

Review & Outlook

THIRD QUARTER 2020

Review and Outlook

There's an old joke about two economists walking down the street. The first points to a \$100 bill on the ground, but the second says, "Don't bother picking it up; it isn't real." When the first asks, "How can you tell?", the second says, "If that were a real hundred-dollar bill, someone else would have picked it up already." The joke pokes fun at economists for

assuming that people will behave rationally and respond to incentives in predictable ways. The assumption is that no rational person would leave \$100 just lying on the ground, so the economists in the joke can ignore the idea that the bill is real.

Our version of that joke today is that one economist points to a set of data, like the stock market, and concludes that the economy is doing well. Meanwhile, another economist says it can't be a real recovery, because real recoveries don't include high

unemployment, a growing number of bankruptcies, and other problems. Of course, with today's economy, the recovery is real and should not be ignored. But there is also high unemployment and other troubling indicators. There are actually two different narratives unfolding at the same time, with economic conditions differing sharply depending on where you live and work.

In our last Review and Outlook, we noted that the run up in the stock market in May and June could be seen as a bit

irrational. We noted the role of historically low interest rates and the number of people stuck at home with no sports to bet on and money to spend. The stock market's performance in the second quarter carried over to the third, with the market enjoying the best August in decades. But that strong

performance was in contrast to a growing number of business closures and rising mortgage delinquencies. In other words, the divide between Main Street and Wall Street continued to grow in the third quarter.

One reason for the split is simply that many wealthy households are

doing quite well. Companies like Zoom and Amazon have benefited from the changes brought about by the pandemic.

Similarly, Peloton has done well, along with Apple, Netflix, and Microsoft. People working at these companies have been able to work from home with no interruption to their income. They are not traveling or eating out as much, so they aren't spending as much as they did before COVID, but they

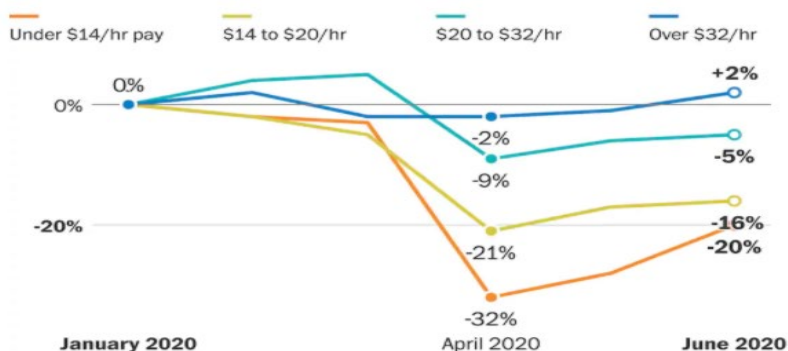
are doing fine. They are still able to buy houses and cars, so housing data looks strong, and car sales are better than expected.

But many people are struggling. Their jobs, if they still exist, don't allow them to work from home. They are facing the threat of layoffs and maybe reduced pay. Many are having to work part-time while staying home while their kids are going to school from home.

Index Performance Data
Total Return as of 9/30/2020

Indices ¹	Q3 2020	Trailing 12 Months
CRSP U.S. Total Stock Market Index	9.20%	14.92%
MSCI Global ex-U.S. Total Stock Market Index	8.25%	10.95%
Bloomberg Barclays U.S. Aggregate Bond Index	0.62%	6.96%

Jobs have rebounded for the top, but not for the bottom
(Chart shows percent change in employment since January 2020)



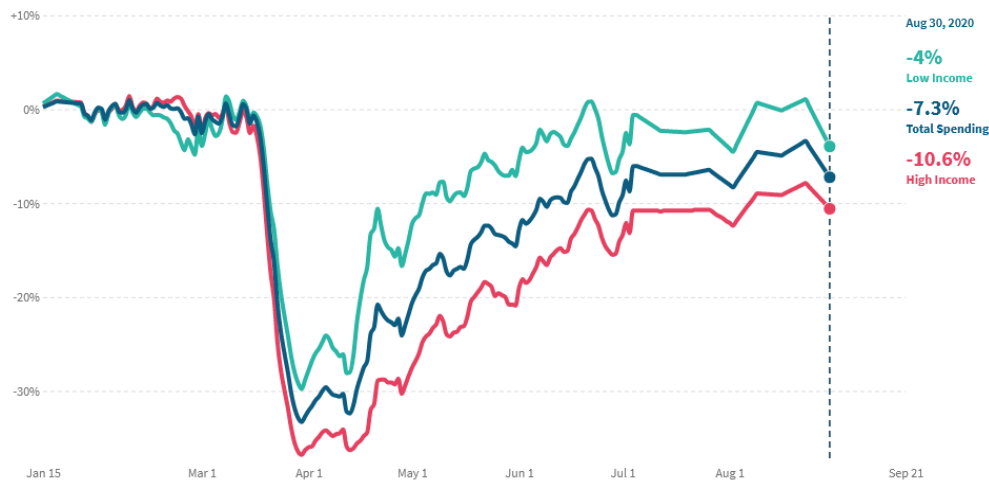
Source: Opportunity Insights analysis of Current Population Survey data

TOM PETERSON/THE WASHINGTON POST

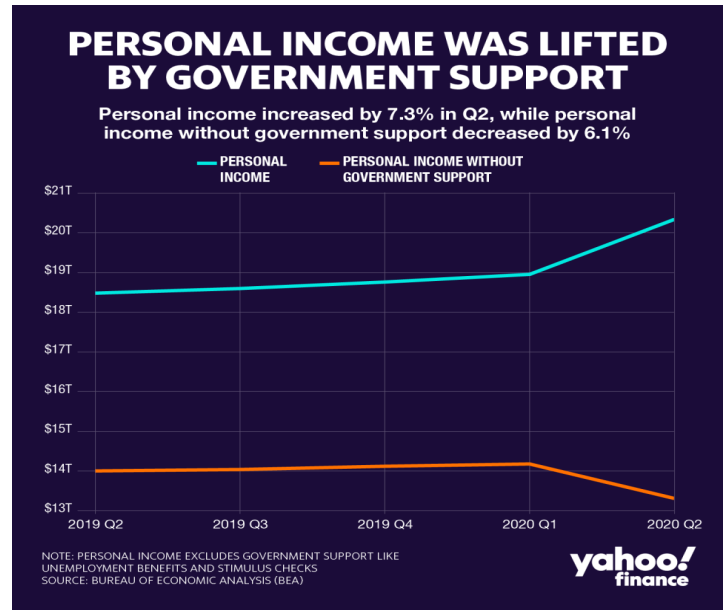
The stock market corrected a little in late September, but is doing well. The largest companies like Apple, Amazon, and Microsoft have, on their own, pulled up major indexes like the S&P 500. Unemployment is also falling, and several metrics point to an ongoing recovery. But the recovery feels tenuous because it is. The stimulus money that supported the economy through July is now in question. Congress has not decided what to do next, and that leaves the rest of us to wonder what will happen with the recovery as a result.

Trying to anticipate what might happen next is tricky, partly because things are changing so fast. Public agencies do not have real time data on things like consumer spending and wages, and it takes time to collect and verify that information. Businesses have to respond to surveys or complete quarterly reports, which means analysts are still waiting on official data showing what happened a few months ago. Initial unemployment claims data comes out weekly, but official unemployment statistics take more time, with some data taking months to collect. Information based on credit card data, GPS tracking, and other 'high frequency' data show that households in low income zip codes have reduced their spending, but not as much as households in high income zip codes. This finding reflects the fact that residents of high-income zip codes are not going to white table cloth restaurants or getting on planes. Their savings rates are up, and they can put money into the stock market. Meanwhile, residents of low-income zip codes typically spend the money they earn because they don't have the same opportunities to reduce spending or grow savings.

We actually saw a historic bump up in personal income in spring. And people on unemployment used the extra benefits to pay for rent, groceries, and other staples. They spent the money quickly, which helped support economic activity. While one debate in Congress was whether or not the added \$600 per week in unemployment benefits made going back to work unappealing, prompting



some lawmakers to argue that the benefits should be reduced or eliminated as a result, the data largely shows that the added benefits did not cause widespread disruptions in the labor market. The fact that some businesses had trouble hiring was mostly due to skills mismatches already present rather than skilled workers preferring to remain unemployed. However, Congress still has not decided what to do next with the stimulus.



The consensus forecast is that GDP will return to pre-COVID levels in the latter half of 2021. But the labor market, is expected to struggle for longer, and the Federal Reserve says we should not expect 4% unemployment again until 2023. This outlook assumes a vaccine is approved this winter and becomes widely available by the late spring or early summer of 2021.

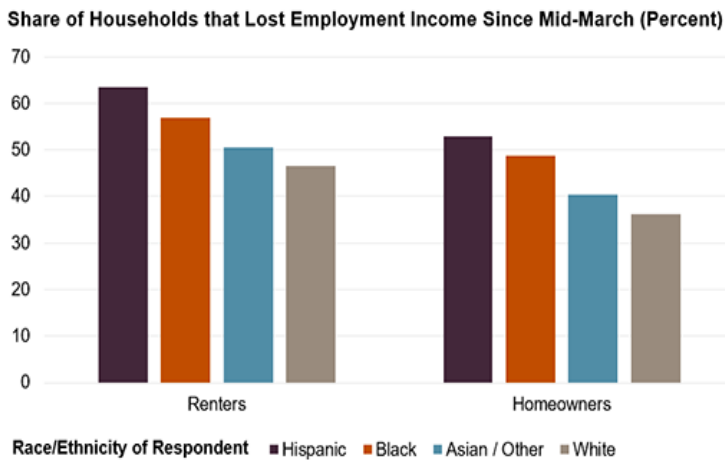
Our last Review and Outlook noted that many people were hoping for, and the stock market was priced for, a V-shaped recession and recovery: a sharp drop followed

by a rapid recovery. This summer, there was talk of a more sluggish, U-shaped recovery, with some joking that it might look more like the Nike swoosh. We have even heard speculation about a double-dip recession, shaped like a "W".

However, we are describing it as a sideways “V” (or the “less than” symbol: <). The top half of the “V” shows the rapid pace of recovery for higher income households, while the lower half of the “V” shows the ongoing struggle for lower income households and households that depend on face-to-face service jobs.

In Focus

Aggregate measures such as GDP and the unemployment rate show us at a glance how the economy is doing. But different people experience the economy in different ways, and we miss those nuances when we look only at aggregate measures or averages. For example, as we write this piece, unemployment is back to around eight percent. But it is much lower for some and much higher for others. And with this recession, the ones paying the highest price are the least able to pay it. The job loss has been most concentrated in lower paying service sector jobs, affecting women and minority communities the most. It is hitting renters more than homeowners. It is affecting women more than men. And it is affecting minority communities more than white communities.



So, what does all this mean for your portfolio? First, we know that market valuations are high by most measures. Historically low interest rates and the lack of other attractive things to spend money on right now are the two things that

give current stock prices a glimmer of plausibility. But prices are high based on earnings, and the longer we go with no new stimulus, the more likely we think a correction is to occur. Next, we add uncertainty surrounding the election, which is now to be preceded by the appointment of a new Supreme Court Justice. We anticipate increased volatility during this period, which means we will stay diversified and wisely use the cash we hold in our accounts.

The Fed chairmen indicated more fiscal stimulus is needed, but given the gridlock in Congress, that may not happen until after the election. And the resulting unease on the part of investors helps explain the recent drop in stock prices, especially the highest priced tech stocks. We think the decline could continue, and as such, we are rebalancing our individual stock portfolio to reduce the size of some positions (like Apple and Microsoft) and to add more positions for diversification. We continue to be only lightly invested in small cap funds, with the plan being to stay that way until more stimulus seems likely. We also continue to be a bit less exposed to foreign markets than other investment firms, and we don't plan to increase those positions until we see more conclusive data about the strength of the U.S. dollar and the impact of COVID-19 on supply chains and international travel.

We raised cash in February and March of this year, and it has served as a helpful buffer during these very uncertain times. Looking longer term, we plan to shift our client's portfolios to be more fully invested. Right now, the S&P 500 is roughly where it was when we raised cash. Given all the uncertainty and the expectation of a further market drop before the election, we anticipate having the opportunity to reinvest the cash at a relatively attractive price point in the very near future. Right now, we plan on reinvesting a portion of the cash in 5G-related REITS and ETFs, but will invest most of it in broad indexes. We are reluctant to favor particular sectors given how unpredictable things are with COVID going into the fall and the range of possible policy decisions.

1. Index price data is downloaded from ICE Data Services. Index performance data is calculated by Axy's portfolio accounting software, a product of SS&C Advent.
 2. The Economic Tracker. (n.d.). Retrieved September 09, 2020, from <https://tracktherecovery.org/>
 3. Cornelissen, S., & Hermann, A. (2020, July 07). Housing Perspectives. Retrieved October 09, 2020, from <https://www.jchs.harvard.edu/blog/a-triple-pandemic-the-economic-impacts-of-covid-19-disproportionately-affect-black-and-hispanic-households>
 This publication is intended to be used as an informational resource only. It is not meant to provide any financial, investment, insurance, legal, accounting, or tax advice, and should not be relied upon by the reader in that regard. We do not receive compensation from any company whose security may appear in our publications. Investments of any type can go up as well as down, and all involve the risk of loss. Please be advised that past performance does not indicate or guarantee future results.