The Cobblestone Advisor

Investment Brief

January 2021

COBBLESTONE
CAPITAL ADVISORS

2020: A Year of Dichotomy

Looking back on 2020 could be considered an exercise in contradiction. It was one of the most difficult and extraordinary years in modern history, both economically and, for many, personally. A pandemic swept across the globe, and the resulting lockdowns and social distancing measures triggered a very deep global recession. Divergences materialized across large swaths of the economy and market. Companies linked to the "new" economy—marked by populations largely confined to their homes that socialize, work, shop, and obtain education online—outperformed for much of the year, while cyclical market segments lagged significantly. These divergences created enormous inequalities and accelerated ones already in place, not just in the performance of economic and market segments, but at the individual, socioeconomic level as well.

Yet despite the grim economic and social backdrop, 2020 was ultimately a very strong year for capital markets. US equities not only went on to recover, they went on to post new all-time highs, with the S&P 500 returning +18.4% for the year. International developed and emerging market stocks also delivered positive returns, up a respective +7.8% and +18.3%. Even bonds rose a notable +7.5%. Real assets, however, remained one of the weakest market segments, as prices for real estate and commodities generally failed to recover to the same extent as with other risky assets.

While the stark contrast between the economy and financial markets may come as a surprise, it is important to remember that as we've discussed in the past, the stock market does not equal the economy. Rarely has this disassociation been more evident and on display than in 2020.

The recent disconnect is partly owed to monetary and fiscal policymakers' actions throughout the year in response to the pandemic, the importance of which cannot be overstated. Policymakers moved quickly to inject incredible amounts of stimulus, helping maintain confidence, keep capital flowing freely, and support the real economy. While these actions were necessary to help bridge to the far side of the pandemic, questions about the adequacy of what has been implemented and long-term financial ramifications remain outstanding.

Still today, while markets remain near their all-time highs, economic data remains weak and notably below pre-crisis levels. The rollover of various high-frequency economic indicators such as consumer debit/credit card transactions, US seated diners, and purchase mortgage applications further clouds the outlook. These indicators, though still above the low levels of March, are beginning to suggest a resurgence in headwinds to the economic recovery. This is further evidenced by December's employment report, which showed the first net loss of US jobs in eight months as payrolls declined by 140,000.

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Total Return (%), Ending 12/31/2020				Annualized		
	Qtr	YTD	1 Year	3 Years	5 Years	10 Years
S&P 500 Stock Index	12.14	18.39	18.39	14.16	15.19	13.86
Russell 2000 (Small Cap Stocks)	31.37	19.96	19.96	10.24	13.24	11.19
MSCI EAFE (International Stocks)	16.05	7.82	7.82	4.28	7.44	5.50
MSCI EM (Emerging Markets)	19.70	18.31	18.31	6.17	12.79	3.63
Bloomberg Barclays US Aggregate Bond Index	0.67	7.51	7.51	5.34	4.43	3.84
Dow Jones US Select REIT	12.92	-11.20	-11.20	1.54	2.99	7.55
Consumer Price Index (% Chg over Period)	0.44	1.16	1.16	1.79	1.85	1.74

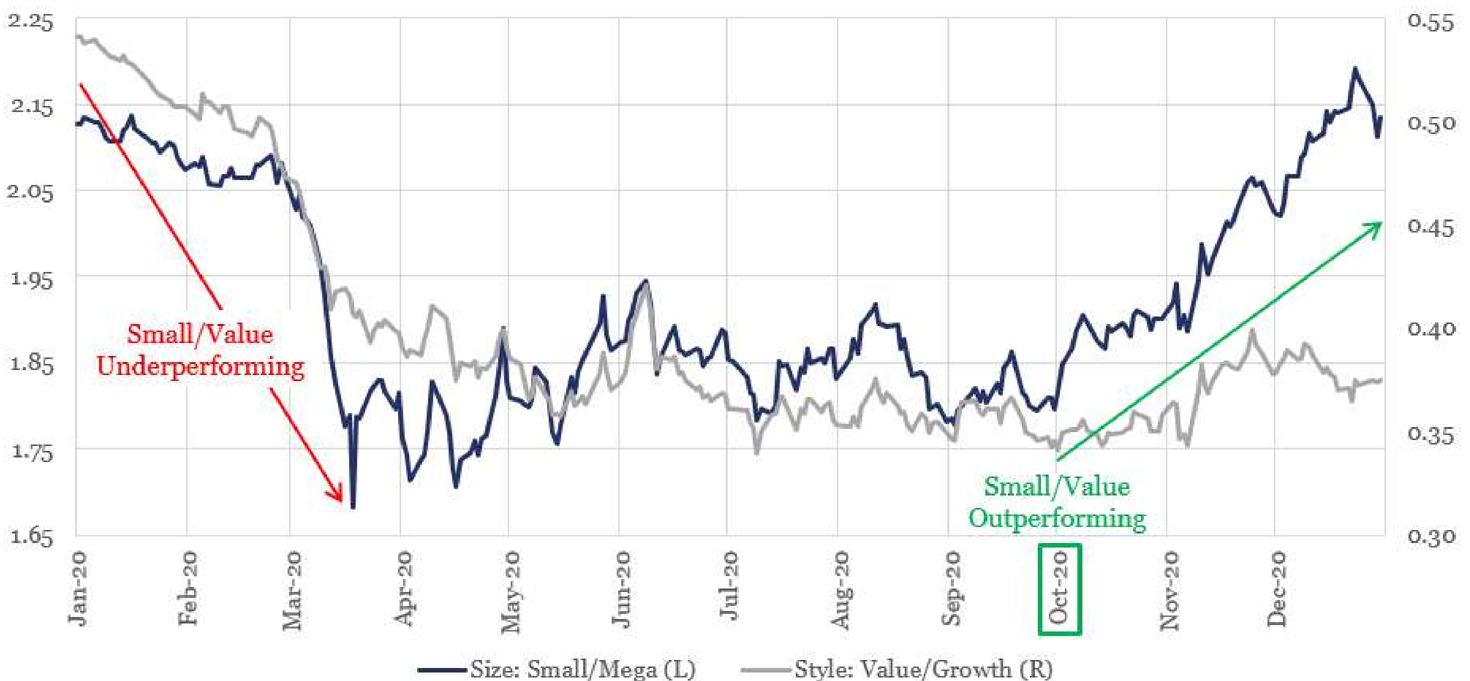
For now, investors seem relatively undaunted. They have begun shifting capital into smaller, domestic-oriented and value/economically sensitive stocks (see chart below), an indication that they expect the cyclical recovery to continue largely unabated. Concurrently, some measures of investor sentiment are signaling euphoria, while other signs of speculation are also materializing. Tesla and Bitcoin, for example, are up a respective +770% and +395% over the trailing year, with the former sporting a forward price-to-earnings ratio of 202 (versus 23 for the S&P 500). Taken together, current market dynamics leave little room for error and suggest an underappreciation of current risks that may lie ahead.

Looking Ahead to What's Next

We now find ourselves at a fork in the road. Will investors' lofty expectations be met, or will developments in the coming months and quarters fall short, setting the stage for a pullback in asset prices?

We see several potential catalysts on the horizon that are likely to determine the answer to this question. First are COVID-19 vaccines, and whether their rollout will be fairly seamless and uptake broad enough to warrant a return to more normal living routines later this year. A return toward normalcy could lead to an economic backdrop supportive of corporate earnings, allowing earnings to grow into what are currently elevated valuations. Fiscal and monetary authorities could continue to step in as and where needed with targeted stimulus, helping keep financial conditions easy. And lastly, with consumer balance sheets bolstered amid elevated savings rates, an easing of mobility restrictions could usher in the release of pent-up demand for goods and services such as clothing, business and leisure travel, restaurants, hotels, and sporting events.

While we will be monitoring these potential catalysts over the next several months, it is plausible that the distribution of vaccines and resulting relaxation of lockdown measures will support a more normalized growth backdrop in 2021. This doesn't mean that the economy or financial markets will continue to recover in a straight line from here. In fact, although we expect market gyrations to remain depressed relative to 2020 levels, we do anticipate some bouts of volatility to materialize in the months ahead. If there are any lessons investors should carry over from 2020, one is that they would be well-served to remain invested according to their long-term asset allocation plan. Doing so can help smooth out short-term market swings as investors navigate an unpredictable market environment.



Source: S&P Dow Jones; FTSE Russell; Bloomberg.
Size: Small/Mega represented by Russell 2000/Russell Top 200. Style: Value/Growth represented by S&P 500 Pure Value/S&P 500 Pure Growth.

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