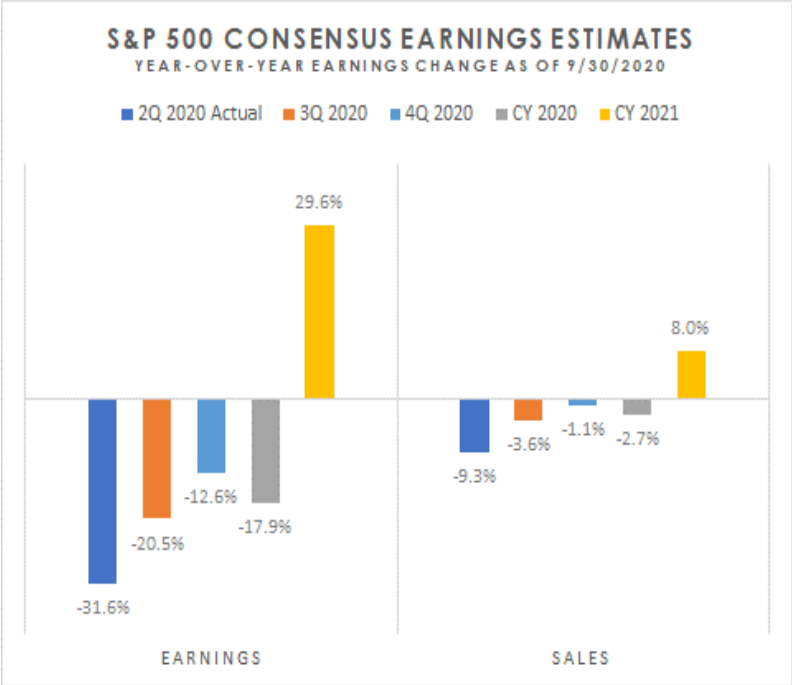
STONE INVESTMENT PARTNERS LLC

Weekly Market Guide | October 12, 2020

CHART OF THE WEEK – WHERE HAVE ALL THE GOOD TIMES GONE!



Source: Stone Investment Partners, Bloomberg as of 10/12/2020

Between the impact of the pandemic and the passing of Eddie Van Halen, lead guitarist for a favorite rock band from my youth, it seems appropriate to title our 3Q earnings preview as "where have all the good times gone." 3Q earnings season begins in earnest this week with the large banks as a major focus of the reports. After posting a much worse year-over-year (Y/Y) decline in 2Q earnings at -52.2%, the financial sector's earnings for 3Q are expected to decline at -22.8% which is only slightly worse than the S&P 500 overall. Earnings estimates for the financial sector continued to improve during 3Q, reflecting the strong rebound in the economy. While overall 3Q earnings estimates look bleak if looked at in isolation, there are some reasons for optimism. The "less bad" trend in Y/Y earnings declines is expected to continue in 3Q and 4Q. While earnings will still post double-digit declines in 3Q, it seems likely that the actual earnings will be better than the -20.5% Y/Y expectations going into this earnings season. While the improvement in actual results versus estimates should be positive, it is unlikely that they match the performance of 2Q with estimates and actuals at -44.1% and -31.6% Y/Y. In our preview to 2Q earnings, we noted that the resumption of earnings guidance would be a positive in reducing uncertainty. The trend of additional companies reinstating earnings guidance should continue in 3Q which reflects better visibility due to the reversal of some uncertainty from the impact of COVID-19. Our **U.S. Reopening Monitor** continues to improve, and widespread lockdowns seem unlikely in our opinion despite a resurgence in global infections. Due to better therapeutic outcomes and society's likely rejection of total lockdowns, increased local restrictions are the more likely path which bodes well in avoiding another complete earnings meltdown. If consensus estimates are correct and the economic recovery continues, the "best of both worlds" could be likely in 2021 with a sharp rebound in corporate earnings and perhaps a COVID-19 vaccine.

WEEK IN PREVIEW

- Geopolitical: Lockdown measures are being re-introduced in parts of the globe to combat the resurgence in COVID-19 infections, so the impact on economic activity will be closely monitored but revisiting wholesale lockdowns is unlikely. Tensions between the U.S. and China will be watched for further escalation. President Trump has recovered from COVID-19, and with the cancellation of the second presidential debate, both candidates will likely campaign instead. Amy Coney Barrett's hearings to replace Ruth Bader Ginsberg on the Supreme Court are scheduled to move forward on October 12. Negotiations on another U.S. fiscal stimulus plan continue, but politics make it unlikely that an agreement can be reached before the election. The IMF releases their World Economic Outlook on Tuesday. Bond markets in the U.S. and Canada are closed Monday for Columbus Day and Thanksgiving Day, respectively.
- U.S.: Consumer (CPI) and producer (PPI) inflation readings for September are expected to cool for the month but move higher on a Y/Y basis. Headline September retail sales are expected to accelerate to 0.8% month-over-month (M/M) from 0.6%. Initial jobless claims will be monitored for a high frequency look at the labor market. Fedspeak continues with more discussion of the new policy framework and economic outlook. Apple (AAPL) unveils their new iPhones on Tuesday. Readings for our **U.S. Reopening Monitor** remained positive last week and new COVID-19 cases fell on a week-over-week (W/W) basis for the second week in a row. Improvement continues in the underlying high frequency economic data for the labor market, air travel and dining but consumer sentiment, transit and retail sales took a step back. The Atlanta and New York Fed's estimate of 3Q GDP growth are 35.2% and 14.1%, respectively. Please see our **U.S. Reopening Monitor** and our ***Guide to the U.S. Reopening Monitor*** for more details.
- S&P 500 3Q Earnings: The 3Q earnings season kicks off with 29 S&P 500 companies scheduled to report earnings. Financials dominate the reports including JPMorgan (JPM), BlackRock (BLK), Goldman Sachs (GS), Wells Fargo (WFC) and other large banks. Other notable reporting companies include Johnson & Johnson (JNJ), Delta Air Lines (DAL) and Honeywell (HON). The calendar year 2020 earnings estimates rose last week. Please see our **Chart of the Week** above for our 3Q earnings preview.
- Europe: Confirmed COVID cases have risen on a W/W basis for fourteen straight weeks in the Eurozone with new restrictions enacted in an attempt to slow the pace. France and the U.K. hit an all-time high weekly infection pace. Eurozone and German ZEW sentiment surveys for October are likely to suffer under the weight of increased infections. The U.K. pace of infections increased for the sixth week in a row with pub closures and local lockdowns being implemented. The U.K. reports September labor market data, but the focus will be on Brexit discussions. Negotiations and posturing between the European Union (E.U.) and U.K. as to the details of their future trade relationship should be fast and furious ahead of the E.U. summit scheduled for October 15-16.
- Asia: China trade data for September is scheduled for release and will be scrutinized for more signs of continued recovery in the Chinese and global economy. Japan posted its second straight week of increases in the pace of infections. Japan August core machine orders are expected to decline while the tertiary industry index should improve for the month.
- Central Banks: The central banks of Indonesia, S. Korea, Chile and Sri Lanka are scheduled to meet with no major central banks expected to change their policy rate.

WEEK IN REVIEW

- Stocks rose by 3.8% for the S&P 500 with all eleven sectors higher for the week. Large cap value as measured by the Russell 1000 Value underperformed slightly at 3.7%. Materials (5.1%), energy (5.0%) and utilities (4.6%) outperformed the S&P 500, while real estate (1.4%), communication services (2.2%) and consumer staples (2.7%) were the biggest laggards. WTI (9.6%) and Brent (9.1%) oil were higher with MLPs (8.4%) and the energy sector (5.0%) higher as well. Small-cap stocks outperformed relative to the S&P 500 with the Russell 2000 higher by 6.4% and small-cap value stocks underperforming at 5.7%. The 10-year and 30-year U.S. Treasury yields were higher at 0.77% and 1.57% respectively.
- High yield credit spreads narrowed reflecting increased risk appetite. AAA municipal bond yields as a percentage of Treasuries declined, causing municipal bonds to outperform. 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. Between the strong 3Q rebound and Federal support so far, states declaring bankruptcy remains an unlikely outcome. Additional support for the states is likely to come in any future stimulus bills, but one of the sticking points to a new deal is the size and distribution of Federal government aid.
- 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 (3.0%) and on a hedged-currency basis (2.5%). MSCI Japan underperformed the S&P 500 returns in U.S. dollar terms (2.4%) and on a hedged-currency basis (2.4%). Emerging market stocks kept pace with the S&P 500 with a non-hedged return of 3.8% for MSCI EM.
- The 10-2 yield curve widened to +62 basis points. Another curve measure of three-month yield six quarters forward minus the current three-month yield rose to +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. External shocks like the current coronavirus-induced recession might not be accompanied by inversion. Stocks have historically had significant advances post-inversion.

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Disclosures

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