2020: An exceptional year

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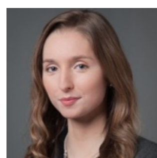

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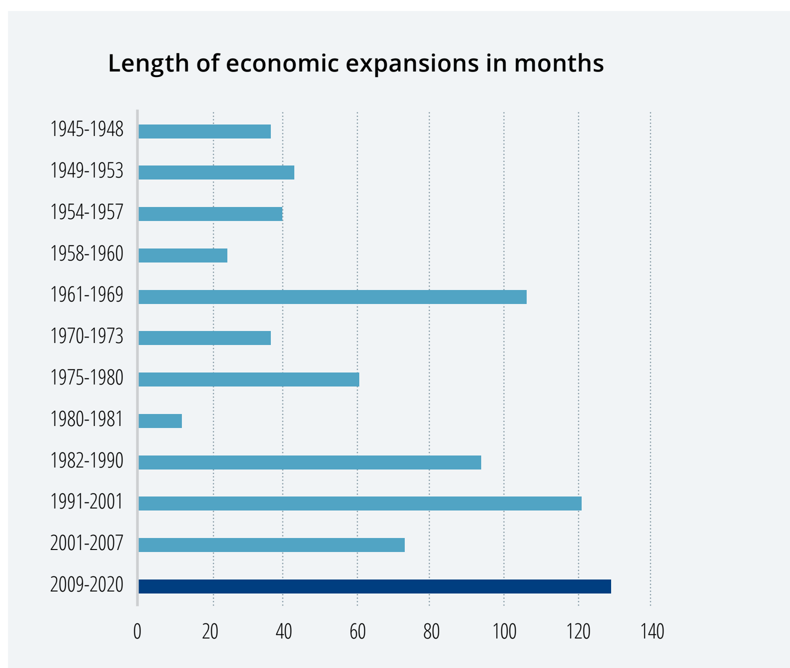
- As 2020 began, the U.S. economy was in the midst of its longest expansion on record.
- The COVID-19 pandemic brought that to a sudden halt; GDP contracted by 31% in 2Q20.
- The policy response was unprecedented and prevented a much deeper economic decline.
- The stock market's preference for growth over value accelerated during the turbulence.
- More recently, trends seem to have begun to normalize.
- Vaccines and economic progress have recently allowed optimism to again gain the upper hand.
- We generally share that view but are more guarded than the most optimistic observers.

Everyone is undoubtedly aware of the immense, almost unthinkably tragic, toll the COVID-19 pandemic has taken in 2020. But as awful as the cost has been in terms of human suffering, the disruption to the global economy has been almost as monumental. It's that aspect of 2020 — the economic and financial toll — as well as our view on what might lie ahead in 2021 — that we explore in the paragraphs below.



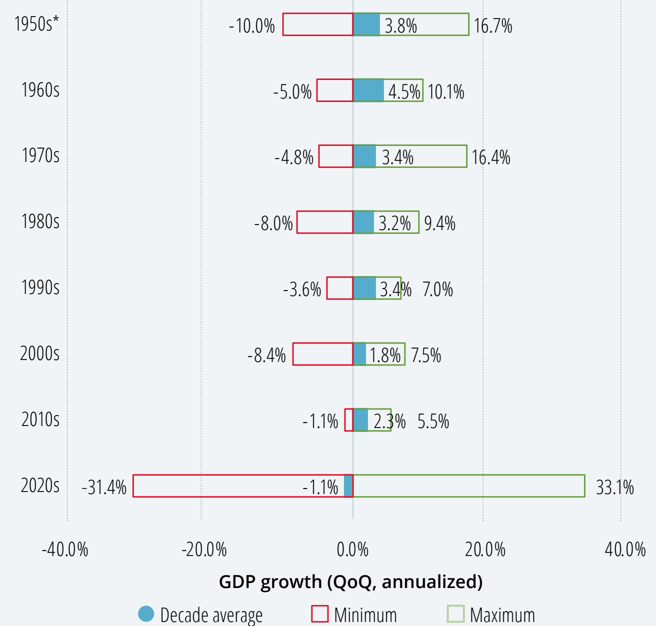
As 2020 began, the U.S. economy had just notched its 126th consecutive month of growth, making the post-Great Financial Crisis recovery the longest economic expansion the U.S. has ever seen. Declining unemployment was one of the defining attributes of this expansion, with payrolls expanding by more than 14 million from the lows reached during the Great Recession in 2008-09. These job gains were led by particularly impressive growth in private-sector employment, yet this acceleration still somehow managed to avoid becoming inflationary as modest wage growth kept inflation in check.

But the COVID-19 pandemic brought everything to a screeching halt: A sharp contraction in economic activity occurred in March as businesses in the U.S. and across the globe shut down to prevent the spread of the virus, causing real GDP to decline at a 5% annual rate in the first quarter and 31.4% in the second quarter. A temporary pause in the rate of new infections during the summer months allowed GDP to rebound by 33.1% in the third quarter as a tentative economic reopening took place worldwide, and in extremely short order the longest expansion in U.S. history gave way to the most exceptional collapse — and most torrid recovery — in GDP that the U.S. economy has seen since recordkeeping began. And yet even now, with multiple vaccines nearing mass distribution and consumer incomes and spending rising again, economic activity has yet to fully regain pre-pandemic levels.

The labor market followed roughly the same path as GDP growth. Nonfarm employment fell by 20.8 million jobs in April alone, completely wiping out all the job growth that had occurred during the previous decade-long expansion. As with GDP growth, the summer respite in infections allowed some healing in the labor market to take place, but by year-end, there were still nearly 5 million fewer jobs on private and government payrolls than at the start of the pandemic.

As dramatic as the declines in GDP and payroll employment were, the policy response to the pandemic was equally unprecedented, with governments and central banks worldwide injecting literally trillions of dollars into the global economy via coordinated fiscal and monetary stimulus programs. In the U.S., the signature program was the $2.2 trillion CARES Act signed into law on March 27, which included a vast array of programs, including direct cash payments to taxpayers as well as the extremely popular Paycheck Protection Program (PPP), a framework for extending largely forgivable loans to businesses designed to help stabilize the labor market by allowing employers to both retain employees and rehire employees once conditions improved. These efforts quite likely saved the U.S. economy from a much deeper downturn.

The most extreme of all time:
The 2020s are already the most exceptional decade on record



*Includes 1947-49; data: BEA, FRED St. Louis Fed, GWI calculations.

Similarly dramatic measures were taken by the Federal Reserve in an effort to stabilize financial markets and encourage economic growth. In the beginning of March, the Fed cut the federal funds target rate by half a point to 1%, only to cut it again less than two weeks later to 0%. Simultaneously, the Fed announced plans to purchase a far broader range of assets than it had ever purchased before, including corporate bonds in both the primary and secondary markets. These measures are unconventional to say the least, and the Fed has clearly signaled its intention to keep many of these programs in place well into 2021 (and beyond), at least until it has become clear that confidence has returned and the U.S. economy has successfully weathered the pandemic.

One result of these unprecedented stimulus efforts was to flood financial markets with liquidity. Bond yields collapsed as Treasury prices rallied. Credit spreads normalized as risk appetites returned, and while it may

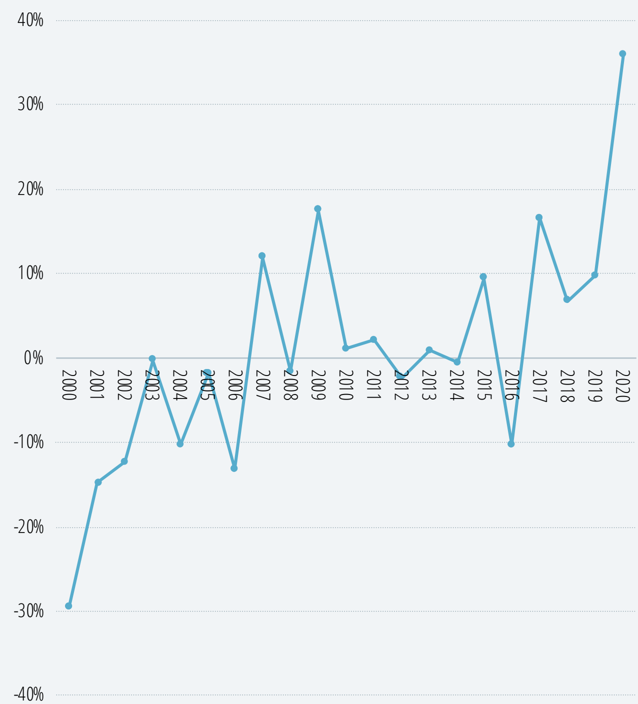
seem counterintuitive, equity markets in the U.S. are on pace to finish 2020 comfortably in the green in spite of the enormous economic damage wrought by the virus and efforts to combat it.

But perhaps one of the most striking aspects of the market's response has been the disparity between growth and value stocks. Growth stocks not only continued their longstanding outperformance against value stocks as the pandemic worsened, but the gap between the two styles actually accelerated as a result of the pandemic. Some of this is understandable: By forcing millions of workers and schoolchildren to embrace the work- and-learn-from-home model, the unique circumstances of the COVID-19 pandemic have significantly increased demand for technology and web-based communications — which is of course the natural habitat of many of the market's most visible high-growth stocks. Temporary business closures and social distancing rules further accelerated other growth-oriented trends already in place as well, favoring more traditional businesses that had begun to embrace digitization long before the pandemic hit (as well as the faster-growing businesses that have long enabled these trends). At exactly the same time, many of the more traditional businesses that rely on face-to-face interaction or accelerating economic growth to remain successful suffered direct hits to their business models as a result of the pandemic and its associated lockdowns. Not coincidentally, many of these industries have significant representation in value-oriented indices.

In fact, as we entered the autumn months, a fascinating dynamic became evident in U.S. equity markets: The relative performance between growth and value began functioning as a referendum on the pandemic. As investors became more optimistic regarding the post-COVID recovery, value was bid higher at the expense of growth. Alternatively, when it looked like the virus was getting the upper hand, growth again reasserted its lead. This relationship has held through the fourth quarter as well, and you can now predict headlines surrounding things like vaccines and next-round stimulus with a strikingly high degree of accuracy by merely observing the spread between growth and value stocks.

Growth vs. value: A referendum on the pandemic

The growth premium widened to extremes not seen since 2000's growth bubble — even as post-COVID optimism puts a bid under value



Of course, any discussion of 2020 would be incomplete without at least mentioning the social unrest that followed the George Floyd tragedy or the 2020 election — which is already being remembered as one of the most contentious in more than a century.

With regard to George Floyd's tragic death and the widespread demonstrations that followed, the unrest that occurred during the summer months remained primarily a social phenomenon, with few obvious or long-lasting impacts on markets or the economy. That said, we are as encouraged as others that institutions across our society are taking a long-overdue look at how they operate, with an eye toward improving opportunity for all. We, like others, are supportive of these efforts and look forward to a brighter, more just future.

With regard to the 2020 election, we have long maintained that elections are mostly noise and have little impact on longer-term market performance, and we have yet to see much in the way of a fundamental reordering of market dynamics. It's true, however, that 2020 provided voters with some very stark choices, making this election cycle potentially more impactful than others. As of this writing control of the Senate still hinges on the outcome of the Georgia run-offs scheduled to take place in early January. Significantly, those contests will determine whether President-elect Biden will face a split or unified Congress.

Looking ahead to 2021, we are of course encouraged that the deployment of at least one highly effective COVID-19 vaccine has already begun. We, like everyone, look forward to a near future when life will regain at least some semblance of "normal." With regard to the political climate, we view it as a clear positive that the country has seemingly begun to heal from some of the worst impacts of a yawning political rift that opened at mid-year, while nonetheless remaining aware that significant animosity remains. We also take it as a good sign that the unexpected tightness of the race — both for Congress and for the White House — will likely temper the most extreme impulses of both sides, regardless of who ultimately wins control of the Senate when Georgia's two seats are decided.

With regard to economic and market performance, we note that a growing number of company management teams are once again becoming confident enough to issue upbeat forward guidance. It's also encouraging that equity market leadership has recently shown signs of transitioning away from growth at any price and toward a more reasoned and disciplined framework of selecting winners and losers. In our view, these are both important steps toward correcting some of the imbalances that have accumulated over the recent market cycle.

These and other developments have allowed optimism to regain the upper hand among a large portion of the investment community. While we generally share that optimism, we are also somewhat more guarded in our outlook than some of the most optimistic observers, noting that profit growth — while impressive — still has some distance to go before it fully catches up with still-stretched equity market valuations. We're also somewhat wary of the possibility of an inflation surprise given the consistency with which comments regarding pricing pressure have begun to show up in anecdotal data. That said, the Federal Reserve has been very transparent about its desire to maintain its accommodative stance well into the future, and the Fed's new inflation-targeting mechanism should allow that to continue.

But regardless of what lies ahead, our view is (and always has been) that a measured, disciplined response to market events always carries with it the best chance of long-term success. That will remain as true in 2021 as it was in 2020.

Data: U.S. House of Representatives (history.house.gov/congressional-overview), U.S. Senate (senate.gov/history/partydiv.htm), 270toWin.com, Bloomberg, GWI calculations.

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