QUARTERLY
INVESTMENT REPORT
Q4 2020

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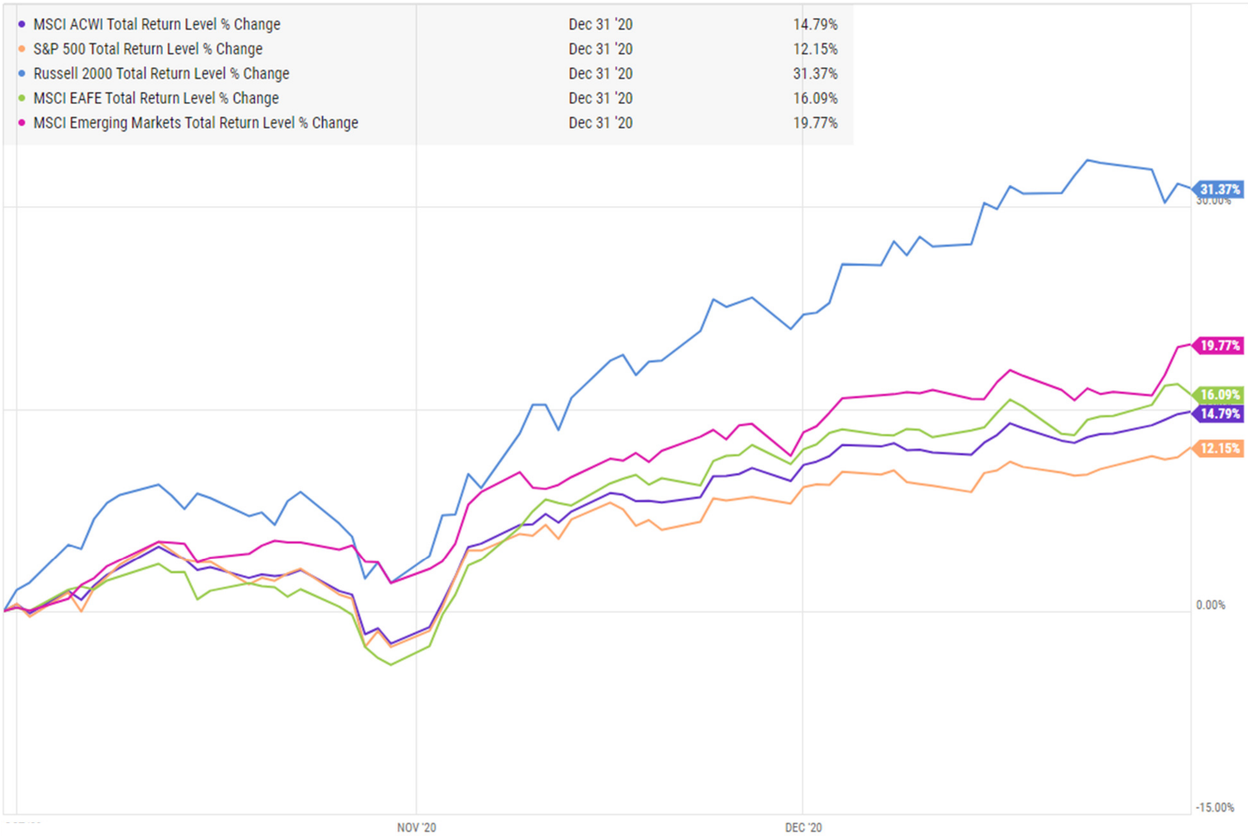
The fourth quarter of the unprecedented and unpredictable calendar year 2020 was characterized by equally incredible market strength and forward-looking optimism. While the novel coronavirus transmission continues throughout the world, the approval and early phases of distribution for numerous vaccines has brought light to the end of the economic lockdown tunnel.

Markets

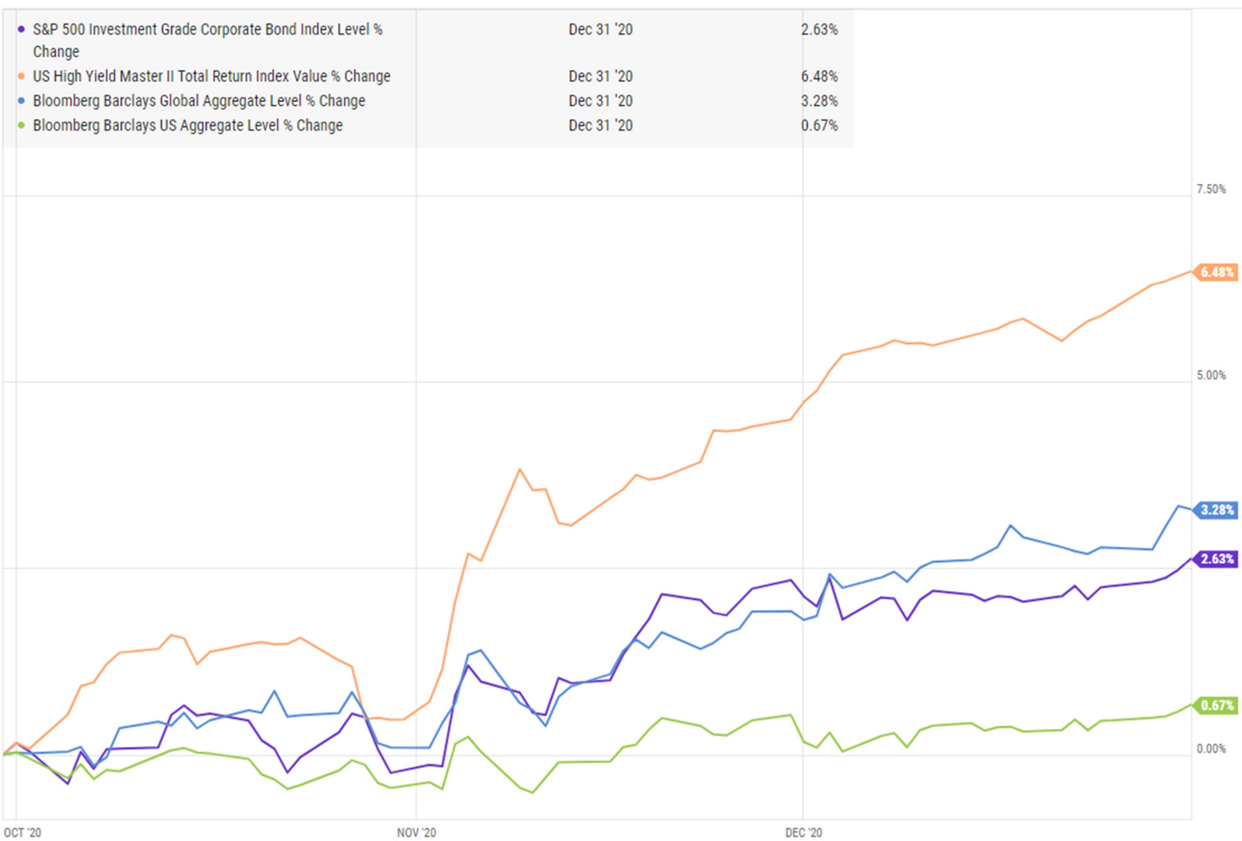
For the three months ended December 31st, the MSCI All Country World Index (global stocks) gained 14.79% on a total return basis, solidifying its 2020 gain of 16.82%. The developing portion of the world also enjoyed strong tailwinds as the MSCI Emerging Markets index (emerging market stocks) ended the fourth quarter with an impressive 19.77% gain, propelling the index to finish 2020 up 18.69%. Domestically, the S&P 500 (large cap stocks) finished the quarter up 12.15%, anchoring its 2020 yearly gain at a previously unexpected 18.40%. Domestic small-cap stocks left the pack behind as it propelled through the final three months of the year gaining 31.37%, finishing with a higher yearly gain than other indexes up 19.96% for the year.



Source: yCharts

Turning to the fixed income, the yield on the 2-year Treasury note fluctuated within a tight range (0.11-0.19%) before ending the quarter where it began at 0.13%. The longer-dated portion of the yield curve steepened significantly as the yield on the US 10-Year began the quarter yielding 0.68%, fluctuated in the range of 0.68-0.97% before ending the quarter in the higher end of the range at 0.93%.

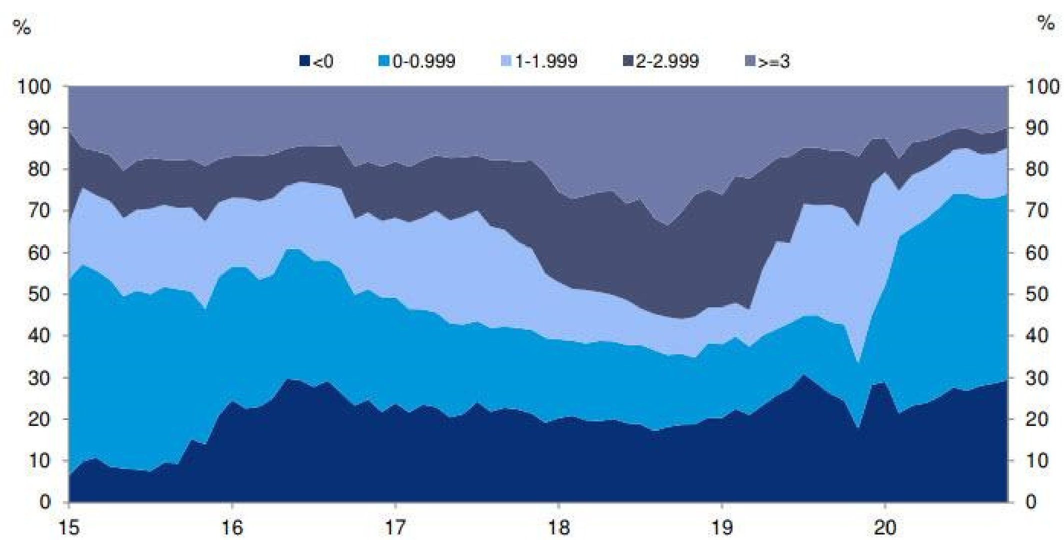
The Bloomberg Barclays U.S. Aggregate and Global Aggregate bond indices gained 0.67% and 3.28% respectively during the 4th quarter. For the year, the U.S. Aggregate Bond Index was up 7.51% while Global Aggregate Bond Index increased by 9.20%. Focusing on corporate bonds, a strong fourth quarter for higher yielding bonds resulted in the US High Yield Master II Total Return index 6.48%. Meanwhile, the S&P 500 Investment Grade Corporate Bond Index gained 2.63% for the quarter and ended the year gains of 10.19%.



Source: yCharts

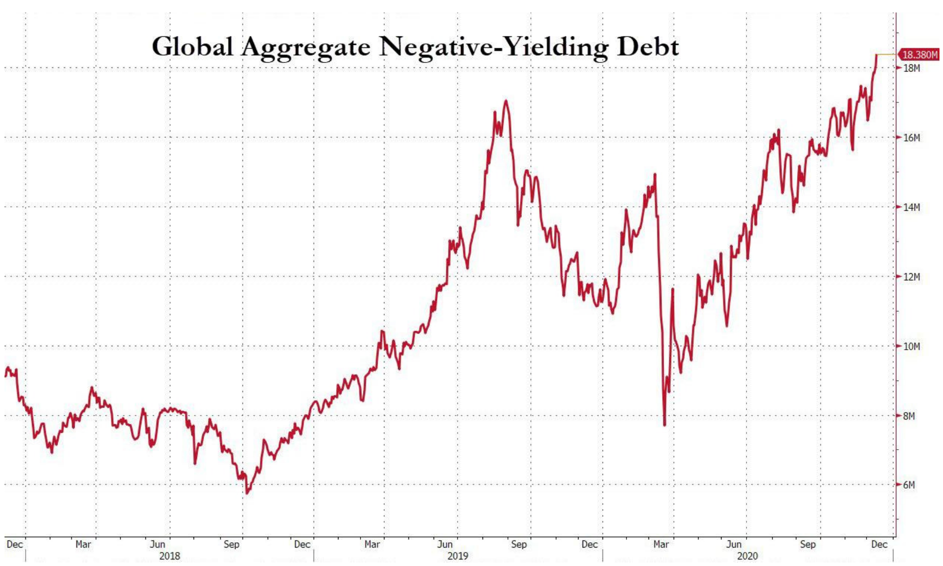
Focusing on the composition of the fixed income market, a recent report from Deutsche Bank highlighted the effect of "one of the key market themes of 2020…the never-ending march lower in yields." According to the report, only 14.9% of global bonds have a yield above 2%, and only 9.9% have yields in excess of 3%. According to the report's author, Jim Reid, "It's not so much the increase in negative yields but the collapse in global bonds yielding below 1%." Specifically, the bucket of bonds yielding 0-1% has exploded during the year, launching from 15.7% of the global total at the beginning of the year to an astonishing 44.7%.

Figure 1: Share of various bonds outstanding in global bond market by their yields. All government and non-government issues used.



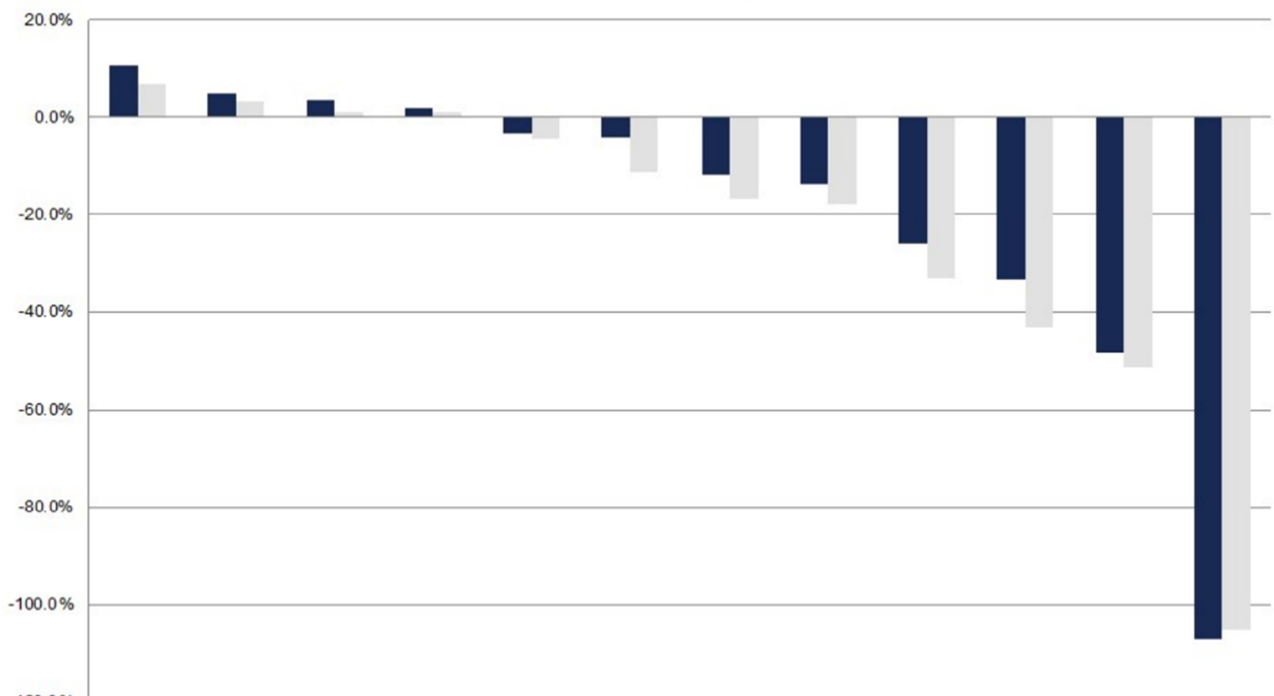
Source : Bloomberg Finance LP, Deutsche Bank

Reid's distinction between the effect of negative-yielding debt and lower-yields is particularly important when put in the context of the sheer volume of negative yielding debt that entered the marketplace throughout 2020. According to Bloomberg Data, global negative-yielding debt exceeded $18 trillion for the first time in history during December.



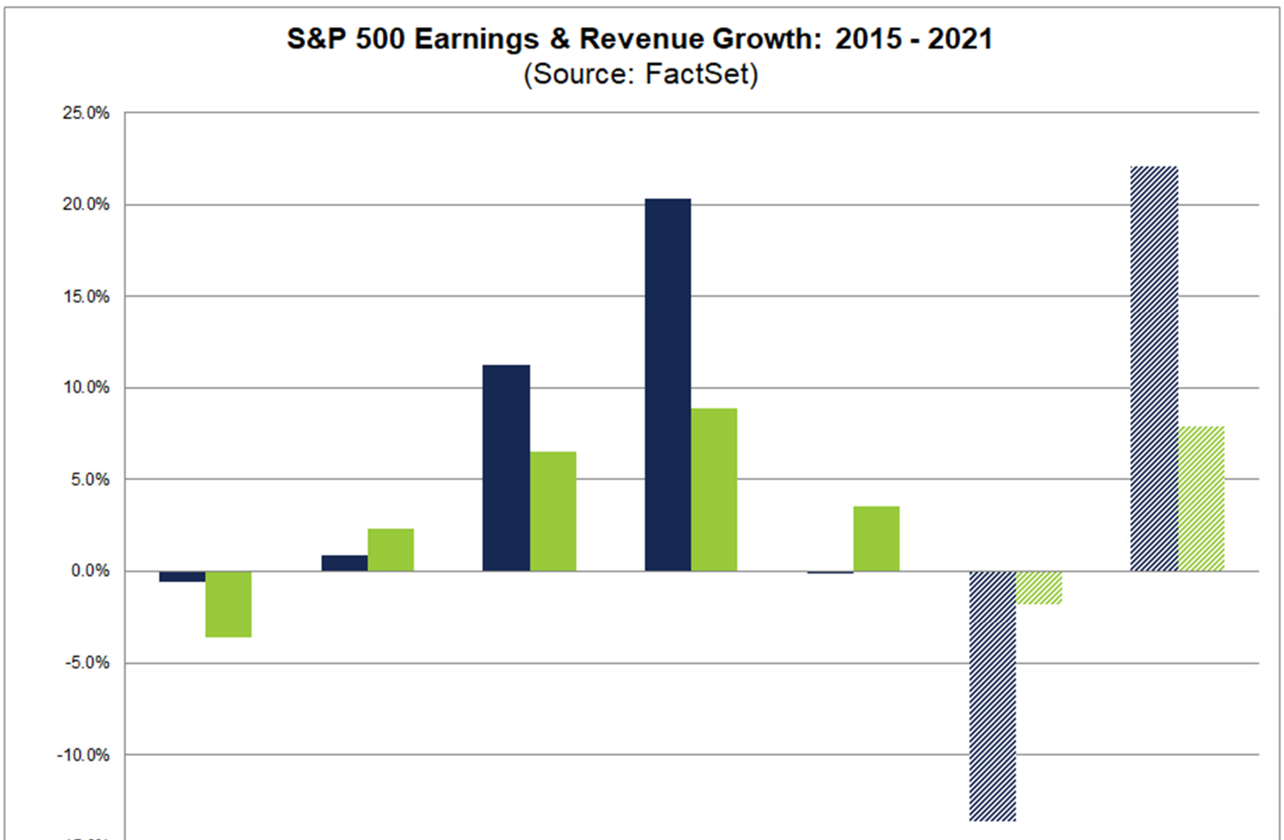
Switching focus to corporate earnings, the final quarter of the year is positioned to end on a brighter note than previously anticipated. As of the most recent report from FactSet in mid-December, the 4Q20 earnings decline is estimated at -9.7% which marked a significant improvement from their previous estimate released at the end of September that had a consensus earnings decline of -12.8%. On a sector level, 8 of the 11 sectors which comprise the S&P 500 have higher earnings growth rates (smaller earnings declines) than compared with the September estimates. For the fourth quarter, 4 sectors are expected to post year over year (YoY) earnings growth, led by the Health Care and Materials sectors while the other 7 sectors are expected to report YoY earnings declines, led by Energy, Industrials, and Consumer Discretionary sectors. On a revenue basis, the optimists have finally overtaken the pessimists as the S&P 500 YoY revenue decline of -1.1% predicted on September 30th was revised in the mid-December report to a YoY growth of 0.1%. If this estimate proves to be accurate, it will mark the first YoY revenue growth since the first quarter of 2020.

S&P 500 Earnings Growth: CY 2020
(Source: FactSet)



	Health Care	Info. Technology	Consumer Staples	Utilities	Real Estate	Comm. Services	Materials	S&P 500	Financials	Consumer Disc.	Industrials	Energy
Today	10.6%	4.9%	3.6%	1.9%	-3.3%	-4.0%	-11.7%	-13.6%	-25.9%	-33.4%	-48.4%	-107.1%
30-Sep	6.7%	3.3%	1.1%	0.9%	-4.5%	-11.3%	-16.8%	-18.0%	-33.0%	-43.4%	-51.5%	-105.2%

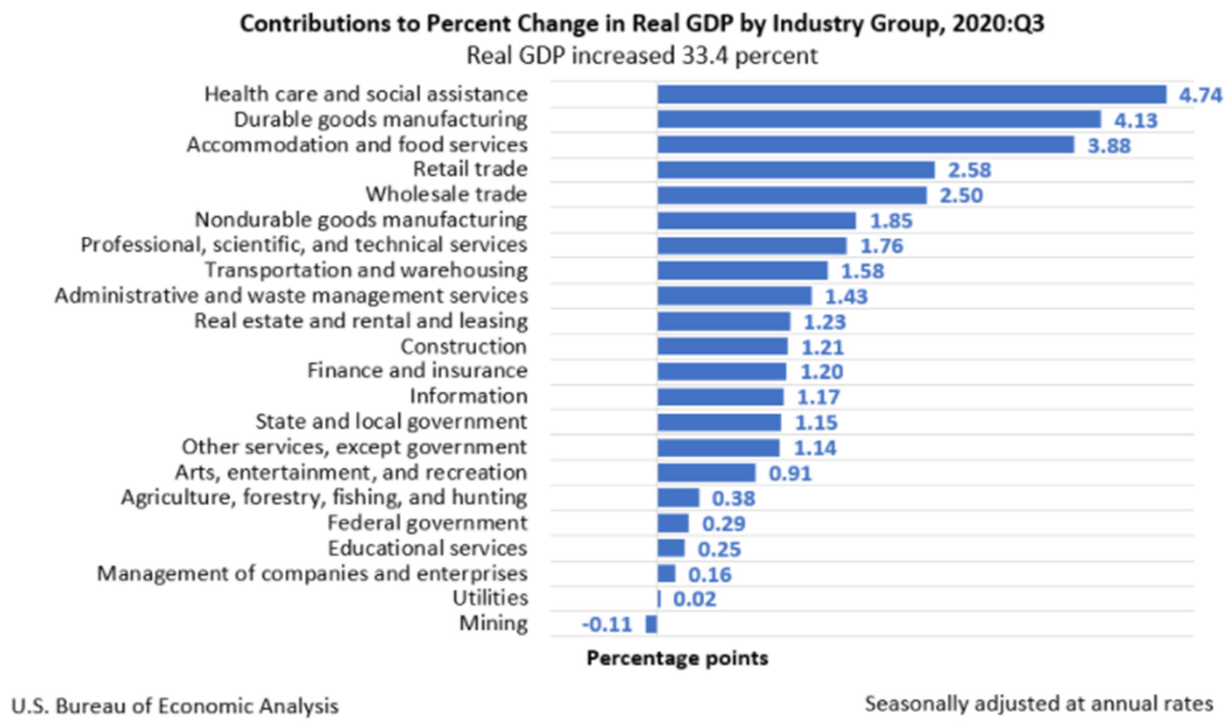
Looking forward to 2021, the S&P 500 is expected to see rebounds in both earnings and revenues with growth in all 11 sectors. According to FactSet, as of mid-December the estimated YoY earnings growth rate for 2021 is 22.1%, which is over double the 10-year average growth rate of 10%. If this estimate becomes reality, it will mark the largest YoY annual earnings growth rate since 2010. The unusually large, expected earnings growth rate can be attributed mainly to the weak comparison of 2020 earnings resulting from COVID-19. On a sector-basis, Energy is expected to lead the way followed closely by Industrials and Consumer Discretionary as the worst hit areas of the pandemic begin their comeback. On a revenue basis, the YoY revenue growth rate for the S&P is projected at 7.9%, also above the 10-year average of 4.5%.



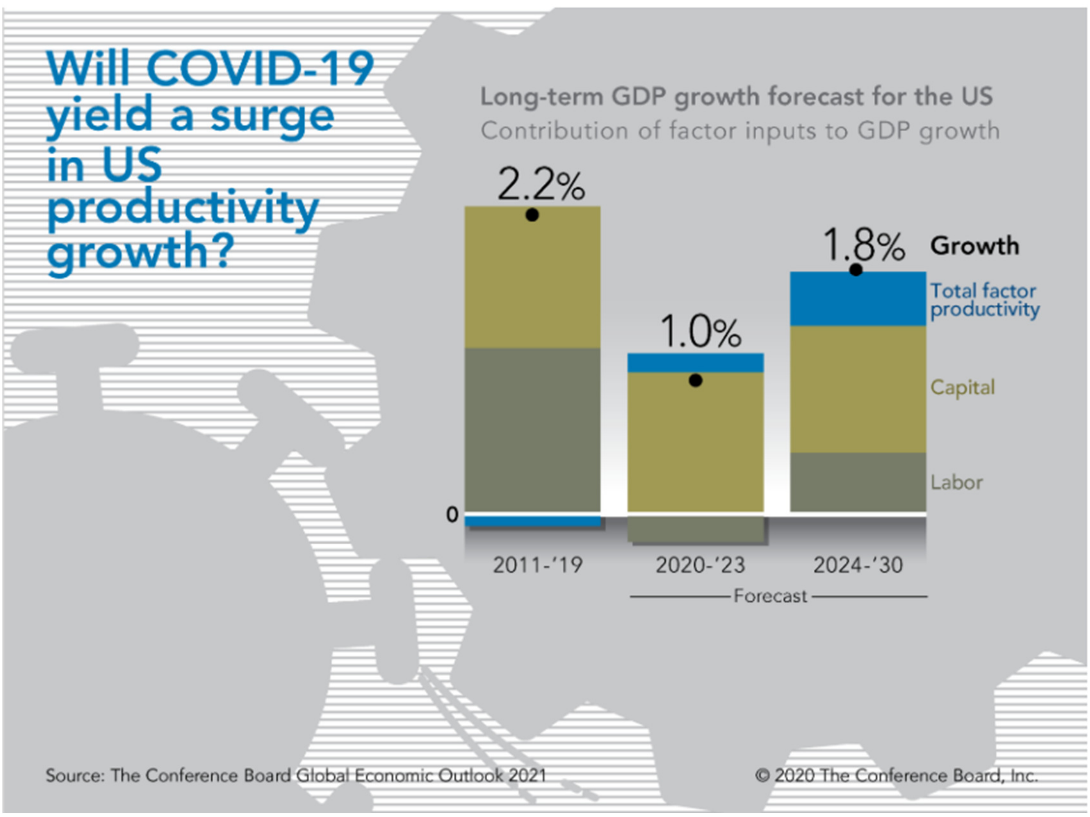
	CY 2015	CY 2016	CY 2017	CY 2018	CY 2019	CY 2020	CY 2021
Earnings	-0.6%	0.9%	11.3%	20.3%	-0.1%	-13.6%	22.1%
Sales	-3.6%	2.3%	6.5%	8.9%	3.5%	-1.8%	7.9%

US Economy

Looking back at the most recent estimate for GDP growth from the Bureau of Economic Analysis in the third quarter of the year, we saw an upwards revision of 0.3% from the previous estimate to a 3Q20 annual growth rate of 33.4%. This upward revision primarily reflected larger increases in personal consumption expenditures and nonresidential fixed investment. On an industry level, we see that private goods-producing industries increased 47.2%, private services-producing industries increased 35.1%, and government increased 10.1% with all figures being compared to the previous quarter on a seasonally adjusted annual rate. Overall, 21 of 22 industry groups contributed to the third-quarter increase in real GDP, with the only industry to see a decline during the quarter being mining.



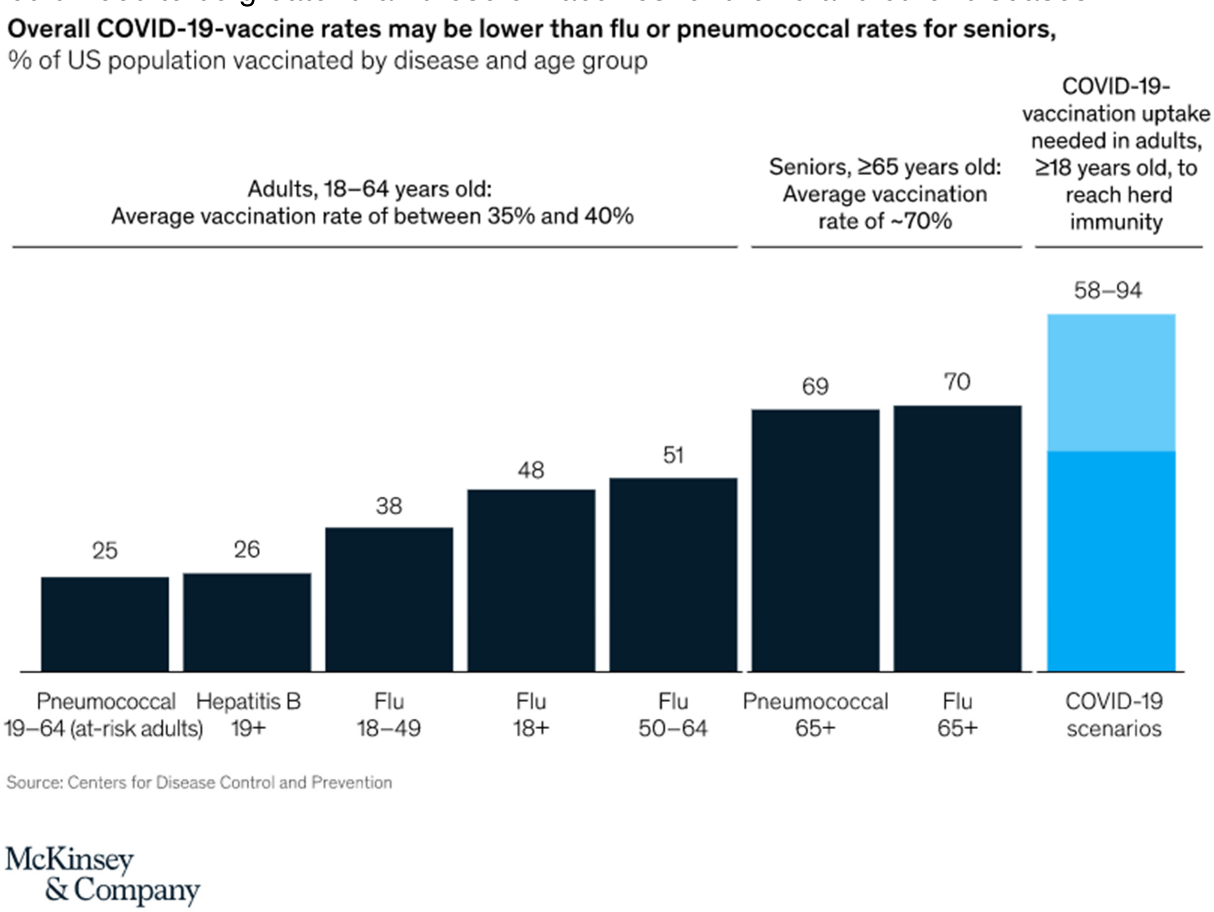
A recent calendar year 2020 GDP estimate released from The Conference Board showed the extent of the damage caused by the pandemic and resulting economic lockdowns will culminate to an annual GDP contraction rate of -3.6% for the year. However, this organization expects the domestic economy to rebound by the same amount in 2021 with a projected GDP growth rate of 3.6%. Looking further out, the medium-term forecasts for the average annual growth rate for the period of 2020-2023 is a steady 1%. Further out, for the period of 2024-2030 the organization expects a real average annual GDP growth rate of 1.8%, which falls short of the annual growth rate seen prior to the pandemic (2.2% form 2011-2019).



Relating to the future path of domestic GDP, during December the US Government passed the second COVID-related stimulus bill, amounting to a package of $900 billion which included a $600 direct payment to individuals and $300 weekly unemployment enhanced benefit among other items.

On this note, we highlight the underlying effect these simulative measures have had on variables such as the U.S. Dollar (USD) and domestic inflation. The U.S. Dollar Index, a measure of the USD against a basket of six major global currencies, fell 6.7% YoY according to data gathered from Seeking Alpha, marking the first annual drop for the currency since a 9.9% decline in 2017. At the end of February 2020, the USD was the world's strongest major currency, but since the Fed's aggressive deployment of policy actions in late March, it is weaker against almost all major currencies at year-end. In terms of inflation, bets for its future increase are on the rise as indicated by BlackRock's iShares TIPS ETF, which tracks inflation-linked US Treasuries. According to data from Bloomberg, during a 6-day period in mid-December, over $1.1 billion was funneled into the ETF, the strongest streak over a given time period since early March. Meanwhile, the spread between the two and 10-year Treasury yield touched the steepest level in three years at the beginning of the month, a further bet on a healthy economy with higher interest rates to come.

According to data analyzed by AlphaSense, as of Friday January 6th, there have been over 17 million doses of the COVID-19 vaccines administered domestically - with over 5 million people having received at least one inoculation. In a tremendous display of human innovation, these vaccines were developed four times faster than any other in history, but they require a rollout four times greater as well according to a recent report from McKinsey & Company. Once everything is said and done, we see the vaccine rollout will amount to the largest simultaneous global public-health initiative ever undertaken. According to the global consulting firm McKinsey & Company, in order to reach the desired level of herd immunity that would allow the US and world at large to return to some semblance of normalcy, adoption ranges for the COVID-19 vaccines would need to be greater than those of vaccines for the flu and other diseases.



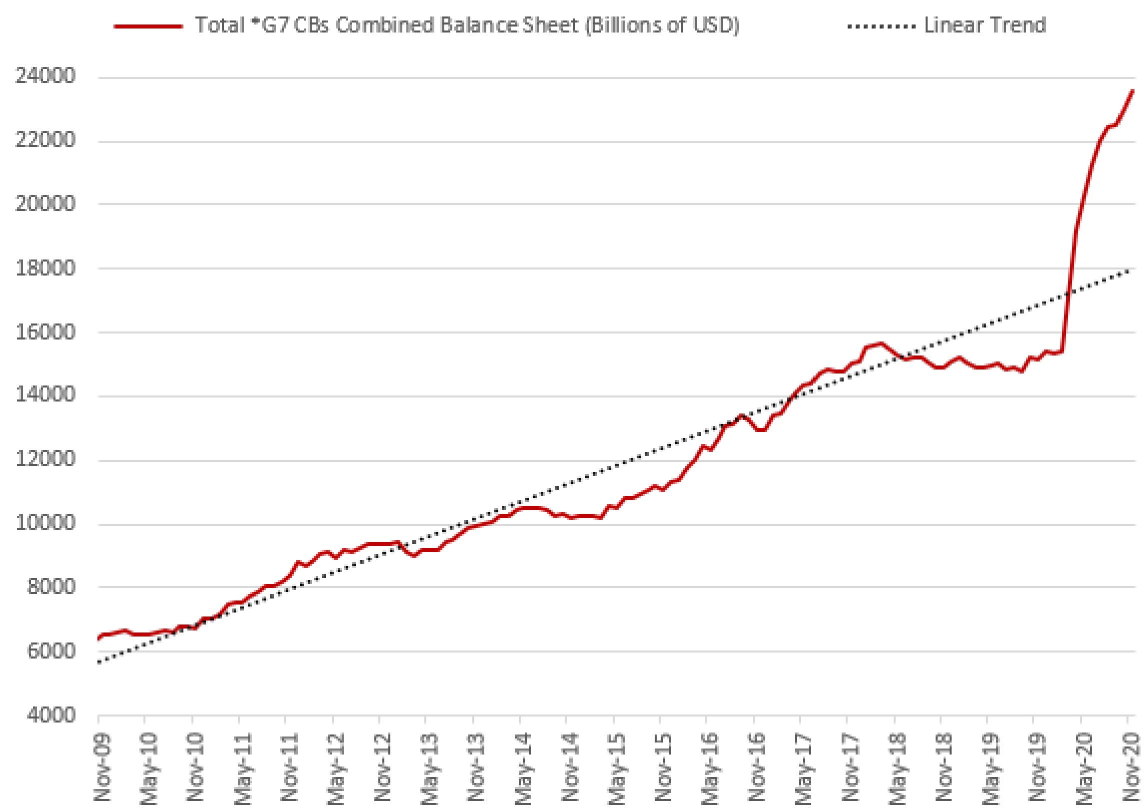
Finishing the domestic recap with the labor market, it appears the post-COVID recovery is stalling about halfway pre-COVID highs. According to data from the Bureau of Labor Statistics, December saw the first monthly job loss since April's record drop. In total there were 190,000 jobs lost during the final month of the fourth quarter. However, October and November's strong labor market gains brought the quarter to a positive ending, adding roughly 800,000 jobs according to data from Bloomberg. The job losses were almost entirely concentrated in the Leisure and Hospitality sectors, which saw employment fall by 498,000 during December. Since February, employment in this sector is down by 3.9 million or 23.2%. In total, the unemployment rate remained unchanged throughout the quarter at 6.7%.

Source: Bloomberg

International Economy

Ending with our focus on the international economy, we first discuss an interesting development noted by the Centre for Economic and Business Research (CEBR). In a report released at the end of December, the organization points out that due to the contrasting recoveries of the world's two largest economies, China will overtake the US to become the world's biggest economy in 2028. This transition is now expected to occur 5 years earlier than previously anticipated. The organization estimates China to attain an average economic growth rate of 5.7% a year from 2021-2025 before slowing to 4.5% a year from 2026-2030. Japan would remain the world's third largest economy until the early 2030's when it will be overtaken by India, pushing Germany down from fourth to fifth largest economy.

According to data from Bloomberg, since February 2020, the G7 central banks combined balance sheet has increased by more than $8 trillion as they work tirelessly to accommodate various financial markets and stabilize confidence. These accommodative policies have led to a dramatic increase in global money supply which has contributed to a sharp inflation in the prices of financial assets, as shown by the Bloomberg World Exchange Market Capitalization for equities topping $100 trillion for the first time in December. The high benchmark of $18 trillion in negative yielding debt was passed immediately following the European Central bank's announcement of an expansions to their monetary stimulus programs by the magnitude of an additional €500 billion in combination with the 9-month extension of the bank's emergency bond purchases.



Sources: Bloomberg, www.christophe-barraud.com

*Note: G7= BoC, BoE (partial data), BOJ, ECB, FED

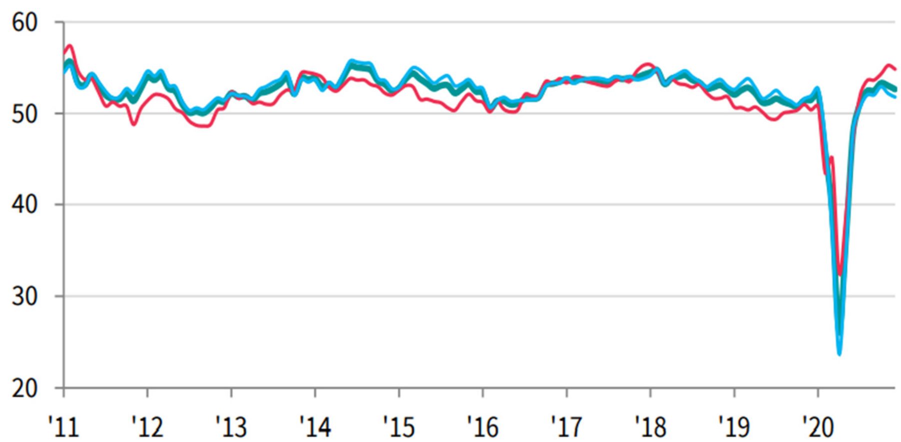
**Note: BOE partial data also available here:
https://www.bankofengland.co.uk/weekly-report/balance-sheet-and-weekly-report

On the global recovery front, the latest PMI readings from IHS Markit showed strong signs of a continuing expansion. The J.P. Morgan Global PMI Composite Output Index, though falling slightly during December to 52.7 from 53.1 in November, remained close to October's two-year high. Five of the six sub-industries covered by the survey logged increased output, with Consumer Services activity falling for the 11th consecutive month at the fastest pace since June. On a country level, economic output expanded in most countries observed, with the strongest growth being logged in Australia, China, and the United States. In contrast, contractions were seen in the Euro Area (on average), Japan, and Russia.

Global Output Index

Composite / Manufacturing / Services (Business Activity)

sa, >50 = growth since previous month



Sources: J.P.Morgan, IHS Markit.

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