Fall Commentary 2020

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Where do we go from here?

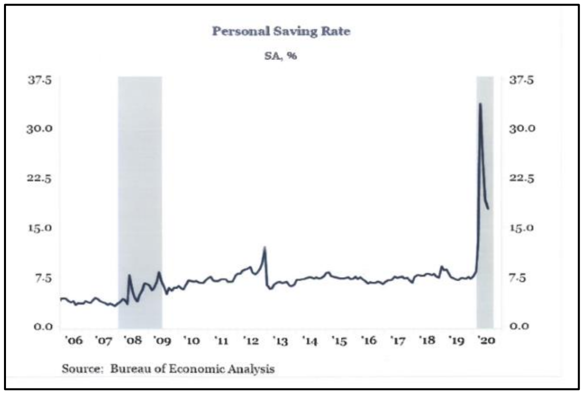
Economic Perspective:

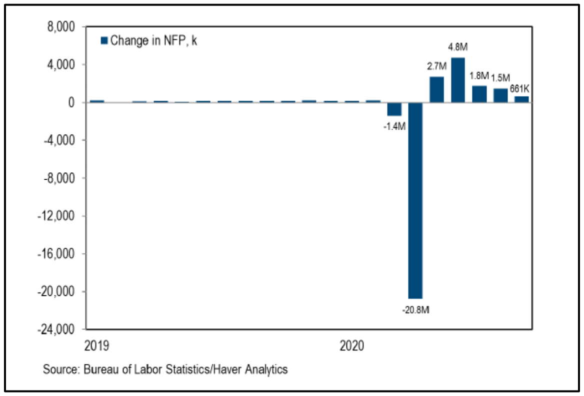
The steep economic rebound we experienced during the third quarter was impressive to say the least. After a 31.4% GDP drop during the second quarter which saw the worst economic data points since the Great Depression, the snap-back recovery during the third quarter was one for the ages. We give thanks to Fed Chairman Jerome Powell, his cohorts at the Federal Reserve as well as our elected officials that were able to support consumers and businesses with ‘fast-and-furious’ stimulative policy initiatives. Thankfully, these policy measures took only months to implement versus years during the global financial crisis of 2007-09! Hence, the ensuing recovery we are still experiencing has been V-shaped and has thus far surpassed even the most bullish economic forecasts.

Leading the way has been the recovery in the ISM Manufacturing and Services Indices. Each has recovered from the low-40s (<50 = economic contraction) during the height of the pandemic to well over 50 (>50 = economic growth) today. The ISM Services Index rise in September to 57.8 was its broadest rise of the year and the ISM Manufacturing Index rise to 55.4 marked its fifth straight monthly advance. The broad-based optimism in the corporate sector has recently propelled the NFIB Small Business Optimism Index to 104 in September – a seven-month high (see chart).

Consumer spending recovered as consumers received paycheck assistance and stimulus checks. As a result, retail sales have rebounded sharply with total sales now above pre-COVID levels. Low mortgage rates continue to provide a positive backdrop for the housing market. Existing home sales have reached all-time highs and the average price of those homes recently topped $300,000. With the consumer personal savings rate still very high (see chart), we believe the outlook for future consumer spending remains bright.

We are mindful that the economy should not only be viewed through rose colored glasses. For example, while the unemployment rate has fallen to 7.9% & employers have added over 11.4 million jobs since May (see chart), many businesses have closed and there are still millions of people unemployed and receiving government assistance. Without an additional round of fiscal stimulus from Congress, we see economic momentum slowing. Recent economic data points warrant caution.





Market Perspective:

The market is anticipating and pricing in additional fiscal stimulus as well as a strong recovery in company fundamentals. Corporate earnings and revenues, after experiencing deep troughs during the second quarter (see chart), are expected to show strong quarter-over-quarter growth during Q3. We view revenue growth, a much less manipulated fundamental metric than earnings growth, to remain a key barometer this quarter to determine the strength of a company's business model and the durability of its growth profile. We will be closely watching this metric during earnings season beginning mid-October.

With market levels at new highs going into earnings season, we are cautiously optimistic that lofty expectations can be met. However, given the dramatic run-up in prices experienced over the last six months, we would not be surprised to see a 'buy the rumor, sell the fact' market pullback with additional volatility in the coming months. The good news is that there is still a considerable amount of cash sitting on the sidelines right now. Recent figures suggest an enormous $4 trillion dollars is waiting to be invested! We believe that any material market correction will likely be aggressively bought by the sidelined cash.

A wild card in the market's equation is of course the potential for another wave of COVID infections during the upcoming flu season. Therefore, economic shutdown worries continue to permeate the investment landscape. Only time, and optimistic vaccine news flow, will put these fears to rest. We warn that delays in the vaccine development process (or push-outs in general availability and distribution to 2022) would not be well-received by the market.

Looking Ahead:

We view pre-election jitters to be normal. Historically-speaking, empirical evidence suggests that markets can do well with just about any election outcome as long as the economy is okay, inflation is in-check and interest rates are below-average. We have a long-held belief that the most important person impacting your investment portfolio is not the President but the Federal Reserve Chair! Monetary policy from the Fed can be swift and far-reaching whereas fiscal policy from DC is often slow and targeted. Therefore, we believe Jerome Powell's words and actions should carry considerably more weight than the election results of November 3rd. As the famous saying goes, 'Don't Fight the Fed!' Therefore, we remain optimistic and constructive on the markets post-election. In the coming year, we are confident that, one-by-one, the market's clouds will disappear. We are all anxious to put this crazy 2020 behind us. Brighter days are ahead.