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Fourth Quarter Outlook

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Vaccine Rollout Key to First Half Growth – Potential New One Dose Vaccine

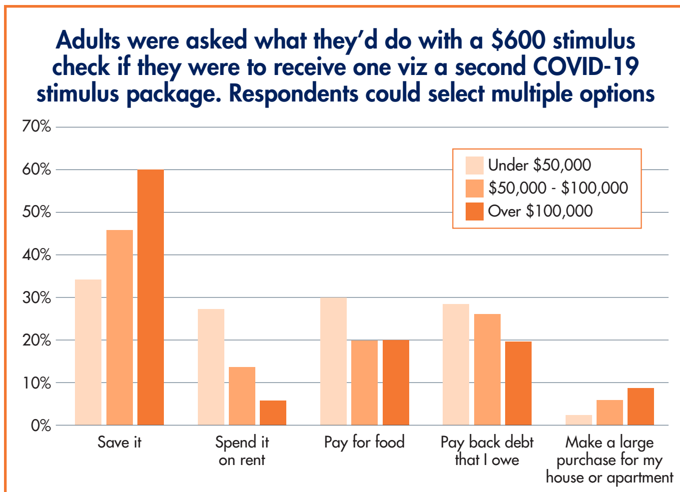
The speed of reaching broad-based vaccinations will likely determine how fast the economy snaps back. Post-vaccine activity will initially depend importantly on economic momentum pre-vaccine. Funding for the states in the last COVID package plus additional funding in the new Biden package should accelerate the current disappointing vaccine rollout. Additionally, a new single dose vaccine coming off trials in the next month or so will provide a further shot in the arm for the rollouts with its simpler logistical requirements.

Third COVID Rescue Package Size and Speed Depends on Bi-Partisan Support

Near-term, President Biden will propose a $1.9 trillion relief package (nearly 10% of GDP) covering a broad spectrum of programs. The proposed rescue package will extend supplemental unemployment coverage to the end of September, increase individual checks from $600 to $2000, broaden funding to state and local governments by $350 billion, and accelerate vaccine rollouts and testing. How fast the Congressional legislative process works depends on whether faster regular order (which requires 60 votes) in the Senate or more complex budget reconciliation process applies. In addition, the delays could result from the Senate impeachment trial. After the Obama Administration took office in 2009 following the Great Financial Crisis, President Obama signed a stimulus package on February 17—one month after taking office. At that time, Democrats controlled the Senate with 60 votes—not the case today. The Biden proposals total fifty percent larger than the Obama stimulus—inflation adjusted. With the current Senate makeup, regular order will require bi-partisan support to achieve 60 votes needed for passage. With their complexity, these proposals might be broken up into separate legislation so that some could be fast-tracked with bi-partisan support.

Many Consumers Will Save Their COVID Checks – Savings Initially Could Help Power the Snapback

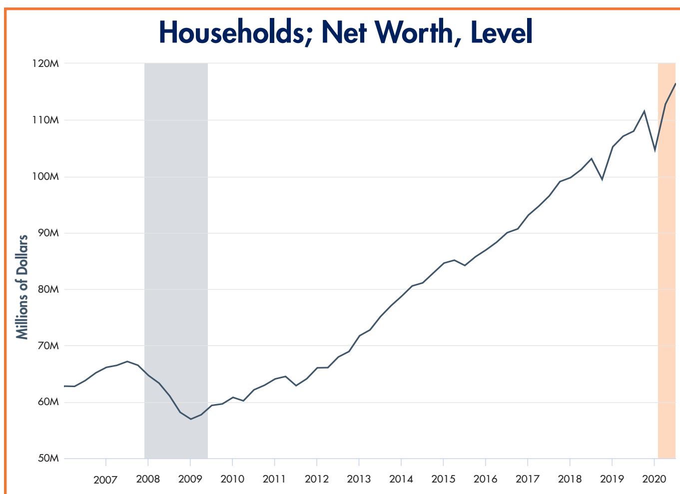
Many consumers will save a large proportion of their $2,000 checks. High levels of savings, reflect, among other factors, both limited availability of and health concerns using consumer services such as restaurants, travel, and leisure activities (see Figure 1). Record consumer savings and vaccinations will likely contribute to an economic snapback sometime in the second half as consumer services open up. With increased savings, Robinhood's merry men (80% are men) will likely use some part of their savings to pursue increased option and stock trading. Above normal option trading levels increases volatility which becomes noticeable during market downturns.



(FIGURE 1) Poll conducted Dec. 18-20, 2020, among 2,200 U.S. adults, with margins of error ranging from +/-3% to +/-6%.

Household Balance Sheets Show Strong Financial Condition

Early lockdowns and continuing limited services led consumers either to spend on goodies or save—and save they did. Households both increased their personal savings rate and improved their balance sheets (see Figure 2). With vaccines distributed by mid-year, the resulting strong consumer balance sheets should particularly benefit a broad group of consumer service sectors that nearly disappeared early in the pandemic.



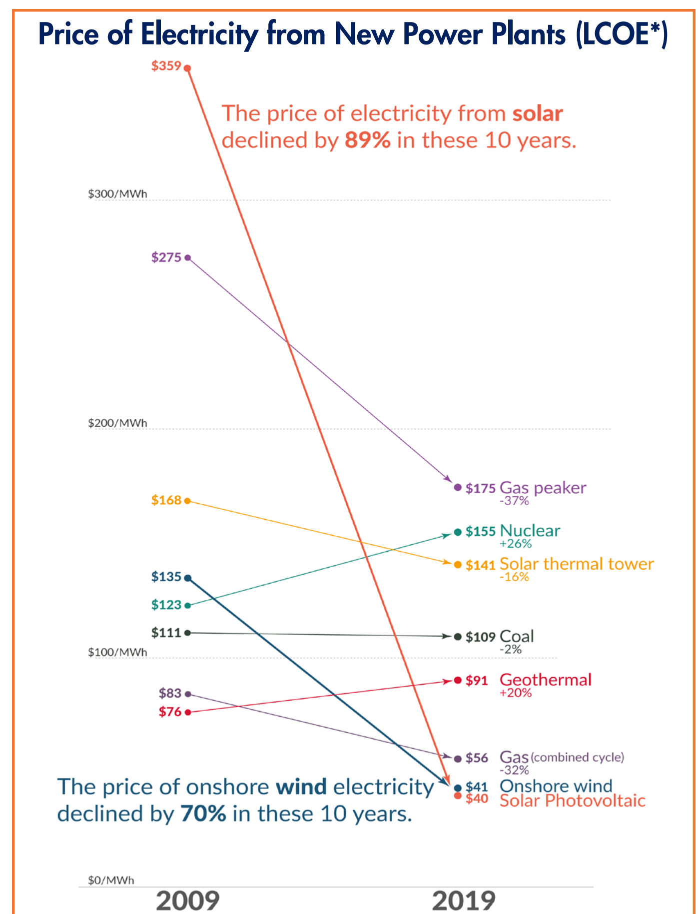
(FIGURE 2) Source: Board of Governors of the Federal Reserve System (US)

The Fed Out of Ammo – Fiscal Policies Step-Up Under the New Administration

As both a Keynesian and former Fed Chair, Treasury Secretary-designate Janet Yellen understands the need for increased fiscal spending to offset the limits monetary policies currently face. Therefore, the Biden administration will likely look to longer-term fiscal spending programs over the coming decade to meet these specific post-COVID-19 needs. Such fiscal stimulus could include, among others, new infrastructure and green energy spending programs. These and other programs will lead to major increases in capital spending by private industry.

Economics of Renewable Energy Generation More Than Regulations Speed the Shift

After quickly reinstating stricter environmental regulations, the Biden administration will likely propose bringing renewable electric generation up to an estimated 80% of power generation by 2035. That would compare to 17% today. Many observers predict that realistically such goals will more likely be reached at a later date — 2050. At the same time, the economics of alternative energy generation, as much as new legislation and regulations, will accelerate this shift. Figure 3 shows a sharp decline in total renewable

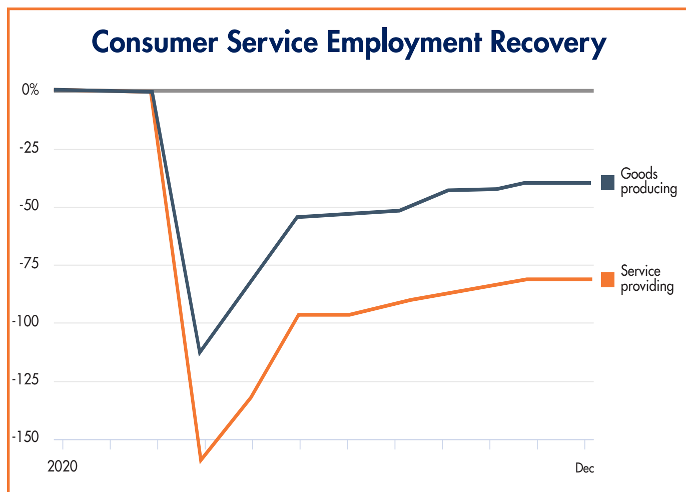


(FIGURE 3) Data: Lazard Levelized Cost of Energy Analysis, Version 13.0
*LCOE – Levelized Costs of Energy – Power Plant Capital and Operating costs

energy costs compared to traditional sources. Currently, states control the mandate for alternative energy development. Speeding uniform change on a national basis will require Congress to enact Federal clean electric standards. With divergent state interests, Congress, so far, has failed to approve such Federal standards.

Long-Term Inflation Increase Likely Responds to Both Lower Labor Market Slack and Recovery of Service Sector

Recently, 10-year yields increased from 0.93% on January 4th to fractionally over 1.1% currently. Rising long-term interest rates reflect concerns that inflationary pressures will respond to increased fiscal spending and the economic snapback. In our view, the economic snapback will quickly bring stronger pricing as consumers find more ways to spend their accumulated savings—particularly for consumer services. Long-term inflation will likely respond to how fast labor market slack falls resulting in increased wages. Reducing that slack will depend on how fast depressed consumer service employment recovers (see Figure 4).

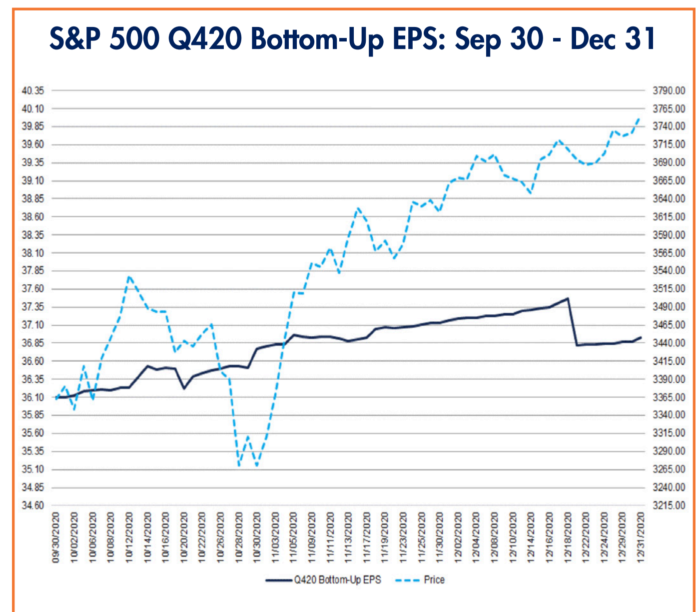


(FIGURE 4) Note: Seasonally adjusted
Source: ADP

Investment Conclusions

2021 Equity Market Performance Dependent on EPS Growth Not Multiple Expansion

Successful fourth quarter vaccine trials gave investors sufficient confidence to look for an economic snapback beginning in the second half of 2021. Their confidence led to fourth quarter 2020 equity markets growth far outperforming the growth of corporate earnings per share (see Figure 5). However hopeful, vaccine trials will not



(FIGURE 5) Source: FactSet

prove sufficient to judge the potential second-half economic snapback. Instead judging the speed of vaccine rollouts will likely prove critical to the timing and which sectors will benefit from the snapback. That snapback will prove key to producing sufficient earnings growth to reduce dependence on multiple expansion for equity market performance. This will become even more important with potentially rising interest rates.

Fixed Income – Shorter-Duration

The cyclical snapback will likely lead to rising interest rates in reaction to possible signs of gradually increasing inflation. Having federalized fixed income markets, the Fed may still hold off attempting to moderate the yield curve's upward tilt unless unexpected pressures result. Nonetheless, with that outlook, investors should stick with shorter-duration fixed income investments. This will avoid the price risk longer duration debt faces from rising interest rates.

Pandemic Disruption – Democratic Control – Opportunity for Active Managers

The disruptive nature of the pandemic will force many business sectors and companies to reposition themselves to meet this change. Adding a rollout of new fiscal programs from democratic-controlled Washington creates opportunities for active managers to differentiate their investment selection skills. These forces may lead investors to selectively consider making greater use of actively managed funds.

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The S&P 500 Index is a market-capitalization-weighted index of the 500 largest U.S. publicly traded companies by market value, the index is widely regarded as the best single gauge of large-cap U.S. equities.

The Russell 1000 Value Index measures the performance of those companies in the Russell 1000 Index with lower price-to-book ratios and lower forecasted growth values. The Index is calculated on a total return basis with dividends reinvested and is not assessed a management fee. It is not possible to invest directly in an index.

The Russell 2000 index is an index measuring the performance of approximately 2,000 small-cap companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small-cap stocks in the United States.

The Russell 2500 Index is a broad index, featuring 2,500 stocks that cover the small- and mid-cap market capitalizations. The Russell 2500 is a market cap-weighted index that includes the smallest 2,500 companies covered in the Russell 3000 universe of United States-based listed equities.

The MSCI World Index captures large and mid-cap representation across 23 Developed Markets (D.M.) countries. With 1,633 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI EAFE Index is an equity index which captures large and mid-cap representation across 21 Developed Markets countries around the world, excluding the U.S. and Canada. With 920 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country.

The MSCI Emerging Markets Index captures large and mid-cap representation across 24 Emerging Markets (E.M.) countries. With 1,125 constituents, the index covers approximately 85% of the free float-adjusted market capitalization in each country. An index is a portfolio of specific securities, the performance of which is often used as a benchmark in judging the relative performance to certain asset classes. Indexes are unmanaged portfolios and investors cannot invest directly in an index. An index does not charge management fees or brokerage expenses, and no such fees or expenses were deducted from the performance shown. Past performance is not a guarantee of future results.

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