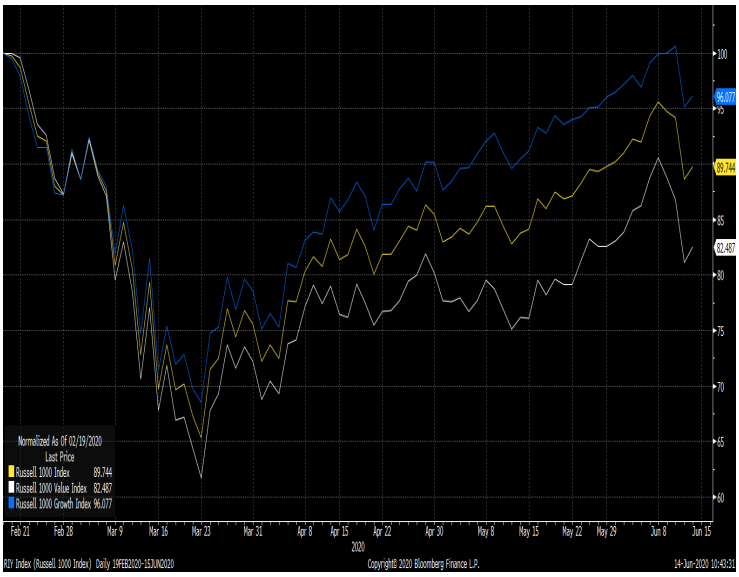
STONE INVESTMENT PARTNERS LLC

Weekly Market Guide | June 15, 2020

CHART OF THE WEEK



Source: Stone Investment Partners, Bloomberg as of 6/14/2020

After a few weeks of outperformance, value went back to underperforming growth last week. For simplicity of explanation, this analysis uses the Russell indexes but other methodologies would have directionally the same results. Short-term, this poor performance is understandable since value stocks generally have more leverage to economic outcomes and more debt. The underperformance of value also holds since the February market peak with value fairing worse on the downside along with growth recently exceeding its February peak (**see chart**). Despite value being a factor that has led to long-term outperformance, the value has historically been subject to long periods of underperformance as the price of admittance to superior gains. Aside from some brief respites, value (+14.2% annualized) has underperformed growth (+19.2% annualized) by a wide margin since the global financial crisis bottom in March 2009. This differential means $100 became about $632 in growth versus $345 in value. Despite the grim performance comparison, the valuation differential between the two styles argues for at least a more balanced allocation between the two currently rather than focusing only on growth stocks. For those interested in more details, AQR recently wrote some excellent pieces about value underperformance linked here.

WEEK IN PREVIEW

- Geopolitical: The fragile relationship between the U.S. and China will be watched and remains a risk to the economic outlook. The U.S. and U.K continue trade talks this week. The U.K. informed the European Union (E.U.) ahead of the July 1 deadline that no extension would be sought regarding access to the E.U.'s single market which ends on January 1, 2021. The U.K. and E.U. leaders meet for high level talks regarding trade on Monday.
- U.S.: Initial jobless claims and continuing claims will be monitored closely for clues as to the strength of recovery in the labor market. May housing data is expected to remain a relative bright spot. Retail sales for May should partially rebound from the steep drop in April. Lots of Fedspeak with Chair Powell speaking to Congress and an additional nine Federal Reserve speakers on tap. Fed Vice Chair Quarles speaks about the bank stress tests on Friday which will be scrutinized for impacts on the financial sector with bank stress test results scheduled for release on June 25. Readings for our U.S. Reopening Monitor deteriorated last week with the primary driver being the financial market indicators. Underlying high frequency healthcare and economic indicators generally remained in a positive trend. Please see our weekly **U.S. Reopening Monitor** and our ***Guide to the U.S. Reopening Monitor*** for more details.
- S&P 500 Earnings Estimates: 2Q earnings will be even worse than 1Q. Consensus estimates for 2Q have steadied around -43.5% year-over-year (Y/Y). More attention should be paid to forward estimates with 2020 earnings stabilizing at -21.4% Y/Y. 2021 earnings estimates held firm last week at almost +29% Y/Y. 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 five S&P 500 companies are expected to report earnings this week.
- Europe: The German ZEW expectations survey for June is expected to improve. European leaders are scheduled to discuss the 750 billion euro recovery fund proposed by the European Commission. The Bank of England (BoE) meets and should leave rates unchanged while possibly expanding their asset purchases.
- Asia: May industrial production and retail sales for China improved to +4.4% and -2.8% Y/Y respectively. Japan reports May trade data which is expected to show imports at -20.7% Y/Y and exports at -26.1% Y/Y. The Bank of Japan (BoJ) is expected to keep policy rates unchanged.
- Central Banks: In addition to the BoE and BoJ, the central banks are busy this week with Chile, Poland, Namibia, Brazil, Mozambique, Taiwan, Indonesia, Switzerland, Norway, Botswana and Russia scheduled to meet with Brazil, Indonesia and Russia expected to lower their policy rates. Consensus expects Taiwan to hold steady but its central bank could surprise with a cut.

WEEK IN REVIEW

- Stocks fell by 4.8% for the S&P 500 with all sectors lower on increased concerns about rising infections weighing on the reopening of the global economy. Technology (-2.0%), communication services (-2.8%) and consumer discretionary (-3.2%) outperformed the S&P 500, while energy (-11.1%), financials (-9.3%) and industrials (-8.0%) were the biggest laggards. WTI (-8.3%) and Brent (-8.4%) fell with MLPs (-12.3%) and the energy sector (-11.1%) underperforming. Small cap stocks underperformed the S&P 500 with the Russell 2000 down -7.9% with small cap value stocks even worse at -9.4%. The 10-year and 30-year U.S. Treasury yield were lower at 0.70% and 1.46% respectively.
- High yield credit spreads widened reflecting decreased risk appetite. AAA municipal bond yields as a percentage of Treasuries increased, and municipal bonds underperformed. 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 developed and stronger against emerging market currencies. Developed international stocks as measured by MSCI EAFE outperformed the S&P 500 returns in U.S. dollar terms (-4.2%) and on a hedged-currency basis (-4.3%). Emerging market stocks outperformed the S&P 500 with the non-hedged return of -1.6% for MSCI EM.
- The 10-2 yield curve narrowed +51 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield narrowed and closed the week at +6 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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