WaterRock Global Asset Management, LLC

MARKET REVIEW & OUTLOOK

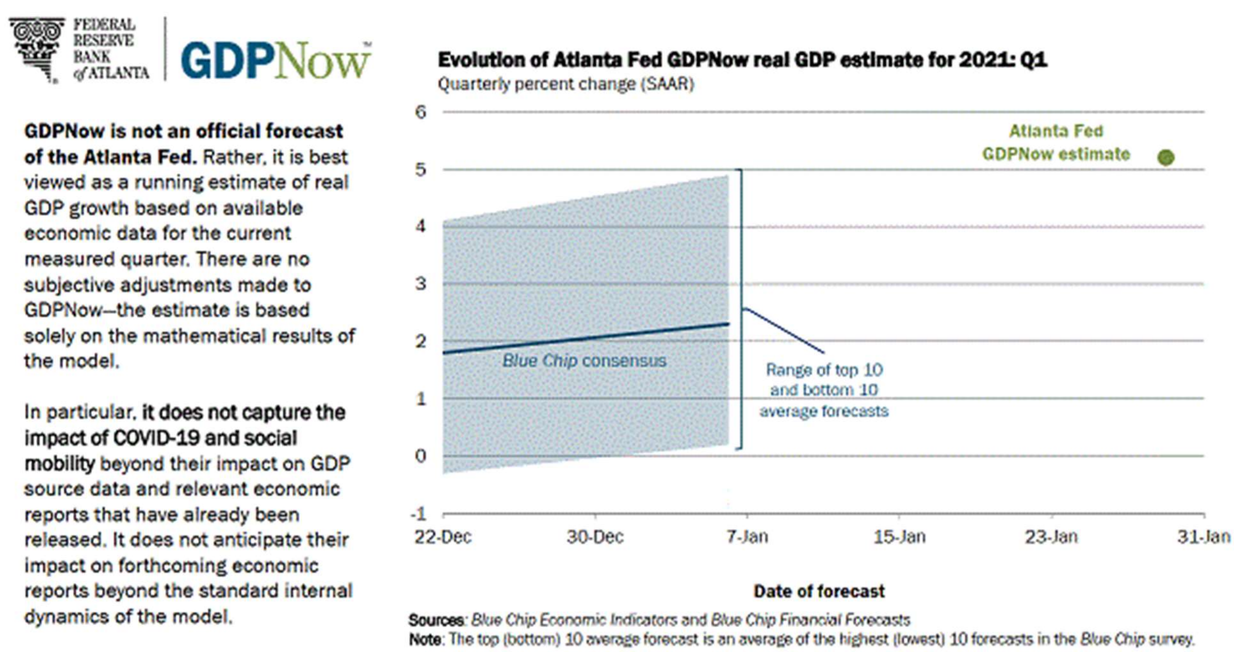
January 2021

KEY TAKEAWAYS

- Global Equities were flying high deep into the month, but as the month aged markets started acting strange and sold off relatively hard to close out the month.
- The 4th quarter GDP report was weaker than the consensus expected, and I think future revisions end up with a negative print for the 4th quarter. The good news is that 1st quarter GDP is likely to resume growth with new stimulus and several large states easing lockdown restrictions.
- The inauguration passed with a lot more bark than bite as 10's of thousands of National Guard troops slept in garages with the capital fenced off.

The U.S. Economy

The 4th quarter GDP report missed the Blue-Chip consensus of over 4% coming in at 4.0% and well below the January 27th forecast of GDPNow at 7.2%. I still think that with the speed at which the consensus numbers declined in December through January, that when all the revisions are completed that the 4th quarter will post a negative number for GDP. The balance of the world seems to be intensifying lockdowns, though in the U.S., specifically California, New York, and Illinois, among others have been in easing mode the last 10 days. In combination with the recent stimulus that has been passed, the U.S. will probably resume growth in the 1st quarter, as the chart below illustrates, though not so likely for many other countries.



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

Stocks and Bonds

The fixed income markets had a volatile month, with the 10-year Treasury finally breaking into the single digit. Early in the month yields got at high at 1.19% nearing the highest level since March 2020. As equity swings started to increase near the end of the month, yields retested 1%. Though by the end of the month as equity craziness reached a fevered pitch and liquidity became a premium selling what you could seemed to gain steam and sent the 10 year yields higher. High-quality fixed income, as measured by the iShares US Aggregate Bond ETF, saw negative returns in response to the increase in base Treasury rates, finishing the month with a loss of -0.74%. The U.S. 10-year treasury bond yield ended the month near the middle of the range at 1.09%, up from December's close of 0.92%.

The U.S. stock market after a rough first day, was riding the wave comfortably higher for most of the month. But as the zaniness of the "meme" highly shorted stocks took the lead late in the month, volatility increased significantly. The Dow Jones Industrial Average dropped -2.04%, the S&P 500 eased -1.11%, and the small cap Russell 2000 bucked the trend soaring +5.00%. The developed international markets followed a similar path as the U.S., though emerging markets also bucked the large cap trend. The MSCI EAFE iShares Core International Developed Markets ETF Index fell -1.43% and the MSCI Emerging Markets iShares Core ETF Index jumped +4.64%.

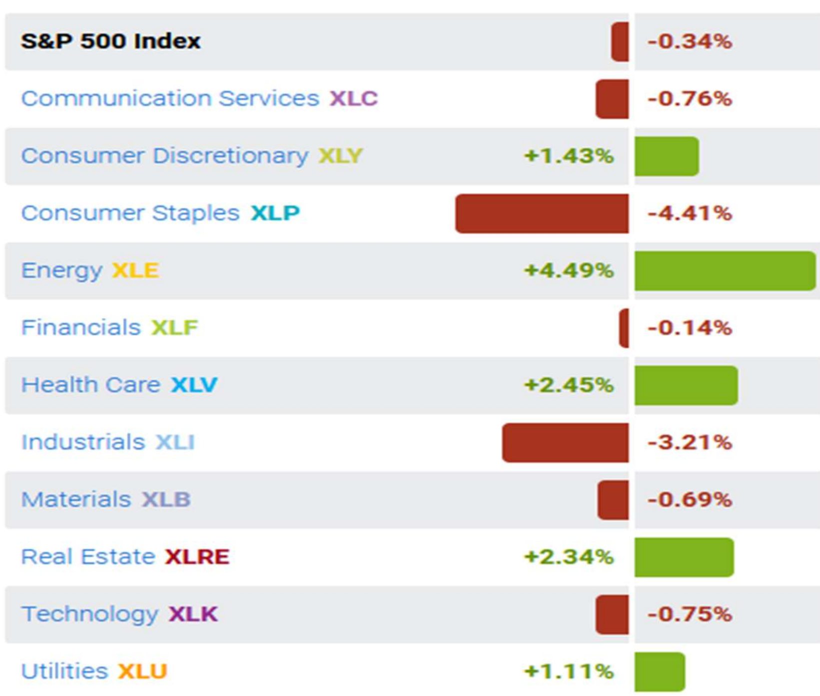
In January, we saw the most mixed sector performance, as can be seen in the chart below, that I can remember with nearly equal green and red for the sectors of the S&P.

The best performers were…

- Energy: +4.49%
- Healthcare: +2.45%
- Real Estate: +2.34%

The worst performers were…

- Consumer Staples: -4.41%
- Industrials: -3.21%



Source: https://www.sectorspdr.com/sectorspdr/tools/sector-tracker

Oil Report

In January, crude oil was strong the first half of the month as Saudi Arabia unexpected and voluntarily choose to reduce oil output to help stabilize prices. The balance of the month was sideways choppy as it seemed every day Europe was announcing new restrictions which drove concern over short term demand for oil. The current NYMEX WTI Crude Oil futures settled at $52.14 and posted a gain of over 7% from the prior month close of $48.52 a barrel. The price for RBOB gasoline followed a similar path to crude oil, though again was stronger than oil. RBOB finished higher by over 10% for the month of January. The oil patch continues to look across the valley, seeing vaccines as the bridge to returning to "normal" and increased use of crude and gasoline.

The Rest of the Data

The news cycle finally moved past the election and renewed lockdowns seem to have faded as well. Now the debate, with the Democrats holding even or majority in the 3 branches, just how big a stimulus can they pass. Additionally, the U.S. seems to be nearing or past the worst of this wave of the coronavirus as cases and hospitalizations have been trending down the last few week and deaths rates seem to have flattened the upward trajectory. The last stimulus is currently providing a boost to 1st quarter GDP, with another potential stimulus in the cards. The vaccine is continuing to get wider distribution, and other than the mutants, things are looking up for economic growth.

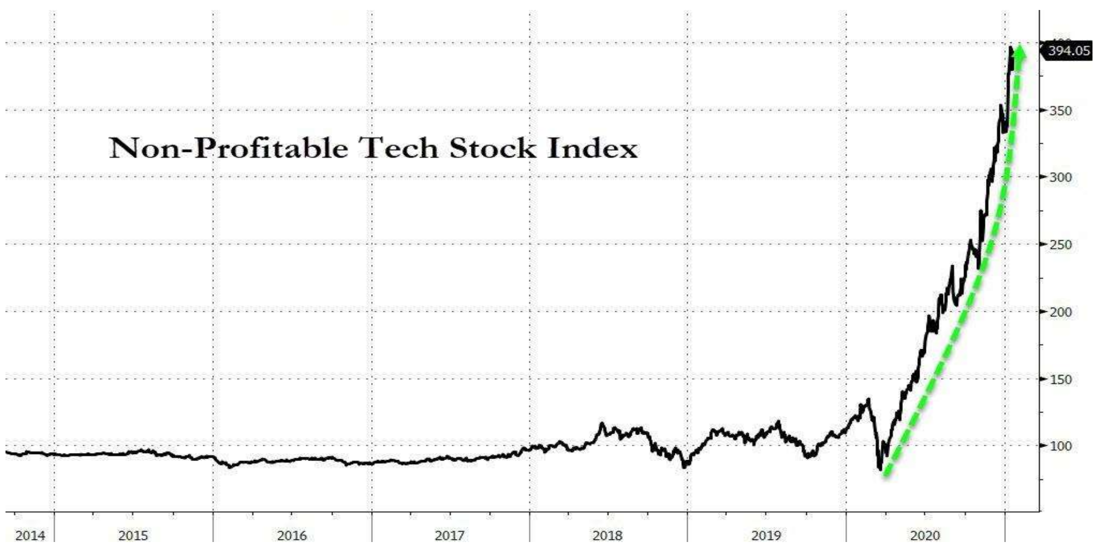
The December ISM Manufacturing Index jumped 3.2 points to 60.7 from November's reading of 57.5, though potentially concerning is that prices paid, a sign of inflation, has strengthened considerably in recent months. Additionally, the ISM Services Index increased to 57.2 from 55.9 in November. Any reading above 50 generally indicates improving conditions. Consumer confidence increased to 89.3 in January, which compares to a downwardly revised figure of 87.1 in December. The unemployment rate remained flat, again coming in at 6.7%, as the economy lost jobs and was far weaker than expectations, -140,000 jobs in December. The Consumer Price Index for All Urban Consumers (CPI-U) was up +0.4% in December on a seasonally adjusted basis. Over the last 12 months, the All-Items Index climbed +1.4% on a non-seasonally adjusted basis. Overall, these numbers suggest a stable low single digit growth rate for the economy. There are now a lot of tailwinds lining up behind the economic recovery, the one item to watch for is inflation. Does inflation move from asset inflation to goods inflation? If so, the Fed may not be on pause as long as they would like.

Summary

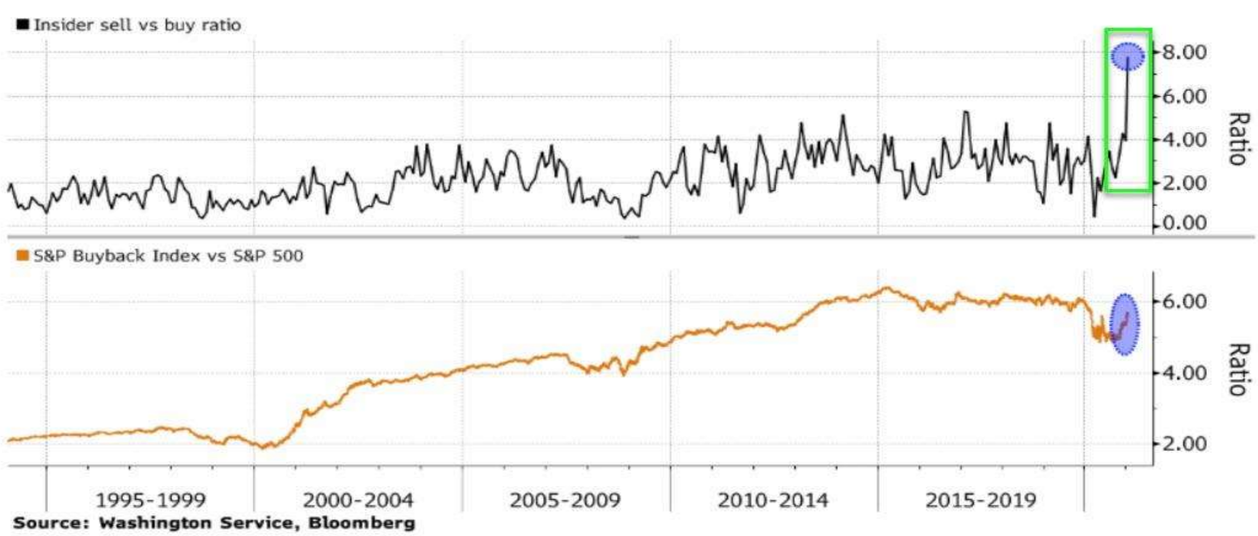
The path forward now seems more clears, at least in the U.S. Easing of lockdown restrictions, increased distribution of the vaccines and 1 or maybe 2 stimulus packages being pumped into the economy. As previously mentioned, potential inflation and the likely increase in base Treasury rates seem the only potential fly in the ointment. The developed international markets had been leading the U.S. by several months, though the past month brings that into question as specifically developed Europe keeps adding restrictions contrary to where the U.S. seems headed.

In the U.S. specifically relating to the stock market, things have gotten a little bit crazy. Valuations have been stretched for years and can always get more stretched. However, the last 6 weeks have me seeing things as having moved into the bubble phase. The initial public offerings of AirBnB and Doordash were met with open arms and bid higher more reminiscent of the late 1990's dot-com bubble. The past week "meme" stock march has been fascinating to watch. Gamestop, by some measures Blockbuster around the advent of Netflix, has gone from $5 in March to almost $500 on Friday. I am not saying sell all, as we saw in 1999, the Nasdaq went up 80% in the 4th quarter alone, but I am saying we seem to have left most semblance of sanity behind as the 2 charts below suggest.

The first chart shows that the more money your company loses the higher the stock price Wall Street is awarding. The second chart shows that the corporate insiders, who should know the most, are selling stock at the highest pace relative to buying in decades.



Source: https://www.zerohedge.com/markets/bullion-bonds-big-tech-bid-bitcoin-bust-bidens-big-day



Source: https://www.zerohedge.com/markets/insider-selling-explodes-record-highs-buybacks-re-emerge

Again, this is not meant to cause fear, 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 on the upside, 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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