# STONE INVESTMENT PARTNERS LLC

# Weekly Market Guide | May 11, 2020

## CHART OF THE WEEK

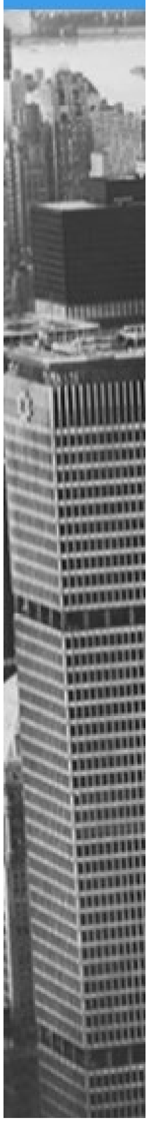

Source: Stone Investment Partners, Bloomberg

History shows that declines in U.S. Treasury yields are typically associated with better performance for both high dividend and dividend growth strategies, so how are these strategies doing? This analysis used iShares Select Dividend ETF (DVY) for the high dividend strategy and WisdomTree U.S. Quality Dividend Growth ETF (DGRW) for the dividend growth. DVY had a worse drawdown than the S&P 500 from the February highs and remains an underperformer, while DGRW has outperformed slightly (see chart). DVY has a much higher expected 4.8% dividend yield versus DGRW at 2.7% and the S&P 500 at 2.1%. DVY's methodology in targeting the higher dividend yield causes a larger exposure to firms with more debt and less profitability in addition to a large slug of utilities. DGRW's methodology gives up some dividend yield to own companies with a better growth profile. The current crisis has led to concerns about dividend cuts and financial distress, so DGRW exhibited better performance since its holdings have better profitability and less leverage. DVY's methodology also led to large underweights in healthcare and technology, the two best performing sectors since the market peak. DVY is a perfectly reasonable holding but investors should be aware of the exposures and tradeoffs for the higher dividend yield when constructing their portfolio. Disclosure: Bill currently owns shares of DGRW.

## WEEK IN PREVIEW

- Geopolitical: Reported economic data this week will continue to be bleak with much of the world on lockdown to fight the spread of the coronavirus during the measurement period, but the markets' attention is turning to the restarting of economies and the eventual rebound in activity. There is much uncertainty about the speed and strength of the economic recovery, so markets could be volatile during any adjustment in the outlook. Credit conditions have improved since the worst of the crisis but remain stressed and should be monitored. Economic data and medical information will continue to be monitored closely for clues as to the outlook. Large U.S. investment managers must make their 1Q 13F filings which will give a glimpse into positioning during the pandemic.
- U.S.: With the historically gruesome April jobs report behind us, initial jobless claims will continue to be monitored for a real-time labor market measurement as the states begin to reopen. Retail sales for April will reflect a large contraction which will confirm a dismal path for 2Q GDP with consumer spending a large portion of the economy. Federal Reserve Chair Powell is likely to push against the markets pricing in expectations of negative rates on Wednesday.
- S&P 500 1Q Earnings Season: With 86% of companies reporting so far, 66% of companies have exceeded earnings estimates. The 1Q blended earning growth rate is at -13.6% year-over-year (Y/Y) which improved slightly from the previous week primarily due to the industrial sector. With 1Q earnings generally heavily trimmed by COVID-19, more attention is paid to forward guidance with 2020 earnings declining further and now expected at -19.7% Y/Y. 2Q earnings will be even worse than 1Q with consensus estimates deteriorating last week at -40.6% Y/Y. Even judging future estimates is complicated with many companies removing earnings guidance due to the unknown depth and length of the shutdown related economic weakness. Earnings season is slowing with 21 S&P 500 companies expected to report including UAA, MAR, CSCO, AMAT and RCL.
- Europe: Eurozone 1Q GDP is expected to be confirmed at -3.8% quarter-over-quarter (Q/Q). German 1Q GDP should hold up a bit better at -2.3 Q/Q. The U.K. 1Q GDP should show a -2.5% Q/Q contraction. The U.K. and the European Union are scheduled to hold Brexit talks throughout the week.
- Asia: Economic data out of China will continue to be watched for indications of the future possible path for the U.S. and rest of the globe. Tickets for the reopening of Disneyland Shanghai today sold out within minutes. April China industrial production is expected to be positive at 1.5% Y/Y while retail sales should reflect some improvement at -5.9% Y/Y. Japan's calendar is light, but April bankruptcies and machine tool orders will reflect the grim economic situation.
- Central Banks: The central banks of New Zealand, Belarus, Mexico, Egypt and Ghana meet with Mexico expected to cut their policy rates.

## WEEK IN REVIEW



- Stocks rose by 3.5% for the S&P 500 with all eleven sectors higher as focus was on the eventual recovery rather than the record setting job losses. Energy (8.3%), technology (6.6%) and consumer discretionary (4.4%) outperformed the S&P 500, while utilities (0.5%), consumer staples (0.9%) and financials (1.0%) were the biggest laggards. WTI (25.1%) and Brent (17.1%) rebounded sharply with MLPs (1.2%) lagging but the energy sector (8.3%) significantly outperforming. Small cap stocks outperformed the S&P 500 with the Russell 2000 up 5.5% with small cap growth stocks the primary driver of the strong showing. The 10-year and 30-year U.S. Treasury yield rose slightly to 0.68% and 1.38% respectively.
- High yield credit spreads narrowed reflecting increased risk appetite. AAA municipal bond yields as a percentage of Treasuries decreased, and municipal bonds outperformed. The negative revenue impacts of the economic lockdown on local governments and talk of state bankruptcy have driven municipal bond valuations to low levels relative to Treasuries. Allowing states to declare bankruptcy should remain an unlikely outcome with the heart of the issue really about the size and distribution of Federal government aid to the states.
- The U.S. dollar was weaker against both developed and emerging market currencies. Developed international stocks as measured by MSCI EAFE underperformed the S&P 500 returns in U.S. dollar terms (0.8%) and on a hedged-currency basis (1.3%). Emerging market stocks outperformed the S&P 500 with the non-hedged return of -0.6% for MSCI EM.
- The 10-2 yield curve widened to +52 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield narrowed and closed the week at +8 basis points. The yield curve has historically provided an accurate forecast of future recessions when the difference in these measures turns negative, also known as inversion. Yield curves are one of the major indicators that we monitor to judge recession risk, but these inversions typically happen more than a year in advance of an economic recession and external shocks like the current coronavirus outbreak might not be accompanied by one. Stocks have historically had significant advances post-inversion.

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