Pegged. 2020 was a record-shattering year. Will 2021 represent a return to normal?

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"These go to eleven."

–Guitarist Nigel Tufnel, *Spinal Tap*

If you were born in a certain era and have a sense of humor that is — ahem — slightly off-beat, the quote above will be familiar. For others, an explanation: In the farcical rock-u-mentary Spinal Tap, the band's guitarist Nigel Tufnel hilariously explains to the film's director how his amplifiers are louder than those used by other musicians because the volume knobs on his go to "11" rather than the standard "10."

If 2020 was a stack of amplifiers, they would all go to 11.

Here's a short list of economic and market indicators that "pegged the board" in 2020, spiking so high (or low) that they can't be reasonably shown alongside even their own histories without re-scaling an axis or two — or resorting to statistical trickery like logarithmic transformation. It's an impressive list.

ECONOMIC CONTRACTION — 2Q20's (-33.4%) was the largest decline in Gross Domestic Product (GDP) in the 72-year history of modern GDP data.

ECONOMIC GROWTH — Conversely, 3Q20's +33.1% rebound in GDP was the series' highest.

THE FED'S BALANCE SHEET — At $7.1 trillion (and rising), the Federal Reserve has never held anything even close to what it holds today.

NEGATIVE-RATE DEBT — $15.6 trillion of global debt will, astoundingly, pay you back less than your original investment.

WEEKLY UNEMPLOYMENT CLAIMS — 6.8 million people filed for benefits on the last week of March, 10x the pre-COVID high.

GOVERNMENT TRANSFER PAYMENTS — Through September, personal transfers totaled $10.7 trillion, 1.5x its pre-COVID high.

SPEED OF THE MARKET CYCLE — The S&P 500® Index went from bull to bear and back again in an ankle-breaking 38 days.[1]

THE GROWTH PREMIUM — The performance premium of large growth vs. value has been as high as +45% in 2020.

10-YEAR TREASURY YIELDS — In August, 10-year yields bottomed at 0.52%, 0.85% below the low dating back to 1962.

And this is just a partial list — we didn't even talk about hyper-partisanship, contested elections, hurricanes, western wildfires or forward earnings multiples, let alone the dozens of other economic and market barometers that also set records in 2020.

Of course, the reason that 2020 was such a record-breaking year is the COVID-19 pandemic and the near-complete economic shutdown during the spring and summer months that was designed to stem its spread. As I write this, the virus is tragically making a comeback and is clearly still calling the shots as far as the market is concerned.

But there is reason to hope. The global efforts to create a vaccine seem to be paying off, with at least one (if not two) late-stage vaccine candidates likely to win emergency use authorization before year-end. For their part, markets are showing an increased willingness to look through the darkest valleys of the pandemic to what comes next, something that has allowed cyclical and value-oriented sectors to begin to chip away at the historic lead that mega-cap growth has built over value. Moreover, a (reasonably) amicable resolution to the hotly contested 2020 election also seems within reach, bringing with it renewed hope that another round of COVID stimulus may be on the way shortly.

Another reason that a return to normalcy may be in the cards for 2021 has to do with the economy itself. Prior to the arrival of COVID, the economy was on reasonably sound footing. While there were soft spots, the unemployment rate was at a generational low of 3.5% — a level not seen since the late 1960s (and before that, not since the post-war boom of the mid-1950s). So far, the recovery in jobs has surpassed the most dire projections by a wide margin — recall that only a few months ago economists were predicting that jobless figures would peak somewhere north of 20% and that double-digit unemployment would persist through 2021. Neither looks likely.

There is of course still a long way to go on the jobs front, particularly since a resurging virus has raised the possibility of renewed shutdowns to stem its spread, but if the economy has retained even a portion of the animal spirits that drove employment growth before the pandemic, it's not unreasonable to imagine labor markets returning to pre-pandemic levels in 2021.

Return to normalcy?

Here are some of the reasons 2021 could represent a return to more normal times:

- The growing likelihood of a COVID vaccine
- Shifting market leadership and an orderly unwind of recent market excesses
- The prospect of renewed stimulus
- A burgeoning jobs market recovery
- An ongoing housing boom
- A recovery in corporate earnings
- An aggressively accommodative Fed
- An amicable resolution of the 2020 election and a compromise-minded government

Real estate has been another hot spot. Housing activity is sometimes described as a "high multiplier" activity, with each point of incremental growth reverberating across the entire economy by way of employment growth, higher consumption and a pervasive wealth effect wrought by rising home equity values. By a number of metrics, housing activity has surpassed pre-COVID levels as a result of historically low mortgage rates, rising employment and a return of pent-up demand suppressed during the spring and summer lockdowns. If these trends remain intact, it's entirely possible that housing will remain a powerful tailwind in 2021.

Markets have provided some of their own fuel for a return to normalcy as well. Corporate earnings naturally collapsed during the pandemic's initial phase as the global economy ground to a halt. Since then, earnings, like employment numbers, have recovered more quickly than many analysts expected as a tentative re-opening progressed and consumption patterns began to return to normal. This recovery in earnings is doubly important given that market valuations remain elevated — after all, keep in mind that the denominator in the P/E equation is earnings; with a little luck and a lot of growth, markets will hopefully continue to grow into their valuations before an unwind becomes chaotic.

Finally, a word about the 2020 election. While the highly partisan and hotly contested nature of the election was a source of concern for many, the nation seems to have walked a fine line between two extremes. Barring a significant surprise prior to inauguration day, the nation seems poised to move forward with a government that may allow the partisan divide to begin to heal. At the same time, the likelihood of a balanced Congress and the narrow margin of victory for Joe Biden should, at least in my view, keep some of the more extreme impulses of both factions in check.

It's worth remembering, though, that we're still in the midst of a tragic and unpredictable pandemic. The economy is still in recession, and the incoming administration is still something of a political unknown. Equity market valuations remain high relative to historical norms, and a significant detour on the road to recovery could cause confidence to erode rapidly. But this is nothing new: Capital markets and the economy are unsterile environments prone to surprises and unforeseen developments. But that, after all, is what creates the evolution and adaptability that lie at the very core of what makes our economy so vibrant. Whatever 2021 has in store, whether "more of the same" or a return to normalcy, we will endure.

And either way, it's hard to imagine that things could get much weirder next year than they were in 2020.

Stay healthy and safe.

1 "Bull to bear" is defined as -20% from the market's pre-pandemic market peak; "bear to bull" as +20% from pandemic trough. Data: Bloomberg.com, GWI calculations.

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