AndCo's Monthly Market Update

December 2020

THE ECONOMY

The events experienced in November could be considered a microcosm of what has transpired in 2020. The news was dominated by the unresolved election, the precipitous rise in the number of new COVID-19 cases, and an unrelenting rise in global markets. As of the time of this report, the presidential election seems resolved but the current administration still vows to press on with further legal challenges. Despite the delay in determining the result of the election, we are not in unchartered waters. The 2000 presidential election was not determined for 36 days as Florida endured numerous recounts.[1] Positive news related to the imminent release of several COVID-19 vaccines was heartily welcomed given the rapid rise in number of new cases.[2] While it is not expected that these vaccines will be available for wide distribution to the general population prior to the end of the year, those that are in high risk jobs such as first responders or medical professionals, and those that are highly susceptible are slated to be first in line. Finally, risk assets continued their march higher during the month as momentum, both for news related to potential vaccines and the general market, drove markets higher.

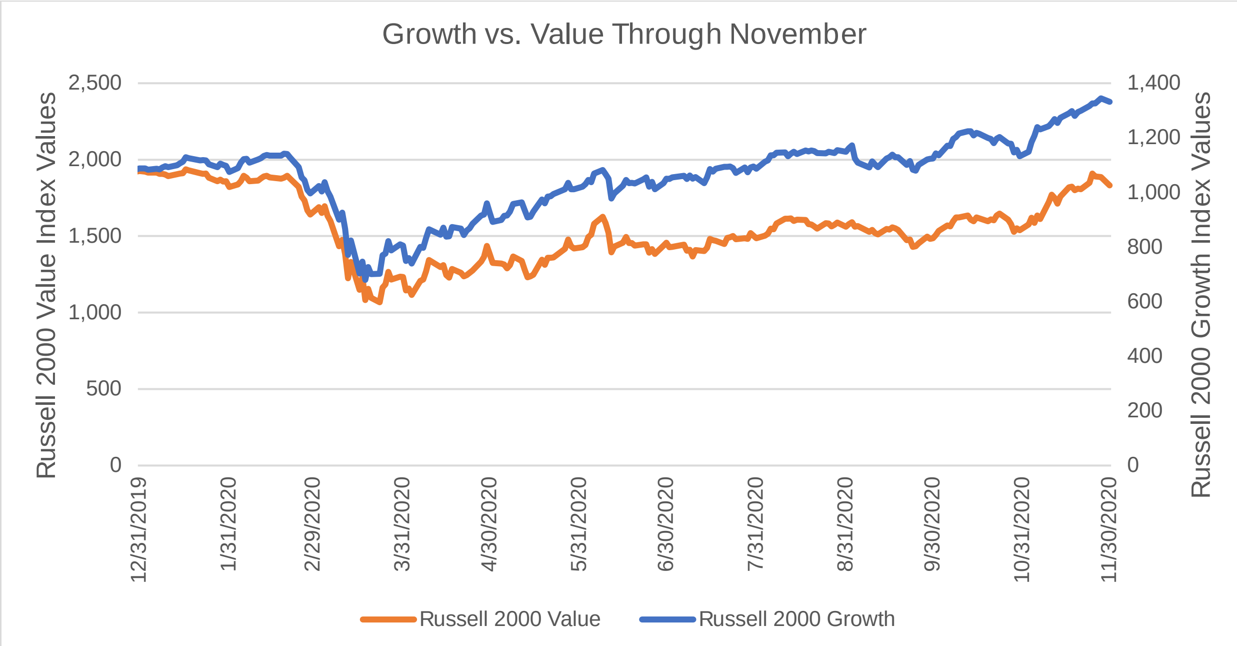
From an economic perspective, while the recovery remains generally intact, numerous data points signaled slowing economic growth. Importantly, several states re-imposed tough restrictions to stem the tide of the pandemic which most likely will act as a headwind to growth in the near future. One area we had been pointing to as a source of strength, the labor market, is showing signs that it may be under pressure. While the release of October's unemployment rate which showing a decline to 6.9%, down from 7.6% in September, initial jobless claims rose slightly which suggested that companies may be laying off workers as the pandemic drags on.[3] Not surprisingly, as a result of the uncertainty, Americans felt less sure about the future which was reflected in the University of Michigan Consumer Sentiment indicator which declined during the month to 76.9, down from 81.2 in October.[4] This decline most likely can be traced back to the weakness in the labor markets.[5] Uncertainty about the future was also reflected in a slight decline in retail sales during the month as consumers weighed their prospects. The combination of fewer hours worked and the lack of second stimulus package from Congress most likely weighed on households.

Despite these concerns, there were sources of strength that can not be ignored. In particular, the housing market remains robust as evidenced by the release of October's housing starts and existing home sales data which handily beat the market's expectations.[6] Equally as important, businesses are continuing to restock inventories as seen in the October durable goods orders which climbed 1.3% during the month.[7] While these numbers can often be volatile, they offer insight into what business owners are thinking about their future opportunities. Finally, monetary conditions remain supportive with the Federal Reserve (the Fed) maintaining its dovish stance on interest rates which should continue to be supportive of future economic growth.[8]

In trying to summarize the economic landscape, there is certainly a little bit of something for everyone. Yes, the economy is most likely slowing as the responses to the pandemic drag on and renewed implementation of preventive measures could result in additional headwinds for the economy. That said, the world is awash in liquidity, vaccines are on the way, the election results appear sorted out, and parts of the economy continue to shine brightly. Given these conditions, we remain positive about the outlook for the economy.

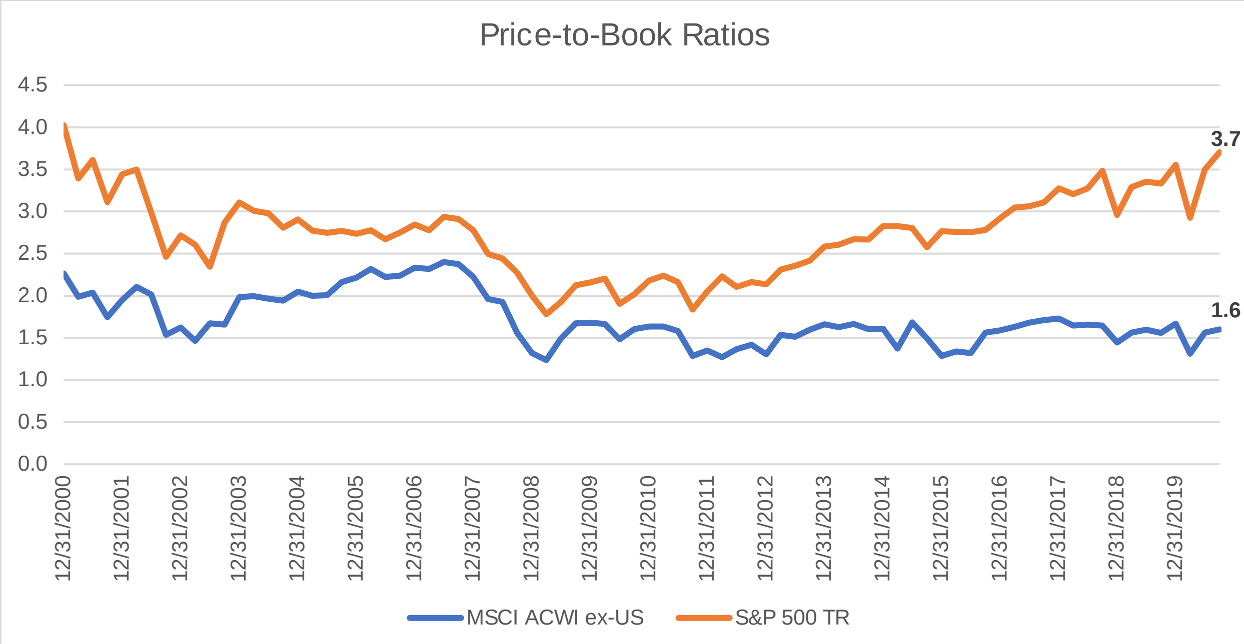
EQUITIES

If at the beginning of the year we had predicted that the world would endure one of the most frightening pandemics, coupled with one of the most severe recessions on record, and yet the US equity market would still deliver double-digit returns, most of our clients would have dismissed us. Yet here we are in November and the S&P 500 Total Return Index has returned roughly 14.0% year-to-date.[9] For the month of November, the index powered higher returning roughly 11.0%, meaning nearly all of the year's return was captured in one month.[10] Looking closer at the numbers, the strong returns were not confined to only US large cap stocks during the month. Small cap stocks, represented by the Russell 2000 Index, which had trailed large caps during the year returned roughly 18.4% in November.[11] Equally as important, value-oriented stocks performed well across the market capitalization, outperforming the large company counterparts. As evidenced, the Russell 2000 Value Index returned 19.3% compared to 17.6% for the Russell 2000 Growth Index during the month.[12] In looking at past periods, when value stocks have outperformed growth stocks in November, that trend has historically continued into December.[13] While it may be too soon to say that there is a rotation under way from growth to value, the extreme valuations in growth stocks, combined with the concentration within a few technology stocks, makes for a compelling argument that investors could look for opportunities in more reasonably priced companies as a way to mitigate some of the risks associated with stocks that have experienced significant gains in recent periods.



Source: Bloomberg as November 30, 2020

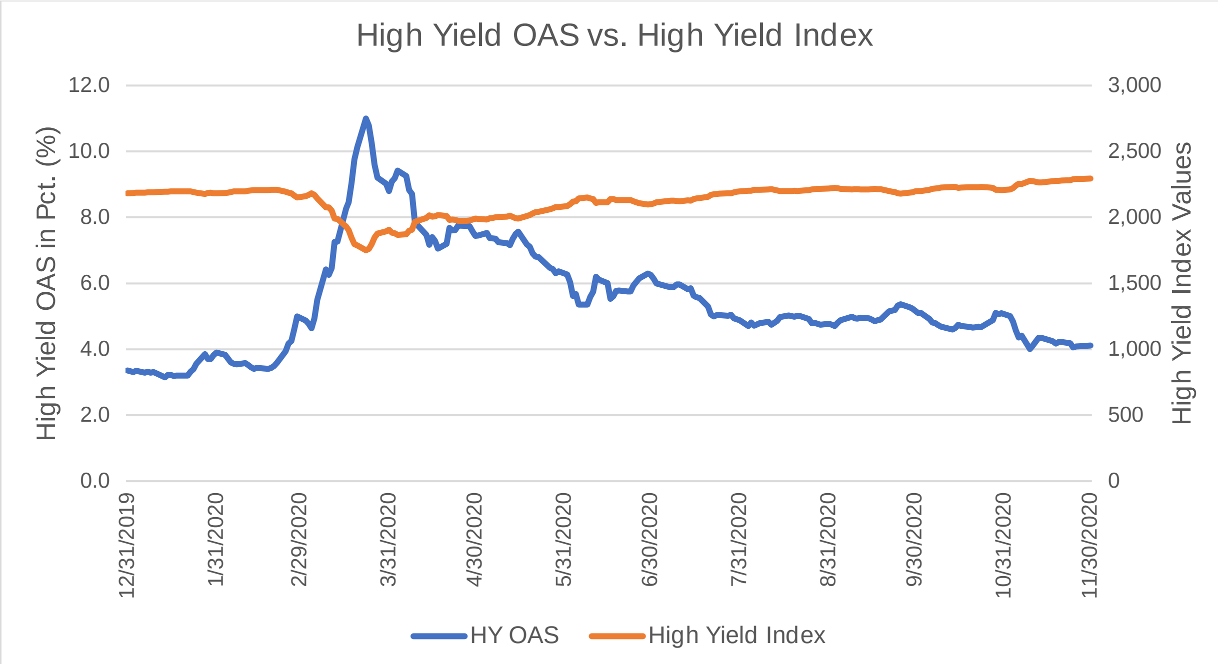
Similar to US markets, global developed and emerging markets experienced strong returns during the month as news related to the release of vaccines for the virus caused markets to surge higher. For the month, developed markets, as represented by the MSCI EAFE Index rose roughly 15.5% while emerging markets, as represented by the MSCI Emerging Markets Index, gained roughly 9.3%.[14] While the recent returns in international markets have been impressive, both developed and emerging markets trail the US, as measured by the S&P 500 Total Return Index, year-to-date and over the longer-term five-year and 10-year trailing periods.[15] However, in comparing valuations across markets, international stocks look less expense compared to their domestic counterparts. The US, and the dollar, has been the benefactor of investors seeking higher potential rates of returns given the differential in interest rates and as a safe haven in recent years as global growth has stagnated. While it is likely that interest rates in both Europe and Japan will remain zero-bound, thus creating a headwind as future growth rates remain below their long-term trends, we believe there is a scenario where global growth begins to recover as vaccines are distributed which could lead to investors seeking higher rates of return outside of the US in undervalued markets. As flows reverse, US dollar weakness could act as a significant tailwind for international assets.



Source: Bloomberg as of November 30, 2020

FIXED INCOME

Fixed income market returns broadly mirrored stocks as lower quality bonds, especially high yield corporate bonds, outperformed higher quality US Treasury and government agency bonds. For the month, the Bloomberg Barclays US Corporate High Yield Bond Index returned roughly 4.0% while the Bloomberg Barclays US Aggregate Bond Index returned roughly 1.0%.[16] During the month, corporate credit spreads continued to tighten across the credit quality spectrum primarily due to the expectations related to the vaccines. With a strong month, investment grade credit spreads are now only slightly wider than where markets began the year. As a result of the continued rally in credit, US high yield bonds have returned roughly 5.0% year-to-date while investment grade as measured by the Bloomberg Barclays US Investment Grade Corporate Index has returned 9.4%.[17] Considering the plunge in the markets we experienced earlier this year, the rally in credit markets has been nothing short of amazing.



Source: Bloomberg as of November 30, 2020

APPENDIX

1. https://www.cnn.com/2015/10/31/politics/bush-gore-2000-election-results-studies/index.html
2. https://covid.cdc.gov/covid-data-tracker/#trends_dailytrendscases
3. Bloomberg, November 2020
4. Bloomberg, November 2020
5. Bloomberg, November 2020
6. Bloomberg, November 2020
7. Bloomberg, November 2020
8. Bloomberg, November 2020
9. Morningstar, November 2020
10. Morningstar, November 2020
11. Morningstar, November 2020
12. Morningstar, November 2020
13. MSIM Applied Equity Advisors, November 2020
14. Morningstar, November 2020
15. Morningstar, November 2020
16. Morningstar, November 2020
17. Bloomberg, November 2020