Market Review – as at June 30, 2020

For the remainder of 2020, the main determinant of market performance will be driven by the spread of the Corona virus, corporate earnings and the US election. This in turn will drive the nature and strength of the global economic recovery. Economics was famously termed a rather “dismal science” at the best of times, though at the moment it seems fixated on capital letters, of all things. Talk of possible types of economic recovery include V-shaped, U-shaped, L-shaped, W-shaped, and so on.

V-Shaped Recovery

Stock markets are clearly taking the view that the V-shaped recovery will prevail (a slump followed by a quick resumption of the upward trend). The impact from the unprecedented fiscal and monetary programs launched across the globe cannot be overestimated. This has been orders of magnitude larger than any time in history and has been successful in getting cash into the hands of individuals and companies, which in turn is being spent.

There is a saying on Wall Street, “the deeper the drop, the bigger the pop.” This proved true in the second quarter as investors responded positively to the stimulus. The MSCI AC World Total Return index rose by 19 percent over the quarter, with the US leading the charge. Their S&P 500 Index gained 20 percent over the last 3 months, versus 13 percent for the Bloomberg European 500 Index and 9 percent for the FTSE 100 Index of UK stocks. US gains were spearheaded by the tech sector, with the NASDAQ Composite Index up by more than 30 percent over the quarter. On a year to date basis, the NASDAQ is actually positive with a return of 12 percent. The remaining indexes, while still below levels from the beginning of the year, have certainly recovered a lot of the first quarter losses.

Valuations Now Stretched

These gains, and worries over future earnings, have pushed stock valuations higher. The forward price/earnings multiple of US stocks, for example, is now at around 24, which as the Financial Times points out, places it at dotcom-era levels. Non-cyclical sectors – for example tech and healthcare – have outperformed, which indicates that investors retain some caution. A significant extension of the rally would likely require a boost in the performance of cyclicals and small cap stocks.

To justify the current valuation, the economic recovery will have to be robust, and it will also have to reverse the decline in company earnings. US corporate earnings for the first quarter of this year declined by around 14 percent relative to the first quarter of 2019. We saw some positive earnings growth in certain defensive sectors such as utilities, health care and consumer staples. Consumer discretionary, energy and financials were the worst hit sectors, and indeed aggregate earnings for the second quarter of this year are expected to slump in excess of 40 percent year-on-year.

Forecasting earnings growth is fraught with difficulty in the current environment. The infection rates (of COVID-19) in various regions are extremely unpredictable. If lockdown measures are reintroduced, this will have a negative impact on company profits, which is not being reflected in current prices. On the one hand, global policymakers have provided a stunning and concerted level of support, which has helped to settle sentiment. But there’s a significant question mark over when a vaccine will be widely available, and indeed over how effective it will be. It remains unclear the speed at which economies around the globe will re-open fully, and indeed how cautious consumers and businesses will be when they do.

Caution from the ECB and the IMF

The European Central Bank (ECB) president Christine Lagarde warns about this very point and suggests that the recovery may be "restrained" as European households save rather than spend. Recent data from the ECB showed a strong rise in household savings in Europe since the pandemic hit, with new savings having surged by 136 percent year-on-year in March and April. She also commented that certain industries – for example airlines and hotel groups – "will probably be hurt irremediably".

The International Monetary Fund (IMF) further downgraded its forecast for global growth, citing the fact that the disease is still spreading across the world. Populous countries such as India and Brazil are seeing sharp increases in the number of deaths. The IMF expects the world economy to shrink by 4.9 percent this year. Their last forecast, done in April, expected a decline of 3 percent, which even then was described as the worst contraction since the Great Depression.

These warnings are being heeded by Government bond markets. If the stock market is sending a signal that it expects a healthy return to growth, the bond market expects the opposite. The 30-year US Treasury real yield – adjusted for inflation – is now below zero, which signals an expectation of trouble ahead.

Volatile Politics

From a growth perspective, timing will be an extremely important issue in the months ahead. If policymakers pull back on their support too soon, a bad recession gets worse. But if they leave it too late there could be inflationary consequences.

Investors should also reflect on the chance of a Biden win in November's US election. In keeping such a low profile up to now, Biden's campaign is, thus far at least, making the election akin to a referendum on President Trump.

Earlier this year, Trump's re-election looked highly likely as economic data posted strong gains and he was acquitted in the Senate impeachment trial. His popularity may have slipped however in the perception of his handling of the COVID-19 crisis and the current social unrest; a recent New York Times/Siena poll shows him to be 14-points behind in the race. It's extremely difficult to gauge sentiment given the very partisan divide in the media. One source will refer to people taking to the streets as protestors, and another will refer to them as rioters. The former view Black Lives Matter as the conscience of the nation and the latter as a political movement who only appear in election years.

This division and unrest could play a part in the outcome of the election if the recent high drama impels, for example, more young people to vote. Biden's campaign has been recently bolstered by the appearance of former president Obama, who remains popular with young people and with people of colour; two core elements of the Democrat support base.

Tougher times Ahead

A key factor in Trump's favour however is that voters seem to remain more confident in his ability to better manage the economy. An ebullient stock market is one of the main positive features in the election campaign of the current administration and thus it's very unlikely that we'll see the introduction of any non-market friendly policies. At least not before November. Thereafter there will be a great deal of money to be repaid and many tough decisions to be made over the nature of public finances.

Even if economists were to correctly identify the capital letter that eventually pens our recovery, there's a very good chance that the stock market will price it incorrectly. The nature of unchartered territory usually leads to great price volatility. Caution is warranted while event risk remains this high.

Macro Indices Report as at June 30, 2020 (%)

	2020						Annualized	
	Jun.	May	Apr.	Q2	YTD	2019	3 Years	5 Years
GLOBAL EQUITY								
MSCI AC World Total Return	3.2	4.3	10.7	19.2	-6.3	26.6	7.2	7.4
MSCI EAFE	3.5	4.4	6.6	15.1	-11.0	22.8	2.2	3.3
NORTH AMERICA EQUITY								
S&P 500 Total Return	2.0	4.8	12.8	20.5	-3.1	31.5	11.5	11.3
DOW JONES INDUS. AVG	1.8	4.7	11.2	18.5	-8.4	25.3	8.8	10.6
S&P 400 Net TR	1.2	7.3	14.1	23.9	-13.0	25.6	1.7	4.8
NASDAQ COMPOSITE INDEX	6.1	6.9	15.5	30.9	12.7	36.7	21.0	17.8
RUSSELL 2000 INDEX	3.5	6.5	13.7	25.4	-13.0	25.5	1.0	4.0
S&P/TSX COMPOSITE INDEX	2.5	3.0	10.8	17.0	-7.5	22.8	4.4	4.9
EUROPE EQUITY								
BLOOMBERG EUROPEAN 500	3.2	3.5	6.6	13.8	-12.2	26.5	1.3	2.0
FTSE 100 INDEX	1.7	3.4	4.3	9.6	-16.8	17.2	-2.4	2.4
CAC 40 INDEX	5.5	3.4	4.1	13.5	-16.2	30.5	1.4	3.8
DAX INDEX	6.2	6.7	9.3	23.9	-7.1	25.5	0.3	2.6
ASIA EQUITY								
MSCI AC Far East Ex Japan	8.0	-1.3	8.2	15.4	-4.4	16.5	4.8	5.2
NIKKEI 225	2.0	8.4	6.7	18.0	-4.7	20.7	6.1	4.7
HANG SENG INDEX	7.4	-6.3	4.4	5.1	-11.9	13.0	4.6	4.8
S&P/ASX 200 INDEX	2.6	4.4	8.8	16.5	-10.0	25.0	6.9	7.5
SHANGHAI SE COMPOSITE	5.6	-0.1	4.0	9.8	-1.0	25.3	5.0	-0.2
SOUTH AMERICA & EM EQUITY								
MSCI EM Net Total Return USD Index	7.4	0.8	9.2	18.1	-9.8	18.4	4.7	5.6
S&P LATIN AMERICA 40	6.1	7.0	5.2	19.4	-36.0	13.6	-6.4	-1.6
BRAZIL IBOVESPA INDEX	8.8	8.6	10.3	30.2	-17.8	31.6	16.7	13.9
S&P BSE SENSEX INDEX	7.7	-3.7	14.4	18.7	-15.0	15.7	6.7	7.3
FIXED INCOME								
ICE BoA 1-3 Year US Treasury Index	0.0	0.1	0.0	0.1	2.9	3.6	2.7	1.8
Barclays US Agg	0.6	0.5	1.8	2.9	6.1	8.7	5.6	4.3
Barclays Multiverse (Unhedged)	0.9	0.7	2.0	3.7	2.5	7.1	4.2	3.8
Citi World BIG US Hedged	0.6	0.3	1.5	2.5	4.4	8.4	5.5	4.5
ICE BoA US High Yield Index	1.0	4.6	3.8	9.6	-4.8	14.4	3.5	4.9
JPM EMBI Global Core - US$	3.5	6.4	2.5	12.9	-2.6	16.1	4.4	5.6
JPM EM Global Core - Local	0.7	4.9	3.7	9.6	-6.8	10.1	0.5	1.9
COMMODITIES								
BLOOMBERG Commodity Index	2.3	4.3	-1.6	5.0	-19.7	5.4	-6.7	-7.7
GOLD	2.3	1.5	5.8	9.9	16.7	18.4	14.2	9.2
OIL (WTI)	9.6	55.0	-40.7	0.7	-66.6	34.1	-20.9	-23.6

Argus Wealth Management
Maxwell Roberts Building
1 Church Street, 3rd Floor
Hamilton HM11, Bermuda

Tel: +1 (441) 295 9000
invest@argus.bm
arguswealth.bm

ARGUS Wealth Management