Simmons
WEALTH MANAGEMENT

Quarterly Investment Report

January 2021

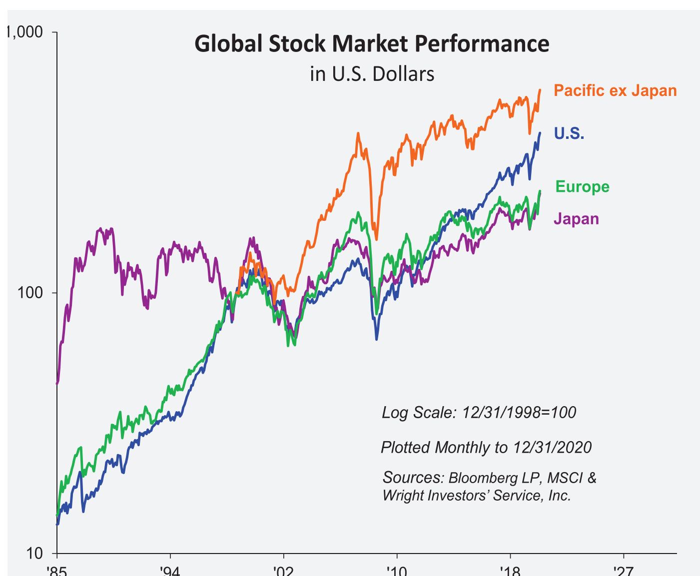
***SUMMARY:** Despite the COVID-19 pandemic that shut down much of the global economy for several months, stocks posted double-digit returns for the second straight year, buoyed by strong fiscal and monetary stimulus measures and optimism about the extraordinarily speedy rollout of several promising vaccines, which could lead to a quick return to normalcy. Bonds also had positive returns as central banks, led by the U.S. Federal Reserve, reduced interest rates to zero and increased already massive asset purchase programs that are likely to last several more years. The resolution of the U.S. elections also eased investor worries.*

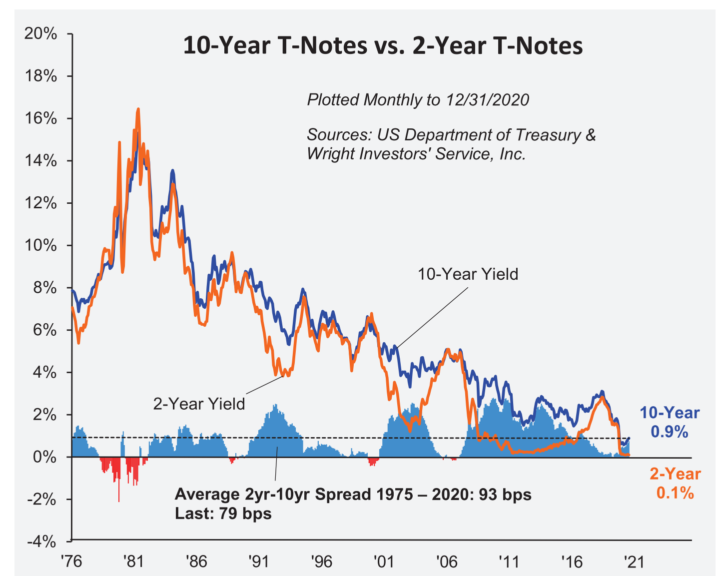
The major U.S. stock indexes closed 2020 at or near their all-time highs following a stunning year that saw the S&P 500 plunge by 27% in a little over a month only to rebound by more than 50% in the middle of the global COVID-19 pandemic. NASDAQ ended the year with a 44.9% return, including dividends, as the technology-heavy index benefited from consumers and businesses working and shopping from home after governments around the world ordered their economies to basically shut down for several months. The S&P 500 gained 18.4% while the Dow Jones Industrial Average returned 9.7%. Last year's returns capped off one of the best two-year runs for stocks in decades. In 2019, NASDAQ returned 36.7%, the S&P 500 gained 31.5%, and the Dow rose 25.3%. After a slow start, small-cap stocks also managed double-digit returns in 2020. The S&P 400 Mid-Cap index returned 13.7% while the S&P 600 Small-Cap index gained 11.3%; in 2019, those indexes returned 26.2% and 22.8%, respectively.

The fourth quarter was the third straight strong quarter for stocks, possibly building momentum for a continuation of the rally into the new year. NASDAQ returned 15.6% in the period, followed by the S&P 500 at 12.1% and the Dow at 10.7%. But small caps were the best performers by far, with the S&P 400 returning 24.4% and the S&P 600 leading the way with a 31.3% gain.

S&P 500 SECTORS

Stocks that benefited from the shift to online shopping, working, and communicating were the best performing categories in the S&P 500 last year. Information technology stocks returned 43.9% while consumer discretionary stocks, many of them ecommerce companies like Amazon, returned 33.3%. Telecommunications companies returned 23.6%. Only three sectors had negative returns for the year, but even they rebounded some in the fourth quarter.





Energy stocks, which were battered all year by falling oil prices due to reduced global demand, fell 33.7% for the full year but were the best performers in the fourth quarter, gaining 27.8% as crude oil prices rebounded more than 20%. Real estate stocks lost 2.2% for the year after thousands of commercial buildings remained empty after businesses sent their employees home to work. However, the sector returned a positive 4.9% for the final quarter. Financial stocks rebounded 23.2% in the final three months of the year to reduce their 2020 loss to a relatively modest 1.7%; bank stocks were under pressure most of the year due to low interest rates and expectations of high loan losses due to the pandemic, although those forecasts have so far been proven to be overly bleak.

FOREIGN STOCKS

Foreign stocks had robust returns in U.S. dollar terms in 2020, aided by a weak U.S. currency and a strong fourth quarter, which lifted many of the averages into the green for the year. Chinese stocks were the best performers, returning 29.5% for the year, including an 11.2% gain in the fourth quarter. Emerging markets, helped by their China weight, were the next best performers, rising 18.3%, pulled up by a strong final quarter, when they gained 19.7%. Similarly, Japanese stocks gained 14.5% after a 15.3% increase in the fourth quarter. In Europe, eurozone stocks ended the year with a 10.9% gain after climbing 15.2% in the last three months of the year. U.K. stocks were one of the few areas to post negative returns for 2020, losing 10.5%, but they jumped 16.9% in the final quarter as the country finally reached a Brexit agreement with the European Union. The U.S. dollar lost more than 8% against the euro and the Swiss franc in 2020, more than 6% against the Chinese renminbi, and nearly 5% against the Japanese yen.

BONDS

Bonds also had positive returns as interest rates around the world hovered at historically low and in some cases even at negative levels. In the U.S., the Bloomberg Barclays U.S. Aggregate returned 7.5% for the year as yields on long-term U.S. government bonds were cut by half. The yield on the benchmark 10-year Treasury note ended the year at 0.91%, down from 1.88% at the end of 2019. Corporate bonds returned 9.4% while high-yield bonds returned 7.1%. Outside the U.S., the Bloomberg Barclays Global Aggregate ex-U.S. index returned 10.1%, helped by the weaker dollar. Gold closed 2020 with a 24.4% gain despite weakening late in the year as investors increased their appetite for riskier assets like stocks.

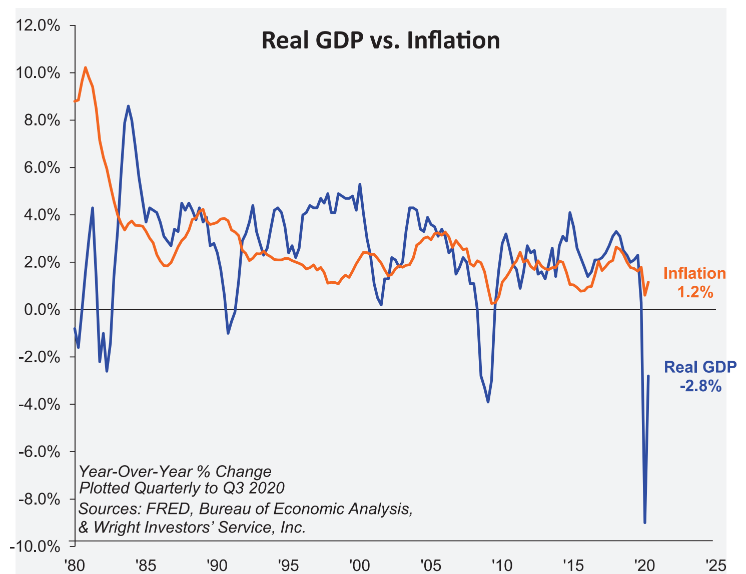
U.S. ECONOMY

The U.S. economy has rebounded sharply from the first and second quarter lockdowns and enters 2021 with a large amount of pent-up demand, we believe. After falling by 31.4% in the second quarter, U.S. GDP jumped a record 33.4% in the third quarter, with growth expected to remain positive in the final three-month period and to continue surging this year. The Federal Reserve's recently updated economic projections call for GDP growth this year of 4.2%, up sharply from a negative 2.4% in 2020 and nearly double 2019's 2.2% pace. Leading economic indicators rose another 0.6% in November, down slightly from the prior month's 0.8% increase. Industrial production rose for the seventh straight month in November, climbing 0.4% although down from October's 0.9% gain.

Global Investment Returns In U.S. Dollars

	Q4 2020		YEAR 2020	
	Stocks	Bonds	Stocks	Bonds
U.S.	**13.0%**	**0.7%**	**20.7%**	**7.5%**
Canada	13.9%	4.4%	5.3%	9.3%
Mexico	31.0%	10.2%	-1.9%	8.6%
Japan	**15.3%**	**2.2%**	**14.5%**	**4.4%**
Pacific ex Japan	20.1%	9.2%	6.6%	14.2%
Australia	22.9%	7.0%	8.7%	14.5%
China	11.2%	5.4%	29.5%	9.3%
Hong Kong	15.5%	N/A	5.8%	N/A
Europe	**15.6%**	**5.7%**	**5.4%**	**13.4%**
France	20.4%	6.7%	4.1%	11.1%
Germany	11.5%	4.7%	11.5%	12.3%
Italy	22.4%	9.5%	1.8%	15.8%
Netherlands	18.4%	5.1%	24.1%	13.1%
Spain	27.7%	7.3%	-4.8%	N/A
Switzerland	8.2%	4.5%	11.6%	10.6%
U.K.	16.9%	7.1%	-10.5%	11.8%
World	**14.0%**	**3.3%**	**15.9%**	**9.2%**
World ex U.S.	15.8%	5.1%	7.6%	10.1%

Sources: MSCI Stock & Bloomberg Barclays Bond Indexes as of 12/31/2020



The manufacturing component rose 0.8%, boosted by a 5.3% jump in the automotive sector, while the capacity utilization rate increased to 73.3%. Likewise, orders for durable goods rose a better-than-expected 0.9%. The expansion continued into December, as the Institute for Supply Management's manufacturing index climbed more than three points to 60.7, its highest reading since August 2018 and more than four points better than expectations.

THE CONSUMER

Consumer purchases have flagged a bit recently as government aid measures played out in the third and fourth quarters but can be expected to rebound following President Trump's signing of a $900 billion stimulus package in late December and promises of more to come in the new year. "Much more money is coming," Trump said as he signed the bill, which includes $600 checks for individuals, although how much more remains to be seen. Retail sales fell 1.1% in November as new outbreaks of the coronavirus caused some states to restrict business activity. Personal expenditures, a broader category, fell 0.4%, largely due to a 1.1% decline in personal income as some stimulus aid, such as increased unemployment benefits, expired. Not surprisingly, then, consumer attitudes deteriorated late in the year. The Conference Board's consumer confidence dropped to 88.6 in December from November's downwardly revised 92.9 reading, while the University of Michigan's consumer sentiment index ended the year at 80.7, down from the prior month's 76.9. After rising in each of the first two weeks of December, initial unemployment claims fell the last two weeks; continuing claims also declined slightly. In November new nonfarm payroll jobs increased by 245,000, less than half of expectations and down from 610,000 in October, although the unemployment rate slid to 6.7%. The December aid package includes $300 a week in supplemental jobless benefits.

HOUSING

The red-hot housing sector cooled a bit in November as lack of inventory and high prices put a damper on sales. Sales of existing homes fell for the first time in five months, declining 2.5% to an annual rate of 6.69 million, although that is 25.8% higher than in the year-earlier period. "Without a doubt, there are too many buyers in relation to sellers," said Lawrence Yun, the National Association of Realtors' chief economist. Another impediment is high home prices, with the median price of a single-family home reaching $310,800, up 14.6% from November 2019. "That is probably the main driver as to why the sales declined," Yun said. Pending home sales fell a similar 2.6%. Sales of new homes were also weaker, falling 11% to an annual rate of 841,000, although that is more than 20% higher than the year-earlier period. The median price of a new home fell slightly to $335,300, down from October but up 5% from a year ago. Forward indicators remained positive. Housing starts rose another 1.2% in November to 1.5 million units – 12.8% over the year-earlier period – while permits increased by 6.2% on a monthly basis and 8.5% versus a year earlier to 1.6 million. The National Association of Home Builders' confidence index fell four points in December to 86, although that is still its second highest reading ever.

INVESTMENT OUTLOOK

We enter 2021 with a good deal of optimism. While we're certainly happy to see 2020 in the rearview mirror, for lots of reasons, let's not forget that the past year was a great one for investors. Not only did stocks and bonds post positive returns in the middle of a global pandemic, but the stock market staged one of its quickest and strongest recoveries on record, with the S&P 500 climbing 52% between its March 18 low of 2447 and its yearend closing of 3756 after plunging more than 27% the month before. Of course, massive, quick U.S. fiscal and monetary stimulus helped, with the passage of the $2.2 trillion CARES Act on March 27 – just weeks after the government lockdowns began – combined with massive assistance from the Fed, which lowered interest rates to zero and increased its balance sheet by more than $3 trillion to more than $7 trillion in just two months. Not only did the Fed continue to buy massive amounts of mortgage-backed securities – fueling a home buying and mortgage refinance boom – and U.S. Treasury bonds – helping to manage the growing federal deficit, but it added corporate bonds to the mix for the first time. It also created five emergency lending facilities.

That assistance may continue in 2021. Passage and enactment of December's $900 billion second stimulus package wasn't as quick and smooth as the CARES Act, but further fiscal aid may be easier to accomplish now that Democrats—who enthusiastically greeted Trump's call for $2,000 relief checks—control both houses of Congress. Of course, more stimulus raises concerns about higher inflation, but that prospect is likely far in the future given the still relatively weak state of the economy.

We can also expect continued support from the Fed, which pledged at its December meeting to continue its massive asset purchases "until substantial further progress" has been made toward its goals of full employment and 2% inflation, which many believe is unlikely at least until 2023. "Together these measures will ensure that monetary policy will continue to deliver powerful support for the economy until the recovery is complete," Fed Chair Jerome Powell said.

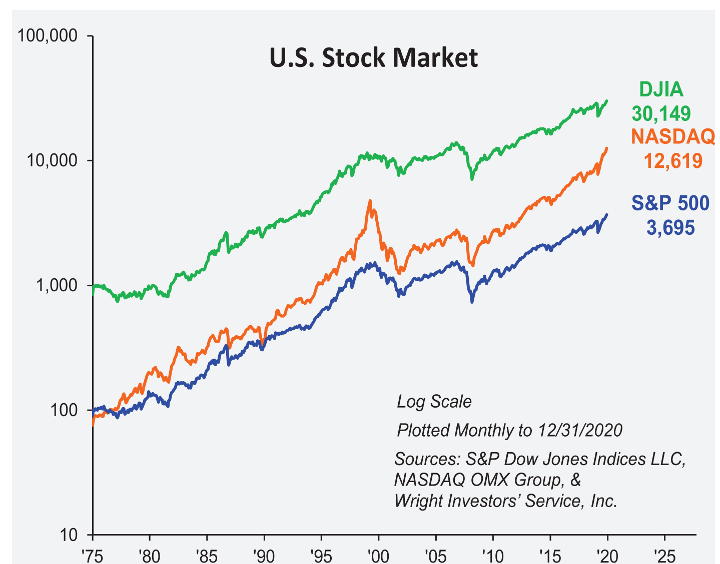
We can also be hopeful that we've turned the corner on controlling and eventually eradicating the coronavirus. It's still too early to tell what the actual efficacy of the various vaccines will be, but the rollout process has already begun, with projections that a large percentage of the world's population will have access to them by midyear. The return of warmer weather in the second quarter and the possibility that some doses could be halved resulting in faster vaccinations may also help. As a result, following what could be a rough first quarter, we anticipate a strong recovery to develop and build throughout the rest of the year. The robust performance in stocks in 2020 largely rested on those assumptions, which we believe are valid.

The stock market's performance in 2020 in the midst of a global pandemic left many people perplexed. Many could not understand how the market could be so buoyant while the headlines were so grim. Yet last year demonstrated the wisdom of disciplined long-term investing in quality stocks and bonds and staying the course. Many investors who sold during the February-March selloff not only locked in their losses but failed to benefit from the sharp snapback that immediately followed, confirming the fallacy of market timing. Those who held steady saw their portfolios rebound in anticipation of the economy and corporate earnings doing likewise. Many people – particularly those in the worst-affected industries like airlines and hospitality – continue to suffer from lost wages and unemployment. But many of the rest have actually prospered by being able to save more money and take advantage of new mobile technologies, two trends that have played a major role in the stock market rally. And it's possible that the most negatively-affected industries will experience a swift turnaround in the not-too-distant future. That's why we're hopeful about the year ahead, while also warding against overconfidence and complacency. For these reasons, we continue to believe that a well-diversified portfolio of quality assets remains the most prudent investment approach.

The U.S. Economy 2019–2022

			% Change In			End of Period Rates	
			Real GDP*	PCE Core Deflator*	Profits from Operations#	90-Day T-Bills	10-Year T-Notes
2019	Q1		2.9%	1.2%	14.6%	2.4%	2.4%
	Q2		1.5%	2.1%	8.7%	2.1%	2.0%
	Q3		2.6%	1.9%	1.3%	1.8%	1.7%
	Q4		2.4%	1.3%	1.3%	1.5%	1.9%
2020	Q1		-5.0%	1.6%	-4.2%	0.1%	0.7%
	Q2		-31.4%	-0.8%	-14.1%	0.1%	0.7%
	Q3		33.4%	3.4%	-15.6%	0.1%	0.7%
	Q4	e	4.6%	1.5%	-19.7%	0.1%	0.9%
2021	Q1	e	2.5%	1.5%	4.5%	0.3%	1.0%
	Q2	e	3.6%	2.0%	16.7%	0.3%	1.1%
	Q3	e	3.8%	1.7%	42.1%	0.3%	1.1%
	Q4	e	3.4%	1.7%	25.4%	0.3%	1.2%
2022	Q1	e	3.0%	1.8%	5.1%	0.3%	1.3%
	Q2	e	2.6%	1.8%	3.2%	0.4%	1.4%
	Q3	e	N/A	N/A	-2.1%	0.4%	1.5%
	Q4	e	N/A	N/A	18.1%	0.4%	1.5%

e: Bloomberg Consensus Estimates; *: Annual Rates; #: Year-Over-Year Change in S&P500 EPS
Sources: Bloomberg LP, Wright Investors' Service, Inc.



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