Market **Insights**

Economy | **Capital Markets**

Q4 2020

Economy

What an unbelievable year! It is hard to imagine that just one year ago was the first time we heard the term coronavirus. The cascading events that ensued changed nearly every aspect of our lives: wearing masks, working from home, and ordering nearly everything online. Yet, the ingenuity and determination of our society to confront and change our dire circumstances was truly impressive. Health care workers rose to the challenge to help those inflicted with the virus. Scientists raced for better therapeutics and a viable vaccine. The federal government initiated a massive program to provide much needed support for small businesses along with higher unemployment benefits for those out of work. At the same time, the Federal Reserve dropped interest rates to zero and embarked on several new and unprecedented stimulus programs to back-stop the credit markets and provide relief for the beleaguered economy. While not perfect, most people did their part to help quell the spread of the virus and, at the same time, keep the economy from falling into another Great Depression. Today, the economic engine has restarted, and although the virus is still raging, we have developed a vaccine and a sense of "normalcy" appears within reach.

As these crazy events unfolded during the year, the capital markets went on a wild and volatile ride. In early February, the stock market as measured by the S&P 500 Index hit a new all-time high. By late March, the market had fallen about 34 percent as the virus raged, with investors uncertain about its path and impact on the economy. Through the spring and summer, the data suggested the virus was waning, but scientists cautioned about a second wave, which hit with a vengeance later in the year. During the crisis, both the Federal Reserve and government unleashed unprecedented stimulus to try halting the devastating economic impact of the virus. The Federal Reserve dropped interest rates to zero, unveiled massive programs to back-stop the credit markets and provided new credit lines to businesses. The federal government embarked on massive deficit spending with aid to small businesses and additional unemployment benefits to individuals along with other historic steps to provide an economic "bridge" to get through this mess.

Today, the combined efforts to save our economy and the lives of those affected by the virus is showing nascent signs of helping. First, two new vaccines by Pfizer and Moderna were recently approved by the FDA for emergency use. Hospitals around the country have started vaccinating the most vulnerable and front-line workers. This process is expected to take months.

On the economic side, several key data points are recovering after a severe contraction earlier in the year. During the depths of the crisis, the nation's unemployment rate quickly jumped to around 15 percent, from a near historic low of 4 percent at the start of the year. The eventual partial re-opening of many businesses helped some jobs return and the unemployment rate fell back to a more modest range of around 6.7 percent. Although many service-related jobs were severely impacted, including restaurants and retail, many manufacturing and housing jobs quickly came back. The combination of low mortgage rates and new remote work arrangements prompted an exodus of homeowners from large cities to suburbs, and generally allowed people more mobility during the pandemic. Consequently, after a steep drop in the spring, the demand for new and existing homes has increased dramatically. The homebuilder sentiment index recently hit an all-time high and building of new homes is the strongest in over a decade. Signs of improvement.

Looking ahead to 2021, both the economy and capital markets appear poised to continue the healing process. The economy is expected to grow around 3-4 percent next year, as pent-up consumer demand along with better corporate capital spending should result in an improving employment picture and overall better growth. This thesis is predicated on a widespread distribution of the coronavirus vaccine and a much lower infection rate within the next year. With the continued help of the Federal Reserve, interest rates are expected to remain low, while a flood of liquidity should continue to buoy the credit markets and keep investors searching for a reasonable yield and modest returns. Further, the federal government is expected to provide much needed financial aid to the unemployed, small businesses and state governments to help "bridge" the financial gap until a more normal environment returns.

Although valuations are elevated for both stocks and bonds, the combination of low interest rates, modest growth and an expected rebound in corporate earnings should provide stability for the capital markets. We expect value stocks, which have significantly underperformed growth for years, to finally start to show signs of life. Also, the massive deficit spending in the U.S. is likely to pressure the dollar and result in an outperformance for foreign markets. Although the path is clearer than a few quarters ago, we still expect heightened volatility and uncertainty as we collectively work our way through these many social and economic issues.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

As the economy continued to improve and with support from the Federal Reserve, both stocks and bonds trended higher during the quarter. Both domestic and international stocks posted double-digit returns while investment grade corporate and high yield bonds posted solid results. The yield on the 10 year U.S. treasury bond rose modestly during the quarter.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)
As of December 31, 2020

	4th QTR	YTD	1 Year	Annualized 3 Year
S&P 500	12.14	18.39	18.39	14.13
Dow Jones Industrial	10.73	9.72	9.72	9.87
Nasdaq Composite	15.67	45.06	45.06	24.38
Barclays Aggregate Bond	0.67	7.51	7.51	5.33
FTSE USBIG Corporate	3.02	10.26	10.26	7.09
MSCI World	14.07	16.53	16.53	11.15

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	8.83%	6.08%	Represents the number of unemployed persons as a percent of the labor force	High, but improving
Consumer Price Index	1.20%	4.00%	Represents changes in prices of all goods and services purchased for consumption	Sharply lower
U.S. Capacity Utilization	73.30%	80.10%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Low, but improving
Gross Domestic Product+	-2.80%	2.70%	Total value of all goods and services produced indicates strength or weakness of the economy	Low, but improving
10 Year Treasury Yield	0.93%	6.17%	Yield on the current 10 year treasury bond	Historically low
Annual Housing Starts	1,547,000	1,430,000	New privately owned housing unit starts annualized rate	Trending higher

*Average from 1966 to Present   + Annualized   *Source: Bloomberg*