mABC LLC
Investment Advisors

INVESTMENT OUTLOOK

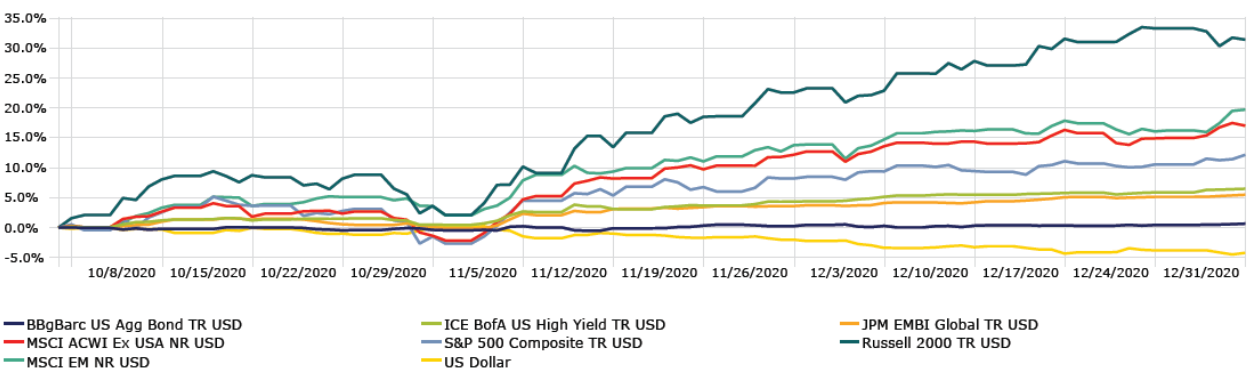
Q4 2020 Market Commentary

With the onset of winter and colder weather across much of the US, COVID-19 cases have surged nationally and remain among the highest levels since the pandemic began[1]. The long-awaited rollout of several vaccines and the inauguration of a new presidential administration will dominate investor attention as this new year begins.

Global Markets Performance

Per Morningstar, the US stock market, as represented by the S&P 500, finished up 12.15% on the quarter, boosting the full year 2020 return to 18.40%. Smaller US stocks[2] rose significantly more during the quarter (up over 31% for the quarter) and finished the year in similar fashion to their larger peers, up 19.96%. International stock markets[3] and emerging markets[4] outperformed domestic equity markets in both the final quarter and the full year, finishing the year up 10.65% and 18.31%, respectively. On the credit side, core bonds[5] rose 7.51% and high yield bonds[6] rose as well, up 6.17% for the year, impacted primarily by moderately widened spreads[a]. Emerging market (EM) bonds[7] rose as well, up 5.88% on the year.

Historical Performance



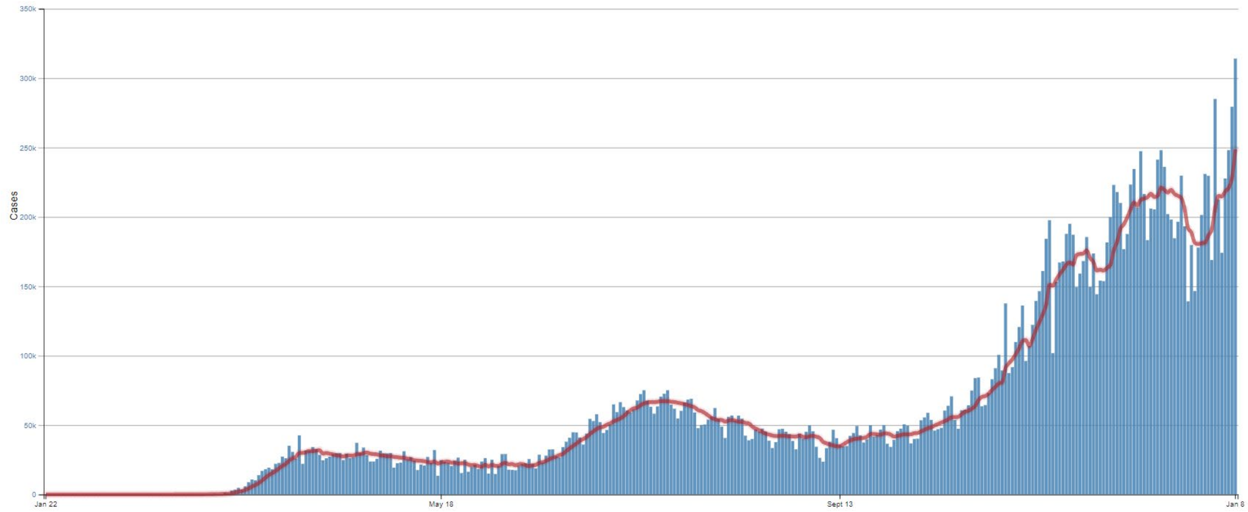
Calendar Year Returns

	YTD	2020	2019	2018	2017	2016
BBgBarc US Agg Bond TR USD	7.51	7.51	8.72	0.01	3.54	2.65
ICE BofA US High Yield TR USD	6.17	6.17	14.41	-2.26	7.48	17.49
JPM EMBI Global TR USD	5.88	5.88	14.42	-4.61	9.32	10.19
MSCI ACWI Ex USA NR USD	10.65	10.65	21.51	-14.20	27.19	4.50
S&P 500 Composite TR USD	18.40	18.40	31.49	-4.38	21.83	11.96
Russell 2000 TR USD	19.96	19.96	25.52	-11.01	14.65	21.31
MSCI EM NR USD	18.31	18.31	18.42	-14.57	37.28	11.19
US Dollar	-6.69	-6.69	0.22	4.40	-9.87	3.63

Coronavirus Update

As the year rolled to a close, COVID-19 cases nationally exploded and ended the year with 7-day average daily case counts over five times higher than they were at the end of September. By state, the case counts per one hundred-thousand are now highest in Rhode Island, Arizona, Tennessee, Oklahoma and South Carolina, in descending order[1].

Daily Trends in Number of COVID-19 Cases in US



Source: Centers for Disease Control and Prevention[1].

New strains of the virus have been detected recently across the globe, most notably in South Africa and the United Kingdom. The UK health system has been inundated with cases through the end of the year, and on January 4th announced a strict lockdown for England to try to control the spread[9]. There is some evidence that the new strains may be more contagious, but thus far they do not appear more likely to cause disease and death[10].

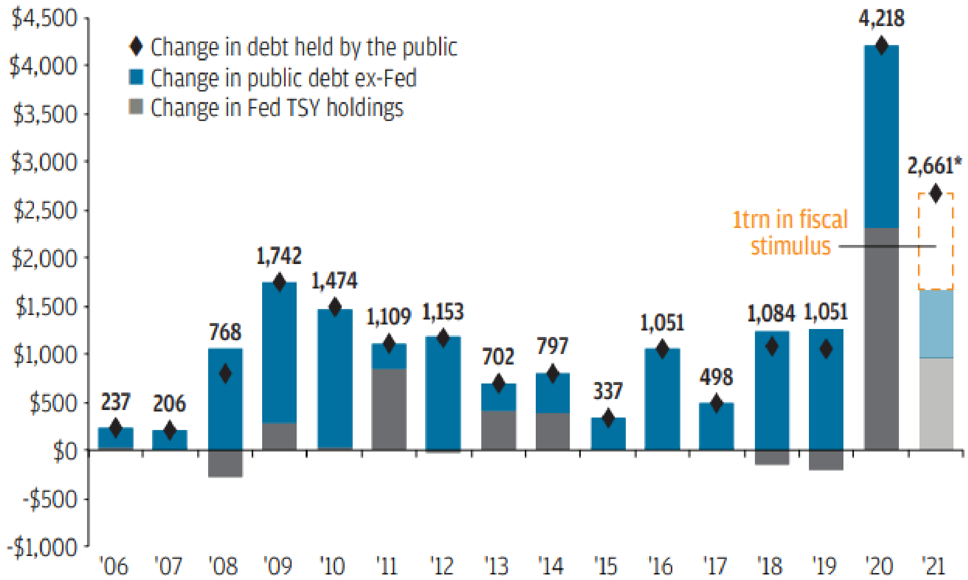
Further, research from scientists at Pfizer and the University of Texas Medical Branch suggest that the current vaccine from Pfizer/BioNTech SE appears to be effective against the new strains of the virus[11]. However, the study was fairly limited and future studies will be required to truly understand the effectiveness of current vaccines against variants of the virus.

An Interest In Rates

Over the course of 2020, interest rates on the short-end and the long-end[b] dropped by nearly 95% and 51%[12], respectively. This sharp and precipitous fall in rates was driven in large part through a reduction in rates by the Federal Reserve (the Fed) as well as the large-scale bond purchase program it put in place.

According to J.P. Morgan Asset Management, the Fed increased its US Treasury positions by about $2.3 trillion over the course of the year. Thus, it effectively purchased over 50% of the total increase in US public debt in 2020[13]. In addition, as 2021 begins it continues to purchase approximately $80 billion in Treasury debt per month, which would add a further $960 billion to the Fed's holdings should that monthly quantity stand pat.

Change In Federal Debt Held By Public & Federal Reserve (USD Billions)



Source: J.P. Morgan Asset Management[13].

As the Fed continues to fund government stimulus programs to fight the COVID-19 pandemic, a chief concern on many investors minds is how all this spending could affect inflation. Analysts at Morgan Stanley argue that inflation due to elevated spending is the potentially the biggest risk this year for markets[14]. Moreover, analysts at J.P. Morgan believe that inflation should naturally return as the economy recovers from the pandemic recession[13].

The Post-Pandemic World

While the coronavirus is likely to be with us for a time, the rollout of several vaccines and the promise of further approvals has provided a light at the end of the tunnel. To that end, many have begun to wonder if the workplace and lifestyle changes that occurred as a result of the pandemic are short-term or enduring in nature.

Companies With Strong Online Business Models

Source: Capital Group[15].

The answer to that question is impossible to know with any certainty, but we do believe that the longer these changes are present the more likely they are to affect behavior long-term. Additionally, certain industries that were en vogue prior to the coronavirus could continue to grow strongly post-pandemic. According to analysts at Capital Group, companies with e-commerce or online business models were already displacing old-economy competitors and the pandemic simply caused a great leap forward in that advantage[15].

However, there are some industries that either can't be digitized or can only be migrated to a certain degree. Restaurants, hotels, and airlines, among others, have limited options and are driven primarily through physical experiences. These businesses may experience their own adjustments post-pandemic, and the industries overall should begin to recover once the virus is largely under control. For example, Chinese domestic air travel has already returned to nearly pre-COVID levels and the cruise industry is taking reservations for 2021 at much higher prices than they were in 2019[15].

Looking Forward

With the pandemic continuing to rage and some countries around the world returning to lockdowns, it is likely that the pandemic could continue to get worse before it gets better. Indeed, both case and death counts in the US nationally are hovering near their highs and remain elevated in early 2021. However, it is also likely that the first quarter of the year could witness a large portion of the US population receive vaccinations for COVID-19.

As the Biden administration approaches its inauguration on January 20th, market attention may begin to focus more heavily on the fiscal implications of a blue wave[c] government. Among others, the Biden agenda focuses on additional stimulus and infrastructure spending, higher corporate taxes, and increased regulations[16]. And as consensus had not expected the Democratic party to gain a majority in the Senate, the market could begin to price in its expectations for the probability of these changes throughout the first quarter.

After a year of incredible volatility in markets, the economy, and our personal and professional lives, it's potentially more important than ever to ensure that you're invested in a manner that suits your long-term goals. We encourage you to reach out to your financial advisor and review your financial plans, and we hope you have a Happy New Year!

As of December 31st, 2020.

References:

Coronavirus data[1] – sourced from CDC, "Trends in Number of COVID-19 Cases and Deaths in the US Reported to CDC, by State/Territory," 3 January 2020. https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases.

Smaller US stocks[2] – as represented by the Russell 2000 TR Index

International stock markets[3] – as represented by the MSCI All Country World ex-USA Index

Emerging markets[4] – as represented by the MSCI Emerging Markets TR Index

Core intermediate bonds[5] – as represented by the Bloomberg Barclays US Aggregate Bond Index

High yield bonds[6] – as represented by the ICE BofAML US High Yield Index

Emerging market bonds[7] – as represented by JPM Emerging Market Bond (EMB) Global Index.

Morningstar performance data[8] – sourced from Morningstar Direct, 2020.

UK strain[9] – sourced from U.S. News & World Report, "U.K.'s Boris Johnson Announces Lockdown to Control Spread of New Coronavirus Strain," by Cecelia Smith-Schoenwalder, 4 January 2020. https://www.usnews.com/news/world-report/articles/2021-01-04/uks-boris-johnson-announces-lockdown-to-control-spread-of-new-coronavirus-strain.

New coronavirus strain features[10] – sourced from Johns Hopkins Medicine, "A New Strain of Coronavirus: What You Should Know," by Robert Bollinger, M.D., M.P.H. and Stuart Ray, M.D., 28 December 2020. https://www.hopkinsmedicine.org/health/conditions-and-diseases/coronavirus/a-new-strain-of-coronavirus-what-you-should-know.

Coronavirus vaccine effectivness[11] – sourced from CNN, "Pfizer's Covid-19 vaccine appears to work against mutation in new coronavirus strains, study finds," by Michael Nedelman, 8 January 2020. https://www.cnn.com/2021/01/08/health/pfizer-vaccine-variant-strain-mutation/index.html.

US Treasury rates[12] – sourced from US Department of the Treasury, "Daily Treasury Yield Curve Rates," 31 December 2020. https://www.treasury.gov/resource-center/data-chart-center/interest-rates/Pages/TextView.aspx?data=yieldYear&year=2020.

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Morgan Stanley inflation predictions[14] – sourced from Forbes, "Democrats in Control Could Usher In A Full Economic Recovery And Another $1 Trillion In Stimulus, But Here's The Catch", by Jonathan Ponciano, 7 January 2020. https://www.forbes.com/sites/jonathanponciano/2021/01/07/democrats-in-control-could-usher-in-a-full-economic-recovery-and-another-1-trillion-in-stimulus-but-heres-the-catch/?sh=41964fc353c5.

Post-pandemic business models[15] – sourced from Capital Group, "U.S. outlook: The future is here, and it's digital," 4 December 2020. https://www.capitalgroup.com/ria/insights/articles/2021-us-outlook.html.

Biden agenda[16] – sourced from Reuters, "Investors reposition for stimulus, spending and tax as they look to Biden," by David Randall, Ritvik Carvalho, and Wayne Cole, 5 January 2020. https://www.reuters.com/article/us-usa-election-georgia-markets/investors-reposition-for-stimulus-spending-and-tax-as-they-look-to-biden-idUSKBN29B0E7.

Glossary:

Spreads[a] – the difference in bond yields of the same maturity but differing qualities, e.g. corporate bonds vs. US government bonds.

Short and long-end interest rates[b] – as represented by the 1-month and 10-year US Treasury rates.

Blue wave[c] – refers to the US Democratic party possessing a majority in the House of Representatives and Senate and controlling the White House.

G4 non-financial corporate debt – debt issued by corporations not operating within the financial sector, e.g. banks. G4 refers to the US, the Euro area, the UK, and Japan.

Phase Three trials[c] – per the CDC, in Phase 3 the vaccines are "given to thousands of people and tested for efficacy and safety." After Phase Three trials are approved, vaccines can be issued to the general public.

Options – a contract that gives the buyer the right, but not the obligation, to buy or sell the underlying asset at a specified price prior to a specified date

Blue chip – typically large capitalization, well-known brands.

Fiscal spending & budget deficits – fiscal spending relates to all government expenses, and a budget deficit implies a government is spending more than it is receiving from taxes, interest, etc.

Liquidity vs Solvency – liquidity relates to having enough cash on hand to continue operating in the short term, while solvency relates to the long-term and whether or not equity is sufficient to continue operating.

Repos (repurchase agreements) – in repurchase markets, borrowers needing cash offer lenders collateral, generally in the form of safe bonds (such as US Government bonds), and in return receive a short-term loan. Repo agreements can be as long as one year, but are generally three months or less, and the most popular tenure is an overnight loan.

Federal funds rate – the interest rate that banks charge other banks for lending them money from their reserve balances (held at the Federal Reserve) on an overnight basis.

Agency mortgage bonds – mortgage securities that are issued by government-sponsored entities (GSEs) like Fannie Mae or Freddie Mac, or guaranteed by a government agency like Ginnie Mae.

Strategic asset allocation – the long-term asset class goals for an investor which specify on average, how much of your money should be invested into stocks, bonds, etc.

Goldilocks – describes an economy that's neither too hot as to spur rapid inflation or too cold to cause a recession; it characterizes an economy operating in an optimal state from a macroeconomic standpoint.

Yield curve – the graphic representation of US Treasury securities as defined by their yield and time to maturity.

One-month & ten-year rates – on the US government yield curve, the securities issued with maturities of one month and ten years, respectively. The US Treasury also issues securities between one month and ten years, and longer than ten years.

Asset location – the tax-arbitrage strategy of placing high-tax exposure assets in low tax-paying accounts, and vice versa. The theoretical benefit is to lower taxes from investments and compound higher long-term capital.