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Market Update: August 2020

August was yet another great month for stocks. Global equities advanced over 6% for the month and are now up 33% in just the past five months. The S&P 500 has returned nearly 58% since the market lows reached back on March 23. The technology heavy Nasdaq Composite has skyrocketed over 72% during the same period.

Investors are showing their optimism … thanks in part to improving economic data, the Fed's promise of support, progress on the vaccine front, and easing trade tensions with China. However, negotiations for another fiscal stimulus package have stalled.

> **Stimulus has carried the market quite far, but the real economy will have to catch up at some point. For now, that doesn't appear to be a reality with additional fiscal stimulus not coming as expected. Consumers have to come to grips that they have less money in their pockets.**
>
> **Chris Dillon, T. Rowe Price – WSJ 8/28/20**

The 5 biggest U.S. companies – Apple, Amazon, Microsoft, Alphabet, and Facebook – have powered the U.S. market rebound and now weigh in at 25% of the value of the S&P 500 Index. Individual investors accounted for about 20% of U.S. shares traded during the first six months of the year, or nearly double the level since 2010.

> **It's one of the year's biggest market stories: Mom-and-pop investors have fallen back in love with stocks, lured by free trading apps, a resurgent bull market led by technology companies and a pandemic that has left millions of Americans at home with little to do.**
>
> **Alexander Osipovich – WSJ 8/31/20**

S&P 500 stock valuations now appear to be quite stretched. The price earnings (P/E) ratio is now in excess of 25 times the previous 12 months of earnings … the highest level since 2002. The forward P/E, measured against earnings expected over the next 12 months, has reached 26 times earnings … the highest market multiple since September 2000.

The valuation of the median stock in the S&P 500 is now in the 100th percentile of historical levels, according to Goldman Sachs. The index itself now trades at the 98th percentile.

> **Many investors appear to be pinning their hopes on a coronavirus vaccine and extensions of jobless benefits and other stimulus from Congress. Any hiccups on these fronts could stall the market's recent rally. At the same time, volatility is expected to remain elevated through the beginning of next year due to the coming presidential election, which is likely to be contentious.**
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> **Stocks might look expensive against these concerns, but some market watchers say it is difficult to reliably predict when valuations are too rich for investors' taste.**

Paul Vigna – WSJ 8/23/20

Back in 1977, the Federal Reserve was directed by Congress to maintain stable prices and boost employment. Last week, the Fed announced that it would no longer make pre-emptive moves to fight inflation, a policy change that should keep interest rates lower for longer periods.

> **The Federal Reserve has just given itself a license to do pretty much whatever it wants.**

James Mackintosh – WSJ 8/30/20

Considered a policy milestone, it is also an acknowledgement of our *slower-growth* economic environment that is characterized by low inflation, low interest rates, and low productivity.

With the revamp of its monetary policy framework, the Federal Reserve has subtly but clearly shifted its priorities away from inflation to employment.

The practical significance is small. With inflation already below the Fed's 2% target and unemployment above 10%, interest rates were going to stay near zero for some years to come, and that hasn't changed.

But it's an important institutional and philosophical shift. Like other pivots over the central bank's 107-year history, this one comes in response to a changed world.

Greg Ip – WSJ 8/27/20

Unemployment claims continue to fall, but at a slow pace. There were 1 million new applications during the week ended August 22, well below the peak of 7 million in March, but still much higher than the pre-pandemic levels of about 200,000 claims a week. Continuing claims, or the number of people collecting benefits, fell slightly to 14.5 million for the week ended August 15.

We're seeing gradual improvement, but we really need to underscore the word "gradual" here. We're only inching along in terms of the labor market's recovery.

Sarah House, Wells Fargo Economist – WSJ 8/27/20

Consumer spending rose in July, but at a slower pace than previous months. Spending in July remained 4.6% below February's pre-pandemic levels. More recent private data suggests that consumer spending has mostly bounced back from the worst days of the pandemic, but the recovery has been uneven across the country.

> **The media and politicians tend to talk about "the economy" as a general term. But I think that will be a misnomer. How fast you will see recovery, or how long you will see depression, depends a great deal on where you are and what part of the economy you are in.**

John Mauldin, Economist – Advisor Perspectives 8/14/20

Households continue to spend less than they take in … which could help fuel future spending. The personal savings rate was 17.8% in July, notably higher than the 7.6% rate recorded back in January.

> **Spending numbers have come back more than the economy as a whole, with the help of a lot of fiscal support. The question going forward is as fiscal support wanes, to what extent will it weaken.**

Jim O'Sullivan, Economist at TD Securities – WSJ 8/28/20

What could be the next shoe to drop? Cities and states are facing significant budget shortfalls. According to the Center on Budget and Policy Priorities, states are looking at a shortfall of $555 billion over the three fiscal years ending in 2022. Cities and towns are facing a $360 billion shortfall over the three years ending December 2022, according to the National League of Cities. Rhode Island and Connecticut could be making budget cuts of 10% to 15% over the coming year.

> **There's an enormous loss of revenue going on, and we don't know how long it will last.**

Richard Ravitch, Volcker Alliance – Barron's 8/28/20

The world economy has become heavily dependent on government support. Bailouts and easy credit helped to soften the impact of the technology crash (2000), the Great Recession (2008), and now the coronavirus pandemic. With each episode, interest rates have declined as government debt has soared.

Low rates can influence unproductive uses … such as companies buying back stock instead of making capital investments. They can also prop up struggling companies (heavily indebted "zombie" companies) and contribute to asset bubbles and their inevitable busts.

> **Our growing intolerance for economic risk and loss is undermining the natural resilience of capitalism and now threatens its very survival … The idea of government as the balm for all crises is appealing in the short term, but it ignores the unintended consequences … lower productivity and weaker growth.**
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> **Ruchir Sharma, Morgan Stanley – WSJ 7/24/20**

Total world-wide debt among advanced economies reached 128% of GDP in July, according to the International Monetary Fund. Back in 1946, total debt reached 124% of GDP in the aftermath of World War II.

> **The war analogy is exactly the right one. We were and are fighting a war. It's a virus, not a foreign power, but the level of spending isn't the problem.**
>
> **Glenn Hubbard, Columbia University – WSJ 8/23/20**

Rapid economic growth helped bring down the WWII debt to less than 50% of GDP by 1959. That is not likely to happen this time around, due to changing demographics and rising entitlement costs associated with health care and pensions.

> **Though vanquishing the virus could bring a surge of optimism, the post-World War II boom would be difficult to recreate. Population growth has slowed in advanced economies, the**

workforce is shrinking as societies age, and productivity is slowing.

By default, if not by design, advanced economies might end up accepting a world of much higher government debt.

Josh Zumbrun – WSJ 8/23/20

Without question, there are considerable near-term challenges in our Covid-19 world. School re-openings present a substantial hurdle, and the economic implications are widespread. Also, flu season is on the horizon, and the U.S. presidential election is just around the corner. On top of all this, September is known to be one of the weakest months of the year for stock investors.

Although the pandemic has triggered an historic drop in global trade, more recent economic data has been generally exceeding expectations. In particular, durable-goods orders and strong manufacturing activity are solid signs for an expanding U.S. economy.

The last five months have been a nice reprieve for investors, but this is certainly no time to become complacent. Remember, two-steps forward…one-step back.

Investors should anticipate an uptick in volatility. Remain calm and keep your discipline. While there are many challenges ahead, there are always just as many opportunities for patient investors.

The next few months offer an opportune time to update your financial planning framework. Stay safe and enjoy the great fall weather.

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