QUARTERLY MARKET COMMENTARY: 2020-Q3

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The third quarter can be described as "bittersweet" as markets approached all-time highs before backing off in a healthy manner. It was reassuring to see how market resilience benefitted client portfolio values, but as markets continued to climb without regard to any economic uncertainties, there was a growing sense of concern regarding downside risk. Markets coming off recent highs during the month of September did provide a brief sigh of relief, but the quick return to levels above our 2021 Dow Jones Industrial Average target of 28,000 signals yet another crossover into overbought territory. How long will this continue and how is this possible with a contracting U.S. Economy and significant unemployment? We remain positive on the recovery of the U.S. economy over the next 12 to 18 months but describe the current scenario as a definitive disconnect between Wall Street and Main Street.

When examining the broader market, we have observed a significant gap in returns between value stocks and growth stocks. Various value-oriented sectors, known for their defensive qualities, have been left behind by their growth counterparts as the COVID pandemic continues to unfold. While growth components are driving the overall S&P 500 returns, we find our defensive portfolios trailing behind this benchmark due to an overweighting in value stocks and a higher cash allocation. It is easy to forget about downside risk when markets continue to run-up, but we must not lose sight of our responsibility in managing risk.

Recently the return gap between value stocks and growth stocks has narrowed. We expect this trend to continue over the next year as the economy heals. During this time, we anticipate sectors such as utilities, financials, and energy to rebound from their significant downturn experienced during the pandemic. We believe the convergence between value and growth will be driven by a rotation from overbought growth stocks back to dividend yielding stocks as well as continued strength in the defensive sectors due to less uncertainty.

The rate of the economic recovery is being monitored very closely starting with a focus on fourth quarter GDP growth projections. The lack of another stimulus package has provided the basis for a reduction in projections by numerous financial institutions. Our observations are consistent with this softer macroeconomic outlook. When analyzing companies on our "Action List" along with the underlying positions within the mutual funds & exchange traded funds that we utilize in client portfolios, we are seeing negative earnings adjustment trends for the current fiscal year driven by weaker fourth quarter expectations. Despite these adjustments, projections for 2021 remain intact and 2022 projections are right around the corner.

Regarding the elections, we do not believe that either administration will have the flexibility to dictate long-term monetary/fiscal policies for at least the next one to two years. The immediate focus and priorities in Washington, D.C. should be related to COVID and the recovery of the U.S economy. Despite signs of inflation, the Federal Reserve has already expressed their goal of keeping rates low to support economic growth. Federal Chairman Jerome Powell has stressed the importance of combining low rates with continued assistance in the form of stimulus packages for any success to be realized.

Consistent with the evolution of the business environment due to COVID, we have already transitioned to virtual client meetings and will be setting up future virtual group events. Please continue to reach out to your consultant should you have any questions regarding your portfolio/financial plan. Please stay safe and we hope to see you soon, either virtually or in person.