Bernard Wealth Management

600 South Adams Road, Suite 100
Birmingham, MI 48009
(248) 556-2900
www.bernard-wealth.com

Third Quarter 2020 Newsletter

Fig. 1 – S&P 500

Fig. 2 – U.S. 10-Year Treasury Yield

Stocks continued to rise in the third quarter of 2020, but gave back some gains in September. The large cap S&P 500 index (**Figure 1**) posted a total return of +8.9%, and is now +5.6% year to date. Small and mid cap US stocks also rose but trailed the S&P 500. The S&P Mid Cap 400 index finished +4.8%, and the Russell 2000 Small Cap index rose 4.9%. Growth stocks continued to lead the market higher, particularly in the technology sector. Traditional value stocks, including energy and financials, have struggled with the uneven economic recovery.

International indexes also logged solid gains. MSCI's Emerging Markets index rose 9.6%, while the Europe, Australia and Far East index rose 4.8%. Emerging market economies, including China, South Korea and Taiwan, have benefited from relatively successful handling of the COVID-19 pandemic.

Earnings estimates for U.S. stocks dropped precipitously with the beginning of the pandemic but have begun to crawl higher. According to Zacks Research, second quarter S&P 500 earnings fell 32.4%, and are expected to decline 22.8% in the third quarter. Transportation (airlines) and Energy are expected to fall more than 100% from the same quarter in 2019. At this point, only the Construction and medical sectors are expected so show earnings growth. For the full year, earnings are expected to be down 20.6% with revenue down 4.7%. Earnings expectations have improved gradually since June, albeit from very low levels, and this has helped sustain the stock rally. Early earnings reports this quarter from large companies, including Fedex, Nike and Oracle, have been stronger than expected and positively received. However, the bar has been raised significantly, with 2021 earnings expected to rise 25.1% over 2020's depressed numbers.

The economy continued to post mixed results in the past quarter, and some of the news was truly bleak. Looking back, 2nd quarter gross domestic product (GDP) declined at an annual rate of 31.4%, an all-time record drop. However, economic activity in many sectors rebounded strongly, and 3rd quarter GDP is currently expected to increase 31.8%. Construction, especially residential home building, has been one of the leaders. Purchasing manager surveys in both manufacturing and services forecast growth as well. Consumer spending has perhaps been the biggest surprise, with the retail sector showing steady month over month improvement. However, traditional bricks and mortar businesses continued to struggle, while online spending grew rapidly.

The jobs situation continued to mar the current economic picture, and that is likely to continue in the near term. The unemployment rate declined to 7.9% in September, after peaking at 14.7% in April. However, the participation rate, which tracks the proportion of the population employed or actively seeking work, has stalled at 61.4%, a material

Index returns taken from Morningstar.com

decline from 63.4% in February. Weekly initial claims for unemployment benefits have remained stubbornly high at more than 800,000 for the entire month of September. Employment generally lags economic recoveries, as businesses are reluctant to hire back workers as their sales and profits improve. Unemployment will likely remain high in the most pandemic-sensitive sectors, including airlines and hospitality, and lower income workers may continue to suffer the largest job losses.

Actions taken by the Federal Reserve, together with stimulus passed by Congress, helped stabilize the U.S. financial system and economy, paving the way for the current recovery. During the quarter, the Federal Reserve assured investors that they are in no hurry to raise interest rates. Low rates (**Figure 2**) should continue to boost home building and help other areas of the economy access credit. The Fed additionally announced that they would allow inflation to rise above their 2% target, possibly for extended periods of time. Unfortunately, with interest rates close to zero, further monetary policy actions will probably have limited impact. Negotiations between Democrats and Republicans for a second round of fiscal stimulus have stalled, dimming prospects for an additional economic boost, at least before the November election.

In the first two months of the quarter, investors poured money into stocks and sectors that had been leading, including technology (**Figure 3**) and the top-heavy S&P 500. Sentiment changed at the beginning of September, as stimulus hopes faded, and investors started to focus on elevated stock valuations. In the past month, those market leaders have suffered the largest declines, while small caps and foreign stocks have held up somewhat better. As the recovery continues, investors may have to look beyond the mega-caps. A well-diversified portfolio that includes multiple sectors and capitalizations may help in achieving solid returns.

We wrote recently about the potential for emerging market stocks (**Figure 4**), as some Asian countries have had relative success dealing with the pandemic. The emerging market indices were traditionally filled with bloated banks and legacy state-run enterprises, which hindered performance. Today the top companies in these markets include Alibaba and Tencent, the giant Chinese platform companies, as well as Taiwan Semiconductor, the world's largest chip maker. These companies still trade at a discount to their U.S. counterparts, adding to their potential.

Fig. 3 – Technology Select Sector Fund

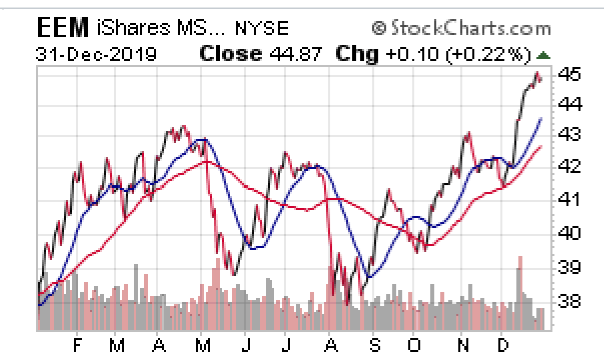

Fig. 4 – iShares MSCI Emerging Markets

It's often said that stock markets climb a wall of worry, and 2020 has brought investors a decade's worth of worries to ponder. In addition to the pandemic, many are now concerned about the upcoming presidential election, wondering if they should sell stocks in advance. We caution against trying to predict or time the market's reaction to the election. Most election-related selloffs have been temporary, and ultimately, buying opportunities.

We encourage you to call us anytime with your questions and concerns.

Best regards,

Kenneth M. Bernard

Kenneth M. Bernard, CFA