January 4, 2021

Overview

Inertia is a powerful force of nature! Equity markets moved up again in December, following their incredible performance of November. The S&P's 500 rose **3.84%** on a total return basis. The Nasdaq Composite was up **5.71%** and the Russell 2000 (Small US Caps) rose even more, with a **8.65%** monthly performance. Revived talks, eventually successful, of a stimulus package of a little over $900 billion kept equity markets on their positive trend and pushed all indices up, stateside as well as internationally.

The broad EPAC BMI (developed economies) was up **5.31%**. The MSCI EM (emerging markets) rose **7.35%.** The USD weakened against major currencies and pushed non-US equities higher as is typical in a general "risk-on" environment. The chart below illustrates this point. The orange line is that of VWHEX, a high-yield bond fund that I use to gain exposure to this relatively risky sector. Since the US election, this fund is up about 5% (the vertical line marks the time of the election/Pfizer announcement).

During that same period, USDU (purple line), the ETF that I use to measure the USD performance vs. other major currencies, went down about 5%. The USD going down does not "cause" the high yield sector to go up. Rather the two movements are coincidental: When the USD goes down, non-US economies (developed and emerging) get a boost since often the major commodities that they consume are priced in USD. That in turn cheers equity investors internationally and the more economically sensitive sectors go up. That would include the high yield bond sector in the US as well as emerging markets bonds and equities for example.

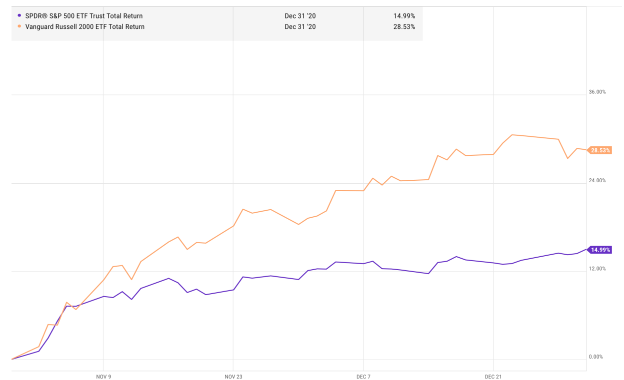
In December, our client portfolios rose between **2.53%** and **4.16%.** Over the same period, a portfolio consisting of 50% ACWI (World Equity Index ETF) and 50% AGG (US bond aggregate proxy) rose **2.39%** As of December 31, the YTD performance of our client portfolios ranged from **7.29%** to **13.97%**. This compares to a **11.91%** performance for our benchmark and of **18.40%** for the S&P's 500 over the same period. As a reminder, the equity allocation in our clients' portfolios ranges currently from 40% to 70%, depending on risk profiles.

Market developments

In December, investors continued to consider the proverbial glass as half-full and to ignore mitigating news of economic weakness, instead remaining focused on the likely economic rebound that the deployment of the Covid 19 vaccine throughout the world should ensure.

Investors pushed indices up again on the basis of continued Federal Reserve support, sustained help from Congress in the form of a new stimulus/relief package for the economy and the likely lessening of the impact of the pandemic in the coming months.

The general "risk on" mood that started with the results of the US election and the Pfizer announcement continued in December as illustrated in the chart below:



The period covered above is the last quarter of 2020. The orange line is that of VTWO, the ETF that I use to gain exposure to the US small cap sector. This index is up about 29% over the last three months. That is about twice the performance of SPY, the ETF for the US large capitalization sector, over the same period.

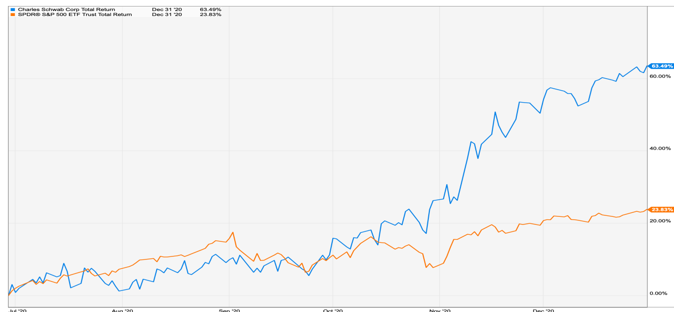
There is no clearer indication in my mind that investors believe strongly that we are "out of the woods", economically speaking, and as a result of the Covid pandemic. The investment mood is quasi-euphoric. Valuations have gone up dramatically in all sectors and other than for parts of some international equity markets that are still lagging their US peers, few obvious investment opportunities remain. This is a time for extra caution.

Not that I believe that we are near a market turn. That is hard to anticipate with so much liquidity available and monetary authorities, here and abroad, decisively positioned to maintain interest rates low or near zero for the foreseeable future. Nevertheless, current equity valuations make for very few investment bargains and caution is warranted.

Tilts and Allocations

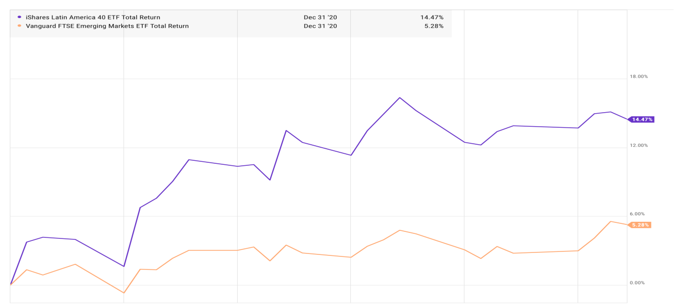
In December I sold the remaining positions that most accounts had in SCHW (Charles Schwab) at around $51/share. I invested the proceeds in SPY. SCHW has made us a lot of money. We entered our position at an average price of $32 for most accounts and sold at an average price of $48, for a profit of about 50% in six to seven months.

Below is a chart of the stock performance (in blue) vs. SPY (orange line) for illustration:



Schwab has allowed our portfolios to outperform the S&P's 500 significantly over our holding period. It is responsible for almost 20% of our average annual performance. As a reference, our average account rose by 11.04% in 2020.

Elsewhere in our portfolios, ILF, the ETF invested in Latin American equities has been doing well since we invested in it at the end of November (purple line in the chart below). This ETF is up 14% vs. "only" 5% for VWO (orange line) the larger emerging market ETF that I use to gain exposure to this sector. I intend to maintain our position until ILF outperforms VWO by another 10% or so. I may close it earlier if the current and favorable trend reverses itself.



Conclusion

We have just collectively lived through a painful year. It has been tragic for some. My thoughts go to those among us who have experienced the loss of a family member or a friend.

As a developed nation, the US should have done better in dealing with Covid 19. However, years of under investment in public health and anything public in general, have borne a high price. The economic and social consequences of this public neglect have become clearer.

It is hard for me to conceive of a world where a continued denigration of anything with the word "government" or with the word "public" in it can lead us to a better tomorrow. Yet, this is what many in Congress continue to virulently advocate. That concerns me a great deal. As a citizen and as an investor.

As investors, we have not paid a price for this ideology and its consequences. Equity markets have viewed the 2017 tax cuts for corporations as an unequivocal economic benefit. They have dismissed the impact that lower government revenues mean in terms of social services not provided, educational budgets cut and infrastructure not built. Yet the mental and physical health of the average American, the education of our kids and our bridges and roads do matter to economic growth…

Hopefully, the incoming administration takes these issues seriously and starts, if not to reverse course, at least to strike a better balance between short term economic benefits and long-term economic and social growth. If that is the case, while we may endure a few bumps along the way, we should, in the end, be better off both as investors and as American citizens.

Thank you for your continued trust and a Happy and Healthy New Year to you all!

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