NOTTINGHAMADVISORS
ASSET MANAGEMENT

Good Riddance 2020, Hello 2021

Life is short. Anything can happen, and it usually does, so there is no point in sitting around thinking about all the ifs, ands and buts."

-Amy Winehouse

With respect to the late, great Amy Winehouse, the team at Nottingham Advisors gets paid to sit around and think about all the "ifs, ands and buts". It's a large part of what we do. That said, there are many days when we feel like we're drinking out of a fire hose, given the amount of research, opinion pieces and things that claim to be research, that comes into our email inboxes on a daily basis. Separating the wheat from the chaff is the key to unlocking valuable insights into the current investment zeitgeist.

A case in point supporting Ms. Winehouse's observation above is the recently concluded Georgia Senate race, where the two Democrats defeated the two incumbent Republicans, in what can only be deemed an upset of epic proportions. The "market" had for weeks been handicapping at minimum a single incumbent win, thereby keeping the Senate in the hands of the Republicans, and offering a check to the "blue" House and Oval Office occupants. Now with control of both Congress and the White House, Democrats may feel emboldened to try and push through more liberal legislation, including large-scale tax hikes, infrastructure and green energy bills, and major public welfare spending. Time will tell.

As I write, the bond market is showing the most acute reaction to the Georgia upset, with yields surging across the board. Among the least mentioned black swan events that might derail this 11+ year bull market, a surge in interest rates would seem the most plausible (right there after "global pandemic"). Much of the tailwind for the remarkable run in equities following the Great Recession of 2008 has been the decline in government bond yields, largely driven by overt central bank intervention.

Source: Bloomberg

At Nottingham, as we try and parse all the different economic, political, social and international scenarios that might create opportunity or increase risk, we occasionally find ourselves going down the proverbial rabbit hole, grasping at arcane unknowns while trying to maintain a level of sanity and perspective. When we catch ourselves talking in circles, we nearly always retreat "back to basics". In other words, focusing on what really matters to investors over long periods of time. Do Georgia Senate races really matter to a long-dated pension fund over the 50+ year time horizon of that fund? Or to a working 45 year-old saving for retirement? Or how about a 73 year-old just entering their golden retirement years? While the short-term impacts of heightened market volatility need to be considered and managed, the real answer is most often "No!"

As most of the people we've encountered recently would rather forget 2020, I think I'll use the remainder of this note to talk about the year ahead – hopefully a much better year on a lot of levels. Before doing that, allow me a brief look back at our January 2020 client note, ***2020 – A Brave New World*** (little did we know…). In that missive, we touched on a few concerns that we had at the time, mainly around historically high US equity valuations. Although there were a few parallels with 1999 at the time, there wasn't the speculative mania that usually accompanies market tops.

Fast forward 12 months, however, and we are admittedly a bit more concerned that the euphoria surrounding all things tech is becoming a little stretched. Might Tesla's addition to the S&P 500 in December mark the top of the equity bubble? Surely, the NASDAQ's 45% return in 2020 should give investors pause when they consider the index's P/E ratio of 66x? Or, how about Bitcoin, which has seen its price triple in the past 3 months. That's a stable currency?

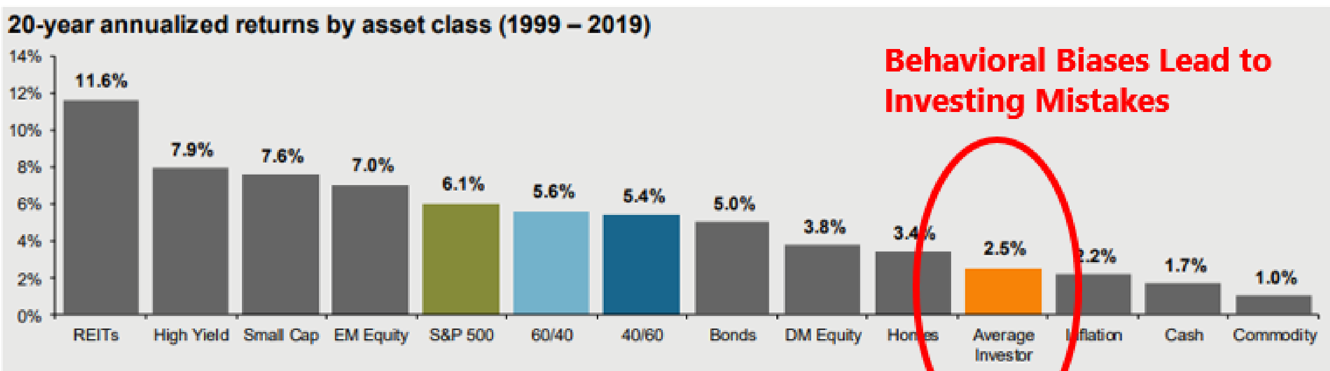
Yet, for each area of excess, there are sectors like Value, small-caps and emerging markets, which have all handily underperformed the broad large-cap growth dominated S&P 500 over the past few years. The S&P 500 Value index underperformed the S&P 500 Growth index by 32% in 2020! US small-caps trailed by 22% while emerging market equities have trailed the S&P 500 by 27% over the past 3 years. Void of fancy tech names they are, but bubbly they are not.

Source Strategas Research Partners

The chart above is one of our favorites in terms of maintaining that long-term perspective. Unlike today's Robinhood traders, Nottingham invests client funds with a time horizon based on years, not minutes. When one considers 10-year holding periods, the chart highlights that equity returns are nearly always positive, with a couple of high profile exceptions – the Great Depression and the Great Recession. Maybe not so evident is that stocks rarely return the average in a given year, more often returning far more or far less than the mean (in actuality, the histogram is highly skewed to the “far more” side). We can see now that based on the above, S&P 500 returns are above their long-term average return, but that number still may move higher.

Despite being “fully valued” by virtually every metric we can think of, US equities still have a tailwind in 2021 that could take them higher. That tailwind is the combination of a commitment to historically low interest rates by the US Federal Reserve, continued pandemic relief legislation and lastly a Democratic platform based around large-scale spending programs. While the easy money over the past decade may have been made, US stocks still could eke out better than average returns this year. In addition, with the alternative being a 0% checking account or a 1.1% 10yr US Treasury Note, the S&P 500’s modest 1.6% dividend yield looks positively robust.

Part of the trick for success in 2021 may be an investor’s ability (i.e courage) to take advantage of market declines while avoiding chasing melt-ups. As the chart below painfully highlights, humans are not exactly wired to do that. We have a tendency to panic during sell-offs and get greedy when we find out our neighbor is making a fortune trading high-flying tech stocks. Discipline will be required more than ever this year as it’s our bet that what has worked the past couple years may not work as well, and some dogs of the preceding 18 months may just have their day.



Source: Barclays, Bloomberg, FactSet, Standard & Poor's, J.P. Morgan Asset Management; (Bottom) Dalbar Inc, MSCI, NAREIT, Russell. Indices used are as follows: REITs: NAREIT Equity REIT Index, Small cap: Russell 2000, EM Equity: MSCI EM, DM Equity: MSCI EAFE, Commodity: Bloomberg Commodity Index, High Yield: Bloomberg Barclays Global HY Index, Bonds: Bloomberg Barclays U.S. Aggregate Index, Homes: median sale price of existing single-family homes, Cash: Bloomberg Barclays 1-3m Treasury, Inflation: CPI. 60/40: A balanced portfolio with 60% invested in S&P 500 Index and 40% invested in high-quality U.S. fixed income, represented by the Bloomberg Barclays U.S. Aggregate Index. The portfolio is rebalanced annually. Average asset allocation investor return is based on an analysis by Dalbar Inc., which utilizes the net of aggregate mutual fund sales, redemptions and exchanges each month as a measure of investor behavior. Returns are annualized (and total return where applicable) and represent the 20-year period ending 12/31/19 to match Dalbar's most recent analysis.
Guide to the Markets – U.S. Data are as of December 31, 2020.

J.P.Morgan Asset Management

Diversification, historically the bedrock of prudent investing, has taken a back seat to risk concentration over the past couple years. In fact, the prudent, diversified investor has been punished for their adherence to risk-management, while the wily day-trader, trafficking in all things tech, has often been rewarded. We think that might change here in 2021 as mean-reversion comes back in vogue.

The next few weeks should see some more volatility as we swear in a new President, seat a new Congress, and continue with the vaccine rollout. There is no telling what may happen with a 50/50 Senate, but it’s likely that at least some of the Democrats base platform will be enacted in the early days. Many of the more ambitious agenda items such as tax reform may not become law until 2022 or later. Either way, the political landscape in the US has changed materially and markets will react as this new reality sets in.

Summary

Our hopes for 2021 are plentiful, yet mainly of the garden variety. First and foremost, an effective vaccine rollout bringing an end to the pandemic would be a good place to start. A broad reopening of the global economy would help too. A lull in the highly vitriolic political scene would be most welcomed, accompanied by the recognition that despite our different political leanings we are all Americans and share an overwhelming common interest. Some semblance of sanity and risk aversion returning to financial markets would be prudent. A measured rise in interest rates to help savers and retirees would be appreciated by many.

As usual, Nottingham stands ready to help guide you through the impending turmoil of the coming year. Whether you need asset management, financial planning, retirement or business advice, we are here to help. Our team looks forward to stepping up its value proposition to our clients by increasing its already steadfast commitment to your financial success. Let us know what we can do for you.

From all of us at Nottingham Advisors, we would like to thank you for your business and wish you all a safe, happy and prosperous New Year.

Very truly yours,

Larry Whistler, CFA
President/Chief Investment Officer
January 2021