

Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management



Quarter 4, 2020

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At the beginning of the year, the United States was enjoying the longest expansion on record. The economy seemed poised to continue its run with the signing of trade deals with Mexico, Canada and China. Donald Trump held comfortable leads in most polls and markets were breaking to new highs. By the end of the first quarter the Covid-19 virus had plunged the US economy into recession and ushered in the fastest bear market with the S&P 500 ultimately declining 34%. Unprecedented monetary and fiscal response saw 5 different relief packages, the largest non-war stimulus in US history, the Fed balance sheet expanding by 70% in just 2 months, record low interest rates and the fastest recovery from a bear market ever. In the final quarter of the year alone we saw the introduction of two vaccines for Covid-19, developed in one tenth of the normal time, a new President elected and a surprise election outcome in Georgia, leaving the Federal government entirely in Democrats' control, though by the slimmest of margins. The fourth quarter also witnessed a changing of the guard in stock leadership with international, especially emerging markets, value and small cap the stars. There have been many false starts when it comes to leadership change in the past 12 years, but this has the potential to last longer.

Data as of Dec 31 st , 2020	Dec. '20	Qtr. 4 '20	YTD '20
S&P 500	3.84%	12.15%	18.40%
MSCI AC World Index (incl. US)	4.68%	14.79%	16.82%
MSCI EAFE (Europe, Asia, Far East)	4.67%	16.09%	8.28%
MSCI EM (Emerging Markets)	7.40%	19.77%	18.69%
Russell Largecap	4.23%	13.69%	20.97%
Russell Largecap Growth	4.60%	11.39%	38.49%
Russell Largecap Value	3.84%	16.25%	2.79%
Russell Midcap	4.69%	19.92%	17.11%
Russell Smallcap	8.65%	31.37%	20.02%

Data compiled by Tamarac Inc.



Fixed Income Markets

The fixed income market largely enjoyed a continued rally of its own in the fourth quarter. Reflecting the risk-on nature of the quarter along with continued green shoots emerging in the economy, high yield bonds again paced the market, returning 1.91% for December and 6.48% for the quarter. The strong performance in the final three months brought the index into positive territory for the year at 6.17%. The broad US Aggregate index eked out a gain of 0.67% for the quarter, helped along by municipal and corporate credits. Departing from this positive return scenario and reversing the multi-year trend of higher prices and falling yields, intermediate and longer dated US Treasuries saw lower prices and higher yields in the quarter. Maturities of 3 years and greater all posted negative total returns. An improving growth outlook dented the attractiveness of the safety trade defined by flight to Treasuries, and investors got comfortable with more risk.

Higher rates could be the surprise of '21...

Curve continues to steepen...

Gold takes a pause, energy rips...



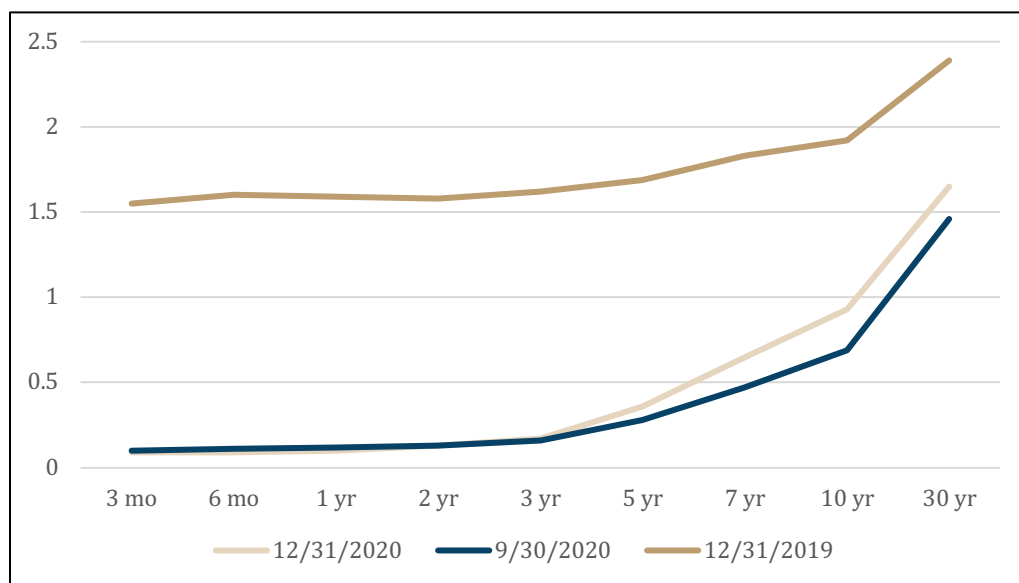
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US Treasury Yields

The curve steepening which began in the summer picked up steam in the final months of the year, resulting in the spread between 2- and 10-year yields being at its widest point in years at the end of 2020. With multiple members of the Fed continuing to push back against the idea of rates moving higher before 2022, it seems highly unlikely that the short end of the curve will move off zero soon. At the same time, encouraging growth prospects and increasing signs of inflation should continue to push longer yields higher. With only 4 of 54 surveyed Wall Street forecasters predicting the 10 year yield above 1.5% in 2021, higher rates might be the greatest surprise.



Commodities

Commodities were again broadly higher in the quarter, spurred on by those most sensitive to the change in economic growth. While the CRB index was up an impressive 13% in the final 3 months, it was not enough to overcome the weakness from the beginning of the year.

Both oil and gasoline rebounded by more than 20% as the growth outlook firmed, though like the CRB both were down for the year. The notable exception was natural gas which barely budged thanks to a warmer than usual start to winter.

A 16% rally for copper strengthened the notion the global economy was turning up.

Gold had a banner year, returning nearly 25%, though like Treasuries found itself out of favor in the quarter.

Commodity	Qtr. 4 '20	Year to Date '20
CRB (broad index)	13.01%	-9.99%
Oil	20.72%	-20.92%
Gold	0.30%	24.59%



Economic Overview

Covid response created winners and losers...

Manufacturing powers higher...

Housing losing some steam in year-end as employment fears weigh...

Large corporations feeling better than small...

International economic picture similar to the US...



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In 2020 Covid-19, and the lockdowns required to help battle it, sent the global economy into a quick and vicious tailspin. Almost as quickly, many public companies began figuring out how to operate in the new reality and, combined with major support from governments and central banks, a recovery – albeit bifurcated and favoring large over small business - began to take shape.

By the end of the year the broad manufacturing sector, both domestically and internationally, had not just found its footing but was showing signs of robust growth. The service sector continued to struggle as capacity limitations, reduced travel and reluctance to re-engage by individuals dented any resurgence.

- The US manufacturing PMI (Purchasing Managers Index) rose 3.2 points to a blistering 60.7 in December, third highest reading globally behind only Brazil (61.5, - 2.4 points) and Taiwan (61.3, +0.1). A reading of 60.7 suggests GDP growth of 5.2% for the fourth quarter.
- The new orders component remained above 60 from July through December, indicating demand led activity.

Housing was a major driver of US economic strength as low mortgage rates helped affordability and an exodus of individuals from cities sent demand soaring. The first sign of a crack in the housing story developed in the final months of the year, however, with consumer confidence in housing falling in the November and December Fannie Mae survey. The driver of the decline was a quarter of respondents citing a fear of losing their jobs.

Late in the year, the service sector of the economy also enjoyed a rebound from depressed levels, though the pace of growth lagged manufacturing. The service PMI rose 1.3 points to 57.2 in December after falling the previous 2 months, remaining below the July recovery high.

In a further indication that the economy is not synched up, the Business Roundtable survey of CEO confidence rose 22.2 points in December to 86.2. The historical average reading for this survey is 81.5 and was at 76.7 at the end of 2019. In comparison, and showing the strains on small business, the NFIB survey of small businesses fell -5.5 points in December to 95.9 and now sits below the historical average of 98.

While the statistical economic rebound in the US has been impressive, the recent resurgence in Covid cases nationally is taking a toll. The December jobs report showed a decline of 140,000 jobs (though the two previous months were revised higher) ending a streak of seven months of growth and resulting in an unemployment rate of 6.7%, nearly double where it started the year.

Similar to the US, internationally there was near universal strength in manufacturing for much of the year while the service sector continued to deal with Covid-19 fallout - only Mexico showed a contraction in manufacturing with a reading of 42.4. In December, the readings for Brazil, China and Mexico fell (though the first two countries remained firmly in expansion territory), something to watch.

While manufacturing continues to hold its own, renewed lockdowns are having an impact on European economies, especially when looking at high frequency current data. Public transit demand in Germany and Italy has plummeted since October as rising new infections have forced governments to curtail movement. Not surprisingly, consumer confidence in Germany fell 7.3 points in December to record a six-month low.

The link between economic statistics on a national and international level and the status of Covid-19 is becoming clear.



Investment Implications

2020 was a wild year...

Superlatives about how unprecedented 2020 was have become commonplace; here are a few more to consider:

- The February to March market decline was the most rapid shift from a bull to bear market ever and the recovery that began on March 23rd would usher in the fastest recovery from a bear market ever.
- Despite 42 companies in the S&P500 suspending their dividends, total dividend payments for the index still rose 0.7% for the year.
- 2020 was only the fourth year ever where the market low was lower than the previous year and the market high was higher than the previous year. In each of the three previous occurrences markets were higher the next year, on average by 21%.

Massive Fed support drove rates lower...

The actions taken by the Federal Reserve and other central banks around the world played a role in first stabilizing markets and then powering them higher. The Fed balance sheet increased by more than 75% in the year as the central bank backstopped just about every asset class imaginable. With interest rates plunging to all-time lows, TINA (There Is No Alternative) came back into vogue.

As the year came to a close, there were competing forces acting on the market and storm clouds were gathering. Revenue for the fourth quarter 2020 in the S&P500 is forecasted to fall -1.3% year over year while earnings are pegged to be -9.8% lower (compared to an actual decline of -6.5% year over year in the third quarter). At the same time, the three-month average of upward earnings revisions hit the highest mark ever at the end of December.

Tech bubble comparisons not perfect...

While comparisons to the '99/'00 tech bubble have become increasingly popular, it is not a perfect analogy. In 1999 the market was being pushed higher by a very small slice of participants; yet the average stock was not participating. At the end of 2020, 90% of the issues in the S&P500 were in an uptrend for the best reading since 2013. Even more broadly, the Wilshire 5000 has been outperforming relative to the S&P500 since September.

It is not as though the market is without points of concern, however. The most immediate is sentiment. The American Association of Individual Investors (AAII) weekly survey ended the year with 46.1% of respondents reading bullish and only 26.8% bearish. This compares to the historical averages of 38% and 30.5% respectively. Money flows are also aggressive, especially into the recently hot sectors like financials and small-cap stocks.

Concerns abound, helping to keep irrational exuberance at bay...

At the same time interest rates, those not pinned to the floor by the Fed, have been marching steadily upward. While not at a point where they are a headwind, at some point higher interest rates historically result in a lower price to earnings multiple for the market. Valuation is extreme by almost every measure. After the surprisingly strong returns of 2020, a healthy correction would not be surprising.



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