Marketline August 2020

Stocks:

While July gave us modest gains in stocks, August was a barn burner. The Dow and the S&P were each up about 7.5% - which in the 'old days' would have been a respectable *year* let alone month. The NASDAQ was a rocket ship, up 9.6%. Returns have been propelled by technology stocks. Apple alone represents over 6.8% of the entire S&P at this point. Just five companies – Apple, Microsoft, Amazon, Facebook and Google (Alphabet) – account for over 20% of the index, and there are scads of additional tech companies in the S&P as well, pushing the overall tech exposure to around 30%. The S&P 500 has become so disconnected from the endeavor of portfolio construction that some institutions have begun to jettison it as a benchmark. For our part, we would never allocate 20% of client portfolios into just five stocks, even though we own four of the five companies listed above in some measure. Comparing results to a such a concentrated benchmark has become an apples and oranges exercise.

A logical question is, why is the market doing so well when the economy is staggering and the election is looming? There are several possibilities:

1. The economy is not staggering; it is better than we think. We recently researched how much in earned income was lost between March and July. As best as we can tell, the loss was between $170 billion and $200 billion. In 2019, income was between $7 trillion and just over $9 trillion depending on whether you count benefits of various types or not. Extrapolating these numbers brings us to the likelihood that less than 10% of annualized income – probably much less – has been lost, and part of that was made up by the government.
2. The market doesn't care about the economy or politics. The market is comprised of businesses, whose job it is to thrive no matter the economic backdrop. Management techniques have helped companies adjust to changing economic circumstances more rapidly than ever. In fact, larger companies can actually thrive in disruption – WalMart, Home Depot, Amazon and Target are posting fabulous results in these pandemic times. Investors believe that the adjustments that companies are making will leave them in better condition when demand comes back, sending ever more dollars down to the profit line.
3. The market cares about the economy, but not today's economy. It cares about next year's economy, which will be better.

We think all these explanations are true to some extent. Savvy investors know that the pandemic won't last forever, the election will be over someday, people will go back to work, and so forth. They also know that it's impossible to fund retirements with a bond portfolio yielding 1%. At that rate, one has to own stocks.

Overseas, results were pale compared to the US. Canadian stocks managed 2.3% but Mexican stocks fell slightly. In Europe, prices rose about 1%. Fresh Covid outbreaks probably suppressed Euro stocks, but it's also apparent that the recovery there is weaker than ours.

Bonds:

The long bond rose in yield pretty substantially, to 1.47%. That's still mighty low, but it's better for income investors than last month's 1.2%. The ten year is around 0.7%. Of course, one bright spot is low mortgage rates, which are spurring home buying. We don't look for much upward movement in rates despite what the Fed has said about supporting higher inflation. An upper boundary is probably around 2%, if that.

Cash is still yielding just about zero, unfortunately. If you really need something better than zero, CDs will give a bit more. We've also resorted to short term bond funds, but none of these is going to knock your socks off.

We have been hunting around for corporate bonds, where yields on paper that's due in the medium to long term maturity range, and low investment grade, are fluctuating at 3% to 4%. Higher yields can be found, but credit quality is a concern. In fact, credit quality nearly everywhere is deteriorating, but that provides opportunities as investors overreact, or simply can't hold paper if it dips below a certain rating. We like Marriott bonds as occupancy in Asia improves, as well as Kraft and Hasbro, but on the other hand we've been selling technology bonds here and there.

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