ICR® 4th Quarter Newsletter – January 2021

Risk assets as a whole powered higher in the final quarter of 2020 as investors embraced the potential for economic reflation. The S&P 500 gained over 12%, foreign stocks were up 16%, and emerging markets led the way with a 19.7% increase. Even as COVID-19 cases spiked again in December, the markets hardly batted an eye – yet another example that investing is a forward-looking enterprise.

The announcements of multiple COVID vaccines provided hope for those sectors of the economy that have been hardest hit by the pandemic. Indeed, after having lagged most other asset classes for years, the small-cap value segment of the market (which generally has more economically-sensitive companies) gained 33% in the fourth quarter. Despite that performance, small-cap value stocks still ended the year up only 1% due to their large earlier losses.

In a clear sign of optimism for a global economic recovery, even commodities gained 10% in the fourth quarter, after having lost over 12% in the first three months of 2020. Energy was the best-performing sector, gaining almost 28%, though that still left the group down a whopping 34% for the year. Financials – another laggard – posted a 23% quarterly gain, but still finished negative for the year.

Interest rates on longer maturity bonds began to creep up during the quarter, with the 10-year yield finishing just shy of 1% and later breaching that threshold in January. Though still historically low, this recent rise may indicate that fixed income investors are beginning to expect some inflation, as the massive fiscal and monetary stimulus measures work their way through the economy. As further evidence of this, the five-year breakeven rate (the implied inflation expectation over the next five years) recently spiked to its highest level since 2013.

Looking back on 2020 feels like eulogizing someone who no one liked but who everyone thought was interesting. While we want to say good riddance to the year, it's also important to appreciate the lessons it taught – both in terms of investing and life in general. With that in mind, here are some of the lessons that will stick with us from 2020.

1. Major market-moving events are rarely the ones everyone is talking about.

A common question in the investment community is, "What keeps you up at night?" Investors often respond with answers such as stretched valuations, rising interest rates, inflation, trade wars, increased regulation, and so on. But most of these answers are the types of things that move markets slowly over time. It's the big, unforeseen events that jolt the markets and shape the future. It's not that a pandemic was seen as an impossibility; it's just that it went from being a general, nebulous risk to a specific and acute reality. It's similar to the way in which we knew terrorism was a threat, but we didn't know what it would look like or when it would happen or what the effects would be until the events of 9/11 changed the course of history.

2. Even when you do see an event coming, the actual course is impossible to predict.

Back in October of 2007, we wrote in our newsletter the following: "We believe the residential property market in many parts of the country is a classic market bubble and the downturn has not found a bottom and the corresponding influence on consumers and the economy has yet to be fully realized." Pretty prescient, right? The problem is, even though we were right about the property market being in a bubble and eventually popping, we didn't appreciate the degree to which those mortgages were entwined in the financial system. We had sold our funds with real estate exposure and felt pretty smart about that until it became clear that the problem wasn't isolated to that sector.

At the beginning of 2020, if someone from the future had told an investor that there would be a pandemic that would kill over two million people (and counting), that the unemployment rate in the U.S. would reach almost 15%, and global GDP would decline by 5%, what do you think that investor would have done to prepare? They might have sold everything and shorted the market. As we know now, the correct answer turned out to be the seemingly most illogical one: buy the riskiest assets you can get your hands on. This often counterintuitive nature of the markets can confound even the most seasoned investor and underscores the importance of humility when analyzing the markets and developing an investment plan.

3. "To thine own self be true"

As mentioned in the last point, 2020 was characterized by excessive risk-taking where some people were using their stimulus check to buy call options on high-flying stocks or piling into trades because their friends told them to. There are myriad anecdotal signs of mini bubbles forming in pockets of the markets. And for a certain type of investor, we don't disparage day-trading or extreme speculation. If you are a natural risk-taker or you've portioned off a small part of your portfolio for that kind of behavior, that's perfectly fine. But, this is one of those times in market history when it's important to ask yourself what type of investor you truly are. If you're tempted to put your life savings into Bitcoin because your friends are getting rich buying it, you have to know how you would feel and what you would do if it lost over 80% of its value again.

Most importantly, it's about looking beyond the numbers and asking yourself why you invest and how your investing will translate to your daily life. Unless it's what you do for a living, your investing shouldn't be an end in itself, but rather a means to fulfilling the life that you want to live or the legacy you want to leave. With the events of this past year, more than ever, we believe this to be true. Figure out what's important to you and focus on maximizing and appreciating those things. Let us know how we can help you accomplish that and, as always, thank you for your support and friendship.

Sincerely,

James A. Heine

James L. Cobb

Market Report (as of 12/31/20)

Index	**2020 (%)**	**3-Year Annualized (%)**	**5-Year Annualized (%)**
S&P 500	16.3	12.0	12.9
Dow Jones Industrial Average	7.3	7.4	11.9
U.S. Aggregate Bond Index	7.5	5.3	4.4
MSCI EAFE (Foreign Index)	5.4	1.6	4.6