

October, 2020

## 2020 Third Quarter Update

**Review:** The S&P 500 rally continued through Q3, returning 8.9% in the quarter and bringing the year-to-date (YTD) return to 5.6%. During the quarter, the S&P 500 surpassed the prior high set in February and set a new record for the fastest bear market recovery (126 trading days vs the prior 310 day record set in 1966-67). Fixed income returns were also positive in the quarter, with the Barclays Aggregate Bond Index up 0.6%.

Period	3Q20	2Q20	1Q20	2019
<b>S&amp;P 500</b>	8.9%	20.5%	-19.6%	31.5%
<b>MSCI EAFE<sup>1,2</sup></b>	4.9%	15.1%	-22.7%	22.7%
<b>MSCI Emerging Markets<sup>2</sup></b>	9.7%	18.2%	-23.6%	18.9%
<b>Barclays U.S. Aggregate Bond</b>	0.6%	2.9%	3.1%	8.7%
<b>Barclays Municipal Bond</b>	1.2%	2.7%	-0.6%	7.5%

<sup>1</sup>Europe, Australia, Far East

<sup>2</sup>MSCI returns are in U.S. Dollars

### What has been driving continued positive equity returns?

In our last update, we cited stimulus measures and the view that the pandemic would not permanently impair corporate earnings as the two key reasons for the rebound in the markets. With another 9% gain in the S&P 500 since then, it is reasonable to ask why stocks have continued to march higher. A commonly cited narrative is that mega cap Tech stocks have been driving the market higher. While it is true that very large companies like Apple, Amazon, and Microsoft have had a significant impact on the direction of the markets, this view is somewhat misleading in that it ignores a large number of other stocks that have also performed well, even outside of the Tech sector.

The common thread among stocks that have outperformed this year is that they are, in most cases, expected to deliver positive revenue growth despite the pandemic-driven recession. Companies with positive revenue growth that have also seen estimates for 2020 revenue *increase* since the beginning of the year have performed even better. The chart on the next page shows that there are 116 companies in the S&P 500 that fall into this category (only 19 of which are in the Tech sector), and on average, their stocks have returned 14.6% YTD. This compares to an average gain of 6.4% for the 111 companies with positive revenue growth but negative revisions to estimates and an average return of -16.6% for the 272 companies with negative revenue growth.

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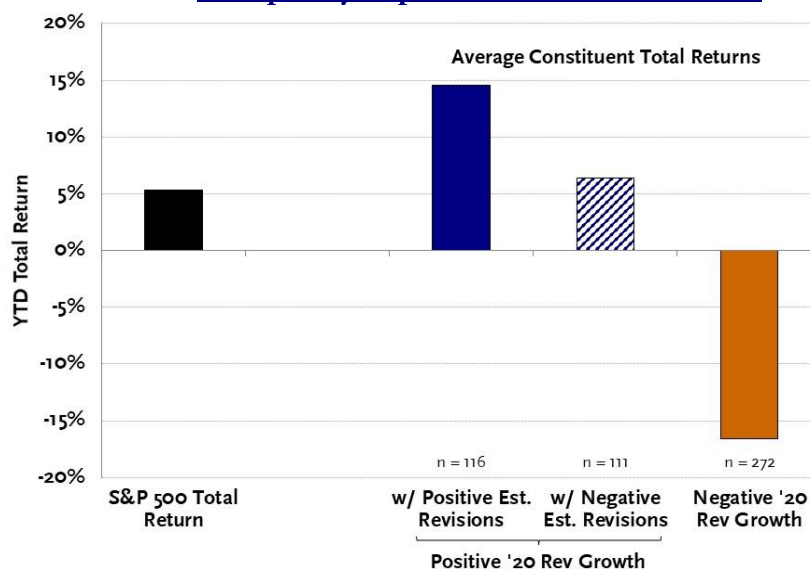
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The fact that companies able to grow in this environment have delivered better total returns than those that are not growing should not be that surprising by itself. However, we believe it is instructive to see the large number of companies expected to deliver positive revenue growth this year and that Tech companies are not dramatically overrepresented.

**S&P 500 YTD Total Return and Average Total Returns for S&P 500 Constituents Grouped by Expected '20 Revenue Growth**



Source: FactSet; as of 9/30/20

**Outlook:** We continue to expect further improvement in the US economy, though the past few months have reinforced our view that the recovery will vary by industry and region depending on case counts, impact of social distancing, and local restrictions.

International growth will likely be mixed, as case counts continue to rise in a number of emerging economies and second waves of infections impact several countries in Western Europe. However, countries facing second waves have, to date, attempted either to avoid lockdowns or to take more targeted approaches to slow the spread of infections.

Potential risks to our near-term outlook include:

- COVID-19 cases/hospitalizations and potential impact on economic recovery
- US political risks (additional stimulus measures and next month's election)
- Re-escalation of US-China tension

**Strategy:** Volatility is likely in the near term due to political risks as well as upcoming third quarter earnings reports. We continue to prefer higher quality companies that are less dependent on the economic cycle, as we believe the market is likely to continue to put a premium on these types of companies in the near term. Despite the strong rebound in equities, we continue to prefer the risk-reward in equities versus fixed income. The most recent guidance from the Fed makes it unlikely we see them raise rates anytime soon, which should support equity valuations.