AndCo's Monthly Market Update

October 2020

THE ECONOMY

After several months of encouraging data, the pace of the economic recovery slowed in September as the combination of concerns related to a potential "second wave" of the pandemic, increasing uncertainty regarding additional stimulus here in the US, and the runup to the US elections weighed on the markets. While there were positive reports related to the potential for therapeutic treatments and vaccines against the COVID-19 virus, hot spots in Europe, and the potential for additional lockdowns in the US, suggested that economies may not open as fast as expected, thereby acting as a headwind to growth. Here in the US, Congress and the President were engaged in a stalemate about the next round of fiscal stimulus. Estimates on the size of the plan range between $1.5 and $2.2 trillion. However, most of the wrangling behind the scenes has to do with the beneficiaries of the stimulus, with many states experiencing disproportionate financial hardships in need of more support. Finally, the US election cycle has entered into the home stretch with Americans suffering campaign fatigue. While the outcome of the election remains undecided, there are a few things both Democrats and Republicans can agree on: the size of the debt/deficit will most likely increase while the value of the US dollar (USD) will most likely decrease. We will look to explore the implications of both later in this update.

Labor markets continued to show signs of improvement in September, albeit at a more moderate pace, with the US Unemployment Rate falling to 7.9%.[1] While the trend in the unemployment rate remains positive, the pace of hiring slowed during the month as evidenced by only 661,000 new jobs added during the month, missing expectations of roughly 850,000 new jobs, and down considerable from the roughly 1.3 million jobs added in August.[2] One area of the economy that continues to show strength is the housing market. New home and pending home sales rose 4.8% and 8.8%, respectively, in August.[3,4] Importantly, with scarce inventories and interest rates near record lows, homes prices continue to rise as evidenced by the 4.8% year-over-year rise in the

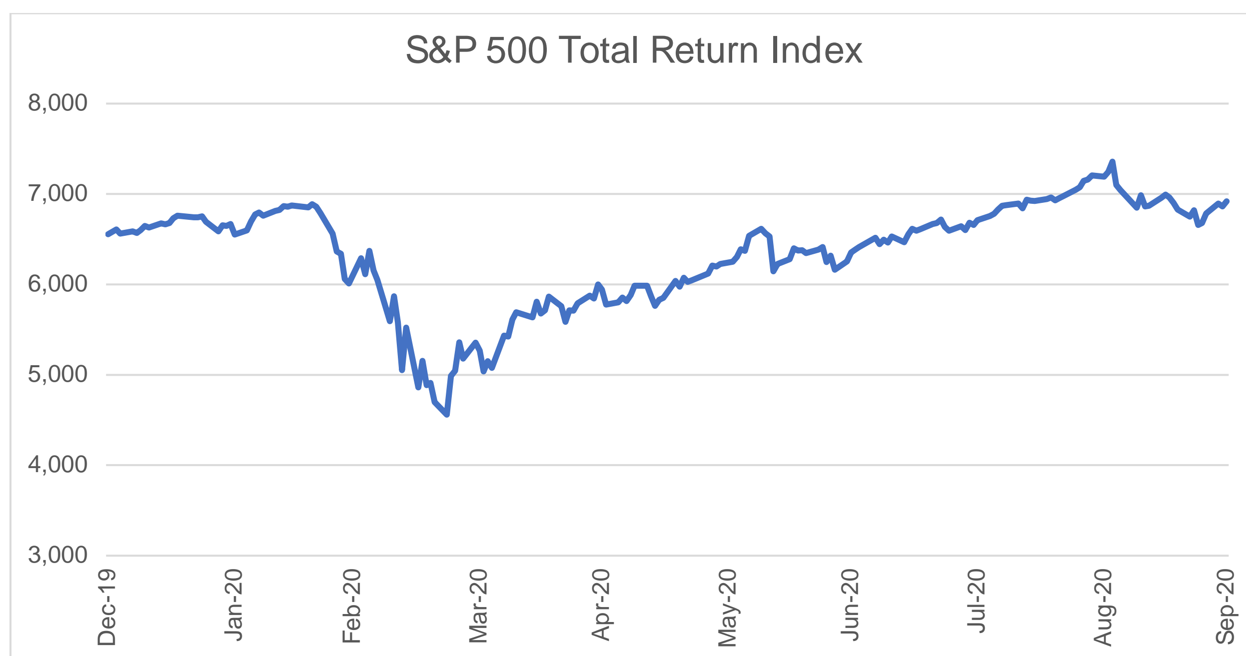
Case Shiller Home Price Index as of July.[5] Given these things, it comes as no surprise that consumer sentiment improved in September with the Conference Board Consumer Confidence Index rising to 101.8, up from 84.8 in August.[6] While the economy will continue to face challenges related to the pandemic and near-term uncertainty related to both the election and additional potential stimulus, the recent trends suggest that growth is returning and better days may be ahead.

Source: Bloomberg as of October 2, 2020

EQUITIES

US equity markets cooled in September with the S&P 500 Total Return Index declining by -3.8% during the month.[7] Despite this negative reading, returns for the 3rd quarter were very strong with the index returning roughly 8.9% for the period.[8] As we have noted in previous updates, the market performance remains bifurcated between large and small cap as well as growth and value stocks. Large technology-related companies such as Facebook, Amazon, Netflix, Microsoft and Google (commonly referred to as the FANMG stocks) are up a staggering 42.5% year-to-date on a price basis.[9] In comparison, the remaining stocks in the S&P 500 Index have declined -3.6% as of September 30th.[10] Given the impressive returns of the FANMG stocks, the dispersion between large and small cap stocks is wide. As of September 30th, The S&P 500 Total Return Index has returned 5.6% year-to-date compared to -8.7% for the Russell 2000 Total Return Index.[11] Similarly, the dispersion between growth and value stocks is stark when you consider that the

Russell 1000 Growth Index has returned 24.3% for the year compared to -11.6% for the Russell 1000 Value Index.[12] Growth stocks have historically done better in periods of uncertainty given their historical ability to continue growing revenues. Additionally, large companies tend to outpace small companies given the size of their balance sheets and their ability to raise capital if need. Given the concerns about the pace of the recovery, continued low US interest rates, and the structural shifts in the economy (work from home, teleconferencing, and limited travel) due to the pandemic, these dispersions may persist until more clarity is gained about the trajectory of the recovery and potential treatments for the pandemic.

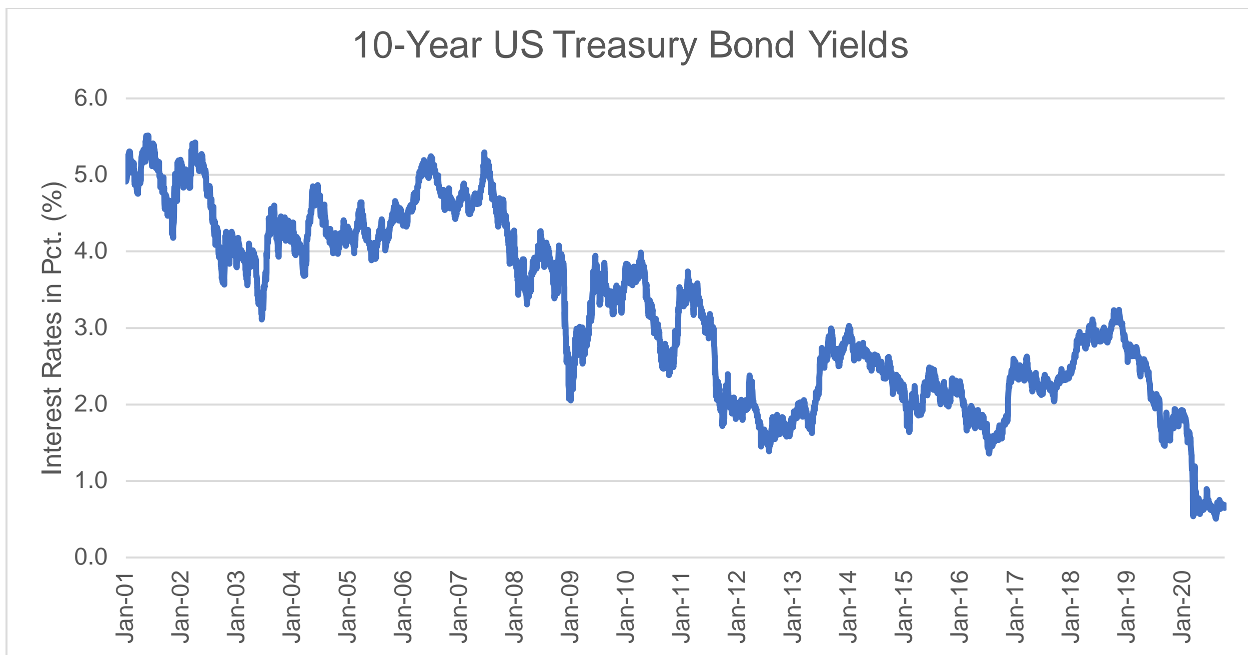


Source: Bloomberg as of September 30, 2020

FIXED INCOME

Fixed income markets were generally lower in September across both quality and credit. For the month, the Bloomberg Barclays US Aggregate Bond Index (Agg) returned roughly -0.1% while the lower quality broadly Bloomberg Barclays US Corporate High Yield Index (High Yield) returned -1.0%.[13] Despite this, fixed income returns were positive on the quarter with the Agg and High Yield indices returning 0.6% and 4.6%, respectively, during the 3rd quarter.[14] As we pointed out in previous months, the one area of concern that investors can agree on is the significant amount of expected US Treasury issuance given the likelihood of an additional stimulus package and persistent budget deficits. Currently, the US Congress is negotiating another stimulus package that could range between $1.5 and $2.2 trillion, all of which would be funded with new

Treasury bonds. While the trend of US interest rates has been lower over the past 20 years, with the announcement of negotiations for another round of stimulus, rates began to move higher in September, albeit from very low levels. Recently, the Congressional Budget Office reported that the budget deficit for the fiscal year 2020 was $3.1 trillion, more than triple the shortfall recorded in 2019.[15] Importantly, the US debt to GDP ratio now stands at 106.9%, or said differently, the total of the outstanding federal debt exceeds the size of the US economy.[16] We are concerned about the potential for higher future US interest rates as investors begin to demand higher returns for the increased risk involved in investing in US Treasury bonds. Additionally, we are cognizant about the potential for negative impacts on the US dollar should investors begin to sell their Treasury bonds and look for better opportunities elsewhere. Finally, the potential for negative impacts on future US economic growth are substantial and rising given the crowding out effect of continued US Treasury issuance in conjunction with the added headwinds that come from servicing the debt load. While it is reasonable to be uneasy about this developing situation, there remains the potential for a change in the trajectory of the situation should the economy recover faster than expected and if a viable treatment for the pandemic is found and distributed in short order.



Source: Bloomberg as of September 30, 2020

APPENDIX

1. Bloomberg as of October 2nd, 2020
2. Bloomberg as of October 2nd, 2020
3. Bloomberg as of September 24th, 2020
4. Bloomberg as of September 30th, 2020
5. https://realstateinvestmentsintl.com/u-s-home-price-growth-picks-up-pace-amid-pandemic-buying-rush/
6. Bloomberg as of September 29th, 2020
7. Morningstar as September 30th, 2020
8. Morningstar as September 30th, 2020
9. Ned Davis Research as of September 30th, 2020
10. Ned Davis Research as of September 30th, 2020
11. Morningstar as September 30th, 2020
12. Morningstar as September 30th, 2020
13. Morningstar as September 30th, 2020
14. Morningstar as September 30th, 2020
15. https://www.cbo.gov/publication/56661
16. https://tradingeconomics.com/united-states/government-debt

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