JUNE 2020

ON A PERSONAL NOTE….

January 1, 2020 marked the start of a new decade. A milestone of a new decade typically is welcomed with optimism and a renewed outlook for opportunity. Unfortunately, thus far, in the beginning of this new decade we have seen brushfires threaten Australia's coast, escalating tensions with Iran, an impeachment trial of the President divide the nation, devastating floods in Indonesia, communal riots in India, earthquakes in Turkey, locusts swarms in Africa, and talk of murder hornets. All of which pales in comparison to the global pandemic of COVID-19, that has brought the global economy to a halt and pushed unemployment markedly higher. Beyond the economics, there is the devastating loss of life around the world. Unfortunately, clients and dear friends of our team have passed away–for that we wish our heartfelt condolences to their families and we will miss them deeply. On top of the global pandemic, in the early part of this new decade, we are now experiencing social unrest across our nation in response to the death of George Floyd.

With that said, we are all feeling a little physically and emotionally drained. Many are experiencing loss and despair whether over the loss of a loved one, a job loss, the stress of their situation, or even a special event or milestone being cancelled. We hope we can take pause and remember to find joy, take care of ourselves, and be reminded there is still plenty of good in the world. Some common suggestions for improved self-care can be keeping a gratitude journal, remembering to appreciate the little things, surrounding ourselves with positive people, and now more than ever, simply being kind.

JUNE MARKET COMMENTARY- MARKET AND ECONOMY AT ODDS

Over the past eleven weeks, 42.6 million Americans have filed for unemployment, the Gross Domestic Product (GDP) of the United States fell by 4.8% in the First Quarter (and will likely fall by more in the second quarter), yet the stock market had another strong month in May with the Standard and Poor's 500 Index rallying nearly 8% to bring the broad market back within 10% of its all-time highs. Many are scratching their heads wondering how the stock market is moving in the opposite direction of the economy. There is a host of history and data showing that markets don't move in lockstep with the economy. We look at a few reasons why that is, and our thoughts on this phenomenon.

Markets are Forward-Looking

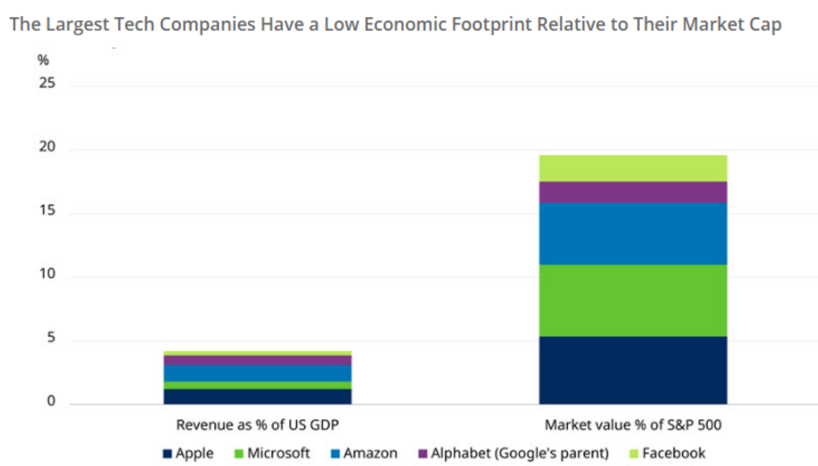
A company's value can be referred to as the present value of all its future earnings. While the value of a company can reflect what is happening right now, it also is based on what is forecast to happen in the future (this is why stocks will see large movements when there is news released or when their quarterly earnings beat, or miss, a prior forecast). In contrast, most economic data is backward looking. For example, the GDP growth figures tell us about what happened in the prior quarter.

Markets being forward-looking is largely why the markets cratered in February and March as the coronavirus spread through the United States. As uncertainty crept into the headlines, prior earnings expectations and prior economic forecasts became meaningless and stocks fell in anticipation of the economic slump that has subsequently been realized. On the same token, while it is easy for us to be focused on the current data such as GDP contraction and skyrocketing unemployment, the situation will not last forever and markets are pricing in the expectation of a recovery.

While we do think that the stock market reaction to coronavirus was overly pessimistic, we suspect that with recent market performance the stock market may be a little ahead of itself and expectations may be overly optimistic. While we believe that the recovery will be reasonably strong, we believe that it may not be as quick, or as uninterrupted, as markets may be expecting—more on this below.

The Stock Market is not Representative of the Economy

The broad stock market is not a very good representation of the overall economy. The Standard and Poor's 500 Index, a broad market index comprised of the 500 largest companies is a good example of this. The index is market weighted meaning that the larger a company, the greater its impact on the index. Microsoft, Amazon, Apple, Google, and Facebook have outperformed as a result of quarantines and people staying at home. These five companies represent 20% of the Standard and Poor's 500 Index. While these five companies make up 20% of the broad market index returns, their combined revenues account for only 4% of the United States' GDP. The smaller companies who tend to have less representation in the stock market index account for 44% of the United States' GPD according to the US Small Business Administration Office of Advocacy.



Past performance does not guarantee future results. Source: Refinitiv Datastream and Schroders. Notes: reported global revenues as of FY2019, with broker estimates used for firms yet to report earnings. Market value as of 5/01/20.

While the markets are approaching their all-time highs, the small businesses that make up 44% of US GDP (eleven times the economic impact of the five largest companies driving the S&P500 returns) are likely to suffer more during, and have a harder time recovering from, the economic shutdown because they typically have smaller cash holdings and credit sources to help buffer the blow.

Market Liquidity

Liquidity is the availability of cash, or the ability to convert fixed assets into cash, so that a company can meet their short-term debts and obligations. As the coronavirus shutdown set in, the fear of companies experiencing liquidity issues rose. This was not helped by many large corporations drawing down their lines of credit to ensure they had ample liquidity. This helped stoke fear in the markets and brought bond markets (a traditional investor safe haven) down right along with the stock markets.

Based on history, there is an old adage "don't fight the Fed." This means that it would be in investors' interests to invest in a manner that aligns with current monetary policy of the Federal Reserve Board, rather than against them. The last two months have been a great example. An additional catalyst in the market that has led to a further disconnect between the market and economy has been the massive stimulus packages that central banks have released. The US Federal Reserve has cut interest rates to zero, pledged to buy government bonds in an unlimited amount, and pledged to buy investment grade and high yield debt. Paired with large fiscal policy from Congress (the expansion of unemployment, stimulus payments, and loans to small businesses) these unprecedented measures have helped to boost stock prices by bolstering liquidity, lowering the cost of borrowing, and providing financing to corporations—all boosting confidence.

So what does it all mean for markets and our portfolios?

While there is a lot of debate over what the recovery may look like, there is at least a bit of consensus among economists that this could be the sharpest and shortest recession in US history. While some are calling for a V-shaped recovery (meaning quick and strong), we believe that the recovery will be strong, but we are not convinced that it will be as quick as markets may be expecting, we think it will be a rocky road, and we don't think that the rising tide will lift all boats evenly.

Government and central bank support have eased fears and liquidity injections are supporting the markets, but it doesn't mean we are "out of the woods." Despite all the liquidity, it may not be enough to keep the hardest hit businesses operating, or to get consumers shopping. As the economy begins to open back up (the most locked down states of New York, New Jersey, and Connecticut all plan to begin opening again this month) we suspect that the number of new cases of the virus will naturally rise and many will be slow to return to "normal life." Revenue and profits are likely to remain under pressure for the foreseeable future. While many industries will continue to see growth, it may be a longer road to recovery for restaurants, travel, leisure, and brick and mortar retail. Unemployment may be starting to peak, but as these industries have a potentially slower recovery, it may take employment some time to recover.

There is a strong positive case: ongoing and creative monetary policy, massive fiscal stimulus (of which we believe we will see at least one more trillion-dollar package), a slowing spread of coronavirus, and growing optimism. Yet, there are also risks: the potential of a second wave of infections, a disruption in the US/China trade deal as tensions rise, uncertainty around the election cycle and growing social unrest. The risks are balanced, and markets can use any excuse to take a step back. We remain cautious putting new money into the markets for clients. The most important things right now are that we avoid a policy error or a second wave of the virus.

As always, if you have any questions, please do not hesitate to contact our team. Be safe, be well.

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Data sources: Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Department of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprice.org (spot gold/silver); Oanda/FX Street (currency exchange rates). News items are based on reports from multiple commonly available international news sources (i.e. wire services) and are independently verified when necessary with secondary sources such as government agencies, corporate press releases, or trade organizations.