BUCKHORN
INVESTMENT ADVISORS

Fourth Quarter Market Review and Comment
January 2021

Updated Market Performance

Returns	4th Quarter 2020	One Year	Annualized 3 Year	Annualized 5 Year	Annualized 10 Year
S&P 500	**12.15%**	**18.40%**	**14.18%**	**15.22%**	**13.88%**
DJIA	**10.73%**	**9.72%**	**9.90%**	**14.65%**	**12.97%**

Performance: October continued the decline from the end of September falling -2.66%. November finished strong ending the month with gains following the election breaking the negative trend after 2 consecutive months of losses. December added to the gains from November posting a return of 3.84%, leaving us with another robust quarter of returns.

After the 3rd quarter posted a gain of 8.93%, the 4th quarter continued the advance rising 12.15%. The Dow Jones Industrial Average (DJIA) trailed the SP500, posting 10.73% gain over the same period. For the previous twelve months the SP500 has returned 18.40%, handily outpacing the DJIA which returned 9.72% over the same period. The annualized three-year returns are mixed with the SP500 being less than the one-year returns posting 14.18% and the DJIA being more than the one-year returns increasing 9.90%. Over the last five years the annualized returns are running well above historical norms (around 10%), with the SP500 returning 15.22% and the DJIA posting 14.65%. The ten-year annualized numbers are also running above long-term averages (around 10.00%); the S&P500 posted 13.88% vs the DJIA which turned in 12.97%.

Breaking down the returns for the Q4 2020, we note that there were five outperforming sectors and six underperformers. **The best sectors were Energy (25.78%), Financials (22.52%) and Industrials (15.19%). The losers during the quarter were Real Estate (4.09%), Consumer Staples (5.64%) and Utilities (5.70%).** The clear winners the last twelve months were Technology (42.21%), Consumer Discretionary (32.07%) and Communication Services (22.18%). Bringing up the rear were Energy (-37.31%), Real Estate (-5.17%) and Financials (-4.10%).

Economy: Growth in the economy will continue to trudge forward. Once the economy is fully operational and threats from the virus have subsided either due to successful distribution of vaccines, continued social distancing, or the development of herd immunity. The economic recovery is going to be path dependent on how long the economy is restricted, how well the virus is contained, and if the transmission can be minimized. The longer the economy remains restricted the more economic damage we will experience extending the length of the recovery. The economy will receive more fiscal relief with a new fiscal stimulus package in the works now. The new fiscal stimulus package will continue to help and support the economy as we work through the process of reopening the economy.

The third estimate of 3rd quarter Gross Domestic Product (GDP) is 33.4% according to the report released at the end of December by the Bureau of Economic Analysis (BEA). The latest estimate suggests that overall economic growth in the 3rd quarter increased 33.4% from the 2nd quarter 2020 and was revised upward .03% from the second estimate. GDP for 2019 came in at 2.3% compared to 2.9% in 2018 and 2.2% in 2017. Currently the New York Fed Staff Nowcast (Forecast of U.S. GDP Growth) has forecasted 2020 Q4 GDP growth at 2.5% and 2021 Q1 GDP growth at positive 6.2%. By comparison, China says their GDP increased at 2.6% in the 4th quarter of 2020. Rebounding from 1st quarter 2020 contraction of -9.8%. China became the first major economy to report growth following the coronavirus pandemic. China's 2019 GDP was 6.1%, 6.6% in 2018 and 6.8% in 2017. Growth rates for the European Union (EU) and the Euro Area were 11.5% and 12.5% respectively in the 3rd quarter 2020. For 2019, GDP rose 1.5% for the EU and 1.2% for the Euro Area. This is down from the 1.9% growth achieved by the EU and the 1.8% achieved by the Euro Area in 2017. GDP Growth forecasts for the end of the 4th QTR 2020 are 7.2% for the EU and 7.5% for the Euro Area.

Unemployment is continuing to trend down but is still well above historical norms (~5.77%). Once all the restrictions on the economy subside the unemployment rate will decrease back to historical averages. According to the Bureau of Labor Statistics, December unemployment remained unchanged at 6.7% from November. Unemployment for 2020 came in at 8.11% and was 3.67% in 2019. The number of unemployed remained unchanged at 10.7 million for December. Although both measures are much lower than their April highs, they are nearly twice their pre-pandemic levels in February of 3.5% and 5.7 million, respectively. The labor force participation rate was 61.5% in December unchanged from November and is 1.8% lower than in February.

Inflation increased 1.23% in 2020, marking the lowest inflation since 2015. Inflation continues to run below historical averages. After averaging ~1.23% in the 3rd quarter 2020, inflation as measured by the Consumer Price Index (CPI) increased to an average of 1.27% in the 4th quarter 2020. The average rate of inflation for 2019 was 1.82% and continues to be subdued by historical standards (~3.07% over last 30 years). The food at home index increased 3.9% over the last 12 months.

Consumption is an important driver of the economy as it represented 68.0% of 3rd quarter 2020 nominal GDP. The U.S. Census Bureau announced in January that retail sales for December 2020 were down -0.7% from November and were up 2.9% above December 2019. Non-store retailers were up 19.2% from December 2019, while food service and drinking places were down 21.2% from last year.

Manufacturing economy grew in December. Economic activity in the **manufacturing sector** expanded for the month of December, with the overall economy notching an eighth consecutive month of growth after contracting for one month (April). The Purchasing Managers Index (PMI®) registered 60.7, an increase of 3.2 from November's reading of 57.5. The PMI signaled a continued rebuilding of economic activity in December, with all subindices remaining in strong growth territory. All six of the manufacturing industries fabricated metal products, computer & electronic products, transportation equipment, chemical products, petroleum & coal products, and food beverage & tobacco products expanded. The New Orders and Production indices continued to expand strongly. The Supplier Deliveries Index continued to reflect suppliers' difficulties in maintaining delivery rates, due to factory labor-safety issues and transportation challenges. The overall economy grew for the 8th consecutive month, according to the nation's supply executives in the latest Manufacturing ISM® *Report on Business®*. Based on historical relationships between PMI and GDP, a PMI of 60.7 corresponds to a 5.2% increase in real gross domestic profit (GDP) on an annualized basis.

Home prices continue to increase at a moderate pace. According to the S&P Case-Shiller Home Price Indices home prices rose in October with the S&P CoreLogic Case-Shiller National Home Price Index rising 8.4% over the last 12 months. Phoenix, Seattle, and San Diego had the largest year over year increases with 12.7% for Phoenix followed by 11.7% for Seattle and 11.6% for San Diego. According to the National Association of Realtors, the year over year change in existing home sales was 37.3% in November for Single family homes between $250,000-$500,000 and housing supply continued to remain tight in November with 2.3 months of supply.

Markets: The markets will continue to be largely driven by the Covid-19 virus, when restrictions will be lifted, and the economy returns to normal. 2020 was a wild and crazy market with the SP500 entering a bear market (February 19th – March 23rd, down ~33.93%) and exiting and entering a new bull market (March 23rd low – Still going, up 67.88%). More stimulus will buy the economy more time while we wait for therapeutics and vaccines to be manufactured and distributed. At this time, the market is expecting more stimulus, so if we do not receive more fiscal stimulus the market will temporarily sell off.

- **Covid-19 Virus: The market reacted fast and furious as it priced in a worst-case scenario. We have since rebounded and ended the year at all-time highs on the SP500. The SP500 posted 33 new closing highs in 2020. This is only the eighth time since 1928 that the year has ended at an all time high.** The immediate impact was felt quick with the closing of most of the global economy. As we continue to work to get on the other side of the virus and the economy returns to normal capacity equity markets should benefit from ultra-low interest rates and the tail wind of all the economic stimulus we have and will receive. The old acronym TINA (There is no alternative) will come back to fashion.
- **Earnings growth for the SP500 is expected to decline -6.8% for the 4th quarter 2020. If the actual decline for the quarter is -6.8%, it will mark the fourth largest year-over-year decline in earnings reported by the index since Q3 2009.** According to FACTSET, of the SP500 companies that have reported earnings as of 15 January (Approximately 26), 96% reported earnings above the mean estimate and 85% have reported sales above the mean estimate. Looking at future quarters, analysts predict a return to growth in the first quarter 2021 of 16.8%.
- **After the continued rally from the low's stocks look rich. *It looks like any meaningful earnings growth is already priced into the market.*** The current 12-month forward Price Earnings (PE) multiple on stocks is 22.3. The long term (20 Year Average) PE for stocks is 15.4, so we do not see a lot of room for valuations to move higher without growth. Lower interest rates allow for higher multiples, so we could maintain these higher levels of P/E's until interest rates return to meaningful levels.
- **Interest Rates are still near Zero again and the Fed is still waiting in the shadows ready to do whatever it takes.** The Federal Reserve dropped short term rates 1.50% in March and launched multiple quantitative easing programs. Rates have since been left unchanged at a range between 0.0-.25%. The Fed continues to closely monitor developments and is prepared to adjust plans as appropriate. The Fed has said that it expects to keep its benchmark short-term interest rate near zero through at least 2023.
- **More fiscal stimulus.** After a few stimulus packages in 2020, we begin 2021 with a new President and a proposed stimulus package of ~1.9 trillion. The stimulus will most likely end up being less than proposed. Any meaningful amount of stimulus will help prop up the economy while we move towards reopening and back to full economic activity.

Forecast:

We continue to think the biggest threat to the stock market is the uncertainty presented by the Covid-19 virus and the uncertainty of how and when the economy will return to business as usual. We think the SP500 will end the 1st Quarter between 3,900 and 4,000. At this juncture, we venture a guess that stocks will end up somewhere between 8% and 10% for the year.

For the next six to twelve months, the Federal Funds rate should remain at its current range of 0%-0.25%. **The 10-year Treasury which is currently priced at ~1.12% should remain in a range between 1.00%-1.25% through the end of the 1st quarter.**

As always, we appreciate your continuing confidence in our firm. Please let us know if you have questions.

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