Quarterly Update – June 2020

Following the dramatic COVID driven market selloff in the 1st quarter, we have had a strong relief rally in the 2nd quarter of 2020. In the midst of business and school closings, thousands of cancelled flights, reduced headcounts in restaurants, people working from home, and cancellation or postponement of countless social events, the financial markets started the recovery. As the virus continued to expand its reach, many business have slowly started the reopening process. While it is unclear how COVID may grow or diminish over the next six months, it is clear that businesses are adapting and the government is supporting the economy in a historic way. Here are the returns of the major asset classes in 2020:

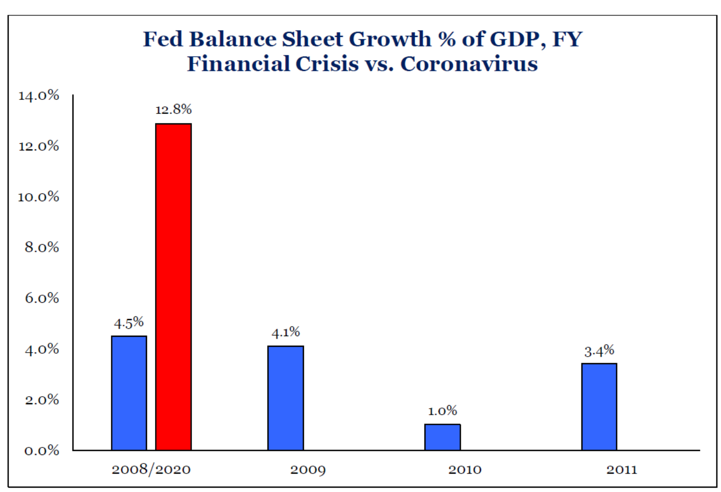
Asset Class	Index	2nd Qtr	Year to	1yr	3yr*
US Large Cap Stocks	S&P500	20.54%	-3.08%	7.51%	10.72%
US Mid Cap Stocks	Russell Midcap	24.61%	-9.13%	-2.24%	5.79%
US Small Cap Stocks	Russell 2000	25.42%	-12.98%	-6.63%	2.01%
Dow Jones Industrial Avg	DJIA	18.51%	-8.43%	-0.54%	9.07%
US Dividend Paying Stocks	DJ Select Dividend	10.86%	-21.68%	-15.15%	-0.44%
NASDAQ	NASDAQ	30.63%	12.11%	25.64%	17.86%
International Developed Mkt Stocks	MSCI EAFE	14.88%	-11.34%	-5.13%	0.81%
International Emerging Mkt Stocks	MSCI EM	18.08%	-9.78%	-3.39%	1.89%
US Bonds	Bar Aggregate Bond	2.90%	6.14%	8.74%	5.32%

[1]

*3yr return is annualized

As you can see from the chart above, the recovery in the 2nd quarter was very strong across practically every asset class. However, it still leaves us in negative territory for the year in seven of the nine major asset classes. The market recovered despite the daily news flow of civil unrest, growing cases of coronavirus, and a huge spike in unemployment following the government mandated shutdowns in March.

You might ask yourself, "Why would the market go up with all this insanity going on in the world right now?" Our answer is, "Don't fight the FED!" The fiscal and monetary response to the COVID pandemic has been overwhelming and equates to approximately 22.7% of US GDP. The combination of tax refunds, expanded unemployment benefits, and bond purchases by the FED have supported both the US consumer and financial markets.



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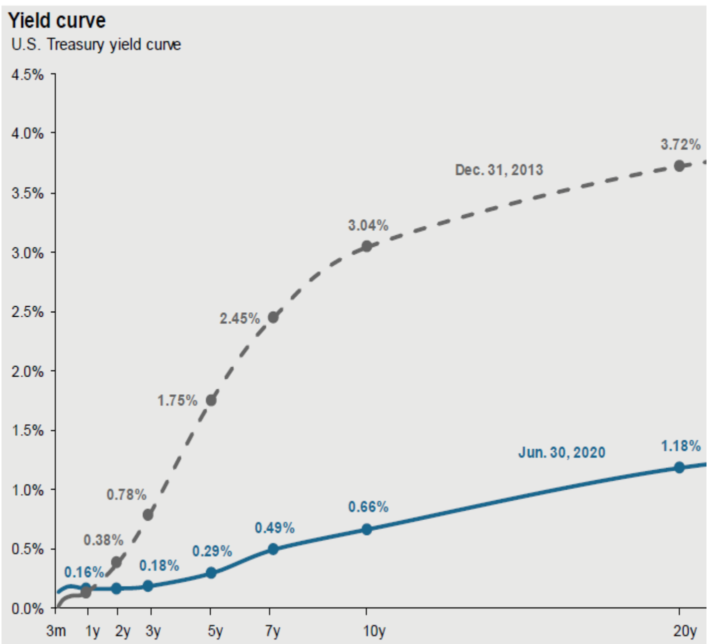
[1] Source: Raymond James Client Center Reporting
[2] Source: Strategas, "Quarterly Review in Charts", p.26

The policy response to the coronavirus has exponentially increased the FEDs balance sheet. The chart below shows the FED began the process of balance sheet reduction in 2017. Here we are three years later with a balance sheet expanded beyond where it was following the Financial Crisis of 2008. In fact, central bankers all over the world are all stepping in to help support their respective economies. Not only are central banks buying assets, but they plan to continue to make asset purchases in the near future. The immense amount of bond purchases by central banks, sovereign wealth funds, and institutional funds have continued to keep interest rates historically low.



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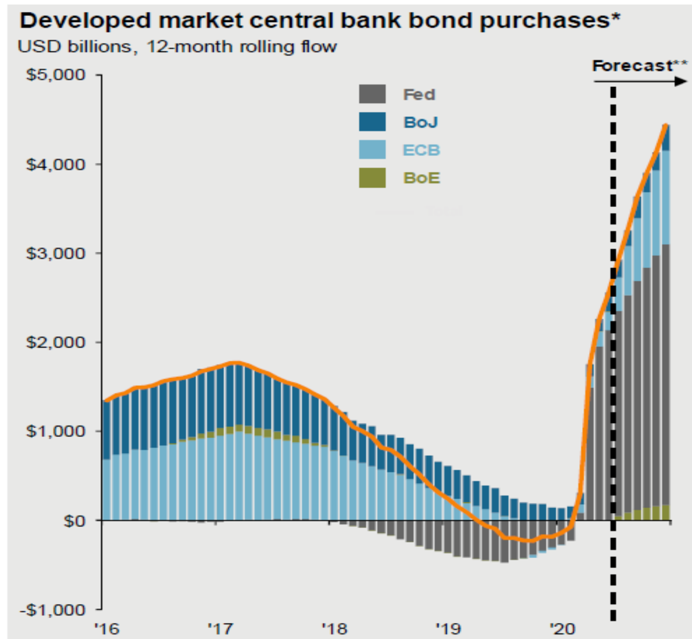

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Even though the market showed amazing resiliency in the 2nd quarter doesn't mean we are "out of the woods" regarding market volatility and meaningful issues to consider. There is a very real possibility the coronavirus worsens as we head into the traditional "flu season". I don't think anyone really knows how this virus will impact us as we restart schools, sporting events, vacations, etc. If there's a resurgence of the virus, a second round of shutdowns is possible. However, the silver lining regarding the recent increase in COVID cases is the fact that the death rate of the disease is significantly lower than it was in March and April. In addition, the probability of new treatments and even a vaccine appear to be on the rise.

Going forward, we are also concerned about soft corporate profits, high unemployment, and the overhang that accompanies the Presidential election. The visibility for corporate profits in 2020 are as cloudy as I can ever remember. Most companies have reduced or removed their earnings guidance. If the company management doesn't have a full handle on the impact of coronavirus on the business, how can investors properly value them. Many investors are simply looking to 2021 and 2022 as they believe the majority of the COVID impact will be behind us by then.

[3] Source: JP Morgan, "Guide to the Markets" p.36
[4] Source: JP Morgan, "Guide to the Markets" p.42

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You can see in the chart to the right that the consensus earnings for the S&P500 are expected to be approximately $125 this year. Some analysts have earnings as low as $110. If this occurs, that would be a $38-53 reduction in earnings from the end of 2019. That's about a 23%-33% reduction in earnings with only a –3% reduction in the price of the S&P500.

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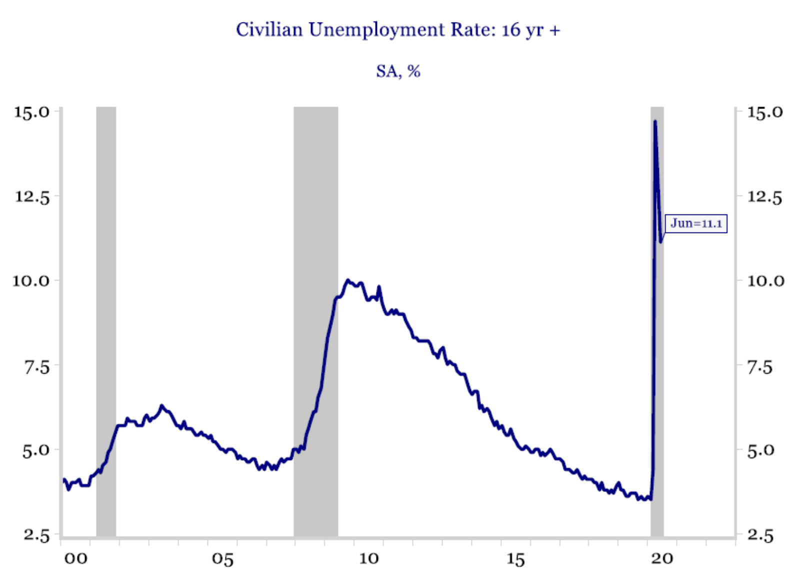
So why the huge disconnect between prices and earnings? We see a growing belief among analyst that earnings may increase dramatically to all time highs in 2021 and 2022. This analyst driven call for a full earnings recovery over the next two years is partially behind the V-shaped recovery we witnessed in the 2nd quarter. If investors start to lose faith in these forward estimates, we believe there may be more downside volatility.

At this point the unemployment numbers are like a double edged sword. When the COVID shutdown started, the layoffs and job losses happened in a flash. Now after a few short weeks, we already see the unemployment rate falling. For example, the US added over 5 million new jobs in June and if that pace continues, this recovery will absolutely have legs. However, the reverse may also be true. If we have a COVID driven round two of shutdowns, the employment picture will deteriorate along with market hopes for a strong recovery.



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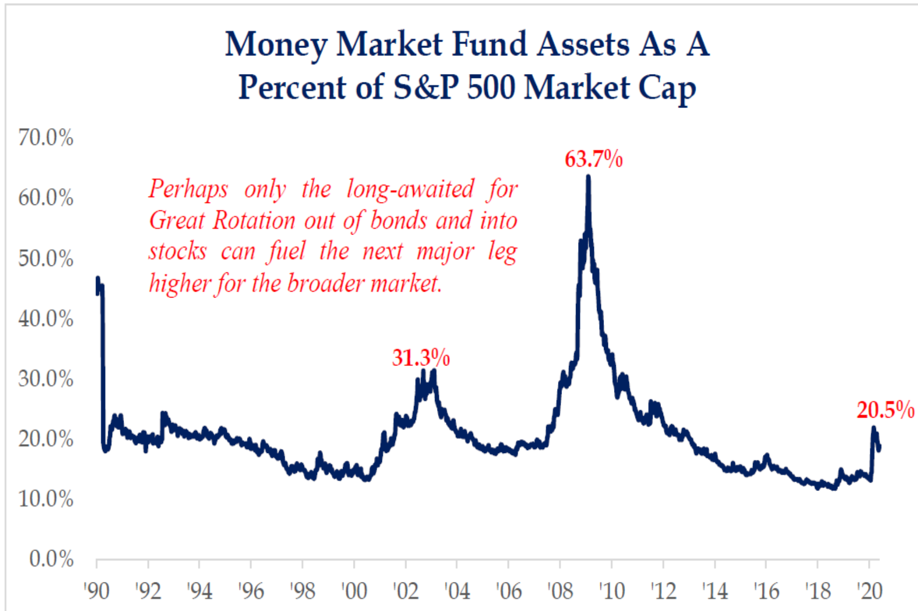
The Presidential election is another possible source of market volatility. We have slightly over four months till the election. President Trump and former Vice President Biden will have a difficult time campaigning like "normal" because many states still have restrictions on large gatherings which impact political rallies and other gatherings. We will break down the PROs and CONs of each candidate next quarter, but for now, get ready for lots of fun presidential TV commercials.

[5] Source: JP Morgan, "Guide to the Markets" p.7
[6] Source: Strategas, "Quarterly Review in Charts" p.8

We are relatively cautious on the market in the very near term. We believe we will probably have a range bound market until we get closer to the Presidential election. The S&P500 is likely to bounce within the 2,850 and 3,300 range (it was trading at 3,100 at the end of the 2nd quarter). We think the market will continue to benefit from fiscal and monetary stimulus, low interest rates, business re-openings, and improving unemployment. The market should also benefit from new cash on the sidelines that can push the market higher.



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There is currently 20% of the value of the S&P500 being held in money market mutual funds. That number is even higher if you consider all the CDs and short term bonds that might be reallocated toward stocks in the next 12 months. Add the value of new savings (US savings rate has ballooned from 10% to 30%) and we believe there is plenty of money to push this market to new highs at some point.

The only exception to this range bound market would be a COVID-19 vaccine announcement or a significant new COVID-19 treatment. Investors would immediately revalue the market and discount the impact of COVID. We believe the market could easily reach and surpass previous market highs if this occurs. In the mean time, we think that it is still a great time for selective stock picking. Growth stocks have performed very well this year and we would expect that to continue. We also expect that Emerging Markets stocks and bonds may benefit from this global business restart and they may also benefit if the US$ begins to slump.

Just like we said last quarter...regardless of the happenings in the market, we sincerely hope that everyone stays safe during these interesting times. Since it is difficult to have face-to-face meetings, please reach out to us with any questions or concerns.

Thank you for the trust you place in our team.

Lynn Shaw	Lynn Shaw II	Kevin Dallas
Managing Director	1st VP Investments	Sr. Investment Portfolio Analyst

[7] Source: Strategas, "Quarterly Review in Charts" p.10

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