FOURTH STREET PERFORMANCE PARTNERS

Independent Investment Consultants

May 2020: Market Review

Major equity indexes extended last month's gains in May as investors focused on the reopening plans of global economies. Plummeting corporate earnings and ongoing weak economic data were overlooked as potential vaccine development and improvements in high frequency economic indicators fueled optimism. The April unemployment rate was 14.7%, the highest level since the Great Depression, and May unemployment figures are expected to reach nearly 20%. The S&P 500 Index gained +4.8%, bringing its year-to-date return to -5.0%. The Dow Jones Industrial Average increased +4.7%, down -10.0% thus far in 2020. Boosted by relative strength in technology stocks, the NASDAQ Composite surged +6.9%. The composite, now in positive territory, has gained +6.2% so far this year as high demand for technology-related products and services drove robust earnings in the sector.

In U.S. economic news, many states began reopening despite ongoing public health concerns. The second reading of first quarter real GDP showed a contraction of -5.0% annualized, revised downward from -4.8%. A steep drop-off in consumer spending, especially elective health care procedures, was a significant contributor to the contraction. Initial jobless claims continue to climb but at a decreasing rate as some businesses begin to reopen. Importantly, continuing claims declined by nearly 4 million in May to just over 21 million. ISM Purchasing Managers' Index data showed an improvement from its level in April, indicating that the pandemic-induced plunge in manufacturing activity is beginning to stabilize. On the other hand, tensions between the U.S. and China have escalated as President Trump revoked the special trade relationship from Hong Kong, subjecting the territory to US tariffs on Chinese goods as imposed by the trade war. The Federal Reserve did not introduce new policies; however, they discussed the use of yield curve control, a tool which manages borrowing costs across different maturities, in the event of further economic distress. Fed officials remain committed to avoiding negative interest rates, however fed funds futures are pricing in negative interest rates within the next twelve months. Among commodities, WTI crude oil ended May at $35 a barrel, up from $19 at the end of April. While OPEC's intervention led to the stabilization of global oil markets, soaring crude oil inventories could prove problematic. Gold ended the month at $1,737, increasing from its price of $1,684 at the end of April.

Within domestic equities, growth outperformed relative to value across all capitalization sizes. Within large cap stocks, the Russell 1000 Growth Index added +6.7% versus a +3.4% gain for the Russell 1000 Value Index. In mid cap equities, the Russell Midcap Growth Index increased +10.1% for the month while the Russell Midcap Value Index gained +4.6%. In small cap stocks, the Russell 2000 Growth Index climbed +9.5% during the month while the Russell 2000 Value added +2.9%.

Major international indexes also posted gains for the month as global containment measures have curbed growth in infection rates. The MSCI EAFE Index gained +4.4% while the MSCI Europe Index added +4.6% for the month. The MSCI Pacific Index increased +4.0% in May. The MSCI Emerging Markets Index posted the weakest results outside of the U.S., returning +0.8% as a large increase in cases in India has limited gains. Emerging market monthly returns were negatively impacted by India (-2.9%), Taiwan (-2.5%), and China (-0.8%).

U.S. treasury markets were mixed in May while riskier bonds outperformed. Yield spreads on non-treasury bonds continued to tighten in the month due to the presence of the Federal Reserve as a buyer of high-quality credit. The yield on the 10-year Treasury closed at 0.65%, modestly higher than last month's close of 0.64%. The Bloomberg Barclays U.S. Aggregate Bond Index added +0.5% for the month while the Bloomberg Barclays Treasury 20+ Year Index declined -2.0%. The Bloomberg Barclays U.S. Treasury Index also posted negative results, contracting -0.3%. On the other hand, the Bloomberg Barclays Corporate High Yield Bond Index was the strongest performer, gaining +4.4% in May as optimism fueled investors' risk appetite.

Significant uncertainty remains as the risk of a second wave of infections looms large. Neither the full extent of the economic damage nor the speed of the recovery is apparent. Central banks and federal governments have continued to support markets but more stimulus may be needed in the coming months. Furthermore, the long-term impact of these measures remains to be seen as the U.S. national debt as well as the Fed's balance sheet continue to expand to record levels.