FUNDAMENTUM
INVESTMENT MANAGEMENT

Weekly Snapshot 6/29//20

Market Review: Week Ending 6/26

Markets were dominated by Covid-19 news last week, as signs of accelerating new cases forced several states (Texas, Florida and Arizona) to roll back reopening plans. These fears led to a 2.9% drop in the S&P 500 Index for the week (and a large decline on Friday) with the index closing at 3009[1]. Even the record 8.2% gain in May Personal Spending and the 16.6% gain in New Home Sales couldn't rally stocks in the face of growing concerns over the coronavirus' impact on the economic reopening, as the national number of new daily cases reached record highs of nearly 40k[1]. Bank stocks lagged again (bank ETF KBE declined 9.7%[1]), as the Federal Reserve's annual Stress Test capped dividends to earnings and eliminated share repurchases[1], both attempts to maintain the bank's hard-fought capital adequacy ratios. As enthusiasm for the V-shaped recovery waned, bond yields continued to fall, with the 10-year Treasury Bond closing at 0.64% and the 5-year Treasury bond closing at an all-time low of 0.29%[1]. Safety trades were back in vogue, which in today's environment include the high-multiple Technology stocks that investors see as companies offering both growth potential and resiliency during stay-at-home periods. On the flip side of the safety trade are airlines, the most extreme reopening cyclical, where the JETS EFT has fallen 30% from its June 8th high[1]. Until investors get a better understanding of the back half of 2020 earnings outlook and direction of the virus, which could come over the next few weeks during Q2 earnings reports, markets are likely to be whipsawed by news about Covid-19 cases and reopening results. Through the close Friday, year to date results for the major indices are as follows: S&P 500 -5.9%, Russell 2000 -16.8%, MSCI EAFE –11.4% and Bloomberg Barclays Aggregate Bond 6.1%[2].

What We Are Watching in the Week Ahead:

- ***Economic Reports*** - The first week of every month is littered with important economic reports that include the Manufacturing and Non-Manufacturing PMIs and most importantly, the Nonfarm Payroll Report[1]. The pace of rehiring is critical for consumer spending and confidence, so investors will be closely watching the Friday jobs report. 3m jobs are expected to be gained in June and for the unemployment rate to fall from 13.3% to 12.2%[1]. Federal Reserve Chair Jerome Powell and Treasury Secretary Steven Mnuchin testify before Congress on June 30 in what is expected to be a broad overview of the economy and monetary policy. Investors will be watching closely for signs of additional stimulus that might come given the threats to the reopening from the virus' second wave.[1]
- ***Valuation*** - Stocks typically sell at a discount to normal valuation levels during uncertain times. This time, we believe the uncertainty of where earnings will bottom during a once-in a-lifetime pandemic, has contributed to the rally in stocks. Rather than debate whether stocks are already discounting the improvements expected from an economy that is re-opening, without company guidance or any history of outcomes during a pandemic, valuation has effectively been eliminated from consideration. We do know that 2019 S&P 500 EPS were $165[1]. What we do not know is what level the economy (and earnings) will recover to - 80% of the previous level? 90%? 100%? And when? It will take many months to answer the question about the level of earnings likely in 2021 (the Congressional Budget Office revised its 10-year economic forecast, projecting that the U.S. economy would require the entire decade to make up for output lost in the pandemic). Until then, investors have largely eliminated high multiples as a reason for stocks to pause. We have been skeptical that stocks could go rally beyond 3000 on the S&P 500 as we've been assuming $150 for "normalized EPS," and willing to assign a 20x PE multiple during this time of extraordinarily low interest rates. Without considering the question of valuation, stocks have rallied beyond that level without pause.

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References: 1. FactSet 6/29/20, 2. Morningstar Direct 6/29/20