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Academy Financial End of Year Review 2020

"Listening to and understanding our client's financial goals allows us to provide the highest level of investment planning advice and service."

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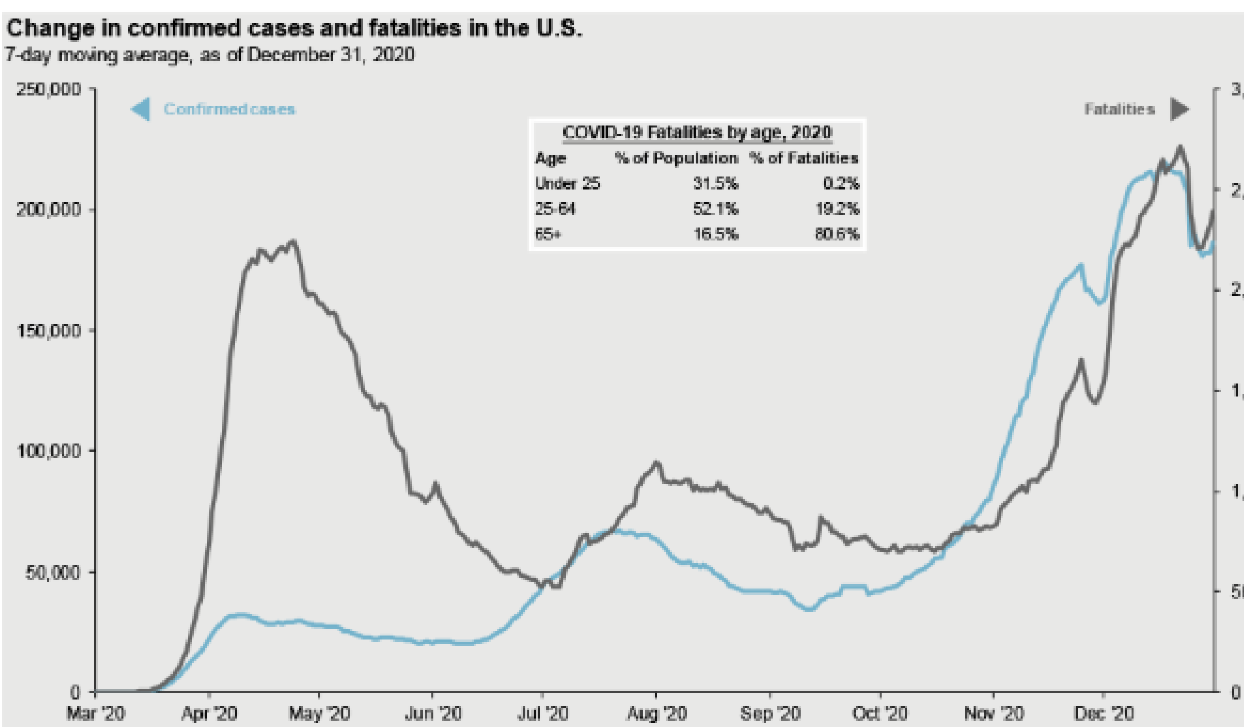
Overview:

% Return as of 12/31/2020[1]			
Equity Indexes	**12 mo**	**YTD**	**3 Yr**
S&P 500	18.4	18.4	14.2
Russell 2500	20.0	20.0	11.3
MSCI EAFE	8.3	8.3	4.8
Emerging Market	18.7	18.7	6.6
Wilshire REIT	-8.5	-8.5	3.05
Bond Indexes			
TIPS	11.0	11.0	5.9
Aggregate	9.2	9.2	4.9
Government	16.1	16.1	9.8
Mortgages	0.6	0.6	1.4
Investment Corporate	7.6	7.6	6.0
Long Corporate	3.8	3.8	6.3
Corporate High-Yield	7.1	7.1	6.2
Municipals	5.2	5.2	4.6
Cash Equivalents			
3-Month T-Bill	0.5	0.5	1.5

This year was highlighted by the COVID-19 pandemic. Markets crashed as the virus spread across the world causing many businesses to shut down and a dramatic increase in unemployment. Cases peaked from March until May. In Q1 of 2020 the S&P 500 was down 19.6%. Interest rates fell to under 1%, commercial real estate and oil collapsed as economic activity slowed with recovering in certain sectors but not in others. Moving into Q2 and Q3, cases began to fall, life moved online, and businesses slowly opened. As we dealt with the pandemic, there began a recovery across investment markets. Q4 has seen a rotation back into the value sectors and international.

One of the dramatic effects of the drop and subsequent rebound was the bifurcation within markets. The differences between Growth stocks and Value stocks, Small Cap vs Large Cap, and Domestic vs International were unprecedented. Fixed income also showed signs of differences. Treasuries had an incredible return due to the drop in interest rates and flight to quality. Muni's and Hi Yield lagged but then rebounded towards the end of the year.



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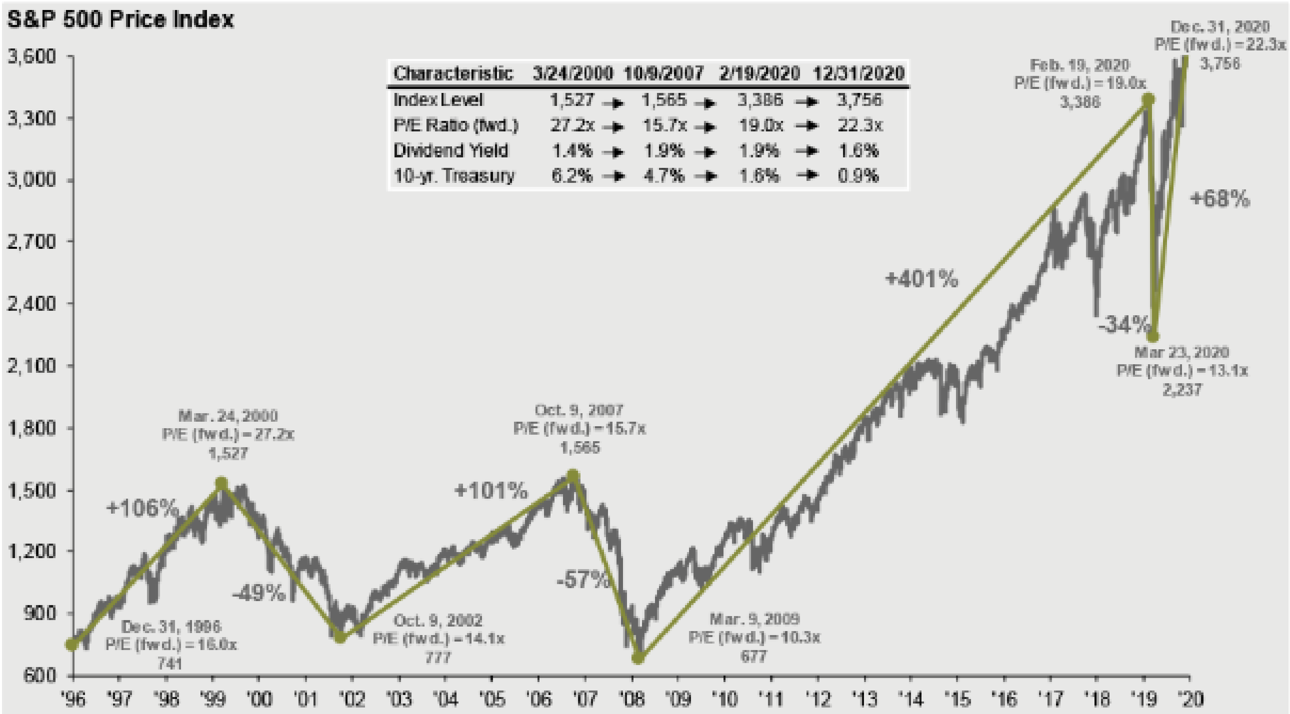

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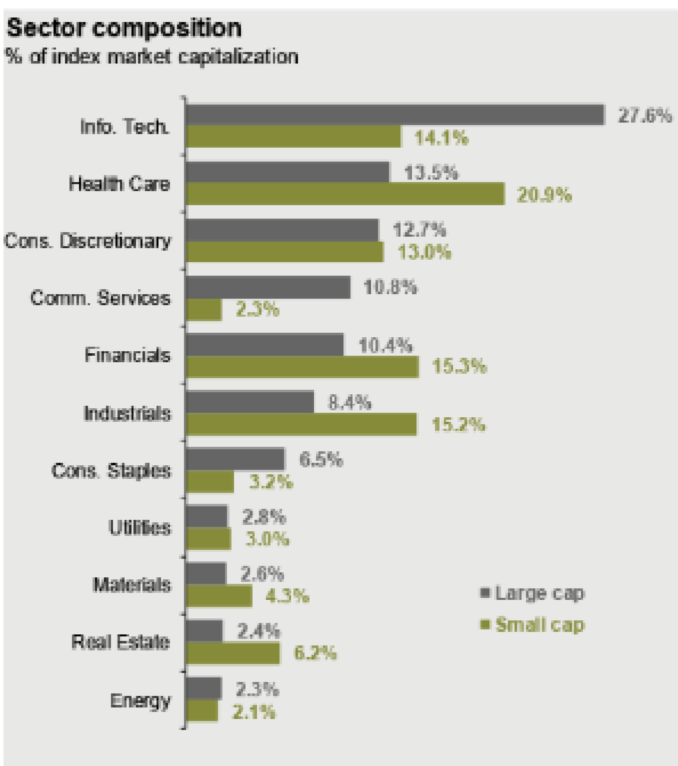
Equity Markets:

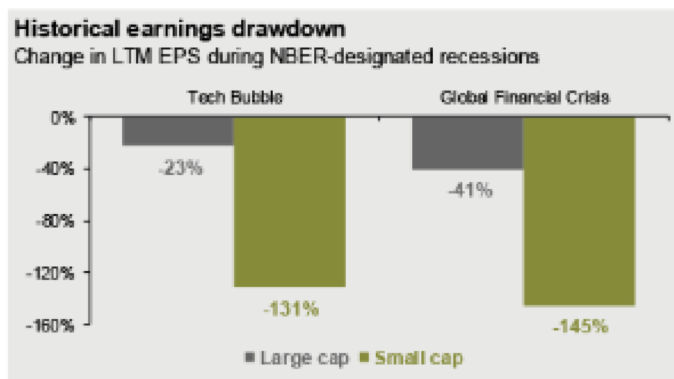
From late February into late March the S&P 500 was down 34%. We saw strong recovery and strong performance towards the back half of 2020. From the end of March to the end of December the S&P was up nearly 70% - simply amazing. Over the calendar year, the S&P climbed 18% for 2020 whereas the Nasdaq rose over 40%. Strong recovery and performance can also be seen when looking at the forward P/E ratio. The fall and rise in forward P/E made it seem as if the markets shrugged off the pandemic and looked forward to 2021. As vaccines are distributed and the world continues to recover from this pandemic we can expect many sectors, even ones beaten down, to show signs of recovery.

It really was a Charles Dickens Tale of Two Cities in 2020. Growth sectors such as Health Care and Technology showed some eye-popping returns. Sectors like Travel & Leisure, Energy, Offline Retail, and Banking fell dramatically in March and have only partially recovered as many moved to an online working world. However, in Q4 these sectors started to recover and had positive returns. Up until September small cap securities underperformed large cap securities with the Russell 2000 -9% by September 30 and the S&P up 4%. The 4th quarter was a classic reversion where the Russell was up 29% and the S&P up 11%. For 2020 both were up at 18% and 16% respectively

A nearly identical pattern occurred with International and domestic where the first 3 quarters the MSCI EAFE was down 9%, the S&P 500 up 4%. A similar reversion happened in Q4 where international was up 15% and the S&P up 11%. For 2020 overall, both were up at 5% and 16% respectively. International equity has a very compelling valuation compared to the U.S. with the P/E of the S&P 500 much higher than that of the MSCI EAFE. While we remain optimistic about U.S. markets with a trend of growth and entrepreneurial spirit, the valuations of international securities remain compelling.

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-Valued
P/E	Forward P/E	22.33x	16.56x	1.79
CAPE	Shiller's P/E	34.24	27.47	1.10
Div. Yield	Dividend yield	1.59%	2.05%	1.37
P/B	Price to book	3.84	2.99	1.16
P/CF	Price to cash flow	15.93	10.79	2.54
EY Spread	EY minus Baa yield	1.35%	0.06%	-0.65





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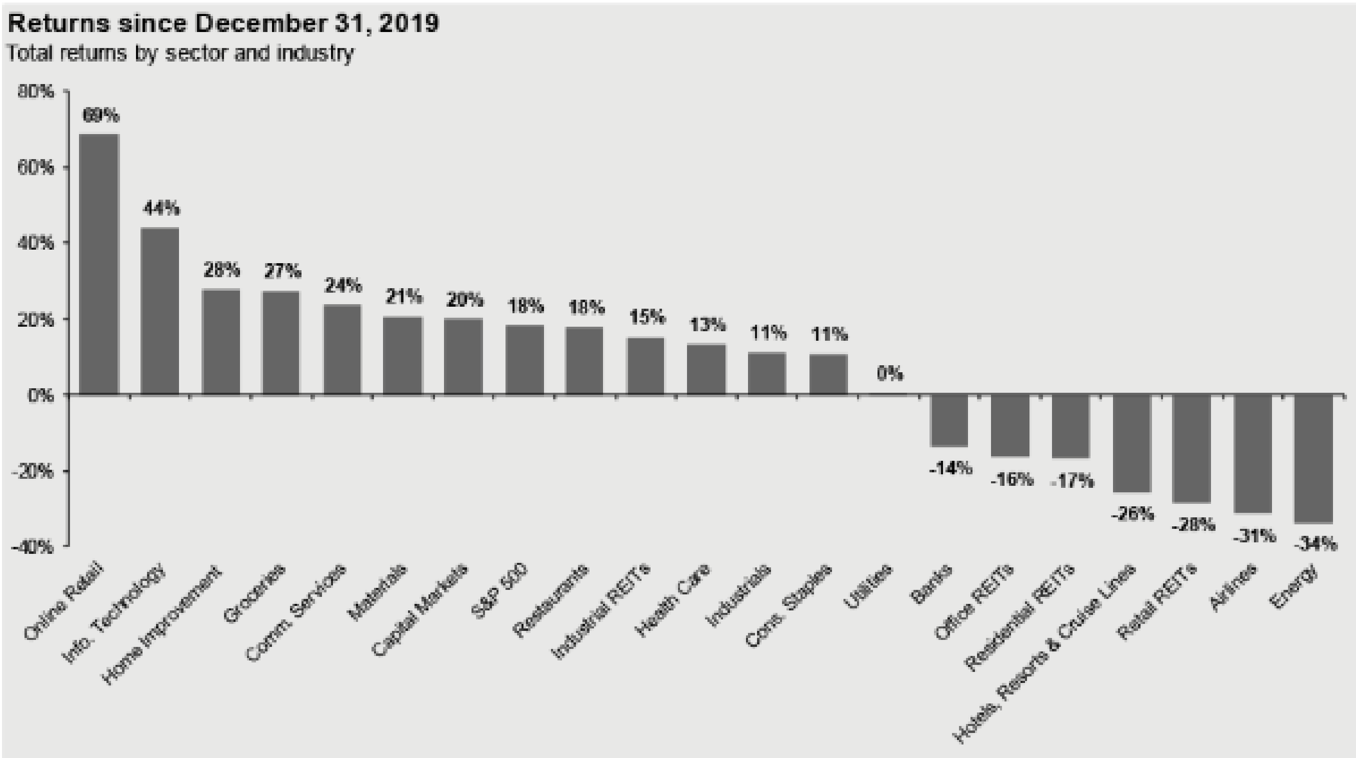

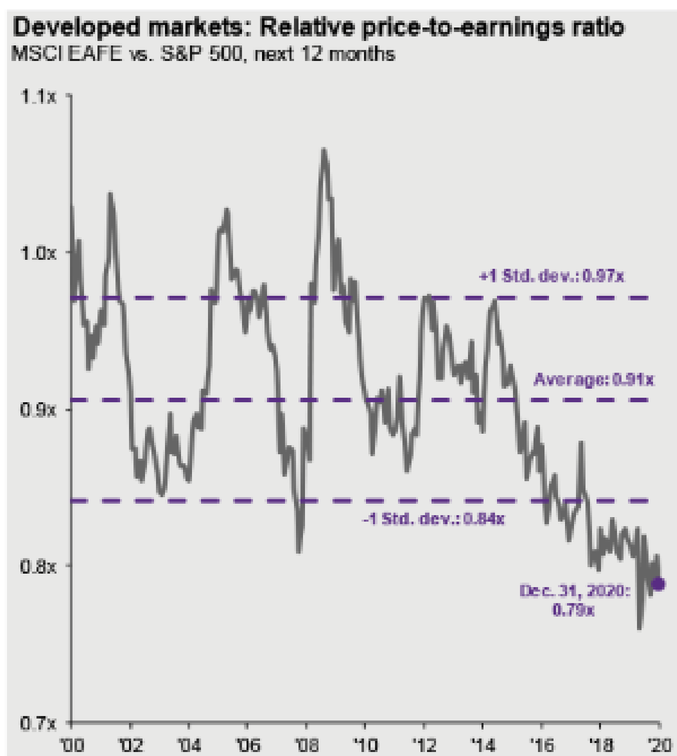

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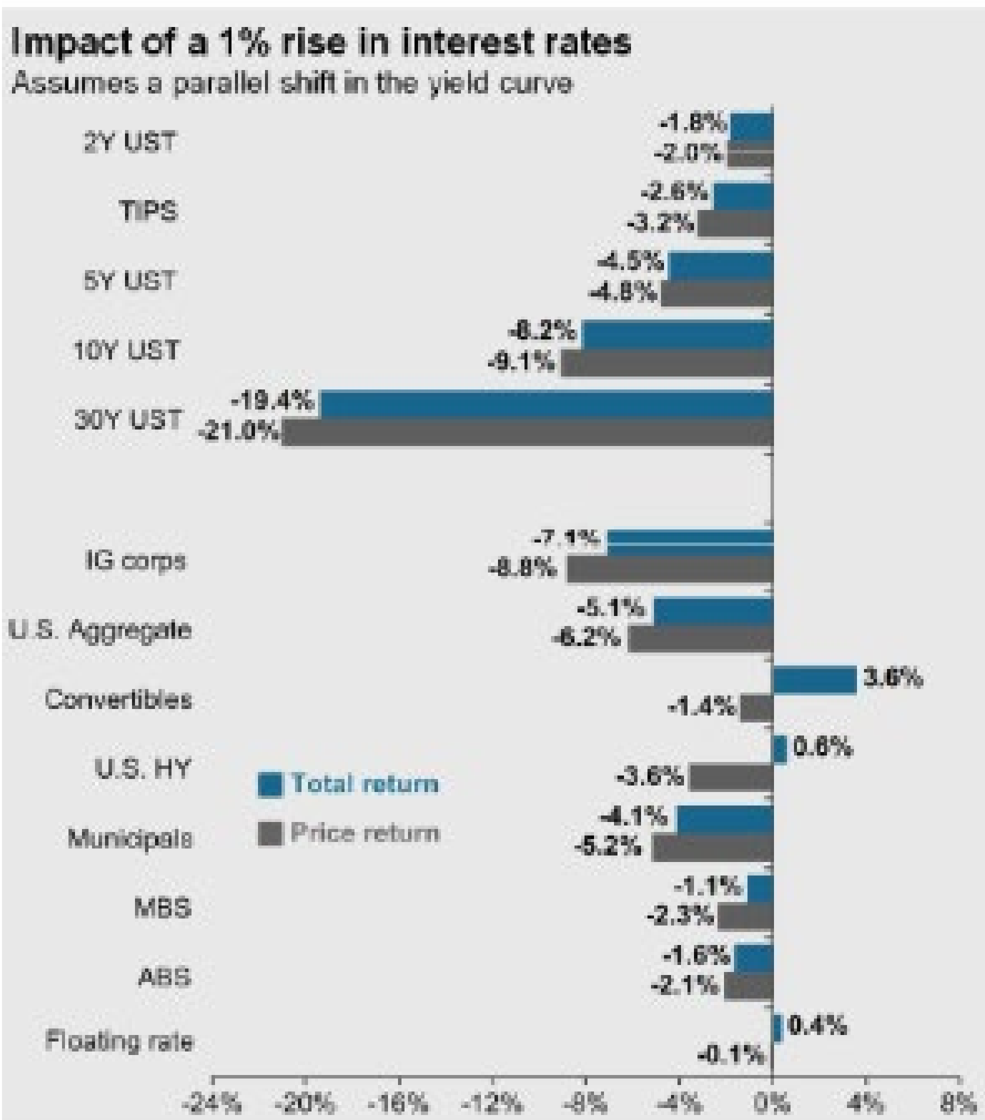
Fixed Income Markets:

Overall, the fixed income market had a strong year. The 10 year fell as low as 0.5% and has been hovering between 0.5-0.8% throughout the pandemic. Only by years end did the yield climb to 0.94%. The Fed has signaled that they will continue to keep rates low for 2021 and beyond, interest rates are expected to stay low in the short term. Our biggest concern is an unexpected spike in rates. We do view that as unlikely in the short term, but as we see in the charts below, any rise in rates can have a dramatic affect on performance.

Intermediate bonds outperformed short-term bonds this year and U.S. bonds outperformed international bonds. Yields for corporate bonds do seem to be worth the risk on highly rated bonds. However as more and more investors look for yield in lower credit quality bonds, we simply don't see the spread being worth the higher risk of hi-yield bonds.



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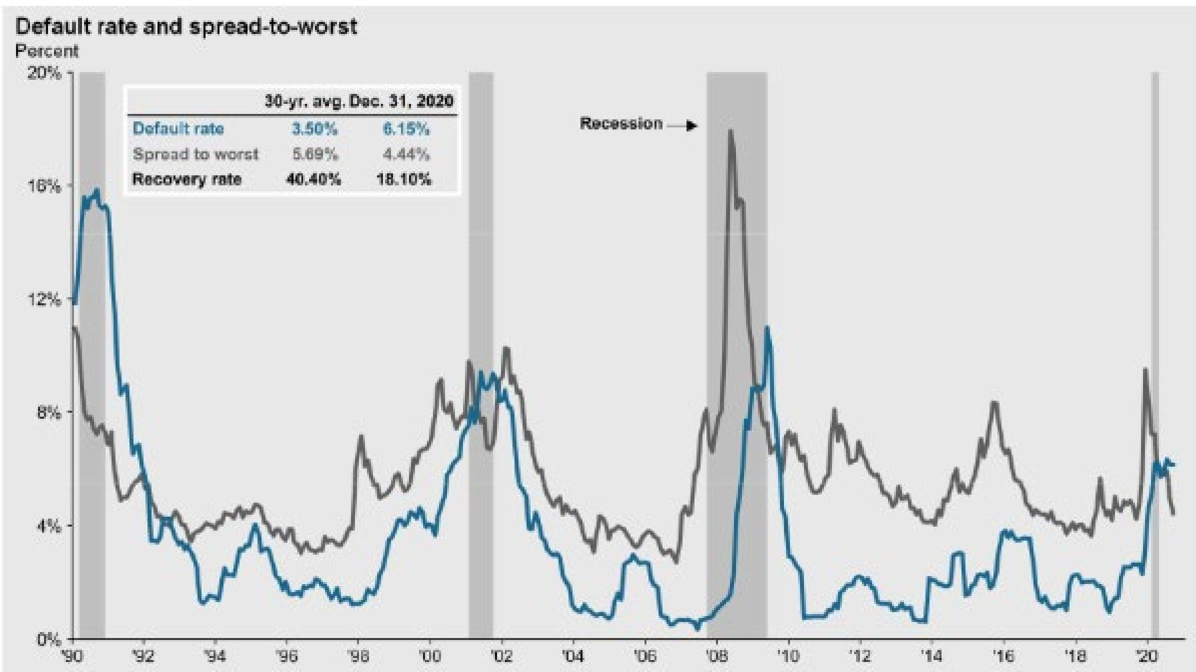
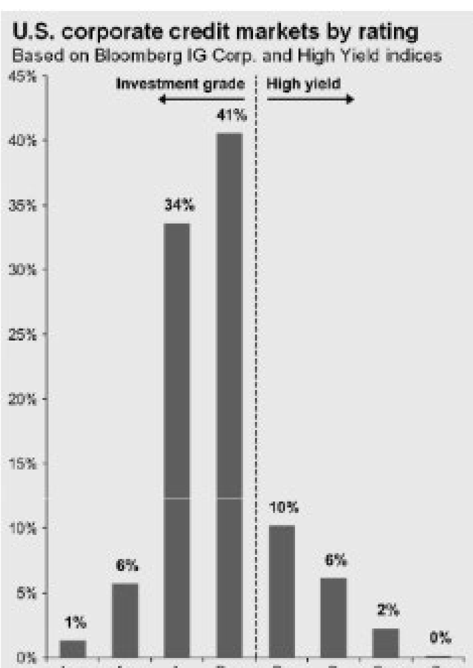
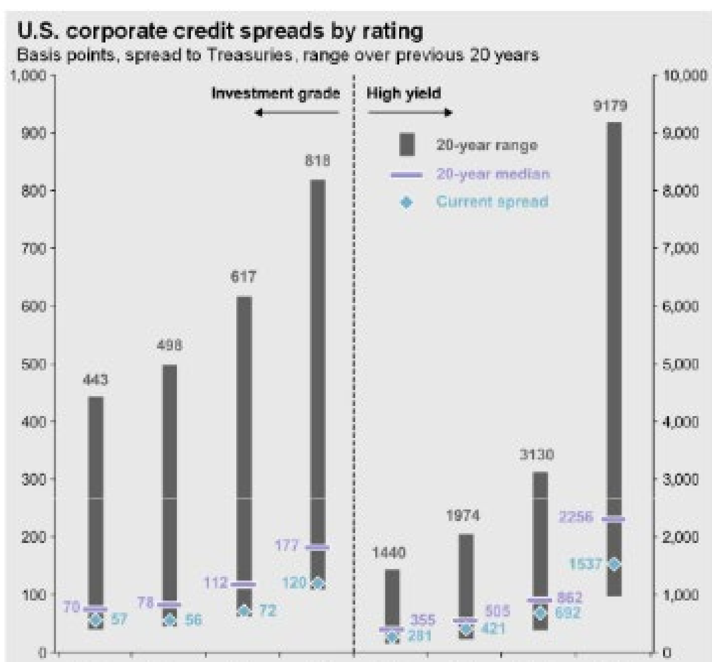
Real Estate:

Real estate was one of the areas that were hardest hit by the pandemic, especially commercial real estate. As businesses and offices began to shut down, commercial real estate under-performed. There are still some opportunities that have potential for strong performance such as warehousing and suburban homes, both areas having solid performance in 2020. Like other beaten down sectors in the equity markets we could see a reversion in commercial real estate in 2021 and beyond.







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Summary:

Living through a year like 2020 it becomes apparent how life is different than investments and financial planning. That we started the year with a presidential impeachment is almost quaint to consider. The pandemic created a justified market rout in securities, the riskier the security the larger the drop. It's here where experienced wealth managers provide an extremely valuable service. The ability to evaluate your specific needs, then take the situation at hand and manage your wealth to the goals established. Preparing for and understanding the heavy market volatility gives us the fortitude to stay true to the path initially established. At the same time, we remain flexible to life changes or even changes in risk tolerance.

As a firm we made a definitive choice to stay in the markets at the worst of the pandemic. Prior to the election there was clear uncertainty from both sides of the political spectrum. Again, we analyzed the situation and make a distinct choice to stay invested. Those that exited and went to cash are likely still waiting for a market dip and have missed out on returns that are key to long term investing. We are firm believers that you cannot time the market, and this has been shown yet again.

One final note. I work closely with all the planners at Academy Financial and I know that in March and April throughout all the turmoil, they were reaching out to you our clients. I saw the concern they had as stewards of your wealth and financial planning. I appreciate the job they did, and I hope you do to. Most important, we want to thank you for trusting us and being part of the team focused on your long term goals.

Have a wonderful New Year and a prosperous 2021.

Sources:

1. Morningstar Data
2. https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/guide-to-the-markets/viewer
3. https://am.jpmorgan.com/us/en/asset-management/gim/adv/insights/portfolio-insights/global-fixed-income-views
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5. https://cdn.brandfolder.io/86JM1UOD/as/gkrrg8sjg3cv836xsm8xpr/Where_We_Stand_2021_Market_Outlook_Brochure.pdf

considered representative of the overall market. The Wilshire REIT Index is designed to offer a market-based index that is more reflective of real estate held by pension funds.

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