



Economic & Investment Strategy Update Winter 2020

The Economy

The winter solstice, on December 21 this year, marks the shortest period of daylight and the longest night of the year in the northern hemisphere – when autumn ends, and winter begins.

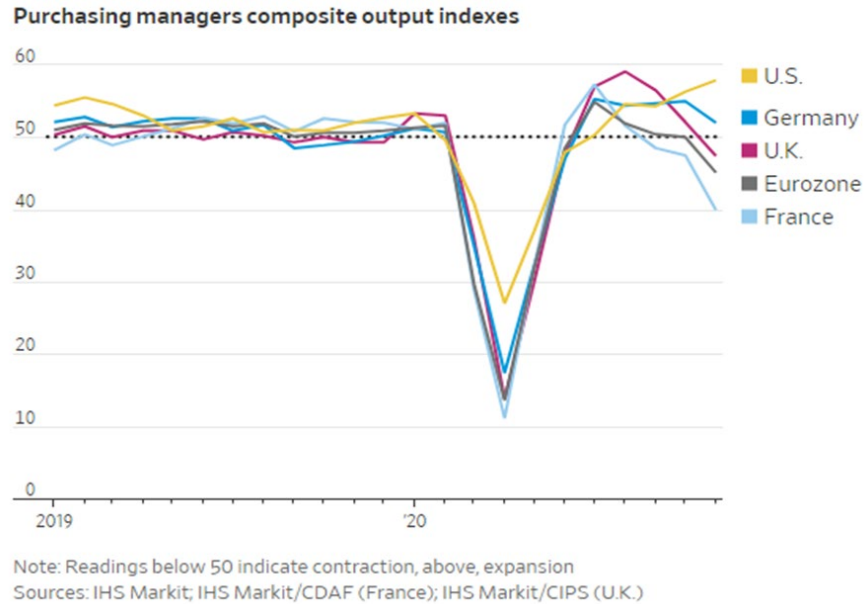
As we transition to winter and look ahead, the words of Hal Borland, American author and naturalist, come to mind: “no winter lasts forever, no spring skips its turn.” For many, it seems as if there is no end in sight to the coronavirus “winter” we are experiencing in the United States and throughout the world. But in early November, we were given hope, with the news of effective vaccine trials, signaling a potential end to the coronavirus pandemic and return to a normal “spring”. The questions are: when do we reach normality and can we adequately bridge the gap between now and then?

To say that the coronavirus pandemic has had an unprecedented impact on our lives would be a significant understatement. The total number of people infected by the virus in the United States exceeds 18 million and more than 300,000 have died. While we have seen the economy rebound from a record historical contraction in the second quarter, there are signs that the pace of the expansion is slowing. Of the more than 20 million jobs lost in March and April, only about half of them have been recovered. We continue to see record levels of weekly new jobless claims as businesses, especially in the service industry, deal with lockdowns and restrictions.

As we look to 2021, all eyes will be focused on “the path of the virus” as Federal Reserve officials have indicated that the recent surge in infections pose a challenge to the economic recovery and that it is too soon to assess the impact of successful vaccines, especially in the near-term.

As reported in The Wall Street Journal, tightening restrictions on businesses and households have pushed much of Europe back into contraction, while the U.S. continues to recover – see chart below. Still, a surge in Covid-19 cases in the U.S. poses a fresh challenge for the economic recovery.





The news of successful vaccine trials was widely described as a “game changer”. Two vaccines, one developed by a partnership between Pfizer and BioNTech and the other by Moderna, were reported to be over 95% effective in providing protection against the coronavirus. These vaccines, using new biotechnology, were developed in less than a year compared to the more than 10 years to develop a traditional vaccine. The Food and Drug Administration granted emergency use authorization to both vaccines in mid-December and distribution has begun, prioritizing essential workers and the most vulnerable first. But a vaccine is not the same as vaccination, and the next challenges will be vaccinating the hundreds of millions of individuals necessary to attain herd immunity.

We will also be closely monitoring activities in Washington, D.C., as a new President and Administration and still yet to be finalized Congress take over.

Over 155 million Americans cast their vote in the U.S Presidential Election in early November. The coronavirus has forced us to change the way we do many things, and the election was no exception, with over 46% of voters voting by absentee mail-in ballot. Former Vice President Joe Biden won the popular vote and enough states to amass 306 electoral votes. The Electoral College ratified the election results and confirmed Biden on December 14 as the next U.S. President. In the U.S. House of Representatives, Republicans gained seats, but Democrats retained their majority. The final make-up of the U.S. Senate will be determined in a special runoff election on January 5 for two U.S. Senate seats in Georgia. If Democrats win both races, the Senate will be equally divided, 50-50, between Democrats and Republicans, but Democrats will regain control of the Senate with Vice President-elect Kamala Harris holding the tie-breaking vote. If the Republicans win one or both seats, they will retain their Senate majority.

The economic recovery has been bifurcated or “K-shaped”. Large-cap firms already adapted to the stay at home economy or industries having robust technology and delivery capabilities have fared well through the Covid-19 business cycle. Small businesses, more dependent on personal service with lower-wage positions such as the hospitality industry, have struggled to stay afloat. It is these industries and workers that are in need of government assistance – see chart below:



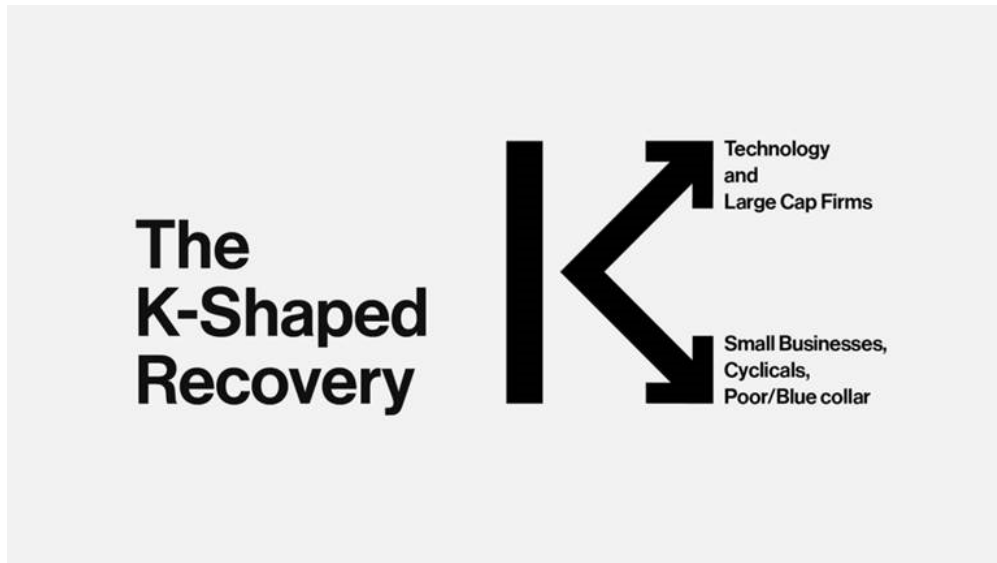


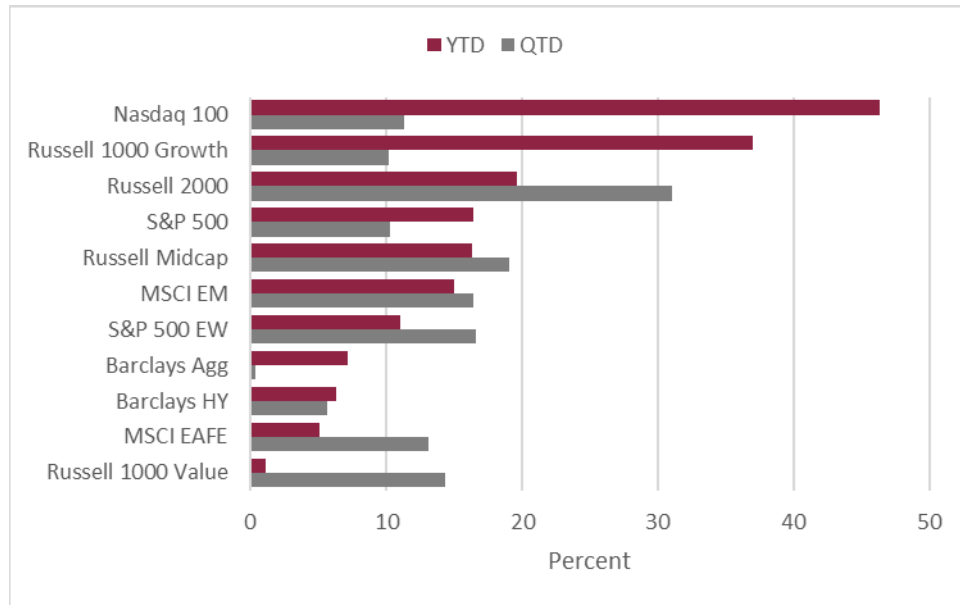
Image courtesy of Nicolas Gavrilenko
MIT Technology Review Insights

After months of negotiations, Congressional leaders reached an agreement on a \$900 billion dollar coronavirus relief package, which provides another round of direct payments of \$600, an additional \$300 in unemployment benefits for 11 weeks, and more than \$300 billion in relief to small businesses. The relief bill was passed by Congress and sent to President Trump for signature. Federal Reserve officials, including Fed Chair Jerome Powell, have publicly called on the legislative and executive branches to provide additional fiscal stimulus to support the economy, noting that the Fed does not have the authority to tax and spend. The amount and timing of any aid in addition to this package will most likely depend on the outcome of the Georgia special election, determining which party controls the Senate.

Investment Strategy

Markets reacted favorably to the November election results and the prospects of divided government. The S&P 500 jumped over 7.3%, the best election week since 1932, according to The Wall Street Journal. Not to be left behind, the Dow Jones Industrial Average gained 6.9% and the tech-heavy Nasdaq composite rose 9%. The stock rally continued to gain momentum as news of successful vaccine trials was released the week following the election with a rotation out of the “stay-at-home” sectors into sectors that would benefit by a reopening of the economy. This was evidenced by energy and financial stocks outperforming technology and consumer discretionary stocks. Also in November, value stocks outpaced growth stocks for the third consecutive month. The Russell 2000 small-cap index recorded its best month, pushing its year-to-date gain to surpass that of the S&P 500. The table below shows the year-to date and quarter-to-date performance for select market indexes as of December 21, 2020:





Source: Morningstar

At its November meeting, the Investment Strategy Committee voted to slightly raise the equity allocation across all of our total return strategies, which includes increasing our allocations to small and mid-cap stocks as well as emerging markets. We are also reestablishing a weighting to high yield bonds, consistent with our risk-on sentiment. This longer-term sentiment is supported by three favorable tailwinds

First, analysts are projecting annual earnings growth of 22% for the S&P 500 in 2021 and price appreciation of close to 10% for the index over the next 12 months, according to FactSet. Second, monetary policy remains accommodative and the Federal Reserve has indicated they plan to keep interest rates low until 2023, which is supportive of equities and other risk assets. Third, the potential “game-changing” impact of approved vaccines and a return to normal is another cause for optimism, in the short and long-term.

But our optimism is somewhat tempered in the short-term as we see coronavirus cases, hospitalizations, and fatalities continue to rise to new highs. The consensus among authorities is that the U.S. will not reach a critical mass in vaccinations until the second or third quarter of 2021. Shutdowns and restrictions have a negative impact on the economy, and we are starting to see that again, most notably, in Europe. As such, we will be vigilant regarding the course of the virus, the progress of the vaccination plan, and what happens in Washington to help bridge the gap until the U.S. and global economies reopen.


Please see our overall recommendations on the next page.

The Investment Strategy Committee



PeoplesBank Wealth Management Relative Asset Class Recommendations

As of 12/22/20



	Unattractive	Slightly Unattractive	Neutral	Slightly Attractive	Attractive
Stocks				X	
US Large Cap				X	
US Mid/Small Cap				X	
International Developed		X			
Emerging Markets		X			
Bonds		X			
US Investment Grade		X			
Inflation Protected Securities (TIPS)				X	
High-Yield				X	
International Bonds	X				
Municipal Bonds		X			
Preferred Stocks	X				
Real Assets					
Real Estate		X			

As of 12/22/20. Recommendations subject to change at any time without notice.

Investment Process

PeoplesBank Wealth Management's asset allocation process develops both long-term (strategic) and shorter-term (tactical) recommendations. The strategic recommendations are based upon how the Investment Strategy Committee believes investment portfolios should be positioned in a generally neutral market environment over the next ten years. The tactical recommendations are meant to highlight opportunities over the next one to two years where the Committee sees either increased opportunity or risk.

The Wealth Management Investment Strategy Committee (ISC) is responsible for establishing and updating both the strategic (long-term) and tactical (short-term) asset allocation for Wealth Management's investment management and trust relationships. The committee is comprised of the senior members of the Wealth Management team. The committee is also responsible for monitoring and updating strategies, managers, and funds within client portfolios. The ISC meets monthly. If you have any questions or would like to discuss PeoplesBank Wealth Management's outlook further, please call or send an email to your relationship or investment officer.

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