Post Oak Private Wealth Advisors
ADVISORY, CONSULTING & INVESTMENT MANAGEMENT

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2020 Year-End Review & Outlook

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How to recap a tumultuous year? I think the only words left to say about 2020 are "good riddance". I am sure you are familiar with the big stories of the past year, so I won't rehash them except to discuss how they impacted the performance of the financial markets in 2020.

Nearly all financial asset classes were up for the year: the major U.S. stock indexes posted strong calendar-year gains of 18.4% for the S&P 500 and 43.6% for the Nasdaq Composite; bonds appreciated as monetary stimulus pushed interest rates lower in the early weeks of the COVID-19 pandemic; gold crossed the $2,000 per ounce threshold in August and finished nearly 25% higher than the start of the year. Energy markets sounded a sour note as oil prices collapsed due to pandemic-related travel and business restrictions.

Ripping away the calendar page may offer a cathartic release, but it won't change the challenges we face in 2021.

All this generally good news presents some degree of relief as we look back over a tumultuous year. However, having lived through 2020, we know there were many troublesome issues underlying these positive numbers. They remain with us as we head into 2021. It is said the stock market is not the economy, and this was never more true as it was this past year. Yes, the stock market boomed, but so did positive case counts, hospitalizations and fatalities related to coronavirus. Ripping away the calendar page may offer a cathartic release after the trials and tragedies of 2020, but it won't change the challenges we face as another new year begins.

The market's wild ride

2020 began with a strong step—the S&P 500 climbed 4% through the first seven weeks of the year. But ominous news out from China—a cluster of pneumonia cases of unknown cause in Wuhan—would soon affect everyone around the globe. In a month, the novel coronavirus would spread from Korea and Japan, to Australia, Europe and eventually the U.S. By March, we had become familiar with COVID-19 and the devastating aftermath of lives lost to the pandemic. New idioms entered the national dialogue—masking, lockdowns, social distance, herd immunity.

Financial markets reacted to the pandemic as early as February—the S&P 500 Index peaked on the 19th before sliding into a bear market in March. It was quickest descent into bear market territory in market history—a drop of over 30% in just 23 trading sessions. Equity volatility, as measured by the CBOE Volatility Index (VIX), spiked to levels last seen in 2008 during the global financial crisis. The initial shock of the pandemic and the regional restrictions on travel and business activity had a dramatic impact on the U.S. economy. A record 20.5 million jobs were lost in April alone, pushing the unemployment rate up to 14.7%. Gross Domestic Product fell by an annual rate of 31% in the 2nd Quarter, the worst stumble for the U.S. economy since 1947, the year the federal government began keeping records on GDP growth.

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But the bounce off of the March 23 bear market low was just as astonishing. The S&P 500 rebounded 20% in Q2, even as the COVID-19 positivity rate and fatalities climbed and economic reports painted a bleak picture. By the midpoint of the year, the benchmark equity index was down only 3% for the year-to-date.

What explains such as rapid reversal? A two-pronged stimulus response from the Federal Reserve and the federal government provided a monetary backstop to the U.S. financial system and unprecedented fiscal support to the crippled U.S. economy in the form of business loans, expanded unemployment insurance and direct payments to taxpayers. Monetary and fiscal stimulus did come to the rescue of many businesses and workers, and the easing of restrictions helped put the overall U.S. economy toward recovery.

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Normally, a full recovery from a bear market takes years, not months or even weeks. Historically, the stock market has taken 3½ years to recover the entirety of losses from previous corrections of this size. But by August, the S&P 500 had clawed back its losses from the COVID-19 bear market and was back in record territory. The momentum wobbled in the weeks leading up to Election Day, but favorable news on vaccine development boosted investor optimism and the S&P 500 was back at all-time highs. The economy also looked better in the second half of the year; employment markets rebounded in May and recorded seven consecutive months of positive job growth, and GDP growth snapped back to expansion mode with a record 33.4% annualized growth rate for the 3rd Quarter.

However, the attractive numbers on employment and economic growth masked a growing and troublesome disconnect—some industries and workers weren't participating in the recovery as much as others, as they were still pinched by coronavirus fears and government restrictions. Notably, many firms in the dining, hospitality, travel, leisure and entertainment sectors continued to struggle and remain on the brink of failure today. The ripple effect spread to employees in these industries, many of whom are still out of work and increasingly unable to cover their basic living expenses. Unemployment has receded from its pandemic peak, but as of November still remains above pre-coronavirus levels and is particularly high within many sectors of the service economy.

At this transition point between calendar years, we see stark contrasts in the economy: stocks are booming even as many parts of the economy struggle; some businesses and workers are doing extraordinarily well, while others worry about having enough money to cover the basics; the federal government finally delivered a second, smaller round of stimulus, even as COVID-19 spread as much as ever in some parts of the country. Despite the dichotomy, we anticipate the bull market for stocks to continue into 2021, primarily for two reasons. First, there aren't many other investments at present offering the high level of earnings growth that's projected for the technology industry. Second, there's $1 trillion of cash sitting on the sidelines right now—a bigger pile of dry tinder than before the coronavirus pandemic—that's primed to fire the current stock market surge. But we know from experience, it's likely to be a bumpy ride.

Forks in the road

This contrast is clearly visible in examining sector performance in the stock market. Technology and communications firms benefited tremendously from the shift to remote work and schooling during the year. Zoom (ZM) was perhaps the transformational product of the year, and the company's stock price appreciated over four-fold from the start of 2020. The tech

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behemoths did well, too; Apple—the biggest stock in the S&P 500—gained over 80% for the year; Microsoft was up over 41%; Google rose by 31%. The strong performance among these heavyweights, among tech stocks in general, helped the Nasdaq 100 Index (the tracking index for the QQQ exchange-traded fund) to a 47% gain for the year.

S&P 500 sector performance as of 12/31/2020	Q4 2020 return	2020 calendar-year return
Technology	11.8%	43.9%
Consumer Discretionary	8.0%	33.3%
Communications Services	13.8%	23.6%
Materials	14.5%	20.7%
Health Care	8.0%	13.4%
Industrials	15.7%	11.1%
Consumer Staples	6.3%	10.7%
Utilities	6.5%	0.5%
Financials	23.2%	-1.7%
Real Estate	4.9%	-2.2%
Energy	27.8%	-33.7%

But the story was much different in the energy sector, which fell over 33% for the year as the price of oil descended to around $20 per barrel in April. Occidental Petroleum, Marathon Oil and Schlumberger were among the biggest disappointments in this sector. The gradual recovery and re-opening of some economies helped oil prices claw back some of this year's decline, but as of year-end the benchmark crude indexes remain below their pre-pandemic levels.

A shift in consumer behavior during the pandemic helped some companies, but often to the detriment of others. Perhaps no firm is a better example of this as Amazon, which saw revenue growth explode throughout 2020 while its Q3 earnings per share grew nearly three-times over the same quarter last year. Amazon helped the consumer discretionary sector notch a 30% return for 2020, with help from fellow e-commerce favorite Etsy (up 300% for the year) and electric car maker Telsa (up nearly 750% for the year).

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But Amazon's rise to dominance during the pandemic came at the expense of traditional retailers, nearly all of whom struggled under business activity restrictions. COVID-19 shutdowns led to some notable bankruptcies in the retail and consumer goods sector: Neiman Marcus, Lord & Taylor, J.C. Penney, Pier One, Men's Wearhouse, and more. Even retailers that were buoyed by panic shopping and hoarding—Kroger, Walmart, Costco, for example—couldn't keep pace with Amazon's torrid growth.

We also saw a divergence among entertainment and leisure as travel slowed to a crawl amid stay-at-home orders. Returns in the airline, hotel and cruise sectors were all down around 30% for the year, while casinos fell nearly 15%. But some of the spending that used to go to travel and leisure was directed toward home improvement—Lowe's and Home Depot both outperformed the S&P 500 for the year. People spent more of their leisure time on social media, contributing to gains for Twitter (up 68% for the year) and Facebook (up 33% for the year), as well as streaming movies and series on digital platforms like Netflix (up 67% in 2020) and Disney+ (which helped Disney's stock price rise 25% in 2020 despite losses in its theme-park business.)

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The uncertain path ahead

Even as many of these same themes are likely to follow us in 2021, there are some reasons to be encouraged, especially related to the spread of the pandemic. Early reports on the first COVID-19 vaccines give us hope, but it will take many months to inoculate a large enough population of U.S. citizens in order to get us closer to returning to normal. We should expect pandemic management (i.e., mask-wearing, social distancing) to continue for several months into the new year.

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As we begin to see the light on the other side, it will be interesting to watch what direction our society and our economy takes going forward. Will returning to normal close the gaps that widened during the pandemic year, or will the new normal see these divergent paths continue? From a business perspective, I can see some changes becoming permanent in the post-pandemic world. Much of the technology that has helped us transition to a work-from-home environment won't go away. That's good news for companies like Microsoft, Adobe and Salesforce that make remote work possible and productive. I don't see businesses becoming less reliant on these products and services anytime soon. Some firms will find home-based workers are more productive and will look to drive earnings growth by cutting costs for office space, furnishings and equipment. That trend will aid service-based businesses, but make life more difficult for commercial real estate owners and lenders. Moreover, the success many firms have found with remote staff will dampen demand for business travel, which may dent the future profitability for airlines and hoteliers.

These post-pandemic changes have the potential to divide winners from losers in the business community. Firms that are challenged by the new reality and are able to adapt to it will be poised to succeed. Airlines won't disappear if there is less business travel, but their profit models may need to change to one that focuses on the specific needs of leisure travelers and vacationers. Amusement parks will again welcome guests one day and cruise ships will set sail once more, but perhaps with a focus on exclusivity and more intimate experiences for their guests. In certain sectors, it will be better to hunt for potential winners instead of making investments across whole industries. However, there may be isolated opportunities in energy, where beaten-down stocks still have room to grow as mobility returns and oil prices rise. Banks are also positioned to benefit from rising interest rates, which have been moving higher over concerns about increased government spending.

It's also likely we'll see stock market volatility persist into 2021, although perhaps not to the extreme levels we witnessed in the early weeks of the pandemic. Volatility is driven by trading, and increasingly trading of financial instruments—stocks, ETFs, index and interest rate futures—is driven by algorithms. There are more money management forms using quantitative models these days than ever before. While "quant" models offer advantages like more rules-based and less emotionally driven decisions, they also create a self-fulfilling cycle of increased trading, and therefore higher volatility. The likelihood of further whipsaws in market volatility raises the prospect of significant market losses and corrections in the months to come. That makes the protection capabilities offered by our hedging strategies more critical for the achievement of your long-term financial goals.

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The other divide that's likely to persist into 2021 is within the federal government. While financial markets have in general reacted favorably to the incoming Biden administration, and with the results of the runoff elections for two Georgia Senate seats forthcoming, the political

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climate is primed to remain contentious and driven by partisan motives for the next two years. Investors will be encouraged if Republicans can maintain control of the Senate; that will likely block Biden's plans to raise taxes on the wealthy or corporations, especially any proposal to raise capital gains taxation. There are many outstanding and pressing issues that affect the lives of millions of Americans, but it will be a tall order for the Biden administration to move the needle on any of them with Congress split on slim margins. What we can expect is for the political rancor to continue for the foreseeable future. Investors would be wise to tune much of this noise out when making decisions that affect their financial future.

As we watch events unfold in the coming year, I am heartened about our prospects for the future because of the resilience of the U.S. economy and the ingenuity of our fellow citizens. These traits were on full display not only in the way our nation rose to the challenges of the COVID-19 pandemic, but also in the efforts put forth by health care researchers and professionals to develop and distribute coronavirus vaccines and treatments. Capitalism will, by definition, continue to reward smart, innovative companies while placing pressure on other firms to stay competitive or exit the market. We continue to believe in the potential of the American economy, best represented by the opportunities for long-term growth available in the U.S. stock market.

We wish each and every one of you a healthy, prosperous and happy year in 2021.