Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK AUGUST 2020

Many people wonder why the stock market continues to go up during this period of uncertainty. Before answering that question, I would first like to ask a few questions myself. How many of my readers have quit using electricity? Internet service? Telephone? How many of you quit eating? Showering? Brushing your teeth or getting dressed in the morning? How many quit using credit cards or bank services, or receiving mail? I suspect I already know the answers … and so do you!

What has changed is how we go about our day and the activities we engage in. We still have to live, and we adjust accordingly, whether we like it or not. Consequently, "essential" companies and the people involved in these businesses adjusted to meeting consumers' needs in this new environment. On the other hand, events, venues and services such as concerts, sports, dining, theaters, airlines, shopping, personal care and settings for dense gatherings have declined materially. These are the things most of us miss. Who would have thought that businesses deemed "non-essential" were instead the fabric of our everyday lives? I can't imagine how difficult it must be for the owner of a hair salon, restaurant, bar or local retail shop, both financially and psychologically, to navigate mandated government closures.

Perhaps you are starting to sense the answer to the original question. Companies that make up the S&P 500, NASDAQ or Dow are primarily deemed "essential" – and were provided the opportunity to make necessary adjustments and continue delivering goods and services profitably, instead of being forced to close by state governments. The high unemployment rate currently affecting the economy is dominated by employees of local, small businesses that were forced to close. This is one reason that the economy remains challenging while the stock market does fine. In addition, Federal Reserve monetary policy has driven interest rates so low that investors are being forced into other more risky areas, like the stock market, to generate any type of return.

Second-quarter gross domestic product (GDP) decline was one of the worst on record. Third- and fourth-quarter GDP is expected to grow, but is anticipated to be down about 5% for the year. A market void of monetary and fiscal stimulus would normally be met by lackluster stock returns, as opposed to the remarkable rebound from the lows of just a few months ago. The challenge is determining how much of the rebound was driven by fiscal stimulus, monetary stimulus or the economy and how it will react if one of these inputs changes. Long-term investors know this is as a short-term condition – perhaps even a short-term, triple effect of the pandemic, trade war and presidential election all aligning at once. None is a reason to change long-term investment objectives.

It might come as a surprise that the return in the S&P 500 through the end of July was 2.38% - but if you excluded the 5 largest companies, the return would be negative (-6.68%). Our chart shows a rebound predominantly driven by the top 3 companies. There are currently 505 companies in the S&P 500, with the 5 largest making up 22.5% of the index and the other 500 companies making up 77.5%. If we expand the list to the top 20 companies, they would represent 35% of the index.

Name	% Weighting in S&P 500	YTD Return	Contribution to S&P 500
S&P 500 (SPY)		2.38%	
Microsoft (MSFT)	5.75%	30.71%	1.77%
Apple (AAPL)	6.40%	45.48%	2.91%
Amazon (AMZN)	4.90%	71.26%	3.49%
Facebook (FB)	2.25%	23.59%	0.53%
Alphabet A (GOOGL)	1.65%	11.09%	0.18%
Alphabet C (GOOG)	1.60%	10.92%	0.17%
	22.55%		**9.06%**
S&P 500 return YTD without top 5			**-6.68%**

Data for calculations taken from Bloomberg for July 30, 2020 return.

The yield on the 5-year U.S. Treasury bond recently reached a record low and currently has an interest rate of 0.218%. After inflation and taxes, the return is negative. Speaking of negative, there are currently $15.93 trillion in bonds around the globe trading with a negative yield. In short, that means an investor pays the debtor for the privilege of owning a debtor's bond; the investor locks in a guaranteed loss if the bond is held to maturity. At a strategy meeting the other day, I told the group about an old Western movie called Monte Walsh. Monte was a cowboy watching his trade wither away, as big money from the east consolidated individual cattle ranches and mechanically modernized the business. But Monte refused to change. That might be me if U.S. interest rates turn negative. At the very least, it is hard to make sense of such an event in the context of our stewardship of client investments.

Thank you very much for your business and your trust in our company.

Greg Sweeney, CFA
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Years of Investment Experience: 34 years
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