

Third Quarter 2020

The Fed's commitment to propping up the economy was on full display this quarter.

Stocks and bonds moved substantively higher in the third quarter powered by an ultra-accommodative Federal Reserve. As is typical coming out of a recession, stocks have recovered faster than the economy itself, which remains in a somewhat fragile state. The US economy continues to show progress in employment, production and spending, yet the rebound has slowed after an initially sharp bounce. The pandemic forced over 23 million Americans out of work at its height, and over 12 million individuals remain jobless and in need of additional fiscal support as we enter the fourth quarter.

Index/Instrument	Category	Q3 Total Return	YTD Total Return
S&P 500	Large-capitalization US stocks	8.93%	5.57%
S&P 400	Mid-capitalization US stocks	4.77%	-8.62%
S&P 600	Small-capitalization US stocks	3.17%	-15.26%
Nasdaq 100	Large-capitalization US stocks	12.62%	31.65%
Russell 2000	Small-capitalization US stocks	4.93%	-8.70%
MSCI World ex USA Index	Developed markets international stocks	5.01%	-6.71%
MSCI Emerging Markets Index	Emerging markets international stocks	9.65%	-0.96%
Bloomberg Barclays US Aggregate Bond Index	Investment-grade US bonds	0.62%	6.79%
Bloomberg Barclays US Treasuries	US government bonds	0.17%	8.90%
Bloomberg Barclays US Investment Grade Corps	US investment-grade corporate bonds	1.54%	6.64%
Bloomberg Barclays US Corporate High-Yield Bond Index	US corporate high-yield bonds	4.60%	0.62%
Bloomberg Barclays US MBS Index	US mortgage-backed securities	0.11%	3.62%
Bloomberg Barclays Global Aggregate Bond Index	Global investment-grade bonds	2.66%	5.72%
Bloomberg Barclays Global High-Yield Bond Index	Global high-yield bonds	4.28%	-0.58%

By the numbers, 2020 is shaping up to be the worst year for the global economy since the Great Depression, with global GDP expected to contract around 5% this year before rebounding by the end of 2021. The virus continues to spread pain, with flare-ups threatening to dampen progress in the US and abroad. While the science fighting COVID-19 has progressed quickly, no single country or economy is expected to return to normalcy until a vaccine is produced, approved, and distributed to the masses – a process most investors expect will take a year or more.

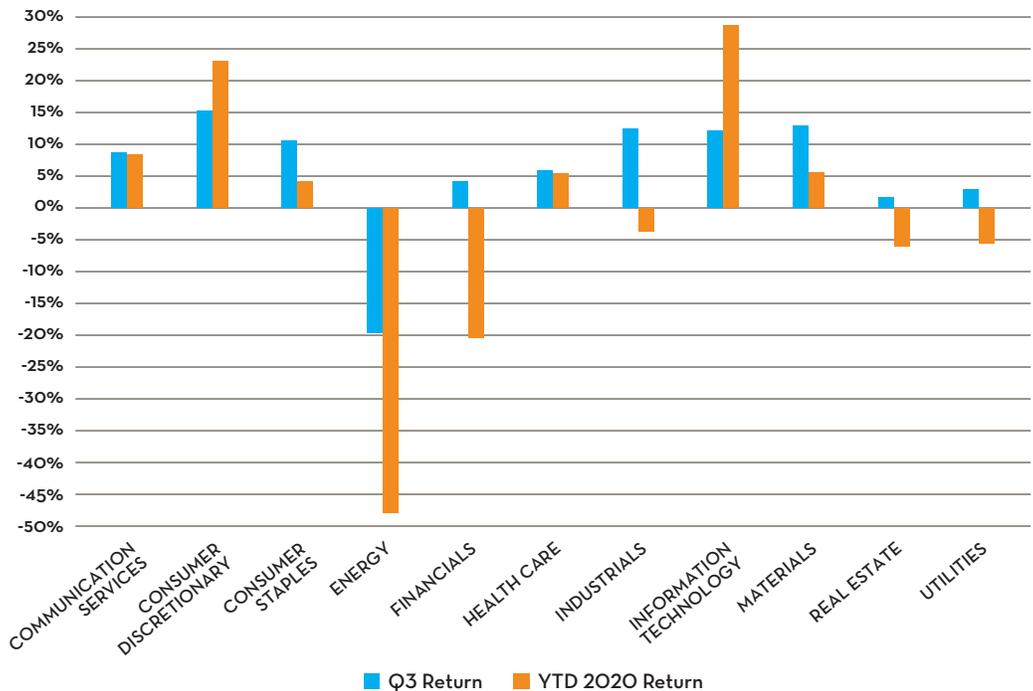
The Fed's commitment to propping up the economy was on full display this quarter. Their current forecast calls for keeping interest rates lower for longer (into 2023) and, in a change from past policy, will allow the economy to run "hot", drawing



Quarterly Outlook

OCTOBER 2020

S&P 500 Sector Returns



more workers into the labor force before cooling it down with an interest rate hike. The new approach will focus on average inflation targeting instead of a specific 2% target. The change in policy de-emphasizes concern that low unemployment leads to excess inflation, a phenomenon we have not seen in many years, mostly due to globalization. In sum, the Fed has remained in “whatever-it-takes mode,” and investors responded by pushing the S&P 500 to fresh highs in August before closing the quarter with a nearly 9% total return to find positive territory for the year. The Fed can only do so much, however, as their primary monetary tool works with lag – a problem for those struggling to pay rent today.

Another dose of fiscal fuel for small businesses, ailing industries, and unemployed individuals is imperative to avoid permanent, lasting damage to the economy. The fiscal support received thus far has provided a necessary bridge to solvency for many. A new fiscal deal has been slow to come as lawmakers and Washington struggle to align our public health and economic wellbeing. For sure, the pandemic has exposed our economic disparities and poked large holes in America’s public health infrastructure. Our ability to adapt to these challenges will determine how quickly we return to pre-pandemic levels of economic output and begin to thrive once again.

Stocks took a necessary pause in September due to concerns of overconcentration and frothy valuations. The third-quarter rally eventually broadened, though, with most sectors gaining ground besides energy. We expect markets to remain rangebound and volatile for the remainder of the year as a recent resurgence in worldwide coronavirus cases weighs on the economy along with political noise and elevated unemployment levels (still at 7.9%).

There is reason for optimism on the horizon even though the economy remains bifurcated. Following a historic 31% plunge in the second quarter, third-quarter



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GDP is expected to rebound by roughly 25%, led by strength in the manufacturing and housing sectors, technology spending, retail sales, and improving productivity. Economists expect that fourth-quarter GDP will likely moderate to about 5%, contracting 4% for the entire year. Creative destruction will continue to reshape the travel and entertainment industries, which constitute a smaller portion of the economy in terms of jobs (still a very painful process). With the easy gains banked, we expect economic progress to be uneven and choppy for the remainder of the year. Nevertheless, we do expect to continue to grind higher overall given the massive amount of stimulus currently in the system.



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