CenterPoint Financial, Inc.

Registered Investment Adviser

Market Outlook – January 2021

Happy New Year! With 2020 in the rearview mirror, we are starting to see a light at the end of the tunnel. COVID-19 vaccines have arrived and though dissemination is slower than desired, current projections indicate that we will have 70% of adults either inoculated or immune as a result of contracting the virus, by the end of July. At this point children are not eligible for vaccination so that 70% puts us just below herd immunity for the entire population but NIAID Director Dr. Anthony Fauci suggests this will be enough to broadly re-open the economy. This finally positive forecast has led broad equity markets to all-time highs as the population dreams of a return to normalcy. Unfortunately, with virus case counts still rising and mass vaccine distribution a logistical nightmare, the economy is most certainly not out of the proverbial woods. Additional governmental support is badly needed to support individuals and businesses that have been most impacted by the virus.

What initiatives are underway to stimulate growth and aid in the recovery?

On December 28, 2020, President Trump signed a bill to provide continued coronavirus relief and fund the government. The $2.3 trillion package, which included $41.4 trillion to fund the government and $900 billion in coronavirus relief, was the result of eight months of contentious negotiations in Congress. President Biden has come into office calling Americans to come together, regardless of political opinions, to embrace the ideology of America. His call for unity will be essential as he asks Congress, with a 50-50 Senate Chamber, to pass his ambitious stimulus plan. With the U.S. still mired in recession under the pressures of the COVID-19 pandemic, and government debt at an all time high, this massive spending package could be a difficult, though necessary, sell.

Biden's plan is two-fold: first, the rescue plan to address COVID-19 and the economic crisis spawned by the pandemic; and second, the recovery plan to expand the base of our economy to engage more Americans as participants. The American Rescue Plan was formally announced on January 12, 2020 with a price tag of $1.9 trillion. President Biden referred to what many economists are calling a K-shaped recovery wherein there is a massive discrepancy between the haves and the have nots. Biden noted, "the wealth of the top 1% has grown by roughly $1.5 trillion since the end of last year [2019] – four times the amount for the entire bottom 50%." This rescue plan, which was signed by Executive Order on January 22, is launching an all-of-government effort to provide equitable emergency relief to working families, communities, and small businesses. The recovery plan will be announced at the end of February 2021 and will include further initiatives to reduce the economic disparity between Americans, boost health insurance, and invest in infrastructure in the U.S with a particular focus on clean energy initiatives. Though his campaign plan included an increase in taxes, both corporate and personal, we do not anticipate these will be addressed until 2022 or 2023 due to the very small majority the Democrats have in Congress.

Only tax increases are revenue generating so all other initiatives will be adding to the government debt. As we have previously discussed, our debt relative to GDP is now higher than it was at the end of World War II. The reality is that we must employ stimulus to keep our country afloat but ultimately that very stimulus, in the form of debt, could crush our future growth. Some economists warn of growing inflation with this much economic

stimulus but with debt growing faster than GDP, we might not see near term broad-based inflation. Thanks to fiscal stimulus, the consumption of goods has grown even as employment has declined. As a result, consumption is no longer a significant driver of job growth. In a webcast to advisers earlier this week, LizAnn Sonders, Schwab's Chief Investment Strategist, described this debt as "a big wet blanket on growth." We do not anticipate that we will have real (i.e., broad-based, traditional) inflation until the labor market recovers, though we will likely have some price shocks due to supply constraints (i.e., household paper goods, groceries, etc.).

What are the risks in the market today?

Despite the potential for a global turnaround in 2021, we see four key risks for markets: an unanticipated rise in the virus or inability to distribute the vaccine; failure to provide enough policy support; a technology war between the U.S. and China; and geopolitical conflicts hitting a breakpoint. Though we have long written and talked about concerns about the rising level of U.S. government debt, the near-term benefits of economic stimulus clearly outweigh the long-term costs. As for China, the change in administration may quell some of the conflict but with both nations focusing on reallocating their supply chains to less volatile trading partners and pursuing domestic production, resolution is years in the future. Beyond China, geopolitical conflicts abound but we are hopeful that a more measured policy approach will stimulate greater collaboration between our trading partners and allies.

What are the opportunities in the market today?

We believe that we are still in a recession and will not leave that recession until Gross Domestic Product (GDP) returns to pre-COVID levels. U.S. GDP growth has averaged 2.5% over the past five years and even with the recovery in the third and fourth quarters, the economy is still roughly $1 trillion below its pre-COVID production rate. We are in the midst of the 4th quarter earnings cycle and approximately 37% of companies in the S&P 500 have announced earnings. Of those, 74% have topped revenue forecasts and 83% have beaten earnings projections. The earnings figure is less significant than revenue because those expectations have been previously downgraded. Revenue figures are generally positive but the sectors most hit by the pandemic have not yet reported. We believe that valuations are overheated across most financial markets, especially in U.S. stocks and bonds. The forward Price/Earnings ratio of the S&P 500 is now 6% greater than that of the rest of the world. This is the widest difference since 2008. Many of the analysts we follow suggest this indicates that the last decade of outperformance by U.S. equities has reached an end and foreign equities are now poised to outperform those in the U.S.

With valuations and growth prospects in both developed and international markets far more attractive than they are in the U.S., CenterPoint is shifting our portfolios to pursue an overweight to both developed and international markets and a neutral weight to the U.S. stock market. Emerging market securities and commodities, in particular, should be buoyed by a weakening of the dollar as catalyzed by monetary and fiscal stimulus. In addition, the expansion of both trade and budget deficits will increase the rate of the dollar's decline.

Drilling down beyond global focus we need to look at sectors and industries. Much of the 2020 run up in the market was due to technology and specifically the FAANG stocks (Facebook, Amazon, Apple, Netflix, Alphabet, (formerly Google)). While technology accounts for 38% of the market capitalization of GDP, it accounts for just 6% of U.S. GDP and only 2% of unemployment. Considering this spread we can see how the market run up is not in line with economic growth. We also need to consider that a second wave of layoffs and unemployment

could be possible, especially for middle managers, as we transition into a post-COVID world and working from home for many becomes a permanent reality. These potential job losses will come on top of the almost 10 million jobs that have already been lost since pre-pandemic levels.

On a positive note, however, we do believe there are U.S. industries meriting investment: disruptive technologies (think digital transformation, ecommerce etc.); healthcare innovation; and sustainability. Over the past eleven months we have all learned how to adapt to a more digital and online life. Even so, we are just beginning to see the ways in which technology will influence our future consumption and production. Healthcare innovation has perhaps never been more relevant than it is today amid a global pandemic. There will of course be changes to our healthcare delivery system but the innovation of healthcare, especially for testing and diagnostics, is incredible. Sustainability is a very broad-brush description but by that I mean clean energy innovation and production, clean water production and consumption, clean technologies, and sustainable food and consumer goods production. These industries were up well over 100% in 2020 even during, or perhaps because of, the pandemic crisis. We have established and added to these positions in client portfolios during the past two years.

What is our strategy?

In summary, we must recognize that despite general optimism surrounding 2021, the global economy is still weak and a return to pre-pandemic levels will take years. Provided that effective distribution of the vaccine occurs as scheduled, we expect the economy to reopen by the second half of 2021. Assuming that monetary and fiscal stimuli continue to support consumers and small businesses through potentially several more quarters of closures, the economy will be in a much better position upon re-opening. We will then need to address the issue of strong economic growth to pay down our overwhelming levels of debt.

As always, we are pursuing investment opportunities for you to manage the current constraints on the economy and the markets and to take advantage of future opportunities. In case you found my earlier descriptions a bit dense, that means increasing exposure to international markets - both developed and emerging, healthcare innovation, disruptive technologies, and sustainable initiatives. On the conservative or protective side of your portfolios we are focused on keeping credit quality high and interest rate risk low in bond investments. This means limiting exposure to infrastructure, certain sectors of corporate bonds, and government bonds that benefit from the current U.S. debt expansion. As these adjustments specifically impact your portfolio we will be in touch with you. Should you have any questions or concerns, or just want to check in, please do not hesitate to reach out to us.

Wishing you all the best for a positive and healthy 2021!

Warmly,

Priscilla N. Gilbert, CFP®