Outlook for September 2020

Key Market Drivers

Global Recovery Continues
Despite virus flareups, economies worldwide continue to recover from the COVID-19 induced recession thanks in part to increased government understanding about how to utilize targeted closures. The speed of each region's recovery will ultimately depend on many factors, including some unique to a specific area.

- **United States**. Housing and business capital spending have nearly rebounded to their February highs. The travel, leisure and commercial real estate industries will take much longer to recover, and employment losses could become permanent. Fiscal policy support for these sectors is essential for replacing incomes and sustaining jobs.
- **Europe.** This region's recovery will naturally be slower due to its greater reliance on the travel and leisure industries. With no fiscal support in sight, the progress of goods-producing countries, like Germany, is vital for preventing an economic relapse.
- **Japan.** Prime Minister Abe's resignation could be a blow to Japan's economic recovery. Although, his successor will likely continue the current fiscal policies. A delay of additional consumption tax increases or a rollback of the current one could stoke consumer spending.
- **China.** The growing tensions between China and the U.S. could limit the recovery in both Hong Kong and the mainland.

Our Perspective

Equity Markets	• U.S. stocks continued their steady summer climb to and through record highs on the backs of extreme monetary ease and a recovering economy. At these valuation levels, investors should proceed with caution. The upcoming elections, a potential resurgence of the virus, and increasing tensions with China could cause downside volatility. • European equity markets have lagged behind the U.S. because they generally lack the technology-driven growth companies that drive valuation levels in a low rate environment. Continued economic recovery with minimal setbacks is needed to drive the region's cyclical companies. • Japanese markets have companies with significant export exposure to the more potent recovery in the Chinese economy. Increased domestic consumer spending is key to closing the valuation gap with U.S. stocks. • Chinese equities are vulnerable to heightened tensions with the U.S. More complete re-engagement of the consumer economy is likely needed for further market gains.
Bond Markets	• Stronger than expected economic growth is driving longer-term interest rates higher and steepening the yield curve. There appears to be some room for intermediate- and long-term rates to move higher. However, the Fed's continued purchases and little inflationary pressure will likely limit the magnitude of any increase. • The lack of another fiscal relief package has placed increased pressure on state and local finances. Expect continued spread widening and underperformance of municipal bonds against Treasurys. • Interest rate spreads between high-yield corporate bonds and Treasurys have narrowed to the extent they may not sufficiently reflect the higher bankruptcy and credit risk inherent in certain sectors of the market. • The declining dollar and rise in oil prices have helped boost emerging market debt by taking some pressure off the commodity-producing countries. Investors should monitor the virus' progression in densely-populated emerging markets.

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Our Perspective (Continued)

Monetary Policies/ Currencies

- The Fed's change to average inflation targeting should keep monetary policy loose for the foreseeable future. Inflation hasn't reached the 2% target for much of the past 10 years, which means the rate will likely need to exceed this level for at least a year before any tightening occurs.
- Core inflation for most of the other developed markets is also nowhere near the 2% target. As such, it's probable the central banks for these countries will maintain their low rates and continue their easy monetary policies despite their apparent ineffectiveness.
- The renminbi's recent appreciation may force the Chinese central bank to lower rates slightly over the coming months, which could also boost the country's economic recovery.
- The incrementally greater Fed accommodation and forward guidance for continued low rates caused the dollar to decline against most currencies. With U.S. recovery and growth rates improving, the dollar should find a base around current levels with further downside limited.

What This Means for Investors

The global economy has come a long way from the depths of the virus-induced lockdowns to optimism around businesses reopening. A complete recovery is likely dependent upon better testing, treatment and, ultimately, a vaccine. As in most recessions, particular sectors and industries will suffer permanent damage, but others will pick up the slack. Despite concerns that certain equity markets are priced for perfection, low interest rates should allow the maintenance of current multiples, which could expand further if the recovery continues into 2021.

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10926058 (09/20)