Berman
CAPITAL ADVISORS

October 12, 2020

BCA Q3 2020 Investment Outlook and Review

BCA Research

Summary Outlook

- Markets continued to rally during the third quarter despite signs of slowing economic data. Technological innovation and remote work themes continue to lead the equity market, although a slight rotation to smaller cap and international equities took place towards the end of the quarter.
- Massive monetary stimulus, extremely low nominal interest rates and a faltering recovery mean these market trends are likely to remain in place until we see clearer resolution on the coronavirus and stronger economic growth.
- High quality bonds moved little during the quarter. Even as risk appetite returned, ultra-low rates and a flat yield curve kept a strong bid to investment grade and Treasury bonds.
- In the near term, Government policy will remain an important factor in financial markets' confidence. The uncertain timing of another round of government stimulus is causing market uncertainty, but the assumption is a package will eventually get passed.
- For the foreseeable future we are likely to see deficit spending continuing at a high level, as there is no apparent penalty for government spending and populist pressures are rising in both political parties.

Third Quarter Performance

In Q3, the equity market continued it's historic rebound from March's pandemic low point. The S&P 500 scored a blistering 35.4% return from April to August, the best five month period since the Great Depression. September trading reduced these returns by 3.9%, but by any measure the rally persisted.

Total Index Return	Q3 2020	YTD 2020
S&P 500	8.9%	5.6%
Russell 1000 Growth	13.2%	24.3%
Russell 1000 Value	5.6%	-11.6%
Russell Small Cap	4.9%	-8.7%
MSCI EAFE (International)	1.3%	-6.7%
MSCI Emerging Markets	8.8%	-0.9%
US Aggregate Bond	0.6%	6.8%
High Yield Bonds	4.6%	0.6%

Source: Factset Research;data through 9/30/2020

Note: Int'l market returns reported in U.S. Dollars

As always, what happens next is the question on investors' minds. At a high level, changing expectations regarding the pace of economic reopening, political events (most especially, the U.S. Presidential election) and progress on a coronavirus vaccine continue to be the dominant factors.

For the quarter as a whole, big tech, consumer and software growth companies still dominated returns. As the Fed continued its zero interest rate and bond buying policies, gold also continued to rally. In general, gold rises during market panics and on negative real rates, a fancy way of saying actual inflation is higher than governement bond yields indicate. However,

market leadership shifted modestly during September, as gold and the NASDAQ Index sold off and smaller and international stocks performed better.

Despite the modestly better tone for out-of-favor investments such as smaller cap and value stocks, the most notable story has been how historically wide the outperformance of growth stocks has been (see chart). This spread is being led by the strong performance of Facebook, Apple, Amazon, Microsoft and Google. The combined market value of these five stocks (approx. $6.9T) account for 23% of the S&P500 Index and just over 34% of the growth benchmark.

Growth hasn't cumulatively outperformed value to this extent since Russell began tracking the two styles in 1986. There doesn't seem to be a near term catalyst for that to change.

Best start to year for Growth and large-caps in decades

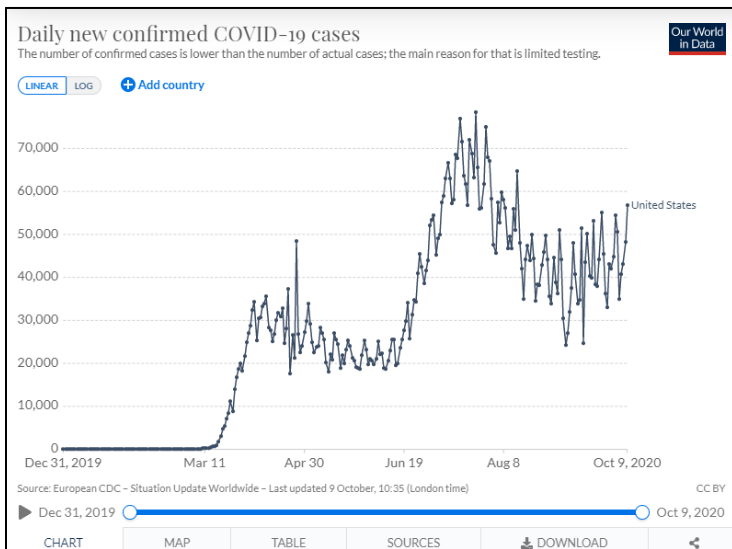
Russell Cap-Weighted Total-Return Indices % Gain
12/31/2019 - 9/30/2020

	Value	Blend	Growth
Large	-10.96	9.62	26.88
Mid	-12.84	-2.35	13.92
Small	-21.54	-8.69	3.88

Source: Russell. Data Total-Return.
Large-cap = Russell Top 200 indices.
Mid-cap = Russell MidCap indices.
Small-cap = Russell 2000 indices.
Blend = broad index at all market-cap levels.

Ned Davis Research SBOX_001.RPT

Coronavirus Impact as we Approach Year End

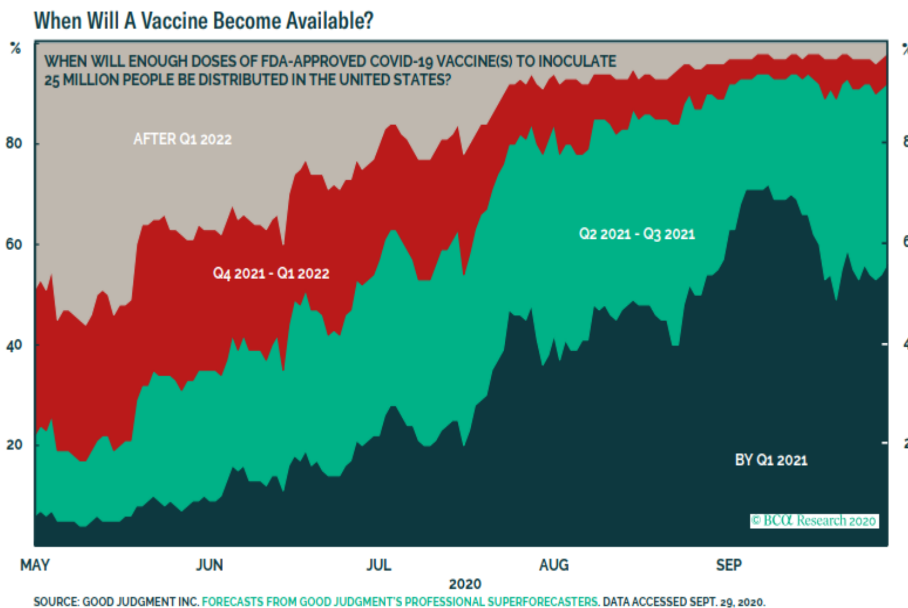


In conversations with just about anyone, coronavirus fatigue is palpable. Nonetheless, the issue remains a major determinant of the near-term outlook. In terms of case count, the 7-day moving average is rising on a global basis. Unfortunately, the U.S. leads the pack among major countries in the new case trend, as can be seen at left.

Critically, though, the death toll itself is not rising. Competing theories purport to explain why the virus is now less deadly. Improved treatments, including less aggressive use of ventilators, the addition of low-cost steroids to the protocol, and a shift in the incidence of cases towards younger, healthier people have all contributed.

BERMAN
CAPITAL ADVISORS

The politicization of the pandemic – debates about mask wearing, movement restrictions, and even the severity of the health impacts – makes it difficult to know what individual states will do after the U.S. Presidential election on November 3rd. While the government seems unlikely to impose the same sort of severe lockdown measures implemented in March, rising case counts will delay reopening plans. The coming winter could increase the risk of a "third wave" of infections, which would likely result in additional stimulus. The market is clearly desirous of more fiscal stimulus, as is the U.S. population overall, but the timing, size and breadth of that stimulus remains a political question.

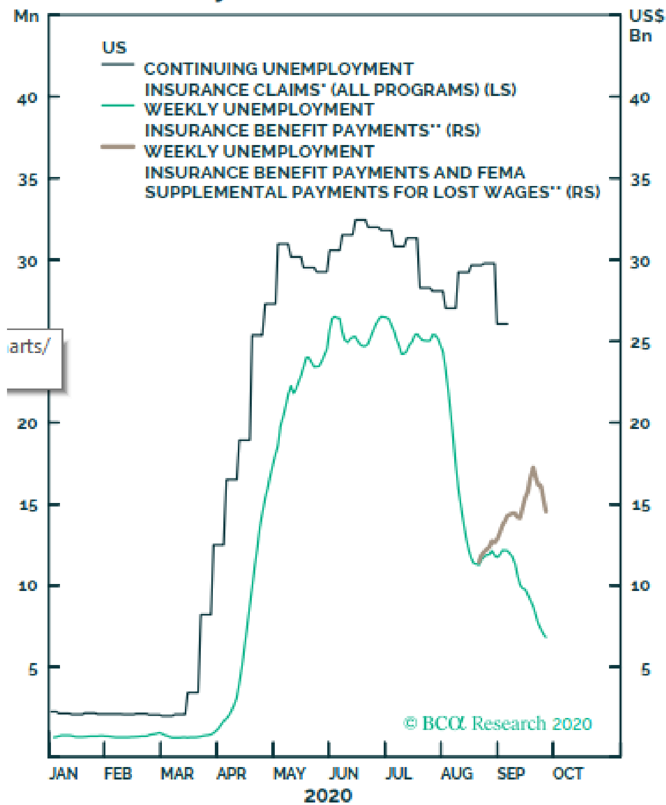


There is great interest in an effective coronavirus vaccine being approved, widely manufactured, and then distributed. Both the approval process and confidence in a potential vaccine have become politicized, but we expect that to fade after the election. The good news is that prediction markets are coming around to the idea a vaccine will be available at an earlier than previously expected date, as seen in the chart at left.

The State of the Global Economy

Economies around the world received large doses of stimulus following the Spring lockdowns. This time around the U.S. was a leader, rather than laggard. However, political infighting and the lasting impact of continued restrictions, business failures and eroded consumer confidence have resulted in signs of a stalling of the economy. Recent evidence for this includes the stubbornly high initial unemployment claims and falling retail sales in August. Consumer confidence numbers are dropping as well.

Relative growth outside the U.S. has also slowed, but to a lesser degree, due to continued efforts to provide fiscal stimulus. China, for example, continues to stimulate its economy. Economists expect the broad-measure fiscal deficit to reach a record 8% of GDP this year and remain elevated into next year, a high level of support. The annual change in total social financing – a broad measure of Chinese credit formation – is expected to hit 35% of GDP, just shy of its Great Financial Crisis-era peak.



In the U.S. the initial fiscal response was so large that aggregate consumer incomes rose during the pandemic. Combined with a gradually reopening business sector, this support brought unemployment claims rapidly lower, but from a very elevated level. Economists do not expect employment to approach 2019 levels for the foreseeable future. The financial markets expect a painful road for the economy, but could still be disappointed by a failure to provide more stimulus. The chart at left shows how sharply unemployment benefits have fallen due to the parties' inability to find common ground. This remains a risk for the market.

Monetary policy remains highly stimulative. In Q3, the U.S. Fed unveiled a new Monetary Policy Framework (MPF) which is truly aggressive and a definitive break from the past. The MPF abandons the Fed's historic idea that it should lift rates whenever the unemployment rate declines towards its "equilibrium" level. Instead, the MPF will guide the Fed to try to maintain an average level of inflation of 2% over the course of the business cycle. This means it will allow inflationary overshoots if recent inflation has been low. For now, the cost of additional debt is incredibly low. Yet down the road inflation could reawaken. We continue to see inflation as unlikely in next year or two. However, faster economic growth and a tightening labor market could indicate more cyclical sectors and real assets, such as real estate, are positioned to benefit.

Investment Implications of a "Blue Wave"

The November 3rd election is only three weeks away and interest is running high in the election, as stark policy differences between the candidates could impact financial markets. 2016 produced a famously surprise election result, so prognosticators are notably cautious this time around. However, the Democratic candidate, Joe Biden, now has a clear lead in the polls. According to prediction markets, the most likely outcome is a Democratic sweep of the Presidency and Congress with associated sharp reversals from the last four years.

Taxes on the wealthy and corporations are thus likely to increase which will directly reduce corporate earnings, an obvious negative for the markets. However, negative sentiment around the tax increases is moderating given the potential offset of a large stimulus bill passing easily thru a Democratic Congress. Spending under a Biden administration would rise even further

than the current baseline. In addition to more pandemic-related stimulus, he has proposed a variety of longer-term spending initiatives including a $2 trillion infrastructure package, a $700 billion "Made in America" plan for federal purchases of domestically produced goods and services and new spending on health and education at about 1.7% of GDP.

This spending could boost economic growth, given the slack in the labor market and the cheapness of borrowing rates. High deficits and a growth boost could, all else equal, benefit more cyclically oriented stocks such as industrials and commodities. It could also weaken the dollar, making international stock markets relatively more attractive. This is the theory, but our strategy is to remain balanced. There have been many calls for value and international stock market resurgence, but growth has stayed too weak and interest rates too low to provide a catalyst. There is a good chance this happens again, leaving recent market trends intact.

Conclusion

It's a cliché to say the market hates uncertainty, but it is often true. Investors face high uncertainty regarding light at the end of the Covid-19 tunnel. Yet with each passing day, we are presumably closer to a vaccine. Even if we have a disputed election, which looks less likely today, the results should be decided by year-end, reducing the policy uncertainty. We think that stocks are relatively more attractive than many other options, but the diversification role of even low-yielding bonds remains critical. Berman Capital continues to seek out attractive investment opportunities and unique managers targeting strong risk-adjusted returns.

Please contact your Berman Capital Wealth Advisor with any questions or comments. Have a safe and healthy Fall.

Sincerely,

Berman Capital Advisors

Important Disclosures:

This information is for discussion purposes only and is being furnished on October 12, 2020. This information is not to be re-transmitted in whole or in part without the prior consent of Berman Capital Advisors. While all the information prepared in this presentation is believed to be accurate, Berman Capital Advisors makes no express warranty as to its completeness or accuracy nor can it accept responsibility for errors appearing in the presentation. No information provided herein shall constitute, or be construed as, an offer to sell or a solicitation of an offer to acquire any security, investment product or service, nor shall any such security, product or service be offered or sold in any jurisdiction where such an offer or solicitation is prohibited by law or registration.

Different types of investments involve varying degrees of risk, and there can be no assurance that the future performance of any specific investment, investment strategy, or product will be profitable or be suitable for your portfolio or individual situation. Please contact BCA to discuss your individual situation.

*Berman Capital uses a variety of third-party data services for research and analysis. These include BCA Research, Ned Davis Research, Factset, Morningstar, among others. Berman Capital makes no express warranty regarding the accuracy or completeness of the data from these services.