2020: YEAR IN REVIEW

Toilet paper, masks, distance learning, virtual celebrations, drive by birthdays. Furloughs, unemployment, unprecedented market volatility, historic GDP growth swings, racial and political tensions. 2020 brought many changes and even more challenges, with many looking forward to closing the chapter on the year and heading into 2021.

Employers were faced with unique and complicated challenges this year, including workplace physical and mental wellness, managing a remote workforce, how to handle leave and sick pay in a pandemic, and the strain on business from related closings or restrictions.

COVID-19

Simply stated, the year 2020 was dominated by COVID-19. While vaccines began to be dispersed and administered, many countries in the world are experiencing second or third waves of spikes in cases in these colder months. As of December 25th, the global death toll had reached 1,744,924, with 19% (329,118) from the United States alone. The total number of confirmed cases reached 79,517,673 globally, with the United States accounting for 23% (18,657,518).

Pneumonia-like cases in Wuhan, China were announced by the World Health Organization (WHO) back on January 9th, stemming from a novel coronavirus. The CDC began screening at three U.S airports on January 20th, after additional cases were reported in Japan. The next day, the CDC confirmed the first person in the US with a confirmed case, a resident of Washington state, the same day a Chinese scientist confirms COVID-19 human transmission. As of this point, the novel virus had killed 4 and infected 200, and two days later the numbers were 19 and 500, respectively. China made the unprecedented move to not only close off Wuhan and its 11 million residents, but restricted Huanggang, another city in China. By January 31st, the WHO declares a public health emergency, their sixth ever declared. California became the first state to issue a stay-at-home order on March 19th, while "flatten the curve" became a frequently heard phrase. The Senate passed the Coronavirus Aid, Relief, and Economic Security (CARES) Act on March 26th, with the House of Representatives approving and President Trump signing into law on March 27th. The CARES Act provided $2 trillion in aid to hospitals, small businesses, and state and local government. As of the end of April, 26.5 million Americans had filed for unemployment since mid-March. A month later on May 28th, the US passed the 100,000 deaths mark, with total cases reaching 2 million on June 10th. The US surpassed 3 million infections on July 7th, the same day the nation announced its withdrawal from WHO, citing its response to the global pandemic. The summer saw many states pause or reverse opening plans.

Vaccine trials began in March, and Operation Warp Speed was announced on May 15th. This interagency program allows for faster distribution of vaccines as multiple vaccines were mass produced ahead of final clinical trial phases, anticipating not all would prove safe or effective and in turn would not be used. A turning point occurred after Pfizer published their vaccine trial results on November 9th, showing the vaccination was 90% effective. A week later, Moderna revealed that their vaccine was 94.5% effective. Both Moderna and Pfizer use an innovative mRNA approach, which has not yet been used in approved vaccines against other diseases. A week after the Moderna announcement, on November 18th, BioNTech announced their trial results, stating a 95% efficacy rate. Two days later both Pfizer and BioNTech submitted their vaccines to their FDA in order to distribute prior to year-end.

As progress was made on effective vaccines, cases grew domestically and globally. Globally, deaths passed the 1 million mark on September 28th. Global cases passed the 40 million mark on October 19th, with the United States remaining the hardest hit country.

In December, the FDA approved three vaccines just as a new, more contagious strain of the virus was detected in the UK, then later found in the United States. By the end of the year, 2.8 million people had received the first of the two doses needed of the vaccine, far below the 20 million projected earlier.

Work from Home

Work, travel, and shopping behaviors were some of the first major pandemic-related changes in daily lives. While not every industry is able to continue to operate with most of their staff remote, many employers quickly shifted in March, with 35% of those employed working from home per the U.S. Bureau of Labor Statistics ("BLS"), (BLS, 2020). The BLS estimates that 37% of U.S. jobs can be performed entirely at home, while the remaining 63% require significant onsite presence. (BLS, 2020) As of November 2020, 22% are still largely in a work from home environment (BLS, 2020). While this shift helped the lockdown last in the spring, it led to new challenges for both employers and employees. Many Americans lack the appropriate facilities or internet capacity to work effectively at home. This could be widening the inequality gap, as many more educated, higher earning employees are more likely to be able to work from home and continue to get paid and advance their careers, while those that are unable to work from home either due to the nature of their job or their facilities or internet capacity, are being left behind. Since the start of the year, 60% of employers who paid an average wage of less than $20,000 told at least some employees not to work, as compared to 39% of employers paying an average wage greater than $80,000 (BLS, 2020).

A survey on the work from home operations was conducted in July and found 62% of those working remotely were doing so with other people in their home. Only 59% were doing so at a desk, and only 29% were in a home office. (Nulab, 2020). Those able to work at a desk were unsurprisingly more productive than those that are not. New frustrations cropped up in this environment, including the remote workforce feeling disconnected as well as the clash of personal and professional demands.

A shift out of cities and into the suburbs and rural areas could be another consequence of work from home. This of course has negative impacts on office space, real estate, restaurants, and bars in these urban areas, but the opposite effect on those suburbs and rural areas that may see a population shift.

The Election

In 2019, the 2020 election was touted as the event of the year. True to form, Covid-19 stole the show. The election looked different in many ways during 2020, including adjustments to rallies and other political gatherings and modifications to absentee ballot and mail-in voting for many states. Seeds of doubt were planted about the election process, and the probability of a contested outcome increased. Throughout early fall, the markets fretted about the election, however, despite delayed results and despite the numerous lawsuits President Trump's camp filed, the markets rallied in November and December on positive vaccine efficacies and the election results.

Pandemic-Induced Bear Market

Market volatility had been relatively calm at the beginning of 2020 as it was for much of 2019. Interest rates remained low, inflation was held in check, unemployment was at a 50-year low, record-setting economic expansion had continued since the Great Recession, corporate profits were projected to rebound, and a Phase One trade agreement between the U.S. and China was finally in the home stretch. The U.S. and China signed the Phase One trade deal on January 15th, just five days before Chinese President Xi Jingping officially announced to the world that an outbreak of the coronavirus was spreading in Wuhan, China. U.S. equity markets initially discounted the seriousness that the virus could rapidly spread to the U.S. and the markets reached new highs into February. However, as the virus began to spread within the U.S., the February market highs were quickly erased as the global economy abruptly plunged into a deep recession amidst the world shutting down to fight the COVID-19 outbreak. The sharp downturn ended the longest running-bull market and economic expansion in U.S. history, as equity markets swiftly moved into a bear market territory, defined as a decline of at least 20% from a recent market peak. Investors feared the devastating impact of the pandemic-induced social distancing measures, the resulting economic and earnings recession, and the collapse of energy prices. It took the S&P 500 price index only 23 trading days to fall 34% from its February 19th record high, making it the fastest drop of this magnitude in history. With an uncertain economic outlook, the markets experienced record high market swings in March, with average daily moves of plus or minus 5%, not witnessed since the Great Depression. Most notably, the Dow Jones Industrial Average, the NASDAQ Composite, and the S&P 500 all fell by 12-13% on March 16th, with the Dow suffering its largest one-day drop on a point basis, declining nearly 3,000 points, as coronavirus fears gripped investors. On April 19th, futures contracts for oil turned negative for the first time in history, showing a complete demand collapse and futures prices falling more than 100%, meaning producers would have to pay traders to take the oil off their hands.

On the path to market recovery

After a sudden market downturn in the first quarter, the markets staged a remarkable comeback. The combined strength of a united fiscal and monetary response flooded financial markets with abundant liquidity and provided support for stocks to swiftly bounce back in April. Despite deteriorating economic data and a disturbing spike in unemployment, especially in the hard-hit industries such as restaurants, lodging, and transportation, equities experienced one of the strongest and quickest recoveries in history. The rebound from the late-March lows marked the shortest bear market in history (1 month) and clocked the fastest round trip back to all-time highs (181 days). For five consecutive months following the market downturn in the first quarter, stocks posted positive returns and set records, fueled by a broader reopening of businesses, a steadily improving economic outlook, better-than-expected corporate profits, a low interest rate environment, and solid progress in vaccine development. The S&P 500 experienced its shortest-ever bear market with a remarkable 35% surge between April and August, its best five-month period since 1938.

Subsequently, domestic equities retreated in September and October as investors shifted their focus to the uncertainty surrounding the U.S. presidential election, the legislative stalemate over coronavirus aid, and rising COVID-19 infection rates. The S&P 500 dropped close to correction territory with a 9.6% plunge in a three-week span during September, before surging again into the end of the year. November's furious rally carried into December, as markets managed to reach new all-time highs thanks to advances on the vaccine front and hopes for economic normalization in 2021. The S&P 500 rose nearly 68% from its March lows to close the year, with an 18.4% annualized return in 2020. Another catalyst for the recent market surge was the approval of a new aid package in response to the pandemic. President Trump signed a $900 billion coronavirus relief package into law on December 27th, which included enhanced federal unemployment benefits, another round of direct payment to households, and money for small businesses, schools, and vaccine distribution. The second round of fiscal stimulus package is expected to offer aid to those that were hit the hardest by the pandemic and bolster the economic recovery. The U.S. stock market reached new record highs to close 2020 and investors are optimistic about getting to the other side of the pandemic chasm, however the risk remains that negative news could cause near-term market volatility, as the virus continues to spread rapidly during the winter months.

Decoupling of Economic Data and Wall Street

We witnessed a disconnect between the gradual recovery of the labor market and the economic activities compared to the rapid comeback of the stock market in 2020. Investors often expect when the economy dips into a recession and slowly recovers from the downturn, stock market movements would mirror the current economic conditions. Although most recent jobs report demonstrated an improvement with the unemployment rate edging down to 6.7% in December from a peak of 14.7% in April, the pace of progress slowed noticeably in recent months as discouraged workers dropped out of the labor force. Furthermore, some states and local governments reinstated new restrictions on businesses and individuals to curtail the spread of the virus, triggering concern that the economic rebound could weaken in the coming months. As disappointing news continued to reveal the economic damage from the pandemic, equities snapped back rapidly this year after the sharp sell-off in March, reaching record highs.

While economic data tends to be backward looking, the stock market is a forward-looking mechanism, focusing on future economic growth and earnings. The stock market rose drastically even before the vaccine had even been approved for emergency use. Investors remain optimistic, focusing on the prospects of a brighter outlook driven by the rollout of safe and effective COVID-19 vaccines, which could ultimately lead to a strong rise in economic and earnings growth in 2021. Moreover, the stock market and the economy have drastically different compositions, which can make them appear disconnected at times. In fact, the sector composition of the S&P 500 is heavily weighted to technology stocks at 39%, which dominated the stock market during the pandemic crisis, yet it only represents about 5% of GDP and 2% of total payroll jobs. Conversely, the industries most impacted by COVID-19, including leisure, hospitality, retail, hotels, transportation, entertainment, and restaurants represent 20% of all payroll jobs and 19% of the economy, however these sectors only represent about 7% of S&P 500 earnings. The hardest-hit industries by the pandemic, which rely heavily on face-to-face interactions, experienced the most devastating loss of jobs, although they have less impact on the stock market as measured by their contribution to earnings and overall market cap.

Powerful Market Rotation

In 2020, we also saw a market rebound that was uneven among different sectors, styles, and regions. The ascent was led by large U.S. companies and growth-oriented stocks, including information technology, communication services, and online retail as these industries thrived in the pandemic with millions of people working from home glued to their phones and computers and shifting most of their shopping online across both essential and nonessential items. With interest rates remaining at historically low levels, this economic backdrop typically bodes well for growth-oriented stocks. Growth stocks, which outperformed for much of the past decade with rates remaining low during most of the period, typically have higher projected earnings prospects and when future earnings are modelled and discounted at lower rates, future earnings and current stock prices, become more valuable.

By contrast, U.S. small cap stocks and value-oriented stocks had been under a significant pressure, trailing their larger peers during the early part of the pandemic. For instance, for most of the year, the top five mega-cap stocks in the S&P 500 by market capitalization, such as Apple, Microsoft, Amazon, Facebook and Alphabet/Google, dominated the other 495 stocks, representing approximately 25% of the overall index. Most notably, the top five stocks surged 38.6% through October, outpacing the rest of the index, which had a loss of 4.8% during the same period. However, these five mega-tech companies underperformed the S&P 500 by 6.5% from early November through mid-December, as hope for a vaccine and a return to normalcy would essentially reduce the importance of these companies in our daily lives.

A new economic cycle typically tends to bring new leadership. The rollout of safe and effective vaccines is expected to clear the way for a strong economic rebound, acting as a catalyst for a rotation in the market leadership. In the fourth quarter of 2020, promising COVID-19 vaccine trials created a favorable backdrop for the pandemic laggards, including small-cap, value, and international equities to lead the way. Domestic small companies, which are closely tied to the health of the U.S. economy and typically deliver strong results during economic recoveries, posted outsized gains in November and December, advancing ahead of larger companies during that same period. With expectations for a durable rebound of economic activity in 2021, we may see continued rotations towards areas of the stock market that lagged recently.

Defined Contribution Plans

At the beginning of the year, plan sponsors were just beginning to process the new SECURE Act when they were suddenly faced with the novel coronavirus. The CARES Act was quickly enacted, leading to a flurry of activity for plan sponsors.

The COVID-19 pandemic placed unique stressors on people, as many were concerned with both their finances and their health. In a survey conducted in April, 36% of those surveyed were very/extremely concerned about their finances, with 22% reporting that they or someone in their household had been furloughed or laid off. This same survey reported 30% of those surveyed were very/extremely concerned about their health, with 15% stating that they or someone they know had been diagnosed with COVID-19. (Fidelity Investments, 2020)

As of March 2020, Fidelity saw a 25% increase in monthly call volumes year-over-year as well as a 15% increased in the daily activity on their participant website. Activity levels are still higher than average, with a 10% increase in November 2020 versus November 2019, and a nearly 30% increase in participant website visits over that same timeframe. (Fidelity Investments, 2020) They also saw a 151% increase in participants stopping or decreasing contributions at the end of the first quarter as compared to the prior year. This quickly reversed during the second quarter.

At the beginning of the crisis, adopting the CARES Act loan and distribution provisions, partial plan terminations, and considering changes to the match were the most frequently discussed plan design issues.

Defined Benefit Plans

Plan sponsors of defined benefit pension plans struggled for years on how to close the gap between the assets they have and their plan's liabilities, or future costs of benefits that they promised to pay. The pandemic exacerbated this problem. While markets are up for the year, long-term return expectations remain muted. Further, the drop in interest rates has a dual negative impact on plans, with low potential fixed income returns as well as low discount rates, the latter of which led to an increase in pension liabilities.

Under the CARES Act, employers may defer contributions (including quarterly contributions) required and due in 2020 until January 1, 2021 (with interest). Note that the CARES Act only defers contributions but does not eliminate requirements. The old adage "pay now or pay later" continues to apply. The CARES Act also provides employers with the option to apply the plan's 2019 adjusted funding target attainment percentage (funded level applicable to benefit restrictions) to the 2020 plan year as well.

Conclusion

2021 expectations include the continuation of inoculations against COVID-19, the hope for herd immunity, and the anticipation of some of the normalcy of the years before 2020. The effects of 2020 will continue to ripple, however, for years to come.

An index is a measure of value changes in a representative grouping of stocks, bonds, or other securities. Indexes are used primarily for comparative performance measurement and as a gauge of movements in financial markets. You can not invest directly in an index and, for comparative purposes; they do not reflect the effect of the various fees inherent in actual investment vehicles.

The S&P 500 Index is a market value weighted index showing the change in the aggregate market value of 500 U.S. stocks. It is a commonly used measure of stock market total return performance.

The Dow Jones Industrial Average is a price weighted index comprised of 30 actively traded blue chip stocks; primarily industrial companies, but including some service oriented firms.

The NASDAQ Composite Index is a market-value weighted index that measures all domestic and non-U.S. based securities listed on the NASDAQ Stock Market.

Gross Domestic Product (GDP) is the market value of the goods and services produced by labor and property in the U.S. It is comprised of consumer and government purchases, net exports of goods and services, and private domestic investments. The Commerce Department releases figures for GDP on a quarterly basis. Inflation adjusted GDP (or real GDP) is used to measure growth of the U.S. economy.

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