Market Commentary

December 2020

Equity and Bond Market Update
(as of December 11, 2020)

Index	YTD	1-Year
Dow Jones Industrial Average TR	+7.7%	+10.2%
S&P 500 Total Return Index	+15.4%	+18.8%
Russell 2000 Total Return Index	+16.0%	+18.8%
MSCI EAFE Index (net)	+4.9%	+7.8%
MSCI Emerging Markets Index (net)	+15.0%	+21.5%
Barclays US Aggregate Bond TR	+7.2%	+7.2%

Economic Indicators

	Statistic	Data as of
Unemployment Rate	6.7%	Nov 2020
Gross Domestic Product (GDP)	+33.1%	Q3 2020
Consumer Price Index (CPI)	+0.2%	Nov 2020
Consumer Confidence (1985=100)	96.1	Nov 2020
30-year fixed mortgage rate	2.92%	12/11/2020
Housing Starts (single family)	1,179,000	Oct 2020
10-Year Treasury Yield	0.90%	12/14/2020

Since the U.S. elections on November 3rd, all major equity markets have rallied, with small-cap stocks, as represented by the Russell 2000 Index, topping all other classes with a +18.4% return since the day after the election. Both Emerging Markets and Developed Foreign markets have seen a +11% return over the same period, and large-cap stocks have climbed +6.4%.

As of today, the U.S. has begun administering COVID-19 vaccinations, of which news of successful trials have been driving markets since the week after the election. These vaccinations are being widely distributed across the U.S. and the U.K. at the same time that positive test cases are spiking, with the case count in some U.S. states increasing by up to +76% from the previous week.

Risk markets, such as the stock market, are forward looking and it makes sense that the market is currently in an up-beat mood, looking to the future when the vaccine is more mass-produced, more widely-distributed, and more broadly-accepted. Ironically, New York politicians are presently once again threatening a "full shutdown", even as these vaccinations are rolling out. But the stock market is a very stubborn when it comes to "current" events having a longer-term effect on equity prices. We saw this earlier this year when we were going into the first wave of infections with a vastly different learning curve at the time than we do today, and then how quickly the market recovered. The U.S. economic recession may last for a handful of quarters, but the month-long "bear market" we experienced in the first quarter this year has already fully recovered less than nine months later.

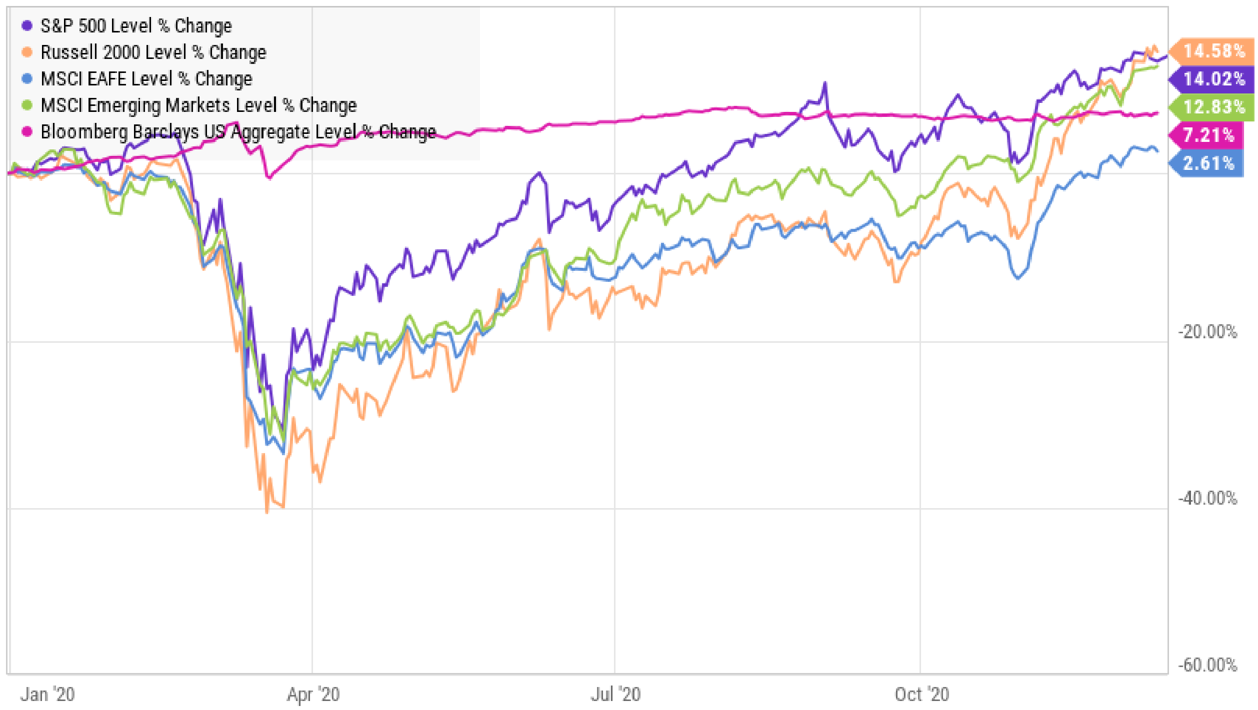
So where does everything that has happened this year leave us now and going into 2021?

The Fed has a number of times reiterated its pledge to keep interest rates near zero until inflation rises consistently. There is also quite a bit of speculation that the Fed would be complacent should inflation run above their target rate of 2% for a time period in order to "make up" for the low inflation environment we have seen already for a number of years. Our last reading from November showed a year-over-year inflation increase of +1.2% (+1.7% if you strip out volatile food and energy prices). Keep in mind that this still historically low inflation number has come after unprecedented stimulus from COVID relief, as well as additional Fed relief to keep the U.S. economy moving as we plowed our way through the initial phases of the COVID pandemic.

Additionally, the Fed is looking for a target unemployment rate defined as "full employment" of 4%. The November rate came in at 6.7%, and has been steadily improving since topping out in April at 14.7%. Prior to the pandemic, the U.S. unemployment rate was at 3.5%, so we have a way to go to get back to that level, and it may take a year or two to get there. However, the strong comeback in employment numbers over the last six months shows the resiliency of the U.S. economy, even in the wake of the worst economic recession since the Great Depression.

At this point, with inflation under control, employment numbers continuing to improve, COVID vaccines rolling out, and a likely makeup of the U.S. government (split Congress with Democratic administration) that has historically been favorable for the stock market, it is safe to say that things are quite positive. But with previously mentioned spiking COVID-positive tests and the threat of ongoing economic

Major Market Indices Price Return (YTD through December 11, 2020)



shutdowns, we may see some uncertainty and volatility in the short-term.

We never like to make predictions, but based on these factors, 2021 should be a good year for the U.S. economy, and as a result, equity markets. The first quarter of this year saw S&P 500 company aggregate earnings down -49% from the first quarter of 2019, and the second quarter was down -33% from the same quarter in 2019. S&P 500 company third quarter aggregate earnings were down only -5% from 2019, so the earnings trend is also showing significant signs of improvement. Based on estimates for our current fourth quarter and adding to actual results for the first three quarters of 2020, we should end up down about -20% to -25% earnings for the entire year versus actual results from 2019. Looking forward for 2021, current estimates for earnings are about +35% to +40% higher than 2020. This would pretty much put us close to being back on track to where we were in 2019. A stronger earnings year for 2021 would put us in line with where we would be had there never been a pandemic and things had been just business as usual. Although these aggregate numbers will look good, it is not to say that everything will be back to the old normal. Many small businesses will have been changed forever, if they are fortunate enough to fully re-open at all.

Always keep in mind that fear, panic, and optimism are not investment strategies, but rather emotions that drive short-term markets.

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Sources:

S&P Dow Jones Indices website (us.spindices.com)
MSCI Barra website (http://www.mscibarra.com)
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