

Q3 • 2020

Capital Market Outlook

“Knowledge is an unending adventure at the edge of uncertainty”– Jacob Bronowski

Q3 ended firmly in the green, with the S&P 500 rising 8.9% for the quarter. July and August saw significant gains with indices reaching new highs. Upside in unemployment numbers as well as other economic data, hopes for an effective vaccine, continued monetary support and better-than-feared corporate earnings and guidance left bulls firmly in charge. The rally was relatively narrow in breadth, centered around large-cap technology, given that those companies appeared to be most resilient during the pandemic, in part due to the stay-at-home measures which these companies help facilitate.

However, as we entered September and as the economy began to further improve, investors began to question the lofty valuations of technology stocks that drove the rally, as well as other high flying, “stay-at-home” economy beneficiaries. This led to the worst month for the S&P 500 since 2011. Looking forward, there remains uncertainty regarding additional fiscal stimulus, the path of the virus, and the outcome of the Presidential election. All things considered; the economy seems to be on far better footing than many had predicted earlier in the year.

We have previously stated that we believe some combination of a vaccine and an effective COVID treatment will be key to ending the restrictions and a step towards returning to normal. Remdesevir, from Gilead, was the first approved treatment and Regeneron just reported positive data for its antibody cocktail (straight up), both important milestones in fighting this disease. Pfizer and Moderna are the two frontrunners in finding an effective vaccine and we expect to see data from Pfizer in October and Moderna shortly thereafter based on management comments. Although the data will be preliminary and with limited safety data, we believe the FDA could approve one or both for immediate use. While it will take time to inoculate enough of the population to harness the virus, we believe the mere fact that there is an effective vaccine will go a long way to improving sentiment and will be viewed as a “light at the end of the tunnel”.

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Capital Market Outlook (cont'd.)

Broadly speaking, the economic recovery during Q3 in the U.S. can be characterized as resilient, despite being centered around certain segments of the economy. Unemployment throughout the quarter continued to drop from 10.2% in July to 7.9% by the end of the summer. In September, notable job gains occurred in leisure and hospitality, trade retail, health care, and professional and business services. Even though we are seeing positive indicators, most investors are focusing on the fourth quarter and beyond and appear to be discounting 2020.

The Federal Reserve has remained highly accommodative, with Fed Chairman Powell stating that the Fed will do whatever it takes to support an economic recovery. That said, it is notable that Chairman Powell has also consistently indicated that additional fiscal stimulus is needed to avoid more significant job losses and possibly permanent damage to the economy.

As we rapidly approach the Presidential election, uncertainty remains over the outcome and the resulting impact on the economy. While we take no view on the outcome of the election, there is some concern among investors regarding the possibility of higher taxes and increased regulation. Regardless of the outcome of the election, we feel positive on the potential for the U.S. economy to see a sharp recovery in 2021, especially if an effective vaccine is distributed broadly.

At AMI, we continue to position portfolios with what we believe to be the appropriate mix of companies benefiting from the current environment and those that should see outsized growth as the economy returns to normal. We also took advantage of some of the market dislocation in September to add high quality secular growth names that had previously been outside of our valuation parameters.

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