Cambridge ADVISORS inc.
INVESTMENT MANAGERS

INVESTMENT PERSPECTIVE DECEMBER 2020

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MARKET COMMENTARY

Stocks finished the year amazingly strong. The large cap stocks in the S&P 500 posted a 12.15% gain in the quarter which brought their year-to-date gain to 18.40%. It's hard to believe that earlier in the year, these same stocks were down -34% and below their 2019 low. Small cap stocks were the worst performing asset class during the first quarter but finished the year as the best performing asset class as the Russell 2000 gained 31.37% in the fourth quarter bringing its return up to 19.96% for the year. International stocks in developed markets were up 16.05% in the fourth quarter which brought them into positive territory for the year with a gain of 7.82%. Emerging market stocks have recouped their losses with their quarterly gain of 19.70% and 18.31% rise for all of 2020. Treasury bond yields rose during the fourth quarter giving the Barclays U.S. Aggregate Bond Index a return of 0.67% for the quarter and 7.51% for the year.

Energy was the best performing sector for the quarter but is still the worst performing sector for the year. Similarly, financials were the next best performer for the quarter but still have a negative return for the year. Real estate was the worst performing sector for the quarter and like energy and financials, its total return for 2020 is also negative. The best performing sectors in 2020 were technology, consumer discretion and communication services.

The S&P 500 is a market cap weighted index which means the larger a company is, the higher their weighting in the index. Five stocks—Apple, Microsoft, Amazon, Alphabet (Google) and Facebook account for over 21% of the index. These stocks have performed very well in 2020 and greatly influenced the stellar returns of the index. JPMorgan notes that these stocks look expensive currently and other stocks of the S&P 500 may start to perform better than these giants. If that's the case, index returns may also suffer comparatively since these stocks are a significant part of the index. JPMorgan recommends still investing in growth but also having exposure to other areas of the market that are more cyclical and value oriented.

The dismal second quarter GDP growth of -31.4% was followed by the fastest real GDP growth of any quarter since World War II. As businesses reopened from the shutdown, third quarter saw GDP growth of 33.4%. Fourth quarter is expected to be around 5%. David Kelly, chief strategist with JPMorgan, expects growth to slow to 1% in first quarter but then sees a surge to 5% in late 2021 and into 2022. He notes that many households are in good financial position and as the economy reopens further as the vaccine becomes more available, there is pent up demand for restaurants, travel and entertainment.

Kelly also thinks that the US may recover the jobs it lost in the shutdown by late 2022. Initially, 22.2 million jobs were lost but since then 12.3 million have been regained. Many of the jobs that haven't come back are in the leisure and hospitality areas that should see a surge in demand once the vaccine is widely administered. The unemployment rate has recovered to 6.7% from its peak in April at 14.7%. The rate could stay above 4% until 2023 as Kelly expects people to re-enter the labor force.

Corporate earnings projections are being revised higher as earnings on the S&P 500 are now expected to be down only about -17% in 2020. At the end of third quarter, Zacks was expecting earnings to be down -20%. Revenues are expected to be -3.8% lower. Earnings projections for small cap stocks are being revised higher as well. Now, their loss for 2020 is expected to be -29% compared to the previous projection of almost -40%. Zacks is projecting 2021 earnings to be 21.9% higher for the S&P 500 and 35% higher for small caps.

With earnings falling in 2020 and stock prices rising, investors have pushed traditional valuation measures like price/earnings ratios aside at least temporarily. The rally in stock prices seems to be based on the anticipation of the successful rollout of the vaccine and reopening of the economy. It also reacted positively to the election results.

The dollar is expected to continue weakening. A weaker dollar tends to help international stock returns. This asset

2020 BENCHMARK RATES OF RETURN

INDEX	FOURTH QUARTER	YTD
S&P 500	12.15%	18.40%
Russell 2000	31.37%	19.96%
International	16.05%	7.82%
Fixed Income	0.67%	7.51%
JPMorgan Diversified*	10.66%	12.27%

*25% S&P 500 large cap stocks,10% Russell 2000 small cap stocks, 15% MSCI EAFE international stocks, 5% MSCI EME emerging market stocks, 5% REITs, 25% Barclays US aggregate bonds, and 5% each in short term Treasuries, high yield global bonds, and commodities.

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have. Also, if your situation has changed, please contact your advisor so we can determine if any changes are needed in your account.

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class may start to outperform again. A weak dollar also helps US stocks with a high percentage of foreign sales.

When the pandemic hit, policy makers reacted quickly and boldly, spending nearly $3 trillion through fiscal policy. The Fed's balance sheet has risen from $4 trillion at the beginning of the year to now more than $7 trillion. Congress reached an agreement for additional stimulus of $900 billion at year-end and additional stimulus could be passed after Biden's inauguration. Some people have asked how long the government can continue to print money. David Kelly believes that as long as they can make the debt payments and are able to maintain the credibility of the money, there is not an imminent problem. Because interest rates have come down so much, the debt burden is about the same as it was before the pandemic even with all the additional debt. Until the Fed would need to tighten and raise rates, Kelly doesn't think there is need to be concerned.

The Federal Reserve cut its benchmark interest rate from 1.50%-1.75%. to 0%-0.25%. At its September 16th meeting, the Fed made it clear that they will be holding short-term rates there for at least the next few years—until the unemployment rate is around 4% and inflation is running above 2%. Currently, inflation remains under control. The Core PCE deflator that the Fed watches was at 1.4% in November. The Fed has a target inflation rate of 2% but has modified that target to be a long term average of 2% which means they could let it go above the average for a while before taking action. JPMorgan thinks that it will reach the 2% target possibly in April but then stabilize.

With a low Fed Funds rate, money market funds will continue to earn basically nothing. We could see a steepening of the yield curve, though, especially as the Fed tapers its bond purchases. This tapering is more likely to happen in 2022 as unemployment gets down to under 5% and the economy needs less help. The 10-year Treasury bond yield rose from 0.68% at the end of September to 0.91% at year end. Although Treasury bonds may not generate a lot of income for the time being, more risk averse investors will still want to include them in their allocations because they are less correlated to stocks than most alternatives.

Market timing is a difficult strategy and one that is not usually successful over the long term. Rather than trying to time the market, a better strategy is to align your investment portfolio with your risk tolerance so that you can withstand the risk and not be tempted to sell out when stocks go down or sell too soon and miss out on continued upward stock performance. We use Riskalyze software to help us measure your risk tolerance so we can help ensure you have the appropriate risk in your investments. If you are unsure about the risk in your portfolio, please talk to your advisor so we can reassess your tolerance and the risk in your investments to make sure they are in line with one another.

2021 Retirement Contribution Limits

Retirement Plans	**2020**	**2021**
401k and 403b Plans	$19,500	$19,500
Catch up contributions*	$ 6,500	$ 6,500
IRAs		
Traditional or Roth IRA	$ 6,000	$ 6,000
Catch up contributions*	$ 1,000	$ 1,000
SIMPLE IRA	$13,500	$13,500
Catch up contributions*	$ 3,000	$ 3,000

*If you are age 50 or older, you can make additional catch up contributions

Cambridge Advisors News

As 2020 came to an end, we reflected on the last 30 years since Cambridge Advisors was founded. We want to thank you again for the trust you have placed in us especially during these difficult times and for the family and friends who you have referred to us. We want to help the people who are important to you. If you know someone who may benefit from our investment management and financial planning services, please let them know about Cambridge Advisors so we can help them plan for their retirement, preserve their wealth in retirement, and leave a legacy for future generations. We waive our investment minimum for people referred to us by our clients and there is no obligation so please do not hesitate to introduce us.

We are also planning for the next 30 years. Recently, we reviewed our technology plans and upgraded our office computers to include cameras and microphones so that we can easily participate in video chat meetings with clients. We can share our screens and conduct review meetings easily for our clients who wish to meet virtually rather than in person. In addition, we replaced and upgraded all our home computers so that our experience working remotely would be the same as if we were in the office. We added security to our remote stations as well so clients would be assured we were protecting their information.

Please do not hesitate to call your advisor if you have any questions or concerns. If you need help accessing the client portal or would like to initiate a logon, please let your advisor know that as well.

Schwab will mail 1099s by the end of January to report distributions from IRAs. They will mail 1099s for taxable brokerage accounts in mid-February. The 1099 now has all information you need for tax reporting purposes — you will not need to provide your accountant a separate report from Cambridge Advisors.

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