Economic Overview

Steve Scranton, CFA, Chief Investment Officer and Economist

That giant "whooshing" sound that you may have heard at the end of June was the public breathing sigh of relief that the worst of the economic damage now appears to be over.

Although we will not get the first estimate of 2nd quarter Gross Domestic Product (GDP) until the end of July, the consensus forecast from most economists is that it will be the worst quarter for economic growth in the history of the United States. Currently forecasts range from a **negative** 25% to 35% annualized. To give some perspective, if we go back since the Bureau of Economic Analysis began keeping records (2nd quarter of 1947) the worst quarter of growth was the 1st quarter of 1958 when the economy shrank by 10.0% annualized.

The good news is that the economy did show signs of a rebound beginning in May — as states started to gradually re-open their economies — and carrying into June.

Jobs

- Jobs growth rebounded after the horrific decline in April. The nation added 7,499,000 total jobs from the end of April to the end of June.

Personal Income

- Personal income is up 3.8% since the end of February through the end of May. Looking behind the headlines, what we see is that wages are down 8.6%, proprietors' income (i.e. small business income) is down 17.4%, interest & dividend income is down 3.2% while government transfer payments are up 61.1%.

Personal Spending

- Even though the consumer saw their income hold up, it is clear that they recognized the temporary nature of that income as the consumer chose to save their income rather than spend it. From the end of February to the end of May, personal spending is down 11.2%.

In recognition of the fact that the official economic data has lagged (most data is through May), it is also helpful to look at some of the more timely alternative economic indicators.

Retail foot traffic. (reported weekly)

- Prodco provides weekly data on retail foot traffic. The year-over-year foot traffic improved from its worst at -97.92% to -50.03% at the end of June.

Restaurant Reservations (reported daily)

- Open Table provided daily data on year-over-year growth in restaurant reservations. Reservations improved from its worst at -100% to -62.47% at the end of June.

TSA Passenger Traffic (reported daily)

- Passenger traffic improved from its worst at 87,534 to 732,123 at the end of June.

In conclusion, the worst of the damage was done in the 2nd quarter. That does not mean that ongoing damage may not occur. In order to focus on an effective game plan to stop the damage, it is important to focus on the incremental progress that occurs and not wish for a "flip the light switch" grand solution.

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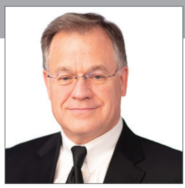


Alternative Strategies

Rick Cloutier, CFA, Chief Investment Strategist

Following the S&P 500's 1st quarter drop of 35%, responding to government stimulus, markets surged in the 2nd quarter. For the quarter, the S&P 500 Index rose 20.5%, the Russell 2000 gained 25.4% and the MSCI EAFE rose 14.9%. While these gains were impressive, they only partially offset the losses experienced in the 1st quarter. Through the first half of the year, the S&P 500 declined 3.08% the Russell 2000 declined 9.13% and the MSCI EAFE declined 5.1%. However, given the extent of the economic damage wrought by the lockdown, the markets' bounce back has been impressive.

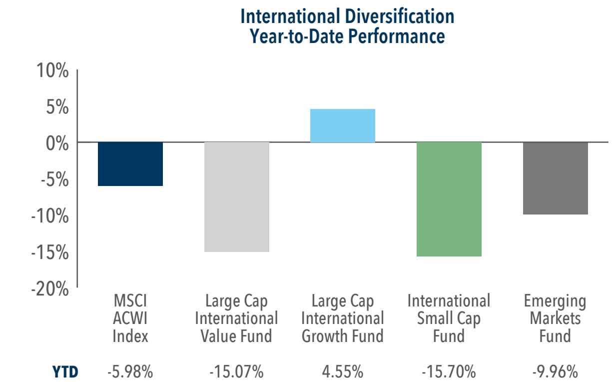
Volatility remained high, resulting in the reversal of our dynamic hedging strategy midway through the quarter as the markets began their rise and, then, the reimposition of the dynamic hedge as markets fell from their peak as the quarter drew to a close. Some of the market's euphoria was lost as COVID-19 cases around the globe jumped when governments started ending the lockdowns. This increase could push out the economic recovery.

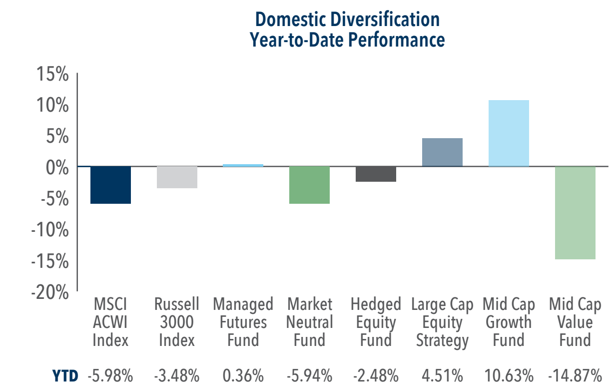
Interest rates remained low throughout the quarter, but the curve steepened as short-term rates declined but long-term rates increased. Consequently, high quality bonds produced single digit returns. More volatile high yield and emerging market bonds staged double digit rallies but, like stocks, remain underwater for the year.

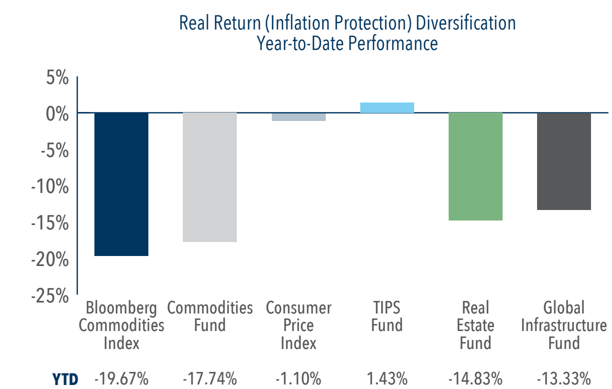
Oil surged higher by quarter's end as producers agreed to production cuts. As a result, oil prices rose over 100% from their April lows; however, even this rise could not overcome the effect the economic decline has had on most other commodities. **For the quarter, commodities as a whole gained 5.5%.** Other real return strategies, like real estate and infrastructure, experienced more impressive double digit increases.

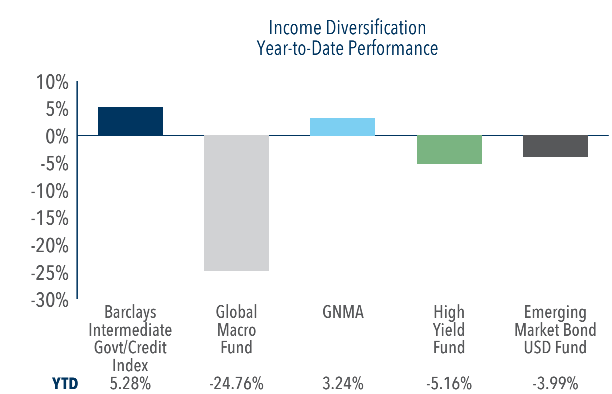
Absolute return or risk management strategies, whose returns are independent of traditional stocks and bonds, continued to lower portfolio volatility. Returns, however, were mixed with single digit positive and negative returns.

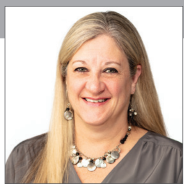
The market's anticipatory nature has looked through the current economic carnage, but the extent of the bounce back should be met with caution. **Given the lack of clarity as to when the pandemic will end and how soon economies will recover, we expect volatility to remain high for the foreseeable future.**











Domestic Equities

Gayle Sprute, Senior Portfolio Manager

Thus far, 2020 has been a tale of two quarters, the 1st quarter's gruesome sell-off and the 2nd quarter's robust reversal. As quickly as the COVID-19 pandemic stripped away more than 30% from US stock values, stimulus efforts and hope for a swift economic recovery vaulted US shares higher in the 2nd quarter. Significant gains were recorded by the Nasdaq, up 31.0%, as well as the Russell 2000, the S&P 500, and the Dow Jones Industrial Average, up 25.4%, 20.5%, and 18.5% respectively.

Although the pandemic maintained an influential grip on the global economy, the US market looked past challenging economic data, instead focusing on recovery hopes. **The 2nd quarter performance drivers were: aggressive monetary and fiscal policy response, hopefulness about moderating virus cases and economic reopening efforts, and treatment/vaccine progress.** Even though the path of an economic recovery remained unknown, fiscal and monetary policy support seemed to act as a backstop for US stocks. Highly anticipated 1st quarter results failed to yield much in the way of company outlooks, though a number of companies highlighted improving sequential demand early in the 2nd quarter.

Given the magnitude of pandemic-driven job and production losses, the National Bureau of Economic Research determined a US recession began in February. Federal Reserve Chairman Powell noted the economic recovery path for the US remained "extraordinarily uncertain." Although economic data began to reflect an improvement from March and April's depressed levels, it was too soon to sound the all clear signal.

The 12-month forward price/earnings (P/E) estimate for the S&P 500 was 21.8x at quarter's end, well above the index's five and ten year averages of 16.9x and 15.2x respectively. Investors will be focused on 2nd quarter earnings in coming weeks, looking for greater clarity on COVID-19's financial and operational impact on companies as well as earnings potential. Uncertainties remain regarding a resurgence in COVID-19 cases, a vaccine timeline, and the pace of consumer reengagement and economic reopenings. Furthermore, the November election has largely taken a backseat to COVID-19 thus far, which is likely to change. **Stocks appear to have priced in a recovery; time will tell if the economy follows suit.**

Fixed Income

Brian Brill, CFA, Senior Portfolio Manager

Investors moved into the acceptance phase that monetary policy will remain very accommodative and that the economic recovery from the traumatic COVID-19 virus will be very muted at best.

As more and more countries and States began to re-open from COVID-19 related closures, initial optimism for a quick recovery have become subdued as more cases popped up in areas thought to be on the downward slope. This reality is nudging investors' opinions closer to the Federal Reserve's (Fed's) sanguine forecast.

Initially, the Fed was most concerned with a properly functioning market infrastructure. To that end, **the Fed response to quell the volatility in the fixed income market has worked very well.** Although that still is near front and center, having the economy return back to growth is at the top of the list.

A comment by Fed Chair Jerome Powell stated the Fed's monetary policy outlook very succinctly, **"We're not even thinking about thinking about rising rates. We are strongly committed to using our tools to do whatever we can for as long as it takes."**

With the Fed seen maintaining a target fed funds rate of 0% – 0.25% until at least the end of 2022, Treasury yields settled into a very tight trading range in the 2nd quarter. This stability has led investors to search for yield in other asset classes that were most impacted previously.

The Fed's quarterly purchases of over $1.8 trillion in securities to keep interest rates low and to maintain liquidity in the financial system has led to impressive quarterly fixed income investment performance. It not only bought US Treasury and mortgage-backed securities, but for the first time ever, investment-grade corporate bonds and ETFs. They have also added stability to the municipal market. With Fed support, corporate and municipal bonds produced very strong returns and corporations took advantage by selling a record amount of corporate debt.

The normal 3rd quarter summer doldrums may experience more volatility this year as stimulus measures undertaken in March and April start to roll off, the simmering trade dispute with China is becoming more confrontational, and the US elections moves into high gear.

International Review

Derrick Wilson, Portfolio Manager

Around the globe, focus largely remained on COVID-19 and the impact to economies. Equity markets rode a wave of good and not-so-good news. **Despite dire outlooks on global growth contracting in 2020, equities posted positive returns during the quarter while chipping away at the losses seen in the previous quarter.**

Starting with China, the reopening of parts of its economy helped to spark optimism, while new virus cases remained low. A new outbreak emerged in June, prompting some renewed closures and travel restrictions. Manufacturing PMI and industrial production data showed a rebound, although still remaining below pre-COVID levels. Chinese equities rose 14.16% over the quarter, bringing the year-to-date return to 5.84%.

It was a different picture in Europe as infections and deaths remained near their peaks within Spain, Italy and France. Economic data showed deterioration with economies remaining closed, but there have been hints of some countries looking at beginning to open back up. Another struggle that continues for Europe is coming to an agreement on a rescue stimulus package between the European Union and member countries. The current proposal calls for a joint issuance of debt and grants totaling 750 billion Euros ($840 billion). European equities increased by 17.78% for the quarter, but year-to-date are down 11.35%, as measured by the Euro Stoxx 50 index.

Separately, the U.K. struggled as Prime Minister Boris Johnson contracted the virus and was ultimately admitted to intensive care before making a recovery. Additionally, Brexit still (yes, still, after four years from the original vote!) hangs out there and seems nowhere near resolution.

Not all news was virus related, however. Geopolitical tensions remained between the US and China, as well as the EU and China regarding trade. China enacted a national security law threatening Hong Kong's autonomy. North Korea blew up an inter-Korean liaison office shared with South Korea. India and China's dispute over land in the Himalayan Mountains turned deadly.

Looking ahead, the forecast remains cloudy. **Equity markets seem to indicate things are on a path out of this storm, yet economic data may not suggest quite the same at this time.** Investors have a lot of inputs and signals to weigh which could lead to choppy markets for the foreseeable future.

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