Investment Review and Outlook – Summer 2020

U.S. Economic Landscape:

As we move through the summer, there is a lot for investors to ponder. Economic news is largely positive, led by strength in retail spending, industrial output and housing starts. Sales of existing homes also surged 21% in June, the largest month-to-month increase on record following three months of sales decline. However, sales were still down 11% from the year earlier. Furthermore, the stronger-than-expected employment report for June reflected the addition of 4.8 million new jobs, a lower unemployment rate and a higher labor force participation rate.

Unfortunately, a recent weekly jobless filing reported an increase in unemployment claims again, after weeks of improvement. Jobless filings for July and August will be closely evaluated for the possible impact from the recent surge in COVID-19 cases. A number of states have already hit the "pause" button on reopening efforts and put in place stricter guidelines on business activity and personal behavior. These measures will have a restraining impact on overall U.S. business activity. In the months ahead, the economy is likely to advance slowly and in an uneven fashion, resulting in modest GDP expansion for the third and possibly the fourth quarters of 2020.

Earnings Season:

We are in the middle of Q2 2020 corporate earnings reporting season. For the most part, companies are holding their own. Key industries are navigating choppy waters quite well, especially the tech and pharmaceutical sectors. The good showing by stocks in these sectors reflects the healthy earnings of these companies and their prospects. However most airline, travel, recreation-related and energy companies are struggling and are likely to continue to do so for some time.

In general, Wall Street analysts' expectations for revenues and earnings have been restrained for the current reporting period. While early profit reports have been mixed, a sufficient number of companies have matched or exceeded conservative forecasts as many are showing a measure of resilience. However, it is still early in the reporting season with many more companies set to report in the next couple of weeks. Corporate profits will probably be at their weakest level in the June quarter, given the shutdown of activity across the economy that started in March.

The Federal Reserve and Government Stimulus Outlook:

On the monetary front, we believe the Federal Reserve is very concerned about the pandemic's effect on the U.S. economy and will continue to support growth by keeping interest rates low and funneling huge sums of money into the economy. This will help banks, business enterprises and households better handle the difficulties brought on by COVID-19.

The situation on the fiscal side is more complicated as Congress and the White House have yet to resolve issues relating to the next economic stimulus package. The main points of debate are payroll taxes, healthcare benefits, and addressing the high unemployment level. It is noteworthy that some earlier stimulus programs are expiring and new proposals are still in a state of flux at the present time in the highly charged, partisan Washington environment.

However, another significant stimulus package from Washington will eventually be put in place, as both political parties vie for a deal that appeals to their respective voter bases while fashioning benefits designed to support individuals, small business and states in need of financial assistance. Granted, both sides of the aisle are far apart on the dollar amount that might be forthcoming as well as many details. As a consequence of congressional disagreement, investors' disappointment could be registered in the financial markets. How the financial needs of so many are played out is our focus.

The 2020 Election:

Then, there is the upcoming election. Campaigns have been gearing up for what certainly is one of the most controversial, contentious Presidential and Congressional campaigns in modern history. At stake are the differing approaches to taxation, regulation, tariff and trade policies, infrastructure spending, international relations and how we view law enforcement in the U.S. These issues figure to have an important impact on the financial markets in the months to come as well as who will eventually be sitting in the oval office in the White House come January 2021.

Stock Market:

Our sense is that positive corporate earnings results, notwithstanding the anticipated difficulties from COVID-19 and its impact on the economy, will be the underlying catalyst to keep equity prices near recent recovery highs in a fairly wide trading range. Over the next few months, given the expected crosscurrents from reported virus infections and fatalities and the offset by the possible availability of a successful COVID-19 vaccine for U.S citizens, we expect the stock market to trade in a range of +10% and -10% from the current level, with periods of unusual volatility. However, the resilience already shown by a significant number of companies during this time and the positive response of the stock market during the challenging first half of 2020 augurs well for stocks in the months to come.

Investors are handling all of this uncertainty quite well, as they balance encouraging economic reports for the future with the recently unchecked climb in COVID-19 infections and fatalities. Hopes for a stimulus package to give assistance to many in the U.S. have helped investor psychology. And, an added positive for the future was the recent $2 trillion stimulus package that was agreed upon by European Union leaders to support the region's economic recovery. In addition to the economy, the bullish case is being furthered by encouraging developments on the COVID-19 vaccine front from several companies.

Investment Strategy:

As we stated at the beginning of this investment review, there is much for investors, as well as for Schroeder Capital, to consider in the period ahead. How the various issues previously discussed work out will likely determine the course of securities markets and how our client portfolios develop over the balance of the summer, into the fall and for the balance of the year. Our investment strategy takes into account the importance that some check on the recent spike in COVID-19 cases will develop in order to improve consumer confidence again and maintain investor optimism. Investors are looking forward to a time when mass sickness in the U.S will largely be a thing of the past.

The key to an environment in which we can build confidence in our institutions and in each other while gradually returning to our lifestyles, as different as that might be, will depend on smart personal behavior disciplines to avoid spreading COVID-19 along with further scientific progress on understanding this disease and identifying remedies. The reopening of our school systems and colleges, religious and sporting venues and other private and public gatherings will be increasingly possible when further progress is evident on both therapeutics to treat the coronavirus and the timing of the delivery of a safe vaccine. Investors are watching this closely. Hopefully, continuing positive news on the vaccine front is only months away which would be a herculean, cooperative accomplishment.

Importantly, there was good news on vaccines during this past week when the U.S. Department of Health and Human Services (DHHS) announced a nearly $2 billion contract with Pfizer and its partner BioNTech from Germany, for 600 million doses of their jointly developed COVID-19 vaccine, BNT162. The contract calls for large-scale production and delivery in the U.S by the end of 2020 of 100 million doses of the vaccine, if it receives Emergency Use Authorization (EUA) or licensure from the U.S. Food and Drug Administration, after completing demonstration of safety and efficacy in a large Phase 3 clinical trial. The agreement also allows the U.S government to acquire an additional 500 million doses. Americans would receive the vaccine for free consistent with U.S. government's commitment for free access to COVID-19 vaccines.

By entering into this agreement now, a safe and effective vaccine can be shipped quickly if approved. The government has also targeted a few other companies with vaccine candidates but the Pfizer-BioNTech agreement is the largest the DHHS has made with any corporate entity that has shown significant, positive results in clinical trials. This approach helps meet the government's goal to begin delivering 300 million of doses of safe and effective vaccine to the American people beginning by the end of 2020.

We note here that Pfizer is a current holding in all of Schroeder Capital's client portfolios. In addition to the very positive announcement between Pfizer and the U.S Department of Health and Human Services, relating to their COVID-19 vaccine entering Phase 3 clinical trials, Pfizer is one of the largest global producers of generic pharmaceuticals in the world and will play a large role in helping increase manufacturing of these important drugs in the U.S. that are currently being sourced from China and other countries.

We are looking forward to a responsible approach to the economic policies of our government and progress in confronting the coronavirus challenges that lie ahead. In this unprecedented, difficult environment, fundamental investment research is critical as we evaluate positions in our securities universe while also seeking new opportunities. We favor high-quality securities with solid balance sheets and earnings with very appealing prospects for the longer-term. That continues to be the hallmark of Schroeder Capital Management and is our strategic approach now as we carefully build investment portfolios at this time that are diversified, with a sharp focus on capital preservation.

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