WaterRock Global Asset Management, LLC

MARKET REVIEW & OUTLOOK

December 2020

BREAKING NEWS

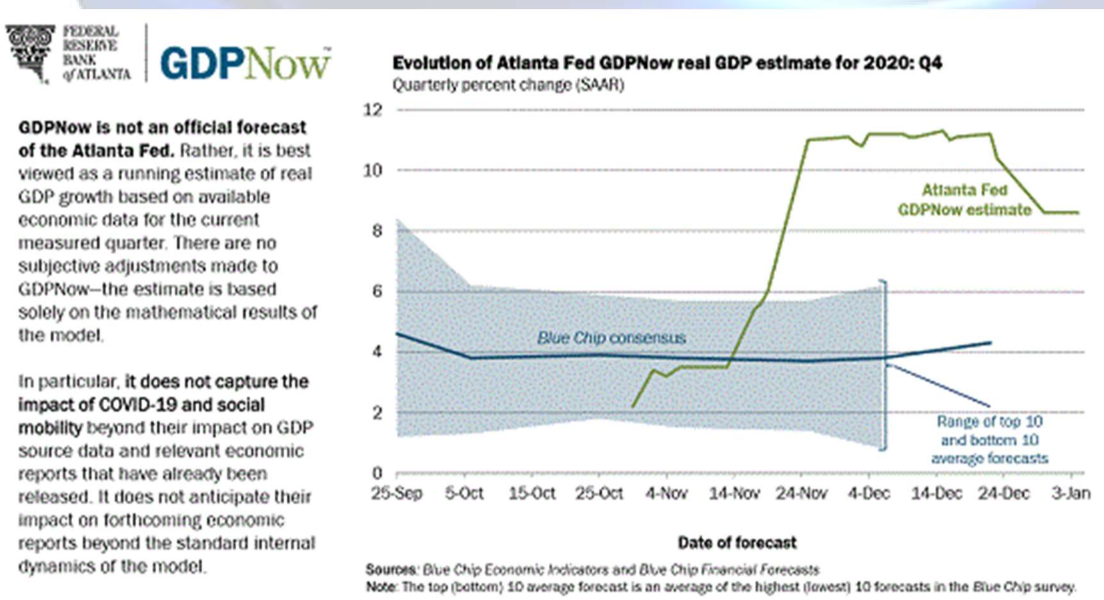
- The S&P 500 had its worst start to a new year since 2001.

KEY TAKEAWAYS

- Global Equities continued the strength seen in November, closing the year at record highs for many of the indices.
- The economic data continues to look challenged in the near term as lockdowns remain in place and many countries, states and cities are making existing lockdowns more stringent.
- Election season continues to near an end, though a couple of items remain. The Georgia Senate runoff on Tuesday(today) and the Electoral College meeting on Wednesday.

The U.S. Economy

As seen in the chart below, the Atlanta Fed GDP forecast has eased from 10%+ to 8.6% as of January 4th and the Blue-Chip consensus of economist has moved to just above 4%. We have been discussing that the economy appears to be growing in the low single digits in the last couple of economy notes. Given the extent and duration of lockdowns we find it hard to believe that either number will be correct, coupled with the stimulus being approved in the waning moments of the year. Thus, whether it is the first print or a subsequent print, we would not be at all surprised to see a negative number for the 4th quarter. Either way, that is in the past. As to the future, first quarter and beyond, the aforementioned stimulus will largely hit in the first quarter and the corona virus vaccine should be more widely available by the end of the first quarter. That sets the stage for a large easing of lockdowns and a corresponding expansion of the economy.



Source: https://www.frbatlanta.org/cqer/research/gdpnow

Stocks and Bonds

The fixed income markets had a lot less volatility during the month compared to November. The battle between vaccine hopes vs. lockdown reality and stimulus chatter kept yields and market participants in check. High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, saw a very muted month as well with a gain of only +0.12%. The U.S. 10-year treasury bond yield had a quick jump to start the month and then was range bound the balance of the month again threatening to break into the single digit, but was stimmed again at 0.97% and had a low of 0.87%. The yield ended at 0.92%, up from November's close of 0.84%.

The U.S. stock market, shown below, had quite the wild ride in 2020, though finishing with a positive upswing in December and many indices finishing at all-time highs. The Dow Jones Industrial Average climbed +3.27%, the S&P 500 rallied +3.71%, and the small cap Russell 2000 jumped +8.52%. The international markets followed a similar path as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index rose +4.97% and the MSCI Emerging Markets iShares Core ETF Index soared +7.30%.

Source: Bloomberg https://www.zerohedge.com/markets/15-trillion-tsunami-2020-crashes-dollar-sparks-golds-best-year-decade

In December, we continued to see a lot of green for the sectors of the S&P. The best performers were…

- Technology: +5.30%
- Financials: +5.74%
- Healthcare: +3.37%

The worst relative performer and only "losing" sector was…

- Utilities: -0.22%

Oil Report

In December, crude oil was again pretty much a one-way trade higher, though less steep than the previous month. OPEC+ reaching a one-month agreement to hold back supplies boosting hopes of continued cooperation. Additionally, the approval of several vaccines has buyers looking past the "dark winter" to a hopefully return to normal come spring. The current NYMEX WTI Crude Oil futures settled at $48.42 and posted a gain of almost 7% from the prior month close of $45.34 a barrel. The price for RBOB gasoline followed a similar path to crude oil, though was meaningfully stronger. RBOB finished higher by nearly 14% for the month of December. The sustainability of these gains will be tested in the months ahead with continued discussions for OPEC+ and the ongoing lockdown vs. vaccine battle.

The Rest of the Data

The news cycle around the economy played over and over between the stimulus talks and the lockdown vs. vaccine that it all became a bit nauseating. In the end, the stimulus finally passed at the 11th hour, several vaccines have been approved and are being administered and cases, hospitalizations and deaths have continued to climb. The stimulus should provide a boost to 1st quarter GDP, the wild card is how fast and effectively does the vaccine get distributed to combat the increase in cases. The timing of the vaccine overtaking the virus will have a huge impact on the timing and robustness of GDP growth going forward.

The November ISM Manufacturing Index slipped 1.8 points to 57.5 from October's reading of 59.3. Additionally, the ISM Services Index eased to 55.9 from 56.6 in October. Any reading above 50 generally indicates improving conditions. Consumer confidence dropped to 88.6 in December, which compares to a downwardly revised figure of 92.9 in November. The unemployment rate posted another drop, coming in at 6.7%, as the economy added a far weaker than expectations, 245,000 jobs in November. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.2% in November on a seasonally adjusted basis. Over the last 12 months, the All-Items Index was stable climbing +1.2% on a non-seasonally adjusted basis. Overall, these numbers suggest a stable low single digit growth rate for the economy. Though as mentioned previously, we are not sure that the revisions will paint the same "rosy" picture when all is said and done.

Summary

The path forward, hasn't changed from much last month and has two divergent paths. On the one hand, the hope is a successful launch of the vaccine helps to overwhelm the virus soon, and everything goes back to normal. We continue to grow the economy in the low single digits like we did in 2019 and before. The other path is a continued slog dealing with a repeat of the serious outbreaks of the corona virus as we did in the spring and a return of 2- or 3-week lockdowns that drag out for 2 or 3 months. Clearly hope is on the side of the vaccine as the other side is not one, we want to continue to endure again. Given the divergent paths it is hard to believe the stock market rallied as much as it did post late March and finish at all-time highs to close out the year. Especially considering the chart on the next page, which shows that the S&P 500 has soared, but corporate profits are little changed the last few years.

Source: https://www.zerohedge.com/markets/15-trillion-tsunami-2020-crashes-dollar-sparks-golds-best-year-decade

Not to fear though, we have built our asset allocation models with dynamic features and quarterly rebalancing. If the markets continue to march higher, we will capture some of those gains and reallocate to less volatile high-quality bonds. If the equity markets enter a period of negative performance, we have dynamic investment vehicles that utilize rules-based defense mechanisms to reduce the risk of the portfolio. Further, if the market gets too extended, some of the vehicles will capture partial gains and wait for the extension to correct.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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