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2020 Third Quarter Investment Market Report

The investment results in September were certainly nothing to brag about, but overall the markets have done something interesting: large cap indices are up while small and midcap stocks have posted modest losses. Given the persistent decline in the U.S. economy and the uncertainties around the resurgent pandemic, the investment situation could have been a lot worse. Is it possible that in the midst of a raging pandemic that is experiencing its second wave, and the associated loss of GDP, that the markets will deliver a positive return for 2020?

The Wilshire 5000 Total Market Index—the broadest measure of U.S. stocks—gained 9.14% in the most recent quarter, and is now hanging onto a 5.54% gain so far this year. The comparable Russell 3000 index is up 4.60% so far this year, despite losing 4.38% in September.

Looking at large cap stocks, the Wilshire U.S. Large Cap index was up 9.56% in the third quarter, and is now up 7.05% for the first three quarters of the year. The Russell 1000 large-cap index now stands at a 5.54% gain, while the widely quoted S&P 500 index of large company stocks gained 8.47% in the third quarter and is now up 4.09% for calendar 2020.

At the other side of the spectrum, the Russell Midcap Index is down 2.84% so far this year.

As measured by the Wilshire U.S. Small-Cap index, investors in smaller companies received a bit of good news: a 4.04% gain for the quarter. Yet the index is still down 10.34% for the year. The comparable Russell 2000 Small-Cap Index is down 8.87% so far this year. The technology-heavy Nasdaq Composite Index gained 12.27% in the third quarter, and stands at a remarkable 23.55% gain through the first nine months of the year.

International investors are generally in the red so far this year. The broad-based EAFE index of companies in developed foreign economies gained 4.20% in the third quarter, but is still down 8.92% for the year. In aggregate, European stocks gained 4.07% over the last three months, but are sitting on a 10.53% loss for the year. EAFE's Far East Index meanwhile, gained 5.21% in the third quarter, but for the year it too is in losing territory, down 4.56%. Emerging market stocks of less developed countries, as represented by the EAFE EM index, gained 8.73% in the most recent quarter, but is still down 2.93% for the year.

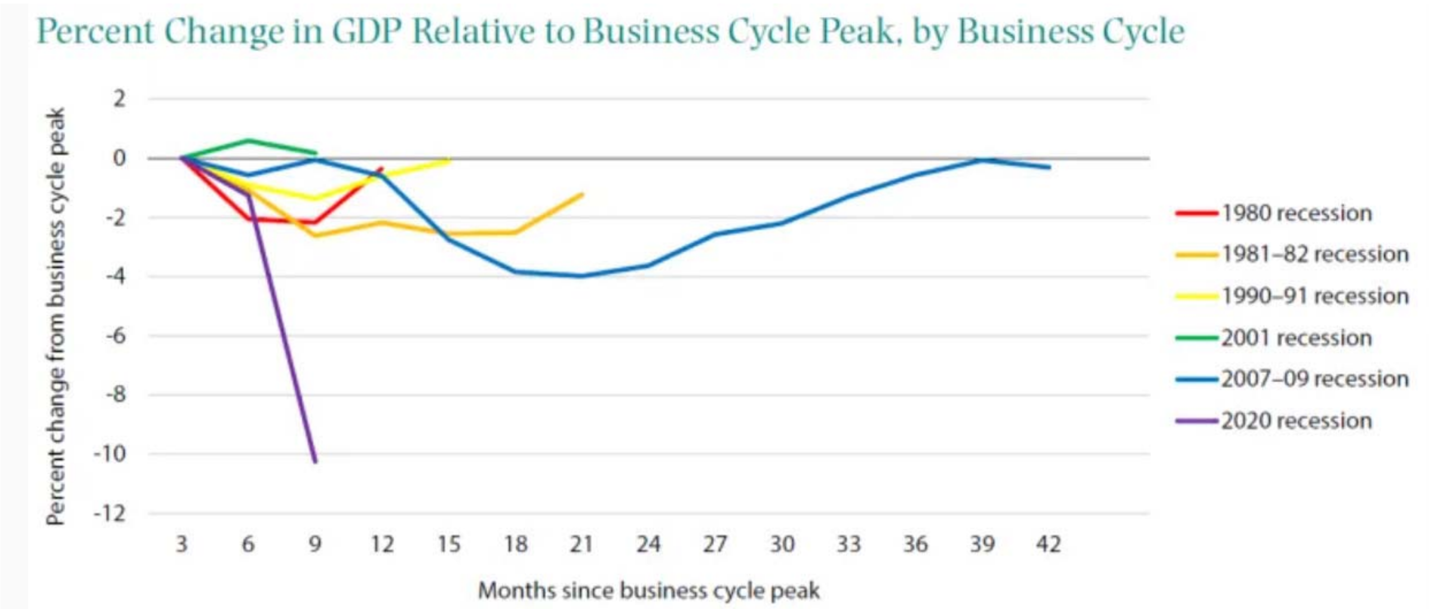
Looking over the other investment categories, real estate, as measured by the Wilshire U.S. REIT index, posted a slim 1.25% gain in the third quarter, but real estate investors are still down 16.74% for the year. The S&P GSCI index, which measures commodities returns, gained 7.59% in the third quarter, but is still sitting on a 19.72% loss for the year.

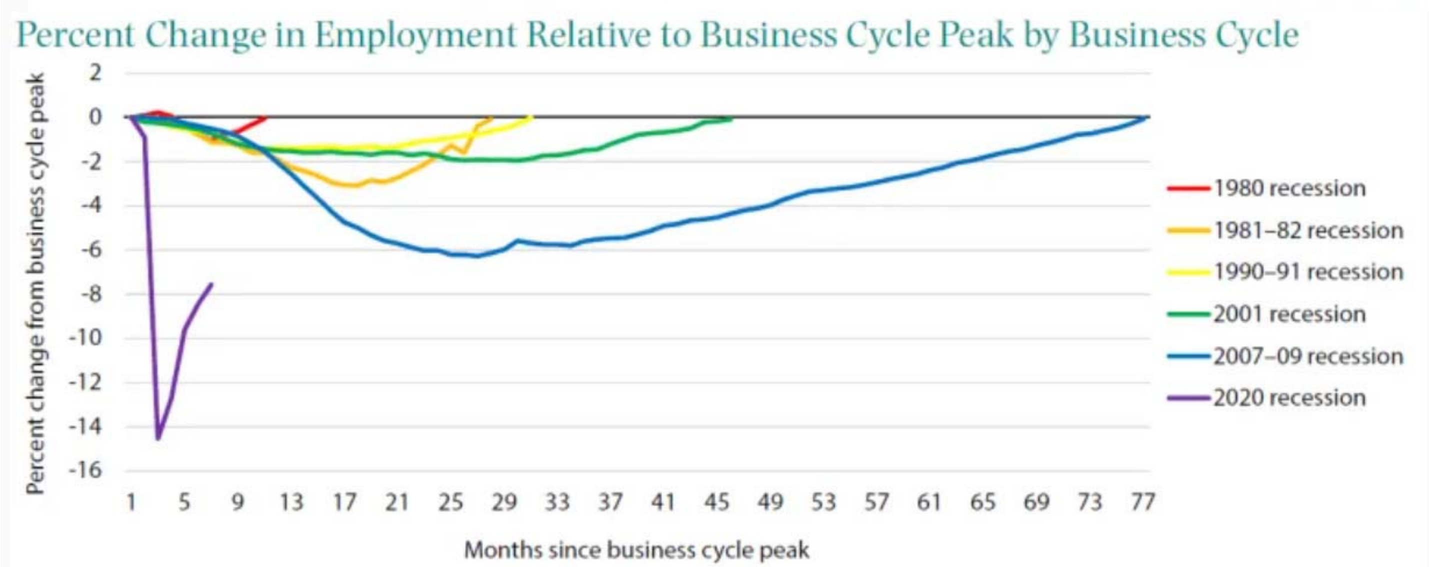
In the bond markets, rates are still scraping along the bottom. Coupon rates on 10-year Treasury bonds stand at 0.69%, while 3-month, 6-month and 12-month bonds are still sporting coupon rates of roughly 0%. Five-year municipal bonds are yielding, on average, 0.29% a year, while 30-year munis are yielding 1.67% on average.

In the early days of the pandemic, most economists and market analysts would have been surprised that the investment markets have held up as well as they have at this point in the year. They would not have been surprised that—as reported by the U.S. Commerce Department—the American economy suffered its sharpest contraction in at least 73 years during the second quarter. GDP plunged at a 31.4% annualized rate, with consumer spending down 33.2% (annualized). April alone saw the loss of 20.5 million jobs. The most optimistic pundits were touting the return of

749,000 payroll jobs in September. At that rate, a full economic recovery could take years, but we should know more when the third quarter's economic data is compiled at the end of October.

To put all this in context, consider the two charts shown here. The top chart shows the change in economic activity in the U.S. from the business cycle peak during past downturns--and the purple line heading straight down--in a way that is really unprecedented--is our current economic decline. In the second chart, you can see the change in unemployment from peak to trough during past economic recessions, and once again you see that the current situation is more dramatic than anything that has come before. We can take some comfort that the purple line is trending back upward faster than any previous cycle, but what happens from there is, of course, unknown.





Will the September declines lead to more losses as we approach the November election? Nobody can predict the future, of course. Looking at history, over the last ten times when the S&P 500 dropped at least 3.5% for the month of September, seven of those following Octobers showed gains for the month. On the other hand, how many times have we seen, as we have recently, stock prices exceeding their earnings by increasing margins? The road ahead for stocks is uncertain, but when in all of market history has that not been true?

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