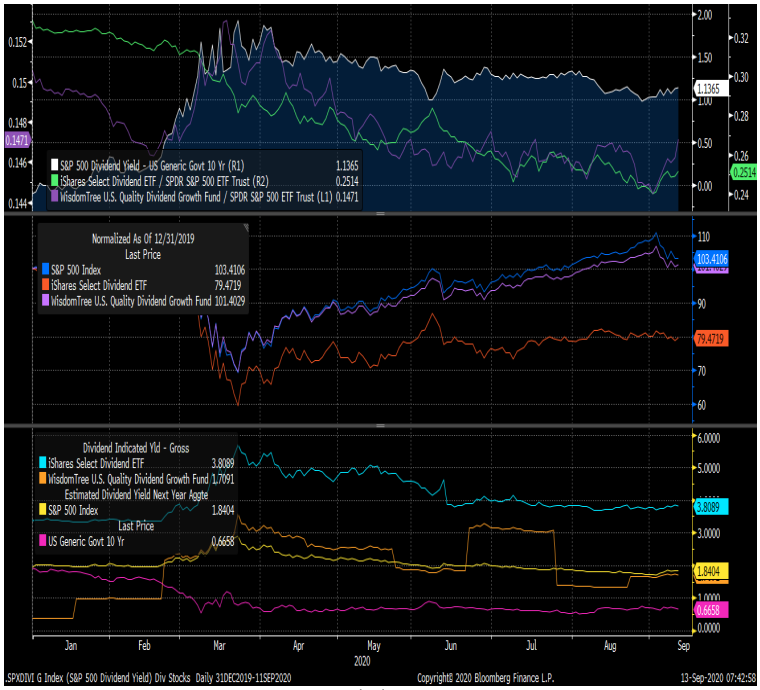
STONE INVESTMENT PARTNERS LLC

Weekly Market Guide | September 14, 2020

CHART OF THE WEEK



Source: Stone Investment Partners, Bloomberg as of 9/13/2020

Just as Bob Dylan wrote "I'll give ya shelter from the storm," dividend strategies may provide some much-needed diversification if the pressure on technology and growth stocks continues. This analysis used iShares Select Dividend ETF (DVY) for the high dividend and WisdomTree U.S. Quality Dividend Growth ETF (DGRW) for the dividend growth strategy. Dividend strategies and particularly high dividend strategies have underperformed year-to-date but have outperformed since the beginning of September (see chart). Dividend strategy outperformance has coincided with the significant weakness in growth and technology stocks, which should be somewhat expected since DVY has only 7% in technology versus 27% for the S&P 500. Interestingly, our example of dividend growth has almost 25% in technology but has still outperformed the S&P 500 since September 1 though it has lagged DVY. DGRW's largest overweight relative to the S&P 500 is industrials, which have outperformed recently. If the impact from the COVID outbreak continues to wane, the big picture seems to support demand for dividend strategies as yield should remain hard to find in a bond market with ultra-low yields. In the wake of the COVID crisis, the S&P 500 dividend yield is at the largest spread over the 10-year U.S. Treasury yield in the modern era. DVY has a much higher expected 3.8% dividend yield versus DGRW at 1.7% and the S&P 500 at 1.8%. 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. In our view, long-term outperformance of DVY relative to the S&P 500 should not be expected, although, it might be utilized by income-oriented investors. Disclosure: Bill currently owns shares of DGRW.

WEEK IN PREVIEW

- Geopolitical: With lockdown measures being re-introduced in parts of the globe to combat a resurgence in COVID-19 infections, the impact on economic activity will be closely monitored. Tensions between the U.S. and China will be watched for further escalation with the Tuesday deadline set by President Trump for a sale of TikTok fast approaching and the reported deal with Oracle still needing approval. The OECD releases new economic forecasts for the G-20 countries.
- U.S.: August retail sales growth is expected to slow and will be watched for the impact of reduced unemployment benefits. Housing continues to be a strength, so August building permits and housing starts should remain firm. The Federal Reserve (FOMC) meets with no change in rates almost assured, but statements and projections will be scrutinized for guidance regarding the new monetary policy framework. Initial jobless claims will be watched closely this week for a high frequency read on the labor market after last week's report raised some concerns about slowing momentum in the job recovery. Readings for our **U.S. Reopening Monitor** moderated last week but initial readings on new COVID-19 cases have now fallen on a week-over-week (W/W) basis for eight weeks in a row. Improvement continues in the underlying high frequency economic data for transit and consumer sentiment, but some weakness is seen in the travel and market-based indicators. The dining component was distorted by the impact of the Labor Day holiday. The Atlanta and New York Fed's estimate of 3Q GDP growth are 30.8% and 15.6%, respectively. Please see our **U.S. Reopening Monitor** and our ***Guide to the U.S. Reopening Monitor*** for more details.
- S&P 500 Earnings: Just three S&P 500 companies are reporting earnings with Fedex (FDX) providing an interesting datapoint for ecommerce. As we forecasted, 2Q earnings showed large earnings declines but handily beat expectations and some companies have reinstated earnings guidance which is a positive in removing some unknowns. 3Q earnings estimates have improved and are expected to be less bad with consensus estimates of -22.2% and -3.9% year-over-year (Y/Y) decline in earnings and sales, respectively. The calendar year 2020 and 2021 earnings estimates improved again last week.
- Europe: Confirmed COVID cases have risen on a W/W basis for ten straight weeks in the Eurozone and could weigh on the outlook. Infection growth picked up again in Germany and France in particular, while Spain is struggling with their highest weekly infection count ever. The Eurozone and German September ZEW sentiment surveys could be softer with the COVID struggles. The U.K. pace of infections increased for the second week in a row after a couple W/W improvements. The U.K. and European Union trade talks have not been going well, so a no deal Brexit at year-end from their current trade agreement seems likely. The U.K. did reach a trade deal with Japan last week. The Bank of England (BOE) meets with no change in policy rate or asset purchases expected.
- Asia: China's August industrial production and retail sales are expected to improve to 5.1% and 0.0% Y/Y, respectively. Japan has had five straight weeks of W/W declines in infections after a streak of increases. Suga, who is likely to be elected PM this week, has pledged continued support for Abe's economic policies, which should be market positive. August Japan trade data should improve with consensus forecasting exports at -16.0% Y/Y and imports at -17.7% Y/Y. The Bank of Japan (BOJ) meets with no change in policy expected.
- Central Banks: In addition to the FOMC, BOE and BOJ, the central banks of Poland, Brazil, Georgia, Taiwan, Indonesia, South Africa and Russia are scheduled to meet with only South Africa expected to cut their policy rate by 25 basis points (0.25%).

WEEK IN REVIEW

- Stocks declined by -2.5% for the S&P 500 with only one out of eleven sectors higher for the week. Large cap value as measured by the Russell 1000 Value outperformed at -1.5%. Traders again took profits in two of the best performing sectors year-to-date, technology and communication services. Materials (0.8%), industrials (-0.3%) and utilities (-0.8%) outperformed the S&P 500, while energy (-6.4%), technology (-4.4%) and communication services (-3.3%) were the biggest laggards. WTI (-6.1%) and Brent (-6.6%) oil were lower with MLPs (-4.9%) and the energy sector (-6.4%) underperforming. Small cap stocks performance was essentially identical to the S&P 500 with the Russell 2000 lower by -2.5% and small cap value stocks underperforming at -3.5%. The 10-year and 30-year U.S. Treasury yield were lower at 0.67% and 1.41% respectively.
- High yield credit spreads widened reflecting decreased risk appetite. AAA municipal bond yields as a percentage of Treasuries rose, causing municipal bonds to underperform. 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. Additional support for the states is likely to come in the next stimulus bill.
- The U.S. dollar was stronger against both developed and emerging market currencies. Developed international stocks as measured by MSCI EAFE outperformed the S&P 500 returns in U.S. dollar terms (1.4%) and on a hedged-currency basis (1.7%). MSCI Japan outperformed the S&P 500 returns in U.S. dollar terms (0.9%) and on a hedged-currency basis (0.9%). Emerging market stocks outperformed the S&P 500 with the non-hedged return of -0.7% for MSCI EM.
- The 10-2 yield curve narrowed to +54 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield rose to +3 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 but external shocks like the current coronavirus-induced recession might not be accompanied by one. Stocks have historically had significant advances post-inversion.

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Disclosures

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