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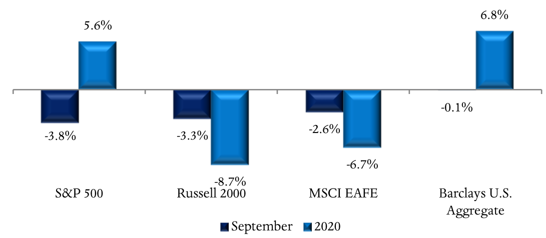
Markets

Global stocks turned in a second consecutive quarter of impressive gains, continuing a historic recovery from the depths of the coronavirus-driven downturn. Investors heralded steadily improving economies as well as accelerating technology trends. However, equities encountered some volatility in September, driven by a combination of the worsening Covid-19 narrative, concerns over the durability of global economic recovery, growing geopolitical risks, and rising US political uncertainty (namely, the inability to pass an additional fiscal package and a potential contested election outcome). During the quarter the S&P 500 and Nasdaq indexes rose +8.9% (+5.6% ytd) and +11.2% (+25.3% ytd), respectively, achieving record highs along the way. The smaller capitalization Russell 2000 benchmark rose +4.9% over the past three months, yet remains -8.7% ytd. Overseas, the MSCI EAFE index added +4.9% during the third quarter, but remained a laggard, down -6.7% ytd. In Europe, the Stoxx 600 rose a modest +0.7% in Q3 (-11.1% ytd). Conversely, Chinese stocks have been among the best performers in 2020, helped by the remarkable success containing the virus, leading the Shanghai index higher by +9.0% over the past three months (+7.9% ytd). Emerging stock markets rallied +7.7% in Q3 (-1.0% ytd).

In fixed income markets, the US 10-year Treasury Note ended the quarter with a yield of 0.68%, broadly flat over the quarter but down from 1.9% at the start of the year. Generally, bond yields fell as the global rebound slowed, and corporate spreads widened. US high yield bonds rallied +4.7% in Q3 but remain down -0.3% ytd.

Commodities generally performed well during the quarter, while consolidating gains towards the latter part. Notably, economically sensitive copper reached a multi-year high ($3.12/lb.) thanks to a resurgence in manufac-



turing, led by China. Gold reached an all-time high ($2,072/oz) in August, before ending the quarter at $1,885/oz. after a strong run (+5.9% in Q3; +24.3% ytd). Crude oil remains in the doldrums, suffering from weak demand. While relatively flat during the quarter, WTI ($40.22/bbl) remains well below the $61.06 it traded at the start of the year.

Geopolitics

In the US, the number of new daily Covid-19 cases peaked on July 17 at 75,643, subsequently declining sharply, reaching a low of 25,774 on September 8, aided by increased vigilance. However, since then, US cases have reversed and are in a moderate uptrend. Most recently, just three states have shown case declines (Texas, Missouri and South Carolina), while cases are higher in 21 states and steady in 26. Yet the rate of overall hospitalizations is declining. Covid-19 news was recently punctuated by President Trump's infection. In Europe, cases were low for most of the summer, but have also started to creep up, especially in Spain, France and the UK. The resurgence has prompted concerns that, as summer turns to autumn and temperatures drop, the virus may become more prevalent. Daily new cases in India and Brazil are in downtrends. On the vaccine front, trials have been progressing positively, with seven global candidates in the final phase of testing.

The US presidential election race heated up, with some initial traction by incumbent Donald Trump in Florida and North Carolina. However, other key swing states including Arizona, Michigan, Pennsylvania and Wisconsin seem to be leaning towards his Democratic opponent, former Vice President Joe Biden. In the Senatorial race, polls appear to have shifted towards a Democratic majority. If the Senate is tied, the Vice President would have the deciding vote. The Republicans' best chance of retaining a Senate majority is to win the seat for North Carolina, whereas the Democrats could win an outright majority in the Senate by winning in Iowa or Montana. The race for the White House and control of the Senate has gained increasing importance in light of the pandemic and the recent inability of the split-houses of Congress to agree on further fiscal stimulus to support businesses and the unemployed.

United States

The US economy continued to make meaningful strides towards recovery over the past quarter. September non-farm payrolls indicated 661,000 jobs were added, which is heartening, but below the 800,000 consensus estimate. The unemployment rate fell to 7.9% from 8.4% in the final report before the November election. High-frequency indicators also maintained their positive trends. Thanks to ample fiscal stimulus, personal income stood 2% above its pre-Covid level, reflecting a swift recovery in wage income. This has been driven by the one-time $1,200 payment under the "Cares Act" as well as $600 per week unemployment assistance from the federal government, in addition to normal state benefits. Further, the Paycheck Protection Program (PPP) kept millions of workers on payrolls who might have otherwise been laid off. These programs have helped to dramatically soften the recessionary effects of the pandemic. It is therefore important to note that the $600 per week additional federal unemployment insurance payments have ceased (affecting approximately 25 million Americans). This benefit has been partially replaced (for fewer people) with a much smaller program, which is also near the end of its funding. In all, state and federal unemployment benefits are gradually becoming exhausted. In an early-September survey, 860 small business owners indicated they had used up all their PPP funding and business closures are

September 2020 Economic Statistics

	Sep-20	Dec-19	Dec-18
Federal Funds Target Rate	***0 - 0.25%***	1.50-1.75%	2.25-2.50%
Consumer Confidence Index	***101.8***	126.5	128.1
Manufacturing PMI Index	***55.4%***	*47.2%*	*54.1%*
Unemployment Rate	***7.9%***	*3.5%*	*3.9%*
JPY/USD	***105.45***	*108.61*	*109.56*
USD/EUR	***1.1718***	*1.1210*	*1.1469*
Gold/oz.	***$1,885.44***	*$1,517.01*	*$1,282.73*
Oil (WTI)/bbl	***$40.22***	*$61.06*	*$45.41*

now on the rise. Given the fragile state of affairs, Washington has commenced bi-partisan talks for another stimulus package, within a range of $1.5 to $2.5 trillion, which may include another round of payments to Americans as well as extended unemployment benefits. The primary point of contention between the Senate and the House of Representatives revolves around the state and local government bail-outs that are needed to balance pandemic related budget deficits.

On the monetary policy front, the big news was the Federal Reserve's shift to average inflation targeting, allowing rising prices to run above the central bank's 2% target for a while to compensate for periods of below-target inflation. The key implication is that interest rates are likely to remain lower for even longer, which was telegraphed by the central bank's Committee. In the meantime, the Fed continues to print $120 billion of new money per month ($1.44 trillion annualized). This amount nearly matches the increased levels of federal government deficit spending. Notably, the central bank's balance sheet now contains nearly $7 trillion in assets, even after the elimination of swap lines with foreign governments and reduced liquidity provided to the repo market. In testimony to Congress, last month, Fed chairman Powell indicated that the current monetary policies would remain in effect until labor markets reached maximum employment, and inflation has risen above 2%, which it is expected to moderately exceed for some time.

Europe

Major European economies continue to struggle on the back of a second wave of coronavirus infections sweeping through the continent, which have led to increased containment measures. Joblessness has risen to 8.1% marking its fifth straight month of increases, a trend that is expected to continue through the end of the year. In another economic headwind, exporters have been challenged by the rising value of the euro, which makes European goods more expensive on world markets. Eurozone economic forecasts have been downgraded once again, with expectations of an 8.1% contraction in 2020, followed by a 5.5% rebound in 2021. Lessening the potential brunt of a second pandemic wave, budget deficit limitations have been lifted, permitting member nations to borrow aggressively to finance their job protection programs. Further, the €750 billion rescue fund remains on tap.

The European Central Bank, which garnered confidence by vowing to do whatever it takes to stabilize local economies and support lending, has thus far been perceived by markets as hesitant to reinforce its efforts, sowing doubts about the future availability of credit. However, these fears may be overstated. In mid-March, the bank promised to spend up to €750 billion to purchase government and corporate bonds, a figure that was subsequently doubled, with much of the firepower still unused.

In the UK, fiscal stimulus has begun to fade. The newly announced job support scheme is less generous than the furlough scheme (which currently supports approximately 10% of jobs). Nevertheless, unemployment is currently at a lowly 4.1%, well below the central bank's 7.5% forecasted peak for this coming winter. On the Brexit negotiation front, there remains a lack of progress, complicated by trade between the UK and Northern Ireland. Looking ahead, the most likely scenario is a limited free trade agreement with considerable transition arrangements. However, the risk of a more adverse scenario is rising. The prospect of no deal is also influencing expectations of Bank of England policy, which is currently reluctant to fully endorse a shift to negative interest rates, but this may come in 2021.

Asia

Economies in Asia are set to benefit as China's shows a strong rebound from the coronavirus pandemic. Recent data showed China's manufacturing activity expanded in September, pointing to a continued recovery for the world's second-largest economy. On the consumer front, Chinese passenger car sales grew at their fastest rate in two years (+8.9% year-over-year), even as subway usage in major cities recovered, to just 10% below 2019 levels, a testament to the government's strong handling of the pandemic.

In Japan, Yoshihide Suga took over as the country's prime minister, replacing the longest-serving premier, Shinzo Abe, who stepped down citing health concerns.

Outlook

As we enter the final quarter of the year we ponder the outcome of the US election. Might it lead to higher corporate income taxes, much needed infrastructure investment, higher wages, and additional fiscal stimulus to support the ongoing economic recovery? From a European perspective, will a second wave of the pandemic further dampen economies, and can a no-deal Brexit be avoided? Most significantly, what might be the probability and timing of approval of one or more Covid-19 vaccines?

In the meantime, we think it's worth looking beyond the recovery from the pandemic, and continue to believe that long term investors should focus on quality equity investments. In addition to our favored large capitalization growth companies, there are robust opportunities in smaller capitalization, European and emerging market stocks.

Given the challenges that society will face emerging from the Covid-19 driven recession, and the time necessary to reach maximum employment, the Federal Reserve's monetary policy is indicative of negative real interest rates for years to come. As such, we continue to see little value in traditional fixed income.

In lieu, targeted absolute return strategies can play an increasingly important role in portfolio diversification. We are currently seeing opportunities in hedged credit, distressed real estate, merger arbitrage, technology patenting and biomedical sciences.

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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