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Capital Markets Review and Outlook

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Economy and Outlook

A surge in Covid-19 coronavirus infections in October raised anxiety levels globally. The number of infections world-wide is now approaching 50 million with a death toll that has exceeded 1.2 million. In the United States, the corresponding figures are 9.4 million cases and over 230,000 fatalities. The pandemic's economic impact is a tale of two economies – strong demand for goods and weak demand for services. This is reflected in the strong rebound in factories across much of the world in contrast to many consumer-oriented service businesses which remain in a quagmire. The chart on the left shows that the Purchasing Managers Index for U.S. manufacturing rose to 59.3 in October, its sixth consecutive month of expansion. This index, from the Institute for Supply Management, is now at its highest level in almost three years. The rebound in factories is also taking place across several countries in Europe and Asia as demand rises. The Purchasing Managers Index for the Eurozone has now reached a 2 ½ year high. There are concerns, however, that the momentum in the manufacturing sector may fade as countries re-impose mobility restrictions due to rising levels of Covid-19 infections; Europe has already imposed restrictions. The lack of an agreement on the next stimulus measure in the United States is also a headwind. Thus far, developed nations have provided over $8 trillion in fiscal and monetary policy stimulus measures to combat the negative economic drag from the pandemic. As a result, third quarter GDP growth has increased sharply for many countries including the United States. The positive effects from the unprecedented stimulus measures are widespread. Unlike what was seen in past recessions, consumer savings rates and credit scores in the United States have increased in response to expanded unemployment benefits, and the forbearance on debt obligations such as rents. Until the pandemic is brought under effective control, more governmental support measures are needed as the current supportive programs will end soon.

Source: Institute for Supply Management

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Health care experts have been warning that the pandemic is likely to worsen as the winter season starts in the northern hemisphere. The Covid-19 vaccine development program continues to make very good progress, and the likelihood of at least one FDA-approved vaccine by year-end is now high. In the meantime, there has also been progress on the therapeutics front with a reduction in fatality rates from the disease. Effectively controlling Covid-19 is the only solution to the global economic downturn. In this regard, there is light at the end of the dark tunnel we are in. Lastly, as of this writing, there is still no winner in the tightly contested U.S. presidential election as votes continue to be counted in a few key states. However, whether in a matter of days or weeks, a winner will be declared which will remove the present state of uncertainty. This will enable the government to refocus its efforts on the next stimulus measures to provide the many businesses, local and state governments, and millions of affected people with much-needed assistance as we await a medical solution to the pandemic.

Equity Markets

For the second consecutive month, equity markets lost ground as investors worried that a renewed economic downturn would follow the resurgence in Covid-19 infections, and the absence of the next phase of the government stimulus program in the United States. The broad domestic equity market represented by the Russell 3000 Index declined -2.2% in October trimming its year-to-date return to +3.1%. Through 10/31/20, the 1-year, 3-year, 5-year and 10-year annualized returns are between +10.2% and +12.8%. For the second month in a row, Mid Cap (+0.6%) and Small Cap (+2.1%) capitalizations both outperformed Large Cap which declined -2.4% in October. However, year-to-date, Large Cap continues to maintain a sizeable lead over the other two capitalizations. From a performance by Style perspective, Value outperformed Growth across all capitalizations in October, most notably in Small Cap and Large Cap with outperformances of +282 bp and +209 bp respectively. However, Growth has handily outperformed Value across all capitalizations this year. With the downturn in the equity markets, Defensives outperformed Cyclicals for the second consecutive month. The growth-heavy Technology sector (-5.1%) was the worst performer for the month, while Utilities (+5%) led all eleven S&P sectors. Energy (-4.4%) continued to lose ground with the weakness in oil prices. For the year, this sector has now lost half its value. Financials held up better with a decline of -0.8% as interest rates rose and the Treasury curve steepened in October. International equity markets had mixed performance for the month. The Developed Markets Index, MSCI EAFE, declined -4%. The reimposition of restrictions in Europe following renewed spikes in Covid-19 infections weighed on the equity markets across the region with declines of -5% to -10% for the month. Japan held up better with a loss of -1.6% helped by the +0.9% strengthening in the Japanese yen versus the U.S. dollar. Emerging markets outperformed developed markets, including the U.S. The MSCI Emerging Markets Index gained +2.1% in October helped by the strong performance in China which rose +5.3%. Equity markets in Korea and Taiwan also posted positive returns. The divergence between developed and emerging markets has led to a sharp contrast in performance this year with the MSCI EAFE index down -10.8%, while the Emerging Markets Index is up +0.1%.

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Fixed Income Markets

Despite the decline in equity markets, there was no flight-to-quality to U.S. Treasuries which, instead, rose sharply in yield as investors began discounting the effects of an additional stimulus package early next year. Although 2-year Treasury yields rose only +1 bp to 0.14%, 5-year yields were up +10 bp to 0.38%, while 10-year and 30-year Treasury yields increased significantly by +19 bp to 0.88% and 1.65% respectively. The Treasury yield curve steepened sharply with the 2-year/30-year yield spread widening by +18 bp to +151 bp. Since the beginning of the year, this spread has almost doubled. In contrast to the equity markets, the corporate bond market performed well with investment grade corporate bond spreads narrowing by 10 bp leading to an outperformance of +90 bp over duration-matched Treasuries. Although net issuance of investment grade debt for the month was -3 billion (because of redemptions), net issuance for the first ten months of the year is over $1 trillion - a record, as companies took advantage of record-low Treasury yields. In contrast, net issuance for the entire year 2019 was $356 billion. The corporate quality curve and credit curve both flattened for the month as BBB-rated bonds outperformed Single-A rated Issues by +34 bp, while long maturity bonds outperformed short and Intermediate Issues by an average of +95 bp. By excess return, Utilities (+115 bp) and Finance (+101) were the best performing major sectors, while Energy (+59 bp) lagged. For the month, the Investment Grade index posted a total return of -0.2% as the rise in Treasury yields offset the tightening in corporate bond spreads. Year-to-date, the index had a return of +6.1%. The High Yield sector performed better than the Investment Grade sector in October. Although the average high yield spread tightened by 8 bp, the higher coupon provided an added performance boost. The best performing sectors for the month include Banking (+1.5%) and Automotive (+1.6%), while the laggards include Leisure (-1.3%) and Oil Field Services (-1.3%). The High Yield sector had a total return of +0.5% in October and +1.1% year-to-date. International government bond markets outperformed the U.S. in October. In contrast to the sharp rise in U.S. Treasury yields, government bond yields declined in the Eurozone with 10-year German bund yields falling by 10 bp. Yields in the United Kingdom increased fractionally, while Japanese government bond yields were little changed. Unlike in the United States, there was a flight-to-quality in Europe on concerns that government-mandated restrictions on commerce due to rising coronavirus cases would lead to further economic downturns. In the currency markets, the U.S. dollar declined against the Japanese yen by -0.9% although it rose +0.5% versus the euro. For the month, the FTSE non-US World Government Bond Index (WGBI) rose +0.3% compared to the -0.9% decline for the U.S. government bond market. However, year-to-date, the ex-US WGBI's return of +5.9% lags the +7.8% return for the U.S. government bond index.

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			Returns as of 10/31/20 (In %)			
		Month	YTD	1 Year	3 Years	5 Years
Russell 3000®	US AllCap Equity	-2.2	3.1	10.1	10.0	11.5
Russell 1000®	US Large Cap Equity	-2.4	3.8	10.9	10.6	11.8
Russell 1000® Growth	US Large Cap Growth	-3.4	20.1	29.2	18.8	17.3
Russell 1000® Value	US Large Cap Value	-1.3	-12.7	-7.6	1.9	5.8
Russell Midcap®	US Mid Cap Equity	0.6	-1.7	4.1	6.8	9.0
Russell Midcap® Growth	US Mid Cap Growth	0.1	14.1	21.1	15.2	14.2
Russell Midcap® Value	US Mid Cap Value	0.9	-12.0	-6.9	0.9	5.3
Russell 2000®	US Small Cap Equity	2.1	-6.8	-0.1	2.2	7.3
Russell 2000® Growth	US Small Cap Growth	0.8	4.7	13.4	7.9	10.4
Russell 2000® Value	US Small Cap Value	3.6	-18.7	-13.9	-4.1	3.7
MSCI ACWI ex-US	Global Equity ex-US	-2.1	-7.5	-2.6	-0.2	4.3
MSCI EAFE	Global Developed Mkts Equity	-4.0	-10.8	-6.9	-1.2	2.8
MSCI EM	Emerging Mkts Equity	2.1	0.9	8.3	1.9	7.9
Bloomberg/Barclays US Agg	US Core Fixed Income	-0.4	6.3	6.2	5.1	4.1
Bloomberg/Barclays US Interm. Agg	US Intermediate Fixed Income	-0.2	5.0	5.1	4.1	3.2
Bloomberg/Barclays US Credit	US Corporate Bonds	-0.2	6.2	6.7	6.0	5.6
Bloomberg/Barclays US MBS	US Mortgage Backed Securities	0.0	3.6	3.9	3.7	3.0
Bloomberg/Barclays US Corp HY	US High Yield	0.5	1.1	3.5	4.2	6.3
FTSE Non-US WGBI	Global Fixed Income ex-US	0.3	5.9	5.0	3.9	3.9