FINANCIAL MARKET SNAPSHOT

Better Than Expected

June 5, 2020

An equity momentum "about-face" has occurred in this market as stock indices have quickly recovered much of the February / March swoon.

A so-far successful re-opening of the economy and indications of some bottoming in the jobs market have added to the optimism.

In our view, the pace of equity gains and early signs of some economic recovery have been better than most had expected.

Positive steps toward an economic re-opening were applauded by investors through May, and market participants managed to shake off still-dire economic numbers. Of note, the U.S. has lost approximately 40 million jobs since the coronavirus crisis began. While typical headline economic data remains weak, we have turned, in part, to improved data such as air travel (TSA screening checkpoints) and freight traffic as early indicators of a burgeoning economic recovery. Meanwhile, Q1 U.S. GDP was revised down to -5.0% (quarter-over-quarter) and Q2 expectations fell as the consensus forecast is now pointing to a 34.2 fall in second period GDP.

Investors bought stocks with both hands in May, and appeared little-worried that forward P/E ratios approached the highs of 1999-2000. Again, market participants chose to bet on U.S. markets, and particularly tech stocks, in part because of the size of the apparent Fed safety net.

Table 1: Notable Returns / Yields / Spreads: Feb. '20 - May. '20

Source: Bloomberg

Note: BBG Barc = Bloomberg Barclays; 10Yr Treasury Yield figures as of the end of the month
High Yield Corp Spreads = Yield-to-Worst differential vs. 10Yr Treasury (end of month)

	Feb '20	Mar '20	Apr '20	May '20
S&P 500 Index	-8.23%	-12.35%	12.80%	4.76%
MSCI EAFE Index	-9.01%	-13.28%	6.61%	4.41%
MSCI Emerging Markets Index	-5.26%	-15.41%	9.18%	0.79%
BBG Barc U.S. Aggregate Bond Index	1.80%	-0.59%	1.78%	0.47%
10-Year Treasury Yield	1.15%	0.67%	0.64%	0.65%
U.S. HY Corp Spread (10Yr)	5.08%	8.79%	7.43%	6.37%

U.S. credit markets recognized a bit of a swoon through mid-month, but bounced back late in the period. U.S. Treasury yields remained stubbornly low as the 10-yr benchmark closed the month at 0.65%. Federal Reserve and other safe-haven buying kept Treasury demand high; the latter perhaps endured as a signal the economic picture still is decidedly unclear. Gold prices perhaps offered a similar signal as well. In all, investors appeared willing to discount the current economic upheaval and the damage to corporate earnings in favor of a 2021 rebound outlook.

A key to some of the optimism has come from some early signs of trend change in the U.S. jobs market. While job losses, according to most unemployment surveys, have been prevalent, the degree of those losses has begun to subside (see Figure 1). Essentially, recent jobs numbers have been

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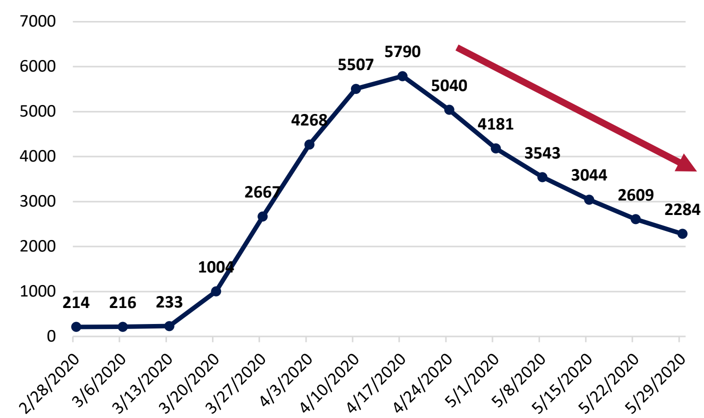
"less bad" in the eyes of market participants. This subtle shift has allowed investors to anticipate an eventual bottoming of the Covid-19-induced unemployment shock.

Indeed, as we craft this commentary, the U.S. Bureau of Labor Statistics has just announced there were 2.5 million job gains in May; a shocking upside surprise. Bloomberg consensus estimates had expected 7.5 million job losses. The U.S. Unemployment Rate actually fell from 14.7% in April to 13.3% in May. While the degree of economic shock may lead to wild swings in unemployment figures, and these numbers may be revised, they seem to confirm what the market has already been pricing in.

While U.S. Initial Unemployment Claims remain high, the directional change in the data set has been viewed positively by the market.

The data set gives some indication that the worst of the jobs market damage may be behind us.

Figure 1: U.S. Initial Jobless Claims (in thousands)
Source: Department of Labor, Bloomberg



In terms of our portfolio management work; as equity prices have begun to recover, we have indeed continued to wade back into equity exposure. However, we continue to do so cautiously, as valuations and still-present economic uncertainty demand a degree of prudence, in our view. We do not have to look back far to recall this market can move very fast, and prices have moved back up quickly in anticipation of some economic recovery. The severe downside momentum has done an about-face in short order. As such, we remain wary that the upside momentum may be a bit overdone here. We have been increasing exposure and participating in the upside equity trend but doing so in a risk-averse manner.

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