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2020 Year in Review: A Tale of Two Markets

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SUMMARY

- At the end of the first quarter last year, there were bear markets across the globe. By the end of 2020, nearly all equity markets had rebounded, finishing positive on the year. It was a remarkable turnaround, and the S&P 500 saw one of the strongest rallies of all time after the fastest drop in history.
- The S&P 500's performance in the final two months of 2020 marked one of the best periods in index's history. When stocks did that well in the past, the momentum continued and led to double-digit returns over the next year.

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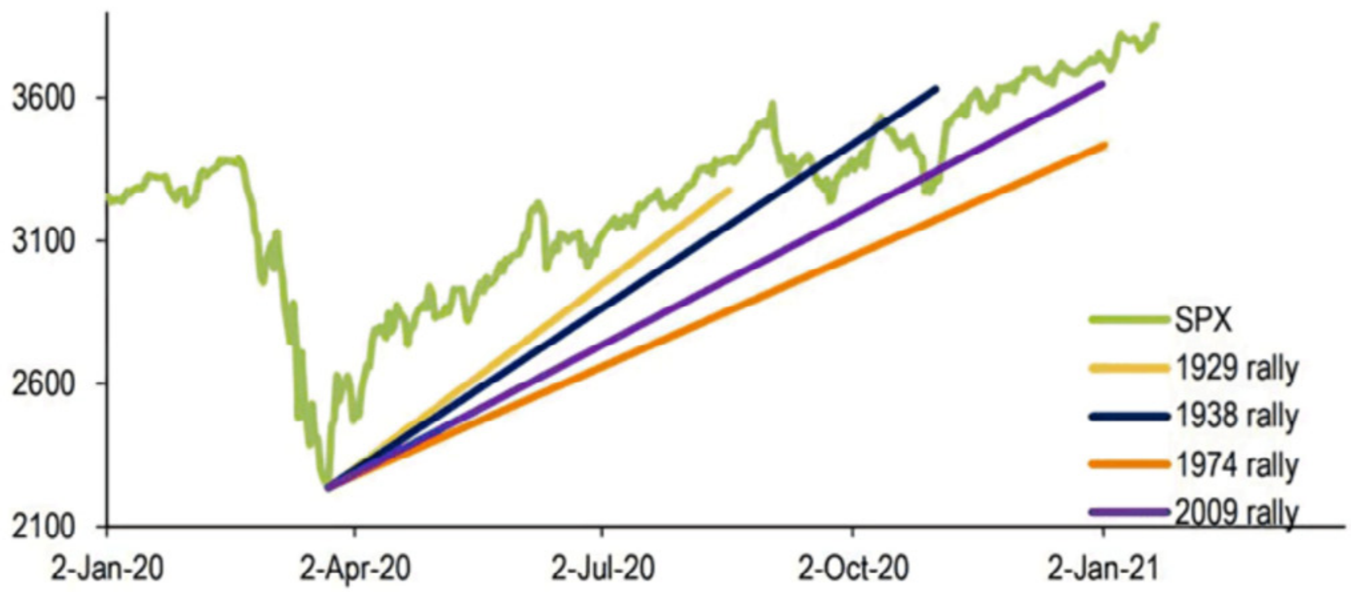
2020: THE DR. JEKYLL AND MR. HYDE MARKET

It's difficult to believe now, but market action was uneventful through the first two months of 2020. Indeed, the S&P 500 made a new all-time high on February 19th while the pandemic was already well underway in China. Then, one week later, everything began to unravel as it became clear that the virus had spread and a pandemic unlike anything we've seen in a hundred years was about to go global. The stock market suffered the fastest 30% drop *in history*, even exceeding the speed of the market crashes of 1929 and 1987.

By March 23rd, the S&P had dropped 33%. But that was it. The next day, the rally began, thanks to a massive stimulus bill and a Federal Reserve that unleashed every tool it had.

The combination equated to the fastest fall <u>and</u> swiftest rally in market history (chart from Bank of America):

Chart 2: The greatest rally of all time



Source: BofA Global Investment Strategy, Bloomberg

While there are many lessons from 2020 for investors, two stand out to us:

1. Markets will continue to surprise us in ways we can't imagine.

2. The only way to deal with these exogenous risks is by executing a consistent process, whether it is a buy-and-hold asset allocation approach or tactical strategies that reduce risk based on various indicators.

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ASSET CLASS REVIEW

The following table highlights major asset class returns for the past fifteen years (from Novel Investor):

Asset Class Returns

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
REIT 35.1%	EM 39.8%	HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%	REIT 2.8%	Sm Cap 21.3%	EM 37.8%	Cash 1.8%	Lg Cap 31.5%	Sm Cap 20.0%
EM 32.6%	Int'l Stk 11.6%	Cash 1.7%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%	Lg Cap 1.4%	HY Bnd 17.5%	Int'l 25.6%	HG Bnd 0.0%	REIT 28.7%	EM 18.7%
Int'l Stk 26.9%	AA 7.6%	AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%	HG Bnd 0.6%	Lg Cap 12.0%	Lg Cap 21.8%	HY Bnd -2.3%	Sm Cap 25.5%	Lg Cap 18.4%
Sm Cap 18.4%	HG Bnd 7.0%	HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%	Cash 0.0%	EM 11.6%	Sm Cap 14.7%	REIT -4.0%	Int'l Stk 22.7%	AA 9.8%
AA 16.7%	Lg Cap 5.5%	Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%	Int'l Stk -0.4%	REIT 8.6%	AA 14.6%	Lg Cap -4.4%	AA 18.9%	Int'l Stk 8.3%
Lg Cap 15.8%	Cash 4.4%	Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%	AA -1.3%	AA 7.2%	REIT 8.7%	AA -5.6%	EM 18.9%	HY Bnd 7.5%
HY Bnd 11.8%	HY Bnd 2.2%	REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%	Sm Cap -4.4%	HG Bnd 2.7%	HY Bnd 7.5%	Sm Cap -11.0%	HY Bnd 14.4%	HG Bnd 6.1%
Cash 4.7%	Sm Cap -1.6%	Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%	HY Bnd -4.6%	Int'l Stk 1.5%	HG Bnd 3.5%	Int'l Stk -13.4%	HG Bnd 8.7%	Cash 0.6%
HG Bnd 4.3%	REIT -15.7%	EM -53.2%	Cash 0.1%	Cash 0.1%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%	EM -14.6%	Cash 0.3%	Cash 0.8%	EM -14.3%	Cash 2.2%	REIT -5.1%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Cap Stocks – S&P 500 Index	9.88%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	8.91%	38.8%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	4.97%	32.5%	-43.1%
EM	Emerging Market Stocks – MSCI Emerging Markets Index	6.95%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	7.15%	35.1%	-37.7%
HG Bnd	High Grade Bonds – Bloomberg Barclays U.S. Agg Bond Index	4.40%	8.7%	-2.0%
HY Bnd	High Yield Bonds – ICE BofA US High Yield Index	7.44%	57.5%	-26.4%
Cash	Cash – S&P U.S. Treasury Bill 0-3 Mth Index	1.11%	4.7%	0.0%
AA	Asset Allocation Portfolio*	7.02%	24.6%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/20.

*Asset Allocation Portfolio is made up of 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Some additional insights:

1. *Small Cap stocks outperformed Large Cap stocks for the first time in 4 years.* Thanks to a huge rally in the 4th quarter, small company stocks outperformed large ones for the first time since 2016.
2. *Cash, while "safer", once again delivered low returns.* Using the 3-month Treasury bill as a proxy, cash returned just a .6% in 2020. Over the last 15 years, its returns have been barely over 1% annualized. We are in a new era of low interest rates. To generate real returns, there is no way to avoid taking some risk.
3. *Real Estate Investment Trusts (REITs) were the only major asset class to finish the year with a loss.* REITs struggles in 2020 because so much of that market is tied to areas of the economy that suffered as a result of the pandemic. Key sectors like Office, Retail (with a heavy mall focus), and Lodging (hotels) saw large losses, and other REIT sectors like Health Care could not fully pick up the slack.

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4. *The S&P 500 outperformed Novel's Asset Allocation strategy for the twelfth consecutive year.* Novel Investor outlines a basic asset allocation portfolio, which they include in the above table as indicated by the gray box with the "AA" heading. We first highlighted the recent weakness of the Asset Allocation portfolio in 2015. In 2020, the S&P once again outperformed the AA portfolio. In the prior decade, from 2000-2008, the AA model consistently beat the S&P 500 despite the portfolio's large allocation to bonds. This remarkable streak highlights both the strength of US Large Cap stocks vs. Mid and Small Cap stocks, as well as the relative weakness in emerging markets and Europe over the past decade. Will 2021 *finally* be the year asset allocation beats the market?

WHAT A STRONG FINISH IN 2020
COULD MEAN FOR THE COMING YEAR

The market had a remarkable finish in 2020, with the best November and December performance since 1950. Market rallies in Q4 aren't unusual, but double-digit rallies over the last two months are rare, with only five occurrences since 1950. In every case, the following year saw a minimum gain of 10% and an average gain of 18% (table from LPL):

A Big End Of Year Rally Is Bullish

>10% S&P 500 Index Gains In November And December

		S&P 500 Index Return	
Year	November/December Return	January Return	Following Year Return
1954	13.6%	1.8%	26.4%
1962	11.6%	4.9%	18.9%
1970	10.5%	4.2%	10.8%
1985	11.3%	0.2%	14.6%
1998	11.9%	4.1%	19.5%
2020	14.3%	?	?
	Average	3.0%	18.1%
	Median	4.1%	18.9%
	% Positive	100.0%	100.0%

Source: LPL Research, FactSet 12/30/20 (S&P 500 price as of noon ET)
All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.
The modern design of the S&P 500 stock index was first launched in 1957. Performance back to 1950 incorporates the performance of predecessor index, the S&P 90.

These types of price studies guarantee nothing, but we find them useful in outlining potential outcomes based on price action and momentum. Further, they can dispel the hot takes that tend to pop up when markets rally as strongly as they have. For example, one might view the recent rally as "too far too fast" or "future gains being pulled forward", suggesting weaker performance in the future. While this thinking makes sense intuitively, the study above shows how this logic hasn't held up historically.

IN CASE YOU MISSED IT

The latest episode of the Corbett Road Podcast was published last week. We discuss our 2021 outlook, the new political landscape, and if the market is in a bubble.

The Corbett Road Podcast is available on all major podcasting platforms, including Apple, Google, and Spotify. Search "Corbett Road Podcast" and be sure to hit Subscribe to get the latest episode as soon as it's released. You can also listen to it on our website at https://www.corbettroad.com/podcasts.

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