AndCo's Weekly Market Update

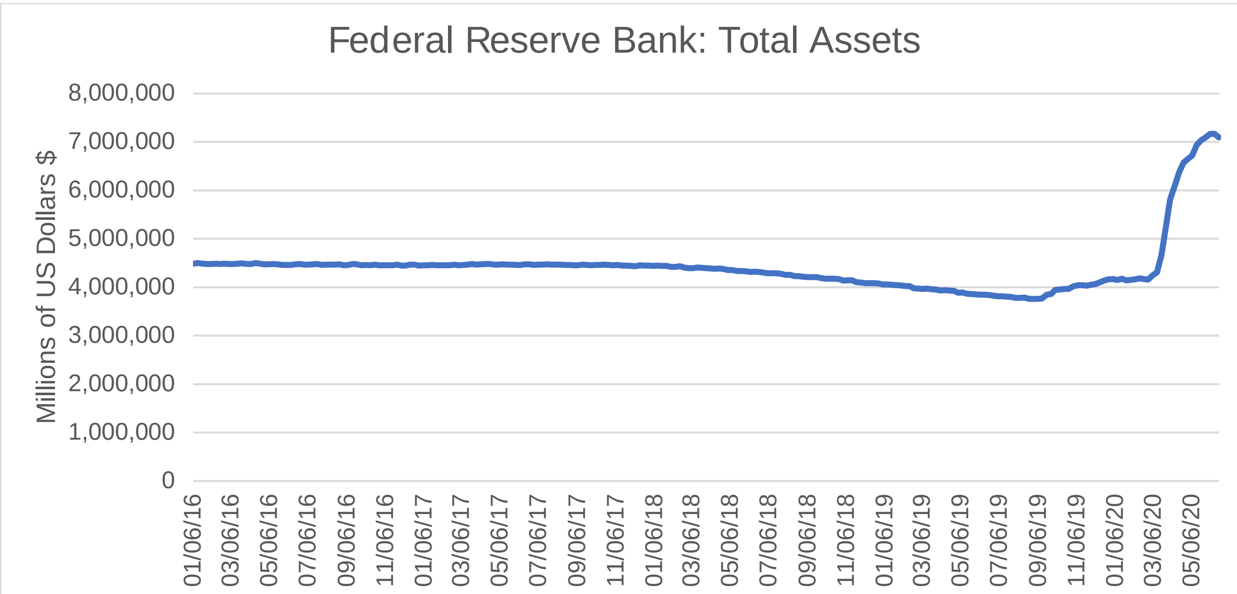
June 22, 2020

THE ECONOMY

US economic data points for the week ending June 19th were mixed. The week began on Monday with the NY Fed Manufacturing Index, a gauge of manufacturing in the New York region, reported its largest increase dating back to 2001[1]. The index rose to -0.2 from -48.5 a month ago[2]. According to Bloomberg, a survey of economists was expecting the index to rise to -29.6. While we are cognizant that there can be extreme volatility in these types of measures, given the magnitude of the outperformance relative to estimates, it gives us hope that the manufacturing recovery is well under way. On Tuesday, we saw US Retail Sales increase 17.7% in May after declining by -16.4% in April[3]. According to the report, sales improved across all categories including both discretionary and essential goods. We received our first disappointing economic reading when US Industrial Output increased less than expected. Industrial production increased by 1.4% in May after contracting by -12.8% in April[4]. Capacity utilization increased only marginally during the period to 64.8%, up from 64% in April[5]. On Wednesday we saw that the US housing market continues to show strength with mortgage applications for the week ending June 12th rising 8.0% after having risen by 9.3% in the previous week[6]. Also, the Mortgage Bankers Association's Purchasing Index rose by 3.5% during the same period, rising to the highest level since 2009[7]. Despite stricter lending standards, home buyers continue to take advantage of low interest rates. The disappoint came on Thursday when US Initial Jobless Claims came in at 1.5 million for the week of June 13th, down only slightly from the previous week[8]. Equally as important, continuing claims for the week of June 6th were reported at 20.5 million which was higher than the consensus expectation of 19.9 million[9]. While many states have begun the re-opening process, labor markets remain soft as jobs continue to be shed and re-hiring is slow to happen. So, what does this all mean? It is important to remember what we are, and have been, going through in terms of both the economy and as a society. Having gone through the worst economic downturn since the Great Depression in terms of magnitude and velocity, it is not surprising that there may be mixed datapoints as we work our way into recovery. Given this complexity, we continue to focus on various measures to evaluate the strength and pace of economic improvement while seeking opportunities to potentially help enhance client portfolios.

On Tuesday, Federal Reserve Bank (Fed) Chairman Jerome Powell delivered his semi-annual testimony to Congress. The meeting was largely uneventful with Powell reiterating that the Fed will remain accommodative and is "committed to using the full range of tools to support the economy in this challenging time[10]." Separately during the week, Vice Chairman Clarida noted in a speech that US inflation remains well below the target 2.0%. Inflation in the US, as measured by the CPI ex-Food and Energy, fell to 1.2% in May, the lowest rate in more than nine years[11]. Given the relatively low levels of US inflation in combination with the continued deflationary pressures resulting from the pandemic, as well as the inconsistent path of the economic recovery, Powell's previous comments regarding the Fed's intent to keep US interest rates low until at least 2021 seem justified.

Finally, in previous updates we have discussed the significant increase in the Fed's balance sheet as a result of its response to the pandemic. Despite numerous programs available to purchase assets, the balance sheet shrank by $74 billion for its June 17th reading[12]. The decline in assets was attributed to foreign central bank liquidity swaps and asset purchases made earlier in the year being unwound. Total assets remaining are an astonishing $7.1 trillion, up $3.9 trillion since last September. The reason that we are watching changes to the balance sheet closely concerns the reaction by the equity market the last time the Fed shifted policy toward removing liquidity. Given that the economic recovery remains fragile, any attempt to remove liquidity may result in increased volatility.

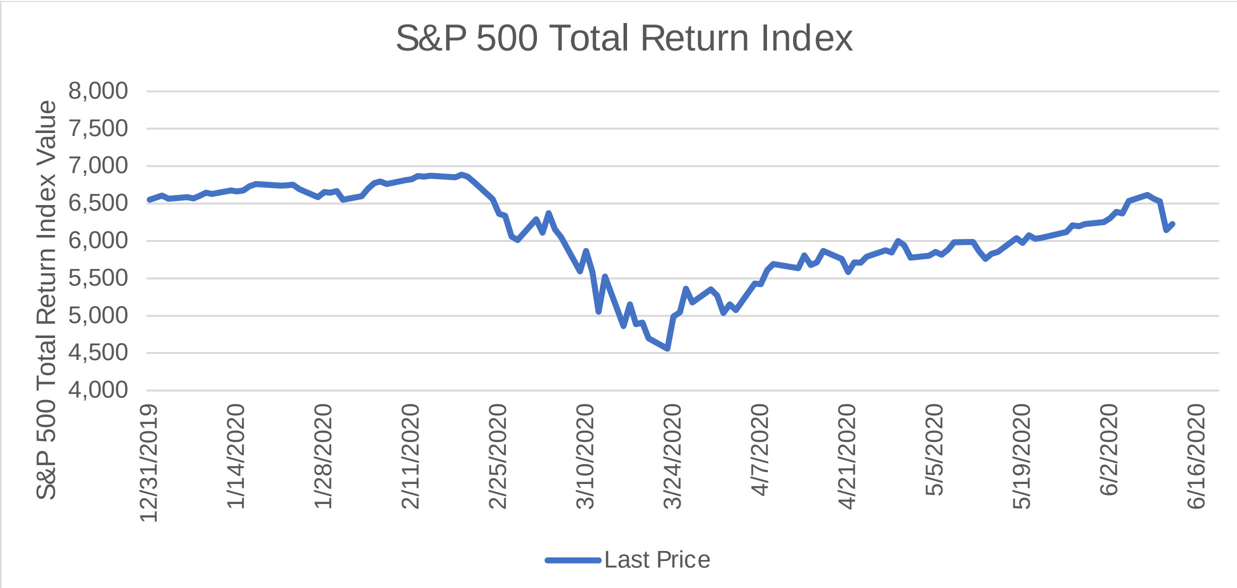


Source: https://fred.stlouisfed.org/series/WALCL#0

EQUITIES

Equity prices resumed their trend higher during the week ending June 19th with the S&P 500 rising by 1.9%, the small cap Russell 2000 gaining 2.3% and the tech-heavy Nasdaq Composite increasing 3.7%[13]. Generally, equity market volatility was lower during the week despite Friday's "quad-witching" event which occurs when equity index options and futures expire simultaneously with single stock options and futures. The week began strongly with markets edging higher on Monday only to stall throughout the remainder of the week on fears that parts of the US are experiencing a second wave of COVID-19 infections. Here in Orlando, the Orange County mayor elected to enforce the mandatory wearing of masks in public as the number of cases of Coronavirus have increased.

As we near the half-way point in the year, investors will begin turning their attention to earnings announcements for the second quarter. From a growth perspective, estimated first quarter earnings growth of the S&P 500 Index is expected to decline -12.7% from a year earlier due to the pandemic[14]. Looking through S&P 500 Index sectors, according to Lipper, 499 companies have reported earnings, and of those 65.1% reported above expectations with consumer staples and information technology leading the way at 75.8% and 74.6%, respectively. Looking at the table below, we can see that only three sectors have experienced positive market returns year-to-date as of June 19th, led by technology companies. Given that the full brunt of the pandemic was not felt until early April, expectations for positive corporate earnings in the second quarter are low. That said, investors continue to flock to technology-related companies given their ability to grow earnings despite the uneven economic recovery.



Source: Bloomberg as of June 19, 2020

S&P 500 Index Sector	2020 Year-to-Date Return as of 06/19	2019 Return
Information Technology	12.1%	48.0%
Consumer Discretionary	6.0%	26.2%
Communication Services	1.7%	30.9%
Healthcare	-0.7%	18.7%
Consumer Staples	-5.0%	24.0%
Real Estate	-7.9%	24.9%
Materials	-7.8%	21.9%
Utilities	-10.6%	22.2%
Industrials	-14.4%	26.8%
Financials	-21.4%	29.2%
Energy	-33.3%	7.6%

Source: Bloomberg as of June 19, 2020

FIXED INCOME

It was a relatively quiet week in US fixed income markets with yields and spreads declining only marginally. As of Friday, June 19th, interest rates, as measured by the US 10-Year Treasury yield were slightly lower at 0.68%[15]. Despite a lack of market action, Chairman Powell announced that the Fed would begin buying individual corporate bonds rated BBB-or higher through one of its varied programs related to the COVID-19 response. Up until now, the Fed has been active in the market purchasing ETFs which has acted as a catalyst for spreads to narrow. That said, the expansion of the program to include individual securities draws into question the potential for moral hazard. With the amount of new bond issuance year-to-date exceeding last year's record setting pace, the Fed is essentially backstopping the corporate bond market. The concerns are two-fold: that companies will continue to increase leverage knowing that the Fed is the buyer of last resort, and that the Fed is effectively capping bond yields which could drive investors into riskier parts of the market to earn sufficient income. While the size of expected purchases of ETFs and bonds is small at $250 billion in comparison to the US corporate bond market, we will continue to watch the implementation of the program closely for signs of market stress.

Appendix

1. Bloomberg as of June 15th, 2020
2. Bloomberg as of June 15th, 2020
3. Bloomberg as of June 16th, 2020
4. Bloomberg as of June 16th, 2020
5. Bloomberg as of June 16th, 2020
6. Bloomberg as of June 17th, 2020
7. Bloomberg as of June 17th, 2020
8. Bloomberg as of June 18th, 2020
9. Bloomberg as of June 18th, 2020
10. Bloomberg as of June 16th, 2020
11. Bloomberg as of June 10th, 2020
12. https://fred.stlouisfed.org/series/WALCL#0
13. Bloomberg as of June 19th, 2020
14. https://lipperalpha.refinitiv.com/wp-content/uploads/2020/06/TRPR_82221_546.pdf
15. Bloomberg as of June 19th, 2020