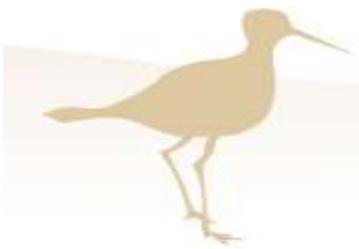


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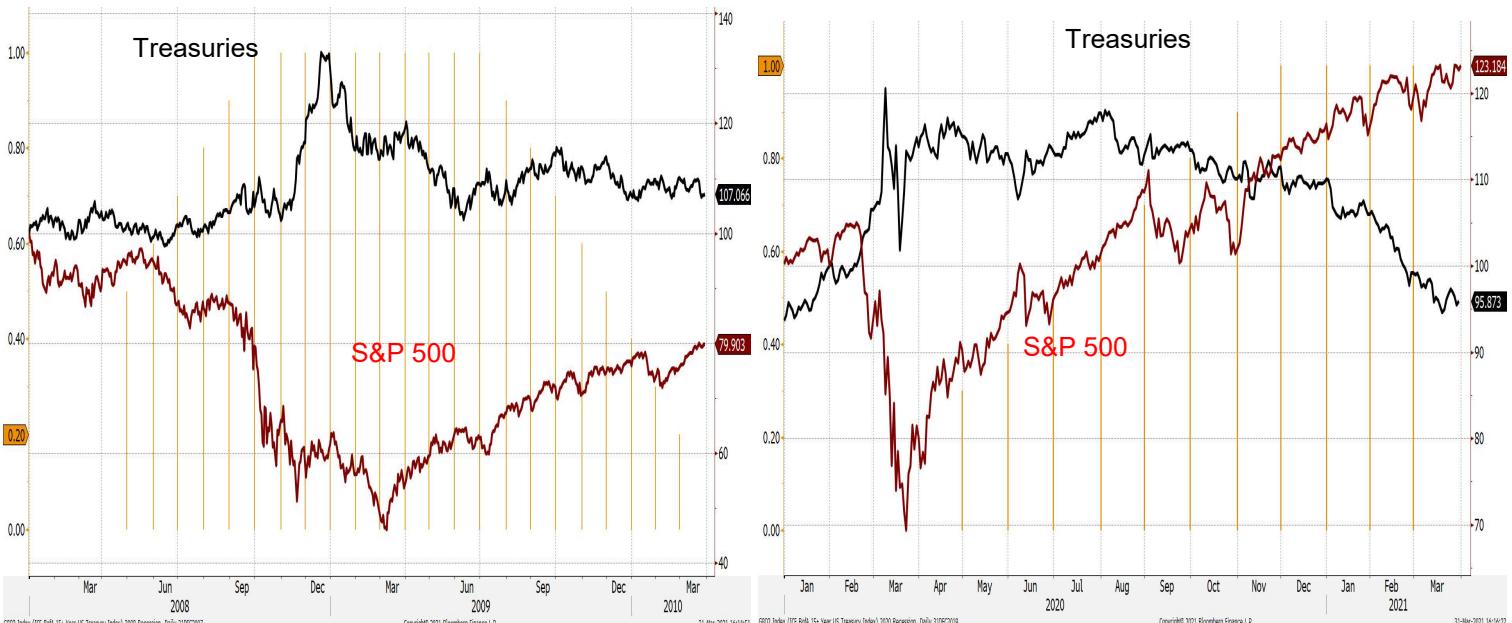
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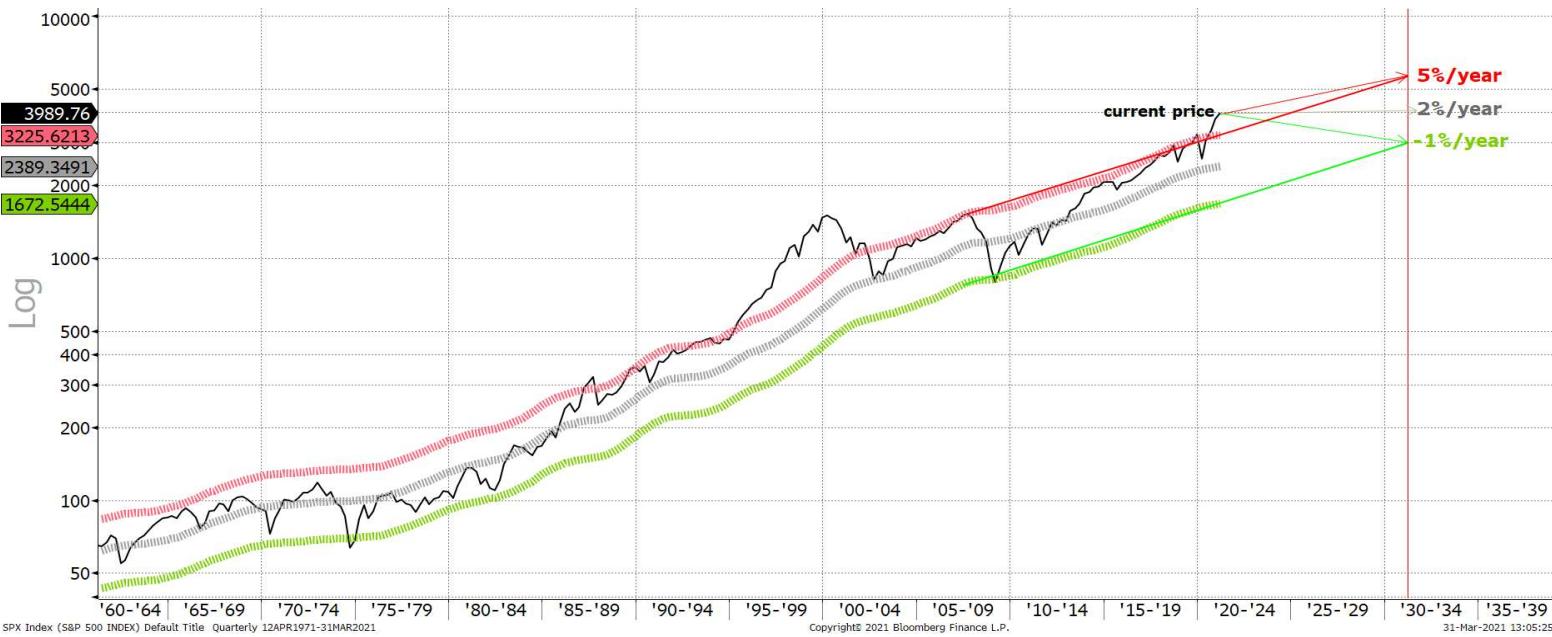
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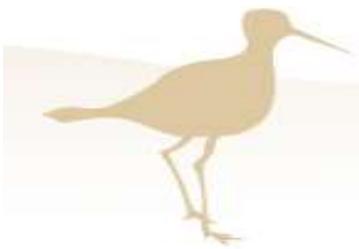


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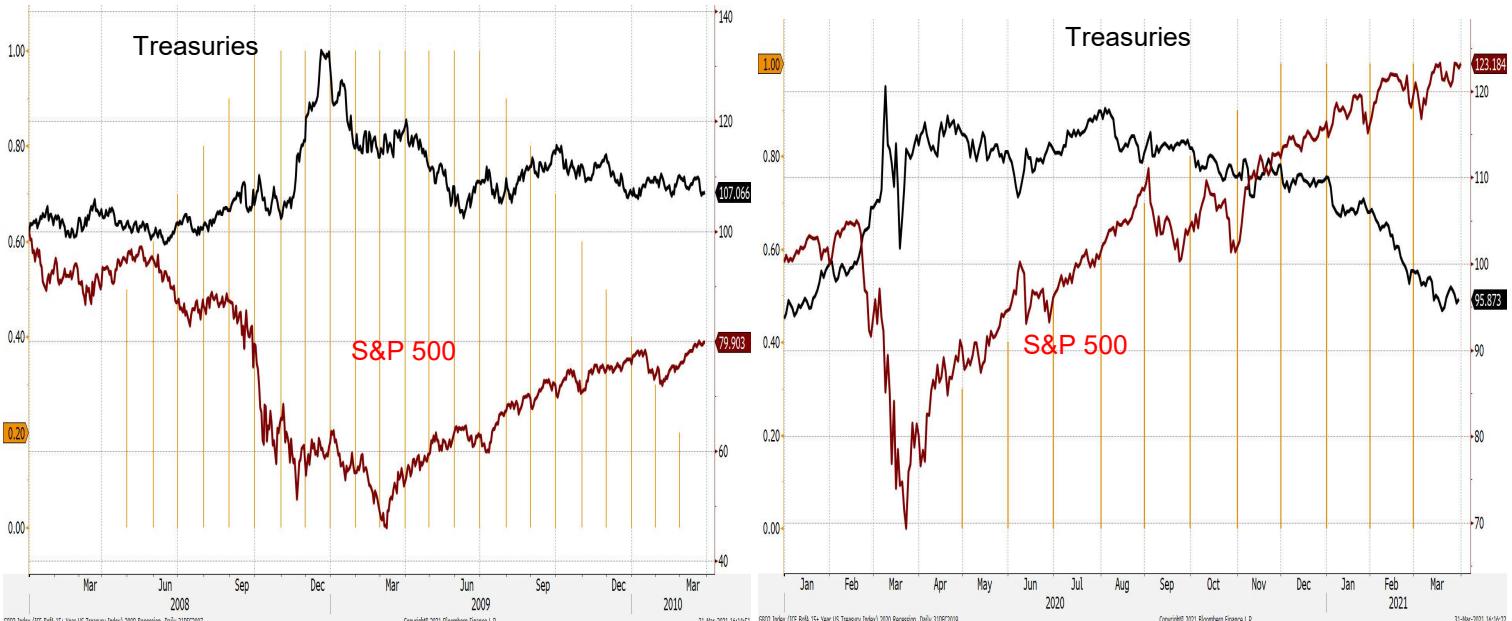
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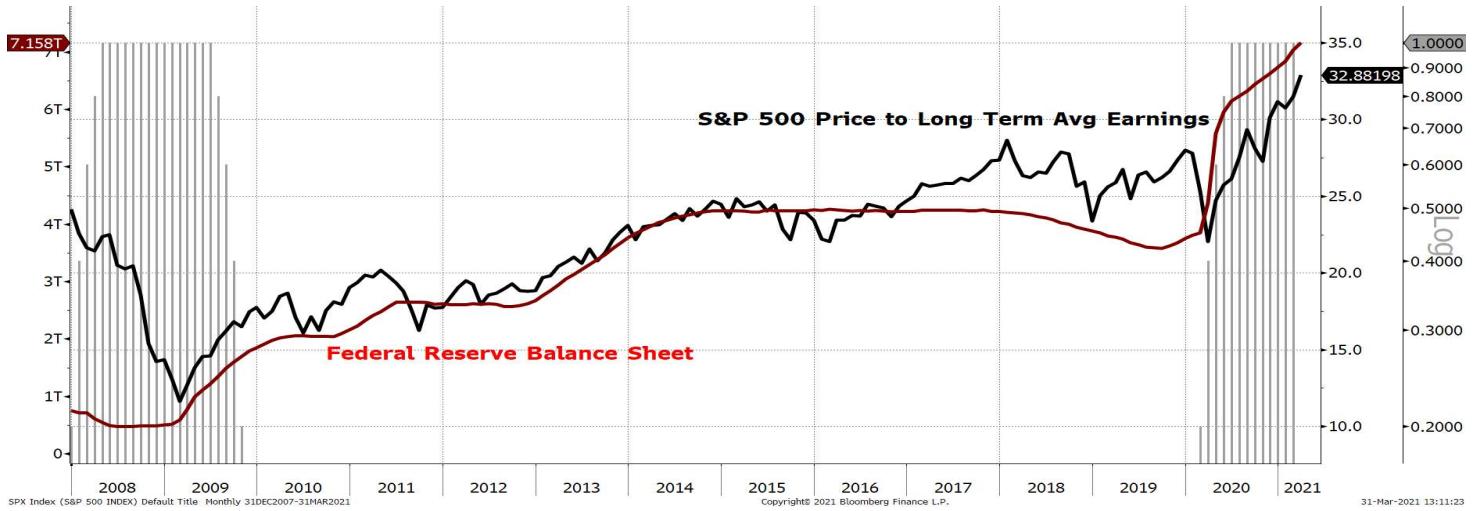
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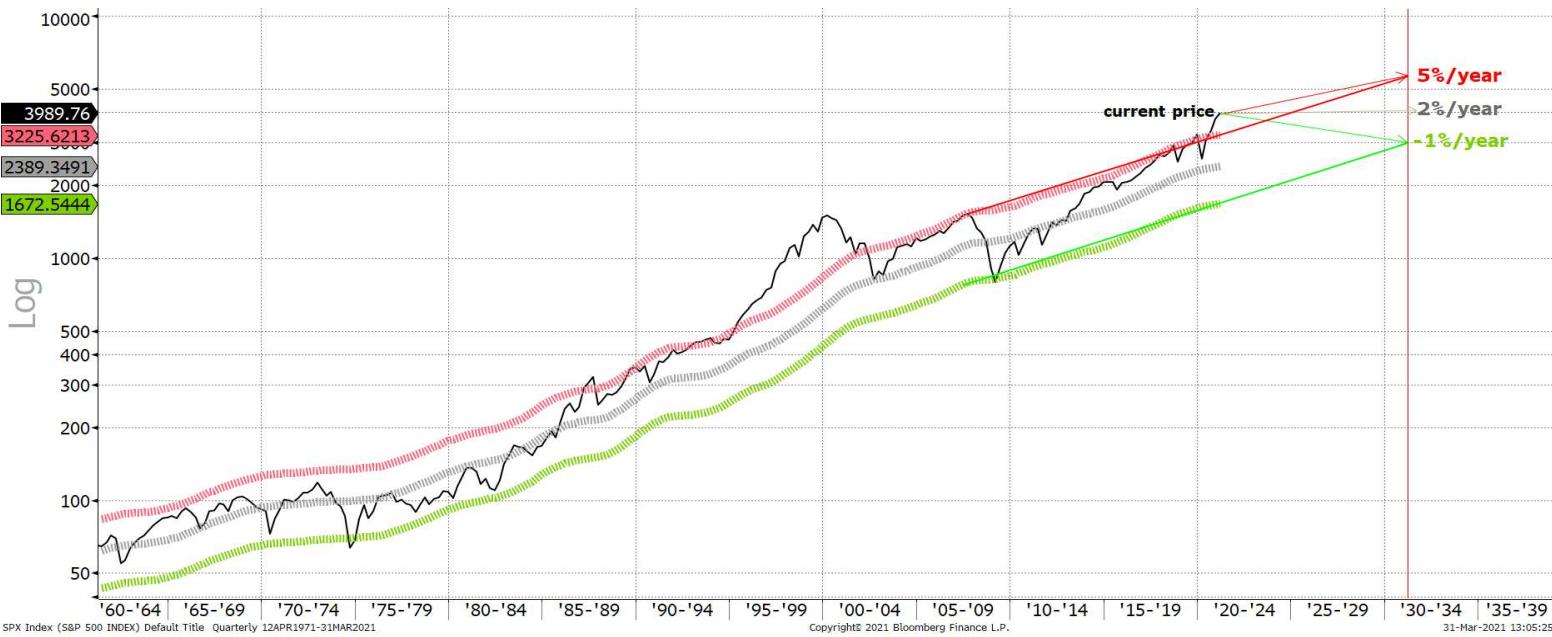
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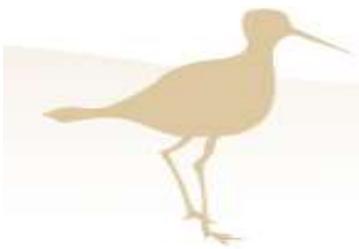


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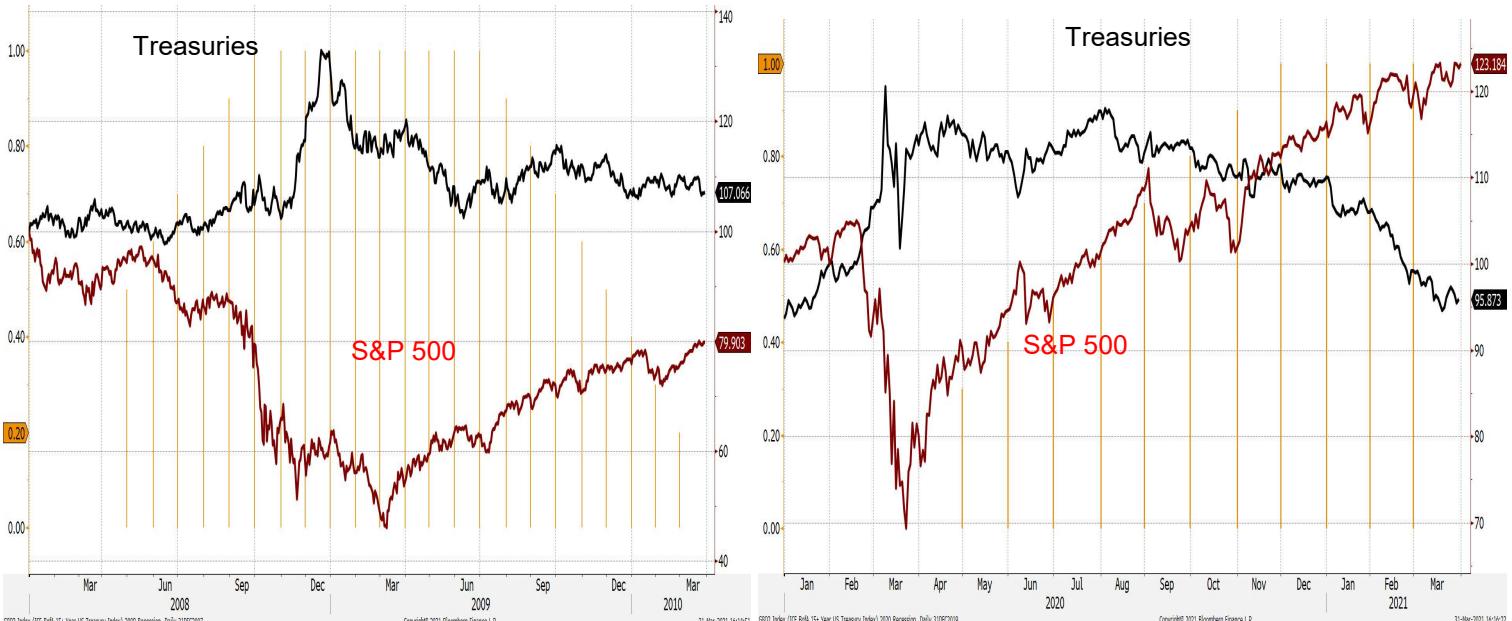
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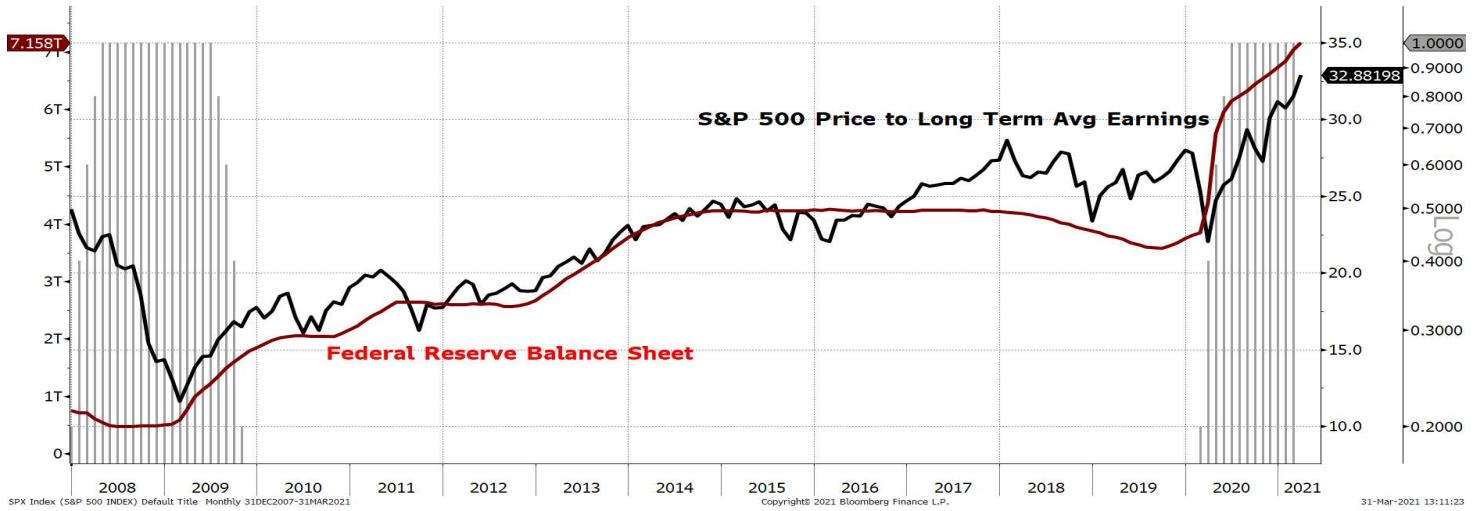
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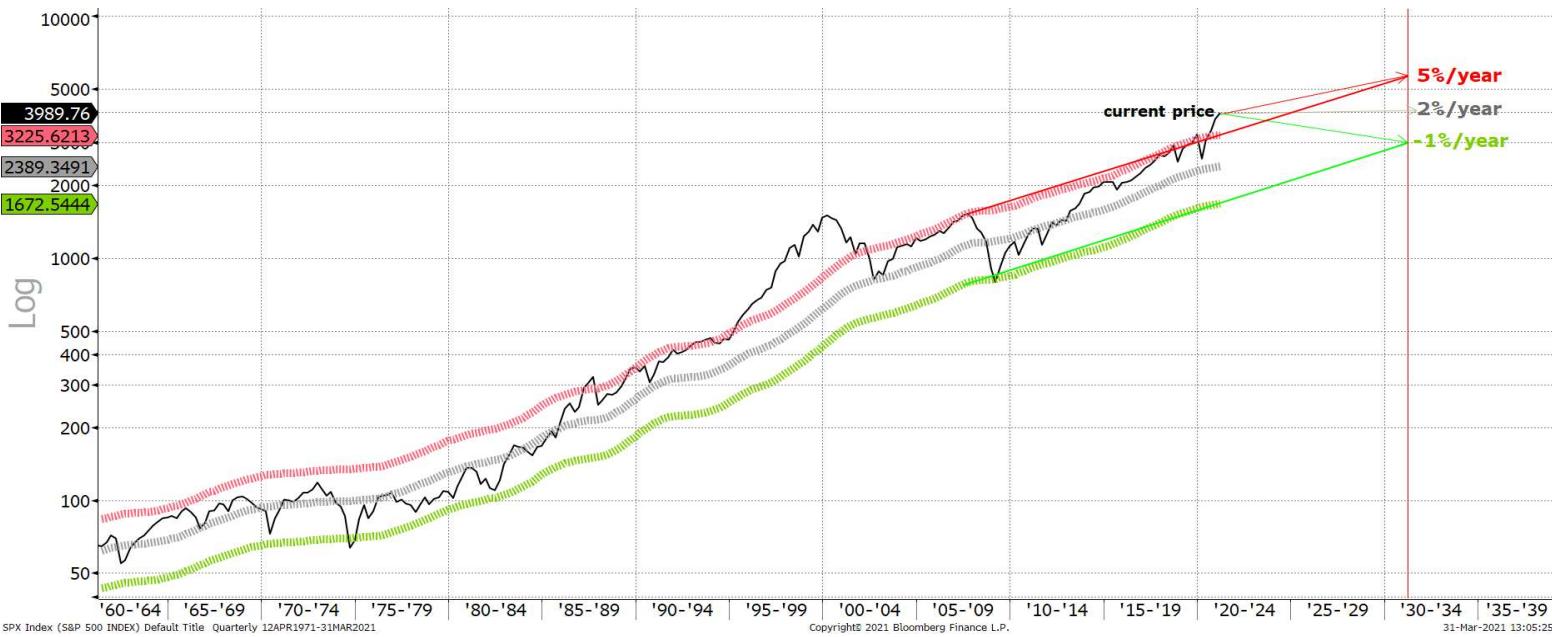
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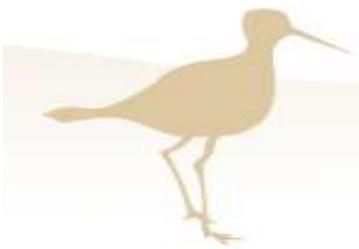


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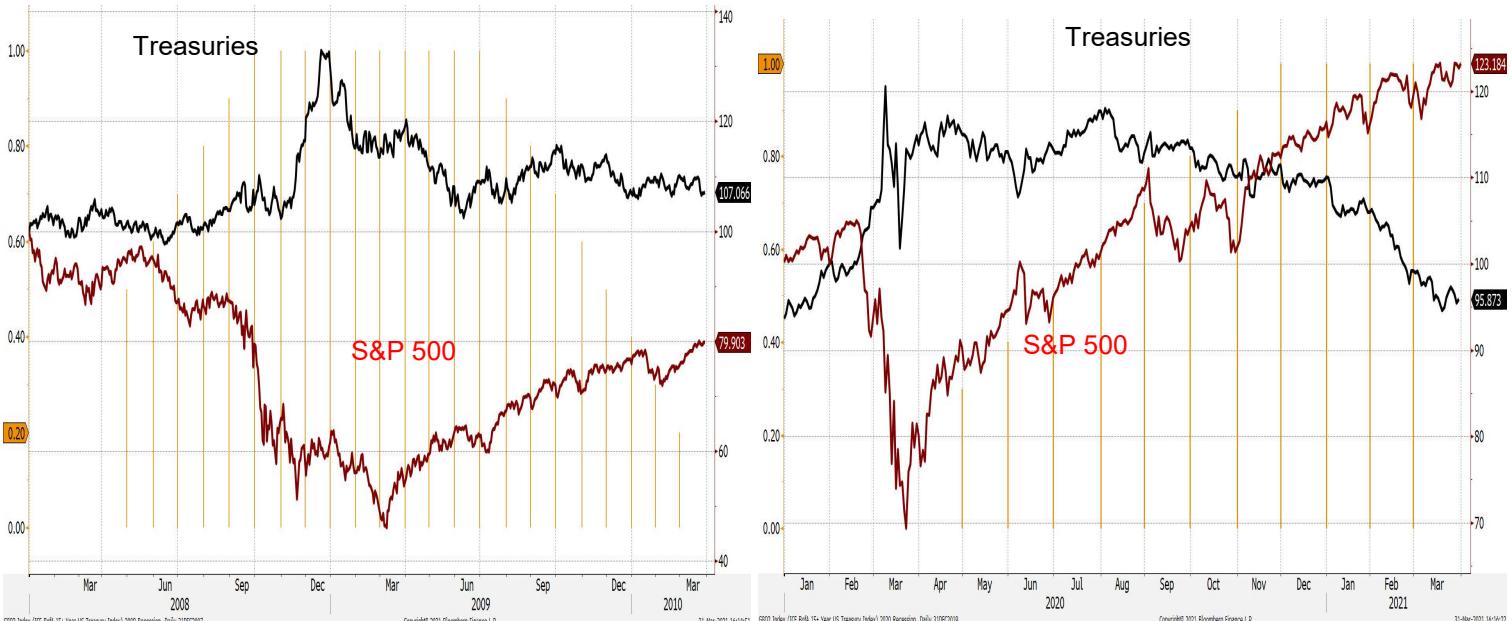
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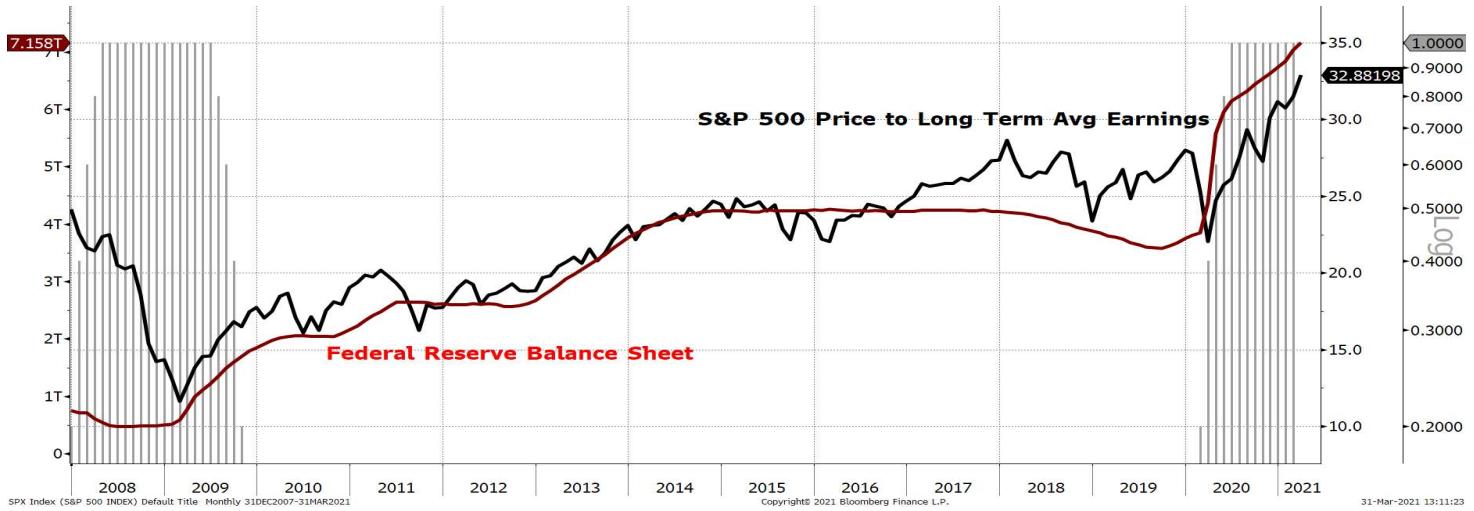
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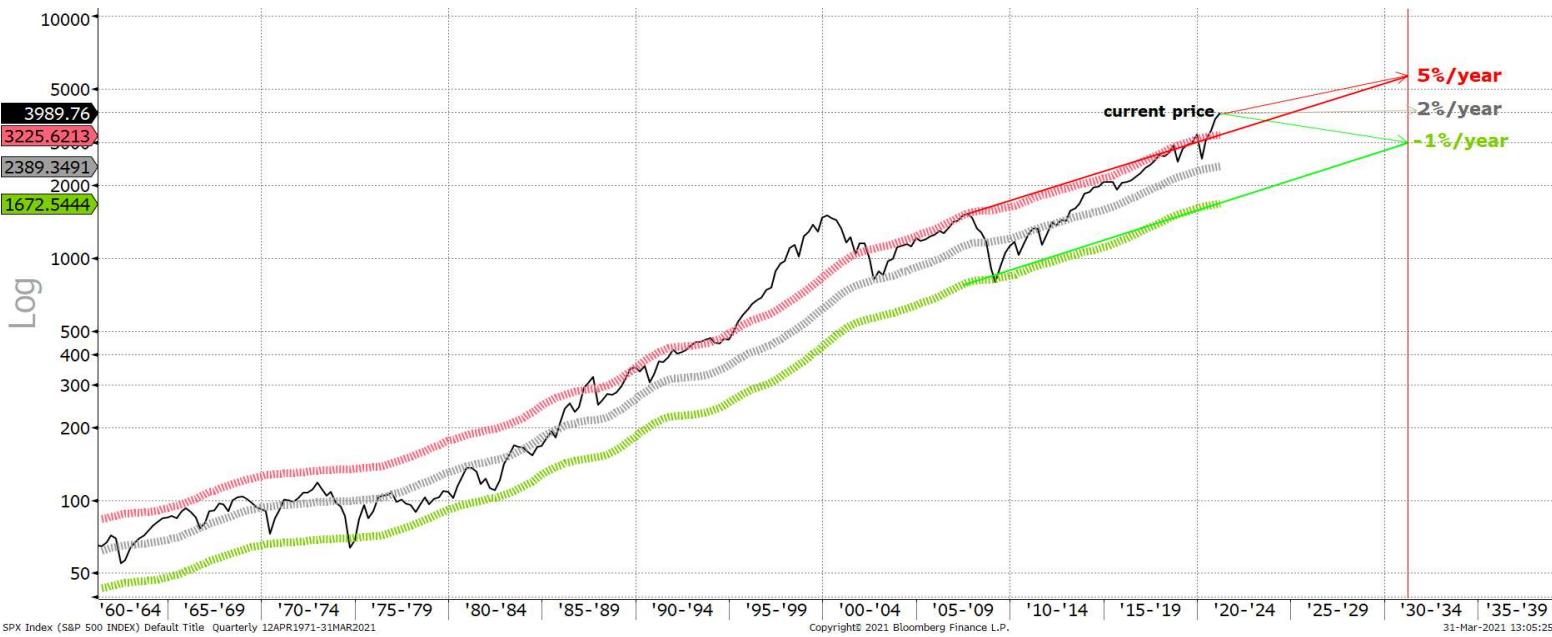
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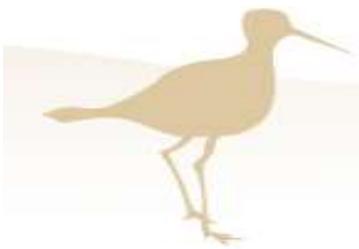


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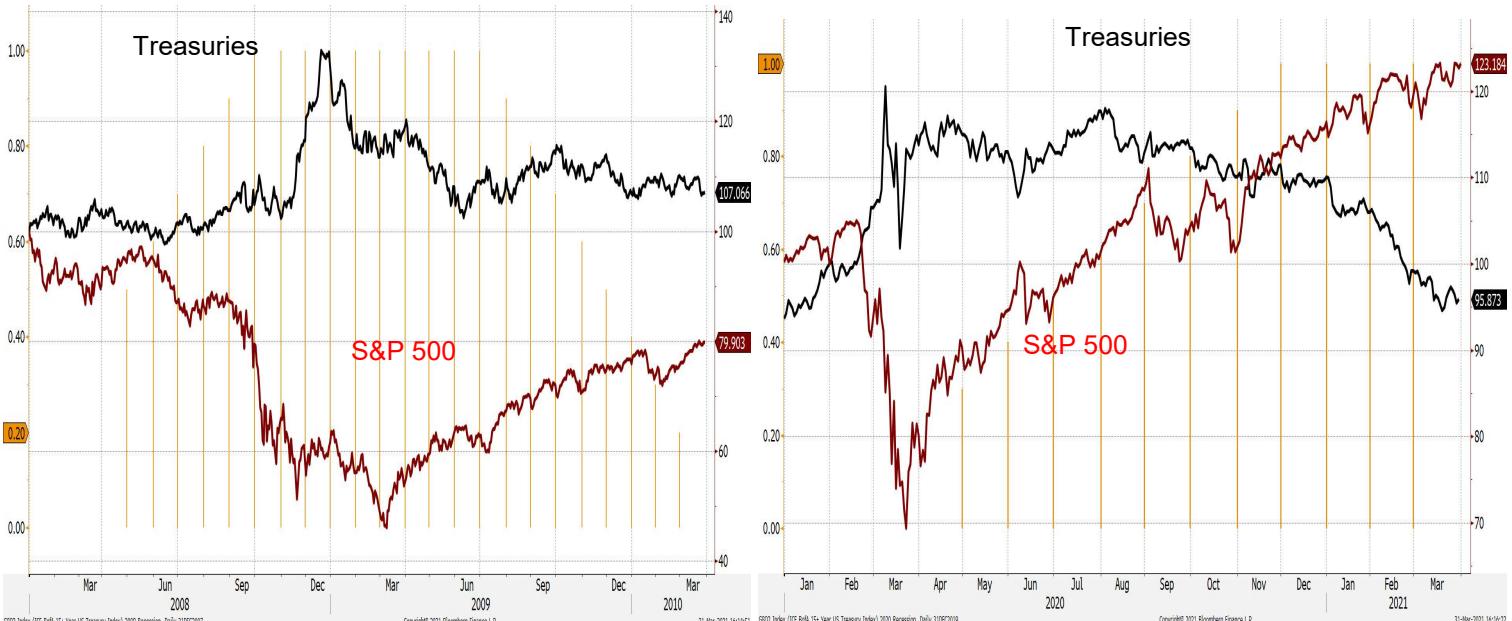
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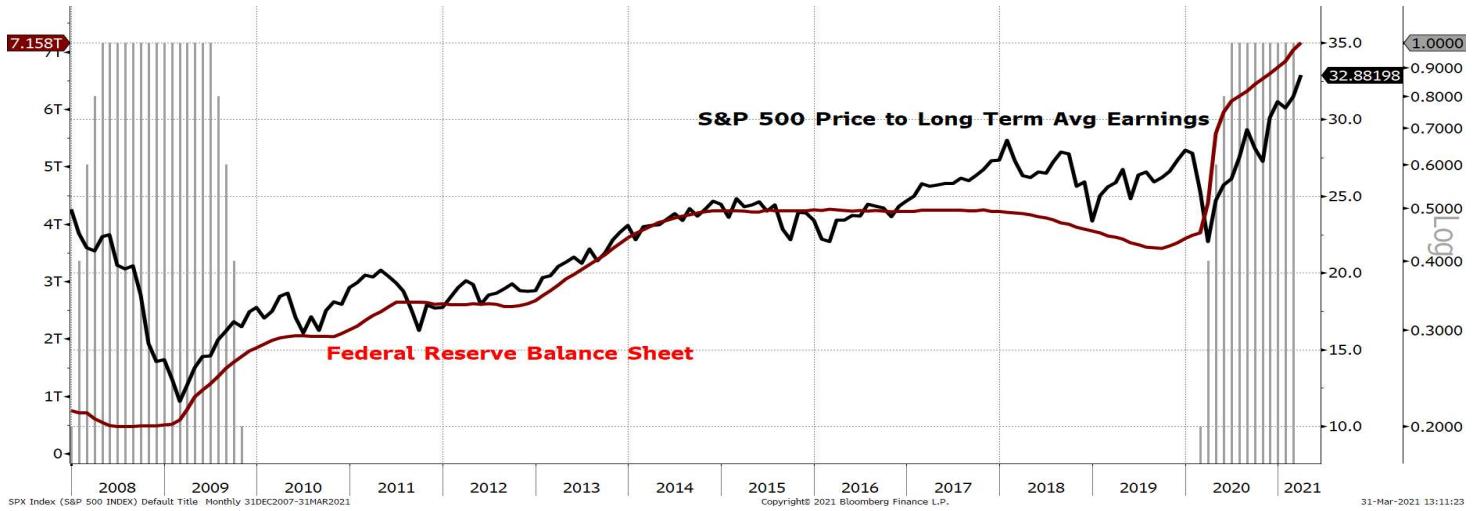
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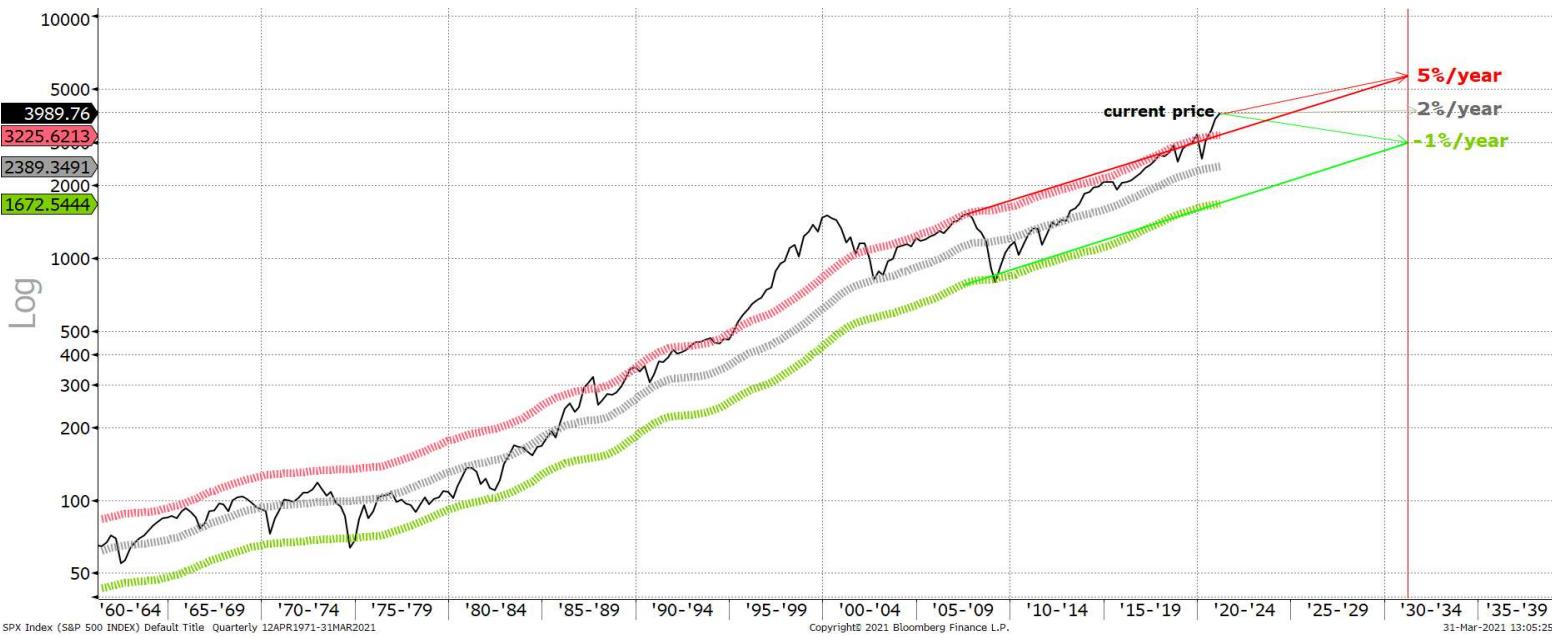
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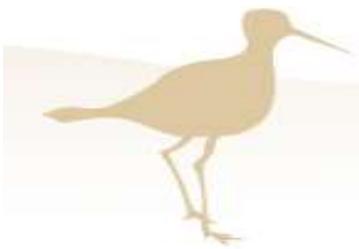


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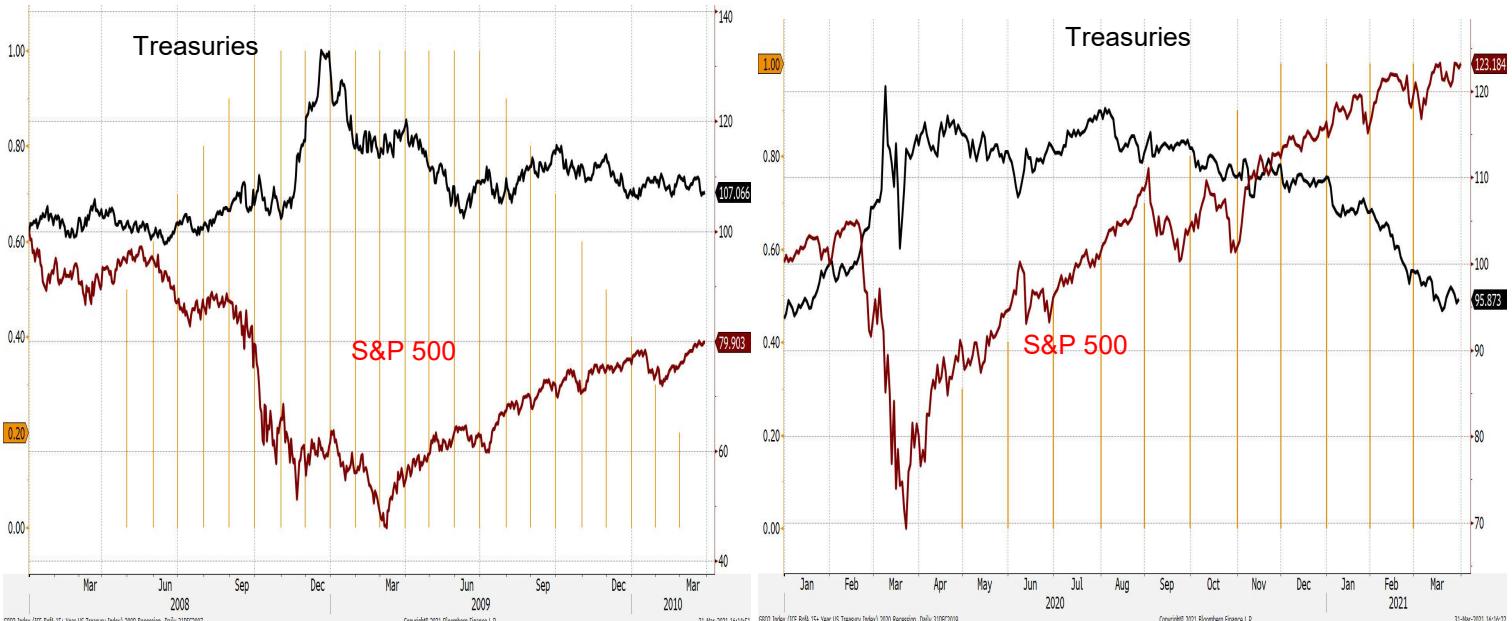
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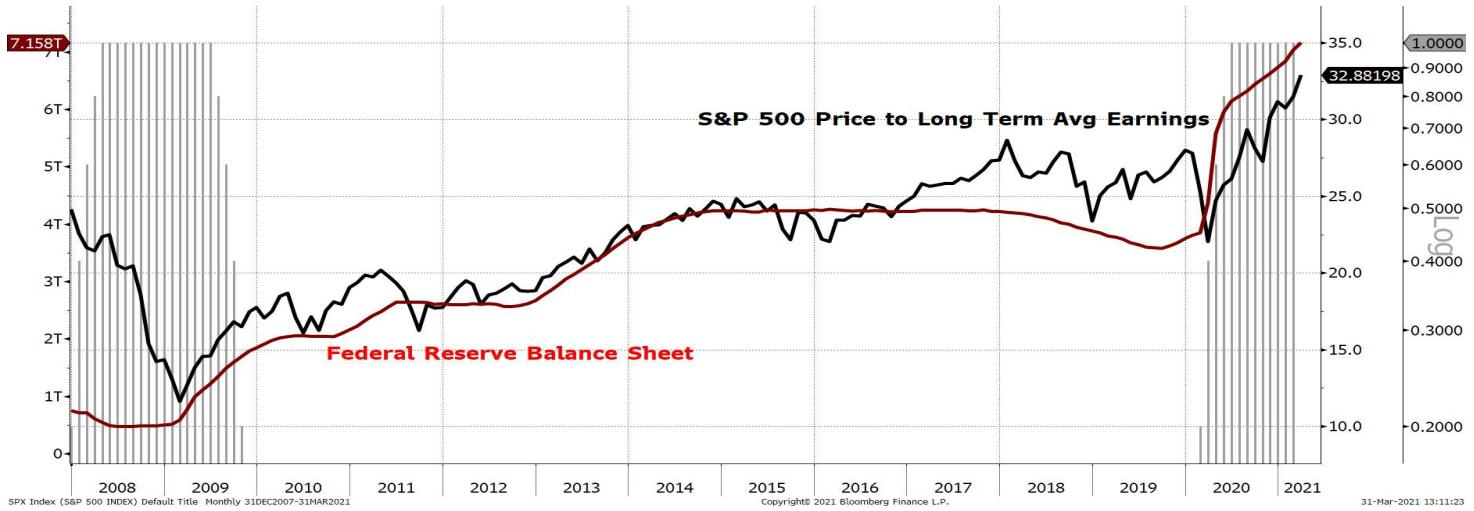
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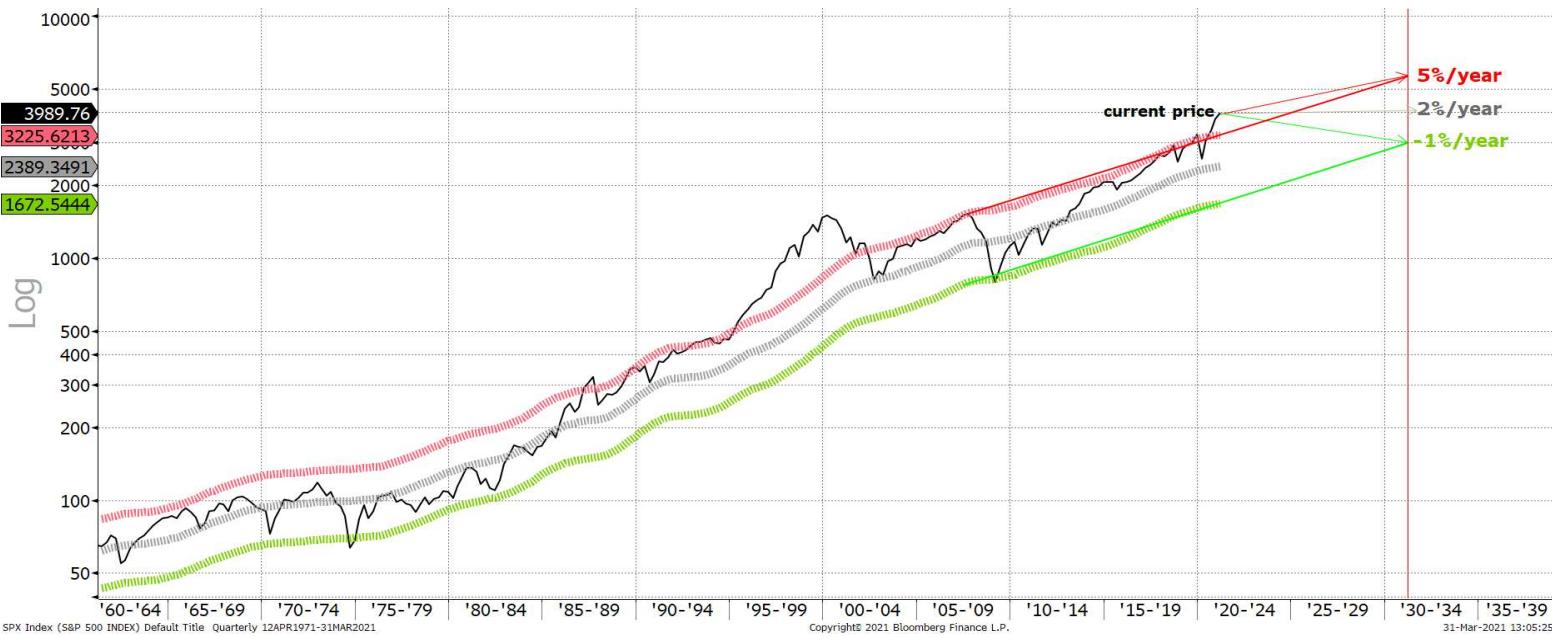
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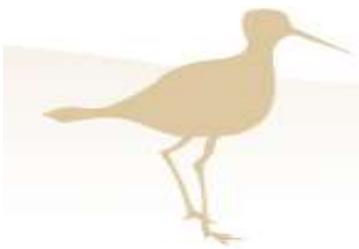


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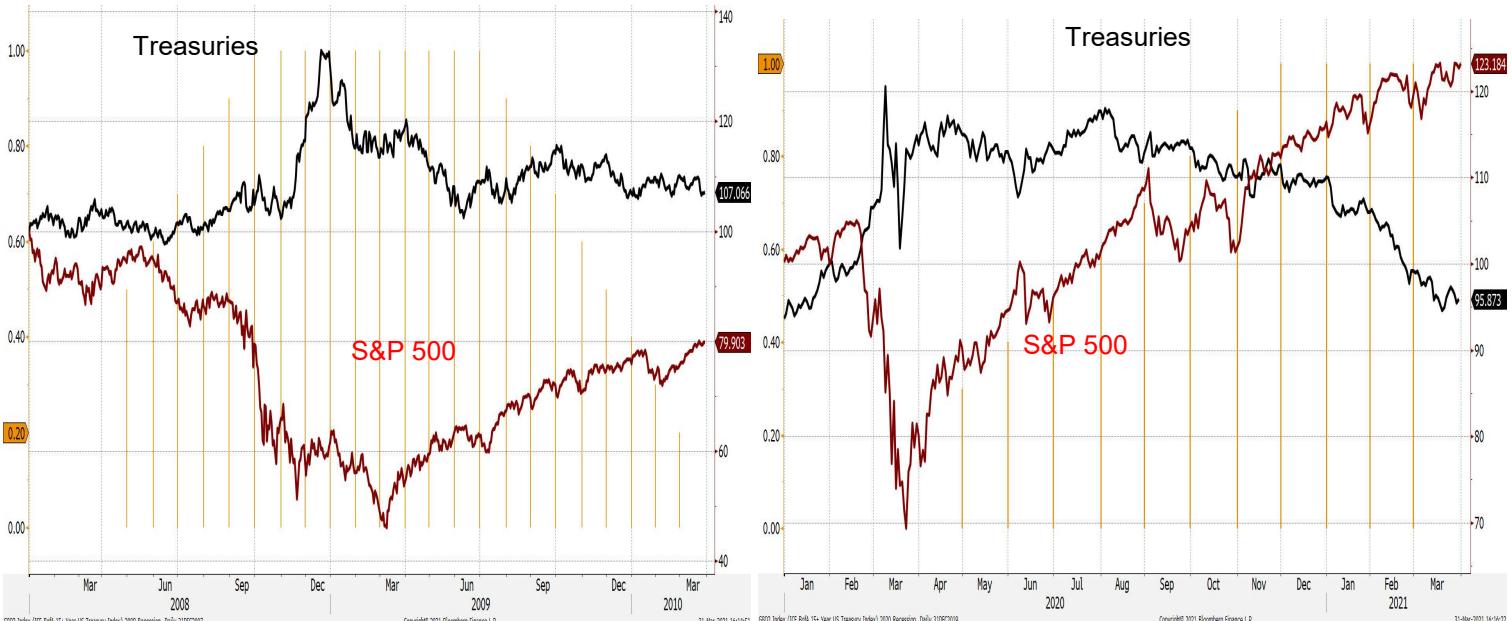
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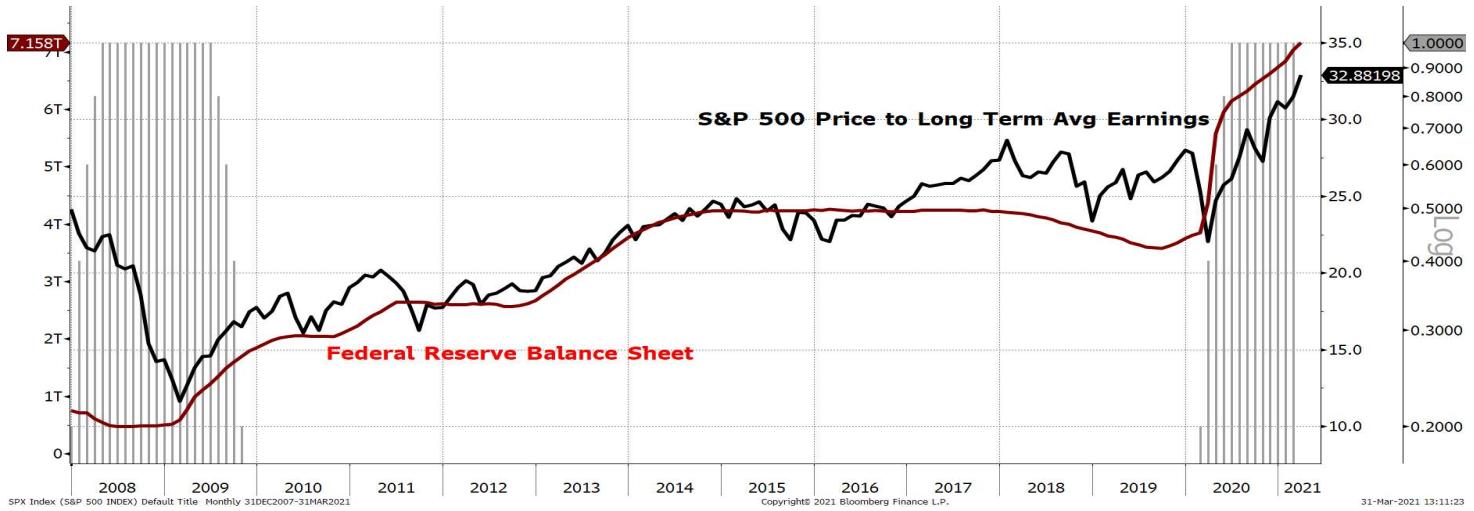
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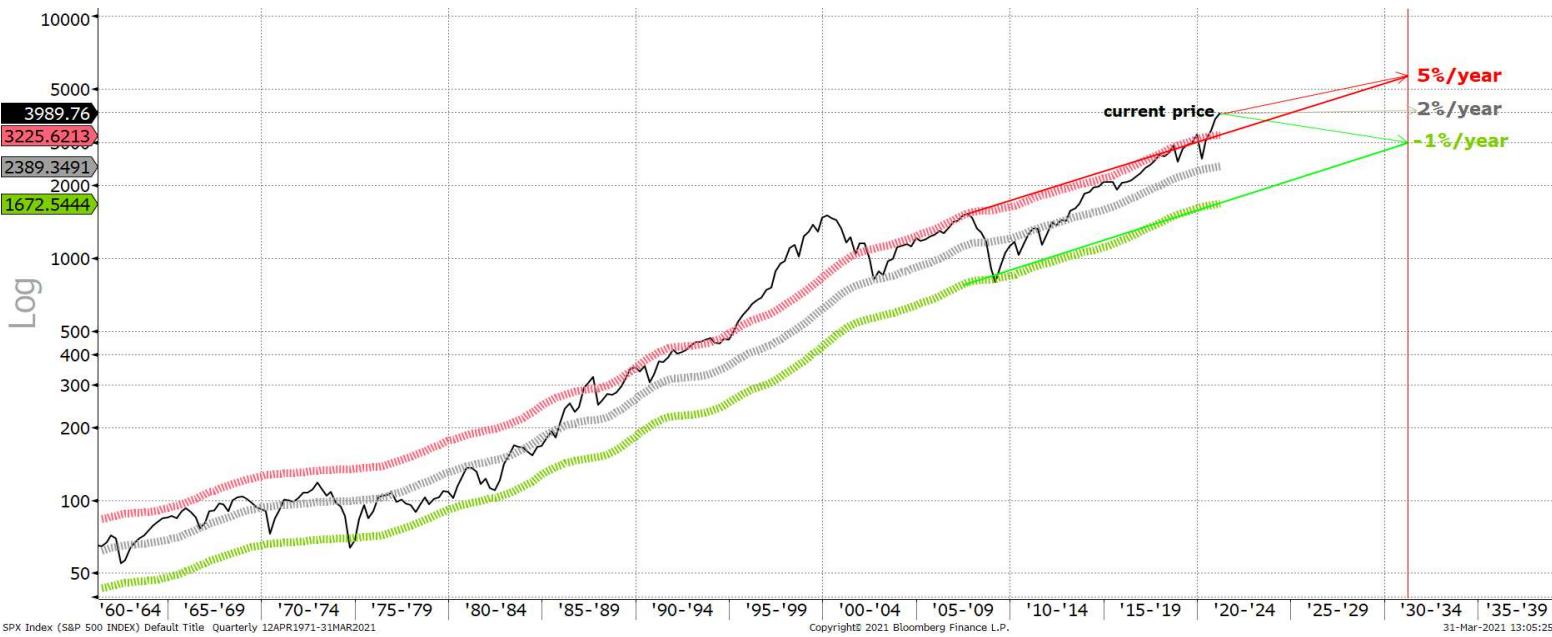
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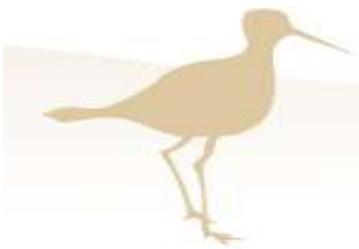


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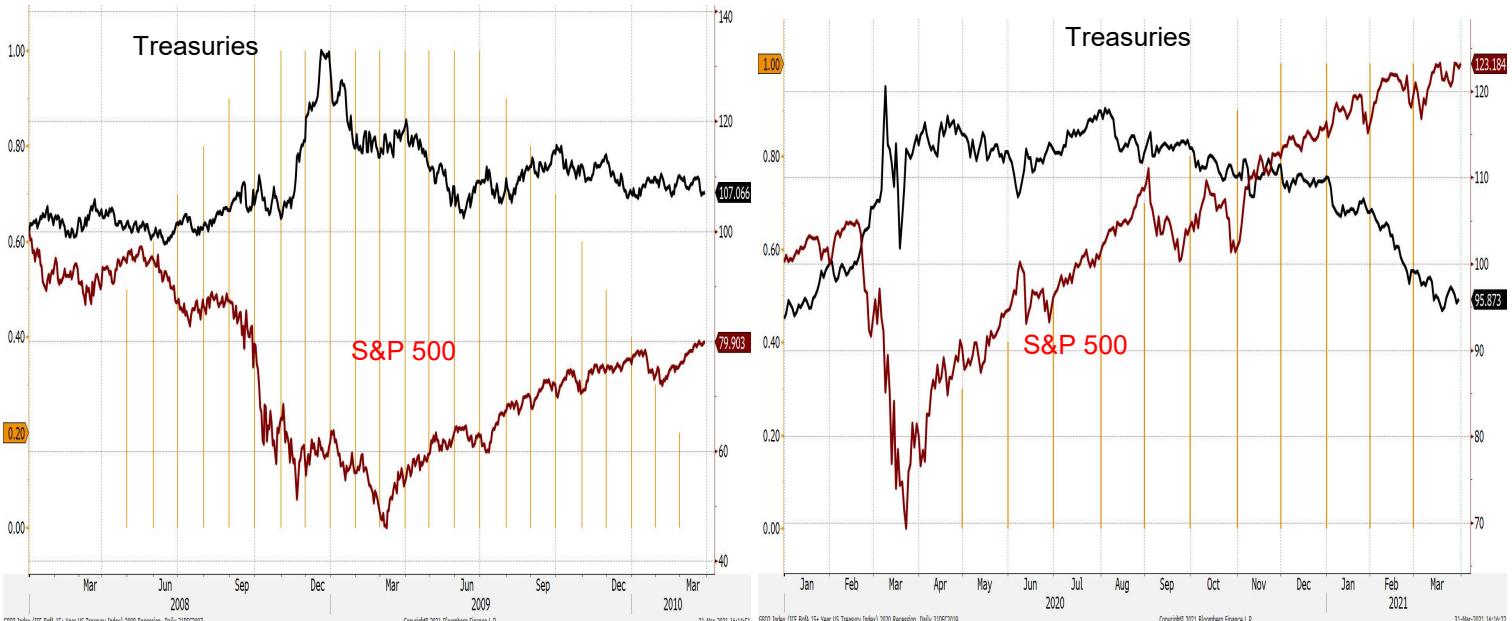
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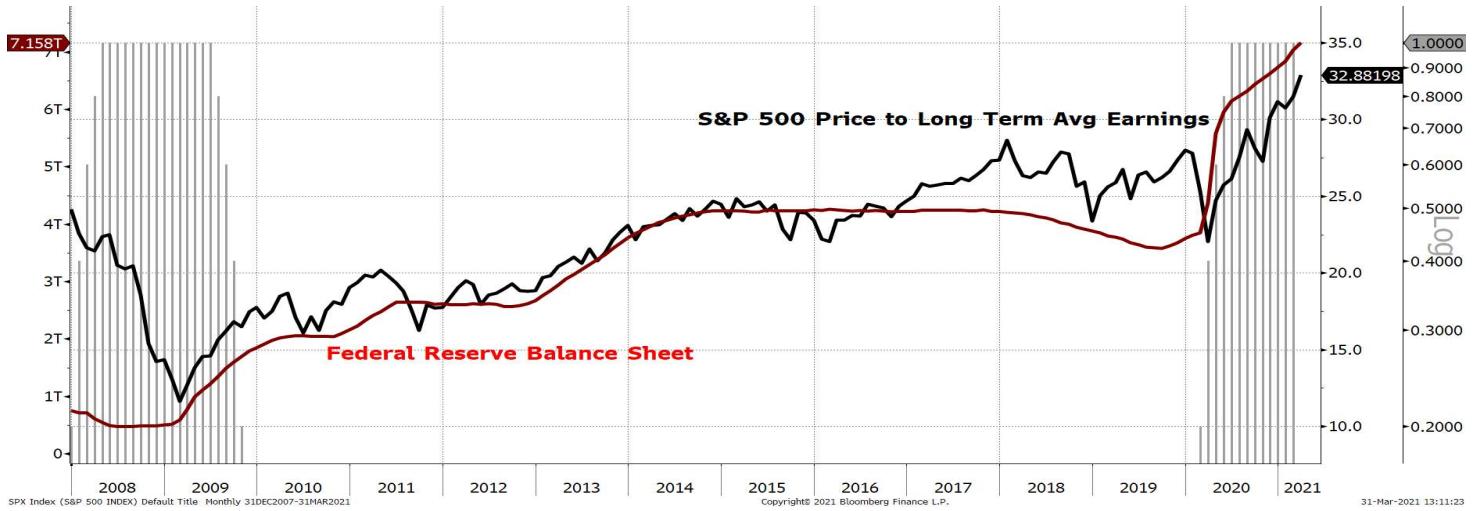
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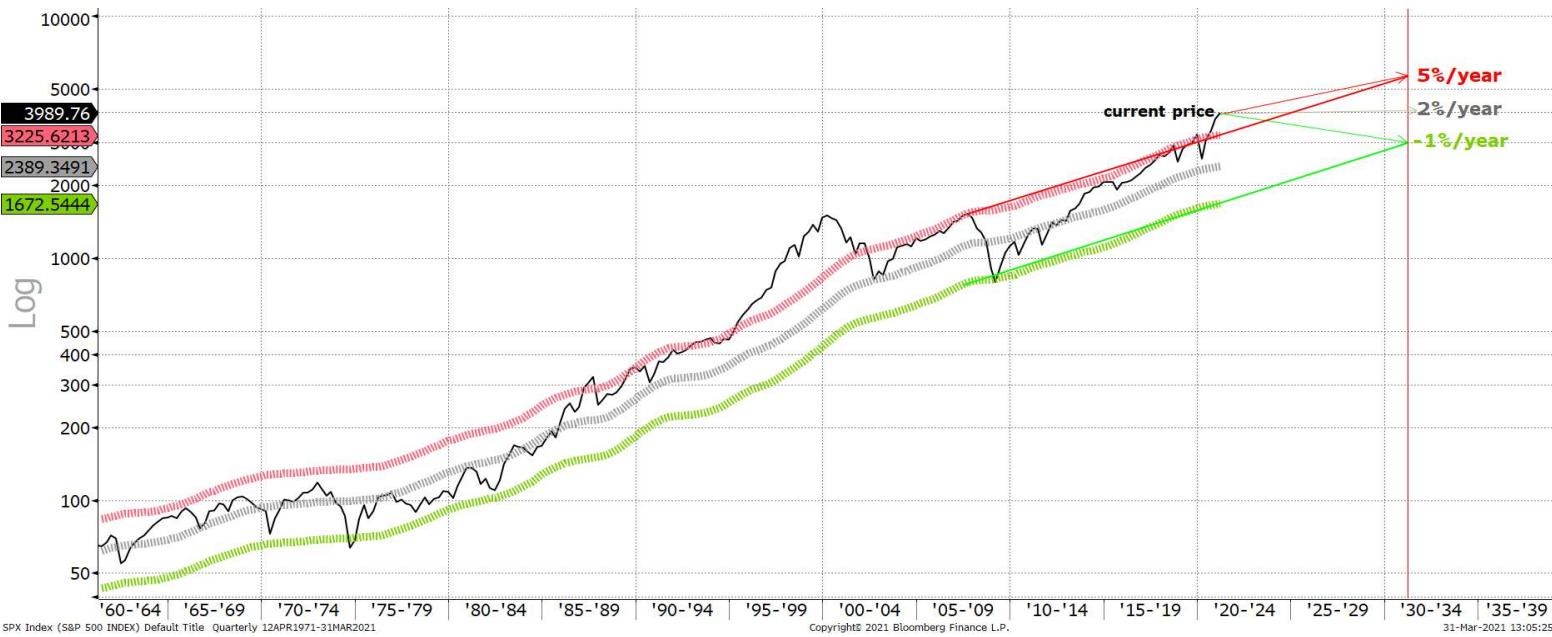
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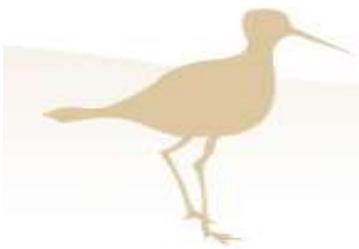


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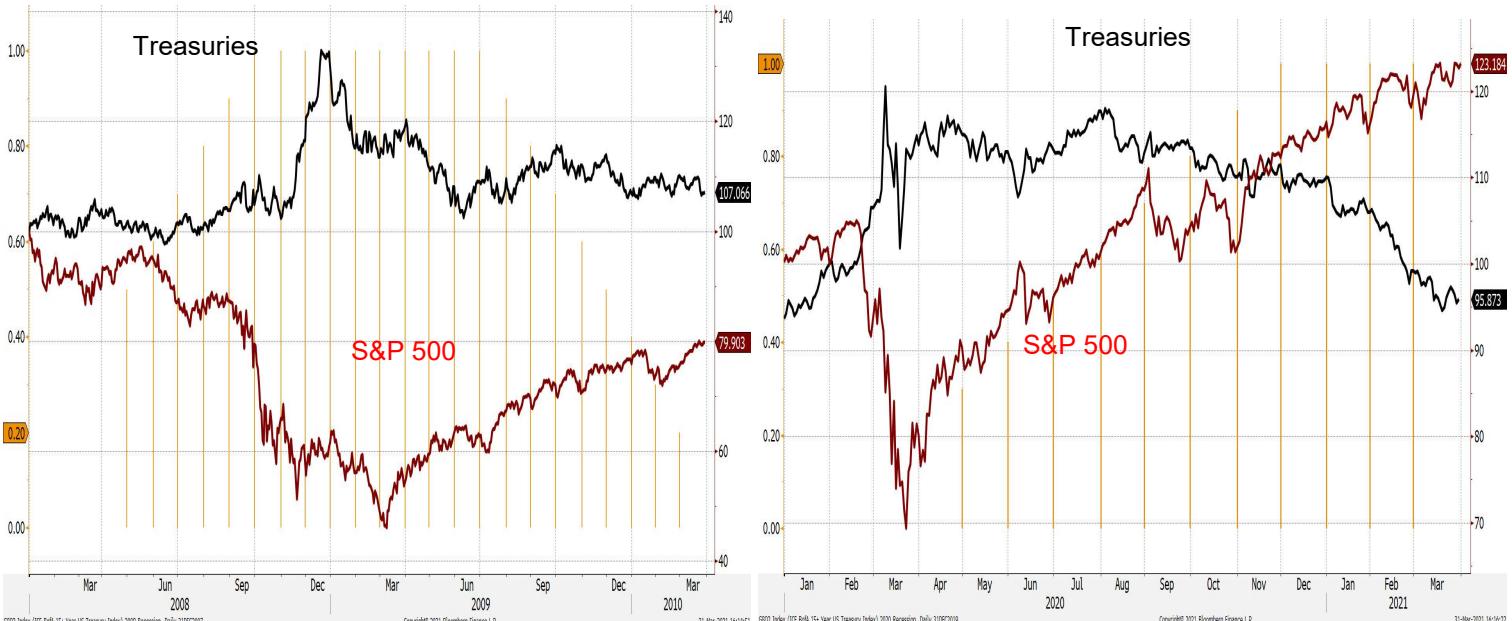
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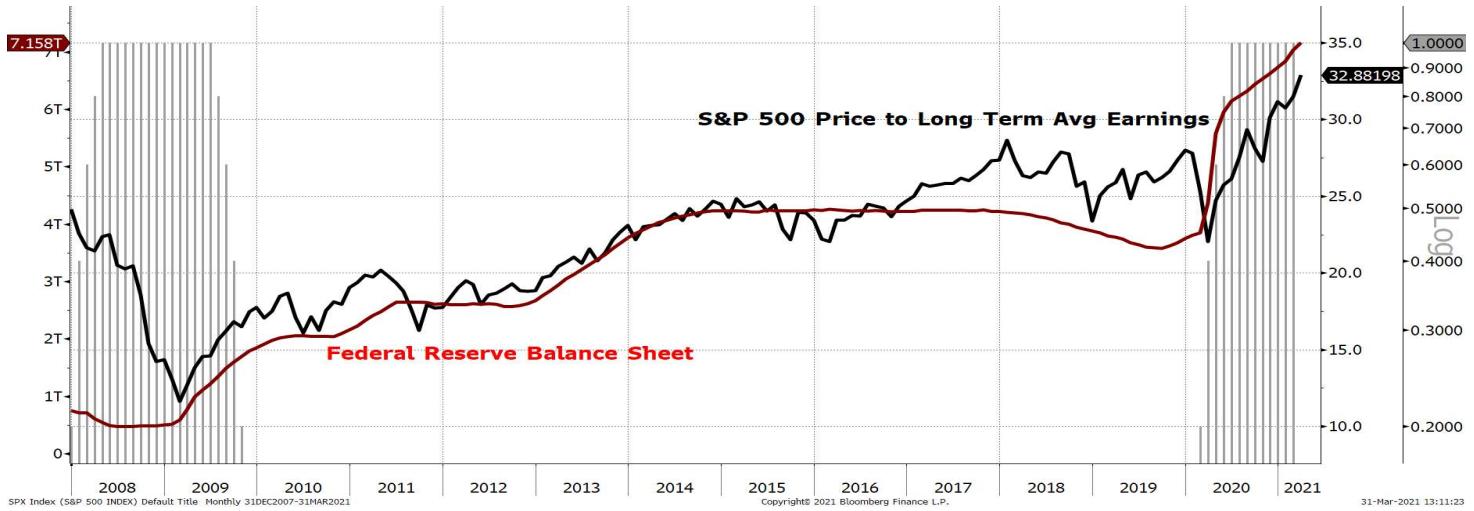
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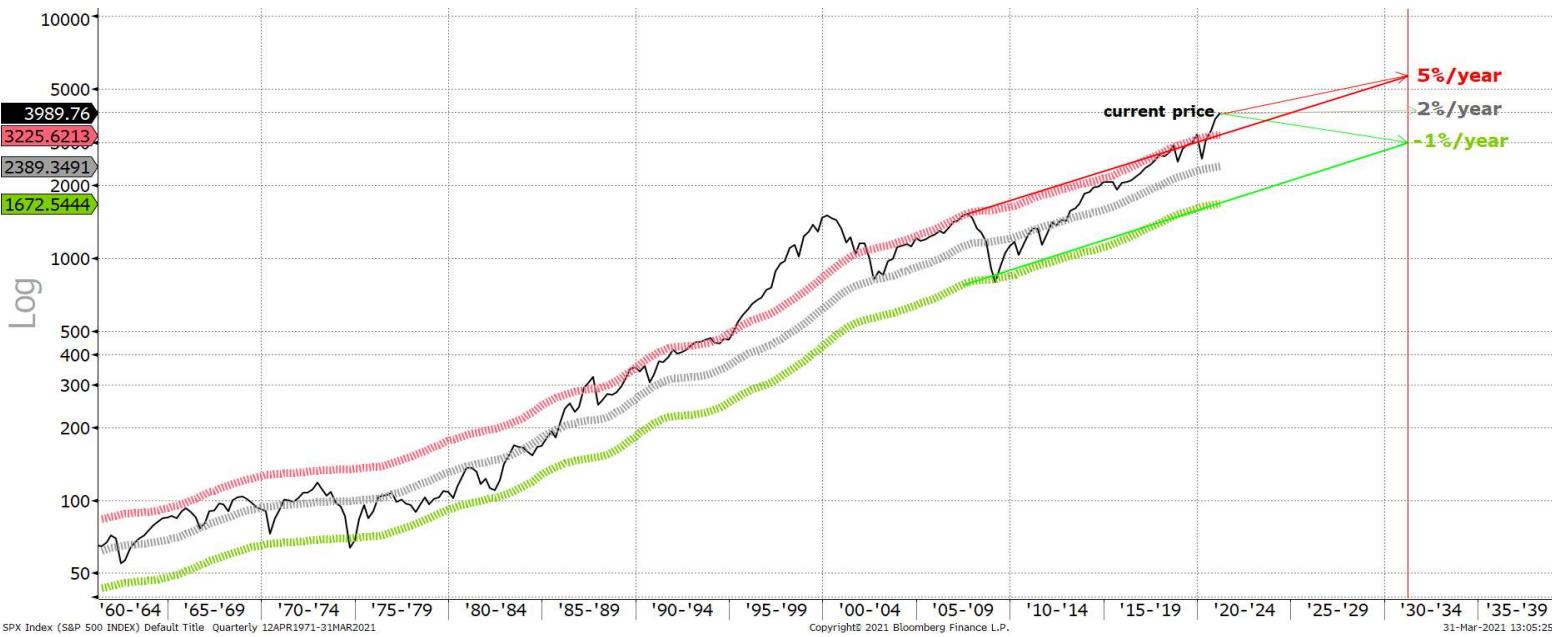
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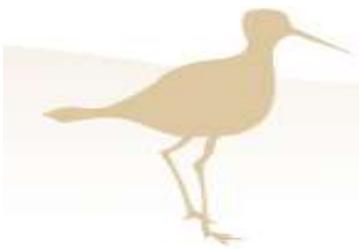


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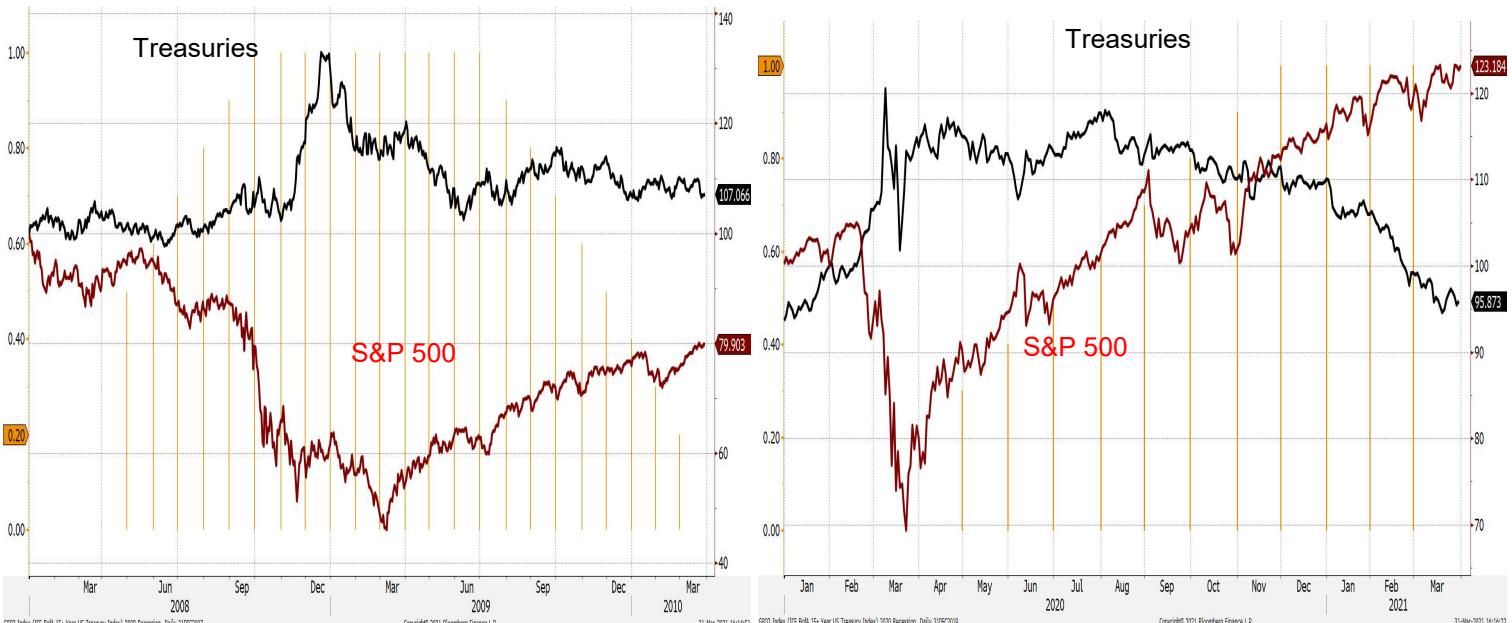
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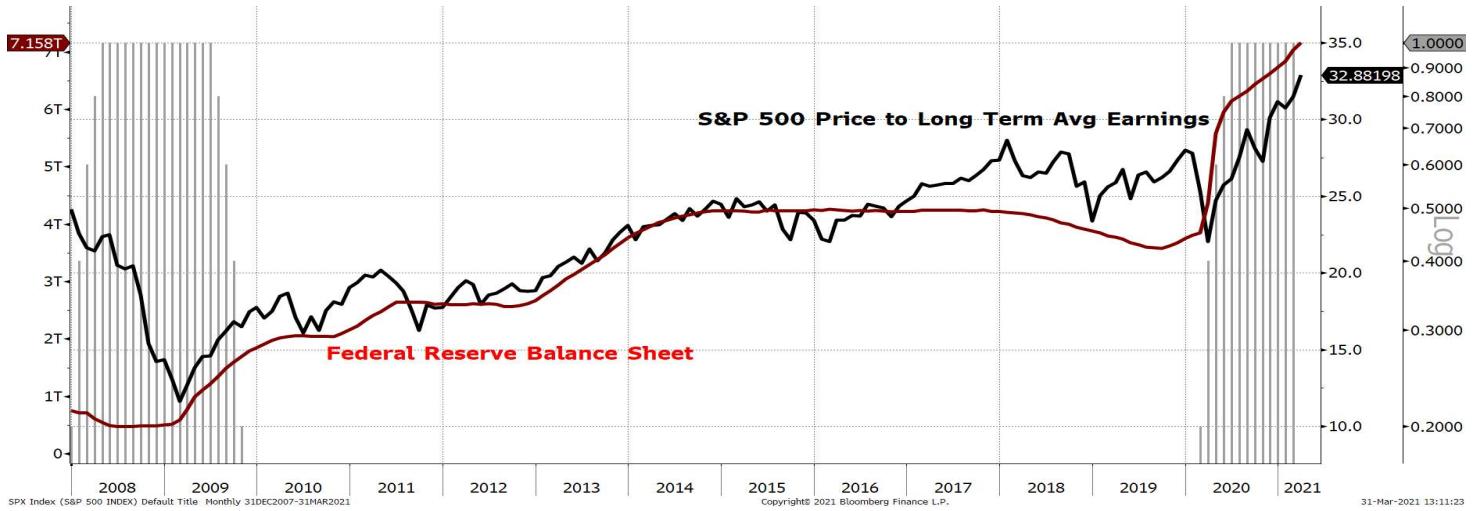
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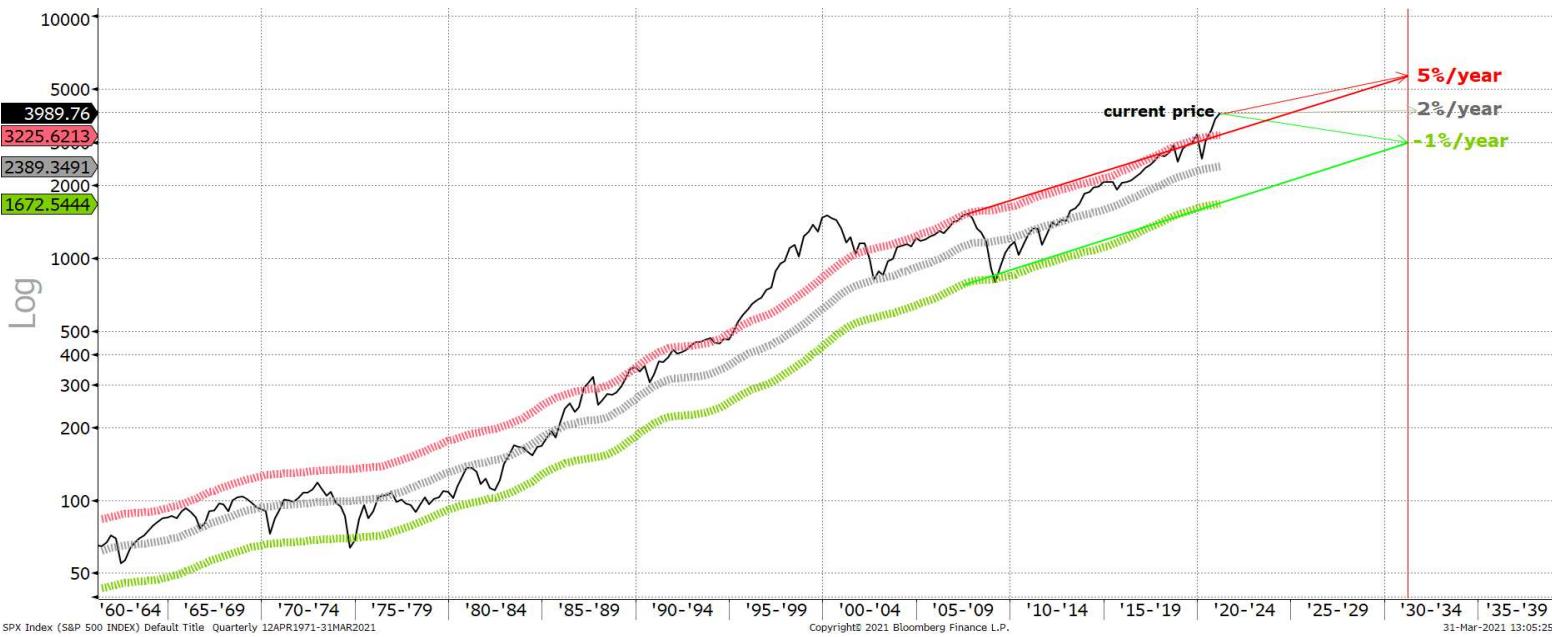
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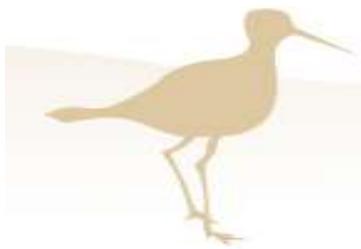


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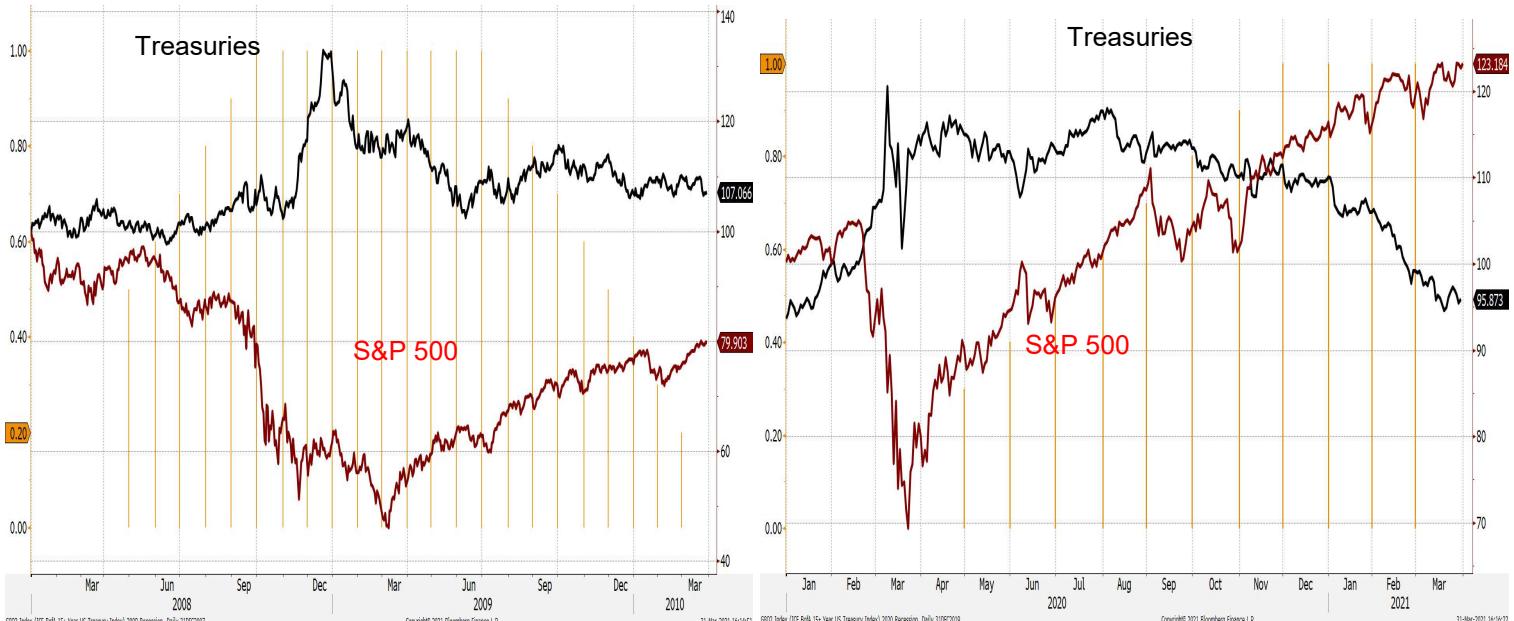
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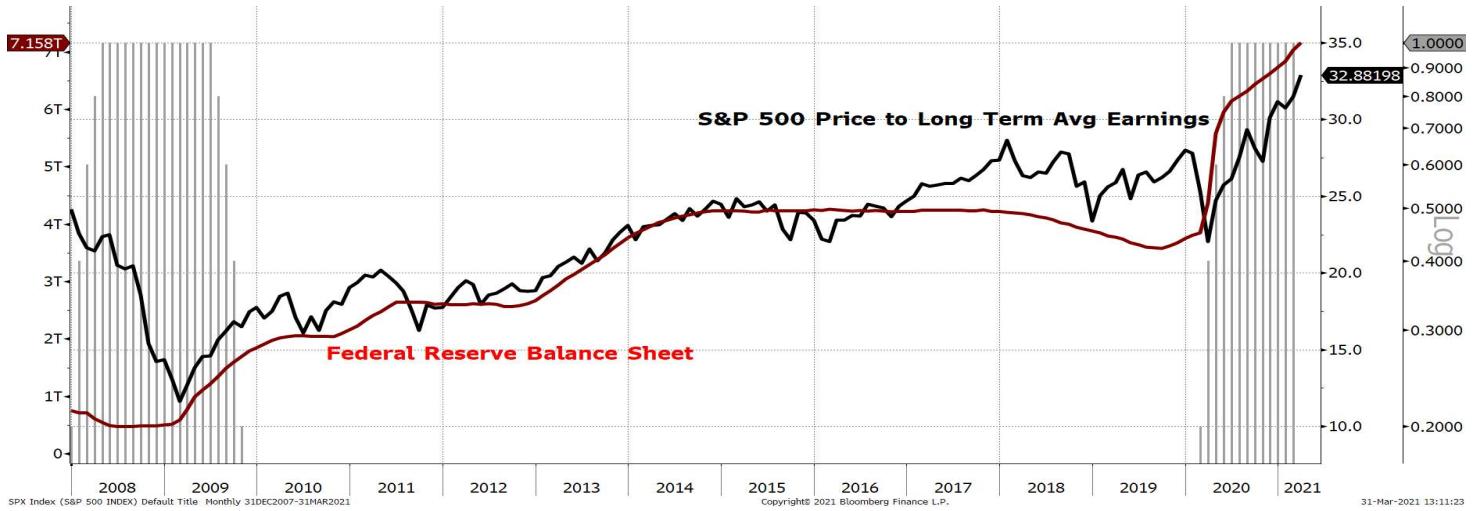
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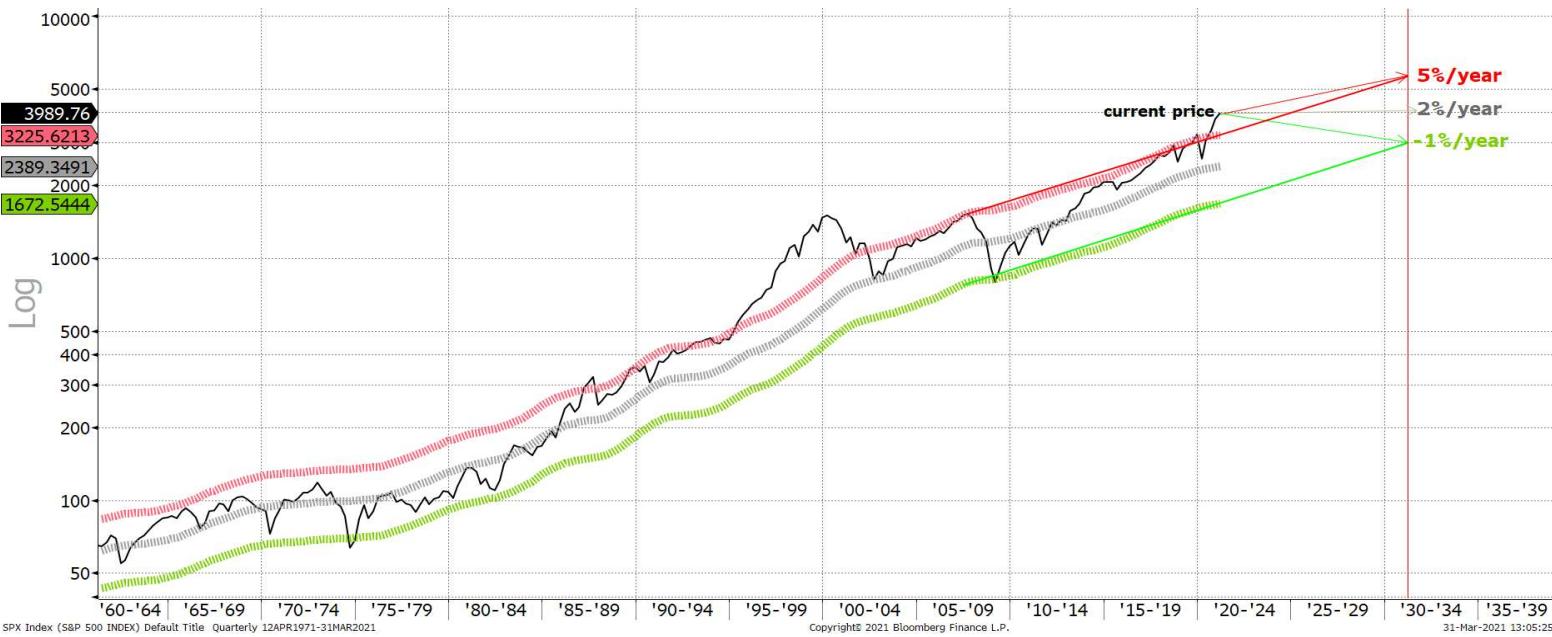
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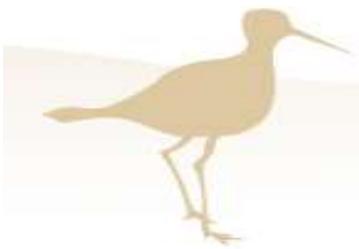


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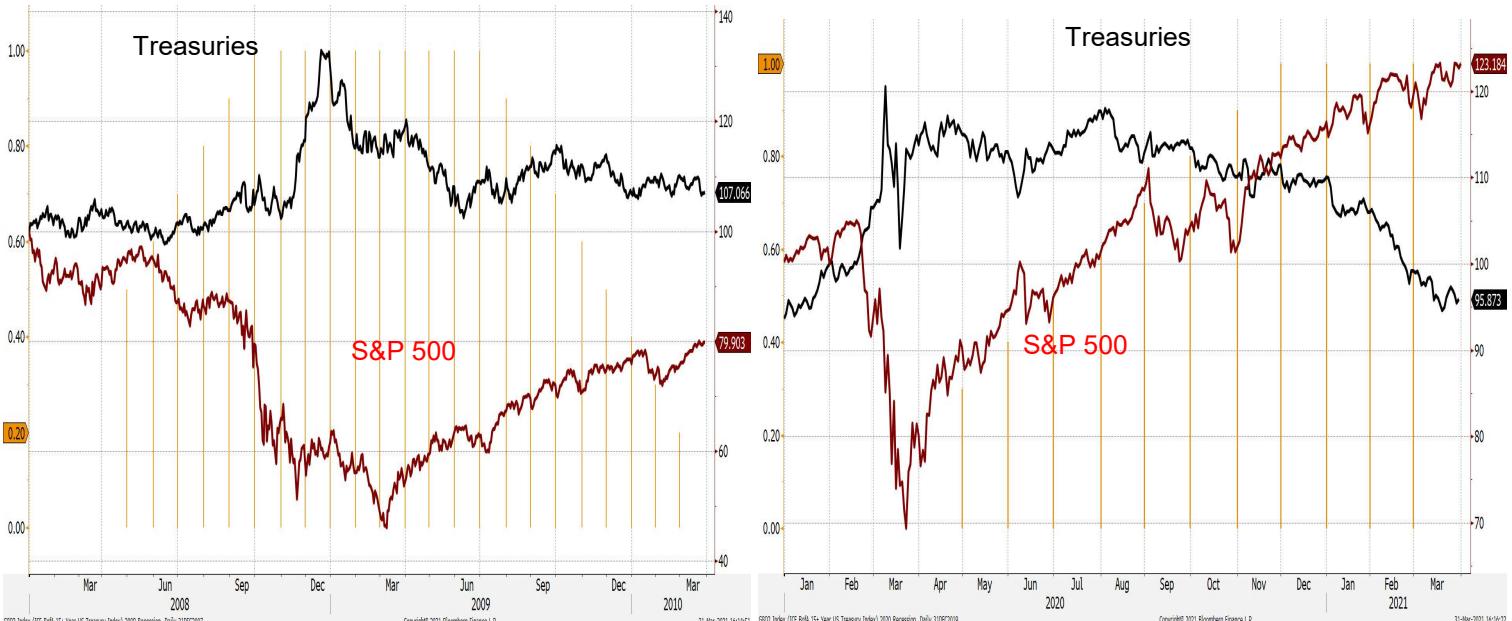
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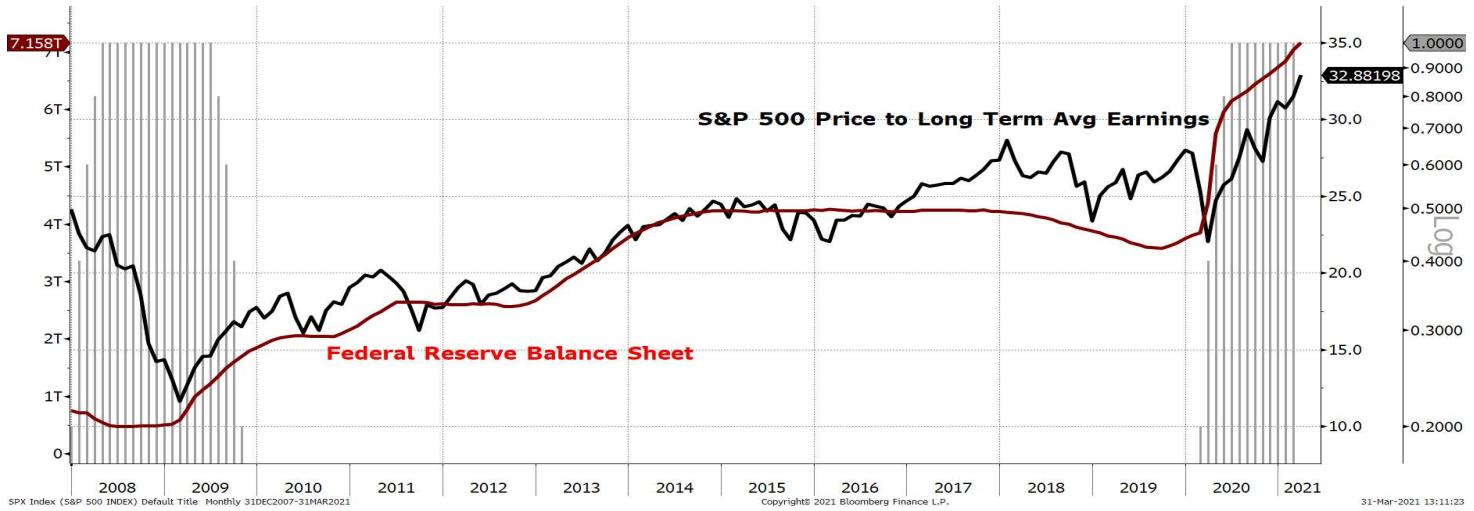
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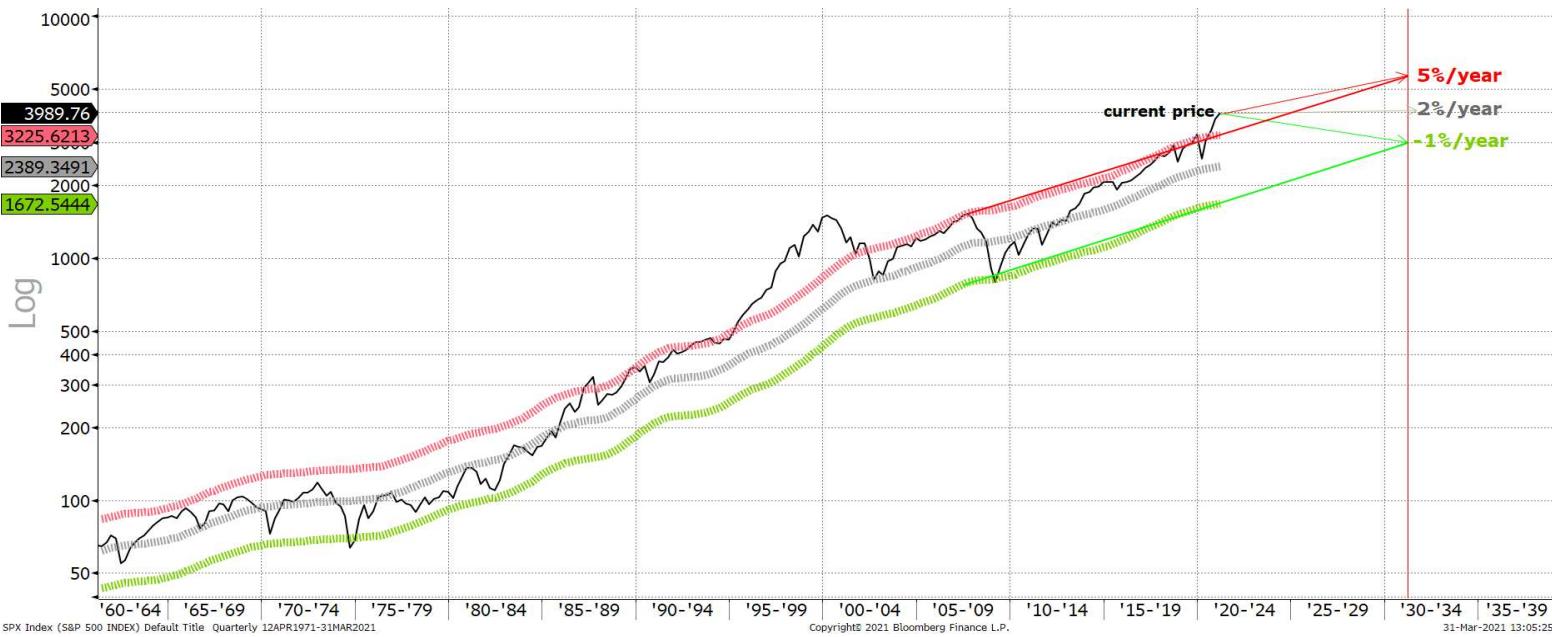
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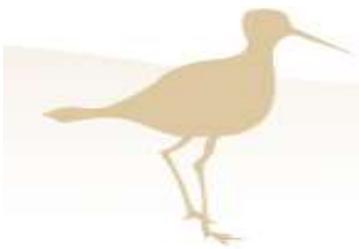


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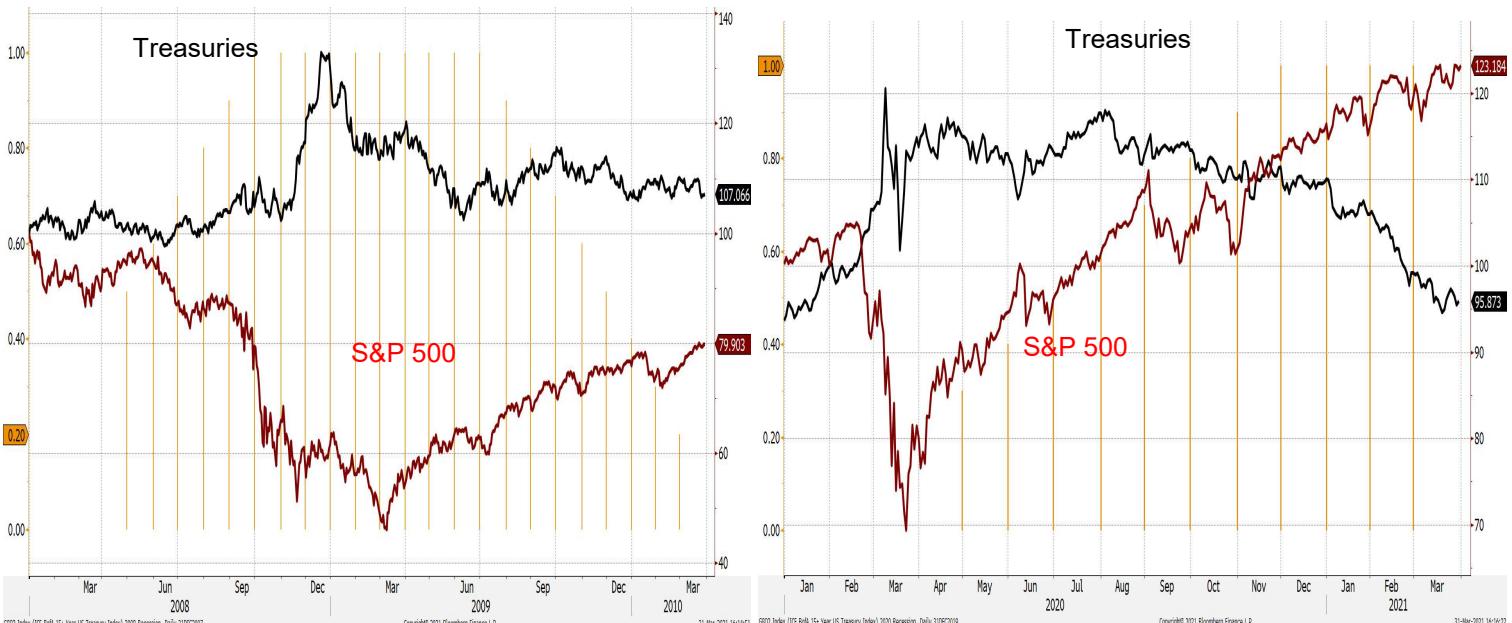
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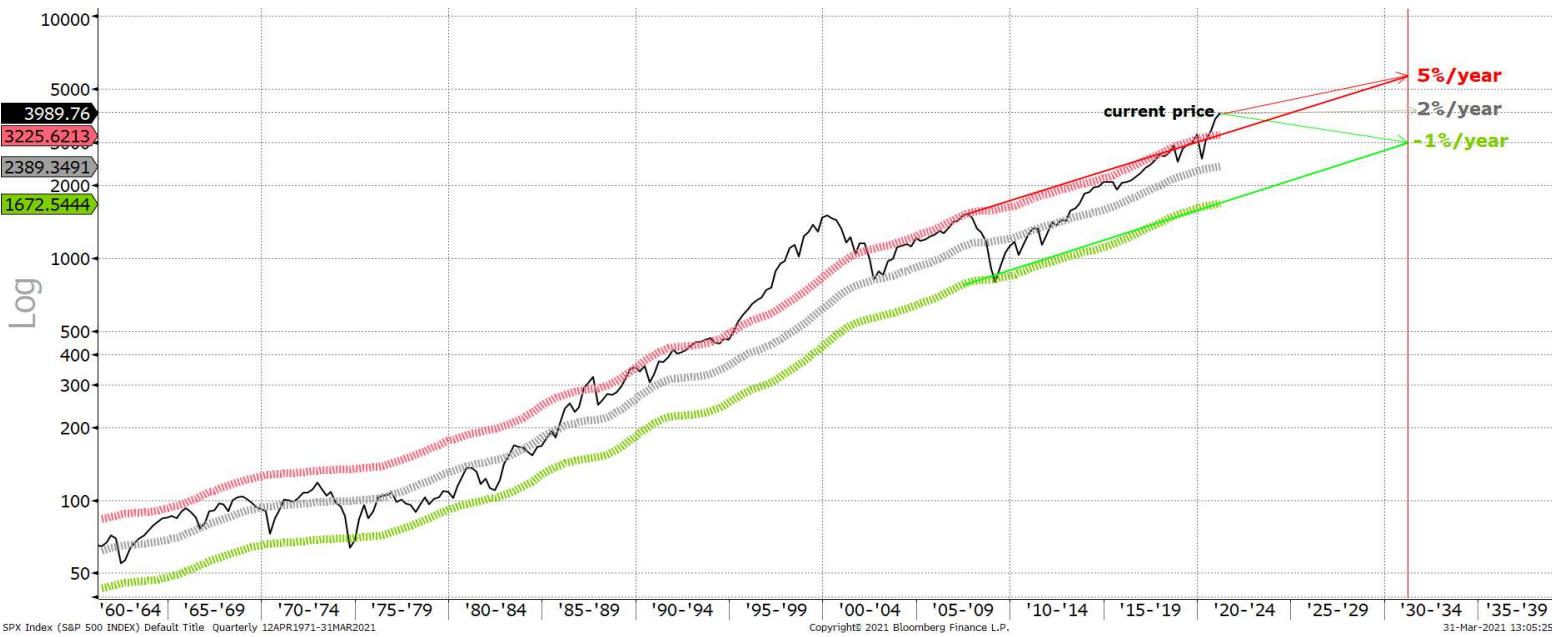
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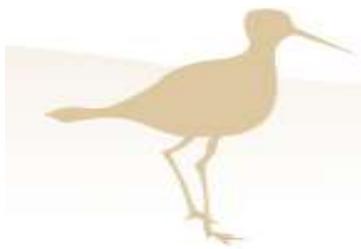


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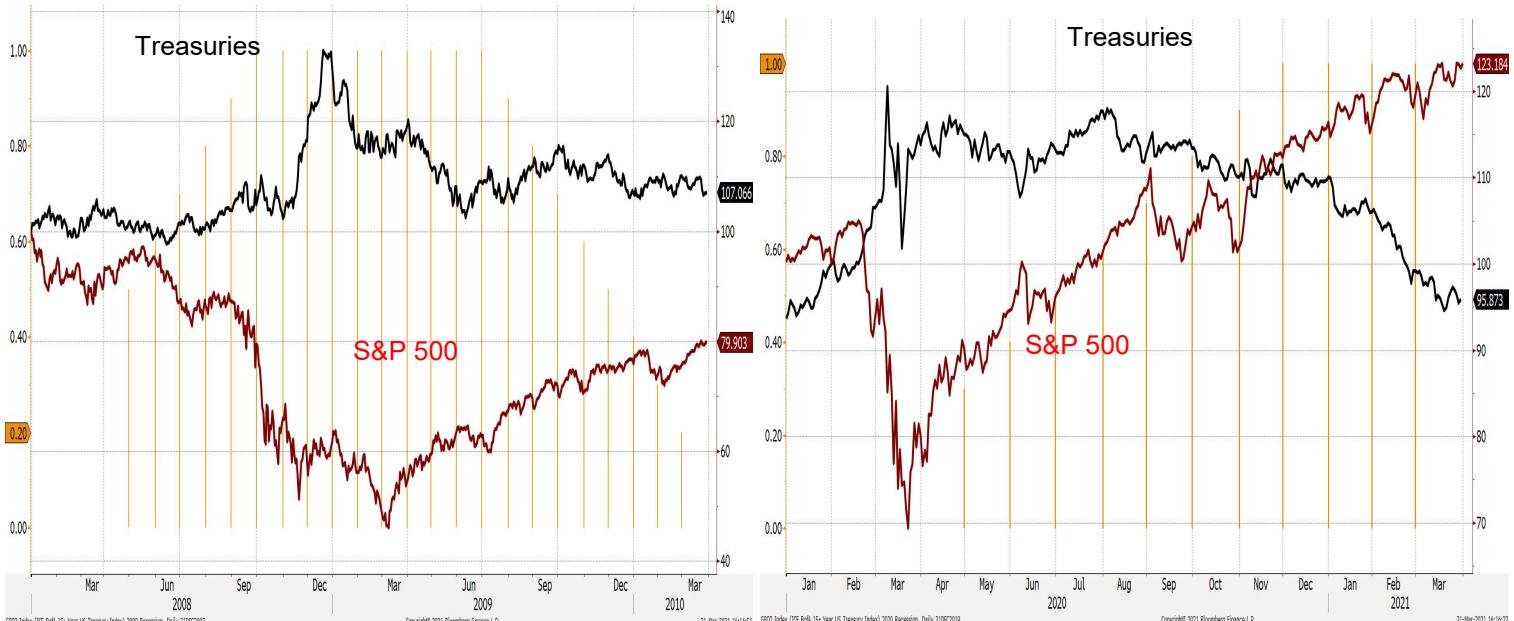
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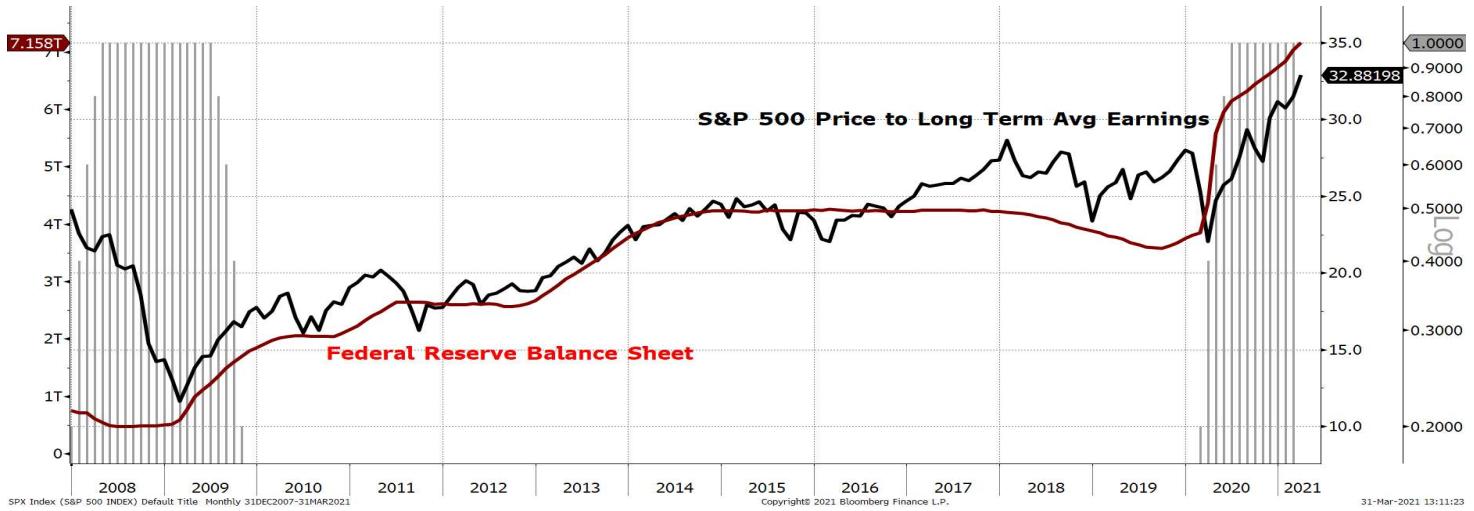
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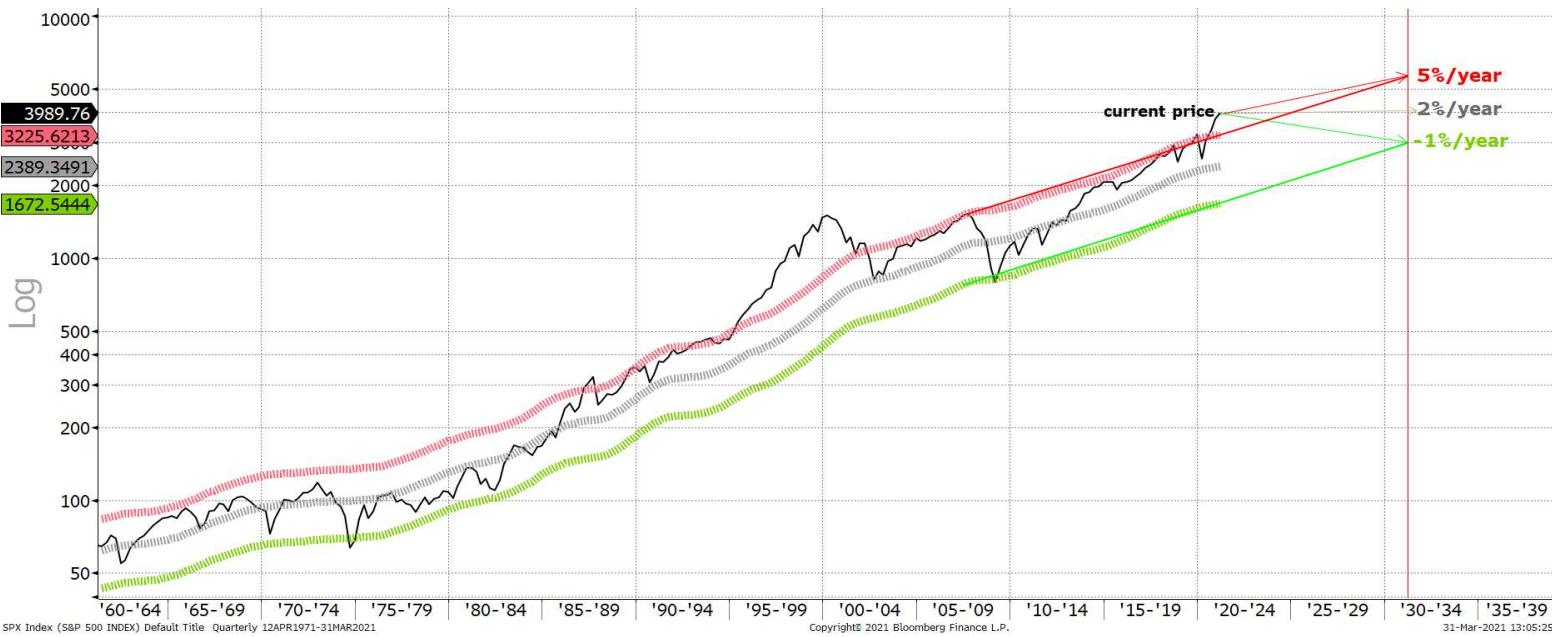
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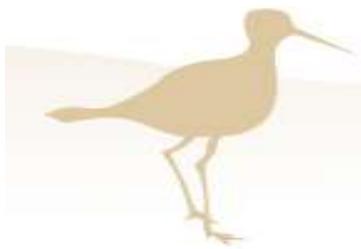


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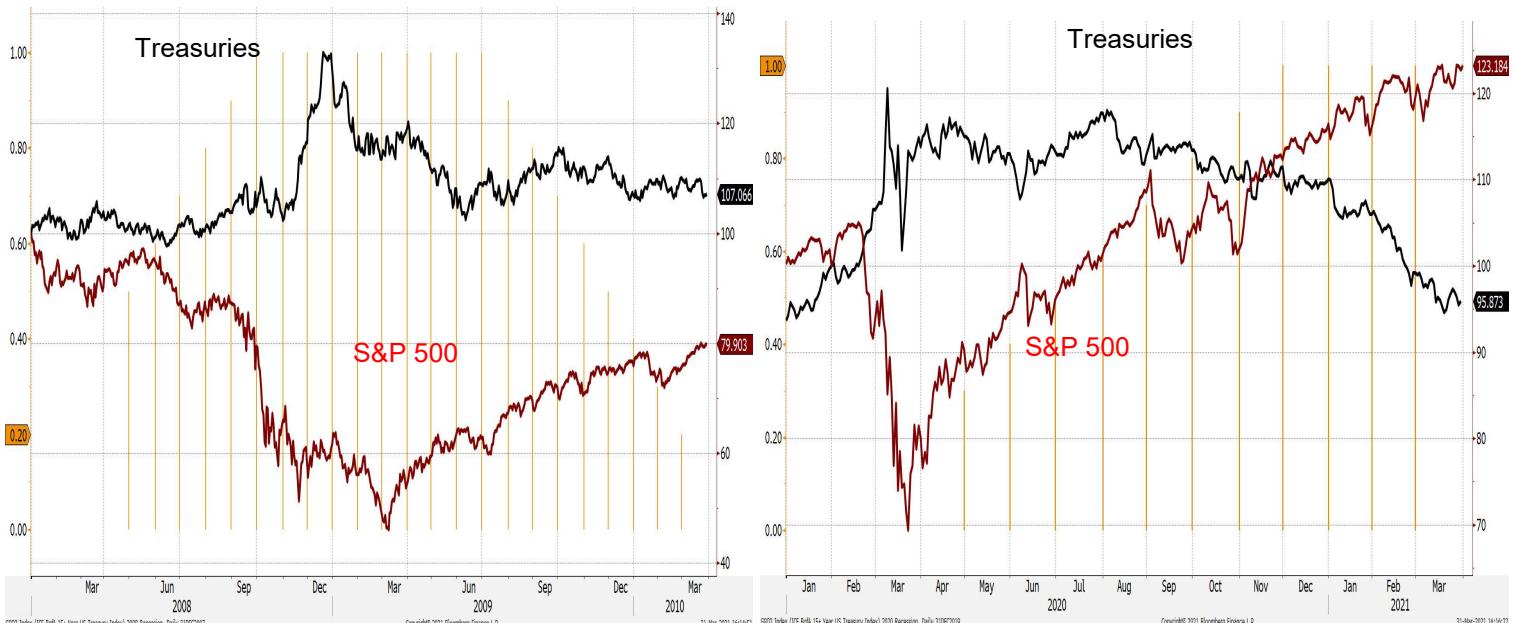
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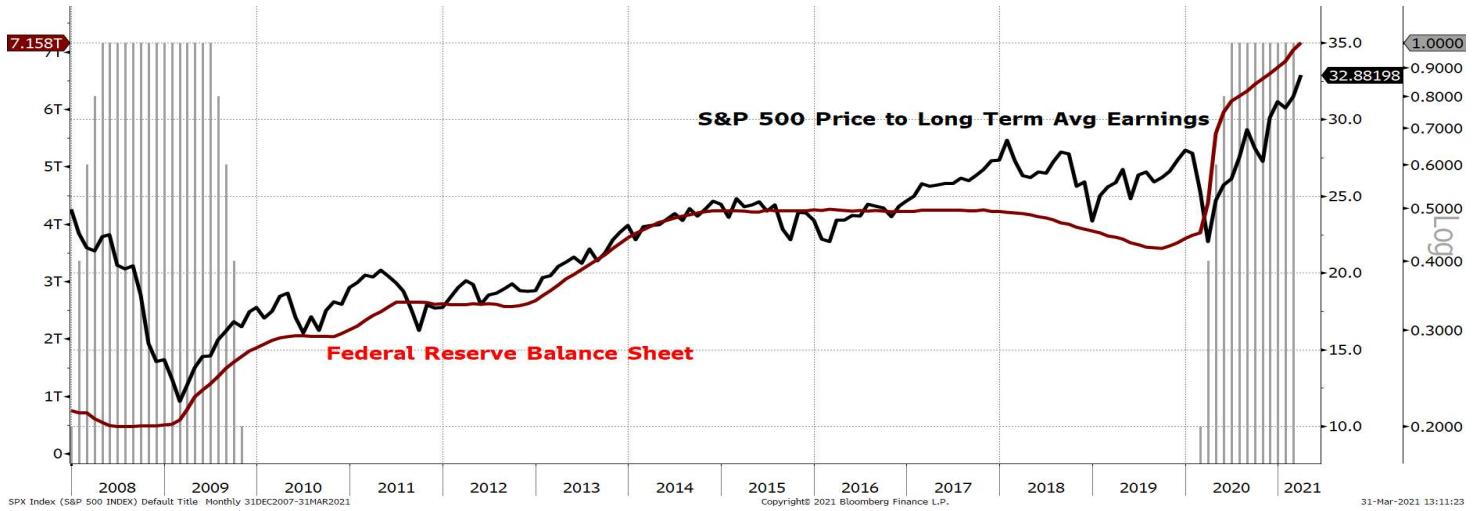
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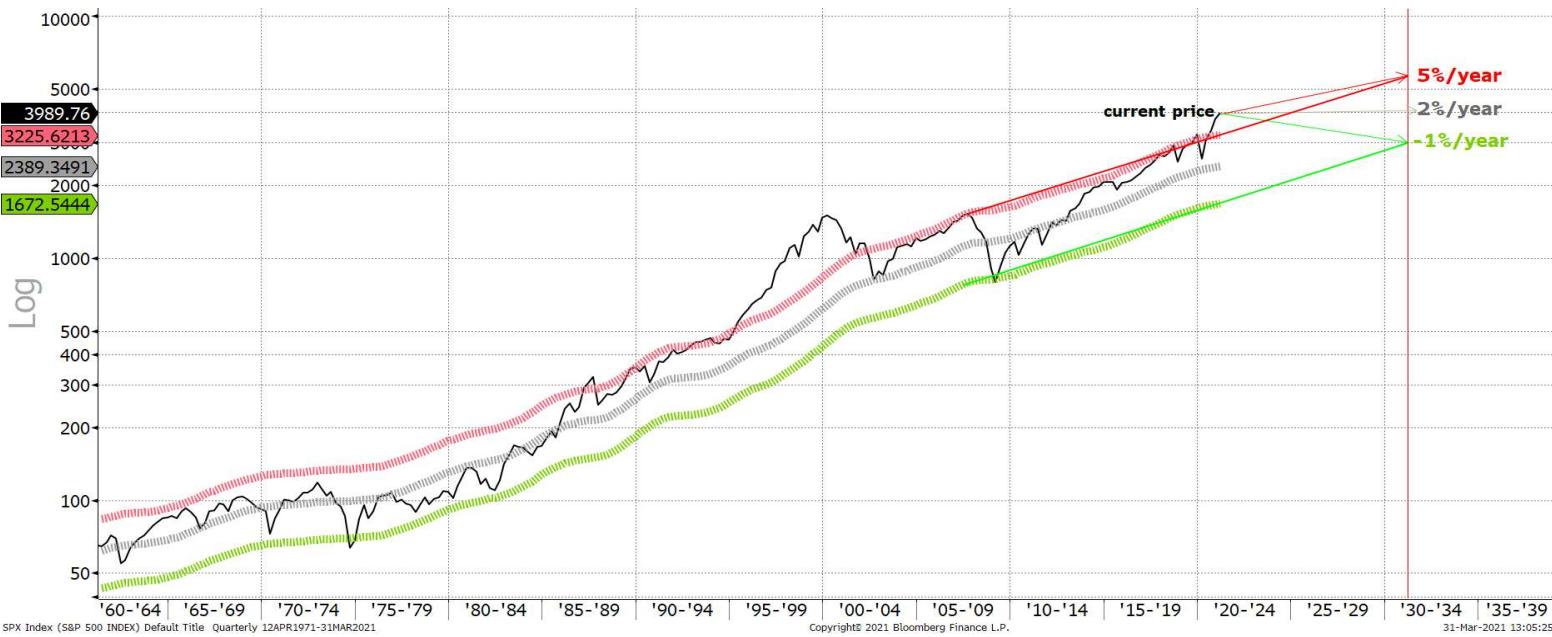
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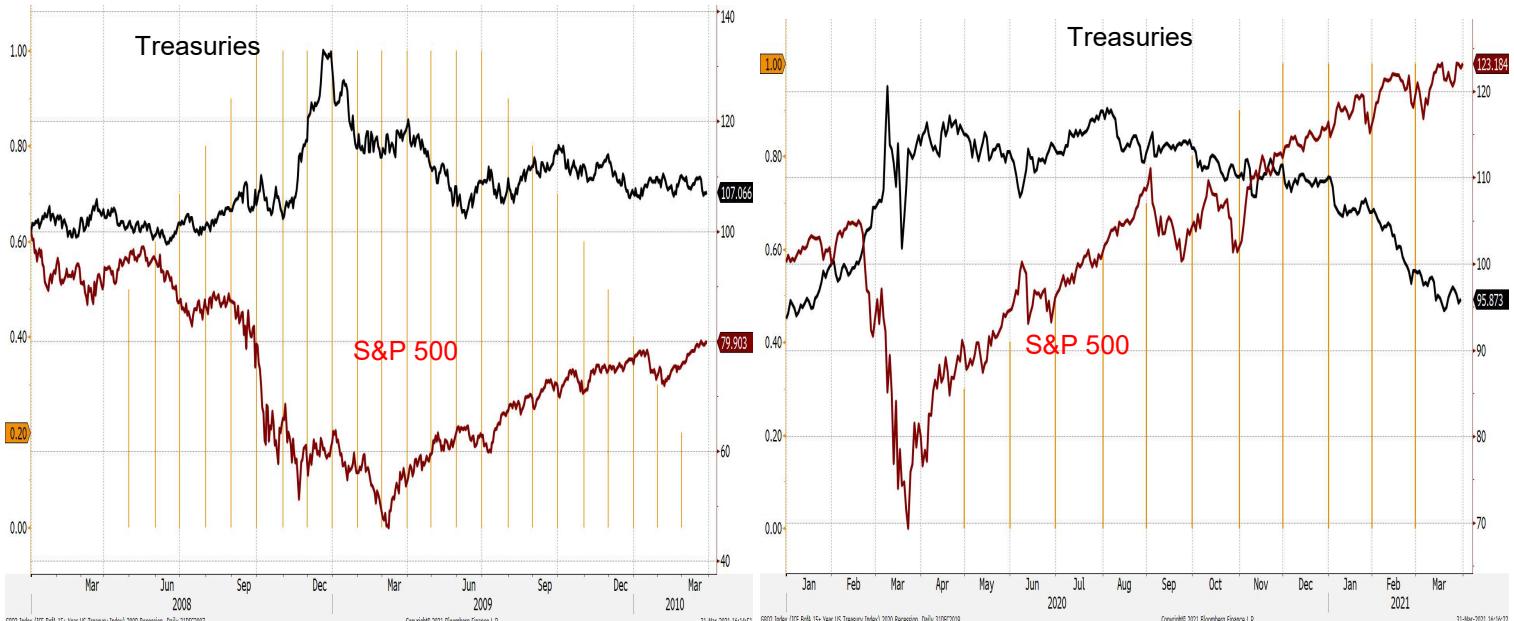
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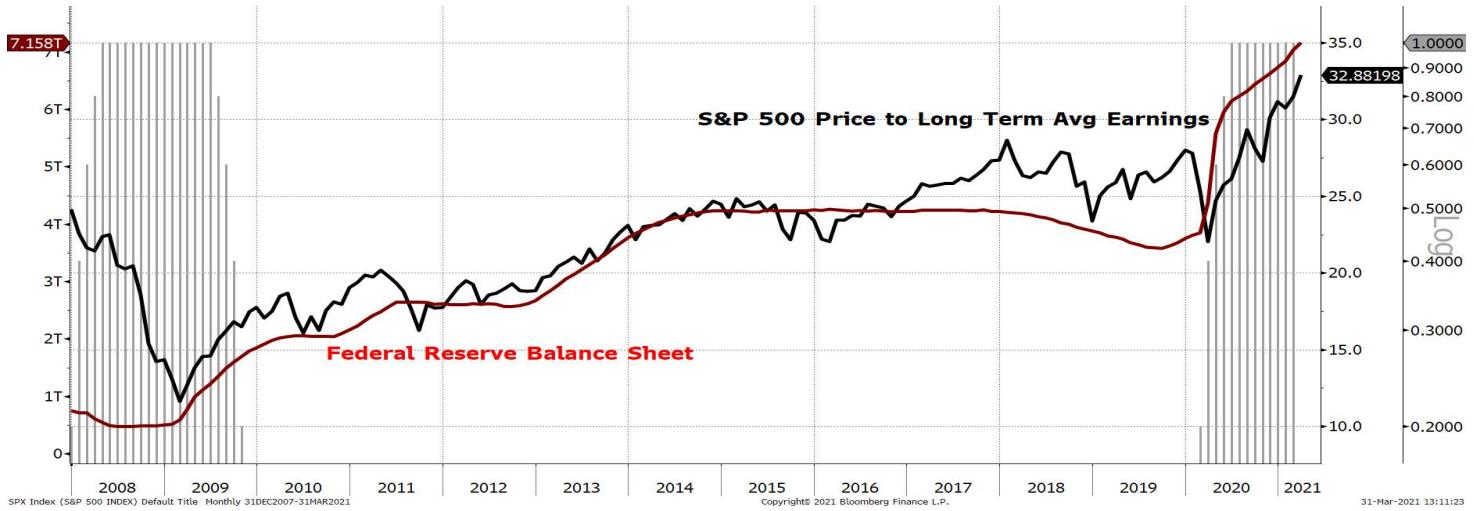
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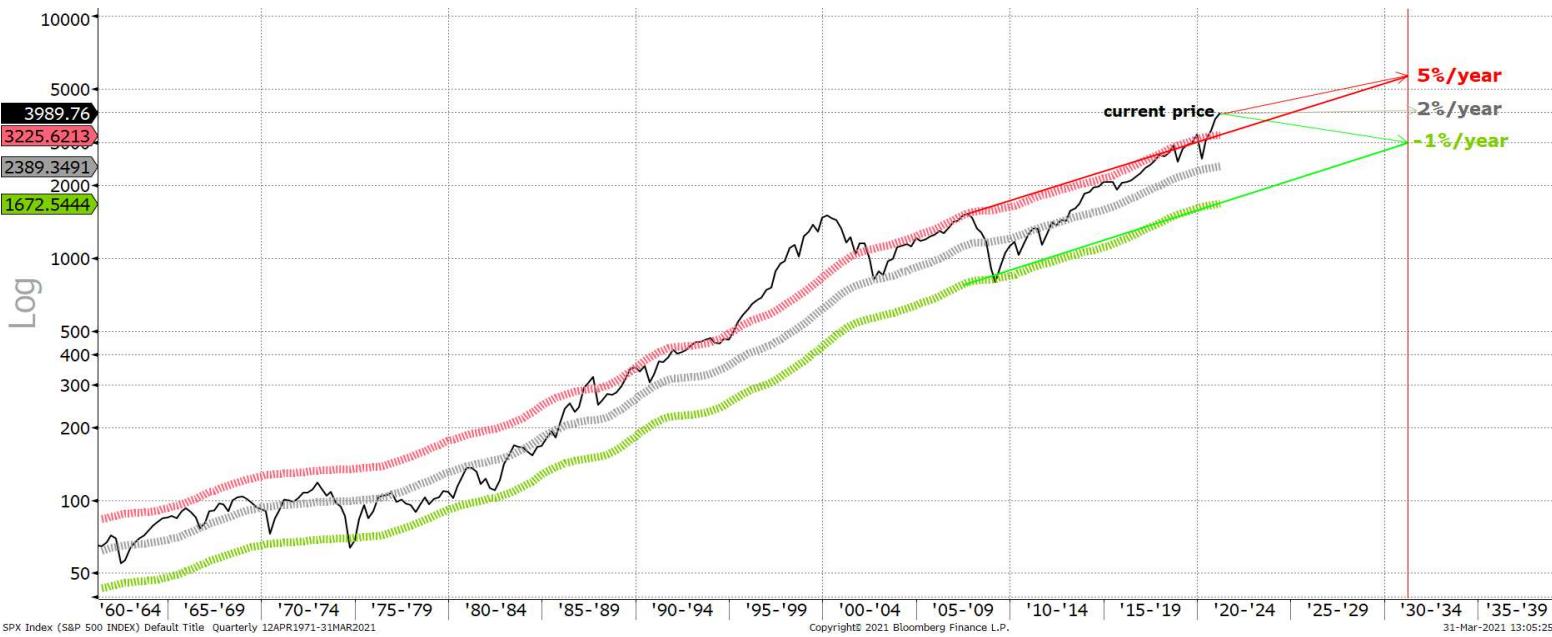
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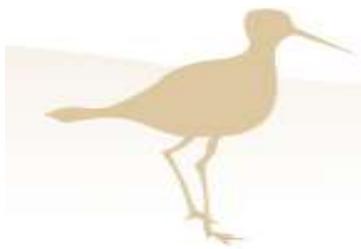


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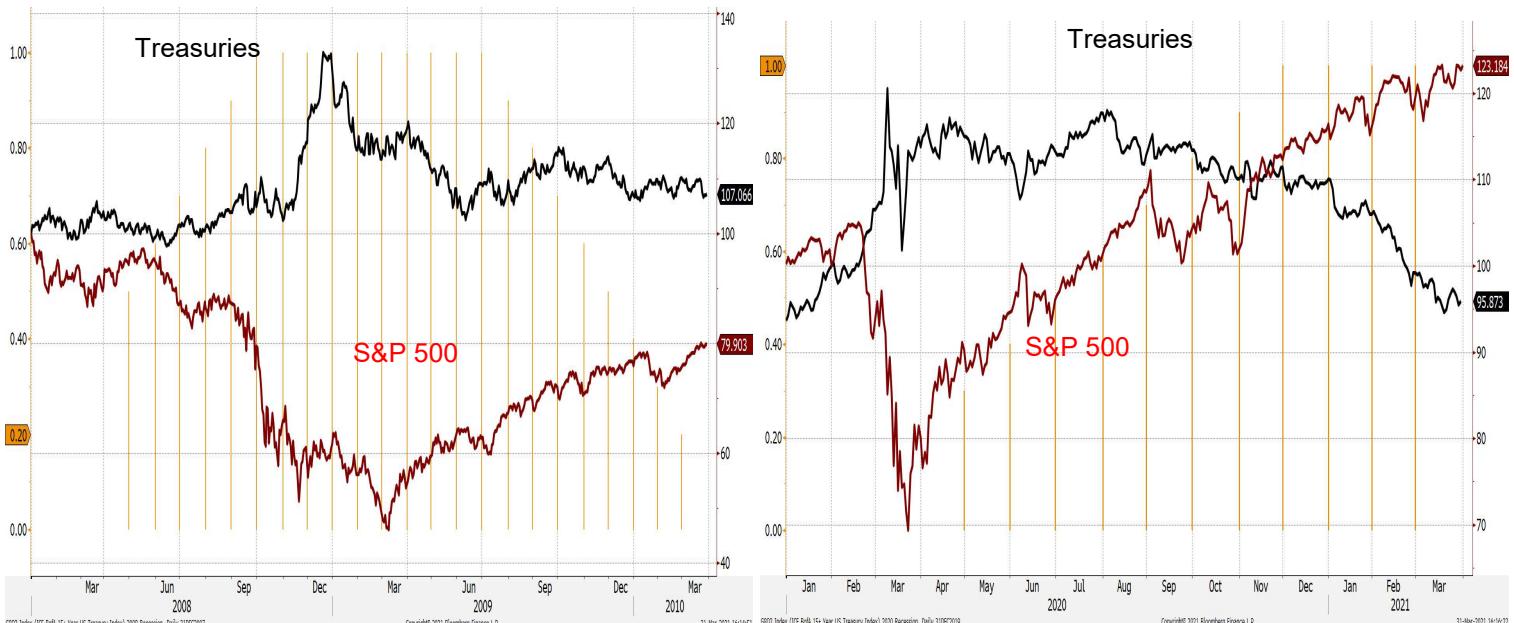
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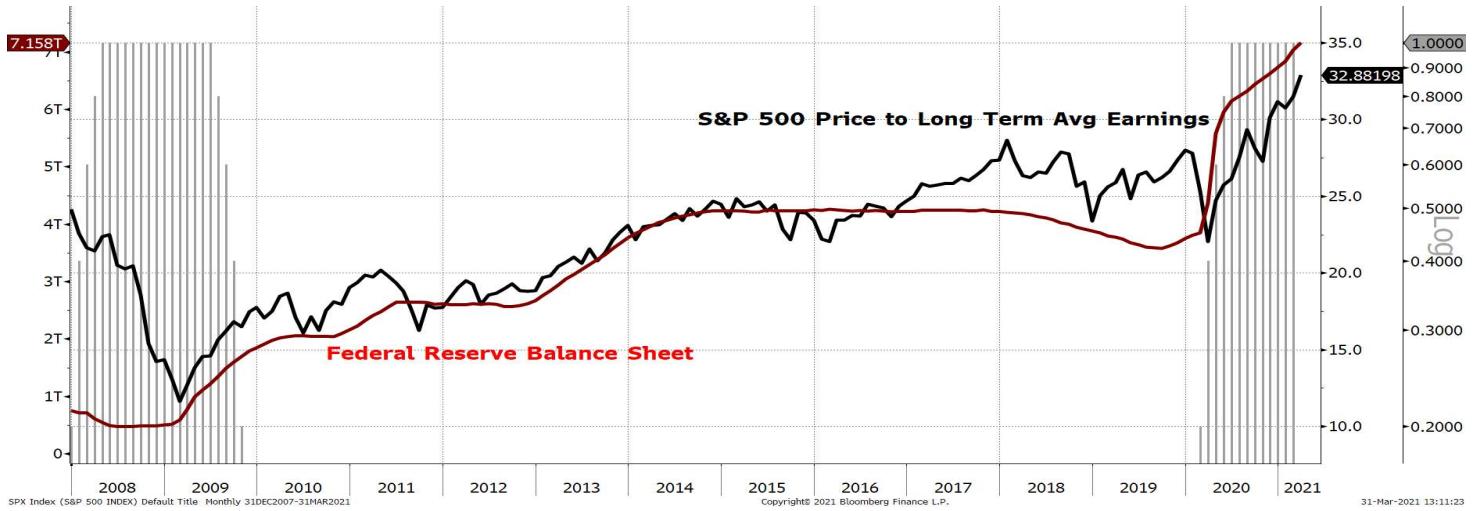
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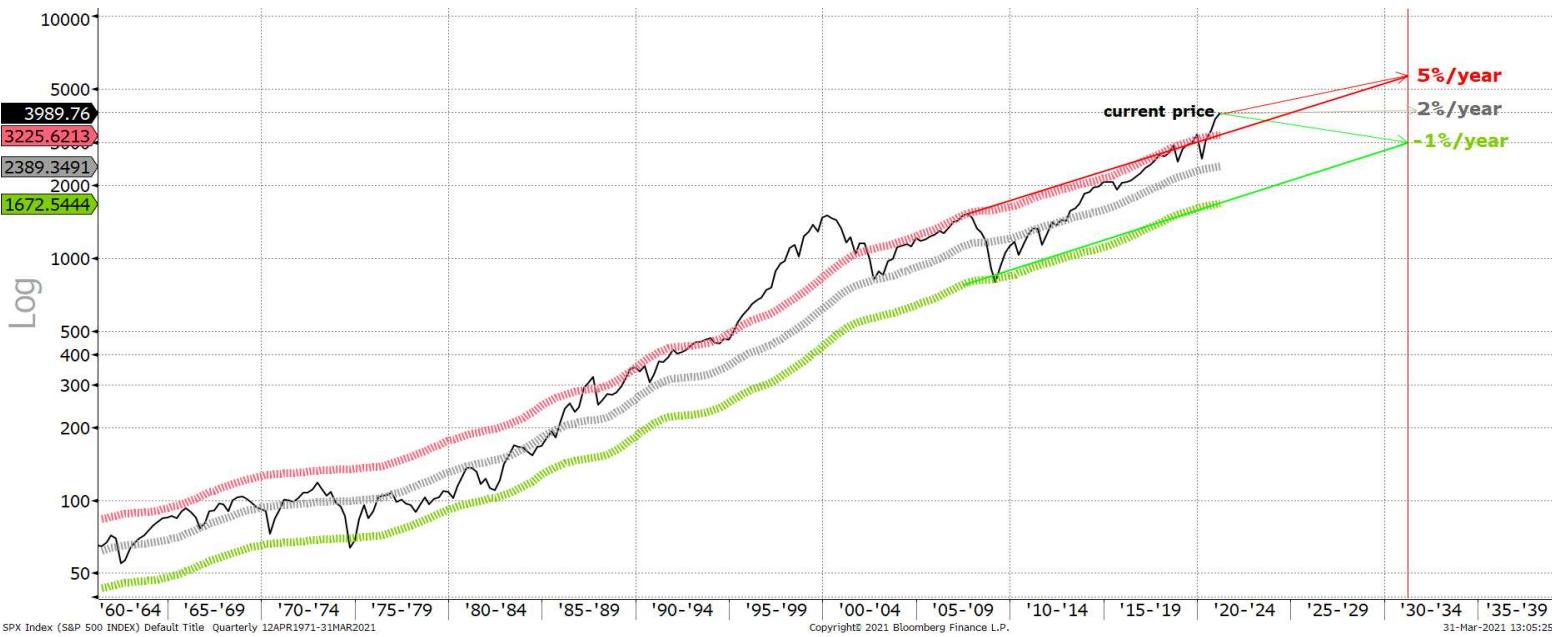
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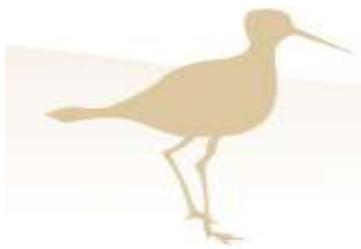


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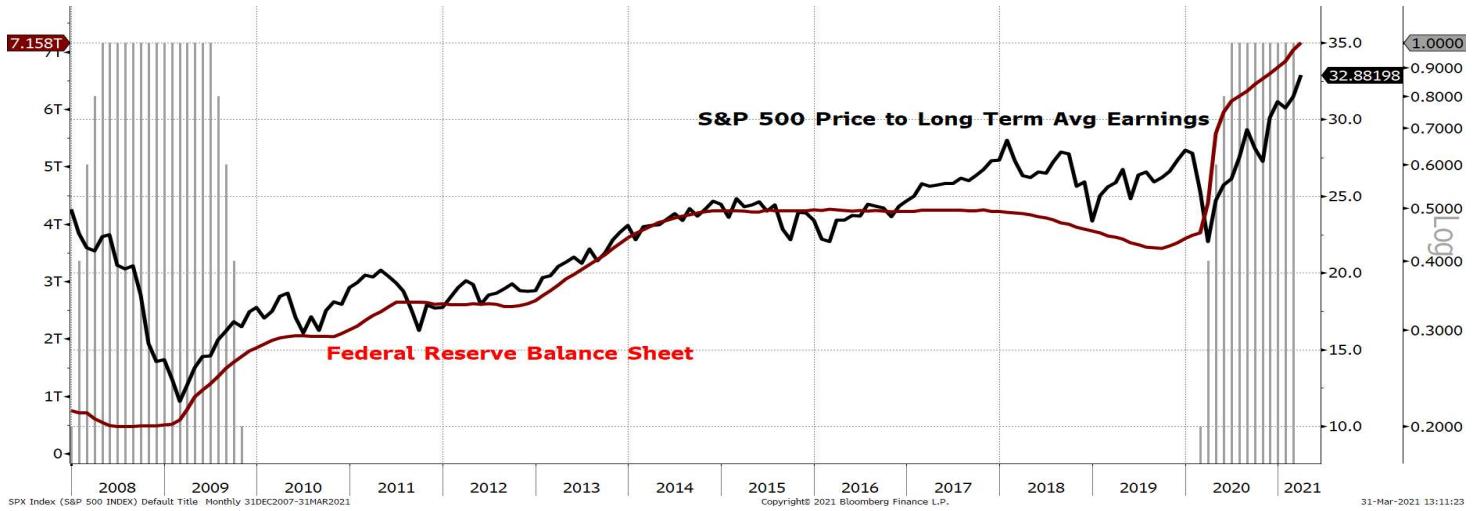
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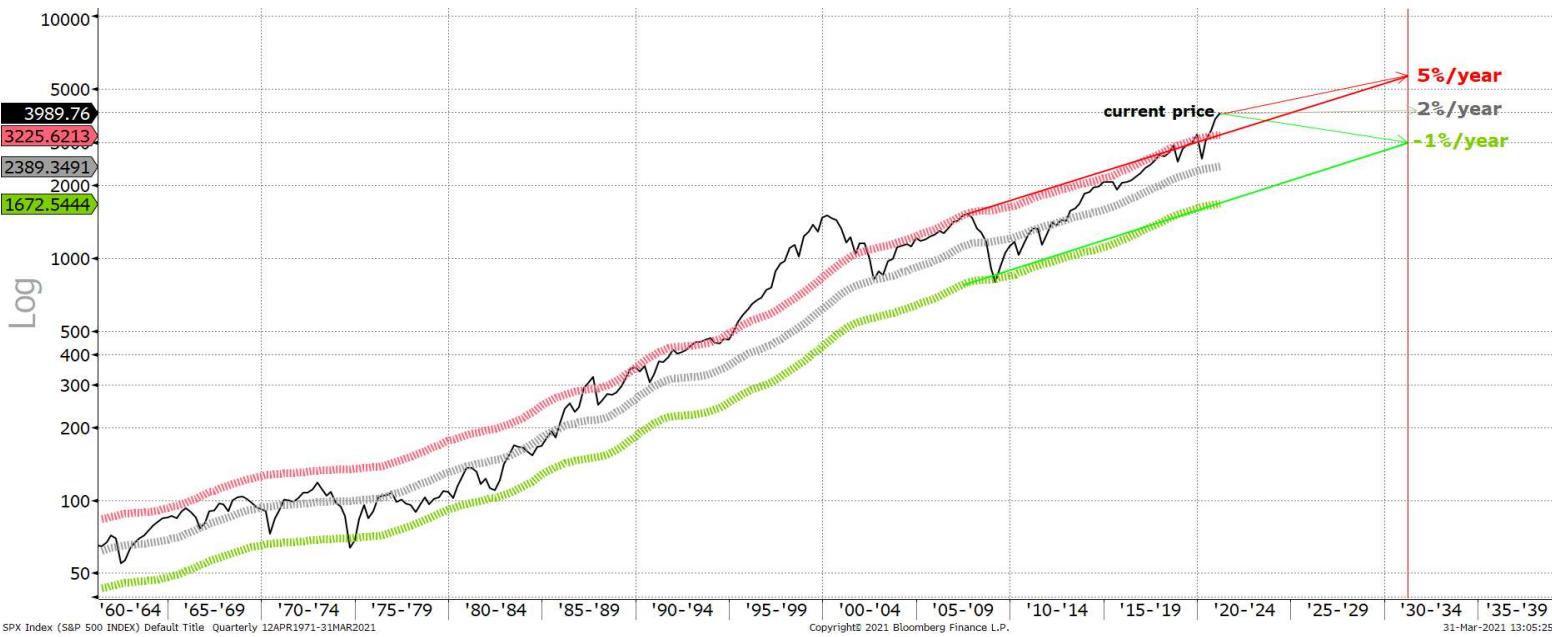
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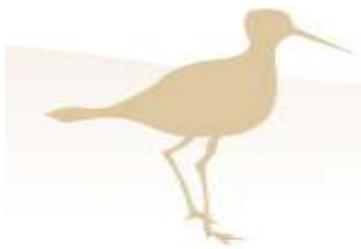


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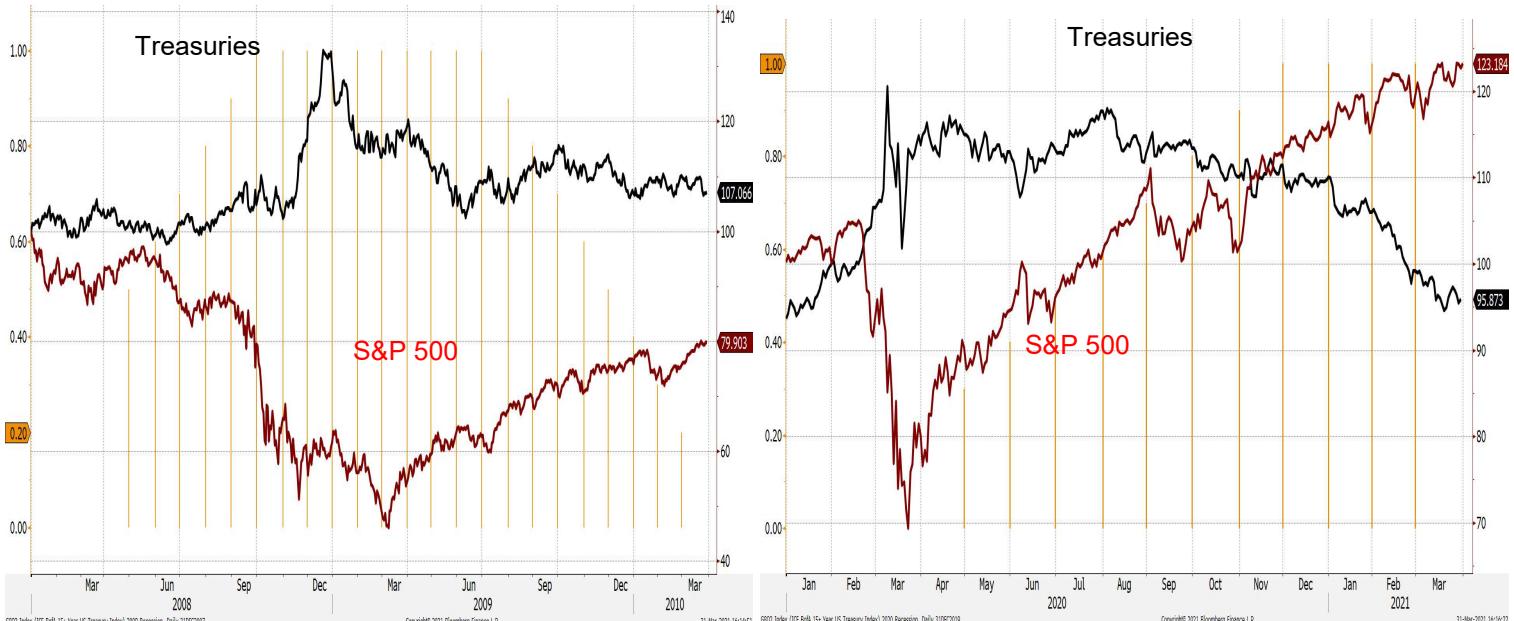
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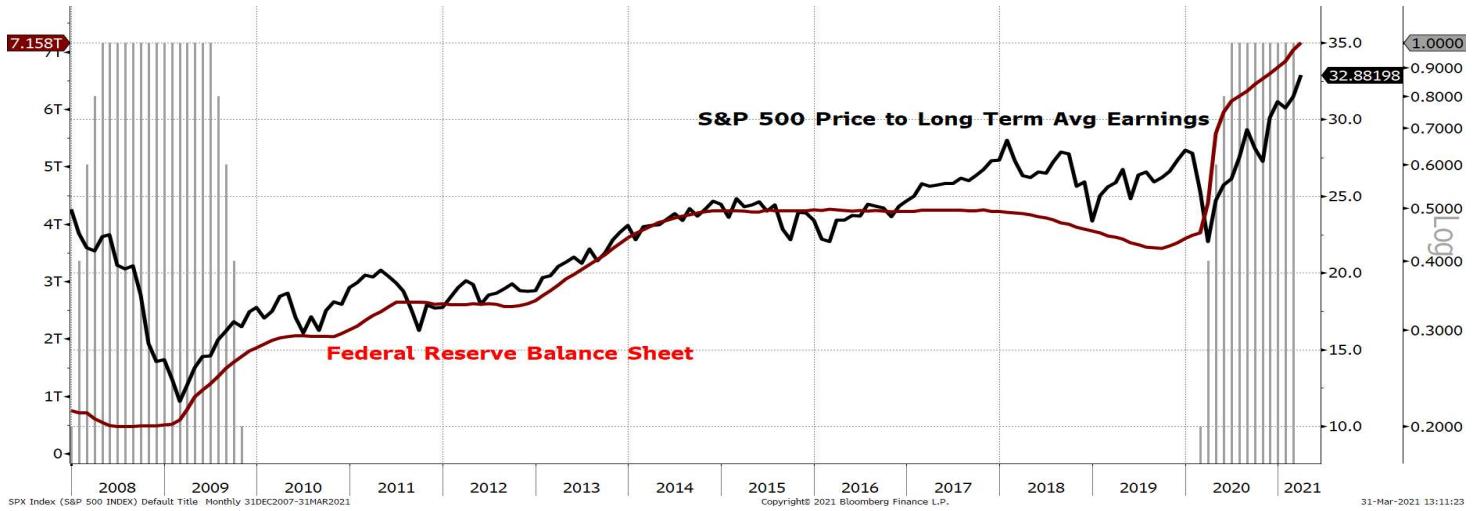
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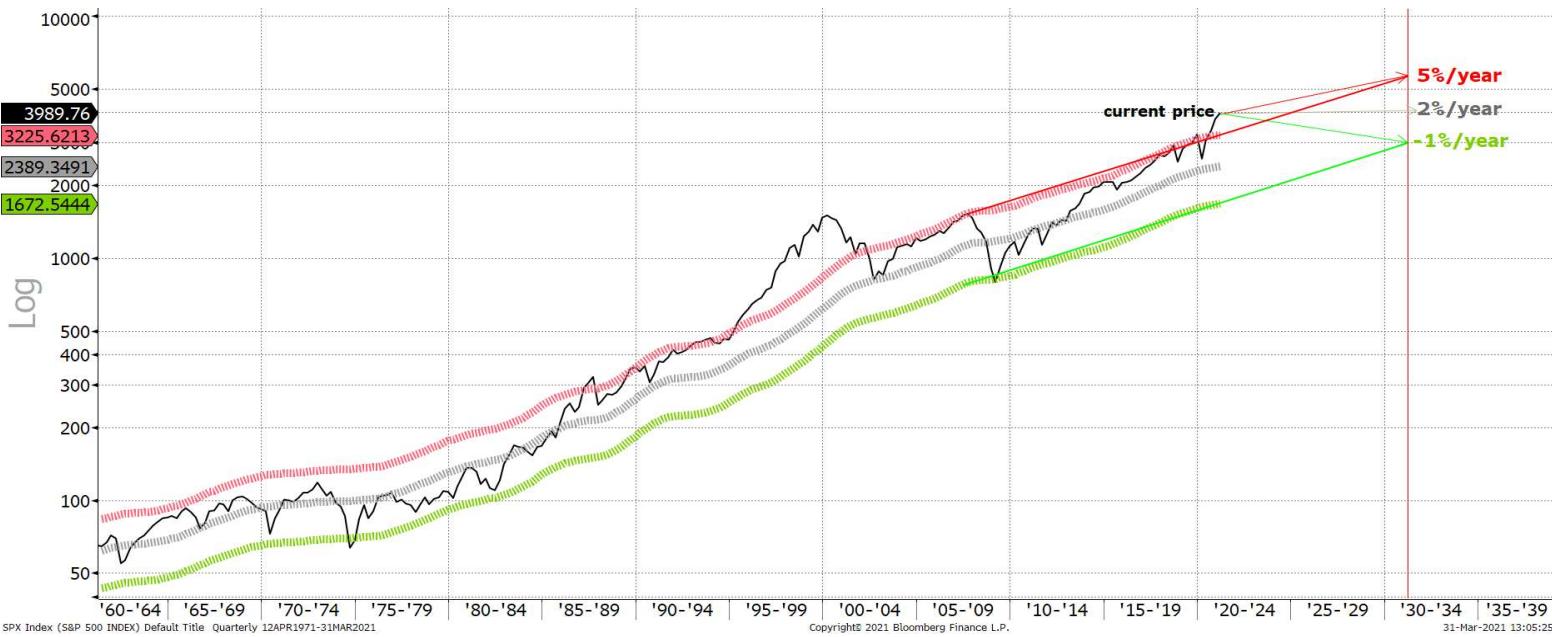
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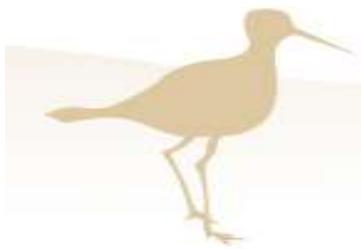


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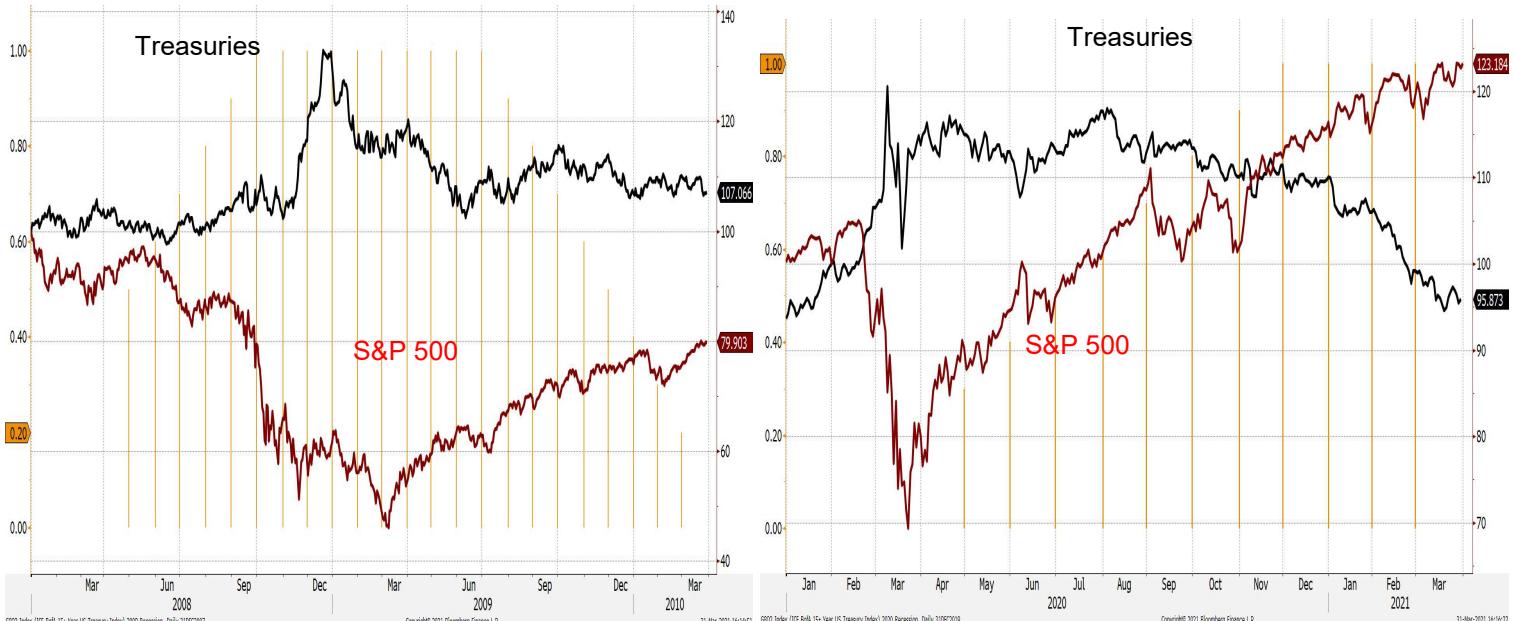
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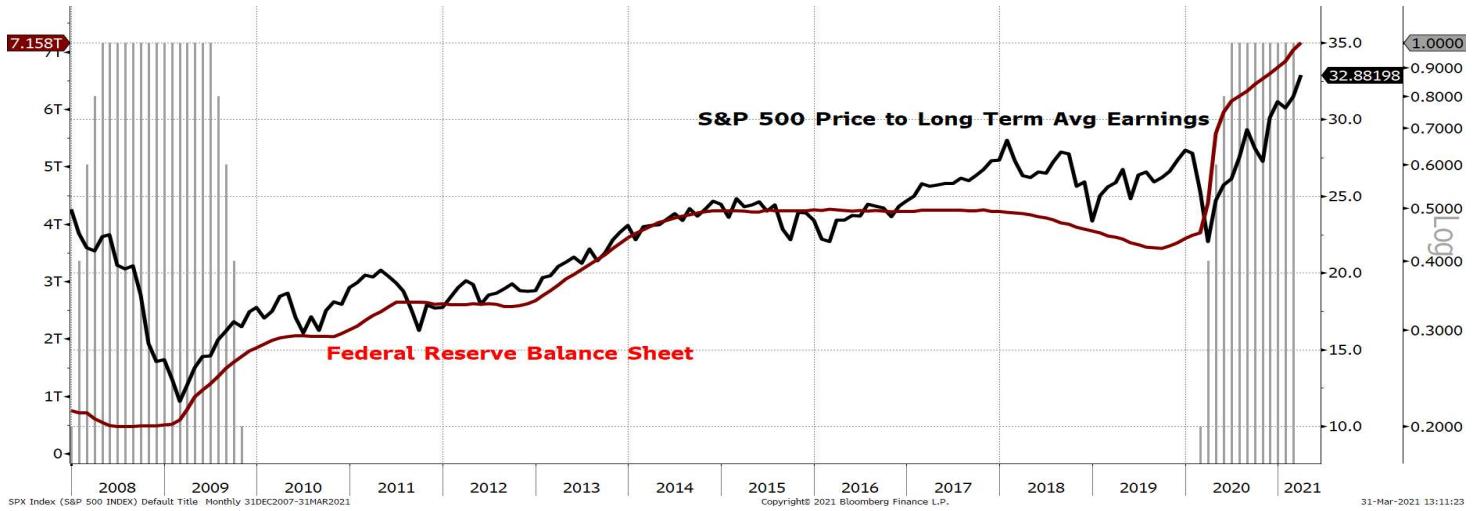
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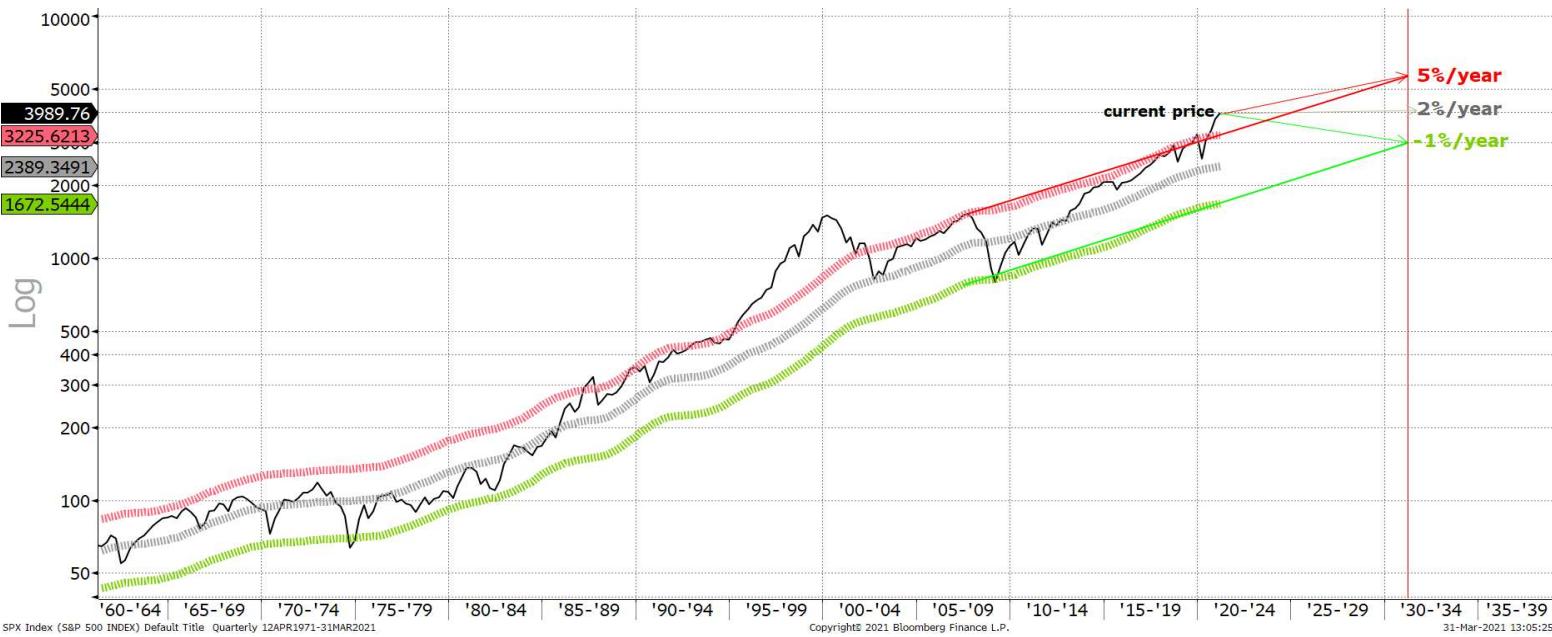
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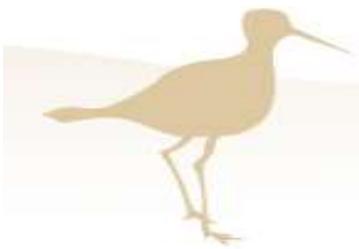


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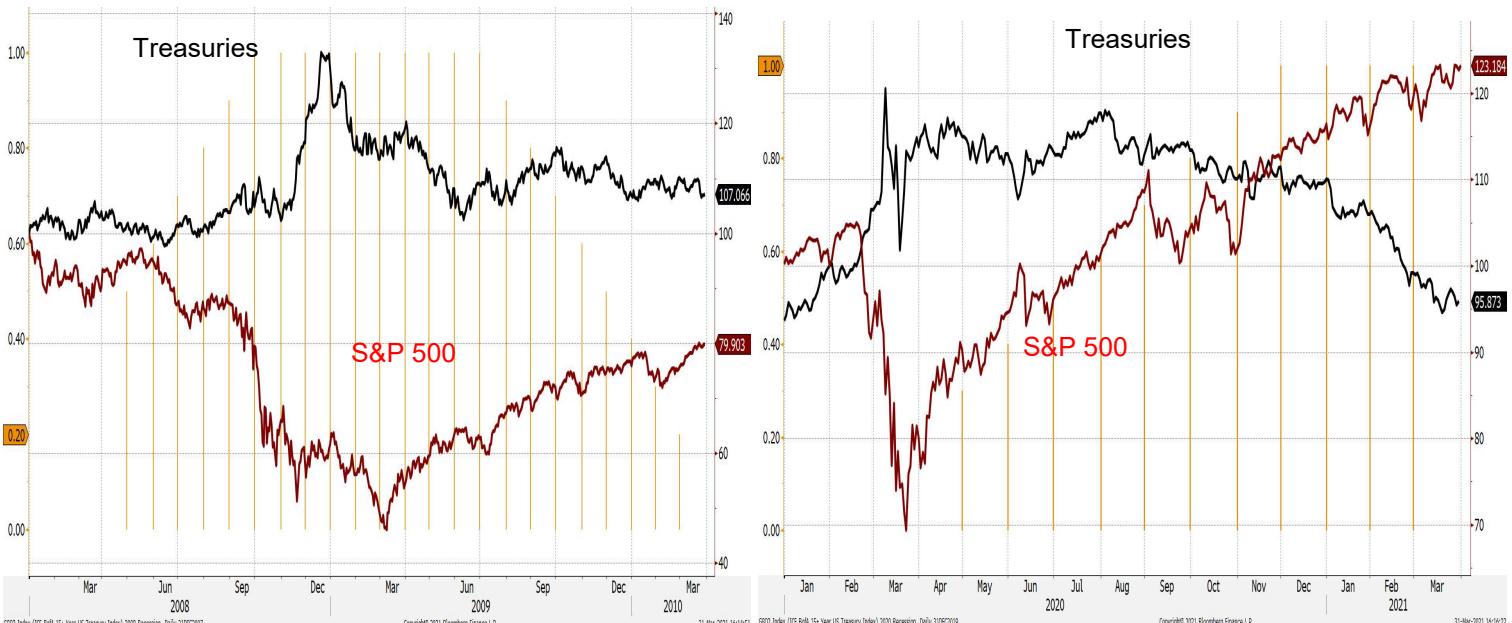
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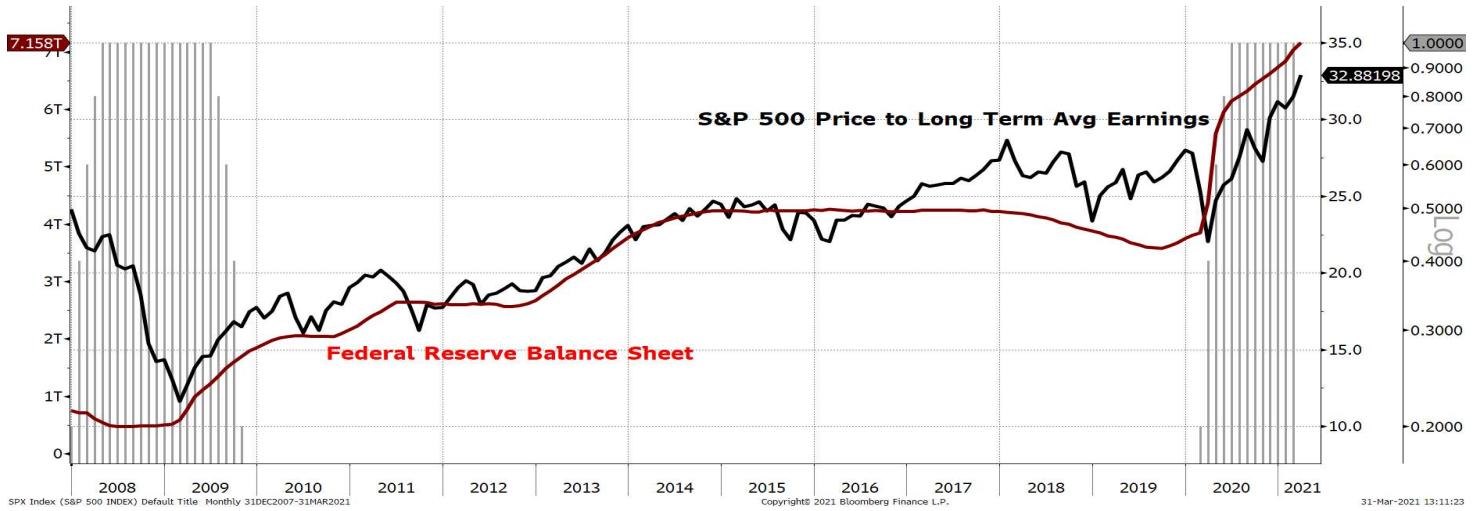
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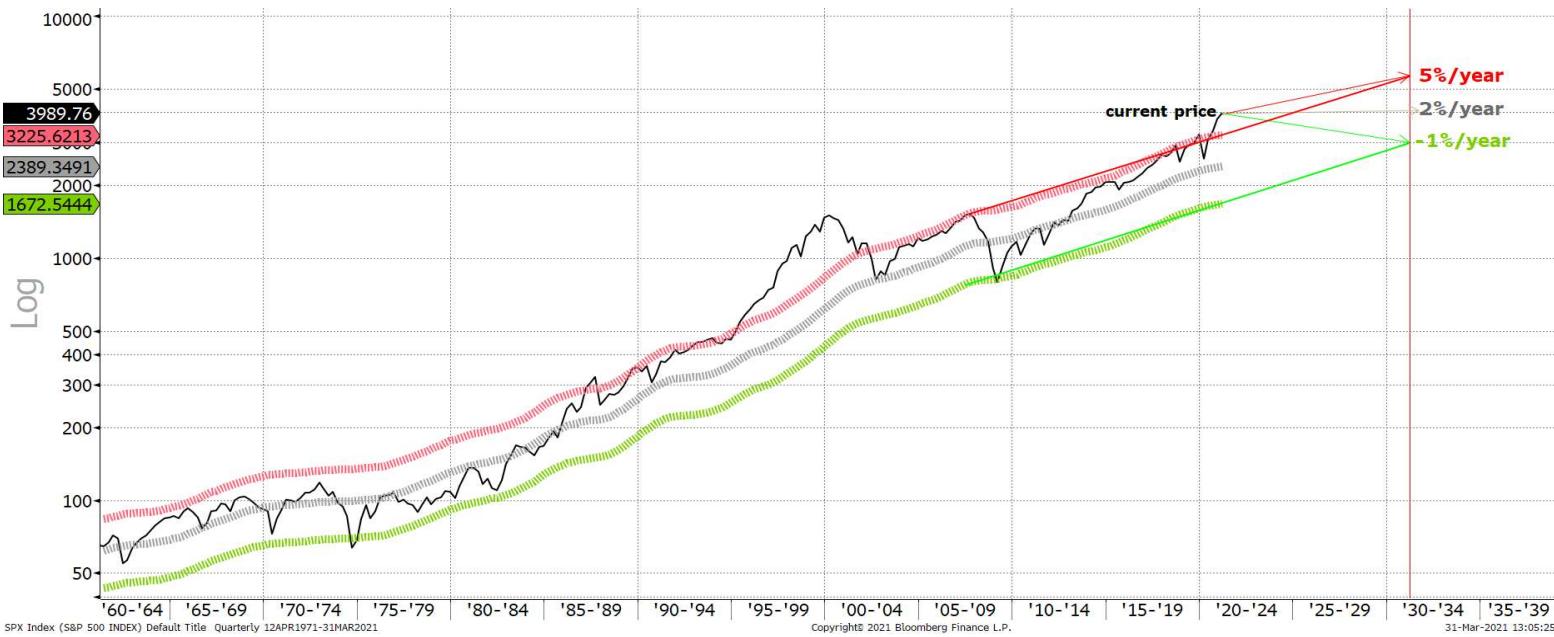
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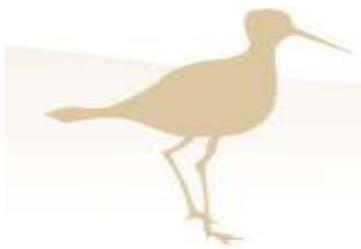


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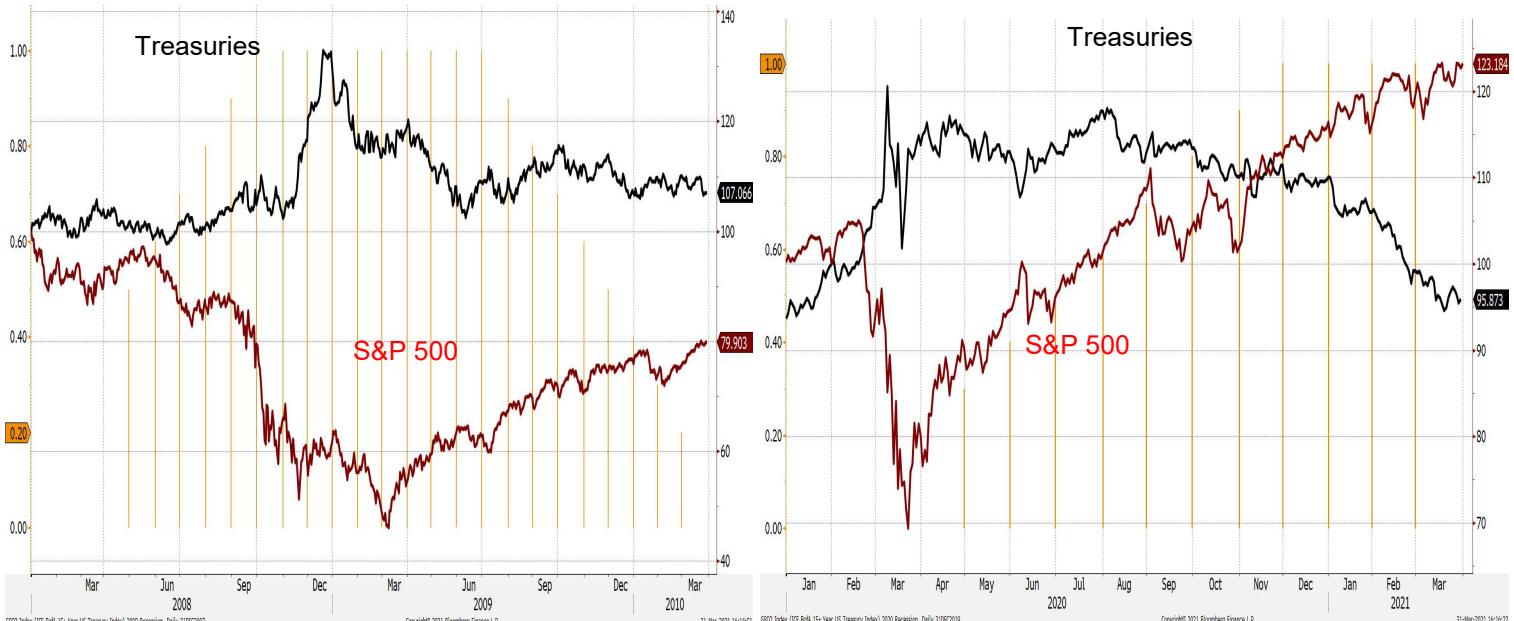
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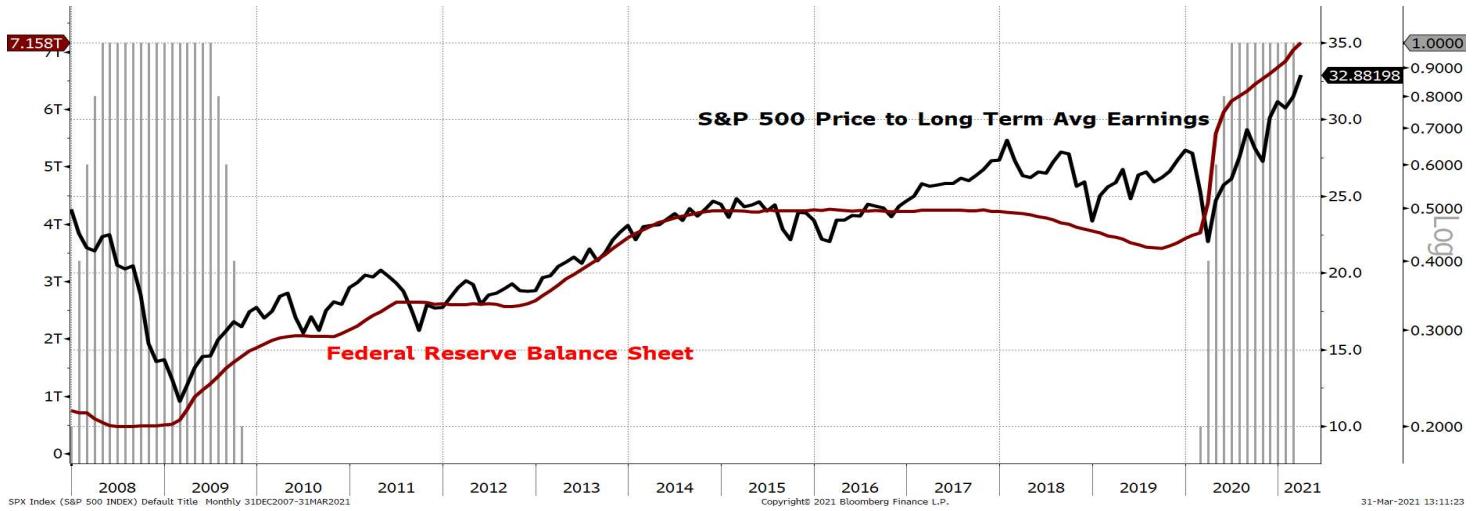
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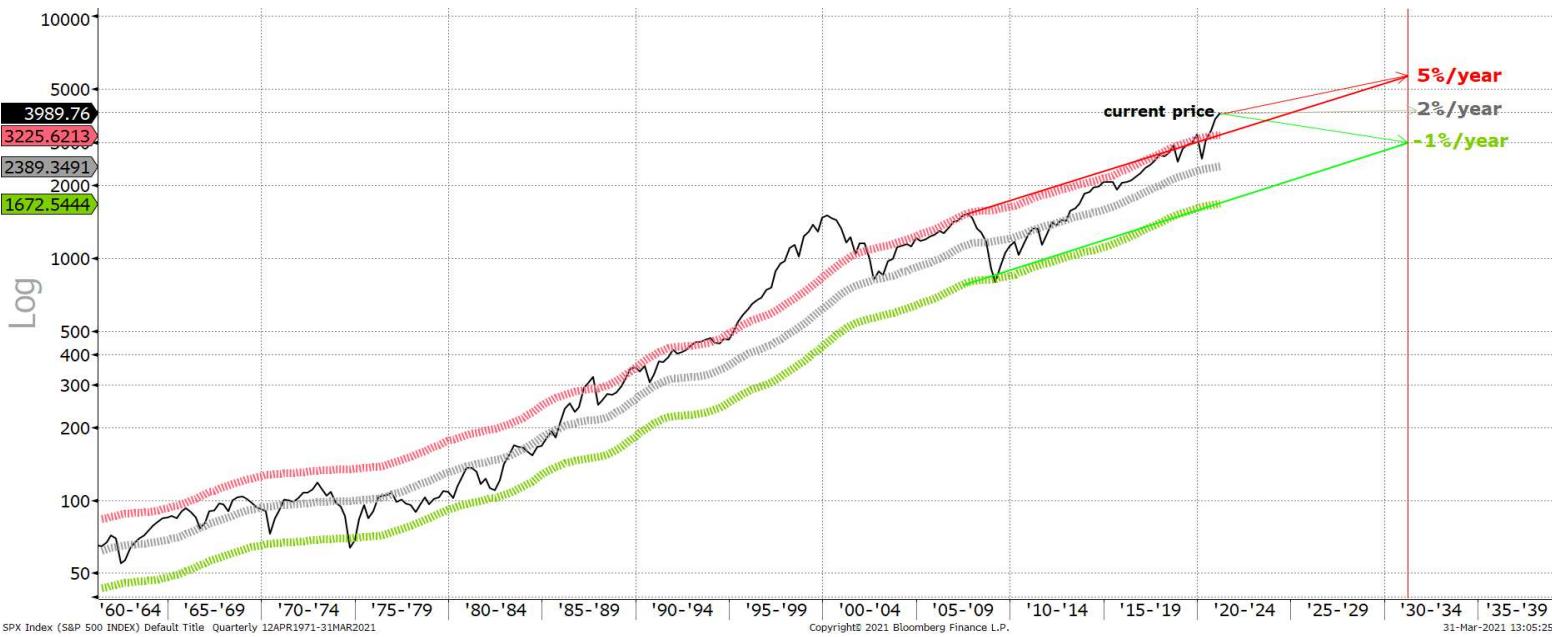
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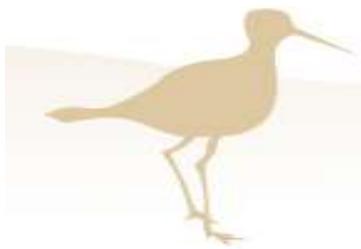


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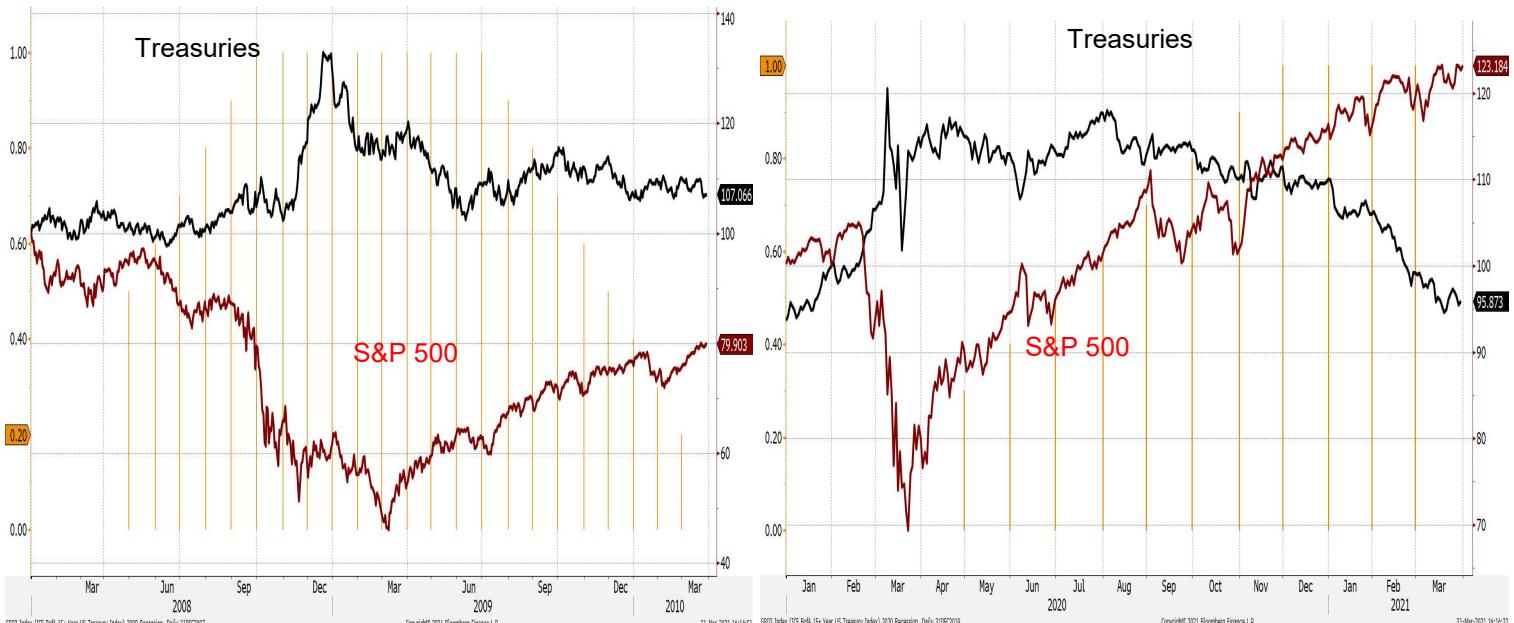
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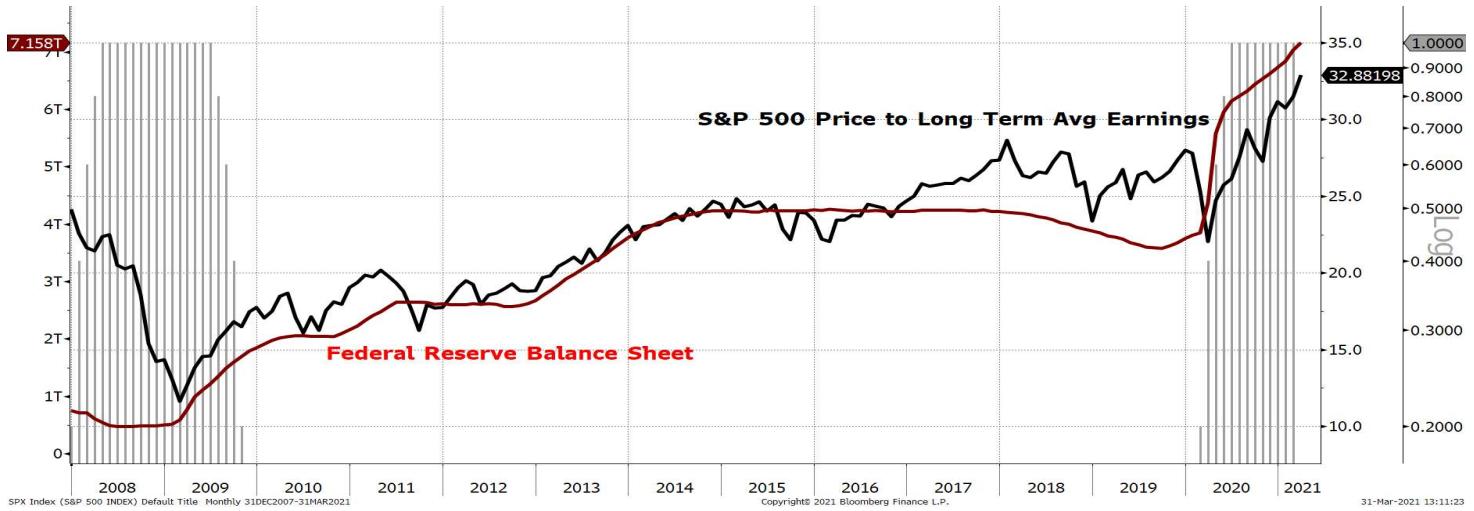
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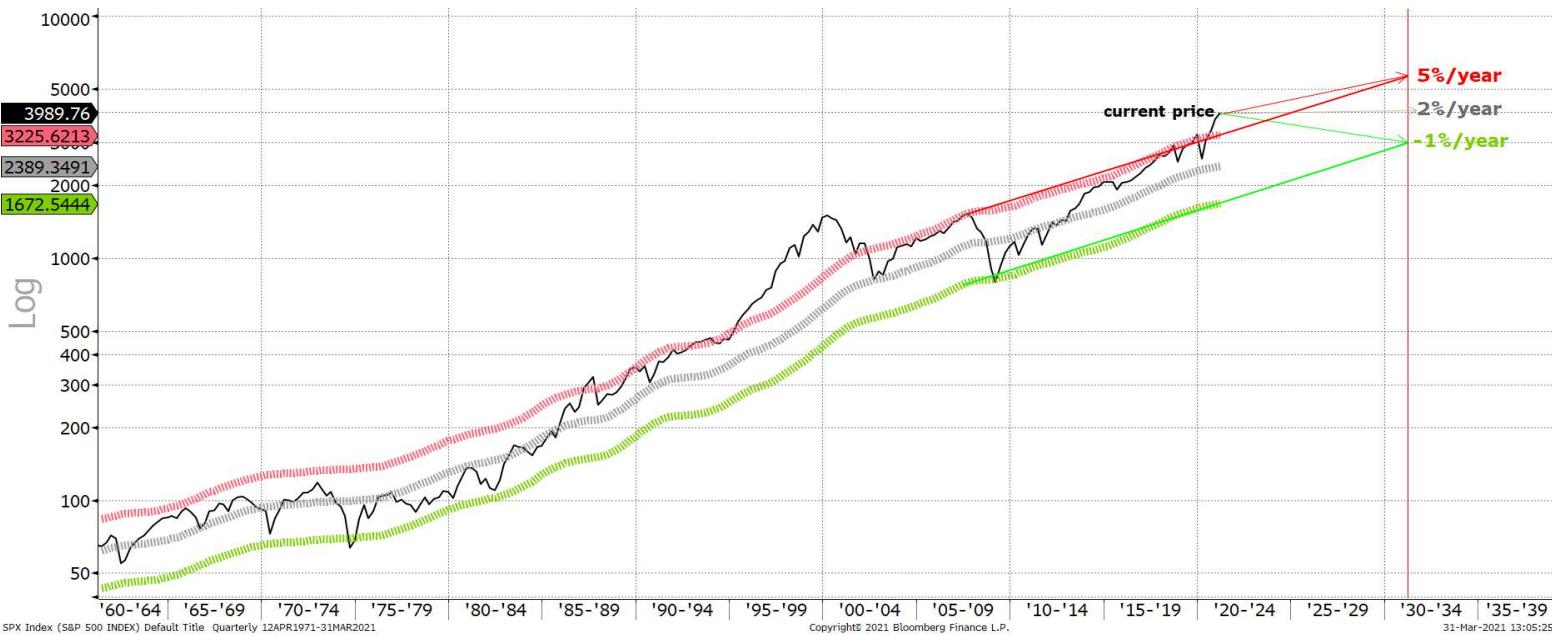
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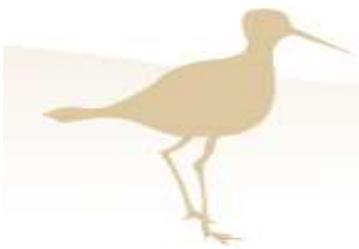


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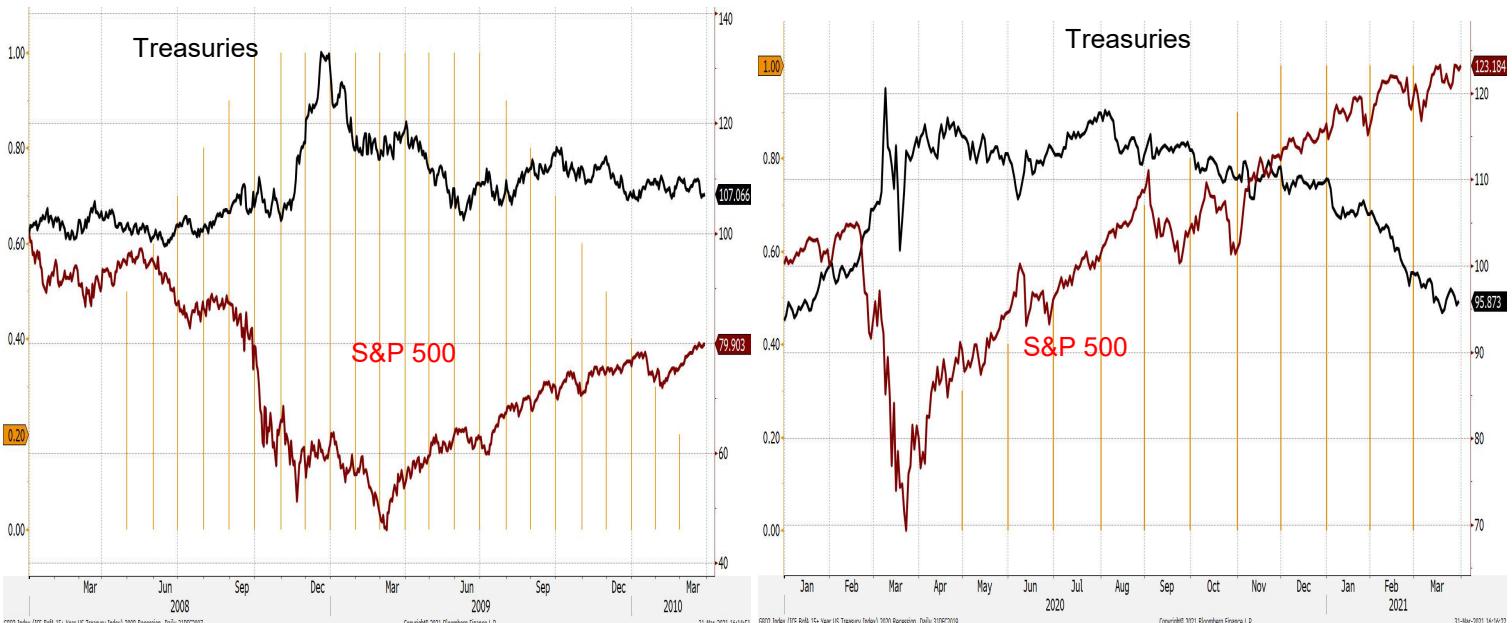
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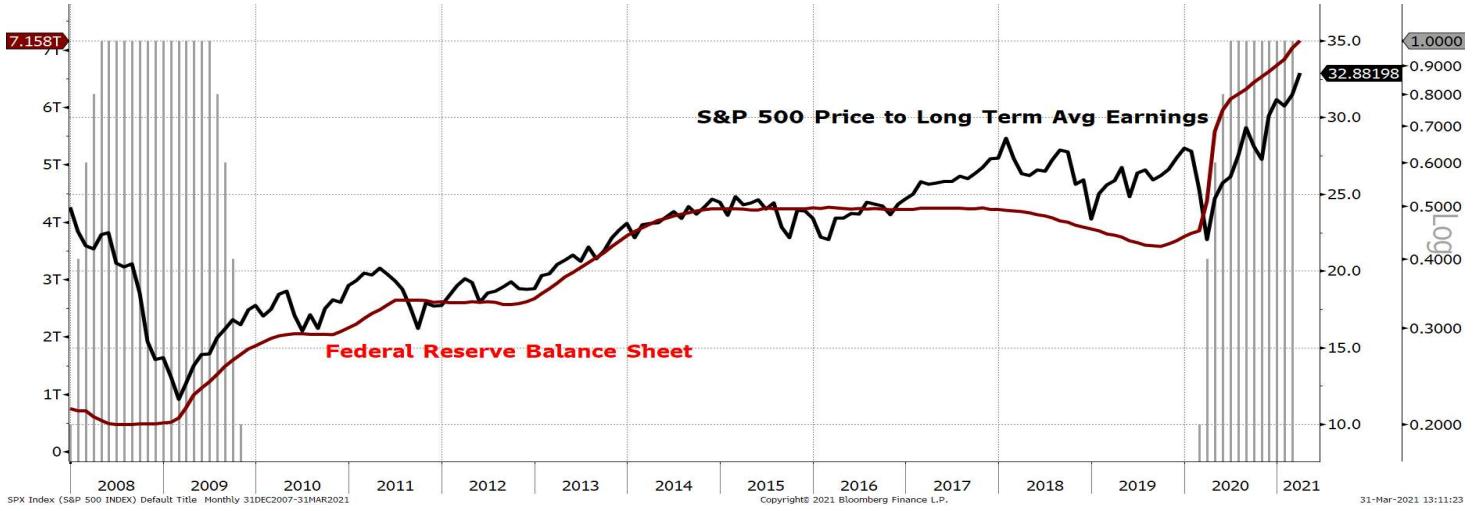
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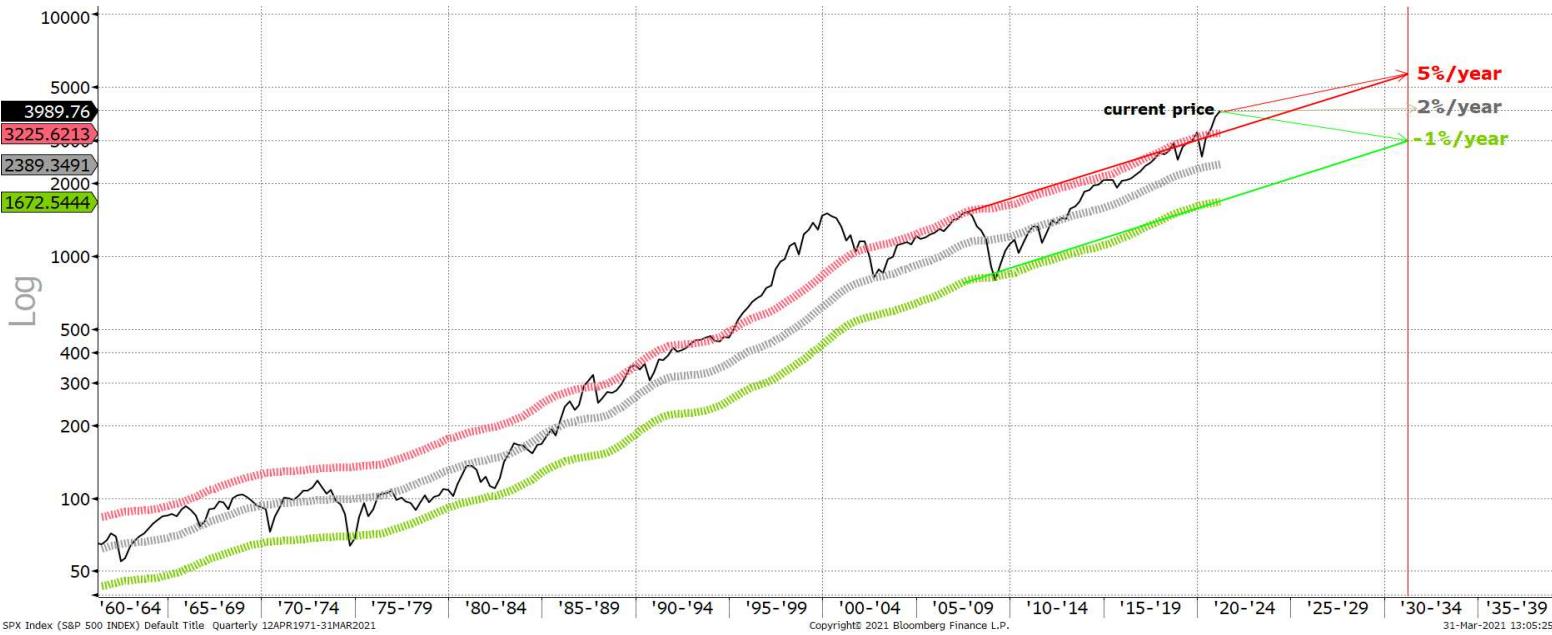
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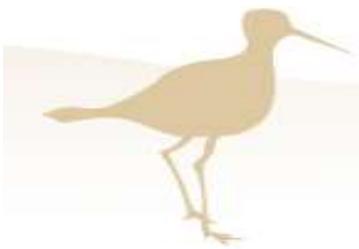


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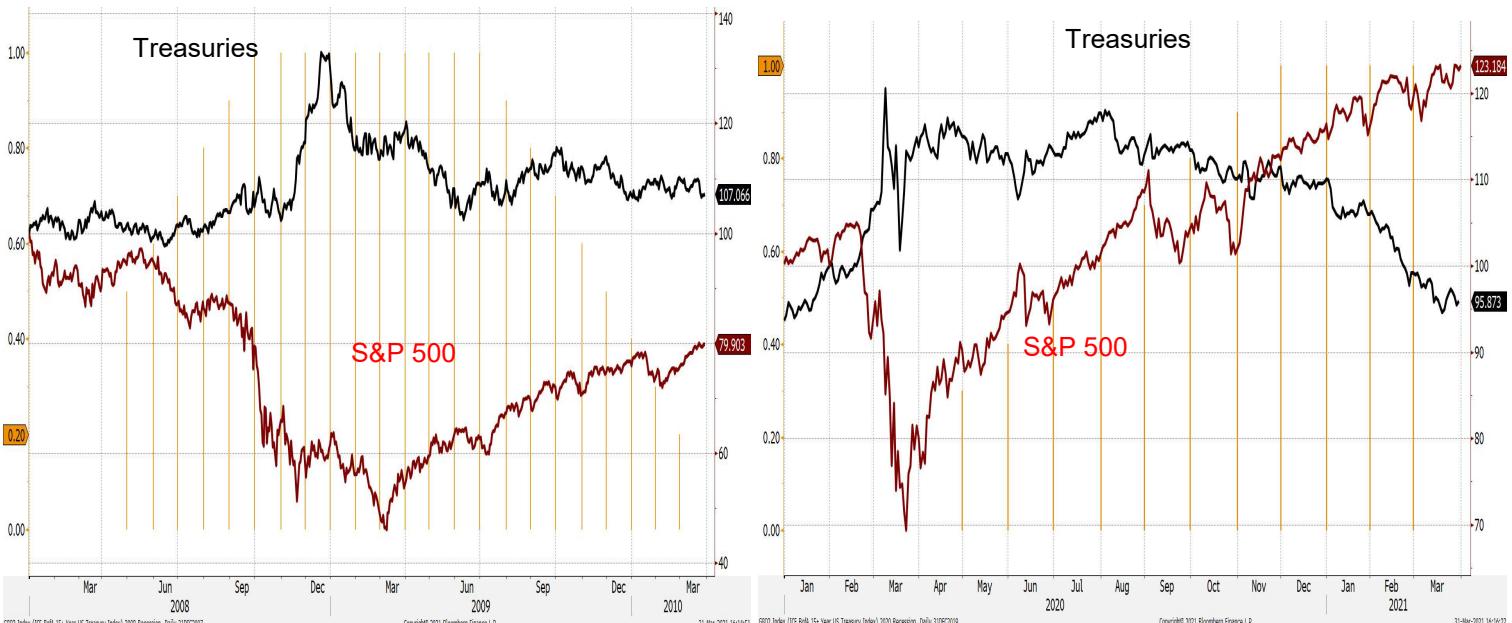
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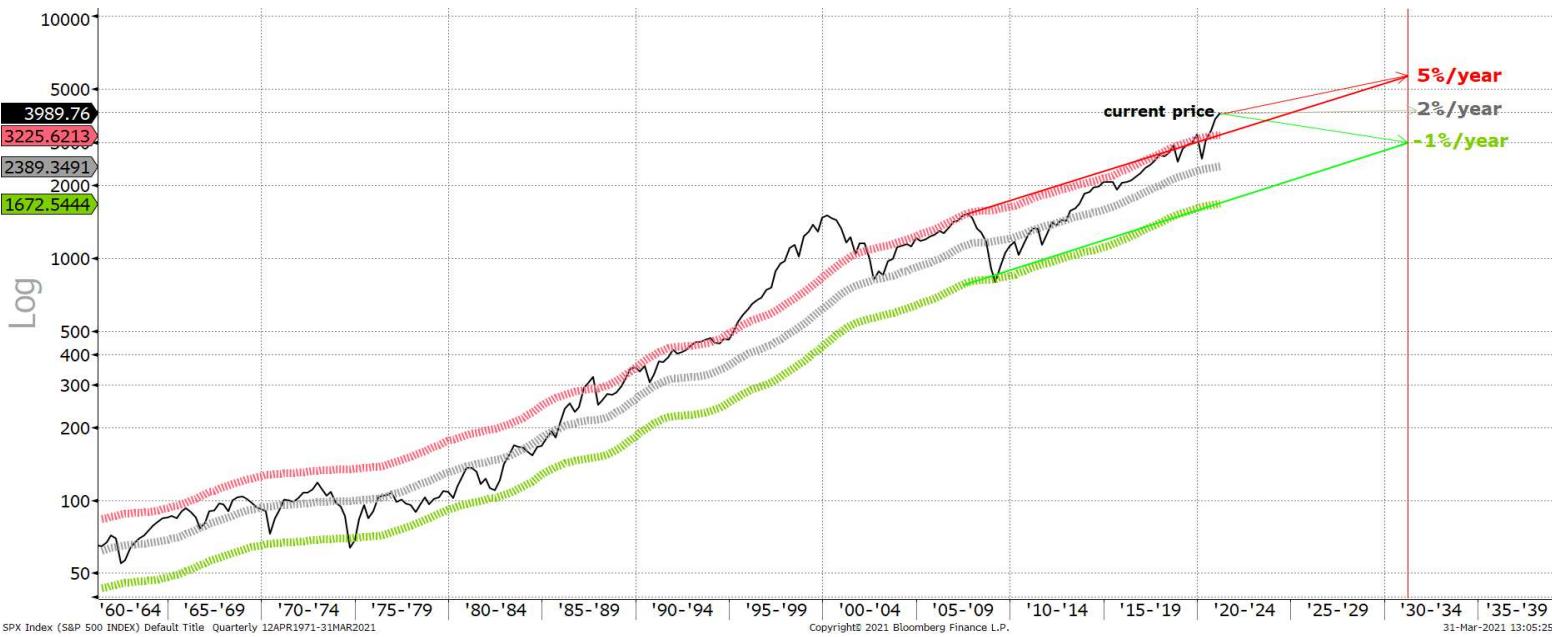
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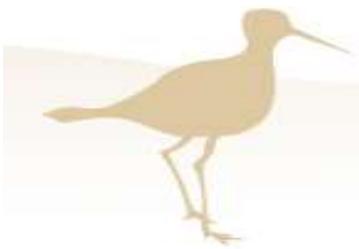


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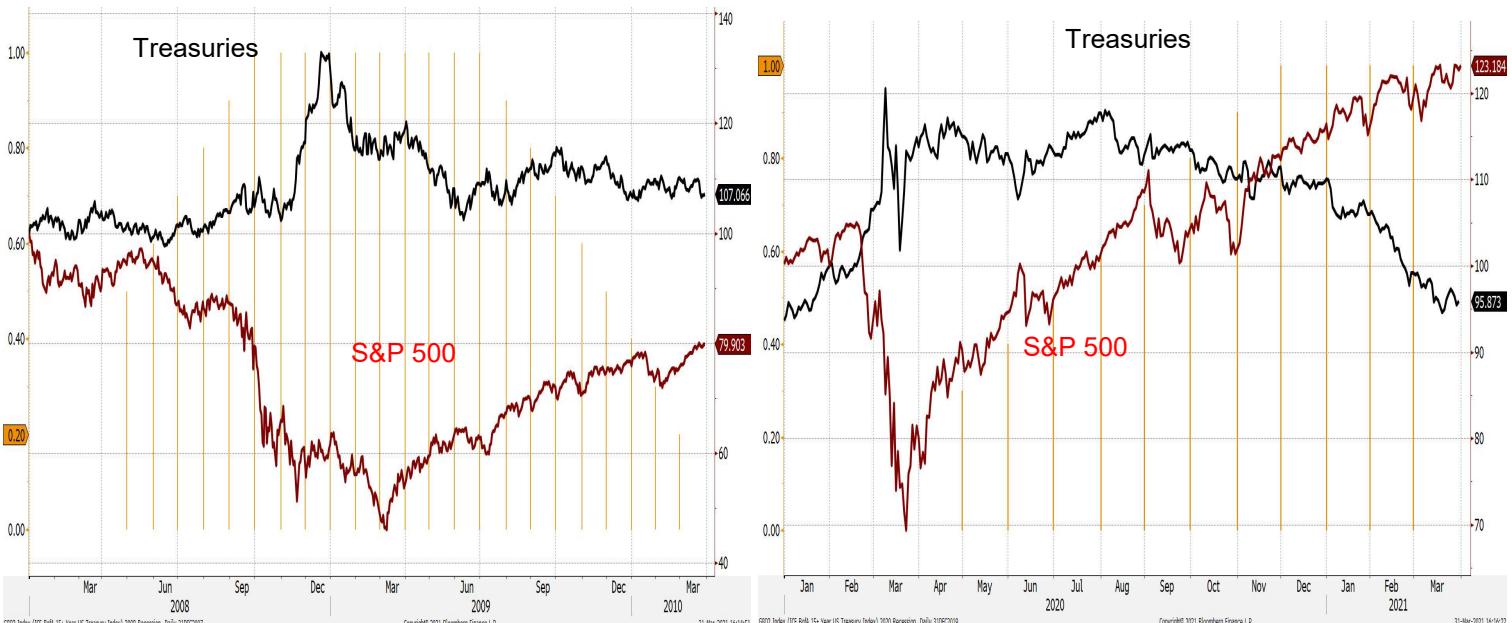
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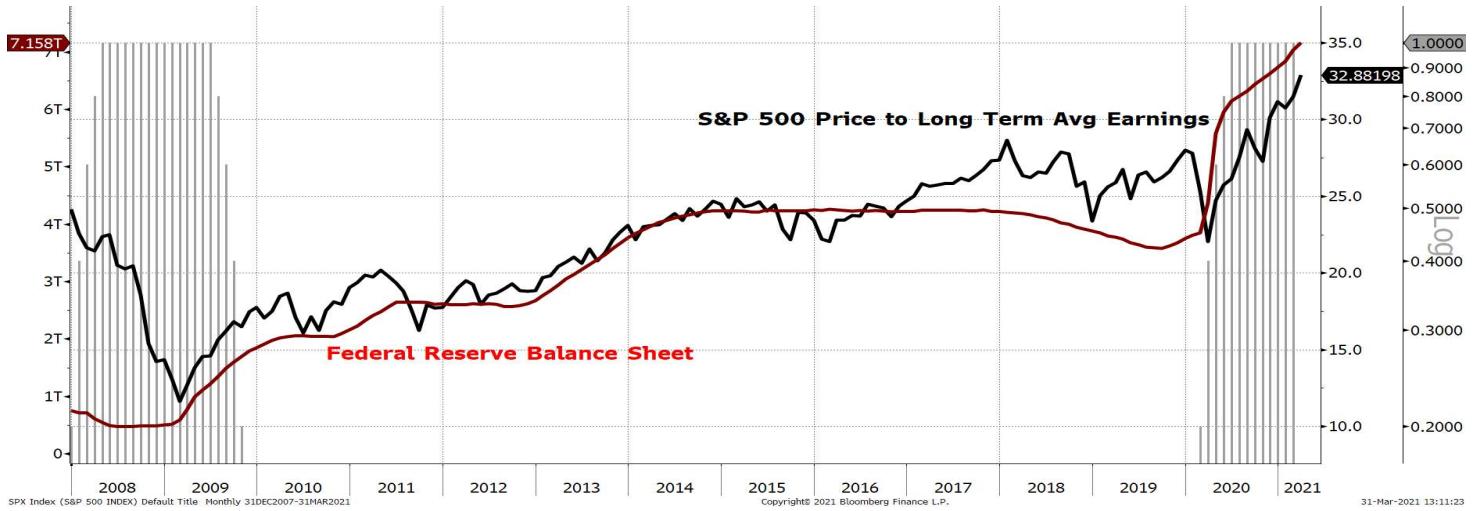
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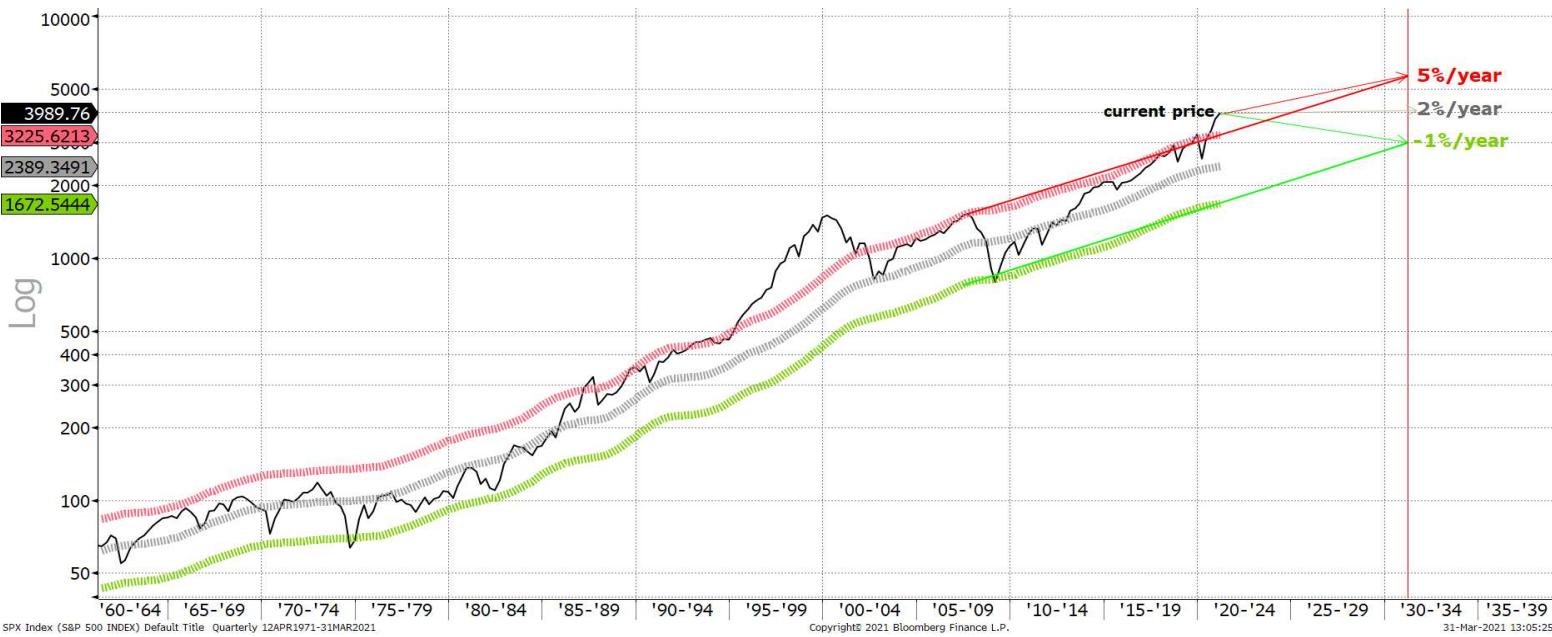
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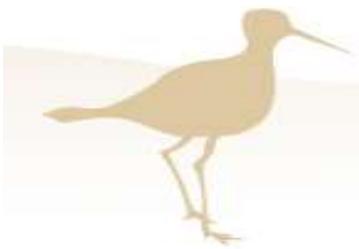


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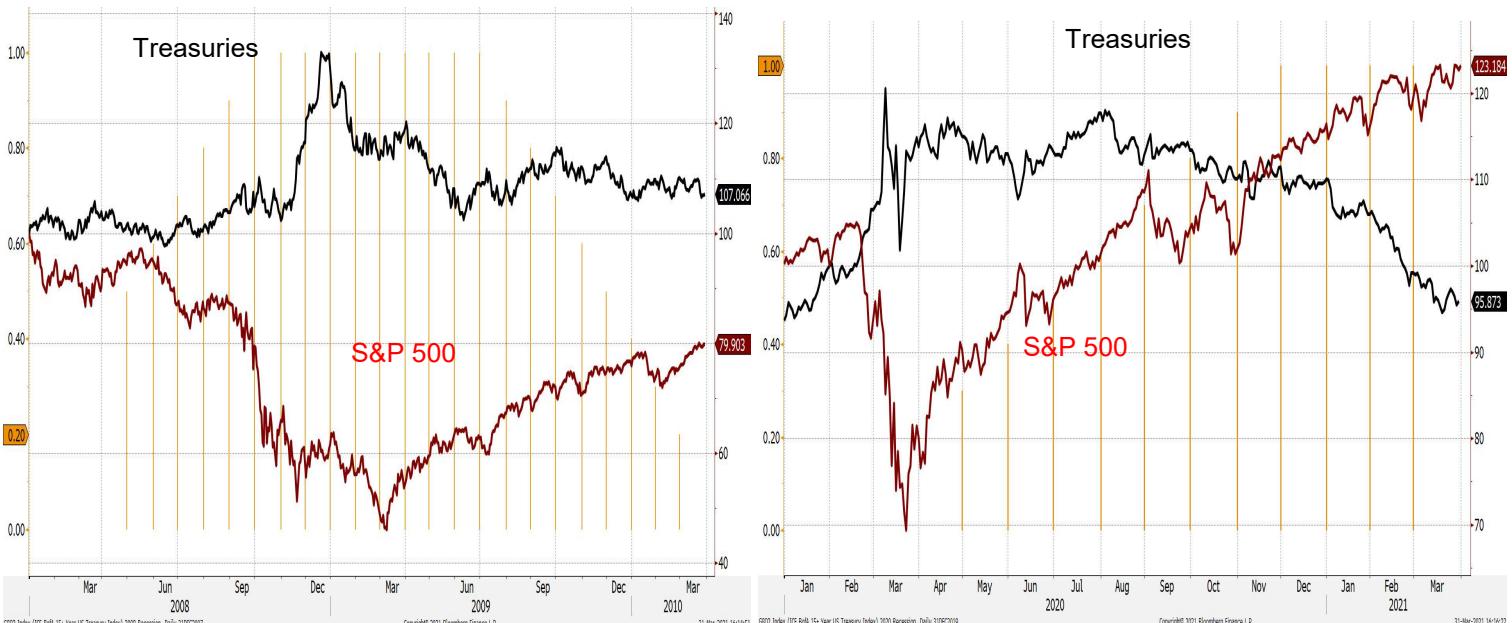
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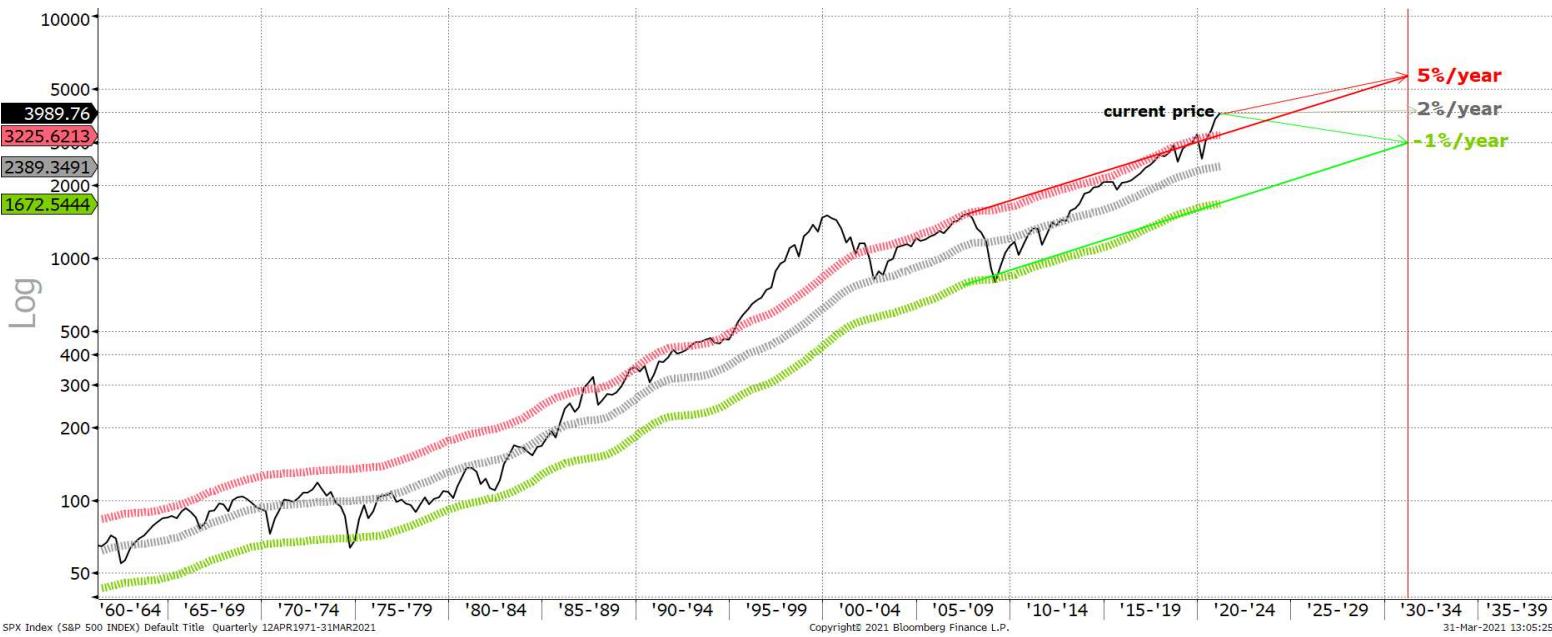
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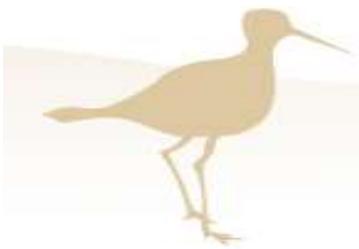


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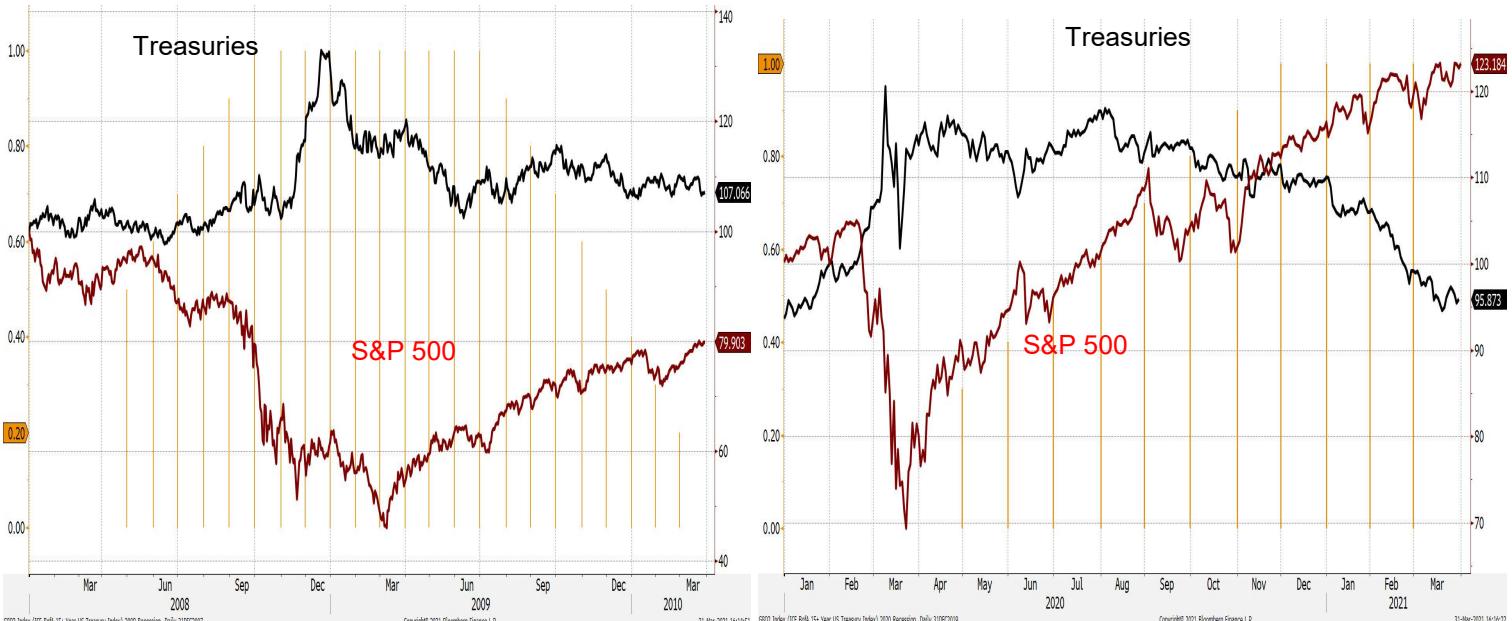
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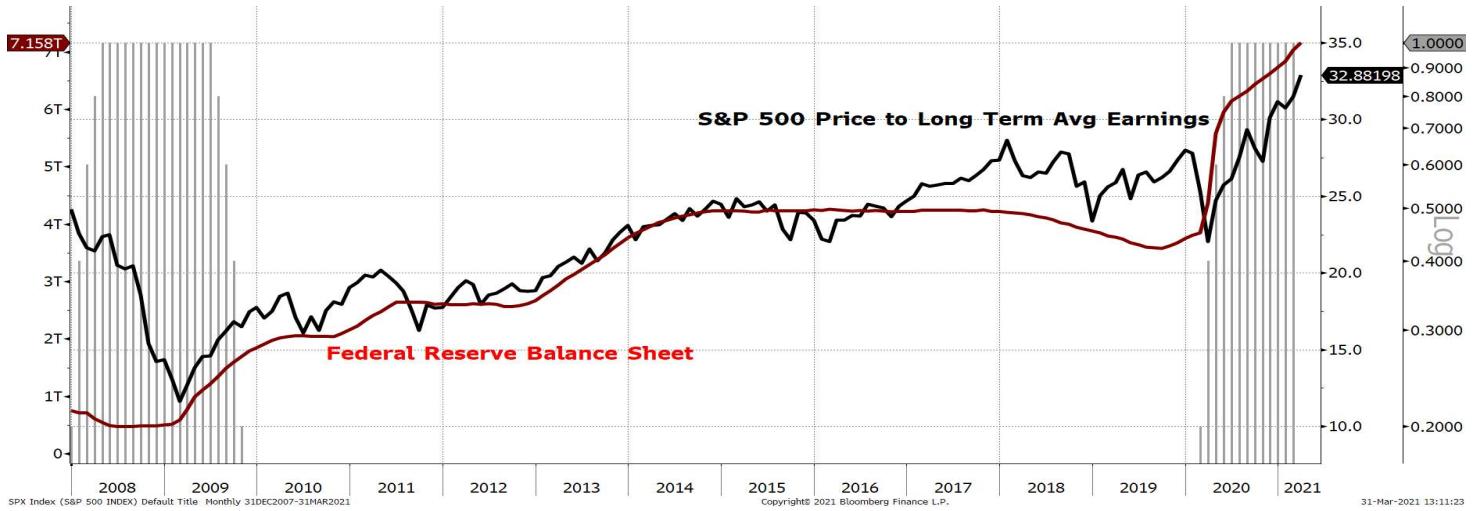
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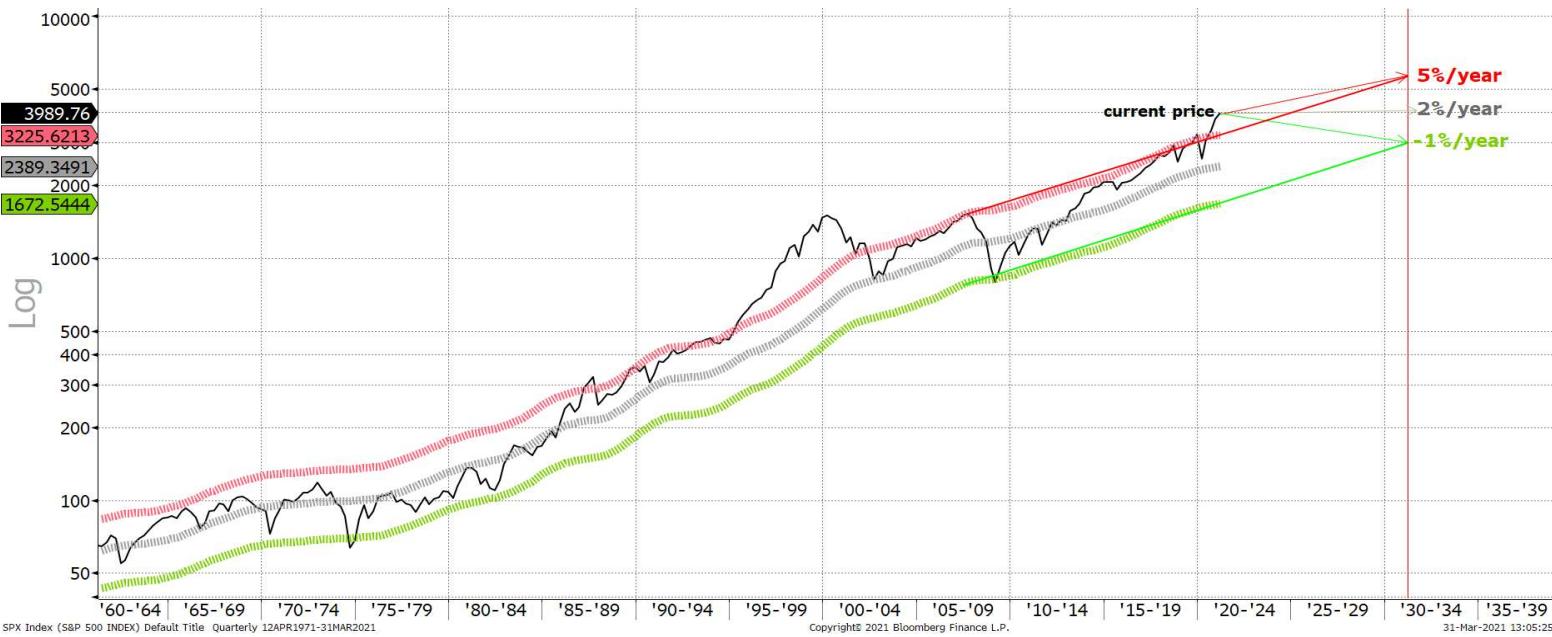
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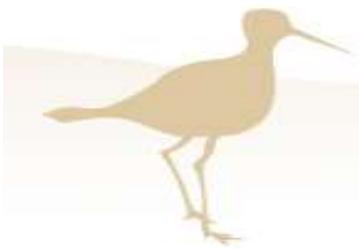


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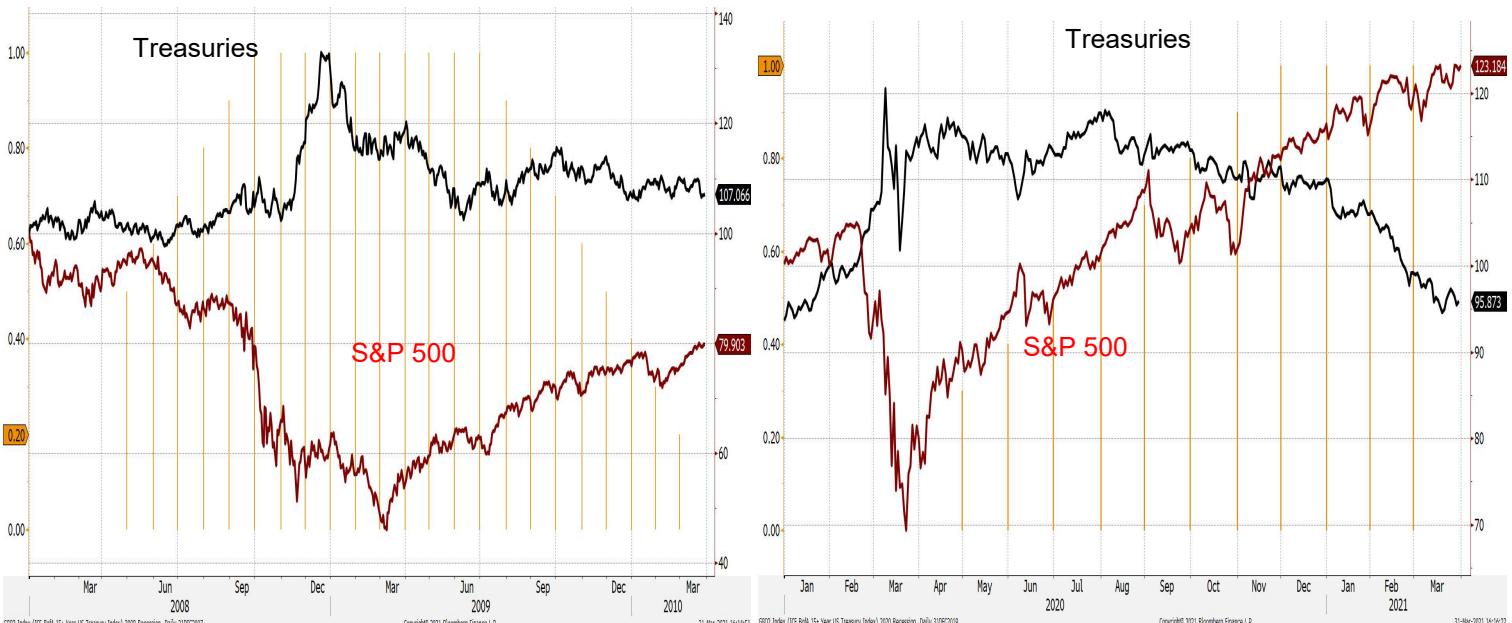
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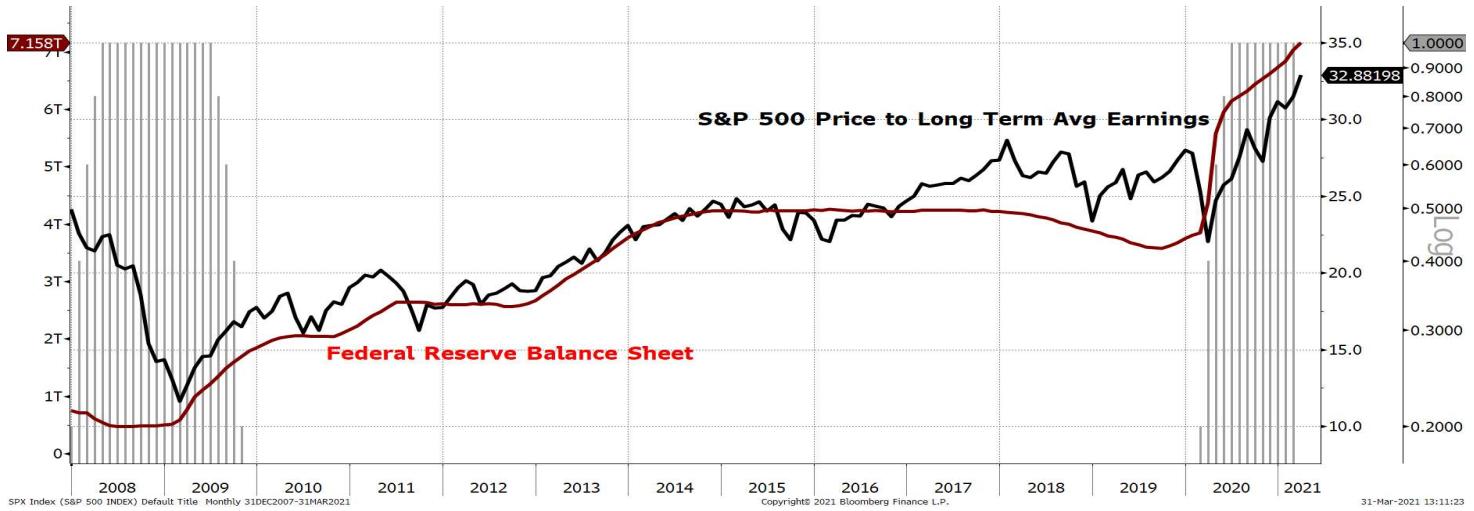
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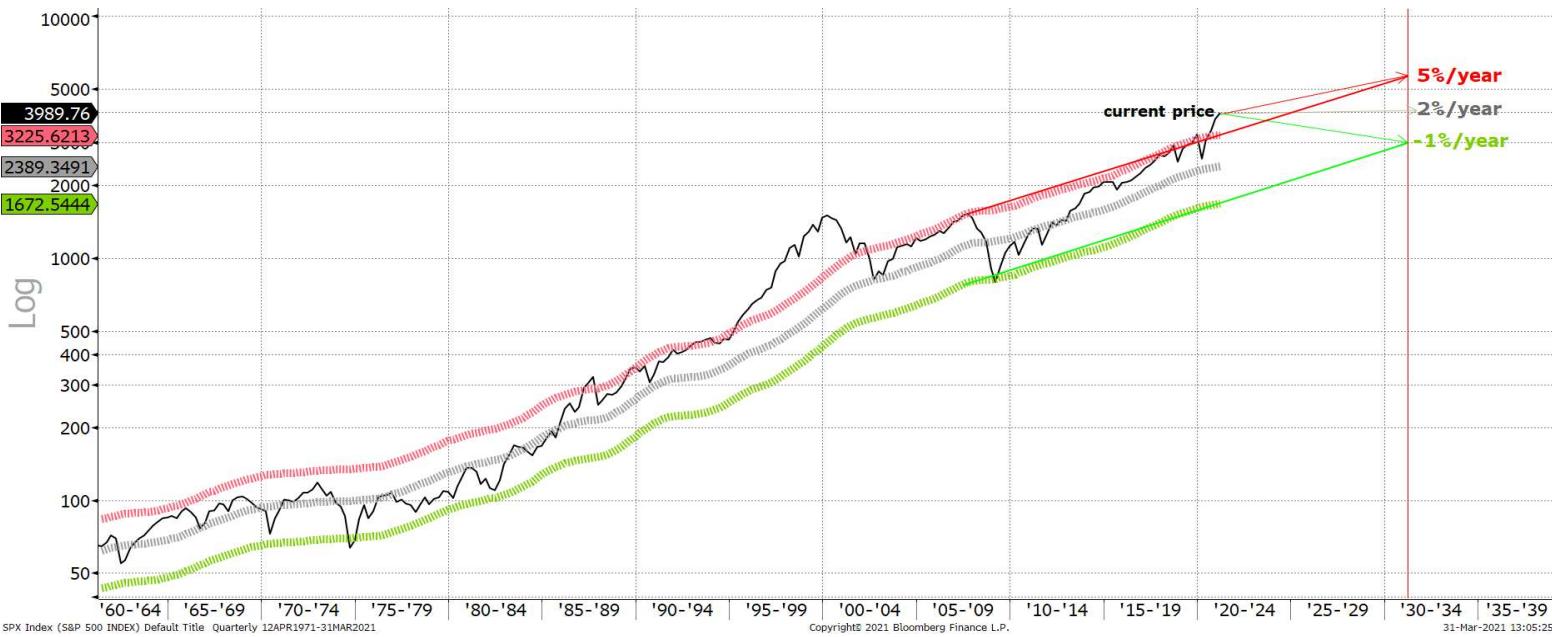
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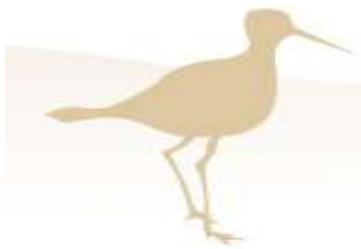


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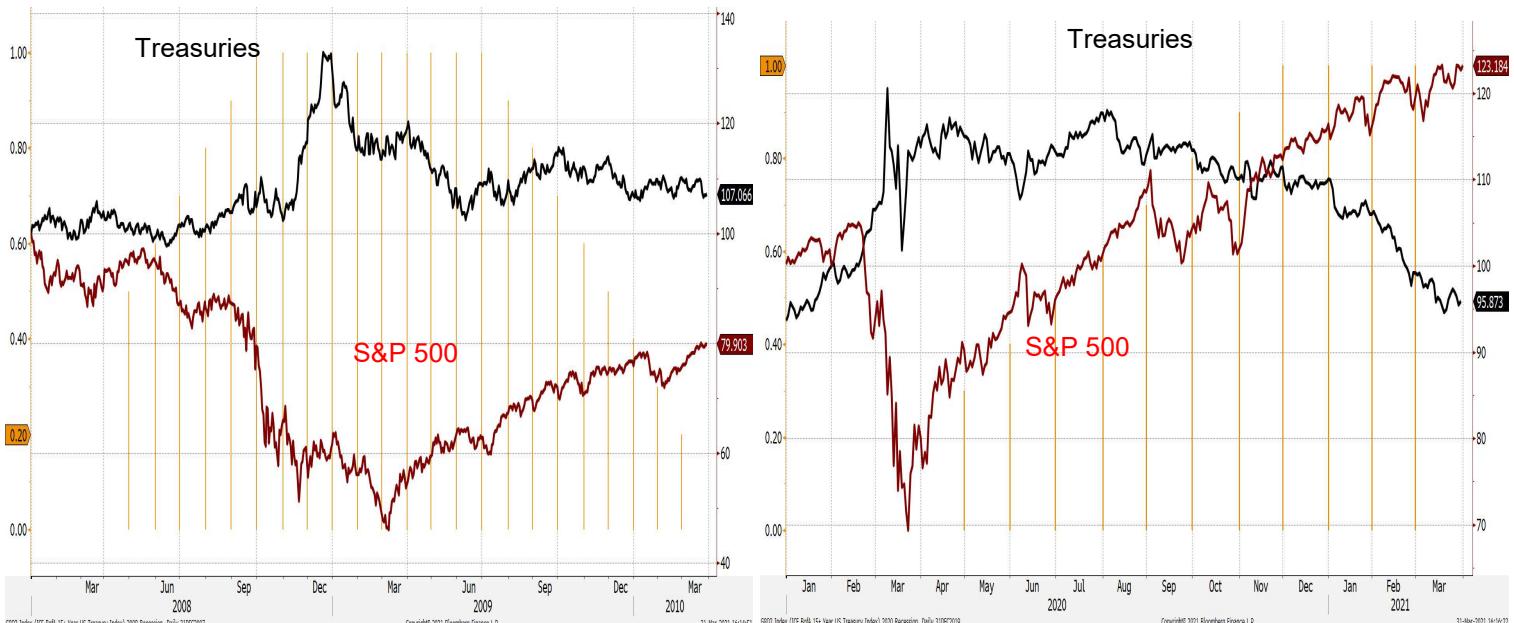
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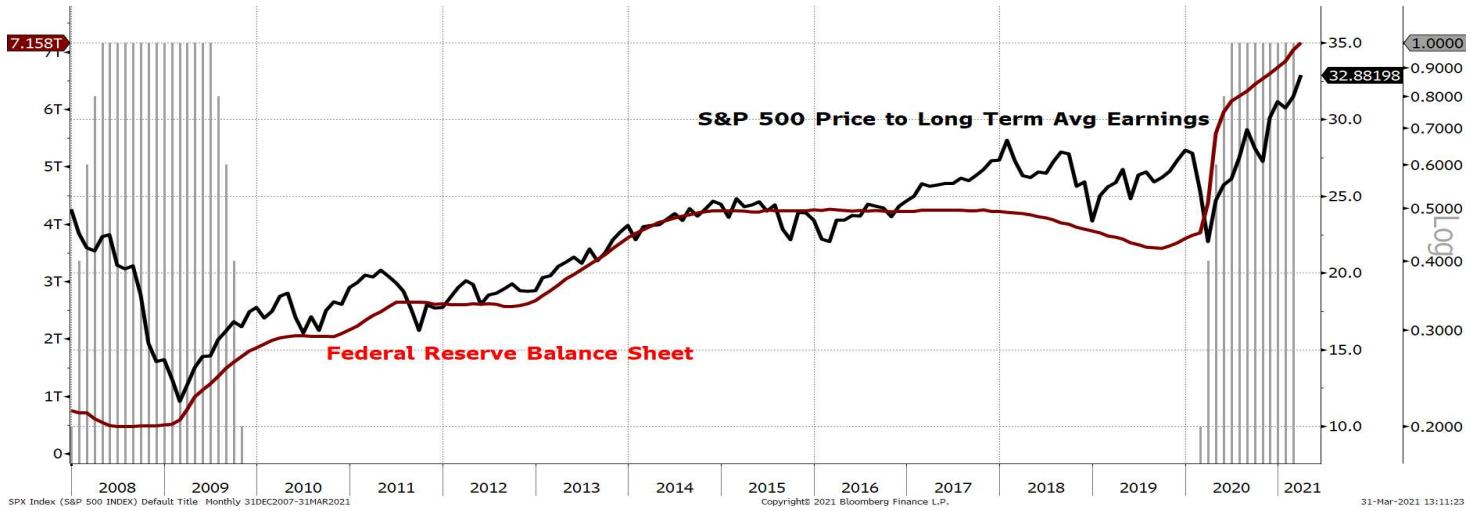
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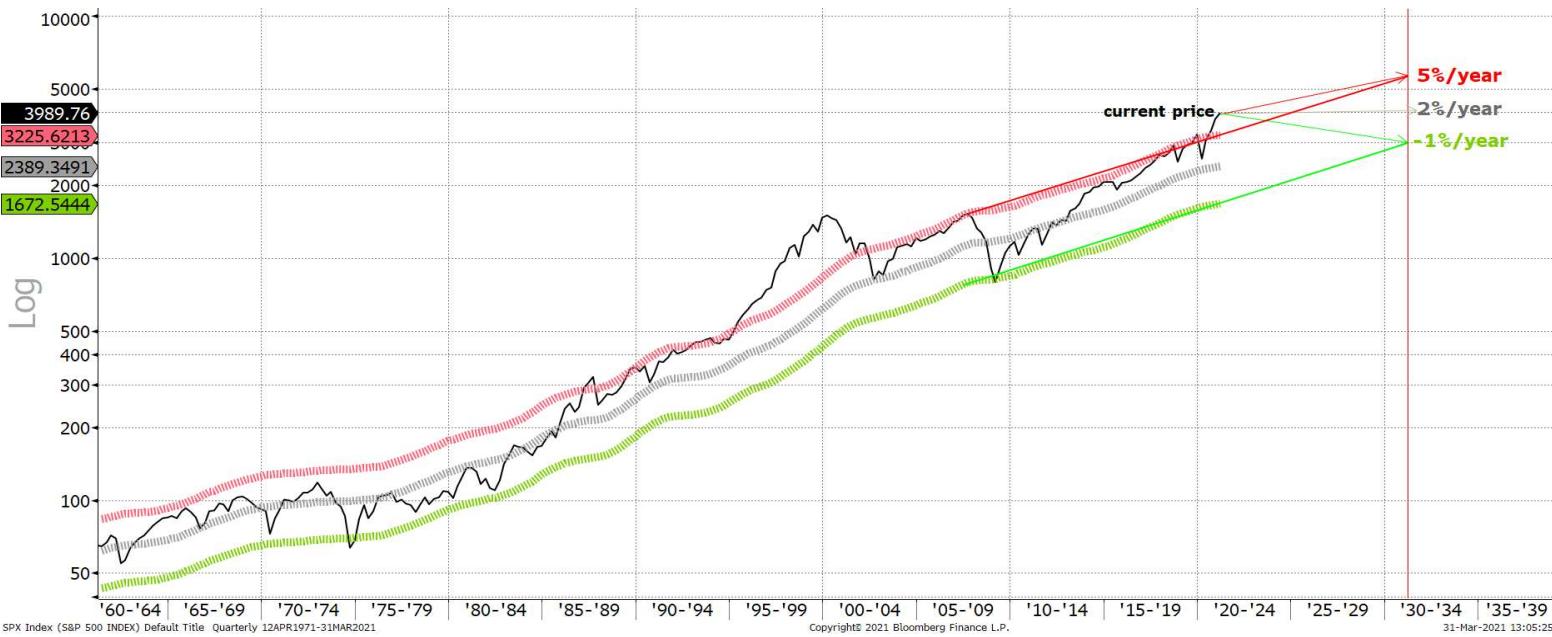
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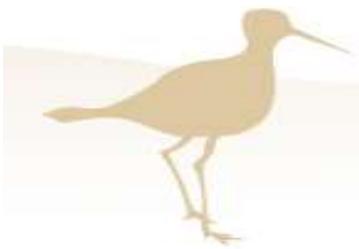


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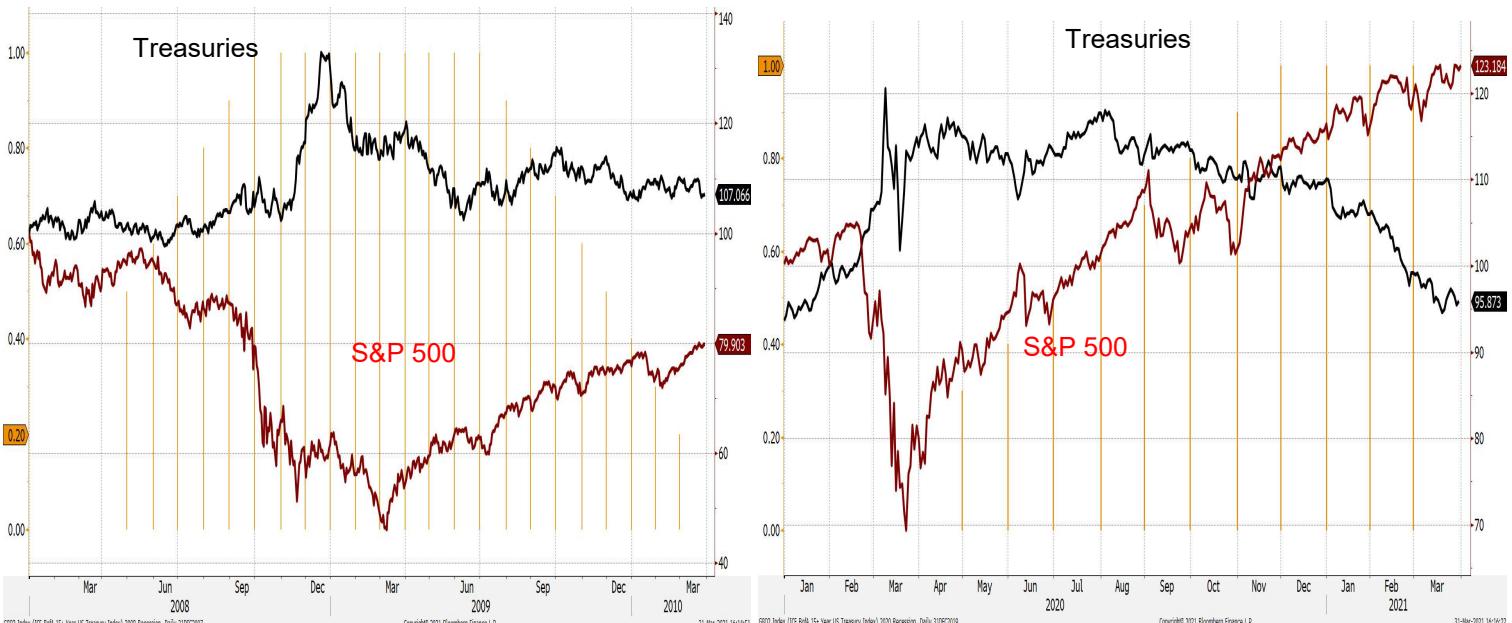
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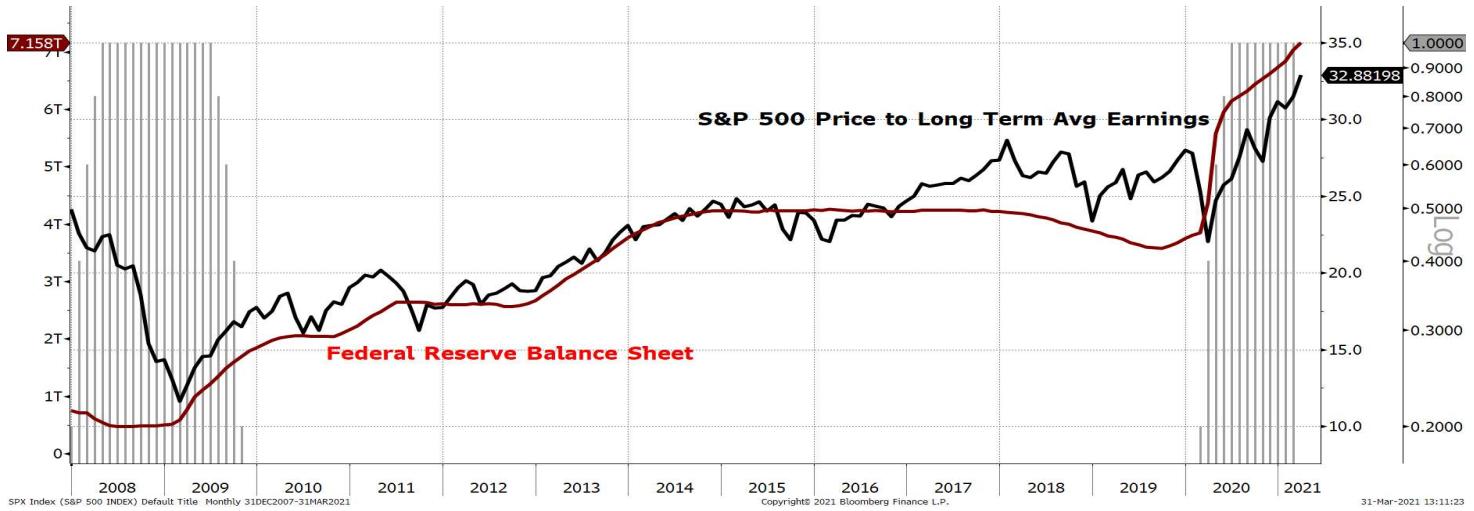
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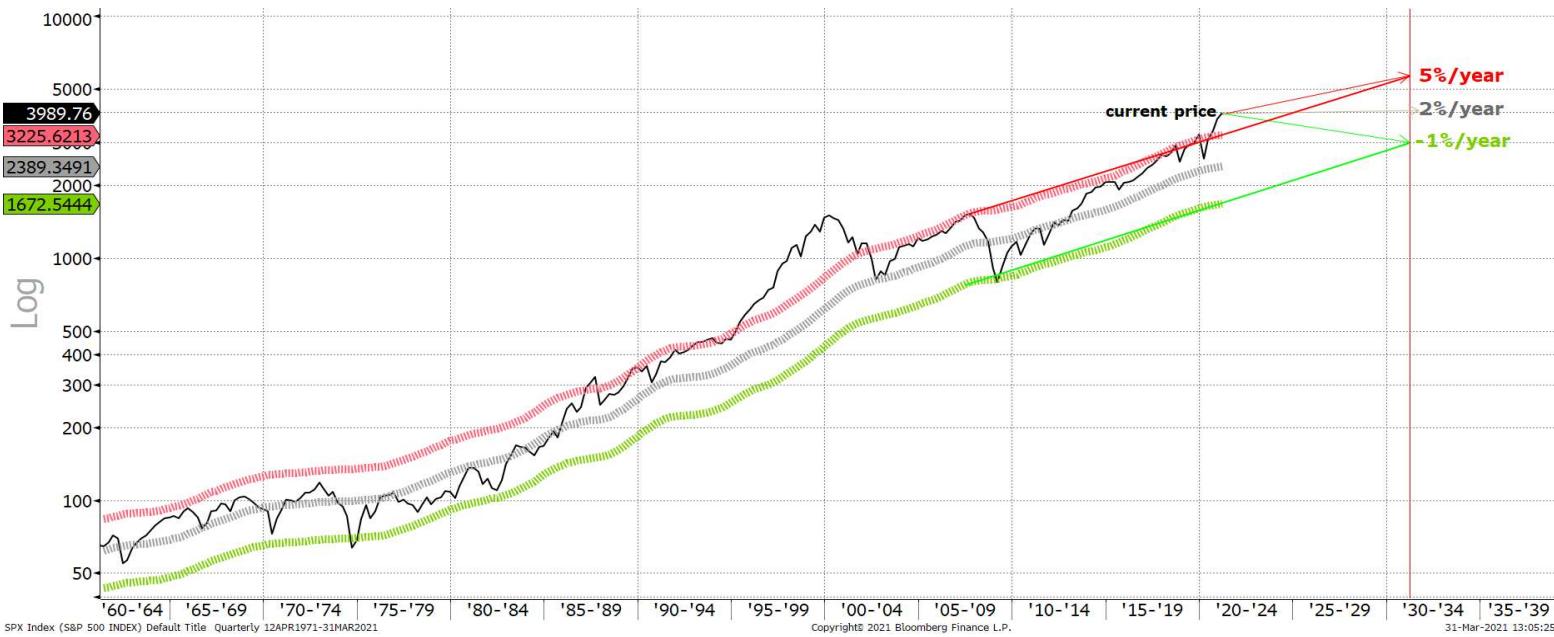
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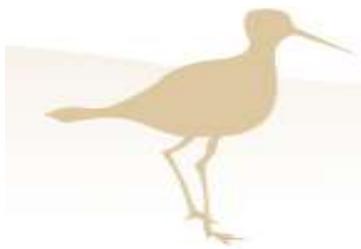


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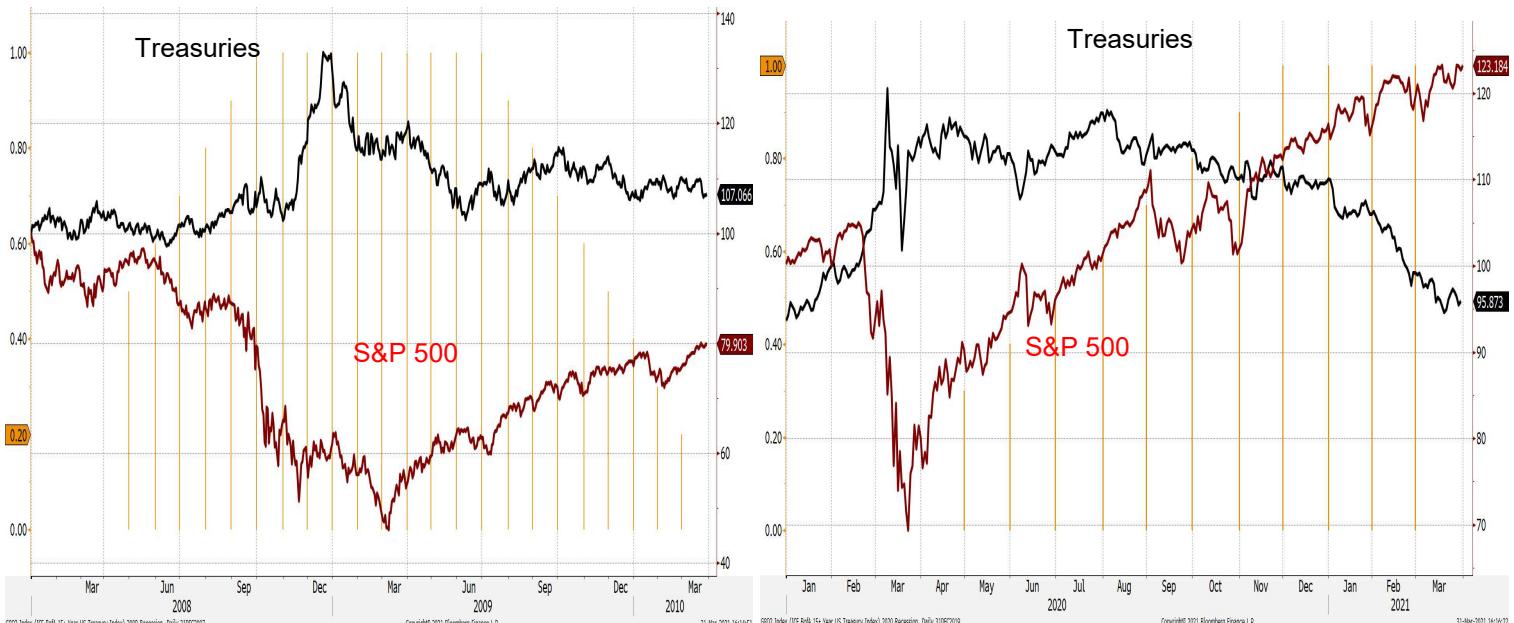
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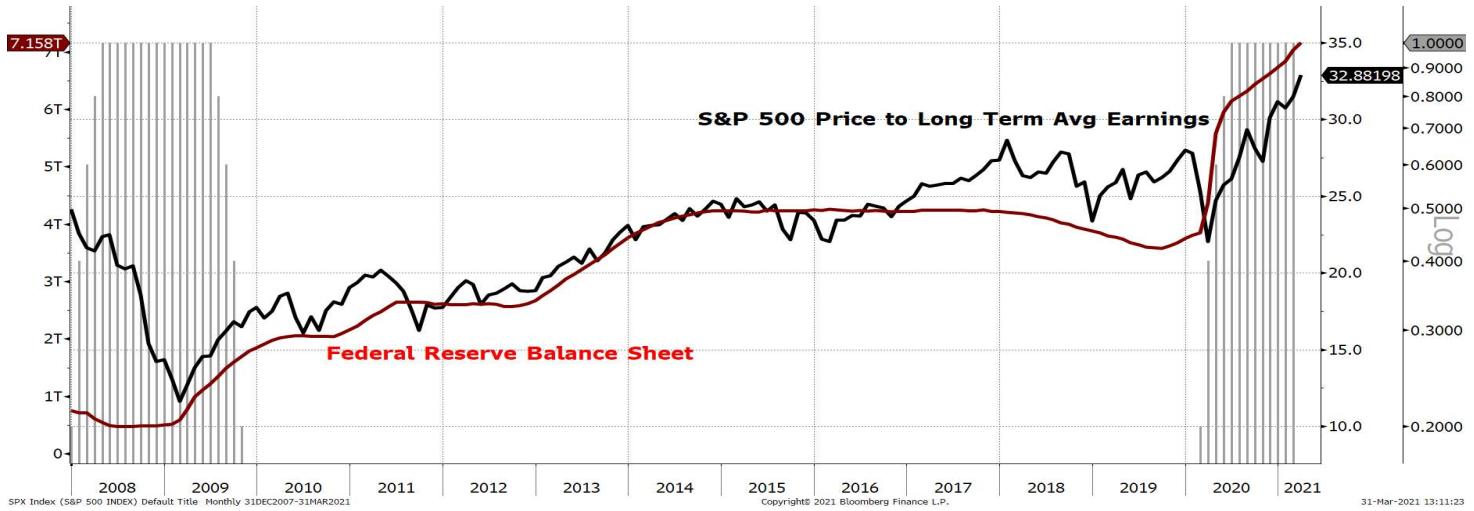
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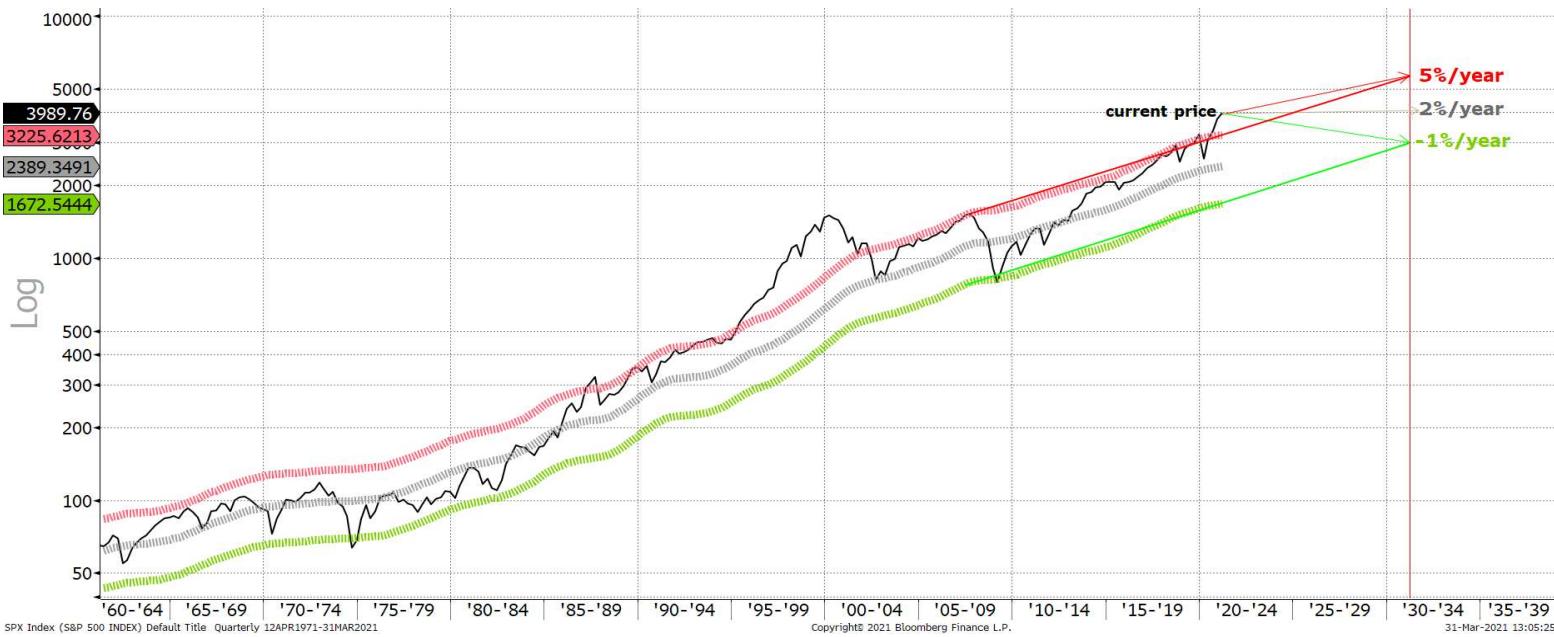
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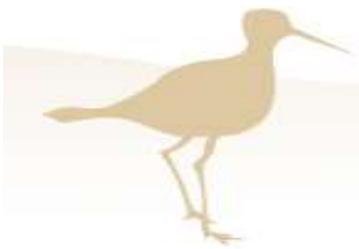


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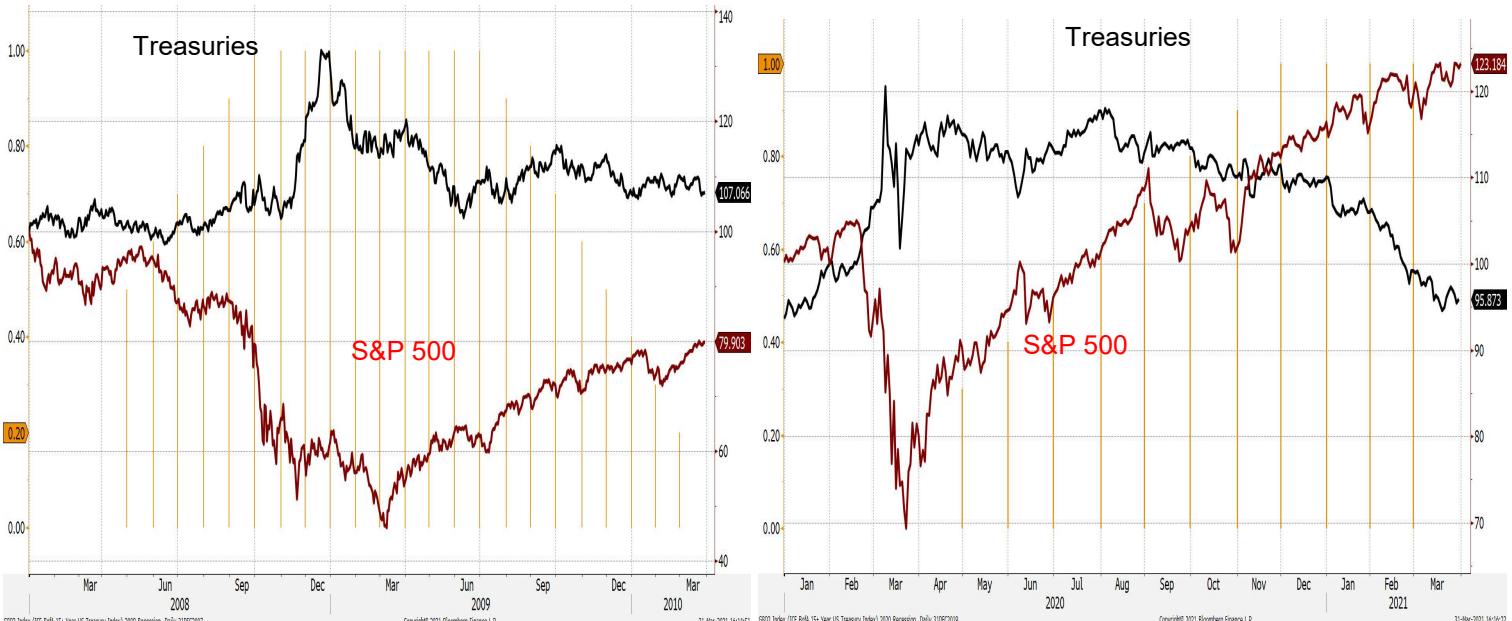
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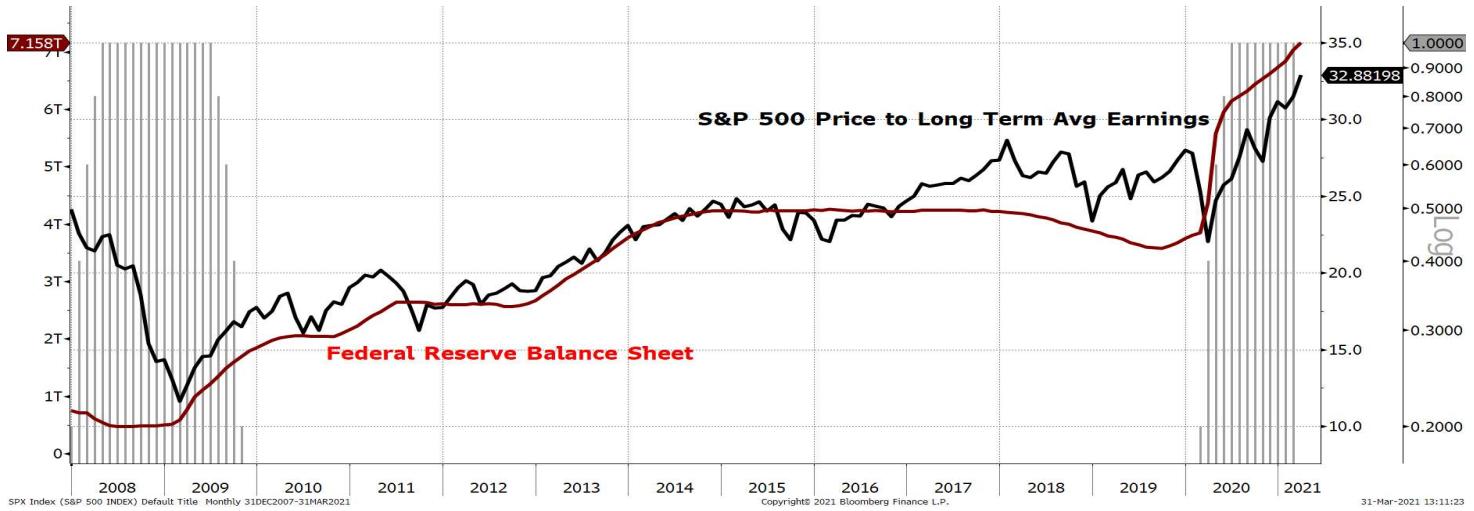
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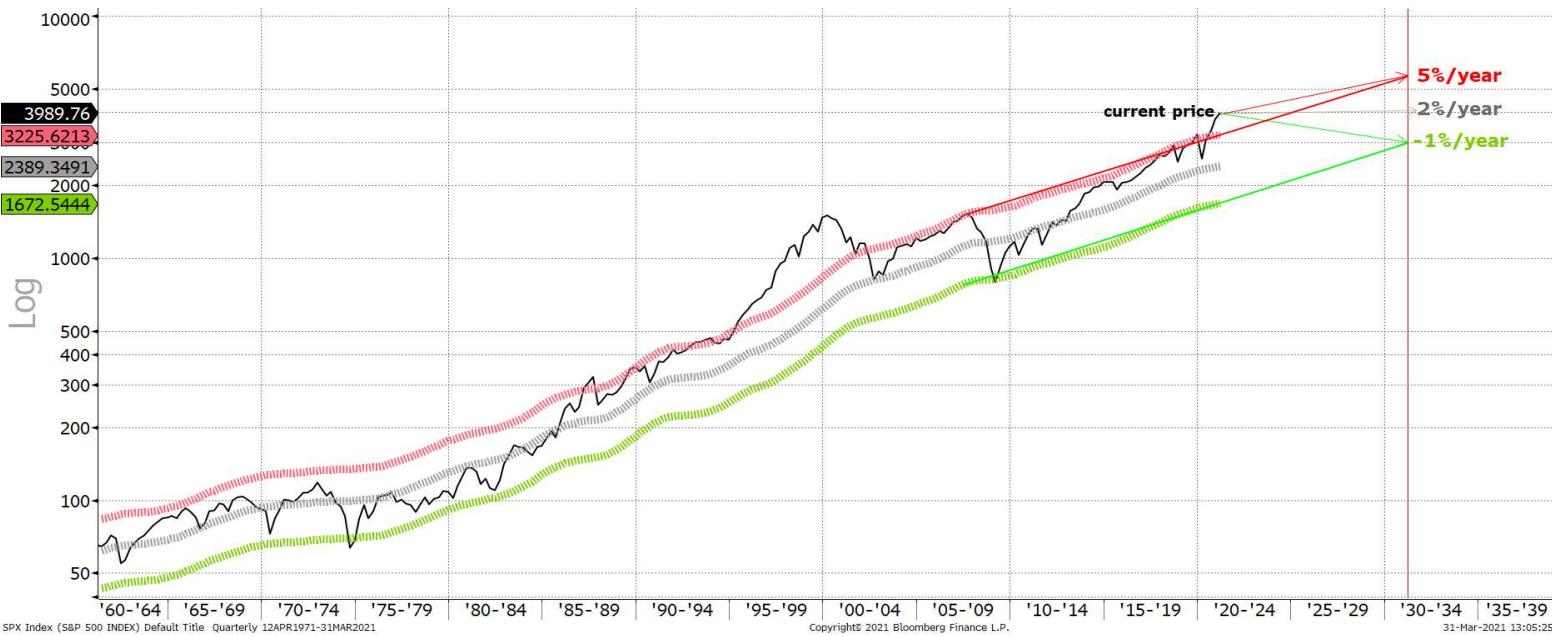
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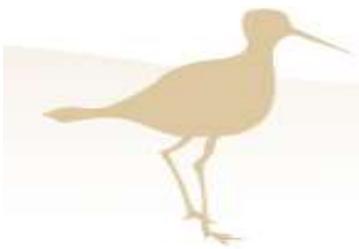


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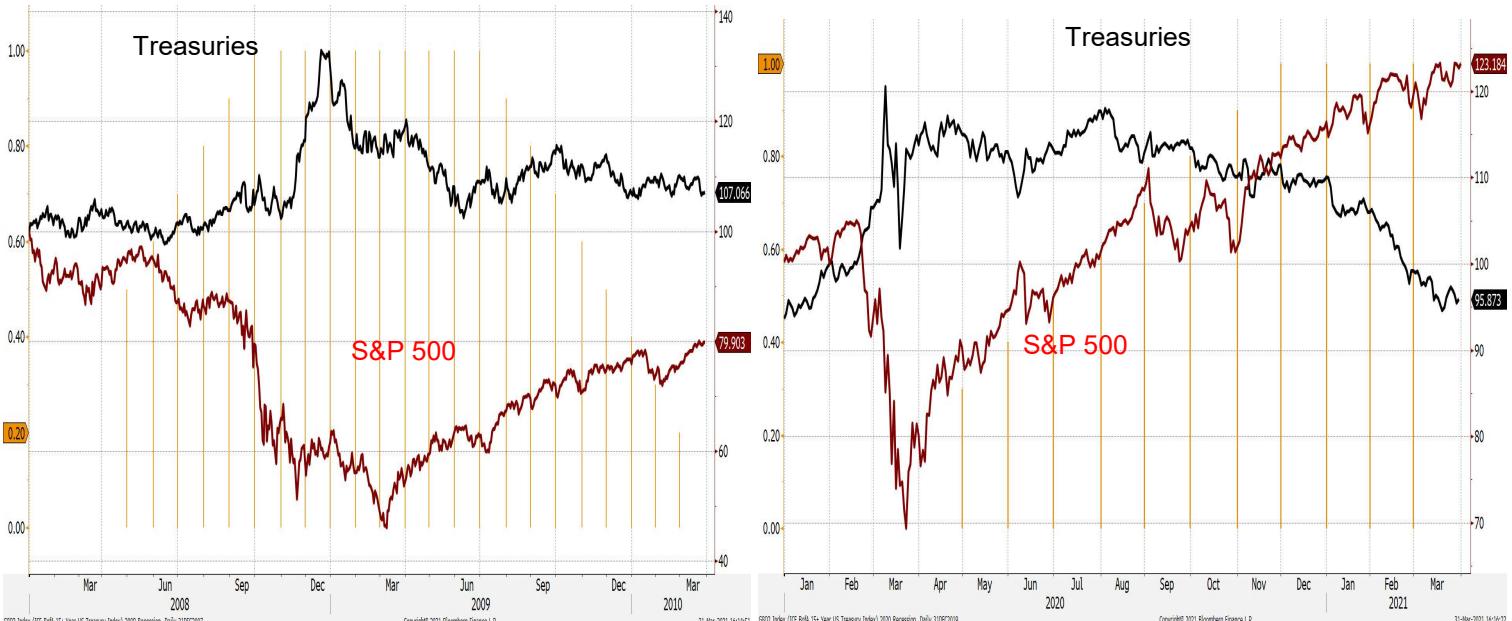
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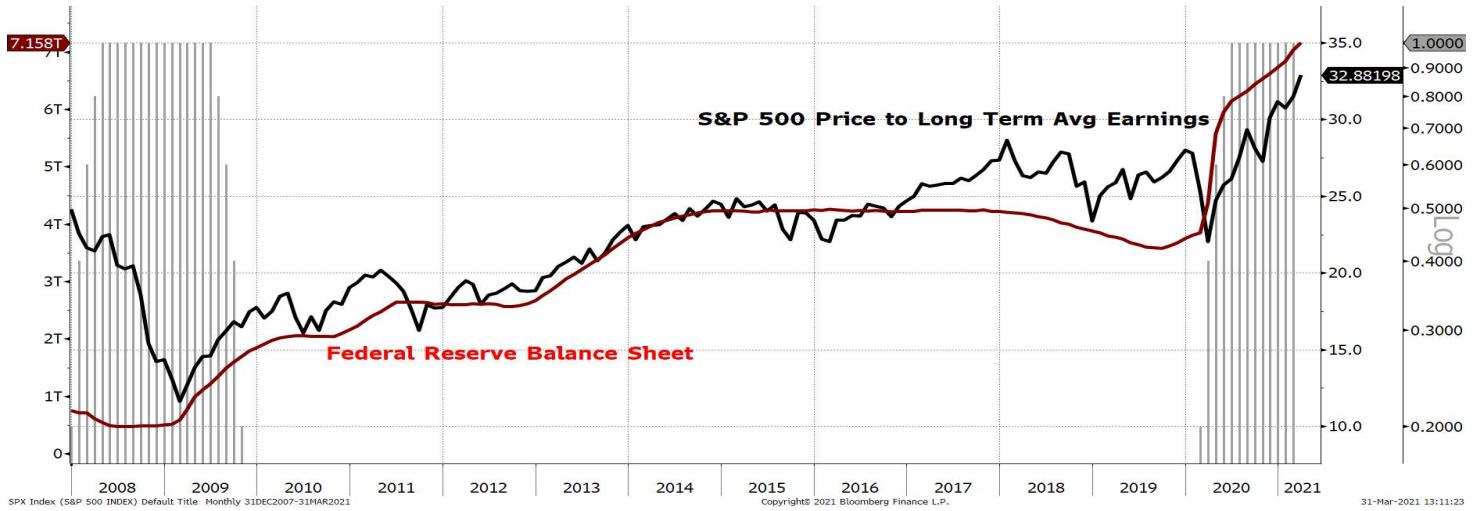
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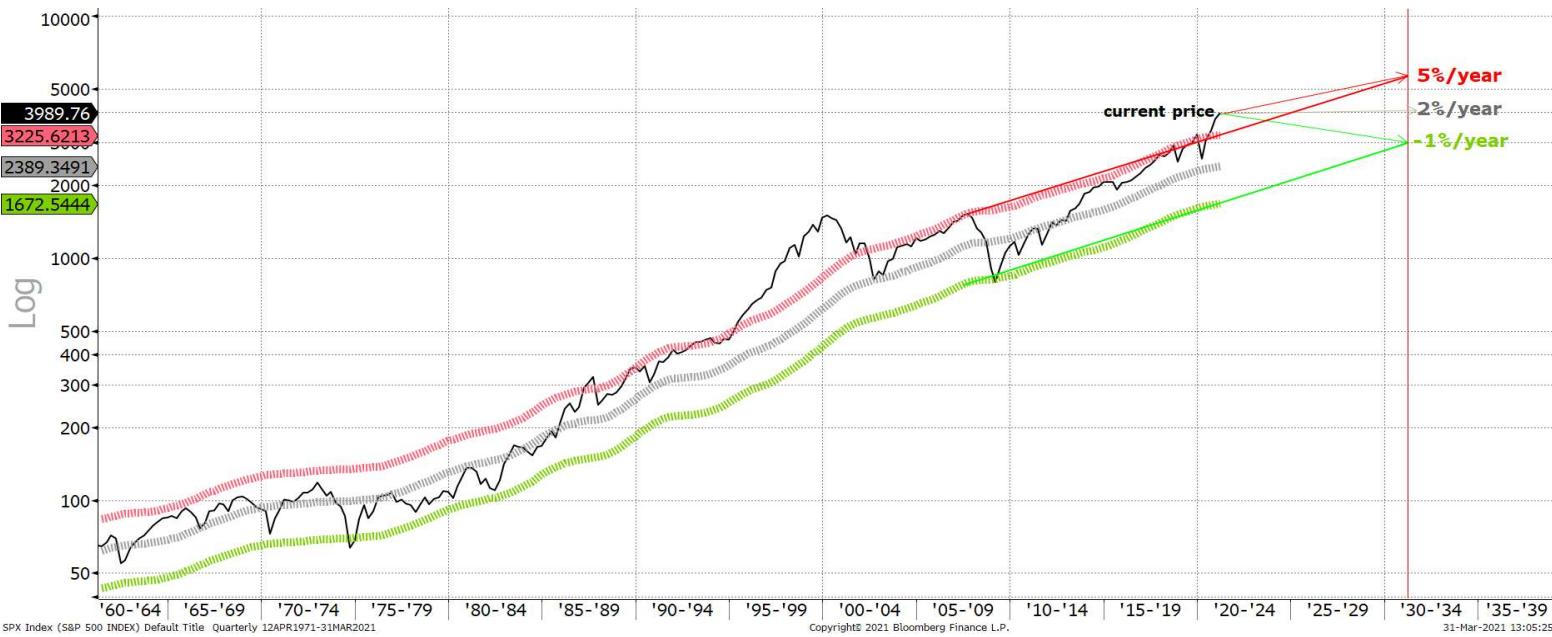
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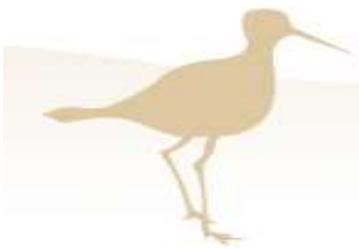


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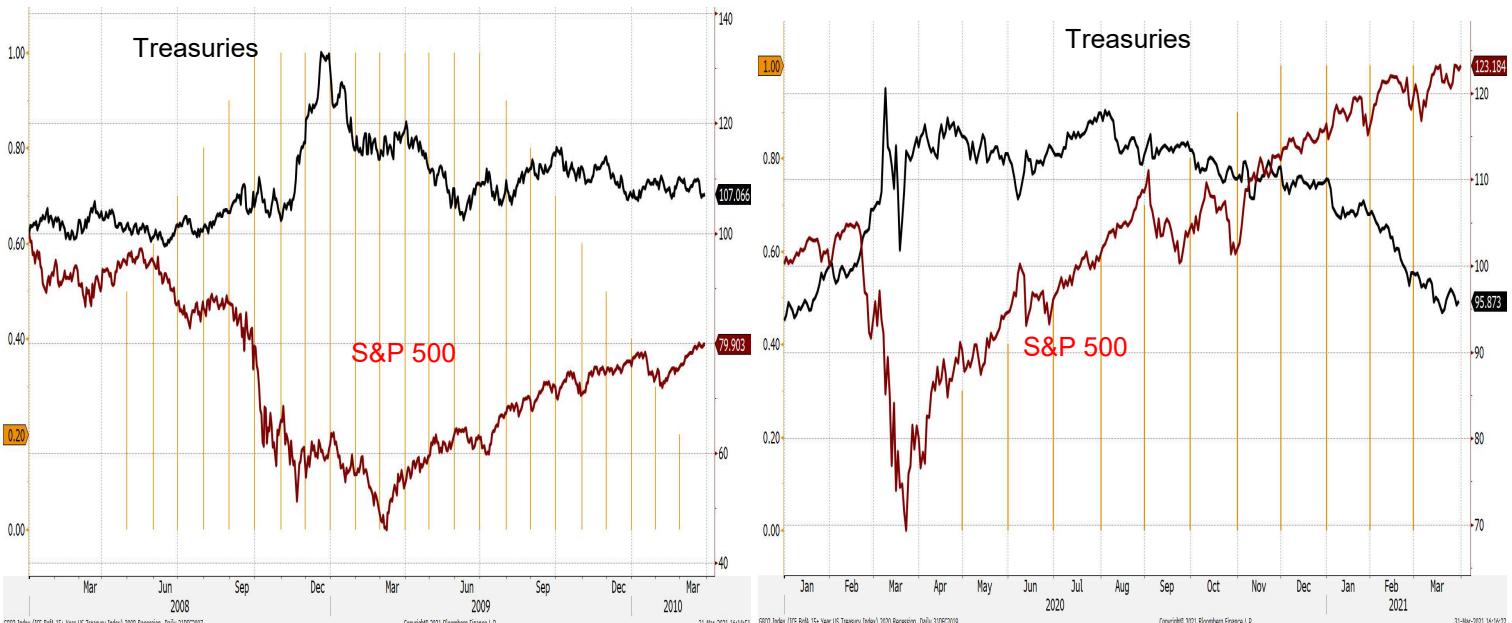
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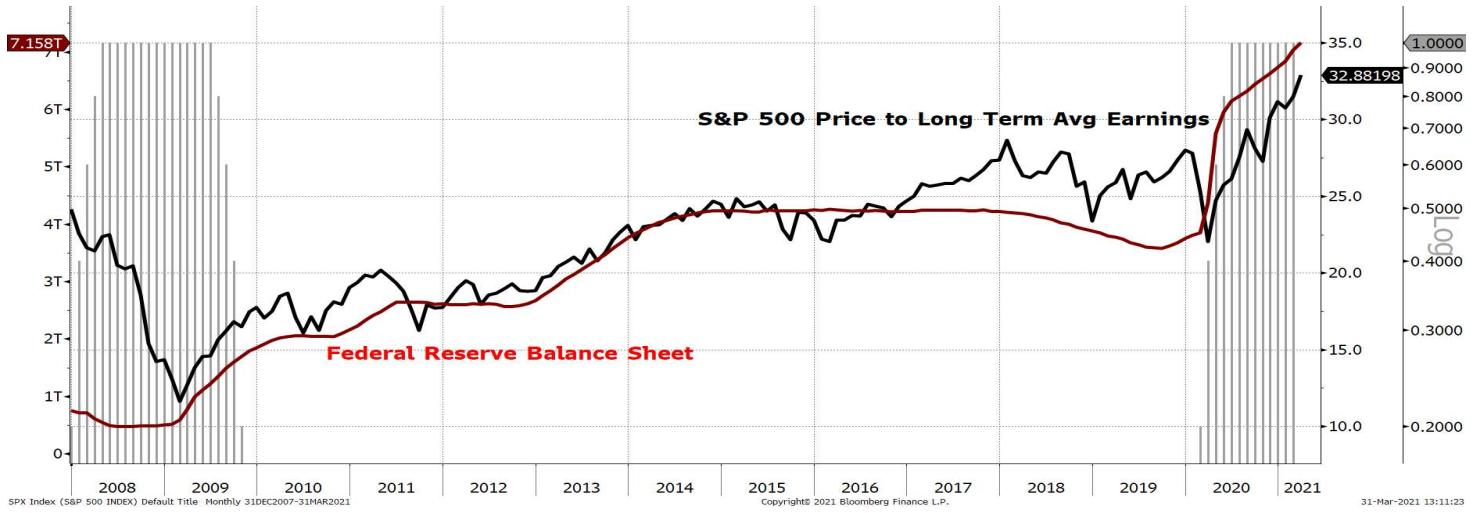
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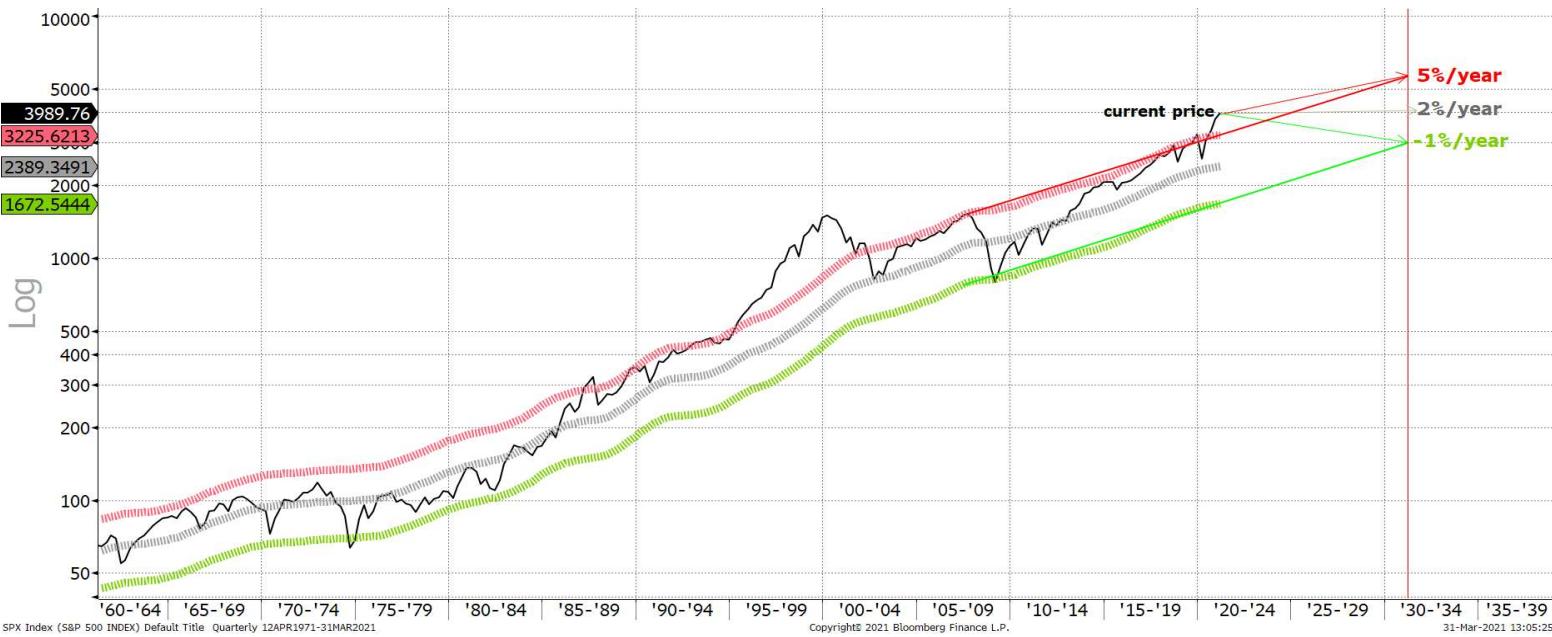
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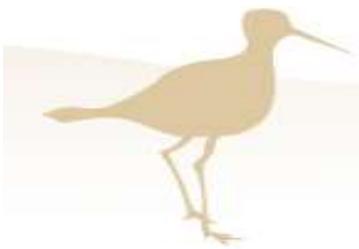


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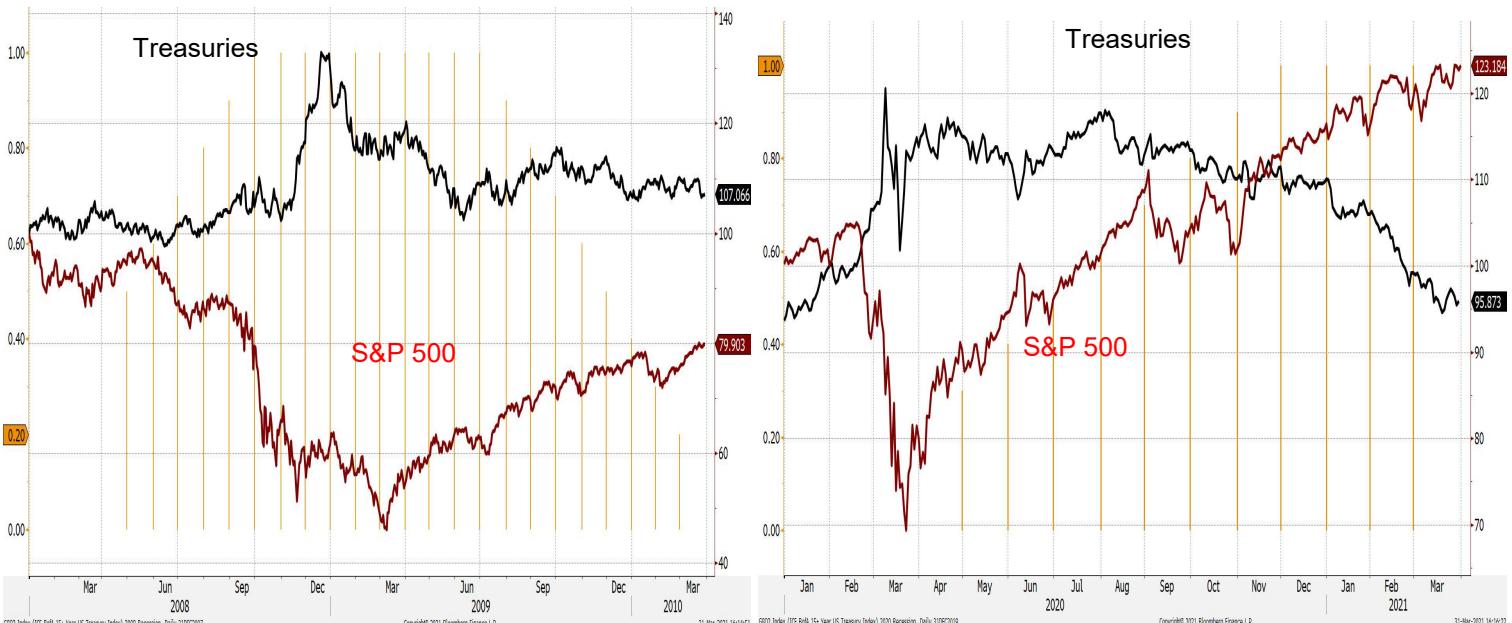
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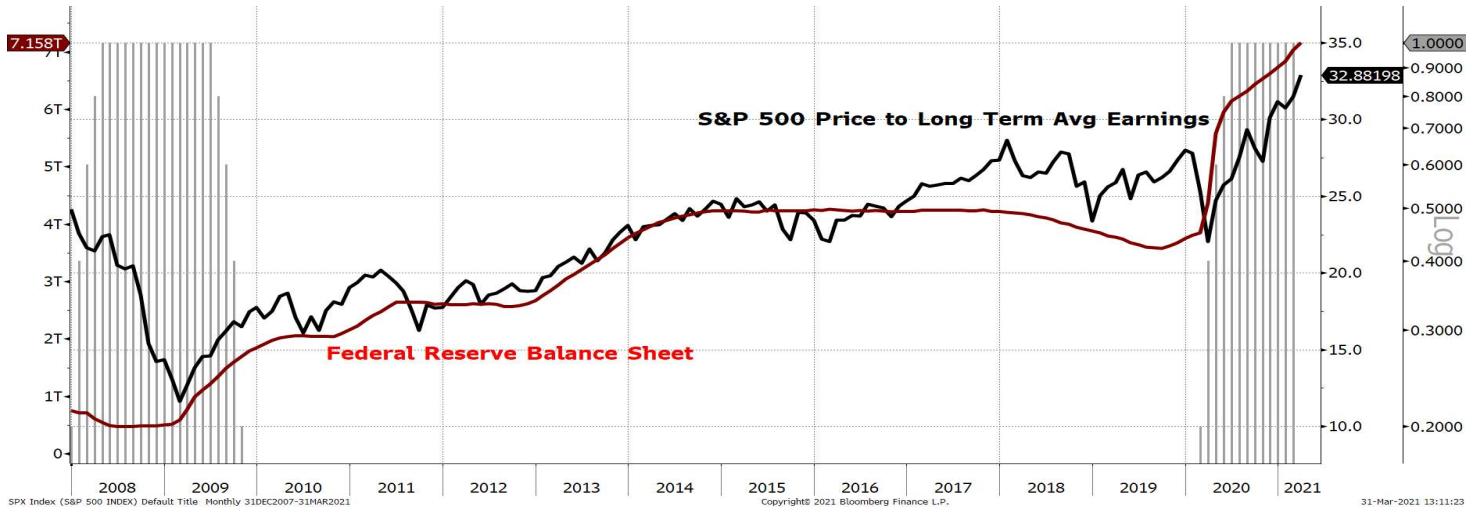
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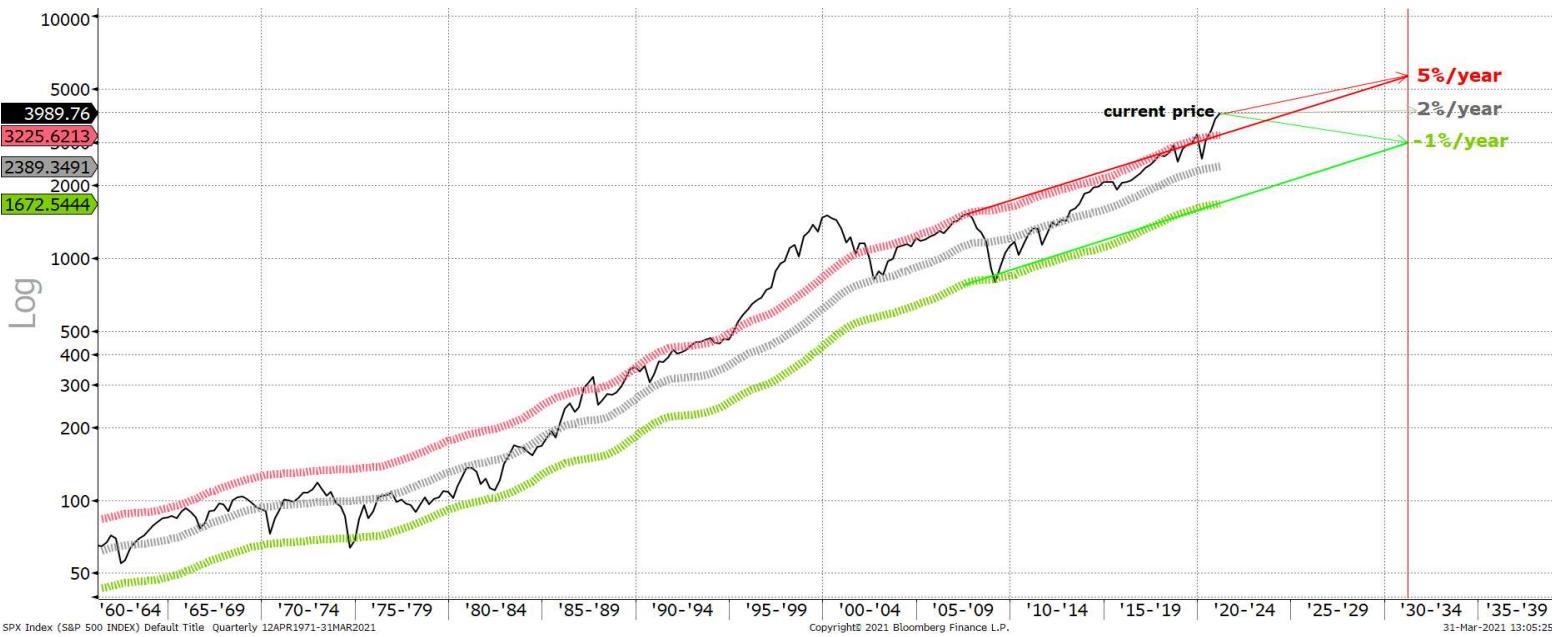
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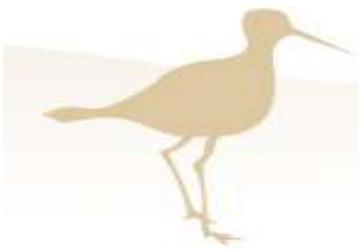


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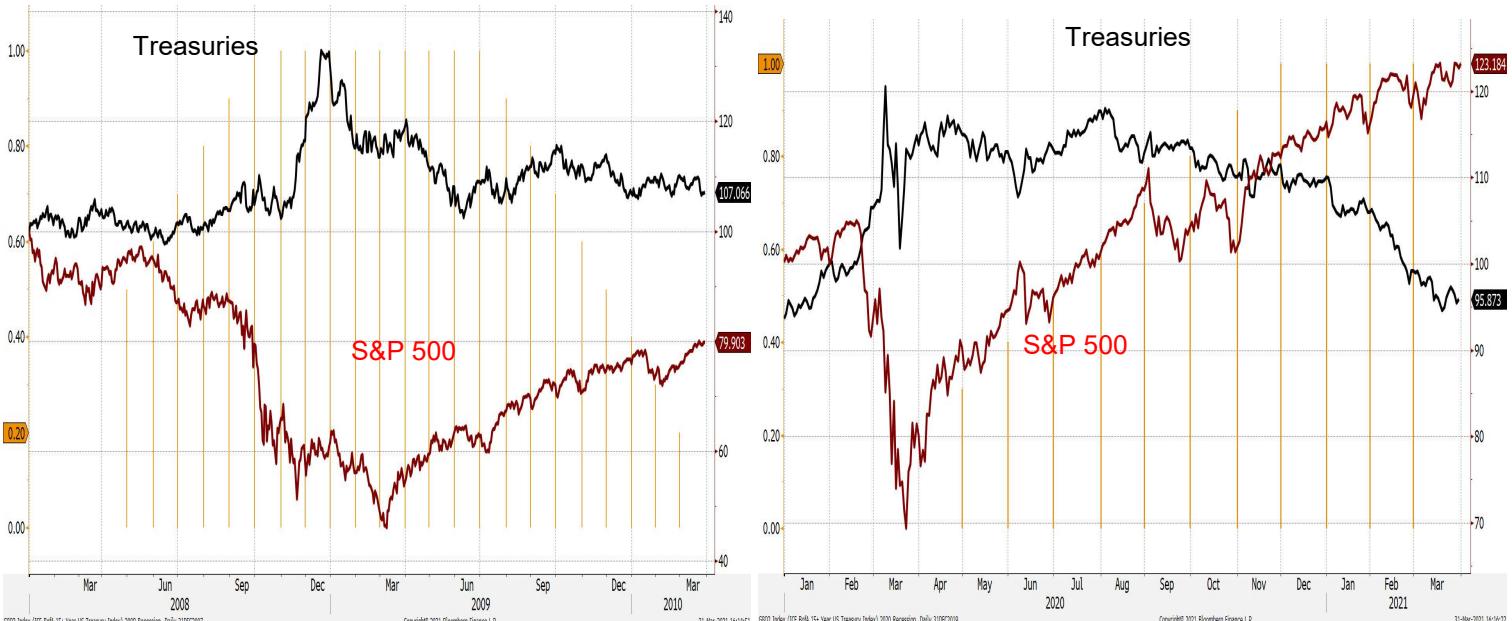
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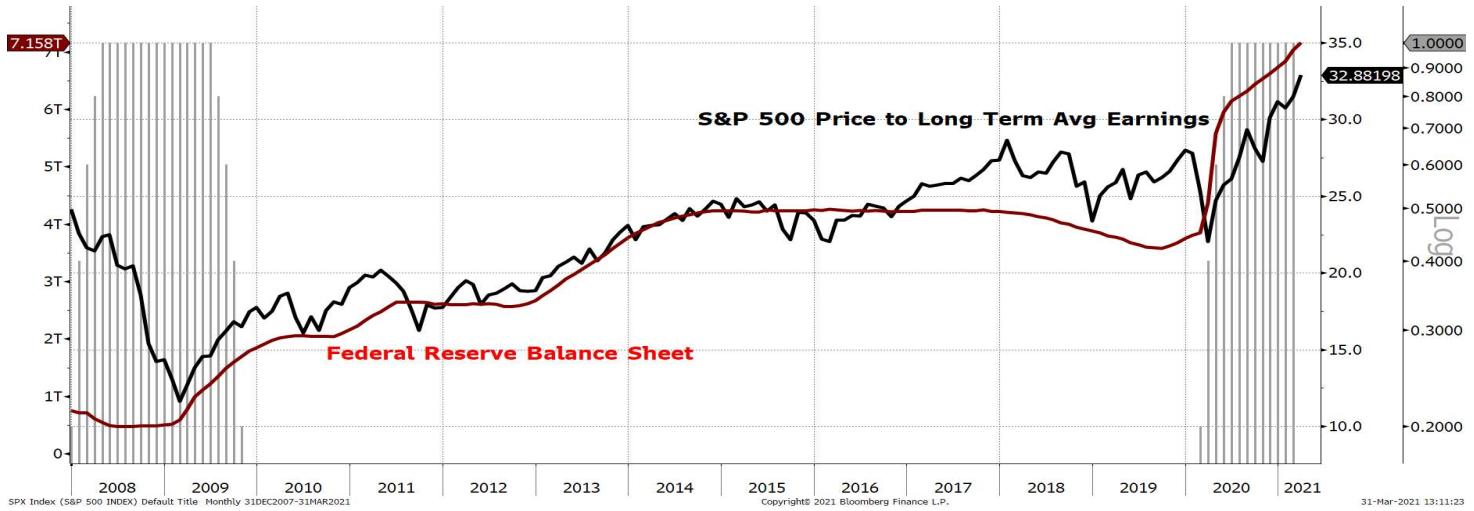
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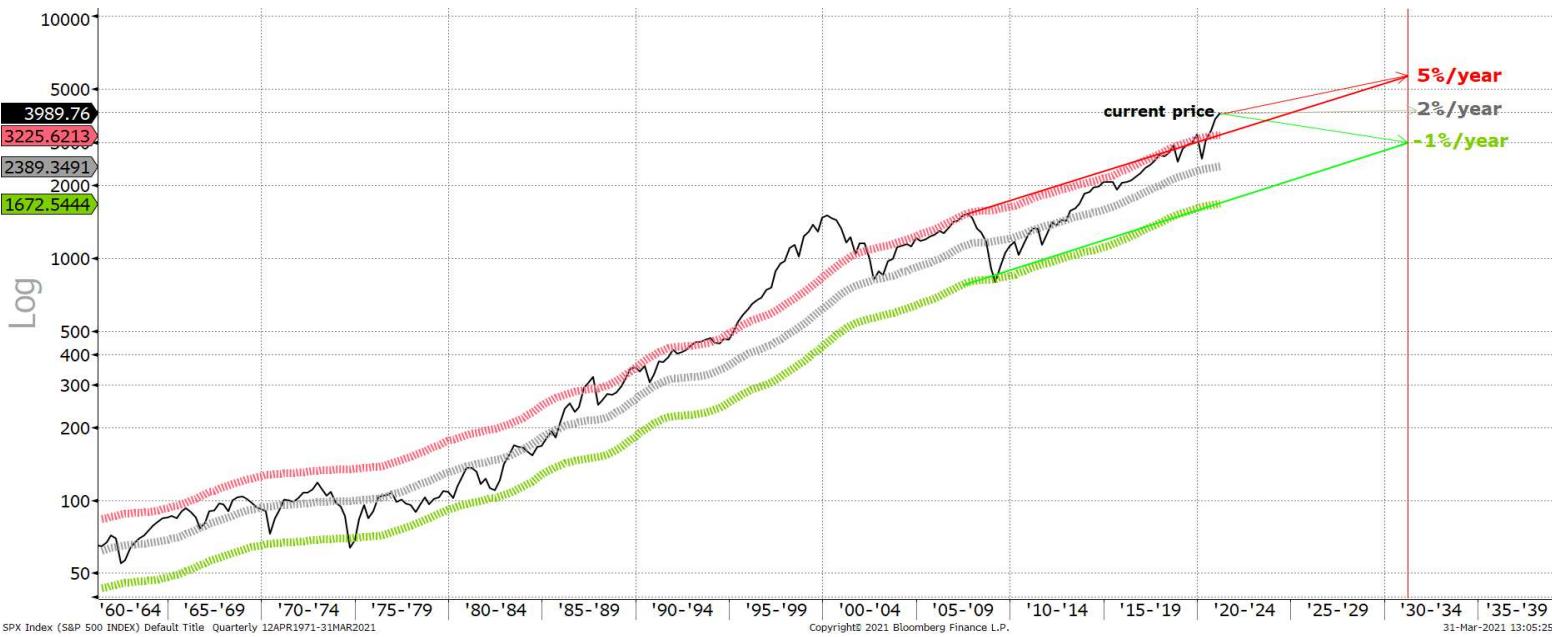
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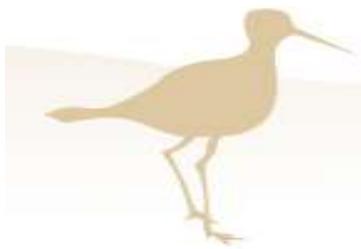


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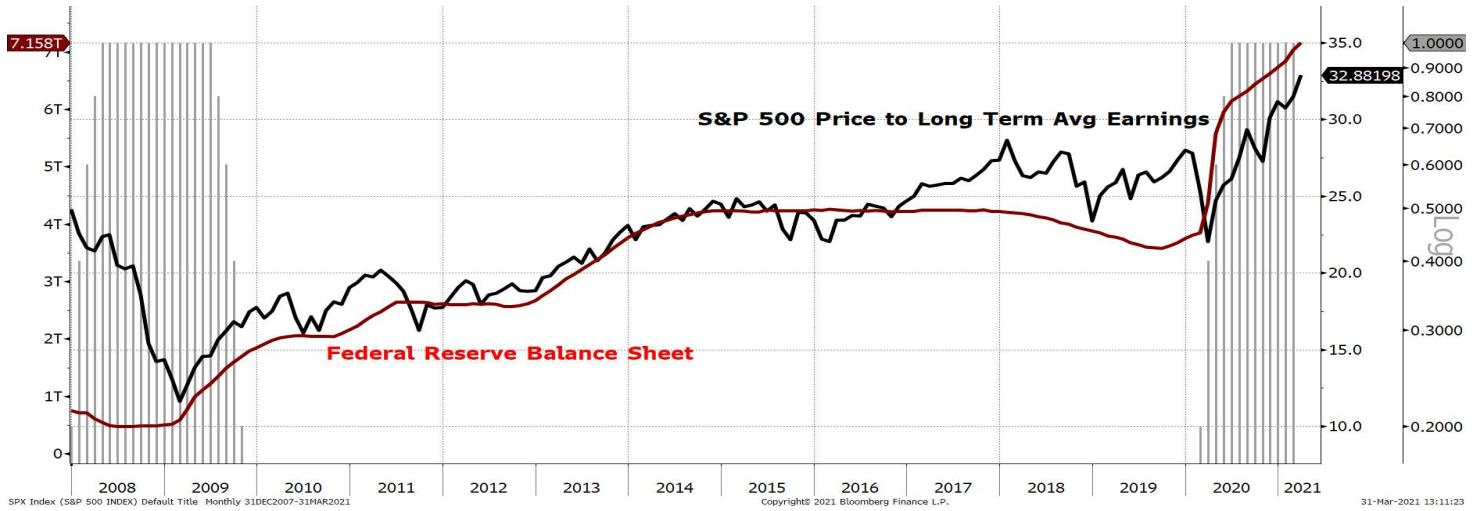
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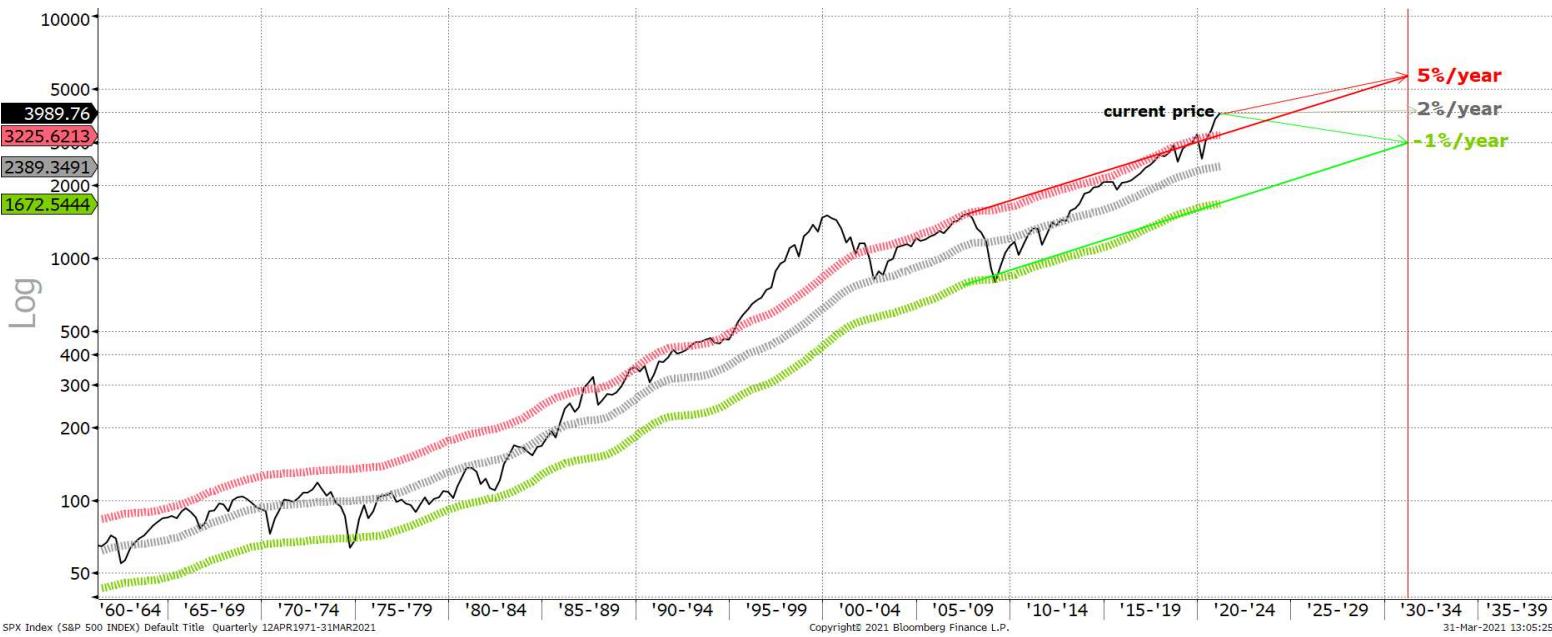
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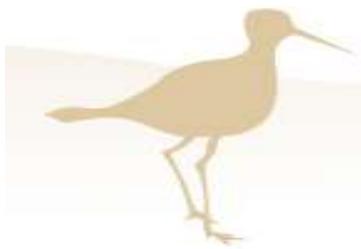


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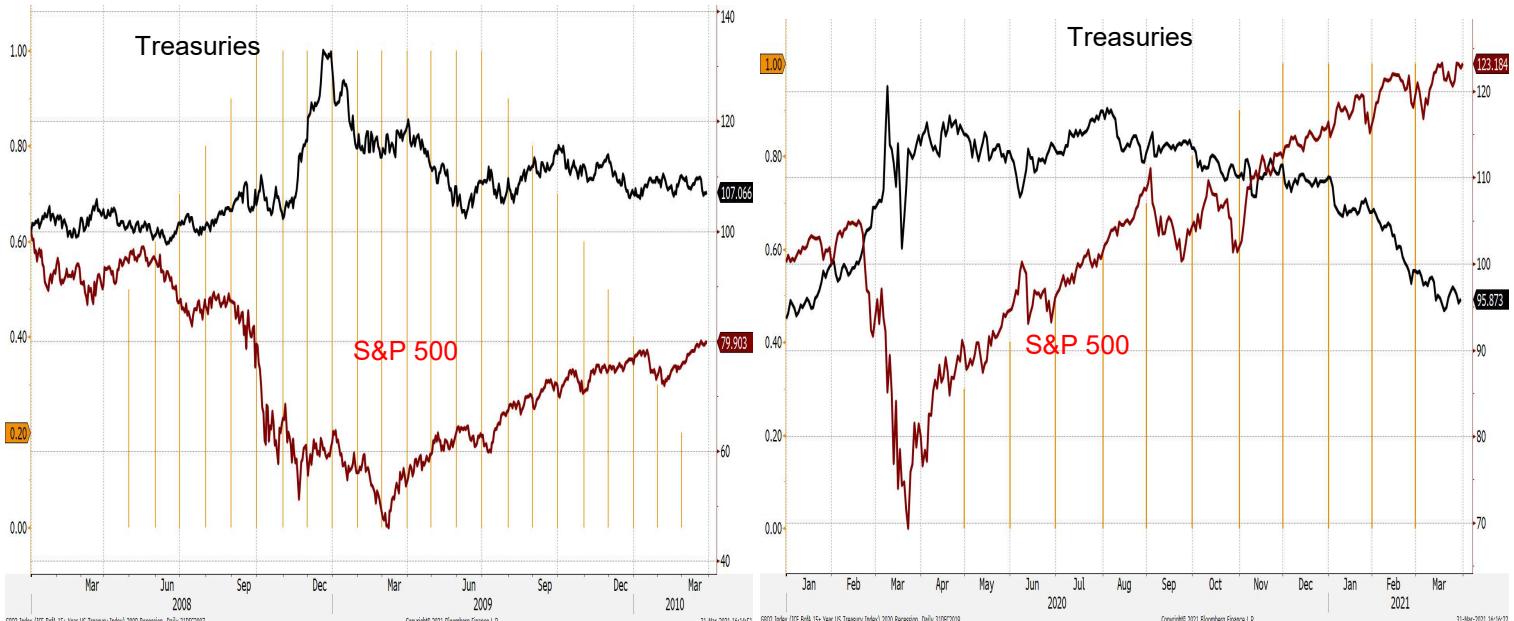
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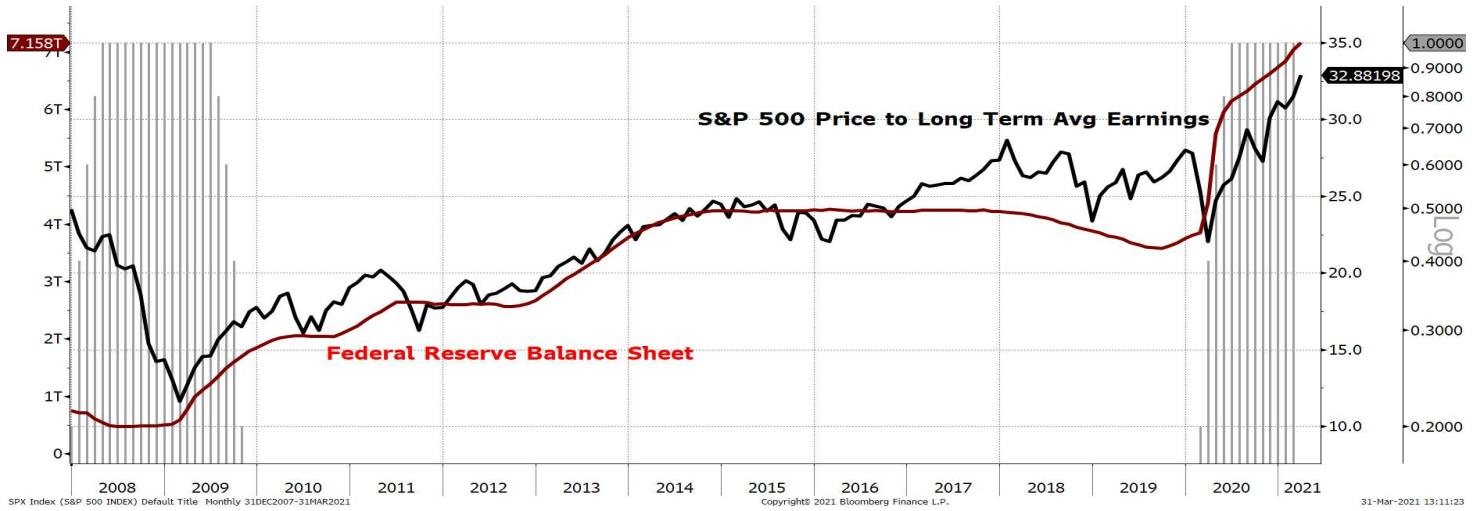
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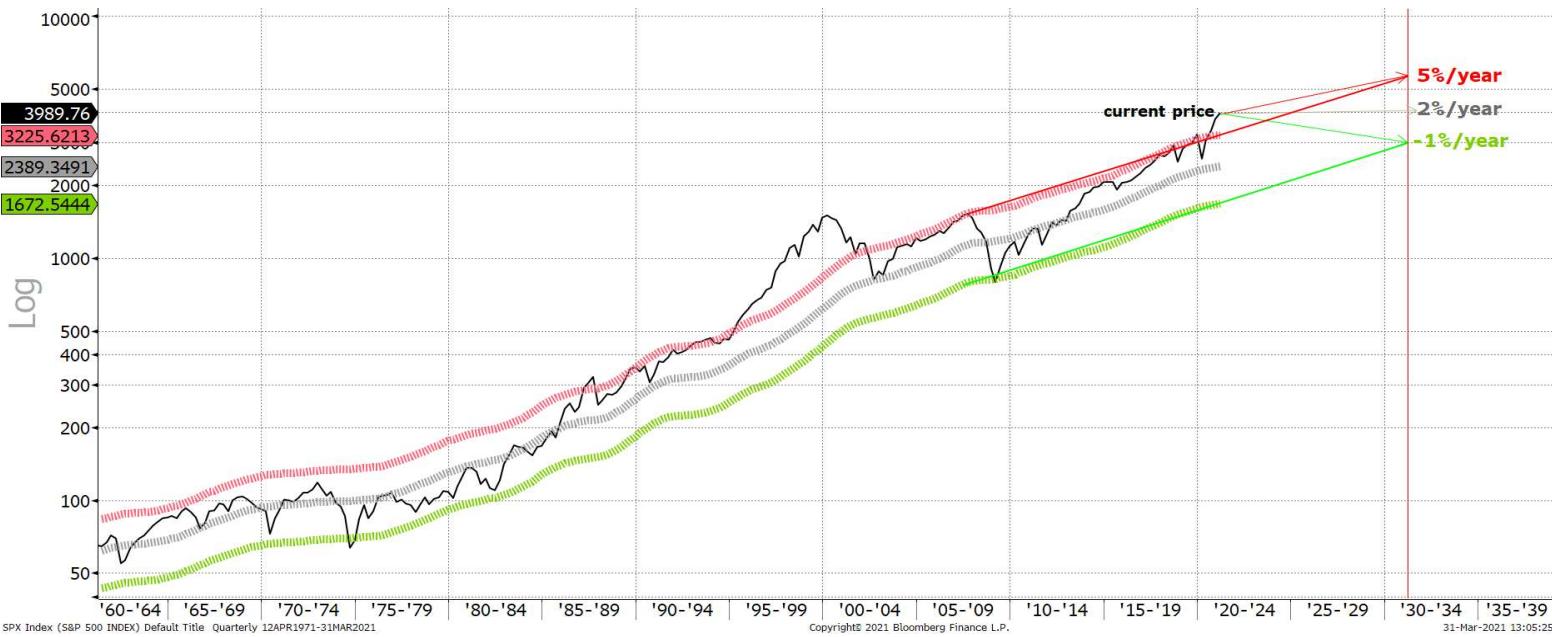
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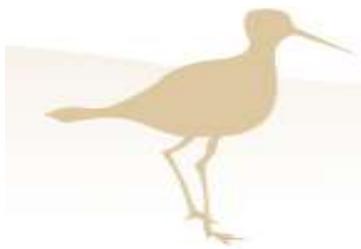


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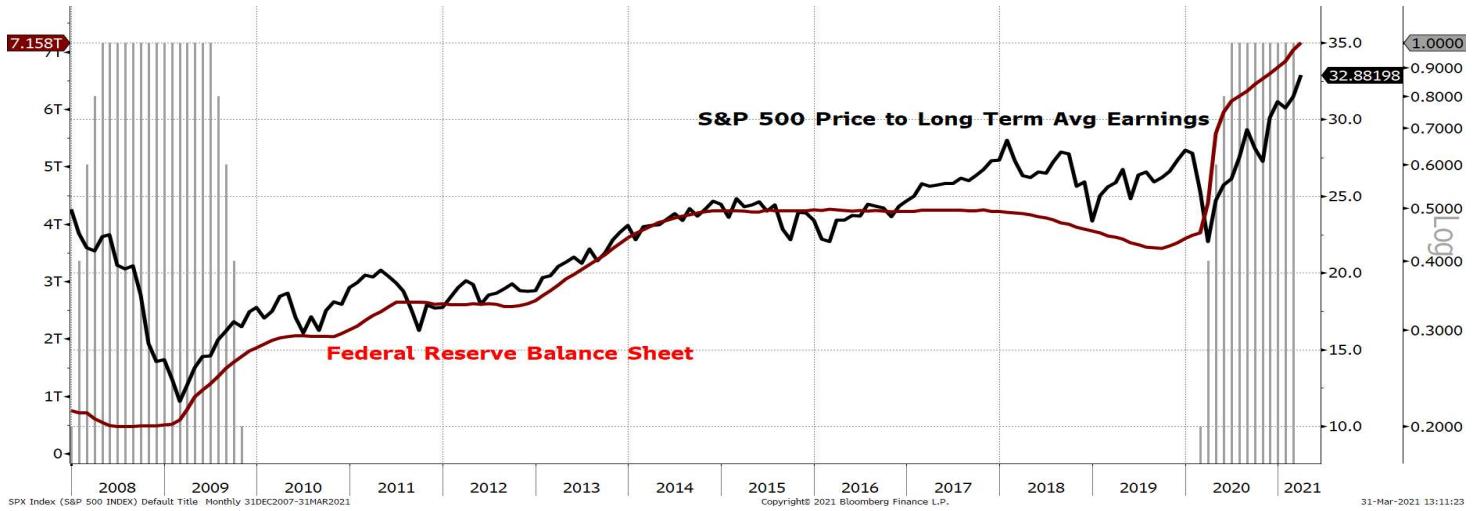
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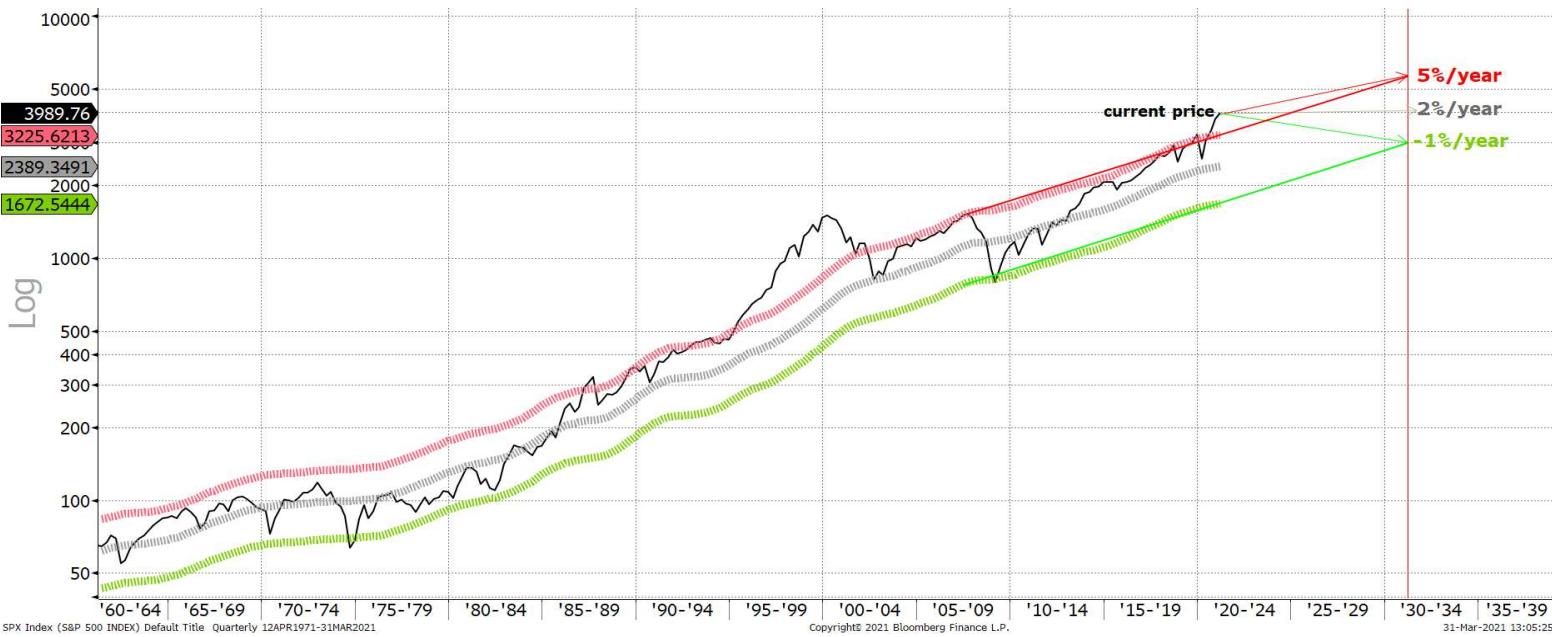
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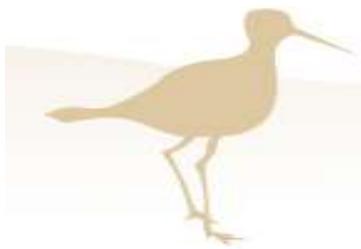


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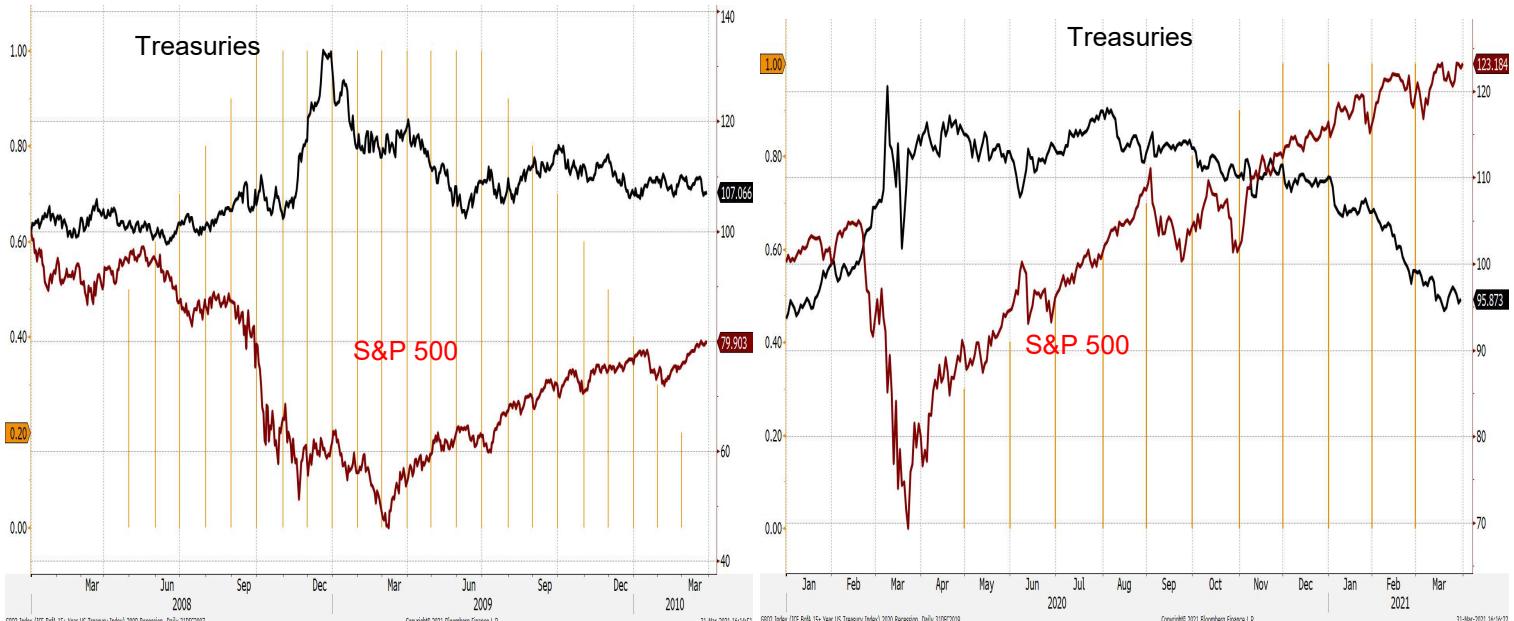
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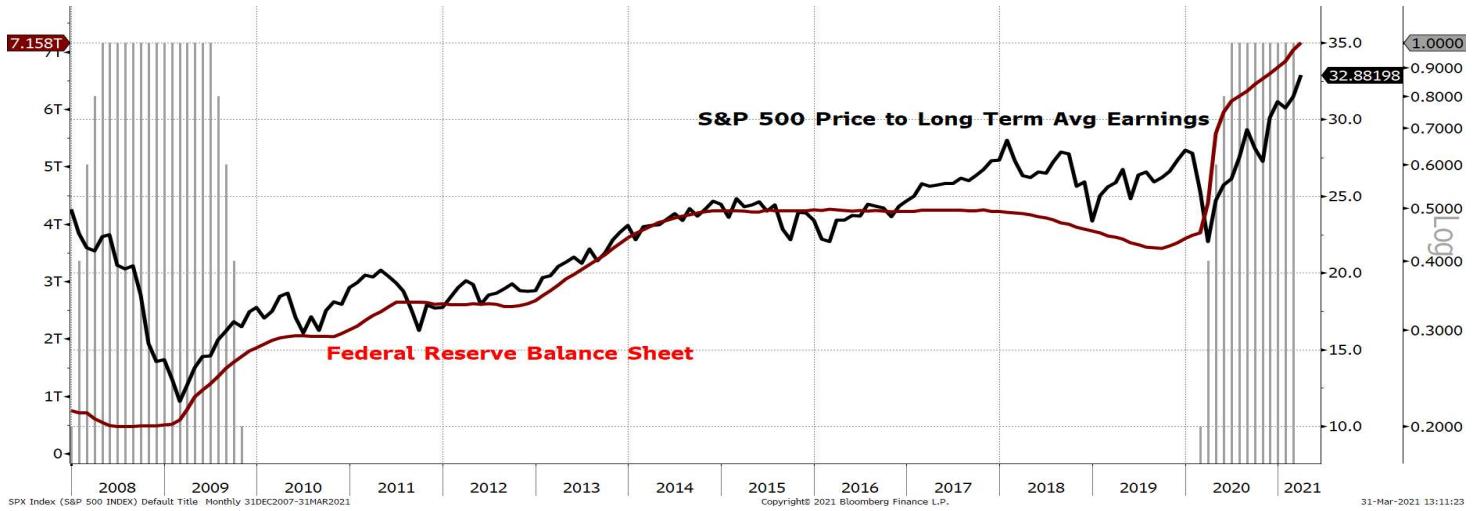
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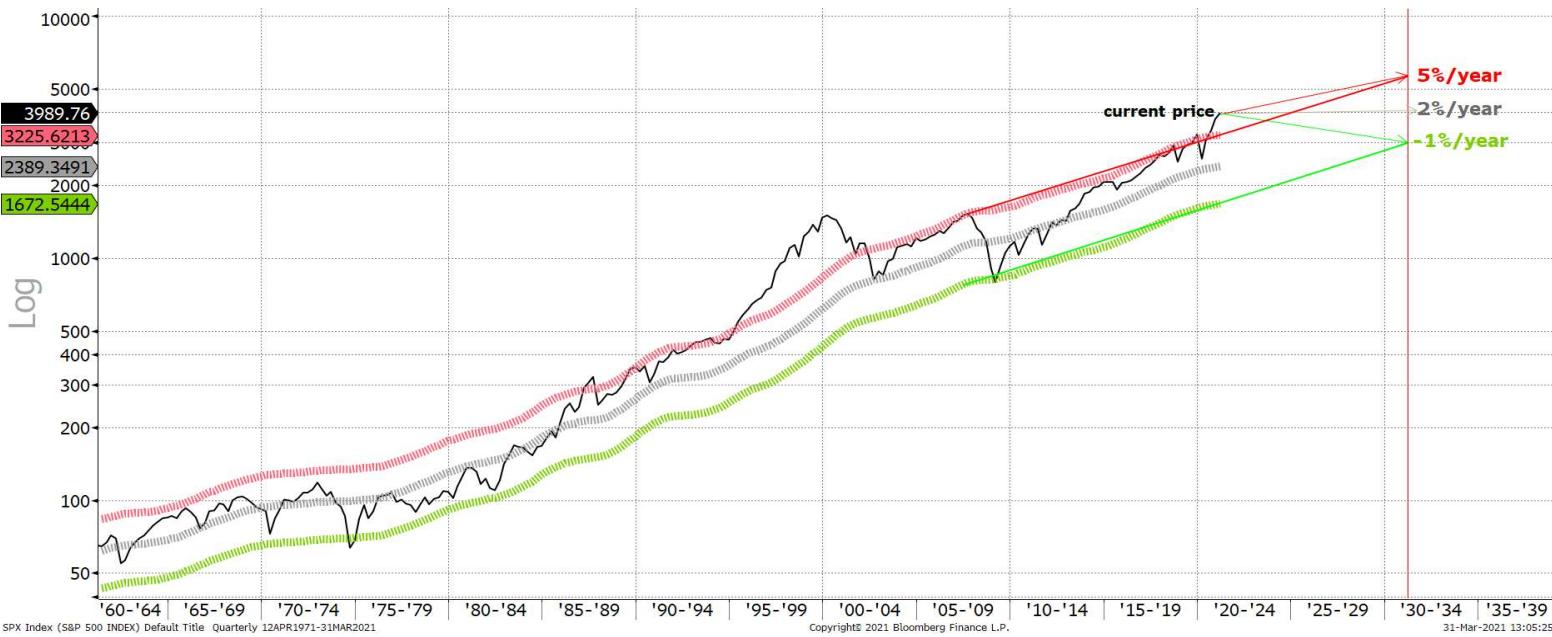
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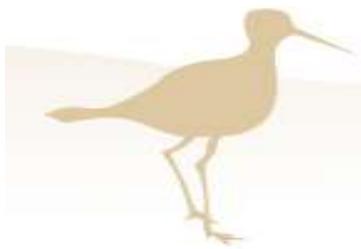


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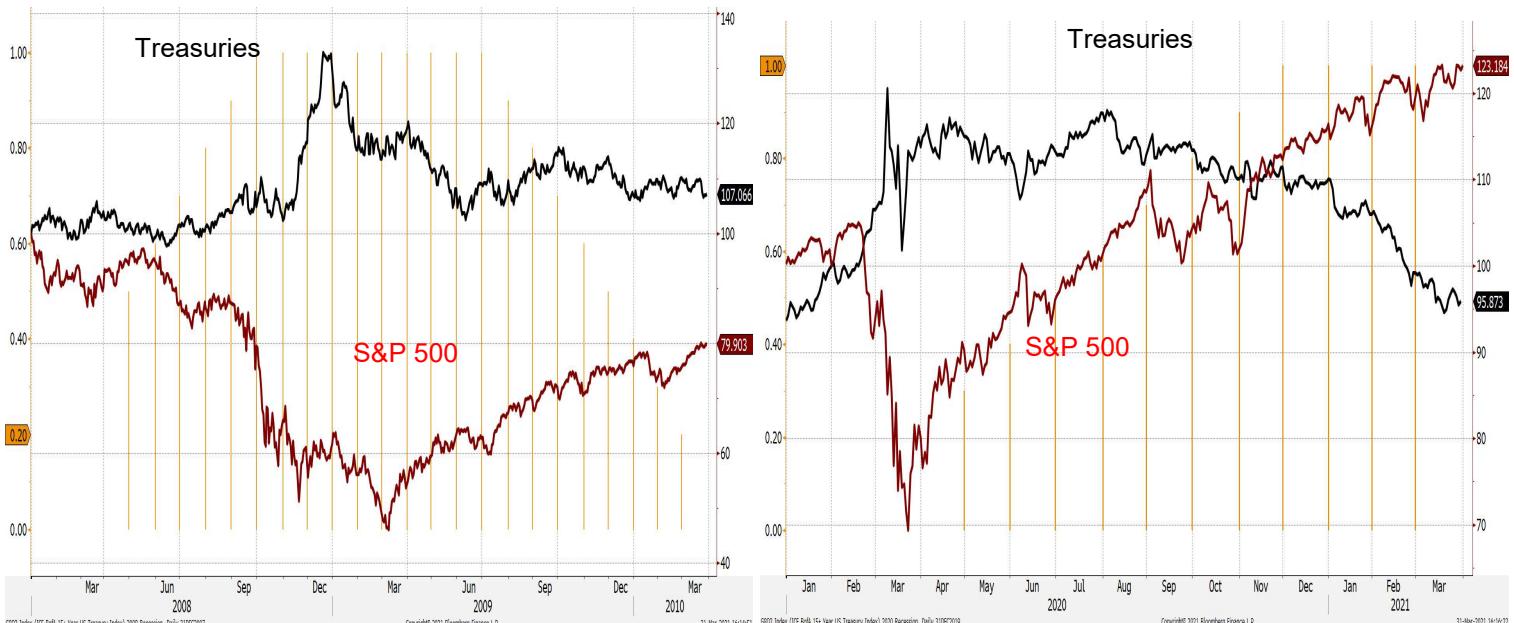
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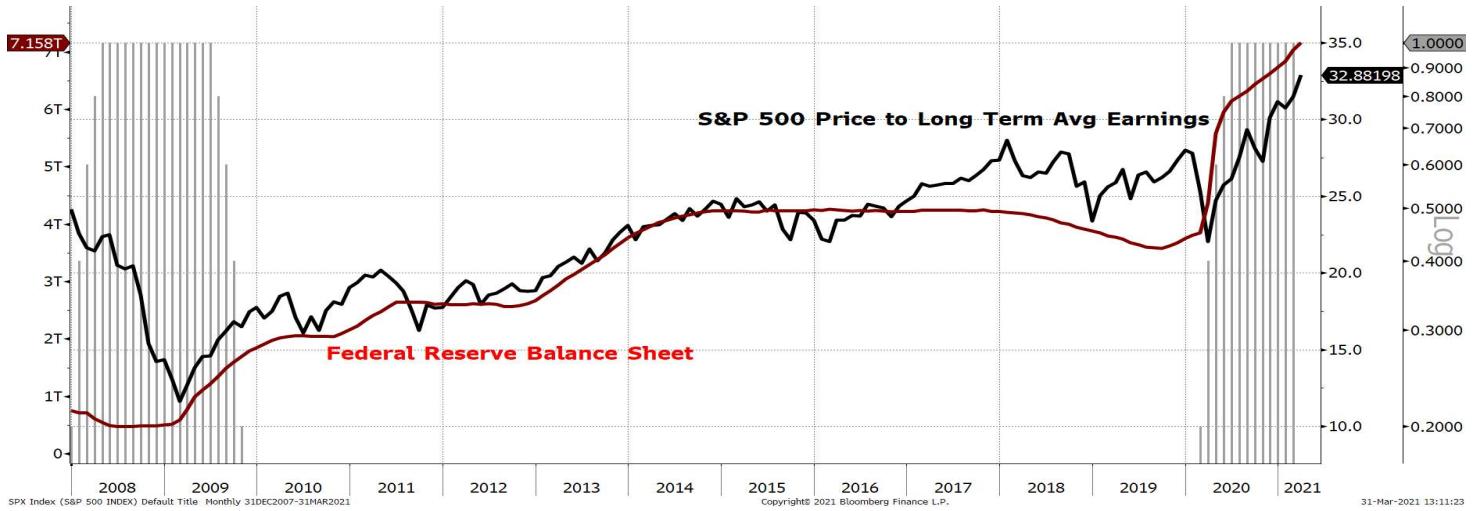
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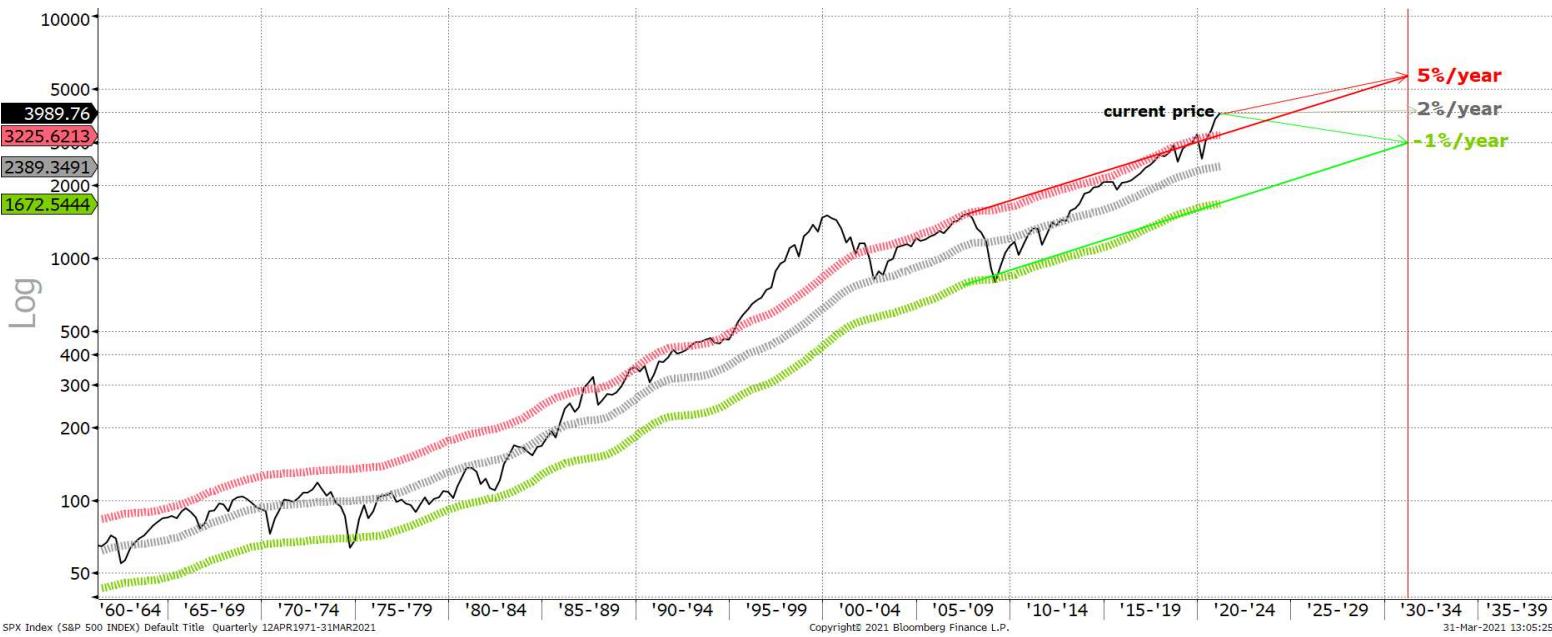
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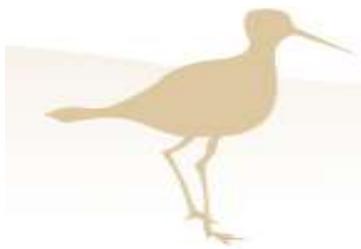


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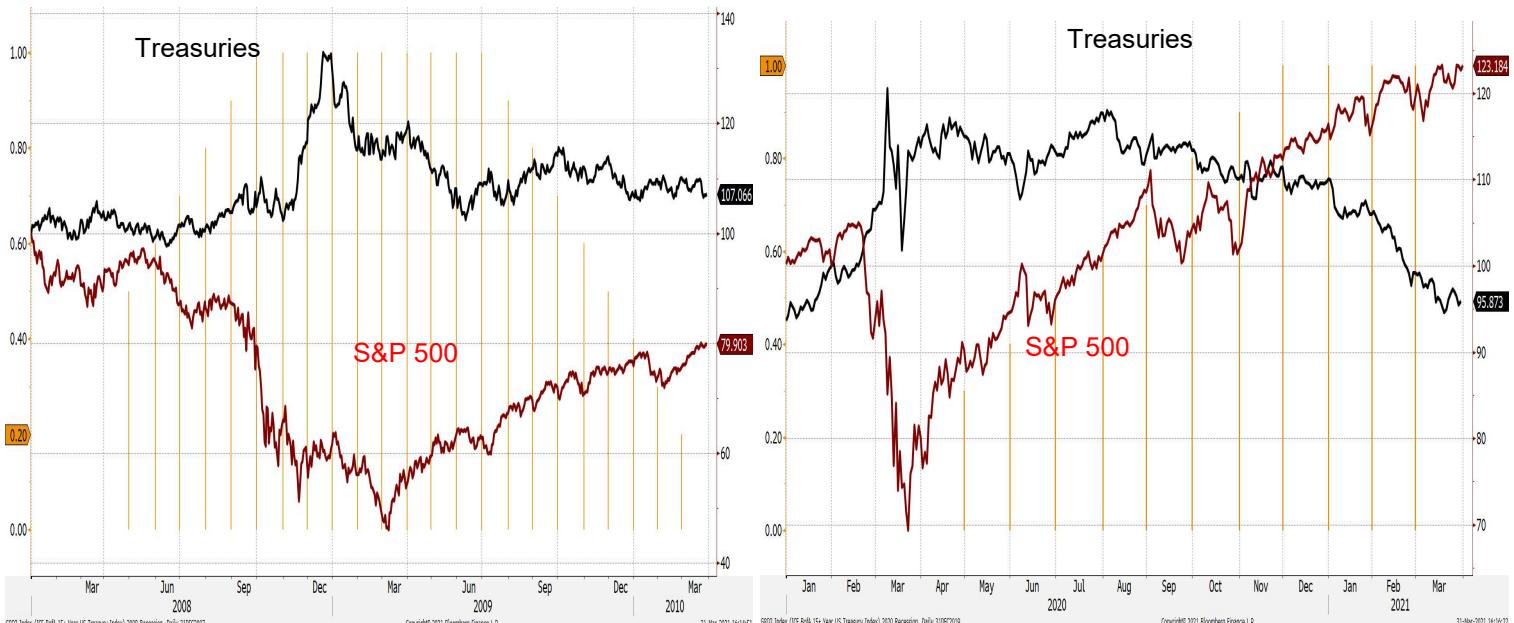
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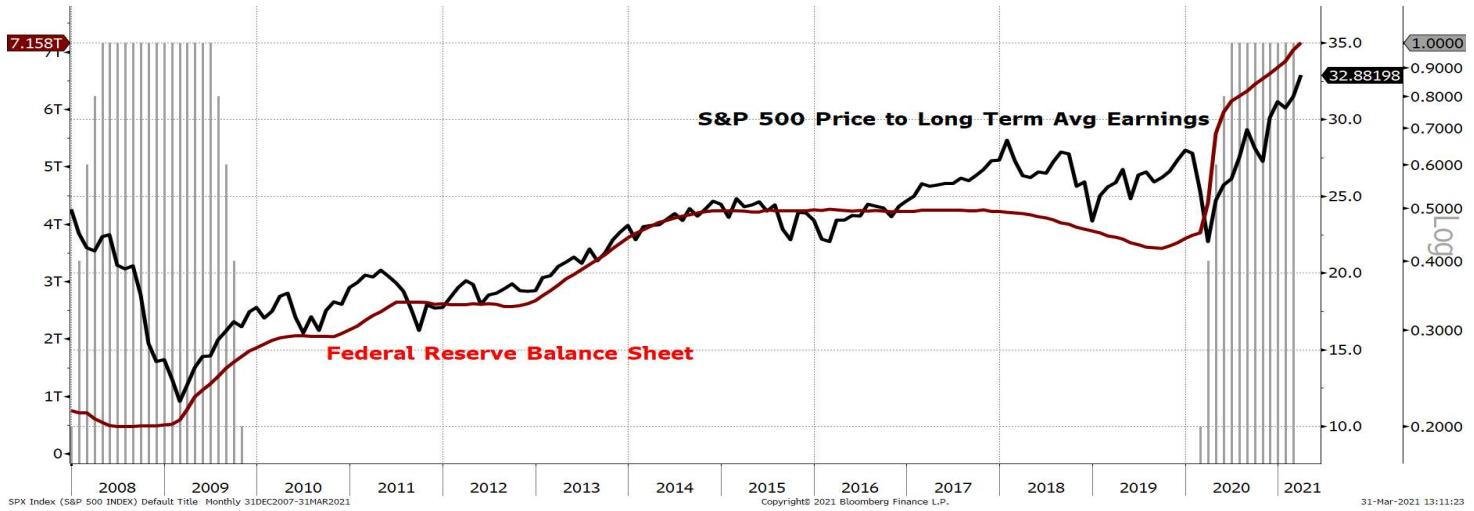
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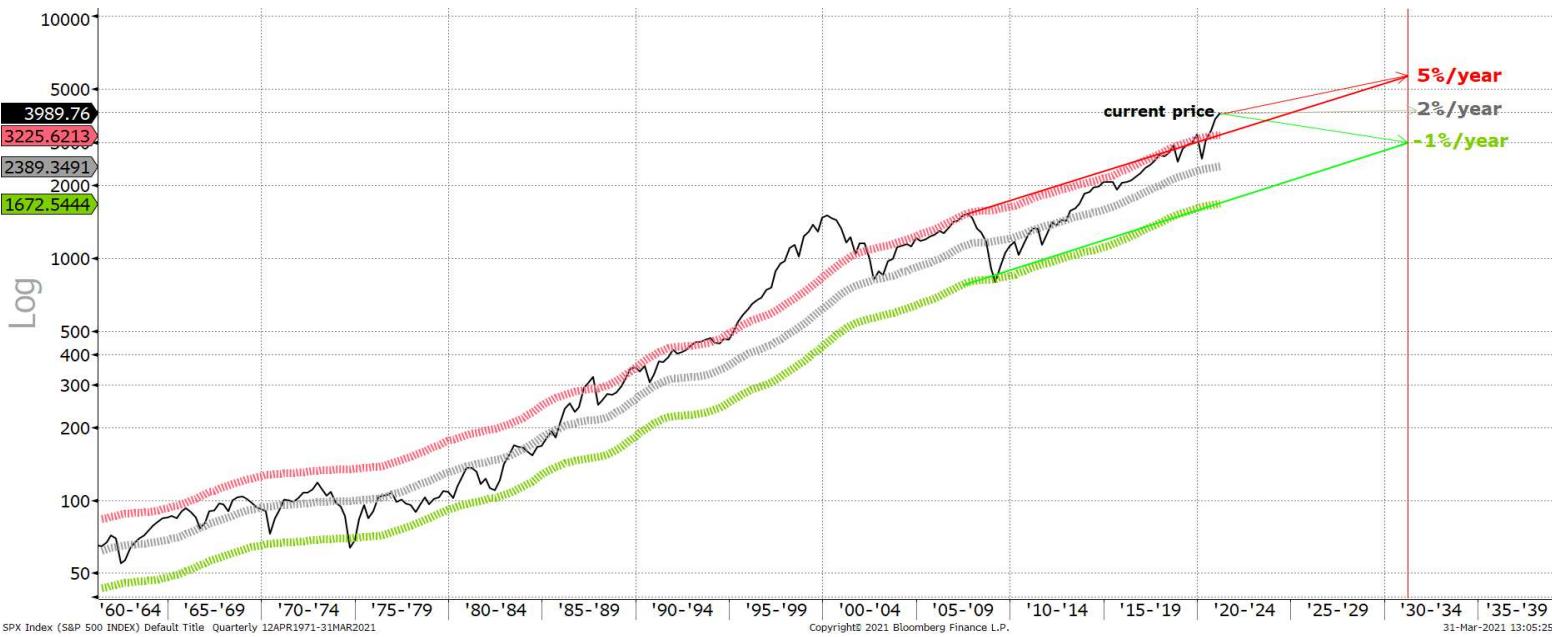
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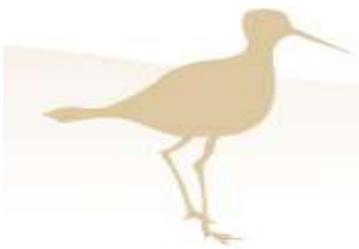


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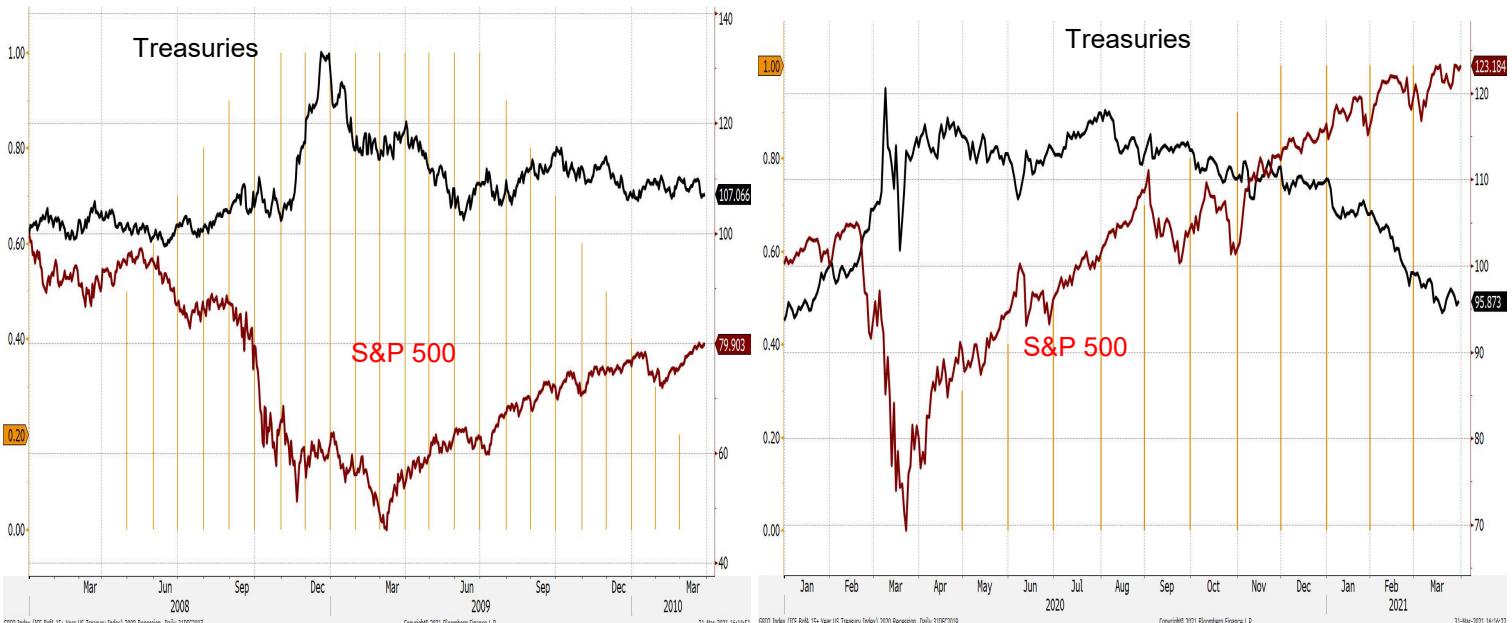
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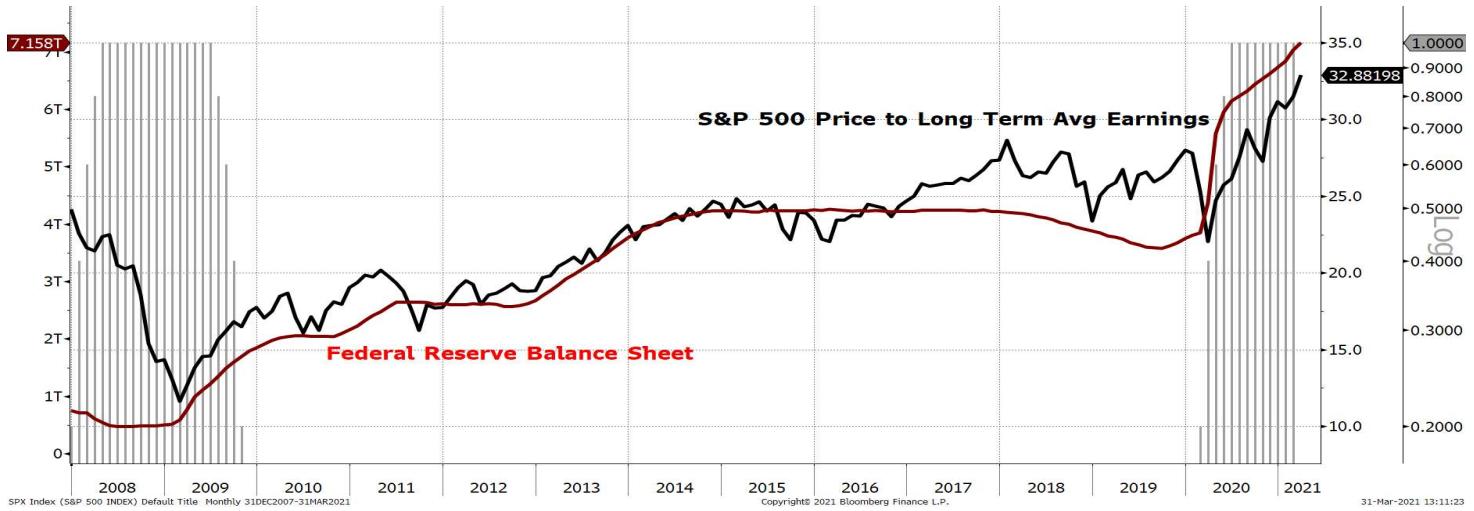
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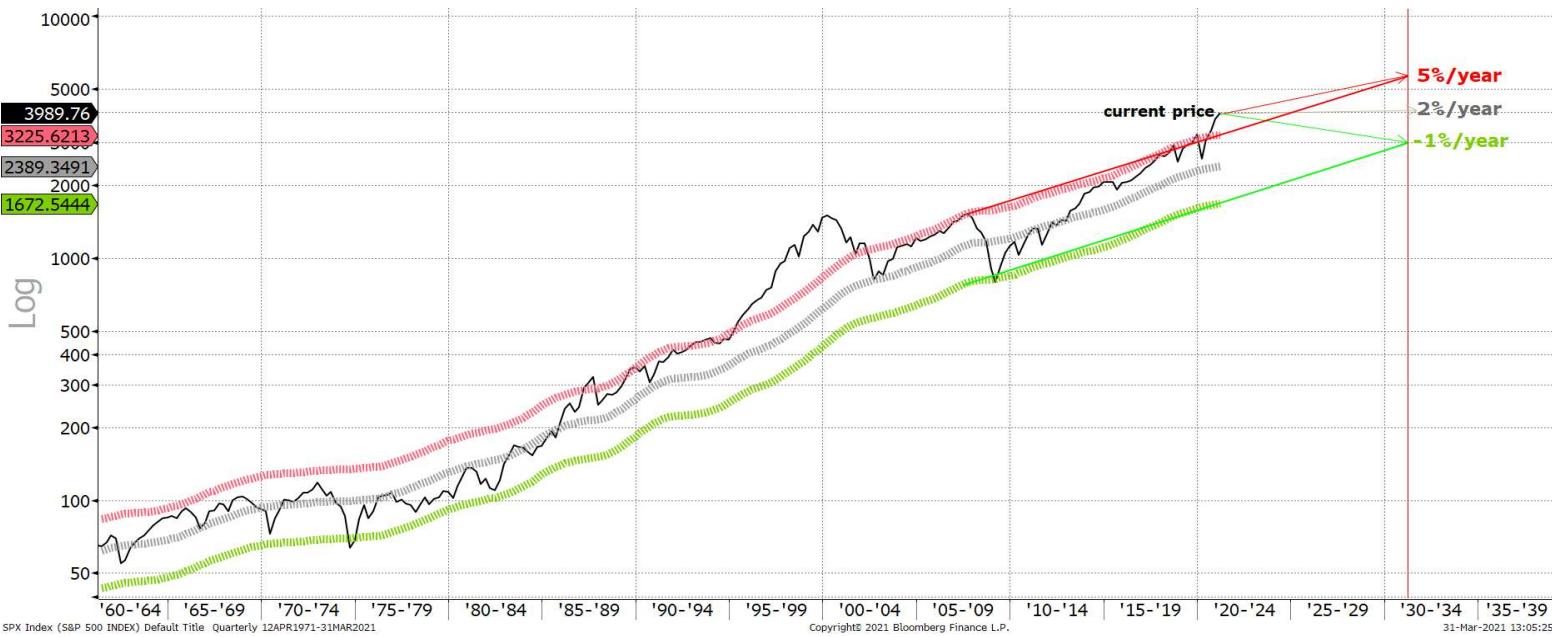
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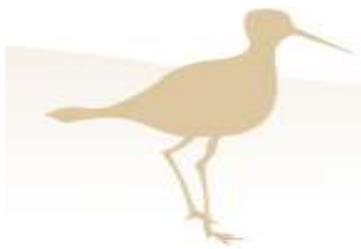


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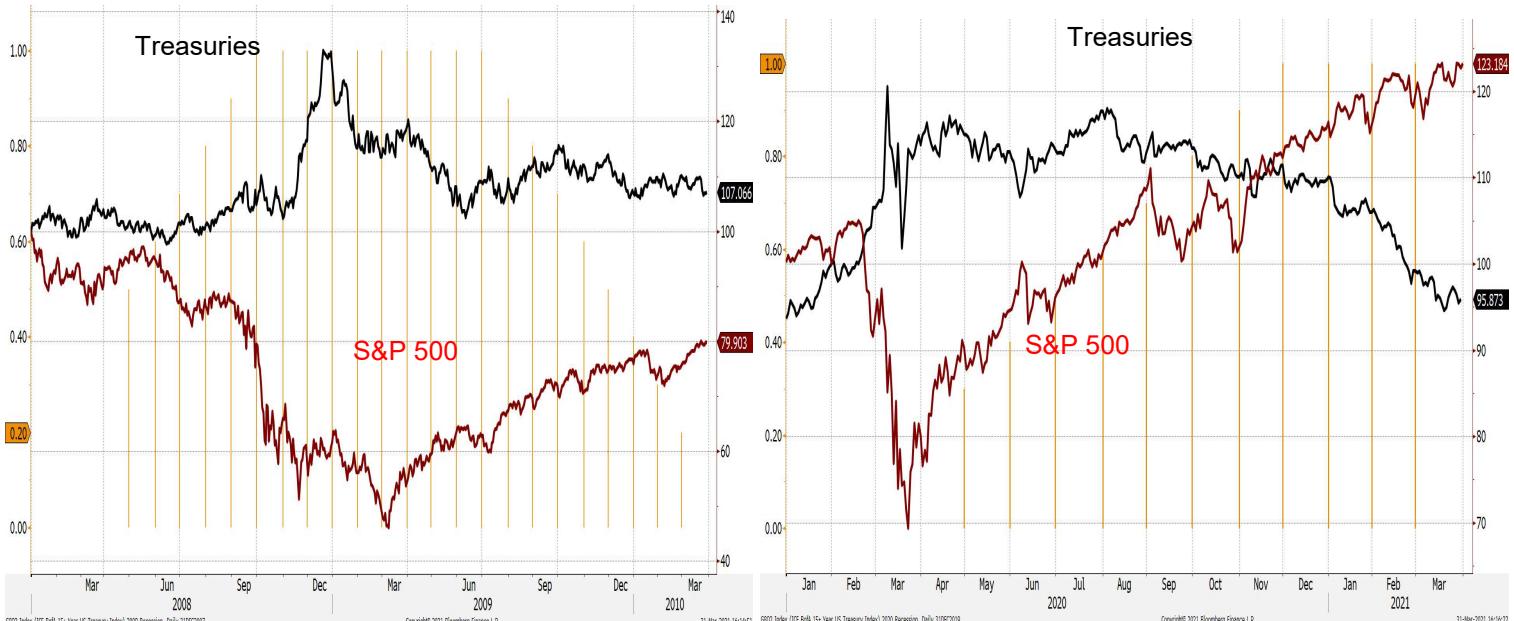
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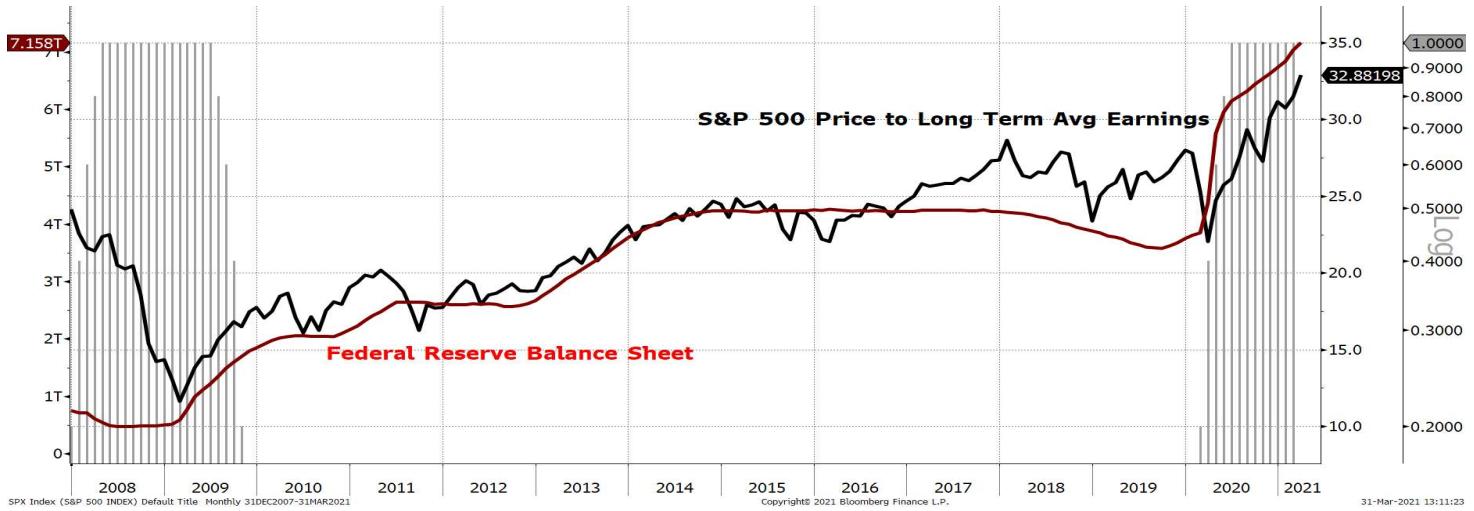
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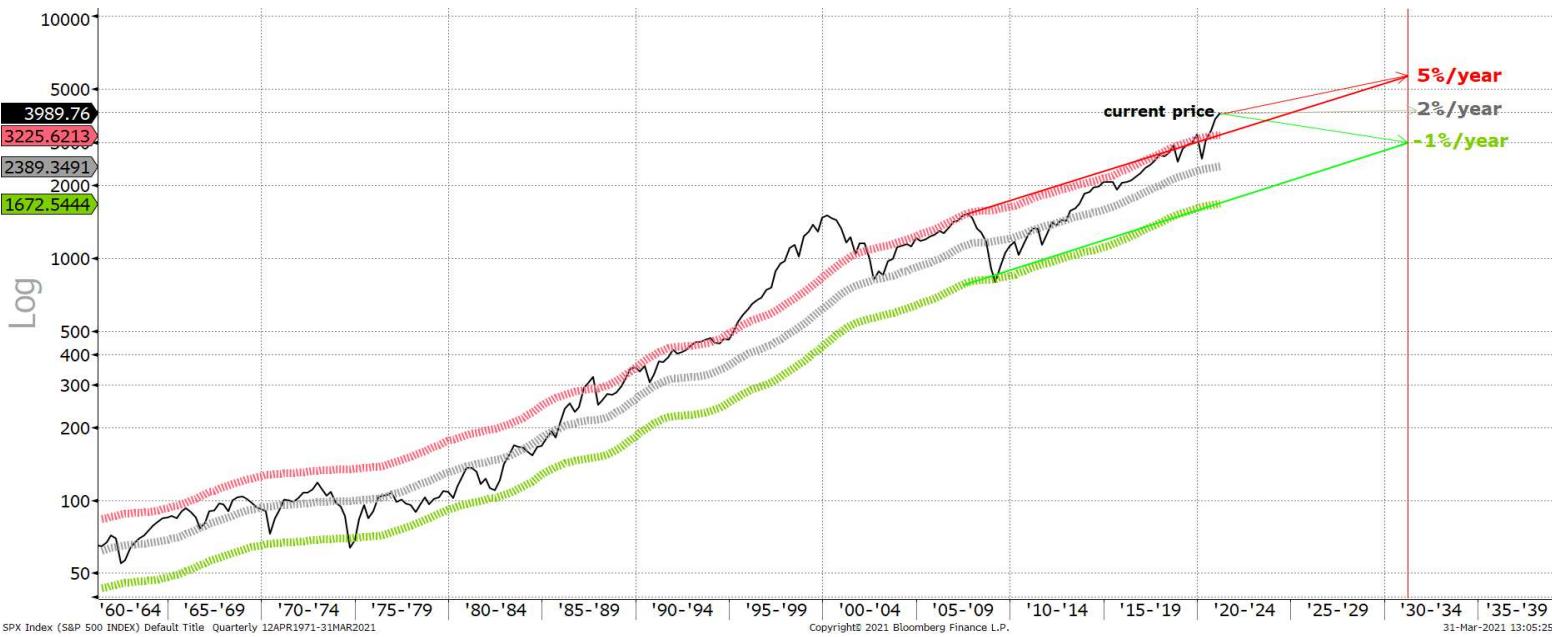
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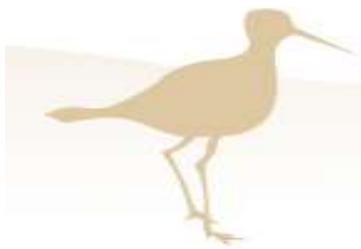


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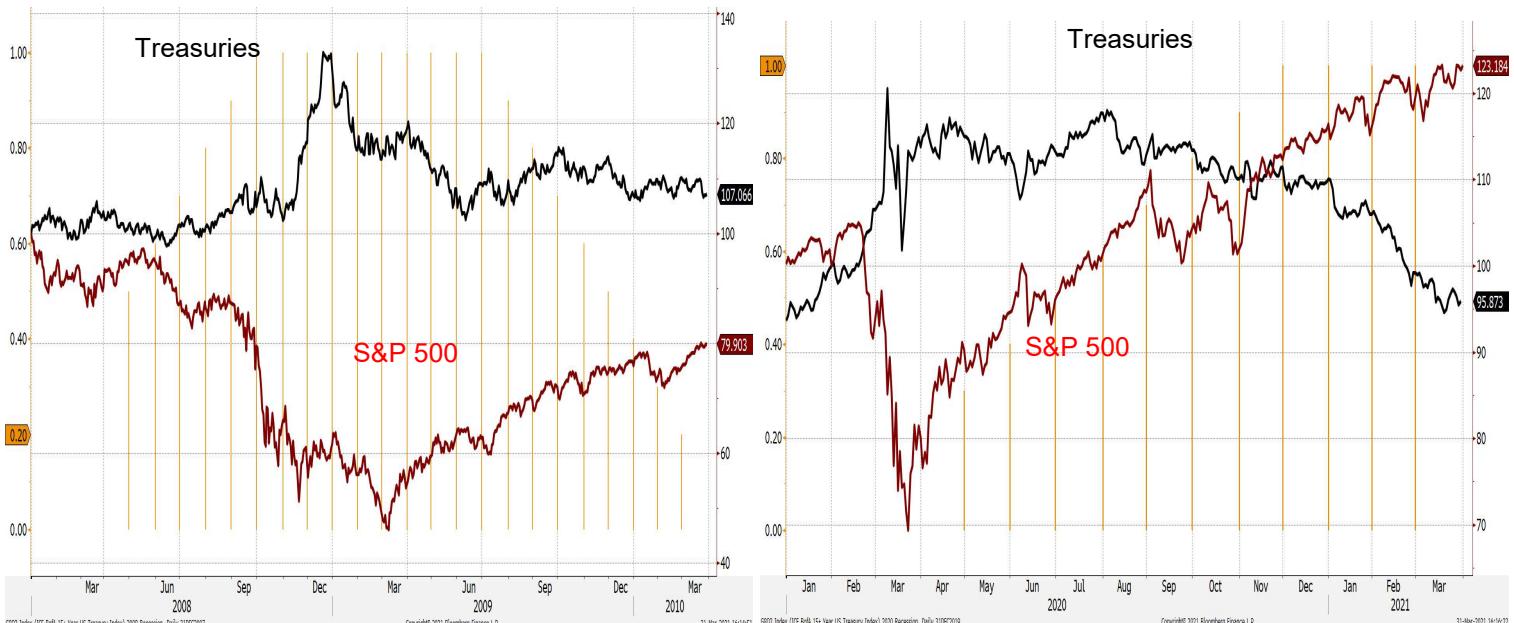
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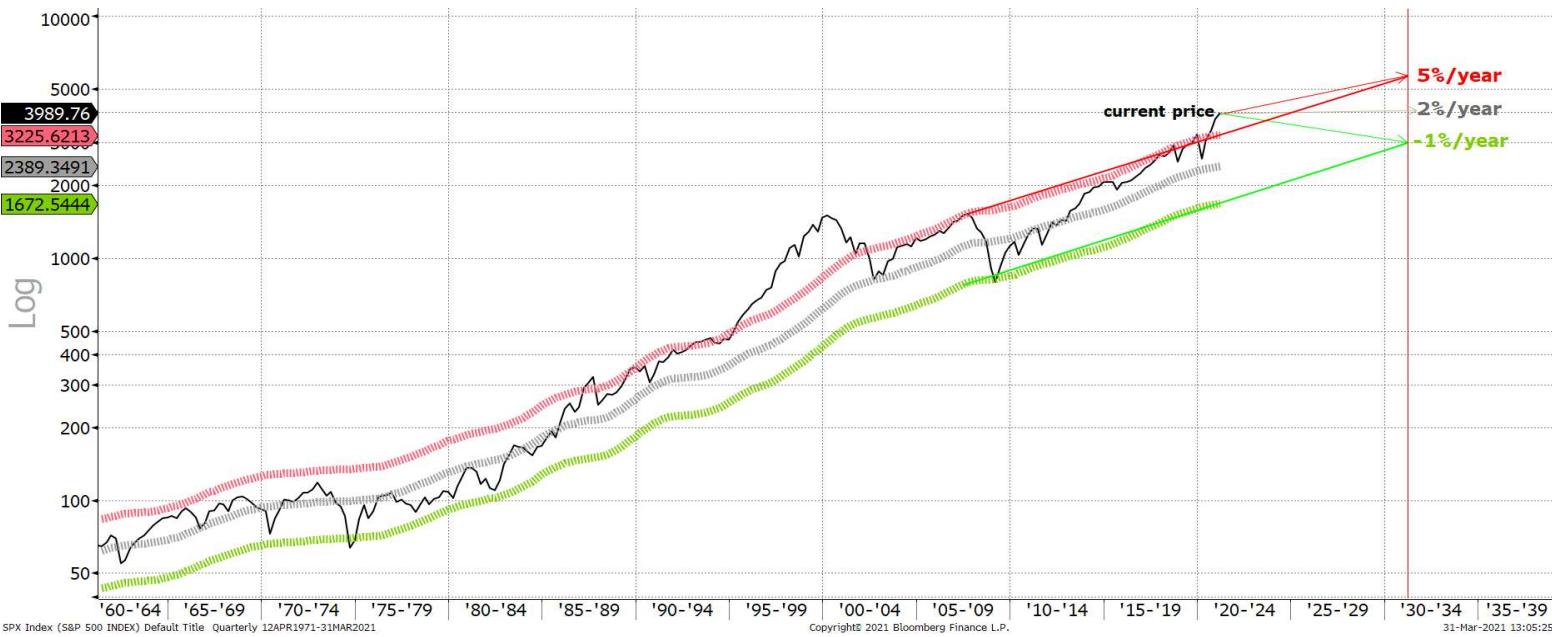
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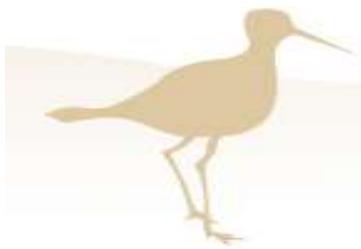


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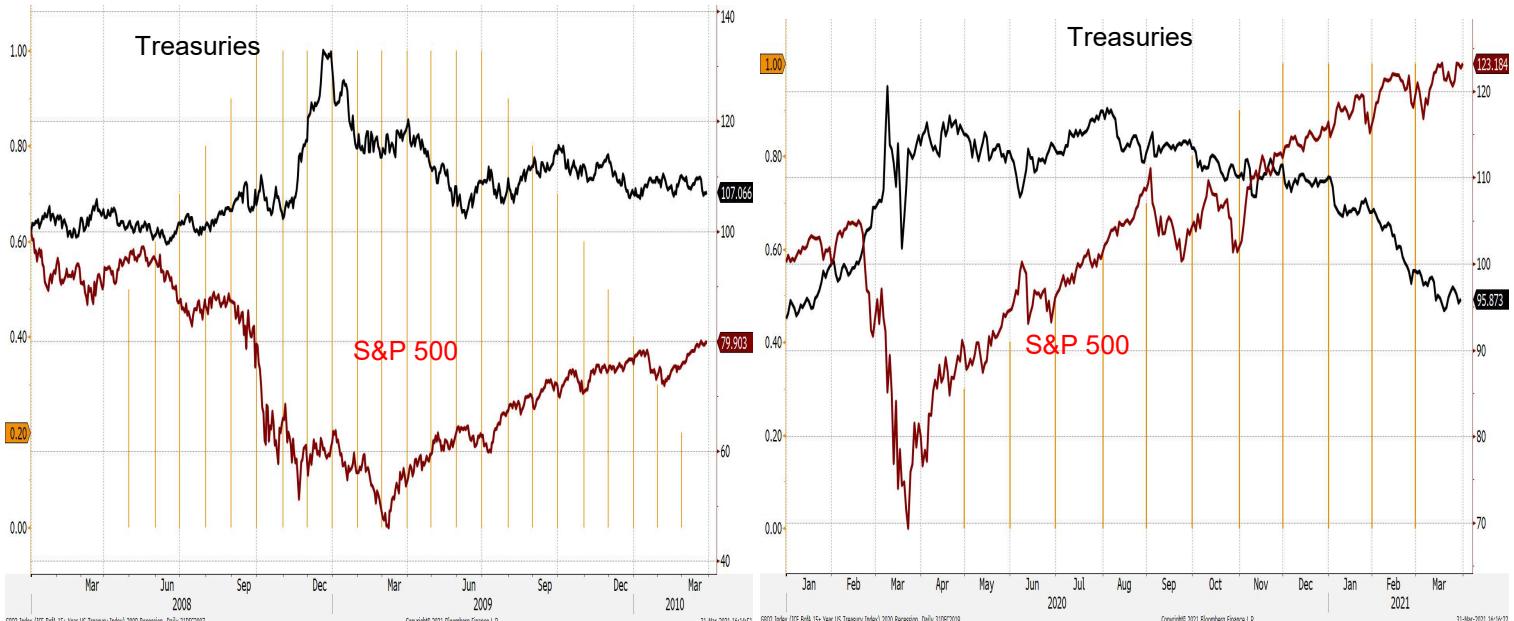
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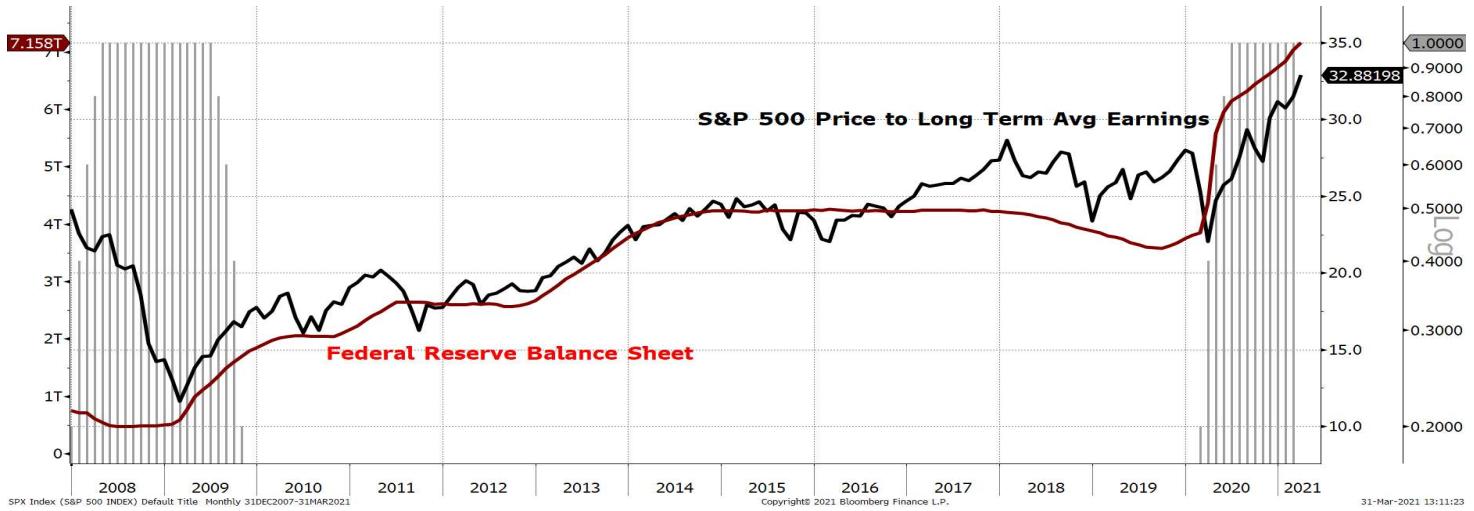
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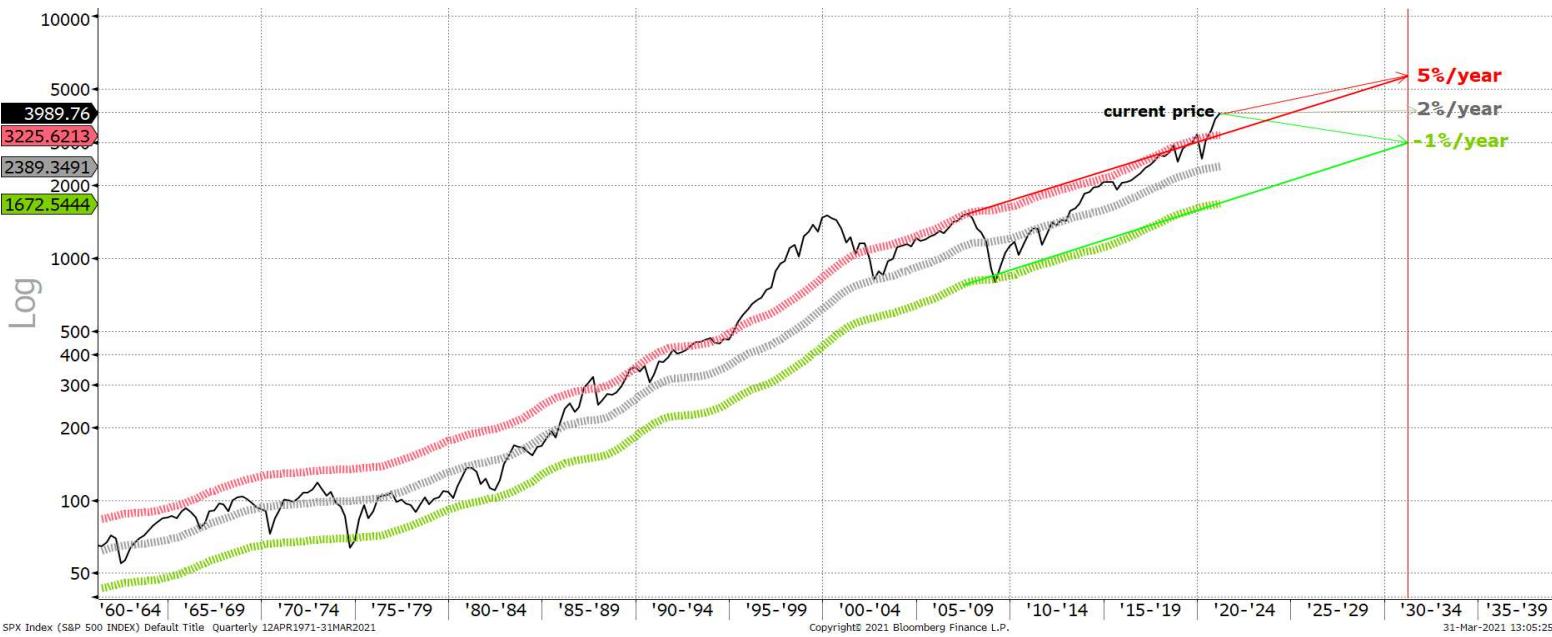
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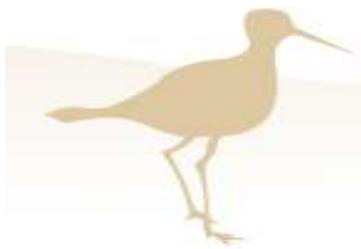


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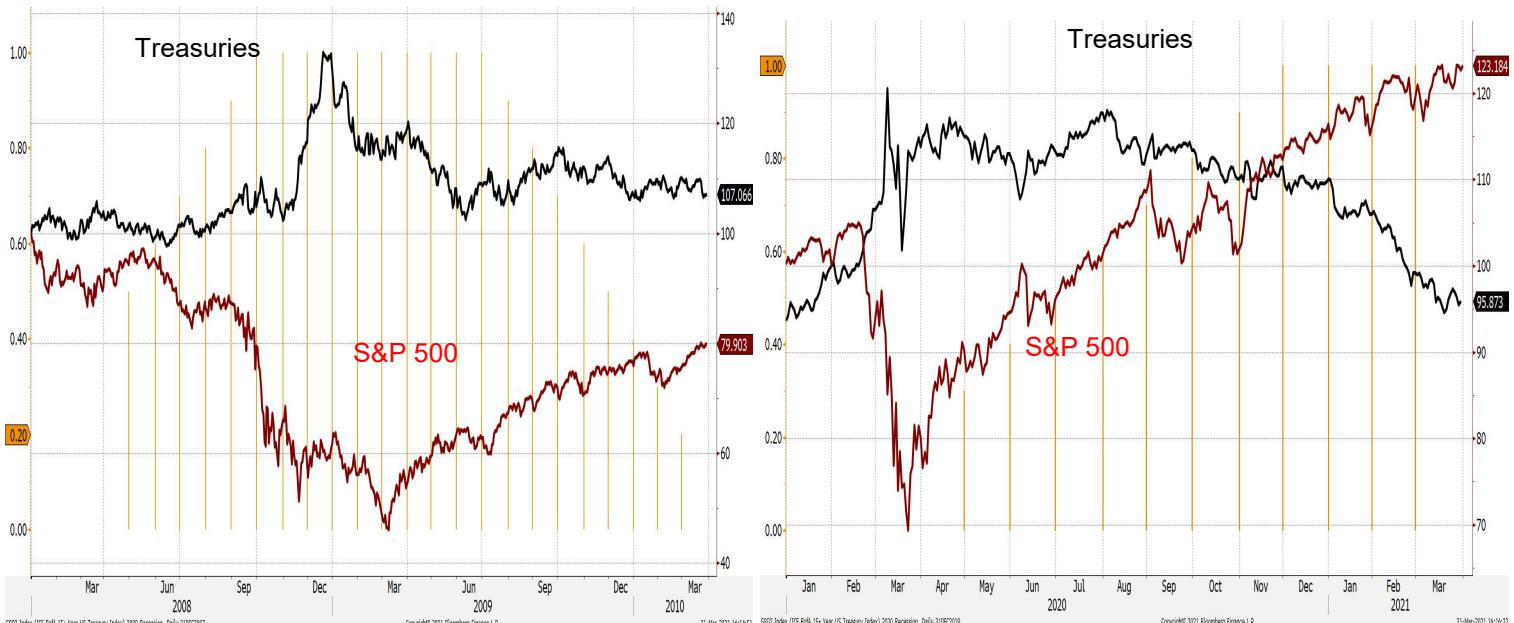
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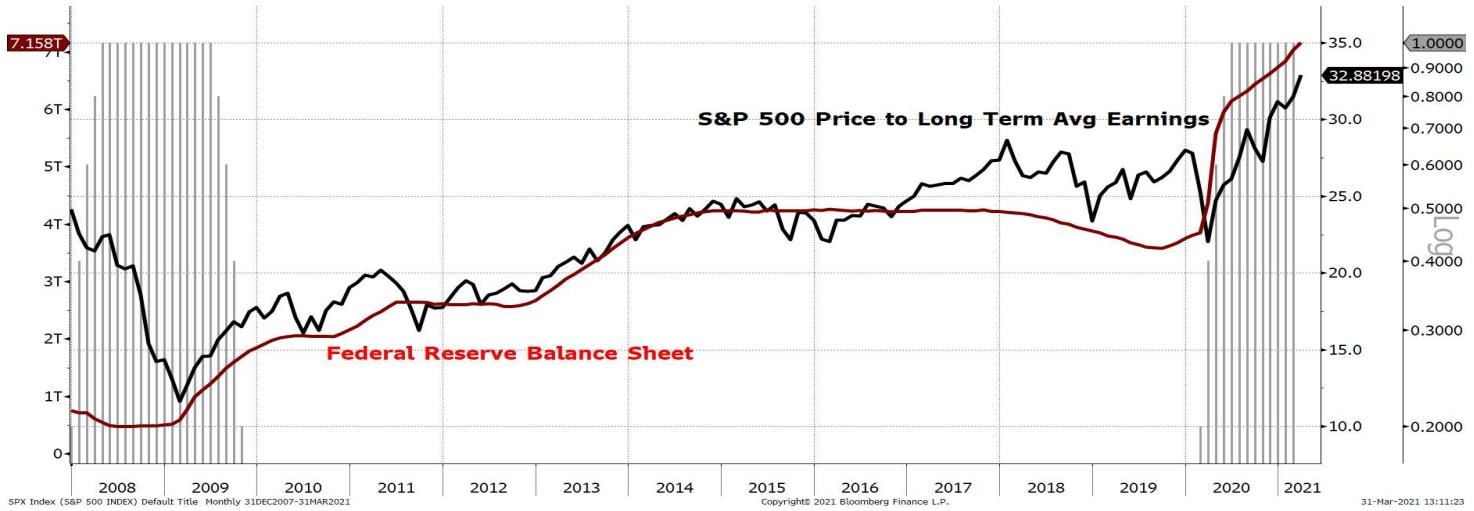
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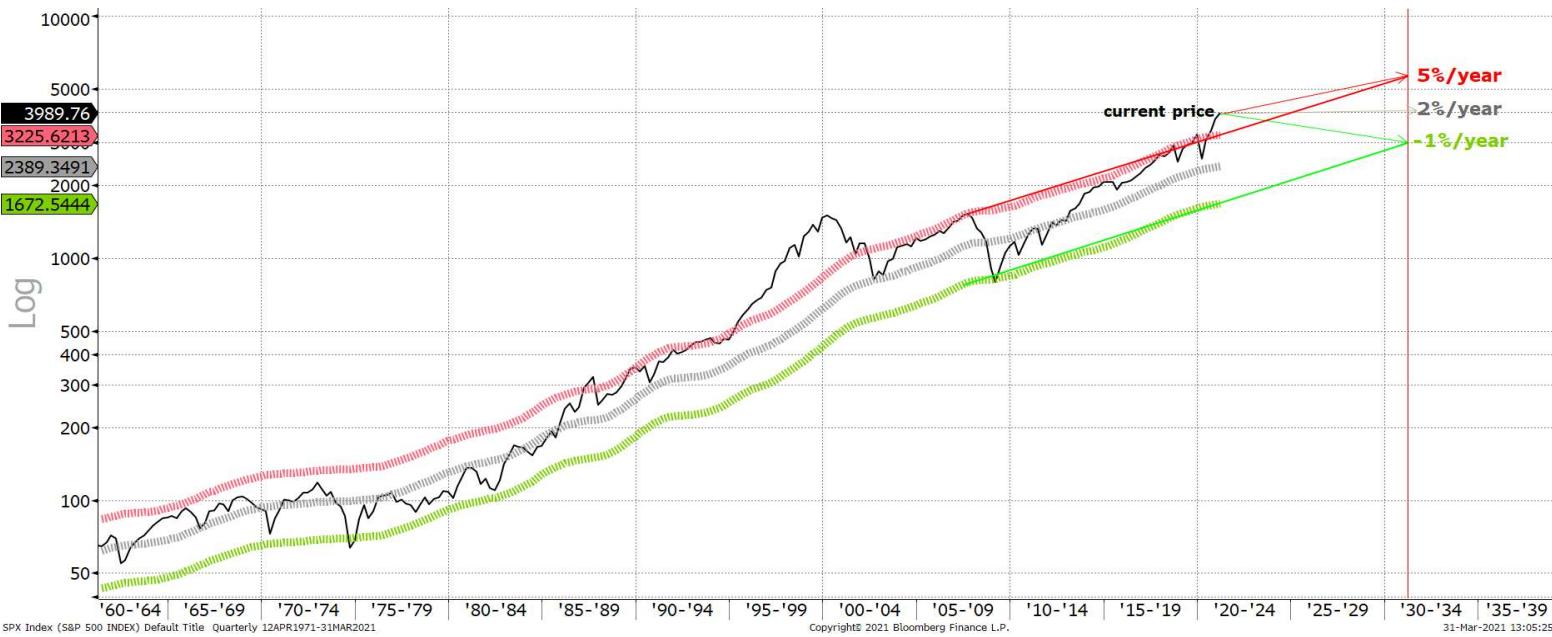
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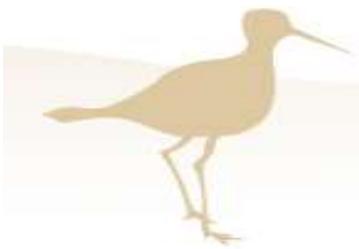


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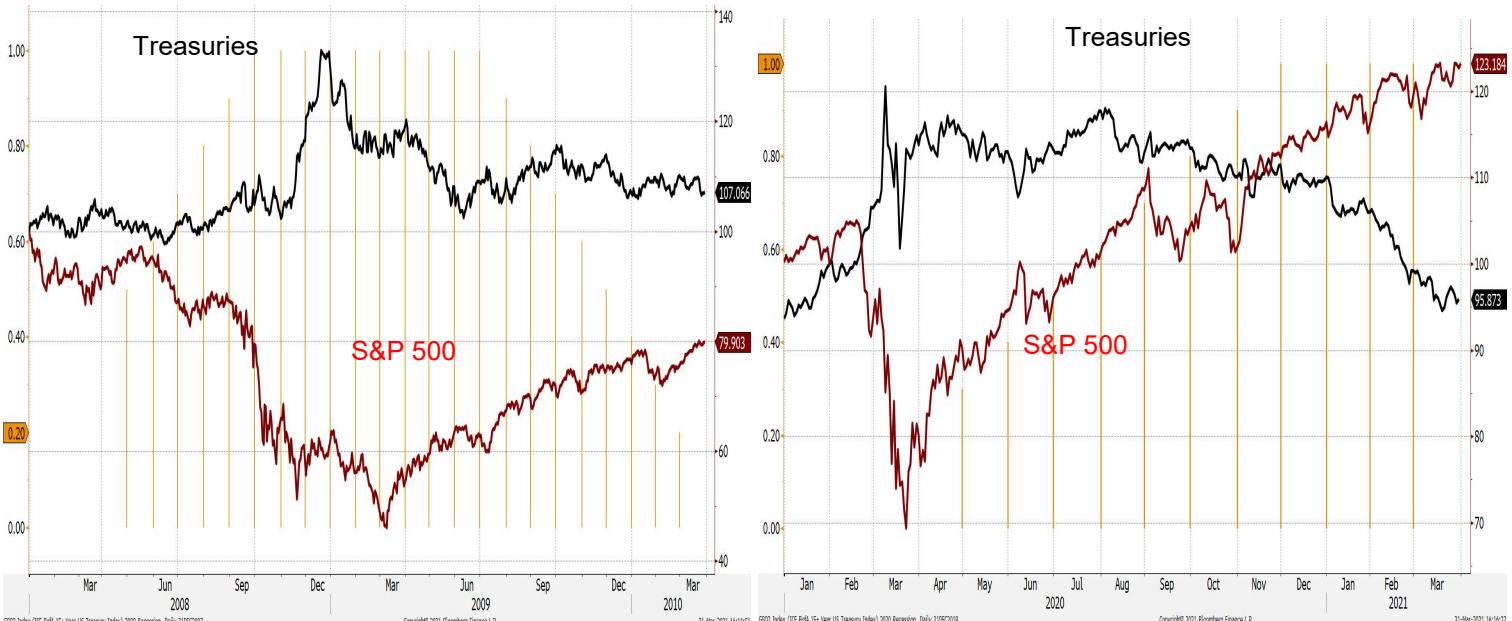
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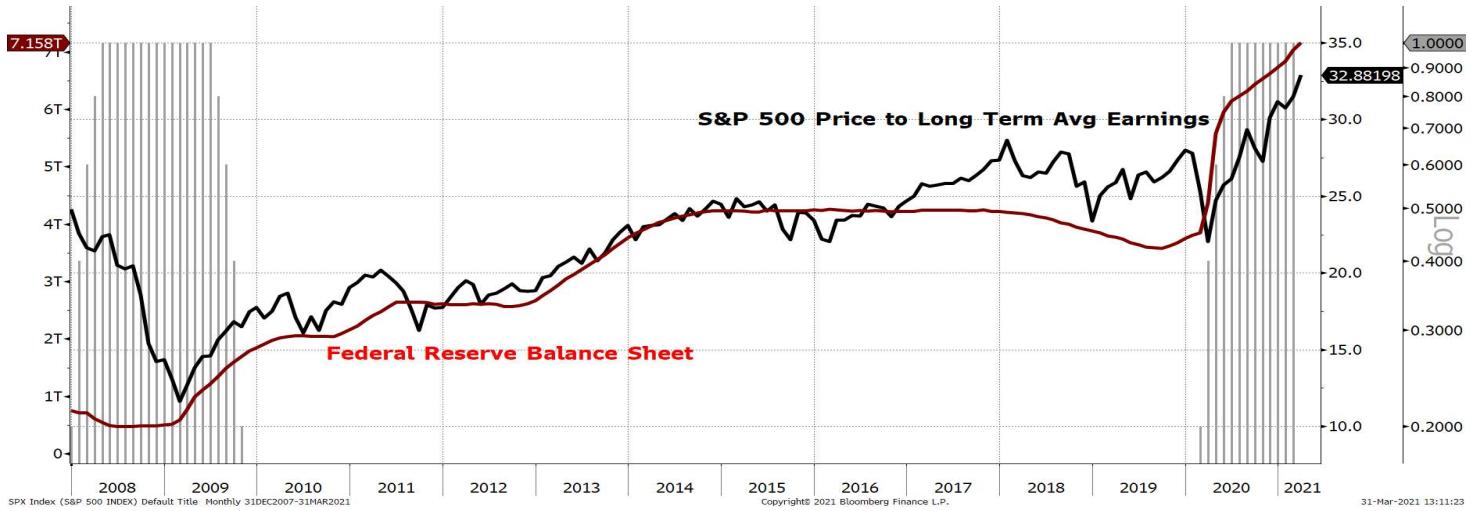
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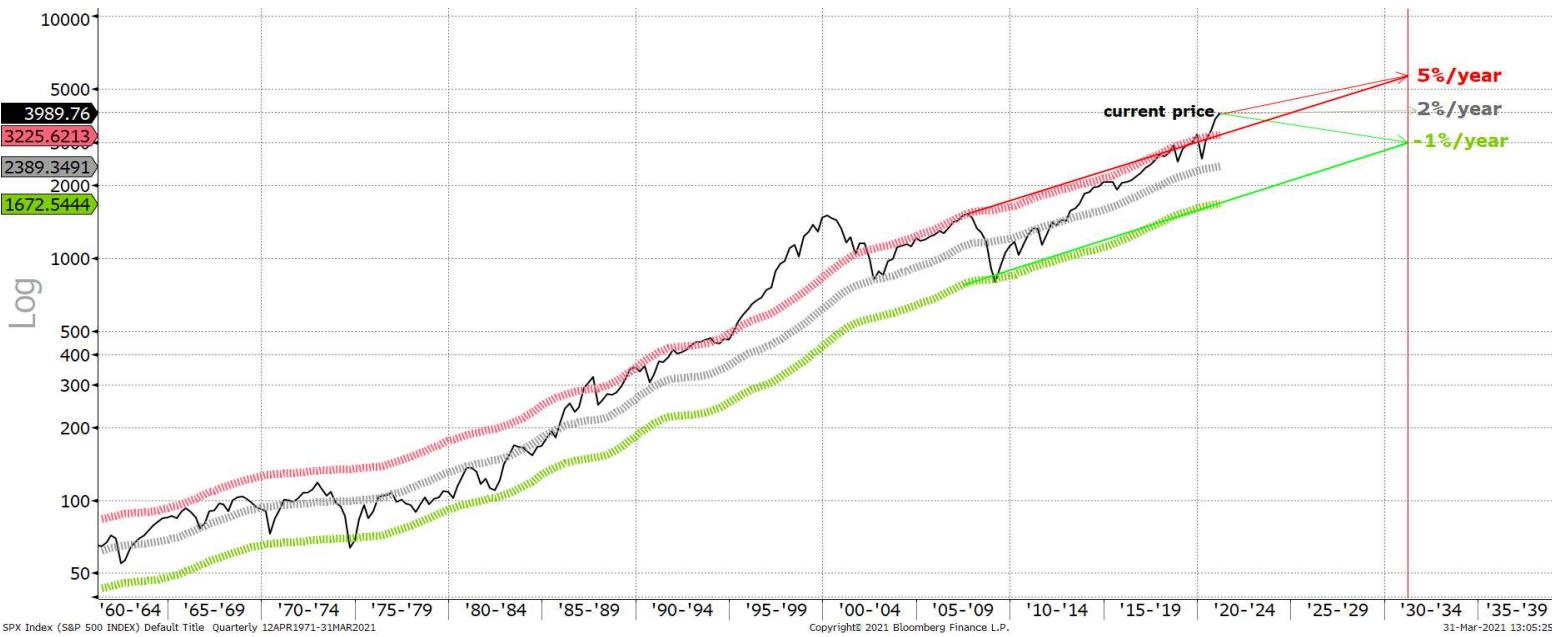
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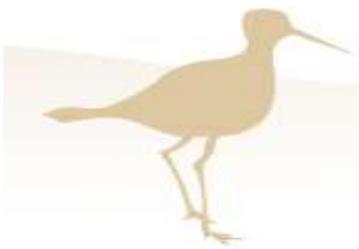


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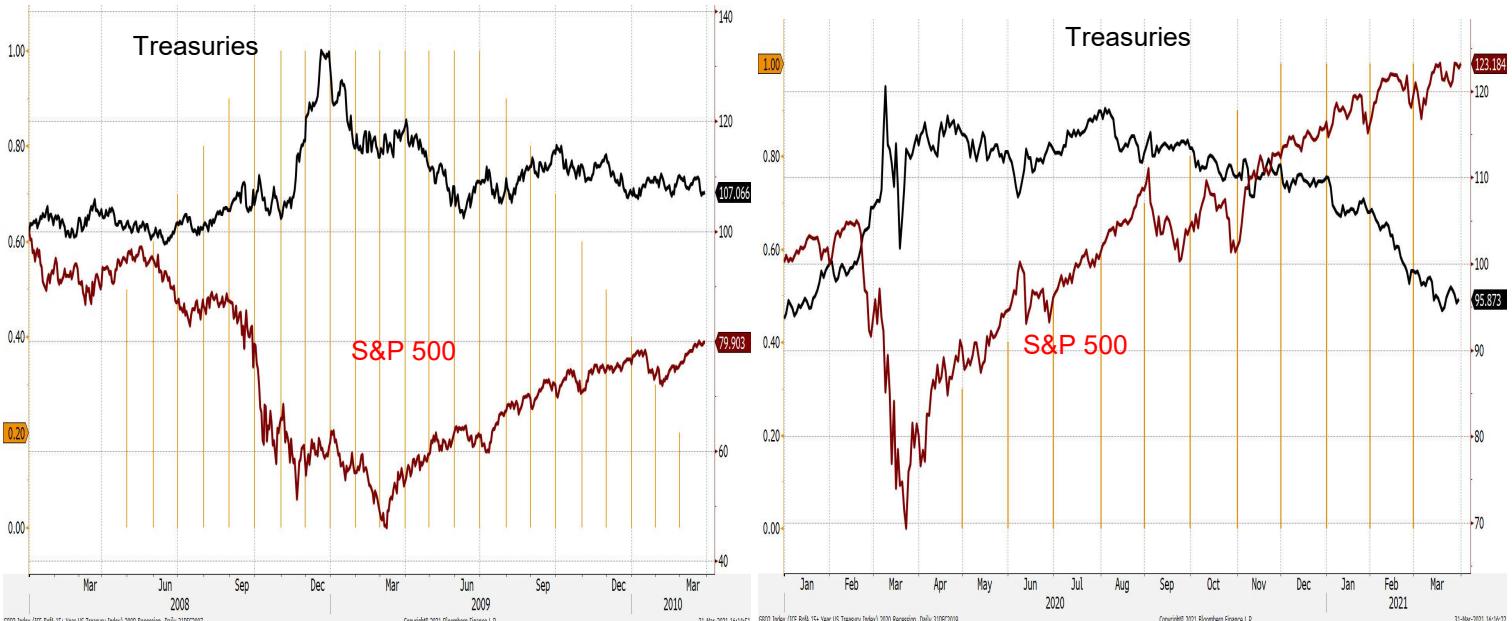
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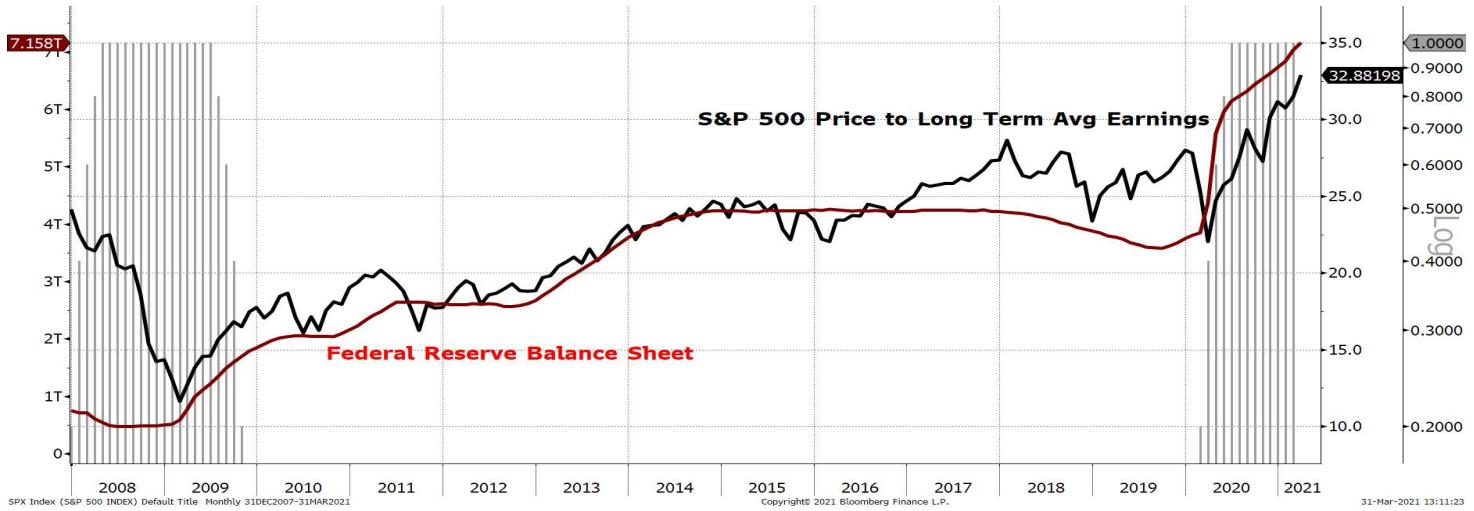
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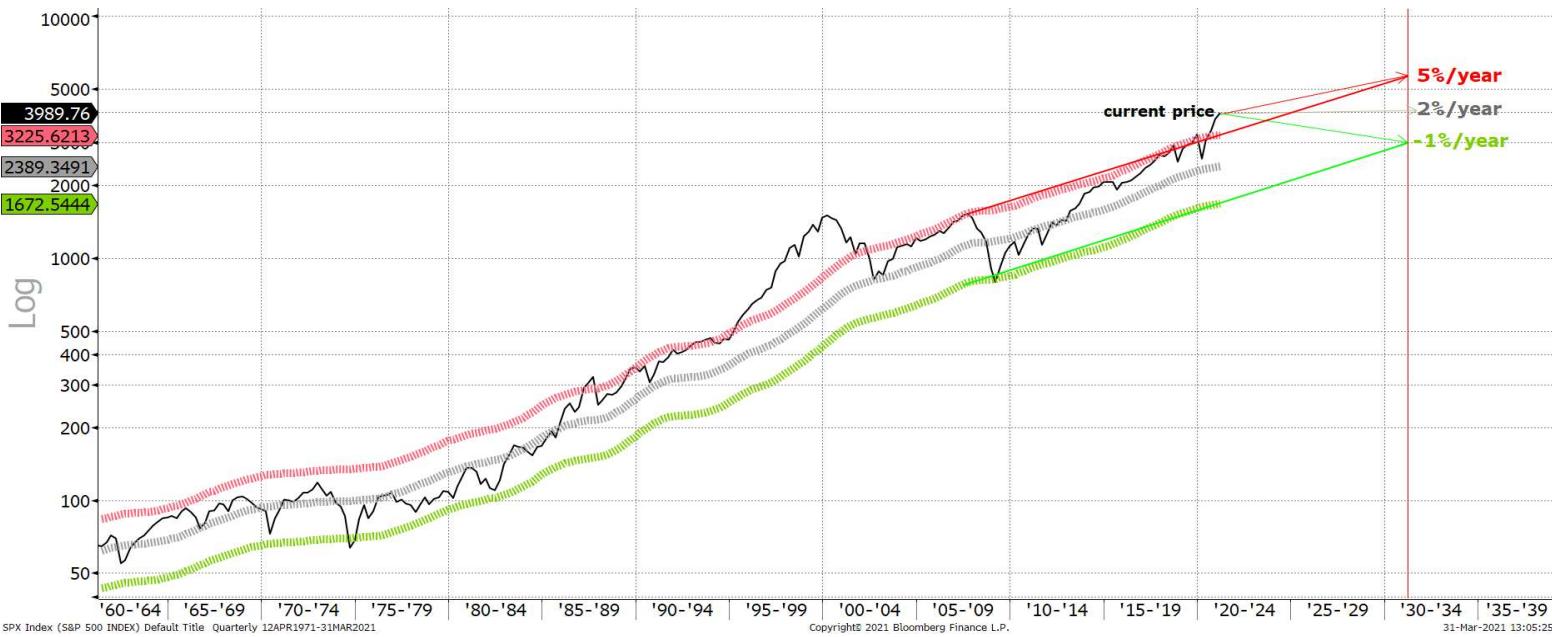
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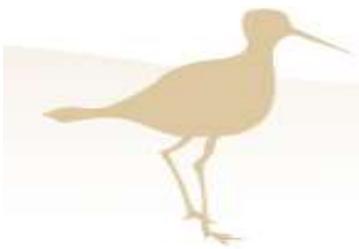


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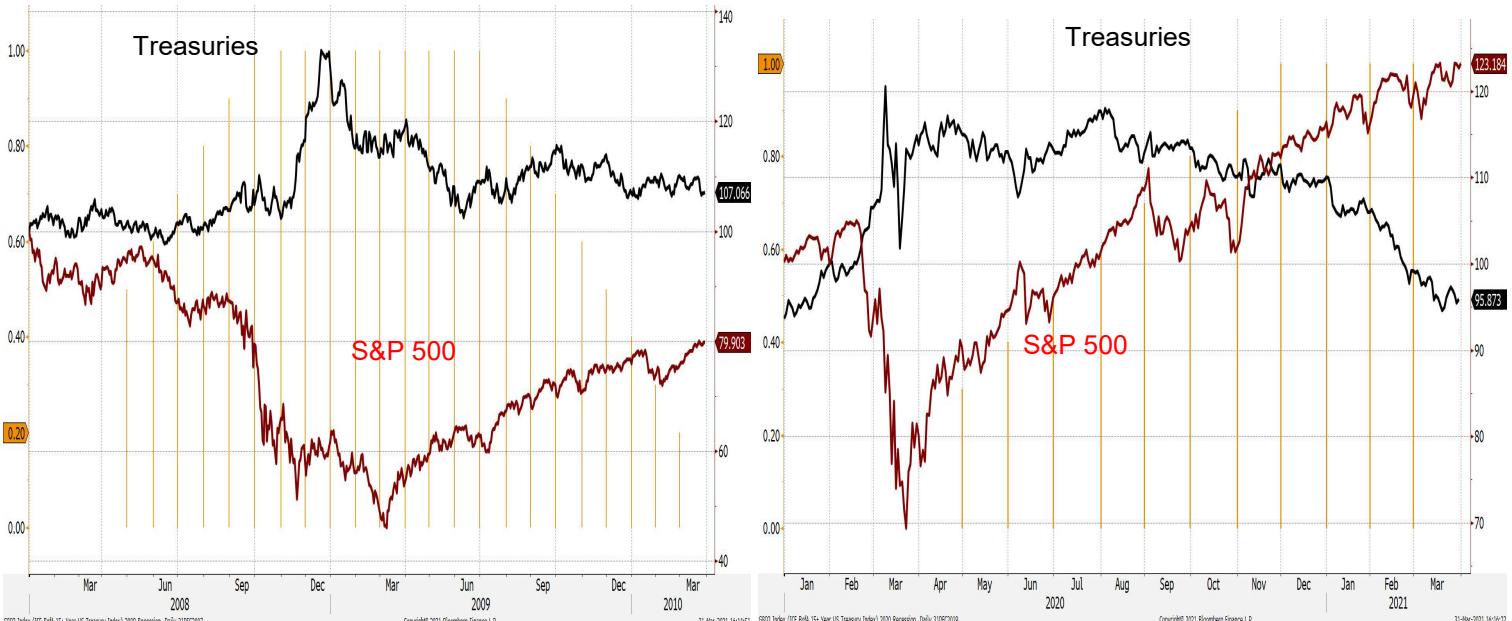
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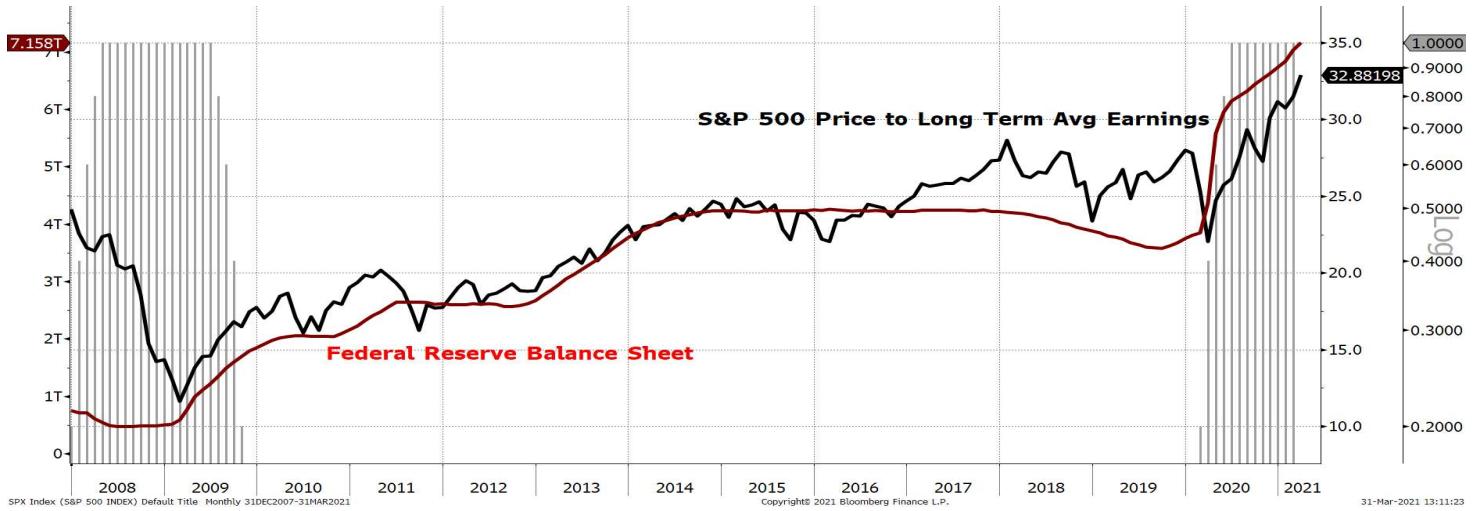
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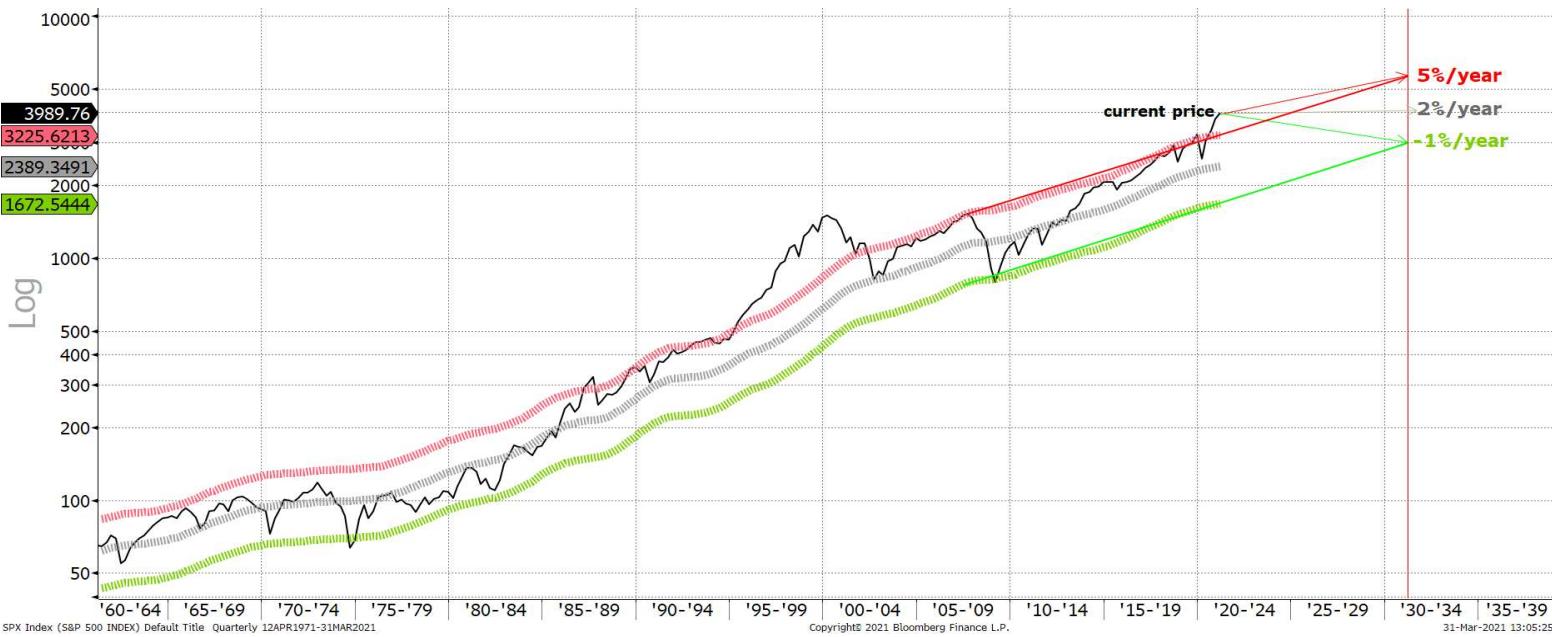
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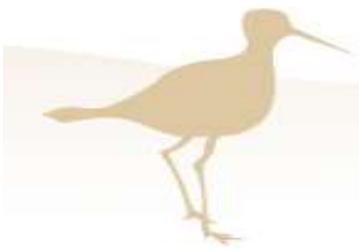


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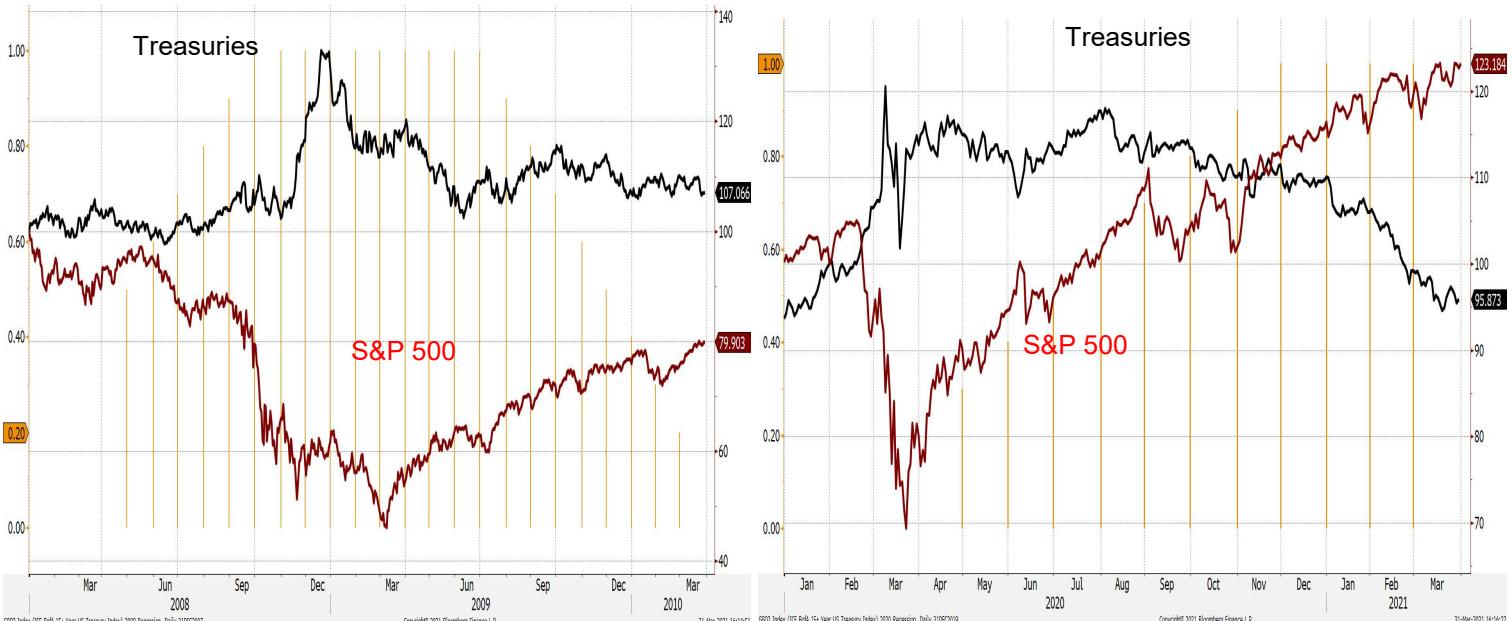
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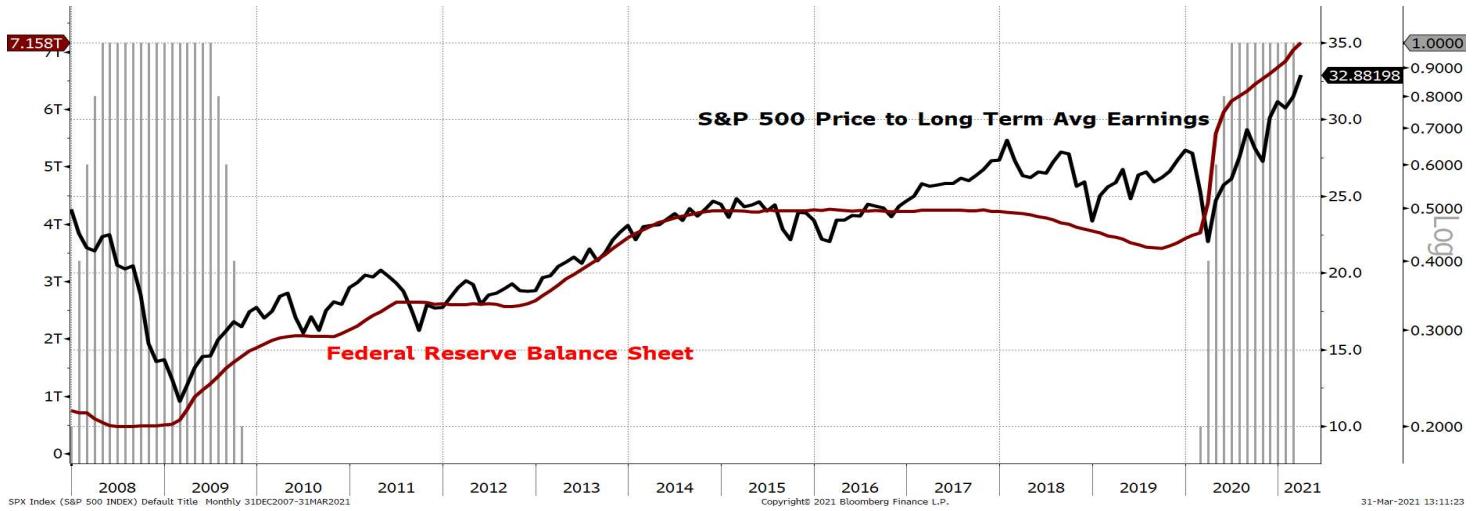
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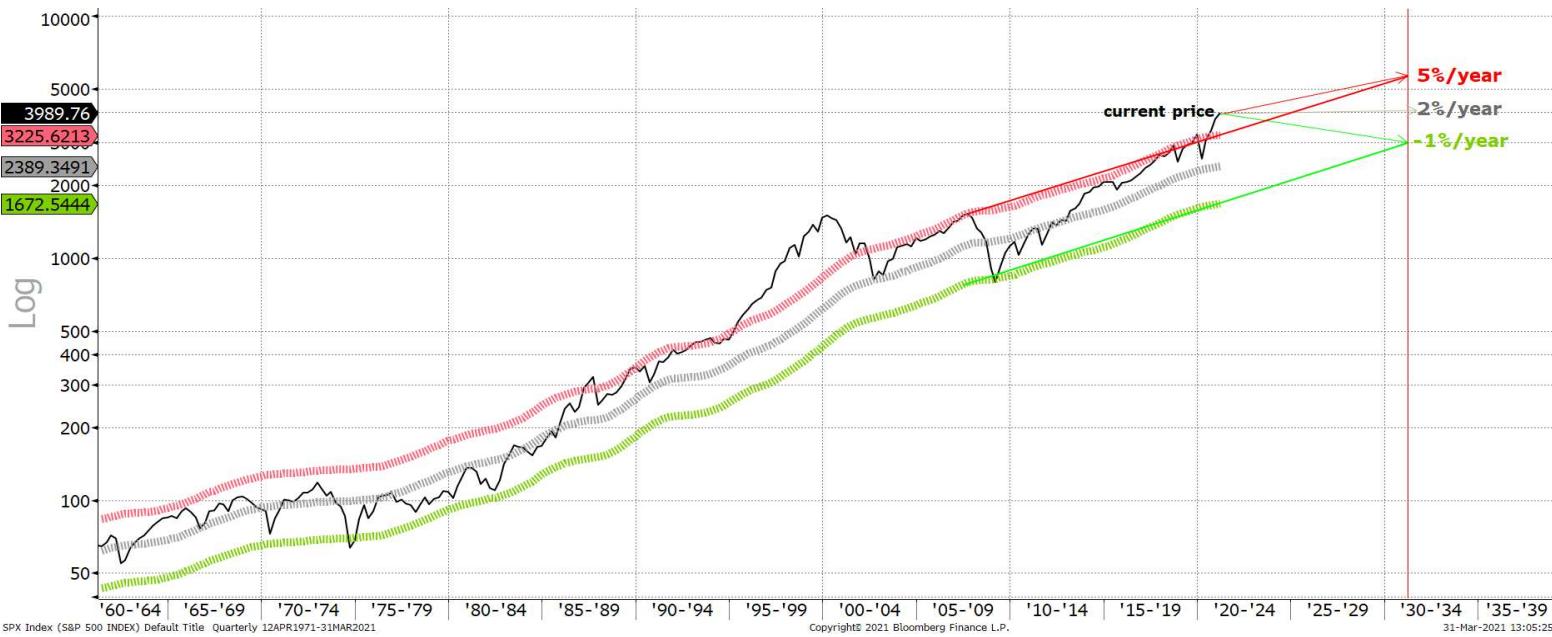
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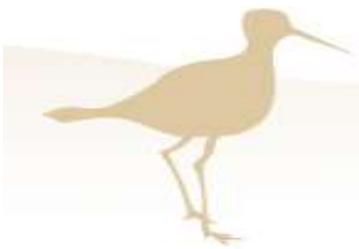


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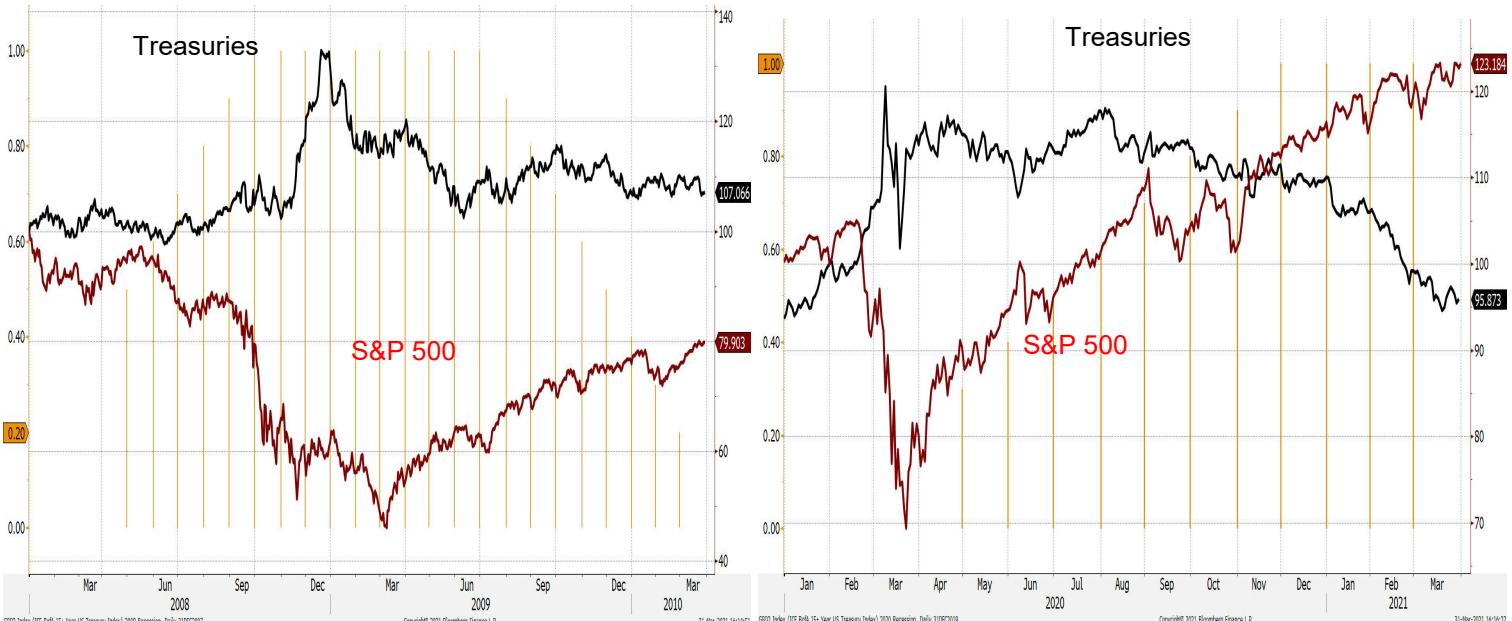
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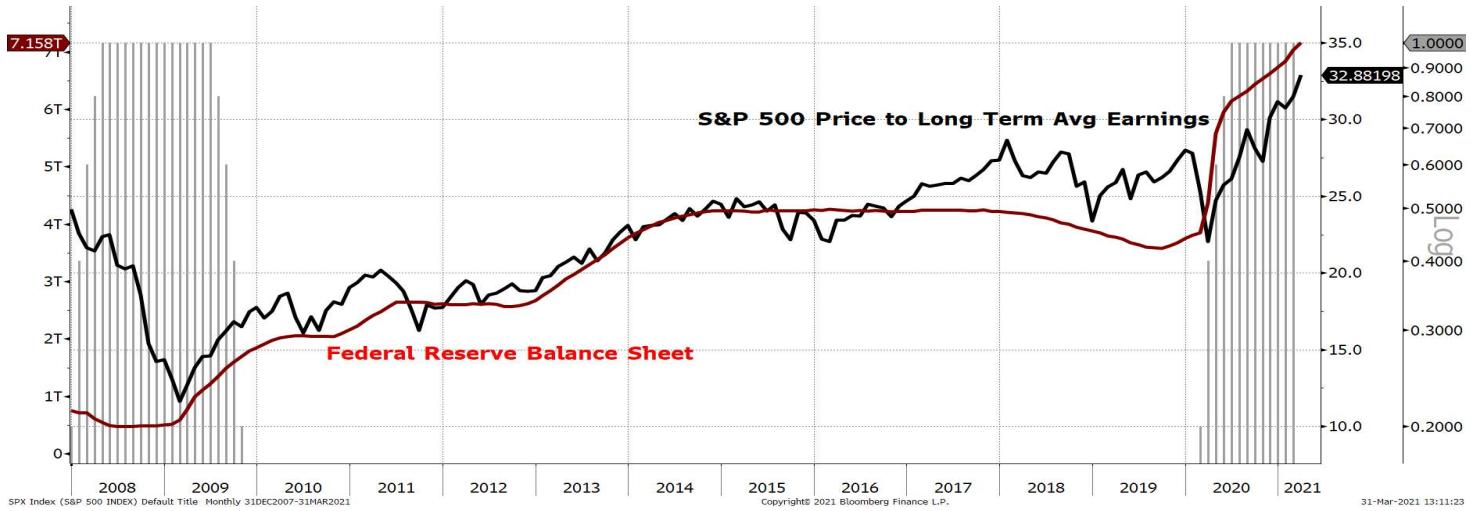
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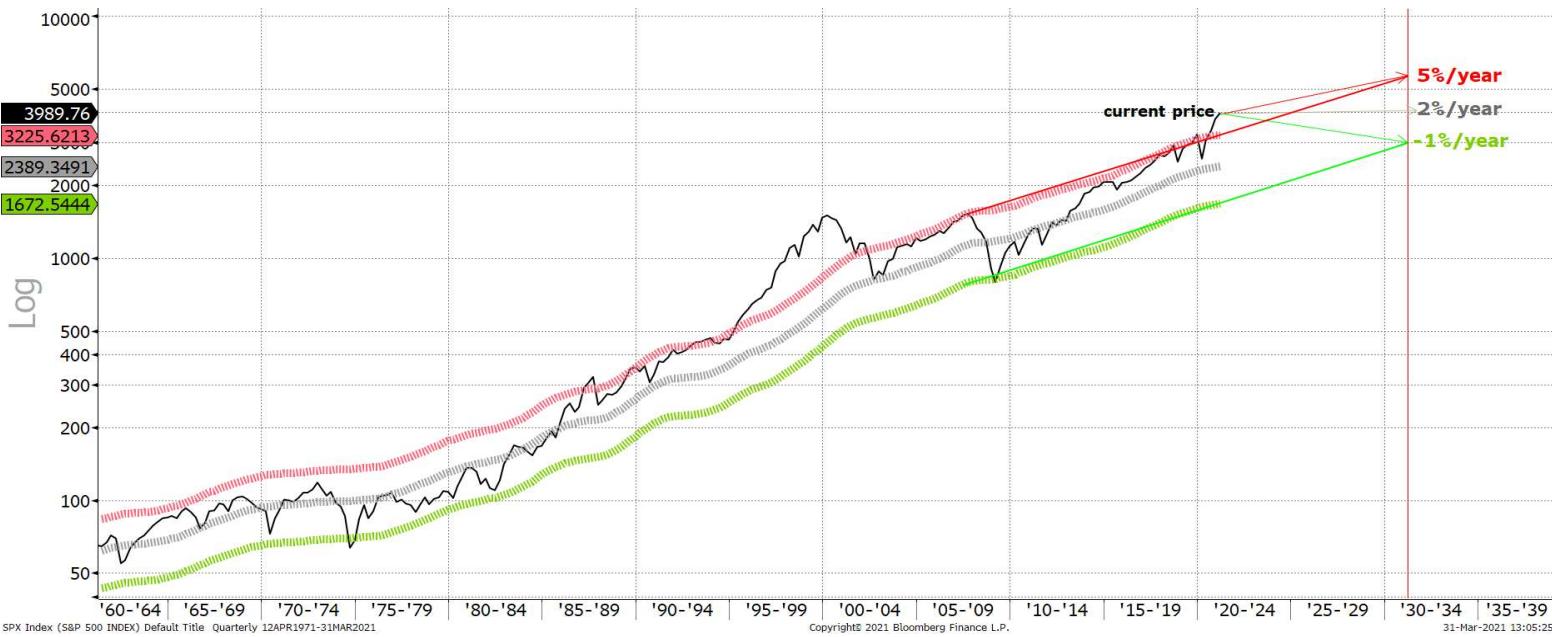
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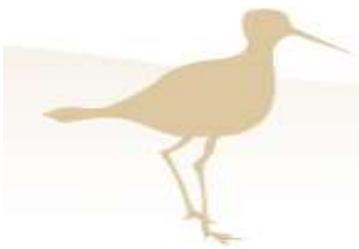


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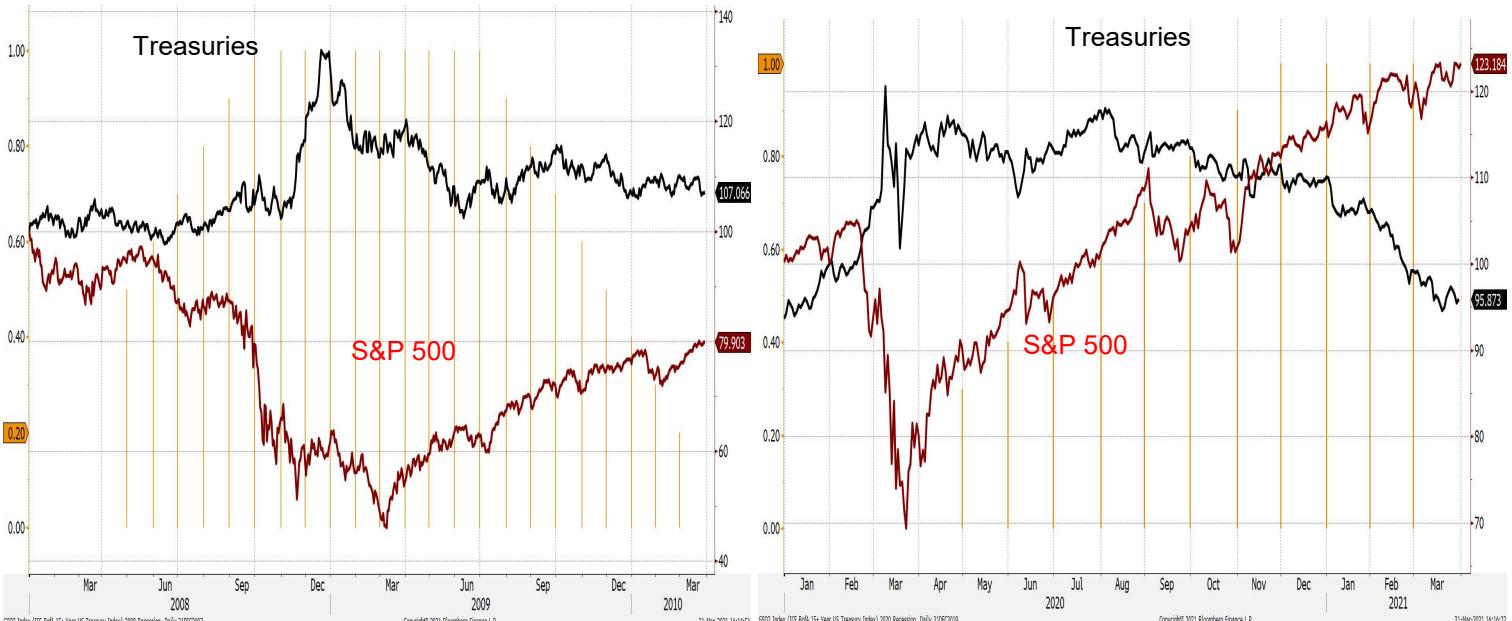
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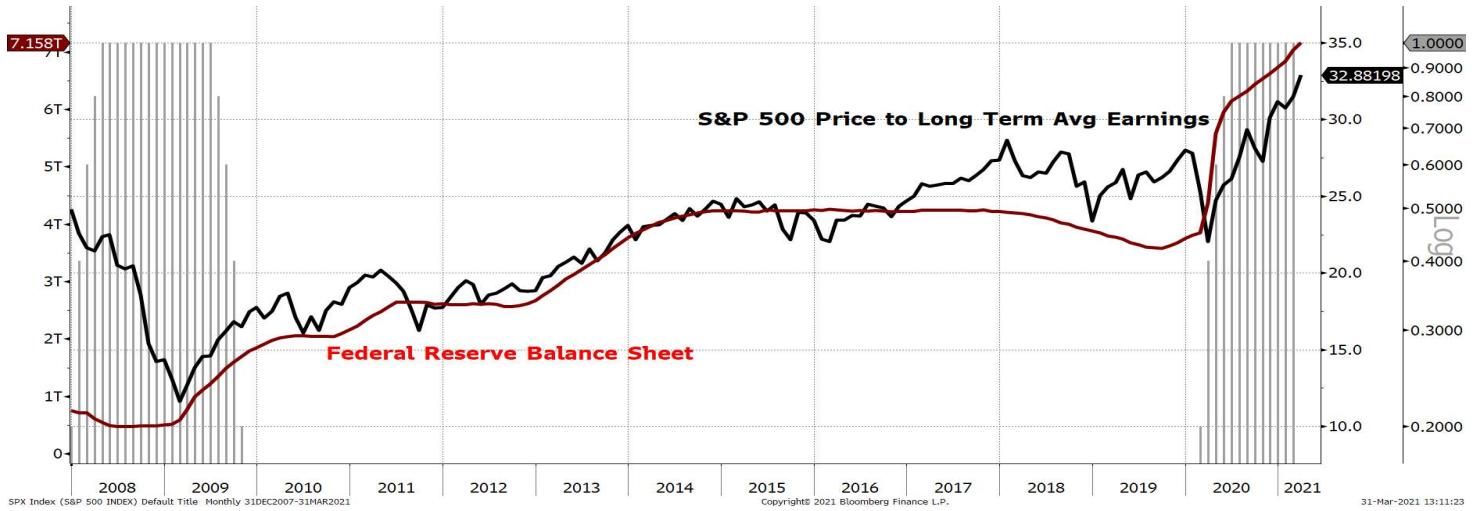
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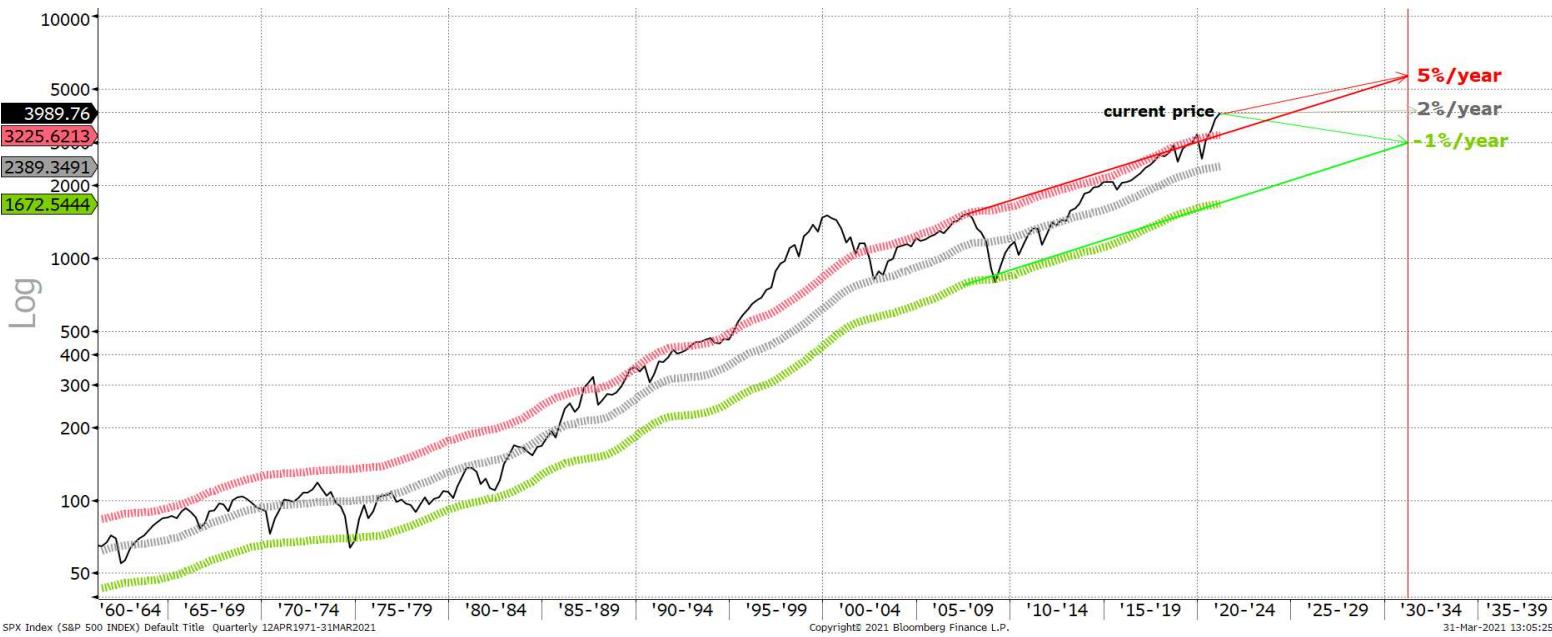
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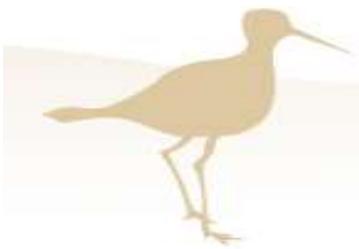


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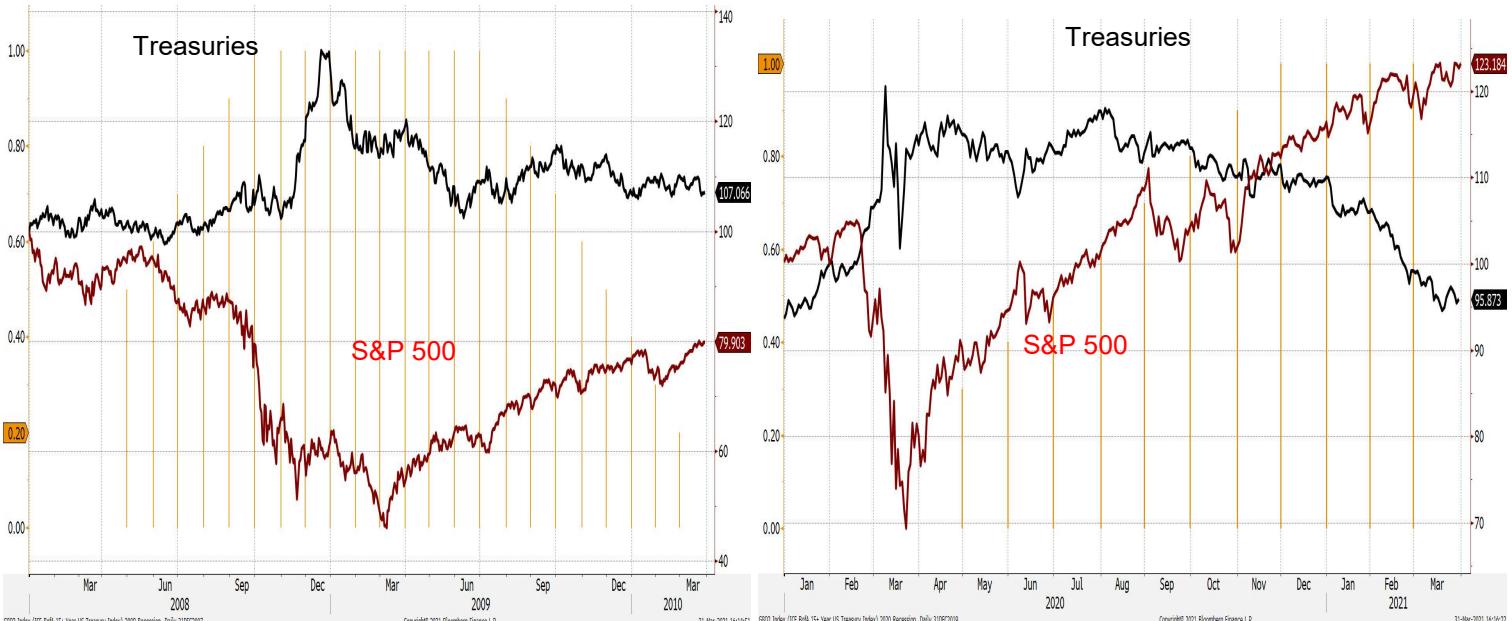
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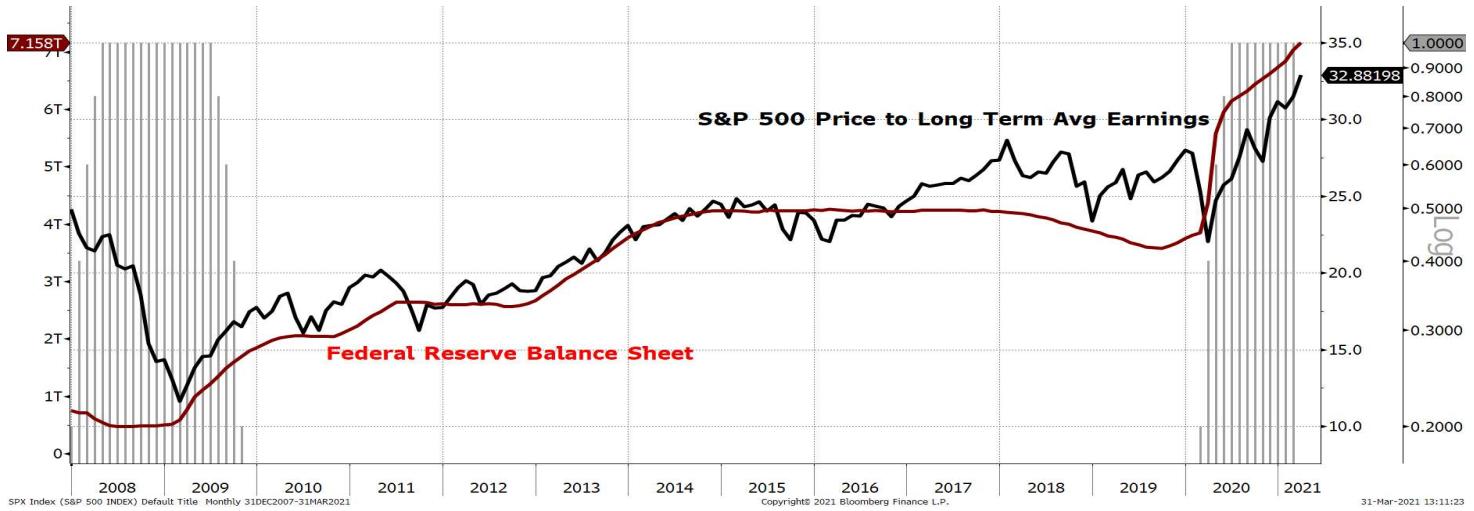
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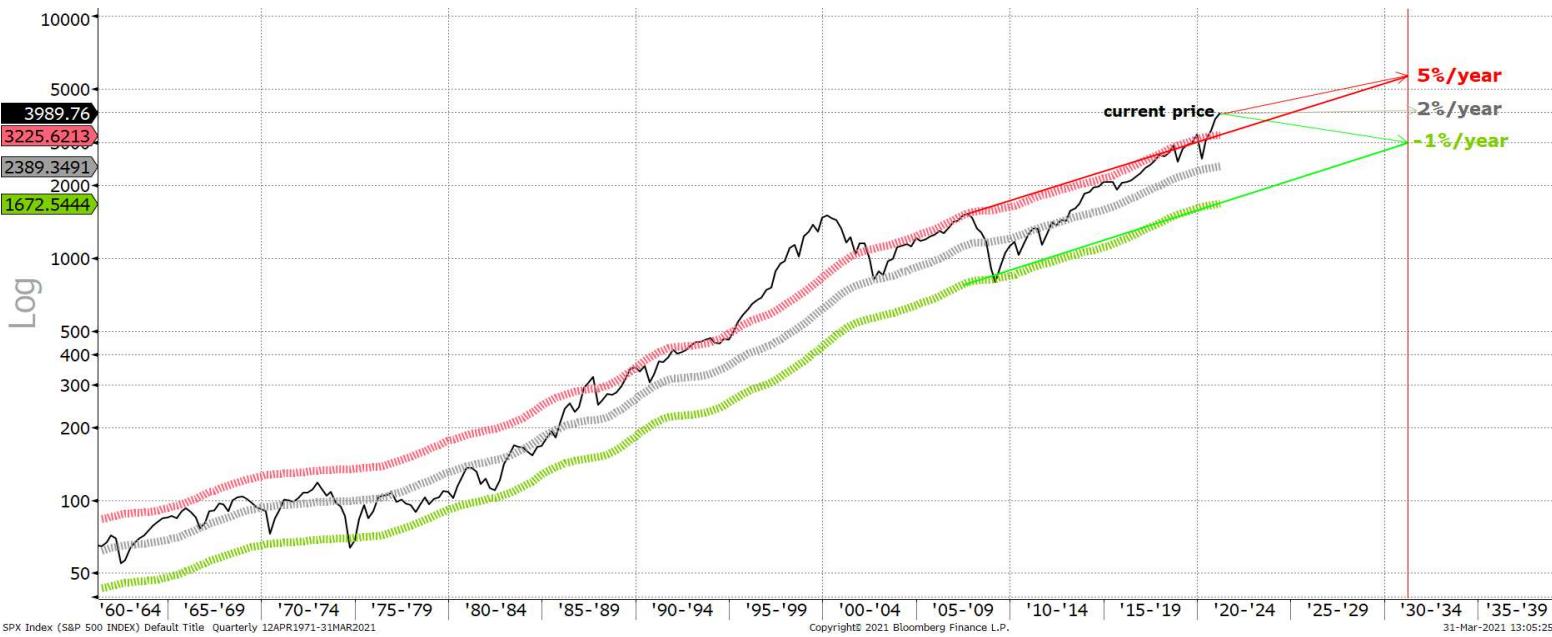
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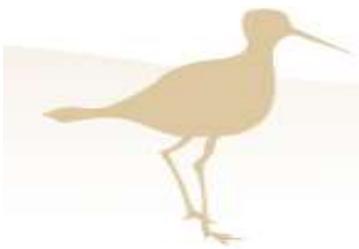


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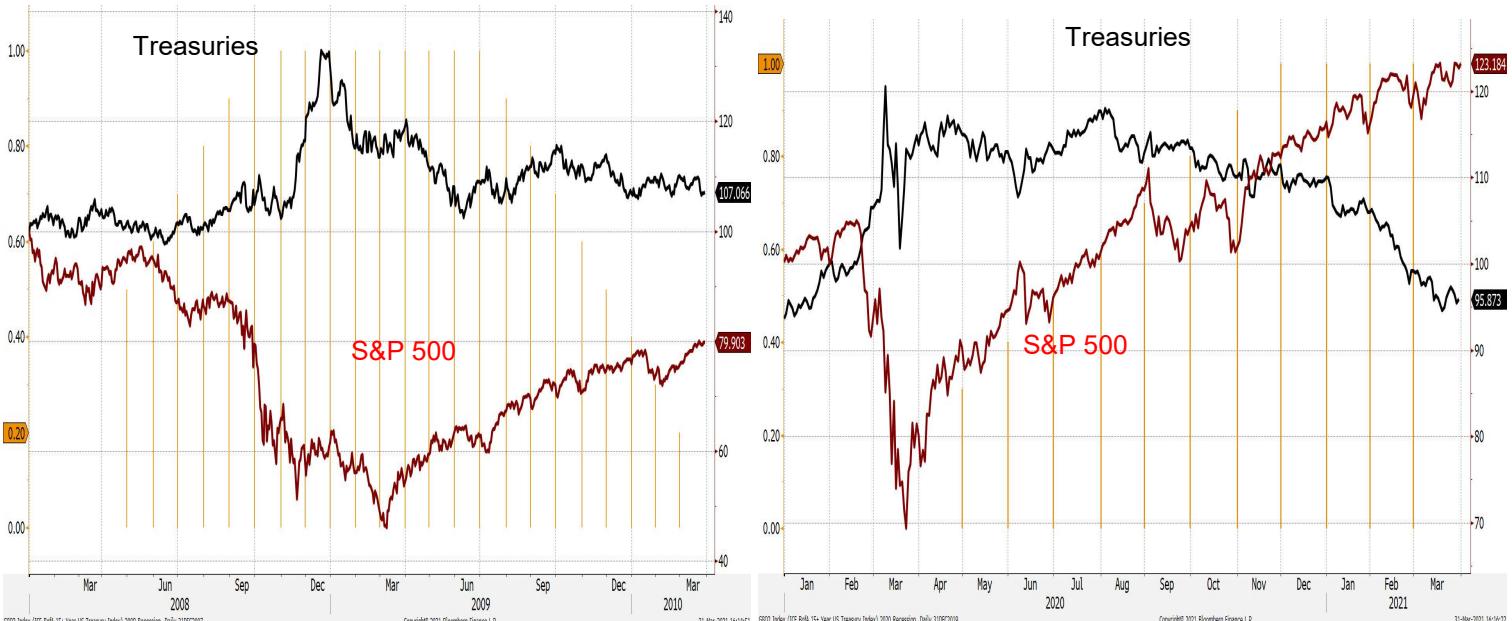
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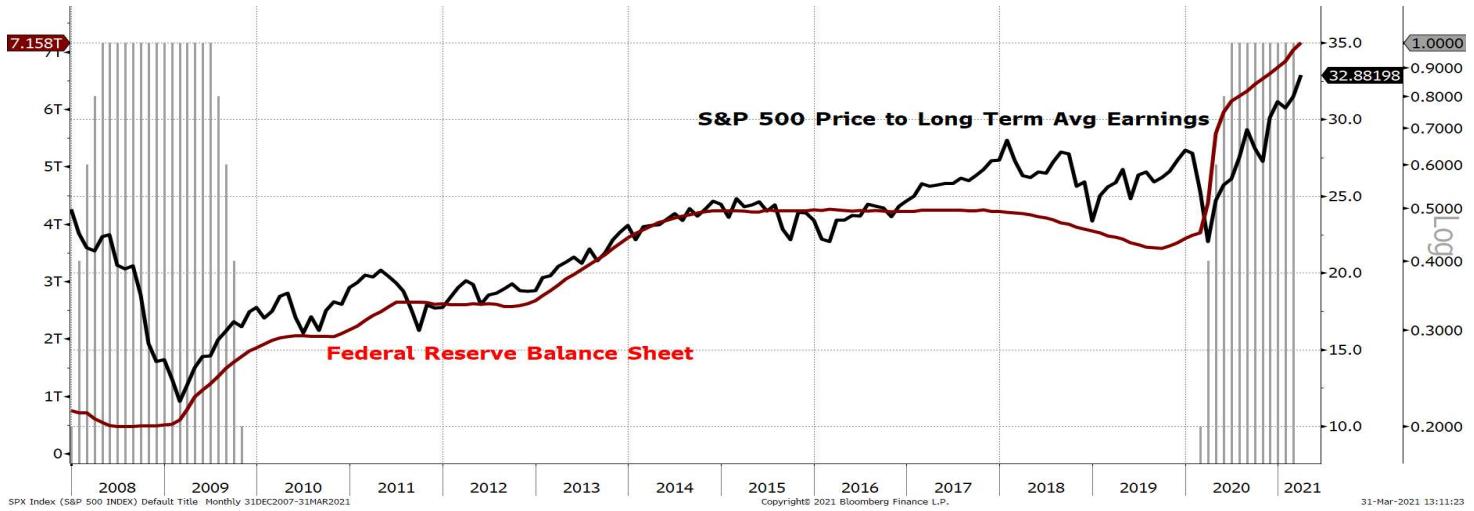
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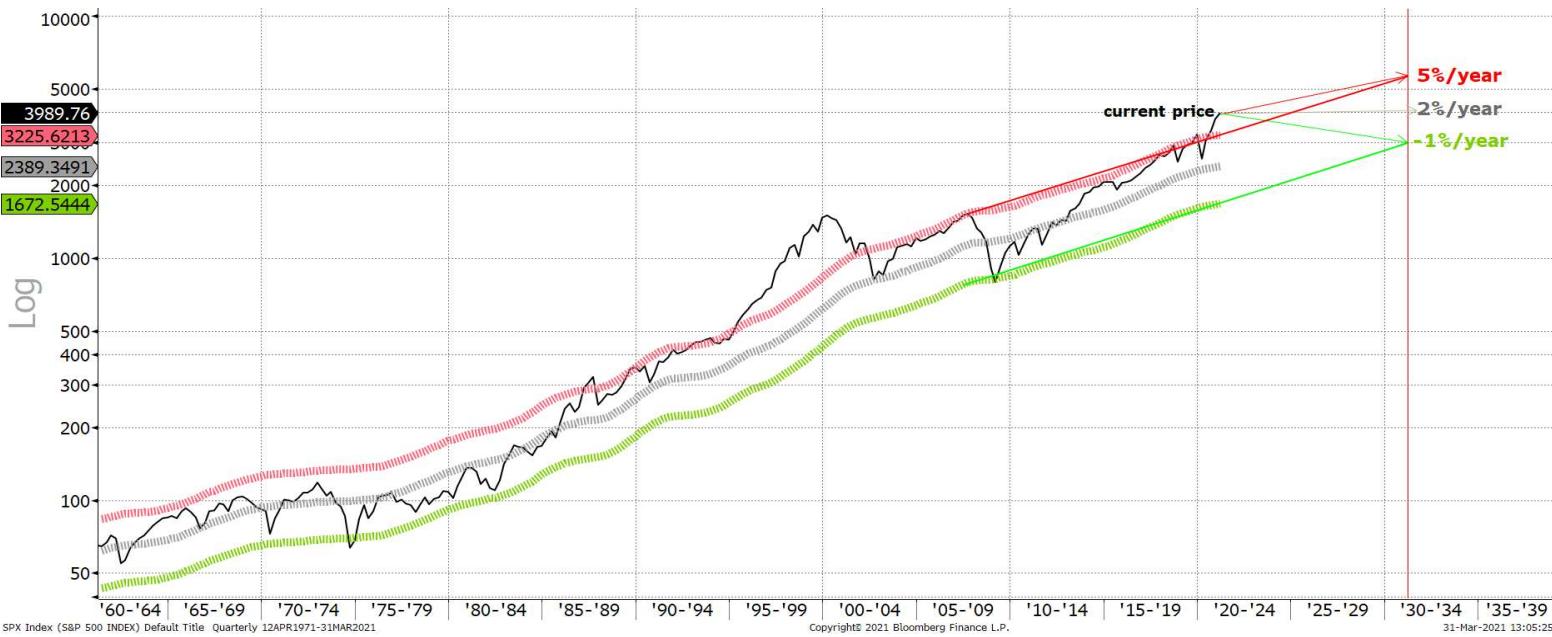
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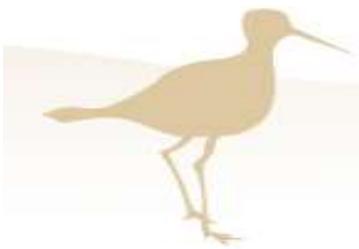


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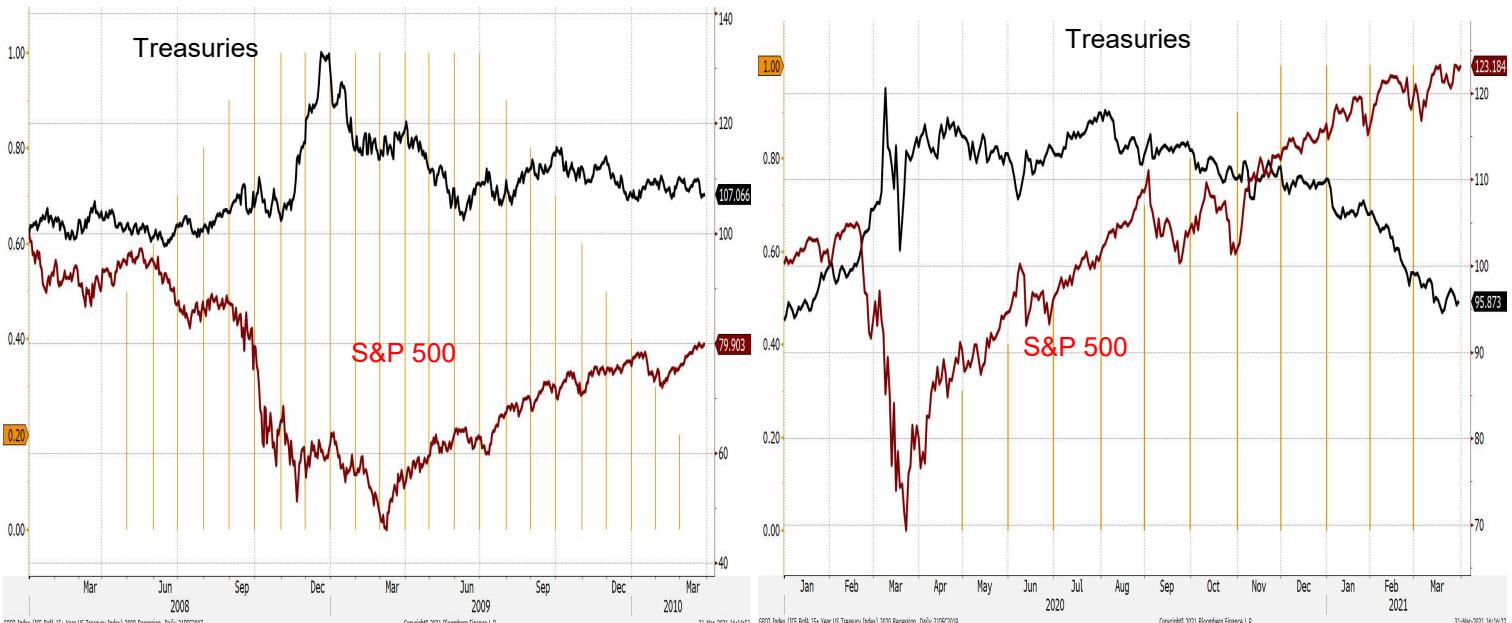
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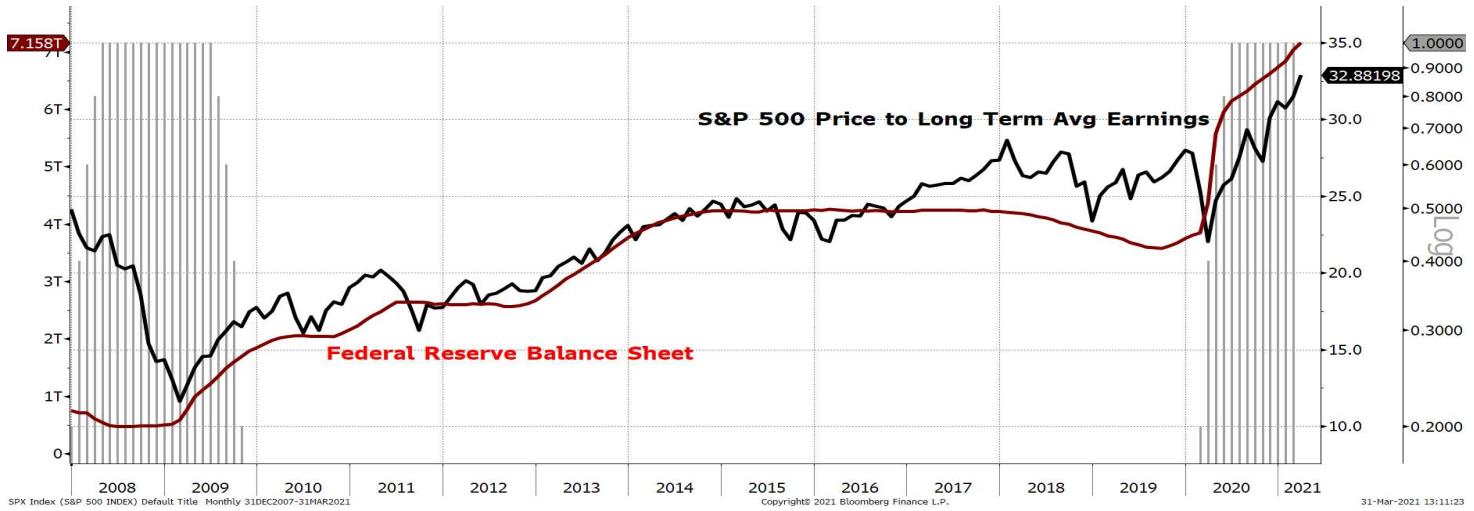
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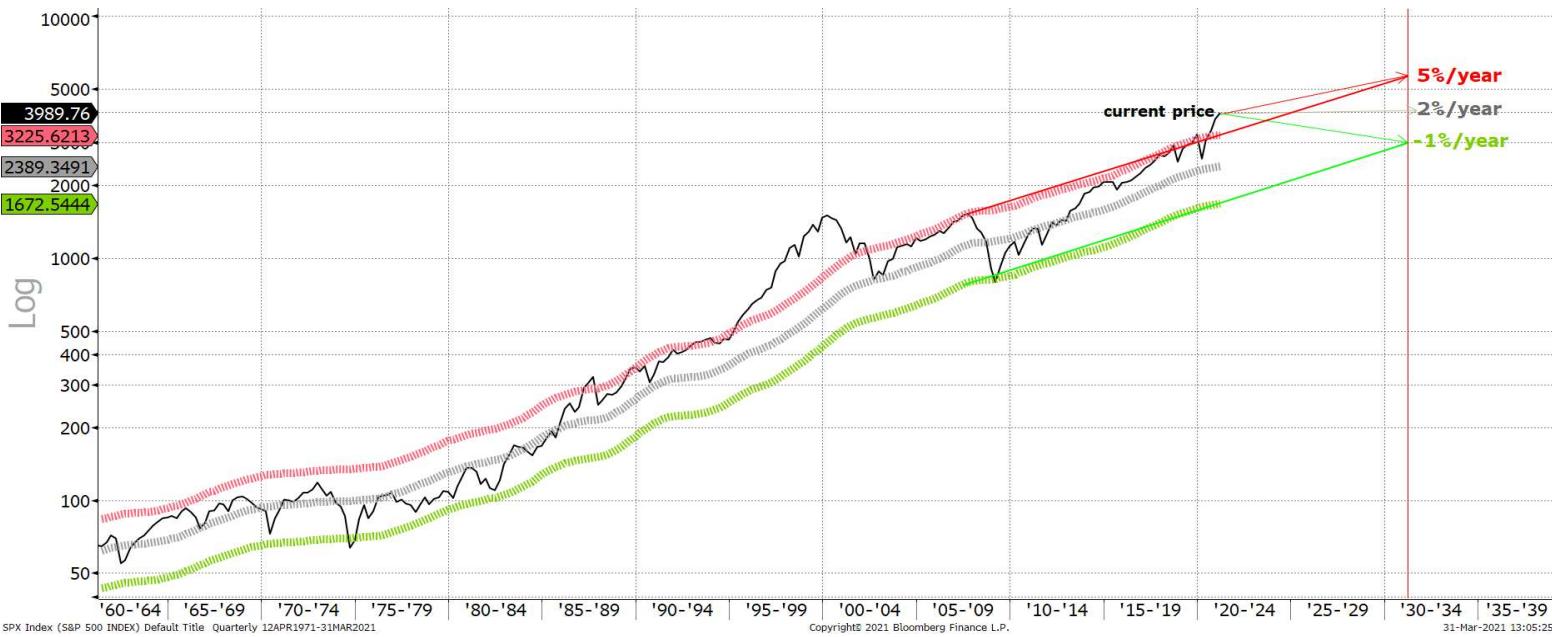
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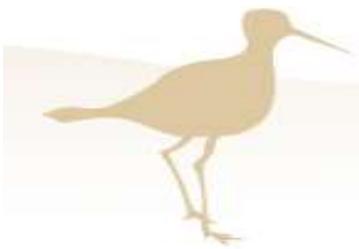


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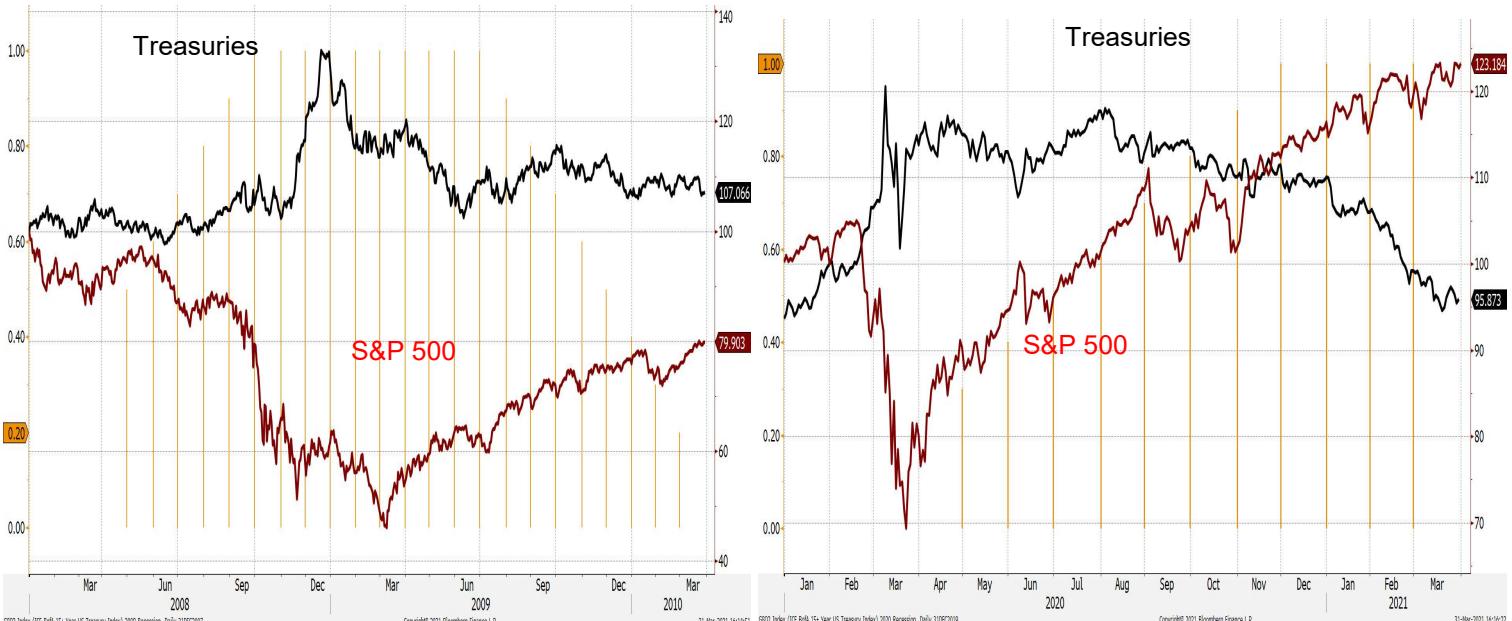
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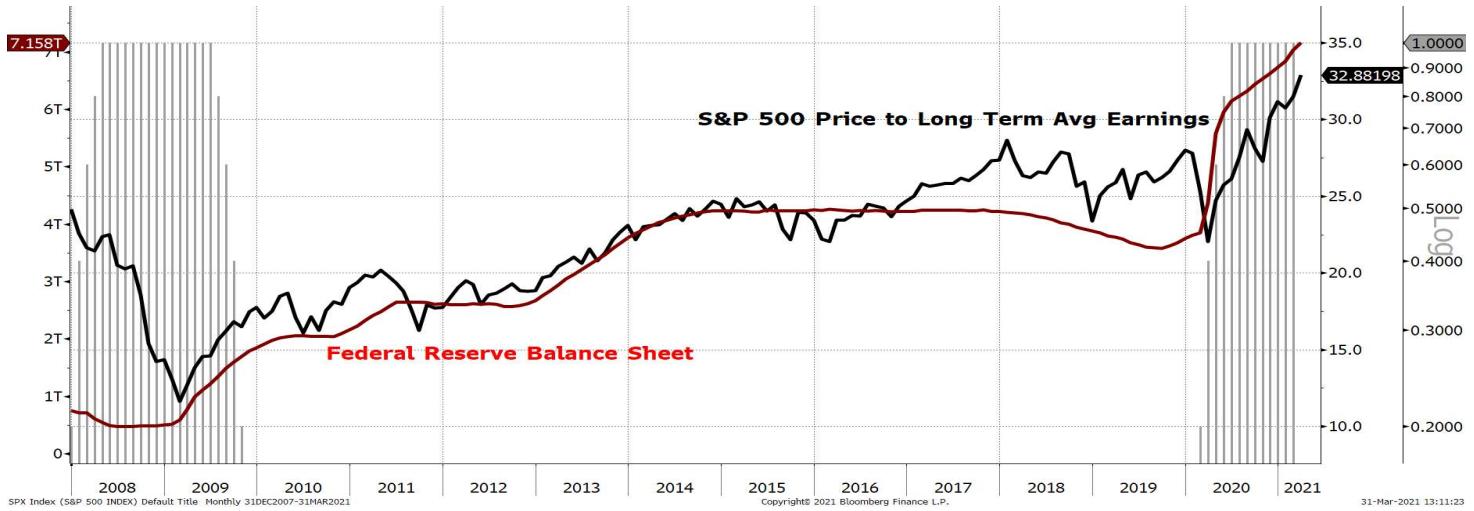
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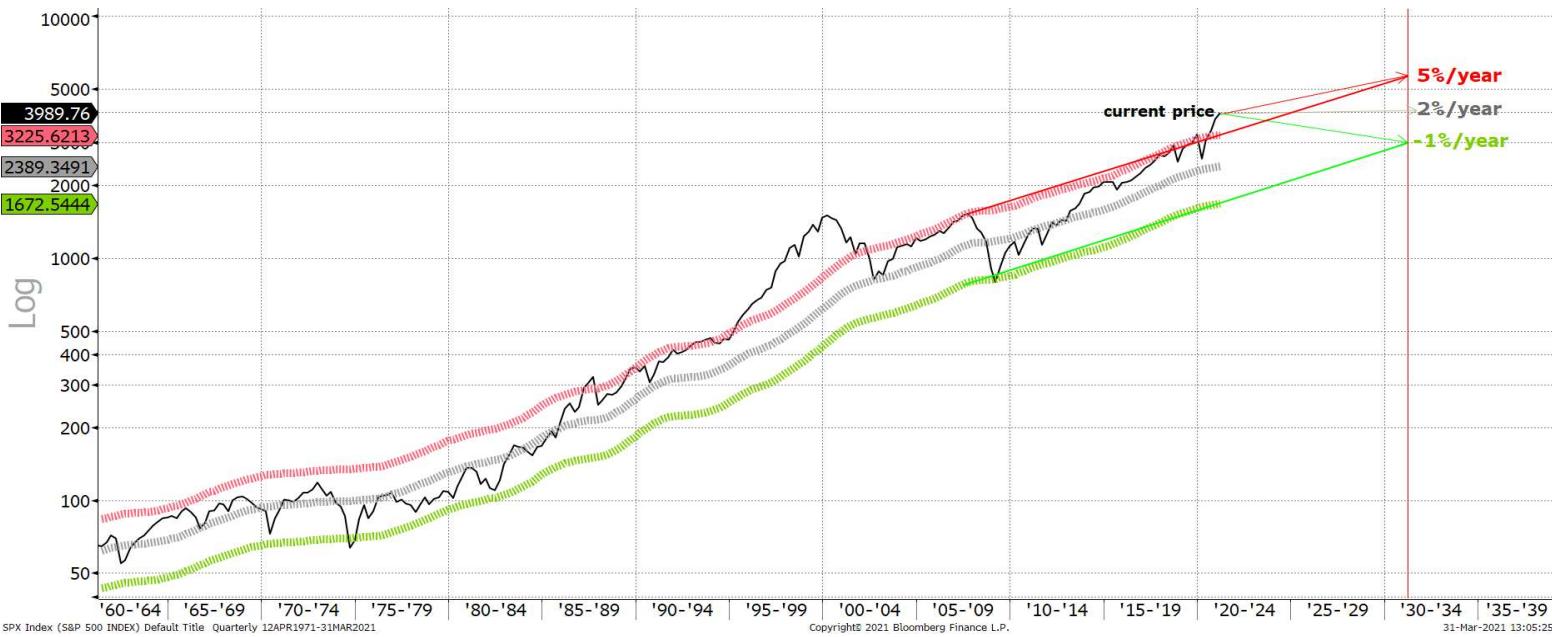
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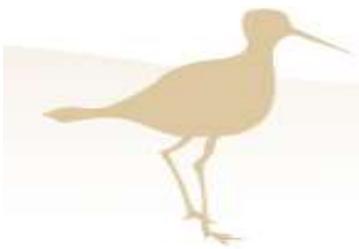


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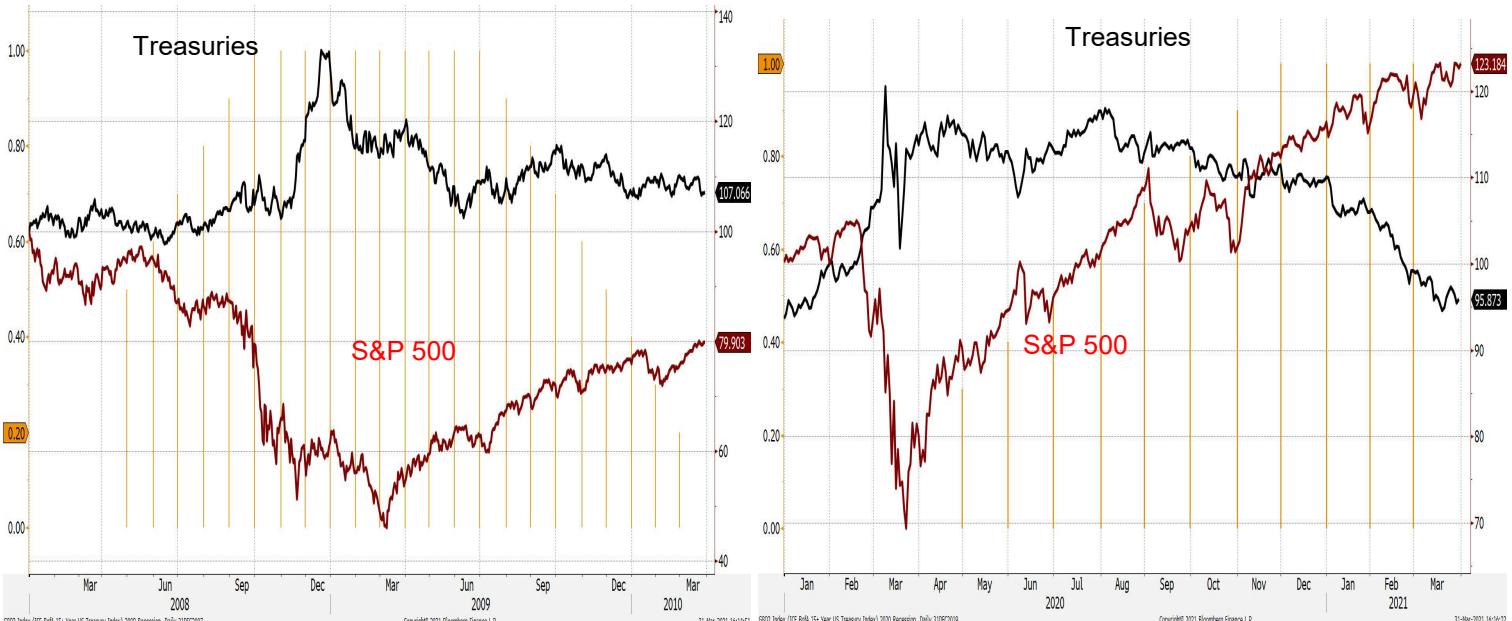
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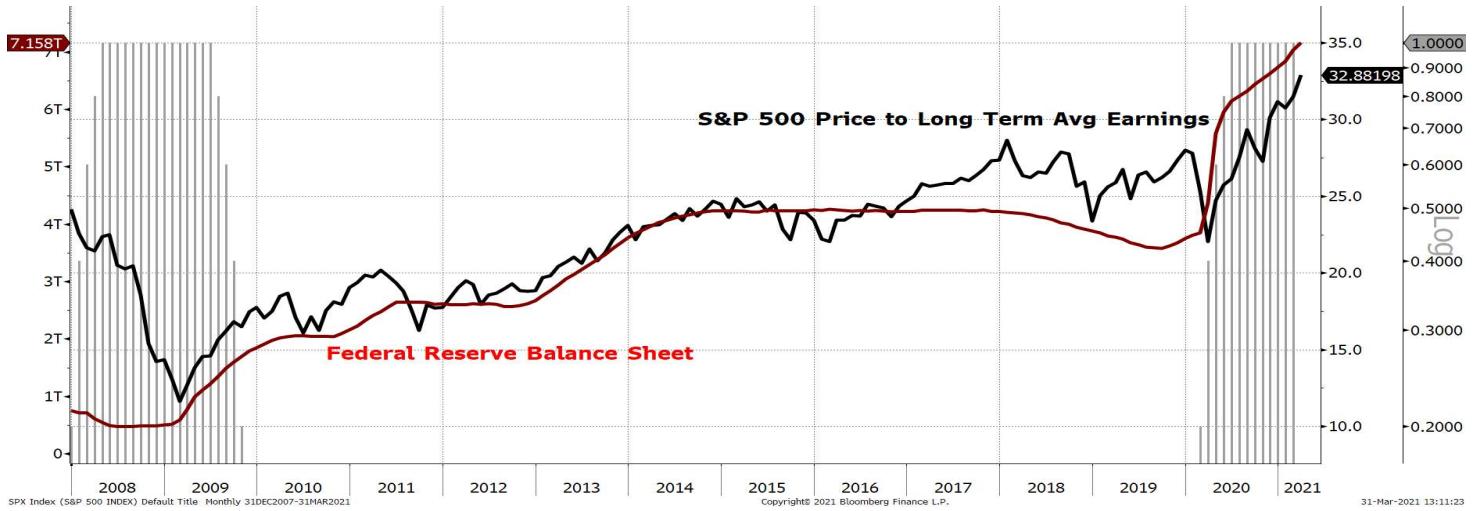
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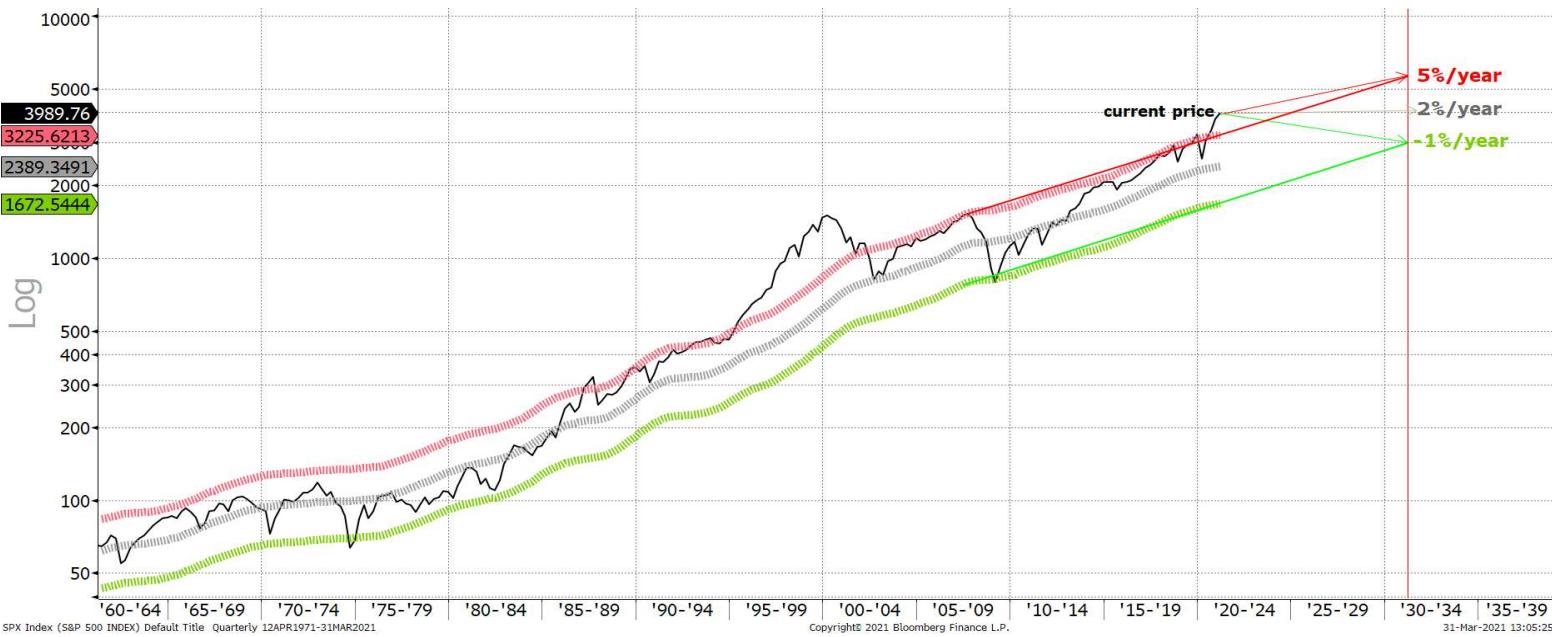
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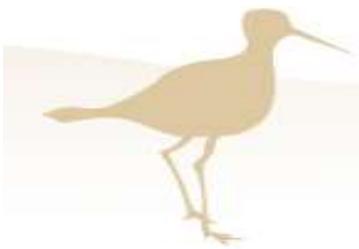


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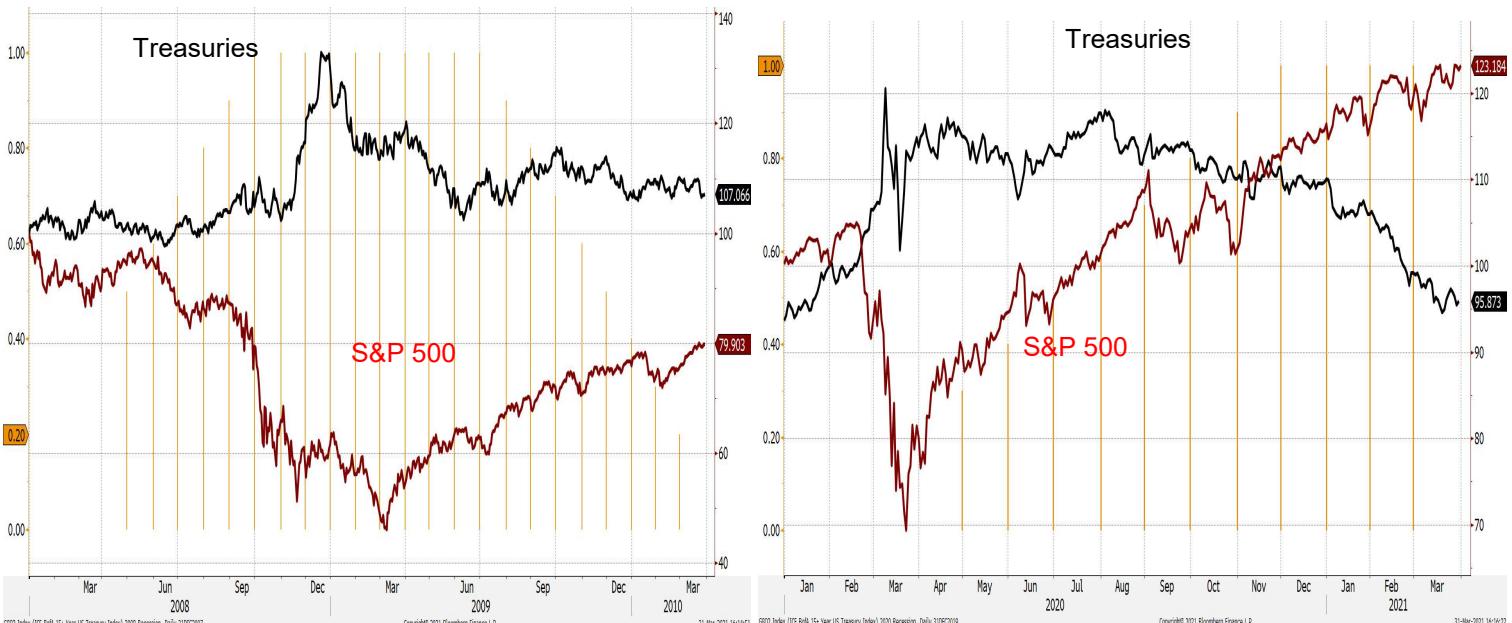
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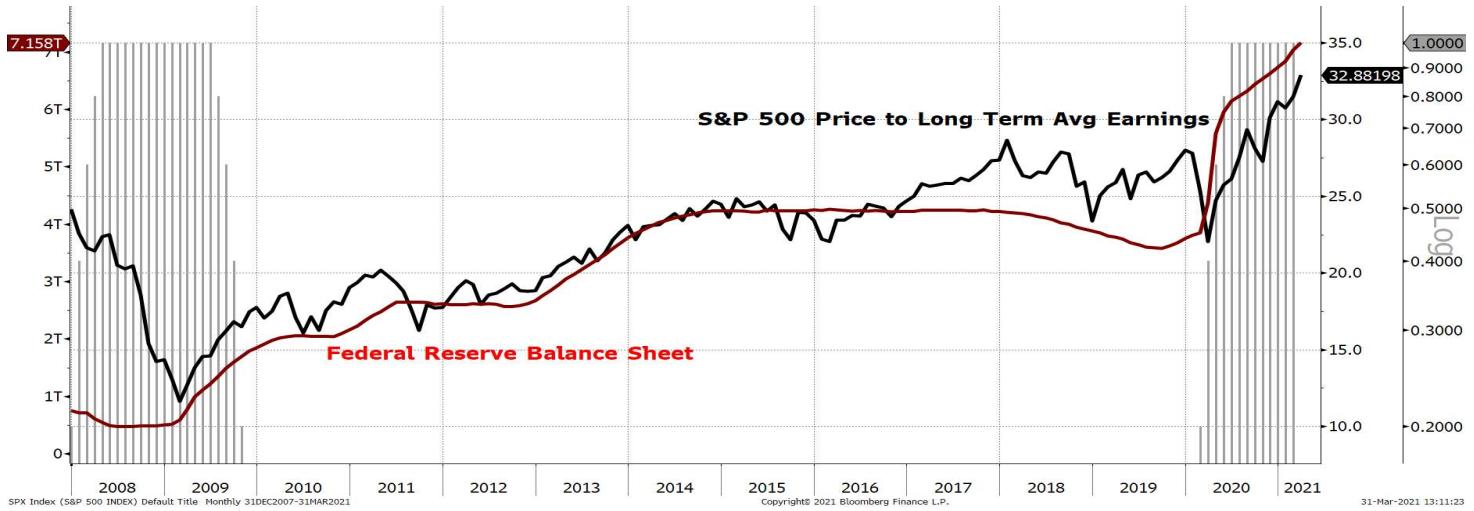
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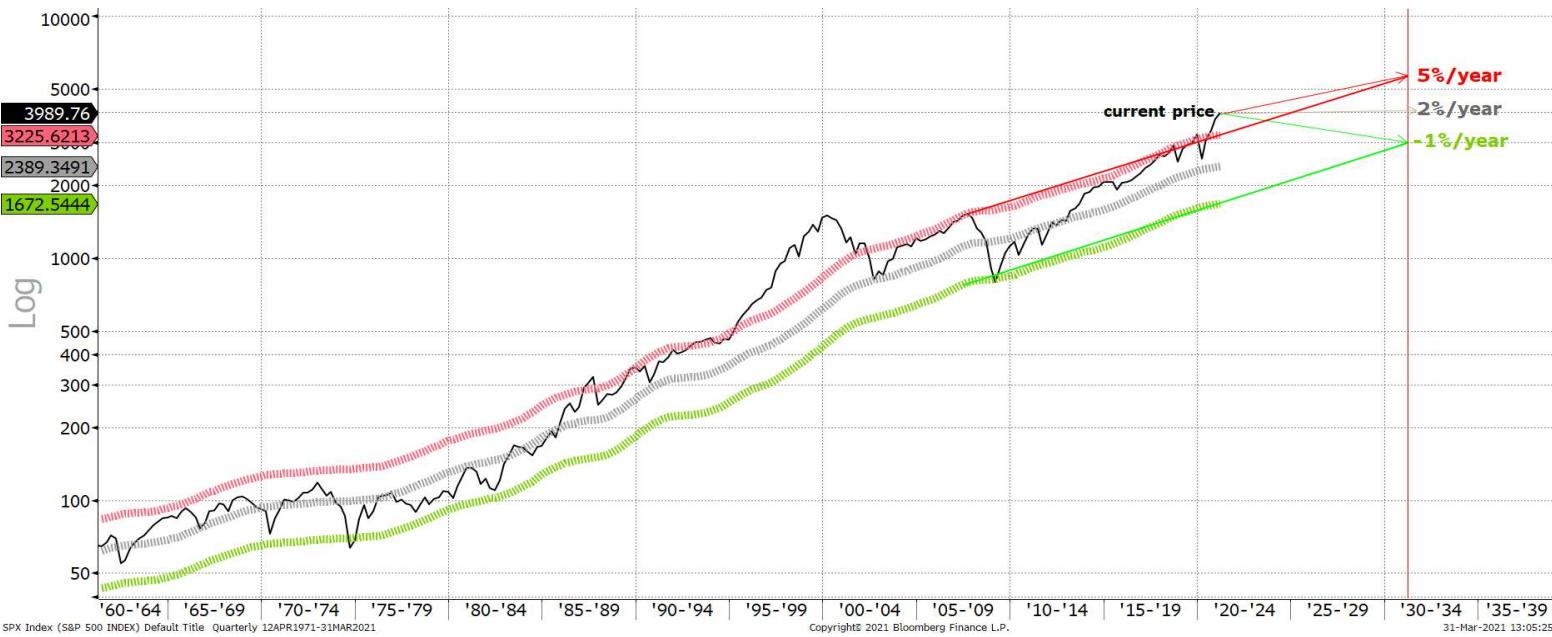
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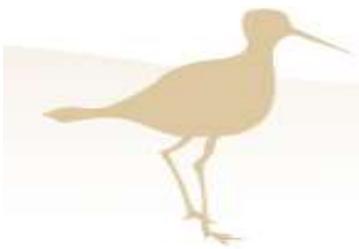


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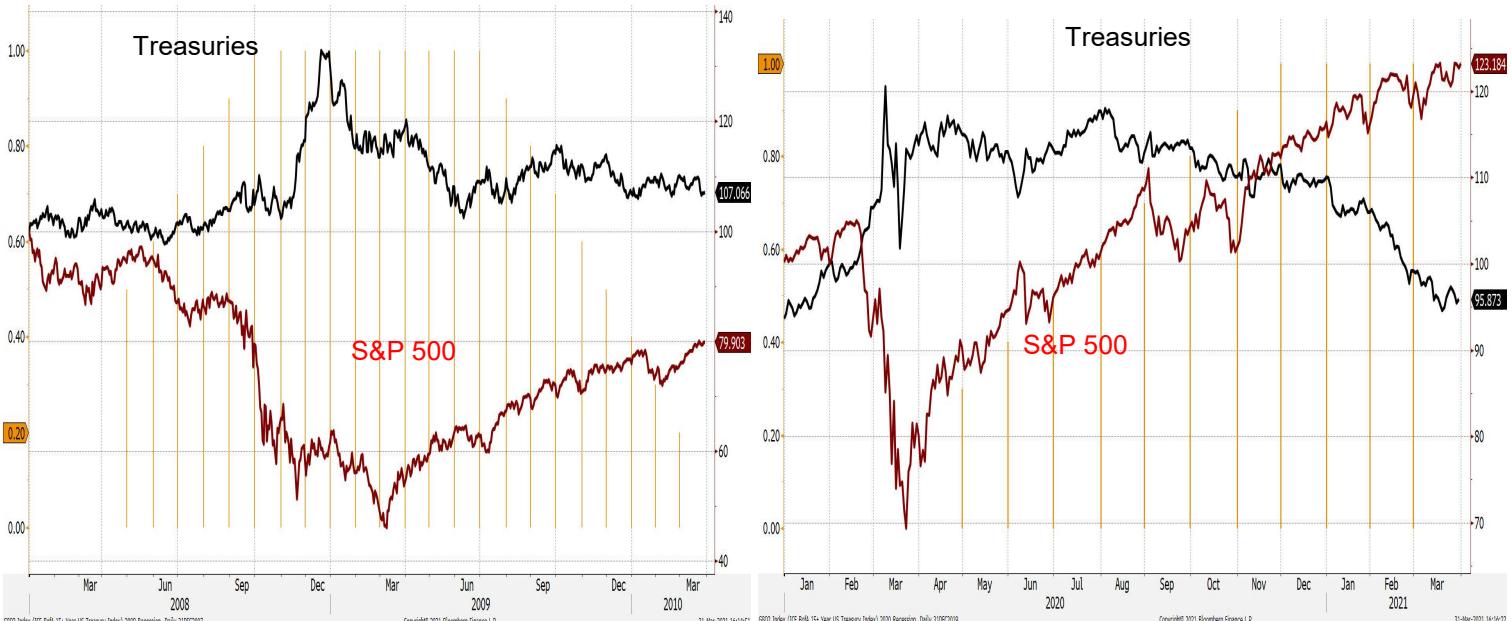
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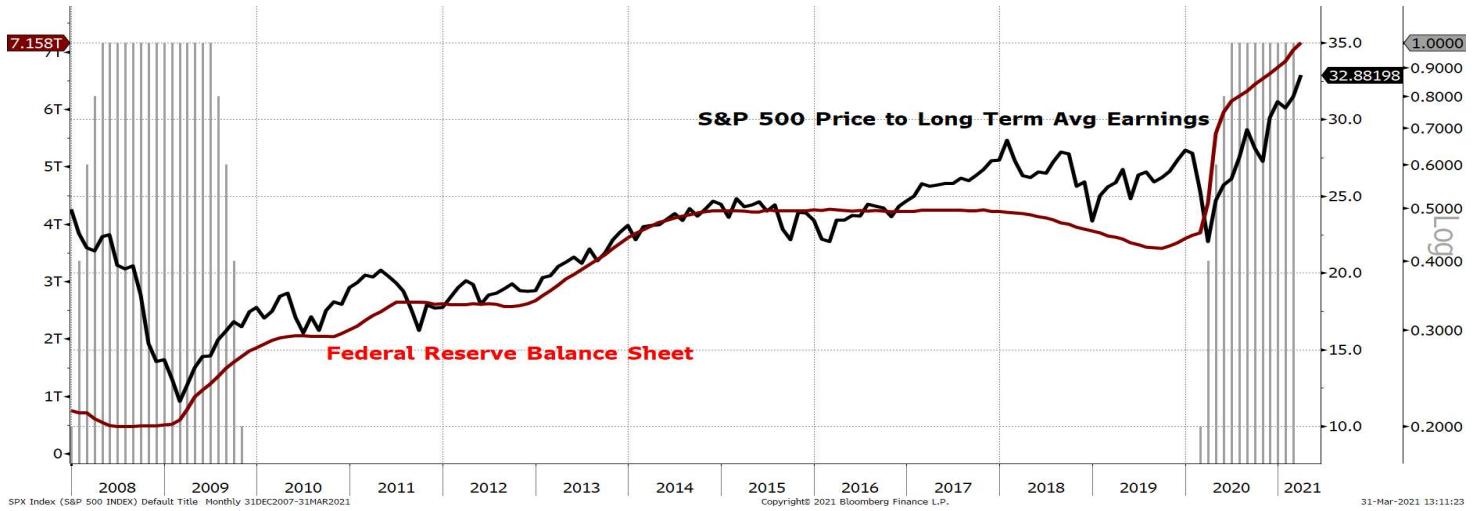
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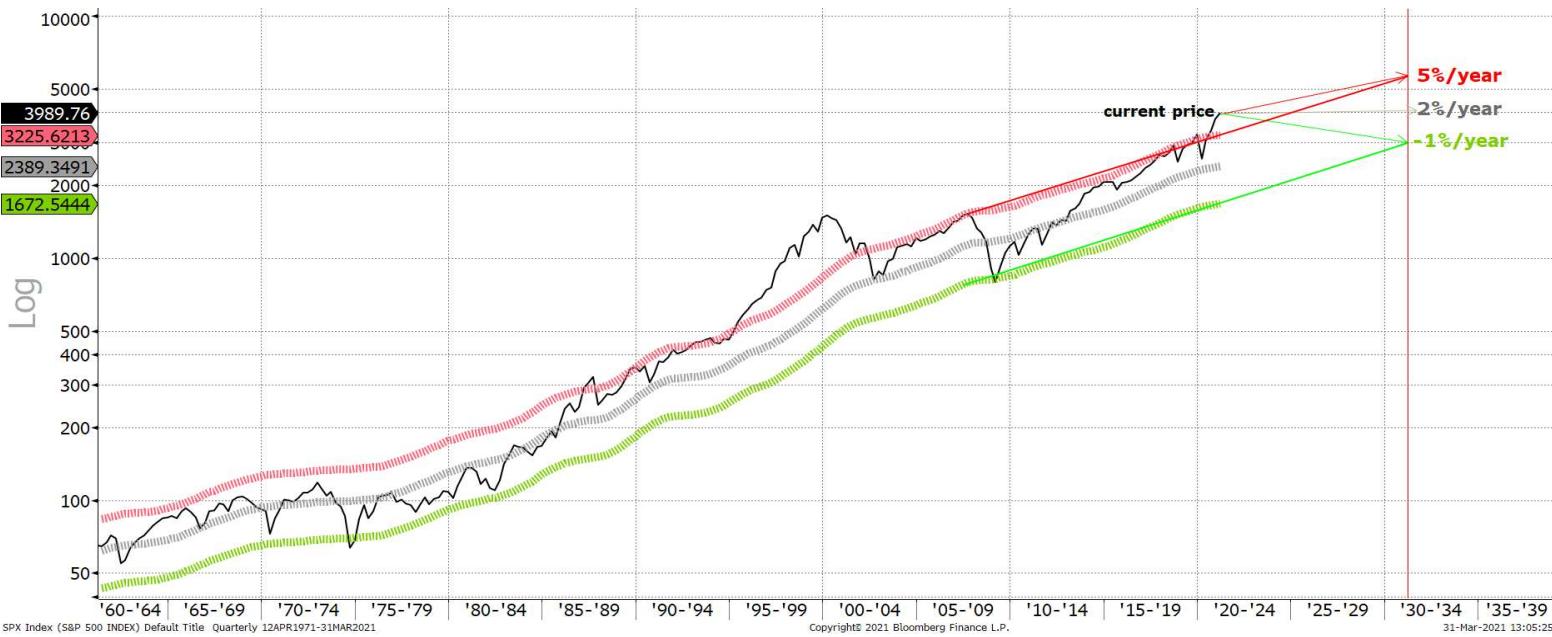
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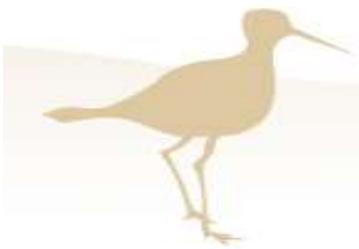


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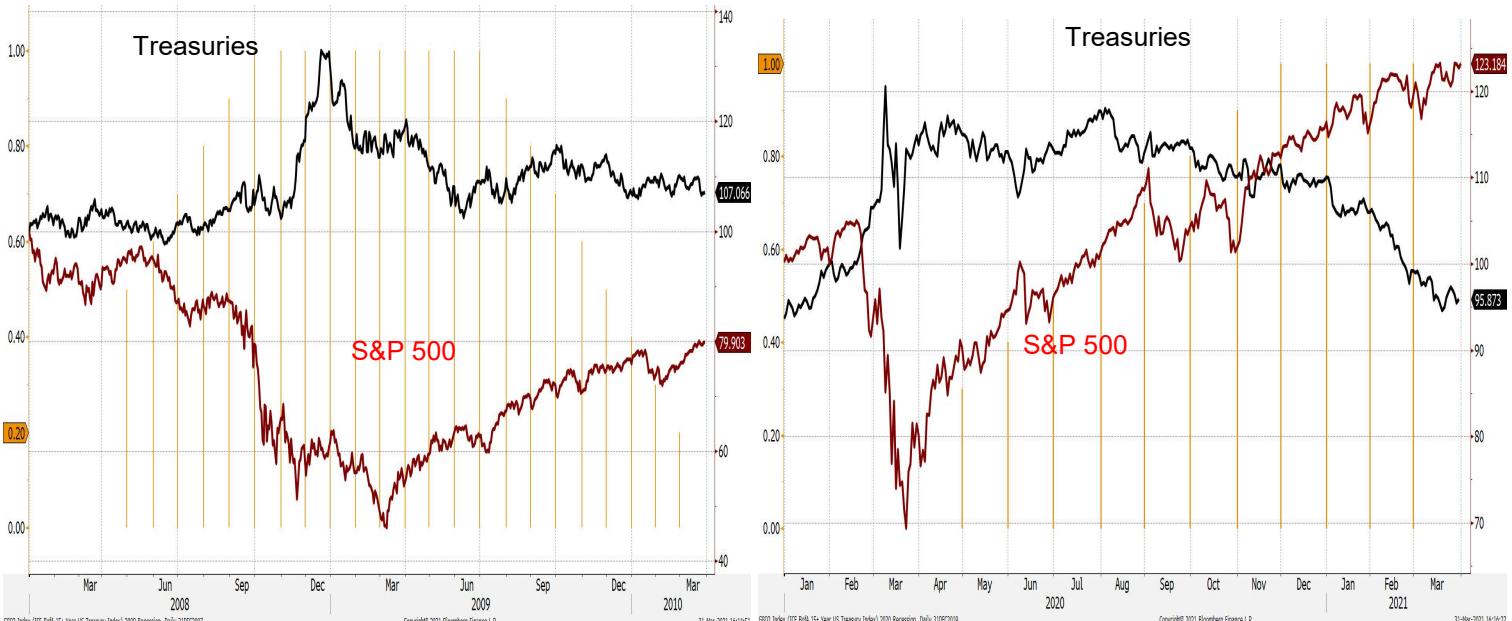
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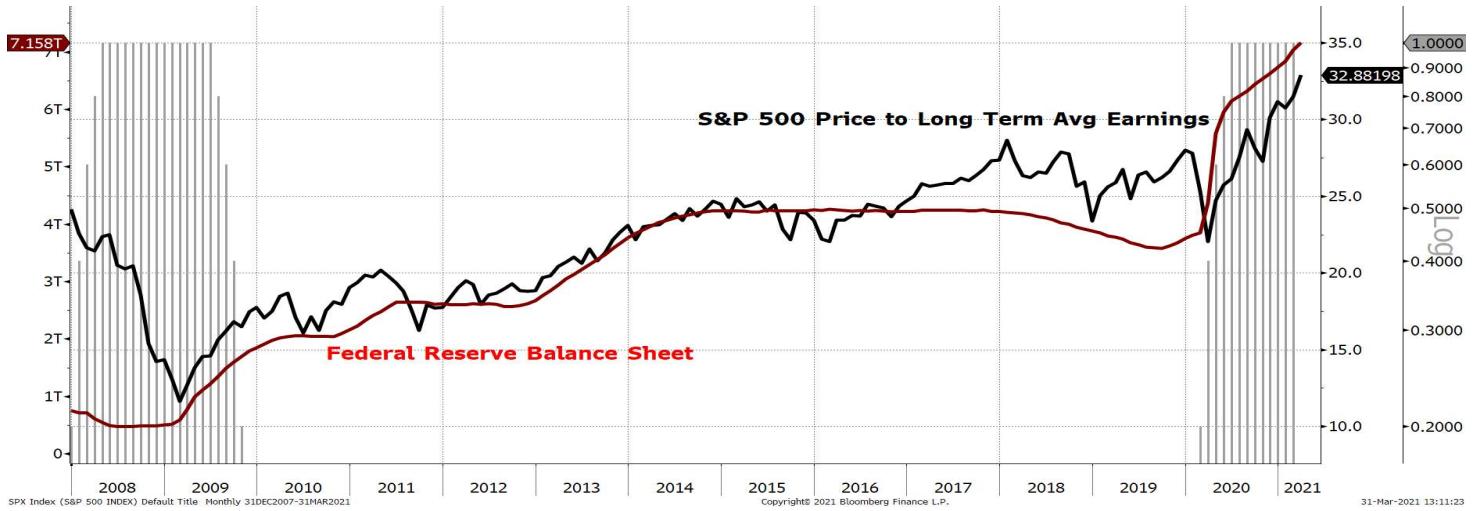
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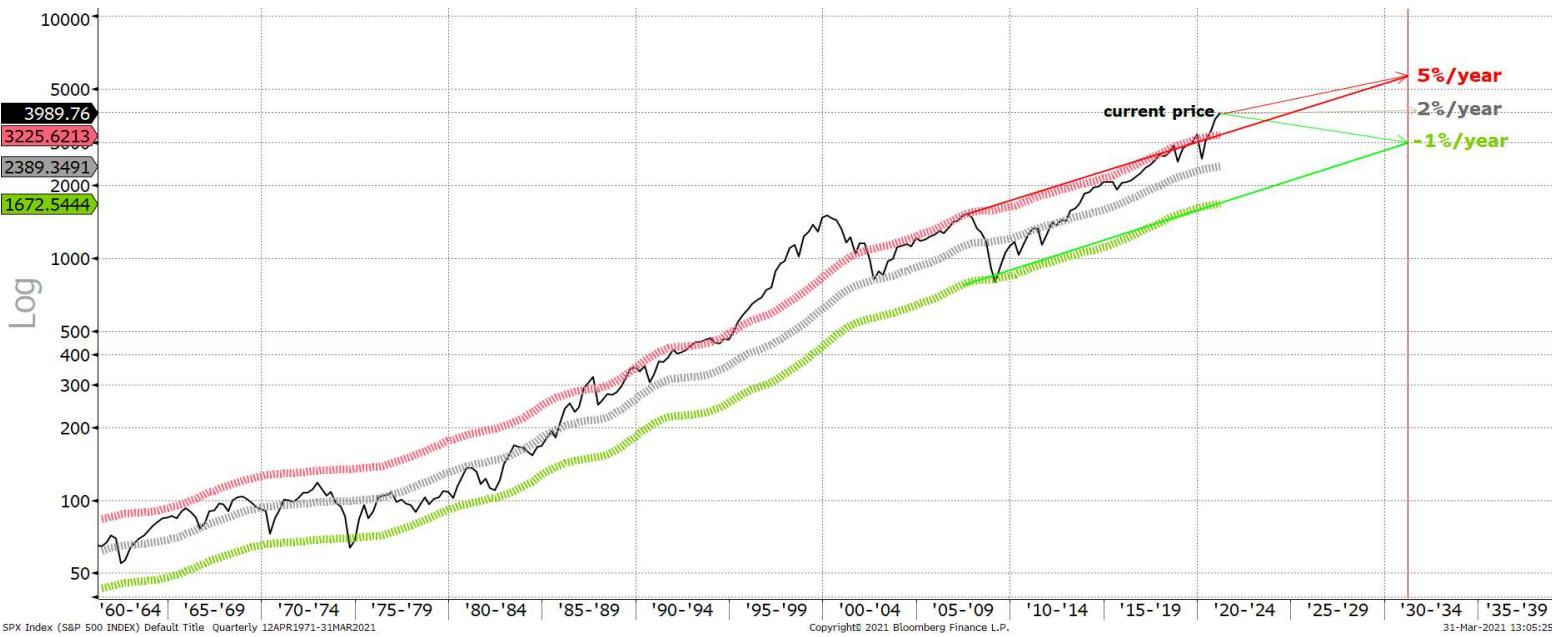
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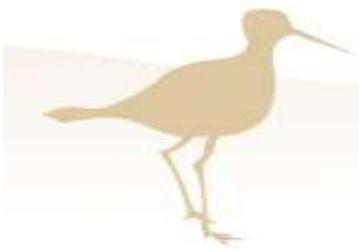


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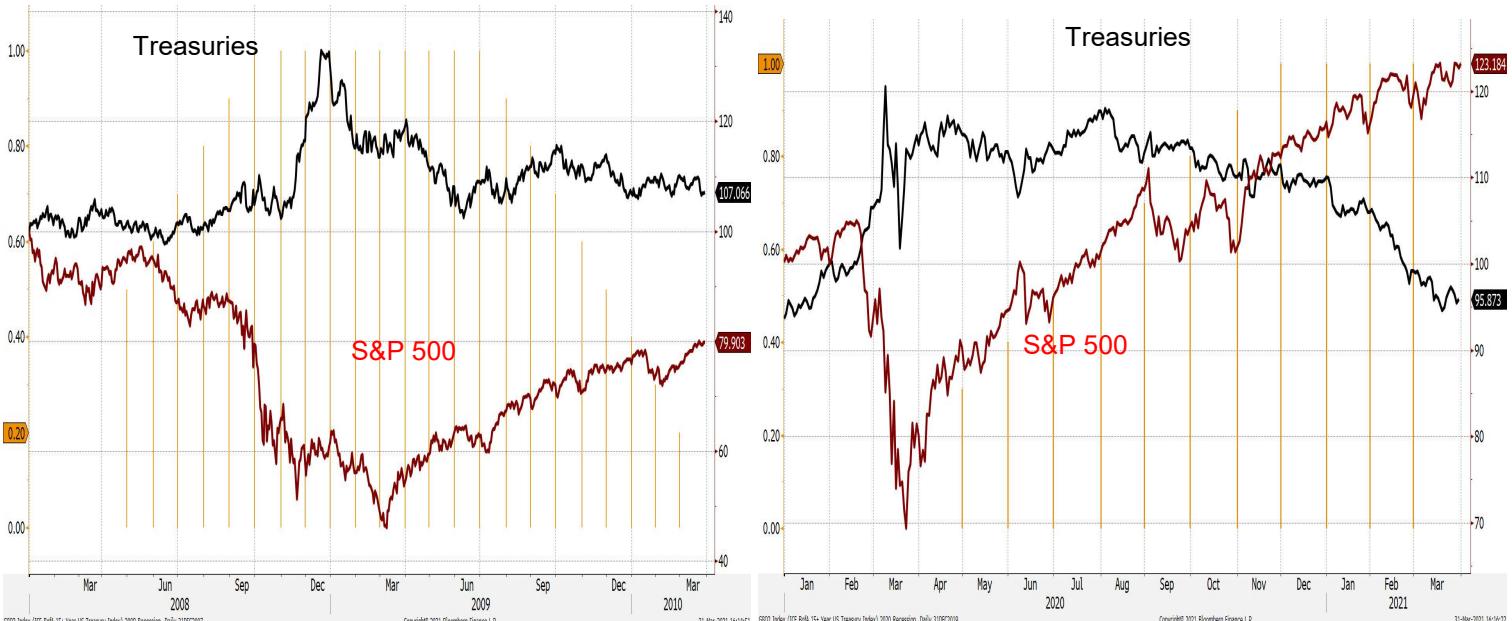
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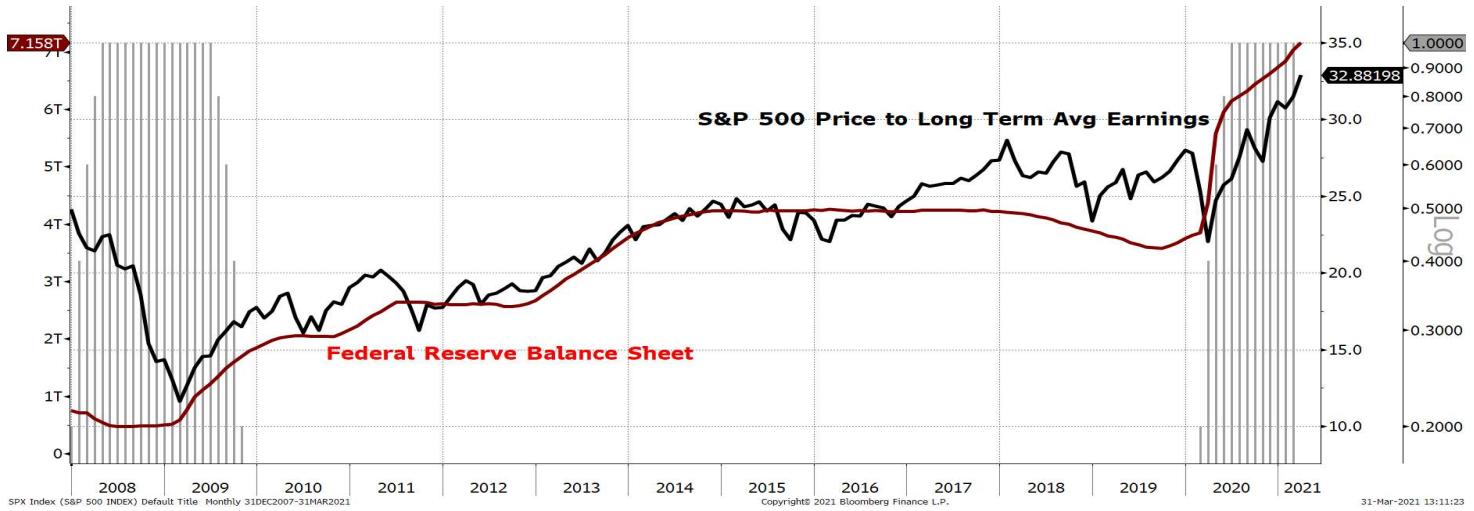
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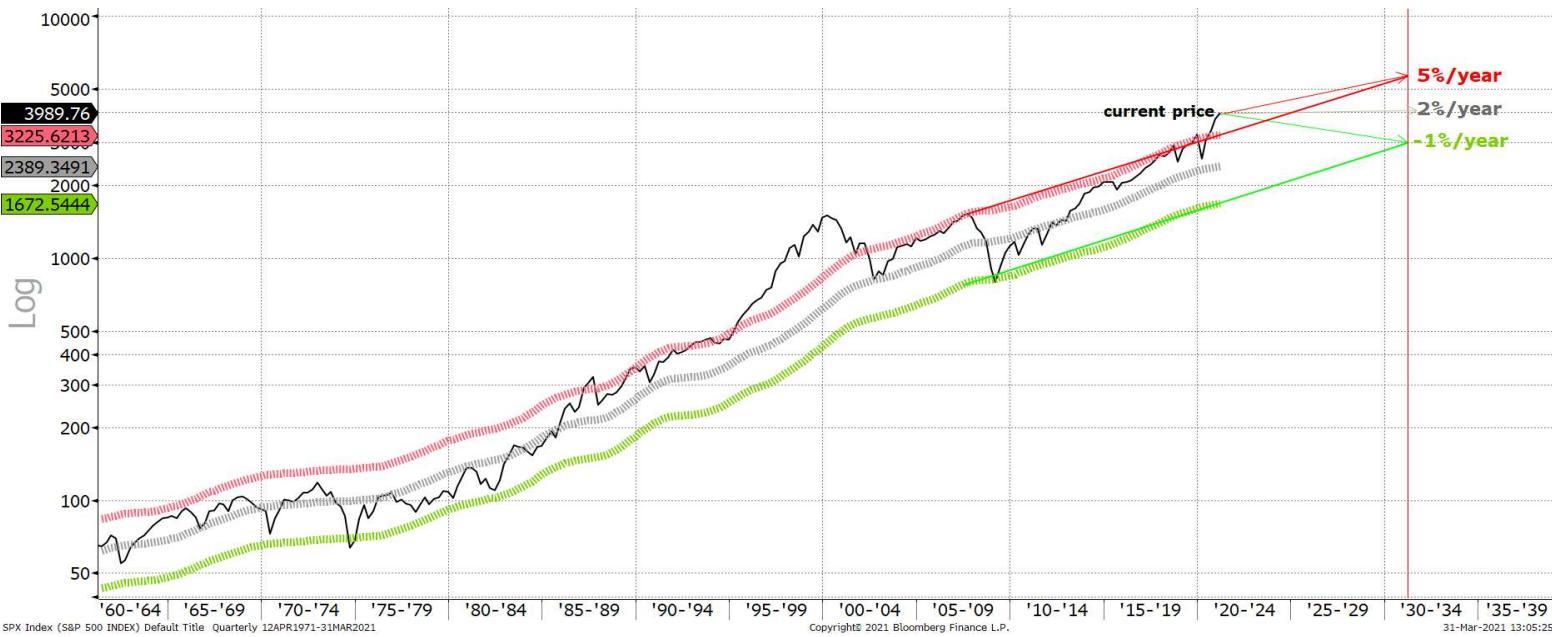
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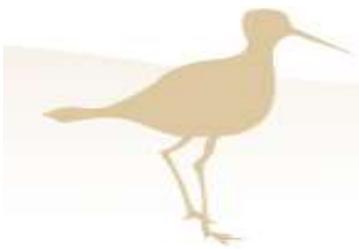


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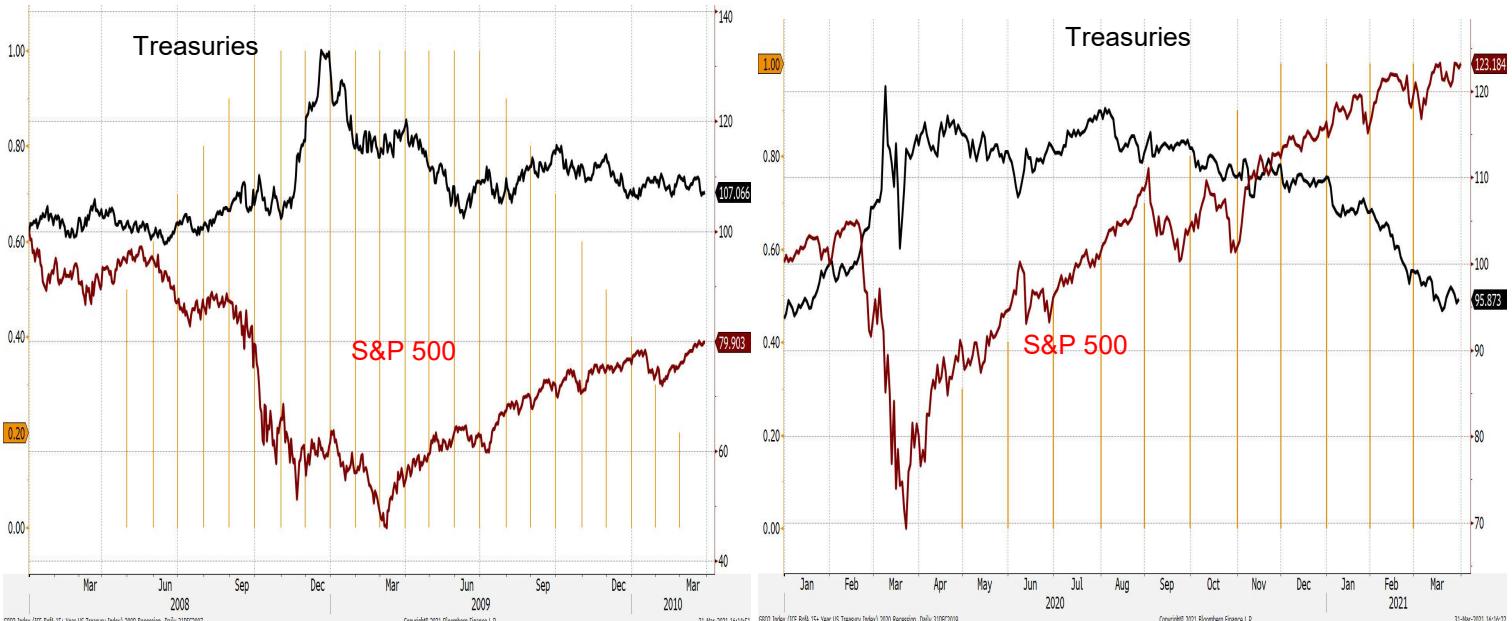
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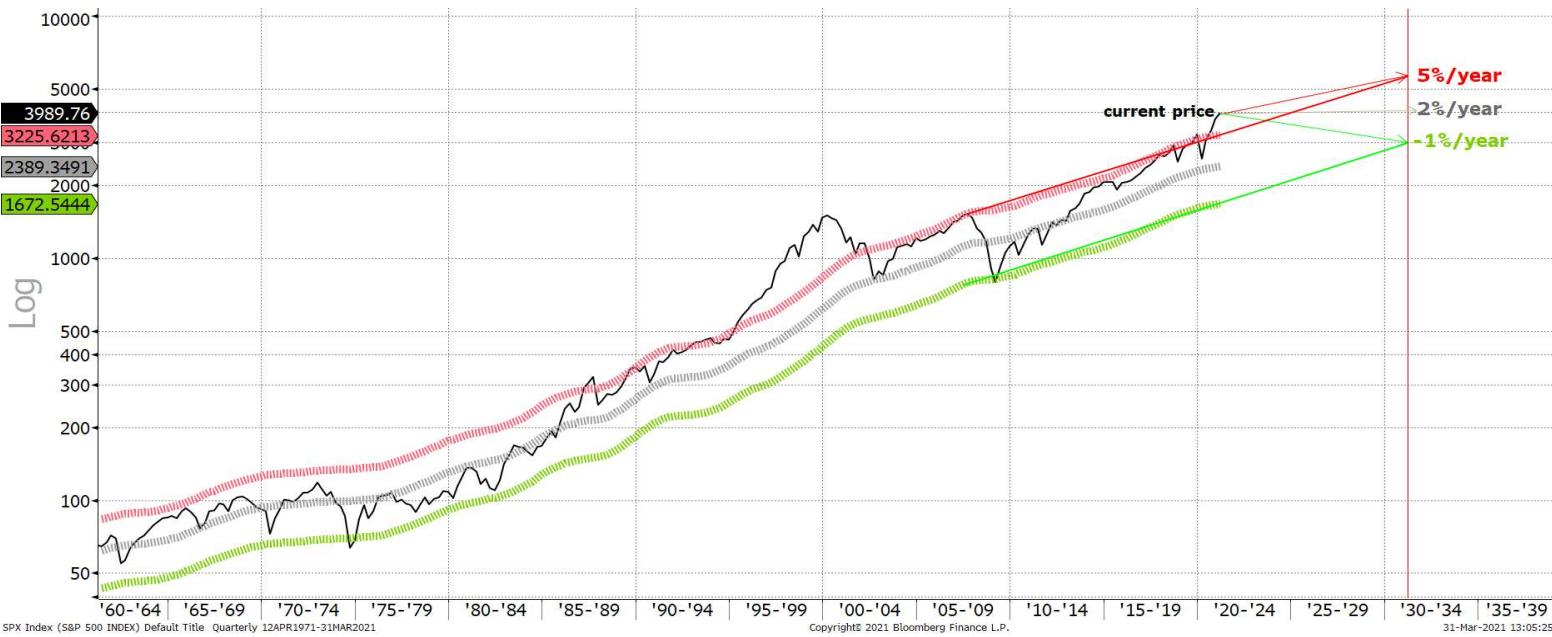
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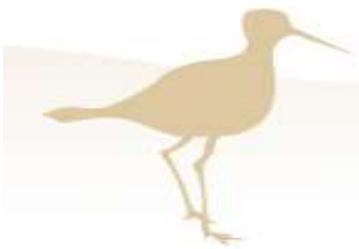


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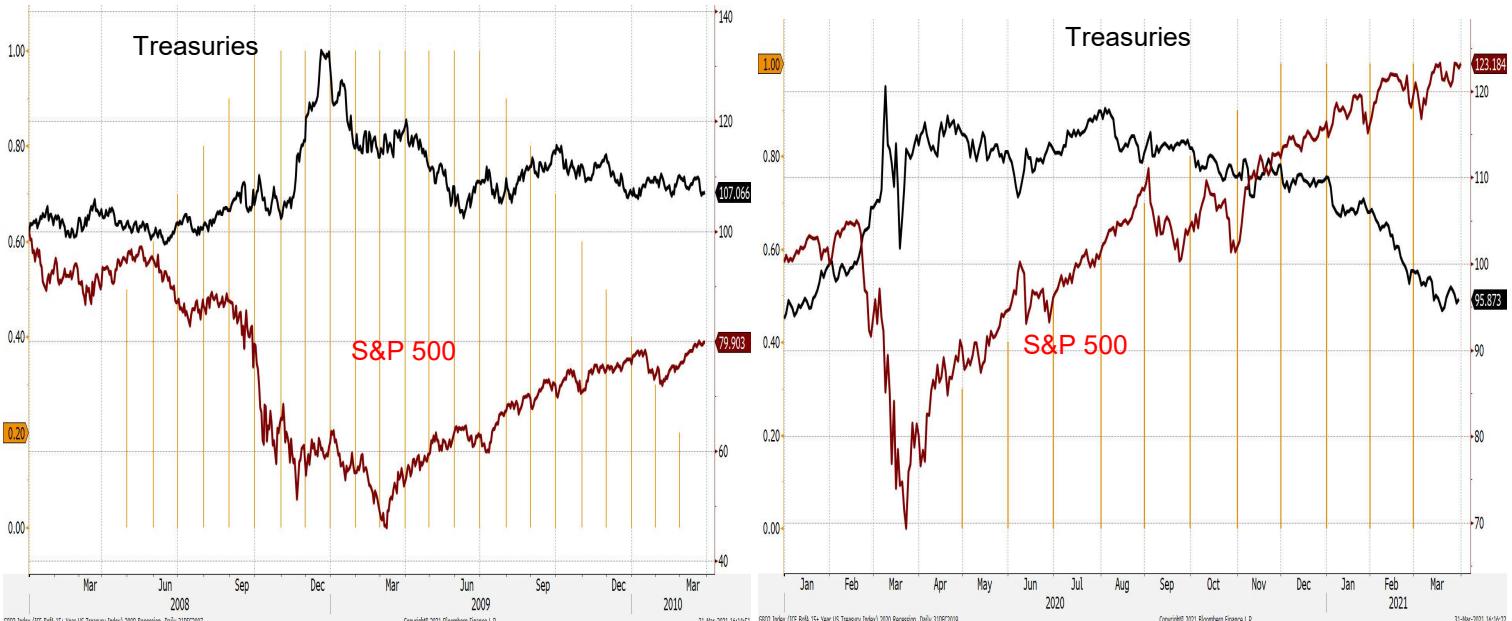
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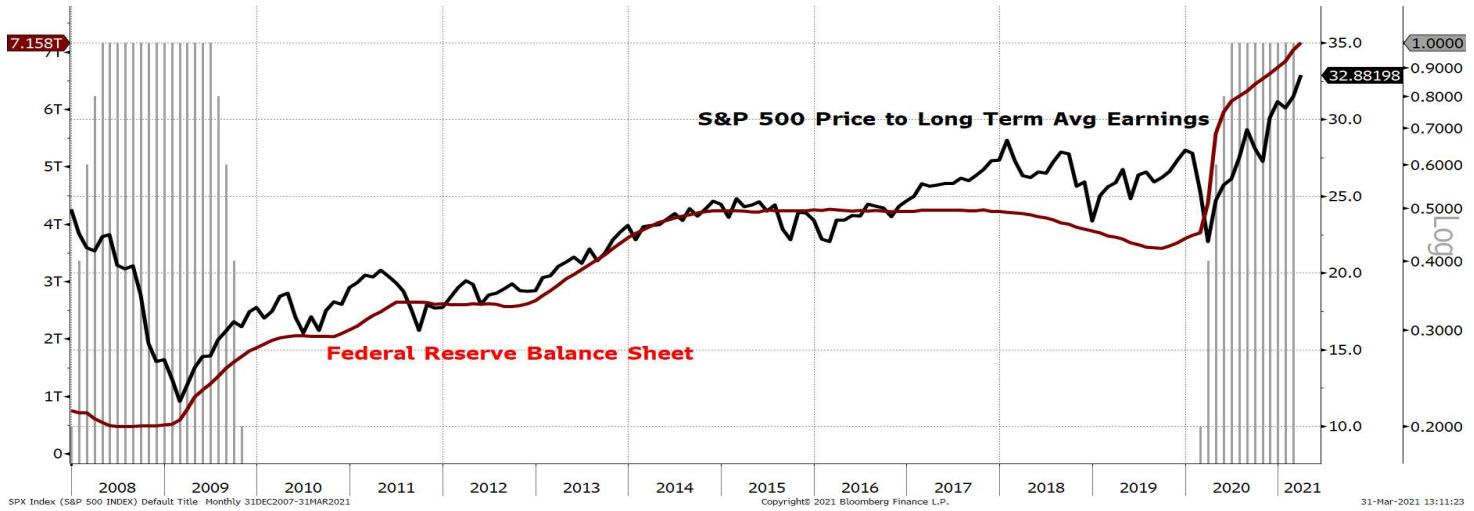
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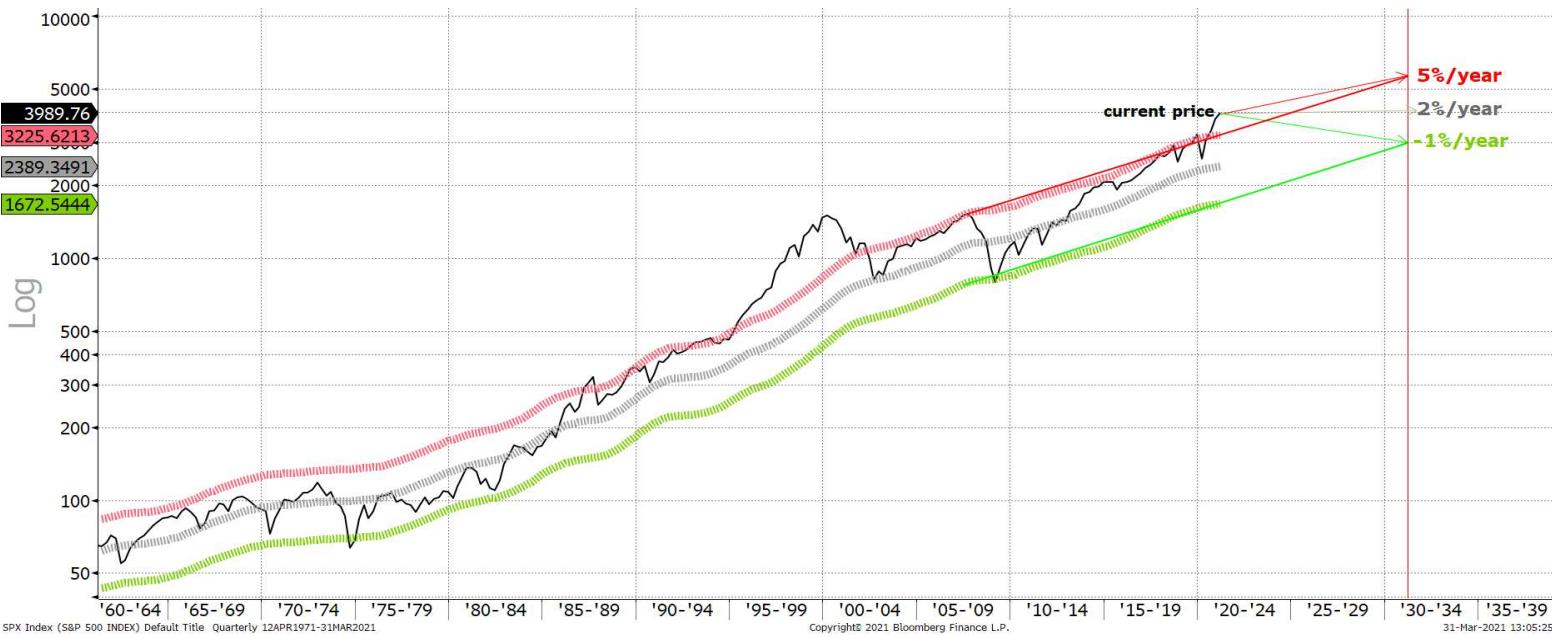
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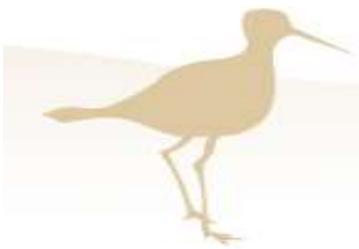


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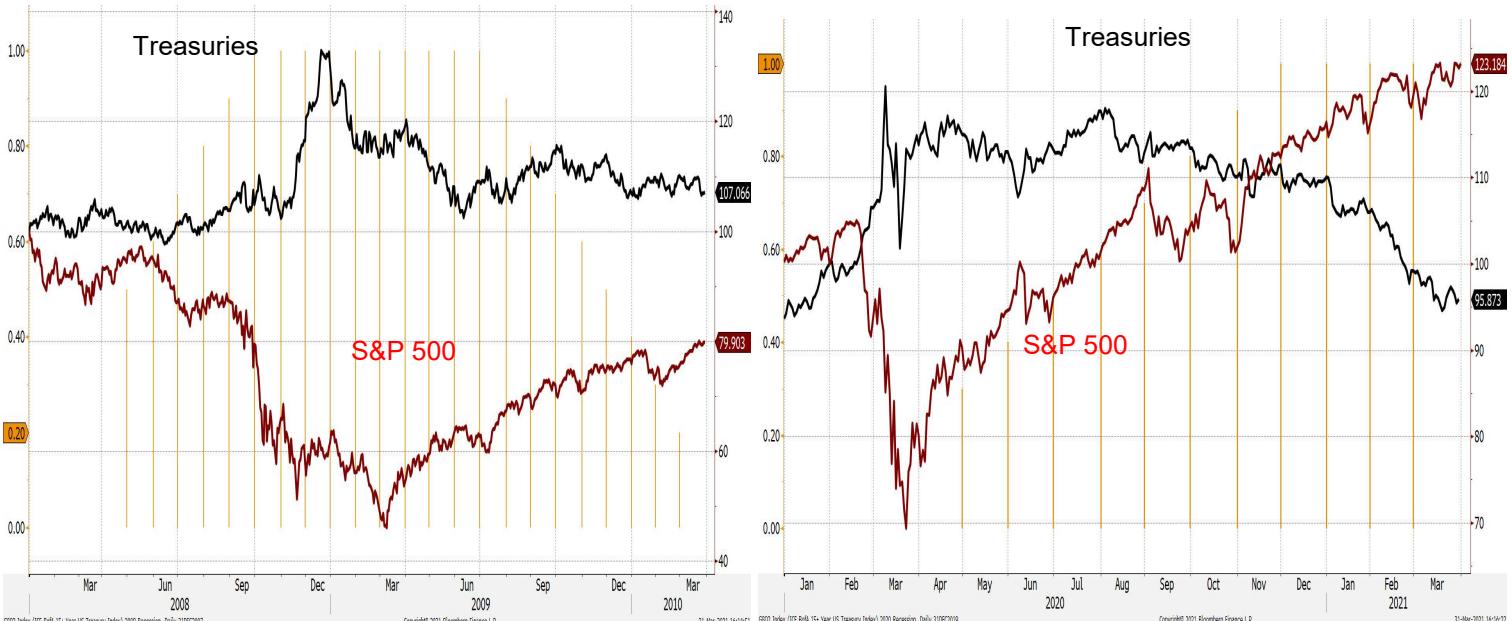
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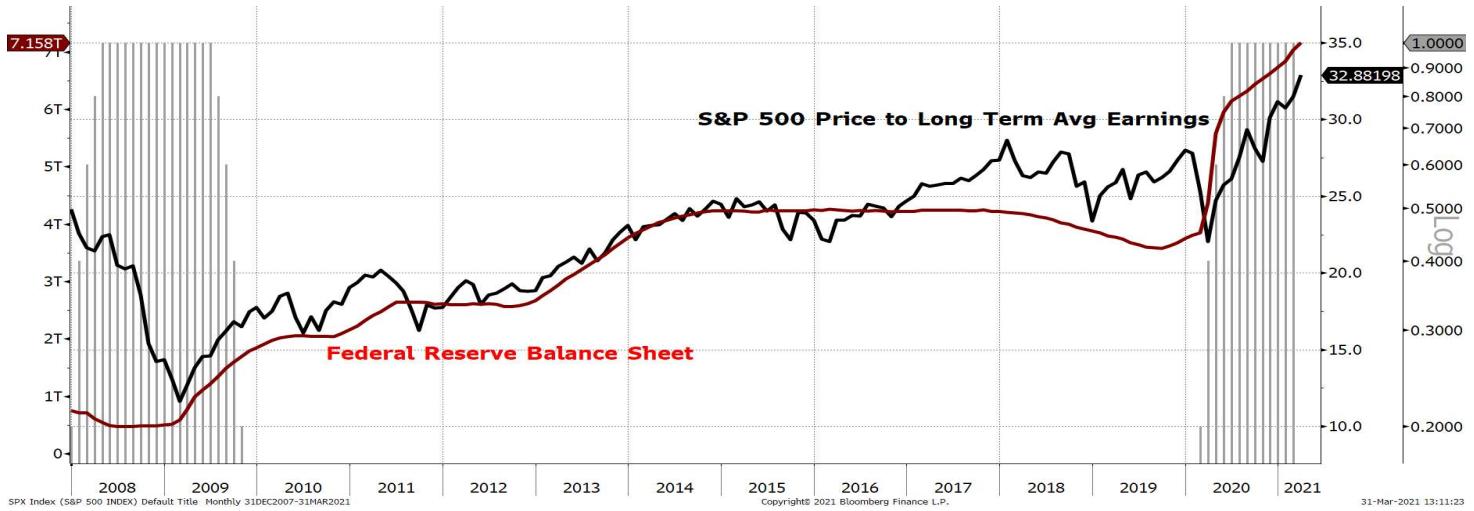
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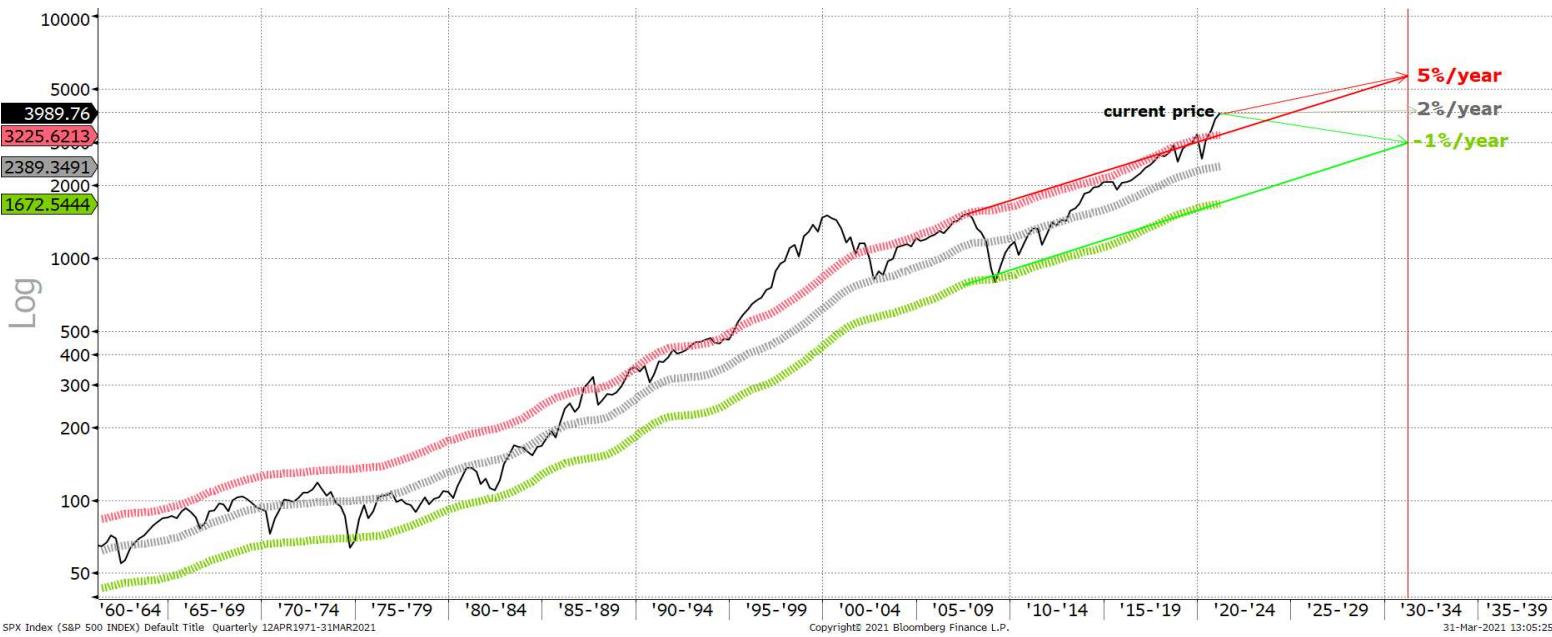
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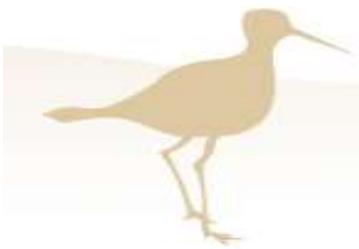


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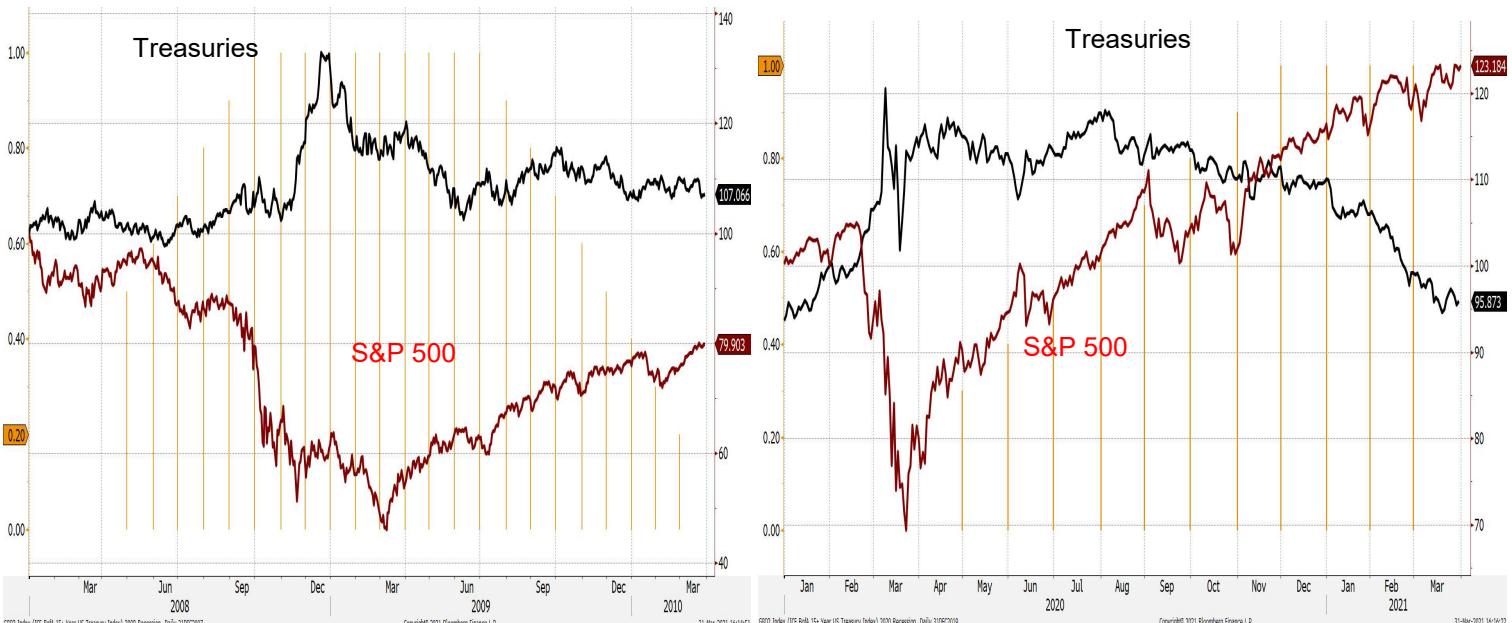
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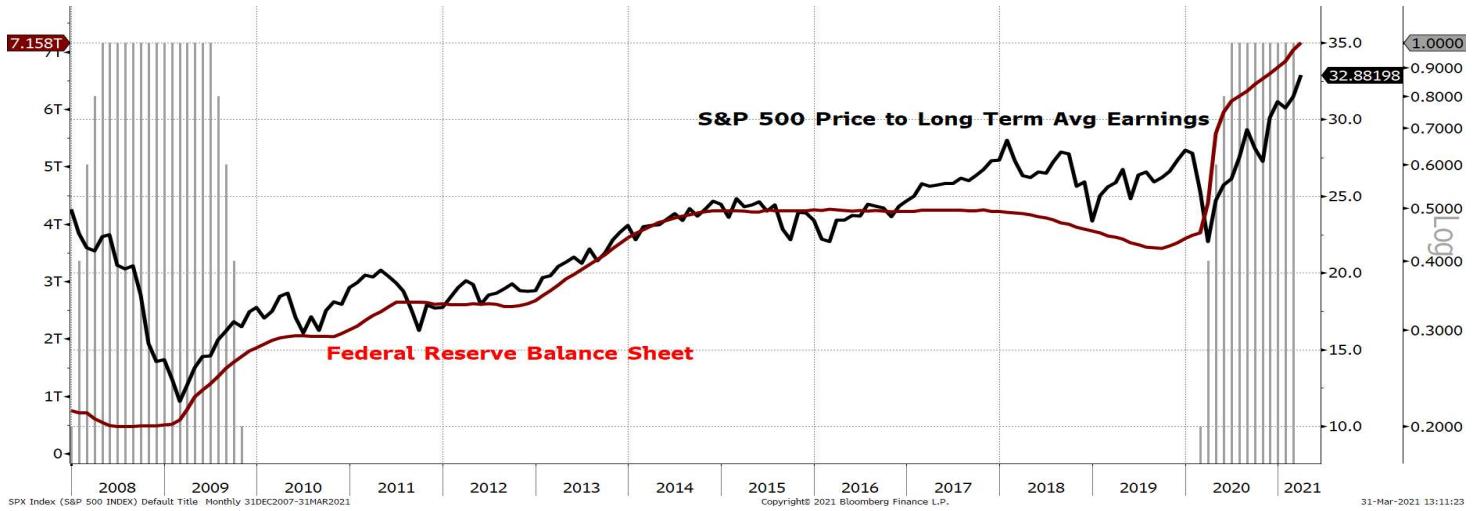
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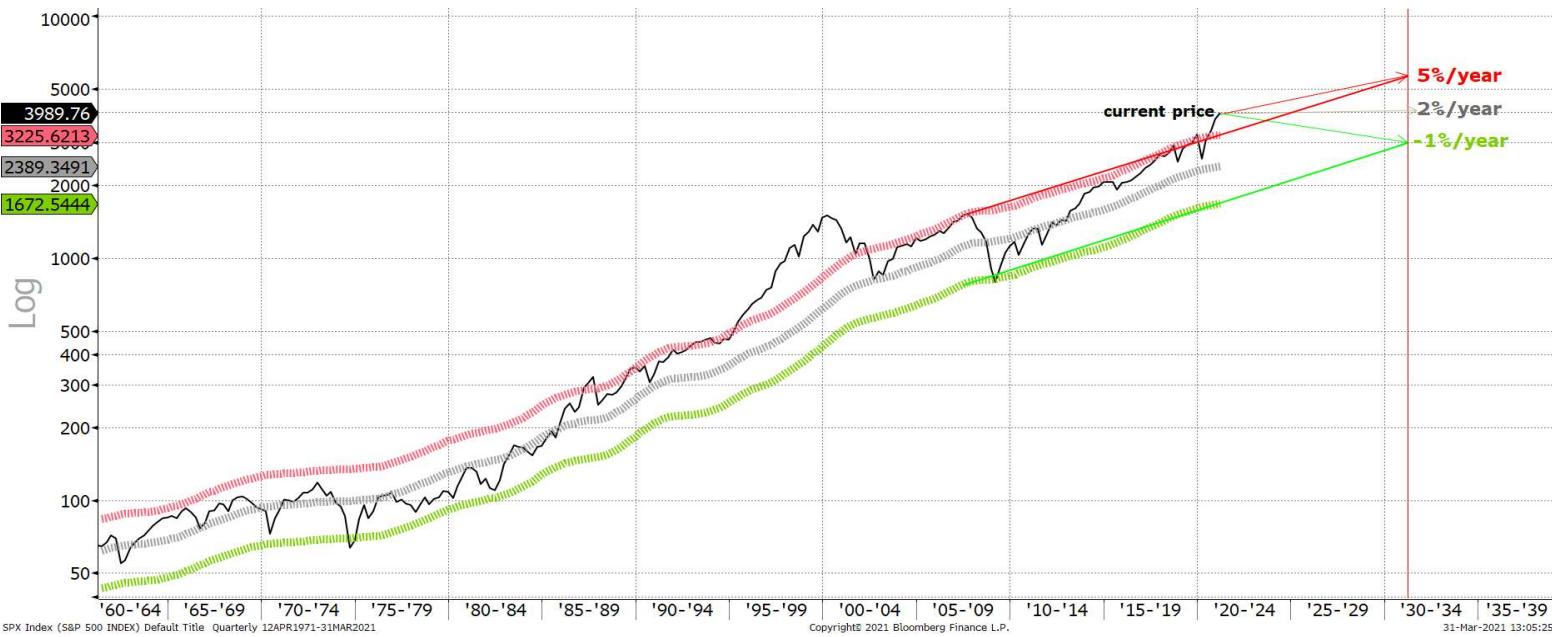
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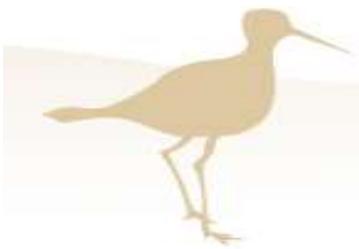


What then, will the future bring? Below is a history of the S&P 500 vs. fair value based on earnings and inflation. I've drawn simple trend lines extending out for the next ten years based on the optimistic assumption that earnings increase and inflation decreases at the same pace that they have been doing. So, possibly trend inflation will drop another 1% (to 1/2% per year) and trend earnings will go up another 90%, but even so, given the elevated level of current prices, we would only see a market that has returned between -1% and 5% per year depending upon where in the normal trading range that we find ourselves. While we will likely see even higher valuations this summer and we do own some stocks where there are compelling stories and good values, I would not add significantly until we see better prices or I manage to find other companies that make sense based on their balance sheet, income statement and prospects instead of their tweets and memes. Once most people are vaccinated, there's a lot of pent up demand to be unleashed and the Fed might need to reverse sooner than expected.



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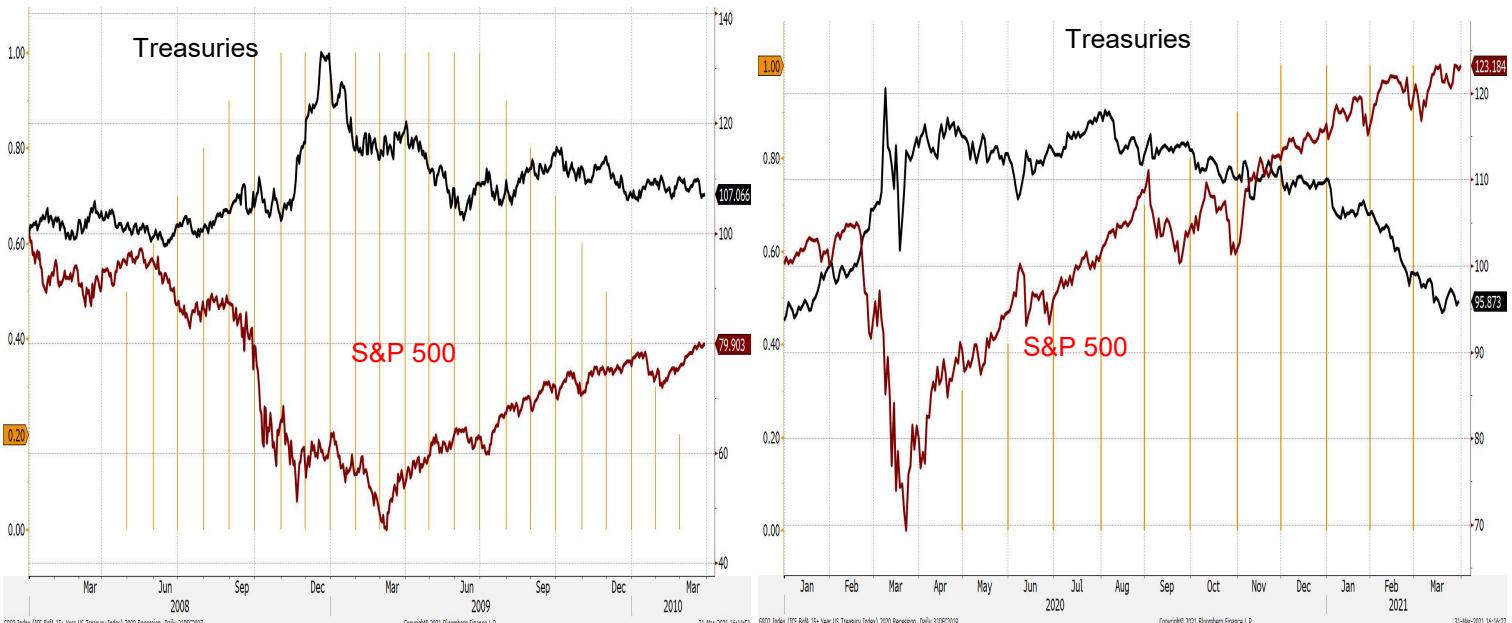
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Godzilla vs. Kong

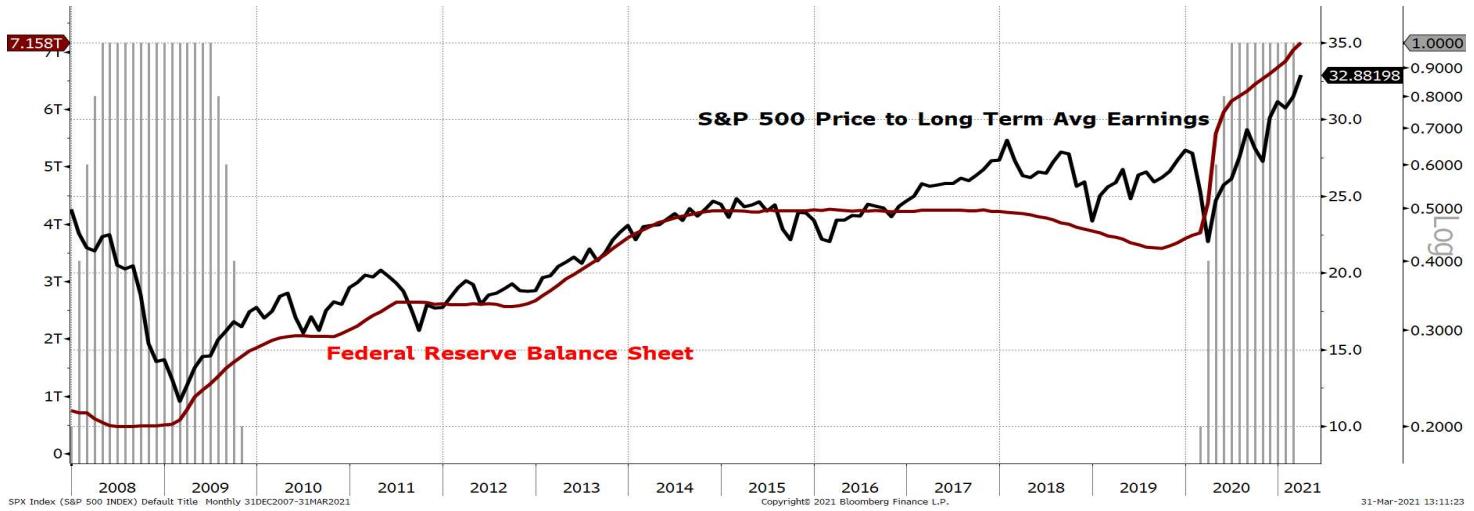
The enormity of the 2020 recession is hard to exaggerate. With the U.S. economy contracting by **\$2.2 trillion** (4 x's the drop in 2009) and 14 million jobs lost (compared to 8 million in 2009), the world suffered an economic shock unlike anything since the

Great Depression. While GDP had already peaked in 2019, the pandemic related lockdowns did more damage in two months than the last three recessions combined. And yet, a year later while 9 million people are still out of work, S&P earnings are down 33% (vs. -45% in 2009) the market is up 23% from its pre-recession peak. How did the markets manage to benefit while the economy suffered? Huge, huge government stimulus – over \$12 trillion (\$120,000 per household) committed, **\$7 trillion spent**. The Federal Reserve injected \$3 trillion into the economy last year by buying securities in the financial markets including “too big to fail” bond funds, municipal bonds, mortgages and agencies, all financed by the sale of Treasury bonds. The US government has authorized another \$6 trillion in direct aid to affected companies and individuals and added stimulus spending. As a result, long term corporate borrowing rates are half of what they were in 2018, mortgage rates have dropped by a third and even junk bond financing costs less than 4.5%. So, while we wait for a return to normal, with employment years away from recovery and now with deficits the largest since WWII; market valuations have been pushed higher and higher to record levels.

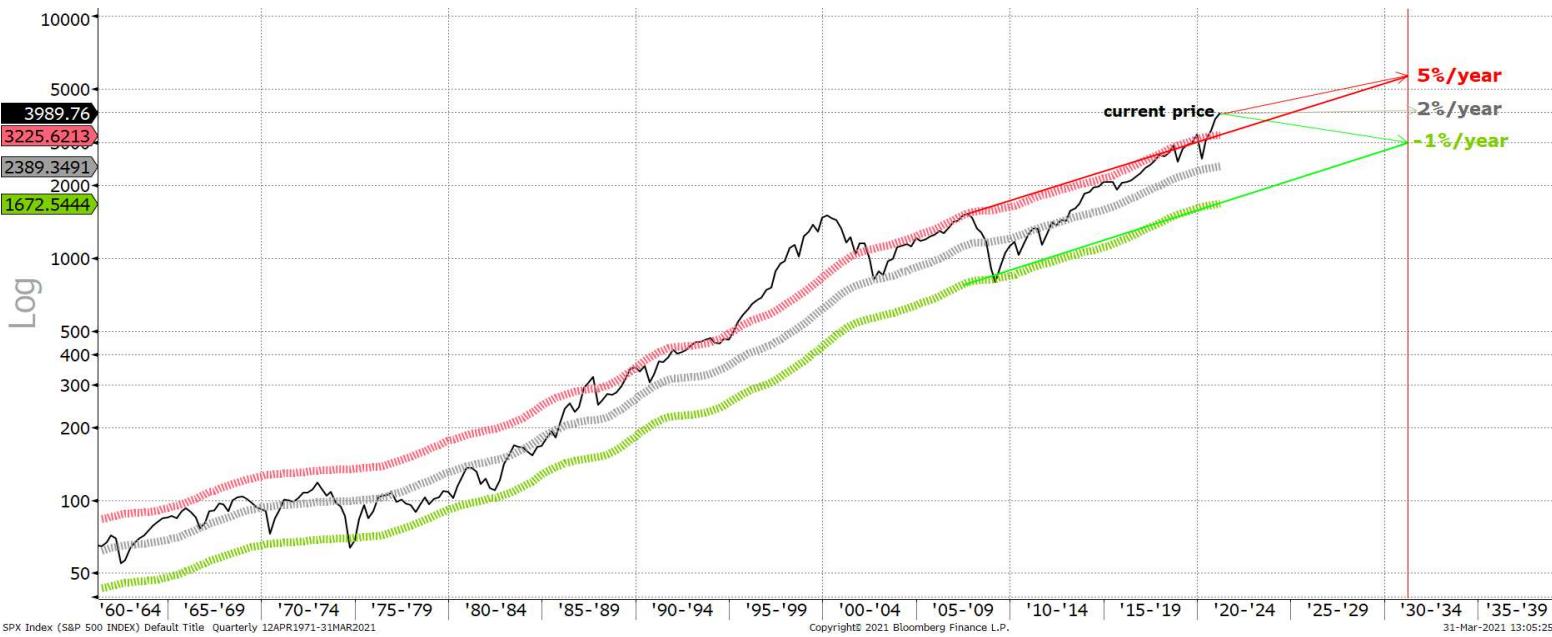
In the charts below, the vertical bars are recession months, the black line is Treasury prices and the red line is the S&P’s value. Generally, in a recession, the price of risky assets like stocks go down and the price of no risk assets like Treasuries go up. That was true for about four weeks last year (right chart) compared to 60 weeks the last recession (left chart). Immediate and dramatic stimulus spending stopped the selling dead in its tracks. This is unprecedented intervention which should provoke serious questions about whose risk is being subsidized by whom.



In the chart below, I've graphed the market's valuation level (how much larger the price is compared to a long term average of its earnings) and changes in the Federal Reserve's balance sheet. As the Fed buys securities, its balance sheet increases, with every dollar it spends working to increase prices. Eventually it will need to sell securities and the money that it gets will come out of the economy pushing values down. Sometimes, as in 2011, just pausing in its purchases will bring the markets back closer to normal. While the Fed will keep buying long term Treasuries and mortgages to keep their rates from going back up and risking stalling the economy, they are already selling good size chunks of their junk bond funds. The risk in owning junk bonds has increased but the prices (for the moment) are still levitating.

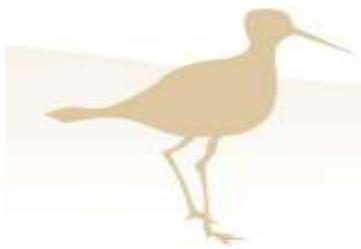


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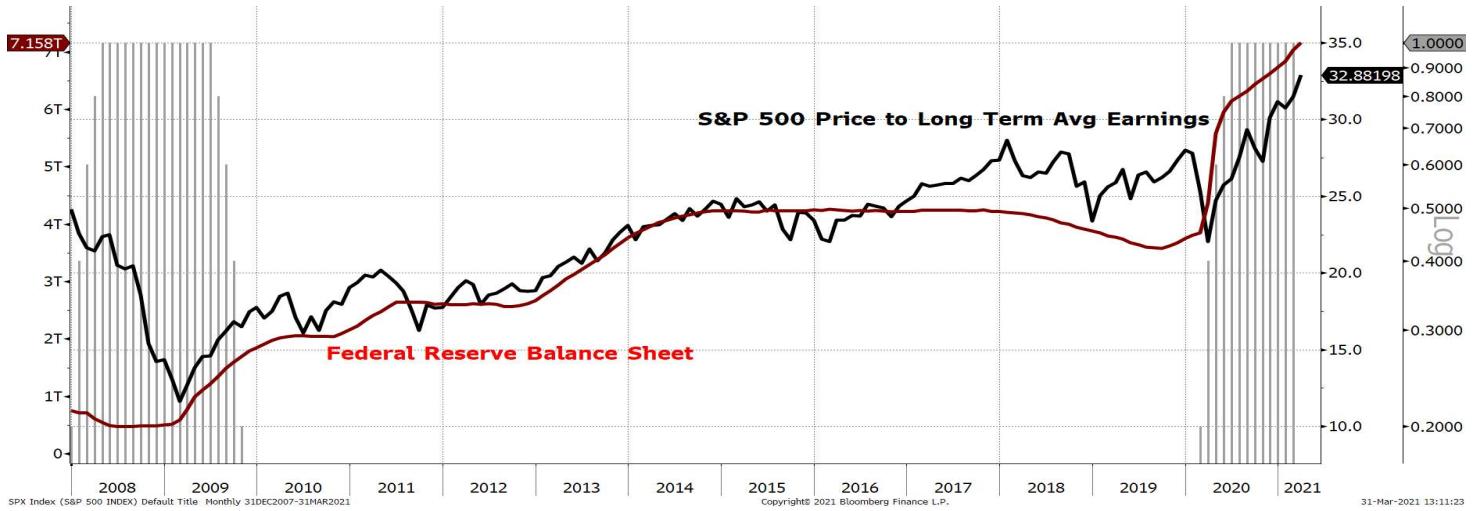
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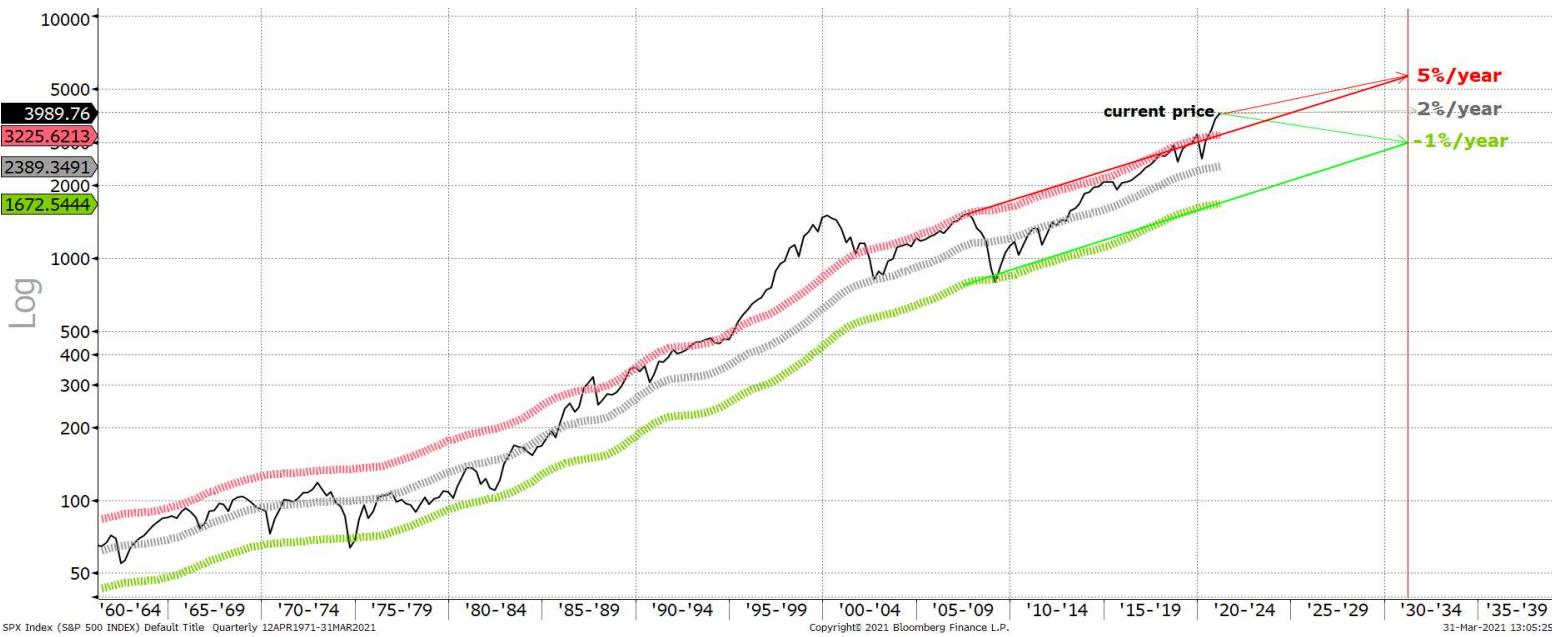
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