The Catholic Foundation of Southwest Iowa
Market & Portfolio Commentary – December 28th, 2020

Foundation Stakeholders:

For much of 2020, perceived headwinds kept sentiment and positioning contained, and money on the sidelines. More recently, investors have become complacent, valuations have gone even higher and the list of worries has dwindled. The success of a recent crop of initial public offerings (i.e. Airbnb) reflects ample liquidity and healthy animal spirits.COVID-19's most vicious infection wave has taken an unimaginable human toll, yet the V-shaped economic recovery appears to be on track. Vaccines are on the way, with forecasts for a full economic reopening by 2021's third quarter. Another round of fiscal stimulus was just signed into law by President Trump last evening. Increasingly bullish sentiment and the absence of positive catalysts suggest stocks are set for a pause as January's traditional new money flow marks a near-term top. We believe that investors need to balance optimism on the economy with an expensive stock market that could face tighter financial conditions, higher inflation and lower valuations.[1]

For all the disappointing and memorable things about 2020, capital market returns are not likely to be one of them. To the contrary, despite an ongoing public health tragedy that has already taken more than 290,000 lives in the US and created a severe sudden-stop recession, asset returns have been strong. Underpinning this dichotomy between the real economy and the hopes embedded in valuations of financial assets has been a phenomenal series of positive surprises that are creating a V-shaped recovery in the face of the pandemic and amid a collapse in about one third of the consumer services activity. The initial size, scale and scope of stimulus from the Federal Reserve and Congress have driven a much faster-than-expected recovery in manufacturing, housing and jobs. Households have amassed a savings buffer of roughly $1 trillion, about twice that of 12 months ago, while paying down credit card and loan balances. Their debt service costs as a share of net worth are at a multi decade low, which has allowed retail spending to completely recover to the pre-COVID-19 level.[1]

We expect the drivers of returns over the next 12 months, and possibly over the entirety of the next business cycle, to be those styles, sectors and geographies that have been patently out of favor over the last 12 months and really the entirety of the past decade. As we have written about before, market leadership has consistently changed from one business cycle to the next. What we will dub the "revenge of the old economy" began in November and we think has more room to run. We believe very strong profit growth (nearly 20%+ across all regions), rising inflation, and a structurally weakening of the US dollar will benefit cyclical value stocks (i.e. financials), small cap US stocks, international equities, and real assets *at the expense* of mega-cap tech and an endless amount of profitless companies that have been in vogue over the last decade plus. Within the CFSWIA portfolios, we have taken *some* profits from our high growth managers (i.e. WCM, for example, which has outperformed its benchmark by about 20% in the last 12 months) and reallocated a portion of the proceeds to financials and other value sectors.

See below for year-to-date net return estimates as of 12/24/20:

Strategic Growth Fund: +15.0%
Moderate Growth Fund: +15.1%
Capital Preservation Strategy: +1.7%

US Large Cap Stocks (S&P 500 TR): +16.7%
US Small Cap Stocks (Russell 2000): +21.7%
Global Stocks (MSCI ACWI): +14.7%

Jonathan Swanson
Institutional Consulting Director
Graystone Consulting
jonathan.swanson@msgraystone.com

[1] The GIC Weekly: In Need of Unpriced Catalysts