Monthly Commentary

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"Looking Through the Right Lens"

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2020 was dubbed "the year for seeing clearly" due to the number being analogous to the description for "perfect" 20/20 vision. It's interesting that we often use this term to describe excellent vision, yet don't necessarily know what it means. As it turns out, 20/20 vision does not mean "perfect" vision; but according to the American Optometric Society, it simply means "seeing clearly at 20 feet what should normally be seen at that distance." 20/20 vision means "normal" vision of an object at a distance of 20 feet. There are other important aspects to vision skills – peripheral awareness, side to side vision, eye coordination, depth perception, focusing ability and color perception – that contribute to overall vision ability.

So, how are you "seeing" your financial world today; what investment and economic outlook do you "see?"

The "Great Lockdown" is over, but fallout remains. Lockdown and reopening sounds straightforward, but as most are quickly observing reopening doesn't mean a quick return to normal. Reopening is complex – supply chains are altered or broken and represent a new "tariff" for business; China/US relations are being strained again on multiple fronts - origins of the virus, China/Hong Kong autonomy; also politics leading up to November. The 30 million people in the US who became unemployed as a result of the lockdown will take time to re-employ; 20 million may return in somewhat timely manner, while a remainder of 10 million may find that their employer remains cautious or unable to bring them back. Current unemployment numbers rival the Great Depression of 1930s, but the policy mix to aid recovery is better thus far. Also, until schools are reopening (and that timeline still appears highly uncertain), we expect economic recovery will be postponed and/or slowed. There is walk-back occurring, but we suspect like 9/11 created new travel rules, COVID-19 is adding to those rules, including BIG government remaining involved in personal and business lives a lot longer than any desire.

Early signs of recovery are beginning to show green shoots in both the domestic and global economy. The resumption of the economic recovery will initially look like a "V" for a short period. But, it will likely be challenging to fully restore to 2019 levels of GDP and low unemployment in a socially-distanced world. That suggests the "V" shaped appearance evolves more "square root" shaped (recovery that was down a lot, up some, then flatter). We are probably in the first inflection point of "down to up." The plateau after the bounce is likely the next phase of travel for the economy. Linking the stock market to the economic letters, it experienced a "V" type move since February 19 to March 23, to May.

Unfortunately, unemployment numbers continue to show still larger than usual filings. That's not surprising; unemployment stats are a lagging indicator – meaning the U-rate will continue to rise well after the economy is improving again as business are slow to fully hire workers until they see concrete improvement in business activities. They will hire when activity requires more help, not before. Yet, "viewing" jobless claims from week to week shows reported numbers are at a decreasing rate. That is much the same for the pace of new COVID-19 cases and deaths. From a health perspective, as long as the "R" number (reinfection rate) stays less than 1, walking-back the economy will continue. As vaccines and treatment are developed/utilized, and our immune systems develop antibodies of protection, the R<1 means infection numbers *should* remain manageable and slowing. Recoveries of health and the economy will continue. [Unfortunately the news media is so "poor- or narrow-sighted" to explain that health and economic conditions can co-exist with an improving recovery trend.] The trajectory of economic recovery at this point is biased upward (improving) as business recovery starts from very low, depressed levels.

Vision is 2020 when looking in the rearview mirror. We can always see "perfectly" at events of the past, knowing with hindsight what actions were likely best. Did you desire to remain invested on March 23 at the recent market low? Did anyone anticipate the current rally would be so powerful on the upside? A one month bear market – come on; who would guess a violent drop "off the cliff" would end after 23 trading days? Unlike past bear markets that developed from excess built in a sector or two, no single industry was at the epicenter of this bear market drop. The drop hit all areas. Yet, from March 23 thru the end of May (just 47 trading days), the S&P500 jumped +36.6%, erasing all but -9.6% of the loss since the last great Bull Market run (ending February 19). During May, the

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S&P added +4.8% to the rally totals from the bottom; many areas of the financial markets rose in May, including value-style, banks, oil, and others which initially lagged at the beginning of the rally from the bottom. With so much economic data still bad, the rally across bonds, stocks, and foreign markets at this point is mostly explained by new liquidity following huge central bank monetary stimulus and support that was activated in recent months.

Style	May	YTD
Mid-Cap Stocks	+7.2%	-13.9%
Small-Cap Stocks	+6.2%	-18.1%
Avg US Stock Fund	+5.7%	-11.6%
Foreign Stocks	+5.2%	-13.2%
Large-Cap Stocks	+4.9%	-7.9%
S&P 500	*+4.8%*	*-5.0%*
Barclays Bond Idx	+0.5%	-5.5%

Client Objectives (Stocks/Bonds)	May	YTD
20/80	+1.7%	-0.6%
35/65	+2.5%	-2.9%
50/50	+3.3%	-3.6%
65/35	+4.4%	-5.8%
80/20	+5.4%	-7.7%
95/5	+6.0%	-9.1%

Seasoned investors know the "best trading days occur near the worst ones." Of course, the low is most difficult to see at the time; but looking back it is easily identifiable. Buying and sticking with an investment strategy/process provides rich benefits. The recent rally testifies to that (time will tell, though). The great challenge is weathering volatility. Stay invested by avoiding too much news – especially where news can literally be consumed 24/7. As with all aspects of life, to achieve gain often requires enduring pain. It also applies to investing – some short-term pain must be endured from time to time to achieve larger long-term gain.

Funny thing (if something can be funny following recent market experiences) the market is not flinching following last week's new headline risks (e.g., Hong Kong, US social protests, etc). Some 96% of S&P500 issues traded above their 50-day moving average. The same is true for small-cap Russell 2000 stocks. That is one of the strongest momentum surges in 50 years and that's with investor sentiment still "unbelieving"; still afraid to be invested for the long term. Historically such powerful momentum surges suggest that strength may need to consolidate in the short-term (next number of weeks); but forward performance over the longer-term (+6 and +12 months) is convincingly bullish.

So, does current market levels, current valuation, really matter when the Fed's balance sheet grew to +$7 Trillion? Should investors be fearful that the market appears overvalued? Is the stock market ahead of how an economic recovery will develop given levels of unemployment?). Which market is right about the outlook – stock market (optimistic) or bond market (pessimistic)? Answer – safe-haven bonds are still cautious (yield curve is staying pretty flat; expected to rise and steepen if economic growth and/or inflation were rising. But, when central bankers flood the system with liquidity, it provides almost no predictive insight in the short-term (1 year and shorter), and does provide a pretty strong relationship with returns being strong over the long-term. Large amounts of liquidity allow most all assets to appreciate and look expensive. Since valuations are a function of both earnings and interest rates (both low), it is difficult to generally describe the market as cheap today. Generally, bonds are very expensive, and stocks are not cheap. Yet, there are areas of the bond and stock market that offer attraction – value style stocks, better quality high yield bonds; and foreign stocks in particular. Some growth stocks look greatly overvalued; be careful with FAANG stocks (again, "funny" comment during a rally in a bear market). In the near term, don't be surprised if the stock market pauses or "cools off" due to valuation and various uncertainties; volatility likely continues.

The stock market is not ahead of the economy. Recall, the stock market is a "leading indicator." It sniffs out (somehow) information before actual economic and business stats are released. At present, the economy and markets appear divergent, with stark differences between backward-looking GDP and the forward looking S&P500. Stock investors anticipate improving economic conditions from a very low starting point. Bond investors see prolonged economic sluggishness, which means some bonds will struggle. Stock investors are usually optimistically forward looking; call them bullish. Bond investors are often pessimistic, looking for the worst event that could thereby downgrade the value of bond holdings. This is where active management (not passive indexing) provides selection benefit. Important, economic recovery is underway and expected to lag from significant self-inflicted damage (lockdown and staggered reopen).

We attempt to look through a "20/20" lens of fact-based, data-driven research to ferret out the "better" ideas of what is occurring in the economic and financial markets. Our experiences guide that understanding the underlying economic and monetary conditions provide a better vision for future direction. If you would like an "eye exam" of your investment portfolio and financial wellbeing, arrange a time to visit us. We are here to help. Stay safe and healthy; stay invested.