MADISON MOSAIC SERIES

4Q 2020 Investment Strategy Letter - SMA

Madison INVESTMENTS

2020 YEAR-END RECAP

Supported by unprecedented levels of fiscal stimulus, ongoing global central bank accommodation, quickly recovering corporate profits, and encouraging news on the Covid-19 vaccine front, risk assets continued their steady and impressive ascent since first putting in their pandemic-related panic lows this past March. For the year, U.S. equities (Russell 3000) rose 20.9% while foreign equities (MSCI ACWI-ex U.S.) climbed 10.7%. U.S. bonds (Barclays U.S. Aggregate) returned 7.5% as interest rates, once again, declined for much of the year.

PERSPECTIVES

> *"Ignorance more frequently begets confidence than does knowledge ..."*
>
> - Charles Darwin

Financial markets are partying like its 1999. Literally. The best explanation for today's full-blown giddiness is that this is exactly what nearly all global central banks seemingly desire. They want elevated asset prices and they are taking historically extreme actions to accomplish this. Surging financial markets clearly provide an important psychological boost to otherwise ailing and fragile economies. Importantly, a key prerequisite for this storyline to play out like it has, so far, is that inflation is also cooperating and remains accommodatingly low. Conversely, high and/or rapidly rising inflation would stifle the effectiveness (and wisdom) of posturing to a radically dovish monetary policy. Thankfully, that is not yet the case.

The current and obvious motive for central banks to take the drastic measures they have taken is that pandemic-scarred and debt-infected global economies remain acutely in need of big-time financial assistance. With no perceived threat of inflation, central banks are not only willing, they also believe they are wholly and justifiably able to respond in-kind to the ongoing pandemic-related crisis. Accordingly, central banks have slashed interest rates while massively increasing both quantitative easing (QE) and overall liquidity. Perhaps more importantly to U.S. investors, the Federal Reserve (Fed) remains (since March 2020) authorized (as needed) to purchase non-government issued debt securities, such as U.S. corporate bonds. This assertive (intrusive) level of direct involvement in U.S. financial markets has clearly emboldened investors over the final nine months of 2020. To date, the Fed is pleased that its uncharted stimulus plan is working largely as hoped.

With the notable exception of China, many large global economies are following similar playbooks. China, is taking a more moderate and cautious tactic, choosing rather to cultivate a longer-term focus while maintaining more "normalized" financial markets. As we move through and beyond this current crisis, China's approach will likely serve them well. Meanwhile, the Fed and U.S. investors appear equally confident that they will know when to say when. But will they? This current "easy button" narrative is seemingly unquestioned by many. Record high investor complacency metrics lend support to this observation. Our question remains – who is acting responsibly and who is acting "confidently"? We'll let the answer to that be our guide.

OUTLOOK & POSITIONING

By nearly any measure, we now "live" in a world of both uncomfortable extremes and disorienting disruptions. Our collective experiences in 2020 undoubtedly testify to that. We believe this recent "recipe" for elevated uncertainty is likely to persist. Accordingly, we also expect to see ongoing bouts of elevated volatility. We know there are always winners and losers, but in a world of extremes, the differences between the "haves" and the "have-nots" is likely to

be exaggerated. In other words, we can anticipate scenarios where winners really win, and losers really lose. This increases the risks and the opportunities for all investors. By implication, not losing takes on greater importance. In short, management matters, arguably now more than ever.

Our conviction in a structurally weaker U.S. dollar (USD) is growing, especially relative to Asian currencies, as the U.S. continues to create and perpetuate unprecedented levels of fiscal and monetary stimulus. A weaker USD would likely benefit international equities and commodities, including gold. Our portfolios are strategically aligned to capitalize on this theme.

Throughout 2020, portfolios were tactically positioned to emphasize the increasingly attractive Asia-Pacific region, including countries such as Japan, China, Taiwan and South Korea. China was the first country to emerge from the COVID lockdowns; it was also able to do so while remaining uniquely conservative with its monetary and fiscal policies. Unlike many other countries, the Chinese Communist Party (CCP) has vowed to minimize the risk of creating destabilizing economic boom and bust cycles. Still, as economic growth remains important to the CCP, especially moving into the year of the party's 100-year anniversary, we don't foresee this moderating posture as a hindrance to the health of the Chinese equity markets. To the contrary, we believe that the broader Asia-Pacific region will continue to provide long-term global investors with an array of attractive opportunities going forward.

Finally, news on the Covid-19 vaccine front has been nothing short of remarkable. Going back to March, we learned that it would take at least 12 to 18 months to develop an effective vaccine. Now, just nine months later, we have two vaccines, from Pfizer and Moderna, that the U.S. is already administering. These vaccines, with indications of greater than 90% efficacy, are based on breakthrough mRNA coding. This technology is uniquely well-designed to stimulate a wide-ranging and effective antibody reaction, improving both the safety and likely durability of the immune response. Medical advancements like this also demonstrate the degree of overall technological progress that has been accomplished in recent years. Sectors with strong emphases on research and development have proven to be historically attractive and remain an area of focus in our portfolios. Biotechnology and (information) technology are two prime examples.

SUMMARY

We are confident our portfolios remain well-positioned for a still stressed global economy. We also embrace our ongoing responsibility to insightfully differentiate between attractive and less attractive asset classes as we strive to deliver superior risk-adjusted returns. As we continue to work through these difficult times as a nation, we truly appreciate your confidence in partnering with us.

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