CETERA® INVESTMENT MANAGEMENT

COMMENTARY

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Our Three Predictions for 2020 Remain Intact

- The economy will likely experience a U-shaped recovery
- Market volatility will remain elevated, but we do not expect a retest of March lows
- Widening market breadth should lead to a shift in market leadership

In early May, we laid out our three primary economic and market predictions for the balance of 2020. They were a U-shaped economic recovery, elevated market volatility without retesting lows, and a rotation into different types of companies and sectors leading markets forward. A month has passed, and the economic and market environment has improved, so let's review these forecasts for any changes.

The U.S. economy has started the reopening process, and given the sharp recession we are experiencing, there is much speculation about the speed and velocity of the eventual recovery. Market optimists suggest a V-shape recovery where the economic decline and subsequent rise are both quick. Market pessimists suggest an L-shape to the recovery where the economy continues to weaken. We still believe the most likely scenario is somewhere between the two perspectives, taking on more of a U-shape, where the recovery is positive but at a slow, modest pace. We believe the economic hit from COVID-19 was front-end loaded with terrible March data followed by even worse April numbers. While we are now seeing May readings that are still bad, the data is slowly improving, as we anticipated: jobless claims are still very elevated, but overall are in decline; weak manufacturing results have bounced off historic lows; and a recovery in air travel that is still about 90% below year-ago levels but, at the same time, has quadrupled from April lows. While we are pleased with these and other so-called "green shoots," we still maintain our belief that the still-weak labor market and general caution will keep consumer spending guarded for some time. Case in point: the sharp jump in the April personal savings rate to 33%, a historic and unprecedented level. More savings—and therefore less spending—possibly suggest a slower U-shaped recovery than the current V-shape the equity markets have optimistically priced in.

Our second prediction was, and still is, that markets will remain volatile but are not likely to hit the lows seen in late March. On the positive front, there are reasons to be optimistic: monetary and fiscal stimulus should help bridge the gap until we see clear evidence of an economic recovery; social distancing and other containment measures have helped slow the growth of new COVID-19 cases; and since many second-quarter economic data estimates had anticipated a June reopening, the lifting of these measures in May is a positive surprise to equity investors. On the other hand, this year's severe drop in corporate earnings, elevated market valuations in which the S&P 500 trades relative to forward earnings are at a level not seen since the early 2000s (22x), political uncertainly around elections in Washington, D.C., and growing concerns about the state of the U.S.-China trade deal may all weigh on investor sentiment for some time. Taken together, these market tailwinds and headwinds will likely keep volatility elevated and potentially pressure equities. Despite this, we believe markets will not test the March lows, and that a more likely scenario is a 10% to 15% correction from current levels. Keep in mind that markets tend to average a correction about once every 12 months, so such a pullback would be fairly normal.

Our final prediction remains that we will likely see market breadth widen, leading to a shift in market leadership. Over the past 12 months through June 4, the technology sector has been the clear driver of broad market returns and has more than tripled the return of the S&P 500 (+35.8% versus +11.0%). Much has been written about the narrow leadership even within this sector. Recessions have historically had consequences that have led to shifts in market dynamics. We believe this current recession will be no different, and we have already seen evidence as the industrial (+17.0%) and financial (+15.5%) sectors have far outpaced the S&P 500 (+9.5%), while the technology sector is just keeping pace (+9.5%) over the past month. We believe the technology sector should continue to benefit from growth in innovation and information access, and financials and industrials, leaders in past post-recession market recoveries, should also continue to benefit from the economy reopening. Beyond a shift in sector leadership, we have also seen market breadth widen as investors have become more confident in the economic recovery prospects. For example, around 96% of stocks in the S&P 500 index are trading above their 50-day moving average.

Recessions are a normal part of the business cycle. However, the COVID-19-induced recession was unusual in its simultaneously impacting both the supply and demand parts of the economy. Social distancing has worked to stem the spread of illness, but these same efforts have led to mounting economic costs. As businesses reopen, optimistic investors have been looking beyond today's poor data to focus on the economic recovery. With this as a backdrop, we remain confident in our three predictions for the balance of this year. We continue to recommend sticking to risk tolerances consistent with your long-term goals and objectives, and being diversified among sectors and asset classes. These are challenging and uncertain times, but your financial professional can help you stay on course.

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Glossary

The **S&P 500 is an index** of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

The **Dow Jones Industrial Average** is a price-weighted average of 30 U.S. blue-chip stocks traded on the New York Stock Exchange and NASDAQ. The index covers all industries except transportation, real estate and utilities.

The **Russell 2000 Index** measures the performance of the small cap segment of the U.S. equity universe and is a subset of the Russell 3000 Index representing approximately 10% of the total market capitalization of that index. It includes approximately 2000 of the smallest securities based on a combination of their market cap and current index membership.

The **NASDAQ Composite Index** includes all domestic and international based common type stocks listed on The NASDAQ Stock Market. The NASDAQ Composite Index includes over 2,500 companies, spanning all 11 sector groups.