AndCo's Weekly Market Update

May 26, 2020

THE ECONOMY

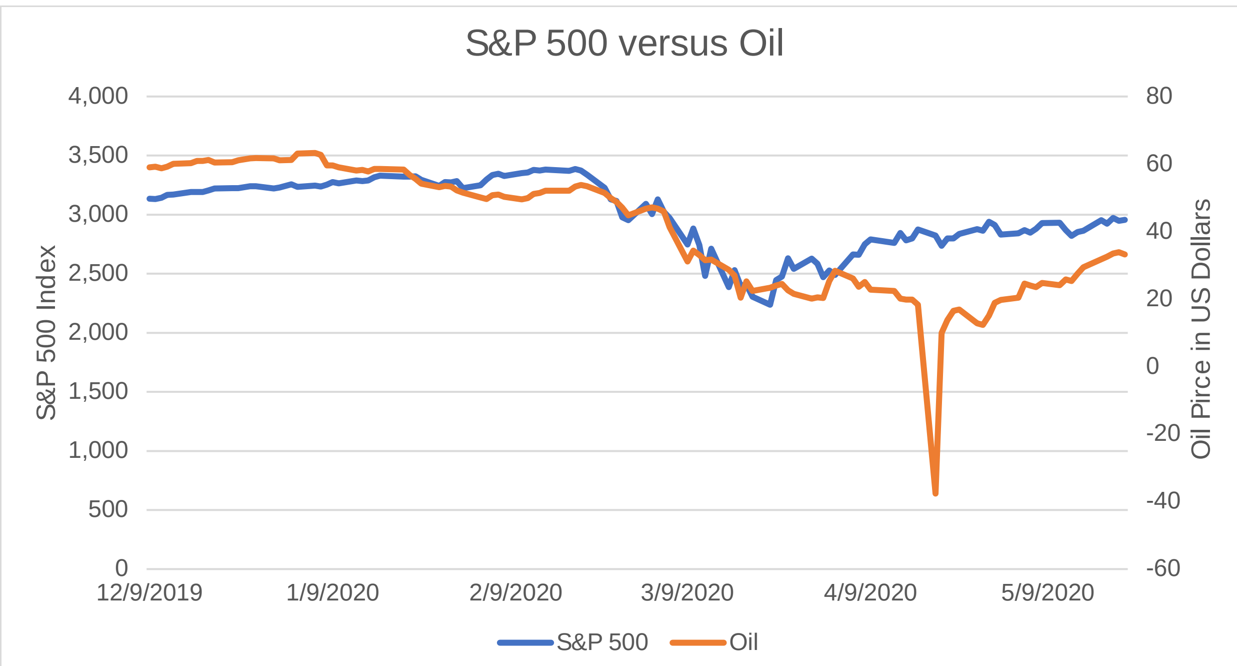
While there will most likely be setbacks in the coming weeks and months resulting from the COVID-19 (Coronavirus) pandemic, we are encouraged and continue to look for signs that life is returning to normal. Most importantly, the country is in the process of re-opening, with all 50 states beginning to roll back restrictions. While it remains a work in progress and too early to determine if re-opening will be successful, the fact that the country is moving forward should be viewed as a positive.

The economic calendar was busy this week with a number of readings that continue to confirm how damaging the pandemic has been to the US and global economy. Initial jobless claims for the week of May 16th came in at roughly 2.4 million, a decline from the previous week[1]. Since the beginning of the pandemic, more than 38.5 million American workers have been displaced. Housing continues to be one area of the economy that is showing strength. While new homes and builders' permits were down month-over-month, home purchases were up by 6.4%[2] for the week ending May 15th. With the average 30-year fixed mortgage rate hovering around the mid-3% range, buyers who can take advantage of low interest rates, or re-finance their current higher rate mortgages, should benefit from lower payments. The US Manufacturing and Services PMI (Purchasing Managers' Index) measures came in at 39.8 and 36.9, respectively[3]. While both measures were below the 50.0 level, signaling contractions in activity, they improved month-over-month. Despite the holiday-shortened week, we will get some important economic readings in the coming days. The second reading of the Q1 US GDP will be released on Thursday, while Friday we will see the personal spending and income numbers along with the University of Michigan Consumer Sentiment Index survey results. These readings should give us a good indicator of the health, resiliency, and mood of the consumer.

From a global perspective, the rhetoric between the US and China has been amplified. Recently, the US administration prevented a government pension fund from investing in Chinese equities while the US Senate approved legislation that could lead to Chinese companies being banned from US stock exchanges. This week also saw China impose a new national security law in Hong Kong, thereby bypassing the city's legislature, which is expected to ban sedition, secession, and subversion against Beijing. It will also enable mainland Chinese national security agencies to operate in the city for the first time. News of the law was roundly criticized by foreign leaders. Markets reacted negatively with the US dollar rising against most major currencies and oil trading lower on concerns for future economic growth.

EQUITIES

It was a very bullish week for US equities with the S&P 500 Index up roughly 3.3%. The index has now risen in five of the last nine weeks. The dispersion within the index remains stark with technology-related companies leading the index higher while most of the other sectors lag. The combination of better valuations, news of potential vaccines and investors looking ahead as the economy begins to re-open have been the primary catalysts for the sharp rise in recent weeks.
The energy sector has been behaving erratically since the onset of the pandemic for a variety of reasons including the lack of storage which resulted in the front-month futures contract temporarily trading at negative prices. Since then, the commodity has staged a solid rally. Why is this important? While the energy sector makes up only 3% of the S&P 500 Index as of April 30th, it has been a significant contributor to the index's overall negative year-to-date return of roughly -7.8% as of May 22nd. Through Friday last week, energy sector stocks were down more than 36% year-to-date[4]. That said, since the trough in the market on March 23rd, energy stocks' returns were up more than 59% compared to roughly 32.1% for the S&P 500 Index[5]. While there is a high probability that pressures on the sector could persist as energy prices remain low, should energy prices continue to creep higher as the economy heals, the sector could see continued positive performance which could act as a tailwind for the broader market.



Source: Bloomberg as of May 22, 2020

FIXED INCOME

It was a relatively quiet week in US fixed income markets. The benchmark US 10-Year Treasury bond traded lower by 7 basis points closing the week at 0.65%[6]. Much of the move lower in interest rates came on Tuesday the 19th as Chairman Powell testified to the Senate Banking Committee that the US economy might not recover until there is a vaccine in place. Additionally, the market had to digest the US Treasury issuing 20-year bonds again for the first time since the mid-1980s. The decision to resume the issuance of longer-dated bonds instead of relying on shorter maturity bonds is twofold: it allows the US to term out its debt as a result of sustained $1 trillion deficits while also improving the liquidity in the longer-end of the yield curve.

Despite the somewhat dire warning from the Chairman, US credit market yields traded lower during the week. High yield credit, as measured by option-adjusted spreads, continued to perform well with spreads falling to roughly 680 basis points over US Treasury bonds[7]. Despite concerns over the potential for rising defaults and bankruptcies as a result of the pandemic, particularly in sectors like energy, travel-related and consumer discretionary companies, investors continue to flock to higher yielding assets as it appears the likelihood for US interest rates to remain lower for longer increases.

Appendix

1. https://www.cnbc.com/2020/05/21/us-weekly-jobless-claims.html
2. Bloomberg as of May 20th, 2020
3. Bloomberg as of May 21st, 2020
4. Bloomberg as of May 22nd, 2020
5. Bloomberg as of May 22nd, 2020
6. Bloomberg as of May 22nd, 2020
7. Bloomberg as of May 22nd, 2020

Important Disclosure Information