

BANK OF MILLBROOK TRUST AND INVESTMENT SERVICES



QUARTERLY REVIEW AND OUTLOOK

PUBLICATION 51

JANUARY 2021

Resilience is the quality that was summoned in us by all the challenges of 2020. And it's also the quality that's going to carry us forward into 2021. - Sheryl Sandberg

In an article written in December, Arianna Huffington wrote that “resilience” should be the single word that sums up 2020. Huffington goes on to say that “resilience is what allows us not to just bounce back but to bounce forward.”

The most amazing aspect of 2020 was the speed at which things changed for us; the near-total shutdown of our commercial and social lives, a pivot to wearing face-masks, embracing social-distancing and using technology for social and business gatherings. We even showed our commitment to resilience by celebrating holidays with family members via Zoom. None of it is perfect, and while we are all weary of the commitment to keeping those we care for safe, we soldier on with the hope of being next in line for the vaccine. The speed that the vaccine was developed, approved and manufactured was a remarkable feat.

The resilience the economy, and particularly, the markets have shown is extraordinary. The sectors of the economy that have been severely damaged by the recession, specifically energy, the service industry, entertainment and travel sectors, has been offset by the tremendous growth in the technology, housing and healthcare sectors. Unemployment experienced wild swings in 2020. We still ended the year with an additional 9.5 million people without jobs than where we began in January.

Looking forward into 2021 there are large challenges that will still be with us in terms of navigating the COVID-19 pandemic. While the year has started with cases increasing and hospitals being overwhelmed, the vaccines are beginning to be distributed, and there is a general optimism that the second half of 2021 will bring a slow opening of businesses, travel, and some normalcy.

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A carry-over from our experiences of 2020 will be some interesting changes to how we work and live. Many city dwellers have de-camped for homes with more space in the suburbs and more rural areas. The evolving changes to the communities they have moved to and the cities they have left will be an interesting thread to follow. The home building/remodeling business has done quite well and it remains to be seen if that continues.

Our work spaces have changed from the WeWork/or Starbucks office phenomenon to our spare-bedrooms. Traditional offices have been disrupted to the point that many companies are using it as a cost-cutting opportunity. Cutting back on the expenses of brick-and-mortar office space can be a plus for many companies' bottom-line, but a huge shock to the commercial real-estate industry.

On top of all that there will be a new administration and many changes coming to Washington. We will be closely monitoring any proposed tax changes and how they may affect our clients.

So let us all hold tight to our ability to be resilient and use it to “bounce forward” into 2021.

Best wishes,



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ECONOMIC OUTLOOK

Summary

As we conclude what has likely been the most unique year in the lives of most people reading this, 2020 left a couple of late-year parting gifts that are likely to benefit the economy in 2021.

In mid-December, the U.S. Food and Drug Administration (FDA) issued the first two emergency use authorizations (EUA) for vaccines to prevent COVID-19. Not only are the reported efficacy of these vaccines (Pfizer-BioNTech and Moderna) both well in excess of the best expectations during the early stages of the pandemic, there are also several other manufacturers with options still in late-stage trials. And although the rollout of the approved vaccines has been slow and bumpy to start, partially due to the holiday season, there is hope that a majority of the population will have been vaccinated by mid-2021. With the most at-risk individuals likely to be among the earliest to receive treatment, there is a belief that social behaviors could begin to normalize after a few months, and the economy (including the areas hardest hit, such as hospitality, leisure, food services, etc.) may begin to fully reopen.

Additionally, in late December and after several months of debate, deliberation and likely stalling to find out the outcome of the Presidential and Congressional elections, Congress finally passed an additional stimulus package totaling \$900 billion. This stimulus package includes a \$600 payment to many individuals and is intended to help bridge the income gap for those impacted by the virus. Though many people have been able to return to work throughout the year, the amount of unemployed individuals is still roughly three times more than it was to start 2020, and the labor force participation rate has declined by nearly 2%. Still, for those who are not in desperate need for these funds, it's likely to turn into savings in the short term and spending in the long term, which should promote growth and hopefully increase GDP in 2021.

An unknown at this point, is how the recent switch in the Senate majority will impact the overall economy. From an economic perspective, there are pros and cons to the Democrats having control of the House, Senate and White House. On the positive side, the likelihood of additional fiscal stimulus is significantly increased, which would likely help boost economic growth and GDP. But at the same time, the potential for higher taxes (both personal and corporate) and increased regulation could potentially dampen economic expectations. Time will tell what legislation will be passed in 2021 and the economic benefits it may (or may not) provide.

Positives

ISM Manufacturing expands at the fastest pace since 2018 (60.7 vs. 56.8 est)

4Q20 GDP estimates have increased to ~9% according to GDPNow (Atlanta Fed)

The UK and EU have finally agreed to a Brexit trade deal after years of negotiation

Negatives

ADP payroll data shows a loss of 123k jobs vs. a gain of 75k expected for December

Retail sales data has been negative for two consecutive months (-1.1%)

More than five million people remain unemployed



EQUITY OUTLOOK

Summary

Global equity markets climbed still further in December as investors continued to focus on positive news impacting the markets and economy. A slimmed-down version of additional stimulus was passed and many taxpayers will be getting relief checks soon. More and more drug makers continue to boast about impressive efficacy rates for COVID-19 vaccines offering much needed hope on that battlefield.

The S&P 500 rose 3.8% in December as the market breadth continues to widen. Growth stocks regained leadership status with the Russell 1000 Growth Index gaining 4.6% but value stocks participated strongly during the month adding 3.8%. The Russell MidCap Index was up 4.7% while the small-cap Russell 2000 Index continued to surge advancing 8.6%. The developed international MSCI EAFE Index rose 4.7% and the MSCI Emerging Market Index rallied 7.3%.

As we have mentioned, expanding breadth has historically been a positive indicator for equity markets. However, there are some near-term factors that could give pause to the current rally. While the vaccine science has been impressive, the vaccination rollout process has been slower than anticipated. A post-holiday infection surge is widely anticipated. As we wave goodbye to 2020 it's almost hard to believe the S&P was up 18.4% in a year with so much turmoil. The new year will hopefully offer more certainty for investors with a focus on fundamentals. The corporate earnings outlook remains strong which should continue to drive equity momentum. Yes, there are likely to be a few hurdles along the way but 2021 gives us many reasons to be optimistic.

Positives

Health care and pharmaceutical industries continue to make medical breakthroughs concerning COVID-19 treatments and vaccines

Many retail investors have been on the sidelines throughout the rally – the pain trade is higher

Accommodative Federal Reserve and global central bank policy

Negatives

Stock valuations, by some traditional measures, look relatively stretched

Vaccination process has been hampered by logistical issues



FIXED INCOME OUTLOOK

Summary

With muted volatility, the yield curve steepened modestly during December as the yield on shorter maturity notes fell a few basis points (bps) and longer maturity Treasury yields moved slightly higher. With the Fed's forecast of zero-bound interest rates for years, the 2-year note yield declined about 3 bps to end the year at 0.12%. The 5-year was unchanged at 0.36% and the 10-year and 30-year bond yields increased by about 7 bps to end at 0.91% and 1.65%, respectively. The rise in longer maturity rates caused the Treasury market to deliver a return of -0.23% for the month. In fact, the Treasury market has delivered a negative return for the last three and six-month periods as well. Even with this negative six-month period, at 8.00%, the Treasury market still delivered its best annual return since 2011.

Investment-grade corporate bonds continued to outperform government debt as seemingly insatiable investor demand bid credit spreads tighter even in the face of record borrowing. Total issuance of investment-grade debt was nearly \$1.8 trillion in 2020, about 60% more than the \$1.1 trillion issued in 2019. The previous record year was 2017 at \$1.25 trillion. During December, credit spreads on the average corporate bond declined by about 10 bps. The sector returned 0.44% for the month.

The implied inflation forecast, as derived from the spread between the 10-year Treasury note yield and the 10-year TIPS (Treasury Inflation Protected Security) yield, finally pierced the 2% level which is the Fed's targeted rate. While alarming to some, even if this level were to be achieved, we believe it should be of little concern for bond investors as this level is unlikely to cause a change in the outlook for Fed policy. At the December Federal Open Market Committee meeting, Federal Reserve Chairman Powell reinforced that the Fed is expecting

to keep rates at the zero-bound and continue to make large-scale asset purchases until both of their policy objectives are achieved. For rates, the Fed's own projections suggest they will hold to the zero bound for at least three more years. For asset purchases, they likewise implied it will be multiple years before they see substantial progress towards both of their mandates.

We continue to believe that longer maturity Treasury note yields can only move modestly higher if short rates remain anchored. Slightly above 1% on the 10-year note still seems to be a reasonable target. We also continue to favor high-quality corporate bonds even though incremental yields are the smallest they have been in years. With the economy normalizing and the issuance of debt declining sharply, investor demand could continue to support the march to even lower in credit spreads. Historic tight levels is not beyond the realm of possibilities.

Positives

Fed policy unlikely to change for years

Asset allocation rebalancing into bonds

Negatives

Economy likely to expand rapidly in second half of 2021

Increasing belief that deficits are irrelevant

Unknowns

Foreign demand for U.S. debt with weaker dollar