Autus
ASSET MANAGEMENT

The year 2020 will certainly be one most people would just as soon move past. A global pandemic, wildfires, hurricanes, social unrest, and an especially contentious political season have been jarring, to say the least.

The economic picture can be summarized pretty concisely: the expansion had been robust, but then the world shut down in the spring because of the coronavirus, causing an economic collapse without historical precedent. Investors have seemed optimistic about a V-shaped recovery, but the outlook remains mixed. Employment is improving, as half the jobs lost in April have been added back and the unemployment rate has declined to 7.9%. Consumer spending has improved, driven by fiscal stimulus and pent-up demand. Business confidence, while still below pre-pandemic levels, has rebounded. The housing market is booming in many parts of the country, with tight supply and consumers embracing work-from-home, suburbanization, and low interest rates. But non-residential construction is troubling, and the commercial real estate market is facing fundamental changes due to the pandemic. Companies have been questioning the need for office space due to an efficient remote workforce. Retail vacancies are on the rise, and the restaurant and travel and leisure sectors are extremely weak.

The volatility in the markets has been unsettling, albeit understandable. We witnessed the shortest bear market in history in February and March, when the shutdown rattled the markets and the S&P 500 lost 1/3 of its value in just 33 days. But unprecedented government stimulus and the Fed's dramatically expanded balance sheet injected tremendous liquidity into the economy, and the stock market made new all-time highs in early September. After the summer's strong gains, the markets have been bouncing around, with alternating broad selloffs and sharp rallies in recent weeks.

In refining our outlook for the markets, we've been focusing on several fundamental factors. Valuations have become somewhat stretched, especially for the largest stocks. The S&P 500 Index is trading at roughly 25x expected earnings for next year, which is measurably higher than levels of the past decade. Earnings declined by 30% in the second quarter, and might not recover to pre-pandemic levels for a couple years. Profit margins are under pressure with slower revenue growth. But the trend is certainly upward, and positive earnings revisions have represented 74% of all estimate changes. Sentiment has been underwhelming, which we see as a positive. Despite the stock market trading near all-time highs, surveys of investor sentiment show a definitive lack of exuberance. And there have been net *outflows* from equity mutual funds and ETFs. Finally, liquidity must be viewed as constructive for the stock market. M2 money supply is up 23% year-over-year, and the Fed's balance sheet stands at $6 trillion. With short-term interest rates near 0%, stocks should continue to benefit from a lack of alternatives.

The elections pose yet another element of uncertainty, but we'll refrain from allowing politics to influence our investment disciplines. It typically has not mattered which party inhabits the White House or controls Congress, but rather the state of the underlying economy that drives markets. As always, we're focused on building high-quality, well diversified portfolios, with a long-term perspective, independent of the political climate.

We understand how difficult, uncertain, and downright scary this year has been. We sure appreciate our clients and friends, and wish everyone safety and good health. We're always here when you need us.

The Partners of Autus — October 6, 2020