"Be Prepared"

Market Commentary – December 2020

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The second estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 33.1% in the third quarter of 2020. This matches the advance estimate and represents historic growth. The components of the 2020 Q3 GDP number are: consumer spending +25.22 percentage points, investment +11.78 percentage points, net exports -3.18 percentage points, and government spending -0.76 percentage point. The sum of these numbers equals +33.06%. Unemployment peaked at 14.7% in April 2020 and has fallen steadily since then to 6.9% in October. The "V-shaped" recovery touted by President Trump is happening. More impressive, this growth was achieved despite lockdowns initiated in some states to "battle" COVID-19. Once vaccines and herd immunity kick in, the remaining industries that are struggling (such as restaurants and travel) should bounce back. Recent news of multiple effective vaccines is encouraging.

The Federal Reserve continues to support financial markets with historic monetary policy easing with the effects of COVID-19 at the center of their radar. In its regularly scheduled announcement on November 5, the Federal Open Market Committee (FOMC) expressed its willingness to keep the federal funds rate at 0% to 0.25% far into the future. Moreover, the balance sheet grew to $7.22 trillion in assets on November 25 and it should grow incrementally going forward. Is it merely a coincidence that the Fed's balance sheet increased by $70 billion since October 28 and the S&P 500 simultaneously rose by 11%?

The presidential election is not yet over despite claims by the media and some politicians that it is. Americans are divided between conservative and liberal policies, but everyone can *hopefully* agree that we want fair elections (regardless of who wins). There is a movement building online that is calling into serious question whether there are nefarious characters, both domestic and worldwide, who meddled with our election on November 3. The mainstream media has yet to report much of this, and it remains to be seen where this goes. Legal experts maintain that our Constitution is equipped to deal with such situations. Is this yet another major black swan event ready to strike? Maybe, maybe not. Absent clairvoyance, an excellent tool we have as investors is to have a plan for both bullish and bearish scenarios in a portfolio (balance between stocks and cash, focusing on multi-cap dividend paying stocks with solid balance sheets). Investors who allow their personal bias to dictate an "all-or-nothing" investment strategy may get lucky, but they also run the risk of being on the wrong side of the coin.

Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market. The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) during 2021 is $165.89, which implies a price-to-earnings (P/E) ratio of 21.8 with the S&P 500 at 3,622. The earnings yield (E/P) of 4.58% represents attractive value relative to the 10-year U.S. Treasury note yield of 0.84%. Earnings estimates for 2021 are starting to creep higher as the end of COVID-19 appears on the horizon. Investors are likely anticipating this already.

While the S&P 500 hit a new high in November, the mega-cap technology stock valuation bubble is increasingly more vulnerable. The S&P 500 peaked at 3,638 on November 27, piercing resistance near the October high (3,550). That level should act as support, as well as the 50-day moving average (3,452) and the 200-day moving average (3,153). The case has been presented in our market commentaries calling into question the rich valuations of mega-cap tech stocks. Curiously, a catalyst for the bursting of the technology bubble may rest with the potentially developing black swan regarding the presidential election. Mega-cap tech firms and executives are allegedly complicit with the election situation (censorship, funding questionable acts, etc.). *If this is ultimately proven to be true*, a lack of trust in technology firms could cascade into a massive sell-off in their stocks. Similar to the Nasdaq 100 crash that started in 2000 and spanned 18 months, tech stock P/E ratios could collapse, and earnings could evaporate (a double whammy). Remember that many investors own these stocks and do not even realize it…yet. Be prepared.