Comments from Joe Terranova, Chief Market Strategist, Virtus Investment Partners
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– Joe Terranova

Getting back to even strength as optimism increases

- To use a hockey analogy, the period of abnormally low U.S. Treasury rates created an opportunity for investors that was akin to a five-on-three power play – a two-player advantage.
- As rates rose slightly toward the end of 2020, that advantage narrowed to more of a five-on-four power play.
- In the last few weeks, however, we've seen a normalization of interest rates. This reflationary environment is being fueled by optimism that society will be fully open by the end of 2021.
- We believe investors and the markets are now back to even strength. The game is five-on-five, which is still winnable, but it has gotten a little harder to score a goal.
- Some projections point to economic growth over 7% for 2021 – the highest level since 1984, and a strong recovery from the 3.5% contraction in 2020.
- The expectation that society is going to normalize is allowing for rates to normalize.
- As this normalization of rates occurs, several things are proving to be true:
    - Risk is the primary word in the financial lexicon for 2021. Investors should focus on their risk exposure and leverage assumptions.
    - Avoid concentration. Being everywhere – instead of being *there* – is critical.
    - Instead of chasing the hot stock, sector, or asset class, diversify by asset class, geography, equity size class, and strategy.

Learning the lessons of 2015 and 2016

- There was a similar reflationary recovery in 2016 after the manufacturing recession of 2015. The election of President Trump drove expectations for supportive new fiscal policies.
- Economic optimism evolved into a reflation recovery in 2016, with yields as the mechanism to represent that optimism.
- In fact, the yield on the 10-year Treasury rose from 1.71% the day after Election Day 2016 to 2.64% just a month later.
- Companies and industries that had been injured by the manufacturing recession in 2015 experienced a sharp rebound in 2016.

Industry	2015 Price Return	2016 Price Return
Oil & gas exploration	-35.5%	31.4%
Construction machinery and heavy trucking	-31.4%	39.9%
Consumer finance	-21.2%	17.7%
Regional banks	-0.28%	30.4%

Stock/Index	2015 Price Return	2016 Price Return
S&P 500® Index	-0.7%	9.5%
Amazon.com	118.0%	11.0%
Apple	-5.0%	10.0%
Google	47.0%	2.0%
Microsoft	19.0%	12.0%

Source: Bloomberg. **Past performance is not indicative of future results.**

- The change in market leadership did not mean that a major shift in strategy was warranted. It simply represented an industry-specific recovery, with areas that had suffered getting back to normal ranges.

Positioning for success in a normalizing environment

- As similar events unfold today, investors should avoid dramatic changes such as concentrating their holdings or moving away from mega-cap technology stocks.
- While we are seeing a decline in growth stocks and in the Nasdaq, it is not signaling a rise in inflation.
- Although value stocks have started to shine, we always view them as an important part of a diversified portfolio. In our view, the growth/value question is not a binary one – the answer is still "yes."
- In a more normal environment, behavior becomes a key consideration. Even if we have a correction of the concentrated gains we saw in 2020, discipline and diversification can help investors get through it.
- And, a correction won't change the secular tailwinds that are still in place:
  - Abundant liquidity that nourishes risk assets,
  - The intangible asset economy that empowers the consumer, and
  - The dramatic supply/demand imbalance for investable assets.

Reflation, not inflation

- At the beginning of 2020, the 10-year Treasury was pricing at 1.92%. Today, the normalized S&P 500® dividend yield sits at 1.5% for a 10-year Treasury.
- No investor should make a change based on where they think Treasuries are headed, or what they think gross domestic product (GDP) will be.
- But we are in a process of reflating to normalization. In that environment, longer duration assets are likely to correct in price.

- And, it is unlikely that long-term investment success could be built on a portfolio of low-quality companies.

Index/Industry	2020 Price Return	2021 YTD Price Return
S&P 500® Index	16.3%	2.3%
Oil & gas exploration	-37.3%	49.4%
Airlines	-31.6%	20.1%
Regional banks	-8.4%	23.7%
Consumer finance	-1.9%	20.9%

Source: Bloomberg. YTD through 3/5/21. **Past performance is not indicative of future results.**

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The S&P 500® Index is a free-float market-capitalization weighted index of 500 of the largest U.S. companies. The index is calculated on a total return basis with dividends reinvested. The index is unmanaged, its returns do not reflect any fees, expenses, or sales charges, and is not available for direct investment.