Bell Bank
Wealth Management

EQUITY & FIXED INCOME OUTLOOK JUNE 2020

Fed Trillions

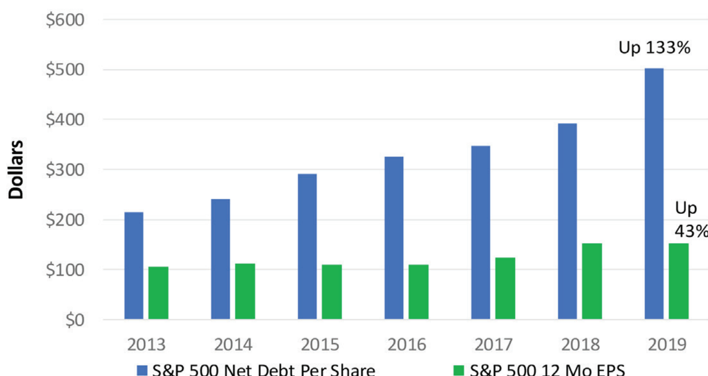
A trillion dollars here and a trillion dollars there – and pretty soon we are talking about real money! The Federal Reserve balance sheet is about $3 trillion higher than it was at the end of February. Simply put, the Fed just printed $3 trillion in cash and injected it into the economy by purchasing securities in the open market. This is called monetary policy. The federal government also has done its part, adding another $3 trillion in fiscal policy programs. Both are aimed at keeping the economy moving forward.

Making Cents of It All

No, this is not poor English. The S&P 500 reached a high of 3386 on Feb. 19, then proceeded to decline to close at 2237 on March 23. It has climbed back up to 3055 today. Using the same price-to-earnings (P/E) ratio in place before the pandemic suggests today's market is expecting S&P 500 earnings to be down about $15 – from $152 to $137 per share – this year. It seems like the damage from unemployment, lost wages, dented confidence, business closures, travel curtailment and a host of other items should amount to a larger loss of earnings than this – but time will tell.

The bond market, represented by the Bloomberg Barclays U.S. Aggregate Bond Index ("the Agg"), has fully recovered and is up 5.5% for the year. A big thank you goes out to the large government bond allocation in this index, but the corporate credits have recovered nicely, too. Municipal bonds have also rallied, even in the face of declining state and county tax collections and increasing financial stress. Perhaps the market has shifted its faith in debt repayment away from the entity issuing the debt and toward the generosity of the Fed and its ability to print money.

Debt per share of the S&P 500 at the end of 2019 was nearly 2.5 times higher than where it was at the end of 2013. Year to date, new debt issuance has already reached $1 trillion.



Is There a Disconnect Between the Economy and the Markets?

This is the most common question we hear. The economy appears to be lethargic due to the factors listed above – while the markets seem to be ignoring all that and moving along without a care in the world.

The main reason for this is that the federal government's fiscal policy looks like it already may be larger than the anticipated decline in gross domestic product (GDP) this year, while asset prices have the additional support from the Fed. Normally, consumer spending makes up nearly 70% of GDP. As consumers went into defensive mode through the pandemic, Fed fiscal policy stepped in to replace consumption. Plus, U.S. monetary policy repaired market liquidity after it had nearly disappeared overnight.

Is there anything further that will interrupt market progress? Sure, any number of things could happen – but our best guess is that another disruption will be met with even more fiscal and monetary policy. Will the Fed take U.S. interest rates negative? Our take suggests the answer is no. The U.S. has had the benefit of watching this experiment in other countries, and the pitfalls appear to outweigh the benefits.

The World Likely Will Keep Spinning

This was our final point last month, and we reiterate it today. We continue to look long term, take advantage of market opportunities along the way while being mindful of risk, and letting income and market appreciation accrue to the benefit of the portfolio. Thank you for sticking with the process through this turmoil.

Greg Sweeney, CFA
SVP/Chief Investment Officer

Tenure: 09/1992

Years of Investment Experience: 34 years

Education: Greg holds a bachelor's degree in business from the University of North Dakota and is a CFA charter holder.

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