Intrinsic Investors

Timely Insights into Markets and the Economy

Investors Quarterly

Christopher P. Shea, CFP®

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Equities

- Investors were encouraged by impressive rally in equities during the most recent quarter. After the gut-wrenching collapse in stocks earlier in the year, people looking for the bottom are starting to ask the question *"Are we there yet?"*

- The answer, of course, depends on to whom you are talking. Research I did back in March makes me *think the market bottomed on March 23, 2020*. I base my reasoning on some financial modeling I did measuring volatility in the S&P 500. Long story short, that model called the bottom on the 23rd. More on this in future reports.

- We are also beginning to see recovery in the manufacturing sector, which moved back into expansion mode in the *June ISM Manufacturing Index report, clocking in at 52.6*. The index is expanding with a reading over 50 and contracting with a reading under 50 (where it spent the last 9 months!) That is helpful. More important, the *ISM Non-Manufacturing Index reported in at an impressive 57.1*, suggesting that the economy is firing on all cylinders again, for now…

- *Weak earnings continue to be the bump in the road to renewed growth.* The earnings recession that started in the third quarter of 2019 presently shows year-over-year trailing earnings down over 21%. Forward earnings do not look any better. We need to see improvement on both fronts to support the current rally mode in the markets.

- The *return of the manufacturing and service sectors to expansion territory* as noted above may prove to be just what the doctor ordered.

Fixed Income

- On the Fixed Income front, returns have been positive this year as investor sought out safe-haven investments like U.S. Treasuries.

- The *Fed returned to an accommodative mode* responding to the economic collapse, which resulted from pandemic driven demise of the longest business cycle in history. A combination of rate-cuts and fiscal stimulus helped stabilize the situation.

- *Jobless data shows slow improvement,* but the actual unemployment rate is still over 10% even after factoring in a great jobs report for June. The massive financial response coming from Washington is similar to the response to the Financial Crisis of 2008, However, unlike that crisis, this one was largely self-inflicted and we are hopeful the economy (and earnings) rebound in the second half of the year.

- According to the National Bureau of Economic Research (NBER), *the U.S. officially entered into recession in February.* Announced in June, this is the fastest the group has ever moved to make such a call. They ignored more traditional economic signals like back-to-back quarters of negative GDP. Of course, the yield curve did invert last summer as we noted on these pages, but as we have pointed out, that can occur for multiple reasons. On a positive note, *the yield has returned to normal*, although at extremely low levels.

- The trick moving forward is to gauge when the recession ends and we return to a new, "New Normal." This is an unconventional year to say the least and it is getting to the point where nothing surprises me anymore. Moreover, it is only half over!

Conclusions

- I have mentioned before that this market feels a little like *1987 where investors got a taste of what a flash-crash feels like*. It is not something you enjoy going through, but the markets recovered by the end of that year.

- The jury is still out on the shape of recovery ("V", "W" "U"). I will settle for any of these, just so it is not an "L!" The return of growth and rising Federal debt will steepen the yield curve because we are *"borrowing from tomorrow to pay for today'*. The only bright spot is that inflation, which we were keeping an eye on should remain somewhat subdued for the time being.

- *Market forecasting is a little like predicting the weather*. If you are right more than half of the time, you are a genius. The same holds true with the markets. What happens in the second half of 2020 is anyone's guess. Fortunately, I am paid to think, not guess. Based on what I can see today, I think we work our way through all of this. Things are still fluid and a bit foggy. *Forecast moving forward is "cloudy, with a chance of sunshine!"* More next time.

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