Wallington ASSET MANAGEMENT
INDEPENDENT INVESTMENT COUNSEL

QUARTERLY NEWSLETTER

2020: FOURTH QUARTER **128TH EDITION**

"Investors might rue the day they ventured into asset classes far from their natural habitat that lack sufficient liquidity in a correction."

~Mohamed A. El-Erian

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CAPITAL MARKETS SCOREBOARD

Equities					
Indices	4Q20 Total Return (%)	2020 Total Return (%)	Index Characteristics		
Domestic			NTM P/E	P/B	Div. Yld. (%)
S&P 500	12.1	18.4	22.7	4.2	1.5
DJIA	10.7	9.7	20.7	4.6	2.0
NASDAQ	15.6	44.9	33.3	6.4	0.7
Russell 1000 Growth	11.4	38.5	31.3	12.4	0.7
Russell 1000 Value	16.3	2.8	18.0	2.4	2.2
Russell 2000	31.4	20.0	29.8	2.4	1.2
International*					
MSCI EAFE	16.1	8.3	17.5	1.8	2.4
MSCI Emerging Markets	19.8	18.7	15.3	2.2	1.7
MSCI United Kingdom	17.0	-10.4	14.4	1.7	2.9
MSCI France	20.4	4.7	18.0	1.8	2.8
MSCI Germany	11.5	12.3	16.0	1.8	2.3
MSCI Japan	15.3	14.9	18.4	1.5	2.0

Fixed Income		
Indices**	4Q20 Total Return (%)	2020 Total Return (%)
Domestic		
U.S. Corp - Gov (1-3 Years)	0.2	3.3
U.S. Corp - Gov (3-5 Years)	0.6	6.5
U.S. Corp - Gov (10+ Years)	1.0	15.5
U.S. Treasuries Master	-0.9	8.2
U.S. Corporates Master	3.0	9.8
U.S. Municipals Master	2.0	5.3
U.S. High Yield Master	6.5	6.2
International*		
Developed Markets Sov Bond	2.3	9.3

Commodities		
Resource	4Q20 Total Return (%)	2020 Total Return (%)
Precious Metals		
Gold	0.3	24.6
Silver	11.6	46.8
Industrial Metals		
Copper	16.0	25.8
Aluminum	13.9	9.9
Energy		
Brent Crude Oil	27.1	-24.4
WTI Crude Oil	20.7	-20.9
Natural Gas	0.5	16.0

Key Rates				
Rates	12/31/2020	9/30/2020	6/30/2020	12/31/2019
U.S. Target Fed Funds Rate	0.25	0.25	0.25	1.75
2-Year U.S. Treasury	0.13	0.13	0.16	1.58
10-Year U.S. Treasury	0.93	0.69	0.66	1.92
30-Year U.S. Treasury	1.65	1.46	1.41	2.39
10-Year German Bund	-0.58	-0.53	-0.48	-0.19
10-Year Japanese Bond	0.04	0.03	0.04	-0.02
30-Year Fixed Mortgage	2.68	2.89	3.16	3.72

Currencies				
Indices/ Exchange Rates	12/31/2020	9/30/2020	6/30/2020	12/31/2019
ICE U.S. Dollar Index	89.94	93.89	97.39	96.39
USD per EUR	1.22	1.17	1.12	1.12
USD per GBP	1.37	1.29	1.24	1.32
JPY per USD	103.25	105.53	107.89	108.68
CAD per USD	1.27	1.34	1.36	1.30

*Returns denominated in U.S. dollars

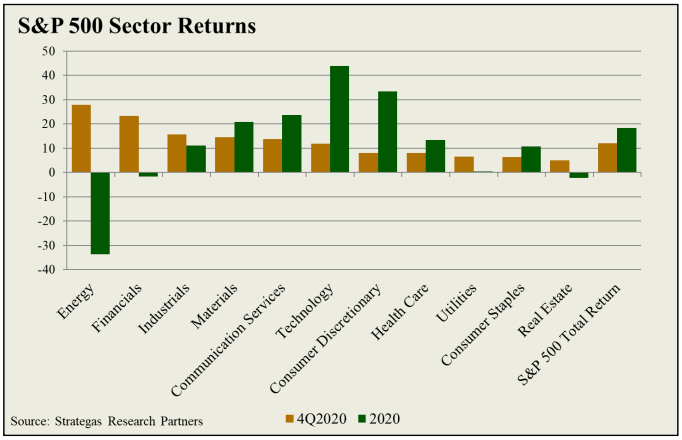
**ICE Bank of America Merrill Lynch (BofA-ML) indices

EQUITIES

The Standard & Poor's 500 index (S&P 500) closed the fourth quarter with a total return (price appreciation plus dividends) of 12.1%, increasing its return after a tumultuous 2020 to 18.4%. The Dow Jones Industrial Average (DJIA) posted a total return in the last quarter close to that of the S&P 500 at 10.7% but trailed significantly for the year at 9.7%. This was the widest margin of relative underperformance by the DJIA in a calendar year since 1988 and is in some ways indicative of the high concentration risk that exists in the S&P 500. That concentration is mostly in the well-known technology stocks as shown by the performance of the NASDAQ Composite Index in 2020, up 15.6% in the last quarter and 44.9% for the year.

The COVID pandemic impacted smaller company stocks particularly hard early in the year due to their lack of resilience relative to larger company stocks. However, the news associated with vaccine progress had a positive impact in the fourth quarter as the Russell 2000 Index comprised of small-cap stocks returned 31.4% for the quarter. The strong fourth quarter led small caps past the S&P 500 for the year, returning 20.0% and overcoming a peak-to-trough decline of more than 40% in the first quarter. International indices also performed positively for the quarter with the MSCI Emerging Markets Index up 19.8% and the MSCI Europe, Australasia, and Far East (EAFE) Index up 16.1% when denominated in U.S. dollars. For the year, they posted returns of 18.7% and 8.3% respectively.

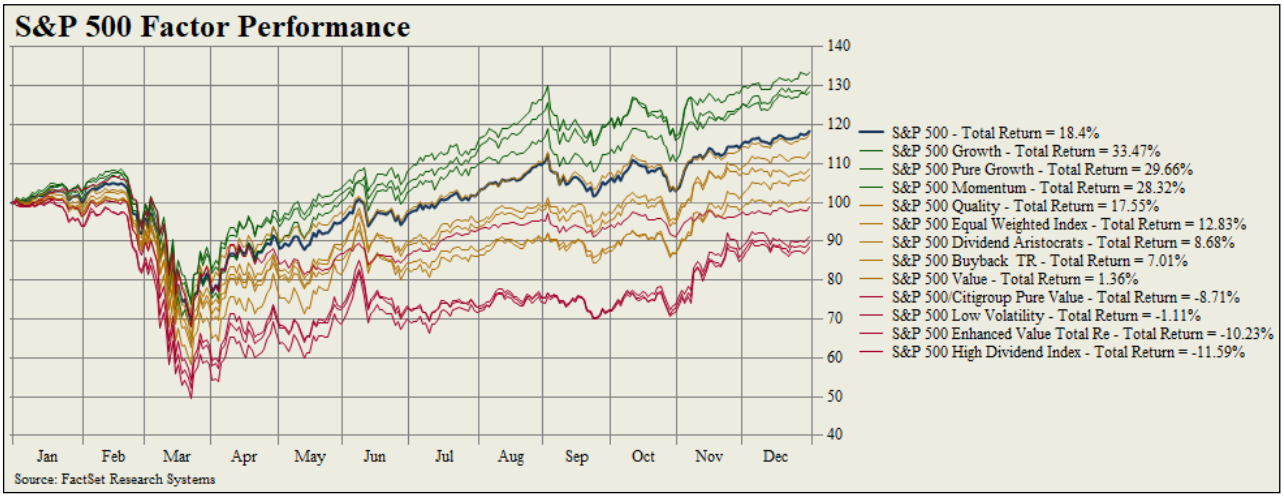
On an S&P 500 sector basis, Energy and Financials Sector stocks led the way in the fourth quarter, up 27.8% and 23.2% respectively, although both finished the year in negative territory (-33.7% and -1.7% respectively). Real Estate Sector stocks were the worst performer for the quarter (4.9%) and posted negative performance for the year (-2.2%). The remaining eight sectors were positive for the year. For the second consecutive year, Information Technology and Consumer Discretion Sector stocks finished first and second at 43.9% and 33.3% respectively.



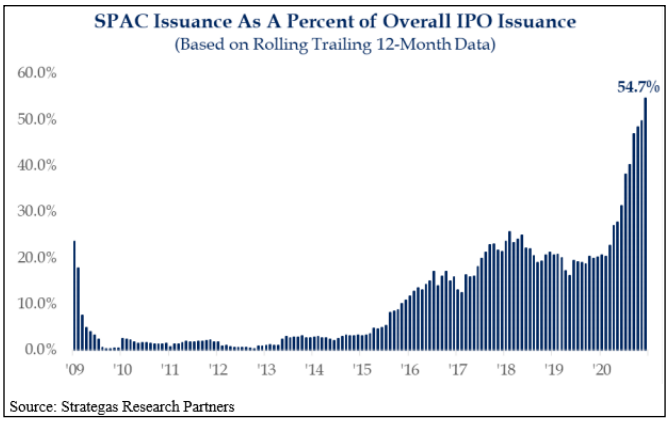
Breadth was strong in the fourth quarter as 90% of S&P 500 companies ended the year in an uptrend, the most since 2013. Still, as previously mentioned, concentration risk within the S&P 500 remains high. Four companies valued over $1 trillion sit atop the index – Apple (which crossed $2 trillion in market cap in August), Amazon, Microsoft, and Alphabet (Google). These four companies plus Facebook (approximately $780 billion) accounted for nearly a quarter of total S&P 500 market cap during the quarter, and on a combined basis represent more market value than the equity markets of singular countries such as Japan, the combined China/Hong Kong markets, and Germany. They are also larger than the U.S. Energy Sector and banking subsector combined. Of note, Tesla was added to the S&P 500 index in December at a market cap of more than $700 billion, making it the largest addition to the index in history.

EQUITIES

The forward price-to-earnings (P/E) ratios of large-cap growth and value stocks as denoted by Russell 1000 indices contracted to relative parity throughout 2009 but have largely diverged since. In September, the Russell 1000 Growth and Value Indices reached their widest relative valuation disparity in nearly two decades. The valuation gap contracted through year-end, albeit slightly. The Russell 1000 Growth Index ended 2020 at a P/E ratio of 31.3x next twelve months (NTM) earnings versus 18.0x for the Russell 1000 Value Index. While growth stocks have generally outperformed their value counterparts since the late 2000's, the opposite occurred in the fourth quarter. The Russell 1000 Value Index posted a return of 16.3% compared to the Russell 1000 Growth Index at 11.4%. Still, the return of the growth index for the year (38.5%) substantially bested that of the value index at just 2.8%. Many value managers posted negative returns for the year. Essentially, 2020 substantially favored a "risk-on" mentality as outperformance was almost exclusively reserved for higher-beta strategies, and most strategies associated with any type of valuation (price-risk) sensitivity drastically underperformed.

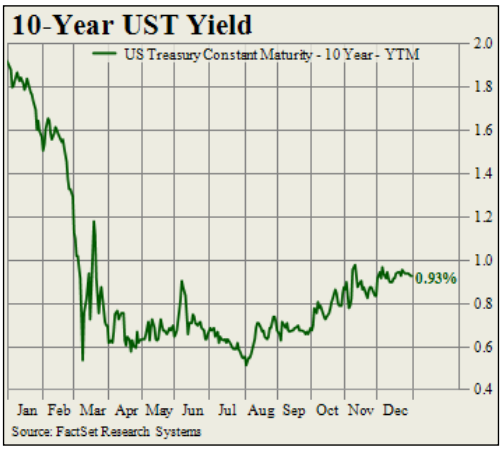


The search for growth also made itself known in 2020's Initial Public Offering (IPO) and Mergers & Acquisitions (M&A) markets. In market value terms, the $168 billion raised in this year's IPO market marked a new record since data tracking began in 1995, far surpassing the previous record of $110 billion set during the tech bubble. The popularity of Special Purpose Acquisition Companies (SPACs), which are shell companies with no operations created solely to merge with or acquire other businesses and take them public, continued through the end of the year. On the M&A side, deals in the U.S. fell more than 50% to near-decade lows during the COVID decline but roared back in the last half of the year. While the year's slow start caused a volume decline of roughly 6% to $3.5 trillion, nearly 40% of the year's volume was announced in the fourth quarter alone. Many analysts expect the upswing in capital market activity to continue in 2021 given the combination of high corporate cash levels, share buybacks in political crosshairs, and other factors.



FIXED INCOME

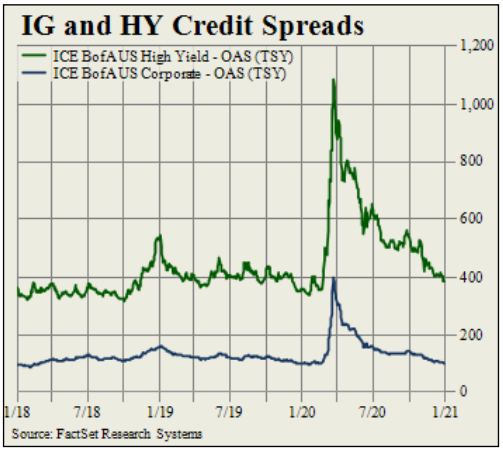
As investors grew more confident over the prospects for COVID vaccines and subsequently the economy, they opted to take on more risk, creating a headwind for U.S. Treasury (UST) performance. USTs in aggregate provided a -0.9% return for the fourth quarter as measured by BofA -ML indices. This lowered their 2020 return to 8.2%. The yield curve (the spectrum of UST yields across varying maturities) steepened as an accommodative Federal Reserve (Fed) continued to anchor short-term rates, and USTs maturing over the next three years provided only a marginally positive return. Increased investor expectations for economic growth and inflation spurred ten-year UST yields to increase from 0.69% to 0.93% over the course of the quarter. This caused long-term USTs with over ten years until maturity to return -3.0% for the fourth quarter.



One headwind for UST prices has been increased issuance to help fund the COVID relief efforts and the federal government at large. Fed bond buying has helped offset much of the increased issuance while increasing the supply of money. Both issuance and Fed purchases have favored short-term USTs, however, leaving a shortage of longer-term USTs. Due to extensive Fed purchases, net issuance of USTs with greater than one year until maturity reached *negative* $441 billion in 2020 according to JPMorgan. Looking forward, net issuance of this longer-term debt is forecast to jump to around $1.8 trillion in 2021. In addition to domestic supply and demand dynamics, the percentage of marketable USTs held by foreign entities has dropped to a 20-year low after peaking during the financial crisis. Foreign buyers with low domestic interest rates, such as Japan, are expected to begin increasing their holdings since UST rates are now more attractive on a relative basis. Continued UST issuance would create a further tailwind for rising interest rates and could thus make the securities even more attractive to foreign buyers. China, however, is widely expected to continue to let its ownership of USTs decline, consistent with what has been a decade-long downtrend.

Even as UST yields stayed in an uptrend through the fourth quarter, the amount of global negative yielding debt continued to increase. In December, global debt with a negative yield to maturity reached an all-time high of $18.4 trillion before ending the year at $17.8 trillion. The previous high watermark was set at just over $17 trillion in August 2019. Further, according to Citi Private Bank strategists, "about four-fifths of the world's investment grade debt yields 1% or less." Global low interest rate policy should eventually act as a headwind for continued increases in UST yields.

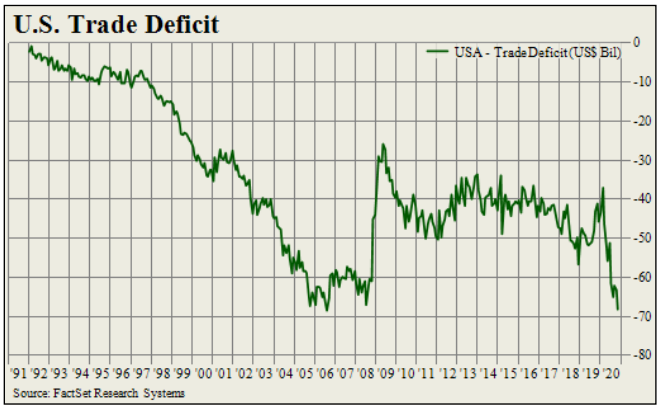
Corporate bonds have been a beneficiary of investors' increased willingness to take on risk amidst low sovereign debt interest rates. In aggregate, investment grade corporate bonds returned 3.0% in the fourth quarter, bringing their 2020 return to 9.8% and surpassing the YTD return offered by USTs. This was caused by credit spreads, the interest rate differential between corporate and government bonds, tightening (narrowing) throughout the fourth quarter. After ending 2019 with corporate bonds offering yields 101 basis points (1.01%) higher than USTs, the spread increased to over 400 bps in the depths of the COVID-instigated downturn in risk assets in March. Since then the spread has continually compressed, driven by government support, investor optimism, and vaccine progress. Spreads ended 2020 at 103 bps, virtually completing a round trip over the course of the year. Credit spreads for high-yield bonds began the year at 360 bps before skyrocketing above 1,000 bps in March. While they have compressed to 386 bps, high-yield bonds have still underperformed their investment grade counterparts in 2020. A 6.5% return in the fourth quarter brought their 2020 return to 6.2%.



ECONOMICS

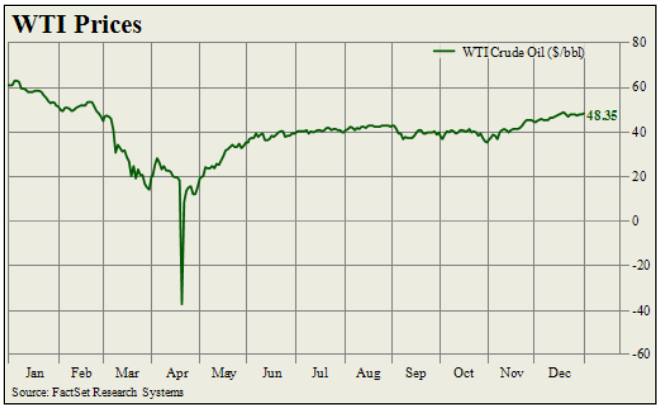
According to the Congressional Budget Office (CBO), the U.S. budget deficit ended the fiscal year in September at $3.1 trillion, over triple the $984 billion level from a year earlier. The annual deficit was 15.2% of Gross Domestic Product (GDP), the highest percentage since 1945 at the end of World War II. The increased deficit was caused by a 47% surge in federal spending (to $6.5 trillion) accompanied with a 1% drop in revenue (to $3.4 trillion). The deficit for the first two months of the 2021 fiscal year was $429.3 billion, a 25% increase over the first two months of the prior fiscal year.

The U.S. trade deficit increased to $68.1 billion in November, the widest level since 2006 and within $150 million of a record. The U.S. typically runs a trade deficit in goods and a surplus in services. In November, the goods deficit was $84.8 billion as imports of consumer goods hit the highest level on record. The services surplus dropped to $16.7 billion, the lowest level since August 2012 as borders largely remained closed. The trade deficit with China was down from 2018, although through November, China had still only purchased $82 billion of its $159 billion commitment to buy U.S. goods in 2020.



The Consumer Price Index (CPI) increased 0.4% month-over-month (M/M) in December after being up 0.2% in November. Over the 12 months ending in December, CPI rose 1.4%. Core CPI, which excludes food and energy, increased 0.1% M/M in December and is up 1.6% over the prior 12 months. Prices that producers receive for goods and services rose 0.3% M/M in December and increased 0.8% over the previous year. While inflation remains below the Fed's 2% average target, market-based 10-year inflation expectations have increased to the Fed target for the first time since 2018.

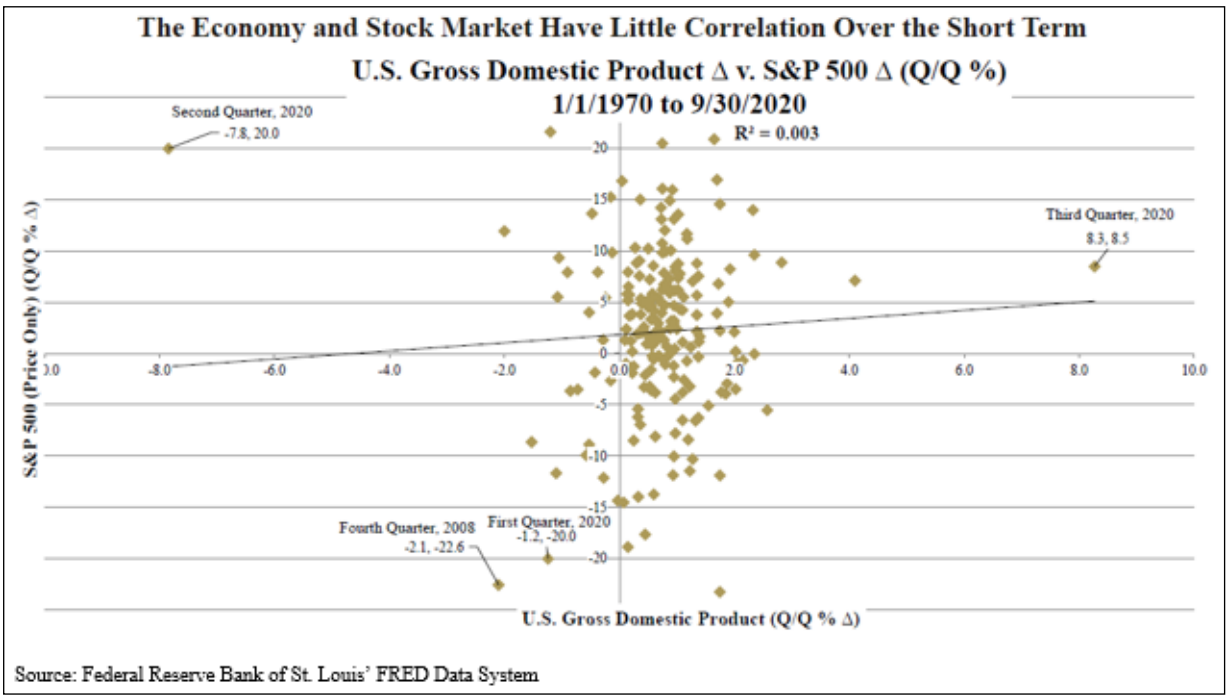
Commodities experienced higher price increases than consumer goods and services in 2020. The Dow Jones Commodity Index increased 13.9% last year. Silver was the biggest gainer, up 47.7%, but soybeans, orange juice, coffee, and gold were all up more than 24%. Natural gas, sugar, wheat, cotton, and platinum were all up more than 10%. Gold started the year at $1,519.50 per troy ounce and closed at $1,893.10, up 24.6%. Oil was the big commodity loser last year. West Texas Intermediate (WTI) crude oil began 2020 at $61.14 per barrel before the price for May futures contracts went negative on their last day of trading in April as supply was overloaded and no buyers wanted to take delivery. WTI prices rebounded and closed the year at $48.35, still down 20.9% for the year after a 20.7% increase in the fourth quarter. Gasoline prices also fell about 17% in 2020.



The number of existing homes sales fell 2.5% in November after increasing in the five previous months, but are still up 25.8% from a year ago. Existing home sales reached a 14-year high in October according to the National Association of Realtors. The median existing home sale price was $310,800 in November, down from a record $313,000 in October. The unsold inventory of existing homes represents a 2.3-month supply at the current sales pace, a record low. The new home supply is better at 4.1 months of inventory. Even though the 30-year fixed mortgage rate hit a record low of 2.66% recently, home affordability is at a 14-year low. This is due to home prices surging; the median existing home sale price of $310,800 in November was up 14.6% from a year earlier. Less than half of new homes sold for under $300,000.

2021: Still So Much Uncertainty

Last year, one of the main questions on the mind of investors was how the stock market generated positive returns while the economy struggled. The answer to that lies with the fact that normally there is little correlation in the short-term between equity markets and the economy (see chart below). More important to the overall performance of equities in recent times has been the state of the credit cycle and the Fed. There exists an old saying in economics related to demand-pull inflation which essentially states inflation is the result of too much money chasing too few goods. The expansion of the Fed's balance sheet no doubt led to some of that money creation finding its way into the financial markets. Still, the correlation last year between the S&P 500 and the economy was as volatile as we have seen in 50 years. The U.S. equity markets performed in a positive manner, but this masked a wide differential in performance between certain types of equities. For example, the Russell 1000 Growth Index posted a return of 38.5% for the year compared to its value counterpart, the Russell 1000 Value Index, at just 2.8%. As written in the previous section on equities, there is a very high concentration risk that now exists in the S&P 500 as a result of a few stocks performing extremely well last year. It is certainly an issue that all equity investors should assess, at a minimum, as we move forward. While there is little correlation between the stock market as a whole and the economy in the short-run, near-term economics will no doubt play a significant role in the relative performance of individual equities in the coming months. Specifically, will the leading stocks of last year, which were not only buffered but enhanced by COVID-driven economics, continue outperforming, or will the more cyclical stocks transition to a leadership role? For that to occur, the economy will have to prove to be on a more solid footing. For fixed income investors, near-term economics will also be of importance as the chase for yield has caused many investors to continue exposing their portfolios to more and more credit risk by investing in alternatives which provide higher performance opportunities. This is not to suggest that such opportunities will prove to be problematic as they may work out well and compensate for the additional risk exposure on capital invested. Similar to more cyclical stocks, economic growth and stability will be of importance. Since economics could have an abnormally high impact on intra-asset class performance, we believe it is essential for investors to have a solid understanding of the economics that led to where we are today (2020) and what may be impactful as we move through this new year.



The year 2020 will likely be remembered as a year in which everything changed, and in which most everyone learned to adapt to conditions, news, and situations as they continued to unfold. This was evident with economic forecasts as economists and the Fed struggled to predict the economic impact of the COVID pandemic. Early on, they predicted the worst economic downturn since the Great Depression of the 1930s but later something similar to the 2007-2009 recession. For example, *The Wall Street Journal* survey of economists in May forecast U.S. economic growth to contract in 2020 at an annual rate of 6.6%, the worst such contraction since the Great Depression. Federal Reserve officials in June also forecast that GDP would contract 6.5% in 2020. The Fed revised their forecast in September to a contraction of 3.7%, and then again in December to a contraction of only 2.4%; both better than the 4.3% GDP decline during the Great Recession ending in early 2009. Economists also followed a similar course with a December forecast of -2.7% for 2020 U.S. GDP. The strength of the economy and employment heading into this pandemic unparalleled in modern times certainly helped the U.S. weather the forced economic shutdown responses to it and contributed to this whipsawing of economic forecasts for 2020.

In the first two months of the pandemic, lockdowns and business closures caused more than 22 million workers to lose their jobs. After the sharp contraction in March and April, the job market snapped back, adding 9.3 million jobs over the next three months. However, job growth has eased since then. Remarkably, the unemployment rate fell from a high of 14.8% to 6.7%. However, there remain 9.8 million fewer people employed than in February. According to the Bureau of Labor Statistics, more than 6 million part-time workers would like to work full time and 2.2 million workers who want a job quit looking for one four weeks ago or longer. The labor participation rate has fallen to 61.5% and initial jobless claims have been in an uptrend recently as job growth of 336,000 in November was followed by a decline of 140,000 jobs in December. Much of the job loss in December was in leisure and hospitality which experienced a decline of 498,000 jobs. Of those job losses, 372,000 were in the food and services industry. State and local governments also laid off thousands of public employees including teachers. There were some bright spots, however, as retailers added 121,000 jobs and manufacturers added 38,000 jobs. Another positive for employment is average hourly earnings were up 0.8% in December and 5.1% from a year earlier.

The December job loss of 498,000 in leisure and hospitality added to what was a devastating year for the sector, as it suffered the most since the start of the pandemic by losing 4 million jobs. These industries remain under siege with ongoing restrictions and lockdowns in many states. Although manufacturing employment is back to pre-pandemic levels, expectations are that it will likely take several years for the unemployment rate to reach pre-pandemic levels as vaccinations and treatments begin defeating the need for ongoing business restrictions. Further, there will no doubt be structural changes as a result of companies being forced toward a remote work environment. Getting the 9.8 million people back to work will be crucial for generating economic growth not only in the U.S. economy but globally, as well. The Technology Sector, which essentially was unfazed by the pandemic, will not be much help as it employs only 2% of the workforce. Of note for equity investors, the sector's representation in the S&P 500 at the close of the year by some measures was nearly 40%.

A Look Forward – Economic Forecasts for 2021

Since the U.S. economic contraction in 2020 was not as severe as initially expected, growth expectations for 2021 have been lowered. Last June, the Fed expected economic growth of 5% for 2021, but reduced it as of now to 4.2%. In similar fashion, the International Monetary Fund (IMF) in June expected the U.S. economy to grow 5.4% in 2021 but in October revised their forecast to growth of 3.2%. The World Bank has also downgraded its forecast for U.S. growth in 2021. There is a substantial amount of uncertainty with these forecasts as the V-shaped recovery of 2020 has already started to fade. IHS Markit reports that economic growth in December was the weakest in three months. Especially uncertain are economic forecasts for the first quarter of 2021; forecasts range from a 1% contraction to 1% growth. If the economy were to contract in the first quarter, that would increase the probability of a double-dip recession in early 2021. To gauge how the economy is performing, the Fed closely monitors the

difference between actual output and potential output, referred to as the output gap. When the economy has been operating above capacity, the Fed has historically been concerned about inflation and tightened monetary policy. When operating below capacity, the Fed's posture is to ease monetary policy. At this time, economic output is far below capacity, so the Fed has implemented easy monetary policy which they have stated will remain in effect for several years. The CBO estimates that it will be 2022 before U.S. GDP approaches 2019 levels, adjusted for inflation. Some economic forecasts reflect an even longer period of time will be required to reach 2019 levels.

Key Factors for the Recovery

While the economy may or may not contract in the first quarter, 2021 economic growth is expected to be robust, especially in the second half of the year on the back of a vaccine-powered rebound. However, even with vaccines, future U.S. economic growth will depend heavily on the job market, consumer behavior, corporate investment, the dollar, and the global economy. Any of these could prove to be a headwind or tailwind for the U.S. economy in 2021, which is indicative of just how tenuous things are now due to the pandemic. Also important to the level of economic growth will be the stimulus emanating from political support and monetary policy.

Consumer Spending

It will be important to have the almighty consumer in a spending mood as consumer spending accounts for nearly 70% of U.S. GDP. The consumer did well early on in the pandemic as retail sales increased every month from May through September. However, retail sales fell 0.2% in October from the prior month and another 1.1% in November. Goods had been the strongest component of retail sales for six months, but they fell 1.0% in November while services fell 0.2%. One constraint on spending is personal income, which fell 1.1% in November for the third straight month. With personal income in decline, a pertinent question is whether the savings rate, currently at a high level of almost 14%, will be used for pent-up demand or held as a permanent safety net. A further offset to declining personal income could be the wealth effect as households' net worth (assets minus liabilities) hit a new record of $123.5 trillion at the end of the third quarter due to increased home, stock, and bond prices. This is an increase of $12.5 trillion from the end of 2019. Ultimately, the impact of consumer spending on economic growth this year will depend upon consumer confidence, the course of the pandemic, and jobs.

Small Business Recovery

Large U.S. corporations with access to the capital markets issued more than $1.75 trillion of corporate bonds and raised billions more by drawing down bank credit lines in 2020. According to the Federal Reserve, U.S. nonfinancial corporations increased their liquidity – cash and short-term money market investments – by 30% in 2020. There has been a flight to the safety of cash. What big corporations do with their cash hoards will impact economic growth going forward; it can be used for productive investments, to repair balance sheets, or returned to shareholders in the form of cash dividends or share buybacks. Small businesses unfortunately have not fared as well. Even though the Paycheck Protection Program provided more than $500 billion to small businesses, thousands are failing. According to the most recent Local Economic Impact Report published by Yelp (September 2020), 163,735 small businesses that were open on March 1 had closed as of August 31 (a 23% increase from the previous month), and 97,966 (nearly 60%) had closed permanently. The new COVID relief bill provides another $325 billion to small businesses which will provide more support. Recently, the Department of Commerce reported that U.S. business formation applications were up 82% in the third quarter of 2020 compared to the same quarter of 2019, so the entrepreneurial spirit is still alive and well in spite of all the hurdles faced. According to the Census Bureau, small businesses employed roughly 62 million workers in 2019, about 47% of the private-sector workforce, so it is imperative that they get needed credit relatively soon to support the recovery in economic growth.

Strength of U.S. Dollar

The dollar is expected by many economists to have a meaningful impact on the U.S. economy in 2021. Whether the U.S. dollar stabilizes, weakens, or strengthens will affect the U.S. and global economy going forward. It has fallen more than 12% against a trade-weighted basket of currencies since mid-March and is at its lowest level in more than two years. A weaker dollar makes U.S. exports less expensive and more competitive while making imports more expensive. The dollar has fallen in large part because: 1) vaccines have reduced some of the uncertainty about the pandemic and thereby the need for a safe haven currency; 2) the Fed and Congress have provided a very aggressive response to the recession; and 3) the U.S. still suffers from the twin deficits – budget and trade. Goldman Sachs and many other analysts maintain the dollar is still overvalued and expect further declines in 2021. While this would likely be a positive for the U.S. economy, it could also prove to be positive for the global economy. Most commodities such as oil are priced in dollars and a weaker dollar would make some of them cheaper to foreign countries. Additionally, much of global debt, especially from emerging economies, is borrowed in dollars and a weaker dollar makes repayment of the debt less expensive. In the same vein, a weaker dollar is inflationary, which would effectively cheapen the repayment of U.S. debt by the federal government.

Global Recovery

According to the World Bank, the U.S. represents approximately 22% of the global economy and is the leading contributor to total world economic output. China follows in second place at about 14% of economic output. Currently most foreign economies are not doing as well as the U.S. economy. The Organization for Economic Cooperation and Development (OEDC) forecasts the 37 developed countries will suffer an economic decline of 5.5% in 2020 and the global economy a decline of 4.2%. The global economic contraction is not only worse than during the recession of 2007-2009, but it is the worst since the Great Depression. The U.S. economy is impacted by global economic activity, but precisely to what extent is not clear. Within the U.S. economy there has been a trend away from global economic integration due to trade barriers and concerns over medical and manufacturing supply chain challenges. Time will tell what direction the Biden/Harris administration will take on these issues and what impact the U.S. will have and/or will benefit from a global recovery. Fortunately, at least for the relatively near term, most countries have adopted aggressive fiscal and monetary responses similar to the U.S. causing the IMF to forecast global GDP to grow by 4.8% in 2021. Such a recovery would no doubt provide a tailwind and be a stimulus for U.S. economic growth.

Political and Monetary Support

Congress passed and President Trump signed on December 27, the $2.3 trillion Coronavirus Response and Relief Supplemental Appropriations Act of 2021. The spending bill, which is 5,593 pages long and was given to Congress just hours before they voted on it, provides $900 billion in stimulus relief for the COVID pandemic in the United States along with $1.4 trillion to keep the federal government funded to the end of its fiscal year, September 30, 2021. There were multiple forms of assistance, the largest of which were appropriations for small business at $325 billion; $166 billion for direct payments of $600 for each eligible adult and $600 per dependent; $120 billion for $300-a-week federal unemployment benefits; $82 billion for public and private K-12 schools and colleges; and $58.4 billion for COVID vaccines, testing, and tracing. More direct payments are likely to be forthcoming in 2021. Alexander Pope, in his famous philosophical poem, *An Essay on Man*, stated "Hope springs eternal…." Hopefully, Washington, D.C. will give way to more bipartisan behavior and any needed support will be provided much more efficiently than we witnessed with this latest round of stimulus.

Meanwhile, the Fed continues its dovish monetary policy, pledging at its December meeting to maintain its monthly purchases of $80 billion of U.S. Treasuries and $40 billion in mortgage bonds. It stated these purchase levels will be sustained "until substantial further progress has been made toward its goal of full employment and 2% inflation." This is in line with the Fed's earlier promise to keep short-term interest rates near zero until they see evidence of a tight labor market and inflation averaging 2%. Of note, Congress did take back $429 billion in CARES Act emergency funding that the Fed has not used and banned the Fed from restarting some of the lending programs that expired on December 31.

Investing in the Face of Significant Uncertainty

The COVID pandemic, mutated strands of the Coronavirus, and the rollout and efficacy of vaccinations continue to confront economic forecasters with a substantial amount of uncertainty as to economic growth in 2021. Thus, investors would be prudent to approach any such forecasts with extreme caution. Placing capital at risk always encompasses some degree of uncertainty but these are highly unusual times. While the level of uncertainty facing investors may not be quite as high as in the early stages of the pandemic, there is still plenty to deal with and from a multitude of directions. Economic forecasts may again prove highly inaccurate as they were last year. The type of recovery the U.S. economy experiences in 2021, assuming a recovery continues, could prove even more impactful to performance than was seen last year. Political stimulus is unknown as we move forward with a new administration. Congress is now controlled by one party and there are vitriolic behaviors and attitudes on both sides of the aisle. Even more important, our lives and the lives and well-being of our loved ones are at a higher level of risk due to the pandemic. Emotions are running high and anxiety and depression are reportedly at record levels. In the face of it all, from an investment perspective, it is particularly important to maintain as much of an unemotional perspective as possible; to not to fall into the trap of succumbing to recency bias that favors recent events over historic ones. It is commonplace for some to extrapolate present conditions and trends without accounting for the resilience or adaptation of individuals, groups, businesses, governments, or nations. Each one of the "Key Factors" referenced above (Consumer Spending, Small Business Recovery, Strength of the U.S. Dollar, Global Recovery) can be radically impacted by changes to not only COVID, but by the responses of leaders at home and globally to beat it. In both the equity and fixed income markets, those investments which have been favored now for many years may be in the initial stages of succumbing to new leadership elsewhere; a phenomenon that often occurs in history with uncommon events. While near-term economics will prove impactful, investors will be well-served this year to be responsive but not overly reactive; to be disciplined but not overly dogmatic; to remain rational; all of which are extremely difficult to accomplish given the environment we live in today.