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Quarterly Commentary

Fourth Quarter 2020

Market Review with Ted Halpern

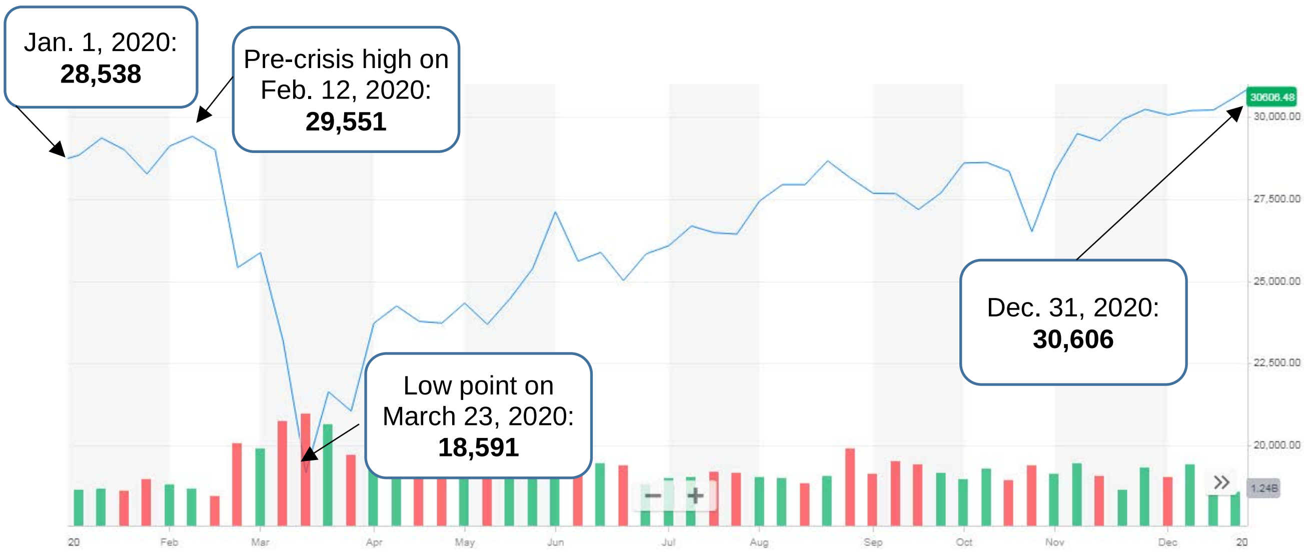
Roller Coaster Ride

Please keep your hands and legs in your car and make sure you are strapped in properly.

A roller coaster warning for investors would have been delightful about this time last year. Perhaps even a heads-up that this roller coaster was also going to travel through a haunted mansion. 2020 was one for the record books!

Markets began the year with rose-colored glasses. After all, 2019 was a terrific year and the economy was doing better than it had in over 50 years! Economic indicators were very healthy. Then came the global pandemic of Covid-19. The DJIA hit a high of 29,551 on February 12. Once news of this crisis broke, and the lockdown came into effect, markets hit their lows of 18,591 on March 23. The extraordinary decline during this five-week period set records in its steepness and swiftness.

As people from around the world adapted to their new realities of working and educating remotely, donning a mask when leaving their homes and social distancing (a new oxymoron), research went into 'warp speed' to find treatment and vaccines. Governments around the globe issued massive stimulus relief bills. Adjusting to this new normal, massive progress in the fight against Covid and the stimulus efforts all helped markets to climb rapidly out of their deep hole. In fact, the DJIA experienced an incredible surge and finished 2020 at record highs of 30,606! Just like a passenger on a roller coaster, we experienced tremendous anxiety, fear and concern all to end up a little ahead of where we started the year, with the DJIA gaining 2,068 points or 9.7%!



Typically, a gain of 9.7% on the DJIA would be an average year for the market. This was no average year in any capacity. The pandemic provided an incredible path for markets and our economy. Thankfully, and speaking only from a market standpoint, these 'event-driven' bear markets tend to be very fast – both coming and going! This one certainly did just that.

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Stock markets are forward looking indicators. I have little doubt that eventually science will win, we will beat back Covid, and normalcy can return. Markets believe this will happen too, and priced in this expectation of future growth even though Covid continues to impact our day-to-day lives. These rapid cycles impact our economy, but policies move far more slowly. It takes a while for jobs to come back and certain sectors of the economy recover slower than others. Right now, lockdowns still are in place in many places domestically and internationally and any resistance to a new vaccine will slow the return of normalcy as well.

There is no question the pandemic will impact the future. The pandemic accelerated existing trends, such as a far more automated workplace and digitized economies. We have more time efficiency from workers avoiding long commutes by working from home, and social interactions will be different for a long time to come, from how we may greet one another going forward to whether we blow out candles on a birthday cake!

These changes create investment opportunities, along with potential landmines to avoid. While certain sectors appear well situated for what is ahead – namely healthcare and technology – others present risk. Commercial real estate in cities and segments of the travel industry may never be the same. People can adapt to crisis quickly but they tend to be far more resistant to re-enter potential dangerous situations.

Extraordinary events highlight what works and what does not work. 2020 provided just such a litmus test. 2020 certainly showed us that “controlling the factors within our control” to be a wise strategy for good times and bad. An investor who was well-diversified prior to this crisis fared far better than one who was overweighting certain sectors. The investor who did not attempt to time this crisis won in a big way against those that thought they could do so. The investor who had the ability to trade and rebalance without restriction or cost saw tremendous opportunities from February through April. Conversely, investors who had to pay retail cost for their investments (through transaction fees, commissions, and holding period restrictions) paid for it with their returns. I am very thankful our clients all had the capabilities mentioned above and did so in an optimized manner for taxes, suitable to their own unique goals and objectives. It was a challenging but rewarding year for investors who followed a prudent plan of action!

Looking ahead, there are reasons for optimism!

Of course, progress with effective vaccines will lead us to a more stable recovery. But many indicators point to reasons for continued market gains. A few of the primary reasons are as follows:

Tremendous liquidity! The Federal Reserve has provided huge amounts of liquidity in multiple ways and have promised to keep rates low. In fact, interest rates are now at levels not seen – except during war times – since 1830! Janet Yellen is anticipated to head the Treasury and she is a major proponent of providing ample liquidity including low rates. Couple this with the recent third round of stimulus and liquidity is more than ample.

Spending, and more spending! The government is in a spending mood. Anticipations for a massive infrastructure bill will help value stocks and segments of the market that were out of favor (building and energy). Consumers are in a spending mood too. As lockdowns lift and jobs return due to a healthier public, so consumer spending will become healthier as well. Personal savings in the US are currently $1.3 trillion higher than pre-pandemic levels. This amounts to nearly 6% of GDP and is fueled with plenty of pent up demand. Interesting to note, corporations have built reserves to record levels too. However, their willingness to spend may be stalled as the call for higher corporate taxes looms.

Healthcare and technology innovation! The pandemic has united countries and companies around the world in an effort to find treatments and a cure. This massive effort is possible due to incredible injections of capital and a substantially reduced regulatory climate for healthcare companies to operate. In coming years, this combination may well create wonderful healthcare developments and great profit. On the technology front, 2020 forced us to adapt to technology in almost all areas of life. These trends were already underway but this crisis has been a catalyst to push those trends years ahead of schedule. This momentum should continue. Many are concerned about tech reaching the bubble-like levels it did 20 years ago. What makes this time different is the incredible profitability and cash reserves of these major tech players. Their cash flows simply did not exist like this two decades ago. In fact, many economists and investors now view technology as almost a 'defensive' sector!

Be careful of potholes on the road to recovery.

The year ahead has many reasons for investors to be optimistic. At the same time, we have significant uphill battles as well. Although vaccines can help get us back to normal, we can expect some interruptions with delivery and resistance to accept them. This will provide some negative news for markets to cope with.

The combination of massive stimulus efforts and government spending programs will help our economy to heal faster but not without great cost! Deficits are building at an incredible rate. While this is manageable for the time being, as payments on this debt relative to our GDP are less than they were in the 1980s and 1990s, this is not sustainable. Eventually, math wins. Massive current deficits and future growing deficits due to entitlement programs, sets the stage for some historic and long-awaited reforms. Remember though, every single penny of government spending is taxed or borrowed from the private sector. These transfers of wealth and income from both current and future taxpayers distort the economy.

Prepare for market gyrations. Markets have recovered wonderfully from their lows in March of 2020. And, to start this year, they are enjoying the prospects of greater stimulus and spending. But, this typically gives way to additional peaks and troughs. It is not uncommon after sustained gains to experience some sharp pullbacks. Adding to this probability is the fact that the top 5 companies in the S&P 500 account for more than their share of the index gains. Couple this with strong desires for IPO and cryptocurrency markets and the likelihood of a pullback is greater. Remember though, these are actually commonplace and do snap back. They are just uncomfortable to experience.

As we say goodbye to a very challenging year. I would be remiss if I didn't share that this past year we saw some clients, dear friends really, pass on too soon. The loss reminds us how much we truly valued our relationship with them. Their memories and lessons learned from them are everlasting.

We work hard to maintain your trust and confidence each day and appreciate the time we have together. I sincerely hope 2021 provides us with much more health, wealth and happiness. May we experience some welcome boredom and may we all be kinder to one another too! I encourage you to always plan for and expect a brighter tomorrow, but still be prepared for the rainy days we know will occur from time to time.

Be well, be safe and be an optimist!

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Investment Commentary with Kirsty Peev, CFP®
Summary:

2020 was a true test of your portfolio strategy—and it passed with flying colors. If you had known on 1/1/2020 that this year would include the fastest bear market ever on record, a global pandemic like we have never seen, job losses, orders to stay at home, oil selling for less than $0, and a myriad of other serious factors to challenge us…you would have expected markets to end 2020 with awful numbers.

Markets rallied in the face of all of those challenges and thrived despite expectations! After a very challenging start to the year, resilient equity and bond markets delivered strong 2020 returns – and your portfolio did too!

Equities:

Strongly positive fourth-quarter and year-end returns. You certainly wouldn't know 2020 was such a challenging year from the year-end returns, which included the major market averages hitting multiple new highs! We would be thrilled to see these kinds of returns in any year. The concentration in technology stocks helped the S&P500 gain 18.3% for the year, with the DJIA returning 9.7%.

A focus on technology and healthcare led us out of the worst of the trough. A restricted working environment for many companies, required them to become leaner and more efficient overnight. As these companies transitioned to remote work, technology stocks soared. We took advantage of this with a stronger focus on growth and technology asset classes. We were also careful to rebalance accordingly to ensure your portfolio has the right mix of risk and return and is not overly dependent on any one asset class. Healthcare benefited from a variety of sectors within the space, including rapid developments in vaccines and consumer staples like home-health, cleaning and care products.

Strong risk-adjusted returns are even better news. Your portfolio is not the S&P 500 or the Dow Jones Industrial Average—these are just two of the main U.S. indices investors use to take the temperature of the market overall. Your portfolio includes domestic and foreign equities from small and large companies, plus a variety of fixed income holdings—corporates, munis, long-term, intermediate-term, and short-term. We have designed your portfolio to include an optimal mix of asset classes for a risk-return profile that is designed for your specific financial situation.

Resilient markets thriving on many factors. We covered these factors in some detail in the Q3 2020 Commentary. However investors still question how markets fared so well in the face of such significant and ongoing challenges, so a review is warranted.

- Markets are looking forward to the economy reopening to massive pent up demand.
- Specific sectors finding opportunities for added efficiency in the face of challenges.
- Improving economic data – unemployment numbers, jobless claims all trending in a more positive direction.
- Ongoing historic levels of fiscal and monetary support and stimulus.
- Vaccines and therapeutics. Massive and coordinated global response to achieving progress in both these areas.

International Equities

Supportive environment for international equities. Developed and emerging market stocks lagged the U.S. in terms of broad market returns during 2020. Equity markets from developed international countries struggled among both the global virus concerns, and additional country and region-specific concerns. One example of this is China, which dominates the emerging market sector. China was the first country to experience the virus-related dip, followed by a fast recovery.

Brexit is now official, after 4 years of negotiations, and 47 years of membership in the European Union. The UK and EU reached a last-minute trade and policy agreement as part of the historic separation. This agreement, which avoided a dreaded 'no deal Brexit', was incredibly important for both sides of the table. The UK is now free to make its own trade policy, and is having talks with the US, Australia and New Zealand –countries that currently do not have free trade deals with the EU.

Global support. Massive stimulus efforts around the globe supported investors, businesses and consumers. The virus affected countries on all continents economically. Stimulus and support packages avoided more serious economic impact from the pandemic than would have otherwise occurred.

Bonds:

Strong Q4 and year-end returns. In the face of a challenging economic environment and historically low interest rates, bonds delivered strong returns. Fundamentals in bond asset classes have been strong throughout the year, however, peak 'market fear' earlier this year affected bonds. As nervous investors fled to cash, bonds dipped in value and created a very short-term liquidity problem. As investor panic subsided, support and backing from the Fed righted the ship. Bond markets very quickly stabilized and recovered in a healthy manner throughout the rest of 2020.

The role of bonds reaffirmed. Bonds have a very important role within your portfolio – for income generation, stability, risk-mitigation and diversification. When equity markets are soaring, bonds can seem less attractive – but they remain important for your long-term investment success.

A diversified bond portfolio remains incredibly important. Longer-term and lower-quality bonds provide higher yields, and must be balanced out with shorter-term, high quality bonds to provide stability. Your bond holdings managed the challenging environment incredibly well.

Many of the fund providers we include within your portfolio added new 'COVID screens' and similar tools to their lineup. These analyses reviewed each bond within the fund to determine the resilience of the bond issuer (borrower) to continue to service their debt in the face of COVID-related-challenges. This type of analysis is critically important and is a key advantage of access to industry-leading, Institutional fund providers.

Expectations and Perceptions for the Future:

EQUITIES

Year of the vaccine and a year of recovery ahead. Already, frontline workers and at-risk populations are receiving the coronavirus vaccine. As vaccinations progress, more normal activities become possible to support future growth. There is massive pent up demand from consumers, which should start to show itself dramatically as the pace of vaccination becomes clearer. There are additional vaccines from various countries already in late-stage trials, which will accelerate vaccination plans if they are approved and adopted.

Investors have become more comfortable with differences between 'Wall Street and Main Street.' An incredibly accommodative environment provides a supportive backdrop for continued market gains in the face of ongoing personal challenges for the population. In fact, 10 years ago we saw the largest coordinated money injection into the economy ever – and in 2020 we received a 'stimulus airdrop' of approximately double the size of that from 10 years ago! JP Morgan described it as an 'unprecedented stimulus bomb in terms of size, speed, and longstanding effect on markets'.

A definitive recovery ahead. Remember, this recession was not caused by a failure of any fundamental system – rather, it was caused by an external shock. The recovery from these kinds of recessions tends to be much swifter than those which occur from a more 'normal' recession.

The path of the economic recovery, and subsequent market movements, are likely to be erratic and uneven – with varying speeds and strengths of recoveries seen across different market segments and countries. The efficiencies and automations created during this pandemic are likely to help with a more efficient path going forward, but it is unlikely to be entirely smooth. We continue to look for value opportunities among these anticipated peaks and troughs.

Significant opportunities exist in international markets. The decline in the value of the U.S. dollar is a positive for international markets, and specific countries are further along in terms of recovery from the pandemic effects

BONDS

The Fed is continuing their bond-buying stimulus efforts- providing added strength and stability to bond markets. This includes the purchase of U.S. Treasuries and agency mortgage backed securities at roughly $120 billion per month. This provided short-term liquidity confidence during 2020, and provides ongoing stability for bond markets while it is warranted. Even though some Fed support programs were not widely used or even needed by bond issuers, the stated backing from the Fed soothed investors' nerves.

Great value in municipal bonds. Municipal bonds remain a bastion of strength, stability and tax-efficient income during challenging times. In a low-rate environment, finding yield without adding risk is a challenge. However, high-quality munis continue to present very attractive value, and are yielding much more than their historical average relative to the spread over Treasuries.

Near-zero rates for the next two years, at least. The Federal Reserve will not raise the Federal Funds rate until various economic indicators are reached. The Fed will continue to do everything in its power to help support the economy. In recent meeting minutes, they stated they see the unemployment rate continuing to decrease over time and GDP continuing to increase. Fed Chair Jerome Powell has recently signaled that the Fed remains strongly committed to using all the tools they have for as long as needed, and they are not out of power or ammunition.

Globally, short-term rates are likely to stay near historically low levels for at least a couple of years before we see any normalization of rates. This provides us with challenges and opportunities. We seek to optimize risk-adjusted return within a variety of bond asset classes to provide income, stability and growth in a zero-interest rate climate. We select high-quality bond fund managers who carefully analyze every bond included within the fund to determine the strength and quality of those holdings in the face of COVID and other challenges.