Investment Update

Fourth Quarter 2020

Normally in our January piece we widen the lens a bit beyond the fourth quarter to comment on the entire prior year. There are many fairly extreme adjectives that would accurately describe 2020's drop and subsequent rise in stocks prices and global economic activity. The same can be said for the pandemic itself, the pace of virus-related news, and most importantly, the pace of vaccine development. We will just say it would have been hard to have made that all up and leave it there – and leave the word "unprecedented" behind, or at least give it a year off.

Equity Markets (Total Return)	4thQ'20	1-Year	3-Year
Dow Jones Industrials	10.7%	9.7%	9.9%
S&P 500	12.1%	18.4%	14.2%
S&P Mid-Cap	24.4%	13.7%	8.4%
S&P Small-Cap	31.3%	11.3%	7.7%
MSCI All-Country World	14.8%	16.8%	10.6%
MSCI Foreign Developed Markets	16.1%	8.3%	4.8%
MSCI Foreign Emerging Markets	19.8%	18.7%	6.6%
US Bond Markets (Total Return)	**4thQ'20**	**1-Year**	**3-Year**
Barclays US Treasury	-0.8%	8.0%	5.2%
Barclays US Municipal	1.8%	5.2%	4.6%
Barclays US Corporate Investment Grade	3.0%	9.9%	7.1%

For all that the world went through, the U.S. stock markets ended 2020 at record highs after strong double-digit performances for the final quarter. September's pattern of choppy trading continued in October, as vaccine optimism waxed and waned. Money rotated back and forth between so-called "stay at home stocks" (like Zoom) or stocks perceived as being able to grow in any environment (like many large-cap tech companies), and "reopening stocks" of companies highly leveraged to a global economic recovery. In November, stock prices rose sharply the first two weeks and continued rising at a more measured pace through the rest of the year. The direction of the Presidential election outcome had generally been anticipated, less so the shift in influence in Congress. Investors seemed to have coalesced around the idea that the balance of control between two parties would produce a relatively favorable mix of policy outcomes or at least preclude more radical outcomes. Further adding to the bullish mood, in each of the three weeks following the election vaccine trial results were released with notably high efficacies and distribution timelines starting almost immediately, whereas most had thought a vaccine might be six months or so off.

The 10-year U.S. Treasury yield had started the year just under 2% and reached .38% in March, but continued to rise further off that all-time low in the fourth quarter, increasing from 0.65% to 0.95%. These low interest rates are still supportive of equity valuations all things being equal, and the price of most assets in general. Equity valuations are currently full by most measures but do not in and of themselves give us pause when considering current or further equity investments. Comparing today's valuation to historical levels calls for a bit of nuance. For instance, there has been a dramatic shift in the fortunes and market weightings of energy and technology companies over the last forty years, and higher margin, asset-light companies should trade at higher multiples of earnings. That said, we certainly recognize that there is not really much room for more multiple expansion in 2021. The economy and company earnings will need to show solid growth for stocks to continue to do well as there are few other variables with much room to surprise to the upside in the near term.

Starting 2021 at record levels with elevated valuations, we would be pleased if at the end of the year we can write to you and say that stocks went up modestly, and without nearly the volatility we saw in 2020. This might not seem like a ringing endorsement of owning or adding to stocks, but investments in bonds might yield 1-2% at best from here, and those returns are simply not adequate to make progress on longer-term investment goals.

A year ago, when we looked ahead to the new decade, ironically enough we said there was some risk that accumulated deficits might constrain the government in providing sufficient stimulus in the next downturn. Given the economic situation last spring and the disfunction in asset markets, it is hard to argue with the swift and broad scope of what the government did, essentially opening the checkbook and asking questions later. However, the ongoing pandemic relief measures certainly are building upon a longer-term deficit and debt problem. It is unclear when and if the negative effects that conventional economics predict will appear, but we can all appreciate what would happen to a household's finances if it carried on spending the way our government has. The current popular counter argument is that deficits do not matter because, unlike a family, the government can create the dollars used to re-pay its debt. While this idea theoretically has some basis, when taken to the extreme, those lending the government money by buying bonds might eventually look at the recently printed dollars they are being repaid with, wonder what they are really worth, and drive their value down.

To perhaps give it more credit, the government's response last spring suggests it might have learned from having acted less decisively in the financial crisis of 2008-'09. In the interim, large banks have been regulated to the point that they pose much less systemic risk to the financial system, which is positive on the surface. However, this denuded them from being the primary private sector source of liquidity and first line of defense in a crisis, forcing the government to do more and act more quickly than it might otherwise have had to. Somewhat contrary to our concern voiced a year ago, now we wonder if massive government intervention will be the only way out of future crises, or at least the default response to one?

We do take heart from the fact that at least in the West, it was entirely the private sector that has raced to produce numerous efficacious vaccines in record time. It was also the private sector that had developed the sorts of technological tools that have allowed the Boston Family Office, and large parts of the economy, to operate smoothly in the pandemic. The idea of a video call had somehow seemed complicated and exotic a year ago, but they are a comfortable part of the daily routine now and often better than an old- fashioned phone call. Nonetheless, we look forward to being able to see our clients again in person soon.

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