LINSCOMB WILLIAMS

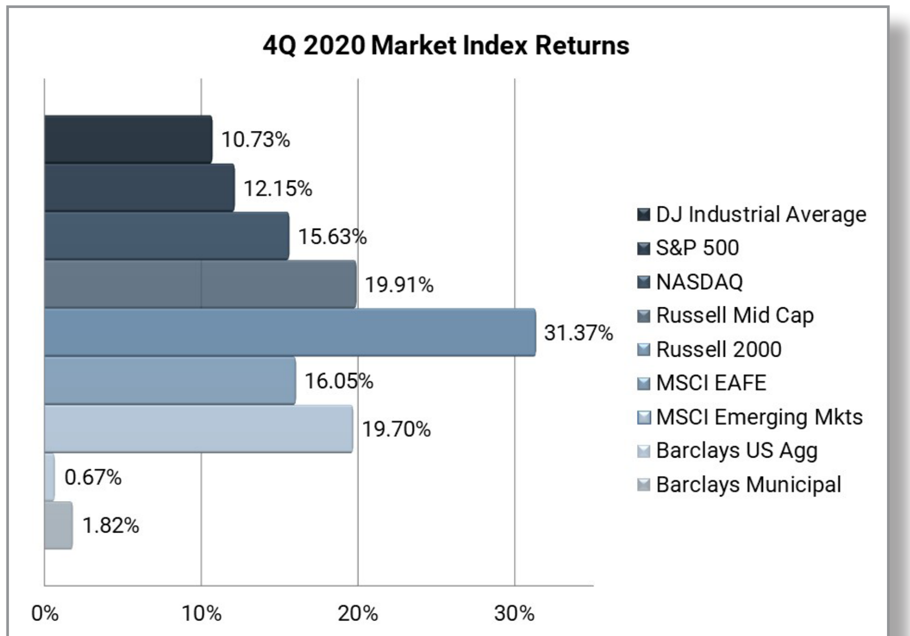
WEALTH MANAGEMENT SINCE 1971

QUARTERLY MARKET COMMENTARY: *Fourth Quarter 2020*

the ECONOMY

As Linscomb & Williams enters its 50th year in business, a salient lesson we've learned, and occasionally had to relearn, is that when it comes to financial markets, you can often expect the unexpected. It's said that hindsight is 20/20, but in 2020, a year that was anything but normal, even perfect hindsight might have led investors astray. Who would've thought that in a 12-month period which included a global pandemic, the sharpest decline in quarterly GDP ever, and a highly contentious political election, that global markets would have an above average year? Not many is our guess. But when it was all said and done, Linscomb & Williams' belief in tried-and-true wealth management strategies once again provided a guiding light through one of the most chaotic years in our existence.

If we had to summarize 2020, we'd call it a transition from cope to hope. We've gone from figuring out how to cope with our new reality in the spring and summer to hoping that recent medical breakthroughs herald a return to normal life sooner rather than later. Early in the pandemic, the U.S. economy unsurprisingly struggled with severe, and nearly immediate, shifts in the way it functioned. Yet, American businesses and workers proved their resilience, adapting quickly to new challenges as best they could. Following a disastrous 1st half, GDP rebounded an astounding 33.1 percent in the 3rd quarter, and is estimated to grow between 5 – 10 percent in the 4th quarter. It is not our intent to minimize the tragic human cost of the coronavirus, which is still exacting a



terrible toll on many, and will continue to be with us in the months ahead. But compared to the depths of the crisis in late March and April, the U.S. economy is in a much better place today. Unemployment, which peaked at 14.8 percent, has already fallen to 6.7 percent. Roughly 12 million net jobs have been created over that time period. To be sure, that still leaves us 10 million short relative to February's peak, so there is still work to do. The progress made already though is probably as good as could be expected. We'd be remiss not to mention that increasing coronavirus cases and hospitalizations in December led to a slowdown as we closed out the year. This is likely why last month's employment report showed a loss of over 100,000 jobs. However, most of the losses were concentrated in the leisure and hospitality sector, and could return quickly alongside collective vaccine uptake. A silver lining to the slowdown may be that it was the catalyst for Washington to pass an additional coronavirus relief bill. While not as broad in scope as the initial CARES Act, at $900 billion, it is a sizeable package. About two-thirds of the bill consists of direct consumer and small business aid.

We've mentioned in previous quarters that due to the nature of the coronavirus, the manufacturing sector has been driving activity, as in-person services are unable to operate at full capacity. The latest business confidence surveys suggest this is still the case. Rising commodity prices, including all-important oil and copper, have incentivized further production in those industries. Also, technology capital expenditures have been increasing at an impressive clip. Economic crises often accelerate trends that were already in place, so it is no surprise to see companies further experiment with how to best leverage emerging technologies to enhance operational efficiency.

Europe's economy followed a similar trajectory to that of the U.S. However, more stringent business and movement restrictions implemented later in the year mean that growth is likely to be relatively flat in the 4th quarter, give or take a few percentage points. The unemployment rate for the now 27-member European Union (E.U.) is currently 7.5 percent. It has not recovered as rapidly as the U.S., but also peaked at a lower level. In general, E.U. countries' approach favored preserving existing jobs rather than replacing income, which could partially explain the difference in the path of unemployment. With everything else going on in the world, Brexit has been flying under the radar. The U.K. officially left the E.U. in January of 2020, with a transition period lasting until the end of the year. As has seemingly become habit amongst politicians, the respective sides waited until the last minute to finalize an exit agreement. It certainly wasn't a flawless process, but the left-tail risk of an extremely messy exit has been taken off the table. One popular take amongst pundits amidst the overly drawn-out Brexit saga was to question the longer-term viability of the E.U. Some went as far as to predict its eventual dissolution in the not-too-distant future. But the pandemic perhaps changed some minds, especially within Europe. With the creation of a mutually backed and agreed upon recovery fund, E.U. member countries may now be more intertwined than ever. The recent rise in the value of the Euro vs. the U.S. dollar suggests investors are now more confident in the group's future.

Moving east, we're comfortable concluding that most of the major Asian economies are in a much better place with regard to the coronavirus compared to their western counterparts. We won't speculate on why this is, but suffice it to say, a number of Asian countries are operating much closer to their version of typical. In Japan, the widely followed Nikkei stock index hit a 3-decade high. It is still about 30 percent away from its late 80's bubbly peak, but the trend is impressive. China, which was "first-in, first-out" of the pandemic, may actually be booming. Manufacturing production is above last year's levels, and consumer spending is coming back. In fact, stocks levered to Chinese consumption growth have been amongst the best performers over the second half of 2020. Exports from South Korea and Taiwan, which have been reliable leading indicators of global economic activity, have rebounded strongly. Commodity exporting countries like Russia and Brazil have their struggles, but both should benefit from higher oil and materials prices.

CENTRAL BANKS

After a flurry of activity early in 2020, news from our global central bankers has been both consistent and uneventful. Not that investors are complaining. The short story is that there's been no indication from any of the major central banks that they'll be altering the current course of policy any time soon. Indeed, markets aren't projecting any interest rate increases until 2023.

That said, there are a few things to keep an eye on. The Federal Reserve (Fed) hinted that it may taper asset purchases later in 2021, if, according to Chairman Jerome Powell, the economic recovery is making "substantial progress." What "substantial progress" means to the Fed is an open question, but we'll be on the lookout for further clarity. Also, the new flexible average inflation targeting regime, in which the Fed will aim to have inflation higher than its 2 percent target for some time in order to hit 2 percent "on average", is an evolving and untested policy. Also, in response to the renewed limits on activity around Europe, the European Central Bank (ECB) increased its Pandemic Emergency Purchase program by 500 billion Euro.

FIXED INCOME

Interest rates were little changed for most of the summer, but began to perk up in the fall. Since the vaccine announcements in November, longer-rates have been trending decidedly higher. The 10-year U.S. Treasury yield closed out the year at 0.93 percent, up from 0.79 percent at the end of September. The comparable 30-year security rate rose to 1.65 percent from 1.46 percent over that same period. Shorter-term rates, on the other hand, barely budged. This has resulted in a "steepening" of the yield curve. Typically, this bond market signal is indicative of an expected pick-up in growth and inflation going forward.

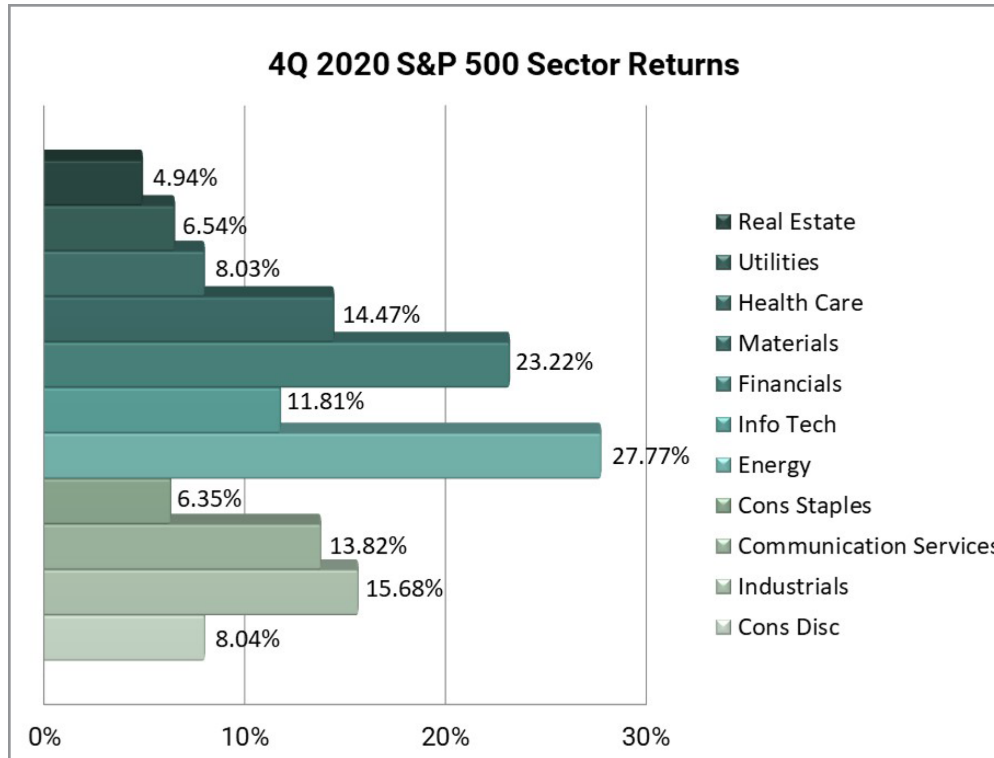
Though rising interest rates can be a headwind to bond performance, the Bloomberg Barclays Aggregate Bond Index, composed of investment-grade treasury, corporate, and mortgage securities, still delivered a modest 0.67 percent in the 4th quarter. Though government bond prices were weak, strong gains from corporate issues more than made up the difference. Overall, investment grade credit gained 3.05 percent. Some riskier fixed income sectors, which tend to be more correlated with equities, also delivered. The high-yield bond market returned 6.45 percent.

Municipal investors were hoping for further state and local aid from the federal government, which, at this point, is yet to come. But it's debatable whether that additional aid is truly needed, with state tax revenues in aggregate only a few percentage points off of 2019's take. In any event, municipal bonds didn't seem to mind, rising 1.82 percent over the year's final three months.

EQUITY

One phenomenon of markets we're keen to respect, which isn't necessarily intuitive, is that strength often begets further strength over shorter time periods. Great returns in a given month or quarter don't necessarily presage poor performance the next. It's frequently the opposite. Such was the case last year. A historic rebound in stocks from late March's trough didn't stop them from surging further in the 4th quarter. The S&P 500 rose 12.15 percent, bringing its year-to-date gain to 18.40 percent. Traditional value sectors were the top performers over 2020's final three months. Energy and financial stocks were up 27.77 percent and 23.22 percent, respectively. Not to be left out, small cap stocks turned in one of their best quarters ever. The Russell 2000 Index gained a whopping 31.37 percent. The promising vaccine announcements in back-to-back weeks in early November seemed to be the trigger that sparked value and small cap's outperformance.

We noted earlier that the U.S. dollar had weakened against the Euro, and in fact, that was generally the case versus most foreign currencies. These periods tend to be beneficial for foreign securities. This proved true in the 4th quarter, with international developed stocks gaining 16.05 percent. Emerging markets fared a bit better, up 19.70 percent. Another catalyst for international shares may have been the U.S. Presidential election results. It is too soon to say whether President-elect Biden's trade policy will be better or worse for markets than Trump's, but we do believe it will be more predictable.



The combination of a continued rally in stock prices in the midst of lower earnings has investors facing valuations that are on the high side historically, especially in the U.S. The forward price-to-earnings multiple on the S&P 500 was above 22x at year end. Lower interest rates, an ongoing economic recovery, and the prospects of further fiscal stimulus has investors looking past the current downturn towards a robust profit rebound in the years to come.

OUTLOOK

As we head into 2021, the question is: Will the “hope” we discussed earlier turn into a reality? We believe the answer is yes. The initial rollouts of both the Pfizer and Moderna vaccine have been a bit bumpy, but already millions have received their initial dose. Other products from the likes of Johnson & Johnson and AstraZeneca are in late-stage trials, or in some countries have already been approved for use. We can’t tell you when exactly the herd immunity threshold, which is considered necessary for coronavirus cases to broadly decline, will be reached. But the Cleveland Clinic expects virus-related hospitalizations to peak sometime in late January. The sooner the burden and potential stressors on medical systems are eased, the sooner the rest of the economy can begin to fully reopen. This is true both in the U.S. and globally.

So, while we may be in for an uncomfortable month or two, there is a light at the end of the tunnel. The previously discussed follow up stimulus package, while not perfect, hopefully helps to bridge the gap between now and then. Though there has been a global slowdown towards the end of the 4th quarter, enough leading indicators are pointing in the right direction that we believe any economic deterioration should be relatively mild and short-lived. There’s sufficient pent-up demand, measured by savings versus potential consumption, that it is likely consumers are ready to get back out there and spend that excess cash when they eventually get the opportunity.

The “blue wave” election scenario in the U.S. that would’ve meant more impactful legislative changes didn’t come to pass, but the results do have implications for the economy and financial markets. If the initial reaction by stocks is anything to go off of, investors seem sanguine about the outcome, though the timing of the vaccine data release likely has something to do with that. First off, investors like the idea of even more fiscal stimulus in the near-term. It wouldn’t surprise us to see a third coronavirus bill come up for a vote as early as the 1st quarter of 2021. Included in the bill could be additional direct stimulus payments of up to $2,000 for those who qualify, enhanced and extended unemployment benefits, and state and local aid. Early estimates suggest it could be greater than $500 billion in total. Second, on trade policy, which is largely under the purview of the President, the thought is that Biden will take a more traditional approach. If anything, there should be less uncertainty. And then there is the potential for higher taxes. No, investors generally don’t like higher taxes, especially on corporations, capital gains, and dividends. But the prevailing wisdom is that the extremely thin majorities in Congress held by Democrats puts a ceiling on how much taxes can be raised. Almost certainly, it would have to be less than what the Biden team had proposed during his campaign. Nevertheless, this remains a bit of a wild card. Also, much of the legislation will have to pass through reconciliation, which places some limitations on the scope of whatever polices are under consideration.

We do think the recovery is poised to continue in 2021, but there are risks to our outlook. First and foremost is, certainly, the coronavirus. Vaccine news has been mostly positive but increasing immunity within the population will take time. Then, there is the expected further fiscal stimulus. We think much of this potential is priced into markets currently, but getting this type of big legislation signed, sealed, and delivered, is easier said than done. Longer-term, the flip side to not enough fiscal spending now may be having too much of it down the road. Might it lead to unexpectedly higher inflation? We don't view that as a big risk for the time being, but something to watch out for down the road. And, of course, the stimulus is debt-financed, though when and how the consequences of that will manifest are more difficult to forecast. On a sector-specific basis, there appears to be bipartisan agreement to "do something" to regulate big technology companies as well as drug prices. What that "something" is remains to be seen.

When looking back on 2020 and forward to 2021, we're reminded of a simple quote from one of our favorite investors, Peter Lynch, of Fidelity Magellan fame. "You get recessions, you have stock market declines. If you don't understand that's going to happen, then you're not ready, you won't do well in the markets." Fortunately, we've seen a lot of different environments over these 50 years. And although last year was new to us all, we feel that our experience has us ready for just about anything the market wants to throw at us in the future. Adhering to our core philosophy was very rewarding last year. Crucially though, a fundamental tenet of that core philosophy is retaining the flexibility to adapt our portfolios as conditions warrant. We will continue to do so going forward.

1400 Post Oak Blvd., Ste. 1000 Houston, TX 77056

P 713 840 1000 **F** 713 840 7802

www.linscomb-williams.com