Investment Strategy Outlook

January 2021



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We suspect that a common conversation topic over the final weeks of the year will be how glad people are to turn the page on 2020 and begin a new year. However, this would be an unwarranted conclusion from investment standpoint, as 2020 wound up being a respectable year for many investors. We are not sure what the most surprising part of 2020 was from an investment perspective. On the one hand, we witnessed a global pandemic, a national lockdown, a brief period where we recorded the worst economic data ever (or at least since the early 1930s), experiencing front month oil contracts trade at *negative* $40 per barrel, we could go on. On the other hand, major equity asset classes (U.S. Large Cap, U.S. Small Cap, International Developed & Emerging Markets) have positive returns on a year-to-date basis after staging one of the greatest rallies of all time over the last nine months in the face of these legitimate issues.

It goes without saying that the forecasts Wall Street formulated a year ago were not very useful to investors this year. Substantially every financial institution's 2020 forecast will end up being too conservative despite most major equity market indices being down well in excess of -30% on a year-to-date basis in mid-March.

In this spirit, we continue to adhere to our philosophy of *preparing* for a wide range of outcomes rather than trying to *predict* what lies ahead over the course of the next 12 months. Having said this, this report serves largely to highlight some of the themes and charts at the top of our minds as we look toward 2021.

Wall Street Institutions' 2021 S&P 500 Forecasts

"Nearly everyone interested in common stocks wants to be told by someone else what he thinks the market is going to do. The demand being there, it must be supplied."

- Benjamin Graham (Warren Buffett's mentor)

Chart 1: Wall St. 2021 S&P 500 targets and EPS forecasts

(We are around 3700 on the S&P 500 as of December 22, 2020)

Financial Institution	Strategist	2021 S&P 500 Target	2021 S&P 500 EPS
Bank of America	Savita Subramanian	3800	$165
Morgan Stanley	Michael Wilson	3900	$193
LPL Financial	Ryan Detrick	3900	$165
Deutsche Bank	Binky Chadha	3950	$194
Credit Suisse	Jonathan Golub	4050	$168
UBS	Keith Parker	4100	$176
BMO Capital Markets	Brian Belski	4200	$175
Jefferies	Sean Darby	4200	$180
Goldman Sachs	David Kostin	4300	$175
JP Morgan	Dubravko Lakos - Bujas	4500	$178

Source: Emily McCormick & Yahoo Finance 11/24/20 - Stock market 2021: Stocks expected to keep climbing as strategists look to brighter 2021

Central Banks' Effect on Asset Prices

Before 2008 it seemed that quantitative easing was largely a theoretical policy tool about which economists enjoyed debating. Of course, this all changed in late 2008 when "QE" was brought to life given the dire circumstances of the global economy at that time. Since then, QE has been implemented time and again, to varying degrees, by central banks around the world. As we have witnessed QE transform into being somewhat commonplace over the last several years, investors have rightfully been pondering and estimating the effect that QE has on asset prices.

Chart 2: Chronology of Quantitative Easing & Tightening

Date	Fed Policy Action
11/25/2008	QE 1 Announced
3/31/2010	QE 1 Terminated
8/27/2010	QE 2 Hinted (Bernanke's famous Jackson Hole speech)
11/3/2010	QE 2 Announced
9/21/2011	Operation Twist Announced
6/29/2012	QE 2 Terminated
9/13/2012	QE 3 Announced
12/31/2012	Operation Twist Terminated
10/29/2014	QE 3 Terminated
10/15/2017	Fed balance sheet normalization begins
10/3/2018	Fed spooks market with rate hikes & balance sheet runoff comments
1/4/2019	Powell indicates "flexibility" regarding balance sheet runoff
7/31/2019	Fed announced end to balance sheet runoff
3/15/2020	QE 4 announced along with other new policy responses

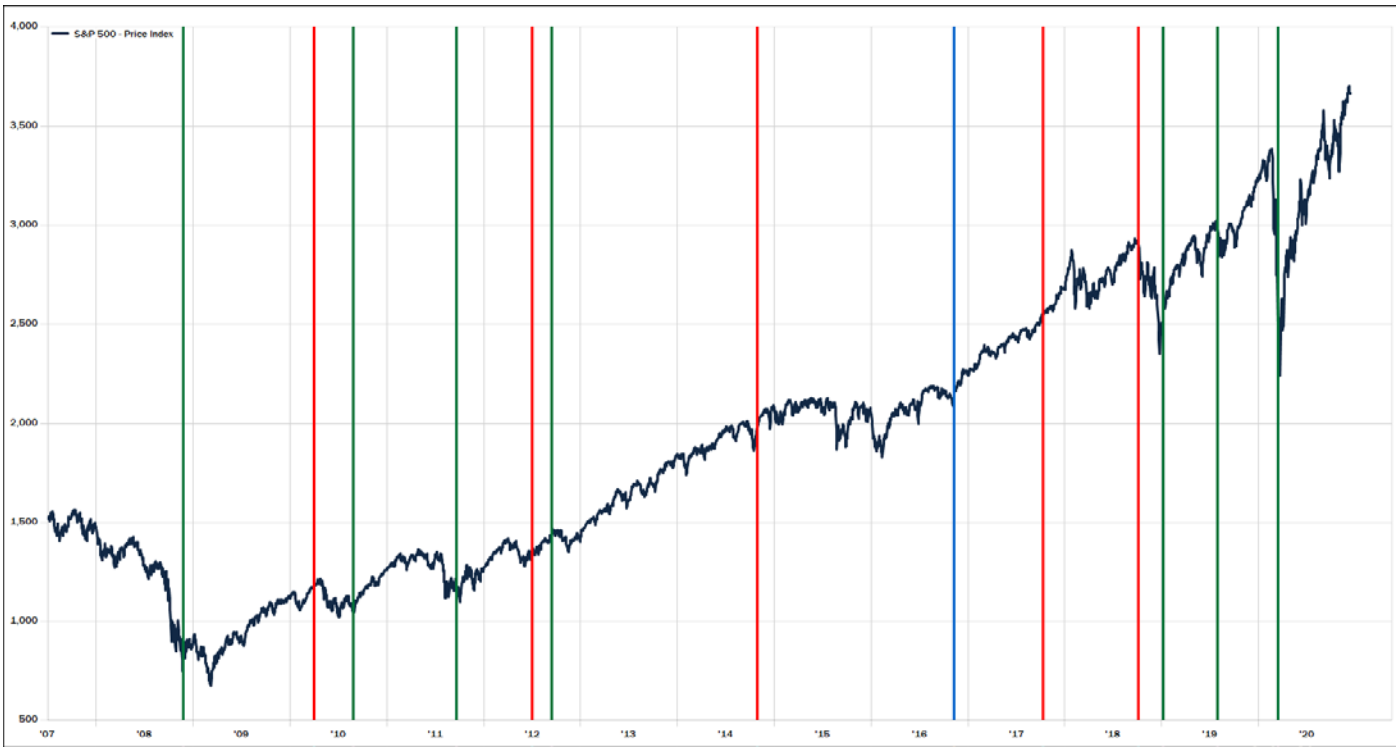
Source Yardeni Research; Ed Yardeni - Chronology of Fed's Quantitative Easing & Tightening

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The fact that economic fundamentals, and most importantly corporate earnings, have significantly improved over the last twelve years is undeniable and supportive of the rising asset prices which ensued. It is an interesting exercise to think about how many great luxuries exist in our lives today (especially from a technology / productivity perspective) that we could not have dreamt about ten years ago! It also supports Warren Buffett being on record on countless occasions saying not to bet against America over ten- and twenty-year time periods.

Nonetheless, we would also contend that 2020 underscored the narrative that central banks absolutely influence asset prices through their asset purchase (QE) programs. We can only wonder how deep the bear market would have been last March without the $22 TRILLION of stimulus that has been unleashed over the last nine months *(Source: BofA Global Research; The Flow Show 12/17/20; Michael Hartnett).* Our belief is that it could have easily rivaled the protracted -57% 2008 sell off in the S&P 500 instead of the brief -36% bear market we experienced in March. Michael Hartnett from BofA Global Research recently observed that central banks are injecting $1.3 billion of liquidity into global financial system on an HOURLY basis (*Source: BofA Global Research; The Flow Show 12/10/20; Michael Hartnett).* We suspect most investors find these figures difficult to rationally comprehend.

Chart 3: S&P 500; Green = Dovish Fed action; Red = Hawkish Fed action; Blue = Trump election interpreted as pro growth



Source MBL Advisors & FactSet 12/12/20

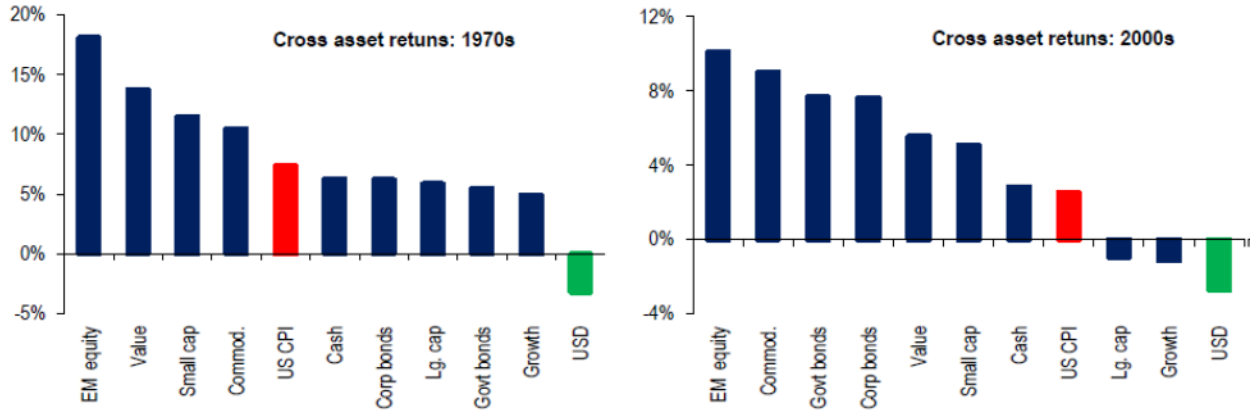
Potential 2021 Analogues

Hartnett is writing a lot about the 2020s possibly resembling the "stagflation" environment of the 1970s. In a world where a lot of "bad news has been good news" for asset prices, is there potential for "good news to be bad news" in the sense that the economy far outperforms the Fed's expectations (or fears) from the spring of 2020? For the last thirty plus years investors have generally had larger concerns than inflationary pressures building within the economy, and this is still likely the case today. Nonetheless, if inflation begins to build some momentum, the bond market will begin to adjust the cost of capital, with or without the Federal Reserve adjusting their current position of maximum accommodative policy.

Hartnett writes the "transition from the 60's to the 70's (stagflation, monetary & fiscal instability, breakdown in global cooperation, civil disobedience) coincided with 3 big, simple trends: (1) rising bond yields, (2) a falling US dollar, and (3) volatile, sideways stock markets… weaker US dollar, higher gold, higher volatility remain favorite big trades of '21." (*Source: BofA Global Research; The Flow Show 12/10/20; Michael Hartnett).*

The 1970s and 2000s are investors' best roadmaps for decades during which the US dollar weakened. Reflationary assets like emerging market equities, US small cap equities and commodities all outperformed during both of those periods when US large cap stocks failed to keep up with inflation.

Chart 4: Asset class returns in the 1970s & 2000s – decades with US dollar weakness



Source: BofA Global Investment Strategy, Bloomberg, Ibbotson, Fama-French growth/value series, Case-Shiller, Bureau of Economic Analysis, Homer & Sylla, A History of Interest Rates; Prior to 1990 Energy = Oil, Gas & Consumable Fuels

Source: BofA Global Research; The Flow Show 7/30/20; Michael Hartnett

2009/10 is another interesting potential analogue for 2020/21. Chris Verrone of Strategas Research Partners has commented that the symmetry between the 2009 and 2020 stock market rallies is "remarkable."

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Chart 5: S&P 500 2009 bottom vs. 2020 bottom



Source: Strategas Research Partners; Chris Verrone 12/10/20

If we were to continue to extrapolate the 2009/10 market pattern, we would be pleased with equity market returns next year, but they would not come easily. 2010 experienced a 9% pullback in January followed by a 17% correction through the summer months on its way to a 15.06% total return year. The summer correction was alarming, as few people believed in the fundamental underpinnings of a new economic expansion only being a year removed from the greatest financial crisis of our lifetimes. But, with the benefit of hindsight these corrections proved to be buyable as policy makers were effective in supporting the global economy and in turn allowing equity markets to ultimately grind higher as recession fears gradually subsided.

Investor sentiment and positioning are running hot by many measures as we move into 2021 (as they were in late 2009), and we surmise they will absolutely need to be checked sooner rather than later (as they were in 1H 2010). We also speculate that sentiment could turn bearish quickly, as more "fast money" has come into this market over the last few months. Although corrections are never fun, they are often healthy and ultimately can prolong bull markets.

Finally, the (late 2016 &) 2017/18 analogue catches our attention as well. The S&P 500 was up 33.79% combined in 2016 and 2017 with the vast majority of 2016's gains coming after the election in the final two months of the year. S&P 500 earnings per share were up 10.51% combined in 2016 and 2017 *(source FactSet).* The S&P 500 was down -4.38% in 2018 although S&P 500 earnings

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per share were up 22.66% in 2018 *(source FactSet)*. What happened? The market front ran the December 2017 tax cuts and then traded sideways in a prototypical "sell the news" fashion (remember the Fed was also tightening monetary policy in 2018 which is not the case today). Could the vaccine and the reopening be another "sell the news" event as risk assets have clearly priced in a plethora of positive outcomes?

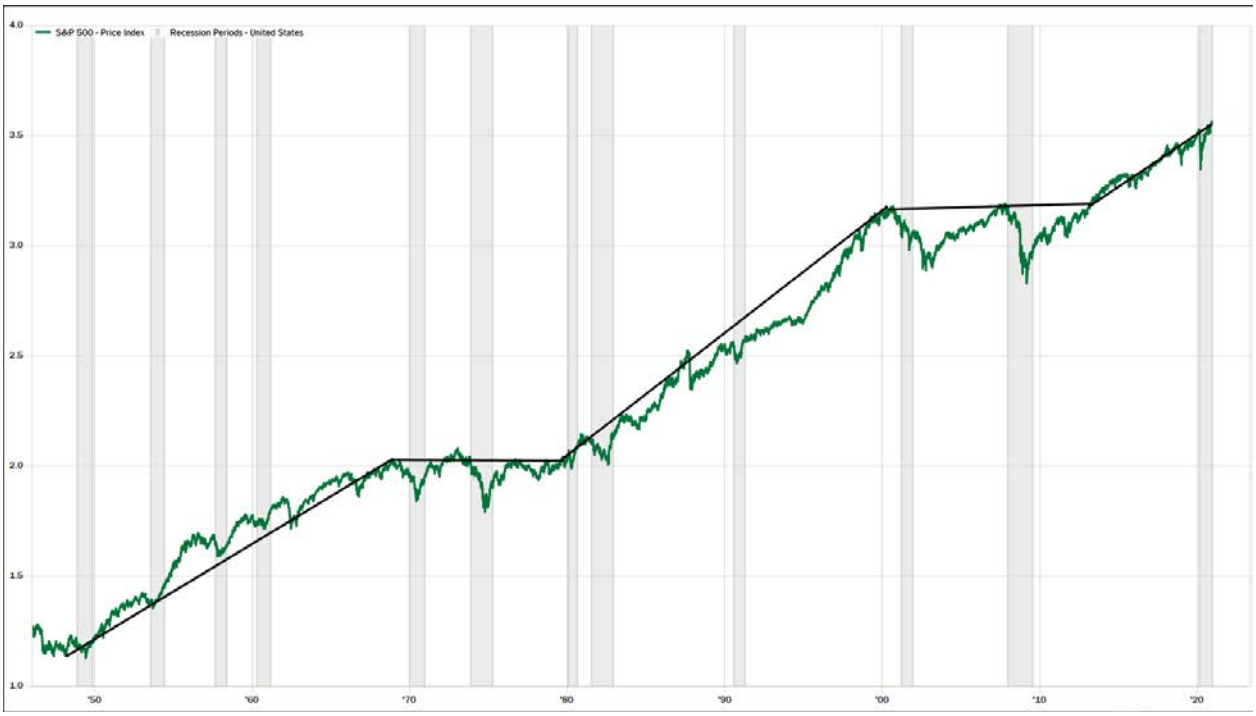
Secular Bull Markets

Secular bull / bear markets speak to longer-term trends in markets which can sometimes last for decades. Studying the history of secular moves in the S&P 500 over the last 70 years can provide us with useful long-term perspectives. Over the last several decades there have been too many significant and historic events to list them all, but we can generalize some time frames and align them with the chart below as follows:

- 1949 – 1968 = secular bull market / post war boom.
- 1969 – 1981 = secular bear market / stagflation, decline of US manufacturing jobs, increased international competition, cost of Vietnam catching up with the US.
- 1982 – 1999 = secular bull market / Volker recession broke the back of inflation, Reagan & Clinton pro-growth economies, tech boom.
- 2000 – 2012 = secular bear market / tech & everything bubble followed by housing bubble / great financial crisis.
- 2013 -20__? = secular bull market / technological revolution coupled with ultra-accommodative policy makers / the "new economy."

The sample set is not very large, but previous secular bull markets have lasted 15-20 years. We are roughly 8 years into the current secular bull market which began in 2013 when we surpassed the previous all-time highs set in March 2000 & October 2007.

Chart 6: S&P 500 1946 – present



Source MBL Advisors & FactSet 12/12/20

There are of course no shortage of opinions and forecasts on Wall Street, but Tom Lee of Fundstrat Global Advisors is someone to whom "everyone" listens when he speaks. He is also somewhat of a contrarian thinker, which in his case has meant being more bullish than most people for the last decade, and frequently correctly so. Lee has espoused an opinion formed by his own research that secular bull and bear markets can largely be explained by demographics.

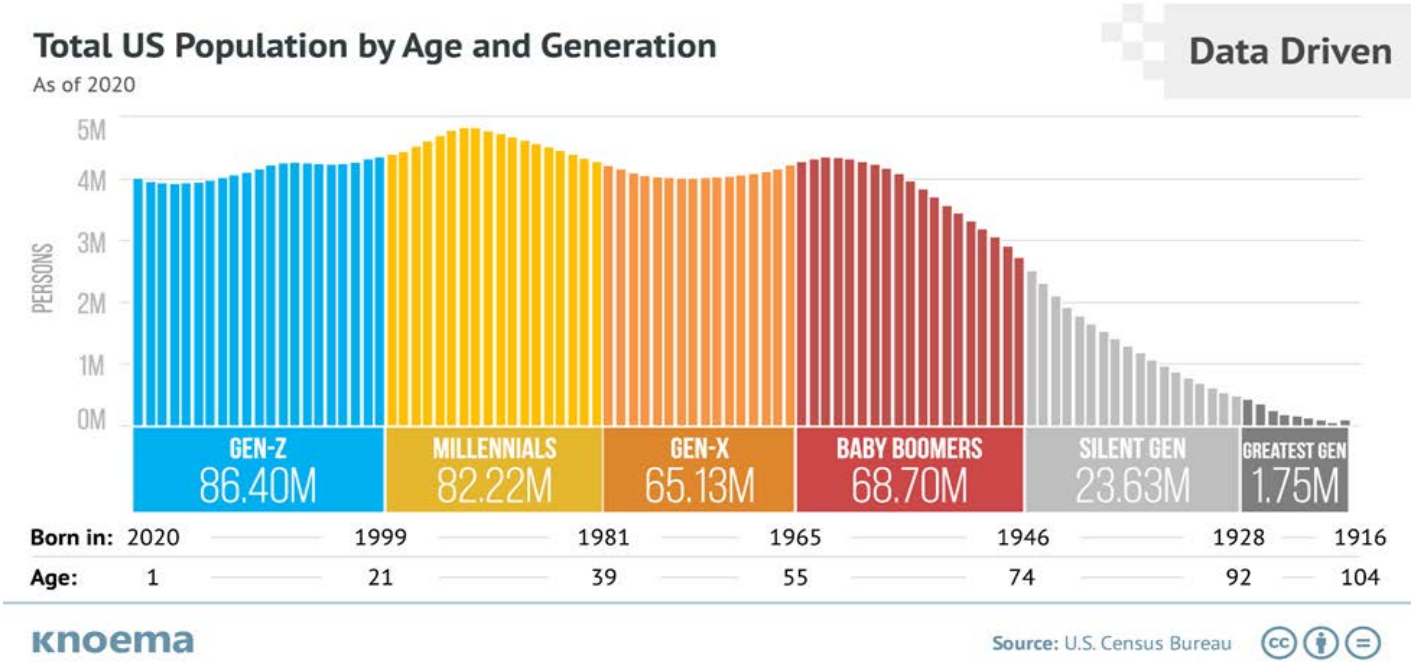
His thesis is that the 30- to 50-year-old age group entirely drives incremental consumer spending within the economy. To state the obvious, this age group is having children, buying houses, entering peak earning and spending years, etc. To support his thesis, Lee uses Chase credit card data which shows that the 30 – 50-year-old age group is the only age group driving credit card spending growth, regardless of the year. In addition, he points to Urban Institute research showing that leverage per person increases from age 20 to age 50, at which point it begins to decline.

Practically translating this into equity market investing, Lee notes that the Silent Generation exited their peak spending years in the early 1930s (big market top), the Greatest Generation exited the peak spending years in the early 1970s (big market top), the Baby Boomers exited the peak spending years in 1999 (big market top) and Generation X was a contracting generation (smaller than Boomers & Millennials).

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According to Pew Research Center, Millennials surpassed Baby Boomers as the nation's largest living adult generation according to population estimates from the U.S. Census Bureau as of July 1, 2019. Lee walks though this information in a video with Josh Brown called "The Four Most Important Market Indicators." (https://www.youtube.com/watch?v=FnhjJJLQ_0I). He believes that Millennials entering their peak spending years is a substantial positive tailwind for the U.S. economy over the next several years. In short, Tom Lee believes that positive demographics will likely allow this secular bull market to continue for several more years.

Chart 7: Population Distribution by Generation



Source: Knoema.com; US Population by Age and Generation in 2020; 4/16/20

2000 vs. 2020

The "bubble" comparisons between 2000 & 2020 are only increasing as global equity markets continue to move higher, seemingly every day. Some of these comparisons are warranted. IPO activity has officially hit the "outrageous" threshold in our opinion, as it has become somewhat commonplace for new issues to double (or more) on their first day of trading. Post-election inflows into equities are hitting record levels on a rolling one-to-two-month basis. The last time we saw crypto currencies go parabolic was in late 2017, which in our judgement is the only other time post 2008 when widespread bullishness and potentially even "greed" were as prevalent as they are today. Our favorite recent

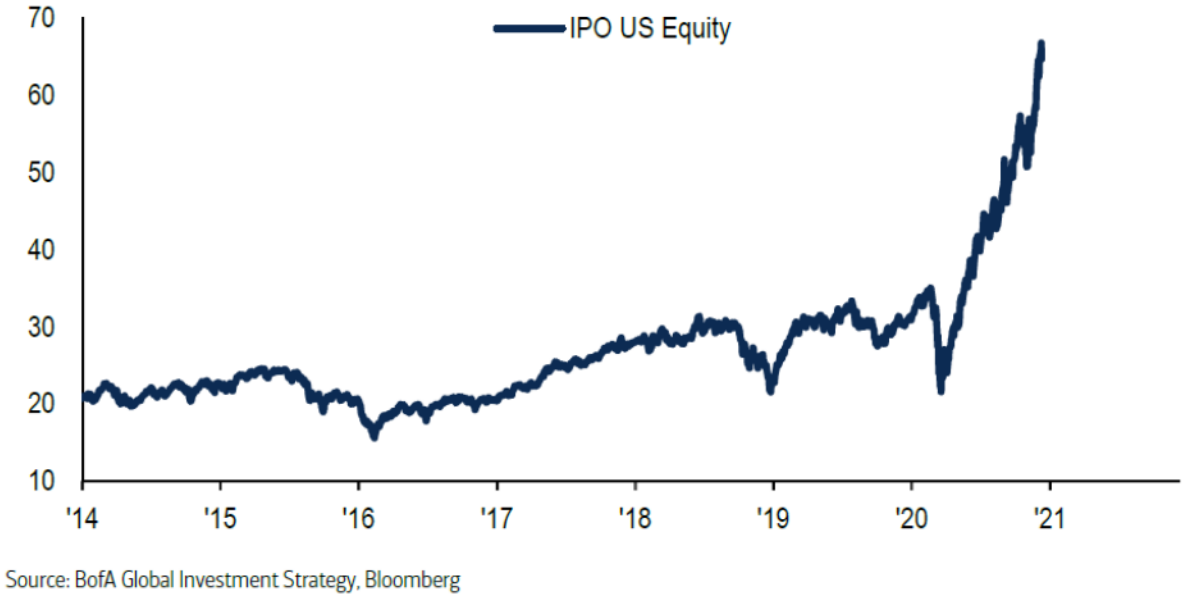
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anecdote highlighting the current borderline euphoric sentiment came from Darren Rovell on Twitter:



Source: @darrenrovell; Twitter

Chart 8: IPO ETF – portfolio of newly traded companies

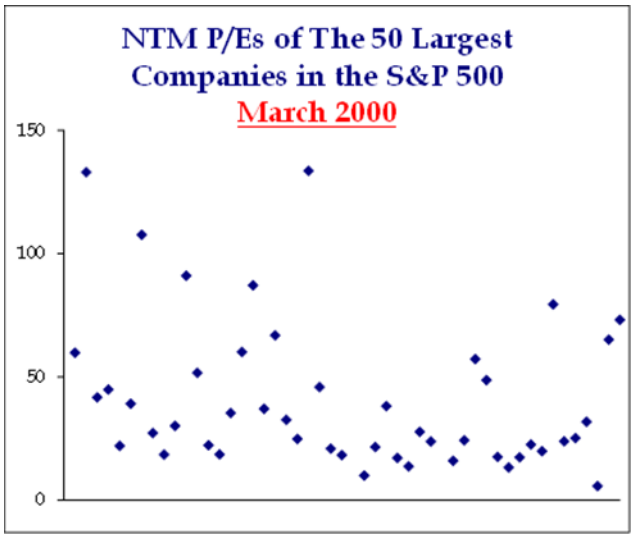


Source: The Flow Show 12/10/20; Michael Hartnett

Having said all of this, we do believe there are a few key differences between 2020 vs. 2000 as well. First and foremost, the largest stocks of today (Facebook, Amazon, Netflix, Google, Microsoft, Apple, Nvidia, etc.) are not reminiscent of the dot.com stocks of the 2000 tech bubble (AOL, pets.com, etc). The companies often referred to as FANGMAN literally just showed us that they got even stronger during a (brief) economic depression! Along with being far superior businesses, the valuations for these high growth technology related businesses are also not what they were back in 2000. Although it sounds somewhat fake, it is important to remind ourselves that the NASDAQ was up 400% + from 1995 – early 2000.

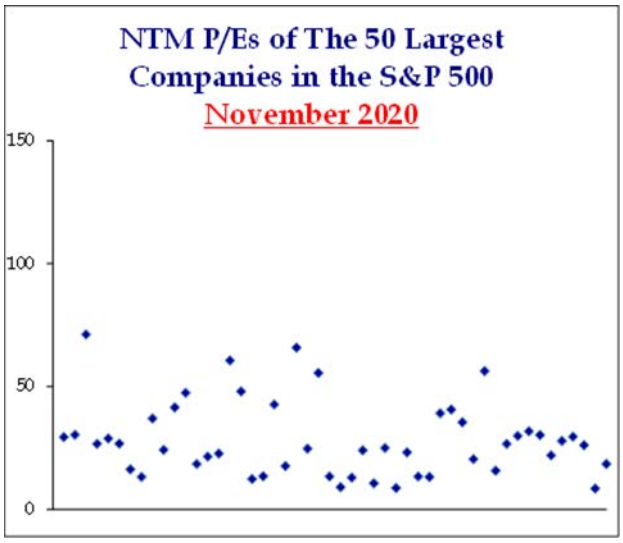
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Chart 9: Median Forward P/E in 2000 = 31x



Source: Strategas Research Partners

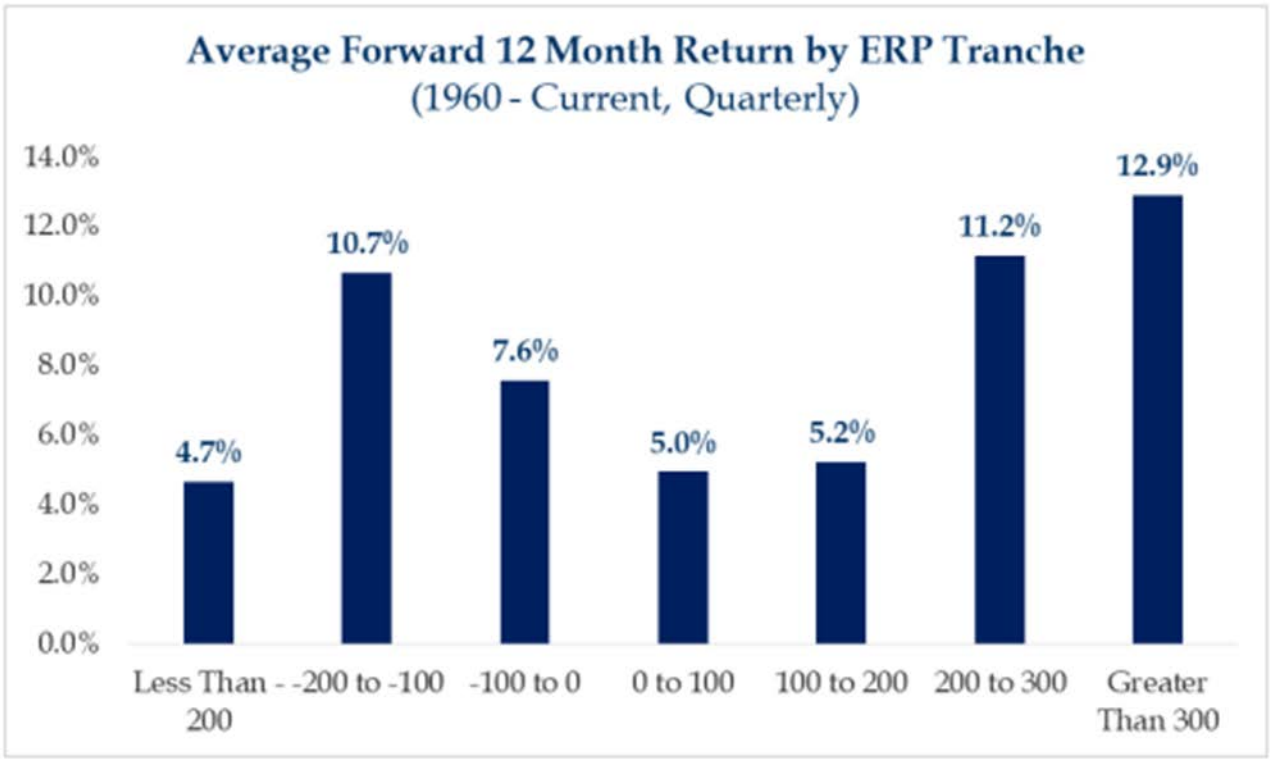
Chart 10: Median Forward P/E in 2020= 25.5x



Source: Strategas Research Partners

Another key difference between 2020 and 2000 is that the risk-free rate was 6% in 2000. Said another way, investors in 2000 had attractive investment alternatives (e.g., bonds) relative to equities.

Chart 11: 12 month forward returns based on starting Equity Risk Premium



Source: Strategas Research Partners

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We measure the attractiveness of stocks (S&P 500) relative to bonds (10-year treasury yield) through something called the Equity Risk Premium. In other words, we try to measure whether equity investors are being adequately compensated for the increased volatility they will experience relative to fixed income investors. In 2000, stocks were extremely expensive both on an absolute basis and a relative basis. The Equity Risk Premium for the S&P 500 was around – 2% back then. Today, stocks are very expensive relative to history, but are still moderately attractive relative to the very low yields which high quality fixed income investments currently offer. Today, the S&P 500 has an Equity Risk Premium around 2.40%.

Final Thoughts

As always, investors will need to access and weigh a plethora of factors as we move into 2021. The economic reopening could be legendary, barring any unforeseen complications with the vaccine and its distribution. Consensus economists' estimates for U.S. real GDP growth are currently around 3.75% for next year. In our opinion, we do not believe it would be completely farfetched for 2021 to have 5% +/- real GDP growth year. For perspective, the U.S. economy has not recorded a year with real GDP growth above 4% since 2000. Corporate earnings could also post impressive numbers next year, which would only be further boosted if CEO confidence continues to rise and manifest itself into a CAPEX cycle.

On the other hand, U.S. equities are now generally trading at their highest valuations ever outside of the 2000 – 2001 tech bubble. We would point out that valuations are rarely the best indicator at large turning points in economic cycles (they underestimate EPS around economic troughs), nonetheless this condition should not excite investors. Shorter term sentiment and positioning metrics are very overbought, and markets will likely need to spend some time digesting the recent gains – potentially similar to some of the analogues mentioned earlier. The list of short term overbought indicators is lengthy but include the following: historically low put / call ratios, very high bullish (& low bearish) readings from investor sentiment surveys, over 90% of equity issues trading above their 200 day moving average (which is actually associated with above average 12 month forward returns but can be climatic in the shorter term), small cap stocks trading at the highest level above their 200 day moving average in 20 years, small caps registering their best month ever in November 2020, equity flows becoming very aggressive over the last few months, cash levels at statistically significant low levels, equity allocations nearing post 2008 high, etc.

The narrative that most of the equity markets gains were attributable to a handful of very large tech names had some legitimacy to it during the May – August timeframe (along with 2018 – 2019). However, since the beginning of September global equity markets have broadened out in a meaningful way, which is usually a very healthy sign. As you can see below, large cap growth stocks have done very little since September 1st while other equity asset classes have performed very well during this same time frame.

Chart 12: Asset class returns 9/1/20 – 12/15/20 (Price only)

Asset class	Returns from 9/1/20 - 12/15/20
U.S. Large Cap (S&P 500)	4.82%
U.S. Large Cap Growth (Russell 1000 Growth)	1.75%
U.S. Large Cap Value (Russell 1000 Value)	10.73%
U.S. Mid Cap (S&P Mid Cap 400)	17.44%
U.S. Small Cap (S&P Small Cap 600)	22.00%
International Developed (MSCI EAFE)	11.08%
Emerging Markets (MSCI Emerging Markets)	11.43%

Source: MBL Advisors & FactSet

The main purpose of the stock market is to make fools of as many men (women) possible.

– Bernard Baruch

Investors will need to stay vigilant by keeping their longer-term goals in perspective and not allowing the short-term swings from greed to fear to influence their investment decisions. Everyone seems to be "on the same side of the boat" moving into next year. Consensus thinking is that (i) the economy will be very strong as it reopens, (ii) therefore stocks will move higher along with corporate earnings next year (iii) even if there are some small pullbacks, there are no "big" worries on the horizon. Our experience tells us that things are usually not this simple or easy. There will very likely be at least a couple of surprises next year which most investors are either not thinking about and / or are taking for granted right now. A few potential issues which investors currently seem complacent around include the current level interest rates, the "idea" that equity market valuations don't really matter anymore because interest rates are so low, Georgia Senate elections, speed of vaccination, levels and trajectory of national debts / deficits, and the markets' dependency on stimulus.

Continuing to pay extra attention to Federal Reserve policy will likely be a very important factor for investors over the next several years. The Fed reinforced its maximum dovish policy last

week, but one must wonder if they are backing themselves into a corner for when they eventually begin to normalize their asset purchase programs and interest rate policy.

> *"We are all at a wonderful ball where the champagne sparkles in every glass and soft laughter falls upon the summer air. We know, by the rules that at some moment the Black Horsemen will come shattering through the great terrace doors, wreaking vengeance and scattering the survivors. Those who leave early are saved, but the ball is so splendid no-one wants to leave while there is still time, so that everyone keeps asking, "What time is it? What time is it? But none of the clocks have any hands."*
>
> *- From **Supermoney** by Adam Smith*

With increasing conviction, we are beginning to believe that the Federal Reserve may be the ones who tell investors exactly "what time it is" in the years to come. If this latest party began in the spring of 2020, we may just be sitting down to dinner so long as the Fed holds true to their recent statement of "keeping rates near zero at least through 2023." Tony Dwyer, the Chief Market Strategist at Canaccord Genuity, likes to say, "the guys printing the money have told us what their plans are."

Through all of this we will continue to remind ourselves that our behavior will be the predominant driver of longer term returns rather than any forecasts or large market calls. There will never be a shortage of issues that cause investors to be uncomfortable in the short term, but long-term investors have an advantage which has never been arbitraged away – a long time horizon.

The main purpose of this writing was to pause to reflect on 2020 and look ahead to 2021, a common practice for almost everyone at this time of year. So we would be remiss in not at least briefly doing the same thing on a personal level. Especially in the wake of a tumultuous year like the one drawing to a close, we take stock of the blessings in our lives and the things for which we are most grateful.

Chief among those for all of us at MBL are the families we have the opportunity to serve and for the trust that you place in each of us every day. Your faith humbles us, emboldens us, and motivates us. While we have not been able to see any of our clients, friends, and families nearly as much as we would like this calendar year, we continue to strive to do all that we can in service to you and your families.

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We look forward to hopefully catching up a lot more in person in 2021! Happy Holidays, Brian, Jonathan, Luther & Billy.

Sincerely,



Brian J. Gift, CFA

Chief Investment Officer

MBL Advisors

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