LaFleur & Godfrey
PRIVATE WEALTH MANAGEMENT

Summer Commentary 2020

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The last three months seemed to last a lifetime. So much has occurred over this time span - economically, financially, politically and even culturally. We will stay away from the cultural issues, except to say this is another one of those unique times in American history where, depending on how we respond, the outcome could dramatically impact the other three.

Economic Outlook:

Our country has never been through an economic event like we've experienced over the last 3 months. Sure, we've had recessions in the past, even severe recessions. We've had a depression that lasted many years. But we've never deliberately shut down our economy. With that came a very rapid and historic increase in the number of unemployed. This predictably created a situation where many businesses, large and small, struggled to survive. This was especially true in the retail, travel, leisure and hospitality industries. Thankfully, we saw a swift response from our government and the Federal Reserve to fight the effects of the shutdown - both fiscally and monetarily. Congress came together and pumped more than $3 trillion in stimulus money into the economy. The Federal Reserve, led by Chairman Jerome Powell, provided the monetary support via various programs which provided the necessary support to the markets, financial institutions, small businesses and consumers.

We have said all along our economy cannot survive a prolonged shutdown. We still believe it to be true. In March, we predicted we would likely see virus cases peak sometime in April. That turned out to be prescient. The curve did indeed flatten which enabled our healthcare system to recover from the initial surge. This set the stage for a gradual re-opening of our economy mid-May. Since then, the sharp snapback in economic activity has been impressive. This is evidenced by numerous favorable economic reports over the past month. First came the 2.7 million jobs created in May - much higher than economists had predicted. This was followed by the June jobs report showing another 4.8 million jobs created - about 1 million more than expected. We realize we have not made up all 20 million + jobs lost, but to recover one-third in just two months' time suggests a stronger-than-expected recovery is upon us. More good news followed. First, the June ISM Manufacturing Index registered a reading of 52.6. Any reading above 50 indicates the manufacturing sector is expanding. For perspective, the index was 41.5 in April. Then, the ISM Non-Manufacturing (Services) Index came in at 57.1 – the same reading as pre-pandemic. Finally, the June Consumer Confidence Index rose to 98.1 from 85.7 in April. While not at the 130 level it was in January and February, the reading suggests there was considerable pent-up demand when the economy opened back up.

The above-mentioned economic data points have us optimistic for the second half of the year but we still have several lingering concerns. First, we believe many of the jobs lost will never come back – possibly as much as one-third or more. Unfortunately, small businesses have been put at a considerable disadvantage in this 'new normal'. As a result, we see many bars, restaurants and small retail shops closing for good. Social distancing dramatically impacts and limits their sales. Can they continue to hang on under that scenario? Frankly, a COVID-19 vaccine may be the only hope for many. Second, we believe the work-from-home (WFH) trend is here to stay. Therefore, we see small and mid-sized businesses forced to make considerable investments in technology just to stay competitive! Employees will need laptops and/or tablets to work remotely, on-premise technology hardware will need to be updated & cybersecurity software will become a high-priority budget item. These short-term investments will be costly and a little painful, but we believe the long-term benefits will far exceed costs. Lastly, a flexible workforce has the potential to be very disruptive to many metropolitan areas around the country. We see a major shift from urbanization to suburbanization. Some companies have already been proactive. For example, in the last two years alone, New York City has seen Goldman Sachs move jobs to Salt Lake City, Alliance Bernstein to Nashville and Deutsche Bank to Jacksonville. Other companies will be forced to leave. If civil unrest continues, we see this trend accelerating as employees flee the city and demand the safety of the suburbs. Unfortunately, state and local government finances were already weak going into COVID-19. This could become quite problematic over time. We will continue to monitor this closely.

Market Outlook:

The path of the markets over the last 3 months has been almost straight up. While we were hopeful in March for a V-shaped recovery, this certainly has surpassed our expectations! The second quarter experienced only two small declines – one in early-April and the other in mid-June. For the most part, the market has been trading on favorable news of the reopening of the economy, the decline in COVID-19 mortality rates and on the hopes for a vaccine. The key will be whether the market shrugs off anticipated terrible 2nd quarter earnings reports beginning in July. After 1st quarter earnings season, many companies removed guidance for the rest of 2020. We believe this was prudent. So what the market will really be looking for out of 2nd quarter earnings season is what management teams are currently seeing in their businesses and the confidence they have for the remainder of the year. Remember, in the long run, fundamentals matter. The market can only stay elevated for so long without an improvement in earnings to bring down the overall extended valuation of this market. We expect better clarity and a dramatic improvement in tone from management teams exiting earnings season. This will likely support the market and enable us to remain rangebound going into the presidential debates and pre-election.

Our long-term forecast is more constructive and positive. In mid-June, Jay Powell and the Fed said they see rates near-zero through at least 2022. Low interest rates will enable our economy to slowly recover which should benefit stocks. As investor confidence improves, we see much of the almost $5 trillion in cash sitting on the sidelines going into the market post-election. While some will surely head towards the safety of bonds, we expect equity allocations to rise – especially in high-quality, dividend-paying stocks. This should provide a favorable backdrop for equities in the near to intermediate-term. The wild cards for the market remain a.) a potential second wave of COVID-19 (negative) and b.) the potential for a vaccine (positive). We see another shutdown of our economy as highly unlikely.

Political Considerations:

Elections can be tricky and almost impossible to predict, especially in July. So, we won't! On the political timeline spectrum, four months is an eternity! Instead, we will try to weather the anticipated volatility pre-election by focusing on our individual companies and monitoring their improvement in fundamentals coming out of the recession. We will look to 'buy the dips' on weakness and opportunistically 'sell into strength' when appropriate. For clients on the risk averse side of the risk tolerance spectrum, we encourage using asset allocation (a move to bonds and/or cash) to reduce portfolio volatility and risk. However, market timing is often a loser's game and investors with a long-term horizon may be best served only making minimal adjustments. We are very confident that our Mega Trends approach to growth investing is appropriate given almost any election outcome. We feel that stock selection right now is as important as it has ever been. This plays well into LaFleur & Godfrey's strengths.

Finally, we thought we'd end by sharing some perspective of historical stock market returns given different election outcomes (courtesy of our friends at Strategas Research). Interestingly, each election outcome typically results in considerably better returns than those expressed by the doom-and-gloom naysayers often interviewed on television. We suggest investors try to tune out the 'noise'. Have a safe & healthy summer!