Looking Ahead to a Post-Pandemic World

We write following a New Year's celebration that, like most everything else in 2020, was far from the norm. The COVID-19 pandemic has tested us all in many ways, yet we trust that sunnier days lie ahead. What comes next and what can we learn from these trying times?

Prepare for the Unknown

Policymakers often fight the last crisis rather than anticipating the next one. In fairness, the latter is inherently difficult given life's many uncertainties. One thing we do know is that this year has shined a spotlight on risk, most notably a need to proactively prepare for it. As advisors, this speaks to several financial planning fundamentals – insurance and medical coverage, legal documentation, and asset allocation strategy.

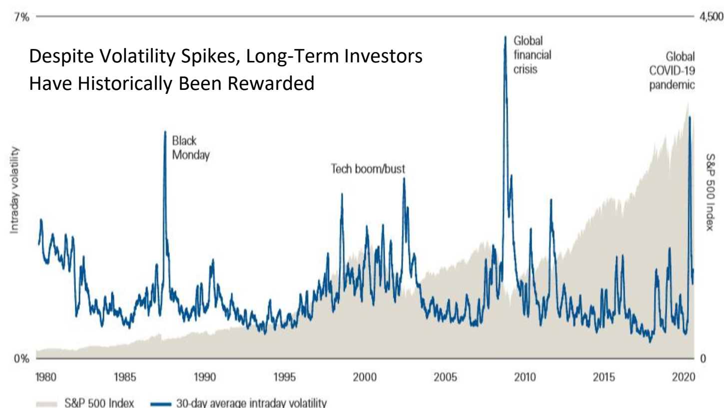
Insurance may be a mundane element of personal finance yet ensuring adequate medical and liability coverage is in place is integral to managing risk. We cannot prevent future eventualities, but we can put ourselves in a position to mitigate harm. For example, with longevity and acute care costs rising, long-term care insurance warrants careful consideration.

Similarly, trust and estate plans, healthcare proxies and other legal documentation can help insulate us from adverse effects of difficult situations. Working with advisors to implement legal safeguards that address your needs and reflect your wishes is recommended.

Your Life - Your Portfolio

Appleton is a strong proponent of personalized asset allocation strategy. Investment products often emphasize track records, and while such history is highly relevant, each client's outcome relative to their objectives is what matters most. As 2020 once again illustrated (see accompanying market notes), avoiding behavioral pitfalls brought on by market turbulence is an important element in achieving asset accumulation goals. Spikes in volatility have at times been severe, although they tend to be relatively brief and have historically not overly compromised long-term returns. Whether in the form of "Black Swan" events or more typical shifts in the economic cycle, a good defense against market downturns lies in staying true to a personalized, risk-aware asset allocation strategy.

Wealth management plans also ought to account for personal needs such as income, funding liabilities, and longevity. For example, a year ago very few anticipated millions of job losses. Portfolio management, like insurance, cannot prevent such occurrences, but aligning investment strategies with your circumstances can help mitigate harm.



Source: Vanguard Group and Bloomberg

Address the Knowledge Gap

Financial literacy is a multi-generational challenge and an impetus to more effectively handling routine and unforeseen financial situations. Managing budgets, debt or retirement plans does not require capital markets expertise, rather an ability to understand and act upon personal financial matters. As Champlain College's Center for Financial Literacy recently emphasized, "financial literacy is linked to positive outcomes like wealth accumulation, stock market participation and smart retirement planning."[1]

Our society has pushed retirement and other financial responsibilities to the individual despite inadequate financial education. According to a 2019 study by the FINRA Investor Education Foundation, only 17% of Americans ages 18-34 were able to correctly answer 4 of 5 basic questions in a financial literacy quiz. Transitioning to an independent professional life or receiving an inheritance can expose those unequipped to handle financial matters. That is why we encourage clients to bring family members into the planning process and seek professional advice when needed.

Resilience, Adaptability and Community

Sarah Ban Breathnach, a best-selling author, stated, "success in life is not how well we execute plan A, it's how smoothly we cope with plan B." Our pandemic experience has been an unexpected test of personal and organizational resilience. No one anticipated navigating a predominantly remote work environment from March through the present, nor the ensuing disruption to our children's education, our family lives, and community.

Trust is a foundation of resilience. Families, friends, colleagues, and community create a valuable support system when dealing with adversity. While pandemic and recession have frayed our nerves, the strength we draw from each other can be an effective anecdote. Like so many others, the Appleton team has adapted well, working together and with our clients and partners. Doing so has helped bridge the constraints of distance and dislocation.

As the Economist emphasized, "we are hardwired to anticipate the future. . . Imagining a positive outcome is a popular technique to build resilience and confidence."[2] We too look ahead to 2021 with optimism. This past challenging year has reinforced the virtues of adaptability, perseverance, and trust, as well as the need to take prudent steps today to mitigate tomorrow's risks.

Our collective well-being is fortified by helping one another. How many times have you heard that "we're all in this together?" Despite its overuse in TV advertising, there is truth to that sentiment. December's Review and Outlook discussed the difficulties faced by non-profits and referenced the CARES Act's charitable giving benefits. Individual generosity makes a big difference, and we strongly encourage community engagement.

At Appleton, we are grateful to serve you and your family and wish everyone a happy and healthy New Year.

1. www.champlain.edu 2. The Economist, 11/27/20

APPLETON PARTNERS, INC.

MARKET OBSERVATIONS & IMPLICATIONS

Tax-Exempt Investment Grade Municipals

- A strong muni bid continued in Q4 with $20B of net fund flows bringing YTD net flows to $39.7B.
- Election overhang and weakening Q4 economic data prompted the Fed to stay accommodative and the Fed Funds rate is now expected to be unchanged through 2023, anchoring the front-end of the curve.
- Prior curve steepening reversed in Q4 as the 10Yr AAA muni dropped 16 bps, reducing the 2-10Yr spread to 57 bps.

	9/30/20	12/31/20	QTD change
2Yr AAA Muni	0.13%	0.14%	+1 bps
10Yr AAA Muni	0.87%	0.71%	-16 bps
30Yr AAA Muni	1.62%	1.39%	-23 bps

- Stimulus and deficit fueled inflation expectations could lead to intermediate and long-term yield curve steepening in 2021. However, 2020 core PCE was revised down to 1.4% diminishing current inflation concerns.
- October saw record $72B issuance as deals were accelerated ahead of the election. November and December declined 57% and 29% YoY respectively. Nonetheless, 2020 produced a record $474B, up 11% over 2019. Expectations for 2021 municipal issuance average about $500B.
- Robust demand coupled with constrained net supply has produced strong performance. 10Yr AAA Muni/UST ratios fell from 113% to 77% in Q4. We see muni valuations remaining elevated and a 10Yr ratio in the 70s during Q1 and possibly longer.
- Credit and long duration outperformed in 2020, while short maturities lagged on a relative basis. GOs held up relatively well during March and April and carried that performance throughout the year. Revenue bonds and lower grade credits underperformed in Q2 but enjoyed credit spread tightening in Q3 & Q4.
- Our UST 10Yr trading range has been revised upwards to 0.80 – 1.25%, although we are mindful of federal deficits and the Fed's balance sheet, among other potential rising rate catalysts.
- Our Intermediate Municipal strategy is targeted to be duration neutral at about 4.60 years and we are focusing on high-grade credits in a 6 to 10-year maturity range.

Investment Grade Corporates & Treasuries

- Extremely low rates, ample liquidity, and healthy demand led IG Corporate issuers to bring a record $1.75T in new supply to market in 2020, up 69% vs. 2019. $210B of new debt in Q4 contributed to this year's record setting supply.
- Issuers were focused on refinancing and shoring up liquidity and we expect new issuance to slow in 2021. Merrill Lynch projects net negative IG Corporate supply of $200B in 2021 after factoring in new issuance, coupons, maturities, and calls. This is a favorable technical factor.
- There has been no lack of buyers with institutional (including non-US) and retail investors aggressively seeking out IG Corporate debt. Spreads remain tight, ending December at 96 bps, a far cry from March's high of 373 bps.
- Despite a very volatile 1H, IG credit spreads ended the year only 3bps wider than where 2020 began. Rates drove modest excess returns and high-quality credit outperformed, led by Single A bonds with an excess return of 0.68%.
- Fueled by a rapid reduction in UST rates, the short end posted a 2020 total return of +3.8%.
- Improving economic forecasts pushed UST yields higher during Q4 with the 10Yr closing 2020 at 93 bps. The Fed retains a strong grip on the short end of the curve and most of the rate action is occurring beyond 5 years. We see this trend persisting unless the Fed adds duration to their monthly bond buying, a move that would mitigate UST curve steepening.

Equities

- In a remarkable year, the S&P 500 rebounded nearly 70% after falling 35% over 23 trading days during Q1. Much of the S&P 500's 18.4% gain for the year occurred in Q4 (+12.2%).
- The market was bolstered by removal of election overhang, vaccine optimism, and anticipated fiscal stimulus. Underlying bull market pillars remain intact: historic fiscal and monetary stimulus, a synchronous global economic recovery, and positive corporate earnings expectations.
- Consensus calls for an uptick in 2021 growth on the heels of what is likely to be further fiscal stimulus on top of the recently passed $900B package. GDP impact could be offset by the potential for corporate and high-income tax increases. We do not foresee major tax policy changes though given the state of the economy and a tight political balance.
- Rates and earnings will influence 2021 equity market performance. Inflation remains subdued although future expectations are trending up. The earnings outlook is favorable, but companies will need to deliver to justify current equity valuations.

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