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In this week's recap: With no fiscal stimulus anticipated and election around the corner, stocks slumped through a difficult week.

Weekly Economic Update

Presented by Edward Papier, CIMA® CFF, November 2, 2020

THE WEEK ON WALL STREET

Stock prices dropped last week as hopes for a fiscal stimulus bill faded and investors focused on rising COVID-19 infections, here and abroad.

The Dow Jones Industrial Average slid 6.47%, while the Standard & Poor's 500 tumbled 5.64%. The Nasdaq Composite index lost 5.51% for the week. The MSCI EAFE index, which tracks developed overseas stock markets, slumped 5.02%.[1,2,3]

A DIFFICULT WEEK FOR STOCKS

Stocks opened the week lower as lawmakers failed to pass a fiscal stimulus bill and a pick up in the number of new COVID-19 cases in the U.S. and Europe. Hardest hit were companies most exposed to pandemic-related economic impacts, including energy, travel and leisure, and industrials.

Losses accelerated mid-week on reports of rising coronavirus-related hospitalizations, along with news that Germany and France were reinstating partial shutdown restrictions.[4]

Stocks attempted to recover on Thursday, but took another leg lower on Friday as earnings reports from the mega-cap technology companies failed to impress investors.

POSITIVE ECONOMIC NEWS

There were several strong economic reports during the week, but investors paid little attention. Among the highlights were durable goods orders, which rose for the fifth consecutive month, a sharp drop in initial jobless claims that were the lowest since March 14th, and a 33.1% annualized jump in economic growth during the third quarter.[5,6,7]

Investors also ignored a strong start to earnings season, which has seen 85% of reporting companies in the S&P 500 index beating earnings estimates by an average margin of 19%.[8]

THE WEEK AHEAD: KEY ECONOMIC DATA

Monday: ISM (Institute for Supply Management) Manufacturing Index.

Wednesday: ADP (Automated Data Processing) Employment Report. ISM (Institute for Supply Management) Services Index.

Thursday: Jobless Claims. FOMC (Federal Open Market Committee) Meeting Announcement.

Friday: Employment Situation.

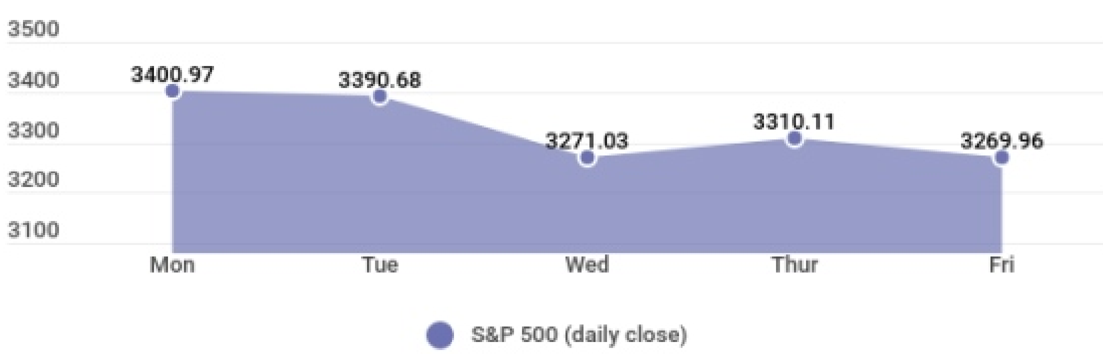
QUOTE OF THE WEEK

"You will not be punished for your anger;

You will be punished by your anger"

BUDDHA

Market Index	Close	Week	Y-T-D
DJIA	26,501.60	-6.47%	-7.14%
NASDAQ	10,911.59	-5.51%	+21.61%
MSCI-EAFE	1,789.64	-5.02%	-12.14%
S&P 500	3,269.96	-5.64%	+1.21%



	Treasury	Close	Week	Y-T-D
	10-Year Note	0.88%	+0.03%	-1.04%

Sources: The Wall Street Journal, October 30, 2020; Treasury.gov, October 30, 2020

Weekly performance for the Dow Jones Industrial Average, Standard & Poor's 500 Index, and NASDAQ Composite Index is measured from the close of trading on Friday, October 23, to Friday, October 30, close. Weekly performance for the MSCI-EAFE is measured from Friday, October 23, open to the Thursday, October 29, close. Weekly and year-to-date 10-year Treasury note yield are expressed in basis points.

OF NOTE

The 60% stock/40% bond portfolio is largely a relic of the past, with alternatives likely to become a bigger portion of investors' portfolios over the next decade, asset management chiefs said during a panel discussion at a recent Milken Global Institute Conference. For decades, investors could rely on a portfolio of 60% equities, 40% bonds to smooth out the stock market's volatility and still meet retirement goals. No longer.[9]

"There is a shift away from the traditional 60/40, 'we will get you into retirement safely' model, partly because of lower return expectations," said Hanneke Smits, chief executive of BNY Mellon Investment Management "If we have years ahead of low rates and perhaps also, in some sectors, anemic growth and companies that can't cut expenses any further, you are going to have to come up with different models to get people going into retirement their desired outcomes."

Here's the math: 60% allocated to the S&P 500 Index equals 60% times 5.70% which equals 3.42%; 40% allocated to 10-year Treasury Notes equals 40% times 0.74% which equals 0.296%. Added together you get a 60% stock / 40% bond return of 3.72%. That's on the optimistic side.

We say optimistic because we're using the high end of Vanguard's recent 10-year forecast for large-cap U.S. stocks. In their October Market Perspectives letter, they are predicting 3.7% to 5.7% annualized. That seems high in comparison to GMO's 7-year Real Return Forecast of negative 5.8% per year, Ned Davis Research's various 10-year forecasts of 0% to 3.36% (essentially earning the dividend yield) and John Hussman's 12-year forecast of slightly negative returns. Let's say the range is 0% to 5.70%. Either way, a 60% stock / 40% bond return of 3.72% is unlikely and not what investors are expecting.

Perhaps that's why the asset management chiefs at the Milken Conference suggested alternatives become a bigger portion of investors' portfolios. What do alternatives look like? On the fixed-income side, we are looking at a 7% to 10% yielding income funds secured by middle market debt, energy royalties and other income plays; on the real estate side are multi-family housing paying 8-10% and targeting IRRs in the high teens/low 20s; on the private equity side, secondaries and co-GP structures are in vogue. For most investments, one must be an accredited investor. The task is then to gain access and conduct proper due diligence. Portfolio sizing is paramount.

Further, there are better weighting processes compared to capitalization weighting and innovative ETFs that can hedge downside risk exposure. In addition, we recommend diversifying to select co-investments, promissory notes, litigation finance and debt strategies with warrants, among others, for a portion of the portfolio.

So, the idea is not to get depressed. Just think differently. Grant Williams recently commented "It seems that the government's share of our economies will continue to rise or stay very elevated for much longer than many had assumed. Our economies are becoming more state economies with central planners trying to manage them. They will fail over the long term, but this set-up may be bullish for selected risk assets and before the long-term negatives hit."

Keep that quote in mind as you think about your portfolio construction. Going into 2010, 10-year government bond yields were 3.86% and the forward return outlook for equities was in the low to mid-teens (then we were coming out of the housing crash and the Great Recession). Our starting point today is vastly different. The next 10 years will look nothing like the last 10 years.

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The Dow Jones Industrial Average is an unmanaged index that is generally considered representative of large-capitalization companies on the U.S. stock market. Nasdaq Composite is an index of the common stocks and similar securities listed on the Nasdaq stock market and is considered a broad indicator of the performance of technology and growth companies. The MSCI EAFE Index was created by Morgan Stanley Capital International (MSCI) and serves as a benchmark of the performance of major international equity markets, as represented by 21 major MSCI indexes from Europe, Australia, and Southeast Asia. The S&P 500 Composite Index is an unmanaged group of securities that are considered to be representative of the stock market in general.

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CITATIONS:

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