INVESTMENT INSIGHTS

Market Outlook

June 2020

The Fed Takes Aim At COVID-19, Is The Rally for Real?

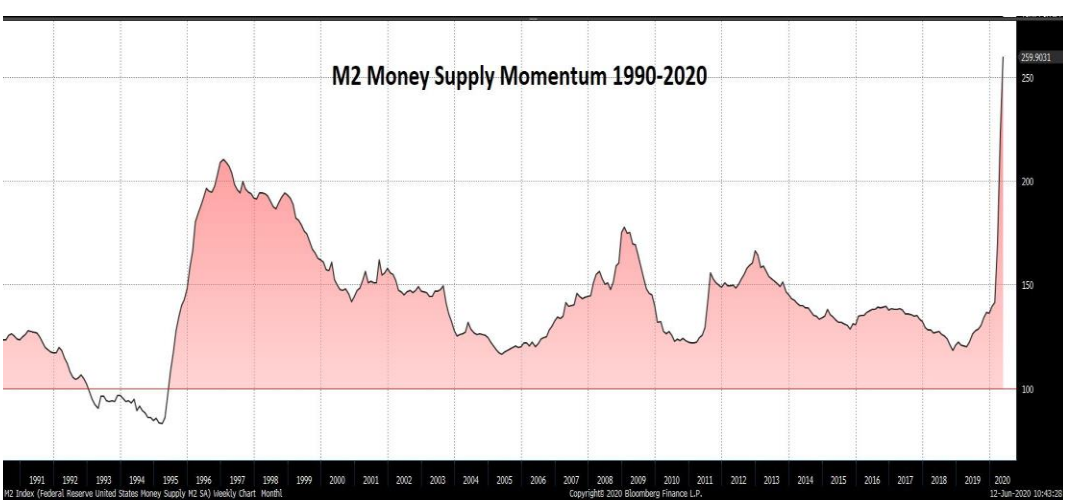
With the stock market rallying so dramatically off the March lows, we are hearing a lot about the disconnect between market performance and economic fundamentals in recent weeks. In thinking about this, it's important to recognize that the market is a forward discounting mechanism that trades based on investor expectations looking out six months or so. Equally important is the fact that investors tend to overreact to uncertainty which we have seen happen in both directions this year. Covid-19 has presented the most uncertain environment for Wall Street analysts in recent memory as it has been difficult to assess what the duration of business closings would be and the extent to which many companies would be operational during this time. The initial market reaction to Covid has been tempered in recent weeks by an unprecedented level of Fed stimulus and an ebb in new cases of the virus. While Fed policy decisions are always open to criticism, their response in this case was both immediate and impactful as the chart below illustrates. The rapid expansion of the money supply, the use of open market operations, and the purchase of corporate debt vehicles has provided a welcome respite for investors as some have declared this to be the shortest bear market on record.

> Fed response to Covid has been immediate and impactful helping to avert the worst case scenario.

Our view is that the policy response has been successful in averting the worst case scenario that was being anticipated in March, but that it is likely the economic dislocations are severe enough to require more time and further policy intervention to repair. We need look no further than an unemployment rate in the 13-15% range to gauge the impact that we can expect to see on consumer spending, personal income and the housing market in the coming months. The market has rallied in response to the fact that the numbers have not been as bad as originally feared, but we are left with the reality that the magnitude of the job loss exceeds that of the 2008-09 financial crisis and

> Economic dislocations are severe enough that more time and policy intervention is likely required to repair the damage.

Change In Monthly M2 Money Supply



Source: Bloomberg L.P.

Bank of New Hampshire
WEALTH MANAGEMENT

is the worst in the U.S. since the Great Depression of the 1930s. Smaller businesses have been hurt to a greater extent than their larger counterparts as many do not have similar financial resources or access to capital markets that is so vital during such challenging times. Fed Chair Jerome Powell has indicated that many jobs will be permanently lost and that the Fed will need to sustain policy initiatives for a lengthy period of time. This suggests that it may take a bit longer than the recent rally would indicate for markets to return to normal.

> Fed will need to sustain policy initiatives for a lengthy period of time.

There have also been significant differences in how various market segments and sectors have performed during this period which may provide a glimpse into some of the changes that we can expect to see in a post-Covid world. Investors have gravitated toward companies where earnings are more resilient in the face of the challenges presented by social distancing. This has caused market leadership to narrow into technology, communications, and companies with a strong online presence or distribution networks. Much has been written about the strong performance of large cap U.S. growth stocks compared to other equity classes such as small cap, mid cap, international and value stocks. The primary driver of this in each situation has been the weighting of technology and communications in each segment. Five of the best performing companies in the S&P 500 year over year (Apple, Microsoft, Google, Facebook, Amazon) make up more than 20% of the index. We have not seen leadership narrow to this degree since the tech bubble in the late 1990s as the index performance has masked the extent of damage to the Main Street economy. For a sustainable recovery to take shape, we will need to see better performance from the financial sector and manufacturers which would tell us that growth was broadening out.

> Social distancing has helped technology, communications and companies with a strong online presence.

> Market leadership needs to broaden to confirm a sustainable recovery.

For now, we're faced with a market where sentiment has perhaps become too optimistic heading into a second quarter earnings season that will show us the full impact of Covid on corporate profits. This has the potential to create a few pockets of indigestion as it is difficult to see a return to pre-Covid levels without more improvement in the underlying economic fundamentals. With that said, barring a renewed acceleration in viral spread, we are optimistic that policymakers have made sufficient headway that we can avoid revisiting the March lows in the months ahead.

> Second quarter earnings reports could temper near term investor optimism.

--Charlie Mathews, CFA

Tech Sector vs. S&P 500 Index

Source: Bloomberg L.P.