Investment Environment & Outlook

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Market & Economic Environment

The political process inevitably brings with it varying degrees of uncertainty. The 2020 Presidential election is no different as the race currently remains undecided. As has been done since the founding of our great republic, the eventual results will bring with it a transition of government (the degree of change remains in question). Amidst this age-old political process, we remain focused on the improving fundamentals of our economy and the labor markets. We also continue to assess the severe impact of COVID-19 on the trajectory of the economic recovery. It is during times of great uncertainty that remaining focused on why you invest is critical. It will allow you to look beyond the short-term influences of the markets and focus on your long-term goals and objectives.

LABOR MARKETS

As the economic recovery evolves, the October jobs report indicated further improvement in the labor markets. The Unemployment Rate fell to 6.9% from 7.9%, the Labor Force Participation rate edged higher to 61.7%, and average hourly earnings modestly grew. Private sector jobs (manufacturing, retail, construction, etc.) increased while the government's payroll declined. With labor markets improving and an uncertain election outcome, a key question on the minds of investors is related to the potential for additional fiscal support measures as we move into 2021.

HOUSING

Single family housing remained robust in September as existing home sales surged +9.4%. This growth resulted from pent-up demand, historically low mortgage rates and accelerated migration activity out of certain urban population centers. Housing inventory fell (-19.2%) to an all-time low. The lack of available supply combined with elevated demand resulted in an imbalance causing the median price of an existing home to increase +14% y/y. Home sales have an economic multiplier effect from a 1st and 2nd order perspective. Housing boosts fundamentals from banking to commodities, which is why this critical part of our economy has more leveragability that its 17% impact would otherwise indicate.

3Q GROSS DOMESTIC PRODUCT

Gross Domestic Product (GDP) measures economic activity and is the sum of all goods and services produced during a specific time frame. As COVID-19 spread globally, governments shut down entire economies as a policy response. The lack of activity and consumer spending swiftly ended the 10-year economic expansion as 1Q & 2Q GDP plunged. Currently, there are continued signs of recovery as we push our way past the most severe economic contraction since the Great Financial Crisis of 2008/09. The 3Q20 GDP print of +7.4% represents record growth and signals that the economy has now recovered 2/3rd of what was lost during the depths of the COVID crisis.

RETAIL SALES

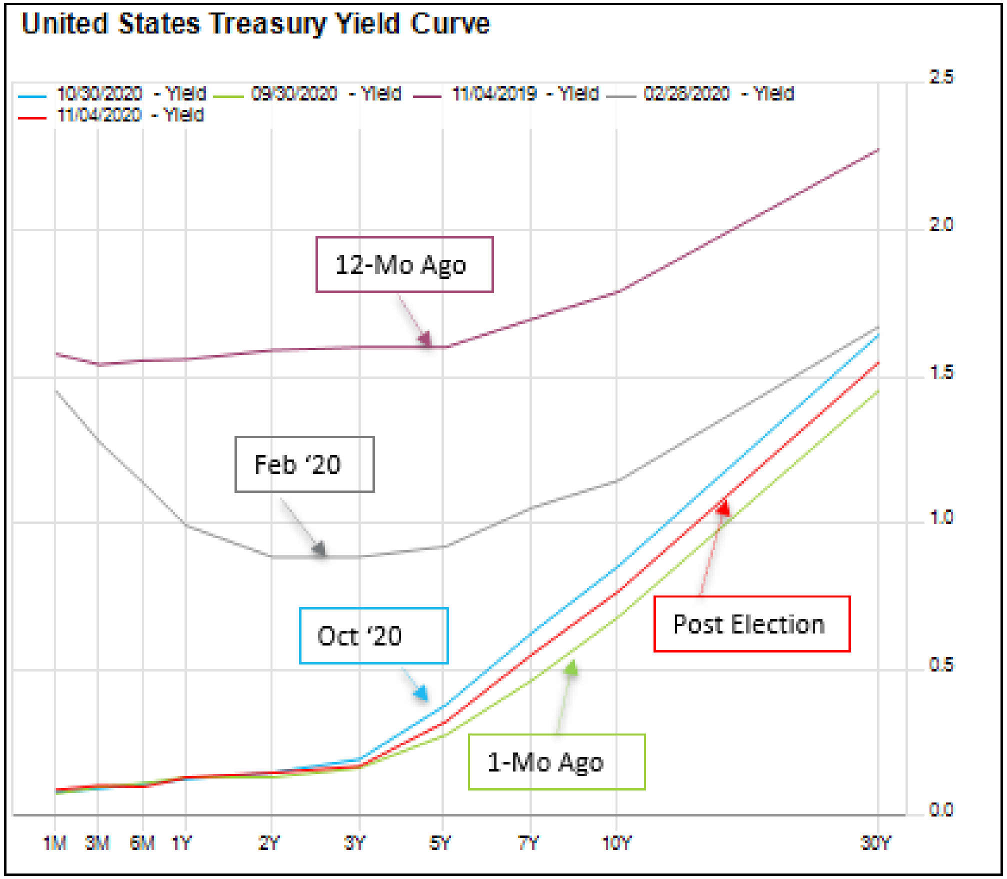
Recently, retail sales continued their rebound from the depths of the pandemic this spring with broad-based consumer spending on all goods except electronics. In fact, sales surpassed their pre-pandemic levels. However, this momentum makes the October measurement of the consumer critical. While retail sales growth remains positive, the growth rate has slowed and now the key question is that of sustainability as we approach the all-important holiday season, especially if we see a resurgence of COVID case counts and an absence of additional fiscal support measures.

Fixed Income Observations

October's credit markets succumbed to the spell of potential election outcome scenarios, specifically a "Blue Wave". The anticipation of further elevated spending influenced and steepened the shape of the yield curve during the month. With an uncertain electoral outcome and the prospects of a "Blue Wave" dimming, the yield curve quickly flattened right after the election. Credit investors also remain wary of the elevated COVID-19 risks that continue to be an ongoing focus of the Federal Reserve. Officials indicate they will hold interest rates at their low levels through 2023. Accommodative monetary policy is designed to allow the labor markets and the economy to recover. Lower rates for longer create a challenging environment for all bond investors searching for income. We continue to recommend avoiding a push for yield that could increase company-specific and credit-related risks, which could introduce the potential for unintended portfolio consequences.

YIELD CURVE

- Amid the Presidential election chaos, November's FOMC meeting didn't result in any new announcements. Rates remain unchanged and Federal Reserve officials pledged to continue asset purchases as COVID weighs on the economic recovery.
- Federal Reserve Chairman Powell reiterated the Central Bank's commitment to using the full range of its tools to support the recovery, while expressing the importance of additional fiscal policy stimulus.
- Treasuries remained little changed after the Federal Reserve's meeting. The 10-yr yield stayed around 77bps and the 30-yr yield also remained steady around 121 bps.
- Through bouts of steepening and flattening in the past few weeks the 2s-10s spread, off its pre-election highs of 75 bps, is now settling in the range of 60-65 bps. 5-30 also off its highs of 130 bps is now trading between 117-122 bps.
- Heightened Treasury volatility will likely continue for some time.



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