Market Update

September 9, 2020

Equities Are Correcting

- After reaching new highs early last week, financial markets tumbled, driven by a broad sell-off in technology stocks.
- The labor market recovery continued, as the economy generated 1.4 million jobs in August, and the unemployment rate fell to 8.4%. However, the pace of the recovery has slowed from previous months, a theme that is echoed in other economic data.
- In speeches throughout the week, Fed officials warned about the fragility of the current recovery. They emphasized the importance of additional government help in supporting the recovery going forward.
- Financial market sentiment has been on a wild ride over 2020. After market fear spiked earlier in the year, sentiment has improved dramatically, over the last few months, on the back of significant monetary and fiscal stimulus.
- Equity markets have been a closely watched barometer for financial market stress. Though some markets, such as the S&P 500, have recovered from the pandemic impact, many international equity markets have struggled to regain their pre-crisis levels.
- At the peak of the crisis, short-term funding markets brought back memories of 2008, with interbank and commercial paper spreads spiking higher. The Federal Reserve and Bank of Canada have eased this stress through a range of liquidity injections.
- Corporate credit markets have improved with the new measures by the Federal Reserve, where it will buy corporate bonds and ETFs that hold corporate issues. This market had been under stress, with elevated spreads on both investment and speculative grade debt. Fed actions have improved liquidity and allowed for new issuance.

U.S. equity's markets, lead by large cap technology stocks, took a breather in the last several trading days. The NASDAQ pulled back to near correction territory, from recent all times highs. What is positive in this development is that we are seeing some rational market activity, after historic upward momentum, in stocks such as Tesla (TSLA) and Apple (AAPL). These stocks made new high after new high after new high. Most of this feverish buying was due to both stocks splitting and new market participants jumping into these companies based on a stock split news announcement. It is important to know that stock splits do not make the company more valuable on a fundamental's basis. They just make the stock cheaper to buy and do not generate more revenues and cost savings for the companies themselves.

We have seen some rotation from large cap, technology and growth stocks, to more beaten down areas of the markets, but not enough yet to suggest that the recent rally in stocks is widening out to the entire market. Value stocks continue to greatly underperform the market and comprise a substantial portion of the constituency, of the S&P 500 and many investor portfolios. As we get closer to a vaccine and more and more of the economy opens up, we feel that these laggards will start to become leaders for the market. However, we have some time to go before that occurs, as we await more positive developments on the virus front.

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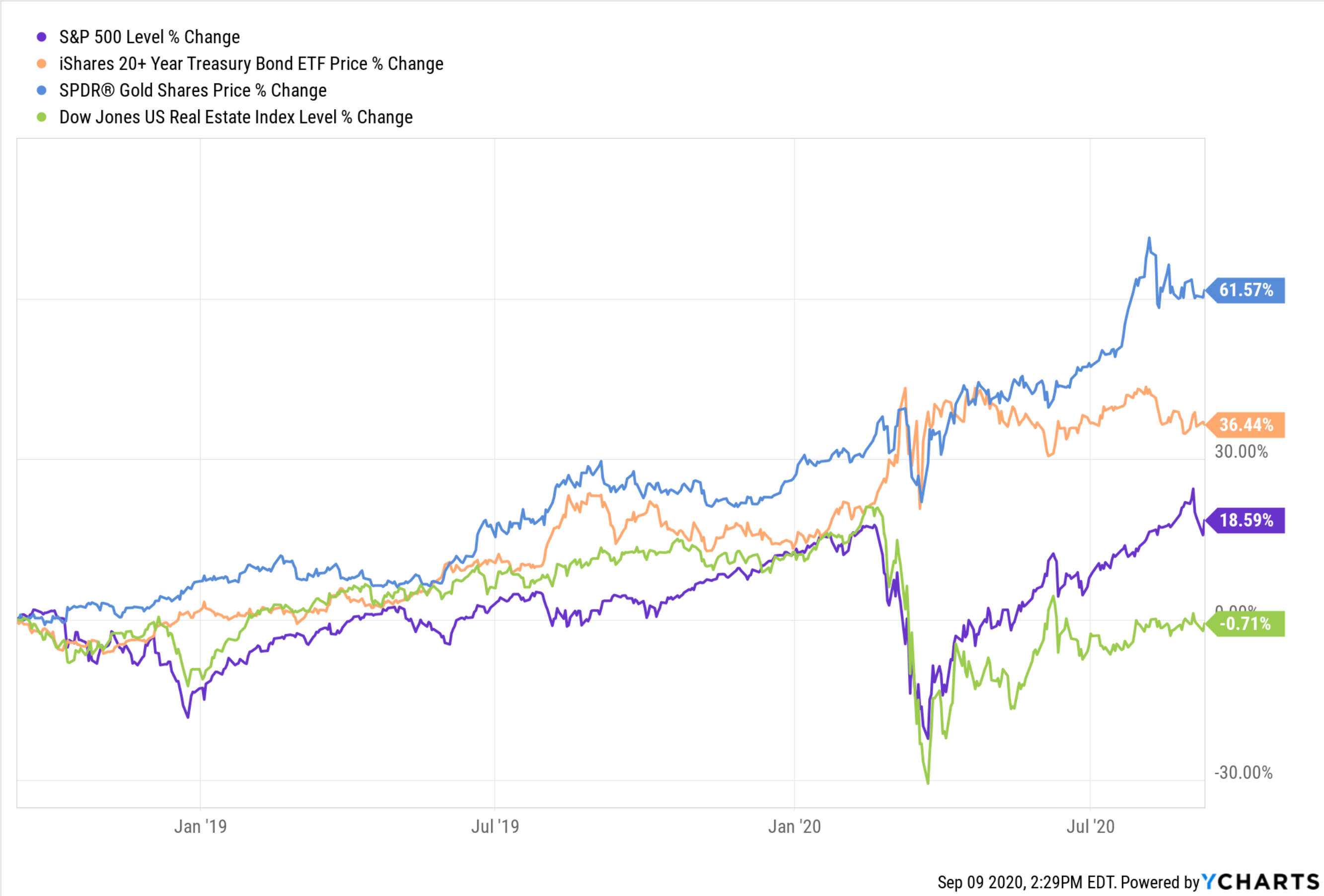

Information in the chart above was taken from sources we believe to be reliable; however, we do not guarantee its accuracy or completeness. Date Range start 09/10/2018.

Although rates are low, the U.S. interest rate yield curve shown below remains positively sloped, showing a slight up tick in rates, from the previous month. Federal Reserve policy is still the main driver of the yield curves remaining positively sloped, but as more good news comes out regarding vaccines and treatments for COVID-19, we anticipate that the curve will remain positively sloped. Historically, positively sloped yield curves have been a signal that the economic environment ahead is looking positive.

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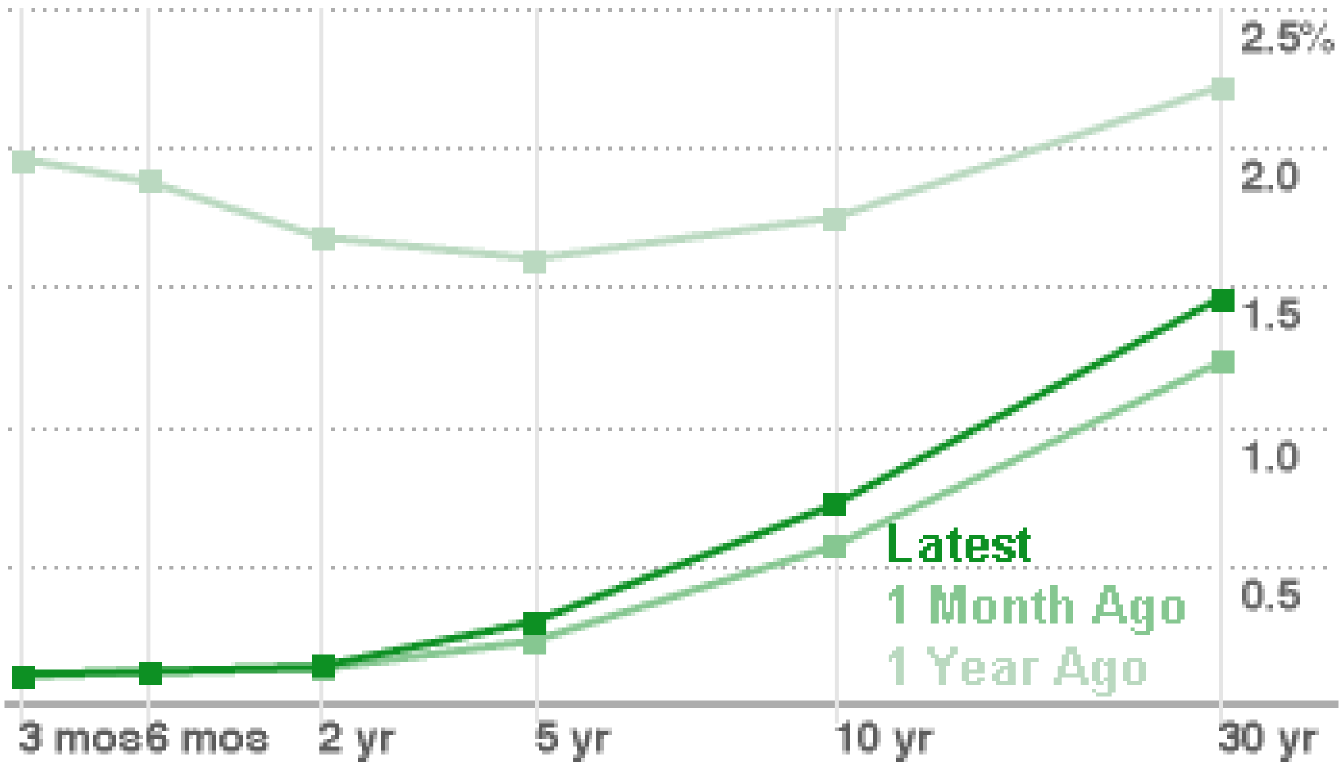

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We are starting to see some signs in the bond markets that the bond bull market run is getting over done, as well. This means that the price of bonds had been going up and yields where going down. However, as this chart shows, there has been an increase in the yield on U.S. bonds, signaling that prices are starting to level off and come down. Bonds, just like stock, can become over bought and selling does occur, lowering prices and raising the yields. The chart is suggesting this even though we are still at historically low interest rate levels, across the bond yield curve.

We are hopeful to see some broadening in the market toward value stock, as the year goes on, but the Coronavirus news will continue to have an impact. The 2020 Presidential race will certainly provide influence on traders and investors outlooks, as we get closer to understanding what the candidate's policy positions will be. Taxation, regulations and trade related issues will be forefront on Wall Street and investors minds.

Having a disciplined investment and risk management process, regardless of market action, is the foundational elements to our portfolio designs. It is this portion of the approach of portfolio management, that helps consistently reduce the long run risk taken in a portfolio of investments. Speculating about near term directions in the markets can be and often is a difficult and risky proposition. We can control the risk and process we take in our portfolio construction, but we cannot control market performance.

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Overall, we prefer domestic equities over international equities. We prefer more value-oriented stocks vs. growth stocks for longer term growth, as we see growth stocks as more fully valued. However, high quality growth stocks are likely to continue to outperform the market in the short term. We are currently neutral to bearish on fixed-income and interest rates. It is important to maintain discipline regarding long-term strategic asset allocation. However, as market conditions dictate, we are looking at tactical opportunities to reduce risk in portfolios, if necessary.

If you have questions or would like to discuss this further regarding your personal portfolio, please contact me at 310-469-7254.

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