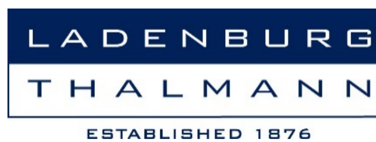

Market Commentary
October 2020

Introduction

While not as strong as it was prior to the Coronavirus outbreak, the economy continued to recover in the third quarter of 2020. Total Coronavirus deaths have exceeded 1,000,000 globally, however, the daily death count is not nearly as high as it was during the height of the pandemic in April. As the summer ends and we enter the latter half of the year, we cannot dismiss the improvement in economic data we have witnessed thus far. For example, the labor market has made considerable strides with the unemployment rate as of September at 7.9%, down from the high this year of 14.7% in April. Additionally, while GDP declined -31.4% in the second quarter of 2020, analysts are projecting positive GDP growth in the third and fourth quarter of this year. Lastly, despite worries of a deflationary environment resulting from lower economic activity, inflation as measured by the Consumer Price Index is up 1.3% on a year-over-year basis as of August. During the quarter the Federal Reserve kept short-term interest rates at 0% and adopted a new strategy of "average inflation targeting". This would allow the Fed to let inflation run higher than the standard 2% target before raising interest rates any further. On the fiscal front, negotiations within Congress for a second stimulus bill came to a halt while investors shifted their attention to the upcoming Presidential election. While we acknowledge that over the short-term these uncertainties can cause volatility in the market, we believe the economy has entered the next expansion and will continue to recover provided that businesses can open up as planned.

Domestic Equities

Through the end of September, the S&P 500 is up 5.57% year-to-date and up 8.93% quarter-to-date. This is remarkable considering where the markets were earlier this year. July and August were positive months for the S&P 500, up 5.64% and 7.19% respectively, while in September the market cooled off posting a return of -3.80%. The strong performance in July and August can be attributed to improving economic conditions resulting from an easing of lockdown measures, a manageable virus situation and continued support from the Fed. The market lost steam in the last month of the quarter as investors shifted their attention towards the upcoming Presidential election in November and the reality that a second stimulus bill may not come to pass before then. In this environment, riskier smaller sized U.S. stocks underperformed their larger counterparts for the quarter with the Russell 2000 index up 4.93% versus the Russell 1000 index up 9.47%. While it is encouraging to see stocks of all sizes end higher in the third quarter, we acknowledge that some of the largest companies may look overvalued compared to their fundamentals and certain segments of the market are disproportionately suffering as a result of the virus. With this in mind, we believe staying well diversified within your U.S. equity allocation is important; not only to help manage risk, but to capture better than expected gains in the event of a broader rally resulting from a catalyst, such as a vaccine approval or a second stimulus bill being passed.

International Equities

In the third quarter, international developed and emerging market equities continued to rebound, returning 4.80% and 9.56% respectively. Performance was driven by optimism surrounding the reopening of international economies, as well as continued fiscal and monetary support. The European Central Bank has continued to provide support, most notably through the European Recovery Plan, a 750 billion euro package of loans financed by the issuance of bonds guaranteed by each member of the European Union. Though COVID-19 infections have risen in some areas of the eurozone, hospitalization and death rates remain low. Following the easing of lockdowns, economic indicators started to rebound during the quarter, including the Markit Euro Area Composite PMI, with a reading of 50.1 in September. As the globe continues to battle the pandemic, downside risks surrounding 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 continued to strengthen. China's official manufacturing and services purchasing manager's indexes remained in expansion territory, with readings of 51.5 and 55.9 in September. Fiscal stimulus in China has not been as extensive as the rest of the globe; however, China's lockdown was relatively shorter and saw lower levels of economic damage. Alternatively, other emerging market economies have felt pressure due to less

effective containment of the pandemic. 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 0.62% in the third quarter, as corporate bonds rebounded sharply after coming under pressure earlier in the year. The Federal Reserve has signaled that interest rates will remain steady for the foreseeable future, announcing that they will be adopting a new "average-inflation" targeting policy that will allow the central bank to let inflation run above their target rate in the short term without necessitating a rate hike. Interest rates remained steady on the quarter, as the long-term outlook for rates continued to hold yields down, with the 10-year U.S. Treasury yield ending the quarter slightly above where it began, at 0.68%. This represents a drop of 1.24% 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 0.39% to 0.59%. 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

On the back of the best quarterly performance in the past 30 years, oil prices were relatively flat for the third quarter of 2020. U.S. West Texas Intermediate crude prices rose slightly, to $39.85 from $39.27. Oil remained range bound after the market began to worry that even with large supply cuts from OPEC+ and curtailments in the U.S., demand will not recover fast and strong enough to draw down the record-high inventories that had built up in the first half of the year. Similarly, uncertainties about a second wave of COVID-19 and renewed restrictions on social gatherings in several major European economies weighed on oil market sentiment.

Real Estate

The housing sector continued to do well throughout the third quarter as the latest recession did not have an adverse impact on the housing market, unlike what was seen during the Great Financial Crisis. Historically low mortgage rates and shifting demographics continued to increase demand for housing during the quarter. In August, new and pending home sales increased more than consensus expectations and existing home sales increased in-line with consensus expectations. Existing home inventories were also tight, with only three months of supply left if the current sales pace continues. Median home prices for existing houses increased to $310,600 in August, the fastest annual pace since 2013. While housing represents less than a fifth of the U.S. economy, it is encouraging that even as other sectors remain under extreme stress, housing continues to flourish and have a positive impact on overall output.

Conclusion

With the Presidential election on the horizon we remind ourselves that being disciplined during this time is the optimal strategy. History tells us that there is typically market volatility in the months leading up to an election but going back to 1928, on average, the S&P 500 exhibits positive performance in the 12-months following an election (source: www.etftrends.com). We believe the economy and market can grind higher if we continue to open the country up for business and avoid any second wave of virus infections that has material economic consequences, such as what took place earlier this year. Our path back to normalcy will not come overnight, but we believe the long-term trajectory for the economy and market is higher.

Although this market outlook has been prepared from public and private sources and data that LTAM believes to be reliable, LTAM makes no representation as to its accuracy or completeness. Any securities, indices, and other financial benchmarks shown are provided for illustrative purposes only, and reflect reinvestment of income, dividends, and other earnings. They do not reflect the deduction of advisory fees. Indices are unmanaged and investors cannot invest directly in an index. Investors should bear in mind that past performance is no guarantee of future results and there can be no assurance that the Program will achieve comparable results. Investment products are subject to investment risk, including possible loss of the principle amount invested and investors should review the prospectus before investing. The information and views expressed are given as of the date of the writing and are subject to change. This information is not to be used or considered as an offer or the solicitation of an offer to sell or buy any securities mentioned herein. Ladenburg Thalmann Asset Management Inc. is a SEC Registered Investment Adviser under the Investment Advisers Act.