Reilly Financial Advisors

THE ECONOMIC MONTH IN REVIEW AND OUTLOOK – SEPTEMBER 2020

U.S. Markets and Economy

Over the last 100 years, September has been the worst month for the stock market overall, and September 2020 dealt investors another loss, further cementing the month's bad (albeit inexplicable) reputation. After an early month head fake, which took the Dow Jones Industrial Average (DJIA) above 29,000 and the NASDAQ above 12,000, the September historical bugaboo reappeared and took the NASDAQ down more than 5% for the month, with the S&P 500 index down 4% and the DJIA, which has trailed the broader indexes on the upside, down 2%.

Last month, we said the sharp recovery for stocks this year was powered by fiscal policy, monetary policy, and hopes for a rapid reopening of the economy. The outlook for all three deteriorated in September, which can explain the month's weakness. Fiscal policy appears gridlocked, with Republicans and Democrats unable to negotiate a compromise on a new spending bill. Although Pelosi and Mnuchin continue to negotiate, the two sides have yet to get to "yes." This delay in needed new stimulus could weaken an economy whose growth rate has already slowed with the expiration of earlier fiscal programs, such as extended unemployment insurance. One indicator, monthly employment growth for September, was weaker than expected and far below the first months of recovery from the COVID-19 economic collapse. Although third quarter GDP will show a strong rise from the depressed second quarter of the year, Wall Street is already anticipating a stall in growth in the fourth quarter without new fiscal stimulus.

And news on the vaccine front was mixed at best. While several vaccines are in Phase 3 trials—the last major hurdle before FDA approval—it is clear that results may not be definitive before the end of the year. Even if there are no further glitches in Phase 3 (one vaccine trial was halted temporarily when an experimental subject had a severe adverse reaction), it will require many additional months to produce, deliver, and administer the billions of doses the world needs to conquer this invisible killer. While the number of vaccine candidates is so large that it is very likely there will be successful distribution of an effective and safe vaccine in 2021, Wall Street wants results now. With no vaccine until next year, stocks must contend with rising rates of infections in many U.S. states, even before winter arrives. Some epidemiologists worry there will be additional spikes as cold weather drives people inside, where the virus thrives. With an estimated 90% of the population still not exposed to the virus, the U.S. is nowhere near the level of herd immunity required to drive down the number of new infections. Spikes in infections will slow economic activity and thus act as a further drag on stocks.

World Markets and Economy

European stocks fell a bit in September but held up better than U.S. stocks. The blue-chip Eurofirst 300 index fell only 1% for the month but is still down 13% for the year. Many countries in Europe seemed to have brought the virus under control only to witness new spikes when virus restrictions were eased. Europe's growth was already slow, and rising infections will only slow it further. Europe must also contend with Brexit as the two sides move closer to a stalemate, which will cause the United Kingdom to leave with no deal. A "no deal" Brexit will harm the British the most, but all of Europe will experience some economic disruption.

Japanese stocks gained slightly for September. New Prime Minister Suga promised to continue the policies of Abenomics, making the leadership transition fairly smooth. In addition, Japan's industrial output rose for the third straight month, signaling a sustained recovery from virus-induced weakness earlier in the year. Overall, the Japanese have done a good job of containing the virus, which has helped their economic growth.

Chinese stocks had a bad month of September, with the Shanghai index falling more than 6%. While the economy continues to recover from the virus, the economic cold war between the U.S. and China will certainly hinder economic growth if Chinese tech champions are kept out of U.S. markets and cut off from American suppliers.

Outlook

The fast-approaching U.S. national elections add to economic and financial uncertainty. The first "debate" settled nothing, and then at the very beginning of October, President Trump was hospitalized after contracting the virus and becoming ill. A number of his closest associates have also tested positive, which means the runup to the elections will be even more fraught with uncertainty.

Can monetary policy save the day? Jerome Powell has already stated publicly that he wants more help from the fiscal side. This is understandable, as the Fed has already undertaken extraordinary measures to shore up financial markets and driven short-term interest rates to zero. The Fed has now promised to keep them there for years and not let up on the monetary gas, even if inflation does reach 2% (a target the Fed never reached during the previous economic expansion). The balance sheet of the Fed has swelled to $7 trillion, up $3 trillion in a matter of months. The balance sheet now includes corporate and municipal bonds, which had never been in the Fed's portfolio since its founding in 1913. But the Fed cannot put money directly in consumers' pockets (like fiscal policy), nor can the Fed stop COVID-19.

U.S. stocks may be exceptionally volatile for the next 30–60 days. While the new bull market should remain intact, we are sailing in uncharted waters. Long-term investors, who remain unfazed during selling squalls, will no doubt be rewarded once again when the sun shines anew on a recovering America.

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