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summaries

SIGMA INVESTMENT COUNSELORS

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MARKET COMMENTARY HINDSIGHT IS 2020

Like most, we are glad to have 2020 in the rear view mirror. As noted in our December Sigma Summaries, there is still much to be grateful for. The same can be said for equity investors who remained invested throughout 2020.

While last year's quarterly results were quite volatile, the annual return for most major market averages were well above long-term historical averages. With "2020 hindsight", we reiterate our constant mantra of the importance of having an explicit plan and the investment discipline to stay within the plan.

For example, the S&P 500 posted a positive 5% return from the beginning of 2020 through mid-February. Then, as the COVID-19 virus turned into a pandemic, the economy came to a screeching halt and the S&P 500 dropped 34% from its February peak to its March lows. This sudden drop in the market caused many portfolios to have a much lower equity ratio versus their target. By sticking to the "plan", we rebalanced many of our accounts by selling fixed income securities and buying more equities. As long term investors, this was the logical course of action. Little did we know that the market was going to rebound so dramatically and quickly. In fact, the S&P 500 rose an incredible 70% from mid-March thru year-end and major U.S. market indices ended 2020 at all-time highs.

The extreme movement in equity prices during 2020 illustrates and accentuates the futility of market timing. COVID-19 was a black swan event that took everybody by surprise. Nearly a year has passed and we are still grappling with getting the virus under control. Moreover, the economy is still struggling and many lives have been lost. Adding to the list of misery is the upheaval that we are experiencing related to our presidential election. And yet, the market continues to climb this wall of worry.

With 2020 hindsight, the adage "never let a good crisis go to waste" proved true as well. Not only did the market correction prove to be a great buying opportunity for many, it also provided an opportune time to harvest significant capital losses in many taxable accounts. Similar to 2008-2009, we anticipate the losses taken will shelter capital gains taxes for several years to come.

U.S. growth stocks were clearly the winners for 2020. However, the last quarter of the year saw the beginning of a rotation into sectors that had trailed most of the year. As shown in the data above, small cap, mid cap and emerging market indices far outperformed U.S. large cap indices in the 4th quarter. With 2020 hindsight, this type of rotation underscores the discipline of maintaining a diversified portfolio.

Looking ahead, we know that each year presents its own challenges. On the political front, we expect to see new regulation in many areas of the economy such as energy, technology and healthcare. We expect a new fiscal stimulus package which will bring a welcomed and important relief to millions of Americans. It will also provide a lifeline to many sectors of the economy, including consumer discretionary, consumer staples, as well as industrials.

On the international front, most economies have suffered a more severe downturn vs. the U.S. We expect these economies to experience a strong rebound in 2021 making foreign market investments very compelling. It will also be important to keep an eye on the geopolitical landscape. New challenges from Russia and China, both intent on stretching their spheres of influence beyond their borders, are likely to test the new administration. While this may initially rattle markets, it may highlight the strength of the U.S. defense contractor industry.

Finally, in 2021, we believe a robust economic recovery may lead to higher interest rates, particularly as rates are near all-time lows. If and when we experience higher interest rates, bond prices will be under pressure. Given this risk, we continue to keep fixed income portfolios invested in the shorter end of the maturity curve. While returns are minimal, we believe this is a more compelling place to be versus the longer end which has the risk of negative returns.

Yes, there will be bumps and concerns along the way, there always are. However, we are optimistic that as vaccines are rolled out and the virus subsides, we will return to a "new normal". This, combined with a more compelling story abroad, will provide solid underpinnings for client portfolios in 2021.

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