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Economic & Market Summary
July 2020

The initial economic impact from COVID-19 has been painful. Data from March and April reflect massive declines in activity and sky-rocketing unemployment as shelter-in-place orders went into effect across the country. However, several weekly and monthly indicators are showing signs of a nascent recovery. Whether or not these encouraging trends continue and how quickly they progress depends on the virus and how well it's controlled. For now, we believe the pace of the recovery will be slower than that of the decline. Consumer spending will be hindered by health and financial concerns. Businesses (some of which are permanently impaired) will be reluctant to invest in new capital as they absorb pandemic-related costs and restrictions while navigating altered customer behavior. A vaccine or some other catalyst that allows people to safely resume their pre-COVID lives and companies to operate at full capacity would quicken the recovery. While several candidates are advancing, a viable vaccine is likely still months away. Until then, our expectations for a quick rebound are measured.

The policy response from Washington has been enormous. Thus far, Congress has allocated about $2.9 trillion in stimulus money or 14% of the total economy. The Federal Reserve has made it clear that interest rates will be kept close to zero while asset purchases (another form of monetary stimulation) will remain at current levels. The actions of Congress and the Fed seem to be mitigating some of the pandemic's economic pressure. The increased unemployment benefits exceed some workers' previous wages and are one reason firms are having difficulty getting employees to return to work. The financial system has stabilized; corporate bond spreads are down from their recent peak and short-term debt markets are functioning normally.

Falling inflation expectations and a "flight to safety" have pushed long-term bond yields to record lows which has made it challenging to invest in bonds. However, we continue to emphasize quality and liquidity with a preference for US Treasuries and corporates with strong financial characteristics.

Though still down about 3% year-to-date, the S&P 500 has rallied 39% since bottoming on March 23. In our view, this reflects the unprecedented stimulus provided by the Fed and expectations for a strong sequential improvement in earnings in Q3 and Q4. Looking further out, consensus estimates suggest that earnings will return pre-COVID levels by the end of 2021. This seems aspirational to us given the uncertainty surrounding the virus. Aggregate equity valuations look a little expensive; the forward P/E ratio for the S&P 500 is 22x. With infections spiking, there is a risk of further restrictions on activity which would compromise the emerging economic recovery and cause equity prices to react negatively. Longer-term, there are socioeconomic risks that bear watching. The virus has disproportionally impacted those on the lowest rung of the economic ladder. Higher taxes and more regulation, both of which are generally bad for equity investors, are tools commonly used by politicians to address such "wealth gaps." While the COVID-19 pandemic has no modern precedent, it's worth noting that crises in general are a part of long-term investing. Maintaining poise and pragmatically assessing risks and rewards in the face of negative events are critical to successful investment outcomes.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address above.