Winter 2021

Investment+ Commentary

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WEALTH MANAGEMENT

A Socially Distant Vaccine

We hope everyone had a lovely holiday season and are staying healthy as we welcome the New Year. This is hopefully the conclusion of our "Socially Distant" COVID-related series of quarterly letters. What a year it has been, and we finally have a light at the end of the tunnel with multiple, effective vaccines rolling out in full force as we speak.

Q4 Review

Equity markets closed out a volatile 2020 with their very own COVID-19 recovery, setting new highs in all major indices around the globe. Technology stocks soared to record highs as their businesses were largely insulated, and in some cases benefitted, from the effects of lockdowns. However, what is more encouraging is the significant recoveries that small cap companies, foreign companies and some beaten down sectors like oil stocks and banks experienced at the end of the year. This leadership shift, which we will touch on later, is healthy for the economy, stock market, and growth in the future.

One of the main events in the fourth quarter was the Presidential Election. Much like 2016, pollsters underestimated the incumbent, President Trump, and his ability to produce votes. Republican candidates also did better than expected in other races further down the ballot. It was thought that a "blue wave" was coming and many feared a Democratic-controlled federal government would lead to sweeping legislative changes, which could hurt the economy. The Georgia runoff senate elections swung in the Democratic direction and Vice President-elect Kamala Harris will have the senate tiebreaker vote. A 50/50 split is much less worrisome than the 52 or 53 seat majority that was feared.

We now have the 21st session of Congress where Democrats have full control, albeit by a very slim margin. This very narrow Democratic majority means that the Democrats will be able to bring bills up for votes on popular issues ranging from increasing the minimum wage to infrastructure to passing additional fiscal support. We would not be surprised if corporate tax rates rise to 28% (still below the Obama-era 35% rate) and individual rates for top earners touch 39.6% again. Any changes to the tax code could be punted to 2022 as part of a negotiated settlement. We suspect the incoming President's preference for the elimination of stepped-up basis upon death is DOA (dead on arrival). Ambitious or progressive legislation like the Green New Deal will be difficult to enact.

It is said that for markets, gridlock in politics is good, as it creates a system of checks and balances between parties. We believe this can be true, but as the gray lines in the chart below depict, market performance (as illustrated by the Dow Jones Industrial Index) has also been positive when there has been a unified Republican or Democrat government. Obviously, market valuations, investor sentiment, and monetary and fiscal environment of the time frames cited are not captured and do matter. Nonetheless, the fact that one party has full control, albeit by the narrowest margin, may not rise to the level of concern certain investors/commentators feared it could be.

Average DJIA Performance During Sessions of Congress: 1901 - 2021

President	Senate	House	Occurrences	DJIA Change (%)	Annualized Return (%)	% of Time Up
D	D	D	20	17.77	7.78	65.0
D	D	R	2	23.96	11.25	100.0
D	R	D	0			
D	R	R	6	21.46	9.53	66.7
R	D	D	11	9.68	3.92	72.7
R	D	R	1	-21.42	-11.35	0.0
R	R	D	6	7.79	1.29	66.7
R	R	R	14	18.39	7.94	78.6

Source: Bespoke Investment Group, LLC

One thing we know is that politicians' ultimate goal is to get re-elected. There are numerous Democrats in historically Republican states that stand to lose their jobs in 2022 if they vote for any radical changes. Even with the 50/50 split in the Senate, it will take just one Democrat to break party ranks to foil plans for any of the major Democratic legislative initiatives such as raising the capital gains tax. Joe Manchin, the Democratic Senator from West Virginia, seems primed to play a significant role in affecting future legislation.

Another fourth quarter development with lasting beneficial implications is the development of viable vaccines to prevent COVID-19. There is now officially a light at the end of what felt like a very long tunnel. As of this writing, over 10.8 million doses of COVID-19 vaccines have been administered in the U.S., with hundreds of thousands more occurring each day world-wide.

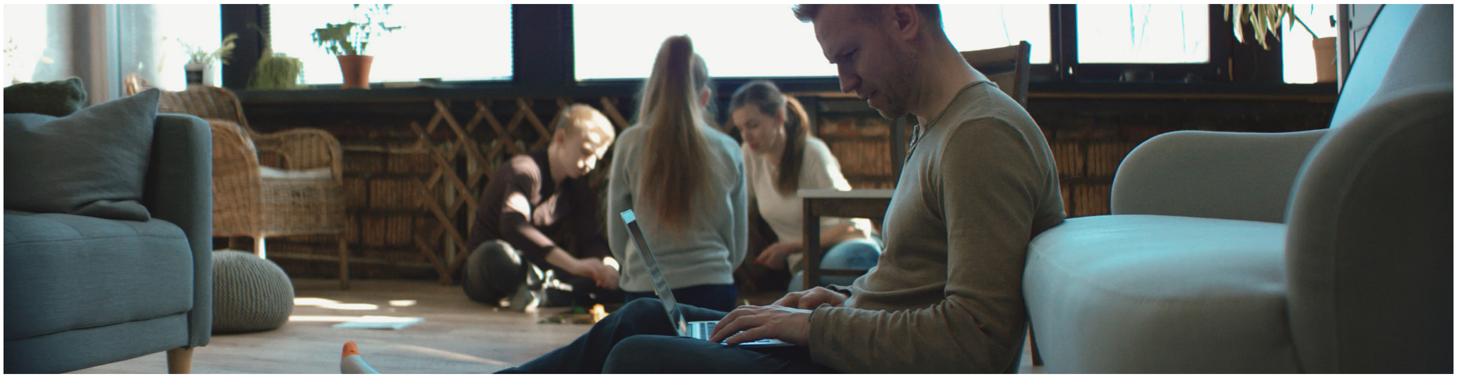
While 2020 was the year of the virus, 2021 will be the year of the vaccine. How fast can people be inoculated? How successful will the vaccine ultimately be? How quickly will confidence be restored once most people are able to return to work, or dine out in restaurants? All these questions are still very difficult to answer, but there seems to be consensus that the economic lows are likely behind us. While this is hopefully good news, that does not mean we are out of the woods in terms of economic and market performance.

A FAMOUS QUOTE BY BENJAMIN GRAHAM, A FAMOUS ECONOMIST AND INVESTOR, COMES TO MIND: “In the short run, the market is like a voting machine — tallying up which firms are popular and unpopular. But in the long run, the market is like a weighing machine — assessing the substance of a company.”

Currently the market reflects investor optimism that the economic lows are behind us, and people are “voting” with their stock bets. Investor sentiment, by many measures, is running hot. So, whether that optimism is warranted bears watching. The speed with which our nation and the world reduce the COVID-19 spread may well determine if investors are being too optimistic.

Did the “Robinhood” Traders Break the System?

The pandemic and lockdowns in March and April created a list of clear winners and losers. People who could work from home were clear winners, while many service industry workers were one example of the unfortunate losers. The “what can you do while you’re locked up at home” attitude made its way into the stock market in the form of what is now known as the “stay at home” trade. Zoom Video, Peloton and Chewy are a few examples of stocks that performed well during the pandemic due to their ability to generate record growth in a time of distress. Other industries were not so fortunate, such as casino operators, airlines or hotels.



While everyone was forced into lockdown, many folks took up day-trading to pass the time, and with this "obvious" trade, came some bubble-reminiscent stock price increases for certain companies. The Nasdaq 100, technology heavy and a clear beneficiary of the terrible situation, was up over 40% for the year, despite a significant decline in March. It seems unlikely that the "stay at home" trade continues in 2021 as people begin dining out, traveling and resuming more traditional pastimes as the world normalizes. The "stay at home" trade could therefore segue into the "reopening" trade.

Anytime the vast majority of people are correctly aligned in their beliefs for a period of time causes us to pause and reflect — what other uniform trades have there been in the past, and how did those trends continue as time passed? Two recent memories come to mind; the mid-2000s and late 1990s. The first was the tech-bubble period of 1998-2000. It was hard to lose money in technology stocks as the internet transformed society, until companies began going public with baseless valuations and the market bubbled over with froth. Investors around the world mandated technology only portfolios, saying "this time it's different" and that gravity didn't exist. The second period of a uniform trade that comes to mind was the mid-2000's real estate bubble. It was so easy to flip a property for a profit, until it wasn't.

This is not to say that the "stay-at-home trade" is going belly-up and Peloton, which provides the user a fantastic workout, will not continue to some extent. There is staying power with many of these companies and business models, however there can be immense value found elsewhere in "real economy" stocks too.

One recurring theme we've heard about across financial news outlets and publications, and even wrote about in a previous quarterly letter, was how successful some retail traders were this past year. It's hard to envision a return to normal, without some serious growth in business and leisure travel, hotel stays, and dining. Can Zoom continue doubling or quadrupling its revenue in the next year? Hasn't everyone signed up for their service already? However, it would be easy to fathom taking twice as many flights next year as you may have in 2020. The demand is pent up and could expose some flaws in any sort of trend-following investments. One thing that most investors are not good at is checking fear and greed at the door and realizing when it's time to pull the plug.

Looking into 2021, we expect technology stocks are here to stay, unlike the companies that went belly up in 2000, and some of the largest names may continue to be a part of our daily lives. However, we think growth could come in other, less talked about areas too. Small cap companies, dividend payers, foreign stocks and value-oriented areas of the market that performed so well after the news of successful vaccines broke, could continue to surprise in the coming year.

2021 Outlook

Looking ahead as the bull market continues from the depths of March, another market-ism comes to mind, "Bull markets climb a wall of worry." So, we thought it would be prudent to highlight a few items that we believe could cause this market to top out in the next 6-12 months.

■ **Biden's Presidency & A Slim Democratic Majority in Congress**
• What will a change in leadership and ensuing policies mean for the markets?
■ **Inflation Outlook**
• With unprecedented stimulus measures, how will this inflow of funds into the economy affect our day to day lives?
■ **A Weakening U.S. Dollar**
• Does a strong or weak dollar mean good or bad returns, and how does that affect foreign and emerging market stocks?
■ **Municipal Debt Concerns**
• The exodus from cities and high-tax states to suburbs and low-tax states has been a trend for some time that is accelerating, but how does this affect our record levels of debt, both federally and on the state and municipal levels?

After what is likely the largest worry of our lifetime, COVID-19, goes away, we must be on the lookout for complacency, check our fear and greed at the door, and stay safe while we patiently await a return to normalcy, in the markets, economy, and our lives.

A final note on our new tradition: As we mentioned in our holiday cards, our team will be making charitable contributions to a few charities every year. We recognize how fortunate we are and would like to support those who are less fortunate and in need. It is one of the ways in which we can help our communities and hope these contributions can help change the lives of others. Each year our team will decide which charities we would like to support and make contributions on your behalf. We wholeheartedly believe helping our communities instead of sending gifts is the best way we can show our appreciation. If there is a cause that is near to your heart, we would like to hear about it.

CHEERS TO 2021.

withum WEALTH MANAGEMENT

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