MANAGED ASSET PORTFOLIOS

MAP VIEWS

First Quarter 2021

You certainly did not need 20/20 vision to see that 2020 was not an ordinary year. From a global pandemic, civil unrest to an election like no other, news headlines took many twists and turns throughout the year. Despite the vast amount of negative news, financial markets ultimately shrugged off the bad news. Global stock and bond markets were aided by ultra-accommodative stances the U.S. Fed and other Central Banks assumed to mitigate the economic damage caused by the Coronavirus. By year's end, most of the world's stock markets showed gains for the year, despite many of them showing losses of 25% or more by the end of the first quarter.

The U.S. dollar continued to retreat, weakening to its lowest level in two and a half years. The dollar retreat fueled rallies in a host of other assets. Gold posted its best annual gain in over a decade. All six primary base metals on the London Metal Exchange ended the year in the black, paced by copper, which rebounded a stout 70 percent from March lows. Cryptocurrencies also surged, as investors seemingly flocked to anything that could not be "printed" by a central bank. Despite the current economic challenges, which are holding prices in check, we believe the seeds of inflation have been sown and will sprout (and grow) over the next few years. We will be publishing another thought piece later this quarter detailing more of our views on the likelihood of inflation.

Looking toward 2021, we believe the economy will continue to face an uneven economic recovery, as the end of COVID-19 is challenging to predict. Currently, we suspect the recovery will be more robust in the second half of the year, as it will take time to develop herd immunity. Realistically, we believe a recovery (back to where the economy was pre-COVID) will not occur until sometime in 2022. As we saw in 2020, it is essential to separate the economy's performance from that of the stock market. Because of the Fed's actions, the markets have staged a much better recovery than the economy. We believe the Fed and other Central Banks will be supportive for the foreseeable future, giving us a degree of confidence that the equity markets will have a tailwind rather than a headwind over the intermediate term.

Despite historically high valuations, we see some market opportunities. We, however, also see risks. In 2020, investors were rewarded for taking on extreme amounts of risk, buying stocks with expensive valuations that only got richer. Companies with better storylines than income statements were bid higher. To give a bit of historical context, in 2019, there were 261 publicly traded companies in the U.S. with market caps greater than a billion dollars that were losing money. Those names returned an astounding 75% through the end of 2020's third quarter. We caution that what worked in 2020 may not work in 2021. Growth names gathered momentum in an environment of historically low-interest rates, which allowed for valuations to reach excessive levels. With the yield on the ten-year treasury bond hovering around 1%, we have difficulty envisioning an environment where interest rates go much lower, which may zap some of the energy from the growth/momentum stocks.

With bond yields near historic lows, while inflation is seemingly on the horizon, we have reduced our bond allocation to around 30% for our balanced accounts, which is the lowest level permitted by the strategy.

Interest rates have been driven down by Central Banks, making it nearly impossible to purchase bonds that offer attractive risk/reward returns. As a result, we continue to keep maturities short (approximately one year) and have reallocated funds previously invested in bonds toward dividend-paying stocks. The dividend yield on the average equity holding in the balanced composite is over 3%. It is challenging to obtain over two percent in bonds without taking on undue interest rate or credit risks.

We are overweight consumer staples, technology, and healthcare while remaining underweight or absent from most other sectors/industries. We have added a few utility names over the past few quarters as we view the valuations and dividend yields as attractive. We believe this is the right sector mix for the uneven recovery we are projecting for the next year.

Earlier this week, the Georgia Senate runoff election took place. It appears that both Democratic candidates will win their respective Senate races, which will provide their party a razor-thin margin (with Vice President Harris casting the deciding vote). Generally speaking, markets prefer when power is split between the parties; however, the recent wins will give the Democratic party control of the White House, Senate, and House of Representatives. As a result, some investors were surprised to see the market rally on this news—a couple of thoughts related to this matter. First, the Democrats have control, but not an overwhelming mandate. Whereas almost every poll predicted the Democrats gaining House seats, the Republicans actually gained seats. Finally, there is the slimmest of margins in the Senate. This narrow majority may stop the ruling party from pushing through some of their more progressive agendas.

Secondly, markets typically fear higher taxes and increased regulation. While the Democratic party talked about such initiatives on the campaign trail, these are not typical times. We view COVID-19 as an "all hands on deck" type situation. We believe the first course of action will be increasing stimulus spending (including funds for infrastructure, education, municipalities, and healthcare). Markets believe the economy needs additional stimulus. Just think back to last quarter; the market would rally on days that it looked like both sides were inching closer to a stimulus deal and would retreat on days that it looked like it would not happen. Markets typically look six to twelve months out, and during this time horizon, we see a lot more spending. Higher taxes and increased regulations are probably more of a threat once the pandemic ends, but for now, they will likely take a back seat to fight COVID-19 and its corresponding economic fallout.

Most recently, violent demonstrations in Washington, D.C., marked a dark day in U.S. history. Some clients were surprised to see the stock market shrug off these events and finish the day with a 400-plus point gain. For the most part, markets tend to focus on events that are likely to have a lasting impact on the economy. While yesterday's events were undoubtedly disturbing, it is unlikely to have long-lasting effects on the economy. However, we would add that U.S. stocks have historically traded at a premium to those in most other markets due to the political stability of the U.S. government. A continued extension of yesterday's activities could likely serve as a catalyst to contract domestic equity valuations.

We want to thank all of you for allowing us the opportunity to serve as your investment advisor. It is a responsibility we do not take lightly and work diligently every day in pursuit of the best risk-adjusted returns. We wish you all health, happiness, prosperity, and peace in the New Year.

Managed Asset Portfolios' Investment team
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