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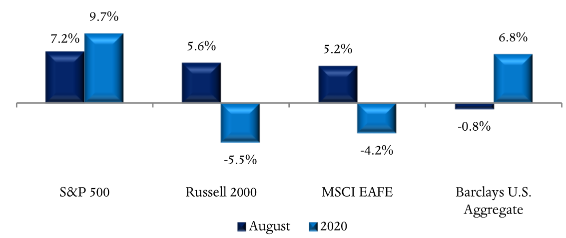
Markets

Risk assets continued to rally in August, supported by a global economic recovery. The ongoing challenges of Covid-19 have not deterred investor enthusiasm, which were lifted by a better-than-expected second-quarter earnings season and the potential for a viable vaccine. The bellwether S&P 500 index leaped by +7.2% during the month (+9.7% ytd), reaching record highs, boosted by the performance of large technology stocks. The smaller capitalization Russell 2000 benchmark rose +5.6% during the period, but still remains in negative territory (-5.5%) for 2020. Overseas equities have seen a less inspiring recovery. The MSCI EAFE index added +5.2% in August (-4.2% ytd). European stocks are still laggards, with the Stoxx 600 index rising +3.1% last month (-9.9% ytd). Asian bourses have produced mixed results thus far in 2020. Shanghai equities added +2.7% in August, performing admirably +14.2% ytd, while Tokyo's Nikkei 225 index increased +6.6% last month (-1.0% ytd). Emerging market stocks breached into positive territory, rising +2.2% in August (+0.7% ytd).

With the focus on the Federal Reserve's annual conference at Jackson Hole, and the affirmation that highly accommodative monetary policy will remain in place for a long time, credit continued to rally amid strong risk appetite. Concurrently, global government bonds dropped slightly; the US 10-year Treasury yield rose by 18 bps to 0.70%, while Germany's 10-year yield was 13 bps higher at -0.40%. The Bloomberg Barclays US Aggregate Index declined -0.8% in August (+6.9% ytd) while the US high yield bond index rose +1.0% during the period (+0.8% ytd).

After touching a record high of $2,075/oz. early in the month, gold bullion slightly lost ground, closing August at $1,968. Silver, however, continued to generate stellar gains. US dollar weakness provided a strong tailwind.



Geopolitics

Several European countries are experiencing a second wave of Covid-19 cases. However, with the exception of Spain, the percentage of positive tests remains below the World Health Organization's (WHO) recommended limit for reopening (5%). In response, governments have implemented targeted measures, such as travel limitations and requirements to wear face masks, eschewing new lockdowns. In the US, the number of daily Covid-19 cases reported has been on a descending path over the past month. Nevertheless, the percentage positive tests remains above the WHO's recommended limit for reopening in 27 US states. In Asia, the number of daily Covid cases rose in India, Indonesia, the Philippines and South Korea but declined in most other countries. In Latin America, the number of new cases remained high although the pace of gains slowed in Brazil, Mexico and Chile. While in the Middle East and Africa, the number of reported new cases continued to decrease across most of the region.

On the US political front, the negotiations relating to a new coronavirus relief bill, post expiry of the CARES Act, remain stalled. The presidential campaign has continued to gather steam with the nomination of Kamala Harris as Joe Biden's running mate against incumbent President Donald Trump. Still-early polling points to a victory for the Democrats.

Japanese Prime Minister Shinzo Abe announced his resignation, citing a long-standing health problem. The announcement came four days after he recorded the longest continuous term of any Japanese prime minister. The LDP has now opted for the simplest method by which their next party president can be elected, likely to take place on 14 September. Yoshihide Suga, currently Chief Cabinet Secretary, has emerged as the front-runner.

United States

Economic data continued to indicate ongoing, though moderating, growth in August, held back by still-high coronavirus infections rates. Heading into Labor Day, the economy added 1.4 million jobs in August (down from 1.7 million in July and 4.8 million in June). Unemployment dropped to 8.4%, more quickly than expected, partially due to some one-off factors, leaving more than 11 million pre-pandemic jobs still to be recovered. Purchasing managers' indices (PMIs) for both manufacturing and services beat expectations by a wide margin, with readings of 56.0% and 58.1%, respectively, indicating expansion in the overall economy for the fourth month in a row. However, other advanced economic indicators, including the Empire State and Philly Fed Manufacturing surveys, fell short of expectations. High-frequency data, such as the Google community mobility index as well as in-store credit card spending, moved sideways during the month. The housing market remained the brightest spot for the US economy, with housing starts, existing home sales, and home-builder sentiment (NAHB) all ahead of expectations.

Late in the month, at the Jackson Hole virtual conference, the Federal Reserve adopted a new monetary framework know as "average inflation targeting." This means that the central bank will seek to make up for periods of below 2% inflation with periods of above 2% inflation in the future, implying that monetary policy will remain stimulative for longer, given that inflation (CPI 2.0% year-over-year, ex-energy) has been running slightly below target for most of the past decade. Looking ahead average inflation targeting could lead to more stimulus and the ensuing risk that inflation will eventually overshoot to the upside (given the lag

August 2020 Economic Statistics

	Aug-20	Dec-19	Dec-18
Federal Funds Target Rate	***0 - 0.25%***	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	***84.8***	126.5	128.1
Manufacturing PMI Index	***56.0%***	*47.2%*	*54.1%*
Unemployment Rate	***8.4%***	*3.5%*	*3.9%*
JPY/USD	***105.89***	*108.61*	*109.56*
USD/EUR	***1.1936***	*1.1210*	*1.1469*
Gold/oz.	***$1,969.75***	*$1,517.01*	*$1,282.73*
Oil (WTI)/bbl	***$42.61***	*$61.06*	*$45.41*

effect). However, it is important to note that monetary policy is quickly approaching its limits (the Fed's QE program is currently running at $120 billion per month, with M2 money supply growing at 29%, more than twice the previous record). Thus, the onus will likely fall on Congress to provide additional fiscal stimulus should the economy require further support.

Europe

European economies continue to be on the mend. EU 27 unemployment increased slightly to 7.2% in July, up from 6.7% a year ago, aided by region-wide social safety nets. As a consequence, consumer confidence has remained stable, allowing retail sales to recover to pre-crisis levels after recent large monthly gains. Industrial production has also rebounded strongly, but still remains below the peak. However, increased new car registrations, fueled by subsidies, together with a positive business climate surveys in Germany, suggest an ongoing manufacturing rebound. High frequency data, including travel and navigation app usage, confirm that the recent resurgence in infections only minimally muted activity. Nevertheless, forward economic indicators, suggest that business confidence remains muted.

In the UK, the Office for National Statistics reported a 20.4% (quarter on quarter) decline in GDP for Q2, after a notable resurgence of 2.4% and 8.7% in May and June, respectively, leaving overall economic output almost 26% below pre-crisis levels. Similar to the continent, consumption has been strong, with retail sales rising back above their pre-crisis level. The services PMI for August rose to 58.8% (a 5-year high) but the

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labor component of the survey was concerning. The unemployment rate has remained low until now despite the substantial decline in economic activity thanks to the furlough scheme, which has been used by over 9 million workers. The program is set to end in October, with an extension having been ruled out by the government. With regard to Brexit, negotiations continue to stall, adding an additional element of employment uncertainty.

Asia

Chinese economic activity continues to draw significant investor attention. The Caixin/Markit manufacturing PMI for August came in at 53.1%, indicating continual expansion. Additional economic data also confirmed that the Chinese economy continues to recover, albeit at a slightly more moderate pace. While industrial production and fixed investment picked up by 4.8% and 8.3% (year-over-year) in July, China's retail sales came in weaker than expected with a contraction of -1.1%. In contrast to the West, consumption has so far lagged production during the recovery, likely linked to the lack of government fiscal stimulus.

Outlook

The swift and sizeable coronavirus policy response from central banks and governments has managed to cushion the economic shock and lift markets. In the meantime, the world waits for an efficacious vaccine. A Mckinsey & Company analysis suggests that global investment in Covid-19 vaccines to date has totaled over $6.7 billion, an unprecedented amount. Until herd immunity is achieved, economies will likely remain constrained by measures aimed at slowing the spread of the virus. Looking ahead, the back to school season (remote learning likely requires a caregiver to be present at home, potentially depressing household income) and ensuing colder weather in the northern hemisphere (reducing outdoor activities) are two fundamental events that may further depress economic output over the coming quarters. Coupled with a highly uncertain US Presidential election looming, and continued tensions with China, especially revolving around technological supremacy, there is the potential for another bout of financial market volatility. This will requires extra fortitude on the part of long-term oriented investors, given that the S&P 500 index's price-to-sales, as well as forward price-to-earnings ratios are at record highs.

Given the high degree of uncertainty surrounding the coronavirus and when a vaccine will become available to thwart it, we continue to favor conservancy, with a focus on quality equity investments where valuations relative to fundamentals remain justifiable. We consider the investment landscape within a framework of negative real interest rates and the unprecedented levels monetary and fiscal stimulus that global financial markets are experiencing today. Previous equity bear markets have almost always been preceded by central bank tightening, yet the current Federal Reserve easy monetary policy is likely to remain for several more years as the committee focuses on maximizing employment, over price stability.

In fixed income markets, risk-free assets, globally, currently offer negative inflation-adjusted returns, with a possibility of a more acute loss of purchasing power should the Federal Reserve allow inflation to run "hot" for an extended period. As such, risk averse investors are faced with the prospect of poor returns, or moving up the risk spectrum. Corporate bonds, both investment and junk rated, have thus been attracting steady flows and may be considered as part of a diversified portfolio that is willing to weather some credit risk and short-term volatility, in exchange for more attractive returns.

Given that government bonds are less effective in their ability to dampen volatility at current yields, we recommend the addition of select alternative assets and strategies to diversified portfolios seeking to balance risk with reward. The case for gold and other precious metals, as a capital preservation tool, continues to be compelling in light of aggressive central bank policies and the large amounts of debt that have been amassed. In addition, we recommend alpha-seeking, non-market correlated, credit and equity strategies, as well as special opportunities in distressed hotels, patents, the European equities and medical technology.

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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