Legacy Financial Strategies

Market Commentary – 4th Quarter 2020

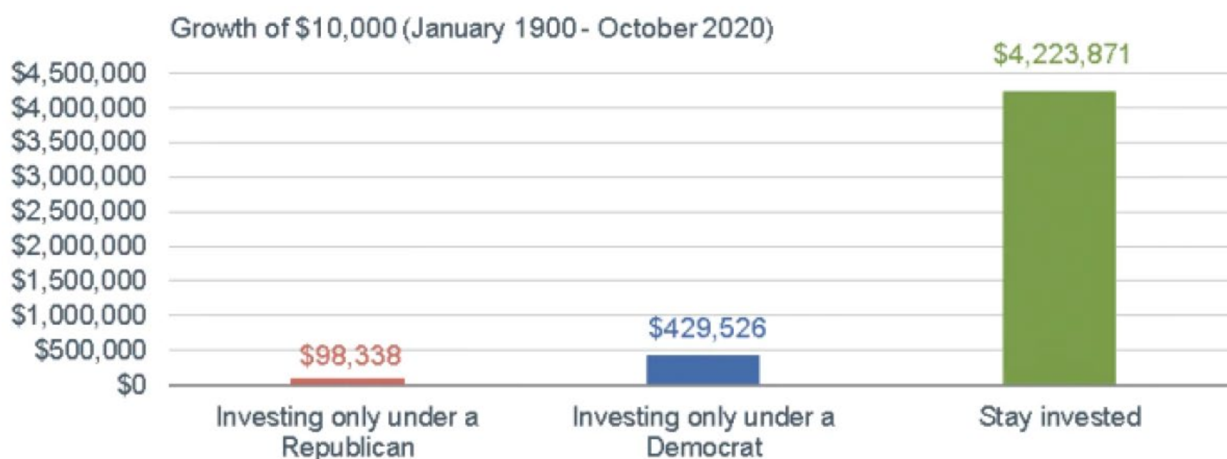
- *Investing in the stock market over time is better than investing in a U.S. President.*
- *Dividends and earnings are responsible for stock market returns over the long-term.*
- *A small number of stocks have contributed to the S&P 500 returns in 2020.*
- *The economy has improved however challenges (and opportunities) exist.*
- *The Unemployment Rate took 4 ½ years to improve to the current level after the last recession ended in June 2009.*
- *A vaccine(s) is the catalyst to continued economic expansion and higher stock prices.*

Summary:

The year 2020 is on track to receive a 1-star rating out of 5 (maybe 10) from most everyone in the world. COVID-19 and the election have created a spectrum of emotions that vary from one person to the next. While some of these same emotions have affected both me and my colleagues, you should feel confident that we have not changed our investment approach or how we handle market uncertainty. I hope this brief paper helps provide you confidence in the considerations we have taken to navigate the events of 2020.

Election Recollection:

History tells us that it is better to be invested in the stock market rather than a particular U.S. President. The chart below illustrates that staying invested over time has produced superior investment results versus investing under one political party. It also indicates that investing only under a Democratic President has been better for your portfolio than under a Republican President. However, The Great Depression, Crash of 1987, Tech Bubble, September 11th, and COVID-19 were inherited by or occurred under a Republican President. These and other negative market events were in no way connected to the White House.

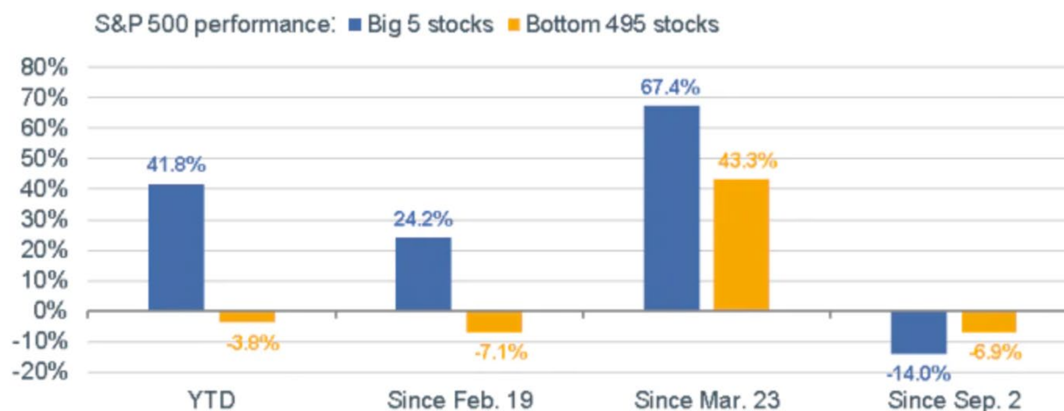


Source: Charles Schwab, Bloomberg, as of 10/2/2020. For illustrative purposes only. The above chart shows what a hypothetical portfolio value would be if a hypothetical investor invested $10,000 in a portfolio that tracks the Dow Jones Industrial Average on 1/1/1900 under three different scenarios: a Republican presidential administration; a Democratic presidential administration; or staying invested in the market throughout the entire period noted. Chart does not reflect effects of fees, expenses or taxes.

A 2020 study from Hartford funds also concluded that the stock market outperformed under a Democratic president from 1933-2019 (post-Great Depression). They did note that if you remove the stock market "boom" inherited by Bill Clinton and the stock market "bust" that George W. Bush inherited the returns are nearly the same. It has long been debated about whether a sitting President can take credit or blame for stock market performance. ***Not debatable is that since 1927, the 10% return for the stock market is mostly attributable to dividends and corporate earnings[1].***

Narrow Market:

I have discussed this in past writings and this trend has continued for a few years. The term "narrow market" refers to the stock market when a small percentage of stocks are responsible for an outsized portion of the gain (or loss). As of October 16, 2020, just 10 stocks were responsible for 28% of the S&P 500 return year-to-date. The "big 5" stocks – Apple, Amazon, Google, Microsoft and Facebook – all of which are contributors, make up over 20% of the market value of the S&P 500. The other 495 stocks make up the remaining 80%. The chart below illustrates how the performance of the "big 5" has dramatically outperformed the other 495 stocks in different periods. For diversified investors, this can be frustrating in the short-term when it comes to portfolio performance. When the market peaked on September 2nd however, the "big 5" fell further. February 19 was the all-time high for the stock market prior to the pandemic and fell 33% before bottoming on March 23rd. Technology stocks and a select group of high growth stocks have benefited from the shift to virtual communication and learning and have helped drive the market higher.



Source: Charles Schwab, Bloomberg, as of 10/30/2020. Performance is based on market cap-weighted average of the 5 largest and 495 smallest S&P 500 stocks. **Past performance is no guarantee of future results.**

Many of the underperforming stocks should benefit when business travel picks up, kids go back to school and consumers return to restaurants, vacation and family outings. My apology for stating the obvious; ***a COVID-19 vaccine/treatment will be a positive catalyst for consumer confidence and the stocks negatively affected by the virus will begin to improve.***

GDP "V":

The U.S. is still in an economic recession which officially began in February 2020. The economy contracted at an annualized rate of 31% in the 2nd quarter of 2020. It expanded at an annualized rate of 33% in the 3rd quarter[2]. These GDP numbers are not as bad or good as they appear. In the U.S., economists annualize the rate of change. Simply put, the annualized GDP number is the change from the previous quarter multiplied by 4. Despite the dramatic swing, real GDP is only 3% lower in dollars than it was one year ago.

The highly watched unemployment rate is 6.9% as of October, down from a record high set in April 2020. Despite the current recession, the latest unemployment level is the same as November 2013 which was 4½ years after the 2009 recession ended[2]. The labor market has rebounded more than the headlines indicate but is still challenged in industries like leisure & hospitality and in highly populated states like California and New York. The Federal Reserve is forecasting a 5.5% unemployment rate by the end of 2021[3]. Labor is a "lagging economic indicator" meaning that it is one of the last economic data points to return to normal during an economic cycle. Economic data only started to turn more positive in May. The last economic cycle that ended in February lasted over 10 years.

Unemployment rate – September 2020:	**6.9%**
Record Low in February 2020:	**3.5%**
Record high in April 2020:	**14.7%**
Unemployment rate - November 2013:	**6.9%**

Manufacturing is showing a strong improvement helped by durable goods purchases (items that last more than 3 years such as cars and appliances). Anyone doing home improvement? The current reading is stronger than 2009-2011 recovery that followed the previous recession[4].

Personal income jumped in the 2nd quarter reflecting stimulus payments and have now normalized and are trending as they were pre-pandemic[4]. According to J.P. Morgan Asset Management estimates, household net worth is at the highest level since 1980 and debt as a percentage of household income is the lowest since 1990[5]. Record low mortgage rates are helping to reduce the cost of housing, a major household expense.

Investment Playbook:

With myriad distractions in 2020, I thought it might be helpful to share some investment considerations that we take to minimize such distractions in any environment. Stocks should be held for 5 years and beyond for growth as their short-term volatility is rewarded with superior long-term returns. Stocks have returned 2 times more than bonds over the long-term and 3 times more than bonds after factoring in inflation[6]. Add the power of compounding and stock returns are considerably greater. Stocks are re-balanced into bonds and cash over time to "convert" growth into income. Cash and bonds are held for income needs over 0-5 years (and to reduce overall portfolio volatility). We invest portfolios in line with clients' risk tolerance and objectives, strive to minimize internal investment fees and minimize taxes where possible. Timing the stock market is difficult and missing the best days has proven to be costly (as I have shared in past writings). The stock market is efficient over time, not overnight which is why we maintain a long-term focus.

As always, we genuinely appreciate the trust you place in your financial advisor and our firm.

Chris Proctor
Chief Investment Officer

Sources:
[1] Epoch Investment Partners 9/30/2020; [2] FRED – St. Louis Federal Reserve; [3] Federal Reserve forecast; [4] Marketfield, Bloomberg;
[5] JPMorgan Guide to the Market Q4-20; 6 Morningstar Andex Chart - 2018

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