ARGUS
Wealth Management

Market Review – as at September 30, 2020

Ronald Reagan once quipped that he's "not worried about the deficit; it's big enough to take care of itself". That spirit remains alive and well in the global response to the COVID-19 pandemic.

Surging Deficits

The fiscal deficit of the US, for example, has hit a record peak, with the Congressional Budget Office predicting that the country is likely to run a full-year deficit of around $3.3 trillion, or 16 percent of gross domestic product. This is more than double the previous record, set in 2009, during the aftermath of the Global Financial Crisis.

To put this in perspective, prior to the pandemic, investors were concerned over the possible destabilising effects of an expanding deficit, then expected to come in at over $1 trillion.

But it's been precisely this profligate attitude to spending that has stopped portfolio values across the globe from collapsing. The MSCI AC World Total Return Index returned 6 percent over the last three months, bringing the index back to even since the beginning of the year.

Stock Jitters

Equity markets stumbled towards the end of the quarter. Since the pandemic began, market reactions have reflected how governments have reacted to dealing with the virus. For example, the collapse in share prices in March was in reaction to the sudden deflationary shock of the lockdowns. The rebound that followed was then in response to the massive government stimulus. And so, in recent weeks we've seen markets wobble in response to increased policy concern over a second wave of infections.

The weakness was led by profit-taking in US tech stocks, with the NASDAQ Composite Index falling by 7 percent in September. This seems a reasonable pause in the so-called K-shaped recovery that the US is having. (The upward tick of that capital letter represents sectors such as technology and healthcare, and the downward leg are those tied to the cyclical fortunes of the economy.) Even with the stumble in September however, the NASDAQ has returned a stellar 22 percent since the start of the year.

Booming Tech

The pandemic has accelerated digital trends for households, education and businesses, and the tech sector still offers solid growth prospects. The lofty valuations have drawn the inevitable comparisons with, for example, the dotcom-era bubble. That however was based on projected earnings of immature companies – a promise of things to be, if you will – rather than the current engines of profitability.

Indeed, the lack of comparable technology powerhouses have left other stock markets well behind the US. Since the start of the year, the Bloomberg European 500 Index has fallen by 13 percent. The UK's FTSE 100 Index declined by 20 percent, France's CAC 40 Index fell by 19 percent and Germany's DAX Index slumped by 6 percent. This is an acceleration of a trend that was already in place for some time and has fundamental implications for geographical portfolio exposure.

Defensive Positions Outperform

Reducing the overall investment climate to its most simple message is that it doesn't pay to go against agents of the state pumping liquidity into the economy. Investors have mainly been attracted to long-dated bonds, and companies with strong balance sheets and solid growth prospects. This is essentially a defensive position, which has a Brave New World kind of irony, since tech stocks have traditionally been regarded as a speculative area. Alternatively, market moves thus far have been less-than-kind to those venturing to sectors that offer seemingly cheap valuations such as financials, industrials and energy.

In economic terms, these cyclical sectors will close the gap on tech when we begin to see a realistic prospect of inflationary pressure and a broad economic recovery. This seems a way off and is fraught with specific risk in so far as the long-term effects of the pandemic should involve extensive restructuring in many sectors of the economy.

Legal Storms Brewing

In legal terms however, the biggest and strongest tech names have to combat the effect of intensifying antitrust sentiment in the US. This may well temper returns-on-equity for the tech sector.

The Department of Justice (the DOJ) is expected to file a lawsuit targeting Google's dominance as a search engine, though it's unclear exactly what they'll allege in terms of abuse. And leaders of the major tech companies have recently been the subjects of Congressional hearings. The usual playbook of antitrust policy is to focus on prices for consumers, but in these cases, discussions are likely to centre around qualitative rather than quantitative issues. Section 230 of the Communications Decency Act of 1996 currently acts as a shield that insulates these companies from the defamation type of legal action that media companies face: “No provider ... of an interactive computer service shall be treated as the publisher ... of any information provided by another ... content provider”.

The DOJ proposed to Congress last week that this exemption be weakened.

Both sides of the political aisle have their own reasons for wanting to regulate the tech sector. This is a concern for investors and threatens market returns independent of the outcome of the upcoming US election.

Election Vitriol

The US election is a concern however in a wider context and looks set to be the most bitter in living memory. While many investors have been unsettled by President Trump's unconventional approach, they have enjoyed his tax cuts and his continued focus on promoting jobs and growth. Joe Biden on the other hand has promised to increase corporate and personal taxes substantially. He's also keen on the US embracing environmentalism, which will entail reversing Trump's policy on pushing for greater investment in oil, gas and coal. Green energy stocks have risen on the strong polling for Biden.

On balance, Trump seems the more market-friendly, though the post-election terrain looks set to prove challenging for the investor whoever proves the victor in November. Global antivirus policies still lack conviction and we're moving into the winter months.

More than ever now we need “big enough” deficit spending to keep the ship afloat.

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

	2020						Annualized	
	Sep.	Aug.	Jul.	Q3	YTD	2019	3 Years	5 Years
GLOBAL EQUITY								
MSCI AC World Total Return	-3.2	6.1	5.3	8.1	1.4	26.6	7.1	9.4
MSCI EAFE	-2.6	5.2	2.4	4.9	-6.7	22.8	1.8	5.2
NORTH AMERICA EQUITY								
S&P 500 Total Return	-3.8	7.2	5.6	8.9	5.6	31.5	11.8	13.2
DOW JONES INDUS. AVG	-2.2	7.9	2.5	8.2	-0.9	25.3	9.9	13.5
S&P 400 Net TR	-3.3	3.5	4.6	4.7	-9.0	25.6	3.3	7.6
NASDAQ COMPOSITE INDEX	-5.1	9.7	6.9	11.2	25.4	36.7	21.0	20.1
RUSSELL 2000 INDEX	-3.3	5.6	2.8	4.9	-8.7	25.5	3.5	8.3
S&P/TSX COMPOSITE INDEX	-2.1	2.3	4.5	4.7	-3.1	22.8	4.6	6.6
EUROPE EQUITY								
BLOOMBERG EUROPEAN 500	-1.7	2.9	-1.0	0.2	-12.0	26.5	0.5	3.1
FTSE 100 INDEX	-1.5	1.8	-4.2	-4.0	-20.1	17.2	-3.7	2.8
CAC 40 INDEX	-2.7	3.4	-2.6	-2.0	-17.9	30.5	-0.2	4.1
DAX INDEX	-1.4	5.1	0.0	3.7	-3.7	25.5	-0.1	5.3
ASIA EQUITY								
MSCI AC Far East Ex Japan	-1.9	4.8	7.8	9.4	4.5	16.5	2.6	7.5
NIKKEI 225	0.7	6.6	-2.6	4.6	-0.4	20.7	6.3	7.1
HANG SENG INDEX	-6.4	2.5	1.5	-2.6	-14.2	13.0	-1.9	5.2
S&P/ASX 200 INDEX	-3.6	3.0	0.5	-0.1	-10.1	25.0	7.2	8.8
SHANGHAI SE COMPOSITE	-5.2	2.7	12.0	9.0	7.9	25.3	1.0	3.3
SOUTH AMERICA & EM EQUITY								
MSCI EM Net Total Return USD Index	-1.6	2.2	8.9	9.6	-1.2	18.4	2.4	7.8
S&P LATIN AMERICA 40	-4.5	-5.6	8.9	-1.9	-37.2	13.6	-13.1	0.2
BRAZIL IBOVESPA INDEX	-4.8	-3.4	8.3	-0.5	-18.2	31.6	7.9	14.3
S&P BSE SENSEX INDEX	-1.4	2.8	8.1	9.6	-6.8	15.7	9.1	9.4
FIXED INCOME								
ICE BoA 1-3 Year US Treasury Index	0.0	0.0	0.1	0.1	3.1	3.6	2.6	1.8
Barclays US Agg	-0.1	-0.8	1.5	0.6	6.8	8.7	5.2	4.1
Barclays Multiverse (Unhedged)	-0.4	-0.1	3.3	2.7	5.3	7.1	4.2	4.0
Citi World BIG US Hedged	0.4	-0.9	1.3	0.9	5.3	8.4	5.3	4.4
ICE BoA US High Yield Index	-1.0	1.0	4.8	4.7	-0.3	14.4	4.1	6.5
JPM EMBI Global Core - US$	-2.0	0.2	4.0	2.3	-0.3	16.1	3.7	5.9
JPM EM Global Core - Local	-1.8	-0.4	3.3	1.1	-5.7	10.1	-0.2	3.3
COMMODITIES								
BLOOMBERG Commodity Index	-3.4	6.8	5.7	9.0	-12.4	5.4	-5.2	-4.5
GOLD	-3.6	-0.4	11.1	6.7	24.6	18.4	14.9	10.8
OIL (WTI)	-6.5	5.2	2.0	0.3	-66.5	34.1	-24.0	-21.9

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