HIGHTOWER
RDM Financial Group

# Market Update

August 14, 2020

## *Key Takeaways*

- Financial markets have been moving higher supported by three primary factors: fiscal stimulus from Washington, monetary support from the Fed and hopes for a COVID-19 vaccine.
- Both the ISM Manufacturing and ISM Non-Manufacturing indices have staged impressive recoveries and are both back above the key 50-level, indicating expansion.
- Employment trends are improving (note: weekly claims are now below the 1 million mark) although we still have a long way to go to recover all of the jobs lost earlier this year.
- Corporate profits came in better than lowered expectations this past quarter. Following a decline of 19.0% in 2020, EPS for the S & P 500 are currently forecast to rise 28.6% in 2021.
- We are keeping an eye on fiscal stimulus talks in Washington, the uncertain trade relationship with China, discovery of a COVID-19 vaccine, the potential for higher taxes and the rate of recovery in the global economy.
- Looking ahead, it may not be until a vaccine is found that the economy can truly recover and regain all of its lost momentum.

Over the past couple of months, we have started to see signs of a rebound in both the U.S. and global economy. We suspect that a full recovery will likely take time (along with a vaccine) and that the path ahead may include some bumps along the way. Equity markets currently appear to be moving higher supported by three primary factors, fiscal stimulus from Washington, monetary support from the Federal Reserve Bank and hopes for a COVID-19 vaccine that should help lead to a more robust and broad-based economic recovery. We believe that the economic recovery may look a little uneven at times over the next several months. However, looking ahead over the next year or two, economic data including GDP, employment, consumer and business confidence and corporate profits are all likely to improve from current levels.

In terms of recent economic data, employment trends have started to improve following a sharp decline back in March and April of this year. Monthly employment data has now increased in each of the past three months and the economy has added back 9.3 million of the 22.2 million jobs lost during the recession (source: Bureau of Labor Statistics). This is a sign that employment trends appear headed in the right direction. In addition, after surging higher following the shutdown of the economy this past Spring, jobless claims have now fallen below the 1 million level for the first time in 20 weeks. While these trends are certainly encouraging, the economy has a long way to go to recapture all of the jobs lost during the recent downturn.

In other parts of the economy, both the ISM Manufacturing and ISM Non-manufacturing indices moved higher again last month and are now solidly back in expansion territory again (i.e. above the 50 level). Their sharp decline this past Spring and rapid recovery over the past few months have taken place at an extraordinary speed. Housing also remains a bright spot with most housing statistics (i.e. mortgage applications, the NAHB Home Builders Index, existing and new homes sales etc…) rebounding and either close to or above pre-COVID-19 levels. Low interest rates along with some pent-up demand and households leaving the city for rural areas have likely played a role.

GDP posted a massive decline last quarter as the economy shutdown and business came to a standstill. However, it's important to recognize that this is looking in the rearview mirror. Looking ahead, the Atlanta Fed (source: www.AtlantaFed.gov) currently forecasts a GDP increase of 20.5% this quarter. According to FactSet data, GDP is currently forecast to decline 5.0% for all of 2020 and increase 4.3% in 2021. In recent weeks, there has been somewhat of a slowdown in the rate of improvement in various real time economic indicators (like restaurant reservations, airline travel etc…) due to the fact several states experienced a rise in COVID-19 cases this summer. However, the trend in new cases and hospitalizations appears to be improving once again, which should hopefully keep the economic recovery on track.

Turning to corporate profits, 89% of companies have now reported second quarter results and year over year earnings per share (EPS) growth took a big hit and declined 33.8% year over year last quarter. On a positive note, profit results came in much better than originally expected last quarter with 83% of companies beating analyst estimates (which is substantially above the levels seen in previous years). While year over year EPS growth is currently forecast to decline during each of the last two quarters of this year, EPS growth is currently forecast to turn positive once again and rise 12.9% in the first quarter of 2020. Overall, corporate profits are currently forecast to decline an estimated 19% for all of 2020 and rebound 28.6% in 2021. Based on current analyst estimates, all 11 sectors of the S & P 500 are currently forecast to generate positive EPS growth next year with 7 out of 11 S & P 500 sectors currently forecast to generate double digit EPS growth.

Looking at market technicals, there have been some positive developments in recent weeks. While the market has been led by a small number of large cap growth stocks in recent quarters (which has gotten our attention), since the market bottom on March 23rd, both the equal weighted S & P 500 and the Russell 2000 small cap index have both modestly outperformed the large cap S & P 500 (meaning we are starting to see somewhat broader market participation). In addition, in recent days we have started to see some improvement in more cyclical parts of the market which is a sign that investors may be starting to focus more on a potential rebound in the global economy and rebound in corporate profits as we head into 2021.

Just this week, Strategas Research reported that 50% of all stocks in the S & P 500 registered a new trading high over the past 20 trading days. While readings like this can be anti-climatic over the next 1-3 months, they have historically pointed to above average market returns over the next 6-12 months. In addition, we find it encouraging that the advance decline line for the S & P 500 recently broke out to a new all-time high. We would like to see a higher percent of stocks trading above their 200-day moving average (currently at 60%) and this is something we continue to monitor. While it is certainly good to see market technicals improve, ultimately we will be watching for a sustained rebound in key economic data including employment, manufacturing, housing, retail sales and corporate profits (to name just a few key variables).

On the interest rate front, U.S. Treasury Bond yields have declined to record-low levels in recent months due to concerns about the outlook for the economy, the Federal Reserve Bank cutting short-term rates to close to 0%, worries about the future outlook for the economy and concerns about a second COVID-19 outbreak later this Fall. At its latest meeting, the

Federal Reserve Bank made it clear that "they are not even thinking about raising rates" any time soon. Federal Reserve officials stand reading to buy additional assets if needed and add to their almost $7 trillion dollar balance sheet (which stood at around $4 trillion dollars before the economic downturn). Interest rates could start to drift higher in coming weeks reflecting some recent improvement in the broader economy. Despite a rising budget deficit due to increased fiscal spending to support the economy, it appears unlikely that interest rates are likely to move significantly higher at least over the next few quarters. Inflation and interest rates may start to move higher over the next several years, but that does not appear to be a big concern over the near term.

In summary, after experiencing a sharp and dramatic downturn in the economy (along with the fastest bear market on record) earlier this year, it looks like the economy is on the mend. Looking ahead, we believe that the economy, corporate profits and financial markets are likely to improve further over the next year or two. However, it's important to point out that there will likely be bumps along the way and the recovery is not likely to be a straight line. Massive stimulus from Washington and the Federal Reserve Bank have helped put the economy on better footing and provided a lifeline for many unemployed workers.

Among various things on our radar, we are keeping an eye on the U.S. trade relationship with China, rising debt levels, the potential for higher taxes, failure to discover a COVID-19 vaccine and an economic rebound that fails to live up to expectations. All of these issues could lead to increased market volatility at times as we head through the second half of the year. Looking ahead, it may not be until a vaccine is found that the economy can truly recover all of the ground lost during the downturn earlier this year. While it cannot entirely protect you from swings in the market which occur over time, having the appropriate asset allocation should help you better ride out the inevitable ups and downs that come with investing.

As always, please do not hesitate to call us with any comments or questions you may have.

Respectfully,

Michael Sheldon CFA®, FRM®
Executive Director & CIO

## RDM Financial Group

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HIGHTOWER
RDM Financial Group



10 Wright Street | Westport, CT  06880 | 203.255.0222

505 Fifth Avenue | 14th Floor | New York, NY 10017 | 212.682.2200

6501 Congress Ave| Suite 240 | Boca Raton, FL 33487 | 561.393.8500

www.rdmfinancialgroup.com