Investment Update

January 2021

2020 Fourth Quarter Update and 2021 Outlook

Review: Equities continued to rally in the fourth quarter, with the S&P 500 up 12.1% to finish the year with a total return of 18.4%. Investor optimism received a boost from better than expected COVID-19 vaccine trial results and subsequent regulatory approvals. Fixed income returns were also positive in the quarter, with the Barclays Aggregate Bond Index up 0.7%.

Period	4Q20	3Q20	2Q20	1Q20	2020
S&P 500	12.1%	8.9%	20.5%	-19.6%	18.4%
MSCI EAFE[1,2]	16.1%	4.9%	15.1%	-22.7%	8.3%
MSCI Emerging Markets[2]	19.8%	9.7%	18.2%	-23.6%	18.7%
Barclays U.S. Aggregate Bond	0.7%	0.6%	2.9%	3.1%	7.5%
Barclays Municipal Bond	1.8%	1.2%	2.7%	-0.6%	5.2%

[1]Europe, Australia, Far East

[2]MSCI returns are in U.S. Dollars

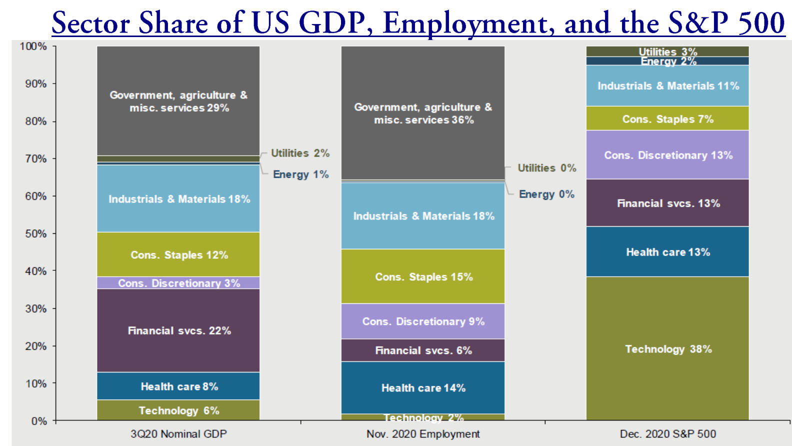
2020: *Annus Horribilis?*

Last year was turbulent on a number of fronts. The pandemic caused the worst global recession since World War II, and there are still a number of challenges to overcome to put the pandemic behind us. However, equities rallied from late March through the end of the year, setting new all-time highs. In Investment Updates over the past several quarters, we have discussed the various reasons behind the rally, but we understand the struggle to reconcile all-time highs in equity markets with an economy still trying to recover in the face of all-time highs in COVID-19 hospitalizations. Thus, we would highlight two key points.

First, it is important to remember that markets anticipate. While such moves are not always correct, this does explain why stock markets have bottomed before the end of almost every recession since the Great Depression—the one exception being the brief 2001 recession when the market was still coming down from the dot-com bubble. Although the cause of the latest recession was atypical, the market anticipation of an eventual recovery was not.

Second, the past year should also serve as a reminder that the stock market and the broader economy are not the same. A good example of the difference can be seen by looking at Technology and Communication Services as a percentage of the S&P 500 versus their respective share of US GDP and US employment. As shown on the next page, the two sectors

(shown as a combined "Technology" category) represent 38% of the S&P 500 but only 6% of Q3 US GDP and 2% of US employment. Therefore, while the economy and stock markets should move in the same direction in the long-term, it is not unreasonable to see some divergence over shorter timeframes.



Source: J.P. Morgan; as of 12/31/2020

Outlook: Economic headwinds are likely in the near-term due to record cases and hospitalizations, leading some states to increase restrictions. However, growth should reaccelerate as vaccine distribution expands and consumer spending improves because of pent-up demand. The second point is an important one, as the US personal savings rate remains significantly higher than pre-pandemic levels—12.9% in November versus a 2014-19 average of 7.4%. This will likely lead to a rapid increase in consumer spending once the pandemic comes to an end and people become more comfortable with resuming normal activities.

The obvious risk to this outlook is the pandemic. The market clearly believes that it is only a matter of when, and not if, it comes to an end. However, it is unclear whether some of the changes in consumer and business trends seen over the past year could persist longer than what is currently expected. For example, will business travel demand rapidly return to pre-pandemic levels, or will the experiences over the past year lead companies to question the need for at least some of it?

International growth will likely be mixed, as countries continue to face economic pressure from the pandemic, and uneven vaccine rollouts will likely lead to uneven economic recoveries. Continued weakness in the US dollar, however, could provide support for some countries, particularly emerging markets.

Strategy: There may be an increase in near-term volatility due to COVID-19 trends and the vaccine rollout. However, we continue to believe the risk-reward in equities is significantly more favorable than fixed income, particularly since the recent increase in longer-dated Treasury yields may continue as the market reacts to expected policies from the new administration. Additionally, the Federal Reserve is unlikely to raise rates for the next few years, which should lead to a positive environment for equities.