

**THIRD QUARTER – 2020 CLIENT NEWSLETTER
REVIEW OF THE MARKETS:**

Index:	3Q20	2020
S&P 500	8.93%	5.57%
S&P Mid-Cap	4.77%	-8.62%
S&P Small Cap	3.17%	-15.25%
Morgan Stanley's EAFE (International Stocks)	4.80%	-7.09%
Barclay's US Aggregate (Bonds)	0.62%	6.79%

ECONOMY & MARKETS:

The stock markets substantially recovered from their March lows and a few major Indices even propelled above their all-time highs. As outlined in our last newsletter, the stock market recovery has been done in somewhat of a disjointed manner. In addition, the divergence between the S&P 500's acceleration and the overall economy continues to widen. This particular point is discussed in more detail on our second page.

GDP for the first quarter came in at -5.0% and for the second quarter was -31.7%. However, it is anticipated to be positive for the third quarter and beyond. The latest unemployment figure came in at 7.9%, down significantly from its peak of 14.7%. While unemployment trends have continued in positive manner, we remain very skeptical that the trend of this sharp recovery will continue. At the end of July, the Federal Government's additional \$600 per week unemployment benefits ended. Thereon, Congress could not agree on a figure for how the unemployment benefits should continue. President Trump then signed an Executive Order providing an additional \$300 per week for six week or until funds reach a certain level in FEMA's Disaster Relief Fund. Retail and consumer spending has been strong, but likely will slow down as the additional unemployment benefits cease.

While we are a delighted to see the stock markets general recovery take place, valuations now are at relatively high levels. According to Factset, the forecasted Price-to-Earnings (P/E) on the S&P 500 is now at 21.9 times earnings. Historically, the five-year average has been around 17.2. As noted before, until a vaccine is discovered, it's incredibly difficult to predict future earnings. While each day brings us all closer to a vaccine, debates continue on safety issues, how fast the vaccine can be mass produced and disseminated, who will be the first ones to receive it, will it be effective long-term or just for a few months, etc... **Further, with the P/E trading back at a relatively high level, a disjointed recovery, and another contentious upcoming election, we do expect volatility to pick up as we progress through the end of the year.**

The Federal Reserve (The Fed) has continued to support its long-term low interest rate policy along with various bond buying monetary policies. These measures have also supported the stock market's recovery in line with the saying "Don't fight the Fed" (aka buy stocks when interest rates are low). Shorter-term rates may remain at low levels indefinitely; a recent CNBC survey has forecasted the Fed remaining on hold until 2023. While interest rates across different maturities have all been pushed to historical low levels, our expectations are that we may see longer-term rates rise slightly over the next several months.

Recently, we hired Wendy Feathers as our new Administrative Assistant to replace Camille's role after she unexpectedly passed away from Pancreatic cancer. Wendy has 20 years of administrative experience and also a degree in Business Administration from Robert Morris University. Wendy resides in Bellevue, PA where she spends her free time doting her grandson and is also an avid reader.

As we have progressed through this new norm with the pandemic, we have sparingly had internal meetings with clients, giving clients the opportunity to meet her in person. We have also conducted Zoom meetings and many conference calls as well. For those internal meetings, full sanitizations occur on a regular basis.

PA Banking & Securities Update: Our governing entity has been very diligent about notifying the public about Covid and other investment scams. Please see the links for more detail:

- 1. <https://www.facebook.com/PABankingAndSecurities>*
- 2. <https://www.dobs.pa.gov/Businesses/COVID-19%20Information%20and%20Guidance/Pages/COVID19Scams.aspx?>*

Markets have done the Implausible – Analysis of an Exuberant Rally

The fastest stock market collapse (S&P 500 was down 34%) was followed by one of the fastest recoveries ever. This was driven by several unprecedented stimulus packages from both the Federal Reserve and Congress. As the recovery progressed, it became clear there is a sharp disconnect between that Stock Index and the Economy. By definition, stocks are driven by projected earnings' growth of its underlying securities; the economy is driven by GDP. Both are highly correlated, but calculated differently. Further, during these unprecedented times, it has become overwhelming clear while living in this "new norm" with Covid there are clear winners and losers. Some of the technology-related companies are clearly benefiting from this pandemic. People are working from home using remote softwares, ordering home goods for delivery, streaming movies, etc... The industries that one would expect to struggle such as airlines, department stores, resorts and casinos are exactly doing that.

The S&P 500 is one of the most widely watched measures for overall stock market activity. However, due to its composition and large company bias, it truly does not fully represent all domestic stocks. By definition, it is comprised of 500 of the largest companies in the United States whereby the company's size (termed capitalization or "cap") represents its weight in the Index. During this Covid crisis, the five largest stocks (Apple, Amazon, Google/Alphabet, Facebook & Microsoft) have benefited dramatically, while others are fighting for survival. These five names now make up 25% of the entire Index's weight and performance; it is the highest concentrated percentage for the top five names in history. Cleverly termed, "The Fab Five" (*basketball reference*), in equal-weight terms, these companies represent only 1% of the S&P 500.

Top 5 Nearing Their Own Quartile



Source: Charles Schwab, Bloomberg, as of 8/21/2020. Past performance is no guarantee of future results.

Our economy is measured by GDP, which is defined as "the monetary value of all finished goods and services made within a country during a specific period". As noted on the first page, U.S. GDP was down in the first and second quarter; however, it is expected to rebound in the third quarter to a positive figure. Consumer spending, which accounts for about 2/3 of GDP has surged in recent months as the stimulus checks have helped many households. However, this may wane in future weeks with the unemployment benefits set to expire. Other GDP components such as government spending and business investment spending, will likely remain sluggish given the continued uncertainty caused by pandemic and politics.

The S&P 500's recent dominance can also be shown in other facets. Compared to the Dow Jones Industrial Average aka "the Dow" (which is comprised of only 30 stocks and is weighted by their stock price, not size of the company), the S&P 500 has outperformed this Index by 6.5% through September. Further, Apple had been an enormous contributor to both Indices. After it's 4:1 stock split in August, a now lower trading price means it will have less of an influence on the Dow, but that will not change for the S&P 500. The S&P 500 has also outperformed its mid-cap and small-cap peers by 14.2% and 20.8%, respectively. Further, this year has deepened the split between "growth" and "value" stocks. Growth stocks are expected to deliver faster than average profits in future; meanwhile value stocks are cheap and trade below their expected worth. Large Growth stocks have outperformed Large Value stocks by 32.1%. While we have tilted portfolios towards these benefiting areas, we do remain diversified as at some point in time, the stock market will rotate its winners and losers.

Conclusion – Articles have been written calling this a "K-shaped economic recovery" meaning economic growth will continue but will be uneven, split drastically between sectors and economic groups. It appears as if the big technology companies will continue to benefit during this pandemic. Meanwhile, smaller "mom-and-pop" companies and the more sensitive industries likely appear they will continue to struggle, particularly as the PPP loans run out. However and as we have seen a few times recently, a market reversal could quickly take place as a result of prospects for a vaccine and/or elevated valuation levels for those benefiting industries.