Monthly Market Insights

Data and opinions as of May 31, 2020

aviso wealth

Global economy drags on while stocks continue to rally

After the strongest April returns since 1938, the S&P 500 spent much of May rangebound, ending the month with a gain of just 4.8% in local currency. Canadian and international markets had similar mid-single digit returns. Bonds also had a quiet month. As of this writing the Government of Canada benchmark 10-year bond yield stands at 0.53%, almost exactly where it started the month. Despite the strong run-up from its March 23 bottom, market behavior hardly bears any resemblance to what is happening in the real economy. We are still caught in the middle of an economic downturn worse than the 2008 financial crisis. However, it's important to remember that markets are always forward-looking and are therefore pricing in some of the eventual recovery. Fueled by record government stimulus, low interest rates, and the outperformance of a few large companies, the S&P 500 has gained more than 35% from its bottom on March 23.

The NEI perspective

Market rally continues but most stocks still lagging. The S&P 500 has retraced most of its losses and is now down only 5% year-to-date (in Canadian dollars it's actually in positive territory!). The market rebound has been led by large tech firms which means on an equal-weighted basis, the index is still down about 16% this year.

Cautious re-opening underway. Countries are taking careful and gradual re-opening measures, which should improve economic activity in the months ahead. However, we remain concerned about a "second wave" and will be closely monitoring the situation.

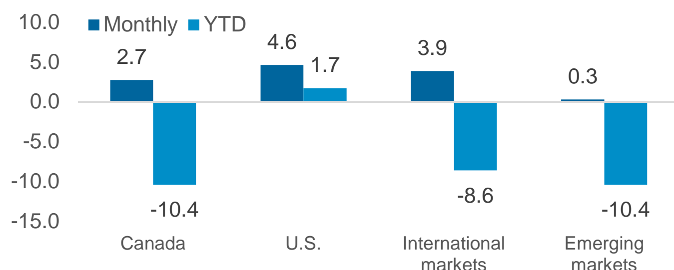
Risks remain balanced. Despite an upward pressure on equities, the risk of new infections, weak fundamentals, and tense U.S.-China relations are just some of the reasons we are staying cautious in the near term.

From NEI's Monthly Market Monitor for June 2020. Click here to get the full report.

NEI

Equity

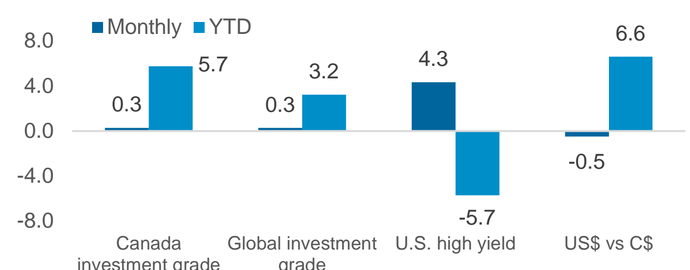
% return in C$



Canada: MSCI Canada; **U.S.:** MSCI USA (C$); **International markets:** MSCI EAFE (C$); **Emerging markets:** MSCI Emerging Markets (C$). Source: Morningstar Direct.

Fixed income and currency

% return in C$



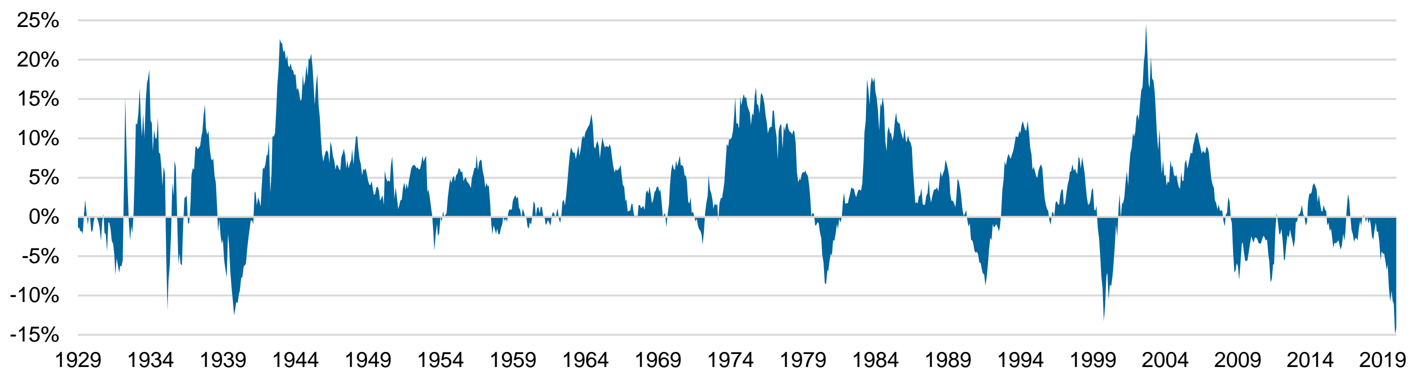
Canada investment grade: Bloomberg Barclays Canada Aggregate; **Global investment grade:** Bloomberg Barclays Global Aggregate (C$ Hdg); **U.S. high yield:** Bloomberg Barclays U.S. High Yield (C$ Hdg). Source: Morningstar Direct.

Growth or value?

You may have heard the words “growth” and “value” used to describe a stock. Value stocks are usually companies that trade at a low price relative to financial metrics such as earnings, revenue, cash flow, or book value, and they also typically pay a dividend. Growth stocks refer to companies with higher growth potential in earnings or revenue. They may or may not pay dividends, as growth companies are often focused on reinvesting into the business. Value stocks can be often found in sectors such as energy, financials, and utilities, whereas growth stocks these days are largely found in the technology sector.

Performance difference between growth and value over the last 90 years

Rolling 3-year returns shown; positive return means value outperformed growth



Source: Fama/French Factors. Data from May 1929 to May 2020.

Although value has historically outperformed growth over the long term, we are now seeing the largest degree of underperformance of value stocks since 1929. Then there’s the question of which types of companies stand to benefit the most in a post-COVID world. Most likely, it will be the ones that require little physical interaction to generate revenue – and we’re already seeing signs of that. Currently the five largest companies in the S&P 500 are Alphabet (Google), Amazon, Apple, Facebook, and Microsoft. To no surprise, they’re all technology companies. Collectively, they make up about 19% of the S&P 500, and year-to-date they’ve had a median gain of 9.7%. As for the other 495 companies? They’ve had a median *loss* of 15.5%.

As economic growth improves and interest rates slowly rise, value will eventually make its comeback. History has shown the two factors move in cycles, so the best bet is to not chase one or the other, but to own some of each. In other words, diversify.

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