Investment Review & Outlook

October 2020

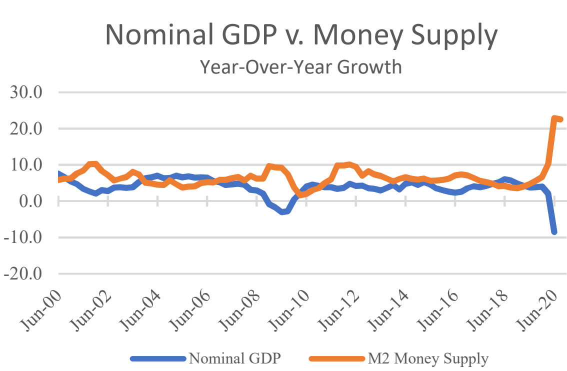
Review

The S&P 500 managed to achieve a new all-time high in early September, continuing its "V-shaped" recovery from pandemic lows. However, the US market rebound since early September has been less robust. Similarly, other developed markets (STOXX Euro 600, Nikkei) performances have flattened in recent weeks.

While many economic indicators point to a loss of momentum recently, the rebound in third quarter US GDP was stronger than anticipated. Consumer spending, business spending, residential construction all contributed to the third quarter advance.

Job growth has been strong, but there has been a clear deceleration in the rate of improvement. The decline in the labor force participation rate is one source of concern. Unemployment claims remain elevated relative to pre-COVID levels. We suspect that it will take a long time for the labor market to fully recover from the virus-related shock.

Massive monetary as well as fiscal stimulus were the cause of the third quarter rebound from the pandemic lows of the second quarter. The Federal Reserve, along with the rest of the globe's central banks, continue to flood markets with liquidity.



Large budget deficits and accommodative monetary policy are the appropriate response to the economic dislocations resulting from the pandemic. Over the near term, the virus is a disinflationary shock given spare industrial capacity and high unemployment. But over the longer term, it may contribute to rising inflationary pressures as higher government spending and deglobalization come into play. Under normal conditions, rapid money supply growth would lead to higher levels of inflation, with a 2 to 3-year lag. But current conditions are far from normal.

Global Markets

All sectors within the S&P achieved positive returns in the third quarter, with the notable exception of the energy sector. Energy now has a mere 2% weight within the S&P 500. In contrast, Information Technology has a 28% weight. The Consumer Discretionary sector led by home building and household appliances was the strongest sector. The Industrial Sector took second place led by the air freight and logistics industry.

Fixed income markets around the globe have been extraordinarily quiet in recent months as central bank policy has kept markets in check amid a steadily progressing economic reopening and recovery.

The US Dollar, as measured by a basket of major world currencies, fell sharply in June and July and has moved sideways since the end of July.

Equity Market Performance
To 30-Sep-2020, in US Dollars

	3rd Quarter 2020	12 Months 9/30/2020
MSCI World Index	7.9%	10.4%
EMU	4.6%	-0.8%
France	2.8%	-6.2%
Germany	8.3%	10.0%
Switzerland	5.1%	11.0%
United Kingdom	-0.2%	-15.8%
Japan	6.9%	6.9%
Pacific, ex Japan	2.0%	-6.1%
EAFE	4.8%	0.5%
USA	9.5%	16.4%
Emerging Markets	9.6%	10.5%

Source: Morgan Stanley Capital International,
Total return, dividends less withholding tax reinvested

Data sources: Standardandpoors.com, Bloomberg, MSCI.com *Continued on page 2*

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Outlook

The world's developed economies continue to report relatively strong numbers. However, we expect the coming months to give way to an extended period of significantly slower growth. The third quarter's strong growth will result in more anemic growth in future quarters. We anticipate that most developed economies will regain their late 2019 high-water marks by mid-2022 and their previous trajectories sometime in 2023. This assumes we have a globally available, efficacious COVID vaccine in the first-half of 2021.

Consensus global GDP growth estimates call for an increase of 5.2% in 2021. The U.S. is forecast to generate growth of 3.7%, while the Eurozone's number is 5.5% and China's is 8%.

Real GDP

% over previous period, SAAR

	FY 2019	1Q:20	2Q:20	3Q:20	4Q20	FY 2020
United States	2.2	-5.0	-31.4	33.0	2.5	-3.6
Canada	1.7	-8.2	-38.7	44.5	5.5	-5.6
Japan	0.7	-2.3	-28.1	11.0	13.0	-5.7
China	6.1	-35.8	56.5	10.4	8.2	2.3
Euro Area	1.3	-14.1	-39.4	56.0	3.5	-6.8
United Kingdom	1.3	-9.7	-58.7	94.3	18.5	-8.7

Source: JP Morgan Chase Bank NA, Economic Research, Global Data Watch, October 2, 2020

The Federal Reserve is committed to a multi-year program of accommodative monetary policy and greater flexibility in the calculation of acceptable limits on inflation. Congress is expected to authorize an additional trillion-plus dollars in coronavirus aid by the election or shortly thereafter.

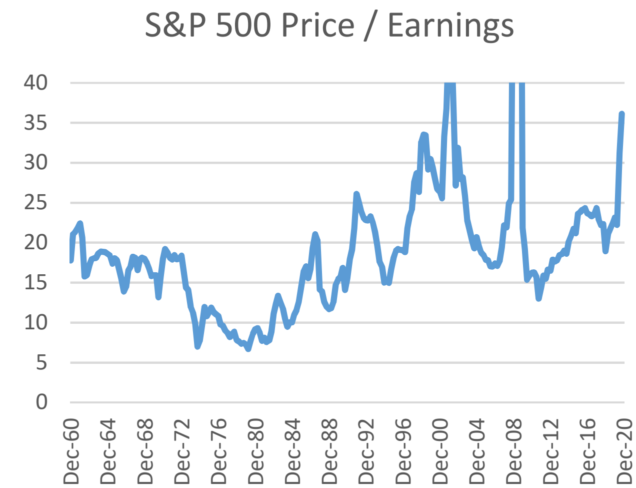
Standard & Poor's 500

	Annual Earnings	%Change Y-o-Y	Price/ Earnings	Year-end Price
Dec-13	100.20	15.8%	18.5	1848.36
Dec-14	102.31	2.1%	20.1	2058.90
Dec-15	86.53	-15.4%	23.6	2043.94
Dec-16	94.55	9.3%	23.7	2238.83
Dec-17	109.88	16.2%	24.3	2673.61
Dec-18	132.39	20.5%	18.9	2506.85
Dec-19	139.47	5.3%	23.2	3230.78
Dec-20e	87.33	-37.4%	39.5	3450
Dec-21e	142.59	63.3%	25.6	3650

Source: Standardandpoors.com September 30, 2020, SlateStone Wealth

While increasing government debt loads of individual countries in isolation would typically weaken their currency, the picture is less clear when everyone is doing it. We would look to relative trends in fiscal deficits to drive currency moves. If a country starts to meaningfully address its deficit, it would likely be rewarded with an appreciating currency, lower inflation and reduced international competitiveness. If any country can get away with large deficits for longer, it is probably the US due to its reserve currency status. Currently, 62% of global foreign exchange reserves are held in US Dollars. The next largest competitor is the Euro accounting for 20% of global reserves. Given the liquidity of the US bond market, we do not expect the US Dollar to surrender its reserve currency status in the foreseeable future.

The high and rising market Price / Earnings ratio is supported by historically low levels of interest rates and will drop as earnings rise next year.



Source: Standardandpoors.com, Sep 30 2020, reported earnings

While bouncing up and down over the balance of the current year, our best guess is that we close 2020 around current levels.

We remain positive in our outlook for the health care sector, despite its recent relative under performance, as a function of ageing demographics on a global scale. Although a democratic sweep of Congress increases the political threat, it is offset to some degree by the power of the "big pharma" lobby. In the Financial sector, we remain concerned about the threat to bank dividends in the name of capital conservation.

On the fixed-income side, our conservative approach to bond investments in the context of credit quality remains in place. The yield curve has begun to "steepen" from very low levels, a process we suspect will continue for an extended period. We do not expect to make any "real" money in bonds but will endeavor not to lose any.

Jupiter, FL

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(800) 773 9282