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Market updates

Investment team updates | 4 September 2020

US equities

Markets

- The US market had another positive week (S&P 500 +3.3%) to round off August. For the month as a whole it was the fifth consecutive monthly gain (S&P 500 +7%) as the index hit all-time highs and gained in all but five trading days during the month. This was the best August for the S&P 500 since 1984, having now moved 36% higher since April and 55% from the depths of the bear market in March. The Nasdaq also gained, up 3.4% for the last week of August and 9.6% for the month – its best August since 2000.
- The sectors which contributed most to the positive performance were communication services, with the likes of Facebook and Netflix outperforming, and tech with particular strength in the cloud software names. The steepening yield curve following the Federal Reserve's policy shift had a positive effect on financials too. The utilities sector was the only one in the red last week, as defensive sectors lagged the market rally. Healthcare also underperformed with weakness in big pharma and biotech.
- Growth outperformed value and cyclicals, however some value names still performed well following positive headlines on vaccine developments and increased testing.
- Against this picture of strength, the last week of August saw a pullback in many of the year-to-date winners as investors took profits, particularly in the big tech names which have propelled the rally. The Vix index of volatility remains quite elevated at around 30, above the range of 10-20 before the pandemic signalling that there is still some nervousness in equity markets, possibly exacerbated by November's election and President Trump's rhetoric concerning a contested result.

Economy

- The Fed's shift in its policy framework was a notable development last week as it announced that it would allow inflation to run over the 2% target to make up for prior inflation shortfalls. There was also a focus on the labour market, which would allow for employment to run higher than previously tolerated too.
- Although no deal has yet been reached on a fifth coronavirus relief bill, there is still a fair degree of optimism that a bipartisan agreement will be reached by the end of September. While the two sides agree over some aspects, there is still a wide disparity in views over enhanced unemployment benefits, government aid and the overall size of the package.

Earnings

- With earnings season mostly behind us it was a fairly quiet week aside from some July quarter reporters in tech and retail names. The tech names in particular displayed strength in earnings with increased adoption and migration to the cloud, ecommerce sales and home PC/laptop sales.
- The bottom-up EPS prediction produced by Factset[1] currently places 2021 S&P 500 EPS at $166, compared with the $163 from 2019 which adds weight to the narrative that earnings will have recovered back to 2019 levels by the end of next year. To achieve this, S&P 500 earnings are expected to increase 26% next year, again according to Factset.

Election

- Although Trump has slightly narrowed the gap in the polls, Democrat candidate Joe Biden remains the frontrunner for the Presidential election. However, the likelihood of a contested election has risen in recent days, especially if the result ends up being close. This could lead to a protracted journey through the courts and delay the final result, as was the case in Bush versus Gore in 2000. The increased prevalence of postal voting this election, largely due to concerns about voting in person, has already been flagged by Trump as a potential issue in case some votes do not arrive or are not counted in time.

Multi-asset

- Our asset allocation group downgraded investment grade (IG) credit to “favour” last week from “strongly favour”, bringing it in line with high yield credit.
- Although technicals remain supportive, with IG the most direct beneficiary of central bank and government support, spreads have rallied meaningfully since their March wides, meaning valuations are slightly rich against long-run averages.
- More broadly, despite our relatively cautious macro view we remain exposed to both equity and credit risk. Lower effective discount rates are a powerful support as economies recover and the Fed’s new policy framework may further entrench these dovish trends.
- Meanwhile, earnings expectations bottomed in mid-May, and in our preferred areas to take equity risk – the US and emerging Asia – they have recovered smartly.

Fixed income

Markets

- It was a good August for equities with the Nasdaq up around 10% and the S&P up around 7%, and this week (ending 4 September) saw the latter reach a new all-time high, led by tech.
- Credit spreads moved a little each way this week, ending it a touch wider. For August, though, European High Yield finished the month at 459bps (compared with 509bps at the end of July); Global IG was at 132 (compared with 139 at the end of July), and EM was at 382 (compared with 408 at the end of July).
- Core government bond yields were higher over August, with the US 10 year at 0.71%, compared with 0.53% for July.
- The VIX volatility index was up by 7 points on 3 September.
- This week (ending 4 September) saw the US dollar stabilising due to stronger US data, while gold and silver lost their appeal a little.

[1] Factset Earnings Insight, 28 August 2020

News

- In Spain, banks Bankia and Caixa are reportedly in talks to merge. This would create a 25% market share.
- 3 September saw US Jobless Claims fall to a post-pandemic low of around 880,000. The US Federal Reserve is still calling for more fiscal support for the economy.
- UK cases of Covid-19 are at their highest since early July, and they are also spiking in Spain, though fatalities are not following suit. Russia now has more than 1 million cases, joining Brazil, the US and India in this unwanted milestone.
- On 3 September the Bank of England said it has plenty of scope for further QE if required. UK house prices, meanwhile, posted a strong one-month gain for August.
- Australia has fallen into technical recession for the first time in 30 years.
- On 2 September the euro area went into deflation (-0.2% year-on-year) while the core measure reached 0.4% year-on-year, the lowest on record.
- Corporate new issuance is picking up after the Summer lull. Daimler issued a "green" bond with a premium of around 10bps compared to non-green debt.
- The China Caixin Manufacturing Index hit 53.1 this week (ending 4 September), the highest since 2011
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Note: all data as at 4 September 2020, unless otherwise specified. Source: Bloomberg.