ASHTON THOMAS
PRIVATE WEALTH

2020 ECONOMIC OUTLOOK

MIDYEAR UPDATE

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CIO REPORT

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2020 has been a volatile year so far in both domestic and international equity markets, and a solid year for high-quality U.S. credit markets, mid-March excepted, when temporary chaos ensued.

We discussed the container ship analogy in our annual outlook earlier this year. Shortly after that, we experienced the "iceberg" event—i.e., the COVID-19 pandemic—which all but brought the world to a standstill and derailed the "steady as she goes" trajectory of developed world economies. We checked in with several third-party strategists who are hopeful for the balance of 2020, but reserve any definitive judgment given the murky forecasting environment in which we find ourselves.

KEY POINTS:

- **US GDP estimates of roughly -6.5%,[1] with risks likely to the downside. Likely not recapturing 2019 levels into 2022.[2]**
- **The 10-year Treasury at or near current levels given Fed support, with a yield of 0.75% +/- 0.25%.[2]**
- **Weak inflationary pressures and, thus, the Fed Funds Rate holding near zero with continued unconventional monetary policy.[3]**
- **Sharp decrease in 2020 US equity EPS of -30%, with the hope of a strong rebound in 2021.[4]**

Kevin M. Churchill, CFA®, CFP®
Chief Investment Officer
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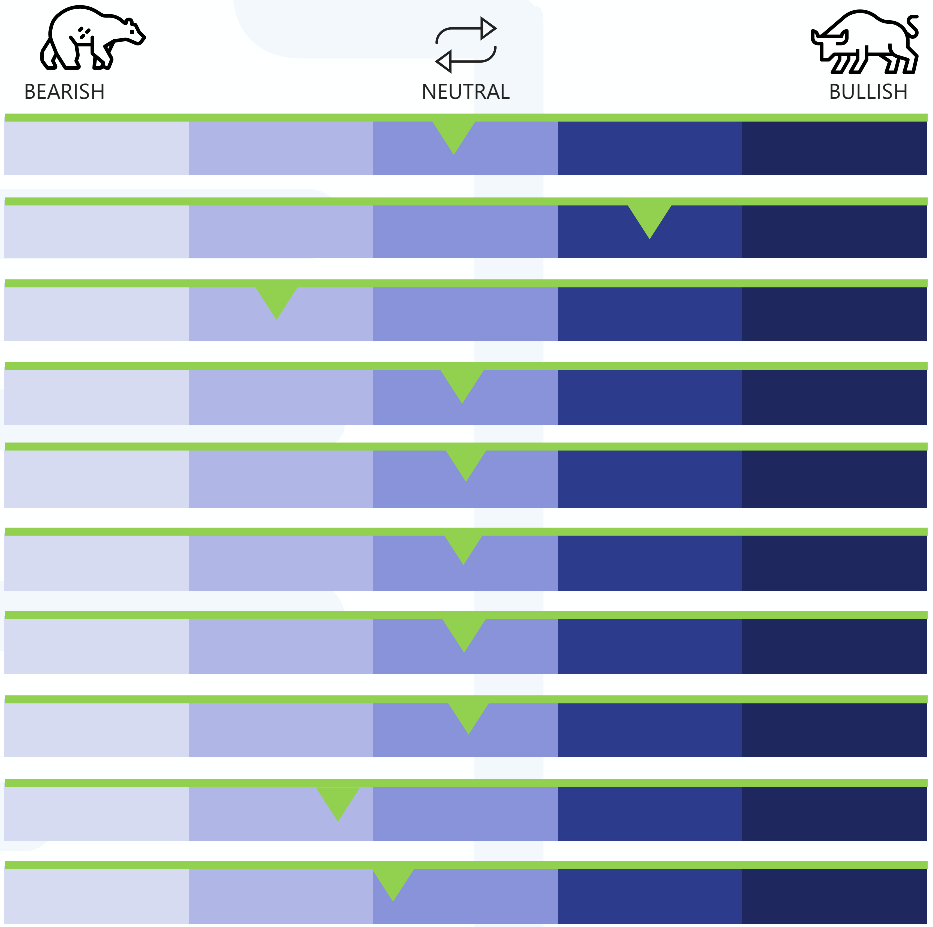
Potential issues for the second half highlighted by the strategists and echoed by us include: a possible "second wave" of COVID-19, the usual elements of risk in any presidential election year, and ongoing geopolitical risk: China, China/India, or North/South Korea, in particular.

The primary concern at present is the duration and depth of the global economic impact of the pandemic. There are some early indications from China that a "second wave" may be on the horizon. China recently closed schools in Beijing and has quarantined several communities[5] and some U.S. states have walked back or slowed reopening measures.[6]

The liquidity influx via the Federal Reserve has equity markets in "full steam ahead" mode, while U.S. Treasury markets appear to be charting a more cautious course. Thus, the equity market rally appears to be more about liquidity than merely hope or wishful thinking.

12-18 MONTH ASSET ALLOCATION OUTLOOK



	VALUATION	TECHNICALS
U.S. Equities	Expensive?	Neutral
U.S. Value	Cheap?	Weak
U.S. Growth	Very Expensive?	Neutral
U.S. Large Cap	Expensive?	Neutral
U.S. Mid Cap	Expensive?	Neutral
U.S. Small Cap	Expensive?	Weak
Int'l Dev Equity	Fair Value?	Weak
Emerging Mkt Equity	Cheap?	Weak
High Quality Fixed Inc	Very Expensive?	Neutral
Low Quality Fixed Inc	Expensive?	Neutral

12-18 MONTH ASSET ALLOCATION OUTLOOK

Summary

We use two factors to drive our Asset Allocation weights: Valuation and Technicals. While we do not want to fight the trend (technicals), we also do not want to disregard valuations. Cheap can get cheaper and expensive can get more expensive. So, while growth has outperformed value for a decade and has been expensive for a few years, it just keeps getting more expensive. Conversely, value just keeps getting cheaper, but has gotten so cheap that a slight overweight seems merited.

Why the Question Marks?

At this point, the "E" in valuation—i.e., earnings—is particularly unknown. For any stable assessment on valuations based, we would have to look to data available prior to the pandemic. Equity valuations are best-guess estimates based on forward-earnings projections. The current level of forward-earnings and economic uncertainty make the guesswork notably murkier and less reliable than usual.

Why So Many Neutral Weightings?

Aside from the 30%+ drop in the S&P 500 in March,[6] some market technicals still look relatively strong. However, ignoring the recent volatility and the current economic uncertainty may not be prudent. It is possible that we could look back six or twelve months from now and view the COVID-19 pandemic as little more than a serious, but brief, blip on the radar. We should know more about the overall direction of the economy in the wake of the pandemic by the end of July.

However, there is more to this story. U.S. equity markets have been showing increasing magnitudes of volatility in recent event-driven selloffs. This trend started in late 2015 into early 2016. That selloff was amplified by the 4Q2018 downturn. Most recently, the 2018 decline was dwarfed by the 2020 pandemic-driven market shock. Much like precursors to a large geological event, the market could be sending progressively louder warning signs that an even sharper or more sustained risk event is on the horizon, liquidity intervention of the Fed notwithstanding. Time will tell. Until more clarity is gained, a neutral stance in many asset classes is likely warranted.

EQUITIES

EQUITIES

M·C·M
Maryland Capital Management

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Principal & Portfolio Manager

STRATEGIST COMMENTARY

Looking Back

- In a "low-to-no" growth environment, in which we now find ourselves, established growth companies should command a premium
- Secular growth stories are still intact
- Certain parts of the economy, especially those that benefit from the work-from-home/stay-at-home pandemic economy, have accelerated (think SaaS)

Looking Forward

- Many indicators and economic data that are coming in lead them to believe 1Q and 2Q 2020 will be a short-term EPS "hiccup"
- Cautiously optimistic for the second half of 2020
- Continue to avoid sectors that have been negatively impacted: hospitality, restaurants, casinos, etc.
- Remain focused on sectors which continue to be "firing on all cylinders" and/or look to potentially benefit from changes which are occurring: consumer discretionary, healthcare, information technology

EQUITIES

NDR
NED DAVIS RESEARCH

Time Hayes, CMT®
Chief Global Investment Strategist

Joe Kalish
Chief Global Macro Strategist

Ed Clissold, CFA ®
Chief U.S. Strategist

STRATEGIST COMMENTARY

Looking Back

- Still very unclear if the March 23rd lows will stand as the low point of this bear market
- This has been the longest stretch of growth stocks outperforming value, yet the most tepid in history on an annualized basis

Looking Forward

- Environment appears to be suitable for growth to continue its outperformance of value
- Monitoring a wide range of possible paths forward due to the unprecedented amount of uncertainty that remains
- Although the pending election has taken a backseat amidst the COVID-19 pandemic, expect those headlines to become front-and-center again soon

FIXED INCOME

FIXED INCOME

K. Sean Clark, CFA®
EVP, Chief Investment Officer

STRATEGIST COMMENTARY

Looking Back

- 2020 has been a cyclical bear market, much like 1987; we are still in a secular bull market overall

Looking Forward

- They are not concerned about inflation picking back up when the velocity of money picks back up, despite the unprecedented infusion of additional money supply
- Feel that the year-end target of S&P 500 at 3,500 is still intact, despite earnings not likely to reach 2019 levels until 2022
- Comfortable that the Fed is on the right path, as credit spreads have tightened significantly following Fed debt purchases

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Chief Executive Officer
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STRATEGIST COMMENTARY

Looking Back

- In the past few months, investors have been focusing on the positive news, the declining growth of the COVID-19 pandemic in Europe and the U.S., and the gradual reopening of their economies
- In addition, bond markets have been buoyed by the Fed's sharp response to the crisis: the central bank committed to unlimited government bond purchases and to buying investment-grade corporate bonds and high-yield bonds (including through ETFs)
- The Fed action contributed to a sharp decline in investment-grade and high-yield spreads, keeping Treasury yields low despite the massive fiscal stimulus being provided

Looking Forward

- High-yield spread over treasuries are still much higher (6%) than before the COVID-19 pandemic (3.5%)
- The stimulus is taking a toll on the dollar which fuels a recovery of emerging markets bonds
- Interest rates are widely expected to stay near zero through 2022
- Believe these trends and Fed policy will continue pushing "risk-on" bond assets further, rallying in the second half of 2020
- The latent risk of a second wave of COVID-19 is on everyone's mind and could easily trigger another flight-to-safety if it materializes

CHARTS

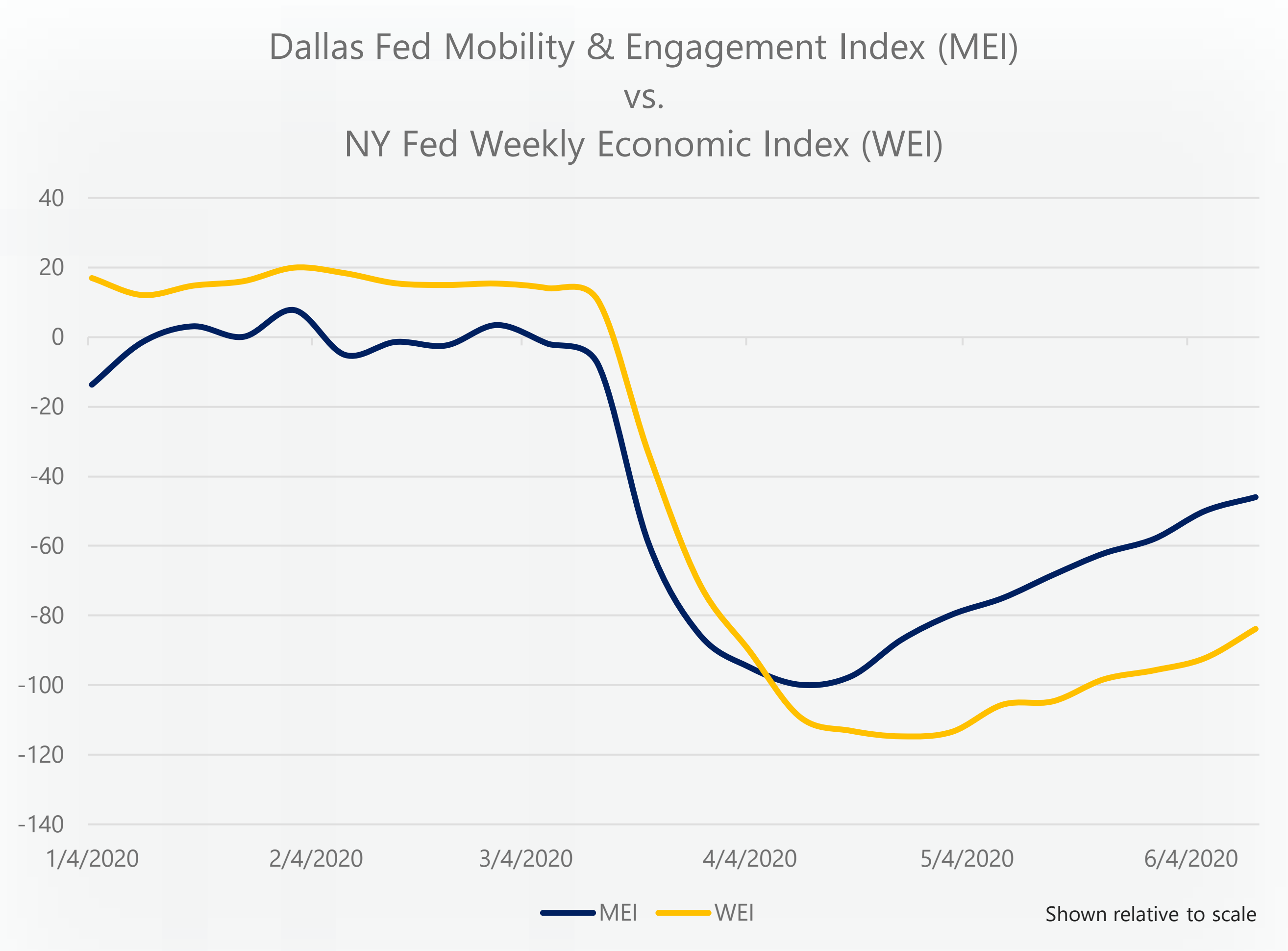
CHARTS

S&P 500 Large Cap Index (Year-to-date through June 25, 2020)

Source: https://www.tradingview.com/chart/

Just looking at the starting point of around 3,200 and the ending point of around 3,100 would make one wonder what all the fuss was about. With the uncertainty discussed, it may feel odd to be down roughly 3% year-to-date by. The Fed-driven liquidity rally[7] has, at least temporarily, staved off the impact of the COVID-19 pandemic on U.S. stocks.

Fed Economic Data: January – June 2020

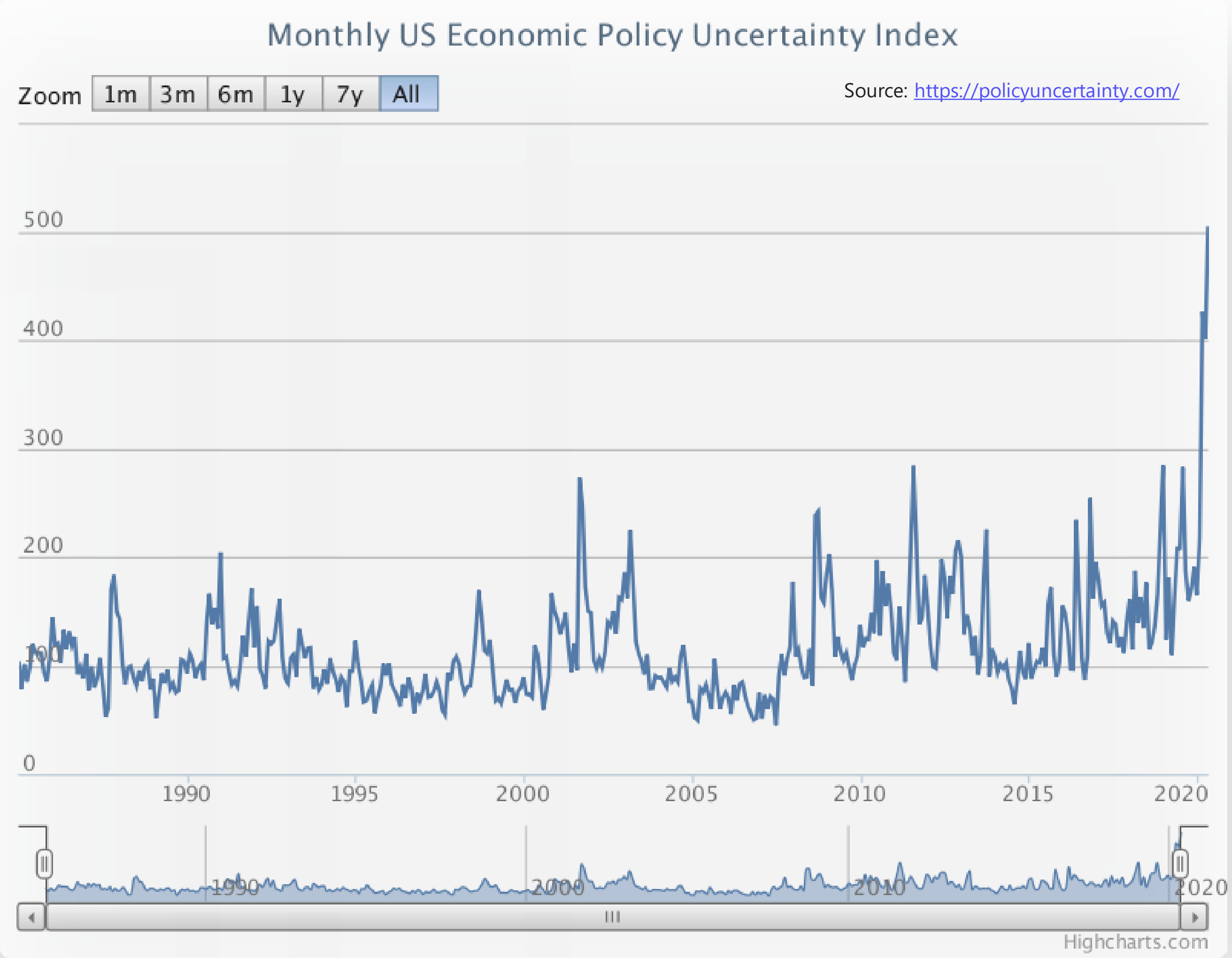


Contrary to the chart above, there may be something to fuss about. Texas was one of earlier states to open. Not surprisingly, is has a leg up on New York, which is still in various versions of controlled reopening. Even at the current pace, however, it will still take a couple of more months just to get economic activity back to zero. New York may well be at year end before it gets to zero, barring a “second wave” shutdown or partial shutdown.

CHARTS

Relative Economic Uncertainty

Finally, as we and the strategists have alluded to, we are seeing a level of economic policy uncertainty we have not seen in the last 30 plus years...and perhaps not even since the Great Depression of the 1920s and 1930s.



DISCLOSURES

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