Thoughts from the Holy City – 2020 & 2021 – A Recap and a Preview

"Success is not final, failure is not fatal, it is the courage to continue that counts"

- *Sir Winston Churchill*

As one of the most hectic years in our lives comes to a close, I am left with a new perspective and appreciation for so many different things. As I reread my commentary for this time last year, I wrote that 2020 would most likely continue with the "uncertainties of 2019," and I can say that was pretty accurate. 2020 proved to be extremely challenging for everyone globally, and for some it was and continues to be more challenging than for others. Covid-19 did have some silver linings. Despite the havoc that Covid-19 caused in the beginning of the year, the world has remained remarkably resilient, and both the domestic and international equity markets and economies have rebounded. Over the next several paragraphs we will take a look back at 2020, providing our thoughts on the past year and insights on the coming year.

2020 & 2021 Elections

In the writing of my annual commentary in 2020 I referenced the elections and the potential impeachment of President Donald Trump. A year later they are both still relevant, but in a different manner. President elect Biden is to be inaugurated on January 20th and we now have finality on the elections for the Senate seats in Georgia, with both seats being won by the Democrats. Democrats now have control of the White House, Senate, and House of Representatives which will usher in a new set of priorities and will impact both the economy and markets. Biden and his cabinet's immediate focus will be on Covid-19 mitigation and recovery, with the bulk of his executive actions focused on climate and foreign policy. In the near term there may be elevated volatility due to policy uncertainty, but expectations of recovery supporting measures and an increase in federal spending will continue to support the market and economy. One of the questions is how will the increased spending be paid for? Biden's tax plan calls for an increase in the corporate tax rate to 28% and a tightening of tax rules on overseas income. It is also expected that there will be middle class tax cuts on the personal side. These changes will most likely be staggered over several years, but some will begin to be implemented as early as 2021.

Domestic Markets

The domestic equity and fixed income markets finished out the year strong with all posting impressive gains despite the drawdown in March and April, as we entered the depths of the Covid-19 crisis. The big technology stocks were the biggest winners of 2020 with the tech focused NASDAQ up over 43% for the year. Following behind was the S&P 500 up 16.26%, the DJIA +7.25%, and the Barclays Aggregate Bond Index +7.51%. The Federal Reserve was swift in the response to the pandemic providing a stimulus package in a record amount of time. The Democratic sweep increases the odds of higher stimulus and spending and the Fed will remain accommodative in supporting the economic recovery. This is positive for economic growth this year, but the prospect of higher taxes and higher taxes will prove to be a headwind for earnings growth in 2022 and 2023. Although the outlook is optimistic for 2021, there will be headwinds from the virus surge, vaccination distribution and the timing and size of the stimulus. Raymond James base case for the S&P 500 in 2021 is a target of 4,025, or a 7% return. This is based on the positive expectation of the economic and fundamental recovery as well as the current low interest rate environment and attractive valuations.

Fixed Income

The past 39 plus years of general interest rate decline have benefitted fixed income total returns, and 2020 continued that precedent. Corporate, treasury, and municipal bonds all posted positive returns in 2020 with the Barclays Aggregate Bond Index returning 7.51% for the year. As a result of the Pandemic both the government and Fed responded with significant monetary and fiscal actions. The Fed's balance sheet has now ballooned to over $7.2 trillion which has further impacted the yield curve, and due to the significant actions, treasury yields declined nearly 30% on the long end and over 90% on the short end. Globally, other countries' central banks have followed the U.S. with their response to the pandemic and have also ballooned their respective balance sheets. The Federal Reserve, European Central Bank, Bank of Japan, and People's Bank of China have amassed over $27 trillion in debt. This has helped to keep rates down as more debt is an incentive for governments to keep interest rates down since they have to service that debt. Looking ahead, the Fed and government are likely to continue with the stimulus and U.S. debt remains attractive to foreign investors as there is approximately $17.1 trillion in negative yielding debt globally. These two caveats will likely mean muted returns for fixed income, but it remains a necessity to allocate to in an effort to keep investors aligned with their respective asset allocation needs.

International Markets

International markets, like the domestic markets, were severely disrupted in the beginning of Covid-19, but despite negative earnings growth, rallied back into positive territory to close out the year. Global central banks and governments mostly responded with aggressive monetary and fiscal actions in the beginning of the crisis, and have continued to support their respective economies throughout the year. Some have confirmed that they will persist in their response efforts in the coming year. Despite the rebound and the assumption that the global pandemic fades, international markets have other headwinds to navigate in 2021. Some sectors of the international markets, such as financials, tend to be negatively impacted by negative interest rates that will most likely persist for the foreseeable future. Second, politics will continue to weigh on the European economic recovery with elections in Germany, Italy, and France. Emerging markets, especially Asia, were impacted by the pandemic earlier, and were swift in their efforts to deal and mitigate the effects. This allowed both their economies and markets to quickly rebound and they remain attractive from an investment perspective. Although our analysts favor the U.S. over international markets, Asia is a close second.

Domestic Economy and Outlook

The pandemic has had varying effects on households and sectors of the economy. Low wage service industries were more affected by job losses with the leisure and hospitality, tourism, spectator events, and restaurants being the hardest hit. Unfortunately, locking things down was necessary in an effort to prevent the spread of Covid-19, but that results in a significant decrease in economic activity. As the economy opened back up, activity increased, but so did the spread of the virus. It is a fine line to manage, but with the vaccines on the way, we expect things to return to some sense of normal in the second half of 2021. GDP is expected to match the fourth quarter of 2019 by the middle of this year as Covid-19 vaccines continue to be distributed globally. One risk is that many people will be reluctant to accept the vaccine. Another risk is that the fed and government pull the support prematurely, sending the economy and markets back into recessionary territory. However, I believe that the incoming administration will have a heavy focus on healthcare issues, preventing the spread of Covid-19, and getting the vaccines distributed as quickly and efficiently as possible.

In Summary

2020 was a year that no one will ever forget, a year in which everyone in the entire world was affected by the same event, but in very different manners. For some, it presented a unique opportunity to spend time with their families and loved ones, but for others it took family members and loved ones from them. Many families were given the opportunity to spend a significant amount of time together and reconnect. Closets, garages, and pantries were cleaned and cleaned again. Many parents developed a new found appreciation for school teachers and everyone in the world realized how important and essential our healthcare workers are to us as citizens. I believe that many people have taken a new perspective on life as a result of the events in 2020. The year was mostly defined by the Covid-19 pandemic, but there were also the Australian brushfires, impeachment of President Donald Trump, the swiftest and deepest recession since The Great Depression, racial inequality protests, west coast wildfires, and the vaccine rollout just to name a few. It was a year that tested us all. As I look to the new year and past the events that recently took place at the U.S. Capitol, I am hopeful that this year will be a year of rebuilding, of progress, and unification. As always, we will continue to manage capital with the mindset of managing risk; thinking about the implications of our decisions in terms of years and decades.

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The S&P 500 is an unmanaged index of 500 widely held stocks. The Dow Jones Industrial Average is an unmanaged index of 30 widely held securities. The Bloomberg Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market. The NASDAQ composite is an unmanaged index of securities traded on the NASDAQ system. The MSCI EAFE (Europe, Australia, Far East) index is an unmanaged index that is generally considered representative of the international stock market. These international securities involve additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. An investment cannot be made in these indexes. It is not possible to invest directly in an index. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 Index, which represent approximately 8% of the total market capitalization of the Russell 3000 Index. International investing involves additional risks such as currency fluctuations, differing financial accounting standards, and possible political and economic instability. These risks are greater in emerging markets.