INVESTMENT STRATEGY UPDATE

ASCENTIAL WEALTH ADVISORS
AN INDEPENDENT PRACTICE

MARKET REPORT

QUARTER 1 • 2021

MARKETS EMBRACE VACCINE OPTIMISM

Markets continued to move higher through the end of 2020, propelled by the distribution of multiple effective COVID-19 vaccines and massive amounts of economic stimulus by governments around the world. After the most rapid bear market correction in history in the spring, most equity markets recovered unusually quickly, with many indices reaching new all-time highs by the end of 2020. Economic indicators have improved, but are still below pre-pandemic levels. Investors seem to be putting their money on the success of the recovery, focused on the post-pandemic economy.

Broad equity results were mostly positive for the year, but with a significant disparity in results between sectors. Technology ended far ahead of the rest of the pack with the NASDAQ gaining +43.6% for the year. Growth stocks outperformed for the year, however there was a slight shift in the fourth quarter, with the Russell 1000 Value index rising +16.3% compared to the Russell 1000 Growth index up +11.4% for the period. A rebound in energy in the fourth quarter was partially responsible, although the energy sector remained one of the worst performers for the year along with financials, real estate, and travel.

Foreign developed market returns were in line with broader US equities. Emerging markets gained steam toward year end, outpacing the S&P 500 in the fourth quarter to catch up and close the year neck in neck with the MSCI Emerging Markets index up +18.3% for 2020.

As the rebound in equities took hold, bond returns stagnated. Most of the return in bonds was achieved in the first half of the year, driven by falling interest rates and high uncertainty. The yield on the benchmark 10-year US treasury bond began the year at 1.9%, and dipped to 0.5% before bouncing back to close the year at 0.9%. Interest rates are expected to remain low for some time, and bond returns may be somewhat handicapped as a result. Low yields on bonds are causing investors to consider other options, and have likely played a role in pushing equities higher.

Index	*2020 (through 12/31)*
S&P 500	+18.4
DJIA	+9.7
EAFE (Int'l)	+7.8
BC Ttl Bond	+7.5

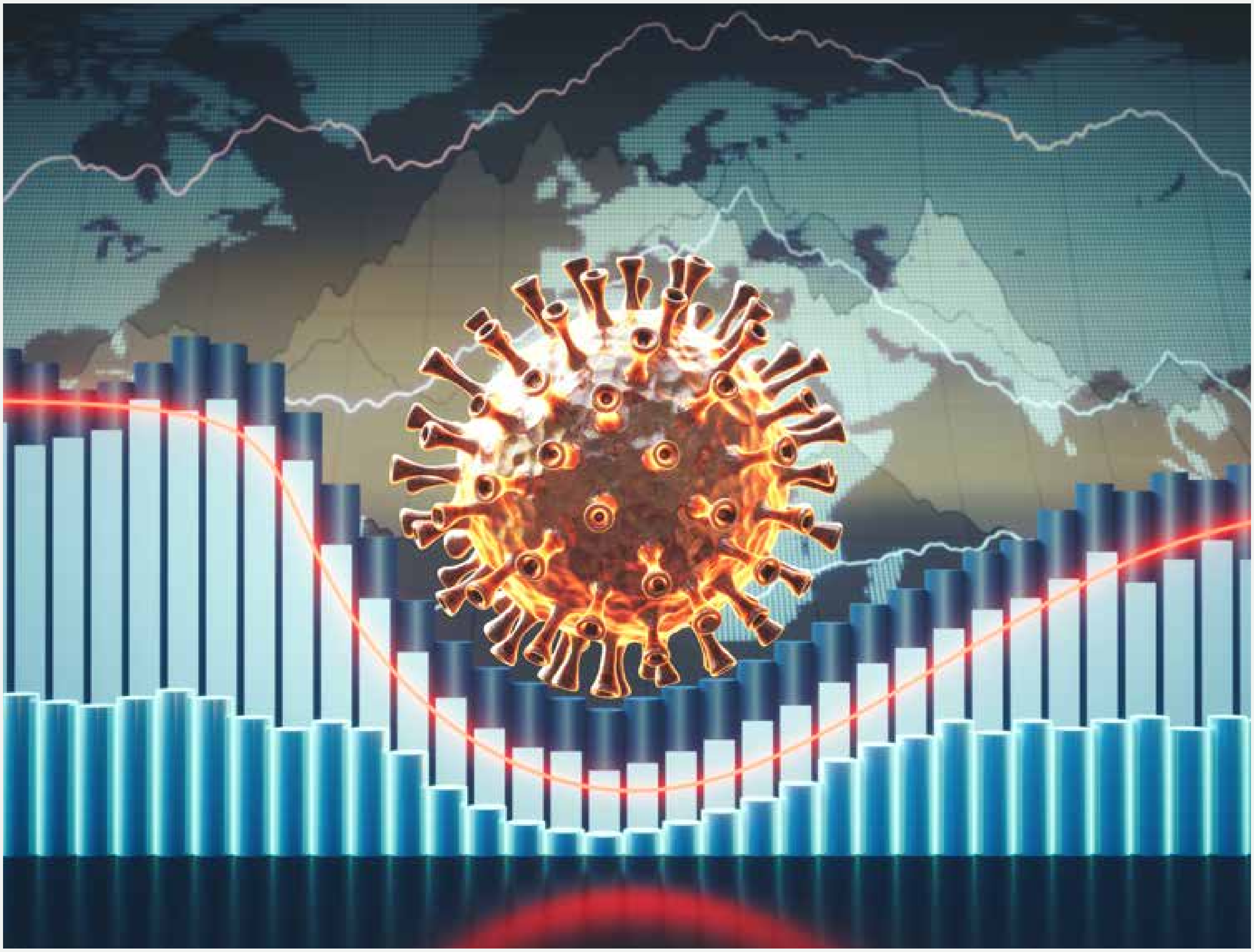
Dow Jones Relative Risk Benchmarks	
Conservative	+8.1
Moderate	+12.2
Aggressive	+16.0

A TOP-HEAVY INDEX

The S&P 500 had a great year in 2020, led by the strong performance from many of its biggest components. While the standard, market-cap weighted S&P 500 index returned 18.4% in 2020, the "equal-weighted" S&P 500 was only up 10.5% for the year. This performance disparity was primarily driven by the market cap weighting of the standard index, which concentrates an enormous share of the index in the top companies and places technology as the largest sector component. Technology performed incredibly well in 2020 fueled in part by pandemic demand.

The high-flying stock of Tesla (TSLA) was the newest addition to the index, replacing Apartment Investment and Management Company (AIV) in late December. Tesla stock increased by an unbelievable 740% in 2020, leaving it with a price-to-earnings (P/E) ratio at 1,350. Companies like Tesla and other more "expensive" tech names have a big impact on the valuation of the broad index.

The top 10 companies in the S&P 500 index account for **28.6% of its market capitalization and 23.7% of its earnings.** (JP Morgan, Guide to Markets, Dec 2020) These stocks also currently carry generally higher P/E ratios, and are making the index look meaningfully more expensive. The market has been more expensive at times historically, and prior to the bursting of the tech bubble, the S&P 500 P/E was 27.2 (March 24, 2000). It is worth noting that current P/E figures should be taken with a grain of salt to a degree because forward earnings estimates vary widely by source. Even if some stocks appear expensive, there are many that are not, creating a challenge and opportunity for investors.



Price-to-Earnings of S&P 500 Components Dec 31, 2020

Top 10	**33.3x**
Remaining 490	**19.7x**
All 500	**22.3x**

(Source: JP Morgan, Guide to Markets, Dec 31, 2020)

At the end of 2020 the top 6 companies based on market cap are technology focused. Looking back just ten years ago, the largest companies included a more diverse group.

Top Ten S&P 500 Companies

2020	**2010**
Apple	Exxon Mobil
Microsoft	Apple
Amazon	Microsoft
Facebook	Berkshire Hathaway
Tesla	General Electric
Google	Walmart Stores
Berkshire Hathaway	Google
Johnson & Johnson	Chevron
JP Morgan	IBM
Visa	Proctor & Gamble

FIXED INCOME — Bonds performed well in 2020, offering portfolios stability when equities fell due to uncertainty and rising in value as interest rates fell. We have been in favor of using a combination of bonds and alternatives as a risk management strategy for some time, and feel that this approach to managing equity risk is even more important now with expectations for persistent low rates and more muted fixed income returns. For both fixed income and alternatives we are in favor of active management to navigate complex and changing conditions.

Our View — Consider alternatives to supplement fixed income

US EQUITIES — Equities have been amazingly resilient, and are pricing in anticipated improvements for future earnings in a post-pandemic world. The S&P 500 was trading at 22.3 times forward earnings at the end of 2020, expensive relative to average. However there has been a wide disparity in performance across sectors, as some have not seen the same success as others and could still offer opportunity as the economy recovers. Equity valuations are also supported by the current interest rate environment, as low rates typically are favorable for stock prices. We are in favor of a more equal weighting between growth and value with growth clearly the past favorite, but value appearing to still have rebound potential. We are also feeling more optimistic about small and mid-sized US companies with the additional stimulus and the vaccine distribution showing promise for a recovery in 2021.

Our View — Balanced exposure to growth and value, more positive outlook for small and mid-caps

INTERNATIONAL EQUITIES — Foreign equities generally posted solid returns for the year after a rally in the fourth quarter, with the MSCI EAFE gaining 16% and the MSCI Emerging Markets index up almost 20% in the fourth quarter alone. In spite of the resurgence of cases globally, investors were focused on the long-term recovery prospects and the benefits of large amounts of government stimulus. Foreign stocks look generally cheaper than US equities, with lower weighting to technology (appearing expensive) and higher weighting to cyclical sectors (currently cheaper). In addition, a weaker US dollar has the potential to provide a nice tailwind for returns. We are in favor of a slightly higher allocation to emerging markets, and given the varying economic conditions between regions and across countries, prefer active management.

Our View — Use active managers to navigate uneven recovery

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