Our Perspectives: Navigating a New Year — The Outlook for 2021

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This commentary was prepared on January 11, 2021, and reflects our view of events at that time. Please visit our website, homesteadfunds.com, for the latest perspectives.

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2020 was an unprecedented year, and it's fair to say that 2021 will also be a year like no other. Here, we take a look at the state of the economy and investment markets in the wake of the COVID-19 pandemic that has caused tragic loss of life and stinging economic pain for so many Americans. With two effective vaccines already entering arms, the shape of 2021 is starting to come into focus. Here's our take on what the year ahead could hold.

First, the Pandemic

After the initial economic shock of the springtime shutdown, the U.S. economy recovered substantially from March and April lows. Still, the pandemic remained out of control as 2021 opened. There are a lot of supportive factors helping the economy, as we'll discuss — but the ravaging pandemic is the stubborn barrier standing between the hardest-hit industries and a real recovery. As long as case counts and deaths remain high, economic activity will be stifled.

That's why the vaccine distribution is key. It's not possible to untangle the pandemic from the economy, so we have to solve the pandemic. Fortunately, the pieces are in place. As the inoculation count climbs, the economy will find more stable footing.

We are forecasting a rebound in economic activity starting around the second quarter of 2021 — a point where we believe that vaccine distribution will have gathered momentum. Once Americans reach a confidence level about their safety, we anticipate that they'll return to pre-COVID-19 activities. In some sectors, there is quite a bit of pent-up demand after a year of limitations. The hardest-hit industries, including travel and accommodations, restaurant and health care, could see a surge of activity in the second half of 2021.

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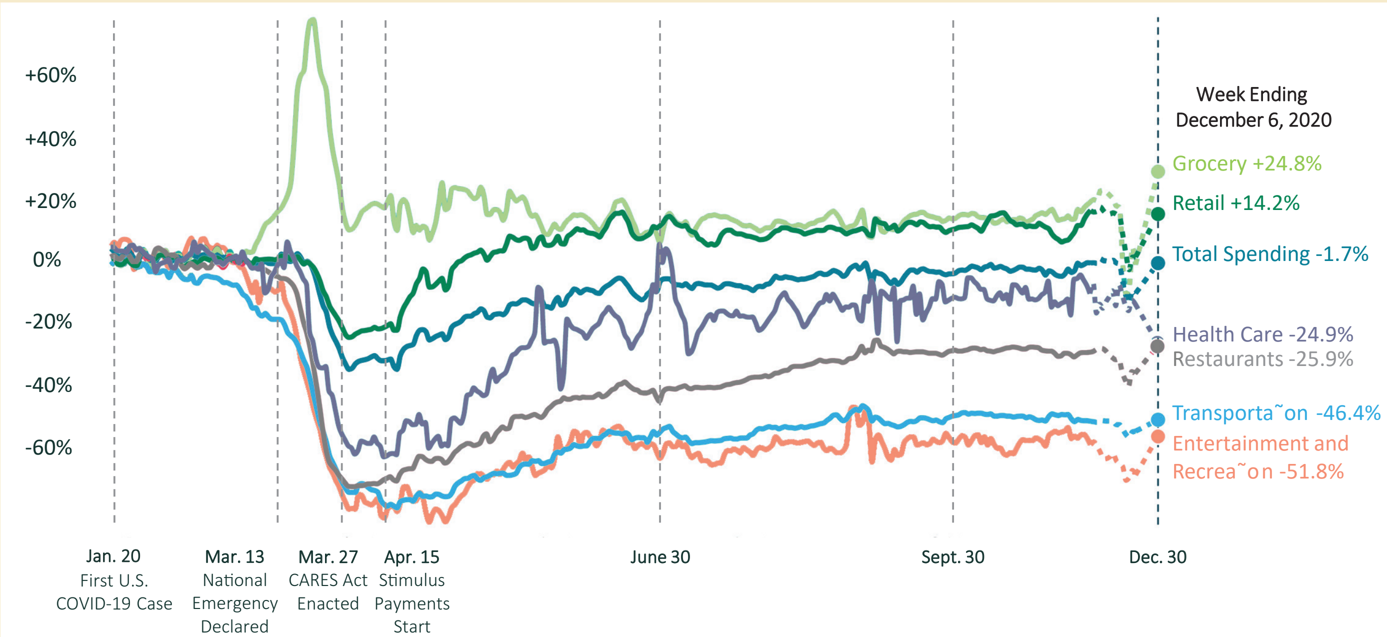
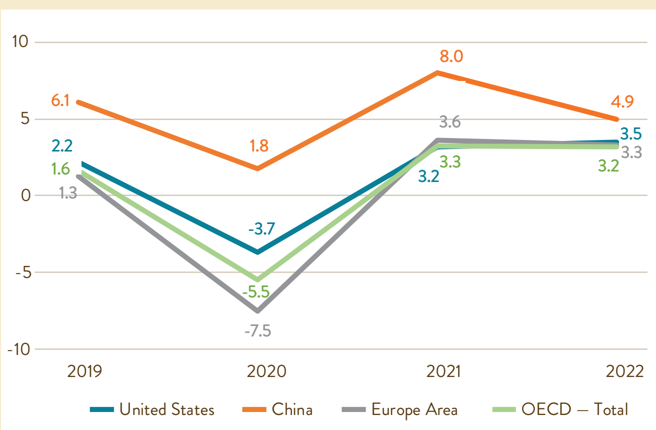
Consumer Spending Depends on Ending the Pandemic

Consumer spending took a hit with COVID-19 impacting household finances. Spending disruptions varied by sector.



Source: Opportunity Insights Economic Tracker. The dashed segment of the line is provisional data, which may be subject to non-negligible revisions as new data is posted.

A V-Shaped Recovery: Real GDP Forecast for Select Economies



Source: OECD (2020), Real GDP forecast (indicator). doi: 10.1787/1f84150b-en (Accessed on 04 January 2021). There is no guarantee that the vaccines will be administered as projected nor that the forecasted recovery will be achieved.

Indeed, the economic outlook is better after the damage of 2020 is now in the rearview mirror. Many economists are calling for a "v-shaped recovery, noting that the "v" in recovery stands for vaccine. We agree that stronger economic growth will be dependent on vaccine distribution and effectiveness.

The Policy Environment Is Supportive

Smart policy moves both at home and abroad were crucial to the initial recovery, but their impact isn't done yet. Both monetary and fiscal policies continue to be integral to supporting the economy and the investment markets.

The Federal Reserve (Fed) swiftly enacted initiatives to slash interest rates, buy up bonds in the marketplace, and offer direct lending programs to corporations and other entities. These tools brought liquidity back to the borrowing markets. But the benefits will continue well into 2021. Committed to keeping its target rate low, the Fed's policy also brings down the cost of new mortgages, credit cards and other consumer borrowing. Corporations also enjoy the lower cost of borrowing.

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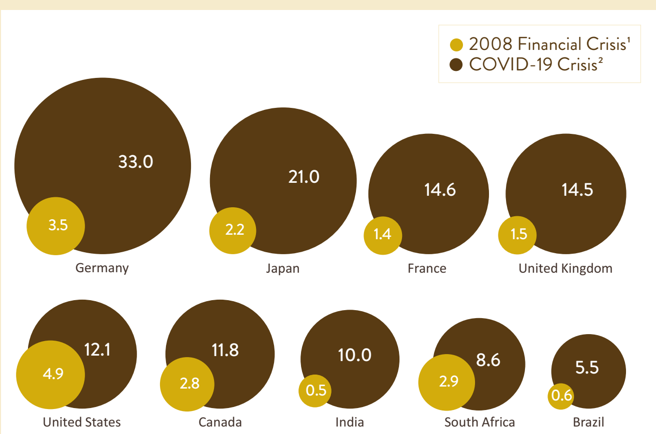
Fiscal stimulus has also gone a long way, and we'll see more support in 2021 as the second stimulus package flows to homes, institutions and into the economy. As the Biden administration takes office, it is likely to focus on continued fiscal support over the course of 2021.

Other green lights are coming from the markets regarding the new administration. Though regulatory policies are likely to tighten up on some businesses, we see evidence that Biden is sticking to a balanced, consensus-building course rather than an extreme agenda. Early cabinet picks are moderate, and that news has been well received by markets.

Fiscal Stimulus Around the Globe (as a percentage of GDP)



[1]Data published by the International Monetary Fund, March 2009. Includes measures announced for 2008-2010. Only fiscal year 2009 information was available for India.

[2]McKinsey & Company, "The $10 trillion rescue: How governments can deliver impact." 2019 GDP taken into account for values related to COVID-19 crisis.

Disruption Poised to Continue

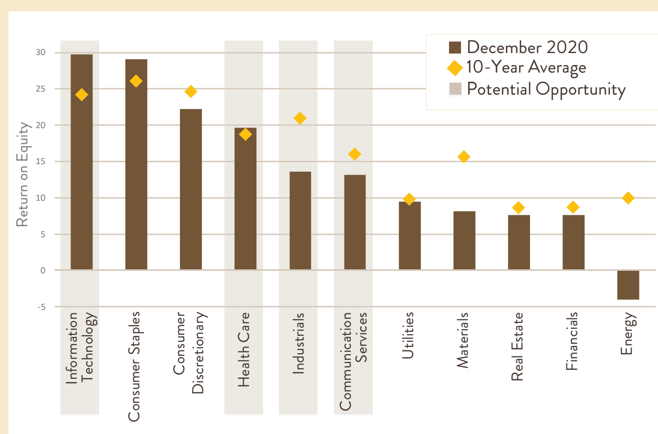
Our portfolio managers have long focused on several themes of "disruption" in their investment portfolios. A number of those trends accelerated at lightning speed in the pandemic-living environment.

Some areas of American life will certainly return to normal once the COVID-19 threat subsides: leisure travel, dining out, convening freely with friends and loved ones. But other things are sure to change. The sea change in working conditions for professional and knowledge workers is likely here to stay, with lasting implications for related industries. It could mean a permanent shift in work-related travel, and it almost certainly means a lasting boost in the technology investments that enable remote work.

Our shopping habits are another good example. As shopping habits adjusted, the shift toward ecommerce, shipping, curbside pickup and delivery lurched forward. Investment in shipping logistics and technology has been a long-standing investment theme of ours, and the changes driven by the pandemic have accelerated that theme.

Indeed, these lasting changes are one of the reasons that many companies were able to hold steady or even expand profitability even as American jobs evaporated. Along with disruption to American life, there was innovation. With corporate profitability set to rebound later this year, current stock valuations are high yet not unsustainable, in terms of stock price-to-forward-earnings ratios.

Where We See Opportunity in 2021



Source: Strategas. *Past performance is no guarantee of future results.* Indices are unmanaged, and investors cannot invest directly in an index. Unless otherwise noted, performance of indices does not account for any fees, commissions or other expenses that would be incurred. Returns include reinvested dividends.

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Five Things to Expect in 2021

With these factors setting the stage for the year ahead, here are some developments we think are likely:

1. **Volatility in stock markets.** With a decentralized vaccine rollout, we expect distribution to hit bumps and setbacks. Continued political upheaval is also a risk going into 2021 and likely to jolt markets.

2. **Low interest rates.** The Fed has committed to its near-zero target interest rate for years to come. This has implications for both investment portfolios and for any markets that depend on or leverage to borrowing costs.

3. **A stronger economic recovery from Q2 onward.** Economic activity is likely to hit a positive inflection point as inoculations accrue.

4. **Rebounding corporate profits.** Companies were aggressive in trimming costs and shoring up balance sheets in the pullback. As sales return, profits are set to rebound.

5. **Inflation returning.** Prices softened considerably during the shutdown, but resuming economic growth, along with hefty monetary and fiscal packages, could drive inflation back into a higher zone.

Positioning for 2021

The shock waves of 2020 were an excellent reminder that the most powerful tool we have for investors is asset allocation. "Timing the market" is an incredibly ineffective approach to investing. The downturn caught most investors by surprise, but the rally also began far sooner than most expected. This is exactly why we urge investors to stick to a long-term asset allocation that's right for their goals and situation. When the allocation is calibrated well, shock waves down and back up are of little concern. The new year is an excellent time to revisit your allocation for fit. Asset allocation does not guarantee a profit or protect against a loss in a declining market. It is a method used to help manage investment risk.

Another key consideration in 2021 is the interest rate environment. With low Fed rates come very low yields on cash accounts. In this environment, short-term, high-credit-quality bond holdings may be advantageous over money market and cash positions for investors who can tolerate slightly more price volatility.

Gross Domestic Product (GDP): One indicator used to track the health of a nation's economy. When the economy is healthy, there is usually a lower level of unemployment, and wages tend to increase as businesses hire more labor to meet the growing demand of the economy.

V-shaped recovery: Occurs when the economy suffers a sharp but brief period of economic decline with a clearly defined trough, followed by a strong recovery.

Past performance does not guarantee future results.

The S&P 500 is a broad-based measure of U.S. stock market performance and includes 500 widely held common stocks. Indices are unmanaged, and investors cannot invest directly in an index. Unless otherwise notated, the performances of indices do not account for any fees, commissions or other expenses that would be incurred. Returns do not include reinvested dividends.

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Interested in speaking with one of our associates about your long-term investment plan? Call us at 800.258.3030, option 2.

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