Situation analysis

September 21, 2020

September equity market correction continues

We retain our glass half-full outlook

Key takeaways

- Today's S&P 500 decline continues September's equity market correction, which has centered on Technology, Communication Services and Consumer Discretionary sectors, all of which had been prior pillars of market strength.
- Three major catalyst are driving today's market decline and the broader September correction: Congressional deadlock for a fifth stimulus package, the virus's resurgence during back-to-school season and November's looming national, state and local elections.
- We retain our glass half-full outlook but respect the ongoing market sell-off and the potential for continued volatility given news and events regarding stimulus plans, back-to-school dynamics and the upcoming election news cycle.

After setting an all-time high of 3,581 on September 2, U.S. large-cap equities as measured by the S&P 500 Index have closed lower every week this month. While today's price moves are inclusive of nearly all geographies, economic sectors and company sizes, this month's stock market correction has centered on the areas of the market that previously witnessed strong price gains this summer. Namely, the Technology, Communication Services and Consumer Discretionary sectors, which demonstrated visible and stable cash flows during an otherwise virus-constrained economy, or what we refer to as scarce growth stories. As we have previously written, today's ultra-low interest rate environment increases the present value of these companies' future cash flows. As a result, this summer, investors pushed valuation, or prices relative to anticipated earnings, well above historical averages and in advance of a full economic recovery. During this month's correction, these scarce growth stories have led market declines, with profit taking after August's strong run a likely initial catalyst now amplified by a broader equity market retreat.

Investors continue to face two investment horizons today: A gradual recovery as the economy reopens and the life after recovery, where a clearer forward economic path emerges. Absent a widely available virus vaccine and therapeutic, we continue to see ourselves in this gradual recovery stage. Thus, in the near term, active news flow continues to drive market price volatility. Today's market decline and the broader September correction are driven by news and events relating to three major catalysts: congressional deliberations for a fifth stimulus package, the virus's response to back-to-school season and the associated impact to consumer spending and worker productivity and, as we draw closer to November, national, state and local election results.

 Important disclosures provided on page 3.

Regarding fiscal deliberations, House Democrats and Senate Republicans remain at odds over a fifth stimulus package to extend enhanced unemployment benefits that expired on July 31. The federal government's formal fiscal year begins October 1 and it remains unclear if the two sides can reach an agreement to supplement the limited benefits provided by President Trump's August executive order by that time. The weekend's passing of Supreme Court Justice Ruth Bader Ginsburg and the ensuing debate regarding filling the open Supreme Court seat prior to the election further highlights the challenge in reaching bi-partisan agreement in today's politically charged environment, especially with a national election just six weeks away.

In the absence of a vaccine, the virus's resurgence during back-to-school season has added to investors' concerns. After declining during most of this summer, confirmed COVID-19 cases in the U.S. increased for the first time since late June, surpassing 40,000 average daily cases and the highest level since September 5. The renewed case increase is challenging economic reopening. If it continues, it threatens a potential reversal in some state and community reopening measures while 27 million Americans continue to seek unemployment assistance.

Recent news flow and events and today's price action furthering September's ongoing market correction remind us that we remain in a gradual, even a fragile, economic recovery. While we respect the challenges facing the economy and the elevated market volatility that ongoing news flow and events will bring, we also respect the potential investment opportunities that volatility may present. Since the March lows, we have repeatedly witnessed sharp moves lower in riskier asset classes such as today met by significant market rallies. While we remain vigilant for potentially negative outcomes, we retain a glass half-full perspective and place a slightly higher weight on ongoing Federal Reserve support and optimism for an eventual vaccine breakthrough relative to Congressional deadlock, virus resurgence during back-to-school season and a contentious election just six weeks away. The news cycle has already picked up to a hectic pace and we encourage clients to engage us however we can help. We remain steadfast in our belief that patient investors will be rewarded for the risks they bear and in the challenges in trying to time the market amid the omnipresent wall of investor worries. As always, we will update you with any changes to our views and we humbly thank you for your trust.