2020 Year In Review

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The year 2020, I believe can best be summarized by the lyrics from R.E.M.'s *It's The End of The World As We Know It:*

> That's great, it starts with an earthquake
>
> Birds and snakes, and aeroplanes . . .
>
> It's the end of the world as we know it
>
> It's the end of the world as we know it
>
> It's the end of the world as we know it and I feel fine

The first 15 days of 2020 were normal. In the beginning of January, there were concerns about a new viral outbreak, later to be named Coronavirus disease 2019, commonly abbreviated as COVID-19[1]. Initially, the markets and the world shrugged off this news as another event similar to H1N1 (2009) or SARS (2003) without a second thought that it would turn into a global pandemic.

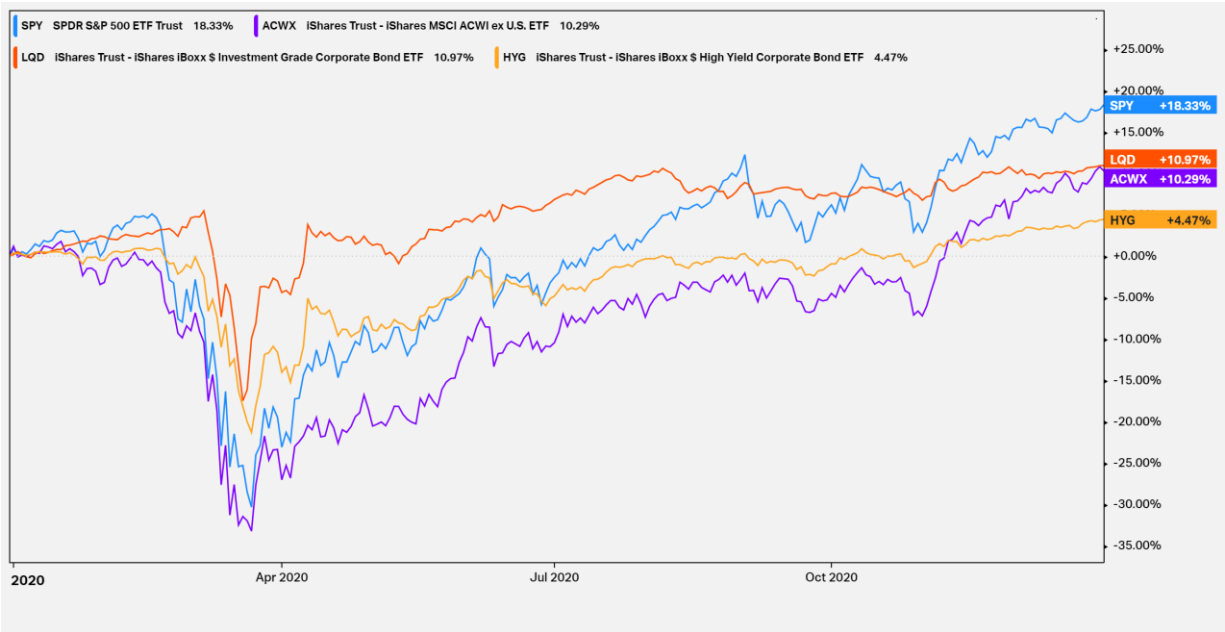
Day 16 of 2020 was the start of the transition from normal to anything but that[2]. As more data was obtained in February on infection and mortality rates, the virulence of the novel virus was better understood. This data prompted countries to begin asking citizens to practice social distancing and only travel out of necessity. At the beginning of March, these "asks" turned into orders to stay at home and only "essential" businesses should remain open. In the US, the counties in the Bay Area were the first to issue stay-at-home orders on Day 76, March 16th [3].

The markets took notice that the Coronavirus was different from past infectious diseases that spread globally. With stay-at-home orders issued and non-essential businesses ordered to close, global equity and fixed income markets rapidly declined due to the prospects that the entire global economy was going to be nearly halted by measures to prevent the spread of COVID-19. By the 23rd of March, the iShares S&P 500 ETF (SPY) and the iShares All-County ex US ETF (ACWX) were down 30.32% and 33.22%, respectively for the year. Corporate bonds also suffered extreme losses during this period as well with the iShares Investment Grade ETF (LQD) and High Yield ETF (HYG) indices following the equity indices lower declining 17.47% and 21.28%, respectively for the year[4,5].

Total Return Indices	Date in 2020		Days From Peak To Trough	Change From Peak To Trough	2020 Performance
	Peak	Trough			
S&P 500 (SPY)	Feb 19	Mar 23	33	-33.72%	18.33%
MSCI ACWI ex US (ACWX)	Jan 17	Mar 23	66	-34.40%	10.29%
US Corp Bond (LQD)	Mar 6	Mar 19	13	-21.76%	10.97%
US High Yield (HYG)	Feb 13	Mar 23	39	-22.03%	4.47%

Source: Koyfin, Peak & Trough Dates - SPY - ACWX - LQD - HYG - 2020 Performance

As we see in the table above, the market reacted swiftly to the prospects and then eventuality of an extreme slowdown in the economy. The National Bureau of Economic Research (NBER) would later announce in June that the US economy entered a recession in February marking the end of the economic expansion that began in June of 2009[6]. This expansionary period was the longest in US history dating back to 1854.



Source: KoyFin

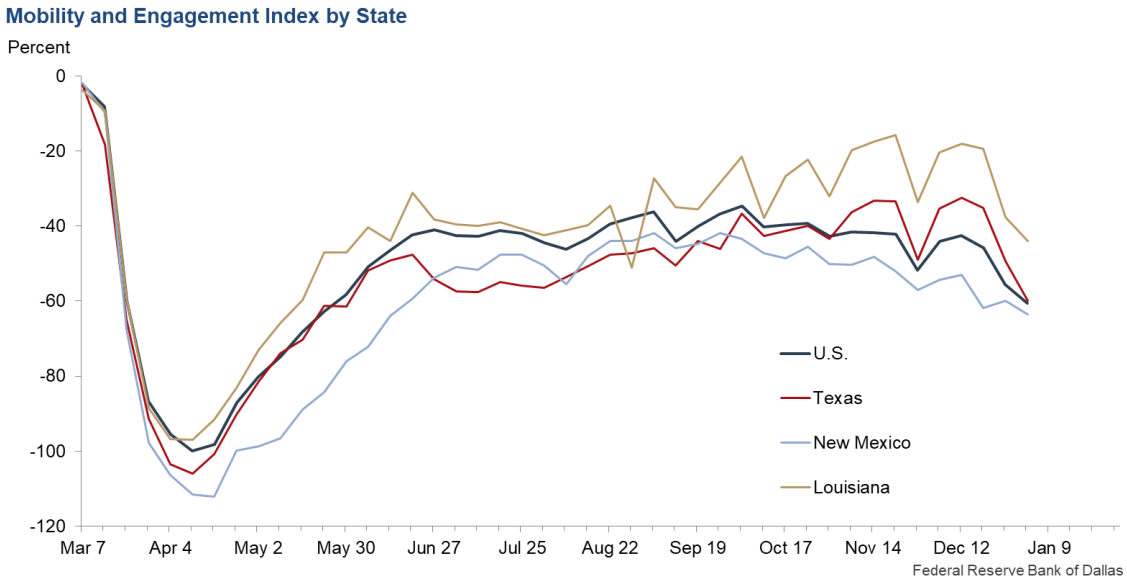
At this point at the end of March, the economic outlook was bleak. GDP in the second quarter declined 31.4% from the previous quarter on an annualized basis. This was the worst quarter in the history of US GDP[7].

Source: US Bureau of Labor Statistics

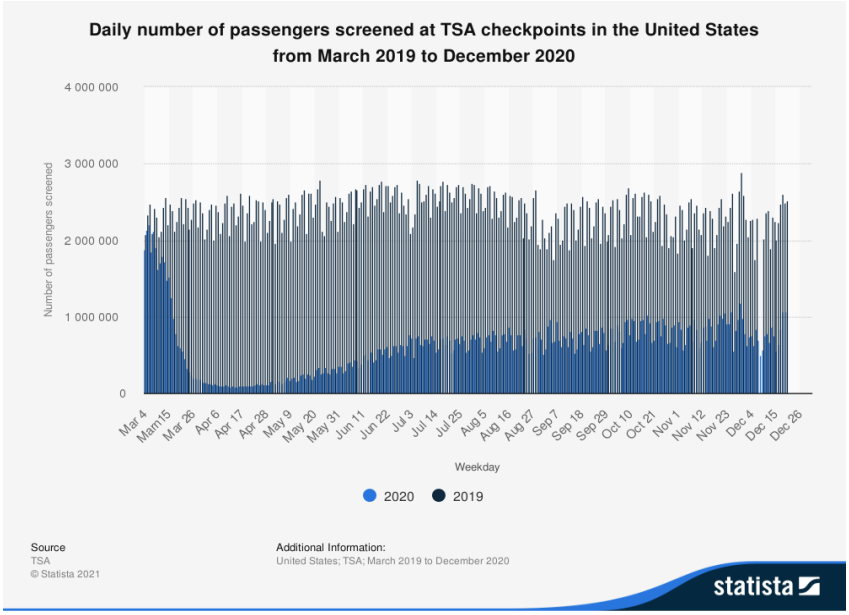
At the beginning of the economic shutdown, businesses laid off a tremendous number of workers. This was businesses, large and small, doing whatever it took to remain viable by reducing costs as much as possible while revenue was either completely cutoff (bars and restaurants) or reduced to a trickle (autos and airlines). A company does not need workers, if they are not allowed to be open or there is no demand for their product. For April, the Bureau of Labor Statistics (BLS) reported that a little more than 23 million people were unemployed[8]. This is nearly a 3.5 times increase in unemployed from the pre-COVID-19 levels in January and February of a little less than 6 million people.

Also in the*Employment Situation* report, the total number of persons claiming any kind of unemployment benefits offered by state or federal government (red line). In January and February, the Department of Labor (DOL) reported that a little more than 2.1 million were receiving some kind of unemployment benefit from local, state, or federal programs. The total number of people claiming benefits increased 15-fold up to a maximum of a 32.78 million people[9]. During this period between February and April, the total number of people employed declined from just under 152.4 million people to approximately 130.3 million people.

The chart below is the Dallas Federal Reserve's Mobility and Engagement Index (MEI) that tracks the mobility of people. This index utilizes GPS data from cell phones to track movement of people and activity level of the economy. The MEI is comprised of data that looks at the number of people leaving their home, how long they stay away at a fixed location (i.e. at work), and the distance people travel. These come together to provide a real-time picture of how people are moving. The index baseline is zero, which is the amount of activity prior to Covid-19 levels in January and February. The index declined markedly as shutdowns and quarantines swept across the country in March and April[10].



Source: Federal Reserve Bank of Dallas



Source: Statista: Daily Number of Passengers Screened at TSA Checkpoints

Another metric showing movement in the economy is data from the Transportation Security Administration (TSA) that tracks the number of people passing through airport security on a daily basis. The chart on the previous page illustrates the substantial decline in the number of people traveling in 2020 compared to the same period in 2019[11].

Looking back upon all of the charts presented so far, it was a dark and bleak time heading into the end of March. Even the world of sports was not able to provide a respite as the NBA, NHL, PGA, MLB, and the NCAA all canceled their respective seasons as a reaction to the virulence of the virus. Please excuse my highly technical jargon to describe the situation, as it is the only apt description: *suboptimal*.

Returning back to the charts for a second look, there is a common theme: economic and market data deteriorated severely as the reality of the deleterious effects of the virus and the resulting need to close the economy and hopefully slow the transmission took hold. After the low point of the market and economic data in late March, there was a tremendous rally in the markets as well as the economic data.

2020 could almost be defined by the opening lines of Charles Dickens' *A Tale of Two Cities:*

It was the best of times (Third Quarter of 2020),

It was the worst of times (Second Quarter of 2020),

It was the age of wisdom (the realization that this virus is worse than previous iterations)

It was the age of foolishness (COVID-19 will be like previous viral outbreaks)

It was the season of light (lockdowns lifting in May and June)

It was the age of darkness (the shutdown in March)

As the lockdowns began to lift in May and June, there was a resurgence in economic activity as seen the Dallas Fed Mobility and Engagement Index. The level of economic activity returned to roughly 60% of pre-COVID-19 levels as measured by MEI. TSA travel figures bounced off nearly no one traveling in March and April to hovering around 30% of 2019 travel volumes since lockdowns lifted in May and June . Another metric indicating a similar pattern is the New York MTA's daily subway system data. The usage rate of New York subways has increased from about 10% in March and April to about 30% since August compared to the same period a year ago[12]. Both of these real-time economic activity measurements are showing that we are currently in a holding pattern. There are restrictions still in place that are limiting capacity at restaurants, parks, and other public places to help prevent a resurgence in cases[13].

This increased economic activity and path towards normalcy led to the best quarter in history for US GDP growth. In the third quarter, GDP increased 33.4% over the previous quarter on an annualized basis[14]. Intuitively, this makes sense as the economy went from an almost standstill to re-opening. As we continue towards re-opening the economy and possibly normalizing our daily activity, the Federal Reserve Bank of Atlanta's GDPNow forecast, as of December 30th, for fourth quarter GDP growth is 8.6% increase from the third quarter on an annualized basis[15].

The stock and bond markets exhibited the much-anticipated V-shaped rally. From the lows of March through the end of the year, the US and International markets increased by more than 65%. There was also a dramatic rally in fixed income with the Corporate and High Yield bonds increasing 34.47% and 32.7% from their respective lows of the year.

Total Return Indices	Trough	From Trough to Year End
S&P 500 (SPY)	Mar 23	69.83%
MSCI ACWI ex US (ACWX)	Mar 23	65.16%
US Corp Bond (LQD)	Mar 19	34.47%
US High Yield (HYG)	Mar 23	32.71%

Source: KoyFin – Trough to year end SPY, ACWX, HYG, LQD

The employment situation started to improve dramatically as the number of unemployed declined from about 23 million to 10 million people. The number of people getting any kind of unemployment assistance declined from approximately 32.7 million people at its peak to 20.3 million, an improvement of 37.5%.

What caused such a quick turnaround from the quagmire of the suboptimal situation? There were two main factors. Action was taken very quickly from a fiscal and monetary policy standpoint. The President and Congress were extremely quick to react to the large spike in unemployment and forced closures of business by getting the CARES Act enacted March 27th[16]. This was the largest economic stimulus package in the history of the United States that provided relief to businesses as well as increased unemployment benefits for individuals. This was later complemented in December by the passage of another stimulus package. The Federal Reserve was also extremely quick to react to the downturn by cutting the Federal Funds Rate by 0.5% on March 3rd and cutting by another 1% on March 16th to bring the overnight lending rate down to a targeted range of 0% to 0.25%[17]. This was further supported by increasing bond purchases[18].

The Federal Reserve's reversal of raising the Federal Funds Rate and reducing their bond purchases to quickly cutting this rate to provide stimulus to the financial markets has driven interest rates even lower from the beginning of the year. The chart below illustrates the decline in Treasury yields across the curve. The 3-Month T-Bill went from 1.54% on January 2nd to 0.33% on March 9th, to end the year at 0.09%[19]. The 10-Year and 30-Year have declined substantially during the year; however, these maturities have increased from their March 9th lows. The 10-Year Treasury reached an intraday low yield on March 9th of 0.318%[20]. These low interest rates have provided homeowners the opportunity to refinance or purchase homes with a mortgage in the high 2%s or low 3%s[21].

Date	1 Mo	3 Mo	1 Yr	5 Yr	10 Yr	30 Yr
01/02/20	1.53	1.54	1.56	1.67	1.88	2.33
03/09/20	0.57	0.33	0.31	0.46	0.54	0.99
12/31/20	0.08	0.09	0.10	0.36	0.93	1.65

Source: US Department of the Treasury

In my opinion, the more important driver of the quick turnaround in the markets was driven by the outlook of the general public both in the US and abroad. The markets and public saw the shutdown of the economy as a temporary measure to combat the Coronavirus. There is also belief that Congress and the Federal Reserve will continue to act quickly and prudently to continue to provide stimulus to both the markets to maintain low interest rates and directly to people to assist in getting through the tough times that shutting the economy has caused. This recession, resulting downturn in the markets, and quick reactions from the Fed and Congress was not normal, similar to the abnormal realities of life in 2020.

In taking the time to examine the differences from previous market collapses and economic recessions, it is apparent that this one is atypical. In previous recessions, there was a financial impetus that led to a recession or worsened the economy. In the 2000 Tech Bubble and the 2008 Housing Crisis, exuberance led to the markets falling and credit drying up. The start of the downfall in the early 2000s was excessive speculation in any company that had a dot-com, such as Pets.com (the modern day equivalent is Chewy.com), and shady accounting at Enron and WorldCom. The 2008 Housing Crisis was fueled by banks and mortgage companies not verifying information about the people they were lending money to. All you needed at the time to be able to purchase a home was simply to produce two pay stubs. These bubbles bursting then started a spiral of lending markets drying up leading to bankruptcies and defaults and extreme levels of pessimism about the economy.

There is a lot to be optimistic about looking forward to 2021. The COVID-19 vaccine is in its initial phase of distribution, and monetary policy is still accommodating to gently rouse a re-awakening economy.

In looking forward, I hope the 2021 Year in Review is able to start with another set of lyrics from a completely different R.E.M. song:

Shiny happy people holding hands
Shiny happy people holding hands
Shiny happy people laughing . . . .

Please have a happy, healthy New Year!

Adam Hoffman, CFA®, CAIA®
Director of Investment Management & Trading

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