Legacy Trust

Investment Perspectives

Mid-Year Market Outlook

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Laina M. Mills, CFA, CFP®
Chief Investment Officer

Key Takeaways

- The Covid-19 pandemic continues to impact economies worldwide
- The stock market recovery has been robust but may be subject to more volatility on increases in virus cases and geopolitical disruptions
- Uncertainty is running high near-term but we believe there are many reasons to be optimistic longer-term
- We recommend maintaining equity allocations at their strategic weights to be best positioned for the economic recovery

The Covid-19 pandemic has reaccelerated since mid-June and has threatened the economic recovery in the U.S. Other high-population countries including Brazil, India and Russia are still in the midst of tackling their first major wave of the outbreak. In the midst of this environment of continued uncertainty in the near-term, we believe there are many reasons to be optimistic about the prospects for the U.S. economy and the stock market going forward.

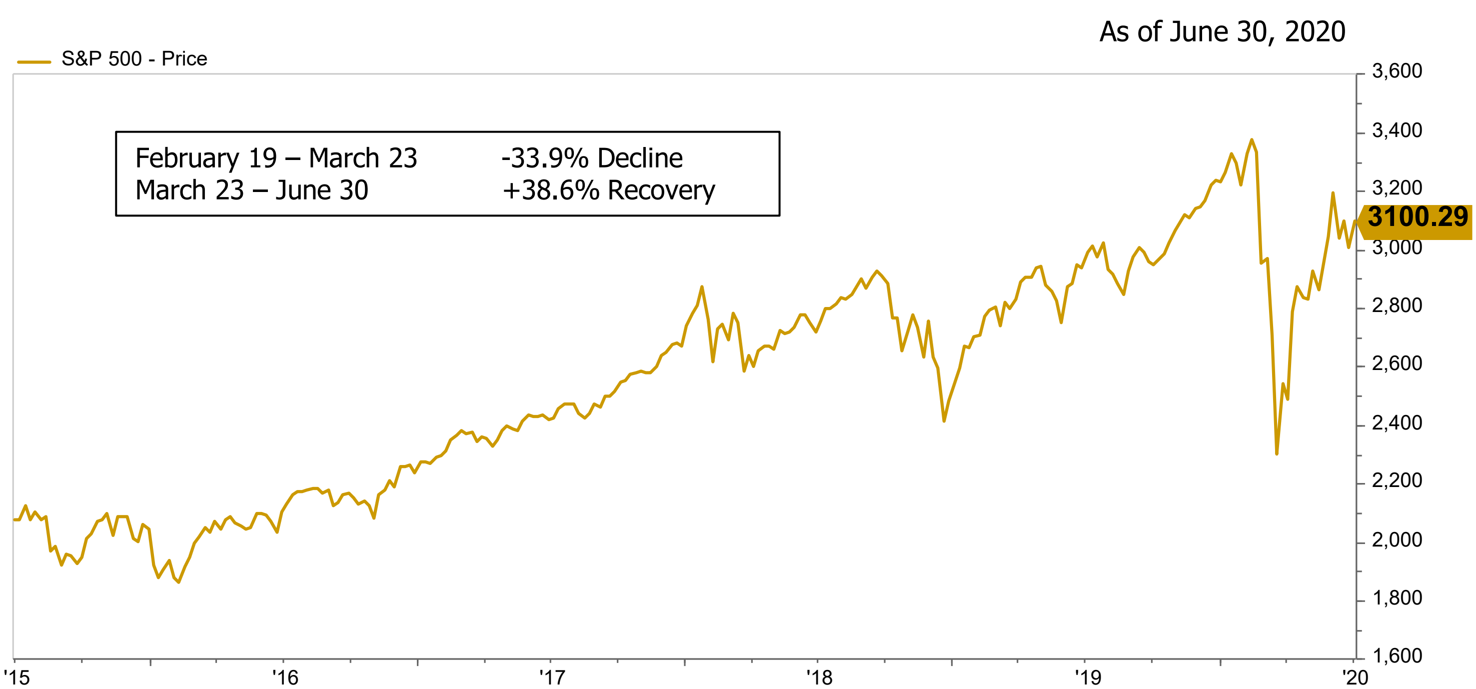
The Covid-19 pandemic has meaningfully reaccelerated on a global basis since May, largely driven by outbreaks in emerging markets including Latin America, Russia, and the Middle East. The U.S. has also experienced a reacceleration of virus cases since mid-June with active outbreaks in key states in the South and West, although we are beginning to see indications that these states may be reaching their peak. Many states have paused or reversed their reopening plans as a result. While it appears that the domestic economy bottomed in April during the wide-spread government shutdowns, the recovery that began to take hold in May and June is moderating as the outbreak continues.

Economic data has rebounded significantly with nonfarm payrolls in May-June reversing about a third of the decline that occurred earlier in the year. Initial claims for unemployment insurance have been largely trending lower and the ISM Services and Manufacturing readings have shown significant jumps off the April lows. However, certain industries in the entertainment and travel sectors remain depressed. Commercial air travel remains much lower than normal and Open Table data shows that restaurant dining remains depressed and is reversing from the beginnings of a recovery that began in May-June. U.S. GDP readings are still widely expected to show a significant decline in Q2 and a partial recovery in Q3, but the worsening of the virus situation has many analysts revising Q3 expectations lower.

Congress is widely expected to pass another round of fiscal support in late July or early August. However, the two sides remain very far apart in expectations for what will be included in this bill and negotiations are ongoing. The failure to pass an additional support package would be received poorly by the markets. Equity markets have been supported in part by the significant fiscal and monetary stimulus measures that have already been enacted. Despite the liquidity pushed into the market, inflation is expected to remain lower for longer (below pre-Covid rates) for several years due to lower consumer demand and heightened unemployment.

Market volatility has been extremely high in 2020 and is expected to remain elevated as we grow closer to the November elections. Sentiment has shifted meaningfully toward the likelihood of a Democratic sweep of the White House, House of Representatives and Senate, which predictive markets now rate at a ~60% probability of occurring. Based on sector- and stock-specific performance, it does not appear that the market has priced in the current odds of a Democratic sweep. In the event that the election plays out as currently predicted, policy risks around higher taxes on high-income households and businesses and increased taxes on capital gains/dividends are likely to take a bite out of company earnings in 2021 and beyond, which will be a headwind for stock prices.

The S&P 500 experienced a 34% peak-to-trough decline from Feb 19 through March 23 but has since rallied significantly and is largely flat YTD. Growth sectors, particularly mega-cap tech and communications, have significantly outperformed as a return to rock-bottom interest rates and a scarcity of growth has increased demand for these companies. Traditional value/cyclical sectors including financials, energy and industrials have lagged but are



still expected to outperform when the pandemic becomes more contained and the economic recovery takes hold.

While equity valuations are today above median levels due to recovering stock prices and falling earnings estimates, they are not out of expected ranges given the environment of low, stable inflation and valuations could have room to grow for some time. The S&P 500 trades at 22x forward earnings today, which is near the top of its range dating back to the mid-90s, but this is occurring in an interest rate environment where rates stand in the bottom 1% of their range over the same period. Accordingly, the difference between the equity earnings yield and bond yield still significantly favors equities today.

In conclusion, we believe the current environment favors investors remaining fully invested in equities relative to the neutral weightings laid out in their Investment Policy Statements. While there are many near-term concerns surrounding the pandemic, the election, and ongoing geopolitical disruption, we believe these are outweighed by the expectation of the pandemic eventually receding and giving way to a true economic recovery, coupled with the ongoing monetary support provided by the Fed. Volatility will be high, especially around the November elections as increased mail-in voting may lead to delayed results and recounts, but this challenge will soon pass and markets will be able to price in the results appropriately. The pandemic has presented new challenges on a variety of fronts but we remain confident in the ability of the economy to adapt and thrive even in through this unique set of circumstances.