Partner Perspectives | Markets at Mid-Year
July 2020
Perspectives from our partner affiliates

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At the start of 2020, no one imagined what would happen to the financial landscape because of the COVID-19 pandemic: from the stunning height of the longest bull market in history, to the fastest bear market on record, and back to positive territory again. Unprecedented federal monetary and fiscal stimulus. Economies stopped cold. Industries potentially changed forever.

Our affiliate investment teams used their experience and research-driven processes to navigate these changes for their clients amid volatile market conditions.

Now, what are they watching as we go forward? We asked our affiliates’ 11 investment teams the same question:

As the world continues to deal with the pandemic, what factors are likely to have the greatest effects on investors during the rest of 2020? On your own portfolios? Are there issues of interest to investors that are being pushed to the background because of the pandemic that bear watching?

Along with their outlook, some teams have offered additional insight on matters including the healthcare industry, consumer behavior, and corporate debt.

We hope you will find their outlooks thoughtful and helpful as we prepare for the rest of an unusual year.
Avoid narrow versions of the future

As is typically the case when investing, but is acutely true now, what you don't know about the remainder of 2020 dominates what you actually do know. Given that, across our products we are seeking to keep our beta/market sensitivity near 1 and, as always, continue to monitor our portfolios for areas of volatility unlikely to be identified by risk models.

The unprecedented combination of a global pandemic, civil unrest, and a divisive presidential election should encourage investors to avoid latching onto narrow versions of the future and instead consider a wide variety of possible outcomes for the second half of this year and beyond.

Companies with good quality, resilient growth prospects, or tending to benefit from a prolonged zero rate environment can be an attractive buy when facing indiscriminate selling. Companies facing prolonged fundamental challenges, with weak balance sheets and heavy reliance on bailouts should carry a higher risk premium in the current environment, especially after rallying sharply on modestly positive news. On the other hand, we know entire industries don't typically zero out. (Although if we had to pick a candidate, some of us would pick cruise lines.)
Economic activity in fits and starts

With COVID-19 likely to stay with us for the foreseeable future, we expect a fairly rocky recovery as we exit, and potentially re-enter, what the International Monetary Fund dubbed the “Great Lockdown.” Leading epidemiologists expect controlling the disease to be like “whack-a-mole” – where once new cases seem to be under control, they will pop up elsewhere. Second waves of infections are nearly assured.

We believe economic activity will progress in fits and starts and the stock market is likely to mirror this volatility. The main factors to watch for that would indicate a more sustainable recovery, beyond vaccine development and effective containment measures, include: employment, consumer confidence, retail sales, and fiscal and monetary support. Looking at the labor markets after the staggering job losses, expectations for a full recovery are beyond our one-year outlook. Many experts think it could take years. In addition to demand risks if virus fears continue, on the supply side, many industries will struggle to function at capacity if social distancing measures remain in place. However, unprecedented government support will help dull the economic pain – if that support continues.

Until now, central banks were effective lenders of last resort. Due to central bank action, financial dislocations have abated, but in our view, equity markets appear to be pricing in too speedy of a recovery. At the same time, current financial repression means there is reduced safety in the typical bond portfolio. Taking into account all these factors, we are likely to continue to hold fairly defensive portfolios, specifically with an allocation to gold for times of market stress.

Challenges such as China-U.S. trade tensions and supply chain disruptions are likely to impact growth opportunities. Nonetheless, the end result of these challenges, combined with COVID-19 pressures, is the likely acceleration of current trends of reshoring manufacturing activity domestically – a boon for the U.S. economy. In this environment, we believe many assets that did well during the pandemic are likely to continue to do so.

We believe economic activity will progress in fits and starts, and the stock market is likely to mirror this volatility.
Recession unlike any other means murkier outlook

The recession of 2020 developed faster than any on record. The National Bureau of Economic Research (NBER) dates it starting in February and recognizes it a mere four months later, compared to an average gap of seven months. This recession is also one of the most severe, with an expected drop of 40% annualized GDP declines in the second quarter relative to the first, pushing severity indices (which measure the amplitude and duration of the recession) to all-time highs. As this is a pandemic-related recession, it has very different characteristics than a typical recession. We have sparse data from the epidemics of 1918-19 and 1957-58 to help guide our forecasts, and these structural breaks occurred when knowledge of viruses was limited. Another confounding factor is that the current downturn represents the first time the demand for consumer services (half of GDP) has fallen. Investors have little to go on when forecasting a recovery.

Historically, recessions present opportunities for value stocks, as these tend to be penalized in cyclical downturns. This scenario is relevant for both the first and second quarter of 2020. In the middle of March, value stocks became three to four standard deviations cheaper relative to history and explained the negative 10% performance gap between value and growth in the first quarter. Encouraged by stimulus checks and vaccine news, investors jumped into the earnings void in mid-March as value stocks became too cheap and they staged a healthy recovery, closing approximately one-half of the historical gap. The biggest investment question of 2020 is: To what extent does the value/growth dichotomy continue? The answer depends upon several factors: the length of this recession (V-shaped or U-shaped), the degree of economic stimulus, the health of the financial system, and the possibility of a vaccine that forestalls additional shutdowns.

Vaccine development is the primary reason our group believes the recession will be V-shaped. This factor’s importance is a surprise to us, as history has shown it has taken years to develop vaccines – it took five years to develop an Ebola vaccine.
Our healthcare analyst expects decisive stage 2 results in the summer, as well as positive stage 3 results as early as the fall. We view several significant drug companies as having robust vaccine candidates. Many drug companies, along with governments, have started to pre-build the vaccines’ capacity. Crucial stage 3 vaccine results will drive optimism as the production lags are much shorter than in the past. The market seems to already be pricing in some of this good news.

Tactically, the background suggests some exposure to value as an earnings recovery seems likely. Discontinuation of stimulus may slow this recovery, as will difficulties in bond markets due to rent payment suspensions. These factors may cause dislocations, but despite recent runs, some exposure to traditional value areas is prudent: High-quality out-of-the-home stocks such as restaurants, gaming, industrial, REITS, and select consumer discretionary stocks fit the bill. We are less enthused about the value names in energy and banking, as the long-term prospects for these industries is dismal. For banking, it appears the yield curve will be flat for some time, and current prices are less than break-even for even the most efficient energy producers.

One major consequence of this pandemic is that we have quickly transitioned from a disinflationary or even mildly stagflationary regime to a deflationary economic regime. The duration of this regime is an open question, but the combination of central banks’ monetization of debt and long-term interest rate trends will tend to support long bonds and growth equities. The recent outperformance of biotech stocks in a challenging market is explained not only by the market searching for vaccine solutions but by low discount rates that cause biotechs to act as very volatile zero-coupon bonds. Essentially, any break-even or cash burning equity (for example, a “software as a service” company) is a duration play that is very valuable in times of meager rates. This duration phenomenon makes it difficult for investors like us who rely on valuation metrics as a safety measure. Flexibility is key, and investors may need to widen their horizons when it comes to investing metrics.

Perhaps inflation might be triggered by relentless monetary easing. Still, demographics and the accumulation of past debt that depresses spending may keep rates low for a long time. Admittedly, several of us have been wrong for years with reflation forecasts. As before COVID-19, growth stock performance may continue once the post-recession bounce occurs. The virus sped up existing trends, and the major one is that financial gravity will remain low and allow long-duration assets to thrive. Our focus on the current recovery has pushed this fundamental change in the markets to the background.
At the core, we believe COVID-19, as well as the prospects for developing effective vaccines and treatments, will be crucial factors in determining how the investment landscape evolves through the end of the year.

Worldwide, the number of daily new cases has not peaked; however, daily deaths appear to have peaked in mid-April. We view this as evidence the healthcare community is getting better at treating patients and reducing mortality. In the United States, the daily case rate remains volatile due to a number of factors. In some regions, new case rates are trending upward. Importantly, daily deaths and hospitalizations in the U.S. as of late June had declined from their peak, which we believe may be the more important statistics to watch.

Looking forward, if a “second wave” of new cases causes hospitalizations and deaths to climb, we would expect economic activity (which has been improving) to lose momentum or potentially take another turn for the worse.

Vaccines and therapeutics to treat COVID-19 are being developed with unprecedented speed and cooperation, and a vaccine could be available as early as the fourth quarter of this year. Wall Street and the healthcare community appear to be cautiously optimistic these efforts will produce fast and effective solutions, but we are still in the early stages of development. We expect investors to keep a close eye on safety and efficacy results from upcoming clinical trials, which are likely to move markets.

In the Equity Income portfolio, we are focused on healthy dividend yields and dividend growth. The global shutdown of economic activity caused by COVID-19 has stressed most corporations. One stress is the willingness and wherewithal to continue to pay a dividend. Fifty-four companies in the S&P 500 Index have reduced or eliminated dividends so far this year. In this environment, our focus on companies with diverse business models, strong balance sheets, resilient cash flows, and a commitment to dividend payment and growth is paramount.

While it’s hard to say the 2020 election has been pushed to the background, it is probably getting less attention from investors than it would in a pandemic-
free environment. The results of the 2016 election taught us that polling data is less than reliable; nevertheless, as we get closer to November we expect increasing focus on election odds and how each candidate’s prospective policies could impact the economy and the market.

We also have observed that many stocks are pricing in a scenario where this environment is the “new normal.” We do not have a high degree of confidence that, one year from now, the majority of Americans will still be working from home, cooking our own food, and shunning air travel. But it’s a possibility. We believe it will be profitable to focus on companies flexible enough to serve customers in whatever environment the new normal turns out to be.

How are you thinking about the consumer collectively, and what are the important data points to follow?

On a state-by-state basis, businesses are being allowed to reopen, sometimes in a limited capacity. This is good news for some, but unfortunately we believe the downturn was too severe for many businesses, primarily small ones, and they will not be back. The fear now is a “second wave,” or uncontrollable resurgence of the virus that throws us back into lockdown mode. The consumer savings rate has skyrocketed, which can serve as good “dry powder” for future spending. However, many are still unemployed. In our view, the key at this point for consumers is to get the economy fully reopened.

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As stimulus programs expire, Fed activity bears watching

The COVID-19 economy and financial markets are being influenced by behavioral changes and monetary and fiscal stimulus. The former affects the level of real economic activity, while the latter influences asset prices. In the next few quarters, we believe the Federal Reserve’s (Fed) support of credit and interest rates will lead to an unprecedented level of liquidity in capital markets. This liquidity will continue to drive asset prices – and asset price correlations – higher. The next signpost for duration and depth of Fed monetary activity occurs at the end of the third quarter, when many programs are set to expire. We believe political and populist pushback will begin to appear in our national dialogue. While we believe fiscal programs have targeted individuals to good effect, the majority of the policy support measures have targeted markets and financial assets.

Of particular concern is the Fed’s execution of individual bond purchases. While broad support of the credit markets was necessary in March when financial conditions collapsed, targeting individual issuers carries even more moral hazard than actions already taken. Within the BBB-rated bond sector, the largest component of the investment-grade universe, credit matrices are widely disparate. Spreads during COVID-19 reflect this reality. Investors should be mindful that with record bond issuance on an already leveraged corporate sector, Fed liquidity support will not make insolvent enterprises viable. Credit research and selection is critical.

As the economy returns to “normal,” the most valuable data series is continuing jobless claims. Approximately 4.5 million companies applied for the Payroll Protection Plan and rehiring is a condition of that aid. How quickly labor markets can heal is key to returning to sustainable economic growth.

The 10-year U.S. Treasury has been locked in a very narrow range during this period, supported by $120 billion of monthly bond purchases from the Fed. If and when this slows, we expect a modest increase in 10-year yields. On the equity side, retail traders have emerged as the marginal buyer. It bears watching how this phenomena plays out over the coming quarters. In the meantime, our focus is on deep dives into balance sheets, free cash flow, and corporate strategy to ensure investment income expectations of interest payments or dividends are met in our portfolios.

While we collectively watch the daily developments in infection data along with treatment and vaccine research, we fully expect that we have moved past lockdowns and are moving into an “adapt, modify, monitor” phase.
Healthcare system’s response could drive equity markets

As investors are painfully aware, global economic activity came to an abrupt halt during the COVID-19 pandemic and subsequent government-imposed lockdowns. U.S. fiscal and monetary policymakers acted swiftly and took bold measures to minimize the impact of the economic shutdown. These unprecedented policy actions have thus far proven to be a tremendous success in mitigating sustained economic damage.

For the rest of 2020, we believe the biggest influence on equity markets will be the healthcare system’s response to the COVID-19 crisis. Timing and success of various vaccines and therapeutics will affect equity markets over the near to intermediate term. With the reopening of the economy, we will very likely see a second wave of occurrence; however, the healthcare system is better equipped than before, and with better treatment options we believe a second wave would just be a bump in the road.

Recent data indicates that April marked the trough in economic activity. Since bottoming in late March, the market has largely discounted the dismal outlook for corporate earnings in 2020 and has shifted its focus to the prospects for growth in 2021 – albeit from depressed levels. However, it can be expected that costs of $3 trillion (and counting) in spending will have some unforeseen negative economic consequences in the future.

We will closely be watching for signs of any inflationary pressures that could lead to higher interest rates as well as an abrupt shift in the Federal Reserve’s current extraordinarily dovish posture. We do worry the trillions in government spending ultimately will result in a weaker U.S. dollar and inflation. Contrary to most academics’ dire predictions, we have seen no dark side (so far) from the massive government spending. This is something we will monitor, as once the spending spigot is turned on, it is difficult to turn off.

The U.S. presidential election will undoubtedly serve as a major focus for investors in the second half of 2020. Current polls favoring Democrats suggest the election could have negative implications for the markets through higher corporate tax rates and increased regulation. We don’t necessarily think a Biden victory would be a big negative for markets; however, a Democratic sweep of both houses of Congress would instill fears of higher corporate and individual taxes and a higher capital gains tax rate. A lot can still happen between now and November. We caution against leaning too heavily on polls, which were proven unreliable in the last presidential election.

Contrary to most academics’ dire predictions, we have seen no dark side (so far) from the massive government spending.
Regardless of the exact shape of the recovery, the outcome of the election, and the risk of a second wave of COVID-19, we believe the key point for investors to recognize is that things are getting better. The pandemic caught the world flat-footed on a variety of fronts, but we have since made tremendous progress in a short period. We expect this trend to continue. Our portfolio consists of both cyclical companies that are well-positioned to benefit from the reopening of the global economy and companies that are seeing an acceleration in their secular growth rates due to the response to COVID-19.

**3. Patients** – The people who seek care from providers in a variety of settings, including emergency rooms, physicians’ offices, outpatient surgical centers, and imaging centers.

The COVID-19 pandemic, and the subsequent restrictions and shutdowns that were imposed on the healthcare industry, affected each of these segments very differently.

First, the providers were hit the hardest because most healthcare professionals not directly involved in the care of patients with COVID-19 were prohibited from providing care to any patients except for emergencies. For many physicians and dentists in private practice, case volumes dropped by as much as 90%. This was economically devastating for them. Hospitals were among the hardest hit. According to consulting firm Kaufman Hall, the median operating EBITDA margin for U.S. hospitals dropped from 6.5% in February to -19% in April. The American Hospital Association estimates hospitals will be negatively impacted by $36 billion in the four months between March and June 2020.

Payers were actually beneficiaries of the shutdown of the economy, especially the healthcare economy. This may seem a bit odd, but given “shelter-in-place” orders for patients and doctors alike, there was a dramatic drop in the number of claims that managed care organizations needed to pay providers. As a result, they generated excess profits. Many managed care plans decided to take these excess profits and reinvest them into the communities they serve.

Patients, meanwhile, were forced to cancel and reschedule office visits and defer elective procedures.

The magnitude of the changes to the healthcare system was greater than we had expected. The nearly complete shutdown of the healthcare industry (18% of U.S. GDP) was unprecedented. Initially, many thought that the shutdown would be short-lived. However, as the incidence and death rates rose, the wait for the curves to flatten and ultimately decline took longer than anyone expected.

While we did not make many changes to our portfolio, we were blessed to have certain companies benefit from the pandemic, especially the trend to telemedicine. In addition, a point-of-care diagnostic test maker benefited from COVID-19 as it developed specific assays for the rapid detection of SARS-CoV-2.

The road to recovery in the U.S. healthcare industry is underway. **It is our opinion that it will take at least a year to bring healthcare companies and players back to pre-COVID levels, both in terms of revenues and profitability.**
Trying to position portfolios for one outcome or to time the next move in asset prices is a fool’s errand.

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Pandemic prognosis: More volatility

The market remains resolutely focused on the rate of COVID-19 infections, deaths, and potential therapies. The shelter-in-place orders were meant to prevent excessive burden on our healthcare system. Whether it was because of or in spite of these measures, broadly speaking, the healthcare system was not overwhelmed. If anything, it faces risk of underutilization. While the number of infections appears to be increasing in at least a dozen states, politicians appear to be taking a more targeted approach to shutdowns. Despite worrying signs, we still do not expect a repeat of widespread lockdowns unless the number of hospitalizations increases beyond the current capacity of hospital systems. Furthermore, the unified effort in the pharmaceutical and biotech industries is encouraging. However, there is no guarantee a vaccine will be approved and broadly distributed to the public within the next 12 months, if ever. News around therapeutics and hospitalization rates is likely to be a source of volatility moving forward.

Moreover, in response to the potential economic impacts, which to date remain uncertain, both fiscal and monetary policy makers from around the world have injected unprecedented amounts of liquidity and fiscal stimulus into the economy. By some estimates, this assistance may amount to nearly 50% of GDP. Such actions helped reduce near-term liquidity concerns, aided near-term economic activity, and significantly boosted financial asset prices. We remain skeptical of the long-term implications and the extent that such actions will truly aid the long-term health of companies as well as the financial well-being of our population, particularly those who do not own financial assets. That said, we acknowledge their upward impact on financial assets.

To that point, while improved trends have recently aided financial assets and resulted in reduced volatility, we continue to see uncertainty and heightened risk of policy error. Trying to position portfolios for one outcome or to time the next move in asset prices is a fool’s errand. We focus on seeking and investing in durable franchises – profitable companies with proven management teams, low leverage, stable operating results, and defensible, differentiated business models – and establishing prudent valuation methodologies. We expect, however, that bouts of extreme volatility (and potentially erratic drawdowns) will rear their heads again within a reasonable investment horizon. We stand ready to capitalize on irrational price movements and bring liquidity to assets that may be sold (or bought) indiscriminately during times of distress. This process has consistently generated alpha on a historical basis.
Consequences loom from stimulus

What matters most right now for risk assets is how quickly the economy can broadly reopen, to what level of economic activity do we return, and how much structural damage has already been done. The liquidity crisis that occurred in March was solved rather quickly and the cracks that opened up in the economy have been largely papered over by monetary and fiscal stimulus measures. So now the key question is: Do those cracks widen and turn into a deep sinkhole? Do we move into a solvency crisis phase, driven by a lackluster recovery (or a second wave of the virus) that causes irreparable damage to corporate and household balance sheets, not to mention state and local governments? We simply do not know the answer to this question yet, and more clarity is not likely to be achieved until later this summer and into the fall. Our portfolios continue to be broadly aligned with the prevailing bullish trend, although we have attenuated credit risk more recently and restocked some dry powder. As always, we stand prepared to react to bouts of heightened volatility and take advantage of attractive relative value and compelling risk-adjusted opportunities as they arise.

One key topic to monitor is the long-term impact of unprecedented monetary and fiscal stimulus measures. The U.S. is projected to run a nearly $4 trillion budget deficit this year, necessitating a massive amount of Treasury issuance. The Federal Reserve will continue to monetize a good portion of this debt, quietly tucking it away in the basement of the Marriner Eccles building like the Ark of the Covenant at the end of Raiders of the Lost Ark. But the remaining Treasury issuance will need to be purchased by actual investors, and at some point these investors may begin to choke on all of the extra supply and demand higher yields. In a world of extremely low yields and excessive leverage, higher Treasury rates in the midst of a tepid recovery would likely not end well.

On a related note, most investors seem to believe never-ending stimulus is now a fait accompli. While this may be true on the monetary side, ongoing fiscal support is less certain but more crucial in order to fill the sizeable GDP output gap. Easy monetary policy and quantitative easing have proven very effective at propping up risk assets, but much less so at stimulating the real economy. Another relief package...
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is likely to pass this summer, although the size and specifics are to be determined. With the November elections on the horizon, this will likely be the last major piece of legislation until after Congress reconvenes in January. With some key CARES Act benefits set to roll off soon, avoiding a fiscal stimulus “air pocket” is critical. The results of the election will also heavily influence the likelihood and shape of any additional fiscal spending. If the Democrats manage a clean sweep or President Trump wins re-election, the fiscal stimulus should continue to flow in some form. If the Democrats take the White House but not the Senate, however, then things could very well grind to a halt as Senate Republicans revert to their Obama-era playbook.

Finally, another scenario that bears mentioning is a faster than expected recovery in economic activity. This is most definitely not on anyone’s radar at the moment, with all attention turned to the current economic wreckage and the pandemic itself. If we do experience a sharp rebound in the second half of the year and carry that momentum into 2021, this would catch many people wrong-footed, most importantly the Fed and policymakers in Washington. This could necessitate a swift and jarring course correction in terms of stimulus, since pumping trillions of liquidity into an economy that is growing rapidly introduces a raft of undesirable side effects.

**How do you see the corporate debt landscape changing, and are you capitalizing on these changes? How do you expect this to affect benchmarks and various fixed income markets as a whole?**

The U.S. corporate debt market experienced a seismic shift on March 23, when the U.S. Federal Reserve announced plans to begin purchasing investment-grade (IG) corporate bonds on a direct basis, and both IG and high yield (HY) bonds indirectly via ETFs. The Bank of Japan and the European Central Bank have long-standing corporate bond-buying programs, but U.S. investors have always looked askance at this practice. Central banks buying their own sovereign debt in connection to sterilization operations or quantitative easing, sure, but the Fed purchasing corporate bonds (or equities, for that matter) has always been viewed as crossing the Rubicon.

The proximate impact of this announcement was not surprising. The Fed effectively gave investors an all-clear signal to buy risk assets, and that is exactly what they did. It is no coincidence that March 23 marked the cycle low for equities and the peak in credit spreads. Having already transitioned from a defensive posture to a much more aggressive stance with respect to credit risk, the portfolios we manage were well-positioned to benefit from this development. Our fundamental thesis was not contingent on stimulus alone, either bog-standard QE or corporate bond-buying in particular, but the Fed backstop created a powerful tailwind for risk assets we are not inclined to fight for the time being.

The longer-range implications are more nettlesome, of course. The implicit transfer of corporate credit risk onto the Fed’s balance sheet has the potential to disrupt price discovery and short-circuit the creative destruction process. This will prevent many zombie companies from shuffling off this mortal coil, shambling along instead while moaning “Liquidity!” long past their sell-by dates. In an ironic twist, the Fed’s recent actions to prop up capital markets (yet again) actually prevents capital markets from serving their basic purpose – accurately pricing risk and efficiently allocating capital. If this dynamic persists, a plausible end result is a moribund economy lacking in dynamism, productivity growth, and the ability to generate wealth outside of rent-seeking, monopolistic pricing power, and financial engineering gimmickry. What dreams may come, indeed.
Uncertainty, volatility ahead as investors learn and adapt

The famous exhortation “don’t judge the economy by the stock market” rings as true as it ever has, perhaps more so. Having learned lessons from the Great Financial Crisis of a decade ago (although one could ask what lessons), central banks and governments globally took action in March as it became more obvious the world economy was facing its steepest decline in generations due to COVID-19 lockdowns. The result was a huge bounce in equity markets to such an extent that some indices are even positive on a year-to-date basis – most notably the NASDAQ in the U.S., which had risen over 10% by mid-June in spite of the country being technically in recession since February.

Cyclically exposed European equity markets have fared worse than the tech-heavy indices in the U.S. They’ve also lagged Japan, which appears to have handled the pandemic much better than other countries. But in a nutshell, all investors are trying to figure out how much the enormous stimulus can offset the economic contraction resulting from the lockdowns. This uncertainty and volatility will continue for the foreseeable future as investors adapt, learn more about the virus, and get answers to questions such as the amount of asymptomatic transmission, when will a vaccine be ready, can we find treatments, will there be more widespread lockdowns? For the moment, given the drop in activity, there is little concern that expansive quantitative easing (QE) and fiscal policy will engender inflation, but there is less certainty about the impacts further out in time. Closer to the present, volatility levels will not in any way be dampened by the presidential race in the U.S., which is already turning out to be a nasty faceoff.

Regional equity market performance has varied, but there has also been a big difference in performance between what are perceived as value and growth sectors. For example: The disparity between the weight of the financials and energy sectors compared to the weight of the IT and healthcare sectors within the MSCI ACWI (All-Country World Index) has rarely been more extreme. There may be some justification for this in the current environment, but we anticipate it will narrow in the longer term.
The COVID-19 pandemic is by far the largest current market performance factor. Optimism and pessimism regarding the development of a vaccine and treatments for the virus move markets on a day-to-day basis. Despite the market’s fixation on vaccines and treatments, “herd immunity” improves daily, which slows the spread of the virus. Another factor that may boost herd immunity is the prevalence of MMR vaccinations in the U.S. The MMR vaccine (mumps, measles, rubella) is thought to offer partial virus immunity since Madagascar and American Samoa have had few virus cases, post large-scale population vaccinations with the MMR vaccine. Despite a recent blip upward in COVID-19 virus infection growth rates in the U.S., we expect virus case growth rates to decelerate again. In addition, Australia, now entering its winter season, is so far not showing significant acceleration in virus case growth rate. Other encouraging signs are the decline in fatality rates, and reports from Italy that indicate the virus is losing lethality as it mutates. New treatments are coming onto the market including an approved drug, Remdesivir, which helps speed patient recovery. Additional bullish factors are accommodative fiscal and monetary policies, including loans to businesses and cash payments to consumers, and asset purchases in addition to two interest rate cuts by the Federal Reserve. The positive fiscal and monetary backdrop should not be ignored as the stock market swings on vaccine and treatment headlines. In summary, we believe the pandemic’s days are numbered as treatments draw nearer to approval and herd immunity builds.

How are you approaching portfolio construction and keeping proper beta exposure?

We have increased portfolio beta and are positioned for the expected economic rebound as the pandemic fades. Our largest sector overweights are consumer cyclicals and industrials as we look for a rebound in economic growth including travel, consumer spending, and capital spending, and we are looking to add to the healthcare and technology sectors, which we think are poised for recovery.
From vaccine to China, many things to watch

Many factors will continue to impact the remainder of 2020. All eyes will be focused on the progress of a vaccine for COVID-19. Although economies continue to open up around the world, many consumers will not return to pre-COVID-19 activity until they are convinced a vaccine is available. Attitudes will improve with the development of anti-viral remedies and successful treatments of the virus. Key variables to monitor are the infection rate, hospital capacity, ICU utilization, and the ability of the healthcare community to handle a potential second wave of the virus.

This leads to changes in consumer spending, confidence, and ultimately the growth of the economy. Broadly speaking, every holding in the portfolio is impacted to some degree but the sectors having a specific impact include the consumer and healthcare sectors. Some healthcare spending is driven by elective procedure volumes while consumer spending is dependent on the confidence of staying employed and remaining healthy. We have seen dramatic swings in restaurant, retail, hotel, flight travel, cruise ship activity, and healthcare utilization, to name a few.

Several items bear close watching as the pandemic runs its course. To reduce the impact from shutting down the economy the Federal Reserve has taken unprecedented actions in terms of expanding its balance sheet while we have also witnessed a ballooning of the Federal deficit. The impact to inflation, interest rates, and the dollar are unknown. In addition, the trade negotiations with China have been put on the back burner while questions/suspicions about the origin and response to the virus have been added to the significant strategic and commercial tensions in the relationship. Finally, the outcome of the upcoming elections will be important to monitor.
About Carillon Tower Advisers

Carillon Tower Advisers is a global asset management company that combines the exceptional insight and agility of individual investment teams with the strength and stability of a full-service firm. Together with our partner affiliates — ClariVest Asset Management, Cougar Global Investments, Eagle Asset Management, Reams Asset Management (a division of Scout Investments) and Scout Investments – we offer a range of investment strategies and asset classes, each with a focus on risk-adjusted returns and alpha generation. Carillon Tower believes providing a lineup of institutional-class portfolio managers, spanning a wide range of disciplines and investing vehicles, is the best way to help investors seek their long-term financial goals.

About Our Affiliates

ClariVest Asset Management applies a behavioral-based investment philosophy in seeking alpha for clients. Our time-tested investment process combines quantitative tools with qualitative work to capture the return potential created as investors react inefficiently to significant shifts in a company's fundamental growth cycle. Portfolio managers work as a cohesive team to manage multiple equity strategies across geographies and the market-cap spectrum.

Cougar Global Investments is a tactical ETF global macroeconomic asset allocation manager that believes the goal of investing is to achieve compound annualized returns for clients. We use a disciplined portfolio construction methodology combining post-modern portfolio theory and risk management to pursue our clients' objectives.

Eagle Asset Management is built on the cornerstones of intelligence, experience, and conviction, driven by research and active portfolio managers. Our long-tenured investment teams manage a diverse suite of fundamental equity and fixed income strategies designed to meet the long-term goals of institutional and individual investors. Our teams have the autonomy to pursue investment decisions guided by their individual philosophies and strategies.

Reams Asset Management (a division of Scout Investments) is a fixed income investment management firm whose mission is to provide high-quality investment expertise and unmatched client service. We apply our consistent investment process across a range of strategies, seeking to take advantage of volatility and react opportunistically to price and valuation dislocation in the bond market. Reams offers clients customized solutions that seek to maximize risk-adjusted total returns over a full market cycle and across a range of fixed income strategies.

Scout Investments' independent equity investment teams take a selective approach, using rigorous research and analysis to seek out high-quality companies and patiently pursue long-term capital appreciation for clients. Our thoughtful approach to asset management extends to cultivating lasting partnerships with our clients.

Disclosure

All investments are subject to risk. Asset allocation and diversification do not ensure a profit or protect against a loss. There is no assurance that any investment strategy will be successful or that any securities transaction, holdings, sectors or allocations discussed will be profitable.

This material may include forward-looking statements. These statements are not historical facts, but instead represent only beliefs regarding future events, many of which, by their nature, are inherently uncertain. You should not place undue reliance on forward-looking statements as it is possible that actual results and financial conditions may differ, possibly materially, from the anticipated results and financial conditions indicated in these forward-looking statements.

There are uncertainties, unknown risks, and other factors that may cause actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements.

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Indices are unmanaged, and one cannot invest directly in an index.

Definitions

The S&P 500 Index measures change in stock market conditions based on the average performance of 500 widely held common stocks. It is a market-weighted index calculated on a total return basis with dividend reinvested. The S&P 500 represents approximately 75% of the investable U.S. equity market.

P/E ratio measures a company's current share price relative to its per-share earnings.

Gross Domestic Product (GDP) is the total value of goods and services provided in a country during one year.

Alpha measures performance against a benchmark.

Beta measures the sensitivity of an investment to the movement of its benchmark.

The MSCI ACWI® (All Country World Index) measures the performance of large and mid-cap stocks across 23 developed markets (DM) and 24 emerging markets (EM) countries.
Partners in asset management

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