CERITY PARTNERS®

Outlook for June 2020

Key Market Drivers

Global Economies Reopen. Tensions Between U.S. and China Resurface.

With the easing of mobility restrictions and the reopening of businesses, the global economy likely bottomed at the end of April. Now all eyes are watching for any spike or resurgence in infection rates and the level to which consumers around the world re-engage. Here in the U.S., we remain concerned that a certain amount of structural (more permanent) unemployment may develop as businesses struggle to stay open under reduced capacity regulations. Additionally, state and local governments may have to reduce employment due to increasing fiscal pressure. Overseas, developed countries have taken some positive baby steps on the road to recovery. Germany and France have agreed to a fiscal recovery plan for European countries most in need that will be financed by the European Union's (EU) budget. This plan still needs approval from the full EU. Japan, one of the hardest-hit economies, has lifted its state of emergency for the entire country.

Amid all the news about the global reopening, a previous market driver has resurfaced. The U.S. and China appear to be devolving into an outright cold war, which would likely have a more significant impact on Chinese economic growth. Investors should watch for renewed tariffs on Chinese products and the continued removal of supply chains out of China.

Our Perspective

Equity Markets

- The U.S. stock market has recaptured approximately 70% of the value lost in the bear market. However, it may have gotten ahead of itself with a V-shaped recovery. We anticipate some pullback from these sharp gains as the economy and corporate earnings are not expected to fully rebound until early 2021.
- The valuation gap between European and Japanese equities has narrowed compared to U.S. equities. That said, the economic damage from COVID-19 is arguably more significant in these regions, so we expect these stock markets to generally track U.S. markets.
- Emerging markets are experiencing inconsistent performance. Increasing energy and commodity prices are helping several previously lagging Latin American stock markets. Chinese equities are coming under pressure from heightened political tensions with the U.S. and potential oversupply issues.

Bond Markets

- The Fed is expected to exert greater control over rates to engineer an upward sloping yield curve. The prospective flood of Treasury securities to finance burgeoning deficits should cause rates to rise. Fed purchases and the safe-haven aspect of the U.S. Treasury market should allow demand to largely soak up this supply.
- Increasing oil prices and optimism over the reopening of the economy have helped the high-yield bond market. Although, the prospective default rate has increased due to solvency concerns of U.S. corporations.
- The negative bond yields of fiscally-conservative European countries have generally made them a poor investment despite the European Central Bank's ongoing purchases. The spread between the German bund and countries with positive yields, such as Spain, Greece and Italy, have contracted to fair value.
- The factors driving the U.S. high-yield market are also helping emerging market debt to recover. Even so, too much reliance on dollar-based debt remains a hindrance to countries with large trade deficits. A flattening to declining dollar is especially helpful to this asset class.

Outlook for June 2020

Our Perspective (Continued)

Monetary Policies/ Currencies

- While the Fed remains committed to providing additional liquidity to challenged markets, it also needs fiscal policy support to prevent broad insolvencies of institutions and businesses. For a variety of reasons, it will likely take some time for Congress to agree on and pass another assistance package.
- The European Central Bank appears to be shrugging off a challenge from the German constitutional court about its aggressive bond purchasing program. The bank's actions should continue to provide ample liquidity to help prop up the region's stunted economic growth.
- The Peoples Bank of China continues to use more traditional rate-cutting policies to ensure ample liquidity. It has also allowed the renminbi to depreciate against the dollar. In addition to being an easing tool, this action facilitated government retribution for U.S. sanctions and heightened rhetoric.

What This Means for Investors

With global economies close to fully reopening by the end of June, the markets are eagerly anticipating signs of the magnitude of consumer and employee re-engagement. We expect numerous closures and structural unemployment in the industries most affected by the lockdown, which may lead to uneven economic results and a subsequent correction in the markets.

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