MONTH IN REVIEW

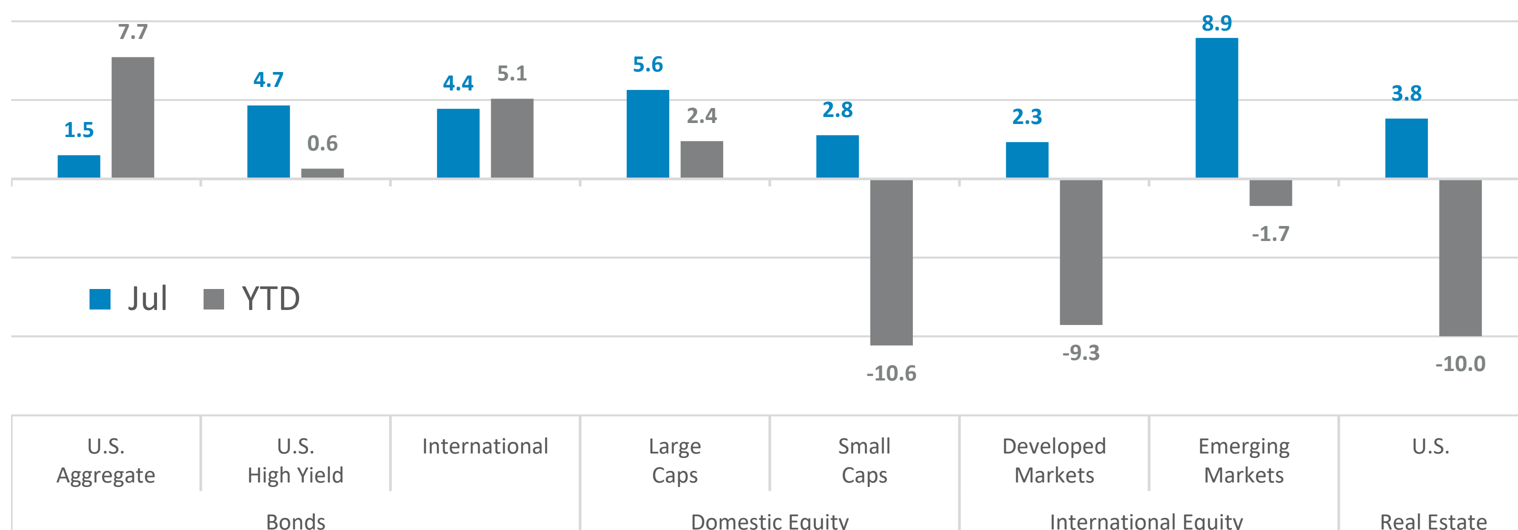
July 2020

Quick Takes

- **Better than expected, part 1.** July provided further evidence that economic activity has improved since coronavirus lockdowns ended. Dozens of high frequency economic indicators reported better-than-expected results for the second straight month.
- **Better than expected, part 2.** Earnings have been boosting the market as 75% of companies in the S&P 500 have reported earnings, and 80% of the reporting companies have exceeded expectations by about +22%, which is the largest surprise percentage since FactSet began tracking the data in 2008.
- **How low can you go, part 1.** U.S. Treasury yields fell throughout July, with the 2-, 5- and 10-year yields reaching record lows at the end of July. According to Deutsche Bank, the yield on the benchmark 10-year U.S. Treasury, 0.53%, is the lowest in 234 years.
- **How low can you go, part 2**. The U.S. dollar has fallen for six straight weeks, and hit its lowest level since May 2018. July marked the worst month for the dollar in a decade. The Bloomberg Dollar Spot Index is off more than -9% from its March high, which has helped international stocks and bonds.

Asset Class Performance

July was strong for risk assets, with positive total returns across the major asset classes. Emerging markets led the way with a +8.9% gain in July. U.S. large cap stocks continue to perform well with a +5.6% return.



Source: Bloomberg, as of July 31, 2020. Asset-class performance is presented by using total returns for an index proxy that best represents the respective broad asset class. U.S. Bonds (Barclays U.S. Aggregate Bond TR), U.S. High Yield (Barclays U.S. HY 2% Issuer-Capped TR), International Bonds (Barclays Global Aggregate ex USD TR), Large Caps (S&P 500 TR), Small Caps (Russell 2000 TR), Developed Markets (MSCI EAFE NR USD), Emerging Markets (MSCI EM NR USD), Real Estate (FTSE NAREIT All Equity REITS TR).

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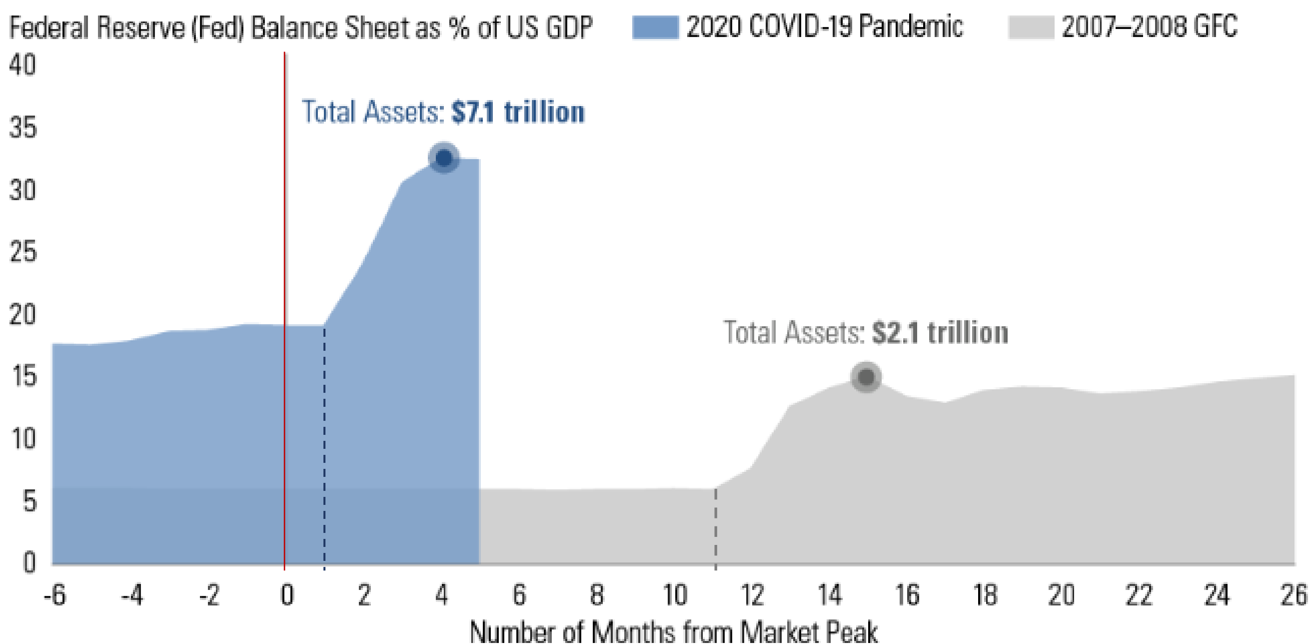
The swift response by policymakers has led to a swift economic rebound.

The policy response to Covid-19 from central banks and governments has been swift and aggressive and truly helped to build a bridge to the other side of the coronavirus lockdowns. The word “unprecedented” was frequently used to describe the economic impact of the COVID-19 pandemic as well as the fiscal and monetary policy responses to it. As shown in the chart below, it took 11 months for the Fed to begin asset purchases after the market peak during the 2008 global financial crisis, and it “only” expanded its balance sheet to a peak balance of $2 trillion. In comparison, the Fed expanded its balance sheet by 84% within six months following February 2020’s market peak, posting its largest balance in history of $7 trillion. Of course the Fed wasn’t alone in its COVID response, according to Cornerstone Macro, the central banks of the Eurozone, U.K., Japan, and China injected another $4.5 trillion of liquidity. Additionally, global governments acted quickly to supplement the monetary liquidity with fiscal relief. The U.S. Government added $3.3 trillion in fiscal stimulus, while the governments of the foreign countries listed above contributed another $7.7 trillion in fiscal stimulus to their economies. In all, the combined central bank liquidity and government stimulus of the U.S. and foreign countries has totaled nearly 30% of their combined economic production (GDP). All the policy action did indeed work, as global markets have substantially rebounded from their COVID troughs. And now economic reports, both in the U.S. and abroad, are routinely exceeding economist expectations, many by record increases, helping to counter the record declines inflicted by the COVID shutdowns. Importantly, U.S. and global Purchase Manager Indices (PMIs) are now back in economic expansion territory (see the PMI charts on the next page), suggesting a V-shaped recovery in the global economy. Of course the healing process is not going to be uniform across all industries and countries, but in the aggregate the “whatever it takes” monetary policy by global central banks and fiscal relief packages by global governments provided the confidence for markets to rebound – and now economies have as well. Policymakers will likely need to continue supporting consumers and businesses until a vaccine is available, or until treatments mitigate the virus by other means, but the pace of economic recovery so far has been impressive and well beyond expectations.

Bottom Line: Though the economic recovery has moderated somewhat from June’s extraordinary pace, the rebound continued in July. Many aspects of the U.S. and global economy are back to pre-pandemic levels, but a full economic recovery will likely require some additional policy support until a vaccine arrives.

The Need for Speed



Source: FRED and Goldman Sachs Global Investment Research. As of June 30, 2020.

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Markets continue to climb the COVID wall of worry.

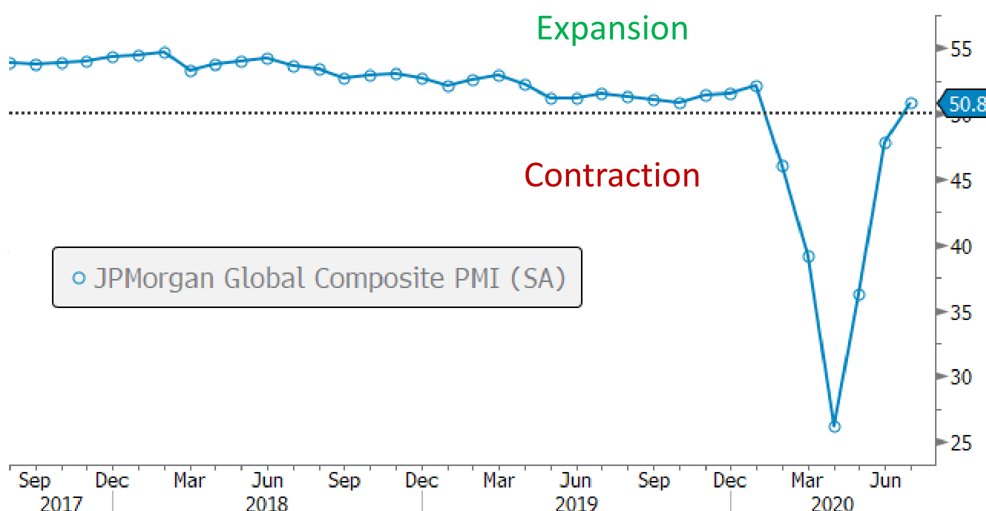
Technically COVID-19 is classified as a novel coronavirus, meaning it is a new, unidentified virus. As such, nobody knew the extent of the medical or economic implications the world was facing as it spread across the globe from China. It was only a few months ago that the pandemic was unfolding and economists were estimating that U.S. economic output could plunge at a -50% annual rate, which a slew of data seemed to be confirming in March and April. As Evercore ISI points out, U.S. GDP did in fact fall to a 5-year low and Eurozone GDP fell to a 15-year low. As seen in the chart below, in just three months the Global Composite Purchase Managers Index (PMI) plunged -26 points. And in just three months it has rebounded +25 points back to expansion territory (levels above 50 indicate economic expansion). The ISM U.S. Composite PMI hit 57.7 in July, its highest level since February 2019. Virtually nobody predicted the speed and magnitude of these rebounds, but it helps explain the tremendous rally by global equities since the March lows.

Now the better-than-expected economic story is playing out in the second quarter earnings season as well. Stated simply, companies are crushing overly bearish estimates. More than 300 S& P 500 index companies have reported second quarter results so far. About 85% are beating Wall Street analysts earnings estimates by an average of +22%. Those are huge relative numbers. Companies always beat estimates, but not by that much. In the first quarter of 2020, about 70% of S&P 500 companies beat analyst estimates by an average of just 3%. In the second quarter of 2019, about 75% of them beat analyst estimates by an average of 5%. Many companies failed to provide guidance ahead of the quarter given the immense uncertainty coming into it, but as companies return to giving guidance, the numbers have been impressive. According to Bespoke Investment Group's calculations, the spread between the percentage of companies that have raised guidance versus those that lowered guidance this season is currently at +10%. That is a stark contrast to when COVID first hit and companies dramatically lowered or withdrew guidance entirely.

U.S. Economic Output

Source: Bloomberg, Institute for Supply Management (ISM).

Global Economic Output

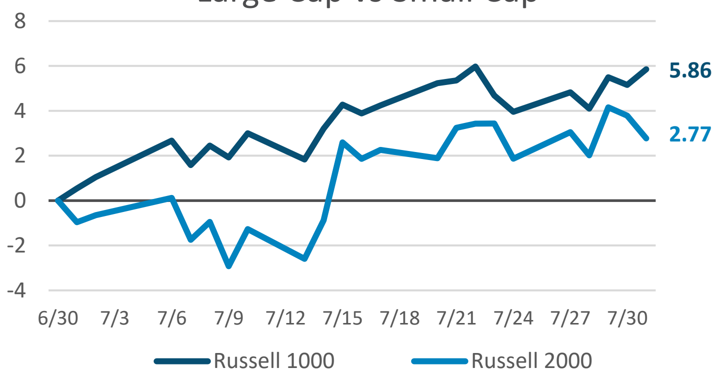


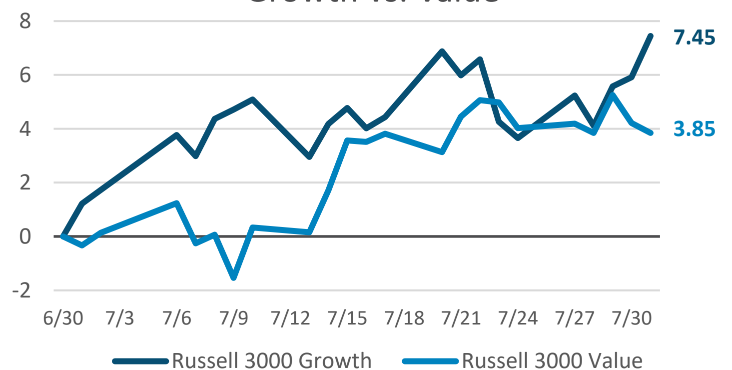
Source: Bloomberg, IHS, J.P. Morgan.

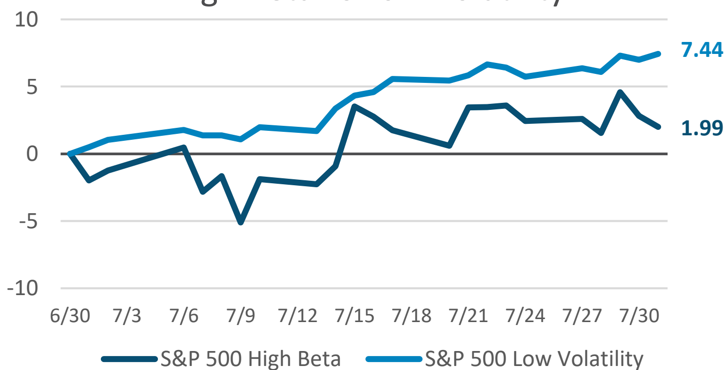
<u>Bottom Line</u>: In the end, it has been remarkable to see the market, the economy, and now corporate earnings recover at a rate nobody anticipated. There are always reasons for concern that face investors, that is the nature of risk assets after all, but the COVID-19 pandemic presented an especially formidable wall of worry given the unknown nature of the virus and the extent it caused the global economy to virtually shutdown for weeks on end. Worries will remain as social unrest, the elections, and U.S.-China tensions still linger. But the global economy, and especially the U.S. economy, have demonstrated remarkable resiliency in the face of the sharpest, and largest, economic contraction most of us have seen in our lifetimes.

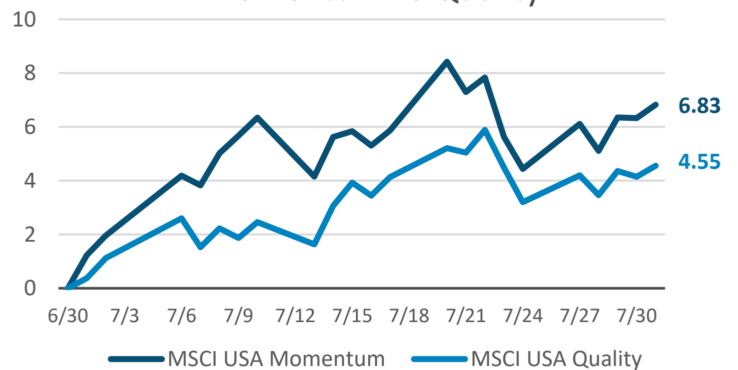
What Worked, What Didn't

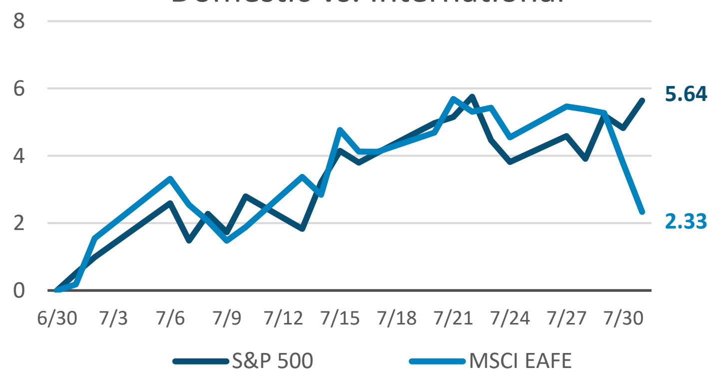
- **Can anything stop Growth?** The Russell 3000 Growth Index gained another +7.5% in July, its fourth straight monthly gain, a period that produced a +37.5% total return. It is the tenth straight month that the Russell 3000 Growth Index has outperformed the Russell 3000 Value Index.
- **Emerging Markets momentum.** The MSCI Emerging Markets Index was the best performing style in July with an +8.9% total return. It is the fourth month in a row Emerging Markets have been positive, in which they have returned +28.6%.
- **Tortoise versus the hare.** The S&P 500 Low Volatility Index had a total return of +7.4% in July, it's best monthly performance since December 2000. The Low Volatility Index has beaten the High Beta Index for all major trailing periods, i.e. the 1-, 3-, 5-, 10-, 15-, 20-, 25-, and 30-year periods.

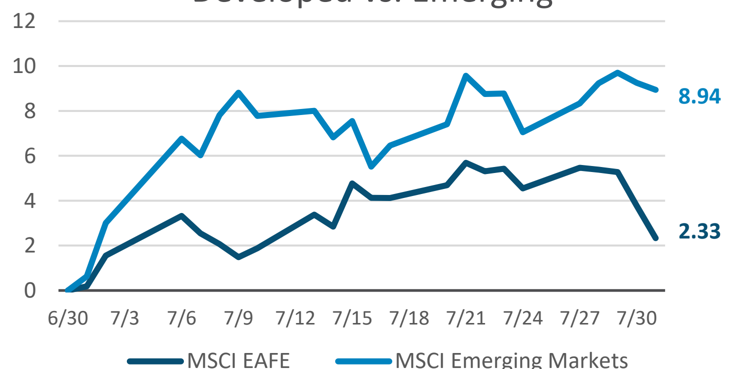












Source: Bloomberg.

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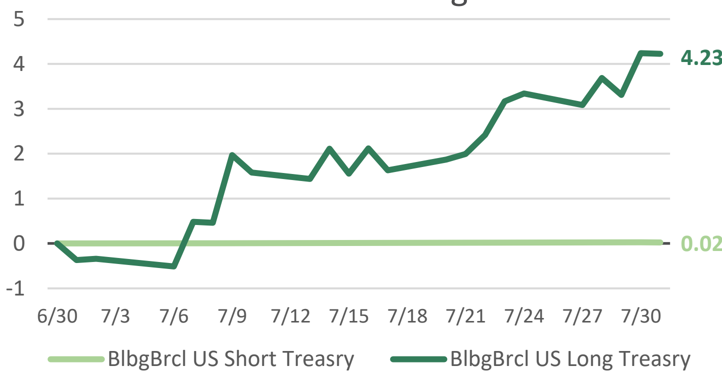
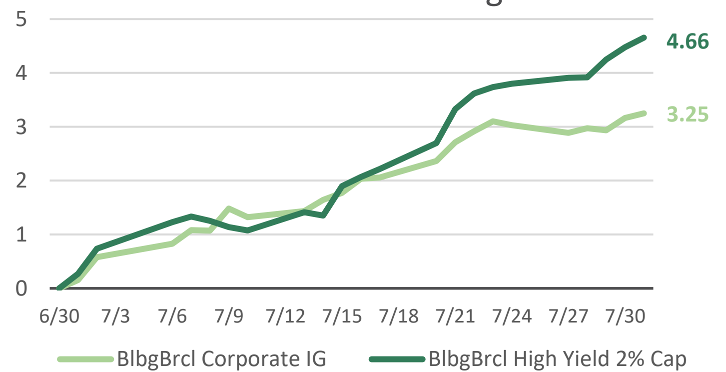
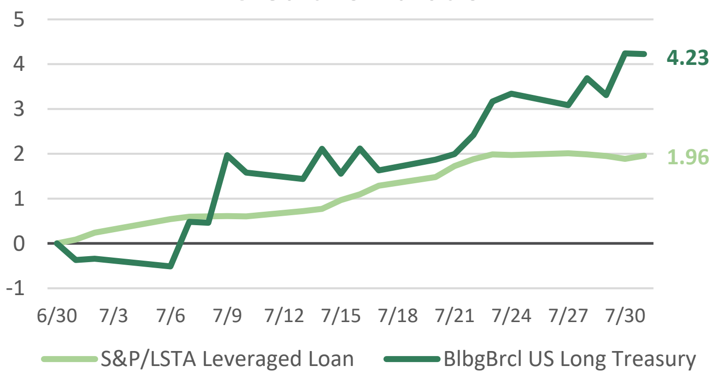
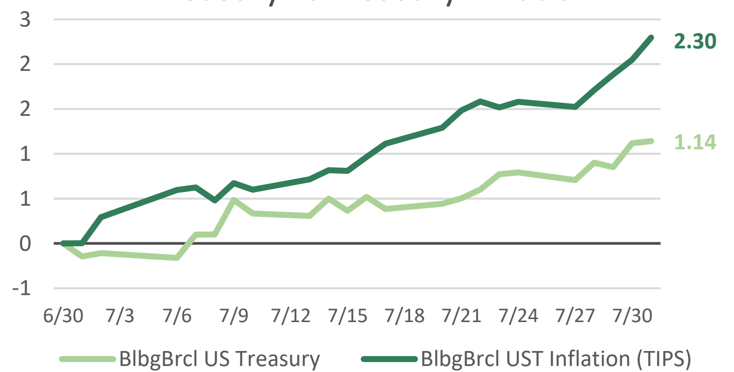
What Worked, What Didn't

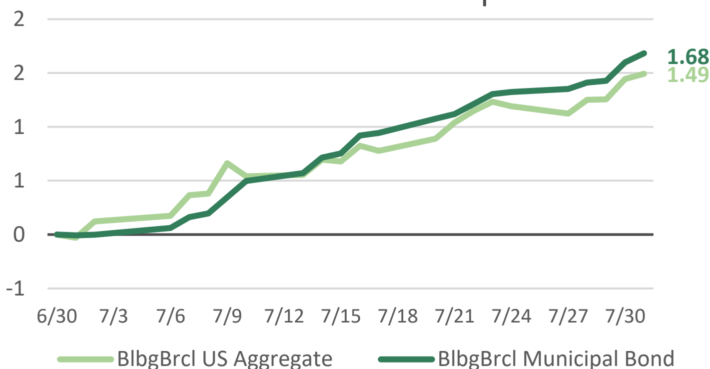
- **Everybody's a winner.** Like equities, virtually all bond sectors were positive in July. And like equities, risk on was the name of the game with High Yield, Long Treasuries, and International Bonds leading bond sectors with gains exceeding +4% in July. High Yield bonds had their best month, +4.7% in July, since October 2011.
- **Duration reigns.** In July, long duration U.S. treasuries returns +4.2%, bringing the 2020 year-to-date returns to an eye-popping +26.3% and the trailing one-year return to +30.5%.
- **Tax Free + Competitive Yields = Winning.** High Yield municipal bond funds had a 4.5% tax free yield at the end of July, giving them the best after tax yield among most bond indices. And after returning +2.7% in July, their 3-month return is +11.1%, the best among the major Bloomberg Barclays bond indices, even before adjusting for taxes.

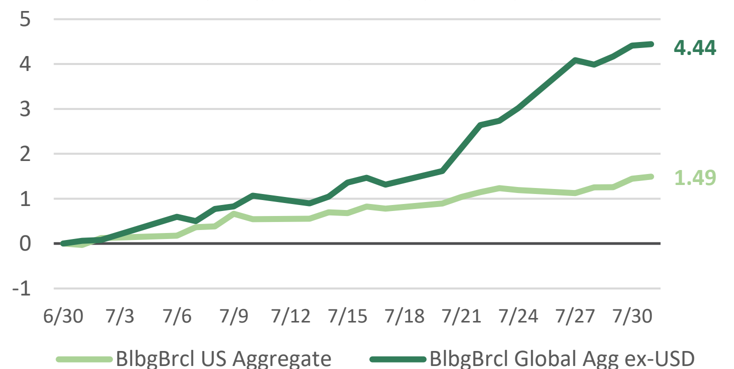












Source: Bloomberg.

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The Importance of Diversification. From period to period there is no certainty what investment will be the best, or worst, performer. Diversification mitigates the risk of relying on any single investment and offers a host of long-term benefits, such as less portfolio volatility, improved risk-adjusted returns, and more effective compounding.

Rank	Jul-01	Jul-02	Jul-06	Jul-07	Jul-08	Jul-09	Jul-10	Jul-13	Jul-14	Jul-15	Jul-16
High	RE 2.25	EM 2.28	EM 4.30	USB 0.15	EM 2.59	IBD 0.55	SCV 2.98	USB -0.01	SCG 1.92	SCV 4.18	IBD 0.35
	LCG 1.40	IEQ 1.10	LCG 2.12	IBD 0.09	MCG 1.49	LCG 0.42	LCV 1.84	LCV -0.11	MCV 1.69	SCG 3.03	HYB 0.10
	EM 1.13	HYB 0.74	IEQ 1.64	HYB -0.66	LCG 1.38	MCG 0.38	MCV 1.79	MCV -0.30	MCG 1.59	MCV 2.67	USB 0.07
	MCG 0.99	MCG 0.67	MCG 1.10	LCG -0.73	SCG 1.16	USB 0.26	IEQ 1.07	SCV -0.50	SCV 1.50	LCV 1.73	LCV -0.09
	IBD 0.62	60/40 0.57	60/40 1.10	MCG -0.74	IEQ 0.84	EM 0.00	60/40 0.48	IBD -0.50	LCV 1.49	MCG 1.49	MCV -0.11
	60/40 0.39	MCV 0.54	LCV 1.03	60/40 -0.82	60/40 0.60	HYB -0.22	SCG 0.44	HYB -0.55	IEQ 1.47	IEQ 1.13	60/40 -0.34
	IEQ 0.38	LCV 0.51	SCV 0.97	SCG -1.02	MCV 0.37	60/40 -0.37	HYB 0.34	IEQ -0.64	LCG 1.13	RE 1.04	SCV -0.46
	HYB 0.31	SCG 0.47	MCV 0.91	LCV -1.39	SCV 0.36	RE -0.56	LCG 0.29	60/40 -0.64	60/40 0.87	60/40 0.85	MCG -0.57
	USB 0.05	LCG 0.47	IBD 0.83	IEQ -1.47	LCV 0.30	SCG -1.00	RE 0.28	EM -0.67	HYB 0.85	IBD 0.70	IEQ -0.65
	SCG 0.00	SCV 0.18	HYB 0.72	EM -1.67	HYB 0.27	IEQ -1.14	IBD -0.05	RE -1.24	RE 0.76	HYB 0.57	LCG -0.72
	LCV -0.12	USB 0.12	SCG 0.53	RE -1.90	USB -0.03	LCV -1.50	USB -0.12	SCG -1.99	IBD 0.42	LCG 0.44	SCG -0.93
	MCV -0.43	IBD -0.21	RE 0.01	MCV -1.91	RE -0.10	MCV -1.73	MCG -0.33	LCG -2.02	USB 0.16	EM 0.30	RE -1.09
Low	SCV -1.89	RE -0.31	USB -0.01	SCV -2.78	IBD -0.15	SCV -2.96	EM -0.64	MCG -2.86	EM 0.14	USB 0.01	EM -1.41

Rank	Jul-17	Jul-20	Jul-21	Jul-22	Jul-23	Jul-24	Jul-27	Jul-28	Jul-29	Jul-30	Jul-31	Jul
High	RE 1.26	LCG 2.51	SCV 2.94	RE 1.53	SCV 0.77	IBD 0.10	SCG 1.84	RE 1.79	SCV 2.67	MCG 0.47	LCG 1.59	EM 8.25
	MCG 1.18	MCG 1.90	LCV 1.22	MCV 0.83	IBD 0.50	HYB 0.09	MCG 1.67	USB 0.07	RE 2.24	IBD 0.39	MCG 0.43	MCG 8.08
	SCG 0.98	EM 1.29	MCV 1.21	IBD 0.62	USB 0.12	USB -0.03	EM 1.55	IBD -0.25	MCG 2.12	LCG 0.32	HYB 0.19	LCG 7.78
	IEQ 0.59	HYB 0.60	EM 0.92	LCG 0.61	MCV 0.10	EM -0.09	LCG 1.50	HYB -0.26	MCV 1.86	SCG 0.30	USB 0.04	IBD 6.46
	EM 0.56	SCG 0.54	IBD 0.48	MCG 0.61	HYB -0.07	60/40 -0.41	IEQ 1.31	SCV -0.29	SCG 1.70	HYB 0.21	IBD -0.10	HYB 5.06
	LCV 0.40	IEQ 0.49	HYB 0.46	LCV 0.57	LCV -0.11	IEQ -0.55	IBD 1.16	LCV -0.32	EM 1.61	USB 0.08	RE -0.21	MCV 4.61
	60/40 0.37	60/40 0.43	60/40 0.30	60/40 0.31	SCG -0.40	LCG -0.57	RE 1.16	60/40 -0.36	LCV 1.34	60/40 -0.42	MCV -0.30	RE 4.12
	LCG 0.34	IBD 0.41	RE 0.26	IEQ 0.27	60/40 -0.42	RE -0.76	60/40 0.72	MCV -0.59	LCG 1.33	RE -0.51	LCV -0.32	LCV 4.00
	HYB 0.28	USB 0.11	IEQ 0.20	HYB 0.20	RE -0.52	MCV -0.85	MCV 0.40	IEQ -0.64	IEQ 1.05	MCV -0.83	60/40 -0.33	60/40 3.82
	MCV 0.27	LCV -0.65	SCG 0.08	USB 0.08	IEQ -0.80	LCV -0.91	SCV 0.39	EM -0.82	60/40 0.96	LCV -1.01	EM -0.69	SCG 3.49
	USB 0.10	MCV -0.92	USB 0.06	SCG 0.07	EM -0.80	MCG -0.98	HYB 0.24	LCG -0.97	HYB 0.56	SCV -1.21	SCG -0.82	SCV 2.09
	IBD -0.03	RE -1.19	MCG -0.38	SCV 0.05	MCG -1.08	SCV -1.53	LCV 0.14	MCG -1.21	IBD 0.37	EM -1.27	SCV -1.11	IEQ 1.94
Low	SCV -0.22	SCV -1.60	LCG -0.92	EM -0.43	LCG -2.23	SCG -1.62	USB -0.07	SCG -1.65	USB 0.12	IEQ -1.48	IEQ -2.13	USB 1.33

Legend

- 60/40 Allocation (60/40)
- Large Growth (LCG)
- Large Value (LCV)
- Mid Growth (MCG)
- Mid Value (MCV)
- Small Growth (SCG)
- Small Value (SCV)
- Intl Equity (IEQ)
- Emg Markets (EM)
- U.S. Bonds (USB)
- High Yield Bond (HYB)
- Intl Bonds (IBD)
- Real Estate (RE)

Source: Bloomberg. Asset-class performance is presented by using market returns from an exchange-traded fund (ETF) proxy that best represents its respective broad asset class. Returns shown are net of fund fees for and do not necessarily represent performance of specific mutual funds and/or exchange-traded funds recommended by the Prime Capital Investment Advisors. The performance of those funds may be substantially different than the performance of the broad asset classes and to proxy ETFs represented here. U.S. Bonds (iShares Core U.S. Aggregate Bond ETF); High-Yield Bond (iShares iBoxx $ High Yield Corporate Bond ETF); Intl Bonds (SPDR® Bloomberg Barclays International Corporate Bond ETF); Large Growth (iShares Russell 1000 Growth ETF); Large Value (iShares Russell 1000 Value ETF); Mid Growth (iShares Russell Mid-Cap Growth ETF); Mid Value (iShares Russell Mid-Cap Value ETF); Small Growth (iShares Russell 2000 Growth ETF); Small Value (iShares Russell 2000 Value ETF); Intl Equity (iShares MSCI EAFE ETF); Emg Markets (iShares MSCI Emerging Markets ETF); and Real Estate (iShares U.S. Real Estate ETF). The return displayed as "Allocation" is a weighted average of the ETF proxies shown as represented by: 30% U.S. Bonds, 5% International Bonds, 5% High Yield Bonds, 10% Large Growth, 10% Large Value, 4% Mid Growth, 4% Mid Value, 2% Small Growth, 2% Small Value, 18% International Stock, 7% Emerging Markets, 3% Real Estate.

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