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Economic Review & Outlook

FIRST QUARTER | 2021

Turning the Page on 2020

In the past year, the U.S. stock market continuously toggled between worries about the recession that grew from COVID-19 restrictions and optimism surrounding the unprecedented stimulus measures that kept the economy moving. Lack of clarity around that balance will likely carry into 2021, along with a host of other questions. How long will it take for things to get back to normal? How will the new political reality impact markets? And what does it all mean for my portfolio?

Here, we look back at a challenging year and how the markets pulled through it all with solid returns. We'll also look ahead, with a focus on both the uncertainty and the opportunities that lay ahead.

Economic Overview

ELECTION CLARITY, AT LAST

Election day in the U.S., which created a sense of anxiety throughout much of the past 12 to 18 months, turned into a multi-week affair that carried into January. After much controversy and multiple legal challenges, we expect to see Joe Biden inaugurated on January 20, 2021. Further down the ballot, the potential "Blue Wave" of Democratic victories in Congress failed to materialize, as Republicans actually gained seats in the House of Representatives. Markets surged in response to the results and the sense that large-scale policy change was unlikely.

The last domino to fall was the U.S. Senate. While Republicans fared better than many expected and secured 50 of 100 seats in November, runoff elections for two seats in Georgia left majority control of the Senate—and thus the scope of Biden's first-term agenda—unknown. The drama ended after the January 5 runoff election, when the Democratic challengers won both seats, increasing the number of Democratic Senators to 48 with two Independents. With Vice President-elect Kamala Harris's ability to settle tie-breaker votes, the Democrats may attempt more ambitious policy change than if Republicans had retained control.

VACCINES, THE TRUE GAME-CHANGER

While COVID-19 infection rates and renewed economic restrictions surged toward the end of 2020, vaccine news dominated investment markets. In November, surprisingly strong trial results started a stock rally, which was later bolstered by speedy government approvals and the beginning of global vaccine distribution and administration in December, lifting expectations for the possibility of a return to normalcy.

CONTINUED STIMULUS UNDERPINS THE ECONOMY

The strong economic and market rebound from the lows of March, largely fueled by unprecedented government stimulus in the U.S. and globally, received another boost in late December with the passage of the COVID-related Tax Relief Act of 2020. Amid political tensions, the deal took longer than many expected. However, the nearly $1 trillion aid package, which comes on top of approximately $3.5 trillion in previously authorized stimulus, provided economic relief for small businesses, state and local governments, enhanced unemployment coverage, and direct payments to many U.S. households—all of which stands to help the continuing economic rebound.

Asset Class Performance

Equities and risk assets continued their upward trend in the fourth quarter of 2020, bolstered by the approval and subsequent distribution of COVID-19 vaccines, reduced uncertainty surrounding the U.S. election, and additional stimulus measures. The favorability of risk assets, together with the prospect of normalcy in global economic activity, propelled emerging market equities to post a nearly 20% fourth quarter advance. International developed stocks also rose sharply, with a 16.1% gain. Commodities (+15.3%) continued to recover from COVID-19 restrictions and worries about global growth. Gold (-0.4%) and bonds (+0.7), traditionally more defensive assets, failed to keep up during the end-of-year rally.

For 2020 as a whole, gold came out on top, mostly due to its very strong first quarter results. Overall, most equity markets had a strong year with emerging markets (+18.7%) performing best while international developed (+8.3%) lagged the rest of the world. The S&P 500 ended the year at 18.4% after recording the shortest bear market and the fastest full recovery in its history earlier in the year. Within the U.S., certain areas of the market fared better than others as large technology-names and growth stocks outperformed. Value stock returns were more muted, though they bounced back toward the end of the year. Bonds gained 7.5% for the year as rates fell, while commodities were hit particularly hard early in the year as the global economy shut down, finishing 2020 down 8.1%.

Q1	Q2	Q3	Q4	2020
Gold 4.5%	U.S. Stocks 20.5%	Emerging Market Stocks 9.7%	Emerging Market Stocks 19.8%	Gold 20.9%
Diversified Bonds 3.1%	Emerging Market Stocks 18.2%	U.S. Stocks 8.9%	Int'l Developed Stocks 16.1%	Emerging Market Stocks 18.7%
U.S. Stocks -19.6%	Commodities 17.2%	Commodities 6.5%	Commodities 15.3%	U.S. Stocks 18.4%
Int'l Developed Stocks -22.7%	Int'l Developed Stocks 15.1%	Int'l Developed Stocks 4.9%	U.S. Stocks 12.1%	Int'l Developed Stocks 8.3%
Emerging Market Stocks -23.6%	Gold 12.1%	Gold 3.6%	Diversified Bonds 0.7%	Diversified Bonds 7.5%
Commodities -36.1%	Diversified Bonds 2.9%	Diversified Bonds 0.6%	Gold -0.4%	Commodities -8.1%

Source: FactSet. Indices used: Commodities—Credit Suisse Commodity Index, Diversified Bonds—Barclays Aggregate U.S. Bond Index, Gold—S&P GSCI Gold Index, U.S. Stocks—S&P 500 Index, Int'l Developed—MSCI EAFE Index, Emerging Markets—MSCI Emerging Markets Index. Indices do not reflect the deduction of advisory fees, transaction charges, and other expenses. You cannot invest directly in an index. Past performance does not indicate future returns.

Our Perspective

WHAT A DIFFERENCE A YEAR MAKES

Just a year ago, investors' biggest macroeconomic worry centered on trade tensions with China, and 2019 closed with an equity rally on the back of a "phase one" deal that promised to help extend the longest economic expansion in U.S. history. That expansion ended abruptly, bringing about a steep—but amazingly short—bear market. Today the landscape feels completely different than it did 12 months ago. We're now trying to transition to new political leadership, continue to battle the most serious pandemic in a century, and deal with mounting government deficits and ongoing social unrest. Does such a drastic change in our environment also demand a change in investment strategy?

Let's look back at the major developments from last year and discuss how they impact our outlook. Then we'll dig into how we're making investment decisions in an ever-changing, still uncertain world.

THE YEAR OF THE PANDEMIC

Most people will remember this year as a difficult one. Many of us lost friends, family, and jobs to COVID-19. Even those not directly affected still dealt with the stress of social distancing, market volatility, and uncertainty around when a vaccine might be available. We are confident that we will put this pandemic behind us, but we will likely feel its impact for years to come.

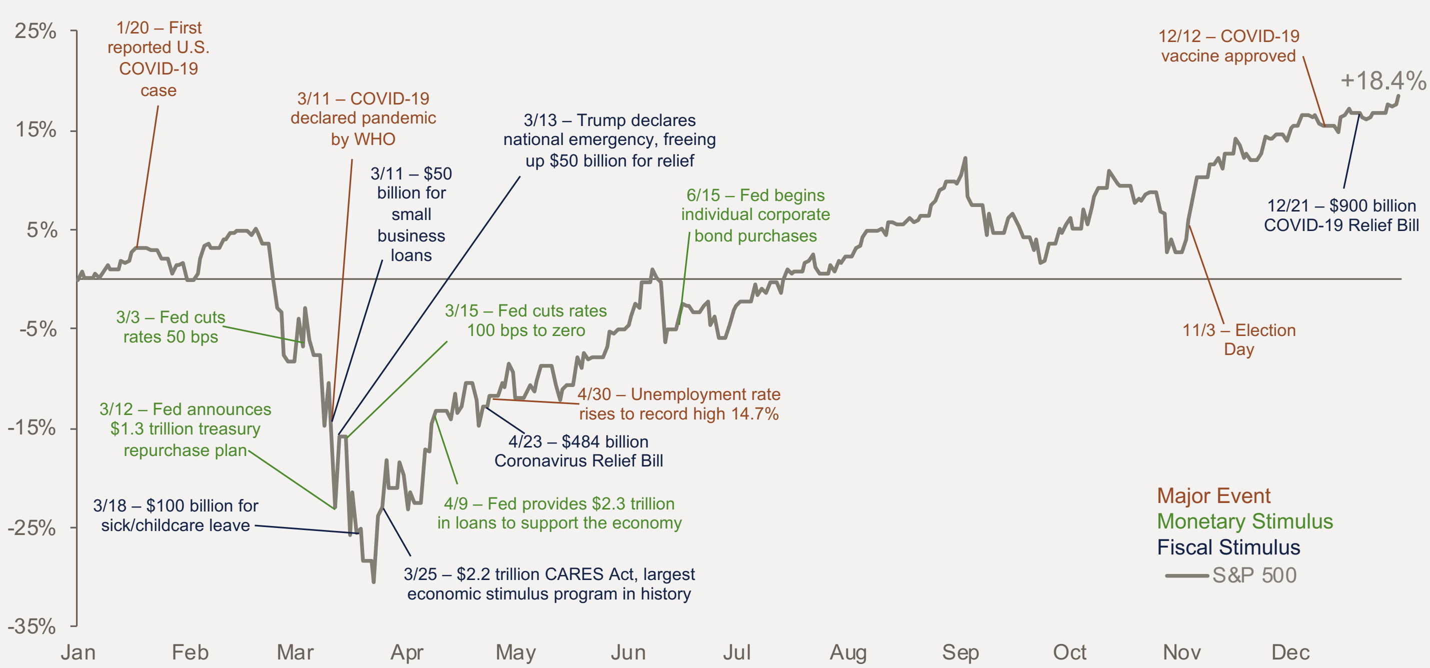
Today, as vaccines are distributed, we can see the light at the end of the tunnel. Uncertainty remains, of course, but early results have been promising, and many are projecting things to largely return to "normal" by early summer. We broadly expect to see accelerated economic growth over the next year as we return to a fully open economy, after which growth should likely return to more of a baseline level, barring other developments.

One of the major investing themes during the shutdown was the increase in working from home, which allowed certain companies (such as Zoom Video) and industries (such as online retailers and semiconductor manufacturers) to thrive during the pandemic's disruptions. Other industries, such as travel and tourism, were hit particularly hard. It will be interesting to see if there are any permanent effects of COVID-19, such as decreased business travel and/or increased telecommuting. On the other hand, there may be pent-up demand to travel as some have put off vacations or visiting family during the past year. Only time will tell what the permanent impact of the virus is on our daily routines.

POLITICS HOLD ONTO THE SPOTLIGHT

Heading into the 2020 elections, many investors were concerned that a Biden victory, especially combined with the potential for Democratic control of both chambers of Congress through flipping congressional districts, could lead to a market

2020 MAJOR EVENTS & U.S. GOVERNMENT RESPONSE



Source: FactSet

selloff. The "Blue Wave" didn't reach the shore, and the market kept climbing, both immediately after the election and for much of the remainder of the year.

With Biden taking office in late January, there could be pushes toward higher regulation, taxation, and climate initiatives, as well as a return to more traditional foreign relations. While some people may worry about a less business-friendly administration, we would remind them that the president has a limited impact on the overall economy and markets.

THE DEFICIT STANDS TO GROW, BUT SO DOES THE ECONOMY

Dating back to the Great Financial Crisis at the end of the last decade, investors have grown accustomed to unprecedented monetary stimulus. The resulting record low (and sometimes negative) interest rates we've seen over the last 10-plus years appear to be the new normal. With rates already low, and assumed to be "lower for longer," it appears that fiscal policy may become the preferred method of stimulus in future years.

These large levels of government intervention reached new heights in 2020. As shown on page 3, the economic and market turbulence experienced during the year was met with record levels of stimulus, helping drive the fastest market recovery in history and allowing stocks to finish the year in positive territory.

Deficits are nothing new, but we may see further increases in their magnitude if this trend continues and big spending remains a bipartisan issue. This pattern has concerned some investors, leading to increased demand for gold and a resurgence of digital currencies such as Bitcoin.

While we see high spending and rising deficits as long-term issues—ones that could lead to higher future inflation or slower growth—we do not believe there is a need to panic. If anything, continued stimulus measures could help stabilize and propel markets for years to come.

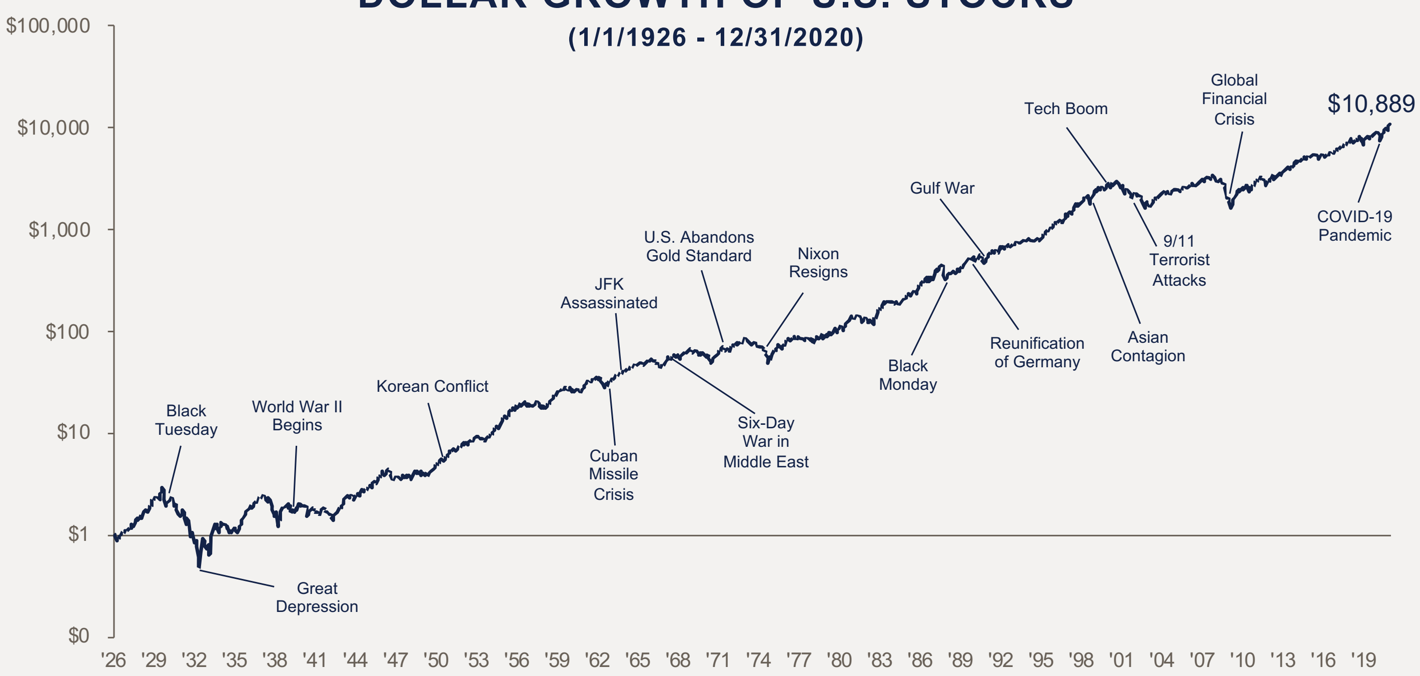
While all these record highs for equities might create concern about a market downturn, we would discourage you from trying to predict a crash or time the markets, as short-term price movements are inherently unpredictable. We believe it is far more likely that this debt pattern will create long-term winners and losers across economies, asset classes, sectors, and even individual industries. Therefore, we continue to recommend diversification as the best defense.

Our Investment Strategy

While a lot has changed in the past year, much remains the same. If 2020 taught us one thing, it's to expect the unexpected. This reminder ties in well with one of our core investment principles—the world (including investments) is inherently uncertain. Because of this, markets are always concerned about something. Political change is constant, and the next surprise is always just around the corner. These realities are not something to fear; rather, they should be embraced. Without them, prudent investors wouldn't have the opportunities they enjoy. Markets have a long history of thriving over time, and investing remains a valuable tool for those who can tolerate short-term stress and keep striving to reach their long-term goals.

DOLLAR GROWTH OF U.S. STOCKS

(1/1/1926 - 12/31/2020)



Indices used: 2005-Present: S&P 500, previous information: Ibbotson Associates, Stocks, Bonds, Bills, and Inflation 2005 Yearbook. Chart based on monthly total returns. Past performance does not indicate future results.

Although one year can look chaotic in the markets, as we saw in the chart on page 3, in the long run the path is consistently upward over time; and even a year like 2020 just looks like a small bump on the way up.

One of the main benefits of a time-based investment approach is it allows us to look through the events of a day, a quarter or even a year, to find those long-term opportunities. While politics and COVID-19 will almost certainly have an impact on markets in 2021, if not much longer, we still see these as short-term issues.

In the short run, markets can be volatile, and just about anything can happen. Because of this, we have to assume the worst and protect the money we may need over the next few years, using conservative vehicles such as short-term, high-quality bonds. It's important to have enough reserves stored away for a rainy day (or year).

In the long run, however, we are optimistic. We believe in human productivity and the market's ability to overcome obstacles. It's done that time and time again, and history tells us, unequivocally, that equities are the primary tool to harvest that growth. That history doesn't mean we can be reckless with our long-term investments. Longer-term risks are omnipresent as well. Inflation is one right now, and it can erode your purchasing power and your gains over time. There is always the potential for certain companies, industries, and even countries to fall by the wayside.

We believe the way you can participate in the market's growth and limit long-term risk is by making sure you have adequate exposure to economies and areas positioned for faster growth, such as emerging markets. We also know it's important to not overpay for that potential; keeping a close eye on valuations is essential.

Finally, we believe diversification is critical to managing risk. While we can observe past performance, we have no way of knowing who tomorrow's winners will be or how the future will unfold. It may be tempting to speculate on the next Amazon or Tesla, but the best path to reaching your long-term financial goals is to cast a wide net and maintain a consistent, reasonable approach.

Conclusion

If there's one thing just about everybody can agree on, it's that we're all happy to say goodbye to 2020. We've been through an all-encompassing health crisis, a severe market downturn (and a remarkable recovery), and a seemingly unending, stressful election. From a purely investment perspective, it wasn't easy to avoid getting caught up in the hype and the emotion of the moment. As we turn the page and look forward to 2021, we encourage everyone to take a deep breath and recognize this moment as an opportunity. It's a chance to look at our investment plans, recognize the lessons we've learned, see the hope that lies ahead, and be assured that we're positioned for long-term success.

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