

ECONOMIC OUTLOOK

Summary

It turns out that not even a worsening pandemic can stop American's shopping habits during the holiday season, where "Black Friday" generally leads the charge. However, actual foot traffic in brick-and-mortar stores was unsurprisingly lower by a reported 37% for the week of Thanksgiving. Fortunately, online sales managed to bridge that gap, as "online-only" holiday shoppers during 2020 increased by a reported 44%.

In a sign of businesses adapting, most retailers started their holiday sales weeks, and in some cases even months, early to avoid capacity issues. "Door-busters" appeared to be a thing of the past, as seemingly all sales were available digitally – though that didn't mean businesses didn't still want you to visit their stores. The utilization of an online purchase with curbside pickup model has become commonplace as businesses hope to avoid direct shipping fees and preserve profit margins. The companies that were able to adapt to the concerns of 2020 and become more digital seemed to experience successes, as overall holiday sales are once again expected to set records. According to Adobe, online-specific holiday sales will total \$184 billion, an increase of 30% from 2019.

Though COVID-19 cases continue to surge, the health of the consumer is a key to unlocking economic growth. If holiday sales are any indication, the consumer is doing well. While there is currently quite a bit of euphoria in the markets about multiple vaccines that have produced better-than-expected results and seem likely to be approved in short order, we are still several months from their distribution en masse. Globally, several countries are already in the midst of a second attempt at partial lockdowns to curb the spread of the virus and there is concern that the U.S. may need to follow suit as cases continue

to increase. Although most economic data points have been favorable and improving for several months, as we approach the winter months with a combination of increasing cases, a new administration that could feel differently about lockdowns, and no significant progress from the government on further fiscal stimulus, there is the potential for some short-term economic turbulence before COVID-19 becomes a thing of the past.

Positives

The Federal Reserve Bank of Atlanta has a 4th quarter GDP estimate of 11.2

Factory orders have increased for six consecutive months

The housing market remains strong with four consecutive months of double-digit growth year-over-year

Negatives

November jobs report disappointed, missing by 215k jobs

Consumer Sentiment has decreased for the first time since June, according to the University of Michigan series

Another month of Congressional gridlock on additional stimulus

EQUITY OUTLOOK

Summary

Equity markets surged in November highlighted largely by tremendous efficacy results from multiple COVID-19 vaccine producers. Stocks also seem to be comfortable as the presidential and congressional election pictures appear to be coming into focus. A massive blue wave never materialized and the likelihood of a divided congress should limit any progressive tax or regulatory changes. Markets also seem to be looking past the rising number of COVID-19 cases to focus more on these positive developments. The S&P 500 closed the month higher by 10.9%.

Perhaps one of the most promising details of the November advance was the widening breadth and participation which historically has been an indication regarding the sustainability of a rally. Value stocks, which have been lagging their growth peers for many months, markedly outperformed. The Russell 1000 Value Index advanced 13.5% while the Russell 1000 Growth Index climbed 10.2%.

This widening participation was not limited to just the growth/value relationship. Mid and small-sized U.S. companies had been trailing year to date but vaulted higher in November. The Russell Midcap Index and Small Cap Russell 2000 Index rose 13.8% and 18.4% respectively over the course of the month.

All 11 economic sectors were positive in November. Notably, the broadening performance characteristics exhibited within broad U.S. equity markets were reflected in specific sector performance. The energy and financial sectors have been the weakest performers in 2020 but were the best two performing sectors during the month, advancing 28.0% and 16.9% respectively.

Momentum remains constructive for investors in the equity markets. Many of the uncertainties hanging over the market seem to be fading as more time passes. Investors can now focus on corporate earnings, which have been amazingly resilient and show signs of improving further in 2021. As we close this tumultuous year, we are very optimistic about the outlook for equity markets.

Positives

Health care and pharmaceutical industries continue to make medical breakthroughs concerning COVID-19 treatments and vaccines

Many retail investors have been on the sidelines throughout the rally – the pain trade is higher

Accommodative Federal Reserve and global central bank policy

Negatives

Stock valuations, by some traditional measures, look relatively stretched

COVID-19 cases are rising across Europe and the U.S.

Unknowns

Trade and foreign policy shifts associated with a changing administration

FIXED INCOME OUTLOOK

Summary

Against the constant drumbeat of market forecasters calling for higher interest rates, they ended little changed for November. Trading in a high-low range of 20 basis points (bps), the 10-year Treasury note actually ended the month 3 bps lower at 0.84%. The 2-year Treasury note ended unchanged at 0.15%. Intermediate maturity Treasury notes (1 year to 10 year) delivered a return of 0.12%. With the inclusion of bonds longer than 10 years, the return was 0.35%.

The logic of those forecasts is rooted in the belief that as the COVID-19 vaccines are distributed broadly, the economy will blast forward as unspent savings are unleashed. When combined with the incremental monetary base supplied by the Fed, this burst of activity will lead to higher inflation and the Fed will be forced to respond by increasing the overnight rate. We see little evidence that inflation will even reach the 2% target of the Fed, let alone run beyond that for an extended period. As such, we believe that it is erroneous to forecast that the Fed will be quick to increase the overnight rate. Longer yields can only move modestly higher if short rates remain anchored. Slightly above 1% on the 10-year note seems to be a reasonable target.

All of the exciting bond market action has been in the corporate bond sector. Narrowing 22 bps in November, credit spreads completed the full round-trip from the widening experienced in March. Investment-grade corporate bonds delivered a return of 2.79%. This brought their year-to-date return to 9.41%, which finally surpassed that of the Treasury bond market (8.25%). Intermediate maturity corporate bonds have delivered 6.92% for the 11-month period which compares to a return of 5.75% for the same maturity Treasury notes. The rally in credit occurred even as the new issuance of corporate bonds will reach a record level this year of about \$1.75 trillion, about 40% larger than the previous 2017 record.

It rarely pays to get spooked out of the corporate bond market when the default rate of high-quality, large capitalization companies is unlikely to increase significantly. Like the stock market, timing wholesale exit and reentry points is nearly impossible. For the BBB segment of the investment-grade bond market, five of the top 20 months for excess return since 1997 have happened since March of this year. We acknowledge that with credit spread levels near the 25th percentile of their distribution over that time, there is clearly less opportunity for significant excess return over the Treasury market from here. Still, as the level of new issuance declines in 2021, we believe that corporate bonds will deliver better returns over the next market cycle.

Positives

Short maturity rates are anchored by Fed policy

Stock market rally could lead to rebalancing into bonds

Negatives

Large 2021 federal budget deficit will need to be financed

A weak dollar could frighten overseas buyers of U.S. debt

Unknowns

Path of the virus, impact on the economy, distribution of vaccines
