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“ The world breaks everyone and afterward many are strong at the broken places. ”

- Ernest Hemingway

The coronavirus pandemic and the ensuing shutdowns that it caused produced the most significant economic shock since the Great Depression. Despite this shock, equity and fixed income markets navigated this turbulent environment remarkably well. While we are not yet prepared to wave the all clear flag, we are feeling optimistic due to recent developments on the vaccination and treatment fronts. Assuming we continue to make progress on these fronts, we are hopeful to get back to closer to normal sometime in the second half of 2021. In this edition of Viewpointe, we discuss what this means in terms of economic growth as well as what it may mean for equity and fixed income returns in 2021. In the asset allocation section, we review 2020 portfolio performance as well as some investment changes we are contemplating. Lastly, we conclude with a discussion regarding selecting beneficiaries on retirement accounts.

Economic Review -

A Spoonful of Sugar

The past year will likely go down in history as one of the most unsettling periods of time that most of us can ever recall. The year 2020 began with a fast-spreading global pandemic, which shook the sense of security that many of the developed world's citizens had grown accustomed to. Most of us had never experienced shortages of food items as well as basic household goods. Most had never seen anything even close to the widespread shutdowns that took place during the first half of the year. It was as though the world we were accustomed to changed overnight and we did not like the sense of insecurity that resulted.

Fortunately, the end appears in sight in terms of the coronavirus. Recent announcements on the vaccination and treatment fronts are promising and provide hope that we will be back to something closer to normal by the second half of 2021. That is welcome news for a populace that is visibly fatigued by what has occurred over recent months.

Unfortunately, the worst may still lie ahead in terms of the number of coronavirus cases as well as fatalities. While some vaccines have received emergency use approval, early doses are being reserved for frontline workers and those considered high risk. Current data indicates that larger scale distribution will not likely occur until the end of the first quarter, or perhaps early in the second quarter. Of course, a lot depends on access to the raw materials necessary to manufacture the vaccines as well as the availability of the infrastructure to distribute, store and administer the vaccines. In short, there are likely to be some bumps in the road on the way to the finish line.

While this may all seem daunting at first, we think things look a lot more positive once you put them in perspective. Ultimately, the mortality rate has been amplified significantly by the elderly and those with preexisting conditions. Assuming those folks receive priority in getting vaccinated, the mortality rate should drop significantly. In fact, some claim that once the elderly and the high risk individuals are vaccinated, the mortality and hospitalization rates will be brought more in-line with the normal flu. This should significantly reduce the virus threat.

Regardless, that leaves us with the need for a temporary economic bridge until the vaccinations take hold. Following the Thanksgiving holiday we experienced a surge in coronavirus cases. As a result, we are seeing an increase in hospitalizations, which is straining the infrastructure in some hot spot locations. Some worry that things will get even worse as people get together for the Christmas holiday.

As we mentioned in the previous edition of Viewpointe, we felt the number and scope of shutdowns would increase in the event the hospital infrastructure was strained. We fear we are reaching that point in a growing number of locations. With that said, we are starting to see an increase in shutdowns across the country. Based upon the current trend, we expect the number and scope of shutdowns to continue to increase. Similar to the first half of the year, this will have a negative impact on economic growth.

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Fortunately, in the first half of 2020 the Federal Government was quick to respond with the CARES Act. The funds provided by this legislation helped prop up consumer spending and kept many businesses afloat. At the present time, similar aid is in the works and we are hopeful that it will be passed. Assuming it is, we feel that it may provide the economic bridge necessary until we start to see relief from vaccinations and treatment. Regardless, we see economic growth as vulnerable in the first quarter of 2021.

While our base case calls for a slow start to the year, we expect a significant surge in economic growth during the second half of the year as vaccinations and treatment result in a return to normalcy. Our data shows that there is a significant amount of pent up demand that we anticipate to be released sometime during the second half of 2021. This demand will counterbalance the beginning of the year weakness. With that said, we anticipate full year growth in the U.S. to come in right around 5%.

Fixed Income Commentary -

Some Talk of Inflation

At their December meeting the Federal Reserve (Fed) indicated they are not looking to increase the degree of accommodation they are currently providing. At the present time, the Fed has injected sufficient liquidity to get the fixed income markets properly functioning again. It is important to note that bond default expectations have significantly declined and credit is readily available.

Additionally, the Fed did not indicate any intention to raise the Fed Funds Rate anytime soon. According to the current dot plot, which provides the Fed's rate hike outlook, the general expectation is for no rate hikes until sometime in 2023. With that said, despite short-term rates being anchored by the Fed Funds Rate, intermediate and long-term rates have started to drift higher. While the Fed continues to apply accommodative monetary policy aimed at keeping rates low, fixed income investors are demanding higher yields.

Some say this demand for higher yield is being driven by expectations of higher inflation around mid-year. In the event inflation starts to rise, these higher yields are necessary in order to protect one's purchasing power. That ultimately leaves us with a Fed that is committed to keeping rates low and a market that is saying we need to be protected from the potential of higher inflation risk. Unfortunately, it is hard to say with certainty what force wins out, especially in a world where the Federal Government is willing to throw trillions of dollars at anything that interferes with economic growth.

Inflation concerns are, however, a bit more noteworthy in recent months given the fact rates have remained resilient in the face of new lockdowns and the expiration of much of the stimulus provided in the CARES Act. So, why are fixed income investors concerned about inflation risks? Well, a few reasons draw our attention. First off, the pent up demand that is building for consumer goods and more importantly services. Some estimate between $1-1.5 trillion in pent up demand has built up from foregone vacations, hotel stays, restaurant meals, sporting events and general leisure and entertainment experiences. A return to normalcy can release this pent up demand in short order. This has the potential to be inflationary.

Additional reasons why inflation may surprise on the upside are the significant increase in both money supply and money growth in recent months. Both have provided an abundance of funds to be used to purchase goods and services. Under the right conditions this could result in inflation in the event this money is spent at a rapid pace.

Given such a backdrop, fixed income investors will likely continue to demand higher yields in coming months. So, what does this mean for interest rates in 2021? For illustrative purposes, the 10-year U.S. Treasury currently yields just under 1%. Looking at the year-end 2021 yield forecasts of 54 Wall Street economists, the higher end of the consensus range falls right around 1.5%. We have, however, read some research reports that do not rule out a year end yield closer to 2%. In percentage terms, such an increase in either case would be significant.

In short, our base case calls for rising interest rates in 2021. This will put downward pressure on fixed income market values, limiting return prospects. We are also likely to experience a steepening of the yield curve as short- term rates remain anchored while intermediate and long-term rates drift higher. While this does not provide a very attractive investment environment in the short-term, prospects should improve once rates rise and finally stabilize. The burning question however remains, how high will the Fed allow rates to rise before they intervene? To a large degree this will be driven by the underlying economic conditions as well as inflation readings.

Equity Commentary -

Pandemic? What Pandemic?

Upon reviewing end of year equity performance, it is hard to believe that equities did so well in the midst of a pandemic and its associated shutdowns. End of year equity resilience was even more remarkable given the controversy surrounding the November election. Even with a weak close of the month, November 2020 ranked as the top November performance for the S&P 500 since 1950, registering roughly an 11% advance. Another interesting piece of trivia is that two of the three best months (measured by total return) for the S&P 500 over the last 30 years occurred during the pandemic. While November came in at #3, April 2020 ranks #1 registering a 12.82% gain. Absolutely, remarkable when you really sit back and think about it.

In recent months, it is important to note that strength has not been reserved for U.S. large-cap stocks. After a rough first half of the year, emerging market and U.S. small-cap stocks really kicked into high gear during the second half of the year. All in all, equity performance surprised us on the upside. So, what do we attribute this outperformance to? Several factors come to mind. First off, is the tremendous amount of liquidity that has been injected into the financial system. The M2 Money Supply has been growing at over 20% for over six months now. This has flooded the system with liquidity that needs to be put to work. Second, corporate earnings expectations for 2021 are rather high. Simply put, corporations are feeling good about earnings prospects in 2021 and investors have been willing to pay up to claim some of those future earnings.

Third, we revert back to the old T.I.N.A. concept. Remember the T.I.N.A. concept that was introduced following the Great Recession? T.I.N.A. stands for There Is No Alternative. With fixed income rates dropping to near record levels during the first quarter of 2020, return prospects quickly dried up. Out of necessity investors had to look for alternatives. Many turned to equity. Lastly, recent announcements on the vaccination front really helped boost equity market performance. This was the primary driver of the November equity rally. Vaccination progress provided a long awaited sign that a return to normalcy was within reach.

While all of these factors contributed to positive equity performance in 2020, as we enter 2021 one has to ask themselves, how much of this has already been baked into the cake? We are of the opinion that most of these factors are already reflected in current stock prices. For this reason, we are cautious at the start of the New Year. One of the primary reasons for our cautious stance is the growing number of lockdowns that are occurring in response to the acceleration of coronavirus cases and the corresponding hospitalizations. We are concerned the numbers will continue to rise during and following the holiday season as people gather together to celebrate. If the number and scale of the lockdowns grow beyond what is currently anticipated, we expect equities to react negatively. We also have some concerns on the valuation front. U.S. stocks are expensive based upon a multitude of measures. In addition, it appears the high 2021 earnings expectations are currently priced in. In the event corporations do not meet these lofty estimates, stock prices will react negatively.

Finally, we get the feeling the equity market is taking comfort in what is expected to be a divided government. What we mean by this is the consensus view is that while the Democrats will control the Presidency and the House of Representatives, the expectation is that Republican's retain control of the Senate. Ultimately, the Senate will come down to the upcoming Georgia Senate runoff. In the event the Democrats take both of the Georgia Senate seats, they will also have control of the Senate. Without a doubt such widespread control would result in a much more significant shift in policy. At the present time it appears equities are more at ease with the general expectation that the Republican's retain at least one of those seats leading to a divided government and in turn more moderate policy.

Asset Allocation -

Closing the Gap

After an extremely soft start, our Lakepointe Classic model portfolios steadily made up ground throughout the remainder of the year. As December winds down, we find ourselves outperforming on the equity front while still trailing a bit on the fixed income front. Equity performance benefitted significantly from outperformance from our mid-cap growth and small-cap growth funds. Both funds stacked up well versus their respective asset class indices as well as versus the S&P 500. This outperformance more than made up for the slight underperformance that we saw in the U.S. large-cap space.

As you may recall, in a previous edition of Viewpointe, we expressed some concern regarding our small-cap value fund. During the first quarter that fund had materially underperformed benchmark. Fortunately, while that fund has not completely caught up, it has closed the gap substantially. While we are pleased with the progress the fund has made, we still are monitoring it closely to ensure that it stays on the right path.

On a calendar year basis we have particularly stacked up well in the international equity space. Both of our developed large-cap international funds have compared favorably to the MSCI EAFE international stock index. Performance in this space was even further bolstered by the performance of our emerging markets fund. It is important to note that recent outperformance in the international space as well as in the U.S. small-cap stock space has us considering adding to our exposure in these areas sometime in January.

While we were able to outperform benchmark on the equity side in our Classic portfolios, we are still trailing a bit in the fixed income space. The drag from the underperformance that we experienced during the first quarter left a high hurdle to overcome. The good news is we were able to make up significant ground and are on track to close the year out fairly close to benchmark. This marks a significant improvement in comparison to where we stacked up at the end of the first quarter of 2020.

While our large-cap individual stock portfolio started off strong, it quickly lost momentum as the U.S. economy shut down. We suffered significant losses in the airline and travel space as well as energy. While we made up ground and actually pulled ahead of the S&P 500 in June, underperformance in the defense contractor space during the fourth quarter once again bumped us below the S&P 500.

As to individual fixed income purchases, we have been reluctant to place many purchases and have found ourselves moving to our actively managed bond funds in many instances. The reason being is that we are reluctant to lock in the current low rates as we are of the opinion that rates will rise throughout much of 2021. We feel that better opportunities in the individual fixed income space will be available in the latter half of 2021 and feel that actively managed funds present better return potential until then.

Financial Planning -

Choosing a Beneficiary for your Retirement Accounts

Selecting beneficiaries for retirement accounts is different from choosing beneficiaries for other assets, such as life insurance. With retirement accounts such as IRA's and 401k's, you need to know the impact of income tax and estate tax laws in order to select the right beneficiaries. Although taxes should not be the sole determining factor in naming your beneficiaries, ignoring the impact of taxes could lead you to make an incorrect choice. In addition, if you are married, beneficiary designations may affect the size of minimum required distributions to you from your IRAs and retirement plans while you are alive. The following are some factors that should be taken into consideration when making your beneficiary designations:

Paying Income Tax on Most Retirement Distributions

Most inherited assets such as bank accounts, stocks, and real estate pass to your beneficiaries without income tax being due. However, that is not usually the case with 401(k) plans and IRAs. Beneficiaries pay ordinary income tax on distributions from pre-tax 401(k) accounts and traditional IRAs. With Roth IRAs and Roth 401(k) accounts, however, your beneficiaries can receive the benefits free

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from income tax, if all of the tax requirements are met. That means you need to consider the impact of income taxes when designating beneficiaries for your 401(k) and IRA assets.

For example, if one of your children inherits $100,000 cash from you and another child receives your pre-tax 401(k) account worth $100,000, they are not receiving the same amount. The reason is that all distributions from the 401(k) plan will be subject to income tax at ordinary income tax rates, while the cash is not subject to income tax when it passes to your child upon your death. Similarly, if one of your children inherits your taxable traditional IRA and another child receives your income-tax-free Roth IRA, the bottom line is different for each of them.

Naming or Changing Beneficiaries

When you open up an IRA or begin participating in a 401(k), you are given a form to complete in order to name your beneficiaries. Changes are made in the same way by completing a new beneficiary designation form. A will or trust does not override your beneficiary designation form. However, spouses may have special rights under federal or state law. It is a good idea to review your beneficiary designation form at least every two to three years. Also, be sure to update your form to reflect changes in financial circumstances. Beneficiary designations are important estate planning documents. Seek legal advice as needed.

Designating Primary and Secondary Beneficiaries

When it comes to beneficiary designation forms, you want to avoid gaps. If you do not have a named beneficiary who survives you, your estate may end up as the beneficiary, which is not always the best result. Your primary beneficiary is your first choice to receive retirement benefits. You can name more than one person or entity as your primary beneficiary. If your primary beneficiary does not survive you or decides to decline the benefits (the tax term for this is a disclaimer), then your secondary (or "contingent") beneficiaries receive the benefits.

Having Multiple Beneficiaries

You can name more than one beneficiary to share in the proceeds. You just need to specify the percentage each beneficiary will receive (the shares do not have to be equal). You should also state who will receive the proceeds, should a beneficiary not survive you. In some cases, you will want to designate a different beneficiary for each account, or have one account divided into subaccounts (with a beneficiary for each subaccount). Keep in mind that, due to legislation passed at the end of 2019 (the SECURE Act), most non-spouse beneficiaries are required to empty their inherited retirement accounts within 10 years (previously, they could take distributions according to their life expectancies).

Avoiding Gaps or Naming Your Estate as a Beneficiary

There are two ways your retirement benefits could end up in your probate estate. Probate is the court process by which assets are transferred from someone who has died to the heirs or beneficiaries entitled to those assets. First, you might name your estate as the beneficiary. Second, if no named beneficiary survives you, your probate estate may end up as the beneficiary by default. If your probate estate is your beneficiary, several problems can arise. If your estate receives your retirement benefits, the opportunity to maximize tax deferral by spreading out distributions may be lost. In addition, probate can mean paying attorney's and executor's fees and delaying the distribution of benefits.

Naming Your Spouse as a Beneficiary

When it comes to taxes, your spouse is usually the best choice for a primary beneficiary.

A spousal beneficiary has the greatest flexibility for delaying distributions that are subject to income tax. In addition to rolling over your 401(k) or IRA to his or her IRA or plan, a surviving spouse can generally decide to treat your IRA as his or her own IRA. These options can provide more tax and planning options. If your spouse is more than 10 years younger than you, then naming your spouse can also reduce the size of any required taxable distributions to you from retirement assets while you are alive. This can allow more assets to stay in the retirement account longer and delay the payment of income tax on distributions.

Although naming a surviving spouse can produce the best income tax result, that is not necessarily the case with death taxes. At your death, your spouse can inherit an unlimited amount of assets and defer federal death tax until both of you are deceased (Note: Special tax rules and requirements apply for a surviving spouse who is not a U.S. citizen). If your spouse's taxable estate for federal tax purposes at his or her death exceeds the applicable exclusion amount, then federal death tax may be due. In other words, one possible downside to naming your spouse as the primary beneficiary is that it may increase the size of your spouse's estate for death tax purposes, which in turn may result in death tax or increased death tax when your spouse dies.

Naming Other Individuals as Beneficiaries

You may have some limits on choosing beneficiaries other than your spouse. No matter where you live, federal law dictates that your surviving spouse be the primary beneficiary of your 401(k) plan benefit, unless your spouse signs a timely, effective written waiver. Furthermore, if you live in one of the community property states, your spouse may have rights related to your IRA regardless of whether he or she is named as the primary beneficiary. Keep in mind that a non-spouse beneficiary cannot roll over your 401(k) or IRA to his or her own IRA. However, a non-spouse beneficiary can directly roll over all or part of your 401(k) benefits to an inherited IRA.

Naming a Trust as a Beneficiary

You must follow special tax rules when naming a trust as a beneficiary, and there may be income tax complications. Seek legal advice before designating a trust as a beneficiary.

Naming a Charity as a Beneficiary

In general, naming a charity as the primary beneficiary will not affect required distributions to you during your lifetime. However, after your death, having a charity named with other beneficiaries on the same asset could affect the tax-deferral possibilities of the non-charitable beneficiaries, depending on how soon after your death the charity receives its share of the benefits.