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THE ADVISOR

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Wall Street Clings to Optimism Amid Ongoing Uncertainty

Happy New Year! Believe it or not, in just two months we will be a full year into the coronavirus pandemic, and all the chaos and uncertainty it has wrought. By that time, we may have a clearer picture about how things are going to shake out for the economy and financial markets in 2021. In the meantime, it's important to continue making safety a top priority when it comes to your physical, mental, and financial health. While there are many reasons to be optimistic, there are also many challenges still ahead.

As 2020 ended, it certainly seemed that Wall Street was feeling optimistic about the new year. Stock prices hit all-time highs on the very last day of trading. What's more, the S&P 500 index finished the year up 16.3% while the tech-heavy Nasdaq grew by nearly 44%. In fact, the stock market has been booming since early November, hitting numerous new record highs despite growing challenges that have carried over into the new year. These include surging Covid-19 cases and deaths, high unemployment, lingering worries about the pace and strength of the economic recovery, and a vaccine rollout that's moving much slower than expected.[1]

However, there have also been some positive developments, and big investors have stayed laser-focused on the good news while mostly shrugging off the bad, as they have since the start of the pandemic. One major bit of good news was the approval of a coronavirus vaccine — two in fact! Another was the release (at last) of a second round of economic relief by Congress. The $900 billion stimulus package was a follow-up to the $2.2 trillion CARES Act approved last March. It was signed into law two days after Christmas and is seen by many economists as vital to keeping the recovery moving forward until the pandemic is under control. What's more, many believe president-elect Joe Biden and his administration will introduce yet another stimulus package sometime soon after his inauguration on January 20th.[2]

Bumps in the Road

Big investors clearly like the idea of more stimulus, as proved by fact that the Dow and S&P both shot to new record highs again in response to the surprise results of the hotly contested Senate runoff race in Georgia on January 5th.[3] Democrats gained two seats in the election, giving them majority power in the Senate and greatly improving the odds that Biden's plan for more economic relief will be approved. Historically, Wall Street prefers a divided government, and many thought a Democratic sweep in Georgia might trigger a

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Assessing Your Risk Tolerance

While investors want the highest returns possible, returns compensate you for the risks you take — higher risks are generally rewarded with higher returns. Thus, you need to assess how much risk you are willing to take to obtain potentially higher returns. However, this can be a difficult task. It is one thing to theoretically answer questions about how you would react in different circumstances and quite another to actually watch your investments drop in value. What you are trying to assess is your emotional tolerance for risk, or how much price volatility you are comfortable with. Some questions that can help you gauge your risk tolerance include:

- **What long-term annual rate of return do you expect to earn on your investments?** Your answer

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Wall Street Clings

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market drop. However, once again we saw investors ignore the potential negatives and focus on the positive. At the same time, the prospect of full Democratic power and more stimulus did trigger some nervousness in the bond market, sending long-term interest rates slightly higher. The yield on the 10-Year Treasury rate topped 1% for the first time since last March.[4]

What might all of this mean for the weeks and months ahead? Well, the potential for more nervousness throughout all the markets certainly exists, and there are several issues that could trigger it. One is the release of earnings reports for 2020's fourth quarter — which could lead to some stock-specific volatility. Another is the weekly release of unemployment data, which began trending in the wrong direction last November. Jobless claims remain far above pre-pandemic levels, and hiring has shown signs of slowing.[5] Also, the first of eight Federal Reserve meetings scheduled for 2021 will take place this month. Finally, there is Inauguration Day, and all the questions about what Joe Biden's presidency will mean for the economy and financial markets going forward. Though he's unlikely to propose any tax hikes while the pandemic is still an issue, raising corporate and payroll taxes are ultimately part of his economic plan. Even though he's said he has no plans to order another national coronavirus lockdown, that could change if infection rates continue to outpace the vaccine rollout.

The Fed Factor

As for those Federal Reserve meetings, they're always closely watched by Wall Street. The good news this year is that they're not expected to have much impact on the markets. As you know, the Fed slashed interest rates to near zero last March in response to the pandemic, and announced open-ended quantitative easing. The stock market loves low interest rates and artificial stimulus, and these measures are likely to remain in place for the foreseeable future. In fact, the Fed has signaled it will hold its benchmark rate to a range of 0 to 0.25% until at least 2023, even if the economy gets back on track and inflation hits its target goal of 2% before that time.[6]

With low interest rates and artificial stimulus likely here to stay, many analysts believe the stock market will continue to show the kind of resiliency it has shown throughout the pandemic. More new record highs could be in store. However, it seems unlikely stock values could continue notching much higher without real corporate earnings finally starting to catch up in a big way. Could that happen this year? Well, anything is possible. There are some genuine reasons for optimism: vaccines are being delivered, the political picture is more clear, and the economic relief that millions of Americans and businesses need is on the way.

There are also still plenty of major challenges, any one of which could quickly undercut investor optimism and send the markets back into correction territory. Some analysts believe it could happen before April, which — as we've noted before — could create a good buying opportunity for certain investors with the right risk tolerance. The bottom line is that it remains essential, especially in this early part of the year, to know that your financial strategy is still aligned with your personal risk tolerance, and set up to help you protect your downside and/or take advantage of potential new opportunities in the coming year!

[1]"January 2021 Stock Market Outlook," Forbes, Jan. 4, 2021

[2]"New Stimulus Package vs. CARES Act: What's Different," cnet.com, Dec. 22, 2020

[3]"Stocks Rally Amid Georgia Runoff Results," Yahoo Finance, Jan. 6, 2021

[4]"10-Year Treasury Yield Jumps Above 1% for First Time Since March," MarketWatch, Jan. 6, 2021

[5]"Weekly Jobless Claims: Little Changed Despite Signs Hiring is Slowing," CNBC, Jan. 7, 2020

[6]"Fed Will Not Hike Rates For Years," fx-empire.com, Sept. 17, 2020

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Overdiversification

Diversify. Diversify. Diversify. While this investment advice seems to be continually discussed, it is possible to overdiversify, which can lead to lackluster returns. Thus, it is important to know the difference between healthy diversification and excess diversification.

The primary benefit of diversification for your portfolio is to spread market risk over different stocks in a way that will decrease the impact any one stock will have on your total return. With an appropriate level of diversification, your overall return will not be significantly impacted if one or even a few investments do not perform as expected.

Thus, it is not just the number of investments you hold that impacts your return, but how they interact with one another. If you keep adding investments that react to the market in the same way, you are not really diversifying. You are just adding similar investments to your portfolio.

Adding too many investments to your portfolio also makes them more difficult to monitor. With too many investments to keep track of, it is more likely that you will miss important information.

Please call if you'd like to review the level of diversification in your portfolio.

Risk Tolerance

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will help determine the types of investments you need to choose to meet that target. Review historical rates of return as well as variations in those returns over a long time period to see if your estimates are reasonable. Expecting a high rate of return may mean you'll have to invest in asset classes you aren't comfortable with or that you may be frequently tempted to sell. A better alternative may be to lower your expectations and invest in assets you are comfortable owning.

- **What length of time are you investing for?** Some investments such as stocks should only be purchased for long time horizons. Using them for short-term purposes may increase the risk in your portfolio, since you may be forced to sell during a market downturn.
- **How long are you willing to sustain a loss before selling?** The market volatility of the past several years will give you some indication of how comfortable you are holding investments with losses.
- **What types of investment do you own now and how comfortable are you with those investments?** Make sure you understand the basics of any investments you own, including the historical rate of return, the largest one-year loss, and the risks the investment is subject to. If you don't understand an investment or are not comfortable owning it, you may be tempted to sell at an inopportune time. Over time, your comfort level with risk should increase as you better understand how risk impacts different investments.
- **Have you reassessed your financial goals recently?** Periodically, your financial plan may need to be revamped. Otherwise, you may find you won't have sufficient resources in the future to meet your goals. Based on your current investment values, determine what needs to be done to meet your financial goals. You may need to save more, change or eliminate some goals, or delay your retirement date.
- **Do you understand ways to reduce the risk in your portfolio?** While all investments are subject to risk, there are some risk reduction strategies you should consider for your portfolio. These strategies include diversifying your portfolio, staying in the market through different market cycles, and investing consistently.

Please call if you'd like help assessing your risk tolerance.

Why Have an Asset Allocation Strategy?

Your asset allocation strategy represents your personal decisions about how much of your portfolio to allocate to various investment categories, such as stocks, bonds, cash, and others. When stock market returns were above average for an extended period, investors did not have much interest in asset allocation. Then, the best strategy seemed to be only owning stocks. But investors are again focusing on asset allocation. Some of the advantages of an asset allocation strategy include:

- **Providing a disciplined approach to diversification.** An asset allocation strategy is another name for diversification, an important strategy for reducing portfolio risk. Since different investments are affected differently by economic events and market factors, owning various types of investments helps reduce the chance that your portfolio will be adversely affected by a particular risk type.
- **Encouraging long-term investing.** An asset allocation strategy is designed to control your portfolio's long-term makeup. It should not change based on economic conditions or market fluctuations.
- **Eliminating the need to time investment decisions.** Market timing is a difficult concept to implement. Not only do investment professionals have a difficult time accurately predicting the market's movements, but waiting for the perfect time to invest keeps many investors on the sidelines. With an asset allocation strategy, you don't have to worry about timing the market; you just have to ensure your investments stay within the proper percentages.
- **Reducing the risk in your portfolio.** Investments with higher returns typically have higher risk and more volatility in year-to-year returns. Asset allocation combines more aggressive investments with less aggressive ones. This combination can help reduce your portfolio's overall risk.
- **Adjusting your portfolio's risk over time.** Your portfolio's risk can be adjusted by changing allocations for the different investments you hold. By anticipating changes in your personal situation, you can make those changes gradually.
- **Focusing on the big picture.** Staying focused on your asset allocation strategy will help prevent you from investing in assets that won't help accomplish your goals. Rather than investing in a haphazard manner, it gives you a framework for making investment decisions.

Your asset allocation strategy will depend on a variety of factors unique to your situation, including your risk tolerance, return expectations, investment period, and investment preferences. Please call if you'd like to discuss asset allocation in more detail.

Business Data

Indicator	Month-end Oct-20	Nov-20	Dec-20	Dec-19	Dec-18
Prime rate	3.25	3.25	3.25	4.75	5.50
3-month T-bill yield	0.10	0.09	0.10	1.52	2.47
10-year T-note yield	0.88	0.84	0.93	1.92	2.89
20-year T-bond yield	1.43	1.37	1.45	2.25	3.03
Dow Jones Corp.	2.23	2.01	1.93	2.84	4.40
GDP (adj. annual rate)#	-5.00	-31.40	+33.40	+2.10	+2.20

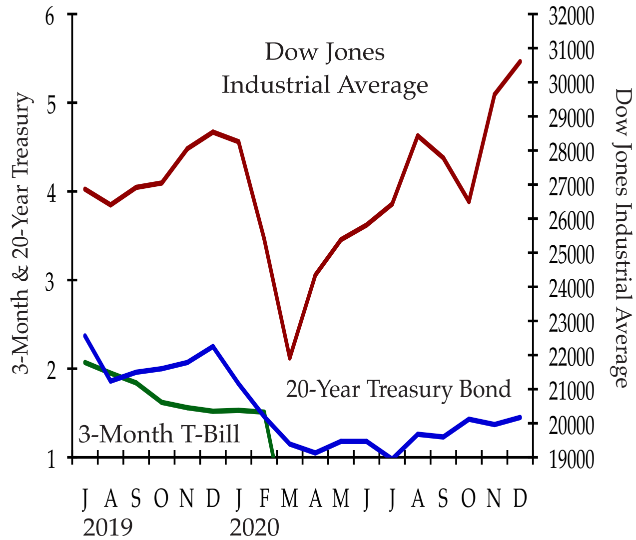
Indicator	Month-end Oct-20	Nov-20	Dec-20	% Change 2020	2019
Dow Jones Industrials	26501.60	29638.64	30606.48	7.2%	22.3%
Standard & Poor's 500	3269.96	3621.63	3756.07	16.3%	28.9%
Nasdaq Composite	10911.59	12198.74	12888.28	43.6%	35.2%
Gold	1881.85	1762.55	1887.60	23.9%	18.8%
Unemployment rate@	7.90	6.90	6.70	91.4%	-5.4%
Consumer price index@	260.28	260.39	260.23	1.2%	2.1%

— 1st, 2nd, 3rd quarter @ — Sep, Oct, Nov Sources: *Barron's, Wall Street Journal*

Past performance is not a guarantee of future results.

18-Month Summary of Dow Jones Industrial Average, 3-Month T-Bill & 20-Year Treasury Bond Yield

July 2019 to December 2020



Know When to Exit

Everyone purchases investments with the expectation that the price will go up, earning profits on that investment. Unfortunately, that doesn't always happen, making it necessary to develop an exit strategy.

It can be difficult to decide when to sell regardless of whether your investment is increasing or decreasing, but more damage can be done to your portfolio's returns when the investment is decreasing. Investors hate selling investments at a loss, which makes it emotionally difficult to do.

Write down your reasons for purchasing an investment and when you will sell. That could include both upside and downside sell criteria. As an investment is declining, it is common to come up with excuses to delay selling — it's a temporary setback, wait until next week, wait until earnings are reported, etc. Then, the further the investment declines, the more likely you will want to wait for the investment to turnaround before selling. That is how large losses are incurred.

Instead, set a firm sell guideline, which will ensure that you don't incur substantial losses. For instance, you might sell an investment when it declines by 5% of your purchase price. While it will probably still be painful to sell the investment at a loss, this will ensure that you don't incur major losses in your portfolio. You have effectively put a cap on your losses.

Please call if you'd like to discuss exit strategies for your investments. FR2020-0915-0028

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