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MARKET PERSPECTIVE *from the Investment Advisory Group*

Tug of War Ongoing but Positive Intermediate Outlook Intact

What Happened?

Markets opened the final week of October on the negative side. Global markets are under pressure on the back of rising US COVID-19 cases and renewed lockdowns across parts of Europe, election uncertainty, and stimulus negotiations that appear to have hit a stalemate.

Our Take

Heading into the election, we have expected that volatility would pick up, which it has done in October during every election year since 1992. We also anticipated that the market would trade in a sloppy fashion. The acceleration of COVID-19 cases adds another layer of near-term angst. However, taking a step back, the big picture is that after rising at a record pace of 60% from the March low, the market has been entrenched in a trading range since peaking in early September.

Indeed, the market is caught up in a tug of war. Upside has been capped by election uncertainty, COVID-19 concerns, the uneven economic recovery and the stalemate on stimulus. Conversely, supporting the bottom of the range is ongoing monetary stimulus, supportive equity valuations compared to bonds and cash, rising profit trends, progress toward COVID-19 vaccines and therapeutics as well as the high probability of stimulus, even if delayed.

Data Source: SunTrust IAG, FactSet

This tug of war is likely to continue near term. However, our intermediate-term thesis remains intact. That is, our work suggests we are likely in the early stages of a multi-year economic expansion and bull market. From the outset, we have thought the economic recovery would be uneven, with fits and starts, but ultimately having a positive trajectory. Additional stimulus would be helpful but a potential delay is not fatal for the recovery. Probabilities still suggest that stimulus is forthcoming—it is more a matter of when, not if in our view–and worsening virus numbers could put pressure on politicians to act. While COVID-19 trends could also weigh on growth, the market will continue to key off of mortality rates, which still remain relatively low (although any level is a negative). Moreover, data on the effectiveness of vaccines in the coming weeks and months should help cushion the market downside.

Importantly, as stocks have traded sideways, earnings have continued to rise. In fact, forward S&P 500 earnings estimates have been increasing at the sharpest rate since coming out of the financial crisis. That is likely to slow somewhat given the COVID-19 uncertainty, but we entered this period with momentum. With just over a quarter of companies reporting, the percentage of S&P 500 companies exceeding both earnings and sales estimates is above 80%, near record levels.

We also do not want to lose sight of the bigger picture. We advise investors to focus less on the next 10% up or down and more on the next 50% to 60%, which the weight of the evidence in our work suggests is higher. Indeed, the average bull market has lasted more than five years and gained well over 100% versus the current bull market duration of about six months and a 60% rise.

S&P 500 Bull Markets (Price Return & Duration)

Begin	End	Years	Price Change %
Oct-57	Dec-61	4.1	86%
Jun-62	Feb-66	3.6	80%
Oct-66	Nov-68	2.1	48%
May-70	Jan-73	2.6	74%
Oct-74	Nov-80	6.2	126%
Aug-82	Aug-87	5.0	229%
Dec-87	Mar-00	12.3	582%
Oct-02	Oct-07	5.0	101%
Mar-09	Feb-20	11.0	401%
Mar-20	Sep-20*	0.4	60%
Average		5.8	179%
Median		5.0	101%

Data Source: SunTrust IAG, FactSet
*Based on September 2nd peak. Past performance does not guarantee future results

Bottom Line & Positioning

The carousel of concerns continues to turn, and markets are likely to remain choppy near term. However, we continue to favor stocks relative to cash and bonds on a 12-month basis. In our notes over the past month, we advised investors who were underweight equities to use pullbacks, such as the one underway, to average into the market—we still view that as a prudent approach.

Within equities, we are maintaining a US bias. Although there has been better price action recently, it still appears premature to endorse a value tilt given the uneven economic trends. From a sector level, we maintain our barbell approach. Currently we see consumer discretionary and technology as having the best growth prospects, which should help during some of the economic unevenness, and materials and industrials as having the best opportunity for recovery as the economy rebounds; the latter of the two would also do well if we did get more stimulus.

Although, we advise an underweight position in fixed income, high quality bonds should provide portfolio ballast, and we continue to see relative value in credit. We also still see the diversifying benefits of holding a modest position in gold as a partial hedge against COVID-19 and election uncertainty as well as US dollar weakness and growing debt.

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