Beacon Trust
INNOVATING WEALTH STRATEGY

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A LOOK AT THE YEAR AHEAD: Ten Investment Forecasts and Four Strategic Wealth Management Themes to Capitalize on Them

December 2020

As we acknowledge each December in presenting our outlook for the coming year, no one can know the unknowable or predict the unpredictable. But, as wealth managers, it is our job to analyze the world around us and invest in the context of the short- and intermediate-term economic landscapes. We have never believed in a "one size fits all" portfolio and have always provided custom tailored advice to our valued clients based on their personal goals and risk tolerances. With this in mind, we would like to share with you our perspective and predictions about some significant events that we believe are likely to unfold in the year ahead.

Beacon's Ten Investment Forecasts for 2021

1. U.S. and international stocks will increase in 2021.

2. The Federal Reserve will not raise interest rates in 2021.

3. A successful series of vaccines will be distributed, enabling the economy to get back close to "normal" by the fall.

4. S&P 500 earnings will increase at double-digit rates in 2021.

5. A somewhat sluggish economy during the first half of the year will be followed by a robust recovery during the back half of the year.

6. Volatility, on average, will decrease over the course of the year.

7. Cyclicals will outperform the mega cap Tech and "stay at home" stocks that led the prior rally.

8. Residential real estate prices will increase, but cool off from 2020's "red hot" levels.

9. Most investment grade fixed income investments will produce coupon-like total returns in 2021.

10. The unemployment rate will decline from 2020 levels, but some job losses will be permanent.

Beacon's Four Strategic Wealth Management Themes for 2021

Beacon's Four Strategic Wealth Management Themes for 2020 echo our forecasts for the coming year and reflect our best thinking to protect capital and improve returns:

1. Return to normalization.
2. Diversification to add value, once again.
3. Disruptive innovation stocks continue to deliver impressive returns.
4. Globalization and cooperation return to center stage.

A Glance Back on the Year That Was

U.S. stocks, surprisingly, delivered double-digit returns in a historic year on a number of fronts. The elephant in the room, so to speak, was the COVID-19 pandemic, which plunged the global economy into recession, stocks into a bear market, and resulted in close to 2 million of deaths worldwide. The pandemic resulted in aggressive responses by the Federal Reserve and Congress, injecting a record 10 trillion dollars of stimulus into the economy, with trillions more to come. Also driving the strong equity results is the composition of the S&P 500 index, with mega cap stocks, such as Amazon.com, Apple, Microsoft, Netflix, Home Depot, and Walmart benefiting from the seismic economic shifts that were unleashed during the pandemic. Smaller and pandemic stricken firms behaved much worse. Bonds also delivered very solid results in 2020, with most intermediate to long-term bond indexes, such as the Barclays Aggregate ("The Agg"), up mid-single digits.

Before we look ahead to 2021, it seems only fair to look back on our 10 forecasts for 2020. What did we get correct and where did we go wrong? In our view, four of our ten predictions were correct, two partially correct, and four wrong.

Let's start with our mistakes. The effects of the pandemic resulted in most of our incorrect forecasts. We thought bonds would provide coupon like returns in 2020, but, in fact, they provided the healthy mid-single digit returns we alluded to earlier. Of course, with hindsight, we now know that the Fed cut short-term interest rates to the 0%-0.25% range, boosting bond returns beyond the coupon clipping territory. The economy entered a recession in early 2020, resulting in declining S&P 500 earnings, thereby resulting in two more of our incorrect forecasts. Another head scratcher was the sharp rise in real estate prices, despite the recession. Record low mortgage rates, constrained inventory, and a desire by many to purchase homes outside of major cities resulted in surging real estate prices at the national level. For example, the S&P CoreLogic Case-Shiller Index of national home prices increased 7%, year over year, upon its last reading.

Let's move on to our prescient calls from 2020. We hit a slam dunk forecasting that volatility would increase in the year. Volatility, measured by VIX, credit spreads, and a number of other metrics, increased the most since 2008. We were also correct in forecasting that the Fed would not raise rates in 2020, despite entering the year with a strong economy. We also forecast there would be no "Phase 2" trade deal with China as a follow-up to the "Phase 1" deal reached in 2019. If anything, relations between the U.S. and China noticeably worsened as COVID-19 swept the globe. We also forecast low inflation in 2020 and the Consumer Price Index (CPI) did remain below the 2% range for most of the year, without dipping into deflation territory. In terms of our partially correct forecasts, we thought stocks would deliver single digit returns in 2020, while they will likely exceed that threshold. We also thought domestic infrastructure investments would perform well in 2020. Infrastructure did outperform many bond indexes in 2020, but they largely consist of Value stocks, which lagged the S&P 500 by a meaningful amount. **Table 1** provides a summary scorecard for our 2020 forecasts.

Table 1: Review of Beacon's 2020 Financial Forecasts

Forecast	Assessment	Rationale for Assessment
Stocks and bonds to deliver single digit returns	Partially Correct	Stocks up double digits, bonds up single digits
The Fed will not raise interest rates	Correct	The Fed did not raise rates and cut them to ≈ 0%
Higher volatility in 2020	Correct	Volatility spiked dramatically and remains elevated
S&P 500 earnings to increase mid-single digits	Incorrect	S&P 500 earnings declined due to the recession
No "Phase 2" trade deal reached with China	Correct	No new trade deal was announced with China
The U.S. economic expansion continues	Incorrect	The economy entered its first recession since 2009
Infrastructure investments to be a winner	Partially Correct	Most U.S. infrastructure funds ↑, but lagged the S&P 500
Fixed income provides coupon-like returns	Incorrect	Fixed income did well as rates fell for most bonds
Real estate to increase, but < 3%	Incorrect	Real estate increased high single digits as rates fell
Inflation to remain below 2% for the year	Correct	Inflation averaged roughly 1.2% over 2020

A Closer Look at Beacon's Ten Investment Forecasts for 2021

There is an element of risk in offering predictions, since the future is uncertain. We can state with confidence that some forecasts we offer for 2021 are again likely to be correct, some incorrect and some partially correct. We can also predict with great confidence that what will ultimately prove to be some of the major events of 2021 are neither on our list, nor likely on anyone else's. Clearly, few people foresaw the devastating COVID-19 pandemic, the most serious since 1918, that rocked the world. It is often the events that few investment strategists are talking about that result in the most extreme market movements.

As noted in our Executive Summary section, Beacon portfolios are custom tailored to each client's unique risk tolerance. Hence, our investment ideas may be appropriate for some clients, while not consistent with the goals and objectives of others. With these important caveats in mind, we humbly offer you some color around our top ten investment forecasts for 2021.

1. U.S. and international stocks will increase in 2021.

It is true that stocks appear expensive when looking at metrics such as a trailing Price to Earnings (P/E) ratio. However, few people successfully drive while looking in the rearview mirror. One reason for the high current P/E is the shrinkage of the E, earnings, due to the pandemic, and record low interest rates, which push up the current discounted value of future earnings. As the economy normalizes over the course of the year, we expect a noticeable rebound in earnings. Once fear further dissipates and investors rationally survey the investment landscape, they will realize stocks are one of the few games in town with the prospect of material growth in a near zero interest rate world. International stocks, such as those represented by the MSCI World Index, also appear to have a superior outlook to bonds and most alternative investments. A year from now we think global equity investors will be pleased once again.

2. The Federal Reserve will not raise interest rates in 2021.

Leadership of the Federal Reserve has said fairly directly that they do not see themselves raising interest rates until unemployment approaches pre-pandemic levels and inflation averages well over 2% for a sustained period of time. In our view, neither of these factors will come to fruition in 2021. Hence, we believe the Federal Reserve's actions in 2021 will be focused on implementing its quantitative easing (QE) program, i.e. bond purchasing, and expansive lending programs, announced in the aftermath of the COVID-19 pandemic acceleration in March and April of 2020.

3. **A series of successful COVID-19 vaccines will be distributed, enabling the economy to get back close to "normal" by the fall.**

It seems likely that at least four vaccines will be approved by the FDA before the end of 2021Q1. Those produced by Pfizer and Moderna have already received FDA emergency use approval. Vaccines by AstraZeneca and Johnson & Johnson also have a good chance of approval by early 2021 and several others are in the R&D pipeline. In short, we believe several of these vaccines will demonstrate the efficacy required to get the COVID-19 pandemic under control, but it will take time. Not only is there a triage process related to how the vaccine is disseminated, but some formulations require multiple doses. We also need to watch any unforeseen side effects from the vaccines. It may be the middle of the year until everyone who wants a full vaccination dose can get one. We will then likely see the easing, and then elimination, of social and business restrictions as we return to a sense of normalcy in the back half of 2021.

4. **S&P 500 earnings will increase at double-digit rates in 2021.**

One silver lining in the recession of 2020 is that earnings results for the coming year are likely to be easy by comparison. For example, it would be shocking to see decimated airline and travel companies having lower earnings in 2021 compared to 2020. This dynamic holds true to a lesser extent for a number of sectors, including Energy, Financials, Industrials, and Consumer Cyclicals. Healthcare and Technology stalwarts are expected to continue to deliver solid results, resulting in a healthy year for corporate earnings. Due to the fragile economy, an increase in corporate taxes will likely be delayed to 2022 or beyond, so rising taxes are unlikely to place a damper on the near-term earnings party.

5. **A somewhat sluggish economy during the first half of the year will be followed by a robust recovery during the back half of the year.**

In our view, the two main drivers of economic growth in 2021 will be the rollout of the COVID-19 vaccines and an improvement in consumer confidence. We noted in Forecast 3 our belief that a successful rollout of the vaccines should be completed in large part by the end of Q2. Consumers will then have to get comfortable resuming old habits, such as taking mass transit, going on vacations, dining out, going to theaters, athletic events, gyms, and a host of other activities that are currently curtailed. Although there is likely a fair amount of pent-up demand, growth is likely to be more gradual than the flip of a switch.

6. **Volatility, on average, will decrease over the course of the year.**

Volatility may be measured in a number of ways, including by the CBOE Volatility Index (VIX). In recent years, VIX has averaged about 15. As of this writing, VIX is in the low 20's and peaked at 85 during the height of the pandemic uncertainty. With the 2020 elections almost behind us and COVID-19 vaccines on the runway, we see volatility gradually reverting towards its long-term levels over the course of the year. A compression in the risk premium is generally a positive for financial assets.

7. **Cyclicals will outperform the mega cap Tech and "stay at home" stocks that led the prior rally.**

The spread between the performance of household growth names and value stocks is near historic levels, surpassed only by the period surrounding the Internet Bubble of the late 90s. The main difference between these two anomalous time periods is the firms leading the most recent rally are "real" in the respect that they have solid business models and significant earnings. So, we don't expect the current market leaders to collapse, but rather for the laggards to catch up to some extent and have better relative performance over the course of the coming year, especially with prospects of higher regulation for the Big Tech ahead.

8. **Residential real estate prices will increase, but cool off from 2020's "red hot" levels.**

As noted earlier in this report, the S&P CoreLogic Case-Shiller Index increased roughly 7% last year versus its historical return closer to 3% per annum. The drop in interest rates as well as the exodus to the suburbs for more space in the wake of the COVID-19 pandemic each played a role in the soaring prices. Both of those scenarios are unlikely to be repeated in 2021, resulting in a more normalized real residential real estate market. The residential real estate market is expected to remain healthy as the unemployment rate continues to decline and the low level of interest rates maintains home affordability, provided prices can remain within the stratosphere.

9. **Most investment grade fixed income investments will produce coupon-like total returns in 2021.**

Interest rates across the entire maturity spectrum are near all-time lows for investment grade bonds, such as U.S. Treasuries. Although the possibility exists that rates will turn negative in the U.S., like they have in several countries around the world, we view it as unlikely given past Fed comments. Thus, we think 0% is a lower bound that will not be approached at the intermediate to long-term end of the U.S. Treasury curve. Given these constraints, there isn't much further that interest rates can fall. Conversely, it may take a while for the nascent economic recovery to be robust enough to see an upward surge in rates. Hence, we think interest rates will be largely range bound for the year, resulting in fixed income returns approximately equal to bond coupons.

10. **The unemployment rate will decline from 2020 levels, but some job losses will be permanent.**

As we close out the calendar year the U.S. unemployment rate stands at 6.7%. Entering the pandemic the number was 3.5%, near a 50 year low. Consumers and businesses, thrust into a COVID-19 induced recession, learned they can do without some things. For example, Zoom is now part of the infrastructure of most companies and educational institutions. Business travel may decline permanently and snow days and the cancellation of school may be a thing of the past as employees and students can "Zoom" into a business meeting or class. On the flip side, there may also be a permanent increase in new jobs, such as in food and telemedicine delivery. Net-net, it may be years before we approach the 3.5% unemployment level again.

Beacon's Four Strategic Wealth Management Themes for 2021

Investment forecasts in and of themselves are interesting, but of little direct value. They must be actionable if they are to be valuable for our clients. Therefore, coupled with our Ten Investment Forecasts we offer Four Strategic Wealth Management Themes for 2021, which are often tied to the specific investments in your portfolio.

1. **Return to normalization.**

As extraordinary, in every sense of the word, as 2020 was, 2021 is slated to be much more mundane. That may be a good thing for investors and non-investors alike, who dealt with enough stress for an entire decade compressed into a single year. As noted in our forecasts, we see a number of financial and economic indicators reverting to more normal levels, such as volatility, valuations, and real estate prices.

2. **Diversification to add value, once again.**

For the past few years, the FAANG stocks, and other large cap Technology stocks, seemed to be the only investments that resulted in superior performance. Diversification, a staple of traditional investment theory, not only didn't help, it often hurt performance on a risk-adjusted basis. Clearly, we don't expect investment grade bonds to set the performance world on fire, but we expect diversified portfolios, including international investments, to result in attractive risk adjusted returns as abnormal reverts to normal.

3. **Disruptive innovation stocks continue to deliver impressive returns.**

   Although we expect a normalization to asset class returns as a whole, we certainly acknowledge that there are always tremendous new investment opportunities on the horizon. For example, in 2020 Tesla and the entire electric vehicle (EV) supply chain delivered truly outstanding investment results. In our view, there are always disruptive technologies working their way into the markets and part of our job is to allocate capital to benefit from these emerging trends. Specifically, investments run or recommended by Beacon Trust that aim to identify some exceptionally innovative companies include Beacon's Core strategy, TLFI's Strategic Opportunities strategy, and the ARK Innovation ETF.

4. **Globalization and cooperation return to center stage.**

   President elect Biden's stated political and economic policies seem to be somewhat similar to those of the Obama Administration. Specifically, the Biden administration has discussed re-entering the Paris Climate Accord, re-engaging with Iran on a nuclear deal, and cooperating with our traditional allies when confronting China and Russia on longstanding issues. Each of these political situations has important investment implications as well that we will be closely following.

We at Beacon look forward to the opportunity to discuss our Ten Investment Forecasts with you, as well as the ways in which our Four Strategic Wealth Management Themes can be custom tailored to your personal situation. As always, we close by thanking you for your loyalty and support. We consider our relationship with our clients a true partnership, and our sole mission as a firm is to add value to our clients in any way we can. It is with the fulfillment of this mission in mind that each of us at Beacon is focused on individual and collective improvements each day. We also wish you a happy, and especially healthy, holiday season and a wonderful New Year.