Market **Insights**

Economy | **Capital Markets**

Q3 2020

Economy

After nine months, it remains difficult to find the proper words to fully express the personal, economic and financial turmoil we all continue to face in the wake of the coronavirus pandemic. The path back to "normal" appears littered with obstacles and the realization that our lives may be altered forever. While most states have "reopened," the new protocols of social distancing and masks in most public places has left a lasting imprint on our collective psyche. Many people continue to stay home, working and learning remotely. The result of which has been the permanent closure of many local small businesses. Still, through all this chaos, there is hope. For those stricken with the virus, better treatments are now available. A vaccine could be available by the new year. From a financial perspective, the massive and unprecedented monetary stimulus by the Federal Reserve and government gave a lifeline to individuals, small businesses and the global financial markets. Today, while it appears the economy is starting to heal, it is apparent that the road back to a full recovery will take years.

Our nation's economy went through a traumatic series of events that resulted in one of the quickest and most severe recessions on record, with several key data points reaching historic levels. The shutdown of businesses and furloughing of workers during the height of the pandemic pushed the unemployment rate close to 15 percent. An unprecedented 22 million jobs were lost within the first two months. Over the next five months, as states and businesses reopened, the economy added back about 10 million jobs and the unemployment rate fell back to around 8.4 percent. Yet the damage has been done. It is estimated that about 60 percent of businesses shutdown from the start of the pandemic won't reopen. The stark reality of the chaotic lockdown and subsequent reopening of our economy led to the most volatile quarter-over-quarter change in Gross Domestic Product (GDP) ever recorded. The annualized pace of second quarter GDP declined 32 percent, which marked the largest quarterly decline ever recorded. The expected rebound for the third quarter of about 20 percent or more would be equally historic.

The fallout from the pandemic and the nascent economic recovery has produced a clear distinction between segments of the economy that have either benefitted or suffered. Not surprising, those businesses tied to the leisure industry have been decimated. Daily airline traffic has been cut in half, hotel occupancy rates are down about 36 percent from last year, and restaurants are operating at 25 to 50 percent capacity. Already, an estimated 16,000 restaurants have closed their doors forever. Unless the economic environment quickly improves, many more businesses will follow. Conversely, amidst the lockdowns and the transition to working from home and remote learnings for students, the demand for all facets of technology has exploded. Consumer based demand has also shifted from in-person to remote transactions, which has benefitted areas such as online ordering and delivery services. It is interesting to remember that many companies got their start during tough economic periods and have gone on to become household names. For instance, McDonald's emerged after the economic downturn in 1948, Walmart originated in 1962 as the S&P 500 Index entered a bear market, and Microsoft and Starbucks were founded during the stagflation era of the 1970s amidst two recessions. History has shown that strong businesses find a way to survive and even thrive when times are tough. Those that can adapt to difficult conditions become stronger.

The economic and societal fallout from the effects of COVID-19 resulted in tremendous volatility in the capital markets through the first nine months. After declining about 34 percent from late February to late March, the S&P 500 Index snapped back about 50 percent over the next five months, one of the strongest on record. While large-cap stocks tended to lead, small- and mid-cap stocks, which were down close to 40 percent at one point, posted an equally impressive rebound from their March lows. While many investors think of the fixed-income markets as boring and uneventful, this year has proven otherwise. During the height of the pandemic and prior to the Federal Reserve stepping in to rescue the credit markets, investment-grade and high-yield bond indices fell close to 20 percent in a matter of weeks. Since that low point, and after the Federal Reserve pledged unlimited support, bonds have since rebounded and mostly recouped all their losses from earlier in the year.

Looking forward, while many obstacles and unknowns litter the road to a full economic and market recovery, there are positive signs that perhaps the worst is behind us and brighter days are ahead. The most immediate need is a vaccine and better treatments for those stricken with the virus. The good news is that researchers around the world are racing to develop a vaccine, with more than 170 candidate vaccines now tracked by the World Health Organization (WHO). Several are currently in phase-three trials. There is hope that a vaccine will be available within the next year or sooner. Along the way, the key drivers of our economy are expected to continue trending in a more positive direction with employment, manufacturing and housing sectors leading the way. It appears both the federal government and Federal Reserve remain all-in to support individuals, small businesses and the flow of capital throughout the crisis. Until we gain more clarity on these many unresolved issues, we expect the capital markets to remain volatile with modest returns going into the end of the year. In this environment, we continue to be vigilant in our research and a bit cautious with our investment allocations in client accounts.

As always, investing in capital markets comes with some risk and uncertainty. We thank you for your continued support of our investment process as we work hard to deliver positive risk-adjusted portfolio returns to our clients. Should you have any questions, please do not hesitate to reach out to your financial adviser.

Capital Markets

Stocks continued to recover during the quarter as economic trends turned slightly positive and signs that a virus vaccine is on the horizon. U.S. treasury yields moved modestly higher and corporate bond returns remained solid as the Federal Reserve continued to support the credit markets.

Disclosure: It is not possible to invest directly into an index. The indices listed above are unmanaged and are not affiliated with the Advance Capital Companies.

Market Index Performance (%)
As of September 30, 2020

	3rd QTR	YTD	1 Year	Annualized 3 Year
S&P 500	8.93	5.57	15.14	12.25
Dow Jones Industrial	8.22	-0.91	5.70	9.96
Nasdaq Composite	11.23	25.40	41.06	21.06
Barclays Aggregate Bond	0.62	6.79	6.98	5.23
FTSE USBIG Corporate	1.59	7.04	8.11	6.48
MSCI World	8.05	2.14	11.01	8.34

Economy from a Historical Perspective

	Latest	Average*	Definition	Comments
U.S. Unemployment Rate	8.40%	6.07%	Represents the number of unemployed persons as a percent of the labor force	Historically high
Consumer Price Index	1.30%	4.00%	Represents changes in prices of all goods and services purchased for consumption	Sharply lower
U.S. Capacity Utilization	71.40%	80.10%	The greatest level of output that a plant can maintain within the framework of a realistic work schedule, accounting for normal downtime	Remains very low
Gross Domestic Product⁺	32.00%**	1.60%	Total value of all goods and services produced indicates strength or weakness of the economy	Expected to rebound
10 Year Treasury Yield	0.70%	6.20%	Yield on the current 10 year treasury bond	Historically low
Annual Housing Starts	1,416,000	1,430,000	New privately owned housing unit starts annualized rate	Trending higher

*Average from 1966 to Present **Estimated ⁺ Annualized *Source: Bloomberg*