Plimoth Investment Advisors®
Investment Management & Trust Services Specialists

# Investment Spotlight

SECOND QUARTER - SUMMER 2020

*"Life moves pretty fast. If you don't stop and look around once in a while, you could miss it."*
*- Ferris Bueller*

The S&P 500 was lower by -3% through mid-year. Had investors celebrated the new year then tuned out entirely, that would appear to be a very humdrum modest pull back like many that have occurred numerous times throughout history. Of course, having just lived through one of the most volatile periods for the stock market in recorded history, the first half of 2020 was anything but ordinary. From new index highs to the fastest ever drop into bear market territory, a booming labor market that rolled into depression-level double digit unemployment, robust consumer spending thwarted by forced business closures amid a global pandemic (ending the longest U.S. economic expansion in history), we have all received a stark reminder of just how quickly the world around us can move and change. As we continue to struggle with stopping the spread of COVID-19 in the U.S. and around the globe, a loosening of restrictive measures along with potential advancements on vaccine development have led to investor sentiment taking a 360 degree turn in a remarkably short period of time.

A painful sell off in U.S. stocks that led the S&P 500 down -34% in only five weeks last quarter (ending the longest bull run in history) was followed by a watershed recovery rally of over 40%. The 20.5% return for the index in the second quarter marked the strongest quarter on record in over two decades. An 18% return for the Dow Jones Industrial Average was the strongest quarter going all the way back to 1987, a period of extreme volatility many investors helping to perpetuate the recent run up have only read about in history books. Technology stocks were the key source of wind in the sails, driving the NASDAQ composite to a remarkable return of 31% in the period. Bolstered by massive monetary and fiscal stimulus, investors showed their optimism for an economic recovery by bidding up risk assets across the board. "FOMO" (the fear of missing out) on making up lost ground in investment accounts brought investors and speculators alike to the table with trading volume in online brokerage platforms surging. ■

## Economic Review & Outlook

With first quarter Gross Domestic Product (GDP) of -5% now in the books and second quarter economic growth expected to be markedly lower, the U.S. economy has officially entered into a textbook recession (two consecutive quarters of negative GDP.) A significant deterioration in the labor market from a half century low level of unemployment at 3.5% to the latest reading of 11% has provided a gale force headwind. Business closures in response to the deadly pandemic have led to a fall

in consumption that will take ample time to fully restore. An upside surprise in the latest Nonfarm Payrolls and Retail Sales reports have improved sentiment, but both remain well below pre-pandemic levels. Although rising labor costs and supply chain issues have increased producer costs, retailers trying to bring back their customer base have lacked pricing power to pass on to consumers, keeping core (ex-food and energy) inflation squarely in check. The price of crude oil surged the most since 1990, but the swing was far more technical than substantive. In a strange circumstance due to a dearth of storage capacity for an oversupply of the commodity, prices turned negative for the first time in history before rallying back.

| | Q2 2020 | YTD 2020 |
|---|---|---|
| Communication Services | 20.0% | -0.3% |
| Consumer Discretionary | 32.9% | 7.2% |
| Consumer Staples | 8.1% | -5.7% |
| Energy | 30.5% | -35.3% |
| Financials | 12.2% | -23.6% |
| Healthcare | 13.6% | -0.8% |
| Industrials | 17.0% | -14.6% |
| Information Technology | 30.5% | 15.0% |
| Materials | 26.0% | -6.9% |
| Utilities | 2.7% | -11.1% |

As you may have seen from our periodic COVID-19 updates throughout the quarter (available through the homepage on our website), we continue to closely monitor the economic reopening process, as well as recent retrenchment in certain states due to a spike in virus infections and hospitalizations. The process will be key to framing our expectations for the pace of economic recovery back to the solid footing the U.S. economy was on before the pandemic pulled the proverbial rug out from under it. ■

## Bond Market Review & Outlook

In stating that the Federal Open Market Committee is "not even thinking about thinking about raising rates" Chairman Jerome Powell has made it perfectly clear that the Fed is most likely on hold with rates until 2022. Short-term rates remained pinned at or near 0% making low risk saving a very challenging proposition. In addition, the Fed has proven their willingness to continue swelling their balance sheet by buying just about any fixed income instrument in the open market. The free market forces long at play in the bond market have been put aside in favor of taking whatever steps are necessary to keep economic stimulus flowing.

Bond prices appreciated in conjunction with a pullback in yields. Despite the risk-on sentiment that dominated the

| | Q2 2020 | YTD 2020 |
|---|---|---|
| **Cash:** | | |
| FTSE 3 Mo. T-Bill Index | 0.1% | 0.5% |
| **Taxable Fixed Income:** | | |
| Barclays US Agg. Bond | 2.9% | 6.1% |
| Barclays Govt./Credit Int. | 2.8% | 5.3% |
| Barclays Govt./Credit Long | 6.2% | 12.8% |
| BofAML High Yield Index | 9.6% | -4.8% |
| **Tax Exempt Fixed Income:** | | |
| Barclays Muni. 5 Year | 3.3% | 2.2% |
| Barclays Muni. 7 Year | 3.3% | 2.3% |
| Barclays Muni. TR | 2.7% | 2.1% |

quarter, conservative investors focused on fixed income instruments were rewarded with positive returns in U.S. Treasuries, corporate, and municipal bonds, albeit far less than high-flying equity returns. Paltry levels of current income and little room for capital appreciation (given the unlikelihood of rates declining further) continue to lead investors out of fixed income investments and into higher risk assets. ■

## Stock Market Review & Outlook

The snap back in stocks that began at the end of the first quarter accelerated through the first two months of the second. The pace of the recovery was nothing short of remarkable. At the midpoint of the year, the broad-based S&P 500 was within striking distance of where it started, recording a modest -3% decline. The NASDAQ Composite however is squarely in the black on a year-to-date basis as leadership narrowed into the largest, most stable, technology companies.

All S&P equity sectors provided positive returns in the second quarter. Consumer Discretionary (+32%) and Information Technology (+30%) were clear winners and moved both into positive territory on a year-to-date basis. Energy (+30%) recovered some lost ground in the quarter but remains the far and away weakest sector thus far this year, off by -35%. Similarly, small cap stocks staged a strong rally in the quarter with the Russell 2000 index higher by 25% but returns remain negative on a year-to-date basis by -13%. Allocations to developed international and emerging markets stocks were positive in the quarter on an absolute basis, but returns trailed relative to the U.S.

| | Q2 2020 | YTD 2020 |
|---|---|---|
| DJIA Index | 18.5% | -8.4% |
| S&P 500 Index | 20.5% | -3.1% |
| Russell 2000 Index | 25.4% | -13.0% |
| MSCI EAFE Index | 14.9% | -11.3% |

The rapid jump in prices has extended the valuation of the stock market. The P/E (price to earnings) multiple of the broad market stands at 22.4x based on current earnings, with a multiple based on forward earnings of 24.9x. A higher forward multiple is indicative of negative implied growth, typically a warning sign for stock investors. Since most S&P 500 companies are now reticent to provide forward earnings guidance for the year given pandemic-related uncertainties, that indicator, while worth considering, carries less weight than in more normal periods. With a thick cloud hanging over future earnings transparency, we continue to focus away from the income statement and on the strong balance sheets of high-quality companies that provide an added margin of safety for shareholders through uncertain conditions. ■

## Closing Thoughts

Leadership in U.S. equities remains narrow into the second half of the year, with the broad market struggling to break back into positive territory on a year-to-date basis that was briefly achieved in early June. Concerns relating to the rise in

the spread of the deadly Coronavirus in certain states, as well as increasing protests relating to racial inequity, have weighed on market sentiment. Expect the upcoming U.S. Presidential election in November to start receiving more airtime in the coming months. The future of tax cuts enacted in 2017 and a ballooning deficit will be key areas of interest for investors.

We will continue to digest the myriad of fast-moving data to sharpen our view of when an economic recovery is likely to be sustained. Second quarter earnings season will soon kick off in earnest. While analysts seem to be giving companies a pass on what is expected to be an abysmal earnings period, we will all be looking for signs of how companies will fare on the other side of this economic shock when the fiscal and monetary stimulus flows subside.

We will continue to share our thinking along the way in the regular communications posted to our website and ask you to reach out at any time to exchange thoughts and ideas on this most interesting of financial environments. ■

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