Our View

A look ahead: First quarter 2021 outlook

December 31, 2020

What are some key factors influencing the economy and markets in the coming months?

Vaccinations

- While the initial roll-out hasn’t been perfect, vaccinations have begun and trials have shown the first approved vaccines to have efficacy rates higher than 90%.
- If a significant portion of the population can be vaccinated in a relatively short time frame, economic activity can finally begin to normalize.

Increased political clarity

- There appears to be cautious optimism in the markets regarding the increased predictability a Biden administration is likely to bring.
- While the market generally tends to prefer a split in legislative power, the Democrats have a razor thin margin in the Senate, making significant tax and regulation changes unlikely while increasing the chances of increased stimulus and infrastructure spending.

Economic strength

- Supportive monetary and fiscal policies have helped the economy surge back from lows during the first quarter of 2020.
- There is still slack in small business and there has been an increase in wealth and savings that could help fuel further economic growth later in the year.

Market rotation

- Investors began to pivot toward smaller-cap, value and emerging market stocks, which had all meaningfully lagged large cap growth stocks.
- Confidence around the effectiveness and acceptance of the vaccine and the durability of the economic recovery should continue to benefit those asset classes down the road.

Asset allocation views: current outlook

<table>
<thead>
<tr>
<th>Equity vs. Fixed Income</th>
<th>Strategic</th>
<th>Tactical</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total equity</td>
<td></td>
<td>+</td>
</tr>
<tr>
<td>Total fixed-income</td>
<td></td>
<td>+</td>
</tr>
</tbody>
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- After the sharp recovery following 2020’s first quarter pandemic correction, equity valuations are historically high and overall market volatility has fallen.
- In the near-term, these conditions make the market vulnerable to negative views with risks coming from rising inflation, rising interest rates and elevated investor sentiment and earnings projections.
- However, despite those risks, there is positive momentum from monetary and fiscal support as well as vaccinations/herd immunity that could encourage record levels of cash to come back into the market.
## Asset allocation views: current outlook (cont.)

### Equities

<table>
<thead>
<tr>
<th>U.S. vs. Int’l</th>
<th>Tactical vs. strategic position</th>
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<tr>
<td></td>
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**Equities**

- Within equity, we favor domestic over international, and within international, we favor emerging markets over developed.
- We maintain the view that the U.S. came into the pandemic with a relatively stronger economy than many other countries and is more resilient and robust, which should help it weather and exit the pandemic in comparatively better shape, particularly when considering the enormous monetary and fiscal response we’ve seen.
- Along with the unprecedented monetary and fiscal stimulus, the dollar has materially depreciated, supporting our overweight to emerging markets, which have also performed well economically.

### Market Cap

- The fourth quarter saw a strong rotation to lower quality and higher leverage, which benefited cyclical and small-caps.
- We’ve added to small-caps, reducing our underweight there, and remain overweight to mid-caps.
- However, we still remain overweight to large caps, particularly the more defensive technology sector, but are monitoring the space closely as valuation concerns persist.

### Fixed-income

<table>
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<th>Duration</th>
<th>Strategic vs. Tactical</th>
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<tr>
<td>Shorter</td>
<td>1–3 yr. 4–7 yr. 10 yr. 15–30 yr.</td>
</tr>
<tr>
<td>Longer</td>
<td>1–3 yr. 4–7 yr. 10 yr. 15–30 yr.</td>
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</tbody>
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- Medium and long-term rates gradually rose during the quarter, driven by signs of economic optimism and the expectation of higher government spending from the incoming administration.
- Highly accommodative policies from the Federal Reserve (Fed), such as its robust purchases of government and other securities, kept rates from increasing even more.
- We see long-term rates under upward pressure going into 2021 and are therefore starting the year short duration.

### Credit Quality

- Credit markets continued to perform well in the fourth quarter with spreads tightening to pre-pandemic levels.
- Riskier credit outperformed, including high yield, emerging markets debt and leveraged loans, while investment-grade and securitized assets underperformed Treasuries.
- While there is little value left in corporate credits, we expect credit spreads to grind moderately tighter.
- We favor lower-quality debt, as the economy should continue to rebound and the yields are higher than those of higher-quality securities.

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1Credit Quality ratings are determined by credit rating agencies Moody’s Investor Services, Inc. or Standard & Poor’s Financial Services, LLC.  

Past performance is not necessarily indicative of future results.