WHILE YOU WERE OUT

Quarter-page sized, pink hued notepads were a staple of most offices in the pre-voicemail, pre-email days. They were a concise means by which a co-worker, by means of checking off one or more boxes and scribbling a few lines of text, could inform you that in your absence something had occurred (e.g., you had received a telephone call or an office visit) and whether that something required your immediate attention (a return phone call or an in-person visit).

Capital markets, inconveniently, do not provide investors with such concise (or targeted) messages and clearly identified next steps. However, in an homage to this early office productivity tool, we assembled this contemporary "While You Were Out" checklist of key economic and market trends and outcomes you may have missed if you were otherwise preoccupied in July:

- The Bureau of Economic Analysis delivered a stunning but not altogether unexpected "message": its initial report on 2Q 2020 trends in the US economy showed that output shrank a worst-ever -9.5% quarter-over-quarter (a -32.9% annualized rate). [i] More contemporaneously, weekly reports on initial jobless claims and continuing unemployment showed an improving – but still dismal – jobs market. Relatedly, messages were relayed by dozens of economists projecting that recent business re-openings could produce a strong (i.e., +18% annualized growth rate) rebound during the year's 3Q, though some of these messengers expressed concerns that a recently resurgent COVID-19 pandemic might put these optimistic estimates at risk.

- Messages were received from outside the US indicating that some geographic areas had achieved better success in tamping down the virus' spread and, as a result, their economies might not be as ravaged and could (uncharacteristically) recover more quickly. Eurozone governments messaged markets and their constituents alike with coordinated and aggressive fiscal policies to support businesses and individuals on the Continent. Partly as a result, the USD continued to decline in value (-6% versus a basket of currencies since April). Gold prices – which eclipsed their previous (August 2011) all-time high by touching $1,980/ounce in July – sent a message about investors' pessimistic sentiments in the face of continued health and economic uncertainties.

- The Federal Reserve met as planned in late July to discuss monetary policies, messaging immediately thereafter that the economy is facing severe challenges and that it intends to keep US interest rates low for the foreseeable future. Bond markets were mostly expecting such a communiqué; yields were little changed in July (e.g., the benchmark 10-year Treasury yield moved within a narrow 0.60% to 0.70% band during the month) and remained at historic lows. US lawmakers, meanwhile, continued to evaluate a next round of fiscal policy stimuli (including enhanced unemployment compensation programs) but without reaching an agreement before the month-end expiration of such benefits.

- Company managements delivered messages about Second Quarter earnings and their expectations for the balance of 2020. The story so far (with roughly 60% of S&P 500 companies having reported through month-end) has been mixed: sales and earnings have modestly exceeded pessimistic projections, but overall quarterly profits remain on track for an expected -35% year-over-year decline. The notable exception: certain "Big Tech" firms (i.e., Apple, Amazon, and Netflix) whose revenues and earnings benefited greatly from the 2Q Great Lockdown. Given lingering virus concerns and business unknowns, most companies are unwilling (and unable) to provide forward earnings guidance for the year's second half.

- Messages started to arrive from financial services firms concerning how the Presidential election in November might impact capital markets in the near-term and, depending on the winner, across the next four years. Most sought to strike inoffensive viewpoints while also recognizing the unique environment in which the election is taking place. Political advertising across all variety of media increased, with the certainty that it will become more prevalent (especially in erstwhile "swing states") and virulent as the summer ends.

It may be tempting to conclude that perhaps equity markets – which last month advanced a further +5.5% in the US and rose +3.8% outside the US – did not fully digest this series of mostly unsettling "While You Were Out" messages. But a more reasoned conclusion – seemingly the only logical one given an elevated US equity market P/E ratio of 27x – is that prices are being underpinned by an opaque optimism that health and economic conditions will soon improve dramatically. Markets seem to have embraced a fingers-crossed hope that the virus will abate, viable medical solutions will soon become widely available, employment and economic activity will rebound sharply, and global central banks will continue to sustain and well-execute policies to maintain historically low interest rates and support capital market liquidity.

Market prices and trends, however, are not infallible predictors. There are ample reasons to question whether the prospective good news already "baked" into current prices adequately reflects the many short-term uncertainties. Investors should remain cautious: layering on additional portfolio risk now may not be soon well-rewarded. As always, owning a mix of assets and sub-asset classes and having sufficient "cash on hand" to meet expected financial needs across a multi-year horizon seems the most prudent way to proceed presently.

Investment Strategy Team

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[i] The government only began compiling and publishing quarterly GDP statistics in 1947. Previously, data was calculated only annually. A -2.6% quarter-over-quarter decline in GDP for 1Q 1958 was the worst quarter prior to 2020.

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