CAUBLE & HARRE
WEALTH MANAGEMENT

12977 NORTH 40 DRIVE, SUITE 213
ST. LOUIS, MO 63141
314-576-1112 | CAUBLEHARRE.COM

Fourth Quarter 2020 Market Letter

Markets ended the year on a strong note. Who would have thought that the markets could recover as much as they have last year? Recovery depends on which assets you are discussing. The Russell 1000 value index rose only 2.7%. The US stock market, as measured by the Vanguard Total Stock Market Index rose 21%. Adding in the growth stocks to the value stock mix helped quite a bit. International markets, as measured by the iShares EAFE index ETF rose 7.5%. International stocks retain their lower relative valuation vs. domestic markets.

Earnings fell 23% during the year. The 21% gain in the market, then, was not a result of earnings gains. Rather, it was entirely a function of the earnings' multiple increasing. What does this mean? Remember, investors are willing to pay different amounts for earnings over time. This change in attitude on the part of investors will cause the markets to rise or fall even if earnings stay the same. During periods when investors want to pay less and less for earnings, even rising earnings may not make markets rise in value. Other periods, like 2020, will be times when investors are willing to pay a lot more for earnings. So much more that even an earnings decline of 23% will result in a higher market, even one 21% higher.

We ended the year on the optimistic side of the ledger. Investors are currently willing to look past COVID-19 and price in a 'normal' economy. We put 'normal' in quotes because we think perfection is being priced in, not normal. Also helping is a Federal Reserve and a Government keeping lots of liquidity available for investment. And finally, a lot of this cash is finding its way into stocks because other alternatives, like bonds, seem to offer little return potential. While earnings tend to persistently rise over time, investor attitudes flow back and forth between pessimism and optimism. These changes in attitude are what create most of the markets' volatility.

Earnings are expected to rise this year to about where they ended 2019. We thought that markets were a bit expensive at the end of 2019, so if the stock market remains flat this year, we should end up in December with only slightly overvalued markets. It would help if nothing unfortunate happens this year, but because a boring news cycle is not likely, we remain cautious about US markets. We believe that international markets are more attractively priced, and diversification continues to be important to control overall risks. Patience will be required.

While markets seem to be expensive, there is some good news to consider. Think about how new technology or systems are adopted and the impact that this can have on economic growth and/or quality of life standards. Years ago, I wrote about cars powered by natural gas. Natural gas is quite abundant in this country, and the technology to use it in automobiles has existed for years. In some countries, it is quite common to see cars powered by natural gas. Not only that, but natural gas is already distributed to many areas and homes in this country, and the technology for home filling devices also exists. So why has this never taken off? Companies like the status quo. It is easy, and risks are perceived to be lower by just doing things the way that they have been done.

Horseshoe crabs offer another example. The blood of horseshoe crabs happens to be quite sensitive to toxins. So much so, that it is quite useful in manufacturing and testing processes that require toxin free environments or results (like pharmaceutical production). There are facilities that bring in thousands of horseshoe crabs into the lab, lay them out of platforms, and extract their blood.

LIZ H. CAUBLE, CFP®
liz@caubleharre.com

PETER B. HARRE, CFA
peter@caubleharre.com

KENDALL M. YOUNG, CFP®
kendall@caubleharre.com

They are then returned to the water, but I do not think they are surveyed to determine their satisfaction with their holiday.

An alternative substance has been created that could take the place of horseshoe crab blood. One might think that companies would switch to the less invasive product. But changing the status quo is quite risky. Changing processes introduces risks that can easily be avoided by following the status quo. Usually, it requires leadership. One company needs to decide that it will blaze the new trail. In this case, I think it was Eli Lilly that began using the new alternative.

What is the point of bringing this up? Our experience with COVID-19 and all its impacts has blown up the status quo. There is no normal way of doing things. Risk and change are the norm and trying something new has become a requirement for survival in some cases. This environment is and will continue to bring forward technologies and systems that are better than current versions and will do so before these new ideas would have been adopted otherwise. A bit tumultuous? Yes. But ending up with a better result is also possible.

Give us a call if you have any questions or topics you would like to discuss.

Regards,

Peter B. Harre, CFA

LIZ H. CAUBLE, CFP ®
liz@caubleharre.com

PETER B. HARRE, CFA
peter@caubleharre.com

KENDALL M. YOUNG, CFP ®
kendall@caubleharre.com