BREAKING NEWS

The September unemployment rate posted another drop, coming in at 7.9%, as the economy added 661,000 jobs. This was a miss from expectations, but stronger than the number printed in August.[1]

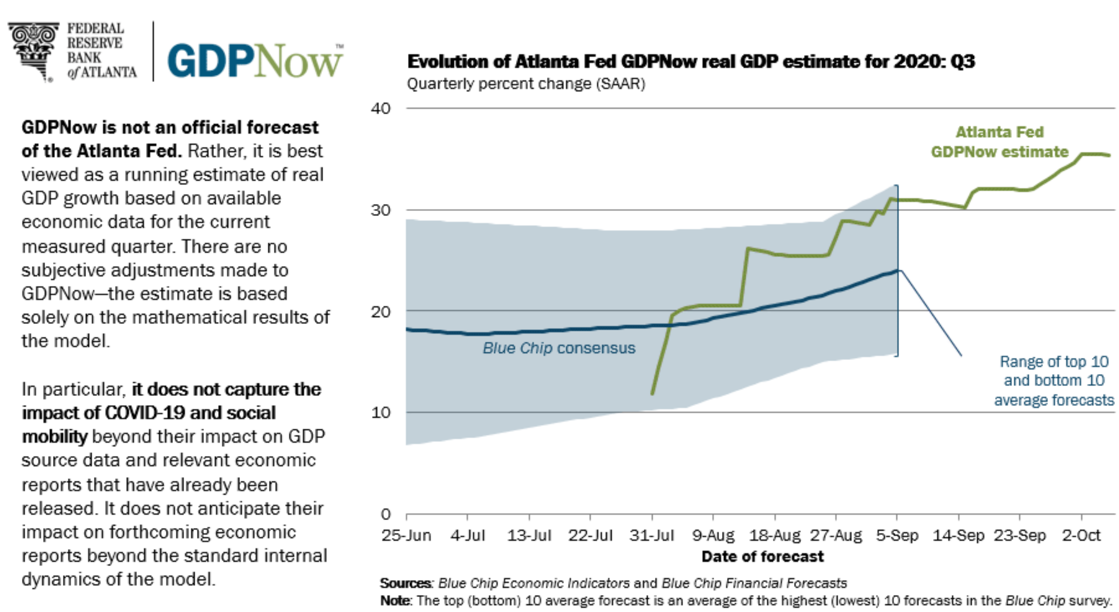
President Trump has tested positive for COVID-19 and is currently under quarantine protocol, although he has returned to living at the White House, which seems to be a positive sign. The election cycle is discussed further below, but the COVID wrinkle was not really on anyone's radar until it happened. The true impact, if any, should be known in the next two weeks.[2]

KEY TAKEAWAYS

- The rally from the pandemic-induced March crash finally met its match in September with broad weakness in U.S. equities.
- Third quarter 2020 U.S. GDP is forecasted to rebound strongly, though the outlook of that strength continuing in the 4th quarter is waning due to a lack of further stimulus.[3]
- Election season is in full swing with the debates kicking off September 29th.

The U.S. Economy

The final estimate for second quarter GDP came out at an annualized -31.4%, slightly better than the second estimate.[4] Now that the third quarter has ended, expectations are even higher than last month's estimate[20], with GDPNow forecast projecting 30%+ growth (as shown in the chart below). It would be unprecedented to see a 30%+ growth quarter after reporting a -30%+ decline in the previous quarter. Unfortunately, this is a geometric measure and not arithmetic, so GDP is likely to still be lower at the end of the third quarter as compared to the end of the first quarter. It

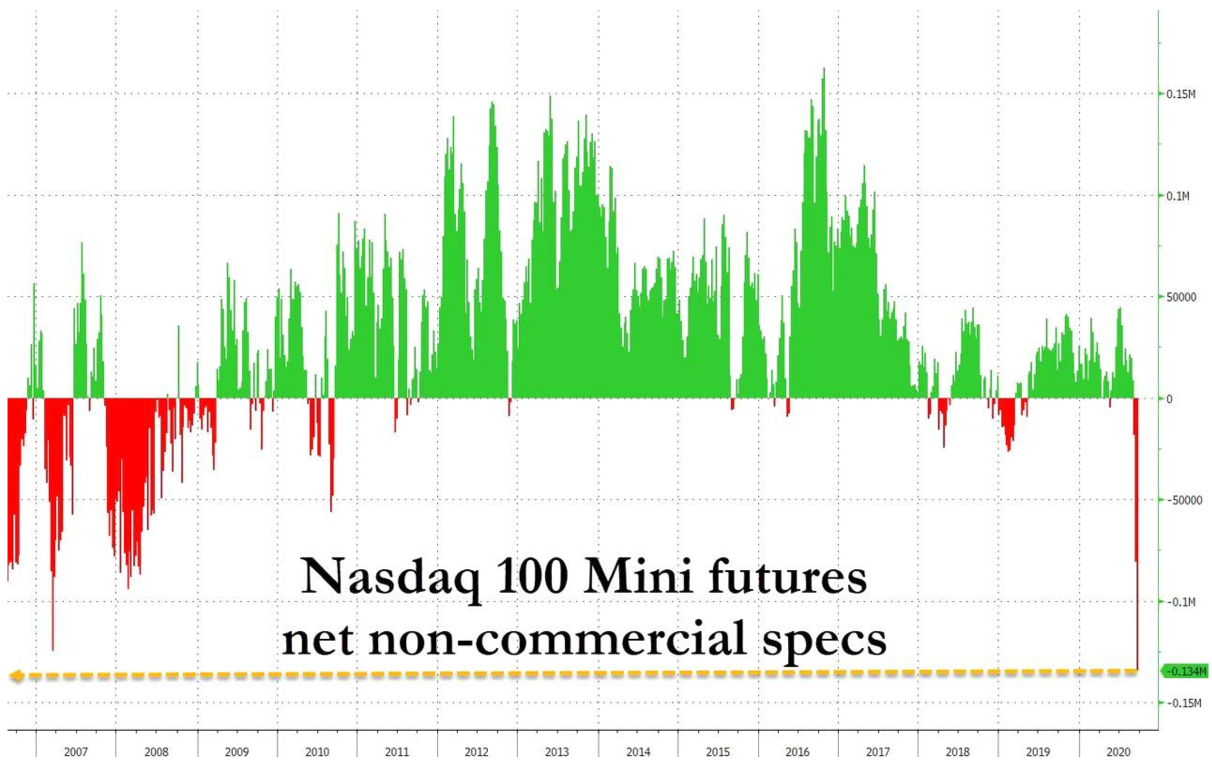


Source: https://www.frbatlanta.org/cqer/research/gdpnow just shows how big of a roller coaster ride we have all been on with the depth of the lows and highs. Forecasters have lost hope for new fiscal stimulus from the U.S. government and, as mentioned in the key takeaways, have begun to reduce growth forecasts for the fourth quarter, though they are still forecasting growth.

Stocks and Bonds

The fixed income markets had a surprisingly quiet September in contrast to the volatility experienced in the equity markets. Historically, equity market volatility equals a strong bond market rally. This month did not follow that usual course. In fact, 10-year U.S. Treasury yields were extraordinarily flat. The yield was essentially flat for the month and barely traded five basis points on either side of that trendline. The lack of movement in government yields did not provide a tailwind for high-quality fixed income either, as measured by the iShares US Aggregate Bond ETF, which was nearly flat at -0.05% for the month.[5] The U.S. 10-year treasury bond price increased slightly during the month with yields ending higher by 0.5 basis points.[6] The yield ended at 0.677%, up from August's close of 0.672%.[6]

The U.S. stock market hit a rough patch during September, ending the seemingly daily record new highs. The Dow Jones Industrial Average slumped -2.28%,[7] the S&P 500 dropped by -3.92%,[8] and the small cap Russell 2000 fell -3.47%. [9] The international markets were also down, but not to the same extent as the U.S. The MSCI EAFE iShares Core International Developed Markets ETF Index slid -2.35%[10] and the MSCI Emerging Markets iShares Core ETF Index eased -1.59%.[11] The chart below provides an interesting perspective. On the one hand, the magnitude of negative positioning in the Nasdaq 100 is as severe as we have seen since July of 2006. On the other hand, the duration of the negative positioning was relatively brief. This raises an interesting question. Is this the pause that refreshes or is it the beginning of a period of weakness?



Source: https://www.zerohedge.com/markets/unprecedented-reversal-nasdaq-shorts-hit-second-highest-ever

In September, we saw a lot of red for most sectors of the S&P. The best performers were…[12]

- Materials: +1.03%
- Utilities: +0.22%

The worst performers were…

- Energy: -15.98%
- Communication Services: -6.10%
- Technology: -5.54%

Oil Shows Signs of Life

September displayed a lot more volatility for oil than in recent months, with a sharp drop the first week of the month on renewed demand concerns and news that Saudi Arabia was cutting prices. Though meaningfully lower for the month, crude oil is only five cents lower than it was on July 31st. The current NYMEX WTI Crude Oil futures settled at $40.22 and posted a loss of almost 6% from the prior month close of $42.61 a barrel.[13] The price for RBOB gasoline followed a similar path to crude oil, though it was "supported" by the numerous hurricanes which made their way through the Gulf Coast region. RBOB finished lower by just under 3% for the month of September.[14] The energy space has remained relatively stable once again, although the massive swings earlier this year may be distorting perception of what "stable" really means in recent months. What little there was, the summer driving season is now behind us and hopefully the same will soon be said for hurricane season.

The Rest of the Data

The COVID-19 pandemic continues to be very fluid in the U.S. and across the globe. Additionally, the responses are starting to bifurcate as well. Geographic and geopolitical areas, whether speaking within the U.S. or around the world, are differing widely in their approaches. Some are sticking with the hard lockdown approach and its resultant harsh impact on the economy, while others are taking more measured approaches. At the end of the day, the fact that so little is known as to which approach is better is probably the most difficult part to digest, as we are over six months into the pandemic now. Either way, many economic indicators continue to show signs of life "after" (let's hope) the depths of the pandemic-related shutdowns.

The August ISM Manufacturing PMI Index increased 1.8 points to 56 from July's reading of 54.2.[15] On the other hand, the ISM Services PMI Index decreased to 56.9 from 58.1 in July, though still a strong reading.[16] Any reading above 50 generally indicates improving conditions.[15,16] Consumer confidence soared to 101.8 in September in the face of a stock market selloff and no fiscal stimulus, which compares to an upwardly-revised figure of 86.3 in August.[17] The unemployment rate posted another drop, coming in at 8.4%, as the economy added, a disappointing miss to expectations, private payrolls added 428k jobs in August.[18] The Consumer Price Index for All Urban Consumers (CPI-U) rose +0.4% in August on a seasonally-adjusted basis. Over the last 12 months, the All-Items Index climbed +1.3% on a non-seasonally-adjusted basis.[19] Overall, these numbers show continued signs of improvement in the economy, setting the stage for potentially record-setting growth in third quarter GDP. Though most signs are pointing to more "normal" growth going forward, the turbocharged growth fueled by fiscal stimulus seems to be on hold, at least for the time being.

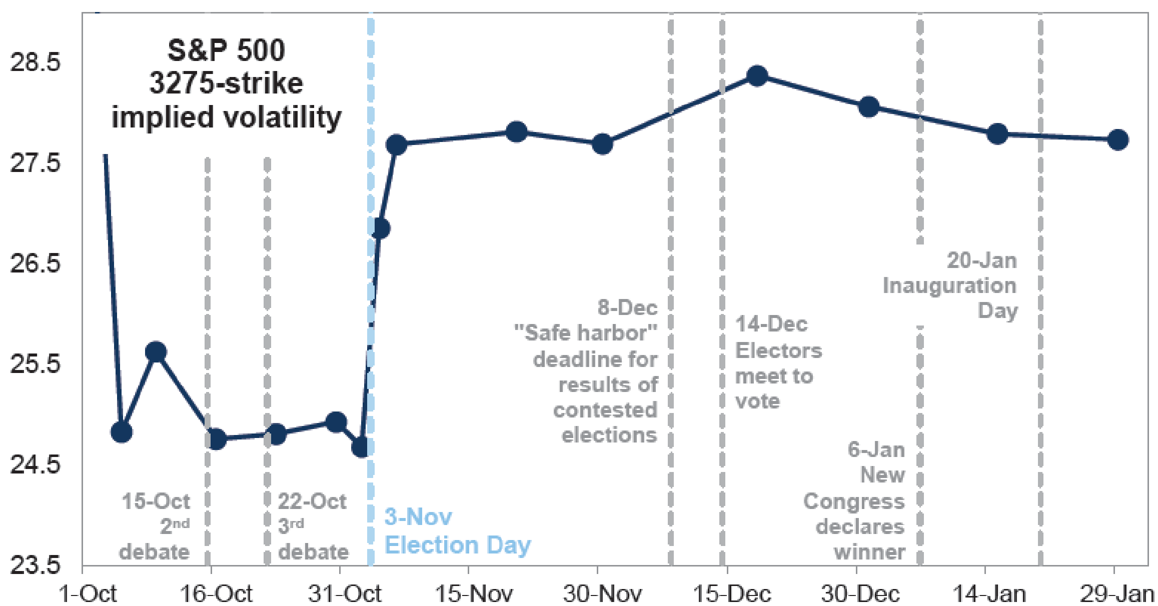
Take-Aways & Outlook

The economic story of the last few months has not really changed. The boost from global monetary support and fiscal stimulus provided a huge tailwind and the economy responded. The lingering concerns of a potential "second" wave of COVID-19 as we move into the winter is likely on most people's minds. If another wave hits, the big questions are how bad will it be and how will governments respond?

Clearly, the elephant in the room is the upcoming presidential election. It is likely we will not see another fiscal stimulus package, as neither side seems willing to give an inch—or another trillion dollars. The election is just over a month away and, as a reference to the last monthly market pulse[20], already over 300 lawsuits have already been filed regarding election-related matters. Also, in last month's piece, we mentioned how the biggest potential risk going into the election was not which candidate would emerge victorious, but rather knowing if any candidate did. At the time, we were not seeing much attention paid to this point, but that seems to have changed. The last couple of weeks have seen increasing focus on the possibility of a contested election and what that could mean for the country.[21]

The chart below shows two pieces of the puzzle. First, it outlines the critical dates of the election process. Second, it shows that the market is pricing in elevated risk through the inauguration date in February 2021. Could this be something like the election of 2016 and the Brexit vote of 2016? The bandwagon "consensus" seems to be getting awfully crowded. Perhaps, this time they will be right. Regardless of your political preference, the best outcome should probably be regarded as having a clear winner on or as closely after election day as possible. If that does not materialize and the contest is dragged out for weeks—or months—2020 may have a few more "surprises" waiting for us. Let us hope that is not the case.

Exhibit 10: Implied volatility curve indicates extreme election uncertainty



Source: Goldman Sachs Global Investment Research

Source: https://www.zerohedge.com/markets/stocks-suffer-worst-september-2011-dollar-election-doubt-soars

Given all that has been discussed, we suggest remaining focused on your long-term financial plan, but also making sure your portfolio is appropriately weighted. As we highlighted in the quarterly asset allocation piece last week[22], we have made some select additions to “risk” via investments we feel have limited exposure to the election, but which fared well during the September selloff. However, other areas which have remained less aggressive are likely to remain so, barring any severe volatility after November 3rd.

Expectations and valuations for U.S. equities remain somewhat rich at this time. The opportunistic components of the core Ashton Thomas strategies have reengaged in risk, but we would still advise against stretching for additional risk. If you have specific questions about your portfolio or financial situation, we are here to help you answer them.

Meanwhile, we will continue to monitor the election and economic situations for more clarity on any substantial changes in direction for the financial markets. As we do so, we will keep you informed of trends and opportunities which may benefit or impact you and your money.

IMPLICATIONS FOR YOUR FINANCIAL WELLNESS

- If election anxiety is causing you stress, perhaps refocusing more time on your family, your pastimes or causes, and your personal wellbeing and less on the endless news (opinion?) cycle may be in order. With the fourth quarter here, it is also a good time to start thinking about your financial goals once again. Your financial plan and a coordinated asset allocation strategy are your best defense against any surprises life may bring your way.
- We are here to help you stay on track financially so you can live your Ideal Financial Life. If you have questions, concerns, or thoughts about your financial plan or your portfolio, we are only a phone call away. Our experienced, credentialed team is working hard to deliver the solutions you need. If the time for your regular review meeting is approaching, you will be hearing from us to schedule that soon.

Kevin Churchill, CFA®, CFP®
Chief Investment Officer
Ashton Thomas Private Wealth

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