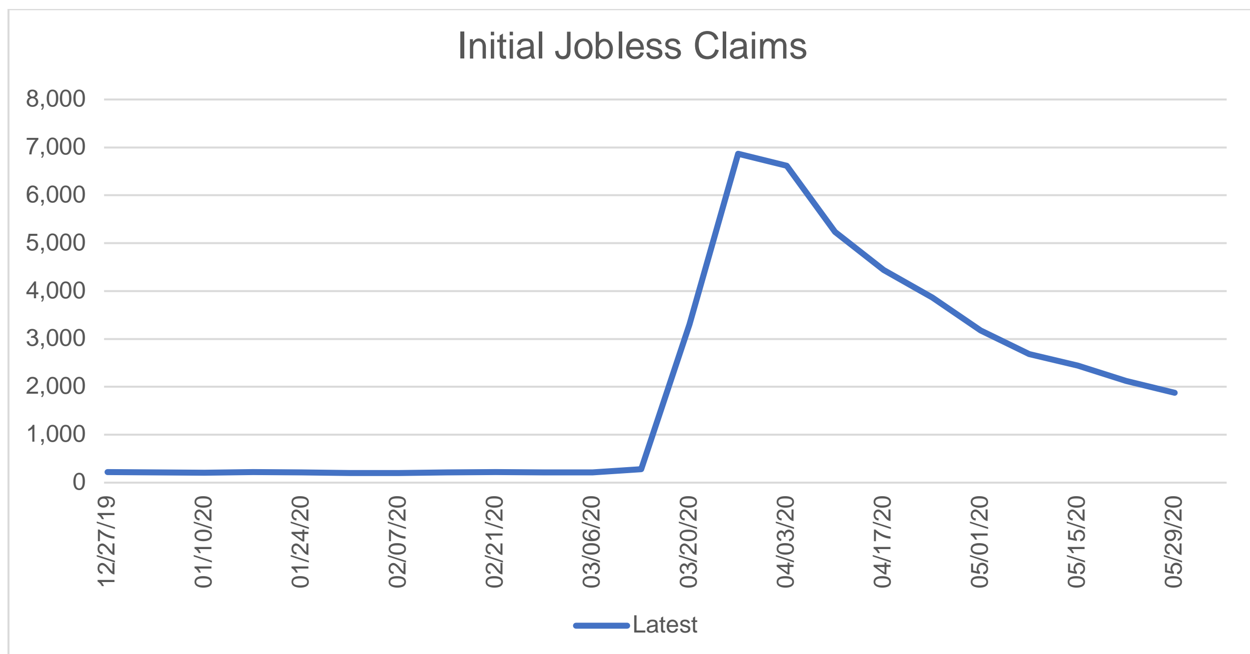
AndCo's Weekly Market Update

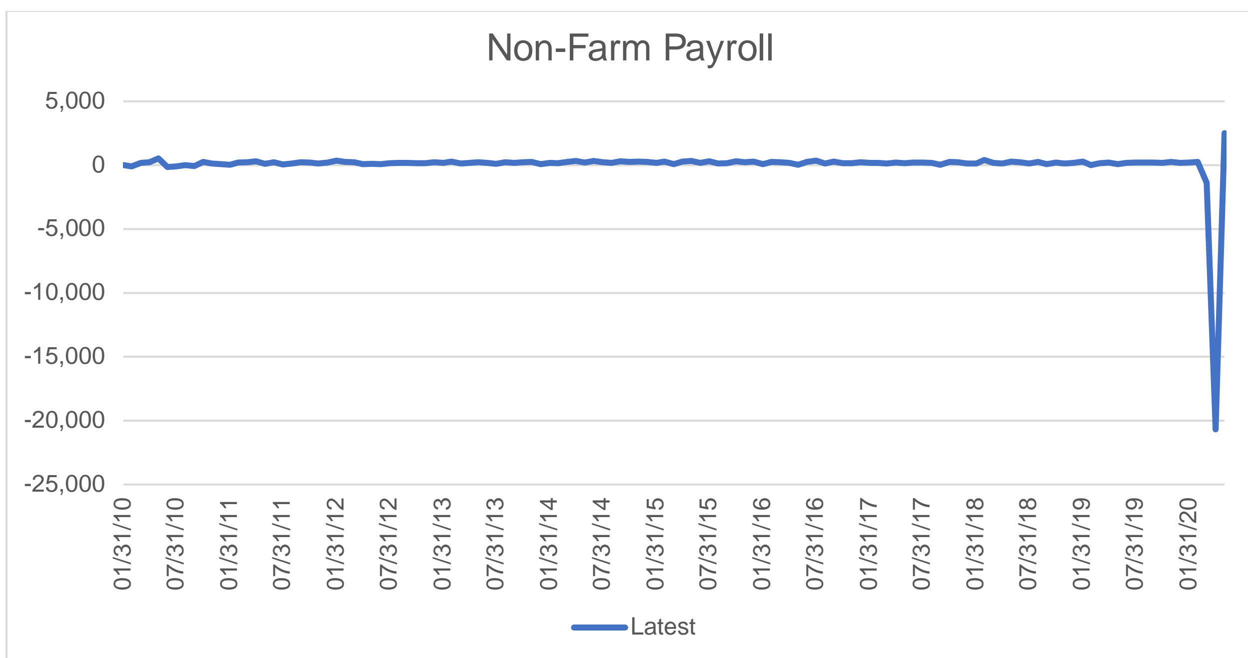
June 8, 2020

THE ECONOMY

It has been a difficult few months to remain upbeat and objective when evaluating the market environment. With the rapid slowdown of the global economy resulting in significant job losses here in the US, it has been very easy to focus on the negatives. However, in recent weeks, we have been encouraged by signs that despite the continued response to COVID-19 (Coronavirus), the economy was beginning the process of healing as states began to re-open. As evidence, this week we saw confirmation that the labor market is improving in both the initial jobless claims and change in the non-Farm Payroll statistics. For the week ending May 30th, initial jobless claims, or those filing for first-time unemployment benefits, declined to roughly 1.83 million, down from 2.12 million the week prior[1]. More importantly, the Bureau of Labor Statistics reported that non-farm payrolls rose by roughly 2.5 million jobs in May compared to a loss of more than 20.5 million in April[2]. As a result, the reported US unemployment rate fell to 13.3% in May[3].

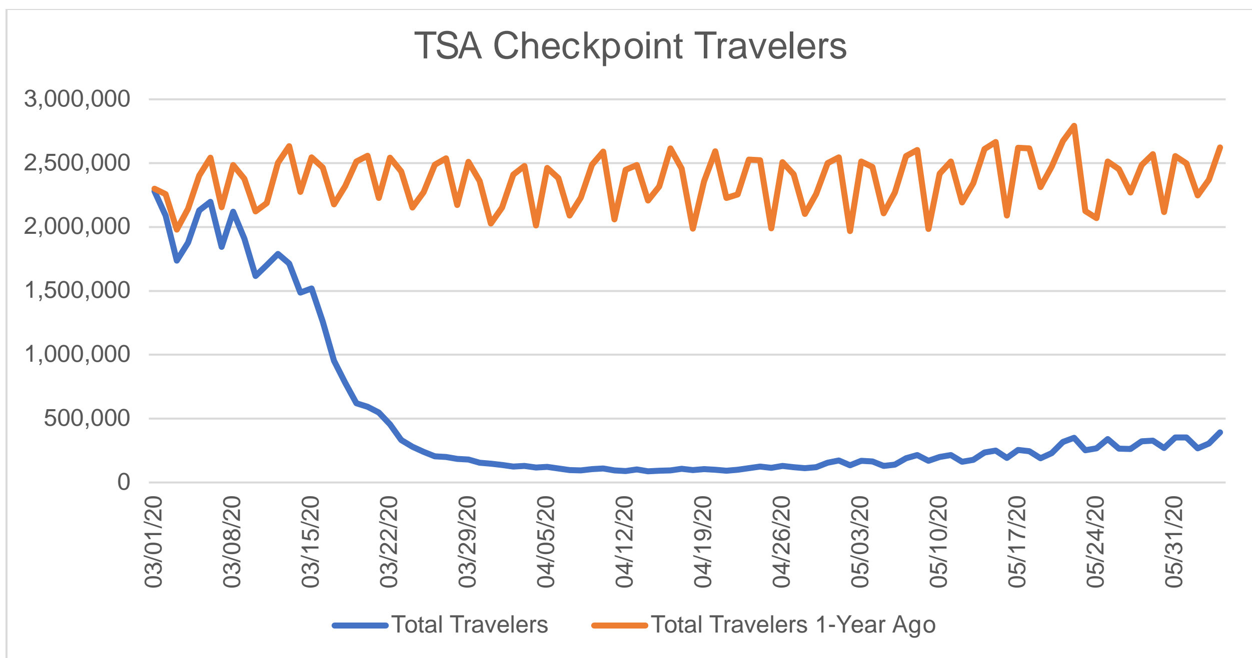


Source: Bloomberg as of June 5, 2020

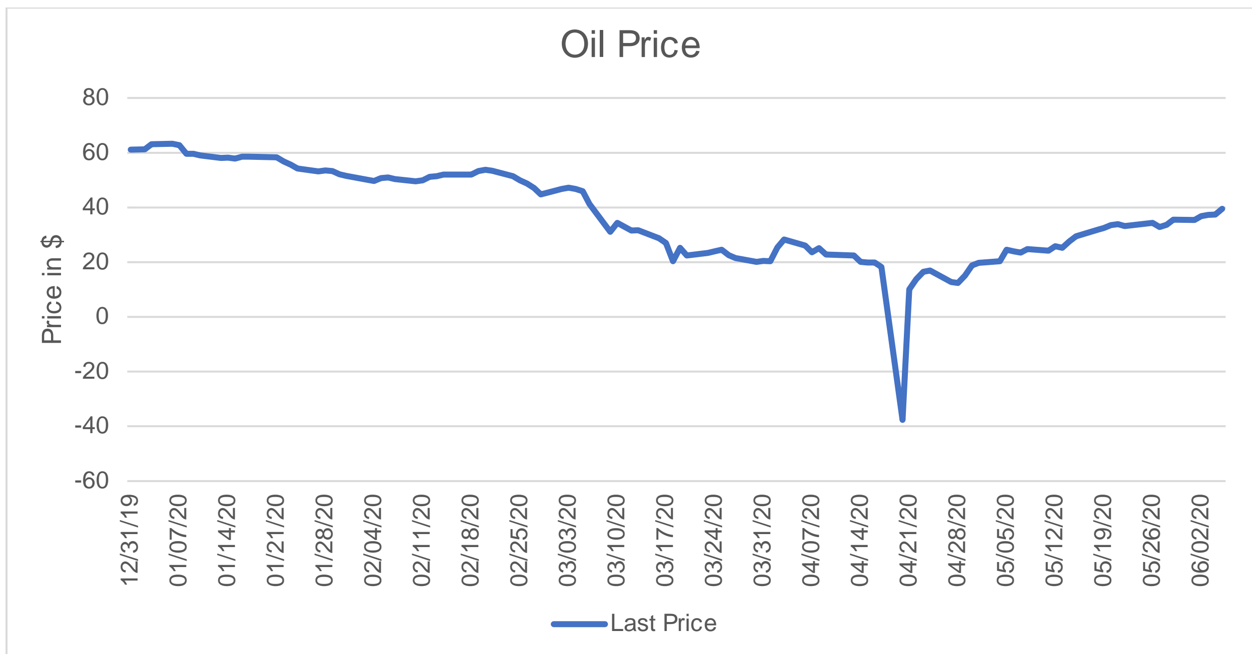


Source: Bloomberg as of June 5, 2020

While improvement in the labor market is likely to be the most widely quoted data point for gauging the economic recovery, we dug deeper to ascertain if the pent up demand resulting from the lockdown is beginning to work its way into the economy. One sector that was significantly impacted was travel and leisure. Locally, Orlando was hard-hit as both Disney World and Universal Orlando remained shuttered which naturally flowed through to hotels, restaurants, rental cars, and other supporting industries. Importantly for Orlando, Universal recently opened and Disney World is scheduled to re-open in July which should be a strong positive for the local economy. In addition, as states have begun lifting restrictions, we have seen an increase in the number of passengers passing through TSA checkpoints in airports. While airline travel may never recover to the previous highs given the structural changes resulting from businesses implementing Zoom®, Skype® and other forms of teleconferencing to replace in-person meetings, it would seem that airport traffic is nonetheless increasing. In anticipation of increasing activity, the oil market has experienced a strong rally in recent weeks as the combination of both greater demand and production cuts are supportive of rising energy prices. While we recognize that these anecdotal observations may not necessarily translate into increased economic output, using a mosaic approach, we believe that when taken in aggregate, they reflect an improving economic reality.



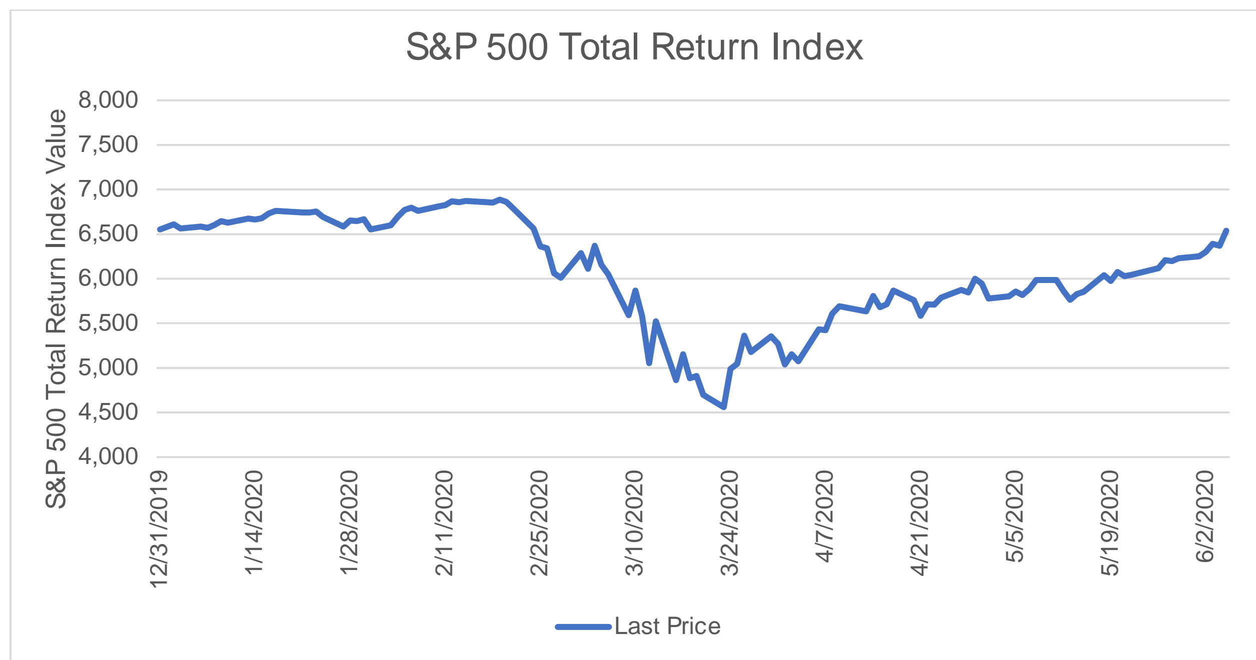
Source: https://www.tsa.gov/coronavirus/passenger-throughput



Source: Bloomberg as of June 5, 2020

EQUITIES

Stocks continued their impressive gains in recent weeks as investors focused on future economic growth. For the week ending June 5th, the S&P 500 was up nearly 5.0% while the small-cap Russell 2000 Index was up more than 8.1%[4]. Looking through the index, it comes as no surprise that the oil and gas sector was the best performer returning 15.4% for the week as oil prices continued to rally while the defensive health care sector returned only .23%[5]. To put into context how impressive the recent rally in stock prices has been, this is the third consecutive week of gains greater than 3.0% in the S&P 500, marking the first time that this has happened since 1982[6]. Despite these impressive gains, the S&P 500 remains slightly negative on the year having returned -0.3%. That said, the index rests roughly 5.0% below the all-time high achieved in February this year. From a valuation perspective, the index now trades at a P/E of roughly 22.2x, above the trailing five-year median of 19.9x[7]. Given the lofty valuation of the index, one point of concern could be the upcoming quarterly earnings season. It is reasonable to expect companies to discount the recent quarter's reporting given the impact from the pandemic. That said, the forward-looking guidance offered by companies will be a critical factor and could test investors' resolve to continue pushing stock prices higher.



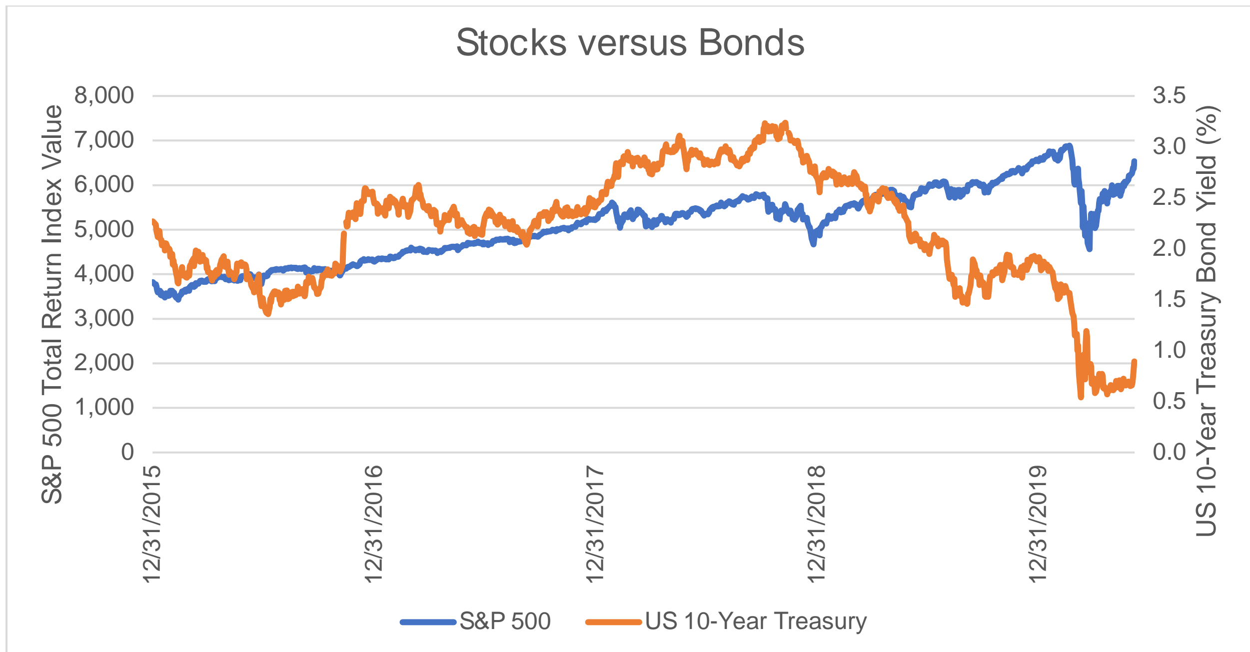
Source: Bloomberg as of May 31, 2020

FIXED INCOME

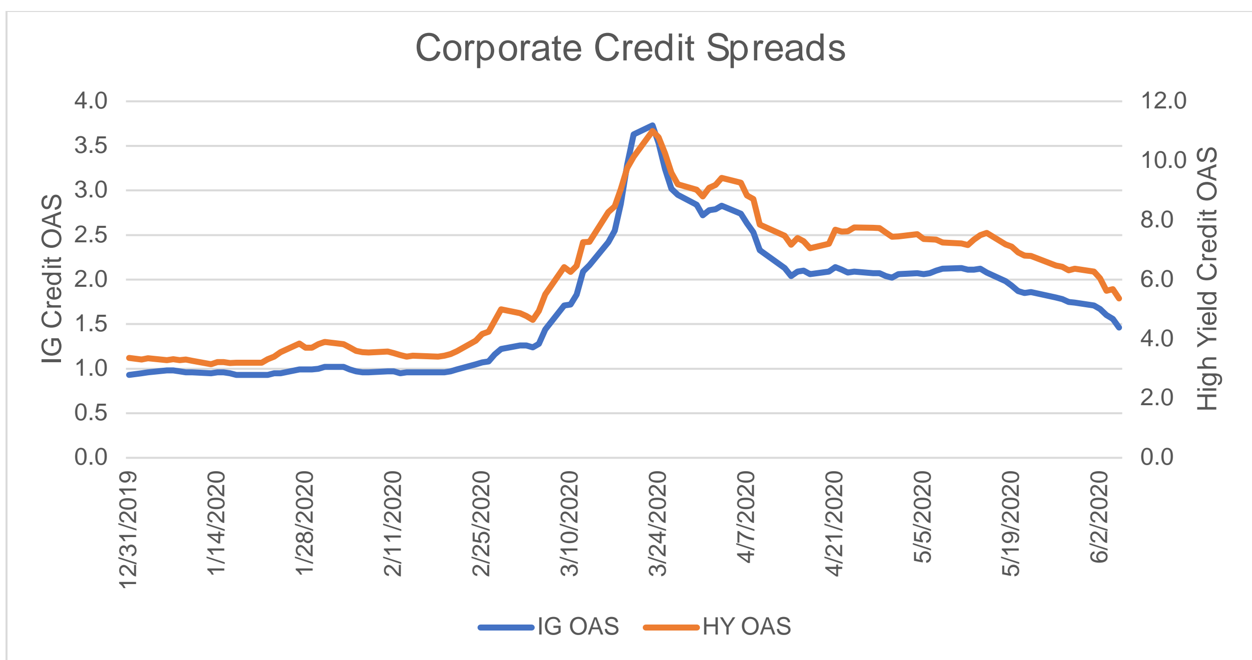
For the week, we saw an impressive move higher in US interest rates as evidenced by the US 10-Year Treasury yield, which increased by 24 basis points to 0.89%[8]. While the magnitude of the yield change may not appear significant, in terms of return, the US 10-Year Treasury bond lost roughly 2.4% for the week[9]. The broader Bloomberg Barclays US Aggregate Bond Index performed better, returning -0.49%, mainly due to investment grade corporate bond spreads tightening[10]. The tug of war between stocks and bonds as to which asset class has a better read on the direction of the economy continues. With the likelihood that the economic recovery is underway, bonds finally capitulated and yields rose. Looking at the chart below, it appears that there is a lot of room for bond yields to increase before they catch up to stock prices. However, such a rise would be counter to the Federal Reserve Bank's (Fed) need to keep interest rates low

in their effort stimulate the economic recovery. Importantly, rising interest rates may signal to investors that inflation expectations are increasing which could put pressure on the Fed to begin tightening monetary policy either by raising short-term interest rates or reducing the size of its balance sheet. Given the adverse reaction in the market the last time Chairman Powell attempted to raise interest rates, in combination with the fragility of the economy, we believe the Fed will most likely wait until inflation measures show definitive signs of increasing before moving forward with a policy shift.

Similar to stock prices, corporate credit spreads continued to move in a positive fashion. For the week, investment grade US corporate credit spreads declined by 28 basis points while high yield spreads declined by 99 basis points[11]. Within high yield, energy-related credits performed strongly with spreads declining by roughly 138 basis points[12]. One of the benefits of the recent period of low interest rates has been the ability of companies to roll over higher yielding bonds at more advantageous rates. As a result, we have seen a significant increase in the amount of debt issued, something we touched on in last week's Market Update. While we remain hopeful that the economy continues to show signs of improvement, should interest rates begin moving higher, the cost of borrowing will increase which could put additional pressures on corporate margins.



Source: Bloomberg as of June 5, 2020



Source: Bloomberg as of June 5, 2020

Appendix

1. Bloomberg as of June 4th, 2020
2. Bloomberg as of June 4th, 2020
3. Bloomberg as of June 4th, 2020
4. Bloomberg as of June 5th, 2020
5. Bloomberg as of June 5th, 2020
6. Bloomberg as of June 5th, 2020
7. Bloomberg as of June 5th, 2020
8. Bloomberg as of June 5th, 2020
9. Bloomberg as of June 5th, 2020
10. Bloomberg as of June 5th, 2020
11. Bloomberg as of June 5th, 2020
12. Bloomberg as of June 5th, 2020

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