

BCM 4Q20 Market & Strategy Commentary

Looking Back to Move Forward: Seeking Higher Ground in an Imperfect World

By the BCM Investment Team

2020 proved that the world, and humanity, is far from perfect. However, its important to focus on progress, not perfection.

Despite the incalculable challenges of 2020, the markets proved to be resilient.

While most existing factor relationships flipped on their heads in 2020, we also saw the emergence of a new kind of "factor"—the "Covid factor."

As we reflect on what may impact the markets moving forward, we believe optimism is warranted in 2021.

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Much will be written about the challenges, difficulties, pain and suffering endured by humanity in 2020. We would like to focus on some of the good that came out of last year's strife:

- Our Democracy, while far from perfect, works. While many did not see their preferred candidates win, as always, this is part of Democracy, and Democracy is still the best system of government humans have yet devised.
- Our society, while far from perfect and through too much tragedy, edged a bit closer to embracing equality in all that the word means. Now we all need to go forth in peace to finally make the words of our founding fathers our creed, our bond...and everyone's reality.
- Our biotechnology and pharmaceutical industries, while far from perfect, are prodigious. Instead of the typical ten years, they created at least three viable vaccines from scratch in less than one year.
- Our health care system, while far from perfect, has been exalted by all those who serve. Faced with the worst pandemic in more than a century, these caregivers' devotion, tenacity, compassion, and disregard for personal well-being is beyond reproach.
- Love, while far from perfect, is a much stronger force than any other. For this, we give thanks...

Stock Indexes Returns (Total)			
For time periods ending December 31, 2020			
1 year returns		2 year annualized returns	
Nasdaq 100	48.88%	Nasdaq 100	44.09%
Nasdaq Composite	44.92%	Nasdaq Composite	40.75%
Russell 1000	20.96%	Russell 1000	26.09%
Russell 3000	20.89%	Russell 3000	25.85%
Dow Jones Total Stock Market	20.79%	Dow Jones Total Stock Market	25.74%
Russell 2000	19.96%	S&P 500 Composite (Capitalization Weighted)	24.77%
S&P 500 Composite (Capitalization Weighted)	18.40%	Russell 2000	22.71%
Dow Jones Transportation Average	16.52%	S&P 500 Composite (Equal Weighted)	20.76%
S&P 400 MidCap	13.66%	S&P 400 MidCap	19.77%
S&P 500 Composite (Equal Weighted)	12.83%	Dow Jones Transportation Average	18.66%
S&P 600 SmallCap	11.29%	Dow Jones Industrial Average	17.27%
Dow Jones Industrial Average	9.72%	S&P 600 SmallCap	16.89%
Dow Jones Utilities Average	1.55%	Dow Jones Utilities Average	13.70%
5 year annualized returns		10 year annualized returns	
Nasdaq 100	24.27%	Nasdaq 100	20.63%
Nasdaq Composite	22.12%	Nasdaq Composite	18.46%
Russell 1000	15.80%	Russell 1000	14.01%
Russell 3000	15.43%	S&P 500 Composite (Capitalization Weighted)	13.88%
Dow Jones Total Stock Market	15.36%	Russell 3000	13.79%
S&P 500 Composite (Capitalization Weighted)	15.22%	Dow Jones Total Stock Market	13.74%
Dow Jones Industrial Average	14.65%	Dow Jones Industrial Average	12.97%
Russell 2000	13.26%	S&P 500 Composite (Equal Weighted)	12.66%
S&P 500 Composite (Equal Weighted)	12.95%	S&P 600 SmallCap	11.92%
Dow Jones Transportation Average	12.44%	Dow Jones Utilities Average	11.86%
S&P 600 SmallCap	12.37%	S&P 400 MidCap	11.51%
S&P 400 MidCap	12.35%	Russell 2000	11.20%
Dow Jones Utilities Average	12.05%	Dow Jones Transportation Average	11.02%

Source: TheChartStore.com, as of 12/31/20. An investment cannot be made directly in an index.

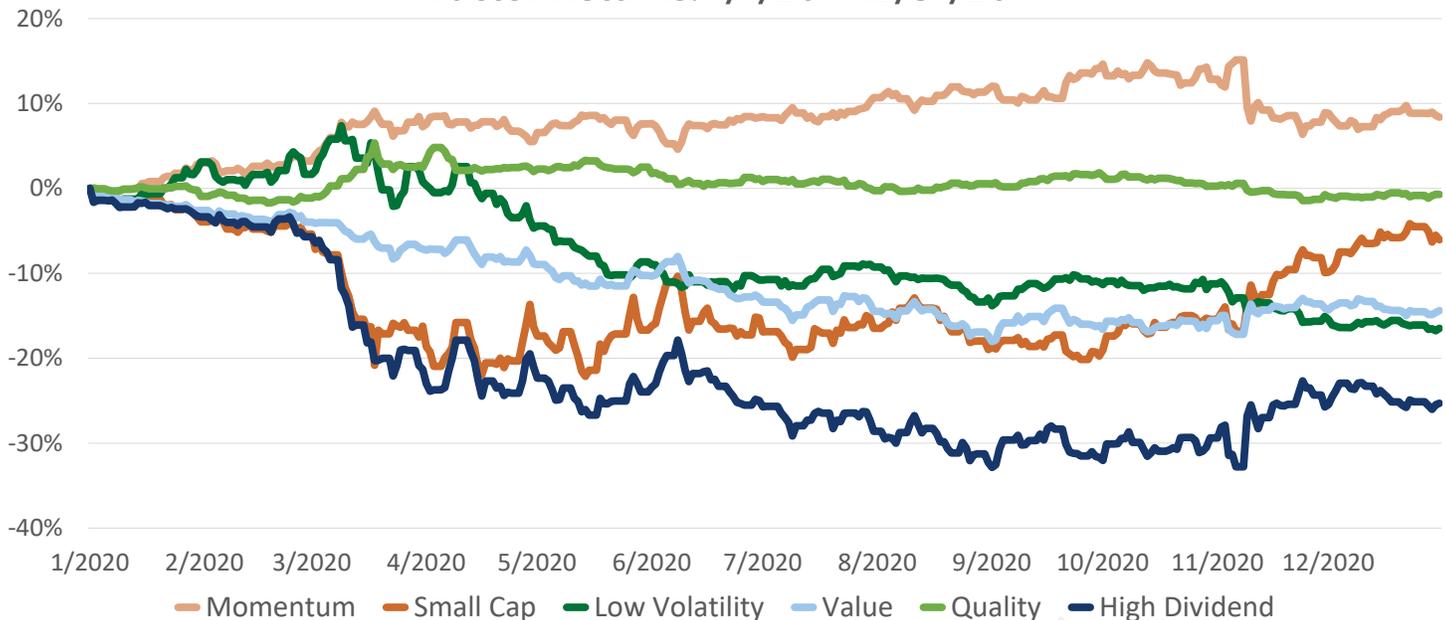
Meanwhile, our financial system and markets—while also far from perfect—showed resilience, resolve and reward in 2020. The chart above illustrates how

consistent U.S. equity markets have been since the Great Recession. In fact, at a high level, 2020 was almost the perfect continuation of the trends established in the decade that preceded it. U.S. equities ruled the roost. The big got bigger. Humanity continued to adopt technology at an increasing rate. Don't fight the Fed. Interest rates can go to zero...even slightly lower...

Of course, annual returns are wholly insufficient to describe a year in which we experienced multiple market cycles. We can't hope to adequately capture all of the nuances of 2020's market landscape, but we do think it's worth expanding on factor returns—a particular point of interest to quantitative managers. Factors, often marketed as "smart-beta," are common attributes that have historically led to one group of equities outperforming another. Examples of widely accepted factors include momentum, size, quality, yield, low volatility, and value. Not only were many of these factor relationships flipped on their heads in 2020, but the change in factor leadership throughout the year made it particularly challenging for any factor-based investors to perform well. Given the extreme and unique circumstances of the year, it appears as though a predominant "Covid factor" emerged.

This Covid factor exhibited attributes of momentum and quality and represented a new way in which investors segmented the equity markets. Companies across various industries with disparate characteristics were split into two groups: those that benefitted from the societal changes brought about by the virus and those that did not. For example, technology companies and homebuilders were beneficiaries of the work from home economy while utilities and commercial real estate companies were not. Of the six most common factors, only one outperformed the S&P 500 index, and the sole factor which outperformed—momentum—captured all of its outperformance in the first half the year. While the second half offered hope for some of the more beleaguered factors, it did not offset the losses suffered earlier in the year. For anyone who lived through 2020 day by day, this simply confirms our intuition. 2020 proved to be a continuation of some long-term trends and a turning point for others.

Factor Returns: 1/1/20 - 12/31/20



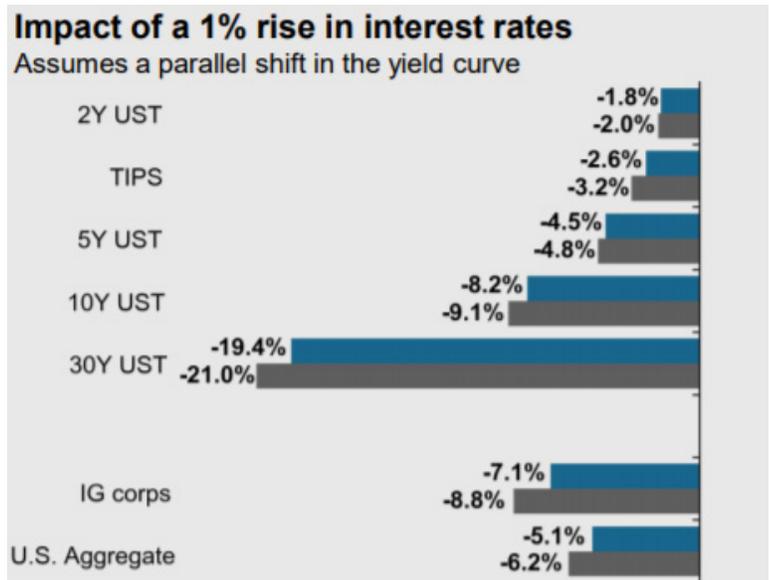
Source: Bloomberg and Beaumont Capital Management (BCM), for the period 1/1/20 through 12/31/20. Factors are represented by the following indices: S&P 500 Momentum Index, S&P 600 Index, S&P 500 Low Volatility Index, S&P 500 Value Index, S&P 500 Quality Index, and S&P 500 High Dividend Index

For the remainder of this letter, we'll attempt to look forward. We humans are constantly subject to our emotional coping skills. Translated, we have biases and one of the strongest is recency bias...what has been happening is going to continue. This bias can endure even in the face of the obvious. While no one knows what the future is going to bring, perhaps a little reflection on what may be important going forward is in order.

- The U.S. dollar has been weakening. Since its March peak, the USD has fallen 13.1%¹ and is near the 2018 low.

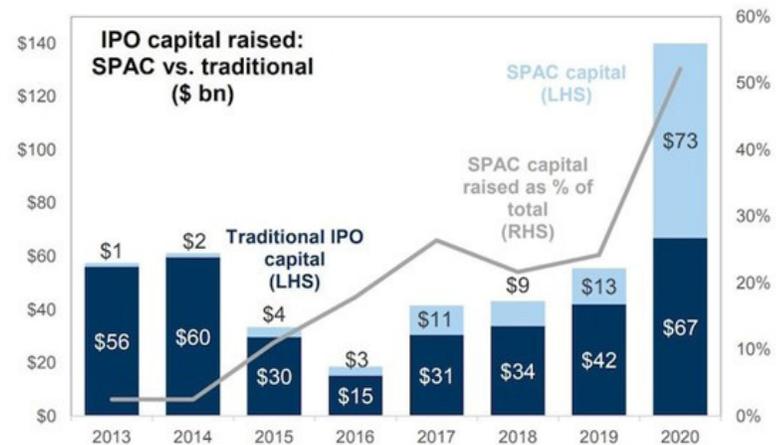
This could provide a tailwind for export-oriented industries, such as manufacturing, and boost international asset classes and commodities. Rising import prices and higher commodity prices may well begin the deflation cycle so notably absent for the past 10 years.

- When is too big too big? Apple is worth ~\$2.2 trillion, Microsoft ~\$1.7 trillion, and Amazon gets the bronze medal at ~\$1.6 trillion.² There are many active anti-trust lawsuits in progress against the mega-cap tech and internet-related companies. At some point, just like AT&T and Standard Oil, oligopolies and monopolies will be split up...
- The Federal Reserve dusted off its 2008 QE playbook with great success and has indicated that monetary easing is here to stay for the foreseeable future. What makes this time different is that Congress embarked on a revolutionary fiscal stimulus program of its own. While it's true that the recovery has been K-shaped, it's safe to say that the U.S. has never before emerged from a recession with household wealth at an all-time high.
- Interest rates cannot fall forever; there is a practical floor even if it is slightly negative. This ensures that returns from fixed income will be lower in the future and traditional static asset allocation portfolios will have to rely almost entirely on equities to meet their return expectations. Worse, if rates rise, fixed income could prove to be a temporary headwind to portfolio returns.
- Retail investors, many working from home with "time on their hands," have embraced the market in a magnitude not seen since the internet bubble of the late 90's. A record was set for the most IPOs in a single year, over half of the IPO proceeds went to special purpose acquisition corporations (SPACs, also referred to as "blank check companies"), and retail interest in equity options is at an all-time high. While there's disagreement about the level of influence these market participants hold, their presence is too large to ignore and has added more emotion to the markets' movements.



Source: JPM Guide to the Markets, as of 12/31/2020

SPAC IPO Volumes have surged in 2020
as of December 16th, 2020



Source: Dealogic and Goldman Sachs Global Investment Research, as of 12/16/20

All in all, we believe optimism is warranted as we launch into 2021. Every year, the degree of life's challenges can be similar to the degree of the market's challenges...they are unknown and often temporarily set us back, but our resiliency and will to overcome have always prevailed. **As always, we thank you for your confidence in and business with BCM.**

Sources and Disclosures

¹ Source: The Chart Store, from 1/8/21

² Source: "List of Public Corporations by Market Capitalization." Wikipedia, Wikimedia Foundation, 12/31/20, https://en.wikipedia.org/wiki/List_of_public_corporations_by_market_capitalization

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