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Performance Reports

Q1 2021 Newsletter | Jeff Griggs, CFA

Due to the wide range of risk tolerances of our clients, some topics or asset classes may have more, less, or no importance to your portfolio. For a detailed analysis, give us a call, or request a detailed performance review.

Big Picture

With the fourth quarter in the rear-view we can finally say goodbye to the wild and chaotic year that was 2020. Amongst all of turmoil, capital markets actually did quite well. While 2020 was home to the fastest bear market ever, it also broke the record for the fastest recovery. After a sharp plunge, US stocks ended the year up an astounding 21.4% in the face of the most disrupted economy we have seen since at least WWII. With the Fed dropping interest rates to zero, and initiating immense easing programs, bonds made excellent returns as well. The biggest story of the fourth quarter was the presidential election. Joe Biden and the democratic party were able to eek out hotly contested wins in the white house and the legislature, eliminating much of the political uncertainty that has been plaguing capital markets.

The election may have taken center-stage in the fourth quarter, but the COVID-19 global pandemic never stopped disrupting the world. From capital markets to our daily lives, the impact of the viral outbreak cannot be understated. However, the fourth quarter marked an important benchmark on the road to recovery, and luckily for all of us, we remain on pace to hit some of the most optimistic timelines. Pfizer and Moderna both had their vaccines approved and the nation has begun distributing them to healthcare workers and the most at-risk populations. While the outgoing administration has been lambasted on their logistical handling of the vaccine roll-out, things are mostly on track and most expect vaccines to be widely available to the general public by mid-summer.

Looking Ahead

I continue to believe that major economic catastrophe will be averted by continued stimulus and easing by the Federal Government and Federal Reserve. With that assumption, we're left in a low-growth, low-rate environment. While the incredible amount of easing the Federal Reserve has already engaged, with more likely to come, there is substantial inflation pressure on the US Dollar. This is somewhat offset by the equally massive easing undertaken by many developed market economies, yet inflation remains the greatest risk to the continued bull market. As long as inflation remains subdued, the Federal Reserve can continue to keep interest rates low, providing cheap financing for growing companies, and the Federal Government can continue to spend virtually unlimited amounts to support the economy in the latter half of the COVID-19 pandemic. However, if inflation begins to rise the Fed will be forced to turn off the spigot, raise rates, and tighten monetary policy. Black swan events aside, this seems the most likely eventual end to the current bull market.

With that said, I will be monitoring inflation closely, but I'm not overly concerned with an inflation scare in the near term. So, what we are left with is a low-growth environment with high valuations. The S&P 500 finished the year with a forward P/E of 18.33x, well above the 10yr median of 15.14x, yet justifiable for two reasons. First, the ultra-low rate environment we are in reduces the required rate of return on stocks and justifies higher valuations. Second, the dominance of ultra-large, highly-profitable, tech firms that have come to represent such a large portion the S&P 500 justifies a higher P/E ratio as future growth expectations for these firms are higher as well. If the coronavirus vaccine deployment continues at the expected rate and remains effective, I believe it is reasonable to expect mid-to-high single digit returns from stocks. However, with muted macroeconomic prospects, we should see individual companies and industries diverge from indices and provide ample opportunity for outperformance by savvy stock pickers.

On the Fridge

Emerging Markets

For the second quarter in a row Emerging Markets beat all other equity classes, returning 19.8% in the fourth quarter. Emerging Markets have lagged for a decade and may be experiencing a long awaited "catch-up."

Energy Sector

The embattled energy sector rose 27.8% in the fourth quarter, largely on vaccine optimism and an economic reopening. Yet energy remains the only sector with a negative annualized return over the last 10 years (-2.7%).

In the Dog House

Real Estate

The real estate sector rose only 4.9% in the fourth quarter, good for last place. Rising rates and continued reopening uncertainty may have led the sector to lag. It finished the year down –2.2%, the second worst behind a –33.7% retreat in the energy sector.

Government Bonds

Government bonds lost –0.8% in the fourth quarter, the second consecutive quarter that they were the worst performing asset class among those we track. Interest rates rising off a very low floor continued to another dismal quarter for the most conservative asset class.

Links and Articles

Big Changes Required
Princeton researchers outline what it takes to hit Biden's lofty climate goals.

In the Eye of the Storm
Guggenheim CIO, Scott Minerd, lays out a sobering perspective.

Does Advertising Actually Work?
The Freakonomics podcast poses a question with big economic implications.

The Invulnerable Hero
Epsilon Theory's Rusty Guinn provides a smart analysis of the GameStop drama.

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Performance

Stocks continued their impressive recovery through the fourth quarter, finishing the year at all-time highs. US equities gained 13.1% in the quarter to finish the year up 21.4%. While developed markets played catch up, rising 15.9% bringing their year-to-date gains to 8.1% and emerging markets gained 19.8% to finish the year up 18.7%. Bonds had a solid quarter. High-Yield bonds rose 6.5%, international bonds rose 5.1% on dollar weakness, and Investment grade bonds returned 3%. On the year, Corporate and international bonds returned 10%, while high-yield and government bonds returned 7% and 8%, respectively. The COVID-19 pandemic is still having a massive effect on the economy, yet S&P 500 earnings only fell -1.5% in 2020 and are expected to grow 8.3% in 2021. I struggle to reconcile how massive unemployment, the shuttering of huge parts of our economy, and a health crisis the likes of which have never seen, have had such a small actual effect on corporate profits, yet the damage is evident in GDP numbers. GDP fell –3.5% in 2020, the first negative year since the Global Financial Crisis, and the worst year since World War II.

	2020 Q3	YTD	LTM	3yr	5yr	10yr
Cash	0.0%	0.5%	1.0%	0.1%	1.1%	0.6%
Fixed Income	2.7%	5.7%	6.2%	4.1%	3.9%	2.4%
Fixed Income Blend	2.7%	5.7%	6.2%	4.1%	3.9%	2.4%
Government	0.2%	8.8%	7.9%	5.5%	3.7%	3.1%
Inflation Protected	3.0%	9.2%	10.1%	5.8%	4.6%	3.6%
Municipal	1.2%	3.3%	4.1%	4.3%	3.8%	4.0%
Floating Rate	0.1%	0.6%	1.1%	1.7%	1.3%	0.0%
Corporate	1.5%	6.6%	7.9%	6.4%	6.0%	5.1%
High Yield	4.6%	0.6%	3.2%	4.2%	6.8%	6.5%
International Bond	4.1%	4.8%	5.5%	3.1%	3.6%	1.3%
Equity	8.3%	1.8%	11.0%	7.7%	10.9%	9.1%
Equity Blend	8.3%	1.8%	11.0%	7.7%	10.9%	9.1%
US Equity	9.6%	7.3%	17.0%	12.8%	14.4%	13.9%
Developed Markets	5.0%	-6.7%	0.6%	1.1%	5.9%	4.9%
Emerging/Frontier	9.7%	-0.9%	10.9%	2.8%	9.4%	2.9%
Alternatives	2.3%	-1.1%	0.4%	0.8%	1.4%	1.6%
Alternatives Blend	2.3%	-1.1%	0.4%	0.8%	1.4%	1.6%

Then energy sector (+27.8%) had the best Q4 with financials (+23.2%) coming up second. This is somewhat unsurprising as those two sectors have been hit especially during the COVID-19 pandemic and had been lagging severely leading into the final quarter of the year. Energy finished the year down -33.7%, while financials were down -1.7%. So, to a large extent the fourth quarter rallies were bounce-back bets as investors saw two vaccines approved and prepared for a post-COVID economy. Info Tech was the big winner on the year, as our lives shifted even further online, from work, to restaurants, to family holidays, social distancing forced us to convert nearly every aspect of our lives online (those that we had not already anyway). However, consumer discretionary rose 33.3% in 2020 as well. This is the real surprising one. Completely unprecedented levels of unemployment coupled with little to no government assistance should have stripped “discretionary” budgets from consumers, but oddly that does not seem to be the case.

	2020 Q3	6mo	YTD	1yr	3yr	5yr	10yr
Information Technology	12.0%	46.1%	28.7%	47.1%	28.1%	27.2%	20.5%
Financials	4.4%	17.2%	-20.2%	-11.8%	-0.1%	7.8%	9.7%
Health Care	5.9%	20.3%	5.0%	20.1%	11.1%	11.9%	15.4%
Consumer Discretionary	15.1%	52.9%	23.4%	28.8%	20.5%	17.0%	18.2%
Consumer Staples	10.4%	19.3%	4.1%	7.8%	9.0%	9.4%	11.8%
Industrials	12.5%	31.6%	-4.0%	1.3%	4.5%	10.8%	11.6%
Energy	-19.7%	4.8%	-48.1%	-45.2%	-20.4%	-9.7%	-3.2%
Utilities	6.1%	9.0%	-5.7%	-5.0%	7.5%	10.3%	10.7%
Materials	13.3%	42.8%	5.5%	12.2%	6.2%	12.2%	9.4%
Communication Services	8.9%	30.8%	8.6%	18.3%	9.3%	10.6%	9.4%
Real Estate	1.9%	15.4%	-6.8%	-7.3%	6.7%	7.9%	10.5%

Source: Morningstar; The 1,3,5, and 10 year performance is annualized.

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Asset Class	Benchmark	Description
Cash	BBgBarc US Treasury Bill 1-3 Mon TR USD	Measures US dollar-denominated, fixed-rate, nominal debt issued by the US Treasury.
Fixed Income	BBgBarc Global Aggregate TR Hdg USD	The Bloomberg Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers.
Government Bonds	BBgBarc US Government TR USD	The Bloomberg Barclays US Government Bond Index comprises the US Treasury and US Agency indices. The index includes US Dollar-denominated, fixed-rate, nominal US Treasuries and US agency debentures (securities issued by US government owned or government sponsored entities, and debt explicitly guaranteed by the US government).
Inflation Protected	BBgBarc US Treasury US TIPS TR USD	The Bloomberg Barclays US Treasury Inflation-Linked Bond Index (Series-L) measures the performance of the US Treasury Inflation Protected Securities (TIPS) market.
Municipal	BBgBarc Municipal TR USD	The Bloomberg Barclays U.S. Municipal Index covers the USD-denominated long-term tax exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds and prerefunded bonds.
Floating Rate	BBgBarc US Trsy Floating Rate TR USD	The Bloomberg Barclays US Treasury Floating Rate Index measures the performance of floating rate bonds issued by the US Treasury.
Corporate Bonds	BBgBarc US Corp IG TR USD	The Bloomberg Barclays US Corporate Bond index measures the investment grade, fixed-rate, taxable corporate bond market. It includes USD-denominated securities publicly issued by US and non-US industrial, utility and financial issuers.
High Yield Bonds	BBgBarc US Corporate High Yield TR USD	The Bloomberg Barclays US Corporate High Yield Bond Index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch and S&P is Ba1/BB+/BB+ or below.
International Bonds	BBgBarc Gbl Agg Ex USD TR Hdg USD	The Bloomberg Barclays Global Aggregate Index is a flagship measure of global investment grade debt from twenty-four local currency markets. This multi-currency benchmark includes treasury, government-related, corporate and securitized fixed-rate bonds from both developed and emerging market issuers. This version excludes USD-denominated debt.
Equity	MSCI ACWI GR USD	The MSCI ACWI captures large and mid cap representation across 23 Developed Markets and 23 Emerging Markets countries. With 2,477 constituents, the index covers approximately 85% of the global investable equity opportunity set.
US Equity	MSCI USA GR USD	Captures broad US equity coverage. The index includes 3,108 constituents across large, mid, small, and micro capitalizations, representing about 99% of the US equity universe.
Developed Market Equity	MSCI World ex USA GR USD	Captures large and mid cap representation across 22 of 23 Developed Market countries, excluding the United States. With 1,023 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Emerging Market Equity	MSCI EM GR USD	The MSCI Emerging Markets Index captures large and mid cap representation across 23 Emerging Markets (EM) countries. With 829 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.
Alternatives	Wilshire Liquid Alternatives TR USD	Measures the collective performance of the five Wilshire Liquid Alternative strategies that make up the Wilshire Liquid Alternative Universe, including the Wilshire Liquid Alternative Equity Hedge, Global Macro, Relative Value, Multi-Strategy, and Event Driven indices. This index is meant to provide a representative baseline for how the liquid alternative investment category performed as a whole. Constituents comprised of '40 Act mutual funds.
US Large Cap Equity	S&P 500	Widely regarded as the best gauge of large-cap US Equities. The S&P 500 is a market-weighted index that includes 500 leading companies and captures approximately 80% coverage of available market capitalization.