Midland Wealth Management

Betsy Pierson, CFA, Chief Investment Officer, and the Investment Management team share their latest Market Insights:

As May comes to an end and summer is on its way, we present a brief economic and market update. The COVID-19 pandemic has caused market volatility and economic shutdowns that most of us have never experienced before. As we begin to open up the economy and move to a new normal, what is in store for the U.S. and the World?

While the U.S. economy is in recession (two negative quarters of GDP growth), the question is what type of recovery is on the horizon. We have outlined several positive points regarding economic growth:

- The Federal Reserve and Federal Government have supplied significant support to keep markets and businesses functioning. Their actions were quick, strong and decisive. The Federal Reserve continues to state they will provide support for as long as needed and Congress is also working on an additional stimulus package to continue supporting the U.S. economy.
- The economy is reopening albeit at a slower pace than pre-pandemic.
- COVID-19 vaccine research continues and will be fast tracked through the FDA when a viable solution is found.
- Financial markets stabilized and improved resulting in less stress in the system.

While these positives may lead us out of recession in the 3rd quarter, we still have a number of concerns that need to be monitored:

1. Risk of resurgence in COVID-19 cases as we open the economy. As we move into the fall/winter flu season, will it re-emerge resulting in a second wave and what impact will it have on economic growth?
2. While we believe we will see a spike in economic growth as the economy reopens, will the unemployment level remain high? There are over 30 million who have been laid off or furloughed. While many will head back to work as businesses reopen, there will remain a substantial number that will not return due to businesses closing, less employees needed as businesses function at 50% capacity, and the overall economic damage to businesses as a result of the shutdown.
3. Impact on inflation and economic growth from the increased U.S. Treasury debt issuance.
4. Increased tensions between the U.S. and China.
5. Presidential election in November.

Following the dramatic decline from all-time highs on the S&P 500 reached on February 19th to the March 23rd lows, the equity markets have significantly rebounded.

Index	Performance Since 3/23/20	Performance Year to Date
S&P 500	31.93%	-5.44%
S&P 500 Growth	35.07%	2.85%
S&P 500 Value	27.90%	-14.77%
Russell 2000	38.52%	-15.56%
Russell 2000 Growth	44.46%	-6.68%
Russell 2000 Value	31.49%	-24.83%
MSCI ACWI Ex US	28.49%	-14.33%

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All markets have moved considerably. We are somewhat cautious regarding the quick and strong rebound we have seen since the market low on March 23rd. Companies have withdrawn all earnings guidance for the second quarter and earnings estimates for the S&P 500 have declined dramatically this year leading to the current valuation on 2020 earnings at a 25x price-to-earnings ratio. Assuming we have a 25% increase in earnings in 2021, getting earnings back to the 2019 levels, the valuation remains historically high at over 19x twelve-month forward earnings. As can be seen in the above chart, companies with earnings growth have benefited most, leading to the largest dispersion in returns between growth and value on record. This market action has benefited our current portfolio structure due to our growth tilt. While we do believe companies with earnings growth will remain strong, we also believe that some high quality industrials and financials are still trading at very low valuation levels which should benefit the value indices over the next few months. We will remain tilted to growth but will be narrowing this tilt due to the above-mentioned extreme outperformance of growth over value.

While we have anticipated a pullback in the market, we have not experienced much of a correction, primarily due to the huge liquidity injection supplied by the Federal Reserve. As you know, markets do not move straight up. We anticipate there may be a 5% to 10% pullback in the next few months leading us to remain slightly underweight our neutral equity position. With the dramatic accommodative actions taken by the Federal Reserve in March and April, interest rates are at or near all-time lows. We do not envision that interest rates will increase dramatically in the near term despite the increased debt issuance.

Thank you for your continued trust and confidence in us. Stay safe and healthy. Please do not hesitate to contact Midland Wealth Management with any questions or concerns.

In case you missed it, please click here for prior market updates or follow us on LinkedIn for current posts.