Marketline October 2020

Stocks:

October was another negative month for stocks, though we should put this into perspective. While the S&P 500 has declined for two months, it is above its value at the start of this year albeit marginally. The Dow is down just 7% for the year, with the difference in the two indices explained by very strong returns in technology stocks. For all that has happened this year, that's a pretty solid outcome. The equanimity towards stocks has been driven by rapid support for the economy at the beginning of the pandemic and very low interest rates, which inflate asset prices. Too, earnings have been coming in somewhat better than expected, and the economy has rebounded faster than expected. Our study of lost wages shows that thus far, the small business failures and job losses that have occurred have amounted to wage losses of less than 10% of US wages paid in 2019 on an annualized basis. And that number is not adjusted for wage gains that have occurred for people who are still working, or government support that in some cases paid the unemployed more than they had been earning. So in terms of who has money to spend, the outlook is not as bad as we would expect.

The fear in the market lately has revolved around rising numbers of Covid tests coming back "positive" worldwide. Rising positive tests can result in lockdowns that again depress earnings. Consequently stocks have traded off in order to account for the possibility that earnings will face another down cycle at some point in the near future. In Europe, shutdowns have proliferated; it is not a strenuous leap of imagination to expect that the same may happen here, and even if it does not, that at least people will moderate behavior on their own to stay at home again. Speaking of Europe, market results have been poor again there this year, with another decline of 5% in the books for October. Of course, Europe is at the moment a hotspot in terms of Covid cases. But also, stimulus payments while seemingly generous in some countries, came very late for the region as a whole. Furthermore, labor issues that have long held back the Eurozone have worsened in this environment.

Looking forward, we remain skeptical that a successful vaccine will materialize soon. From the outset of this pandemic our opinion has been that natural mutation towards a more infectious but less deadly disease and better treatments will be the most likely mitigators of the human cost of this pandemic, reducing the Covid event to a dull roar in the background for some years. In this environment, businesses and people will adjust to some tolerable level of activity that allows our economy to grow.

Bonds:

This month marked a change. Short yields remained the same (sorry to everyone who wants more income off savings accounts!) but the longest dated bonds rose in yield. This means the yield curve steepened. Some participants believe a steepening is a predictor of an improving economy – in this case it could simply mean that the US is borrowing a boat load of money every week and higher rates are required to clear the market. In fact, while some shapes of the yield curve are predictive, a steep curve is not one of those shapes. It *can* mean a better economy – or not.

Still, any change is important. In this case, the long Treasury yield rose from 1.46% to 1.66%, quite a big jump in a month. However, the ten year, which dictates a lot of important rates in our economy such as mortgage rates, was flat. We could see a brief foray up towards 2% on the long bond in coming months, for all sorts of reasons: more government borrowing, an improving economy, rising inflation expectations…. But we think that level would be a buy point given what we know today.

Our overarching goal as we manage bond portfolios is to spread exposure among credit quality, maturity, and coupon, and to manage by finding ways to improve the portfolio along these metrics by making occasional swaps from one bond to another. To this end, we continue to investigate continuing care residences in the municipal market – many of which still need to expand given longer term demographic pressures. On the credit side (corporate issues), travel related issues are interesting, and AT&T's bonds have been attractive. Recent sales include US Cellular and Sysco bonds, which appreciated over our holding period.

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