Market Commentary

Fourth Quarter 2020

Fredric P. Lutcher, CFA
Managing Partner

Thomas J. D'Auria, CFA
Managing Partner

Good riddance to 2020. Although very few people will look back on the past year with positive thoughts, US equity markets surprised many by providing above-average returns. If we had told you that during the past year, we would experience a global pandemic that would kill several hundred thousand people, an unprecedented decline of more than 33% in 2nd quarter US GDP, an estimated decline in S&P 500 earnings of 20%, and a spike in unemployment to nearly 15% during the Spring, few would have predicted a rise in the S&P 500 benchmark of over 15% to record levels.

US equity markets continued moving higher during the fourth quarter, furthering the powerful rebound from the March lows. During the three-month period, the S&P 500 Index increased by 12.1%, bringing the full year 2020 return to 18.4%. From the March lows, the S&P 500 has rebounded an astounding 70%. Fixed income yields moved higher during the quarter as investors reacted to positive news on the COVID vaccine. Rates on the benchmark 10-year US Treasury note moved modestly higher during the quarter as confidence in a continued economic rebound through 2021 grew. The 10-year note ended the year at 0.92%, meaningfully higher than the 0.68% yield on September 30, but far below the 1.92% yield at the end of 2019. During its December meeting, the Federal Reserve reiterated its commitment to keep the short-term Fed Funds rate near zero into 2023 to help boost a reviving economy.

Oil prices moved higher, continuing their rebound from the spring as economic growth improved and travel increased, albeit in an uneven pattern. The price for benchmark West Texas Intermediate rose by almost 20% during the fourth quarter. After starting the three-month period at $40.22, oil declined during October before reversing and moving steadily higher for the final two months of the quarter. Oil prices ended the year at $48.52. While down from the $61.06 price at year-end 2019, the improvement in oil prices over the past nine months bodes well for normalizing supply/demand ratios. This continued stability in oil prices gives investors more confidence in the forecast for continued economic growth. We have long believed a fair price for oil in a "normal" economy was in the range of $50-$70 per barrel. We are now approaching the lower end of that range as unused capacity is taken offline and travel continues to increase modestly.

Economic and Market Outlook

The fourth quarter of 2020 saw a continued economic rebound from the historic declines earlier in the year. As we learned more about the virus, restrictions eased in many parts of the country and economic activity showed continued improvement. The Unemployment Rate in the US, declined to 6.7% in November, continuing its retrenchment from nearly 15% in April 2020. Further declines in unemployment will be tied to vaccine rates, the removal of lockdowns and restrictions, and the confidence by business owners to rehire people. While we do not expect to see unemployment return to its pre-pandemic level of 3.5% any time soon, continued improvement to approximately 5% during 2021 is likely.

TANDEM
INVESTMENT PARTNERS

29 Emmons Drive, Suite A-5
Princeton, NJ 08540
Tel 609-452-2100

2271 Porter Way
Lancaster, PA 17601
Tel 215-208-7994

220 S Pleasant Street
Prescott, AZ 86303
Tel 928-521-5628

© 2020 Tandem Investment Partners LLC. www.tandeminvestment.com All rights reserved.

Real GDP growth surprised to the upside in the third quarter, rising by 33.4% after a precipitous decline in the prior quarter. While we will not have full year 2020 GDP figures for a few more weeks, the Federal Reserve now expects the full-year decline to approximate 2.4%, significantly better than the expected -3.7% estimate as recently as September. 2021 could see GDP growth of 4% or higher, meaning that 2021 real GDP will surpass 2019 levels. This improved economic outlook has driven earnings estimates and stock prices higher during the past several months. S&P 500 earnings are expected to decline approximately 15% for the full-year 2020, which is significantly better than the 25-30% decline forecast during late summer. Preliminary estimates for 2021 are for a gain of 20% or more, resulting in full-year 2021 earnings approximately 5% higher than 2019 levels. The continued revisions in economic and earnings forecasts, along with the late-December stimulus agreement, has pushed equity prices to all-time highs. As equity prices continue to reach new highs, we believe some of the expected returns in 2021 have been pulled forward into 2020. Although there is room for further advancement in US equity prices, we do not expect to see prices rise as much as earnings during 2021.

The 2020 elections held few surprises for investors. Democrats now control both Houses of Congress with razor thin majorities. Even though we have one-party rule, passing significant legislation will be challenging as nearly every member of the party in power will need to support legislation to pass laws. Transformative changes in law under these circumstances will be difficult. There has been some discussion of ending the Senate filibuster which would allow legislation to pass with simple majorities.

That said, we believe Democrats will continue to push fiscal stimulus including more direct payments to citizens and municipal governments. This will add to the extremely accommodative monetary policy already in place, supporting higher spending by consumers in 2021. One effect could be higher than expected inflation which may push inflation higher than currently expected. Although the Federal Reserve has said they will not even consider raising rates for an extended period, inflation rates that reach above 2% for several months could change their stance. We have already seen the 10-year Treasury yield surpass 1% in early January for the first time since March 2020 as fixed income investors anticipate higher inflation trends.

We wrote in our last commentary of some concerns we had about valuations assigned to a few companies along with a bifurcation of returns between growth and value companies. Although value stocks meaningfully outperformed growth stocks in the fourth quarter, a few specific market segments warrant continued vigilance. Bitcoin has risen seven-fold since its March 2020 lows, despite little change in the outlook for the crypto-currency. SPACs (special-purpose acquisition company) were all the rage during 2020. A SPAC is a fancy name for a company that has no ongoing business, and only cash as an asset. The cash can then be used to purchase a private company at an agreed upon price which morphs the private company into a publicly traded entity. 112 companies eschewed the traditional IPO route, choosing instead to be acquired by a SPAC during the past year. There are a few potential problems with this method of becoming a public company. The first is that it avoids the traditional “Road Show” where management of a company hoping to go public meets with hundreds of institutional investors in a series of meetings over several weeks. During these meetings, investors get to analyze the company’s financial projections, ask questions, and decide what a fair value for the company should be. A second risk is that when a SPAC purchases a private company there is only one party on each side determining valuations. To us, the most obvious risk is that investors bid up prices of SPACs when they are only holding cash on their balance sheet in the hope that the company will make an intelligent purchase at a fair valuation.

TANDEM
INVESTMENT PARTNERS

29 Emmons Drive, Suite A-5
Princeton, NJ 08540
Tel 609-452-2100

2271 Porter Way
Lancaster, PA 17601
Tel 215-208-7994

220 S Pleasant Street
Prescott, AZ 86303
Tel 928-521-5628

© 2020 Tandem Investment Partners LLC. www.tandeminvestment.com All rights reserved.

One example of a SPAC gone wrong is Nikola which hopes to become the leader in electric trucks. The company has no revenues at all, yet after coming public via a SPAC last Spring, reached a market valuation of more than $35 billion by June. After the announcement of several failed deals and collaborations, the stock declined over 85% by mid-December. While SPACs and Bitcoin are not investments we would consider for your portfolio, they are signs of speculation and frothiness in certain investing segments that need to be monitored as we go through 2021.

Portfolio Positioning

Client portfolios continued to see modest asset allocation adjustments during the past three months as the sharp increase in equities from the March lows warranted rebalancing to bring portfolios back in line with target allocations. This process of trimming winners and adding to underperformers is a proven unemotional method of increasing long-term returns while reducing portfolio risk. At times, one can feel foolish by selling stocks that seem to be moving higher nearly every day. Yet those who live on a momentum strategy can be easily whipsawed and see months of gains wiped out in just a few days when their fortunes turn against them. Tandem added to equities in the spring after the sharp declines and began reducing equities in late summer after the stunning rebound. Our adherence to individual asset allocation for each client based on their risk tolerance is one of the differentiating factors at Tandem. After an extremely volatile year, we believe it is prudent to revisit your asset allocation and risk profile to see if changes are warranted. *We are including a copy of our most recent Risk Tolerance Questionnaire. Please complete this and return it to us via email, fax, or regular mail so we can update your files.*

We believe equities can move higher during 2021, albeit in an uneven pattern due to the vagaries of vaccine distribution, political uncertainty, and the level of fiscal accommodation the new Congress will provide. Stocks are no longer undervalued, but that does not mean they are facing an imminent selloff. Rather, they will be more attuned to changes in economic developments with those stocks that would benefit most from a normalized economy (travel, consumer, industrial) tracking economic progress more closely. Dividends continue to play an important role in our total return investing style, particularly in a year where we expect earnings growth to exceed capital appreciation. We remain overweight in companies with strong balance sheets, and diversified customer bases or differentiated product lines.

Conclusion

The new year brings hope for better times. Many uncertainties from the last few months are now resolved which has provided a tailwind to financial markets. Those who predict only gloomy times ahead ignore the decades of resilience the US economy has withstood. Companies adapt to changing preferences and regulations, with those that do not being replaced by new leaders. Many of the market leaders of today were not public companies 20 years ago. At Tandem, we know we cannot control many daily events. We understand this can seem daunting at times. By adjusting the overall level of risk in each client portfolio individually, we endeavor to control one of the most important factors in long-term investment results. Our time-proven, methodical investment philosophy takes much of the emotion out of daily decision making, leading to better long-term risk-adjusted returns.

As always, we enjoy hearing from our clients and encourage you to contact us if you have any comments or questions about your investments. A Happy and Healthy New Year to each and every one of you!

December 31, 2020

TANDEM
INVESTMENT PARTNERS

29 Emmons Drive, Suite A-5
Princeton, NJ 08540
Tel 609-452-2100

2271 Porter Way
Lancaster, PA 17601
Tel 215-208-7994

220 S Pleasant Street
Prescott, AZ 86303
Tel 928-521-5628

© 2020 Tandem Investment Partners LLC. www.tandeminvestment.com All rights reserved.