PALUMBO
WEALTH MANAGEMENT
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PWM Weekly Observations

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Philip G. Palumbo, CFP®
Chief Investment Officer

Doug Augenthaler, CFA® CFP®
Chief Portfolio Strategist

Prognosticators Delight

The magic of the new year is that prognosticators get to wipe the slate clean and begin anew, and as usual there is no shortage of prognostications for 2021. **The more common themes call for a weaker dollar, stronger international markets, a spark of inflation, a rebound in small cap stocks, and the like. We have a different perspective.** Our advice is:

- **Don't worry about small cap stocks or large cap stocks or even international stocks**
- **Don't worry about interest rates**
- **Don't worry about the new normal, and what that might look like**

We attempt to reduce portfolio risks, and at the same time, potentially reduce the reward by utilizing a diversified portfolio. The rationale is simple. When times are tough and markets are down, **we strive to limit losses as best we can**, so that when better days return, **the recovery can be faster and the compounding of returns can begin again.** We often call that a **'win by not losing'** strategy. This doesn't mean we are guaranteeing that you will not lose. No one can do that. Investment losses are a reality, but whenever there is a loss, **you need to recover that loss before you can begin to grow your wealth again. The less you lose, the faster that process can begin. That is the essence of a 'win by not losing' strategy.** This **requires discipline to stay the course despite events that tempt you stray and that can be difficult, but it allows us to sleep better at night.**

Most of our clients have built their wealth over thirty-to-forty year periods, so protecting capital is our first priority with growth right behind it. **This is critical to our clients, particularly as they approach retirement and may not have the time to recover from large losses.**

This philosophy allows us to look at markets in a somewhat different light, and as we see it, these are the key questions that will be a critical component for all the other questions that are being discussed by the prognosticators out there.

1) Will there be a serious COVID setback? (example, a mutation that circumvents vaccines)

As we outlined last week, we believe that some of the changes brought by COVID are temporary and some are permanent, but **the core of that analysis is that vaccines work** and ridding ourselves of COVID is just a matter of time. **Odds are good that this is the case, but as we all know, things happen. There is always the chance that vaccines do not work as advertised.** There is always a chance that a mutation comes along that is able to circumvent the vaccines. We don't view these as likely events, but they are not impossible either.

Should the unlikely occur, the next bout of COVID anxiety would likely be much more difficult than the first. COVID fatigue is a real issue, and if vaccines somehow fail, we are hard pressed to imagine a scenario that is positive for markets. **Economic damage becomes less transitory and more structural and that is not a good thing for long term profits and, therefore, stocks.** While we have little doubt that the FED and other Central banks would pump more money into the economy, we see those efforts as being taken against a backdrop of real structural economic damage. **There is reason to believe that stocks would no longer rally along with additional monetary or fiscal easing as they have done to date.**

2) How much additional money will central banks inject into the global economy?

Assuming the COVID vaccines perform as advertised, we still need to confront the substantial damage that has already be done to the global economy. A second stimulus bill has now been signed, but a Democratic administration can be expected to propose at least one more round of stimulus, if not more. **More money sloshing around the economy needs to find a home and it makes sense that much of this will be reflected in asset prices.**

As we have discussed on several occasions in these pages over the last year**, all that money sooner or later, should be reflected in rising inflation.** The typical response would be an increase in interest rates, and we believe that markets will attempt to comply, but we can't afford that. The interest costs on our enormous debt are already very high despite very low rates. So, we would expect the FED to keep rates low by any means possible. In short, a spark of inflation has the potential to turn into something more significant. **A combination of continued low rates and more money being pumped in would imply increasing upward pressure on asset prices. The more money that gets pumped in, the greater the upward pressure and the more likely the Fed is to take extraordinary action to keep rates down despite inflationary pressures.**

3) At what point do valuations matter?

Of course, the upward pressure of a rapidly growing money supply on markets is totally disconnected from valuations, and this is a primary reason that **valuations are a poor tool for market timing**. As John Maynard Keynes said in the 1930's, **"Markets can stay irrational longer than you can stay solvent."** But we also know from history that, **eventually, valuations DO matter.**

There is little question that global markets are very highly valued now compared with historical norms. The argument for these valuations is that rates are very low. (If asset values are worth the discounted values of their cash flows, a lower discount, or interest, rate implies valuations should be higher.) **We don't disagree with the theory, but we also realize that rates are where they are due to substantial intervention by central banks. They are not free market rates.** In that sense, interest rates may not truly reflect economic reality and therefore may not be a good measure to calculate value. **This is a very academic argument, but it still provides a useful framework for viewing markets today. We know that valuations matter eventually, we just don't know when 'eventually' arrives.**

From our perspective, **this means that this is likely to be an eventful year**. We just need to wait and see which way the event(s) lead the markets. **While others are placing their bets, we continue with our disciplined approach that we believe will serve our clients well in 2021 and beyond**.

Wishing everyone a Happy, and above all, a Safe New Year!

What We're Reading

- How mRNA Vaccines Work **(3 Minute Video)**
- This Time Is Not Different | More Debt, Less Growth
- Traders Boost Bets Against Dollar to Highest in Almost a Decade
- Pictures of the Year
- Only One Number Mattered to Global Markets in 2020
- Married Couples have Social Security Options
- Weekly jobless claims fall for a second straight week

Markets This Week

The traditional end of year rally held true to form as the final week of the year generally came up green, led by large cap stocks. The exceptions were the Home Builders, reacting to slowing sales as rising prices make homes more unaffordable, and Energy, which really needs the vaccines to work for a recovery.

US Equities	1 week	YTD	Fixed Income	1 week	YTD	Sector Breakdown	1 week	YTD
S&P 500 (SPY)	1.32%	18.33%	20+ Yr. Treasuries (TLT)	0.28%	18.15%	Consumer Disc. (XLY)	1.84%	29.63%
Dow (DIA)	1.25%	9.59%	Barclays US Aggregate (AGG)	0.17%	7.47%	Info. Technology (XLK)	0.74%	43.62%
NASDAQ (QQQ)	1.35%	48.40%	Intermediate Municipal (MUB)	0.02%	5.12%	Financials (XLF)	1.83%	-1.73%
Russell 1000 Growth (IWF)	0.78%	38.25%	US Corporate Bonds (LQD)	0.26%	10.97%	Health Care (XLV)	1.77%	13.29%
Russell 1000 Value (IWD)	1.22%	2.73%	Barclays US High Yield (HYG)	0.29%	4.46%	Utilities (XLU)	2.43%	0.51%
Vanguard Mid-Cap (VO)	-0.15%	18.10%				Industrials (XLI)	0.62%	10.91%
Vanguard Small-Cap (VB)	-0.62%	19.19%				Energy (XLE)	-0.58%	-32.67%
						Materials (XLB)	1.13%	20.47%
International Equities	**1 week**	**YTD**	**Commodities**	**1 week**	**YTD**	Consumer Staples (XLP)	1.09%	10.10%
MSCI EAFE (EFA)	0.83%	7.59%	Commodities (PDBC)	0.73%	-7.85%	Comm. Services (XLC)	1.84%	26.91%
MSCI Emerging (EEM)	3.07%	17.03%	Gold (GLD)	1.14%	24.81%	REITS (VNQ)	1.25%	-4.61%
						Homebuilders (XHB)	-2.91%	27.98%

The table above is an analysis of the weekly and year to date returns of various markets/sectors that we follow (More RED = worse performing markets/sectors; More GREEN = best performing markets/sectors). Source: IEX Trading & PWM Research.

Retirement Planning:

How retirement planning needs to change in the new year

It may be time to revisit traditional approaches to retirement planning.

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Tax Planning:

[New Covid relief bill boosts tax breaks for charitable giving in 2021]

Giving to charity is about to pay off a little more.

Health:

[The Worst New Year's Resolutions for 2021, According to Doctors]

It's possible that the types of resolutions you are making are, in fact, setting you up for failure.

Entrepreneur:

[Three Shifts That Every Entrepreneur Needs To Make In 2021]

Entrepreneurs who succeed in building strong, sustainable businesses know that success doesn't come from a great idea.