Madison INVESTMENTS

# MONTHLY PERSPECTIVES - DISCIPLINED EQUITY

## August 2020

In the final days of July, with the S&P 500® Index on its way to another stellar 5.6% monthly return, the official GDP results were issued for the second quarter. At a -31.9%, it was the worst recorded quarter in history for economic growth. Once again, the stark contrast between our economic woes and stock market returns was vividly in evidence. One insight into this seeming contradiction can be found in the divergences among the major domestic stock indices, which has been notable this year. The leading index for 2020 through July was the tech-heavy NASDAQ composite, up 20.5%, while the Dow Jones Industrial Average lagged at -6.1%. The S&P 500 was in between, up 2.4%. While the COVID epidemic has been trampling many companies, the technology companies that have led the market have flourished as locked-down Americans focus on Internet commerce and entertainment. Five firms, Apple, Facebook, Amazon, Google parent Alphabet and Microsoft, account for close to 40% of the NASDAQ and 20% of the S&P 500, while only Microsoft and Apple are part of the Dow. These tech firms are all up double-digits year-to-date. A better sense of the fate of the average company comes from the equal-weighted S&P 500, where each stock is given the same influence on returns. This benchmark is down -6.5% for the year.

In terms of the robust monthly returns, it was a broad rally with only the Energy Sector in negative territory and the Financial Sector lagging the Index. A rebound in retail sales helped propel the Consumer Discretionary Sector up by 9.0%.

Even more vital than the impact of mega-cap tech stock success on market returns this year has been the unprecedented fiscal and monetary stimulus coming from Washington and the Federal Reserve. As July wound down a major aspect of the CARES Act fiscal stimulus, the $600 per week unemployment bonus, came to an end, putting millions of families into potential financial hardships, since around 32 million Americans are currently collecting unemployment benefits. Falling back to pre-CARES unemployment levels would mean an average cut in benefits of some 61%. While many expect a new package of aid to be approved by Congress in August, the details have yet to be worked out and expectations are that it will not match the original CARES Act in terms of size or reach.

While market returns since March suggest overall optimism, we see considerable complications, the reduction in stimulus being just one. Domestically, the rise in COVID cases, particularly across our populous southern states, is especially worrisome. Backing off the more aggressive economic openings in these states is already underway and could become more severe if the trend lines don't respond. One of the best ways to measure the economic outlook is to listen to the major domestic banks whose business interests intersect with the broad economy through corporations, small businesses, consumers and international influences. One of the most telling points we're hearing in these calls is how little visibility there is. As JP Morgan Chase CEO Jamie Dimon said in mid-July, "You're going to have a much murkier economic environment going forward than you had in May and June...the word unprecedented is rarely used properly. This time, it's being used properly."

We are already hearing concerns from clients regarding the impact of the November elections and what a change of administration might mean for the economy. While top-down policies clearly count, it would be a mistake to align changes in Washington leadership with any predictable economic or market outcome. Macro factors can easily overwhelm policy shifts and even the consequences of seemingly straightforward policy shifts can lead to unforeseen results. What we are all looking forward to is a world less dominated by the pandemic; a relief likely relying on biology and the massive efforts being deployed worldwide to find treatments and a vaccine. While the market is quick to respond to any bright news on medical treatments and vaccines, experts have predicted that we won't be back to normal activities for at least another year or even longer.

One lesson we can already take from the past six months is the complexity of forces that drive markets. If in the depths of the market crash in March investors had been given a magical look into the future via the charts of COVID incidence across the country in July, the decision to retreat from the market would have looked obvious. Of course, just the opposite was called for as the market rallied sharply from these lows. As the leaders of our largest banks are telling us, attempting to make the same sort of predictions in this climate is particularly speculative. The alternative is to focus on the knowable. We can analyze a company's business model, its fiscal soundness and its competitive position in its industry. Focusing investments on the strongest companies in enduring economic sectors with an eye on valuation seems to us the only sensible way to proceed.

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