# Perspectives

A Quarterly Newsletter for Clients of Parsons Capital Management


Quarter 2, 2020

*by John Mullen and Ruth Mullen*

**A painful bear market in the first quarter was met with** an equally impressive rally in the second. Never before has a bear market brought on by a recession lasted only four weeks, though no bear market had ever been met with such a forceful response from policy makers around the world. If the Federal Reserve responded to the 2008 crisis with a bazooka, Chairman Powell unleashed a howitzer as the Fed grew its balance sheet to $7 trillion at the end of the quarter from just $4 trillion at the start of the year. Domestically, the one constant was the outperformance of growth compared to value. Small and mid-cap stocks outperformed their larger peers, though still lagged meaningfully for the year. In a further sign that the risk rally was truly on in the second quarter, Emerging Markets led all major groups higher in June as the global economy slowly reopened. Export and commodity-sensitive markets were especially impressive, highlighted by China with a positive year-to-date return of +1.2%—the only country in the green.

| Data as of June 30, 2020 | June '20 | Qtr. 2 '20 | YTD '20 |
|---|---|---|---|
| S&P 500 | 1.99% | 20.54% | -3.08% |
| MSCI AC World Index (incl. US) | 3.24% | 19.39% | -5.99% |
| MSCI EAFE (Europe, Asia, Far East) | 3.44% | 15.08% | -11.07% |
| MSCI EM (Emerging Markets) | 7.40% | 18.18% | -9.67% |
| Russell Large Cap | 2.21% | 21.83% | -2.80% |
| Russell Large Cap Growth | 4.35% | 27.84% | 9.81% |
| Russell Large Cap Value | -0.67% | 14.29% | -16.26% |
| Russell Mid Cap | 1.80% | 24.61% | -9.12% |
| Russell Small Cap | 3.53% | 25.41% | -12.93% |

*Data compiled by Tamarac Inc.*

## *Fixed Income Markets*

While the percentage swings may not have been as extreme as equity markets', perhaps no corner of the investment world witnessed a larger change in sentiment and fortunes than the fixed income market. Before the Federal Reserve stepped in to support fixed income, the market had seized up as forced liquidations from fund and ETF redemptions swamped any buying. Once the Fed moved to stop the bleeding, ultimately committing to purchasing bonds both directly and through funds, calm returned to the market. By the end of the quarter, the US Credit Index was positive for the year with a +4.82% return on the strength of a +8.22% return in the quarter. Municipal bonds also rebounded nicely in the quarter, +2.72%, to finish the first half of the year +2.08%. High-yield bonds fared the best in the quarter, +10.18%, though they were still negative for the year at -3.80%.


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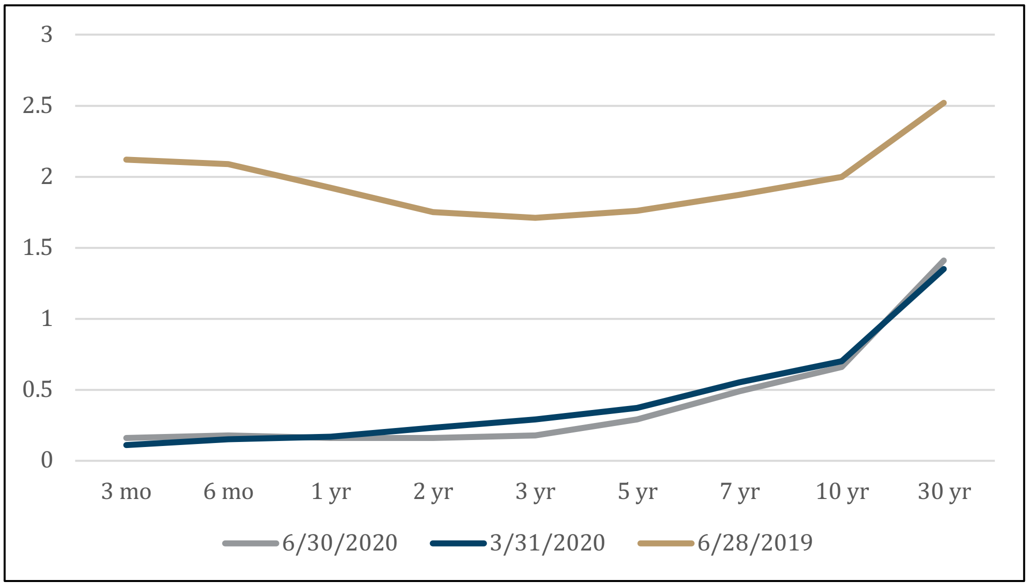
## US Treasury Yields

*Noticeable shift lower in the curve…*

*Curve lower, but steeper…*

The drastic actions taken by the Federal Reserve in the first quarter brought the yield curve as low as it has been since 2015, when the Fed first began raising rates. Throughout the second quarter there was very little change in the overall shape of the curve, but a slight move higher in the longest end indicated improving sentiment for economic growth prospects.




## Commodities

*One for the record books…*

*Oil went negative, while metals shined…*

Commodity markets made their own history in the quarter.

At the close on Friday April 17 oil, as measured by West Texas Intermediate, was already down -70% for the year at $18/barrel. By the end of the day Monday, WTI was priced at -$36.98—yes, negative—as collapsing demand fed fears of a storage glut. A day later WTI ended the day at $8.91/barrel and enjoyed a relatively uninterrupted advance through the rest of the quarter. Following WTI's lead, gasoline rallied +263% in the quarter, though it is still down -27% for the year.

In a sign that the global economy really may have bottomed, copper—long relied on as a sign of economic health—advanced steadily throughout the quarter, logging a +21% gain.

Gold continued its resurgence, valued as a hedge against inflation and a seemingly better store of value than paper currency.

| Commodity | Qtr. 2 '20 | Year to Date '20 |
|---|---|---|
| CRB (broad index) | 13.33% | -25.49% |
| Oil | 91.47% | -35.77% |
| Gold | 13.24% | 18.00% |

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# Economic Overview

*What will the recovery look like…*

The second quarter stands out both for the unprecedented economic numbers witnessed and the volatility of those numbers, as the global economy went on pause in an effort to contain the SARS-COV-2 virus. The US saw a reduction in activity unlike anything outside of the Great Depression, but equally historic numbers as activity began to rebound with a gradual reopening. As June came to an end, the economy had clearly moved off its low. The question became: What kind of rebound will follow (V, W, U, square root)?

In the US, March and April stood out for their weakness as stay-at-home orders swept the nation.

*Unprecedented weakness to start the quarter…*

- Retail sales plunged a combined -21.8% in the two months.
- Manufacturing production fell -20%.
- Nonfarm payrolls shed 22.1 million jobs in just two months.
- Household savings rate ballooned to 33% in April.

Beginning with May, and continuing in June, green shoots started to emerge, giving hope that the contraction had bottomed and the economy was starting to reopen, at least in a halting fashion.

*Signs of life begin to emerge in May…*

- Retail sales boomed in May (latest available) by +17.7%, the largest month-to-month gain in history.
- The manufacturing PMI (Purchasing Managers Index) rose +9.5 points to end the month at 52.6, firmly back in expansion territory, with strength broadly based across industries.
- The non-manufacturing index (services) rallied an even more impressive +11.7 points to 57.1.

Combined with other, more high frequency but less often cited measures of economic activity (like miles driven, passengers checking through TSA, Open Table reservations), these data points indicate that the recession which began in February ended in May. The 2020 recession (Great Shut-in?) was truly breathtaking in both its depth and short lifespan.

*Economic recovery global in nature…*

Globally, the broad rebound in activity was equally as impressive as the one in the US. In a notable sign of broad-based improvement, economic surveys for countries including China, Japan, the EZ, Australia, Canada, South Korea, Brazil, India, Mexico, Australia and Brazil all improved at varying rates. China, Australia and Brazil all joined the US in expansion with PMI (Purchasing Managers Index) readings above 50.

In Europe, data continued their steady improvement as more of the continent's economies opened. PMIs, consumer confidence and measures of business climate all bounced sharply in June, yet remained well below their pre-Coronavirus levels. As an example of a sharp rebound in an important part of the global economy, the German IFO Export Expectations report jumped from -26.7 to +2.3, a historic surge.

*China stands out for its impressive recovery…*

Japan, where authorities took a less restrictive approach to containing the virus, saw signs of improvement, albeit more fragile. The Japanese service PMI for June came in at 42.3 after finishing May at 26.5; however, the manufacturing PMI actually slipped lower to end June at 37.8.

Perhaps most impressive was the rebound in the Chinese economic data. By quarter's end, the manufacturing PMI, auto sales and Leading Economic Indicators (LEIs) had all returned to their pre-crisis levels. More high frequency data points such as retail sales, rail traffic and industrial production all moved higher as well. Some blemishes remained, but on balance China's economy looked well on its way to recovery.

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## Investment Implications

*Recovery underway, continued volatility likely…*

A recovery, both domestically and internationally, seems to be underway. It will likely remain jagged and volatile as countries will be forced to tamp down activity to deal with Covid outbreaks and flare-ups in the coming months and quarters. The initial bounce as world economies begin to reopen will be steep due to easy comparisons, giving the impression of a V-shaped recovery. The reality is likely to be different, perhaps a bounce then a plateau, until a vaccine and/or mitigating treatment become widely available.

In the US, the fast and furious rally off the March 23 low produced the third-best 65-day return of all time, trailing only 2009 and 1982. Looking back at the ten best such scenarios historically, the returns for the market in the short term tend to be uninspiring, at best. Extending to the three, six and twelve months forward, returns are positive in nine of ten observances—each with above-average market performance.

*Third-best rally of all time, but uncertainty persists…*

Perhaps not surprising with all of the unknowns facing the world, the second quarter witnessed a total of 170 companies in the S&P 500 suspending forward guidance. The stock returns for those companies withdrawing guidance, on average, is -12.8% for the year, significantly worse than the index as a whole, with much of the underperformance in just the final weeks of June. Investors are drawing negative conclusions when information is lacking, a clue to how important sentiment is right now in driving stock returns.

During the record-setting bull run that began in 2009, three phrases became common. The first, "climbing the wall of worry," was a nod to the notion that there was seemingly always something for investors to worry about. Due to this, exuberance rarely got out of control and the longest bull market in history was also the least embraced. While there are signs that at the current moment markets are too sanguine, with the put/call ratio low and bulls outnumbering bears nearly 3:1 at the end of June, there are also clearly numerous issues to concern market participants. Two which have our attention are the upcoming election and recurring international tensions.

*A return of TINA…*

The next two phrases often went together: "buy the dip" because "there is no alternative" (TINA) were defining investment philosophies underpinned by the notion of Federal Reserve support and financial repression. Both of these axioms are even truer today and can be expected to stay true for the foreseeable future.

*Much to worry about, but Fed support helps to offset…*

So the market is poised between fear of a protracted economic slowdown or even another contraction stemming from Coronavirus and greed due to the flood of liquidity unleashed by central banks here and abroad providing an underpinning to support markets. A correction is possible at any point, sparked by any of the myriad of issues confronting us. A new bear market is at this juncture a lesser probability. As with everything these days, events could change the outlook quickly ... stay tuned.



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