# The Cobblestone Advisor

Investment Brief

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COBBLESTONE CAPITAL ADVISORS

## A Halting Recovery

In the third quarter, US equities continued their impressive recovery from the COVID-19 pandemic lows of late March. After increasing +20.5% in the second quarter, US large cap stocks were up +8.9% in the third quarter, despite a correction of -10% that began in early September. The S&P 500 is now up +51.7% from its March 23 low, +5.6% year-to-date, and +15.1% over the last year. While this increase is a bit difficult to reconcile with all that has happened in the world over the last 12 months, 2020 is proving to be a stark reminder of the inherent unpredictability of financial markets.

Small-/mid-cap US stocks and international stocks—both developed and emerging markets—were also up in the third quarter. Nevertheless, these other segments of the stock market remain in negative territory for 2020, continuing a pattern of divergence that has been in place for most of the past decade. Likewise, the pattern of Growth stocks outperforming Value stocks continues relatively unchecked, as lower interest rates and the recent dislocations in traditionally cyclical parts of the economy have provided investors justification to bid up Growth stocks with less concern for valuation than might otherwise prove prudent. Growth stocks have outperformed Value stocks (as measured by the Russell 1000 indices) by 43%, 19%, 12%, and 7% annually over the last 1-, 3-, 5-, and 10-year periods, respectively, and now sport valuation premiums approaching levels not seen since the tech stock frenzy of the late 1990s. Understandably, this phenomenon is beginning to test the patience of investors that may not be accustomed to having to wait this long to see the benefits of diversification in their portfolios. However, just as trees don't grow to the sky, neither should we expect the same group of stocks to outperform all others indefinitely.

The recovery that we have seen in the markets likely reflects a number of realities. At or near the top of the list are the incredible amounts of stimulus that have been thrown at the economy to help bridge to the far side of a pandemic event that the market seems willing to consider temporary. Most importantly though, we continue to see signs that a hesitant economic recovery remains underway.

The services sector—which includes the hospitality and retail industries and has been the hardest hit part of the economy since March—has started to improve globally. The Markit Global Services PMI hit a seven-month high (52.0) in August and continued to signal expansion in September, now indicating three consecutive months of expansion amid a further reopening of businesses and greater end-client demand. Growth was underpinned by rising levels of incoming new work, as COVID-19 lockdowns and restrictions were eased in many territories. Financial services and business services, important sources of job creation, both experienced a strong revival as well.

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| Total Return (%), Ending 9/30/2020 | | | | Annualized | | |
|---|---|---|---|---|---|---|
| | Qtr | YTD | 1 Year | 3 Years | 5 Years | 10 Years |
| S&P 500 Stock Index | 8.93 | 5.57 | 15.14 | 12.26 | 14.12 | 13.72 |
| Russell 2000 (Small Cap Stocks) | 4.93 | -8.69 | 0.39 | 1.77 | 7.99 | 9.84 |
| MSCI EAFE (International Stocks) | 4.80 | -7.09 | 0.49 | 0.62 | 5.26 | 4.61 |
| MSCI EM (Emerging Markets) | 9.56 | -1.16 | 10.54 | 2.42 | 8.96 | 2.50 |
| Bloomberg Barclays US Aggregate Bond Index | 0.62 | 6.79 | 6.98 | 5.24 | 4.17 | 3.63 |
| Dow Jones US Select REIT | 0.83 | -21.36 | -22.33 | -1.85 | 1.99 | 7.02 |
| Consumer Price Index (% Chg over Period) | 0.96 | 0.48 | 1.20 | 1.76 | 1.80 | 1.75 |

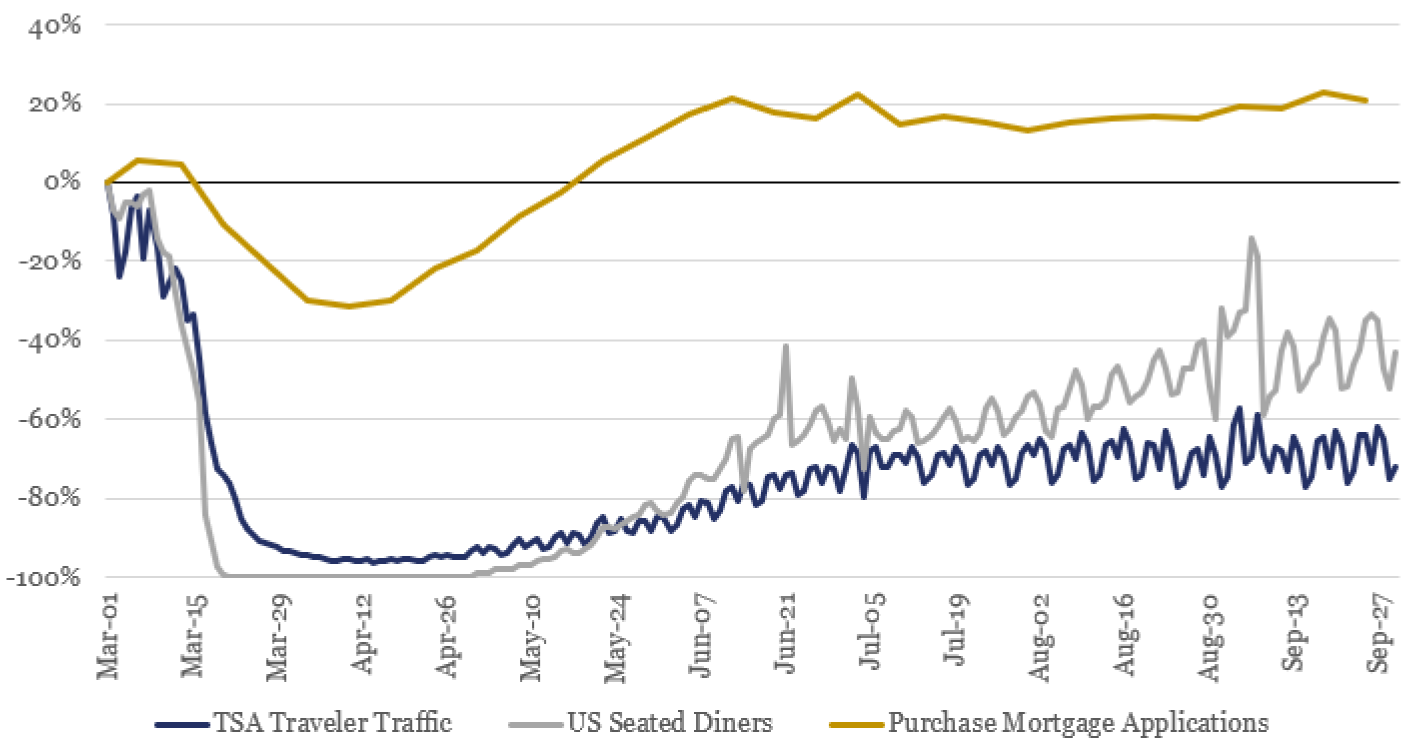
Most encouragingly, this uptick in economic activity happened despite a second wave of COVID-19 hitting many parts of the US that were largely spared during the first wave in the spring. The below graphic shows a handful of high-frequency economic indicators—data points that can be measured and reported regularly and in real-time. These indicators suggest that the economy continued to trudge higher during the summer months, a contrast to the near cessation of economic activity that we witnessed in March and April. To be sure, some of the metrics—especially those related to travel and leisure—remain at extremely depressed levels. However, the trend provides some measure of reassurance that future ebbs and flows in the course of the global reaction to the hazards of COVID-19 can be navigated without necessarily resorting to the total lockdown that was so economically damaging at the outset of the pandemic.

In order for the recovery to be sustainable, we will need to see continued healing in the labor markets. Recent data suggest reason for cautious optimism. Unemployment fell to 7.9% in September after hitting an 80-year high in April. Continuing jobless claims are also signaling that the worst of the recession for the labor market is likely behind us. However, if this improvement in the job market stalls or reverses course, we run the risk that layoffs meant to be temporary become permanent.

In this regard, the continued importance of monetary and fiscal stimulus cannot be overstated. While the stimulus measures enacted thus far have been essential in helping allow the US economy to remain afloat through the crisis, concerns about the adequacy of what has been implemented are rising at the same time the political will to inject further stimulus into the economy may be waning.

So, while the continued improvement in financial markets and early signs of an economic recovery are encouraging, the near-term outlook as it relates to the pandemic and its lingering impact on economic growth is quite murky. Further, with US elections now less than a month away, overall uncertainty is extremely high.

Investors should be prepared for this uncertainty to bring potentially significant bouts of volatility over the remainder of the year, and perhaps beyond. However, it is important to remember that short-term volatility does not compel activity, either in anticipation or in response. Portfolios that are appropriately constructed and in alignment with long-term client objectives are specifically designed to withstand periods like this.




Source: Transportation Security Administration, OpenTable, Mortgage Bankers Association, Bloomberg.