Fourth Quarter 2020 Commentary

Dear Clients,

Please find enclosed your December 31, 2020 Investment Reports.

The financial markets ended a turbulent year on a strong note. It hardly needs saying, but during the dark days of March, with pandemic fears rampant and the global economy falling off a cliff, very few if any market observers would have predicted that stocks would end the year near all-time highs. In 2020, U.S. stocks led the major equity markets. U.S. large-cap stocks gained 21.5% and U.S. small-cap stocks delivered 19.1% for the year. Developed international stocks gained 10.2%. Emerging-market stocks rose 15.5%.

In the fourth quarter, foreign stock markets were particularly strong, with gains in the mid-teens, outperforming the S&P 500 by several percentage points. Value stocks also beat growth stocks and small caps far outpaced large caps. Riskier assets in general got a boost from the resolution of presidential election uncertainty and surprisingly positive Phase 3 COVID-19 vaccine results announced in early November.

The comforting full-year returns masked the incredible volatility and stress investors faced earlier in the year. Stock markets around the world were down between 30% and 40% from January 1 to the market bottom on March 23, in what was the quickest/sharpest bear market in history. From the low point, stocks surged into year-end. The S&P 500, developed international, and emerging-market stock indexes all roared back more than 65%. Small-cap U.S. stocks nearly doubled. Moving on to fixed-income, core bonds gained a strong 7.5% for the year, providing positive returns both during and after the market crisis period. The 10-year Treasury yield touched an all-time low of 0.5% in August and ended the year at 0.93%, roughly a full percentage point below where it started 2020.

Benchmark Returns

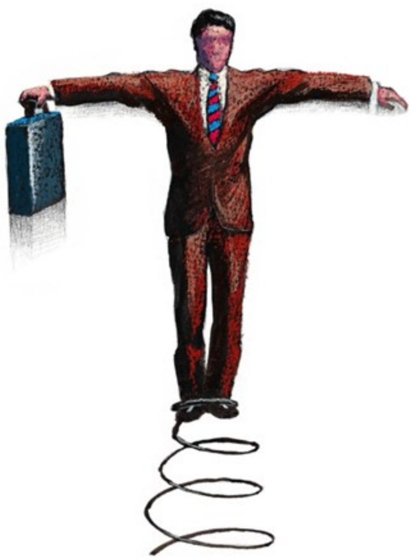
	Last Quarter	Last Twelve Months	Last Five Years
US Large Cap Stocks	11.7%	21.5%	16.2%
US Mid Cap Stocks	18.0%	18.2%	13.3%
US Small Cap Stocks	27.1%	19.1%	13.6%
International Developed Stocks	17.0%	10.2%	8.7%
Emerging Market Stocks	17.6%	15.5%	12.7%
US Bonds	0.7%	7.5%	4.4%
Global Bonds	5.1%	10.1%	4.9%
US REITs	11.2%	-8.7%	3.5%

Data source: Morningstar Direct. Past performance does not guarantee future results. It is not possible to invest directly in an index. Last five years data is annualized. Market indexes include:

US Large Cap Stocks: CRSP US Mega Cap TR USD
US Mid Cap Stocks: CRSP US Mid Cap TR USD
US Small Cap Stocks: CRSP US Small Cap TR USD
Emerging Market Stocks: FTSE Emerging TR USD
International Developed Stocks: FTSE Developed Ex US TR USD
US Bonds: Barclays US Aggregate Bond TR USD
Global Bonds: Barclays Global Aggregate Ex USD TR USD
US REITs: MSCI US REIT NR USD

Unfortunately, any discussion of the big-picture outlook must still begin with the COVID-19 health crisis and its recent "third wave" resurgence in the United States and second wave surge in many other countries, particularly across Europe. The public health impact in the United States is increasingly severe, reaching all-time highs in daily deaths and current hospitalizations. This is leading to increasingly aggressive—albeit still localized—economic lockdowns across the country. And that raises the risk of a sharp slowdown in the economy, if not an outright contraction, heading into 2021. Recent weak labor market data (weekly initial claims for unemployment insurance have been rising again), falling household income (down 1.1% in November), and slumping retail sales (down 1.1% in November, the largest decline since April and the biggest November monthly drop since 2008) indicate this is already happening. At their mid-December meeting, the Fed reiterated yet again that "the path of the economy will depend significantly on the course of the virus."

While the economy faces a high degree of uncertainty in the near-term, the likelihood of widespread distribution of effective vaccines in the first half of 2021 supports the case for a relatively strong economic rebound beginning in the second or third quarter—barring a derailment of the vaccine rollout or some other shock—as lockdowns are lifted and pent-up consumer and business spending is released.



After months of political bickering and delay, congressional Republicans and Democrats reached agreement in the eleventh hour on a compromise $900 billion pandemic relief bill. Among its key provisions, it will make direct payments of $600 to qualifying individuals, extend $300 per week in extra unemployment benefits through mid-March, and authorize nearly $300 million in forgivable loans to small businesses. More fiscal aid may be requested in the early months of President-elect Joe Biden's administration, including money for strapped state and local government budgets.

Monetary policy is expected to remain accommodative as the recent rollout of the Fed's "average inflation targeting" suggests that core inflation "moderately above" their 2% long term target will be tolerated for some time before they start to raise interest rates. Currently most Federal Open Market Committee participants don't expect a need to raise rates until at least 2024. Of course, that is subject to change. The Fed is currently forecasting inflation of 1.8% in 2021 and 1.9% in 2022. Inflation should get a boost from the economic recovery and may temporarily rise above the 2% target though it is not likely to remain elevated as long as unemployment remains high and excess economic capacity exists. The Fed is forecasting a 5.0% unemployment rate for 2021 and 4.2% in 2022. As for fiscal policy, the outcome of the elections suggests increased odds for a larger fiscal stimulus plan in conjunction with the potential for higher corporate and individual tax rates.

After the U.S. stock market's incredible rebound since late March market sentiment (investors' collective willingness to take risk) is very bullish and very optimistic. When sentiment reaches such extremes, it can be a contrary indicator for the market in the very near term. Sentiment is currently in the "extreme optimism" zone, where subsequent market index returns have historically been negative on average. In contrast, crowd sentiment hit its most pessimistic reading in 11 years when the market plunged in late March setting the stage for a powerful market rally boosted by an overwhelming monetary and fiscal policy response. Intuitively, extreme investor optimism implies a lot of good news is already priced into the market. This leaves the market vulnerable to any type of fundamental disappointment, whether on the economic or corporate earnings fronts, the pandemic/vaccine front, or the political/geopolitical front.

Of course, beyond these specific short-term risks, equity investors should always be prepared for market volatility. It comes with the territory and is the price paid to earn the higher expected returns from owning stocks over the longer term.

We appreciate your confidence and trust and we sincerely wish everyone a healthy, happy, peaceful, and prosperous New Year.

Timothy S. Healey
Chief Investment Officer

Janet R. Hayes
Chief Operating Officer

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