Martone Capital Management: Weekly Investment Commentary (1/11/2021)

Investors started off 2021 the same way they ended 2020: by focusing on the positives of long-term improvements in economic growth, hopes that the vaccine rollout will allow more economic reopening and expectations that monetary and fiscal policies will remain highly supportive of risk assets. But the risk with this stance is that stocks are already discounting a highly favorable macro-outlook and are expensive based on historic measures.

It appears to us that the economic recovery (and eventual expansion) is still in its early stages, but capital markets are much further along the cycle. Following the previous three recessions, it took several years for global equities to fully recoup their losses, but that happened in only a matter of months in 2020. Stocks and other risk assets could be vulnerable if economic growth is less robust than what is already priced into the markets. But at the same time, if growth is stronger than expected, that could create more upward pressure on interest rates and inflation, which would likely hurt equity valuations.

We expect equity returns to be relatively moderate (but still positive) in 2021, but to trail the recovery in the economy and corporate earnings. We also believe we will continue to see an uneven rotation away from growth, large caps and U.S. stocks toward value, small caps and non-U.S.

As we move forward, we see a number of tailwinds for the broad stock market in 2021. But given the extreme run up in prices in recent months, we also believe stocks have effectively "borrowed" from future returns. As such, we think equity returns will be and stock markets could be vulnerable to a near-term consolidation or correction.

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