Investment Environment & Outlook

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Market & Economic Environment

The market's resiliency since the March lows indicates that investors continue to look past the historically bad economic data points and the elevated viral infections at an eventual recovery. Record levels of monetary and fiscal policy support continue to provide an economic backstop for companies and individuals struggling with the depths of the recession. The policy initiatives also are influencing investor sentiment and buoying demand for risk-based assets. However, even against a healthier stock market backdrop, human behavior remains unpredictable, which should serve as a reminder that the investment environment can change quickly and requires you to remain on guard.

2nd QUARTER GDP

The severity of the historic economic decline remains evident. The initial read of 2Q20 GDP, a broad measure of the U.S. economy, showed a contraction of -9.5% from 1Q20, or approximately -32.9% annualized. Shaped by the stay-at-home orders, sharp declines in consumer spending, a collapse of business investment and import/export activity offers a sober assessment of the environment.

CONSUMER CONFIDENCE

July's confidence levels noticeably declined due to the acceleration of viral case counts along with the economy and re-opening activities that appear to be losing momentum. Today, consumers are less sanguine in their outlook, which could impact future spending activities and the economic recovery process. We will continue to monitor future confidence levels as they directly influence spending levels and underlying economic growth rates.

CONSUMER SPENDING

Spending and income levels are two consumer variables directly impacted by the COVID-19 environment. June personal income readings recorded a decline as the government transfers (i.e. support payments) fell. Consumer spending continued its gradual rebound off the lows seen during the initial phases of the health crisis. Will the rolling over of consumer confidence adversely impact spending levels and the economy recovery?

LABOR MARKETS

The slowing of economic re-opening activities, shutting down of specific businesses and associated layoffs impacted labor markets in mid-July. The initial jobless claims, which measure the number of workers who filed for unemployment benefits, increased more than expected. Furthermore, job openings declined, which could also signal challenges ahead for the labor market. Is this stall temporary or something more deeply rooted across the economic landscape?

CPI

After declining for three consecutive months, consumer prices increased +0.6% m/m Core inflation is now +1.2% y/y. June marked the first month where price discounting declined as economic re-opening activities accelerated. It is likely that inflation will remain muted for some time to come, but supply chain disruptions and the trends toward deglobalization could be an inflationary risk that will evolve over time and should be monitored.

MANUFACTURING

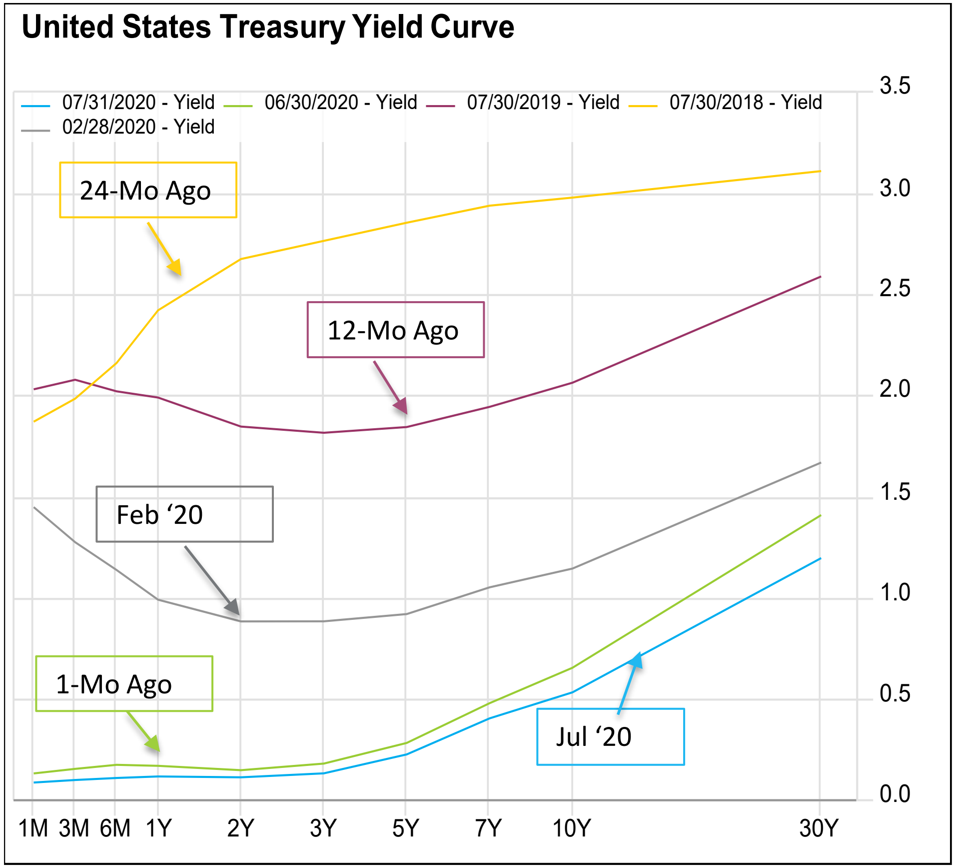
July ISM manufacturing data increased more than expected and touched a 16-month high. As employment declines slowed, new orders and production fueled the strongest manufacturing reading since 3/19. While manufacturing accounts for only 11% of the economy, activity levels are highly correlated with capital expenditures, suggesting that business investment could gradually return as the economy slowly emerges from the COVID-19 turmoil.

Fixed Income Observations

During their July meeting, the Federal Reserve maintained the current level of interest rates and were explicit in their commitment of the extensive support facilities implemented earlier this year. Policy makers will continue to shape and influence the credit markets with their backstop pledges through the broad purchasing of fixed income instruments across different asset classes and offering lending facilities to small businesses. Low yields continue to create a challenging environment for all bond investors and while lowering credit quality requirements in the search for yield is tempting, it could have unintended consequences. We continue to recommend avoiding a push for yield that could increase company-specific and credit-related risks.

YIELD CURVE

- The Federal Reserve remains cautious due to elevated risks and an uncertain economic outlook stemming from COVID-19. Policy makers remain dovish for the foreseeable future as interest rate policy is expected to remain accommodative through 2022. Federal Reserve Chairman Powell continues to pledge to "do whatever it takes" in support of the economic recovery.
- While Federal Reserve made no major announcements in their July policy meeting, they left target interest rates unchanged at 0-2.25, continue their asset purchase program, and the Fed Chairman called on fiscal policy makers for additional support.
- During July, the Treasury Curve bull flattened. The 10-yr treasury yield closed at 52.8 bps, which is a new all-time low. The 30-yr yield closed at 1.19%. The 2-10 yr spread flattened and closed the month at 41 bps.
- While Fed officials have commented that negative rates are not an appropriate measure, markets are still pricing in 20% probability of a rate cut by the end of the year.



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