the CARES Act KO'd a bad recession in May. *Full stop.*

When the economy stood at a halt in April, incomes understandably took a hit (*gold bars*). The expansion of UI benefits, stimulus checks, and other government programs more than offset these losses (*orange bars*) and even boosted total income (*grey line*) above where it was pre-pandemic. If this had not been done, we'd be writing a completely different note. This was policy success.

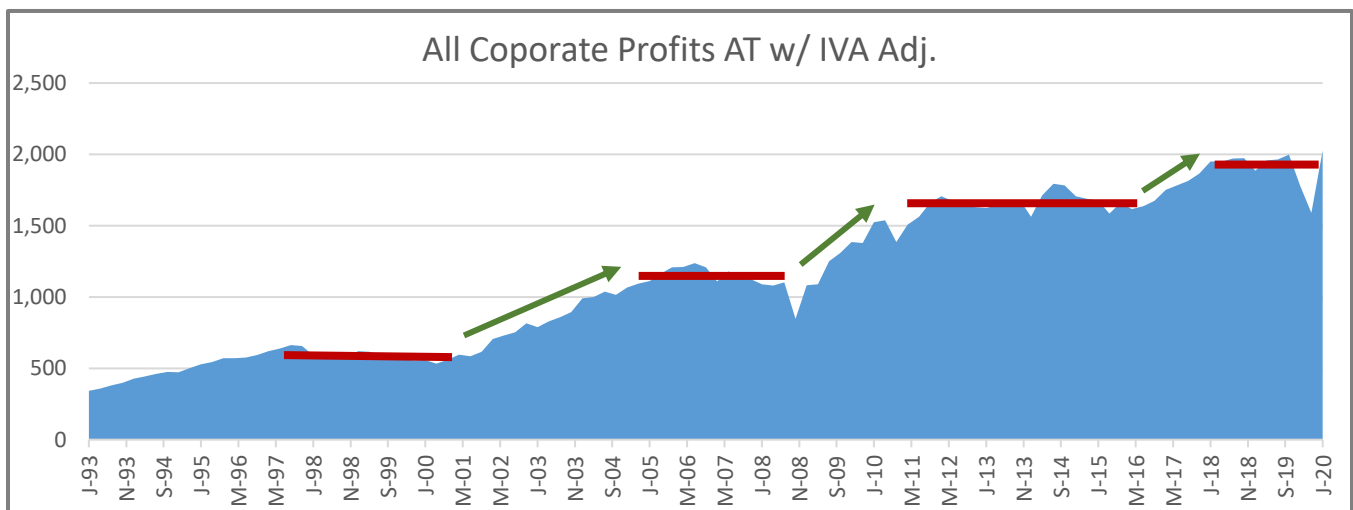
The one rule that makes all this work? *Americans will always spend.* Interestingly enough, the health nature of the pandemic gave pause to this time-tested axiom. Don't get me wrong, Americans still spent at a good clip all things considered, but not at the 95 cents on the dollar rate they have historically. The chart on the right from Morgan Stanley's Economic team shows just how much savings have built up in households. This has kept the economy afloat throughout the fall, and we'd bet it will be rocket fuel in 2021 in the services sector. *Remember, Americans always spend.*



5. **Low Business Investment: Check.** Business investment is all about psychology. When business operators feel pessimistic about the future, they pull back on future plans. When they feel optimistic, they bolster them. The key here is to remember that **one person's spending is another person's revenue**, so having a good long runaway for investment to ramp up sets the stage for a durable recovery (*gold & copper lines below*).



Further making our case that a new cycle has begun, we see the COVID-19 recession as more of a “grand finale” of sorts to a slowing process that had been in place since 2018 (chart above). We can show this in another way too – corporate profits (*something we like a lot as investors*). When investment is on the rise, corporate profits increase. When investment starts to slow, corporate profits slow. This defines economic cycles in a sense, and while not perfect, it's critical to have a pretty good idea of where we are in it. (*The X-axis of both these charts is the same, so compare them!*)

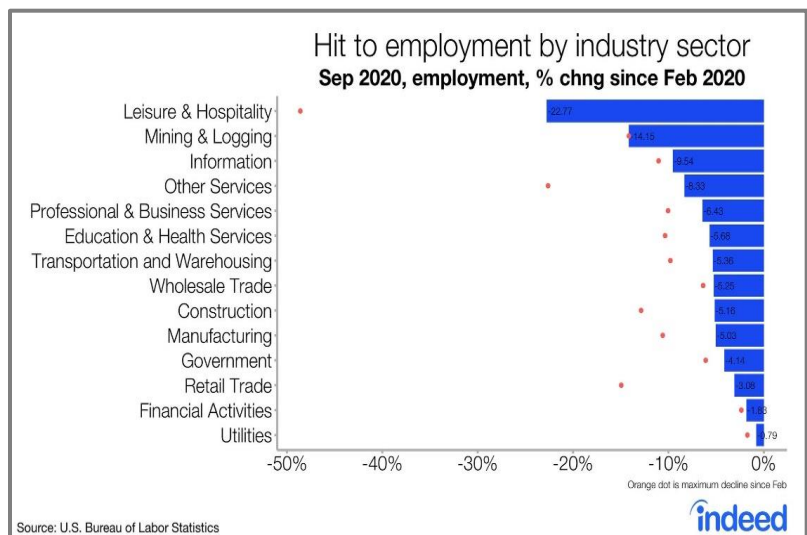


All 5 variables signaling the start of a new cycle have been checked. Therefore, our go forward outlook is just that – we’ve begun a new economic cycle and should be positioned accordingly. That means [It’s Time to Build](#), as Mr. Andreessen says. Inventories need to be restocked and investments need to be made. Industrials, cyclicals, financials – long demographic tailwinds help healthcare and housing. Energy shifts help electrification. [Deployment](#) helps spread efficiency and generate better returns on capital.

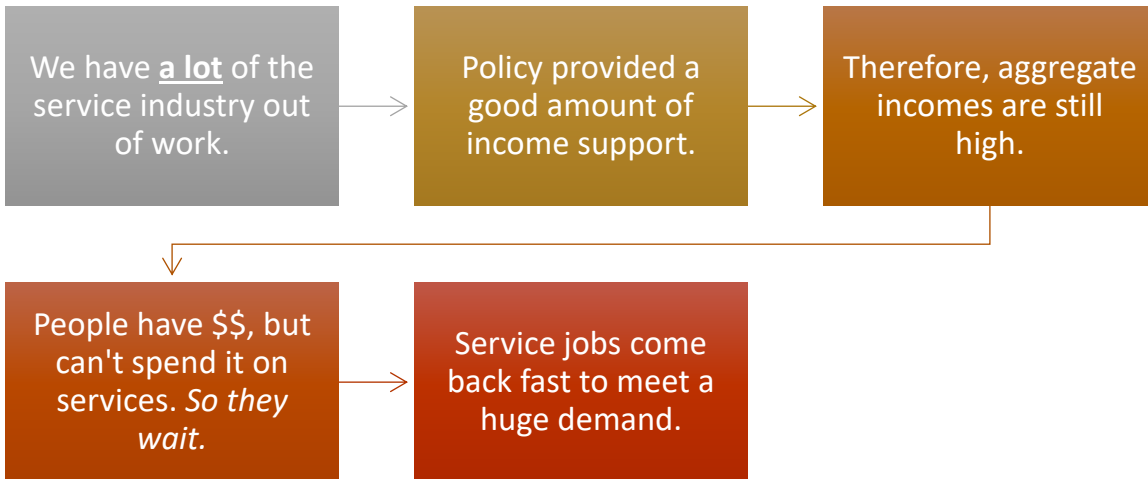
What’s Different This Time?

All recessions and recoveries are different, but most follow roughly the same playbook and this one is no exception. However, the COVID-19 recession has a few unique properties that make us very encouraged on the recovery ahead.

1. **The “nobody’s fault” recession.** Folks are likely to pass blame very quickly when things turn down – that’s normal politics. But having a substantial amount of fiscal support can go a long way in jumpstarting a recovery (*like we had this time!*). Unfortunately, that’s usually stymied by a cohort that believes “*they had it coming*”. Of course, there have been plenty of bad actors that set off a bad string of events, but recessions hurt everyone. It’s not the time to hold back fiscal help for a self-proclaimed noble cause. Luckily, COVID-19 cut through this norm and made it easy for policy makers to unleash the big guns of fiscal policy. There was no industry to blame or witch-hunt to commence. A crisis hit, everyone was affected, and policy makers acted swiftly with a big hammer. Proof? **The amount of global government spending as a % of GDP is nearly 5x what it was in 2008.**ⁱ That’s big. That’s helpful. And that’s exactly why we are looking at a robust recovery.
2. **Households aren’t leveraged.** This means that families, by and large, are in good financial shape. [Interest payments](#) are at an all-time low. [Home equity](#) is looking great. [Checking accounts](#) are flush. [Credit card delinquencies](#) are also at an all-time low. This is one hell of a starting point to begin a recovery. Of course, defaults are going to be higher in 2021 as some special moratoriums end, but there is ample room for increase considering how low levels are now.
3. **Recovery = Repair. This should be a fairly quick one.** Whatever broke in a recession must be repaired. After the dotcom bust in 2000, it took years to deflate the excess in telecom. After 2008, the financial and housing sectors were repairing for nearly a decade. In this recession, our broken sector was the services industry and the hardest hit were our low wage workers, concentrated in leisure &

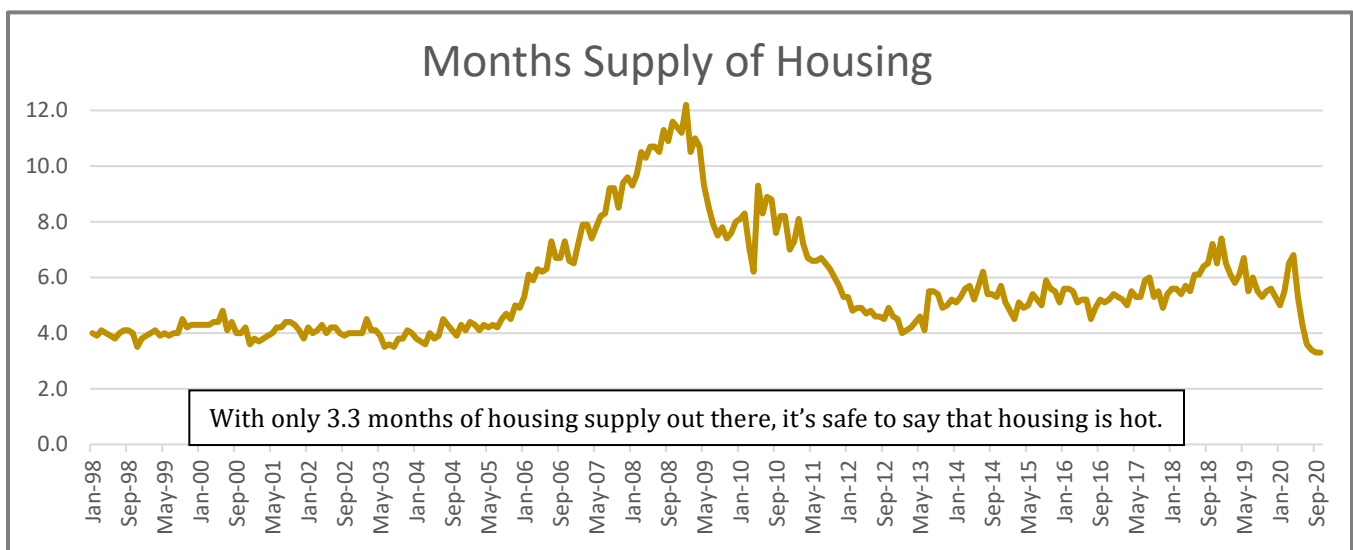


hospitality (*chart above*). Luckily, this is a sector that can turn off and on pretty fast and will adjust quickly when our health crisis ends. We wouldn't bet against a big boom in the travel and services industry in the second half of next year and that would bring a lot of jobs with it.



2021 to travel? Are you crazy? Yes, 2021. It's not about when COVID-19 is over. It's about when people are confident that it will be over. The confidence is what prompts people to schedule vacations, make birthday plans, restart wedding countdowns, etc. When the confidence is back, the economy is back.

4. **Housing and Healthcare: the demographic winds of change.** Housing and related items make up roughly 20% of our economy. Healthcare is another 20%. And banking funds the whole thing. After 2008, an extensive repair was needed in banking and housing – and the Affordable Care Act made some changes in healthcare for good measure. This time around, our backbone couldn't be stronger. Banking is rock solid. Innovation in healthcare is high and demand is growing. And housing isn't only hot because of working from home – Generation Y has been at the cusp of home ownership for a while and COVID pushed them over the edge. This trend isn't going to reverse, housing inventory is at multi-decade lows!



Optimistic, but allow for setbacks.

We're optimistic about the economy as we emerge from the COVID-19 crisis into a new cycle and believe we are positioned incredibly well. However, there **will** be setbacks along the way. Some we'll see, some we won't. That's why we stick to our rules: allow good businesses to **compound** good returns, have a **plan** and be disciplined, and **don't sell** unless the business is truly broken.

Author's Note: As I walk around my mostly empty building in uptown Charlotte, it's easy to forget how crowded it was just a year ago. It's near second nature to grab my mask as I head into a store or stand farther apart in a queue. In the face of a global pandemic, Humanity (all of us) adapted quickly. We may not like it and it's far from perfect, but we've done it by and large.

The global population changed its collective behavior in the matter of months – amazing, isn't it? All year we've written, "***We are in the midst of a human crisis, not a financial one...and we know better than to bet against humanity.***" Yes, it's easy to criticize when we live it every day, but stepping back that's a bet I'd make time after time. Humanity's resolve is strong and it's been proven once again throughout all the empty corridors, vacant stadiums, and altered holiday gatherings across the world.
Never bet against humanity.

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ⁱ <https://www.csis.org/analysis/breaking-down-g20-covid-19-fiscal-response-june-2020-update>

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