Perspectives

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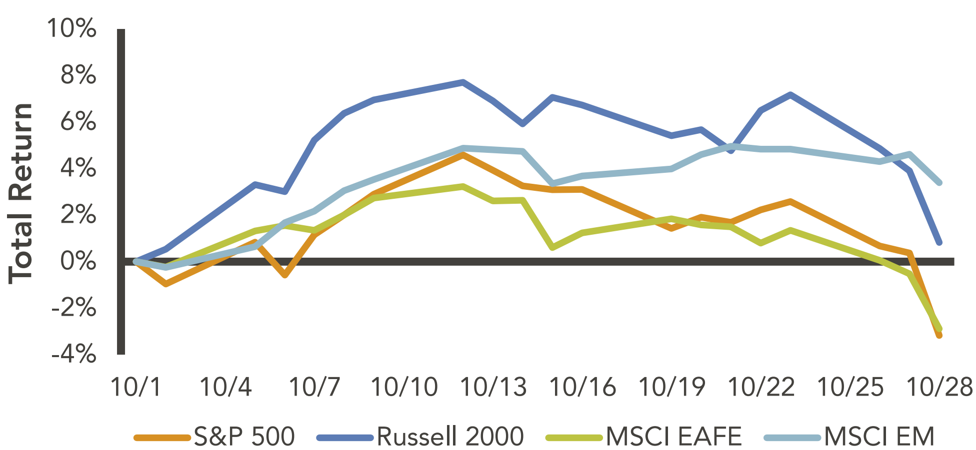
Equities Falter Amid Uncertainty

Evan Frazier, CAIA
Research Analyst,
U.S. Equities

October has been a tale of two months for equity market participants. While the first half of the month saw solid performance from risk assets, major equity indices have struggled in recent days as investors continue to grapple with political, economic, and public health uncertainty. The broad-based S&P 500 Index continued its slide on Wednesday, dropping 3.5% amid flights to safe havens including the dollar and U.S. Treasuries. Small capitalization stocks have experienced a similar pullback in late October, culminating in a Wednesday decline of 3.0% for the Russell 2000 Index. As of market close on October 28th, the two domestic indices are down 6.8% and 5.8% from their respective intramonth peaks. International developed equity indices have also retreated during the latter half of the month, with the MSCI EAFE Index down 5.9% from its mid-October high. Emerging market stocks have not seen drawdowns of the same magnitude in recent days, however the MSCI EM Index did give up 1.1% during Wednesday's market rout. Perhaps unsurprisingly, October has also seen a surge in the CBOE Volatility Index, which has risen over 50% in the past two weeks, reaching a level not seen since June.

Exhibit 1: Equity Indices Whipsaw in October



Source: Bloomberg

One of the main drivers of recent equity market volatility is uncertainty surrounding the resurgence of COVID-19, both at home and abroad. The United States is now averaging roughly 70,000 new coronavirus cases per day (and rising), which constitutes an increase of over 20% from last week alone. More than 10 states have recorded their highest number of deaths in a single day during the month of October, prompting many officials to call for additional shutdowns of non-essential businesses. Europe has also seen a spike in COVID-19 infections, with countries like Belgium and the Czech Republic reporting records for new daily cases within the last week. On Wednesday, German Chancellor Angela Merkel and French President Emmanuel Macron both announced new lockdown measures aimed at curbing the spread of the virus within their countries and alleviating pressure on their already strained healthcare systems. These measures — which include the closures of restaurants, bars, and gyms — go into effect this week and could last more than a month. While these and other efforts may serve to better control the spread of the virus, they will likely result in lower earnings for many businesses, as well as higher unemployment.

While the EU has provided multiple rounds of stimulus to its member nations, U.S. equities have been further hampered by a lack of fiscal relief measures. The CARES Act, passed in March, offered support to beleaguered companies in the early days of the pandemic and helped spur many indices to new highs. Since that time, efforts to pass a second stimulus bill have failed, and hopes for a bipartisan aid package in the coming weeks have all but faded. Recent GDP numbers are encouraging, as the U.S. economy saw an annualized and seasonally adjusted growth rate of 33.1% in the third quarter, which beat previous estimates and represents a 7.4% increase from the previous three-month period. That said, economists predict modest growth going forward, and millions are still unemployed and heavily dependent on government benefits. With a deeply divided Congress and a contentious election now less than a week away, individuals and companies alike are unsure of when to expect additional relief. This uncertainty contributes negatively to investor sentiment and can lead to earnings disappointments and market drawdowns.

Though we are pleased with market performance since March lows, the uncertainty surrounding the COVID-19 pandemic presents an ongoing danger to equities, evidenced by recent drawdowns. Recent data on increased infections, hospitalizations, and deaths related to the coronavirus are concerning, especially with the winter months quickly approaching. To this point, Asian countries like China, Taiwan, and South Korea have had success in containing the virus, which helps explain why emerging market indices have held up relatively well in the last few weeks. That said, due to their cyclical nature and dependence on global economic growth, non-U.S. equities are particularly likely to suffer in the face of widespread lockdowns related to a "second wave" of COVID-19 cases. U.S. stocks will also be affected by the virus going forward, as well as fiscal uncertainty. Still, there are reasons to be optimistic. The resolution of the upcoming U.S. election will provide some clarity to investors regarding future tax and regulatory policy. Additionally, global central banks continue to deliver unprecedented monetary support, and a sustained low interest rate environment will benefit many struggling businesses, especially growth-oriented names. Finally, and perhaps most importantly, the race for a COVID-19 vaccine may be nearing the finish line, as many experts believe effective treatments will be available for broad dissemination as early as the beginning of 2021. It will ultimately be this vaccine that leads the global economy out of its coronavirus-induced malaise once and for all. Until then, it is reasonable to expect significant fluctuations in equity indices like those experienced in recent days. Investors should exercise restraint and remain focused on long-term policy objectives, even in the face of volatile markets in the coming months.

PREPARED BY MARQUETTE ASSOCIATES

180 North LaSalle St, Ste 3500, Chicago, Illinois 60601
CHICAGO BALTIMORE MILWAUKEE PHILADELPHIA ST. LOUIS

PHONE 312-527-5500
WEB MarquetteAssociates.com

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