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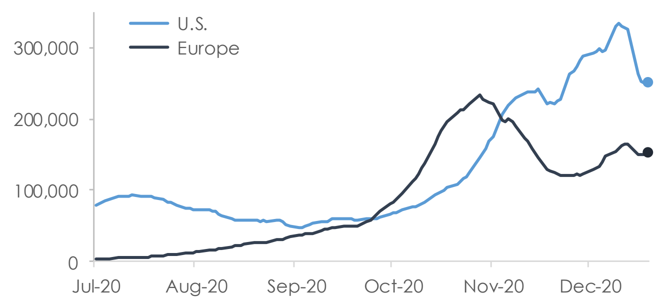
# Client Letter | Fourth Quarter 2020 Recap & 2021 Outlook

## A Resurgent Virus Collides with Positive Vaccine Data

Two conflicting themes defined the fourth quarter: a resurgent virus and encouraging vaccine data. Figure 1 shows coronavirus case counts spiked in the U.S. and Europe as social distancing fatigue kicked in and the holidays approached. State and local governments responded by dialing back reopening plans and introducing new restrictions. Overwhelmed hospitals faced capacity issues, and public health officials warned the winter months would be dark.

FIGURE 1

**Confirmed COVID-19 Cases by Region** (7 day moving average)




*Source: MarketDesk Research, World Health Organization*

Investors' attention focused on vaccine development as case counts surged. Optimism was high as markets intently watched multiple vaccine candidates start late-stage trials. Investors' optimism was ultimately rewarded in early November when Pfizer and Moderna both released encouraging vaccine trial data. The two vaccine candidates each demonstrated an efficacy rate above 90%, and the two drug manufacturers asked for emergency use authorization (EUA) within a month. The FDA granted the two vaccine candidates EUA in December, and vaccine distribution kicked off shortly thereafter.

The positive vaccine trial results represented the first tangible step toward reopening the economy. Investors overlooked the virus's resurgence and cheered the prospect of reopening the economy sooner. Global stock markets rallied, and investors repositioned portfolios as the reopening phase suddenly appeared within sight.

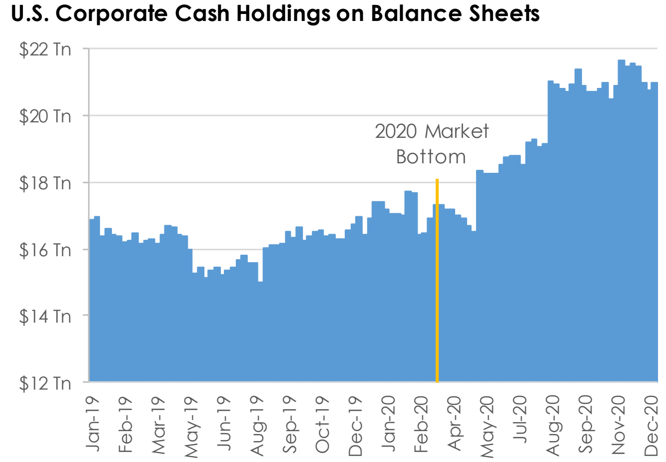
## U.S. Equity Markets Hit Multiple Record Highs

Positive vaccine data unleashed a powerful pro-cyclical rotation in the fourth quarter. The S&P 500, Dow Jones, and Russell 2000 all hit record highs multiple times. Trend reversal was the story in the fourth quarter. Riskier small caps outperformed after trailing their large cap counterparts for most of the recovery. Cheap value stocks outperformed as investors rushed into beaten up companies. Energy (rising oil prices as oil demand projections increased), Financials (rising interest rates), and Industrials (stronger economic growth projections) were the top three performing sectors. Sectors less exposed to economic growth, such as Real Estate, Utilities and Consumer Staples, broadly underperformed.

Beneath the market surface, the dominant investment themes remain intact. Interest rates are pinned near zero, and the Federal Reserve continues to purchase bonds. The two monetary policies are highly accommodative and intended to support the economic recovery. Corporate earnings are surprisingly strong despite the global health pandemic. There is a chance 2021 earnings could be even better than forecast with increased operating leverage (e.g., lower expenses with strong sales growth). On top of this, corporate balance sheets are flush with cash after companies rushed to issue debt earlier in 2020.

FIGURE 2

**U.S. Corporate Cash Holdings on Balance Sheets**




*Source: MarketDesk Research. Note: Data based on S&P 500 constituents.*

Investor sentiment remains strong even though the outlook is uncertain. DoorDash and Airbnb both completed successful initial public offerings (IPOs). Tesla was added to the S&P 500 Index in December. Special purpose acquisition companies (SPACs), which raise money via an IPO to purchase an unknown business at a later date, continue to raise large sums of money. If investors are nervous about the future, their actions are not showing it. Investors' willingness to pay higher valuations and take on increased risk is likely due to the Federal Reserve's aggressive monetary support. The market appears convinced the Federal Reserve will step in to support the economy if things get bad.

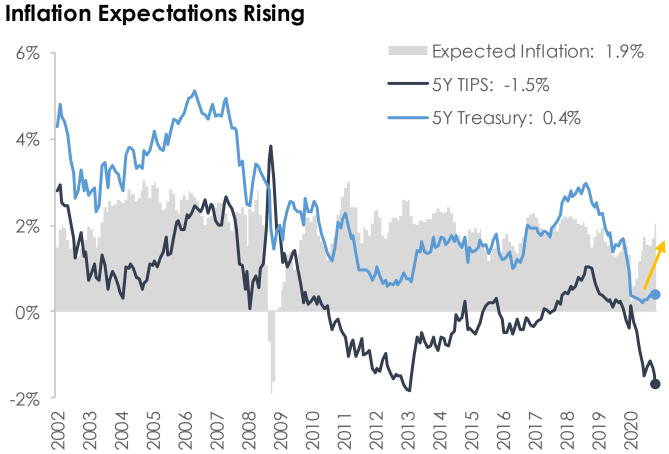
## Treasury Yields & Inflation Expectations Drift Higher

While treasury yields drifted higher in the fourth quarter, the dominant theme in the credit markets continues to be historically low interest rates. Savers are still hungry for income and searching for yield. The positive vaccine trials and push toward reopening gave credit investors the comfort to increase portfolio risk in exchange for higher yields. As a result, high-yield corporate bonds, which tend to be riskier, outperformed investment grade corporate debt and U.S. treasuries. Investors' appetite for higher credit risk could remain strong with the Federal Reserve's accommodative monetary policies in place.

Figure 3 shows inflation expectations rose in the fourth quarter. The combination of low interest rates and significant fiscal stimulus are likely driving inflation expectations higher. Too much inflation can be a bad thing, but too little inflation can be equally concerning. If markets are correct and inflation rises, bonds and equities could sell off. The Federal Reserve is walking a proverbial tightrope and will be watching inflation closely.

FIGURE 3

**Inflation Expectations Rising**




Source: MarketDesk Research

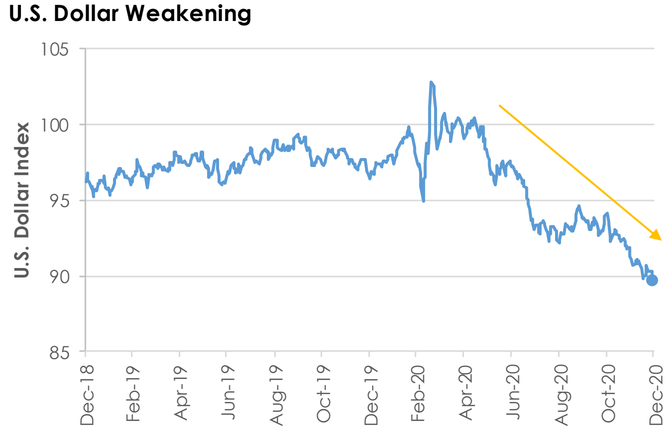
## International Equities Outperform

International equities were supported by a combination of encouraging vaccine data and U.S. dollar weakening during the fourth quarter. The favorable trends led both the Developed Market ex U.S. Index and Emerging Market Index to outperform the S&P 500 Index. Similar to the U.S. equity market, the theme in international markets was trend reversal. Regions and countries hit hardest by the virus, such as Latin America, developed Europe, and Singapore, broadly outperformed. In contrast, China, whose exports and economy held up stronger as the virus was contained, underperformed.

One of the primary factors to watch in international markets will be the U.S. dollar. The U.S. dollar benefitted from its safe haven appeal during the pandemic. However, the trend started to reverse in the fourth quarter after positive vaccine data increased risk sentiment. Figure 4 shows the recent U.S. dollar weakening trend, which could continue in the coming months if investors rotate out of safe haven assets in search of economic growth and higher yields. A weaker U.S. dollar generally makes international assets more attractive to U.S. investors.

FIGURE 4

**U.S. Dollar Weakening**




Source: MarketDesk Research

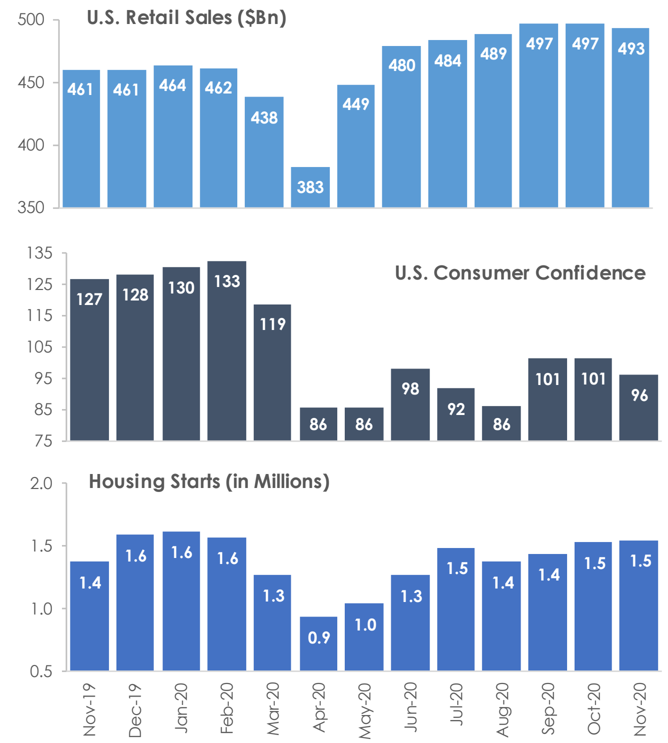
## Economic Recovery Shifts into Lower Gear

Economic data pointed to a gradual deceleration as the quarter progressed. While the economy continued to grind higher, the gains were smaller. Economic releases in the coming months will likely show the reintroduction of virus restrictions pressured economic growth. However, the economic decline will likely not be as steep as spring 2020 because the most recent restrictions were less harsh.

The U.S. consumer continues to be one of the bright spots. Figure 5 highlights the U.S. consumer's surprising strength. U.S. consumers paid down credit card debt and saved more. Retails sales surged as investors rotated to online shopping. Household net worth jumped to a record high. Credit scores increased. Homeowners refinanced mortgages to lock in lower interest rates. However, the gains were limited to higher income households. Lower income households did not participate in the soaring stock market and rush to refinance. The growing consumer confidence gap could put the economic recovery at risk.

FIGURE 5

**U.S. Consumer Health Dashboard**




*Source: MarketDesk Research, U.S. Census Bureau, The Conference Board, National Association of Realtors*

## 1Q 2021 Investment Outlook

The pandemic brought about many changes in 2020. Remote work became the norm, and companies increased their technology budgets. Corporate balance sheets now hold large cash reserves after companies rushed to issue debt. Consumers spent more time at home, which translated into more casual wear and home cooking and a higher savings rate. The question is how many of those changes will stick in 2021.

Some changes will last longer than others. As an example, interest rates are expected to remain low for multiple years. The consequences from low interest rates are significant. Low interest rates support more expensive valuations and hurt savers. However, low interest rates could also encourage more capital investment and economic growth.

The biggest unknown is the pandemic's long-term economic impact. The Federal Reserve's aggressive policy support bridged the economy through the worst of the pandemic. The question is whether the economic recovery can sustain itself, or if it will need additional support. 2021 should help clarify some of the investment trends that will define the next decade.

## THIS QUARTER IN NUMBERS

FIGURE 6

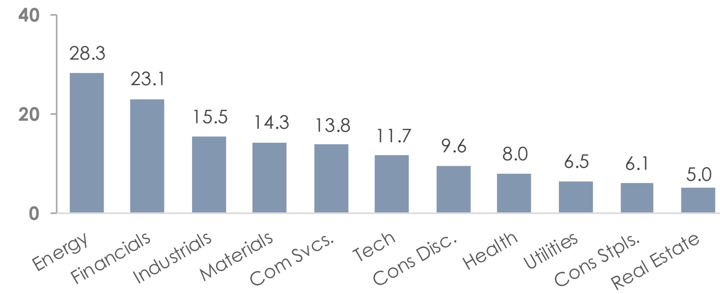
**U.S. Style Returns (4Q 2020 in %)**

| | Value | Blend | Growth |
|---|---|---|---|
| Large | 16.2 | 12.1 | 11.4 |
| Mid | 20.5 | 19.9 | 18.8 |
| Small | 33.3 | 31.3 | 29.6 |

*Data Reflects Most Recently Available As of 12/31/2020*

FIGURE 7

**U.S. Sector Returns (4Q 2020 in %)**




*Data Reflects Most Recently Available As of 12/31/2020*

FIGURE 8

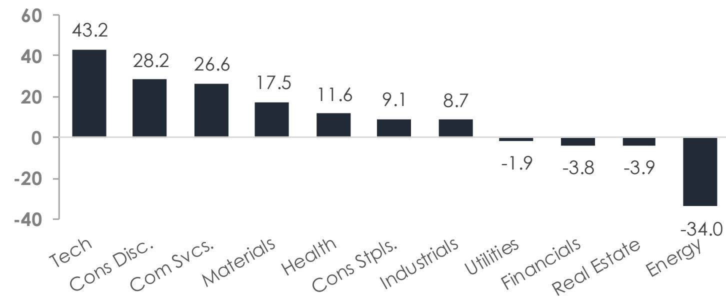
**U.S. Style Returns (2020 in %)**

| | Value | Blend | Growth |
|---|---|---|---|
| Large | 0.9 | 17.1 | 37.7 |
| Mid | 2.5 | 14.9 | 34.0 |
| Small | 2.6 | 18.2 | 33.3 |

*Data Reflects Most Recently Available As of 12/31/2020*

FIGURE 9

**U.S. Sector Returns (2020 in %)**




*Data Reflects Most Recently Available As of 12/31/2020*

FIGURE 10

**Market Data Center**

| Stocks | Level | 1 month | 3 months | YTD | 1 year | 3 years |
|---|---|---|---|---|---|---|
| S&P 500 | 3,756 | 3.7% | 12.1% | 0.0% | 17.9% | 46.3% |
| Dow Jones | 30,606 | 3.3% | 10.7% | 0.0% | 9.3% | 30.4% |
| Russell 2000 | 4,908 | 8.6% | 31.3% | 0.0% | 19.6% | 32.5% |
| Russell 1000 Growth | 1,605 | 4.4% | 11.4% | 0.0% | 38.0% | 82.8% |
| Russell 1000 Value | 833 | 3.7% | 16.2% | 0.0% | 2.2% | 17.3% |
| M SCI EAFE | 1,174 | 5.0% | 15.7% | 0.0% | 7.3% | 11.9% |
| M SCI EM | 71,693 | 7.1% | 18.4% | 0.0% | 16.8% | 15.7% |
| NASDAQ | 12,888 | 4.9% | 13.1% | 0.0% | 48.4% | 104.5% |

| Dividend Yield | NTM P/E | P/B |
|---|---|---|
| 1.52% | 22.4x | 4.1x |
| 1.87% | 20.6x | 4.7x |
| 1.04% | 30.0x | 2.3x |
| 0.66% | 31.2x | 11.9x |
| 2.05% | 17.9x | 2.4x |
| 2.13% | 17.6x | 1.7x |
| 1.45% | 15.3x | 2.0x |
| 0.55% | 30.1x | 8.3x |

| Fixed Income | Yield | 1 month | 3 months | YTD | 1 year | 3 years |
|---|---|---|---|---|---|---|
| U.S. Aggregate | 2.14% | 0.1% | 0.7% | 0.0% | 7.4% | 15.8% |
| U.S. Corporates | 2.66% | 0.1% | 3.4% | 0.0% | 10.8% | 23.5% |
| Municipals (10 yr) | 2.11% | 0.7% | 1.8% | 0.0% | 5.1% | 13.0% |
| High Yield | 4.88% | 1.9% | 5.7% | 0.0% | 4.1% | 15.1% |

| Key Rates | 12/31/2020 | 11/30/2020 | 9/30/2020 | 6/30/2020 | 12/31/2019 | 12/31/2017 |
|---|---|---|---|---|---|---|
| 3 yr Treasuries | 0.17% | 0.17% | 0.16% | 0.18% | 1.60% | 2.00% |
| 10 yr Treasuries | 0.92% | 0.84% | 0.68% | 0.65% | 1.92% | 2.43% |
| 30 yr Treasuries | 1.65% | 1.58% | 1.45% | 1.41% | 2.39% | 2.76% |
| 30 yr Fixed Mortgage | 2.88% | 2.94% | 3.08% | 3.27% | 3.86% | 3.85% |
| Prime Rate | 3.25% | 3.25% | 3.25% | 3.25% | 4.75% | 4.50% |

| Commodities | Level | 1 month | YTD |
|---|---|---|---|
| Oil (WTI) | 48.52 | 7.0% | 6.8% |
| Gasoline | 1.34 | 10.3% | 5.8% |
| Natural Gas | 2.53 | -12.4% | -11.4% |
| Propane | 0.65 | 13.8% | -5.0% |
| Ethanol | 1.25 | 0.8% | 6.8% |
| Gold | 1,895 | 6.4% | 47.9% |
| Silver | 26.41 | 16.9% | 70.0% |
| Copper | 3.51 | 2.7% | 33.7% |
| Steel | 963 | 20.4% | 33.6% |
| Corn | 4.84 | 13.6% | 29.1% |
| Soybeans | 13.10 | 12.4% | 55.2% |

*Data Reflects Most Recently Available As of 12/31/2020*