PRIVATE CAPITAL MANAGEMENT

Q4 2020 Commentary

January 15, 2021

"Keep on rockin' in the free world"
– Neil Young

Capping off a tumultuous year, global equities delivered strong returns in the fourth quarter of 2020 finishing at record highs. Multiple catalysts including rebounding economic fundamentals, COVID-19 vaccine milestones, and certainty regarding the U.S. 2020 elections fueled these gains. To say 2020 was a volatile year is an understatement. The CBOE Volatility Index (VIX) spiked sixfold during the depth of the COVID-19 market downturn, surpassing the highest reading seen during the Global Financial Crisis[1]. The S&P 500 declined 33.79% from February 20 to March 23, 2020. Since March 23, the S&P was up almost 70% ending the year with a +18.4% gain. The S&P 500 experienced the worst monthly return (-12.35% in March 2020) since 2008, followed by two of the best monthly returns (+12.82% in April 2020 and +10.95% in November 2020) in the same timeframe. Long-time laggards, value and small capitalization equity, finally outperformed their counterparts in the fourth quarter.

		Index Returns (%)			
Equities	**Level**	**1 week**	**QTD**	**YTD**	**1 year**
S&P 500	3756	1.45	12.15	18.40	18.40
Dow Jones 30	30606	1.35	10.73	9.72	9.72
Russell 2000	4908	-1.41	31.37	19.96	19.96
Russell 1000 Growth	1605	0.86	11.39	38.49	38.49
Russell 1000 Value	833.42	1.31	16.25	2.80	2.80
MSCI EAFE	2148	1.44	16.09	8.28	8.28
MSCI EM	1291	3.16	19.77	18.69	18.69
NASDAQ	12888	0.66	15.63	44.92	44.92
Fixed Income	**Yield**	**1 week**	**QTD**	**YTD**	**1 year**
U.S. Aggregate	1.14	0.22	0.67	7.51	7.51
U.S. Corporate	1.79	0.47	3.05	9.89	9.89
Municipals (10yr)	0.90	0.08	1.78	5.62	5.62
High Yield	4.97	0.50	6.45	7.11	7.11

Source: JP Morgan. Data as of 12/31/2020. You cannot invest directly in an index

ELECTION 2020

Americans cast their votes in the 2020 election facing unusual and highly divisive campaign rhetoric. Initial results indicated the U.S. would have a divided government, an ambiguously bullish outcome for equity investors. This narrative changed following the Georgia special election as Democrats picked up both run-off seats in early January. Democrats and Republicans now each hold 50 seats in the Senate with the tie-breaking vote going to Vice President-elect Kamala Harris. What does this mean for investors? Democrats will not have free rein to legislate at will. Such a narrow margin in the Senate means it will be difficult for Democrats to overcome a Republican filibuster and that agenda items will need to appeal to both progressives and moderates within the Democratic Party. To be sure, a Senate majority is hugely important for the Biden administration as it allows Democrats to use reconciliation to pass legislation, including budget bills, with a simple majority. Democrats will also use this majority to confirm judges and attempt to swing judicial philosophy back towards the left. Markets reacted positively to the Georgia election results with stocks rallying and interest rates rising.

[1] VBOE VIX close data 2/14/2020 13.68, 3/16/2020 82.69, 11/20/2008 80.86. Data from www.cboe.com

COVID-19 VACCINE

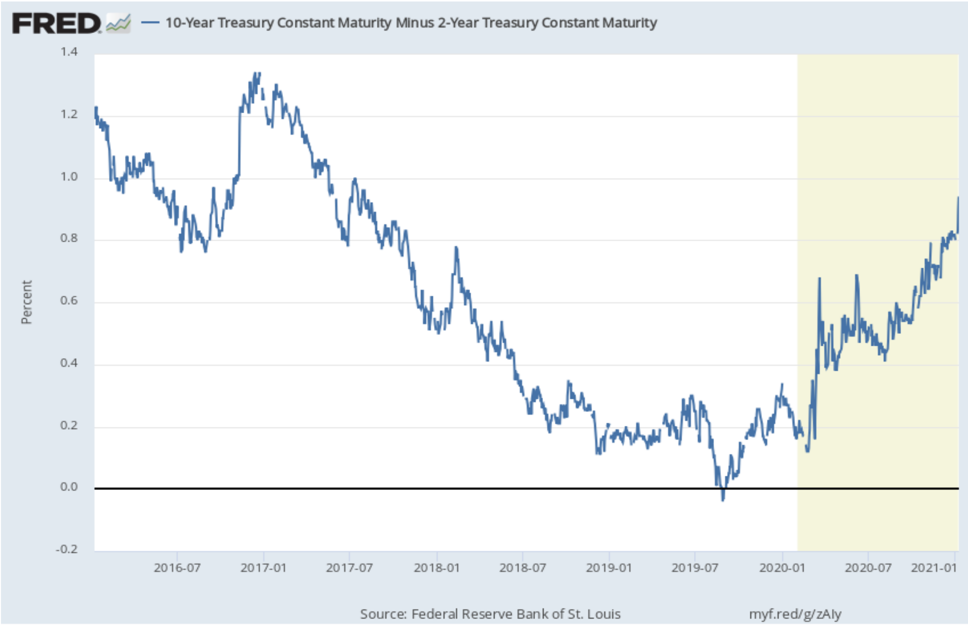
Pharmaceutical companies and researchers made significant progress fighting the pandemic in the fourth quarter. Two leading COVID-19 vaccine candidates produced by Pfizer/BioNTech and Moderna received Emergency Use Authorization from the U.S. FDA. Shortly after, these vaccines were distributed across the U.S. intended for front line health care workers and at-risk populations. Logistical and administrative delays have since hindered vaccination efforts. As of January 7, 2021, only 5.9 million people have received one COVID-19 vaccine dose with over 21 million total doses distributed. Populous states such as California, New York, and Texas are reporting used dosage rates of less than 50%[2]. Fortunately, additional funding for vaccination efforts was authorized in the most recent stimulus bill that should improve some of these bottlenecks. President-elect Biden announced a mass vaccination campaign to reach 100 million people in his first 100 days in office. This would be a positive tailwind for risk assets and the global economy at large should the campaign be successful.

GLOBAL ECONOMY

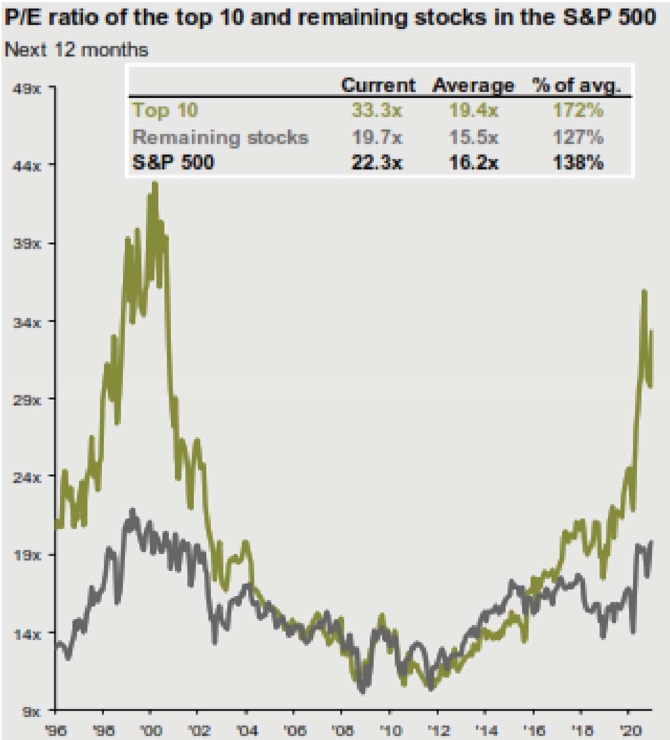
Meanwhile, the global economy continues to recover with GDP expected to accelerate past pre-COVID-19 levels later this year.[3] The Conference Board Leading Economic Index rose in November, albeit at a decelerating pace.[4] Data from the Institute for Supply Management (ISM) was largely positive in December as the Manufacturing PMI registered 60.7% and Services PMI 59.4% (reading above 50 indicates expansion). Supply chain issues remain a top concern as many manufacturers are experiencing increased input costs, labor shortages, and lack of inventory to fulfill all available orders.[5] Congress passed another stimulus package at the 11th hour providing additional funding for the Paycheck Protection Program ("PPP 2.0"), $600 stimulus payments for qualifying individuals, and enhanced unemployment benefits, among other items. PPP 2.0 does have stricter rules to qualify for a loan, but good news for business owners lay in the details. The stimulus bill states that expenses paid with forgiven PPP loan funds (including the original PPP loans) are tax deductible[6]. Many are expecting Democrats will pass additional stimulus, with more funding for ailing state and local governments, and larger one-time stimulus payments to individuals.

TREASURY YIELD CURVE

The U.S. yield curve continued to steepen following the Georgia election results. The bond market is signaling that policies generated by a unified Democratic government will put upward pressure on longer-term rates. Additional stimulus spending, potential for large scale infrastructure programs, and the Federal Reserve's continued lower for longer stance on short-term rates have the potential to enhance near-term economic growth which may further steepen the curve.



[2] COVID-19 Vaccinations in the United States. Centers for Disease Control and Prevention. Covid.cdc.gov. Accessed 1/7/2021
[3] World Economic Outlook (October 2020). IMF.org. Accessed 1/7/2021.
[4] The Conference Board Leading Economic Index for the U.S. conference-board.org. Accessed 1/7/2021
[5] ISM Report on Business. https://www.ismworld.org/supply-management-news-and-reports/reports/ism-report-on-business/. Accessed 1/7/2021
[6] Consolidated Appropriations Act, 2021. https://www.congress.gov/116/bills/hr133/BILLS-116hr133enr.pdf. Accessed 1/7/2021



Source: 1Q21 the Guide to the Markets. JP Morgan.

GLOBAL EQUITY VALUATIONS

Global equity valuations continue to trade above historical averages. Low interest rates are contributing to these higher valuations. The value of an asset increases when its cash flows are discounted at lower interest rates. Additionally, stock market valuations tend to be elevated early in economic expansions as stock prices typically advance ahead of rising earnings. Throughout the pandemic, mega capitalization companies offered defensive and growth characteristics for investors leading them to deliver above average market returns for the year. Presently, mega cap companies have high forward P/E ratios relative to the rest of the market. As of 12/31/2020, the top 10 S&P 500 companies had a forward P/E ratio of 33.3X relative to a long-term average of 19.4X. Excluding these companies, the remaining S&P 500 companies had a forward P/E of 19.7X relative to a long-term average of 15.5X. Stubbornly high valuations could lead investors to temper future return expectations.

Fortunately, 2020 is in the record books. Our global economy is recovering, COVID-19 vaccines are being administered, and more vaccine candidates are on the way. We remain cognizant of early cycle risks paired with above average asset valuations, along with the unknowns of battling a global pandemic. Notwithstanding the volatility we experienced in 2020, we remain committed to managing client assets with a focus on superior risk-adjusted returns over full market cycles. Thank you for your continued trust and we look forward to 2021.

Sincerely,
The Private Capital Management Team