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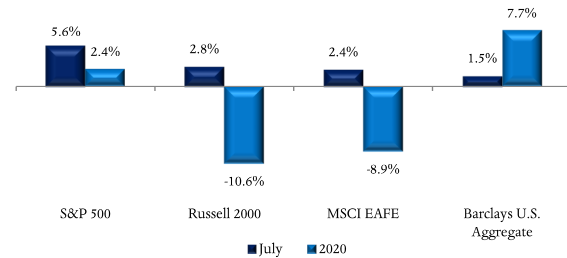
Markets

US equities continued their recovery rally on improved, yet decelerating, economic activity. While new Covid-19 infections rose in most states, the rate appeared to slow towards the end of the month, and hopes for a vaccine were boosted by positive early-stage trial results. In July, the S&P 500 advanced +5.6%, breaching back into positive territory for 2020 (+2.4% ytd). The smaller capitalization Russell 2000 rose a more modest +2.8% and remains down -10.6% ytd. The tech-heavy Nasdaq composite performed most impressively (+6.9% in July / +20.4% ytd). Overseas stock markets were mixed, influenced by US Dollar weakness, as well as rising Covid-19 cases in Europe and Japan. Overall, the MSCI EAFE index added +2.4% in July (-8.9% ytd). In Europe, the Stoxx 600 benchmark declined -0.9% during the month (-12.6% ytd). Asian equities showed dispersion, with strong performance in Shanghai (+12.0% in July / +11.2% ytd), and a decline in Tokyo (-2.6% in July / -7.2% ytd). However, the star during the month was the MSCI Emerging Marked index, which rallied +9.0% (-1.5% ytd).

Credit and US government bonds also rallied in July, leading the Bloomberg Barclays US Aggregate index higher by +1.5% (+7.7% ytd). Towards the end of the month, the US Treasury yield curve set record lows out to the ten-year point (trading at 0.54%).

In precious metals, gold leaped to a record high (+11% in July) after rising for eight consecutive weeks (+33% ytd). Similarly, silver experienced its best month in over forty years (+34% in July / +45% ytd). Conversely, the US Dollar declined -4% in July, the steepest drop since September 2010. Energy markets remained placid as OPEC+ continued to be effective in balancing supply and demand for crude oil. The WTI benchmark ended July at $40.27/bbl, down from $61.06 at year-end.



Geopolitics

The US is less than three months away from Presidential and Congressional elections (35 Senate seats and all House of Representative seats are up for grabs), with polls predicting a swing to the Democrats. The pandemic, recent protests, and the economic slowdown have all had an impact on voting intentions. With growing support for Democrat Joe Biden, markets will soon start to focus on key policy areas, which could see a material shift, as we get closer to November 3.

United States

Since mid-June, daily new infections in the US have been upward trending. The initial Covid-19 outbreak was prevalent in the northeastern states, but over the past two months infections have risen across the rest of the country, particularly in the Sun Belt. As a result, many states have partly reversed, or paused, their reopening plans. Encouragingly, despite a higher number of daily new infections, the number of new daily deaths, as a result of the virus, is lower now than at the prior peak. This is due to a variety of factors including the younger average age of those being infected, improved treatment, increased social distancing among older age groups, and greater overall vigilance.

US second quarter GDP declined 9.5% year-over-year, the largest ever recorded, leading to a two-quarter $2.1 trillion decline in the economy. However, the ongoing recovery in economic data remains encouraging. US

retail sales have rebounded by 27% since their low in April (led by motor vehicles, furniture, clothing and electronics) and are just 1% below their peak in January of this year. Not all the data is picking up at such a rate though. High-frequency mobility data has begun to slow as the spread of the virus has increased. Small business revenue has partly recovered, but still remains circa 20% below pre-Covid levels. Manufacturing entered expansionary territory with a reading of 54.2%, but the employment component of the PMI remained contractionary (below 50). July's consumer confidence reading also fell.

The US economy added 1.8 million jobs during the month of July, sending the unemployment rate down, for the third straight month, to 10.2%, approximately a four-tenths recovery off the bottom. Of note, the $600 weekly federal unemployment benefits expired at end-July. This is important because a University of Chicago study found that 68% of those receiving this support were getting an average of 34% more than they earned when working. As a result, data shows that Total Personal Income has risen at a 12% annualized rate this year. Given the expiry of jobless benefits, and the economy's fragility, Congress had begun negotiations on another round of economic stimulus. However, with the conservative Senate's $1+ trillion plan too far apart from the more generous $3+ trillion House of Representatives proposal, the stimulus talks stalled. As a result, President Trump issued executive orders to deliver aid to Americans affected by the pandemic, including $400 per week unemployment benefits, deferral of a certain portion of payroll tax, and extension of student loan relief until the end of the year.

In the economic battle between the Federal Government (in concert with the Fed) and Covid-19, the 12-month budget deficit, through June, was over $3 trillion, and the central bank's balance sheet has grown by nearly the same amount (from $4 to $7 trillion). In turn, the US national debt has surged to $26.6 trillion, and rising quickly. Unsurprisingly, Fitch Ratings downgraded its outlook for US government bonds to

July 2020 Economic Statistics

	Jul-20	Dec-19	Dec-18
Federal Funds Target Rate	***0 - 0.25%***	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	***92.6***	126.5	128.1
Manufacturing PMI Index	***54.2%***	*47.2%*	*54.1%*
Unemployment Rate	***10.2%***	*3.5%*	*3.9%*
JPY/USD	***105.88***	*108.61*	*109.56*
USD/EUR	***1.1774***	*1.1210*	*1.1469*
Gold/oz.	***$1,974.69***	*$1,517.01*	*$1,282.73*
Oil (WTI)/bbl	***$40.27***	*$61.06*	*$45.41*

'Negative' from 'Stable' citing "ongoing deterioration in US public finances" and the "absence of a credible fiscal consolidation plan."

Europe

The European Union (EU) appears to have managed Covid-19 better than many other regions, though there are some concerns about the recent rise in cases. The Eurozone economy shrank by a record 15.0%, year-on-year, in the second quarter, entering a steep recession, driven by coronavirus-induced lockdowns which have led to 7.1% unemployment. European consumer confidence also stalled after healthy gains in previous months, but the composite PMI improved significantly, to 54.8%, well above April's 13.6% abysmal reading.

To stimulate the region's economies, the EU agreed to a €750 billion recovery fund. This is a significant part of an overall €1.75 trillion economic rescue package. Importantly, the recovery fund will be backed by common bond issuance by the European Commission. This is a significant step toward potential fiscal integration across the EU and has increased appetite for European assets, including the currency.

Daily new cases of Covid-19 in the UK had been falling, but, similar to neighboring countries, an increase in cases has surfaced, coincident with the lifting of activity restrictions. A summer economic plan put forward by the Chancellor aims to introduce measures to get the economy back on its feet by reducing stamp duty, cutting VAT for the food and hospitality sectors and offering companies £1,000 per furloughed employee re-

tained until the end of January.

Asia

In China, GDP for the second quarter grew by 3.2% year on year, one of the few global economies to expand, made possible due to being the country of origin of Covid-19, with a then less contagious strain, and tight controls. Recent mobility data from China (and neighboring South Korea from which they import high-tech equipment) indicates a solid recovery without a significant rise in coronavirus cases. Both countries appear to show, at least so far, that a recovery is possible, without a vaccine, if the virus can be brought under control via preventive measures.

Southeast Asian nations will likely benefit from China's economic rebound as the country commands a majority of regional exports. However, for the first time in recent memory, the broad region's output is expected to contract by 1.6% in 2020. Only a very small number of economies in Asia and the Pacific will actually grow this year, namely China by 1.0%. Most economies in Asia and the subcontinent are expected to contract in 2020, and some quite sharply; Korea by circa 2%, India by 4.5%, and Japan by 5.8%, given their dependence on remittances, tourism, and/or commodities. As for 2021, regional GDP is expected to rebound by 6.6%, with China growing at 8.2%.

Outlook

The policy response to Covid-19 from global central banks and governments has been swift and sizeable, helping lift markets, as policymakers have aimed to bridge the economic gap. Economists at Brussels-based economic think tank Bruegel estimate that US transfer payments will lead to an economic boost worth more than 9% of GDP. Even so, more than half the circa 132,500 US business closures are now marked as permanent. Looking ahead, the main risk to the global economy appears to be that emerging infections stifle reopening plans during the coming fall and winter seasons. As such, we expect governments to continue supporting consumer incomes and businesses until a vaccine is available and/or herd immunity is developed.

Given the greater than usual uncertainty around the outlook for the virus and a vaccine, we continue to favor a conservative, quality-oriented, approach to equity investing. Market breadth thus far in 2020 has been at a historically narrow level, with a similarly extreme variance leading growth stocks to outperforming value. Should the economy recover, as we anticipate, this bodes well for cyclical earnings growth, and the prospects for a broadening of equity participation.

Politicians recently gained control of the money supply with their first foray into Modern Monetary Theory (MMT), which enlists the help central bankers to finance federal deficit spending via creation of new money. M2 money supply increased +22.6% year-over-year, the highest level post-WWII. Looking ahead, it is doubtful that they will give up this tool unless forced to by the open market, such as inflation. In such a scenario, fixed income investors may see their purchasing power erode, given the Federal Reserve's intention to keep rates as low as possible for an extended period. We therefore remain of the opinion that savers are not being sufficiently compensated by the current risk-free rates (US 10Y real rates are presently -0.90%). There are also signs that consumer inflation may be about to heat up, including the price of precious metals and a declining US Dollar (heralding higher import prices). From a macroeconomic perspective, the US is producing much less than before, but its labor force is getting paid more, which is a recipe for rising prices. As such, gold, which has recently broken-out to all time highs on the back of staggering investor flows, is likely to be the best safeguard of purchasing power, especially given that $16 trillion of sovereign bonds (mostly European and Japanese) are trading with negative yields to maturity (meaning those that own them have to pay the governments).

As an alternative to bonds, at this junction, we recommend that risk-averse clients reduce their portfolio market correlation and volatility by including select alternative and market neutral strategies (such as real estate, arbitrage, patents, and credit, to name a few), in order to earn a stable return over time, without incurring undue risk.

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Sources: Barclays, Bloomberg, Bureau of Labor Statistics, Conference Board, Department of Agriculture, Federal Reserve, Financial Times, IMF, Institute for Supply Management, MSCI, Reuters, Russell, Standard & Poor's, and the Wall Street Journal.

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