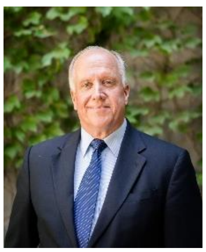
2020 – 4th Quarter Review & 2021 Outlook

Economic and Investment Review

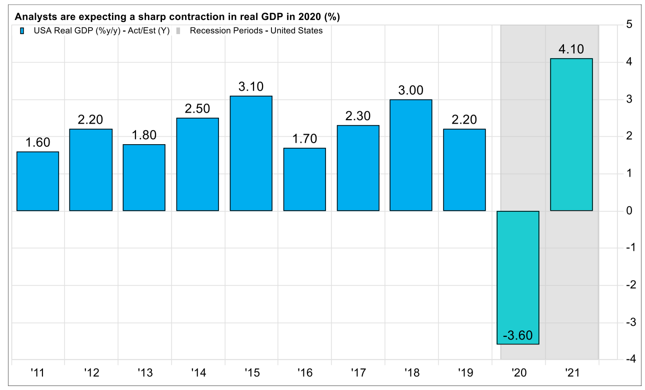


Mark Anderson

Chief Investment Officer

Economic Growth: The first release of the 2020 Q4 GDP report showed annualized economic growth of 4.0%. Reported growth was slightly below the estimate of 4.2%. The Bureau of Economic Activity (BEA) states that "the increase in fourth quarter GDP reflected both the continued economic recovery from the sharp declines earlier in the year and the ongoing impact of the COVID-19 pandemic, including new restrictions and closures that took effect in some areas of the United States." Personal Consumption growth of 2.5% missed the estimate of 3.1% due to a resurgence of the coronavirus. There was weakness in furnishings and durable household equipment, recreational goods and vehicles, food and beverages for off-premises, gasoline and other energy goods, transportation services and food services & accommodations. There was strength in health care and recreation services.

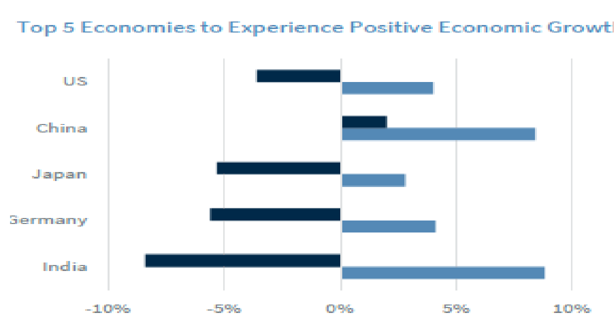
The initial report showed GDP of -3.5% for the full year 2020. This was the first calendar year contraction in GDP since 2008. The contraction was entirely due to the pandemic and government-imposed restrictions and not due to an economic cycle or financial stresses. Because of this, the rebound should be tied to vaccine distribution and lifting of restrictions. Strong economic growth is expected to return in the second and third quarters of 2021. The consensus GDP estimate is 4.1% for the current year.



Source: FactSet

Estimates range from 2.5% to over 7.0%. Goldman Sachs is forecasting 2021 GDP of 6.6% based on significant stimulus from President Biden's COVID-relief plan, government spending and a strong rebound in consumer spending. Consumers have amassed significant cash and savings that are expected to be focused on satisfying pent up demand for goods and services brought about by the pandemic. Entertainment, restaurants and travel will likely be a big part of that focus as the virus is brought under control.

Global growth in 2020 was the worst since World War II. Global growth is estimated to have declined 5.2% in 2020, however, it is expected to rise 4.2% in 2021. This would mark the largest rebound in economic growth over any two-year time period. All

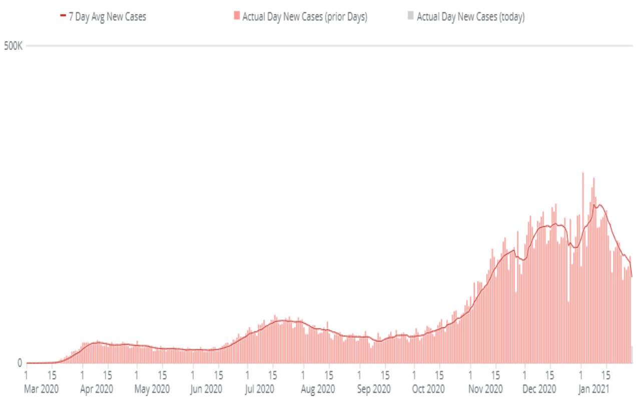


Source: Raymond James

five of the largest global economies are expected to see positive growth in 2021.

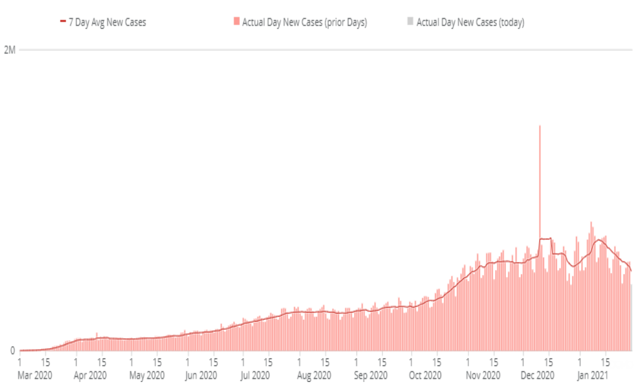
US and Global deaths have reached unthinkable levels of 464,000+ and 2,321,000+ respectively. However, US and Global cases of the Coronavirus appear to be trending down.

US Coronavirus Cases



Source: Domo

Global Coronavirus Cases



Source: Domo

Hospitalizations are falling in some countries but it is uncertain if this is due to vaccine distribution or stricter lockdowns. New deaths in the US and globally have ticked down recently but remain near peak levels. However, the situation in long term care facilities appears to be improving more quickly than the general population as the vaccines are being widely utilized.

Raymond James Chief Investment Officer states that "it is anticipated that around 75% of the population will likely be able to return to normal activities by the third quarter, as roughly half of the population is likely to be inoculated by the end of July, and another 25% of the population that are considered 'healthy adults' have an extremely low mortality rate."

Dr. Kelly, Chief Investment Strategist for JP Morgan Asset Management, has a similar position on the timeline of the virus. He states that "the spreading pandemic is slowly and painfully adding to the number of Americans with at leas partial immunity to the virus. In addition, the approval of two apparently very effective vaccines in the U.S. in December should allow for the inoculation of roughly 150 million people in the first half of 2021. Assuming that further vaccines are also approved, growing immunity, along with better testing and therapeutic drugs, should allow the number of cases and fatalities to drop precipitously over the summer, allowing life to largely return to normal by the fall of 2021."

COVID related unemployment peaked last April at 14.7%. Since then, the unemployment rate has fallen steadily to 6.3% in January. Based on the consensus estimate, unemployment is expected to continue to fall though 2021 to 5.9% by the end of the year. Prior to the pandemic, the unemployment rate fell to 3.5%, the lowest level over the last 50 years.

In regards to the employment situation, Dr. Kelly recently commented that "much of the remaining employment decline from the pandemic is in sectors that will have a hard time reopening while the pandemic continues, including the leisure, hospitality, travel, retail and food services industries. In addition, state and local government cutbacks continue to weigh on payroll employment." He expects the unemployment rate to fall close to 5% by the end of 2021 and close to 4% by the end of 2022.

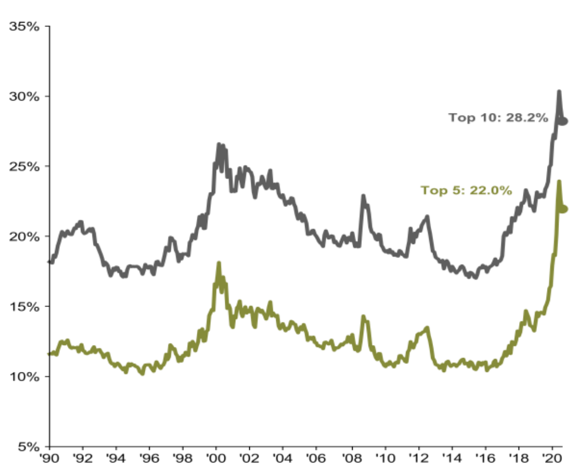
Inflation typically troughs following a recession, however, continued stimulus spending and consumers making up for lost time may cause a short-term bump up. Goldman Sachs states that "core PCE inflation should briefly bounce above 2% in the spring as we lap the weakest pandemic base effects, but then return to a sub-2% trend." They think that a tighter labor market will be required for inflation to exceed 2% sustainably in the years ahead.

Synchronized global fiscal and monetary stimulus is expected to continue until the impact of the virus has been largely mitigated. Governments around the world will likely continue to spend in an effort to provide some support to citizens and businesses impacted by the pandemic. As a result, budget deficits as a percent of GDP are expected to increase. Global central banks have maintained expansionary policies by keeping short term interest rates low and by purchasing record levels of securities in an effort to stabilize the markets.

Equity Markets

Equity markets largely shrugged off what is expected to be a relatively short-term impact of the pandemic. As the vaccine light at the end of the tunnel grew brighter the markets pushed higher. The U.S. large cap equity market, represented by the S&P 500, returned 18.4% in 2020. Investors flocked to growth stocks that were largely able to maintain earnings and were less impacted by the virus. The S&P 500 Growth index was up 31.9% for the year compared with -1.4% for the S&P 500 Value index. A relatively few stocks had enormous impact on the equity index.

Weight of the top 5 and top 10 stocks in the S&P 500

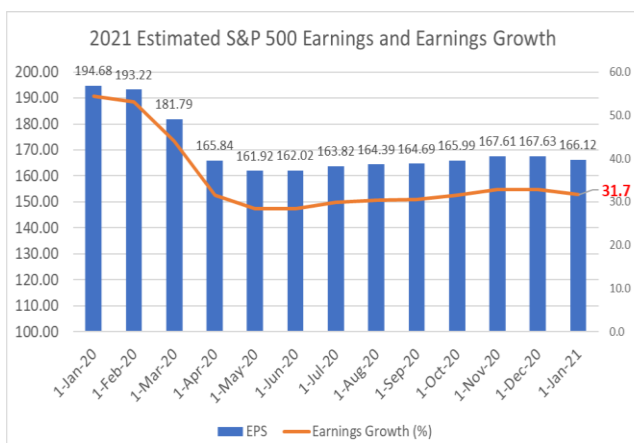


Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management

The five largest stocks in the S&P 500 currently are Apple, Microsoft, Amazon, Facebook and newcomer Tesla. The return for the S&P 500 on an equal weighted basis was nearly 6% below the regular weighted benchmark for the same time period.

FactSet outlines that with 59% of S&P 500 companies posting fourth quarter results, 81% have reported a positive EPS surprise compared to the 5-year average of 74% and 79% have reported a positive revenue surprise compared to the 5-year average of 62%. If the final EPS number matches the current percentage, it will be the second-highest reported quarter since FactSet began tracking the metric in 2008. The Financials sector reported the largest positive surprise, followed by Information Technology and Materials. JPMorgan Chase and Goldman Sachs were the two largest contributors to earnings growth in the Financials sector. Apple and Microsoft were the two largest contributors in the Information Technology sector. The Energy sector reported the largest negative surprise, followed by the Industrial Sector.

Despite the positive quarterly surprises relative to consensus estimates, 2020 earnings for the S&P 500 are expected to have declined by over 16%. However, investors have been willing to put 2020 behind them and focus on 2021 and beyond. Earnings growth is expected to return in a big way in 2021. The consensus 2021 estimate for earnings growth for the S&P 500 is currently 31.7%.



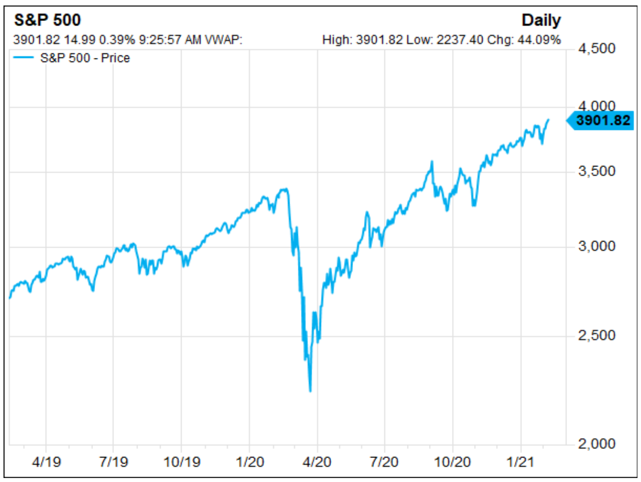
Source: FactSet, Fortress Asset Management

Information Technology lead all sectors in revenue growth at 10.8%, followed by Health Care at 10.6%.

The Energy sector reported the largest year-over-year decline of all sectors at -33.0%, followed by Industrials at -9.4%. The airline industry was the greatest negative contributor to the Industrial sector.

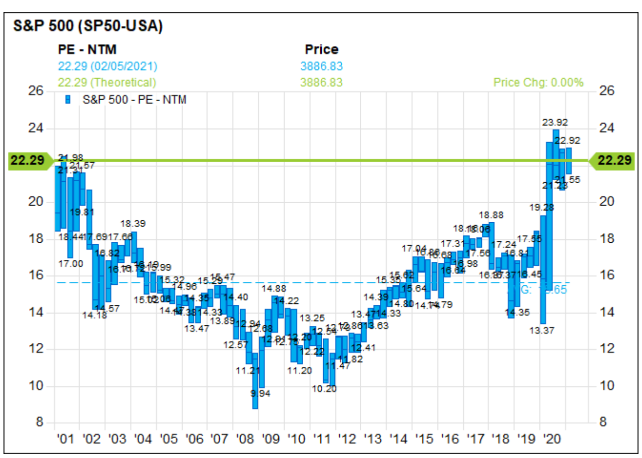
For Q1 2021, analysts are projecting earnings growth of 19.6% and revenue growth of 4.8%. Q2 is expected to be the big re-opening quarter with projected earnings growth of 48.7% and revenue growth of 15.1%. Any resurgence in COVID-19 or delays in distribution of the vaccine could cause a delay to the rebound.

The S&P 500 is once again trading at all-time highs.



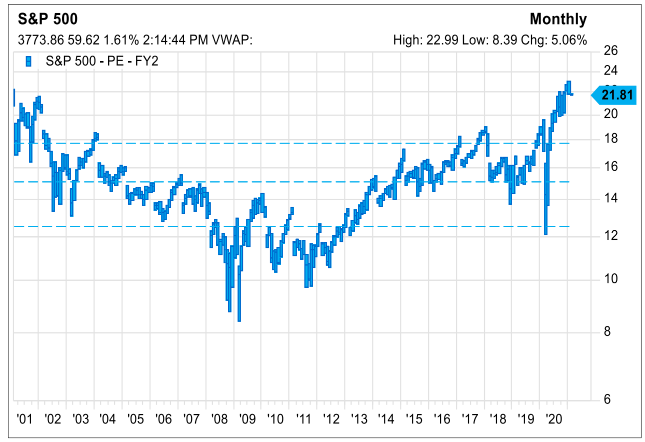
Source: FactSet

The next twelve months price earnings multiple for the S&P 500 is 22.3X.



Source: FactSet

The current 12-month forward PE ratio is significantly above the 5-year average of 18.0X, the 10-year average of 16.0X and the 20-year average of 15.7X. In fact, the S&P 500 is trading above and beyond one standard deviation from the mean for the past twenty years of PE history.



Source: FactSet

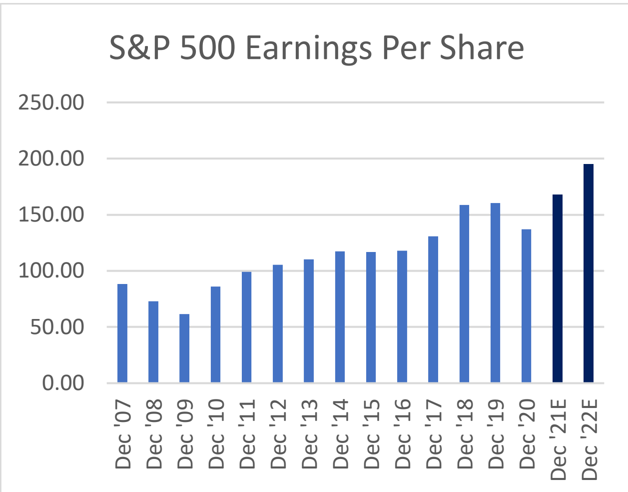
Over the past 25 years when the PE multiple has been at current levels, 1-year returns have been negative more often than they have been positive and 5-year annualized returns have been flat. However, when interest rates (as measured by the 10-year US Treasury) are below 5%, rising rates have been associated with rising stock prices.

Many people have made the comparison of the current time period with the dot com bubble in the 2000-2001-time frame. However, it should be noted that PE multiples in the dot com period were based on hoped-for earnings compared with actual earnings and the prospect for a continued trend of earnings growth today.

The 12-month consensus target price for the S&P 500 is 4,085. This target price indicates an 8.3% upside from current levels and 8.8% for the year.

Goldman Sachs is forecasting that the S&P 500 reaches 4300 over the next twelve months based on 31% earnings growth. Our forecast at Fortress Asset Management of 4046 is more in line with the consensus estimate and is based on earnings growth of 22.5%. We expect the 12-month forward PE multiple to remain near the current level through 2021 and then begin a process of reverting to the mean over the following two calendar years.

The equity market has largely been driven by P/E multiple expansion in recent years. It is likely that earnings growth will carry more of the valuation load going forward. Earnings per share for the S&P 500 fell from 160.49 for 2019 to a projected 137.39 for 2020. A strong rebound in earnings per share is expected over the next two years. The consensus estimates for 2021 and 2022 are currently 170.50 and 197.24 respectively.



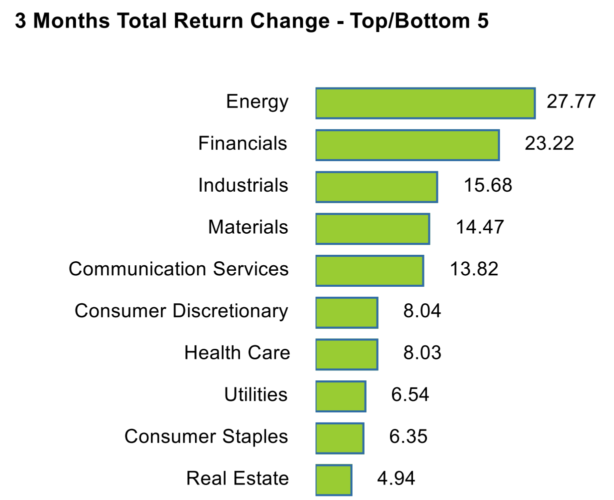
Source: FactSet

The S&P 500 was up 12.14% in Q4, 18.40% year-to-date and for 1 year through December 31. Large cap value stocks finally outpaced large cap growth stocks in the fourth quarter; however, large cap growth stocks significantly outperformed for the year. Mid cap and small cap stocks benefited from the reopening trade and gained significant ground on large cap stocks in Q4.

2020 Q4 Returns				
		YTD	**1 Year**	**3 Years**
EQUITY	**Q4 2020**	**12.31.20**	**12.31.20**	**Annualized**
S&P 500	12.14	18.40	18.40	14.14
S&P 500 Value	14.49	1.36	1.36	6.76
S&P 500 Growth	10.66	33.47	33.47	20.51
Dow Jones Ind Avg	10.73	9.72	9.72	9.90
S&P Mid Cap 400	24.37	13.66	13.66	8.45
S&P Small Cap 600	31.31	11.29	11.29	7.74
MSCI EAFE	16.05	7.82	7.82	4.28
MSCI Emerging Mkts	19.70	18.31	18.31	6.17

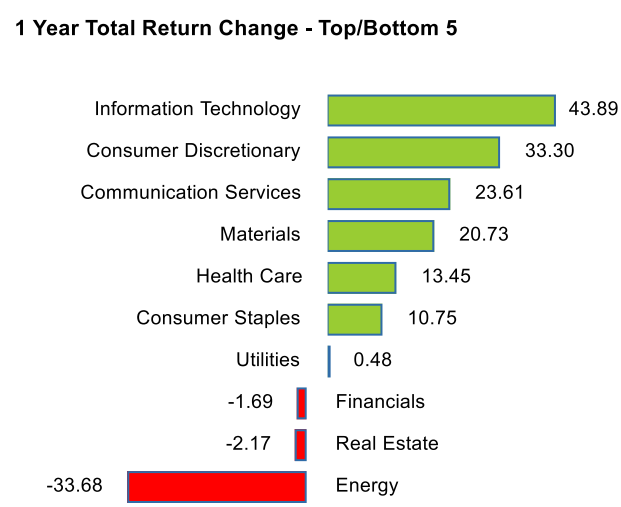
Source: FactSet

Energy and Financials have been two of the worst performing sectors since the pandemic began. However, since vaccines have been announced the sectors' fortunes have improved dramatically.



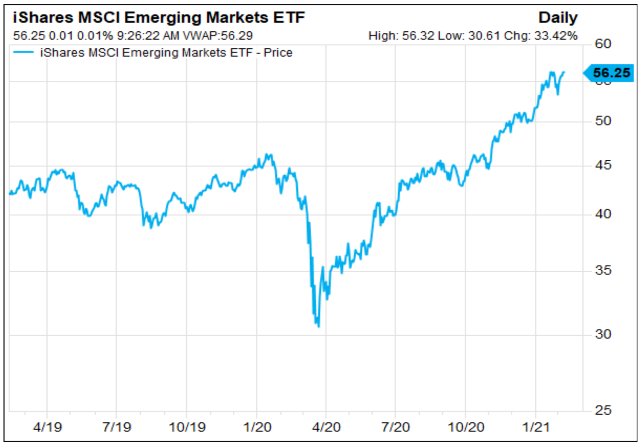
Source: FactSet

Information Technology was the strongest sector in 2020. Apple and Microsoft were sector leaders. The Consumer Discretionary sector was next in line with Amazon and Tesla leading the way. Communication Services followed as Facebook and Alphabet (Google) were relatively unfazed by the pandemic. Financials, Real Estate and Energy were heavily impacted by COVID-19 and were the laggard sectors for the year.



Source: FactSet

Developed international stocks had strong performance in Q4 but continued to lag other equity sub-classes for longer periods of time. Emerging market stocks continued to outpace international developed market stocks during the quarter and matched the S&P 500 return for the year. The Emerging Markets index benefited from the 27.9% technology weighting.

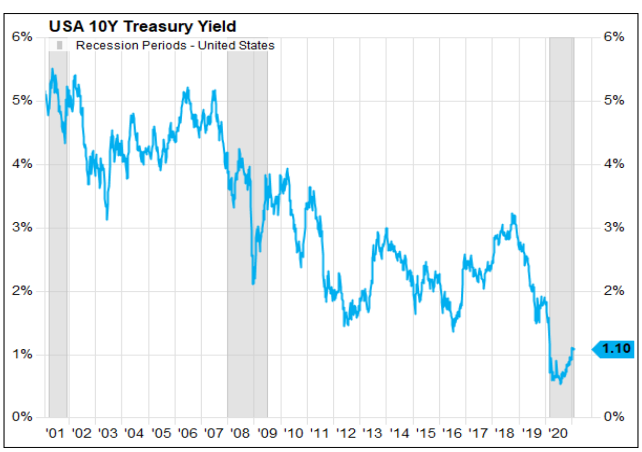


Source: FactSet

The prospect for reopening in addition to ongoing monetary/Fed support and massive fiscal/government support should allow for positive equity returns in 2021 even though valuation levels appear stretched. It is still important to focus on companies with strong balance sheets, margins and earnings or at least the high probability of reestablishing pre-pandemic financial strength to support future growth.

Fixed Income Markets

Bond holders have benefited from the general decline in interest rates over the past twenty years. As rates have declined, the price of bonds and bond funds have risen. The 10-year US Treasury was trading at historically low rates late last summer and has since trended up to 1.10% currently.



Source: FactSet

This long-term decline in rates has benefited homeowners in the form of lower mortgage and refinance rates. Lower rates have also benefited business owners and corporations in making capital less expensive. Of course, the negative side of the coin is less income is generated for investors. The consensus estimate for the yield on the 10-year US Treasury is 1.25% for the end of 2021. Factors supporting higher rates include improving economic growth due to vaccine distribution and near record fiscal deficits and the related increase in issuance. Estimates for the 10-year range from 0.85% to 1.65%. We started the year at 0.92% on the benchmark security. If in the final outcome, rates are up 30 – 35 basis points (0.30 – 0.35%) the total return for 10-year investment grade securities would likely be flat to slightly negative. Because of this outlook, it may be advisable to seek a greater percentage of income and total return from equities than would normally be the case. However, it is important to remember that fixed income is an essential tool for managing volatility and downside risk. The worst year for corporate bonds in the past thirty years was -4.9% and -5.2% for municipal bonds. (Bloomberg Barclays US Corporate Bond Index, Bloomberg Barclays Municipal Bond Index) This compares with -37.0% for S&P 500 domestic equity index over the same time period.

Investment grade bonds, as represented by the Bloomberg Barclays U.S. Aggregate Index, were up 0.67% for the fourth quarter and 7.51% for 2020. Municipal bonds, as represented by the S&P Municipal Index, were up 1.86% and 4.95% for the same respective periods.

2020 Q4 Returns				
FIXED INCOME	Q4 2020	YTD 12.31.20	1 Year 12.31.20	3 Years Annualized
B B US Agg Bond	0.67	7.51	7.51	5.34
S&P National Muni	1.86	4.95	4.95	4.43
B B High Yield	6.23	4.95	4.95	5.24

Source: FactSet

The municipal bond market rebounded following the selloff in March as stimulus programs and vaccine development helped to reduce investor concerns. Somewhat surprisingly, credit quality has remained relatively stable. Related revenues have held up much better than was feared and state and local governments have taken steps to adjust budgets accordingly. Municipal bonds may become even more attractive to individuals in mid-to-high tax brackets based on the anticipated higher tax rates proposed by the Biden administration.

High yield bond spreads relative to comparative US Treasuries widened to extreme levels during early days of the pandemic and related lock downs. A record amount of high yield bonds were issued in 2020 in an effort to bridge cash flow disruptions. Spreads have tightened somewhat since that time and are expected to continue the trend through 2021.

Despite the tightening, defaults have increased. S&P Global Rating on November 23, 2020 said it expects the U.S. trailing-12-month speculative-grade corporate default rate to rise to 9% by September 2021 from 6.3% in September 2020. J.P. Morgan expects the default rate to decline to 3.5% in 2022. For most investors, investment in high yield bonds is best done in funds with diversified holdings and seasoned, professional managers and analysts.