WestStar

Wealth Watch

January 2021

"New Beginnings are Often Disguised as Painful Endings" *~Lao Tzu*

It is with utter certainty that nobody would characterize 2020 as anything but painful. It began with the advent of a global pandemic, the ramifications of which proved unprecedented and dire, and ended with a riot in our Nation's capitol. But within the essence of the quote above exists a central truth—adversity often masks opportunity to begin anew.

While 2020 was the year of the virus, 2021 will be the year of the vaccine. Furthermore, a new administration has assumed the helm of government. Given these fundamental and significant developments, what might we expect for markets and the economy?

What You Need Know:

- 2020's volatile environment witnessed both positive and negative milestones, yet nearly all major market indices were positive for the year
- WestStar's tactical positioning proved beneficial
- There are a number of reasons for optimism heading into 2021
- The new Administration's policies indicate several specific themes we might anticipate
- Areas of opportunity exist given our expectations for 2021 and beyond

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Asset Class Index Performance* 2020

US Small Cap Stocks	19.96%
US Large Cap Stocks	18.4%
International Emerging Market Stocks	18.31%
International Bonds	10.11%
International Developed Market Stocks	7.82%
US Investment-Grade Bonds	7.51%
High Yield Bonds	7.11%
Alternative Investments	3.19%
Money Market (Cash)	0.74%
Commodities	-3.12%
Real Estate	-8.18%

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Market Performance

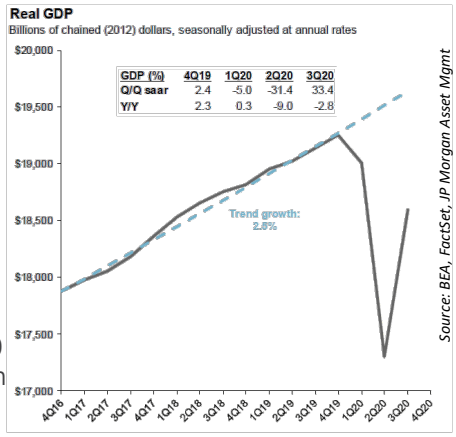
Over a year of tremendous tumult, most major market indices finished 2020 in solidly positive territory. The rebound following the first quarter's drop was temporarily halted in the negative months of September and October but recovered handily in November and December, the S&P 500 ending the year at an all-time high. As can be seen in the column to the left, small cap stocks (the Russell 2000 Index) was the best-performing category of 2020 followed closely by large cap (S&P 500) and emerging market stocks. The two areas that struggled were commodities amid global supply and demand fears and real estate given the shutdown, travel restrictions, and onset of remote work and commerce.

WestStar Tactical Strategy

Our tactical strategy shifted in June to emphasize small cap stocks over large cap given our expectation they would outperform during economic recovery. While a bit early, the strategy proved beneficial given the category's 31%+ rise in the fourth quarter. We remain overweight stocks at this time given our expectation of continued recovery in 2021 and, as of mid-December, underweight Fixed Income. Within Fixed Income we are emphasizing high yield over investment-grade and deemphasizing international bonds. We are also maintaining our de-emphasis of Real Assets due to our expectation of mild near-term inflation and our neutral-weight of Alternative Investments given the possibility of near-term volatility.

2020 Year in Review: The Storm Before the Calm

The overriding influence on markets and the economy in 2020 was no doubt the COVID-19 pandemic. The fallout reverberated throughout every facet of life as we know it on a global scale. It was a year of extraordinary events—both positive and negative—including:



• **Deepest but shortest recession on record:** As the effects of the novel coronavirus were a complete mystery, governments around the world closed borders and shuttered economies. US GDP plummeted an annualized 31% in the second quarter—the most severe on record. While the third quarter rebound of 33% made the 2020 recession the shortest in history, growth remains below pre-COVID levels.

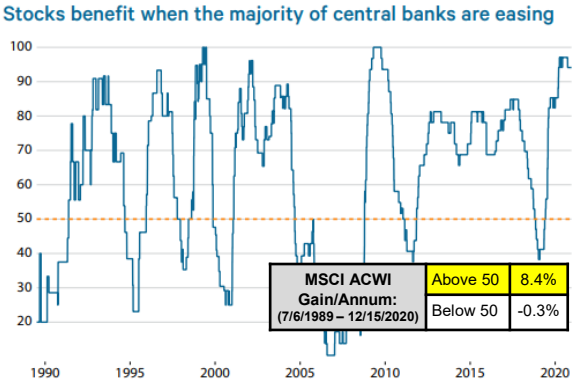
• **Unemployment from 50-year low to post-Depression high:** The economy added 22.8 million jobs between February 2010 and February 2020, but the shutdown caused a 22.2 million loss of jobs. Since April we have regained 12.3 million jobs but still have a long way to go.

• **Negative oil prices:** Oversupply and a global halt in demand led to a spot oil price of -$37.63/barrel on April 20th.

• **Shortest bear market on record:** Bear markets that overlap recessions last one year on average. In 2020, however, the market digested in weeks what it normally does in months, and at 40 trading days was the shortest ever. Again, while 2020 was the year of the virus, 2021 will be the year of the vaccine and positive developments on multiple fronts suggest reason for optimism.

*Large Cap: S&P 500 Index; Small Cap: Russell 2000 Index; Int'l Devel: MSCI EAFE Index; Int'l Emerg: MSCI Emerging Markets
Lynch 3-Month US Treasury Index; Real Estate: FTSE EPRA/NAREIT Developed Index; Commodity: Bloomberg Commodity In

Reasons for Optimism in 2021



Source: Haver Analytics, Ned Davis Research, Inc.

There were multiple factors indicating that 2021 would turn the page on 2020 for the better. We ended the year with two effective COVID vaccines being distributed and a third on its way. An additional stimulus bill totaling $900 billion was enacted with more potentially on the way. The strength of the housing market is at levels not seen since 2006, benefitting from fiscal stimulus, record low mortgage rates, and demand for larger suburban homes. Outside the US, global manufacturing has seen a robust rebound, the European Union and the United Kingdom reached a Brexit trade agreement and China's "V-shaped recovery" was evident. Finally, as shown on the chart at left, over 90% of central banks around the world are easing which historically has indicated strong stock market performance.

New Administration, New Agenda: Themes for 2021 and Beyond

In the last issue of WestStar's Wealth Watch we covered three potential election outcome scenarios, one of which included a change of control of both the Presidency and the Senate. As this was the actual outcome of the elections, let us examine the potential effects on the following areas:

• **COVID Plan & Stimulus:** A plan for a $1.9 trillion relief plan was announced, spanning direct assistance to households, businesses and local governments as well as a coordinated federal effort on testing, vaccine production and distribution. Such a robust strategy would be stimulative but may be scaled back on Republican opposition.

• **Clean Energy and Infrastructure:** The first day rejoining of the Paris Climate Accord, "Build Back Better" campaign theme and general focus on advancing "green" initiatives may highlight electric vehicles, wind/solar energy, pollution reduction, etc. as a priority.

• **Healthcare:** The Administration will seek to reinforce and strengthen the Affordable Care Act which would benefit the Managed Care industry.

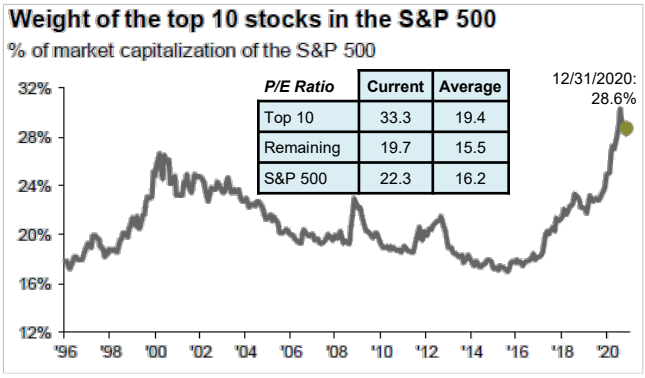
• **Trade:** International trade-liberalization has become antiquated due to supply chain concerns and the evolution of political attitudes on the subject. The focus of the new Administration will likely be more cooperative rather than adversarial in this regard and a more predictable approach will have a calming effect on markets.

• **Taxes & Regulation:** While the Biden campaign proposed tax increases on annual incomes exceeding $400,000 and raising the corporate rate from 21% to 28%, it may be lower on the priority list relative to the other aforementioned agenda items. It is less likely that a tax hike will be enacted amid continued economic weakness related to the COVID pandemic, but if it were the stimulative effects of the policies discussed above would supersede any resulting negative effects at this time.

Given these themes, research indicates the industries primed to benefit most include Renewable Electricity, Independent Power Producers, Integrated Oil & Gas, Construction Materials/Machinery, Building Products, Managed Care, and Healthcare Facilities.

Adhere to Your Long-Term Strategy But Strive for Optimal Implementation

While it is of vital importance to maintain your long-term investment strategy regardless of the near-term environment, one should also note factors that might affect optimal implementation. In this vein we are reminded of the Tech Bubble of the early 2000's. At that time the stock market was dominated by a single industry (Technology) and a few major companies. The lesson learned amid that crash was that taking a passive indexed investment approach may be risky, as in so doing one may inadvertently be making large bets on the prevailing most expensive stocks. Today's market looks similar, in that the top 10 stocks represent almost 30% of the S&P 500 and are presently much more expensive than the remaining 490 (see chart at right). It is for this reason that we recommend implementing your long-term strategy by incorporating an active, diversified approach to proactively capitalize upon areas of opportunity and avoid areas of risk.



P/E Ratio	Current	Average
Top 10	33.3	19.4
Remaining	19.7	15.5
S&P 500	22.3	16.2

Source: FactSet, Standard & Poor's, JP Morgan Asset Management

Index; Core Bond: BbgBarclays Aggregate Index; Int'l Bond: BbgBarclays Global Aggregate ex-USD Index; High Yield: BbgBarclays US Corporate High Yield Index; Cash: BofA Merrill dex; Alternatives: Wilshire Liquid Alternatives Index

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