CLEARPOINT

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JANUARY 2021

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2020, A YEAR OF HINDSIGHT

BY ANEET DESHPANDE, CFA, CHIEF INVESTMENT STRATEGIST, SENIOR MANAGING DIRECTOR

2020 RECAP

2020 saw a global pandemic with 85.84 million cases and claimed the lives of 1.86 million people (and counting)[1], a global recession, and a presidential election. Who could have imagined that under those circumstances global markets would close the year at, if not above, all-time highs?

"Black swan" events are often characterized as being improbable, unpredictable, severe in their impact, and eventually rationalized after the fact with 20/20 hindsight (perhaps somewhat ironic that it was the year of 2020). It begs the question: what was the "black swan"—the pandemic or the market recovery? It goes without saying, 2020 was a year that confounded market observers, economists, and practitioners alike—"black swan" or not.

While the notion of a pandemic may have been predictable, its consequences and impacts were largely unpredictable, and continue to evolve, as policy prescriptions test things such as our individual and economic freedoms and business and life priorities, among many others. Extreme and rare events may also accelerate the pace of trends, or reverse them, as we see a wide range of individual and economic adaptations in response to COVID-19's realities. Trends in how we work and spend our leisure time, constrained by the pandemic, have brought forward, or changed, many trends—creating winners and losers seemingly overnight.

CLEARSTEAD CONTINUES TO BOLSTER TEAM WITH NEW TALENT

We are pleased to announce that we have added talent to the Private Client team with Jessica Martin and Chelsea Enslow.

Jessica Martin has joined Clearstead as a Client Planning Associate. Jessica comes to us from Bober, Markey, Fedorovich & Company where she was a Staff Tax Accountant. She has a Bachelor of Science Degree in Accounting and a Master of Taxation, both from the University of Akron.

Chelsea Enslow has joined Clearstead as a Client Service Associate. Chelsea recently moved to Cleveland from California and has spent most of her career in the financial services industry, in both client service support and back-office support. She holds a BA in History from the University of California, Santa Cruz.

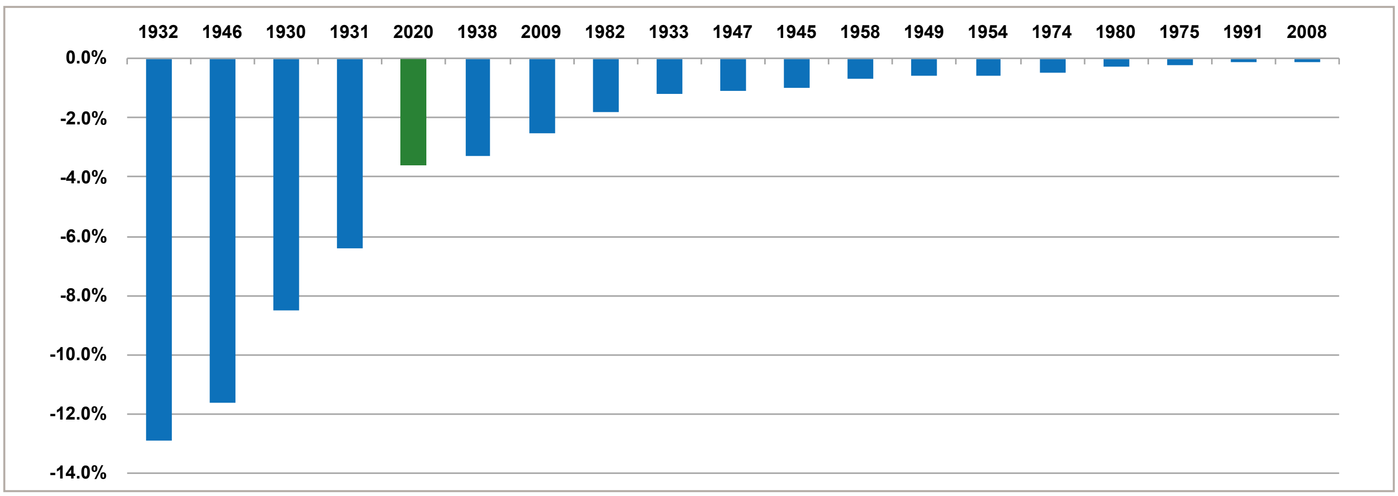
These changes underscore the firm's commitment to building its investment consulting practice, promoting the next generation of leadership, and maintaining a rigorous investment process.

Examples can be seen in increased on-line shopping and how that continues to reshape the retail industry, which is already experiencing dramatic consumer shifts. Work from home and deurbanization provided a jolt to things like cloud computing and suburban housing markets, and new vaccination platforms helped expedite vaccine development processes. The list goes on, however, and the overarching theme and unambiguous winner throughout this crisis was technology. Technology allowed corporations, and individuals, to adapt to the COVID-19 world in ways which, perhaps, were unimaginable ten years ago.

Economy

As 2020 began, the economy was favorably positioned given the economic momentum of 2019. The economy was better positioned to deal with the pandemic from a position of relative strength as opposed to relative weakness. What made the recession of 2020 different compared to past recessions was its self-inflicted nature. Economies around the world, including the U.S., were forced to shut down given the uncertainty of COVID-19. As a result, the U.S. economy suffered one of the deepest economic declines on record, with GDP declining -8.99%[2] in Q2 while the unemployment rate reached a peak of 14.70%[3] during April.

Contractions in GDP by Calendar Year, 1930-2020



Source: Bloomberg LP, Clearstead, 2020 Real GDP estimates assumes a Q4 2020 GDP increase of +2.8% (Quarterly, SAAR) from the Conference Bord Economic Forecasts for the U.S. Economy, as of 9-Dec.

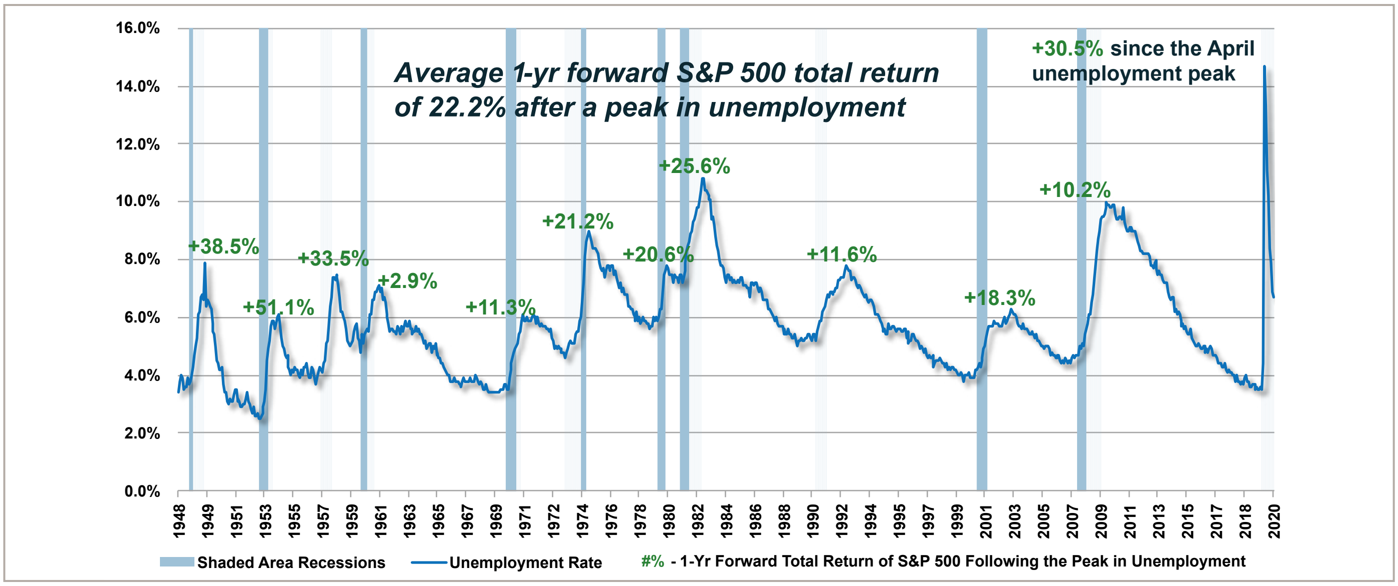
Fiscal and monetary policies such as the CARES Act and the numerous monetary policy programs helped stabilize and stimulate capital markets and the economy. As the economy reopened, the country's output significantly increased with pent up demand—GDP increased a record +7.40%[4] in Q3 while Q4 is estimated to be +2.8%[5]. The employment backdrop also improved, and the unemployment rate steadily declined from the April peak of 14.7%[3] to 6.7%[3] (as of November 2020) over the course of the year; however, the rate remains well above pre-pandemic levels (3.5% as of February 2020).

Markets

<u>Equities</u>

There is the economy, and then there are markets. In the short term we have to remain mindful of the fact that capital markets do not have to reflect economic fundamentals, and in fact, can be heavily influenced by external forces such as psychology and central banks. With that in mind, equity markets suffered significant declines as the pandemic crippled economies around the globe. The S&P 500 experienced its fastest bear market (a market decline of greater than -20%) in history, with the index losing -26.6%[3] over 15 trading days. In sum, the index would decline -33.8%[3] over 23 trading days between February 19th and March 23rd. The fiscal and monetary policy response during March and April helped bolster markets by ensuring significant liquidity remained in markets while fiscal measures were designed to help individuals and corporations "bridge" the self-imposed shut down of the economy. Fueled by growth stocks, equity markets responded in kind and, by early August, the S&P 500 had recouped all its losses. Like so many other points in history, in the face of bad news the stock market rallied in anticipation of a recovery.

Unemployment Rate and Equity Returns



Source: Clearstead, U.S. Bureau of Labor Statistics, Unemployment Rate [UNRATE], retrieved from FRED, Federal Reserve Bank of St. Louis; https://fred.stlouisfed.org/series/UNRATE, May 10, 2020, Bloomberg LP – 1 yr forward (monthly) total returns from month of peak unemployment. Return since April peak in unemployment is total return of S&P 500 from 30-April-20 to 31-Dec-20. Past performance is not an indicator of future results.

Fixed Income

Fixed income markets similarly witnessed significant volatility throughout the month of March as the U.S. bond market was besieged by a lack of liquidity. Ultimately, treasuries benefitted from the flight to safety as the Federal Reserve reduced its policy rate to near zero while implementing significant quantitative easing. Additional measures implemented by the Federal Reserve, through a series of programs, stabilized short-term money markets as well as corporate debt markets.

The U.S. treasury market (Bloomberg Barclays US Treasury Total Return Index) gained +9.6%[3] from the beginning of the year through March 9th. During this period, the 10-year U.S treasury yield fell from 1.92%[3] to .54%[3]. The U.S. 10-year yield remained range-bound through the remainder of the year, never exceeding 1.00%.

Corporate bonds (both high yield and investment grade) suffered through March as investors grappled with recessionary and pandemic-related consequences, particularly for riskier borrowers. Those fears abated as the Federal Reserve announced a series of programs during March, some of which explicitly supported corporate bond markets. Combined with record low interest rates, corporate bonds rallied and 2020 witnessed a record amount of issuance from both high yield ($390bn) and investment grade ($1.81tn) companies.

	2020	Max Drawdown in 2020	Time to Recovery (trading days)
Equity			
Russell 1000	20.9%	-34.8%	98
Russell 1000 Growth	38.5%	-31.5%	55
Russell 1000 Value	2.8%	-38.3%	184
Russell 2000	19.9%	-41.7%	168
Russell 2000 Growth	34.6%	-40.4%	102
Russell 2000 Value	4.6%	-44.7%	176
MSCI EAFE	7.8%	-33.9%	170
MCSI Emerging Markets	18.3%	-33.7%	145

Source: Bloomberg LP, Clearstead, Max Drawdown = total return decline from peak to trough, Time to Recovery = # of days to recover losses from trough.
Past performance is not an indicator of future results.

2020, A YEAR OF HINDSIGHT

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	2020	Max Drawdown in 2020	Time to Recovery (trading days)
Fixed Income			
Bloomberg Barclays Aggregate	7.5%	-6.3%	71
Bloomberg Barclays High Yield	7.1%	-20.8%	99
Bloomberg Barclays Municipal Bond	5.2%	-10.9%	94

Source: Bloomberg LP, Clearstead, Max Drawdown = total return decline from peak to trough, Time to Recovery = # of days to recover losses from trough. Past performance is not an indicator of future results.

2021 EXPECTATIONS

Economy

Our focus in 2020 was centered around a discipline of understanding three areas that we believed would most heavily influence the economy and markets: fiscal response, monetary response, and the medical response. These three points remain critical to our thinking for 2021.

Thankfully, greater certainty has availed itself thanks to the development of vaccines and therapies, a better understanding of the virus, and improvements in testing. Monetary policy—while likely creating excesses in markets—remains highly accommodative for the economy and many of the extraordinary programs launched in the depths of the crisis have wound down. Lastly, fiscal support continue to bear significant importance given the joblessness millions of Americans face—many of whom do not benefit by the stock market going higher. Total non-farm payrolls now stand at 143 million, still 10 million jobs below pre-crisis (February 2020) levels, and new job additions are increasing at a slower pace—leaving the prospects for a jobless recovery real. We believe the economic recovery that we have witnessed is likely to continue (current Federal Reserve projections are for GDP growth of 4.2%)[7] albeit at a likely slower pace, and perhaps most importantly, the range of potential outcomes for the economy remains wide for 2021.

U.S. Economy Then & Now

	Pre-Pandemic	Pandemic Lows	Most Recent	Observations
GDP (SAAR)	$19,254bn	$17,302.50	$18,583.50	GDP remains -3.5% below the peak
Unemployment Rate	3.5%	14.7%	6.7%	Recovery in employment has slowed
Total Non-farm Payrolls	152,436m	130,303m	142,629m	Economy needs to add ~10m more jobs
Weekly Jobless Claims	282k	6,867k	787k	Claims moderating, well above pre-crisis levels
NFIB Small Business Optimism	104.5	90.9	101.4	Small business sentiment improved - still weak
Conference Board Consumer Confidence	132.6	85.9	88.6	Consumer confidence remains weak
Existing Home Sales (SAAR)	5.76m	3.91m	6.69m	15-year highs
New Homes Sales (SAAR)	716k	570k	841k	14-year highs
Median Home Price (existing homes)	$270k	$281K	$311k	Home prices never declined
CPI (YoY)	2.30%	0.10%	1.20%	Inflation remains low, deflationary risks subsided
ISM Manufacturing PMI	50.1	41.5	57.5	Manufacturing rebound with goods demand, 2-yr highs
ISM Services PMI	57.3	41.8	55.9	Services remain below pre-pandemic level
Industrial Production (YoY Change)	-0.24%	-16.26%	-5.5%	Rebound in production but still down YoY

Source: Bloomberg LP, Clearstead, Pre-pandemic denotes the immediate reading(s) prior to the pandemic, Pandemic Lows represents the worst reading during the crisis, Most Recent denotes the most recent reading for the respective data (weekly, monthly, quarterly) as of 31-Dec. SAAR = Seasonally Adjusted Annual Rates.

Markets

Equities

Following last year's strength in equity markets, expectations for equities are more muted going forward. In 2020, equity markets were bolstered by growth stocks and on balance benefitted from a recovery in earnings, central bank liquidity, low interest rates, and low inflation. The earnings recovery is expected to continue as analysts expect earnings for S&P 500 to grow by +21.7%[8] in 2021. Additionally, global central banks are likely to continue their highly accommodative policies ensuring that interest rates will remain low and liquidity plentiful. All else equal, that backdrop should be supportive for equity markets. That said, risks to the corporate earnings backdrop remain, whether through policy action by the new administration or renewed disruptions to the global economy from the pandemic. All told, our expectations for equity markets are more subdued as compared to 2020, and like the economy, the potential range of outcomes is likely wider than usual and significant bouts of volatility should be expected.

Fixed Income

Fixed income's exceptional performance in 2020 resulted from a variety of factors, notably from interest rates, which fell across the entire yield curve. Like equities, the return potential as we look towards 2021 is quite lessened as compared to 2020. With a starting point of low interest rates, the upside in U.S. treasuries is low while risks are higher given the duration (interest rate sensitivity) of those securities along with the potential for rising inflation expectations.

Similarly, within corporate credit markets, the upside is likely constrained given the low levels of both interest rates and credit spreads. The sum of these variables leaves fixed income with lower total return prospects in 2021, while also reducing the portfolio protective feature that had been exhibited by fixed income in the past.

Fixed Income's Portfolio Stabilizing Characteristics Likely Impaired Relative to Prior Periods Given the Low Beginning Yields

Bear Market		10-Year Treasury Yield			Aggregate Index	U.S. Treasury	S&P 500
Start Date	End Date	Start	End	Change in Yields	Total Return	Index Total Return	Total Return
3/24/2000	10/9/2002	6.2%	3.6%	-2.6%	29.1%	31.4%	-47.4%
10/9/2007	3/9/2009	4.6%	2.9%	-1.8%	7.2%	15.4%	-55.2%
2/19/2020	3/23/2020	1.6%	0.8%	-0.8%	-0.9%	5.4%	-33.8%

Source: Bloomberg LP, Clearstead. Past performance is not an indicator of future results.

CLOSING

A few pages cannot begin to do 2020 justice, particularly for those most affected by the pandemic. With that said, our focus continues to be on helping our clients meet their objectives while maintaining a rational set of expectations given the evolving backdrop. As we begin 2021 for client portfolios, lowered (short and long-term) expectations for both fixed income and equities continues to lead us to emphasize the incorporation of private investments into the total portfolio as a potential means of increasing the probability of meeting objectives. Since the path of markets is not knowable, we would also like to reinforce that "controlling the controllable" is of utmost importance, particularly as it relates to 2021. Reviewing asset allocation, reviewing investment policy statements, reviewing liquidity needs, reviewing estate plans, and reviewing tax strategies, are all of great importance. As famed investor Howard Marks so eloquently said in 2001 "You Can't Predict. You Can Prepare."

We would like to thank you for the trust and confidence you have placed in Clearstead and look forward to working with you in 2021.

Notes:

(1) https://coronavirus.jhu.edu/map.html, as of 5-Jan-2021
(2) Bloomberg LP, Clearstead, QoQ annualized decline of -31.4%
(3) Bloomberg LP
(4) Bloomberg LP, Clearstead, QoQ annualized increase of +33.1%
(5) Conference Board estimates for the U.S. Economy, as of 9-Dec
(6) SIFMA, US Corporate Bond Issuance, as of 3-Dec
(7) https://www.federalreserve.gov/monetarypolicy/files/fomcprojtabl20201216.pdf
(8) Factset Earnings Insight
(9) https://www.oaktreecapital.com/docs/default-source/memos/2001-11-20-you-cant-predict-you-can-prepare.pdf?sfvrsn=2

MARKET BENCHMARK RETURNS

December 31, 2020		1M	3M	12M	YTD
US Large Cap	S&P 500	3.8%	12.1%	18.4%	18.4%
US Small Cap	Russell 2000	8.7%	31.4%	20.0%	20.0%
Developed Intl	MSCI EAFE	4.6%	16.0%	7.8%	7.8%
Emerging Intl	MSCI Em Mkt	7.4%	19.7%	18.3%	18.3%
Real Estate	NAREIT	2.8%	9.2%	-5.9%	-5.9%
Core Fixed	BarCap Agg	0.1%	0.7%	7.5%	7.5%
Short Fixed	BarCap 1-3Yr	0.1%	0.2%	3.3%	3.3%
Long Fixed	BarCap LT G/C	-0.2%	1.7%	16.1%	16.1%
Corp Debt	BarCap Corp	0.5%	2.8%	9.4%	9.4%

Source: Bloomberg

The performance data shown represent past performance. Past performance is not indicative of future results. Current performance data may be lower or higher than the performance data presented.