QUANTITATIVE ASSET MANAGEMENT, LLC
Investment & Advisory Services

July 10, 2020

Quarter Ending June 30, 2020

Year-to-Date Performance	YTD Index	Close
Dow Jones Industrial Average	-9.55%	25,812.88
NASDAQ Composite Price	12.11%	10,058.77
Standard & Poor's Averages	-4.04%	3,100.29

On February 19th, the U.S. stock market hit a new all-time high of 3,386. Shortly after, investors began to price in the anticipated effects of the COVID-19 pandemic and economic shutdown. In five weeks, the S&P 500 was down 34% to a low of 2,237. By the end of June, the S&P 500 was at 3,100, down only 4.5% from where it started 2020. The speed and velocity of this market correction was unlike any other in history.

At QAM, we spend an abundant amount of time researching companies, reading through balance sheets, and studying annual reports. This type of analysis is an essential part of our investment process and sets us apart from most investment advisors. However, during any market top or bottom, there is a very important aspect of investing that is impossible to measure: the impact of emotions on an investor's psyche.

Over the last few months, emotional-based investment decisions have been a dominant force on the market. Fear and greed (or fear of missing out on a rally) have been the main catalyst in creating the market's "v-shaped" recovery. During the March downturn, many investors felt the full impact of how emotions can drive market momentum, eventually hitting bottom on March 23rd. From that date until June 8th, the S&P 500 rallied 45%. This immediate recovery created a huge change in investor sentiment. Emotions went from complete fear to wondering "did I miss out on the rally and opportunity to buy equities?" Investors are now chasing investment performance, and, in the case of the NASDAQ, the index is hitting all-time highs.

Broad-based equity indexes, like the S&P 500, have always been a barometer of current market and economic sentiment. Over the last few months that sentiment has changed dramatically. The biggest issue with the current market pricing is this: many investors are buying into the market at valuations that would suggest the coronavirus pandemic and economic shutdown has or will have little to no impact on the economy. At QAM, we feel that that is not the case. Nobody is exactly sure to what extent, but this pandemic *will* have an impact. The broad-based economy and most publicly traded companies are facing a reality that is dramatically different from what is being reflected by equity indexes. For example, in terms of S&P 500 year-to-date performance, Tech (15%) and Consumer Discretionary (7.2%) are the only two sectors with positive returns. Meanwhile, four sectors have lost more than 10%: Energy (-35.3%), Financials (-23.6%), Industrials (-14.6%), and Utilities (-11.1%). What makes these numbers more interesting it that the hardest hit sectors have usually been the stocks that hold up best during market volatility (defensive and dividend paying stocks).

We have spent a lot of time talking about the very "popular" tech stocks that makeup FAANGM (Facebook, Amazon, Apple, Netflix, Google, and Microsoft). Due to their huge market capitalizations, these six stocks drive the overall performance of most indices. To put this into perspective, the S&P index finished the second quarter down 4.5%. Without the six FAANMG names, the S&P was down 8.5% year-to-date. This is a dramatic adjustment and should give investors some pause as to the “health” of the overall economy.

When it comes to chasing performance, Tesla (the electric car company) is the new poster child of speculative fervor and emotional investing momentum. Currently, the market capitalization of Tesla is equal to the combined market cap of GM, Fiat/Chrysler, Honda, BMW, Nissan, Hyundai, Mercedes, and Ford. In addition, five times in the last month Tesla has gone up more than the entire market value of Ford in one day. Tesla certainly has a valuable first starter advantage in the electronic vehicle category. Anyone who has bet against the stock has lost a lot of money. However, Tesla currently makes about 2% of the cars as those other manufacturers. More importantly, the car companies mentioned above are in the first inning of rolling out their own electric vehicles. Tesla stock may run higher; however, it can take years and even decades before an investor breaks even. Just consider that it took Microsoft 15 years to regain the record highs of 2000.

The final numbers are not in, but GDP is expected to decline 20-30% for the second quarter and 5-10% for the full year. In addition, the unemployment rate is expected to be around 10% in late 2020 and into 2021. At this point, these numbers are just estimates; however, the magnitude of these data points indicates that there will be a significant economic impact on the economy.

Respected investor Jeremy Grantham points out that “the current P/E on the U.S. market is in the top 10% of its history…the U.S. economy in contrast is in its worst 10%, perhaps the worst 1%. We have never lived in a period where the future was so uncertain and yet the market is 10% below its previous high. The current market seems lost in one-sided optimism when prudence and patience seem much more appropriate.”

As we stated before, at QAM, our analytical and economic research drive our investment decisions. These methodologies have a proven track record over time. In the short-term, those data points and performance number can be thrown out of whack by inefficiencies, momentum, and emotional based investment decisions. Simply put, panic and greed are not investment strategies. They might appear to be correct in the short-term, but emotional-based investment decisions will almost always lead an investor to make the wrong decision and the wrong time.

We will leave you with a quote from Charles Schwab: “Neither ‘get in’ or ‘get out’ are investment strategies: they are gambling on a moment in time.” At QAM, we are investors who take the long-term approach to investing.

As always, please give us a call or send an e-mail if you have any questions.

Stay safe.

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