

2021 Outlook: Back to the Future



After a year that upended social and market norms, the distribution of a COVID-19 vaccine should allow the economy to return to a new normal as we progress through 2021:

- Household consumption will remain the backbone of GDP, but spending habits will be different.
- The labor market is poised to improve, benefiting from increased productivity and rising wages, but office settings and commutes won't look the same.

We believe we are in the initial stages of a new expansionary cycle, offering a favorable runway for financial markets over time. That said, we expect a few bumps along the way, as conditions look to live up to the expectations that drove the strong stock market recovery last year.

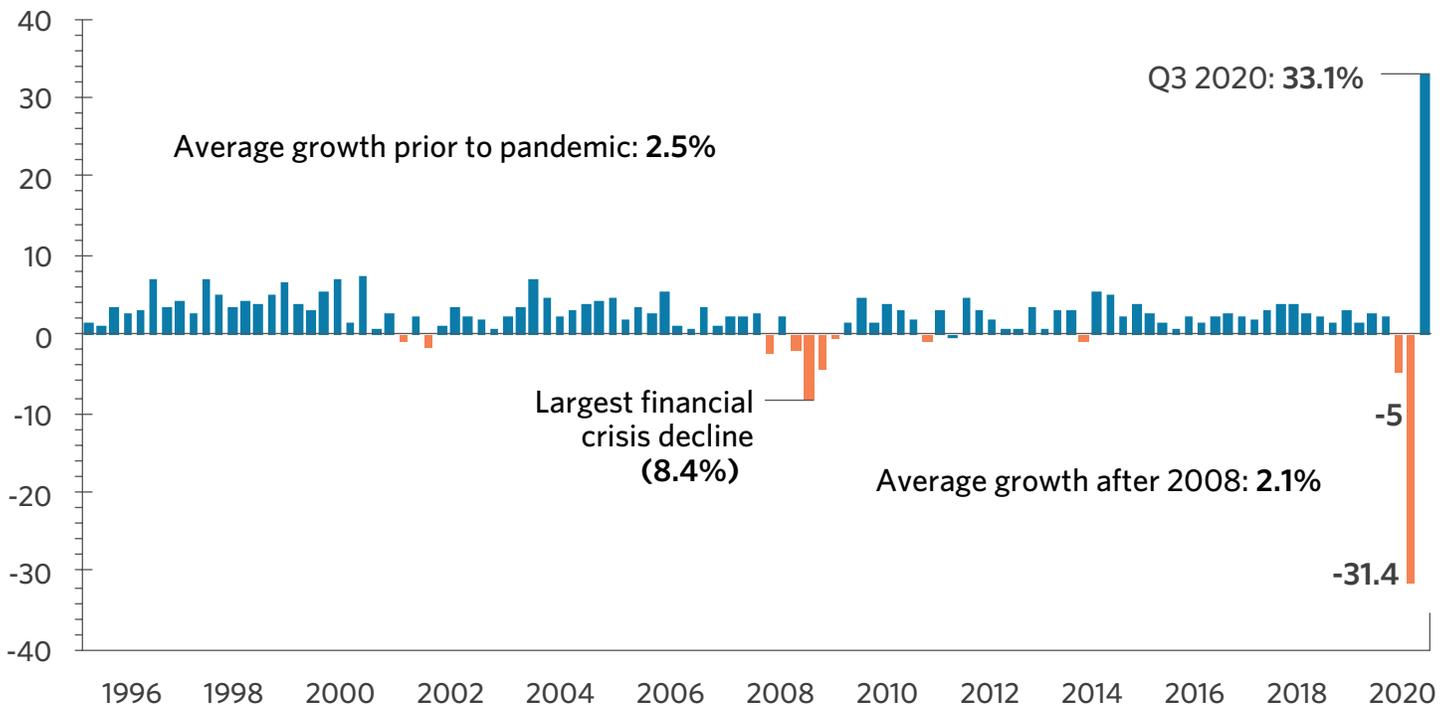
Here are eight key views for the year ahead.

1 The U.S. economy gets a boost from the shift to a post-vaccine phase.

2020 included the largest quarterly decline (Q2) and increase (Q3) in U.S. GDP on record. The pandemic-induced shutdown and partial reopening produced seismic swings in consumption and output. We expect a smoother trajectory in 2021, with above-average GDP growth of more than 4% for the full year.

We anticipate tepid expansion in the early portion of the year, stunted by lingering measures to slow the spread of COVID-19. Growth should accelerate as the vaccine becomes widely available, allowing consumer, work, leisure and travel habits to return toward more sustainable levels.

GDP Swings Largest in History (Annualized Quarterly GDP Growth, U.S.)



Source: FactSet, Edward Jones calculations.

We think 2021 will begin a multi-year economic expansion, with widespread distribution of the vaccine sparking progress toward a new normal for the U.S. economy. Meanwhile, the one-two punch of monetary and fiscal policy stimulus will keep a tailwind at the economy's back.

We expect consumer spending to remain roughly 70% of GDP, but habits are changing. Increased online shopping, strength in the housing market and housing-related purchases, and shifts in leisure and entertainment activities all impact GDP. We're also anticipating a larger work-from-home base, shifts in commercial real estate, increased automation and adjustments to business travel. Along with further labor market improvement, these can support healthy household consumption growth and spur

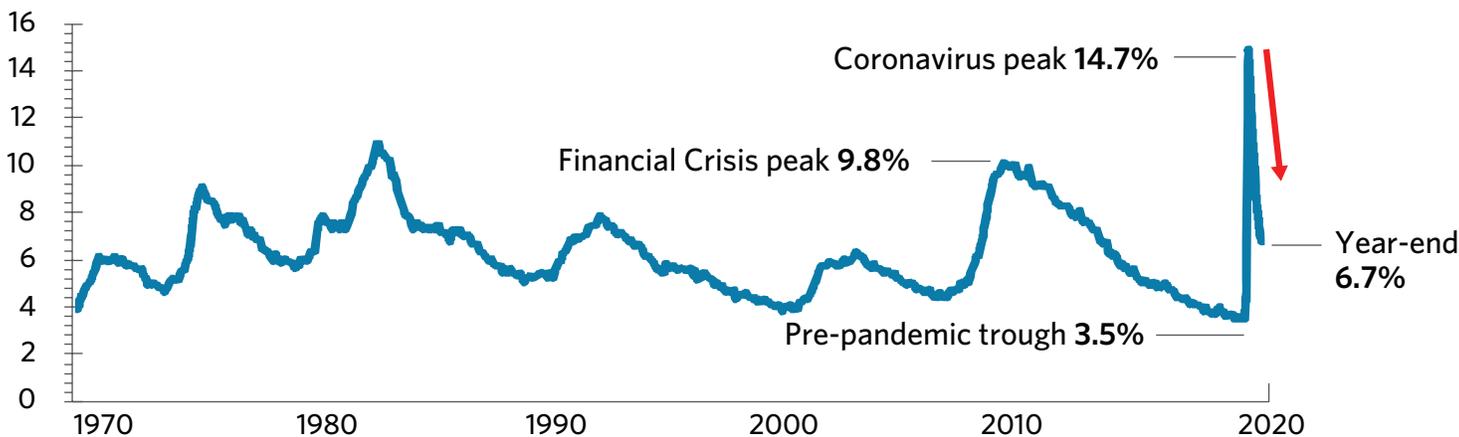
higher labor productivity gains (similar to the trend in the late 1990s), which is a key driver of GDP.

The resiliency and vibrancy of the U.S. economy should show as the year progresses. With GDP entering the year below pre-pandemic levels, sufficient slack remains to fuel above-average growth as the recovery gains traction.

Over the past 40 years, GDP growth averaged 3.4% in the first year of an expansion, compared with an overall average of 2.6% since 1980. While we anticipate GDP growth to settle back toward more modest levels as the expansion persists, stronger growth in 2021 should form a reasonably firm foundation for corporate profits and stock market performance.

2 Unemployment continues to decline, supporting a consumer comeback.

U.S. Unemployment Rate



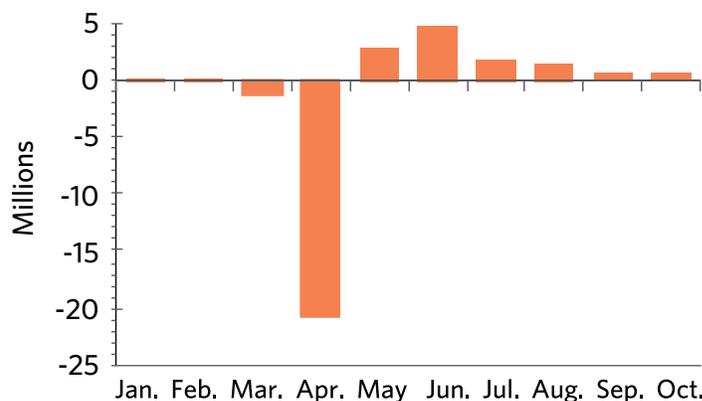
Source: U.S. Bureau of Labor Statistics.

Further improvement in the labor market will be a key driver to a durable, self-sustaining recovery in 2021, in our view. The unemployment rate has declined at a much faster pace than in previous recessions, but there is still plenty of lost ground to make up. Only about half of the jobs lost in March and April have been recovered so far.

The prospects of effective COVID-19 vaccines and a faster return to normal improve the medium-term outlook. However, the recent surge in coronavirus infections and hospitalizations could weigh on the economy and job creation in the near term, especially in industries impacted by social distancing measures, such as leisure and hospitality. We don't think unemployment will snap back to a pre-pandemic level of 3.5% in 2021, but the labor market will continue to heal as the economy gradually reopens.

Consumer spending has led the economy out of recession in 2020, largely supported by government income transfers that helped bridge the income gap created by the pandemic. As fiscal support is phased

Job Growth Slows



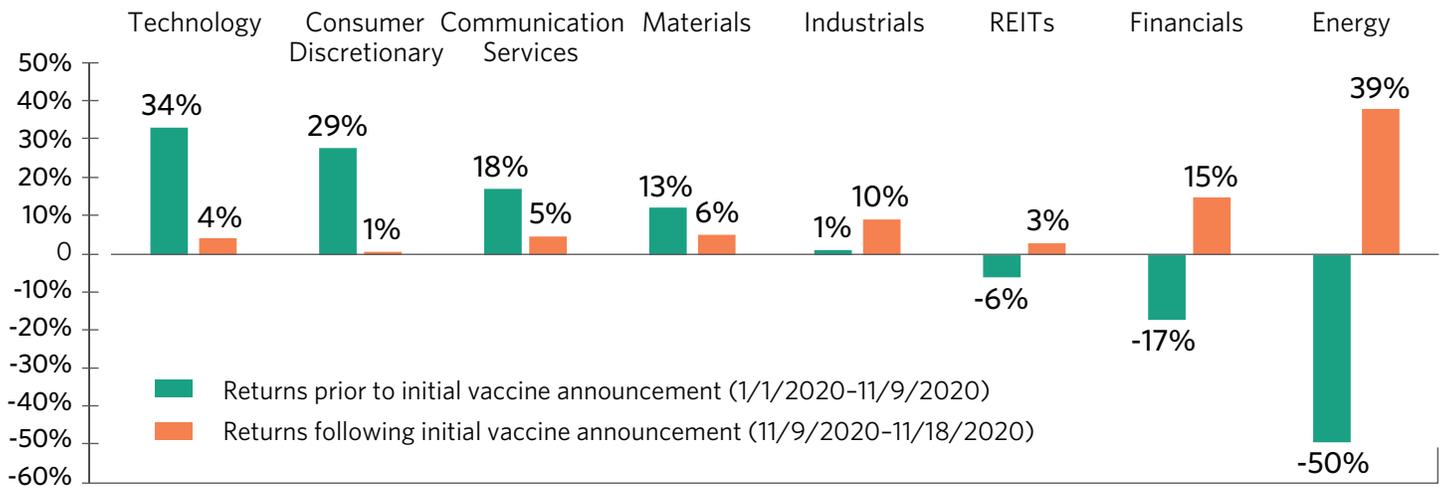
Source: U.S. Bureau of Labor and Statistics.

out in 2021, an improving labor market will take center stage in sustaining the growth in household disposable income.

We believe further job gains and healthy consumer balance sheets will drive personal consumption higher. At 13.6%, the personal savings rate is double its last 20-year average, representing pent-up spending power if consumers return to their usual spending patterns.

3 The bull market continues with broader shoulders.

Leadership Shifted Sharply after Vaccine News



Source: Morningstar Direct. Past performance is not indicative of future results.

We think the distribution of an effective COVID-19 vaccine will ease a durable rebound in economic activity. Along with an accommodative Federal Reserve and the prospects for additional fiscal aid, this suggests the newly emerging bull market in stocks has legs. As the economy improves, pent-up demand for services is unleashed and interest rates remain relatively low, corporate earnings will continue to recover and likely reach their 2019 pre-pandemic peak by the end of 2021.

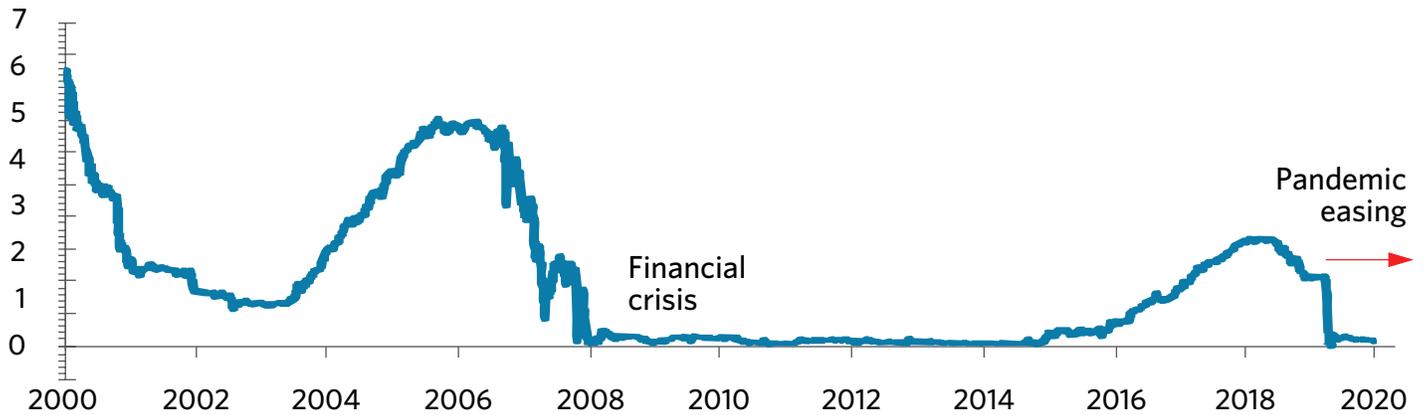
A handful of U.S. large-cap tech names accounted for a disproportionate share of the market gains in 2020. Between January and the end of October, shares of the five largest companies in the S&P 500 - Apple, Microsoft, Amazon, Facebook and Google - rose 38% on average, compared with a 1% increase for the other 495 stocks in the index. We believe that as the economic reopening accelerates in the second half of 2021, the rally will broaden to economically sensitive investments that have lagged, including small-cap and international stocks.

Cyclical sectors face easy earnings comparisons in 2021 and trade at discounted valuations. But pandemic trends such as digitalization and staying at home are likely to last and will continue to support technology stocks. We recommend investors maintain appropriate diversification to benefit from the increased participation from stocks across market caps, investment styles and regions.

We see further upside in stocks but think some of the gains were pulled into 2020 as valuations expanded. The price-to-earnings ratio will likely normalize somewhat in 2021, partially offsetting the boost from an expected 22% growth in earnings. Therefore, we expect moderate equity returns and likely a continuing decline in volatility. With that said, the path to a full economic recovery will be bumpy, triggering occasional episodes of market indigestion, although likely less severe than what we witnessed in 2020.

4 The Fed keeps its policy rate near zero even as the economy improves.

Rates Set to Stay Low but Positive



Source: FactSet.

We expect the Fed to keep rates near zero for at least the next two years. Even with the increasing likelihood of COVID-19 vaccines boosting activity in 2021, there will still be significant slack in the economy and labor market by the end of the year. Because of this, the Fed will avoid tightening policy prematurely and risk a repeat of the 2013 “taper tantrum,” which saw a surge in Treasury yields after the Fed communicated it would reduce the pace of its asset purchase program. With that said, investor fears about tapering could still create short-term volatility.

Under its recently updated policy framework, the Fed will tolerate above-target inflation to make up for earlier shortfalls. With consumer inflation expectations anchored at low levels, it will take time to achieve this objective.

In the near term, if the economic recovery is threatened by renewed COVID-19 lockdowns, the Fed has additional capacity to act.

More support could come by:

- Increasing the quantity of bond buying;
- Shifting the composition of asset purchases toward longer-term bonds; or
- Capping yields (yield curve control) to keep borrowing costs low.

We think the Fed is unlikely to consider negative interest rates given their limited evidence of success in other advanced economies.

5 Longer-term interest rates rise modestly as inflation ticks up.

While short-term rates remain anchored under continued Fed stimulus, we think the longer end of the rate spectrum will trend modestly higher this year. Ten-year Treasury rates are starting the year

below 1%, the lowest level to start a calendar year in history. That said, 10-year yields have nearly doubled from the all-time low in 2020, responding to an improved outlook for the economy.

With the most severe economic effects of the pandemic behind us, we expect a durable rebound in demand to spur slightly firmer inflation, leading longer-term rates higher. Ten-year yields peaked at just above 3% during the decade-long expansion leading up to 2020, well below peak rates of previous expansions. Given ongoing monetary policy stimulus, we don't anticipate yields returning to anything resembling that level in the coming year, but we do think the yield curve will steepen somewhat.

Rates will remain low by historical standards, meaning overall bond yields are unlikely to become dramatically more compelling for investors this year. We think appropriate allocations to investment-grade corporate and municipal bonds, as well as exposure to high-yield bonds, can offer some increased yield for fixed-income

portfolios. Despite this, we think fixed-income allocations will continue to demonstrate their portfolio value by helping protect against bouts of equity market volatility. A gradually steepening yield curve would, in our view, support allocations to cyclical and value (dividend income) investments as the recovery broadens investment leadership.

With meaningful slack in the labor market and economy likely to persist in 2021, we doubt inflation pressures will rise dramatically in the short run. But the Fed's balance sheet is bloated, and markets are firmly pricing in an extended period of extraordinary monetary policy stimulus, along with very low inflation. An unanticipated surge in consumer prices is a small but material market risk we're keeping a close eye on.*

6 The global economy recovers, but geopolitical uncertainties remain a source of volatility.

The pandemic hit the reset button on the economic cycle for most of the world's major economies. We think 2021 will see the global economy progress in the early stages of a new expansionary cycle that will support international equity market performance. Developed markets will, in our view, benefit from stronger fiscal and monetary policy coordination across Europe, which should help spur the recovery as many European economies emerge from lockdown protocols. Several major developing economies, most notably China, appear slightly further into the new expansion, given the timing of their pandemic experience and accelerated policy stimulus. We think global GDP will expand in 2021 by the fastest pace since 2010.

We expect U.S.-China relations to return to the headlines. While we don't believe the Biden administration

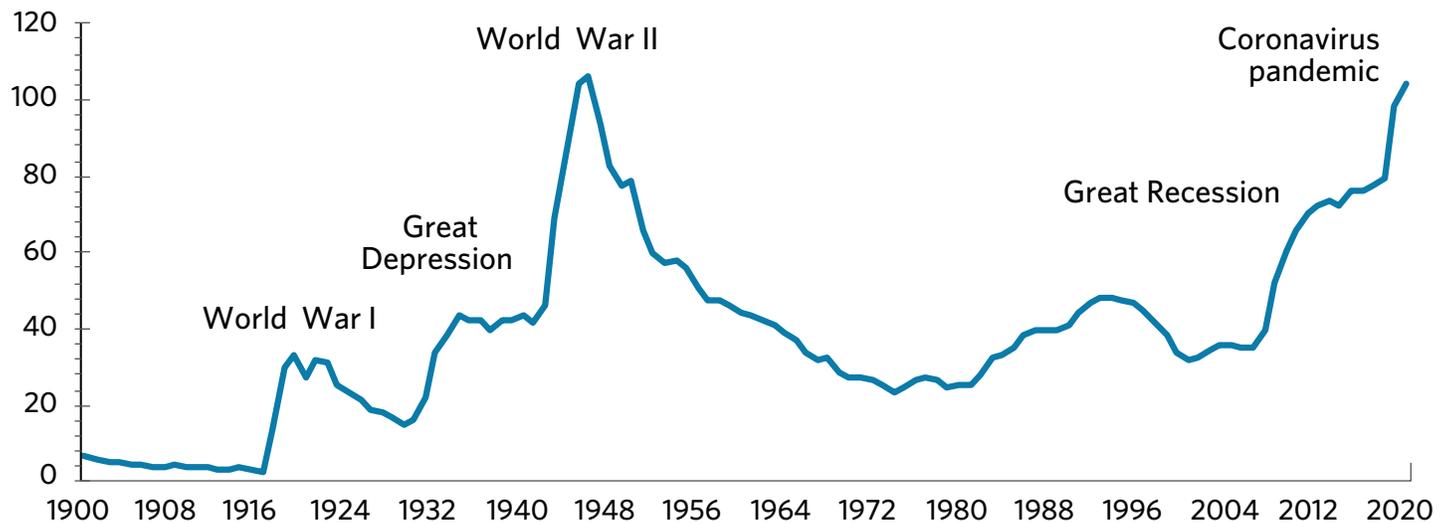
will take the same approach President Trump did, we think President Biden will maintain a somewhat hard-line stance on China when it comes to trade and national security. We expect existing tariffs to be used as leverage, particularly as policymakers seek to boost growth. We don't expect the trade rhetoric to be quite as contentious as it was in 2018 and 2019, but we suspect periodic tensions between the U.S. and China will be sources of occasional market anxiety this year.

International equities outperformed U.S. markets in the early stage of the post-financial crisis recovery in 2010 and the phase of synchronized global growth in 2016-2017. The prospects of a renewed global upswing should, in our view, lend a hand to international market performance, supporting our recommendation for a neutral allocation to international equities as part of a well-diversified portfolio.

*Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal.

7 Government debt rises to new heights but doesn't come to a head yet.

Federal Debt Held by the Public (Percent of GDP)



Source: Congressional Budget Office.

The pandemic has pushed the budget deficit to record levels. U.S. federal debt will likely rise above 100% of GDP in 2021 for only the second time in history – the first was during World War II. Rising GDP will help slow the ascent, but with 50% of the budget going to entitlement programs such as Medicare, Medicaid and Social Security, and another fiscal aid package needed to help get the economy to the other side of the pandemic, government debt will continue to climb this year.

This is not a pot set to boil over immediately, however. While debt as a percentage of GDP is headed for historic highs, it remains below levels that will initiate financial stress or insolvency. Fortunately, the U.S. remains one of the more vibrant economies in the developed world, and low interest rates will allow the government to borrow at low costs for some time to come.

Nevertheless, shifting demographics and ongoing structural deficits are likely to make

rising government debt a more prominent risk down the road. We don't think this will threaten long-term opportunities in investment markets, but elevated government debt does pose a headwind to potential economic growth over time. It can limit the flexibility of fiscal policy, raise interest expense and, if left unchecked, eventually crowd out private investment.

We think these risks will become more acute decades from now, requiring tougher budget choices in the future. In the meantime, we think the Biden administration will explore opportunities for higher tax policies in an effort to raise government revenue.

If you're concerned about government debt risks, ensure appropriate diversification within your fixed-income portfolio, with the majority allocated to investment-grade bonds. To address long-term government debt/interest rate risks, ensure a proper allocation to global equities and domestic equities with rising dividend potential.

8 The U.S. dollar's rise takes a breather.

Short-term changes in the dollar's value are difficult to predict, given all the factors that cause them. However, we think the dollar could flatten or potentially weaken over time against other global currencies.

For historical perspective, the U.S. dollar has generally trended lower over the past 50 years, moving in 15-year cycles. Since the Great Recession, the dollar has mostly been in a bull market, driven by faster U.S. economic growth, higher domestic interest rates and its role as a "safe haven" during times of uncertainty. However, the dollar peaked in early 2017 and has remained rangebound since.

We doubt the U.S. dollar will collapse or lose its status as the world's reserve currency, as some predict. But there are reasons to believe certain factors that pushed the currency higher over the last decade are gradually reversing:

- a. The dollar has been a countercyclical currency, rising when global growth slows and falling when it accelerates. As global growth begins to rebound, this will likely exert some pressure on the dollar.
- b. The Fed was the only major central bank to normalize monetary policy in the last business cycle, as the European Central Bank and Bank of Japan pushed policy rates below zero. The 2020 recession led the Fed to quickly cut interest rates near zero and expand its balance sheet at a faster pace than other central banks. Looking ahead, the Fed will not want to hike rates until inflation picks up materially, while interest rates in Europe and Japan are already negative and likely won't fall much further. This dynamic will provide less support for the dollar.
- c. The rising U.S. federal budget deficit and the trade deficit will continue to be headwinds for some time.

In five of the past seven years, the rising dollar reduced returns for international developed stocks by an average of about 3% a year when compared to returns in local currencies. We believe a partial reversal of the last decade's strength will support international investment returns.

New Normal, Consistent Approach: Focus on What Matters Most to You in 2021

- **Make your financial resolutions.** Revisit your important financial goals for 2021 and beyond with your financial advisor. Review your budget to determine your flexibility, and then prioritize your financial resolutions. Depending on your situation, priorities could include replenishing your emergency fund, taking advantage of retirement accounts, paying down debt and/or increasing savings toward a financial goal.
- **Review your diversification.** As the market's focus swings between near-term uncertainties and longer-term growth prospects, we expect leadership among asset classes and sectors to rotate. Cyclical and more economically sensitive areas of the market are likely to benefit as a COVID-19 vaccine supports a sustained expansion. Industries such as technology and growth-oriented investments are positioned for more secular growth trends.

At the same time, periodic setbacks on the road to recovery will, in our view, favor allocations to bonds and defensive equity sectors. We recommend a neutral allocation between stocks and bonds, based on your strategy's risk and return profile. We believe maintaining diversification across a variety of asset classes, including international exposure, can improve your chances for long-term success and prepare you for rotating market leadership.

- **Set appropriate expectations for your portfolio.** We think bonds will continue to play an important role in portfolios, particularly as a buffer against periodic market pullbacks. That said, we believe interest rates will remain at fairly low levels this year. We recommend reviewing the level of predictable income you expect your bond portfolio to generate. Consider an overweight allocation to U.S. high-yield bonds as a way to enhance income now. Laddering bond maturities can help you take advantage of higher rates down the road.

While full equity valuations and persistent economic challenges are likely to produce bouts of volatility, we expect rising corporate earnings and supportive policy to point toward positive returns in 2021. Systematic investing and periodic rebalancing can help you navigate volatility. Keep your investment performance expectations realistic and your portfolio decisions aligned with your long-term goals to help stay on track as you progress through 2021 and beyond.

- **Create or update your estate plan.** While potential changes in tax policy, including items such as the estate tax exemption and step-up in basis for inherited assets, remain uncertain at this stage, we do know the SECURE Act, passed in late 2019, made meaningful changes related to the inheritance of retirement accounts. If appropriate, consult with your financial advisor and estate-planning professional to ensure you have adequate insurance in place, documented beneficiaries and an up-to-date estate plan.

Past performance does not guarantee future results. Diversification does not guarantee a profit or protect against loss in declining markets. Investors should understand the risks involved in owning investments, including interest rate risk, credit risk and market risk. The value of investments fluctuates, and investors can lose some or all of their principal.