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INVESTMENT PERSPECTIVES

>>FOURTH QUARTER 2020

Predictions can be hazardous, especially to your portfolio

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It's human nature to desire some ability to control the world around us, or at least to prepare ourselves for things we can't control. One form of this impulse is the frequent appearance of consumer finance advice columns suggesting how investors can take advantage of some coming trend, or protect their money from an anticipated adverse event.

The literary form has flourished this year, beginning with articles on "how to escape the clutches of a bear market" and moving to "don't get left behind" and "Bidenize your investments." These types of articles all share two unfortunate characteristics: They attempt to predict the future, and they assume that securities markets will respond to the anticipated future scenario in predictable ways.

Wrong and wrong. As the Danish politician K.K. Steincke (and later the American philosopher Yogi Berra) noted, it's difficult to make predictions, especially about the future. We humans have proved to be creative and insightful in many ways, but we're frankly terrible at predicting the future. We consider too few possible outcomes, and we don't see downstream implications very well. Very few "experts" saw this year's bear market coming, and fewer still anticipated a quick rebound.

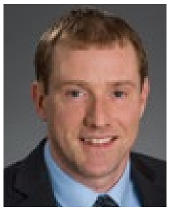
No one knows today what the President, Congress, or the Federal Reserve will do next year — and no one can predict how markets will respond, either. We don't recommend taking any action today in anticipation of a *possibly* adverse change that *might* occur next year; the result could be quite painful if the change didn't occur, or if markets didn't respond as anticipated.

All the same, good investment managers must think through many different potential scenarios, considering a wide range of possible market reactions. It's a common mistake to go all-in on any specific future prospect; better to build portfolios that can withstand unexpected shocks and can benefit from a wide variety of possible futures.

That's not as hard as it might seem, especially for investors focused on the longer term. The American economy is remarkably resilient and robust; it will withstand near-term surprises and political crises that may occur from time to time. Our history is filled with such events. A portfolio of stocks and bonds, properly diversified and focused on high-quality companies, will endure.

>> PERSPECTIVES ON THE ECONOMY

On the bumpy road to economic recovery



By Allen Laine, CFA
Equity Analyst,
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Perhaps the most closely watched indicators of an economy's health are the various employment statistics — and for good reason, since economic growth and employment are linked. Prior to the pandemic, the U.S. was enjoying one of the best employment scenarios in decades: The unemployment rate was the lowest since the late 1960s and there were well over a million more jobs available than people seeking work.

Oh, how things have changed! Once the shutdowns took grip in response to the outbreak of COVID-19, we saw a historic spike in the unemployment rate to 14.7%. Within several short months, the rate ratcheted back down to 7.9% as of September; that's certainly a dramatic recovery, but it's still far from the 3.8% pre-pandemic level.

The rate of improvement in employment has moderated, as have other indicators of the economy. This is not surprising. The "easy ground" has been made up and the economy still faces challenges brought on by the pandemic. For a full recovery, the virus threat needs to be greatly diminished, which essentially requires a vaccine or an efficacious therapy option made widely available. We are seeing evidence that several vaccine candidates appear to be effective; however, we are still likely months away from approval and mass distribution. Until that time, expectations should be for modest improvements in economic data barring any large setbacks. While our return to economic normalcy has shifted to a slower pace and likely will have some disruptions short-term, we will get there in time. The employment statistics will provide a good indication of our progress along that path.

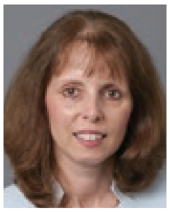
U.S. UNEMPLOYMENT RATE

The unemployment rate remains elevated despite a rapid fall from the pandemic-driven peak.

Source: Bureau of Labor Statistics

>> FOCUS ON EQUITIES

Stock market investors buckle up for what could be a wild ride



By Rose Grant-Brooks
Equity Strategist,
Eastern Bank Wealth Management

If you were told in the beginning of 2020 that you would experience the worst pandemic in more than 100 years, the highest unemployment rate since the Great Depression, the largest quarterly decline in GDP in history, and a 38% fall in the stock market in just 23 days, would you have believed it? Few investors would have believed this remote possibility, and perhaps fewer still would have stayed calm even if they did believe it. Yet investors who did not take any action and remained in the market fared well as the market hit an all-time high just five months later.

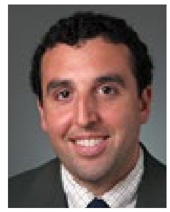
For the rest of 2020, we expect the equity markets to remain volatile for several reasons. This election year is unlike any other; investors had to consider the possibility that control of the Presidency and the Senate might not be known even into January. Emergence of another wave of COVID-19 in the U.S., most likely in the late fall or winter, is a possibility that cannot be ignored. And another downturn of the U.S. economy could be around the corner.

After their historic summer rally, U.S. equity markets are trading at market multiples considered higher than normal; these valuations can be explained by interest rates that are near all-time lows and likely to stay in this range for a long time. Earnings have declined owing to the economic downturn caused by the pandemic, but most likely earnings are at the low point for this cycle. Looking ahead, we think earnings should rebound into next year and will be supported by fiscal policy and perhaps another monetary stimulus injection. However, the outlook for a full economic recovery and continued strength of the equity markets depends upon the approval of an effective vaccine with a good safety profile. This would return both consumer and business confidence and most likely lead to an increased level of spending from both.

In the near term, market volatility is likely to remain elevated especially through year end. Presidential elections can cause near-term volatility, especially in this unusual year, but in the long run, equity markets have advanced no matter which party is in the White House.

>> FOCUS ON FIXED INCOME

Fed adjusts its policies for lack of inflation



By Tom Bussone
Fixed Income Strategist,
Eastern Bank Wealth Management

The 10-year U.S. Treasury yield ended September at 0.69%, just above its all-time closing low of 0.51%. Despite the rebound in equities, Treasury yields remain in a tight trading range as the Fed continues to buy about $80 billion of Treasury bonds each month. With no money to be made in Treasury debt, both investment grade and high-yield corporate bonds have performed well.

The Federal Reserve believes that 2% inflation will help the economy achieve price stability and maximum employment. After years of inflation persistently falling below the mark, Fed Chair Jerome Powell announced a new long-term framework. The Fed will now allow inflation to overshoot its 2% target after periods of low inflation; this indicates that the central bank will maintain its accommodative monetary policy for an extended period. By saying it will likely refrain from raising rates, the Fed has created a favorable environment for risk assets.

Despite the Fed's efforts to boost prices, our view is that inflation won't be a concern for investors over the next year as the economy tries to recover from all the job losses related to the pandemic. For now, the monetary stimulus is feeding into asset prices, not consumer prices. At some point in the future, however, Treasury Inflation-Protected Securities will help investors protect their fixed income assets from rising inflation; until then, the securities are likely to underperform as inflation expectations for the next 10 years remain well under 2%. We prefer to keep most of our exposure in investment grade credit, along with a small weighting in both high-yield and preferred securities.

10-YEAR TREASURY NOTE YIELD

Treasury yields have hit all-time lows, driving investors to seek yield elsewhere.

Source: FactSet

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