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Patten & Patten, Inc.

# 4Q20 Market Outlook

# Market commentary

- We enter the Fourth Quarter of 2020 hopeful that several lingering uncertainties will be resolved before the New Year. These include potential vaccines for the coronavirus; the outcome of the US election; and the formal departure of the United Kingdom from the European Union, known as “Brexit”. We expect the nature of the uncertainties will contribute to heightened volatility, and their resolutions could unsettle markets. They should not, however, persist into the New Year.
- There is global fixation on vaccine approvals, with several of the leading candidates expected to announce results in late October. Optimism among investors is high that a vaccine could be approved on a limited or emergency basis before Thanksgiving. We are concerned that vaccines are viewed as the panacea to immediately and permanently end the disruption from COVID-19 and that any disappointment in this regard could forestall the ongoing economic recovery.
- There are daunting challenges with respect to vaccine manufacturing and distribution that need to be overcome, including ultra-cold chain logistics. That said, the medical and scientific communities continue to make important progress on understanding and treating COVID-19. This has manifested in improved mortality rates and an expanded standard of care that should continue to provide encouraging results. Despite regional surges in cases, the health impact of the virus is now considerably more manageable than during the Spring. We look forward to 2021 when the threat of COVID-19 and its impact on the economy should be much less pronounced.
- Twenty years ago, on the day after the Presidential election, voters woke to a surprising and extremely rare situation – an unresolved election. The S&P 500 suffered a near 12% correction until bottoming in mid-December once the election dispute was resolved. There is a growing probability of a similar occurrence this year – i.e., results of the US election on November 3<sup>rd</sup> might not be determined for several weeks. Mail-in ballots, partly in response to concerns regarding COVID-19, are estimated to be 2 – 3 times typical volumes, and rules vary by state as to when those ballots must be received and counted. The volume and purported validity of mail-in ballots could, therefore, delay determination of the winner.

# Market commentary (*continued*)

- If the election outcome is delayed, we caution clients to anticipate elevated market volatility until resolution. Fortunately, there are provisions in our Constitution to settle contested elections in relatively short order. **We expect the New Year will begin, as normal, with an Inauguration and a new session of Congress.**
- In a process that began in the Summer of 2016, the United Kingdom is on the verge of formally separating from the European Union. Complicated by COVID-19, neither the UK nor the EU made progress this year toward negotiating an orderly exit. Instead, there is a high probability of a “No Deal” or “Hard Brexit” – i.e., a departure without new trade agreements -- on December 31, 2020. We expect a Hard Brexit would create turmoil in the markets, particularly in foreign exchange as investors seek safe havens, such as the US Dollar and US Treasuries.
- We further anticipate the impact on the US economy will be indirect, but we also acknowledge that forecasting the magnitude and extent of such an event is exceptionally difficult. While the impact of Brexit will carry over into 2021 and markets will require time to adjust, we believe the US economy should be relatively insulated from extreme political uncertainty in Europe and the United Kingdom.
- We are disappointed, yet not surprised, that Congress failed to enact additional fiscal support in the Third Quarter. Numerous programs comprising early phases of COVID-19 “rescue” packages provided important and necessary support to the economy. Most of those programs have expired, and it appears that economic recovery could stall without an additional package before yearend. The markets, on the other hand, remain buoyed by enormous liquidity support from the Federal Reserve. The Fed’s aggressive actions during the Spring should maintain low interest rates and support for equity valuations.

# Markets

# Year to date and historical performance of various asset classes

Asset Class	YTD	1 year	3 Year Annualized	Total Returns since...	
				Trough*	Peak*
<b>Domestic Equities</b>					
S&P 500	16.88	18.39	13.47	68.00	11.23
S&P 500 Equal Weight (RSP)	11.88	13.09	9.93	78.85	9.09
Dow Jones Ind. Avg.	8.19	9.34	9.28	65.07	4.85
NASDAQ Comp	43.41	45.81	23.42	87.11	30.90
Russell 2000 (IWM)	19.59	20.06	9.75	98.32	17.65
<b>International Equities</b>					
Shanghai Composite (CIN)	20.50	22.51	6.14	33.07	21.31
Hedged Japan (DXJ)	2.52	0.39	-0.49	39.27	4.88
Hedged Europe (HEDJ)	-3.85	-3.71	2.87	44.23	-5.02
Asia Pacific ex. Japan (EPP)	5.08	5.51	4.11	66.56	4.49
Emerging Markets (EEM)	15.49	16.45	5.81	69.30	17.16
Brazil (EWZ)	-18.97	-16.59	1.66	84.66	-12.44
Canada (EWC)	6.00	7.26	4.83	79.51	2.94
India (EPI)	16.39	16.54	2.87	102.87	17.91
Mexico (EWW)	-4.27	-6.92	-3.34	71.60	-9.36
<b>Bonds</b>					
Long Treasuries (TLT)	17.10	16.44	9.54	-4.73	8.84
Inv. Grade Corporates (LQD)	10.19	10.53	7.67	22.37	7.32
High Yield Corporates (HYG)	3.73	3.79	5.19	31.79	2.93
<b>Commodities</b>					
Gold (GLD)	23.47	26.92	13.80	20.60	16.24
Silver (SLV)	43.65	50.69	16.33	94.64	39.06

\*Stock market trough at 03/23/2020. Stock market peak at 02/19/2020. YTD through 12/20/2020

Source: Thomson Reuters Datastream

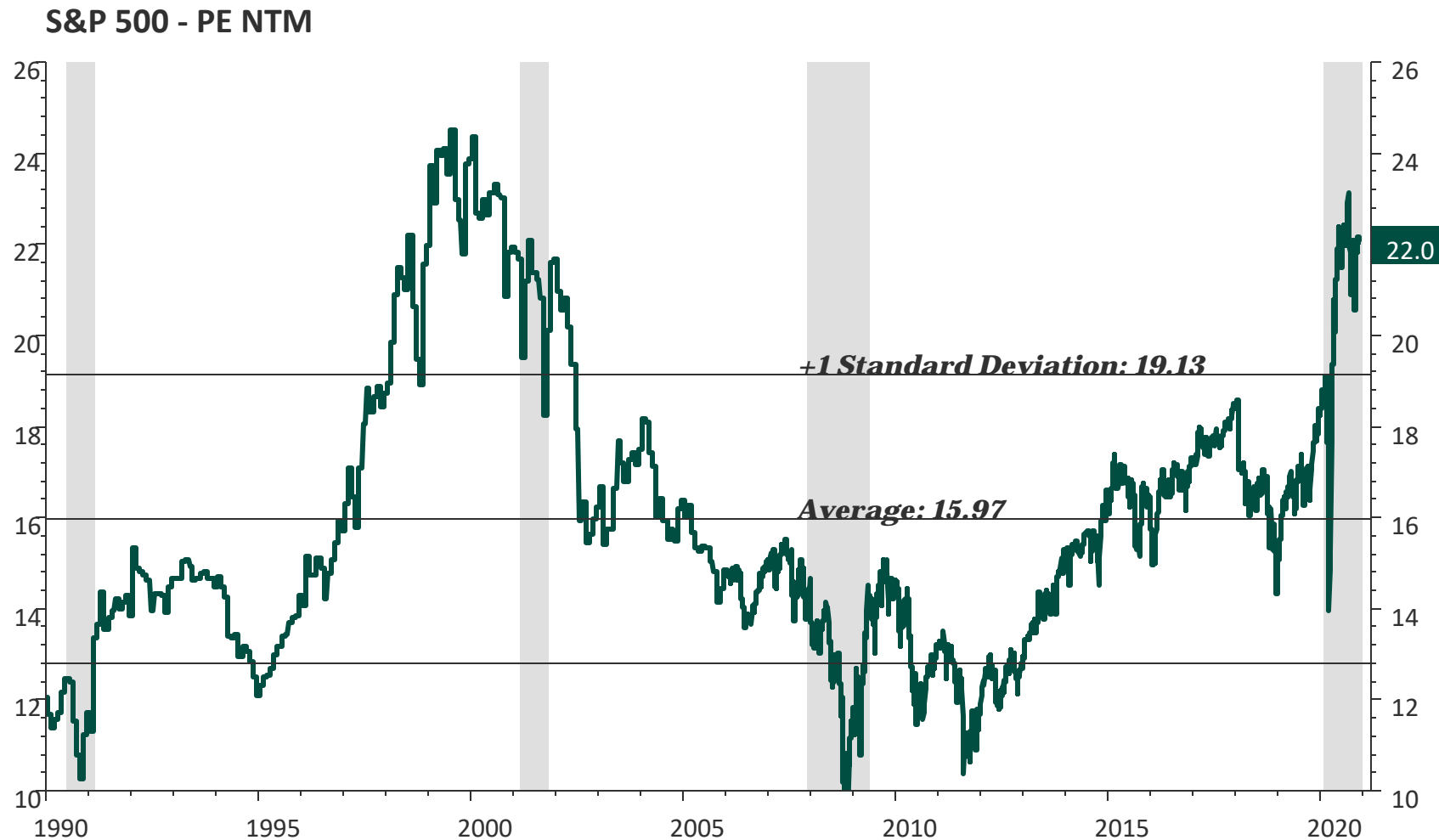
# Year to date and historical performance equity sectors

Domestic Equity Sectors	YTD	1 year	3 Year Annualized	Total Returns since...	
				Since Trough*	Since Peak*
<b>Domestic Equities</b>					
Consumer Discretionary	38.51	40.43	20.57	97.57	30.83
Retail (XRT)	39.25	41.09	13.25	135.85	42.34
Consumer Staples	11.59	13.01	8.49	47.27	9.03
Energy	-27.24	-25.98	-12.16	81.46	-18.78
Oil & Gas Exploration (XOP)	-35.43	-33.49	-23.38	100.45	-17.63
Financial Services	-0.88	-0.11	4.26	71.48	-2.64
Regional Banks (KRE)	-10.45	-10.99	-3.13	83.24	-5.94
Health Care	18.15	19.32	14.90	60.72	15.78
Industrials	10.32	11.14	8.52	81.44	6.63
Materials	17.92	19.62	7.71	95.68	21.10
Technology	43.96	46.49	27.55	85.76	29.74
Telecom	-8.63	-7.65	2.40	19.13	-8.41
Utilities	-1.40	-0.69	7.64	41.00	-10.13
Transportation (IYT)	14.67	15.92	6.63	86.68	14.94
Real Estate	-6.06	-3.47	4.64	54.74	-12.43

\*Stock market trough at 03/23/2020. Stock market peak at 02/18/2020. YTD through 12/20/2020

Source: Thomson Reuters Datastream

# S&P 500 Valuation

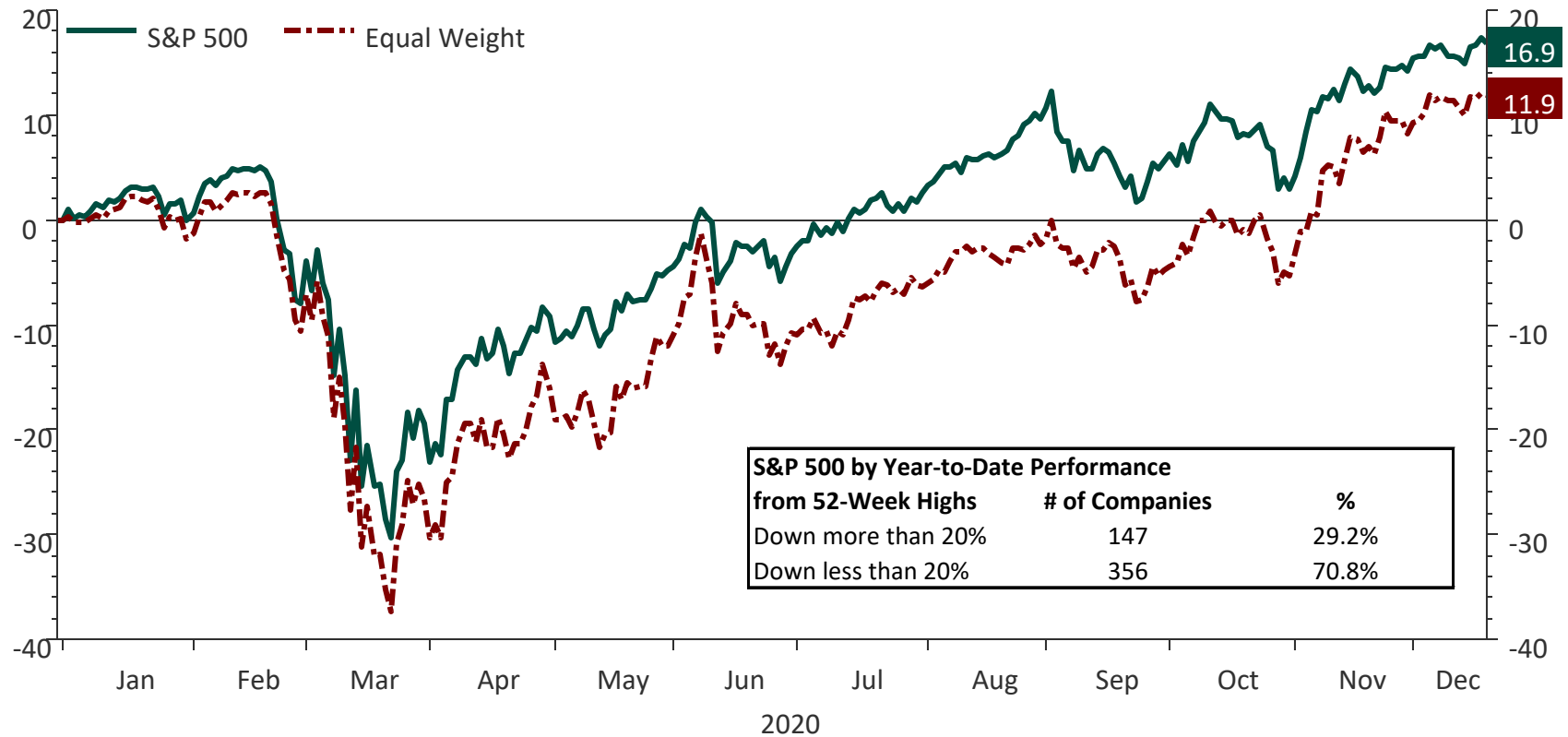


Source: Refinitiv Datastream

# Bifurcated Market

## S&P 500 vs. Equal Weight S&P 500

Year-to-Date Percent Change



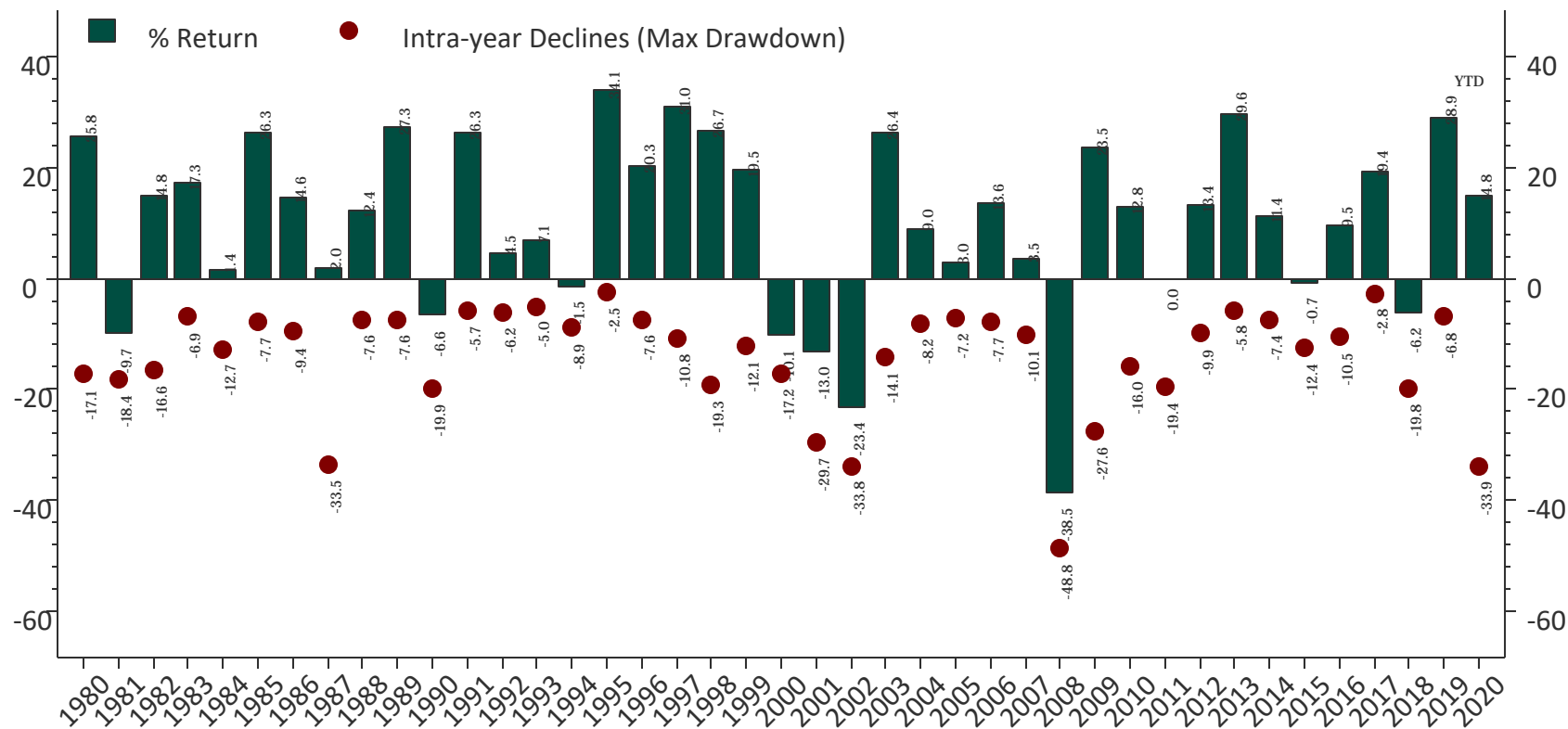
S&P 500 by Year-to-Date Performance from 52-Week Highs		
	# of Companies	%
Down more than 20%	147	29.2%
Down less than 20%	356	70.8%

Source: Refinitiv Datastream



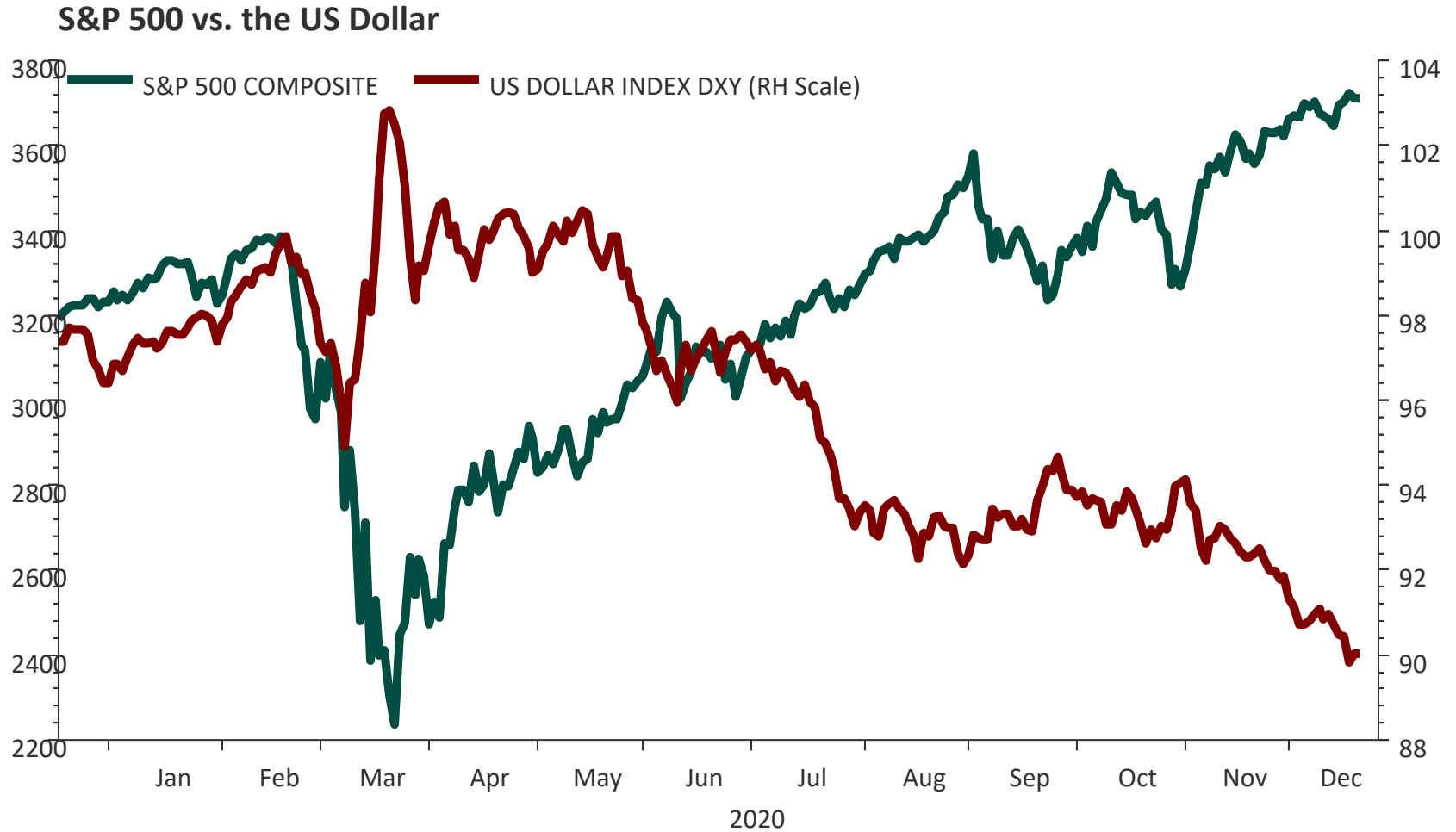
# Stock Market Sell-offs are Normal

## S&P 500 Intra-year Price Declines (Max Drawdown) vs. Yearly Price Returns



Source: Data provided by Thomson Reuters

# S&P 500 vs. the US Dollar



Source: Refinitiv Datastream

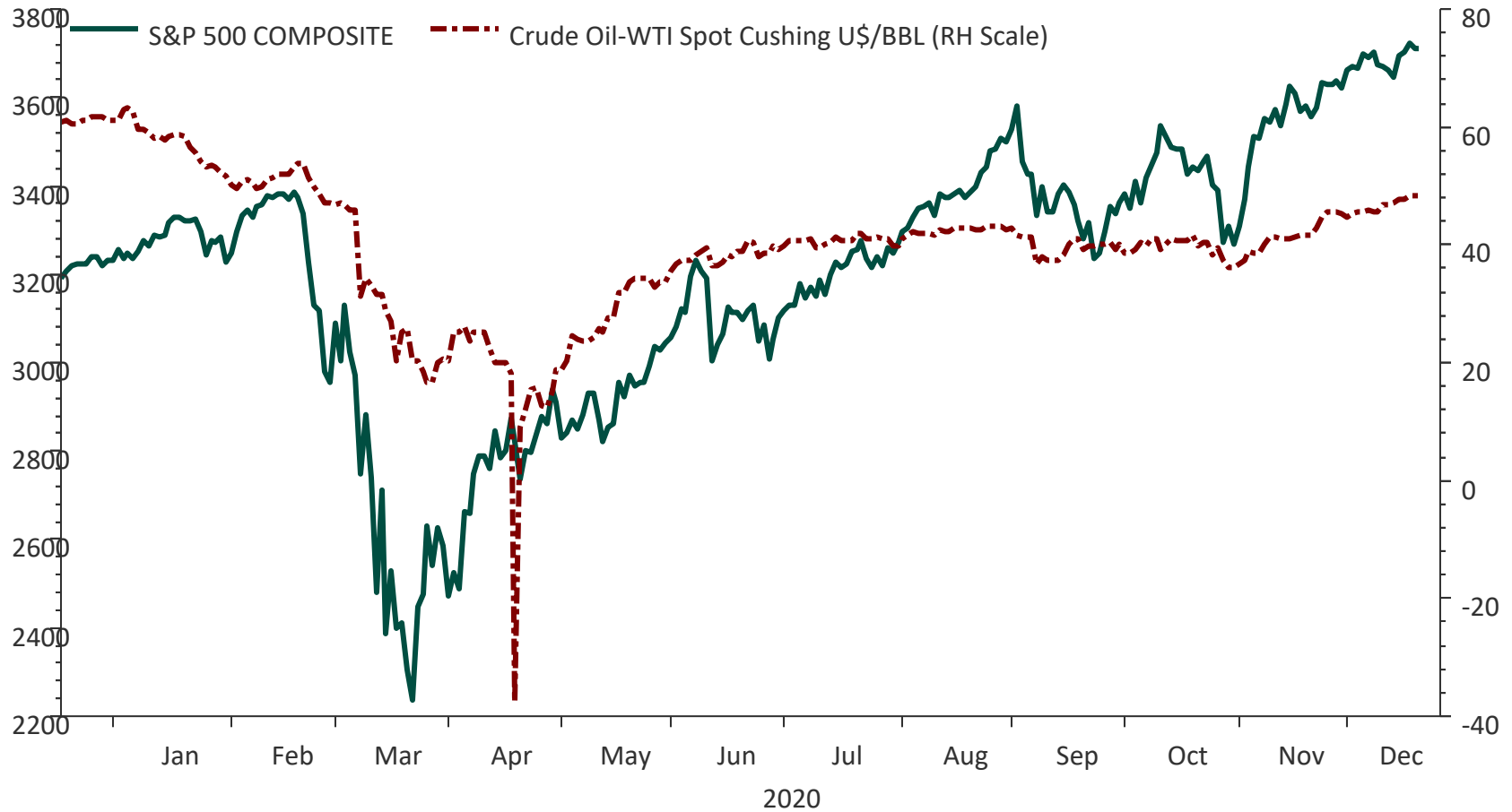
# S&P 500 vs. the 10-Year Treasury



Source: Refinitiv Datastream

# S&P 500 vs. the price of crude oil

## S&P 500 vs. WTI Crude Spot



Source: Refinitiv Datastream

## LME Copper Spot Price

\$/MT

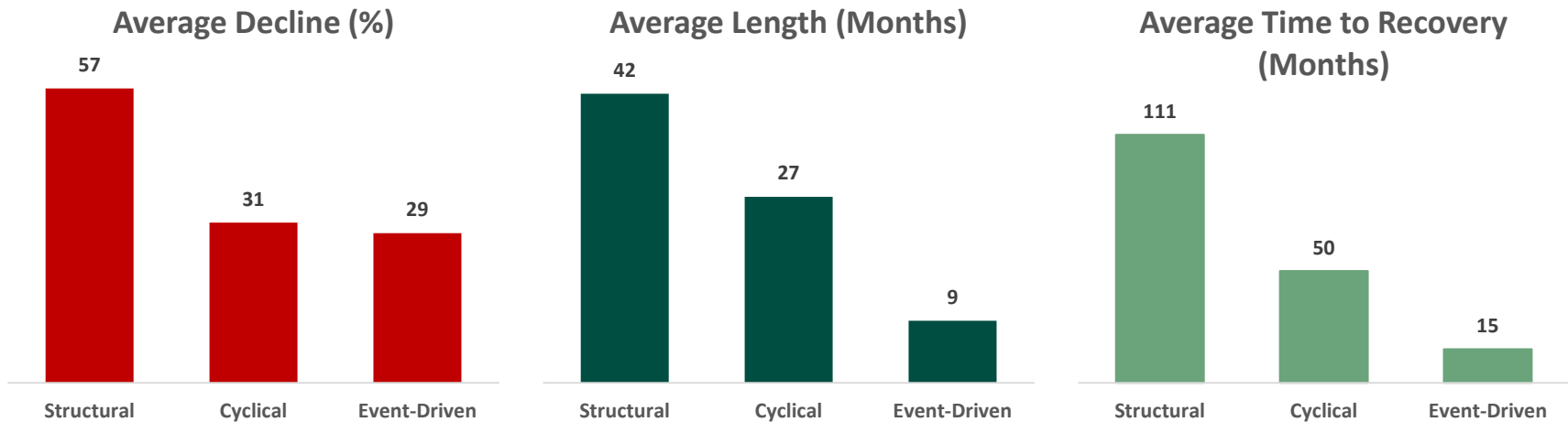


Source: Refinitiv Datastream

# Characteristics of a bear market

	Pre-Bear	Structural	Cyclical	Event-Driven
Rising Rates		✓	✓	Maybe
Exogenous Shock		Maybe	Maybe	✓
Speculative Rise in Equity Prices		✓	✗	✗
Economic Imbalances		✓	✗	✗
Rising Productivity		✓	Maybe	✓
Unusual Strength in the Economy		✓	✗	✗
New Era Belief		✓	✗	✗

## US Bear Markets & Recoveries



# Interest Rate Outlook

# Global Interest Rates

## Global Bond Yields on December 21, 2020

Maturity	US	Canada	UK	Germany	Switzerland	Japan	Spain	Italy	Brazil	Greece
2 year	0.123	0.241	-0.102	-0.724	-0.791	-0.120	-0.602	-0.455	4.600	NA
5 year	0.378	0.446	-0.080	-0.754	-0.715	-0.112	-0.472	-0.089	5.895	0.200
10 year	0.935	0.723	0.208	-0.579	-0.481	0.010	0.066	0.548	7.325	0.657
30 year	1.674	1.277	0.753	-0.179	-0.334	0.650	0.874	1.433	NA	NA

## Change in Global Bond Yields since December 14, 2020

Maturity	US	Canada	UK	Germany	Switzerland	Japan	Spain	Italy	Brazil	Greece
2 year	-0.002	-0.011	-0.012	-0.009	-0.039	0.021	0.007	0.004	0.015	NA
5 year	-0.003	-0.004	-0.031	-0.008	-0.018	0.018	0.016	0.018	0.115	0.091
10 year	-0.013	-0.019	-0.029	-0.008	0.003	0.007	0.017	0.017	0.050	0.010
30 year	-0.026	-0.013	-0.045	-0.016	-0.025	0.021	0.007	0.008	NA	NA

Source: Data provided by Thomson Reuters



# Forward interest rates

## Forward Rate Analysis

### US Dollar Swap Curves

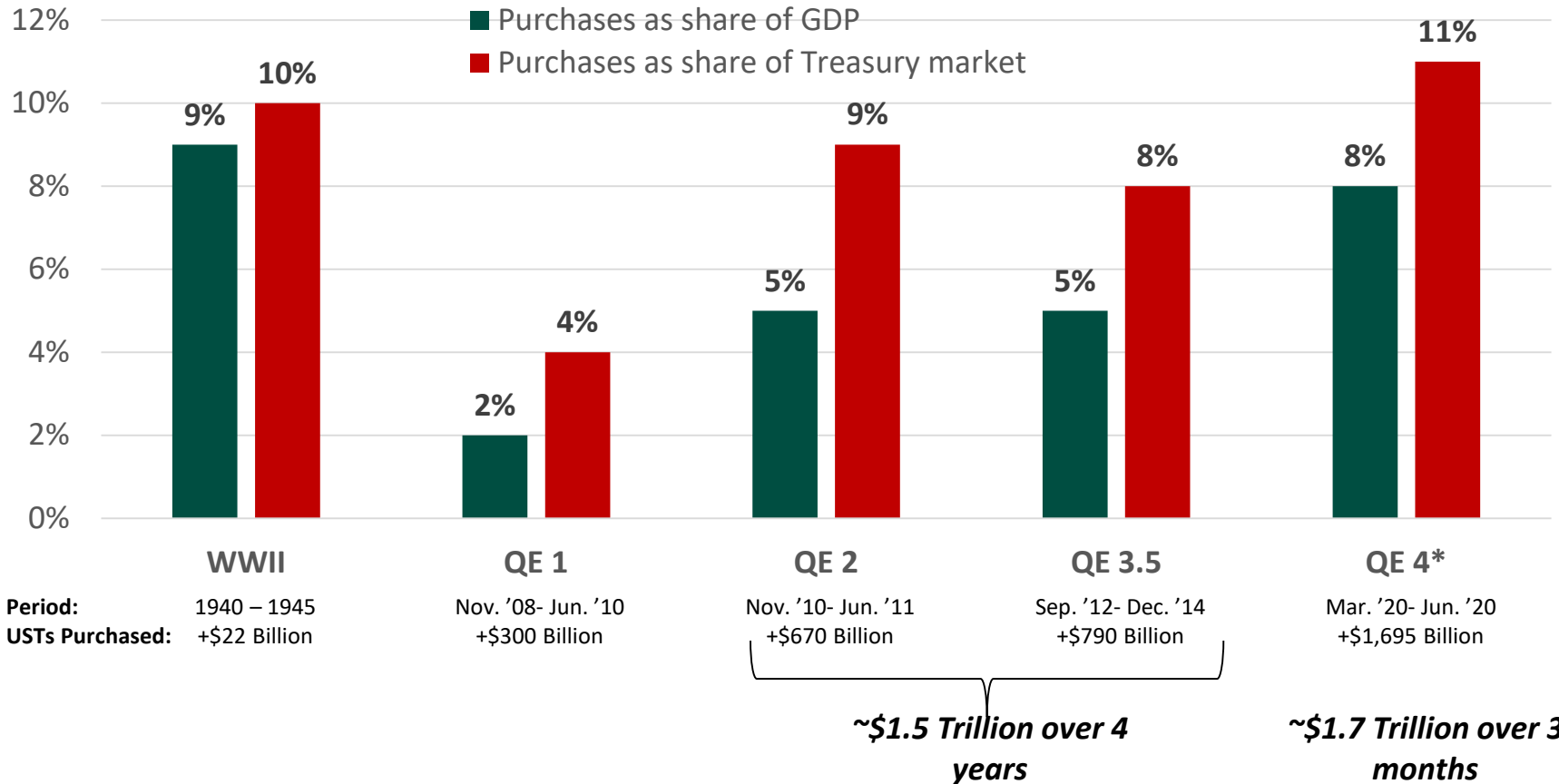
Maturity	Forward Rates						Chg (in bp)
	Current	6 Mo	1 year	2 year	5 year	10 year	
1 year	0.187%	0.192%	0.210%	0.346%	1.133%	1.689%	150
2 year	0.204%	0.226%	0.278%	0.476%	1.228%	1.758%	155
3 year	0.247%	0.308%	0.387%	0.609%	1.312%	1.730%	148
5 year	0.437%	0.531%	0.632%	0.854%	1.444%	1.761%	132
10 year	0.926%	1.006%	1.083%	1.244%	1.597%	1.754%	83
30 year	1.381%	1.424%	1.446%	1.490%	1.578%	1.551%	17
2 - 10 Curve	<b>72</b>	78	81	77	37	(0)	
1 - 30 Curve	<b>119</b>	123	124	114	45	(14)	

\*market rates as of 12/21/2020 and based on 3 month LIBOR.

Source: Data provided by Thomson Reuters

# Fed Purchases of Treasuries

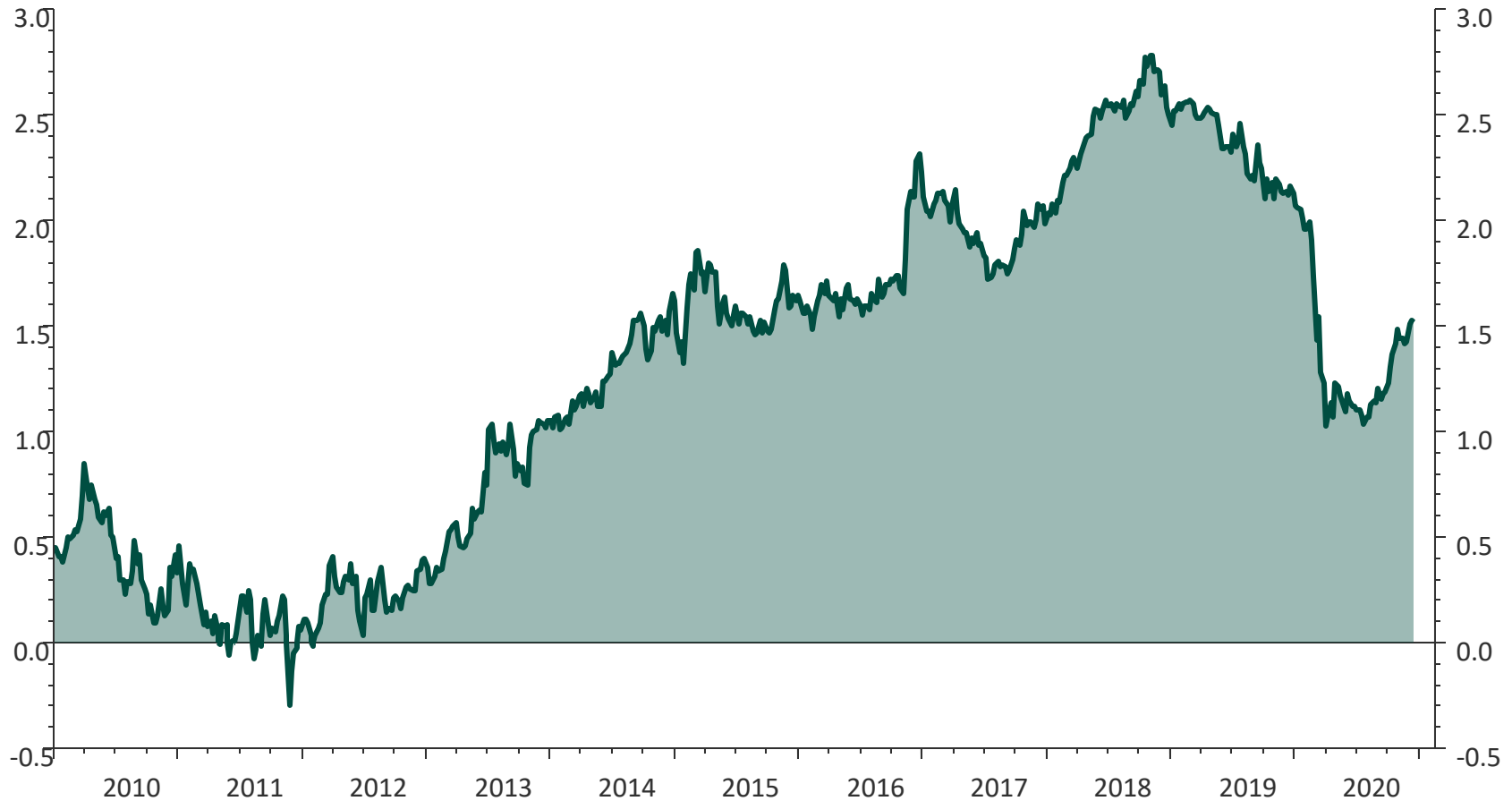
Fed purchases of Treasuries during various QE programs as a share of nominal GDP and public debt outstanding; %



Source: JP Morgan, Patten & Patten

# US Treasury – German Bund Spread

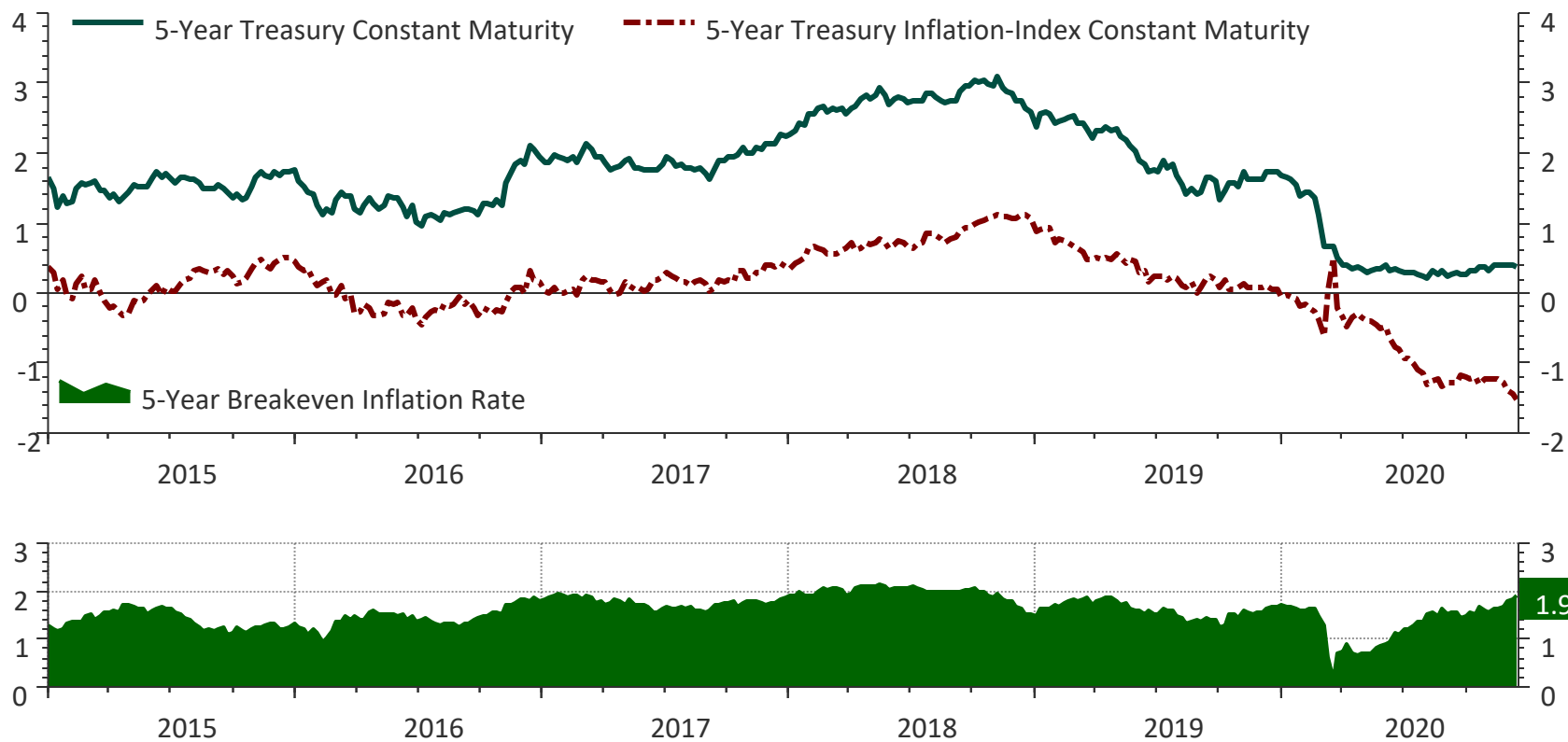
## 10-Year US Treasury-German Bund Spread



Source: Refinitiv Datastream

# Low inflation expectations

## 5-Year Breakeven Inflation Rate

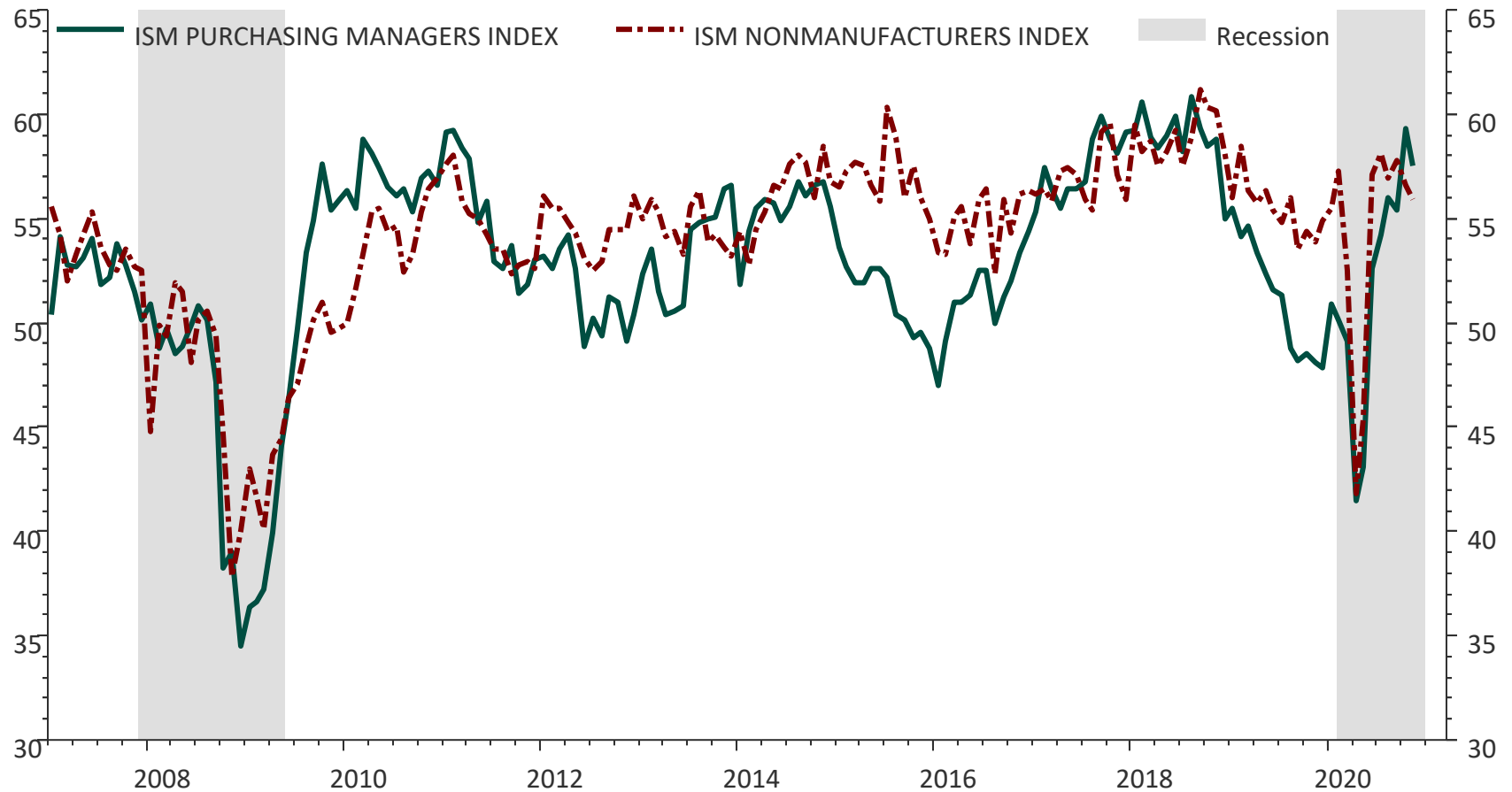


Source: Refinitiv Datastream

# Economic Backdrop

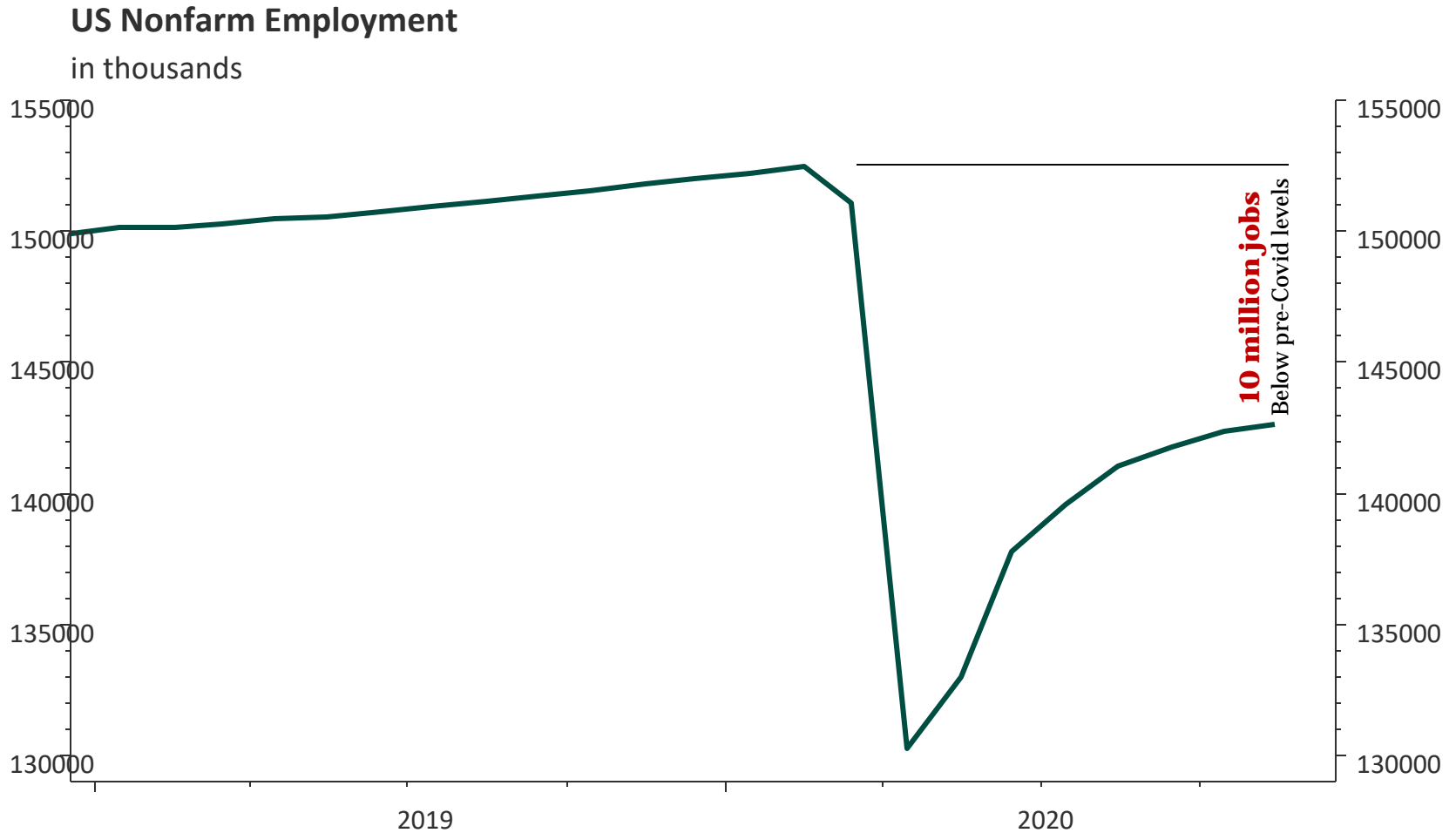
# Manufacturing and Services Sectors Expand

## ISM Manufacturing PMI and Non-Manufacturing NMI



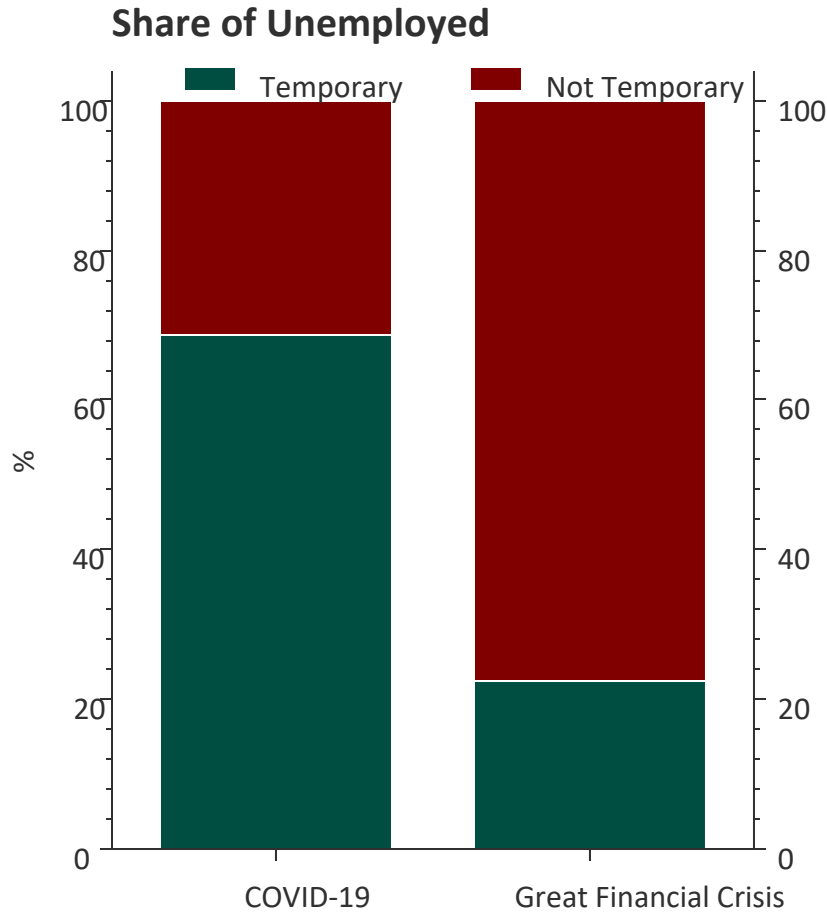
Source: Refinitiv Datastream

# Labor: Significant Slack in Labor Market

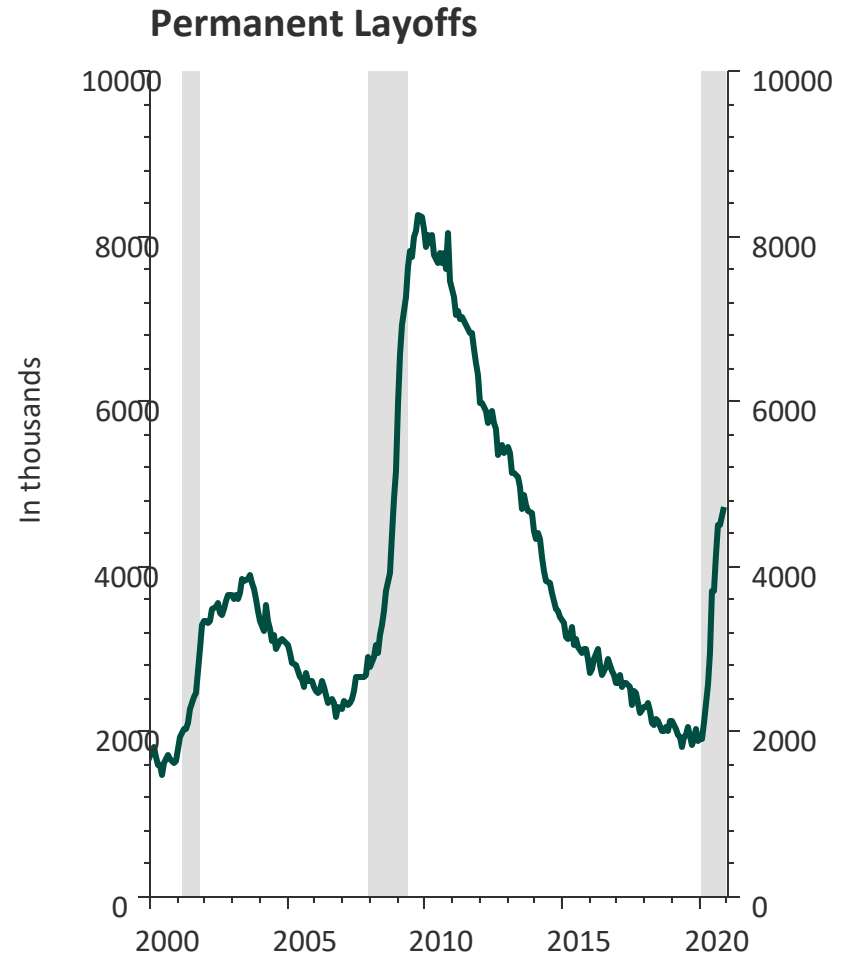


Source: Refinitiv Datastream

# Labor: A majority are temporary but permanent layoffs increasing



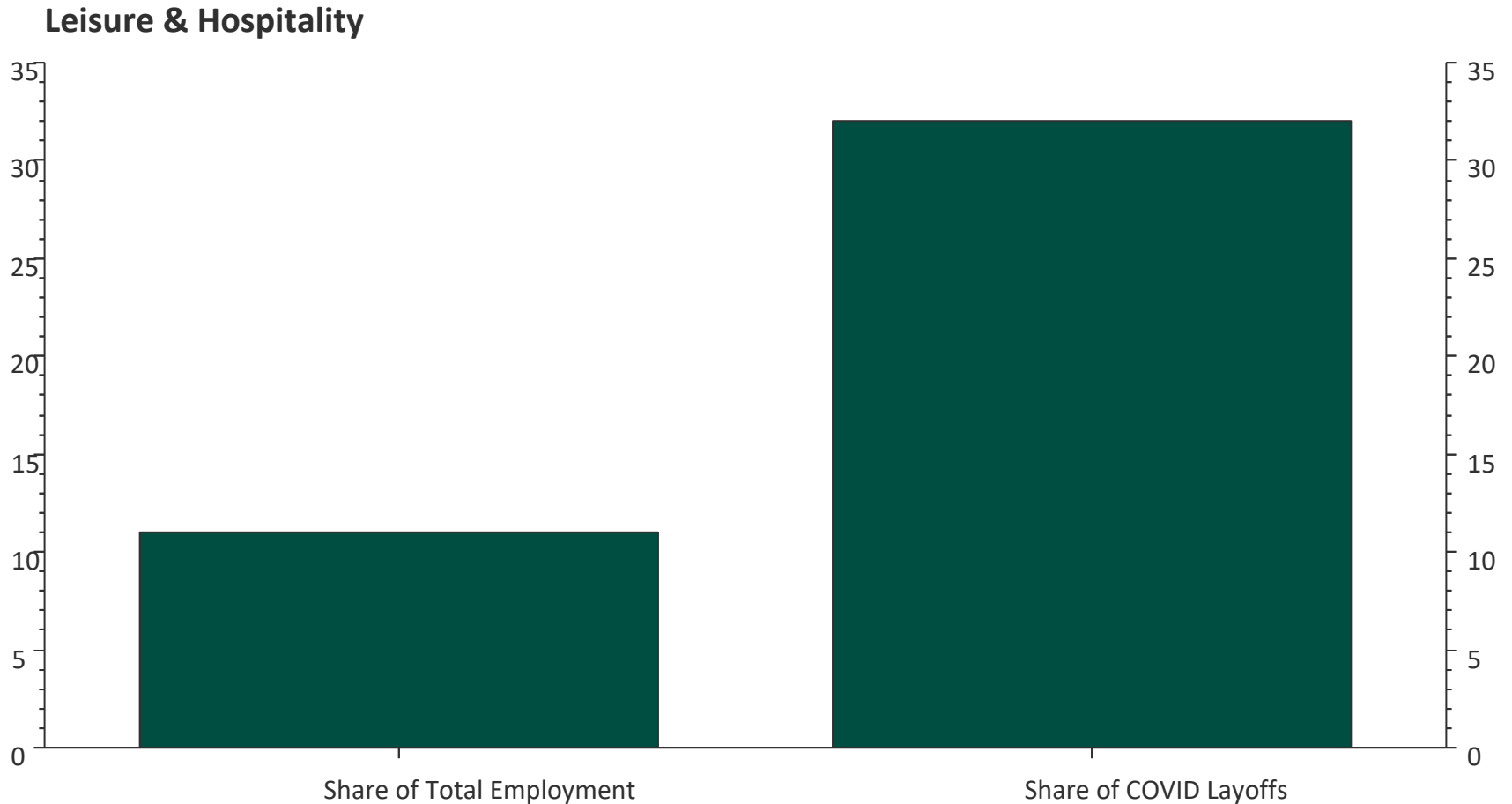
Source: Refinitiv Datastream



Source: Refinitiv Datastream



# Labor: Leisure & Hospitality hit hardest

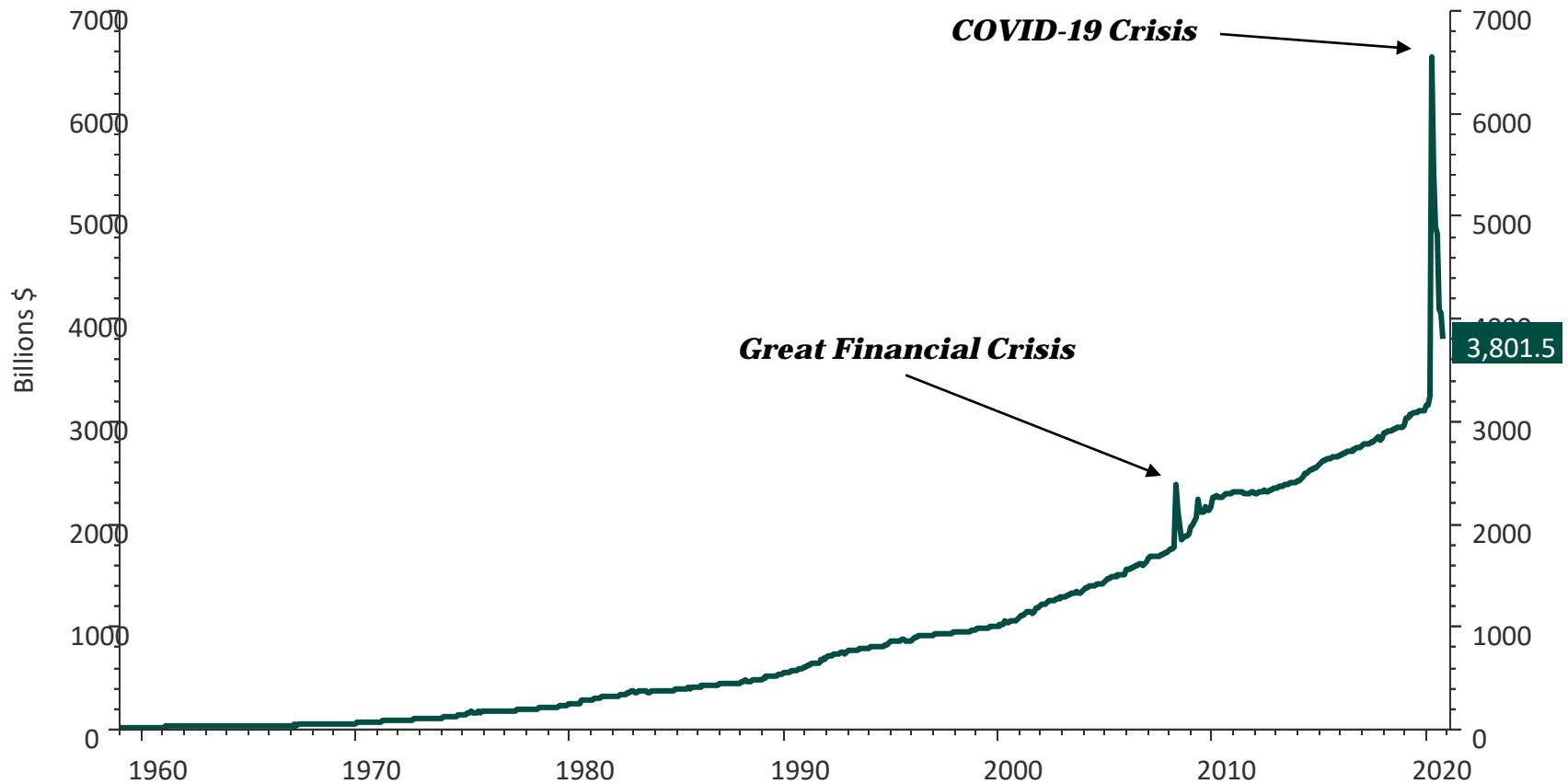


Source: Refinitiv Datastream

# Rapid & Robust Fiscal Response

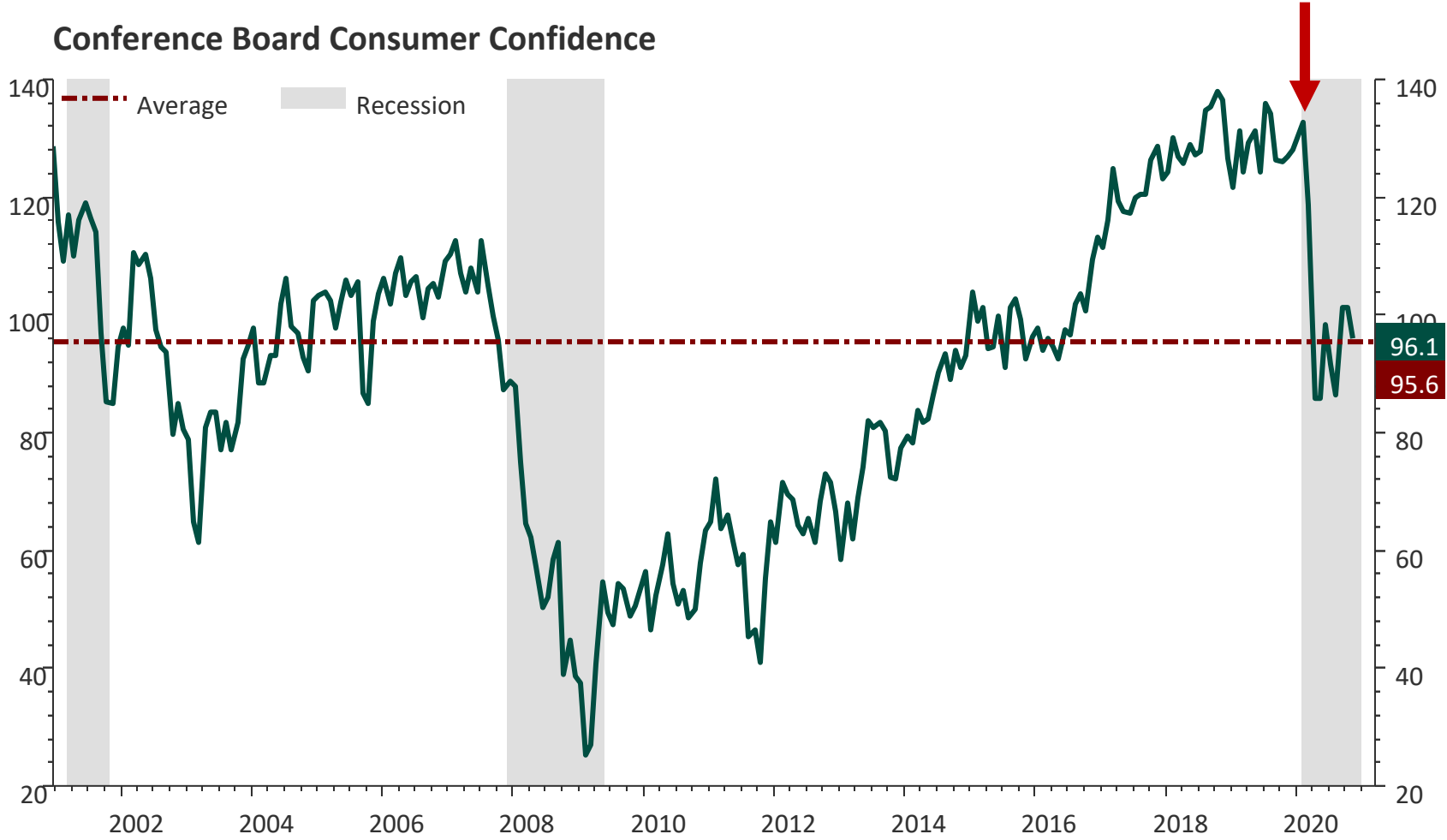
## Government Social Benefits

Annualized Rate, Seasonally Adjusted



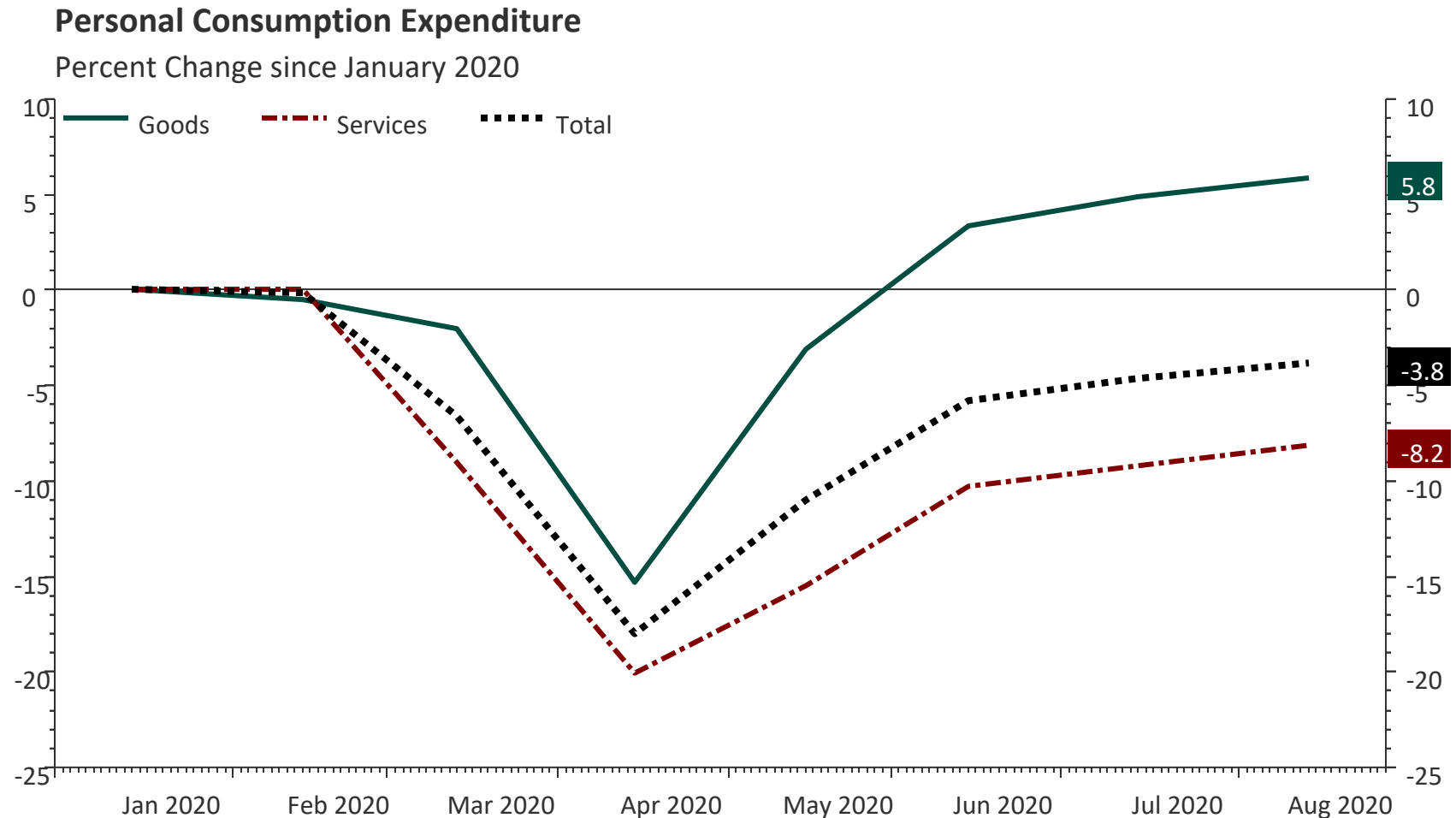
Source: Refinitiv Datastream

# Consumer: Confidence rattled by COVID-19



Source: Refinitiv Datastream

# Consumer: Spending on Goods Quicker to Recover

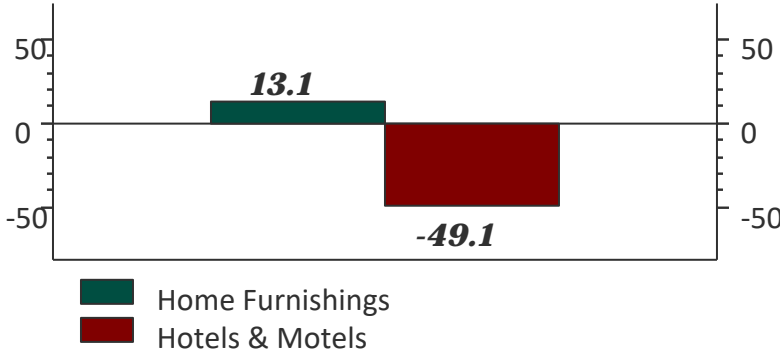
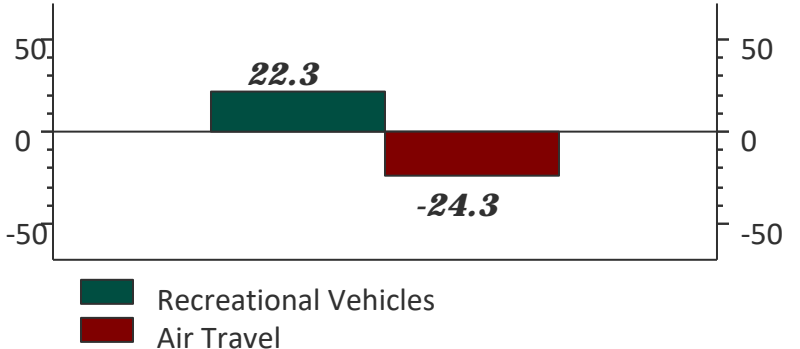
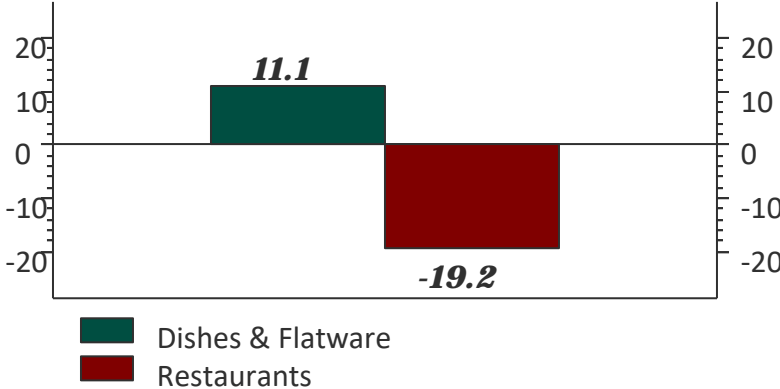
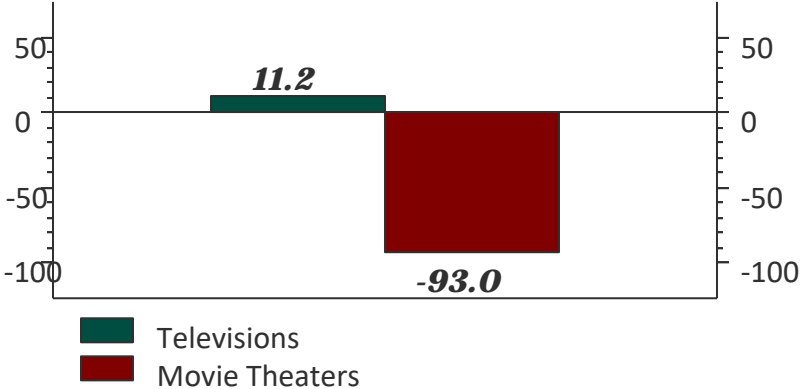


Source: Refinitiv Datastream

# Consumer: Winners & Losers

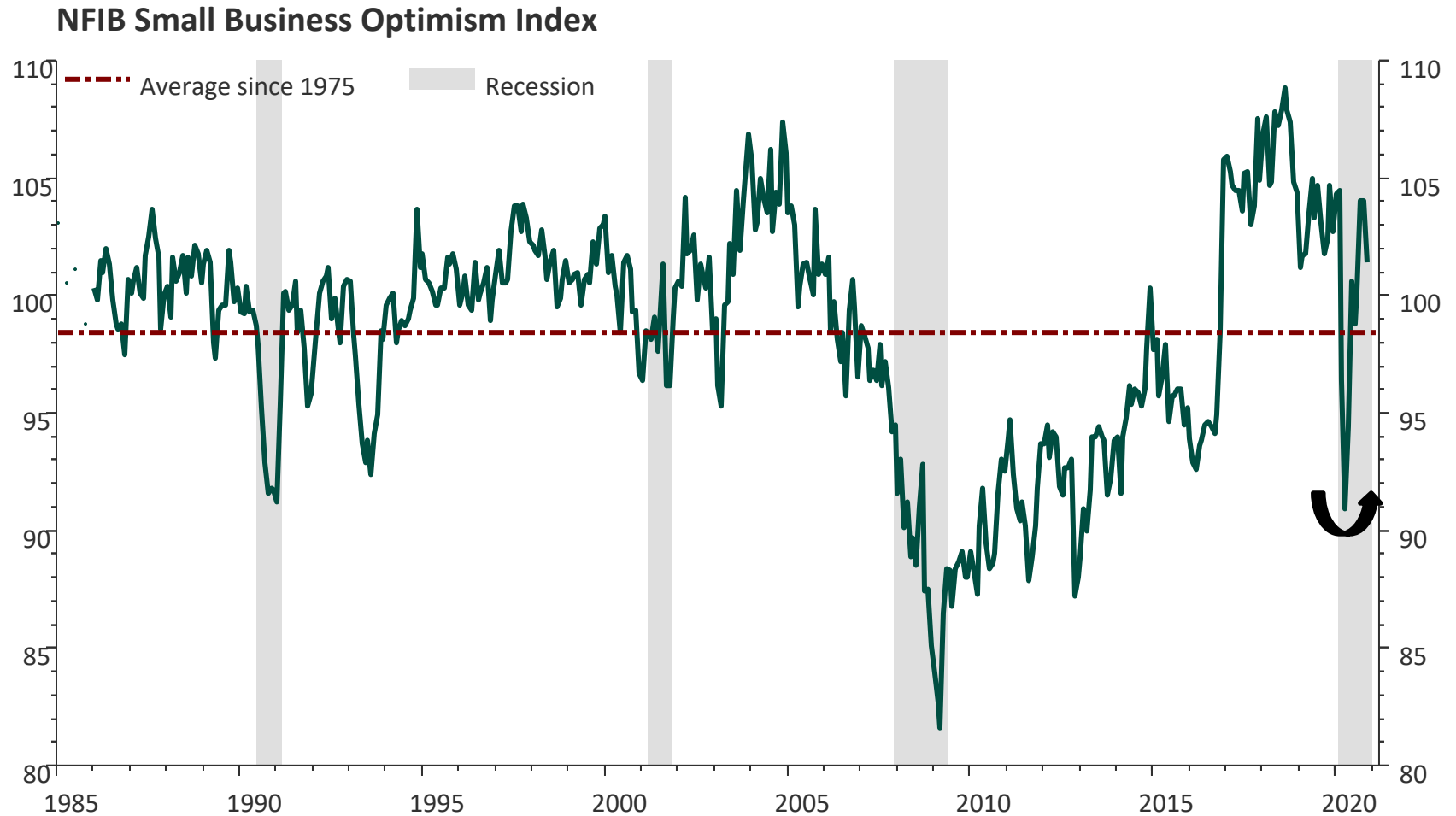
## Personal Consumption Expenditure by Category

% Change January 2020-October 2020



Source: Refinitiv Datastream

# Strong Rebound in Small Business Optimism



Source: Refinitiv Datastream

# President's party is not a good predictor of market performance

## Annualized Total Return on S&P 500 by President

President	Annualized % Return	Beginning	End
Trump	+15.0	11/8/2016	10/19/2020
Obama	+12.3	11/4/2008	11/8/2016
G.W. Bush	-2.6	11/7/2000	11/4/2008
Clinton	+18.9	11/3/1992	11/7/2000
H.W. Bush	+14.9	11/8/1988	11/3/1992
Reagan	+14.8	11/3/1980	11/8/1988
Carter	+11.4	11/1/1976	11/3/1980
Ford	+16.5	8/9/1974	11/1/1976
Nixon	-0.6	11/5/1969	8/9/1974
Johnson	+9.3	11/22/1963	11/5/1969
Kennedy	+11.5	11/7/1960	11/22/1963
Eisenhower	+15.3	11/3/1952	11/7/1960
Truman	+15.0	4/12/1945	11/3/1952
Roosevelt	+9.9	11/7/1932	4/12/1945
Democrat	+12.6		
Republican	+10.5		