Capital Market Outlook

"Fall seven times and get up eight"– Japanese proverb

The stock market entered the second quarter facing a significant level of uncertainty, yet the S&P 500 had one of its best performing quarters ever, with the index gaining more than 20%. The sharp recovery in stocks was driven by optimism surrounding the reopening of the economy, evidence of a flattening of the curve, and aggressive monetary and fiscal stimulus from the federal government which has signaled a "do whatever it takes" approach to support the economy (and markets) during the pandemic. The unprecedented steps taken to support the economy have led investors to look past the current economic dislocation and focus on 2021 corporate earnings, where the expectation is that fundamentals will return to normal.

As for the current status of the pandemic, after a decline in cases in April and May in the U.S., we have seen a spike in cases mainly centered in states that fared relatively well in the early days of the spread as these states reopened their economies. Despite the increase in cases, the death rate has fallen as healthcare workers have gained substantial knowledge on proper treatment protocols. This decline is despite the fact that a highly effective treatment has remained elusive. So far, Remdesevir is the only approved treatment but it is limited to more severe hospitalized cases. Hydroxychloroquine (HCQ) showed early promise but has since had mixed results in trials. There are still many treatments being tested but it appears as though a vaccine is an area of greater focus at this point. With nearly 150 vaccines in development, we are optimistic one or more will prove effective. We should see phase 3 data from the early leaders in the Fall but the first COVID vaccines could very well be similar to flu vaccines in that they are only 50% effective. If successful, we expect vaccines to be available to the general public in late 2020 or early 2021. Until a vaccine or effective treatment is found, there will likely be ebbs and flows in reopening plans and economic growth.

As the economy reopened, employment numbers surprised to the upside throughout the quarter and buoyed the rally in the stock market. After dismal readings for March and April in which the economy shed more than 20 MM jobs, the economy regained 3 MM jobs in May and nearly 5 MM jobs in June, well above expectations. While the unemployment rate in June remained high at 11%, the trend in the data is clearly positive and has led to optimism that the economy can recover quickly once an effective treatment and/or vaccine are found.

Capital Market Outlook (cont'd.)

Consumer spending, the backbone of the economy, remained remarkably resilient despite significant job losses. After a steep decline in March, retail sales came back nicely in May, demonstrating the effectiveness of the Paycheck Protection Program and enhanced unemployment benefits providing hope that consumers will continue to spend to support the economy despite broader uncertainty. The housing market also showed signs of strength throughout the quarter, in particular new construction of single-family homes, as people migrated away from city centers.

Despite the increase in cases in some Sun Belt states, we view another lockdown similar to that seen in March as highly unlikely, not only due to severe economic consequences of such a move but simply due to human psychology and the desire to leave the home. However, as some restrictions on the ability to go out to restaurants and other businesses where large numbers of people congregate are put back into place, there is the likelihood that we see some short-term impact on the economic data. On balance, we believe consumers feel like they have more knowledge on how to protect themselves and local governments can thus be more measured and thoughtful in their response to minimize any negative economic consequences. However, the longer-term impact on consumer behavior, and companies' ability to adapt to the new environment remain unanswered at this point.

Amid the global pandemic, 2020 is also an election year in the U.S. and the stock market has perhaps only just begun to incorporate the likelihood of a change in administration this November. There could be some volatility based on polling data as we approach November, given the possibility of a shift in tax and regulation policy. At AMI, we remain laser-focused on investing in high-quality companies that are positioned to grow through both economic cycles and shifting political winds. It is our belief that we have positioned the portfolio with the appropriate balance of companies doing well in the current environment and those positioned to benefit from the upcoming economic recovery.

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