Market Review and Outlook—July 6, 2020

Best Market Quarter in Decades—The figures below from the past quarter are astounding. There isn't too much to celebrate, for they follow one of the worst quarters in history. They illustrate the critical lesson that *investors acting on fear are rarely rewarded*. This is also why we strive to keep clients' focus on the horizon, on the future, and not on the day-to-day, even when the day-to-day involves a once-in-a-century pandemic.

U, V, Swoosh—We simply don't know the path of this pandemic, when or where cases, and deaths will rise, plateau, fall, or rise again. However, much uncertainty was resolved over the past three months. We saw the immense magnitude of the Congressional fiscal support, and this enabled the US economy to largely survive a two-to-three month lockdown. The Federal Reserve Bank also shifted into overdrive, and bought much of the immense quantity of government bonds issued to bankroll the multi-trillion dollar fiscal support. We found that the fastest and steepest economic decline was also one of the swiftest, and has already begun to recover.

As for the pandemic, progress has been made both in the US and globally. While more is discovered daily, we have learned much about this new virus, we have developed treatments, and we are researching vaccines. We have seen the partial success of hand-washing, proper distancing, and face coverings. We have drastically ramped up production and availability of PPE, personal protective equipment—not only for hospitals and first responders, but increasingly for all who seek it.

Stocks Rebound, Sharply—Investors quickly realized that the world is continuing, and that companies will, largely, stumble through this pandemic. Investors began looking beyond the current month, and even the current year. With this less emotional, new focus, investors began to repurchase the stocks they had sold in a hurry in February and March. This occurred around the world, as the table illustrates.

Bonds—The primary tool the Fed has during an economic meltdown is lowering interest rates. This has helped, however it installs an incredible headwind for future bond returns. This leaves investors stuck between a rock and a hard place—roller-coaster returns from stocks, or anemic and perhaps negative future returns from bonds.

And So?—On the next page we will discuss in some depth the uncertainty we face. Most investors did one of three things during the meltdown: bought, sold, or simply held on. If you bought, you likely did quite well and have a stock-heavy portfolio and should consider rebalancing. If you held on, you can breathe now, but your portfolio could be close to 'right.' If you sold, you have the difficult task to identify how to rebuild your stock

Category	3 Months	12 Months	3-Yr Avg	5-Yr Avg	10-Yr Avg
Fidelity Cash Reserves	+0.00%	+1.11%	+1.35%	+0.87%	+0.44%
Intermediate Term Bond	+3.89%	+7.89%	+4.84%	+3.90%	+3.66%
Intermediate Muni Bond	+2.68%	+3.13%	+3.35%	+3.14%	+3.50%
Large-Cap Stock	+19.61%	+3.74%	+8.15%	+8.35%	+12.22%
Mid-Cap Stock	+22.13%	-6.19%	+2.41%	+3.86%	+10.02%
Small-Cap Stock	+22.95%	-11.41%	-0.64%	+2.49%	+9.32%
Foreign Large-Cap Stock	+16.24%	-4.66%	+0.30%	+1.79%	+5.33%
Diversified Emerging Markets	+20.68%	-3.66%	+1.15%	+2.46%	+3.27%
Health	+23.22%	+17.18%	+11.29%	+6.57%	+15.97%
Technology	+33.78%	+25.97%	+20.38%	+18.50%	+17.44%
Moderate Allocation (60% stocks)	+13.05%	+2.30%	+5.04%	+5.22%	+7.88%

The data in this table comes from Morningstar and is as of June 30, 2020.
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levels.

Desperately Seeking, a Crystal Ball—It may sound incredible, but this is a more difficult time for investors than three or so months ago when the stock markets were in meltdown. The market crash was terrible on many fronts, however it was easy to recommend a path to the future for investors—buy what has fallen, sell what has held up well. This ’be greedy when others are fearful and fearful when others are greedy’ guideline has served investors well for centuries, and did quite well earlier this year.

Fear has dissipated, but we are far from greedy times. Making recommendations is most difficult when assets are neither cheap nor expensive. It’s a bit like weather forecasting—sunny days and 100% rain days are the easy ones to predict.

What Can Go Right in a Pandemic—Successes in many states and countries are largely tied to a strong public health policy, coordinated government financial support, and societal acceptance of the public health-driven restrictions. The contrast between states and countries which ’broke the back’ of COVID-19, and those which are still wrestling with the pandemic is sharp. Given this sharp contrast, the steps to successfully address COVID-19 are crystal-clear. While the steps are neither easy nor cheap, the cost, in dollars and lives, of failing to take these steps are significant enough that it can drive government leaders to take these steps. There is a further cost to doing a poor job—successful states and countries are penalizing residents from unsuccessful states and countries, through travel bans and restrictions. This isn’t designed to be punitive, but rather to enable their continued success.

What Can Go Wrong—Just in the past few weeks, we have seen an uptick in cases in most US states, and a sharp uptick in several cities and states. We have also seen continued surges in cases in certain countries, including Brazil and much of Latin America. In several of these locations, there is ‘COVID-fatigue,’ a desire by residents to get back to normal life, and a resistance to a continuation of (or increase in) restrictions. This makes it even more challenging for leaders to change course and adopt a successful, public-health driven approach to COVID-19.

Uncertainty Reigns—There are always many future economic scenarios to consider, however often there are ‘probable scenarios,’ one or two which are most likely, and when there are two it is best when they aren’t too far off from each other. In the US, we can stumble forward through our patchwork approach, with some mid-course policy corrections in hotspots, but overall moving forward economically until the point at which a vaccine is discovered, produced, and distributed world-wide and we are only then ‘back to normal.’

However in the US, we may find that the Congress gridlocks during this election season and is unwilling to provide the fiscal support needed if the current patchwork of hotspots (Arizona, California, Florida, Texas) continues or grows, stalling the very young economic recovery that has come from all states reopening at some level in recent months. This would most likely break investor’s confidence that a full recovery is reliable.

Global Perspective—China and European countries were hit by COVID-19 earlier than the US and other regions, and on average they are addressing the pandemic better, and are on a more solid economic recovery path than the US. There are exceptions, and this can certainly change, but as of this writing, there are notable investable regions with better near-term economic paths than the US.

Election Investing—We have noted two facts several times during election years. First, markets dislike uncertainty and in November (or perhaps not until December), we will be certain as to the make-up of Congress and who will lead our nation starting in January. That is a positive.

Second, it is nearly impossible to adopt significant legislative change without the White House and both chambers of Congress led by the same party. The last two major changes were the 2017 tax cuts, and the Affordable Care Act in 2010. There is currently a non-trivial chance that all three will be held by one party. While half of the country could be pleased at a significant legislative change in the next two years, history suggests that it is less likely that the markets will be as supportive.

Investing During the Current Uncertainty—We don’t have a high conviction on what will transpire, to the COVID-19 pandemic, or the economy, inside the US and beyond. We don’t see any bargains in the investing world, which provide solace during uncertain times. When on a long trip, if you are not certain where you are or where you are going, the one thing to avoid is flooring it. We recommend keeping your investment approach moderate at this time, neither loading up on or avoiding the typical major asset classes. We are ‘driving down the middle of the lane,’ until we see something familiar, and our confidence rises that we are on the right path. This is a once-a-century global pandemic—it is OK to admit that you don’t know what the future will bring, and to proceed cautiously. However, the last quarter proved that giving up on investing during uncertain times isn’t cautious, it is abandonment. There is a future; it just isn’t yet in focus.