Investment Review & Outlook

July 2020

Review

Nothing is "normal." Experience with business cycles and market patterns that relate to them are of questionable value in the current environment. Given the uncertainty, many companies have withdrawn from the normal pattern of discussing their forward-looking expectations of sales and earnings growth when they release their quarterly reports.

Normally, certain sectors of the economy through a build-up of unwanted inventory or excess debt, reach a tipping point as a function of rising interest rates. The coronavirus resulted in a sudden stop in economic activity on a global scale. The sudden stop scenario means any economic data is out-of-date by the time it is published. We use economic trends to build assumptions and predictions about our financial future, now everything revolves around the unknowable path of the contagion. The economic and market outlook will to some extent be determined by medical issues, not simply inventory or debt levels.

An enormous amount of money and talent is being thrown at the virus on a global scale in the search for an efficacious treatment or vaccine. We expect that science will prevail, but do not have a meaningful timetable.

Despite the social and health uncertainties we face, U.S. stocks ended their best quarter in more than 20 years. This is a remarkable accomplishment considering that just three months ago, the coronavirus pandemic closed businesses around the world, brought the global economy to a virtual standstill and caused U.S. stock indices to lose nearly 35% of their value over a six-week period in Q1.

The subsequent rebound has been far stronger than many imagined. The resurgence in the equity market has been due, in large part, to the unprecedented $1.6 Trillion stimulus package from the Federal Reserve combined with the fiscal stimulus from Congress.

Massive monetary stimulus has driven US Treasury yields below the 1% level through the 10-Year maturity, coupled with the Fed's promise to keep them there for an extended period.

Global Markets

Global markets achieved a remarkable rally in the second quarter despite a dismal outlook for the global economy and corporate profits. The expectation of a meaningful rebound in the third quarter allowed markets to look past the pandemic's negative impact. All the S&P 500 sectors generated positive returns in the quarter. Defensive sectors like utilities and consumer staples lagged the broader market. Consumer discretionary (internet retail & homebuilding) as well as technology shares led the market higher. Intermediate maturity Treasury notes generated a minimal positive return, while the U.Ss Dollar drifted lower over the quarter.

Equity Market Performance
To 30-Jun-2020, in US Dollars

	2nd Quarter 2020	12 Months 6/30/2020
MSCI World Index	19.4%	2.8%
EMU	19.7%	-6.9%
France	16.2%	-10.3%
Germany	26.5%	-2.6%
Switzerland	11.0%	5.9%
United Kingdom	7.8%	-17.7%
Japan	11.6%	3.1%
Pacific, ex Japan	20.2%	-12.7%
EAFE	14.9%	-5.1%
USA	21.6%	7.8%
Emerging Markets	18.1%	-3.4%

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested

Data sources: Standardandpoors.com, Bloomberg, MSCI.com *Continued on page 2*

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Outlook

As the world economy begins to emerge from the devastating lockdowns of the second quarter, we look for a meaningful rebound in global economies in the second half of the year. We expect the full year GDP growth for 2020 to still be in the red for most of the world's major economic regions.

Consensus global GDP growth estimates call for an increase of 5.1% in 2021. The U.S. is forecast to generate growth of 4%, while the Eurozone's number is 5.4% and China's is 8%

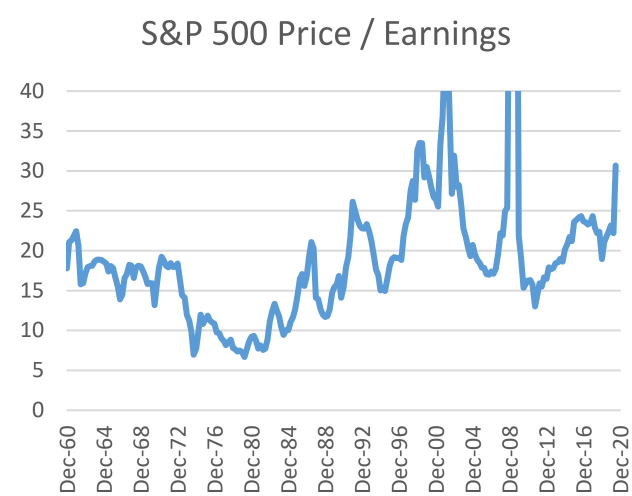
Real GDP % over previous period, SAAR						
	4Q:19	1Q:20	2Q:20	3Q:20	4Q20	FY 2020
United States	2.1	-5.0	-31.0	20.0	4.5	-4.7
Canada	0.6	-8.2	-36.0	30.0	5.5	-6.2
Japan	-7.2	-2.2	-27.0	10.0	8.0	-5.8
China	6.9	-34.7	48.8	21.6	5.6	2.0
Euro Area	0.2	-13.6	-40.0	60.0	7.0	-6.4
United Kingdom	0.0	-8.5	-56.7	63.9	23.4	-9.4
Source: JP Morgan Chase Bank NA, Economic Research, Global Data Watch, July 2, 2020						

The massive stimulus programs in the U.S., from both the Federal Reserve and Congress, go a long way in explaining how equity markets were able to ignore what will be abysmal second quarter GDP numbers to be released at the end of the month. Congress is expected to authorize an additional trillion dollars in coronavirus aid in August.

Standard & Poor's 500				
	Annual Earnings	%Change Y-o-Y	Price/ Earnings	Year-end Price
Dec-13	100.20	15.8%	18.5	1848.36
Dec-14	102.31	2.1%	20.1	2058.90
Dec-15	86.53	-15.4%	23.6	2043.94
Dec-16	94.55	9.3%	23.7	2238.83
Dec-17	109.88	16.2%	24.3	2673.61
Dec-18	132.39	20.5%	18.9	2506.85
Dec-19	139.47	5.3%	23.2	3230.78
Dec-20e	91.80	-34.2%	33.8	3200
Dec-21e	145.66	58.7%	25.1	3650

Source: Standardandpoors.com June 30, 2020, SlateStone Wealth

We lack confidence in the consensus earnings estimates. We expect that the missing confidence will return as the economy begins to rebound in the second half of 2020 and into next year. But at this point, there are just too many unknowns. In the meantime, it is worthwhile to remember that a stock's value is a function of the discounted present value of all future earnings. While it is difficult to put a price on what that value should be at any moment it time, it will certainly rise over the long-term. The high and rising market Price / Earnings ratio is supported by historically low levels of interest rates and will drop as earnings rise next year.



We hope that the S&P 500 has already seen its low point in late March near the 2200 level. The market's volatility in both directions does not make long-term investment any easier. We are thinking that volatility will remain elevated, given the political, economic and medical unknowns. While bouncing up and down over the balance of the current year, our best guess is that we close 2020 around current levels.

We remain enthusiastic in our outlook for the health care sector as a function of ageing demographics on a global scale coupled with dimishing political threats domestically. In the Financial sector, we remain concerned about the threat to bank dividends in the name of capital conservation.

On the fixed-income side, our conservative approach to bond investments in the context of credit quality remains in place. The yield curve has begun to "steepen" from very low levels, a process we suspect will continue for an extended period. We do not expect to make any "real" money in bonds but will endeavor not to lose any.

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