Investment Tally & Perspective

MAJOR ASSET CLASS RETURNS	4th Qtr. 2020	1-Year	3-Year	5-Year
Equities				
S&P 500	12.1%	18.4%	14.2%	15.2%
MSCI EAFE	16.0%	7.8%	4.3%	7.4%
MSCI Emerging Markets	19.7%	18.3%	6.2%	12.8%
Fixed Income				
Barclays Capital US Aggregate	0.7%	7.5%	5.3%	4.4%
Barclays Capital US Corp. Inv. Grade	3.0%	9.9%	7.1%	6.7%
Barclays Capital Emerging Market	4.5%	6.5%	5.5%	6.9%
Other Assets				
MSCI US Reit Index	11.5%	-7.6%	3.5%	4.8%
S&P GSCI	14.5%	-23.7%	-8.2%	-1.9%
ICE WTI Crude Oil	20.6%	-20.5%	-7.1%	5.5%
Comex Gold	0.4%	24.7%	13.1%	12.2%

Source: Capital IQ — All returns greater than one year are annualized

Market Activity –

Stocks around the world posted strong returns for the fourth quarter. International equities led due to a weaker dollar and a shift into more cyclical sectors and economies. Fixed income returns were muted as yields rose throughout the quarter.

Economic Activity –

The economy, despite some recent softening, continued to improve from the dramatic decline witnessed in April. The economy faced multiple headwinds in the fall and winter, including another wave of COVID-19, reduced fiscal support, and election uncertainty. Weekly initial jobless claims, one of the best near real time indicators of the labor market's health, stalled out during the fall. After spiking near 7 million in late March, claims fell significantly through August before losing momentum. The most recent reading of 787,000 is well above the 217,000 seen in late February. Though this picture is troubling, the labor market can only heal so far without a vaccinated public. Of the approximately 10 million jobs lost since February, 4 million are attributable to retail, leisure, and hospitality.

Consumer balance sheets remain strong, as income continues to track higher than February and spending remains lower. Important to note is that these statistics track aggregate data, and some consumer cohorts are likely in a much worse position. Goldman Sachs expects U.S. GDP to grow 6.4% in 2021, with the unemployment rate dropping to 4.8%.

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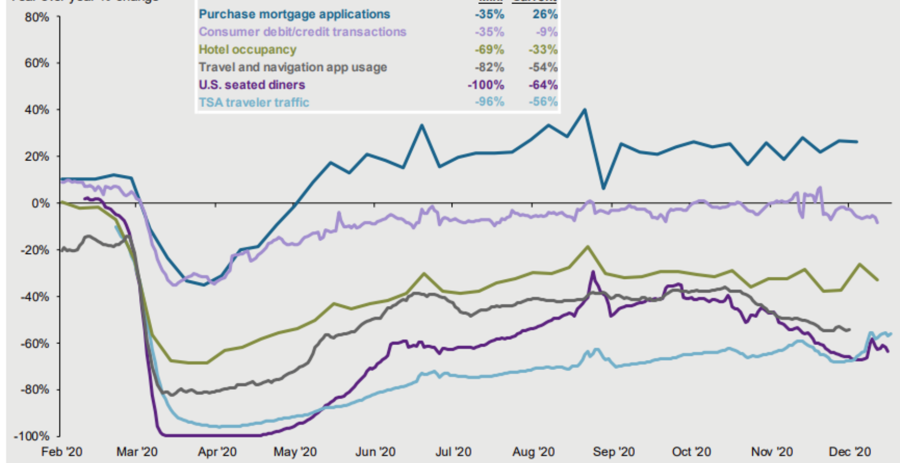

Source: App Annie, Chase, Mortgage Bankers Association (MBA), OpenTable, STR, Transportation Security Administration (TSA), J.P. Morgan Asset Management. *Consumer debit/credit transactions, U.S. seated diners, and TSA traveler traffic are 7-day moving averages. App Annie data is compared to 2019 average and includes over 600 travel and navigation apps globally, including Google Maps, Uber, Airbnb and Booking.com. Consumer spending: This report uses rigorous security protocols for selected data sourced from Chase credit and debit card transactions to ensure all information is kept confidential and secure. All selected data is highly aggregated and all unique identifiable information—including names, account numbers, addresses, dates of birth, and Social Security Numbers—is removed from the data before the report's author receives it. *Guide to the Markets – U.S.* Data are as of December 31, 2020.

J.P.Morgan Asset Management

Global GDP is also expected to rebound strongly next year. China is expected to continue to grow briskly, posting 8% growth in 2021, which is particularly impressive given the shallow decline realized in the spring. The resurgent virus in the U.K. and E.U. is causing near term economic pain, with expectations of negative growth in the fourth quarter, though this will be fleeting.

Monetary & Fiscal Policy –

As highlighted in prior communications, the Fed and global central banks are continuing their aggressive easing campaigns. According to analysts, it is unlikely the Fed will reduce its asset purchases until 2022, while an increase in the Federal Funds rate is not expected until 2024. This should provide ample stimulus for the economy and market. An interesting statistic from TCW that demonstrates central bank largess: the ECB and the Bank of Japan will own over ½ of their sovereign bond markets by the end of this year.

After months of wrangling, Congress finally passed another stimulus package in December, which includes direct individual checks, expanded unemployment benefits and another round of PPP loans to impacted businesses. On the heels of the stimulus bill's passage, Democrats won both senate elections in Georgia. While this outcome was unexpected late last year, it became more probable in the polls closer to the election. The market reacted favorably to this development, as odds for additional fiscal stimulus in the upcoming months increased. Goldman Sachs expects an additional stimulus bill amounting to $750 billion by March. Offsetting this positive injection into the economy are potential tax increases on corporations and wealthy individuals. A possible unwelcome side effect from stimulus may be marginally higher inflation and a pull forward of restrictive Fed policy.

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	22.33x	16.56x	1.79
CAPE	Shiller's P/E	34.24	27.47	1.10
Div. Yield	Dividend yield	1.59%	2.05%	1.37
P/B	Price to book	3.84	2.99	1.16
P/CF	Price to cash flow	15.93	10.79	2.54
EY Spread	EY minus Baa yield	1.35%	0.06%	-0.65

Source: J.P. Morgan

Valuation & Sentiment –

Sentiment is bullish. In the latest American Association of Individual Investors investor survey, the ratio of bulls to bears and the absolute level of bullish respondents are one standard deviation above average. Other sentiment indicators register similar results. As a related aside, the pandemic caused many Americans to take up stock and option trading. Reduced commissions, stimulus checks, social distancing, a lack of sports or sports betting, and a bear market persuaded these participants to try their hand (often with great success). Schwab had new account growth of 18% through September 2020.

Valuations continue to expand as stock prices reach all-time highs. An intuitive justification for elevated valuations is the lack of compelling alternatives to stocks. We expect higher interest rates to serve as a catalyst for repricing assets, and for restoring attractive alternative to equities. Offsetting lower equity valuation multiples wrought by higher rates will be earnings growth. The pace of this adjustment period will determine the level of market volatility we experience.

Investment Outlook and Strategy

Last year was historic in many ways - a pandemic on a scale not seen in over a century, a record-breaking decline in economic activity, unprecedented monetary and fiscal responses, and all-time highs in stock markets. As the new year commences, our hopes for a tranquil 2021 have been dashed.

No matter your political affiliations, people across the political spectrum found the riot at our nation's Capital last week quite disturbing. Given recent reports, it is possible we have not seen the last of these events. Yet, from this jarring and distasteful uprising we see an unintended positive development - In a Congress that has been steeped in partisan gridlock, these events may well produce a rolling snowball headed toward a governing center with increased cooperation and compromise. Fostered in a highly polarized environment, fringe players at both ends of the political spectrum will likely feel center-leaning pressures that demand a more productive Congress which would serve the economy and its citizens well.

While the events in Washington last week were certainly shocking, so was the market's reaction, as the S&P 500 posted a gain of 1.9%. A rising market in the face of turmoil is a stark example of the underlying strength of the pillars supporting this market. Fiscal stimulus combined with Fed actions result in a huge amount of liquidity entering the economy that is largely offsetting the decline in GDP caused by the pandemic. Further, given that monetary and fiscal actions generally work with a lag of six to eighteen months, the rebound in economic activity will likely gather momentum over the next year or two.

Though we find ourselves more in agreement with the bull case versus the bear narrative, there are two primary risks that we are closely monitoring. First is inflationary pressures - Due to recent changes in Fed policy objectives, higher inflation will not immediately be met with a policy change from accommodative to restrictive. Over time, asset price inflation and a tightening labor market may create imbalances earlier than generally expected, which would compel the Fed to pivot to a more restrictive policy. This would create an unfavorable environment for equities as asset prices adjust to higher interest rates.

A more subtle risk is confidence and trust in our government and corporate governance. This risk may best be explained by example – developments following the tech bubble in the late 1990s. As the structure and plumbing of the internet were being built in the '90s, investors clamored for anything that had a ".com" as part of its name. The speculative mania reached a turning point in March 2000 from which share prices of speculative companies declined to or near zero. Yet the damage outside of the tech sector was rather limited the first two years of the tech bust (2000-2001). The greatest declines, which included innocent, non-tech companies, was caused by two humongous accounting frauds - Enron (2001) and WorldCom (2002). These companies were well known and widely owned (Fortune magazine had named Enron the Most Innovative Company six consecutive years, 1996 through 2001). Their bankruptcies led to the demise of Arthur Anderson, one of the largest accounting firms. As a result of this pain and anguish, investors lost faith in corporate accounting and governance, and this lack of investor trust was manifested by investors selling stocks en-masse. The lack of trust was the main factor for the sharp market decline in 2002-2003. While we have no definitive insight on whether similar frauds are present today, we are closely monitoring pockets of speculative excess which create the conditions for such occurrences.

Putting it all together, we are maintaining our investment outlook at neutral.

FINANCIAL PLANNING FOR 2021 IN THE FACE OF COVID-19

Goodbye 2020 and So Nice to Meet You 2021. The warm welcome to the new year follows a year marked by the COVID-19 pandemic which caused an economic shock and market plunge in the first half of the year, and deep and lingering uncertainty for the remainder of the year. Although 2020 was unprecedented, the pandemic experience contained several important lessons for 2021 and future years.

The first and second steps to mitigate the impact from a year like 2020 are a well thought out financial plan and a cash emergency fund. While the advisable amount of funds one should keep liquid and available is best determined on an individual basis, a general guideline is between 6- and 9-months' worth of expenses and, if you are in or near retirement, boosting this to up to 12 months of reserves is advised. If you currently do not have an emergency fund or it has been depleted, it is recommended to save a percentage of your income vs. a set amount. Once that is defined, you should develop (or update) a budget. Utilized correctly, the budgeting process helps minimizing expenses and allocating funds to your personal priorities.

Once you have a budget in place and the emergency savings account that is being funded, determine how much you can contribute to a retirement plan. It is important to build retirement funds when able, as economic shocks can cause job losses and early retirements as evident with the pandemic which left many with a smaller nest egg than anticipated.

As the number of deaths and hospitalizations continue to rise in the U.S. due to COVID-19, it is vitally important that health and life insurance needs are reviewed. Are your basic estate planning documents in place? Now is the time to review these with your adviser and attorney as well.

Lastly, it is recommended that your portfolio asset allocation be revisited and, to derive benefits from portfolio rebalancing, it is important to stick to a strict schedule in a disciplined manner. The last three years show the importance of adhering to one's asset allocation. After negative equity returns in 2018, the following year (2019) was the 10th best year in the 93-year history of the S&P 500 Index. The strength carried into the first seven weeks of 2020, as stock indices reached record levels in late February. As the scope of the pandemic became more evident, stock prices then declined over 30% in the next month, before ending the year with double-digit returns. The point being - it is vital that investors are comfortable with their allocation and avoid reacting emotionally (fear) during periods of market turmoil.

For our clients, know that we are available for all your 2021 financial planning needs and, as always, please contact us if we may be of assistance in any manner.

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