clearstead
MARKET MINUTE

2020 VOLUME : MAY REVIEW

This month's Market Minute reflects the views of Clearstead's Research Team and was composed by [Daniel Meges, Director, Research]

OVERVIEW

Global equity markets exhibited a wide dispersion of returns in May, with US market trading up nearly +4.8% (S&P 500) by the end of the month. Meanwhile, overall Emerging Markets barely moved, and the Chinese markets traded down. US markets were buoyed by the gradual economic re-opening in most US states as well as progress to develop an effective vaccine for the Coronavirus by year's end. These monthly market gains were made despite nearly universally poor economic data being reported across the globe in May, poor near-term corporate earnings reports, and a marked deterioration in the economic relationship between the US and China. Between April and May's strong returns, the S&P 500 is now down only -5.0% YTD and about -10% from its all-time high close achieved on February 19, 2020.

DOMESTIC EQUITY

As of May 31, 2020

U.S. EQUITY MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
DJIA	4.7%	16.4%	-10.1%	4.8%
S&P 500	4.8%	18.2%	-5.0%	12.8%
Russell 2000	6.5%	21.1%	-16.0%	-3.5%
Russell 1000 Growth	6.7%	22.5%	5.2%	26.3%
Russell 1000 Value	3.4%	15.1%	-15.7%	-1.7%

U.S. equities continued to move higher in May as concerns about the Coronavirus and its potentially negative economic impact subsided somewhat amid hopes for a treatment. Small caps (Russell 2000) outpaced large caps (S&P 500) amid hopes for domestic economic resilience, while growth (Russell 1000 Growth) outperformed value (Russell 1000 Value) by +3.3% as investors continued to favor growth stocks. Given the volatility of sentiment regarding the coronavirus and the lack of clarity around the virus's impact on corporate earnings and economic growth, we remain cautious of the market rally and cognizant that the market may reverse course if the US experiences a new spike in cases or if the path to a near-term vaccine erodes.

INTERNATIONAL EQUITY

As of May 31, 2020

INTERNATIONAL EQUITY MARKETS				
Index	1 Month	Quater-To-Date	Year-To-Date	1 Year
MSCI ACWI ex USA	3.3%	11.1%	-14.8%	-3.4%
MSCI EAFE	4.4%	11.1%	-14.3%	-2.8%
MSCI Emerging Markets	0.8%	10.0%	-16.0%	-4.4%
MSCI EAFE Small Cap	7.1%	18.3%	-14.3%	-0.8%

Developed international equity markets also rebounded in May as the reopening of many European economies progressed, but still lagged the gains made in the US markets. The developed markets (MSCI EAFE) were up +4.4%. Meanwhile, emerging markets (MSCI EM) were up only +0.8% as many EM countries, particularly in Latin American and in India, continue to see Coronavirus cases swell. Small cap stocks (MSCI EAFE Small Cap) led the rally in developed markets, gaining as much as +2.7 percentage-points more than their large cap peers.

As global markets grapple with the market impact of the Coronavirus, they are also simultaneously facing the prospect of an increasingly strained relationship between the US and China. The month of May saw a steady stream of negative headlines including the US Senate passing a bill to increase the accounting scrutiny of Chinese firms whose shares trade on US exchanges, an acrimonious World Health Organization Summit which saw both sides trade accusations regarding the spread of the Coronavirus, and the US threatening sanctions and tariffs related to China's treatment of Muslim religious minority as well as a planned law to curtail some of Hong Kong's legal rights and autonomy. US relations with China are likely to figure prominently in the upcoming US Presidential campaign and it is highly likely that the US-China relationship deteriorates further as the election approaches.

FIXED INCOME

As of May 31, 2020

FIXED INCOME MARKETS				
Index	1 Month	Quarter-To-Date	Year-To-Date	1 Year
BarCap US Aggregate	0.5%	2.3%	5.5%	9.4%
BarCap Global Aggregate	0.4%	2.4%	2.1%	5.6%
BarCap US High Yield	4.4%	9.1%	-4.7%	1.3%
JPM Emerging Market Bond	5.9%	8.2%	-4.5%	1.8%
BarCap Muni	3.2%	1.9%	1.2%	4.0%

Two dynamics were driving fixed income security returns in May. The first, was the steepening of the US yield curve as yields for longer-dated Treasuries began to reflect the US government spending dynamics over the next 12 to 24 months. Secondly, the risk-oriented fixed income, such as corporate high yield and emerging market debt, saw spreads tighten over the course of the month as investors sought out higher yielding products. Although fixed income risk assets (i.e. HY & EMD) have been exceptional performers for the past two months, they still lag the BarCap US Aggregate index on a YTD basis. Municipal bonds also witnessed a strong rally in May, but the "AAA" 10-year Muni/Treasury ratio remains elevated relative to its longer-run average.

Since mid-April the 10-Year Treasury has traded in a relatively narrow band as fixed income market participants believe the Fed will adopt a "Yield-Curve Control" policy that would put a cap on the yields of longer-term U.S. Treasury debt by actively intervening in debt markets to maintain a target rate. Such a policy could reinforce the "lower for longer" interest rate outlook

CLOSING

As we have noted previously, bear market rallies are not uncommon during a recession. Many companies have suspended earnings guidance during their most recent quarterly calls and it is likely that the global economy in a post-COVID-19 world looks very different than it did prior to the virus outbreak. This uncertain backdrop likely sets the stage for bouts of volatility in markets until the nature of post-COVID 19 recovery becomes clearer and visibility into the corporate earnings outlook is sufficient to support sustained advances in financial markets.

The probability of the most severe economic scenarios envisioned in mid-March have steadily diminished as both fiscal and monetary policy quickly ramped up, but the markets are increasingly pricing in a very benign post-COVID-19 world in 2021 which may not come to pass. Given this backdrop, we believe selective investment opportunities are likely to emerge for patient investors.

Sources: