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Market Commentary
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Introduction

After a tumultuous first quarter of the year, the market came roaring back during the second quarter of 2020 amid an economic recession. Coronavirus has dominated the headlines for most of this year and has taken a toll on the economy with global cases exceeding 10 million and cases in the United States exceeding 2.7 million at the end of June. Despite the recent surge in new cases in the United States and expected poor economic data that was released throughout the second quarter, more recent data has started to improve, and forecasted data paints a better backdrop. For example, the unemployment rate as of June stood at 11.1%, however this is down from the higher 13.3% rate we saw in May. Additionally, while GDP declined -5% in the first quarter of 2020 and is expected to be negative in the second quarter of 2020, analysts are projecting positive GDP growth in the third and fourth quarter of this year. Lastly, inflation has fallen sharply with the Consumer Price Index up only 0.1% on a year-over-year basis as of May, however, inflation is expected to move higher in 2021 as the economy recovers. The Federal Reserve continued to be supportive throughout the second quarter keeping short-term rates at nearly 0% and acting as a buyer and seller of last resort for the bond market. It is expected that this will continue as the Fed was recently quoted that they aren't even "thinking about, thinking about" raising rates. While the economy has been challenged in the front half of this year, we are optimistic an economic recovery can occur in the second half of 2020.

Domestic Equities

It is hard to believe that the S&P 500 is only down -3.08% year-to-date through the end of the second quarter. The second quarter could not have been any more different than the first quarter. During the first quarter, the S&P 500 experienced the fastest 30% drawdown in history, while in the second quarter, the S&P 500 returned 20.54%, the best quarterly performance since 1998. The extraordinary rally in large cap U.S. stocks in the second quarter can be attributed to a combination of unprecedented levels of fiscal and monetary stimulus, hopes of a coronavirus vaccine and the gradual easing of social distancing policies across the country. The market looked past the poor economic and earnings data released throughout the quarter and onto the prospect of a potential economic recovery in the latter half of the year. Riskier smaller stocks outpaced larger stocks in the U.S., with the Russell 2000 index returning 25.42% for the second quarter and the Russell 1000 index returning 21.82%. This rally in stocks has caused equity valuations to look expensive relative to history. While prices appear disconnected from their fundamentals, low borrowing costs and additional Fed stimulus may justify higher stock prices. Therefore, while we are still taking on equity risk, we continue to be mindful of current valuations and the uncertainty around the effect of the virus going forward.

International Equities

In the second quarter, international developed and emerging market equities rebounded, returning 14.88% and 18.08% respectively. Performance was driven mainly by optimism surrounding the gradual reopening of international economies, as well as continued fiscal and monetary support. For example, the European Union recently reopened its borders to fourteen countries and the European Commission has also announced a plan to borrow 750 billion euros in the market and disburse grants and loans to embattled European countries to aid in recovery from the economic impact of the coronavirus. While this has supported positive returns for international markets, the need for economic stimulus is significant; in an update to its world economic outlook, the IMF estimated that Global GDP is now expected to contract at a 4.9% rate in 2020, with many developed nations likely falling into recession. As the globe continues to battle the pandemic, downside risks surrounding slowing global economic growth persist, but due to supportive policy globally, signs of an economic recovery are beginning to appear.

Within emerging markets, China's economic recovery has begun to pick up steam as exports and services have benefited from government support policies and the reopening of some global markets. Despite the initial outbreak taking place in China, it appears that China is poised to reach a recovery this year, with its industrial production rising to 4.4% year over year in May, up from 3.9% in April, and it's manufacturing purchasing managers index climbing to a three-month high of 50.9 in June, from 50.6 in May, signaling expansion. Alternatively, other emerging market economies have felt pressure from the volatility in energy prices, affecting oil exporters from certain Latin American and Middle Eastern countries. Overall, China continues to be a global growth engine supporting the process of reopening both globally and domestically so we will continue to keep a watchful eye on their path to recovery.

Fixed Income

The fixed income market, as measured by the Bloomberg Barclays US Aggregate Bond index, returned 2.90% in the second quarter, as corporate bonds rebounded sharply after coming under pressure in the first quarter. In response to the stress in financial markets in the first quarter, the Federal Reserve took extraordinary action over the past quarter by using a variety of lending facilities to restore order to credit markets. Recently, the Fed announced it will be buying individual corporate bonds in lieu of only buying ETFs, which allows them to buy up to $750 billion worth of corporate credit. Interest rates remained steady on the quarter, as demand for longer duration securities continued to hold yields down, with the 10-year U.S. Treasury yield ending the quarter where it began, at 0.66%. This represents a drop of 1.26% from the beginning of the year. As both short and long-term rates remained relatively stable during the quarter, the difference between long and short-term rates stayed within a range of 0.36% to 0.68%. We believe the projected path for interest rates will remain stationary, as the Federal Reserve has little incentive to lower rates below zero because of the extraordinary measures they are already undertaking to restore order to financial markets. Moving forward, we believe fixed income securities will provide significant diversification benefits to equities as the path to recovery becomes clearer.

Alternatives

Alternative asset classes rose along with equity markets in the second quarter of 2020. Oil prices registered their best quarterly performance in 30 years during the second quarter, staging an incredible recovery after falling to record lows in April. U.S. West Texas Intermediate crude prices surged over 91%, reflecting the best quarterly performance for U.S. crude since the third quarter of 1990 when it soared 131%. U.S. crude ended the second quarter of 2020 at $39.27 up from $20.48 from the beginning of the quarter. Oil prices were supported by the initial deal by OPEC+ in April to cut output by 9.7 million barrels per day (bpd), 10% of the world's oil supply, during May-June. Further support to the oil market came in June when OPEC+ said they would extend record oil production cuts through July.

Real Estate

The housing sector has held up relatively well during this stressful period. Unlike the recession that took place after the Great Financial Crisis, this recession is impacting the service side of the economy and not the housing sector. Historically low mortgage rates have buoyed demand, but coupled with low levels of supply, new home prices have not been impacted by the current slowdown and have increased 1.7% compared to a year ago. Elevated home prices should have a positive impact to the consumer, supporting their net worth and enhancing their confidence on the overall economy. Sales are lower compared to pre-crisis levels, but have rebounded since the recession began; For example, pending home sales were up 44.3% month-over-month in May, although they are still down -10.4% from a year ago. As states begin to open with social distancing measures in place, we could see an increase in home sales in the months ahead.

Conclusion

As the economy restarts its engine and we look onto the second half of the year, we believe the path of economic recovery depends on three factors. One factor is whether there will be a second wave of infections that disrupts the country's reopening plans. The second factor is how much permanent damage has been done as a result of containment measures. The last variable is the effectiveness of monetary and fiscal stimulus going forward. Although we acknowledge the recent pickup in total Coronavirus cases, it is encouraging to see certain areas of the economy are improving. For example, on May 31st 352,947 people went through TSA airport security checks however on June 22nd, as reports of a surge in new cases started to appear, TSA counted 607,540 passengers. Therefore we are hopeful of a robust economic recovery in the back half of the year and will continue to take an independent and objective approach when examining the path of the virus.