2021

Reflections and *A Way Forward*

OUTLOOK

STIFEL

2021 OUTLOOK

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A LETTER FROM OUR **CHIEF INVESTMENT OFFICER**

My team and I are very pleased to share with you our *2021 Outlook: Reflections and A Way Forward*. Following a very strong year in 2019, the historic bull market continued into 2020 with the S&P 500 reaching a record high in February. But then, as we all know too well, the world was shocked by the outbreak of a new strain of coronavirus and the related illness, COVID-19. This triggered a steep bear market and a recession, which was met with unprecedented fiscal and monetary support. Following the record self-imposed shutdown of our global economy in the first half of the year, we pivoted to the reopening of business and the economy in the second half. And by August, the market had recovered its losses.

> **2021 will be defined, to a good degree, by the distribution and adoption of vaccines to combat the virus and get us quickly on a path to herd immunity.**

There was also a call to action to the medical research community, which in turn responded with advancements in therapeutics and, eventually, vaccines. And along the way, we all learned more each day about how to live with the risk of the virus, from social distancing, to masks, to practicing good hygiene. We ended 2020 with two approved vaccines and the start of inoculation programs. 2021 will be defined, to a good degree, by the distribution and adoption of vaccines to combat the virus and get us quickly on a path to herd immunity.

We provide a more detailed look back in our *2020 Year in Review*. Take, for example, the S&P 500. We started the year with a forecasted return of 5.0%, modestly below our long-term assumption of 7.75%. But the pandemic caused the bear market, which for the S&P 500 meant a decline of -33.8% from February 19 to March 23. But through the balance of the year, the S&P 500 rose 70.2%, ending the full year with a positive return of 18.4%. The journey was highly unusual, but we ended the year above our forecast.

Of course, 2020 included historic U.S. elections, with former Vice President Joe Biden winning the presidency, Democrats keeping control of the House of Representatives, though with fewer seats, and control of the Senate remaining unknown until the January runoff elections in Georgia. At the time of this writing, two possible scenarios remain. If Democrats win both runoff elections, they gain control of 50 senate seats, making Vice President-elect Kamala Harris the deciding vote, as she will serve as President of the Senate. If Republicans win just one seat, they keep majority control of the Senate and we'll have a divided government. We go deeper in *A Divided Government – 2020 Election Implications for 2021*.

The 2020 coronavirus pandemic has accelerated many trends we've been monitoring, captured by our article *The Coronavirus: Impact on Our Major Investment Themes*. Our review includes a discussion of advances in medical innovation, e-commerce, remote working/learning, and the prospect for a cashless economy, for example.

And we provide perspectives on key topics again this year:

- An update to our Geopolitical Dashboard;
- *Financial ID: Handling Uncertainty and Unknowns With Behavioral Finance*;
- *Important Tenets of a Successful Investment Strategy*;
- An important foundation: *Stifel's Approach to Asset Allocation*; and
- Where to find our work: *Stifel Guidance*.

Finally, we share our *2021 Outlook*. We again provide our views on three possible scenarios for the coming year, with a base case that is positive, informed by our positive outlook on vaccines. We also provide case guidance on portfolio positioning and dynamic leanings, as well as more negative and more positive scenarios.

We hope you find this piece informative and helpful. We welcome, as always, your thoughts, observations, and comments.

Michael P. O'Keeffe, CFA
Chief Investment Officer

2020 YEAR IN REVIEW

In this publication last year, we had a constructive outlook on the economy and capital markets anchored, in part, on positive but slow economic and earnings growth and the additional role of fiscal support. However, the world was turned upside down by COVID-19, a pandemic that led to a global shutdown, a surge in unemployment, a recession, and the fastest bear market in history.

Response and Recovery

Due to the pandemic and "Great Lockdown," as coined by the International Monetary Fund, the U.S. economy entered a recession in February, and GDP is estimated to have declined 3.6% for the year. This is below the trend rate of 2.0% and lower than the 2.2% growth in 2019.

In an effort to offset the economic damage from the pandemic, monetary and fiscal policy responses were swift and substantial. The Federal Reserve (Fed) even took actions between scheduled meetings. Its actions included: lowering rates to the lowest level since the financial crisis, expanding its balance sheet through a bond-buying program, establishing a variety of lending facilities, and extending dollar swap lines to a range of central banks.

The federal government's fiscal response included emergency aid for healthcare organizations and coronavirus treatment research ($8.3 billion), funds toward the Coronavirus Aid, Relief, and Economic Security (CARES) Act ($2.3 trillion), and additional funds to support small businesses and hospitals and expand testing. As a result, the economic recovery happened at a faster pace than anticipated.

For example, after peaking at 14.7% in April, the unemployment rate fell to 6.7% in November, which is about level with where it was in March 2014. In fact, if we go back to June, the Fed was forecasting unemployment to end 2020 at 9.3%. So, unemployment has been recovering better than expected. Similar recoveries can be seen in housing and business sentiment and outlook data. For instance, lower mortgage rates and working remotely has led to increased demand for housing. Truck shipments declined but have since recovered. Factory orders and durable goods orders are also showing a V-shaped recovery.

The NFIB Small Business Optimism Index declined earlier in the year and has recovered, but not quite to pre-pandemic levels. The rebound for the small business economy has been uneven, and for many businesses, the future is uncertain. The Purchasing Managers Indexes seek to measure, in the manufacturing and service sectors, the direction of current and future economic trends. These indexes show a clear V-shaped recovery, returning to pre-pandemic levels.

In contrast, consumer-related data is showing mixed results. While measures such as retail sales and consumer credit have made a strong recovery, the forward-looking measure of consumer confidence has additional room to recover before reaching pre-pandemic levels.

> **"In an effort to offset the economic damage from the pandemic, monetary and fiscal policy responses were swift and substantial. The Fed even took actions between scheduled meetings."**

Coronavirus: Some Hope After a Year of Turmoil

The coronavirus is believed to have started in animals and spread to humans in Wuhan, China, at the end of 2019. The first case was confirmed in the U.S. on January 21, and by the time the World Health Organization (WHO) declared the COVID-19 outbreak a pandemic in March, there were 118,000 cases worldwide in 114 countries. To combat the virus, countries imposed restrictions and stay-at-home policies, while the Trump administration initiated a program (Operation Warp Speed) to facilitate and accelerate the development of vaccines. By the end of the year, in a historic achievement, the U.S. Food and Drug Administration (FDA) had approved two vaccines for emergency use authorization. During 2020, over four million people were vaccinated, and it's anticipated that at least 50% of the U.S. population will have been vaccinated by mid-2021.

> **2020 was a historic year for equity markets, which hit an all-time high before falling into a bear market in a matter of weeks.**

U.S. Election: Politics and Pandemic Collide

Like many aspects of life, the coronavirus also impacted politics and the elections. In particular, it changed how presidential campaigns are conducted and how citizens vote. Campaign rallies were held virtually, debates were canceled, a record number of voters cast their ballots by mail, and final outcomes weren't determined for several days, and in some cases, weeks. President Trump tested positive for the virus. Ultimately, Joe Biden was formally confirmed as the winner with 306 Electoral College votes. When looking, state by state, at the projected margin of victory for Biden or Trump across all 50 states and Washington, D.C., the average margin of victory was 19.5%. There were only eight states where the margin of victory was less than 5%. So, one party or the other dominated in most states. From state to state, we are divided. In Congress, Democrats maintained control of the House, but with fewer seats. As of this writing, the Senate remains a toss-up as we await the results of the Georgia runoff elections.

Equity Market Review

2020 was a historic year for equity markets, which hit an all-time high before falling into a bear market in a matter of weeks. Despite the ongoing COVID-19 pandemic and increase in cases, equity markets recovered over the course of the year, delivering strong returns. For the full year, the S&P 500 was up 18.4% and the Russell 1000 was up 21.0%, mainly on the Fed's accommodative stance, Congress' fiscal policy, positive vaccine news, and better-than-expected earnings. Growth stocks continued their outperformance of value, with the Russell 1000 Growth Index up 38.5% versus 2.8% for the Russell 1000 Value Index. Small cap stocks, as represented by the Russell 2000 Index, underperformed large caps, up 20.0% for the year.

Non-U.S. markets also had positive returns, but generally weaker than those of U.S. equities. For the year, the MSCI EAFE Index, representing non-U.S. developed markets, was up 7.8%. In the eurozone, economic data deteriorated as the uncertainty related to the COVID-19 pandemic impacted all segments of the economy. With hopes of offsetting some of the impacts of the pandemic, the European Central Bank (ECB) announced a 750 billion euro Pandemic Emergency Purchase Programme (PEPP), conducting purchases through the end of 2020. In addition, in terms of fiscal policy, Italy announced a 25 billion euro package, France announced a 45 billion euro package, and Germany is considering as much as 400 billion euros of support.

Emerging markets, as measured by the MSCI EM index, were up 18.3%. A relatively weaker dollar and recovering commodity prices helped to offset the negative impact from the increase in COVID-19 cases. Also, China, emerging markets' largest economy, has made a dramatic recovery from the pandemic, with industrial production, manufacturing, and retail sales all growing in the second half of the year. China was the only major economy to show growth in 2020.

Fixed Income Review

The 10-year Treasury yield was at 1.92% at the start of 2020 and declined through the year, settling at 0.91% on December 31. The spread between the 2-year and 10-year Treasuries steepened in 2020, and 3-month and 10-year Treasuries briefly turned negative in March on fears that COVID-19 would have a sizable impact on global growth.

The 10-year Treasury yield fell to as low as 0.50% in August, and the 30-year hit a low of 0.99% in March amid a flight to perceived safety during the pandemic, the upcoming election, and an increase in purchases of Treasuries by the Fed. Both, however, rallied into the end of the year on reduced election uncertainty and prospects of a COVID-19 vaccine.

The Bloomberg Barclays U.S. Aggregate Index, representing investment-grade taxable bonds, returned 7.5% for the year. The Bloomberg Barclays U.S. Municipal Bond Index, representing investment-grade municipal bonds, returned 5.2%. High-yield bonds, as measured by the ICE BofA ML U.S. High Yield Index, were up 6.2% ◆

After a year absorbed by the pandemic and politics, 2021 will be more about the restart and revival of our economy and a refocus on more traditional fundamentals. The road to recovery remains uncertain, but businesses and households can now better plan for the future as there is more clarity on how we progress to the other side of this health crisis.

The road to recovery remains uncertain, but businesses and households can now better plan for the future as there is more clarity on how we progress to the other side of this health crisis.

Looking across a variety of measures, so far we've seen a V-shaped recovery in many segments of the economy, in good part due to the historic fiscal and monetary support. Meanwhile, business sectors more directly impacted by the virus have yet to make a meaningful recovery. Given the environment, we saw companies benefitting from the work-from-home trend and with strong recurring revenue outperform last year. As we look forward into 2021, we see a broadening out of returns to the sectors and markets that were more affected by the lockdowns.

The consensus is currently forecasting 3.8% GDP growth for 2021, and our view of the economy is also constructive. Our base case (70% probability) sees economic growth accelerating above its long-term trend and earnings growth rebounding sharply. Our view is predicated on the following baseline assumptions:

- A successful campaign in which a large portion of the U.S. population is vaccinated by the summer and the majority of developed and emerging market countries by year-end.
- The federal government stands ready to step in further if the economic recovery falters.
- Inflation rises, but not to a point to force action by the Fed.
- President-elect Biden prioritizes economic recovery and doesn't immediately pursue significant corporate or income tax increases.
- Treasury yields rise, but not materially as they are tempered by the longer-term growth outlook and inflation expectations.
- Geopolitical tensions and policy uncertainty decrease as the world focuses on the healing and revival of the global economy. ◆

We view our base-case scenario as the most likely outcome. However, we also review the possible upside and downside risks to our view.

Bull Case (15% probability):

When we ask ourselves about possible drivers for better-than-expected economic and market results, we focus on three factors: a faster timeline for herd immunity and a faster return toward "normal" for consumers, greater fiscal support, and increased business spending on account of reduced uncertainty. In this scenario, inflation might rise on increased private sector spending and accelerated economic activity, but it remains under control due to proactive Fed policy.

Bear Case (15% probability):

In turn, when we ask ourselves about possible drivers for economic and market results worse than we expect, we focus on the coronavirus. In this scenario, investors are overoptimistic and there is a delay in the vaccination timeline due to logistical setbacks or a lower percentage of the population volunteering for the vaccine. As a result, COVID-19 cases once again surge, dampening consumer and business confidence and negatively affecting "animal spirits." This results in a deflationary shock. Company earnings fall and stock returns are negative. ◆

	2021 TARGET	OUR VIEW	COMMENT
MACRO VIEWS			
Core PCE Inflation	2.0%	Trending Higher	Inflation will move higher as the economy accelerates, but the output gap may take longer to close, thereby keeping inflation from running too hot.
Real GDP	3.75% - 4.25%	Above Trend	A bridge to "normalcy" via a vaccine and a surge of pent-up demand in sectors constrained by the virus will drive GDP above its long-term trend.
Volatility (VIX)	-	Modestly Above Average	The VIX averaged 29.2 in 2020, up from 15.4 in 2019. We see volatility lower than last year, but still elevated as the path to recovery will be bumpy.
U.S. Dollar	-	Modestly Weaker	A recovering global economy, lower rate differential, and rising inflation expectations will put pressure on the dollar.
EQUITY			
U.S. Equities Large Cap (S&P 500)	10% return (4,073 index)	Positive returns above our long-term capital market assumptions	2020 saw a pandemic-induced recession and subsequent V-shaped recovery in many segments of the economy, in part due to strong policy support. In 2021, a strong global economic recovery and rebounding earnings will underpin market returns.
U.S. Equities Small Cap (Russell 2000)	13% return (2,208 Index)		
Developed Markets (MSCI EAFE)	13% return (2,376 index)		
Emerging Markets (MSCI EM)	14% return (1,448 index)		
FIXED INCOME			
Federal Funds Rate	0.00% - 0.25%	No change to monetary policy	The Fed has signaled a patient approach and allowing inflation to overshoot 2%.
10-Year Yield	1.25% - 1.50%	Higher	A stronger economy will lift rates, but a more patient Fed and a tepid longer-term growth outlook will limit the rise in rates.
Investment-Grade Credit (OAS)*	100 - 125 basis points	Slight Widening	Spreads are at the lower end of their historical range, and there is some room for widening.
High-Yield Credit (OAS)	375 - 425 basis points	Slight Widening	

**Option-Adjusted Spread*

ALLOCATION **INSIGHTS**

Our portfolio recommendations continue to be anchored in our long-term outlook, with a focus on diversification both across and within asset classes. Our dynamic leanings are against our long-term strategic asset allocation (SAA) and result from our short-to-medium-term views. Below is a table capturing our current views. We acknowledge that this table can sometimes be difficult to translate to a holistic portfolio allocation, so here is our explanation.

With the election uncertainty largely behind us and having received good news about a COVID-19 vaccine, a consistent theme that is propagated across our leanings is the continued economic and personal recovery. As a result, we see the potential for cyclical and underperforming segments of the market to begin to make up some of that underperformance.

Between equity, fixed income, and alternative investments, our dynamic asset allocation (DAA) is equal to our SAA that corresponds to each risk profile.

Within equity, we make several decisions, one of which is how to dynamically allocate between U.S. and non-U.S. equity. Our current leaning is to overweight non-U.S. equity, both developed and emerging markets, versus U.S. equity.

Investors should also consider investments across market capitalization (large cap, mid cap, and small cap) and style (value versus growth). In the U.S., we remain overweight U.S. small cap relative to U.S. large cap, and overweight to U.S. large cap value as we expect this style to make up for recent weak performance.

Outside the U.S., we are neutral between developed and emerging markets equities and recommend a diversified approach to both. But again, we are overweight non-U.S. stocks versus U.S. stocks.

Within fixed income, we are overweight to U.S. high yield relative to U.S. investment grade, with the guidance to implement this leaning only using active managers. Within investment grade, we remain neutral between corporates, government, and securitized bonds. We are overweight Treasury inflation-protected securities (TIPS) as we believe inflation will trend higher through the year on account of accommodative central banks, continued fiscal support, and a restart of the economy. ◆

“Our portfolio recommendations continue to be anchored in our long-term outlook, with a focus on diversification both across and within asset classes.”

EQUITY

ASSET CLASS	PREVIOUS	CURRENT	COMMENTS
U.S. Equity	■	▼	Our base case assumes a strong global economic recovery in 2021, supported by fiscal and monetary stimulus, a gradual return to “normal,” and vaccine availability. Equity markets outside the U.S., which generally underperformed in 2020, are more dependent on trade and levered to cyclical sectors, which should bode well for their performance. A weakening dollar is expected to be a tailwind for non-U.S. markets.
U.S. Large Cap	▼	▼	Smaller businesses, or those in weaker financial condition, have suffered and some have gone out of business as a result of the COVID-19 shutdowns. Risks still remain, but we are more upbeat looking forward as the vaccine provides clarity for a path forward, and the economic data continues to suggest that the economy is regaining ground.
Large Value versus Large Growth	▲	▲	The large cap value segment of the market has underperformed large cap growth as many of the underlying companies were more impacted by the COVID-19 lockdowns and social distancing measures. Now that the uncertainty of the election is largely behind us and a vaccine is available, value stocks are poised to outperform given their greater cyclical exposure.
U.S. Small Cap	▲	▲	Smaller businesses, or those in weaker financial condition, have suffered and some have gone out of business as a result of the COVID-19 shutdowns. Risks still remain, but we are more upbeat looking forward as the improving economic data suggests that the economy may be regaining ground.
Small Value versus Small Growth	■	■	We recommend a diversified approach, investing in both small cap value and growth.
Non-U.S. Equity	■	▲	Our base case assumes a strong global economic recovery in 2021, supported by fiscal and monetary stimulus, a gradual return to “normal,” and vaccine availability. Equity markets outside the U.S., which generally underperformed in 2020, are more dependent on trade and levered to cyclical sectors, which should bode well for their performance. A weakening dollar is expected to be a tailwind for non-U.S. markets.
Non-U.S. Developed Markets	■	■	We are neutral within non-U.S. equity between developed and emerging markets as we find the risks to be balanced between both.
Europe versus Japan	■	■	The European economy is more exposed to global trade with public companies generating 50% of revenue outside of Europe. Japan has been relatively successful at containing the virus, and ongoing structural and corporate reform is a tailwind for company earnings. However, both Europe and Japan face some challenges that keep us at neutral within developed markets, for now.
Emerging Markets	■	■	A weaker dollar, stable oil prices, and a stronger global economy should benefit most emerging market countries. However, weaker healthcare systems and less attractive relative valuations keep us on the sidelines, for now, relative to non-U.S. developed markets.

(Continued on next page.)

▲ Overweight ▼ Underweight ■ Neutral

ALLOCATION **INSIGHTS**

	ASSET CLASS	PREVIOUS	CURRENT	COMMENTS
FIXED INCOME	U.S. Investment Grade	■	▼	Within fixed income, we are tilting to an overweight of U.S. high yield relative to U.S. investment grade with the use of active management. Default rates in high yield are above their 30-year average, and while the impacts of COVID will persist, we believe there is opportunity in certain cyclical sectors and the potential for yield enhancement in a low-yield environment.
FIXED INCOME	*Corporates* *Government/Agency* *MBS*	■	■	We recommend a diversified approach to the full spectrum of investment-grade fixed income.
FIXED INCOME	*Inflation Protected*	■	▲	The Fed has revised its policy framework to allow for inflation to be above 2% for extended periods of time. We believe inflation will trend higher through the year on account of accommodative central banks, continued fiscal support, and a restart of the economy.
FIXED INCOME	Duration	■	■	The Fed is expected to stay accommodative for the foreseeable future, and while interest rates will likely move higher as the economy recovers, we don't anticipate rates rising significantly. We believe we are in a "lower for longer" environment and remain neutral duration.
FIXED INCOME	U.S. High Yield	■	▲	Within fixed income, we are tilting to an overweight of U.S. high yield relative to U.S. investment grade with the use of active management. Default rates in high yield are above their 30-year average, and while the impacts of COVID will persist, we believe there is opportunity in certain cyclical sectors and the potential for yield enhancement in a low-yield environment.
ALTERNATIVES	Private Assets	■	■	For investors interested in alternative investments and able to handle illiquidity, exposure to some combination of private equity, private debt, and/or private real estate can be considered as part of a diversified portfolio.
ALTERNATIVES	Hedge Funds	■	■	For investors who are interested in alternative investments, are able to handle less liquidity, and have conviction about manager skill, exposure to hedge funds can be a helpful part of a diversified portfolio. This is especially true in volatile, low-return environments.

▲ Overweight ▼ Underweight ■ Neutral

2020 ELECTIONS: INVESTMENT IMPLICATIONS FOR 2021

Contributed by Brian Gardner

Gridlock Is Coming

The 2020 election produced historic outcomes that will impact the way Washington operates for at least the next two years. At the presidential level, the election was an unusual rebuke of a first-term president. President-elect Joe Biden's win was only the second time since 1900 that an incumbent president (Donald Trump), who had previously been elected to replace a president from the opposing party, failed to win a second term (Jimmy Carter was the other). However, Mr. Biden suffered the most losses of House seats by a newly elected president since 1960, and the best he can hope for in the Senate is a 50-50 split, depending on what happens in runoffs for two Senate seats in Georgia. If Republicans win at least one of the Georgia runoffs, the GOP will keep the majority in the Senate, which would mark the first time since 1884 that an incoming Democratic president did not have a unified government. Even if Democrats sweep the Georgia runoffs and win back the Senate, a 50-50 tie will make running the Senate difficult. The outcome of the election is de facto gridlock – Congress is unlikely to pass sweeping legislation given the close splits in the House and the Senate. Thus, any policy changes in the coming two years are likely to come from the regulatory agencies.

Pandemic-Focused First 100 Days

Ever since Franklin D. Roosevelt's first term, incoming presidents have looked to "hit the ground running" in their first 100 days in office. President-elect Biden will take office during a significant resurgence in COVID-19 cases, so many of his initial actions will likely be related to the pandemic. The preeminent concern of the incoming administration will be the efficient distribution of COVID-19 vaccines. No governmental action will matter to the economy and the markets as much as effectively vaccinating the population against COVID-19. The Biden administration will likely push for another round of COVID-relief aid, but in the wake of Congress' approval in December of a fourth round of COVID relief (depending on how you count the previous relief bills), we think there is little chance that Congress passes another COVID relief bill for at least the next six months unless the economy significantly underperforms expectations. Even if Democrats win the Senate majority by sweeping both Georgia runoffs, I believe the additional COVID relief legislation will be a longshot for a while.

With sweeping legislation off the table for the next few months, the Biden administration will be limited in what actions it can take that might have a material impact on the economy and the markets. One area where we expect

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> **Lawmakers in both parties agree on infrastructure, but differences on priorities and funding often derail ambitious plans.**

quick action is immigration, as the incoming administration can quickly reverse some Trump administration policies. The ban on immigration from predominantly Muslim countries is likely to be reversed quickly. The new administration can also speed up consideration of H-1B visa applications, which had slowed in recent months.

Forecasting Minimal Reform Longer Term

As we noted above, gridlock will have a firm hold on Congress in the next two years. This means that sweeping legislation is unlikely. Regardless of the outcome of the Georgia races, prospects for sweeping changes in tax policy seem remote. With a closely divided House and Senate, chances of tax hikes on individuals and corporations, capital gains, dividends, and estates are quite low. The Biden administration and congressional Democrats will probably propose tax hikes, but it is hard to see tax increases passing Congress. Some in Congress might make a run at passing comprehensive immigration reform, but again, that is probably a non-starter in a deeply polarized country. An increase in the number of H-1B visas is possible, but even a small increase could be a heavy lift.

Infrastructure spending will also be on the agenda in 2021, but ambitious plans are unlikely to get much traction. Instead, Congress will probably reauthorize the five-year surface transportation bill. Lawmakers in both parties agree on infrastructure, but differences on priorities and funding often derail ambitious plans. Congress will need to address funding for highway construction since a traditional source of revenue, the gas tax, is becoming a less effective revenue generator as drivers move to electric vehicles.

A "Green" Agenda: Climate Change *and* Cannabis

Climate change will be a priority issue for the Biden administration, but the Green New Deal is a non-starter. Some easy steps the Biden administration could take a return to the Paris climate agreement, but the market implications for such a move are limited due to the lack of enforcement mechanisms. A carbon tax is likely to be floated by some Democrats. A carbon tax is not only a revenue generator but is seen as a deterrent and a tool in fighting climate change, but the proposal is deeply unpopular among Republicans in Congress and probably will not be enacted. Rather than punitive measures like a carbon tax, Congress might look to subsidies like tax credits for carbon recapture initiatives. The regulatory approval process for energy-related projects is likely to slow down, and financial regulators are likely to push companies to disclose more about their exposure to climate risks.

The other part of the green agenda is cannabis. The House recently passed legislation to decriminalize marijuana at the federal level. The Senate is unlikely to consider that bill in 2020, so it

Yellen will also likely have a significant say regarding nominations to the Federal Reserve Board, but the most impactful selections for Fed spots are a year away.

will be back to the starting blocks for decriminalization legislation in 2021. Despite changing societal attitudes on drug legalization, legalizing cannabis remains controversial in Congress, and it is doubtful Congress will approve decriminalization over the next two years. Legislation known as the SAFE Banking Act, which would allow depository institutions to provide banking services to legal cannabis companies (in states that have legalized cannabis) and related industries, stands a better chance at passing in 2021 but is by no means a forgone conclusion.

Biden's Picks Signal Economic Agenda

Personnel is policy and given the expected gridlock, this is more true than usual. So far, President-elect Biden's personnel nominations for Cabinet positions and key White House posts signal that Mr. Biden will govern as an establishment figure rather than as a populist, which should not be much of a surprise given that he has worked in Washington for roughly 40 years. His nomination of former Federal Reserve Chairwoman Janet Yellen to be Secretary of the Treasury suggests that Mr. Biden will push a left-of-center economic agenda, but given gridlock on Capitol Hill, the selection of Dr. Yellen means little regarding the outcome for fiscal policy. Dr. Yellen's track record at the Fed indicates that she will oppose further regulatory relief for the financial services sectors, but we doubt her nomination means the pendulum is going to dramatically swing back in the other direction. Banking regulation might be relatively stable at least during the beginning of the Biden administration. As Treasury Secretary, Yellen will have influence over who is appointed to run the financial regulatory agencies, including the Consumer Financial Protection Bureau (should Mr. Biden decide to fire the current CFPB Director) and the Securities and Exchange Commission, which are two agencies that progressives view as key assignments. Progressives may have been shunned from most Cabinet positions, but Mr. Biden and Dr. Yellen could placate progressives by nominating people from among their ranks to run these agencies. This could be a negative for nonbank financials.

Reshaping the Federal Reserve

Yellen will also likely have a significant say regarding nominations to the Federal Reserve Board, but the most impactful selections for Fed spots are a year away. The Fed is governed by a seven-member board. With the recent confirmation of Christopher Waller, there is currently one vacancy to the Fed, which Mr. Biden will be able to fill in 2021. Fed Chairman Jerome Powell's term runs until February 2022, so should the Biden administration decide to replace him (we think there is a good chance Powell gets a second term), a new Fed Chair is still a year away, and Fed policy will likely remain unchanged in the meantime, depending on developments with COVID-19.

In addition to the current vacancy, the Biden administration will have opportunities to start reshaping the Fed starting in late 2021, when the term of Randal Quarles as Vice Chairman of Supervision (VCS) expires. Technically, Vice Chairman Quarles can stay on the Fed's board, since his term as governor runs until 2032, but we expect the Biden administration will replace him as VCS and that Mr. Quarles will leave the Fed shortly thereafter. Also, Vice Chairman Richard Clarida's term expires in January 2022, so significant changes at the Fed will probably not occur in the first year of the Biden administration, but when the makeup of the Fed starts to change, those changes will be to reinforce the Fed's accommodative policy and rather moving the Fed toward a more restrictive policy.

> **The recent announcement of a lawsuit brought by a group of state attorneys general could be just the beginning of a new wave of antitrust actions.**

New Attorney General, New Policy

Of the cabinet positions that have yet to be announced, the Attorney General nomination (as of this writing) might be the most significant for investors. Populist skepticism in both parties about the concentration of economic power is growing, and there is an ongoing debate on how to use antitrust laws to address this issue. The recent announcement of a lawsuit brought by a group of state attorneys general could be just the beginning of a new wave of antitrust actions. Even where the government does not seek to break up firms, we think the Biden administration could 1) slow approval of merger applications or pressure firms to restructure proposed mergers and 2) levy hefty fines against companies that are found guilty of engaging in anticompetitive behavior.

During the presidential campaign, Mr. Biden proposed expanding the Affordable Care Act to include a public option. With the gridlock in place, the prospects for enacting a public option are low. Even if Democrats win the Senate majority via the Georgia runoffs, passing healthcare legislation in 2021 will be difficult. If Republicans keep the Senate, then the prospects for a public option are close to zero. Although legislative changes to the ACA are unlikely, the Justice Department could block healthcare mergers, including those among hospitals and pharmaceutical companies.

Changing the Tone on Trade

The Biden Administration has indicated that it wants to normalize trade relations, but that might not be as easy is it seems. A change in tone and style from the Trump administration's approach is likely, but a return to the pre-Trump era is unlikely. Regarding China, the U.S. will likely adopt a multilateral approach, but American tariffs on Chinese imports will probably remain in place at least initially. Unions and some key Democrats support the tariffs, and it would be politically difficult for President-elect Biden to remove them right away. A group of U.S. businesses has sued to overturn the tariffs on the grounds that the Trump administration exceeded its legal authority in imposing them. If the plaintiffs win in court, then the Biden administration might have political cover to scrap the tariffs, but we do not expect significant changes absent a favorable court decision.

Conclusion

After the 2020 election, gridlock will prevent major changes in federal policy. The Biden administration might reverse some Trump era regulatory policies, which could lead to a slightly more restrictive regulatory environment than some sectors have experienced over the past four years, but early personnel announcements by the Biden transition team suggest modest rather than radical policy changes. Among the areas on our radar is antitrust law, which could be used to block or restructure mergers, crack down on unfair and uncompetitive practices, and reshape the landscape in some sectors. ◆

THE CORONAVIRUS: IMPACT ON OUR MAJOR INVESTMENT THEMES

Over the last few years, we've developed a set of major investment themes that influence our short-term investment decisions and our views on the medium- and long-term direction of the economy and the markets, both here in the U.S. and around the world. The coronavirus pandemic came out of nowhere in early 2020, and its impact has shaken the world. And, interestingly, the world's response has had a significant impact on our major investment themes, in many cases accelerating progress we expected further out in the future. We'll review each major theme and offer perspective on how each theme has been impacted by the coronavirus pandemic.

> **Working remotely has meant that our commute has been eliminated and our work lives have come crashing into our home lives, literally. So people have had to learn how to create boundaries, both in time and in physical space.**

Productive Competition

Our 2020 Outlook focused on the idea that we've begun a decade of productive competition. By this, we meant the world was getting ever more competitive, but such competition would push us as individuals, and as businesses, to work harder, work smarter, be more innovative, and ultimately be more productive. So productive competition. And, in an odd way, 2020 has been defined by our fight against, or competition with, a novel coronavirus.

So this theme remains in place, with our competition with the virus leading to new dimensions of improved productivity. We'll discuss some of these further below, but think about it. We're more able to work remotely today. We've learned to stay productive, and the technology platforms allowing us to work remotely have expanded and improved. We've innovated. We've had hundreds, if not thousands, of companies around the world inventing new therapeutics and vaccines to combat the virus. And they're succeeding. Tough as it has been, our fight, or competition, with the virus has led us to be more productive.

Breaking Boundaries: The Fourth Industrial Revolution

This medical innovation is an example of an even more accelerated Fourth Industrial Revolution (4IR), an important investment theme for many years. 4IR is the idea of breaking down the boundaries between the physical, digital, and biological worlds, with advances in areas like artificial intelligence, the Internet of Things, genetic engineering, quantum computing, robotics, and other technologies. Whether it be the mapping of the coronavirus genome in just a few days, or the speed with which messenger RNA (mRNA) vaccines have been developed, 4IR medical innovations are accelerating as a result the pandemic.

Other areas of 4IR innovation include the advancement of e-commerce, the use of robots to reduce human contact, the speedier advance of cashless purchases, and improvements in virtual working technology, including video conferencing and virtual group meetings. Today one can do all their shopping online, increasingly with augmented reality (AR) tools to view products in their home or office. And who would have thought whole businesses, and entire school systems, could operate remotely and effectively? The 4IR, such as the cloud and advanced computing systems, is playing a key role.

Shifting Demographics

Shifting demographics has been a theme in focus. So how has the coronavirus pandemic affected this theme? Here are a few examples. First, consider millennials and their focus on work/life balance. Working remotely has meant that our commute has been eliminated and our work lives have come crashing into our home lives, literally. So people have had to learn how to create boundaries, both in time and in physical space, to separate their work lives from their home lives. This has been important to millennials, who really value work/life balance. But this has also led to a move from densely populated metropolitan areas to suburban environments and has been at least one factor attributing to the strong housing market.

A second example? A shift in consumer preferences that favor the evolving consumer. Various surveys have been conducted that indicate a change in how we shop and how we get entertainment. The increased focus on health and hygiene, natural and organic foods, digital versus physical on-demand entertainment or exercise, and athleisure clothing are examples of some trends that have been accelerated by the pandemic.

And, finally, for years to come, we'll be studying the pandemic's impact on the U.S. population and our workforce. For example, given the travel restrictions and border closures, there have been fewer immigrants this year to the U.S. And interestingly, the Brookings Institution is calling for a possible "baby bust," with possibly 300,000 to 500,000 fewer births over the next year due to the pandemic. The ultimate long-term impact is unknown, but the pandemic's impact on demographics could, in turn, have a negative impact on consumer demand, the size of the workforce, and GDP in future decades.

Geopolitical Tensions and Protectionism

Even before the pandemic, we focused on geopolitical tensions and protectionism. Technology advances, including 4IR, have broken down the barriers of globalization. Back in 2005, Thomas Friedman wrote about this in his best-selling book, *The World Is Flat*. He described ten forces of a more global world, including web browsers, outsourcing, offshoring, and supply-chaining. All of this has led to accelerating globalization of our economies.

But, as we've shared, more recently, local populations in many developed countries have called upon their political leaders to protect them from global competition, which has increased protectionism around the world. The U.S.-China trade war is an obvious example, with the U.S. increasing tariffs in 2019 to the benefit of U.S. companies.

And, of course, the global response to the coronavirus pandemic has amplified this deglobalization trend. Some examples. First, and simply put, countries all around the world shut their borders. Second, massive unemployment caused local governments to favor its citizens for local jobs. For example, in the U.S., President Trump signed an executive order freezing green cards for new immigrants and suspending temporary work visas for skilled workers through 2020. Third, China, a major beneficiary of globalization, has been blamed for the virus. So countries, in general, may be inclined to be tougher on China going forward. And finally, the pandemic exposed the weakness in some supply chains and reliance on other countries. At the onset of the crisis, governments introduced export curbs on medical supplies such as personal protective equipment and ventilators, and many companies were faced with challenges completing production because their supply factory was either closed or needed items that were sitting at vacant shipping docks.

Managing Through Economic Recovery

A more recent theme in focus for us is the idea of managing through economic recovery. This started with people and businesses needing to manage through the economic shutdown and recession, spurred by the pandemic. Businesses were forced to adjust to survive, like retailers shifting to curbside pickup, restaurants pivoting to outdoor seating, or car dealerships completing sales online. On a larger scale, this meant some companies suspending share buybacks and/or dividends and capital investment plans. And through this, hundreds, if not thousands, of businesses, small and large, closed permanently. Some major retailers were struggling even before the coronavirus due to the acceleration of e-commerce. The coronavirus accelerated the decline. For example, J. Crew and Neiman Marcus both filed for bankruptcy.

The human toll of the virus and the disruption it's caused have been undoubtedly tragic. But these challenging times have also brought forth innovation and American entrepreneurship. In fact, new business formations were 1.5 million in the third quarter of 2020, an 82% increase from a year earlier. This bodes well for the future of job creation.

Conclusion

As part of our process, we identify major investment themes, which inform and define much of our work. They affect our short-term investment decisions and our medium-to-long-term views here in the U.S. and around the world. And the coronavirus pandemic has shaken all of them, from productive competition, to the Fourth Industrial Revolution, to deglobablization. We will, of course, continue to assess the world through a post-COVID lens and how the recovery back toward "normal," accelerated by vaccines, will continue to influence these themes further. ◆

NAVIGATING THE **GEOPOLITICAL LANDSCAPE**

As mentioned throughout this report, the coronavirus impacted virtually all facets of our world, and that's particularly true for geopolitics. Last year, we developed a geopolitical dashboard to serve as a framework for identifying and tracking risks, such as key drivers of economic competition and market volatility. In this year's article, we review and provide updates to many of the potential elements of our dashboard, especially in the context of the pandemic and the U.S. election.

U.S.-China Competition: Here to Stay

In 2020, President Trump banned American companies from working with Chinese firms that may have been collecting personal information of American citizens. As an example, ByteDance's social media app TikTok has been scrutinized in the process, leading to the potential sale of its U.S. operations to Oracle and Walmart.

Since 1953, the Chinese Communist Party (CCP) has implemented a series of five-year plans focused on social and development initiatives. This year, the CCP announced its 14th five-year plan. In the draft of the plan, emphasis was placed on protecting intellectual property rights and advancing R&D with a focus on key technologies, including artificial intelligence and integrated circuits.

President-elect Joe Biden has indicated he intends to address China's abusive practices and intellectual property theft – with a focus on technology and 5G. Biden has made remarks to encourage bipartisan agreement on investments in R&D and education to better enable companies to compete with China.

We believe that U.S.-China competition is here to stay, and in our geopolitical dashboard, we've increased the potential market impact of this competition. We believe it will come into greater focus for investors again once COVID-19 is behind us.

Coronavirus Resurgence: Still Possible

While two vaccines have been approved and possibly more in the coming months, we believe a resurgence of the coronavirus could still occur. How quickly we reach herd immunity and stop the spread of the virus will depend on logistical factors and demand for the vaccine. We expect at least half of the U.S. population to be vaccinated by the end of the first half of 2021

European Fragmentation: Coronavirus Brings Nations Together

As mentioned in our article *The Coronavirus: Impact on Our Major Investment Themes*, the coronavirus accelerated several trends, including protectionist policies. Countries instituted travel restrictions and bans to prevent the spread of the coronavirus and give local citizens a better shot at job openings. Fragmentation in the European Union has been an ongoing concern, but during the pandemic, the region came together with a coordinated response to financially support markets and economies in a time of need.

"We believe that U.S.-China competition is here to stay, and in our geopolitical dashboard, we've increased the potential market impact of this competition."

The EU increased its fiscal response, and the European Central Bank (ECB) provided additional monetary support. Early in the pandemic, the EU passed a 540 billion euro ($591 billion) relief package to support member states, workers, and businesses. Over the summer, EU leaders passed a 750 billion euro ($908 billion) stimulus package to be used across all 27 member states. In addition, the European Council agreed upon a long-term budget plan, totaling 1.074 trillion euros ($1.3 trillion), which will be spent over the next seven years. With regard to monetary support, the ECB began a bond-buying program worth about 1.35 trillion euros ($1.52 trillion), with the ability to further expand support for governments. While fragmentation in Europe remains likely, we believe the recent crisis may have ushered in unity, at least for the time being.

Russia-West Relations: Tensions Increasing

While President Trump has had a more open dialog with Russian President Vladimir Putin, Joe Biden is expected to have a different approach. In the beginning of the Obama administration, Biden supported the opportunity to re-establish open dialog with Russia. However, during his eight years in office, specifically following the annexation of Crimea in 2014, that sentiment changed.

Biden's experiences with Russia as Vice President, along with his references to the country as an opponent, rather than a competitor, lead us to suspect that relations with Russia will be strained under the new administration.

LatAm Populism: A Boost from Coronavirus?

As Latin American countries deal with impacts of the coronavirus pandemic, economic crises remain, and populist leaders continue to lead. Populist presidents were elected in Brazil and Mexico in 2018 and in 2020, respectively, and Bolivia elected a new socialist president in a landslide victory. We are monitoring for a potential shift in Latin America as voters elect new presidents in 2021 in Ecuador, Honduras, Peru, Chile, and Nicaragua, along with Congress and Senate elections in Mexico and Argentina.

U.S.-Europe Relations: Improving

We expect EU leaders are hoping to strengthen relations with the U.S. The Trump administration has been a proponent of bilateral deals and somewhat unpredictable actions. Along with a new agenda, it is expected that the Biden administration will confirm its commitment to NATO and rejoin the Paris climate agreement and the World Health Organization.

Italy Populism: On Shakier Ground

In the early days of the pandemic, Matteo Salvini, a populist and leader of Italy's far-right League Party, tried to use the coronavirus to his advantage. For example, he used Europe border closures to denounce the European Union and deployed propaganda to imply migrants were responsible for the outbreak. The pandemic, however, worked against Salvini, with his public support declining.

While Salvini's populist position has weakened, populism remains present in Italy. There has been an increase in support for the Brothers of Italy, led by Giorgia Meloni, who is just as, and potentially more, right leaning than Salvini.

Salvini's League Party and Meloni's Brothers of Italy have developed relationships with international leaders, and populism continues to gain traction in Italy.

China Trade Tariffs: Phase One Deal Intact

While the Trump and Biden administrations may differ on their approach to trade deals, Biden has communicated he intends to keep intact the Phase One trade deal that President Trump orchestrated with China, along with the tariffs currently in place. Under the current agreement, a 25% tariff remains on $250 billion dollars of Chinese industrial goods, and China maintains more than $100 billion on U.S. goods.

Brexit: Resolved

In January 2020, the United Kingdom agreed to leave the EU and officially entered into a transition period set to end on December 31, 2020. The main focus in the transition was to negotiate a comprehensive trade agreement. During this period, the UK remained a part of the EU's single market and customs union, but disengaged politically. The deadline to extend the transition period was July 1, 2020, and the UK did not agree to an extension. This meant the UK would have to leave the EU by the end of the year with or without a trade agreement.

After several months of negotiation, the UK and the EU reached an agreement in the last week of December that respected to a good degree the "red lines" of both sides. Among other things, the EU avoids a hard border between the Republic of Ireland and Northern Ireland, and the UK gets the "zero tariff, zero quota" on trade in goods. However, the deal will still result in a large increase in border controls and checks when compared to trade among EU members. Future trade-related issues will be resolved by the principle of "managed divergence." This allows either side to retaliate, following a judicial review, if the other side has gained an unfair competitive advantage. At the time of this writing, the deal still remains to be ratified by both the British and European Parliaments and approved by all 27 EU members.

We have removed Brexit from our geopolitical dashboard.

Conclusion

While 2020 was not necessarily a year of heightened geopolitical tensions like in years past, it was a year that could potentially alter the geopolitical landscape in the years ahead. Over the next decade, we expect geopolitics to play an even bigger role as the world wrestles with growing interconnectedness through technology and protectionism. ◆

NAVIGATING THE **GEOPOLITICAL LANDSCAPE**

EVENT	LIKELIHOOD	MARKET IMPACT	DESCRIPTION
European Fragmentation	3	5	European fragmentation remains present; however, the coronavirus has brought nations together.
D.C. Gridlock	4	6	Regardless of the outcome of the Georgia Senate runoff, we see the scope for significant legislative changes more limited.
U.S.-Europe Relations	4	7	Still a strategic ally; however, relationship occasionally challenged via NATO and tariffs. Joe Biden's presidency may improve relations.
North Korea Conflict	5	3	Denuclearization is still in the works. China remains a liaison between U.S. and North Korea.
Hong Kong Tensions	5	5	Tensions between Hong Kong and China have risen significantly over the last few years and are likely to remain elevated.
Italy Populism	5	5	While Salvini's populist position has weakened, populism remains present in Italy. There has been an increase in support for the Brothers of Italy, led by Giorgia Meloni, who is just as, and potentially more, right than Salvini.
China Trade Tariffs	5	9	Phase One trade deal has been agreed upon. Joe Biden has indicated he intends to address China's abusive practices but intends to keep the Phase One trade deal and current tariffs in place.
LatAm Populism	6	3	Populism remains a driver in Latin America, and anti-establishment policies may impact investor confidence. The coronvirus may further boost populism in Latin America.
South China Sea Conflict	6	4	China expands activity on Spratly Islands, a crucial international shipping route. Potential for military clash with U.S.
Major Terror Attacks	6	4	Terrorist attacks are unpredictable events that may pose disruption.
Cyberattacks	7	4	As society becomes more digitized, the world is more prone to attacks via hacking.
Coronavirus Resurgence	7	9	While the coronavirus continues to spread, countries have begun to reopen their economies. Vaccines have been developed and distributed. Manufacturing capabilities may impact the speed of distribution.
Gulf Tensions	8	4	Tensions in the Gulf region have somewhat subsided in 2020, though they could spark back up at any point.
Russia - West Relations	8	5	Russia and the U.S. appear to be coexisting but continue to fight for power through proxies. Joe Biden's presidency may increase tensions further.
U.S.-China Competition	10	7	Competition for global leadership will impact markets; tech will continue to play important role.

HANDLING UNCERTAINTY AND UNKNOWNS WITH **BEHAVIORAL FINANCE**

2020 felt like an emotional roller coaster ride amidst all the uncertainty and unknowns. This was true for the average investor, who went from feeling euphoric during the February all-time high for the S&P 500 to hitting the panic button as the market then corrected at the fastest pace on record. Our behavioral biases are elevated during times of stress and uncertainty such as these, leading us to make emotionally driven decisions. Such decisions may feel right at the moment, but might not be the best course of action and could hurt in the long run. As we embark on a path to normalcy, we have the opportunity to remind ourselves of the lessons learned and how we, as investors, can navigate the short term while holding to our long-term plan. So how might behavioral finance help?

Well, behavioral finance combines psychology with finance to understand the connections between the markets and an individual's emotions, their identities, and the decisions they make. Human beings don't always make rational investing decisions, as they are largely influenced by their emotions. Have you ever wondered why investors "buy high and sell low?" Or why do people who love a good sale in another part of their life shy away from deeply discounted investments?

How do we manage our emotions during challenging times?
We believe a good approach is to start by becoming more familiar with these common investor biases. Second, we should try to think about how we would feel, or personally react, in a stressful situation. Then third, we should review and refine our investment plan that seeks both long-term success and emotional resilience.

> **The investor's chief problem – even his worst enemy – is likely to be himself.**
>
> *– Benjamin Graham*

Step 1: Familiarize Yourself With Common Investor Biases

THE FIVE MOST COMMON INVESTOR BIASES

Loss Aversion
Most investors have a natural aversion to losing money, but studies indicate that losses have a much stronger impact on preferences than do gains. **People care a lot more about losing a dollar than they do about making a dollar.** Investors subject to this bias could panic sell during sharp market declines.

Herd Mentality
The herd behavior is usually when individuals tend to behave like the larger group they are associated with. **Individually, they might not have necessarily made those choices.** Common reasons for this may include acceptance by the group, member influence (positive or negative), or the idea that large groups could not be wrong.

Recency Bias
Another common bias is recency bias, where **we most easily remember something that has happened recently,** and this feeling makes us uncomfortable. During volatile periods, investors are vulnerable to short-term decision-making that could undermine their long-term success.

Availablity Bias
The more you see information repeated, the more you think that information will be true without reviewing other potential outcomes.

Hindsight Bias
Investors acting in the heat of the moment might regret actions taken later on, or **some of those decisions might seem irrational in hindsight**.

HANDLING UNCERTAINTY AND UNKNOWNS WITH **BEHAVIORAL FINANCE**

Step 2: Know Yourself

Each investor brings a different set of interests and priorities to investing. While some may want to be actively involved in the market and might react strongly to market swings, others are less interested in playing an active role. At Stifel, we use some basic principles of behavioral finance to understand how someone will likely react to various investment strategies and market conditions. Through our Financial ID questionnaire, our clients can draw upon our six-dimensional model, which focuses on analyzing risk attitudes and decision-making preferences.

One such measure is labeled **Composure**, which measures an investor's ability to withstand short-term market swings. Investors who react strongly to short-term market fluctuations typically get stressed or anxious and have the urge to react. This can be detrimental to long-term success.

Another measure worth highlighting is **Belief in Skill,** which is an investor's general conviction in professional investment expertise. Such expertise may focus on generating big "upside" returns, or it may focus on providing downside protection, like when a skilled manager keeps losses to -6% in a market posting a -10% return. Downside protection can be very comforting for, and therefore valued by, certain investors. An investor with high Belief in Skill would likely prefer an actively managed portfolio and be more willing to pay for these services. An investor with low Belief in Skill would prefer a passive, lower-cost portfolio. An investor who is more neutral on this dimension may prefer a balanced approach.

Step 3: Refine Your Plan to Overcome Behavioral Biases

After learning about common investor biases and self-evaluation, perhaps with our Financial ID model, it's time to review the investment plan to consider possible adjustments. For example, an investor with low Composure could hold a little more cash to provide some cushion or consider investing in strategies that seek downside protection. As another consideration, we also recommend rebalancing portfolios, a routine process to "sell winners," which helps us overcome some behavioral biases.

In any event, as shared in our 2021 Outlook article *Tenets of an Investment Strategy*, an investment plan is best designed in consideration of one's objectives, risk tolerance, liquidity needs, and behavioral preferences. Such a plan is most often implemented with a well-diversified portfolio of products and securities invested across multiple asset classes. By incorporating behavioral principles and practical applications such as the Financial ID, the investor can customize the plan and be better equipped to handle volatility, like that experienced in 2020. ◆

STIFEL'S **BEHAVIORAL FINANCE**

Stifel's behavioral finance capabilities synthesize academic insights from behavioral finance, representing practical applications to help clients have a comfortable investment journey, despite market uncertainties and periods of heightened volatility.

The Stifel Financial ID (SFID) is a simple questionnaire that enables us to build a highly detailed profile of your decision-making preferences and attitudes to risk. SFID's six key indicators reveal how you think and feel about investing. Understanding them can help you make better investment decisions.

To learn more about the Financial ID and our behavioral finance capabilities, speak with your Stifel Financial Advisor.

TENETS OF AN **INVESTMENT STRATEGY**

As you review this Outlook 2021 report, you may be thinking about developing or refining your investment strategy. Here are four important considerations as you do so:

1 DEFINE GOALS AND OBJECTIVES

Most often, people invest to meet certain goals and objectives. Yours might include achieving a certain income to support your retirement or lifestyle, funding a child's education, or accumulating capital for a large purchase. And these goals and objectives are usually personal, relating more to life than to the markets. So, you will be well served to clearly define the goals and objectives of your investment portfolio.

2 BE DIVERSIFIED

There is no one "ideal" asset allocation strategy, given your goals and other factors like time horizon and risk tolerance. And your investment strategy will benefit from diversification, which is designed to reduce your portfolio's overall risk, when compared to less diversified investments. Diversification can be achieved by investing in multiple asset classes, such as stocks, bonds, and cash, with a well-defined asset allocation strategy. Diversification may be enhanced by being diversified within each asset class.

3 ALIGN IMPLEMENTATION

Your Stifel Financial Advisor can work with you to implement the asset allocation strategy you adopt. Your investments might include individual stocks or bonds, mutual funds, exchange traded funds, separately managed accounts, or even alternative investments. The key is to build allocations to these investment opportunities in a way that aligns with your asset classes in your asset allocation strategy.

4 REVIEW AND REFINE

You can also work with your Stifel Financial Advisor to review the results of your strategy from time to time, keeping in mind your goals and objectives. In periods of increased volatility and uncertainty, as we saw this year, engaging your Financial Advisor can really help. By doing so, you may avoid making emotional decisions, keeping perspective and focus on your long-term investment plan. And as markets change and/or your goals and objectives evolve, you and your Financial Advisor may choose to refine your investment strategy over time.

STIFEL'S APPROACH TO **ASSET ALLOCATION**

Typically, your Stifel Financial Advisor will work with you to develop an asset allocation mix strategy based on your unique objectives. Behind the scenes, he or she will consult with us – the Investment Strategy Team – to help refine the investment mix that is appropriate for you. The following describes an asset allocation framework we provide to your Financial Advisor.

First, your Financial Advisor will work with you to identify an appropriate risk profile, ranging from conservative to aggressive. Then three other important choices are discussed: the equity strategy, the fixed income strategy, and liquidity preferences.

U.S.-Focused Versus Global Equity: We provide two choices for the asset mix equity strategy. The U.S.-Focused offering is designed for clients who prefer to balance their non-U.S. equity exposure with a preference for U.S. stocks. In this case, the U.S./non-U.S. mix is approximately 70%/30%. For clients who prefer more global exposure, we seek to align the U.S. exposure with the U.S. market capitalization in the global equity market, resulting in an approximate U.S./non-U.S. mix of 55%/45%.

Taxable Versus Tax-Sensitive Fixed Income: We provide two choices for the asset mix fixed income strategy. The Taxable offering invests in taxable bonds and is most often used by entities that do not pay income taxes, such as private foundations. The Tax-Sensitive offering assumes the investor is paying income taxes, and therefore, focuses the majority of its fixed income exposure in tax-advantaged bonds like municipals.

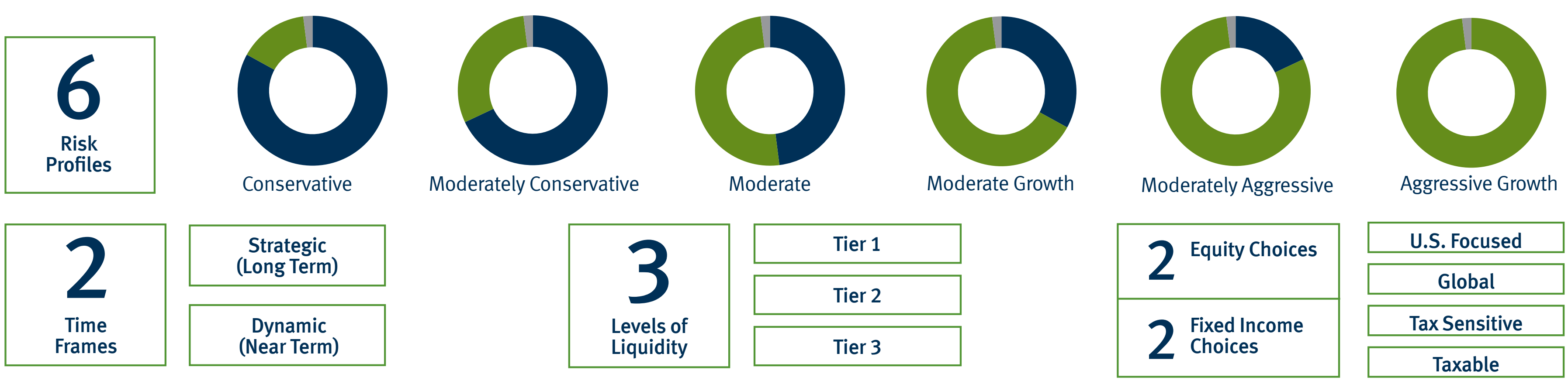
Liquidity Tiers: We offer three liquidity tiers in our asset allocation guidance offering.

The most liquid tier, ***tier one,*** includes investment exposure to publicly traded markets that can generally be sold, if needed, and excludes alternative investments.

Our ***second liquidity tier*** exposes a small percentage of the portfolio to hedge funds, products sometimes available in a limited partner (LP) format. These funds sometimes require a one-year lock-up, usually with quarterly redemption terms after that. In any case, redeeming such an LP position requires advance notice and is subject to general redemption terms of the specific LP.

Our ***third liquidity tier***, often most appealing to institutional or ultra-high-net-worth investors with less need for liquidity, builds up the allocation to alternative investments by adding positions in the private markets, such as private equity, private debt, or private real estate. Such investments usually require a lock-up of the invested capital.

And finally, your Financial Advisor can work with you to elect to invest in a Strategic Asset mix, designed as a diversified strategy for the long term. Or, you can choose to invest in our Dynamic Asset mix guidance, where we will adjust our strategic leanings in consideration of shorter-term views.



STIFEL **GUIDANCE**

The Stifel CIO Office develops economic and market analysis, and corresponding investment guidance, for the benefit of Stifel clients. Below is a brief overview of our work, along with some helpful links.

DAILY

Through our association with iHeartRadio, we broadcast **Stifel Investor Insights**, offering perspectives each day.

WEEKLY

Market Sight|Lines is a weekly note designed to help clients and colleagues focus on key insights amid the roar of market noise. We also share a corresponding **video summary** and a podcast available here: **Spotify**, **Apple**, **Omny**, **Google**.

Market Pulse provides an update shortly after the market close on days the S&P 500 Index moves up or down 2%.

The Investment Strategy Brief is a monthly **video series** sharing our thinking on the current economic and market environment, as well as related investment guidance. A slide deck is also provided, and the podcast is available here: **Spotify**, **Apple**, **Omny**, **Google**.

WEEKLY, MONTHLY, AND QUARTERLY

The **weekly**, **monthly**, and **quarterly** **Market Perspectives** provide a recap of the most recent period's global market results.

MONTHLY

The monthly **Favorite 15** shares useful information from our favorite 15 slides for the month.

Michael O'Keeffe sits down with leaders at Stifel and in the finance industry for thought-provoking conversations related to the finance industry in the monthly podcast **Conversations with Michael O'Keeffe**.

QUARTERLY

Stifel's **Allocation Insights** provides our thinking on our dynamic asset allocation leanings given the current economic and market environment.

ANNUAL

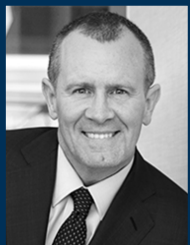
Stifel **Outlook** provides our views for the year ahead and related articles.

ADDITIONAL RESOURCES

Stifel's Approach to Asset Allocation summarizes our asset allocation approach and provides a catalogue of various recommended asset mix models.

The Stifel **Financial ID** **video series** provides an overview of our work in behavioral finance and the related Stifel Financial ID model.

CIO OFFICE



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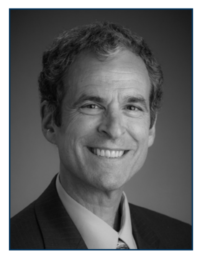

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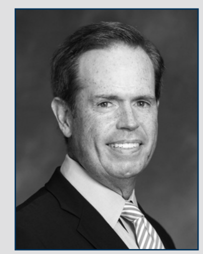

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INDEX DESCRIPTIONS

The **Standard & Poor's 500 Index** is a capitalization-weighted index that is generally considered representative of the U.S. large capitalization market.

The **Dow Jones Industrial Average (DJIA)** is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the NASDAQ.

The **Russell 1000** is a subset of the Russell 3000 Index. It represents the top companies by market capitalization. The Russell 1000 typically comprises approximately 90% of the total market capitalization of all listed U.S. stocks.

The **Russell 2000 Index** measures the performance of the 2,000 smallest companies in the broader Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

The **Russell 2500 Index** measures the performance of the 2,500 smallest companies in the broader Russell 3000 Index, which measures the performance of the 3,000 largest U.S. companies based on total market capitalization.

The **Russell Microcap** is defined as a capitalization-weighted index of 2,000 small cap and micro cap stocks that captures the smallest 1,000 companies in the Russell 2000, plus 1,000 smaller U.S.-based listed stocks.

The **Dow Jones U.S. Select Dividend Index** aims to represent the U.S.'s leading stocks by dividend yield.

The **S&P 500 Dividend Aristocrats®** measures the performance of S&P 500 companies that have increased dividends every year for the last 25 consecutive years. The Index treats each constituent as a distinct investment opportunity without regard to its size by equally weighting each company.

The **S&P 500 Health Care Index** comprises those companies included in the S&P 500 that are classified as members of the GICS® health care sector.

The **Euro STOXX 50® Index** represents the performance of the 50 largest companies among the 19 supersectors in terms of free-float market capitalization in 11 Eurozone countries.

The **Nikkei 225 Index** is a price-weighted index of the 225 top Japanese companies listed in the Tokyo Stock Exchange.

The **MSCI EAFE Index** (Europe, Australasia, and the Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the U.S. and Canada.

The **MSCI EM (Emerging Markets) Europe, Middle East, and Africa Index** is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of the emerging market countries of Europe, the Middle East, and Africa.

The **MSCI Europe Index** is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of the developed markets in Europe.

The **MSCI World Index** is a free float-adjusted market capitalization-weighted index that is designed to measure the equity market performance of developed markets.

The **MSCI AC World Index** is comprised of equity securities belonging to 23 developed markets and 24 emerging markets countries.

The **Bloomberg Barclays U.S. Treasury Bills Index** includes U.S. Treasury Bills that have a remaining maturity from one month up to (but not including) 12 months. It excludes zero coupon strips.

The **Bloomberg Barclays Global Aggregate Index** is market value-weighted inclusive of accrued interest and covers the most liquid portion of the global investment- grade fixed-rate bond market, including government, credit, and collateralized securities.

The Bloomberg Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related, and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and nonagency). Provided the necessary inclusion rules are met, U.S. Aggregate-eligible securities also contribute to the multicurrency Global Aggregate Index and the U.S. Universal Index, which includes high yield and emerging markets debt.

The **Bloomberg Barclays U.S. Government/Credit Index** includes all bonds that are in the Barclays Government Bond Index and the Barclays Credit Bond Index. The Barclays Government Bond Index is a measurement of all publicly issued debt securities issued by the U.S. government or its agencies, as well as quasi-federal corporations or corporate debt guaranteed by the U.S. government. The Barclays Credit Bond Index includes all publicly issued, fixed rate, nonconvertible investment-grade, dollar-denominated, SEC-registered corporate debt.

The **Bloomberg Barclays Mortgage-Backed Securities Index** is a measurement of the movement of the 15- and 30-year fixed rate securities backed by mortgage pools of the Government National Mortgage Association (GNMA), the Federal Home Loan Mortgage Corporation (FHLMC), and the Federal National Mortgage Association (FNMA). All returns are market value-weighted inclusive of accrued interest.

The **Bloomberg Barclays U.S. Corporate High-Yield Bond Index** covers the U.S. dollar-denominated, non-investment-grade, fixed rate, taxable corporate bond market. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below. The index excludes emerging markets debt. The U.S. Corporate High-Yield Bond Index is part of the U.S. Universal and Global High-Yield Indices.

The **Bloomberg Barclays U.S. Municipal Bond Index** covers the U.S. dollar-denominated long-term, tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

The **Credit Suisse Leveraged Loan Index** tracks the investable market of the U.S. dollar-denominated leveraged loan market. It consists of issues rated "5B" or lower, meaning that the highest rated issues included in this index are Moody's/S&P ratings of Baa1/BB+ or Ba1/BBB+. All loans are funded term loans with a tenor of at least one year and are made by issuers domiciled in developed countries.

The **Dow Jones U.S. Select REIT Index** intends to measure the performance of publicly traded REITs and REIT-like securities. The index is a subset of the Dow Jones U.S. Select Real Estate Securities Index (RESI), which represents equity real estate investment trusts (REITs) and real estate operating companies (REOCs) traded in the U.S. The indices are designed to serve as proxies for direct real estate investment, in part by excluding companies whose performance may be driven by factors other than the value of real estate.

The **BofA Merrill Lynch Adjustable Rate Preferred Securities Index** tracks the performance of U.S. dollar-denominated investment-grade floating rate preferred securities publicly issued in the U.S. domestic market. Qualifying securities must have an investment-grade rating (based on an average of Moody's, S&P, and Fitch) and must have an investment-grade-rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long-term sovereign debt ratings).

The **BofA Merrill Lynch Core Plus Fixed Rate Preferred Securities Index** tracks the performance of fixed rate U.S. dollar-denominated preferred securities issued in the U.S. domestic market. Qualifying securities must be

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rated at least B3 (based on an average of Moody's, S&P, and Fitch) and must have an investment grade-rated country of risk (based on an average of Moody's, S&P, and Fitch foreign currency long-term sovereign debt ratings).

The **BofA Merrill Lynch U.S. High Yield Master II Index** is a market value-weighted index of all domestic and Yankee (bonds denominated in U.S. dollars and issued in the U.S. by foreign entities) high-yield bonds, including deferred interest bonds and payment-in-kind securities.

The **Bloomberg Commodity Index** ("BCOM" or the "Index") is designed to be a highly liquid and diversified benchmark for commodity investments.

The **HFRI Fund Weighted Composite Index** is an equal-weighted index utilized by numerous hedge fund managers as a benchmark for their own hedge funds. All single-manager HFRI Index constituents are included in the HFRI Fund Weighted Composite Index, which accounts for over 2,200 funds listed on the HFR database. Funds included in the index must report monthly returns, report net of all fees returns, report assets in U.S. dollars, and have at least $50 million under management or have been actively trading for at least 12 months.

Cash & Cash Equivalents is represented by the Bloomberg Barclays U.S. Treasury 3-6 Months Bill Index, comprised of treasury bills issued by the U.S. government with less than one year to maturity.

U.S. Gov't Bonds is represented by the Bloomberg Barclays U.S. Government Bond Index, comprised of the U.S. Treasury and U.S. Agency indexes.

U.S. Corp IG Bonds is represented by the Bloomberg Barclays U.S. Corporate Bond Index, comprised of the investment grade, fixed-rate, taxable corporate bond market.

High Yield Bonds is represented by the Bloomberg Barclays U.S. Corporate High Yield Bond Index, comprised of U.S. dollar-denominated, high yield, fixed-rate corporate bond market securities.

U.S. LC (Large Cap) equities is represented by Russell 1000 Index, comprised of 1,000 of the largest U.S. securities based on a combination of their market cap and current index membership.

U.S. SC (Small Cap) equities is represented by the Russell 2000 Index, comprised of 2,000 of the smallest U.S. securities based on a combination of their market cap and current index membership.

Dev Int'l Equities is represented by the MSCI EAFE Index, comprised of equity securities that belong to markets outside of the U.S. and Canada.

EM Equities is represented by the MSCI EM Index, comprised of equity securities that belong to emerging markets.

Moderate Bench stands for moderate benchmark portfolio return, which is a blended portfolio of stocks (60% weight, represented by MSCI AC World Index) and bonds (40% weight, represented by Bloomberg Barclays U.S. Government/Credit Index).

Indices are unmanaged, do not reflect fees and expenses, and you cannot invest directly in an index.

DISCLOSURE

Asset Class Risks and Description of Terms

Bonds – Bonds are subject to market, interest rate, and credit risk. Prices on bonds and other interest rate-sensitive securities will decline as interest rates rise. Municipal bonds may be subject to state and alternative minimum taxes, and capital gains taxes may apply. High yield bonds have greater credit risk than higher quality bonds. Bond laddering does not assure a profit or protect against loss in a declining market. Yields and market values will fluctuate, and if sold prior to maturity, bonds may be worth more or less than the original investment.

Cash Equivalents – Portfolios that invest in very short-term securities provide taxable or tax-advantaged current income, pose little risk to principal, and offer the ability to convert the investment into cash quickly. These investments may result in a lower yield than would be available from investments with a lower quality or longer term.

Duration – Duration is a measure of the sensitivity of the price – the value of principal – of a fixed-income investment to a change in interest rates. Duration is expressed as a number of years.

Equities – Portfolios that emphasize stocks may involve price fluctuations as stock market conditions change. Small and mid capitalization stocks are typically more volatile and carry additional risks, since smaller companies generally are not as well established as larger companies.

International/Global Investing/Emerging Markets – There are special considerations associated with international and global investing, including the risk of currency fluctuations and political and economic events. Investing in emerging markets may involve greater risk and volatility than investing in more developed countries.

Alternative Investments or Non-Traditional Assets – Alternative investments may include, but are not limited to: Real Estate Investment Trusts (REITs), Commodities, Futures, Hedge Funds, Venture Capital, Limited Partnerships, Private Equity, etc.

Real Estate – When investing in real estate companies, property values can fall due to environmental, economic, or other reasons, and changes in interest rates can negatively impact the performance.

Commodities and Futures – The risk of loss in trading commodities and futures can be substantial. You should therefore carefully consider whether such trading is suitable for you in light of your financial condition. The high degree of leverage that is often obtainable in commodity trading can work against you as well as for you. The use of leverage can lead to large losses as well as gains.

Hedge Funds – Investors should be aware that hedge funds often engage in leverage, short- selling, arbitrage, hedging, derivatives, and other speculative investment practices that may increase investment loss. Hedge funds can be highly illiquid, are not required to provide periodic pricing or valuation information to investors, and often charge high fees that can erode performance. Additionally, they may involve complex tax structures and delays in distributing tax information. While hedge funds may appear similar to mutual funds, they are not necessarily subject to the same regulatory requirements as mutual funds.

Venture Capital – Venture capital investments involve substantial risks. The risks associated with investing in companies in the start-up or expansion stages of development are greater than those of companies in later stages, because the companies' business concepts generally are unproven and the companies have little or no track record.

Limited Partnerships – Generally, limited partnership investments are suitable only for a narrow class of relatively sophisticated investors. Limited partnership investments may be speculative in nature and be subject to resale restrictions or illiquidity. An investment is appropriate only for investors who have the capacity to absorb a loss of some or all of their investment.

Private Equity – Private equity funds are not appropriate for all investors. Investors should be aware that private equity funds may contain speculative investment practices that can lead to a loss of the entire investment. Private equity funds may invest in entities in which no secondary market exists and, as such, may be highly illiquid. The funds are not required to provide periodic pricing or valuation information to investors and often charge high fees that can erode performance. Additionally, they may involve complex tax structures and delays in distributing tax information.

Mutual Funds and Exchange Traded Funds – The investment return and principal value of an investment in funds will fluctuate, so that an investor's shares, when redeemed, may be worth more or less than their original cost. ETFs trade like a stock and may trade for less than their net asset value. There will be brokerage commissions associated with buying and selling exchange traded funds unless trading occurs in a fee-based account.

Standard Deviation – Standard deviation is a measure of the dispersion of a set of data from its mean. It is calculated as the square root of variance by determining the variation between each data point relative to the mean. If the data points are further from the mean, there is higher deviation within the data set.

Risk Profiles

RP 1 Conservative – A conservative investor values protecting principal over seeking appreciation. This investor is comfortable accepting lower returns in exchange for a higher degree of liquidity and/or stability. Typically, a Conservative investor primarily seeks to minimize risk and loss of principal.

RP 2 Moderately Conservative – A moderately conservative investor values principal preservation, but is comfortable accepting a small degree of risk and volatility to seek some degree of appreciation. This investor desires greater liquidity, is willing to accept lower returns, and is willing to accept minimal losses.

RP 3 Moderate – A moderate investor values reducing risks and enhancing returns equally. This investor is willing to accept modest risks to seek higher long-term returns. A moderate investor may endure a short-term loss of principal and lower degree of liquidity in exchange for long-term appreciation.

RP 4 Moderate Growth – A moderate growth investor values higher long-term returns and is willing to accept considerable risk. This investor is comfortable with short-term fluctuations in exchange for seeking long-term appreciation. The moderate growth investor is willing to endure larger short-term losses of principal in exchange for the potential of higher long-term returns. Liquidity is a secondary concern to a moderate growth investor.

RP 5 Moderately Aggressive – A moderately aggressive investor primarily values higher long-term returns and is willing to accept significant risk. This investor believes higher long-term returns are more important than protecting principal. A moderately aggressive investor may endure large losses in favor of potentially higher long-term returns. Liquidity may not be a concern to a moderately aggressive investor.

RP 6 Aggressive – An aggressive investor values maximizing returns and is willing to accept substantial risk. This investor believes maximizing long-term returns is more important than protecting principal. An aggressive investor may endure extensive volatility and significant losses. Liquidity is generally not a concern to an aggressive investor.

A Note on Risk Assessments

The Stifel Financial ID ("SFID") is a proprietary questionnaire which helps us understand an investor's attitudes toward and emotions about investing. We can use a client's Financial ID to help manage his/her/their investing experience. "Risk Attitude" is one of the six dimensions we measure. It is a behavioral assessment of the individual's feelings and appetite for risk. Separately, we use a dedicated Risk Assessment Questionnaire

("RAQ"), which is an industry-standard requirement, in the process of opening and maintaining any account here at Stifel. The RAQ results in a specific "Risk Tolerance" score based on such considerations as time horizon, income requirements, and liquidity a need, which is used to describe a specific account's investment objective and to determine the suitability of any given investment for that account. In the situations where a client's Risk Attitude and the Risk Tolerance for that client's account(s) is (are) different, it is important to review them both to determine whether changes in the management of the account are warranted.

Important Notes and Disclosures

The recommendations made for your actual portfolio will differ from any asset allocation or strategies outlined in this document. The model portfolios are not available to investors since they represent investment ideas, which are general in nature, and do not include fees. Your asset allocation will be customized to your preferences and risk tolerance, and you will be charged fees. You should ensure that your portfolio is updated or redefined when your investment objectives or personal circumstances change.

Diversification and asset allocation do not ensure a profit or guarantee against losses. Investing involves risk, including the possible loss of principal. Any data on past performance contained herein is no indication as to future performance. The value of any investment may fluctuate as a result of market changes. The information in this document is not intended to predict actual results, and no assurances are given with respect thereto.

Assumptions are estimates based on historic performance and an evaluation of the current market environment. References to future expected returns and performance do not constitute a promise of performance for any asset class or investment strategy, nor should they be relied on as advice or interpreted as a recommendation to engage in the purchase or sale of any security or financial product. The assumptions are subjective estimates based on circumstances and events that may not occur. Further, any valuations given in this document may not accurately reflect the values at which investments may actually be bought or sold, and no allowance has been made for taxation.

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Led by Stifel Chief Investment Officer Michael O'Keeffe, the Stifel CIO Office is comprised of several investment professionals. The team works collaboratively with other Stifel professionals to develop macroeconomic analysis, market analysis, strategic and dynamic asset allocation guidance, applied behavioral finance, and specific investment solutions for advisors and clients.

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