rebalance

Winter 2021

"2020" Hindsight

A black swan is an unpredictable event that is beyond what is normally expected of a situation and has potentially severe consequences. Black swan events are characterized by their extreme rarity, severe impact, and the widespread insistence they were obvious in hindsight. Black swan events are part of investing.

The COVID-19 pandemic was a classic black swan event, and 2020 is a year that will never be forgotten. The pandemic was a catalyst for human and economic tragedy, the unprecedented rapid development of a vaccine, and a contentious presidential election. Loved ones were lost, a global recession and related bear market developed, and panic buying created supply shortages of certain goods. Schooling and work moved into the home, and our planet enjoyed a brief respite from emissions greenhouse gases.

While everyone was eager to move on from 2020, we also learned, or perhaps re-learned, a great deal during the past year. Rebalance's Market Review this quarter highlights some of these lessons.

1. **Prepare for the "black swan event", not what is in the news.** As we entered 2020, investors obsessed about the upcoming election. But could one predict that we were two months away from the emergence of a deadly virus? One that we were totally unprepared for and that would cause global governments

to institute lockdowns leading to a rapid halt to the global economy? No. That is why the Rebalance investment strategy is built to prepare investors for unanticipated shocks such as black swan events.

2. **Stock markets dislike uncertainty.** Sometimes even negative information is a positive if it increases certainty. The stock market started to recover in late March and April of last year, even as the news got worse, mainly because investors started to understand the magnitude of the issues caused by the pandemic. As in life, it is always preferrable to know the truth. Uncertainty and a lack of information make markets "think" short term – in days instead of years – which causes extreme volatility.

3. **Don't fight the Fed.** One reason stock markets began to become positive is because the Federal Reserve reacted swiftly and powerfully to the developing crisis and quickly applied stimulus. Not only did the Fed increase liquidity (cash) in the system, they supported certain markets through direct purchases of instruments such as high yield bonds. The magnitude of the Fed's response was a powerful force that helped stabilize the capital markets.

4. **As hard as it is, stick with your long-term plan.** You may have felt like a fool when the stock market sank rapidly. Human beings have survived life on planet earth by running away from danger and we are "wired" to do so as a result. Surviving and thriving in difficult stock markets often requires investors to override this instinctual behavioral, and to look at danger calmly and as a possible opportunity. If you can fight your instincts during a stock market collapse, you will feel like a genius during the recovery!

5. **Having the right mix helps you endure stock market selloffs.** Good financial planning and the right investment portfolio can help you be prepared for and live through difficult markets. In addition to having a cash reserve to fund known spending, having the right investment mix is key. Did you learn anything about yourself during the bear market of 2020? Do you feel that your investment mix is right for your age, financial needs, and risk tolerance? Talk to your Rebalance financial advisor if you want to discuss these important lessons.

6. **In any extreme period certain asset classes outperform others.** Many people pay attention to well publicized equity indexes/benchmarks such as the S&P 500. In 2020, the "stay at home stocks" prospered. In fact, only five stocks including Amazon, Apple, and Microsoft, drove nearly 60% of the S&P 500 performance. Other investment categories suffered during 2020 given that they were disadvantaged by the same trends (e.g. real estate). If history is a guide, these other categories will again have their day, which is why our firm's rebalancing discipline is so essential to generating the most investment return for the least amount of risk.

7. **Rebalancing works.** Warren Buffett once said that it is wise for investors to be "fearful when others are greedy, and greedy when others are fearful." This statement is somewhat of a contrarian view on stock markets and relates directly to the price of an asset: when others are greedy, prices typically surge, and one should be cautious lest they overpay for an asset. When other investors are fearful, it may present a good buying opportunity. Due to rebalancing-driven stock purchases, several asset classes appreciated over 20% from April to December.

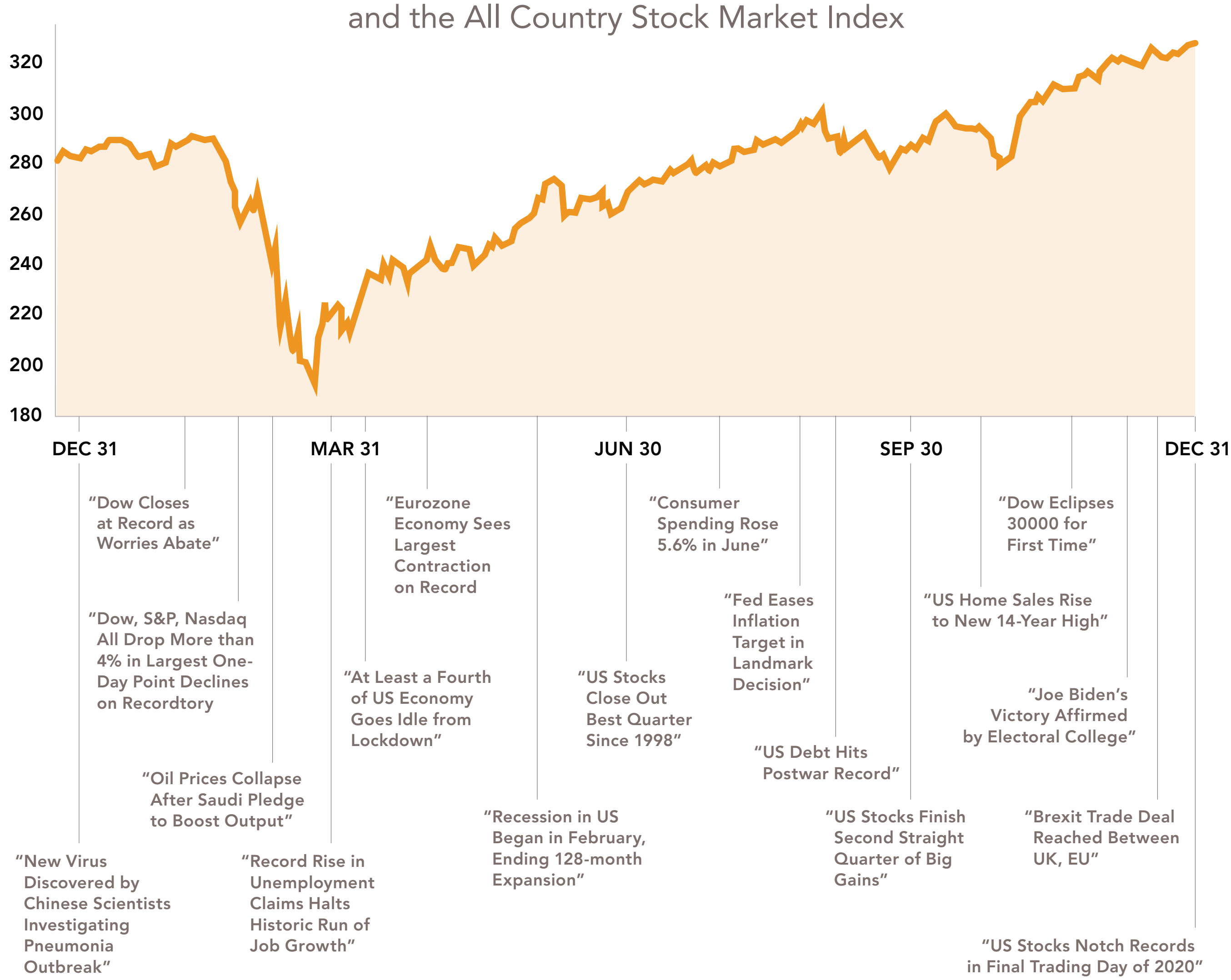
8. **History is not always a great guide.** In past bear markets, large-cap technology stocks lead the market down, while in 2020, they outperformed. Small cap and real estate stocks got hit particularly hard during the market selloff and did not participate in the early part of the recovery like they "normally" would. It is unique to see that the stocks which outperformed during the downturn also outperform during the upturn.

9. **Waiting for the "right time" is riskier than it seems.** In between February and March of 2020, the stock market dropped 30%. New market highs were achieved 5 months later. The forces at work in 2020 were incredibly powerful and set the stage for quite a shoving match. A virus related economic full stop was met first by the monetary bazookas of global central banks and then the extremely rapid development of an effective vaccine. If you held onto cash until the "coast is clear", you made the common mistake of trying to time the market. When stock markets move up, it usually happens quickly and that is why it is important to stay fully invested.

10. **Bonds can become risky.** Riskier bonds offer higher yields than safer bonds, but this often comes from the assumption of credit risk. Riskier bonds can move in concert with equities during economic disruptions since they essentially have a credit or equity risk component. During 2020, these bonds also suffered from moments of illiquidity in markets. This "market function" issue is one of the reasons why the Federal Reserve purchased riskier bonds as part of its response to the economic crisis in 2020. Additionally, "safer" bonds, such as U.S. Treasuries, are paying historically low rates of interest, setting the stage for a decline in value when interest rates rise.

Headlines from 2020

and the All Country Stock Market Index



We had quite a journey together in 2020 and look forward to being with you next year and beyond. As time goes on, there will be more stock market corrections, more difficult situations, and more opportunities to apply the lessons that were reinforced in 2020. The investment experience and knowledge that was gained this year is a silver lining that will pay dividends in the future.

World Markets Review

Fourth Quarter 2020

	US Stock Market	International Developed Stocks	Emerging Markets Stocks	Global Real Estate		US Bond Market	Global Bond Market ex US
Q4 2020	**Stocks**					**Bonds**	
	14.68%	15.85%	19.70%	12.55%		0.67%	0.94%
Since Jan 2001							
Avg. Quarterly Return	2.3%	1.6%	3.0%	2.4%		1.2%	1.1%
Best Quarter	22.0% Q2 2009	25.9% Q2 2009	34.7% Q2 2009	32.3% Q3 2009		4.6% Q3 2001	4.6% Q4 2008
Worst Quarter	-22.8% Q4 2008	-23.3% Q4 2008	-27.6% Q4 2008	-36.1% Q4 2008		-3.0% Q4 2016	-2.7% Q2 2015

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index [net div.]), US Bond Market (Bloomberg Barclays US Aggregate Bond Index), and Global Bond Market ex US (Bloomberg Barclays Global Aggregate ex-USD Bond Index [hedged to USD]).

The **Rebalance Investment Committee** works with two broad asset classes as the basic building blocks of our client portfolios: Growth and Income. During the fourth quarter of 2020 these asset classes performed as follows:

Growth Asset Classes

Large U.S. Stocks. Stocks markets surged globally in the fourth quarter of 2020 based on the equity market's anticipation of the positive economic impact of both a coronavirus vaccine and additional government support programs for those negatively impacted by the pandemic. Stock markets have been looking beyond the economic downturn in 2020 to better times ahead in 2021 and this trend continued during the fourth quarter.

Small Cap Stocks. Like their large-cap counterparts, small company stocks rose sharply in the fourth quarter driven by hopes for a positive earnings year in 2021. Smaller companies were hit particularly hard in the pandemic related downturn and rallied back forcefully during Q4 as the idea of reopening the economy became more of a reality.

International Developed Stocks. The weaker dollar added strength to foreign developed stock markets in the fourth quarter, on top of the same anticipation for a strong 2021 economic recovery experienced in domestic markets. When the dollar weakens, it generally increases returns in foreign markets as those currencies strengthen relative to the dollar and add to market returns as measured purely in local currencies.

Emerging Market Stocks. Emerging market stocks (EM) benefited from a weak dollar and related translation effect in the fourth quarter like their developed market counterparts. EM stocks also benefited from China's economic rebound and strength in commodity markets which fuel many emerging market businesses. Additional strength came from semiconductor companies like Samsung which saw a strong rebound in demand

Real Estate. Like stocks, U.S. real estate investment trusts (REITs) performed positively during the fourth quarter. Real estate has been particularly hard hit by the impact of nationwide "stay at home" orders impacting bricks and mortar retainers as well as the new "work from anywhere" rules at companies that traditionally required workers to report to an office. As with other areas of the market, real estate equities are looking forward to positive trends in the future.

Income Asset Classes

U.S. Government Bonds and TIPS. Both interest rates and inflationary expectations rose slightly during the fourth quarter in line with a more favorable economic outlook and the massive amounts of fiscal and monetary stimulus. This rise in interest rates negatively impacted returns in government-issued fixed income including U.S. Treas-ury bonds which generally fell during the quarter. Treasury Inflation Protected (TIPS) bonds prices rose during the quarter along with rising inflation expectations.

U.S. Corporate Bonds. U.S. investment-grade (higher-quality) corporate bonds prices rose slightly during the fourth quarter as credit markets continued to heal and liquidity conditions improved. High Yield Corporate Bonds. U.S. high-yield (i.e., more speculative) bonds enjoyed both liquidity-driven tailwinds as their investment grade bond counterparts during Q4 2020 and equity-oriented optimism. As a result, high-yield bonds significantly outper-formed investment-grade corporate bonds in the quarter.

Emerging Market Bonds. Emerging market sovereign debt very often is issued in U.S. dollars and benefits when the dollar weakens vs. the local currency of the issuing country. This happens because the debt payments in dollars are effectively reduced when the local currency strengthens. Emerging market bonds benefited from a weaker dollar and positive economic developments in Q4 2020.

Preferred Stocks. As a “hybrid” security that is part fixed income and part equity, pre-ferred stocks often are influenced by forces driving both stock and bond markets. In the fourth quarter of 2020, preferred stocks were influenced by the same positive forces pushing stocks higher, resulting in a positive performance.

The Rebalance Investment Committee

The Rebalance Investment Committee meets several times a year to review our client portfolio options, asset class selections, and overall economic factors. The Committee's goal is to curate client portfolios that generate the most investment return for the least amount of risk.

The Rebalance Investment Committee meeting in New York, April 2019 (left to right: Scott Puritz, Burton Malkiel, Jay Vivian, Sally Brandon, Charles Ellis and Mitch Tuchman)

Rebalance and its clients are fortunate to have such respected and savvy financial experts guiding key investment decisions.

Professor Malkiel is an emeritus Princeton University economics professor, a former board member of The Vanguard Group, and the author of the investment classic *A Random Walk Down Wall Street.*

Dr. Ellis was for three decades the managing partner of Greenwich Associates, the leading strategic advisor and consultant to large institutional investors around the world. He was Chairman of the Investment Committee of the famed Yale Endowment, and he has served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over $100 billion in IBM investment funds for more than 400,000 employees worldwide.

We thank them for their input and wisdom.
Very truly yours,

Your Rebalance Team