Matt's Market Update

IN THIS REPORT

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Market Review

Global equity markets followed up their strong Q3 gains with even more powerful rallies in Q4. The growth theme led by technology companies finished the year with strong momentum as the NASDAQ gained +15.63% in Q4 (topping the +11.24% gain in Q3). Some have dubbed 2020 the "everything rally" and this was certainly true in Q4 as most of the major market averages logged double-digit gains. What really stood out though was the breadth of the rally to finish off an incredible year for markets. It wasn't just about Large-Cap Growth in Q4 as it was for the first three quarters of 2020. Q4 witnessed market-leading gains for small-cap stocks as the Russell 2000 surged higher by +31.37%. Foreign stock markets, left for dead most of the year, roared back in Q4 with a gain of +17.01% for the MSCI ACWI ex USA index. Not to be left out, the S&P 500 (+12.15%) and Dow Jones Industrials (+10.73%) registered solid gains as well.

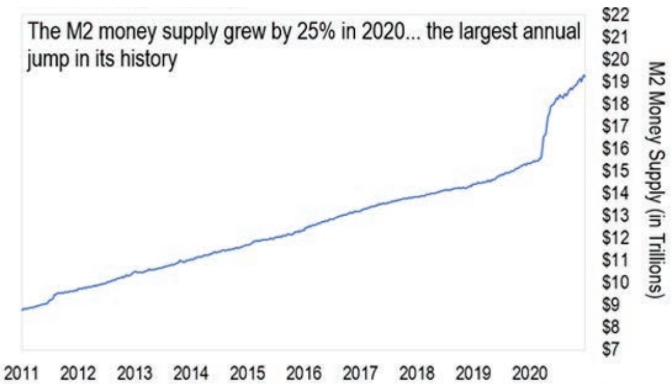
As many have pointed out before, the word "unprecedented" was perhaps the most over-used, yet appropriate word to describe the events of 2020. It certainly applies well to global equity market reactions to the pandemic. 2020 was characterized by the worst global health crisis in over 100 years, the worst global economic depression since the 1930s, a summer of civil unrest across major American cities and over 75 million people in the U.S. filing for unemployment benefits. How then to explain the high returns and raging optimism in the equity markets at year-end? The answer is the trillions of dollars the Federal Reserve and other global central banks have pumped into the economy since the crisis began and the expectation that more is coming in 2021.

Two charts on the next page really highlight what drove markets higher in 2020. The First chart shows the 25% increase for 2020 in the U.S. M2 money supply. M2 is a broad measure of money defined as the amount of bills and coins in circulation, plus the dollars that exist in electronic form in bank accounts and money market mutual funds. As the Fed flooded the economy with stimulus in the form of Paycheck Protection Programs, pandemic relief checks and numerous other "stimulus" measures, capital naturally found its way into the global equity markets. The second chart shows how this playbook of throwing massive amounts of capital at the Covid pandemic was global in nature. The stimulus created as a percentage of GDP in 2020 in response to Covid dwarfs the amount spent in 2008 to combat the global financial crisis. Most assume at this point that the Fed has done all it can do to support equities and that the U.S government (through expanded fiscal policy) must now take the lead in providing support. However, what does this say about global equity markets that are in near perpetual need of intervention and stimulus to keep prices elevated?

What is the Market Expecting?

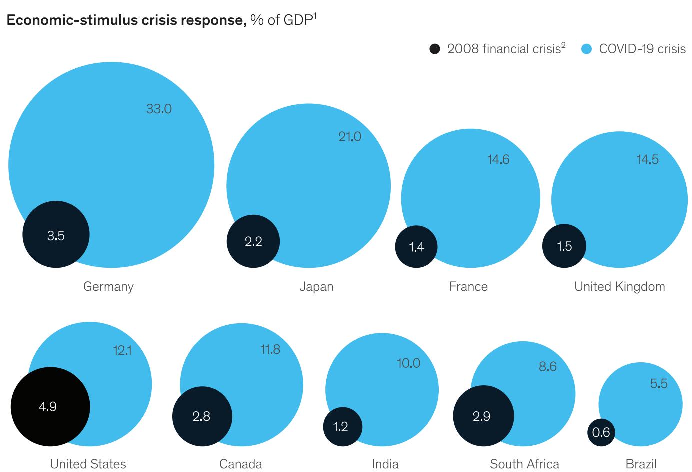
With global equity markets trading at all-time highs in terms of price and valuations at year-end, expectations for good news are running high. In particular, three narratives seem to be dominating the financial press as the 2021 predictions come in.

M2 MONEY SUPPLY



Source: Bloomberg

COVID-19 STIMULUS VS. 2008 FINANCIAL CRISIS STIUMULUS



Source: McKinsey & Company

First, the vaccine roll out will be mostly completed by mid-summer, thus unleashing an economic boom in the second half of the year. Second, massive fiscal stimulus from the government is coming soon and this fresh injection of capital will power economic growth. Finally, the first two items should inevitably lead to significantly higher interest rates and inflation. How realistic are these current assumptions?

Let's briefly look at each item with some points to consider. As to the vaccine roll out, early indications are that it's proceeding slower than expected. Not surprisingly, progress varies greatly by state. Meanwhile, case counts and hospitalization rates haven't yet peaked. While we certainly are optimistic on the ultimate vaccine distribution, the mid-summer goal seems optimistic. Finally, on this point, what happens post-vaccine? Will proof of vaccination be required for air travel or simply to return to work?

These future details may certainly slow the immediate rebound in economic growth that the market seems to be assuming. Regarding stimulus, it's certainly on the way, but the questions are really on the ultimate amounts and timing. The democrat majority is by the slimmest of margins so the flow of new spending initiatives may not be as bountiful or quick as the stock market is expecting. Finally on interest rates and inflation, put us in the skeptical camp. The reality is we already have inflation in asset prices, commodities, residential housing and a variety of other services. What the market is looking for is higher inflation as measured by the Consumer Price Index (CPI). The Fed will watch this measure in order to determine if inflation is getting out of control. The Fed has said on multiple occasions that they're willing to let inflation "run hot" in order to achieve real economic growth. Unfortunately, the structural issues affecting the economy will remain with us even in a post-Covid world. These factors include aging demographics, massive debt levels and the impact of technology on lowering prices. Finally, there is an estimated 7 to 10 million people out of work currently. It will take time for these jobs to come back and unfortunately, many likely won't. This too argues for less inflation from a CPI perspective. Thus, interest rates in our opinion are likely to be stuck in this lower range for the foreseeable future.

Digitization and You

At Sentinel Benefits, we are always thinking about the future. Our investment team believes that the future will look quite different from the present. 'Thinking outside the box' of traditional asset classes and mixes has become a necessity since society, as the saying goes, jumped the shark from analog to digital a while ago. Nearly everything in our lives has become digitized. Merriam-Webster's definition of 'digitize' is straight-forward, "to convert something (such as data or an image) into digital form". We would add assets to that mix too. In that case, we must ask ourselves what hasn't already become digitized?

The depth of digital accessibility has evolved to its current state in a matter of just four decades, starting with the introduction of the first personal computer by IBM. While not the birth of the computer itself, it appears to have been the first time we could secure an individual-based platform to use in our own homes. Since then, we have continued to compound computing power right down to the size of our own palms.

How does this all impact individuals' financial plans? Take a look around…assets have become almost completely digital. For example, your bank account is online where you can move money around without touching paper. Most of us pay our mortgage without sending a check, and investments are no longer necessarily traded with paper stock certificates, rather via online custodians. Even real estate is in the process of tokenization with ownership that can be sliced and diced to fractions, allowing many traditional non-investors part ownership of world-class buildings.

Indeed, over the past half-century, the financial system and the old way of doing business/moving money has been turned upside down. Perhaps the ultimate disruptor to traditional finance is cryptocurrency; in particular, the invention of Bitcoin just 12 years ago by an entity (a group or an individual) named Satoshi Nakamoto. Our contention is that digitization is still in its infancy. Digital assets and cryptocurrency are revolutionary and will challenge traditional business and transactions. The financial system as measured by the enormous bond market has been sinking in recent years, most profoundly in 2008 and again in late 2019. Banks are scrambling to get to the lifeboats created by this new world. Old deposit and loan business models have been left behind through perpetually low interest rates and relentless debt expansion.

Most recently, there has been mention of creating CBDC's (central bank digital currencies) as banks realize that the proverbial rugs are being pulled from beneath their feet. The final blow to the traditional system may be the implementation of cryptocurrency transactions and decentralized exchanges.

As your advisors, we are very aware of the approaching changes to the financial system. We're diligently weighing potential impacts on your financial plan. It is not a time to be complacent; our response to these shifts will make a difference as you save for house, retirement, wedding… or adjust to this digitized world. We are here to discuss these changes with you as the world moves fast and paradigms shift.

Our Portfolio Strategy & Allocation Outlook

It was another very quiet quarter in terms of actual changes within both our private client and retirement plan portfolios. For the most part, we remained spectators to the "everything rally" unfolding as optimism over positive vaccine news took risk assets higher. One topic we keep coming back to in our asset allocation meetings is the question of growth vs. value exposure. As you're well aware, the growth style of investing (led by the technology sector) has dominated the investment landscape recently.

Just to illustrate the overwhelming advantage for growth, take a look at this recent chart from Morningstar, which compares the relative performance of fund managers across different style categories.

VALUE VS. GROWTH

	1-Year (1/1/2020-12/31/2020)	3-Year (1/1/2018-12/31/2020)	5-Year (1/1/2016-12/31/2020)	10-Year (1/1/2011-12/31/2020)
Large Value	2.68	5.46	9.30	9.40
Large Growth	34.84	20.22	18.04	14.66
Value Underperformance:	-32.15	-14.75	-8.74	-5.26
Mid-Cap Value	2.84	3.81	8.37	8.87
Mid-Cap Growth	37.32	19.25	17.43	13.27
Value Underperformance:	-34.48	-15.45	-9.06	-4.40
Small Value	3.84	2.13	7.88	7.81
Small Growth	36.91	18.01	17.31	13.06
Value Underperformance:	-33.06	-15.89	-9.43	-5.25

Source: Morningstar Direct. Returns are annualized.

Per Morningstar, the gap in performance between growth and value hasn't been this wide since the dot-com bubble of 1999. After which, a large value rally took place. In addition, 2020 marked the fourth consecutive calendar year for growth outperforming value. Therefore, the obvious question for investors is whether this will be the year for value to outperform or at least close the gap. We're hardly convinced on the former, but fairly certain of the latter. While our portfolios have tilted towards growth, we've consistently maintained exposure to managers who follow a value style of investing.

On a side note, if you only invest in index funds, you may be leaning towards growth. For example, the top six holdings in the Russell 3000 index (representing over 20% of the market cap) are technology companies. With the prospects of an improving global economy post-pandemic, the potential for rising interest rates and expected massive fiscal stimulus bode well for the value sectors of the market in 2021, but it's far from a certainty.

Please let us know if you'd like to discuss your personal investing and financial planning needs.

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Sentinel Benefits
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Market Scoreboard

Index Returns (%)	Q4 2020	YTD	1 Year	3 Year	5 Year	10 Year
S&P 500	12.15	18.40	18.40	14.18	15.21	13.88
DJIA	10.73	9.72	9.72	9.90	14.65	12.96
NASDAQ	15.41	43.64	43.64	23.13	20.80	17.12
Russell 2000	31.37	19.96	19.96	10.24	13.25	11.20
MSCI ACWI Ex USA	17.01	10.65	10.65	4.88	8.92	4.92
Barclays Aggregate Bond	0.67	7.51	7.51	5.34	4.43	3.84

Source: Morningstar

S&P 500 TR: A market capitalization-weighted index of 500 widely held stocks often used as a proxy for the large-cap segment of stock market.

Russell 2000 TR: Consists of the smallest 2000 companies in the Russell 3000 Index, representing approximately 7% of the Russell 3000 total market capitalization often used as a proxy for the small-cap segment of the stock market.

Barcap Aggregate Bond TR: The Barclays Capital Aggregate Bond Index is a market capitalization-weighted index, meaning the securities in the index are weighted according to the market size of each bond type. Most U.S. traded investment grade bonds are represented. The index includes Treasury securities, Government agency bonds, Mortgage-backed bonds, Corporate bonds, and a small amount of foreign bonds traded in U.S.

MSCI EAFE NR USD: Widely accepted as a benchmark for international stock performance, the EAFE Index is an aggregate of 21 individual country indexes that collectively represent many of the major markets of the world.

DJ US Industrials TR USD: Computed by summing the prices of the stocks of 30 U.S. companies and then dividing that total by an adjusted value--one which has been adjusted over the years to account for the effects of stock splits on the prices of the 30 companies.

NASDAQ: Measures the performance of all issues listed in the Nasdaq Stock Market and is often used as a proxy for the large-cap technology segment of the U.S. stock market.

DJ/UBS Commodity: The DJ-UBSCI is composed of futures contracts on physical commodities and is often used as a proxy for broad-based exposure to the commodity markets.

Date of First Use: 1/20/2021 QMRC-007-01212021