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Portfolio Comments
For the Quarter Ending December 31, 2020

The late Steve Jobs, in the course of a Stanford University commencement address, provided the following insight based on his own life experiences: “You can’t connect the dots looking forward; you can only connect them looking backwards. So, you have to trust that the dots will somehow connect in your future. You have to trust in something – your gut, destiny, life, karma, whatever.”

And so we find ourselves at the end of 2020, and what a year it has been! Connecting the dots backwards, to before ‘pandemic’ and ‘COVID-19’ were part of our everyday lexicon, we can probably all reflect on different actions we might have taken in our personal, professional and investing lives had we known of the tectonic shifts coming. But we didn’t know, and acting on trust became necessary as we got some things right and some things wrong. Trust in the resilience of our communities, healthcare systems and education institutions, trust in the adaptation of the workforce and monetary and fiscal measures to support the economy, trust that those most vulnerable can receive the help they need, and now trust that safe and effective vaccines can be produced and distributed on the scale required to return the world to some kind of normalcy.

If the U.S. stock markets can be viewed as a barometer, trust that the dots of recovery will continue to connect going forward is running high, at least in certain sectors, as evidenced by the spectacular rebounds from March lows. Disparities in industry performance, however, have only been magnified by the pandemic era and it is only now that we are seeing some investor momentum swing back towards the more economically sensitive and conservatively valued sectors.

The S&P 500 closed on December 31st at 3,756 representing a return of 12.15% for the final quarter of 2020 and a robust 18.40% for the year. The less tech-heavy Dow Jones Industrial Average also posted strong numbers, although lagged the S&P 500. The DJIA ended December at 30,606 for a return of 10.72% in the past three months and 9.72% for 2020. On the back of vaccine optimism heading into 2021, the year-end closing numbers for both the S&P 500 and the DJIA represented record highs.

In terms of index performance, it is perhaps the swiftness and magnitude of the rebound from March lows that has been the most astonishing.

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The S&P 500 plummeted -34% as the reality of the pandemic set in and the swathes of shutdowns took effect, but the index has since recovered around 67% from this bottom, making it the shortest downturn in history. The spread between winners and losers has nonetheless been very wide, marking a polarization of returns between certain sectors. At one end of the spectrum Information Technology, which has been well positioned for the 'new normal', has gained over 43% this year, while Energy at the other end, which suffered amid the most severe collapse in oil demand in modern times, had dropped more than 33%. With the top five companies, by weighting, in the S&P 500 currently representing over 20% of the index, it is not hard to understand how these big winners are distorting broader economic metrics.

Turning to numbers more directly indicative of the 'real economy's' health, according to latest figures released by the Bureau of Economic Analysis, U.S. Gross Domestic Product (GDP) increased at a record annual rate of 33.1% in the third quarter of 2020. This bounce was strong, no doubt, but to put it in context, it was on the back of a 31.4% decline in the second quarter and economic output still remains below pre-virus levels.

The COVID-19 pandemic also caused a surge in unemployment, which jumped from a 50-year low of 3.5% at the start of the year to an alarming record spike of 14.7% in April. By the end of November, the figure from the U.S. Bureau of Labor Statistics had dropped to 6.7% with the labor market still being 9.8 million jobs short of pre-pandemic levels. Still, personal incomes declined 1.1% month-on-month in November as pandemic assistance phased out. To bring unemployment back down to a more economically healthy level of around 4% will realistically require a full and sustainable reopening.

The Central Bank continues unabated on its path of providing unprecedented support in the form of large-scale public and private sector fixed income asset purchases, or Quantitative Easing (QE), as well as accommodative interest rate policies. Asset purchases appear on The Federal Reserve's balance sheet and the level of assets now stands at over $7.4 trillion, up from $4.2 trillion at the beginning of March. Most of this ramp-up had occurred by the beginning of June, with the level of assets holding pretty steady since. During March and April the Fed purchased $1.5 trillion in Treasuries, almost all of the debt the Treasury Department issued at the time, and since then it has been adding about $80 billion a month in Treasuries.

In his opening remarks following the December meeting of the Federal Open Market Committee (FOMC), Fed Chairman Jerome Powell stated that "the current economic downturn is the most severe of our lifetimes." At the same time, the Central Bank has expressed tempered optimism going forward, now projecting economic growth next year above 4%, as well as a drop in the unemployment rate to around 5% a year from now.

The Fed's reinstated Zero Interest Rate Policy, as well as demand for high quality dollar investments, has helped push yields lower across all major fixed income products. The benchmark 10-year Treasury yield fell below 1.00% for the first time ever in early March before bottoming at 0.52% in early August. In the past month it has stayed steady, hovering just below the 1.00% level, still historically very low. Going forward, the Fed is forecasting that it will maintain zero interest rates through 2023 and continue QE for as long as necessary.

The rapid expansion of the Fed's balance sheet, spurred in no small measure by its absorption of the ballooning government debt issued to provide urgently needed pandemic relief, has led to

renewed fears of impending inflation. But so far, according the Central Bank's measure, inflation remains stubbornly low, at 1.4% year-over-year, and below the Fed's target of 2%. Nevertheless, it is a figure to keep a close watch on. Even with the U.S. dollar acting as the global reserve currency, a sustained expansion in money supply cannot be an indefinite substitute for real economic growth.

In the latest data for the third quarter of 2020 compiled by the International Monetary Fund (IMF), the global share of U.S.-dollar-denominated exchange reserves held by foreign central banks (U.S. Treasury securities, U.S. corporate bonds, U.S. mortgage-backed securities, etc.) fell to 60.5% of total allocated foreign exchange reserves. This is the lowest level since 1995, indicating perhaps a waning appetite abroad for U.S. debt. As the pandemic hit, the U.S. dollar was seen as a safe haven in March, rising to a three-year high of 102.99 against a basket of currencies (a standard measure). However, it ended December at 89.96, down 6.8% on the year and 12.7% from its March high.

Government response, both at home and abroad, in terms of providing monetary relief and stimulus in response to battle the economic effects of the pandemic, has been nothing short of staggering. After all, and especially when much less was known about the virus, the stark choice faced by leaders was presented as shut down or face a health disaster. In this scenario spending more appeared as the only viable option.

According to the IMF's October Fiscal Monitor, worldwide fiscal measures in response to COVID-19 and the associated lockdowns have totaled about $11.7 trillion or around 12% of global GDP (a figure that has likely since risen). The IMF estimates that, as a result, government deficits (the shortfall between revenues and expenses) would rise by an average of 9% of GDP in 2020, while global public debt is forecast to approach a record 100% of GDP and stabilize around that level until 2025, up from about 83% in 2019. The Fund, however, does not view this explosion of public debt as the "most immediate risk." Rather, premature withdrawal of fiscal support by governments would pose a greater threat to nations' recoveries.

The U.S. federal government ran a deficit of $3.1 trillion in fiscal year 2020 (to the end of September), more than triple the deficit for fiscal year 2019. This deficit amounted to 15.2% of GDP, the greatest deficit as a share of the economy since 1945, and Financial Year 2020 was the fifth year in a row that the deficit as a share of the economy grew. Revenues in for the year fell 1% from last year, while outlays surged 47%, in large part due to emergency responses to mitigate the economic effects of the pandemic. In the first two months of this fiscal year, to the end of November, the federal government has run a deficit of $430 billion.

U.S. government debt now exceeds $27 trillion (it first reached $1 trillion in 1981) and exceeds GDP. Going forward, we will need an economy that grows above the rate of the cost of borrowing, but for now the focus has squarely been on guarding against immediate economic downside risks. Jerome Powell, for one, in calling for more stimulus is of the opinion that "the risk of overdoing it is less than the risk of under doing it."

More direct government stimulus did finally arrive in December in the form of a 5,600-page piece of legislation to spend $900 billion that emerged after a seven-month debate in Congress, and attached to a $1.4 trillion spending bill to keep the government running through the next fiscal year. The first fiscal stimulus passed in

March cost $2.2 trillion and included $1,200 direct checks for most American adults and $600 additions to weekly unemployment benefits. This time around, direct checks were reduced to $600 and supplemental unemployment payments to $300 / week through March. Many, including President Trump, have vociferously demanded that the check amount be raised to $2,000, but Senate Majority Leader Mitch McConnell, a Republican, refused to present the amended payment for a standalone vote, and instead introduced a new bill tying the proposal to matters relating to investigating the integrity of the Presidential election and efforts to amend legal protections afforded to social media companies.

And so, onto the November 3rd 2020 U.S. Presidential election, which, true to form for the year, was like no other that preceded it. Going into what was a tight race, Donald Trump had incumbency in his favor (most sitting Presidents get re-elected) albeit during an economy-battering pandemic and his Democratic rival, Joe Biden, had the polls on his side (which proved to be concerningly off, again). The election will be remembered for, among other reasons, the stark partisan divide with little chance of a candidate swaying any of his opponent's supporters, and the records it broke.

First, there was record voter turnout across the country. According to tallies now certified by the Electoral College for all 50 states and the District of Columbia, Joe Biden beat out his rival to now become President-elect, which would make him the 46th President of the United States, having received more than 81 million votes, the most ever for a presidential candidate. Georgia, the last state called for Mr. Biden on November 13th, brought his final Electoral College vote count to 306 compared to Mr. Trump's final tally of 232 (270 is the threshold needed to win the White House). After inauguration, Kamala Harris, Mr. Biden's running mate, would make history as the first woman and the first woman of color ever to be elected Vice President of America.

President Trump, for his part, received more than 74 million votes, surpassing the previous record set by then-President President Barack Obama in 2012 by more than 7 million, giving him the most votes of any sitting president in U.S. history. 2020 was also the highest voter turnout rate, estimated at around 66%, since 1900. In addition, due to conditions created by the pandemic, records were shattered for the number of absentee and mail-in votes cast.

Even with the election now almost two months behind us, and January 6th, the date Congress meets to formally count the votes cast by the Electoral College, looming close, not everyone is ready to accept the official results. Most vocal in protesting the integrity of the election has been President Trump himself, as evidenced by his very frequent statements to that effect on social media. The main issues of contention are the security and accuracy of widely-used electronic voting machines and software, the reliability and chain-of-custody of mailed ballots, rule changes to accommodate voting during a pandemic, and issues of whether election observers were given adequate access to effectively monitor the counting process. A myriad of legal efforts have been mounted, including one in which 106 Republican members of Congress backed the 17 Republican attorneys-general in filing a brief with the Supreme Court to delay certification of the presidential electors in four battleground states that Mr. Trump lost. So far, Donald Trump and his ardent supporters have not made enough legal headway that would point towards any overturn of the result, and the path forward is very narrow if it exists, but he has never been shy in his attempts to deliver audacious surprises.

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In the down votes of the November election, the Democrats retained control of the House of Representatives, albeit with a reduced majority, having lost a net nine seats. Two hotly-contested January run-off elections in Georgia for the Senate will determine whether we go forward with a still-divided Congress. This, in turn, will determine the scope of the more progressive agendas that could be advanced.

Beyond our borders, as much could be written about what is transpiring abroad at humanitarian, government, fiscal, and central bank levels. COVID-19 is, after all, a global pandemic and while the level of response varies, other countries and regions have turned to the same measures to protect and support their citizens in terms of shutdowns, social distancing, fiscal relief packages and the eagerness to develop and distribute effective and safe vaccines.

Amid these circumstances, and at the eleventh hour in terms of Brexit negotiations, British lawmakers approved a free-trade agreement with the European Union at the end of December, an important milestone towards finalizing the U.K.'s parting from the bloc after 40 years as one of its largest constituents. Agreements were also reached regarding security and nuclear power.

On December 2nd, the United Kingdom became the first country to approve a COVID-19 vaccine that has been tested in a large clinical trial when it granted emergency-use authorization to a vaccine from pharmaceutical firms **Pfizer Inc. (PFE-NYSE)** and **BioNTech (BNTX-Nasdaq)**, just seven months after the start of clinical trials. China and Russia have also approved the use of vaccines, but under less stringent trial conditions. The U.K. was also the first to approve a vaccine developed by Oxford University and **AstraZeneca PLC (AZN-Nasdaq)**. In the U.S. emergency use approval has been given to the Pfizer/BioNTech vaccine as well as one developed by **Moderna, Inc. (MRNA-Nasdaq)**. While there are substantial supply chain issues to be faced, vaccines are now being rolled out in many countries across the world, with priority being given to the most vulnerable and those most at risk to exposure.

At the start of 2020, nobody had heard of COVID-19, since the term had yet to be invented. On March 10th the World Health Organization declared it a global pandemic. By the end of this year, there have been 83 million confirmed cases around the world and more than 1.8 million deaths. In the U.S., confirmed cases stand at more than 20 million and deaths above 350,000. Very sobering numbers indeed. But we end the year with hope. If 2020 is remembered as the year of the pandemic, there is optimism that 2021 will be the year of the vaccine and we can cautiously make our way back to a sense of normalcy in our everyday lives.

In terms of the markets, and our disciplined approach to investing, we end the year hopeful as well. Value investing strategies have not produced standout returns this year compared to the outsized gains enjoyed by some sectors and stocks whose valuations have soared under current conditions, but we have seen a shift in the closing months of the year as focus turns towards an economy that should continue to open back up. We also anticipate additional fiscal stimulus and no abatement in Fed behavior to support the economic recovery.

And so, we look forward, trusting the dots of good things to come will connect, but also reflect with gratitude on your continued trust is us as your financial advisor through unpredictable times. We wish you and your loved ones health, above all, and happiness and prosperity in the year to come!

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