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MARKET MATTERS

MONTHLY INVESTOR UPDATE July 7, 2020

Executive Summary

- *Market Matters* has moved from a weekly to a monthly publication schedule.
- New daily COVID-19 cases are increasing globally, including the U.S. with the South and West as the main hotspots.
- BioNTech/Pfizer and Moderna announced progress in human clinical trials for a vaccine.
- Equity returns were strong in June, reflecting optimism, but so was demand for bonds, reflecting apprehension (and central bank intervention). Small-cap and growth stocks outperformed.
- The economy is improving, but we're still in a deep recession. A V-shaped recovery is possible, but not likely. Equities will require a V-shaped recovery for valuations to be justified.

COVID-19 Update: Curving Up

New daily COVID-19 cases are increasing globally, led by the U.S., Brazil, and India, while cases are also increasing rapidly in Mexico.[1] Within the U.S., cases are increasing across the South and West, with Florida and Arizona having the highest increases in cases per capita over the last week, along with increased hospitalizations and percentage of positive tests.[2]

As we have discussed in prior issues of *Market Matters*, the availability of intensive care unit (ICU) beds is a key indicator of whether governments will want to impose additional restrictions. According to the U.S. Centers for Disease Control and Prevention (CDC), utilization of ICU beds is over 70% for many states in the South and in Arizona and Nevada, as of July 3.[3] New face mask requirements have been implemented in Texas, Kansas, and Arizona. Texas and California (which has been one of the most impacted states) both paused their re-openings, closed bars, and placed restrictions on restaurants and gatherings.[4]

On the positive side, coronavirus-related deaths in the U.S. have been trending down since they peaked in April, BioNTech and Pfizer announced a successful early-stage human vaccine trial, and Moderna announced that its vaccine effort will enter a late-stage trial this month with 30,000 volunteers. Dr. Anthony Fauci, director of the National Institute of Allergy and Infectious

[1] "COVID-19 Dashboard," Johns Hopkins University & Medicine. Visited July 3, 2020.
[2] "Coronavirus in the U.S.: Latest Map and Case Count," *The New York Times*. Visited July 3, 2020.
[3] "State Representative Estimates for Percentage of ICU Beds Occupied (All Patients)," U.S. Centers for Disease Control and Prevention (CDC). Visited July 3, 2020.
[4] "U.S. Surpasses Global Record For New COVID-19 Cases Recorded In A Day," NPR. July 3, 2020.

Diseases, indicated in an interview that we may have results on Moderna's trial between early winter and the beginning of 2021.[5]

On the economic front, local governments in the U.S. and worldwide are unwilling to impose further lockdowns,[6] in part because the coronavirus' spread is better understood, which means less drastic measures may allow countries to manage the virus without inflicting such severe economic distress on businesses and individuals.[7] Face masks play an important role in that understanding, which is why even Texas, which previously prohibited jurisdictions from requiring face masks, is now requiring them across most of the state.

Economic Update: Anticipation

U.S. economic indicators, employment in particular, pointed to improving conditions, but the measurements took place before the most recent spike in COVID-19 cases and subsequent restrictions in many states. Additionally, the CARES Act's extra $600 weekly unemployment benefit ends this month, which could potentially hamper the recovery.

The unemployment rate fell more than expected from 13.3% in May to 11.1% in June. However, weekly unemployment claims remained elevated at 1.4 million, compared to 1.5 million the week prior. The unemployment rate among Black Americans and Asian Americans, which increased in May – in contrast to May's significant decline for the general population – did decline in June.

Market Index Trailing Total Returns				
as of 6/30/2020	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500	1.99%	-3.08%	7.51%	10.73%
Russell 2000	3.53%	-12.98%	-6.63%	2.01%
MSCI EAFE USD	3.40%	-11.34%	-5.13%	0.81%
MSCI Emerging Markets USD	7.35%	-9.78%	-3.39%	1.90%
Bloomberg Barclays U.S. Agg Bond	0.63%	6.14%	8.74%	5.32%
Bloomberg Barc U.S. Corp High Yield	0.98%	-3.80%	0.03%	3.33%
Bloomberg Barc Global Agg Bond USD	1.01%	0.61%	0.71%	2.52%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

Market Update: Global Dichotomy

Returns for the month of June were positive across all major asset classes, which presents somewhat of a dichotomy. Equity returns were positive for domestic and global indices as optimism improved. The S&P 500 Index saw its best calendar quarter since 1998. However, the

[5] "COVID-19 vaccines to enter late-stage trial by end of July, Fauci says," *Reuters*. July 2, 2020.
[6] "Countries are 'highly unlikely' to impose full lockdowns again if there's a second wave, analysts say," *CNBC*. June 25, 2020.
[7] "How Exactly Do You Catch Covid-19? There Is a Growing Consensus," *Wall Street Journal*.

positive returns in bond markets in June were more due to apprehension (and central bank intervention) as strong demand for government securities and high-quality bonds kept yields low despite an increase in supply.

Small-capitalization stocks, which have materially underperformed large-cap stocks for the last several years, outperformed slightly for the month of June (see table below). It is a small difference, but certainly a change from prior periods and likely driven by a growing risk appetite during the month.

Large Cap vs. Small Cap Trailing Total Returns				
as of 6/30/2020	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500 (large cap)	1.99%	-3.08%	7.51%	10.73%
S&P 600 (small cap)	3.74%	-17.85%	-11.29%	0.56%
Russell 1000 (large cap)	2.21%	-2.81%	7.48%	10.64%
Russell 2000 (small cap)	3.53%	-12.98%	-6.63%	2.01%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

Value stocks, which have materially underperformed growth stocks for the last several years, continued the trend during the month of June (see table below). The preference for growth is likely driven by a belief that the worst of the recession is over and by a fear that many value stocks are cheap because they will continue to suffer as a result of the pandemic.

Value vs. Growth Trailing Total Returns				
as of 6/30/2020	**MTD**	**YTD**	**1 Year**	**3 Year**
S&P 500 Value	-0.95%	-15.52%	-4.50%	3.74%
S&P 500 Growth	4.10%	7.93%	17.75%	16.75%
Russell 1000 Value	-0.66%	-16.26%	-8.84%	1.82%
Russell 1000 Growth	3.84%	-3.06%	3.48%	7.86%

Periods longer than a year are annualized. Returns include dividends or interest. Source: Morningstar.

The recent and longer term outperformance of large-cap and growth stocks was likely also driven by sector allocations. Large-cap and growth stocks have, as compared to small-cap and value stocks, a relatively higher exposure to technology and consumer discretionary sectors, and a relatively lower exposure to financials, energy, and consumer staples. Large-cap technology stocks have shown resilience during the pandemic; consumer discretionary stocks perform well during economic recoveries; financials are hurt by low interest rates and lower financial activity; the energy sector was hurt badly during the pandemic; and consumer staples did well during the pandemic but have historically lagged during economic expansions.

Historically, small-cap stocks have outperformed during economic recoveries. If the current economic recovery falters, we could see investors prefer larger companies, which tend to be financially stronger and better able to withstand a recession. Historically, growth stocks have outperformed during economic expansions. Value stocks tend to perform better in a downturn, but sector allocations have blurred the outlook.

From a valuation perspective, small-cap stocks are still relatively more expensive than large-cap stocks,[8] although both are expensive by historical standards based on forward P/E ratios. Growth stocks are relatively more expensive than value stocks, as is to be expected, based on forward P/E ratios.

Trying to time market allocations to large-cap, small-cap, growth, or value stocks is very difficult, especially in times of volatility. However, investors can keep a long-term investment approach that includes the various market segmentations.

Economic Outlook

The economic data released thus far for the second quarter shows a U.S. and global economy that is in the middle of a significant recession. Many data points are showing month-over-month improvements in economic data in late May and June, but year-over-year economic data remains relatively weak. Additionally, late June and early July brought a significant spike in new cases of COVID-19, leading some states to pause their re-opening process.

Equity markets saw significant improvement with 100-day gains in the S&P 500 ending in early July registering its largest gain since 1933. The gains were driven by unprecedented amounts of fiscal and monetary stimulus, very low interest rates, and a belief that the U.S. and global economy would snap back quickly from the COVID-19-led economic recession. Additionally, interest rates near zero have likely led many investors to allocate to equities.

Due to the strong movement in equities during the second quarter, most valuation models show that U.S. equities are now overvalued based strictly upon valuation metrics. We continue to believe that equity markets are requiring a V-shaped economic recovery to be able to sustain current valuations.

We still believe it's possible, but not likely, that a very sharp but short recession occurs (V-shaped). However, recent spikes in COVID-19 cases may prolong the recession and cause consumer confidence to wane if it were to continue. Looking ahead to the second half of the year, economic conditions will likely be driven by any changes in the spread of COVID-19 and geopolitical events. As we get closer to November, markets will also likely start focusing more on the upcoming presidential and congressional elections and about how each candidate positions his respective campaign.

In this time of great uncertainty, it is important that clients are invested in a highly diversified portfolio. Those with short-term investment horizons will likely continue to face heightened volatility. At the same time, those with intermediate- and long-term investment horizons may find very attractive opportunities that have presented themselves in financial markets.

[8] "Weekly Market Recap," J.P. Morgan. July 6, 2020.

We are here to support you and navigate these times of uncertainty together. Knowledge is power, and we're committed to equipping you and your financial professional with the tools and information you need to weather this storm. We are continuing to watch market developments and are here to assist you with evaluating and understanding these economic changes. Please contact your financial professional to discuss your portfolio or should you have any questions/concerns.

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