Cygnus
ASSET MANAGEMENT, LLC

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A View from the Bevy – 4Q20

Market Overview

2020 was a wild year for the stock market as well as the world in general. Despite an ongoing pandemic, economic uncertainty and political tension most major market indices ended the year at or near all-time highs. Let's look back at what happened in the markets in 2020 and discuss our outlook for 2021.

A deeper look at the positive year-end results for stocks reveals a wild and volatile ride in 2020. After reaching all-time highs in January, stocks took a deep dive beginning in mid-February after the true devastation of COVID-19 became apparent and economies around the world began to shut down. The market experienced the fastest sell-off since the 1929 crash, beginning on February 20th and ultimately ending the longest bull market in history. Between mid-February and late-March, The Dow Jones Industrial Average (DJIA) lost 37% of its value.

By April, however, stocks had recovered enough to enter a new bull market – ending the shortest bear market in U.S. history. There was additional volatility in the Fall, as a September drawdown was sparked by the technology stocks that had led the rebound, but the market ultimately remained strong through the close of the year. Both the S&P 500 and DJIA ended the year at record highs.

This impressive performance of the market indices, however, masks the significant divergence seen on a sector-by-sector basis. Although we often discuss the market as a singular entity, we must keep in mind that it is a collection of individual stocks. Investors will tend to reward companies with strong balance sheets and that are in industries benefitting from current trends, even in the current environment when the economy is not fully recovered from the pandemic-induced recession.

Stock Market Indices	4th Quarter	Total Year
S&P 500	12.14%	18.39 %
S&P 500 (Equal-Weight)	18.29%	12.76%
Dow Jones Industrial Average (DJIA)	10.73%	9.72%
NASDAQ Composite	15.67%	45.06%
Russell 2000	31.36%	19.93%
MSCI World	13.96%	15.90%
MSCI World ex U.S.	15.85%	7.59%
MSCI Emerging Markets	19.70%	18.31%

Source: Raymond James

In 2020 the market was particularly bifurcated. Investors flocked to the beneficiaries of stay-at-home orders like e-commerce delivery company Amazon, online meeting company Zoom and fitness company Peloton. On the other hand, entertainment and travel-related stocks were pummeled by the shutdowns and some may take years to recover.

The overall positive performance of stocks in 2020 puzzled many. The economy has not fully recovered, unemployment remains high, and the spread of COVID-19 is not yet under control. Ultimately, however, stock markets are forward-looking, focused more on the future than the present. Investors wasted no time projecting a light at the end of the tunnel of the pandemic and stocks rose accordingly.

Outlook

As we enter the new year, we are still in the early stages of an economic recovery. Many economists expect the economy and corporate profits to grind slightly higher in the first half of the year as vaccines are distributed, before surging in the second half of 2021 when we get COVID-19 under control. This optimism bodes well for stocks in 2021, particularly combined with the accommodative monetary policy of the U.S. Federal Reserve (Fed) and the possibility of a stimulative bi-partisan infrastructure bill from Congress.

There are still some risks, however, that could temper enthusiasm during the year. Considering the events that occurred at the Capitol on January 6, it is clear that political instability and division will continue to be a risk for markets. However, with the Electoral College votes officially counted by Congress and Joe Biden definitively declared the winner of the election a major uncertainty has been removed from markets.

Although the headlines are currently focused on the events at the Capitol, markets will likely focus on developments with COVID-19. How quickly and efficiently vaccines will continue to be administered is obviously crucial in bringing the pandemic under control. December saw vaccine distribution start more slowly than expected as states and hospitals tackle the logistical issues of this massive undertaking. We expect a more unified national distribution plan at the federal level under the new administration, but how quickly that can be implemented is unclear at this time.

Once the vaccine is distributed, pent-up demand for travel and leisure activities could come with increased inflationary pressures in the second half of the year. If inflation runs too far above the Fed's average target level, they could be forced to increase interest rates. Another concern is that the current valuation of the market is high. The price-to-earnings ratio of the S&P 500 is at levels not seen since the 2009 Financial Crisis.

With all that being said, there are always risks in the market, and overall, we feel that the positives outweigh the negatives as we enter the new year. We are generally optimistic about markets as the world begins to get the virus under control and recover from the economic damage of 2020. We will of course monitor the situation closely, communicate with you as warranted and adjust client portfolios as we deem appropriate.

We wish you and Happy and Healthy New Year. Please stay safe, and don't hesitate to contact us with any questions or concerns.

Of Interest: Avoiding Investment Fads

Investment fads can lead to manias that are characterized by excessive enthusiasm for a certain investment or investment style that proves to be unsustainable over the long-term. As one Nobel laureate said, "There's one robust new idea in finance that has investment implications maybe every 10 or 15 years, but there's a marketing idea every week."

Investment fads are often confused with larger secular trends, which persist over the longer-term and are based on fundamentals rather than enthusiasm. While it is possible to make money on investment fads, like any investment based on market timing, it can be very risky. It might be tempting to seek out the seemingly latest and greatest investment ideas, letting short-term investment themes influence your investment approach can hamper long-term returns.

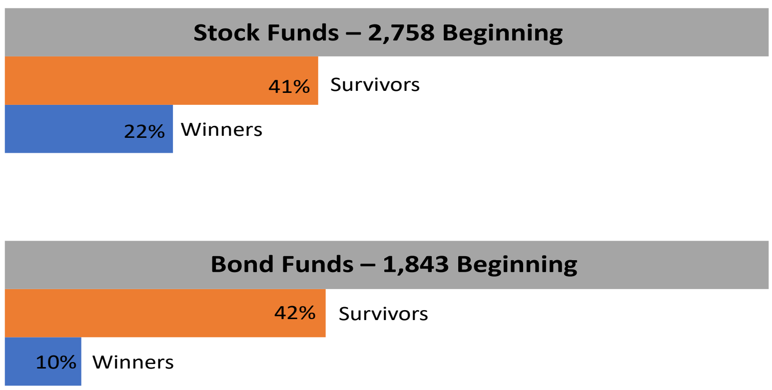
Investment fads, and funds created to capitalize on them, are nothing new. In the early 1990s attention was focused on the rising "Asian Tigers" of Hong Kong, Singapore, South Korea and Taiwan. A decade later a lot was written about the emergence of the "BRIC" countries of Brazil, Russia, India and China.

Funds targeting hot industries, such as the "Nifty Fifty" in the 1950s and the "go-go" stocks in the 1960s piqued investor interest at those times. More recently the dotcom and real estate bubbles burst, which many of us experienced first-hand.

On the flip side, while a few years ago it might have been tempting to call cryptocurrencies a fad, it seems that they have more staying power than initially thought. Especially after this year when the pandemic has moved us closer to a cashless society.

It is important to keep in mind, however, that many investment fads, and indeed, most investment vehicles, do not stand the test of time. A large proportion of funds fail to survive over the longer-term.

As shown in the chart below, according to a 2020 mutual fund study conducted by Dimensional Fund Advisors (Dimensional), of the 2,758 equity funds in existence at the beginning of 2000, only 41% were still open at the end of last year. For fixed income funds the numbers are similar, with only 42% of the 1,843 funds available to U.S.-based investors over the same period around today.



Source: Dimensional Fund Advisors (Dimensional)

When funds are forced to close or liquidate it is often due to lack of investor interest, limited assets or poor performance. This puts a burden on the end-investor and may even create a tax event.

While fashionable investment ideas will come and go, it is important to remember that a long-term, disciplined investment approach based on research and implemented to meet your personal objectives is the most reliable path to success.