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2020 Q4 Investment Outlook-

During the fourth quarter of 2020, headlines were dominated by the November US elections. The markets responded positively and the S&P 500 Index resides near its all-time high. After the election, there was a healthy broadening of positive sentiment across industry groups resulting in almost 90% of the NYSE trading above their 200-day moving averages. There is low recession risk as the bulk of indicators reflect a successfully recovering economy. However, market sentiment resides at extreme optimistic levels and valuations are stretched. These conditions warrant caution, but are not indicative of a pending correction and can persist if interest rates and liquidity are supportive.

Fiscal spending will likely be a top priority for the incoming administration. Proposals are already being made for additional support to households and businesses and vaccine distribution. New infrastructure spending and efforts to advance green technologies are also expected, which can be positive for markets. However, we worry about policies that are historically anti-growth, such as increasing taxes or regulation during this recovery. To put this in perspective, if the 2017 cut to corporate income tax rates was repealed, it would cost corporate America over $180 billion per year, which from today's levels would reduce after tax S&P 500 earnings by approximately 12%.

Economic recovery lost momentum in the fourth quarter, but is still trending positive. Businesses are concerned about potential economic policy in the new administration and renewed government-mandated business closures due to Covid concerns. The NFIB Small Business Optimism Index has declined back below the long-term average. For the first time since April, nonfarm payrolls declined in December and there was a rise in layoffs in the beginning of 2021. Consumers also retrenched amid a spike in COVID cases, distancing restrictions, and waning fiscal stimulus. Retail sales fell marginally in December, the third consecutive monthly decline, and Consumer Sentiment remains well below the pre-crisis level. The negative impact of these weaknesses, however, should be limited by the latest COVID relief bill approved on December 27 and additional fiscal stimulus likely to be passed following the inauguration.

On the brighter side, industrial production increased in December, now up in 7 of the last 8 months, and well above consensus. The Institute for Supply Management's Manufacturing and Services indices are both continuing to indicate strong expansionary growth. According to the International Monetary Fund, vaccination campaigns, concerted health policies, and government financial support are expected to help lift global GDP by +4.2% in 2021. The pace of vaccine distribution will be key in boosting confidence and lowering uncertainty.

According to Factset's *Earnings Insight* on January 15th, the S&P 500 is expected to report a year-over-year decline in earnings of -6.8% for the fourth quarter. Looking back to September 30th, the estimate had been for a -12.7% decline. As we highlighted over the last two quarters, earnings estimates are still overly bearish and are slow to be revised up. Q3 had the highest proportion of earnings beats since recording began in early 2000's. The 5-year average margin of earnings beats is +6.3%, so reasonable we may finish Q4 positive. This trend should continue for the next few quarters due to the additional fiscal stimulus and accelerating vaccine rollouts not yet factored into expectations. The current annual earnings growth estimate for the S&P 500 in 2021 is +22.5%, far eclipsing the -12.9% in 2020. The 12-month bottom-up price target puts the S&P 500 over 4100, 8% higher than the current level.

One of the most important themes we see playing out in 2021 is a consumption boom across corporate entities, households, and government due to pent up demand and new fiscal spending. All three elements have plenty of money to spend and are prepared to do so as vaccinations roll out and restrictions are lifted. In 2020, US households will have accumulated close to 3 trillion dollars (Chart 1) in net savings, primarily due to forced Covid related restrictions. Corporate balance sheets have the highest percentage of cash on their balance sheets in over 20 years, approximately $1.7 trillion dollars. CEO confidence continues to improve, a leading indicator for capital expenditure and investment. Corporate share buybacks, at a 10-year low, should also accelerate. 2020 government support totaled $8.5 trillion dollars, with the addition of $900 billion due to the Coronavirus Supplementary Appropriation bill approved on December 27th (Chart 2). Further, the Biden administration has proposed another $1.9 trillion support and spending bill once in office. These immense amounts of liquidity will eventually find their way to the equity markets.

A major fourth quarter trend change was a steepening of the yield curve. This was caused by a selloff in longer dated bonds, resulting in higher yields out on the curve (the Federal Reserve is still holding short term rates near zero). A moderately upward sloping yield curve tends to be bullish for stocks as money leaves fixed income. The current rise has been received positively by the stock market and is supporting reflation themes that are primarily benefiting cyclical sectors like industrials and financials. Reflation is a fiscal or monetary policy designed to expand output, stimulate spending, and curb the effects of deflation, usually during the first phase of economic recovery after a period of contraction.

Reflation, along with a surge in pent-up demand, will result in an uptick in inflation this year. We believe this will be a temporary demand driven increase, rather than a durable shift that will require a monetary policy response of raising interest rates. However, recent dollar weakness has driven commodity buying so caution is warranted if this trend accelerates. The Federal Reserve has been deliberate to telegraph that they will allow inflation to overshoot historical targets before acting. If yields rise too quickly, it could stall the market like we saw during the "Taper Tantrum" in 2013, when the Fed prematurely withdrew support by quantitatively tightening.

Our investment playbook continues to focus on significant secular trends, durable and high-quality businesses, and above-average growth potential. The world has never seen such a pace of change with powerful, exponentially growing technologies with adoptions driven by network effects. We have selectively broadened exposure to recovering cyclical sectors, and small capitalization companies. We remain flexible and patient for the right opportunities. The path of least resistance for the market continues to be higher.

We are disciplined, focused on the facts, fundamentals, and long-term trends most relevant to your investments.

Morse Asset Management Investment Team

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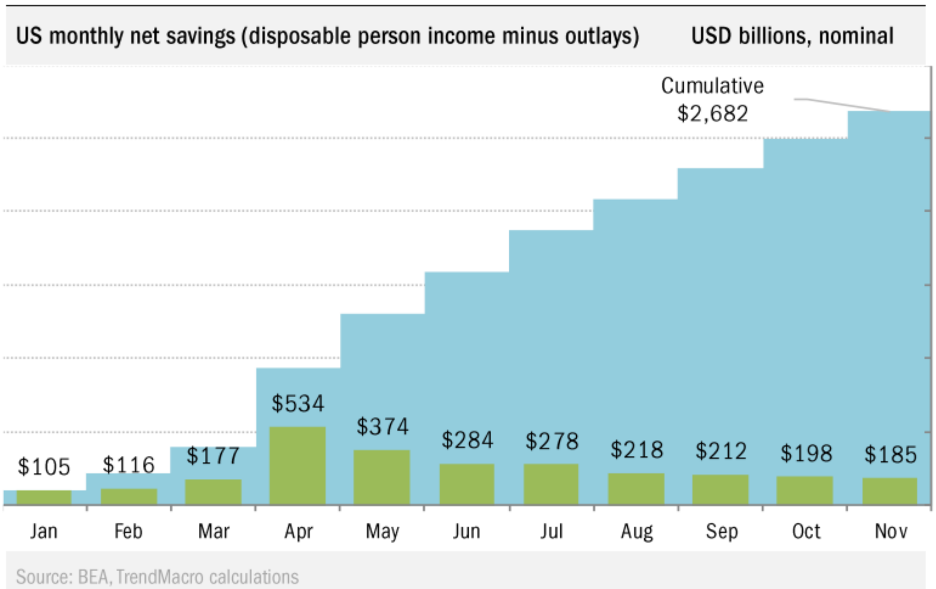
1. United States Household Monthly Net Savings



Source: BEA, Trend Macro

2. United States Monetary and Fiscal Support during the Covid-19 epidemic

U.S. monetary and fiscal support nearly 40% of GDP

Program/Act	Size ($ Billions)	Date Implemented
Monetary Policy		
Treasury Purchases*	2,134	2020-03-13
Agency Purchases*	1,068	2020-03-13
Primary Dealer Credit Facility	Unlimited	2020-03-27
Commercial Paper Funding Facility	Issuer max outstanding	2020-04-17
Money Market Mutual Fund Liquidity Facility	Unlimited	2020-03-27
Term Asset-Backed Securities Loan Facility	100	2020-06-25
Primary & Secondary Corporate Credit Facility	750	2020-06-29 and 2020-05-15
Paycheck Protection Program Liquidity Facility	Unlimited	2020-04-24
Municipal Liquidity Facility	500	2020-05-26
Main Street Lending Program	600	2020-06-11
Total Monetary	5,152	
* Projected through 2020		
Fiscal Policy		
Coronavirus Preparedness	8	2020-03-06
Families First	192	2020-03-18
Coronavirus Aid, Relief, and Economic Security (CARES)	1,721	2020-03-27
PPP/Health Care Enhancement	485	2020-03-27
Loan to airline industry	46	2020-04-14
Coronavirus Supplementary Appropriation	900	2020-12-27
Total Fiscal	3,352	
Total Support	8,504	
Total Support as a share of GDP	39.4%	
Sources: Federal Reserve Board, Congressional Budget Office, Bureau of Economic Analysis, congress.gov.		
Ned Davis Research		ECON_56.RPT

Source: Ned Davis Research, Federal Reserve, Congressional Budget Office, Bureau of Economic Analysis, congress.gov