Economic and Capital Markets Commentary

The Fed vs. The Virus…

In some sense, words fail to capture the devastation – physical and psychological, financial and economic – that Covid-19 has unleashed on the globe in a few short months. In time, we will look back on these events and more fully understand their significance. As we live through them, however, all we can do is our best – our best to protect ourselves and those around us, our best to adapt to a new 'normal,' personally and professionally, and our best to try to understand what the future may look like and how we should plan and position for such a future.

Investors started the year with optimism that global growth would continue, if not accelerate. And despite daily headlines and the disease's rapid spread, U.S. stocks moved higher until mid-February, presumably on the expectation that the virus would be contained. Overnight, attitudes changed. Starting on February 19th, the S&P 500 Index dropped 10% in six days and continued tumbling into March. Gold prices rose and the yield on the ten-year U.S. Treasury hit an all-time low. 'Recession' was no longer whispered. A month later, the Index was down 34% from its high and the record-breaking bull market was over.

Simultaneously, debt markets experienced massive dislocations. A flight to safety – cash – was overwhelming the financial system. The Federal Reserve, having already cut interest rates once, stepped in and exceeded investors' expectations. "Whatever it takes" became the mantra – stabilize markets and support the economy, independent of what Congress and the Administration was planning (Congress did finally pass the CARES Act in late March). Stocks started to rally.

It is estimated that one quarter of the U.S. economy was shutdown, virtually overnight, hitting small businesses and hourly workers the hardest. For many publicly-traded travel, leisure, and entertainment companies, business came to a complete stop. While most of these companies will survive, the effect on small businesses – hair and nail salons, bars and restaurants, gyms and day care centers, etc. – may not be known for years. Early economic data – initial jobless claims, the unemployment rate – were shocking, yet stocks rallied, posting the strongest two months (April and May) since 2009 (when the market turned the corner on the Great Recession).

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Did the Market – the collective input of investors – know something the economic data didn't show, or was this another case of "irrational exuberance" (Fed Chairman Alan Greenspan, 1996) with U.S. stocks pricing in a strong V-shaped economic recovery. June provided an initial answer – southern states that opened their economies the earliest began to see spikes in infections, and the bear market rally stalled – implying that a lot of good news was built into stock prices.

Investors typically price stocks based on corporate earnings. Current earnings estimates are all but meaningless, however, because the virus has left companies (and analysts) unable to accurately forecast demand for their goods and services. The key, therefore, is the speed of the recovery – when will economic activity return to some level of normalcy (roughly two thirds of U.S. gross domestic product is driven by consumer spending). We continue to believe that a full economic recovery could take three to four years, assuming that we can hold the line on the spread of Covid-19 and find a way to safely vaccinate a significant percentage of the global population within a reasonable period of time. In this scenario, it is important for clients and investors to maintain sufficient liquidity for their short-term needs and to regularly review their accounts with their Portfolio Manager, with a focus on diversification and their intermediate- and long-term goals.

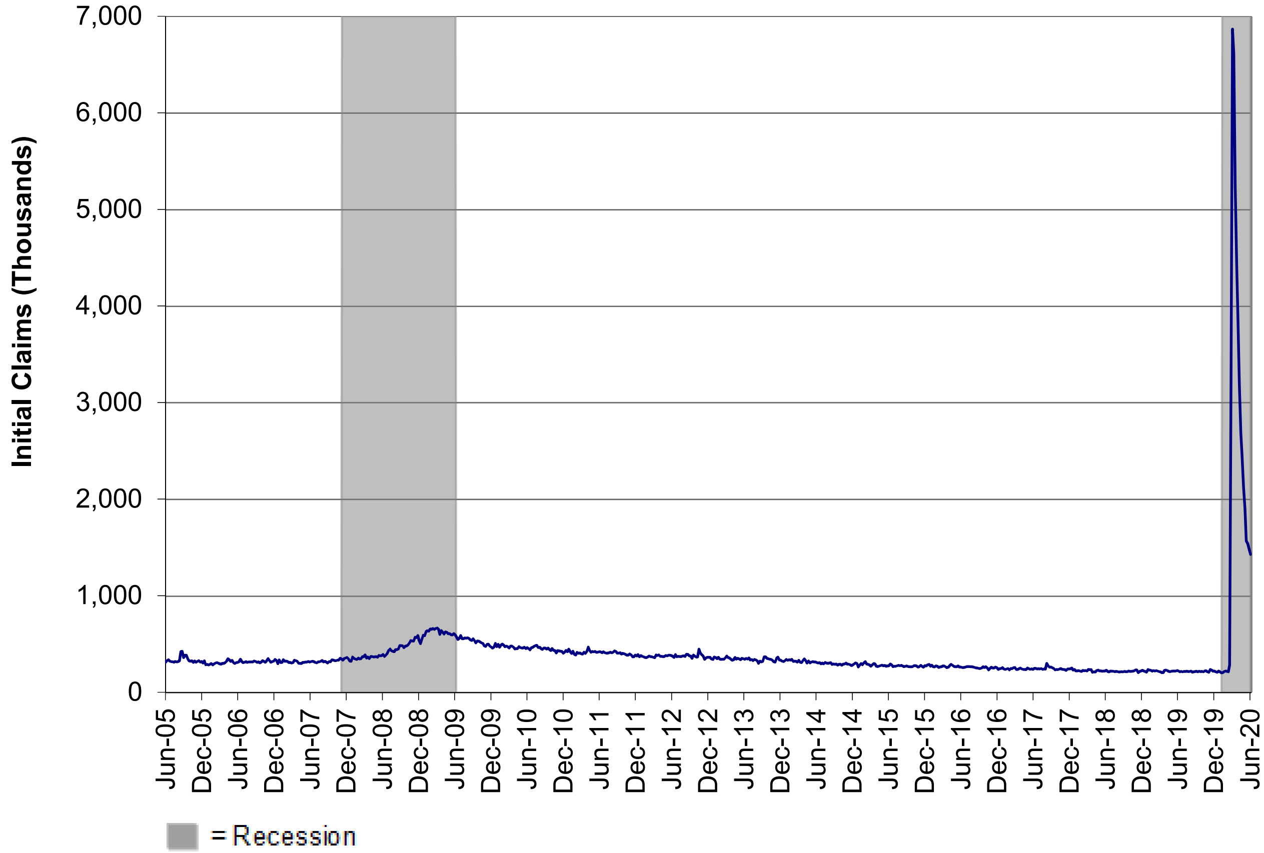
Finally, we would like to say "Thank you" to all health care workers, first responders, those on the front lines, and their families. Your hard work and tireless sacrifice is truly appreciated.

Economic and Capital Markets Data

	June 30, 2020	December 31, 2019	June 30, 2019	June 30, 2015
S&P 500 Index	3100	3231	2942	2063
Price / Earnings Ratio	22.2x	21.6x	19.4x	18.5x
Yield	1.95%	1.82%	1.91%	2.05%
Federal Funds Rate	0.25%	1.75%	2.50%	0.25%
10 Year U.S. Treasury Yield	0.66%	1.92%	2.01%	2.35%
Gold	1781	1517	1410	1172
Oil (Brent)	41	66	67	64
GDP (Annualized)	-32.9%	2.1%	2.0%	3.0%
Unemployment	11.1%	3.5%	3.7%	5.3%
Inflation (Annualized)	0.6%	2.3%	1.6%	0.1%

U.S. Weekly Initial Jobless Claims

Fifteen Years

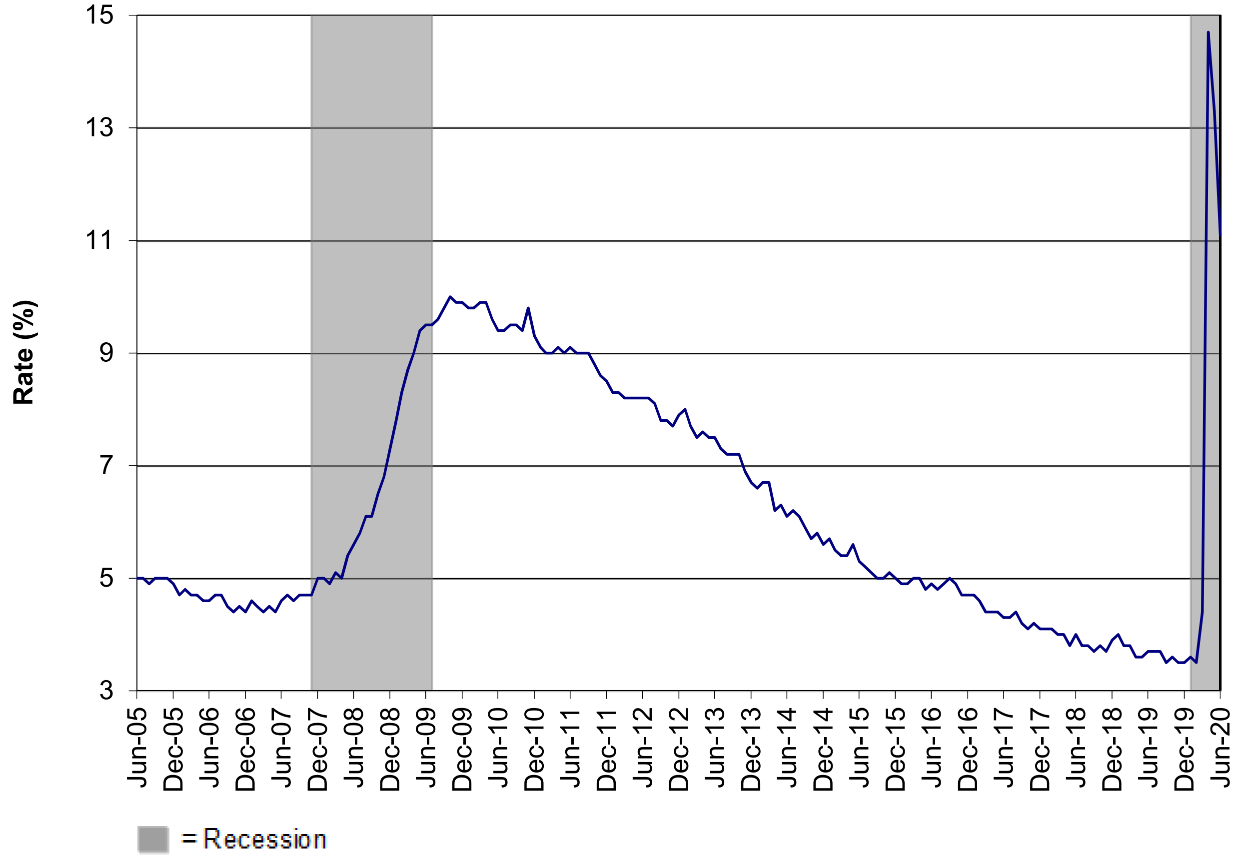


Since mid-March, cumulative initial jobless claims have surpassed forty million. After the initial spike, however, new claims have decreased for 13 straight weeks.

Courtesy of Bloomberg; Please note that this chart is as of June 26, 2020

U.S. Unemployment Rate

Fifteen Years

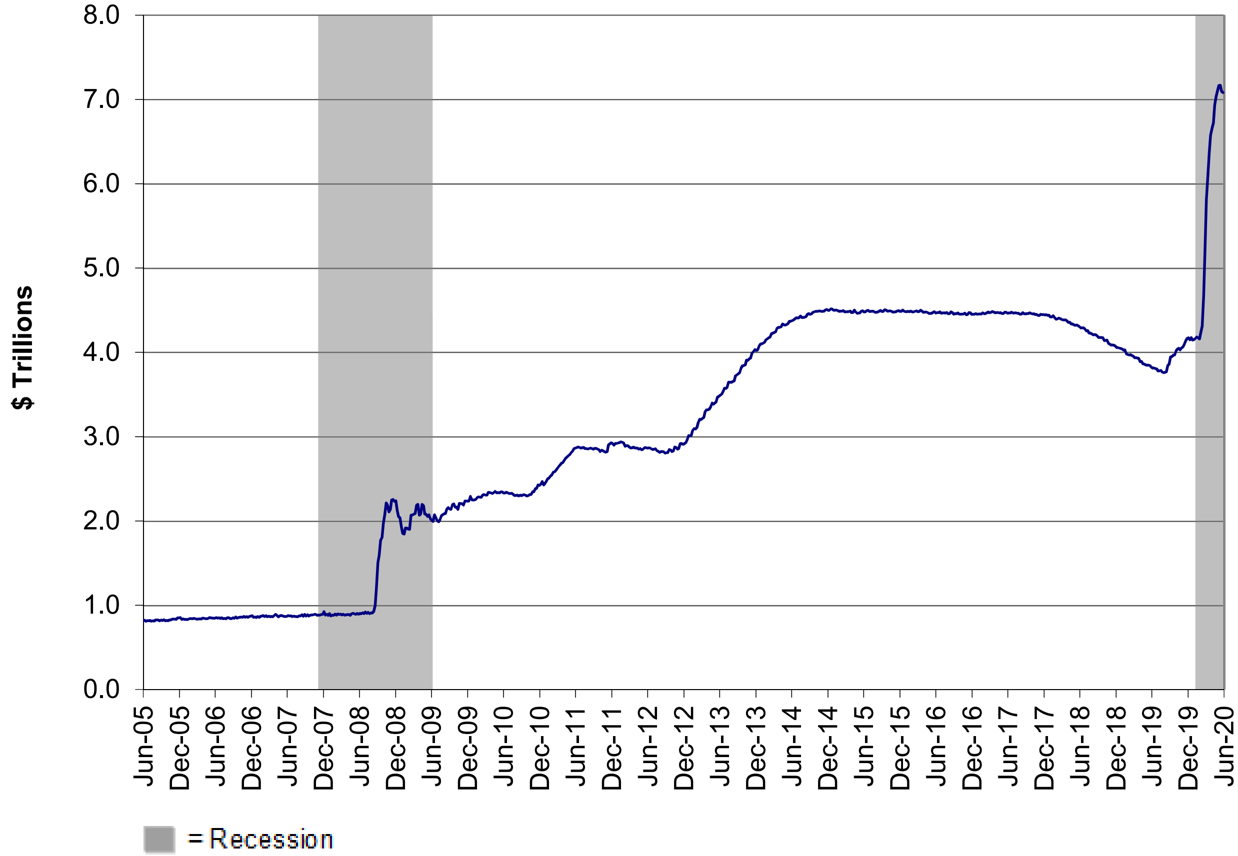


While the unemployment rate has recently declined from its initial spike, we expect it will take much longer to get back to mid-single digits.

Courtesy of Bloomberg

U.S. Federal Reserve Balance Sheet

Fifteen Years

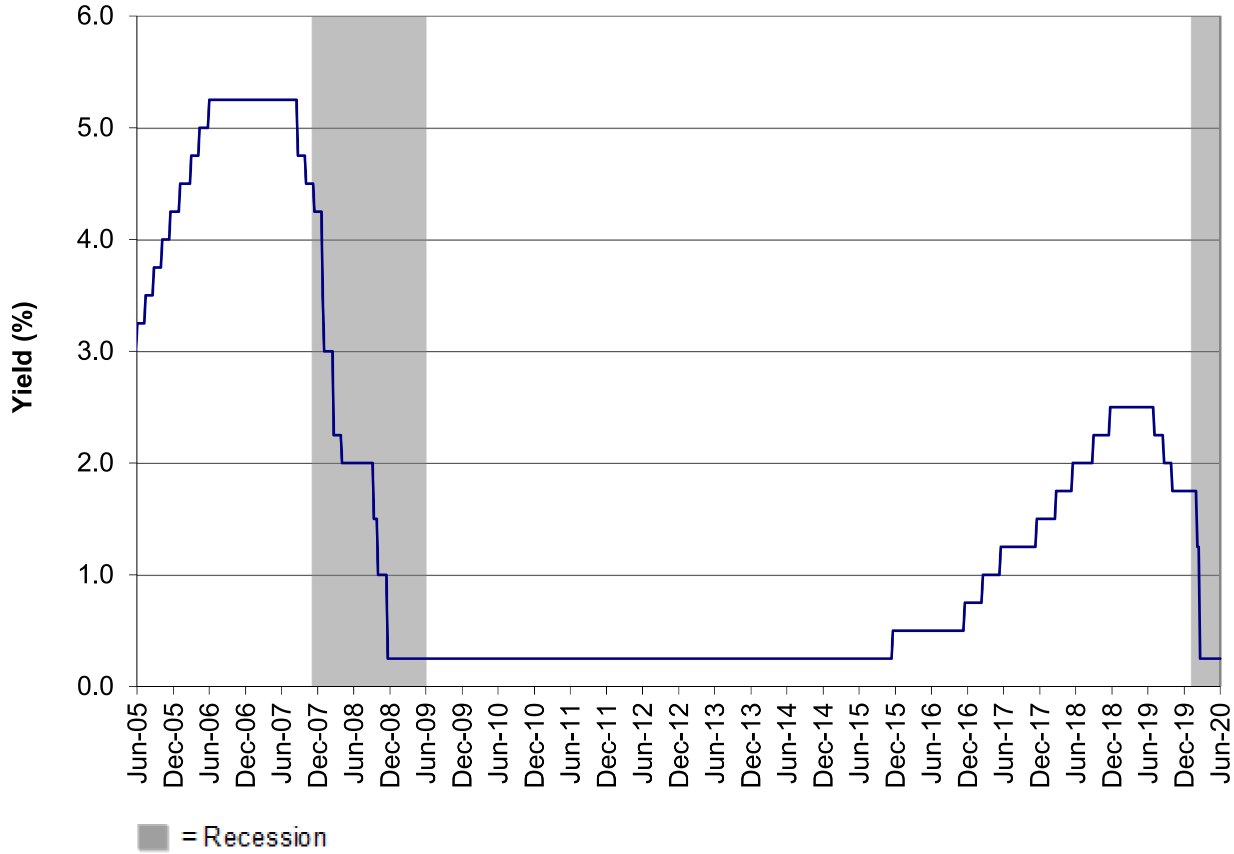


Clearly, the Fed's ‘recession playbook’ now involves significantly increasing the size of its balance sheet to "stabilize" markets. By purchasing assets in such significant quantities, however, the Fed runs the risk of distorting financial markets.

Courtesy of Bloomberg; Please note that this chart is as of June 24, 2020

U.S. Federal Funds Target Rate

Fifteen Years



The Federal Reserve is committed to keeping interest rates low. However, lower rates may not benefit consumers until confidence in the recovery picks up.

Courtesy of Bloomberg

U.S. Treasury Ten-Year Bond Yield

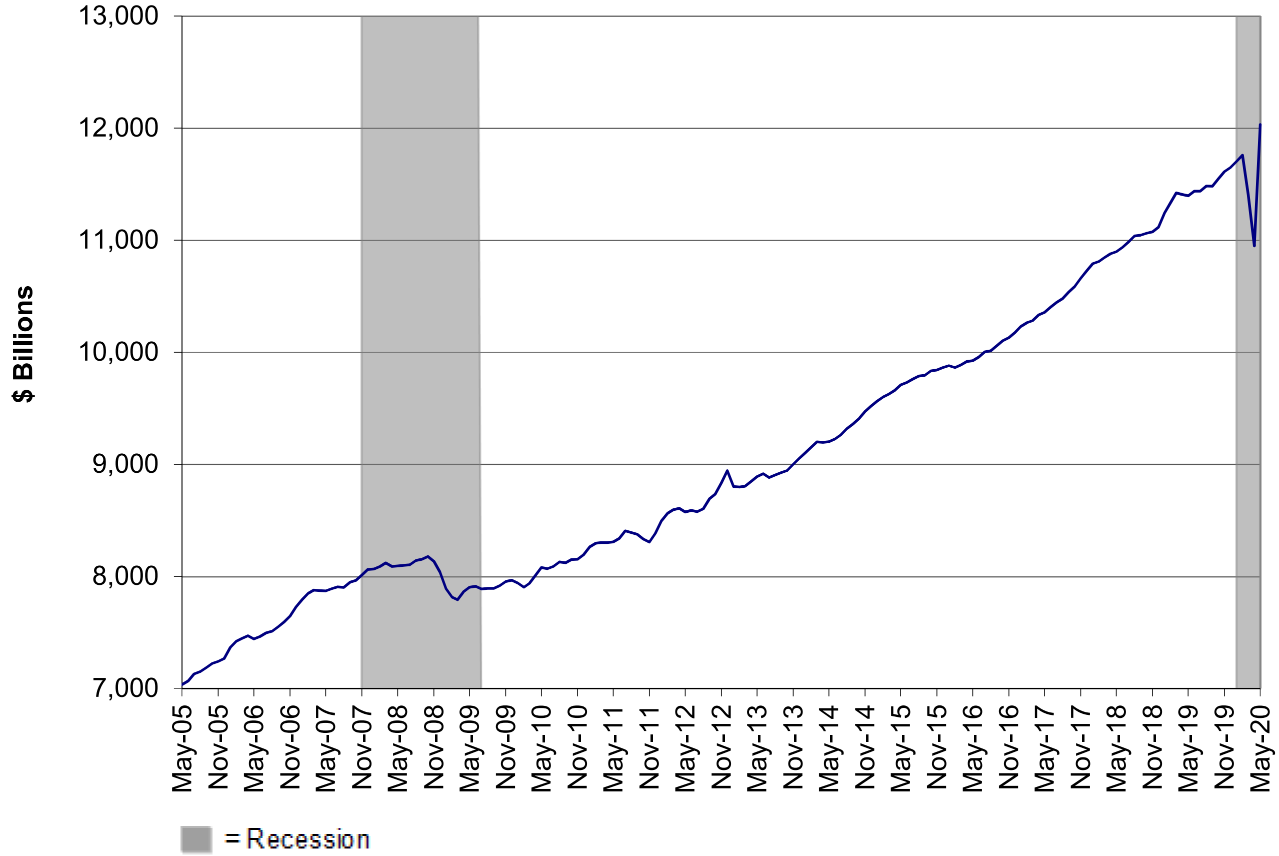
One Year

Interest rates of all maturities have declined dramatically, impacting returns on safe assets, mortgage rates, borrowing costs, and equity prices.

Courtesy of Bloomberg

U.S. Employment Compensation & Unemployment Benefits

Fifteen Years

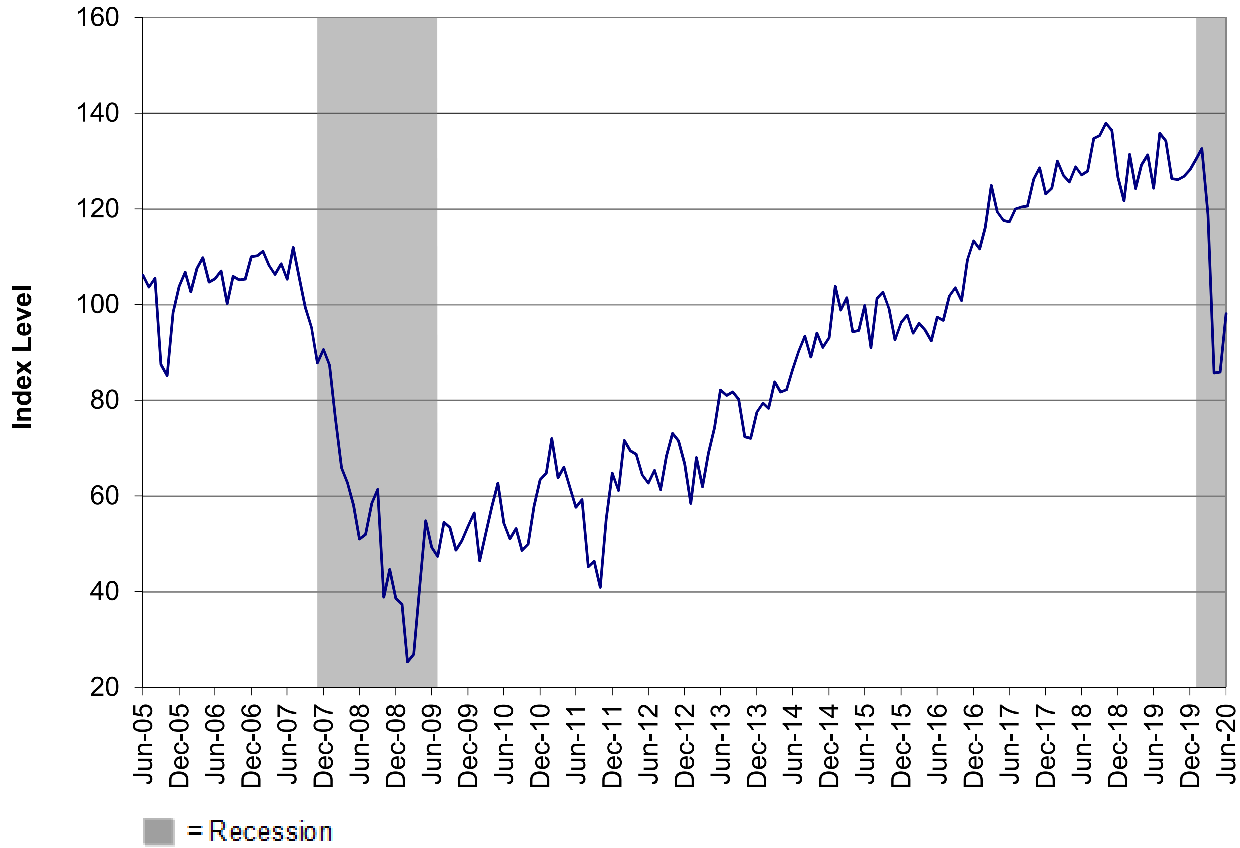


Unlike prior downturns, CARES Act government benefits were so significant that they increased total employee compensation during the crisis through May.

Courtesy of Federal Reserve Economic Data; Please note that this chart is as of May 1, 2020

Consumer Confidence Index

Fifteen Years

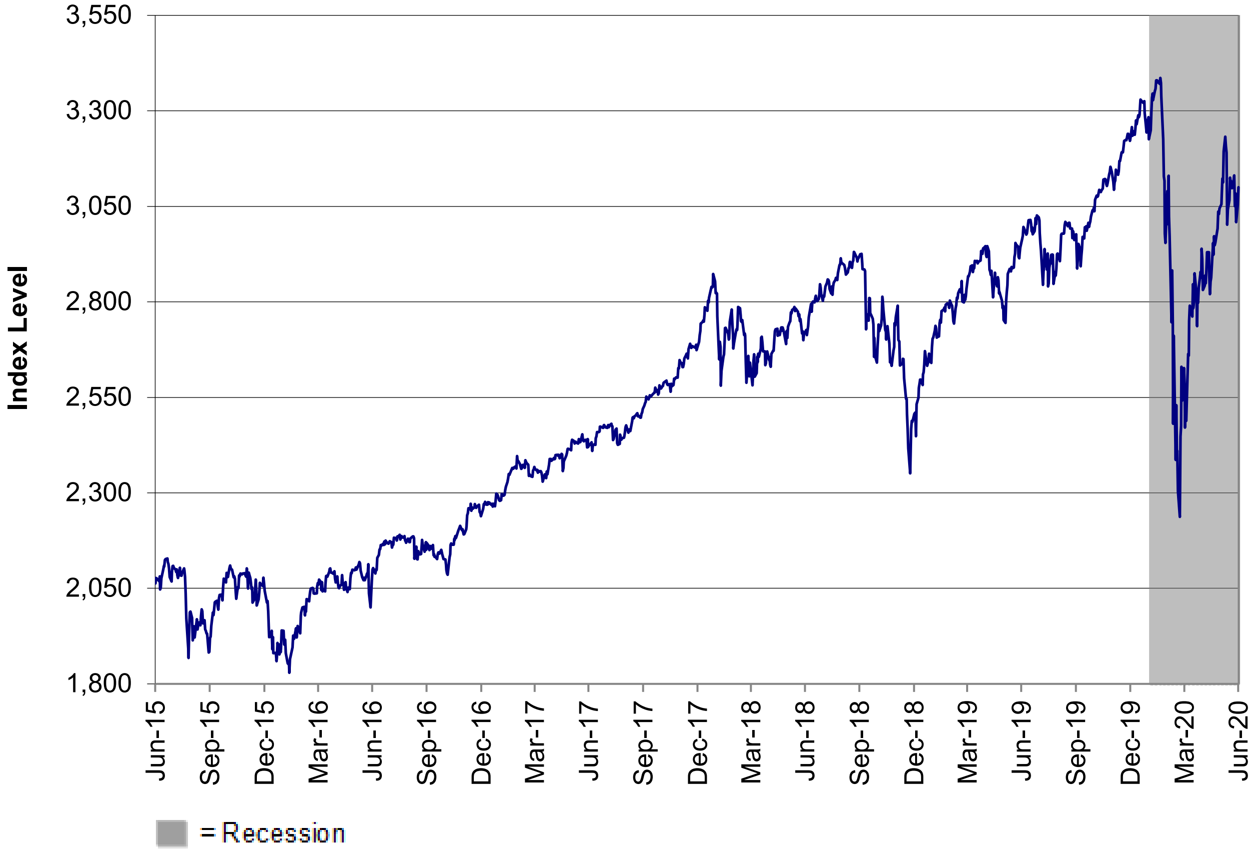


While lower than the past several years, consumer confidence is still significantly higher than it was during the 2008-2009 recession. This may be due to expectations that layoffs are 'temporary' as well as cash payments received under the CARES Act.

Courtesy of Bloomberg

Standard & Poor's 500 Index

Five Years

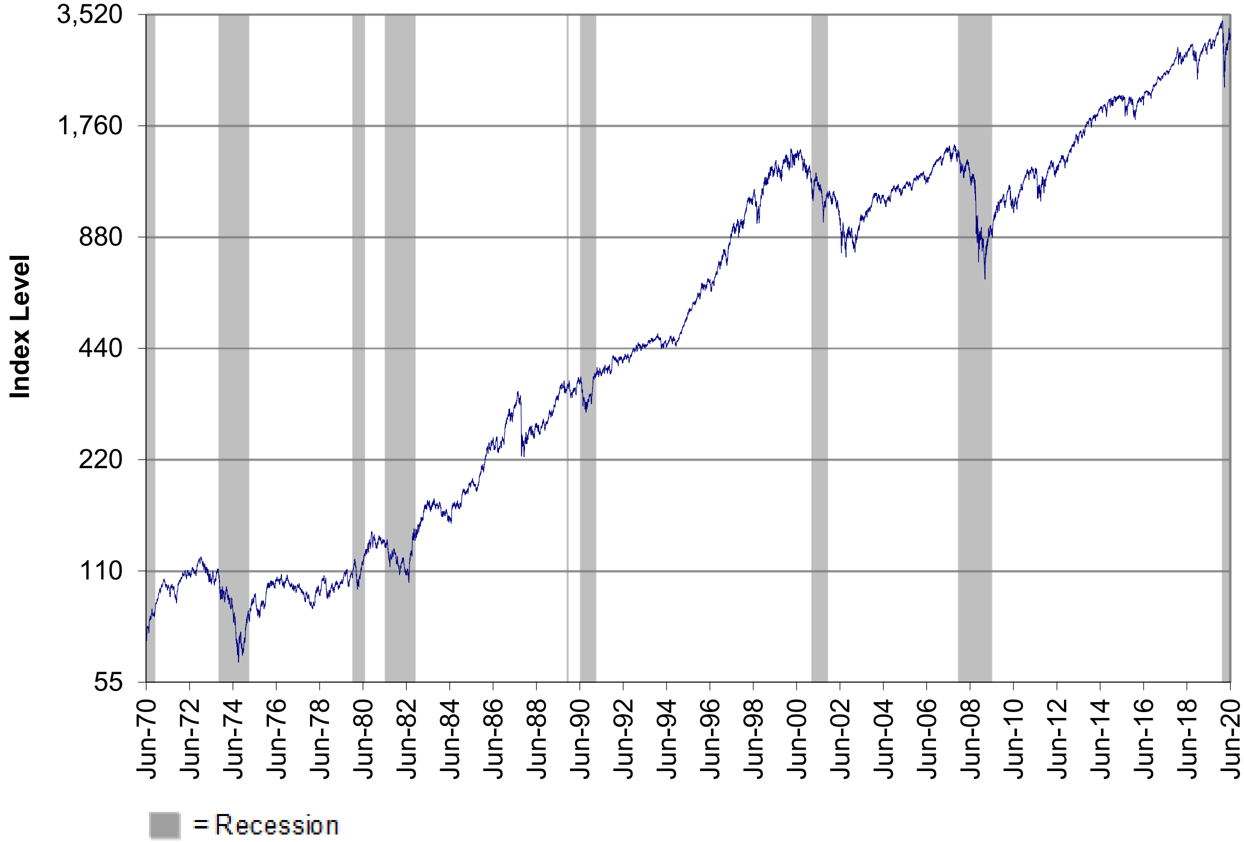


The rapid recovery in stocks is a historic anomaly; bear markets caused by recessions have always lasted longer than several weeks.

Courtesy of Bloomberg

Standard & Poor's 500 Index

Fifty Years



Over the long-term, stocks remain the only liquid asset class with the potential for growth in excess of inflation.

Courtesy of Bloomberg; Please note that this chart is using a logarithmic scale.