REFERENDUMS

A record number of US voters are expected to cast ballots in the nationwide election that ends tomorrow, weighing-in on their current and prospective representation in local, state and Federal governments. Though passions are running high – and will prospectively not abate immediately after polls close – putting this biennial (or, in the case of choosing a President, quadrennial) "temperature check" in the proverbial rear view mirror will hopefully produce some reduction in the collective national anxiety in November. (Please see ***Overreactions to Elections Have Consequences*** for additional Mill Creek perspectives on elections and investing).

Periodic US election cycles and their immediate outcomes aside, capital markets are arguably a referendum mechanism through which global investors *vote* daily on how they think economic, policy decisions, and societal trends may affect broad asset classes and individual securities therein. Throughout 2020, of course, COVID-19 and the impact of related regional efforts to curtail its spread have added an entirely new and (when the year began) unexpected dimension to thinking about the risks that can affect investment portfolios. Some of the key October datapoints relevant to global capital markets in 2020 included:

- The US Bureau of Economic Analysis released its first estimate of Third Quarter 2020 GDP. The record-setting +33.1% (annualized) rate of growth followed a similarly record-setting decrease of -31.4% during the prior quarter. The report was stronger than recent consensus estimates (+30%), which themselves had been boosted in recent months as various data showed rising levels of economic activity.

- Stronger consumer spending on goods (particularly autos) and services (most particularly healthcare, as doctors' and dentists' offices re-opened and elective hospital surgeries were again possible) boosted the economy. Not surprisingly, spending remains substantially below pre-crisis levels in the categories of travel, food services, accommodations, and recreation.

- Government stimulus programs had a more muted economic impact during the Third Quarter. PPP loans continued to work their way through the economy, but $1,200 payments (aggregating to nearly $1.1 trillion) of one-time stimulus checks to most taxpayers was not repeated. Declining unemployment resulted in lower total unemployment benefits and a reduction in "pandemic compensation" payments to certain recipients quarter-over-quarter.

- Net of these two widely-divergent quarters, the US economy will finish 2020 with a net -2.5% decline if GDP achieves the current consensus (+4% annualized) growth rate during 2020's final quarter. That top-line number would not be too much different than 2009's Global Financial Crisis outcome (-2.8%) though clearly the two economic contractions have little else in common.

- US and global equity prices continued to trend higher for the first third of the month before finishing on a downward trend and losing a similar -2.2% (Russell 3000 and MSCI ACWI Indexes) in October. Upticks in positive cases for Covid-19 in the US and Europe – and fears that the pandemic could get worse as the northern hemisphere gets deeper into fall and winter- contributed to markets' monthly declines. In addition, the pending US Presidential election and Congress' inability to agree on additional fiscal stimulus before the election weighed unfavorably on US equity market prices.

- With nearly two-thirds of S&P 500 companies reporting results thus far, the *good news* is that revenues and earnings are mostly exceeding estimates by a wide margin. The *less good news*: year-over-year revenues are currently projected to decline by -2.1% and per share earnings by -9.8%. Although another decline in quarterly earnings is projected in the Fourth Quarter, analysts expect EPS growth rates will turn positive beginning in Q1 2021.

- US bond market yields increased in October, producing modest losses on taxable bonds (-0.5% Bloomberg Barclays US Aggregate Index) and on tax-exempt bonds (-0.2% Barclays 1-10 Year Muni Bond Index). The U.S. Treasury yield curve steepened during the month with the 10-year bond yield moving +17 basis points higher (but to a yield of just 0.88%) while the 1-3 month segment of the yield curve was largely unchanged. With the Fed Funds rate pegged at zero, we expect that this divergence will continue over the near term absent an unexpected 'risk off' event that would push bond prices higher (and their yields lower).

- Credit spreads, after widening in September for the first time in five months, narrowed once again and are below long-term averages for both investment grade and high yield bonds. Lower new issuance, the possibility of an economy-boosting fiscal stimulus in 2021, and a rising amount of negative yielding government debt in non-US markets have all been supportive of credit segments of the US bond market heading into year-end.

The key to what transpires within domestic and worldwide economies – and to global capital markets – across the balance of 2020 and at the start of 2021 is how governments and consumers alike react to the current surge in COVID-19 cases. We will, of course, continue to

assess how these variables could influence the investment decisions we make and the portfolio returns we seek to produce on your behalf.

Investment Strategy Team

Mill Creek Capital Advisors

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