WaterRock Global Asset Management, LLC

MARKET REVIEW & OUTLOOK

October 2020

BREAKING NEWS

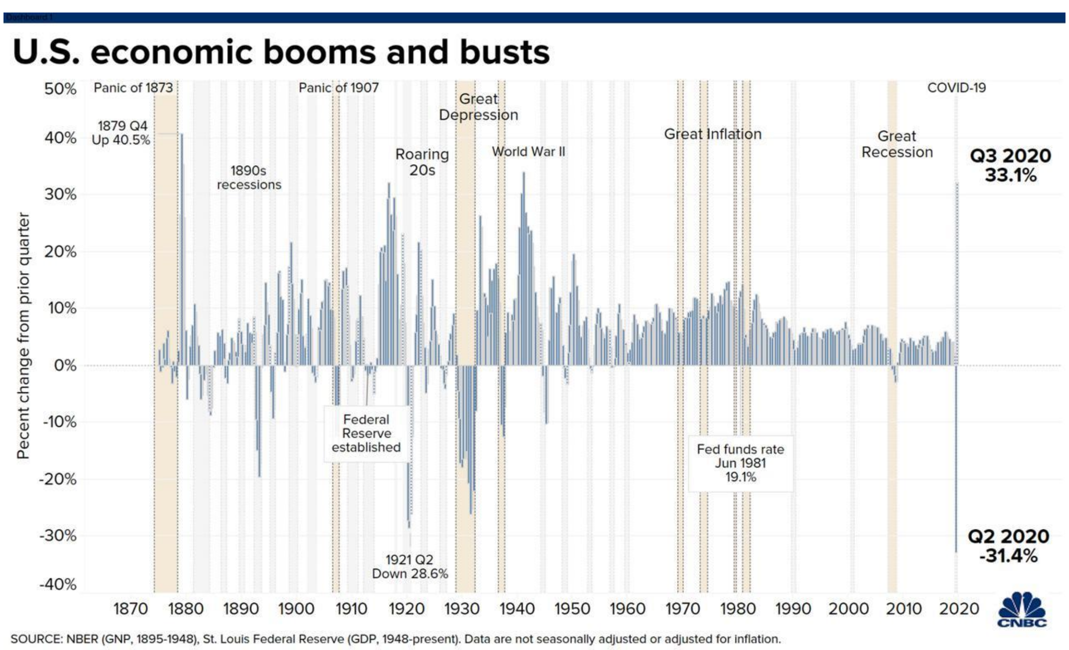
The good news, the election has passed. The bad news, the much-feared contested Presidential election is upon us. It appears the market is focused on control of the House and Senate, which don't look like they will change. With gridlock in D.C. the risk of big changes is down. As a result, the stock market has had a strong rally, showing little concern for the potential contested Presidential race.

KEY TAKEAWAYS

- Large Cap U.S. equities continued to struggle in October on the back of no new stimulus, European corona virus lockdowns and the uncertain election outcome.
- Third quarter 2020 U.S. GDP rebounded strongly as forecasted, coming in at 33.1%, though the outlook for the 4th quarter continues to wane because of the items cited above.
- Election season is hopefully nearing the end with only 3 days left.

The U.S. Economy

Let's talk numbers. Third quarter GDP reported an annualized +33.1%, slightly better than the estimated 32% from the GDP Now forecast. The chart below shows the unprecedented volatility in GDP the last two quarters. In fact, you must go back to 1879 to find a stronger GDP report than the 3rd quarter of 2020. With the third quarter now behind us, the expectations for the 4th quarter continue to wane. We have been days away from a new stimulus deal for weeks and with the election upon us a deal seems less likely in the short term. The combination of no new stimulus likely and many of the previous benefits rolling off, leaves fewer government tailwinds to help the economy. Additionally, the reimplementation of lockdowns in European will probably cause some retrenchment here in the U.S. as people prepare for a potential second wave.



Stocks and Bonds

The fixed income markets had a surprisingly weak October in the face of continued volatility in the equity markets. As a reminder, historically, equity market volatility equals a strong bond market rally. This month followed the opposite course with the 10-year U.S. Treasury yield soaring during the month. The large increase in government yields was mitigated by a decline in yield spreads for high-quality fixed income, as measured by the iShares US Aggregate Bond ETF, which ended with a small loss of -0.45% for the month. The U.S. 10-year treasury bond yield increased in two large moves during the month with yields ending higher by almost 20 basis points on the stimulus any day news. The yield ended at 0.86%, up from September's close of 0.68%.

The U.S. Large Cap stock market hit another rough patch after an early October rally, generally ending the month lower. The Dow Jones Industrial Average dropped -4.61%, the S&P 500 lost -2.77%, and the small cap Russell 2000 bucked the trend gaining +2.04%. The international markets followed a similar path as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index slid -3.92% and the MSCI Emerging Markets iShares Core ETF Index also bucked the trend climbing +1.77%.

In October, we again saw a lot of red for most sectors of the S&P. The best performer was…

- Utilities: +5.05%

The worst performers were…

- Technology: -5.00%
- Energy: -4.11%
- Health Care: -3.62%

Oil Oozes…

In October, crude oil continued to trade with more volatility, like we saw in September, driven by continued concerns about demand impacts from the growing number of corona virus related lockdowns. The energy space is coming into focus again as the headlines and government actions regarding the corona virus are gaining more airtime. The current NYMEX WTI Crude Oil futures settled at $35.72 and posted a loss of over 11% from the prior month close of $40.22 a barrel. The price for RBOB gasoline followed a similar path to crude oil. RBOB finished lower by almost 13% for the month of October. After the busiest hurricane season in many years, I am sure the Gulf region is very happy that winter is almost here.

The Rest of the Data

The corona virus pandemic is regaining attention across the U.S. and the globe. The biggest difference between now and March, is that the discussion is more around the number of cases versus the number of deaths. The case count has been frequently setting new records, along with the number of tests administered. The good news, if you can call it that, is that the number of deaths per day has been relatively flat over the last few months. Interestingly, the WHO, World Health Organization, is starting to look at the impact of the lockdowns outside of the corona virus. Suggesting that lockdowns should be a last resort due to the impact of people not going to the doctor for non-corona virus related illnesses, the emotional impact of being lockdown and the economic impact to having large portions of the economy closed. Unfortunately, the poorest people of the world are bearing the brunt of the lockdowns and are living the expression, “sometimes the cure is worse than the illness”.

The September ISM Manufacturing Index eased 0.6 points to 55.4 from August’s reading of 56.0. On the other hand, the ISM Services Index increased to 57.8 from 56.9 in August. Any reading above 50 generally indicates improving conditions. Consumer confidence eased modestly to 100.9 in October, which compares to a downwardly revised figure of 101.3 in September. The unemployment rate posted another drop, coming in at 7.9%, as the economy added a strong, 661,000 jobs in September, but another miss to expectations. The Consumer Price Index for All Urban Consumers (CPI-U) rose +0.2% in September on a seasonally adjusted basis. Over the last 12 months, the All-Items Index climbed +1.4% on a non-seasonally adjusted basis. Overall, these numbers show a stable growing economy that is probably growing GDP at a rate of 2 or 3%. Growth is likely to be significantly below the 3rd quarter and will probably end 2020 as a year of contraction.

Summary

The path forward is uncertain on several levels. What happens next with the corona virus is one that impacts all of us. With the number of cases increasing and the number of cities, states, and countries returning to lockdown or adding restrictions economic headwinds become a concern. The fact that the number of deaths per day is stable is a positive sign and shows that medical professionals are getting better at treating those who test positive.

The other uncertainty, especially in the U.S. is the presidential election. We may know the result of the election by the time you are reading this newsletter. Until there is a declared winner, progress on a new fiscal stimulus bill will likely be stymied. The worst-case scenario is a long drawn out conclusion to the election, at the same time the corona virus takes a turn for the worse. In that scenario, we would hope partisanship is set aside and aid/stimulus is passed, but we are not going to hold our breath.

With the election resolved, hopefully for next month’s update we will have a clearer picture on the economy, markets, and if appropriate the framework for the next round of fiscal stimulus. If the corona virus does not flare up or is mild, the stage could be set for a strong economic recovery for 2021.

If you have specific questions about your portfolio or financial situation, we are here to help. Long-term financial planning is designed to deal with uncertainty like those we discussed above. Our portfolio management process is to design a prudent allocation across many asset classes. Equities are for long-term growth and several vehicles that we utilize offer defensive mechanisms to mitigate equity market declines.

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