CORRIGAN FINANCIAL, INC.

Market Update: September 2020

While global equities declined approximately 3% in September, investors were still able to register gains in excess of 8% for the quarter. Over the past six months, U.S. stocks values have soared more than 30% … finishing their best two-quarter performance since 2009. After the steep first quarter plunge, stocks have clawed their way back to modest year-to-date gains.

> **U.S. stocks turned in a second consecutive quarter of dramatic gains, continuing a historic stock-market recovery that few predicted in the depths of the March downturn … a journey that has confounded many investors with its sheer velocity and strength.**
>
> **Gunjan Banerji – WSJ 9/30/20**

The market rally by some measures has been the best in over 80 years. The S&P 500 needed just 126 days to go from a record high to a bear market (defined as a drop of 20% or more) and then to reach a new record. In previous downturns it has taken more than 1,500 trading sessions, or about six years, for the index to return to new record levels.

> **This year's wild ride is even more striking against the backdrop of the recession and pandemic gripping the U.S. Millions of Americans remain unemployed, corporate profits have collapsed at the steepest rate in a decade, and the pandemic hasn't been contained.**
>
> **Gunjan Banerji – WSJ 9/15/20**

Given the difficult economic backdrop, why have stocks rebounded so quickly? Most of our institutional resources cite the following influences: fiscal and monetary stimulus, historically low interest rates, benign inflation pressures, the dominance of U.S. technology companies, expectations for a stronger economy, and optimism surrounding the potential for a vaccine.

Everything about this crisis has been oversized and has moved at warp speed. If the economy continues its recovery and real GDP growth is anywhere close to the current consensus view, the stock-market bull may just be getting warmed up.

Jim Paulsen, Leuthold Group – WSJ 9/15/20

U.S. GDP, which was down 31% on an annualized basis in the second quarter, is expected to gain nearly 30% in the third quarter, according to the Atlanta Fed forecast. Still, there are over 11 million fewer jobs than in February, and the unemployment rate is well above pre-pandemic levels.

If Congress is unable to extend fiscal aid to U.S. households in the coming weeks, the U.S. economy will be particularly susceptible to a cutback in consumer outlays – especially from the lowest-income families.

James Watson, Oxford Economics – WSJ 9/16/20

Jeffrey Kleintop, Schwab's Chief Global Investment Strategist, believes the global economy has likely transitioned to the *second stage* … or a more gradual pace due to inventories being restocked and pent-up demands having already been met.

The move to the third and final stage of recovery, when all sectors can return to normal, will require widespread availability of a Covid-19 vaccine. This offers some explanation for the market's near daily obsession with vaccine headlines.

Jeffrey Kleintop, Charles Schwab & Co. – 9/16/20

Applications for unemployment benefits remained over 800,000 a week during September. The total remains well above pre-pandemic levels … but well below the seven million that applied in March. The pace has slowed because the high rate of layoffs has basically offset the workers who have returned to previous jobs or found new work. The number of people actually collecting benefits declined to 11.8 million as of the week ended September 19.

We're getting to the point where the easy hiring is behind us. This next leg of the recovery is going to be much more driven by the underlying strength of the economy rather than businesses just recalling workers.

Ryan Sweet, Moody's Analytics – WSJ 9/24/20

Home sales rose for the third straight month in August, driving this summer's housing market well ahead of last year. Sales of new single-family homes topped 1 million last month for the first time in 14 years. Sales were up 10.5% on an annualized basis, with sales of homes priced at more than $1 million rising 44% nationally.

Housing inventories are at historically low levels, as potential buyers look for more living space, while potential sellers keep their homes off the market due to coronavirus-related concerns.

> **The pandemic has aggravated the housing market's longstanding lack of supply, creating a historical shortage of homes for sale.**

Nicole Friedman – WSJ 9/21/20

Thanks to dwindling inventory levels and exceptionally low mortgage rates, the median sales price of an existing home in August was $310,600 … 11.4% higher than the same month last year.

> **Rapidly rising house prices are effectively canceling out the increased purchasing power that buyers are getting from lower interest rates.**

Redfin Corp, Real Estate Brokerage – WSJ 9/21/20

According to Black Knight Inc., mortgage refinancings jumped 200% in the second quarter from a year earlier. The boom in refinancing corresponds to a boom in mortgage-backed securities issued by Ginnie Mae, Fannie Mae, and Freddie Mac, which totaled a record $322 billion in August.

> **Much of the demand for mortgage securities comes from the Federal Reserve itself, which said in March it would purchase an essentially unlimited amount of mortgage bonds in an attempt to backstop the credit markets.**

Orla McCaffrey – WSJ 9/16/20

Federal Reserve Chairman Jerome Powell confirmed on September 16 that the Fed will keep interest rates at near-zero rates through 2023 and continue to purchase $120 billion of Treasury and agency bonds each month.

The goal is to drive down the unemployment rate and push inflation to modestly exceed the Fed's 2% target. With an unemployment rate in excess of 8% and inflation well below 2%, the Fed has a long way to go reach these goals.

> **In effect, the Fed's monetary policy will be implicitly supporting the federal government's fiscal policy. By purchasing nearly $1 trillion of Treasury securities annually at the present pace, the central bank "monetizes" a significant portion of the debt issued to cover the federal government's budget deficits.**

Randall W. Forsyth – Barron's 9/17/20

It's quite an arrangement when you think about it. The government spends more money than it takes in and issues bonds to cover the difference. The Fed then simply purchases the bonds. It works … until someday when maybe it doesn't.

The Fed also updated their economic projections. The outlook for this year has improved, but a slower recovery is expected going forward.

> **Officials also now see a less-bad recession in 2020 – down 3.7% versus a forecast 6.5% drop in June – followed by 4% and 3% gross domestic product growth in 2021 and 2022, respectively.**

Nicholas Jasinski – Barron's 9/16/20

Chairman Powell expressed the need for more fiscal support, noting concerns regarding employment levels, struggling small businesses, and budget shortfalls for state and local governments.

> **It was a clear message to Congress.**

Liz Ann Sonders, Charles Schwab & Co. – Advisor Perspectives 9/17/20

While the U.S. economy remained on its path to recovery during September, European and Asian economies struggled against the rising pace of virus infections. Economic surveys in France, Germany, and Japan saw recent declines in activity. Some European countries, including the U.K., France, Spain, and the Netherlands, have imposed restrictions due to accelerating infection rates.

The recovery has been slower in other parts of the world … an indication that the global economy may struggle to return to pre-pandemic levels of output until a vaccine becomes widely available.

Harrison/Hannon – WSJ 9/23/20

China's economy continues to recover after recording a solid rebound in retail sales in August. Retail sales have now returned to pre-coronavirus levels. State-run statistics also point to rebounds in factory production and investment, as well as declining unemployment. Overall, economists see third-quarter growth reaching 6% … consistent with levels recorded before the pandemic.

China's growth spurt isn't the beginning of a robust recovery but an uneven bounce fueled by infrastructure construction … An honest look at the forces behind China's growth this year shows a doubling down on state-managed solutions, not real reform. State-owned entities, or SOEs, drove China's investment-led recovery.

Though Beijing talks about "market allocation" efficiency, it isn't guided by what mainstream economists would call market principles. The Chinese economy is instead a system of state capitalism in which the arbiter is an uncontestable political authority.

Rudd/Rosen – WSJ 9/22/20

In a recent UBS Evidence Lab survey of more than 1,000 chief financial officers, 75% of respondents were considering moving, or have already moved, some production out of China. Half of the U.S. executives were planning to move more than 60% of their firms' China-based production.

Even with all the geopolitical struggles and supply chain concerns, global trade recovered about half of its pandemic losses by mid-year, according to the Kiel Institute for the World Economy. Countries where trade has rebounded, including China, South Korea and Germany, are experiencing better economic growth than those relying more heavily on services.

Global trade is rebounding much more quickly this year than it did after the 2008 financial crisis, lifting parts of the world economy and defying predictions the pandemic could send globalization into permanent retreat.

Eun-Young Jeong/Tom Fairless – WSJ 9/20/20

Unfortunately, when it's all said and done, shareholders are left with high stock valuations and very low bond yields. That's a recipe for lower future returns, and investors will need to trim back their performance expectations.

> **What's more, the ability of bonds to cushion pain is reduced, relative to history, because there's no more room for bond yields to fall. That leaves you with a lower return on a 60/40 (60% stock/40% bond) portfolio than it used to get, and also more risk.**
>
> **Ben Inker, GMO – Barron's 9/18/20**

If you are wondering what to expect for future investment returns, Vanguard just released its 10-year market forecast. They expect U.S. stocks to deliver annualized returns of only around 5% and bonds to generate just over 1% annually over the next 10 years. Vanguard also forecasts that foreign stocks should generate returns of just over 8% … and value stocks to outperform their growth counterparts.

While large growth stocks have dominated the markets for some time, that trend may finally be running out of steam. Cyclical, or so-called value stocks … industrials, materials, and energy … have finally started to show signs of life. The rotation from growth stocks to cyclical stocks is consistent with the expectation of a rebound in U.S. and global economic activity.

Recent research suggests that the pricing of value stocks relative to growth stocks may be the widest in history. In fact, to get back to historical relationships, value stocks would have to outperform growth stocks by nearly 80%.

> **It's natural to think in the post-Covid world there will be more use of technology and the Internet. Well, those opportunities have already been amply explored by the market and are fully priced. I've studied hundreds of years of capital markets and have never seen growth beat value by as wide a margin as we've seen.**
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> **Rob Arnott, Research Affiliates – Barron's 9/18/20**

Many investors are also questioning whether they should "stay the course" during this time of extreme social, economic, and political uncertainty. In short, Charles

Schwab Investment Management reminds us that there is no need to “respond” at least without taking the time to revisit your financial plan and long-term goals.

> **The thing for folks to remember is that we have over 100 years of financial data and science that guides the basic investing principles … and that 100 years covers some extremely dire times for the country. A lot of the strategy that we use when we build portfolios is to protect us in the face of a future that we can’t predict.**

Townsend/Bartick – Charles Schwab Investment Management 9/29/20

Sound planning is about *anticipating* obstacles and taking advantage of longer-term opportunities. If you find yourself *reacting* to short-term information or events, you probably don’t have much of a plan to begin with.

Always remember that winners anticipate … while losers react. In other words, stick to the plan and do your best to ignore the noise.

Daniel G. Corrigan, CPA/PFS, CFP®