Birch Hill
INVESTMENT ADVISORS

# Market View

## January 2021

### POSITIVE RETURNS FOR STOCKS

US stocks continued to move higher during 2020's last quarter, with the S&P 500 Index and the Dow Jones Industrials returning 12% and 11%, respectively. Small and mid-capitalization stocks were even stronger, returning 31% and 24% during the quarter. All equity indexes produced attractive returns in 2020 (see Market Indicators box). However, those annual returns conceal the story of a rapid, deep bear market and the subsequent 68% S&P 500 rebound.

By 2020's end, many stocks were no bargain. Recent initial public offerings and some technology stocks appear rather frothy as some investors have bought based on momentum and not underlying valuation. With interest rates stuck under 1%, equities could continue to trend upward, but we expect ongoing volatility.

Short-term interest rates stayed very low during the fourth quarter while longer-term rates inched slightly higher. The 2-year US Treasury note yield was unchanged over the quarter and ended the year at 0.13%. The yield on 10-year US Treasury bonds rose from 0.69% at the quarter's start to 0.93% at year-end—still well below the 3% level of November 2018, when Treasuries last offered reasonable returns. While the Federal Reserve has pledged to hold short-term interest rates close to zero through 2023, some economists believe longer-term rates will gradually rise as economic growth improves.

### REASONABLE ECONOMIC GROWTH IN 2021

Rebounding from the second-quarter COVID-19 shutdown, the US economy grew by an astounding 33.4% annualized rate in the third quarter. Fourth-quarter growth is expected to be less than 3%, but the virus's surge makes that forecast less certain than usual. It seems likely that the US economy will shrink by less than 4% for all of 2020. Economic growth in early 2021 will depend on the pandemic's path. Vaccine distribution and the resulting decline in infections should allow normal economic activity to resume later this year. Many forecasters now predict 2021 will achieve reasonably positive 3.5% economic growth.

| Market Indicators | | 12/31/2020 |
|---|---|---|
| **TOTAL RETURN** | | |
| **US Stock Markets** | 4th Qtr | Year-to-date |
| S&P 500 Index | 12.1% | 18.4% |
| S&P 400 Mid Cap | 24.4% | 13.7% |
| Russell 2000 Small Cap | 31.4% | 19.9% |
| **Int'l Stock Markets** | | |
| ETF Returns in US$ | | |
| EAFE Index (Europe, Australasia, Far East) | 15.7% | 7.6% |
| Japan (MSCI Index) | 14.8% | 15.4% |
| China (Xinhua 25) | 12.2% | 8.9% |
| Emerging Mkts Index | 18.4% | 17.0% |
| **US Fixed Income Yields** | 12/31/2019 | 12/31/2020 |
| 6 Mo US T-Bill | 1.60% | 0.09% |
| 2 Yr US T-Note | 1.58% | 0.13% |
| 10 Yr US T-Note | 1.92% | 0.93% |

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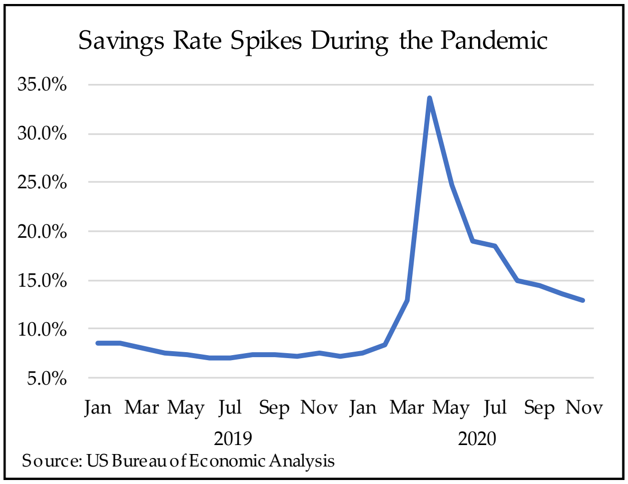
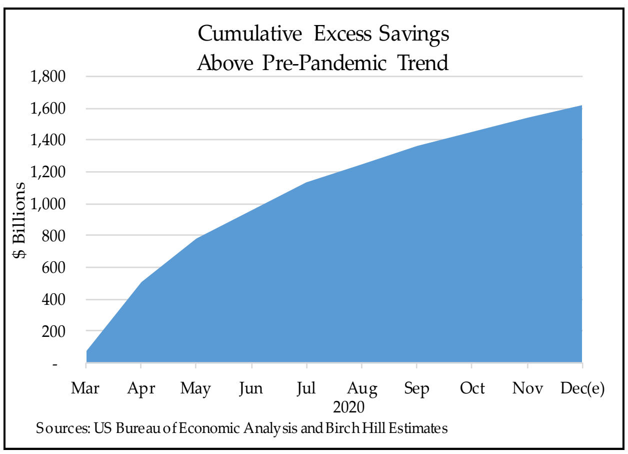
## HIGHER PERSONAL SAVINGS TO FUEL 2021 GROWTH

The $2.2 trillion CARES Act, enacted in March 2020, provided significant federal support to many individuals through $1200 one-time payments and four months of $600 per week supplemental unemployment compensation. This helped to stabilize income among the hardest-hit individuals, including restaurant, hospitality and retail industry workers. A late December COVID-19 aid package provided an additional $900 billion of relief. US Bureau of Economic Analysis (BEA) figures show that total personal income edged slightly higher during 2020.




Personal savings rates skyrocketed early in the pandemic and remained elevated through year-end. During the decade before the pandemic, individuals' saving averaged 7.2%. In March 2020, as pandemic-related shutdowns began, the savings rate rose to almost 13% and then swelled to more than 33% in April. The rate gradually declined but remained elevated at 12.9% in November, the most recent data available.

The surge in savings is understandable during a period when the average American's personal income remained largely unchanged while opportunities to spend have shrunk. Travel and leisure spending plummeted. Sales fell more than 10% at restaurants, gasoline stations, clothing stores and department stores. While grocery store sales grew and online sales surged, the average consumer ended each pandemic month with a growing surplus of funds. Unfortunately, this isn't true for all Americans. Some have been hit hard by unemployment and illness.




During the pandemic, US consumers saved about $1.6 trillion that they would have spent in normal economic times, according to BEA data and Birch Hill estimates. That sum equals more than 7.5% of the annual value of all US economic activity.

Birch Hill anticipates consumers will spend most of their excess savings after the pandemic. Some hard-hit industries will likely turn around rapidly. However, many current estimates of economic growth appear to assume the vast majority of the pandemic's excess savings will go unspent. Given traditional spending patterns and pandemic-induced pent-up demand, we suspect many consumers will spend freely in late 2021 and 2022.

## MORE NORMAL ACTIVITY, BUT ALSO POTENTIAL VOLATILITY

To the surprise of many, 2020 turned out to be a good year for stock prices, despite the dramatic springtime plunge and subsequent rebound. Investors expect economic activity and corporate profits to eventually become more normal in 2021. Consumers' willingness to spend their excess savings from last year will affect the course of economic growth over the next several years. Just as the pandemic produced periods of significant economic uncertainty, the post-pandemic recovery will likely have surprises. Investors should be prepared for financial market volatility.

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