Comments from Joe Terranova, Chief Market Strategist, Virtus Investment Partners
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"Balance and reasonable portfolio expectations are prudent approaches to the end of the pandemic and the beginning of a bull market for society."
– Joe Terranova

The Roaring Twenties expectations

- We all hope to experience a bull market for society – not just for risk assets – in 2021.
- But some investors are expanding those hopes to extrapolate another decade similar to the Roaring Twenties.
- Just as the end of the 1918 Spanish Flu pandemic was followed by a decade-long economic boom, some people are expecting a similar surge when the COVID-19 pandemic ends.
- The concern is that investors will give in to the temptation of recency bias and concentrate their portfolios in areas that have tended to benefit from robust economic growth, while abandoning the necessary ballast afforded by taxable fixed income and multiple equity size classes and investment strategies.
- Regardless of what lies ahead, portfolios need balance to succeed and endure volatility. Concentration is antithetical to long-term investing.

Putting the 1920s in historical perspective

- While the Roaring Twenties saw economic growth exceed 4% per year, that growth was fueled by factors other than post-pandemic spending.
- The decade of the 1920s was marked by the most dramatic change in tax policy in U.S. history.
- In 1913, the personal income tax was enacted, with a top rate of 7%. By the time of the pandemic, after wartime tax hikes, that rate had skyrocketed to 77%.
- Andrew Mellon became Secretary of the Treasury in 1922, and advocated for lower taxes to stimulate growth. During his tenure, the top marginal tax rate declined steadily:
    - 1922: 58%
    - 1923: 50%
    - 1924: 46%
    - 1925-28: 25%
- Despite the lower rates, income tax revenues soared during the 1920s, growing from $719 million in 1921 to $1.16 billion in 1928 – an increase of 61%.[1]
- This is not to suggest that taxes should or should not be raised as we move out of the COVID-19 pandemic.
- The point is that the growth of the 1920s was not driven solely by pent-up demand. There was more to the Roaring Twenties than the end of a pandemic.

Risk continues to be the most important word

- The critical question for 2021 remains "How much can I lose?" not "How much can I profit?"
- There have been only two policy-induced recessions in history: 1981-82 and 2020. After the '81-'82 recession, the economy grew more than 7% in 1984, and more than 4% in 1985. But there was a significant moderation in growth after that.
- Similarly, we could see the economy heat up in 2021 and 2022, but possibly return to the levels of prior years shortly thereafter.
- Today's investors should not be concentrating investments solely toward risk assets that are highly levered to a multi-year economic boom. Nor should they be abandoning their portfolio ballast, which is taxable fixed income.
- In 2020, we learned an important lesson about the dangers of concentration, in particular toward hyper-growth. The lesson should not be ignored in 2021 by making concentrated allocations to low-quality, highly leveraged risk assets.
- This is the time to implement balance and set reasonable expectations for portfolios, which will afford investors the time to enjoy the coming, and much needed, bull market for society.

[1] The Heritage Foundation, "The Historical Lessons of Lower Tax Rates."