Marketline December 2020

Stocks:

The market ended 2020 with another surge, the Dow and the S&P rising over 3% and the NASDAQ reasserting its dominance by rising almost 6%. Overseas, results were also pretty good, with results in Mexico ramping up by 5.7% and European stocks up about 3%. Canada was the laggard, up just over 1%; energy and mining stocks are prominent on the Canadian exchange, and these were somewhat flat during the month.

For a year as tumultuous as 2020 proved, stock returns were not bad at all with most indices closing the year at all time records. Returns from tech stocks were stupendous. Most analysts expect the same for 2021. But high expectations are the building blocks of disappointment. After two great years in a row, a slack year is 'due' and should not be surprising. We were all glad to see the books close on 2020, but challenges remain, and we could understand a correction if economies do not improve as quickly or as much as investors expect, or that there are other sources of volatility that we are not seeing now. Too, bond rates could rise enough (see below) that investors start to allocate away from stocks into bonds. The lesson here is that when "everyone" is expecting smooth sailing it may pay to prepare for squalls.

Even in an expensive market, pockets of value remain. Banks, other financial stocks, real estate investment trusts, travel related companies, some retailers – these can be on your shopping list if you're looking for low prices. Foreign stocks have nosed their way onto our radar screen as well. It's been a long time since international stocks have performed well. International stock exchanges tend to be concentrated in cyclical stocks instead of technology, where all the action has been these last ten years. But that has only made values overseas even more attractive. We would think seriously about paring technology stock exposure – not to remove the sector from portfolios entirely, but even stalwarts such as Microsoft and Apple deserve scrutiny right now.

Bonds:

Rates rose a bit last month; the long bond rose to 1.64%. Still, that's no higher than we closed out October, and much lower than where we started the year – at 2.39%. Even after all these years of decent bond returns and ever lower rates, the bond market still dished out strong returns last year. The Vanguard Total Bond fund was up 8.8%; that return is competitive with the long term annual return on stocks!

Still, clouds are on the horizon for bond holders. Debts are rising fast as governments borrow to mitigate the effects of the pandemic; and supply chains have still not recovered, creating shortages here and there. Even prices of the basics - lumber, steel, and copper - are much higher than they were just a year ago. These signs of inflation, and the temptation to use inflation to reduce the economic overhang of government debts, do not bode well for bond investors in the near future.

When rates are on the rise, we employ several tactics to turn that trend to the advantage of our clients. One tactic is to reallocate from cash or stocks into bonds. We aren't tempted to do this yet, since rates are still very very low, but if we see long Treasuries breach 2%, we'll start looking for opportunities. Another tactic is to replace lower yielding bonds that we already own with higher yielding bonds from a different sector. We had been able to do this in fairly steady fashion until last year. The tide is turning though: just lately we were able to sell a technology company bond to swap into other sectors. That money went to issues from retail, communications, pharmaceuticals, and a couple other consumer goods companies, culminating in a decent pick-up in yield.

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