Business and Commercial Insights

The Phoenix Rises

OUR TAKE ON THE RECOVERING ECONOMY FOR BUSINESSES

By John Traynor, CIO, People's United Advisors Inc.

2020 was a year for the history books. On top of the tragic losses brought on by the COVID-19 pandemic, Americans coped with widespread unemployment, shuttered schools, social reckoning over long-simmering racial inequalities, and a divisive presidential election. It's no surprise that so many of us wish to slam those history books shut and put it all behind us.

However, it's important to take some lessons from 2020. The health, economic, and racial challenges that our country faced were not some unpredictable "black swan" events, but rather the confluence of existing threats. How we reacted to those challenges was our chance to see our true selves as individuals, as communities, and as a country. Adversity brought out strengths we didn't know we had to meet challenges we didn't see, and introduced us to who we have always been.

As investors, we witnessed a decline in the Dow Jones Industrial Average from what was then an all-time high in February 2020 to historical lows in March. That 33-day 33% decline was the fastest bear market on record. An oil price war between Russia and Saudi Arabia also erupted in early March, pushing futures prices on a barrel of oil to -$40, a seemingly impossible occurrence. As can be seen in *Figure 1*, many investors predicted a depression that would rival the 1930s.

When faced with this adversity, we took a step back and considered the positive impact of the Fed lowering interest rates to near zero, the fiscal stimulus from Washington, and the underlying strength of the economy. We are most proud of our decision to raise the equity exposure in our portfolios in early April rather than follow our panic-stricken peers and sell out. Instead of fixating on the supposed abyss that the stock market was falling into, we anticipated a phoenix rising from the ashes of the COVID collapse.

That's one key lesson investors should take away from the turmoil of 2020; when faced with adversity, we must strive to see the larger picture of what's happening in the world around us. We should not fixate on an individual tree, but rather see the forest. We hope investors can remember to focus on the big picture and stick to their long-term plan. If they can do that, they will emerge from the ashes of 2020 to soar like a phoenix in the period ahead.

Looking to the Year Ahead

- **The reset.** After a period of extreme volatility, we see the beginning signs of a reset across the operating backdrop.
- **The lessons.** We revisit a period of enormous upheaval in the 70s and 80s for perspective on the lasting changes that 2020 delivered.
- **The outlook.** We offer our take on the 2021 outlook for growth, employment, confidence, and leading indicators of the business environment.

THE YEAR AHEAD: A RESET

At the time of this writing, the Biden administration has begun its term with a refreshing sense of calm. It appears that a power-sharing agreement for the Senate has been developed but we will assume that no matter the outcome, we will continue to see a contentious environment in Washington. As we watch the initial policies of the Biden administration take shape, it appears that one theme for the year ahead is "hitting the reset button." In both domestic and foreign policy, President Biden is likely to reset many policies back to pre-Trump positions.

Likewise, this is a time of reset for the broader market environment. Here are our thoughts about what that means:

Re-Engaging Internationally. One of the most controversial aspects of the Trump administration was its movement away from a multilateral international policy toward unilateralism. We believe the Biden administration will look to re-engage with our European allies and renew the U.S. commitment to NATO. On trade, Biden has already stated he wants to rejoin the Trans-Pacific Partnership with our Asian trading partners. Moves like these should support the global stock markets; we expect portfolios with international exposure to do well in the coming year.

Restoring Confidence. Many Americans lost confidence in our leading institutions amid the challenges of the pandemic. Along those lines, we desperately need to see higher confidence in the vaccines developed to fight COVID-19. According to the latest Gallup Poll, only 63% of Americans were willing to take a vaccine—too low a figure for the U.S economy to return to a "pre-COVID" state. In order to feel safe to resume our lives and patronize our local businesses, we have to trust (effective) vaccines.

Reconcile Our Communities. A tragic scene played out across the country last year when racial tensions exploded after the death of George Floyd, exposing how far apart our communities still are. In early 2021, the storming of the Capitol shocked our national sensibilities and exposed emotions, still raw after the election. President Biden has said that starting a healing process will be an important aspect of his governance. Healing our many schisms is a herculean, but critical, task. We may not see a direct economic impact from any progress made on this front next year, but a more-united country will surely pay us long-term dividends.

We look to the new year with great hope. Just as the phoenix rose from its ashes, signifying rebirth, we too can emerge from the challenges of 2020 to become better investors and better citizens. We should not wish to forget last year, but instead value the lessons we learned and grow to new heights.

The Investor "Hysteria" Cycle

Unsurprisingly, the Armageddonists were at it again once COVID hit.

FIGURE 1: TIMING IS EVERYTHING
S&P 500, January 2020–Mid December

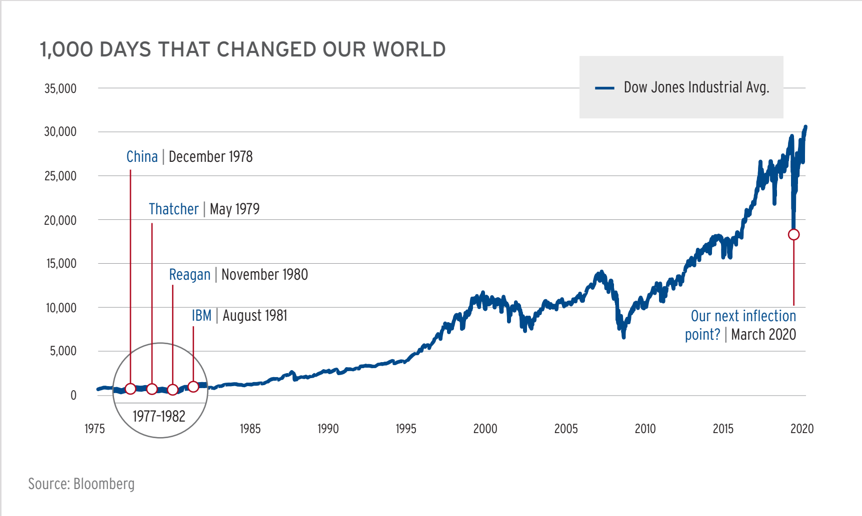
1. "...another 50% correction... also a long L-shaped bottom..."
   – David Stockman | March 4, 2020
2. "...a recession deeper than that following the 2008 financial crisis... a new Great Depression"
   – Mouriel Roubini | March 24, 2020
3. "...S&P 500 to lose about two-thirds of its value..."
   – John Hussman | March 26, 2020
4. "... Take out the low of March..."
   – Jeffrey Gundlach | March 31, 2020
5. "...the worst bear market in my lifetime..."
   – George Soros | April 1, 2020
6. "...a 40% slide from current levels..."
   – Scott Minerd | April 6, 2020
7. "...this strikes me as ludicrous..."
   – Albert Edwards | April 23, 2020
8. "...We are in a depression, not a recession..."
   – David Rosenberg | May 12, 2020

Sources: Bloomberg, JPMAM. 11/17/2020

ADVERSITY FUELS OPPORTUNITY

In December 1978, just as many Americans were going to the opening weekend of Superman or dancing to the new number-one hit "Le Freak" in a disco, a meeting was taking place on the other side of the world—one of four events over the subsequent 1,000 days which would change the world. Deng Xiaoping, the newly installed leader of the Chinese Communist Party, officially announced a campaign of "modernizations" which launched the impoverished nation into an unprecedented period of growth. Just a few short months later, on May 4th, 1979, Margaret Thatcher was elected prime minister of Great Britain, while on November 4th, 1980, Ronald Reagan was elected president of the United States. These two leaders lowered tax rates and regulations, throwing off the stagnation of the 1970s and laying the foundation for years of growing prosperity. Finally, on August 12th, 1981, IBM introduced the personal computer, delivering the information age to the home, the office, and eventually to the phone in everyone's pockets.

These four events set in motion many of the economic, social, and political challenges and opportunities we face today. China's economic opening unleashed the colossus

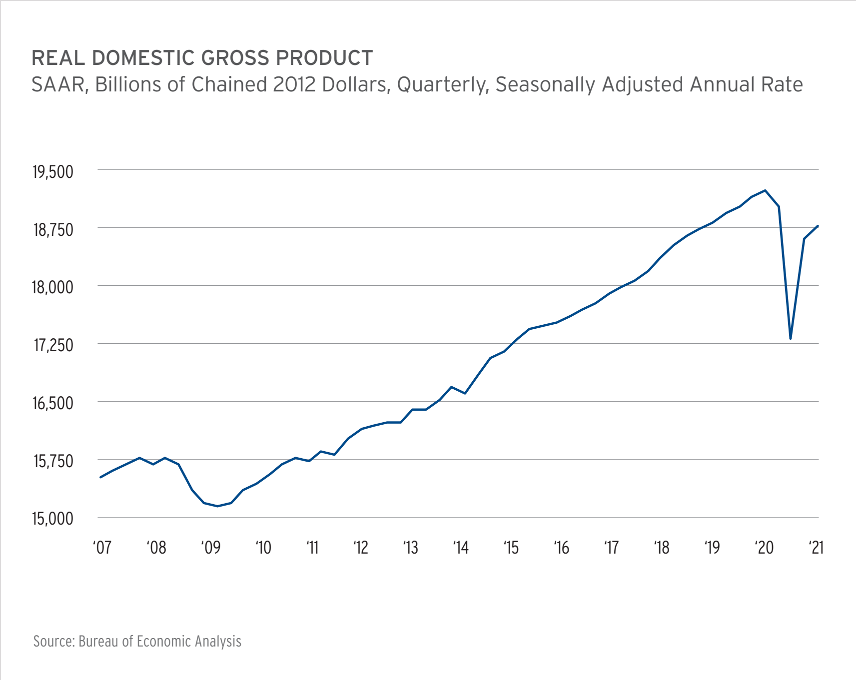


that is today an economic and military competitor to the United States - as well as a global supplier, a customer, a partner, and a competitor to businesses around the world. Reagan and Thatcher brought forth a renaissance in the ideologies of both free markets and free people. The ensuing rising tide lifted many, but not all, boats. Finally, the introduction of the IBM PC began a revolution that continues to this day, creating a new type of knowledge worker in the office tower and on the factory floor.

Business leaders during that 1,000-day period can be forgiven for failing to predict all the changes to come. But as those changes took hold, the observant acted. New businesses were born, new processes adopted, and new markets explored. Similarly, we believe the events of the last 365 days could have an incredible impact on the business models of today.

ECONOMIC GROWTH FOR 2020 AND 2021

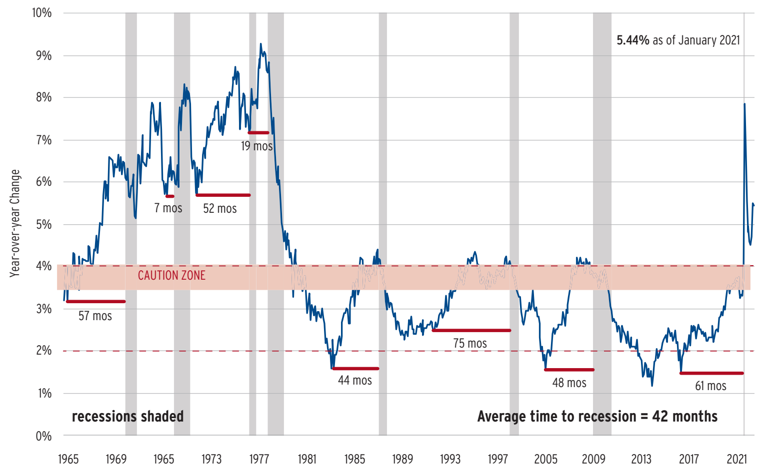
- Fourth-quarter economic growth was reported at an annual rate of 4.1%, bringing to a close the tumultuous year. For the full year, economic growth declined by -3.5%, the largest decline since 1946 when the U.S. was transitioning to a peacetime economy after WWII. The 2020 decline was based primarily in the services sector, while the goods-producing sector held up relatively well.
- The incredible resilience of the economy, combined with unprecedented levels of fiscal and monetary support, allowed the U.S. economy to avoid the depression many were forecasting in the spring of 2020.
- The economic momentum evident in the fourth quarter should propel the economy through 2021. Private nonresidential fixed investment, or capex, increased at a 13.8% annual rate. Strength was seen not only in technology spending but also in equipment, which rose by 24.9%. The only major area where capital spending remains depressed is infrastructure. The adjustment to how we work today and into the future is continuing to roil commercial real estate markets.



TRENDS IN WAGES

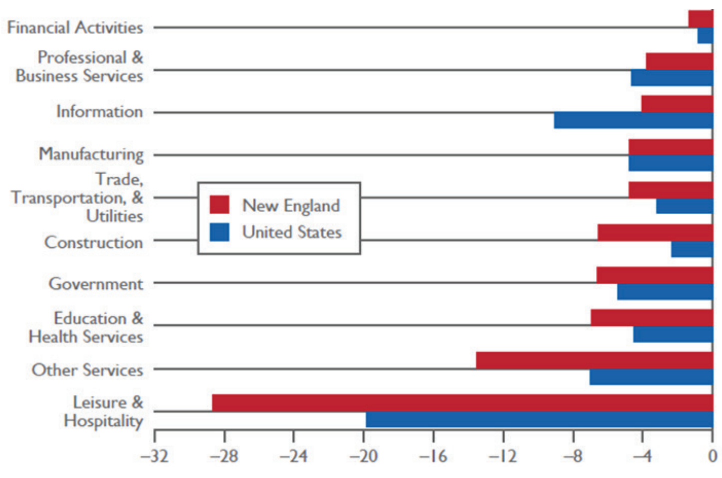
- The accompanying chart illustrating wage gains shows a tremendous spike coinciding with the depths of last year's economic rout. Normally an increase in wages, along with low inflation, would be a welcome sign. Unfortunately, this bump is attributed to the loss of jobs in the low-wage sectors of our economy rather than overall robust wage growth.
- The January jobs report showed a further increase in wage growth from December, which serves to illustrate the continued headwinds for jobs in low-wage industries.
- A healthy job market will actually be evident through reduced wage growth in 2021. If we see the counterintuitive slow-down in wage growth this year, then we will also see the rehiring of low-wage workers.

AVERAGE HOURLY EARNINGS
Private Production & Non-supervisory Personnel



Source: Bureau of Labor Statistics

EMPLOYMENT GROWTH BY SUPERSECTOR
Percent change, November 2019-November 2020



Source: U.S. Bureau of Labor Statistics
Note: Data are seasonably adjusted. New England's Information supersector is based on data from NH, MA and CT only. New England Economic Indicators is published by the Federal Reserve Bank of Boston. New England Economic Indicators aggregates data released prior to December 22, 2020.

WHEN TO EXPECT A LABOR FORCE RECOVERY

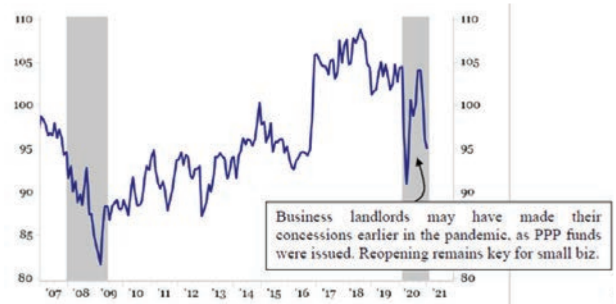
- The recession in 2020 was unique in many ways, one of which was the relative strength in manufacturing while the services economy faced extreme difficulties.
- Services represent over 70% of the private-sector economy and over 80% of the jobs in the U.S. These jobs are best represented by the leisure and hospitality industry, which is composed of restaurant and hotel workers. The chart illustrates the incredible job losses in this sector over the 12-month period. During prior recessions, this sector has acted as a shock absorber by holding up better than other areas of the economy. In 2020, restaurants and hotels were among the hardest hit because of social-distancing restrictions and consumer nervousness about being tightly packed in enclosed spaces.
- The successful rollout of COVID-19 vaccines will be the key to driving the recovery in the services economy. As consumer confidence increases in the vaccination program, we believe a rebound in restaurant and hotel business will follow, although it will not be the sharp rebound that many hope for.

CONSUMER AND BUSINESS CONFIDENCE STILL LAGGING

- For a robust and sustainable economic rebound to take place this year, we need to see both consumer and business confidence increase. Currently, both measures of confidence are still hovering near recession lows. The increase in COVID-19 cases seen in December and January, along with increased restrictions placed upon restaurant dining, have served to lower confidence throughout the country.
- A sustained economic recovery rests on rising consumer confidence. Re-engaging with local businesses by shopping and dining again will boost hiring in the service sector and help drive employment back to pre-pandemic levels.
- Increases in capital spending by business owners will only take place when confidence in the sustainability and strength of the recovery takes hold. Businesses are already spending on technology to improve their connection to customers, but we need to see broader spending on equipment to ensure the economy continues on its upward path.

CONFERENCE BOARD: CONSUMER CONFIDENCE
SA, 1985=100

NFIB: SMALL BUSINESS OPTIMISM INDEX
SA, 1986=100

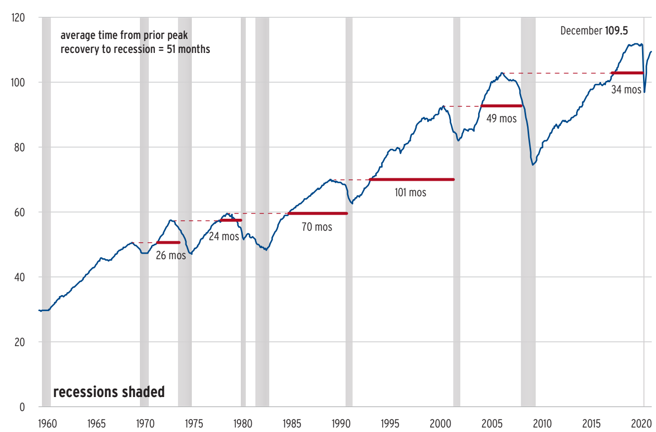


Sources: Strategas, The Conference Board and National Federation of Independent Business

WHAT THE LEADING ECONOMIC INDEX IS SHOWING

- The Leading Economic Index (LEI) has long been a reliable indicator of future economic trends, both declining and advancing scenarios. The accompanying chart illustrates the roughly twelve-month warning we get prior to a recession as the index starts to decline. In 2020, we received no such warning. The unprecedented nature of the COVID-19 recession can be seen in the dramatic drop in the index from its February-2020 level.
- While the LEI did not give us a warning prior to the 2020 recession, we do believe the sharp rise since the late spring recession bottom is a positive sign for continued economic growth. The strength in manufacturing activity, lean inventory levels, and strong order growth all point to robust growth in 2021 and beyond.

LEADING ECONOMIC INDICATOR INDEX



Source: The Conference Board

USING THE LESSONS OF 2020

We can put 2020 behind us while still remembering some critical lessons. First, we must remember that we are in a volatile era with many embedded risks. The pressures of the past year brought these challenges to the forefront, but unresolved tensions will be with us as we go forward. Second, 2020 was a good reminder that our economic environment and our investment environment can be unexpectedly volatile at any time. It's crucial to stick to your long-term goals in such moments, as we fortunately saw many of our investors doing. Third, we saw the incredible innovation and adaptation among businesses this year in response to adversity. Those efforts helped to propel our economy out of the worst depths, but there are more changes—and more dividends—to come from these innovations and adaptations. The sharp business leaders and investors will stop to consider how these changes will shape 2021 and beyond. ■