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Investment and Financial Consultants

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2020 ECONOMIC AND FINANCIAL MARKETS REVIEW

As uncertain as 2020 was due to the pandemic and the contentious election, the stock market's short-term movements were similarly erratic. 2020 began with gains in the major market averages, which were followed by the fastest decline of 30% or more in stock market history. Then, the stock market indices staged a remarkable recovery even while economic, pandemic, and political uncertainties were worsening. This recovery was initially driven by the Federal Reserve Board, which implemented stimulus plans by lowering short-term interest rates to zero and printing money to buy long-term bonds. This process of buying bonds, known as "Quantitative Easing," is intended to increase the price of bonds, thereby reducing interest rates in the bond market toward zero. With lower interest rates, businesses and consumers can borrow money cheaply, which helps the economy to recover. However, lowering interest rates also reduces the yield that investors can earn on fixed-income investments such as money market funds, bank accounts, CDs, and bonds. With such low rates, investors had no choice but to shift money into equities, thereby propelling the stock market higher.

As winter began, optimism over vaccines and relief that presidential election uncertainty subsided propelled a year-end stock market rally. As a result, the S&P 500 Index ended 2020 up 16.26%, while the Dow Jones Industrial Average ended the year up 7.25%. The Bloomberg Barclays U.S. Intermediate Government/Credit Bond Index increased by 6.43% during 2020.

The Federal Reserve Board has indicated that it will keep interest rates near zero for the foreseeable future until the U.S. economy fully recovers. Successful vaccines reducing the pandemic's impact on the economy should also help the stock market continue its positive momentum from 2020. However, some offsetting headwinds may come into play during 2021. For example, stock investors will react negatively if the new Biden administration passes tax increases through Congress. In particular, an increase in the capital gains tax rate would likely cause investors to sell securities before a new tax law goes into effect. It is also possible that setbacks related to the pandemic may create further economic instability and investor weariness.

Another risk for stocks in 2021 is that corporate earnings do not grow enough to keep up with relatively high stock valuations. Entering 2021, the stock market is richly valued, and unanticipated weak corporate earnings could harm stock prices. Also, seeing the stock market perform well during bad economic conditions encouraged investors and traders to take on additional risk by buying volatile stocks. Often, when investors get too complacent and investor sentiment gets too high, the stock market underperforms.

During 2020, technology stocks outperformed most other industries as the stay-at-home and work-from-home trends were profitable for companies such as Apple, Facebook, Netflix, Google, Amazon, and Microsoft. In 2021, we expect other sectors of the economy that did not perform well in 2020, such as health care, energy, financials, and leisure to perform better as the economy recovers. We also like companies that have a history of paying relatively high dividends. Dividend- paying stocks will likely benefit this year because, in general, dividend yields on many stocks are higher than the interest being paid on corporate and government bonds.

We continue to favor large companies over small companies and short-term bonds over long-term bonds. Although gold and other precious metals gave back some of their gains late last year, we expect them to perform well again this year as the U.S. government continues to print money and increase its debt burden. Gold is also a reliable hedge against potential future inflation and a weaker U.S. dollar.

As always, we will continue to monitor ongoing economic and financial market conditions. In the meantime, please contact us if you have any questions regarding your investment portfolio or the financial markets in general.

** Index returns were obtained from the Wall St. Journal and Bloomberg Barclays on January 1, 2021.*