FORZA

Strengthening Our Clients' Financial Lives

Forza Investment Advisory, LLC

FROM THE DESK OF BOB CENTRELLA, CFA ***January 6, 2021***

2020 REVIEW AND 2021 OUTLOOK

Happy New Year and wishing you all good health and prosperity in 2021. As my friend said, "*Let's Get it Done in 21*"! **As for 2020, what a year**! Pandemic, bear market, economy shutdown, no sports, economy reopening, sports, bull market, election, vaccine … Wait a minute, is this 2021 or 2030? It seems like we went through a 10-year market cycle in 9 months. It was also a year of the fever. The bad fever – Covid related, and then there was Crypto fever, SPAC fever, IPO fever, and Online Gambling fever to name a few. Through it all, we saw stocks turn in a great year even though at one point in March the S&P 500 declined 34% from its top reached only 33 days earlier on February 19th. At that point who thought we'd ever come back? Five months later, stocks had regained all the decline (Aug 18th) and we were back to square one. If old Rip Van Winkle had slept through those 6 months and woke up on 8/18, he might have thought he didn't miss a thing. But the stark reality was that the pandemic kas killed millions worldwide, halted business and travel and wreaked general havoc on people's lives.

We enter 2021 with a new President and what appears to be a Democratic House and now Senate. As usual, today's market reaction (to Democrats sweeping Georgia) is contrary to what investors were expecting – similar to the general election when Biden winning brought the beginning of a rally and not a decline. In theory, 2021 should be a catch-up year where earnings catch up to stock prices and the economy catches back up to full operation. But with the Fed providing free money and expectations for more government stimulus, markets can move higher. More on that later.

Below is a list of asset class performance for key assets in 2020:

Asset Class Performance December, Since 3/23, and YTD - Total Return (%)

US Related

ETF	Description	December	Since 3/23	YTD
SPY	S&P 500	3.83	70.05	18.52
DIA	Dow 30	3.36	66.94	9.68
QQQ	Nasdaq 100	4.97	85.09	48.71
IJH	S&P Midcap 400	6.62	92.30	13.75
IJR	S&P Smallcap 600	8.31	90.10	11.34
IWB	Russell 1000	4.20	75.34	20.87
IWM	Russell 2000	8.79	99.32	20.19
IWV	Russell 3000	4.53	77.25	20.69
IVW	S&P 500 Growth	4.08	78.55	33.30
IJK	Midcap 400 Growth	6.49	94.01	22.61
IJT	Smallcap 600 Growth	8.82	92.89	19.21
IVE	S&P 500 Value	3.40	58.77	1.26
IJJ	Midcap 400 Value	6.87	90.04	3.78
IJS	Smallcap 600 Value	7.59	86.97	2.72
DVY	DJ Dividend	3.39	60.37	-4.88
RSP	S&P 500 Equalweight	4.22	80.29	12.79
FXB	British Pound	2.51	18.77	2.86
FXE	Euro	2.33	13.12	7.94
FXY	Yen	1.07	7.38	4.62
XLY	Cons Disc	2.49	84.97	29.71
XLP	Cons Stap	1.74	41.93	10.24
XLE	Energy	4.59	68.01	-32.46
XLF	Financials	6.35	69.93	-1.62
XLV	Health Care	3.87	54.02	13.41
XLI	Industrials	1.13	84.10	11.10
XLB	Materials	2.53	91.76	20.58
XLK	Technology	5.70	86.30	43.84
XLC	Comm Services	3.45	68.50	27.04
XLU	Utilities	0.64	43.16	0.59

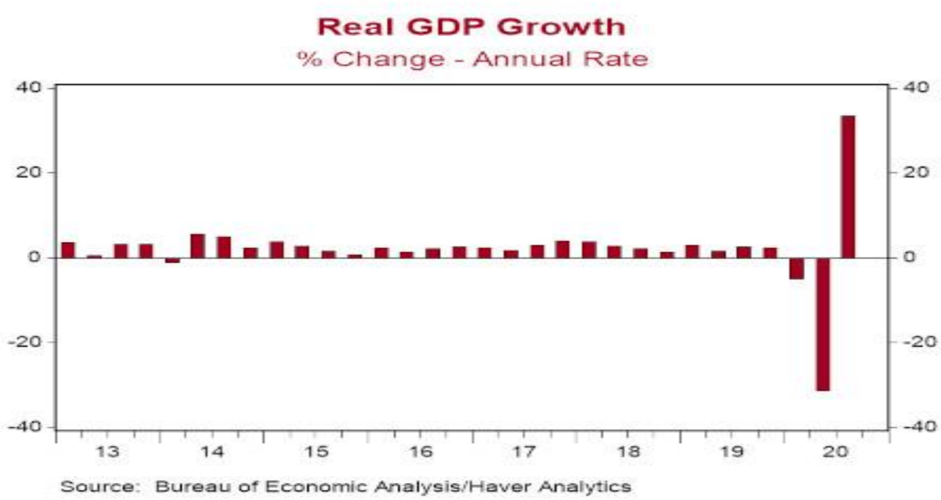
Global

ETF	Description	December	Since 3/23	YTD
EWA	Australia	6.37	91.32	8.33
EWZ	Brazil	12.22	81.38	-20.41
EWC	Canada	3.48	79.31	5.88
ASHR	China	5.45	62.46	36.26
EWQ	France	3.19	65.01	3.16
EWG	Germany	5.47	75.19	10.77
EWH	Hong Kong	4.54	39.23	4.21
PIN	India	10.30	92.14	18.64
EWI	Italy	4.14	59.70	1.88
EWJ	Japan	5.41	53.27	15.49
EWW	Mexico	7.12	73.66	-3.12
EWP	Spain	3.17	51.68	-3.60
RSX	Russia	9.35	64.14	-0.15
EWU	UK	5.14	53.42	-11.55
EFA	EAFE	5.21	60.97	7.80
EEM	Emerging Mkts	7.02	71.37	16.91
IOO	Global 100	4.69	64.88	18.73
BKF	BRIC	4.31	61.81	16.46
DBC	Commodities	5.38	32.70	-7.90
USO	Oil	6.55	-15.47	-67.80
UNG	Nat. Gas	-13.30	-27.35	-45.49
GLD	Gold	7.01	21.91	24.81
SLV	Silver	16.84	99.80	47.45
SHY	1-3 Yr Treasuries	0.03	0.39	3.03
IEF	7-10 Yr Treasuries	-0.26	0.30	9.98
TLT	20+ Yr Treasuries	-1.14	-3.79	18.25
AGG	Aggregate Bond	0.12	6.81	7.51
BND	Total Bond Market	0.15	7.10	7.71
TIP	T.I.P.S.	1.09	9.33	10.83

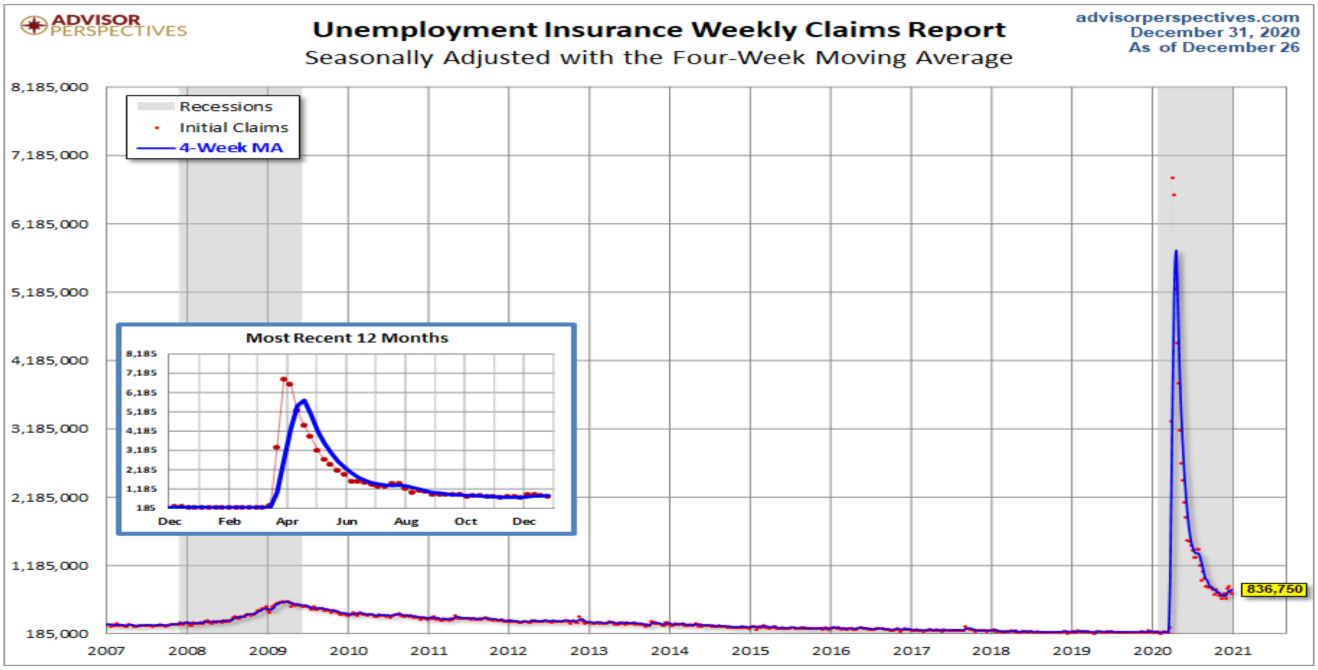
Recapping 2020, the results are quite impressive. Investors piled into everything from bitcoin to emerging markets with an expectation that a powerful economic revival would lead to continued gains. Speaking of bitcoin, it returned 307% in 2020 but it was not the winner. Ethereum returned 472% to claim the title for assets I follow. The stock market often recovers (or declines) far sooner than the economy. So, the market is saying big economic recovery in 2021. In looking at returns this year, the first thing that stands out is that those who thought value would unseat growth were dead wrong. Growth won across all market caps. The best stocks were the likes of Apple, Amazon, Microsoft, Tesla, Netflix, Nvidia and other large cap growth companies. The S&P 500 Growth index climbed 33.3% while the Value index barely rose 1.3%. The second thing standing out is that gains were broad-based with only energy stocks (-32%) lagging sharply (financials and utilities also fell behind). The NASDAQ (+48.7%) saw its biggest outperformance relative to the S&P 500 (+18.5%) since 2007. Outside the US, Brazil fell sharply while most other countries posted gains as well, ironically led by China's 36% gain. Gold (+24.8%) and Silver (+47.45%) also shone brightly.

ECONOMY

Where to start? The 2020 economy was like nothing I can remember in my lifetime including the several recessions I lived through. With a recession, you knew that eventually the country would climb out of it, brutally slow but steady. What we went through this year was unthinkable – shutting down the world's economy for weeks at a time. Not knowing what would reopen if ever again. It's hard not to be angry with "the country not to be named" that released this virus and led to the misery the world is being put through. Chart after chart of economic data just shows a massive spike down beginning in March and new all-time lows being reached for almost every indicator. In Q2, US GDP declined a record 31.4% when everything was essentially shut down. The good news is GDP revived sharply in Q3 accelerating up 33.4% and looks to have risen about 5% in Q4.



The lone bright spot during the pandemic has been housing. New home sales, existing sales and housing starts have been solid as consumers move to the burbs from cities. Meanwhile unemployment which was as low as 3.4% nationally prior to Covid, peaked at 14.7% in April. It now hovers around 6.7% in November but has a long way to go. It may take years to get back below 4%. Some 22 million people lost jobs at the peak in March and April! The number of weekly unemployment claims hit a high of 6.86 million in March and now stands at 787K. Prior to Covid weekly claims were at 200K, companies were hiring, and the workforce was expanding.



In summary, we've been through hell and are now on the way back. The V-shaped recovery is in force and further growth will depend on the path of Covid, the pace of vaccinations and the level of restrictions on businesses imposed by states. Look for about 5% growth in the quarter just ended and a possible slowdown in Q1 to resume as the year progresses. Assuming the current new administration doesn't shut the economy down again and provides stimulus as promised I wouldn't expect a double dip recession and we get back to normalized growth by the end of the year. An infrastructure bill, clean energy program, and higher taxes on corporations, capital gains and higher-earners also look to be part of the Biden agenda.

BONDS

In terms of interest rates, the Fed is dead set on leaving short-term rates near zero for all of 2021, and letting inflation rise modestly above its 2.0% target. The Fed has already said it _wants_ to see inflation exceed that target for a prolonged period before it raises rates. Higher inflation might get the Fed to start _thinking_ about ending quantitative easing, but lifting short-term rates is an issue for 2022 and beyond, not 2021.

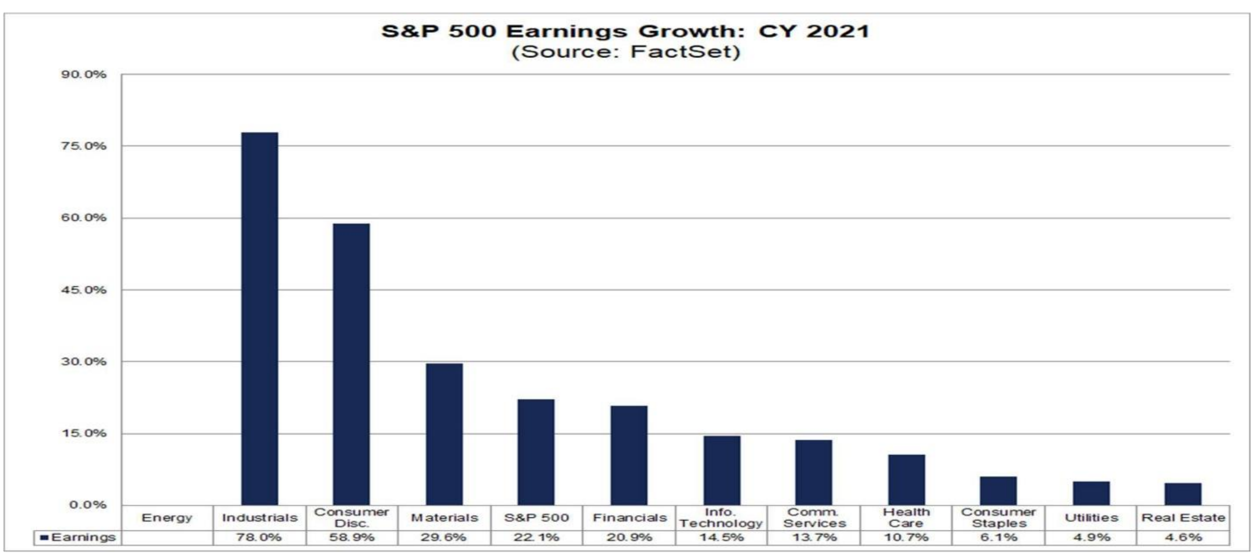
Long-term interest rates, however, should drift higher as investors get more confident about the economic recovery and see higher inflation. We just saw the 10-yr UST rise above 1.0% for the first time since before the pandemic. Prior to the pandemic the yield was around 1.9%. Yields could move even higher from here, but the low level of short-term rates (0%), the Fed's commitment to keep short-rates low, and investor skepticism about how long higher inflation will last should keep long-term rates from soaring.

The Barclays Bond Aggregate returned 6.5% in 2020. Pretty good for fixed income. For 2021, bonds returns could be flat and even negative if Treasury yields push higher. A balanced approach of bonds, preferred shares, convertibles, and high yield could generate a low/mid-single digit return. Not exciting but a good cushion if things worsen again.

STOCKS

Stocks had a *phenomenal* year considering what we went through. As mentioned earlier, stocks tend to move ahead of the economy as investors look forward. A LOT of good news is baked into stock prices right now. S&P earnings are forecasted to end 2020 at around $135, down 17% from $162 in 2019. Estimated 2021 EPS are around $167. Using the $167, the S&P 500 (at 3756 YE20) trades at around 22x forward earnings. The 5-yr average is 17.4x and the 10-yr is 15.7x. So, stocks are not cheap vs historical standards, but this is no ordinary time either. If earnings were to be normalized to pre-Covid, the forecasted number for this year would be about $192.00. That would put the S&P at 19.5x normalized forward earnings, still a bit pricey but more reasonable. You also need to factor in today's level of interest rates which has led to TINA (there is no alternative). This also may explain some of the rapid rise in bitcoin and other crypto currencies. With interest rates so low, stocks are the best house on the block – if not the only house on the block. And crypto became an alternative asset class rather than low-yielding bonds.

Our base case for equities in 2021 starts with the Biden administration to be sworn in to take control of the government and Senate to be controlled by Democrats. Markets would have preferred a split Congress, so there are some questions. On the positive side, expect more fiscal stimulus and a possible infrastructure bill. The potential negatives now include higher corporate taxes, individual taxes, and capital gains rates. But I'm going to assume tax increases are a 2022 event. I do expect increased financial regulation and possible regulation of large tech companies. We will assume vaccines are more rapidly given over the next 3 months and are effective leading to continued reopening of the US economy. This leads to a comeback in Corporate earnings with growth around 22%+ over depressed 2020 earnings. With such high EPS growth , you would expect stocks to charge ahead. However, given the somewhat stretched valuation we look for the S&P to return 8-10% overall. Certain sectors such as financials, consumer cyclicals, industrials and materials should show stronger gains as they are more economically sensitive. I especially like exposure to travel/hospitality companies that benefit from reopening. Energy is a wildcard, but if oil stays above or near $50/barrel then it could also be a strong sector. Tech and consumer, which benefitted from Covid, are likely to show slower growth in earnings.



Our downside case is for a floundering economy due to lingering Covid concerns, weaker earnings, and a market correction of 10-15% before snapping back to a breakeven-type year. I do expect a typical 5-10% correction at some point this year regardless of the scenario. The question is from what level does it happen. Another major concern is the potential for higher taxes – promised by Biden. Just as lower taxes benefitted earnings a few years ago, it will hamper earnings if it happens. Stocks react to earnings, so 2022 could be a difficult year.

I must admit that I am generally a bullish US equity investor. But this year, my level of bullishness is more muted given stock valuations and the amount of good news already reflected in prices. My preference is to look for pullbacks to purchase good companies. I recommend a barbell approach with core growth companies on one side and economically sensitive and reopening companies on the other. I continue to like exposure to mid and small cap companies (up to 5-10% of equities) and I'm probably more bullish on international stocks than I have been in the past.

I'd be remiss if I didn't include a quick word on crypto currencies. I'll include it here in the equity section. Personally, I don't quite understand the valuation for Bitcoin, Ethereum and others. But I believe that the pandemic and TINA contributed to their rise this year. It has become a major asset class and is beginning to be assimilated into world economies. Large institutions are now committing billions of dollars to purchasing crypto currencies and this is legitimizing them and giving them staying power. It's hard for me to advocate buying it as I don't know how to value it. But if you want to own it, I suggest dollar-cost averaging over time. You will get a pullback at some point.

OUTLOOK & SUMMARY
Framing the year ahead let's summarize our base case scenario:

- Economic growth to return with Q1 slower but building through the year. Jobs growth will pick up as the economy reopens putting money back in people's pockets. Q2 & Q3 to be very strong.
- Corporate earnings growth returns to 20%+ in a snapback. Q2 & Q3 supercharged.
- Equity returns of 8-10% on a base case scenario including dividends.
- Bond returns likely to be flat if not negative if bond yields move higher. Low single digit returns for a diversified approach.
- The Fed is on call and no rate moves expected but likely to still provide financial market liquidity as are worldwide central banks.
- Global economies must reopen, and vaccines must be effectively and rapidly distributed.
- Brexit is resolved but how will it impact world trade and finance?
- How much good news have stocks already priced in?
- What geopolitical event will surprise us this year?

In summary, Forza's recommendations for 2020 as follows:

1. We still prefer equities and are neutral on bonds but still maintain both in the overall allocation of assets for balanced portfolios. We are looking for stocks to return in the 8-10% range in a most-likely scenario but expect volatility. As usual, it will not be a straight line up.
2. We will see ups and downs including another possible 5-10% correction during the year.
3. We continue to overweight US stocks but like International exposure.
4. Mid and small caps should do well in a recovering economy.

We are entering the January corporate earnings season. I'm anxious to hear what companies did in the 4th quarter and how things look to start the new year. Have a great 2021 and let's talk in the coming month for an update.

Bob