



## Economic & Investment Perspectives

**Figure 1: Returns – 12/31/2020** (Source: Yahoo!, ACIMA)  
 Conditional formatting: green (high) to red (low) for each time period

Bonds	ETF	Dec	Q4	2020	Max Draw Down	Current vs. 52-wk High	Current vs. 52-wk Low
US Aggregate Fixed Income	AGG	0.1%	0.7%	7.5%	-11.5%	-1.3%	12.0%
U.S. Treasury Bonds	GOVT	-0.8%	-1.4%	7.3%	-6.2%	-4.6%	5.0%
Investment Grade Corp Bonds	LQD	0.2%	3.4%	11.0%	-26.9%	-0.9%	31.6%
Muni Bonds	MUB	0.7%	1.8%	5.1%	-15.3%	-0.8%	17.2%
High Yield	HYG	2.0%	5.8%	4.5%	-23.7%	-1.4%	29.3%
Non-US Fixed Income	BNDX	0.4%	1.1%	4.7%	-9.1%	-0.4%	8.6%
Emerging Markets Bond	EMB	2.2%	6.0%	5.4%	-27.5%	-1.1%	36.4%
<b>Global Equity</b>							
ACWI Global Equity	ACWI	4.7%	14.4%	16.3%	-34.8%	-0.3%	70.2%
United States	VTI	4.7%	14.7%	21.1%	-36.5%	-0.2%	77.8%
International Developed	EFA	5.0%	15.7%	7.6%	-35.1%	-1.4%	59.5%
Emerging Markets	EEM	7.1%	18.4%	17.0%	-35.0%	-0.6%	71.7%
<b>Global Equity by Region</b>							
United States	VTI	4.7%	14.7%	21.1%	-36.5%	-0.2%	77.8%
Europe	IEUR	4.9%	15.8%	5.3%	-38.5%	-1.9%	65.8%
Asia ex-Japan	AAXJ	6.3%	17.0%	23.4%	-30.7%	-0.6%	69.2%
China	MCHI	2.2%	10.0%	27.8%	-26.3%	-4.4%	61.9%
Japan	EWJ	5.3%	14.8%	15.4%	-31.5%	-0.4%	62.4%
Latin America	ILF	12.6%	40.7%	-11.7%	-56.0%	-15.7%	88.9%
<b>US Equity</b>							
US S&P 500	IVV	3.8%	12.2%	18.4%	-35.3%	-0.2%	70.4%
NASDAQ 100 QQQ	QQQ	4.9%	13.1%	48.4%	-30.5%	-0.3%	90.2%
US Large Growth	IWF	4.4%	11.4%	38.3%	-33.5%	-0.7%	88.1%
US Large Value	IWD	3.7%	16.3%	2.7%	-39.4%	-1.5%	62.6%
US Eqwt S&P 500	RSP	4.2%	18.4%	12.1%	-40.7%	-0.1%	80.8%
US Mid Cap	IJH	6.5%	24.4%	13.6%	-44.1%	-1.3%	95.0%
US Small Cap	VTWO	8.6%	31.4%	20.2%	-43.8%	-2.6%	105.8%

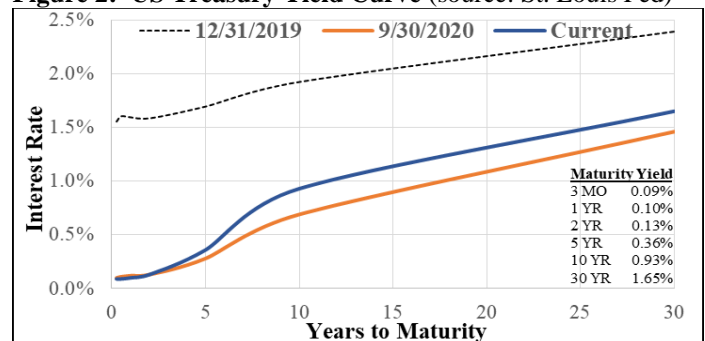
Equity markets continued to soar in December, capping a stunningly strong quarter and year. Despite the worsening health and economic impact of the pandemic, investors cheered the rollout of multiple vaccines and the removal of US election uncertainty. Returns for December (Figure 1) and the fourth quarter (Q4) were led by riskier, economically-sensitive segments (small and mid cap stocks, emerging markets, high yield). Performance highlights for the month and quarter include the following:

- Global equity (ACWI): +4.7% this month (Q4 +14.4%).
- US Equity: The broad market (VTI) gained 4.7% in December (Q4 +14.7%), and the S&P 500 (IVV) rose 3.8% (Q4 +12.2%). Economically-sensitive stocks outpaced its defensive issues for the month and quarter; small-cap stocks posted another strong month, as the Russell 2000 (VTWO) gained 8.6%, capping a stunning Q4 +31.4%, while the largest tech and e-commerce stocks (Nasdaq QQQ) were up 4.9% this month (Q4 +13.1%).
- Non-US Equity: Emerging market stocks (EEM) out-performed developed markets (EFA) for the month (+7.1% vs. +5.0%) and quarter (+18.4% vs. +15.7%), led by a rebound in Latin American shares (ILF +12.6% this month, Q4 +40.7%). European shares (IEUR) rose 4.9% this month (Q4 +15.8%).
- Fixed Income: The US Aggregate bond index gained 0.1% in December (Q4 +0.7%). US Treasuries were down 0.8% as interest rates rose marginally (Q4 -1.4%). High yield bonds gained 2.0% (Q4 +5.8%) and emerging market debt earned 2.2% in December (Q4 +6.0%) as credit spreads tightened.

## Interest Rates and the Economy

Figure 2 graphs the US yield curve, which plots yields (Y-axis) for various maturities (X-axis) of US Treasuries. Long-term interest rates moved slightly higher during the fourth quarter but remain well below pre-crisis levels. According to the Federal Reserve (Fed), short-term yields are likely to remain near zero for years to come, and the belief that the Fed will “manage” the yield curve through asset purchases and quantitative easing should keep interest rates low across maturities as well.

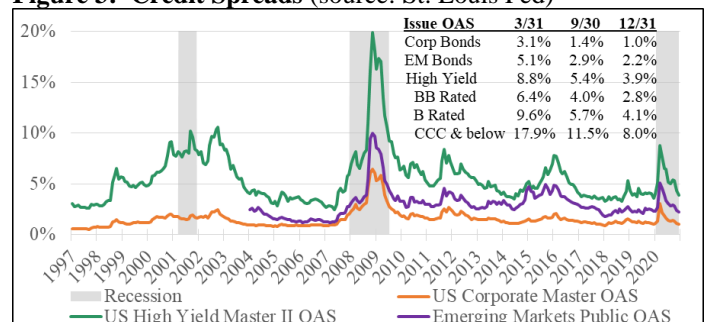
**Figure 2: US Treasury Yield Curve** (source: St. Louis Fed)



For bonds other than US Treasuries, we focus on the option-adjusted spread (OAS) between various bond yields and comparable US Treasuries. High spreads signal fear; low spreads signal optimism as investors are willing to accept lower returns for riskier assets. As illustrated in Figure 3 below, credit spreads have erased the first quarter’s fear-related spike, including a significant decline in Q4, confirming the “risk-on” mood of the markets.

- Investment grade corporate bonds yield 1.0% over comparable Treasuries, approximately unchanged versus 2019 year-end.
- Emerging market bonds carry an average yield premium of +2.2% versus +5.1% in March and +2.3% at 2019 year-end.
- High yield (non-investment grade) spreads had spiked to almost 9% before falling to +3.9% today, marginally above 2019 year-end levels (+3.6%). The riskiest bonds (rated CCC & below) now carry credit spreads below pre-pandemic levels.

**Figure 3: Credit Spreads** (source: St. Louis Fed)

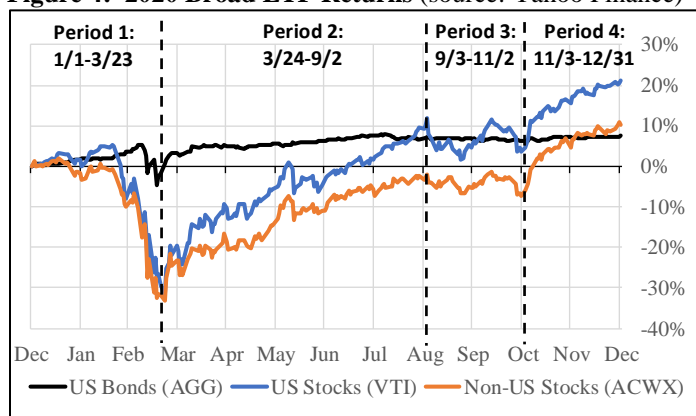


## 2020 Hindsight

The carnage of Q1 seems like a distant memory, when pandemic health and economic fears drove the world into recession and stocks into a bear market. Stock markets have marched relentlessly higher since, surpassing pre-pandemic highs and ending the year at or near all-time highs. In the following analysis, we use ETF daily total returns to proxy various equity and bond market segments and divide the year into four separate time periods (not calendar quarters), summarized below and illustrated in Figure 4:

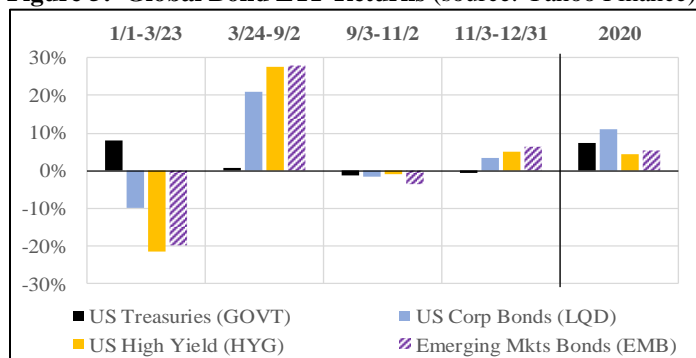
1. January 1 to March 23, the bottom of the pandemic meltdown;
2. March 24 to September 2: market recovery to new highs;
3. September 3 to November 2: equities sideways-to-down amid renewed pandemic concerns and US election uncertainty;
4. November 3 to December 31: renewed rally on vaccine hopes and the removal of US election uncertainty.

**Figure 4: 2020 Broad ETF Returns** (source: Yahoo Finance)



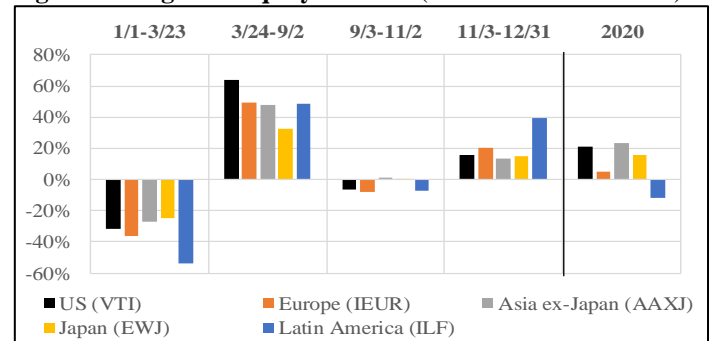
**Bonds:** The relative stability of US bonds (black line in Figure 4 above) masks upheaval in the credit markets during 2020. Figure 5 (below) graphs the total returns of various bond ETFs across the four distinct periods. US Treasuries offered the only place to hide in the global meltdown as investors aggressively sold risk assets and retreated to the safety of long-term US government bonds. Meanwhile, credit spreads spiked to panic levels in March, driving high yield and emerging market debt down 20% by March 23. That’s when the Fed stepped in, providing credit facilities and injecting liquidity through direct purchases of corporate bonds and ETFs. The credit markets responded swiftly, rising 20-30% as spreads tightened and concerns over financial market stability eased. Bonds fell slightly in September-October, but rallied post-election. For the year, US Treasuries held onto their crisis gains, while investment grade corporate bonds gained 11%, out-performing high yield and emerging market credit.

**Figure 5: Global Bond ETF Returns** (source: Yahoo Finance)



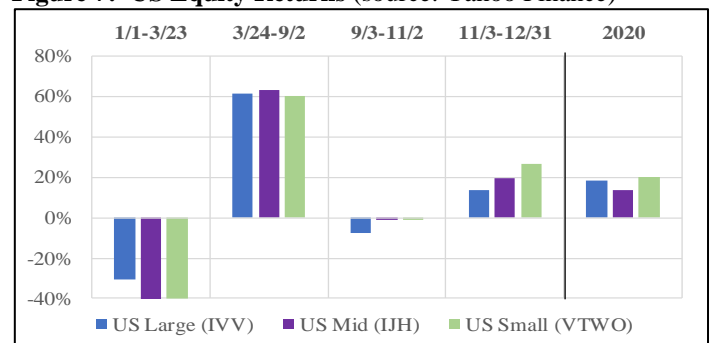
**Global Equity:** Equity returns had more twists, turns and leadership changes in 2020 (Figure 6 below). When stocks bottomed on March 23, US equities (VTI) were down 32% YTD; European stocks (IEUR) were down 36%; Latin American equities (ILF) had fallen 54%; Asian equity averages (AAXJ and EWJ) fared marginally better. US stocks led the subsequent rebound and were up 63% from March 24 through September 2, while most other regions were up nearly 50%. Markets paused on September 2 and moved sideways-to-down until the US elections. The rally resumed on November 3 with a “risk on” tone, especially in the US. For the full year, all regions except Latin America logged positive returns, led by China (MCHI +28%) the US (VTI +21%).

**Figure 6: Regional Equity Returns** (source: Yahoo Finance)



**US Equity:** For most of 2020, US equity returns (Figure 7 below) were dominated by ultra-large tech and e-commerce stocks. By March 23, the S&P 500 (IVV) was down 30%, but mid cap (IJH) and small stocks (VTWO) had fallen roughly 40%. Large stocks were able to keep pace with the subsequent 60%+ rally, and by September 2, the S&P 500 (IVV) was at an all-time high and was up 12% YTD while mid and small caps were still down 4%. Market leadership then shifted; large caps (IVV) fell 7% by early November (mid and small caps were flat), and the post-election rally was decidedly “risk on” as small caps (VTWO) rose 26% by year end to finish 2020 +20% (IVV +18% YTD).

**Figure 7: US Equity Returns** (source: Yahoo Finance)



## Bottom Line

2020 was a terrible year filled with health, economic, and political uncertainty, but it was a fabulous year for stocks and bonds (if you ignore the stomach-churning volatility). The Q1 meltdown underscored the importance of diversification, as stocks crashed but high quality bonds maintained their value. For much of the year, huge e-commerce stocks outpaced cyclical areas, reigniting “bubble” concerns; however, since early September, markets have exhibited typical early cycle behavior, led by small caps, emerging market equities and debt. We expect this trend to continue for the foreseeable future, but with more muted returns.



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