Investment Environment & Outlook

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Market & Economic Environment

As investor optimism about the ongoing recovery is pitted squarely against the realities of the global recession, patience and discipline are critical especially during an election year. Investors should expect the unexpected around the elections, hence the term "October Surprise". News of the President contracting COVID throws more uncertainty on an incredibly fluid political environment. The degree of influence on the election is unknown and will depend on a multitude of evolving factors that we will continue to carefully monitor. Against this backdrop it is important for investors to remain focused on predictable and stable cash flows from high-quality, dividend paying stocks as well as the use of Investment Grade bonds to act as ballast against potential volatility.

PRESIDENTIAL ELECTION

Political initiatives can bring unintended consequences which create winners and losers in the marketplace. The election outcome will inevitably influence the debate on how the political leaders handle the challenges associated with the COVID-19 induced recession. Regardless of the election outcome, markets will remain resilient and continue to follow their cyclical patterns which present both opportunities and challenges to investors.

CONSUMER CONFIDENCE

September's confidence levels surged as consumers expressed a more upbeat view of labor market, income expectations, and business conditions. While lingering headwinds remain, a less sanguine consumer could be positive for future spending trends that would be supportive of the economic recovery.

BANK CAPITAL ALLOCATION PLANS

The Federal Reserve's June results of the 2020 Dodd-Frank Act Stress Tests showed that banks were adequately capitalized to withstand an economic/financial shock. Given the environment's severity, policy makers took additional steps to ensure stability by capping bank dividends and prohibiting share repurchases during 3Q20. They recently extended those constraints into 4Q20 as they focus on the harsh COVID-19 induced economic challenges. Further upcoming capital adequacy tests will determine when the banks' capital distribution strategies can return to a more normalized pattern.

LABOR MARKETS

As the economic recovery evolves, the September jobs report indicated the improvement in the labor markets slowed. The Unemployment Rate fell to 7.9% from 8.4% and the Labor Force Participation rate edged lower 61.4%/ Private sector jobs increased and numbers on government payroll declined. The mixed data reflects the stops and starts that investors should become accustomed to as the economy continues the healing process.

GOVERNMENT FUNDING

Bipartisanship was briefly on display at the end of September as Congressional leaders and the Administration reached a deal on a stopgap measure to keep the government funded through mid-December. Funds ranging from farm aid to food assistance were part of the negotiated deal. The challenges of reaching the deal were only exacerbated by the political tensions of an election year. Now the attention will focus on whether Congress can reach an agreement on a 5th COVID-19 support package.

RETAIL SALES

After rebounding strongly during the early parts of the summer, retail sales increased at a more pedestrian pace in August +0.6%. Is the worst of the economic impact behind us? With consumers driving 70% of GDP growth, much will depend on the continued healing of the labor market and the recovery of lost jobs to determine the durability of retail spending trends

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Fixed Income Observations

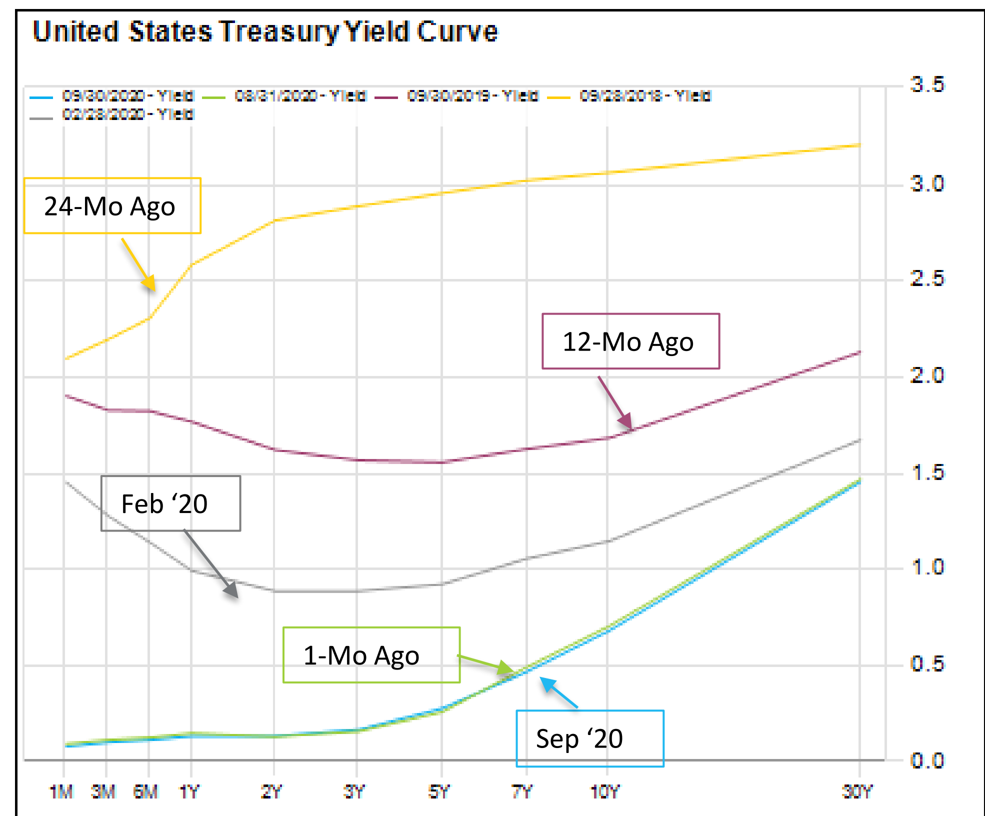
After the Federal Reserve's announcement in August on how they plan to adjust the strategy to execute on their core mandate, the September FOMC meeting was largely uneventful. Policy makers discussed an improved assessment of the broader economic environment. However, the risks from COVID-19 remain entrenched leading them to anticipate that interest rates will remain at current levels through 2023. Maintaining low rates is designed to allow the labor markets to recover and to adjust to their new inflation framework. Lower rates for longer create a challenging environment for all bond investors. As we expressed before, lowering credit quality requirements in the search for yield is tempting, but it is likely to carry unintended consequences. We continue to recommend avoiding a push for yield that could increase company-specific and credit-related risks.

YIELD CURVE

- At the September FOMC meeting, the Federal Reserve left rates unchanged and pledged to continue their asset purchasing activities at current levels. While policy makers stand ready to use their range of tools to support the markets, Chairman Powell explicitly expressed the need for more fiscal stimulus to support the ongoing economic recovery.

- The Treasury curve ended September little changed. The 10-yr yield closed at 68.5bps and the 30-yr yield closed at 1.4. At 117.bps, the 5yr-30yr spread flattened slightly (-3bps) during the month. The 2yr-10yr spread showed similar flattening activity, closing at 55 bps.

- The lack of volatility in the bond markets, in contrast to equities, is largely attributable to the Federal Reserve anchoring the credit markets. It important to remember that an uneven economic recovery, the virus, stimulus talks, high levels of unemployment and the Presidential elections are still headwinds requiring investors to remain vigilant.



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