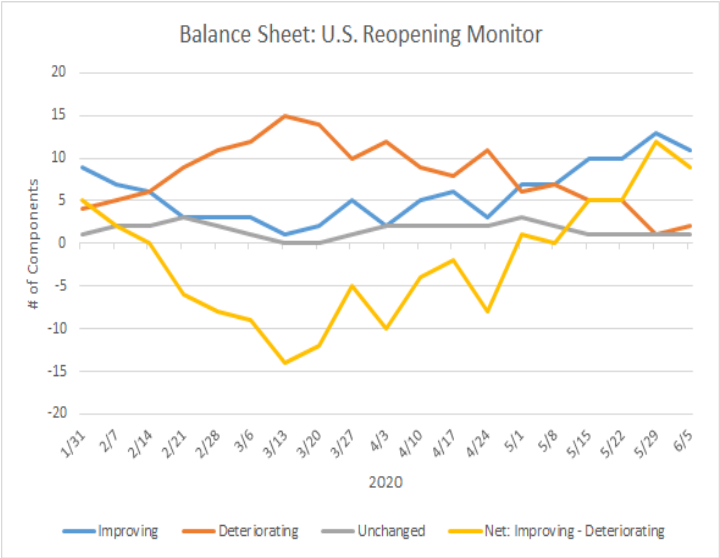
STONE INVESTMENT PARTNERS LLC

Weekly Market Guide | June 8, 2020

CHART OF THE WEEK



Source: Stone Investment Partners, Bloomberg as of 6/8/2020

The May U.S. jobs report beat all expectations last week and raised hopes of a "V-shaped" economic recovery. Markets clearly responded to the better news with a rise in Treasury yields and strong outperformance from value stocks which tend to be more economically sensitive. Despite every economist expecting a significant decline, nonfarm payrolls increased by 2.5 million for the month with the unemployment rate declining to 13.3% from 14.7%. While there were several statistical issues with the data, early job growth relative to expectations is clearly a positive development. With the S&P 500 almost at breakeven for the year, stocks are now discounting better future corporate earnings and economic growth with markets likely to be volatile during any adjustments in the outlook. There remains much uncertainty about the path and strength of the economic recovery, so our **U.S. Reopening Monitor** provides non-traditional and high frequency healthcare, economic and financial market data to judge the robustness of the recovery in real-time. One way to visualize the data is to look at the number of factors in the monitor improving or deteriorating on a week-over-week basis. The net reading (improving minus deteriorating) remains at a strong level and well above the lows of mid-March (**see chart**). The full updated monitor is available here and more details are available in our *Guide to the U.S. Reopening Monitor*.

WEEK IN PREVIEW

- Geopolitical: Deterioration in the relationship between the U.S. and China will be watched and remains a risk to the economic outlook. Both sides seem to be keeping things at a simmer currently rather than allowing it to boil over with May Chinese trade data over the weekend indicating probable Chinese purchases of U.S. soybeans. OPEC+ agreed to a one-month extension of production cuts on Saturday. The OECD releases their economic outlook on Wednesday.
- U.S.: After the much better than expected May payrolls report last week, initial jobless claims and continuing claims will be monitored closely for clues as to the strength of recovery in the labor market. May consumer and producer inflation will continue be muted. The Federal Reserve meets on Wednesday and should leave rates unchanged but will continue its pledge to do everything possible to support the economic recovery. Please see our **Chart of the Week** and our weekly **U.S. Reopening Monitor** for timely readings on the economic situation.
- S&P 500 Earnings Estimates: The 1Q earnings season is essentially over and clocked in at -14.9% year-over-year (Y/Y). 2Q earnings will be even worse than 1Q with consensus estimates steadying at -43.3% Y/Y. More attention should be paid to forward estimates with 2020 earnings stabilizing at -21.3% Y/Y. 2021 earnings estimates even increased slightly last week. Judging future estimates is complicated with many companies removing earnings guidance due to the unknown depth and length of the shutdown related economic weakness. Only three S&P 500 companies are expected to report earnings this week.
- Europe: The Eurozone Sentix Investor Confidence reading improved to -24.8 from -41.8. The European Central Bank (ECB) left policy rates unchanged as expected but boosted the amount of asset purchases via the Pandemic Emergency Purchase Programme (PEPP) by 600 billion euros to 1.35 trillion through June 2021. The U.K. negotiations with the European Union (E.U.) continue with the deadline for extending access to the E.U.'s single market looming on July 1.
- Asia: China's May trade data showed exports at -3.3% Y/Y while imports declined to -16.7% Y/Y. Exports were driven by medical supplies so underlying demand still looks soft due to the global lockdown. The headline trade numbers obscured some better news with imports primarily lower due to pricing rather than volume and agriculture imports providing hints that China is abiding by the phase one trade agreement with the U.S. Japan upwardly revised 1Q GDP to a -2.2% annualized rate but 2Q GDP is expected to be significantly worse.
- Central Banks: In addition to the Federal Reserve, the central banks of Kazakhstan, Uganda, Serbia, Ukraine and Peru meet with Ukraine expected to lower their policy rate.

WEEK IN REVIEW

- Stocks rose by 4.9% for the S&P 500 with all sectors higher with the May payrolls report fueling continued optimism about the reopening of the global economy. Energy (15.4%), financials (12.2%) and industrials (10.5%) outperformed the S&P 500, while healthcare (0.2%), consumer staples (1.9%) and utilities (2.4%) were the biggest laggards. WTI (11.4%) and Brent (19.7%) rose with MLPs (13.3%) and the energy sector (15.4%) outperforming. Small cap stocks outperformed the S&P 500 with the Russell 2000 up 8.1% with small cap value stocks even stronger performers at 11.4%. The 10-year and 30-year U.S. Treasury yield were higher at 0.9% and 1.67% 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 outperformed the S&P 500 returns in U.S. dollar terms (7.0%) and on a hedged-currency basis (6.0%). Emerging market stocks outperformed the S&P 500 with the non-hedged return of 7.8% for MSCI EM.
- The 10-2 yield curve steepened at +68 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield widened and closed the week at +10 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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Disclosures

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