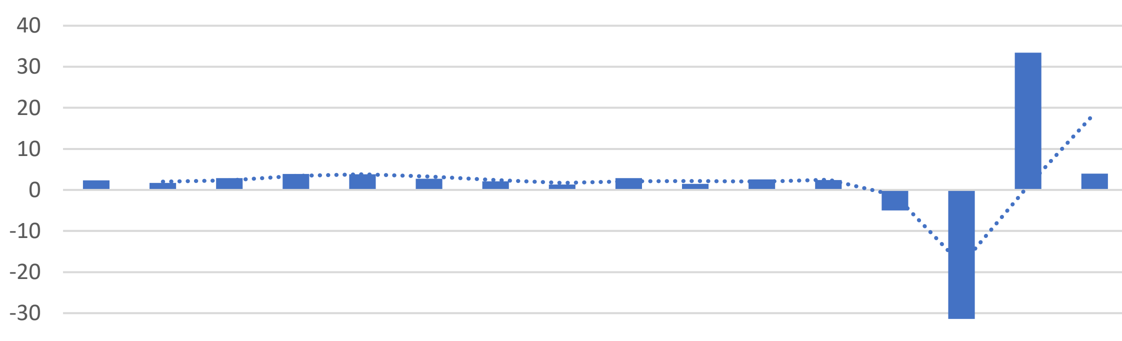
Market Commentary – February 2021

To say the coronavirus pandemic has been a challenging and destructive force for markets and economies would be a tragic understatement. Beginning late in the first quarter of 2020, mandatory shutdowns and social distancing requirements began to take their toll on business and productivity worldwide. Of course, some sectors of the economy were impacted much more dramatically than others. The travel and hospitality industries were especially hard hit, and job losses were mostly among low wage workers. On the other hand, the lockdowns and work from home trend have been beneficial for other areas of the market like streaming services, telemedicine, home improvement retailers and other companies that have effectively incorporated e-commerce into their business models.

While there may have been a few bright spots, the pandemic has caused the biggest drawdown in economic activity since the Great Depression; and it happened very quickly. Real GDP in the United States dropped a staggering 36.4% in the first half of 2020. For some perspective, thebalance.com reports, that it took roughly four years during the Great Depression (1929-1933) for the U.S. economy to shrink by about 26%. As restrictions were eased, third quarter GDP roared back at an annualized rate of 33.4%. Fourth quarter GDP, at 4.0%, was also higher than the preceding three-year quarterly average of 2.5%.

Real U.S. GDP: Quarterly Percent Change 2017-2020



	Q1 2017	Q2 2017	Q3 2017	Q4 2017	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020	Q4 2020
Real GDP	2.3	1.7	2.9	3.9	3.8	2.7	2.1	1.3	2.9	1.5	2.6	2.4	-5	-31.4	33.4	4

Source: U.S. Bureau of Economic Analysis, seasonally adjusted annual rates

The continued U.S. economic recovery will be directly related to how quickly vaccines become available nationwide. The Federal Reserve is predicting that growth in 2021 will be above 4%, while the Congressional Budget Office (CBO) is expecting a more measured recovery over the next several years. Specifically, CBO foretells that labor conditions will continue to improve, but the unemployment rate will not reach pre-pandemic levels until 2024. Inflation will rise gradually over the next few years and likely rise above the 2% target after 2023. The federal funds rate will remain near zero through the second quarter of 2024 and the rate on 90-day Treasuries will follow the federal funds rate closely.

Regardless of just how quickly global economies recover, most analysts agree that the post-pandemic era will provide new opportunities and challenges for investors. The economic contraction and resulting recession related to COVID, began in February of 2020. The end of that recession will mark the beginning of a new business cycle. The business cycle refers to the natural rise and decline of economic growth over time, and follows a four-part pattern: Expansion, Peak, Contraction and Trough. According to the Bureau of Economic Analysis, before the pandemic, the U.S. economy had been expanding since mid-2009. New business cycles are generally marked by improved productivity and growth on one hand and a higher risk of inflation and rising interest rates on the other.

With U.S. stock valuations already stretched, growth in equities may be faster abroad. In fact, China may well become the world's largest economy in the coming years. While although the pandemic originated there, China is the only country in the world that suffered only one quarter of negative growth as a result. So, by generally accepted metrics, China's economy never entered a recession related to the virus. In stark contrast, many European economies may suffer a full year of negative GDP growth as arguably unnecessary lockdowns remain in place.

Other market trends that will impact equity investors include a shift from the expensive growth stocks that have outperformed over the last decade to sectors and industries with more attractively priced options. Small and mid-sized companies will likely outperform the mega-cap stalwarts that have driven the performance of the S&P 500 over the last decade. We are especially interested in technologies such as robotics and artificial intelligence that will lead innovation in the years to come.

Higher inflation will likely be the most impactful element affecting investors, especially in the fixed income markets. Longer term interest rates will rise as a result, which will have a negative impact on bond prices. Coupon rates will therefore be especially important going forward. Two areas within the fixed income markets are particularly attractive. Taxable municipals and emerging market bonds may enjoy the most success as investors seek yield and relative safety, while avoiding the bubbly equity markets. Additionally, alternative asset classes such as real estate and precious metals may outperform the traditional bond portfolio as well.

In order to address these emerging trends, we will be modifying our model allocations in the first quarter of 2021. Please call with any questions you have concerning your portfolio or if you would like to change your risk tolerance. As always, we are humbled by your trust and honored to serve as your fiduciary advisors. Also, if you have not done so already, please contact our office to set-up your client portal.

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1) You have any changes to your financial condition or would like to reevaluate your risk tolerance.
2) You change your "mailing" or "physical" address.
3) You change banks thereby impacting a standing "MoneyLink" or other money movement instructions.

If you wish to schedule a phone conference or meeting with your advisor, please contact our office.

BUSINESS CONTINUITY & DISASTER RECOVERY

FMI maintains a current Business Continuity and Disaster Recovery Plan to address the actions we will take should we encounter events similar to the Katrina floods, 911 attacks, or other similar disasters. The plan also addresses our response to short-term business interruptions—ice storms, extended power and/or internet outages, etc.

In the event of a bona fide disaster or short-term interruption, we will be available via normal communication modes – email and phone.

In the event you are unable to contact us during a bona fide disaster or short-term interruption and you need to access your accounts or account information, you may call Schwab directly:

Schwab Alliance: 800-515-2157

OFFICE CLOSURES

Please take note of our upcoming holiday office closures:

Friday, April 2, 2021 (Good Friday)

Monday, May 31, 2021 (Memorial Day)

Monday, July 5, 2021 (Independence Day Observed)

Monday, September 6, 2021 (Labor Day)

OFFICE HOURS

Please take note of our office hours:

Monday – Friday

8:00 a.m. – 4:30 p.m.

FORM ADV, PART II

Please contact your Advisor if there are any changes in your financial situation or investment objectives. Please contact Harold F. Grubbs, President of Financial Management, Inc., (501) 227-7400, if you wish to impose, add or modify any reasonable restrictions to the management of your account by your Advisor, Financial Management, Inc. Our current disclosure statement is set forth in a written disclosure brochure based on Part II of Form ADV and is available for your review upon request.

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