RDM CAPITAL ASSOCIATES
WEALTH MANAGEMENT

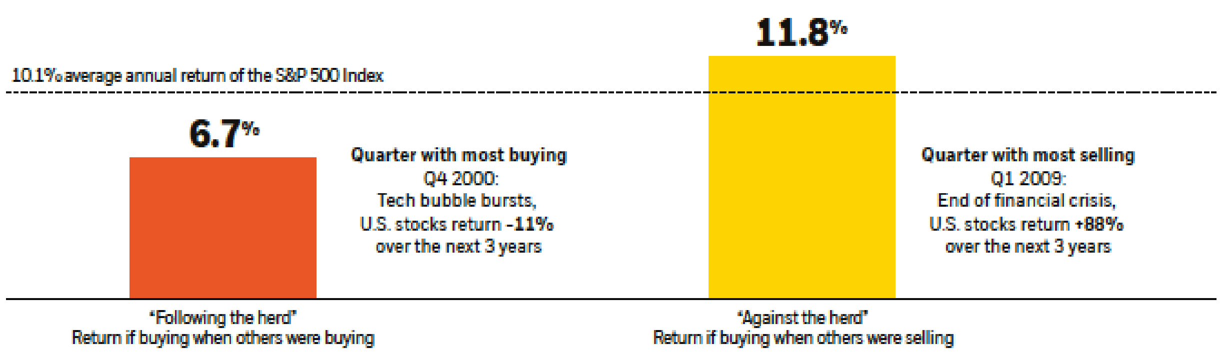
Second Quarter 2020 Market Commentary
July 2020

Covid-19 Developments and Looming Election

The second quarter 2020 was positive for equity markets as the S&P 500 recovered much of the ground lost during February and March due to the emergence of Covid-19 and the subsequent national shutdown, rising 20% and logging the best quarterly return since 1998. Stocks are up approximately 40% since the pandemic low on March 23rd. Much of the market stabilization in the quarter was due to progress with the re-opening of the economy in most states and a stabilization in the death rate from Covid-19, despite spikes in reported cases in some states, which the markets have interpreted to mean that another large-scale national shutdown is less likely. Markets are pricing in a continued economic recovery over the next ~ six months, as several economic indicators have surprised to the upside, including recent employment data showing a quicker return to work than expected for many temporarily unemployed Americans.

The example of the second quarter rebound illustrates the importance of keeping emotions out of investing during times of great market volatility or weakness and staying the course with an investment plan:

The average investor gets the timing wrong
3-year returns based on direction of quarterly stock flows over the last 25 years (1995-2019)



Source: Morningstar as of 12/31/19. "Following the Herd" represents the average of the following 3-year returns of the S&P 500 Index for each of the largest 20 quarters of inflows for US equity mutual funds and ETFs, as defined by Morningstar. "Against the Herd" represents the average of the following 3-year returns of the S&P 500 Index for each of the largest 20 quarters of outflows for US Equity mutual funds and ETFs, as defined by Morningstar. Past performance does not guarantee or indicate future results. Index performance is shown for illustrative purposes only. You cannot invest directly in an index.

Despite this renewed sense of investor confidence after the second quarter market recovery, it is no time to dismiss the continuing risk to markets from Covid-19. As we foreshadowed in our recent mid-quarter updates, we expect market returns to remain volatile and react to fluctuations in the virus over time and the related economic implications. As infections rise, particularly those severe infections that lead to hospitalizations or death, we expect markets to weaken due to the proportionately increasing likelihood that state and local governments will need to shut down their economies. On the other hand, as progress is made in constraining the virus, we expect markets to react positively in expectation of an eventual return to economic normalcy. To illustrate, the late quarter sell-off seen in late June was largely attributable to a rise in cases across several southern and western states, like Texas and Arizona, and suspension or rollback of economic re-openings there. However, we do not expect a large-scale national shutdown to occur again barring the most dire circumstances. The economic damage that would occur from a second national shutdown would be too severe and the hospital system appears to be far better equipped to manage the virus than earlier this year.

Looking ahead to the third quarter, we expect the investment world to focus on the following major themes in the marketplace:

1. Covid-19 Re-openings and Forward Economic Guidance from Government and Business

We expect that economic re-openings across the U.S. and internationally will continue to move forward in fits and starts. There is no magic bullet that is going to arrive in the near term to eradicate the coronavirus. Keep in mind that even generally effective vaccines are not universally effective, are not effective indefinitely, and not everyone in the public will choose to become vaccinated. Indeed, polls show that approximately 25% of people may choose not to be vaccinated for covid-19, even if a proven vaccine becomes available. For these reasons, the coronavirus is likely a virus that the public will be co-existing with for some time, even if better therapies and effective vaccines emerge. Unfortunately, it's likely that pockets of coronavirus spread will crop up from time to time until herd immunity is reached, if it's even possible with this particular virus. Investors will obviously monitor the situation closely, given that many are still rightly traumatized from the swift collapse in markets earlier this year. We should expect the market to react to spikes in coronavirus cases quickly to the downside and recover to the upside relatively slower as caution abounds.

Relatedly, economic indicators will provide insight into the economic recovery as data like consumer confidence and service and manufacturing surveys shed light on economic activity. As these indicators improve over time and as government leaders provide guidance that businesses are going to be allowed to re-open over time, we expect markets to respond in expectation of improving trends in employment and GDP. On the other hand, as re-openings stall or are rolled back due to case numbers and economic indicators reflect a chilling in economic activity, investors will respond to the closures negatively in expectation of more permanent business closures and unemployment. Ultimately, the economic recovery will not truly take off until Americans feel comfortable returning to normal social and economic activity. In the meantime, to buy the economy time until this occurs, we expect additional fiscal and monetary stimulus to be implemented later in the quarter after much of the fiscal support for the labor market runs off in July.

Many economists and investors have attempted to predict the pace of the economic recovery – whether it will be "V" shaped, "U" shaped, "W" shaped, etc. Given the extreme caution and fear that continues to persist in the general public, we feel that the recovery will likely not be "V" shaped and more of a gentle slope upward reflecting a slow return to normal economic activity. Additionally, the composition of economic activity will be permanently changed for some industries with an acceleration of remote work, healthcare and social interaction and e-commerce replacing physical retail and entertainment. Different geographical locations at home and abroad will experience different paces of recovery depending on hotspots in coronavirus infections. We expect equities sensitive to an economic re-opening to out-perform in the third quarter, barring a large second wave of infections that cause a national shutdown, as well as technology stocks that benefit from e-commerce.

2. Upcoming Presidential Election

In a typical election year, the upcoming election would dominate investor focus. However, 2020 has been anything but typical. Nonetheless, with only four months to go until the 2020 presidential election, investors will increasingly gauge the likelihood of either Donald Trump or Joe Biden winning the election and the related economic implications that may drive markets. As markets abhor uncertainty, neither candidate presents as much uncertainty as Trump did prior to the 2016 election. This is because Trump is now president and investors have had four years to dissect his economic agenda and impact on markets. Previously, Biden was vice president for eight years and investors better understand his economic philosophy than an unknown or inexperienced challenger. As we've noted in the past, it is important to take much of the market prognosticating with a grain of salt when it comes to the near-term impact of the election. Many predicted that a Trump win in 2016 would sink markets, yet the opposite occurred. Further, the composition of Congress is at least equally as important for policy-making, yet is often underappreciated. Last, campaigning politicians often make promises related to their presidential agendas that do not come to fruition given a president's limited ability to unilaterally control policy.

Two main variables exist that could impact markets. First, tax policy between the two candidates is likely to be a main differentiator. Second, the candidates positions on trade will also significantly diverge. On tax policy, we expect a Biden administration to roll back much of the tax cuts for businesses that were enacted in 2017, which lowered the U.S. corporate tax rate to 21% from 35%. We could see a ~ 28% corporate tax rate under the Biden administration, which after being enacted would be at least a short-term headwind for stocks due to the negative impact on corporate earnings. On the trade front, a Biden win could be a positive for markets as investors generally view tariffs and trade-restrictions as negative for corporate earnings and the Trump administration has aggressively used tariffs as a means to seek more equitable trade deals. Ultimately, the totality of the impact that the election may have on markets is primarily headline-driven and unpredictable in the short-term, as we saw in 2016, and dependent on a number of variables that will take years to play out.

As usual, all comments are welcome and appreciated.